

Section 2. Monetary and fiscal policy

2.1. Monetary policy¹

2.1.1. Key monetary policy decisions

In 2016, the Bank of Russia implemented a conservative monetary policy aimed at mitigating inflation. Commercial banks decreased their demand for central bank refinancing as the Reserve Fund was spent, in which case the central bank had to employ a set of instruments to prevent an increase in the money supply. It happened twice over the course of the year – on June 14 and September 19 – that Russia's central bank cut 0.5 percentage points off the key rate, to 10% p.a. With a declining inflation rate and inflation expectations available during the year, a rather moderate decline in the key rate suggested growth of the real interest rate in the money market. Maintaining a positive real rate in the money market helps prevent prices from hiking upwards as the savings appeal strengthened, although there is risk of economic slowdown. There is another thing to be considered: interest rates in real terms were low in the Russian Federation all the way till 2016, including that Russia had lower rates than other developing countries (see Fig. 1–2).

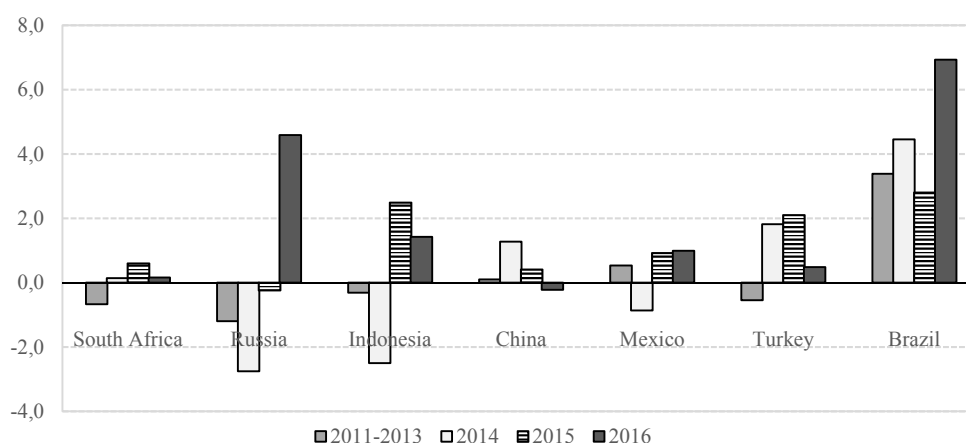


Fig. 1. Real money market rates in countries of emerging markets, G20 member states (% p.a.)

¹ Authors of chapter: A. Bozhechkova – RANEPA, Gaidar Institute; A. Knobel – RANEPA, VAVT under Ministry of Economy; A. Kiyutsevskaia – RANEPA, Gaidar Institute; P. Trunin – Gaidar Institute.



Fig. 2. Real interest rate on legal entity loans with maturities less than 1 year in the Russian Federation, 2011–2016 (% p.a.)

Given still high expectations for inflation, it is not until Q1–Q2 2017 that the Bank of Russia is expected to consider cutting the key rate any further. In 2017, in our view, the central bank will have to figure out how to establish and maintain an uneasy equilibrium between achieving the inflation target and avoiding the adverse effect of the monetary policy on economic activity in the country.

Since January 1, 2016, the refinancing rate has been adjusted for the key rate, thereby making the monetary policy more transparent for domestic and foreign economic agents, raising investors' confidence in Bank of Russia's signals. As a reminder, with an inflation targeting regime in place, the interest rate is the key instrument of monetary policy that influences crediting in volume terms, the monetary base or other macroeconomic indicators. Any change to the key interest rate constitutes a signal to economic agents about relaxing or tightening the monetary policy, which has immediate impact on their expectations. In this context, setting the refinancing rate – that has a more administrative function – equal to the monetary policy rate makes central bank's signals more clear.

As noted above, with a substantial budget deficit and budget financing by spending the Reserve Fund, commercial banks decreased their demand for both ruble and foreign currency refinancing. The Bank of Russia has since April 1, 2016 suspended 12-month foreign currency repo auctions because of lower demand for these instruments and higher demand for 28-day foreign currency repos. As a reminder, the regulator also suspended 365-day foreign currency repos in May 2015 amid a stable situation in the FX market, and it was not until December 2015 that 365-day foreign currency repos were conducted again due to the need for refinancing commercial banks' debt on previous 1-year foreign currency repo auctions, and because Russian companies made scheduled repayments on their external loans, as well as due to an increasing demand for foreign currency in response to a Fed's rate hike in December 2015. With a relatively stable FX market and low demand for refinancing 1-year foreign currency repo auctions, such operations are not expected in the offing. In our view, the regulator in general shouldn't resort to this instrument unless financial stability is exposed to risks, and the ruble exchange rate should stay free floating so that the economy is able to promptly adapt to new terms of trade.

Central bank's decision to sell some of the federal bonds (OFZs) of its own portfolio was responsible for preventing growth in the monetary base. Furthermore, the OFZs sales may facilitate liquidity and depth of the secondary market of federal securities.

In 2016, in an effort to discourage growth of foreign currency denominated liabilities in banks and to promote financial stability, the regulator added 1 percentage point to the required reserves ratio for bank foreign-currency denominated liabilities on April 1 and July 1, and also added 0.75 percentage points on August 1. Furthermore, on August 1, 2016 the Bank of Russia added 0.75 percentage points to the reserve requirements for all types of ruble denominated liabilities of credit institutions. At the same time, note that the increase of the required reserves ratio is a headwind to banking business profits by increasing bank funding through deposit acquisition, which encouraged lower deposit rates that were already on the slide because of liquidity surplus. For instance, the rate on retail ruble denominated deposits with maturities of 1 year or less dropped from 8.53% p.a. in January, to 6.22% p.a. in October 2016 while rates on foreign currency denominated deposits were down from 0.99% p.a. in January, to 0.56% p.a. in October 2016. However, the contraction of deposit rates in real terms was tempered to a certain degree as inflation and inflation expectations subdued. In general, in our view, the hike of the required reserves ratio was quite an efficient measure of constraining growth of the monetary base.

The regulator has since December 23, 2016 raised interest rates on foreign currency swaps that purchase US dollars and Euros for rubles from 0% to a relevant overnight LIBOR rate, and on foreign currency swaps that sell US dollars for rubles from 1.5% to a LIBOR rate plus 1.5 percentage points. The decision was made in response to higher interest rates in external markets due to a tougher Fed's monetary policy. For instance, a U.S. Federal Reserve meeting of December 13–14 decided to add 0.25 percentage points to its federal funds rate target, to 0.5–0.75% p.a.

Finally, one important aspect needs to be emphasized here. The Bank of Russia made its monetary policy more transparent through regular publications of analytical reviews and statistics, including information on inflation expectations, external debt repayment schedule, etc., as well as a series of reports on economic research of pressing issues. In our view, the provision of information concerning objectives and outputs of monetary policy measures, the discussion of the nature of inflation processes are consistent with the information policy practice of central banks in developed economies and contribute to a more efficient monetary policy as a whole. However, note that one of the key issues that narrow considerably the effectiveness of central bank communications is economic agents' insufficient confidence in Bank of Russia's statements. As an illustration, economic agents' projection for inflation rate in 2017 is much higher than 4%. In this context, should the inflation target in 2017 have been achieved, this would significantly raise economic agents' confidence in central bank's commitments, as well as the reputation of the central bank would be improved, and a lower inflation rate would be expected.

2.1.2. Money market

The broad monetary base gained 7.6% in 2016, to Rb 11.9 trillion as of January 1, 2017. Note that in 2015 the monetary base contracted by 2.5%, to Rb 11.0 trillion. In 2016, the monetary base increased basically in response to a shrunken balance on the general government accounts with Russia's central bank as the Reserve Fund was spent. Additionally, the monetary

base increase via this channel was not fully offset by a decline in volumes of Bank of Russia's operations providing liquidity to commercial banks (see *Fig. 3*).

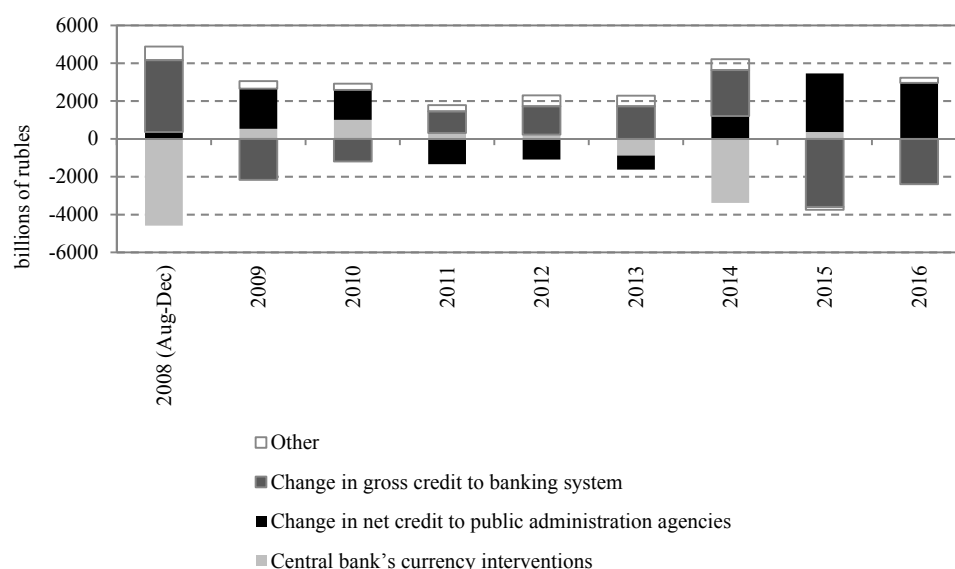


Fig. 3. Key factors that influenced changes to broad monetary base in 2008–2016

Sources: Bank of Russia, Gaidar Institute's own calculations.

All the components of the broad monetary base increased at the 2016 year end. In particular, deposits of credit institutions with the Bank of Russia were up 40.8%, to Rb 785.5bn, bank required reserves rose 31.1%, to Rb 484.7bn, correspondent accounts of credit institutions saw a positive growth of 14.3% (to Rb 1822.7bn), and cash in circulation increased 3.1%, to Rb 8789.8bn. Overall, surplus reserves¹ in M12 2016 contracted in terms of volume by 6.2%, to Rb 2608bn (see *Table 1*).

Table 1

Dynamics of broad monetary base in 2016 (bln Rb)

	01.01.2016	01.04.2016	01.07.2016	01.10.2016	01.01.2017
Monetary base (broad definition)	11,043,8	10,974,5	10,785,6	11,541,2	11,882,7
- cash in circulation, including cash in vaults of credit institutions	8,522,2	7,998,3	8,241,9	8,277,8	8,789,8
- correspondent accounts of credit institutions with the Bank of Russia	1,594,0	2,177,4	1,712,4	2,224,8	1,822,7
- required reserves	369,8	398	394,3	483,9	484,7
- deposits of credit institutions with the Bank of Russia	557,8	400,9	436,9	554,8	785,5
- Bank of Russia's bonds held by credit institutions	0	0	0	0	0
For reference: surplus reserves	2152	2,578	2,149	2,780	2,608

Source: Bank of Russia.

In 2016 the Bank of Russia did not carried out currency interventions under a free-floating exchange rate regime (see *Fig. 4*). Note that with an inflation targeting regime in place, a market-driven exchange rate makes the economy more adaptive to external environment and resilient to adverse shocks.

¹ Surplus reserves in the banking system comprise deposits of credit institutions with the Bank of Russia and correspondent accounts of credit institutions with the Bank of Russia.

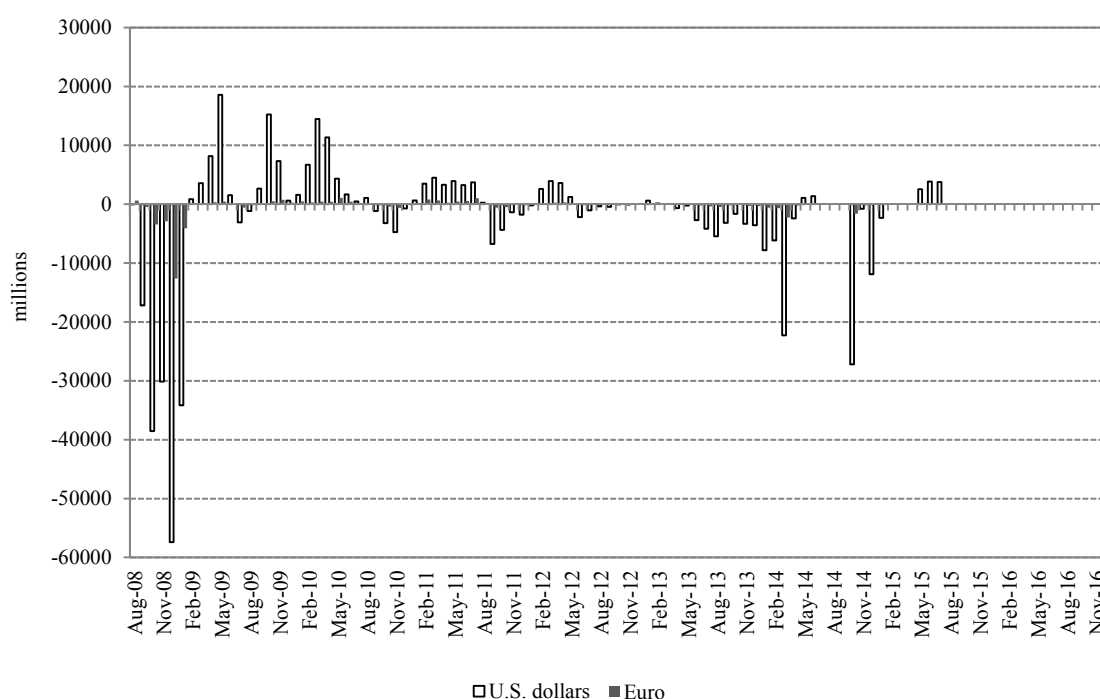


Fig. 4. Bank of Russia's currency interventions (net foreign currency purchases) in 2008–2016

Source: Bank of Russia.

Overall, the Bank of Russia has cut considerably its intervention in the FX market after the global financial crisis, which makes the monetary base dynamics less reliant upon currency interventions.

Russia's international reserve assets increased USD 9.3bn (2.5%) at the 2016 year end, to USD 377.7bn as at early January 2017 (see *Fig. 5*). The FX reserves shrank in terms of volume by USD 2.3bn (0.7%). The monetary gold reserves swelled by USD 11.6bn (24.0%) during the same period compared to the value seen earlier in the year, which was due to a positive revaluation of this asset in H1 2016, totaling USD 15.1bn, and due to a partially offset effect of declining gold prices in global market in some months of H2 2016. As a result, as of January 1, 2017 the foreign currency reserves accounted for 84.1% of the total reserves (86.8% in 2015), and gold made up 15.9% (13.2% in 2015). Russia now holds sufficient reserves to ensure sustainability of its balance of payments, because they cover both 17 months of imports of goods and services in Russia (16 months in 2015) and external debt payments that fall due in 2017. Note that the adequacy of international reserves that have recently seen no change in terms of volume enhances as imports of goods and services contract and the external debt becomes smaller. This allows Russia to ensure its macroeconomic and financial sustainability amid economic problems arising from worsening terms of trade and from Western sanctions freezing Russian economic agents out of global capital markets.

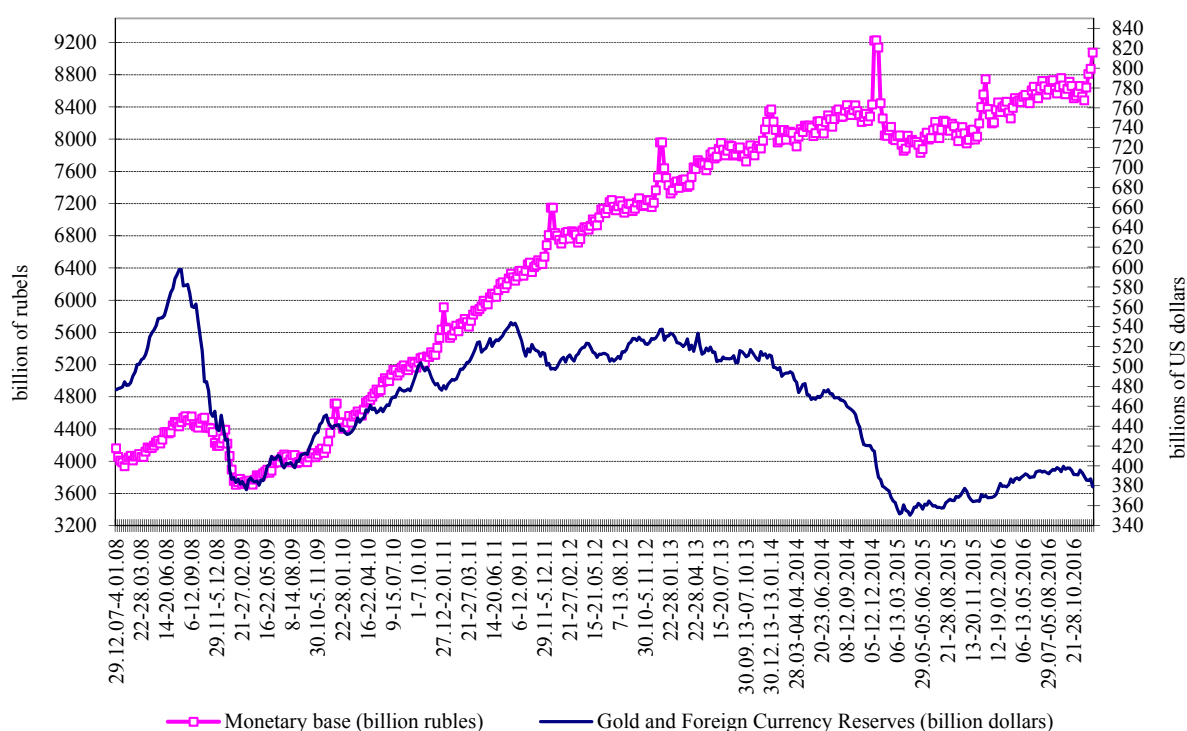


Fig. 5. Dynamics of monetary base (narrow definition) and holdings of foreign currency and gold (international reserves) in 2008–2016

Source: Bank of Russia.

As noted above, the monetary base dynamics in 2016 was largely determined by the debt owed by credit institutions to the Bank of Russia (see Fig. 6). As a reminder, the trend of strong growth of the Bank of Russia's operations to provide loans to credit institutions has been afoot since 2011. In 2014, amid a restricted access for Russian banks to the international capital market, banks' debt to the regulator nearly topped peak values seen during the global financial crisis (second half of 2008 – 2009), showing a 2.1-fold increase in 12 months, to Rb 9.3 trillion as of January 1, 2015. In 2015, the trend reversed subsequent to a liquidity inflow to the banking sector via the budget channel: credits, deposits and other funds raised by credit institutions amounted to Rb 5.4 trillion as of January 1, 2016, a 42% decline from 2014. In 2016, banks' ruble denominated debt to the central bank was halved again, to Rb 2.7 trillion, as spending of the Reserve Fund continued. In this context, the percentage share of credits and deposits of Bank of Russia's assets dropped 6.9 percentage points, to 11.4% as of early September 2016, whereas it was 30.3% earlier in 2015 (see Table 2).

The decline in Bank of Russia's lending to commercial banks is fully offset by massive spending of the Reserve Fund due to financing of the federal budget deficit. In particular, capital inflows to the banking sector in response to a shrunken balance on the general government accounts with the Bank of Russia amounted to Rb 3.0 trillion in 2016 (Rb 3.1 trillion in 2015).

In the period between August and December 2016, the Bank of Russia conducted intensively 1–6-day deposit operations aimed at collecting the money received by the banking sector via the budget channel. Rb 280.3bn were lent on average at such auctions, and the average weighted rate stood at 9.98% p.a. Additionally, base the Bank of Russia decided in September 2016 to issue 3-month-coupon bonds with maturities of 3, 6 and 12 months as a supplementary measure

of tempering growth of the monetary base. The regulator intends to make decisions on certain bond issuances as may be required from time to time, with due regard to transiting to a liquidity structural surplus¹ in the banking sector. According to the data as at early January 2017, no bonds were issued by the Bank of Russia.

