MINISTRY OF EDUCATION AND SCIENCE OF THE RUSSIAN FEDERATION
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ECONOMIC POLICY

Tutorial Manual

Recommended by the Methodical Commission of the Faculty of Foreign students for international students,
studying in the B.Sc. programme "Economics"

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МИНИСТЕРСТВО ОБРАЗОВАНИЯ И НАУКИ РОССИЙСКОЙ ФЕДЕРАЦИИ
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ГОСУДАРСТВЕННОЕ РЕГУЛИРОВАНИЕ ЭКОНОМИКИ

УЧЕБНО – МЕТОДИЧЕСКОЕ ПОСОБИЕ

Рекомендовано методической комиссией факультета иностранных студентов
для иностранных студентов,
обучающихся в ННГУ по направлению
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Рецензент:

Учебно– методическое пособие представлено в виде сжатого содержания курса лекций,, списка литературы по предмету «Государственное регулирование экономики» для иностранных студентов, обучающихся в ННГУ по направлению «Экономика» (бакалавриат).

Дисциплина рассматривает широкий диапазон используемых государством прямых и косвенных инструментов. Учащиеся должны понимать взаимодействие государственной экономической политики и экономической деятельности хозяйствующих субъектов, а также перспективы и возможные результаты государственного вмешательства в экономику. Дисциплина рассматривает проблемы воздействия государства на экономический рост, фискальную и денежно-кредитную политику, социальную политику, регулирование международной торговли и т. д.

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Content

INTRODUCTION	**5**
TOPIC 1. THE INTRODUCTION TO ECONOMIC POLICY	**6**
TOPIC 2. TAX POLICY	**9**
TOPIC 3. FISCAL POLICY	**14**
TOPIC 4. MONETARY POLICY	**20**
TOPIC 5. ANTI-INFLATION POLICY	**25**
TOPIC 6. ANTIMONOPOLY POLICY	**28**
TOPIC 7. ECONOMIC STRUCTURE AND INDUSTRIAL POLICY	**32**
TOPIC 8. INVESTMENTS AND INNOVATION POLICY	**34**
TOPIC 9. INTERNATIONAL INTEGRATION AND POLICY	**39**
TOPIC 10. STATE POLICY IN THE SOCIAL SPHERE.	**42**
BIBLIOGRAPHY	**46**
APPENDIX	**50**

INTRODUCTION

The discipline inspects a wide range of government direct and indirect tools to intervene into markets. Students should understand the interaction of governmental economic policy and economic activity of business entities as well as efficiency, prospects and possible results of governmental intervention into economy.

The goal of the discipline is the study of the principles, methods, and tools of governmental economic policy.

There are the following tasks in accordance with the set goal:

- Understanding the role of government in economy, reasons and preconditions of creation of the system of state regulation of economy;
- Studying the legislative and executive governmental structures, directions and methods of governmental policy
- Understanding fiscal policy and monetary policy of the state;
- Understanding state policy in the field of science and investments;
- Examination of social protection and incomes policy;
- Studying state regulation of foreign economic activity etc.

It begins with the historical aspect of economic policy, and after that shows its development and current situation. The discipline concerns the main debated government functions challenges such as economic growth models, fiscal and monetary systems performance, unemployment level, foreign exchange policy, international trade regulation etc.

By the end of this course, students get ready to foresee different economic policies implementation consequences.

This subject requires preliminary study of the following subjects: Economic Geography, Microeconomics, Macroeconomics, Economic History, History of Economic Thought and Statistics. The course of Economic Policy will be useful when studying Regional Economics and Policy, Accounting, Investments, World Finances, Economics of the Public Sector, Taxation and World Economic Relations.

TOPIC 1. THE INTRODUCTION TO ECONOMIC POLICY

Questions for the lectures and the seminars:

Economic policy: definition objects and aims. Market failures and governmental interventions. State bodies and their functions. The Economic Policy instruments.

The role of Government in economic development - historical approach: the theory of mercantilism (T, Mun. A. Monchrestien), the classical theory (A. Smith, D. Ricardo), the Keynesianism (J-M. Keynes), monetarism (I. Fisher, M.Friedman), dirigisme (F. Perroux) etc.

Models of governing: planned economy, market economy in Europe, the USA, Asian countries.

Economic policy is the system of governmental legislative, executive and supervisory measures, carried out by the government institutions and public organisations in the economic field aiming at stabilization and development of economy. It covers the systems for setting levels of taxation, government budgets, the money supply and interest rates as well as the labor market, national ownership, and many other areas of government interventions into the economy.

Most measures of economic policy can be divided into either fiscal policy, which deals with government actions regarding taxation and spending, or monetary policy, which deals with central banking actions regarding the money supply and interest rates.

The government regulates different economic activities, companies, regions, sectors of economy, foreign economic relations, global processes, etc.

The economic policy includes:

1. Industrial policy (management of enterprises in the public sector and government consumption of goods and services);
2. Tax policy;
3. Monetary and anti-inflation policies;
4. Antimonopoly policy;
5. innovation and investment policy;
6. International Integration and policy;
7. State policy in the social sphere.

The main objects of government economic policy are financial sector, real sector and social sphere (table 1).

Table 1

The main objects and instruments of government economic policy

Financial sector	Real sector	Social sphere
money credits taxes budgets state property etc.	industries investments innovations competition monopolies foreign economic relations etc.	Demography employment and unemployment incomes and wages health and education etc.

Main economic functions of the state authorities:

- Adoption of laws;
- Creating and maintaining a competitive environment;
- Promote and support economic growth;
- Redistribution of income and wealth;
- Efficient use of resources, their distribution;
- Structural changes of the economy;
- Monitoring of key macroeconomic indicators (inflation, employment), etc.

A lot of famous economists expressed their views on the role of the state in the development of the national economy (table 2)

Table 2

The evolution of views on the role of the state in the development of the national economy

Theory (period)	Representatives	The main idea	Characteristics
Mercantilism (till the XVIII century)	T. Mun, A. Monchrestien	The state is the institute of political power and a spokesman of the economically dominant class interests.	Wealth is identified with the money. The accumulation of money can be achieved by using state power. Major management function of the state is protectionism. The idea of a police state.
The classical theory (XVIII - 30-ies of the XX century)	A. Smith	The state is a defender of the economically dominant class interests.	Protection from external threats; Protection of the individuals rights against violation on the part of other members of society; The government should assume the production of public goods.

The Keynesianism (since the 30-ies of the XX century)	J-M. Keynes	The state is an active regulator of the economy.	High share of national income is redistributed through the state budget; Government entrepreneurship; Wide use of fiscal and financial regulators to stabilize the economic situation, smoothing cyclical fluctuations, maintain high growth rates and high employment
Monetarism (since the 50-ies of the XX century)	I. Fisher, M. Friedman	The reduction of state intervention, the reference to indirect methods of regulation.	The state should provide conditions for the process of capital accumulation and productivity of production; The monetary policy is the main the instrument of government regulation.
Dirigisme (since the 40-ies of the XX century)	F. Perroux	The state is an active regulator of the economy.	Indicative planning; The concept of the General economic equilibrium

There are different models of economic policy used in different countries. The main features of these models are represented in table 3.

Table 3

Models of state regulation of economy

Model	The share of the state participation (% of GDP)	General features
American (liberal)	35-40%	Promotion of entrepreneurial activity; The enrichment of the most active part of the population; The goal of social equality is absent; Maintaining a stable environment and economic equilibrium; The government operates through legislation, tax, monetary and antimonopoly policies.
Japanese (Asian)	35-40%	State paternalism; Lifelong employment; Participation of the government in workforce training; High level of impact on main directions of economic development (innovation, investment, structure of economy, social sphere, foreign economic activity).
The Swedish (Scandinavian)	More than 60%	Active social policy aimed at reducing social inequality; The high level of social guarantees;

		The state undertakes to ensure a high level of life and development of infrastructure (transport, R & D, etc.); High level of taxation.
German (social market)	About 50%	Active social policy; Social partnership; Priority support of small and medium business; Active regulations of prices, duties, and technical standards.
French	About 50%	Active social policy; High level of taxation; The government regulates the prices of food, housing, medical care, goods and services.

TOPIC 2. TAX POLICY

Questions for the lectures and the seminars:

Taxes: the concept, functions, types of taxes. The profit tax, income tax and other in Russia and foreign countries. Taxation in different countries of the world. Tax policy: concept and structure. Fiscal Federalism: definition and peculiarities. Models of Fiscal Federalism: federalism in Canada and Germany, etc.

Taxes are charges levied on individuals and organisations in an economy. These are contributions to the budget of the corresponding level or the extra-budgetary fund, implemented by the payers on the conditions determined by laws.

Taxation is used to achieve the following.

- To raise revenue to finance government spending. The state has traditional functions, such as state administration, army, law-enforcement activity and security of citizens, national defense, protection of the environment and natural resources, transport, roads, telecommunications. In the XX century, socio-cultural functions were added (health, education and so on).
- To influence firms' and households' behaviour. For example, by making some goods more expensive, taxation can lead to households switching to other products or changing their consumption patterns (e.g., taxes placed on fuel may reduce energy usage). Taxes regulate property and social stratification of society, i.e. they support social balance by changing the ratio between the incomes of separate social groups with the aim of smoothing inequality between them.
- To fulfill social function. Certain categories of taxpayers can have exemption from some taxes (low-income families, disabled, pensioners, single mothers, large families,

immigrants, students). There are some tax exemptions of some socially significant goods and services (with exemption from VAT, sales tax, customs duty), or, on the contrary, the government can increase the luxury tax (through the high VAT, excises, etc).

