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**RUSSIA TODAY: ECONOMY, FINANCE, SOCIETY**

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**Abstract**

As crisis in the Russian economy, finance and society grows, the causes of it become more obvious. Nowadays this topic gains great relevance and importance. The main objective is to reveal the factors causing the crisis phenomena in the economy. The major tasks were focused in accordance with the set objectives to reveal the main factors and ways of overcoming the economic downfall in Russia. The instrumentation includes the methods such as analysis of scientific base, as well as synthesis of the obtained data into theoretical conclusions and practical recommendations. Methodological and theoretical basis includes scientific works of Russian and foreign scholars. Russian economy in 2015 and 2016 is characterized by emerging crisis phenomena. The article presents the assess of the performance of the financial bloc of the government and the Central Bank, reviews and suggests a new alternative economic and financial policy in Russia, stimulating consumer demand of the population and investment activity of both business and population that will lead to economic growth.

**Keywords**

Economic crisis — Economic stabilization — Economic structure — Import substitution

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## Introduction

What happened in Russia during those distant 2000s, when neither pensions nor financial allowances, nor social benefits, living wages or minimum monthly wages were annually indexed to inflation? All those payments were meager. More than 80% of the population officially considered themselves poor. In 2002, the average pension amounted to 1 600 rubles or 85% of the subsistence minimum (in 2002, the latter was 1 895 rubles). The replacement rate of pensions amounted to 23% of the lost earnings. Allowances and social benefits were estimated based on the minimum living wage (MLV), which was 300 rubles or 16% of the subsistence minimum.

Also, let us remind that the pension reform of 2002 had two main goals: the first – to increase the citizens' interest in retirement insurance savings and to remove their wages from shadow, and the second, based on the first one, – to increase the level of material security and the creation of more decent living conditions for pensioners. In other words, the main goal of the pension reform was to bring pensioners out of poverty. In less than 13 years (the period of pension reform in Russia), with all the disadvantages of the pension reform and inefficiency of the investment part of the state pension, that was much discussed in mass media, today we can say that Russia has finally defeated poverty. Let us consider statistics. Today, the statistics authorities have concluded, that only 15.1% of Russians live below the poverty line. Over the last 13 years, the pension has increased 11.5-fold, and in 2015 the average pension reached 13 900 rubles, which is 41.9% of lost earnings (the average salary in October 2015 was 33 200 rubles). It took the Russian Federation 13 years to reach the average pension level specified by the International Labour Organization (ILO) – 40% of the average wage; the minimum living wage has increased almost 20-fold, and the subsistence minimum – 5.5-fold<sup>1</sup>. All of that was done because the calculation of pensions, allowances and social payments became linked to the subsistence minimum and indexed annually by the amount of annual inflation. It should be also noted, that in all civilized countries, pension and allowances are indexed annually at the rate not less than the annual inflation rate, therefore this is not a Russian know-how.

Only due to the annual indexation of pensions, allowances and social welfare payments by the amount not lower than inflation, pensioners were pulled out of poverty, along with those citizens, who are unable to earn a living for themselves. Russia managed to establish a rather delicate balance, which can be easily destroyed by ill-conceived actions, where consequences are not assessed properly. It is easy to revert back from the achieved level of life quality in Russia. All the above concerns average indices of pensions, allowances and salaries achieved in Russia. Now let us consider minimum pensions and the subsistence minimum in Russia's different regions, given that two-thirds of pensioners receive pensions at the subsistence minimum level. It is exactly here that we see how delicate the achieved balance is. Let ask ourselves: what is the minimum pension that can be assigned to a retiree? The minimum pension available to any citizen cannot be less than the subsistence minimum of a pensioner in the concerned region, as this is written in the law on pension insurance for the citizens of the Russian Federation. However, it should be noted, that the subsistence minimum is determined by regions. The regions try to set the subsistence minimum level as low as possible. This is quite understandable, since the lower subsistence minimum in the region, the less number of the poor, because the latter is determined by the minimum subsistence level. So far, the Russian legislation lacks the

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<sup>1</sup> The average salary in Russia by regions in 2015 (Shkola investor, 2015). (June 29, 2016) from <http://investorschool.ru/srednyaya-zarplata-v-rossii-po-regionam-v-2015-godu>.

concept of the minimum pension. If the amount of gross pension, along with other payments to pensioners, is less than the established regional subsistence minimum, pensioners are paid social surcharge to the level of subsistence minimum. In Russia, depending on the region of residence, there are significant differences in the levels of minimum pension. If we consider, for example, the Central Federal District (CFD) without the city of Moscow, the minimum pension ranges from 5 973 rubles in Kursk region (which is the subsistence minimum) up to 7 549 rubles (subsistence minimum) in Moscow region. In Tambov region, it makes 6 238 rubles (subsistence minimum), in Tula region – 6 860 rubles (subsistence minimum). With this statistics used to determine poverty by the subsistence minimum, it turns out that a resident of Kursk with the income of 5 973 rubles lives better, than a resident of Tambov with the income of 6 238 rubles, or a resident of Tula with an income of 6 860 rubles. We can say that, for most of the Russian Federation, the minimum pension does not exceed 7 000 rubles per month, with the exception of Moscow (9 046 rubles), the Extreme North and the Arctic regions: Kamchatka (12 804 rubles), Yakutia (11 506 rubles), Chukotka Autonomous Region (15 885 rubles), Sakhalin region (10 043 rubles) etc<sup>2</sup>. These regions are located at a great distance from the central part of the country, where climate is severe, and food, goods and services are much more expensive. It should be also noted that, in 2015, prices on pharmaceuticals and food increased by 20%, and prices on housing and utilities infrastructure – by 15%. At that, in some regions, the increase in costs of housing and communal services amounted to 20% or even more, given that from July 1, 2015 a payment for capital repairs of multi-occupancy buildings was added to communal services throughout the country. It is easy to conclude that Russian pensioners are not rich, considering that two-thirds of them receive pensions equal to subsistence minimum.