Table 2

Bank of Russia Balance Sheet in 2015–2016

	January 1, 2015		January 1, 2016		September 9, 2016	
	billions of rubles	% of assets/liabilities	billions of rubles	% of assets/liabilities	billions of rubles	% of assets/liabilities
Funds placed with nonresidents and securities issued by nonresidents	18.378.6	55.9	21.995.2	62.9	20.278.5	61.0
Credits and deposits	9.950.2	30.3	6.400.3	18.3	3.776.1	11.4
Precious metals	2.726.3	8.3	3.647.3	10.4	4.314.7	13.0
Securities	622.5	1.9	719.9	2.1	518.6	1/6
Other assets	186.6	0.6	920.4	2.6	2.682.6	8.1
Total assets	32.897.6	100	34.947.2	100	33.248.6	100
Cash in circulation	8.840.9	26.9	8.522.5	24.4	8.283.5	24.9
Funds in accounts with the Bank of Russia	13.876.0	42.2	12.573.3	36.0	10.311.4	31.0
<i>of which:</i> <i>Russian government funds</i>	9.144.3	27.8	8.130.7	23.3	6.529.5	19.6
<i>funds of resident credit institutions</i>	2.869.7	8.7	2.528.3	7.2	2.657.0	8.0
Float	1.9	0.01	0.4	0.0	4.4	0.0
Outstanding bonds	-	-	-	-	-	-
Liabilities to the IMF	840.8	2.6	1.074.2	3.1	1.553.7	4.7
Other liabilities	100.4	0.3	160.4	0.5	583.6	1.8
Capital	9.054.1	27.5	12.503.7	35.8	12.512.0	37.6
Total liabilities	32.897.6	100	34.947.2	100	33.248.6	100

Source: Bank of Russia.

With a strengthening ruble, banks decreased their demand for central bank FX refinancing over the course of the year. While in 2015 banks owed USD 26.2bn, on average, to the central bank on foreign currency repos, in 2016 their debt decreased considerably, to USD 13.4bn on average. In December 2016, banks' debt averaged USD 7.6bn, including USD 7.2bn (USD 2.6bn on average in December 2015) on 28-day repos and USD 0.1bn (USD 17.1bn on average in December 2015) on 1-year repos (see Fig. 7). In 2016, the average weighted rate on 1-year repo auctions stood at 4.2% p.a. (1.7% p.a. in 2015), while the average weighted rate on 28-day repo auctions in 2016 was 2.5% p.a., an increase of 0.9 percentage points from 2015.

As regard to foreign currency swaps, a foreign currency swap to provide foreign currency liquidity to the banking system averaged USD 515.1m in 2016. Note that the rate on the ruble-denominated leg of a swap stood at 9–10.5% and on the foreign currency denominated leg at 22 – 1.5% until December. The former was subsequently raised to equal a LIBOR rate. Despite the fact that banks use foreign currency swaps out of today/out of tomorrow on particular days, the key instrument of FX refinancing is foreign currency repos, which can be explained by comfortable terms of foreign currency denominated credits for the longer term.

¹ As defined by the Bank of Russia, the structural deficit/surplus of liquidity occurs when the banking sector is facing a situation where credit institutions are starving for liquidity through operations with the Bank of Russia. The reverse case – credit institutions have a strong need to deposit money in the Bank of Russia – is the structural surplus of liquidity. The estimated structural deficit/surplus of liquidity is the difference between the debt owed on Bank of Russia's refinancing operations and absorption operations.

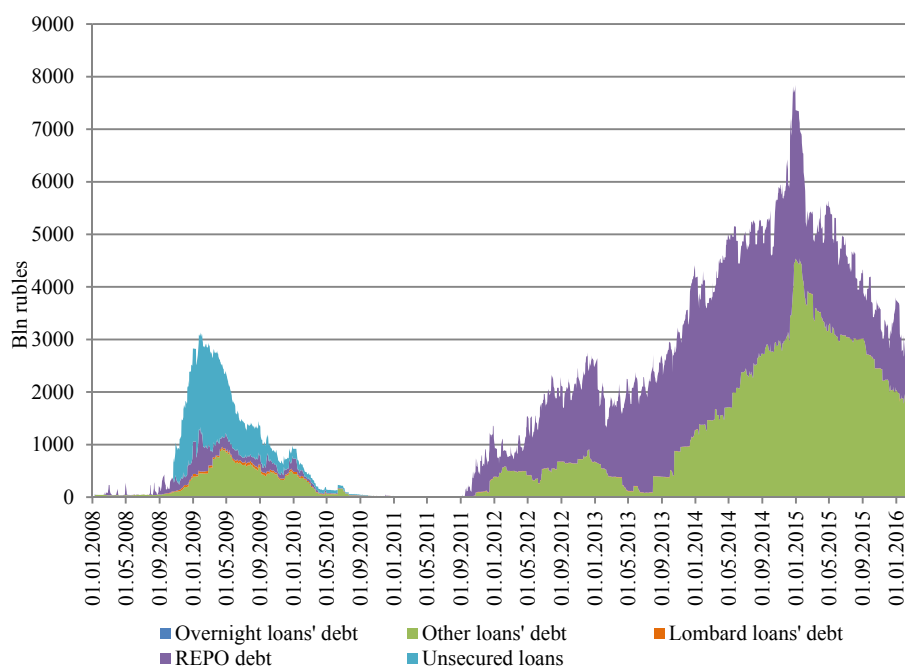


Fig. 6. Commercial banks' ruble-denominated debt (under key instruments) to the Bank of Russia in 2008–2016

Source: Bank of Russia.

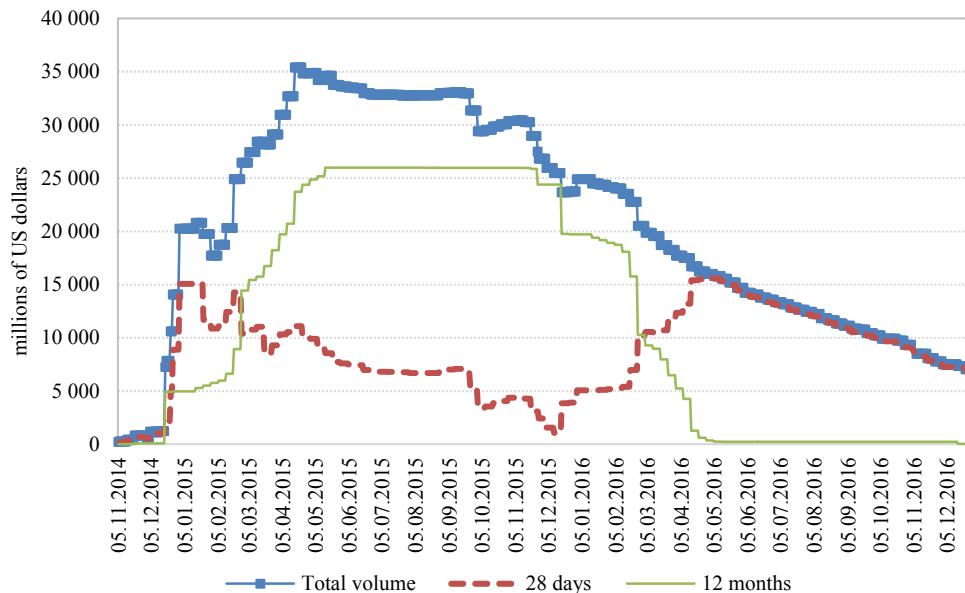


Fig. 7. Amounts to be repaid by credit institutions in 2nd leg of foreign currency repos in 2014–2016

Source: Bank of Russia.

In 2016, as noted above, the banking sector decreased its demand for ruble and foreign currency refinancing from the central bank. The massive capital inflows to the banking sector due to the spending of the Reserve Fund facilitated a surplus in the money market that was facing a liquidity deficit subsequent to the global financial crisis. The interbank interest rate¹ lost 0.9 percentage points in 2016 (from 11.0% p.a. on average in January 2016, to 10.1% p.a. on average in December 2016). Overall, over the course of 2016 the interbank interest rate was staying within the boundaries of the band set by the central bank, hitting its lower boundary from time to time, which was also because the banking sector shifted to a liquidity surplus and due to subdued demand for the central bank liquidity provision. The average MIACR on ruble denominated interbank overnight loans loosened from 12.7% in 2015, to 10.5% p.a. in 2016 (see Fig. 8). Overall, the Bank of Russia 2015–2016 interest rate policy proved efficient in terms of achieving the operational goal of narrowing the gap between interbank interest rates and the key rate. This is related to a money market stabilization, a more predictable Bank of Russia’s interest rate policy that allows economic agents to revise their expectations beforehand.

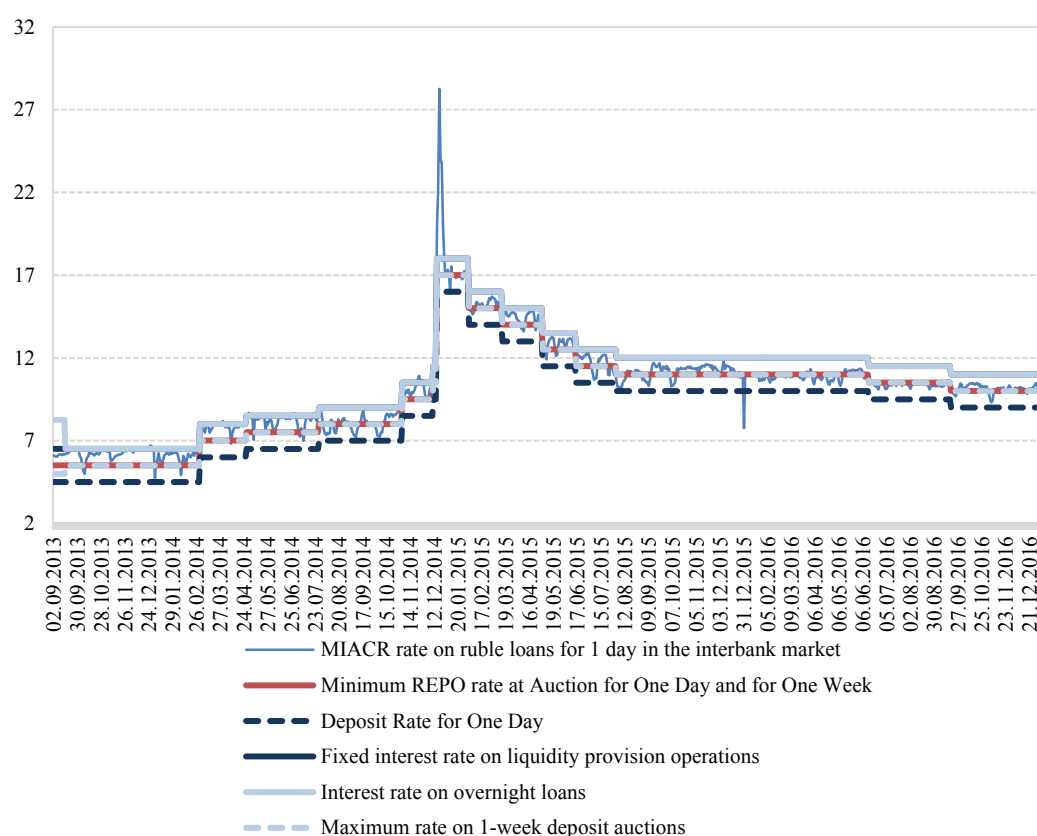


Fig. 8. Bank of Russia’s interest rate band, and dynamics of interbank lending market in 2013–2016

Sources: Bank of Russia, Gaidar Institute’s own calculations.

¹ Interbank interest rate (Moscow InterBank Actual Credit Rate) is monthly average MIACR on overnight interbank ruble-denominated loans.

In 2016, the annualized M2 was growing by an average of 11.3% (7.4% in 2014, 6.5% in 2015). In the period between January and December 2016, the monetary base saw an average increase of 11.4% year-over-year, while the money multiplier underwent no change. The money multiplier (the M2 to Monetary Base ratio) averaged 3.3 in the period between January and December 2016, (3.2 in 2014, 3.3 in 2015). The money multiplier value was equal to the average for developing economies (Ukraine, Belarus, Kazakhstan), whereas it tends to vary within a range of 5–8 in developed countries. Note that the money multiplier rose in Eastern Europe countries over the past two decades as their banking system advanced further. For example, the Poland's money multiplier increased from 3.1 to 6.8 in the period between 1993 and 2016.

In the period between 1999 and 2015, the level of monetization of the Russian economy (the M2 to GDP ratio) tripled, to 63.8% in 2015, reaching for the first time the degree seen in Central and Eastern Europe countries that are traditionally characterized by a higher degree of monetization. For example, the ratio of M2 to GDP in Poland stood at 64.6% in 2015 (40.6% in 1999). For comparison, the ratio of M2 to GDP during the same period increased by 2.2 times, to 37.6%, by 3.1 times, to 42.1%, in Kazakhstan in 2014, by 3.0 times, to 50.2%, in Ukraine. Developed countries have even higher GDP monetization owing to a more advanced financial system: e.g., Germany reached 166% in 2015.

2.1.3. Inflation processes

In December 2016, the inflation rate stood at 5.4% over December 2015, which was much higher than the 2015 level 2015 (12.9%). In 2016, after reaching peak levels in January (+10.0%), the M12 inflation subsequently fell over the course of the year (see *Fig. 9*). As a result, the inflation rate hit a new all-time low at the year end, the previous all-time low was 6.1% (2011).

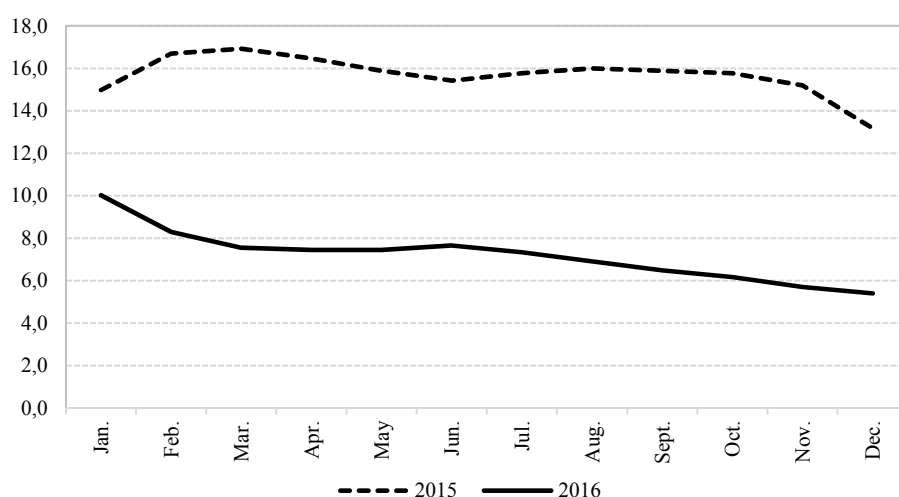


Fig. 9. CPI growth rates in 2014–2016 (12-month % change)

Sources: Rosstat, Gaidar Institute's own calculations.

The inflation rate slowed down in 2016 subsequent to the inflation upsurge of 2015 in response to a double depreciation of the Russian ruble, which, amid a stable ruble exchange rate, was driven by a stagnation in economy and a moderately tough monetary policy of

Russia's central bank. In M12 2016, for instance, the key rate was up as little as 1 percentage points, while the inflation rate (% change, month over month) was down by 7.5 percentage points. In this context, despite the high inertia of inflation expectations (12.4% in December 2016) as well as low degree of economic agents' confidence in the inflation targets, it is very likely Russia's central bank will achieve its medium-term inflation target by 2017.

As shown in *Table 3*, in period between January and December 2016, consumer goods prices saw a slower growth rate over 2015 (4.6% in December 2016 over December 2015 vs. 14.0% in December 2015 over December 2014) (see *Fig. 10*). The growth in prices of butter (+20.5%), milk and dairy products (+9.5%), fish and seafood (+8.6%), grains and legumes (+6.4%), alcoholic beverages (+6.4%) contributed most to the growth in food prices as a whole. A stronger ruble and the bumper crop of 2016 slowed down the growth in food prices.

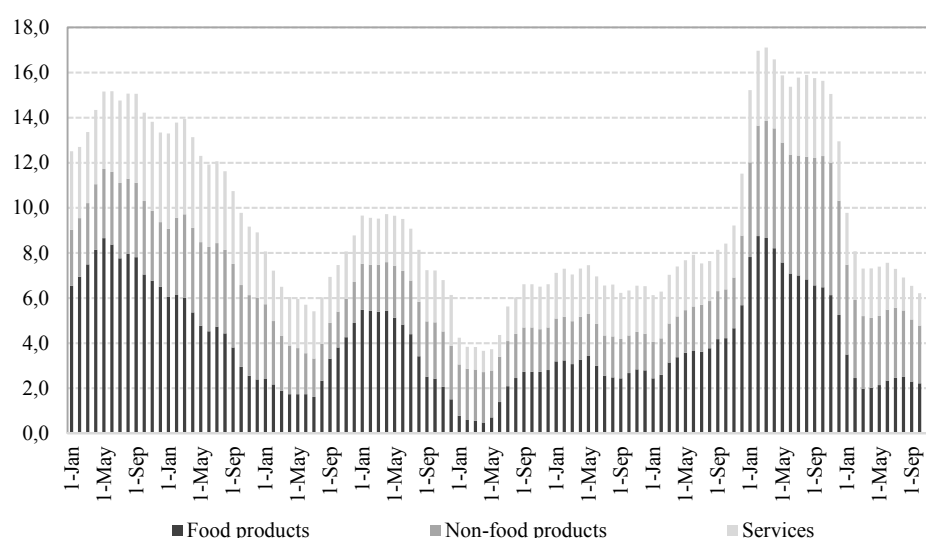


Fig. 10. Structure of inflation in 2008–2016
(% change vs. same month previous year)

Sources: Rosstat, Gaidar Institute's own calculations.

Table 3

**Annual growth rate of prices of certain consumer goods and services
in 2012–2016 (% change, December over December)**

	2014	2015	2016	2014–2016 ¹
1	2	3	4	5
CPI	11.4	12.9	5.4	32.6
Food products	15.4	14.0	4.6	37.6
Grains and legumes	34.6	15.5	6.4	65.4
Butter	14.5	10.6	20.5	52.6
Sunflower oil	5.0	37.2	3.4	49.0
Pasta-based food products	8.4	19.5	4.5	35.4
Milk and dairy products	14.4	11.5	9.5	39.7
Eggs	4.6	9.8	-0.7	14.0
Bread and bakery products	7.5	13.2	5.9	28.9
Meat and poultry	20.1	4.3	1.6	27.3
Fish, other seafood and products thereof	19.1	20.9	8.6	56.4

¹ Inflation rate in 2013–2016.

Cont'd

1	2	3	4	5
Fruits and vegetables	22.0	17.4	-6.8	33.5
Alcoholic beverages	13.7	10.7	6.4	33.9
Non-food products	8.1	13.7	6.5	30.9
Textiles	7.4	19.7	7.6	38.3
Clothing and underwear	6.2	12.8	7.3	28.5
Textile goods	6.2	13.0	7.5	29.0
Footwear	5.7	15.1	9.2	32.9
Washing and cleaning agents	9.2	22.4	6.3	42.1
Medicaments	13.1	19.6	4.9	41.9
Motor gasoline	8.6	4.8	3.8	18.1
Tobacco products	27.1	26.6	17.8	89.6
Services	10.5	10.2	4.9	27.7
Utility services	9.4	10.1	5.4	27.0
Medical services	9.2	11.1	7.8	30.8
Early childhood education services	15.6	16.8	9.3	47.6
Health and leisure services	7.6	14.4	7.3	32.1
Passenger transport services	7.3	10.7	6.6	26.6
Cultural organizations services	9.9	7.2	5.8	24.6

Source: Rosstat.

The continuing ban on food imports from EU countries, Norway, the U.S.A., Canada and Australia that the Russian government introduced in late June 2015 had no stronger effect on the dynamics of prices of the sanctioned goods, because manufacturers and retailers almost adapted to the ban, as was evident from slowing growth of prices of the relevant types of products.

Prices of nonfood products were growing at a slower pace, from 13.7% in 2015 to 6.5% in 2016. Prices of tobacco products rose faster (+17.8%) than of other products in the same group due to an excise tax lift and depreciation of the ruble. A point of note is growth in prices of footwear (+9.2%), textiles (+7.6%), textile goods (+7.5%), clothing and underwear (+7.3%), washing and cleaning agents (+6.3%). Overall, nonfood prices saw a considerably slower growth rate in response to a stable FX market and a slightly stronger ruble amid heavy reliance of the Russian nonfood market on foreign supplies.

