

# **MONITORING OF RUSSIA'S ECONOMIC OUTLOOK:**

TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

**No. 17(55) October 2017**

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## MAIN TRENDS AND CONCLUSIONS

Optimistic projections for Russia's GDP for 2017, and even for 2018, driven by positive international rankings, have prompted seeking new positive factors that could bolster up this upbeat sentiment.

Among the factors is the intention of some of the parties to the OPEC+ deal to extend production cuts until the next year end, in an effort to not to mess up with the ongoing oil market trends. Meantime, Russian agricultural producers are all set to expand the cereal acreage next year, thereby keeping up record-breaking harvests and export supplies, the more so as Russia has given not a single promise to stem the process. Infrastructural hypotheses on the construction of Eurasia high-speed railway connecting the Central Europe to China and of a bridge to link the Russian island of Sakhalin with the Japanese island of Hokkaido are under discussion as part of long-term, albeit multitrillion, projects.

However, a growth factors analysis has led to modest conclusions about outlooks. While making Russia a world's largest producer of grain is indeed a positive move (provided that years-long speculations will give way to the construction of granaries that are in short supply), GDP can hardly be expected to grow considerably with a small proportion of agricultural produce in it. Moreover, there is no need to discuss oil price trends simply because they are easy, according to the international experience, to cast an evil eye on, and \$55 a barrel is bearable enough for slow motion.

This year's economic upturn has been spurred, according to most estimates, by the construction of a bridge that will link the Crimea peninsula to mainland Russia, and of the Power of Siberia gas pipeline, and by some military spending. Although these statistics are relevant, this can hardly be regarded as a steady growth model. Furthermore, the growth is accounted for by limited budget (and quasi-public) resources, businesses are reluctant to resort to market sources, the corporate lending market is almost stagnating despite some interest rate cuts.

The retail lending market is faced with somewhat better trends, continuing its path to recovery, according to our experts. In the year to August 2017 retail credit outstanding increased Rb 710bn or by 6.3%, with retail borrowers refocusing their attention on rouble loans. Foreign-currency retail credit outstanding dropped to \$2.3bn, and retail credit outstanding as at 1 September 2017 totaled Rb 11.9 trillion.

The increase in retail credit outstanding amid interest rate cuts was caused by new loans, of which housing loans made up nearly 20% (Rb 930bn in H1 2017).

The quality of credit portfolio was stabilizing. Overdue loans as at 1 September 2017 represented 8.0% of total retail credit outstanding. Overdue loans in nominal terms continued to grow, however, newly arising debts were growing at a faster pace, and therefore the share of overdue loans decreased. Moreover, repayments of old loans and interest payments continued outrunning the issuance of new loans. Therefore, in H1 2017 the bank lending's net contribution to households' budget stood negative at -Rb 488bn. Incremental cuts on interest rates, as well as possible shifts in the loan structure toward

cheaper housing loans will speed up this process. Overall, the lending market's recovery increased the relevance of bank loans for households' budget and pushed up consumption.

The Russian middle class's social sentiments and wealth status assessment have somewhat improved, according to experts based on the 2016–2017 sociological studies of the RANEPA's Institute for Social Analysis and Forecasting. The post-crisis recovery growth in the middle class has been set back by labour and employment, although the social structure of the society has somewhat improved: the middle-class close periphery have expanded, whereas the lower class somewhat decreased in number. Representatives of these classes and of the lower middle class by and large believe their wealth status has deteriorated, whereas the core middle class and its close periphery say it has deteriorated or not deteriorated (jointly making up a total of 62% for all social groups).

Meantime, all the groups place a high value on educational background and professional skills as an opportunity for success, however, the core middle class and the related close periphery are much more positive about their opportunities with regard to further education, running a business, having a new job. In addition, all the social groups are in fear of their future, while those at the bottom of the social scale are most prone to economic insecurity.

According to recent business surveys, overall uncertainty about the economic situation, what it is now and what it can become, remains the key headwind to output growth. Shortage of personnel, particularly skilled personnel, ranks second among the growth constraining factors. However, this factor was mentioned less frequently in Q3 2017, down to 20% (from 25% in April–June), according to specialists of the Gaidar Institute.

Oddly enough, the industrial sector is not yet prepared to enhance labour productivity to address the issue of personnel shortage. Overall, only 20% of enterprises say they have low labour productivity, and not more than 8% of enterprises recognize this factor as a headwind to output growth.

These data look interesting enough given the fact that in terms of economic output Russia lags (quite often) by far behind developed countries. There are, however, countries that are by far behind Russia in terms of economic output, for some of which Russia is acting as donor.

Russia resumed its involvement in the international development assistance (IDA) in 2004, showing a considerable growth in economic aid in 2009, when \$785m were allocated to help recipient countries deal with the aftermath of the global financial crisis. Official development assistance was increasingly growing since 2013 to reach more than \$1bn annually in 2015–2016. While previously Russia's assistance was shared almost equally between multilateral (programs of UN, World Bank, etc.) and bilateral assistance arrangements, today bilateral channels are most favoured (up to 75%). In addition, bilateral relationships have been retargeted from budget support to project financing and technical assistance. Liabilities write-offs is a main form of the development assistance (approx. \$425m last year). Total IDA is measured by the ratio of donors' annually assistance to their gross national income. The Russian ratio is not more than 0.09%, and Russia plans to reach 0.1% by 2020. Thus the ratio will move up towards values recorded in 2016 among the traditional donors (G7 states), at 0.18% (USA) to 0.7% (UK).

Russia is active regional donor within the Eurasian Economic Union (EEU). The actual level of economic development assistance to EEU countries is far

beyond the support that was provided through, above all, transfers arising from the absence of export duty on energy supplies.

A point to note is that the Russian (federal) budget has eventually sustained large-scale losses from using such a mechanism. This was a reason why a so-called tax manoeuvre was designed to focus on the oil industry, including incremental cuts to remove export duties while increasing the minerals extraction tax (MET). Furthermore, the development of such a taxation mechanism had been increasingly coming to the fore. The mechanism was supposed to deal with the across-the-board transition of the Russian petroleum industry toward development projects involving higher-than-normal operating costs. Hence a brand-new tax on extra revenue (TER) has been extensively debated within the industry.

