MONITORING OF RUSSIA'S ECONOMIC OUTLOOK:

TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

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1. DRAFT FEDERAL BUDGET FOR 2022–2024: ENSURING PUBLIC FINANCE SUSTAINABILITY

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The draft federal budget for 2022–2024 can be characterized by insignificant growth in budget revenues, substantial reduction in shares of GDP of budget expenditures and reallocation thereof as compared with the pandemic-related pattern of public expenditures and budget surplus. On a three-year horizon, the budget policy will be aimed at facilitating public finance sustainability. This suggests utilization of such instruments as the fiscal rule and accumulation of the reserves of the National Welfare Fund (NWF) against the possibility of a negative global economic scenario.

The RF Government has developed the draft federal budget for 2022–2024 and submitted it to the State Duma. As seen from *Table 1,* within the next three years federal budget revenues are expected to grow in nominal terms at the rate below the rate of inflation (1–2% against 4%), that is, a decrease in federal budget revenues in real terms. With anticipated GDP performance taken into account, federal budget revenues will decline by 2.1 p.p. of GDP by 2024 as compared with the estimate for 2021; it concerns both oil and gas revenues (a decrease of 1.1 p.p.) and non-oil and gas revenues (0.9 p.p.).

According to the draft federal law, after a pickup of 12.7% in oil and gas revenues in 2022 as compared with the current year they will be declining in nominal terms, too, in the next two years relative to the level seen in 2021. Non-oil and gas federal budget revenues are expected to grow by 1.1% in 2022 and on average 5.6% in 2023–2024 on the previous year with the projected inflation rate of 4%. Notwithstanding that the share of oil and gas revenues in the revenue side of the budget has been steadily declining during the past five years from 43% to 35%, correlation between the annual average price for oil and budget revenues was equal to 84%. It means, firstly, that the federal budget still depends on the price for oil despite the fact that the RF Ministry of Finance jointly with the Central Bank of Russia mange the Russian ruble/US Dollar exchange rate by means of the fiscal rule[1]; secondly, the price of oil and the Russian ruble/US Dollar exchange rate still have a strong impact on economic sectors which are not related with extractive industries.

Also, the draft federal budget is characterized by numerous tax novelties aimed mainly at facilitating a stable tax treatment and upgrading the efficiency of the tax stimulus program and the standard of tax administration. It concerns, in particular, system-based upgrading of the VAT treatment mechanism in international trade in services; introduction of standard personal income tax

1 It envisages purchasing of foreign exchange with additional revenues from the oil and gas sector for the NWF and setting of the level limit on budget expenditures.

Table 1

The main parameters of the federal budget, billion Rb

Indicators	2021 (estimate)	2022 (draft law)	2023 (draft law)	2024 (draft law)
Revenues, including:	**23 782.3**	**25 021.9**	**25 540.2**	**25 831.8**
as % GDP	*19.1*	*18.8*	*18.0*	*17.0*
Oil and gas revenues, including:	**8 466.3**	**9 542.6**	**9 194.6**	**8 564.6**
% GDP	*6.8*	*7.2*	*6.5*	*5.7*
Non-oil and gas revenues	**15 316.1**	**15 479.3**	**16 345.6**	**17 267.2**
% GDP	*12.3*	*11.6*	*11.5*	*11.4*
Expenditures, overall	**24 058.0***	**23 694.2**	**25 241.1**	**26 354.4**
% GDP	19.3	17.8	17.8	17.4
Including non-interest expenditures	22 901.2	22 290.9	23 538.8	24 492.7
% GDP	*18.4*	*16.7*	*16.6*	*16.2*
Deficit (–) / Surplus (+)	-275.7	1 327.7	299.1	-522.7
% GDP	*-0.2*	*1.0*	*0.2*	*-0.3*

Source: Notes to the draft federal law "On the Federal Budget for 2022 and the 2023–2024 Planned Period."

* The estimate is made with taking into account additional expenditures within the limits of excess of the estimate of the volume of non-oil and gas revenues over the projected one envisaged in the development of Federal Law No.385-FZ of December 8, 2020 "On the Federal Budget for 2021 and the 2022–2023 Planned Period."

deductions for taxpayers who have dependent children and disabled persons under care; reforming of the system of privileges in respect of new-type individual investment accounts (for attracting individuals' funds on a long-term basis to the financial sector); switchover to taxation of non-residents' employment earnings at the rate set for residents; introduction of additional profit tax privileges for IT companies (tax deductions on investments and application of a surcharge rate to the depreciation rate; exemption from taxation of profit of foreign-controlled companies (a foreign entity established without the legal entity status) in cases where it is infeasible to determine such profit by virtue of the specifics of such companies' establishment and operations under their personal laws; further development of the tax legislation along the lines of international tax cooperation with the OECD countries and the G20 and implementation of the deoffshorization policy; establishment of a preferential tax regime on the Kuril Islands; introduction of a zero declaration regime of "USN.online" payment of the single tax and insurance contributions for micro-sized businesses and private entrepreneurs with the staff of up to 5 employees and revenues of maximum Rb60 mn a year (with the "revenues" item of taxation); switchover to a single tax payment (account) for entities and private entrepreneurs (a "tax purse") making it feasible to pay taxes by means of a single payment order and others.

At the same time, the draft law includes some controversial initiatives. In particular, it is proposed to introduce excises on "high-calorie carbonated soft beverages" in order to "limit consumption of such products" and receive "additional revenues." In our view, it is an excessive measure because, firstly, the negative effect on health is observed only in case of regular consumption thereof in combination with other sugar-containing products (fast food, sweets and pastries) and low physical activity.[1] According to the data of the Euromonitor International, at present Russia is not an active consumer of sugar-containing beverages[2], nor are they the main source of sugar for the population (2% of consumption). Secondly, the expected volume of such budget revenues is estimated at maximum Rb20 bn, that is, an insignificant overall budgetary efficiency. It is noteworthy that by virtue of their unfavorable impact on production and employment similar taxes were abolished in Denmark and Slovenia.[3]

The modification of the taxation scheme in metallurgy and the chemical industry by way of linking the severance tax rate to stock exchange prices for relevant primary products should be considered as positive because this facilitates reduction in non-oil and gas deficit of the federal budget with an increased tax burden affecting business entities' motivation to a lesser extent. At the same time, from experience of the oil industry higher severance tax rates make it necessary to differentiate them on a permanent basis for development of low-margin assets. It requires an insight into economic efficiency of development of Russia's resource base, while the Russian classification of solid minerals lacks the notion of profitable reserves. Furthermore, it is important to take into account future payments related, for example, with the carbon border tax in metallurgy; this tax becomes effective in 2026 (the EU climate regulation).

