# MONITORING OF RUSSIA'S ECONOMIC OUTLOOK:

## TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

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# MAIN TRENDS AND CONCLUSIONS

The plunge of the share of oil and gas revenues from 46.9% in 2018 to 40.9% in 2019 is acknowledged as a significant fact by the experts who have been analyzing the federal budget execution results. Overall, **budget revenue declined only slightly** (by 0.2 pp of GDP) thanks to the increased VAT receipts. **Expenditure, on the contrary, increased** – by 0.6 pp of GDP (or Rb 1.5 trillion in nominal terms), due in the main to the ongoing implementation of national projects. However, any further growth of budget spending coupled with shrinking budget receipts is fraught with the risk of the federal budget becoming misbalanced.

According to the year-end results of 2019, the **budget once again demonstrated a surplus**, but its actual amount of 1.8% of GDP had shrunk by 0.8 pp of GDP relative to 2018. On the back of the rapidly shrinking oil prices and revenues coupled with the adverse macroeconomic effects of the coronavirus pandemic, the main guarantee of the government's ability, in 2020, to fulfill its obligations, including those relating to the national projects and additional long-term social liabilities, will be the **resources of the National Welfare Fund (NWF) accumulated over the previous three-year period,** which amount to 7.1% of GDP. The liquidity held by the NWF and the potential of the domestic government debt market will suffice to cover the gap produced by the loss of the oil and gas revenues if the average annual price of oil falls below $ 40 per barrel, although it is quite probable that a part of the investment expenditures will be carried forward to the next periods.

All these negative factors may just as well translate into a shrinkage of regional budget revenues, lack of proper balance in regional budgets and an increasing government debt, as has been noted by our experts after reviewing the year-end execution of the regions' budgets for 2019. However, **the sufficiently high level of budget sustainability currently demonstrated by RF subjects** will help prevent the onset of a regional budgetary crisis – at least in the short run.

Practically all the RF subjects **showed positive revenue growth rates.** However, that growth has become slower compared with that in 2018, amounting to 9.5%, while expenditure has been increasing at a much faster rate (by 14.2%). As a result, budget surplus dwindled to nearly zero. At the same time, **the government debt of regions declined** – to Rb 2.1 trillion, which amounts to 22.5% of budget revenue, compared with 25.3% a year earlier. A high debt burden (over 50%) is still shouldered by 26 regions, whereas in 2018, the number of such regions was 42.

In their overview **of the results of Russia's foreign trade in 2019,** our experts point to a shrinkage of the fuel and energy exports by 8.8% in response to the sliding world prices of energy resources. Non-raw non-energy exports shrank to a lesser degree, by 0.8%. Imports, on the contrary, gained 2.2% relative to 2018.

Our researchers note that in H1 2020, in view of the emerging external shocks, the revenues generated by sales of oil and petroleum products (44% of last year's total exports) can plummet relative to 2019. For the exports of natural gas, which in 2019 accounted for 11.7% of total exports, an additional negative factor was the anomalously warm winter in Europe (the main market for Russian natural gas). As for metal prices, these have been sliding so far at more moderate rates.

Our experts have analyzed **the prospects for supplies of Russian oil to Belarus** in the context of the ongoing tax maneuver in Russia's oil industry (which includes, among other things, a gradual reduction in customs duties on oil to zero-rate tariff). In the event of a fixed volume of oil exports, Russian companies will be receiving a decreasing premium, paid to them by Belarusian oil refineries for the duty-free oil. This is the preliminary agreement achieved in February 2020. After considering the outcome of such a scenario, our experts have come to the conclusion that for the Russian economy, a quite different scenario would have been more preferable. Under the latter scenario, crude oil exports to Belarus would be somewhat reduced, while Russia would be increasing the oil-refining capacities in its own territory, and this would appear to be in perfect accord with the logic of the tax maneuver.

# 1. FEDERAL BUDGET EXECUTION FOR 2019: KEY RESEARCH INSIGHTS

S. Belev, I. Sokolov, T. Tischenko

*The federal budget execution for 2019 compared to the previous year is marked by a reduction of the share of oil and gas revenues which shrank to 40.9% against 46.3% in 2018. At the same time, total federal budget revenues have decreased insignificantly (down 0.2 p.p. of GDP) mainly due to considerable growth of proceeds from VAT (up 0.8 pp of GDP) on the back of VAT rate rise from 18 to 20%.*

*Increase of the federal budget expenditures against last year came to 0.6 p.p. of GDP or around Rb 1.5 trillion in nominal terms due to the implementation of the national projects. Further growth of respective financing on the back of falling federal budget revenues raises the risk of its imbalance.*

*NWF (National Wealth Fund) markedly increased in 2019 (up to 7.1% of GDP against 3.9% of GDP year earlier) resulting from crediting of accumulated in 2018 additional oil and gas funds to NWF accounts. Although liquidity available in NWF will markedly contract on the back of acquisition of the Sberbank shares, it will be sufficient for the implementation of all state obligations even amid unfavorable external economic conditions in medium-term perspective.*

According to the Federal Treasury, **the federal budget revenues** during 12 months 2019 decreased compared to the previous year by 0.2 p.p. of GDP to 18.4% of GDP, although increased in the nominal terms by Rb 717.1 bn (*Table 1*). Non-oil and gas revenues demonstrated upward trends in the course of three quarters of 2019 and stood at 0.9 p.p. of GDP at the year-end relative to January-December 2018, meanwhile oil and gas revenues contracted by 1.1 p.p. Of GDP.

**Oil and gas revenues** have contracted by 1.1 p.p. of GDP against 2018 including due to a decrease of proceeds from MET by 0.4 p.p. of GDP and export customs duties by 0.8 p.p. of GDP. This was driven by the ruble appreciation against the dollar and decline of the average crude oil price as well as a change from

*Table 1*

Key parameters of the federal budget for January-December 2018–2019

| Index | January-December 2018 | | | January-December 2019 | | | Change, 2019 to 2018, pp. GDP |
|---|---|---|---|---|---|---|---|
| | RB bn | GDP % | % of planned volume | Rb bn | GDP % | % of planned volume | |
| **Revenues, of which** | **19 454.4** | **18.6** | **102.7** | **20 171.5** | **18.4** | **101.1** | **-0.2** |
| oil and gas revenues | 9 017.7 | 8.6 | 102.3 | 8 247.7 | 7.5 | 105.2 | -1.1 |
| non-oil and gas revenues | 10 436.7 | 10.0 | 103.0 | 11 923.8 | 10.9 | 98.3 | 0.9 |
| **Expenditures, of which** | **16 713.0** | **16.0** | **95.5** | **18 213.2** | **16.6** | **94.2** | **0.6** |
| interest expenditures | 806.0 | 0.8 | 99.0 | 730.8 | 0.7 | 94.0 | -0.1 |
| non-interest expenditures | 15 907.0 | 15.2 | 95.4 | 17 482.4 | 15.9 | 94.2 | 0.7 |
| **Federal budget surplus/deficit** | **2 741.4** | **2.6** | **-** | **1 958.3** | **1.8** | **-** | **-0.8** |
| Non-oil and gas deficit | -6 276.3 | -6.0 | | -6 289.4 | -5.7 | | 0.3 |
| *To note: GDP (in current prices, Rb bn.)** | 104 335 | | | 109 361 | | | |

*Advance estimate for 12 months of 2019.
*Sources:* Minfin of Russia, Federal Treasury, own calculations.

*Table 2*

## Key tax revenues of the federal budget in 2015–2019

| | GDP % | | | | | 2019 to 2018 г., p.p. GDP |
|---|---|---|---|---|---|---|
| | 2015 | 2016 | 2017 | 2018 | 2019 | |
| Revenues – total | 16.4 | 15.7 | 16.4 | 18.6 | 18.4 | -0.2 |
| Oil and gas | 7.0 | 5.6 | 6.5 | 8.6 | 7.5 | -1.1 |
| Of which: | | | | | | |
| MET | 3.7 | 3.3 | 4.4 | 5.9 | 5.5 | -0.4 |
| Export duties | 3.3 | 2.3 | 2.1 | 2.8 | 2.0 | -0.8 |
| Non-oil and gas | 9.4 | 10.1 | 9.9 | 10.0 | 10.9 | 0.9 |
| Of which: | | | | | | |
| corporate profit tax | 0.6 | 0.6 | 0.8 | 0.9 | 1.1 | 0.2 |
| VAT on goods sold on the territory of the Russian Federation | 2.9 | 3.1 | 3.3 | 3.4 | 3.9 | 0.5 |
| VAT on goods imported in the territory of the Russian Federation | 2.1 | 2.2 | 2.2 | 2.3 | 2.6 | 0.3 |
| excise duties on goods manufactured on the territory of the Russian Federation | 0.6 | 0.7 | 1.0 | 0.8 | 0.5 | -0.3 |
| excise duties on goods imported in the territory of the Russian Federation | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.0 |
| Import duties | 0.7 | 0.7 | 0.6 | 0.6 | 0.7 | 0.1 |
| Other revenues | 2.4 | 2.7 | 1.9 | 1.9 | 2.0 | 0.1 |

*Sources:* Federal Treasury, own calculations.

July 1, 2019 of the dampen component calculation on the crude oil resources[1]. As a result, the share of MET in the overall volume of oil and gas revenues of the federal budget demonstrates sustainable upward trend from 38.3% in 2014 to 72.4% in 2019.

**Non-oil and gas revenues** of the federal budget increased in 2019 relative to the previous year by 0.9 p.p. of GDP due to growth of all tax receipts except excises which share in share of GDP contracted by 0.3 p.p. VAT revenues demonstrated the highest growth (*Table 2*) on the back of the rate growth from 18 to 20% as well as imports growth resulting from the ruble appreciation (receipts from VAT on imported goods have increased by 0.3 p.p. of GDP). It should be noted that despite the growth of the VAT rate its C-efficiency did not change in 2019[2].

