Section 4. Real sector of the economy

4.1. Production macrostructure

4.1.1. Dynamics of the Russian economy in 2014

Analysis of the dynamics of the Russian economy macroeconomic indices for the period 2009–2014 showed that the gradual decline of economic growth was accompanied by increasing disparity in production, a decrease in innovation by manufacturers and increased problems related to the imbalance of the technical and technological characteristics of the basic funds and investments in fixed assets in basic economic activities. Development, based on the extensive use of the main factors, increase in production costs reduced the competitive ability of the Russian economy. Expanding domestic consumer demand was supported by the growth of salaries outstripping labour productivity. The growth of investments in fixed assets did not result in a corresponding increase in return per unit of the resources used.

Table 1

Main macroeconomic indices of social and economic development in 2008–2014, % compared with the previous period

	2008	2009	2010	2011	2012	2013	2014
GDP	105.2	92.2	104.5	104.3	103.4	101.3	100.6
Industrial production index	100.6	90.7	107.3	105	103.4	100.4	101.7
Extraction of commercial minerals	100.4	99.4	103.8	101.8	101	101.1	101.4
Manufacturing industries	100.5	84.8	110.6	108	105.1	100.5	102.1
Agricultural products	110.8	101.4	88.5	123.0	95.2	106.2	103.7
Investments in fixed assets	109.9	84.3	106.0	110.8	106.6	99.7	97.5
Retail trade turnover	113.7	94.9	106.5	107.1	106.3	103.9	1,025
Volume of paid services to the population	104.3	97.5	101,5	103.0	103.7	102.1	101.3
Export	134.6	63.7	132.1	131.3	102.7	98.8	94.9
Import	129.4	63.7	133.6	129.7	105.4	102.6	90.2
Consumer prices index, at the end of the year	113.3	108.8	108.8	106.1	106.6	106.8	111.4
Price index of the industrial goods manufacturers, at the end of the year	93.0	113.9	116.7	112.0	105.1	103.7	105.9
Actual disposable monetary income of population	102.4	103.0	105.9	100.5	104.6	104.0	99.0
Actual acrrued salary	111.5	96.5	105.2	102.8	108.4	104.8	101.3
Level of overall unemployment, %	6.2	8.3	7.3	6.5	5.5	5.5	5.2

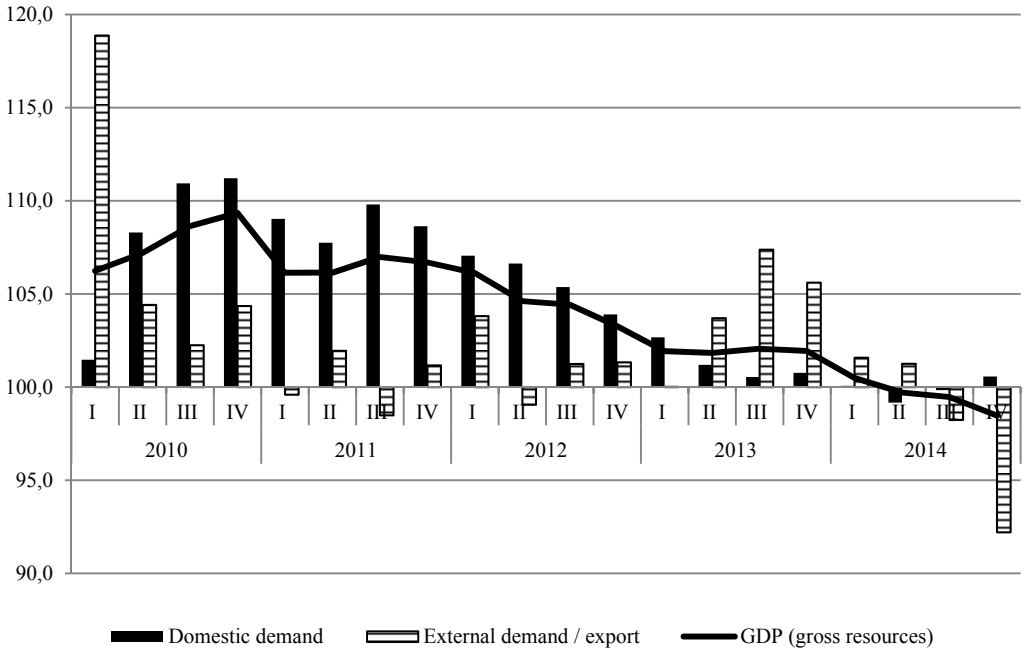
Source: Rosstat (Russian Statistics Service).

On the whole, the macroeconomic situation in 2014 was determined by the trends, which had formed in H2 2012, and was characterised by a gradual weakening of the dynamics of development, as a result of aspects of both external and domestic demand.

The features of the functioning of the economy over the period 2010–2014 were due to differences in the post-crisis recovery of certain components of the aggregate demand. While, in

2010–2012 the rates of growth of domestic demand outstripped growth of the GDP and external demand, since Q2 2013 the dominant factor in the Russian economy has become the sharp deceleration of the growth of consumer and investment demand. In 2013 the increment of GDP fell to 1.3% compared with the 3.4% of the previous year, while, at the same time, the growth rate of external demand increased to 104.6% compared with the previous 101.4%, while growth in domestic demand slowed to 101.3% compared with 105.5%.

In H1 2014 GDP growth remained positive, with average indices matching H1 of 2013. The deceleration of the growth of external demand during H1 of 2014 was changed by decrease in H2 by 4.1% compared with the corresponding period of the previous year. In Q4 2014 the export of Russian goods and services was 92.2% of the corresponding period of 2013, and was one of the factors contributing to the fall of the quarterly GDP indices that then occurred (the first time since 2009). The situation in Q4 2014 improved a little, due to the rapid growth of domestic businesses consumption, supported by an increase in the domestic supply of goods and services. Therefore, overall, the results of 2014 showed a GDP growth of 100.6% with a reduction of external demand by 2.0% and a stabilisation of domestic demand (*Fig. 1*).

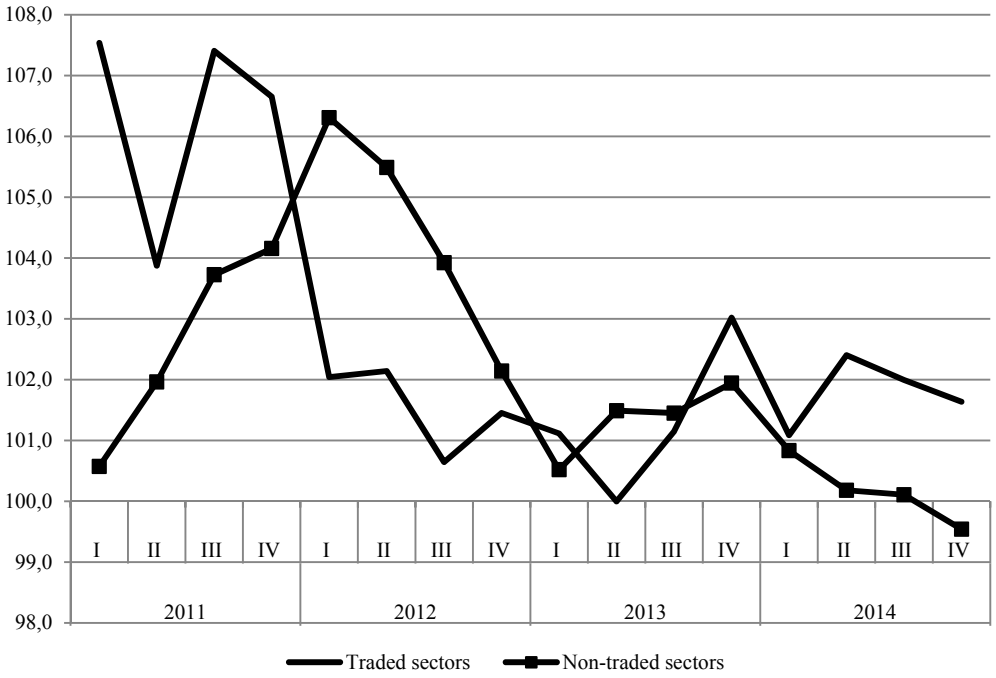


Source: Rosstat.

Fig. 1. Dynamics of GDP by the domestic and external demand components in 2010–2014, % compared with the corresponding quarters of the previous year

The index of the output of goods and services in terms of basic types of economic activity in 2014 was characterised by a continued strengthening of their dynamics in comparison to 2013 and amounted to 100.4%. At the same time, the traded sectors (extractive, manufacturing industries and agriculture) grew faster than the non-traded sectors (trade, construction, transport, market services, etc.). The strengthening of the contribution from the traded sectors of the economy had been evident since H2 2013. In 2014 the increment in this sector was

1.6% and in the non-traded sector – 0.3%. Compare this with the corresponding indices in 2012 which were 1.6 and 4.3% respectively (*Fig. 2*).



Source: Rosstat.

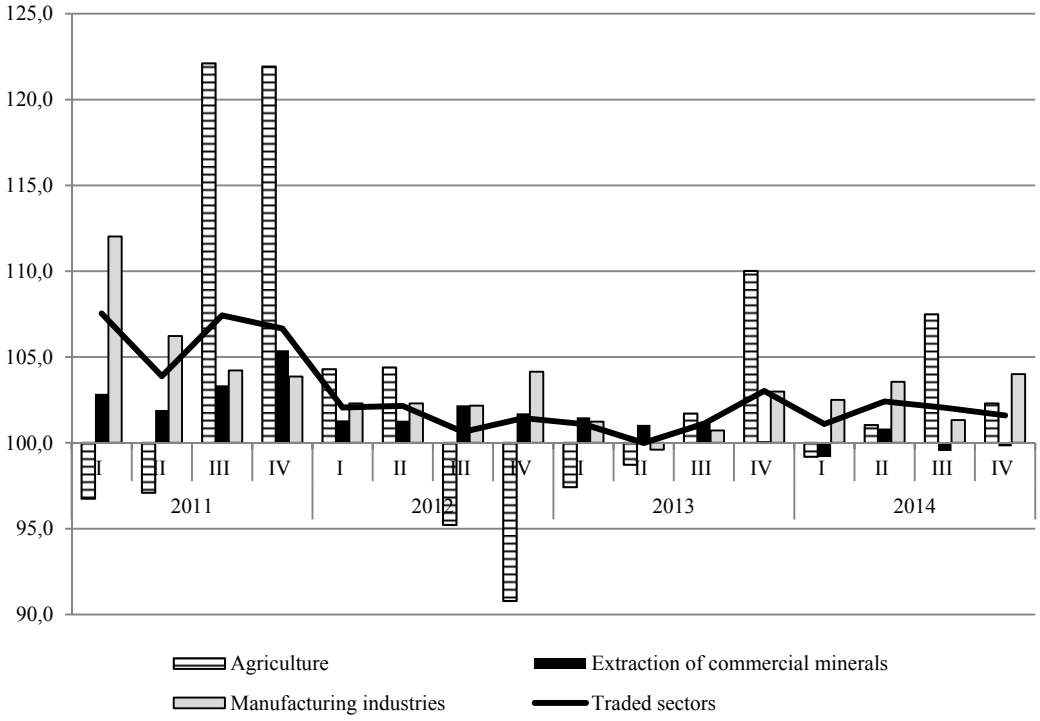
Fig. 2. Dynamics of GDP in the traded and non-traded sectors of the economy in 2011–2014, % compared with the corresponding quarters of the previous year

In 2014, for the traded sector of the economy the annual index of industrial production amounted to 101.7%. At the same time, for manufacturing industry focused mainly on the domestic market, the output in 2014 increased by 2.1% compared with 0.9% in the previous year. The character of industrial dynamics in 2014 was also positively affected by a gradual acceleration of the rates of the extraction of commercial minerals. The index of the physical production volume of extracted commercial minerals in 2014 amounted to 101.4% compared with the previous year. In 2014 the positive contribution of agricultural production to the general economic indices also increased. In the traded sector the devaluation of the Russian ruble contributed to a revival of economic activity and to the development of import substitution (*Fig. 3*).

Capacity utilisation in industry in 2014 returned to the levels of 2012. In 2014 the growth of productivity in the traded sector also exceeded the corresponding indices in the non-traded sector. Furthermore, the use of spare capacity for this did not require additional investment costs.

In 2013–2014 the deceleration of domestic demand affected most strongly the non-traded sector of the economy, which had been the main source of economic growth during the previous three years. The growth rates of retail trade turnover reached their peak in Q4 2011, and then, during 2012–2014 gradually slowed down, but at the same time remained the main drivers supporting the positive dynamics of development. In 2014 the index of retail trade turnover amounted to 102.5% compared with 103.9% in the previous year, while the indices of

wholesale trade turnover were 97.6% and 100.6%, respectively. The dynamics of consumer demand in the field of non-traded market services was determined by a deceleration of personal income growth, increasing inflation and the increasing debt burden of the population, which resulted in a weakening of the dynamics of the retail and wholesale trades.



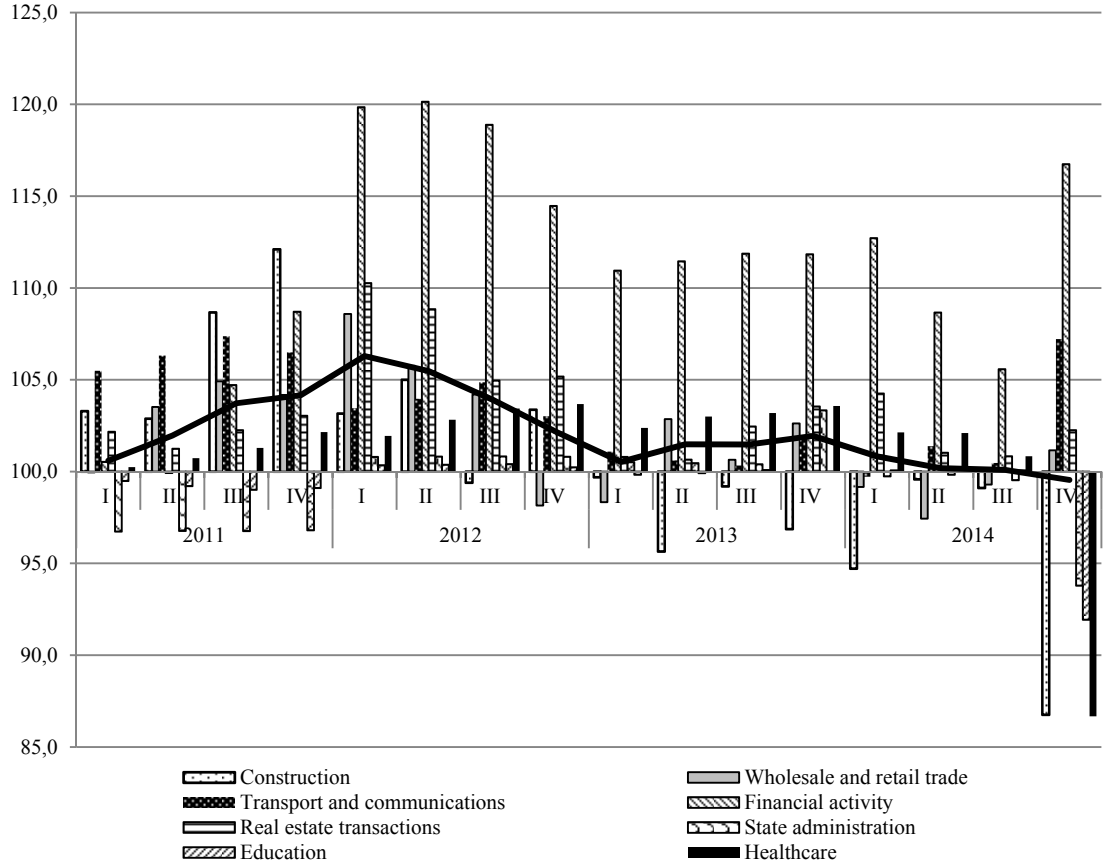
Source: Rosstat.

Fig. 3. Dynamics of GDP in the traded sector of the economy in 2011–2014, % compared with the corresponding quarters of the previous year

The macroeconomic situation in the Russian economy was extremely adversely affected by a deceleration, of business activity in the construction and investment complex which had started in Q4 2011 and, since 2013 had reached the stage of a reduction in the volume of construction works. In 2014 the reduction of investment in fixed assets had reached 2.5%, with the reduction of the volumes of construction works being 4.5% in annual terms. The general economic dynamics were adversely affected by the stagnation of demand for transport services and a deceleration of the growth rates of communication service provision to 100.5% in 2014 compared with 104.5% in the previous year. In the segment of non-traded goods, only the financial services sector and real estate operations were characterised by stable positive dynamics (*Fig. 4*). In Q4 2014, the slowdown of the dynamics of social service provision during the three previous quarters changed to a sharp fall in the rates of healthcare and education services.

The key indicators of the domestic market were defined by the ratio of the growth of domestic production for domestic consumption and for the external market on the one hand, and of the dynamics and structure of imports on the other. The deceleration in domestic production was due both to the low competitiveness of domestic goods and services compared with

their imported equivalents, and to low production efficiency in the non-traded goods and services segment compared with the export-oriented sector of the economy.



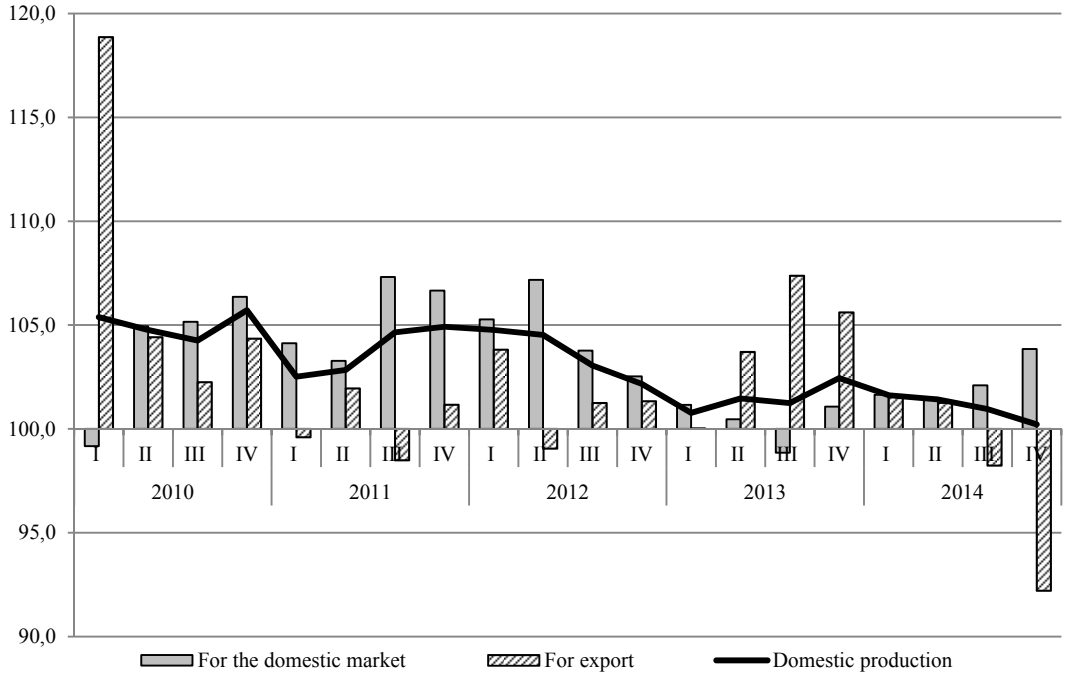
Source: Rosstat.

Fig. 4. Dynamics of GDP in the non-traded sector of the economy in 2011–2014, % compared with the corresponding quarters of the previous year

The increased concentration of income in the export-oriented sector of industry with the undeveloped structure of inter-sectoral resource redistribution placed pressure on the domestic market. In 2010–2011 the development of the export sector of the economy meant that the intensity of the exit from the crisis in domestic production for the domestic market matched the pre-crisis level of 2008. In 2012–2013 the situation was complicated by the instability of the dynamics of domestic goods production for both the internal and external markets. A decrease in demand on the part of the export-oriented industries from Q2 2012 to Q1 2013 resulted in a substantial weakening of the growth of domestic production. Since Q3 2012 a decrease in investment demand and weakening of consumer demand resulted in a slowing of the growth rates of goods and services output for the internal market that remained until Q1 2014.

Changes in foreign trade market conditions in H2 2014 led to acceleration in the dynamics of the domestic goods and services production for the internal market due to increasing growth in the manufacturing industries, including the development of import substitution in the sectors producing goods affected by the embargos. At the same time, production for the domestic market weakened the impact of the declining trends in exports through a reorienta-

tion of the flow of commodities towards the domestic market, and of imports – due to the increased substitution of Russian products. As a result, according to the figures for 2014, the dynamics of domestic production remained positive (100.9% compared with 2013) with an increase in the production of goods for the domestic market by 2.3% and a reduction of imports by 6.8% (*Fig. 5*).

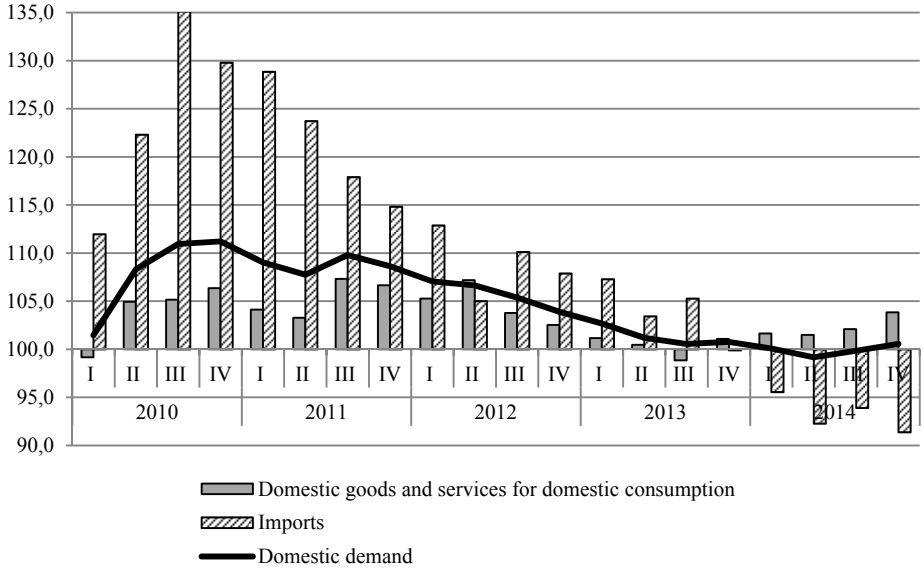


Source: Rosstat.

Fig. 5. Dynamics of the components of domestic production of goods and services in 2010–2014, % compared with the corresponding quarters of the previous year

While noting the significance of the domestic market dynamics as the dominant factor in the development of the Russian economy during recent years, it is worth mentioning the peculiarities of the formation of the domestic market resources. A large scale decline of imports in both 2014, and in 2009, determined the structural changes in the domestic market. With the weakening of consumer demand, income of population and the ruble exchange rate there was an increase in the share of domestically produced goods.

However, weak growth in the production of goods and services for the domestic market meant that it remained clearly insufficient to halt the trend of declining domestic demand on both the consumer and the investment markets. In 2014 the share of imports in the domestic market resources was 24.5%, and in retail trade commodity resources it was 41.0% (*Fig. 6*). Despite certain positive shifts, related to the strengthening of the positions of the domestic manufacturers it is quite obvious that a stable change of the domestic market resource structure to benefit domestic production requires significant time and efforts.



Source: Rosstat.

Fig. 6. Dynamics of the components of domestic demand in 2010–2014, % compared with the corresponding quarters of the previous year

With the established structure of competitive capacity, import substitution in 2010–2014 was concentrated in those industries biased towards industrial assembly. This determined the change in the proportions of the imports of investment and intermediate goods (*Table 2*). In particular, the increased share in imports of intermediate consumption goods reflected the inadequate localisation of the main production and components.

Table 2

Import structure by functional pattern of use (according to the balance of payments methodology), % compared with the results, 2010–2014

	Goods		
	consumer goods	**investment goods**	**intermediate goods**
2010	40.7	19.5	39.8
2011	36.6	21.4	42.0
2012	38.1	24.9	37.0
2013	37.6	24.3	38.0
2014	36.1	24.5	39.4
Q1	38.0	23.2	38.8
Q2	34.7	26.1	39.2
Q3	35.6	23.4	41.0
Q4	36.5	25.2	38.3

Source: Rosstat.

In 2013–2014, the increased proportion of investment and intermediate goods in the import structure together with the reduction of that of consumer goods was a qualitatively new process for the Russian economy. All other things being equal, the dynamic growth of imports should have contributed to a change in the competitive environment, and the development of the real sector under this situation should have depend on the intensity of the domestic investments oriented towards the modernisation and diversification of production. At the same time, the high share of imports in the retail trade turnover, and in the volume of investments in fixed assets, strengthened the dependence of the gross resource balance of the economy on

changes in the conditions on the foreign economic market. In 2014, the fall of investments in fixed assets resulted in a simultaneous reduction in demand for domestic and imported capital goods and strengthened the development of negative trends on the domestic market. Additional difficulties appeared in 2014 due to the limitations imposed on the supplies of certain types of technological equipment necessary for realising the investment plans of the extractive and manufacturing industries and of infrastructure projects.

4.1.2. The Use of GDP in 2010–2014

Household consumption remained the main factor driving the positive trend of the Russian economy in 2010–2014, however, the contribution of personal consumption and the state administration sector in the GDP dynamics during this period had been substantially weakening. The dynamics of consumer demand was significantly affected by the deceleration of the growth of actual income, the increased burden on households to repay debts on loans, and rising inflation, while there was also a continued high proportion of income conversion into foreign currency.

The economic model of 2010–2014 was focused on the priority implementation of state social guarantees and obligations. In order to maintain living standards and preserve social stability, spending on state administration increased from 18.78% of GDP in 2010 to 19.9% of GDP in 2014, and, on the whole during this period, remained above the pre-crisis level (*Table 3*).

Table 3

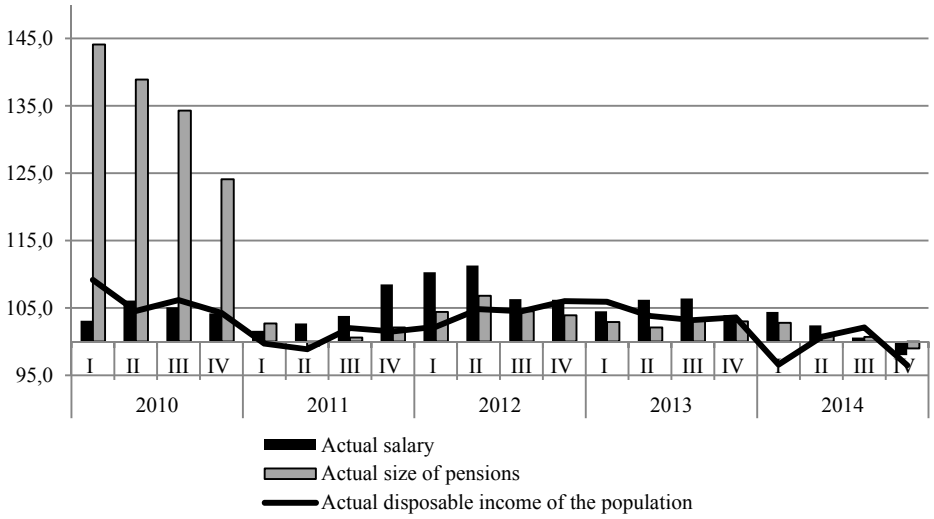
Structure of GDP used in 2010–2014, % of total, at current prices

	2010	2011	2012	2013	2014
Gross domestic product	100	100	100	100	100
Including:					
Final consumption expenditure	70.2	67.1	69.1	72.5	73.9
of households	51.0	48.6	49.9	52.4	53.7
of state administration, including individual goods and services and collective services	18.7	18.1	18.8	19.7	19.9
of non-profit organisations, servicing households	0.5	0.4	0.4	0.4	0.4
Gross accumulation	22.6	25.0	24.9	22.9	20.9
Net export	8.1	8.5	7.3	5.9	6.9
Statistical discrepancy	–0.9	–1.2	–1.5	–0.4	–1.7

Source: Rosstat.

In 2013 real household income exceeded the pre-crisis level, so, by 2014 the potential for increases in wages and social benefits was notably exhausted. The population's actual disposable income in 2014 amounted to 99.0% of that in 2013, while actual salary, which represents the dominant component of income for the population was 101.3% and the actual size of pensions amounted to 100.9% respectively.

In terms of the population's monetary income, the remuneration of labour in 2014 amounted to 66.7% (+1.4 percentage points in relation to the corresponding index of 2013), social benefits to 18.2% (–0.4 percentage points) with a further reduction of the contribution of income received from property and entrepreneurial activity. Taking into account that wages have the greatest influence on the level of income for the population, the downward trend of actual wages seen by the end of the year, is the main determinant of the social factors affecting the living standards of the population in 2015 (*Table 4*).



Source: Rosstat.

Fig. 7. Dynamics of the actual income of the population in 2010–2014, % compared with the corresponding periods of the previous year

Table 4

Structure of monetary income of the population in 2010–2014, % of the total

	2010	2011	2012	2013	2014
Total monetary income	100	100	100	100	100
Remuneration of labour, including hidden wages	65.2	65.6	66.0	65.3	66.7
Income from entrepreneurial activity	8.9	8.9	8.6	8.6	7.8
Social benefits	17.7	18.3	18.3	18.6	18.2
Income from property	6.2	5.2	5.1	5.5	5.3
Other income	2.0	2.0	2.0	2.0	2.0

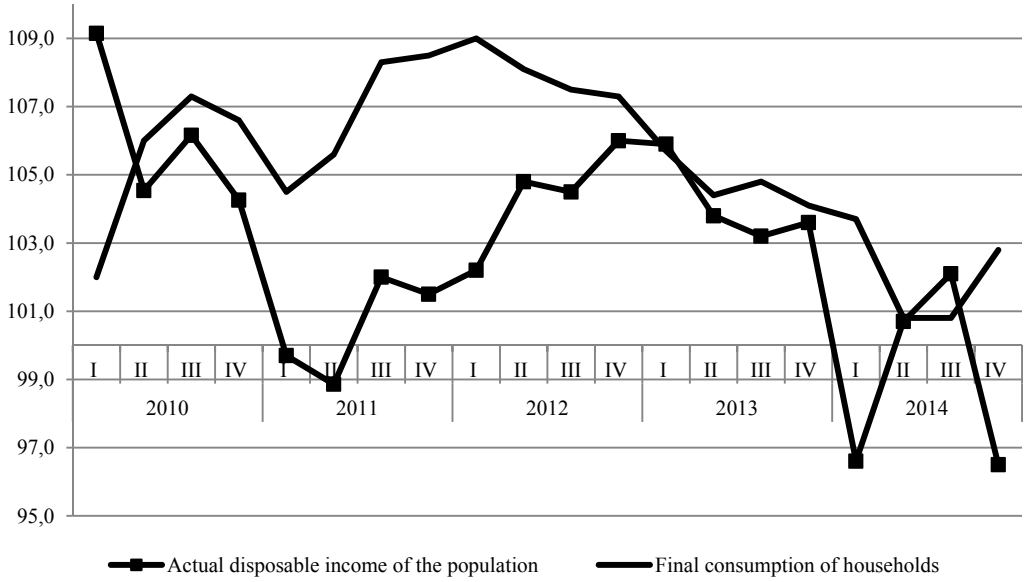
Source: Rosstat.

In 2014 the growth rates of final consumption expenditure of households began slowing down noticeably. In Q2 and Q3 2014 the growth rate of such final consumption expenditure was 0.8% (in the previous year this index was 4.6%), due to the stabilisation of the actual income of the population at the level of January – September of 2013. The growth rates of actual salary in January – September amounted to 102.4% compared with 105.8% in the previous year, while the actual size of granted pensions grew respectively, by 101.5% compared with 102.7%.

In Q4 2014, with a reduction of the actual income of the population by 3.5% and of actual salaries by 2.0% in relation to the corresponding period of the previous year, there were sharply increased inflationary expectations, along with a drop in the ruble exchange rate and the appreciation of imported goods. These had a significant impact on consumer behaviour, resulting in an increased expenditure by households by 2.8% compared with Q4 2013 and by 7.0% compared with the previous quarter. So, the results of 2014 showed a growth in household final consumption expenditure amounting to 1.9% (in the previous year this index was 5.0%).

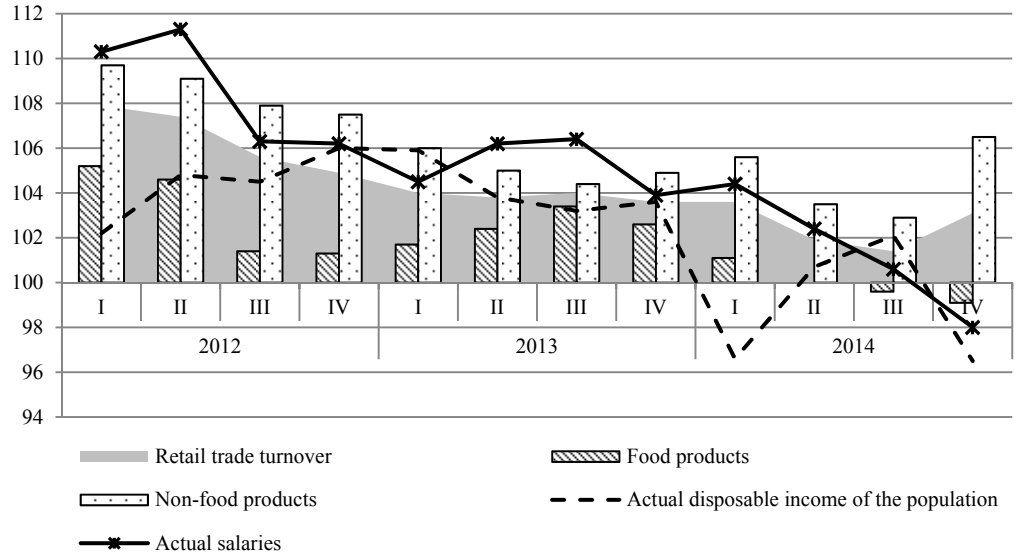
With the decelerating trend in the growth of the final consumption expenditure of the population, in 2014, the growth in retail trade turnover was only 2.5%, and in services for the population was 1.3% compared with those in the corresponding period of the previous year. A sustained slowdown of retail trade turnover took place in 2014, simultaneous with that in the

food product sector (99.9% compared with the same index for 2013) and in non-food products (104.7%). The retail trade turnover dynamics in 2014 was significantly influenced by price dynamics. The consumer inflation index in 2014 was 111.4%. In 2014, the increase of prices for food products by 15.4% (in the previous year this index was 7.3%) was the dominant influenced on inflation. The price indices for non-food products and for paid services for the population during 2014 increased by 8.1 and 10.5%, respectively.



Source: Rosstat.

Fig. 8. Dynamics of actual disposable income of the population and final consumption of households, % compared with the corresponding quarters of the previous year



Source: Rosstat.

Fig. 9. Indices of the actual income of the population and of retail trade turnover in 2012–2014, % compared with the corresponding periods of the previous year

The uncertainty of the economic situation and growing inflation risks changed the structure of the population's expenditure fairly significantly. In 2014 the main feature of the change in consumer behaviour was an enhancement of the process of converting savings into foreign currency (*Table 5*).

Table 5

Structure of the monetary expenditure of the population in 2013–2014, % of the total

	Monetary income	Purchase of goods and payment for services	Including		Payment of compulsory payments	Savings	Among them	Purchase of foreign currency	Growth (+), decrease (-) of money in population's hands
			purchase of goods	payment for services			in deposits and securities		
2013	100	73.6	55.9	15.5	11.7	9.8	6.3	4.2	0.7
Q 1	100	78.3	58.7	17.3	11.2	9.8	5.2	3.7	-3
Q 2	100	72.8	55.1	15.6	11.8	9.7	7.9	3.9	1.8
Q 3	100	76.7	58.1	16.1	11.8	6.9	2.9	5.2	-0.6
Q 4	100	68.3	52.7	13.7	11.8	12.3	8.5	4	3.6
2014	100	75.1	57.5	15.3	11.9	6.9	0.7	5.9	0.2
Q 1	100	82.3	61.8	17.6	12.1	0.3	-6.9	7	-1.7
Q 2	100	73	55.5	15.2	11.5	10	5.1	4.6	0.9
Q 3	100	75.4	57.6	15.3	11.9	7.2	2.6	4.6	0.9
Q 4	100	71.6	56	13.6	12	8.7	0.7	7.3	0.4
October	100	75.5	58.1	15.1	11	6.5	0.6	8.6	-1.6
November	100	76.7	59.3	15.3	11	6.7	0.6	5.8	-0.2
December	100	65.4	52.2	11.5	13.4	11.7	0.9	7.3	2.2

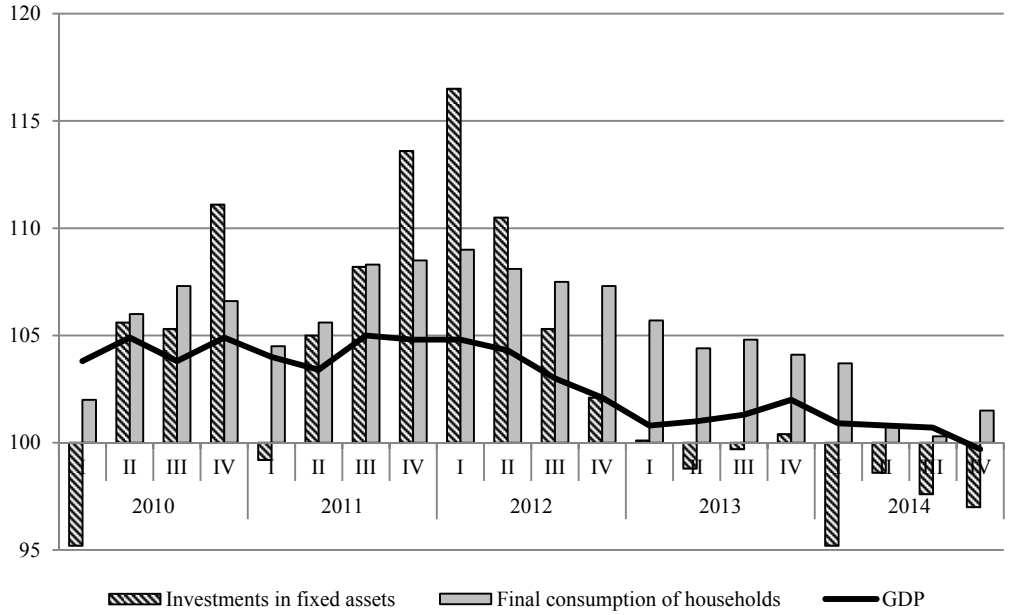
Source: Rosstat.

Among the components of domestic demand during 2013–2014, the largest reduction was observed in respect of investment demand. In 2014 investments in fixed assets reached only 97.5% of their index of the previous year, strengthening their negative impact on the dynamics of GDP, especially if we take into consideration the reduction in investment and construction activity which began in 2013.While the decrease in investments in fixed assets in Q1 2014 can be explained by delays in financing state capital investments, the situation in Q2, Q3 and Q4 started to be dominated by the growth in the cost of credit resources, restrictions on the access of Russian companies to borrow on international financial markets, and sizeable geopolitical risks.

The situation was exacerbated by the increased scale of capital outflows. During January–September 2014 the export of capital amounted to $78.6bn, however in just Q4, alone, it then amounted to $72.8bn. So, the results for 2014 show a capital outflow which exceeded that of the crisis year 2008, and reached $151.5bn. This is 2.47 times greater than the corresponding index of the previous year. The increased economic and geopolitical risks resulted in a more than three-fold reduction in direct foreign investment.

Comparison of the GDP dynamics by the end-use components shows a reduction in the share of gross capital formation and net exports. Under the impact of a sharp drop in income to the economy, the proportion of gross capital formation in the 2014 GDP fell to 26.1% (in 2013 this index was 27.5%), and the share of investments in fixed assets fell to 19.0% (the average during the period 2010–2013 was 19.8%, of GDP).

The capital account of the balance of payments shows the asymmetry of the formation of domestic saving resources and their use for investment purposes. A characteristic feature of the Russian investment model is the significant volume of savings, a sizeable part of which the economy is not able to transform into investment. We should note that capital account analysis shows that the Russian economy has been a net creditor over the past decade.



Source: Rosstat.

Fig. 10. Dynamics of final consumption of households and investments in fixed assets in 2010–2014, % compared with the previous year

Table 6

Key indicators of the investment potential of the economy during 2008–2014, % of GDP

	2008	2009	2010	2011	2012	2013	2014
Gross saving	33.3	24.6	29.8	32.9	30.9	27.5	26.1
Gross capital formation	25.5	18.9	22.6	25.0	24.9	22.9	20.9
Of which:							
gross saving of fixed capital	22.3	22.0	21.6	21.4	21.9	21.9	20.7
change in inventories	3.2	-3.1	1.0	3.6	2.9	1.0	0.2
Investments in fixed assets	21.3	20.6	19.8	19.3	20.2	20.0	19.0
End-of-year resources of the Reserve Fund	9.8	4.7	1.7	1.5	3	4.3	6.4
End-of-year resources of the National Welfare Fund	6.3	7.1	5.8	5	4.3	4.3	4.4
End-of-year deposits of individuals	14.3	19.3	21.2	21.3	22.8	24.7	26.3

Source: Rosstat.

4.1.3. Structure of GDP formation by income sources

On the whole, the post-crisis development of the economy resulted in the reproduction of the economic proportions typical of 2007, and this was one of the factors causing the slowdown of economic growth in 2011–2014. The low growth rates of the Russian economy are a reflection of the declining development potential. This is confirmed by average capacity utilisation being at the level of the pre-crisis maximum, with an absence of large-scale investments, as well as by the record low level of unemployment.

The situation is complicated by the long-term trend of rising production costs associated with the tariff policies of the infrastructure monopolies, increase in the costs of raw, and other, materials outstripping the prices for the final goods, as well by rising labour costs.

Economic relations in 2010–2014 were characterised by the redistribution of income from enterprises to the population. The share of wages in the GDP increased from 49.7% in 2010 to

52.3% in 2014. As a result, the commodity sector has faced serious constraints on further increases in expenditure on wages, taking into account the existing trend (since 2012) for a weakening of the growth of both production volumes and productivity.

Table 7

Structure of GDP formation by income sources in 2010–2014, % of total, at current prices

	2010	2011	2012	2013	2014
Gross domestic product	100	100	100	100	100
Including:					
remuneration for labour of employees, including hidden wages and mixed income	49.7	49.6	50.2	51.8	52.3
net taxes on production and imports	17.7	19.4	15.9	15.2	15.2
gross profit of economy and gross mixed income	32.6	31.0	33.9	32.9	32.5

Source: Rosstat.

