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## **[The End of the Reserve Fund, The End of An Era](#)**



On 1 February 2018 the Reserve Fund (RF) of the Russian Federation officially ceased to exist. The remaining funds were transferred to the National Welfare Fund (NWF). The NWF does not finance the budget per se, but specializes in infrastructure and other investment projects. It marks the end of a highly symbolic story: a fund that once evoked hopes for economic development and diversification. How should this fund — and its precursor, the Stabilization Fund — be commemorated? And what does its demise mean for the Russian economy?

The Stabilization Fund (*Stabfond* in Russian) was officially established on 1 January 2004 during a period of rapidly rising global oil and gas prices. The fund's task was to collect oil extraction taxes and export customs and to smooth potential budget imbalances. The latter were likely to emerge in case of an oil price drop, given that the Russian budget relied substantially on revenues from the export of natural resources.

This seemingly technical instrument of financial management was in fact deeply political. In the 1990s, oligarchs were too powerful to comply with any tax that took in a substantial share of their resource revenues. Besides, resource prices were low and the issue of imposing a tax on resource extraction and export was not

much discussed. Being able to collect taxes on oil revenues in the early 2000s was thus a big political change relative to the 1990s. This change was not only related to Putin's new arrangement with oligarchs. After the financial crisis of 1998, Russia's elites, including its oligarchs, became more conciliatory. Taxes became more acceptable in return for stability. Therefore, owners of big businesses agreed to new taxes during negotiations over a tax reform in 2000-2001. What they did not anticipate, however, was that prices of natural resources were about to skyrocket shortly after.

### **Growth or Low Inflation?**

Once the Stabilization Fund reached the level of 500 billion rubles, which happened at the end of 2004, discussions in the Russian policy-making and beyond started about how to use this money. The law on the Stabilization Fund stipulated that funds exceeding the mark of 500 billion rubles could be spent or invested in the domestic economy. However, the Russian Minister of Finance Aleksei Kudrin, backed by Putin, opposed this solution as he feared a subsequent surge in inflation. A heated debate followed. Would inflation really follow from such a move? Was low inflation more valuable than any growth caused from additional state investments? In fact, the policy of accumulating excessive financial reserves in emerging markets often has a detrimental effect on the GDP of those countries, [depriving them of resources to finance development](#). Within Russian economic policy-making circles a majority supported the investment and growth option— not just the Ministry of Economic Development, the Ministry of Regions, the Ministry of Industry and Trade, the Accounting Chamber, the Public Chamber, but also the majority of Duma and Federation Council deputies.

Since the government decided to entrust the Central Bank with the management of the Stabilization Fund — and the government also put the fund's money in foreign currency, mostly in dollars —the controversy became even greater. “Why is our Stabilization Fund located in America?” [asked](#) the popular writer Mikhail Veller. An economic expert Dmitry Belousov expressed his surprise as to why Russia uses its oil revenues to support its competitor — i.e., [the United States](#). Journalists from the business weekly “*Ekspert*” [bemoaned](#) that the Russian financial system is not sovereign and that Russia uses “the rest of the world as a bank” by depositing its money in foreign banks and by incurring foreign loans, instead of using its own financial system for either. In fact, in the period 2007-2008 the amount of the Stabilization Fund was approximately equal to the volume of credits Russian state and private holdings incurred in the West, almost \$500 billion.

The anti-inflation camp in Russian financial policy proved more powerful in the period 2004-2008. However, the idea to invest at least a share of the SF in the domestic economy gained a lot of supporters, too. Putin hesitated between the two options and sought a compromise between them. As an expression of this compromise, the SF was split at the beginning of 2008 into two funds with diverging functions: the Reserve Fund and the National Welfare Fund. The Reserve Fund was from now on to finance the budget in case of an insufficient budget income. The National Welfare Fund had to manage pensions and potentially provide resources for large-scale investments in the Russian economy, especially infrastructural ones.

### **Then Came the Crash**

The global financial crisis 2008-2009 was a usefulness test for the Reserve Fund and of the National Welfare Fund. The RF in particular served to rescue the financial system and replace missing budget revenues. On the eve of the crisis, the Reserve Fund amounted to \$140 billion; after being deployed in the emergency, the Reserve Fund [dipped](#) to just \$25 billion. It quickly became clear that this money does not make much difference when it comes to improving the wider performance of the economy. The fund merely helped to extinguish the fire. During the crisis, liquidity was necessary, but was not able to provoke a positive dynamic of investment and growth. A development policy that had been pursued only halfheartedly before the crisis was then partly discredited. Reforms that had not been undertaken before the crisis were even more difficult to realize during the crisis and during the period of economic stagnation that followed. Thus, it turned out that proponents of using resources of the Stabilization Fund for financing investment or institutional reforms during the oil boom period were right. By 2009, the chance for a high-impact economic investment policy was already gone.

In 2011, the government returned to an excessively cautious policy, as it became clear that financial fragility with a permanent risk of a renewed crisis would continue. The Russian government opted for a policy of just collecting abundant revenues instead of funding new investments by means of them. At the same time, the

government launched a modernization policy financed initially from other sources that was however too selective, badly designed and underfunded. In 2013, following the ideological turn of the regime towards national conservatism, the National Welfare Fund became an instrument of investment policy, too. However, investments financed in this way – large-scale infrastructure projects benefiting oligarchs in the first place – were again hardly promising in terms of a substantial contribution to economic growth.

Overall, the funds did not fulfill expectations that emerged in the oil boom period (2004-2008). They showed that substantial revenues alone are not a deciding factor for the economy, when not accompanied by a smart industrial policy and institutional reforms. 2014 initiated the story of their demise. In conditions of a political and economic crisis, the Reserve Fund could only be used to gradually replace missing budget revenues and did not have the potential it could have had in conditions of a growing and open economy. In 2017, its level sank so radically that authorities decided to dissolve it by the end of the year. As for the National Welfare Fund, it continues to finance large-scale investment projects whose benefit for the economy and society is debateable. The funds that once evoked hopes for a major developmental push could only be as good as the economy that employed them. An economic system that is a synthesis of oligarchic and state capitalism offers only limited possibilities for actual socioeconomic development, even if it has abundant revenues at its disposal. *Stabfond* and its successors the Reserve Fund and the National Welfare Fund taught Russians a lesson that money alone is not omnipotent and matters less for development than growth-inducing economic structures and practices.

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