On the whole, **dynamics of non-oil and gas revenues** of the federal budget demonstrated sustainable upward trend in recent years.

**Federal budget expenditures** over January-December 2019 against January-December 2018 went up 0.6 p.p. of GDP amid insignificant reduction of the budget cash execution (94.2% against 95.5%). They posted growth by Rb 1,500.2 bn in absolute terms.

With a breakdown into **functional classification of expenditure** (*Table 3*) the federal budget expenditure demonstrates growth by share of GDP during January-December 2019 relative to 12 months of 2018 by 0.2 p.p. of GDP with respect to “National economy” and “Housing and utilities”, up 0.1 p.p. of GDP regarding “Environmental protection”, “Healthcare”, and “Social policy.” This dynamic correlates with the budget policy priorities set by the President’s Executive Order of May 7, 2018. Contraction of the federal budget allocations in 2019 against 2018 is observed solely on spending on servicing state foreign debt by 0.1 p.p. of GDP. On the remaining items of functional classification, the

1 Federal Law of July 30, 2019 No. 255-FZ “On Introduction of Changes in the Second Half of the Tax Code of the Russian Federation”.
2 C-efficiency in 2019 stood at 49.9% against 48.2% in 2018.

*Table 3*

Federal budget expenditures in January-December 2018–2019

| | January-December 2018 | | | January-December 2019 | | | Change 2019 to 2018 | |
|---|---|---|---|---|---|---|---|---|
| | Rb bn | as % of GDP | Cash execution, % | Rb bn | as % of GDP | Cash execution,% | Rb bn | p.p. of GDP |
| **Expenditure – total,** *including:* | 16 713.0 | 16.0 | 95.5 | 18 213.2 | 16.6 | 94.2 | 1 500.2 | 0.6 |
| Nationwide issues | 1257.2 | 1.2 | 89.0 | 1366.3 | 1.2 | 85.6 | 109.1 | 0.0 |
| National defence | 2827.1 | 2.7 | 92.3 | 2997.2 | 2.7 | 92.7 | 170.1 | 0.0 |
| National security and Law enforcement | 1971.1 | 1.9 | 96.2 | 2083.1 | 1.9 | 95.5 | 112.0 | 0.0 |
| National economy | 2402.2 | 2.3 | 93.5 | 2824.5 | 2.5 | 91.8 | 422.3 | 0.2 |
| Housing and Utilities | 148.8 | 0.1 | 88.1 | 283.7 | 0.3 | 84.2 | 134.9 | 0.2 |
| Environmental protection | 116.0 | 0.1 | 98.8 | 197.5 | 0.2 | 91.7 | 81.5 | 0.1 |
| Education | 722.6 | 0.7 | 95.9 | 826.6 | 0.7 | 93.1 | 104.0 | 0.0 |
| Culture and Cinematography | 94.8 | 0.1 | 84.3 | 122.4 | 0.1 | 87.8 | 27.6 | 0.0 |
| Healthcare | 537.3 | 0.5 | 96.3 | 713.0 | 0.6 | 95.6 | 175.7 | 0.1 |
| Social policy | 4581.9 | 4.4 | 99.3 | 4881.1 | 4.5 | 99.7 | 299.2 | 0.1 |
| Physical culture and Sports | 64.0 | 0.1 | 86.9 | 81.4 | 0.1 | 91.5 | 17.4 | 0.0 |
| Mass Media | 88.5 | 0.1 | 99.9 | 103.5 | 0.1 | 99.9 | 15.0 | 0.0 |
| Public debt servicing | 806.0 | 0.8 | 99.0 | 730.8 | 0.7 | 94.0 | -75.2 | -0.1 |
| Intergovernmental fiscal transfers | 1095.5 | 1.0 | 99.7 | 1002.1 | 1.0 | 95.7 | -93.4 | 0.0 |

*Sources:* Finance Ministry of Russia, Federal Treasury, own calculations.

federal budget expenditure in share of GDP stayed unchanged in 2019 relative to 2018.

According to flash data, **the federal budget expenditures on the implementation of the federal projects** in 2019 came to Rb 1,600.3 bn on the back of cash execution at 91.4%. In the overall volume of the federal budget expenditures on these goals half of the funds was allocated on two national projects: "Demography" – 31.1% (Rb 498.3 bn) and on the modernization of highway infrastructure 19.1% (Rb 306.1 bn) (*Table 4*).

**The federal budget surplus** at 2019 year-end stood at 1.8% of GDP (Rb 1,958.3 bn) up 0.8 pp. or down Rb 783.1 bn of budget surplus recorded for January-December 2018. Non-oil and gas deficit contracted from 6.0% of GDO to 5.7% of GDP.

According to the Ministry of Finance of Russia, as of January 1, 2020, public **debt** stood at Rb 13.6 trillion (12.4% of GDP against 12.0% in 2018), including domestic debt – Rb 10.2 trillion (up Rb 995.5 bn for 12 months 2019) and external debt – Rb 54.8 bn (up USD 5.7 bn for 12 months 2019).

The total **amount of the National Wealth Fund** (NWF) up from Rb 4,036.0 bn (3.9% of GDP) to Rb 7,773.1 bn (7.1% of GDP) during January-December 2019. Accrued during 3-year period sovereign reserves serve as the key factor for the federal budget sustainability amid plummeting crude oil prices seen during first months of 2020. In the context of plummeting oil and gas revenues and on the back of unfavorable macroeconomic consequences of coronavirus transmission **the NWF funds will be the key pillar for the implementation of the state obligations in 2020** including the national projects. The decision to purchase the Sberbank shares using the funds of the NWF although cuts its liquidity by Rb 2.8 trillion but will not have critical effect on the federal budget obligations.

*Table 4*

## Financing of national projects from the federal budget in 2019, Rb bn.

| | Description | Total expenditure | | |
|---|---|---|---|---|
| | | Budget quarterly breakdown as of 31.12.2019 | Cash execution | For reference: as% of budget allocations |
| | Всего: | 1 750.0 | 1 600.3 | 91.4 |
| 1 | NATIONAL PROJECT «DEMOGRAPHY» | 522.0 | 498.3 | 95.5 |
| 2 | NATIONAL PROJECT «HEALTHCARE» | 160.3 | 157.1 | 98.0 |
| 3 | NATIONAL PROJECT «EDUCATION» | 108.4 | 98.7 | 91.0 |
| 4 | NATIONAL PROJECT «HOUSING AND URBAN ENVIRONMENT» | 105.3 | 98.8 | 93.8 |
| 5 | NATIONAL PROJECT «ECONOGY» | 55.6 | 36.9 | 66.3 |
| 6 | NATIONAL PROJECT «SAFE AND QUALITY ROADS « | 142.3 | 138.2 | 97.1 |
| 7 | NATIONAL PROJECT «PRODUCTIVITY AND EMPLOYMENT SUPPORT» | 7.1 | 6.2 | 87.1 |
| 8 | NATIONAL PROJECT «SCIENCE» | 37.9 | 37.6 | 99.1 |
| 9 | NATIONAL PROGRAM «DIGITAL ECONOMY» | 100.7 | 73.8 | 73.3 |
| 10 | NATIONAL PROJECT «CULTURE» | 14.2 | 14.0 | 99.0 |
| 11 | NATIONAL PROJECT «SMALL AND MEDIUM-SIZED ENTERPRISES AND SUPPORT OF INDIVIDUAL ENTREPRENEURSHIP « | 60.6 | 56.4 | 93.1 |
| 12 | NATIONAL PROJECT «INTERNATIONAL COOPERATION AND EXPORTS « | 87.7 | 78.1 | 89.1 |
| 13 | COMPLEX PLAN "MODERNIZATION OF INFRASTRUCTURE" | 347.8 | 306.1 | 88.0 |

*Sources:* Russian Ministry of Finance, Federal Treasury, own calculations.

Thus, one can conclude that owing to the fiscal consolidation seen in 2016–2018, the adaptation of the state expenditure to the oil prices in the range of USD 40–45 per barrel was secured. At the same time, implementation of national projects commenced in 2019 and adopted on March 12, 2020 Law on amendments in the federal budget[1], which committed additional long-term social obligations raised the cost of the federal budget balance to USD 53 per barrel (under exchange rate Rb 76 to USD). Hence, notable change of average annual oil price below the balance price can lead to the budget deficit and raise doubts on the feasibility of implementation of all investment projects (they constitute the major share of expenditure on the national projects) during 2020 (there is a major risk of shifting their implementation for indefinite term).

However, even in the event of oil prices below 40 USD/bbl, in our view, additional measures of the budget policy tightening will not be needed (revision of the fiscal rule and sequester of spending) because there will be sufficient both funds in the NWF and domestic market of public debt for financing shortfall in revenue. Meanwhile, when the consequences of the current economic shock will have long-term effect, there inevitably will be revision of the volume and structure of the federal budget expenditures for 2021 and 2022.

1 According to adopted on March the planned period 2021 and 2022"

# 2. REGIONAL BUDGETS IN 2019

I. Arlashkin

*Results for 2019 look rather positive: consolidated budgets of 50 regions boasted of surplus, public regional debt demonstrates a downturn trend, rates of budget revenues growth outstrip the inflation rate. However, revenues growth rates slowed down against 2018 and surplus in the regions as a whole contracted to near zero. Expenditures (14.2%) were growing at a significantly faster pace than the revenues (9.5%). Implementation of regional and federal projects at the subnational level requires sustainable growth of expenses and current rates of economic growth amid plummeting oil prices and coronavirus pandemic can fail to secure sufficient growth of budget revenues. In this context, already in 2020 certain regions can face fiscal imbalance.*

**Revenues**

**Revenues of the consolidated budgets of the subjects of the Russian Federation increased in nominal terms** in 2019 against 2018 by 9.5% (*Table 1*) above the inflation rate[1].

