MONITORING OF RUSSIA'S ECONOMIC OUTLOOK:

TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

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TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

Having analyzed the draft federal budget for 2010–2022, our experts have come to the conclusion that **its main characteristics were formed in accordance with the budgetary rule and national priorities.** At the same time, during the next three years the topmost priority of Russia's budgetary policy – namely, budget sustainability – will remain unchanged.

It is planned that by the year 2022, budget revenues will grow by 9.3% in nominal terms relative to 2019, while their share of GDP is expected to decrease from 18.5% in 2019, and to 17.2% in 2022. The RF Ministry of Finance expects that Russia's non-oil-and-gas revenues **will be continually** d**eclining** due to the growth rate of oil production's lagging behind the dynamics of GDP, as well as due to the expected drop in world crude oil prices. As far as budget expenditures are concerned, our experts pay attention to the fact that in 2018, they hit a ten-year low of about 16.1% of GDP. The reasons for their decline were the application of the budgetary rule coupled a number of changes in the structure of budget expenditures viewed by our authors as a positive step, which has opened up possibilities for an additional 0.5 p.p. increase in the growth rate of GDP. However, our experts believe that the positive effects of the newly introduced budgetary rule and the changes in the structure of budget expenditures do not go beyond the said advantages, because the changes that are most important for economic development lie beyond their scope. And they consider it unlikely that the new budgetary rule adopted in 2017 will continue to be applied in the future. The authors have come to the conclusion that if the current scope of state functions and the current size of the public sector of the economy should remain unchanged, Russia's national goals can be achieved **only provided that federal budget expenditures are increased by 0.5–0.7 p.p. of GDP per annum in the form of investments in human capital and infrastructure as early as the period 2020–2022**.

Having assessed the state of the balance of payments in Q3 2019, our researchers note **a modest increase in Russia's current account** relative to Q2 2019 (to $ 12.9bn vs. $ 10.6bn) and, on the other hand, a considerable decrease therein relative to Q3 2018 ($ 27.4bn). They believe that the main reason for this decrease was **the worsening of the balance of foreign trade in goods** (a 23% drop in Q3 2019 relative Q3 2018). Our experts also note a reduction in net capital outflow from the private sector of the economy, which amounted to $ 1.4bn vs. $ 18.8bn in Q3 2018. They expect that by the end of the current year, there will be **an increase in the balance of Russia's financial account caused by the softening of the monetary policy of the developed countries and by the rising attractiveness of Russian financial assets**. Russia's balance of payment can also be negatively affected by such factors as a drop in prices for energy carriers, instability in the global economy, and a possible toughening of anti-Russian sanctions.

Having analyzed the dynamics of industrial production in Q3 2019, our experts emphasize the fact that **growth was achieved in both the extractive**

and manufacturing sectors. However, when specifying the concrete industries with a positive output dynamics, they note that over the course of the past few months that dynamics **was determined, to a large extent, by favorable market conditions**. **Our authors point out that these growth rates cannot be sustained in conditions of declining domestic demand.** The manufacturers participating in our business opinion surveys indicate that orders are on the decline in the domestic market, and that their clients are leaving, while the number of export orders is dwindling. The most compelling indirect evidence that the demand for goods is in decline is a palpable drop in wholesale turnover: in January-August 2019, this indicator amounted to 97.9% relative to the same period of last year.

Our experts have analyzed the latest alterations that have been prepared for introducing in the State Program for the Development of Agriculture in 2013–2025, as well as the adjustments to the State Program for the Development of Rural Areas, based on the draft federal budget for 2020–2022. While the latter program **envisages a sharp rise in expenditures on rural development, the draft budget envisages a more that four-fold reduction in the amount of funding allocated to that program, which cannot but affect its implementation**. The experts believe that in this case it is logical that the program should be revised. On the other hand, the Program for the Development of Agriculture envisages, in particular, that the growth rate of gross agricultural output should be more modest than previously planned, amounting to a mere 15.1% during the whole eight-year period (2017–2025). At the same time, the Program envisages a very high rate of exports growth and active imports substitution. According to the authors, **the resulting imbalance between the low growth rate of production and the high growth rate of exports can lead to the non-achievement of the goals stipulated in the State Program** with regard to exports, and if these goals are achieved, the said imbalance can lead to the inability to fully meet domestic demand for agricultural products.

In their work on issues related to pharmaceutical care provision in Russia, our experts point out that **the availability of pharmaceuticals remains low, and people have to cover more than half of the associated costs out of their own pocket**. There are serious problems concerning the planning and execution of government purchases, and one can observe a very broad differentiation across territories in the availability of pharmaceuticals. Thus, for example, according to data for 2017, in some RF subjects over the course of that year the expenditures on orphan drugs supplied per 10,000 patients amounted to more than Rb 1.5m, and in other RF subjects – less than Rb 300,000.

The authors suggest some **possible directions for improving pharmaceutical care provision in Russia.** Among other things, the suggested measures envisage that the pharmaceutical care provision system should guarantee the universal coverage of all citizens, the inclusion of a broad assortment of prescription pharmaceuticals in a list compiled with due regard for their efficacy, and independent control of prescription reasonability.

1. FEDERAL BUDGET FOR 2020–2022: MAIN PARAMETERS

I. Sokolov

Main parameters of the federal budget have been formulated in accordance with the fiscal rule and national priorities. Hence, the contraction of oil and gas revenues are not offset by non-oil and gas receipts growth, nevertheless the government plans to run a budget surplus during the entire three years.

As a result of ongoing fiscal adjustment, the federal budget expenditures hit 10-year minimum (16.1% of GDP) in 2018. However, due to the need to implement national projects, expenditures for the period of 2019–2022 will be around 17% of GDP. Furthermore, one should note a number of issues: low level of cash execution of funds allocated for national projects; controversial results from shifting financing across years among projects; sufficiency of resources and measures aimed at achieving national projects as was indicated in the President's May Executive Order.

On the whole, fiscal adjustment will remain a priority for the budgetary policy for the next three years. At the same time, the question of how to make up for a shortfall in oil and gas revenue remains unanswered.

Draft law "On the Federal Budget for 2020 and the 2021–2022 Planning Period" (hereinafter draft law) submitted to the State Duma on September 30 provides preliminary estimates of the 2019 federal budget execution as well as budget parameters for the next three years.

The Ministry of Economic Development of Russia hacked back to drafting three forecast scenarios in the submitted together with the draft budget forecast of socioeconomic development of Russia for 2020 and the 2021–2022 planning period (hereinafter, forecast). If in 2017–2019 two scenarios were debated, baseline and conservative ones, then target scenario was added to the last version of the forecast.

Draft budget was based on the economic baseline forecast with main parameters given in *Table 1*.

Table 1

Main parameters of the baseline forecast

	2019 (estimate)	2020 (forecast)	2021 (forecast)	2022 (forecast)
GDP, Rb bn.	108414	112863	120364	128508
GDP growth rates, % to previous year	1.3	1.7	3.1	3.2
Urals average price, USD/bbl.	62.2	57.0	56.0	55.0
RUR/USD average annual exchange rate	65.4	65.7	66.1	66.5
Consumer price index (%, year-on-year)	3.8	3.0	4.0	4.0

Source: explanatory note to draft federal law "On the Federal Budget for 2020 and the 2021–2022 Planning Period".

