

## Section 2. Monetary and fiscal spheres

### 2.1. Monetary policy<sup>1</sup>

#### 2.1.1. Monetary policy trends

In 2019, a sharp and largely unexpected slowdown in inflation led to a significant easing of monetary policy. Over the course of that year, the Bank of Russia reduced its key rate five times: four times by 0.25 percentage points on June 14, July 26, September 6, and December 13; and by 0.5 percentage points at a meeting of its Board of Directors on October 25. As a result, the key rate declined from 7.75% to 6.25% per annum, thus approaching, according to the estimates of the RF Central Bank,<sup>2</sup> its neutral level.<sup>3</sup>

Over the course of 2019, the movement pattern of the key rate was shaped, on the one hand, by the rising inflation risks in the H2 2018 and early 2019 caused by the raise of the VAT rate at the beginning of 2019, a decline of the world market for energy prices, and an increase in inflationary expectations. As a result, in January-May 2019, the regulator did not ease its monetary policy, keeping the key rate unchanged. At the same time, the RF Central Bank's rhetoric regarding future decisions began to somewhat relax in March-April 2019, as the inflation index passed a local peak (5.3% in March 2019 compared to March 2018). It was only in June 2019 that the Bank of Russia switched over to actually reducing the key rate.

However, in reality, the surge in inflation turned out to be more moderate, and its duration shorter than expected. This happened due to both an early tightening of monetary policy in 2018 and a combination of several other circumstances, in particular the ruble's strengthening as trading conditions improved and the risk of capital outflows decreased in response to monetary policy easing in a number of developed countries, as well as a slow growth demonstrated by domestic demand following fiscal policy toughening. As a result, over the course of 2019, the

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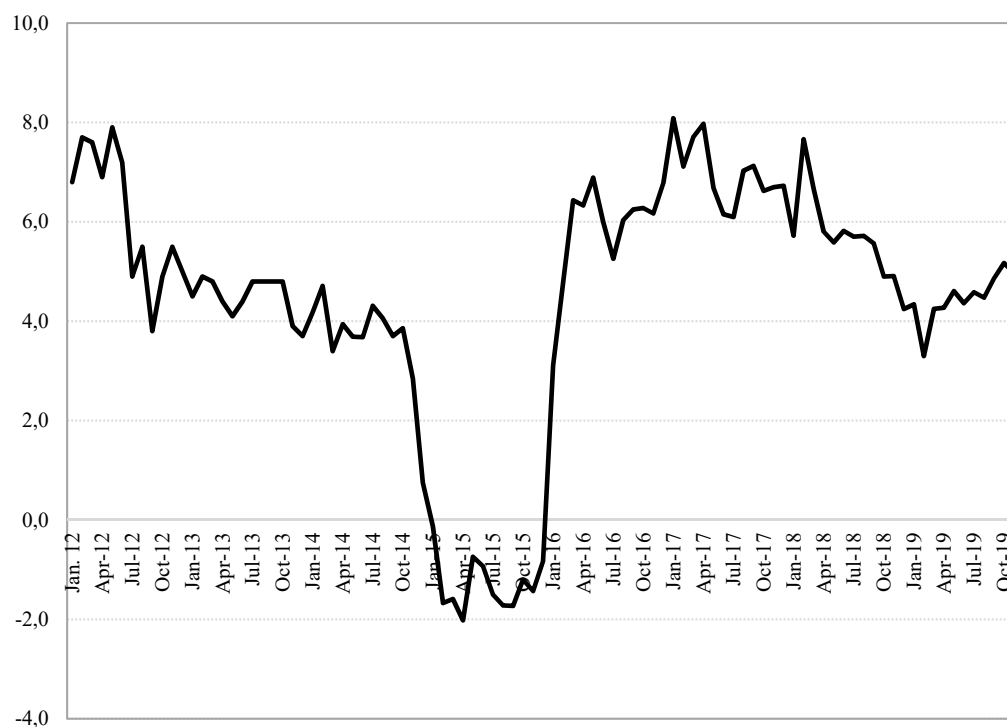
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<sup>2</sup> Guidelines for the single state monetary policy for 2020 and the period 2021–2022, p. 38.

<sup>3</sup> A neutral key rate secures the achievement of an inflation target and a zero output gap. A neutral interest rate level has neither a stimulating nor a restraining effect on economic activity.

Bank of Russia repeatedly adjusted its inflation predictions. Thus, in March, the year-end inflation projection for 2019 was reduced from 5.0–5.5% to 4.7–5.2%, and in October, to 3.2–3.7%. At the end of 2019, actual inflation was below its forecast values and amounted to 3%.

As monetary policy eased, banks' lending conditions also softened. Thus, the real interest rate on newly issued corporate loans with maturities of more than three years, calculated on the basis of actual inflation movement over the previous 12 months, decreased from 5.8% per annum on average in January–November 2018 to 4.5% per annum over the corresponding period of 2019 (*Fig. 1*).



*Fig. 1.* Real interest rate on corporate loans with maturities of more than three years in Russia, 2011–2018 (% per annum, based on the actual inflation pattern over the previous 12 months<sup>1</sup>)

Source: Bank of Russia; Rosstat; own calculations.

Nevertheless, in 2019, the real key interest rate remained at a relatively high level compared to the other developing countries that were implementing inflation targeting (*Fig. 2, Table 1*). At the end of 2019, the RF Central Bank's key rate exceeded inflation by 3.25 percentage points, which is lower than in Mexico (4.5 percentage points) and Kazakhstan (3.9 percentage points), but slightly higher than in the other developing countries that were targeting their inflation (for example, in the Republic of South Africa (2.5 percentage points) and Indonesia (2.3 percentage points)).

<sup>1</sup> The real interest rate was calculated using data on accumulated inflation over the previous 12 months (December 2019 to December 2018), based on the assumption of the adaptive nature of inflationary expectations in Russia.

Table 1

**Inflation and key rates in some developed and developing countries**

	Actual inflation (December 2019 to December 2018,%)	Key rate (end of year, % per annum)
<b>Developing countries</b>		
Peru	1.9	2.3
Indonesia	2.7	5.0
Mexico	2.8	7.3
Chile	3.0	1.8
<b>Russia</b>	<b>3.0</b>	<b>6.25</b>
Poland	3.2	1.5
Columbia	3.8	4.3
Hungary	4.0	0.9
RSA	4.0	6.5
Brazil	4.3	4.5
Kazakhstan	5.4	9.3
India	7.4	5.2
Turkey	11.8	12.0
<b>Developed countries</b>		
EU	1.3	0.0
UK	1.3	0.8
Norway	1.3	1.5
New Zealand	1.9	1.0
Australia	1.9	0.8
Iceland	2.0	3.0
Canada	2.2	1.8
USA	2.3	1.5
Czech Republic	3.2	2.0

Source: Central banks' websites.

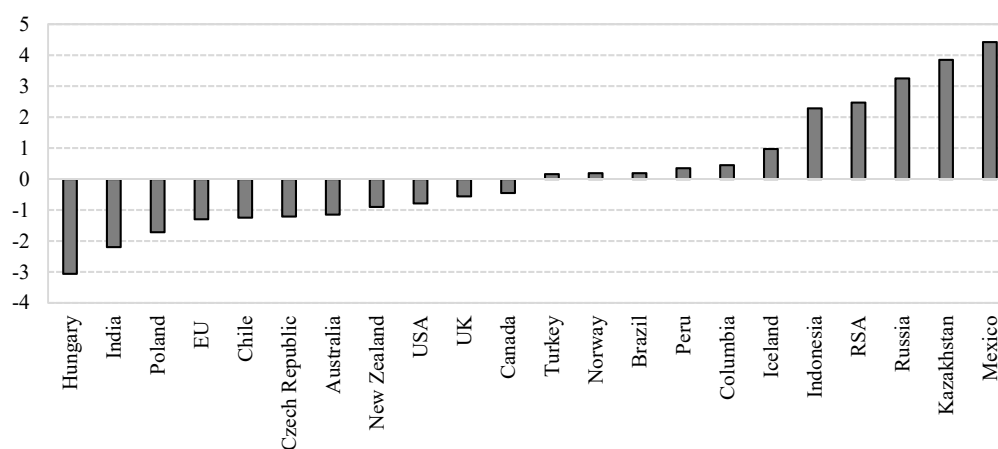


Fig. 2. The real key rate at year-end 2019 in Russia (% per annum, based on the actual inflation pattern over the previous 12 months)

Source: Central banks' websites; own calculations.

In 2020, with the global economy slowing down as a result of the coronavirus epidemic, increased global uncertainty and a sharp drop in oil prices, we can expect a temporary increase in inflation above the target level and its return to 4% in 2021. However, given the significant fall in below-target inflation in late 2019 and early 2020, as well as a possible significant slowdown in economic activity, we believe that monetary policy tightening is only possible if there is a serious threat to financial stability in Russia.

2.1.2. The money market

In 2019, the money market continued to operate in the context of a structural liquidity surplus in the banking sector,<sup>1</sup> which had first appeared back in 2017 as a result of spending the sovereign wealth funds and the implementation, by the Bank of Russia, of measures designed to secure the financial recovery of certain banks. In 2019, the liquidity surplus averaged RUB 3.0 trillion, remaining at the level of 2018.

In order to absorb liquidity and keep the interest rates within the established interest rate band, the RF Central Bank relied on deposit auctions and placed additional issues of Bank of Russia coupon bonds (KOBR). As a result, the amount of funds raised through the deposit auctions in 2019 averaged RUB 1.6 trillion, while in 2018 this index had reached RUB 2.2 trillion. At the same time, in 2019, the RF Central Bank slightly increased its KOBR offer for a period of 3 months. Thus, in 2019, the volume of KOBR in circulation jumped from RUB 1.4 trillion to RUB 1.9 trillion (*Table 2*).

It should be noted that, according to the forecasts released by the Bank of Russia, liquidity surplus in the banking sector can persist for the next 3 years. So, with due regard for the deferred purchases of foreign currency in the domestic market,<sup>2</sup> the regulator expects the structural liquidity surplus to rise to the level of RUB 5 trillion in the situation of the fiscal rule being applied under the basic scenario.

In 2019, in the context of a significant liquidity surplus, there was a slight shrinkage in the amount of debt owed by credit institutions to the Bank of Russia. At the end of 2019, the amount of loans attracted by credit institutions from the Bank of Russia decreased by 6%, to RUB 2.5 trillion (*Fig. 3*). At the same time, in 2019, in the structure of requirements established by the RF Central Bank for the banking sector, a large share was taken up by debt on loans secured by non-marketable assets (the average monthly volume of loans issued amounted to RUB 242 billion), while the average monthly volume of loans allotted through repo auctions over the same period was only RUB 1.4 billion.

*Table 2*

**The Bank of Russia’s balance sheets in 2017–2019**

	01.01.2017		01.01.2018		30.11.	
	billions of rubles	% of assets / liabilities	billions of rubles	% of assets / liabilities	billions of rubles	% of assets / liabilities
1	2	3	4	5	6	7
Funds placed with non-residents and foreign issuers securities	18,878.5	61.3	24,496.1	62.2	25,500.9	59.7
Loans and deposits	3,517.8	11.4	3,672.5	9.3	3,392.6	7.9
Precious metals	4,505.2	14.6	6,123.9	15.6	6,867.1	16.1
Securities	886.1	2.9	1,038.8	2.6	1,127.4	2.6
Other assets	1,535.7	5.0	2,286.0	5.8	4,254.8	10.0
<b>Total assets</b>	<b>30,815.1</b>	<b>100.0</b>	<b>39,368.9</b>	<b>100.0</b>	<b>42,726.0</b>	<b>100.0</b>

<sup>1</sup> The structural surplus is characterized by the formation of a steady excess of liquidity among credit institutions and the need for the Bank of Russia to carry out operations to absorb it in order to keep interest rates on the interbank lending market close to the key rate. It is measured by the difference between the requirements of the Bank of Russia for credit institutions and the requirements of credit organizations to the Bank of Russia for standard instruments for the provision and absorption of liquidity, supplemented by the balanced amount of claims of credit institutions and the Bank of Russia for specialized Bank of Russia refinancing instruments.

<sup>2</sup> The implementation of deferred purchases from February 2019 is associated with the suspension of the purchase by the Bank of Russia of foreign currency for the RF Ministry of Finance under the fiscal rule in the domestic foreign exchange market from August to December 2018.

*Cont'd*

1	2	3	4	5	6	7
Currency in circulation	9,539.4	31.0	10,312.8	26.2	10,175.9	23.8
Funds in accounts with Bank of Russia	11,003.2	35.7	14,526.6	36.9	17,732.0	41.5
<i>including RF Government</i>	4,565.7	14.8	7,894.7	20.1	11,154.6	26.1
<i>resident credit institutions</i>	4,812.4	15.6	4,381.7	11.1	4,828.6	11.3
Credit float	0.7	0.0	0.05	0.0	-	-
Securities issued	356.8	1.2	1,388.3	3.5	1,510.0	3.5
Liabilities to IMF	1,407.8	4.6	1,616.4	4.1	1,404.1	3.3
Other liabilities	120.8	0.4	130.6	0.3	514.2	1.2
Capital	8,386.5	27.2	11,394.3	28.9	11,389.8	26.7
Profit for reporting year	-	-	-	-	-	-
<b>Total liabilities</b>	<b>30,815.1</b>	<b>100.0</b>	<b>39,368.9</b>	<b>100.0</b>	<b>42,726.0</b>	<b>100.0</b>

Source: Bank of Russia.

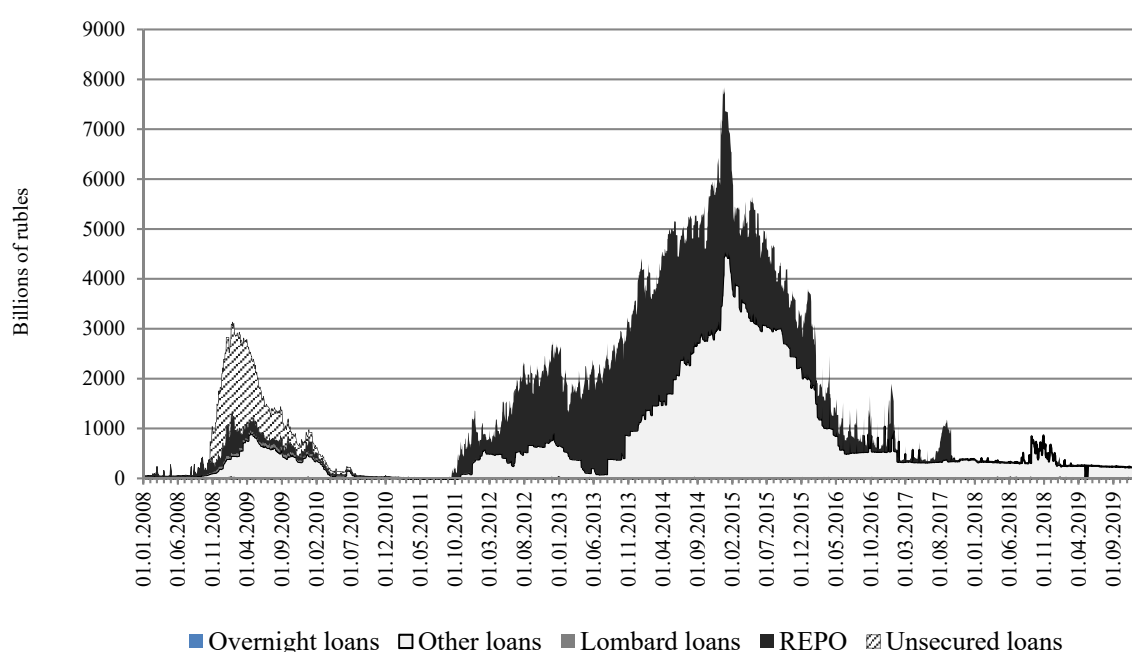


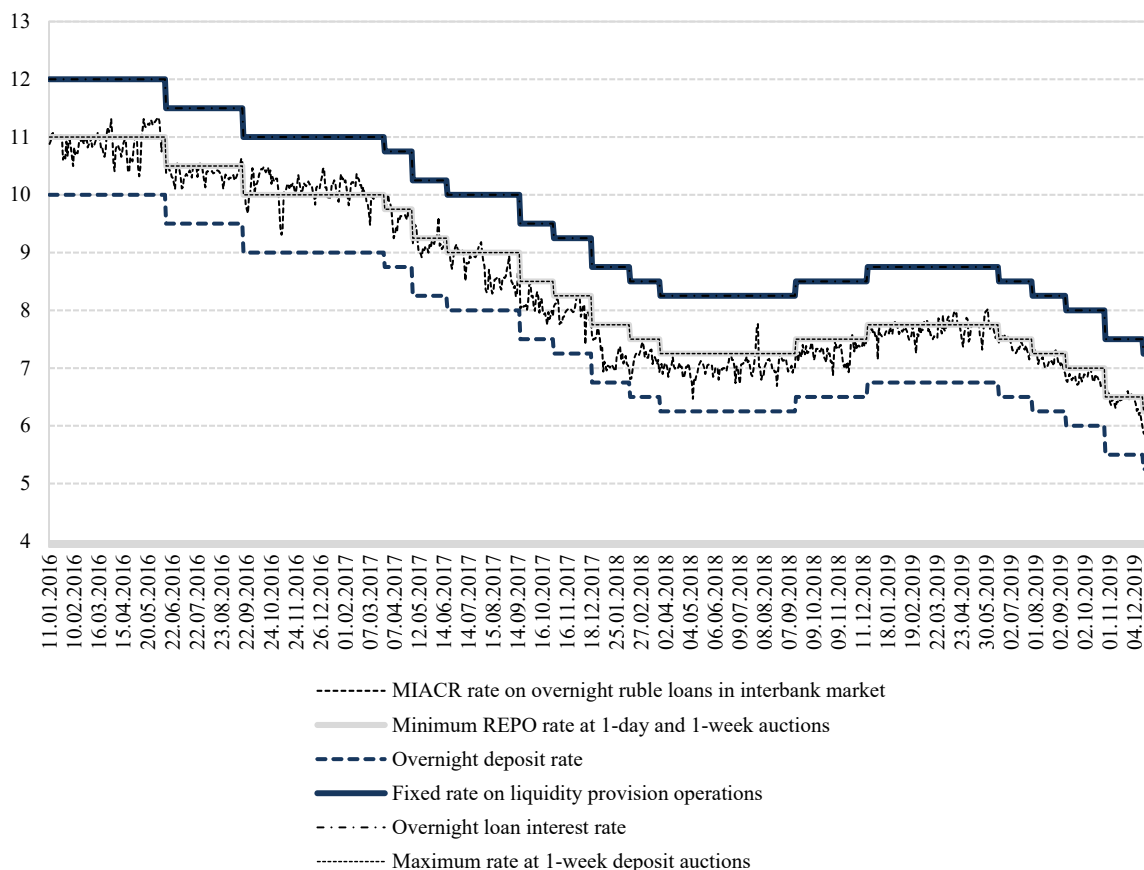
Fig. 3. Debt of commercial banks to the Bank of Russia, rubles, 2008–2019

Source: Bank of Russia.