Federal budget expenditures are expected to be cut considerably from 19.3% of GDP in 2021 to 17.4% of GDP. In 2024, the volume of the expenditure side of the federal budget will decrease by 1.9 p.p. of GDP as compared to 2021, while non-interest expenditures decline more dramatically within the same period (2.2 p.p. of GDP). The overall volume of the planned federal budget expenditures on national projects in 2022–2024 amounts to over Rb8.6 trillion, which is equal on average to 11.9% of the overall planned budget expenditures. So, the weight of funding national projects increases in the pattern of federal budget expenditures (9.1% in 2019–2020).

In terms of the functional classification of expenditures, the most dramatic cuts in 2024 relative to 2020 are expected to take place in respect of such items as "Social Policy" – a decrease of Rb 647.9 bn or 2.3 p.p. of GDP, "General Inter-Budget Transfers" – Rb329.8 bn or 0.6 p.p. of GDP and "Healthcare" – Rb99.6 bn or 0.4 p.p. of GDP primarily because of cuts in financing of pandemic-related measures of social support and medical services. The highest increase in expenditures in 2024 relative to 2020 is expected on such items as "Public Debt Servicing" – a 2.3-fold increase (over Rb1 trillion or 0.5 p.p. of GDP), "Environmental Protection" – an increase of 61.2% (Rb159.4 bn or 0.1 p.p. of GDP), "Education" – 37,3% (Rb357.2 bn without changes in shares of GDP).

By preliminary estimates, in 2021 the overall volume of inter-budget transfers out of the federal budget to regions was equal to 2.8% of GDP. In 2022–2024, it will keep decreasing (in GDP shares) to the level seen in 2019. Advanced growth in regions' consolidated budget expenditures mainly because of the federal authorities' decisions with no proper compensation by way of transfer of revenues provided for gives cause for concern (implementation of national projects; pay increases to public sector employees; increases in minimum

1 URL: https://ac.gov.ru/news/page/eksperty-obsudili-riski-vvedenia-akciza-na-napitki-s-soderzaniem-sahara-26961
2 As of 2018, in Russia average annual consumption of alcohol-free beverages per person is equal to 84.42 liters (for comparison: 410.7 liters in China). URL: https://www.bbc.com/russian/news-47815673
3 URL: https://www.vedomosti.ru/business/articles/2021/06/22/875183-aktsizov-sladkie

monthly wage; inflation-adjusted indexation of social benefits; investment expenditures growth).

In programmatic formats of the expenditure side of the federal budget for 2022–2024, there are substantial changes as a result of departure from structuring public programs into subprograms and core measures, introduction of a new budgetary tool in terms of a complex of process measures and abolition of such instruments as departmental special-purpose programs and priority projects. The new structure will make it feasible to allocate expenditures across projects and process tools and upgrade beyond doubt correlation of expenditures with outputs.

In 2022 and 2023, implementation of the federal budget is expected with surplus of 1% and 0.2% of GDP, respectively, while in 2024, with an insignificant deficit of 0.3% of GDP. In the three-year period under review, non-oil and gas deficit will amount on average to 6.1% of GDP, a very low historic level.

With balanced budget in place, but owing to the existing limitations imposed by the fiscal rule on spending of oil and gas revenues, sustainable growth in borrowings from Rb2 trillion in 2021 to Rb2.9 trillion in 2024 is planned (a 1.5-fold increase). Further, public borrowings will remain the sole source of covering the federal budget deficit in the next three years.

As a result, the public debt will grow from Rb22.1 trillion (17.8% of GDP) in 2021 to Rb31.9 trillion (21.1% of GDP) by 2024. Funds are expected to be borrowed primarily on the domestic debt market: the internal debt will increase from Rb17.3 trillion in 2021 to Rb26.3 trillion in 2024, while the external debt grows to Rb5.6 trillion in 2024, an increase of the mere Rb0.8 trillion relative to 2021.

At the same time, the projected NWF balances will be equal to Rb23.3 trillion (15.4% of GDP) as of the end of 2024 against Rb13.9 trillion (11.2% of GDP) as of the end of 2021. Actually, in the next three years there will be equal growth both in public debt and the NWF balances.

The policy of increasing public debt with simultaneous speeded-up accumulation of funds in the stabilization fund raises questions in terms of justification and viability. The pros include risks of dramatic depreciation of prices for energy commodities and a substantial decrease in the volume of exports of other goods, as well as the likelihood of a new financial crisis and other unforeseeable negative developments. However, within the framework of this strategy it is advisable to bring into correlation revenues from long-term assets with expenditures on public debt servicing. The most likely explanation of the federal policy of management of liabilities and assets consists in accumulation of the NWF balances for funding the so-called mega-projects which are expected to become long-term drivers of economic growth.

In view of projected public debt growth, the risk of long-term growth in expenditures on servicing thereof may materialize; such expenditures have been growing since 2008 (from 0.35% of GDP in 2008 to 1.1% of GDP in 2024).

Overall, the federal budget revenues dynamic in 2022–2024 correlates with the projected economic growth rates, while the planned downward dynamic of non-interest expenditures outrunning the rates of reduction in total federal budget expenditures points to a feasible small decrease in their impact on the economy which is expected to be made up for by allocation of a portion of funds out of the NWF for investment purposes.