The baseline forecast envisages sustainable economic development in 2021–2022 at the rates exceeding 3%. Herewith, fixed investments growth in real terms should exceed 5% already in 2020. These are rather ambitious plans which will require fiscal and monetary easing for their implementation. Meanwhile, it is highly possible to expect a recovery of private investment activity

due to low domestic demand and a feasible deterioration of foreign economic conditions. On the whole, the main risks for the implementation of the baseline scenario are global recession, losing momentum of structural reforms, and dynamics of domestic consumer lending.

Main parameters of the federal budget (*Table 2*) are given taking into account tasks of the implementation of national objectives set by the Presidential Executive Order of May 7, 2018 No. 204. Comparison of the 2020–2021 federal budget indicators set in the Law on the federal budget for 2019–2021 and presented in the draft law under review demonstrate retention of the main budget parameters practically at the same level. For example, **revenues in 2020 and 2021 were revised upwards by merely 7.9 and 1.3%, and expenditure by 2.7 and 3.0% respectively in nominal terms.**

Table 2

Main parameters of the federal budget

	Rb bn				% of GDP			
	2019 (estimate)	2020 (plan)	2021 (plan)	2022 (plan)	2019 (estimate)	2020 (plan)	2021 (plan)	2022 (plan)
Revenue	20 174.9	20 379.4	21 246.5	22 058.3	18.5	18.1	17.7	17.2
Including:								
Oil and gas	8 239.5	7 472.2	7 679.4	7 730.6	7.6	6.6	6.4	6.0
Non-fuel	11 935.5	12 907.1	13 567.1	14 327.6	10.9	11.4	11.3	11.1
Expenditure	18 293.7	19 503.3	20 634.0	21 763.3	16.8	17.3	17.1	16.9
Deficit (–) / surplus (+)	1 881.2	876.1	612.5	295.0	1.7	0.8	0.5	0.2
Non-fuel deficit	-6 358.3	-6 596.2	-7 066.9	-7 435.7	5.8	5.8	5.9	5.8

Source: explanatory note to draft federal law "On Federal Law for 2020 and the 2021-2022 Planning Period."

By 2022, the federal budget revenues are projected to rise by Rb 1,883.4 bn or by 9.3% in nominal terms against 2019, **at the same time revenues in shares of GDP will decrease from 18.5% of GDP in 2019 to 17.2% of GDP in 2022**. Year-on-year dynamics of revenues growth in nominal terms will constitute 1.0% in 2020, 4.2% in 2021, and 3.8% in 2022 relative to the previous year in the context of projected inflation level (CPI) in 2020–2022 in the range of 3.0–4.0–4.0%, respectively.

Dynamics of the main federal budget parameters, volumes of borrowing and public debt for the next three-year period are consistent first of all with the task of ensuring fiscal sustainability. Even in case of a possible decline of oil prices to the baseline level set by the fiscal rule **the budget deficit will not exceed 1.5% of GDP** and can be financed from the National Welfare Fund.

In the course of 2020–2022 the Finance Ministry of Russia expects contraction of oil and gas revenues down to the 2019 level due to lagging behind of the oil production from GDP dynamics and projected decrease of global crude oil prices. It should be noted that the draft budget forecast for global oil prices does not correlate with the average prices growth rates calculated on crude oil spot prices set in the World Bank forecast (the oil price growth is projected).

Receipts from VAT, the main source of non-fuel revenues, will be growing according to forecast due to VAT hike from 18 to 20% and improvement of tax administration. Proceeds from the corporate tax, import duties and excises on imported goods are projected in shares of GDP for the period of 2020–2022 in the framework of traditionally used by Finance Ministry calculation method

at the 2019 level. In the meantime, according to our predictive assessment receipts from non-fuel revenues can average at 0.1–0.2 p.p. of GDP below the level set in the draft law first of all due to excessively optimistic expectations of dynamics of excises on domestically produced goods.

The federal budget expenditures are planned in accordance with the current fiscal rule: they are projected to increase from 16.8% of GDP in 2019 to 17.3% of GDP in 2020 exclusively due to growth of proceeds from non-fuel revenues. In 2021, the federal budget expenditures will amount to 17.1% of GDP against 16.9% of GDP in 2022.

In 2018, the federal budget expenditures stood at 16.1% of GDP the minimum for the decade. Such outcome of the fiscal consolidation resulted from the enforced fiscal rule and translated into the reduction of spending on the national defense and social policy as well as ensures uptick of spending on education, healthcare, social and industrial infrastructure. This positive step, according to our estimates, **created possibilities for additional increase of GDP growth rates to the tune of 0.5 p.p.**

However, there terminate positive effects for the economy from the enforced fiscal rule and change in the structure of the budget expenditure due to the fiscal consolidation and adoption of national projects. **Paramount structural changes required for the breakthrough development lie outside their realm**: reduction of barriers for the private initiative development, attraction of private investments into Russian scientific and academic and technological development, reduction of state participation in the economy and raising of public administration efficiency, creation of comfortable regulatory environment, independent and impartial judicial and law enforcement systems.

Adherence to the enforced in 2017 fiscal rule is highly doubtful, due to a number of reasons:

- Marginal expenditures were raised from 2019 by the annual amount of Development fund (Rb 585bn), which de-facto weakened the fiscal rule;
- When exceeding the threshold of 7% of GDP the NWF assets will be invested in the national economy, which will mean easing of the rule;
- Receipts from raising the VAT rate and the tax maneuver enforced in the oil sector will be insufficient both for offsetting contracting oil and gas revenues and for financing national projects in the course of 2023–2024.

Taking into account the oil price, consensus forecast for the period until 2024 growth of baseline price by $5 will additionally raise 0.5-0.6 pp. of GDP of the federal budget revenues without compromising fiscal sustainability.

Spending on the national projects set by the draft law exceeds spending allocated on the national projects data sheets by 4.8% on average. Total expenditure on the national projects will amount to 10, 12, and 20% in 2020, 2021, and 2022, respectively. Increase in expenses for the period 2020–2022 is planned primarily in “Science”, “Demographics”, and “Safe and High-Quality Roads” by 20.8%, 18.0%, and 4.3%, respectively.

At the same time, important aspects of this increase raise questions. Firstly, spending spree on the national projects with low spending execution of budget funds seen in 2019 raise **risks of a nominal execution of measures aimed at disbursement.** Secondly, **spending spree on certain national projects with simultaneous decrease of spending on other national projects** can reduce total multiplicative effects for the entire economy. Thirdly, attention should be drawn to **the balance of expenses distribution among the national projects:**

allocations on certain projects seem rather low despite their importance for the achievement of the national targets.

The situation with fiscal spending transparency remains unsatisfactory. **Classified appropriations for 2020 will increase to Rb 3,322.8 bn (2.9% of GDP or 17% of the federal budget expenditure).** The share of classified outlays of the Russian budget still by an order exceed the same indexes of public finance seen in developed countries. Common practice of classifying the federal budget expenditure envisages "liberal" treatment of Article 5 of the law "On State Secrets" open to secrecy solely for budget spending on "intelligence, counter-intelligence, and intelligence-gathering activities as well as counterterrorism efforts."

On the whole one can note that dynamics of the federal budget expenditure for the next three years is in line with the parameters of the enlarged government budget determined by the budget forecast until 2036. Against the backdrop of the effective fiscal rule and amid consistently falling revenues from the fuel sector, the budget forecast envisages gradual reduction of budget expenses by 2.2 p.p. of GDP – from 34.7% of GDP to 31.9% of GDP from 2019 until 2036. According to our estimates, **public expenditure should be maintained at no less than 34.5% of GDP under the current level of state participation and the scale of public sector in order to resolve issues of structural development.** That is why, already in 2020–2022 **it would be necessary to increase the federal budget expenditure by 0.5–0.7 p.p. of GDP in each year of the three-year period in favor of investments in the human capital and infrastructure** in order to achieve national goals.