In 2014, by reducing the financial performance of the activities of enterprises and manufacturing industry, these organisations changed their pricing policies. That year's price index for manufacturing industry increased by 8.5% (compared with 1.6% in 2013). On the whole, for 2014, the net financial result of the activity of the organisations throughout the economy fell by 9.9% compared with the previous year. This decrease in the financial results was due to a continuing low level of business activity, a deterioration of the external trading conditions and a narrowing of consumer and investment demand.

The dynamics of industrial production in 2014, to a considerable degree, was driven by the conditions for lending and for the financing of working capital. The proportion of working capital in manufacturing industry being funded by bank credits amounts to nearly 40%, and in the production of machinery and equipment, to almost 80% (due to the long-term technological production cycles). Accordingly, the limitations of the access by companies to borrowing on the global financial markets, the increased cost of credit, and the depreciation of the ruble have resulted in an increase in manufacturers' prices, which has put additional pressure on profitability and the overall level of profits.

On the whole, the net financial result of the activity of organisations throughout the economy has been falling since 2013. The dynamics of this net financial result over the year was heterogeneous: since August the growth in H1 2014 has been replaced by a fall due to the influence of the sectoral and financial sanctions. By the end of 2014, it had decreased by 9.1% compared with 2013 and by 23% compared with 2012.

The negative dynamics of the net financial result of the activity of the organisations was due to a continued contraction in demand, especially for investment; to the deceleration of demand growth in the consumer market, and, at the end of the year, to the deterioration of the external economic market conditions for hydrocarbons, and to increases in costs.

The dynamics of the net financial result for certain types of activity have been volatile, depending on their orientation towards exports or the domestic market.

Devaluation of the ruble positively influenced the financial results in the extractive sector (growth by 54.4%, while in the previous year there had been a fall of 2.6%), including in the extraction of fossil fuels (growth by 62.6%; in the previous year only by 1.9%).

In practically all types of activity oriented towards final demand, the net financial result for enterprises has been falling since August 2014. In the manufacturing industries the net financial result fell by 44.0% in 2014 (in the previous year it had fallen by 28.2%).

In 2014 changes could be observed in the structure of the net financial result for manufacturing industries due to the increase in the share of the metallurgical sector, which received additional profit growth as a result of the weakening of the ruble exchange rate, improvements in the conditions on the global markets and an increase in domestic prices. There was a further contribution from the increase in the share of the food industries as a result of higher price growth as a consequence of the weakening of the competition from imports and increase in production volumes.

In the production of goods of investment demand in 2014 there was a greater fall in the net financial result and a reduction in production profitability.

The negative dynamics of the net financial result can be observed in other major sectors of the economy: in construction (81.9% compared with 2013) and in transport and communication (42.1%).

Table 8

Profitability of sold goods, products, works and services by types of economic activity in January–September of 2010–2014, %

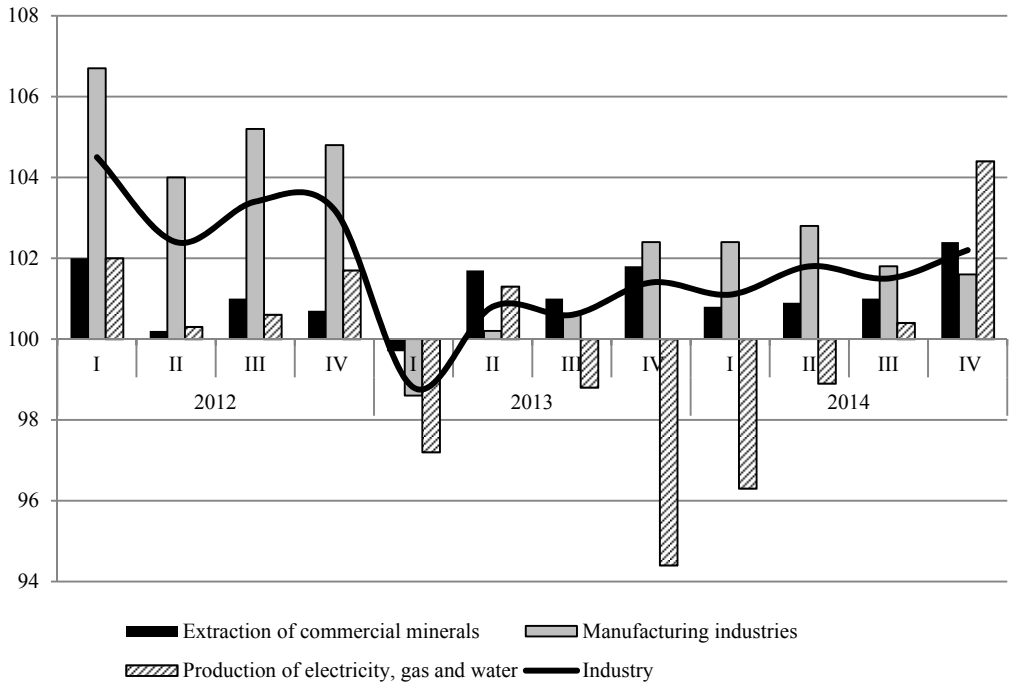
	2010	2011	2012	2013	2014
Total	11.6	11.2	10	7.7	8.7
Including:					
Agriculture	12.2	11.8	15.2	7.1	18.3
Fishery, fish-breeding	25.0	22.9	23	19.7	32.4
Extraction of commercial minerals	32.8	36.4	32.6	27.3	25.4
Including:					
fossil fuel extraction	30.4	32.5	30.2	26.3	24.1
Manufacturing industries	14.4	13.4	11.9	9.7	10.2
Among them:					
production of food products	12.6	8.3	11.2	9.9	9.8
textile and clothing production	5.3	7.2	7.8	6.1	9.5
production of leather, leather goods and footwear	6.9	7.7	8.9	9.7	5.3
processing of wood and wood products	1.0	6.0	5.5	7.0	12.0
cellulose and paper production;	10.6	11.9	10.9	8.3	10.5
production of coke and oil products	22.8	20.0	14	10.1	9.7
chemical production	19.1	24.1	23.9	18.3	19.7
production of rubber and plastic articles	7.5	7.5	8.5	10.1	7.0
production of non-metallic mineral products	8.1	12.0	13.5	10.4	9.1
metallurgical production and ready-made goods	19.5	16.7	12.2	10.7	15.2
production of machinery and equipment	7.3	7.0	7.3	7	6.4
production of electric, electronic and optical equipment	9.0	8.5	8.3	7.7	8.8
production of vehicles and equipment	4.2	6.1	6.8	5.8	4.0
production and distribution of electricity, gas and water	6.9	6.6	3.8	4.1	4.3
construction	4.1	3.4	3.8	3.5	3.3
wholesale and retail trade	8.3	9.4	8	6.7	7.1
hotels and restaurants	7.3	6.6	7.4	6.3	6.6
transport and communication	15.0	13.4	13.8	11.3	10.7
Among them:					
railway transport activity	8.8	6,1	7.8	3.3	3.6
other overland transport activity	-4.2	-5.9	-2.9	-6	-8.1
transportation via pipelines	17.4	19.1	17.1	15	15.8
communications	51.5	27.9	27.7	28.3	25.6

Source: Rosstat.

4.1.4. Dynamics and structure of production by types of economic activity

Since H2 2012 the Russian economy has started to show the signs of a deceleration in growth. The greatest influence has been its own inherent limitations, connected with the fact that the structure of the economy has not undergone any substantial changes, and the impact potential of the factors contributing to the growth has turned out to be almost exhausted. Thus, external demand for Russia's main commodities, which constitute the basis of her export potential, has been falling while domestic demand has weakened as a result of the decline in the income of the economy and the growth in costs. The volumes of domestic and foreign investments in fixed assets have also contracted sharply. In 2014 the situation became even more complicated, influenced by the weakening of the national currency, increases in the manufacturers' prices and the imposition of mutual sanctions.

Compared with the previous year the results of 2014 show a growth of industrial production amounting to 1.7%; a growth in the extraction of commercial minerals by 1.4% and a growth in manufacturing industry by 2.1%. The rapid pace which manufacturing industry had been registering from Q4 2013 until Q3 2014, only yielded its first position to the extraction of commercial minerals in Q4 2014.



Source: Rosstat.

Fig. 11. Dynamics of industrial production by types of economic activity in 2010–2014, % compared with the corresponding quarters of the previous year

The dynamics of the manufacturing industries are quite significantly differentiated by the type of economic activity, while they are mostly affected by the different relative production rates of capital and consumer goods. A slow recovery of investment demand determined the peculiarities of the functioning of the machine-building complex.

Table 9

Production indices of the main types of the manufacturing industries in 2010–2014, % compared with the previous year

	2010	2011	2012	2013	2014
Manufacturing industries	110.6	108.0	105.1	100.5	102.1
production of food products, including beverages, and tobacco	103.2	103.9	104.1	100.6	102.5
textile and clothing production	108.8	100.8	100.7	104.3	97.5
production of leather, leather products and footwear	119.9	105.7	98.1	95.6	97.2
processing of wood and wood products	113.4	110.2	96.2	108.0	94.7
cellulose and paper production; publishing and printing activity	103.1	106.5	105.8	94.8	100.4
production of coke and oil products	106.0	103.8	103.1	102.3	105.7
chemical production	110.6	109.5	104.1	105.4	100.1
production of rubber and plastic articles	124.4	111.4	112.8	105.9	107.5
production of other non-metallic mineral products	114.5	107.4	110.7	98.0	101.8
metallurgical production and production of ready-made metallic goods	112.4	107.0	104.8	100.0	100.6
production of machinery and equipment	115.2	111.1	102.7	96.6	92.2
production of electric, electronic and optical equipment	118.9	111.9	106.4	99.0	99.5
production of vehicles and equipment	127.2	117.2	110.3	102.2	108.5
other industries	120.6	105.3	102.6	95.4	102.7

Source: Rosstat.

Compared with the average index for manufacturing industry in 2014, very rapid growth was registered in the production of food products (102.5%), oil products (105.7%) and in the production of rubber and plastic articles (107.5%). The instability of the dynamics of the machine-building and metallurgical complexes was determined by the weakening of the investment demand dynamics which had started in November 2012. In 2014 the production of machinery and equipment fell by 7.8%, and the production of electrical, electronic and optical equipment fell by 0.5% compared with the previous year. In the production of vehicles and equipment the differentiation of results by the type of production was strengthening: in 2014, in the automotive industry, the fall in production reached 12.5%, while, by contrast, production of vessels, aircraft, spacecraft and other vehicles increased by 24.0% compared with the previous year. As a result, the overall annual increase in the "production of vehicles and equipment" was 8.5% and was actually entirely due to the scaling-up of government orders.

The consumer sector of industry was also characterised by unstable development dynamics. In textile and clothing production the reduction of the output in 2014 amounted to 2.5% and in the production of leather, leather products and footwear, by 2.8%. The difficulty of the situation on the corresponding commodities markets was a result of the downtrend of production in these areas being superimposed on a decline in imports under the corresponding headings.

The dynamics of the extraction of commercial minerals in each quarter of 2014 was characterised by some acceleration. The index of extraction of fossil fuels in 2014 compared with the previous year amounted to101.0%, and in Q4 had increased to 102.4%. Compared with the previous year oil extraction in 2014 had increased by 1.3%, with an increase in processing volume by 4.9%. The fast growth of oil product production conditioned the acceleration of the increase in the rates of export of the products by 8.7% with a reduction in the volume of exported crude oil by 5.6% compared with 2013. Compared with the same year, the extraction of gas fell by 5.8% while its export fell by 12.1%.

4.1.5. Characteristics of demand and use of the workforce

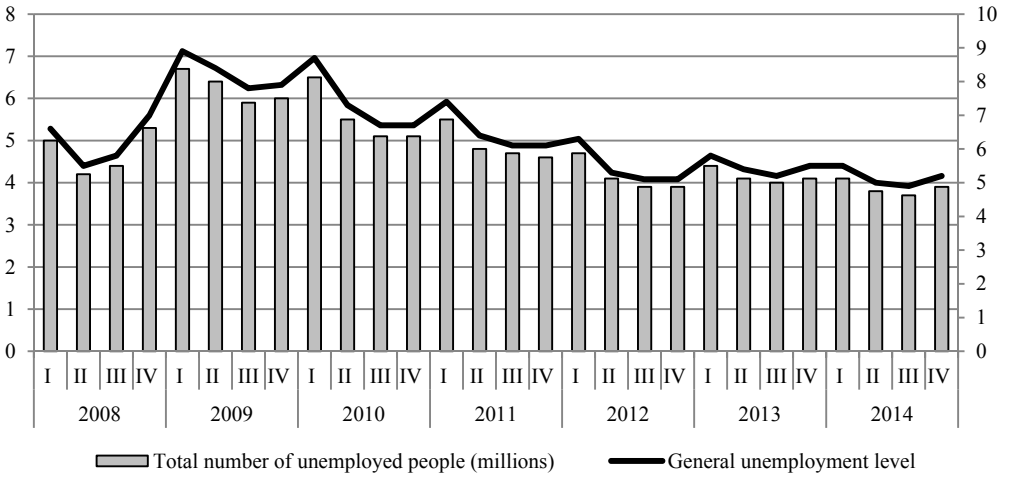
Over the past fifteen years Russian economic development has been characterised by weak growth in the level of employment, with a fairly stable trend towards an increased level of the

economic activity of the population and for a decrease in total, and registered, unemployment. We should note, that the crisis of 2008–2009 did not, itself, sharply and negatively affect the labour market, and this fact was also due to the government's complex of anti-crisis measures. In 2013 the average annual number of people engaged in the economy actually recovered to the pre-crisis level of 2008, and the overall level of unemployment fell to its minimum for the whole period of observation since 1990. However, it is worth mentioning, that the changes in the main features of the labour market in 2009–2014 were taking place against a background of a significant deceleration in the rate of economic growth, and at the same time the increased demand for labour largely reflected the inherent limitations of economic development, conditioned by a decrease in efficiency of the use of labour resources.

In 2014 the number of the economically active and employed population, on average, amounted to 75.4m, which corresponds closely to the indices for 2012. The unemployment index in 2014 remained at a level of 5.2% (using International Labor Organisation methodology), although in H2 2014 the decrease in unemployment came to a halt.

The employment services recorded that, on average, 9.1% fewer citizens were registered as unemployed in 2014 compared with in 2013. During the whole of 2014 the number of vacancies recorded by the employment services exceeded the number of registered unemployed people. However, the employers' need for staff started to decrease from 2.1m in August 2014 to 1.4m vacancies in December. The tension coefficient, calculated per 100 declared vacancies in December increased to 73.4 people, compared with 46.8 people in July 2014.

The deterioration of the economic situation predicted for 2015, will provoke an increase in unemployment and a reduction of employment on the labour market. However, the expected scale of layoffs will be less significant compared with the crisis of 2008–2009 since the restructuring of employment in recent years has resulted in a reduction of the scale of overstaffing. Furthermore, the fall in the working age population, as a demographic factor, will smooth the tension in the labour market.



Source: Rosstat.

Fig. 12. Total number of unemployed people in 2008–2014 (millions)

Since the year 2000, the average number of people in the Russian economy employed in industry and in agriculture has been decreasing, while there has been an expansion of demand for labour in trade, construction, the financial sectors and state administration, and this largely

mirrors the overall global trends in the labour market. However, during this period in Russia, the number of people, employed in the science and education sectors has begun to decrease.

In industry the number of people employed has been decreasing at the highest rate, largely due to a decrease in demand for staff in manufacturing industry, with the cautious staffing policies in the mining and energy sectors.

The structure of employment in manufacturing industry has been determined by the dynamic reduction of the number of people employed in the machine-building and consumer complexes.

The significant differentiation of the wage levels by type of economic activity has particularly influenced the changes in the structure of employment (*Table 10*).

Table 10

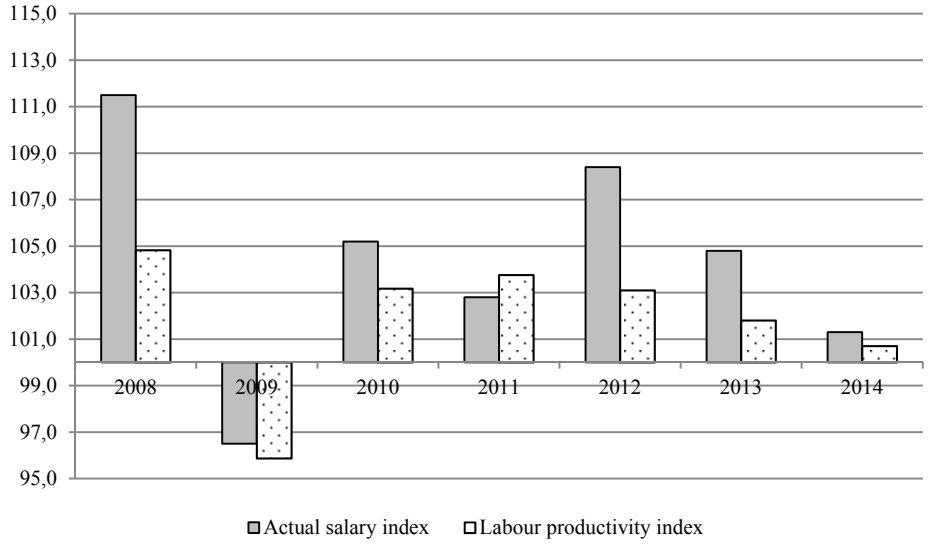
Average annual rates of change in the number of people employed in the economy, and of their nominal salaries, by type of economic activity in 2008–2014

	Average annual rates			Relation of nominal salary to the average Russian level, %		
	of the number of employed people	of nominal salary				
	2008–2013	2008–2013	2014	2008	2013	2014
Average indices throughout the economy	99.8	111.5	109.2	100	100	
Agriculture, hunting and forestry	99.1	113.2	111.4	49.0	52.8	54
Fishery, fish-breeding	99.6	110.7	111.9	112.8	108.9	111
Extraction of commercial minerals	100.6	110.3	109.2	192.1	181.8	181
Manufacturing industries	97.9	111.0	10-9.2	92.8	90.8	90.0
Production and distribution of electricity, gas and water	100.5	111.1	108.0	110.2	108.2	107
Construction	100.9	108.3	107.7	107.4	93.0	90.0
Wholesale and retail trade	100.6	109.2	109.2	86.3	77.8	79.0
Transport and communication	99.9	110.7	107.6	120.1	116.1	114
Financial activity	102.9	108.6	109.7	242.2	212.6	210.0
Operations with real estate, leasing and provision of services	102.5	109.7	111.0	123.0	113.6	116.0
State administration and provision of military security; social insurance	99.9	113.6	105.4	123.4	135.8	131.0
Education	98.6	115.7	110.3	65.5	78.7	79.0
Healthcare and provision of social services	99.4	113.4	110.9	75.5	82.0	83

Source: Rosstat.

In terms of wage levels, the leaders in the economy over the last fifteen years have remained the extractive industries, the production of oil products and the financial sector. Only in 2013 did the machine-building complex come close to the average economy index for wages and exceeded, on the whole, the salary levels across the rest of manufacturing industry. The shortfall of remuneration for workers in the scientific research and development sector has started to close. However, in the education and healthcare sectors pay levels remain below average.

Analysis of the dynamics of the Russian economy during the past 20 years shows that, with the established labour market model, the reaction of employment to sharp crises in the economy has been less significant compared with the sharp falls in actual salary. The post-crisis recovery was accompanied, as a rule, by weak growth in the demand for labour and this illustrates the general low efficiency in the use of labour. The reaction of wage levels during such periods was significantly greater.



Source: Rosstat.

Fig. 13. Indices of actual salary and labour productivity in 2008–2014 throughout the economy, % compared with the previous year

The shift of employment from the goods manufacturing sector to the services sector during the period of 2009–2014 was accompanied by an overall increase in productivity and the faster growth of real wages. The growth in demand for labour in the extraction of commercial minerals sector with a reduction in the efficiency of the workforce has resulted in an increase in overall wage costs and has limited the possibilities for increasing average monthly pay rates. With regard to the production of electricity, gas and water, as well as in the field of construction, with the weakening of growth in added value in these types of activity in 2009–2014, there was registered a decrease in labour productivity, but at the same time there has been a positive trend in the growth of real wages.

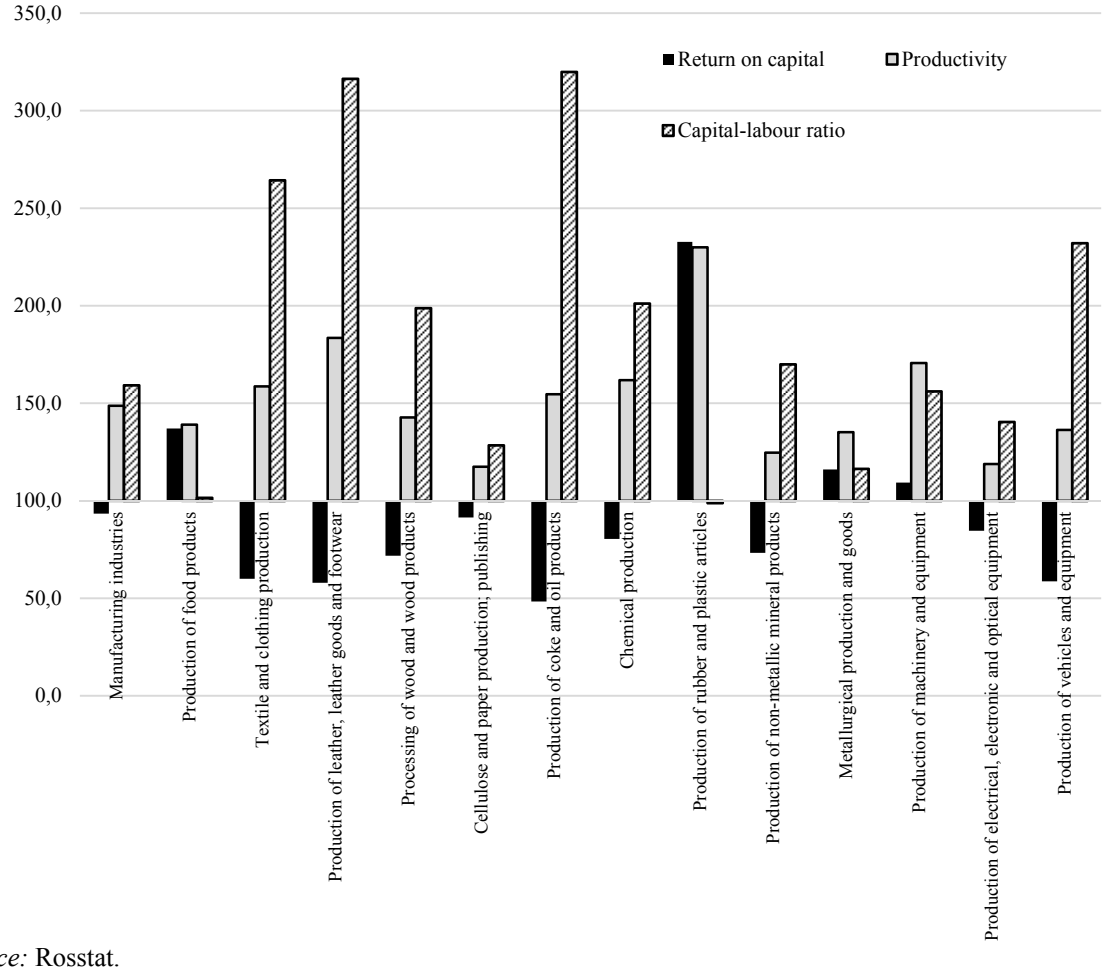
Manufacturing industry has shown a preservation of the trend towards the restructuring of employment through reducing unproductive jobs. The average annual rate of reduction of the number of employees in manufacturing industry in 2009–2014 amounted to 2.1% (during the period of 1999–2008 this index was 1.2%). As a result, labour productivity in manufacturing industry is growing at a rate twice that of the average in Russia.

From 1999–2014 a growth of production in manufacturing industry was registered across almost all types of economic activity, with fairly significant variation in the dynamics of the annual reduction in the average number of workers. We can assume, that the average salary, by type of activity, in manufacturing industry (excluding the production of oil products), is within the range of 44–117% of the average Russian level, and that this has had a significant impact on the inter-branch and inter-sectoral mobility of the workforce.

The highest rates of reduction in the number of workers are typical of such types of activity as manufacturing, textile and clothing production (pay rates here are only 44% of the average-Russian level), the processing of wood and wood products (57%), the production of rubber and plastic articles (71%), and the production of machinery and equipment (93%), together with a number of other types in which the actual wage levels remain markedly lower than the average-Russian pay rate.

With high rates of staff turnover (hiring and firing) the turnover of jobs (the elimination of old positions and the creation of new ones) – as a feature of their renewal – remains rather low. Moreover, the rate of turnover is the result mostly of the liquidation of jobs within active enterprises, rather than by their creation.

Comparison of the dynamics of product output, investment in fixed assets and the number of people employed, by type of economic activity, shows that, to provide increased labour productivity, it is those aspects related to the efficient use of basic production factors which are of paramount importance. During the period 2005–2012, with the growth of investment in fixed assets, typical of Russian industry, generally outstripping the product output dynamics, and with the trend towards a reduction of the number of staff, growth took place in the capital costs per worker. However, this did not result in adequate changes in labour productivity, and, in the end, strengthened the trend for a reduction in return per unit of capital. Thus, we can assume that irrational investment policy has led to a reduction in the efficient use of the factors of production, and that this has negatively affected the financial results of economic activity.



Source: Rosstat.

Fig. 14. Labour productivity, capital-labour ratio and return on capital in manufacturing industry in 2012, % compared with 2005

It is worth adding, that, despite the rather restrained rates of renewal of fixed assets and of the rate of introduction of new jobs, a steady trend in the restructuring of employment by level of education has appeared in the economy. The structure of the labour market is rapidly shifting towards the growing demand for a high-skilled workforce. Throughout almost all observed types of economic activity within the structure of employment one can observe an increase in the proportions of employees with higher and secondary vocational education.

Forecasts regarding the structure of the Russian workforce in relation to educational attainment in the coming decades warn of the possibility of a growing imbalance between the quality of the workforce and requirements of the jobs available, as well as the mismatch in the structure of the demand for employees in relation to the types of activity compared with their existing competencies.

4.2. The Decomposition of Russia's GDP Growth Rate in 1999–2015

Since about the mid last year, Russian expert community has been actively involved in adjusting forecast on the Russia's 2015 economic growth rates downgrading it to negative. For example, unlike the forecasts in July 2014, with growth rates within a range of around 1-2% year-on-year, currently we are talking about an economic slump. Forecasts as of March 2015 predict contraction at: 1.5% - Fitch Rating, 2.9% - World Bank, 3% - the RF Ministry of Economic Development, IMF and Citi Group, 4.8% - the RF CB and EBRD and 5.5% - Moody's. Moreover, solely forecasts made by OECD and the UN remain relatively optimistic. The OECD forecasts zero growth in Russia and the UN – stagnation and slow positive trend at 0.2%.

At present, according to the January version of the official (Ministry of Economic Development) MED's forecast,[1] the RF GDP this year will contract by 3% against last year, with an average annual price of oil being $50 per barrel. As far as production factors are concerned, they are going to see negative dynamics: labor force will contract by 0.9% (from 67.9 in 2014 to 67.4m in 2015), while investment will fall by 13.7%; and net capital outflows will come up to $115bn.

It is our opinion that the economic contraction forecast for 2015 is not too pessimistic because of the negative dynamics of the key factors having an effect on the development of GDP. These factors can be identified using the method we suggest, which is based on the method of decomposing the macroeconomic indicators into their structural, foreign trade, and cyclical (business cycle and random shocks) components which is applied in developed countries (OECD), except that it has been refined to take account of the Russian economy peculiarities. These peculiarities imply a heavy reliance on foreign trade trends approximable through the dynamics of global crude oil prices.

Following the logic of our calculations, *the first stage* in the decomposition of the GDP growth rate into its components consists in separating the structural component in accordance with the methodology practiced in the OECD countries.

The structural component of the economic growth index is the fundamental one. The most important property of the structural component is the slow movement of its value over time. In contrast to the structural component, the cyclical component, which is determined by a current situation in the market, is a rapidly changing value.

[1] http://economy.gov.ru/minec/activity/sections/macro/prognoz

One of the most frequently cited examples of extraction of the structural component of the macroeconomic index is the estimate that describes the potential (structural) GDP index (as well as the output gap) which, in accordance with one of the existing definitions of potential GDP, represents the maximum output level achieved when all production factors are used in full and the capacity load is at its normal level (60–65%). It should be noted that, in the framework of our decomposition methodology, the terms 'structural' and 'potential' will be applied as synonyms, with due regard for the existence of different interpretations of the notion of potential GDP.

In order to estimate the aggregate factor productivity index, the potential (structural) GDP, and the output gap, the OECD Economics Department applies the production function methodology,[1] whereby it is possible to derive the potential GDP value by separately estimating the inputs of production factors into the rate of economic growth. This method applies the following log linear equation, where GDP is estimated on the basis of labor input, capital input and aggregate factor productivity (AFP) values (1):[2]

$$\Delta \ln(Y_t) = \Delta \ln(E_t) + \alpha \Delta \ln(K_t) + (1-\alpha)\Delta \ln(L_t), \quad (1)$$

where Y – is actual GDP volume
K – is actual capital volume,
L – is actual labor volume,
E – is AFP,
α – is elasticity of capital input in output; the value of returns to scale effect is assumed to be constant, i.e. $\alpha = 0.3$, and $1 - \alpha = 0.7$.[3]

Once the average estimated labor and capital inputs in GDP are found (the coefficients applied to logarithms of the variables of labor and capital inputs), the value of aggregate factor productivity can be found; its smoothed-curve representation is obtained by applying the *Hodrick–Prescott filter*, which demonstrates 'trend' or 'potential' factor productivity. Then the resulting value is once again entered in the production function equation alongside the values of actual capital reserves and the estimated 'potential' labor volume (based on the already known non-accelerating rate of unemployment (NAIRU)), and the resulting GDP growth rate is taken to be the potential GDP.

The Hodrick–Prescott filter was applied to the structural component of the GDP growth rate obtained by applying the method described above in order to remove the fluctuations that are difficult to explain in economic terms.

The second stage of Russia's GDP growth rate decomposition consists in separating its foreign trade component explainable by specific trade conditions, in particular the movement of world oil prices.

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[1] Giorno C., Richardson P., Roseveare D. and van der Noord P. *Estimating Potential Output, Output Gaps and Structural Budget Balances // Economics Department Working Papers.* 1995. No. 152. OECD.

[2] For the purpose of our calculation, this function is expressed as *logarithmic increments*, i.e., growth rates.

[3] In our calculations, we apply the empirically obtained estimates of labor input elasticity and capital input elasticity for the developed countries, which are also compatible with Russia's statistics (for further detail, see Bessonov V. A. *O dinamike sovokupnoi faktornoi proizvoditel'nosto v Rossiiskoi perekhodnoi ekonomike* [On the Aggregate Factor Productivity Movement in the Russian Economy in Transition]. *Ekonomicheskii zhurnal VShE* [The Economics Journal of the National Research University Higher School of Economic]. 2004. No 4, pp. 542–587).

The theoretic substantiation for the hypothesis that explains the influence of the oil price growth rate and the price level on the growth rate of GDP relies on the mechanism whereby oil prices influence the rate of economic growth in the long run (cointegration ratio) and over short-term periods (error correction model)[1]; and on the analysis of household behavior in terms of changes in their inclination to save and to consume in response to temporary and constant increases in the level of household income (microeconomic level).

The dependence of the level of GDP on the movement of oil prices can be described by an investment mechanism within the framework of the Solow model, which works as follows: an improvement in trade conditions causes a transfer of income, which is subsequently invested, in its turn increasing the amount of capital and pushing up GDP. Thus, in a long run, a dependence can be observed between the levels of GDP and oil prices (or, which is the same thing, between the growth rate of GDP and the growth rate of oil prices). At the same time, over the entire period under consideration, we observe a rising level of world prices for oil and the transitional movement between different phases of economic development, with their specifically different rates of GDP growth. In other words, we follow the correlation between the level of world prices for oil and the growth rate of GDP (and not GDP level), which can be estimated by using cointegration ratios and the error correction model.[2]

The strength of this dependence can be further enhanced by the effects of the mechanism of economic agents' response to changes in the level of income received by them. The logic of analysis of the effects of temporary and constant income increases corresponds to the permanent income hypothesis suggested by M. Friedman in 1957.[3] In case of an unexpected income increase, an individual considers it to be only a temporary phenomenon, and so a considerable portion of the income increment is saved instead of being spent on current consumption. If later on the income remains high, the individual adapts (get used) to this higher income level and begins to consume more, while the saving norm is reduced. Consequently, the inclination to consume is low if the increase in income is temporary. When this principle is applied to our mechanism of response to income movement, it means that economic agents, while adapting to new levels of oil prices, do not believe that this higher level of oil prices will stay over a long-term period (or become permanent)[4].

In our model, the logic employed in estimating the consequences of changes in the level of oil prices is analyzed in relative terms; in other words, the important factor is the starting oil price level before the onset of its growth/decline - that is, returns to scale related to the movement of oil prices. Thus, in order to identify the foreign trade component within the rate of GDP growth dependent on the deviation of the actual price of oil from its multiyear average estimate (i.e. trade conditions), it is feasible to estimate the interdependence between the

[1] For more detail, see *Kazakova* M.*,* Sinelnikov-Murylev S. *Kon"iunktura mirovogo rynka energonositelei i tempy ekonomicheskogo rosta v Rossii* [Economic Situation on the World Energy Carriers Market and Rates of Economic Growth in Russia]. *Ekonomicheskaia politika* [Economic Policy]. 2009. No 5, pp. 118–135.

[2] *Kzakova M.V.* Vklad neftegazovogo sektora v dinamiku *ekonomicheskikh pokazatelei v Rossii* i v mirovoi praktike [Input of the Oil and Gas Sector in the Movement of Economic Indexes in Russia and in the World Practices] // *Rossiiskii vneshneekonomicheskii vestnik* [Russian Foreign Trade Herald]. 2009. No 8, pp. 66–72.

[3] Friedman, M. A *Theory of the Consumption Function.* Princeton. NJ: Princeton University Press, 1957. Ch. 2, 3.

[4] For more detail, see Sinelnikov-Murylev S.*, Drobyshevsky S., Kazakova M. Dekompozistiia tempov rosta VVP Rossii v 1999–2014 godakh* [Decomposition of Russian GDP Growth Rates in 1999-2014] // *Ekonomicheskaia politika* [Economic Policy]. 2014. No 5, pp. 7–37.

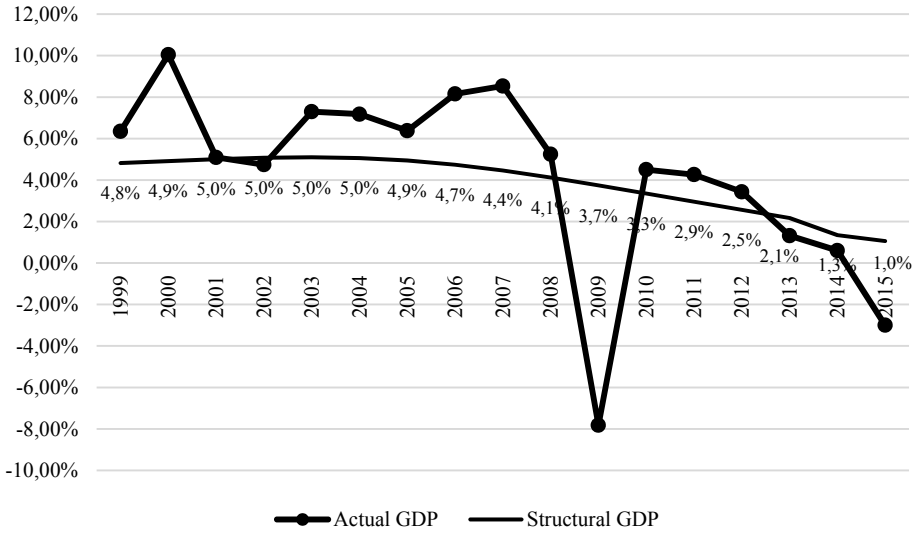
'residual values' after subtraction from the value of actual structural GDP growth (GDP growth unexplainable by the movement:

$$\Delta Y_t^{resid} = \gamma_0 + \gamma_1 \frac{P\_oil_t}{\overline{P\_oil_t}} + \tau_t. \quad (2)$$

The estimation derived from equation (2) makes it possible to identify the GDP growth component dependent on trade conditions, with due regard for the scale of deviation of the actual price of oil from its multiyear average. The foreign trade component of GDP growth rate, explainable by favorable trade conditions, is estimated by the theoretic significance of the relevant variable applied in the regression described above (2) (i.e., the theoretic significance of the difference between the actual and structural GDP growth rates at a given actual ratio of the current oil price to its multiyear average).

At the *last stage* of the decomposition of GDP growth rate into its components, its cyclical component is separated, which incorporates the business-cycle component and random shocks. This component can be interpreted as the residuals from equation (2) obtained after subtraction of the structural and foreign trade components from the actual GDP growth rate.

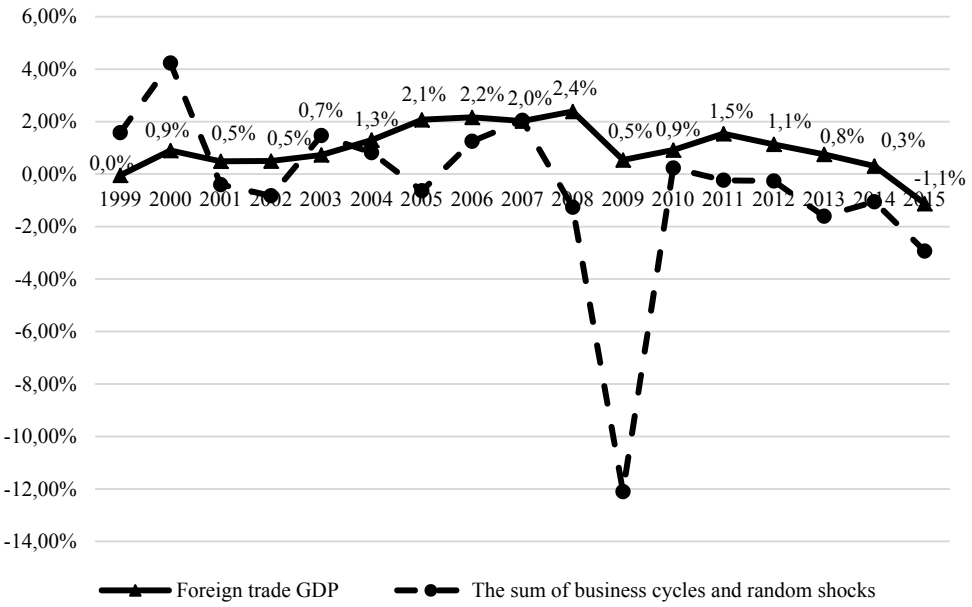
As a result, the actual, structural and foreign trade components of Russia's GDP growth rate, as well as its cyclical component (i.e. the sum of the business-cycle component plus random component) - the calculated residuals of regression (2)), will appear to be as follows *Fig. 15* and *16*. These components of the GDP growth rates were estimated by us parting from the first Federal State Statistics Service (Rosstat) estimates of Russia's economic growth rates and the IMF assessment of the world oil price in 2014. Moreover, in our calculations we used the official MED forecast according to which Russia was facing a 3% slump vis-à-vis previous year at the average annual oil price of $50 per barrel.



Source: Rosstat, MED, own calculations.

Fig. 15. The Actual and Structural GDP Growth Rates, as a percentage to the previous year, 1999–2014, 2015 forecast

According to our estimates, over last 10 years structural component in Russia's economic growth rate contracted (about from 5% to 1.3%, see *Fig. 15*) and in 2015 will also decline (to 1%). It should not be surprising: as was mentioned above, labor and investments are contracting, money does not go to the economy, and, on the contrary, leave it.



Source: Rosstat, MED, IMF, own calculations.

Fig. 16. Foreign trade and cyclical growth rates of GDP, % to the previous year, 1999–2014, and 2015 – forecast

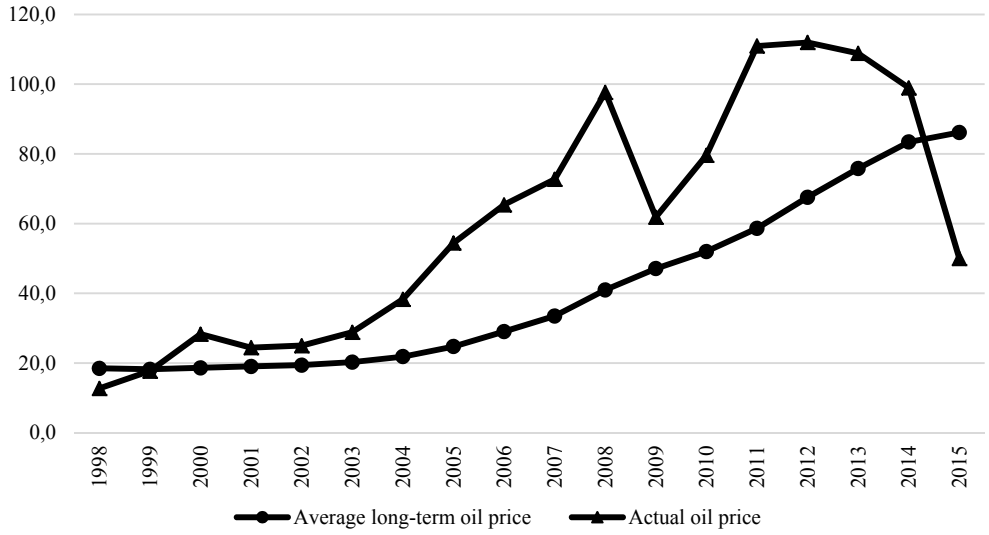
Regarding foreign trade component, commencing sustainable oil price growth this component also went up. Moreover, if in 2000 the foreign trade component was less than 1 percent, than in 2008 it reached its maximum for the whole period of 2000-2008 to about 2.4% with the oil price at 98dol/barrel (also maximum for given period). It should be noted that due to favorable terms of trade the Russian economy got out of the 2008-2009 crisis with minimum losses than it could have been under unfavorable terms of trade (note that in 2009 oil price dropped to $62 per barrel for a short-term period and already in 2010 oil prices reached $80 per barrel).

The period 2008-2014 was characterised by overheating of the economy (early 2008), and then the global economic crisis (second half of 2008-2009) and a subsequent new phase of the business cycle of the Russian economy. In these years a gradual decrease in the structural and foreign trade components of the growth can be observed due to the slowdown in the growth of the fundamental factors and decreased demand for Russian exports, the key items of which are raw materials.