According to our experts, the tax is supposed to ensure the minerals resource rent is extracted and the investment environment is suitable for development projects involving higher-than-normal operating costs. It would be reasonable, according to the experts, to apply TER jointly with MET, with a serious cut in the MET rate (in which case MET would ensure minimum tax revenues for the federal budget). It also would be reasonable to cut the crude export duty rate to zero while making the TER rate progressive. TER should be applied for greenfield projects while cutting the MET rate for brownfield projects (with high level of reserves depletion).

Concerns about potential budget losses arising from the transition to TER may be addressed upon testing the tax on a limited number of oil fields. Anyway, it is a challenge to administer TER, which, in theory, is a more advanced taxation tool: TER opens up potential opportunities and incentives for subsoil users to understate tax liabilities by understating revenues and overstating expenses/costs. This, according to the authors, will therefore require efficient control over taxpayers' costs/expenses, highly qualified and "uncorrupted tax authorities". ●

## 1. RUSSIAN RETAIL LENDING MARKET YET TO RECOVER TO PRE-CRISIS LEVELS

M.Khromov

*New parameters of retail lending continue to recover in 2017 amid interest rate cuts. However, the effects of the downturn of 2015 have yet to be overcome, loans for households' consumption are now less important than they were in 2012–2013, and new loans are not enough to cover the cost of previous loans and interest payments.*

In August 2017, banks saw retail credit outstanding increase Rb 186bn or by 1.6%, the highest monthly growth this year and since spring 2014, thus showing that the domestic retail lending market is gearing up.

In the year to August 2017 retail credit outstanding increased Rb 710bn or by 6.3%. And, apart from the seasonally driven contraction in January, the retail lending market was on the rise for nearly six months since April 2016.

Retail borrowers refocused their attention on rouble loans. Year-to-month rouble-denominated credit outstanding increased Rb 736bn or by 6.6%, whereas foreign currency credit outstanding fell Rb 0.4bn or by 16%. As a result, rouble credit outstanding at August-end reached Rb 11.8 trillion, hitting a new historical high for rouble loans. Foreign-currency retail credit outstanding dropped to \$2.3bn, reaching levels seen in H1 2004. Total retail credit outstanding as at 1 September 2017 ran at Rb 11.9 trillion.

Retail credit outstanding increased on the back of new retail loans. Banks issued Rb 4.7 trillion in new retail loans in January-July 2017, up 23% year-over-year.

Housing loans accounted for nearly 20% of new loans (Rb 930bn). However, housing loans in 2016 made up 21% of new loans. Consumer loans are the major contributors to the lending market growth. The lending downturn of 2015 has yet to be overcome despite the increase in new loans for the second consecutive year. Total outstanding loans and new housing loans in January-July 2017 stood at 4% and 3%, respectively, showing a decline from the same period of 2014.

The quality of credit portfolio was stabilizing gradually. Overdue loans at August-end represented 8.0% of total retail credit outstanding, with the year-to-month value down 0.3 percentage points. Meanwhile, overdue loans in nominal terms continued to grow following the uptrend in the credit portfolio, however, newly arising debts were growing at a faster pace, thereby reducing the proportion of overdue loans. The year-to-month ratio of loan loss provisions to retail credit outstanding in banks was down from 10.8 to 10.1%. In contrast to overdue loans, year-to-month provisions shrank in nominal terms by 0.8%.

Furthermore, there was gradual decrease in the proportion of payments on loans that were not paid when due within a calendar month. While in early 2017 there were more than 13.5% of payments on such loans, the proportion dropped to 12% in summer months, nearing values seen in 2013 (11–11.5%).

The lending market recovered amid mounting importance of bank loans for households' budget. New bank loans at the end of H1 2017 reached 21%

of households' final consumption expenditure, which was still below peak values of 2013–2014, when new loans were comparable with 25–27% of final consumption expenditure. In the course of the crisis of 2015–2016, new loans represented just 15–18% of households' final consumption expenditure.

The reduction of interest rates on retail loans was a factor driving up the retail segment of the lending market. In H1 2017, the actual cost of banks' retail portfolio was down to 16% p.a. from 16.5–17.0% of the past two years.

However, retail borrowers' interest payments were considerable enough. In H1 2017, individuals paid Rb 869bn in interest payments on bank loans, similar to the amount (Rb 874bn) registered a year earlier.

Because of high debt servicing cost, the lending market has not managed after 2014 to regain its role of a source of financing of households' budget. Repayments of old loans and interest payments were still outrunning the issuance of new loans. In H1 2017, the bank lending's net contribution to households' budget stood negative at -Rb 488bn, an equivalent to 2.6% of final consumption expenditure. To reach a "zero" value, the credit portfolio annualized growth rate has to become equal to the average cost of loans, that is, up to 15–16% from what it is now (6–7%). Incremental cuts on interest rates, as well as possible shifts in the loan structure toward cheaper housing loans will speed up this process. ●

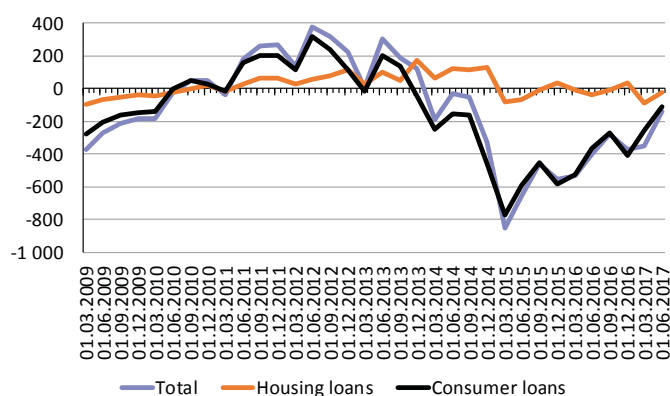


Fig. 1. Bank loans contribution to households' disposable financial resources, billions of rubles per quarter

