National Research University 'Higher School of Economics'
(Moscow, Russia)
'Development Center' Institute

Natalia Akindinova
Andrey Chernyavskiy
Nikolay Kondrashov

Economic Stagnation in Russia, Growth-stimulating Policies and Fiscal Sustainability Assessment

BOFIT seminar
Helsinki, 25 March 2014

General outline

❖ Russia's stagnation

❖ Theoretical and applied questions of fiscal multiplier calculation for Russian data

❖ Possibilities for growth-stimulating policies in Russia

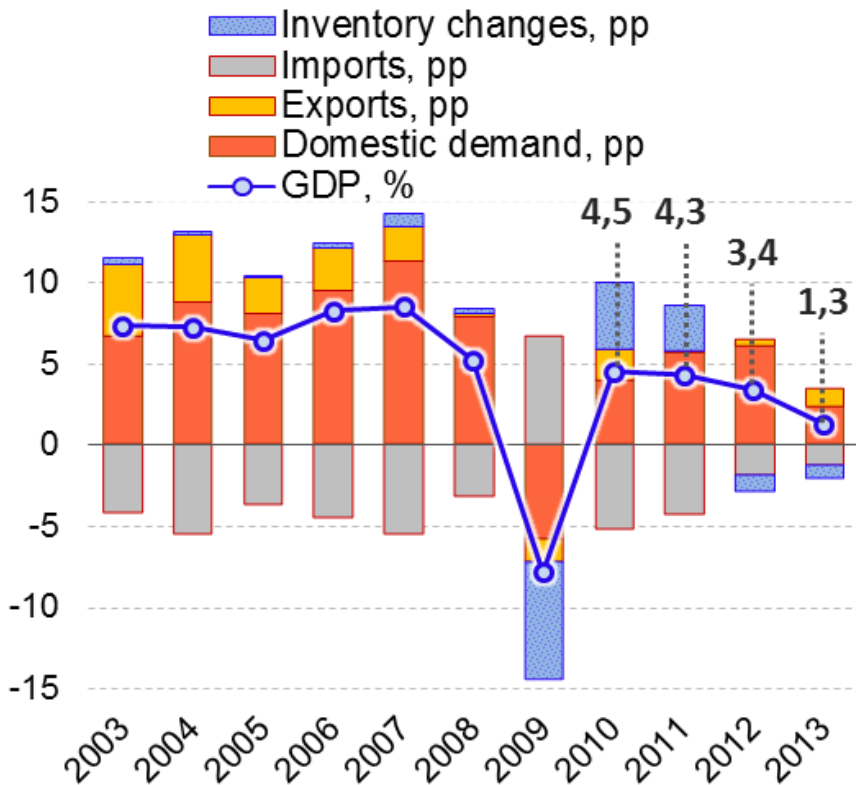❖ Debt sustainability of Russian federal budget in case of drastic slump in oil prices

Russia's stagnation

Economic slowdown

GDP dynamics by demand components

Legend:
- Inventory changes, pp
- Imports, pp
- Exports, pp
- Domestic demand, pp
- GDP, %

Values above bars: 4,5   4,3   3,4   1,3

Source: Russian Federal State Statistics Service, estimates by "Development Center" Institute, Higher School of Economics
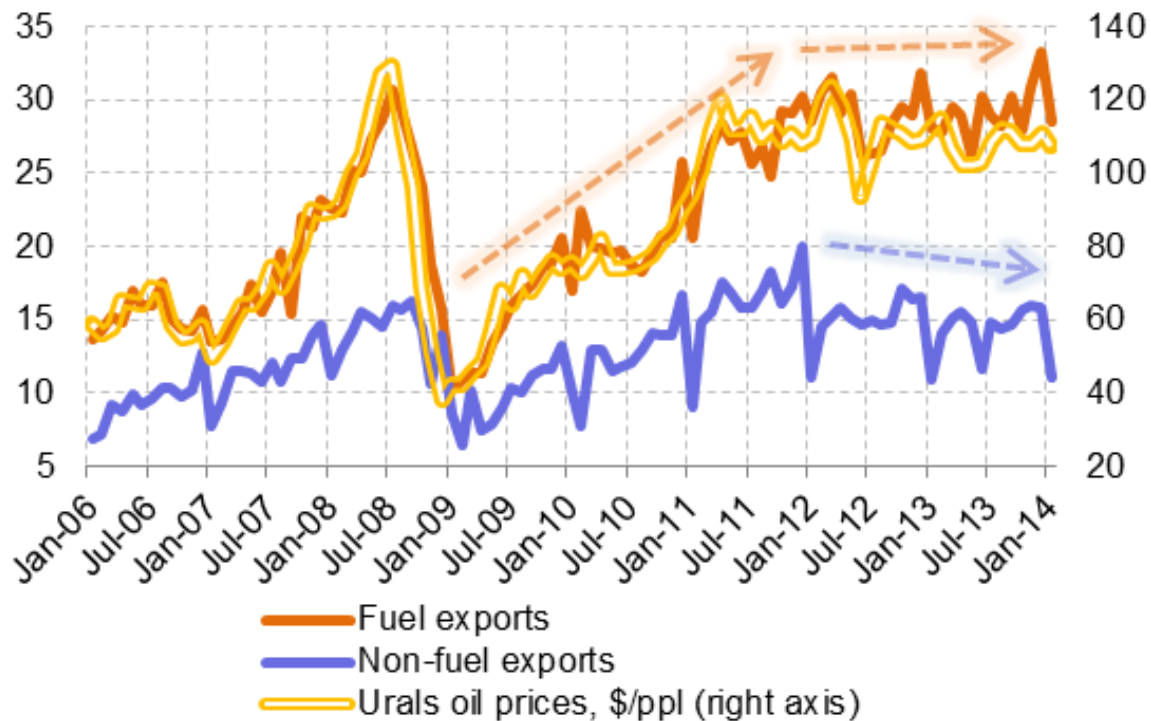
- ❑ Stabilization of both prices and volumes of fuel exports in 2012
- ❑ End of gain from after-crisis inventory accumulation
- ❑ Investment climate worsening
- ❑ Dramatic cutback in investment activities
- ❑ Weakening of private sector
- ❑ Household consumption slowdown

