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The review provides a detailed analysis of main trends in Russia's economy in 2013. The paper contains 6 big sections that highlight single aspects of Russia's economic development: the socio-political context; the monetary and credit spheres; financial sphere; the real sector; social sphere; institutional challenges. The paper employs a huge mass of statistical data that forms the basis of original computation and numerous charts.

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Russia's Macrostructure of Production in 2013

Post-crisis dynamics of the Russian economy in 2009-2013

The global economic crisis impacted on the Russian economy in the following areas: (1) there was a sharp drop in prices and in foreign demand for the basic commodities that form the basis of export potential; (2) domestic demand decreased due to falling revenues for the economy and falling population incomes; (3) narrowed supply of imported goods, which form more than one third of domestic market resources; and (4) changes in the direction of investments, with a sharp drop in the domestic investment in capital assets and an intensive outflow of capital abroad.

Analysis of the dynamics of the national economic indicators shows that the gradual decline in the pace of economic growth was followed by increasing disparities in production, consumption and finance, as well as by reduced innovation activity by manufacturers, strengthening of the problems connected with imbalances in the technical and technological characteristics of the fixed assets, and investment in capital assets and in basic economic activities. Expansion of demand from domestic consumers was supported by an increase in wages significantly above increasing productivity. Growth of investment in capital assets did not result in a corresponding increase in output per worker or per unit invested. (*Table 1*). Development based on the extensive use of the principal factors which increase production costs and a high proportion of imports in the domestic market resources have reduced the competitive ability of the Russian economic as well as the dynamics of growth.

Prior to the crisis in 2008 the Russian economy was characterised by a simultaneous expansion of external and domestic demand, with the cumulative effect of the internal factors, regulating the level of business activity offsetting the impact on economic growth of the weakening external demand. The reasons for the far-reaching extent and prolonged reaction to the global crisis of 2008-2009 had an inner nature. In the acute phase of the crisis in 2009 the decrease in domestic demand was deeper, so the recovery process took almost two years, while, in 2010, external demand exceeded the pre-crisis index of 2008 (*Fig. 1*).

Table 1

Main macroeconomic indicators of social and economic development in 2008-2012 as % of the previous year

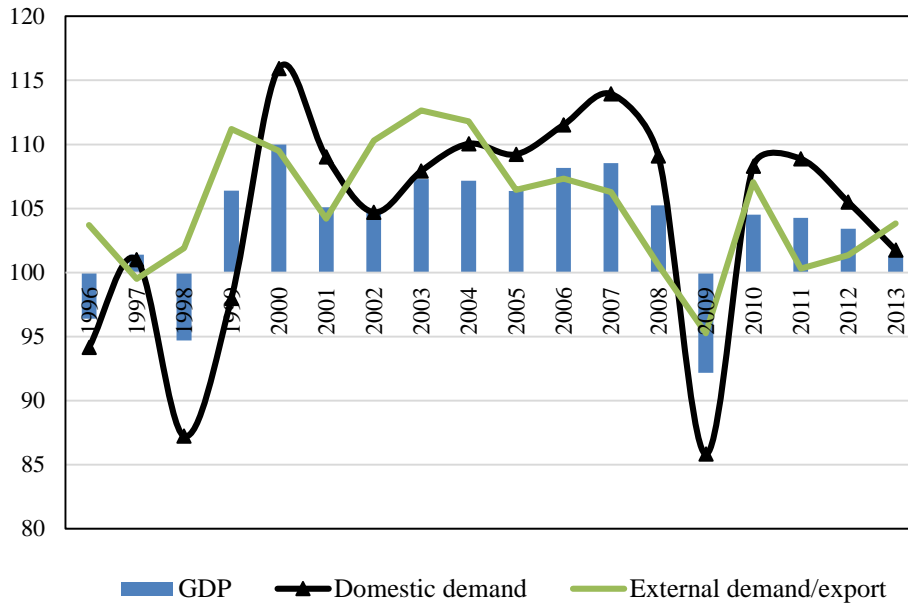
	2008	2009	2010	2011	2012	2013
1	2	3	4	5	6	7
GDP	105.2	92.2	104.5	104.3	103.4	101.3
Industrial production index	100.6	90.7	107.3	105	103.4	100.4
Mining and quarrying	100.4	99.4	103.8	101.8	101	101.1

Cont'd

1	2	3	4	5	6	7
Manufacturing industries	100.5	84.8	110.6	108	105.1	100.5
Agricultural production	110.8	101.4	88.5	123.0	95.2	106.2
Investments in capital assets	109.9	84.3	106.0	110.8	106.6	99.7
Retail trade turnover	113.7	94.9	106.5	107.1	106.3	103.9
Fee-based services to citizens	104.3	97.5	101.5	103.0	103.7	102.1
Exports	134.6	63.7	132.1	131.3	102.7	98.8
Imports	129.4	63.7	133.6	129.7	105.4	102.6

End of year consumer price index	113.3	108.8	108.8	106.1	106.6	106.8
End of year producer price index	93.0	113.9	116.7	112.0	105.1	103.4
Real disposable incomes	102.4	103.0	105.9	100.5	104.6	103.3
Real accrued salary	111.5	96.5	105.2	102.8	108.4	105.2
Level of general unemployment, in %	6.2	8.3	7.3	6.5	5.5	5.5

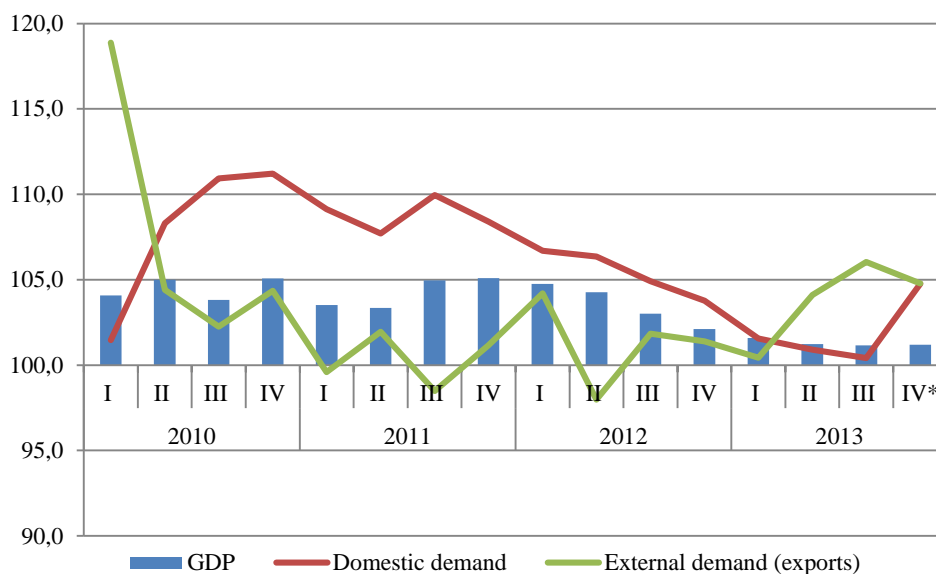
Source: Federal State Statistics Service.