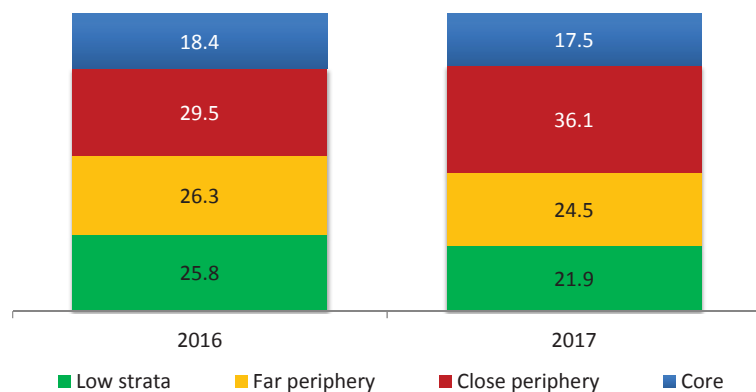
## 2. THE MIDDLE CLASS IS GETTING OUT OF THE CRISIS, BUT HAS APPREHENSIONS ABOUT THE FUTURE

E.Aвраamova, D. Loginov

*The social well-being of the Russian middle class in terms of the dynamics of its financial standing and opportunities of successful self-actualization has somewhat improved. According to representatives of the middle class, the prospects of self-actualization depend primarily on a high level of education, rather than an opportunity to start one's own business or find a new job. However, more than a half of the respondents from the core and close periphery of the middle class fear the future<sup>1</sup>.*

Stabilization of the social and economic situation in Russia – as seen from the official statistical data – brings up the question of how different social groups have passed through the unfavorable period. Proceeding from the annual dynamics of the identification parameters of the middle class, the following conclusions can be made:

- As the level of the financial standing based on judgmental estimates rose somewhat, it permits us to state the expansion of the middle class;
- Judgmental estimates of the social situation have changed for the better (even more than those of the financial situation) and this factor defines the prospects of the middle class expansion, too;
- As a year before, such an identification parameter of the middle class as the social and occupational status was utilized the least (*Table 1*).



**Note:** Low strata meet none of the parameters of the middle class, far periphery and close periphery meet 1 parameter and 2 parameters, respectively, while the core of the middle class, the complete set of identification parameters.

*Fig. 1. The identification pattern of the working population, %*

*Table 1*

DYNAMICS OF IDENTIFICATION PARAMETERS OF THE MIDDLE CLASS, %

Identification parameters of the middle class	Number of respondents, %	
	2016	2017
Social and occupational status	32.2	28.7
The level of financial status	49.2	53.3
Social status	60.3	67.4

Generally, it can be concluded that after the acute phase of the crisis the labor market and employment situation still hinders recovery growth in the

<sup>1</sup> Representative sociological surveys carried out by the RANEPА's Institute for Social and Economic Analysis and Forecasting constitute the information base of the research (over 3000 respondents were surveyed in 2016 and 2017).



number of the middle class. At the same time, if the social patterns of the middle class of the past two years are compared it can be stated that some recovery is evident (*Fig. 1*): close periphery of the middle class has become broader and the low strata has decreased in number.

Having judged positively the dynamics of the number of the middle class in general, let's discuss in more detail the distribution of identification parameters across stratification groups (*Table 2*).

*Table 2*

DYNAMICS OF THE FINANCIAL SITUATION OF THE MIDDLE CLASS, % BY LINE

Identification groups	Financial situation		
	improved	Remained unchanged	Became worse
Low strata	8.0	32.2	59.8
Middle class far periphery	14.5	34.1	51.4
Middle class close periphery	30.7	45.9	23.4
Middle class core	35.0	42.2	22.8
Generally	22.6	39.4	38.0

In 2017, the society is divided, on one hand, into the low strata and far periphery of the middle class whose representatives – over 50% – believe that their financial situation got worse and, on the other hand, the core and close periphery of the middle class whose situation – judging by their own estimates – either improved or remained unchanged. Proceeding from the above data, it can be assumed that if for the first group the economic crisis is still going on, it is over or coming to an end for the second group. However, one can speak only about general trends because as seen from *Table 2* even in the core of the middle class over one-fifth of its representatives believes that their financial situation got worse during the past year.

Respondents were asked a question about self-actualization opportunities in the existing social and economic situation (*Table 3*). The existence of such opportunities is recognized by a considerable share of low strata representatives whose number is close to a half of the relevant group, while starting from the far periphery of the middle class the relevant share grows and amounts to 80% with the middle class core, but does not exceed this indicator.

*Table 3*

DISTRIBUTION OF ANSWERS TO THE QUESTION: "IS IT POSSIBLE FOR PEOPLE LIKE YOU TO FULFILL YOURSELF AND REALIZE YOUR AMBITIONS?", % BY LINE

Identification groups	Is it possible for people like you to fulfill yourself and realize your ambitions?		
	Yes, sooner yes	No, sooner not	Difficult to answer
Low strata	47.5	46.1	6.4
Middle class far periphery	59.6	34.4	6.0
Middle class close periphery	76.0	17.6	6.4
Middle class core	80.7	14.7	4.6
Generally	66.5	27.5	6.0

Representatives of various stratification groups have different ideas about the factors which can facilitate people to realize their ambitions (*Table 4*). All the respondents are unanimous that a high level of education and professionalism matters much, while the idea of retraining and getting familiar with innovations is more widespread among the representatives of the middle class core and middle class close periphery. So, if in the middle class core one representative in three spoke about the need of getting familiar with innovations, in the low strata it was one representative in ten.