Under the conditions of a structural liquidity surplus, the money market interest rate in 2019 stayed mainly in the lower part of the interest rate band. The interest rate on the interbank lending market<sup>1</sup> slid from 7.6% per annum on average in January 2019 to 6.2% per annum on average in December 2019. The dynamics of the one-day interbank rate followed the movement pattern of the Bank of Russia’s key rate. In this regard, from January to May, it remained at a stable level, which then gave way to a smooth decline until the end of the year. In general, over the course of 2019, the interbank interest rate did not go beyond the boundaries of the interest rate corridor established by the RF Central Bank, which indicates that the regulator has indeed achieved the operational objective of its monetary policy. The average deviation of the one-day MIACR rate from the key rate became significantly smaller (plunging from 3.8% in 2018 to

<sup>1</sup> The interbank rate is the average monthly MIACR index for interbank overnight ruble loans.

1.8% in 2019). The average annual MIACR rate for interbank overnight ruble loans increased from 7.1% per annum in 2018 to 7.2% per annum in 2019, due to the continuing relatively tight lending conditions over the period January-May 2019 (*Fig. 4*).



*Fig. 4.* The Bank of Russia interest rate band and the movement of interbank market interest rates in 2013–2019

*Source:* Bank of Russia; own calculations.

In 2019, broad money increased by 4.7%, to RUB 16,823.4 billion (in 2018, by 9.3% to RUB 16,063.4 billion). Among the fastest-growing components of broad money by the end of 2019, we can point out Bank of Russia bonds held by credit institutions and the correspondent accounts of credit institutions with the Bank of Russia, their volume having increased 41.0% to RUB 2,052.8 billion, and 38.3% to RUB 2,621.7 billion, respectively. The amount of required reserves increased by 7.3% to RUB 617.6 billion. Note that the growth of required reserves occurred in the main due to the Bank of Russia’s decision to raise required reserve ratios on liabilities to individuals in foreign currency for banks with a universal license, banks with a basic license and non-bank credit institutions by 1 percentage point to 8.00%, effective from 1 July 2019. Also note that this decision aimed at playing down the incentives for banks to increase their foreign currency liabilities. The amount of bank deposits with the Bank of Russia decreased by 46.0%, to RUB 1,766.6 billion. The volume of cash in circulation increased by 2.9%, to RUB 10,241.5 billion. Overall, the volume of excess reserves for 2019 increased by 9.8% and amounted to RUB 5,680.8 billion (*Table 3*).

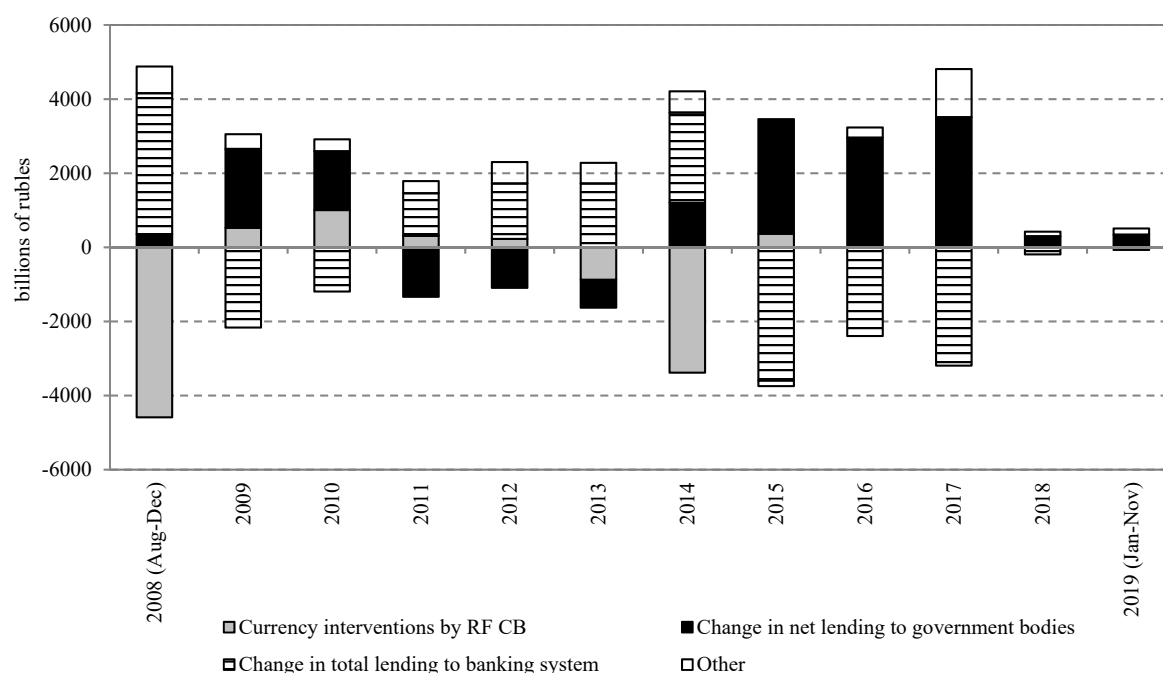
*Table 3*

**The broad money dynamics in 2019 (billions of rubles)**

	01.01.2018	01.01.2019	01.01.2020
Monetary base (broad)	14,701.5	16,063.4	16,823.4
- currency in circulation, including cash balances of credit institutions	9,539.0	10,312.5	10,616.1
- correspondent accounts of credit institutions with Bank of Russia	1,930.7	1,898.2	2,625.5
- required reserves	506.2	575.3	617.4
- deposits of credit institutions with Bank of Russia	2,373.2	1,903.5	1,027.7
- Bank of Russia bonds held by credit institutions	352.4	1,373.9	1,936.7
For reference: excess reserves	4,656.3	5,175.7	5,589.9

Source: Bank of Russia.

The structure of the money supply formation in 2019 is similar to its structure established in 2018 (Fig. 5). From January through November 2019, the most significant factors that shaped broad money were changes in the balances of the general government accounts with the RF Central Bank, as well as the Bank of Russia's liquidity provision/absorption operations with the banking sector. Thus, an increased money supply due to an increase in the net credit to government bodies (RF government deposits on accounts with the RF Central Bank less government bonds acquired by the Bank of Russia) over the period of January-November 2019 amounted to RUB 0.3 trillion, while as a result of a shrinkage in the net volume of liquidity provision (absorption) operations, the monetary base lost RUB 0.1 trillion. An analysis of the factors underlying the money supply formation points to neutrality of the foreign currency purchase operations in accordance with the fiscal rule established for monetary policy: the funds withdrawn by the RF Ministry of Finance in order to replenish the National Welfare Fund go back into the national economy as a result of currency purchases by the Bank of Russia.



*Fig. 5. The money supply formation factors*

Source: Bank of Russia.

The dynamics of foreign exchange reserves in 2019 was almost totally determined by the volume of Bank of Russia's foreign currency purchases for the RF Ministry of Finance in accordance with the fiscal rule. Since the beginning of 2019, the Bank of Russia has resumed its foreign currency purchases in the domestic foreign exchange market to the value of the surplus oil and gas revenues received whenever the actual price of oil jumped above USD 41.2 per barrel. In addition, in February 2019, the regulator began making deferred purchases, which increased the daily volume of foreign currency purchases by an average of USD 2.8 billion. In 2019, the regulator acquired RUB 3.5 trillion. In 2018, the volume of the RF Central Bank's foreign currency purchases in the domestic foreign exchange market was approximately RUB 2.1 trillion. Thus, as demonstrated by the year-end result for 2019, the value of the Bank of Russia's international reserve assets gained USD 85.9 billion (18.3%), and as of January 1, 2020, it amounted to USD 554.4 billion, thus hitting its record high of the period after the global financial crisis (*Fig. 6*). It should be reminded that the historic high was reached by the volume of international reserves in August 2008, and amounted to USD 596.6 billion. It should be noted that the index of monetary gold reserves for 2019 increased by USD 23.5 billion (27.0%), due in the main for its upward revaluation in response to the rising gold prices on world markets during certain months of 2019, to the value of USD 16.5 billion. As of January 1, 2020, the share of foreign exchange reserves in the total amount of reserve assets amounted to 80.1% (vs 81.5% in 2018), and the relative share of gold was 19.9% (vs 18.5% in 2018).

It should be remembered that the year 2018 saw some significant changes in the structure of foreign exchange reserves: the relative share of assets denominated in RMB soared from 2.8% to 14.2%, while that of assets denominated in USD plummeted from 45.8% to 22.7%. Later on, according to data for H1 2019, the new structure of foreign exchange reserves remained basically unchanged (USD 24.2%, RMB 13.2%). The shift in their structure was apparently caused by the need to minimize the potential geopolitical risks. However, as a result, the monetary authorities had to sacrifice their returns on investment denominated in US dollars, because over the period 2018–2019, in response to the problems faced by the Chinese economy, the yuan was losing in value relative to the US dollar. Meanwhile, in our opinion, the medium-term prospects for the US economy look better than those for the Chinese economy. Besides, US economic policies are more consistent and predictable, making US dollars the preferred asset for investing in international reserves.

At present, the volume of reserves is sufficient to maintain the sustainability of the RF balance of payments, because it covers 16 months of imports of goods and services into the Russian Federation (vs 16 months in 2018), as well as the interest on external debt due to be paid in 2020. In view of such a high level of sufficiency of international reserves, it is doubtful that the deferred purchases indeed need to be realized under the fiscal rule, given that these operations, being neutral with respect to money supply and interest rates, would exert an additional downward pressure on the ruble exchange rate. The weakening of the ruble, in its turn, can give rise to increased inflationary risks, as well as a slowdown in the industrial production growth rate across several sectors of the Russian economy that depend on imports of investment goods.

In 2019, the average monthly growth of M2 (compared with the corresponding period of last year) was 8.7% (vs 11.0% in 2018), and that of the monetary base was – 1.9% (vs 29% in 2018). As a result, the money multiplier (the ratio between M2 and the monetary base) amounted to 3.0 (vs 2.8 in 2018). The accelerated growth of M2 relative to the monetary base occurred in the main due to an increase in the corporate lending volume in a situation of softening loan



conditions, both in terms of loan price and otherwise. It is noteworthy that the achieved money multiplier index corresponds to its average value for developing economies (Ukraine, Belarus, Kazakhstan), while in the developed countries it is usually in a range of 5 to 8. It should also be noted that over the past 20 years in the countries of Eastern Europe, as their banking systems developed, the money multiplier was demonstrating an upward movement pattern. Thus, for example, in Poland over the period 1993–2019, the money multiplier increased from 3.1 to 5.1, while in Russia over the same period it increased from 1.4 to 3.0.

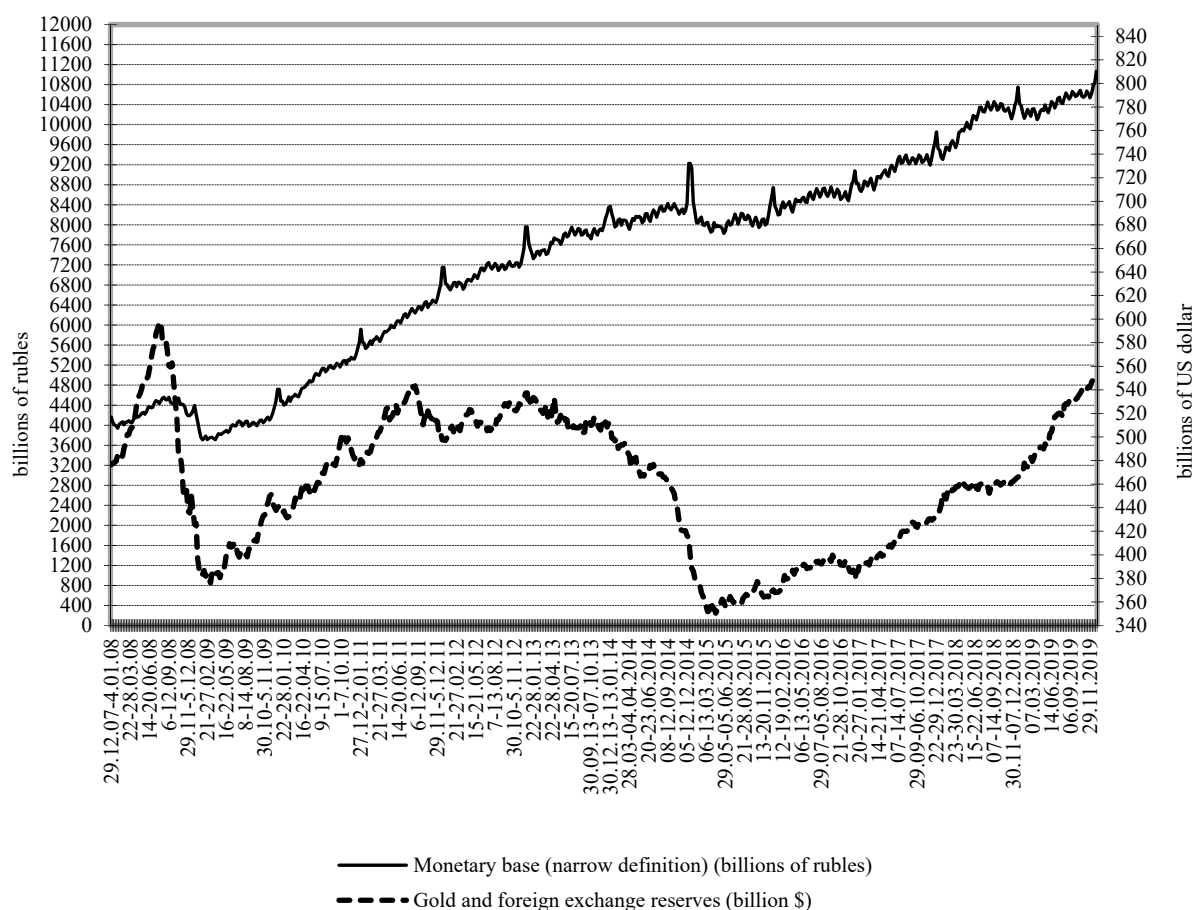


Fig. 6. The movement of the monetary base (narrow definition) and gold and foreign exchange (international) reserves in the Russian Federation, 2008-2019

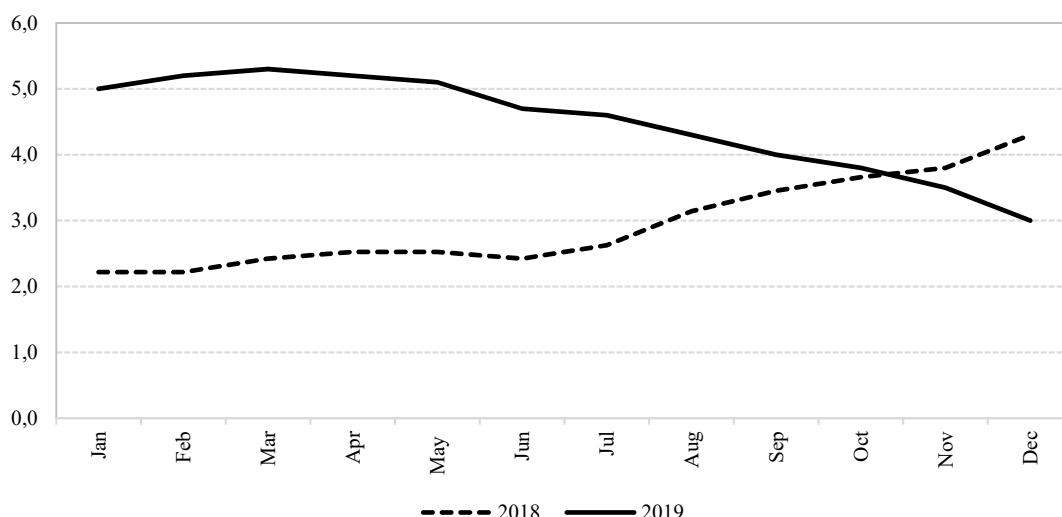
Source: Bank of Russia.