Over 2010-2012 favorable terms of trade allowed the Russian economy to preserve positive growth rates at 3-4% with oil price above $110 per barrel. However, already in 2013 GDP growth rates contracted to 1.3% and in 2014, according to the latest Rosstat data, constituted only 0.6%. It should be noted that average annual price of oil were high and constituted nearly $99 per barrel. The sharp drop of oil prices happen in the end of the year. Low GDP growth rates with favorable terms of trade are explained by the fact that the economy gets

adapted to high prices (and consequently to high export revenues) and with time invest less and spend more on current consumption by analogy with an individual within permanent-income hypothesis described above. Moreover, the scale of oil price change is important: when we speak about the growth from $38per barrel in 2004 to $54 per barrel in 2005, transfer of 'oil' revenues to the economy turns out to be more than in case of price growth from $110 per barrel to $112 per barrel in 2011-2012. Thus, with time importance of oil prices in the economic growth rates decline and in the long-term practically comes to zero.

The negative foreign trade component of Russia's GDP growth rates in 2015 (–1.1%) can be explained by the logic of our method of decomposition: the worsening of the terms of trade (a fall in crude oil prices to $50 per barrel) makes the actual price fall below the long-time average annual ($86 per barrel) (see *Fig. 17*).



Source: IMF, own calculations.

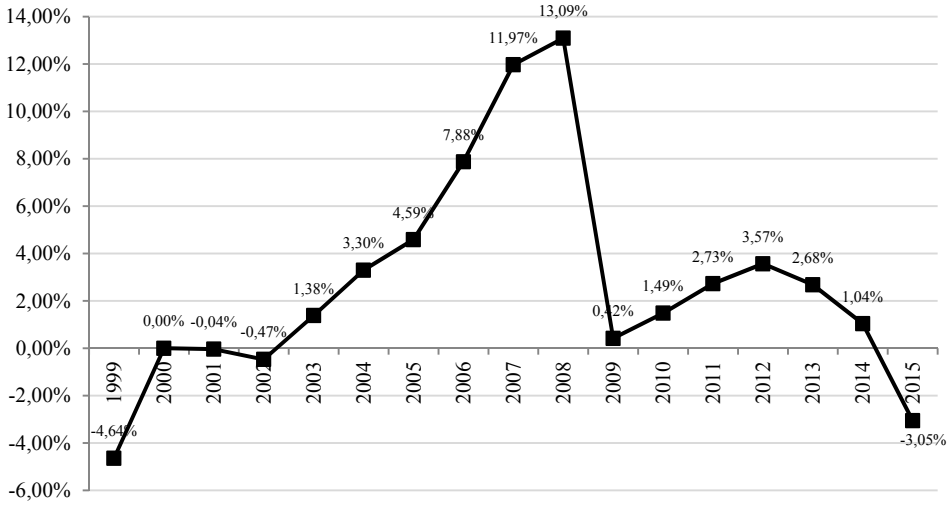
Puc. 17. Actual and average long-term price of Brent, $ per barrel, 1999–2014, 2015 forecast.

Whereas in 2012–2014, the Russian economy entered the lower phase of the economic cycle after overheating and, consequently, cyclical component shifted into negative area (see *Fig. 16)*. The aggregate rate of economic growth is close to zero, because the negative value of the cyclical component is compensated by the positive foreign trade component.

The cyclical component of the economic growth remains negative in 2015, besides it contracts vis-à-vis 2014 which allows us to draw a conclusion about strengthening of the cyclical recession in the Russian economy in the current year.

The decomposition of the GDP growth rate into its components has allowed us to estimate Russia's GDP output gap, that is the deviation of the current GDP from that obtained on the basis of the above method of determining structural GDP, which, as shown, in certain conditions can be considered as the potential GDP (*Fig. 18).*

As can be seen on *Fig. 16* and *18*, in 2012–2015 Russian economy moved to the low cycle phase after overheating, and consequently cyclical component turned negative. Aggregate economic growth rates were close to zero because the negative cyclical component is compensated by a positive foreign trade one.



Source: authors' calculations.

Fig. 18. The output Gap in the Russian Economy (%), 1999–2014, 2015 forecast.

Between 2010 and 2014, the gap in the output is a positive one and constitutes about 2-3% due to the fact that the level of real GDP exceeds a structural one. Nevertheless, there was no economic overheating because the real GDP growth rates were less than the structural GDP growth rates: under high oil prices, production factors are used to 100% and there is no growth of their volume

In 2015, the output gap resulting from the decomposition of Russia's GDP growth rates appears to be negative (see *Fig. 16*), being indicative of the fact that there is no economic growth factors for the time being.

Based on our estimates, the Russian economy in 2014 got closer to its *production possibility frontier* (in other words, the actual growth rate of GDP was near to its potential value). Under the circumstances, stimulating fiscal and monetary policies are inefficient. However, with a negative gap in 2015, the actual output appeared to be less than the potential one, in which case, stimulating monetary and fiscal policies would have a positive effect on the economy in terms of higher economic growth rates.[1] At the same time, it is worthwhile noting that this effect should not be expected to last long. The support to import substitution and the manipulation with interest rates or the ruble's exchange rate can indeed have some impact on GDP growth rates, but within a very short period of time, because the foregoing factors are not essential for economic growth.

According to the Gaidar Institute estimates, in order to achieve potentially feasible growth rates which approximately equal average world growth rates (about 3%), Russia needs to annually over 3 years increase its workforce by 1 m people, investments in main capital should grow by 3.4% (in other words, $200-300 bn for 3 years). Instead, over last several year investments do not grow (for example, 2013 demonstrated a slump by 0.2% against 2012, and

[1] A more detailed description of the method of decomposing Russia's GDP growth rates and the interpretation of the results we obtained can be found[1].in the article written by *Sinelnikov-Murylev S.,Drobyshevskiy S., Kazakova M. The decomposition of Russia's GDP growth rates in 1999—2014. Ekonomicheskaya Politika. 2014. No. 5. pp. 7–37, and* http://iep.ru/ru/publikatcii/7125/publication.html

in 2014 by 2.5% against 2013. As for 2015, the official forecast reports a slump, as was mentioned before, by 13.7%). The number of employed in the economy does not growth either over recent years (this number comes to about 68 m people). Forecast for 2015 posts its reduction and consequently growth of unemployment.

Currently unfavorable terms of trade are coupled with acute geopolitical situation, including sanctions and countersanctions. Nevertheless, to our mind, current slowdown of Russian economy is, first of all, explained by structural factors: contraction of labor force and investments. In these circumstances, according to a classical economic growth model, the only source of growth lies in the growth of total factor productivity (in other words, efficiency of available factors) which is not feasible in the near future. In view of this, measures aimed at increasing the efficiency of production functions usage should, first of all, include quality upgrade of institutions and business environment, including clamp down on the corruption, reform of the judicial and law enforcement systems, reduction of barriers and market monopolization, quality reform of the social safety net (including education, health care and pension systems which, in turn, contribute to the increase in the quality of human capital as a new factor in economic growth). These measures lay the foundation for the implementation of structural reforms aimed at the diversification of the economy and, as a result, at moving to a new path of long-term economic growth and advance in living standards.

4.3. Russian industrial enterprises in 2014. (analysis on the basis of surveys)

This section was prepared on the basis of the business surveys of industrial enterprise managers, carried out on a monthly basis from September 1992 by the E. T. Gaidar Institute for Economic Policy (the "IEP") in accordance with the European harmonized methodology, and covering the whole territory of the Russian Federation. The panel includes nearly 1,000 enterprises, with a combined workforce exceeding 13% of the workers, employed in industry. The panel is biased towards large enterprises in each of the defined sub-sectors. The typical rate of return of questionnaires is 70–75%.

The business survey questionnaire contains a very small number of questions (not more than 15–20). The questions are qualitative, not quantitative. The simple structure of the questions and answers allows respondents to fill in the questionnaires quickly and without using any other documentation. It is crucially important that the respondent for each enterprise is a manager at the highest level, having a complete picture of the overall situation within the company and directly linked to the management of the enterprise.

During the analysis of the business survey results a specific derived index, called the 'balance', is used. Balances are calculated as the difference between the percentage of those who answered "will increase" (or "above the norm") and the percentage of those who answered "will decrease" (or "below the norm"). The difference thus obtained allows us to represent the distribution of answers to each question as a single digit with either a '+' or '–' sign.

The balance is interpreted as the first derivative or speed of a certain process. If the balance of the answers related to any expected change in prices has a '+' sign, it means that the average prices will increase in the nearest future (in other words, the number of enterprises, which have returned information about the projected growth of their prices, prevails). For instance, a monthly increase of the balance from +10 to +17% indicates that the average industry prices will increase more intensively, since the number of enterprises forecasting their growth, has increased. A negative balance would mean a decrease in average prices (a larger number of

enterprises planning deliberately to decrease their prices). A change of the balance from -5 to -12% would be interpreted as an increase in the intensity of price reductions.

4.3.1. Dynamics of the main indices of Russian industry

The year just ended, 2014, did not become a turning-point for the crisis in Russian industry. The industry remained relatively stable during this period which had been difficult, both for Russian society and for the Russian economy. Moreover, the IEP industrial optimism index[1] showed that in the second half of the year companies felt more confident than they did at the beginning of the year (*Fig. 19*). Furthermore, even during the last two months, the managers of those enterprises remained optimistic, despite the shock behaviour of the currency and credit markets, while there was also heightened public anti-crisis rhetoric from the government.

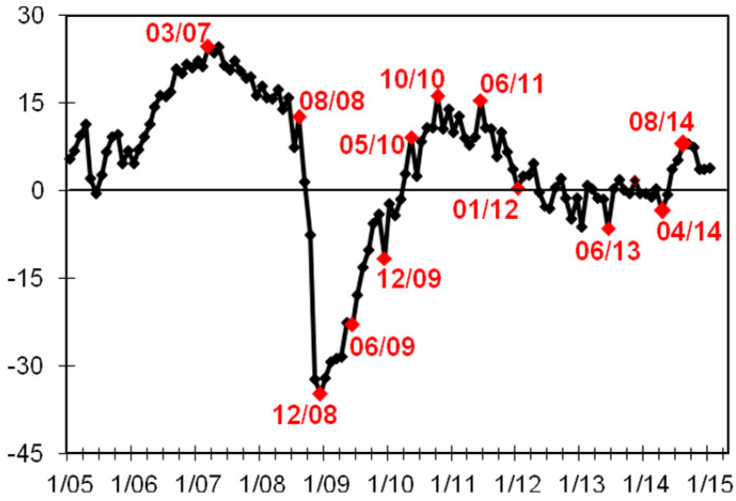


Fig. 19. The IEP industrial optimism index, 2005–2015

The beginning of 2014 turned out to be fairly comfortable for Russian industry. The positive dynamics of demand provided support for output without an increased redundancy in the stocks of finished products. The typical start-of-year decrease in demand for industrial products was lower than usual. In January, measured on the basis of the initial data, the dynamics of production output, following the demand, showed not such a strong decrease compared with that of previous years. After clearing the data of seasonality, on balance, the changes in output in January even became positive.

[1] The index is based on the arithmetic mean value of balances (different answers) of four questions from the IEP's monthly business questionnaire:
1. Actual change in demand, balance = % growth – % decrease.
2. Evaluation of demand, the difference of evaluations = % above the norm + % norm – % below the norm.
3. Evaluation of the stocks of finished products, balance = % above the norm – % below the norm, the opposite sign.
4. Plans to change output, balance = % growth – % decrease.

The balances of the 1st and 4th questions are cleared of seasonal and calendar factors. The index may vary from –100 points to +100 points. Positive values of the index mean that positive evaluations prevail. Negative values of the index mean that negative evaluations prevail. A decrease in the value of the index means a worsening of the situation, while growth in the value of the index means an improvement in the situation.

However, pessimistic forecasts of the demand, output, prices and investment indicated that the enterprises were uncertain of early and steady industrial growth. The demand and output forecasts did not manage to reach the usual beginning-of-year positive level. Therefore investment plans remained at the post-crisis minimum level which was established as early as August 2013.

Indeed, the following months showed that the recovery of the operational mode of Russian industry in the beginning of 2014 was carried out with difficulty and this did not bode well for the formation of new positive trends. The more intense than usual decline in demand caused a deceleration of output, while retaining normal levels of surplus stocks of finished products. As a result, the evaluations of unsatisfactory current demand continued to prevail. But such a predominance was relatively small, stable and, on the whole, better than in the previous year. Companies were therefore not inclined to give sharply negative assessments of the situation at the beginning of 2014.

However, at that time the enterprises could only increase their prices with extreme caution, and forecast only modest growth for the future (*Fig. 20*). The growth of the actual prices in January and February 2014 turned out to be the most moderate within the period of 2009–2014, with the natural exception of the beginning of 2011, when an increase in insurance premium rates pushed companies into the most rapid rate of increase in prices at the beginning of a year in the period since 1995 (!). According to detailed analysis, almost all of the momentum of the price increases at the beginning of 2014 fell on government enterprises.

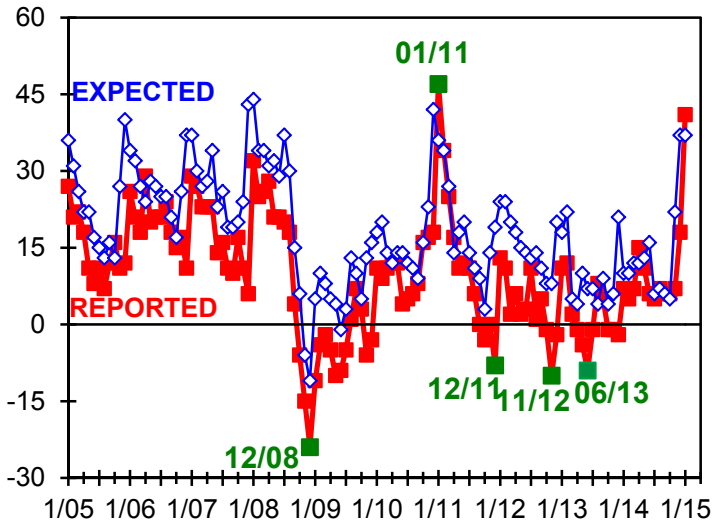


Fig. 20. Changes in selling prices (balance = %growth - %decrease)

The situation is similar with regard to price forecasts. The spike in this index was registered by the surveys only in December 2013, after which the projected price growth rate returned to the band it had occupied in March-November 2013. In previous years the enterprises retained high price forecasts during the first two to three months of each year. The government sector of Russian industry retained its leadership with regard to the price expectations of January-February 2014.

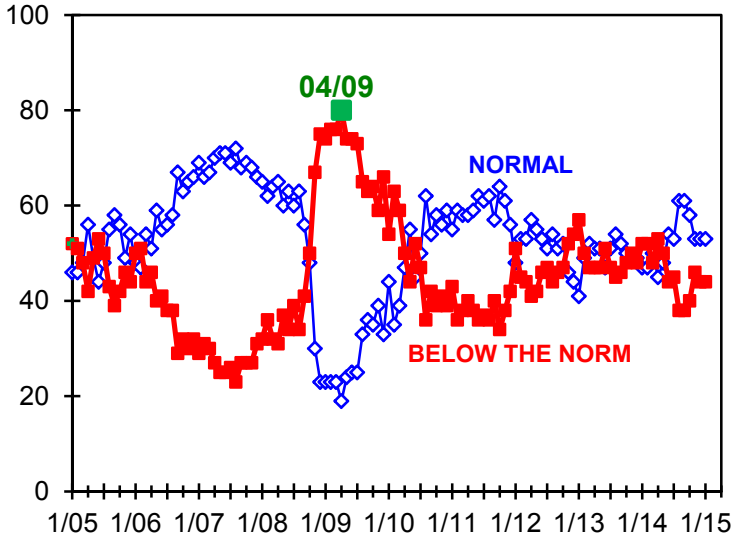


Fig. 21. Dynamics of the main evaluations of solvent demand

The end of Q1 did not demonstrate any fundamental changes in comparison with the first months in respect of demand, output, employment or the investment dynamics of Russian industry. The recovery of demand, which finally started, received adequate evaluation on the part of companies with, for the first time in 2014, the proportion of "normal" evaluations exceeding (although minimally) the "below the norm" evaluations *(Fig. 21)*. Industry demonstrated once again its high adaptive capacity under the conditions of the current complex situation and uncertainty, which has increased due to the Ukrainian crisis. The modest volumes of surplus stocks of finished products confirm this point of view (*Fig. 22*). Nevertheless, it is completely understandable that the enterprises have decided to continue their investment pause. The balance of investment intentions remained in the negative zone, i. e. the answers in respect of planned decreases prevailed over those on possible investment growth. However, the actual deceleration of investment and the pessimism of their plans were perceived as quite normal by the majority of Russian industrial enterprises under the conditions of protracted stagnation and the total absence of observable prospects of any exit from such a situation. Only 37% of them considered the volumes of their actual investments in Q1 2014 to be "below the norm".

In March the prices set by the enterprises started to give in to inflationary pressure. Industry was forced to maintain a relatively high price growth rate, although during the last two years the balance by the end of Q1 had already lost its high January rate and tended towards zero. In 2014, under the conditions of pressure on the ruble exchange rate and the strengthening of inflationary processes, companies were forced to change their price policies even to the detriment of sales. Increases in costs to companies also influenced their changes in pricing policy. According to the surveys, the rate of growth in production costs increased in late 2013- early 2014 and reached its highest level since the beginning of 2011.

The terms of lending to the industry, despite the efforts made by the Central Bank of the Russian Federation, in Q1 2014 did not undergo any visible changes. According to the assessments made by the enterprises, the summary credit availability remained at a level of 70%, still within the band in which it had been resting for the previous 4 (four!) years. Neither

was there a change in the average minimum ruble credit rate, offered by banks. It amounted to 12.5% per annum, remaining unchanged for the fourth consecutive month.

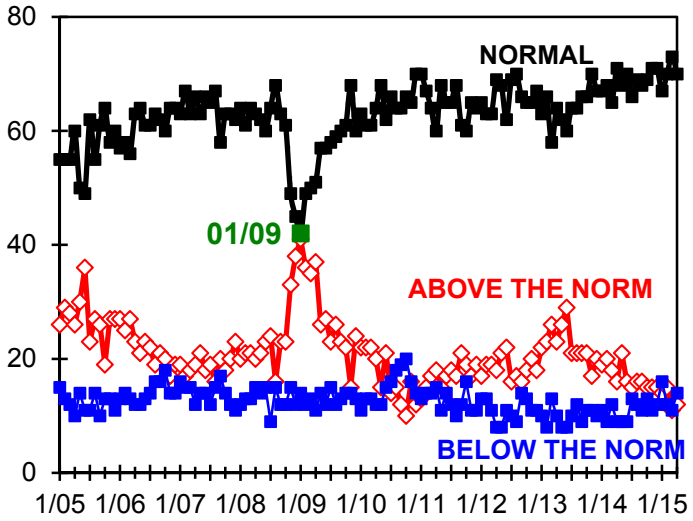


Fig. 22. Dynamic estimates of stocks of finished products, %

The beginning of Q2 turned out to be a difficult period for the industry. The actual changes in demand and output had negative dynamics, and their forecasts did not promise any improvement in the situation. The initial data showed an absolute growth in demand in March, but it was extremely weak. According to the enterprises' evaluations, by April 2014, the Ukrainian crisis had had a heavy impact, particularly on the sales of Russian products on Ukrainian markets. All other consequences of these events are significantly behind the decrease in demand on the part of the Ukrainian consumers in terms of scale. Under these conditions, the expectations of the enterprises for future changes in demand (according to the initial data) had dropped almost to zero, although during the previous post-crisis years the April levels had remained at +10 to +17 points. Exclusion of seasonality reduced the index to the post-crisis minimum (-4 points), which had previously only been registered in the middle 2012. Neither have further production dynamics made the enterprises optimistic. During March and April the initial balance of output plans lost 30 points; cleared of seasonality, minus 6 points, and dropped to an eighteen month minimum. At the same time, industry had been forced into more intensive price growth, which was hardly likely to contribute to the stimulation of demand.

However, in May the situation improved for Russian industry. The initial data on demand did not show the traditional holiday decrease in sales compared with April (as had happened in 2013). As a result, exclusion of seasonality indicated an improvement in the demand dynamics. This situation became more promising to a slightly larger proportion of enterprises than previously: the share of the “normal” answers increased to 50% when evaluating the demand, equaling the “below the norm” percentage of answers. Similarly, production output in May 2014 did not undergo the decline typical for this month. The initial data showed that it remained at the April level, and the data, cleared of seasonality, indicated a growth in intensity, rare in the two previous years. It appears that, in May industry neither felt the recession predicted for it, nor the effects of sanctions, promised by our Western 'partners'. In fact, the

events in Ukraine tended to favour Russian industry output, both as a result of the objective departure of the Ukrainian competitors from the sales, raw materials and materials markets, and by the subjective growth of military and political patriotism under the new geopolitical conditions. A growth of optimism was also registered in the enterprise forecasts in May. As a result, all the previous losses shown by this index in March and April were won back, and the balance of the output plans returned to the normal level of expectation – which, though moderate when compared to the standards of the pre-crisis and first post-crisis years, was still very decent considering the wide-spread expectations of recession.

Business investment intentions in May improved slightly and reached -5 points. That is, plans to decrease investments still prevailed over intentions for expansion, although this predominance decreased month on month. During the first 5 months of 2014, the balance of investment intentions (*Fig. 25*) grew by 9 points after its failure, in the summer of the previous year, when it had dropped by 16 points. The industry, thus, was constantly getting rid of its investment pessimism. At the same time, the Ukrainian crisis did not have any adverse impact on the investment plans of Russian industry: only 1% of the respondents in Q2 indicated any decrease in their investments (plans) under the influence of these events.

However, the end of the first half of 2014 turned out to be unsuccessful for Russian industry. In June the actual dynamics of the majority of industry indices showed a return to the previous, less promising pathways. The June demand dynamics preserved those of May with demand changing towards a negative balance. But, while for the 'holiday' month of May this had actually appeared to be an encouraging result, for more or less normal-working June this kind of dynamic was evaluated as a deterioration of the situation when using formal clearance methods. The intensity of the drop in demand returned to that of the previous, February-April levels. However, evaluations of the June sales volumes demonstrated a growth in satisfaction with the current demand among enterprises. The proportion of the “normal” answers increased by 5 points and reached 53%, becoming the ten-month maximum of this index. Industry, thus, gave a positive assessment of the sales dynamics by the end of Q2. The rates of both output and growth in demand during June remained at the previous level of May. However, the difference in the number of working days also resulted in a decrease in the index, cleared of seasonality, by 5 points, but it still remained in the positive zone. So, output growth in June was sustained, although with lesser intensity.

According to the business evaluations bank lending terms in Q2 2014 underwent changes, both in respect of the offers and of the ability of the enterprises to service them. However they were so minor that they did not go outside the bands in which they had remained for the previous four years. In June, the average minimum rate, offered by the banks dropped to 12.6% after having reached its twelve-month maximum of 12.7% in May. Note that in February 2014 a twenty-two-month minimum of this index was registered, at 12.3%. The absolute minimum of the post-crisis monitoring of the bank rate was recorded by the enterprises in October 2011, at 11.8% per annum in rubles. On the whole, the availability of credit (taking into account all lending terms) in Q2 2014 was acceptable to 67% of the industrial enterprises. This was 3 points worse than the result for Q1, but still it did not move outside the band in which this index had remained for 4 consecutive years.

Since the end of 2013, the industry has continued to have sufficient capacity to service its current loans, and was equal to 82% of the enterprises, which had taken loans. The industry's maximum capacity to pay its debts was registered on the basis of the surveys in Q3 2013 and was equal to 87%. Note that this index has not fallen below 80% since Q2 2010.

Early in the H2 2014 the surveys showed obvious positive changes in most of the industry indices. The improvement of the dynamics of demand and estimates of the stocks of finished products caused active growth in industrial production. The initial growth rate increased by 14 points (cleared of seasonality, by 10 points) and reached its three-year maximum. The production plans of the enterprises also looked optimistic. Over three consecutive months the initial balances (increase-decrease) of the index remained constant, with a very high level of optimism: a three year maximum when cleared of seasonality. Industry, thus, not only ventured to grow its output in July, but also retained its 'appetite for risk' over the following months.

The positive dynamics of the actual output and industry plans were maintained at the beginning of H2 by fundamental changes in the structure of the limitations on industrial growth (*Fig. 23*). The July demand recorded a sharp reduction of the limitations on the demand side – domestic demand held back output growth of only 48% businesses, while in Q2 2014 this factor stood at 58%. The minimum mention of domestic demand after the 2008–2009 crisis was registered at the end of 2010 and amounted to 45%. The negative impact of competing imports was recognised in the middle of the year by 26% of the enterprises and was sustained for the second consecutive quarter at this lowered level due to the exchange rate policy carried out by the Central Bank of the Russian Federation. Correspondingly, at the end of 2013, industry reported that it had reached the historical maximum (34%) of the negative impact of imports on the output dynamics (since 1995!). Pre-default local maximum (1998) had amounted to 16%, while the pre-crisis maximum (of 2008–2009) was 31%.

There were fewer limitations of demand on the supply side. The most interesting result of July 2014 was the decrease to 29% in references to the "uncertainty of the current economic situation and its prospects", compared with 34% in April. It looks as if the negative impact of the Ukrainian crisis and the loud announcements of Western sanctions were more than successfully countered by the response measures (rhetoric) of the Russian Government. A lack of equipment (production capacity) was subsequently mentioned less and less often, which obviously contradicted the conclusions drawn by some experts on the "overheating" of Russian industry (the economy), allegedly, at that time, working at the limit of its production capacity. In the summer of 2014 Russian industry suffered more strongly (on a greater scale) from a lack of staff, than from a lack of production capacity. At least one third of businesses lacked sufficient workforce, to increase their output growth. In fact such a situation was being registered by the surveys for the previous eighteen months despite the soothing official statistics regarding the low level of unemployment. This last circumstance brings with it substantial problems for businesses.

In August 2014 a strengthening of the positive trends in Russian industry took place. The actual changes in demand retained their positive dynamics, and as a result, the reached sales volumes were particularly appreciated by manufacturers, allowing them to preserve the growth in output. The dynamics of demand and its forecasts definitely and positively influenced the assessments of the stocks of finished products. The demand balance index improved in August by three more points, with the positive changes during the summer months amounting to 12 points. As a result, the estimates of demand reached the top of the forty-month indices. Another advantage was the strengthening of the positive investment plans of industry. The balance of this index, starting from June, was positive (after a twelve-month negative period) and reached +7 points. Against the background of the positive dynamics of demand, output and the assessment of the stocks of finished products such a build-up of investment

optimism looked natural, but was not realised in official statistical reporting and was not reflected in official forecasts.

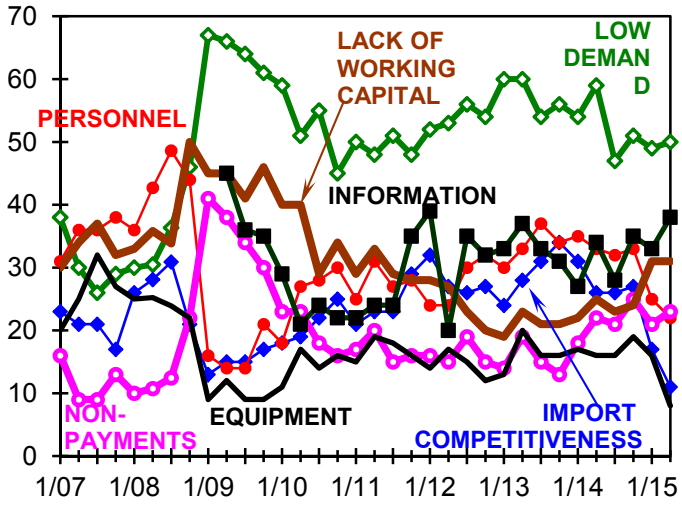


Fig. 23. Limitations of industrial growth, 2007–2015, %

The only negative trend in August was an increase in lending rates offered by the banks, by 0.5 percentage points. However, at the time this did not impact on the evaluation of credit availability by businesses.

At the end of Q3 the majority of the indices of Russian industry had remained at their previous levels. Stable demand dynamics allowed the maintenance of the previous output growth rates given the unchanged evaluations of stocks of finished products and the steady price policies of manufacturers. The moderation of price growth was also explained as a result of the success of enterprises in lowering costs. In the Q3 2014, according to evaluations by the manufacturers, the rate of growth of product costs fell to +12 points after reaching +33 points at the end of 2013, a record for the previous two and a half years. The forecasts of changes in the costs, received in 2014, suggested a further lowering of this index. In Q3 the forecasts fell to a post-default minimum. In other words, Russian industry had never planned such a moderate growth of product costs, as occurred in the second half of 2014, since July of 1998.

The demand forecasts in Q3 continued to gain in optimism, which in September reached a sixteen-month maximum. The same situation existed in respect of business output plans. Since May they had been approximately constant at a very optimistic, level, although, after a January-February rise the optimism of these evaluations is typically expected to vanish gradually and, by October-December to move into the negative zone (i. e. expectations of a decrease in output start to prevail over plans for output growth). Once cleared of seasonality the September 2014 figures showed that the optimism of the output plans had reached a three-year maximum.

It was only the terms of providing loans to the industry that upset the optimism of the Q3 evaluations. In September the industrial enterprises began to feel the deterioration in the lending terms that had been projected by the experts for a long time. Firstly, the summary credit availability fell to a four and a half year minimum and satisfaction with the proposed lending terms fell to 61%. During the previous four and a half years this index had not gone below 65%. Secondly, the average minimum rate on credits offered by the banks, exceeded 13%, a

situation which had not happened in the previous eighteen months. The tightening of the lending terms logically affected business borrowing plans. In Q3 the balance of this index fell to +8 points, which was the minimum for the whole four-year period of its being monitored. However, industry maintained a high capacity to service its existing credits. Moreover, in Q3 2014 this capacity increased up to 89%. The proportion of enterprises, capable of servicing their credits, turned out to be the highest for the whole monitoring period (since the beginning of 2009).

The beginning of Q4 was evaluated no less positively by the enterprises than the end of Q3. Good demand dynamics and successful control over the stocks of finished products allowed industry to maintain production growth in October. On the whole, the demand dynamics in 2014 showed a positive pathway which was atypical of recent years. The initial data showed the preservation of the sales change rates after January within a very narrow corridor, without the deterioration of the index at the beginning of Q4 typical of the previous post-crisis years. This fact was duly evaluated by the manufacturers: satisfaction with the demand in August-October was at the highest levels since the end of 2011.

The dynamics of industrial production (*Fig. 24*) in H2 2014 also differed for the better from the output dynamics of the previous year. The initial balance of the index (growth rate) was more stable and remained at higher levels in comparison with the corresponding periods of 2012–2013. Clearance of seasonality showed a stabilisation of the output growth rates at the level of the two-year maximum.

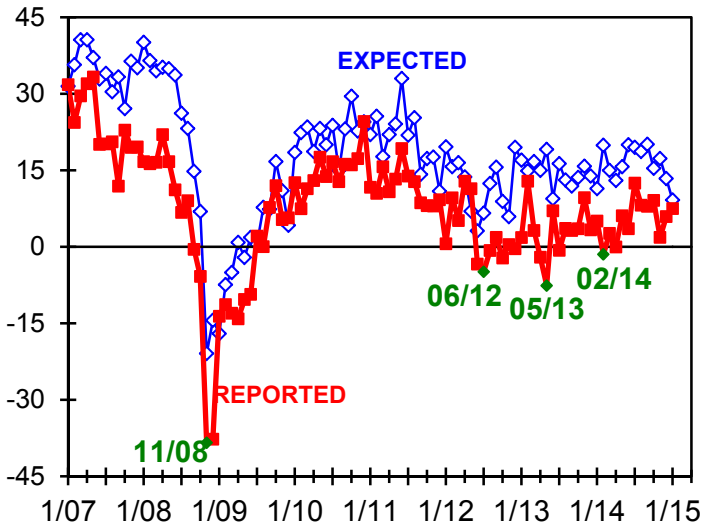


Fig. 24. Changes in production volumes, cleared of seasonality
(balance = %growth - %decrease)

The evaluation of obstacles to output growth in Russian industry allows to confirm the positive changes in the demand and output dynamics within H2 of 2014, and also allows evaluation of the actual scale of resource limitation in respect of further growth of production.

The restraining influence of the domestic demand at the beginning of H2 fell by 12 points and almost reached the post-crisis minimum. Furthermore, growth of the index in Q4 amounted only to 4 points, and as a result only half of Russian industry faced limitations on the side of demand by the end of the year (*Fig. 21*). However, inadequate demand remains the most

common obstacle to growth in the output from Russian industry. Resource limitations were mentioned by the enterprises to a much smaller extent. One third of Russian industry is fearful of increasing production due to the "uncertainty of the current economic situation and its prospects" (on *Fig. 23* this specified factor is indicated as "information"). With the developing Ukrainian crisis this factor moved to second or third position in the enterprise ratings, although before the crisis it had fallen to 5th position.

The "lack of skilled personnel" took second place in order of importance as a resource limitation (and was third in the general rating) for Russian industry. It was mentioned in Q4 2014 by 30% of the enterprises. In addition to this, during the previous 6 quarters, lack of personnel took second position in the ratings on four occasions, i.e. it was considered by the enterprises as the second most important resource limitation after inadequate demand. The third-placed factor in resource limitation for industry was the shortage of the working capital. In 2014 the deficiency of this resource was mentioned by 23% of the enterprises, which is just 2 points bigger (i. e. is worse) than the average result of 2013, when the absolute minimum of the index, amounting to 19%, was registered (for the whole period from 1993–2014). So, the tightening of the lending terms (with the loans most often being used by business precisely for financing working capital) has not significantly worsened the availability of these resources to industry as yet.

Production capacities take only fourth position among the limits on the resources necessary for industry to increase production. By the end of 2014 only 20% of industrial enterprises faced a lack of production capacity in the short term. This index value is the post-crisis maximum. In other words, even under the conditions of the greatest lack of production capacity since the beginning of 2009, the scale of the phenomenon is significantly behind that of the shortage of other resources. Even fewer problems were experienced by Russian industry with regard to raw materials and semi-finished products. Only 11% of the enterprises pointed at a shortage of these production resources, even though this index became the maximum for the previous 15 quarters.

November became the only month of the second half of the year when the enterprises did not manage to maintain positive dynamics of the main industrial indices. Negative changes in demand did not live up to expectations for the import substitution effect which had been indicated by the Government, although a positive attitude was preserved in the plans, forecasts and evaluations of the stocks of finished products. The output growth rate, which, in the previous months had been showing unexpectedly positive values, in November, moved to more expected levels. However, the plans of the enterprises did not become sharply negative. In November they lost only 4 points in respect of the initial data, which even allowed the formal methods of clearance to show an improvement in the resulting value of the output plans by 3 points and that the plans' balance had maintained its closeness to the post-crisis maximum.

By the end of 2014, a powerful inflationary wave finally reached the costs and price plans of the enterprises. In Q4 2014 the rate of growth of industrial production costs jumped by 21 points. The surveys had not registered such sharp changes in this index in any of the previous 7 years. As a result the balance of the changes in costs reached their maximum for the previous 15 quarters. The forecasts of changes in production costs were adjusted even more. After the rate of their expected growth had been registered in Q3 as the minimum for the preceding sixteen years (i.e. for the whole post-default period!), in November this rate increased by 36 points. This change in the index even surpassed the record for the end of 2010, when industry

was preparing for the increase in insurance premiums, and it was second only to the leap in cost forecasts in the post-default October of 1998.

In Q4 the investment plans of the enterprises started to lose their optimism (*Fig. 25*). In November their balance went down by 6 points, reaching a level of -11 points. So, the short period of expectation of a revival in investment activity (June-September) changed to a sharp return to the previous, extremely pessimistic investment moods of industry. That is why the decrease in the evaluations of investment plans by 18 points during these three months may serve as evidence of a further deepening of the investment crisis in Russian industry, even taking into account the import substitution, expected (planned) by the Government. However, the influence of the latter on investments is not as clear cut. If the import substitution, generated both by administrative measures, and by the exchange rate policy really does lead to an increase in demand for domestic products, this situation will put Russian manufacturers in a privileged position and allow them to use idle capacity, which under the previous conditions had been uneconomic. As a result, the incentives for companies to modernise and to extend their facilities may weaken. The unpredictability of political decisions with regard to economic sanctions also discourages investment. The problem is that if sanctions are cancelled, those Russian enterprises that had decided to invest, may once again find themselves in the same competitive market with imports. In this case they will hardly be able to achieve their planned results, since, for example, they may have previously been forced to use only affordable domestic equipment in their investment projects, due to the sanctions imposed.

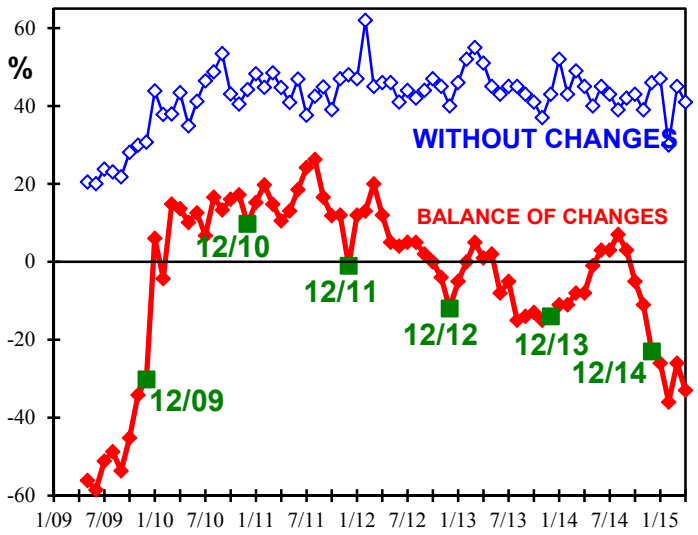


Fig. 25. Expected changes in capital investment in fixed assets in comparison with the previous year, %

Another factor in the decrease of investment activity was the further tightening of lending terms. Firstly, the average minimum rate, offered by the banks, reached 13.9% per annum (*Fig. 26*). There had not been such a high level of the ruble credit rate since the middle of 2010. Secondly, the overall evaluation of credit availability for industry also deteriorated. The perceived difficulty in obtaining credit jumped by 11 points and reached 27%. This figure represents the proportion of the industrial enterprises that considered the current credit availabil-

ity to them to be “below the norm”. Such a pessimistic evaluation of the situation with credits had not been registered by industry since the beginning of 2010.

In December, Russian industry managed to avoid a crisis recession. The initial data on the demand dynamics at the end of 2014 showed the typical growth of negative trends. The balance of changes (the growth rate) fell to -20 points, thus reaching the sort of December values common in previous years. Consequently, there was no mention by Russian industrial enterprises of anything 'crisis-like' or even of 'pre-crisis'” in the sales dynamics. Exclusion of seasonality did not provide any unusual negative signs, either. The current rates of the changes in demand turned out to be worse in comparison with the levels seen for the beginning and middle of 2014, but similar to the indices for twelve months previously. Neither did the stocks of finished products give the enterprises any cause for concern. During the whole second half of 2014 Russian industry showed the utmost care in the management of its stocks, maintaining stock levels with minimum redundancy so that the balance of evaluations (“above the norm” - “below the norm”) remained constant. On the contrary, the proportion of the “normal” responses in November-December reached its historical maximum. In such a situation a possible crisis of production would not receive any additional support through the use of accumulated stocks, and any unexpected positive scenario in 2015 would be supported by the need to replenish stocks. The output dynamics of Russian industry at the end of 2014 looked very optimistic. In December, according to the industry evaluations (based on initial data), the rate of change in production improved and surpassed the corresponding results of the previous years. Exclusion of seasonality shows an index growth of 3 points after the November decline of 7 points.

However the pricing policy, lending terms and investment plans of industry at the end of 2014 were adequate for the actions of the Central Bank of the Russian Federation. In December, Russian industry predictably and successfully realised the November price forecasts. These forecasts suggested one of the most intense increases in sales prices since the increase in Uniform Social Tax (insurance premiums) at the beginning of 2011. The rate of growth in prices during the month increased by 11 points, after having remained more or less constant over the previous six months. However enterprises had to plan for further price growth: the December forecast increased further, by 13 points, and reached a four-year maximum. Industry investment plans, on the contrary, continued to deteriorate. By December the balance of the index fell to a five-year minimum. Worse values were registered only in the crisis year 2009. So, the short period of renaissance of investment plans, as registered by the surveys of June-September 2014, changed to an even deeper decline in the index, a decline which no one expects will be overcome in 2015.

Credit lending terms for industry at the end of 2014 continued to become tougher as expected (*Fig. 26*). According to the evaluations (which did not show a 'win back' to the full extent of the rise to 17% of the key rate of the Central Bank of the Russian Federation on 16 December) credit availability in December fell to 50%, although in August 2014 this index was still equal to 67% and remained within the band which had been established for more than 4 years. The minimum rate, according to which the banks were ready to lend money to Russian industry, also increased in December. It reached 14.8% per annum in rubles, although, of course, this does not reflect the more recent changes in the credit market.

The first data on the state of Russian industry for the beginning of 2015, declared to be a crisis year, contain few signs of a crisis. The actual dynamics of demand and output, evaluation of the stocks of finished products and plans for the recruitment of workers are typical for

the month of January, and even look optimistic against the background of the (pre-) crisis panic. The latter, however, affected the forecasts of demand, output plans and investment intentions, which therefore could not reach the usual level of optimism. By contrast, the pricing policy of industry and the bank lending terms has reacted very decisively and adequately to the policy being carried out by the Government.

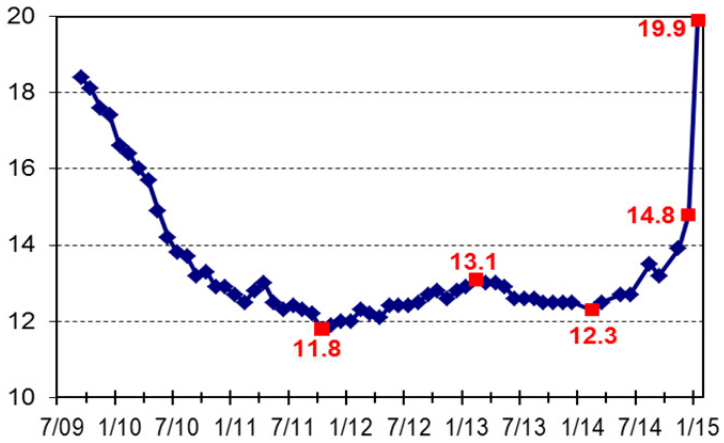


Fig. 26. Average ruble credit minimum rate, offered by banks, % per annum

4.3.2. The effect of the Ukrainian crisis on Russian industry

The Ukrainian crisis, in which Russia actively started to participate from the beginning of March of 2014, immediately provoked the first and, naturally, strong reaction on the country's stock and currency markets. The statistics for these segments of economics allow us to monitor, the behaviour of the players on, literally, a minute-by-minute basis. So, what were the moods and expectations in Russian industry? How did Ukrainian crisis affect the real economy?