Table 4

DISTRIBUTION OF ANSWERS TO THE QUESTION: "WHAT CAN HELP YOU FIRST AND FOREMOST NOW TO REALIZE YOUR AMBITIONS AND BECOME SUCCESSFUL?", % BY LINE

Identification groups	What can help you first and foremost now to realize your ambitions and become successful?					
	High level of education and professionalism	Readiness to embrace innovations	Scrupulousness and prudence	Skills to cultivate relations with the management	Other	Difficult to answer
Low strata	37.3	10.8	4.4	11.8	29.6	6.1
Middle class far periphery	39.0	12.3	6.0	7.5	30.7	4.5
Middle class close periphery	41.2	23.4	5.1	9.8	17.2	3.3
Middle class core	44.1	29.0	2.5	5.5	17.2	1.7
Generally	40.4	18.9	4.7	8.9	23.2	3.9

Table 5

THE SHARE OF POSITIVE ANSWERS TO THE QUESTION: "IS IT THE RIGHT TIME NOW TO ...", %

Identification groups	Is it the right time now to				
	get a new education	open your own business; do business	Change your job; look for a new job	Make large purchases	Make savings
Low strata	40.9	25.0	17.2	19.6	26.4
Middle class far periphery	54.1	31.7	15.1	27.1	37.7
Middle class close periphery	61.3	42.5	28.0	38.9	55.2
Middle class core	68.4	45.6	27.7	47.7	52.9
Generally	56.3	36.6	22.4	33.3	44.2

It is interesting to compare general estimates of self-actualization prospects with those of concrete opportunities (*Table 5*). As seen from the data above, more than a half of respondents rated positively the prospect of getting a new and more required education. At the same time, respondents are more cautious about the prospects of starting one's own business, finding a new job and making large purchases and savings; the number of respondents who assessed positively such prospects is less than a half.

At the same time, estimates of the representatives of different stratification groups vary greatly. In their estimates, representatives of the middle class core and the middle class close periphery agree (over 60%) that it is the right time to get an education. However, the share of such estimates is higher with the core middle class representatives, while with the low strata respondents it is much lower. As regards positive estimates of the prospects to make large purchases and savings, the middle class core is ahead again of the middle class close periphery and the more so the strata which stand below on the social ladder. The same can be said about the estimates of the prospect of doing business. The prospect of changing a job is rated the lowest by the respondents including the middle class core and middle class close periphery.

Though representatives of the middle class core and middle class close periphery assess quite positively their prospects in the current situation, almost 50% of them feel apprehension about the future (*Table 6*).

As regards groups which stand low on the social ladder, the sense of uncertainty about the future is the highest. The only difference of the middle class core and the middle class close periphery from all other groups is that they have a smaller number of respondents who find themselves permanently in the state of social depression.

Table 6

DISTRIBUTION OF QUESTIONS TO THE ANSWER: "DID YOU FEEL APPREHENSION ABOUT THE FUTURE DURING THE PAST YEAR?", % BY LINE

Identification groups	Did you feel apprehension about the future during the past year?			
	Often	Sometimes	Rarely	Had no apprehension about the future
Low strata	22.3	26.7	20.9	30.1
Middle class far periphery	13.9	29.9	20.8	35.4
Middle class close periphery	6.7	20.0	21.4	51.9
Middle class core	7.2	28.7	22.8	41.3
Generally	12.0	25.4	21.4	41.2



### 3. INDUSTRIAL SECTOR FEELS FINE ABOUT ITS LABOUR PRODUCTIVITY

S.Tsukhlo

*The issue of labour productivity has constantly been debated among analysts and government officials. The common understanding here is that labour productivity is low and needs to be ramped up. According to our business survey, the level of satisfaction with labour productivity reached its peak in 2017. Only 8% of enterprises in Q3 2017 recognized low labour productivity as a headwind to output growth. Furthermore, the industrial sector is not yet prepared to enhance labour productivity to address the issue of personnel shortage.*

The Russian industrial sector was successful in enhancing labour productivity as early as in the course of the recent crisis, according to recent business surveys. This is exactly what that makes the crisis of 2015–2016 different from the crisis of 2008–2009. This is most likely caused by the uncommon nature of the former and by how the government treats the fight against unemployment.

The ongoing crisis is softer than the previous one, with the Russian industrial sector showing no crisis-related layoffs. The domestic labour market is characterized by shortage of skilled employees in the industrial sector, and therefore enterprises have to be extremely careful with their layoff policies.

Russian government authorities have played their part in shaping the labour market as it is now. They stated as early as late 2014 that they would not pull administrative strings against enterprises over crisis-related layoffs. Thus, Russian industrial enterprises were permitted to use their discretion regarding the employment policy in the course of the crisis of 2015–2016. And the policy, including the labour productivity management, was successful.

As a result, enterprises managed to attain the best possible labour supply that could be achieved in the course of the ongoing crisis. More than 80% of enterprises said their manpower was adequate by the end of the crisis. The industrial sector saw not a single upsurge in excessive employment in 2015–2016. Enterprises' average annual assessments of excessive employment in 2010–2016 were absolutely stable, ranging within 9–12% (representing the share of enterprises considering their manpower as "more than adequate in the context of expected changes in demand"). The figure jumped up to 25% in 2009, while it stood at 37–39% prior to the Russian default of 1998.

A similar situation with labour productivity is unfolding in the industrial sector. First, a relatively free way of determining employment policies in 2015–2016 predetermined a standard

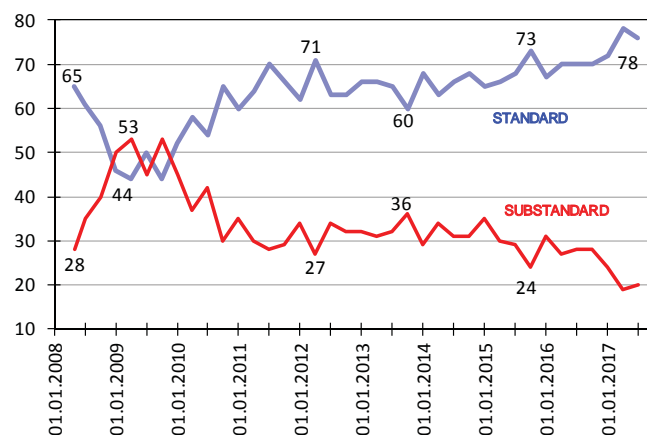


Fig. 1. Russian industrial enterprises' assessments of labour productivity, 2008–2009, %

level of labour productivity. No slumps whatsoever and, therefore, hikes in negative responses were registered in the course of the recent crisis. The opposite developments took place in 2008–2009. The then anti-layoff policy of the government authorities brought about an excessive employment in the industrial sector, lower labour productivity and lower level of satisfaction. Second, the crisis of 2015–2016 allowed industrial enterprises to handle the situation in a relatively quiet manner and to build up the employment policy that drove labour productivity up to the peak level of 2017, according to the recorded level of satisfaction. Only 20% of enterprises say they have low labour productivity.