According to preliminary estimates, the level of monetization in the Russian economy (the ratio of M2 to GDP) over the period 1999–2019 jumped threefold to 47.3% in 2019, almost reaching the level of the countries of Central and Eastern Europe, which have been traditionally characterized by a higher monetization level. For example, in Poland, the ratio of M2 to GDP in Q3 2019 amounted to 69.0% (vs 40.2% in 1999). For reference, in Belarus the ratio of M2 to GDP over the same period (in Q3 2019) increased 2.1 times to 35.6%, in Kazakhstan 2.6 times to 35.9%, in Ukraine 1.9 times to 35.7%. In the developed countries, the index of monetization relative to GDP is even higher, due to a higher level of the financial system’s

development: for example, in the UK this indicator in Q3 2019 rose to 152.1%, and in Switzerland to 192.7%.

**2.1.3. Inflationary processes**

Having reached a local maximum in March 2019 (5.3%), over the period of April to December 2019 the growth rate of prices for consumer goods and services (relative to the previous 12 months) was continuously sliding. The acceleration of inflation at the beginning of 2019 was caused by the raise of VAT and the weakening of the ruble over H2 2018. Nevertheless, the proactive measures that the regulator was implementing in the fall and winter of 2018 coupled with the efforts to tighten monetary policy made it possible to minimize the upward inflation deviation from its target. Later on, a gradual decline in the rate of inflation was also facilitated by the slow growth of domestic demand in the context of a tight fiscal policy, the strengthening of the ruble, a good harvest, and a relatively stable situation in the global financial markets. At the end of 2019, annual inflation (relative to the previous 12 months) amounted to 3% (vs 4.3% at the end of 2018) (Fig. 7).



*Fig. 7. The CPI growth rate in 2018–2019 (% for the previous 12 months)*

Source: Rosstat; own calculations.

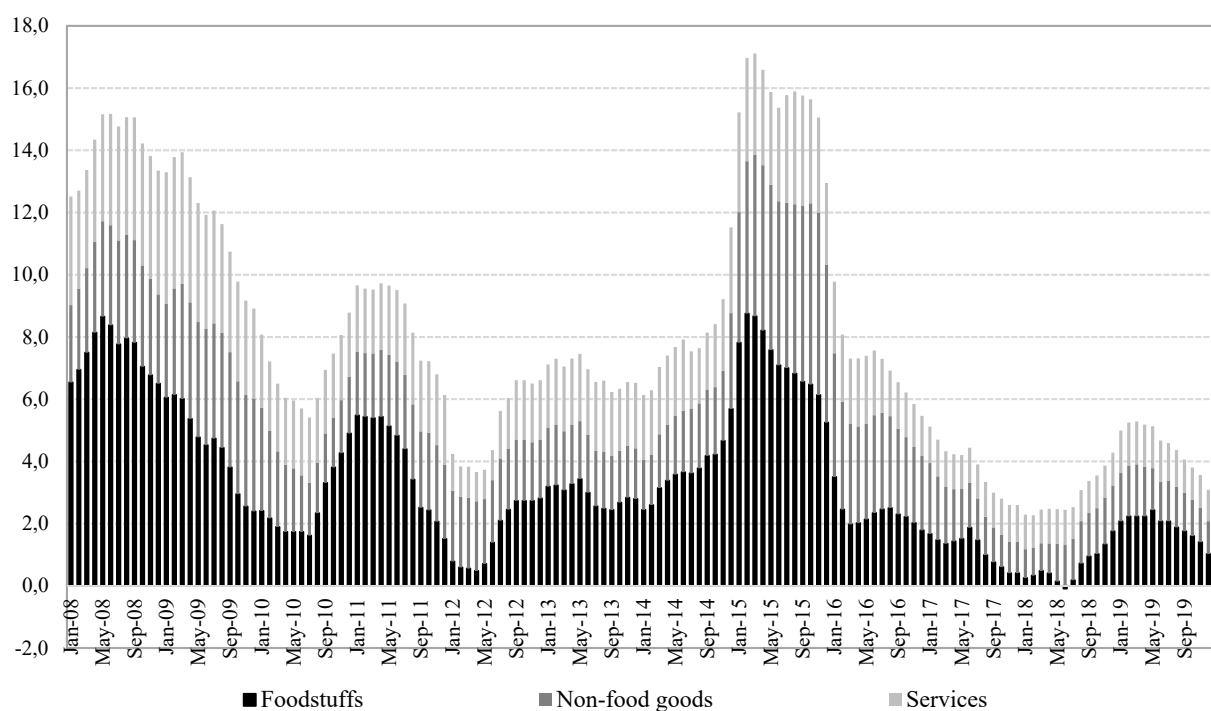
Food inflation accelerated from 4.7% in December 2018 to 6.4% in May 2019. Thereafter, along a slow growth of household incomes, the ruble strengthening, and a good harvest, the growth rate of food prices declined. Thus, in June-September 2019, deflation was observed in the food sector (-0.5% in June, -0.3% in July, -1% in August, -0.5% in September). It should be noted that such a long period of disinflation has been recorded for the first time since 2011. As a result, in December 2019, the growth rate of food prices in annual terms (relative to the previous 12 months) amounted to 2.6% (vs 4.7% in December 2018) (Figure 8).

Non-food inflation peaked in March (4.8% on March 2018), and then steadily declined to 3.0% in annual terms in December 2019 (vs 4.1% in December 2018). At the year end, the highest surge was demonstrated by the prices of tobacco products (11.0%), medicines (6.9%), and washing and cleaning products (4.9%).

A significant slowdown in the growth rate of gasoline prices from 9.4% (in December 2018 relative to December 2017) to 1.9% in December 2019 (in annual terms) occurred as a result of the agreement between the RF Government and a number of major oil companies, effective until July 1, 2019. It should be reminded that the surge of gasoline prices in April-June 2018 was associated with the high oil prices and the ruble's depreciation in April in response to the toughening of economic sanctions imposed on Russia.

According to the year-end results of 2019, paid services to the population rose by 3.8% (vs 3.9% in 2018). The leaders in price growth were passenger transport services (6.1%) and education services (5.6%).

Core inflation (cleared of seasonal and administrative factors), after a lengthy period of growth (throughout 2018 and the first 5 months of 2019), began to decline in June and reached 3.1% in annual terms in December 2019.



*Fig. 8.* The structure of inflation in 2008–2019 (% , month to the corresponding month of the previous year)

*Source:* Rosstat; own calculations.

The inflation slowdown was accompanied by a decrease in inflationary expectations. According to the InFOM survey results released by the Bank of Russia, the median one-year forward inflation expectation rate was 8.3% in November, down 2.1 percentage points on its year-beginning value (*Fig. 9*). In December 2019, inflationary expectations rose to 9%, but in January 2020 their index once again returned to the level of 8.3%. In general, inflationary expectations have remained quite high. However, given the adaptive nature of inflationary expectations, the observed slowdown in the current inflation index creates the conditions for their further decline.

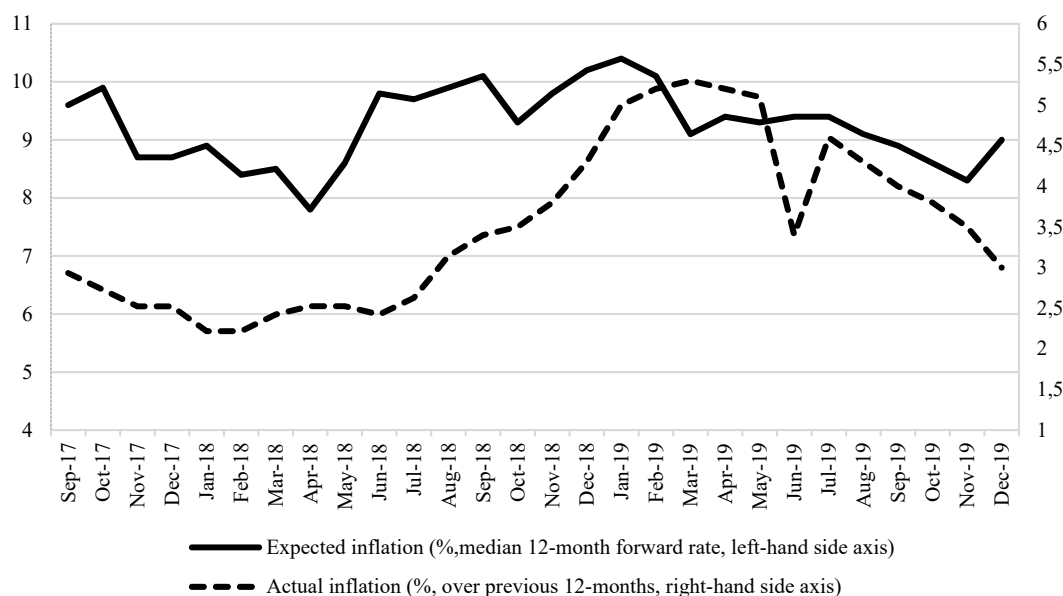


Fig. 9. Inflation and inflationary expectations

Source: Rosstat; Bank of Russia.

The movement pattern of real personal income continues to be the factor that harnesses inflation. In 2019, it gained 1.5% compared with 1.1% in 2018. At the same time, real personal income is still below its 2014 index. In 2019, the average growth rate of real wage amounted to 2.7% (vs 7.0% in 2018). Retail trade turnover is also growing at a slower rate: 1.6% in 2019 compared with 2.8% in 2018. The ruble strengthening against the US dollar, by 11% in 2019, has also contributed to a slowdown in the Consumer Price Index (CPI) growth. The temporary weakening of the ruble in August 2019 (by 4.9%), due to a plunge of oil prices coupled with capital outflows from emerging markets, did not significantly affect the CPI dynamics.

Table 4

**The annual growth rate of prices for certain types of consumer goods and services in 2017–2019 (% , December relative to December of previous year)**

	2017	2018	2019	2017–2019
1	2	3	4	5
<b>CPI</b>	<b>2.5</b>	<b>4.3</b>	<b>3.0</b>	<b>10.1</b>
<b>Foodstuffs</b>	<b>1.1</b>	<b>4.7</b>	<b>2.6</b>	<b>8.6</b>
Butter	9.6	3.6	10.0	24.9
Fish and seafood	3.8	3.7	5.2	13.2
Sunflower oil	-8.6	1.8	-2.9	-9.7
Milk and dairy products	5.2	2.9	6.1	14.9
Pasta	-0.7	1.4	5.7	6.4
Bread and Bakery	2.7	5.2	6.3	14.8
Alcoholic beverages	2.9	1.3	1.2	5.5
Fruits and vegetables	1.2	4.9	-2.0	4.0
Cereals and legumes	-1.3	1.2	15.2	1.4
Meat and poultry	-2.3	9.7	0.2	7.4
Eggs	-14.2	25.9	-5.0	2.6
<b>Non-food goods</b>	<b>2.8</b>	<b>4.1</b>	<b>3.0</b>	<b>10.2</b>
Gasoline	7.3	9.4	1.9	19.6
Tobacco products	8.6	10.1	11.0	32.7
Textiles	3.7	1.7	1.3	6.8
Washing and cleaning products	0.6	3.1	4.9	8.8

*Cont'd*

Footwear	4	1.9	1.2	7.2
Knitwear	3.3	2.5	2.4	8.4
Clothes and underwear	3	2.3	2.2	7.7
Pharmaceuticals	-3.4	4.6	6.9	8.0
<b>Services</b>	<b>4.4</b>	<b>3.9</b>	<b>3.8</b>	<b>12.6</b>
Preschool education services	5.2	3.8	3.8	13.3
Passenger transport services	6.8	4.3	6.1	18.2
Medical services	5	4.3	3.8	13.7
Education services	7.5	8.4	5.6	23.1
Housing and utilities	4.6	3.7	4.3	13.1
Communications	4.7	2.4	4.2	11.7

Source: Rosstat.

Let us compare the CPI growth rates in Russia and some other countries (*Table 5*).

*Table 5*

**The movement of CPI in some countries in 2017-2019,  
% per annum**

	2017	2018	2019	2017-2019
Azerbaijan	7.9	1.5	2.4	12.1
Armenia	2.6	1.8	0.7	5.2
Belarus	4.6	5.6	4.7	15.6
Kazakhstan	7.1	5.3	5.4	18.9
Kyrgyzstan	3.7	0.5	3.1	7.4
Moldova	7.3	0.9	7.5	16.4
<i>Russia</i>	2.5	4.3	3.0	10.1
Tajikistan	6.7	5.4	8.0	21.5
Ukraine	13.7	9.8	4.1	30.0
Germany	1.7	1.7	1.5	5.0
France	1.2	1.6	1.5	4.4
USA	2.1	1.9	2.3	6.4
Netherlands	1.3	2.0	2.7	6.1

Source: Interstate Statistical Committee of the CIS (<http://www.cisstat.com/>), OECD database (<http://stats.oecd.org/>).

Since 2017, Russia has reached a CPI growth rate comparable to that in the developed countries. In 2019, inflation in Russia amounted to 3.0%, while in the Netherlands it was 2.7%, and in the USA, 2.3%. Moreover, among the CIS members, Russia has been one of the countries with the lowest rates of inflation. According to the intermediate results for 2019, the highest CPI growth rates were typically observed in Tajikistan (8.0%) and Moldova (7.5%) (*Table 5*).

In 2019, the Producer Price Index (PPI) also demonstrated a significant decline, while deflation lasted for 7 months, which is a record of the entire observation period. The growth rate of PPI amounted to -4.3%, while in 2018 this indicator stood at 11.7%. A PPI plunge was noted in the Russian economy for the first time since 2008, when the PPI growth rate amounted to -7%. Moreover, in 2008, deflation lasted for only 4 months. The slowdown in PPI growth in 2019 will continue to exert a downward pressure on the CPI dynamics in 2020.

Thus, the Bank of Russia' policy of high interest rates and their slow decline, designed to curb inflation after its surge in 2015 (12.9%), proved to be successful. Over the past 3 years, inflation in Russia stayed either below its target or slightly above it. The temporary tightening of the monetary policy in 2018 helped minimize the risks of an accelerated inflation in 2019. However, long-term hovering of the real interest rate in positive zone is fraught with the risks of an economic growth slowdown. In addition, economic growth in 2019 was sustained by the implementation of national projects, which turned out to be slower than expected, and a tight fiscal policy imposed an additionally constraints on aggregate demand.

In the context of external shocks in 2020, the key objective of monetary policy is to ensure financial stability and keep inflation close to the target level, as well as to prevent a significant increase in inflationary and devaluation expectations of economic agents.

#### 2.1.4. The balance of payments and the ruble exchange rate

According to the preliminary balance of payments estimates for 2019 released by the Bank of Russia, the current account balance amounted to USD 70.6 billion, which is 38% (or USD 42.9 billion) less than the corresponding figure for 2018.<sup>1</sup>

The goods trade balance amounted to USD 163.1 billion, which is 16% less (USD 31 billion) than in 2018 (USD 194.4 billion) (*Fig. 9*). A decisive role in this decline was played by a shrinkage of exports by 5.7% (by USD 25 billion) from USD 443.1 billion in 2018 to USD 417.9 billion in 2019.<sup>2</sup> This decline is primarily due to the downward movement of the average annual export prices of oil, petroleum products, natural gas, and Russia's other main exports (*Table 6*) with a stable supply volume (*Fig. 11*). One exception was liquefied natural gas, whose export price plunge by more than 12% was accompanied by a 75% increase in its physical supply volume, due to Yamal-LNG's capacities, which translated into a 58% increase in its deliveries abroad, from USD 5.3 billion to USD 8.4 billion.

The goods trade balance shrinkage, in addition to the downfall of export prices, was also contributed to by an increase in imports of 2.5% (USD 6 billion), from USD 248.7 billion in 2018 to USD 254.8 billion in 2019, which can be explained by the ruble's strengthening: according to the Bank of Russia, in 2019 the real effective exchange rate of the ruble against foreign currencies gained 2.5% on 2018.<sup>3</sup>

There was also a shrinkage in the balance of trade in services, which amounted to USD -34.8 billion in 2019, compared with USD -29.9 billion in 2018, i.e. the year-end negative balance increased by 16.4%. At the same time, service exports fell insignificantly, by 1.5% (or by USD 1 billion in absolute terms, from USD 64.6 billion to USD 63.6 billion), while service imports rose significantly, by 3.9%, from USD 94.6 billion to USD 98.3 billion.