In December 2016, the price of paid services to individuals increased 4.9% over December 2015. The growth in prices of early childhood education services (+9.3%), medical services (+7.8%), health and leisure services (+7.3%), passenger transport services (+6.6%) was highly responsible for the growth in prices of paid services as a whole.

According to OOO INFOM's public opinion polls that are published monthly by the Bank of Russia, the median one-year ahead expected inflation rate in 2016 was much higher than the actual inflation rate over the prior 12 months (by 5.7–7.4 percentage points), nearing short of just 1.6 percentage points of the actual inflation rate of 2015. This result proves the inertia nature of inflation expectations. Note that both high inflation expectations and the inertia nature thereof are headwinds to a softer monetary policy by slowing the inflation downward pace.

Finally, we will compare consumer price growth rates in Russia with other countries (see Table 4).

In 2016, Russia was ranked 3rd among CIS countries for consumer price growth rate, after Azerbaijan, Ukraine, Belarus, Kazakhstan and Tajikistan. The inflation rate in Russia in 2016 was, on average, 16 times the inflation rate in developed countries. Overall, the Russian Federation continued facing a high inflation rate compared with both developed countries and emerging market economies.

The aggregate demand recovery is one of the sources of risks of inflation in 2017 that, all else being equal, may lead to an uptrend for consumer goods prices. In particular, nominal wages were up 7.7% in Q1 and Q2 2016, and 8.1% in Q3 compared to the same periods of 2015. In the period between September and December 2015, nominal wages increased by an average of just 3.4% year-over-year. In 2017, pensions were indexed to the actual inflation rate of 2016 (5.4%), as well as financing of the expenses required to attain target wages in certain industries, as set forth by the Presidential Executive Orders issued in May 2012, continued.

Table 4

**Consumer prices dynamics in various countries
in 2013–2016, % a year**

	2014	2015	2016	2014–2016
Azerbaijan	-0.1	7.6	15.7	24.4
Armenia	4.6	-0.1	-1.1	3.3
Belarus	16.2	12.0	10.6	43.9
Kazakhstan	7.4	13.6	8.5	32.4
Kyrgyzstan	10.5	3.4	-0.5	13.7
Moldova	4.7	13.6	2.4	21.8
Russia	11.4	12.9	5.4	32.6
Tajikistan	7.4	5.0	6.1	19.6
Ukraine	24.9	43.3	12.4	101.2
Germany	0.9	0.2	0.5	1.6
France	0.5	0.0	0.2	0.7
United States	1.6	0.1	1.3	3.0
The Netherlands	1.0	0.6	0.3	1.9

Sources: Interstate Statistical Committee of the Commonwealth of Independent States (CIS STAT) (<http://www.cisstat.com/>), OECD database (<http://stats.oecd.org/>).

An extra source of the higher inflation risk in 2017 is accelerated growth rates of the M2 by increasing the monetary base as the Reserve Fund is spent to cover a budget deficit. The increase in the monetary base by spending the Reserve Fund is higher than its decline driven by thinning banks' debt to the central bank, as well as by Bank of Russia's deposit auctions. In this context, interest rates were on the slide in Q1-Q2 2016, despite that the key rate was constant until mid-June. In particular, rates on retail ruble denominated deposits with maturities of 1 year or less dropped from 8.53% p.a. in January, to 7.0% p.a. in November 2016 (in September 2016, the rate fell to 6.18% p.a., the lowest in 2016).

Furthermore, one should avoid neglecting exchange rate risks that may arise in response to a possible worsening of terms of trade. The ruble may depreciate due to uncertainty about the dynamics of crude oil prices (including the issues facing China's economy), as well as a tougher Fed's monetary policy.

The foregoing (the inertia nature of inflation expectations, budget deficit, consumer demand recovery) pose risks of the central bank failing to achieve the target inflation rate at the 2017 year end. At the same time, the inflation rate is still slowing in favor of reaching the target rate. Therefore, in our view, the central bank will continue a policy of slowly declining key rate until the bank officials are sure that the target inflation rate will be reached.

2.1.4. Balance of payments and exchange rate

Through much of 2016, the ruble's nominal exchange rate strengthened against both the US dollar and the euro. Having reached peak values of 83.59 and 91.18 rubles on the January 22nd, the exchange rate of the US dollar and the euro against the Russian ruble dropped to lows of respectively 62.05 and 67.50 rubles by the October 26th (see *Fig. 11*) after Fed's officials

deferred a federal funds rate raise, as well as the economic downturn slowed down in Russia. The ruble depreciated in early 2016 in response to a Fed's federal funds rate hike, as well as in August in response to a higher volatility of global crude oil prices and the shrunken trade balance of Russia, to USD 4.9bn, lowest since April 2009. The strengthening of the ruble exchange rate against the US dollar since mid-November 2016 was driven a series of factors, including the results of the US presidential elections, as well as an OPEC meeting on the November 25th and 30rd, when country-members reached an agreement to cut crude oil production by 1.2 million b/d, to 32,5 million b/d. The year-end ruble's nominal exchange rate strengthened against the US dollar and the Euro by respectively 12% and 15.6% over December 2015.

Through much of 2016, the Russian ruble strengthened against the national currency of other trade partners. Having touched the lowest since June 2003 in February 2016, the ruble real effective exchange rate saw a strong strengthening. With the dynamics of consumer prices slowing at a steady pace, the upward trend was driven first of all by a stronger ruble's nominal exchange rate. As a result, the ruble real effective exchange rate rose by the end of the year, gaining more than 31.1% over February 2016 and 20.8% over December 2015. Although the devaluation effect of 2014 is not over yet after two years, a strengthening ruble nominal exchange rate tempers a positive effect of a softer inflationary pressure.

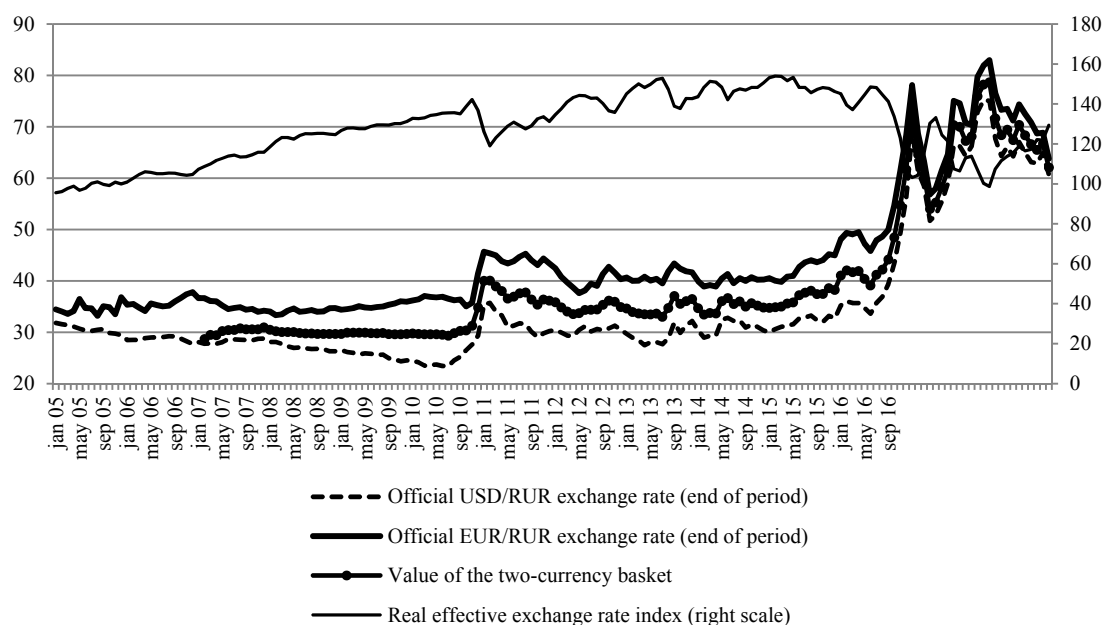


Fig. 11. Dynamics of Russian ruble exchange rate in 2003–2016

Sources: Bank of Russia, own calculations

It is critical – in terms of both the Bank of Russia exchange rate policy and the regulator's medium-term plans – that the volatility of the ruble exchange rate against both the US dollar and the Euro continued declining in 2016. For instance, the average intramonth volatility of the

US dollar and Euro exchange rate against the Russian ruble¹ dropped in 2016 to 1.6% compared to 2.7% in 2015 and to 1.8% compared to 2.7%, respectively. Note that all the developing countries saw exchange rate volatility decrease steadily as economic agents adapted to a new exchange rate mechanism subsequent to an upsurge by shifting to a free floating exchange rate.

The overall situation in the Russian FX market in 2016 shows, first, that Russian economic agents have adapted to a new environment created after the regulator introduced a free floating exchange rate, and, second, the ruble exchange rate has become less reliant on market trends of global crude oil prices.

The BoP data for 2016 show a substantial decline in current account surplus compared with 2015. At the same time there was massive slowdown of net private capital outflows due to slower rates of repayment of loans, thus facilitating a stronger ruble at the 2016 year end.

According to the Bank of Russia's preliminary assessment of the balance of payments (BoP) for 2016, the current account balance stood positive at USD 22.2bn, a decline of USD 46.8bn (-68%) over 2015. The decline of USD 58.1bn (from USD 148.5bn in 2015 to USD 90.4bn in 2016) in a positive balance of trade was highly responsible for that.

Exports of goods dropped in terms of value basically in response to a decline in the average annual price of crude oil (in 2016, average export prices of supplies to foreign countries were USD 289.2 per ton (compared to USD 365 per ton in 2015) and the resulting decline of average annual prices of petroleum products (in 2016, average export prices of supplies to foreign countries were USD 294.5 per ton (compared to USD 393 per ton in 2015) and natural gas (in 2016, average export prices of supplies to foreign countries were USD 157.4 per thousand cubic meters (compared to USD 226 per thousand cubic meters in 2015) (see *Fig. 12*). As a result, exports of crude oil, petroleum products and natural gas accounted for 54% of total exports, down 4.3 percentage points compared with 2015 (see *Fig. 13*).

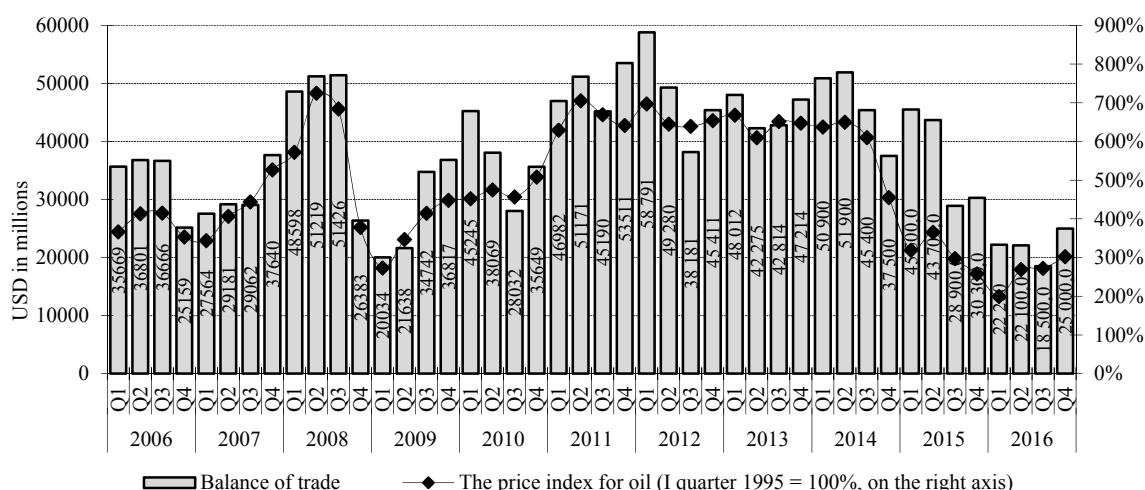


Fig. 12. Russia balance of trade and global oil price index
(Q1 1995 = 100%) in 2006–2016

Sources: Bank of Russia; EIA; Gaidar Institute's own calculations.

¹ Intramonth volatility of the ruble exchange rate against foreign currencies is calculated using daily official exchange rates and is expressed as a percentage ratio of exchange rate standard divergence to its average monthly value.

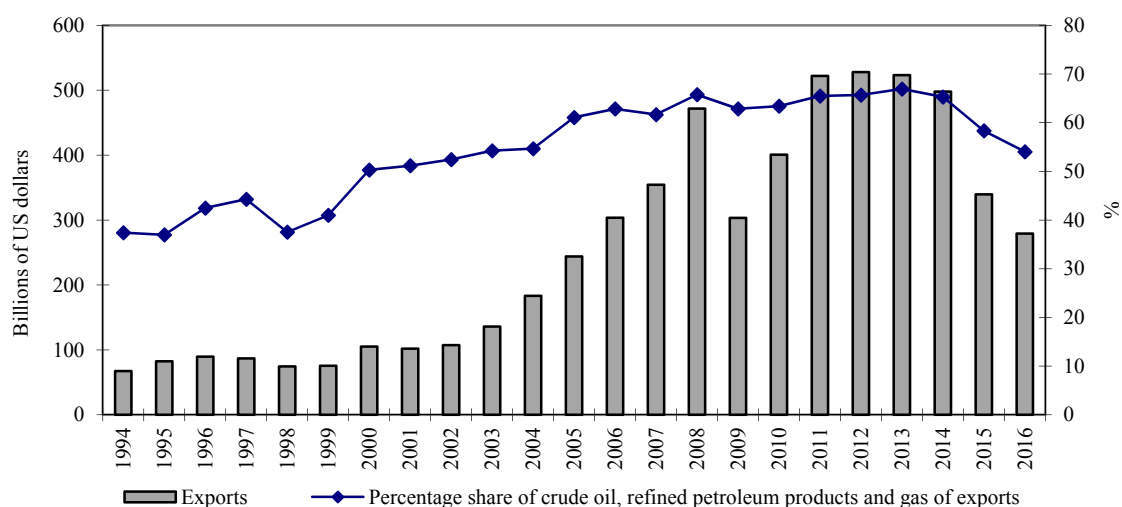


Fig. 13. Dynamics of exports of goods and of percentage share of fuel and energy sector products in 1994–2016

Source: Bank of Russia.

Russia's fuel and energy exports in terms of value dropped USD 50.1bn (-23.2% compared with 2015) while the rest of exports fell USD 7.8bn (-6.1% compared with 2015). Non-energy exports contracted due to falling prices of wheat, metals, fertilizers, as well as because the Russian manufacturing industry failed to increase supplies in terms of physical volume.¹

Stabilization of the ruble's real exchange rate was a reason that caused stagnation of non-resource exports: according to the Bank of Russia, the index of ruble's real effective exchange rate against foreign currencies stood at -0.4% in January-December 2016 compared to the same period of 2015. The ruble's real exchange rate saw minor changes on average in 2016 compared to the rate reported in 2015, which kept imports almost at the same level in value terms. Imports declined by USD 1.6bn (-0.8%), although they started to recover gradually: while Q1 2016 imports (in value terms) accounted for 85% of the level recorded in Q1 2015, they were up to 108% in Q4 2016.

At the same time, imports of services saw a decline of USD 14.3bn (from USD 88.6bn in 2015 to USD 74.3bn in 2016), which was in part due to contraction of imports of transport services, but it was mostly because individuals cut back on their international travel (- USD 11.2bn).

The same level (about USD 50bn) of exports of services and the decline in imports of services together were responsible for the reduction of a negative balance of trade in services, from -USD 36.9bn in 2015 to -USD 24.3bn in 2016. The compensation of employees balance underwent minor changes (-USD 2.5bn in 2016 compared with -USD 5.1bn in 2015). The balance of compensation of employees saw minor changes (-USD 2.5bn in 2016 compared to -USD 5.1bn in 2015). The rest of the current account components remained almost unchanged: the investment income balance was at about -USD 32bn, the balance of secondary income at about -USD 32bn, and the balance of rent at about 0.

¹ For details see A. Knobel, A. Firanchuk. Specifics of Russia's exports and imports in January-August 2016 //Economic Development of Russia. 2016. Vol. 23. No. 11. PP. 15–21.

Therefore, the balance of trade in services and the balance of trade, whose balance depends largely on the dynamics of hydrocarbons prices, are the key factors that determine a current account balance.

The current account surplus declined along with a comparable contraction of the financial account deficit, which ran at USD 12.3bn in 2016 (compared to USD 70.9bn in 2015) (see *Table 5*). Russian economic agents' liabilities to foreign economic agents shrank by USD 3.4bn at M12 (-USD 72.2bn as at 2015 year-end). Residents' foreign asset holdings (foreign economic agents' liabilities to Russian peers) increased USD 8.9bn in 2016 (2015 saw a USD 1.4bn decline in this indicator).

Table 5

**Balance of payments' principal accounts, and dynamics of external debt
in 2013–2016 (bn USD)***

Indicator	2014					2015					2016				
	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4*	Year
Balance of current accounts and of capital accounts	25.5	11.8	-3.9	-17.8	15.5	30.0	16.3	7.8	14.5	68.7	12.3	0.4	0.5	7.6	20.8
Financial account (excluding reserve assets)**	22.5	16.9	0.1	-15.9	23.5	37.5	19.4	2.6	11.3	70.9	7.0	-2.2	-0.3	7.8	12.3
Change in foreign exchange reserves ('+' denotes an increase, '-' denotes a decrease in reserves)	-27.4	-10.3	-5.7	-64.2	-107.5	-10.1	-2.2	9.7	4.3	1.7	2.6	4.4	3.1	-1.8	8.2
Net errors and omissions	-3.0	5.1	4.0	1.9	8.0	-2.6	0.9	4.5	1.1	3.9	-2.7	1.8	2.4	-1.6	-0.1
Change in Russia's external debt ('+' denotes an increase, '-' denotes a decrease of debt)	-13.0	16.9	-51.9	-81.0	-129.0	-43.7	-0.6	-19.1	-18.1	-81.5	2.2	3.3	-4.5	-0.8	0.2
Change in Russia's sovereign external debt	-8.1	3.5	-7.7	-7.8	-20.1	-8.1	2.9	-4.1	-1.8	-11.1	1.5	3.9	4.4	-2.9	6.9
Change in Russian private sector's external debt	-4.4	12.6	-43.8	-68.0	-103.5	-36.0	-2.3	-15.0	-17.5	-70.9	1.6	-0.4	-9.0	1.2	-6.5

* – preliminary estimate; ** – excluding foreign currency reserves.

Source: Bank of Russia.

Federal government agencies' external liabilities increased USD 3.2bn in 2016 as foreign asset holdings dropped USD 0.6bn. In 2016, the growth in monetary regulators' commitments, USD 0.1bn, was offset by an equal decline in foreign asset holdings.

Net capital outflows in the non-public sector amounted to USD 15.4bn in 2016, which is 3.7 times less than the amount recorded in 2015 (see *Fig. 14*). Much of the capital outflow dynamics was owed to operations in the banking sector. In particular, the amount of net capital outflows fell by 6.5 times, from USD 34.2bn to USD 5.3bn. A slowdown in the repayment of bank external debts and liabilities had the strongest effect on the dynamics of the balance of banks' operations with the rest of the world. In 2016, banks' liabilities to non-residents dropped by USD 27.4bn, while they were down USD 60.0bn in the previous year.

Banking sector's external debts and liabilities were partially repaid through selling foreign assets. For instance, banks' foreign asset holdings declined by USD 22.1bn in 2016 (-USD 25.8bn in 2015). Additionally, banks' repayment of foreign currency loans on repos with the Bank of Russia (USD 9.8bn as at 2016 year-end) was responsible for the shrinkage of foreign asset holdings in the banking sector.

Net capital outflows from other sectors were 2.3 times less than in 2015, to reach USD 10.1bn in 2016. The non-bank sector saw its external liabilities increase USD 21.0bn, whereas they dropped by USD 5.8bn in 2015. At the same time, the inflow pattern of non-bank sector's foreign debts and liabilities underwent some changes: direct investment inflows were USD 25.8bn (USD 5.9bn in 2015), portfolio investment inflows amounted to USD 0.7bn (-USD 4.7bn in 2015), loans and credits dropped by USD 7.5bn (-USD 4.8bn in 2015) while other liabilities increased USD 4.3bn (outflow of USD 2.2bn in 2015 was followed by inflow of USD 2.1bn in 2016). Such a great increase in direct investment inflows most likely stemmed from a deal on selling a 19.5% stake in Rosneft worth EUR 10.5bn. Overall, a positive increase in foreign liabilities is indicative of the fact that in 2016 the non-bank sector managed to raise much more funds than was needed to repay its external debts. This was also facilitated by the non-bank sector successfully refinancing its external debts despite limited access to the global capital market due to the continuing sanctions against Russia.