It is expected that the tight fiscal policy will allow **preserving the budget surplus in 2020–2022 and to keep non-fuel deficit below 6% of GDP.** Meanwhile, according to our estimates the size of the fiscal gap calculated on the assumptions of long-term forecast of social and economic development until 2036 (Ministry of Economic Development of Russia, November 2018) varies from 9.4 to 10.1% of the total GDP. This is below the 2015 estimates (13.6%)[1]. which demonstrate somewhat improvement of the long-term fiscal equilibrium of the enlarged government mainly due to executed in 2016–2018 measures of fiscal consolidation and the pension reform. However, the issue of shortfall in fuel revenues in the long-run remains unresolved. So far, the Finance Ministry does not announce about the discussion of parameters of non-resources tax maneuver towards higher taxation of consumption and property.

1 *Goryunov E., Kazakova M., Kotlikoff L., Mamedov A., Nazarov V., Nesterova K., Trunin P., Shpenev A.* Russia's fiscal gap. – National Bureau of Economic Research. 2013. - № w19608.

2. THE BALANCE OF PAYMENTS IN Q3 2019: A TRADE BALANCE DECLINE

A. Bozhechkova, P. Trunin

In Q3 2019, Russia's trade surplus fell significantly due to a declining value volume of exports coupled with a slight growth in imports. Net capital outflow from the private sector was caused by the banking sector's foreign liabilities shrinking at a faster rate than that of its foreign assets. In spite of the absence of any new economic sanctions, the worsening trade conditions and mounting tensions in the world financial market pushed down the ruble's exchange rate against foreign currencies in Q3 2019.

According to the balance of payments preliminary estimates released by the Bank of Russia, the current account for Q3 2019 was $ 12.9bn, which is somewhat above its previous quarter's level ($ 10.6bn), but significantly below the corresponding index for Q3 2018 ($ 27.4bn).

The main reason behind the current account decline was the worsening balance of trade in goods (*Fig. 1*), which amounted to $ 36.6bn, having lost 7.3% compared with Q2 ($ 39.5bn), and 23% compared with Q3 2018 ($ 47.8bn).

As a result, the trade balance for the first three quarters of 2019 was $ 122.9bn, which is 10.4% below the corresponding index for January-September 2018 ($ 137.2bn).

This happened, *firstly*, because of the **shrinking value volume of exports**, which amounted to $ 101.5bn (for reference: in Q3 2018 it was $ 110.4bn), which can be explained by the lower global prices for Russia's main exports (by 5–10%) compared with 2018 (oil, petroleum products, natural gas, ferrous metals, coal, aluminum, copper, nickel[1]), because the physical volume of those exports stayed at the same level.

Secondly, **the volume of imports** increased to $ 64.9bn, which is 4.5% above its index for the previous quarter ($ 62.1bn) and 3.5% above its index for Q3 2018 ($ 62.7bn). **The growth of imports had been sustained by the ruble's strengthening up until August 2019** (according to data released by the Bank of Russia, the ruble's real effective exchange rate against foreign currencies in January-September 2019 was +1.3% relative to January-September 2018)[2].

The balance of trade in services for Q3 2019 was $ -10.5 bn, which is higher than the corresponding indices for the previous quarter ($ -8.4 bn) and for Q3 2018 ($ -8.8bn). That movement pattern could be explained by the increasing imports of services alongside their almost unchanging exports. **Compared with the previous year, exports of services fell** (due in the main to the shrinking tourism into Russia) by 1.1%, from 17.4 to 17.2bn, while **their imports increased (pushed up largely by the cost of transport services and outbound tourism)** by 6.5%, from $ 26.1bn to $ 27.8bn.

1 See *Knobel A., Firanchuk A.* Foreigh trade in January-April 2019: recovery growth of non-oil exports // Russian Economic Developments. 2019. V. 26. No. 7. P. 23–28.

2 For the effects of the ruble's exchange rate movement pattern on trade, see *Knobel A.Yu.* Estimation of import demand function in Russia // Applied Econometrics. 2011. No. 4 (24). P. 3–26.

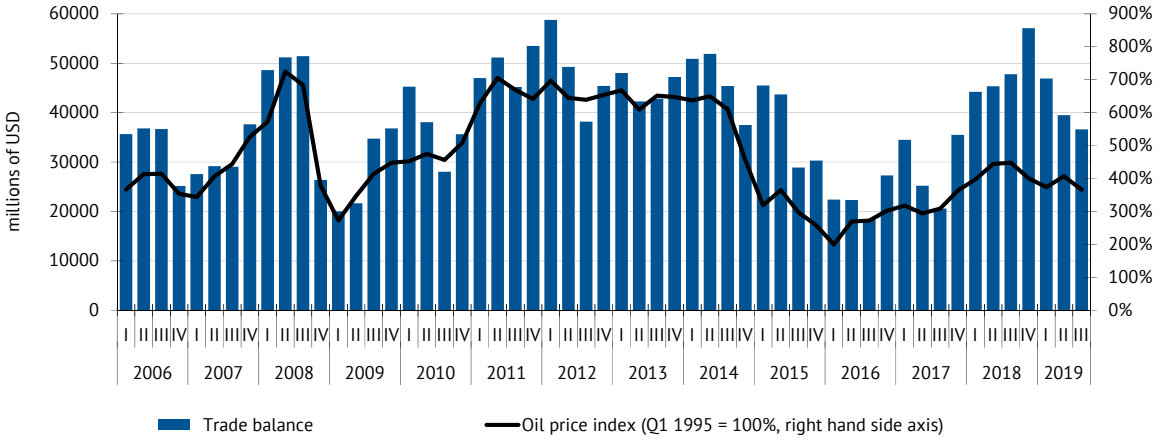

Fig. 1. Trade balance and the movement of oil prices

Source: Bank of Russia; IMF.

It should also be noted that over the first three quarters of 2019, the balance of services was $ -24.7bn (vs. $ -23.0 over the corresponding period of 2018). Later on, if the ruble's real effective exchange rate should gain, imports of services will continue to increase at a faster rate than their exports[1].

The balance of investment income for Q3 2019 amounted to $ -11bn, compared with $ -19bn in Q2, and $ -8.4bn a year earlier.

The other components of the current account (the balance of compensation of employees, the balance of rent, the balance on secondary incomes) are, traditionally, much smaller than its main components discussed earlier, while their movement patterns have little effects on the current account balance.

In Q3 2019, **the financial account balance was positive**, amounting to $ 1.8bn (in Q3 2018, it had a deficit of $ 24.1bn.). The net capital inflow was secured by the accelerated shrinkage of foreign financial assets ($ -3.9bn in Q3 2019) relative to that of foreign financial liabilities ($ -2.2bn in Q3 2019).

The leaders in reducing their financial assets were the banking sector and the government administration bodies. Thus, over the course of Q3 2019, the foreign assets held by banks declined by $ 6.7bn (vs. $ +8.6bn in Q3 2018), while the amount of foreign assets held by government administration bodies shrank in the main due to redemption of previously issued loans**,** by $ 3.1bn (vs. $ -0.7bn in Q3 2018). The other sectors, on the contrary, increased their foreign assets ($ +5.8bn in Q3 2019 vs. $ 0.5bn in Q3 2018). **Corporate money outflow** in the form of foreign direct investment amounted to $ 7.5bn (vs. $ 1.0bn in Q3 2018), that in the form of portfolio investments – to $ 1.4bn (vs. $ 0.7bn in Q3 2018). The other types of foreign assets remained unchanged in Q3 2019, while in Q3 2018 these gained $ 3.3bn.