Main sources of revenues were taxes, levies and regular payments for the use of natural resources (up 20%), excises (up 19.4%), total tax (14.6%), and fiscal transfers (17.6%) including subsidies (45%), subventions (19.6%) and other intergovernmental fiscal transfers (72.3%). Significant growth of target fiscal transfers amid insignificant increase of equalization transfers (up 4.8%) and significant contraction of fiscal equalization (down 67.8%) was due to the implementation of national and federal projects at subnational level. For example, the share of transfers for the implementation of corresponding projects has come to 24% of the total volume of transfers from the federal budget to RF subjects or Rb 572.2 bn in nominal terms.

Growth of the corporate tax and personal tax returns at end-2019 was less than in 2018 coming to 8.2% (22.8% in 2018) and 8.3% (12.4% in 2018) respectively. Nontax revenue up 5.9%.

2019 saw a contraction of property tax return (down 3.3%) mainly due to a reduction of corporate property tax return (down 6.8%) on the back of corporate movable property tax exemption.

On the whole, **the majority of the main revenue sources taking into account the low inflation rate demonstrated an upward trend** in real terms.

**Practically all RF subjects demonstrated upward trend regarding consolidated budgets revenue growth** except Kaluga region (99% against 2018), Sebastopol (97.2%), Republic of Bashkortostan (99.8%), Khanty-Mansi autonomous district—Yugra (98.1%), Kemerovo region—Kuzbass (95.3%0, and Republic of Khakassia (90.9%)on the back of the last year high base.

According to advance results of the execution of the regions' consolidated budgets for 2 months of 2020, fiscal and nontax revenues up 0.8% against the same period of 2019, and corporate tax returns contracted by 14.9%. In the context of current plummeting of crude oil prices amid coronavirus pandemic one can expect a reduction of regional revenues at end-2020.

1 Annual CPI advance estimate 104,5 for 2019 (December 2019 to December 2018 – 103.0).

*Table 1*

Revenues of the consolidate budgets of RF subjects in 2019

| Revenues | Rb bn 2019 | Growth in % 2019/2018 | % of GDP | | |
|---|---|---|---|---|---|
| | | | 2017 | 2018 | 2019 |
| **Revenues, total** | **13 568.0** | **9.5** | **11.7** | **11.9** | **12.4** |
| **Fiscal revenues, including:** | **10 150.5** | **7.7** | **8.9** | **9.0** | **9.3** |
| Corporate income tax | 3 358.1 | 8.2 | 2.8 | 3.0 | 3.1 |
| Personal income tax | 3 955.2 | 8.3 | 3.5 | 3.5 | 3.6 |
| Excises | 755.2 | 19.4 | 0.7 | 0.6 | 0.7 |
| Total tax | 596.3 | 14.6 | 0.5 | 0.5 | 0.5 |
| Property tax | 1 350.8 | -3.3 | 1.4 | 1.3 | 1.2 |
| **Nontax revenues** | **840.4** | **5.9** | **0.9** | **0.8** | **0.8** |
| **Intergovernmental fiscal transfers, including:** | **2 450.7** | **17.6** | **1.9** | **2.0** | **2.2** |
| Grants | 921.6 | -10.9 | 0.8 | 1.0 | 0.8 |
| Subsidies | 557.5 | 45.0 | 0.5 | 0.4 | 0.5 |
| Subventions | 396.6 | 19.6 | 0.4 | 0.3 | 0.4 |
| Other intergovernmental fiscal transfers | 575.0 | 72.3 | 0.2 | 0.3 | 0.5 |

*Sources:* Federal Treasury, own calculations.

**Divergence of fiscal and nontax revenues of the regions' consolidated budgets** has been observed for the third year in a row. For instance, at end-2019, regions with high fiscal capacity (13 subjects without equalization transfers in 2019) boasted growth of fiscal and nontax revenues by 8.8%, meanwhile regions with average fiscal capacity (41 subjects) posted growth of 6.3%, and regions with low fiscal capacity (31 subjects) – 5.7%. Thanks to interbudgetary fiscal transfers there was a reduction in differentiation of regional revenues: in 2019, the highest growth of own revenues (all revenues minus subventions) was recorded by regions with low fiscal capacity – 10.9%, while regions with average and high fiscal capacity it stood at 9.1% and 8.8%, respectively.

### Expenditures

Growth of expenditures of the consolidated budgets of RF subjects in 2019 against 2018 came to 14.2% significantly above the revenue growth (9.5%) and the inflation rate (4.5%).

**Expenditure growth was observed in 83 regions,** and in 79 regions exceeded inflation for the same period. Contraction of the nominal volume of expenditure occurred in the Republic of Mordovia (5.8%), which is resolving the issue of public debt reduction, and in the Republic of Khakassia (5.9%) facing low rates of revenue growth.

The share of own (i.e. not financed by targeted intergovernmental fiscal transfers) expenditures of regions and municipalities allocated on the implementation of national and federal projects in 2019 constituted barely 4.7% of the total volume of expenditures of the consolidated budgets of the regions, and in 2020 it should come to 4.8%, in 2021 – 5.1%, and in 2022 – 5.5%. By itself, this burden on the subnational budgets does not pose a threat to fiscal balance of the regions although it can strengthen adverse effects from other factors (in particular, slowdown of revenue growth rates). Regarding certain regions, there is no interconnection between the share of own expenditure on the implementation of national and federal projects in the overall expenditure and the level of budget deficit in 2019, i.e. implementation of the projects supposedly has not significantly adversely affected fiscal balance of certain regions.[1] According to advance data on the execution of the consolidated budgets of the regions there was no notable deterioration of the fiscal balance. However, with the increment of additional expenditure on the implementation of national and federal projects the situation with fiscal balance can becomnot too bright.

On the whole, **the structure of expenditure** of the regions' consolidated budgets did not undergo significant changes (*Table 2*). However, one should underscore the increment of spending on items "National economy" (19.7% in 2019 against 2018) and "Environmental protection" (67.7%)on the back of the implementation of national and federal projects at the subnational level. Healthcare **was also a priority of the budget policy** (spending up 22.8%). Slowdown of expenditure growth rates on education, culture and social policy most likely is due both to optimization of expenditure policy in these spheres as well as termination of the period of advanced growth of wages in the public sector and bringing them to the average level across regional economy. Reduction of the public debt and decrease of the interest rates in the economy led to the contraction of expenditure on its servicing: the share in expenditure structure at end-2019 came to 0.8% – minimum since 2011.

*Table 2*

### Functional structure and expenditure dynamics of the consolidated budgets of RF subjects in 2019

| Expenditure | Expenditure structure, % | | | Increment, % | |
|---|---|---|---|---|---|
| | 2017 | 2018 | 2019 | 2019/ 2017 | 2019/ 2018 |
| **Expenditure, total** | **100.0** | **100.0** | **100.0** | **25.5** | **14.2** |
| Nationwide issues | 6.1 | 6.3 | 6.2 | 27.9 | 12.2 |
| National security and Law enforcement | 1.1 | 1.2 | 1.1 | 29.6 | 8.7 |
| National economy, including | 21.2 | 20.8 | 21.8 | 29.1 | 19.7 |
| Agriculture and fishery | 2.5 | 2.3 | 1.9 | -2.4 | -3.4 |
| Transport | 5.2 | 4.7 | 5.1 | 22.6 | 22.7 |
| Public road system (road funds) | 8.8 | 8.9 | 9.5 | 35.5 | 21.9 |
| Other issues in the sphere of national economy | 4.7 | 4.9 | 5.3 | 41.3 | 23.8 |
| Housing and Utilities | 10.4 | 10.2 | 10.2 | 22.3 | 13.7 |
| Environmental protection | 0.3 | 0.3 | 0.5 | 149.3 | 67.7 |
| Education | 24.9 | 25.4 | 24.7 | 24.8 | 11.3 |
| Culture and Cinematography | 3.8 | 3.7 | 3.5 | 17.1 | 8.9 |
| Healthcare | 7.8 | 8.0 | 8.6 | 37.8 | 22.8 |
| Social policy | 20.4 | 20.3 | 19.8 | 21.7 | 11.2 |
| Physical culture and Sports | 2.3 | 2.4 | 2.4 | 26.3 | 13.3 |
| Mass Media | 0.4 | 0.4 | 0.4 | 19.5 | 9.5 |
| Servicing of public and municipal debt | 1.2 | 0.9 | 0.8 | -21.1 | -5.1 |

*Sources:* Federal Treasury, own calculations.

1 However, the share of own expenditure on the implementation of projects depends on the level of fiscal capacity of a region. Adverse effect of additional burden on subnational budgets can be offset for regions with high fiscal capacity, and other region – intergovernmental fiscal transfers.

**Budget balance and public debt**

At end-2019 results, **50 out of 85 regions executed consolidated budget with a surplus** and total surplus of the consolidated budgets of regions stood at Rb 4.7 bn. However, compared to 2018 indexes (then 70 regions posted surplus to the tune of Rb 510.3 bn), this data demonstrates excess of expenditure growth rates over revenues growth rates.

Budget surplus permitted regions to continue taking measures aimed at reducing public debt. **Nominal volume of debt of the regions contracted** during 2019 to Rb 2.1 trillion (down Rb 0.1 trillion) constituting 22.5% of fiscal and nontax revenues of regional budgets (at end-2018 – 25.3%).