*Table 6*

#### **The movement of prices for Russia's main exports, in 2019 relative to 2018**

Goods group	Share of in total exports, %	Average export price, USD/t		Price increase, %
		2019	2018	
1	2	3	4	5
Crude oil	28.6	454	496	-8.5
Petroleum products	15.8	468	520	-10.0
Natural gas*	9.8	189	223	-15.0
Ferrous metals	4.3	446	503	-11.2
Coal	3.8	78	85	-8.8
Mineral fertilizers	2.0	243	241	+0.5
Natural gas, liquefied **	1.9	121	144	-15.8
Wheat and meslin	1.5	201	192	+4.8
Aluminum	1.1	1,696	1,727	-1.8

<sup>1</sup> See Bozhechkova A., Knobel, A., Trunin, P. Russia's balance of payments 2018: current account balance hits highest // Russian Economic Developments. 2019. Vol. 26. No 2. P. 3–7.

<sup>2</sup> The data on exports and imports in this section, and in the section of the overview on foreign trade, differ slightly, due to the use of different sources of information. The data on the shrinkage of exports were extracted from the balance of payments of the RF Central Bank.

<sup>3</sup> On the effect of exchange rate dynamics on trade, see Knobel A., Firanchuk A. Foreign Trade of Russia in January–August–August 2017 // Russian Economic Developments. 2017. Vol. 24. No 11. P. 12–18.

Cont'd

	1	2	3	4	5
Timber		1.1	227	234	-2.8
Copper		1.0	5,892	6,327	-6.9
Fish, fresh and frozen		0.7	1,830	1,794	+2.0
Vegetable oil		0.5	712	762	-6.5
Nickel		0.4	13,712	12,821	+6.9

\* price in USD/m<sup>3</sup>

\*\* price in USD/thousands of m<sup>3</sup>

Source: Federal Tax Service; own calculations.

In 2019, the balance of investment income and the balance of wages both changed very significantly. The former declined by USD 5.9 billion (from USD -38.6 billion to USD -44.5 billion), due in the main to an increase of USD 5.8 billion in incomes payable (investment income repatriation), while incomes receivable remained unchanged; and the latter lost USD 0.3 billion (from USD -3.0 billion to USD -3.3 billion).

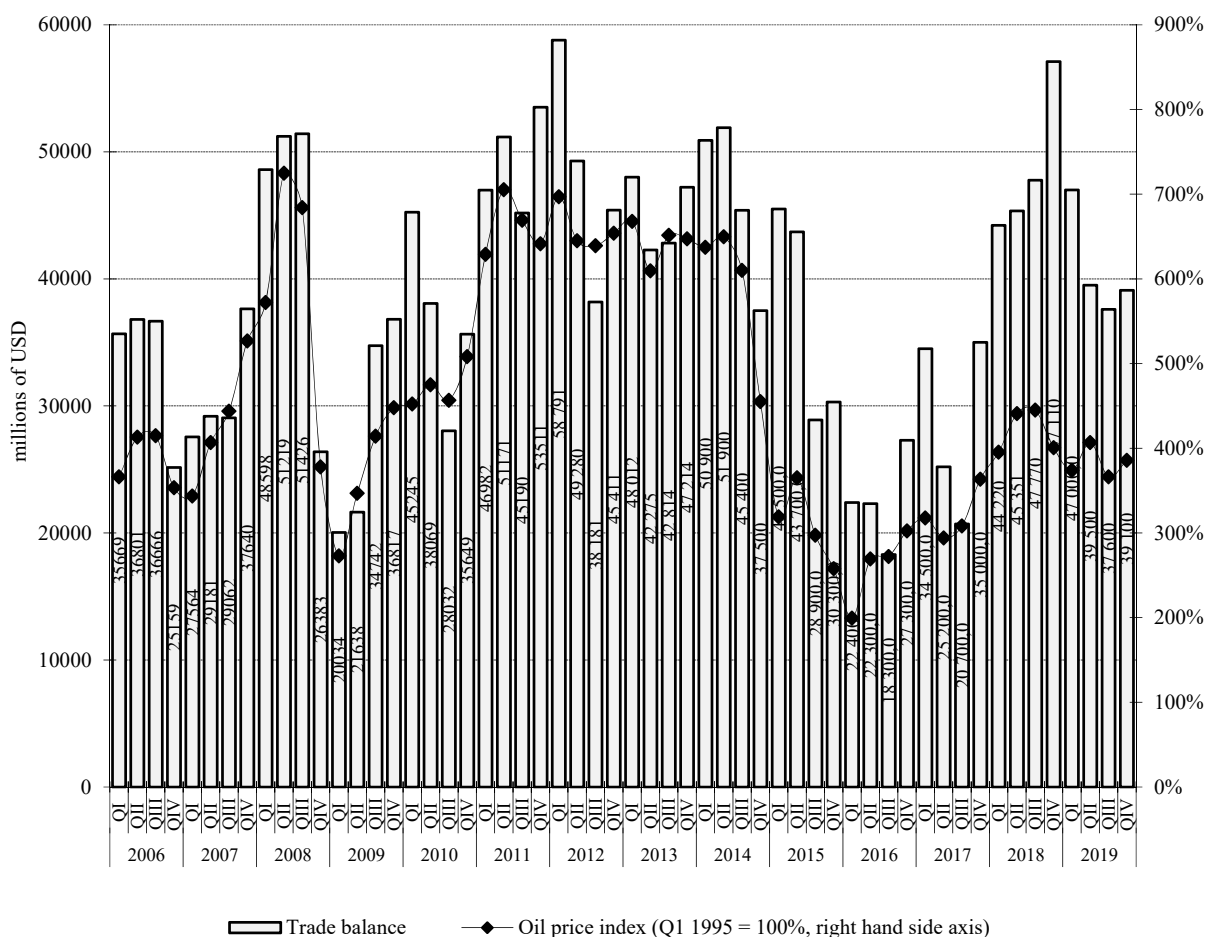


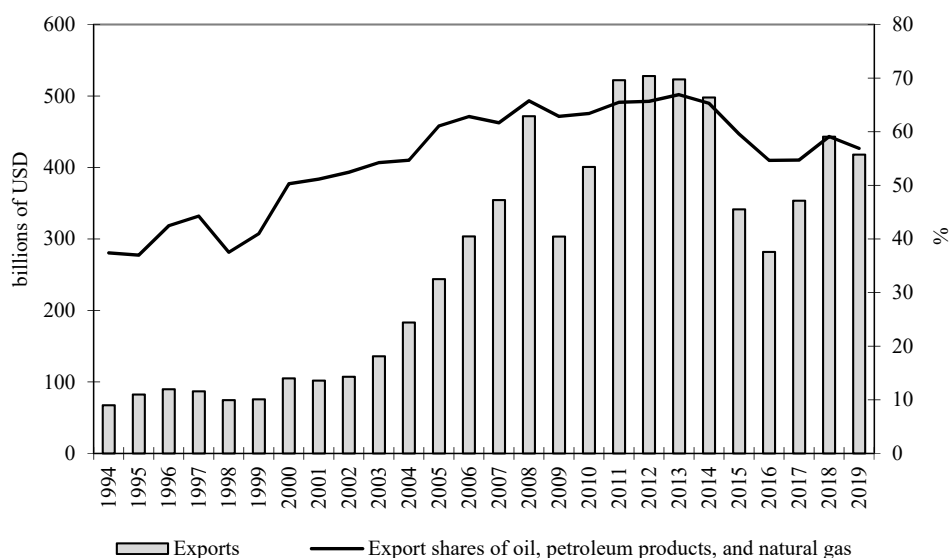
Fig. 10. Trade balance and the movement of oil prices

Source: Bank of Russia; IMF.

A significant reduction in the current account balance was in part offset by a financial account surplus, which in 2019 amounted to USD 1.8 billion, compared with a deficit of USD

76.5 billion in 2018. The net capital inflow was secured by an increase in financial liabilities by USD 28.3 billion by the year-end of 2019 (in 2018, financial liabilities lost USD 36.7 billion) coupled with a smaller increase in financial assets compared with 2018 (USD 26.5 billion in 2019 vs USD 39.8 billion in 2018).

In 2019, growth of foreign liabilities occurred in the main due to the operations in the non-banking sector (USD 25.7 billion in 2019 vs -4.2 billion in 2018) and those conducted by federal administration bodies (USD 22.0 billion in 2019 vs USD -5.5 billion in 2018). By contrast, the banking sector over the same period reduced its foreign liabilities: USD -20.1 billion in 2019 vs USD -25.0 billion in 2018.



*Fig. 11.* The movement of goods exports and the export shares of products of the fuel and energy complex, 1994–2019

Source: Bank of Russia.

The growth of financial assets of Russian residents abroad occurred predominantly due to operations in the non-banking sector. Thus, in 2019, the foreign assets in the other sectors grew by USD 25.7 billion (in 2018, their growth amounted to USD 30.8 billion), while those held by banks gained USD 1.7 billion (vs USD 7.6 billion in 2018). The amount of foreign assets held by government administration bodies shrank by USD 0.9 billion (vs an increase by USD 1.4 billion in 2018).

In 2019, the volume of foreign direct investment inflow in the non-banking sector (USD 26.9 billion vs USD 5.9 billion in 2018) was almost completely offset by its outflow (USD 26.3 billion vs USD 29.6 billion in 2018). There was a decrease in the inflow of portfolio investment into Russia’s non-banking sector in 2019 (by USD 3.2 billion vs USD 0.7 billion in 2018), which took place alongside a growth in portfolio investment outflow (by USD 2.1 billion vs USD 1.4 billion in 2018). The other liabilities of the non-banking sector increased by USD 1.9 billion (vs USD 1.3 billion in 2018), while the other assets increased by USD 3.5 billion (vs USD 10.1 billion in 2018).

As a result, net capital outflow from the private sector in 2019 fell sharply, to USD 26.7 billion (vs USD 63.0 billion in 2018) (*Fig. 12*). At the same time, in 2019, net capital



outflow from the banking sector was USD 21.8 billion (vs USD 32.6 billion in 2018). In the non-banking sector, net capital outflow plunged even deeper, to USD 4.9 billion (vs USD 30.4 billion in 2018).

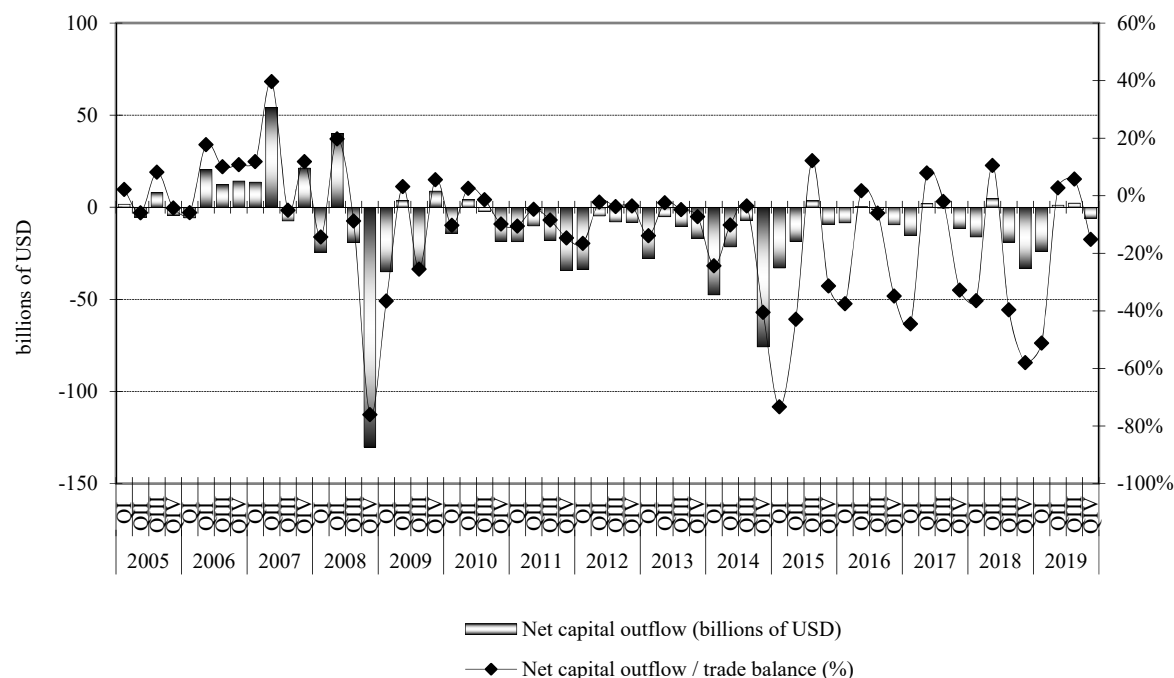


Fig. 12. Net capital outflow from the private sector in 2005–2019

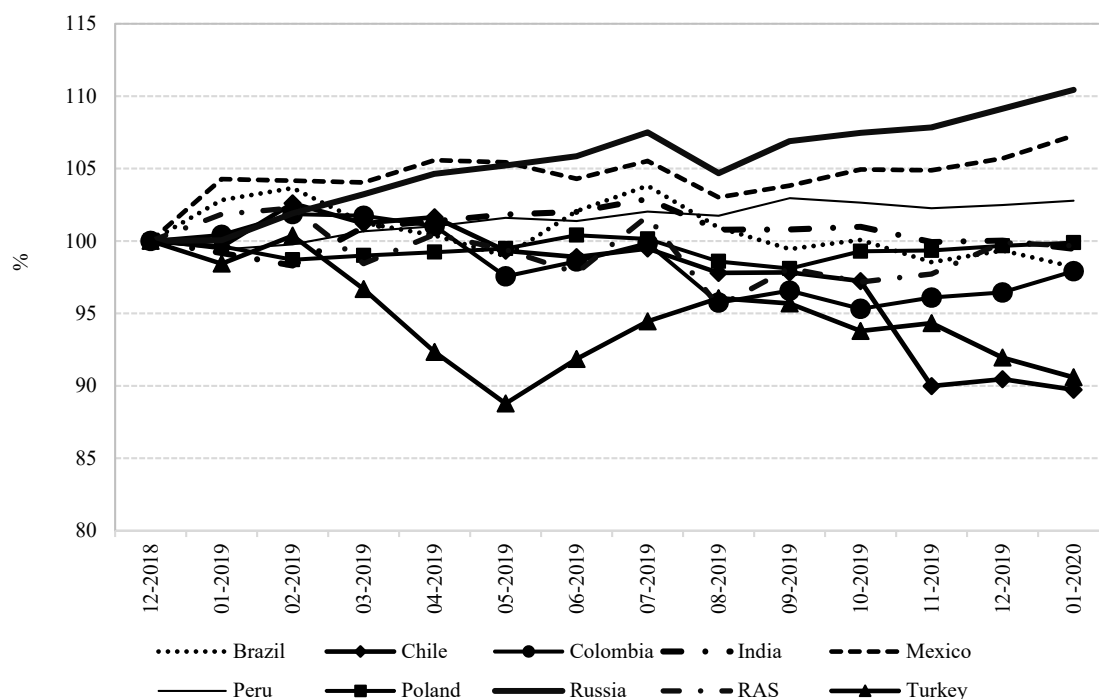
Source: Bank of Russia; own calculations.

The international reserve assets over the course of 2019 gained USD 66.5 billion (vs USD 38.2 billion in 2018), thus amounting to USD 554.4 billion at the year-end – as noted earlier, this is their record high after the global financial crisis. It should be reminded that the previous record high of the international reserves index had been reached in August 2008 and amounted to USD 596.6 billion. The movement pattern of international reserves in 2019 was primarily shaped by the purchase in the domestic forex market, by the RF Ministry of Finance implementing the fiscal rule, of foreign currencies to the total value of RUB 3.5 trillion (vs RUB 2.1 trillion in 2018). The increased amount of foreign currencies purchased in the domestic forex market under the fiscal rule in 2019 can be explained by the fact that the Bank of Russia carried out not only its planned but also deferred purchases, caused by their suspension in August–December 2018.

As a result of the fiscal rule, the ruble exchange rate has become less dependent on oil prices, and is now being determined to a higher degree by capital flows. Therefore, due to an improved situation with capital inflows into the Russian Federation, in 2019 the ruble climbed 10.9% against the US dollar, to 61.9 per USD. The capital inflow into the Russian economy was facilitated by the fact that the US Federal Reserve and the ECB resorted to monetary policy easing, as well as by the positive rhetoric of trade negotiations between the USA and China since September 2019.

It should be noted that in 2019, the ruble gained more in nominal terms than the national currencies of the other developing countries where inflation is targeted. Thus, in 2019, while in Peru and Mexico the increase of the national currency's nominal effective exchange rate amounted to 2.8% and 7.3%, respectively, Russia's national currency strengthened by 10.4% (*Fig. 13*). At the same time, the national currencies of many other developing countries were weakening (-9.4% for the Turkish lira, -2.1% for the Colombian peso, -1.8% for the Brazilian real). The ruble's strengthening can be explained by the high attractiveness of the Russian OFZ market in the context of high interest rate differentials between the Russian economy and the economies of developed countries, in absence of tougher sanctions. Thus, the share of non-residents in the Russian OFZ market in 2019 increased from 24.4% to 32.2%.