The shrinkage of foreign liabilities in Q3 2019 resulted from banks' operations ($ -8.1bn in Q3 2019 vs. $ -3.8bn in Q3 2018). Meanwhile, the non-banking sector increased its foreign liabilities (growth by $ 4.6bn in Q3 2019 vs. decline by $ -8.4bn in Q3 2018). **The volume of foreign direct investment inflow amounted to $ 6.6bn ($ -4.0bn in Q3 2018**), while the inflow of portfolio investment lost $ 1.3bn (vs. $ -0.6bn in Q3 2018). The amount of loans and borrowings received from abroad rose to $ 1.0bn (vs. $ -2.0bn in Q3 2018). The increase in

1 See *Knobel A., Firanchuk A.* The foreign trade turnover of services in 2018: growth in exports // Russian Economic Developments. 2019. V. 26. No. 5. P. 7–13.

2. The balance of payments in Q3 2019: a trade balance decline

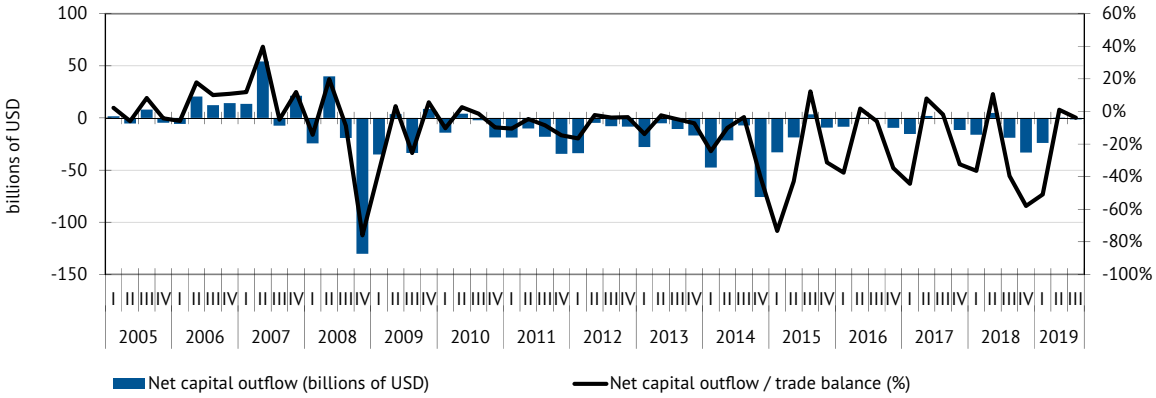

Fig. 2. Net capital outflow from the private sector in 2005–2019

Source: Bank of Russia; Gaidar Institute calculations.

the volume of government administration bodies' liabilities to foreign countries in Q3 2019 amounted to $ 1.2bn (vs. $ -2.0bn in Q3 2018). As a result, the share of non-residents in Russia's OFZ market as of 1 September 2019 was 29.7%.

Overall, **net capital outflow from the private sector in Q3 2019 amounted to $ 1.4bn,** compared with an outflow of $ 18.8bn in Q3 2018 (*Fig. 2*). At the same time, net corporate capital inflow over the course of Q3 2019 was $ 0.1bn ($-6.5bn in Q3 2018), while banks demonstrated their net capital outflow to the value of $ 1.5bn ($ 12.3bn in Q3 2018).

The growth of international reserve assets over the course of Q3 2019 amounted to $ 15.9bn (vs. $ 5.0bn in Q3 2018), and so their volume rose to $530.9bn. This movement pattern was caused in the main by the purchase, in the domestic forex market by the RF Ministry of Finance, of foreign currencies to the total value of approximately Rb 886.9bn (vs. Rb 548.2bn in Q3 2018), in the framework of the budgetary rule.

Over the course of Q3 2019, the ruble lost 2.1% of its value against the US dollar, plunging to 64.4 per USD, much of its downward movement occurring in August. The ruble's weakening was contributed to by **declining prices of oil**, which lost 9.2% in Q3 2019 relative to Q2 2019 and slid to $ 61.9 per barrel, and **capital outflow from the developing markets** in response to a slowdown in the global economic growth rate. According to our estimations, the ruble has remained an undervalued currency, and given the current state of fundamental factors, the estimated exchange rate of the US dollar does not exceed Rb 62 in nominal terms[1]. Nevertheless, the ruble's adjustment to its long-term level may be interrupted by some new external shocks.

Until the end of 2019, **the easing of their monetary policies by the developed countries will work towards increasing the attractiveness of Russian financial assets**. However, a worsening balance of payments, beside the traditional risks associated with falling prices of energy carriers, may also result from financial instability in the global economy, as well as from the possible introduction of tougher economic sanctions against Russia.

1 Estimation of fundamentally substantiated real exchange rate of the ruble // Russian Economic Developments. 2015. V. 22. No. 2. P. 16–19.

3. INDUSTRIAL PRODUCTION DYNAMICS IN Q3 2019: MARKET FACTORS[1]

A. Kaukin, E. Miller

Based on the results of Q3 2019, the industrial production demonstrated growth which was facilitated by positive dynamics both in the primary and manufacturing sectors. At the same time, it is not absolutely certain that growth will continue in the long-term prospect. In the past few months, output growth observed in a number of sectors can be largely explained by a favorable market situation, but it cannot be maintained amid shrinking domestic demand.

According to the data of the IHS Markit company[2], **in September 2019 the business index of manufacturing sectors decreased considerably in Russia: the slump turned out to be the largest since May 2009**[3]. As per the data of the survey, manufacturers pointed to the reduction of the volumes of orders, loss of customers on the domestic market and a decrease in the number of export orders.

A decrease in the "balance of estimates of demand on products (the portfolio of orders)" component of the business confidence index, which component was calculated by the Rosstat in the manufacturing and primary sectors in September 2019, is another evidence of the reduction of domestic demand. Also, **indirect evidence of shrinking domestic demand is a decrease in the wholesale trade volume**: in January-August 2019 the value of the index was equal to 97.9% on the same period of the previous year. According to the results of the surveys of industrial enterprises carried out by the Gaidar Institute, the main output growth limitation for 52% of enterprises was domestic demand, too[4].

Low consumer demand and risks related to its further shrinkage on the back of reduction of the rate of consumer lending and maintenance of the tight monetary and credit policy with simultaneous toughening of the budgetary policy[5] may seriously affect in the short-term prospect the expected growth rates of industrial production, however, the situation varies by the sector (bellow is the analysis of the dynamics of production trends in individual sectors).

On the basis of the latest statistics published by the Rosstat in respect of industrial production indices in manufacturing, experts of the Gaidar Institute carried out decomposing and disaggregation of a trend component[6] of the sectorial output series. The results of processing of the series of the industrial production index are presented in *Fig. 1* and point to slow industrial growth in Q3 2019. **In September 2019, growth was equal to +102.6% on the relevant period of the**

1 The authors express gratitude to M. Turuntseva and T. Gorshkova for their assistance in carrying out the statistical analysis.