### **Economic Crisis in Russia**

A reasonable question arises: "Why is the government passing on the economic crisis in the country to retirees and those who cannot support themselves financially and have to live on allowances? And why would the government not consider other sources of replenishment of the budget?" In our previous articles, we have been repeatedly giving examples and calculations in favor of a graduated scale on the personal income tax. We offered to tax incomes exceeding 50 million rubles at a rate of 50%. This would replenish the state budget with additional 800 billion to 1 trillion rubles, and would affect slightly more than 4% of working citizens. All countries with market economy apply either differentiated or progressive scales for the personal income tax (PIT): France – 75%, Japan – almost 60%, Germany – 45%, and the USA – 35%. At the same time, certain individuals in Russia are able to pay taxes at the rate of 50%. In other words, Russia has people to be charged those taxes, and there is plenty of money to be paid. Let us focus on large state companies, their number in Russia amounts to 30. In 2014, an average income of top managers of those Russian state-owned companies has increased 1.6-fold. Thus, each of the 12 members of the Executive Board of Rosneft received on average around 215.3 million rubles per year. In Gazprom, each of the 16 top managers (Executive Board members) received 150 million rubles; in RusGidro, each of the 5 Board members received almost 180 million rubles; in Russian Railways (RR), 25 Board members received almost 80 million rubles each. According to RBC, in 2015, the salary of the President and Board Chairman of the VTB Bank Mr. A. Kostin amounted to more than 3 million rubles a day, and that of the Director General of the VTB-24 Mr. M. M. Zadornov was 14,9 million dollars or 960 million rubles per year (if converted into rubles at the exchange rate of July 8, 2016). The top managers of the VTB

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<sup>2</sup> The average salary in Russia by regions in 2015 (Shkola investor, 2015). (June 29, 2016) from <http://investorschool.ru/srednyaya-zarplata-v-rossii-po-regionam-v-2015-godu>.

group continue to remain in *The Forbes* list, despite that, in the first half of 2015, the VTB group received 17.1 billion rubles of net loss, according to IFRS, and wrote off 27 billion rubles of "bad" debts. At that, in these conditions, the costs of the top management support increased by 5%. It turns out that the economic and financial crisis in Russia hits only pensioners, teachers, doctors, and university professors. In 2015, economic crises did not touch top managers of state-owned companies (almost all the 30 largest state-owned companies), their incomes continued to grow. Let us give just two examples. The 12 Executive Board members of Rosneft earned 2.7 billion rubles in the six months of 2014, and 2.8 billion rubles in 2014, despite that oil prices fell by more than 2.5 times. Gazprom is not far behind Rosneft in promoting its top managers. For the first nine months of 2015, 1.74 billion rubles were allocated on payments to 16 Board members; at that, the average income of each Board member amounted to 102.4 million rubles. For the same period of 2014, the Board members gained 1.60 billion rubles, i. e. the annual growth amounted to 8.5%. At the same time, most experts point to quite a sharp decline in the production of oil and gas by the company, which led to a decrease in cash flow by almost three times, from 14 billion USD in 2014 to 5 billion USD in 2015. According to the Ministry of Energy, from January to August 2015, the Gazprom group enterprises have extracted 258.8 billion m<sup>3</sup> of gas, which is 11% lower than the same rates in January–August of 2014. According to the statements of Gazprom, corporate sales profit over nine months of 2015 decreased by 17.12% – down to 547.5 billion rubles calculated based on the Russian Accounting Standards. At the same time, in 2015, the incomes of Gazprom's top management continued to grow, despite the decline in physical, economic and financial performance of the company. Similar examples can be given for each of the 30 state-owned companies<sup>3</sup>.

We believe the reader is now convinced, that there are people in Russia, who can pay taxes on their personal income at higher rates. The earnings of the top management at private companies are about the same. There is only one reason why the implementation of a differentiated scale on personal income tax may be rejected; the point is that the majority of the government members (Deputy Prime Ministers and Ministers) are either chairmen or members of Board of Directors at state-owned companies, while large private companies have their own representatives at the State Duma and the Federation Council. They lobby for their own interests in the government and at the Federation Council, and do not want to lose any part of their huge incomes. Thus, there is a conflict of interests. At the same time, the incomes of pensioners, the majority of pensions being 6-7 thousand rubles a month, may very well be limited, which is explained by the fact that the indexation of pensions for inflation would lead to higher inflation. So why, during the crisis in Russia, do the rich get richer and do the poor get poorer? Here is another question: why is the government, at the suggestion of the financial sector, trying to reduce the pensioners' incomes, those crumbs that they receive, not to index the salaries of state employees, and at the same time raising the excess profits of top managers at state-owned companies? After all, the implementation of a differentiated rate of the personal income tax would allow to slow down the sharp social stratification between the super-rich and the poor.

It is time to realize that, in state-owned companies, salaries of top managers should not exceed the average salary in the company (organization, holding, or corporation) by 500 to 10 000 times or even more. One could somehow explain differences in income rates at no more than 20 to 50 times. If Mr. Kostin makes more than 3 million rubles a day, while an

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<sup>3</sup> Top-10 managers of state-owned companies with the highest revenue (Federal press, 2015) (May 16, 2016) from [http://fedpress.ru/news/econom/news\\_business/1418973793-top-10-menedzherov-goskompanii-s-samymi-vysokimi-dokhodami](http://fedpress.ru/news/econom/news_business/1418973793-top-10-menedzherov-goskompanii-s-samymi-vysokimi-dokhodami)

ordinary employee at a regional VTB branch earns 120 to 150 thousand rubles a year (10–12 thousand rubles a month), it would take the latter over 20 years to earn a daily salary of Mr. Kostin.

Private business is not far behind, with over 10 000-fold differences in incomes. Private companies follow the example of state-owned companies: they can do that as long as they are allowed to. Such differences in the incomes of employees at the same enterprise (organization) can be found nowhere else in the world. This significant stratification between the super rich and the poor may be eliminated by implementing salary restrictions that would contribute to the growth of wages in all sectors of the economy.

In Russia, five years ago the income gap between 10% of the richest and 10% of the poorest social strata was 15-fold; in Moscow it was 41-fold. Many economists called this income gap critical. According to some economists, in 2014, the disparity in earnings in Russia was 21–22, while in Moscow it was around 55–60.

In 2015, the gap may even increase. This is where additional sources of budget replenishment are hidden.