In 2019, the foreign debt of the Russian Federation increased by USD 26.8 billion, amounting to USD 481.5 billion as of January 1, 2020. The foreign debt of government administration bodies grew by 58.0%, to USD 69.5 billion, as a result of foreign capital inflow into the Russian OFZ market. The foreign debt of banks and enterprises remained practically unchanged at the level of USD 399.1 billion.



*Fig. 13.* The movement of nominal effective exchange rates of national currencies in the developing countries targeting inflation (December 2018 = 100%)

Source: BIS; own calculations.

Our year-end estimate of capital flight for 2019 (*Fig. 14*), which amounted to USD 7.9 billion for 2018, now shrank to USD 6.3 billion,<sup>1</sup> reflecting the success of Russia's authorities in blocking illegal channels of capital flight.

<sup>1</sup> Capital flight is calculated according to the IMF methodology; it is the sum of 'trade loans and advance payments', 'questionable deals', and 'net errors and omissions'.

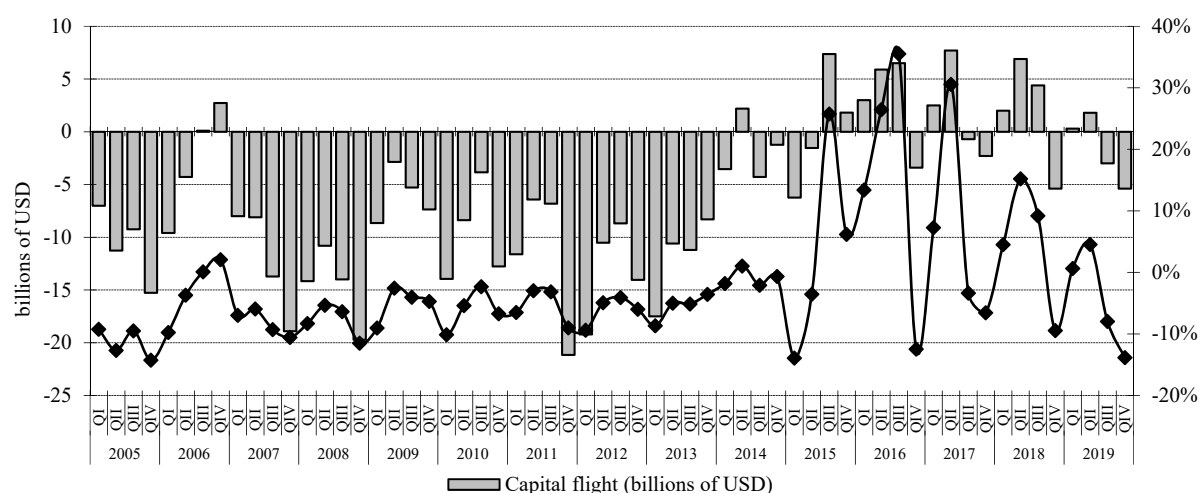


Fig. 14. Capital flight dynamics in 2005–2019.

Source: Bank of Russia; own calculations.

In 2020, in the context of a large-scale fall in oil prices and the weakening of the ruble, the current account will be significantly reduced. At the same time, the negative balance of the financial account is unlikely to reach the values of previous crises (in 2014 it was -130 billion dollars, in 2008 -140 billion dollars), given that the external debt of Russian economic agents has significantly decreased, which reduces the demand for currency for its refinancing. At the same time, the Bank of Russia, within the framework of the budget rule and the sale of a controlling stake in Sberbank to the government, will sell foreign currency, which will help stabilize the ruble exchange rate.

According to our estimates, the fundamental exchange rate of the ruble to the dollar at the price of oil is 30-35 dollars per barrel. it is 74-76 rubles / USD, and at 45-50 dollars / bbl - about 70 rubles/USD. Accordingly, monetary policy measures should be aimed at preventing significant exchange rate deviations from these levels due to the development of panic, since in the event of a sharp weakening of the ruble, the foreign exchange market may stabilize on a much weaker ruble, which will cause a strong deviation of inflation from the target level, a re-evaluation of country risks and large-scale capital outflow.

## 2.2. Fiscal policy<sup>1</sup>

### 2.2.1. Characteristics of budgets of the budgetary system of Russia

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

In 2019, revenues of the budgetary system of Russia according to the fresher data released by the Ministry of Finance of Russia in shares of GDP against the previous year remained flat

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amounting to 35.8 percent of GDP (*Table 7*), meanwhile in absolute terms they have increased by RUB 1,860 billion. Solely 39.4 percent of the revenues increment of the enlarged government budget (RUB 732.8 billion) have been secured by the federal budget and 62.4 percent (RUB 1,160.8 billion) by the increment of the consolidated budget of the RF subjects receipts. However, in the overall volume of the revenue part of the enlarged government budget a share of federal and subnational levels budget in 2019 against 2018 has changed insignificantly: a share of the federal budget has contracted from 52.1 to 51.5 percent and a share of the consolidated budget of the RF subjects has gone up from 33.2 to 34.6 percent.

Dynamics of oil and gas revenues of the enlarged government budget is negative: contraction of receipts in 2019 in comparison with the previous year constituted 1.1 percentage points of GDP or RUB 770 billion, meanwhile non-oil and gas revenues went up in 2019 to the maximum for the 5-year period level coming to 28.3 percent of GDP up by 1.1 percentage points of GDP against the previous year.

*Table 7*

**The main parameters of the enlarged government budget in 2015–2019**

	2015		2016		2017		2018		2019*		Dev in 2019 relative to 2018
	RUB bn	% of GDP	RUB bn	% of GDP	RUB bn	% of GDP	RUB bn	% of GDP	RUB bn	% of GDP	pp. of GDP
<b>Revenue including:</b>	26 922	32.3	28 181	32.8	31 047	33.7	37 320	35.8	39 180	35.8	0.0
- oil and gas	5 863	7.0	4 844	5.6	5 972	6.5	9 018	8.6	8 248	7.5	-1.1
- non-oil and gas	21 059	25.3	23 337	27.2	25 075	27.2	28 302	27.2	30 932	28.3	1.1
<b>Outlays</b>	29 741	35.7	31 324	36.4	32 396	35.2	34 285	32.8	37 115	33.9	1.1
<b>Deficit (-) / surplus (+)</b>	-2 819	-3.4	-3 143	-3.6	-1 349	-1.5	3 035	3.0	2 065	1.9	-1.1
For reference: GDP, RUB billion	83 087		85 616		91 843		104 335		109 361**		

\* Hereinafter data for 2019 is preliminary – formed on the basis of the progress report released by the Federal treasury on the execution of budgets as of January 1, 2020.

\*\* Estimate GDP.

Sources: Ministry of Finance of Russia, Federal treasury, Rosstat.

Expenditures of the budgetary system of Russia after 3-year downturn from 36.4 percent of GDP in 2016 to 32.8 percent of GDP in 2018) moved up to 34.0 percent of GDP in 2019, which was predominantly due to allocation of additional funds for the implementation of national projects.

The budget surplus of the enlarged government for January-December 2019 amounted to 1.9 percent of GDP down 1.1 percentage points of GDP in 2018.

***The main tax returns in the budgetary system of Russia***

According to 2019 figures, fiscal revenues of the enlarged government budget moved up (*Table 8*) moreover the growth was reported across the majority of revenue items.

The highest growth of returns was from VAT (up by 0.7 percentage points of GDP or up by 14 percent in 2018 prices). Receipts from the profits tax up by 0.3 percent of GDP or up by 7 percent in 2018 prices. Insurance contributions and PIT moved up insignificantly (up 0.1 percentage points of GDP or up by 3–4 percent in 2018 prices).

Russia; *Tischenko T.V.*, candidate of science (economics), senior researcher, Budget Policy Studies Department, IAES, RANEPA.

Returns from excises have decreased (down 0.3 percentage points of GDP or down 17 percent in 2018 prices), from MET (down 0.4 percentage points of GDP or down 4 percent in 2018 prices), from customs duties and levies (down 0.2 percentage points of GDP or down 4 percent in 2018 prices).

Table 8

**The main tax returns in the enlarged government budget of the Russian Federation in 2015–2019, in percent of GDP**

	2015	2016	2017	2018	2019	Dev in 2019 relative to 2018 pp. of GDP	Growth in 2019 in prices of 2018 relative to 2018, in %
Revenue* (total) including:	32.0	32.0	32.6	35.3	35.2	-0.1	2
Corporate income tax	3.1	3.2	3.6	3.9	4.2	0.3	7
PIT	3.4	3.5	3.5	3.5	3.6	0.1	3
Insurance contributions*	6.4	6.6	6.7	6.6	6.7	0.1	4
VAT	5.1	5.3	5.6	5.8	6.5	0.7	14
Excises	1.3	1.6	1.7	1.5	1.2	-0.3	-17
MET	3.9	3.4	4.5	5.9	5.5	-0.4	-4
Customs duties and levies	3.3	2.4	2.1	2.9	2.7	-0.2	-4

\* Revenue (total) and insurance contributions without double count of insurance contributions for the non-working population, total value of receipts differ from the official one by given value.

Sources: Federal Treasury, Rosstat, own calculations.

**Oil and gas revenues.** The MET-oil base rate remained in place in the amount of RUB 919 per ton as it was in 2018. Dynamics of returns from MET was determined by USD exchange rate and the oil price. USD/RUB rate demonstrated a downward trend (*Fig. 15*) The price of a ton of crude on average in 2019 was down 5–6 USD than in 2018. As a result, actual ruble rate on MET-oil constituted in 2019 on average over 11,000 RUB/t, meanwhile a year earlier it was above 12,000 RUB/t.

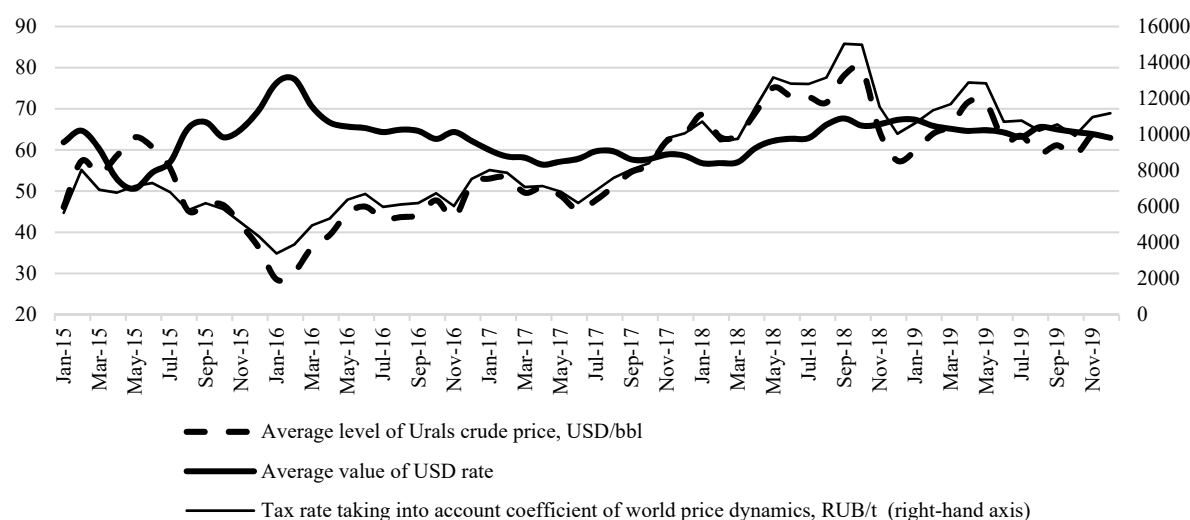


Fig. 15. Dynamics of actual MET-oil rate, Urals price and USD rate in 2015–2019

Sources: Rosstat, CB of RF, FCS of Russia, FTS of Russia.

**Corporate income tax.** In 2019, returns from the corporate income tax demonstrated an upward trend (up by 0.3 percentage points of GDP). As can be seen on *Fig. 16* the profit-making companies demonstrated income growth and somewhat contracted the proportion of loss-

making enterprises. This confirms that the restriction in place from 2017 regarding provision for losses carryforward accrued over the previous periods to the tune of not more than 50 percent of the taxable income continues to exert positive fiscal effect.

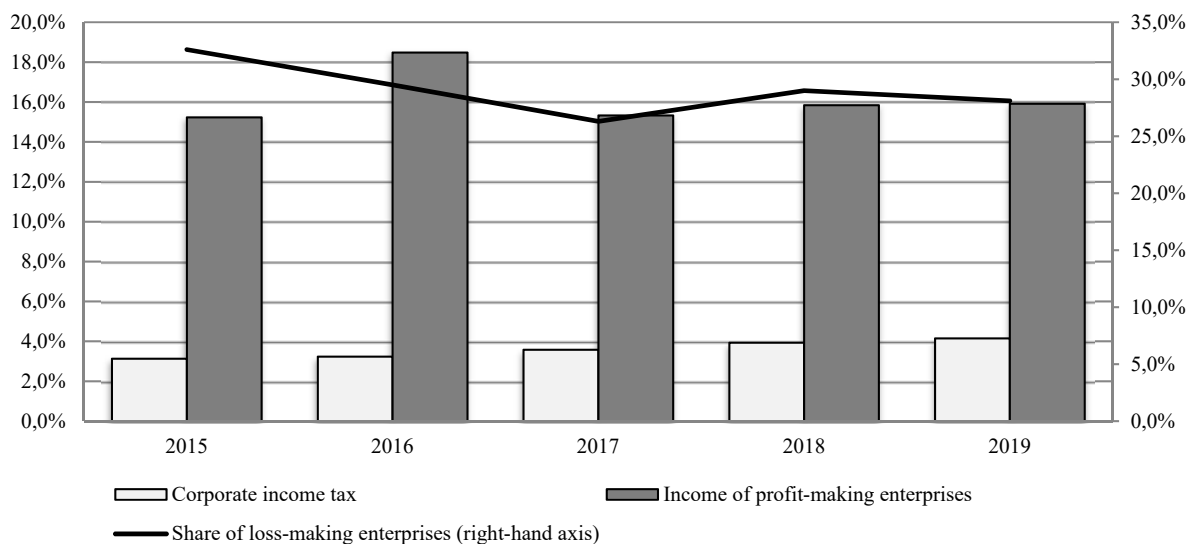


Fig. 16. Dynamics of returns from the corporate income tax to the budgetary system of the Russian Federation, income of profit-making enterprises (percent of GDP), share of loss-making enterprises in percent in 2015–2019

Sources: Federal Customs Service, Rosstat, own calculations.

**Insurance contributions and PIT.** In 2019, In 2018, there were no legislative changes in the rates or estimation of base of insurance contributions. According to advance data, the payroll fund on accrued wage relative GDP increased, which resulted in growing receipts from insurance contributions and PIT in shares of GDP (Fig. 17).

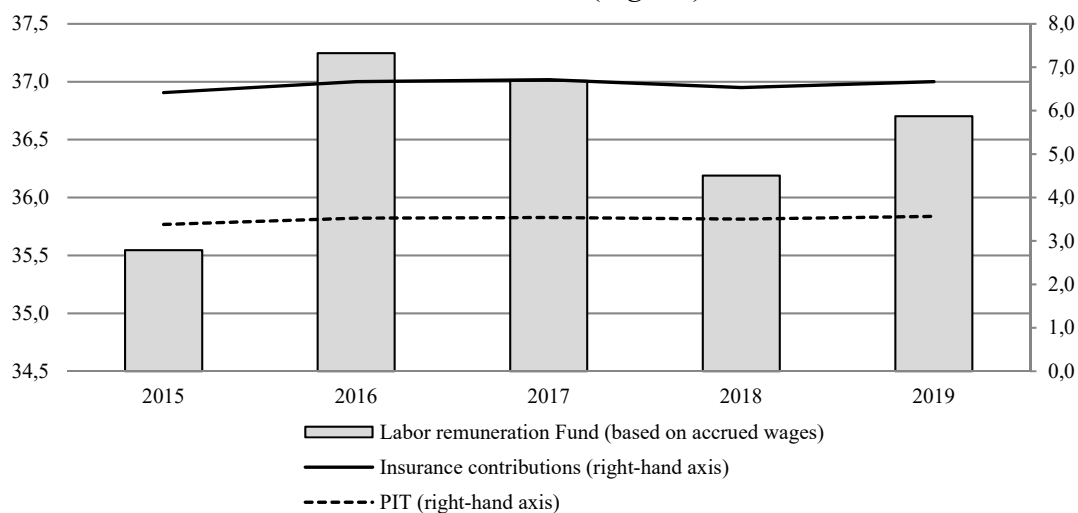


Fig. 17. Receipts from insurance contributions, PIT, and payroll fund (on accrued wages) in 2015–2019, in percent of GDP

Sources: Rosstat, Federal Treasury, own calculations.

VAT. Returns from VAT in 2019 rose by 0.7 percentage points hitting 6.5 percent of GDP, which was mainly due to growth of the VAT base rate from 18 to 20 percent (*Table 9*).