- To regulate economic activity. The development of some activities can be encouraged due to tax exemptions (small business, agriculture, implementation of new technologies, investments of private business, investment in the mining industry and so on). The government can regulate cyclic fluctuations of structural changes, prices, investment, research and development, environment, foreign economic relations. The government introduces new and repeals the old taxes, change and differentiate their rates, etc.

Types of taxes include the following.

Direct taxes. These are taxes placed on households' incomes and firms' profits, for example:

- income tax (it is levied on employees' income);
- corporation tax (it is levied on firms' profits);
- capital gains tax (it is paid when you sell an asset, such as shares and houses, that has gone up in value);
- inheritance tax (it is paid when you inherit income and assets);
- national insurance taxes (these are payments made by individuals and their employers to finance pensions and social security).

Indirect taxes. These are incurred when items are purchased. The producer is legally obliged to pay these taxes but adds them onto the price to try to pass them on to the customer. They include:

- value added tax (it is paid when most goods and services are bought);
- excise duties (these are specific taxes paid on particular goods and services, such as alcohol);
- customs duties (these are taxes levied on imports into the country).

Tax reliefs installed by the government are:

- the non-taxable minimum of the tax object;
- exemption from taxation on certain items of tax objects (for example, R & D expenditures);
- exemption from taxation for individuals or categories of payers (for example, disabled persons);
- reduction of tax rates;

• changes in term of payment (deferral of taxes), etc.

The following are the different types of taxation system (figure 1):

• Progressive. In a progressive taxation system the average rate of tax increases as people earn more money. The income tax system in the UK is progressive; as people earn more they move into higher marginal tax brackets. The increasing marginal tax rate pulls up the average amount of tax paid per pound.

• Regressive. In a regressive tax system the average rate of taxation falls as income increases. This can occur if, for example, the same amount of tax is paid regardless of individuals' or firms' income levels. On average, therefore, the more income you have, the lower the tax paid per pound earned.

• Proportional. A proportional tax occurs when the percentage of their income that people pay in tax stays constant whatever they earn, that is, the average rate of tax is constant.

So, in a progressive taxation system the average rate of tax increases as income increases. In a regressive taxation system the average rate of tax decreases as income increases, in a proportional taxation system the average rate of fax is constant.

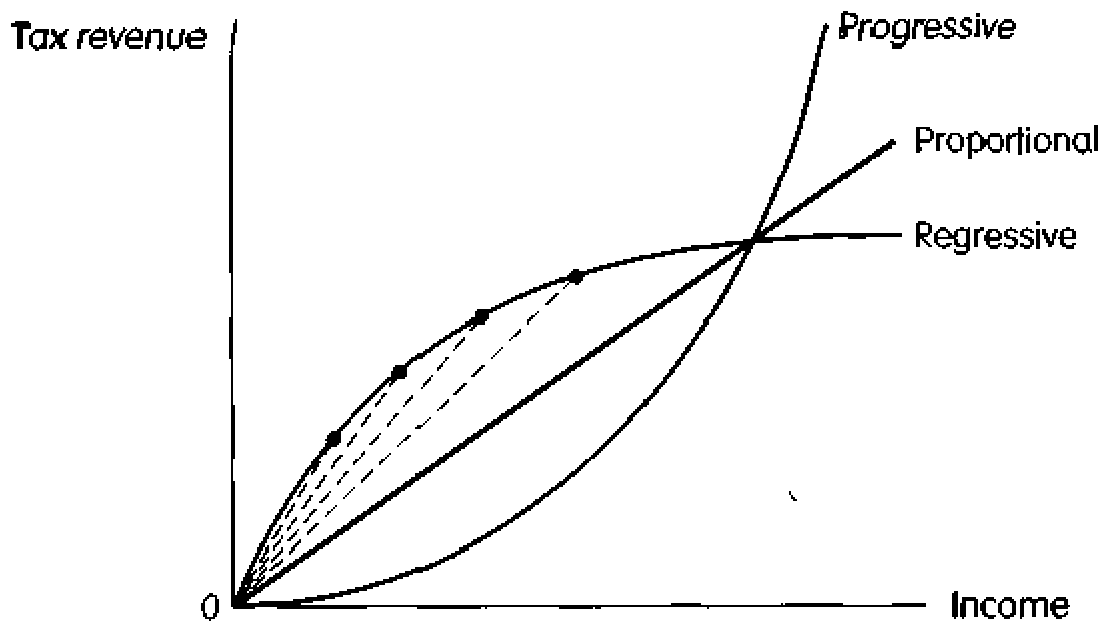

Figure 1. Types of taxation system

An effective taxation system should be the following.

• Understandable. Individuals and organisations should be able to understand how their tax is calculated or they will think it is unfair.

• Cost effective to administer. If a taxation system is too complex then too much will be spent administering it and collecting the tax, thereby wasting resources.

• Difficult to avoid paying.

• Non-distortionary. It should not alter market signals in an undesirable fashion; for example, it should not discourage the production or consumption of a product below the socially efficient level.

The fairness of a taxation and benefit system can be measured in terms of the following.

• Horizontal equity. This occurs if people in the same situation pay the same amount of tax.

* Vertical equity. This occurs if taxes are regarded as fair between different income groups. Obviously, what is regarded as fair is very controversial and people will have very different opinions on what they think a taxation system should involve.

Taxation as a government policy instrument

The factors to consider when assessing the effectiveness of taxation as a government policy instrument include the following.

- Taxing people and firms can reduce their earnings but cannot directly increase their income. This can only be done if the taxation revenue is redistributed in some way. It is therefore important to consider not just what taxes are charged, but what is done with the money raised.
- There is always an incentive for tax avoidance and tax evasion. Avoidance occurs when individuals or firms take legal steps to avoid paying as much tax, for example, by finding loopholes in the system. Tax evasion is illegal and means that people are trying to get out of paying the tax that they are meant to pay.
- Increasing tax can have a disincentive effect. For example, increasing income tax can lead to there being less incentive for people to work (or at least to work more hours) because the amount that they earn is relatively little after tax. This is known as the poverty trap. On the other hand, a tax cut can have an incentive effect and, according to Laffer, may increase tax revenue, as explained below.

Professor A. Laffer highlighted that the total tax revenue depends on the tax rate and the income being earned; if cutting the tax rate encourages people to work and thereby increase incomes then this can increase tax revenues (see Figure 2).

If the average rate of tax was zero then no tax revenue would be raised. As the average rate of tax increases more tax revenue is raised. However, if the tax rate is set too high then this might discourage people from working and firms from investing, therefore reducing the income and the tax revenue being earned. Laffer argued that the US (between 1981 and 1984) had

reached a point where the tax rate was too high and acting as a disincentive to firms and households to earn more. A tax cut would encourage more earnings and lead to an increase in revenue.

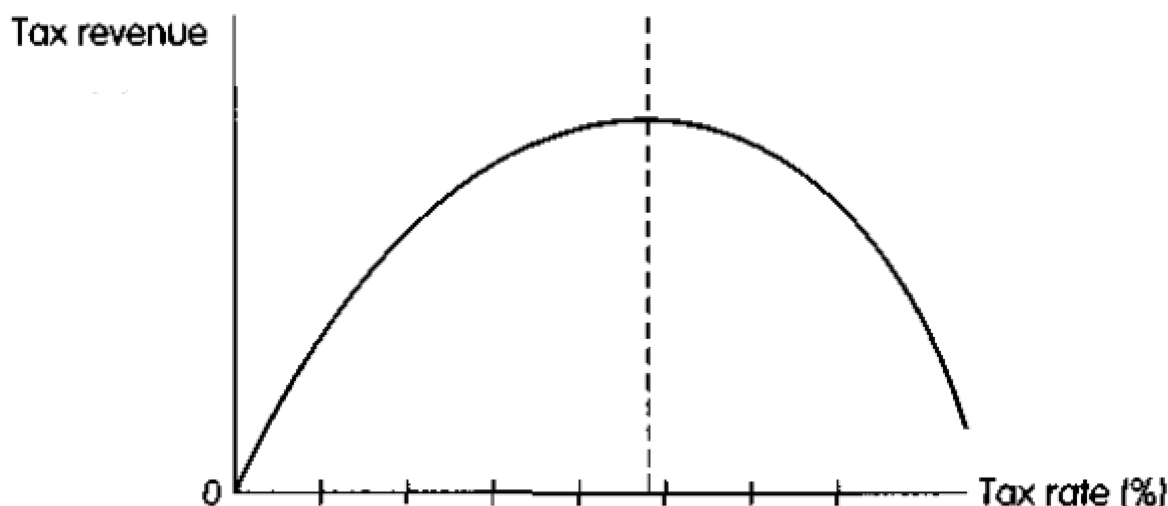

Figure 2. The Laffer curve

International regulation of double taxation

Usually all developed countries impose taxes upon revenues earned on their territory. Many countries (USA, Canada, Japan, UK and Russia) tax the income of their private and legal persons gained abroad. The result is a so-called double taxation.

In Russia, the government authorities count taxes paid abroad of the Russian physical and legal entities.

Fiscal federalism

Fiscal federalism is a system of relations (political-legal, economic, financial), aimed at the search for a balance of interests of the Federation, its regions and local authorities in order to achieve sustainable territorial development, availability of consumption of basic public goods.

Fiscal federalism is the division of revenue collection and expenditure responsibilities between different levels of government. Most countries have a central (or federal) government; state, county or regional governments; town councils and, at the lowest level, parish councils. Each level has restrictions on the tax instruments it can employ and the expenditures that it can make. Together they constitute the multi-levelled and overlapping administration that governs a typical developed country.