Source: Federal State Statistics Service.

Fig. 1. The changing of dynamics of the GDP components of domestic and external demand in 1996-2013, as % of previous period

Differences in the rates of recovery of individual components of the aggregate demand determined the features of the functioning of the economy in 2011-2013. While the results from the last four years indicate accelerated growth in domestic demand relative to GDP and external demand, the quarterly dynamics shows how these changes altered and constrained the development of the Russian economy (Fig. 2). The overall cause of stagnation in the Russian economy in 2013 was a slowdown in the growth of domestic demand in the third quarter of 2011. A further factor in the reduction in growth of GDP was the decrease in export dynamics from the second quarter of 2010 until the first quarter of 2013. Despite the increase in external demand from the second quarter of 2013 in relation to the corresponding period of the previous year, this failed to stimulate the rate of GDP growth, since the dynamics of domestic demand weakened sharply in 2013, and, in fact, it was only the export of goods and services which helped to preserve the positive nature of the GDP dynamics, albeit, weakly. In 2013 the growth in domestic demand was 1.7% while that of external demand was 3.8%, against 5.5% and 1.4%, respectively, in 2012.



Source: Federal State Statistics Service.

Fig. 2. Changing dynamics of GDP components of domestic and external demand in 2010-2013, as % of the corresponding quarters of the previous year

Compared with 2012, the 2013 index of output goods and services for key economic activities was 100.5%. In 2013 the volume of industrial production increased by only 0.4% on the previous year. During Q2 and Q3 of 2013 negative annual and quarterly growth rates were recorded in relation to the corresponding periods of the previous year in manufacturing activities orientated mainly towards the domestic market. December 2013 was only the third time within the year that there was growth in manufacturing output (1.6% on an annualised basis) but this suspended the downturn of the IV quarter and stabilised the growth for the year at around the level seen in 2012. Weak growth in mining activity amid unfavourable weather forecasts for the winter of 2013-2014 started to influence industrial dynamics from Q2 of 2013, mainly due to increased demand in the domestic market and from traditional importing-countries as the heating season approached. In 2013 the index of physical production volume in the mining sector was 101.2% of the previous year.

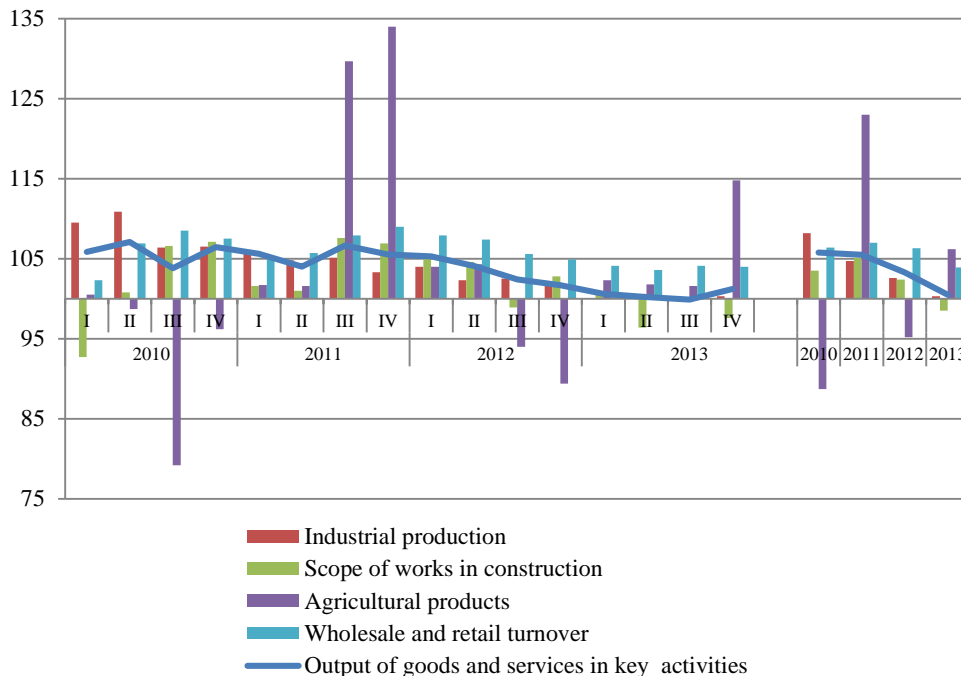
This extremely negative influence on the macroeconomic situation in the Russian economy had a slowdown effect on business activity in construction and the investment complex from Q4 of 2011, so that by 2013 the volume of construction works began to decline. In Q2 and Q3 of 2013 the fall in investments in capital assets reached 1.4%, while, for the whole year it was 0.3% in relation to the corresponding period of 2012, with the volume of construction works being reduced by 1.5% in annual terms.

Other fields of the real sector of the economy also negatively influenced the dynamics of the overall national economy. Low industrial growth and in the consumer and investment markets, a stagnation of demand for transport services, as well as the slowing down of growth in communications services to 4.5% in 2013, against 5.6% in the previous year could all be noted.

There was also slowing of consumer demand and wholesale turnover. The growth of retail turnover in the last three years reached its peak in Q4 of 2011 but steadily slowed during 2012-2013 yet still remained the main driver of economic growth (Fig. 3). In 2013, retail turnover

increased by 3.9% having increased by 6.4% in the previous year, while the wholesale trade had increased by 0.9% and 3.4% respectively.

Despite the downward trend, sales in in 2013 were some of the steadiest against the risks in the economic development sectors.



Source: Federal State Statistics Service.

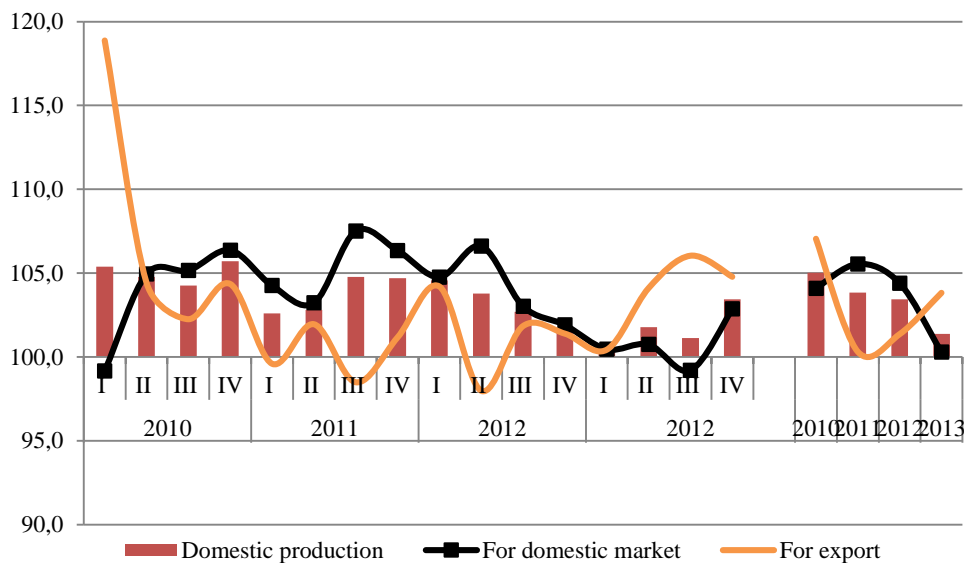
Fig. 3. Indices of output of goods and services in key economic activities for 2010-2013, as % of the corresponding period of the previous year

A positive factor maintaining the positive growth of GDP in 2013 was an increase in agricultural production by 6.2% compared with 2012. As a result this sector managed to reach the level of 2011.