Russia's foreign debt remained nearly unchanged in 2016, running at USD 518.7bn as of January 1, 2017. Note that in 2016 Russian private sector's foreign debt shrank by USD 6.5bn (-USD 70.9bn in 2015) (see *Table 5*). Russia's foreign debt increased USD 6.9bn in 2016, whereas it was down USD 11.1bn in 2015.

According to the data on January–September 2016, banks' assets swelled USD 6.2bn through cash foreign currency transactions with nonresidents (a decline of USD 7.8bn in the same period of 2015). Banks' foreign currency asset holdings dropped USD 8.1bn (a USD 0.6bn decline in Q1–Q3 2015) in response to cash foreign currency buy/sell transactions with individuals at money exchanges, as well as due to closing/opening of foreign currency deposits at bank foreign exchange offices. As a result, according to Bank of Russia's estimates, foreign currency cash in hand increased USD 3.2bn, to USD 43.6bn, in the period between January and September 2016. According to the Russian BoP data, the nonfinancial sector transferred USD 5.1bn (compared to USD 11.3bn in January–September 2015) to foreign contracting parties in Q1–Q3 2016.

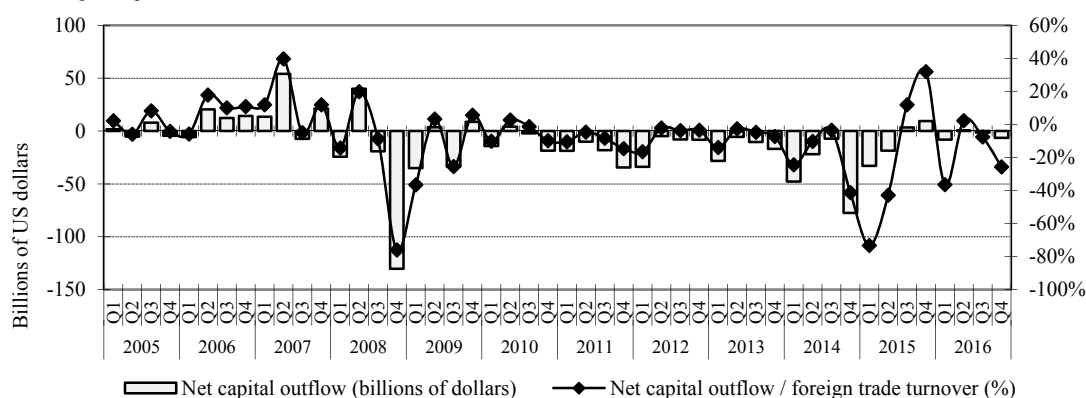


Fig. 14. Dynamics of net capital outflows in 2005–2016

Sources: Bank of Russia; Gaidar Institute's own calculations.

At the 2016 year end, the 2015 capital flight (see Fig. 15) worth, according to our estimates, USD 3bn gave way to an inflow of USD 2.3bn¹.

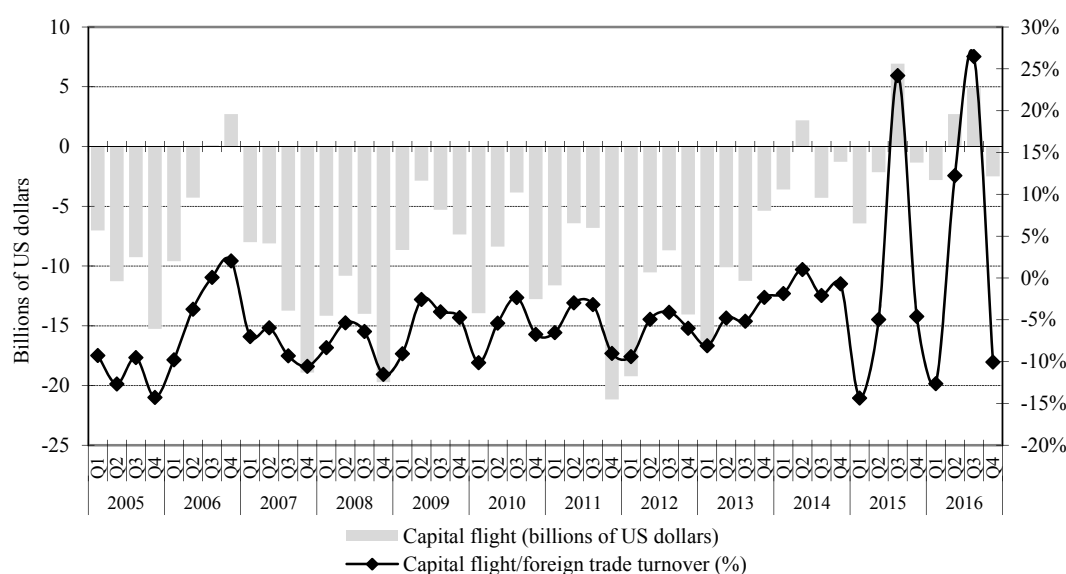


Fig. 15. Dynamics of capital flight in 2005–2016

Sources: Bank of Russia; Gaidar Institute’s own calculations.

In 2017, with global crude prices staying at what they are now (about USD 55 per barrel) and the ruble’s nominal exchange rate at 60 rubles per US dollar, one should expect the ruble’s real exchange rate to strengthen, exports to increase in value terms by 25–40%, and imports to grow by 10–15% compared to 2016. It appears that an increase in the current account balance will be offset by the Bank of Russia purchasing foreign currency for the Ministry of Finance under a provisional budget rule within a volume of federal budget revenues generated if crude oil is traded USD 40 per barrel. Although this measure will in part alleviate the effect of oil price fluctuations on the ruble’s nominal exchange rate, it may force the ruble to weaken in the short term. Risks of ruble devaluation are above all attributed to a possible worsening of terms of trade as well as potential tightening of Fed’s monetary policy, which may spur capital outflows from emerging markets.

2.2. Fiscal policy

2.2.1. Assessment of budgets of the budgetary system of the Russian Federation²

Basic parameters of Russia’s budgetary system

In 2016, fiscal revenues of the enlarged government surpassed 2015 volumes both in absolute terms (by RUB 1,253bn) and in relative terms by 0.5 percentage point of GDP (see Table 6). Expenditures of the enlarged government went up by 0.8 percentage point of GDP

¹ We use the IMF method to measure capital flight, that is, the sum of “trade credits and advances”, “dubious operations” and “net errors and omissions.”

² Authors of chapter: S. Belev – Gaidar Institute, IAES RANEPa; A. Mamedov – Gaidar Institute, IAES RANEPa; E. Fomina – Gaidar Institute, IAES RANEPa; S. Shatalova – Gaidar Institute, IAES RANEPa.

and by RUB 1,581bn in absolute terms. The fiscal deficit of the enlarged government in 2016 was up compared to the level of the previous year (3.7% of GDP in 2016 against 3.4% of GDP in 2015). It should be noted that the fiscal deficit reported in 2015–2016 surpassed manifold its 2013–2014 volumes both in absolute and in relative terms.

Table 6

Basic parameters of the budget of the RF enlarged government in 2012–2016

	2012		2013		2014		2015		2016		Change in 2016 against 2015, percent of GDP
	RUB bn.	% GDP	RUB bn.	% GDP	RUB bn.	% GDP	RUB bn.	% GDP	RUB bn.	% GDP	
Revenues	23 089	34.5	24 082	33.9	26 371	33.3	26 494	31.8	27 747	32.3	0.5
Expenditures	22 826	34.1	24 931	35.1	27 216	34.4	29 308	35.2	30 889	36.0	0.8
Deficit (–) / Surplus (+)	263	0.4	-849	-1.2	-845	-1.1	-2814	-3.4	-3 142	-3.7	-0.3
Reference: GDP, RUB bn.	66 927		71 017		79 200		83 233		85 881		–

Sources: Federal Treasury, Rosstat, Gaidar Institute own calculations.

Analysis of the main parameters of the enlarged government demonstrates that in 2016 growth of state expenditure against 2015 was more moderate – with revenues growing by 0.5 percentage point of GDP, expenditures moved up by 0.8 percentage points of GDP. Meanwhile, in 2015 expansion of state spending by 0.8 percentage point of GDP occurred amid decline of revenues by 1.5 percentage point of GDP. Nevertheless, the outstripping growth of expenditures in comparison with revenues dynamics resulted in larger deficit of the budgetary system in 2016. Emerging trend urges restriction of further budget deficit growth of the enlarged government in order to avoid grave risks for budget and macroeconomic stability.

Revenues from the main taxes to the budgetary system of the Russian Federation

In 2016, the tax burden practically stabilized at the level of the previous year (*Table 7*). Meanwhile, dynamics was mixed across certain components of the tax burden. Revenues from mainly oil and gas sector (hereinafter oil and gas revenues) continued falling – the amount of customs duties and levies declined by 1.0 percentage point of GDP against the 2015 level (by 25.0% in real terms) and revenues from the Mineral Extraction Tax (MET) contracted by 0.5 percentage point of GDP (by 13.9% in real terms). Shortfall in revenues from oil and gas sector was offset by the growth of revenues from other taxes. At the same time, revenues from personal income tax, VAT and profit tax marginally – in the range of 0.1–0.2 percentage point of GDP (by 1.0–2.0%). Revenues from insurance contributions and excises demonstrated notable growth by 0.6 and 0.3 percentage point of GDP, respectively (by 7.1% and 20.4%).

A number of changes were implemented in taxation of the oil and gas sector. In 2016, export duty standard rate on crude oil was not cut to 36% and stayed at 42%. The rate's reduction to 30% is planned from 2017. In the course of implementation of the so-called tax maneuver, the MET standard rate increased from RUB 766 to 857 per ton from January 1, 2016. Simultaneously, coefficient C_{met} was raised from 530 to 559 used for calculation of the indicator, which describes specifics of oil extraction. Planned increase from 4.4 to 5.5 of correcting coefficient C_{mc} (critical micelle concentration) regarding gas condensate was also effected. Moreover, natural gas tax calculation received coefficient, which measures export profitability of a unit of reference fuel (K_{rn}) of extracted hydrocarbons. During 2016, its basic

value amounted to 0.7317 and equated to 1 for certain categories of tax payers. This decision was aimed at withholding additional profit obtained by natural gas exporters owing to positive ruble devaluation effect.

Table 7

**Revenues from the main taxes to the budget of the enlarged government
of the Russian Federation 2012–2016, % of GDP**

	2012	2013	2014	2015	2016	Change in 2016 against 2015	
						Percent of GDP	Real growth, %
Tax burden	32.1	31.6	31.1	29.0	29.1	0.1	-2.0
Profit tax	3.5	2.9	3.0	3.1	3.2	0.1	1.1
Personal income tax	3.4	3.5	3.4	3.4	3.5	0.1	2.0
Insurance contributions	5.8	6.2	6.0	6.4	7.0	0.6	7.1
VAT	5.3	5.0	5.0	5.1	5.3	0.2	2.4
Excises	1.3	1.4	1.4	1.3	1.6	0.3	20.4
MET	3.7	3.6	3.7	3.9	3.4	-0.5	-13.9
Customs duties and levies	7.4	7.0	6.9	4.0	3.0	-1.0	-25.0

Sources: Federal Treasury, Rosstat, Gaidar Institute own calculations.

Despite the fact that the tax maneuver envisaged to replace revenue shortfall due to reduction of export duty of crude oil and petroleum products with receipts from the MET increased rates on crude oil, external economic conditions resulted in a reduction of receipts on crude oil profit in share of GDP (*Table 8*).

Table 8

Volume of export duties on energy resources and MET in 2012–2016, % of GDP

	2012	2013	2014	2015	2016
MET	3.7	3.6	3.7	3.9	3.4
Export duties on energy resources	6.1	5.7	5.8	3.3	2.3
Crude oil	3.7	3.3	3.3	1.7	1.2
Petroleum products	1.7	1.7	1.9	0.9	0.5
Natural gas	0.6	0.7	0.6	0.7	0.6

Sources: Bank of Russia, Federal Treasury, Rosstat, Gaidar Institute own calculations.

The decline of oil and gas revenues was mainly determined by falling prices on Urals crude, which finally was offset neither by ruble's devaluation nor by indexation of the MET standard rate (see *Fig. 16*). In 2016, the MET rate actually averaged a bit over RUB 3,000 per ton against nearly RUB 3,500 per ton in 2015.

Value added tax on goods sold on the territory of the Russian Federation ("internal VAT") increased slightly in 2016 as a percentage of GDP (by 0.2 percentage point). Whereas VAT on goods imported to the territory of Russia reflected the values seen in 2014 (see *Table 9*). Russia continues to have better VAT collection rate on imported goods over that on goods manufactured in Russia as well as an upward trend of the VAT effective rate, which is gradually returning to the 2012 level.

In 2016, revenues from *excises* stopped falling and even surpassed the level seen during the relatively successful 2013 as a percentage of GDP. As *Fig. 17* suggests, revenues from all main groups of excisable products increased last year. Excise duties on tobacco products increased by 0.1 percentage point of GDP and remained the main excisable group. Revenues from excise duties on petroleum products and natural gas moved up (by 0.12 percentage point of GDP). Trend on revenues from alcoholic products reversed (+0.07 percentage point of GDP in 2016).

Revenues from excise duties on sale of motor vehicles and motorcycles remained flat and continued to make up an inconsiderable share of revenues.

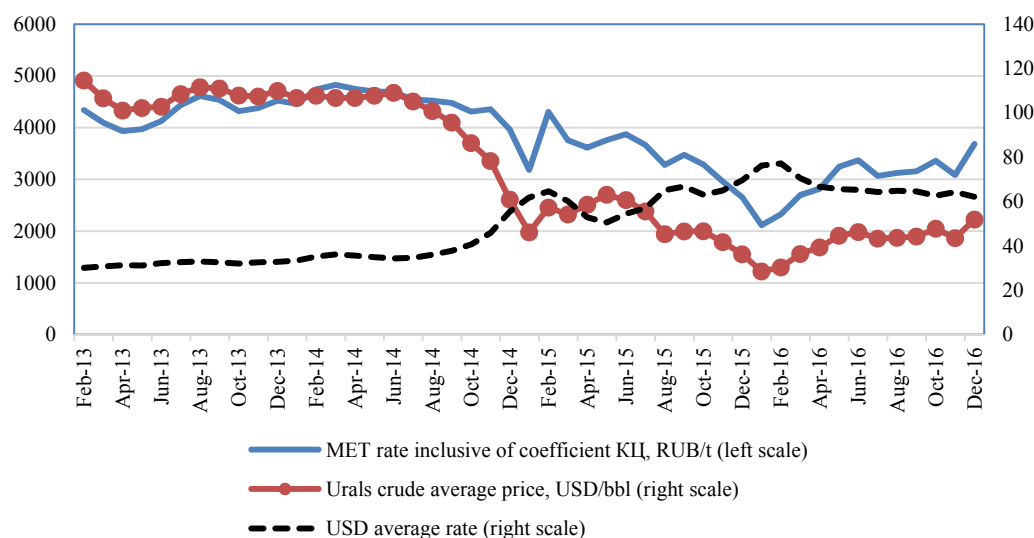


Fig. 16. Dynamics of actual MET tax rate, Urals crude price and USD rate in January 2013–2016

Sources: Consultant+, Bank of Russia, Gaidar Institute own calculations.

Table 9

Dynamics of final consumption, imports and VAT receipts to RF budgetary system in 2012–2016, % of GDP

	2012	2013	2014	2015	2016
Revenues from VAT	5.7	5.0	5.0	5.1	5.3
VAT on goods sold on the territory of the Russian Federation	3.0	2.6	2.8	2.9	3.1
VAT on goods imported to the territory of the Russian Federation	2.7	2.4	2.2	2.1	2.2
VAT effective rate*, %	8.1	6.8	7.0	7.3	7.7
VAT effective rate on goods sold on the territory of the Russian Federation**	6.0	5.0	5.4	6.0	6.3
VAT effective rate on goods imported to the territory of the Russian Federation***	13.1	11.2	10.8	10.4	10.8

* The ratio of VAT receipts to final consumption.

** The ratio of VAT receipts for goods sold on the territory of the Russian Federation to final consumption less import value.

*** The ratio of VAT receipts for goods imported to the territory of the Russian Federation to the value of imports.

Sources: Rosstat, Finance Ministry of Russia, Gaidar Institute own calculations.

Observed dynamics on excises reflects the fact that in 2016 tobacco products to a major extent were subject to indexation of rates (in particular, on cigarettes excise duty went up from RUB 960 to RUB 1,250 per 1,000 sticks and from 11% to 12% of calculated value). Regarding alcoholic products, either there was no rate growth (for strong beverages) or it was insignificant (for wines, cider, and mead came to 1 ruble per liter and for beer 2 rubles per liter). Meanwhile, contraction of sale volume of alcoholic products in physical quantity slowed down for all types.

Regarding *insurance payments* 2016 saw raised threshold requirement for contributions taxed at base rate (the rate remained flat):

- RUB 718,000 for contributions to Social Insurance Fund (against RUB 670,000 in 2015)
 - RUB 796,000 for contributions to Russia's Pension Fund (against 711,000 in 2015).
- This increase coupled with wage bill growth (estimate according to average gross payroll) by 2.8 percentage points of GDP in 2016 resulted in insurance payments growth.

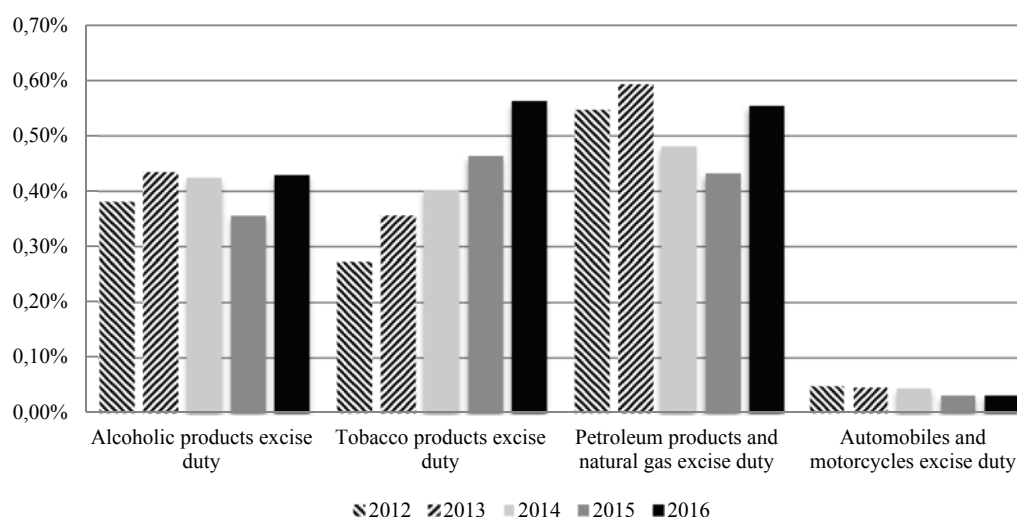


Fig. 17. 2012–2016 revenues from excise duties by group of excisable products, as % of GDP

Sources: Federal Treasury, Gaidar Institute own calculations.

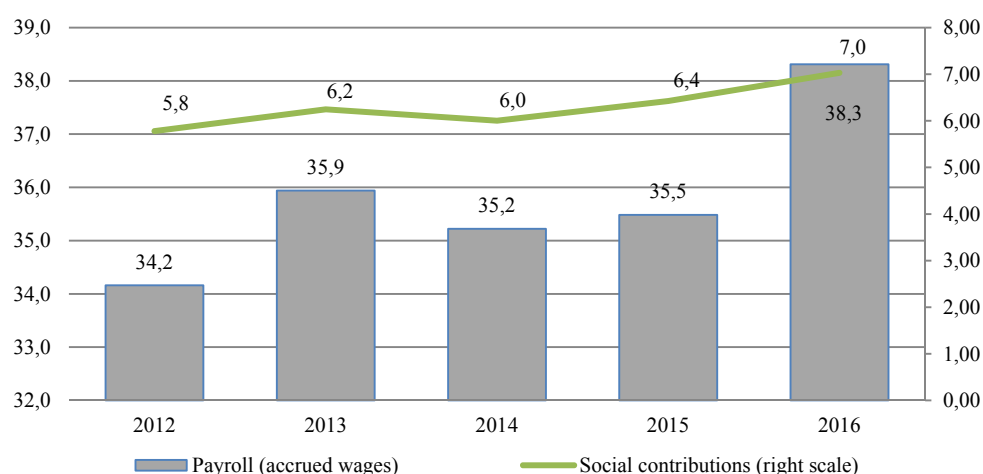


Fig. 18. 2012–2016 revenues from insurance contributions and wage bill (according to gross payroll), as % of GDP

Sources: Federal Treasury, Rosstat, Gaidar Institute own calculations.