Debt burden[1] on the budgets of regions with high fiscal capacity practically has not changed and on the budgets of regions with average and low fiscal capacity has contracted by 5.9 and 4.3 p.p., respectively (*Fig. 1*). High level of debt burden (over 50%) retains with 26 regions (against 42 regions in 2018), and ultrahigh (over 100%) – solely in Republic of Mordovia although it shrank somewhat (from 237 to 211%)

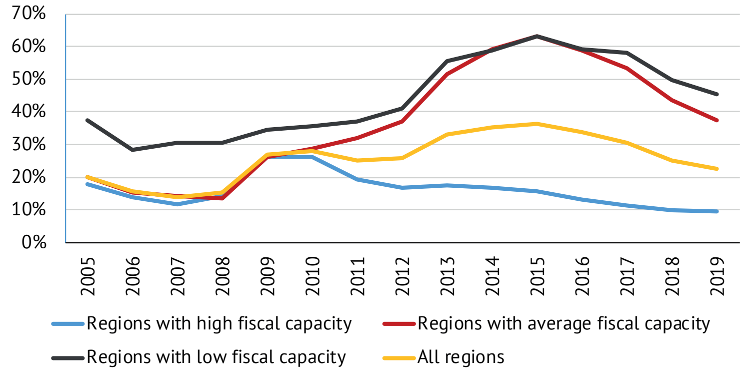



*Fig. 1. Debt burden on regional budgets, %*

*Sources:* Finance Ministry of Russia, Federal Treasury, own calculations.

**The structure of regions' public debt has not practically changed**: as of end-2019 budget loans amounted to 42% of the total debt, bonds – 28%, bank loans – 27%, and state guarantees – 3%. Thus, at end-2019, regions' consolidated budgets were executed with surplus and regions' public debt continued falling. However, taking into account plummeting crude oil prices amid coronavirus pandemic one should expect contraction of revenues and regions' expenditure growth, which on balance can lead to growth of fiscal imbalance and public debt. Meanwhile, high current level of regions' fiscal sustainability will permit (to a larger extent, in short-term perspective) avoid regions' budget crisis.

1 Ratio of public debt of RF subjects to fiscal and nontax revenues of RF subjects.

# 3. RUSSIA'S FOREIGN TRADE IN 2019: STABILIZATION OF NON-OIL AND GAS EXPORTS

A.Knobel , A. Firanchuk

*In 2019, exports of fuel and energy commodities decreased by 8.8% as compared with the previous year on the back of a drop in global prices of energy commodities. Non-oil and gas exports declined by 0.8% in value terms because of depreciation of global prices of some commodities of this group that failed to be compensated by weak growth in the volume of exports (+1.5%). From July, imports surpassed the index values of the previous year, having increased by 2.2% over the year.*

**Dynamics of Exports and Imports**

In 2019, in value terms exports decreased as compared with the previous year to $422.8bn (94.0% from the value seen in 2018). Particularly, exports of fuel and energy commodities fell by 8.8% ($262.5bn). Exports of other commodities saw an insignificant decrease of 1.4% to $160.4bn (*Fig.* 1). In 2019, in value terms imports surpassed by 2.2% the value of the previous year and amounted to $243.8bn. Positive dynamics of import supplies as compared with the previous year was observed from July (*Fig.* 2).

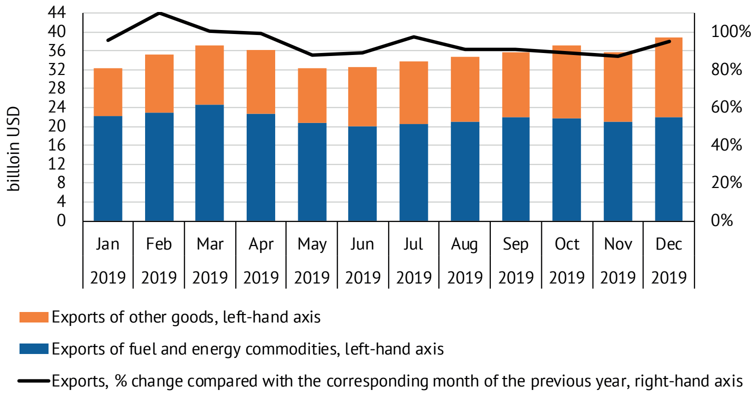



*Fig. 1. Dynamics of Russia's exports in 2019*

*Source:* own calculations based on the data of the Federal Customs Service of the Russian Federation.

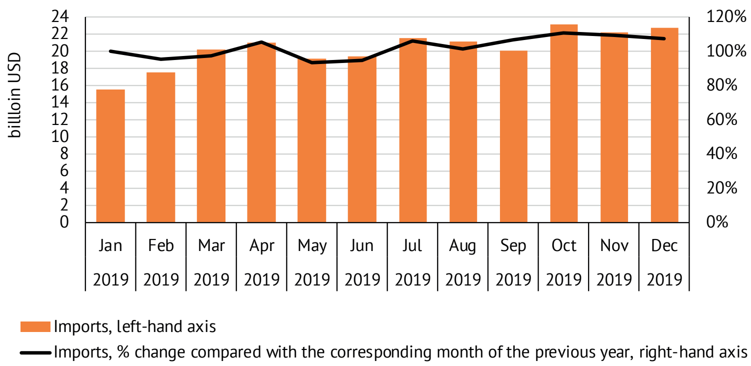



*Fig. 2. Dynamics of Russia's imports in 2019*

*Source:* own calculations based on the data of the Federal Customs Service of the Russian Federation.

Short-term dynamics of exports of fuel and energy commodities followed changes in global prices of energy commodities remaining at the level which was much below the peak values – 70% from the value seen in 2013 (*Fig.* 3). Exports of other goods were more stable, primarily, because of weaker volatility of global market prices and a large number of goods which determined the overall dynamics. In the past two years (2018 and 2019), exports of goods, except for fuel and energy commodities, surpassed by about 4% the value seen in 2013. Such dynamics was much below the growth rates of the global trade in 2013–2019 and the USD inflation rate, which factor was the evidence of Russia's share in global exports stabilizing at the level below the pre-crisis one. In the mid-term prospect, dynamics of imports (through the ruble exchange rate) and GDP growth rates depends on global prices of primary products, too. In 2019, imports amounted to 77% from the value seen in 2013, while exports of all goods, to 80%.

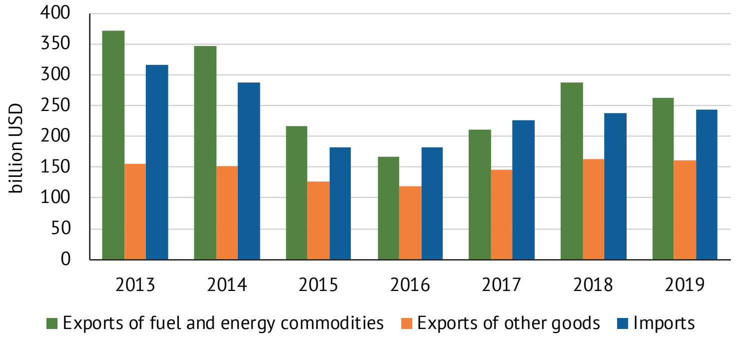



*Fig. 3. Dynamics of Russia's exports and imports in 2013–2019, billion USD*

*Source:* own calculations based on data of the Federal Customs Service of the Russian Federation.

## Ruble Exchange Rate and Foreign Trade

In the past few years, there has been a sustainable positive correlation between the volumes of imports and the Ruble/Dollar real exchange rate (*Fig.* 4)[1]. In H1 2019, both the indices were below the values seen in the relevant period of the previous year, while in H2 2019 they were higher. Overall, in 2019 import volumes and the ruble real exchange rate were quite stable (year on year): +2.2% and -0.9%, respectively. It is noteworthy that imports reacted promptly to any changes in the current exchange rate, which situation is quite typical of small open economies. Elasticities of Russian import volumes in US Dollar value terms based on the exchange rate and real GDP volumes are quite similar[2], which factor by virtue of a higher volatility of the exchange rate makes it the main determinant of import volumes in the mid-term prospect. Note that weakening of the ruble exchange rate affects imports in value terms, primarily, through reduction of volumes of imported goods.

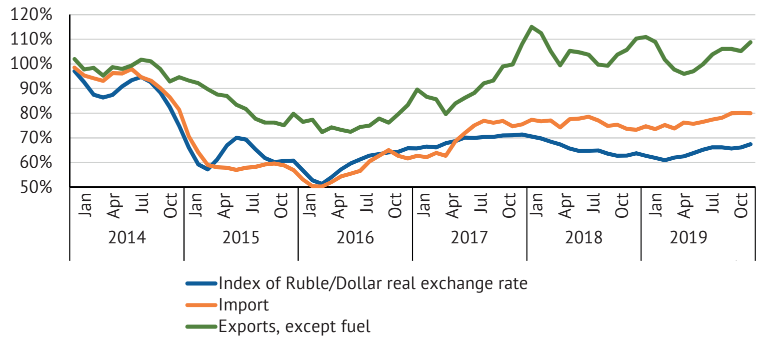



*Fig. 4. Dynamics of imports, non-fuel exports and the ruble real exchange rate in 2014–2019, % change compared with the corresponding month of 2013*

*Source:* own calculations based on the data of the Federal Customs Service of the Russian Federation and the Central Bank of Russia.

The value of exports of non-oil and gas goods correlates weakly with the index of ruble real exchange rate because of high volatility of global prices of other raw materials – the main part of non-fuel exports. For example, exports of metals and fabricated metal products – the second most important export commodity group – account for a quarter of Russia's non-fuel exports. At the same time, in 2013–2019 prices of steel in Europe fluctuated in the range of $420 to $650 per ton. It is noteworthy that a simultaneous decrease in non-fuel exports and the ruble exchange rate and the subsequent recovery in 2014–2017 are related to changes in global prices of the main non-fuel export commodities which correlate well with oil prices.

## Export Prices

As seen from *Table* 1, in 2019 most of large export commodity groups (singled out by the Federal Customs Service) saw a decrease in export prices (except

1 See: Knobel A., Firanchuk A. Foreign Trade in 2018: Growth in Non-Oil and Gas Exports // Russia's Economic Development. 2019. Vol. 26. No. 4. P. 11–19.
2 See: Bussière M, Gaulier G, Steingress W. Global trade flows: Revisiting the exchange rate elasticities // Open Economies Review. 2020. Mar 9. P. 1–54.

for food products, some fertilizers and a number of items in the "Machinery, equipment and transport vehicles" group). Changes in the volume of exports did not have a common trend.