The dynamics of the domestic market were defined by the ratio of growth of domestic production for domestic consumption and external markets, on the one hand, and the dynamics and structure of imports, on the other. The post-crisis recovery of domestic production for the domestic market was extremely slow, though its fall during the acute phase of the crisis in 2009 was not as abrupt as the fall in imports. The sharp drop in domestic production was due both to the low competitiveness of domestically-produced goods and services compared to imported ones, and to the low efficiency of production in the non-tradable goods and services sector compared to the export oriented sector of the economy.

The level of external demand for minerals and raw materials is of fundamental importance for the Russian economy as is the direction of use of the income from foreign trade. An increase of income concentration in the manufacturing sector oriented towards exports puts pressure to on the domestic market. If we consider that the rapid growth of the export sector of the economy in 2010 determined the strength of recovery of domestic production for the domestic market, then in 2011-2012 even the acceleration of the average annual growth of domestic production, up to 5.0%, was not enough to prevent the consequences of a slowdown in export growth to

0.8%. In 2013 the situation was compounded when the pace of domestic production slowed to 0.3% against 4.4% of a year earlier, while exports fell to 98.8% of those of the previous year.

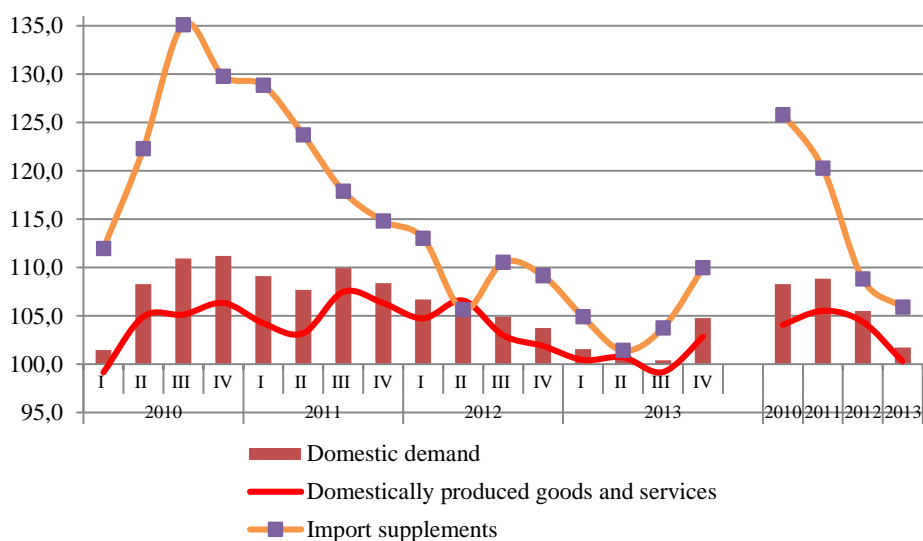


Source: Federal State Statistics Service.

Fig. 4. Domestic production dynamics in 2010–2013, as % of the corresponding quarter of the previous year

While noting the importance of the domestic market dynamics, as the dominant factor in the development of the Russian economy in 2010-2013, one must take account of the details affecting the domestic market resources. The starting conditions of the recovery were characterised by the quantum index of the volume of basic manufacturing activities within the economy having fallen by 9.8% in 2009 compared to the previous year while the import volume had fallen by 30.4%. This massive decline in imports in 2009 determined the structural changes of the domestic market; i.e. with decreased consumer demand and incomes and the weakening of the ruble, there was a transient increase in the share of domestically manufactured goods (Fig. 5). However, given that the Russian economy had, for the previous ten years, been operating under accelerated growth of imports relative to domestic production, during the recovery from the crisis the structure of domestic market resources in 2010 was repeating the structure of the 2007 pre-crisis level. Later, in 2011-2013 the domestic market resource structure changed (for the worse) due to an increase in the share of imported goods in domestic market resources from 24.9% to 26.7%. In 2013, the share of imported capital goods accounted for 6.2% of investments and 44% of the retail trade commodity resources.

In the absence of reserves of competitive capacity, import substitution in 2010-2012 concentrated in the manufacturing sector with a high proportion of industrial assembly. This determined the change in proportions between the imports of investment and intermediate goods. In particular, the increase in the share of intermediate consumption goods stimulated the recovery of the assembly machine industry from the crisis, but at the same time reflected the inadequate localisation of production of the main components.



Source: Federal State Statistics Service.

Fig. 5. Dynamics of domestic demand components in 2010–2013, in % to corresponding quarter of the previous year

Table 2

**Structure of imports by functional nature of utilisation
(balance of payments methodology) % of total**

	Goods		
	Consumer	Investment	Intermediary
2006	46.2	17.0	36.8
2007	44.4	18.9	36.7
2008	41.8	23.8	34.4
2009	44.3	19.7	36.0
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

Source: Federal State Statistics Service.

The increasing share in the import structure of investment and intermediate goods in 2010-2012 with a decrease in the share of consumer goods was qualitatively new process for the Russian economy. Ceteris paribus, the dynamic growth in imports was to promote the change in the competitive environment, where the further development of the real sector in this situation would depend on the intensity of investment in fixed assets, focused on the modernisation and diversification of production. However, the high share of imports in the retail trade and in the volume of investments in fixed assets increased the dependence of the gross resources balance of the economy on changes in the external economic situation. In 2013, a fall in investments in fixed assets led to a simultaneous decrease in demand for domestic and imported capital goods and increased the development of negative tendencies in the domestic market.