To evaluate the initial reactions of the industrial enterprises to the Ukrainian crisis, from 3–5 March 2014 the Gaidar Institute conducted the first express survey among enterprise managers, using the new method, developed in recent years. The results of the survey allow us to understand how the negative scenario of the development of military and political events related to Ukraine, can affect the volumes of Russian industrial production. The middle of March was also marked by two other important events: the referendum conducted in Crimea, and the subsequent acceptance of Crimea and the city of Sevastopol as constituent members of the Russian Federation. This prompted us to conduct a repeat survey with precisely the same questions, but in a radically new situation. The two weeks, which had passed after the first survey, allowed the enterprises to evaluate more precisely the consequences of the foreign policy crisis for their own production, together with their actual actions and active probing of the positions of business partners when taking into account the massive propaganda campaigns triggered in all the participants in the conflict.

The reactions of the enterprises to these surveys themselves allows us to draw some first conclusions. Firstly, unusually large numbers of answers were received very quickly, indicating the presence of extreme tension in our society, resulting from the Ukrainian crisis. Secondly, the phrase “the negative scenario of development of the military and political events,

related to Ukraine" did not give rise to either a single objection or request for clarification, even though the respondents have the opportunity to do this and constantly use it in other situations. It appears that, in regard to this question, there is a significant similarity of attitudes across our society. Thirdly, the answers to a question having a simple definition and a style of answers familiar to our respondents, were, unusually, often accompanied by additional comments. Fourthly, the majority of answers from the enterprises were definite and without reservation. This means that the respondents had clearly formed their vision of the consequences of the above events, so this, in turn, leads to the following, meaningful conclusions:

The first (at the beginning of March) evaluations, made by the enterprises, were almost equally divided between the two variants: "there will not be any significant influence" (50%) and "there will be a decrease in output" (46%). So, industry initially expected a massive decrease in output due to the Ukrainian crisis. The reasons for this could be twofold. Firstly, the consumers of Russian products in Ukraine may just reduce their purchases solely as a result of internal economic problems, which would be exacerbated by the explicit and implicit participation of Russia in this crisis. Secondly, the aggravation of Russian-Ukrainian relations may lead to frequent border closures, increased political risks for Russian suppliers and their refusal to ship their products. Although Russia, by contrast, called for the preservation of economic ties and tried to revive economic cooperation with separate regions of Ukraine, the comments made by the companies indicated that, in the first stage of the crisis, Russian industry was evaluating mostly the direct consequences of the decrease in demand on the part of Ukraine in the case of the developing negative scenario of events. More long-term and indirect production losses, resulting from the deceleration of business activity within the Russian economy could not be efficiently and adequately evaluated at that time.

The actual development of the crisis changed the expectations of Russian industry. Among the enterprises questioned in the middle of March, there were fewer forecasts of the restraining effect of the negative development of the crisis on production volumes. While, in the first survey, 46% of the enterprises made such forecasts, this number then dropped to 37%, and the proportion of the "there will be no significant influence" answers increased to 57%, with the forecasts of a positive influence reaching 7% (4% in the first survey). So, industries started to evaluate the impact of the Ukrainian crisis on their own output less pessimistically.

A detailed comparison of the results of these two surveys at a micro-level (this was possible, since almost precisely same enterprises took part in both surveys) showed that nearly 80% of the participants preserved their forecasts of the impact of a negative development of the crisis on industrial production volumes, while 17% reconsidered that the effect would be for the better, and 3% indicated that it would be worse.

The results of the two surveys showed the highest expectations of negative changes to be for ferrous metallurgy, while, in the space of these two weeks, chemical production and mechanical engineering had reconsidered their forecasts to show improvements although they were still in the forefront of those expecting a decrease in output. In light industry 30% of enterprises also expected a decrease in production. It looks as if the public statements of our Western partners, about the targeting of the sanctions, have had an impact on Russian industry evaluations of their consequences. While, in the first survey, the Government industrial sector expected a fairly moderate influence of the Ukrainian crisis on its output, in the second survey such fears among the "state-owned plants" were particularly prevalent.

Summing up the results of these two express surveys of industry managers in relation to the influence of the negative development scenario of the Ukrainian crisis on the output of

Russian, we can come to the following conclusions: Firstly, according to the forecasts made by the enterprises, the escalation of the crisis will have a significant influence on Russian industry, and in most cases it will be negative. Secondly, different branches of industry will suffer to different extents because of the crisis. Thirdly, the characteristics of the nation building events in modern Ukraine, the perceived bourgeois spinelessness of our 'Western partners' and the decisiveness of the Russian Government have allowed the enterprises to reduce the pessimism of their initial forecasts.

To evaluate the full range (rather than just the output volumes) of the actual (and unexpected) consequences of the Ukrainian crisis, we conducted three additional surveys among the enterprises: in Q2, Q3 and Q4 2014.

In April we introduced a new question for the enterprises on the actual consequences of the Ukrainian crisis for industry in respect of a much broader set of considerations. In July and October this question was repeated. The results provided an evaluation of the actual economic consequences of the crisis for Russian industrial enterprises in these three quarters of 2014.

According to the surveys, the majority of enterprises are still not feeling any consequences of this crisis on their activity (*Fig. 27*). The proportion of the "there are no significant consequences" answers confidently takes first position. However, at the end of 2014 the level of the sentiment regarding the "insignificance" of the Ukrainian crisis essentially fell from two thirds to a half. It appears that the protracted nature of this conflict and the efforts made by its participants (despite these efforts sometimes being very half-hearted and selective) did their job – almost half of Russian industry had started, finally, to feel its consequences.

The greatest actual influence of the Ukrainian crisis on Russian industry in 2014 consisted of a decrease in demand on the part of Ukrainian consumers. The topmost placing of this factor is totally logical, since the economy of our neighbouring state is going through an extremely difficult situation with uncertain prospects. But another aspect is surprising: during the period following the first measurement, the evaluation of the decrease in demand only rose by 5 percentage points, despite the evident aggravation of the military, political and economic situation.

The only problem, the scale of influence of which significantly increased during the three monitoring waves, was the delivery of raw materials, other materials and component parts from Ukraine. It appears that the political will of Kiev influenced this situation under the conditions of the expanding conflict, by stopping the deliveries of goods, critically important for Russian industry. It is far less likely to suspect that the Ukrainian manufacturers themselves had voluntarily refused to sell their products in Russia. However, since August 2014 the Russian side has also started to use administrative limitations with regard to the import of Ukrainian manufacturers' products.

As a result, by the end of the year, the decrease in output due to the Ukrainian crisis was marked for only 9% of Russian industrial enterprises. This result is higher than the evaluations made in Q2 and Q3, but it still remains extremely insignificant, taking into account the growing tension and the public activity of the participants in the conflict. We can add to this negativity the equally insignificant decrease in demand on the part of other Russian enterprises, suffering from decreased sales to Ukraine.

Although Russian industry has received some advantages as a result of this crisis, and the scales of these increased by the end of the year, they still remain insignificant. Only 11% of Russian manufacturers had felt the effects of the departure of their Ukrainian competitors

from the joint sales markets, and only 6% noticed their departure from the markets for raw materials and other materials.

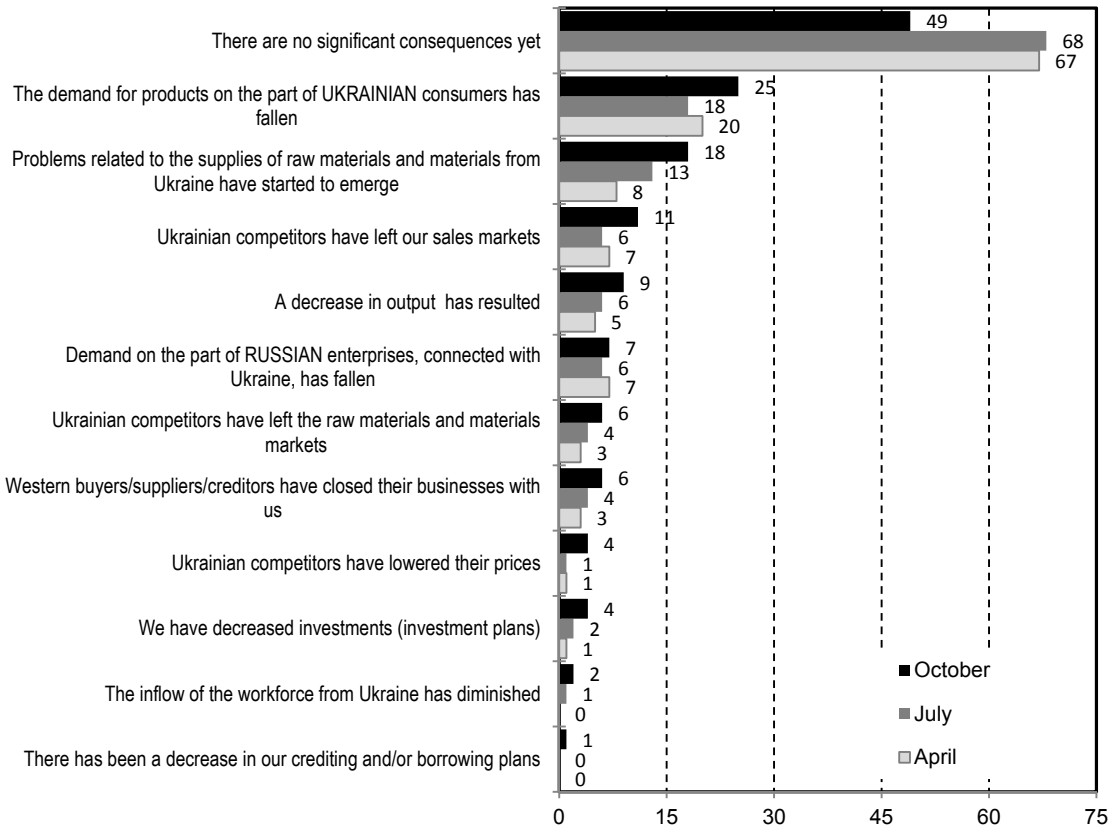


Fig. 27. Actual consequences of the Ukrainian crisis for Russian industry, 2014, %

The sanctions constantly being announced by politicians, have been put in place by the Western partners against up to 6% of Russian industrial enterprises. However, their effects remain very insignificant and dramatically contradict the abundance of words, spoken in relation to this matter.

4.3.3. Reserves of production capacity in Russian industry

The problem of capacity utilisation by Russian industry became one of the hot topics of 2014. Almost the only results from this discussion were a) the point of view that Russian industry is working at the limit of its (possible) production capacity and b) that the measures aimed at the stimulation of demand for industrial products, are dangerous due to the growth of inflation. Let us consider the evaluations of the sufficiency / insufficiency of production capacity, made by the enterprises themselves, on the basis of a representative set of direct indices, as a result of recent data (collected in October 2014).

The results of the surveys show that, in 2014, the production capacity utilisation in Russian industry amounted on average to 66%, starting at 65% at the beginning of the year and rising to 68% in Q4. This data may be assessed in different ways, taking into account the dampened

growth of the economy. Let us evaluate the data by considering the maximum possible capacity utilisation.

Direct evaluations of the latest index show that Russian industry is ready immediately, without any further investment, to bring capacity utilisation under normal operating conditions (i. e. with all relevant maintenance and repair procedures) for the output of competitive products (i. e. manufactured products, which will be sold) up to 81–82%. The total spare capacity is thus 13–14 percentage points, i. e. the volume of industrial product output could be increased by almost 20% compared with the current level.

However in different sectors of industry the capacity reserves differ fundamentally. While the food industry reserves stand at 20 points, in light industry and forestry an increase in utilisation of only 8 and 9 points is possible. The reserves for growth are significant in ferrous metallurgy (18 percentage points), mechanical engineering (16 percentage points) and the building industry (14 percentage points).

According to direct evaluations, made by the enterprise managers (who, one must suppose, know the real possibilities of their production better than anyone), after the crisis of 2008, a lack of capacity connected with the expected changes in demand was registered for only 6–9% of enterprises (*Fig. 28*). In 2014 this index was equal to 7%. And 24% of enterprises have excess capacity (we must repeat that this is: "in relation to the expected changes in demand"). So, the balance of the evaluations turns out to be positive, and it has always been so. This was the case even in 2011, when the expectations of a return to the pre-crisis output growth rates were at a maximum. For the main, industry appears sufficiently provided with capacity for the expected industrial growth. In 2012–2014, 69% of enterprises were in this position. As a result we see, that not less than 90% of Russian industry has got at least sufficient capacity to satisfy the expected demand.

However, the expectations of the enterprises with regard to future demand may be extremely pessimistic. In other words, industry may be capable of satisfying only the decreasing volumes of demand which it is considering when evaluating its capacity. Such a suggestion is quite logical for the end of 2014, when the majority of even the official forecasts did not look too optimistic. However the direct monitoring of the enterprise forecasts shows otherwise.

Firstly, the annual balance of the demand forecasts by industry in 2014 was positive and equal to +6 points and turned out to be better, than the result achieved in 2013. However, only 13% of industrial enterprises in 2014 had predicted the decrease in demand for their products. This value is close to the post-crisis minimum of the index, which was registered in 2010 and amounted to 12%. The industry has the same low extent of pessimism in the forecasts of demand as it had at the beginning of the exit from the previous crisis. In 2014, most of industry was rather optimistic: 20% expected a growth in demand and 65% hoped to maintain its volume without any changes.

Secondly, the expectations of sales growth prevail over the forecasts of sales decreases in the demand forecasts made by those enterprises having enough production capacity to satisfy such demand. In other words, industry thinks that it has enough capacity to satisfy the growing volumes of demand. For 2010–2014, the level of capacity utilisation in the group of enterprises with sufficient volume was within the interval 69–71%. These figures may be interpreted as follows: the majority of these enterprises (namely 69%) are ready to satisfy the expected demand through the output of their products, without needing any additional investment, and that this includes increasing utilisation to a greater extent than is currently the case.

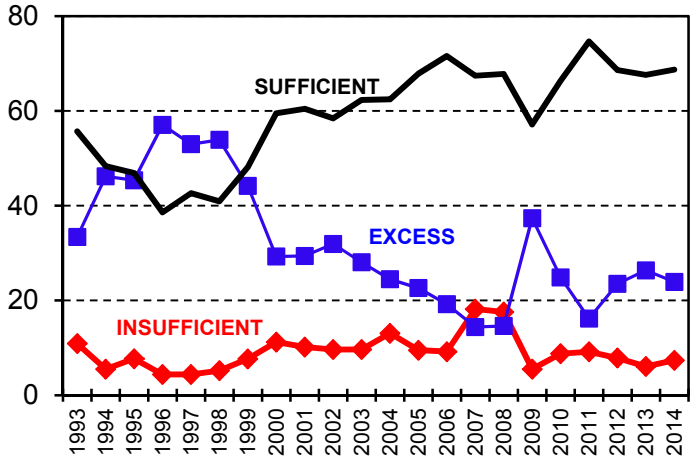


Fig. 28. Average annual evaluations of the capacity available for industrial growth, %

Thirdly, only those enterprises with excess capacity differ in their pessimism in relation to demand. This group's balance of sales forecasts was negative for 2014, i. e. their plans for a decrease in demand prevailed over their expectations for its growth, and stood at -9 points. With their excess capacity the ratio of capacity use was low and amounted to 56% in 2014. Furthermore, those enterprises with excess capacity have always shown the most moderate levels of utilisation. In the crisis year 2009, the index had fallen to 46%, but during the three following years it increased to 59%. Other groups of enterprises were not able to demonstrate such significant changes in utilisation. The reason for the increase in utilisation might, odd though it may seem, be the activation of investments in the phase of active exit from the crisis, since the companies' lack of competitiveness would be the result of the under-use of a significant part of their capacity.

Fourthly, enterprises with insufficient capacity are less represented in Russian industry. The forecasts of demand in this group are characterised, as would be expected, by their being the most optimistic. The balance of their expectations has never been negative. Even in the crisis year, 2009, it amounted to +4 points, and by 2011 had increased to +24 percentage points, i. e. it had almost reached the pre-crisis maximum (+26 percentage points). In 2014 it was equal to +16 percentage points being influenced, among other things, by the forecasts of decreasing sales.

So, after the crisis of 2008–2009 Russian industry has never worked at the limit of its production capacity. It has either had sufficient capacity for future industrial growth, or has had an excess volume of capacity. Only a very small proportion of enterprises (7%) were not able to change their capacity utilisation in response to changes in demand for their products.

One more index – the readiness of the idle capacity to be brought into competitive production – also shows the successes of industry with regard to the preparedness of its equipment for meeting possible growth in demand. According to the evaluations made in 2014, 23% of enterprises had idle capacity in the highest state of preparedness ("one has only to turn on the switch"). A year earlier such evaluations were made by only 11% of companies. The greatest successes in respect of such capacity were those registered to light industry, which during the previous year, was able to raise its share of idle capacity in the highest degree of preparedness

from 10 to 30%. By contrast the proportion of capacity requiring significant investment fell from 33 to 8%.

The proportion of capacity in the next highest degree of preparedness (use "with minimal investment") fell from 37 to 29%. A similar decrease (from 28 to 19%) also occurred with those parts of the capacity which were still able to produce competitive products, but required "significant investments". Light industry was, again, the most successful in this respect (a decrease from 33 to 8%).

The proportion of capacity beyond recovery (with which competitive products could no longer be produced even with investment) had fallen during the year from 10 to 5%. However, the results in 2013 turned out to be extremely high when seen in the context of the whole seven years of monitoring. In 2009–2012 the proportion of the capacity beyond recovery was evaluated by the enterprises as 2–3%.

On the whole, future (possible) industrial growth in Russia is better provided with production capacity, than with a sufficient workforce. Indeed, during recent years industry has seen a sustainable provision of excess capacity but a deficiency of staff (*Fig. 29*).

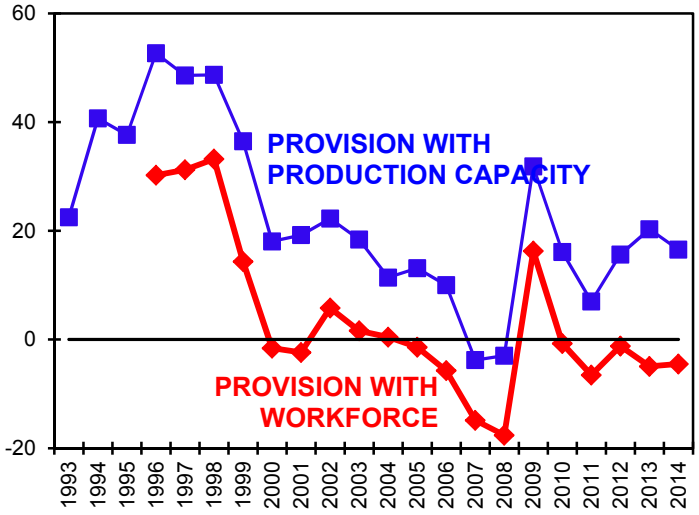


Fig. 29. Balances of provision of expected industrial growth with production capacity and workforce, %

A comparison of the evaluations of capacity and workforce at a micro-level provides detail for the previous conclusions and shows that, over the period 2009–2014, 66–73% of industrial enterprises were equally provided with these resources, i. e. the overwhelming majority. Within these enterprises the "sufficient" evaluations prevailed both with regard to capacity, and to workforce. The proportion of such enterprises in 2013 amounted to 55%. So, a little more than half of Russian industry had both enough capacity, and sufficient workforce for potential industrial growth. To this can be added another 9% of enterprises, the ones that had surpluses both of capacity and workforce, meaning that they, too, would not have any problems meeting a revival in demand.

By contrast, in 2014, 4% of enterprises suffered because of lack of both workforce and capacity, and were therefore in the most unenviable position. However, the size of this, the most problematic segment, is not large. Previously (in 2008) the proportion in this position had increased to 7% and while, in some quarters of that pre-crisis year, the index had reached 9%

this was not actually a particularly high value either, taking into account the heating up of Russian industry. But already, by 2009, the proportion of such provision (more precisely, of such lack of provision) of workforce and capacity in industry had dropped to 1%.

So, the domestic industry is now far better provided with production capacity than with an adequate workforce, meant to use its capacity in order to revitalise Russian industry and to meet the growth in demand for its products. Under such conditions which are at least evident to business, Government policy must be aimed at ensuring the availability of training and at directing the workforce to this sector of the economy by reducing, for instance, other types of 'post-school' education.

4.3.4. Industry staffing problems

The evaluations of staffing problems by Russian enterprises confirm this point of view. Firstly, the lack of sufficient industrial workforce has already been in either second or third position in the ratings of obstacles to growth in output for two years. Since the beginning of 2009, insufficient demand has ranked first.

As a result (and therefore secondly) industry has been forced to use its existing workers more intensively than its existing machinery and equipment. While “normal” + “above the norm” intensities of capacity utilisation, were registered in the middle of 2014 for 54% of enterprises, the corresponding levels for the utilisation of workers was registered for 68% of enterprises.

Thirdly, recruitment plans show that industry is still not able to solve its staffing problems. The balance of these plans, after the seasonal rise to +7 points in January of 2014 and its stabilisation in February-March at zero, then descended 'into the red' (i. e. there were more forecasts within the industry of decreases in the numbers of workers, than of their increase), though this was not so significant, as in previous years.

Fourthly, one cannot rely on a growth in labour productivity as a way of solving the staffing problems of Russian industry. No less than 60% of the enterprises surveyed after the crisis evaluated their actual productivity as normal, and in 2014 this index amounted to 66%. Thus, the evaluations of this situation by the majority of the enterprises surveyed are clearly different from the evaluations made by experts and officials. The plans announced by industry to increase productivity in Q3 2014 showed a positive balance, amounting to only +6 points, while in Q2 in stood at +15 points.

Nevertheless there is still an opinion among the experts and politicians, that enterprises, at their own initiative, are making workers redundant because of overstaffing due to stagnation, and that by doing so, they are achieving the optimal number of workers for those enterprises under the current conditions. Since the official statistics did not give a direct answer to the question about the real reasons for the dismissal of workers from Russian industrial enterprises, in 2012 the Gaidar Institute began conducting an annual monitoring of this problem, by asking direct (and sometimes unpleasant) questions of company managers. As a result, we now have three different approaches that allow us speak quite confidently about the real, rather than the official reasons for the dismissal of workers from Russian industry, and which logically supplement the multi-year monitoring of business staffing problems.

The overall assessment of the results, obtained in 2014, showed the preservation of a negative situation on the labour market for employers: the workers more often leave at their own initiative, than by being dismissed by the administration. In 2014 these proportions were respectively: 71% and 24%. In 2012 they were: 65% and 27% while in 2013 the figures were

76% and 30%. So, currently, workers are almost three times more likely to leave a company of their own volition, than as a result of 'urging' by the administration. During previous years this ratio was 2.4 and 2.5 times respectively.

Amongst the reasons for workers leaving enterprises on their own initiative, reaching retirement age continued in top position (*Fig. 30*). Of the enterprises consulted 50% indicated this as the reason in 2014. The result, obtained in 2013, was similar (54%) where this cause also took first position in the ratings, while it was only in 2012 that the voluntary retirement of workers who reached the retirement age took second position, according to the employers.

So, Russian industry has entered an era of staffing deficiency, the main (in terms of numbers) reason for which is the irreversible (in the truest sense of the word) process of aging of the workers. This problem could be solved only by training new workers in specialised secondary educational institutions. However, the Soviet system of industrial and technical education was replaced almost totally by the higher education system, and its graduates have little willingness to be employed as workers in industrial enterprises. According to the results of our monitoring, such industrial enterprises have difficulties particularly with the recruitment of skilled workers, while the demand for other categories of workers (non-skilled workers, technical and engineering employees and managers) is either absent, or easily satisfied by means of recruitment. As a result, industry is already irreversibly losing skilled workers and this cannot be stopped even by raising salaries. The reinstatement of the system of specialised secondary education, and the redirection to this system of school leavers is a long process, and our Government and industry has less and less time to perform this as a means of providing a civilised solution to the problem. However, the stagnation of the economy, under the conditions in which we have been living during recent years, has postponed the occurrence of the really tough consequences of the education policies which have been in place over the last twenty years. However this does mean that there is still some time to search for a solution to the problems.

In 2014 the largest voluntary retirements took place in the forestry industry (64% of the answers among enterprises, 2013 – 52%), the chemical industry (58% and 53% of the enterprises, respectively), mechanical engineering (56% and 45%) and light industry (53% and 51%). The metallurgical industry had probably, in the previous years, 'solved' the problems of many of its staff reaching retirement as its retirement rate has now decreased by more than a factor of two. Traditionally, the voluntary retirement of older staff, during the years over which monitoring has been conducted, has been smallest in the food industry.

Low salary levels have for the second year taken second position in the ratings for why workers leave their employment. In 2014 it was mentioned by 41% compared with 47% during the previous years. So, this reason for leaving became less prevalent in industry, although it retained its position behind leaving as a result of reaching retirement age to almost the same extent as in 2013.

The reduced prevalence of leaving due to low salaries may be linked to a growth in salaries. The quarterly monitoring showed an increase of 9 points in the proportion of "normal" evaluations by the enterprise managers for the salary sizes of workers, technical and engineering employees. As a result, 71% of industrial enterprises currently pay their workers a “normal” salary. This result represents a maximum for the whole seven-year monitoring of the index. Its minimum value was registered in April 2009, at 37%.

The main industries which had seen large numbers of workers leaving in 2013 due to low salaries, generally retained their ratings in 2014 as well. In 2014 the industries from which

most workers left due to low salaries were the building industry (56%, 2013 – 63%), the forestry industry (52%, 2013 – 64%), the food industry (47%, 2013 – 65%) and mechanical engineering (46%, 2013 – 55%). During last year the metallurgical industry managed to reduce its losses of personnel because of low salaries, while the chemical industry traditionally has the fewest problems in this area.

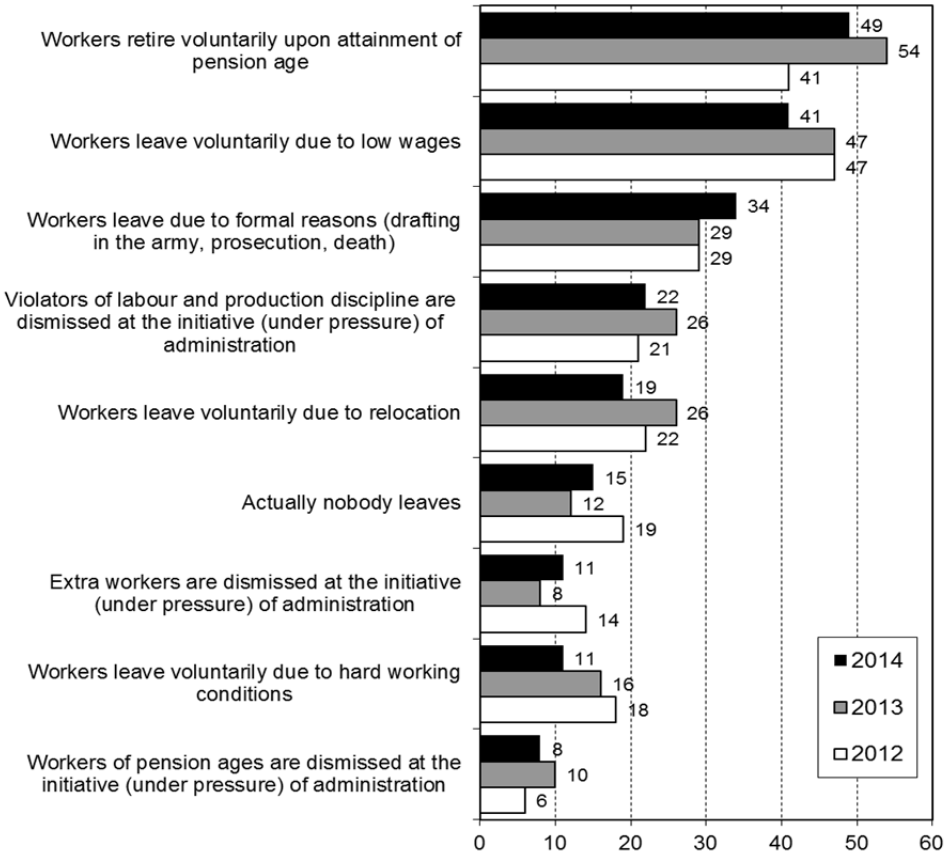


Fig. 30. Real reasons for why workers left industrial enterprises, 2012–2014, %

'Harsh working conditions' was the third reason causing workers to choose to leave their industry, as tracked during the monitoring. It consistently takes last position in the reasons rating, in 2014 being mentioned by only 11% of the enterprise managers.

Violations of labour (production) discipline remain the main (in terms of numbers) reason for the dismissal of workers by their industrial employers. In 2014 such dismissals were exercised by 22% of the enterprises, compared with 26% in 2013 and 21% – in 2012. The possibility of this reason for dismissals in 2014 was growing due to the increase of a company size, and was most prevalent in ferrous metallurgy, the food industry and forestry.

Redundancies of excess (surplus) workers are almost two times less frequent. In 2014 this approach was exercised by 12% of the enterprises surveyed, which is close to the average value over the three years of monitoring. As in the previous case, the likelihood of dismissal for this reason also increases with growth in enterprise size and is especially high in ferrous metallurgy.

The dismissal of workers because they have reached retirement age takes last position in the ratings for dismissals at the employer's initiative. On average, the monitoring showed that 8% of enterprises use this practice. Again, the possibility of such dismissal also increased with the growth of enterprise size. However such dismissals are used far less frequently in some sectors. In non-ferrous metallurgy, forestry and the building industry it is preferred not to dismiss workers simply because they have reached retirement age.

So, for Russian industrial enterprises the problem of having sufficient skilled personnel remained the most acute resourcing issue of 2014. The potential for crisis reduction in industrial production in 2015 will only be able to displace the critical aggravation a little way towards the recovery of stable economic growth, but will not solve it. Obtaining the required numbers of skilled workers for industry through the use of migrant labour, or as a result of increased domestic birth rate are either unreal, or require such a long period of time and sufficient resources from the Government that realisation of them cannot be considered to be on the foreseeable planning horizon. Increased labour productivity therefore remains the only reasonable strategy for solving the problem.

4.4. Investments in fixed assets

Last year the trend towards declining investment in fixed assets was fairly predictable being determined by the fall of investments, which had been under way since Q2 2013. According to the results of 2014, investments in fixed assets amounted to 97.5%, while the volume of completed construction works was 95.5% of that in the previous year. The proportion of investments forming the GDP in 2014 amounted to 19.1% and was thus 0.9 percentage points lower than the corresponding index in 2013.

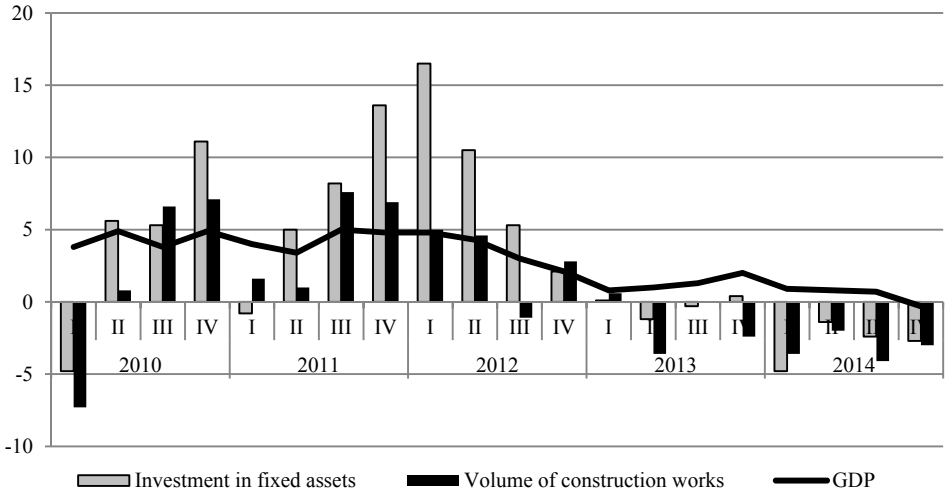
The dynamics of investment in fixed assets is differentiated for large and small enterprises. Through a reduction of the total volume of investment in fixed assets in 2014 by 2.5%, the investment in the fixed capital of large and medium-sized enterprises declined by 4.3% (*Table 11*). So, under conditions of increasing unpredictability in the development of the situation on the domestic market, big business regarded taking investment decisions with great caution. Investment by small businesses and the volumes of their investments showed positive dynamics (although not observable by direct statistical methods), and the cumulative share of these in 2014 was 27.1% of the total volume of the investments in fixed assets.

Table 11

Dynamics of the physical volume of investments in fixed assets 2009–2014, % in comparison with the previous year

	2009	2010	2011	2012	2013	2014
Investment in fixed assets (across the full range of organisations, including recalculations for investments, not observable by direct statistical methods)	84.3	106.0	108.3	106.6	99.8	97.5
Large and medium-sized organisations (investments in fixed assets not including small business entities and volumes of investments, not observable by direct statistical methods)	82.5	105.1	110.4	100.7	91.4	95.7

Source: Rosstat.



Source: Rosstat (Russian Statistics Service).

Fig. 31. Dynamics of investments in fixed assets in 2010–2014, % compared with the corresponding quarters of the previous year

The structure of investments in fixed assets by type of main funds in 2012–2014 changed due to an increase in the volumes and proportion of investments in the construction of dwellings and a reduction in the specific weight of investments in non-residential buildings and other forms of construction.

This change of investment structure between housing and industrial construction determined the features of the development of the construction and investment complex in 2014, which was reflected in a reduction in the total investment in machinery and equipment, and vehicles (*Table 12*).

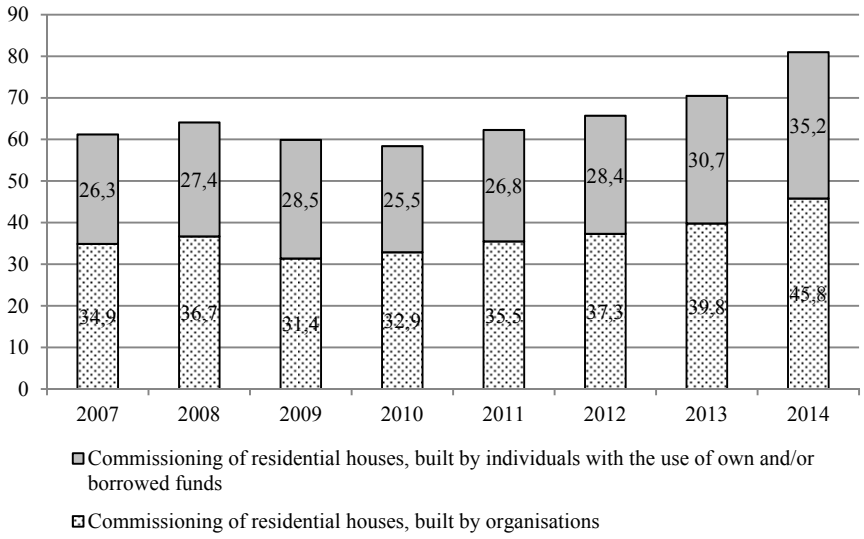
Table 12

Investments in fixed assets by type of the main funds in 2010–2014 (excluding small businesses and any parameters of informal activity)

	Rb bn					% of the total				
	2010	**2011**	**2012**	**2013**	**2014**	**2010**	**2011**	**2012**	**2013**	**2014**
Investments in fixed assets	6,625	8,445.2	8,446.2	9,493.4	9,852.91	100	100	100	100	100
Including: dwellings	384.3	396.9	439.2	550.6	642.3	5.8	4.7	5.2	6.1	6.5
buildings (except residential) and constructions	3,610.6	4,577.3	4,417.4	4,840.8	4,909.6	54.5	54.2	52.3	50.2	49.8
machinery, equipment, vehicles	2,179.6	2,896.7	3,006,8	3,366.5	3,358.5	32.9	34.3	35.6	35.1	34.1
among these:										
acquisition of domestic machinery, equipment, vehicles	1,787.3	2,357.9	2,519.7	2,825.2		27.0	27.9	29.8	29.8	
acquisition of foreign machinery, equipment, vehicles	392.3	538.8	487.1	541.3		5.9	6.4	5.8	5.7	
Other	450.5	574.3	582.8	735.5	942.5	6.8	6.8	6.9	7.7	8.6

Source: Rosstat.

Positive changes in the commissioning of the total area of residential development had been under way since H2 of 2011, and was connected with some improvements in the situation related to the financing of housing construction. In 2014, across all types of properties, a total of 81.0m sq. metres was commissioned, which was 14.9% bigger than the corresponding index of the previous year. Individual developers built 35.2m sq. metres of total residential space, which made up 43.5% of the total volume of the dwellings commissioned in 2014. (*Fig. 32*).



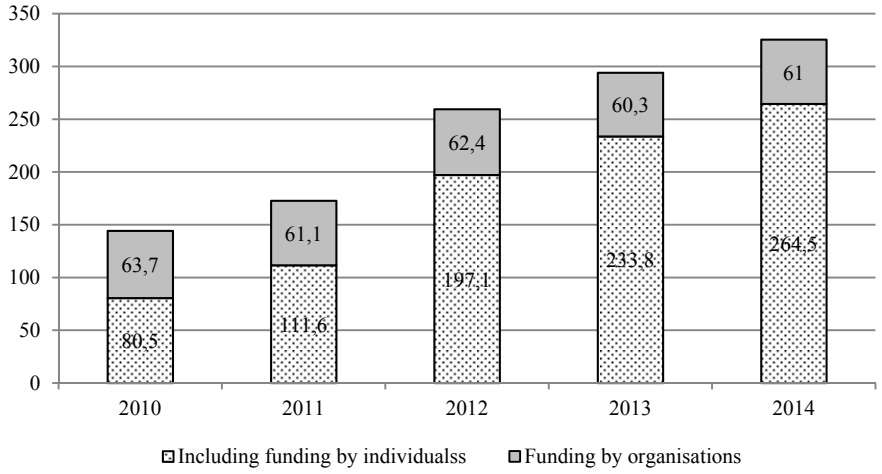
Source: Rosstat.

Fig. 32. Dynamics of commissioning of residential houses in 2007–2014, million sq. metres

Within the structure of the financing of shared housing construction we can observe an increase in the volume and proportion funding by individuals (i.e. members of the public) with a decrease in the extent of funding by organisations (*Fig. 33*). In 2014 the total of funding by private individuals amounted to 81.2% of the total volume of funding by organisations and individuals, directed at equity in construction, which was 5.3 percentage points higher than the corresponding index in 2012 when the volume of contributions had recovered to its pre-crisis level. The increase in individuals' investment activity was supported by the scale-up of lending. In 2014 mortgage loans were granted to the sum of Rb 1,806.9bn, which was 1.3 times bigger in comparison to the previous year.

The financing of investment activity in 2014 was clearly segmented. In nominal terms, the investments using enterprises' own funds increased while investment with the use of budgetary funds and bank credits fell, in comparison with 2013.

The results for 2014 indicate that the proportion of enterprises' own funds in the structure of investments in fixed assets increased to 48.1%, exceeding by 2.9 percentage points the index of the previous year (*Table 13*).



Source: Rosstat.

Fig. 33. Funding of shared housing construction according to source of finance in 2010–2014, Rb bn.

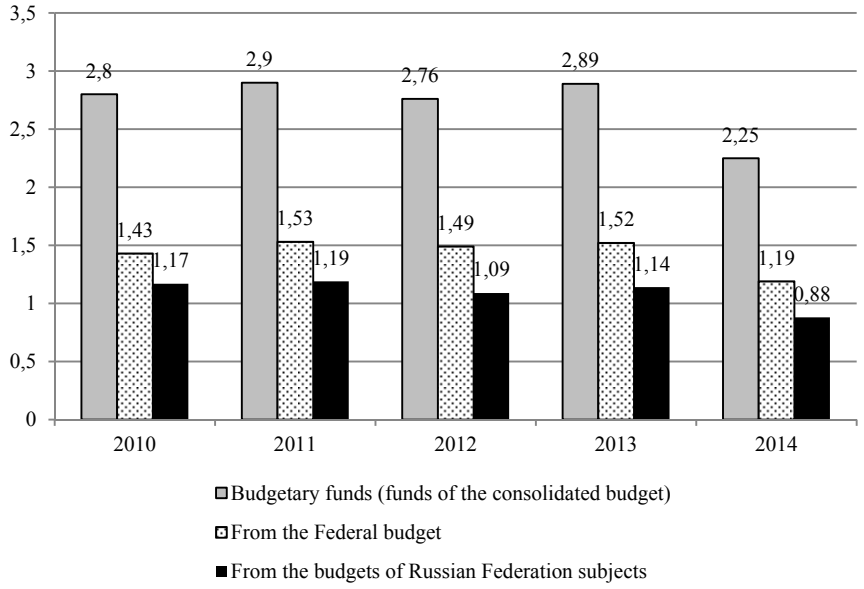
Table 13

Investments in fixed assets, by funding source 2010–2014 (excluding small businesses and investments, not observable by statistical methods)

	Rb bn					% of the total				
	2010	**2011**	**2012**	**2013**	**2014**	**2010**	**2011**	**2012**	**2013**	**2014**
Investments in fixed assets	6,625	8,445.2	9,595.7	10,047.5	9,852.9	100	100	100	100	100
Including by funding source:										
own funds	2,715	3,539.5	4,274,6	4,548.5	4,736.7	41.0	41.9	44.5	45.2	48.1
raised funds	3,910	4,905.7	5,321.1	5,499	5,116.2	59.0	58.1	55.5	54.8	54.8
Including:										
bank credits	595.8	725.7	806.3	1,000.9	918	9,0	8.6	8.4	10.0	93
among them the credit granted by foreign banks	150.0	149.4	113.7	107.4	108.5	2.3	1.8	1.2	1.1	1.1
borrowed funds of other organisations	404.7	485.8	588.2	625.1	632.6	6.1	5.8	6.1	6.2	6.4
investments from abroad				78.8	83.6				0.8	0.9
budgetary funds	1,294.9	1,622	1,712.9	1,909.7	1,598.3	19.5	19.2	17.9	19.0	16.2
from the Federal budget	661.9	855,1	926.6	1004.8	846.5	10.0	10.1	9.7	10.0	8.6
from the budgets of the constituent subjects of the Russian Federation	542.8	665.7	677	752.1	622.9	8.2	7.9	7.1	7.5	6.3
from local budgets			109.3	152.8	128.9			1.1	1.5	1.3
resources of extra-budgetary funds	21	18.2	33.3	27.9	20.9	0.3	0.2	0.4	0.3	0.2
funds of organisations and individuals, raised for shared construction	144.2	172.7	259.5	294.1	325.5	2.2	2.0	2.7	2.9	3.3
including individuals' own funds	80.5	111.6	197.1	233.8	264.5	1.2	1.3	2.1	2.3	2.7
other	1,449.4	1,881.3	1,920.9	1,562,5	1,537.3	21.9	22.3	20.0	15.6	15.6
funds of higher level organisations	1,161.8	1,604.0	1,611.3	1,192.1	1,248.4	18.0	19.0	16.8	13.0	12.7
funds received from the issue of corporate bonds	0.9	0.4	4.2	8.6	7.1	0.01	0.01	0.04	0.0.2	0.1
funds received from share issues	72.4	82.0	95.6	98.3	84.7	1.4	1.0	1.0	1.0	0.9

Source: Rosstat.