However, it should be noted that, over the last 10 years, there has been established certain social well-being, though rather delicate. The majority of retirees do not consider themselves as poor, since they have confidence in the future. Pensions are still rather low, but the government annually indexes them by not lower than 15% on average (the inflation rate plus the growth of PFR incomes). As a result, the scale of the nominal and real pension increases every year. According to the Central Election Commission of the Russian Federation, 80% of the older generation go to vote, and over the last 5-6 years they voted for existing power, providing it with 40-50% of the votes.

Future retirees, now working citizens, got additional incentive. From January 1, 2015 a new formula for pension calculation became operative. According to this formula, the amount of pension is directly linked to the service record of the future pensioner and to the income that was charged with premiums to the Pension Fund. Besides, citizens got the opportunity to abandon the investment part of the state pension, which would allow them to increase their pensions by 35-40% compared to those who did not abandon the investment part of their pension. Another incentive, implemented from January 1, 2015, concerned the law that allows people not to retire upon reaching the retirement age and to continue working to earn a higher pension. If, having reached the retirement age, a citizen continues to work for 5 years more, his or her pension increases by 1.7 times. If he or she delays their retirement for 10 years, their pension grows by more than 2 times. It seems like this incentive is as good as it gets. To broadly implement it, the government and the executive authorities should conduct explanatory work among the population. Currently, only 15% of working citizens are aware of the possibility to postpone their retirement and to later receive a much higher pension. It looks like the government decided to destroy the delicate stability in the social sphere and in the society as a whole, accepting the offer of the Finance Ministry to abandon the indexation of pensions to inflation, and to index pensions in 2016 by just 4% (in the last 13 years, including 2015, pensions were indexed to inflation, while the incomes of the Pension Fund were growing by an average of 15% annually)<sup>4</sup>.

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<sup>4</sup> Pension reform of 2014 (Pensionnyy ekspert, 2014), (April 10, 2016) from: <http://pensia-expert.ru/trudovye-pensii/pensionnaya-reforma>.

Where would this take us and how much would this initiative by the Finance Ministry cost the budget of the Russian Federation? We will try to show this using specific examples. The Finance Minister Mr. Siluanov explains this decision by the need to balance the budget and to reduce its deficit. Is that really the case? According to Mr. Siluanov, the pension indexation in 2016 would cost the budget 500 billion rubles (if indexing pensions to inflation). It should be noted that this money was available at the Pension Fund. However, despite the moratorium on transfers to non-governmental pension funds (NPFs) of the investment part of the pension, which has been existing for the last two years, in May 2015 the Finance Ministry (A. Siluanov) transferred 514 billion rubles to NPFs. This money would be enough for the indexation of pensions in 2016, without borrowing from the state budget. In our previous works, we many times argued that NPFs are unviable and inefficient. While the officials, who live at the expense of pension savings of the citizens, are still arguing that this is an additional source of investment in the economy of the country and that these investments will save the country's economy in the context of the sanctions of the West. They try to convince people that today this is nearly the only source of investment available in the country. But none of them ever explained what will become available to a citizen, who has sent his investment part of the pension to NPF, upon his retirement. It turns out that the citizen gets nothing. Therefore, in this paper, we have to attract the working people's attention to the practices of NPFs, given that citizens need to decide on the investment part of their state pension until December 31, 2015.

Do pension savings of the citizens serve as investments in the country's economy? Let us make some calculations. The expected inflation rate in Russia in 2015 may be around 16%, according to estimations by most experts. NPFs should allow 4-5% for the rate of return (NPFs are stock companies, and their main goal is to make profit), plus one needs to allow about 3% for the support of their structures (NPFs have nice offices, expensive cars, and their employees receive high wages). Commercial banks (their main goal being also making profit) that take this money from NPFs would also allow 7-8% for the rate of return and service. When summing it all up, we get the cost of this loan for business, which is equal to 32% per annum. In the parlance of Mrs. Nabiullina, "the money should be expensive and have their price" (Pensionnyy ekspert, 2015). If we take such a "long" ruble at the interest of 32% per annum for 10 years, we will have to return the sum increased 3.5-fold, while taking it for 20 years increases it almost 8-fold. Everyone remembers what resulted from the increase of the key rate to 17% per annum: the cost of loans for legal entities and individuals increased up to 20–25% per annum. Despite the fact that, in July 2015, the Central Bank of the Russian Federation lowered its key interest rate to 11%, the loans are still expensive, ranging from 18% to 20% per annum and even higher, whereas lending in the country is still frozen. What kind of "self-destroyer" would take a loan at 32% per annum in the form of pension savings investment? All the NPFs owners have one and the same goal – to be able to use tens of billions of rubles of pension savings and to pump huge sums of money into their own pockets. Thus, no real investments in the economy have ever been made, and will never be made in future.

### **Investment Climate in Russia**

Now let us describe a few financial schemes, where funds are formally invested in the country's economy, though in fact the money is withdrawn from the economy. Consider, for example, NPF owners Mr. Motylev and Mr. Kudrin, we wrote of them many times before. Mr. Motylev owned land, mines, banks and ten various NPFs. He used NPFs to buy land and mines through his own banks, at prices significantly higher than the market prices. Based on these assets, he developed a business plan for 20 years, assuming that these

assets will bring profit at the level of 20% per annum. Currently, the value of these assets is 5 billion rubles, while in 20 years it will grow to 50 billion rubles.

If one sells these assets after 20 years, the profitability of pension savings will amount to fabulous 35–40% per annum. In the first quarter of 2015, Mr. Kudrin, the owner of Welfare of Compulsory Pension Insurance, the largest NPF, bought the stocks of Promsvyazbank in the amount of 7 billion rubles. According to the same 20-year business plan, the shares will bring the NPF up to 20% per annum of profit, while the capitalization of the stock in 20 years will grow to 70 billion rubles. We are almost tempted to ask Mr. Kudrin, whereby will the capitalization of the bank grow 10-fold in 20 years? However, these transactions resulted from the fact that the NPF owners got the cash into their pockets. Unlike the accounts of future retirees, this money will be secured by land, mines, and financial stocks. They may actually cost much less than the invested funds at the time of purchase. Today, there are more than a dozen similar financial schemes designed to “pump” pension savings to NPF owners’ pockets. These include the so-called mortgage participation certificates (MPCs), and the collusion with the banks, when NPF owners allocate pension savings to troubled banks. When a bank goes bankrupt, retirement savings “disappear” and no one is responsible for their loss. Therefore, when we are told (by Kudrin and Siluanov) that the investment part of the state pension should be saved to help the economy, we are almost tempted to ask them: “Why are you cheating people?” Experts came to the conclusion that investments in NPFs were virtually never regained. In 13 years, it became obvious that people go into this business not to incur losses, but to use billions of rubles of pension savings to their own interests.