Moreover, on the back of the ruble appreciation imports have grown which has also contributed to the increase of returns from VAT on imported goods (such returns have gone up by 0.3 percentage points of GDP). It should be noted that despite the raise of the VAT base rate there was no decrease in its collection in 2019.

*Table 9*

**Dynamics of VAT returns in the budgetary system of the Russian Federation,  
percent of GDP**

	2015	2016	2017	2018	2019
Revenue generated by VAT	5.1	5.3	5.6	5.8	6.5
Including:					
VAT on goods sold on the RF territory	2.9	3.1	3.3	3.5	3.9
Vat on goods imported to the RF territory	2.1	2.2	2.3	2.3	2.6
Effective VAT rate, percent	7.3	7.4	7.9	8.7	10.0
Fiscal performance coefficient (C-efficiency), percent	40.4	41.4	43.8	48.2	49.9

*Sources:* Rosstat, Federal Treasury, own calculations.

**Excises.** In 2019, the main reason for the decrease of budget receipts from excises by 0.3 percentage points of GDP was the introduction of a “reverse excise, envisaged within the implementation of the tax maneuver in the oil and gas sector, which was aimed at the control over the price growth on fuel (on the back of the increase of the MET base rates) by way of actual subsidizing of the refining sector via the reduction of excise tax on petroleum products on condition of meeting certain conditions.

Returns from other excisable goods have barely changed relative to the previous year level.

***Outlays of the budgetary system of the Russian Federation***

According to advance data the budget system expenditure increased in 2019 by 1.1 percentage points of GDP in comparison with 2018.

For the implementation of defined in the May Executive Order of the President of Russia<sup>1</sup> national goals, the twelve national projects and complex plan of modernization of infrastructure have been outlined. Their specific features are the Intersectoral character and rather high proportion of investment spending. The launch of the national projects required the development of a rather large list of normative documents, and establish cooperation with the regions. As can be seen from *Table 10*, the cash execution of spending on the implementation of the national projects from the consolidated budget of the Russian Federation during 2019 according to current data constituted around 91.6 percent. A little more than RUB 200 billion remained unspent besides three quarters account for the federal budget.

The best indicators of budget discipline regarding the national projects implementation have been shown by Science (99.1 percent) and Healthcare (97.3 percent). The worst indicators have been shown by Ecology (71.2 percent) and Digital economy (75.1 percent). Undoubtedly, the cash execution should not become a goal in itself because the effectiveness of the national projects implementation is marked by delivery of results and indicators, whether life conditions of the citizens and business environment change for the better. It is also obvious that without timely financing is rather hard to deliver any positive results.

<sup>1</sup> Executive Order of the President of the Russian Federation of May 7, 2018 No. 204 “On National Goals and Strategic Tasks of the Russian Federation for the Period through 2024”.

Table 10

**Data of the execution of the expenditure regarding budget appropriations envisaged for the implementation of national projects during 2019 (current data)**

No.	National projects	Consolidated budget of Russia, RUB billion		
		Plan	Cash execution (current data)	Reference: percent of budget appropriations
	<b>Total</b>	<b>2 444.2</b>	<b>2 238.5</b>	<b>91.6</b>
1	Demography	728.4	693.7	95.2
2	Healthcare	219.7	213.7.2	97.3
3	Education	194.2	175.6	90.4
4	Housing and urban environment	243.2	217.0	89.2
5	Ecology	69.1	49.2	71.2
6	Safe and quality roads	297.5	283.4	95.3
7	Productivity and employment support	7.6	6.6	87.3
8	Science	38.0	37.7	99.1
9	Digital economy	111.2	83.5	75.1
10	Culture	26.2	25.3	96.3
11	Small and medium-sized enterprises and support of individual entrepreneurship	68.4	64.0	93.6
12	International cooperation and exports	91.3	81.7	89.5
13	Complex plan of modernization of infrastructure	349.4	307.1	87.9

Sources: Federal treasury, own calculations.

Among the main reasons for a relatively low cash execution of expenditures on national projects are the following:

- Novelty of a number of measures envisaged within national projects, which in its turn, involves the need to develop and adopt corresponding normative and guidance documents prior to disbursement of funds;
- Sectoral specifics of the projects when dynamics of the cash execution directly depends on the demand from the part of recipients of budget support (for example, in case of requests of SME for privileged loans);
- Features of financing certain steps regarding national projects, for example, payment from budget funds only upon completion of works (which is prevailing at construction projects). However, in this case the cash execution reflects the actual dynamics of delivering project results;
- Unnecessary extended effective in 2019 procedures both in case of procurements for state and municipal needs and within preparation of necessary documents (for example, rule for the provision of intergovernmental fiscal transfers, subsidies to legal entities).

It should also be noted that the Federal Law of November 12, 2019 No. 367-FZ “On the Suspension of Certain Provisions of the Budget Code of the Russian Federation and Establishment of Specifics for the execution of the Budget Code in 2020” envisages transfer of unused in 2019 balance of budget appropriations of the federal budget to 2020 for the same purposes. Such decisions can be adopted by the Council under the President of the Russian Federation on strategic development and national projects, meanwhile reasons for incomplete disbursement of budget funds and the need of their use must be explained.

Functional breakdown of expenditure reported insignificant growth of industrial items of the enlarged government budget (*Table 11*). For example, spending grew on the items “Healthcare” by 0.2 percentage points of GDP and on “Education” – by 0.3 percentage points of GDP. The breakdown of the enlarged government budget demonstrates an upward trend regarding industrial spending on the back of national projects, which strengthens positive influence of the fiscal policy on economic growth.



*Table 11*

**Expenditure of the enlarged government budget in 2015–2019, percent of GDP**

	2015	2016	2017	2018	2019	Dev. in 2019 relative to 2018, pp. of GDP
<b>Outlays, total</b>	<b>35.7</b>	<b>36.4</b>	<b>35.2</b>	<b>32.8</b>	<b>33.9</b>	<b>1.1</b>
General state issues	2.2	2.2	2.1	2.0	2.0	0.0
National defense	3.8	4.4	3.1	2.7	2.7	0.0
National security and law enforcement activities	2.5	2.3	2.2	2.0	2.0	0.0
National economy	4.5	4.5	4.7	4.3	4.6	0.3
Housing and utility sector	1.2	1.2	1.3	1.3	1.3	0.0
Environmental conservation	0.1	0.1	0.1	0.1	0.2	0.1
Education	3.6	3.6	3.5	3.5	3.8	0.3
Culture, cinematography	0.5	0.5	0.5	0.5	0.5	0.0
Healthcare	3.4	3.6	3.1	3.2	3.4	0.2
Social policy	12.6	12.7	13.1	11.9	12.2	0.3
Physical fitness and sports	0.3	0.3	0.4	0.3	0.3	0.0
Mass media	0.2	0.1	0.1	0.1	0.1	0.0
Servicing state and municipal debt	0.8	0.9	0.9	0.9	0.9	0.0

Sources: Finance Ministry of Russia, Federal treasury, own calculations.

Notable growth of spending of the enlarged government budget in 2019 against 2018 was reported in relation to items “National economy” and “Social policy” (up by 0.3 percentage points of GDP each), which can be assessed as a trend towards a proactive fiscal policy.

#### 2.2.2. Specification of the federal budget

##### *The basic parameters of the federal budget*

In 2019, the revenues of the federal budget against the previous year increased by RUB 732.8 billion in nominal terms, but decreased in shares of GDP by 0.1 percentage point of GDP to 18.5 percent of GDP (*Table 12*) which was due to a reduction of receipts from the oil and gas component of the budget by 1.1 percentage point of GDP to 7.5 percent of GDP (Rub 8,247.7 billion). Meanwhile, non-oil and gas revenues went up by 0.9 percentage points of GDP to 10.9 percent of GDP (RUB 11,939.5 billion) which is the minimum for the last 5-year period. As a result, the share of oil and gas revenues in the overall amount of revenues in 2019 contracted to 40.8 percent against 46.2 percent seen in 2018, which speaks in favor of a reduction of budget dependence on revenues from the current economic situation. The volume of basic oil and gas revenues calculated on the basis of the fiscal rule<sup>1</sup> hit RUB 4,967.4 billion (RUB 4,756.3 billion in 2018) and the volume of additional oil and gas revenues hit RUB 3,280.3 billion (RUB 4,261.4 billion in 2018).

In 2019, the federal budget expenditures moved up by 0.6 percentage points of GDP to 16.6 percent of GDP or by RUB 1,500.2 billion compared to January-December 2018 hitting RUB 18,213.2 billion. The federal budget surplus has contracted to 1.8 percent of GDP against 2.6 percent of GDP in the previous year, non-oil and gas deficit demonstrated a downward trend, which commenced in 2015 hitting 5.7 percent of GDP in 2019.

In the course of the year, the original version of the Law on the federal budget was subject to changes twice – in June and December of 2019.<sup>2</sup> One should highlight a downward revision of the oil and gas revenues in the federal budget in late 2019 relative to the original text of the law from 7.8 to 7.2 percent of GDP, which was due to the expectations of the fall of the global prices on hydrocarbons, to the adjustment of the structure of oil production as well as to the

<sup>1</sup> On base oil price to the tune of 41,6 USD/bbl. for 2019.

<sup>2</sup> Federal Laws of July 18, 2019 No.175-FZ and December 2 2019 No. 389-FZ.

consequences from a number of tax changes adopted in 2019. The federal budget expenditures, on the contrary saw an upward revision by 2.5 percent in nominal terms in late 2019. For example, the approved federal budget expenditure moved up in July 2019 by RUB 256.5bn including on the implementation of state program “Development of transport system” – by RUB 78.0bn. In December of the same year, the amount of annual budget appropriations was increased by another RUB 195.7bn including on the state program (Management of public finances and regulation of financial markets” – by RUB 121.5bn and “Securing of national defense capability” – by RUB 36.9bn.

*Table 12*

**The main parameters of the federal budget in 2015–2019, percent of GDP**

	2015	2016	2017	2018	2019			Dev. in 2019 relative to 2018, in pp. of GDP
					Law on FB for 2019*	Law on FB for 2019 with amendments **	Actually	
<b>Revenue including:</b>	<b>16.4</b>	<b>15.7</b>	<b>16.4</b>	<b>18.6</b>	<b>18.9</b>	<b>18.4</b>	<b>18.5</b>	<b>-0.1</b>
Oil and gas	7.0	5.6	6.5	8.6	7.8	7.2	7.5	-1.1
Non-oil and gas	9.4	10.1	9.9	10.0	11.1	11.2	10.9	0.9
<b>Outlays</b>	<b>18.7</b>	<b>19.1</b>	<b>17.8</b>	<b>16.0</b>	<b>17.0</b>	<b>17.1</b>	<b>16.6</b>	<b>0.6</b>
<b>Deficit (-) / Surplus (+)</b>	<b>-2.3</b>	<b>-3.4</b>	<b>-1.4</b>	<b>2.6</b>	<b>1.9</b>	<b>1.3</b>	<b>1.8</b>	<b>-0.8</b>
Non-oil and gas deficit	-9.3	-9.0	-7.9	-6.0	-6.1	5.9	-5.7	0.3
<i>GDP, RUB billion</i>	83 387	86 010	92 089	104 335	105 820	108 414	109 361	
<i>Urals USD per barrel.</i>	51.2	41.9	53.0	70.0	63.4	62.2	63.6	

\* Federal Law of November 29, 2018 No. 459-FZ “On the Federal Budget for 2019 and the 2020 and 2021 Planning Period”

\*\* Federal Law of December 2, 2019 No. 389-FZ “On Amendments to the Federal Law ‘On the Federal Budget for 2019 and the 2020 and 2021 Planning Period’”

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

***The main sources of revenue***

Parameters of the federal budget revenue part execution for 2019 on volumes and structure are presented in *Table 13*. The amount of returns from the oil and gas components contracted against 2018 which was due to an adverse dynamics of receipts from MET by 0.4 percentage points and from export customs duties by 0.8 percentage points of GDP on the back of the ruble appreciation against the U.S. dollar and decrease of the average crude oil price, as well as owing to a revision commenced from July 1, 2019 of the calculation of damping component of the excise tax on crude oil supplied to refineries which was partially compensated by the rise from October 1, 2019 of the MET rate in crude extraction within the tax maneuver adjustment effective in the oil sector.<sup>1</sup> As a result, the share of MET in the total volume of oil and gas revenues demonstrates a sustainable upward trend from 38.3 percent in 2014 to 72.4 percent in 2019.

*Table 13*

**The main tax returns in the federal budget in 2015–2019**

	percent of GDP					Dev in 2019 relative to 2018, pp. Of GDP
	2015	2016	2017	2018	2019	
1	2	3	4	5	6	7
<b>Revenue, total</b>	<b>16.4</b>	<b>15.7</b>	<b>16.4</b>	<b>18.6</b>	<b>18.5</b>	<b>-0.1</b>
<b>Oil and gas revenues</b>	<b>7.0</b>	<b>5.6</b>	<b>6.5</b>	<b>8.6</b>	<b>7.5</b>	<b>-1.1</b>
<i>Of which:</i>						
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

<sup>1</sup> Federal Law of July 30, 2019 No. 255-FZ “On Amendments in Part II of the Tax Code of the Russian Federation.”

*Cont'd*

1	2	3	4	5	6	7
<b>Non-oil and gas revenues</b>	<b>9.4</b>	<b>10.1</b>	<b>9.9</b>	<b>10.0</b>	<b>10.9</b>	<b>0.9</b>
<i>Of which:</i>						
Corporate income 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 into the territory of the Russian Federation	2.1	2.2	2.2	2.3	2.6	0.3
Excises on goods produced on the RF territory	0.6	0.7	1.0	0.8	0.5	-0.3
Excises on goods imported into the RF territory	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.

The volume of non-oil and gas revenues of the federal budget in 2019 against the previous year rose by 0.9 percentage points of GDP on the back of total tax receipts growth except excises, which amount in share of GDP contracted by 0.3 percentage points of GDP. The highest growth of non-oil and gas revenues of the federal budget was demonstrated by VAT, which was due to an increase of the VAT base rate rise. On the whole, dynamics of the non-oil and gas revenues of the federal budget demonstrated a stable upward trend.

#### ***Federal budget expenditures***

The federal budget expenditures in 2019 amounted to 16.6 percent of GDP up by 0.6 percentage points of GDP or RUB 1,500.2 billion against 2018 (*Table 14*).

*Table 14*

#### **Federal budget expenditures in 2018–2019**

	2018			2019			Dev in 2019 relative to 2018	
	RUB billion	% of GDP	Cash execution, percent	RUB billion	% of GDP	Cash execution, percent	RUB billion	pp. of GDP
<b>Expenditure, total Including:</b>	<b>16 713.0</b>	<b>16.0</b>	<b>95.5</b>	<b>18 213.2</b>	<b>16.6</b>	<b>94.2</b>	<b>1 500.2</b>	<b>0.6</b>
General state issues	1 257.2	1.2	89.0	1 366.3	1.2	85.6	109.1	0.0
National defense	2 827.1	2.7	92.3	2 997.2	2.7	92.7	170.1	0.0
National security and law enforcement activities	1 971.1	1.9	96.2	2 083.1	1.9	95.5	112.0	0.0
National economy	2 402.2	2.3	93.5	2 824.5	2.5	91.8	422.3	0.2
Housing and utility sector	148.8	0.1	88.1	283.7	0.3	84.2	134.9	0.2
Environmental conservation	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, 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	4 581.9	4.4	99.3	4 881.1	4.5	99.7	299.2	0.1
Physical fitness 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
Servicing state and municipal debt	806.0	0.8	99.0	730.8	0.7	94.0	-75.2	-0.1
Intergovernmental fiscal transfers	1 095.5	1.0	99.7	1 002.1	1.0	95.7	-93.4	0.0

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

Federal Budget expenditures growth in shares of GDP in 2019 relative to the previous year is registered across five functional classification sectors:

- “National economy” – up by 0.2 percentage points of GDP on the back of expenditures growth by 0.1 percentage point on agriculture, public road system and on the item “Other issues in the sphere of national economy”;
- “Housing and utility sector” and “Environmental protection” – up by 0.2 and by 0.1 percentage points of GDP, respectively;
- “Healthcare” – up by 0.1 percentage point of GDP including 0.05 percentage points of GDP each on items “Inpatient care” and “Other issues in the sphere of healthcare”;
- “Social policy” – up by 1.0 percentage point of GDP due to the increase of budget appropriations on the social safety net, family and childhood protection, and on other issues in the sphere of social policy.

Shrinkage of the federal budget allocations in 2019 is reported solely across expenditures on the public debt servicing by 0.1 percentage point of GDP. Regarding other functional classification sections, the federal budget expenditures remained flat in 2019 relative to 2018.

The federal budget structure across non-productive and productive expenditures was subject to certain changes in favor of the latter: the share of productive expenditures in the total volume of expenditures went up from 19.1 percent in 2018 to 20.3 percent in 2019 or from 3.0 to 3.4 percent of GDP.

There were no significant changes regarding cash execution of the federal budget outlays in 2018–2019 (94.2 percent in 2019 against 95.5 percent in 2018).