A decline of 8.8% in ***fuel and energy commodities*** exports can be explained by a fall of export prices of oil, petrochemicals, coal, and piped gas (8–16%) with insignificant changes taking place in export volumes of relevant products (-5% to +3%). Oil exports saw a weak decrease in export supplies of petrochemicals (-7m tons) and growth in crude oil exports (+7m tons) with a stable aggregate export volume of 410m tons. Exports of liquefied natural gas kept growing; its share in the overall exports amounted to 1.9% (+0.7 p.p.).

Exports of ***food products and agricultural raw materials*** remained in value terms at the level of the previous year (-0.6%). Exports of ***grain*** amounted to 31.8 m tons, having returned to the level seen in 2017 (33 m tons) after peak values registered in 2018 (44 m tons).

Exports of ***chemical products*** fell somewhat (-1.7%). The reduction of exports of ammonia and rubber on the back of decline of global prices was made up for by growth in prices and volumes of exports supplies of potassic fertilizers.

After substantial growth in 2018, export prices of ***timber and pulp and paper products*** declined (a decrease of 3–30%). As a result, exports fell by 8.1% in value terms. Exports supplies of unprocessed timber and paper pulp kept falling in volume terms (a decrease of -17% and -3%, respectively), while those of highly processed products (processed timber, plywood and paper) increased somewhat.

The value of ***metal*** exports declined by 14.1% on the back of falling global prices after growth in 2018. Export prices of all main metals depreciated in the range of -3% to -17%, except for nickel (+7%). The tonnage of exports of all main metals decreased, too; some items saw a drop of tens of percent. An exception was copper whose export expansion was offset by a negative effect of price.

The reduction of exports of energy commodities, rubber, ammonia, carbon steel, ferro-alloys and timber in value terms was mainly caused by worsening of the pricing environment, while that of exports of grain, cast iron and aluminum, by a decrease in supply volumes.

The overall exports of high-tech commodity groups – ***"Machinery, equipment and transport vehicles"*** and ***"Other goods"*** – were stable in value terms (-0.3%). Exports of goods out of the first group shrank to $27.7bn (-5.0%), while those of the other group increased to $8.5bn (+19.0%). Note, exports of cars with engine capacity of 1.5–1.8 L kept growing (+22%) and those of medium-duty trucks recovered (+25%). Overall exports of lorries amounted to 7%. Growth in average export prices can be explained by changes in the pattern of car exports. Export prices and volumes of the main export items of household appliances (washing machines and video displays) decreased. Exports of fuel elements, combustion turbines and open railway cars declined, too.

The RF President's May Decree (2018) set the objective to increase exports of non-oil and gas commodities to $250bn by the year 2024. To achieve this goal, it is necessary to ensure annual export growth of 10%. As seen from dynamics of the past few years, non-oil and gas exports saw recovery growth until 2018, but then it slowed down. In 2019, non-oil and gas exports fell by 0.8% in value terms due to depreciation of global prices and sluggish growth in export volumes (+1.5%) (*Table* 2).

*Table 1*

## Changes in prices and volumes of main export commodity supplies in 2018–2019

| FEACN | Name | Price | | Change in 2019 on 2018, , % | | | Share in exports in 2019, % |
|---|---|---|---|---|---|---|---|
| | | 2018 | 2019 | prices | In volume terms | In value terms | |
| **Food products** | | | | | | | |
| 0302-0304 | Fresh and frozen fish, USD per ton | 1794 | 1830 | 2 | -4 | -2 | 0.7 |
| 1001 | Wheat and meslin, USD per ton | 192 | 201 | 5 | -28 | -24 | 1.5 |
| **Fuel** | | | | | | | |
| 2701 | Fossil coal, USD/ton | 85 | 78 | -9 | 3 | -6 | 3.8 |
| 2709 | Crude oil, USD/ton | 496 | 454 | -8 | 3 | -6 | 28.6 |
| 2710 | Petrochemicals, USD/ton | 521 | 468 | -10 | -5 | -14 | 15.8 |
| 2711110000 | Liquefied natural gas, USD/cubic meter | 144 | 121 | -16 | 78 | 50 | 1.9 |
| 2711210000 | Natural gas, USD/thousand cubic meter | 223 | 189 | -15 | 0 | -15 | 9.8 |
| **Chemical products** | | | | | | | |
| 3102 | Mineral nitrogen fertilizers, USD/ton | 200 | 201 | 0 | 4 | 4 | 0.68 |
| 3104 | Mineral potassic fertilizers, USD/ton | 230 | 248 | 8 | 7 | 15 | 0.55 |
| 3105 | Mixed mineral fertilizers, USD/ton | 301 | 293 | -2 | -5 | -7 | 0.75 |
| 2814100000 | Liquid ammonia, USD/ton | 269 | 240 | -11 | 10 | -2 | 0.26 |
| 4002 | Synthetical rubber, USD/ton | 1697 | 1589 | -6 | -2 | -8 | 0.37 |
| **Timber and articles thereof** | | | | | | | |
| 4403 | Unprocessed timber, USD/cubic meter | 78 | 70 | -10 | -17 | -25 | 0.26 |
| 4407 | Processed timber, USD/ton | 234 | 227 | -3 | 3 | 0 | 1.06 |
| 4412 | Plywood, USD/cubic meter | 505 | 415 | -18 | 3 | -16 | 0.27 |
| 4702-4704 | Wood pulp, USD/ton | 709 | 494 | -30 | -3 | -33 | 0.24 |
| 4801 | Newsprint, USD/ton | 562 | 445 | -21 | 7 | -15 | 0.13 |
| **Metals and metal goods** | | | | | | | |
| 72 | Ferrous metals, USD/ton | 503 | 446 | -11 | -12 | -22 | 4.3 |
| 72 (except 7201-7204) | Ferrous metals (except for cast iron, ferro-alloys, waste products and wrenching iron), USD/ton | 503 | 486 | -3 | -41 | -43 | 3.1 |
| 7201 | Cast iron, USD/ton | 373 | 339 | -9 | -26 | -33 | 0.34 |
| 7202 | Ferro-alloys, USD/ton | 1680 | 1506 | -10 | 0 | -10 | 0.29 |
| 7207 | Carbon steel semiproducts, USD/ton | 498 | 413 | -17 | -8 | -23 | 1.43 |
| 7208-7212 | Carbon steel flat rolled stock, USD/ton | 603 | 545 | -10 | -17 | -25 | 0.89 |
| 7403 | Refined copper, USD/ton | 6329 | 5892 | -7 | 8 | 0 | 0.97 |
| 7502 | Unfinished nickel, USD/ton | 12828 | 13712 | 7 | -1 | 6 | 0.43 |
| 7601 | Unfinished aluminum, USD/ton | 1750 | 1696 | -3 | -10 | -13 | 1.09 |
| **Machinery, equipment and transport vehicles** | | | | | | | |
| 840130 | Heat-producing unexposed units (fuel elements), USD per unit | 385 | 351 | -9 | -11 | -19 | 0.19 |
| 8411123009 | Other combustion turbines, with draught of over 44 кN, but max. 132 кN, thousand USD per unit | 4016 | 3449 | -14 | 3 | -12 | 0.29 |
| 8450111100 | Household washing machines, USD per unit | 166 | 154 | -7 | -18 | -24 | 0.04 |
| 852872 | LCD TV sets, USD per unit | 336 | 315 | -6 | -15 | -21 | 0.07 |
| 860692 | Open railway cars, thousand USD per unit | 29.76 | 38.19 | 28 | -30 | -11 | 0.03 |
| 8703231940 | Cars with effective engine cylinder capacity of over 1500 cm3, but max. 1800 cm3, USD per unit | 8.92 | 9.21 | 3 | 18 | 22 | 0.14 |
| 8704229108 | Other lorries with gross weight of 5–20 tons, USD per unit | 32.65 | 38.17 | 17 | 7 | 25 | 0.03 |

*Source:* own calculations based on the data of the Federal Customs Service of the Russian Federation.

*Table 2*

## Changes in prices and volumes of the main non-oil and gas export supplies by commodity groups in 2018–2019

| Exports of non-oil and gas commodities out of commodity groups: | Supply volume, billion USD | | Change in 2019 on 2018 % | | |
|---|---|---|---|---|---|
| | 2018 | 2019 | In value terms | price | In volume terms |
| Food products and agricultural raw materials (except for textile) | 24.4 | 24.3 | –1 | 3 | –3 |
| Mineral products | 0.1 | 0.1 | –23 | –10 | –12 |
| Chemical products, rubber | 25.7 | 25.2 | –2 | –3 | 1 |
| Rawhide, furs and articles thereof | 0.2 | 0.1 | –26 | –3 | –23 |
| Timber and pulp and paper products | 12.1 | 11.2 | –7 | –8 | 1 |
| Textile, textile products and footwear | 1.2 | 1.3 | 14 | –3 | 17 |
| Precious stones, precious metals and articles thereof | 5.6 | 11.9 | 112 | 27 | 67 |
| Metals and metal products | 42.4 | 36.4 | –14 | –9 | –6 |
| Machinery, equipment and transport vehicles | 20.5 | 21.5 | 5 | 2 | 3 |
| Other goods (without arms) | 2.6 | 2.8 | 7 | 1 | 6 |
| Other** | 13.1 | 11.9 | –9 | | |
| Total | 148.0 | 146.7 | –0.8 | –2.3 | 1.5 |

* Data on commodity group 710229 "Industrial diamonds" are unavailable.
** Includes classified commodity positions from the group "Machinery, equipment and transport vehicles" and "Other goods".
*Source:* own calculations based on the data of the RF Federal Customs Service.