Personal income tax. In 2016, cash income minus social contributions declined by 1.4 percentage point of GDP whereas revenues from the personal income tax all the same increased insignificantly by 0.1 percentage point. This reflected the growth of payroll fund in the economy

as a whole in percent of GDP (*Fig. 19*) and, consequently, its share in cash income went up. Increased share of officially reported salary, which led to a larger personal income tax base and affected Rosstat macro indicators to a lesser extent calculated with an account of shadow economy.

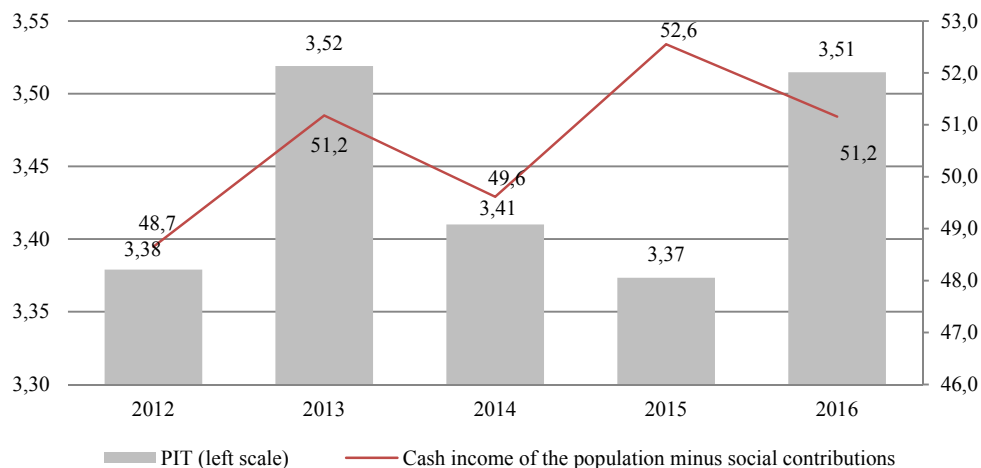


Fig. 19. Revenues from PIT and cash income less social benefits in 2012–2016, as % of GDP

Source: Federal Treasury, Rosstat, Gaidar Institute own calculations.

The profit tax. 2016 saw revenues from the profit tax grow slightly as a percentage of GDP by 0.1 percentage point) reflecting growing profit of profit-making businesses as a share of GDP from 15.2% to 17.1% (see *Fig. 20*). Partly it was due to depreciation of the ruble that helped Russian exporting enterprises to enhance competitiveness against foreign manufacturers by partially offsetting the effect of falling aggregate demand as well as to generate “extra” revenues for such enterprises. Moreover, the share of loss-making businesses continued declining (back to the 2013 level of 31%).

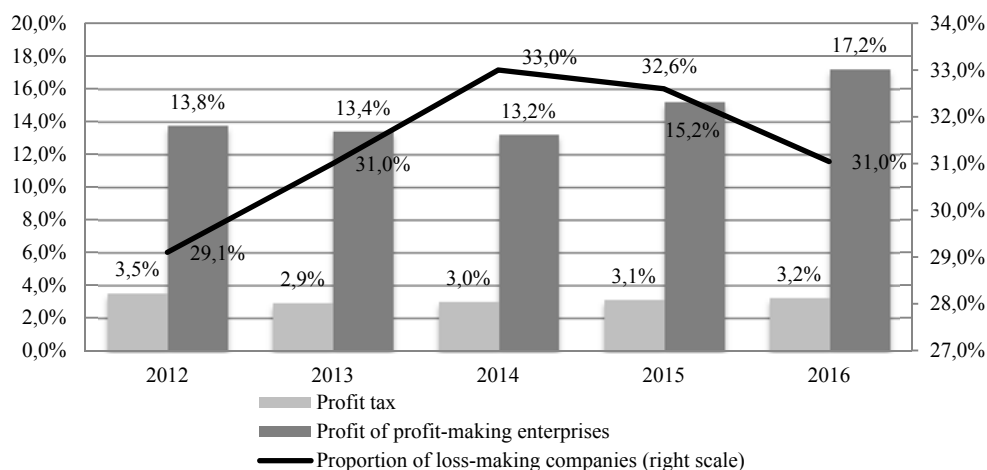


Fig. 20. Dynamics of revenues from the profit tax to Russia's budgetary system, profit of profit-making businesses (% of GDP) and share of loss-making enterprises in 2012–2016

Sources: FTS of Russia, Rosstat, Gaidar Institute own calculations.

Russia's federal budget expenditure

As was mentioned above, the federal budget expenditure in 2016 increased by 0.8 percentage above those in 2015 (see *Table 10*). Herewith, one can note changes in spending for certain lines of budget expenses of the enlarged government in the range of -0.1 to +0.6 percentage point of GDP.

Table 10

Enlarged government expenditure in 2012–2016, as % of GDP

	2012	2013	2014	2015	2016	Change in 2016 against 2015, percentage of GDP
Expenditure, total	34.1	35.1	34.4	35.2	36.0	0.8
General public issues	2.1	2.1	2.1	2.2	2.2	-0.1
State and municipal debt service	0.6	0.6	0.7	0.8	0.9	0.1
National defense	2.7	3.0	3.1	3.8	4.4	0.6
National security and law-enforcement	2.9	3.0	2.8	2.5	2.3	-0.1
National economy	4.9	4.6	5.7	4.5	4.5	0.0
Housing and community amenities	1.6	1.5	1.3	1.2	1.2	0.0
Environmental protection	0.1	0.1	0.1	0.1	0.1	0.0
Education	3.8	4.1	3.8	3.6	3.6	0.0
Culture and mass media	0.7	0.7	0.7	0.6	0.6	0.0
Health and sports	3.7	3.6	3.5	3.7	3.9	0.2
Social policies	11.0	11.8	10.6	12.1	12.2	0.1

Sources: Federal Treasury, Rosstat, Gaidar Institute own calculations.

Commenced even in 2011, increased spending for ‘National Defense’ continued. In 2016, growth came to 0.6 percentage point of GDP and was driven by the implementation of state armaments program designed for 2011–2020 coupled with the introduction of a new system of military compensation and war pensions. Moreover, in November 2016, the Law on the Federal Budget for 2016 was amended triggering noticeable growth of spending for ‘National Defense’ (by RUB 740bn, in more detail see below). Additionally, in 2016, expenditure of the enlarged government for ‘Health and Sports’ went up by 0.2 percentage point on 2015. Increased expenditure for this budget item reflected spending growth of health care in nominal terms by 9.2% on 2015 and physical culture and sports by 2.9%. The most noticeable growth of expenditure for health care was due to provision of outpatient care, which grew by 7.4% in nominal terms against 2015. In more detail, we analyze factors affecting dynamics of expenditure for health care when we look at the budget of the mandatory medical insurance federal fund.

In 2016, spending for ‘Social Policy’ grew by 0.1 percentage point against 2015. In 2016, we can talk about the containment of social expenditure due to lump sum indexation of pensions by 4% (since April 1) meanwhile in 2015 it was done twice. This being said, the amount of other social benefits was indexed in line with the real inflation level recorded in 2015.

In 2016, expenditure for ‘Service of State and Municipal Debt’ also went up by 0.1 percentage point of GDP.

Meanwhile, regarding a number of budget items there was a small reduction of spending in shares of GDP – ‘General Public Issues’ by 0.1 percentage point of GDP and ‘National Security and Law Enforcement’ by 0.1 percentage point of GDP. Regarding other budget items, budget expenditure of the enlarged government in percent of GDP remained at the level of the previous year.

The ratio of “productive” (human capital and infrastructure) and “unproductive” outlays was in favor of unproductive expenses in 2016 in the enlarged government budget, first of all, owing to increasing spending for ‘National Defense’ as well as weak growth of spending on social policy.

Deficit of Russia’s budgetary system

At year-end 2016, the volume of deficit of the enlarged government amounted to 3.7% of GDP up 0.3 percentage points of GDP against 2015 3.4% of GDP). As was mentioned above, the deficit of the enlarged government has been growing since 2013. *Table 11* provides sources for financing the budget deficit of the enlarged government in 2012–2016.

Table 11

Sources for financing budget deficit of budgets in Russia in 2012–2016, as % of GDP

	RUB bn					% GDP				
	2012	2013	2014	2015	2016	2012	2013	2014	2015	2016
Sources for financing deficit of budgets, total	-263	849	845	2 814	3 142	-0.4	1.2	1.1	3.4	3.7
Sources for internal financing of deficit of budgets	-281	797	992	3 110	3 127	-0.4	1.1	1.3	3.7	3.6
State securities	550	436	1 016	9	524	0.8	0.6	1.3	0.0	0.6
Loans of credit institutions	162	283	217	102	-103	0.2	0.4	0.3	0.1	-0.1
Change in budget account balances	-923	-715	-3 047	1 339	3 492	-1.4	-1.0	-3.8	1.6	4.1
Other sources	-70	793	2 805	1 660	-786	-0.1	1.1	3.5	2.0	-0.9
Sources for external financing of deficit of budgets	18	52	-147	-296	15	0.0	0.1	-0.2	-0.3	0.02
State securities	164	185	-47	-183	110	0.2	0.3	-0.1	-0.1	0.1
Loans of foreign states	-26	-22	-25	-51	-17	0.0	0.0	0.0	-0.1	0.0
Loans of credit institutions in foreign currency	0	-1	0	0	-28	0.0	0.0	0.0	0.0	0.0
Other sources	-119	-110	-74	-63	-50	-0.2	-0.2	-0.1	-0.1	-0.1

Sources: Federal Treasury, Gaidar Institute own calculations.

The most part of the deficit of the enlarged government in 2016 was financed from internal sources – around RUB 3,127bn (3.6% of GDP), and from external sources – solely RUB 15bn (0.02% of GDP). We can also stress that for the first time since 2013, there was a surplus balance as a whole both on sources of financing the deficit in foreign currency, and securities denominated in foreign currency.

A significant part of funds obtained from internal sources for financing deficit in 2016 – around RUB 3,492bn or 4.1% of GDP – came from item “Change in budget account balances”. Mainly, this item is formed from the funds of the Reserve Fund (see below).

* * *

Overall in 2016, analysis of the budget parameters of the enlarged government demonstrates that the growth of public expenditure slowed down somewhat. Nevertheless, as in 2015, it exceeded the revenue part, which triggered further increase of the budget deficit. This fact urges further reduction of the deficit in order to avoid significant risks for budget and macroeconomic sustainability. Additional issue is the fact that the deficit growth was accompanied by non-production expenses, first of all, due to build-up of spending on defense as well as somewhat growth of interest expenses and social policy spending.

2.2.2. The characteristic features of the federal budget¹

The specific features of the budgeting process at the federal level

In 2016, certain amendments were made to RF legislation, whereby the specific features of the budgeting process at the federal level were determined. In particular, the alterations introduced by Federal Law No 71-FZ dated May 30, 2016 '*On Suspending Paragraph Four of Item 2 of Article 179 of the Budget Code of the Russian Federation*' are designed to optimize the procedures for adjusting government (municipal) programs. With due regard for the complicated economic situation, the provision of the Budget Code of the Russian Federation (hereinafter to be referred to as RF BC) whereby all government (municipal) programs were to be brought in conformity with the budget law (or budget decision) by April 1, 2016 was suspended for one more year (until January 1, 2017).

In the course of the approval of the federal budget for 2017 and the planning period 2018–2019, it was decided to switch over to three-year budget planning. In this connection it is noteworthy that the decisions concerning the timelines for considering a new draft law and the amendments to the current law on the federal budget for 2016 were influenced by the State Duma election. In order to ensure the adoption of the federal budget for 2017–2019 by the newly elected State Duma, the election date was moved to September. Meanwhile, just as it had done in 2015, the Government of the Russian Federation submitted its draft law with a one-month delay (by November 1, and not by October 1). Thus, in particular, it was the specific purpose of *Federal Law No 158-FZ dated June 2, 2016 'On Suspending Some Provisions of the Budget Code of the Russian Federation and Introducing Alterations into Some Legislative Acts of the Russian Federation'* to optimally organize the budgeting process and to create adequate conditions for the State Duma of the seventh convocation to consider the draft laws on the federal budget and the budgets of government extrabudgetary funds for 2017–2019. Federal Law No 158-FZ created the legal foundation for the Government of the Russian Federation to submit these draft federal laws to the State Duma by November 1, 2016. Another important point is that Federal Law No 158-FZ envisaged the suspension, until January 1, 2017, of the provisions stipulated in Article 199 of the RF BC, whereby the budgetary rule for federal budget was established.

Federal Law No 409-FZ dated November 30, 2016 '*On the Introduction of Alterations into the Budget Code of the Russian Federation and Recognizing Some Provisions of the Legislative Acts of the Russian Federation to be Null and Void*' was adopted in order to provide proper legal conditions for preparing the draft federal law on the federal budget for 2017 and the planning period 2018–2019, and also to consolidate the possibility for prompt redistribution, whenever necessary, of budget allocations to special expenditure functions. By that Federal Law, the norms stipulated in paragraph eight of Item 3 of Article 184.1; paragraph five of Item 2 of Article 199; and the norm stipulated in Article 205 of the RF BC concerning the approval, as part of basic budget targets, of conditionally approved expenditure items, are to be suspended until January 1, 2017, in order to ensure the established ceiling for federal budget deficit in the federal budget for 2017–2019.

¹ Authors of chapter: A. Mamedov – Gaidar Institute, IAES RANEPa; T. Tischenko – Gaidar Institute; E. Fomina – Gaidar Institute, IAES RANEPa; A. Khuzina – IAES RANEPa.

It should also be noted that the *Main Directions of Budgetary Policy for 2017–2019* had been prepared by the RF Ministry of Finance very shortly before the draft law was submitted to the State Duma, which is indicative of the formal (technical) role of such documents.

We can also point out several specific features of the budgeting process that have to do with the law on the federal budget for 2016. To begin with, this is the first time since the switchover to a three-year budget at the federal level (from the period 2008–2010 onwards) that the budget was initially adopted for a period of one year only without approved planning-period targets. Secondly, the law was amended only once while the budget for 2017–2019 was being discussed and approved.

The basic parameters of the federal budget

As demonstrated by the year-end results of 2016, RF federal budget revenue amounted to 15.7% of GDP, which is 0.7 pp of GDP below the corresponding figure for 2015 (the plunge did not exceed 1.5% in nominal terms – see *Table 12*). The downward movement of aggregate federal budget revenue was caused by the radical shrinkage of its oil and gas component, which in 2016 shrank by 17.4% even in nominal terms, and by 1.4 pp as a percentage of GDP. At the same time, an even deeper plunge was avoided thanks to the noticeable growth in the amount of non-oil and gas revenues: over the year 2016, that component increased by 0.7 pp of GDP (or by 10.5% in nominal terms).

Table 12

The main parameters of the federal budget over the period 2012–2016, % of GDP

	2012	2013	2014	2015	2016			Change in 2016 relative to 2015, pp of GDP
					2016 Federal Budget Law*	2016 Federal Budget Law, as amended**	actual	
Revenue	19.2	18.3	18.6	16.4	17.5	16.1	15.7	-0.7
<i>Including:</i>								
oil and gas revenues	9.8	9.3	9.7	7.0	7.7	5.8	5.6	-1.4
non-oil and gas revenues	9.4	9.0	8.9	9.4	9.8	10.4	10.0	0.6
Expenditure	19.3	18.8	19.0	18.8	20.5	19.8	19.1	0.3
Deficit (-) / surplus (+)	-0.1	-0.5	-0.4	-2.4	-3.0	-3.7	-3.4	-1.0
non-oil and gas deficit	-9.9	-9.8	-10.1	-9.4	-10.7	-9.3	-9.1	-0.3
<i>GDP, RUB bn</i>	<i>66,927</i>	<i>71,055</i>	<i>77,893</i>	<i>83,233</i>	<i>78,673</i>	<i>82,815</i>	<i>85,881</i>	
<i>Price of Urals, USD/ barrel</i>	<i>110.6</i>	<i>108.0</i>	<i>97.6</i>	<i>51.2</i>	<i>50.0</i>	<i>41.0</i>	<i>41.9</i>	

* Federal Law No 359-FZ dated December 14, 2015 'On the Federal Budget for 2016'.

** As amended on 22 November 2016 by Federal Law No 397 FZ.

Sources: Federal Treasury; Rosstat; Gaidar Institute own calculations.

Federal budget expenditure executed over 2016 amounted to 19.1% of GDP, which is 0.3 pp of GDP above the corresponding index for 2015 (in nominal terms, it increased by 5%). This growth in expenditure was contributed to by an increase in both interest and non-interest spending: the growth of expenditures related to public debt servicing amounted to 19.8%, and that of non-interest expenditures – to 4.6%. A more detailed discussion of the movement patterns of different expenditure functions follows later in our review.

The year 2016 saw a continuation of the increase in the federal budget deficit, which climbed to 3.4% of GDP, thus overshooting its 2015 level by 1.0 pp of GDP. At the same time, the non-oil and gas deficit kept on decreasing, thus continuing the downward trend that began as far back as 2015: it amounted to 9.1% of GDP, which represented a 0.3-pp-of-GDP drop on 2015. In other words, in recent years the dependence of the federal budget on the situation in global

energy markets has been *de facto* steadily declining. Thus, the share of oil and gas revenues in total federal revenue was steadily on decline: from 51% in 2014, to 43% in 2015, to 35% in 2016. This fledging trend is strongly related to a considerable shrinkage of Russia's oil and gas revenues and, correspondingly, of their share of GDP. Thus, while GDP growth in nominal terms by the year-end of 2016 had amounted to 3.2%, production growth under the *Mineral Resources Extraction* section of the federal budget had been only 1.4%, which resulted in a shrinkage of its relative share in the structure of GDP by 0.2 pp. At the same time, gross value added in terms of physical volume under the *Mineral Resources Extraction* section of the federal budget gained 0.2% in 2016, while GDP in terms of physical volume over the same period lost 0.2%. Thus, the shrinkage of the relative share of *Mineral Resources Extraction* in GDP had been caused by the unfavorable behavior of export prices for energy carriers.

Traditionally, the planned targets in a new budget are based on the most conservative version of a macroeconomic forecast; on the one hand, this approach makes it easier to execute the budget, while on the other, it imposes certain constraints on the possibility to influence economic development through budgetary policy. However, in 2016, even the most conservative forecast proved to be too optimistic. Some of the basic macroeconomic parameters plunged below their forecasted values: the price of oil (USD 41.6 per barrel instead of USD 50 per barrel); GDP growth rate (-0.2 instead of +0.7%); and inflation (5.4 instead of 6.4%). These developments made it necessary to correspondingly adjust all basic parameters of the federal budget, which resulted in a budget deficit growth exceeding the initial estimate of 3% of GDP (*Table 12*). This suggests that macroeconomic forecasting can be partially used as a tool for forming the 'targeted' budget parameters and for adjusting the budget in the phase of its adoption (in order to ensure the observance of all norms of the RF Budget Code), while further budget adjustment may be done later, in the course of budget execution, which clearly reduces the transparency of the budgeting process as a whole.

When considering the issue of ensuring a balanced federal budget, it is important to note that the federal budget for 2016 would have been balanced if the average crude oil price had stood within the USD 107–110 per barrel range. It should be reminded that the federal budget for 2008 had been balanced at the average annual oil price of 57.5 USD per barrel. This discrepancy shows that over the period 2008-2016, Russia considerably increased her budget expenditure; and it also indicates a huge growth in budget risks associated with the high volatility and weak predictability of world prices for energy carriers.

The main revenue sources

As far as their volumes and composition are concerned, the parameters of execution of the revenue side of the federal budget for 2016 are presented in *Table 13*. In 2016, the aggregate revenue of the federal budget dropped by 0.7% relative to 2015. The dynamics of the revenue side of the federal budget continues to be determined by the size of oil and gas receipts, despite the emergence of a trend towards lessening the budget's dependence on MET and export duties on crude oil and petroleum products. Thus, in 2016, oil and gas revenues declined by 1.4 pp of GDP relative to 2015. At the same time, the non-oil and gas component of the revenue side of the federal budget increased by 0.7 pp of GDP, which made it possible for the budget to partly compensate for the decline in its oil and gas component.