TOPIC 3. FISCAL POLICY

Questions for the lectures and the seminars:

The budgetary system concept. The structure of the budgetary system: federal and unitary states. The federal budget: definition, revenues and expenditures. The main functions of the federal government and expenditures of the federal budget. The budget deficit. The national debt. Federal budget of Russia: income and expenditures. Fiscal policy: concept and structure. Discretionary and automatic fiscal policy. Stimulating and limiting fiscal policy (Expansion and restriction). Automatic stabilizers.

Budget is a form of generation and expenditure of money funds intended for financial support of the federal government and local authorities.

Annual budget is compiled for one financial year which corresponds in Russia to a calendar year and lasts from the 1st January to the 31st December. In the USA financial year begins the 1st October, in Japan it begins the 1st April.

The government in a unitary state is made up of central and local government. Central government is responsible for the national provision of some goods and services, such as the National Health Service and the police force etc. Local government is responsible for regional, city-based or town-based services, such as street cleaning and local amenities (e.g., swimming pools).

Budget system of the Russian Federation is a totality of the federal budget, regional budgets of the Russian Federation, local budgets and budgets of extra-budgetary funds which are regulated by Russian legislation.

Federal budget is intended for execution of expenditures liabilities of the Russian Federation (see Table 4).

The federal budget is composed of two, not necessarily equal, parts: expenditures and tax receipts (revenues). Federal tax receipts consist primarily of individual and corporate income taxes, national insurance taxes and employer contributions, excise taxes, and estate and property taxes. Federal government expenditures, excluding compensation of employees, can be broken down into two basic categories: purchases of goods and services; and, transfer payments from the government to individuals, including interest payments on the national debt, which are essentially transfer payments from one group of individuals (taxpayers) to another (debt holders).

Government spending covers a wide range of goods and services, including:

- defense;

- social security benefits (e.g., government payments to people if they are ill or unemployed);
- education;
- repayments on previous borrowing.

The government will need to spend money to intervene to solve the market failures and imperfections that arise in the free market. For example, government spending may be needed to provide public and merit goods, to encourage greater production of positive externalities or to reduce instability in some markets.

To finance its spending the government raises funds from the following,

- Taxation (see the previous topic).
- Borrowing; for example, from banks and individuals. The government sells bonds or other securities. Some government bonds are short term, and some are long term.

The value of tax receipts minus expenditures determines the status of the annual federal budget. If expenditures exceed tax receipts, then a budget deficit exists. If tax receipts exceed expenditures, then a budget surplus exists. And, if tax receipts are equal to expenditures, we have a balanced budget.

Table 4

Consolidated Budget of the Russian Federation (in billion roubles)

	2012	2013
Revenues	8064.5	8164.7
of which:		
profit (income) tax of organizations	1979.9	1719.7
profit (income) tax of organizations	2261.5	2499.1
for goods (works, services) sold on territory of the Russian Federation	0.3	0.3
excise on goods (products) produced on territory of the Russian Federation	441.8	491.4
aggregate income tax	271.7	292.8
property tax	785.5	900.7
tax, dues and regular payment for natural re-sources usage	41.7	43.2
revenue from use of state and municipal property	277.7	302.1
payments for natural resources usage	31.6	34.2
uncompensated revenue	1680.1	1576.6
Expenditures	8343.2	8806.7
of which on:		
objectives affecting the state as a whole	508.2	546.1
state and municipal debt service	74.6	91.2

national defence	4.0	4.4
law enforcement and state security	94.6	106.6
national economy	1608.5	1730.4
of which on:		
fuel and energy complex	29.6	35.6
agriculture and fishery	240.5	297.1
transport	296.9	297.1
public road system (road funds)	646.3	731.2
communications and informatics	55.2	54.2
scientific research for national economy	0.9	0.9
other fields of national economy	244.2	216.3
housing – communal utilities	881.3	901.9
social-cultural arrangements	5130.7	5396.6
general inter-budget transfers between budgets of constituent entities of the Russian Federation and municipal entities	19.5	4.9
Proficit, deficit (-)	-278.7	-642.0

Source: based on [14]

Fiscal policy involves the use of changes in government spending and the taxation and benefit systems to influence the economy and to achieve particular macroeconomic goals. Fiscal policy can be used to affect both the aggregate demand and the aggregate supply. Fiscal policy is the most important economic tool available to the federal government.

There are two types of fiscal policy: discretionary fiscal policy and automatic fiscal policy.

Discretionary fiscal policy

Discretionary fiscal policy occurs when the government makes a deliberate attempt to change the level of economic activity.

Discretionary fiscal policy is the deliberate manipulation of taxes and/or government spending by the government to alter real GDP and employment, control inflation, and stimulate economic growth or to achieve particular economic objectives. The Federal government changes taxes (usually the rate of tax) and government spending. These changes do not occur automatically.

The tools of discretionary fiscal policy are:

1. the government can vary its expenditure for public works and other programs.
2. the government can vary welfare payments and other types of transfer payments.
3. the government can vary tax rates.

Fiscal policy is examined in two situations: (1) recession and (2) demand-pull inflation.

Expansionary Fiscal Policy.

When recession occurs, an expansionary fiscal policy may be used.

It has three main fiscal policy options: (1) increase government spending (transfers etc.), (2) reduce taxes, or (3) some combination of the two. If the Federal budget is balanced at the offset, fiscal policy during a recession or depression should create a government budget deficit, so government spending excess of tax revenues. A hike in Social Security benefits may lead to unemployment. If unemployment increases, government can finance different public programs such as roads, urban reconstruction, and others. Of course, these programs must be well thought out and socially productive. There is no sense in pushing through wasteful and foolish public works programs merely to make jobs.

An increase in government spending will raise an economy's aggregate demand. Alternatively, government could reduce taxes to increase the aggregate demand.

But a larger tax cut than an increase in government spending is required to achieve the same amount of the aggregate demand. This is because part of a tax reduction boosts saving, not consumption. To increase initial consumption by a specific amount, government must reduce taxes by more than that amount. Besides, temporary tax changes may have less effect than permanent ones, consumption expenditure may be influenced less by transitory changes in income than by permanent changes.

Government can combine spending increases and tax cuts to produce the desired initial increase in spending and the eventual increase in aggregate demand and real GDP.

When demand-pull inflation occurs, a restrictive or contractionary fiscal policy may be used.

Restrictive Fiscal Policy

The increase in aggregate demand might have resulted from a sharp increase in investment or net export spending. The government looks to fiscal policy to control the inflation; its options are opposite those used to combat recession. It can (1) decrease government spending, (2) raise taxes, or (3) use some combination of these two policies. When the economy faces demand-pull inflation, fiscal policy should move toward a government budget surplus—tax revenues in excess of government spending.

Government can reduce its spending to slow or eliminate demand- pull inflation. If inflation is a dangerous problem, it may be worthwhile to cut back on certain kinds of transfer payments.

Just as government can use tax cuts to increase consumption spending, it can use tax increases to reduce it.

Government can combine spending decreases and tax increases to reduce aggregate demand and check inflation.

Automatic fiscal policy

Automatic fiscal policy, sometimes called "automatic stabilizers," involves changes in government spending and/or taxes that occur automatically, without any additional action.

Automatic or Built-In Stabilizers include:

• unemployment benefits;

• corporate tax or profit tax;

• a progressive income tax.

Built-in stability arises because in reality our tax system is such that tax revenues vary directly with GDP.

Virtually all taxes will yield more tax revenues as GDP rises. In particular, personal income taxes have progressive rates and result in more than proportionate increases in tax collections as GDP expands. Furthermore, as GDP increases and more goods and services are purchased, revenues from corporate income taxes and sales and excise taxes will increase. And, similarly, payroll tax payments increase as economic expansion creates more jobs. Conversely, when GDP declines, tax receipts from all these sources will decline.

Transfer payments (or "negative taxes") behave in the opposite way as tax collections. Unemployment compensation payments, welfare payments, and subsidies to farmers all decrease during economic expansion and increase during a contraction. Tax revenues vary directly with the level of GDP which the economy actually realizes.

The economic importance of this direct relationship between tax receipts and GDP comes into focus when we consider two things.

1 Taxes reduce spending and aggregate demand.

2 It is desirable from the standpoint of stability to reduce spending when the economy is moving toward inflation and to increase spending when the economy is slumping.

In other words, the tax system builds some stability into the economy. It automatically brings about changes in tax revenues and therefore in the public budget which counter both inflation and unemployment. A built-in stabilizer is anything which increases the government's

deficit (or reduces its surplus) during a recession and increases its surplus (or reduces its deficit) during inflation without requiring explicit action by policy makers.

As GDP rises during prosperity, tax revenues automatically increase and, because they reduce spending, they restrain the economic expansion. In other words, as the economy moves toward a higher GDP, tax revenues automatically rise and move the budget from a deficit toward a surplus.

Conversely, as the GDP falls during recession, tax revenues automatically decline, increasing spending and cushioning the economic contraction. With a falling GDP, tax receipts decline and move the public budget from a surplus toward a deficit. The low level of income GDP will automatically yield an expansionary budget deficit; the high and perhaps inflationary income level GDP will automatically generate a budget surplus.

In a proportional tax system the average tax rate remains constant as GDP rises; in a regressive tax system the average tax rate falls as GDP rises. Tax revenues will rise with GDP under progressive and proportional tax systems and may either rise, fall, or remain the same when GDP increases under a regressive system. The more progressive the tax system, the greater is the economy's built-in stability.

The built-in stability provided by tax system has reduced the severity of business fluctuations. But built-in stabilizers can only diminish, not correct major changes in equilibrium GDP.