In assessing the mid-term growth in non-oil and gas exports and economic development, dynamics of exports in natural units is more informative because price effects are more volatile and do not virtually depend on internal factors.

Growth in non-oil and gas exports surpassed the target values set for commodity groups "Textile" (+17%) and "Precious Stones and Metals" (+67%). Growth in the latter's exports is related to the sale of $5.33bn worth of gold to the UK. It is noteworthy that the sale of monetary gold abroad can be regarded not as exports, but as modification of the pattern of gold and foreign currency reserves. Without taking into account the above-mentioned export supplies of gold, non-oil and gas exports fell by 2.2% and 7% in value and volume terms, respectively.

Growth of +6% in exports of the "Other goods (without arms)" commodity group in volume terms was close to the target value. Exports of metals fell considerably (-6%), while other large commodity groups of non-oil and gas exports saw insignificant changes in their export volumes.

**Geographic Pattern of Trade Turnover**

In 2019, the share of the EU in Russia's trade turnover kept shrinking (by 1.1 p.p.). It is to be mentioned that dynamics of imports from the EU (-0.1%) and exports to the EU (-7.8%) were even worse than with other trade partners (+4.0% and -4.5%, respectively). The share of APEC countries kept growing (+ 0.85 p.p.) on the back of growth in trade turnover with China (+0.91 p.p.) (*Table 3*).

The share of CIS states and the EEU increased by 0.23 p.p. and 0.36 p.p., respectively. The share of Ukraine in Russia's trade turnover shrank dramatically to 1.7% (-0.46 p.p.). A drop in exports to Ukraine in value terms amounted to 30.5%, the worst result among all countries with a share of over 1 p.p. in the trade turnover; imports fell by 11.5%. Growth in the share of the EEU in Russia's trade turnover is related to growing exports to Kazakhstan (+7.7%) and Armenia (+24.5%) and imports from Armenia (+30.4%).

*Table 3*

### Geographic pattern of Russia's trade turnover with its main trade partner – countries in 2013–2019

| Region/country | Share in Russia's trade turnover, % | | | | | | | Change: 2019 on 2018 , p.p. |
|---|---|---|---|---|---|---|---|---|
| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | |
| **EU** | **49.6** | **48.1** | **44.8** | **42.8** | **42.1** | **42.8** | **41.7** | **-1.11** |
| Ukraine | 4.7 | 3.5 | 2.8 | 2.2 | 2.2 | 2.2 | 1.7 | -0.46 |
| Turkey | 3.9 | 4.0 | 4.4 | 3.4 | 3.8 | 3.7 | 3.9 | 0.19 |
| Norway | 0.3 | 0.3 | 0.3 | 0.3 | 0.2 | 0.2 | 0.5 | 0.27 |
| Switzerland | 1.4 | 0.9 | 0.9 | 1.1 | 1.0 | 1.0 | 1.0 | -0.07 |
| **APEC** | **24.8** | **26.9** | **28.1** | **29.9** | **30.4** | **31.0** | **31.8** | **0.85** |
| including: | | | | | | | | |
| China | 10.5 | 11.3 | 12.1 | 14.1 | 14.9 | 15.7 | 16.6 | 0.91 |
| US | 3.3 | 3.7 | 4.0 | 4.3 | 4.0 | 3.6 | 3.9 | 0.30 |
| Japan | 3.9 | 3.9 | 4.1 | 3.4 | 3.1 | 3.1 | 3.0 | -0.04 |
| Republic of Korea | 3.0 | 3.5 | 3.4 | 3.2 | 3.3 | 3.6 | 3.7 | 0.05 |
| Vietnam | 0.5 | 0.5 | 0.7 | 0.8 | 0.9 | 0.9 | 0.7 | -0.15 |
| **CIS** | **13.4** | **12.3** | **12.5** | **12.3** | **12.5** | **11.8** | **12.1** | **0.23** |
| **Member-states of the Eurasian Economic Union (EEU)** | **7.4** | **7.2** | **7.9** | **8.5** | **8.8** | **8.2** | **8.6** | **0.36** |
| including: | | | | | | | | |
| Armenia | 0.2 | 0.2 | 0.2 | 0.3 | 0.3 | 0.3 | 0.4 | 0.09 |
| Belarus | 4.1 | 4.1 | 4.5 | 5.1 | 5.2 | 5.0 | 5.0 | 0.00 |
| Kazakhstan | 2.8 | 2.7 | 2.9 | 2.8 | 3.0 | 2.7 | 2.9 | 0.27 |
| Kirgizia | 0.3 | 0.2 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.01 |

*Source:* own calculations based on the data of the RF Federal Customs Service.

**External Shocks and Trade**

The outbreak of coronavirus has led to the slowdown of the economy of China, Russia's largest trade partner, and downward adjustment of the global economic growth forecast. These developments provoked a substantial decrease in global prices of oil, while the failed OPEC+ negotiations on reduction of oil production triggered a dramatic collapse of oil prices since 1990.

Over the past few quarters, experts expressed their concerns over the possibility of forthcoming recession because of the escalation of trade wars and a number of other factors. Specifically, the reversion of the yield curve in the US – a popular indicator of forthcoming recession – took place in August 2019. More importantly, until March 2020 the US saw the most extended (11-year long) period of "bull" market growth, which was evidence that shares were overvalued and the market was probably overheated. The US market's reaction to the outbreak of coronavirus and restrictive measures introduced to fight it have triggered a full-scale collapse since 1987.

The coronavirus pandemic will have serious consequences for the global economy. The Federal Reserve and a number of central banks have cut urgently interest rates, however, the effect of this instrument is rather limited because interest rates in developed countries are already next to zero.

As regards Russia, the dynamics of global oil prices is undoubtedly more important: crude oil and petrochemicals accounted for 44% of Russian exports in 2019. In H1 2020, this item of exports is expected to decrease substantially as compared with 2019[1]. The value of natural gas export supplies is following oil prices with a time lag.  However, in case of natural gas (11.7% of Russian exports in 2019) an additional unfavorable factor is abnormal warm winter in Europe, which is the main consumer of Russian natural gas. Prices of main metals are depreciating moderately.

Owing to the drop in oil prices, weakening of the ruble exchange rate amounted to about 20%. It is known from experience of 2014–2016 that the value of imports has elasticity at the rate close to 1, so it is believed that imports are going to decrease by tens of percent in H1 2020.

It is to be pointed out that in the past few years overseas trips were a major item of imports of services (36% in 2018) and an important item of exports of services (18% in 2018). Undoubtedly, the imposed restrictions on air travelling will have a highly negative effect on Russia's value of foreign trade in services and air carriers.

1 The current price of Brent oil is 40–50% below the previous years' level.

# 4. TAX MANEUVER AND CRUDE OIL SUPPLIED TO BELORUSSIA

A. Kaukin, E. Miller

*Development of crude oil supplies between Russia and Belorussia in the context of gradual reduction in customs duties to zero-rate tariff on crude oil depends on further specification of current arrangements. In the event of fixed volumes[1] of crude oil supplies to Belorussia, the oil companies will bear financial losses by getting a reduced premium paid to them by Belorussian oil refineries for the duty-free oil supplies. The Russian economy would prefer quite a different option envisaging moderate decrease of crude oil supplies to Belorussia while increasing their own oil-refining capacities which would be in response to the implementation of tax maneuver in Russia.*

From January 1, 2019[2], Russia launched the final stage of the tax maneuver[3] aimed at eliminating inefficiency coming from subsidizing national economy by artificially low oil prices[4]. The number of planned changes include: bringing customs duties on oil and petroleum products to zero-rate tariff during 2019–2024; raising the MET base rate by the amount equal to reduced export duty rate on oil; targeted subsidizing of oil refining sector and consumers of petroleum products via the mechanism of reverse excise on crude oil, tax deduction and compensation[5].

These changes affect the oil refining sector of Belorussia because oil supplies to Belorussian oil refineries up to date were carried out on special conditions. More specifically – without paying customs duty[6] (according to Gaidar Institute

1 Agreement signed between the Government of the Russian Federation and the Government of the Republic of Belorussia on measures to settle trade and economic cooperation in the sphere of exports of oil and petroleum products (concluded in Moscow on 12.01.2007, ver. Of 10.10.2018) states that the Ministry of Economic Development and the Ministry of Energy of Russia coordinate indicative balances of export supplies of crude oil from Russia to Belorussia with the Ministry of Economic Development of Belorussia and the Belorussian State Concern for Oil and Chemistry before October 1 of each current year for the next calendar year. Current version envisages exports volume of 24 mln through 2024, these annual crude oil volumes can be changed depending on technical potential of main pipelines not more than 2%. чем на 2%. Detailed specification (including pricewise) will depend on adopted agreements by the parties.