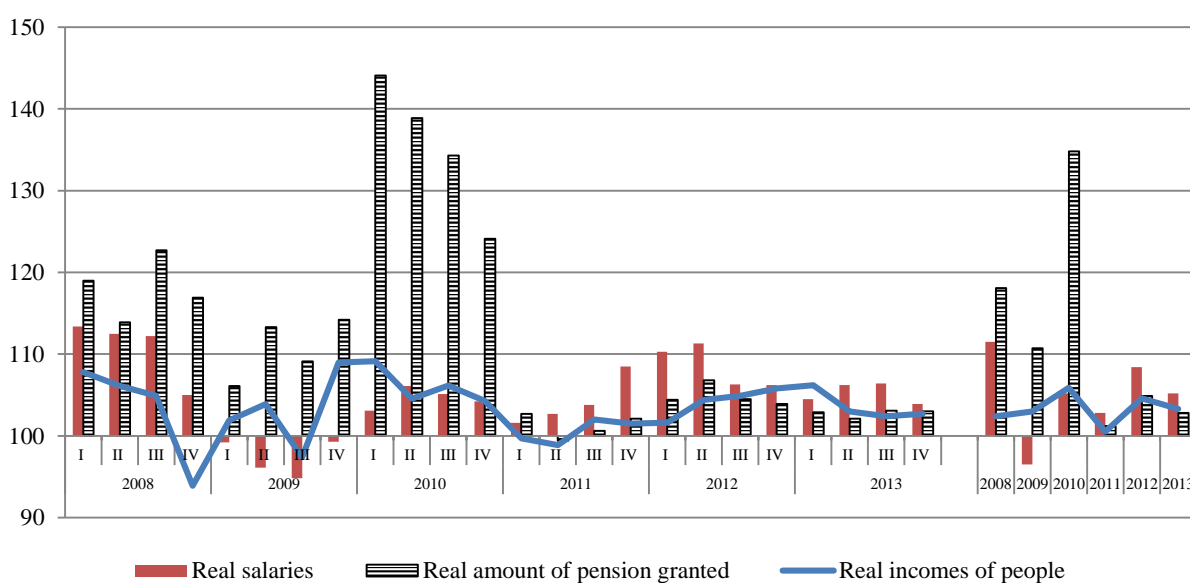
4.1.2. Main features of GDP use in 2009–2013

The model of recovery from the crisis in 2008 which was adopted was primarily focused on the implementation of state social guarantees and obligations. In order to maintain the standard

of living and social stability, governance costs in 2009 rose to 20.8% of GDP; and, in the period 2010-2013, remained above the pre-crisis level.

In 2009-2013, the growth rate of real income and real wages remained stable and positive; which represented a crucial difference from the situation of recovery from the consequences of the 1998 crisis.

The structure of real incomes in 2009-2010 changed under the influence of the advanced growth of real pensions by 1.5 times compared to the pre-crisis levels in 2008 with the recovery of real wages. In 2010, the share of social benefits in the monetary income of the population was 17.7% having increased by 6.1 percentage points compared to 2007 with a decrease in the share of wages by 2.3 percentage points, and of the income from property and business by 3.2 percentage points. In the period of 2011-2013 the situation changed and an acceleration in the growth of real wages could be noted, including an increase in the level of wages in the budget sector of the economy. For pensions, this growth was much slower than in the period of 2009-2010. In 2013, the growth in real household disposable incomes compared to 2010 was 8.6%, while of real wages, 17.2%, and of real pensions, 9.1%. The share of wages in 2013 amounted to 65.9% of cash earnings; and social benefits to, 18.4% (+0.7 percentage points compared to the indices of 2010) with a further decrease in the contribution of income from property and entrepreneurship.



Source: Federal State Statistics Service.

Fig. 6. Dynamics of real incomes in 2008–2013, as % of the relevant period of previous year

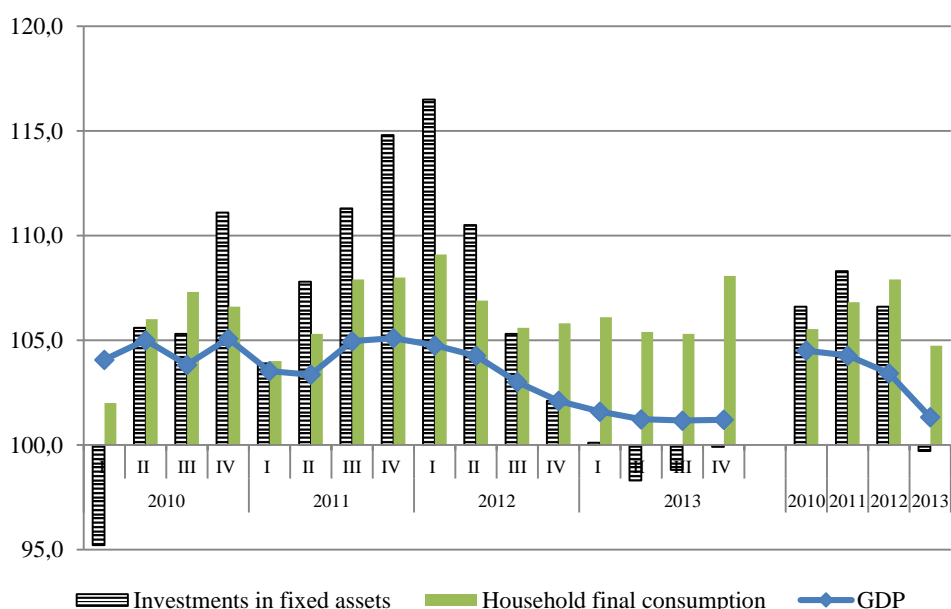
Income growth was one of the key factors in maintaining the positive dynamics of the domestic market. In 2010, household final consumption reached the pre-crisis level of 2008, and average annual growth in 2011-2012 reached 107.3%. However, in the second half of 2012 a slowdown became apparent, and in 2013 there was further slowdown of household final consumption expenditure to 104.7% compared to the previous year. While, in 2010-2012, the domestic market had operated with simultaneous expansion of investment and consumer demand, in 2013 household final consumption became the exclusive factor maintaining the

domestic market and positive GDP growth. The share of final consumption in 2013 reached 71.6% of GDP and was the highest for the last fourteen years, except for in the acute phase of the crisis in 2009.

Table 3

Structure of utilised GDP in 2008–2013, in actual prices, % of total

	2007	2008	2009	2010	2011	2012	2013
Gross Domestic Product	100	100	100	100	100	100	100
Including:							
Expenditure on the final consumption	66.1	66.7	75.4	70.2	67.4	69.5	71.6
Households	48.2	48.4	54.1	51.0	48.9	49.9	51.7
Public Administration	17.3	17.8	20.8	18.7	18.2	19.2	19.5
Non-Profit Organisations servicing households	0.6	0.5	0.6	0.5	0.4	0.4	0.4
Gross Savings	24.2	25.5	18.9	22.6	25.1	24.6	23.2
Gross Investment in Fixed Assets	21.0	22.3	22.0	21.6	21.5	22.0	21.5
Change in Inventories Stock	3.2	3.2	-3.1	1.0	3.7	2.6	1.8
Net Export	8.6	9.2	7.4	8.1	8.6	7.4	5.6
Statistical Discrepancy	1.1	-1.5	-1.8	-0.9	-1.2	-1.5	-0.4



Source: Federal State Statistics Service.