The effectiveness of fiscal policy

The effectiveness of fiscal policy depends on the following,

- The accuracy of government forecasting. Intervention will depend on where the government thinks the economy is at any moment and where it thinks it is heading. If either of these estimations are wrong then fiscal policy may not remedy the problems effectively; it may even make them worse.
- The impact of any policy changes. The government may base a policy on a set of assumptions about the behaviour of households and firms, only to find that they do not react in the expected way or at the expected time. Not only are delays likely between the economy changing position and the government realising this, but delays are also likely when it comes to agreeing a policy response to this change. Lastly, there may be a delay in the policy change taking effect. For example, an income tax cut may not lead to an immediate increase in consumer spending; households may wait for a while before deciding to increase consumption. This is particularly likely if consumption is linked to permanent income rather than current income

- The funding of government spending may also create problems. It is possible that fiscal policy by the government may lead to less private sector investment. This is called ‘crowding out’. Crowding out can occur because, with higher levels of government spending, the Central Bank does not need to keep interest rates as low as it otherwise would to maintain the desired level of demand overall in the economy. As a result, the higher interest rates may deter private sector investment because borrowing is more expensive. The effect of this depends in part on the sensitivity of investment to changes in the interest rate. Also, if the government attracts private finance by selling bonds then these funds will not be available for other private sector projects; these projects have been ‘crowded out’ as the government has the funds that would be needed to go ahead with them.

TOPIC 4. MONETARY POLICY

Questions for the lectures and the seminars:
Types of money. Liquidity. The monetary system. Monetary mass structure. Money aggregates. The law of money circulation. Emission: definition and governmental control. Cash and deposits. Credit: definition and types. The credit and banking system. The Central Bank: the role and functions in the economy. Regulation of banking operations. The structure and regulation of the financial market. Monetary policy: concept and objectives. Monetary policy instruments: the discount Rate, the reserve ratio, open- market operations. Easy money policy and tight money policy.

Money is an instrument that can be used to buy and sell goods, to earn through your work, to invest, etc.

The main functions of money are distinguished as: a medium of exchange; a unit of account; a store of value; a standard of payment etc.

The banking system of the Russian Federation consists of two levels: the first level is represented by the Central Bank and the second level is represented by different commercial banks and other financial institutions.

The main functions of the Central Bank of the Russian Federation are:

- To control emission of the national currency, the Central Bank has a monopoly on money creation, controls the issue of notes and coins;
- To be the banker to the government;
- To manage government finances (the execution of the budget and public debt management, storage of foreign reserves and mandatory reserves of commercial banks);

- To hold gold and foreign-exchange reserves that can be used when trying to influence the exchange rate;
- To be the Banker to commercial banks (this is the clearing center and the lender of last resort);
- To promote and maintain monetary and financial stability to contribute to a healthy economy;
- To regulate the banking sector (the Central Bank produces the banking law and controls compliance, coordinates the activities of commercial banks by issuing and withdrawal of licenses);
- To explore monetary policy (money supply in the economy and inflation, exchange rate, simultaneously serving as a buyer and seller of foreign currency).

Targets of the Central Bank are: 1) control over the money supply, 2) control over the level of interest rate, 3) control over the exchange rate of the national currency.

Monetary aggregates

Monetary aggregate is a statistical indicator characterizing the quantity of money. Monetary aggregates used for the analysis of quantitative changes of monetary circulation and to develop measures on regulation of the dynamics of the money supply. The different types of money are typically classified as "M"s. Monetary aggregates are financial assets that either function directly as money and as the medium of exchange or they are extremely liquid and easily converted to money. The monetary aggregates usually range from M0 (narrowest) to M3 (broadest), its quantity depends on the country's central bank.

In developed countries the following units are used to determine the money supply.

The aggregate M0 is equal to cash in circulation (paper notes and coins) and funds on current accounts. The aggregate M1 is equal M0 plus time and savings deposits in commercial banks. The aggregate M2 is equal M1 plus savings deposits in specialized credit institutions. The aggregate M3 is equal M2 plus deposit certificates of major commercial banks, it can also include other commercial paper, savings bonds, etc.

Monetary policy

Monetary policy represents one of approaches to stabilization (together with the fiscal, foreign trade, structural policy) aimed at smoothing the economic fluctuations.

It's the way in which a government or central bank controls the supply of money and credit in an economy.

The aim of monetary stabilization is provision of: 1) a stable economic growth, 2) full employment, 3) the stability of the price level, 4) the balance of payments.

The fundamental objective of monetary policy is to assist the economy in achieving a full-employment, noninflationary level of total output. Monetary policy consists of altering the economy's money supply to stabilize aggregate output, employment, and the price level. It entails increasing the money supply during a recession to stimulate spending and restricting it during inflation to constrain spending.

The Central Bank alters the size of the nation's money supply by manipulating the size of excess reserves held by commercial banks. Excess reserves are critical to the money-creating ability of the banking system. The Central Bank controls excess reserves and the money supply; we will explain how changes in the stock of money affect interest rates and aggregate demand.

Tools of Monetary policy

The Central Bank can influence the money-creating abilities of the commercial banking system. There are three instruments of monetary control which The Central Bank uses to influence commercial bank reserves:

1 Open-market operations

2 Changing the reserve ratio.

3 Changing the discount rate

Open-Market Operations

Open-market operations are the most important way the Government controls the money supply. Open-market operations refer to the buying and selling of government bonds by the Central Bank in the open market. It buys and sells bonds from or to commercial banks and the general public. These purchases and sales of government securities affect considerably the excess reserves of commercial banks.

If securities are purchased from commercial banks and the public, commercial bank reserves are increased. If the Central Bank sells securities in the open market, commercial bank reserves are reduced.

The Reserve Ratio

At the same time The Central Bank can manipulate the legal reserve ratio to influence the ability of commercial banks to lend.

Raising the reserve ratio increases the amount of required reserves banks must keep. If banks lose excess reserves, their ability to create money by lending is diminished.

Lowering the reserve ratio changes required reserves to excess reserves and enhances the ability of banks to create new money by lending.

So, a change in the reserve ratio affects the money- creating ability of the banking system in two ways:

1 It affects the size of excess reserves,

2 It changes the size of the monetary multiplier.

Changing the reserve ratio is a powerful technique of monetary control, but it is used infrequently.

The Discount Rate

One of the functions of a central bank is to be a “lender of last resort”. Central banks lend to commercial banks which can have unexpected and immediate needs for additional funds. This transaction is analogous to a private person’s borrowing from a commercial bank.

Thus, the Central Bank will make short-term loans to commercial banks. In this case the interest rate is called the discount rate (table 5).

Table 5

Official interest rates of Central banks (in %)

UK	0.5
Canada	1.75
Germany	3
USA	0.86
Japan	0.3
Russia	8
China	2.79

Source: based on [56]

The point is that commercial banks borrowing from the Central Bank increase their reserves, enhancing their ability to extend credits.

The Central Bank has the power to establish and manipulate the discount rate at which commercial banks can borrow from the Central Bank. From the commercial banks’ point of view, the discount rate is a cost entailed in acquiring reserves. When the discount rate is decreased, commercial banks are encouraged to obtain additional reserves by borrowing from the

Central Bank. Commercial bank lending based on these new reserves will constitute an increase in the money supply.

An increase in the discount rate discourages commercial banks from obtaining additional reserves through borrowing from the central banks. An increase in the discount rate therefore is consistent with the monetary authorities' desire to restrict the supply of money.

If the Central Bank changes interest on loans it grants to commercial banks, commercial banks change interest on their loans. This action influences considerably the supply of money.

Easy Money and Tight Money

Easy monetary policy is associated with the use of interest rates as an instrument to achieve goals. Suppose the economy is faced with recession and unemployment. The monetary authorities decide an increase in the supply of money is needed to stimulate aggregate demand to help absorb idle resources. To increase the supply of money, the Central Bank must expand the excess reserves of commercial banks. In this case the main steps of the Central Bank are:

1. Buy Securities. The Central Bank buys securities in the open market. These bond purchases will be paid for by increases in commercial bank reserves.

2. Reduce Reserve Ratio. The reserve ratio should be reduced, automatically changing required reserves into excess reserves and increasing the size of the monetary multiplier.

3. Lower Discount Rate. The discount rate should be lowered to induce commercial banks to add to their reserves by borrowing from the Central Bank.

This set of policy decisions is called an easy money policy. Its purpose is to make credit cheaply and easily available, to increase aggregate demand and employment. So, the process is as follows. If there is unemployment and recession, the Central Bank buys bonds, lowers reserve ratio or lowers the discount rate. The money supply rises. Interest rate falls and investments increase. Aggregate demand increases too. And as a result, real GDP rises.

Tight monetary policy is associated with the maintenance of a certain level of money supply.

On the other hand, excessive spending is pushing the economy into an inflationary spiral. The Central Bank should attempt to reduce aggregate demand by limiting or contracting the supply of money. The key to this goal lies in reducing the reserves of commercial banks. In this case the main steps of the Central Bank are:

1. Sell Securities. The Central Bank should sell government bonds in the open market to tear down commercial bank reserves.

2. Increase Reserve Ratio. Increasing the reserve ratio will automatically strip commercial banks of excess reserves and decrease the monetary multiplier.

3. Raise Discount Rate. A boost in the discount rate will discourage commercial banks from building up their reserves by borrowing from the Central Bank.

This group of directives is labeled a tight money policy. The objective is to tighten the supply of money to reduce spending and control inflation. So, the process is as follows. If there is inflation, the Central Bank sells bonds, increases reserve ratio or increases the discount rate. The money supply falls. Interest rate rises and investments decrease. Aggregate demand decreases too. And as a result, inflation declines.

TOPIC 5. ANTI-INFLATION POLICY.

Questions for the lectures and the seminars:

The inflation concept. Types of inflation: creeping, galloping, hyperinflation. Inflation indexes: the GDP Deflator and the consumer price index. The inflation effect. Anti-inflation policy: the policy of income and expenditures policy.