2. BALANCE OF PAYMENTS IN Q3 2021

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In Q3 2021, the current account surplus of the RF balance of payments picked up considerably as compared to the same period of the previous year. It happened primarily owing to the appreciation of prices for primary products and increased export volumes thereof. At the same time, there was substantial growth both in the private sector's net capital outflow and foreign exchange purchasing within the framework of the fiscal rule. With special drawing rights (SDR) granted to Russia within the framework of the IMF's decision on a new allocation of SDR among its member countries, Russia's international reserves increased.

According to the preliminary estimate of the balance of payments published by the Central Bank of Russia, in Q3 2021 the current account surplus was equal to $40.8bn, a substantial increase on Q2 2021 ($18.2 bn) and an order of magnitude more than in Q3 2020 ($3.9 mn).

The balance of trade in goods amounted to $56.8 bn, an increase of 46% on Q3 2020 ($18.8 bn) (*Fig. 1*). As a result, Q1 through Q3 2021 the balance of trade amounted to $124.5 bn, an increase of 81% on January-September 2020 ($68.8 bn) owing to a substantial upturn in the value of exports which was equal to $134.9 bn in Q3 2021 (for reference, $79 bn in Q3 2020) and driven both by steady export volumes and higher global prices for Russian main hydrocarbon export commodities, such as oil, petrochemicals and gas as compared with 2020.[1] It is noteworthy that in Q3 2020 non-hydrocarbon exports (ferrous metals, coal, aluminum, copper, nickel, food and machinery) grew considerably, too, (from $47.2 bn to $72.9 bn) relative to Q3 2020 on the back of appreciation of prices for these commodity items and amounted to $178.2 bn in the first three quarters of 2021, an increase of 54% as compared to January-September 2020 ($126.1 bn).

In Q3 2021, import supplies grew up to $78.1 bn, an increase of 2.5% and 30% on Q2 2021 ($76.2 bn) and Q3 2020 ($60.2 bn), respectively. A pickup in imports was accompanied by the reorientation thereof towards capital goods and increased volumes of pharmaceuticals and other related supplies.

In Q3 2021, the balance of trade in services was equal to -$4.6 bn, an increase of 28% in absolute terms on Q2 2021 (-$4.1 bn) and an increase of 12% relative to Q3 2020 (-$3.6 bn). Such dynamics were substantiated by an upturn both in imports and exports of services (both in absolute and relative terms). As compared with Q3 2020, exports of services picked up (mainly on the back of growth in transportation services and a partial revival of tourist trips to

1 On the principles of formation of export prices, see: A. Yu. Knobel and D.E. Kuznetsov. The Principles of Formation by Russian Companies of Prices on Export Markets // The Journal of the New Economic Association. 2019. Issue No. 1 (41). P. 100–127.

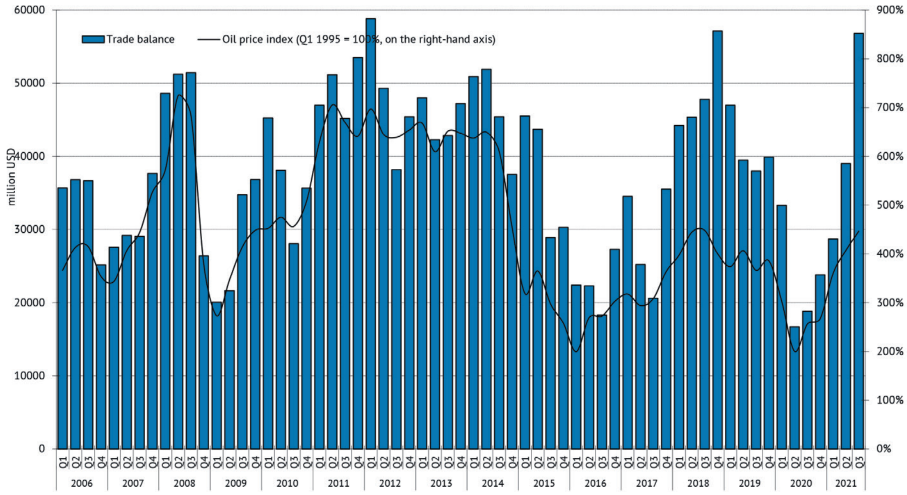

Fig. 1. Trade balance and dynamics of oil prices

Source: The Central Bank of Russia; the IMF.

Russia) by 26% from \$10.7 bn to \$13.5 bn. Imports increased (mainly owing to transportation services and a partial renewal of Russians' travelling abroad) by 27% from \$14.3 bn to \$18.1bn. It is noteworthy that in Q1 through Q3 2021 the balance of trade in services amounted to -\$11.4 bn, which is almost equal to the value of the relevant indicator for January-September 2020 (-\$11.9 bn).

In Q3 2021, the investment income balance amounted to -\$9.6 bn, a substantial reduction (owing to the seasonal factor) in absolute terms relative to Q2 2021 (-\$16.5 bn), but almost the same value as in Q3 2021 (-\$9.5 bn).

Other components of the current account balance (labor cost balance, rent balance and secondary income balance) do not generally account for a substantial value as compared with the abovementioned main balances, nor have their dynamics any significant effect on the current account balance.

In Q3 2021, the financial account balance (without reserve assets) turned out to be almost equal to the previous year's one (the deficit of \$8.9 bn against \$8.6 bn in Q3 2020). However, this indicator's structure underwent substantial changes. Specifically, in Q3 2021 the private sector's net capital outflow amounted to \$33.9 bn, a four-fold increase on Q3 2020 (*Fig. 2*). This value corresponds to net capital outflow seen in Q4 2018 amid the increase in sanctions rhetoric against Russia, tightening by the US Federal Reserve of its monetary policy and higher risks of investments in emerging markets because of financial instability in Argentina and Turkey.

The banking sector's net capital outflow was equal to \$5.3 bn (\$5.1 bn in Q3 2020). The volume of net capital outflow from other sectors amounted to \$28.6 bn (\$13.7 bn in Q3 2020), which corresponds to the level of capital outflow from other sectors in the crisis Q4 2014 (\$30.5 bn).