The premise that low labour productivity hampers the Russian industry's output is not supported by enterprises' assessments. On average, only 8% of enterprises have recognized this factor as a headwind to output growth since the advent of the crisis of 2015–2016. This is well in line with an opportunity emerged in the course of the ongoing crisis that enabled industrial enterprises not only to lay off but also to hire personnel, thereby, on the one hand, fighting against unemployment that turned out to be lower than it is supposed to be in times of crisis (this was reasonable for the situation at hand despite being unexpected for observers), and, on the other hand, to achieve their staffing targets. In Q3 2017, only 8% of enterprises still recognized labour productivity as a headwind to output growth.

The labour force (above all, skilled personnel) rank second in terms of scarcity after "uncertainty about the economic situation, what it is now and what it can become" in the Russian industrial sector. However, this factor was mentioned less frequently in the third quarter, reaching an inter-crisis low of 20%, whereas 25% of enterprises said as early as Q2 2017 they were faced with personnel shortage, reaching a 10-quarter high, which was accounted for by the highest hopes of recovering from the ongoing crisis. It is the lost hopes amid employment uptrend in the sector that enabled industrial enterprises to reduce the ongoing personnel shortage.

However, the industrial sector is not yet prepared to enhance labour productivity to address the issue of personnel shortage. This measure was the least favoured by enterprises when it comes to ongoing or expected personnel shortage. It was always not more than 10% of enterprises (and only 5% of enterprises in 2017) that chose this measure to deal with staff scarcity (no matter whether they were faced with serious or moderate shortage of personnel). ●

## 4. RUSSIA'S ECONOMIC AID TO OTHER COUNTRIES IN 2016

Yu.Zaitsev, A.Knobel

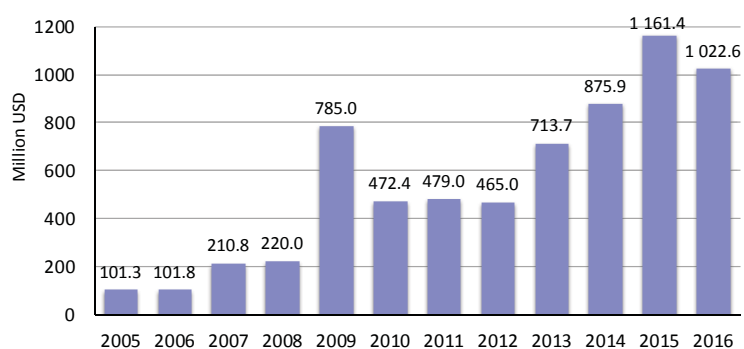
*In the past few years, the volumes of Russia's aid to foreign states remained high. Also, substantial growth was observed in the share of the bilateral development aid (when the aid is channeled directly to the recipient) as compared to the multilateral aid (when it is provided through international organizations). This can be explained by expansion of aid programs to former-Soviet states, including programs aimed at promoting the Eurasian economic integration.*

In 2004, the Russian Federation joined again the ranks of international donors. At present, the Government of the Russian Federation is carrying out its own policy of international development assistance (IDA) based on the approved guidelines<sup>1</sup>.

### The Dynamics of Economic Aid Volumes

Substantial economic aid growth was registered in 2009 when the Government of the Russian Federation allocated over \$785m to finance programs aimed primarily at handling the consequences of the 2008–2009 international crisis in recipient-countries. For example, in 2009 the Anti-Crisis Fund of the Eurasian Economic Community<sup>2</sup> which was later transformed into the Eurasian Fund for Stabilization and Development was established on the initiative of the Russian Federation.

From 2013, the aid volumes started to grow substantially. So, in 2014–2016 the Russian Federation contributed \$500m worth of the authorized capital to the Russian-Kirgiz Development Fund (RKDF)<sup>3,4</sup>. In the past two years, the annual total volume of the Russian aid exceeded \$1bn (Fig. 1).



Source: The RF Ministry of Finance and the OECD Development Assistance Committee.  
Fig. 1. The volumes of official development aid provided by the Russian Federation in 2005–2016, million USD

1 The guidelines for the state IDA policy of the Russian Federation were approved by the Resolution of April 20, 2014 of the President of the Russian Federation: [http://www.mid.ru/foreign\\_policy/official\\_documents/-/asset\\_publisher/CptiCk6B6Z29/content/id/64542?p\\_p\\_id=101\\_INSTANCE\\_CptiCk6B6Z29&\\_101\\_INSTANCE\\_CptiCk6B6Z29\\_languageId=ru\\_RU](http://www.mid.ru/foreign_policy/official_documents/-/asset_publisher/CptiCk6B6Z29/content/id/64542?p_p_id=101_INSTANCE_CptiCk6B6Z29&_101_INSTANCE_CptiCk6B6Z29_languageId=ru_RU)

2 The official Web-site of the Eurasian Economic Community. URL: [http://www.evrazes.com/about/sp\\_af](http://www.evrazes.com/about/sp_af)

3 The Agreement of May 29, 2014 on Development of Economic Cooperation in the Context of the Eurasian Economic Integration and the Agreement of November 24, 2014 on the Russian-Kyrgyz Development Fund between the Government of the Kyrgyz Republic and the RF Government. URL: [http://www.rkdf.org/ru/o\\_nas/normativnye\\_dokumenty](http://www.rkdf.org/ru/o_nas/normativnye_dokumenty)