Fig. 7. Dynamics of household final consumption and the investments in fixed assets in 2010–2013, as % of the relevant period of the previous year

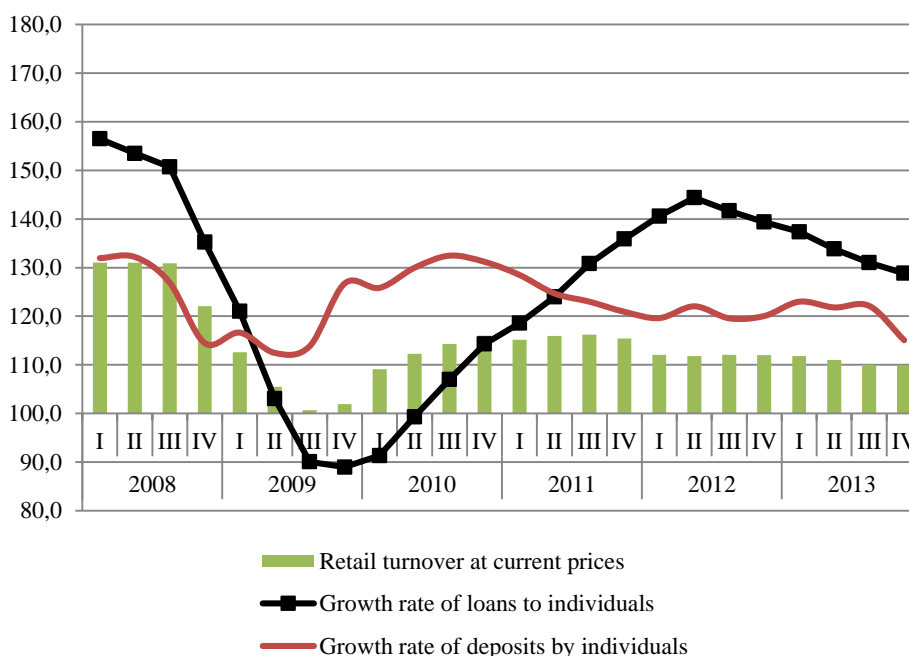
In 2013, retail trade turnover showed a slowdown caused by a general decline in economic growth and a narrowing of the retail credit market. However, the main factor slowing the turnover of the retail trade was a decrease in the growth of incomes of the population compared to 2012. Real incomes for 2013 increased by 3.3% which was 1.3 percentage points lower than for the growth of the same indicator in 2012.

By the end of 2013 retail trade turnover had increased by 3.9% compared to 2012 when the index had been 4.6% compared with the year earlier. This included food products (2.5% against 3.6%); and non-food products (5.0% vs. 8.6%). It should be noted that the slowdown in retail turnover was not accompanied by a significant change in the pattern of consumer behavior; the

share of savings income of the population remained at 10% - the level of the previous year. The major changes were not changes in savings but in the proportions of foreign currency purchased and an increase of cash on hand of the population in favour of the latter. Typical of 2013 was the fact that, along with a slowdown in sales in the non-food sector, the structure of household consumption expenditure changed, with the proportion of food products significantly decreasing. Thus, in times of financial instability, the public does not always reduce their expenses, but begins to make purchases more efficiently.

In 2013, against the background of an apparent deterioration in the economic dynamics, and in an effort to minimise social risks, the public was rather reluctant to purchase many types of services. From the 2013 results we can see that the volume of paid services to the population increased by only 2.1%, against 3.7% of the year before. In the structure of paid services to the population the public utilities and transport and communications services continued to dominate. The negative impact on the level of demand helped prices and tariffs; the consumer price index for services in January-December 2013 compared with January-December 2012 amounted to 108.1%, against 105.4%. As a result, in 2013, in the structure of population income to the share of paid services was 14.8%, that is, 0.4 percentage points lower than in 2012. The then current trends in the Russian economy had an impact on the development of most types of paid services for the population.

The market dynamics for household services were determined by the gradual expansion of demand for the services of qualified professionals. In 2013 the entire volume of household services increased by 5.9%. The share of household services in the structure of the paid services market sector was about 10%. The most succinct sectors were those for two types of service: the maintenance and repair of vehicles, machinery and equipment; and for the repairs and construction of housing and other buildings, amounting to 60.8% of the total volume.



Source: Federal State Statistics Service.

Fig. 8. Volumes and dynamics of loans to the public; and of deposits in 2008–2013, as % of the relevant quarter of the previous year

Demand from the public was supported by the growth of consumer and mortgage lending. Slight weakening in the growth of household deposits was observed only in the acute phase of the crisis. The peak of population credit activity fell towards Q4 of 2009; followed by rapid increase until Q2 of 2012 with a gradual slowdown in growth in subsequent periods. Despite the decreasing lending activity, the nature of income use in 2013 was affected by problems with loan repayments, resulting in a slowdown in savings and in expenditure for current consumption.

The structure of GDP use was determined by the changing proportions between final consumption and gross savings. Comparative analysis of the GDP dynamics by end-use components illustrates the decline in the share of gross savings and net exports. Influenced by a sharp drop in the share of gross income in the economy, in 2013, the share of gross savings in the GDP dropped to 28.4%, against 32.6% in 2011, while the share of fixed asset investments remained at the average of the period 2010-2013 and amounted to 19.8% of GDP.

The capital account balance of payments illustrates the asymmetry of saving resources and the use of savings for investment purposes. Characteristic of the Russian investment model are significant amounts of savings, where the problem is not in finding resources but in the efficient transformation of them into capital investments. Please, note that analysis of the capital transactions account shows that, over the last decade, the Russian economy is a net creditor. In 2013, net capital outflows amounted to \$62.7bn and \$8.1bn.

Table 4

Key indicators of the investment potential in the period 2008–2013, as % of GDP

	2008	2009	2010	2011	2012	2013
GDP	100.0	100.0	100.0	100.0	100.0	100.0
Gross savings	33.3	24.6	29.8	32.6	30.5	28.4
Gross capital formation	25.5	18.9	22.6	25.1	24.6	23.2
Of which						
Gross formation of fixed capital	22.3	22.0	21.6	21.5	22.0	21.5
Changes in stock inventories	3.2	-3.1	1.0	3.7	2.6	1.8
Investments in fixed assets	21.3	20.6	19.8	19.4	20.3	19.8
Reserve fund	9.8	4.7	1.7	1.5	3	4.3
National Welfare Fund	6.3	7.1	5.8	5	4.3	4.3
Deposits by individuals	14.3	19.3	21.2	21.3	22.8	24.7

Source: Federal State Statistics Service.

4.1.3. Changes in structure of GDP by sources of income

The low competitiveness of the Russian economy is due to the persistence of high costs for the production of goods and services. Analysis of the goods and services account balance of payments shows that for the period of 2001-2011 the share of intermediate consumption averaged 41.8% of the gross economic resources, with limiting deviations from the mean, of +1.1% in 2009 and -1.8% in 2002. Thus, the share of value added at basic prices changed very insignificantly as was determined by the retention of a high material intensity of production. The structure of production costs and of services costs illustrates the increase in the share of material costs at the expense of raw materials and the fuel and energy component. Changes in final demand had a determining influence on the dynamics of the volume of gross output for all types of business activity. Changes in the structure of gross value added production for the whole period of 2009-2013 were determined by the decrease in the share of industry with an

increase in the contribution of trade, construction, the financial sectors of the economy, and the real estate market. It should be noted that the post-crisis economic developments in the implementation of anti-crisis measures to maintain social and strategic industries generally contributed to a mirroring of the proportions typical of 2007 which then became one of the factors slowing economic growth in 2011-2013.