2 The Index of IHS Markit PMI of manufacturing industries // URL: https://www.markiteconomics.com/Public/Home/PressRelease/2a2da5ec9fcb4af8aca0938ef2b77877

3 The slump amounted to 46.3 points. The index of IHS Markit PMI varies from 0 to 100. The index value of over 50 points indicates an overall increase as compared to the previous month, while that of below 50, an overall decrease.

4 *S. Tsukhlo.* The Industry in September 2019: Stable Demand as an Obstacle to Growth // The Monitoring of Socio-Economic Situation in Russia. 2019. No. 15. P. 9–10.

5 See, for example, A. Vedev.: Why the Speed-Up of the Economy is Infeasible without the NWF's resources. URL: https://www.iep.ru/ru/kommentarii/aleksey-vedev-pochemu-uskorenie-ekonomiki-nevozmozhno-bez-sredstv-fnb.html

6 The disaggregation of the trend component was carried out by means of the Demetra package with utilization of the X12-ARIMA procedure.

previous year. The trend has remained the same since the end of 2018. Industrial growth was facilitated by growth in the primary sector (+103.9% in September 2019 on the relevant period of the previous year) and the manufacturing sector (+102.0% in September 2019, respectively). In production of power, gas and water, Q3 2019 saw around-zero growth rates (+100.01% in September 2019 on September 2018; *Table 1*).

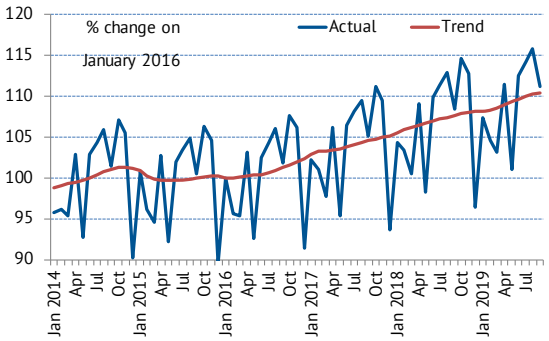

Fig. 1. The dynamics of the industrial production index in 2014–2019 (the actual data and the trend component), % on January 2016

Source: The Rosstat, own calculations.

A number of factors restrained growth in production of key natural resources: the extension of the OPEC+ agreement on reduction of the daily production of oil to 228,000 barrels; a decrease in the exports by the PAO Gazprom of gas supplies to the EU countries (because their gas storage facilities were filled to full capacity) and Turkey (because of the competition with less expensive gas supplied via the TANAP pipeline from Azerbaijan); a drop in coal supplies to Europe (shrinkage of demand on coal on the part of European countries) and infeasibility to increase coal supplies to Asia because of a heavy load on the transport network. Despite the effect of the above factors, **the primary sector saw positive dynamics in Q3 2019** (*Fig. 2*).

Among the **factors which underpinned growth in the primary sector** were probably the following: **First**, the fulfillment of obligations on reduction of the daily production of oil in full is complicated by the clearance of the organochlorine contamination of the Druzhba crude oil pipeline and a fall in oil production in Saudi Arabia after attacks on its oil-refining facilities (as a consequence, in August the reduction of oil production in Russia amounted to 140,000 barrels of oil per day, while in September, to 160,000 barrels of oil per day which was below the target). **Second**, in August the volume of exports of the Gazprom Company was underpinned by a decrease in the supply of pipeline gas from Norway and liquefied natural gas from Qatar. **Third,** in respect of the tariff on export transportation of power-generating coal in the direction of dock stations of the North-Caucasian Railway a decreasing coefficient (in the amount of 0.9259 applied to the effective tariffs of Section 2 of Schedule of Prices No. 10-01) was temporarily introduced from July and it had a positive effect on Russian exporters' costs in Q3 2019.

Based on the results of Q3, the main contributors to growth in the manufacturing industry were the following: the food industry owing to a substantial excess over the last year's output indices of the agrarian sector (the yield of grain, pulses, potatoes and vegetables largely surpassed the results of 2018); the chemical industry mainly owing to the pharmaceuticals industry (whose growth was related to increased demand on domestic generics on the part of Kazakhstan, Uzbekistan and Belarus); the production of other non-metallic mineral products on the back of growth in manufacturing of building materials (*Fig. 2*).

At the beginning of H2 2019, growth continued in the iron and steel industry, though prices of metals remained below the level of 2018 because of large smelting volumes in China, excessive supply in the US and low demand on the part of the EU's domestic market. Growth in the steelmaking industry can be probably explained by formation of inventories in the building industry in Q2 (for implementation of future investment projects)[1].

1 The Review of Metallurgy: Exports are Falling, There is Hope only for Domestic Demand // The Metallurgy Quarterly Bulletin. RIA Rating. URL: https://riarating.ru/industry_newsletters/20191003/630136239.html

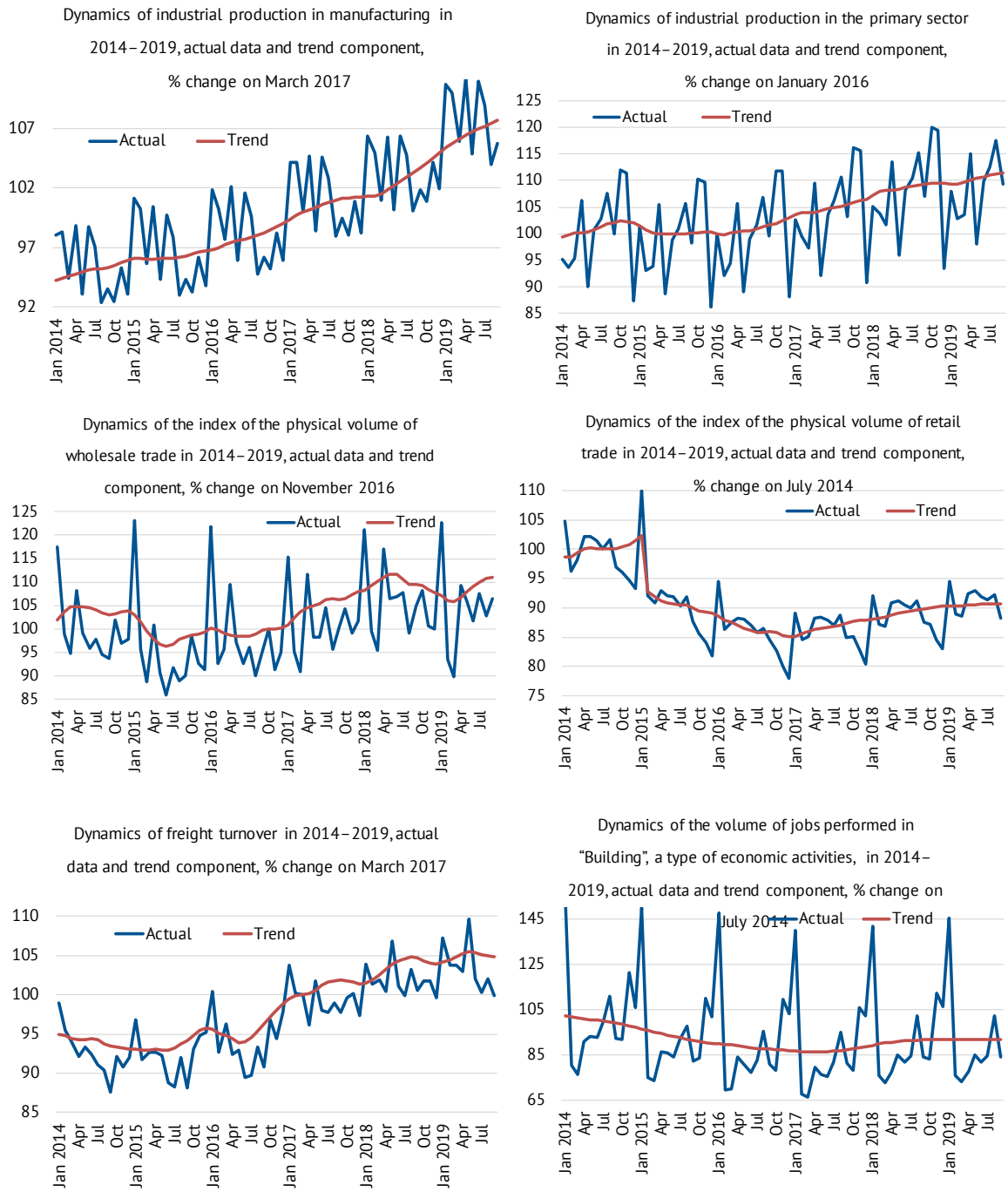

Fig. 2. The dynamics of industrial production indices by the sector in 2014–2019, actual data and trend component

Source: The Rosstat, own calculations.