Such a considerable capital outflow in Q3 2021 was mainly driven by a pickup in the private sector's demand for foreign assets amid expectations of the Fed's tightening of its monetary policy. So, banks' foreign assts growth accounted for \$4.2 bn in the banking sector's capital outflow pattern (a decrease of \$7.4 bn in foreign assets in Q3 2020), while a decrease in foreign liabilities was equal to \$1.2 bn (-\$2.2 bn in Q3 2020). Other sectors' net capital outflow was

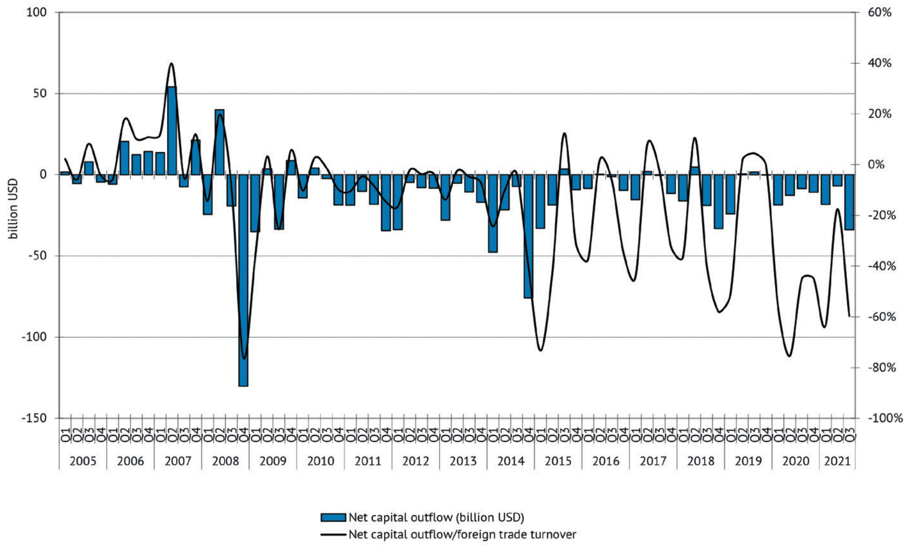

Fig. 2. The private sector's net capital outflow in 2005–2021

Source: The Central Bank of Russia; own calculations.

substantiated mainly by growth of $22 bn in foreign assets ($3.3 bn in Q3 2020) with a decrease of $4.4 bn in foreign liabilities (-$13 bn in Q3 2020).

Other sectors built up assets in terms of outgoing foreign direct investments (an increase of $9.0 bn as compared with -$2.9 bn in Q3 2020), trade loans and advance payments ($6 bn as compared with $6.4 bn in Q3 2020); acquisition of other assets ($4.4 bn as compared with -$2.3bn in Q3 2020), as well as outgoing portfolio investments ($3 bn as compared with $2.1 bn in Q3 2020). A decline in other sectors' foreign liabilities took place on the back of reduction in other liabilities (a decrease of $4.4 bn as compared with -$8.5 bn in Q3 2020), portfolio investments ($3.2 bn as compared with -$3.6 bn in Q3 2020), loans ($1.6 bn as compared with -$2.9 bn in Q3 2020). At the same time, Q3 2021 saw inflow of foreign direct investments in other sectors: $4.8 bn against $2.1 bn in Q3 2020.

In Q3 2021, the government increased foreign liabilities by $5.9 bn as compared with a decrease of $0.4 bn in Q3 2020 on the back of a pickup in nonresidents' investments in government securities. As a result, the share of nonresidents on the OFZ market within three months grew from 19.5% early in June 2021 to 21.4% early in September 2021 owing to a reduction in geopolitical risks and a higher yield on investments in Russian government securities amid tightening of the monetary policy. We remind that early this year the share of foreigners on the Russian OFZ market was equal to 23.3% and was gradually declining because of sanctions rhetoric, internal and geopolitical risks and expectations of the Fed's tightening its monetary policy.

Excess of the current account surplus over capital outflow on the financial account was offset by growth of $29.6 bn in international reserve assets (-$2.3 bn in Q3 2020). Growth in foreign exchange reserves was driven by purchasing of foreign exchange by the RF Ministry of Finance within the framework of the fiscal rule where the oil price exceeded the cut-off price (about $12.5 bn in Q3 2021) and granting to Russia of special drawing rights (SDR) in the amount of $17.5 bn within the framework of the IMF's decision on a new allocation of SDR among its member-countries.

In Q3 2021, capital outflow increased 11-fold on the "net errors and omissions" item which is partially indicative of unaccounted capital flight: -$2.2 bn in Q3 2021 against -$0.2 bn in Q2 2021 (Q3 2020 saw capital inflow of $2.5 bn on this item).

Owing to considerable improvement in trade conditions on one side and a pickup in capital outflow on the other side, based on results for Q3 2021 the Russian ruble/US Dollar exchange rate remained virtually unchanged (Rb72.76 per $1) as compared to Q2 2021. Despite favorable external economic conditions, appreciation of the ruble was hindered by the fiscal rule, export of capital by the private sector and market participants' expectations of the Fed's tightening its monetary policy. From the Q3 2021 results, the fundamentally justified Russian ruble/US Dollar exchange rate calculated on the basis of the model taking into account oil prices, interest rates prevailing in Russia and abroad, the situation on financial markets, as well as the Russian fiscal rule remained at the level of Rb67–68 per $1, that is, the ruble was undervalued by 7–8.6%[1]. In our view, provided that the situation remains stable on the international and Russian markets the ruble may appreciate up to the abovementioned fundamentally justified level before the end of the year on the back of a favorable situation on global commodity markets and the Central Bank of Russia' tightening of its monetary policy.