The proportions of budgetary funds changed within the structure of the borrowed funding used for financing investments in fixed assets. In 2014, Rb 1,598.3bn of investment in fixed assets was financed using budgetary funds, which amounted to 16.2% of the total volume of investment in the economy. In comparison with the year 2013, the volume of financing of investments in fixed assets using budgetary funds had therefore fallen by Rb 311.4bn, with approximately equal participation of the funds, received from the Federal budget and other budget sources (*Fig. 34*). The share of state investments in 2014 amounted to 2.25% of GDP, having fallen by 0.74 percentage compared with 2013.



Source: Rosstat.

Fig. 34. Share of budgetary funds in investments in fixed assets in 2010–2014, as % of GDP

In accordance with the Federal Targeted Investment Programme for 2014 (as revised on 1 January 2015) provisions, in the amount of Rb 596.70bn, including Rb 575.01bn from the Federal budget, were made available. In 2014, using annual limit, provisions in the amount of Rb 413.3bn (71.9%) from the Federal budget, and Rb 12.9bn from the budgets of the Federation subjects, were made available. The actual use of funds from all sources of finance amounted to Rb 369.7bn, or 62.0% of the volume of the funds, available for the year, from all sources.

Altogether, in 2014 2,476 construction sites, facilities and events were financed. According to Rosstat data, in 2014 207 objects were actually commissioned out of the 826 objects which it had been, planned to commission. One of the main reasons for delays in commissioning remains the late elimination of restrictions on financing by the main budgetary fund managers.

In 2014, the structure of investments in fixed assets by type of ownership underwent changes due to the influence of a reduction in investment by the state and state-owned corporations. In 2014, the aggregate share from organisations with these types of ownership was

equal to 20.7% of the total volume of investments in fixed assets (in the previous year this index was 24.3%).

The main factor, impeding the development of negative tendencies in the construction and investment complex, remained the increase in the absolute volumes and proportions of private investments, as well as the investments, made by organisations and enterprises of mixed, foreign and joint (Russian and foreign) ownership, in the structure of investments in fixed assets.

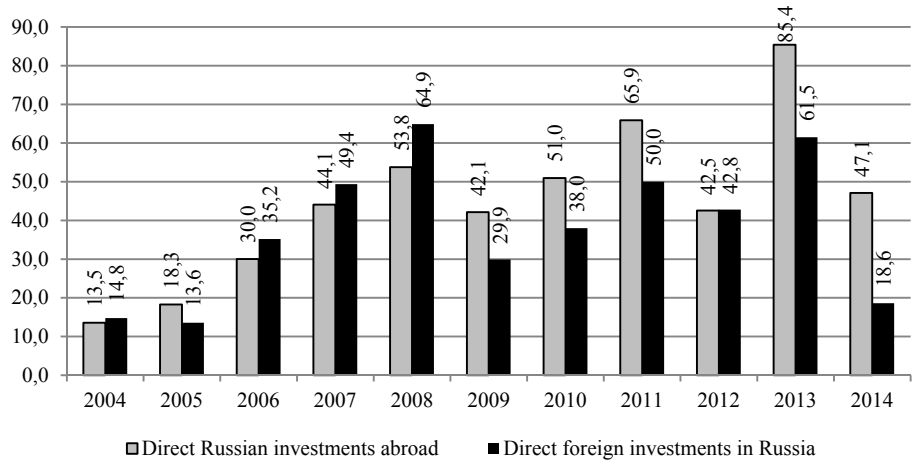
With the reduction in volume of the state funding of investments in fixed assets in 2014, the participation of the banking sector notably weakened. In 2014 the proportion of bank credits in the structure of funding sources amounted to 9.3%, compared with 10% in the previous year. The changes in the bank lending structure in 2011–2013 were defined by an increase in the volume and proportion of the credits granted by Russian banks, which replaced credits with foreign banks. In 2014 the absolute reduction of bank lending in comparison to that of 2013, was connected with a Rb 83.5bn decrease in lending by Russian banks.

It is worth noting, that in 2014 the volume of funds, aimed at investments using credits with foreign banks, increased by Rb 1.1bn compared with the previous year, however this did not compensate for the contraction of foreign credits, which took place in 2013. In 2014 the credits, granted by foreign banks, remained below their level in 2010 by almost 28%.

The reaction of foreign investors to the change in the geopolitical situation was a sharp reduction of the scales of investment in the Russian economy. The investments, received from abroad in 2014, amounted to Rb 83.6bn, and their share was equal to just 0.9% of the total volume of investments in fixed assets.

The financing of investment programmes was adversely affected by a strengthening of the tendency towards capital outflow, amounting to $151.5bn (in 2013 this index amounted to $61.6bn).

Foreign direct investment in the non-financial sector of Russian enterprises in 2014 decreased 3.3 times compared with that in 2013 and amounted to 62% of the index in the crisis year, 2009. Russian investments abroad in 2014 fell in comparison to 2013, after reaching a maximum during the period 2009–2014. So, in the period 2009–2014 the non-financial corporation sector was a net exporter of capital (*Fig. 35*).



Source: the Central Bank of the Russian Federation.

Fig. 35. Direct foreign investments in the Russian economy and Russian investments abroad by non-financial enterprises in 2004–2014, $bn.

The share of investment, using the funds from parent organisations in the structure of financing sources fell to 12.7% (in 2012 this index was 19.0%). In Russian practice, the funds of parent organisations are mostly represented by large holdings, joint-stock companies and financial and industrial groups with state participation. The weakening of the activity of these institutional investors during 2013–2014 had an extremely negative impact on the overall dynamics of investments in fixed assets.

In 2014, the own funds of enterprises and organisations remained the main source of finance for investments in fixed assets. It is worth noting that, in a situation of increasing risk and a general trend towards a decrease in income, enterprises behaved in a rather reserved fashion towards any investment in production.

In 2014, the changes in the structure of investments in fixed assets in relation to type of economic activity were defined by a stabilisation of the construction and investment activity of industry and by an increase of activity in pipeline transport, the cumulative share of which amounted to almost half of the total investment in the economy. The volume of investment in pipeline transport amounted to 104.7% when compared with the corresponding index in 2013, and was the result of a continuation of existing investment projects. It is worth mentioning, that the current structure of investment in transport is increasing the risks of a growing disparity between the development of different types of transport. Over the last four years investment in rail transport has been diminishing, which, in the medium term, may lead both to limitations of the overall transit potential, and have an impact on the development of logistics services (*Table 14*).

Table 14

Investments in fixed assets (excluding small businesses and volumes of investment, not observable by direct statistical methods), % in comparison with the previous year

	2010	2011	2012	2013	2014
Total	106.0	108.3	106.6	99.8	95.7
agriculture	89.1	114.6	92.8	96.0	93.0
fishery, fish-farming	108.8	137.4	127.4	77.4	83.3
industry	106.1	110.9	107.4	96.8	99.9
extraction of commercial minerals	106.6	113.8	111.8	93.6	105.9
manufacturing industries	101.5	105.3	106.7	101.4	98.6
production and distribution of electricity, gas and water	112.5	114.7	101.7	95.8	92.9
construction	110.9	90.6	79.9	84.0	81.2
wholesale and retail trade	120.2	90.0	107.1	103.1	110.7
hotels and restaurants					108.4
transport and communications	102.4	118.3	98.4	88.5	92.1
financial activity	112.9	136.8	111.4	80.8	74.9
real estate operations	125.4	91.9	100.8	104.4	103.1
state administration	115.2	112.4	98.7	93.7	84.4
education	84.9	122.0	85.2	77.9	97.4
healthcare and provision of social services	109.7	113.0	93.6	98.8	71.9
provision of other services	103.6	103.5	111.8	75.0	72.7

Source: Rosstat.

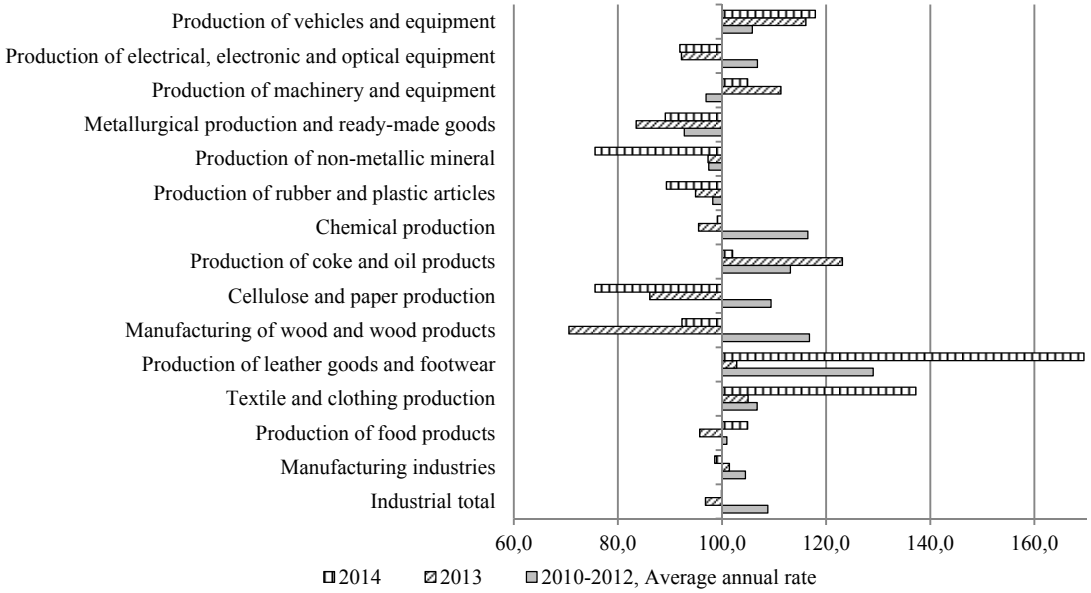
In 2014, investment in fixed assets in industry by physical volume remained approximately at the level of the previous year. However, in the same year the structure of the investments in fixed assets in industry underwent changes due to the influence of an upsurge in investment activity in the field of fossil fuel extraction. This upsurge compensated for its failure in the previous year and allowed a stabilisation of the situation in this type of economic activity.

Investments in fixed assets for the production and distribution of electricity, gas and water fell by 7.1% in comparison with 2013. A notable feature of 2014 was the suspension of the positive dynamics of investment in fixed assets in the manufacturing industry, which had been observed over the previous four years.

In 2014 investments in fixed assets in the field of vehicle production (117.9%), the production of coke and oil products (102.0%) – the cumulative share of which amounted to more than 40% of the investments in the fixed assets of manufacturing – were growing at a faster pace than the overall average. At the same time it is worth mentioning, that the investment activity in these branches of economic activity was accompanied by a simultaneous increase of investment activity on the part of associated industries of the machine building complex, producing capital goods. In 2014 investment in the production of machinery and equipment amounted to 104.9%. Investment in the production of electrical equipment, electrical and optical equipment over the previous six years had been subject to fairly substantial fluctuations, and, although, this type of economic activity in investment in fixed assets exceeded the pre-crisis level of 2008, the reduction in activity in 2013–2014 does not provide sufficient grounds for any positive forecasts in the short term.

With the tendency towards an overall reduction in the volume of investment in fixed assets, which has become established in the last three years, a decline has been registered for investments in the development of industries associated with metallurgy (89.1% in comparison with the same index in 2013) and those industries producing constructional materials (75.6%).

In 2014 the tendency for an increase in investment activity in the consumer complex was preserved, being connected with an active involvement in the production of competitive capacity and the activation of import substitution. In the food products industry the increment of investments in comparison with the previous year amounted to 4.9%, while, in textile and clothing production it was 37.2%, and in leather and footwear production, 69.5% (*Fig. 36*).



Source: Rosstat.

Fig. 36. Dynamics of investment by type of activity in manufacturing industries in 2010–2014, % in comparison with the previous year

In 2013–2014 the main factors, restraining the investment activity of organisations, were insufficient demand for products and high interest rates, as well as uncertainty over the economic situation. In 2015 it is expected, that the predicted decline of investment in fixed assets will make the largest contribution to the rate of decrease of economic growth.

4.5. Oil and Gas Sector

Oil and gas industry remains the basic sector of Russian economy playing the key role in shaping revenues of the state budget and the country's trade balance. In 2014 the national crude oil output reached its maximum over the period since 1990. In the second half of the year the sector's performance felt a negative impact of the lowering world prices for oil and the financial and technological sanctions introduced against Russia. Legislative acts providing for tax incentives in order to encourage the development of hard-to-recover oil reserves and for the differentiated taxation of natural gas production have come into effect and the principal decisions regarding restructuring of the system of oil sector's taxation have been taken.

4.5.1. Dynamics of the World Oil and Gas Prices

In the first half of 2014 the situation on the global oil market was characterized by the persistence of high world prices for oil observed all through the recent years (*Table 15, Fig. 37*). The basic factors shaping such prices were a noticeable strengthening of demand for oil due to the world economic growth (first of all, in China and other Asian countries) and the conservative policy of OPEC as regards the increase of oil production by countries – members of the organization. However, in the second half of the year the situation changed dramatically: the continuing growth of global oil production combined with relatively weak demand led to the remarkable drop of the world prices for oil. In 2014 the global oil output was up 2.1% primarily due to the growing production in the US that was conditioned by the development of shale oil deposits. Meantime, the increase of the global demand for oil was as small as 0.7% (*Table 16*). As a result of the notable excess of oil supply over demand the price for Brent crude oil fell from $111.9 per barrel in June 2014 down to $62.2 per barrel in December. However, OPEC did not take any steps to reduce production of oil in order to balance the global oil market: it chose to leave unchanged the earlier established output quota thus prioritizing the preservation of its market share. As a result in 2014 the price for Russian Urals crude oil on the world (European) market averaged $97.7 per barrel, or fell by 9.3% as compared with the previous year. It hit the bottom in December when the price for Russian oil dropped down to $61.1 per barrel.

Table 15

World prices for oil in 2000–2014, $/barrel

	2000	2005	2010	2011	2012	2013
Price for Brent crude oil, Great Britain	28.5	54.4	79.6	111.0	112.0	108.8
Price for Urals crude oil, Russia	26.6	50.8	78.3	109.1	110.3	107.7

Table 15 (continued)

	2014 IQ	2014 IIQ	2014 IIIQ	2014 IVQ	2014
Price for Brent crude oil, Great Britain	107.9	109.8	102.1	76.0	98.9
Price for Urals crude oil, Russia	106.5	107.7	101.2	75.3	97.7

Source: IMF, OECD/IEA.

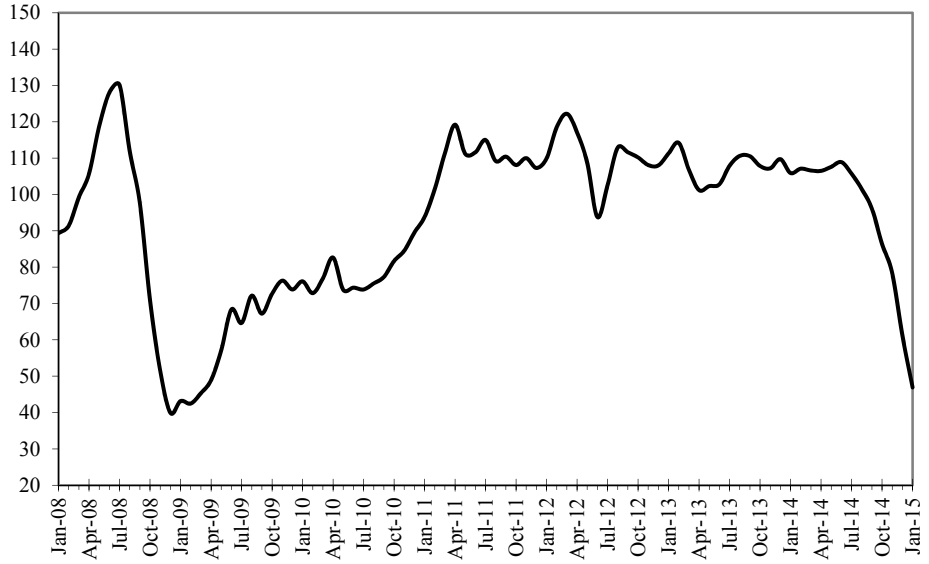
Table 16

World demand for oil in 2010–2014, as % of the previous year

	2010	2011	2012	2013	2014
World, total	3.1	0.9	1.2	1.4	0.7
OECD countries	1.3	–0.8	–1.1	0.4	–1.1
including: North America	2.0	–0.3	–1.7	2.1	0.0
Europe	–0.3	–2.3	–3.2	–0.9	–1.9
Non-OECD countries	5.2	3.0	3.6	2.4	2.4
including: Asia (except for countries of the Middle East and former USSR)	7.9	3.2	4.0	2.5	2.5

Source: OECD/IEA.

The price for Russian natural gas on the European market also displayed a downward trend. The prices for gas supplied under long-term contracts are usually tied to prices for petroleum products and with a certain lag follow the world prices for oil (*Table 17*). Moreover, in recent years prices for Russian gas were also pulled down by the changing situation on the European gas market, i.e. the growing competitive supply from other gas producing countries and lower spot prices for gas as compared with prices under long-term contracts. All this has forced "Gazprom" to bring down its sale prices for gas on the European market.



Source: Ministry of Economic Development of the Russian Federation.

Fig. 37. Price for Urals crude oil in 2008–2014, $/barrel

Table 17

World prices for oil and natural gas in 2005–2014

	2005	2010	2011	2012	2013	2014
Average world price for oil, $/barrel	53.4	79.0	104.0	105.0	104.1	96.2
Price for Russian gas on the European market, $/1,000 m^3	212.9	296.0	381.5	431.3	402.0	376.0

Source: IMF, Rosstat.

4.5.2. Dynamics and Structure of Production in the Oil and Gas Sector

In 2014 the output of oil in Russia reached 526.7 million tons which is the maximum level over the period since 1990 (*Table 18*). A positive effect on the dynamics of oil recovery was produced by the recent putting in operation of several large new fields in Eastern Siberia and the changes in taxation system that stimulate the development of new production regions and better oil recovery at the functioning fields. At the same time the growth rates of oil production in recent years have been notably falling (*Table 19*) primarily due to the worsening of recovery conditions. A great share of operating fields have entered the stage of declining output while new fields in most cases have worse mining, geological and geographic parameters and their development requires higher capital, operational and transport expenditures. At the moment Russian oil industry has approached the ceiling of its production capacities. To make up for the declining production of oil at the operating fields, one has to develop both new fields in regions with poorly developed or lacking infrastructure and idle reserves of lower quality oil in the developed regions.

Table 18

Oil production and processing in the Russian Federation in 2000–2014

	2000	2005	2010	2011	2012	2013	2014
Production of crude oil including gas condensate, million tons	323.2	470.0	505.1	511.4	518.0	523.3	526.7
Primary oil refining, million tons	173.0	208.0	249.3	258.0	270.0	278.0	294.4
Ratio of oil refining to crude oil production, %	53.5	44.3	49.4	50.4	52.1	53.1	55.9
Crude oil conversion rate, %	71.0	71.6	71.1	70.8	71.5	71.7	72.4

Source: Federal Service of State Statistics, Ministry of Energy of the Russian Federation.

Table 19

Production of crude oil, petroleum products and natural gas in 2000–2014, as % of the previous year

	2000	2005	2010	2011	2012	2013	2014
Crude oil including gas condensate	106.0	102.2	102.1	100.8	101.3	100.9	100.7
Primary oil refining	102.7	106.2	105.5	103.3	104.9	102.7	104.9
Gasoline	103.6	104.8	100.5	102.0	104.3	101.3	98.8
Diesel fuel	104.9	108.5	104.2	100.3	98.7	103.1	107.4
Heating oil	98.3	105.8	108.5	104.6	101.6	103.3	102.0
Natural gas	98.5	100.5	111.4	102.9	97.7	102.1	95.7

Source: Federal Service of State Statistics, Ministry of Energy of the Russian Federation.

At the same time in 2014 growth rates of oil processing remained higher than those of oil production primarily due to faster growth of petroleum products' export that was stimulated by lower export duties on these items as compared with export duties on crude oil. As a result of higher growth rates in primary oil refining, its ratio to crude oil production increased from 42.5% in 2004 to 55.9% in 2014. However, the crude oil conversion rate over this period actually did not improve and in 2014 was as low as 72.4% which is far below the level of developed countries where this indicator reaches 90-95%. The technological upgrading of oil processing industry remains one of the most critical tasks for the development of Russia's oil sector.

The largest producers of oil in 2014 were "Rosneft", "LUKOIL", "Surgutneftegaz" and "Gazprom". The share of these four companies amounted to 73.8% of the total oil production in the country. Medium-size companies ("Tatneft", "Bashneft", "Slavneft" and "RussNeft")

accounted for 13.1% of the total oil output. The share of other producers (over 100 smaller oil-producing entities) was as small as 9.5% (*Table 20*).

Table 20

Share of selected companies in the total Russian output of crude oil in 2010–2014

	Total oil output in 2010, million tons	Share in the total output, %	Total oil output in 2012, million tons	Share in the total output, %	Total oil output in 2013, million tons	Share in the total output, %	Total oil output in 2014, million tons	Share in the total output, %
Russia, total	505.1	100.0	518.0	100.0	523.3	100.0	526.7	100.0
Rosneft	112.4	22.3	117.5	22.7	192.6	36.8	190.9	36.2
LUKOIL	90.1	17.8	84.6	16.3	86.7	16.6	86.6	16.4
TNK-BP	71.7	14.2	72.5	14.0	–	–	–	–
Surgutneftegaz	59.5	11.8	61.4	11.9	61.5	11.8	61.4	11.7
Gazprom including Gazprom neft	43.3	8.6	46.1	8.9	48.5	9.3	49.8	9.5
including: Gazprom	13.5	2.7	14.5	2.8	16.3	3.1	16.2	3.1
Gazprom neft	29.8	5.9	31.6	6.1	32.2	6.2	33.6	6.4
Tatneft	26.1	5.2	26.3	5.1	26.4	5.0	26.5	5.0
Bashneft	14.1	2.8	15.4	3.0	16.1	3.1	17.9	3.4
Slavneft	18.4	3.6	17.9	3.5	16.8	3.2	16.2	3.1
RussNeft	13.0	2.6	13.9	2.7	8.8	1.7	8.6	1.6
NOVATEK	3.8	0.8	4.2	0.8	4.3	0.8	4.3	0.8
Operators of PSA	14.4	2.9	14.1	2.7	14.0	2.7	14.4	2.7
Other producers	38.2	7.6	44.1	8.5	47.6	9.1	50.1	9.5

Source: Ministry of Energy of the Russian Federation, author's calculations.

In recent years, the share of public sector in the Russian oil industry has notably expanded. In 2013, the state-owned company "Rosneft" took over "TNK-BP" that inclusive of its share in "Slavneft" produced 15.7% of the total domestic output of oil. In 2014 the ownership title to "Bashneft" accounting for 3.4% of the Russia's total oil output returned to the state. As a result in 2014 the share of state-owned companies in the national oil production reached 58.6% (our own estimates, *Table 21*). Meantime, the respective share of "Rosneft" taking into account its part in other entities was as high as 38.1%.

Table 21

Share of state-owned companies in the Russian crude oil production in 2014

	Total oil output, million tons	Share in the total oil output, %
Rosneft including its share in the output of other entities	200.5	38.1
Gazprom including Gazprom neft including their share in the output of other entities	60.6	11.5
Tatneft	26.5	5.0
Bashneft	17.9	3.4
Zarubezhneft (production on the territory of Russia)	3.2	0.6
State-owned companies, total	308.7	58.6

Source: Ministry of Energy of the Russian Federation, author's calculations.

"Gazprom" preserves its dominant positions in the Russian gas sector. However, in recent years its share in the total domestic output of natural gas notably reduced: from 83.2% in 2008 down to 68.1% in 2014 (*Table 22*). At the same time the contribution of other producers (oil companies, "NOVATEK", operators of PSA, etc.) increased. Altogether, the share of independent producers in 2014 gas output reached 31.9% including 8.2% provided by the largest independent producer of gas - "NOVATEK" company.

Table 22

Share of selected companies in the total Russian output of natural gas in 2010–2014

	Total gas output in 2010, billion m^3	Share in the total output, %	Total gas output in 2012, billion m^3	Share in the total output, %	Total gas output in 2013, billion m^3	Share in the total output, %	Total gas output in 2014, billion m^3	Share in the total output, %
Russia, total	665.5	100.0	671.5	100.0	684.0	100.0	654.2	100.0
Gasprom including Gasprom neft	513.9	77.2	489.4	72.9	489.1	71.5	445.5	68.1
including: Gasprom	509.0	76.5	478.5	71.3	476.3	69.6	432.1	66.1
Oil companies	66.6	10.0	71.1	10.6	76.8	11.2	78.1	11.9
NOVATEK	37.8	5.7	51.3	7.6	53.0	7.7	53.7	8.2
Operators of PSA	23.3	3.5	26.8	4.0	27.8	4.1	28.0	4.3
Other producers	23.9	3.6	32.9	4.9	37.3	5.5	48.9	7.5

Source: Ministry of Energy of the Russian Federation, author's calculations.

A new factor able to affect further development of the national oil and gas sector are economic sanctions against Russia introduced in 2014 by the US, the EU and some other countries in response to the Ukrainian developments. In addition to financial sanctions limiting access to external financing for Russian companies, in the second half of 2014 a number of developed countries introduced a ban on the supply to Russia of equipment and technologies for the development of three categories of fields: deposits in the Arctic shelf area, deepwater deposits and shale oil deposits. All the three categories of projects are critically dependent on foreign technologies. At the same time the investment cycle of projects for the development of Arctic shelf and deepwater fields is rather protracted and from the oil production point of view the negative effect of blocking such projects may show up only in the long term. Besides, in case prices for oil remain low the implementation of many projects of the kind will be suspended due to their economic inefficiency.

The situation with technologies for the development of shale oil deposits is more difficult. According to estimates of US EIA, Russia ranks first in the world by technically recoverable resources of shale oil. In case of applying modern technologies the development of these deposits is more cost-effective than the development of offshore fields. Meantime, the time needed for the development of these resources is much shorter. Under the conditions of sanctions Russia won't be able to develop its resources of shale oil and thus offset the decline of production at dwindling operating fields.

It should also be taken into account that technologies used for the development of shale oil deposits (horizontal drilling, hydraulic fracturing) are applied as well for the development of traditional oil deposits, first of all the ones with high level of resource depletion, in order to provide better oil extraction. Therefore, the ban on supply of equipment for horizontal drilling and hydraulic fracturing may also lead to the premature closing of operating fields due to the impossibility of their enhanced recovery.

Under the conditions of technological sanctions deeper recovery of traditional fields assumes crucial importance for the sustaining of oil production and export. In this regard both more active use of respective foreign technologies not included in the sanction list and the development of own technologies for enhancing oil recovery are necessary.

4.5.3. Dynamics and Structure of Oil and Gas Exports

In the situation of slowing growth of oil production, one can observe stabilization of petroleum exports (*Tables 23* and *24*). In 2014 the total exports of crude oil and petroleum products amounted to 388.2 million tons or were only 0.05% above the level of the previous year. Exports of petroleum products continued growing (up 8.7% as compared with 2013) while exports of crude oil shrank (by 5.6%). In 2014 the ratio of oil exports to oil output fell down to 42.4%. At the same time the ratio of exports to the output of heating oil exceeded 90%, the ratio for diesel fuel reached 61.6%. The ratio of gasoline exports to the output of this product was 10.9% (for reference: in 2005, it amounted to 18.5%, in 2010 – to 8.2%, in 2013 – to 11.2%).

Exports of natural gas in 2014 notably fell (by 12.1% as compared with the previous year). In recent years, the basic factor of gas exports' decline was the shrinking of supplies to the European market where the share of other gas producing countries has greatly increased. As a result, exports of Russian gas to the non-CIS countries in 2014 fell by 23% as compared with 2006 when the volumes of gas supplies from Russia to Europe reached their maximum. The ratio of net exports to the output of gas dropped from 31.4% in 2005 to 25.3% in 2014.

Table 23

Proportions between production, consumption and exports of oil and natural gas in 2000–2014

	2000	2005	2010	2011	2012	2013	2014
Oil, million tons							
Production	323.2	470.0	505.1	511.4	518.0	523.3	526.7
Exports, total	144.5	252.5	250.4	244.6	239.9	236.6	223.4
Exports to non-CIS countries	127.6	214.4	223.9	214.4	211.6	208.0	199.3
Exports to CIS countries	16.9	38.0	26.5	30.2	28.4	28.7	24.1
Net exports	138.7	250.1	249.3	243.5	239.1	235.8	222.6
Domestic consumption	123.0	123.1	125.9	140.7	142.1	137.5	141.3
Net exports as % of production	42.9	53.2	49.4	47.6	46.2	45.1	42.3
Petroleum products, million tons							
Exports, total	61.9	97.0	132.2	130.6	138.1	151.4	164.8
Exports to non-CIS countries	58.4	93.1	126.6	120.0	121.2	141.1	155.2
Exports to CIS countries	3.5	3.9	5.6	10.6	16.9	10.3	9.6
Net exports	61.5	96.8	129.9	127.2	136.8	150.0	162.8
Oil and petroleum products, million tons							
Net exports of oil and petroleum products	200.2	346.9	379.2	370.7	375.9	385.8	385.4
Net exports of oil and petroleum products as % of oil production	61.9	73.8	75.1	72.5	72.6	73.7	73.2
Natural gas, billion m^3							
Production	584.2	636.0	665.5	687.5	671.5	684.0	654.2
Exports, total	193.8	207.3	177.8	184.9	178.7	196.4	172.6
Exports to non-CIS countries	133.8	159.8	107.4	117.0	112.6	138.0	124.6
Exports to CIS countries	60.0	47.5	70.4	67.9	66.0	58.4	48.0
Net exports	189.7	199.6	173.5	179.2	171.6	189.3	165.5
Domestic consumption	394.5	436.4	492.0	508.3	499.9	494.7	488.7
Net exports as % of production	32.5	31.4	26.1	26.1	25.6	27.7	25.3

Source: Federal Service of State Statistics, Ministry of Energy of the Russian Federation, Federal Customs Service, author's calculations.

Table 24

Dynamics of Russian exports of oil, petroleum products and natural gas in 2005–2014, as % of the previous year

	2005	2010	2011	2012	2013	2014
Oil, total	98.4	101.2	97.6	98.2	98.6	94.4
including: non-CIS countries	99.1	106.1	95.7	98.7	98.3	95.8
Petroleum products, total	117.9	106.2	98.5	104.4	109.6	108.7
including: non-CIS countries	119.1	109.6	94.6	100.8	116.4	109.8
Gas, total	103.7	105.6	104.0	96.6	109.9	87.9

Source: Federal Service of State Statistics.

The analysis of dynamics of Russian oil exports over a long term reveals a notable strengthening of oil sector's export orientation as compared with the pre-reform period. The ratio of net exports of oil and petroleum products to the output of oil increased from 47.7% in 1990 to 73.2% in 2014. However, one should keep in mind that this is due not only to the increase of absolute export volumes but also to the remarkable drop of domestic oil consumption following market transformation of the Russian economy, improvement of oil utilization efficiency and replacement of heating oil by natural gas. It's noteworthy that the share of petroleum products in the total petroleum exports increased from 18.2% in 1990 to 42.2% in 2014 (*Table 25*). Still, one should take into account that due to the low oil refining depth the major part of Russian exports of petroleum products consists of heating oil that in Europe is used as an input for further processing and production of light oil products. In 2014 the share of heating oil in the total exports of petroleum products amounted to 53%.

Table 25

Net exports of petroleum products in 2005–2014

	2005	2010	2011	2012	2013	2014
Net exports of petroleum products, million tons	96.8	129.9	127.2	136.8	150.0	162.8
Share of petroleum products in the net exports of oil and petroleum products, %	27.9	34.3	34.3	36.4	38.9	42.2

Source: Federal Service of State Statistics, Federal Customs Service, author's calculations.

The lowering of world prices for oil and gas and the reduction of physical volumes of gas export resulted in the shrinking of fuel and energy items' share in the Russian exports down to 69.5% in 2014, with the share of crude oil amounting to 31.0% and the share of natural gas – to 11.0% (*Table 26*).

Table 26

Cost and relative importance of fuel and energy exports in 2005–2014

	2005		2010		2013		2014	
	Billion $	%*	Billion $	%*	Billion $	%*	Billion $	%*
Fuel and energy items, total	154.7	64.1	267.7	67.5	371.8	70.6	345.4	69.5
including: oil	83.8	34.7	134.6	34.0	173.7	33.0	153.9	31.0
natural gas	31.4	13.0	47.6	12.0	67.2	12.8	54.7	11.0

* as % of the total Russian exports.
Source: Federal Service of State Statistics.

4.5.4. Dynamics of Prices for Energy Products on the Domestic Market

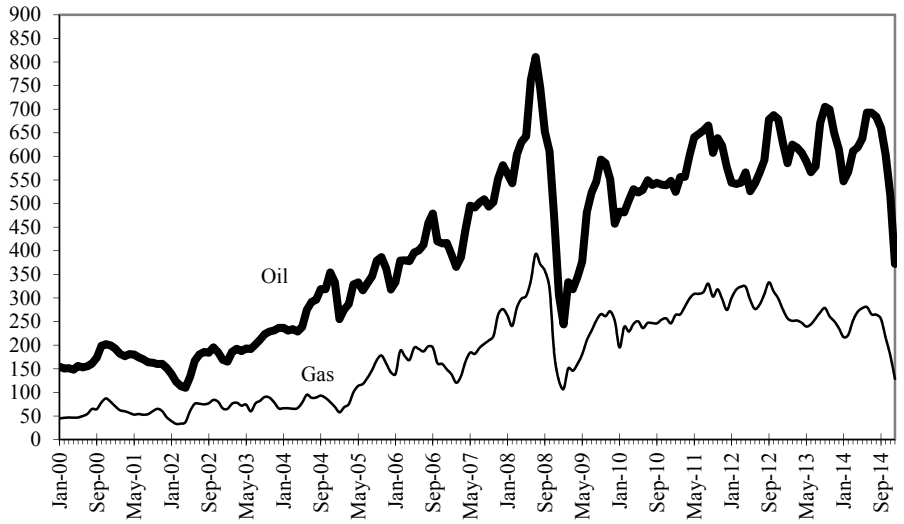
Prices for oil and petroleum products on the domestic Russian market are basically determined by the corresponding world prices so that to provide equal profitability of supplies to foreign and home market, i.e. are net back prices equaling the world price minus export customs duty and export shipment costs. In recent years the growth of world prices for oil and petroleum products drove the rise of prices on the domestic market. But in the second half of 2014 lower world prices and ruble exchange rate resulted in a notable decline of domestic prices in dollar terms (*Table 27, Fig. 38* and *39*). It's noteworthy that due to the high export duties there still remains a great gap between the world and domestic prices. In 2014 the domestic price for oil (producer price) averaged only $41.1 per barrel, or 42.1% of the world price (price for Urals oil on the European market).

Table 27

Domestic prices for oil, petroleum products and natural gas in dollar terms in 2000-2014 (average producer prices, $/ton)

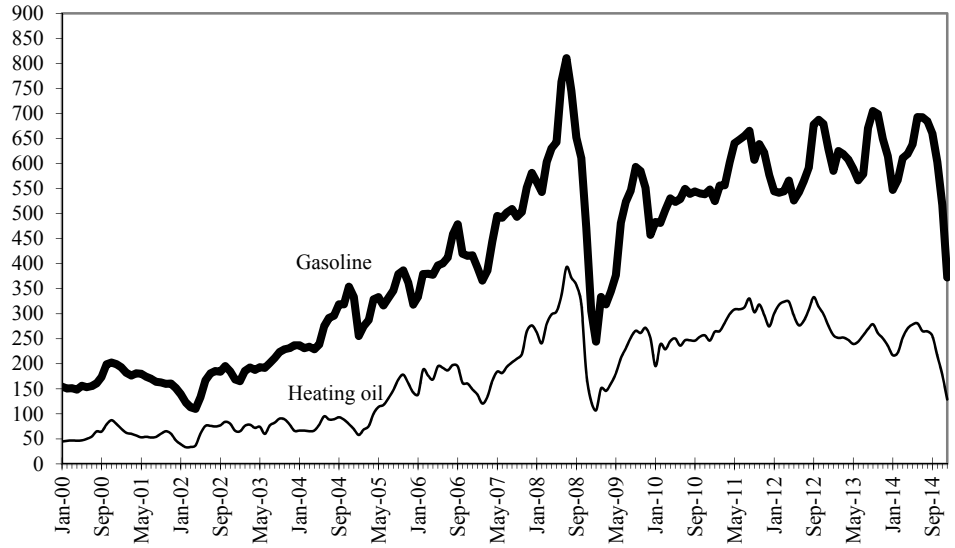
	2000 Dec.	2005 Dec.	2010 Dec.	2011 Dec.	2012 Dec.	2013 Dec.	2014 June	2014 Dec.
Oil	54.9	167.2	248.2	303.3	341.1	346.1	364.6	178.9
Gasoline	199.3	318.2	547.9	576.9	628.7	614.4	692.7	372.3
Diesel fuel	185.0	417.0	536.1	644.9	774.2	698.0	677.2	419.3
Heating oil	79.7	142.7	246.3	274.6	275.3	235.8	280.6	128.7
Gas, $/1,000m^3	3.1	11.5	20.5	21.3	40.3	39.8	42.4	29.1

Source: calculated using data of the Federal Service of State Statistics.



Source: calculated using data of the Federal Service of State Statistics.

Fig. 38. Average producer prices for oil and gas in dollar terms in 2000–2014 (oil - $/ton, gas - $/1,000m^3, right axis)



Source: calculated using data of the Federal Service of State Statistics.

Fig. 39. Average producer prices for gasoline and heating oil in dollar terms in 2000–2014 ($/ton)

Domestic prices for gas remain the subject of state regulation. In order to ensure the competitiveness of national economy the government supported far lower level of the domestic gas prices as compared with that of the world market. In 2014 the domestic price for gas (the price paid by industrial consumers less indirect taxes) averaged only 26.4% of the price for Russian gas on the European market.

4.5.5. Tax Regulation of the Oil and Gas Sector

In the beginning of 2014, new statutes of tax regulation aimed to encourage the development of hard-to-recover oil reserves came into force. These provisions were enacted by Federal Law No. 213-FZ of July 23, 2013 "On introducing amendments to Chapters 25 and 26 of Part II of Tax Code of the Russian Federation and Clause 3.1 of the Law of the Russian Federation "On customs tariff"". This Law establishes differential rates of mineral extraction tax (MET) depending on the reservoir permeability, size of the oil-bearing formation and the degree of deposit depletion. The Law establishes application of a special MET degression coefficient *Кд* [Kd] reflecting the difficulty of oil recovery. Depending on the parameters of a specific field (hydrocarbon reservoir) the *Кд* value may be 0.8, 0.4, 0.2 and 0. A special coefficient – *Кдв* [Kdv] – is introduced for reflecting the depletion of a specific hydrocarbon reservoir. In case of high depletion (over 80%) the coefficient is degressive and its value is determined using a special formula.

So, five coefficients reflecting major rent-shaping factors are currently applied to MET: coefficient *Кц* [Cts] reflecting the dynamics of world prices for oil; coefficient *Кв* [Kv] reflecting the degree of depletion of a specific subsoil area; coefficient *Кз* [Kz] reflecting the size of reserves in a particular field; coefficient *Кд* [Kd] reflecting the difficulty of oil recovery and coefficient *Кдв* [Kdv] reflecting the depletion of a specific hydrocarbon reservoir.

The application of price coefficient (*Kц*) for the purposes of taxation permits making allowances for the world prices for oil that shape producers' gross income. This coefficient is applied for all deposits. Meantime, other coefficients are designed to alleviate tax burden for fields with increased development costs (depleted fields, small deposits, hard-to-recover reserves). Higher costs associated with the development of such deposits are taken into account by applying lower tax rates.

In 2014 amendments to Law No. 5003-1 "On customs tariffs" adopted by Federal Law No. 213-FZ came into effect. According to them oil recovered in the fields where the share of initial recoverable oil reserves qualified as productive sediments of Tyumen suite in the total initial recoverable oil reserves in the deposit is not less than 0.8, is included in the list of oil types for which special formulas of calculating export duty rates are established. These formulas envisage lower export duty rates for oil from such deposits.

Special formulas for calculating export duty rates are also applied for high viscosity oil and oil developed in fields located in Eastern Siberia (within the borders of the Sakha (Yakutia) Republic, the Irkutsk Region and Krasnoyarsk Territory), the Nenets Autonomous District, the Yamalo-Nenets Autonomous District to the north from 65 degrees north latitude as well as in Caspian sea and on continental shelf.

The system of taxation in gas sector was also notably revised in 2014. On July 1, 2014 a new procedure for determining MET rates for producers of natural gas and gas condensate came into effect. It is based on applying special formulas and coefficients that take into account various factors shaping profitability of gas and gas condensate production and marketing. This procedure was adopted by Federal Law No. 263-FZ of September 30, 2013 "On introducing amendments to Chapter 26 of Part II of Tax Code of the Russian Federation and Clause 3.1 of the Law of the Russian Federation "On customs tariff"".

The new procedure provides for considering a number of important rent-shaping factors when establishing MET rates: the price for gas on foreign and domestic markets, the price for gas condensate, the price for Urals oil, the rate of export duty on oil, the exchange rate of US dollar relative to ruble, the share of recovered gas in the total amount of crude hydrocarbons recovered from a particular field, the difficulty of recovering gas and gas condensate, the degree of depletion of a specific subsoil area, the geographic location of a field, the depth of hydrocarbon reservoir, the specifics of developing particular fields.

The introduced procedure of establishing MET rate for natural gas allows taking into account basic factors that determine profitability of gas production and marketing and provides for the necessary differentiation of tax burden depending on the specific conditions of fields' development.