Inflation occurs when there is a sustained increase in the general price level over a given period.

There are two primary types of inflation: demand-pull and cost-push.

Demand-pull inflation occurs when spending on goods and services drives up prices. . If demand is growing faster than supply then this will pull prices up, causing demand-pull inflation. If firms cannot meet the demand then they will increase their prices. Demand-pull inflation is characterised by shortages, low levels of stocks, long waiting lists and queues. In this situation firms will be eager to produce more as soon as they can. They may invest in extra capacity, but this can take time to come online. In the short term supply is likely to be price inelastic because firms may not be able to recruit staff easily or produce more given the existing equipment. This means that an increase in demand will affect prices more than output. Low taxes and spendthrift government spending are the main causes of demand-pull inflation.

Cost-push inflation is caused by costs increasing. Businesses must acquire raw materials, labor, energy, and capital to operate. If the price of these were to rise, it would reduce the ability of producers to generate output because their unit cost of production had increased, for example, higher wages that are not related to productivity gains, higher import prices or monopoly suppliers pushing up their prices. Faced with higher costs, firms increase their prices to customers to maintain profit margins.

If these increases in production cost are relatively large and pervasive, the effect is to simultaneously create higher inflation, reduce real GDP, and increase the unemployment rate.

According to monetarists, inflation occurs when there is too much money supply in the economy. With more money circulating this leads to more demand in the economy and then higher prices. This is a form of demand-pull inflation that is caused specifically by excess growth of the money supply

Inflation can cause a number of problems and negative consequences for an economy, such as the following.

- Inflation leads to reduction of real incomes of the population (with uneven growth of nominal incomes) and deterioration of living conditions among representatives of social groups with solid income (pensioners, students, workers of public sector, etc., whose incomes are paid from the state budget).
- Inflation results in loss of savings of the population (the increase of interest rates on deposits, as a rule, does not compensate for the fall in real size of savings) and strengthening the social stratification of society into rich and poor
- Inflation causes reduction of investments in the economy, because it is unprofitable to lend on a long term, and decline in production due to rising costs and rising unemployment.
- If prices are increasing this creates costs for firms because they may have to update their promotional material to reflect the higher prices. For example, this means reprinting brochures, updating price lists and changing vending machines. These are called ‘menu costs’.
- With higher rates of inflation, individuals and firms may have to search more to find the best returns on their savings. This will be necessary to preserve the real rate of return (i.e., the return adjusted for inflation). The costs of searching around are called ‘shoe leather costs’.
- Not all individuals will have the bargaining power to ensure that their own earnings rise at the same rate as prices are increasing. If your wages do not increase as much as prices then, in real terms, you are worse off. Your real income has fallen. The ability of an employee to bargain for higher wages in line with inflation depends on the extent to which they are in demand and/or whether they are well represented by trade unions. Inflation may therefore redistribute real incomes. Some groups may find that their earnings keep pace with inflation; others may not. This means that inflation has redistributive effects.
- Internationally, if the prices of firms in a country are increasing faster than their trading partners then this may make the country’s products uncompetitive compared to those of foreign firms. This may reduce the earnings from exports and increase the spending on imports.

This will affect the balance of payments adversely. Domestically, a country may also struggle to compete because imports will be relatively cheaper.

- Inflation may also damage business confidence because of fears about the future impact on costs. This may reduce levels of investment.
- Tax thresholds often do not increase in line with inflation. If employees gain a pay increase to match inflation then they are not better off in real terms. However, with higher nominal pay individuals may enter a higher tax band and therefore be worse off. This is called fiscal drag. Again, inflation is redistributing income.

Two types of economic policy are used to regulate inflation:

1. The policy aimed at reducing the budget deficit, limiting credit expansion, deterrence of money issue. According to the monetarist, a government can apply targeting (regulation) of the growth rate of the money supply within certain limits (in accordance with the GDP growth rate).

2. The policy of regulation of prices and incomes, aiming to link the growth of earnings to price growth. Government can use the indexation of the income defined by the subsistence level or a consumer basket and can match it with the dynamics of the price index.

To control inflation there are a variety of methods that the government may use, such as the following.

- Reducing the aggregate demand. To control demand-pull inflation the government reduces the level of the aggregate demand in the economy. This may be done using deflationary fiscal or restrictive monetary policies.
- Reducing costs. To control cost-push inflation governments may do the following.
  - Governments may introduce wage controls to prevent wages from increasing too fast. This is known as an incomes policy. However, incomes policies can lead to frustration on the part of employers, who want to offer more money to reward and attract good quality employees. Employees may also be frustrated and look for better-paid jobs abroad.
  - Governments may try to influence the exchange rate to make the external value of the national currency stronger.
- Setting inflation targets. The authorities can set clear targets for inflation and can try to convince households and business people that such targets will be met. As a result, wage claims and price increases were linked to this level of expectations. If, on the other hand, people think that inflation is going to be very high then they will demand high wages. This could cause higher prices due to cost-push inflation. This inflation could then stimulate higher wages, higher costs and higher inflation again. This is called the “wage-price spiral”.

- Other measures.
- stimulation of production through tax cuts and investments;
- reduction in public spending and effective tax policy, which can reduce the deficit of the state budget;
- regulation of the money supply, etc.

TOPIC 6. ANTIMONOPOLY POLICY

Questions for the lectures and the seminars:
Monopoly: the concept and types. Criteria for determining the degree of monopolization of markets. Antimonopoly policy: concept and methods. Price regulation of natural monopolies. Development and support of small business. The competition. A small business as an economic entity of the market economy. Analysis of competitive environment. Governmental support of entrepreneurship

Monopoly is an exclusive right to manufacture, trade and other activities that belongs to one person, to a certain group or the state. A pure monopoly is a situation where a unique product is being produced or sold entirely by a single firm, and entry to the industry is blocked by serious barriers. A product can be a good, such as jewelry, computers or energy, or it can be a service, such as garbage disposal or sewage removal. Economists differentiate between different types of monopolies based on why the monopoly exists, such as where the barrier to entry for new companies comes from, which could be high entry costs or legal restrictions.

Oligopoly is a situation where one, two, or three firms dominate the industry, potentially resulting in higher-than-competitive prices and sustainable economic profits.

A natural monopoly exists when economies of scale are so extensive that a single firm can supply the entire market at lower unit cost than could a number of competing firms. Such conditions exist for the public utilities, such as electricity, water, gas, telephone service, and so on. In these cases economies of scale in producing and distributing the product are very large and large-scale operations are necessary if low unit costs and a low price are to be obtained. In this situation competition is uneconomic. If the market were divided among many producers, economies of scale would not be achieved, unit costs would be high, and high prices would be necessary to cover those costs.

Natural monopolies are organized in the field of energy system, Railways, gas and oil spheres (e.g. *Transneft, Gazprom* in Russia).

Public ownership has been established in a few instances: the Postal Service at the national level, while mass transit, the water system, and garbage collection are public enterprises at the local level.

Industrial concentration exists whenever a single firm or a small number of firms controls the major portion of the output of an industry.

To prevent different abuses the government undertakes antimonopoly or antitrust regulation.

The government antimonopoly regulation is conducted in two directions:

1. There are few markets where conditions impede competition, i.e. in natural monopolies. In this case the government creates the public and regulatory agencies to monitor their economic behavior and first of all to control over prices.
2. On the other markets, where the monopoly has not become a necessity, the government control takes the form of antimonopoly legislation.

Methods of Antimonopoly regulation are divided in two groups: administrative and economic (table 6).

Table 6

Methods of Antimonopoly regulation

Administrative methods	Economic methods
• Special laws; • Penalty, ban, coercion; • Abolition of quotas, licenses; • Public ownership of the monopoly; • The registry of economic entities; •Division of the company into several companies; • Control of mergers and acquisitions	• Establishing upper levels of prices and tariffs; • Small and medium enterprises support; • Reduction of customs tariffs •Support for companies producing similar products.

Antimonopoly policy includes:

1. Restrictive measures. They are provided for by the special laws and are applied by the governmental authorities to the economic entities that violate antitrust law. Restrictions on monopolistic activities are divided into prohibitions against agreements that restrict competition, and prohibitions on abuse of enterprises of its dominant position. Monopolistic activity and unfair competition are prohibited, as well as actions of governmental bodies, which may negatively affect the competition. The laws prohibit exclusively high or exclusively low price, seize goods from circulation in order to create or maintain a deficit or to increase prices.

2. The control over economic concentration. The government controls establishment and amalgamation (merger and acquisition) of commercial organizations, activity of unions and associations, liquidation and division (separation) of state and municipal unitary enterprises.

3. Prohibition on unfair competition. The following actions are prohibited: false, inaccurate or distorted information, which may cause losses or damage; incorrect comparison of own goods with similar products of competitors; acquisition, use, disclosure of scientific-technical, industrial, commercial information or trade secrets without the consent of the owners; wrong information about method, place of manufacture, consumer properties and the quality of the goods; any information that can damage business reputation.

4. Restrictions on the actions of authorities, which may have injurious effect on competition. The development of market relations implies the elimination of direct interference of the public authorities in the activities of enterprises. It is illegal to make regulations and to commit acts which restrict the independence of enterprises, create discriminatory or favorable conditions for some of them, restrict competition and infringe on the interests of enterprises or citizens.

5. Register as an instrument of antimonopoly control. If an enterprise has more or less than 35% of the market share it can be included or excluded from the state register.

Models of Antimonopoly regulation

Models of Antimonopoly regulation can be divided into American and European.

Differences in Antimonopoly policy of the countries of the world are the following:

1. In the U.S. uncompetitive intercompany cooperation is prohibited;
2. In Europe such co-operation is allowed;
3. In Europe it's allowed to create non-competitive vertical relationships between suppliers and manufacturers, in the United States and Russia such relationships are prohibited.
4. Now these models draw together.