Oil exports stabilized
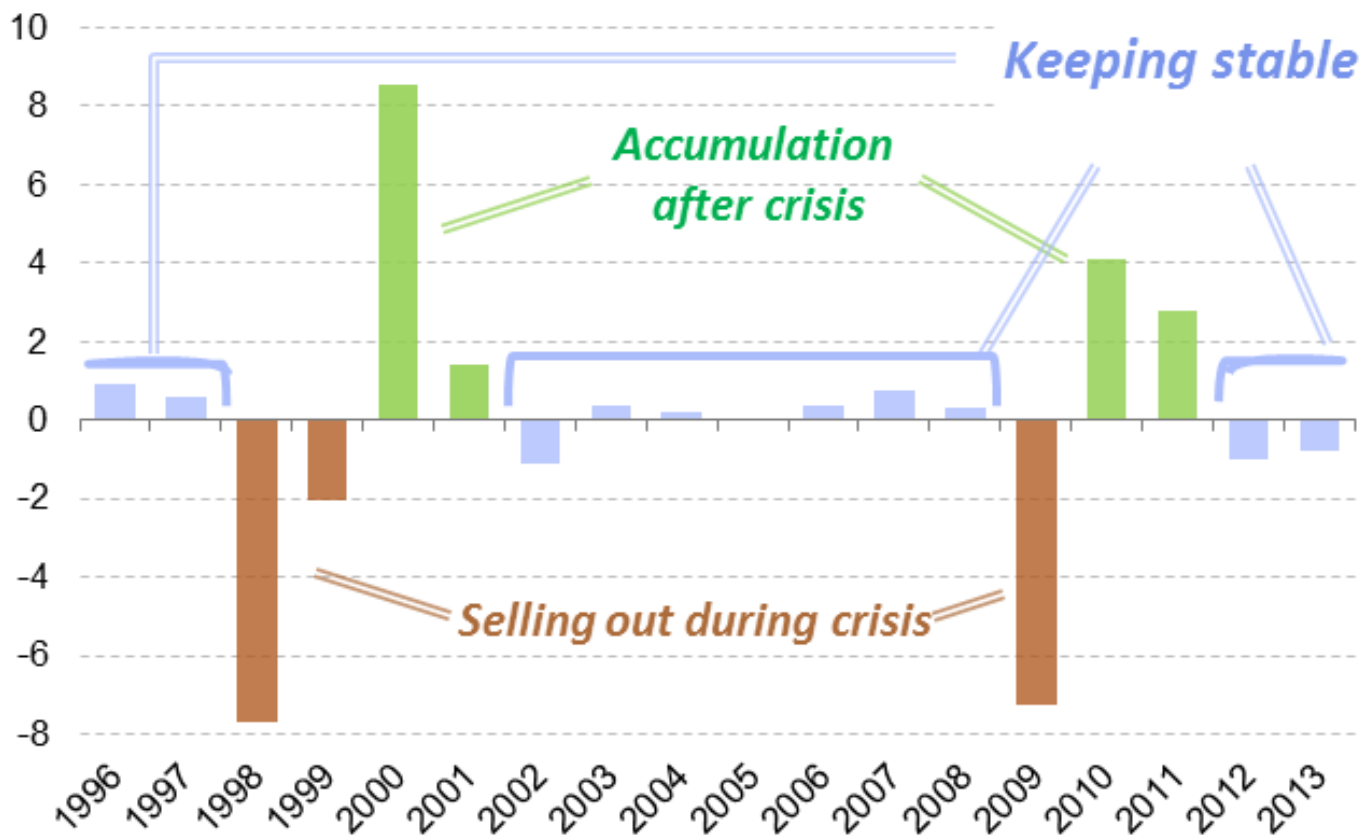
Commodities Exports Dynamics, $ bn

Source: Russian Federal State Statistics Service

Inventory accumulation stopped

Changes in inventory (contribution to GDP growth, pp)