The program structure of the open part of the federal budget outlays at the year-end 2019 (*Table 15*) reports increment of the program expenditures by 1.9 percentage points of GDP relative to 2018 on the back of the expenditure growth on innovation development and modernization of economy by 0.8 percentage points of GDP and national security priorities by 1.4 percentage points of GDP amid the contraction of the budget appropriations on “New quality of life” by 0.1 percentage point of GDP and “Balanced regional development” by 0.2 percentage points of GDP.

The proportion of the federal budget expenditures has gone up to 78.5 percent against 69.9 percent a year earlier.

*Table 15*

**Federal budget expenditures on the implementation of state programs  
in 2018–2019**

	2018			2019			Dev in 2019 relative to 2018	
	RUB billion	% of GDP	Cash execution, percent	RUB billion	GDP, percent	Cash execution, percent	RUB billion	pp. of GDP
1	2	3	4	5	6	7	8	9
<b>Expenditure, total</b>	<b>16 713.0</b>	<b>16.0</b>	<b>95.5</b>	<b>18 213.2</b>	<b>16.6</b>	<b>94.2</b>	<b>1 500.2</b>	<b>0.6</b>
<i>Including on implementation of state programs (open part)</i>	<i>11 677.0</i>	<i>11.2</i>	<i>93.6</i>	<i>14 305.3</i>	<i>13.1</i>	<i>91.5</i>	<i>2 628.3</i>	<i>1.9</i>
Including across directions:								
I. New quality of life	5 603.9	5.4	93.0	5 739.3	5.3	90.8	135.4	-0.1
Including SP “Development of Pension System”	3 020.3	2.9	100.0	3 129.2	2.9	99.8	108.9	0.0
II. Innovative development of economic modernization	2 266.0	2.2	92.6	3 272.9	3.0	88.6	1 006.9	0.8
III. National security provision*. **	880.8	0.8	98.3	2 382.1	2.2	98.6	1 501.3	1.4

*Cont'd*

1	2	3	4	5	6	7	8	9
IV. Balanced regional development	1 311.7	1.3	96.2	1 172.3	1.1	90.2	-139.4	-0.2
V. Effective state	1 614.6	1.6	92.5	1 738.7	1.6	96.7	124.1	0.0

\* According to Portal of state programs, “National security provision” embraces the following SP financed in 2018-2019: “National defense provision”, “National security provision”, “Peacekeeping and combating crime”, “Protection of population and territories from emergency situations, ensuring fire safety and water safety.”

\*\* In 2018, the open part of the program structure of the federal budget excluded spending on SP “National defense provisions”, and in 2019 actual spending on this program amounted to RUB 1,475.0 billion.

Sources: Finance Ministry of Russia, Federal Treasury; <https://programs.gov.ru/>; own calculations.

Cash execution of the program part of the federal budget expenditures constituted 91.5 percent against 93.6 percent seen in 2018. For a number of state programs the actual amount of execution relative to the approved annual volume comes to 85 percent: state programs – “Environmental conservation” (74.9 percent), “Implementation of state national policy” (78.8 percent), “Development of ship building and machines for the development of the offshore fields” (56.8 percent), “Development of pharmaceutical and medical industry”, “Social and economic development of the Arctic zone of the Russian Federation” (84.2 percent), “Public finance management and regulation of financial markets” (83.4 percent).

#### ***Deficit and debt at the federal level***

Regarding flow of funds taken as a source of the federal budget deficit financing the following dynamic has been noted (*Table 16*):

– the amount of borrowing on the domestic market constituted in 2019 RUB 2,083 billion against 1,037 billion in 2018;

– the volume of budget funds allocated for the repayment of obligations on bonds placed on the domestic market moved up from RUB 529 billion in 2018 to RUB 705 billion in 2019;

– the volume of receipts obtained from the sale of shares and other forms of equity participation in the state ownership came to RUB 11.5 billion in 2019 (RUB 12.8 billion in 2018);

– returns from repayment of budget loans hit RUB 53 billion 2019 against RUB 70 billion in 2018;

– balanced result on the amount of placed and redeemed state bonds on the external market constituted in 2019 RUB 260 billion against the negative value seen in 2018 to the tune of (-) RUB 50 billion.

*Table 16*

#### **Sources of financing the federal budget deficit in 2015–2019**

	RUB billion					percent of GDP				
	2015	2016	2017	2018	2019	2015	2016	2017	2018	2019
<b>Sources of financing deficit, total</b>	<b>1 961</b>	<b>2 956</b>	<b>1 331</b>	<b>-2 742</b>	<b>-1 974</b>	<b>2.4</b>	<b>3.4</b>	<b>1.4</b>	<b>-2.7</b>	<b>-1.8</b>
<b>Financing of deficit from internal sources</b>	<b>1 242</b>	<b>-684</b>	<b>2 091</b>	<b>1 396</b>	<b>919</b>	<b>1.5</b>	<b>-0.8</b>	<b>2.3</b>	<b>1.3</b>	<b>0.8</b>
State securities	15	492	1 123	507	1 378	0.0	0.6	1.2	0.5	1.3
Other sources	1 227	-1 176	968	889	-459	1.5	-1.4	1.1	0.8	-0.4
<b>Financing of deficit from external sources</b>	<b>-296</b>	<b>43</b>	<b>-126</b>	<b>-135</b>	<b>289</b>	<b>-0.4</b>	<b>0.0</b>	<b>-0.1</b>	<b>-0.2</b>	<b>0.3</b>
State bonds	-183	110	41	-50	260	-0.2	0.1	0.0	-0.1	0.2
Other sources	-113	-67	-167	-85	29	-0.1	-0.1	-0.2	-0.1	0.1
<b>Change in remaining balance</b>	<b>1 015</b>	<b>3 597</b>	<b>-634</b>	<b>-4 003</b>	<b>-3 182</b>	<b>1.3</b>	<b>4.2</b>	<b>-0.8</b>	<b>-3.8</b>	<b>-2.9</b>

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

According to the information released by the Ministry of Finance of Russia, as of January 1, 2020, the volume of public debt hit RUB 14.2 trillion (or 13.0 percent of GDP against 12.0 percent seen in 2018) including domestic debt – Rub 10.2 trillion (growth over 2019 by RUB 1,002.3 billion), and external – USD 54.8 billion (up by USD 5.8 billion in 2019).

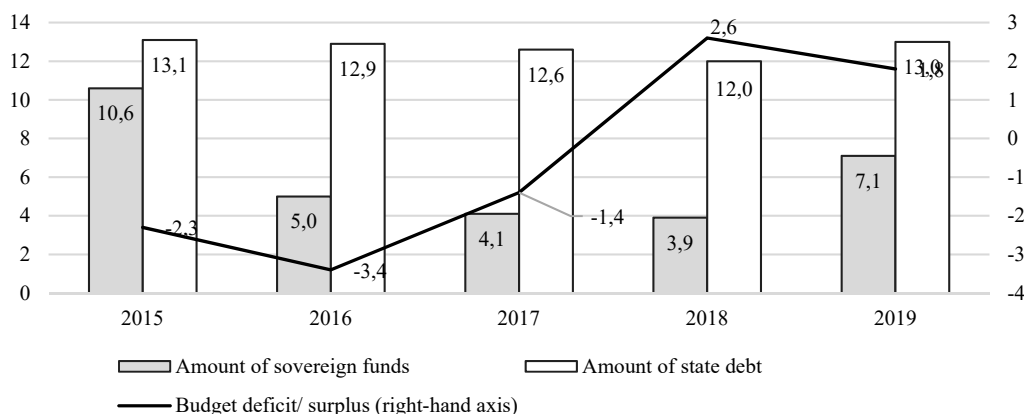
Total amount of the National Wealth Fund (NWF) in rouble terms for January-December 2019 increased from RUB 4,036.0 billion (3.9 percent of GDP) to RUB 7,773.1 billion (7.1 percent of GDP). During 2019 the following operations with NWF funds were performed:

- cash outflow to the tune of RUB 4.7 billion (RUB 5.1 billion in 2018) for co-financing of pensions savings for insured individuals who paid additional insurance contributions for funded pension;

- receipts to the tune of RUB 4,122.2 billion. (RUB 906.7 billion in 2018) within the amount of additional oil and gas revenues of the federal budget in 2018<sup>1</sup>.

The NWF funds for securing balanced (covering deficit) budget of the Pension Fun of Russia in 2019 were untouched (in 2018 for these purposes RUB 1,108.2 billion were spent). Switch rate from the revaluation of the NWF funds hit RUB 380.4 billion in 2019.

Judging by the dynamics of the federal budget deficit, public debt, and sovereign funds (Reserve Fund and National Wealth Fund prior 2018) in shares of GDP in 2015-2019 (*Fig. 18*) we should note the return in 2019 of the public debt volume to the 2015 level and commencement of the federal budget surplus in recent two years and growth of the sovereign reserves (during 2015–2018 the volume of the sovereign funds was constantly shrinking in shares of GDP).



*Fig. 18. Dynamics of the federal budget deficit, public, and sovereign funds in 2015–2019, percent of GDP*

Sources: Federal Treasury, own calculations.

While analyzing the dynamic and the structure of the main parameters of the federal budget for 2019 both relative to the 5-year period and compared to the previous year, one should note the development of upward trends regarding increment of non-oil and gas fiscal revenues as well as keeping the public debt and the NWF volume at the level acceptable for securing budget sustainability.

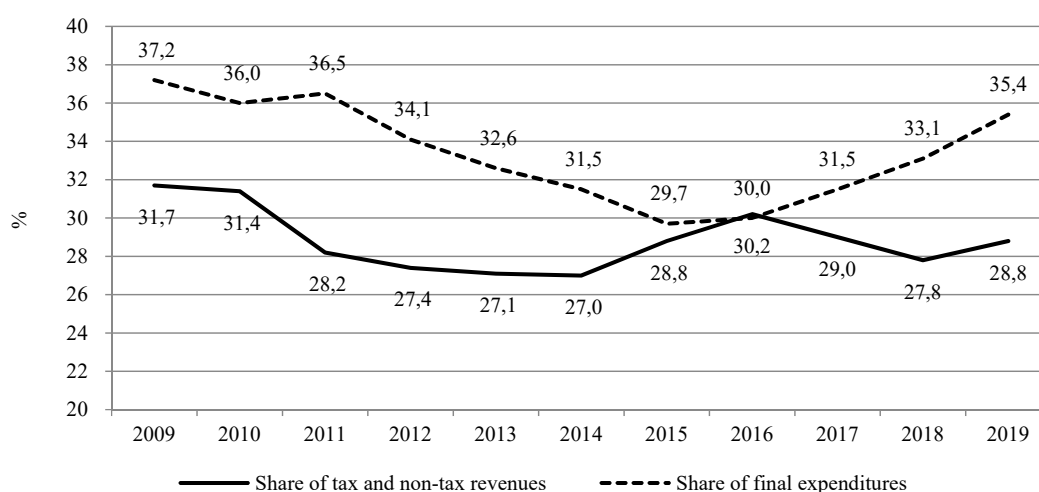
<sup>1</sup> Order of the Finance Ministry of Russia of July 17, 2019 No. 364 “On the Use of Additional Oil and Gas Revenues of the Federal Budget appropriated in 2018 for the National Wealth Fund”.

Observed from early 2020 decline of the oil prices will be some sort of a stress test for the budgetary system. Implementation of the national projects and 2020 additional long-term social obligations adopted in March have led to the fact that the federal budget can be balanced under the oil price not lower than USD 53/bbl and the exchange rate around RUB 67 per USD. Under a prolonged stay of the oil price below that target one should expect a postponement of the budget investment costs. From our point of view, it is not expedient in the short run to conduct a new expenditure consolidation or other tightening of the fiscal policy because there will be sufficient funds in the NWF and the market capacity will suffice for offsetting the shortfall in budget revenues. However, when deterioration of macroeconomic conditions will have medium-term, it will become inevitable both to review the volumes and the structure of the federal budget expenditures.

### 2.2.3. Interbudgetary relations and subnational finances

#### *Analysis of the main parameters of the consolidated budgets of the RF subjects*

Primary trends in the relations between various levels of power are reflected in the structure of revenues and expenditures of the consolidated budgets of the subjects of the Russian Federation. *Fig. 19* exhibits data reflecting the share of tax and non-tax revenues and final expenditures of the consolidated budgets of the RF subjects in the overall amount of tax and non-tax revenues and final expenditures of the RF consolidated budget and state extrabudgetary funds. In order to ensure compatibility of the data for the period under review and exclude double count data on parameters of the budgetary system of the Russian Federation as well as expenditures of the consolidated budgets of the RF subjects have been adjusted taking into account insurance contributions for mandatory medical insurance of the non-working population.



*Fig. 19.* Share of tax and non-tax revenues and expenditures of budgets of the budgetary system of the Russian Federation in 2009–2019, percent

Sources: Federal Treasury, own calculations.

*Fig. 19* demonstrates that in 2015–2016 there was a certain decentralization of tax and non-tax revenues, which not due to the transfer of the revenue sources from the federal to the regional level, but with a lower growth rates of tax and non-tax revenues of the federal budget

compared to the regional ones. Later on trends changed: 2017–2018 saw an increase of centralization of tax revenues at the federal level with simultaneous growth of the share of regional expenditure liabilities. The share of tax and non-tax revenues of the regions' consolidated budgets in tax and non-tax revenues of the budgetary system of the Russian Federation decreased from 30.0 percent seen in 2016 to 27.8 percent in 2018 and a corresponding share of regional spending in the expenses of the budgetary system went up from 30.2 percent to 33.1 percent over the period.

2019 saw an upward trend of expenditure obligations of subnational budgets (this indicator went up by 2.3 percentage points compared to the previous year and constituted 35.4 percent), and the share of regional and local budgets in tax and non-tax revenues moved up by 1 percentage points and came to 28.8 percent. Despite a certain growth of regional share of revenues, the imbalance between the level of decentralization of revenues and expenditures of the regions' budgets in 2019 continued growing. On the whole, regions' share in the structure of revenues and expenditures of the budgetary system in 2019 is comparable to the 2011 situation.

Let's analyze in more detail the revenues part of subnational budgets. Dynamics of the main components of revenues of the consolidated budgets of the RF subjects is given in *Table 17*. The right-hand side of the table demonstrates revenues in real terms (adjusted for inflation), which according to Rosstat came to 3.0).

*Table 17*

**Revenues of the consolidated budgets of the RF subjects in 2015–2019**

	In nominal terms, RUB billion.					Real increase, percent			
	2015	2016	2017	2018	2019	2016/ 2015	2017/ 2016	2018 / 2017	2019 / 2018
<b>Revenues, total</b>	<b>9 308</b>	<b>9 924</b>	<b>10 758</b>	<b>12 392</b>	<b>13 572</b>	<b>1.2</b>	<b>5.8</b>	<b>10.5</b>	<b>6.3</b>
Including:									
<b>Tax and non-tax revenues</b>	<b>7 625</b>	<b>8 289</b>	<b>8 986</b>	<b>10 222</b>	<b>10 993</b>	<b>3.2</b>	<b>5.8</b>	<b>9.1</b>	<b>4.4</b>
<i>Including tax revenues:</i>	<i>6 925</i>	<i>7 574</i>	<i>8205</i>	<i>9 429</i>	<i>10 103</i>	<i>3.8</i>	<i>5.7</i>	<i>10.2</i>	<i>4.0</i>
Corporate income tax	2 108	2 279	2528	3 105	3 358	2.6	8.2	17.8	5.0
PIT	2 808	3 019	3252	3 654	3 956	2.0	5.1	7.8	5.1
Excises	487	662	612	632	755	29.1	-9.8	-0.8	16.0
Taxes on aggregate income	348	388	447	520	596	6.0	12.2	11.6	11.3
Property taxes	1 069	1 117	1 250	1 397	1 351	-0.8	9.2	7.2	-6.1
<i>Non-tax revenues</i>	<i>700</i>	<i>715</i>	<i>781</i>	<i>794</i>	<i>890</i>	<i>-3.0</i>	<i>6.5</i>	<i>-2.5</i>	<i>8.9</i>
<b>Transfers from other budgets</b>	<b>1 617</b>	<b>1 578</b>	<b>1 703</b>	<b>2 085</b>	<b>2 453</b>	<b>-7.4</b>	<b>5.3</b>	<b>17.4</b>	<b>14.2</b>
<b>Other revenues</b>	<b>66</b>	<b>56</b>	<b>69</b>	<b>85</b>	<b>127</b>	<b>-19.2</b>	<b>18.7</b>	<b>18.2</b>	<b>-44.5</b>

Sources: Federal Treasury, own calculations.

As is seen from *Table 17*, the growth of the subfederal budgets revenues in real terms observed from 2016 continued in 2019, although its rates decreased vis-à-vis 2018. The total amount of tax and non-tax revenues adjusted to CPI in 2019 went up by 4.4 percent in comparison with 2018. Furthermore, the growth rate of actual returns from the corporate income tax hit 5 percent, from PIT – 5.1 percent. One should note the increase of returns from excises by 16.0 percent and from the aggregate income tax by 11.3 percent. Returns from the property tax contracted by 6.1 percent, however, due to a small their share in the revenue structure of the regions' consolidated budgets this reduction did not reflect on the total revenue dynamic. The volume of intergovernmental fiscal transfers received by the regions has gone up by 14.2 percent, i.e. the growth rates of financial assistance have exceeded the growth rates of tax and non-tax revenues of regional and municipalities.