Besides, in 2014 came into effect a special soft tax regime for the development of new offshore fields. It was adopted by Federal Law No. 268-FZ of September 30, 2013 "On introducing amendments to Parts I and II of Tax Code of the Russian Federation and relevant legislative acts of the Russian Federation in connection with implementing measures for tax and customs tariff stimulation of crude hydrocarbons production on the continental shelf of the Russian Federation". This regime is based on lower ad-valorem MET rate differentiated by shelf zones and the standard profit tax. Export duty and property tax are not levied in case of offshore projects.

Principal decisions on restructuring the system of oil sector's taxation were taken in 2014. Federal Law No. 366-FZ of November 24, 2014 "On introducing amendments to Part II of Tax Code of the Russian Federation and relevant legislative acts of the Russian Federation"

envisages a notable lowering of export duties on oil and petroleum products and the compensatory raising of MET base rate. According to the taken decisions the base rate of MET for oil producers is to be raised step by step from Rb 493 per ton in 2014 up to Rb 919 per ton in 2017. At the same time the marginal rate of export duty on oil (coefficient in the formula for calculating the marginal rate) is reduced from 59% in 2014 down to 30% in 2017 (*Table 28*). Simultaneously, export duties on "dark" petroleum products relative to the export duty on crude oil are raised (up to 100% thereof in 2017) while those for "light" petroleum products are reduced.

Table 28

Rates of MET and export duties on oil and petroleum products in 2014–2017

	2014	2015	2016	2017
Basic rate of MET for oil production, rubles per ton	493	766	857	919
Export duty on crude oil: coefficient in the formula for calculating the rate of export duty	0.59	0.42	0.36	0.30
Export duties on petroleum products: coefficients relative to the export duty on oil				
Gasoline	0.90	0.78	0.61	0.30
Diesel fuel	0.65	0.48	0.40	0.30
Heating oil	0.66	0.76	0.82	1.00

Source: Tax Code of the Russian Federation, Federal Law No. 366-FZ of November 24, 2014.

The implementation of these measures that have been called "a tax maneuver" will result in a remarkable redistribution of tax burden: the share of MET in rent taxes imposed on the oil sector will grow sizably while that of export duties will notably reduce. So, MET will become the principal rent tax and will perform the basic functions of tax regulation in the sector.

To our mind, such changes are economically indispensable and correspond to the principles of rent taxation and international practices. MET should play the key role in the oil sector's taxation system while the role of export duties should be seriously diminished (up to their total cancellation in the future). At present, it is the export duty that actually serves as the basic tax in the oil sector. In 2014, the share of export duty in the structure of price for exported oil (given standard tax rates) amounted to nearly 50% and was almost twice higher than that of MET.

The high level of export duty on oil makes it necessary to regulate the effective rate of this tax (set lower duty rates and the term of their application for selected fields) in order to bring the tax burden in compliance with the actual conditions of oil recovery, i.e. to assign export duty the functions that should be performed by MET. Meantime, MET cannot fully perform its regulating function due to the high export duty.

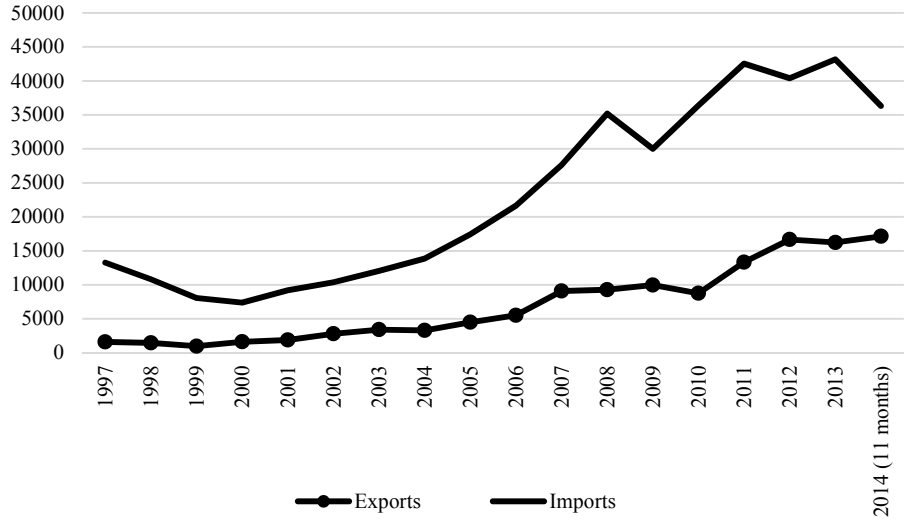
The lowering of export duties on oil and petroleum products will have a number of positive effects. First of all, it will reduce the ongoing subsidizing of oil processing sector and thus will create real stimulus for its modernization and deepening of oil refining. Besides, it will greatly decrease the subsidizing of other Customs Union members by Russia that occurs owing to duty-free supplies of Russian oil and petroleum products. At the same time the growth of domestic prices for oil and petroleum products with their approaching to the world level as a result of export duties' lowering will create correct price guides for market operators and will strengthen incentives for the improvement of energy efficiency that in its turn will foster the decrease of Russian economy's energy intensity.

4.6. Russian agriculture: the impact of sanctions

4.6.1. General Outline of Agricultural Performance

On 7 August 2014 Russia introduced restrictions on import of food products from countries of the European Union, the US, Canada, Norway and Australia[1] (hereinafter – retaliatory sanctions) in response to their sanctions against Russia driven by political developments in the Ukraine. This step astonished a lot of people in the country and even more so abroad as at the moment of enforcing retaliatory sanctions Russia remained a large-scale importer of foodstuffs. For many years one could observe an upward trend in imports of agricultural and food products that by 2013 amounted to $43.2bn *(Fig. 40)*.

High import volumes used to be a subject of public scrutiny and concern. But beginning from 1998 and even more so from 2006 the pattern of agricultural production in Russia started undergoing great changes: agriculture was adjusting to new conditions, new efficient production facilities were being put in operation, the location of production over the country's territory was actively transforming, in some sectors the output was falling while in the others it was growing. In 2006 the Federal Law "On the development of agriculture" was adopted that established a middle-term planning for state support of agriculture – initially the term was set at 5 years but later it was extended up to 8 years (in the framework of State programs for agricultural development and regulation of agricultural, input and food markets). In 2006 started the implementation of Priority national project of agrifood sector development and beginning from 2008 state support was provided under the State Programs. This resulted in the growth of budget funding and higher predictability of state support to agriculture.

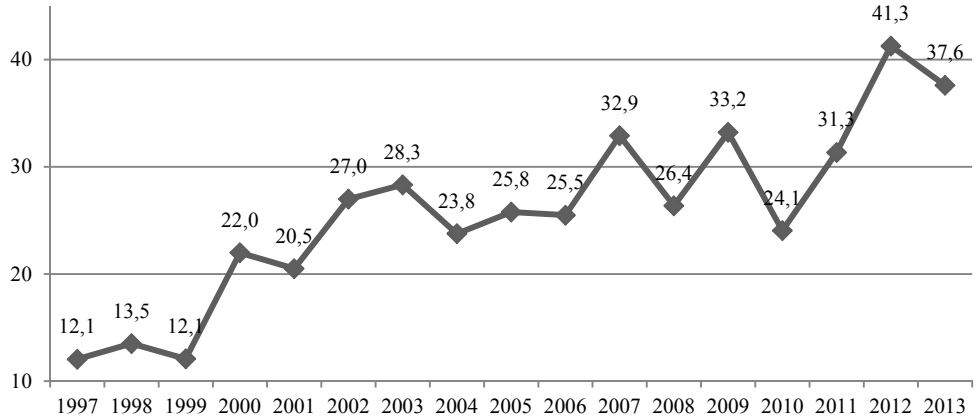


Source: Rosstat, Federal Customs Service.

Fig. 40. Exports and imports of agricultural and food products, million dollars

[1] RF Government Resolution of August 7, 2014 No. 778 "On measures for the implementation of RF President Decree of August 6, 2014 No. 560 "On the enforcement of selected special economic measures aimed at ensuring food security of the Russian Federation"".

These developments led to the change of some regions' contribution to the overall production. The growing import purchases of items the production of which in the country in that period was not profitable due to different reasons were accompanied by bigger export sales of other items that were competitive on the foreign markets. First of all this relates to grains including corn and vegetable oils. The structure of export and import transactions started to improve. For instance, while in 1997-1998 exports were as small as 12-14% of import volumes, in 2012-2013 the proportion grew up to 41-38% (*Fig. 41*). It implies that Russia has become not only a large importer but also a large exporter of agricultural products. In 2013 total exports amounted to $16.2bn thus exceeding the 2006 level almost 3 fold.



Source: Rosstat, Federal Customs Service.

Fig. 41. Russia: ratio of food and agricultural exports to imports in 1997–2013, %

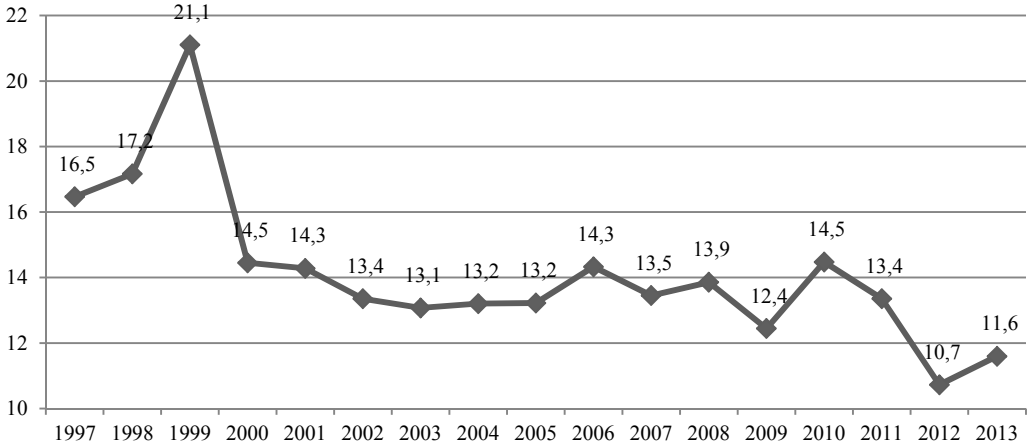
As a result, if measured by the ratio of import-export balance to the expenditures of population on foodstuffs, the general indicator of food dependency has fallen and beginning from 2000 is relatively stable ranging from 11 to 14% (*Fig. 42*). In the country at large food products became more affordable for consumers (despite some negative developments persisting in some regions and groups of population) owing to the general growth of real incomes: the share of foodstuffs in the total consumer expenditures has fallen, the structure of personal consumption improved and the level of per capita consumption of meat products became comparable to that of the pre-reform period.[1]

The Doctrine of Russia's food security[2] sets thresholds of food independency for 8 products or product groups. By the moment of retaliatory sanctions' launching the level of demand satisfaction met these requirements for grains, potatoes, vegetable oils, sugar and poultry meat. There still remained problems with the supply of dairy products, beef, pork, vegetables and fruit. *Fig. 42* and *43* show that before the introduction of sanctions and retaliatory sanctions not only the general indicator of dependency on imports but also similar indicators for selected groups of foodstuffs (except milk and dairy products) were improving. Still, domestic

[1] Uzun V.Ya., Shagayda N.I. *Prodovol'stvennaya bezopasnost' v Rossii: monitoring, tendentsii i ugrozy* [Food security in Russia: monitoring, trends and threats]. // Russian Presidential Academy of National Economy and Public Administration (RANEPA), 2014. http://www.ranepa.ru/news/item/3674-prod-bez.html

[2] RF President Decree of January 30, 2010 No. 120 "On the adoption of Doctrine of food security of the Russian Federation".

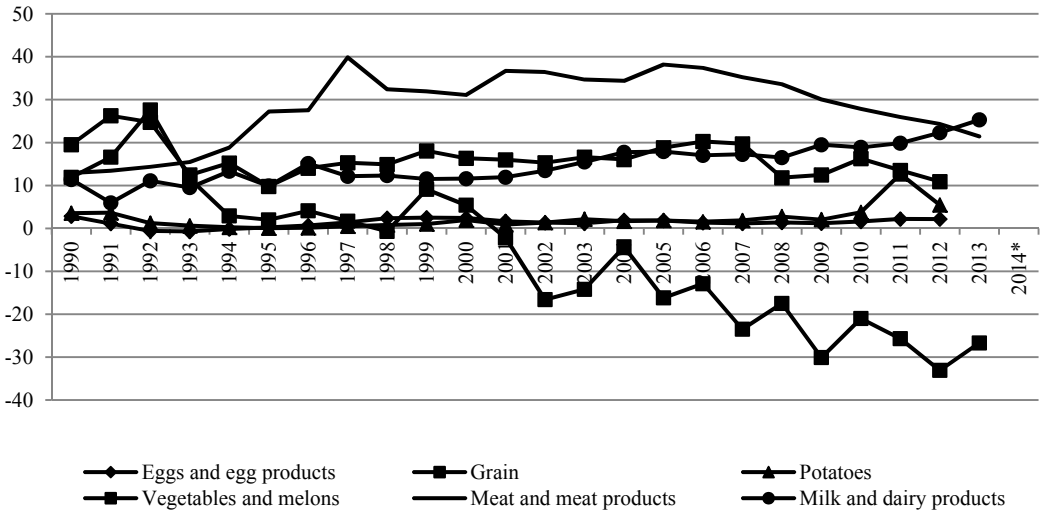
output failed to satisfy respective demand. Therefore the substitution of imports by Russian products could not occur at once but required some time and certain conditions. Consequently, an instantaneous ban on import should have resulted in the replacement of importers by other ones but it also could not happen at once.



Source: Rosstat, Federal Customs Service.

Fig. 42. General indicator of food dependency in 1997–2013, %

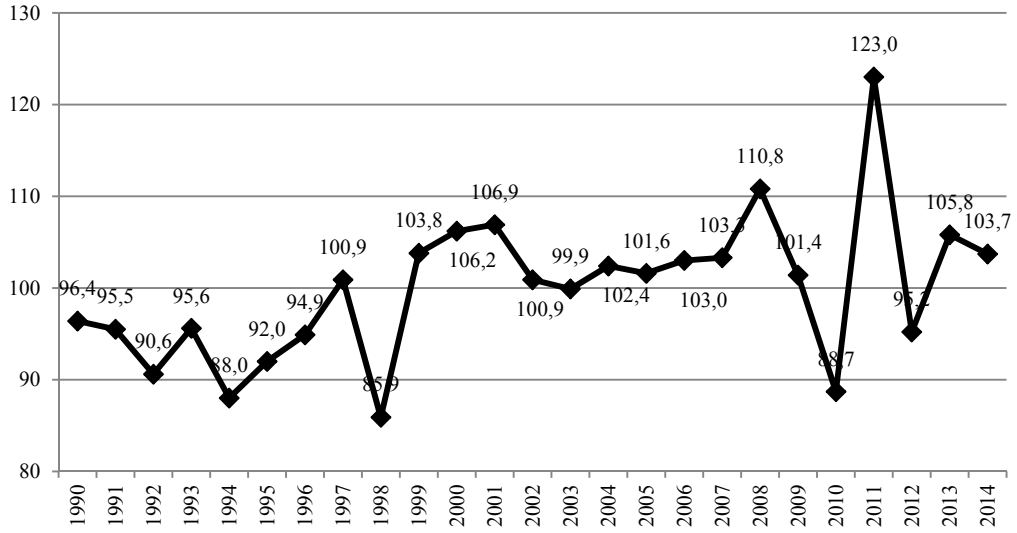
According to data of the RF Federal Customs Service, in August 2014 the decrease of imports relative to the respective period of 2013 was 3%, in September – about 11%, in October – already 18% and by the year end – 25%. To some extent this is due to the shrinking demand for food. For instance, in November 2014 the sales of meat and meat products fell by almost 7% as compared with October, those of milk – by 1.8%, of bread – by nearly 5%. At the same time the sales of fish and fish products grew by 4.8%, of vegetable oils – by 1.5%, of eggs – by 1.3%, of flour – by 8.2%.



* 9 months.
Source: Rosstat.

Fig. 43. Dependency on imports (ratio of import-export balance to the domestic consumption), %

Many experts regarded the ban on import of agricultural and food items to Russia from selected countries as a new opportunity for the development of domestic farming. Indeed, 2014 was favourable for agriculture – the sector's index of production exceeded the respective indicator for 2013 that was quite a good year for farming (*Fig. 43*).



* preliminary data.
Source: Rosstat.

Fig. 44. Growth rates of agricultural production relative to the previous year in 1990–2014, %

Growth rates of agricultural production relative to 2013 amounted to 103.7% (in 2013 – 105.8%).

In 2014 the output of grain reached 103.8 million tons, the output of sunflower seeds – 8.8 million tons, that of sugar beets – 32.7 million tons, of livestock and poultry (slaughter weight) – 8.5 million tons (including 2.8 million tons of pork and 3.8 million tons of poultry meat), milk – 30.5 million tons, eggs – 41.3 billion pieces[1].

A sharp devaluation of ruble has provided additional advantages for Russian farm producers on the markets occupied by importers. Products of the latter are becoming too expensive for Russian consumers and they will have to reorient to domestic produce. According to data of the Customs Service, in 2014 the cost amount of food imports fell by 7.7% as compared with 2013. The biggest decrease of physical import volumes was demonstrated by such items as cheese and curds (31.8%), fresh-frozen meat (24.3%), frozen fish (16.2%), poultry meat (13.6%) and butter (13.2%). Meantime, imports of corn grew (by 22.3%) as well as those of products containing cocoa (by 14.4%) and coffee (by 12.6%).

At the same time the continuation of sanctions war against Russia can have a negative effect on the performance of national agriculture since its success in recent years was largely determined by the adoption of new foreign technologies, the purchase of foreign seeds and other inputs. If introduced, retaliatory sanctions in respect of these inputs (a ban on supply of pedigree young stock, eggs, seeds and hybrids) will have serious consequences for the most advanced production units. In this regard less productive and poorly modernized corporate

[1] According to Rosstat data.

farms, individual private and even household farms turn out to be more sustainable to external shocks as compared with high-tech but reliant on imported inputs and technologies agroholdings.

The war of sanctions showed how much the country is dependent on the external world. Therefore, there is an urgent need to work out and implement the schemes for supporting agricultural research; for the creation of laboratories, seed stations and livestock breeding farms on the basis of public-private partnership in order to attract investments; for the development, maintaining and distribution of new varieties and breeds; for the education of students and provision of agricultural extension services. One should work out incentives that could motivate foreign companies to organize production and dissemination of elite seeds, modern technologies of herd improvement, to launch production of science-intensive products. With this in view it would be rational to extend the notion of food security by setting the threshold levels of self-sufficiency in elite seeds, pedigree livestock, inputs, etc.

4.6.2. Impact of Sanctions and Retaliatory Sanctions on Relationships within the Eurasian Economic Union

Russia faces serious risks due to the fact that the country's leadership takes a lot of strategic decisions without due regard to the interests of its allies and commitments before them. The Eurasian Economic Union (EAEU) has a common customs territory. The procedure of changing its borders is not specified in the treaties on the establishment of the Customs Union and the EAEU. In 2014, Russia incorporated Crimea and thus unilaterally changed the customs area of the EAEU. No official agreement of other countries-members of the Union was obtained. In response to Russia's actions the US, the EU and some other countries imposed sanctions on it. These sanctions had a negative effect not only on the Russian economy by also on the economy of other members of the EAEU.

When elaborating sanctions against Russia, the EU countries went through a long coordination procedure in order to reach consensus. The European Union introduced respective sanctions only upon receiving the official consent of all its members. In the EAEU Russia imposed the ban on import of agricultural products without negotiating it with the allies. The Protocol on measures of non-tariff regulation in respect of the third countries (Addendum 7 to the EAEU Treaty) contains a provision permitting unilateral introduction of sanctions (Clause 50 of the Protocol). The procedures of coordinating such a decision with countries-members and the Eurasian economic commission are specified in Clauses 51-56 of the Protocol. A similar rule was already in effect in accordance with the Agreement on non-tariff regulation measures of January 25, 2008. When launching retaliatory sanctions Russia got no official consent of its partners in the EAEU and the latter did not introduce similar sanctions. A lot of problems appeared because of that. Belarus and Kazakhstan continue importing products from countries against which Russia introduced sanctions. It's quite natural that businessmen from these countries have got a strong incentive to re-export the imported items to Russia. The legal acts of the Customs Union, the Common Economic Space and the EAEU have no provisions restricting re-export but Russian authorities are against it. Business has surely found ways for evading Russia's ban: falsification of documents on commodity origin, drawing up of transit documents, change of packing cases, minor processing, etc.

The effective agreements enable Russia to forbid import from the countries subjected to retaliatory sanctions without the consent of other countries of the Union. But the maximum term established for such restrictions is 6 months. Therefore, in February 2015 Belarus and

Kazakhstan will get the grounds to either require that Russia lifts retaliatory sanctions or to join them.

Russia needs to get the consent of its allies in simpler cases as well. For instance, if Russia imposes a temporary ban on the import of vine from Moldova, there can be all sorts of reasons for that. But in case no simultaneous bans are imposed by Belarus and Kazakhstan, the entrepreneurs from these countries will be able to import the items forbidden by Russia and to sell them on the territory of Russia as well.

The situation with Ukraine is similar. Russia threatens to exclude Ukraine from the CIS zone of free trade and to raise duties on its produce up to the level applied for the EU countries. Belarus and Kazakhstan do not support this idea and are going to preserve the effective terms of trade with Ukraine. The introduction of unilateral sanctions against Ukraine by Russia will generate new risks of the Ukrainian commodities' re-export.

In 2014 the lack of agreement in allies' actions has already provoked the appeal of Belarus to the Eurasian economic commission (EAEC) requesting not to extend import restrictions unilaterally imposed by Russia on the goods supplied to the customs territory of Belarus and forwarded in transit through the Russian territory to Kazakhstan. There were also applications to the EAEC concerning the introduced phytosanitary restrictions. Because of the discrepancies being in place, customs check-points at the Russia-Belarus border resumed their operation thus impairing the common customs territory.

It should be also noted that the association of Kazakhstan, Belarus and Russia into the Eurasian Economic Union *per se* poses certain risks to domestic agriculture. Countries-members should unify their customs duties, quotas and tariffs; revise regulations and standards of food safety; reform the procedures of certification and testing of compliance with regulations. Moreover, special attention should be paid to the working out of coordinated position of EAEU countries at the current negotiations with WTO, in particular concerning the rules of building state reserves for the purposes of food security.

So far, all the post-Soviet countries apply various tools for supporting agriculture - national measures of budget support differ greatly not only by their nature but also by amounts and mechanisms of implementation. For instance, in Russia the producer support estimate (PSE) calculated using the OECD methodology reaches 17% of output, in Kazakhstan – 12%, in Ukraine – 1%. In Belarus this indicator was not calculated but the study carried out by the RANEPA Center of agrarian policy showed that the ratio of budget support therein exceeds the respective Russia's and Kazakhstan's indicators several fold. Given that Russian farm producers *a priori* loose to their Belarus colleagues and it's still hard to talk about common agricultural policies. Many years are needed for forming mutually beneficial common policy in respect of the third countries.

4.6.3. Situation on Selected Food Markets

Import ban under retaliatory sanctions introduced by Russia in 2014 has had a short-term effect and will have long-term consequences for markets where the share of imports from countries subjected to restrictions is significant. Let's reiterate that these are meat and dairy markets and the market of fruit and vegetables.

On the market of pork the share of imports in consumption (including sub-products and fat) amounts to 26.2%, of them the share of countries against which sanctions are applied is as

high as 24.1%. For poultry meat these indicators equal 12.5% and 7.6%, respectively, for beef – 33.6% and 7.3%.[1]

In 2014 the RF government introduced restrictions on import of pork twice. First – in January when the embargo was set on import from the EU of live pigs, pork and products out of pork due to the detection of African swine fever virus in Lithuania and Poland. Second – in August when it was done in the framework of retaliatory sanctions. The restrictions resulted in a notable drop of pork imports – by 35.3% within 8 months 2014 as compared with the same period of 2013. The decrease of poultry meat and beef imports was less dramatic – by 16.3% and 9.2%, respectively.

The ban on import of pork has resulted in its remarkable restructuring and led to temporary complications in the import supply logistics. Due to the suspension of deliveries from the EU at the beginning of 2014, 40% of pork in the first 6 month of the year was imported from Canada[2]. And after the introduction of retaliatory sanctions in August Brazil has become the major supplier of pork to the Russian Federation. In October for the first time in 10 recent years started the deliveries of pork from China that were earlier forbidden due to the sanitary reasons.

The supplies from Brazil and China partially compensate the deficit of raw meat inputs on the market but they are unable to fully absorb the share of countries subjected to sanctions. Besides, in the conditions of market geography change importers needed time for signing new contracts and as a result in the first months after the introduction of bans there emerged a gap in the supply of raw meat. This had an impact on the price situation on the market. From the beginning of 2014 the growth of purchase prices for pork exceeded 65%[3].

The growth of prices on the pork market is due not only to the emerged deficit of raw meat inputs but also to the diversification of supplies shifting from most competitive to less efficient meat exporters.

After the introduction of retaliatory sanctions on import of food products the RF government sees its main task in ensuring accelerated import substitution. In the Russian pig breeding this process started in 2013 while earlier (in 2006-2012) the increase of domestic output just covered the positive dynamics of pork consumption.

Russian pig breeding has a potential for increasing production volumes thanks to large pig farms many of which have already announced construction of new complexes. Only the announced investments of seven biggest companies after their enterprises reach full capacity in 2017-2020 are able to provide for the increase of domestic pork output by 1.1 million tons live weight (or about 0.8 million tons slaughter weight). In recent years imports of pork and live pigs in slaughter weight didn't rise above 0.8 million tons and including sub-products and fat – above 1.2 million tons.[4] In this regard there is a risk of over-investment in the sector and the consequent over-saturation of the market, drop of prices and decline of profitability.

The dairy market is also characterized by a high share of imports with many EU countries being suppliers of milk products to Russia before the introduction of sanctions. According to estimates of IKAR the share of imports in the consumption[5] of cheese reaches 50.5% (2013),

[1] Data of the Institute for Agricultural Market Studies (IKAR).
[2] According to data of the National Union of Pig Breeders.
[3] Data of the Institute for Agricultural Market Studies (IKAR).
[4] Data of the National Union of Pig Breeders including trade with countries of the Customs Union.
[5] Including supplies from countries of the Customs Union.

in the consumption of butter – 41.1%. Imports from the countries subjected to retaliatory sanctions account for 30.3% of cheese consumption and 10.3% of butter consumption.

The comparison of import volumes in 2014 and 2013 allows to conclude that the introduction of retaliatory sanctions did not produce a strong effect on the Russian dairy market. By the end of 2014 imports of all categories of dairy products (except cheese) were not noticeably smaller than those in the previous year (*Table 29*). But this is just the surface reflecting short-term dynamics.

Table 29

Imports of dairy products in 2013–2014, tons

Item	2013	2014	2014/2013, %
Milk and cream, non-condensed	266 103	273 329	102.7
Milk and cream, condensed	220 184	164 596	74.8
Butter milk, coagulated milk and cream, yoghurt, kefir	80 928	72 158	89.2
Milk whey, condensed and non-condensed	143 071	115 541	80.7
Butter	144 359	137 795	95.4
Cheese and curd	438 498	288 141	65.7

Source: Federal Customs Service.

First, in the first half of the year imports of dairy products demonstrated growth as compared with the respective period of 2013 and as a result their reduction following sanctions did not have a serious impact on the annual total for 2014. For instance, in the first 6 months of 2014 imports of whole milk products to Russia increased by 49.7%, those of butter and milk fats – by 50.4%, dry milk – by 10.5%, dry milk whey – by 29.3%[1]. Growth of import volumes at the beginning of the year was conditioned by low prices for milk on the world market owing to the increase of dairy production in key exporters of this product – the EU, the US and New Zealand. Bigger imports of whole milk products to Russia covered the deficit of raw milk on the domestic market due to the decrease of its production in the country. Besides, Russian producers have higher unit costs of producing butter and therefore cannot compete with foreign suppliers.

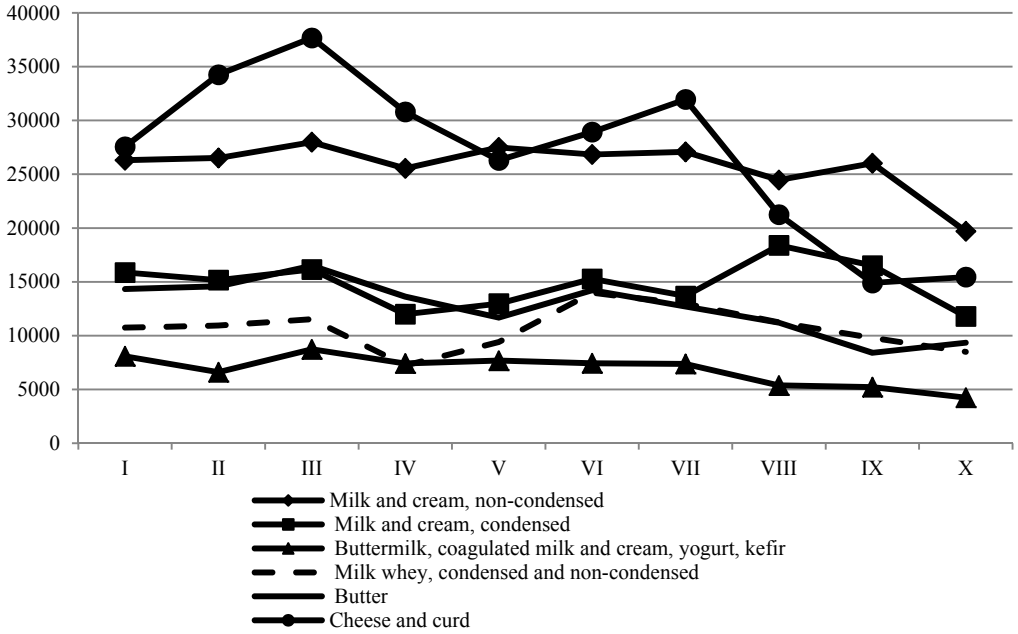
Second, an important role on the Russian market of milk belongs to the Belarusian produce that is not subjected to sanctions and is supplied (or at least should be supplied) to the territory of Russia under pre-agreed inter-state balances. In the first half of 2014 the share of Belarus in the total imports of whole milk products amounted to 71%, in those of condensed milk and cream – 82%, butter milk, yoghurt and kefir – 60%, dry milk whey – 76%. As a result of the introduced retaliatory sanctions the geographic structure of milk imports became less diversified and the share of Belarus surged up to 90% and more for some types of commodities.

The share of Belarusian products in the Russian imports of butter and cheese is not big (about 27%) while the dependence on European suppliers of these items was rather strong. The EU countries accounted for nearly 60% of import supplies of cheese. Therefore the introduction of sanctions primarily affected these groups of dairy products the processing of which requires the biggest milk inputs per unit (*Fig. 45*). The withdrawal from butter and cheese markets of countries under sanctions was partially compensated by larger supplies from Belarus whose share in the structure of butter imports grew from 27 to 52% and in the structure of cheese imports – from 27 to 64%.[2]

Such a strong dependence on Belarusian supplies of dairy products is fraught with certain risks. First, in the conditions of deficit of domestic raw milk on the Russian market, Belarus is

[1] According to data of the Federal Customs Service.
[2] According to data of the Federal Customs Service.

raising prices for this item supplied to Russia while prices for it on the world market have been falling all through 2014. Second, the own capabilities of Belarus to produce dairy products are not limitless. Following greater demand from Russia, the country itself felt short of raw milk. As a result various "grey" schemes are being applied when Belarusian milk processors buy inputs in the EU, e.g. in Lithuania.



Source: Federal Customs Service.

Fig. 45. Dynamics of dairy imports in 2014, tons

So, after the introduction of retaliatory sanctions Russian dairy companies have got a stimulus for development. One of the basic problems in the development of dairy production and import substitution is the deficit of raw milk. In the situation of year by year shrinking of dairy herd, decrease of raw milk output and non-efficient distribution of funds under the existing state support of the sector prices for raw milk in Russia rose by more than 40% over the two recent years. Still, there are some factors that hold back private investments in the dairy industry and impede its development. Low attractiveness of the sector is due to the long period of investments' pay back, high volatility of prices for raw milk and inputs on the Russian market, non-competitiveness (in terms of both price and quality) of milk-intensive products (cheese, butter, dry whey, dry skimmed milk, dry whole milk), the lack of extensive and consistent state support. In case the "window of opportunities" that opened owing to import substitution is not filled by domestic dairy producers, the decrease of imports from one group of countries will be compensated by more expensive imports from the other.

On the vegetable market the share of imports in consumption (2013 data) amounts to 18.8%, including 5.8% from the countries subjected to sanctions. Consumption of fruit depends on import supplies to an even greater extent – their share is as high as 58.5% including 14.7% from countries under embargo[1]. Given that the production of fruit and vegetables in Russia is a seasonal activity and the existing storage capacities are not sufficient, the depend-

[1] Data of the Institute for Agricultural Market Studies (IKAR).

ence on imports of vegetables and fruit is even greater in winter and spring periods (from November to April) when the market is affected by the deficit of domestic produce.

In 2013, the EU countries accounted for 20% of potato imports (Egypt – for 29%, China – for 13%). 24% of tomatoes were also supplied from the EU (39% - from Turkey, 10% - from China). At the same time the share of these countries in imports of frozen vegetables to Russia was as high as 79% (that of China – 7%).

Market supply of apples and pears on the Russian market is basically provided by imported items the share of which is about 80%. In 2013, the EU countries accounted for about 59% of the apple and pear imports.

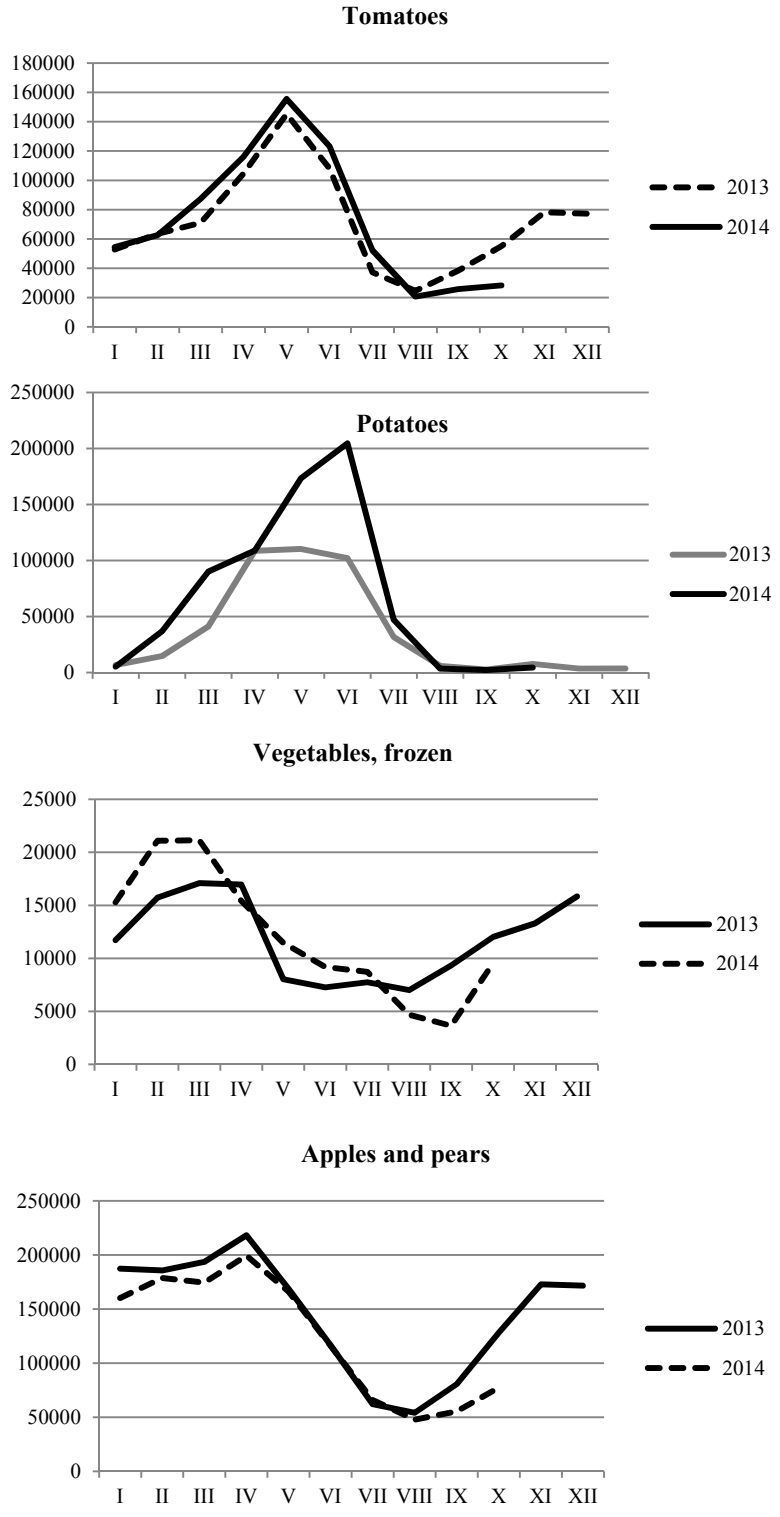
In 2014, 3155 thousand tons of vegetables were imported as compared with 2980 thousand tons in 2013 (annual total). Imports of fruit amounted to 5014 thousand tons versus 6352 thousand tons in the previous year[1]. So, the overall imports of vegetables in 2014 grew by 5.8% as compared with 2013 primarily due to the intensive imports (e.g. of potatoes) in the first half of the year. Imports of fruit dropped by 21% due to the introduced retaliatory sanctions.

The examination of import supplies' dynamics by selected groups of commodities reveals that right after the enforcement of sanctions imports of vegetables and fruit fell (*Fig. 7*). Imports from countries subjected to retaliatory sanctions were partially replaced by bigger supplies from other countries that had already been Russia's permanent trade partners. First of all, this refers to Belarus that increased exports of vegetables and fruit to the Russian market despite the fact that the country has never been their large producer. Therefore, the Belarusian origin of this produce raises doubts. Trade with other CIS countries – Kazakhstan and Moldova – became more active. There appeared few new countries among suppliers since time was needed for signing new contracts.

Following the enforcement of sanctions the geographic structure of import supplies changed. Belarus, Kazakhstan, China, Moldova and Israel were among major exporters of potatoes to Russia. There started purchases of frozen vegetables in China, Belarus, Ukraine, Serbia and Moldova. The major suppliers of apples and pears were China, Serbia, Azerbaijan, Belarus, Ukraine, Armenia and South Africa. Tomatoes were primarily imported from Ukraine, Belarus, Turkey, China, Morocco and Azerbaijan.

Do domestic producers have any chance for substituting imports of some groups of fruit and vegetables in the current situation or one can expect only a replacement of one import supplier by another? Traditionally big volumes of vegetables and fruit in Russia are grown by households. There are few large producers able to ensure sufficient volumes and stability of supplies to trade networks that feel short of quality domestic produce out of season. Besides, most of them have no storage capacities. Meantime, smaller producers – individual private farms – cannot offer traders big lots, year-round supply and suitable commodity assortment. Therefore, the development of competitive environment for medium-size farm producers urges the creation of a system of wholesale food markets.

[1] According to data of the Federal Customs Service.



Source: Federal Customs Service.

Fig. 7. Dynamics of vegetable and fruit imports in 2013 and January-October 2014, tons

So, the introduction of retaliatory sanctions against supply of food items from a whole range of countries opens opportunities for import substitution on some food markets. One more factor fostering this process is the devaluation of national currency conditioning the shrinkage of cheap imports to the country. At the same time, there are certain risks and dangers for the implementation of import substitution strategy as Russian producers use imported inputs the prices for which have surged. In the current economic situation the cost of investment resources is growing. Non-controlled growth of new investment credits supported by the government may result in over-production (first of all in pig breeding). In the medium run real disposable incomes of population are expected to further fall pulling the demand for food products down. In this case there may develop a situation when the ensuring of food security becomes impossible due to the aggravating problem of economic availability. And the most important factor is that lower rates of economic growth bring about the risk of curtailing budget support.

4.6.4. Shift of Budget Support Priorities

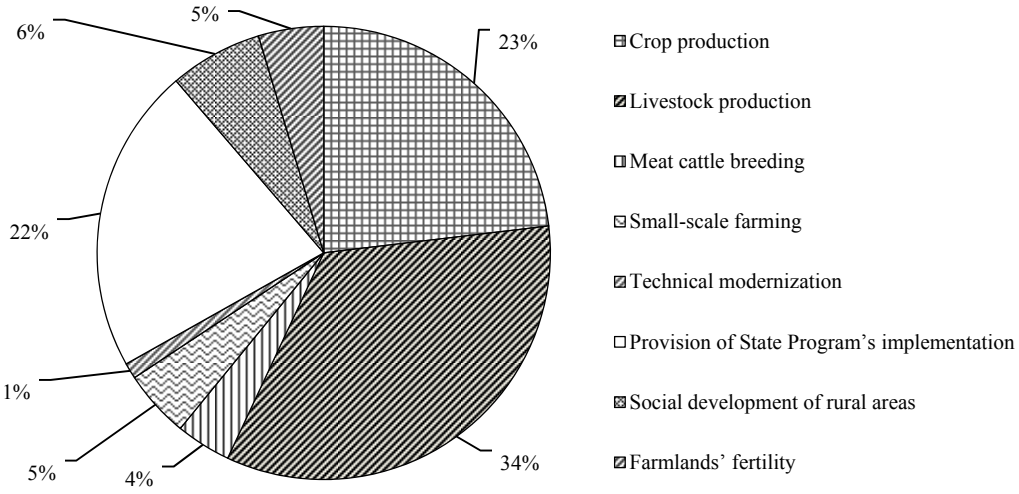
The State program for agricultural development and regulation of agricultural, input and food markets for 2013-2020 (hereinafter – the State Program) which is the second such program beginning from 2008 is one of the "longest" instruments of long-term planning in a selected sector of national economy. It consists of 8 basic blocks–sub-programs (*Fig. 8*), two of which are covered by separate federal target programs (FTP): FTP "Sustainable development of rural areas in 2014-2017 and for the period till 2020" and FTP "Development of Russian farmlands' reclamation for the period till 2020".

In 2014 the financing of State Program notably reduced as compared with the previous year – from Rb 213bn to Rb 170.1bn. However, while the funds allocated to the sub-program for crop production development were cut 1.7 fold, those for livestock production development – 1.2 fold, for technical and technological modernization – 4.3 fold, the outlays for administrative support of the State Program's implementation[1] were *vice versa* nearly doubled. Now measures for bureaucratic support of the Program cost almost as much as the development of crop production (23%). Appropriations to the development of meat cattle breeding, improvement of farmlands' fertility and sustainable development of rural areas slightly grew but the aggregate share of these measures does not exceed 15% of the allocated funds.