4 Resolution No. 740-r of December 27, 2014 of the Government of the Russian Federation.

Table 1

## DISTRIBUTION OF RUSSIAN AID AMONG KEY RECIPIENTS (MILLION USD)

Provision of aid	2011	2012	2013	2014	2015	Total in the 2011–2015 period.	2016	Total in the 2011–2016 period	The share of the recipient in the total volume of aid in the 2011–2016 period, %*
Bilateral aid (total)	240.4	214.71	361.85	660.29	902.14	2379.4	762.06	3141.45	66.59
Afghanistan	4.91	0.45	n.a.	4.95	2.56	12.87	-	-	0.35
Azerbaijan	3.18	1.73	n.a.	0.48	0.01	5.4	-	-	0.15
Armenia	3	5.79	5.26	5.86	37.37	57.28	-	-	1.55
Belarus	n.a.	0.11	1.47	2.5	2.97	7.05	-	-	0.19
Guinea	5.87	0.97	n.a.	16.79	6.25	29.88	-	-	0.81
Iran	n.a.	0.1	n.a.	1.3	1.3	2.7	-	-	0.07
Jordan	n.a.	2.6	5.44	3	4.99	16.03	-	-	0.43
Yemen	1	1.5	n.a.	0.36	2.36	5.22	-	-	0.14
Kazakhstan	n.a.	1.6	0.08	0.55	0.57	2.8	-	-	0.08
Kenya	1.5	2.88	2.19	2	n.a.	8.57	-	-	0.23
Kirgizia (including contributions to the Russian-Kyrgyz Development Fund)	12.65	37.92	76.73	202.87	322.81 (150)	652.98	-	-	17.67
Cuba	n.a.	5.58	2.76	176.98	351.97	537.29	-	-	14.54
DPRK	22.39	15.5	33.61	68.42	59.77	199.69	-	-	5.40
Morocco	n.a.	0.08	1.98	1.5	0.6	4.16	-	-	0.11
Namibia	2.45	0.09	0.46	n.a.	0.06	3.06	-	-	0.08
Nicaragua	73.63	10.86	36.4	17.24	5.56	143.69	-	-	3.89
Serbia	13.1	9.49	36.47	16.21	11.25	86.52	-	-	2.34
Sudan	n.a.	0.01	2.56	0.05	1.54	4.16	-	-	0.11
Syria	n.a.	11.17	12.95	7.33	22.1	53.55	-	-	1.45
Tajikistan	6	15.21	17.12	19.48	21.76	79.57	-	-	2.15
Tanzania	0.63	0.07	3.37	1.37	1.37	6.81	-	-	0.18
Tunisia	0.87	0.04	1.98	1.65	1.12	5.66	-	-	0.153
Uzbekistan	n.a.	0.92	0.34	1.15	0.52	2.93	-	-	0.08
Multilateral aid (total)	238.59	250.3	351.81	215.56	259.26	1315.5	260.5	1315.52	33.41
IBRD	70	70.36	69.56	42.48	59	311.4	-	-	8.43
IDA	24.59	46.91	45.48	39.71	71.22	227.91	-	-	6.17
IMF	-	-	95.5	-	-	95.5	-	-	2.58
IMF (MISZ)	5.38	3.34	2.69	1.92	-	13.33	-	-	0.36
UNDP	1.1	1.1	1.1	1.31	1.31	5.92	-	-	0.16
UNFPA	0.3	n.a.	0.3	0.3	0.3	1.2	-	-	0.03
UNHCR OFFICE	2	2	2	2	5.31	13.31	-	-	0.36
UNICEF	1	1	1	1	1	5	-	-	0.14
Other UN institutions	64.96	49.64	67	78.15	79.53	339.28	-	-	9.18
Regional banks for development	39.86	36.49	3.91	3.69	3.11	87.06	-	-	2.36
Other multilateral institutions	22.5	31.46	39.76	34	25.47	153.19	-	-	4.15
Russia's total aid volume	478.99	465.01	713.66	875.85	1161.4	3694.9	1022.56	4717.47	100
Share in the Russian GNI	0.024	0.022	0.033	0.043	0.087	-	0.081	-	-

\*For individual countries and institutions it is based on the 2011–2015 data.

Source: The OECD Development Assistance Committee and the RF Ministry of Finance.



### From Multilateral Development Aid to Bilateral One

From the day of establishment of the international development assistance system till 2014, the Russian official development aid (ODA)<sup>1</sup> was distributed virtually evenly between multilateral aid channels and bilateral ones (*Table 1*). Starting from 2014, the share of bilateral aid started to grow and amounted to 74.5% in 2016. The prospect of introducing promptly a design approach in international development assistance and forming the national practice of evaluation of efficiency of Russian investments is the case for use of the bilateral aid. In addition, bilateral aid provision mechanisms facilitate development of the domestic system of awarding aid provision contracts and upgrade procedures for data collection and reporting.

One of the UN's IDA goals which was later recognized by the OECD Development Assistance Committee was allocation on the annual basis of aid to donors in the amount of 0.7% of the gross national income (GNI)<sup>2</sup>. As regards the Russian Federation, in the past few years this index did not exceed 0.09% (*Table 1*). However, the RF Government set the goal to increase IDA expenditures to 0.1% of GNI by 2020<sup>3</sup>. In its turn, growth in the aid volumes brings Russia's index closer to traditional donor-countries' indicator (the G7 countries) which varied from 0.18% (US) to 0.7% (UK) in 2016<sup>4</sup>.

Under bilateral development aid programs, the RF Government concentrates efforts on assisting development of CIS states, Syria and Cuba. So, among CIS states the largest recipients of the Russian aid are Kirgizia (\$322.81m), Armenia (\$37.37m) and Tajikistan (\$21.76m)<sup>5</sup>. Note that the Russian Federation remains the largest donor of humanitarian aid for Tajikistan (12.6%) after Germany (23.3%)<sup>6</sup> (*Table 1*).

It is noteworthy that the past year saw consolidation of the trend of Russia's providing the bilateral aid; the trend is characterized by a decrease in the budget support (\$35.55m) and growth in the volumes of project financing and technical aid (\$49.56m and \$45.13m, respectively)<sup>7,8</sup>.

In 2016, writing-off of debts remained a main form of assistance in development. So, the total volume of debts written off by the Russian Federation amounted to \$424.94m. Kirgizia and Mongolia were among the largest debtors whose debts were forgiven. Russia wrote off \$30m worth of Kirgizia's debts in H1 2016, while in June 2017 it forgave Kirgizia the aggregate out-

1 ODA is provided as grants, loans and other cash transfers or in kind (goods and services) to partner-countries.

2 The 0.7% ODA/GNI target – a history. OECD. URL: <http://www.oecd.org/dac/stats/the07odagnitarget-ahistory.htm>

3 Resolution No.320 of April 15, 2014 of the Government of the Russian Federation on Approval of the State Program of the Russian Federation: "State Finance Management and Financial Market Regulation".