On the whole, the decline in Russia's oil and gas revenues in 2016 was caused by a considerable fall in world oil prices, and it should be added that the aforesaid budget losses were partly compensated for by the ruble's weakening against the US dollar. As regards the

composition of the oil and gas revenues in the federal budget for 2016, it is obvious that the lion's share of them was generated by MET, while the share of export duties had been declining since 2015 (as a result of the implementation of the 'tax maneuver'). As indicated earlier, the volume of revenues from MET shrank by 0.5 pp of GDP relative to 2015, whereas the drop in revenues from export duties was almost twice as large – 0.9 pp of GDP). Revenues from export duties on energy carriers could have fallen even more significantly than that, if the legislative authorities had had not taken the decision that the basic rate should remain at its 2015 level. These legislative changes, which in fact violated the very logic of the 'tax maneuver', noticeably conduced to alleviating the federal budget losses caused by the drop in oil prices.

Table 13

**The main tax receipts in the federal budget over the period
2012–2016**

	% of GDP					Change in 2016 relative to 2015, pp of GDP
	2012	2013	2014	2015	2016	
Revenue, total	19.2	18.3	18.3	16.4	15.7	-0.7
Oil and gas revenues	9.6	9.2	9.4	7.0	5.6	-1.4
including:						
MET	3.6	3.5	3.6	3.8	3.3	-0.5
export duties	6.1	5.7	5.8	3.3	2.3	-0.9
Non-oil and gas revenues	9.6	9.1	8.9	9.4	10.0	+0.7
including:						
Corporate profit tax	0.6	0.5	0.5	0.6	0.6	0.0
VAT on goods sold in RF territory	2.8	2.6	2.8	2.9	3.1	+0.2
VAT on goods imported into RF territory	2.5	2.4	2.2	2.1	2.2	+0.1
Excises on goods produced in RF territory	0.5	0.6	0.7	0.6	0.7	+0.1
Excises on goods imported into RF territory	0.1	0.1	0.1	0.1	0.1	0.0
import duties	1.1	1.0	0.8	0.7	0.6	0.0
export duties	0.2	0.2	0.2	0.1	0.1	0.0

Sources: Federal Treasury; Gaidar Institute own calculations.

The growth of the non-oil and gas revenues of the federal budget was associated with a notable rise in revenues from a number of taxes as well as in non-tax revenues, resulting from the receipt of additional revenues from the partial privatization of Public Joint Stock Company *Rosneft Oil Company* (about RUB 70bn). Tax revenues from the sale of goods in the territory of the Russian Federation increased by 0.2 pp of GDP, while revenues from VAT on imports and 'domestic' excise taxes grew by 0.1 pp of GDP. In 2016, the volume of revenues from import duties, corporate income tax, excise taxes on imports, and customs duties on exports (apart from the oil and gas component) remained at its 2015 level.

The expenditure side of the federal budget

In 2016, the volume of federal budget expenditure amounted to 19.1% of GDP, which represented a rise by 0.3 pp of GDP relative to 2015 (in nominal terms, expenditure increased by 5.1% – see *Table 14*). The rise in expenditure involved both interest and non-interest expenditures. The rise in interest expenditures (+19.8%) was due to a significant increase in expenditures on external debt servicing (+28%), while the growth rate of domestic debt servicing was much smaller (+1%). One of the factors behind the increase in debt servicing was the build-up of debt in 2016: in 2015, the volume of domestic debt declined by 1.1%, while over the course of 2016 its nominal growth amounted to 4% (for more details, see below). Yet another factor was a slight increase in interest rates.

Table 14

**Federal budget expenditure over the period 2015–2016
(by-function distribution of federal budget expenditure)**

	2015	2016	Change		Budget execution, relative to approved annual budget projections, %		Deviation of implementation of annual targets in 2016 from that in 2015, %
	% of GDP	% of GDP	nominal growth rate, %	pp of GDP	2015	2016	
Expenditure total, including:	18.8	19.1	5.1	0.3	98.5	98.7	+0.2
Nationwide issues	1.3	1.3	-2.0	-0.1	98.6	97.1	-1.5
National defense	3.8	4.4	18.7	0.6	99.8	99.2	-0.6
National security and law enforcement activity	2.4	2.2	-3.4	-0.2	98.8	100.4	+1.6
National economy	2.8	2.7	-1.0	-0.1	96.5	95.9	-0.6
Housing and community amenities	0.2	0.1	-50.0	-0.1	98.0	95.5	-2.5
Environmental protection	0.1	0.1	26.9	0.0	99.4	99.6	+0.2
Education	0.7	0.7	-2.1	0.0	99.2	99.1	-0.1
Culture, cinematography	0.1	0.1	-2.9	0.0	99.8	96.3	-3.5
Healthcare	0.6	0.6	-1.9	0.0	97.8	97.6	-0.2
Social policies	5.1	5.3	7.6	0.2	99.6	99.7	+0.1
Physical culture and sports	0.1	0.1	-18.3	0.0	97.8	88.7	-9.1
Mass media	0.1	0.1	-6.7	0.0	99.9	99.9	0.0
Government debt servicing	0.6	0.7	19.8	0.1	87.5	97.1	+9.6
Inter-budgetary transfers	0.8	0.8	-1.5	0.0	99.7	99.8	+0.1

Sources: Federal Treasury; Gaidar Institute own calculations.

When analyzing the data presented above it can be seen that the growth in the total volume of federal expenditures over the course of 2016 was mainly due to a rise in the government spending under the *National Defense* section by 0.6 pp of GDP (or by 18.7% in nominal terms). In 2016, government spending under the *Social Policies* section of the federal budget increased by 0.2 pp of GDP (or by 7.6% in nominal terms) relative to 2015. The aforesaid growth in social expenditure was largely due to a significant increase in expenditures on pension provision (which grew by 11% in nominal terms).

At the same time, there was a decrease in the amount of funding designated to some expenditure lines. Government spending under the *National Economy* section of the federal budget declined by 0.1 pp of GDP (or by 1% in nominal terms), while government spending under the *National Security and Law-Enforcement Activity* section decreased by 0.2 pp of GDP (or by 3.4% in nominal terms).

When expressed in percentage points of GDP, government spending under the other major functional sections of the federal budget remained practically unchanged relative to 2015.

It should be noted that the dynamics of spending under the *National Defense*, *Social Policies*, and *National Economy* sections of the federal budget was strongly influenced by the amendments introduced to the federal law on the federal budget for 2016 in November 2016. As a result of those amendments, budget allocations were redistributed among various expenditure items of the federal budget, and the volume of expenditure was increased by RUB 304bn by comparison with the previously approved one. This growth in expenditure was associated with the rise in allocations to *National Defense* (by RUB 740bn) and *Social Policies* (by RUB 177bn). The aforesaid rise in defense spending was mainly determined by the allocation of funds to military-industrial complex enterprises for the purpose of repaying their previous bank loans with payback periods expiring in 2016–2018. The allocation of the whole payback amount in 2016 was intended to reduce the corresponding expenditure in 2017–2018. The increase in government spending under the *Social Policies* section of the federal budget

was largely determined by the rise in government spending on pension provision. At the same time, the introduced amendments resulted in a decrease in the amount of funding designated to some expenditure lines. The most significant decline in funding (by RUB 427bn) was suffered by the *National Economy* section of the federal budget.

The federal budget for 2016 comprised a number of additional norms that permitted to use the budget's undistributed reserves in the course of its execution. In particular, the budget included a budget reserve fund designed to finance the implementation of additional measures aimed at supporting individual branches of the economy (within the framework of the government's 'anti-crisis plan'), providing social support for citizens and rendering financial assistance to the Russian Federation's subjects. This budget reserve fund amounted to RUB 65bn (with the possibility of being increased by RUB 150bn at the expense of the previous federal budget's surpluses left unspent by the beginning of 2016). The budget also envisaged the possibility of using up to RUB 342.2bn upon the RF President's or the RF Government's decision (in the situations specified in the instructions of the RF President). These norms, which considerably increased the share of reserved funds, conducted to a decrease in the transparency of the federal budget, which had been already not too high as it was due to the existence of a significant proportion of 'closed' (or classified) articles of the federal budget.

Table 14 also presents data on the execution of the expenditure side of the federal budgets for 2015–2016 relative to the approved annual budget projections. As far as these data are concerned, it can be noted that in 2016, the proportion of the executed annual budget over the approved one amounted to 98.7%, which represents a 0.2 pp rise relative to 2015. The most significant growth in the aforesaid proportion was registered with regard to the following two sections of the federal budget: *Government Debt Servicing* (by 9.6 pp) and *National Security and Law Enforcement* (by 1.6 pp). However, some of the budget functions were executed in a much lesser proportion relative to their annual targets: *Physical Culture and Sports* (by 9.1 pp); *Culture and Cinematography* (by 3.5 pp); *Housing and Community Amenities* (by 2.5 pp); and *Nationwide Issues* (by 1.5 pp).

The amount of federal budget expenditure allocated to the implementation of government programs (GP) in 2016 (Table 15) was RUB 8,700bn or 10.1% of GDP, which was a step down by 0.2 pp of GDP relative to 2015. The share of program budgeting in the total volume of federal budget expenditure for 2016 shrank to 52.9% vs. 55.0% in 2015; meanwhile, the share of unclassified items in the total volume of expenditure allocated to the implementation of government programs in 2016 did not change relative to the previous year (89%).

Table 15

**Federal budget expenditure over the period 2015–2016
(by-function classification)**

Government program title	2015 (actual)		2016 (actual)		Change in 2016 relative to 2015	
	RUB bn	% of GDP	RUB bn	pp of GDP	in nominal terms, %	pp of GDP
1	2	3	4	5	6	7
Expenditure allocations for government programs	8,594	10.3	8,700	10.1	1.2	-0.2
- including non-classified program budgeting	7,714	9.3	7,763	9.0	0.6	-0.2
- including budgeting directions:						0.0
<i>New quality of life block, including:</i>	<i>3,341</i>	<i>4.0</i>	<i>3,411</i>	<i>4.0</i>	<i>2.1</i>	<i>0.0</i>
GP Development of education	447	0.5	429	0.5	-4.0	0.0
GP Development of healthcare	378	0.5	375	0.4	-0.8	0.0

Cont'd

1	2	3	4	5	6	7
GP Social support for citizens	1,147	1.4	1,208	1.4	5.3	0.0
GP Public order maintenance and crime prevention	839	1.0	841	1.0	0.2	0.0
<i>Innovative development and modernization of the economy block, including:</i>	2,161	2.6	2,150	2.5	-0.5	-0.1
GP Economic development and innovative economy	127	0.2	98	0.1	-22.8	0.0
GP Development of science and technology	150	0.2	147	0.2	-2.0	0.0
GP Development of industry and improvement of its competitive capacity	168	0.2	230	0.3	36.9	0.1
GP Development of transport system	830	1.0	825	1.0	-0.6	0.0
GP Development of agriculture and regulation of agricultural products, raw materials and foodstuffs	222	0.3	218	0.3	-1.8	0.0
GP Russia's outer space activities	170	0.2	192	0.2	12.9	0.0
<i>Balanced regional development block, including:</i>	714	0.9	854	1.0	19.6	0.0
GP Socioeconomic development of Crimean Federal Okrug	94	0.1	112	0.1	19.1	0.0
GP Development of federative relations and creation of conditions for efficient and responsible management of regional and municipal finance	659	0.8	665	0.8	0.9	0.0
<i>Efficient government block, including:</i>	1,267	1.5	1,337	1.6	5.5	0.0
GP Management of state finance and regulation of financial markets	785	0.9	878	1.0	11.8	0.1
<i>Expenditures on implementation of government programs (classified budgeting)</i>	<i>880</i>	1.1	<i>937</i>	1.1	<i>19.1</i>	0.0

Sources: Federal Treasury; Gaidar Institute own calculations.

As far as the four major expenditure lines of the government programs are concerned, their dynamics in 2016 and the main changes therein as compared to 2015 were as follows:

- government spending on the *New Quality of Life* block remained practically unchanged, at around 4.0% of GDP. When expressed as a share of GDP, the volume of budget funding for the government programs *Development of Healthcare*, *Development of Education*, *Social Support for Citizens* and *Public Order Maintenance and Crime Prevention* also remained practically without any change. When expressed in nominal terms, the amount of funding designated to this expenditure line changed only insignificantly, within the range between -4% (GP *Development of Education*) and +5.3% (GP *Social Support for Citizens*);

- government spending on the *Innovative Development and Modernization of the Economy* block declined by 0.1 pp of GDP, to 2.5% of GDP. The volume of budget funding for the government program *Development of Industry and Improvement of Its Competitive Capacity* increased by 36% in nominal terms, or by 0.1 pp of GDP. When expressed as a share of GDP, the volume of spending on the other government programs remained unchanged, while slightly decreasing in nominal terms;

- government spending on the *Balanced Regional Development* block grew by 19.6% in nominal terms, or by 0.1 pp of GDP. At the same time, the volume of budget funding for the government program designed to promote the socioeconomic development of the Crimean Federal Okrug went up in nominal terms, while spending on the government program *Development of Federative Relations and Creation of Conditions for Efficient and Responsible Management of Regional and Municipal Finance* was increased by a mere 0.9%.

- government spending on the *Efficient Government* block did not change in terms of a share of GDP, while in nominal terms it slightly increased – by 5.5%. At the same time, the volume

of funds allocated to the government program *Management of State Finance and Regulation of Financial Markets* gained 11.8% in nominal terms, or 0.1 pp of GDP.

Most of the increase in the non-classified program and non-program expenditures was associated with the growth in budget allocations to 'long-lasting' undertakings, such as the inter-budgetary transfers to the Pension Fund, the normative legal liabilities to step up payment for labor, and other social payments.

Among other things, the *Institutional Classification of Budget Expenditures* makes it possible to analyze the regularity and the degree of budget expenditure implementation with regard to individual ministries and institutions. *Table 16* shows a list of 10 chief budget funds managers (CBFMs) with the least year-end indices of expenditure implementation relative to the annual targets for 2016.

Table 16

CBFMs with the least degree of budget expenditure implementation relative to annual targets, year-end indices for 2016

No	CBFMs	CBFM code	Budget execution, %	
			2015	2016
1	Federal Space Agency	259	91.7	58.5
2	Federal Agency for Ethnic Affairs	380	95.9	67.1
3	Federal Agency for Air Transport	107	76.3	70.9
4	RF Ministry of Justice	318	91.0	86.9
5	RF Ministry of Economic Development	139	96.4	88.1
6	RF Ministry of Sport	777	97.9	88.8
7	State Duma of the Federal Assembly of the Russian Federation	330	97.0	91.9
8	Executive Office of the President of the Russian Federation	303	97.7	92.2
9	Federal Agency for Mineral Resources	49	99.0	93.1
10	Federal Water Resources Agency	52	85.9	93.5

Sources: Federal Treasury; Gaidar Institute own calculations.

Special attention should be drawn to the fact that, judging from their 2016 year-end results, six out of the ten analyzed CBFMs had budget execution rates well below 90%. It is also important to note that in 2016, nine out of the aforesaid ten institutions displayed budget execution rates much smaller than they had been in 2015. Only one out the ten CBFMs (the Federal Water Resources Agency) increased its annual budget execution rate (by 7.6 pp) as of year-end 2016. The most noticeable decline in the budget execution rate was shown by two CBFMs, the Federal Space Agency (by 33 pp) and the Federal Agency for Ethnic Affairs (by 29 pp). The remaining seven CBFMs saw their budget execution rates drop by 4–9 pp relative to 2015.

Deficit and debt at the federal level

The volume of federal budget deficit in 2016 amounted to RUB 2,956bn, or 3.4% of GDP (the corresponding indices for 2015 are RUB 1,955bn and 2.3% of GDP respectively), which is the record high of several recent years in a row. *Table 17* presents data concerning the sources of federal budget deficit financing in 2012–2016.

In 2016, most of the funds spent on financing the federal budget deficit came from domestic sources (RUB 2,914bn, or 3.4% of GDP), while external sources provided just RUB 43bn (or 3.4% of GDP) for that purpose.

Table 17

The sources of federal budget deficit financing over the period 2012-2016

	In absolute terms, RUB bn					% of GDP				
	2012	2013	2014	2015	2016	2012	2013	2014	2015	2016
Sources of deficit financing, total	37	323	334	1,955	2,956	0.1	0.5	0.4	2.3	3.4
Deficit financing from domestic sources	19	270	480	2,251	2,914	0.0	0.4	0.6	2.7	3.4
government securities	511	358	1,025	15	492	0.8	0.5	1.3	0.0	0.6
movement of residuals	-470	-951	-3,248	954	3 506	-0.7	-1.3	-4.1	1.1	4.1
other sources	-22	863	2,703	1,282	-1,085	0.0	1.2	3.4	1.5	-1.3
Deficit financing from external sources	18	53	-147	-296	43	0.0	0.1	-0.2	-0.4	0.0
government securities	164	185	-47	-183	110	0.2	0.3	-0.1	-0.2	0.1
credits granted by foreign states	-26	-22	-25	-51	-17	0.0	0.0	0.0	-0.1	0.0
other sources	-119	-110	-74	-63	-50	-0.2	-0.2	-0.1	-0.1	-0.1

Sources: Federal Treasury; Gaidar Institute own calculations.

A considerable part of the funds from domestic sources spent on financing the federal deficit (approximately RUB 3,506bn, or 4.1% of GDP) was provided under the article *Changes in the Resulting Balances of the Budgetary Control Accounts*, which largely has to do with operations involving the use of the Reserve Fund, which accounted for covering about 70% of the deficit. As a result, over the course of 2016, the Reserve Fund dwindled by 59% (or by 73%, if exchange rate changes are taken into account).

The resulting account balance for 2016 related to the article *Other Sources* amounted to RUB 1,085bn (1.3% of GDP). The volume of deficit financing raised by issuing government securities amounted to around RUB 492bn (0.6% of GDP).

Table 18 shows the changes undergone by the composition of the government debt of the Russian Federation in 2012–2016.

Table 18

Government debt of the Russian Federation over the period 2012–2016

	RUB bn					% of GDP				
	2012	2013	2014	2015	2016	2012	2013	2014	2015	2016
RF domestic debt, RUB bn	4,978	5,722	7,241	7,308	8,003	7.4	8.1	9.1	8.8	9.3
<i>less government guarantees, RUB bn</i>	4,071	4,432	5,476	5,573	6,220	6.1	6.2	6.9	6.7	7.2
RF foreign debt										
RUB bn, at RF CB's exchange rate	1,542	1,822	3 057	3,644	3,106	2.3	2.6	3.9	4.4	3.6
<i>less government guarantees, RUB bn</i>	1,196	1,450	2 377	2,779	2,395	1.8	2.0	3.0	3.3	2.8
Total, RUB bn	6,520	7 544	10,298	10,954	11,110	9.7	10.6	13.0	13.2	12.9
<i>less government guarantees, RUB bn</i>	5,267	5,882	7,853	8,354	8,615	7.9	8.3	9.9	10.0	10.0

Source: RF Ministry of Finance; Gaidar Institute own calculations.

The aggregate year-end 2016 government debt of the Russian Federation amounted to 12.9% of GDP vs. 13.2% of GDP a year earlier. The change in the amount of government debt was caused by Russia's domestic debt having been increased by 0.5 pp of GDP against the background of a 0.8 percentage point drop in the amount of external debt (recalculated in rubles in accordance with the official exchange rate of the ruble set by the Central Bank). In 2016, the amount of government guarantees contained in the federal budget did not exceed 2.9% of GDP.

It can be noted that the slight shrinkage in the volume of government guarantees relative to early 2016 (3.1% of GDP) marked a halt in the continual growth trend visible since 2012 (when the volume of government guarantees had amounted to 1.9% of GDP).

It can be said with confidence that the year 2016 saw a notable change in the composition of the aggregate government debt of the Russian Federation, which shifted in favor of its domestic component: over the course of 2016, the share of domestic debt soared to 72% relative to 67% a year earlier. Such changes in debt composition are known to be conducive to budget sustainability in general, because Russia's domestic debt is denominated in the national currency, which decreases the risk of a sharp increase in debt servicing costs caused by the volatility of the ruble's exchange rate.

