At a Glance

- The Russian economy is in recession, but growth is projected to resume in 2017 after another contraction in 2016. The economy continues to adjust to low oil prices and the sanctions environment. Lower public revenues, fiscal consolidation, and inflationary pressures remain key policy challenges for the medium term, as well as the need for structural reforms.

- The key long-term economic challenge is to strike a balance between increasing productivity for diversified growth while simultaneously reducing vulnerability by investing in people—in education, health, and social protection.

- Through a combination of analytical and advisory services and a portfolio of ongoing projects, the World Bank collaborates with the Russian Federation in strategic areas to increase growth and diversification, expand human potential, and improve governance and transparency—all areas critical to Russia's long-term sustainable development.

**Country Context**

Russia is a vast, resource-rich country, with immense diversity. After a turbulent political and economic transition in the 1990s, Russia experienced over a decade of high and almost uninterrupted economic growth, driven largely by a super cycle commodity boom, particularly historically high oil prices.

Poverty rates decreased dramatically, and the middle class grew, as more and more people began to enjoy the benefits of inclusive growth. Since 2012, however, the pace of economic growth has slowed, and now with the dual impact of low oil prices and sanctions, Russia finds itself in a period of prolonged economic stagnation. The remarkable achievements of the previous two decades are now at risk of being erased. At 8.2% (US$5/day 2005 PPP terms), the poverty rate in 2015 was at the 2007 level.

Key economic challenges include how to jump-start the economy to put it back on a path of strong and sustained growth. Russia will have to strike a fine balance between increasing productivity at all levels (country, firm, and individual) and diversifying growth away from a reliance on oil while simultaneously investing in its people and improving the access to and quality of services.

Weakening growth and sharply lower commodity prices, however, have narrowed the room for Russian policy makers to maneuver. Policies to support a smooth fiscal adjustment that distributes the burden across the economy and promotes long-term productivity growth will be critical.
The World Bank and The Russian Federation

The World Bank Group Country Partnership Strategy for the Russian Federation aims to support efforts to:

- increase growth and diversification through better management of public finances, improved investment climate and innovation, a stronger financial sector, better infrastructure, and more effective protection of the environment
- expand human potential through improvements in education, health, and social protection
- deepen Russia’s global and regional role as a donor
- improve governance and transparency through more accountability and better service standards in public administration, procurement, and financial management

The nine projects currently under implementation focus on public finance management, financial literacy, statistics, judicial reform, municipal infrastructure, the preservation of cultural heritage, hydro-meteorology, and forestry. Projects under preparation address development challenges such as preschool education, social inclusion, integrated environmental monitoring, skills and vocational education, and urban transport. The Russia Federation Systematic Country Diagnostic: Pathways to Inclusive Growth is under preparation and will be completed at the end of 2016.

Key Engagement

The World Bank’s knowledge program continues to be at the center of its engagement in Russia. Like in so many other high-middle-income countries, demand remains high for the World Bank’s tailored analytical and advisory services at both the federal and regional levels of government. Ongoing knowledge work is focusing on the investment climate and economic diversification, agriculture, health and education, indigenous people and social accountability, spatial inequalities, and connectivity and growth.

The World Bank’s value added has been its capacity to facilitate knowledge sharing, bringing together relevant experiences from across the globe to showcase possible solutions to Russia’s key development challenges.

Through its Advisory Services and Analytics (ASA), the World Bank has been able to contribute to improvements in the investment climate in Russia. Since 2012, the Bank has been providing support to ongoing government investment climate reforms and recommendations on the legislative and procedural changes required to streamline selected areas of the business environment.

As a result of the Government’s targeted efforts, Russia has significantly improved its investment climate conditions along the dimensions captured by the Doing Business indicators. Russia is now ranked 51st in the Doing Business 2016 report, which represents a jump of 69 positions since 2012.

Since 2007, the World Bank has entered into more than 80 Reimbursable Advisory Services (RAS) agreements with Russia to help the country address its development challenges. The current RAS portfolio includes 15 activities in such areas as innovation, the investment climate, early childhood development, higher education, health care, and food security.

Russia continues to partner with the World Bank to showcase and share its successful development experience with other countries and to strengthen its capacity to deliver development knowledge and aid.
Recent Economic Developments

The recession continued in the first half of 2016, as real GDP contracted by 0.9% y-o-y. Low oil prices and restricted access to international capital markets continue to adversely affect Russia’s economy. The real effective exchange rate depreciated by 5.8% in the first eight months of 2016, benefiting the tradable sectors, namely agriculture, chemicals, leather, and rubber production.