In September 2019, growth in manufacturing of transportation vehicles was justified by an increase in the output of light commercial vehicles, mainly busses. In experts' view[1], the industry faces a decrease in output until the end of the year due to weak consumer demand and reduction of the state support (Rb 10.4bn of funds have been allocated out of the federal budget since the beginning of this year,

1 *T. Romanova*. The sales of cars will fall this year after two years of explosive growth // The Vedomosti daily. 04.10.2019. URL: https://www.vedomosti.ru/business/articles /2019/10/04/812909-prodazhi-avtomobilei#_

including Rb 6 bn and Rb4 bn spent on automotive lending on preferential terms and privileged leasing, respectively. This program was extended from June 1, 2019).

In Q3 2019, the dynamics of other key branches, particularly, the building industry, freight turnover, retail trade, and paid services to households were close to zero.

So, relatively sustainable growth remained in the food industry and the chemical industry. In other sectors (the metallurgy and manufacturing of transportation vehicles), growth looks set to be short-termed because it is related to the favorable market situation which is unlikely to be preserved in the long-term prospect. Also, **the existing concerns over further cooling of the domestic consumer demand (and the shrinkage of state subsidies in the automotive industry) will have a restraining effect on output volumes in future, too.**

Table 1

Change in the output index by the sector of the economy, %

Name of sector	Share in the industrial production index	September 2019 on September 2018	September 2019 on August 2019	Change over the past few months
Industrial production index		102.59	100.29	Slow growth
Mining	34.54	103.87	100.22	Slow growth
Manufacturing	54.91	101.98	100.28	Slow growth
including:				
Production of food products, including beverages and tobacco	16.34	111.02	100.79	Growth
Textile and sewing industry	1.14	101.98	100.26	Slow growth
Production of leather, leather articles and footwear	0.27	97.39	99.74	Slow recession
Woodworking and production of wood articles	2.02	107.36	100.74	Growth
Pulp and paper production	3.35	79.58	97.95	Recession
Production of charred coal and petrochemicals	17.25	102.48	100.25	Slow growth
Chemical industry	7.56	114.07	101.13	Growth
Production of rubber and plastic articles	2.14	98.06	99.66	Slow recession
Production of other non-metallic mineral products	4.02	106.06	100.33	Slow growth
Metallurgy and production of fabricated metal products	17.42	123.39	101.77	Growth
Manufacturing of machines and equipment	6.97	96.67	99.93	Stagnation
Manufacturing of electrical, electronic and optical equipment	6.27	96.69	99.96	Stagnation
Manufacturing of transportation vehicles and equipment	6.75	107.95	100.61	Growth
Other industries	2.42	99.94	99.76	Stagnation
Power-, gas- and water supply	13.51	100.01	100.00	Stagnation
Wholesale trade		101.37	100.90	Growth
Retail trade		100.95	100.07	Stagnation
Freight turnover		100.20	99.74	Stagnation
Building		100.07	100.02	Stagnation
Volume of paid services to households		102.55	100.24	Stagnation

Source: The Rosstat, own calculations.

4. STATE PROGRAMS ON DEVELOPMENT OF AGRICULTURE AND RURAL REGIONS: WHAT CHANGES MAY BRING

V. Uzun

Ministry of Agriculture of the Russian Federation prepared their regular changes to the State program on development of agriculture for 2013–2025[1]. These changes raise questions regarding the feasibility of implementation of import substitution tasks and growth of agribusiness products. State program of integrated development of rural regions approved in May of this year will also change significantly[2]: the draft of federal budget for 2020 and 2021 and 2022[3] suggests reduction of financing of this program by four plus times, which may also lead to certain issues of its implementation.

State program on development of agriculture and regulation of markets of agribusiness products, raw materials and food[4] has been traditionally subjected and is still subjected to numerous changes. Let us consider the latest changes, which have influenced or may critically influence on development of agrarian sector.

Articles of agrarian budget require protection

State program on integrated development of rural regions suggested increase of expenditures of the federal budget for rural development from Rb 79 to 1057 billion (by 13.4 times)[5]. No textual changes were introduced since its approval, however, draft of the federal budget for 2020 and for planned period of 2021 and 2022 suggested to reduce financing of this program by more than four times (*Table 1*). Such **a sharp reduction of financing may result in failure of implementation of the State program activities**.

Probably, financing of the mentioned State program was questioned even prior to its approval. A Note was added to the text saying that overall amount of financial provision of State program and financial provision of projects (programs) under its implementation as well as the amount of federal budget allocations will be specified after approval of the law on federal budget for the next financial year and planned period. However, the issue is that target indicators and indicators of the State program were calculated based on the foreseen amounts of financing. **After approval of State program, their articles of expenditures shall be protected during the whole period of its implementation.** If actual amounts of financing are reduced by several times, then, State program should be logically reconsidered.

Similar adjustments were made to the State program on agricultural development. A Note also appeared in the "package" of amendments introduced in 2019 granting the right to Ministry of Finances to amend allocations provided

1 URL: https://regulation.gov.ru/projects/List/AdvancedSearch#npa=95149
2 Ref.: Government Decree of the Russian Federation of May 31, 2019 № 696 «On approval of State program of the Russian Federation «Integrated development of rural regions and on amendments to certain acts of the Government of the Russian Federation».
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4 Approved by Government Decree of the Russian Federation of July 14, 2012, № 717.
5 *V.I. Uzun* State program on integrated development of rural regions: project analysis // Economic development of Russia. 2019. V. 26. No. 5. P. 30–34.

Table 1

Financing of State program "Integrated development of rural regions" according to program passport and draft budget for 2020–2022

	2020	2021	2022	Total amount for 2020–2022
Financing according to State program passport, Rb billion	79.2	160.6	193.1	433.0
Financing according to draft of federal budget for 2020–2022, Rb billion	35.8	34.4	34.9	105.1
Ratio of allocated finances according to draft of federal budget for 2020–2022 against budget assignments suggested by passport of State program, %	45.2	21.4	18.1	24.3

Sources: Integrated program on development of rural regions approved by Government Decree of the Russian Federation of May 31, 2019 № 696; draft of Federal law: "On Federal budget for 2020 and for planned period of 2021 and 2022".

for in the program when preparing and adjusting annual laws on federal budget. It is also unlikely to increase the confidence of agricultural producers that the envisaged types and sizes of support will operate throughout the entire period of the State program implementation.