Source: Russian Federal State Statistics Service, estimates by "Development Center" Institute, Higher School of Economics

Investment climate worsening

- The uncertainty of the priorities of economic policy took place
- The deviation between the declared objectives and real policy in the sphere of business and government relations was growing
- Instead of stable taxation rules - several-fold increase in insurance payments for individual entrepreneurs
- Instead of property rights protection - the growing practice of fast withdrawal of land and buildings when implementing projects with a strong interest from the government or its affiliated structures
- Instead of reducing administrative and enforcing pressures on businesses - enforcement agencies were increasing their activities and impeding business development

Cutback in investment activities

Investment and Construction Dynamics (100 = December 2010, SA)
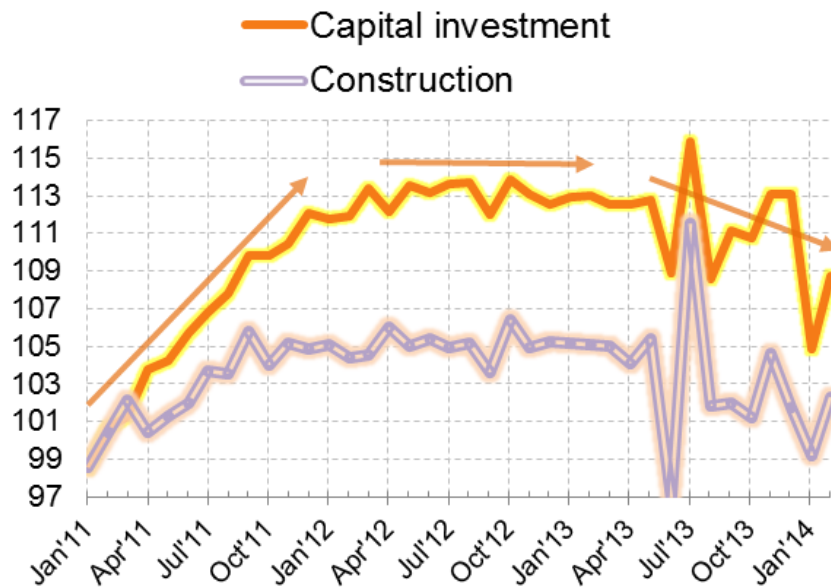
Net Private Capital Inflow Dynamics, $ bln

Source: Russian Federal State Statistics Service, estimates by "Development Center" Institute, Higher School of Economics
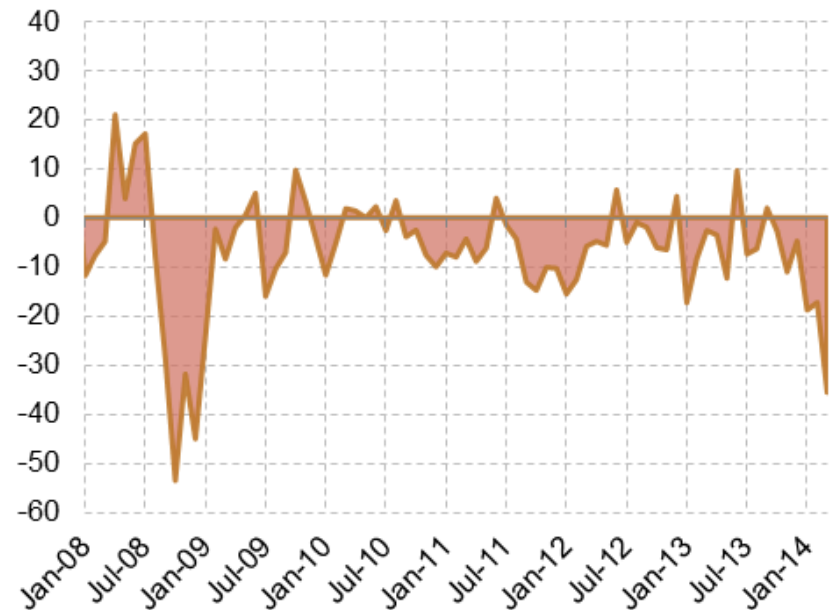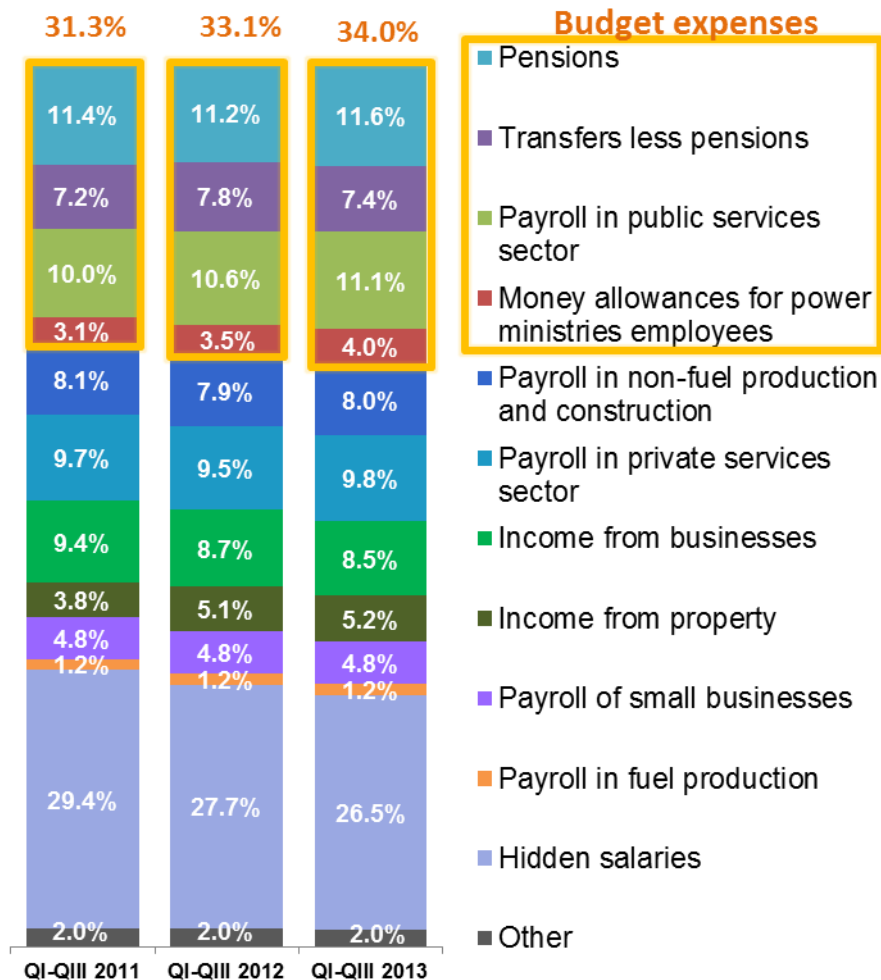
Source: Bank of Russia, estimates by "Development Center" Institute, Higher School of Economics