1 For more details, see: A.V. Bozhechkova, S.G. Sinelnikov-Murylev and P.V. Trunin. Factors of the Ruble Exchange Rate Dynamics in the 2000s and the 2010s // Voprosy Ekonomiki. 2020. No.8. P. 1–18.

3. RETAIL DEPOSITS IN JANUARY THROUGH AUGUST 2021

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The slowdown in the growth rate of retail deposits is due to the policy of low rates of the Central Bank of the Russian Federation in 2020 and the introduction of a tax on interest on retail deposits, which came into force in 2021. The increase in the key rate of the Bank of Russia contributed to an increase in bank deposit rates and allowed to reduce the rate of outflow of funds from fixed deposit accounts. The low level of interest rates on deposits will contribute to the gradual redistribution of retail resources, which will result in an increase in popularity of savings accounts and further promotion of banking products related to investments in the stock market.

Retail deposits[1] still remain one of the most significant resources for banks: as of September 1, 2021, they make up 28.8% of the volume of bank liabilities. For comparison: corporate deposits – 31.5%, funds of banks – 9.8%, public funds – 7.9%, loans from the Bank of Russia – 2.3%. The share of equity stood at 10.1%.

The total volume of retail deposits as of September 1, 2021 hit Rb32.7 trillion, practically unchanged from the beginning of the year, the drop in eight months in absolute terms amounted to Rb159.4 bn, or 0.5% (as of September 1, 2020, an increase of Rb1.7 trillion, or 5.5%, was recorded for the same period).

Ruble deposits amounted to Rb25.9 trillion; for eight months of this year, a decrease of 0.7% was recorded (for the same period last year – an increase of 4%). Foreign currency deposits amounted to Rb6.8 trillion (an increase of 0.3% since the beginning of 2021, a year ago – an increase of 11.4% due to the fall in the ruble exchange rate). Despite extremely low interest rates on foreign currency deposits, the level of dollarization[2] remains the same – as of September 1, 2021, the share of foreign currency deposits in the total amount of retail deposits amounted to 20.9% (as of the corresponding date last year – 20.6%). The stability of foreign currency deposits is ensured by two main factors: the relative stability of the ruble exchange rate and, as a result, zero currency revaluation[3] of balances on retail deposit accounts, and the growth of inflationary expectations of the population, restraining the flow of foreign currency deposits to ruble accounts.

A significant increase was recorded in retail escrow accounts under contracts of participation in shared construction, for eight months the increase amounted to Rb1,323.6 bn, or 112.8%. The increase in this indicator is largely due to

1 Including deposits and funds on accounts.
2 All foreign currency accounts are taken into consideration.
3 Recalculation of balances on retail deposits denominated in foreign currency into ruble equivalent when preparing accounting statements.

the growing popularity of mortgages and the extension of state support for preferential mortgage lending.

According to the Deposit Insurance Agency,[1] the average size of the deposit placed in one bank was, as of April 1 of this year, Rb283,000 (excluding small deposits of less than Rb1,000). The average amount of depositors' funds in escrow accounts amounted to Rb5.2 mn.

The attracted funds of non-resident individuals as of September 1 of this year amounted to Rb522.3 bn, having decreased by 6.4% since the beginning of the year. At the same time, funds in accounts (accounts used for settlements) increased by 6.3% during the analyzed period, while deposits (savings accounts that bring interest) decreased by 20.6%.

The number of savings certificates is also decreasing. Since the beginning of the year, their value volume has fallen by 52.9% to the level of Rb5.7 bn. This financial instrument has practically lost any attractiveness due to the imposed restrictions on turnover.[2]

The temporary structure of deposits has not undergone major changes. As a year ago, funds in accounts are in the greatest demand (38.5% of the total volume of deposits), the growth of which for the eight months of this year amounted to 8.2%. This category includes savings accounts, the advantages of which consist in relatively high interest rates (corresponding to fixed deposits) and the possibility of flexible account management (the number of transactions in the form of deposits and withdrawals in the absence or low level of the irreducible balance is practically unlimited). The share of long-term deposits for a period of more than one year accounts for 34.4%, a decrease of 4.8% in eight months. Banks sometimes offer relatively attractive interest rates on these deposits, thereby ensuring the stability of the resource base at a low cost of funding. *Fig. 1* demonstrates how banks' interest expenses have been declining in recent years and at the same time the share of interest expenses on individual accounts has been growing.

The reduction in the total number of credit institutions leads to the occurrence of insurance cases in the bank deposit market. The Deposit Insurance Agency (DIA) for the first nine months of 2021 paid insurance compensation to 150,400 depositors for a total amount of Rb51.6 bn. Insured events for the same period occurred in relation to 21 banks participating in the deposit insurance system. Compensation payments by the Agency began on the sixth or seventh working day after the insured event. The current limits of insurance compensation provided 98% of bank depositors with the opportunity to fully recover their funds at the expense of the mandatory deposit insurance fund.[3]

In accordance with the decision of the Board of Directors of the DIA dated April 27, 2021, starting from Q3 2021, the base rate of insurance contributions of banks to the Mandatory Deposit Insurance Fund (FOSF) is increased from 0.1% to 0.12% of the settlement base. The amount of additional and increased additional rates of insurance premiums remains at the same level – 25% and 300% of the base rate, respectively. In the spring of 2020 by the decision of the Board of Directors, the rates of insurance contributions of banks to the FOSF, starting from Q1 2020, were reduced to increase the capabilities of the banking system to restructure loans to the population and support lending to

1 URL: https://www.asv.org.ru/news/448165
2 Amendments to the Civil Code (Federal Law No. 212-FZ of 26.07.2017) prohibit the sale of bearer securities from 01.06.2018.
3 URL: https://www.asv.org.ru/news/493284