Slowdown in agricultural growth with increasing exports and declining product imports

Import substitution and a sharp increase in exports have become the main objectives of the agricultural policy of recent years. This is reflected in the State program for development of agriculture and regulation of markets of agricultural products, raw materials and food. Changes introduced in 2019 envisage export growth in 2025 compared to 2017 by 2.2 times. A number of measures was outlined aimed at replacing imported domestic products. It is quite obvious

Table 2

Volumes of export, import and domestic consumption of agricultural products (in comparable prices of its sale by agricultural producers in 2018)

	2017	2018	2019	2020	2021	2022	2023	2024	2025
Growth rate of domestic agricultural consumption %	100.0	101.3	102.8	103.5	105.7	107.7	110.0	112.5	115.1
Growth rate of agricultural exports, %	100.0	106.5	111.1	115.7	129.6	157.4	189.8	208.3	210.6
Rate of decline of agricultural imports, %	100.0	95.5	91.2	87.1	83.2	79.4	75.9	72.4	69.2
Cost of agricultural products, Rb, billion in comparable prices 2018:									
Gross output	5409	5479	5561	5598	5717	5826	5950	6085	6226
Export	678	722	753	785	879	1067	1287	1413	1428
Import	918	877	837	800	764	729	696	665	635
Consumed domestically	5649	5634	5644	5613	5602	5487	5359	5338	5433

Sources: Data on growth rates of domestic consumption of agricultural products are given in accordance with Russian State agricultural program https://regulation.gov.ru/projects/List/AdvancedSearch#npa=95149. Growth rates of agricultural exports were accepted as equal to growth rate of agricultural products according to State agricultural program. The rate of decline in imports was assumed to be 4.5% per year (average prevailing percentage for 2013–2017). The cost of gross, exported and imported agricultural products for 2017 was determined using the methodology developed by the Center for Agro-Food Products of IPEI RANEPA (see. Scientific report on the subject: Impact of agricultural exports on the agri-food sector of Russia. M., 2019). Value of agricultural products consumed domestically is calculated as gross output minus exports plus imports.

that it is possible to achieve the set goals for export growth and import substitution only with respective high rates of the industry development. At the same time, **State program provides for a rather modest growth rate of gross output of the industry: 15.1% over eight years (from 2017 to 2025**).

In the previous edition of State program dated 08.02.2019, rate of planned growth was slightly higher, i.e. 16.3%. Ministry of Agriculture of Russia justified the need for a 20% increase in gross output over the specified period when preparing versions of State program in order to achieve high export growth rates if additional financing provided. However, this proposal was not taken into account when approving amendments to the State Program.

Imbalance between low production growth rates and high growth rates of export and import substitution may lead to failure to fulfill the tasks of the State program on import substitution and export. If these tasks are completed then there may be an issue related to fulfilment of domestic needs for agricultural products. **As calculations of *Table 2* show, domestic consumption in this case can be reduced by about 10%**.

Dynamics of growth rates in the value of export and import agricultural products as well as consumed in the domestic market is shown in *Fig.1*.

Summarizing, it should be emphasized that when realizing ambitious tasks of modern agrarian policy of import substitution and increasing exports, it is necessary to take into account to a greater extent the need to achieve the main goal: satisfy domestic needs of the country's population.

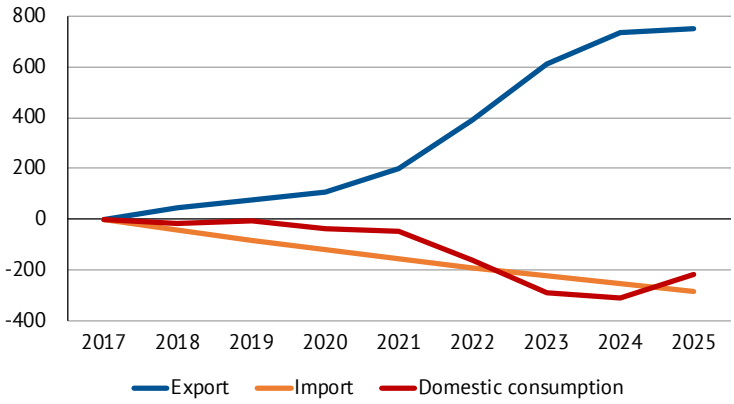


Fig. 1. Growth of export, import and domestic consumption of agricultural products compared to 2017, RB billions

Source: calculations of data given in Table 2.

5. PROVISION OF PHARMACEUTICALS IN RUSSIA: CURRENT SITUATION AND PROSPECTS FOR THE FUTURE

N. Avksentiev, V. Nazarov

An analysis of the consumption of prescription pharmaceuticals and the structure of pharmaceutical care costs has demonstrated that the availability of pharmaceuticals is still low, and that households have to pay for more than half of those costs. It has also been revealed that availability of pharmaceuticals varies broadly across different Russian territories. Many of the existing pharmaceutical care programs have to deal with issues that have to do with lack of proper planning in the implementation of government purchases. This article suggests several pharmaceutical care models that target all citizens without any exceptions; aim for the placement of a broad assortment of prescription pharmaceuticals on the government provision list, with due regard for their efficacy; rely on an independent control of the reasonability of prescription of pharmaceuticals in each case; imply a cost-effective organization of the pharmaceutical provision system, and the introduction of differentiated co-payment programs for the population.

The May 2018 Presidential Executive Order set a number of ambitious goals for the healthcare system. These goals cannot be achieved without implementing modern approaches to pharmaceutical care, including the outpatient care programs.

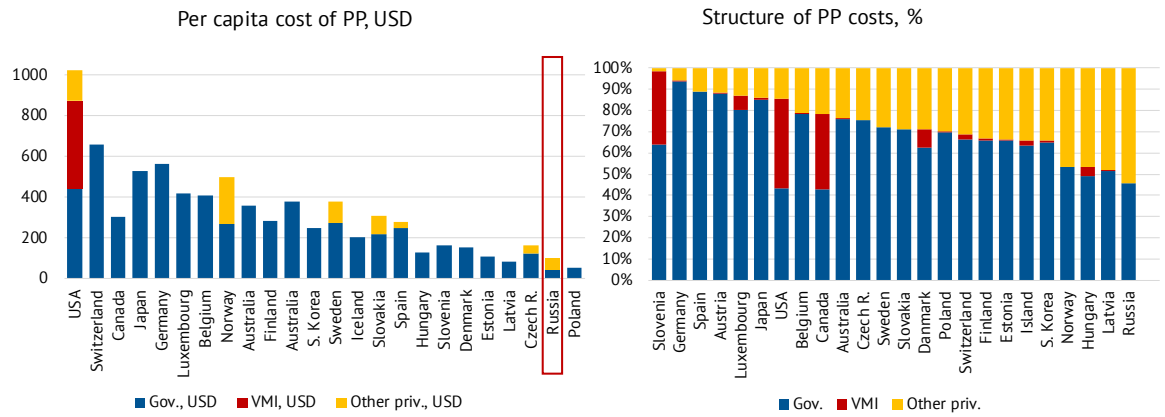
In a majority of the developed countries, the provision of prescription pharmaceuticals is viewed as an inalienable part of government guarantees in the healthcare sector. However, in Russia the pharmaceutical care guarantees are quite limited. **In most cases, outpatients have to pay for pharmaceuticals out of their own pocket. The exceptions are the few special exemption programs**:

- Program for the Provision of Essential Pharmaceuticals (ONLS);
- Twelve High Cost Nozologies Program (12 VZN);
- Regional Free-of-charge Pharmaceutical Provision;
- Pharmaceutical care for patients suffering life-threatening and chronic progressive rare (orphan) diseases resulting in shorter lifespan or disability;
- Supplementary free-of-charge provision of pharmaceuticals for patients with HIV, AIDS, tuberculosis with multiple drug resistance.