Private sector is weakening

Household Income Structure, %

	Budget expenses
	■ Pensions
	■ Transfers less pensions
	■ Payroll in public services sector
	■ Money allowances for power ministries employees
	■ Payroll in non-fuel production and construction
	■ Payroll in private services sector
	■ Income from businesses
	■ Income from property
	■ Payroll of small businesses
	■ Payroll in fuel production
	■ Hidden salaries
	■ Other

	QI-QIII 2011	QI-QIII 2012	QI-QIII 2013
	31.3%	33.1%	34.0%
Pensions	11.4%	11.2%	11.6%
Transfers less pensions	7.2%	7.8%	7.4%
Payroll in public services sector	10.0%	10.6%	11.1%
Money allowances	3.1%	3.5%	4.0%
Payroll in non-fuel production	8.1%	7.9%	8.0%
Payroll in private services	9.7%	9.5%	9.8%
Income from businesses	9.4%	8.7%	8.5%
Income from property	3.8%	5.1%	5.2%
Payroll of small businesses	4.8%	4.8%	4.8%
Payroll in fuel production	1.2%	1.2%	1.2%
Hidden salaries	29.4%	27.7%	26.5%
Other	2.0%	2.0%	2.0%

Real salaries dynamics, y-o-y, %
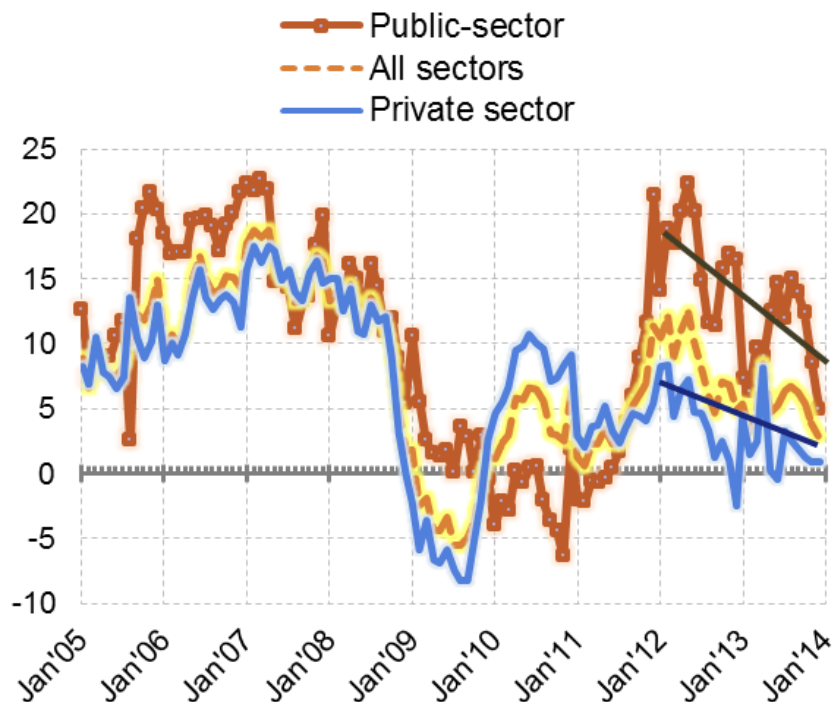
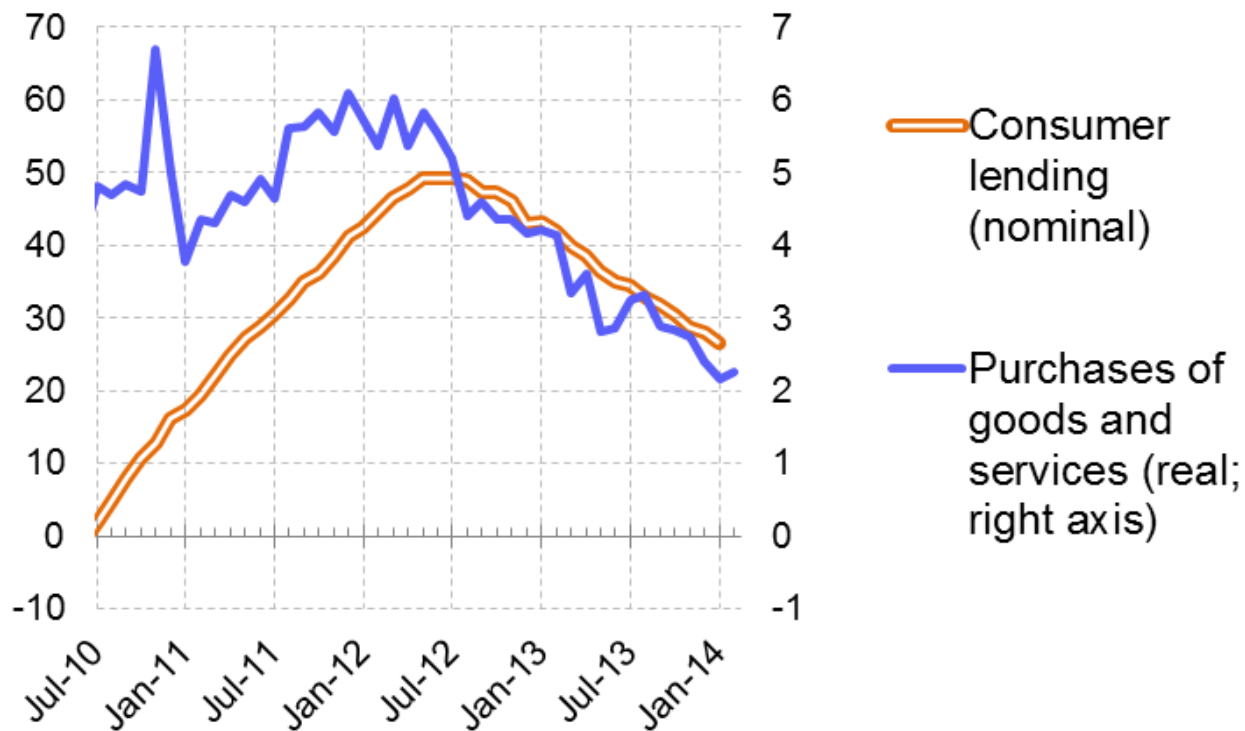Legend:
- Public-sector
- All sectors
- Private sector

Source: Russian Federal State Statistics Service, estimates by "Development Center" Institute, Higher School of Economics

Household consumption slowdown

Household lending and consumption

Source: Russian Federal State Statistics Service, estimates by "Development Center" Institute, Higher School of Economics

Theoretical and applied questions of fiscal multiplier calculation for Russian data

General principles of fiscal stimulus

▶ Promptness of fiscal stimulus measures;

▶ Correspondence of the value of fiscal package to the crisis depth;

▶ Duration of fiscal economic stimulus measures should correspond to the crisis duration;

▶ Fiscal stimulus measures should be diversified, since the influence on economy of certain increase of expenses or decrease of taxes is not known beforehand;

▶ Possibilities (space) for additional measures should be left in formation of package of measures of fiscal stimulus;

▶ Fiscal stimulus measures should not create a threat for budget stability;

Definition of fiscal multiplier

General definition:

$$FM_t = \Delta Y(t) / \Delta G(t)$$

where $\Delta Y(t)$ – GDP growth in year *t*;

$\Delta G(t)$ – budget spending growth in year *t*.