Another factor determining the increase of production costs was the increasing cost of labour. The dynamics of the domestic market of 2009-2013 were based on a redistribution of income from business to the population. The share of wages in GDP in 2013 increased to 52.0% as against 50.5% in 2012. It should be noted that, after 2008, the manufacturing business sector already faced restrictions on the further increase in expenditure on wages as a result of the sharp slowdown in growth of production and productivity. Before the crisis of 2008 there had been the possibility for correcting the dynamics of wage costs due to changes in the price and tariff policy. However, in 2011-2013 the use of this factor was limited by the narrowing of effective demand in the domestic market.

Table 5

**Structure of GDP formation by income sources in 2007–2012, % of total,
at current prices**

	2007	2008	2009	2010	2011	2012	2013
Gross Domestic Product	100	100	100	100	100	100	100
Including:							
Compensation of employees, including hidden wages and mixed income	46.7	47.4	52.6	49.6	49.7	50.5	52.0
Net taxes on production and imports	19.2	20.0	16.6	17.8	19.5	19.9	19.2
Gross economy income and gross mixed income	34.1	32.6	30.8	32.6	30.8	29.6	28.8

Source: Federal State Statistics Service.

Opportunities for further growth in labour costs have become quite rigidly limited by changes in the competitive environment in the commodity markets due to increased pressure from imports and a decrease in the financial performance of businesses and organisations. In 2012-2013, profitability in the economy remained below pre-crisis levels. With an overall downward trend in domestic effective demand, restrained business pricing policies did not lead to an increase in output or an increase in production costs, due to the increased cost of fuel and electricity which provoked a decrease in the financial performance of their activities.

Moreover, the reduction in the financial performance of businesses and organisations in 2013 increased their current restrictions on financing and investment activities. Reduction in the net financial result of the economy led to a critical slowing in earnings growth at the disposal of enterprises, amounting to 4.7% in the first nine months of 2013 versus the 26.3% of a year earlier. Between January - September 2013, the net financial result for the whole economy grew by 83.3% from a year earlier: including in mining, by 96.9%; in manufacturing industries, by 68.3%; in the production and distribution of electricity, gas and water, by 74.5% and in transport, by 83.3%. In general, the economy return on items sold in January-November of 2013 amounted to 7.7% and was 2.3 percentage points lower than the previous year. The deterioration in financial performance relative to the previous year can be explained by cost inflation. In manufacturing activity during January-September of 2013, the proportion of loss-making enterprises increased to 29.7%, which was 2.3 percentage points greater than the previous year. The most significant influences were the fall in the net financial result, lower profitability in the engineering industry and in the production of construction materials due to reduced demand from the construction industry. In January-September 2013 the producer price index in the

manufacturing sector amounted to 103.1% (104.2% in the previous year), with the rate of price growth in the mining sector at a level of 11.9% (24.4%); in the production and distribution of electricity, gas and water it was 9.8% (7.2%).

In the production of fuel and energy minerals a decrease in profitability was amplified due to the shift of production to regions with more complex and costly conditions for fossil fuel extraction.

Table 6

**Return on sold goods, products and services; and return on assets of businesses
by type of economic activity for January-September 2012–2013, in %**

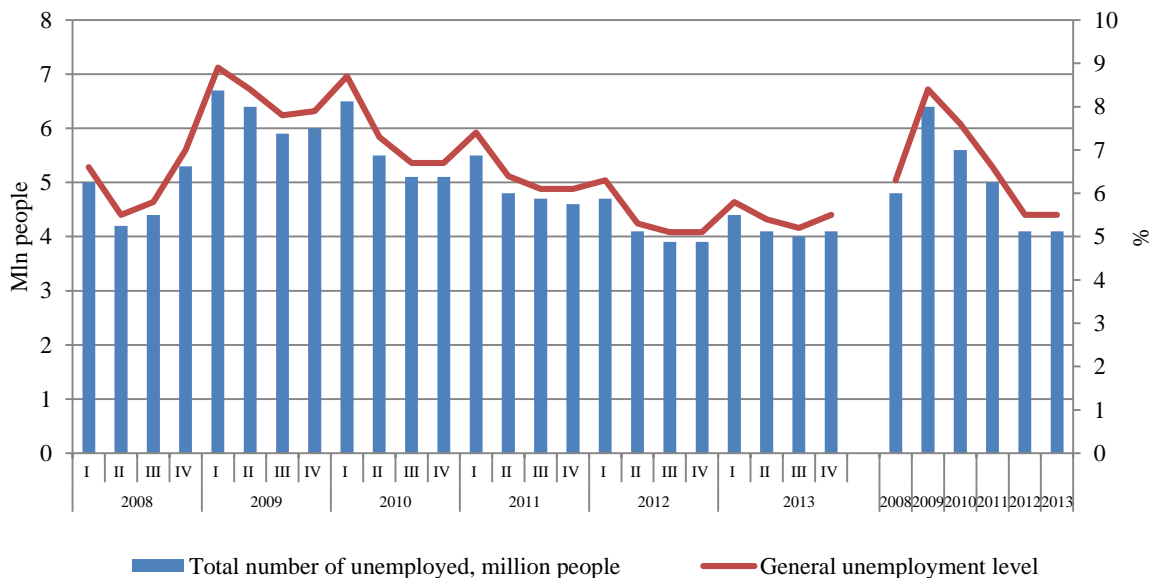
	Profitability of			
	Sold goods, products and services		Assets	
	2012	2013	2012	2013
Total	9,7	7,7	6,8	5,0
Including:				
Agriculture	11,7	6,3	4,8	2,5
Fishing, fish farming	21,4	21,5	18,7	15,1
Mining operations	31,0	25,1	15,3	12,7
Including:				
Production of fuel and energy resources	28,8	24,1	15,2	13,1
Manufacturing	11,0	9,5	8,1	4,9
Of which:				
Food production	11,1	10,1	6,8	6,1
Textile and clothing industry	12,3	7,1	5,0	3,5
Production of leather, leather goods and footwear	8,1	6,2	3,9	1,8
Wood processing and production	5,3	8,1	2,1	1,8
Pulp and paper production;	10,5	9,0	6,7	3,7
Production of coke and refined petroleum	11,3	9,6	12,7	6,0
Chemical production	22,9	16,7	15,8	7,5
Manufacture of rubber and plastic products	9,1	8,7	8,3	6,0
Non-metallic mineral products	12,4	9,8	6,5	3,6
Metallurgical production and manufacture of finished metal products	11,8	9,9	7,8	4,9
Machinery and equipment	7,7	7,5	4,5	3,5
Manufacture of electrical, electronic and optical equipment	8,1	8,9	6,0	5,6
Transport vehicles and equipment	6,0	5,8	2,7	2,3
Production and distribution of electricity, gas and water	4,7	4,7	2,1	1,3
Construction	3,8	3,5	1,7	1
Wholesale and retail trade	8,2	7,1	7,9	7,2
Hotels and restaurants	8,4	6,7	5,6	4,2
Transport and communication	12,2	9,9	5,7	4,1
Of which:				
Railway transport activity	3,5	1,4	2,7	0,7
Road-transport activity	-0,8	-4,7	1,7	0,2
Transport via pipelines	14,9	13,3	6,6	5,7
Communications	26,7	26,0	8,3	8,4

Source: Federal State Statistics Service.