Now, let us return to the issue of the state's failure to index pensions to inflation, and to where this will lead. As it was noted earlier, two-thirds of pensioners in today's Russia receive pension at the level of the subsistence minimum, i. e. the minimal pension. If we abandon the annual indexation of pensions for inflation, after three years, the number of pensioners receiving pensions at the subsistence level will be 80%, while in five years it will make 90%. Currently working citizens will no longer be interested in ensuring that their employer has sent the premiums to the pension fund, since the level of their pension will not depend on the insurance premiums transferred to the pension fund. Nevertheless, pension in retirement will still be at the level of subsistence minimum. Many of us remember the early 2000's, when there was much talk about that the majority of companies paid wages in envelopes, paying neither the personal income tax, nor the insurance contributions to non-budgetary funds. Largely thanks to the pension reform, over the past 10 years, the government managed to bring wages out of the shadows, and today the problem of paying wages at business companies in envelopes is not as acute as it was before. We can even state that this problem has been taken off from the table. The question is whether the government wants to bring business back to the days when salaries were paid in envelopes? If yes, the pension fund budget may lose from 15% to 20% of income from insurance premiums. The Social Insurance Fund (FSS) and the Federal Compulsory Medical Insurance Fund (FOMS) will also lose their income. The federal budget may lose up to 3% of the personal income tax, as it is also charged on the wages of working citizens.

Considering that the annual budget of the Russian Pension Fund is about 7 trillion rubles, the loss of 15% will account for 1.050 trillion rubles, while FSS and FOMS will miss 400 billion rubles, the expected revenues of the federal budget in 2016 will be about 13.7 trillion rubles, while a loss of income of 3% will amount to 400 billion rubles. Thus, total losses of the federal budget and off-budget funds will amount to 1 850 billion rubles. In this case, the Pension Fund will have to search for 1 850 billion rubles rather than 500 billion

rubles mentioned by Mr. Siluanov, needed to index the pensions to the annual inflation. This will lead to imbalance of the current financial and credit systems of extra-budgetary funds. Today, extra-budgetary funds successfully solve the challenges they face. They enjoy virtually no subsidies from the federal budget. It should be highlighted that only the Pension Fund of the Russian Federation receives a subsidy from the federal budget, that amounts to 1.23% of the GDP, which is around 1 trillion rubles. The other two funds are not subsidized. If the government abandons the investment part of the pension (6%), which is also about 1 trillion rubles per year, then the Pension Fund would also be fully self-sufficient. So why to destroy the already existing and successfully operating financial institutions (extra-budgetary funds)?

One could understand the financial bloc of the government, if the funds released from the reduction of budget expenditures on the social sphere (pensions, allowances, and public sector wages) were allocated to the real economy. Though, in fact, this money is derived from the Russian economy and invested in the US Treasury bills. For the first 9 months of 2015, more than 600 billion rubles were transferred into the securities of the United States. This resulted in the increase of the Reserve Fund by 9.7 billion dollars. For the full year of 2015, the financial bloc of the government plans to invest 1 070 billion rubles in the US securities and to remove these funds from the Russian economy, and to cut budget expenditures. Thus, investing funds in the US economy, the financial bloc of the government is involved in its development and inhibits the growth of the Russian economy. One may ask, whether it is possible in today's conditions not to index pensions, allowances and public sector wages, and at the same time to invest national funds in the economy of the West. The financial and economic bloc of the government is deliberately trying to copy the path taken by Greece in the last 5 years. In Greece, it all began with budget cuts, freezing pensions, allowances, and public sector wages; thus, money was withdrawn from the national economy and used to repay debts to creditors. Over the 5 years of austerity in Greece, pensions were reduced by 40% and wages – by 37% on average. As a result, the country's GDP decreased by 30%. Its debt to creditors now amounts to nearly 220% of GDP, and the debt continues to grow. In July 2015, a new austerity program and sale regulations of the state assets to creditors were adopted in Greece. European creditors, in return, allocated 82 billion euros, which will be used mostly to pay off the debts. Today, no one knows when the improvement program of the Greek economy will be completed and the country will come out of the recession. By the way, neither the Prime Minister of Greece Alexis Tsipras, nor the Greek people or the European creditors believe in this recovery program of the Greek economy. All of this led to mass discontent in the Greek population, which was forced to change their priorities and political views, including even the older generation, who hardly ever change their political views. Even 2.5 years ago, political rating of Tsipras and his Syriza party did not exceed 3%, while in 2015, the Syriza party has twice won the elections and formed the majority in the Parliament, based on the results of the last election. And again Tsipras headed the government. A reasonable question arises: why has Russia chosen the path similar to that of Greece?<sup>5</sup>

In our previous papers, we have more than once cited the remarks by Henry Kissinger to the German newspaper *Hendelsblatt*. Speaking of the austerity in the European Union, we again refer to his comment: "I'm not sure I understand how economic growth can be achieved through the austerity. Even though in theory it is all right, I'm afraid that if the requirements for the new cuts will prevail, the political system can collapse even before the

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<sup>5</sup> D. Buymova, Elections in Greece risk change policy in the country and Europe (RIA, 2015), (July 5, 2016) from <http://ria.ru/world/20150125/1044142954.html>.

whole process is completed". Maybe, someone wants that the political system in Russia collapses as well?<sup>6</sup>.