Ad hoc definition:

$$FM_t^i = \Delta y(t) / \Delta G^i(t)$$

where FM_t^i – fiscal multiplier reflecting the impact of *i* budget spending increase on GDP in year *t*;
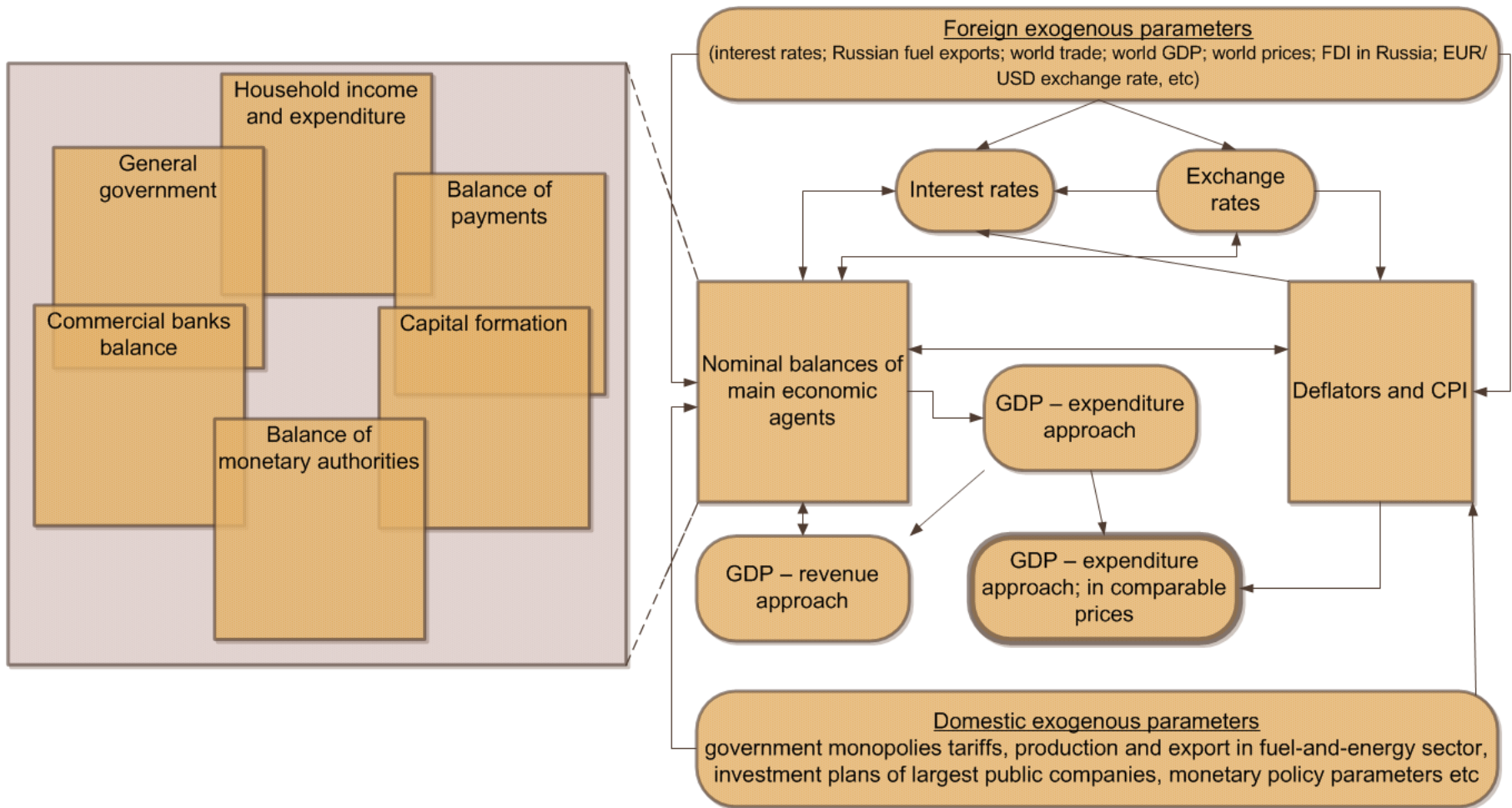