Essential amendments were made in the State Program due to the introduction of retaliatory sanctions against food supplies from the EU. A new point ranking second was added to the five traditional guidelines of agricultural and food policies that were: 1) ensuring of Russia's food independence in accordance with criteria set by the Doctrine of food security of the Russian Federation adopted by the RF President Decree No. 120 of January 30, 2010; 2) improvement of Russian food products' competitiveness on the domestic and foreign markets in the framework of Russia's accession to WTO; 3) improvement of financial stability of agricultural and food enterprises; 4) sustainable development of rural areas; 5) reproduction and more efficient use of land and other inputs in agriculture as well as "greening" of production.

[1] The sub-program "Provision of State Program's implementation" incorporates measures for improving the management of State Program and the system of taxation in agriculture, provision of public services and works, forming of public informational resources in the field of ensuring food security, carrying out of phytosanitary and veterinary control, etc. Except for the latter, all other measures have only an indirect bearing on the support of farm producers and are primarily intended for the strengthening of bureaucratic apparatus of agrifood sector management.

The newly added point is the accelerated import substitution for meat, milk, field and greenhouse vegetables, seed potatoes, fruit and vegetable products.



Source: State Program as amended by Federal Law No. 349-FZ of 02.12.2013 "On the federal budget for 2014 and for the planning periods of 2015 and 2016".

Fig. 47. Structure of financing by basic directions of State program for agricultural development and regulation of agricultural, input and food markets in 2014

For the implementation of this task 5 new sub-programs will be added to the 8 already existing beginning from 2015: "Development of field and greenhouse vegetable growing and seed potato production", "Development of dairy cattle breeding", "Support of pedigree livestock breeding, selection and seed production", "Development of wholesale distribution centers and social catering infrastructure", "Development of financial credit system of the agrifood sector" (*Table 30*).

Table 30

Financing of State Program from the federal budget, million rubles

Sub-program	Financing from the federal budget, million rubles				
	2013	2014	2015	2016	Total till 2020
1	2	3	4	5	6
Sub-program 1. Development of crop production, processing and marketing of crop products	67468	39288	51838	61678	555391
Sub-program 2. Development of livestock production, processing and marketing of livestock products	73313	57449	30709	40034	346447
Sub-program 3. Development of meat cattle breading	4903	6738	6949	9348	76548
Sub-program 4. Support of small-scale farming	8620	8189	9760	15 796	114280
Sub-program 5. Technical and technological modernization, innovational development	5300	1900	3145	4106	31 610
Sub-program 6. Provision of State Program's implementation	21429	37394	24045	25493	229031
Sub-program 7. Development of field and greenhouse vegetable growing and seed potato production	0	0	7000	7041	43039.6
Sub-program 8. Development of dairy cattle breeding	0	0	24224	34317	247401
Sub-program 9. Support of pedigree livestock breeding, selection and seed production	0	0	7190	12 707	77335
Sub-program 10. Development of wholesale distribution centers and social catering infrastructure	0	0	2433	10 310	79 279
Sub-program 11. Development of financial credit system of the agrifood sector	2000	0	10000	11200	86700

Cont'd

1	2	3	4	5	6
FTP Social development of rural areas till 2013	9012	0	0	0	9012
FTP Preservation and restoration of farmlands' fertility and of agricultural landscapes as the national endowment of Russia in 2006-2010 and for the period till 2013	6625	0	0	0	6625
FTP Sustainable development of rural areas in 2014-2017 and for the period till 2020	0	11293	13993	16129	139610
FTP Development of Russian farmlands' reclamation in 2014-2020	0	7899	8578	9981	81909.6
TOTAL	197671	170150	187864	258139	2126220

Source: Resolution of RF Government No. 1421 of December 19, 2014 "On introducing amendments to the State program for agricultural development and regulation of agricultural, input and food markets for 2013-2020".

So, the Ministry of Agriculture suggests supporting the "window of opportunities" that opened for Russian food suppliers following the introduction of retaliatory sanctions by the increase of State Program's financing within its 8-year term from the current Rb 1.5 trillion up to Rb 2.1 trillion.[1] Although earlier the government intended to optimize the State Program's budget by cutting it by at least 20%[2], it didn't happen – on the contrary, additional Rb 20bn of respective allocations were included in the enacted budget for 2015. However, this is rather a compensation of funds cut in 2014 than above-projected appropriations. There are plans to allocate Rb 50bn more in the framework of anti-crisis plan for supporting import substitution.

In order to improve availability of food in the aggravating economic situation and to foster demand for domestic produce the government adopted measures for forming the system of internal food aid. Thus, Government Executive Order No. 1215-r of July 3, 2014 enacted the Concept for developing internal food aid in the Russian Federation that specifies the latter as "a system of state assistance to population in the form of direct supplies of foodstuffs to relevant individuals or by providing them with monetary aid for the purchase of food in order to improve nutrition and ensure a balanced diet based on rational rates of food consumption". A similar system of assisting the neediest people short of funds for healthy nutrition such as pregnant and breastfeeding women, school children, handicapped, families with incomes below the subsistence minimum has long existed in developed countries, e.g. in the US and the EU. In case this measure embraces 15 million of most vulnerable Russian citizens, the demand for domestic produce will surely rise. According to estimates of the RF Ministry of Agriculture, in 2014 the total deficit of food for poor people was as big as 5.7 million tons to the amount over Rb 317bn.

There is a very serious lagging behind in the implementation of sub-program "Technical and technological modernization, innovational development of the sector". Modernization of agriculture first of all suggests technical re-equipment and transfer to more advanced farm technologies in order to reduce costs and raise productivity. Low rates of technical and technological renovation of agricultural production on the whole and stagnation of farm machinery building in particular were identified as the most serious challenges for the Russian agri-

[1] Presentation of amendments to the State Program: speech of the RF Minister of Agriculture N. Fyodorov, October 2014.

[2] Report of the RF Minister of Finance A.Siluanov at the meeting of the Government *"Gosprogrammy urezhut radi optimizatsii byudgeta"* [State programs will be cut in order to optimize the budget]. *Nezavisimaya gazeta*, No. 215 (6262), 06.10.2014.

cultural sector.[1] To overcome this negative trend, next year the support of investment projects will be provided not through subsidizing of credits and loans taken for these purposes but by direct reimbursement of a part of their cost upon putting of investment objects in operation. For that end the Ministry of Agriculture is working out an investment map of Russian agriculture taking into account proposals of regions.[2] The following directions are named as priority ones: development of dairy cattle breeding, creation of seed selection centers, strengthening of storage infrastructure, improvement of soil fertility, provision of farm producers with machinery and credits. 9 thousand credit agreements all over the country have been included in the list of priority investment projects eligible for subsidizing.

In order to expand marketing of farm products, the creation of wholesale distributional logistical centers (including those on cooperative principles) will be financed as a separate budget item. The Ministry of Agriculture has worked out a departmental target program "Development of agricultural consumer cooperation till 2025" the basic projected instrument of which will be the support of input supply, marketing and processing cooperatives through providing grants for the development of material and technical facilities. But it's not clear whether it will be financed in the conditions of budget deficit.

4.6.5. Ways for Improving Agricultural Policies in the Current Situation

1. Sanctions, retaliatory sanctions, drop of prices for oil and the consequent devaluation of ruble have changed the economic situation in the country, resulted in the surge of prices for imported food items and triggered the rise of prices for domestic foodstuffs. In these conditions the government should refrain from mistakes made during the previous crises (1917-1921, 1929-1930, 1990-1991), namely trying to hold down the purchase prices for farm products bought from domestic producers. Given the new exchange rate of ruble, the world prices for agricultural products have become much higher than those of the domestic market. Any attempts to retain this situation, to make national producers sell their output at the prices far below the world ones have always ended with a total deficit of food and empty shop shelves. In the new conditions only in case domestic producers receive the world or close to them prices, they will have real incentives for increasing production and import substitution.

2. The crisis has already led to and in the following months will further aggravate the drop of personal incomes, with lower decile groups being most affected. The growing prices for food products will inevitably result in shorter consumption, especially of higher quality products. The shrinking of demand may lead to the withdrawal from farm business of those producers who entered it for receiving high profits. The corporate pattern of agricultural production is less sustainable than farmer one – it's not a mere coincidence that family farms are prevailing all over the world. The change of market situation may cause the worsening of financial performance and bankruptcy of agroholdings that in the previous years have already accumulated serious creditor indebtedness. It's necessary to elaborate the policy for restructuring debts of such entities with the ultimate goal of preserving production facilities and their transfer to small businesses working under contracts with large processing and marketing companies.

[1] National report «On the progress and implementation in 2013 of the State program for agricultural development and regulation of agricultural, input and food markets for 2013-2020".
[2] Report of the RF Deputy Minister of Agriculture A.V.Petrikov at the XIX Nikonov's readings in the Free Economic Society of Russia.

3. In the crisis situation the government should by no means promise to feed everybody or strengthen the centralization of food supply. During previous crises prices for and deficit of food products led to the active involvement of all population in farm production. About 36 million families in the country have summer cottages ("dachas") and household plots. In the crisis situations their role in family food supply and incomes immensely grows. At the beginning of 1990s the average share of returns from household farming in incomes of rural families increased from 21.5% (1990) to 41.6% (1992). In recent years the role of these farms notably dropped as it was cheaper to buy everything in a food store or at the market – incomes in kind brought only 7% of family incomes in rural areas. In the changed situation the government should render assistance to such farms for the expansion of their production, help them with provision of seeds (for instance, even less severe crisis of 2008 led to a sharp increase of seed potato purchases by population) and other inputs. Agriculture is a domain of small business. One should support farmers and individual rural entrepreneurs, remove fantastic bureaucratic procedures hindering their access to land and other inputs. Small entrepreneurs are efficient when they are united in cooperatives, are acting in concert with large businesses. The development of cooperation and contract farming policies will help to ensure sustainability of agricultural production.

4. The lion's share of budget funds still goes to large-scale agribusiness. Small- and medium-size farms have far scarcer access to markets of basic inputs, to subsidizing and other forms of state support. At the same time they produce over 50% of agricultural output. In this regard it seems necessary to re-guide agricultural policies so that to enable small farm producers and their cooperatives to participate in the implementation of State Program together with large agroholdings. In order to cut transaction costs we can recommend providing services to rural borrowers primarily through credit cooperatives. Cooperatives may assume all the commitments related to recording, application for and payment of all subsidies that a specific farm producer is eligible for under all measures and programs.

6. The program of sustainable development of rural areas should not be limited to the per capita financing of social and communal infrastructure and providing of young specialists with dwelling. No doubt very important, these two directions of government support fail to encompass the whole range of rural population's needs that differ by regions of the Russian Federation. It's worth using here the experience of the European Union's project "Leader plus" that envisages involvement of rural population in revealing the most urgent problems and distribution of grants on a competitive basis by open voting.

7. The decision of the RF Ministry of Agriculture on the direct reimbursement of a part of investment projects' cost upon their putting in operation instead of subsidizing interest rates of credits and loans taken for these purposes is absolutely correct from the theoretical point of view. First, it's difficult to plan the budget for reimbursing interest rates at the moment of their unpredictable growth. Second, according to Supplement 2 of the WTO Agreement on Agriculture unbound subsidies for the modernization of farms are classified as "green box" support measures while subsidies for the reimbursement of interest rates distort input markets and are included in the "amber box". Still, there is one fact raising concern: farm producers can enter the program of priority investment financing only if they are included in the lists recommended by the regional departments of agriculture. The terms of participating in the program of technical modernization in most cases are not specified thus increasing the risk of corruption.

8. With the creation of Customs Union and the EAEU Russia has ceded a part of its sovereignty. In the new conditions the government has to coordinate its decisions with the alliance partners. The most important issues to be coordinated with members of the EAEU are:

- changing of the Union's customs borders;
- introduction of bans on import or export of basic food products from the selected countries and unions;
- introduction of temporary sanitary and epidemiological restrictions on import of selected agricultural and food items from the selected countries;
- introduction of export duties on selected products and inputs.

When taking foreign policy and economic decisions Russia should bear in mind the risks associated with their impact on the alliance partners.

4.7. Foreign Trade

From the point of view of foreign economic conditions and the world market situation, 2014 was a very hard year for the Russian Federation. The drop of prices for oil, the dramatic devaluation of national currency, the introduction of sanctions by Western economies and the retaliatory sanctions introduced by the RF government have hindered the development of Russian foreign trade. A standstill of basic economic indicators observed in the first half of the year gave way to their sharp drop at the year end. As a result, in 2014 Russia's foreign trade turnover decreased as compared with the previous year (the decrease reaching 6.9%) for the first time since 2009.

4.7.1. World Economic Situation

According to projections of IMF the growth rates of the world economy after the slowdown to 2.7% in the first half of 2014[1] should have increased up to 3.5% in the second half of the year and up to 3.8% in 2015. However, the world economy does not grow evenly and the challenges it faces are not fading away. In developed economies the demand remains weak and in the middle run this can result in the lowering of growth rates all over the world. In China the economic growth is slowing down. The domestic demand in a number of the top economies in Latin America remains sluggish. The geopolitical tensions caused by situation in the Ukraine and the Middle East are hampering economic development not only inside but also outside these regions.

On November 25, 2014 the *US* Bureau of Economic Analysis released its second estimate of GDP growth in the III quarter[2]. Although markets anticipated slower growth, the second estimate was higher than the preliminary one: according to it the annualized increase in the III quarter amounted to 3.9% whereas initially it was estimated at 3.5%. Growth relative to the respective quarter of the previous year reached 2.4% (preliminary estimate – 2.3%).

According to the final data, in the II quarter of 2014 the US economy grew by 4.6% in annual terms. So, in the past two quarters the American economy grew at the highest rate since 2003. The US economic indicators (from production to employment and retail sales) evidence that at the beginning of the IV quarter the economy preserved this impetus. The growth forecasts for the last three months of 2014 are slightly below 3.0%.

[1] http://www.imf.org/external/pubs/ft/weo/2014/02/pdf/c2.pdf
[2] http://www.bea.gov/newsreleases/national/gdp/gdpnewsrelease.htm

In December 2014 the Federal Reserve System revised upwards its forecast for the US GDP annual growth – up to 2.3-2.4% (as compared with earlier projected 2-2.2%) and up to 2.6-3% in 2015. According to estimates of the US Central Bank the level of inflation in 2014 will be 1.2-1.3% instead of 1.5-1.7% (the previous estimate) while in 2015 – 1-1.6%. At the same time unemployment rate in 2014 is expected to reach 5.8% instead of 5.9-6% according to September estimates, in 2015 – 5.2-5.3%.

Economic situation in the *EU* countries remains difficult – the latest business reviews show that a noticeable recovery is hardly possible in the coming months. According to the preliminary estimate of Eurostat[1], in the IV quarter of 2014 GDP in Eurozone (EU18[2]) grew by only 0.3% as compared with the previous quarter while that of the European Union at large (EU28) – by 0.4%. In total, GDP of 18 Eurozone countries in 2014 grew by 0.9%, that of 28 countries of the European Union – by 1.4%.

Report of the People's Bank of China[3] says that in 2015 the economic growth in *China* may slow down to 7.1%. According to data of the State Statistical Department of PRC, over 2014 the GDP increased by 7.4%. This annual total is the lowest for the Chinese economy since 1990 (for reference: in 2013 the growth of GDP amounted to 7.7%). Indicators of Chinese economic performance in the past year were close to expectations of the government (the official forecast being "around 7.5%") that in recent months took some steps for encouraging business activity in the country.

In 2015 a further slowdown of economic growth in PRC is projected. For instance, IMF has brought down its estimate of the Chinese economy's growth in 2015 by 0.3 p.p. – down to 6.8%, in 2016 – by 0.5 p.p. down to 6.3%.

In January 2015 a regular IMF Bulletin "World Economic Outlook" (WEO) was released that forecasts the world economic growth in 2015-2016 at the rate of 3.5% and 3.7%, respectively, which is 0.3% below estimates of the October 2014 WEO release. This revision is due to the worsening of outlook for the economies of China, Russia, Eurozone countries and Japan as well as to the fading business activity in some countries – major exporters of oil following the plunging of oil prices. Growth forecasts were improved only for the US economy (*Table 31*).

In October 2014 the World Trade Organization (WTO) published «World Trade Report 2014»[4] that contains basic indicators reflecting the current trends in the development of international trade in commodities and services. In 2013 the growth of the world commodity trade remained moderate – 2.2% (in 2012 – 2.3%). At the beginning of 2014 the slow rates persisted: in the I quarter of 2014 the volumes of international trade in commodities exceeded those of the respective 2013 period by 2.1%.

The sluggish growth of international trade in 2013 was conditioned by the combination of many factors including weaker demand for imported items in the developed countries (-0.3%) and a moderate increase of imports in the developing economies (4.7%). As to exports, their growth both in developed and developing countries was modest (by 1.5 and 3.6%, respectively). The 2013 trade and production indicators were affected by the lingering recession in the EU, the high rate of unemployment in Eurozone countries (except Germany) and the uncer-

[1] http://ec.europa.eu/eurostat
[2] Eurozone (EU-18) includes Belgium, Germany, Estonia, Ireland, Greece, Spain, France, Italy, Cyprus, Luxemburg, Latvia, Malta, the Netherlands, Austria, Portugal, Slovenia, Slovakia and Finland.
[3] http://www.pbc.gov.cn/publish/english/963/index.html
[4] http://www.wto.org/english/res_e/publications_e/wtr14_e.htm

tainty about time frames of monetary stimulus' curtailment by the US FRS. The latter contributed to financial instability in the developing countries in the second half of 2013, especially in some countries with emerging markets.

Table 31

Dynamics of the world GDP and world trade (increase as % of the previous year)

	2010	2011	2012	2013	2014	Forecast		Difference between forecasts of October 2014 and January 2015	
						2015	2016	2015	2016
World GDP	**5.1**	**3.9**	**3.4**	**3.3**	**3.3**	**3.5**	3.7	**–0.3**	**–0.3**
Countries with developed economies	***3.0***	***1.7***	***1.2***	***1.3***	***1.8***	***2.4***	***2.4***	***0.1***	***0.0***
United States	2.4	1.8	2.3	2.2	2.4	3.6	3.3	0.5	0.3
Eurozone	2.0	1.5	–0.7	-0.5	0.8	1.2	1.4	-0.2	-0.3
Germany	4.0	3.4	0.9	0.2	1.5	1.3	1.5	-0.2	-0.3
France	1.7	2.0	0.3	0.3	0.4	0.9	1.3	-0.1	-0.2
Italy	1.8	0.4	–2.4	-1.9	–0.4	0.4	0.8	-0.5	-0.5
Spain	–0.3	0.1	–1.6	-1.2	1.4	2.0	1.8	0.3	0.0
Japan	4.5	–0.6	1.5	1.6	0.1	0.6	0.8	–0.2	-0.1
Great Britain	1.8	1.1	0.3	1.7	2.6	2.7	2.4	0.0	-0.1
Canada	3.2	2.5	1.7	2.0	2.4	2.3	2.1	-0.1	-0.3
Other countries with developed economies	5.9	3.2	2.0	2.2	2.8	3.0	3.2	-0.2	–0.1
Countries with emerging markets and developing countries	***7.4***	***6.2***	***5.1***	***4.7***	***4.4***	***4.3***	***4.7***	***–0.6***	***–0.5***
Commonwealth of Independent States	4.8	4.8	3.4	2.2	0.9	-1.4	0.8	–2.9	-1.7
Russia	4.3	4.3	3.4	1.3	0.6	-3.0	-1.0	-3.5	–2.5
Less Russia	6.0	6.1	3.6	4.3	1.5	2.4	4.4	-1.6	-0.2
Developing Asian countries	9.5	7.8	6.7	6.6	6.5	6.4	6.2	-0.2	-0.3
China	10.4	9.3	7.7	7.8	7.4	6.8	6.3	-0.3	-0.5
India	10.1	6.3	4.7	5.0	5.8	6.3	6.5	-0.1	0.0
Latin America and Caribbean countries	6.2	4.6	2.9	2.8	1.2	1.3	2.3	–0.9	–0.5
Brazil	7.5	2.7	1.0	2.5	0.1	0.3	1.5	-1.1	–0.7
Mexico	5.6	4.0	4.0	1.4	2.1	3.2	3.5	-0.3	-0.3
World trade in commodities and services	***12.6***	***6.1***	***2.9***	***3.4***		***3.8***	***5.3***	***–1.1***	***–0.2***
Imports									
Countries with developed economies	11.4	4.7	1.2	2.0		3.7	4.8	-0.6	–0.2
Countries with emerging markets and developing countries	14.9	8.8	6.0	5.5		3.2	6.1	–2.9	–0.2

Source: http://www.imf.org/external/pubs/ft/weo/2015/update/01/

In 2013 *China* became the top world trader with foreign trade turnover amounting to $4,159bn (44.6% of GDP) and exceeding the 2012 indicator by 7.5%. The PRC's balance of trade has been positive since 1994 and in 2013 reached $259bn (2.7% of GDP).

The *United States of America* descended to the second place with 2013 foreign trade turnover of $3,909bn (23.4% of GDP). The country preserved quite a sizable deficit of trade balance: in 2013 it amounted to $749.5bn (4.5% of GDP). As compared with 2012, the deficit of US trade balance reduced by 5.4%.

Germany has retained its third place with 2013 foreign trade turnover being $2,642bn (73.5% of GDP). The positive trade balance amounted to $264bn (7.3% of GDP).

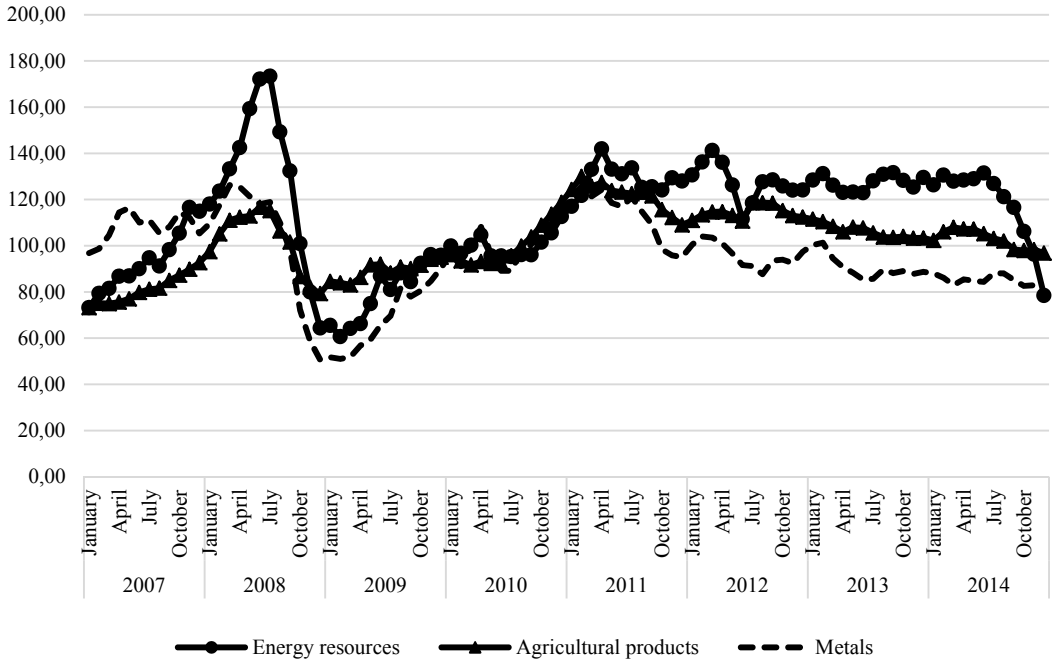
In 2013 the *Russian Federation* descended to the 10th place from the 8th that it occupied in 2012 with exports reaching $523bn (25% of GDP). The share of Russian exports in the total world commodity exports was 2.8%. By the amount of imports Russia remained in the 16th place – its commodity purchases in foreign countries amounted to $343bn (16.4% of GDP).

The share of Russian imports in the world total remained 1.8%. In the aggregate volume of world trade Russia ranked 13th with its share in the world trade turnover being 2.5%. The country's balance of foreign trade was positive and reached $179bn (8.5% of GDP).

4.7.2. Conditions for Russian Foreign Trade: Price Trends for Basic Items of Russian export and import

From the middle of 2014 the expansion of supply on commodity markets coincided with the slowdown of the world economic growth, especially in developing countries that used to account for the major part of demand for raw inputs. As a result, beginning from summer 2014 prices for basic commodities – agricultural products, energy resources and metals – started to steadily decline.

In the III quarter of 2014 the World Bank's price index for energy resources decreased by 6.2% as compared with the previous quarter, that for agricultural products – by 5%; the price index for metals grew by 2.6% but in October-November resumed its falling *Fig. 48*).



Source: http://siteresources.worldbank.org/INTPROSPECTS/Resources/334934-1304428586133/ Commodity MarketsOutlook_October2014.pdf

Fig. 48. Commodity price index of the World Bank (2010 = 100)

In the first half of 2014 the price situation on the world oil market remained favourable: the price for Brent oil was above $100 per barrel. But after reaching their annual maximum ($111.87 per barrel) in June, oil prices started falling: in the III quarter the price for Brent oil slid down by 5.7% as compared with the previous quarter, that for North American WTI – by 3.9%. Such a decrease superseded the period during which prices for oil fluctuated within quite a narrow band around $105 per barrel that was a "desired price range" for the OPEC countries. In fact, 2011-2013 was one of the least volatile 3-year periods in the recent history of oil market.

In the IV quarter of 2014 the drop of oil prices accelerated. In October 2014 the average monthly price fell down to $87.27 per barrel which was 20.3% below the respective indicator of 2013 and 10.3% below the level of the previous month.

At their meeting on November 27, 2014 the OPEC countries decided to leave unchanged the total amount of quotas for oil production at the level of 30 million barrels a day. As a result, on November 28, 2014 the price for Brent oil fell by 7.1% as compared with the previous day – down to $71.89 per barrel.

After the declaration of UAE that OPEC wouldn't cut quotas for oil production even if prices for oil dropped down to $40 per barrel, on the 16th of December 2014 the price for Brent oil fell below $60 per barrel for the first time since July 2009.

The average price for Brent oil in 2014 was $98.9 per barrel – 9.1% lower than in 2013. Over the year the price for North American WTI fell by 4.9% - down to $93.1 per barrel.

The price for Urals oil followed the world market trend and in the first half of 2014 remained relatively stable fluctuating between $106.4 and $108.9 per barrel. But in the second half of the year it started falling. The average price of Urals oil in 2014 was $97.6 per barrel or 9.5% below the 2013 level.

The drop of oil prices in the second half of 2014 was most remarkable since the 2008 crisis. The key factor of mid-term price trend was the changing of structure of the world oil market due to the shale revolution in the United States. The growth of oil extraction therein produces increasing pressure on the world prices. There were also other factors that influenced the market of oil. First, political tensions in Libya and Nigeria reduced and following that oil production increased by 1.5 million barrels a day. Second, due to the accident at the refinery in Venezuela the demand for crude oil temporarily fell by 0.65 million barrels a day. Third, dollar strengthened relative to other currencies following the curtailment of quantitative easing (QE) program in the US. Of no small importance was the decision of OPEC not to cut production and let the market "search for equilibrium" on its own in the conditions of persisting excessive supply of oil.

The dynamics of prices for gas retains its notable segmentation by regions: there is a great difference between prices for this item at the North American, European and Asian markets.

The lowest prices for gas continue to be observed in the United States, although in 2014 their growth was quite noticeable: according to data of the World Bank, in 2014 the spot price for gas at Henry Hub averaged $4.38 per 1 million British thermal units (BTU) which is 17.5% above the 2013 indicator.

The prices for gas remain the highest in East Asia despite lowering by 0.4% in 2014 as compared with 2013. According to data of the World Bank, in 2014 the price for liquefied natural gas imported by Japan averaged $15.95 per 1 million BTU.

At the European market the price for gas in 2014 fell by 14.7% as compared with 2013 down to $10.1 per 1 million BTU (average spot import price).

The situation on the world market of non-ferrous metals started worsening since the end of 2011 and has not recovered as yet.

In 2013 average prices for aluminium fell down to $1,846 per ton which is 8.6% below the level of 2012. In summer 2014 a slight upward trend was observed and in August the price for this item grew up to $2,030.5 per ton – the maximum level since February 2013. After that the drop of prices resumed and continued in September and October. In November the price for aluminium was up again exceeding $2,000 per ton. However, it failed to maintain this level for a long time and in December fell down to $1,909.5 per ton. According to data of the

World Bureau of Metal Statistics (WBMS)[1], in 2014 the world market of alluminium displayed a deficit of 849 thousand tons. The global stocks of this metal at the end of 2014 totaled 6,397 thousand tons. In January-December the demand amounted to about 50,550 thousand tons.

In 2014 the basic factors of shorter demand for copper were sluggish industry dynamics in Eurozone and the decrease of purchases by China that accounts for 40% of the world consumption of this metal. To a certain extent prices for copper were supported by the recovery observed in the industrial sector and residential property market in the US. Still, in March 2014 the price for copper fell to its minimum since October 2009 – down to $6,650 per ton. In July it rose up to $7,113.38 per ton but afterwards resumed its sliding down.

In the first half of 2014 a stable demand for nickel from producers of stainless steel was observed. As a result in the time span from January to July the price for this item grew by 26.2% - up to $19,117.65 per ton. But at the year end the negative dynamics resumed. However, the average annual price for 2014 exceeded that for 2013.

According to London Metal Exchange, in 2014 prices for aluminium were above the 2013 level by 1.1%, those for nickel – by 12.4%; meantime, the prices for copper fell by 6.4% (*Table 32*).

Table 32

Average annual world prices, 2004–2014

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Oil (Brent), $/barrel	37.4	54.38	65.15	72.32	97.64	61.86	79.64	110.9	111.97	108.9	98.9
Natural gas (USA), $/million BTU	5.89	8.92	6.72	6.98	8.86	3.95	4.39	4.00	2.75	3.73	4.38
Natural gas (European market), $/million BTU	4.28	6.33	8.47	8.56	13.41	8.71	8.29	10.52	11.47	11.79	10.05
Natural gas (Japan), $/million BTU	5.13	5.99	7.08	7.68	12.55	8.94	10.85	14.66	16.55	15.99	15.95
Copper, $/ton	2866	3679	6722	7118	6956	5149	7534	8828	7962	7342.8	6901.3
Aluminium, $/ton	1715	1898	2570	2638	2573	1665	2173	2401	2023.3	1846.7	1867.4
Nickel, $/ton	13823	14744	24254	37230	21111	14655	21809	22910	17557	15032	16893

Source: calculated using data of the World Bank.

In 2014 the World Bank's index of prices for agricultural products fell by 3% as compared with the previous year due to the lowering of prices for grains (by 1.9%), cocoa, coffee and tea (by 3.9%). Meantime, prices for vegetable oils, meat (primarily beef) and sugar grew.

Average prices received by Russian exporters reduced in line with the global market trends. The reduction concerned average export prices for crude oil, natural gas, mineral fertilizers, ferrous metals and copper.

As to average import prices, their slight growth at the beginning of the year in August was superseded by sliding down. As a result, in 2014 prices for imported commodities fell by 4% as compared with 2013: those for items from the CIS countries were down by 5.1%, from the non-CIS countries – by 1.4% (*Table 33*).

Since in February and from August to December the lowering concerned not only average export prices but also average import prices, in 2014 the worsening of terms of trade for Russia slowed down. While in 2013 the index of terms of trade equaled 93.4 points, in 2014 it was 96 points.

[1] http://www.world-bureau.com/readnews.asp?id=19

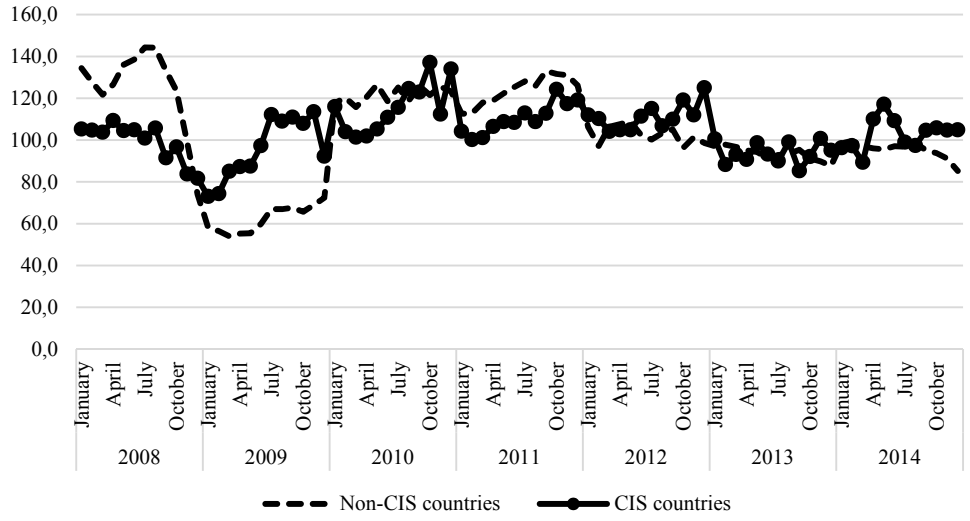
Table 33

Indices of export and import prices in 2014 (as % of the respective month 2013)

	Export			Import		
	Total	**to non-CIS countries**	**to CIS countries**	**Total**	**from non-CIS countries**	**from CIS countries**
January	98.5	98.6	97.8	100.4	100.2	101.6
February	97.6	98.8	91	98.6	99.2	93.6
March	97.3	98.6	89	101.5	101.7	99.7
April	99.2	98.2	106.3	101.7	102.3	96.6
May	99.4	97.3	113.9	101.4	101.8	97.3
June	98.9	97.6	108	100.4	100.6	98.9
July	98.3	98.4	97.5	101.2	101.5	98.5
August	95.6	95.8	94.1	97.3	97.4	96.6
September	92.3	92.4	92.1	94.5	94.7	92.4
October	90.1	90.2	89.7	95.2	96.3	84.8
November	85.3	85.1	86.55	92.2	93.4	82.6
December	80.2	79.6	85.0	92.4	93.4	81.0
2014	**94.3**	**94.1**	**95.7**	**98.2**	**98.6**	**94.9**

Source: RF Ministry for Economic Development.

Meantime terms of trade with the CIS countries slightly improved: the respective index grew from 94.8 to 100.8 points. Terms of trade with the non-CIS countries continued worsening but not as fast as in 2013: the index was up from 94.8 to 95.4 points (*Fig. 49*).



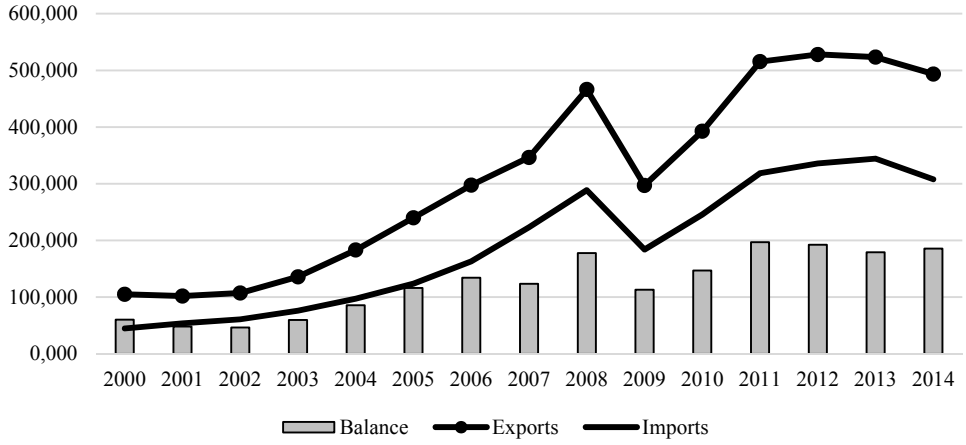
Source: RF Ministry for Economic Development.

Fig. 49. Russian Federation: Index of foreign trade in 2008-2014

4.7.3. Basic Indicators of Russian Foreign Trade in Commodities

In 2014 Russian foreign trade turnover calculated according to the balance of payments' methodology amounted to $804.7bn which was 6.9% below the respective 2013 indicator. Foreign trade turnover with the non-CIS countries fell by 5.4% - down to $700.4bn, that with the CIS countries – by 16.4% down to $104.3bn.

Russian exports in 2014 reduced by 5.1% as compared with 2013 – down to $496.7bn. Russian imports for the first time since 2009 fell by 9.8% - down to $308bn. The balance of foreign trade in 2014 was positive - $188.7bn or 3.7% above the 2013 indicator (*Fig. 50*).



Source: Central Bank of the Russian Federation.

Fig. 50. Basic indicators of Russian foreign trade in 2000–2014, billion dollars

Due to the slowdown of the global economic growth the situation on the world markets of major commodities of Russian export has notably deteriorated. As a result the general price index for items exported from Russia fell by 5.7%. The value of crude oil supplies to foreign consumers dropped by 11.4% as compared with 2013 whiles the average contract price reduced by 6.2%; the respective rates of decrease for natural gas were 18.6% and 7.4%. Prices for other commodities sold to foreign consumers fell by an average 3.5%.

The physical volume of export sales remained at the level of 2013 owing to the growth of supplies to non-CIS countries by 1.6%. The physical volume of exports to CIS countries dropped by 10.1%. The supplies of fuel and energy products in physical terms fell by 3.1%, the decrease for natural gas and oil being even greater – 12.1% and 5.6%, respectively. These were only petroleum products that were exported in bigger physical volumes (up 8.9%). The volumes of supplies of other commodities increased by 2.6%. So, the negative dynamics of Russian exports was primarily conditioned by the price factor given that the physical volumes of export supplies stabilized.

The reduction of import value was driven by both the lowering of average import prices and the decrease of physical volumes of commodities supplied to Russia. Thus, in 2014 import purchases of commodities in physical terms were 7.5% below the level of 2013 (those from the non-CIS countries were down 6.8%, from the CIS countries - down 12.2%). The prices for imported items fell by 1.8% as compared with 2013 (that from the non-CIS countries – by 1.4%, from the CIS countries – by 5.1%). Along with shorter demand (one of the reasons being the depreciation of ruble), the negative dynamics of this indicator is due to the impact of restrictions on import of selected groups of commodities from foreign countries introduced by the Russian Federation in August 2014 (*Table 34*)

Table 34

Indices of Russian foreign trade in 2010–2014 (as % of the previous year)

	2010		2011		2012		2013		2014	
	Physical volumes	Average prices	Physical volumes	Average prices	Physical volumes	Average prices	Physical volumes	Average prices	Physical volumes	Average prices
Export	110.2	116.9	97.3	131.1	99.7	101.7	104.3	95.8	100.0	94.3
Import	130.8	101.2	125.6	109.8	104.8	96.6	99.2	101.4	92.5	98.2

Source: RF Ministry for Economic Development.

The export-import coverage ratio grew from 152% in 2013 up to 160.3% in 2014.

The coefficient of foreign trade imbalances (the ratio of trade balance to trade turnover) was up from 20.6% in 2013 to 23.2% in 2014.

Structure and Dynamics of Commodity Exports

In 2014 Russian commodity exports shrank by 5.1% as compared with 2013 (down to $496.7bn) due to the curtailment of supplies to the CIS (by 12.9%, down to $68.0bn)) and to non-CIS countries (by 3.7%, down to $428.6bn). The share of non-CIS countries in the total exports grew from 84.1% up to 86.3% (*Table 35*).

The structure of Russian exports in 2014 remained basically unchanged as compared with 2013. Mineral items accounted for 70.5% thereof while in 2013 their share was somewhat higher – 71.6%. The share of fuel and energy products reduced from 70.6% in 2013 down to 69.5%.

The value of mineral exports fell by 7.1% both due to the decrease of physical volume of oil exports by 5.6% and to the lowering of oil price by 6.2% as compared with 2013. The physical volume of gas exports shrank by 12.1% while the average export price for this item fell by 7.4%. In 2014 Russian gas exports totaled 172.6 billion m^3. Supplies to the non-CIS countries reduced by 9.7% - down to 124.6 billion m^3, while those to the CIS countries – by 17.8% down to 48 billion m^3.

Table 35

Dynamics of Russian exports in 2004–2014

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Exports, billion $	183.2	243.8	303.6	354.4	471.6	303.4	400.6	515.4	528.0	523.3	496.7
including:											
Non-CIS countries, billion $	153.0	210.2	260.2	300.6	400.5	255.3	338.0	436.7	445.2	444.9	428.6
Exports as % of GDP	31.0	31.4	30.1	26.7	28.1	24.3	25.8	27.1	26.2	25.0	26.6
Growth rates as % of the previous year											
Volume index	110.7	104.7	105.8	105.0	96.8	97.0	110.0	97.8	99.9	96.3	
Price index	122.7	126.9	119.7	110.9	137.4	76.4	119.8	132.9	101.6	94.7	

Source: the Bank of Russia, RF Ministry for Economic Development.

The drop of crude oil and gas exports was not compensated by higher value of petroleum products' sales the physical volume of which increased by 8.9%. Overall, export supplies of petroleum products in 2014 mounted to the record level of 164.8 million tons. Their exports to non-CIS countries grew by 10% - up to 155.2 million tons while those to the CIS countries dropped by 6% - down to 9.6 million tons. In 2014 average contract prices were 2.7% lower than in 2013.

According to data of the Federal Customs Service, liquid fuel not including biodiesel continued to dominate in the structure of petroleum products' exports but its share therein fell down to 52.9% versus 56% in 2013 basically due to the lowering of average export price (by 5.4%).

The share of metals and metal products grew from 7.8% in 2013 to 8.2% in 2014. This growth was conditioned by the increase of physical volumes of exports of ferrous metals – up by 5.2% (while average contract prices for them fell by 2.7%) and of refined copper – up by 30.5% (contract prices for it being 8.8% below the 2013 average). Physical volume of nickel exports remained at the level of 2013 but owing to the growth of average contract prices for this item by 7.3%, the value of respective exports also increased by 7.3%. The physical volume of aluminium exports notably dropped – by 13.3% as compared with 2013. The growth

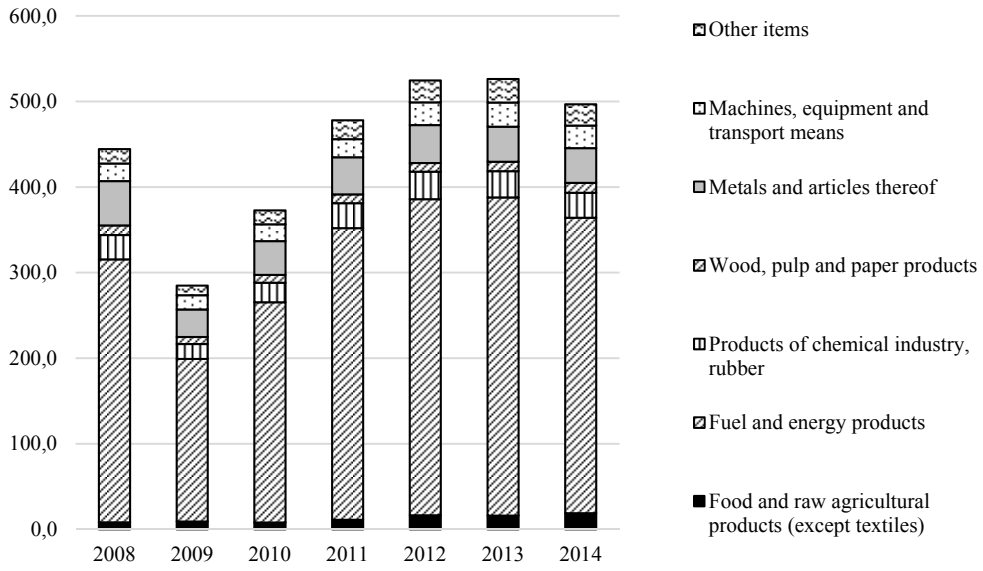
of average contract prices by only 1.4% failed to compensate for such a drop and as a result the value of aluminium exports was down by 12.1%.