3. Retail Deposits in January through August 2021

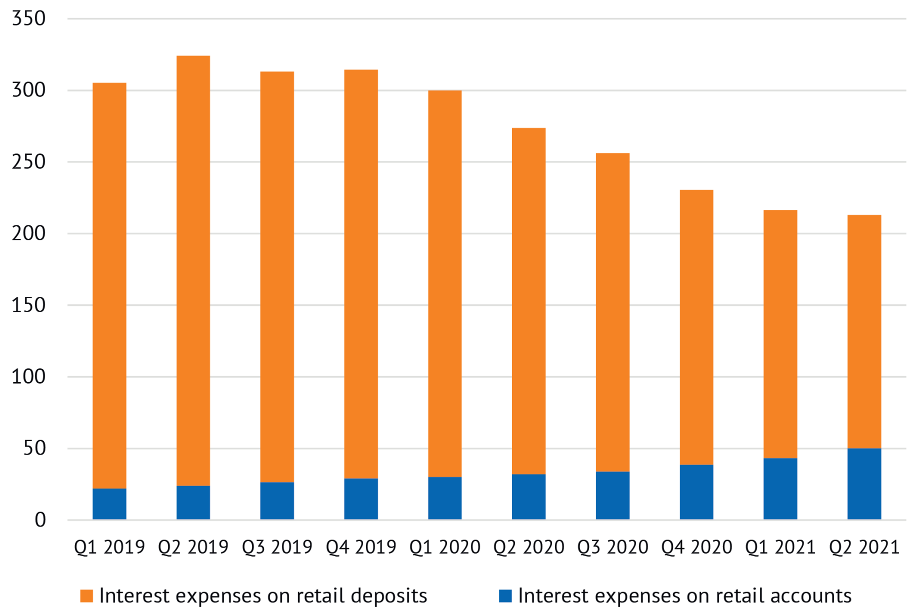

Fig. 1. Dynamics of banks' interest expenses on accounts and retail deposits in 2019–2021, Rb bn

Sources: Report on financial performance (Form No. 102) for the period from April 1, 2019 through July 1, 2021 / Bank of Russia. URL: http://www.cbr.ru/banking_sector/otchetnost-kreditnykh-organizaciy/; own calculations.

the economy (base rate – from 0.15% to 0.1% of the settlement base, additional rate – from 50% to 25% of the base rate, increased additional rate – from 500% to 300% of the base rate). Given the slight increase in the base rate, this decision will not dramatically affect the level of bank deposit rates.

A significant change in the situation on the deposit market in the absence of external shocks is not expected. According to the August results, the weighted average rate of banks on retail deposits with a maturity of up to a year was 3.86%, which is 0.48 p.p. higher than at the end of 2020. The average deposit rate for more than a year has increased to 5.8% (plus 1.63 p.p. by December 2020). The emerging increase in bank interest rates associated with an increase in the key rate may suspend the outflow of funds from retail deposit accounts, but in the near future their real profitability, taking into account expected inflation, will be close to zero or will remain in the negative zone.

In the short term, a slight increase in the nominal yield on deposits is possible, which will balance the flow of funds from fixed deposits to savings accounts. Under these conditions, credit institutions will be able to stabilize the structure of their resource base, as well as reduce interest rate and liquidity risks.

In general, the banking policy regarding retail deposits will remain unchanged: low interest rates on deposits of individuals will be combined with the active promotion of investment services, such as: trust management of client funds (for example, investments in mutual funds); brokerage services (independent execution by clients of transactions of purchase and sale of various financial instruments on the Russian stock market and on foreign platforms); as well as various structural (complex) products consisting of a combination of various financial instruments (for example, a combination of deposit, insurance and investments in securities). On the one hand, the conservatism of the population in the form of adherence to traditional products will contribute to maintaining high amounts of funds in bank deposits and accounts, which will allow banks to continue optimizing interest costs and increase profits. On the other hand, the gradual transition to investment banking products (mutual funds, individual investment accounts, brokerage accounts, etc.) will provide banks with the opportunity to diversify market risks and at the same time increase commission income on trade and intermediary operations. Another task of banking management will be to restore customer confidence in the structural products developed in previous years; with an increase in the level of their transparency, banks will be able to resume proposals for unit-linked (ULLI)[1] and cash-value (CVLI)[2] life insurance, contributing to an increase in the long-term resource base.

1 A mixed investment and insurance product is a combination of a client's life insurance and investments in shares and bonds of Russian issuers.
2 A long-term investment program that combines two tools: insurance protection and money accumulation.

4. LABOR MARKET AND MANDATORY PENSION INSURANCE SYSTEM: CURRENT TRENDS AND LONG-TERM RISKS

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The problem of long-term sustainability of the mandatory pension insurance system (MPS) of the Russian Federation is highly dependent on trends in the labor market. Their analysis, as well as scenario forecasts based on it, indicate the presence of risks that could lead to a decrease in the volume of insurance contributions relative to GDP in the future.

The two main sources of financing for the MPS system are insurance contributions and transfers from the federal budget. In 2020, these two sources accounted for about 99% of all income.

Despite the dependence of the mandatory pension insurance system on budget transfers (they provide about a quarter of all expenses for the payment of insurance pensions), the risk of its financial support is quite limited. The risk itself is mainly due to the fact that there is still no procedure for calculating transfers fixed in regulatory documents. Currently, most of the transfers are determined based on the planned amount of pension indexation, the amount of which is set by agreement between various state authorities, and then approved by law.

Therefore, the main risk in terms of financing the MPS system is due to the variability of income received from insurance contributions, which are influenced by the following factors:

1. Effective insurance premium rate;
2. The amount of the base of insurance premiums, which depends on:
   - economic growth rates;
   - the total share of wages of employees in GDP, including income from informal employment[1];
   - the share of hidden income in the total structure of income from the employment of employees.

Let's focus on the dynamics of the last two factors and assess what long-term economic trends may affect them in the future. Our analysis does not consider the factor of economic growth, since it is not directly related to the influence of the labor market on the MPS system.

Often, new technologies are considered one of the most significant risks for the pension system, to the extent that they determine changes in the marginal productivity of employees and can lead to a decrease in the share of wages of

1 In this case, such employment is understood as an income-generating activity (hereinafter referred to as hidden income), from which insurance contributions are not paid in part or in full. In addition, informal employment also includes activities that bring professional income (self-employment).