When Russia is compared with other countries by the consumption level of prescription pharmaceuticals and the structure of pharmaceutical care costs (*Fig. 1*), it becomes obvious that **the availability of pharmaceuticals in this country is still low, and people have to cover more than half of the associated costs out of their own pocket**.

At the same time, one can observe a very broad **differentiation across territories in the availability of pharmaceuticals** supplied under regional programs. Thus, for example, in some RF subjects in 2017, the expenditures on orphan drugs supplied per 10,000 patients amounted to more than RUB 1.5m, and in other RF subjects – less than RUB 300,000[1].

1 Own calculations, based on the following data: *Kutuzov P., Gritsenko P.* Making orphans cough: What will change in the market of orphan pharmaceuticals after the introduction of centralized



*PP – prescription pharmaceuticals.

Fig. 1. International comparisons for pharmaceutical care provision

Source: OECD Health Statistics 2018 (except for Russia and the USA), data for 2017 or nearest year; for Russia – own calculations based on budget statistics, the RF Ministry of Health and DSM Group; for the USA – calculations based on data released by the Centers for Medicare and Medicaid services.

From 2019 onwards, the issues that have to do with government purchases of pharmaceuticals supplied for the treatment of 5 orphan diseases have become far less acute, after the powers for providing pharmaceutical care to these groups of patients were reassigned to the federal 12 VZN program. At the same time, in spite of the many benefits involved (stable funding from federal sources, the existence of a single register of recipients, well-balanced financial structure of the program), presently no new pharmaceuticals can be placed on the program list if their price is higher than the price of alternative drugs that have been included in that list. So, the cases when under the federal program older drugs are purchased because their prices have plunged after the appearance of licensed analogues (thus, for example, since 2010, Imatinib lost 96%, and Rituximab – 48% of their initial price[1]), while the responsibility to provide patients with better and costlier new-generation pharmaceuticals is shifted onto the RF subjects.

As of 2017, out of the 15.5m people enjoying the right to free-of-charge pharmaceuticals covered by the ONLS program, the in-kind option was requested by only 3.85m, while the others chose the cash compensation option. The situation is further complicated by the fact that many of the pharmaceutical care benefits funded under the ONLS program are also included in regional programs, and so their recipients can simultaneously receive the cash compensations envisaged by the ONLS program and the in-kind benefits funded by the budgets of the RF subjects.

Almost all of the pharmaceutical care programs have been faced with some issues associated with planning and executing government purchases. The alterations (enacted from 1 January 2019) to the procedure of determining the initial contract price cap geared to the so-called reference price (the average weighted price applied in government purchases over the last 12 months) produced the situation where the initial cap price set in a government purchase contract was quite often below the economically feasible price level. As a result, a significant

government purchases: https://vademec.ru/article/sirot_otkashlyal-_kak_pomenyaetsya_rynok_orfannykh_preparatov_posle_tsentralizatsii_zakupok/

1 Own calculations, based on data included in the State Register of Pharmaceutical Substances (SRPS) and the Unified Information System in the Field of Public Procurement.

percentage of government purchases failed to take place for lack of offers, the upshot being lengthy delays in pharmaceutical supplies.

What can be the possible directions for improving pharmaceutical care provision in Russia

The issue of double coverage of one and the same benefit, its most visible example being the lack of proper financial coordination between the ONLS program and regional programs, can be dealt with by introducing two separate lists of pharmaceuticals supplied under these programs (while possibly keeping on both lists the most vital and essential pharmaceuticals). This approach may also in part help resolve the negative selection issue associated with the ONLS program: as citizens can make a choice between the in-kind option and cash compensation, it is mostly those recipients who need actual pharmaceuticals but for a number of reasons cannot get them in the framework of regional programs that have stayed with the ONLS program. If two separate lists are introduced, the motivation for staying with the ONLS program in order to receive pharmaceuticals in kind will become stronger.

However, this proposal could actually be implemented only if **a single federal register of recipients under the ONLS and regional programs is created**, because not all of the 'regional' recipients are also included in the federal program. To avoid making the necessary pharmaceuticals less available to such patients, it is necessary to keep the duplicated lists of pharmaceuticals.

Another method of 'targeted' improvement of the pharmaceutical care provision mechanism in Russia could be **the introduction of customized prescriptions**, one example being the identification of groups of patients maximally benefiting from the use of each costly pharmaceutical.

The prospective pharmaceutical care provision model

A comprehensive solution to all the accumulated problems faced by the pharmaceutical care provision system for outpatients can become possible only through in-depth reforming of the existing system. In our opinion, **the new unified pharmaceutical care provision system should have the following characteristics**:

- universal coverage of all citizens;
- inclusion of a broad assortment of prescription pharmaceuticals in a list compiled with due regard for their efficacy;
- administration at the federal level;
- independent control of prescription reasonability;
- organization based on the principle of compensation of the cost of pharmaceuticals;
- introduction of differentiated co-payments for the consumers.

The concept of a mechanism for the interaction between the principal participants in the suggested pharmaceutical care provision scheme could be as follows.

A patient visits a physician who, after considering the indications, issues an electronic prescription. In a pharmacy, the patient purchases the pharmaceutical needed. The amount to be paid out of the patient's pocket is calculated on the basis of the set 'compensation price', so that he or she pays only the difference between the actual price and the reference price. If that difference should turn out to be negative, the patient covers the fixed minimum co-payment amount. The pharmacy delivers the pharmaceutical from its stock created independently

by making purchases in the commercial market, and after that the pharmacy requests the compensation of its costs from the budget.

The substantiation for the prescription of each pharmaceutical is checked by medical insurance companies. In the event of finding out a violation, a medical insurance company (MIC) imposes a fine on the medical organization, the amount of the fine being determined on the basis of the reference price of the disputed prescription drug.

To create such a system, a lot of preparatory work will be needed, involving the creation of infrastructure for information exchange between its participants, as well as allocation of a big chunk of additional funding. We estimate that to cover all the prescription drugs that are currently on the list of vital and essential pharmaceuticals, but are actually paid for from each patient's own pocket, by 70% government co-financing, a total of Rb 430bn per annum will be needed. However, the final cost of the suggested pharmaceutical care provision program may be either less than the calculated figure (the calculations were based on market retail prices, and not the reference prices which may stand below the average prices – for example, at the level of the minimum price assigned to a given international nonproprietary name), or more than the said amount (if in response to the diminished financial burden on the consumers the consumption of pharmaceuticals should increase).

That is why it would be worthwhile to proceed gradually when implementing the suggested pharmaceutical care provision system – for example, by first launching a pilot project targeting a certain group of patients in need of certain international nonproprietary names. At present, such an experiment, aimed at testing a pharmaceutical care provision scheme for the outpatients being followed after an acute altered cerebral blood circulation episode, myocardial infarction, or other acute cardiovascular diseases or cardiovascular surgery, is planned for 2020–2022. In our opinion, **in the framework of that project, it would be worthwhile to test the mechanism of compensation of the cost of pharmaceuticals (described earlier) in several RF subjects.** In the final analysis, this can translate into a more efficient pharmaceutical care provision for outpatients, and will provide a pathway to creating a comprehensive universal system encompassing the greatest possible number of patients.

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