* * *

The role of the 2016 federal budget in the achievement of the planned socioeconomic policy goals is rather controversial. It cannot be called a development budget, because its 'productive' functions related to human capital and infrastructure were underfunded (in line with the stable trend observable over recent years). At the same time, the budget for 2016 could hardly be called a stabilization budget, either, because of the presence of a stable deficit (both total and primary deficit); to cover it, a substantial portion of the Reserve Fund was spent; the expenditures related to public debt servicing likewise notably increased. However, it should be understood that there are no simple recipes for dealing with that problem – given, moreover, the less than optimal structure of the previously assumed government spending obligations coupled with the currently unfavorable economic situation.

2.2.3. Intergovernmental fiscal relations and sub-national finance¹

Analysis of principal parameters of the consolidated budget of subjects of the Russian Federation

The revenue and expenditure structure of Russia's consolidated budget reflects main trends in the relationship between various public administration levels. *Fig. 20* presents data reflecting the percentage of tax revenues and expenditure of subjects of the Russian Federation in total tax revenues and expenditure of Russia's budget system (the consolidated budget of the Russian Federation and of public off-budget funds).

As shown in the Figure, 2016 saw a reversal trend toward centralization of revenue and expenditure at the federal level. In 2016, the percentage of sub-national budget expenditure in Russia's consolidated budget swelled to about 33.7% year over year (the data for the Republic of Crimea and the city of Sevastopol are hereinafter excluded for the purpose of comparability between time series). The percentage of regional tax revenues in the budget system revenues increased during the same period from 28.6% to 29.7%. To note, both indicators ultimately failed to reach the level of 2014 despite growth.

¹ Authors of chapter: I. Arlashkin – Gaidar Institute, IAES RANEPa; N. Barbashova – Gaidar Institute; A. Mamedov – Gaidar Institute, IAES RANEPa.

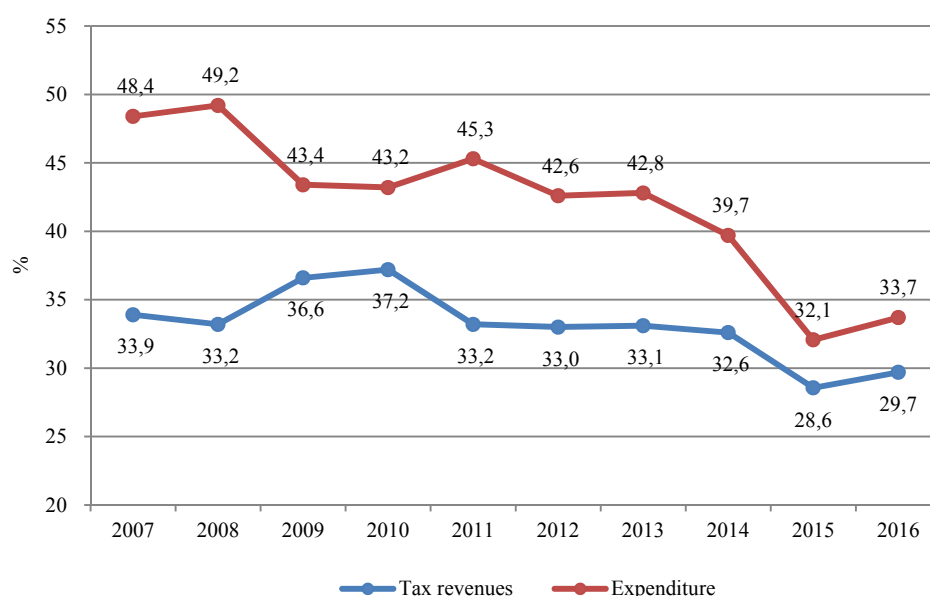


Fig. 20. Percentage of tax revenues and of sub-national budget expenditure in the Russian budget system revenue and expenditure structure in 2007/2016, %

Note. Excluding the Republic of Crimea and the city of Sevastopol.

Sources: Federal Treasury of Russia, Gaidar Institute own calculations.

Let us now consider more carefully the revenue side of sub-national budgets. The dynamics of the principal components of consolidated budget revenues of subjects of the Russian Federation is shown in *Table 19*. The growth of revenues in real terms is shown in the right-hand column of the table.

Table 19

Consolidated budget revenues of subjects of the Russian Federation in 2012–2016

	Revenues (in nominal terms), rubles in billions					Growth in real terms, %			
	2012	2013	2014	2015	2016	2013/2012	2014/2013	2015/2014	2016/2015
Revenues, total	8.064	8.165	8.743	9.191	9.785	-17.2	-3.8	-8.6	1.00
Tax and nontax revenues	6.385	6.588	7.141	7.585	8.238	-13.8	-2.7	-6.4	3.00
<i>Including tax revenues:</i>	5.800	5.967	6.461	6.890	7.493	-12.3	-2.8	-6	3.20
profit tax	1.980	1.720	1.962	2.099	2.272	-33.1	2.4	-5.2	2.70
personal income tax	2.261	2.499	2.679	2.788	2.803	-6.6	-3.7	-7.9	-4.60
taxes on aggregate income	272	293	314	346	385	19.8	-3.8	-2.7	5.60
property taxes	785	901	955	1.067	1.115	20.7	-4.8	-1.3	-0.90
excise duties	442	491	479	484	659	42.6	-12.4	-10.5	29.20
Transfers	1624	1.515	1.545	1.538	1.547	-24.1	-8.4	-18.5	-4.60
Other revenues	56	62	57	68	0	-75.1	-17.4	4.8	-100.00

Note. Excluding the Republic of Crimea and the city of Sevastopol.

Sources: Federal Treasury of Russia, Gaidar Institute own calculations.

In 2016, consolidated budget revenues of subjects of the Russian Federation increased 1% year over year in real terms, as shown in *Table 19*. Note that both total and tax revenues were driven by positive dynamics in real terms in 2016 for the first time since 2012 (predominantly

on account of profit tax, taxes on aggregate income and excise duties), thereby indicating a somewhat upturn in the economy. Of special note, however, is the continuing trend toward declining personal income tax revenues in real terms, thereby indicating that individuals' wellbeing deteriorated in real terms even amid a slowing inflation rate. The 4.6% YoY decline in real terms in transfers from the federal budget affected predominantly the fiscal capacity of regions eligible for government grants.

Let us now consider more carefully tax and nontax revenues in terms of regions (*Table 20*).

Table 20

Russian regions classification according to change in main types of consolidated budget tax and nontax revenues of subjects of the Russian Federation in 2015 and 2016, in number.

	Main types of consolidated budget tax and nontax revenues of subjects of the Russian Federation											
	A growth of more than 25%		A growth of 10 to 25%		A growth of less than 10%		A decline of less than 10%		A decline of 10 to 25%		A decline of more than 25%	
	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016
in nominal terms												
Tax and nontax revenues, total	2	5	16	47	49	26	15	5	1	0	0	2
Profit tax	15	35	16	27	15	8	12	3	15	9	10	3
Personal income tax	0	1	4	11	56	71	23	2	0	0	0	0
in real terms												
Tax and nontax revenues, total	2	0	0	15	9	49	48	16	24	3	0	2
Profit tax	9	29	6	23	10	11	19	8	21	8	18	6
Personal income tax	0	2	0	5	2	46	41	31	40	1	0	0

Sources: Federal Treasury of Russia, Gaidar Institute own calculations.

A comparative analysis of the 2015–2016 dynamics of the main types of own-source revenues of regional budgets shows substantial growth in budget revenues, including figures in real terms. In real terms, tax and nontax revenues of 11 regions were driven by positive dynamics in 2015, while the number of such regions increased to 64 in 2016, that is, only 21 regions saw their revenues decline in real terms. At the same time, most of the revenues were generated from the profit tax. In real terms, profit tax revenues increased in 25 regions in 2015, with only 9 subjects of the Russian Federation experiencing a more than 25% growth, while 2016 saw profit tax revenues increase in real terms in 68 regions, with a growth rate being more than 25% in 29 subjects of the Russian Federation.

The following regions ranked at the top in terms of own-source revenue dynamics in 2016: The Republic of Crimea (29%), the city of Sevastopol (26%), the Chechen Republic (26%), Magadan Region (26%) and Ulyanovsk Region (27%). The following Russia's republics were top-ranked in terms of profit tax revenues: the Chechen Republic (173%), the Republic of Tyva (139%), the Republic of Ingushetia (100%).

Personal income tax revenues accelerated at a more moderate pace in 2016: growth rates varied within a range of 0 to 10% for the overwhelming majority of the regions (46 of 85).

There was a considerable decline in own-source consolidated budget revenues in some regions. In 2016, for instance, Sakhalin Region and Nenets Autonomous Okrug saw their annualized tax and nontax revenues decrease by 31% and 27% respectively, basically because the regional profit tax rate was cut to attract potential investors.

On the whole, it is worth noting that the situation with own-source sub-federal budget revenues in 2016 improved compared with the parameters seen in 2015. Most of the regions

exhibited growth of own-source revenues in real terms (55 regions in 2016 against 11 in 2015). At the same time, own-source revenue growth rates varied within a range of 0% to 10% in most of the subjects of the Russian Federation (49 of 85 regions). In 2015, most of the regions stood within a range of -10% to 0% (48 subjects of the Russian Federation). A slowing inflation rate was a positive factor influencing the consolidated budget figures (5.4% in 2016 against 12.9% in 2015). It must be emphasized that both regions with a well-developed economic base (Vologda Region) and subjects of the Russian Federation with a relatively low degree of revenue potential (The Republics of Crimea, of Ingushetia, of Tyva) exhibited substantial growth of tax revenues. The deepest decline in own-source revenues was recorded in regions that introduced tax allowances (Nenets Autonomous Okrug, Sakhalin Region), in which case the decline constitutes a development tool rather than the affect of the crisis. Thus the analysis of own-source revenues of the budget of subjects of the Russian Federation leads to a conclusion about an upturn in the Russian economy in 2016 compared with 2015.

We now analyze changes in the expenditure side of consolidated budget of subjects of the Russian Federation in 2016 (*Table 21*).

Table 21

**Consolidated budget expenditure of subjects of the Russian Federation
in 2015-2016**

	As % of total		As % of GDP		Growth, %	
	2015	2016	2015	2016	in nominal terms	in real terms
Nationwide issues	6.4	6.3	0.73	0.73	3.0	-2.3
National Security and Law Enforcement	1.1	1.1	0.13	0.13	8.9	3.4
National economy Including:	19.7	20.2	2.24	2.33	7.2	-5.1
Agriculture and fishery	3.3	2.8	0.38	0.32	-11.7	-16.2
Transport	4.2	4.4	0.48	0.51	9.7	4.1
public roads (road funds)	7.8	8.7	0.89	1.01	17.1	11.1
Other issues related to the national economy	2.4	4.3	0.27	0.49	86.3	76.8
Housing and communal services	9.0	9.4	1.03	1.09	9.7	4.1
Environmental protection	0.2	0.2	0.02	0.03	17.0	11.0
Education Including:	26.1	25.6	2.97	2.97	2.9	-2.3
pre-primary education	7.3	6.8	0.83	0.79	-2.4	-7.4
general education	14.6	14.7	1.66	1.70	5.6	0.1
secondary vocational education	2.0	1.9	0.23	0.22	0.9	-4.3
other issues related to education	1.3	2.2	0.15	0.26	77.9	68.8
Culture, cinematography	3.3	3.4	0.38	0.40	8.8	3.2
Healthcare	14.3	12.9	1.63	1.49	-5.5	-10.3
Social security policy	15.8	16.6	1.80	1.93	10.5	4.8
Physical culture and sports	2.0	2.1	0.23	0.25	11.7	6.0
Mass media	0.5	0.4	0.06	0.05	-8.7	-13.4
Municipal and public debt servicing	1.6	1.5	0.18	0.18	1.3	-3.9
Expenditures, total	100.0	100.0	11.39	11.57	4.8	-0.6

Sources: Federal Treasury of Russia, Gaidar Institute own calculations.

The data presented in *Table 21* suggest that subjects of the Russian Federation exhibit a stable spending structure despite a small cut to budget financing of social industries, with healthcare and pre-primary education bearing most of the cuts, whereas there was a boost in spending on social security policy, physical culture and sports. As to the real economy, most of the cuts fell on the agricultural sector.

In the following, we consider the dynamics of key parameters of consolidated budgets of subjects of the Russian Federation, as measured as a percentage of GDP (*Table 22*).

Table 22

Dynamics of consolidated budget revenues and expenditure of subjects of the Russian Federation in 2012-2016, as % of GDP

	2012	2013	2014	2015	2016
Revenues	12.05	11.49	11.04	11.04	11.56
including:					
profit tax	2.96	2.42	2.48	2.52	2.65
personal income tax	3.38	3.52	3.38	3.35	3.51
federal budget transfers	2.15	2.13	2.17	1.85	1.90
Expenditure	12.47	12.39	12.76	11.39	11.57
Deficit (-) / Surplus (+)	-0.42	-0.9	-0.66	-0.23	-0.01
<i>For reference: GDP, rubles in billions</i>	66 927	71 055	79 200	83 233	85 881

Note. Excluding the Republic of Crimea and the city of Sevastopol.

Sources: Federal Treasury of Russia, Gaidar Institute own calculations.

As shown in *Table 22*, regional budget revenues, including personal income tax and profit tax revenues, as well as federal budget transfers, as measured as a percentage of GDP, increased in 2016 over the level seen in 2015. Budget deficit reached a 5-year low in 2016.

Let us consider more carefully how subjects of the Russian Federation ran their consolidated budgets (with a deficit/surplus), as expressed in number of regions (*Table 23*).

Table 23

Execution (with a deficit/surplus) of consolidated budgets of subjects of the Russian Federation in the period between 2008 and 2016

Year	Number of subjects of the Russian Federation that ran a	
	budget deficit	budget surplus
2012	67	16
2013	77	6
2014	74	9
2015	75	8
2016	53	30

Note. Excluding the Republic of Crimea and the city of Sevastopol.

Sources: Federal Treasury of Russia, Gaidar Institute own calculations.

The regional data also suggests an improvement in the equilibrium of consolidated budgets of the Russian Federation and in the regional finance as a whole.

Financial aid from the federal budget

In 2016, the total amount of federal budget intergovernmental transfers to regions contracted both in nominal terms (-2.2%) and as a percentage of GDP (-0.09 percentage points of GDP) compared with 2015 (*Table 24*). At the same time, the decline fell on intergovernmental fiscal transfers of all types, except budget capacity equalization grants and other intergovernmental fiscal transfers. However, the increase in budget capacity equalization grants (+0.02 percentage points of GDP) failed to compensate in full for fiscal equalization grant cuts (-0.04 percentage points of GDP). Subsidies bore most of the decline both in nominal terms and as a percentage of GDP. Subventions were cut insignificantly in nominal terms, while other intergovernmental fiscal transfers increased. The foregoing changes influenced the structure of federal financial aid to budgets of subjects of the Russian Federation. For instance, subsidies lost 2.9 percentage points in 2016 compared with 2015, whereas 1.3 percentage points were added to grants.

Table 24

Federal budget transfers to subjects of the Russian Federation in 2014-2016

	2014		2015		2016		YoY growth in 2016	
	rubles in billions	as % of total	rubles in billions	as % of total	rubles in billions	as % of total	nominal, %	percentage points of GDP
Transfers regions, total	1607	100	1603.6	100	1 567.8	100	-2.2	-0.09
Grants	774.7	48.2	650.9	40.6	656.2	41.9	0.8	-0.01
Including:								
budget capacity equalization grants	439.8	27.4	487.7	30.4	513.7	32.8	5.3	0.02
grants as support to budget equalization measures	334.9	20.8	163.2	10.2	131.7	8.4	-19.3	-0.04
Subsidies	409.9	25.5	400.2	25.6	356.5	22.7	-10.9	-0.06
Including:								
national economy development subsidies	241.9	15.1	258.2	16.1	231.9	14.8	-10.2	-0.04
Subventions	308.2	19.2	336.6	21	334.3	21.3	-0.7	-0.01
Other intergovernmental fiscal transfers	114.2	7.1	215.9	13.5	220.8	14.1	2.3	0.00

Sources: Federal Treasury of Russia, Rosstat, Gaidar Institute own calculations.

The change in the amount of subventions is indicative of sub-national budgets becoming more independent in exercising the delegated powers. At the same time, the number of subventions grew up to 30 (27 in 2015) in 2016, including 10 subventions to the Republic of Crimea and the city of Sevastopol, some of which duplicated subventions allocated to other subjects of the Russian Federation.

Subsidies made a substantial contribution (22.7%) to intergovernmental fiscal transfers to regions in 2016. Ninety eight types of subsidies were allocated in 2016, although the State Program of *The Development of Federal Relations and the Creation of Conditions for Efficient and Prudent Regional and Municipal Finance Management* (hereinafter – The State Program) contemplated a reduction in the number of subsidies to 86 in 2016. Thus no consolidation and optimization of the number of subsidies took place in 2016.

Although other intergovernmental fiscal transfers increased in nominal terms, they remained unchanged as a percentage of GDP, with growth (from 50 to 57) in the number of other intergovernmental fiscal transfers compared with 2015. In addition, account must be taken of a lack of transparency and formalization regarding the manner they are appropriated and allotted.

Reducing the percentage of targeted financial aid in federal transfers still remains one of the fiscal policy priorities. The percentage of grants in federal transfers to subjects of the Russian Federation increased as a whole, with the relevant State Program's indicator having been achieved. However, the indicator could not be achieved given the fact that grants as partial compensation for extra costs of increasing public employees' remuneration pertain largely to subsidies and not to grants.

It is worth noting that growth of the percentage of grants in the structure of intergovernmental fiscal transfers to regions was driven up largely by cutting targeted financial aid and by growth, albeit small, of nontargeted transfers. Growth of budget capacity equalization grants coupled with equilibrium grant cuts should be deemed to be a positive move because the latter are allotted in a much less transparent manner.

In analyzing the process whereby the federal authorities appropriate transfers to regions, it is important to consider the effect of federal aid on the differentiation of revenues of subjects of the Russian Federation by assessing the equilibrium features of the financial aid from the federal budget (*Table 26*).

Table 25

Percentage of grants in intergovernmental fiscal transfers

Indicator	2015	2016
Percentage of grants in intergovernmental fiscal transfers in accordance with the state program (plan), %	40.0	41.0
Percentage of grants in intergovernmental fiscal transfers (estimate), %	40.6	41.9
Percentage of grants in intergovernmental fiscal transfers, excluding grants as partial compensation for extra costs of increasing public employees' remuneration (estimate), %	36.9	39.9

Sources: Federal Treasury of Russia, the State Program of The Development of Federal Relations and the Creation of Conditions for Efficient and Prudent Regional and Municipal Finance Management, Gaidar Institute own calculations.

Table 26

Variation coefficient of regional consolidated budget revenues (per capita, having regard to budget expenditure index) in 2008–2016, %

Year	Tax revenues	Tax revenues and budget capacity equalization grants	Tax revenues, grants, subsidies
2012	66.1	57.8	51.9
2013	63.7	55.3	48.1
2014	59.0	51.2	49.9
2015	66.1	60.3	56.0
2016	55.6	42.1	37.3

Sources: Federal Treasury of Russia, Russia's Ministry of Finance, Gaidar Institute own calculations.

As shown in Table 25, differentiation of sub-national budget revenues decreased in 2016. The variation coefficient of tax revenues of consolidated budgets of subjects of the Russian Federation dropped from 66.1 to 55.6% mainly due to the plunge of tax revenues in Sakhalin Region in 2016. Given budget capacity equalization grants, the variation coefficient of regional budget revenues fell from 60.3 to 42.1%. Considering the result obtained after the appropriation of all grants and subsidies, the variation coefficient decreased to 37.3% (56% in 2015).

Deficit and debt at the regional level

Table 27 presents the structure of sources of financing of the consolidated budget deficit of subjects of the Russian Federation in 2011–2016.

Table 27

Sources of financing of consolidated budget deficit of subjects of the Russian Federation in 2012–2016, rubles in billions

	2012	2013	2014	2015	2016
Sources of deficit financing - total	278.5	642.0	447.8	171.6	12.6
Domestic sources of deficit financing	278.5	642.8	447.8	171.6	40.8
Government (municipal) securities	38.2	77.6	-9.2	-5.8	32.0
Credit institutions' loans	162.3	282.6	217.4	101.6	-102.6
Federal budget loans	5.0	43.0	169.3	167.4	181.6
International financial institutions' loans	0.0	2.2	-1.1	0.0	-0.6
Change in cash balances	-74.6	98.1	19.2	77.4	-32.0
Other sources	147.6	139.3	52.2	-168.9	-37.6
External sources of deficit financing	0.0	-0.8	0.0	0.0	-28.2

Sources: Federal Treasury of Russia, Gaidar Institute own calculations.