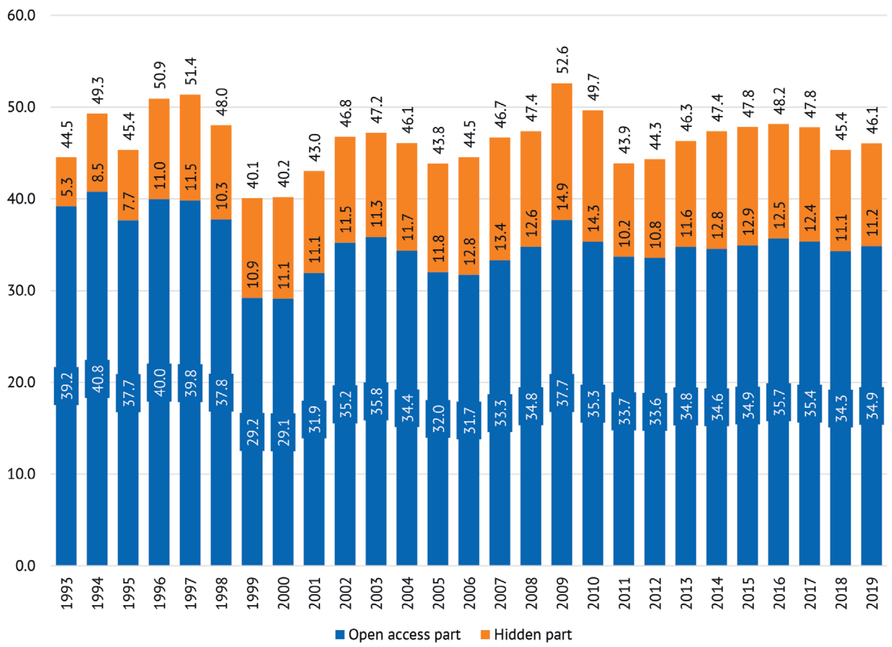

Fig. 1. The share of wages in GDP in Russia, %

Source: Russian Statistical Yearbook. Annex.

employees in GDP. However, statistics demonstrate that the share of wages in Russian GDP has changed over the past decades, however without an obvious upward or downward trend (*Fig. 1*).

Can we expect an increase or decrease in the share of wages in GDP in the long term? If we turn to the experience of developed countries, it should be noted that in many of them there is a decrease in this indicator. During the period 1975–2012, out of 59 countries with official statistics that allow us to assess this trend, there was a drop in the share of wages in 42 countries. For example, in the USA, the share of the wage fund (PAYROLL) began to decline from the 1960s, and over the period 2000–2015 it decreased from 63.3 to 56.7%. Nevertheless, the decline in the considered indicator is not stable and is not observed in all countries. Modern research links this trend with various reasons:

- the development of capital-intensive technologies that partially or fully automate low-skilled labor. Researchers agree that modern technological progress, as in the past, leads to a decrease in the share of labor in national income[1];
- an increase in the share of multinational companies in the global economy, which leads to a decrease in competition. Due to their monopoly position, such companies have a high profit margin and, accordingly, a low share of labor costs in total costs[2];

1 *Acemoglu D., Restrepo P.* Robots and jobs: Evidence from US labor markets //Journal of Political Economy. 2020. T. 128. No. 6. P. 2188–2244; International Monetary Fund, «Understanding the downward trend in labor income shares», IMF World Economic Outlook, chapter 3, April 2017; *Karabarbounis L., Neiman B.* The global decline of the labor share //The Quarterly journal of economics. 2014. T. 129. No. 1. P. 61–103.

2 Decoupling of wages from productivity: What implications for public policies? // OECD Economic Outlook. 2018. Volume 2012. Issue 2; *Dorn, D., Katz, L. F., Patterson, C., & Van Ree nen, J.* Concentrating on the Fall of the Labor Share. American Economic Review. 2017. No. 107(5). P. 180–85.

- the globalization, as a result of which an increasing part of the world's labor-intensive production is concentrated in developing countries with low labor prices. As a result of changes in production chains, the share of labor income in the economy of developed countries is decreasing.[1]

All these factors have been in effect for a long time, but they have not led to a decrease in the share of PAYROLL in Russian GDP in recent decades. Rather, on the contrary, the period of the 2000s was characterized by mainstreaming of new technologies in Russia and the growing importance of capital-intensive companies in the extractive sector, which was not reflected in the dynamics of the share of labor income in total income.

A significant risk for the MPS system is the potential growth of the number of self-employed in the economy. The introduction of a self-employment regime can currently be assessed as a rational measure to "whitewash" the Russian labor market. According to the estimates of the Accounting Chamber for the four pilot regions by the end of 2019, the introduction of a new tax regime led to a decrease in the share of labor income hidden from the Federal Tax Service (FTS): partly due to the legalization of employment of those persons who in the past remained in the shadows, partly due to the legalization of shadow part-time jobs of officially employed. According to estimates based on the report of the Accounting Chamber, around 40% of the new self-employed came from the shadow sector, and around 50–55% legalized their shadow side jobs. Thus, only 5–10% could use the tax regime to reduce deductions to the Federal Tax Service, and this value should be considered the upper limit, most likely, they were somewhat less.

However, there are a number of factors that can lead to an increase in the self-employed in the future due to a decrease in the number of people employed under standard labor relations. Firstly, this regime is attractive both for employers and for many employees. At the same time, there is a risk of using various "schemes" for transferring employees to such a mode of work. Secondly, the spread of remote employment and new formats of services using Internet platforms will also lead to an increase in the number of self-employed.

Although the projection of the number of informally employed is problematic, according to available estimates, the number of people employed in the shadow sector may decrease from 9.8 mn in 2020 to 3.5 mn in 2030, while the officially self-employed may grow from 1.5 mn to 12.5 mn people. Accordingly, the number of informally employed, according to the definition we use, may increase from 11.3 mn to 16 mn people while maintaining the total number of employed.