### **Economic Crisis and Russian Society**

We believe that the ongoing hard economic and financial policy, conducted by the financial bloc, as well as the Central Bank fighting inflation by monetary methods, only aggravate the economic, financial and social situation in Russia. If the economic and financial policy does not change, Russia's GDP may decrease in the three following years (2015–2017) by 8-10%, individual incomes may become 15-20% lower, unemployment levels may rise to 6-8%, and among young people – up to 20%, and the number of small and medium-sized businesses may decrease by 50%. Thus, in the first nine months of 2015, the number of small and medium-sized enterprises decreased by 29.4% on the year-to-year basis. All of this may lead to social tensions, mass discontent, and change of political commitments. People will no longer vote for the authority, not even the older generation, which currently provides the existing power with 50% votes in elections. Both the society and the economy may collapse.

Speaking at the State Duma, Mr. Siluanov noted that, "In the fourth quarter we expect a slowdown in economic growth rate, and we will see positive economic growth as early as in the last months of this year and early next year" (5-TV, 2016). The Minister of Economic Development Mr. Ulyukayev, answering journalists' question regarding checking the fall of the Russian economy, said that in the third quarter of 2015, Russia's economy reached a "delicate trough". But all these statements of the leaders of the economic and financial governmental bloc (Ulyukaev and Siluanov) are not supported by any calculations and are baseless. Is this actually the case? If we look at the economy structure, we will find that 71% of the total volume of Russia's economy consists of consumer market (wholesale and retail trade) amounting for 50%, and of domestic investments, i.e. investments of companies and enterprises in their own development, which make 20%. The results of nine months of 2015 have shown that there are no growth signs in either consumer demand or domestic investment. According to the results of the first 10 months of 2015, Russians' real income fell by 10.9% on the year-to-year basis; retail sales fell by 11.7%. According to the Bloomberg Agency, Russians' real wages fell to the level of 1999<sup>7</sup>. The poverty rate in Russia increased by 20%, with an average 16.1 million people living below the poverty threshold in 2014<sup>8</sup>. Moreover, the continued decline in consumer demand of the population creates an endless circle: production reduces resulting in another decline in people's income, eventually leading to another reduction of the demand. We are almost tempted to ask the financial bloc of the government: "How many years will we go around in this circle?"

The investments in fixed capital continue to decline as well. According to the Rosstat, the investments of Russian companies in the first eight months (January–August) of 2015 into fixed capital have decreased by 6%. This is a very significant indicator for the economy.

<sup>6</sup> H. Kissinger, The US need to rethink its attitude to world order, (Centrasia, 2012), (July 8, 2016) from <http://www.centrasia.ru/newsA.php?st=1354610700>.

<sup>7</sup> A. Andrianova, Russia Sees Biggest Decline in Wages, Retail Sales Since 1999 (Bloomberg, 2015), (August 21, 2016) from <http://www.bloomberg.com/news/articles/2015-11-19/russia-sees-biggest-decline-in-wages-retail-sales-since-1999>.

<sup>8</sup> Millions more Russians living in poverty as economic crisis bites (The Guardian, 2016), (August 20, 2016) from <https://www.theguardian.com/world/2016/mar/22/millions-more-russians-living-in-poverty-as-economic-crisis-bites>.

It reflects the status of the entire economy. Reduction of investments in fixed capital has a delayed effect. In 2015, the implementation and financing of investment projects started in previous years and in the first quarter of 2015, still continued. Though, the number and volume of such projects in Russia is decreasing because of high costs of loans and reduction in corporate profits, which also does not allow them to invest their own funds in their corporate development. By the end of 2015, the decline in investment in fixed capital can reach 8%, while in 2016 the reductions could be even greater, because the country meets 2016 without any investment backlog. Regional budgets also cut investment costs, thereby reducing the volume of road construction, housing and utilities infrastructure objects, economy-class housing, new factories or processing enterprises. The government shifted to regional budgets the implementation of the Presidential Decree of May 7, 2012, where the aim was to bring the average salary in public health service and education to the average salary in the region. Regions brought their salaries up to their average. As a result, the proportion of expenses on salaries in the structure of regional budgets has reached an average of 33% in three years, while in some regions it grew up to 40%. At that, investment expenses have decreased by 9%, and in some regions – by 5%. However, these funds could be only sufficient for major repairs of the regional administration building. This is clearly demonstrated in Figure 1.

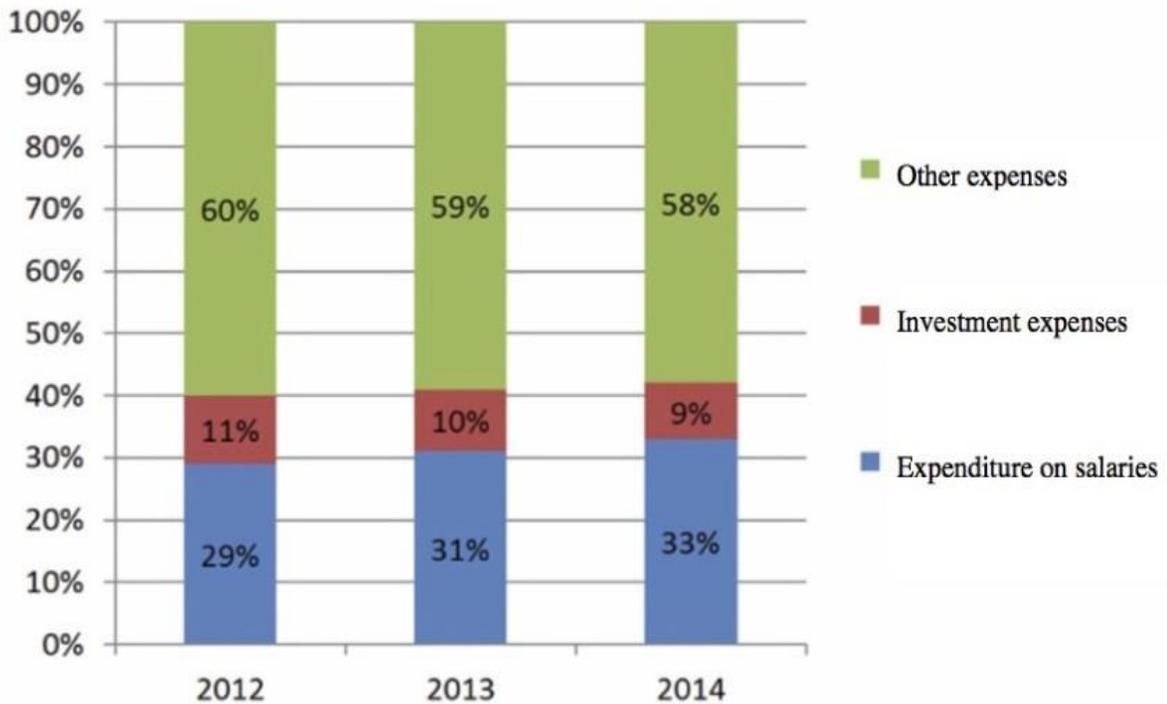


Fig. 1 The proportion of expenditures on salaries and investments in regional budgets