Small and medium enterprises support

One of the main goals of government antimonopoly policy is support and development of competition. Nowadays government tries to create the best conditions for small and medium business' development.

The basic goals of government policy in the area of development of SMEs in the Russian Federation are as follows: developing small and medium businesses for the purpose of creating a competitive environment in the economy of the Russian Federation; fostering conditions favorable for the development of small and medium businesses; ensuring the competitiveness of

small and medium businesses; rendering assistance to small and medium businesses in the promotion of goods(works, services) and the results of intellectual activities they produce in the market of the Russian Federation and the markets of foreign states; increasing the number of small and medium businesses; supplying jobs for the population and developing self-employment; increasing the share of the goods (works, services) produced by small and medium businesses in the gross domestic product; increasing the share of taxes paid by small and medium businesses in the tax revenues of the federal budget, the budgets of the subjects of the Russian Federation and local budgets.

The main measures of state support of SMEs are following:

1. Special tax regimes, simplified rules for tax accounting, and simplified forms of tax declarations on certain taxes for small-sized enterprises;

2. A simplified accounting system for SMEs that conduct certain types of business;

3. A simplified procedure on compilation of statistical accounts by the SME;

4. A preferential procedure of calculations for the privatization of state and municipal property by SMEs;

5. Peculiarities in procedure of participation of SMEs as suppliers (performers, contractors) in the placement of orders for the supplement of goods, performing of works, or rendering services for state and municipal needs;

6. Measures for ensuring the rights and legal interests of SMEs during the execution of the state control (supervision);

7. Measures on ensuring the financial support of SMEs;

8. Measures on the development of the support infrastructure for SMEs and

There are three main directions of government support to small businesses:

- regulation of the environment of small business;
- regulation the internal environment of small business;
- improvement of small business development.(see Table 7)

Table 7

Types of government support

The first set of measures	The second set of measures	The third set of measures
improving the legal framework	providing credit funds, privileges, subsidies, grants	optimization of the organizational structure of government support at the federal, regional and municipal levels of government;
reforming of taxation system	providing state guarantees	provision of resources for each level of the system of government support

removing administrative barriers	development of lease financing	creation and improvement of programs to support small businesses at all levels of regulation
providing access to information	creation of a guarantee fund	
creating a favorable public opinion about the entrepreneur	training and retraining of staff	
promoting foreign economic activity of small enterprises	introduction mechanism of accelerated depreciation	
protection against crime	orientation of small enterprises to solve the priority socio-economic and environmental problems of the territory	
realization of antimonopoly measures		

The Government provides support for SMEs to develop small and medium entrepreneurship, to increase of SME share in GDP, to increase in employment and development of domestic competition. This support can take different forms, where each form helps entrepreneurs to reach specific goals. Among these forms there are:

– financial support: lending of money under favorable conditions – lower interest rate, longer term, etc. This type of support is one the most popular among entrepreneurs;

– special tax regimes: lower tax rate for some sectors, simplified taxation and requirements for documents;

– renting or acquisition of property under favorable conditions;

– provision of services or delivery of goods for state needs.

TOPIC 7. ECONOMIC STRUCTURE AND INDUSTRIAL POLICY

Questions for the lectures and the seminars:

Types of economic structures. Input-output balance. Private and public enterprises: governmental policy. Public sector and public property. Privatization and nationalization. Production and environmental problems in economy. Environmental management: methods and tools.

The structure of the economy is the division of economy, economic objects into parts according to certain criteria and the establishment of relationships between the constituent parts.

In recent years industrial policy has joined antitrust regulation, as a distinct form of government economic regulation. Industrial policy comprises governmental actions to promote the economic vitality of specific firms or industries. Antitrust and industrial regulation alters the structure or restricts the conduct of private firms, generally reducing their revenues or increasing

their costs. Industrial policy promotes the interests of selected firms and industries, usually adding to their profitability.

The main goals of the **industrial** policy are:

• overcoming structural deformations in economy;

• bringing the structure of production in accordance with the solvent demand;

• ensuring scientific and technical progress;

• maintenance of ecological and economic security of the country;

• promoting the development of efficient and competitive production and market infrastructure, etc.

There is the International Standard Industrial Classification of All Economic Activities that allows having the same approach to the division of all Economic Activities in different countries.

The main activities according the International Standard Industrial Classification of All Economic Activities are:

A - Agriculture, forestry and fishing

B - Mining and quarrying

C - Manufacturing

D - Electricity, gas, steam and air conditioning supply

E - Water supply; sewerage, waste management and remediation activities

F - Construction

G - Wholesale and retail trade; repair of motor vehicles and motorcycles

H - Transportation and storage

I - Accommodation and food service activities

J - Information and communication

K - Financial and insurance activities

L - Real estate activities

M - Professional, scientific and technical activities

N - Administrative and support service activities

O - Public administration and defence; compulsory social security

P - Education

Q - Human health and social work activities

R - Arts, entertainment and recreation

S - Other service activities

T - Activities of households as employers; undifferentiated goods- and services-

producing activities of households for own use

U - Activities of extraterritorial organizations and bodies [68]

The complete classification is represented in appendix 1.

TOPIC 8. INVESTMENTS AND INNOVATION POLICY

Questions for the lectures and the seminars:

Definition and types of investments. Investment climate and attraction of foreign investments. Investments policy: targets, objects, participants and tools. Governmental support of investment activity.

Definition and types of innovations. Technological capabilities. Technological stages. Innovation policy: targets, objects, participants and tools. Governmental support of research and development.

Innovation is finding a better way of doing something. Innovation can be viewed as the application of better solutions that meet new requirements. This is accomplished through more effective products, processes, services, technologies, or ideas that are available to markets, governments and society.

Technological stage is the concept of the theory of scientific and technical progress, introduced into science by Russian economists D. S. Lvov and S. S. Glazyev. Change of the technological stage in the economy determines the uneven progress of scientific and technical progress. Technological structure is a set of related industries, with common technical level and considered as a structural subsystem of an economic system - an alternative to such subsystems as industry.

There are five technological stages (table 8). Currently the sixth stage begins to develop, it is based on nano -, bio- and space technologies.

Table 8

Technological stages

	Technological stage				
	1	2	3	4	5
Period	1770-1830	1830-1880	1880-1930	1930-1980	1980-1990 till 2030-2040
Period in Russia	End of XVIII–beginning XXП	1830-1970	1880-1990	Since the end of 30-ies	Since the end of 80-ies
Technological leaders	the UK , France, Belgium	the UK, France, Belgium,	Germany, USA, UK, France,	The USA, countries of Western	Japan, the USA, the EU

		Germany, the USA	Belgium, Switzerland, Netherlands	Europe, the USSR, Canada, Australia, Japan, Sweden, Switzerland	
The core of technological stage	the Textile industry, textile machinery, steelmaking, processing of iron, the construction of canals, the water engine	Steam engine, railroad construction, transport, machine building, , coal, machine-tool industry, ferrous metallurgy	Electrical engineering, heavy engineering, production and rolled steel, power lines, inorganic chemistry	Automobile, tractor industry, non-ferrous metallurgy, production of durable goods, synthetic materials, organic chemistry, production and processing of oil	electronics, computing, optical-fiber equipment, software, telecommunications, robotics, manufacturing and processing of gas, information services
The key factor	Textile machines	Steam engine, machine	Motor, steel	internal combustion Engine, petro chemistry	microelectronic components
The advantage of this technological stage	Mechanization and the concentration of production at factories	the Growth of the scale and concentration of production on the basis of use of the steam engine	the Increasing flexibility of production based on the use of the electric motor, standardization of production, urbanization	Mass and serial production	the Individualization of production and consumption, increasing production flexibility, coping with environmental constraints on energy based on automatic control system, the telecommunication technologies
Forms of business organization	Small craftsmen's workshops, small businesses	Large enterprises, joint stock company	National monopolies and oligopolies, banks, financial capital	Transnational corporations	Large and small firms united by electronic network

Innovation policy is a component of the economic policy which expresses the government's attitude to scientific and technical activity, defines the goals, directions, forms of

activity of the governmental bodies of the Russian Federation in the field of science, engineering and implementation of achievements of science and technology.

Priorities of science, technology and engineering development in the Russian Federation include:

- Security and terrorism resistance;
- Nano systems;
- Information and telecommunication systems;
- Life Sciences;
- Prospective armaments, military and special equipment;
- Environmental management;
- Transport and space systems;
- Energy efficiency and nuclear power.

Governmental support of innovative activity

Governmental support of innovative activity is the set of measures taken by the governmental authorities in accordance with legislation of the country and in order to create the necessary legal, economic and organizational conditions and incentives for legal entities and individuals, engaged in innovation activity.

The main forms of governmental support of innovation activities:

- tax remissions;
- educational services provision;
- information support;
- financial support (including subsidies, grants, loans, borrowings, guarantees, etc.);
- export support;
- infrastructure provision;
- development of competition, motivating companies to innovate;
- stimulation of innovation;
- grants or subsidies to innovative companies;
- tax stimulation of innovative companies;
- development of innovation infrastructure;
- support of technological-innovative projects, etc.

Investment is putting capital into business with the expectation of gain. Investments are divided into real and financial.

Real investments or investments in non-financial assets include the following categories:

- fixed capital investments;
- intangible investments (patents, copyrights, goodwill, etc.);
- research and development expenditures;
- investments in inventories growth;
- other non-financial assets (acquisition of land property, natural resources etc).

Financial investments are investments of organizations in securities of other enterprises, bonds of state and local loans, in charter capital of other enterprises.