$\Delta y(t)$ – change of GDP growth rate in year *t* in real terms (percent points) due to *i* budget spending increase in year *t*, $\Delta G^i(t)$ (% of GDP)
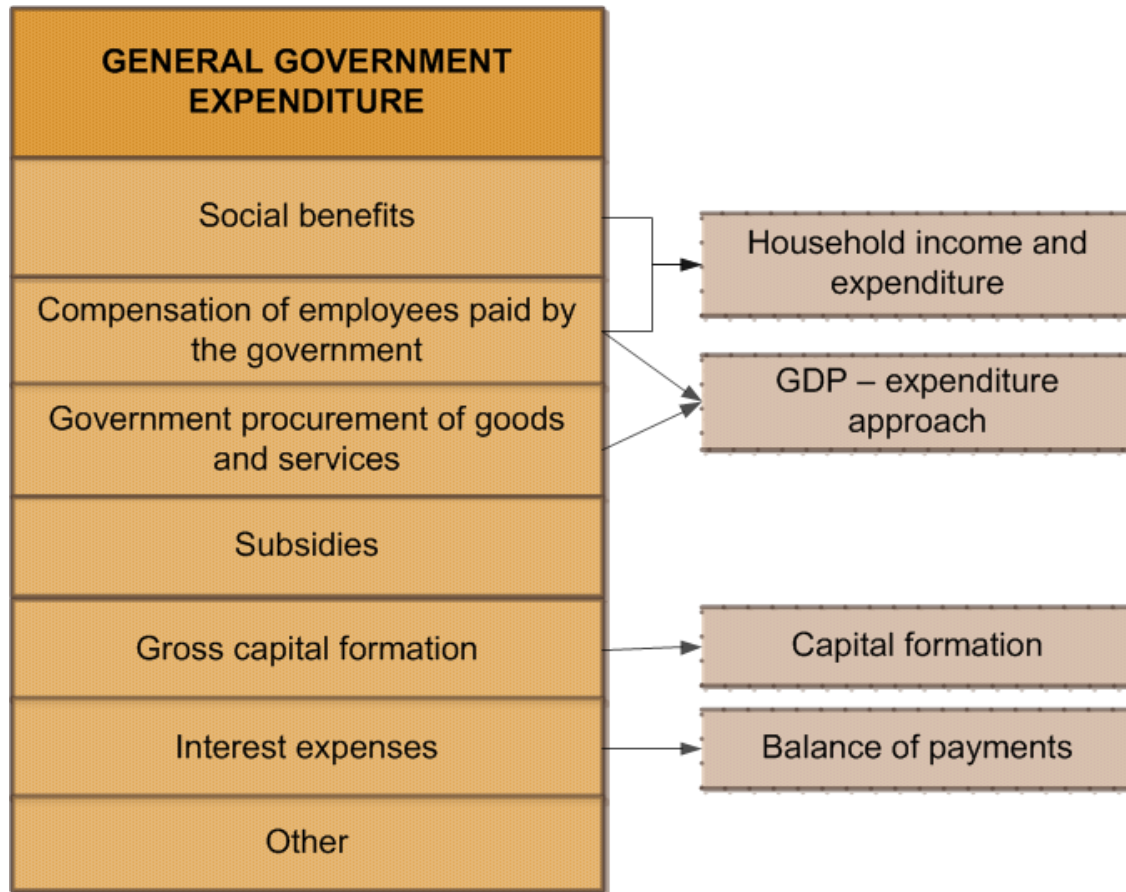
Concept of Macrobase