The flexible exchange rate helped stabilize the balance of payments. Worsening terms of trade in the first half of 2016 resulted in a reduction in the current account surplus to 3.0% of GDP (from 7.1% of GDP in the same period in 2015). Net capital outflows moderated on the back of lower debt repayments in the banking sector. Foreign direct investment inflows remained moderate.

Monetary policy remains prudent and consistent with inflation targeting (set at 4% at end 2017 and in 2018). In the first eight months of 2016, inflation slowed and averaged 7.7% (compared to 16.0% in 2015), largely due to the sharp deceleration in food inflation. The banking system remains stable but still vulnerable to macroeconomic risks.

Fiscal consolidation continues. In the first half of 2016, general government primary expenditures shrank by about 1.2% of GDP, leading to an improvement in the primary non-oil fiscal deficit to 7.3% of GDP (from 9.5% in 2015). This was accomplished by freezing public salaries; indexing some public pensions below inflation; and instituting an additional 10% across-the-board cut for all expenditures, except for defense and social benefits. The Government targets a federal budget deficit of 3.3% of GDP in 2016.

The unemployment rate increased slightly in the first seven months of 2016 to 5.7% from 5.6% in 2015, as the labor market continued to adjust to real wages. Real wage growth was zero compared to a contraction of 8.7% in 2015. Public transfers and pensions were indexed below inflation and decreased in real terms, adversely affecting the poor. The poverty rate (US$5/day in 2005 PPP) grew from 6.3% in 2014 to 8.2% in 2015, and real consumption of the poorest decile contracted by 14%.

Economic Outlook

A weak external climate, low commodity prices, and sanctions will dominate Russia’s medium-term outlook. Economic prospects for major advanced and emerging economies have deteriorated amid weak global trade and manufacturing activity. The recent extension of European Union (EU) sanctions until January 31, 2017, will continue to limit Russia’s access to international capital markets, hurting its investment climate.

However, with average oil prices projected to increase to US$53.2/barrel in 2017 and US$59.9/barrel in 2018, domestic demand is expected to recover. Russia’s real GDP is projected to contract by 0.6% in 2016, before recovering to 1.5% in 2017 and 1.7% in 2018.

Low household income growth is expected to worsen poverty in 2016. Labor income will become the most important driver of increasing incomes for the bottom 40% of the population. Below inflation indexation will be sensitive for people at the bottom of the income distribution, as many of them depend on pensions and public transfers. The poverty rate (US$5/day in 2005 PPP) is expected to grow in 2016 to 8.7%.
Project Spotlight

Local Initiatives Support Program

Across the Russian Federation, communities, especially in rural areas, often lack access to good quality social services and infrastructure and live in poor conditions, very different from those found in large metropolitan areas. Limited citizen participation in local decision making contributes to this situation and often leads to the ineffective use of local budgets and slow overall development progress.

Since 2007, the World Bank has partnered with regional governments to help tackle these challenges and contribute to improved development outcomes across rural Russia. The Local Initiatives Support Program (LISP) is assisting regional governments in identifying, prioritizing, and addressing specific community needs—with direct input from local citizens. Provided as RAS, the World Bank brings to this engagement its extensive experience in community-driven development approaches—tested in communities throughout the world—and adapted to the realities of Russian rural life.

Through LISP, citizens are invited to come together at community meetings to discuss, debate, and identify key development needs and possible solutions. Through a highly deliberative process, the community decides on suitable projects or initiatives and submits them for approval to regional tender boards that are made up of representatives from regional ministries and, in some cases, civil society organizations (CSOs). Project financing comes primarily from regional budgets, with additional contributions from municipalities and local businesses. To help ensure greater community ownership of the projects, citizens also contribute financially, on average, about 10% of the overall project cost.

Most projects supported under LISP are small-scale, demand driven micro-projects that aim to improve the quality of local social infrastructure (community centers, cultural and sports facilities, roads and bridges, water supply, and gas distribution networks). The World Bank has supported eight regional governments to implement LISP: Republic of North Ossetia-Alania; Republic of Bashkortostan; Stavropol and Khabarovsk Krai; Kirov, Tver, and Nizhegorodskaya Oblasts; and the Jewish Autonomous Oblast.

Over the past nine years, more than 3,000 projects based on local initiatives have been implemented in Russia, benefiting about 1.5 million people annually. The success of LISP has also been recognized at the federal level. In 2016, through an agreement between the World Bank and the Ministry of Finance of the Russian Federation, a new national program on participatory budgeting and community-driven development was launched, allowing the LISP approach to be introduced in 24 more regions in Russia.