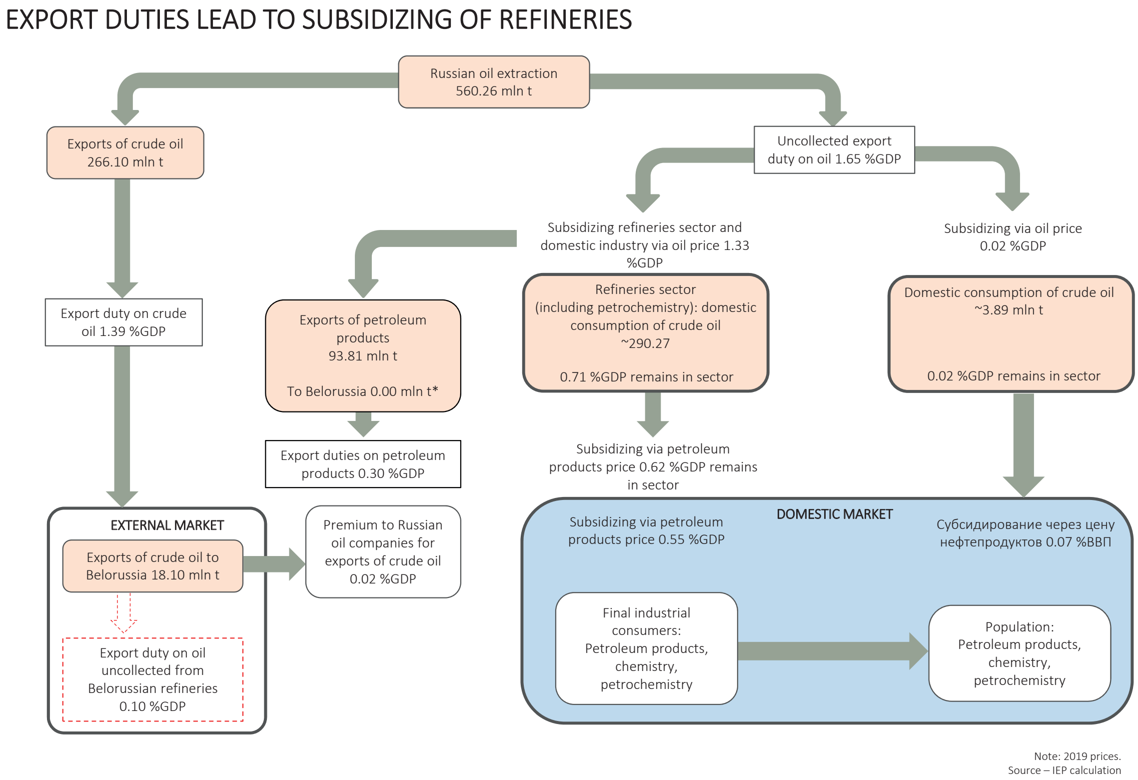
2 According to the Federal Law of August 3, 2018 No. 305-FZ "On Amendments to Article 3.1 of the Law of the Russian Federation "On Customs Duty" and Federal Law of August 3, 2018 No. 301-FZ "On Amendments to Part II of the Russian Tax Code."

3 In detail on parameters of tax maneuver and risks of their manual control see: Zhemkova A.M., Idrisov G.I., Kaukin A.S., Miller E.M. Price freezing – termination of the tax maneuver? // Russian Economic Developments. 2019. Vol. 26. No. 1. P. 31–35. Kaukin A.S., Miller E.M. Tax maneuver in the oil sector: risks of "manual control" // Russian Economic Developments. 2019. Vol. 26. No. 7. P. 87–92.

4 On factors for launching the tax maneuver see: Idrisov G.I., Sinelnikov-Murylev S.G. Export Duty of Oil: abolish impossible retain // Neft Rossii. 2011. No. 12, pp. 72–77; Idrisov G.I., Sinelnikov-Murylev S.G. Moderization or Conservation: the role of export duty on oil and oil products // Economic Policy. 2012. No. 3. P. 5–19. Idrisov G.I., Kaukin A.S. Tax Maneuver: acceleration of economic growth to the detriment of budget consolidation // Russian Economic Developments. 2019. Vol. 23. No. 6. P. 35–39.

5 Compensation is the share of the difference between export netback (export price of oil minus transport costs and export duty) in "sea ports of the North-Western FD" and the base price. In the event when the base price is higher than export netback, the companies make extra payments to the budget.

6 Agreement between the Government of the Russian Federation and the Government of the Republic of Belarus on Measures of Adjustment of Trade and Economic Cooperation in the Sphere of Oil and Petroleum Products Exports (Signed in Moscow on 12.01.2007, ver. of 10.10.2018).




*Indicative balance of Russia and Belorussia on supplies of gasoline, diesel oil, and heating oil in 2019 is zero. See, Indicative balance showing neither profit nor loss. Till late 2019, Russia will not supply gasoline, diesel oil, and heating oil to Belorussia // Neftegas.ru. 12.10.2018. URL: https://neftegaz.ru/news/Trading/197801-indikativnyy-balans-po-nulyam-rossiya-do-kont-sa-2019-g-ne-budet-postavlyat-v-belorussiyu-benzin-dize/.

*Fig. 1. Distribution of subsidy received by the Russian economy on the back of knock-down oil prices (in 2019 prices, the average annual Bent price was 63.69 USD/bbl, exchange rate – Rb 64,62 to USD)*

estimates, shortfall of tax revenues to the RF budget resulting from the oil supplies to Belorussia will amount roughly to 0.1% of Russia's GDP, in detail see *Fig. 1*[1]), but taking into account the premium to companies-suppliers for duty-free oil.

*Fig. 2* demonstrates components of the oil prices for Belorussian oil refineries. It is apparent that their variation from domestic oil prices in Russia lies in the premium paid to the Belorussian oil refineries by Russian oil producing companies for duty-free oil supplies. The size of the premium is determined by contracts signed between oil refineries of Belorussia and Russian oil producers and, according to various data[2], amounts to 6–19 USD/t. Gradual reduction of customs duty to zero-rate tariff envisaged by the tax maneuver will raise the

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1 Estimates demonstrate that crude oil supplied to the domestic market in the event of been sent for export would have secured budget revenues from the customs duty in the amount of around 1.7% of GDP. This amount can contingently be viewed as a subsidy transferred to the domestic market. Calculations show that the mechanism of charging export duties leads to subsidizing not consumers of the energy resources but mainly domestic oil refineries. Similar mechanism is true of Belorussian oil refineries which in 2019 got 18.1 mln t of crude oil, which means that foregone revenues to the Russian budget from the uncollected export duty in this case amounted to around 0.1% of GDP.

2 Exact data is unavailable. As a source we used: Toporkov A., Vavina E., Bocharova S. Russia agrees to make concessions to Belorussia in oil supplies // Vedomosti. 21.02.2020. URL: https://www.vedomosti.ru/business/articles/2020/02/21/823623-rossiya-soglasna-na-ustupki-v-postavkah-nefti.

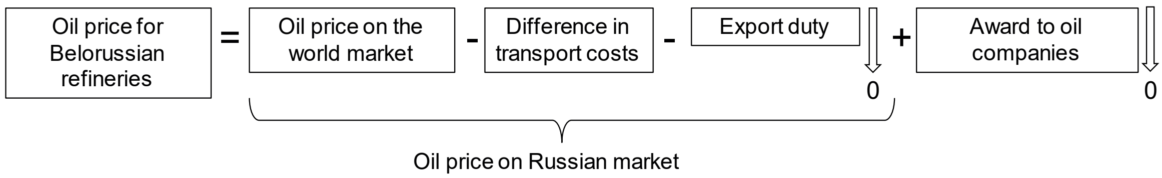


*Fig. 2. Components of oil prices for Belorussian oil refineries*

Russian crude oil price for Belorussia to the tune of the export duty (on the back of leveling domestic Russian and world oil prices minus transport costs) for which Belorussia would like to get compensation.

During 2019, countries failed to come to an agreement of the mechanism and compensation amount. On February 21, 2020[1], preliminary agreement was announced: compensation will be at the expense of Russian oil companies via annual reduction of their premium by 2 USD/t. Let us analyze in more detail how this change will reflect on each party.

*Table 1* provides export volumes of Russian crude to Belorussia across certain companies. Further calculations on the premise that in 2020 supplies will grow from 18.1 to 24 mln t of crude oil and will stay at that level though 2024. It is also assumed that proportions of oil supplies between companies-exporters will remain in place. Within scenario 1 (further interpretation of calculations has been provided) exchange rate amounts to 64.6 Rb/USD, oil price – 63.7 USD/bbl.[2]), parameters and formula for calculation of customs duty rate were taken from the RF Law of May 21, 1993, No. 5003-1 “On Customs Tariff” (ver. of 18.02.2020) (in detail see *Table 2*). *Table 2* also provides other scenarios: scenario 2 with oil price at 32 USD/bbl, exchange rate 78Rb/USD; scenario 3 with oil price – 40 USD/bbl and exchange rate of 70 Rb/USD; and scenario 4 with oil price at 50 USD/bbl and exchange rate of 65 Rb/USD. Pairs “oil price” — “exchange rate” were taken from historic average monthly data (for January 2016, March 2016, and January 2015).

*Table 1*

## Exports of Russian oil to Belorussia by Russian companies, unit

| | 2019 | 2020–2024 |
|---|---|---|
| Supplies of oil to Belorussia, including: | 18.1 | 24.0 |
| Rosneft (including Bashneft) | 8.8 | 11.7 |
| LUKOIL | 2.8 | 3.7 |
| Surgutneftegaz | 2.6 | 3.5 |
| Gazprom neft | 1.7 | 2.3 |
| Tatneft | 1.2 | 1.6 |
| Independent | 1.0 | 1.3 |

*Sources:* own calculations with the use of data from: Toporkov A., Vavina E., Bocharova S. Russia agrees to make concessions to Belorussia regarding oil supplies // Vedomosti.. 21.02.2020. URL: https://www.vedomosti.ru/business/articles/2020/02/21/ 823623-rossiya-soglasna-na-ustupki-v-postavkah-nefti.

*Table 3* provides calculation results of the premium for duty-free oil supply by Russian companies to Belorussia during 2019–2024 across companies-export-

1 Toporkov A., Vavina E., Bocharova S. Russia agrees to make concessions to Belorussia in oil supplies // Vedomosti. 21.02.2020. URL: https://www.vedomosti.ru/business/articles/2020/02/21/823623-rossiya-soglasna-na-ustupki-v-postavkah-nefti.