Figure 1

The proportion of expenditures on salaries and investments in regional budgets<sup>9</sup>

<sup>9</sup> S. Sulakshin; L. Kravchenko and A. Degtev, Socio-economic development of Russia in 2015 (Tsentr Sulakshina, 2015), (June 8, 2016) from <http://rusrand.ru/docconf/sotsialno-ekonomicheskoe-razvitie-rossii-v-2015-gg>.

Therefore, it should be noted that no increase in the two most major components of the Russian economy is going to happen any time soon – neither in 2015, nor in 2016. The mechanisms provided by the government for 2016, abandoning the indexation of pensions, allowances, and state employees' salaries on the amount of annual inflation, will only reduce the real earnings of the population. Following the example of the government, the business also refused to index salaries of their employees.

Having considered in detail the consequences of the actions of the governmental financial bloc that conducts strict economic and financial policy, now let us now consider the impacts and outcomes of the tight monetary policy carried out by the Central Bank, and first of all, the following statement made by the Chairman of the Central Bank of the Russian Federation Mrs. Nabiullina: "There is extra money in the Russian economy to beat inflation, and the main task of the Central Bank is to withdraw this money from the economy"<sup>10</sup>. Is this actually the case?

What does "extra money in the economy" mean? It means that money is too cheap (bank rates are very low, businesses and population take a lot of loans without any restrictions, demand exceeds supply, which provokes inflation; there is much money in the economy, and the latter tries to balance supply and demand by rising prices). The question is, where are low interest rates on bank loans available in Russia? Where in this country can you see a surplus of money, when do the population sweep everything away from the shelves? It is just on the contrary. Over the 10 months of 2015, consumer demand decreased by about 11.7% on a year-to-year basis. Therefore, the situation in Russia is quite different.

The key indicator characterizing the security of the national economy with money (fluid assets) is the economy monetization factor. This indicator equals to the ratio between money supply (cash, funds on accounts of enterprises, bank deposits of enterprises and population) and gross domestic product (GDP). This indicator characterizes saturation of an economy with money. In other words, monetization of the economy is the amount of money used by enterprises to pay off to each other for goods and services, as well as to pay salaries to their employees. The population buys goods in stores, pays for the services, businesses and citizens pay taxes, etc. All transactions in the economy should be carried out through money.

As of July 1, 2014, the monetization factor of the Russian economy was 47.1%, while in November 2015, as assumed, this factor is 10% less and amounts to 37–39%<sup>11</sup>.

According to the Central Bank of the Russian Federation, in the 11 months of 2015, the monetary base in its broad definition decreased by 12.7%<sup>12</sup>.

The monetary base in its broad definition means the amount of cash in circulation inclusive of balances in cash offices of credit organizations, the amount of funds on correspondent accounts of credit organizations with the Bank of Russia, obligatory reserves and total funds on deposits of credit organizations with the Bank of Russia.

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<sup>10</sup> N. Makeev, Nabiullina has found extra money (Moskovskiy Komsomolets, 2014), (June 8, 2016) from <http://www.mk.ru/economics/article/2014/02/14/985289-nabiullina-nashla-lishnie-dengi.html>.

<sup>11</sup> A. Zakharov, Statistics on the dynamics of economic development of Russia (Finik, 2015), (June 9, 2016) from <http://finik.me/post/222/#sthash.PNruotFO.dpuf>.

<sup>12</sup> Money supply (Banki, 2016), (June 12, 2016) from [http://www.banki.ru/wikibank/denejnaya\\_baza](http://www.banki.ru/wikibank/denejnaya_baza).

This monetization factor was typical of the Russian economy (37–39%) in the early 2000s. The lack of money in the economy caused emergence of flourishing barter. Payments to contractors for goods and services, as well as salaries to workers, were paid in finished products. About 80% of the economy was in shadow, barter payments were not reflected in the enterprise reports, there was double accounting, and taxes were paid neither by companies nor by individuals. This has led to degradation of the economy. Does the Russian economy actually need this?

The average economy monetization factor is 125%, in Japan and the Netherlands it is about 250%, in China, Switzerland and Spain – almost 200%, in the UK and France – 160%. Even in Brazil (81%), Bulgaria (82%) and India (76%) this index is higher than in Russia. Today, the monetization factor of the Russian economy is on the same level as that of Paraguay (46%), Uruguay (45%) and Romania (43%)<sup>13</sup>.

Analyzing the indicators shown in Figure 2, we can conclude that countries with sustainable market economies generally have a high economy monetization factor. A reasonable question arises, whether the Central Bank strives to achieve the monetization levels of Argentina or Nigeria – the countries that experienced two defaults over the past 10 years?