Exports of chemical industry's produce continue falling for the second year in turn: in 2014 they amounted to $29.1bn which was 5.2% below the 2013 level. Chemical products accounted for 5.9% of the total exports of most important items. The leading positions in this commodity group belong to fertilizers, inorganic chemical products and organic chemical compounds.

In 2014 the share of machines, equipment and transport vehicles in the structure of exports fell down to 5.3% versus 5.4% in 2013 (in 2012 – 5.1%). Supplies of items belonging to this commodity group to foreign countries reduced by 7.1%. The most seriously affected was the export of trucks – it dropped by 18.5% as compared with 2013.

A notable reduction of exports value was observed in the following groups of the extended commodity classification: "Raw hides and skins, fur skins and articles thereof" (down by 31.9%), "Precious stones, precious metals and articles thereof" (down by 17.6%).

Growth of export supplies was registered in the following commodity groups: "Textiles, textile articles and footwear" (up by 18%), "Wood, pulp and paper products" (up by 6.1%). It's noteworthy that exports of food products increased by 16.7%; the share of this commodity group was up by 0.7 p.p. owing to the growth of wheat exports' value 1.6 fold conditioned by bigger physical volumes of shipments (primarily to the non-CIS countries).



Source: Federal Customs Service.

Fig. 51. Shifts in commodity structure of Russian exports in 2008–2014, billion $

Structure and Dynamics of Imports

The aggravation of geopolitical situation that triggered the introduction of sanctions against the Russian Federation by Western economies, the retaliatory measures of the Russian government limiting supply to the RF territory of selected types of agricultural and food products from the same countries, a sharp devaluation of the national currency at the end of the year and the drop of both consumer and business solvent demand have led to the curtailment of import purchases.

In 2014 Russian imports fell by 9.8% as compared with 2013 – down to $308bn due to the reduction of supplies from both non-CIS countries (imports from which totaled $271.7bn or 7.9% below the respective indicator of 2013) and countries-members of CIS (their supplies amounted to $36.3bn – 21.7% less than in 2013). The share of non-CIS countries in the total imports grew from 85.9% to 88.2%.

Table 36

Russian Imports in 2004–2014

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Imports, billion $	97.4	125.4	164.3	223.5	291.9	191.8	248.6	318.6	335.8	344.3	308.0
including											
Non-CIS countries, billion $	76.4	103.5	138.6	191.2	253.1	167.7	213.3	275.5	288.5	240.2	271.7
Imports as % of GDP	16.5	16.2	16.5	17.2	17.4	15.0	16.1	16.7	16.6	16.4	16.6
Growth rates as % of the previous year											
Volume index	124.2	122.4	130.1	127.1	113.5	63.3	135.4	122.2	105.1	86.6	88.6
Price index	106.1	106.5	105.5	107.6	117.8	99.1	101.6	109.1	97.3	104.0	101.8

Source: the Bank of Russia, RF Ministry for Economic Development.

The peak of imports' drop was registered in the IV quarter when the volume of commodity supplies from foreign countries fell by 19.4% as compared with the respective period of 2013; in December the drop was already as deep as 24% (as compared with December 2013).

The decrease of imports was observed in actually all commodity groups of the extended commodity classification except for "Mineral products" (up by 5.5%) and "Precious stones, precious metals and articles thereof" (up by 25.8%). A notable reduction of import supplies was registered in the following commodity groups: "Textiles, textile articles and footwear" (down by 12.8%), "Metals and articles thereof" (down by 12.7%), "Machines, equipment and transport means" (down by 11.7%), "Wood, pulp and paper products" (down by 11.3%), "Products of chemical industry" (down by 7.4%). Imports of "Foodstuffs and raw agricultural products" fell by 7.8% due not only to the introduction of food embargo but also to the devaluation of ruble that raised the competitiveness of domestic food products and at the same time limited import potential.

It should be noted that imports of capital goods was falling faster than imports of consumer commodities. For instance, in January-September 2014 import purchases of capital goods decreased by 5.5% as compared with the respective period of 2013 while those of consumer commodities were down by only 2.9%.

Serious problems emerged in the Russian oil and gas sector due the introduction of ban on import supplies of technological equipment for oil and gas companies. According to data of the Center for International Trade[1], in 2013 Russia imported equipment for its oil and gas industries to the amount of $2bn; in 2014 over half of these purchases were subjected to embargo imposed by the EU and US in August 2014. In 2013 the basic suppliers of equipment for oil and gas production were Japan, Canada, the US, Norway, South Korea, China, Belarus and the countries of European Union (Germany and Italy). The share of imports from countries that introduced sanctions against Russia amounted to 56.8% ($1.172bn). These countries primarily supplied tools for drilling hard rocks or rocky soils, pumping equipment, drilling machinery and floating drilling rigs. The most harmful for Russian economy is the ban on supplies of rotary equipment and the equipment for telemetry that is used for field modeling

[1] http://wto.wtcmoscow.ru/novosti/2629

According to the opinion of the RF Ministry of Industry and Trade, in the nearest future it is impossible to substitute many types of equipment with the one produced in Russia. The Ministry expects that China may become their supplier to Russia but admits that the efficiency and quality of Chinese analogues is far below the Western standard.

At the beginning of August Russia banned import of food products from the countries that imposed sanctions against it: the US, countries-members of the European Union, Canada, Australia and Norway. The ban concerns beef, pork, poultry meat, sausages, fish, vegetables, fruit, dairy products and some other items.

As a result in the III quarter of 2014 food imports fell by 5% as compared with the respective period of 2013.

In January-September 2014 the share of imported *meat of bovine animals* (beef) on the Russian market was as high as 72.9%. The CIS countries remained major suppliers of fresh and chilled bovine meat: in the III quarter of 2013 they accounted for 68.4% of the respective imports while in the III quarter of 2014 – for already 78.9%. Bovine meat was primarily supplied from Belarus the share of which grew from 51.7% up to 69.9%. The share of Ukraine in import purchases of fresh and chilled beef fell from 13.7% down to 6.7%, that of the EU countries – from 11.2% down to 7.2%. Imports of bovine meat from Australia in the III quarter of 2014 discontinued and supplies from the US dropped by 37% as compared with the respective quarter of the previous year.

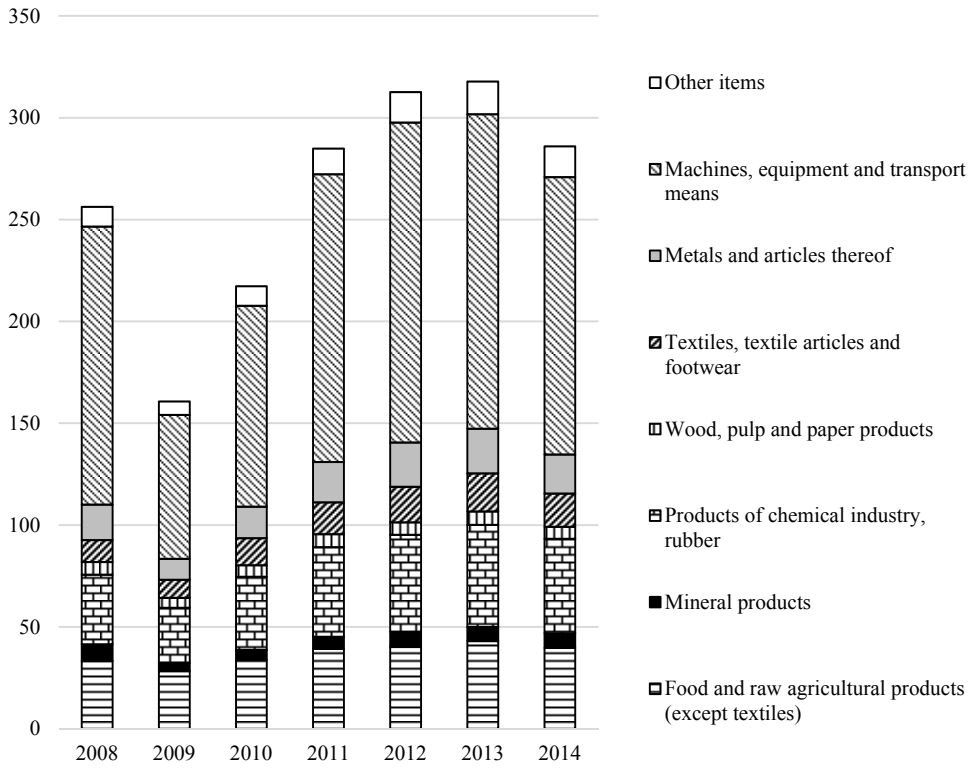


Fig. 52. Shifts in commodity structure of Russian imports in 2008–2014, billion $

At the same time the value of aggregate imports of fresh and chilled bovine meat in the III quarter of 2014 grew by 13.2% as compared with the III quarter of 2013. The growth was

conditioned by larger supplies from Argentine (up 83.9% in physical terms and 4.5 fold – in value terms) and Kazakhstan (up 39.1 and 8.5 fold, respectively). New Zealand and Uruguay have entered the Russian market.

Brazil remained the major supplier of frozen bovine meat to Russia – the country's share grew from 54% in the III quarter of 2013 up to 60% in the III quarter of 2014. A large supplier was Paraguay despite the shrinkage of its share from 28.9% to 22%. In the III quarter of 2014 imports of frozen bovine meat grew by 24.2% as compared with the III quarter of 2013.

In January-September 2014 the share of imported fresh, chilled and frozen *meat of swine* (pork) on the Russian market was 18.7%. As compared with the respective period of 2013, imports of pork in the III quarter of 2014 dropped by 43.5% in physical terms and by 27.1% in value terms. In the III quarter of 2013 pork was primarily supplied from the EU countries the share of which in the total Russian imports of this item amounted to 63.8%. In the III quarter of 2014 supplies from the EU countries actually came to a full stop. At the same time supplies from Serbia notably grew: while in the III quarter of 2013 it sold to the Russian market 40 tons of pork to the amount of $0.181m, in the III quarter of 2014 its supplies increased up to 4,480 tons to the amount of $17.1m. Supplies also grew from such countries as Brazil (by 63.2%), Chile (2 fold), Belarus (3.2 fold) and Kazakhstan (3.4 fold).

Imported *poultry meat and edible offal*, fresh, chilled or frozen, in January-September accounted for 10% of the Russian market. In the III quarter of 2013 47.1% of these items were imported to Russia from the US. The Russian Federation was the second largest market (after Mexico) for the US poultry meat. In the III quarter of 2014 the respective supplies from the US dropped by 64% as compared with the III quarter of 2013 and as a result the country's share fell down to 19.7%. Poultry meat imports from countries of the European Union reduced by 36% while those from Argentine grew by 75.5%, from Brazil – by 58.8%, from Chile – by 30.7%, from Belarus – by 69.4% and from Kazakhstan – 2.7 fold.

In 2014 imports of *fish products* to the Russian Federation amounted to 649.2 thousand tons which is 16.2% less than in the respective period of the previous year. In 2013 the leading suppliers of fish to Russia were Norway (39.9%), Chile (10.4%) and China (9.2%). The major supplier of fresh or chilled fish was Norway that in the III quarter of 2013 accounted for 88.7% of the respective Russian imports. In the III quarter of 2014 the Norwegian fish imports dropped by 63.4% and the share of the country fell down to 57.2%. Meantime, supplies of fresh fish from Morocco grew 2 fold, from Tunisia – by 68.2%, from Turkey – by 97.7% and from Faroe Islands – 6.3 fold.

The bulk of *milk and cream*, concentrated or sweetened, in the III quarter of 2013 was supplied from Belarus (72.4%). The EU countries accounted then for 13.3% of the respective imports. In the III quarter of 2014 their share fell down to 4.1% while the share of Belarus increased up to 91.4%.

The share of imported *cheese and curd* on the Russian market in the III quarter of 2014 amounted to 38.6%. As compared with the III quarter of 2013 imports of these products fell by 41.6%, those from the EU countries – by 42.1%. At the same time imports of cheese and curd from Uruguay grew 11.8 fold, from Argentine – by 17.4%, from Serbia – by 19.8%, from Switzerland – 2.4 fold, from Belarus – by 32.4% and from Kazakhstan – 2 fold.

Import is an important source of *fresh vegetables and fruit* for Russian consumers. The respective supplies largely consist of long-storage items: potatoes, carrots, onions, garlic, cabbages, pumpkins, marrows and apples. Russia imports over one half of consumed apples, pears and salads, from 12% to 15% of onions and carrots and about 25% of fresh tomatoes.

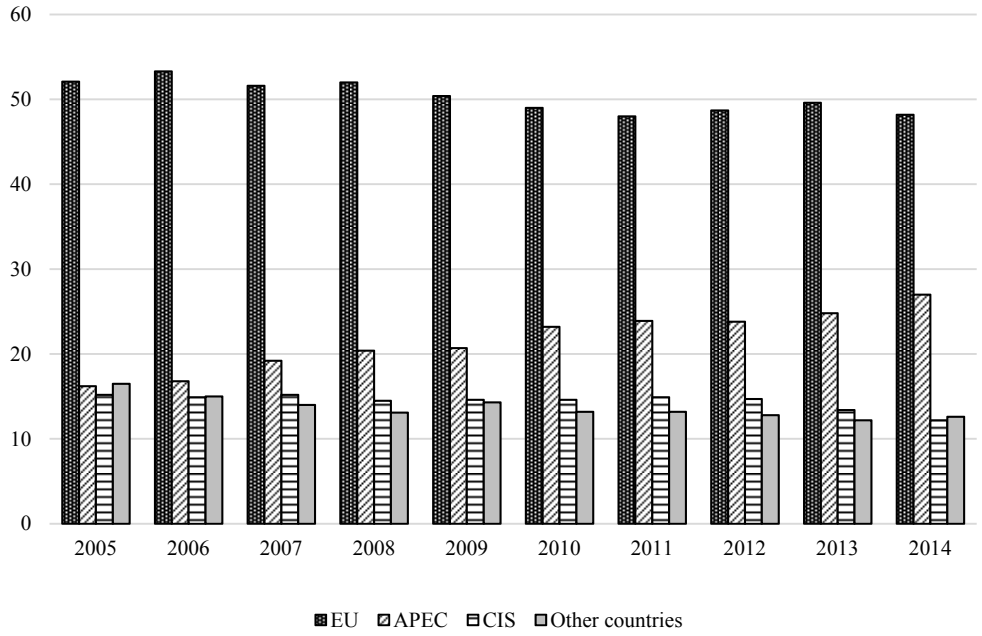
The major suppliers of fresh vegetables to the Russian Federation are Turkey, China and Israel that account for one half of the total vegetable imports in physical terms.

In the III quarter of 2014 the first place among suppliers of potatoes belonged to China (54.9%), the second – to Israel (22.7%), the third – to Egypt (12.9%).

According to data of the RF Ministry for Economic Development, the share of imported products in the structure of retail commodity resources is gradually decreasing. While in the I quarter of 2014 it amounted to 43%, in the II and III quarters it fell down to 41% (in the I, II and III quarters of 2013 – 44%). The share of imports in the volume of food resources in the I quarter of 2014 equaled 38% (in the I quarter of 2013 – 36%), in the II quarter – 37% (35%), in the III quarter – 33% (35%).

4.7.4. Geographic Structure of Russian Foreign Trade

In 2014 the share of EU countries in the geographical structure of Russian foreign trade fell down to 48.2% (from 49.6% in 2013), that of the CIS countries – down to 12.2% (from 13.4% in 2013). At the same time the share of countries-members of Asia-Pacific Economic Cooperation (APEC) increased from 24.8% to 27%.



Source: RF Federal Customs Service.

Fig. 53. Geographical structure of Russian foreign trade in 2005–2014, %

The share of countries-members of the European Union in the Russian foreign trade reduced due to the ban on import of selected food products from the EU, the US, Canada, Australia and Norway introduced by Russia in August 2014. Supplies from the following countries were most affected (2014 annual data): Denmark – down by 26.3%, Greece – down by 18.6%, Slovakia – by 19%, Latvia – by 18.9%, France – by 17.4%, Portugal – by 15.1%, Poland – by 15%.

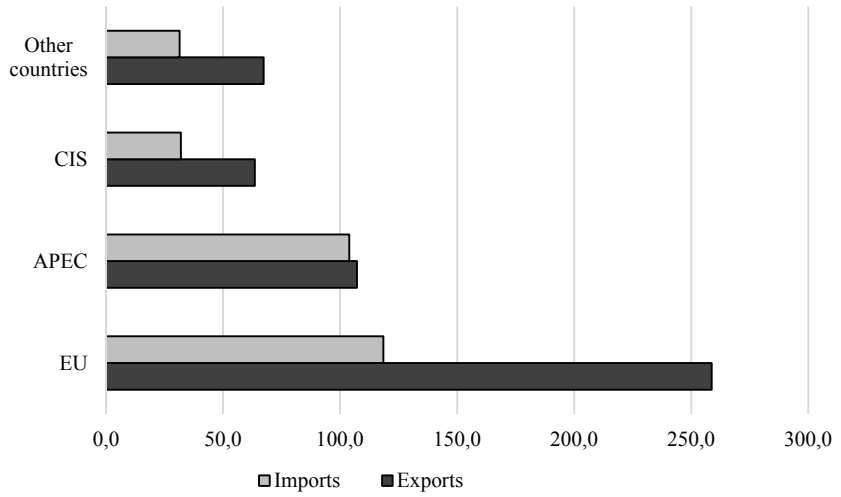
Despite declarations of the Russian government about the necessity to increase imports of food products from the CIS countries, the supply of commodities from the Commonwealth

has fallen as well. In 2014 imports from Kirghizia dropped by 33%, those from Ukraine – by 31.9%, from Uzbekistan – by 30.4%, from Turkmenistan – by 34.8%, from Belarus – by 15.6%, from Armenia – by 11%.

In 2014 a negative balance was registered in trade with 22 countries the share of which in the total Russian foreign trade turnover amounted to 22.3%. It was the biggest in trade with China (–$13.4bn), the US (–$7.8bn), France (–$3.2bn), Austria (–$2.7bn), Brazil (–$1.6bn) and Hong Kong (–$1bn).

Since 2010 the largest trade partner of the Russian Federation is *China*. In 2014 its share in the Russian foreign trade turnover amounted to 11.3% which is 0.8 p.p. more than in 2010. At the same time in 2014 the foreign trade turnover between the two countries fell by 0.5% (down to $88.4bn) after reaching its maximum ($88.8bn) in 2013. The balance of trade is negative for Russia: the supply of goods from PRC is well above the reciprocal commodity flow. For instance, in 2014 Chinese imports to Russia amounted to $50.9bn (4.3% below the 2013 indicator) while Russian exports to China equaled $37.5bn (5.3% above the 2013 indicator). As a result the balance of foreign trade was negative for Russia – -$13.4bn.

The *Netherlands* preserved their second place – in 2014 their share grew up to 9.4% from 9% in 2013 despite the reduction of foreign trade turnover by 3.6% basically due to the drop of supplies to Russia by 10.1%. In 2014 Russian exports to the Netherlands amounted to $68bn while Russian imports from this country – to only $5.3bn. As a result the balance of foreign trade was positive for Russia – $62.7bn.



Source: RF Federal Customs Service.

Fig. 54. Basic indicators of Russian foreign trade by regions in 2014, billion $

Despite the reduction of foreign trade turnover by 6.5% (as compared with 2013) due to the mutually introduced sanctions, *Germany* continued to rank third among the major trade partners of the Russian Federation. In 2014 its share in Russia's foreign trade turnover amounted to 9% (in 2013 – 8.9%). The volume of export supplies from Russia to Germany increased by 0.3% - up to $37.1bn. The volume of imported German commodities fell by 13.1% - down to $33bn. The balance of foreign trade was positive for the Russian Federation - $4.1bn.

4.7.5. Regulation of Russian Foreign Trade[1]

Tariff regulation

Export duties

In compliance with RF Government Resolution No.276[2] of March 29, 2013 in 2014 the RF Ministry for Economic Development on a monthly basis adjusted the rates of export customs duties on crude oil and selected categories of commodities produced thereof.

RF Government Resolution No.2 of January 3, 2014 "On introducing amendments to RF Government Resolution No.276 of March 29, 2013" provides for the reduction of export customs duties on crude oil and diesel fuel. The methodology of calculating export customs duties on crude oil was revised. Amendments are applied in case the average price for Urals crude oil on the world markets of crude oil (Mediterranean and Rotterdam) over the period of monitoring exceeds the level of $182.5 per ton. Before the introduction of amendments the formula for calculating the rate was unified and envisaged the application of coefficient 0.6. In 2014 the coefficient 0.59 was applied; in 2015 it will equal 0.57 and beginning from 2016 – 0.55. The rate of export duty on diesel fuel is cut from 66% down to 65% in 2014, down to 63% in 2015 and down to 61% in 2016.

Table 37

Rates of export duties on crude oil and petroleum products in 2013-2014, $/ton

	Crude oil	Petroleum products	
2013			
January 1	395.6	261.1	
February 1	403.3	266.2	
March 1	420.6	277.6	
April 1	401.5	265.0	
May 1	378.4	249.7	
June 1	359.3	237.1	
July 1	369.2	243.6	
August 1	379.8	250.6	
September 1	400.7	264.4	
October 1	416.4	274.8	
November 1	395.9	261.2	
December 1	385.7	254.5	
2014			
January 1	401.0	264.6	
		Diesel fuel	**Other types of petroleum products except gasoline and diesel fuel**
February 1	386.3	251.0	254.9
March 1	384.4	249.8	253.7
April 1	387.0	251.5	255.4
May 1	376.1	244.4	248.2
June 1	385.0	250.2	254.1
July 1	385.2	250.3	254.2
August 1	388.4	252.4	256.3
September 1	367.6	238.9	242.6

Source: Resolutions of RF Government, information of the RF Ministry for Economic Development.

RF Government Resolution No.705 of July 25, 2014 "On introducing amendments to rates of export customs duties on commodities exported from the Russian Federation outside the

[1] When preparing this section data of the information law portal ГАРАНТ.РУ were used.
[2] RF Government Resolution No.276 of March 29, 2013 "On calculation of export customs duties on crude oil and selected categories of commodities produced thereof and on invalidation of some decisions of the Government of the Russian Federation".

territories of counties-members of the agreement on Customs Union" specifies that due to the Russia's accession to WTO export duties on 210 items of the Foreign Economic Activity Commodity Nomenclature (FEACN) are lowered beginning from September 1, 2014. It applies to sea products, seeds, mineral products, raw hides and skins, wood and articles thereof, precious and semi-precious stones and metals, waste and scrap of ferrous metals, refined copper, copper base alloys, nickel and articles thereof, aluminium and articles thereof, waste and articles of non-precious metals.

Import duties

Under the Protocol of accession to the World Trade Organization (WTO) Russia has undertaken a commitment to gradually lower import customs duties. The first stage of cutting tariffs was carried out right after the accession to WTO, the second – in August 2014. Within 2014 Russia also revised its tariffs (primarily downwards) in order to comply with decisions of the Eurasian Economic Commission.

In compliance with Decision of the Board of Eurasian Economic Commission (EEC) No.9 of January 29, 2014 "On establishing rates of import customs duties under the Common Customs Tariff of the Customs Union on selected types of paper and paperboard" the rates of import customs duties on these items have been lowered.

The rates of customs duties on selected types of bleached paper and paperboard were cut from 15% to 5%. The duty rate on light-weight coated paper in rolls of width > 15 cm was lowered from 12.5% down to 10%. Let's note that earlier (from 20.04.2013 to 19.01.2014) a reduced temporary rate of 5% was applied for this item. Duty rates on paper and paperboard for writing, printing or other graphic purposes were lowered from 15% to 10% (for the time period from 01.03.2014 to 31.08.2014 inclusive a temporary rate for these items was set at 5%).

Decision of the EEC Board No.3 of January 31, 2014 "On establishing rates of import customs duties under the Common Customs Tariff of the Customs Union on selected types of AC motors" specifies that until December 31, 2015 inclusive the rate of import customs duty on multi-phase AC motors of an output from 7.5 kW to 37 kW will be raised from 0 to 5% of the customs value.

In compliance with the RF Government Decree No.163-p of February 10, 2014 commodities imported to Russia for the purposes of organizing and holding 2014 Olympic Games in Sochi were subject to a special customs procedure allowing relevant organizations to import the named commodities free of customs duties, VAT and customs fees.

Decision of the EEC Board No.46 of March 25, 2014 "On establishing rates of import customs duties under the Common Customs Tariff of the Customs Union on selected types of fowl meat and machines for drilling to the depth of 200 m or more and on approval of the draft Decision of the Board of Eurasian Economic Commission" alters the rates of import duties on selected types of fowl meat and drilling machinery.

The alteration also concerned rates of import duties on machines for drilling to the depth of 200 m and more for which combination rates were temporarily applied. The amendments reduced the size of their specific component.

In compliance with Decision of the EEC Board No.13 of March 4, 2014 "On introducing amendments to the Foreign Economic Activity Commodity Nomenclature (FEACN) of the Customs Union and the Common Customs Tariff of the Customs Union in respect of selected

types of motor vehicles for the transport of 10 persons or more including driver" import duties on long-distance buses were raised.

The rate of import customs duty on new buses of emission class 4 and higher with diesel or semi-diesel engine, overall length 11.5 m or more, having 41 or more seats (including driver), luggage space not less than 5 m and designed to transport only seating passengers and their luggage was established at the level of 18% of the customs value (formerly – 0%). A zero rate of customs duty is preserved for buses of emission class 5 with engine power over 308 kW, overall length over 13 m, having over 55 seats (including driver) and luggage space over 12 m.

Decision of the EEC Board No.16 of March 28, 2014 "On introducing amendments to the Foreign Economic Activity Commodity Nomenclature (FEACN) of the Customs Union and the Common Customs Tariff of the Customs Union in respect of selected types of mill rolls" raises the rate of import duty on forged steel rolls for rolling mills up to 8.3% of the customs value (formerly – 0%). A zero rate of customs duty is preserved for hot mill work rolls and backup rolls for hot and cold rolling of net weight over 180,000 kg and containing 4.7% wt or more of chrome as well as for cold mill work rolls containing 4.7% wt or more of chrome.

In compliance with Decision of the EEC Board No.15 of March 28, 2014 "On establishing rates of import customs duties under the Common Customs Tariff of the Customs Union on selected types of rare-earth metals, scandium and yttrium, whether or not intermixed or inter-alloyed" a zero import duty is applied for these items from May 1, 2014 to April 30, 2015. Otherwise the rate of import duty equals 5% of the customs value.

Decision of the EEC Board No.51 of April 8, 2014 "On establishing rates of import customs duties under the Common Customs Tariff of the Customs Union on selected types of component parts and movements used in production of clocks and watches" lowers rates of import duties on these items. For the time period from 10.05.2014 to 09.05.2017 inclusive a zero (instead of 9%) import duty is set for cases for wrist-watches and pocket watches of non-precious metals and parts thereof. For the same period import duties on straps, bands and bracelets out of non-precious metals for the named watches are reduced from 15% to 5% of the customs value. On a regular basis duty rates on electrically operated watch movements are lowered from 15% to 5% and those on movements with automatic or other winding – from 15% to 10% (for all watches).

Decision of the EEC Board No.30 of April 16, 2014 "On establishing rates of import customs duties under the Common Customs Tariff of the Customs Union on selected types of fowl and turkey meat" introduces an ad-valorem import duty on these items at the rate of 80% of the customs value. Earlier a combination rate was in force – 80% but not less than 0.7 euro per 1 kg.

Decision of the EEC Board No.64 of May 13, 2014 "On establishing rates of import customs duties under the Common Customs Tariff of the Customs Union on selected types of timber out of some kinds of tropical wood" sets a zero rate of import duty for these items. It is to be applied from the date of its enactment till May 31, 2016 inclusive.

Decision of the EEC Board No.63 of March 13, 2014 "On introducing amendments to the Foreign Economic Activity Commodity Nomenclature (FEACN) of the Customs Union and the Common Customs Tariff of the Customs Union in respect of selected types of components for switch gear with SF6 insulation and to Decision of the Board of Eurasian Economic Commission No.91 of April 24, 2013" introduces temporary zero rates of import customs duties on these items (SF6 circuit breakers, disconnecting and grounding switches, grounding switches, through insulators, alluminium alloy cases for the named devices). A zero import

duty will be applied for these items from July 1, 2014 to December 31, 2015. Earlier the duty rate for these components was 13.3% of the customs value, that for the respective cases – 5%.

In order to comply with Russia's tariff commitments to WTO the EEC Board has taken Decision No.77 of May 26, 2014 "On introducing amendments to the Foreign Economic Activity Commodity Nomenclature (FEACN) of the Customs Union and the Common Customs Tariff of the Customs Union in respect of selected commodities in compliance with commitments of the Russian Federation to WTO and on approval of the draft Decision of the Board of Eurasian Economic Commission". According to this Decision beginning from September 1, 2014 a number of sub-items were added to FEACN of the Customs Union, e.g. 4016 10 000 1 – articles of cellular rubber for technical purposes; 4017 00 000 1 – tubes, pipes and hoses with fittings suitable for transportation of gases or liquids; 8411 12 300 3 – turbo-jets of a thrust over 44 kN but below 60 kN. The commodities are intended for civil aircraft. One more item is 8411 12 800 1 – engines of a thrust over 132 kN but below 145 kN that are used for the production thereof.

One more group of commodities in respect of which rates of import duties were lowered is meat. For instance, 15% of customs value but not less than 0.15 euro per 1 kg is to be paid when importing short cut forequarters of fresh or chilled goat meat. The same rate is applied for boneless meat of this animal. The established import duty on whale meat is 16.7% but not less than 0.167 euro per 1 kg. The lowering of import duties also concerned fish including smoked fish (except edible fish sub-products).

In compliance with Decision of the EEC Board No.47 of June 23, 2014 "On introducing amendments to the Foreign Economic Activity Commodity Nomenclature (FEACN) of the Customs Union and the Common Customs Tariff of the Customs Union in respect of selected commodities in compliance with commitments of the Russian Federation to WTO" beginning from September 1, 2014 import duties are reduced down to 6.7% of the customs value for the following commodities: other tubes, pipes and hoses with fittings intended for civil aircraft, fittings and engines for the latter. For other commodities the rate is cut down to 6.5% (except aircraft engines subject to 8% duty).

Import duties on some food products, machinery, equipment, aquatic bioresources, plants, articles of wood and medical products were revised. Beginning from December 31, 2014 the rates are lowered for such items as cherry purees and pastes, some kinds of carpets, absorption heat pumps, coin- or disc-operated record players with laser reading system.

In compliance with Decision of the EEC Board No.103 of July 7, 2014 "On establishing rates of import customs duties under the Common Customs Tariff of the Customs Union on selected types of retreaded tyres and selected types of footwear in compliance with commitments of the Russian Federation to WTO and on approval of the draft Decision of the Board of Eurasian Economic Commission" the rates of import duties on these items are lowered beginning from September 1, 2014. In particular, this concerns retreaded tyres for motor vehicles (including station wagons and racing cars). The rate of import duty imposed on them is 15% but not less than 2.02 euro per unit (instead of 17.5% but not less than 4.13 euro per unit).

One more category of commodities concerned is selected types of footwear with outer soles and uppers of rubber or plastics. For instance, import duty on ski boots and cross-country ski footwear is established at the rate of 7.4% plus 0.46 euro per 1 pair (earlier – 10% but not less than 1 euro per 1 pair).

In compliance with Decision of the EEC Board No.103 of July 7, 2014 "On establishing rates of import customs duties under the Common Customs Tariff of the Customs Union on

terephthalic acid and its salts" a zero import duty is applied for this item from September 2, 2014 to December 31, 2015. Liquid dielectric transformers having a power handling capacity of 148,000 kVA are also eligible for a zero rate during the same period (initially the rate was 5% of the customs value).

Decision of the EEC Board No.110 of July 15, 2014 "On establishing rates of import customs duties under the Common Customs Tariff of the Customs Union on selected parts of gas turbines" provides for a temporary (from September 2, 2014 to September 1, 2016 inclusive) reduction of the rate of import duty on these items from 8 to 0% of the customs value.

In compliance with Decision of the EEC Board No.52 of July 16, 2014 "On establishing rates of import customs duties under the Common Customs Tariff of the Customs Union on selected types of commodities in compliance with commitments of the Russian Federation to WTO" rates of import duties on some commodities are lowered beginning from September 1, 2014. In particular, it applies to blue whiting, household refrigerators-freezers and freezers, plasma and LCD TV sets, motor vehicles for the transport of goods manufactured more than 5 but less than 7 years ago. The specific component of the combination rate for baby napkins and pumpers and selected types of furniture was reduced. Lower import duty will be temporarily (from September 1, 2014 to August 31, 2015 inclusive) applied for palm oil in containers with net weight 20,000 kg or less.

RF Government Resolution No.736 of July 31, 2014 "On the introduction of import customs duties in respect of commodities the country of origin of which is the Republic of Moldova" on a permanent basis fixes import duties on respective commodities at the rate of the Common Customs Tariff of the Customs Union in accordance with regime of the most favoured nation. Among the commodities concerned are bovine meat (fresh or chilled), vegetables and some edible roots and tubers, wheat and meslin, barley, oats, maize, malt beer, some alcoholic drinks and wines. Let's remind that the Republic of Moldova is a member of the CIS area of free trade. The introduction of duties is due to the need to restrain excessive commodity imports.

Decision of the EEC Board No.160 of September 16, 2014 "On establishing rates of import customs duties under the Common Customs Tariff of the Customs Union on selected types of component parts for manufacturing electrical products" sets zero rates of import duties on the respective items. In particular, this concerns electronic circuits that earlier were subject to 3.33% and 3.3% import duty.

In compliance with Decision of the EEC Board No.67 of September 18, 2014 "On introducing amendments to the Foreign Economic Activity Commodity Nomenclature (FEACN) of the Customs Union and the Common Customs Tariff of the Customs Union in respect of selected types of diesel engines" a zero rate of import duty will be temporarily (up to September 30, 2017 inclusive) applied for diesel engines used for the production of goods-carrying motor vehicles with cubic capacity of a cylinder 18,500 cm^3 or more and engine power not less that 500 kW. Earlier the rate of import duty on the named engines amounted to 5% of the customs value. To be eligible for the zero import duty, the intended use of this commodity should be certified by an authorized body.

In compliance with Decision of the EEC Board No.65 of September 18, 2014 "On introducing amendments to the Foreign Economic Activity Commodity Nomenclature (FEACN) of the Customs Union and the Common Customs Tariff of the Customs Union in respect of selected types of amino-aldehyde resins" beginning from November 1, 2014 import duty on polymethylene diphenyl isocyanate will be cut from 7.7% of customs value down to zero. The

main application of this substance is the production of rigid polyurethane foams used in construction for heat insulation, in manufacturing of refrigerating equipment, for pipe insulation, etc. It is also used for the production of building sealants and adhesives.

In compliance with Decision of the EEC Board No.64 of September 18, 2014 "On introducing amendments to the Foreign Economic Activity Commodity Nomenclature (FEACN) of the Customs Union and the Common Customs Tariff of the Customs Union in respect of selected types of pressing equipment for aircraft industry" some presses for aircraft industry will be eligible for a zero rate of import duty from the moment of the Decision's enforcement till June 30, 2015 inclusive.

RF Government Resolution No.959 of September 19, 2014 "On the introduction of import customs duties in respect of commodities the country of origin of which is Ukraine" specifies that in case Ukraine proceeds to the implementation of its agreement with the EU, its commodities supplied to Russia will be subject to import duties. In particular, this concerns meat, dairy and confectionary products, fruit, vegetables, cereals, alcoholic drinks, cigarettes, sanitary equipment, furniture, clothes, footwear and passenger cars. The duties will come in force 10 days after the revelation of Ukraine's actions to apply or implement the Association Agreement with the EU. In this case import of Ukrainian commodities will be subject to import duties at the rate of the Common Customs Tariff of the Customs Union in accordance with regime of the most favoured nation.

Decision of the EEC Board No.171 of September 23, 2014 "On establishing rates of import customs duties under the Common Customs Tariff of the Customs Union on selected types of watches" provides for a temporary (from November 1, 2014 to August 31, 2015) application of combination import duty on some types of wrist-watches. It amounts to 10% of the customs value but not less than 4 euro per 1 unit. The duty applies to electrically operated wrist-watches with mechanical display only as well as to other wrist-watches without automatic winding. Earlier these items were subject to a zero import duty.

In compliance with Decision of the EEC Board No.97 of October 9, 2014 "On introducing amendments to the Foreign Economic Activity Commodity Nomenclature (FEACN) of the Customs Union and the Common Customs Tariff of the Customs Union in respect of selected types of polyethylene" a temporary zero duty is imposed on import of polyethylene for three-layer anticorrosive coating of large diameter pipes. It will be applied from December 1, 2014 to August 31, 2015 inclusive. Earlier the rate of import duty on this item was 6.5% of the customs value.

Decision of the EEC Board No.221 of December 2, 2014 "On establishing rates of import customs duties under the Common Customs Tariff of the Customs Union on natural calcium phosphates, natural aluminium calcium phosphates and phosphatic chalk, ground" provides for a temporary (from January 5, 2015 to January 4, 2016) application of a zero import duty on these items (earlier – 5% of the customs value).

Non-Tariff Regulation

Bans and restrictions

In compliance with Decree of the RF President No.560 of August 6, 2014 "On application of special economic measures aimed at ensuring the security of the Russian Federation" import to our country of selected types of raw and processed agricultural products and foodstuffs is banned or restricted till August 6, 2015. This refers to commodities from the countries that have introduced economic sanctions against Russian legal and physical bodies or have acced-

ed to this decision. If needed, this term can be altered at the suggestion of the RF Government. The latter should also elaborate a precise list of commodities subject to import bans or restrictions.

Besides, the Cabinet of Ministers is charged with ensuring the balance of commodity flows and with preventing an accelerated growth of prices for agricultural and food products.

One should provide for an operational monitoring of commodity markets and control over situation thereon in coordination with higher regional authorities. A set of measures aimed at expanding the supply of domestic products should be elaborated and implemented.

RF Government Resolution No.778 of August 7, 2014 "On measures for the implementation of Decree of the RF President No.560 of August 6, 2014 "On application of special economic measures aimed at ensuring the security of the Russian Federation"" introduces a one-year ban on import to Russia of selected types of raw and processed agricultural products and foodstuffs. This refers to commodities originating from the US, countries of the European Union, Canada, Australia and Norway. In particular, the ban concerns bovine meat, pork, fish, milk and dairy products, vegetables, fruit, nuts, cheese and curd. Excepted from the list are baby food products.

RF Government Resolution No.830 of August 20, 2014 "On introducing amendments to RF Government Resolution No.778 of August 7, 2014" excludes items having no domestic analogues from the list of agricultural and food products from the EU and the US that are subject to import ban. For instance, the ban is lifted for Atlantic salmon and trout juveniles in order to sustain production capacities of commodity fish farming. The sanctions also do not apply to lactose-free milk and dairy products, seed stock (potatoes, peas, sweet hybrid corn, seed onion), biologically active dietary supplements, vitamin mineral complexes, flavour additives, protein concentrates and their mixes, dietary fibers and additives.

Protective measures

Decision of the EEC Board No.68 of May 13, 2014 "On extending application of the anti-dumping measure established by Decision of the Customs Union Commission No.904 of December 9, 2011" extends the application of anti-dumping duty in respect of forged steel rolls for metal-rolling mills originating from Ukraine up to February 27, 2015 inclusive. Formerly this duty was to be applied till June 26, 2014. It amounts to 26% of the customs value and is levied in addition to import duty.

At present 10 measures for protecting domestic market are in effect in the Customs Union (*Table 38*).

Table 38

Measures for protecting domestic market in the Customs Union

Commodity	Item code in FEACN of the Customs Union	Country-exporter	Type of measure	Short description of the measure
1	2	3	4	5
Some types of steel pipes	7304, 7305, 7306	Ukraine	Anti-dumping duty	Producers OJSC "INTERPIPE NTZ", LLC "INTERPIPE Niko Tube", OJSC "INTERPIPE NMTZ" – 19.4%; others – 37.8%
Roller bearings	8482	PRC	Anti-dumping duty	Producer – Wuxi Roller bearing, Ltd. – 31.3%; others – 41.5%
Forged steel rolls for metal-rolling mills	8455	Ukraine	Anti-dumping duty	26% of the customs value

Cont'd

1	2	3	4	5		
Flat-rolled products of iron, polymer-coated	7210, 7212, 7225	PRC, Taiwan, Hong-Kong, Macao	Anti-dumping duty	Producers – Angang Steel Co, Ltd, PRC – 12.9% Dalian POSCO Co., Ltd, PRC – 11.4%, Shandong Guanzhou Co., Ltd – 8.1%. Others – 22.6%		
Electrodes of graphite	8545	India	Anti-dumping duty	Producers – Graphite India Limited, plant «Durgapur», plant «Nashik», plant «Bangalore» – 32.83%, HEG Limited – 16.04%. Others – 32.83%.		
Cold-reduced seamless tubes and pipes of stainless steel	7304	PRC	Anti-dumping duty	19.15%		
Enameled baths of cast iron	7324	PRC	Anti-dumping duty	51.87%		
Light commercial motor vehicles	8704	Germany, Italy, Turkey	Anti-dumping duty	FRG – 29.6% Italy – 23% Turkey – 11.1%		
Tableware and kitchenware of porcelain	6911	All countries	Special protective	From September 29, 2013 to September 28, 2014 – $1,479 per ton. From September 29, 2014 to September 28, 2015 – $1,035.3 per ton. From September 29, 2015 to September 28, 2016 – $591.6 per ton		
Grain harvesters and their parts	8433	All countries	Special protective (quotas)	Import quota		
				2014	2015	2016
			Republic of Belarus	50	52	34
			Republic of Kazakhstan	300	309	204
			Russian Federation	424	437	288

Source: http://eurasiancommission.org/ru/act/trade/podm/mery/Pages/default.aspx