An additional risk for the MPS system may be the growth of the share of small and medium-sized businesses (SMEs). Such growth is laid down as one of the goals within the framework of the national project "Small and medium-sized entrepreneurship". In 2020, as part of the support for SMEs affected by COVID-lockdown, the insurance premium rate was significantly cut. During the crisis, this was necessary, however the provision of such benefits for an indefinite period can hardly be considered justified, since it seriously reduces the stability of the MPS system and increases the burden on the federal budget.

What do the results of modeling the impact of the growth of the share of employed in small and medium-sized businesses and the share of informally employed on the income of the MPS system indicate? Several scenarios were

1 Understanding the downward trend in labor income shares. IMF World Economic Outlook, chapter 3, April 2017.

considered to forecast the contribution base of insurance contributions. In the "no change" scenario, it is assumed that the share of wages in GDP, including income from informal employment, remains at the level of the average for 1993–2019. This corresponds to the trend of the last three decades when the share of labor income in GDP fluctuated around an average of 46.5% and with a standard deviation of 2.9%.

Within the framework of the scenario modeling risks from the labor market (assumes an increase in informal employment and employed in SMEs), it is predicted that the volume of insurance contributions will significantly decrease by 2050 from 5 to 4.2% of GDP (*Fig. 2*). The decrease is due to the projected decrease in the number of workers in the formal sector due to their transition to self-employment (0.6 p.p.), as well as an increase in the share of SME workers in the context of a decrease in the rate of insurance contributions for small and medium-sized businesses (0.2 p.p.).

If we calculate the amount of insurance contributions relative to the number of pensioners, it becomes obvious that the demographic factor is an important factor: the aging of the population and the associated deterioration in the ratio of the number of pensioners and people of working age. During the period of raising the retirement age, this parameter is steadily growing (until 2028), but then its decline is predicted (*Fig. 3*).

Thus, trends in the labor market, primarily related to the growth in the share of small and medium-sized businesses and informal employment, will lead to a decrease in the contribution base and income of the MPS system from insurance contributions in the long term. In the period 2021–2028, the effect of raising the retirement age will compensate for the decrease in income from insurance contributions. However, in the future, this problem may begin to worsen again if measures are not taken both in terms of parametric tuning of the MPS system[1] and in terms of improving its financing mechanisms, including the gradual abandonment of the practice of supporting businesses and, in particular, SMEs through the provision of benefits at the rates of contributions to MPS.

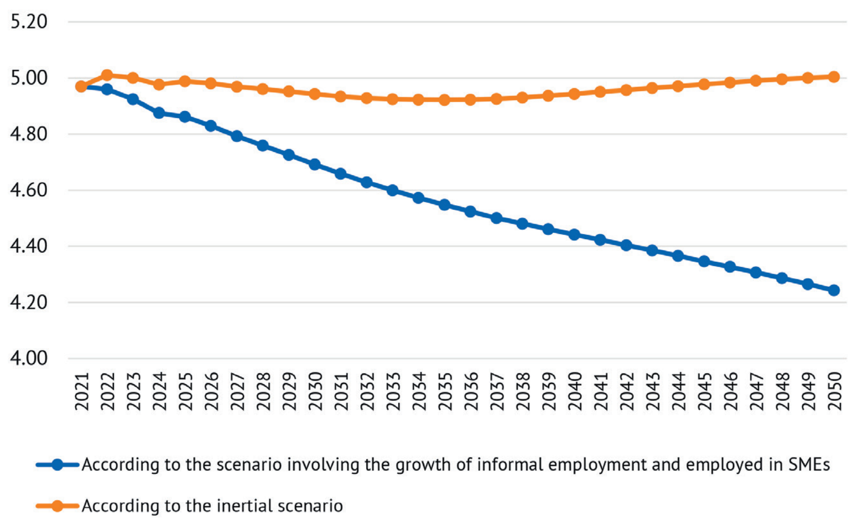

Fig. 2. The volume of insurance contributions for the payment of pensions in PFR, % of GDP

Source: own calculations.

1 See executive summery "Factors of growth of insurance pensions in the medium and long term" (May 2021).

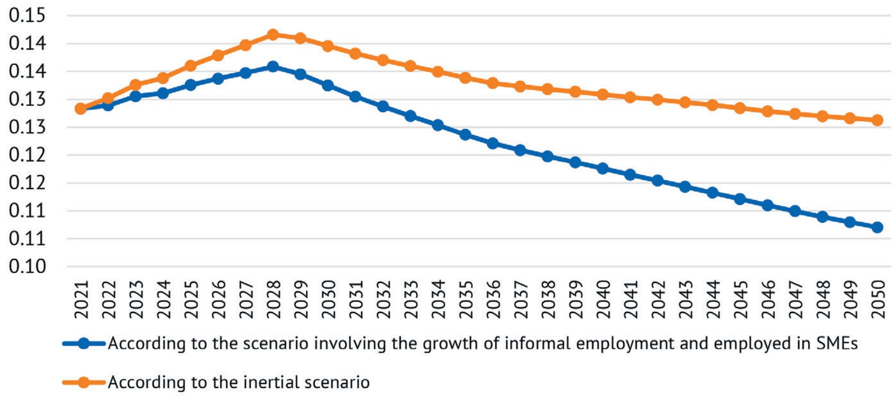

Fig. 3. The volume of insurance contributions for MPS per 1 mn pensioners, % of GDP

Source: own calculations.

The establishment of professional income tax rates 2–3-fold lower than the personal income tax rate and exemption from payment of contributions to MPS may be considered an appropriate temporary measure that contributes to the withdrawal of such persons from the "shadow". However, the exclusion of millions of able-bodied persons from the solidary pension system, on the one hand, undermines its financial basis, and on the other hand, leads to the fact that these persons, having reached retirement age, will not be able to start receiving an insurance pension. Therefore, we consider it necessary for all able-bodied persons, including the self-employed, to develop a strategy for their inclusion in the MPS system.