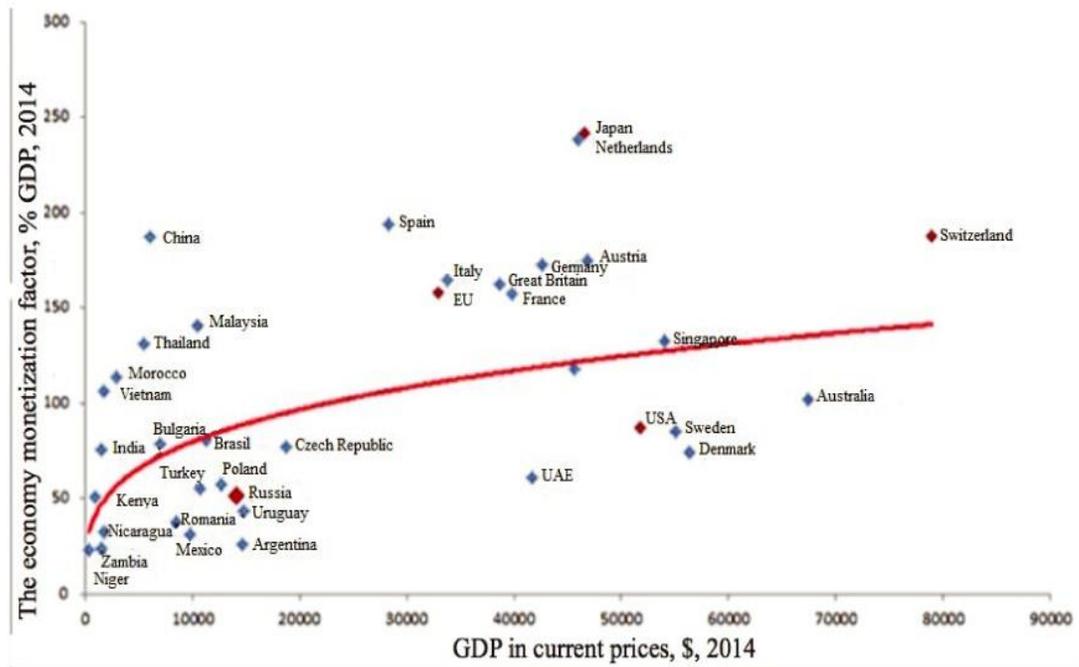


Fig. 2 The economy monetization factor of various countries

Figure 2

The economy monetization factor of various countries. The economy monetization factor, % GDP, 2014; GDP in current prices, \$, 2014<sup>14</sup>

<sup>13</sup> The Russian economy drained (Krizis-kopilka, 2014), (June 8, 2016) from <http://krizis-kopilka.ru/archives/14927>.

<sup>14</sup> C. McLoughlin and N. Kinoshita, Monetization in Low- and Middle-Income Countries (IMF Working Paper, 2012), (September 23, 2016) from <https://www.imf.org/external/pubs/ft/wp/2012/wp12160.pdf>.

Why is there so little money in the Russian economy? Because for many years the Central Bank pursued a focused policy to reduce money supply in the country, thus trying to reduce inflation. Today everybody in Russia, except for the management of the Central Bank, is convinced that the policy to reduce money supply in the economy does not contribute to lower inflation, but on the contrary, provokes inflation. We will try explain in detail at least three reasons, why the monetary policy pursued by the Central Bank is raising inflation.

*Reason 1.* Due to the shortage of financial resources, the availability of bank loans both for enterprises and the population decreases, while the cost of loans increases. Today, the interest rates on short-term credits in Russia that are available for business are 20% and higher, while for the population they are 23% and higher. As a result, the growth rates of loans provoke an increase in production costs, which manufacturers are forced to include in the cost of their products, which leads to higher prices on finished goods, eventually increasing inflation. This makes the Russian business less competitive and provokes a decrease in consumer demand.

*Reason 2.* Low economy monetization factor results in high velocity of money circulation and causes mistrust towards the national monetary system. Economic agents are in a hurry to exchange money for goods or to buy US dollars or euros as soon as possible, which inevitably leads to high inflation. This is exactly what is currently happening in the Russian economy.

*Reason 3.* When business enterprises are unable to obtain cheap loans, while needing money for their development, they are forced to raise consumer prices for goods, works and services. This is exactly what the enterprises are doing – after raising prices on their services (housing and utilities infrastructure, transportation, food production, etc.), which cannot be ignored by consumers. As a result, prices start rising simultaneously, which also leads to inflation.

An interesting situation has been established in Russia: as a result of many years of struggle against inflation, the Central Bank has created a shortage of money supply, which is the cause of high inflation.

Under these circumstances, the situation in the banking sector aggravates, and a sharp decline in lending is accompanied by growing overdue debt on corporate and consumer loans. In detail this is described in our paper "Russia's economy: current status and future prospects"<sup>15</sup>.

All of this has led to an increase in interest rates on loans, which is a heavy burden on the real economy, while banks suffer huge losses from the credit crunch. In these circumstances, the Russian economy can only fall, and this is exactly what is happening in the Russian economy today. The current threat of the approaching banking crisis and the need for a radical shift in the economic and financial policy was noted by German Greff, the President and Chairman of Sberbank. Garegin Tosunyan, President of the Association of Russian Banks, also expresses his concern about the situation in the banking sector and the policy of the Central Bank of the Russian Federation, speaking about the policy of the Central Bank: "Tough interest-rate policy, in our opinion, is not the best tool to fight inflation.

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<sup>15</sup> N. Kulikov and A. Kulikov, "Russian economy: what is it, what it will be?" *Finansovaya analitika: problemy i resheniya* num 33(267) (2015): 2-17.

This policy results in sharp reduction of profits in the banking sector and everything goes to the fact that we may need another recapitalization of banks at the end of the year or early next year". According to Mr. Tosunyan, in order to raise the monetization factor, it would be logical to use a tool controlled by the Central Bank and capable of directly influencing the economic growth. Today, many economists and politicians come to the conclusion that it is necessary to change Russia's economic and financial policy. There is no known example in the global economy, where withdrawing money from an economy would make it grow<sup>16</sup>.

When talking about the first 10 months of 2015, it should be noted that none of the performance indicators of the Russian economy have shown any sustainable positive dynamics; all indicators were declining: industrial production – by 3.3%, processing industry – by 4.9%, retail trade – by 11.7%, investment in fixed capital – by 6%, foreign trade – by 30%, and real incomes of population – by 10.9%. The downturn of the economic activity in Russia is accelerating. In the third quarter of 2015, the RSBY Index showed acceleration of the rate of economic activity downturn in the segment of small and medium-sized businesses by 1.8%, which amounted to 42.8 points against 44.6 points in the second quarter<sup>17</sup>

Among the major components of the index, there is a noticeable decline in sales, which fell from 48.1 points to 43.5 points. Forecasts for the fourth quarter of 2015 are also rather pessimistic: the business expects reduction in revenue, despite the fact that the last months of the year are traditionally favorable for companies in terms of revenues due to growing activity of the population before the New Year holidays.