The presented data show that, the consolidated budget of subjects of the Russian Federation faced a better situation than that seen in 2012–2015: the budgets ran a deficit of only RUB 12.6bn, which is many times less than the values recorded in previous years. The balance of commercial (bank) loans and of budget loans is to be noted in particular. The bank loan balance came to be negative and, more importantly, considerable in absolute terms (-RUB 102.6bn) for the

first time during the period under review, that is, loan repayments outstripped new lending. Conversely, the budget loan balance came to be positive and comparable in absolute terms (RUB 181.6bn) with the commercial loan balance. These figures reflect a federal policy aimed at replacing more expensive bank loans with cheaper budget loans (at an interest rate of 0.1% p.a.) within the regional debt structure. The role of securities increased somehow, with the securities balance being positive (RUB 32.0bn) as distinct from that over the past two years but much less than the budget loan balance.

Table 28

**Public and municipal debt owed by sub-national budgets
in 2011–2016, as % of GDP**

	As at 2012 year-end		As at 2013 year-end		As at 2014 year-end		As at 2015 year-end		As at 2016 year-end	
	% of GDP	growth, percentage points of GDP	% of GDP	growth, percentage points of GDP	% of GDP	growth, percentage points of GDP	% of GDP	growth, percentage points of GDP	% of GDP	growth, percentage points of GDP
Total for regional budgets	2.00	-	2.40	0.40	2.70	0.20	2.90	0.20	2.74	-0.16
Total for regional budgets (excluding Moscow and the Moscow Region)	1.60	-	2.10	0.50	2.30	0.30	2.60	0.20	2.55	-0.05
Total for municipal budgets	0.40	-	0.40	0.00	0.40	0.00	0.40	0.00	0.42	0.02

Sources: Russia's Ministry of Finance, Rosstat, Gaidar Institute own calculations.

The regional debt dynamics was generally driven by a steady upward trend in the period of 2012–2015, from 2.0% of GDP as at 2012 year-end to 2.9% of GDP as at 2015 year-end (*Table 28*). Regions had their debt reduced by 0.16 percentage points to 2.7% of GDP (however, it increased slightly RUB 35bn, or by 1.5%, in nominal terms) at 2016 year end, whereas municipalities saw their debt rise 0.02 percentage points to 0.42% of GDP. Thus a substantial debt ramp-up was halted at the regional level during the year under review. Given a small amount of accumulated liabilities, neither the regional nor the municipal debt is posing any serious macroeconomic risk for the national budget system as a whole. However, a more precise assessment of the regional debt and related budget risks requires analysis by subject of the Russian Federation (see *Table 29*).

Table 29

Public debt owed by subjects of the Russian Federation in 2012–2015

	Dynamics of public debt owed by subjects of the Russian Federation in a certain period (in nominal terms), number of subjects of the Russian Federation						
	a growth of more than 50%	a growth of 15 to 50%	a growth of less than 15%	no change	a decline of less than 15%	a decline of 15 to 50%	a decline of more than 50%
2012	18	29	14	0	8	10	1
2013	31	36	8	0	6	1	0
2014	12	44	18	0	5	1	2
2015	7	27	31	0	15	1	0
2016	1	13	33	3	25	6	1

Note. Arkhangelsk Region and Nenets Autonomous Okrug are presented as a single subject of the Russian Federation; the data exclude Crimean Federal Okrug (to ensure full compatibility in various years).

Sources: Russia's Ministry of Finance, Gaidar Institute own calculations.

The data on the debt dynamics by region also confirm an improved equilibrium of consolidated budgets of subjects of the Russian Federation in 2016. The number of regions with a debt growth of at least 15% decreased considerably, except for a single region (Tyumen Region) where the debt increased more than 50%. The number of subjects of the Russian Federation that had their debt reduced over the year doubled (from 16 to 32), with a reduction of more than 50% in the city of Moscow. Therefore, although the number of regions that had their debt increased (47) was still bigger than that of the regions having their debt reduced (32), this ratio narrowed substantially compared with that seen a year earlier (65 to 16).

Examination of the Russian regions' debt structure (see *Fig. 21*) reveals a change toward a notable increase in federal budget loans up to 42.1%, thus adding 7.2 percentage points to the value seen earlier in 2016.

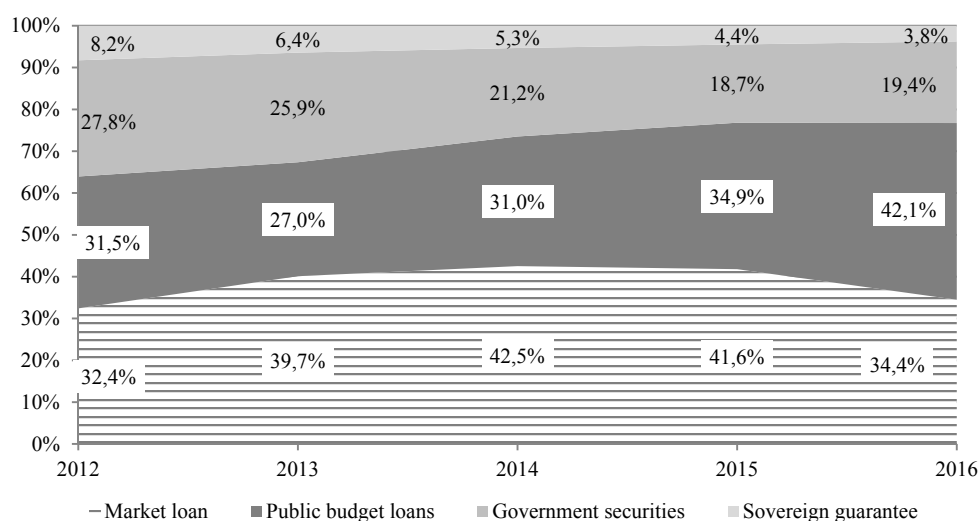


Fig. 21. Public debt structure of subjects of the Russian Federation in 2012–2016

Notes. 1) the presented data exclude the Crimean Federal Okrug (to ensure full compatibility of various periods); 2) in 2015–2016, 0.4% of the public debt owed by subjects of the Russian Federation is accounted for by other debt instruments not shown in the diagram (mostly Kemerovo Region's liabilities).

Source: Russia's Ministry of Finance.

Fiscal debt increased amid a plunging percentage of commercial loans (-7.3 percentage points) and a small percentage growth of securities (+0.8 percentage points). Thus this once again points to the above noted trend toward replacing commercial debt with budget loans across regional budgets, thereby reflecting current federal policy priorities toward regions. This however creates the risk of heavier dependence of subjects of the Russian Federation on federal budget loans, and thereby pressurizing harder Russia's Ministry of Finance and government to write off or freeze the relevant payments. No matter how simple such a measure appears to be to the extent of addressing the accumulated debt issue facing certain subjects of the Russian Federation, it may seriously undermine the budget discipline at the regional level and aggravate the issue of soft budget restrictions by sub-national government authorities in Russia.

* * *

On the whole, a reversal of certain negative trends developed in 2014–2015 was observed in 2016. The percentage of sub-federal budgets in the budget system increased in general, growth

rates of tax and nontax revenues outpaced the inflation rate, both deficit and debt were reduced (as a percentage of GDP). However, there were few negative trends worth pointing out. For instance, the decline in personal income tax revenues was indicative of a declining household real income. All in all, Russia's regions faced a heterogeneous financial situation. Further cuts to federal budget transfers had an adverse effect on regional revenues.

2.2.4. Description of main off-budget funds¹

In the following, we analyze the budget execution of the two main (in terms of size and value for the budget system) public off-budget funds: The Pension Fund of Russia (hereinafter – PFR) and The Federal Compulsory Medical Insurance Fund (hereinafter – FCMIF).

Pension Fund of Russia

The PFR's revenues amounted to RUB 7625bn, or 8.9% of GDP, in 2016. The year-over-year PFR's revenues increased 7.0% in nominal terms and 1.5% in real terms (or by 0.32 percentage points of GDP). The PFR expenditure amounted to RUB 7829bn (or 9.1% of GDP). The PFR's expenditure increased 2.1% in nominal terms and decreased by 3.1% in real terms (or by 0.9 percentage points of GDP). While the Pension Fund's budget was RUB 543.6bn in deficit (or 0.65% of GDP) in 2015, it was notably reduced to RUB 204.4bn (or 0.24% of GDP) in 2016 on account of higher-than-expected growth of revenues.

We now consider more carefully the PFR revenue components in 2016 (see *Table 30*).

Table 30

Pension Fund of Russia' revenues in 2015–2016, rubles in millions

	2015	2016	Revenue nominal growth in 2016, % change – year to year	Revenue real growth in 2016, % change – year to year
Revenues, total	7,126,634	7,625,248	107.0	101.5
including				
Tax and nontax revenues	4,021,467	4,258,412	105.9	100.5
Compulsory social insurance contributions	3,878,731	4,144,434	106.9	101.4
Uncompensated receipts	3,105,167	3,366,836	108.4	102.9
Federal budget transfers to the budget of the Pension Fund of Russia	3,091,683	3,355,303	108.5	103.0
including				
Compulsory pension insurance transfers from the federal budget to the budget of the Pension Fund of Russia	814,181	988,588	121.4	115.2
including				
Federal budget transfers to the budget of the Pension Fund of Russia for the notional pension capital valorization	680,098	676,878	99.5	94.4
Federal budget transfers to the budget of the Pension Fund of Russia as compensation for the insurance component due to adding non-qualifying periods to the pensionable service	9,065	12,079	133.2	126.4
Federal budget transfers to the budget of the Pension Fund of Russia as compensation for shortfalls in the Pension Fund of Russia's budget revenues due to the establishment of reduced rates on compulsory pension insurance contributions	342,898	392,037	114.3	108.5

Sources: the data for 2015 are based on Federal Law of October 31, 2016 No. 378-FZ “On Execution of the Budget of the Pension Fund of Russia in 2015”, the data for 2016 are based on the data released by the Federal Treasury: Federal Treasury of Russia, Russian public off-budget funds' budget as at January 1, 2017. Gaidar Institute own calculations.

¹ Authors of chapter: N. Aksentiev – FRI under Finance Ministry of Russia, ISAF RANEPa; E. Grishina – ISAF RANEPa.

Compulsory social insurance contributions amounted to RUB 4144bn (or 4.83% of GDP) in 2016. The insurance contribution inflow increased 6.9% in nominal terms and 1.4% in real terms, whereas insurance contributions subject to the additional rate for insured individuals exposed to harmful working conditions fell 2.9% in nominal terms, thus reflecting job cuts in progress.

The PFR budget received RUB 3355bn from the federal budget in 2016, which is a YoY increase of 8.5% in nominal terms and of 3.0% in real terms. The biggest (in size) compulsory pension insurance transfer from the federal budget amounted to RUB 988,6bn in 2016, which is a YoY increase of 15.2% in real terms. In real terms, transfers to the PFR for retirement benefits as part of social welfare, as well as notional pension capital valorization transfers, contracted by 7.5% and 5.6% respectively, whereas transfers for retirement benefits due to adding non-qualifying periods to the pensionable service, as well as due to the establishment of reduced rates on compulsory pension insurance contributions, increased 26.4% and 8.5% respectively.

We now consider more carefully the PFR expenditure components in 2016 (see *Table 31*).

Table 31
Pension Fund of Russia's budget expenditure in 2015–2016, rubles in millions

	2015	2016	Expenditure nominal growth in 2016, % change – year to year	Expenditure real growth in 2016, % change – year to year
Budget expenditure – total	7,670,270	7,829,672	102.1	96.9
including				
Nationwide issues	104,781	107,256	102.4	97.1
including the exercise of functions of governing bodies of public off-budget funds of the Russian Federation	102,414	106,447	103.9	98.6
Social security policy	7,565,387	7,722,322	102.1	96.9
Retirement benefits	6,264,047	6,613,400	105.6	100.2
including				
Payment of the federal social security supplement to retirement benefits as part of social security benefits related to other than program activities of management bodies of public off-budget funds of the Russian Federation (social security benefits and other payments to individuals)	42,145	99,807	236.8	224.7
Payment of the insurance component of pension as part of social security benefits related to other than program activities of management bodies of public off-budget funds of the Russian Federation (social security benefits and other payments to individuals)	5,782,134	6,050,187	104.6	99.3
Payment of public retirement benefits as part of social security benefits related to other than program activities of management bodies of public off-budget funds of the Russian Federation (social security benefits and other payments to individuals)	390,950	414,886	106.1	100.7
Social security benefits for individuals	444,145	462,053	104.0	98.7
including the retirement savings transfer to nongovernment pension funds as part of public functions within the framework of social security policy related to other than program activities of management bodies of public off-budget funds of the Russian Federation (social security benefits and other payments to individuals)	527,033	279,669	53.1	50.4

Sources: the data for 2015 are based on Federal Law of October 31, 2016 No. 378-FZ “On Execution of the Budget of the Pension Fund of Russia in 2015”, the data for 2016 are based on the data released by the Federal Treasury: Federal Treasury of Russia, Russian public off-budget funds’ budget as at January 1, 2017. Gaidar Institute own calculations.

In 2016, the PFR spent RUB 106.4bn on the exercise of functions of governing bodies of public off-budget funds of the Russian Federation, which is a YoY decline of 1.4% in real terms. RUB 7722bn were spent on social security policy, down 3.1% in real terms. Spending on retirement benefits rose both in nominal terms (+5.6%) and in real terms (+0.2%). In real terms, spending on the insurance component were reduced by 0.7%, whereas spending on public retirement benefits rose 0.7%. In 2016, spending on the funded component rose 35.4% in real terms, reflecting growth of funded pension entitlements among those who retired during the period under review.

A substantial amount was spent on the federal social security supplement to retirement benefits – a 2.4-fold increase in nominal terms, from RUB 42.1bn in 2015 to RUB 99.8bn in 2016 – because some regions switched from the provision of regional social security supplement to the federal social security benefit.

In 2016, the PFR spent RUB 462.1bn on social security benefits for individuals, which is a YoY growth of 4.0% in nominal terms (+1.3% in real terms). RUB 298.0bn were spent on monthly cash payments (MCPs) to disabled individuals, which is a 1.8% hike in real terms, and RUB 281.6bn were spent on the provision of maternity (family) capital, an increase of 5.5%, whereas spending on MCPs to veterans were cut 0.7% in real terms. RUB 67.2bn were spent on compensations to persons nursing unemployable citizens and disabled children, a 1.1% hike in real terms. Even the spending on social security for holders of the Soviet Union Hero Gold Star and of the Socialist Labor Hero Gold Star was reduced in nominal terms due to attrition of the said categories of beneficiaries.

All in all, it may be inferred that the PFR's budget equilibrium improved in 2016: the budget deficit was reduced (by 0.42 percentage points of GDP), while budget revenues increased due to the growth of insurance component contributions (by 0.16 percentage points of GDP).

Federal Compulsory Medical Insurance Fund

In 2016, the Federal Compulsory Medical Insurance Fund's (hereinafter – FCMIF) budget revenues totaled RUB 1658bn (see *Table 32*). Compulsory medical insurance contributions for individuals accounted for about 98% of the revenues: RUB 1006bn in compulsory medical insurance contributions for employees (including RUB 11bn in self-employed individuals' contributions), and RUB 618bn in contributions for unemployed individuals. The federal budget transfer as compensation for shortfalls in the FCMIF revenues arising from the establishment of reduced rates on compulsory medical insurance (hereinafter – CMI) for certain categories of payers amounted to RUB 25.4bn. The refund for targeted transfers not used in the past year, the last among the traditional key FCMIF revenue items, amounted to RUB 7.7bn in 2016.

In 2016, the FCMIF's revenues saw a meager decline of about 0.04% in real terms compared with 2015. However, allowance must be made for the fact that the FCMIF's real revenues rose steadily until the previous year, and a halt in growth may aggravate the CMI deficit issue down the road, especially in light of the need to raise medical personnel wages to the levels set forth in the *Presidential Executive Orders of May 2012*.

In 2016, the FCMIF's expenditure amounted to RUB 1.590bn, most of which was accounted for by the subvention (RUB 1459bn or 92% of total expenditures) to local CMI funds for the implementation of the CMI baseline scheme (see *Table 33*).

Table 32

Federal Compulsory Medical Insurance Fund's revenues in 2016

Revenues	Implementation, RUB bn	implementation %	Real change compared with 2015
Total	1657.6	99.8%	0.0%
Including:			
Compulsory medical insurance contributions for employees	1006.4	98.8%	3.6%
Compulsory medical insurance contributions for unemployed individuals	617.8	100.0%	-4.9%
Intergovernmental transfer to the Federal Compulsory Medical Insurance Fund' budget for compensation for shortfalls of revenues arising from the establishment of reduced rates on compulsory medical insurance contributions	25.4	100.0%	1.2%
Refund for transfers not used over previous years	7.7	-	-38.2%

Sources: Federal Treasury of Russia, Gaidar Institute own calculations.

Table 33

Federal Compulsory Medical Insurance Fund' expenditure in 2016

Expenditure	Spent, RUB bn	Spent, %	Real change compared with 2015
Total:	1590.2	94.2	-7.9
Including:			
Subventions to the budget of local compulsory medical insurance funds for the provision of financing to the organization of compulsory medical insurance on the territory of subjects of the Russian Federation	1458.6	100.0	-3.0
Other intergovernmental fiscal transfers for the provision of financing to lump-sum payments to medical personnel	2.9	91.9	49.2
Other intergovernmental fiscal transfers to the budget of local compulsory medical insurance funds for the provision of extra financing to specialized, including high-tech, medical aid within the scope of the compulsory medical insurance baseline scheme	15.0	100.0	51.1
Provision of financing to prenatal, labor and postnatal care, as well as to preventive medical examination for infants at the age of one year or less	17.8	95.0	-7.9
Financial aid for the provision of high-tech medical aid outside the scope of the compulsory medical insurance baseline scheme	89.0	98.1	8.7
Co-financing of costs arising from the provision of high-tech medical aid to nationals of Russia outside the scope of the compulsory medical insurance baseline scheme	5.4	90.0	1.8
Equilibrium grant from the Federal Compulsory Medical Insurance Fund's budget to the federal budget	0.0	0.0	-100.0
Other expenditures	1.5	29.1	-81.1
Budget execution results: surplus (+) / deficit (-)	+67.7	-251.9	-98.1

Sources: Federal Treasury of Russia, Gaidar Institute own calculations.

In addition, local compulsory medical insurance funds received other intergovernmental fiscal transfers for the provision of financing to lump-sum payments to medical personnel (RUB 2.9bn) and extra financing to specialized, including high-tech, medical aid within the scope of the CMI baseline scheme (RUB 15bn). Unused appropriations were observed only with regard to transfers for the provision of financing to lump-sum payments to medical personnel: RUB 3.2bn were initially supposed to be allotted for this purpose.

In 2016, RUB 17.8bn were spent on the annual FCMIF transfer to the Social Insurance Fund for the provision of financing to prenatal, labor and postnatal care, as well as preventive medical examination for infants at the age of one year or less, a YoY decline of about 3% in nominal terms.

In 2016, the federal budget received two FCMIF transfers, namely the financial aid for the provision of high-tech medical aid outside the scope of the CMI baseline scheme (RUB 89bn) and for co-financing of costs arising from the provision of high-tech medical aid to nationals of Russia outside the scope of the CMI baseline scheme (RUB 5bn). The implementation of these transfers was 98 and 90% respectively.

Another transfer to the federal budget – the equilibrium grant (or the so-called ‘reverse transfer’) worth RUB 91.2bn – was initially budgeted in the FCMIF. This type of transfer worth about RUB 92bn was made for the first time in 2015. While this transfer was also made in 2016 under Paragraph 22, Article 51, Federal Law No. 326 “On Compulsory Medical Insurance in the Russian Federation”, the relevant provision was repealed at the end of the year, and therefore the money was ultimately left in the FCMIF. The need to accumulate FCMIF’s resources for raising medical personnel wages was an informal reason for the ‘reverse transfer’ repeal. At the same time, the repeal enabled the FCMIF to run a budget surplus of more than RUB 67bn for the first time since 2013. In addition, the repeal partially accounts for a substantial (about 8%) decline in the FCMIF’s expenditure in real terms compared with 2015. The expenditure in real terms was also driven down by a 3% fall of subventions earmarked for the implementation of the CMI baseline scheme.