4 Total flows by donor. OECD Stat. URL: <http://stats.oecd.org/Index.aspx?datasetcode=TABLE1>

5 The data of the Query Wizard for International Development Statistics for 2015. URL: <http://stats.oecd.org/qwids>

6 Russia is seeking to prevent a new civil war in Tajikistan. URL: <http://www.putin-today.ru/archives/31841>

7 Total flows by donor. OED Stat. URL: <http://stats.oecd.org/Index.aspx?datasetcode=TABLE1>

8 Yu.K. Zaitsev. Programs for International Development Assistance in the Context of Support of Investment Activities of the Russian Business in Developing Countries: Prospects and Challenges // National Strategy Issues. Moscow, 2013. No. 5. P. 54–71.



standing debt of \$240m.<sup>1</sup> Also, \$174.2m worth of Mongolia's debts was written off with the outstanding balance set at the level of \$3.8m<sup>2</sup>.

Despite the fact that the bilateral aid is dominating, the multilateral aid is still an important channel of funding IDA programs (25.5% of the aggregate ODA volume in 2016). At present, the key IDA multilateral partners of the Russian Federation are the institutes of the World Bank Group (53% of the multilateral ODA), the World Food Program (WFP), UN Development Program (UNDP) (36% of the multilateral ODA), the Food and Agriculture Organization (FAO) and the International Fund for Agricultural Development (IFAD)<sup>3</sup>. The abovementioned international organizations' development assistance programs in which Russia participated were aimed at promoting food security and consolidating the healthcare and education systems.

#### ***The Eurasian Economic Integration and the Russian Development Aid***

As seen from the international experience, the economic integration in terms of tariffs reduction and investment flow liberalization often brings about market failures related among other things to information asymmetries and foreign effects due to utilization of new regulation standards in the national economy. Technical assistance programs aimed at consolidating domestic producers' export and investment potential and developing the infrastructure within the scope of economic aid programs may be instrumental in handling such failures.

The Russian Federation is the most interested regional donor on the territory of the Eurasian Economic Union (EEU) and has a potential to provide economic aid to promote the economic integration. For example, a priority of the RKDF's economic aid projects is to ensure adaptation of the Kirgiz economy for joining the EEU and that goal is one of Russia's strategic interests primarily in the energy sector, transport and the agriculture.

Also, it is noteworthy that the actual level of development assistance to the EEU member-states is much higher than the aid volumes alone primarily because of transfers due to a lack of export duties on energy supplies. If Russia sells energy commodities to its EEU partner without export duties, that partner does not pay for each commodity unit the sum which is equal to the existing export duty and receives energy commodities at a price which is below the global price approximately by the value of that export duty. As regards natural gas, there is no such thing as the global price, however, the Gazprom is relieved from export duties when it sells gas to Belarus and Armenia, so the price of such gas supplies is reduced by the value of the export duty. So, according to the calculations Russia's oil and gas transfers to its EEU partners amounted to about \$9.1bn in 2011, \$11.8bn in 2012, \$9.3bn in 2013, \$6.5bn in 2014, \$4.5bn in 2015, \$4bn in 2016 and \$3.8bn in 2017 (a decrease observed in the past few years was related to a drop in the global oil prices and a tax maneuver in the oil and gas sector which has been carried out since January 1, 2015)<sup>4</sup>. ●

1 Russia Wrote Off \$240m Worth of Debts to Kirgizia. The Vedomosti Daily. June 20, 2017. URL: <https://www.vedomosti.ru/economics/news/2017/06/20/695219-kirgizii>

2 Russia forgave Mongolia \$174 worth of debts for pragmatic reasons. The Moskovsky Komsomolets Daily, January 22, 2016. URL: <http://www.mk.ru/economics/2016/01/22/rossiya-prostila-mongolii-dolg-v-174-mln-iz-pragmaticheskikh-soobrazheniy.html>

3 The Russian Federation's Official Development Assistance (ODA). OECD, 2016. URL: <http://www.oecd.org/russia/russias-official-development-assistance.htm>

4 A.Yu. Knobel. The Eurasian Economic Union: Prospects of Development and Possible Obstacles // Voprosy Ekonomiki (The Economic Issues). Moscow: Issue No.3, 2015. P. 87–108.

## 5. TAX ON EXTRA REVENUE TO INTRODUCE IN OIL INDUSTRY

Y.Bobylev, O.Rasenko

*The development of the Russian oil industry requires new greenfield projects involving high development costs. In this context, the idea of introducing a tax on extra revenue (TER) for the oil industry has been debated extensively. The tax is supposed to ensure the minerals resource rent is extracted and the investment environment is suitable for development projects involving higher-than-normal operating costs. However, TER represents a more sophisticated form of taxation that requires proper tax administration.*

The tax on extra revenue is a specific rent tax that is based on net revenue and is a much more flexible tool for taxation purposes than the currently effective minerals extraction tax (MET) and export duty that are based on gross revenue. When in force, TER will automatically make the tax burden compliant with oil production conditions in each specific oil field, thus creating environment suitable for investment, including investment in development projects involving higher-than-normal operating costs (including HTR reserves).

The tax base for TER is defined as the difference between revenue from hydrocarbons and oilfield development capex/opex and uncompensated expenditure of prior tax period. The tax is levied after capex are compensated in full. The TER rate can be progressive (the rate will increase with the height of revenues) or single. With the progressive tax scale in place, the tax rate is defined using the P-factor that is calculated as the ratio of accumulated oil extraction revenues to accumulated capex/opex (*Table 1*). In our view, the progressive tax scale should be prioritized.

It would be reasonable to apply TER jointly with MET, with the latter being the minimum tax warranty ensuring that the government generate a certain level of tax revenues from the implementation of a project. Since TER performs the function of basic minerals resource rent tax, MET should be levied at a low enough tax rate, e.g., an ad valorem rate of 15%. MET will ensure that the government can generate revenues from the moment when oil production kicks off (till the moment when TER revenue inflows start to come in), as well as amid low crude prices and high operating costs. When TER is in force, it would be reasonable to set a zero rate on the oil export duty.

*Table 1*

TER RATES FOR OIL PRODUCTION	
P-factor (t – 1)	TER rate (t), %
Up to 1.00	0
Over 1.00 to 1.10	10
Over 1.10 to 1.20	20
Over 1.20 to 1.30	30
Over 1.30 to 1.40	40
Over 1.40 to 1.50	50
Over 1.50 to 2.00	60
Over 2.00 to 3.00	70
Over 3.00	80

Source: own calculations.