▸ Balance-econometric model

▸ Demand-driven

▸ Covers all major sectors of the Russian economy

▸ Yearly

▸ Up-to-14-years depth of the retrospective series

▸ Medium-term

General scheme of Macrobase

Government expenditure

Fiscal multipliers estimation results

Expenses	Multiplier
public services (with spillover effect)	0.80
public services (without spillover effect)	0.54
social transfers	0.58
investments	0.81
procurement of goods and services	0.70
subsidies to enterprises and organizations	0.1-0.2

Possibilities for growth-stimulating policies in Russia

Economic slowdown conditions

▸ relatively stable external environment

▸ **Technological factors** (the potential exhaustion in oil production, depreciation of fixed assets, a reverse in technological production, shortage of skilled workforce etc)

▸ **Institutional limitations** (insufficient competition, excessive bureaucratic regulation, poor quality of public administration, high business costs, etc)
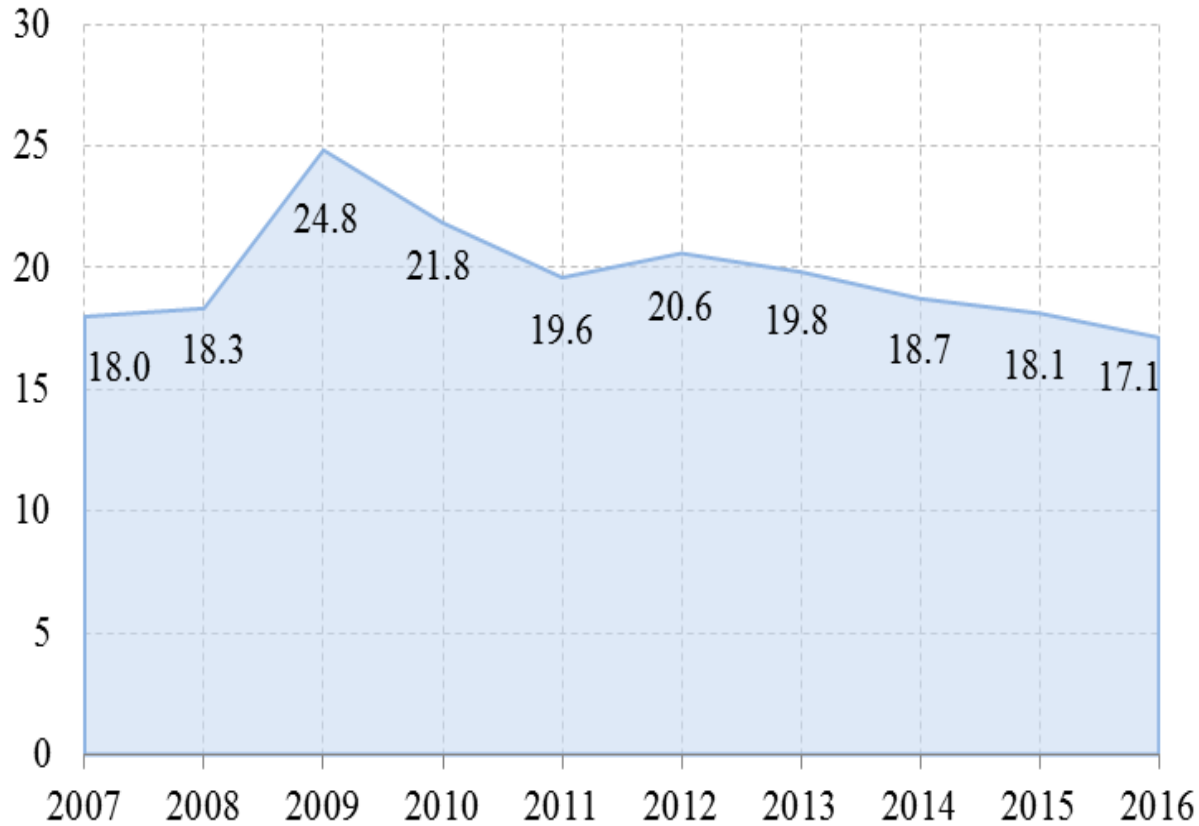
Institutional limitations