2 Average annual for 2019.

*Table 2*

Parameters for the calculation of a result obtained from reduction of the premium for companies-exporters

| Scenario and its parameters | | Unit of measure | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|---|---|
| Scenario 1 | Dollar exchange | Rb/USD | 64.6 | 64.6 | 64.6 | 64.6 | 64.6 | 64.6 |
| | Oil price | USD/bbl | 63.7 | 63.7 | 63.7 | 63.7 | 63.7 | 63.7 |
| | | USD/t | 465.0 | 465.0 | 465.0 | 465.0 | 465.0 | 465.0 |
| | Export duty under tax maneuver | USD/t | 94.9 | 76.0 | 57.0 | 37.9 | 19.0 | 0.0 |
| | | Rb/t | 6 132.9 | 4 910.7 | 3 681.2 | 2 451.7 | 1 229.5 | 0.0 |
| Scenario 2 | Dollar exchange | Rb/USD | 64.6 | 78.0 | 78.0 | 78.0 | 78.0 | 78.0 |
| | Oil price | USD/bbl | 63.7 | 32.0 | 32.0 | 32.0 | 32.0 | 32.0 |
| | | USD/t | 465.0 | 233.6 | 233.6 | 233.6 | 233.6 | 233.6 |
| | Export duty under tax maneuver | USD/t | 94.9 | 29.7 | 22.3 | 14.8 | 7.4 | 0.0 |
| | | Rb/t | 6 132.9 | 2 316.7 | 1 736.7 | 1 156.6 | 580.0 | 0.0 |
| Scenario 3 | Dollar exchange | Rb/USD | 64.6 | 70.0 | 70.0 | 70.0 | 70.0 | 70.0 |
| | Oil price | USD/bbl | 63.7 | 40.0 | 40.0 | 40.0 | 40.0 | 40.0 |
| | | USD/t | 465.0 | 292.0 | 292.0 | 292.0 | 292.0 | 292.0 |
| | Export duty under tax maneuver | USD/t | 94.9 | 41.4 | 31.0 | 20.7 | 10.4 | 0.0 |
| | | Rb/t | 6 132.9 | 2 897.1 | 2 171.8 | 1 446.4 | 725.4 | 0.0 |
| Scenario 4 | Dollar exchange | Rb/USD | 64.6 | 65.0 | 65.0 | 65.0 | 65.0 | 65.0 |
| | Oil price | USD/bbl | 63.7 | 50.0 | 50.0 | 50.0 | 50.0 | 50.0 |
| | | USD/t | 465.0 | 365.0 | 365.0 | 365.0 | 365.0 | 365.0 |
| | Export duty under tax maneuver | USD/t | 94.9 | 56.0 | 42.0 | 28.0 | 14.0 | 0.0 |
| | | Rb/t | 6 132.9 | 3 639.7 | 2 728.4 | 1 817.1 | 911.3 | 0.0 |

*Source:* own calculations.

ers. Option 1 provides retention of the premium rate for Russian oil companies for the duty-free supply of oil to the tune of 10 USD/t during 2020–2024, and option 2 envisages a reduction of the premium rate by 2 USD/t annually till zero-rate in 2024. Calculations demonstrate that for the Russian oil companies which supply crude oil to Belorussian refineries execution of option 2 will cost $ 720 mln for the period under review (this amount arises only from the premium reduction paid by Belorussia; additional profit of the Russian companies proceeding from the oil price growth as a result of reduction of customs duty is paid to the Russian budget on the back of raised MET).

*Table 4* provides calculations of actual subsidy to Belorussian refineries as per two above options. In option 1 the price structure for Belorussian refineries changes on the back of the reduction of customs duty, and in option 2 reduction of customs duty is coupled with a reduction of the premium to Russian oil companies. Calculations show that reduction of customs duty per ton of crude oil does not equal a reduction of the premium to oil companies: customs duty in the context of adopted macro conditions is falling by 19 USD/t annually and the premium to oil companies falls only by 2 USD/t. Calculations in scenarios 2–4 have demonstrated that this difference is contracting amid reduction of the world oil price (in scenario 2 where the oil price is the lowest in reviewed scenarios and amounts to 32 USD/bbl reduction of export duty comes to 7 USD/t)[1].

Thus, **reduction of the export duty rate on Russian crude draws domestic prices nearer to the world ones.** Regarding supplies to Belorussia **the effect of these changes for the Russian budget is positive** on the back of reduced losses from subsidies for Belorussian economy: according to calculations, in 2019 from each ton of crude exported to Belorussia the budget fell short of $ 94.

Reduction of the premium paid by Belorussia to Russian oil companies will lead to financial losses incurred by the latter. Meanwhile, price growth on supplied oil to Belorussia will not lead to increase of profits of Russian exporters because additional profit will be withdrawn on the back of a proportional growth of MET. In the event of adoption at the state level of agreements on retaining current volumes of crude supply to Belorussia these financial losses can not be compensated. Otherwise, the Russian companies will get additional incentive to increase their own refining, which reflects the logic of the tax maneuver by partial reduction of oil supplies to Belorussia (in this case partial faze out of Belorussian petroleum products on the world market is feasible).

**From the standpoint of Belorussia, purchases of Russian crude are economically efficient**, because even amidst gradual abolition of the export duty this oil becomes the cheapest offer.[2] Moreover, in the medium-term this is technically expedient because Belorussian refineries are tuned to refining Russian oil (in 2019 refining of Norwegian oil more than likely was carried out by diluting it with Russian oil or by diluting at tanker loading – swop-contracts).

1 Reduction of the export duty per ton of oil is equal to a reduction of the premium to oil companies at the oil price around 20 USD/bbl.
2 Being land-locked creates logistic problems (costs of tanker loading and oil shipments by railroad is higher that by pipeline; launch of Odessa Brody pipeline requires pumping of buffer oil).

## 4. Tax maneuver and crude oil supplied to Belorussia

*Table 3*

### Rate and amount of premium for supply of oil without export duty in 2019–2024 across companies-exporters

| | Unit of measure | 2019 | | 2020 | | 2021 | | 2022 | | 2023 | | 2024 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Op1 | Op 2 | Op 1 | Op 2 | Op 1 | Op 2 | Op 1 | Op 2 | Op 1 | Op 2 | Op 1 | Op 2 |
| Premium rate for oil supply minus export duty | USD/t | 10 | 10 | 10 | 8 | 10 | 6 | 10 | 4 | 10 | 2 | 10 | 0 |
| Premium for oil supply without export duty: | USD mn | 181 | 181 | 240 | 192 | 240 | 144 | 240 | 96 | 240 | 48 | 240 | 0 |
| Rosneft (with Bashneft) | USD mn | 88 | 88 | 117 | 93 | 117 | 70 | 117 | 47 | 117 | 23 | 117 | 0 |
| LUKOIL | USD mn | 28 | 28 | 37 | 30 | 37 | 22 | 37 | 15 | 37 | 7 | 37 | 0 |
| Surgutneftegaz | USD mn | 26 | 26 | 34 | 28 | 34 | 21 | 34 | 14 | 34 | 7 | 34 | 0 |
| Gazprom neft | USD mn | 17 | 17 | 23 | 18 | 23 | 14 | 23 | 9 | 23 | 5 | 23 | 0 |
| Tatneft | USD mn | 12 | 12 | 16 | 13 | 16 | 10 | 16 | 6 | 16 | 3 | 16 | 0 |
| Independent | USD mn | 10 | 10 | 13 | 11 | 13 | 8 | 13 | 5 | 13 | 3 | 13 | 0 |

**Note**. Option 1: retention of premium rate for oil supply without export duty–10 USD/t in 2020–2024 (Op1); Option 2: reduction of premium rate for oil supply without export duty by 2 USD/t annually (Op2).
*Source:* own calculations.

*Table 4*

### Amount of subsidy (difference between export duty and premium to Russian oil companies) for Belorussian refineries on the back of duty free trade of oil under implementation of tax maneuver in Russia under various macro scenarios and options of premium rates for companies-exporters for supply of crude without export duty to Belorussian refineries

| Amount of subsidy for Belorussian refineries with paying premium to Russian oil companies for duty-free sale of oil | Unit of measure | 2019 | | 2020 | | 2021 | | 2022 | | 2023 | | 2024 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | B1 | B2 | B1 | B2 | B1 | B2 | B1 | B2 | B1 | B2 | B1 | B2 |
| Scenario 1 | USD/t | 84.9 | 84.9 | 66.0 | 68.0 | 47.0 | 51.0 | 27.9 | 33.9 | 9.0 | 17.0 | -10.0 | 0.0 |
| | USD mn | 1 536.9 | 1 536.9 | 1 583.9 | 1 631.9 | 1 127.2 | 1 223.2 | 670.6 | 814.6 | 216.7 | 408.7 | -240.0 | 0.0 |
| Scenario 2 | USD/t | 84.9 | 84.9 | 19.7 | 21.7 | 12.3 | 16.3 | 4.8 | 10.8 | -2.6 | 5.4 | -10.0 | 0.0 |
| | USD mn | 1 536.9 | 1 536.9 | 472.8 | 520.8 | 294.4 | 390.4 | 115.9 | 259.9 | -61.5 | 130.5 | -240.0 | 0.0 |
| Scenario 3 | USD/t | 84.9 | 84.9 | 31.4 | 33.4 | 21.0 | 25.0 | 10.7 | 16.7 | 0.4 | 8.4 | -10.0 | 0.0 |
| | USD mn | 1 536.9 | 1 536.9 | 753.3 | 801.3 | 504.6 | 600.6 | 255.9 | 399.9 | 8.7 | 200.7 | -240.0 | 0.0 |
| Scenario 4 | USD/t | 84.9 | 84.9 | 46.0 | 48.0 | 32.0 | 36.0 | 18.0 | 24.0 | 4.0 | 12.0 | -10.0 | 0.0 |
| | USD mn | 1 536.9 | 1 536.9 | 1 103.9 | 1 151.9 | 767.4 | 863.4 | 430.9 | 574.9 | 96.5 | 288.5 | -240.0 | 0.0 |

**Note**. Option 1: retention of premium rate for oil supply without export duty–10 USD/t in 2020–2024 (Op1); Option 2: reduction of premium rate for oil supply without export duty by 2 USD/t annually (Op2).
*Source:* own calculations.

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