Let us analyze the changes which occurred in the expenditure part of the consolidated budgets of the RF subjects in 2019 (*Table 18*).



*Table 18*

**Expenditures of the consolidated budgets of the RF subjects**

	percent to total		pp. of GDP		Deviation	
	2018	2019	2018	2019	In nominal terms, %	pp. of GDP
<b>Expenditures, total</b>	<b>100.0</b>	<b>100.0</b>	<b>11.47</b>	<b>12.41</b>	<b>14.2</b>	<b>0.94</b>
General state issues	6.3	6.2	0.72	0.77	12.1	0.05
National security and law enforcement	1.2	1.1	0.13	0.14	8.7	0.01
National economy, including:	20.8	21.8	2.38	2.70	19.7	0.32
Agriculture and fisheries	2.3	1.9	0.26	0.24	-3.4	-0.02
Transport	4.7	5.1	0.54	0.63	22.7	0.09
Public road system (road funds)	8.9	9.5	1.02	1.17	21.9	0.15
Other issues in the sphere of national economy	4.9	5.3	0.56	0.66	23.7	0.10
Housing and utility sector	10.2	10.2	1.17	1.26	13.6	0.09
Environmental conservation	0.3	0.5	0.04	0.06	67.7	0.02
Education, including:	25.4	24.7	2.91	3.07	11.3	0.16
Pre-school education	7.1	7.1	0.81	0.88	14.7	0.07
General education	12.2	11.9	1.4	1.48	11.6	0.08
Second vocational education	1.9	1.8	0.21	0.22	7.7	0.01
Other issues in sphere of education	4.2	4.0	0.49	0.49	6.3	0.00
Culture, cinematography	3.7	3.5	0.43	0.44	8.8	0.01
Healthcare	8.0	8.6	0.92	1.07	22.8	0.15
Social policy	20.3	19.8	2.33	2.46	11.2	0.13
Physical fitness and sports	2.4	2.4	0.27	0.29	13.2	0.02
Mass media	0.4	0.4	0.05	0.05	9.5	0.00
Servicing state and municipal debt	0.9	0.8	0.11	0.10	-5.1	-0.01

Sources: Federal Treasury, own calculations.

*Table 18* exhibits that the functional structure of the regional expenditure in 2019 changed slightly compared to the previous year. Among major structural changes, one should note an increase of spending on national economy (by 1.0 percentage points mainly due to increased spending on transportation and public road system), as well as on healthcare (up by 0.6 percentage points). This being said, a reduction of spending on social policy by 0.5 percentage points and education by 0.7 percentage points.

Practically all functional components of regional expenses increased in 2019 in nominal terms except expenses on assistance to agriculture and servicing of public and municipal debt. The same conclusion can be made regarding expenses in shares of GDP: the highest rates of spending accounted for assistance to the economy (except agriculture) and healthcare.

The total share of expenditure of the consolidated budgets of RF subjects in GDP in 2019 increased by 0.94 percentage points of GDP in comparison with 2018 and constituted 12.41 percent of GDP, which was the highest indicator since 2012.

Let us analyze dynamics of the main parameters of the consolidated budgets of the RF subjects in shares of GDP (*Table 19*).

*Table 19* exhibits that 2019 demonstrated an ongoing upward trend of the real revenues of the regions' consolidated budgets. Increased both the total amount of revenues and the main components – returns from the corporate income tax and PIT. Having said that, the volume of transfers from the federal budget was growing at outstripping rates in comparison with the tax revenues of the subjects, which to a large extent was due to provision of additional financial assistance allocated on the implementation of national projects. The real level of regions' expenditure in 2019 also increased in a greater degree than the revenues. Summarizing the results of the budget execution a small surplus has popped up to the tune of 0.004 percentage points of GDP (a year earlier surplus amounted to 0.49 percentage points of GDP).

Table 19

**Dynamics of revenues and expenditures of the consolidated budget  
of the RF subjects, percent of GDP**

	2015	2016	2017	2018	2019
<b>Revenues</b>	<b>11.16</b>	<b>11.54</b>	<b>11.68</b>	<b>11.96</b>	<b>12.41</b>
including:					
Corporate income tax	2.53	2.65	2.74	3.00	3.07
PIT	3.37	3.51	3.53	3.53	3.62
Transfers from Federal budget	1.94	1.83	1.85	2.01	2.18
<b>Expenditures</b>	<b>11.37</b>	<b>11.55</b>	<b>11.74</b>	<b>11.47</b>	<b>12.41</b>
<b>Deficit (-) / Surplus (+), pp. of GDP</b>	<b>-0.21</b>	<b>-0.01</b>	<b>-0.06</b>	<b>0.49</b>	<b>0.004</b>

Sources: Federal Treasury, own calculations.

Therefore, the sphere of interbudgetary relations, on one side, demonstrated rise of proportion of the regions in the structure of the budgetary system and growth of real revenues, and on the other – outstripping growth of budget expenses. In the event, when external shocks (fall of oil prices, coronavirus pandemic) result in the contraction of financial backstop from the federal budget, these trends can adversely impact the regions' budgets sustainability in the medium term.

***Financial assistance from the federal budget***

The total amount of intergovernmental fiscal transfers from the federal budget significantly increased in 2019 in comparison with 2018 both in nominal terms (16.7 percent) and in shares of GDP (2.2 percentage points of GDP) (Table 20). The increment was, first of all, due to an increase on other intergovernmental fiscal transfers (+1.8 percentage points of GDP) and subsidies (+1.4 percentage points of GDP, which was due to the need of the implementation of national projects at the regional and municipal levels by way of granting to corresponding budgets of federal targeted transfers.

Changes related to grants for securing balance: their sharp rise in 2018 relative to 2017 (2.2 percentage points of GDP) was offset by a notable contraction seen in 2019–1.5 percentage points of GDP relative to 2018. Change in the transfers amount has led to a change in the structure of financial assistance from the federal budget: the share of subventions (non-target financial assistance) in 2019 decreased by 1.5 percentage points of GDP in comparison with 2018 and amounted to 38.7 percent which is below the 2017 level.

Table 20

**Fiscal transfers to the budgets of the subjects  
of the Russian Federation from  
the federal budget**

	2017		2018		2019		Increment in 2019 to 2018	
	RUB bn.	%to total	RUB bn.	%to total	RUB bn.	%to total	Nominal, %	pp. of GDP
1	2	3	4	5	6	7	8	9
<b>Transfers to regions, total</b>	<b>1 690.1</b>	<b>100.0</b>	<b>2 044.8</b>	<b>100.0</b>	<b>2 387.2</b>	<b>100.0</b>	<b>16.7</b>	<b>2.2</b>
<b>Grants</b>	<b>759.0</b>	<b>44.9</b>	<b>1 035.5</b>	<b>50.6</b>	<b>924.0</b>	<b>38.7</b>	<b>-10.8</b>	<b>-1.5</b>
Including:								
Grants for equalization of fiscal capacity	614.5	36.4	644.5	31.5	675.3	28.3	4.8	0.0
Grants for ensuring fiscal balance	133.8	7.9	380.4	18.6	237.6	10.0	-37.5	-1.5

*Cont'd*

<b>Subsidies</b>	<b>419.8</b>	<b>24.8</b>	<b>381.8</b>	<b>18.7</b>	<b>556.6</b>	<b>23.3</b>	<b>45.8</b>	<b>1.4</b>
Including:								
Subsidies for development of national economy	242.4	14.3	190.0	9.3	209.9	8.8	10.5	0.1
<b>Subventions</b>	<b>326.1</b>	<b>19.3</b>	<b>331.7</b>	<b>16.2</b>	<b>396.6</b>	<b>16.6</b>	<b>19.6</b>	<b>0.4</b>
<b>Other intergovernmental fiscal transfers</b>	<b>185.1</b>	<b>11.0</b>	<b>295.8</b>	<b>14.5</b>	<b>510.0</b>	<b>21.4</b>	<b>72.4</b>	<b>1.8</b>

Sources: Federal Treasury, Rosstat, own calculations.

The amount of subventions has gone up (by 0.4 percentage points of GDP) together with their number<sup>1</sup>: from 32 seen in 2018 to 37 in 2019. This can demonstrate somewhat growth of dependence of subnational budgets from the federal budget regarding the execution of delegated powers.

As was already mentioned, increment of subsidies volume amounted 1.4 percentage points of GDP. Alongside this their number sharply increased: from 74 seen in 2018 to 113 in 2019. Without subsidies diverted for the implementation of priority programs, national and (or) federal projects, the number of subsidies hit 70, meanwhile the state program “Development of the Federative Relations and Creation of Conditions for Effective and Responsible Management of Regional and Municipal Finances” (hereinafter – SP “Development of the Federative Relations...”) envisages a reduction of the number of subsidies in 2019 down to 55. Thus, plans for optimization of the number of subsidies were unfulfilled.

The real volume of other intergovernmental fiscal transfers seen in 2019 went up by 1.8 percentage points of GDP in comparison with 2018 (up by 2.6 percentage points of GDP in comparison with 2017), meanwhile their number was increasing: 77 in 2017, 93 in 2018, and 108 in 2019. At end-2019 other intergovernmental fiscal transfers accounted for a fifth of the total amount of fiscal transfers from the federal budget diverted to regions.

The increment of targeted fiscal transfers is partly due to the implementation of national projects at the regional and municipal levels. For example, the share of subsidies allocated for the implementation of national projects comes to 53.1 percent and other intergovernmental fiscal transfers – 42.4 percent (*Table 21*). Without fiscal transfers diverted for the implementation of national projects, the structure of financial assistance in 2019 is as follows: grants – 50.9 percent,<sup>2</sup> subsidies – 14.4 percent, subventions – 18.5 percent, and other intergovernmental fiscal transfers – 16.2 percent. Proportion of other intergovernmental fiscal transfers exceeds the proportion of subsidies, which suggests the imbalance of interbudgetary policy to the reduction of the least formalized and transparent (i.e. other intergovernmental) fiscal transfers.

*Table 21*

**Transfers from the federal budget to the budgets of the RF subjects  
for the implementation of national projects**

	Amount in 2019	
	RUB bn	% to total amount of transfers of this type
1	2	3
<b>Total</b>	<b>572.2</b>	<b>24.0</b>
<b>Grants</b>	<b>295.7</b>	<b>53.1</b>
Including:		
Current grants	91.9	59.3

<sup>1</sup> The number of transfers is determined by the number of unique items of expenditure (13-16 code positions in the classification of budget expenditure), envisaged in the report on the federal budget execution.

<sup>2</sup> This corresponds targeted value of corresponding indicator of SP “Development of federative relations...”

Cont'd

1	2	3
Investment grants	16.4	12.0
Consolidated grants	187.4	70.7
<b>Subventions</b>	<b>60.1</b>	<b>15.2</b>
<b>Other intergovernmental fiscal transfers</b>	<b>216.4</b>	<b>42.4</b>

Sources: Federal Treasury, own calculations.

The effectiveness of transfers assigned for the implementation of national projects as a separate instrument can indirectly be assessed according to regularity of provision of corresponding funds in the course of the financial year, i.e. according to the ratio of the amount of funds assigned for the first three months to the annual amount of allocated funds (*Table 22*).

On the whole, transfers assigned for the implementation of national projects were allocated in the course of the year less regularly than other transfers, which can partly be explained by the novelty of this instrument and the need to the tuning of interaction procedures between the stakeholders of the interbudgetary relations.

Table 22

### Regularity of transfers allocation on the implementation of national projects

Transfers	Regularity, percent
<b>All transfers</b>	<b>61.9</b>
<b>Transfers on the implementation of national projects</b>	<b>49.8</b>
Including:	
“Culture”»	55.7
“Digital economy of the Russian Federation”	0.0
“Education”	54.1
“Housing and urban environment”	37.0
“Ecology”	28.3
“Small and medium-sized enterprises and support of individual entrepreneurship”	58.4
“Productivity and employment support”	35.3
“Healthcare”	37.2
“Demography”	56.6
“Safe and quality roads”	56.4
“International cooperation and exports”	23.8
Complex plan “Modernization of infrastructure”	38.3
<b>Other transfers</b>	<b>65.7</b>

Sources: Federal Treasury, own calculations.

From 2016 onwards, the interregional inequality of tax returns has been gradually increasing (*Table 23*). In this regard, 2019 saw a stronger income spread on the back of receiving transfers than it was in 2016–2018. However, equalization effect obtained from these types of transfers remains. For example, against the backdrop of equalization seen in 2019, inequality contracted by 23 percent (in 2018 – by 24 percent), and on the back of grants and subsidies it fell by 35 percent (in 2018 – by 34 percent).

Table 23

### Coefficient of income inequality of the regions' consolidated budgets (per capita inclusive index of budget expenditure)

Year	Tax revenues	Tax revenues and grants for equalization of fiscal capacity	Tax revenues, grants, subsidies
2014	0.590	0.512	0.499
2015	0.661	0.603	0.560
2016	0.556	0.421	0.373
2017	0.558	0.413	0.377
2018	0.586	0.444	0.387
2019	0.603	0.464	0.390

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

### *Regional deficit and debt*

In 2019, the consolidated budgets of the RF subjects were executed with a surplus to the tune of RUB 4.7 billion (in 2018 with a surplus to the tune of RUB 510.3 billion). This being said, the number of regions boasting of the budget surplus against 2018 has decreased 1.4-fold and has come to 50 (*Table 24*). Thus, the fiscal balance of the regions' consolidated budgets somewhat decreased during 2019.

*Table 24*

#### **Execution (deficit/surplus) of the consolidated budgets of the RF subjects in 2014–2019**

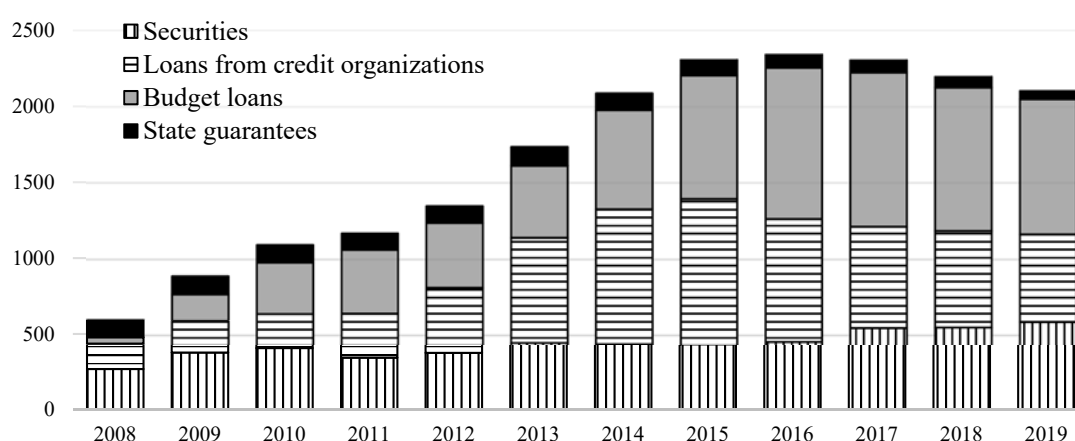
Year	Number of RF subjects which executed budget with	
	deficit	surplus
2014	74	11
2015	76	9
2016	56	29
2017	47	38
2018	15	70
2019	35	50

*Sources:* Federal Treasury, own calculations.

The nominal amount of public debt of the RF subjects at end-2019 contracted from RUB 2.21 to 2.11 trillion. It contracted during the year from 25.3 to 19.2 percent in relation to the amount of tax and non-tax revenues of the RF subjects.

Budgets of certain regions exhibited a reduction of debt burden: at end-2018 forty-two regions reported debt exceeding 50 percent of tax and non-tax revenues of their budgets, and at end-2019 the number of such regions hit 26 (i.e. the number of regions with conditionally safe level of the debt burden went up from 43 to 59). By the period-end results for 2019, solely Republic of Mordovia reported public debt in the amount exceeding 100 percent of tax and non-tax revenues (in 2018 such situation was typical for the Kostroma regions).

The structure of the regions' public debt somewhat changed during the year: the share of budget loans by the end of the year amounted to 41.9 percent falling against late 2018 by 0.7 percentage points (*Fig. 20*).



*Fig. 20.* Nominal amount (RUB billion) and structure (percent) of public debt of RF subjects in 2008–2019

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

The proportion of loans from the credit institutions has also decreased by 1.6 percentage points and the amount of securities has gone up by 2.9 percentage points. At the same time, the nominal amount of securities has increased by 6.7 percent, budget loans have decreased by 5.7 percent, and credit institutions loans contracted by 9.5 percent against the 2018 amount. Thus, the regions' public debt demonstrates a downward trend across all sources minus securities.

However, taking into account the reduction of oil prices amid coronavirus pandemic, one should expect a significant contraction of revenues and expenditures of the regions (first of all for the assistance to economy and social expenses) in 2020, which finally will end up to increasing budget imbalance and growth of public debt. At the same time, the high current level of regional fiscal sustainability will allow (at least, in the short-run) to avoid a critical situation with the budgets of the subjects of the Federation.