IMD (10-score scale of the International Institute for Management Development in Vienna):

▶ Russia is a 3-4 point score behind the developed countries.

▶ By our calculations, 1 point score = an annual increase of GDP growth rates by at least 0.31 pp

Budget Rule as a limitation (since 2013)

Federal Budget Expenditure (% GDP)

Source: RF Ministry of Finance

Budget Rule: with or without?

Economic Growth Rates at Different Expenditure Amounts

	2012	2013	2014	2015	2016
Federal budget expenditures, % of GDP (Base Case)	20.6	19.8	18.7	18.1	17.1
Federal budget expenditures, % of GDP (Case A)	20.6	19.8	20.6	20.6	20.6
Excess of expenditures in Case A over Base Case, % of GDP			1.9	2.5	3.5
Excess of GDP growth rates in Case A over Base Case, pp			1.5	0.5	0.7

Source: RF Ministry of Finance, estimates by "Development Center" Institute, Higher School of Economics

Economic effect of price decrease in carrying out the government purchases

Growth Rates of Macro indices at Reduction of Prices for Government Purchases of Goods, Services and Investments (by 10%, 20% and 30% in 2014-2016)

	2014	2015	2016
Public investment physical volumes growth rates, % (Base Case)	3.8	2.9	3.0
Public investment physical volumes growth rates, % (Case B.2)	5.2	4.3	4.4
Investment deflator, % (Base Case)	106.2	106.0	105.4
Investment deflator, % (Case B.2)	104.9	104.7	104.0
Change in investment physical volumes growth rate, pp	1.3	1.4	1.3
Change in public consumption physical volumes growth rate, pp	4.5	5.2	5.2
Change in GDP growth rates, pp	0.85	0.93	0.95
Change in GDP deflator growth rates, pp	-1.1	-1.2	-1.2

Source: estimates by "Development Center" Institute, Higher School of Economics

Prospects of monetary easing

- Outflow of capital

- Ruble depreciation

- Little effect on GDP growth

Debt sustainability of Russian federal budget in case of drastic slump in oil prices

Influence of an External Shock (80 $/ppl)

Influence of External Shocks on the Economy in General and the Federal Budget with $80 per barrel

	2014	2015	2016
GDP, RUR bln (Main Areas of the Budget Policy)	72,640	78,876	85,487
GDP growth rate, % (Base Case)	1.6	1.8	1.9
GDP, RUR bln (under $80 / bbl)	67,234	73,096	78,582
GDP growth rate, % (under $80 $ / bbl)	-2.9	1.4	1.2
Nominal exchange rate (Base Case)	32.4	33.5	34.5
Nominal exchange rate (under $80 / bbl)	35.2	36.7	38.2
Federal budget revenues, RUR bln (Base Case)	13,510	14,525	15,360
ratio to GDP, %	18.6	18.4	18.0
Federal budget revenues, RUR bln (under $80 / bbl)	11,937	12,781	13,444
ratio to GDP, %	17.8	17.5	17.1
Federal budget expenditures, RUR bln (under $80 / bbl)	13,847	14,855	15,629
Deficit, RUR bln (Base Case)	-337	-330	-269
ratio to GDP, %	-0.46	-0.42	-0.31
Deficit, RUR bln (under $80 / bbl)	-1,910	-2,074	-2,185

Condition of long-term debt sustainability

b=(-g)/(1+g)*d
where b- is the ratio of the budget deficit and GDP;
 g - is nominal GDP growth rate;
d - is the desirable balance of state debt and GDP.

To obtain the necessary value of budget deficit, that a task of supporting the balance of state debt and GDP at the level of 15% is set;
The nominal growth rate in 2017, with the low oil prices, shall amount to 7.5%;
Then, to support the sustainable balance of the state debt and GDP deficit of the federal budget should decrease from 2,8% of GDP in 2016 to 1% of GDP in 2017.;
 Such a reduction of budget deficit demands the reduction of budget expenses by approximately 750 bn rubles (by 4.7% of the general volume of expenses).

Thank you for your attention!