## 5. TAX ON EXTRA REVENUE TO INTRODUCE IN OIL INDUSTRY

Thus TER is supposed to replace the bulk of MET, the export duty and export duty incentives that are granted using an imperfect mechanism.

The TER regime involving the progressive tax scale ensures that the taxation system is progressive and the tax burden is differentiated. For highly-efficient projects TER ensures that the state extracts the minerals resource rent on a progressive scale basis. The higher are global crude prices, the bigger is the state's share of net oil and gas revenues (*Table 2* shows calculations that were made using our financial model for the development of a standard oil field). The state's share of net revenues gets smaller amid low oil prices as well as high operating costs, thereby creating more favourable environment for the development of projects involving high costs (*Table 3* presents calculations made using the financial model for the development of a standard oil field; global oil price is \$50/b, standard oil project costs are given as 100%).

*Table 2*

TAX BURDEN AND RETURNS ON INVESTMENT IN OIL PRODUCTION AMID VARIOUS CRUDE OIL PRICES

Taxation regimes	Global crude oil price, \$/b							
	30	40	50	60	80	100	120	150
1. Taxation system in place (including MET and ED incentives)								
State's share of revenues, %	46.8	53.0	56.7	59.1	62.2	64.3	65.7	67.1
State's share of net revenue, %	84.9	79.8	77.5	76.3	74.8	74.3	74.0	73.7
Internal rate of return, %	7.4	12.6	16.5	19.8	25.1	29.1	32.4	36.6
2. TER regime: TER=0–80%; MET=15%; ED=0								
State's share of revenues, %	37.4	48.3	54.7	59.3	66.7	71.3	73.5	76.4
State's share of net revenue, %	67.8	72.9	74.9	76.4	80.2	82.4	82.8	84.0
Internal rate of return, %	11.5	14.8	17.5	19.4	23.0	25.5	28.2	30.9

**Note.** ED stands for export duty.

*Source:* own calculations.

*Table 3*

TAX BURDEN AND RETURN ON INVESTMENT WITH VARIOUS OIL PRODUCTION COSTS

Taxation regimes	Costs, %					
	50	80	100	120	150	200
1. Taxation system in place (including MET and ED incentives)						
State's share of revenues, %	58.1	57.3	56.7	56.1	55.1	53.9
State's share of net revenue, %	71.6	75.0	77.5	80.4	85.5	97.0
Internal rate of return, %	31.4	21.1	16.5	12.8	8.2	1.5
2. TER regime: TER=0–80%; MET=15%; ED=0						
State's share of revenues, %	65.3	58.2	54.7	51.1	45.3	36.6
State's share of net revenue, %	77.7	76.2	74.9	73.4	70.2	65.9
Internal rate of return, %	27.3	20.4	17.5	15.3	12.6	9.2

*Source:* own calculations.

When a single tax rate is applied, factors such as the variety of mining, geological and geographic conditions for the development of oil fields and large differences between project economics are considered to a lesser degree. In highly-efficient projects this will cause shortfalls in the minerals resource rent for the state. In low-efficient projects the single rate may be found too high and therefore be a headwind to their implementation.

In contrast to the single tax rate, the progressive tax rate ensures that the state has a bigger share of budget oil and gas revenues amid increasing crude prices and the tax burden is lower amid falling prices. The progressive tax rate

is more useful when in case of higher or lower opex. In contrast to the single tax rate, the progressive rate ensures a lower tax burden amid increasing oil production costs, that is, more favourable environment for the investment in development projects involving higher-than-normal operating costs.

Taxes on extra revenues are widely applied in the international practice, varying in specific features from country to country. For example, Norway, the United Kingdom and Australia apply single rates of rent taxes on revenues. Kazakhstan applies the progressive tax on super profits, with the tax rate ranging within 0-60%. Developing countries apply production sharing agreements (PSAs) that are driven by a mechanism similar to that of TER. Modern PSAs apply production sharing progressive sliding scales, in which the state's share increases depending on certain factors (oil production level, P-factor, etc.). Special P-factor taxes are applied, too.

Various TER concepts were considered in Russia as early as the late 1990s/early 2000s, but none of those has been adopted so far.<sup>1</sup> In our view, TER was not introduced at that period primarily due to its tax administration complexity and concerns about shortfalls in federal budget revenues. Therefore, more simple taxation tools were prioritized, namely royalty and crude excise duty (until 2002), MET since 2002.

A new TER draft bill has recently been prepared, including a TER pilot introduction for a limited number of greenfield and brownfield projects (pilot projects). The draft bill provides for a single tax rate, high enough MET, and restricts cost recovery for TER tax base assessment for brownfield projects, as well as the scope of taxation. A decision on broadening the TER coverage will depend on the pilot projects' outputs.

While TER, in theory, is a more advanced taxation tool, it can be efficient in practice subject to a much more complex tax administration than that of MET and export duty. TER opens up potential opportunities and incentives for subsoil users to understate tax liabilities by understating revenues and overstating expenses/costs. This poses the risk of federal budget revenues falling below their potential value.

The following should be done to ensure that the TER regime is efficient:

1. Relying on oil market (not transfer) prices for tax assessment. It is reasonable at the initial stage to use estimated (reference) prices that may be calculated using reverse calculation in accordance with global oil prices less export duty and export transportation costs.

2. Efficient control over taxpayers' costs/expenses (to ensure that the tax base is not understated by deliberately overstating costs/expenses).

3. Competent and non-partisan public control (highly qualified and uncorrupted tax authorities).

In our view, it is more reasonable to apply TER for greenfield projects than for brownfield projects, as the latter is more complex in terms of administration. Advanced development of producing oil fields could be stimulated using more simple taxation mechanisms, e.g., the MET rate for oil fields with high level of reserves depletion can be cut way below the current rate established under the taxation system in force. This will reduce the tax burden in advanced stages of oil fields operation, promote more advanced development and boost the oil recovery factor. ●

1 Bobylev Yu. Tax reforms in the mineral extraction sector. M.: IET, 2001.

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