Low efficiency in the use of production factors is one of the main reasons for the sharp slowdown in economic growth and the reduction in the competitiveness of the Russian economy. In the short-term, changes in economy income and in inflation will be completely determined by the dynamics of growth in labour productivity and by the efficiency of investments. Given the dynamics of the fixed capital investments, demographic factors, labour efficiency, and fixed asset, energy output ratio, the growth potential of the Russian economy is between 1.5 - 2.0%. The problem of limited growth potential can be solved by the active implementation of structural reforms.

4.1.4. Key trends and changes in the efficiency of use of labour resources

For the last fifteen years the average annual numbers of employees has grown weakly to maintain a reasonably stable trend towards a higher level of economic activity within the population, and a reduction in the total of the registered unemployed. The crisis of 2008-2009 had no negative impact on the labour market as a result of the implementation of a set of measures to maintain the standard of living and to help the employment figures. The anti-crisis measures adopted helped to avoid negative trends in the labour market. Although the unemployment rate rose to 8.3% in 2009, in 2010 there was, however, a recorded steady decline in the number of unemployed. The number of the economically active and of employed members of the population in 2013 averaged 75.5 million and 71.4 million respectively, which corresponds broadly to the parameters of 2012. The unemployment rate for 2012-2013 remained at 5.5% (using ILO methodology); although in the second half of 2013 the decline in unemployment halted. In 2013 the average number of people employed in the economy had recovered almost to the pre-crisis level of 2008, while the overall unemployment rate fell to a historic low for the entire observation period since 1990.



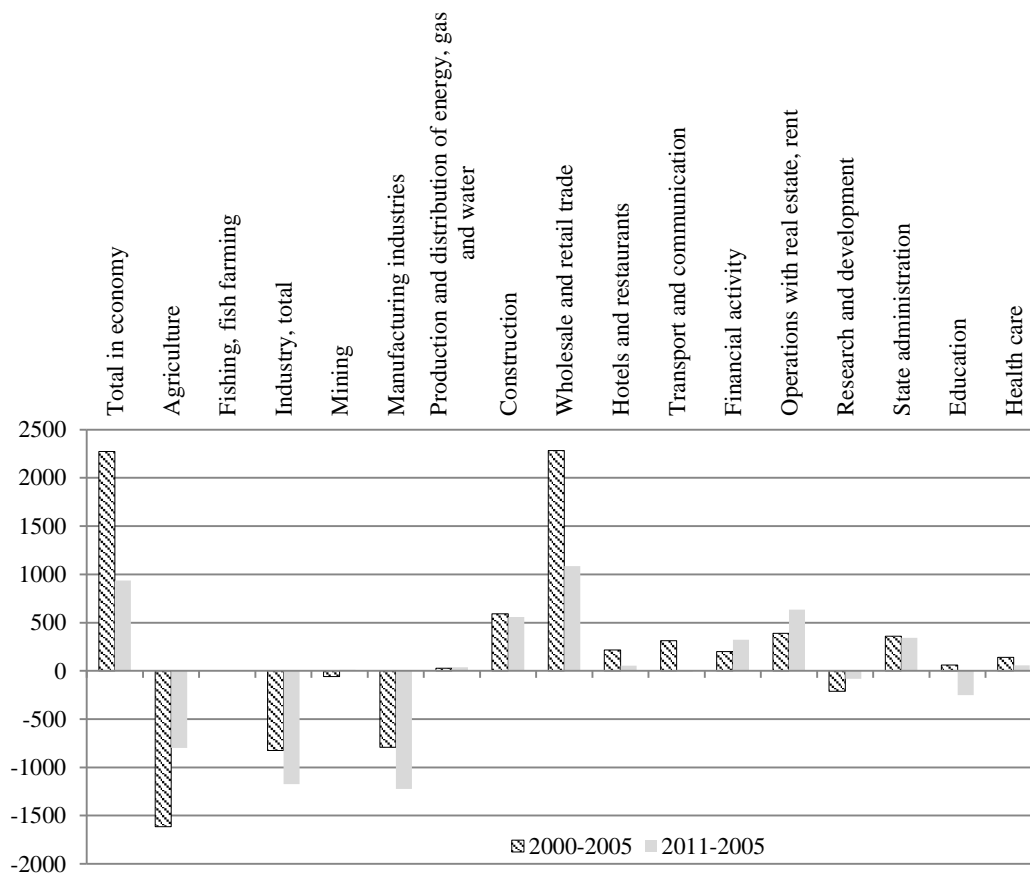
Source: Federal State Statistics Service.

Fig. 9. Total number of unemployed in 2008–2013, million people

On average, in 2013, employment offices reported 15% fewer unemployed people than in 2012. Throughout 2013 the number of vacancies listed by employment offices exceeded the number of registered unemployed. However, employers' requirements for workers had started to decline in June 2013. At the end of December 2013, the data bank of the employment services indicated that there were 1.4 million job vacancies. The tension coefficient, based on 100 reported vacancies, decreased from 91.3 persons in late December 2012 to 56.5 persons in June 2013 and rose to 76.1 persons at the end of December 2013.

A characteristic feature of the Russian economy at the moment is a further reduction in the average number of employees in industry and agriculture, with an expansion in demand for workers in trade, construction, finance, and public administration. Alarmingly there is also a

reduction in the numbers employed in science and education, as well as weak demand for health care staff.



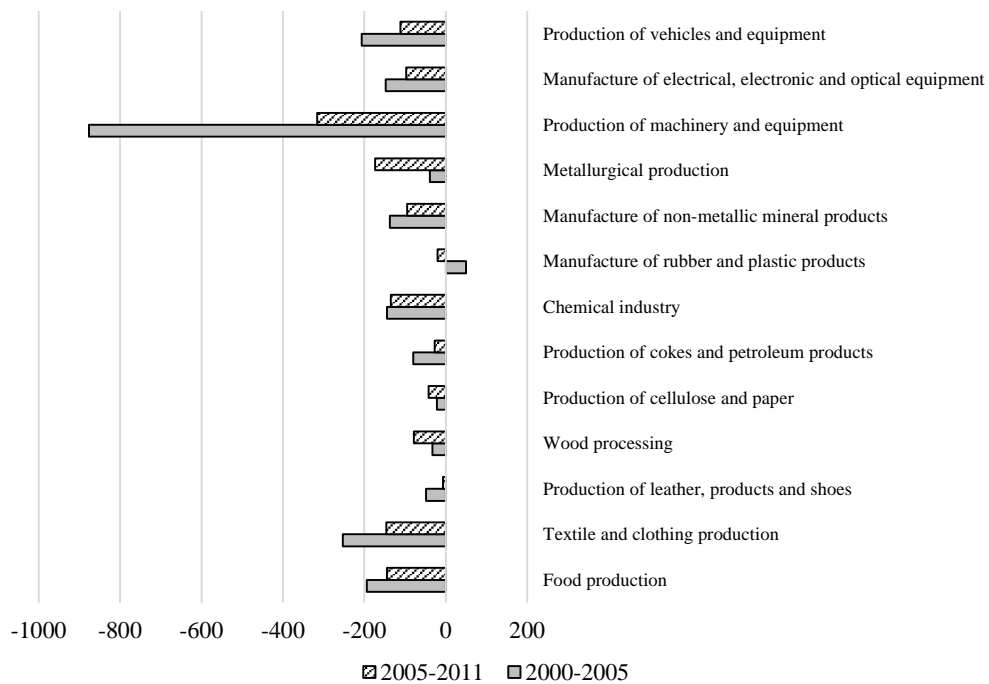
Source: Federal State Statistics Service.