Most economists have long agreed in their forecasts that in 2015 the fall of the Russian GDP was within the range of 3.8–4.0%. In early November 2015, the Central Bank decreased their expectations to 3.9–4.4%. We will not refer to the forecasts of the IMF or the European Commission, who also predicted deterioration of the Russian economy in 2015–2017. We do not always trust them, and there are good reasons for that; but we will look into this issue specifically in the next paper. There is no reason to state that the Russian economy has already bottomed or that it will start to grow in 2016. In 2016, GDP will decrease by 2-3%. This follows from all the performance indicators of the Russian economy for the first 10 months of the current year. The year 2017 does not look promising either: household incomes will decrease, along with consumer demand. According to Mr. Siluanov, 80% of the Reserve Fund will be spent. In these circumstances, no economic growth can be expected. What should we do? For dynamic sustainable growth of the Russian economy, it is necessary to refill its financial resources, which should be done primarily through internal resources, rather than external. After the global financial crisis, many countries have significantly increased monetization of their economies to offset the effects from the negative impact of the speculative money inflow. Increasing the amount of money invested in the economy and reducing their cost, these countries increase investment volumes and encourage economic growth<sup>18</sup>.

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<sup>16</sup> G. Tosunyan, Russia still holds a high place in the world in terms of inflation (Bankir. 2016), (May 7, 2016) from <http://bankir.ru/novosti/20151118/tosunyan-rossiya-po-prezhnemu-zanimaet-vysokoe-mesto-v-mire-po-urovnyu-inflyatsii-10113925>.

<sup>17</sup> On the current situation in the Russian economy following the results of January–October 2015 (Moscow: The Ministry of Economic Development and Trade of the Russian Federation, 2015).

<sup>18</sup> The European Commission has lowered its forecast for the Russian economy (News.mail, 2015), (June 8, 2016) from <https://news.mail.ru/economics/23865889>.

The experience is not far to seek. Let us consider the actions of governments and central banks in Japan, the USA, China, and European Union during the crisis period of 2008–2009.

The Japanese government introduced tax supplements to companies (118 billion dollars). Moreover, 5 trillion yen (54 billion US dollars) was directed to population, small and medium-sized businesses and regions; the emergency fund for companies was established to support the companies, which were unable to get a loan in the amount of 1 trillion yen (10 billion US dollars); the Central Bank of Japan reduced the discount rate from 0.5 to 0.3%. The government of Japan addressed to the leading national and regional banks with a request to issue more loans to small and medium-sized businesses that work in the real estate property sector. And the result was not long in coming. Japan emerged from the crisis without any economic or political turmoil.

In 2008, the government of Germany adopted a turnaround plan for two years with a total volume of 500 billion euros. The personal income tax was reduced from 15% to 14% since July 1, 2009. Moreover, the contributions of working citizens to health insurance were also lowered from 15.5% to 14.5%. Expenditure on education was increased by 18 billion euros, and unemployment benefits to citizens with children were increased as well. To German citizens who wished to buy a car, the government began to pay a lump sum of 2.5 thousand euros, provided that the owned car was at least 9 years old, while a new one had to be purchased in the same year. Angela Merkel addressed to small and medium-sized enterprises in Germany, asking them not to refuse from the help offered by the government in support of the market. To this end, the government has allocated additional 100 billion euros to support small and medium-sized businesses.

During the crisis, the Danish Central Bank took unprecedented measures. With a view to intensify construction activity in the housing market, the Bank lowered deposit rates to zero, whereas in the period of crisis, commercial banks offered their customers a negative mortgage rate. In other words, the bank paid a bonus to clients who took loans. In December 2008, the Central Bank of Canada lowered the refinancing rate to 0.1%, the lowest level since 1958.

Why are the financial bloc of the government and the Central Bank of Russia doing the other way round? We can say that the financial bloc of the government and the Central Bank, by their actions, deliberately program the continued fall of the Russian economy in 2016, because the 2016 budget passed by the State Duma provides no incentives for either consumption or investment in the economy. The financial bloc of the government and the Central Bank are trying to build in Russia an economic model with no place for the real sector and no need for people.

## **Conclusion**

Today's Russia needs a new alternative economic and financial policy, that would stimulate consumer demand and investment activity of both business and population. The management of the governmental financial bloc and of the Central Bank, whose career evolves within the framework of cooperation with the dollar hub, cannot provide any radical change in the economic or financial policy. In the current situation of the Russian economy, the government and the management of the financial bloc, as well as the Central Bank, need new people with extensive working experience in the real sector of economy and regional finance. This is the only way to overcome the economic and financial crisis in Russia. We

believe that the new people will invest money into the economy and will be able to bring the economy monetization factor up to 80–90% (currently it is 40%) in a couple of years, and that will trigger quite different processes in the economy. Companies will get cheap loans and therefore become able to lower prices on goods and services, workers will receive wages that will result in growing consumer demand, companies will have to produce more products and services that will result in higher wages and eventually in the consumer demand increase. All of this will contribute to the economy growth. Today's Russian economy can be steered out of the economic crisis within a year through the real market mechanisms, rather than through doing nothing or waiting until the oil price rises above 100 dollars per barrel. Devaluation of the ruble at cheap loans can be easily overcome. The historic and global experience shows that, in a period of economic crisis, only new people in governments and central banks are able to steer the country out of the crisis.

The paper turned out to be quite pessimistic, though we must admit that there is still a lot to be improved in the Russian economy, before irreversible processes begin. But if the existing economic policy continues in 2016, it will be difficult to predict the consequences. We would like to draw attention to the urgency of the existing problems in the Russian economy, which may cause upheavals in society and result in a change of political regime in the country. We can understand President Vladimir Putin: it is difficult for him to make such a decision, since the West will start to put pressure on him, trumpet that Putin removed marketeers (liberals) from the government, and immediately bring down all the ratings of the Russian economy and finance. Nevertheless, such a decision should be taken, and the sooner the better. People currently heading the financial bloc of the government and the Central Bank have nothing to do with the market economy. Russia needs an independent, autonomous economic and financial policy, though this does not mean rejection of the dollar, euro or yuan. We have described in detail what is to be done; the only thing left is to apply the given recommendations.

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