Foreign investments into the economy of Russia are regarded to all types of investments of the capital invested by foreign investors with the aim of gaining profits. Investments are subdivided into direct, portfolio and others.

Measures of investment activity regulation include two groups (Table 9).

Table 9

Measures of investment activity regulation

Administrative measures	*Economic* measures
• Adoption of special legal acts and state programs; • Licensing and registration; • Management of state property; • Quotas; • Protection of investors ' rights.	The fiscal policy: • tax remissions • grants, subsidies etc. The monetary policy: • regulation of interest rates; • granting loans; • refinancing commercial banks. The industrial policy: • Public participation; • Public funding and government support. The other measures • State regulation; • Antimonopoly policy; • Foreign economic policy.

Investment climate is the situation in which an investment is made. Investment climate is the economic, financial and other conditions in a country that affect whether individuals and businesses are willing to lend money and acquire a stake in the businesses operating there. The investment climate is a significant contributing factor in the performance of an investment.

Investment climate is affected by many factors, including: transport and geographical position, poverty, crime, inflation, infrastructure, workforce, national security, political instability, regime uncertainty, taxes, rule of law, property rights, competitive environment, government regulations, government transparency and government accountability, ecological situation. Factors affecting the

investment climate include macroeconomic conditions, the political situation, and consumer confidence.

In Russia the basic general and specific legal acts such as the Corporate Law, Taxation Code, Foreign Investment Law, Customs Code, Labour Code, Currency Law, Security Law, Bankruptcy Law, Mortgage Law, Land Code, Forest Code, Environmental Protection Law etc. have been passed.

Work on the development of the legislative basis for investment activity continues in Russia at the moment. The legal acts which were adopted and which are being developed to support investment process, are devoted to

- Protection of shareholders' rights;
- Simplification of the system of legal persons' registration;
- Simplification of the procedure of securing permitting documentation for the implementation of investment projects.

Federal Law of 25 February 1999 No 39-FZ On Investment Activity in the Russian Federation Realised in the Form of Capital Investments envisages state regulation of investment activity, in particular, creation of favourable conditions for development of investment activity by perfection of the taxation system.

Advantages of investing in Russia include:

1. Dynamic economic growth. Russia boasts one of the most dynamically developing and attractive economies in the world. GDP growth was 1,3% in 2013.

2. Favourable geographic position. Russia's geography facilitates building effective international and domestic supply-production-market chains. Russia borders with Asia, Europe, and the North American continent.

The main advantages are:

- sea routes — Russia is bounded by three out of four world oceans;
- airports, rail and road routes
- pipelines, etc.

3. Vast natural resources. Russia takes the first place in the world per capita resources. It is well placed among the richest countries in terms of natural gas, oil, coal, minerals, metals and energy. Its forest water resources are the largest in the world.

4. High scientific and technological potential of the country. Strong Russian scientific knowledge provides excellent opportunities for research and development partnerships with Russian research institutes and universities. Critical technological areas eligible for government co-financing on a competitive basis are aerospace, aviation, shipbuilding, automotive, machinery, metallurgy, construction, chemistry and pharmaceuticals, nuclear physics and many others.

5. Large consumer market. With a population of over 140 million people and constantly increasing income per capita, Russia provides a large and booming internal market offering attractive growth potential.

6. Strong government support. Investment in the Russian economy is strongly supported by federal and regional authorities. Such federal initiatives as the Investment Fund, Foreign Investment Advisory Council and special economic zones as well as public-private partnership opportunities and large investment and development programs serve to accelerate the investment inflow and to further enhancing the Russian investment climate.

7. Attractive taxation system. With a personal income tax rate of 13% for residents, corporate tax rate of 24%, and VAT rate of 18%, Russia has one of the most generous non-offshore tax regimes in the world, aimed at promoting investment and further developing the economy.

8. Highly skilled and well-educated human capital. Russia has one of the most highly skilled workforces in the world. Excellent educational background, extensive R&D and engineering practice allows Russian professionals to take up leading positions in areas such as natural and applied sciences, programming, R&D, engineering, etc. Russia offers:

- a knowledge-based economy;
- a highly educated workforce;
- strong scientific and research base;
- extensive R&D and engineering facilities.

9. Stable social and political system. Following a transition period, the Russian economy has achieved macroeconomic and financial stability [6]

TOPIC 9. INTERNATIONAL INTEGRATION AND POLICY

Questions for the lectures and the seminars:

World economic relations and world economic activity. Types and forms of world economic relations. The World Trade Organization membership. Tools of trade policy:. Currency exchange. Foreign exchange policy.

Foreign economic relations comprise the following activities: foreign trade, foreign investments, international information and labour force exchange, production co-operation (various joint ventures, joint banks and other forms), currency financial relations.

Being the main component of foreign economic relations, foreign trade is a very important factor in economic development of many countries of the world that take part in the international division of labour and co-operation.

State supervision of export-import operations is exercised by all industrial nations. It is based on international trade rules and principles established in international trade practice. Protectionism occurs when governments try to protect the interests of their domestic producers and consumers, preventing unjustified competition, complying with national trade policy. It prevents free trade and introduces barriers to trade.

Lowering trade barriers is one of the most obvious means of encouraging trade. The barriers concerned include customs duties, tariffs and other (non-tariff) measures such as import bans and quotas, that restrict quantities selectively, licensing, technical barriers and industrial standards, testing and certification procedures, anti-dumping actions.

Customs duties and customs tariffs are levied on goods that convey across the customs border of the country and defined by legislation. A customs tariff is a list of customs duties systemised in accordance with the nomenclature of goods and charged in accordance with the legislation of a country.

The primary effect of a tariff is to raise the price of the imported good to the domestic consumer. The effect of a tariff is to redistribute some of the consumers' surplus (from free trade) to domestic producers, and some to the government. The tax revenue raised from tariffs goes to the budget.

Most goods imported to Russia are subject to a wide range of customs duties. Taxes on imported goods may be divided into revenue tariffs and protective tariffs.

Revenue tariffs are usually applied to products not produced domestically, for example, tee, coffee, bananas, cars, etc. Rates on revenue tariffs are modest; their purpose is to provide the Federal government with tax revenues.

Protective tariffs are designed to shield domestic producers from foreign competition. Although protective tariffs are usually not high enough to prohibit import of foreign goods, they put foreign producers at a competitive disadvantage in selling in domestic markets.

Export customs duties are established for a significantly fewer number of goods than for imported goods. These include mainly oil and oil products, gas, wood, non-ferrous metals and products manufactured with them. Export duty rates are lower on average than import duty rates.

The following types of duties are applied:

- ad valorem, charged in percentage to customs value of the taxed goods;
- specific, charged at the fixed rate for unit of the taxed goods;
- combined, using both types of the above mentioned customs duties.

Full exemptions may also be granted for items imported into a country temporarily for display at trade shows and exhibitions.

Non-tariff measures are the tools of administrative regulation of foreign trade activities. Nontariff barriers (NTBs) refer to licensing requirements, unreasonable standards pertaining to product quality and safety, or unnecessary bureaucratic customs procedures.

Licensing is the permission for importing, exporting or transiting the goods, free removal of which across the customs border of the country is not permitted. License (export or import) is the sanction issued by the competent state body for performing foreign trade operations. Japan and the European countries frequently require their domestic importers of foreign goods to obtain licenses. By restricting the issuance of licenses, imports can be restricted.

A country may impose certain regulations or standards on products from abroad to make it more difficult for them to be allowed in.

Quoting is also practised in foreign trade activities regulation. Quotas are limits placed on the amount of goods that may be imported from a particular country. Quotas actually come in two varieties: the strict quota, which sets an actual quantitative limit on imports; and, the variable quota, which limits imports to a fixed percentage of total domestic sales.

In order to protect local producers of goods, quantitative limits for some goods imported from other countries are set up. For example, a limit might be placed on the number of sales or the market share of new cars from a foreign country. Quoting is the implementation of quantity and value restrictions for imports and exports of goods during a certain period on certain kinds of goods, countries and groups of countries. Import quotas specify the maximum amounts of commodities which may be imported in any period. Import quotas can more effectively retard International commerce than tariffs. A product might be imported in large quantities despite high tariffs; low import quotas completely prohibit imports once quotas are filled.

The quoting of imports is used as a protective measure in cases when the danger of causing damage to manufacturers of such competitive goods in the country occurs. A quota, like a tariff, raises the price paid by domestic consumers.

Voluntary export restraints (VERs) are agreements negotiated between governments to restrict exports, in which the exporting country "voluntarily" agrees to limit its exports to the importing country. The effects of a VER are much like those of a quota.

Some governments subsidize firms that export goods and services. By offering below-market (interest rate) loans, offsetting shipping and customs costs, providing tax breaks, and the like, the government is lowering the production and distribution costs of the exporter and allowing them an "unfair" advantage against unsubsidized competitors. Much like the defenders of dumping, many argue that if foreign governments want to subsidize exports and drive down prices paid by foreign customers, that benefits consumers.

TOPIC 10. STATE POLICY IN THE SOCIAL SPHERE

Questions for the lectures and the seminars:

Social Policy: definition and methods. Demography and population policy: regulation of fertility and mortality. Government intervention into the labour market: employment and unemployment, migration flows. The income of the population and income policy. The Laffer curve and the Gini index. Structure, development and reform of the education system. The structure and development of the health system. Governmental Policy in the health care and educational systems. Social protection: pensions, cash benefits etc.

Social policy primarily refers to guidelines, principles, legislation and activities that affect the living conditions conducive to human welfare.

Social Policy is focused on those aspects of the economy, society and policy that are necessary to human existence and the means by which they can be provided. These basic human needs include: water, food, and shelter, a sustainable and safe environment, the promotion of health and treatment of the sick, the care and support of those unable to live a fully independent life; and the education and training of individuals to a level that enables them fully to participate in their society.

Social policy aims to improve human welfare and to meet human needs for education, health, housing and social security. Important areas of social policy are the welfare state, social security, unemployment insurance, environmental policy, pensions, health care, social housing, social care, child protection, social exclusion, education policy, crime and criminal justice.

Social policy is aimed to the following tasks:

1) to stabilize the living standards of the population and prevent mass poverty;

2) to keep low level of unemployment;

3) to maintain a stable level of real incomes of the population by carrying out of anti-inflationary measures and indexation of income;

4) to develop the social sphere (education, health, housing, science, culture and art), etc.

The social policy is implemented in three priority areas:

1. Income Policy.

• guarantee of a minimum wage, which is the base wage in all spheres. Regular revision of the minimum wage is a basic element of income policy.

• differentiated approach to taxation of different social groups, that creates the base of income redistribution in society.

• transfer payments, e.g. payments of various allowances and subsidies to low-income and socially vulnerable groups of the population,

• indexation of fixed income. Such compensation is achieved by converting income in accordance with the price index.

2. Employment regulation.

The state creates conditions for the realization of the person's ability to work with the purpose of receipt of income. Such conditions include:

• free choice of profession, sphere and place of work;

• obtaining the desired level of education;

• financial support and opportunity of retraining.

The main problem in the field of employment is reduction of the unemployment rate. The government uses tax incentives to enterprises that create new jobs, regulates the entry of foreign workers, etc.

3. Social partnership.

Social partnership is represented by coordinated actions of the government, employers and trade unions with the purpose of creating good conditions in the labor market, i.e., working hours, leave, conditions and safety of work, remuneration, rights and obligations of the employee, etc.

The first two points of social policy will be examined in more detail.

Income policy

The government transfers money from the population with high incomes to the population with low incomes via the state budget. It uses differential taxation of various groups of income recipients and social benefits.

Factors contributing to income inequality include the following.

1. Ability Differences. People have different mental, physical, and aesthetic talents.
2. Education and Training. Individuals differ significantly in the amounts of education and training they have obtained.
3. Discrimination. Labor market discrimination generates income inequality.
4. Tastes and Risks. People who takes arduous, unpleasant jobs and to work long hours with great intensity tends to earn more.
5. Distribution of Wealth.
6. Luck, Connections, and Misfortune.

Government’s tax system and transfer programs do reduce significantly the degree of inequality in the distribution of income.

The Lorenz curve

Different indicators are used to quantify the difference in the income. The Lorenz curve reflects the degree of income inequality (figure3).

The Lorenz curve is a helpful graphical device for presenting a summary representation of an income distribution and it has played an important role in the measurement of inequality.

The Lorenz curve is constructed by arranging the population in order of increasing income and then graphing the proportion of income going to each proportion of the population. The graph of the Lorenz curve therefore has the proportion of population on the horizontal axis and the proportion of income on the vertical axis. If all households in the population had identical incomes the Lorenz curve would then be the diagonal line connecting the points (0, 0) and (1, 1). If there is any degree of inequality, the ordering in which the households are taken ensures that the Lorenz curve lies below the diagonal since, for example, the poorest half of the population must have less than half total income.

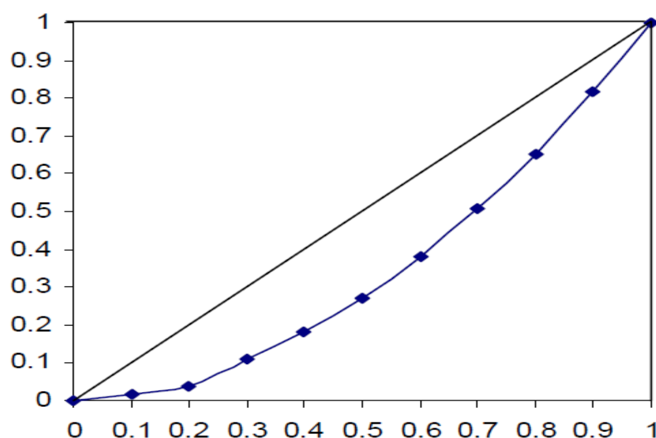

Figure 3. Lorenz Curve

Unemployment

There are several causes of unemployment. These include the following.

- Cyclical (or demand-deficient) unemployment.
- Structural unemployment.
- Seasonal unemployment.
- Frictional (search) unemployment.

Government intervention to reduce unemployment includes:

1. Demand side policies

By using demand side policies the government can boost the aggregate demand and provide jobs for those who are involuntarily unemployed, that is, individuals who have the necessary skills and who want to work, but for whom there are no jobs available. Demand side policies include;

- cutting direct taxes to boost spending by firms and households;
- increased government spending;
- reducing interest rates to stimulate borrowing and spending.

2. Supply side policies

In the case of voluntary unemployment the problem is not a lack of jobs; it is a question of whether individuals want to or have the required skills to work. If the government intervened to increase spending to provide more jobs than this would not solve the problem. What is needed here is help for individuals to get work that is actually there already, that is, supply side policies.

To reduce voluntary unemployment the government might do the following.

* The government could invest in training to provide the skills that people need to get jobs in other industries.

* It could change the benefits and tax system to make being unemployed less of an option, that is, force people to accept a job.

* The government could reduce the tax wedge. Taxes drive a wedge between the pay that employees receive and their take-home pay.

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APPENDIX 1.

The International Standard Industrial Classification of All Economic Activities

A - Agriculture, forestry and fishing
01 - Crop and animal production, hunting and related service activities
02 - Forestry and logging
03 - Fishing and aquaculture
B - Mining and quarrying
05 - Mining of coal and lignite
06 - Extraction of crude petroleum and natural gas
07 - Mining of metal ores
08 - Other mining and quarrying
09 - Mining support service activities
C - Manufacturing
10 - Manufacture of food products
11 - Manufacture of beverages
12 - Manufacture of tobacco products
13 - Manufacture of textiles
14 - Manufacture of wearing apparel
15 - Manufacture of leather and related products
16 - Manufacture of wood and of products of wood and cork, except furniture; manufacture of articles of straw and plaiting materials
17 - Manufacture of paper and paper products
18 - Printing and reproduction of recorded media
19 - Manufacture of coke and refined petroleum products
20 - Manufacture of chemicals and chemical products
21 - Manufacture of basic pharmaceutical products and pharmaceutical preparations
22 - Manufacture of rubber and plastics products
23 - Manufacture of other non-metallic mineral products
24 - Manufacture of basic metals
25 - Manufacture of fabricated metal products, except machinery and equipment
26 - Manufacture of computer, electronic and optical products
27 - Manufacture of electrical equipment
28 - Manufacture of machinery and equipment
29 - Manufacture of motor vehicles, trailers and semi-trailers
30 - Manufacture of other transport equipment
31 - Manufacture of furniture
32 - Other manufacturing
33 - Repair and installation of machinery and equipment
D - Electricity, gas, steam and air conditioning supply

35 - Electricity, gas, steam and air conditioning supply
E - Water supply; sewerage, waste management and remediation activities
36 - Water collection, treatment and supply
37 - Sewerage
38 - Waste collection, treatment and disposal activities; materials recovery
39 - Remediation activities and other waste management services
F - Construction
41 - Construction of buildings
42 - Civil engineering
43 - Specialized construction activities
G - Wholesale and retail trade; repair of motor vehicles and motorcycles
45 - Wholesale and retail trade and repair of motor vehicles and motorcycles
46 - Wholesale trade, except of motor vehicles and motorcycles
47 - Retail trade, except of motor vehicles and motorcycles
H - Transportation and storage
49 - Land transport and transport via pipelines
50 - Water transport
51 - Air transport
52 - Warehousing and support activities for transportation
53 - Postal and courier activities
I - Accommodation and food service activities
55 - Accommodation
56 - Food and beverage service activities
J - Information and communication
58 - Publishing activities
59 - Motion picture, video and television programme production, sound recording and music publishing activities
60 - Programming and broadcasting activities
61 - Telecommunications
62 - Computer programming, consultancy and related activities
63 - Information service activities
K - Financial and insurance activities
64 - Financial service activities, except insurance and pension funding
65 - Insurance, reinsurance and pension funding, except compulsory social security
66 - Activities auxiliary to financial service and insurance activities
L - Real estate activities
68 - Real estate activities
M - Professional, scientific and technical activities
69 - Legal and accounting activities
70 - Activities of head offices; management consultancy activities
71 - Architectural and engineering activities; technical testing and analysis
72 - Scientific research and development

73 - Advertising and market research
74 - Other professional, scientific and technical activities
75 - Veterinary activities
N - Administrative and support service activities
77 - Rental and leasing activities
78 - Employment activities
79 - Travel agency, tour operator, reservation service and related activities
80 - Security and investigation activities
81 - Services to buildings and landscape activities
82 - Office administrative, office support and other business support activities
O - Public administration and defence; compulsory social security
84 - Public administration and defence; compulsory social security
P - Education
85 - Education
Q - Human health and social work activities
86 - Human health activities
87 - Residential care activities
88 - Social work activities without accommodation
R - Arts, entertainment and recreation
90 - Creative, arts and entertainment activities
91 - Libraries, archives, museums and other cultural activities
92 - Gambling and betting activities
93 - Sports activities and amusement and recreation activities
S - Other service activities
94 - Activities of membership organizations
95 - Repair of computers and personal and household goods
96 - Other personal service activities
T - Activities of households as employers; undifferentiated goods- and services-producing activities of households for own use
97 - Activities of households as employers of domestic personnel
98 - Undifferentiated goods- and services-producing activities of private households for own use
U - Activities of extraterritorial organizations and bodies
99 - Activities of extraterritorial organizations and bodies