Fig. 10. Change in employment by type of economic activity in the periods 2000–2005 and 2005–2011, (thousands of employees)

The number employed in industry has declined the most rapidly, especially in manufacturing industry. The structure of employment in the manufacturing industries has been determined by the dynamic reduction of employment in the engineering and consumer sectors.

It should be noted that the high level of differentiation of wages by type of economic activity had a significant effect on the change in employment by type of economic activity.

Wages in manufacturing industry remain below the average for the economy with the most significant gap in the consumer complex sector. In 2012, only the wage levels in the machine-building complex approached the economy average and exceeded the general wage-level in manufacturing industry. For the past fifteen years the leading wages in the economy have been for the extractive industries, the production of petroleum products, and the financial sector. In recent years, a reduction in the wage gap in the R&D sector has been recorded. In education and health care the level of pay is below average for the economy. In 2011-2013, with the increase in the level of public sector wages, this sector saw an increased inflow of staff.



Source: Federal State Statistics Service.

Fig. 11. Change in employment numbers in the manufacturing industries in 2000–2005 and 2005–2011, (thousands of employees)

Since 2003, a weakening trend in the growth of labour productivity has been reported with a reduction of return on investment in fixed capital and fixed assets.

Table 7

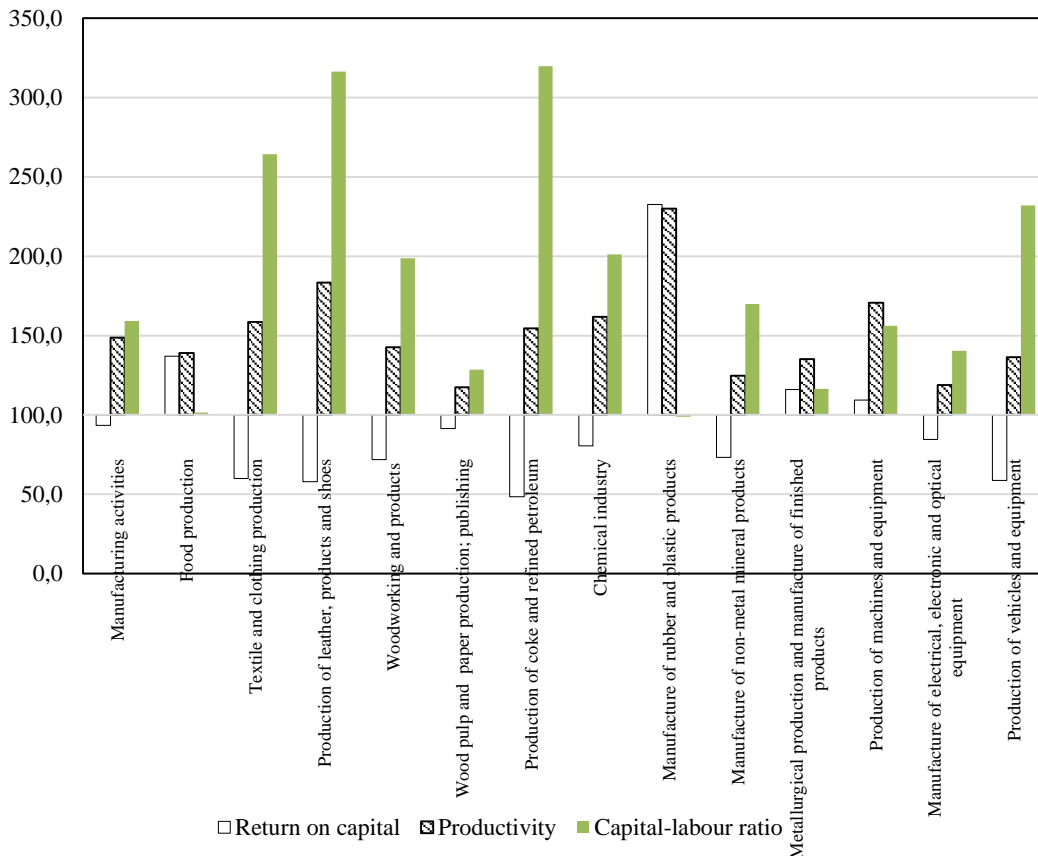
Dynamics of growth in labour productivity by type of business activity in 2003–2012, as % of the previous year

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013*
Economy in general	107.0	106.5	105.5	107.5	107.5	104.8	95.9	103.2	103.8	103.1	101.0
Of which:											
Agriculture, hunting and forestry	105.6	102.9	101.8	104.3	105.0	110.0	104.6	88.3	115.1	98.1	104.2
Fishing, and fish farming	102.1	104.3	96.5	101.6	103.2	95.4	106.3	97.0	103.5	103.1	105.0
Manufacturing	108.8	109.8	106.0	108.5	108.4	102.6	95.9	105.2	104.7	103.6	101.7
Production and distribution of electricity, gas and water	103.7	100.7	103.7	101.9	97.5	102.1	96.3	103.0	100.3	99.7	98.0
Construction	105.3	106.8	105.9	115.8	112.8	109.1	94.4	99.6	102.2	99.6	94.8
Wholesale and retail trade	109.8	110.5	105.1	110.8	104.8	108.1	99.0	103.6	102.1	105.2	102.4
Hotels and Restaurants	100.3	103.1	108.5	109.2	108.0	109.2	86.7	101.7	99.5	101.8	100.0
Transport and communication	107.5	108.7	102.1	110.7	107.5	106.4	95.4	103.2	105.5	100.8	98.1
Real estate, renting and service activities	102.5	101.3	112.4	106.2	117.1	107.5	97.5	104.0	102.7	101.7	95.3
For reference: Dynamics of return on investments in fixed assets	95.4	94.3	95.9	92.7	88.5	95.8	109.3	98.6	96.4	97.07	98.4

*Preliminary evaluation.

Source: Federal State Statistics Service.

Labour productivity is quite significantly differentiated by economic activity. With high rates of workforce turnover (hiring and firing) jobs turnover (elimination of old jobs and the creation of new) characterising their update remains rather low. This turnover is supported predominantly by the closing of jobs at existing enterprises rather than job creation.



Source: Federal State Statistics Service.

Fig. 12. Labor productivity and return on capital in manufacturing industries in 2012, as % compared to 2005

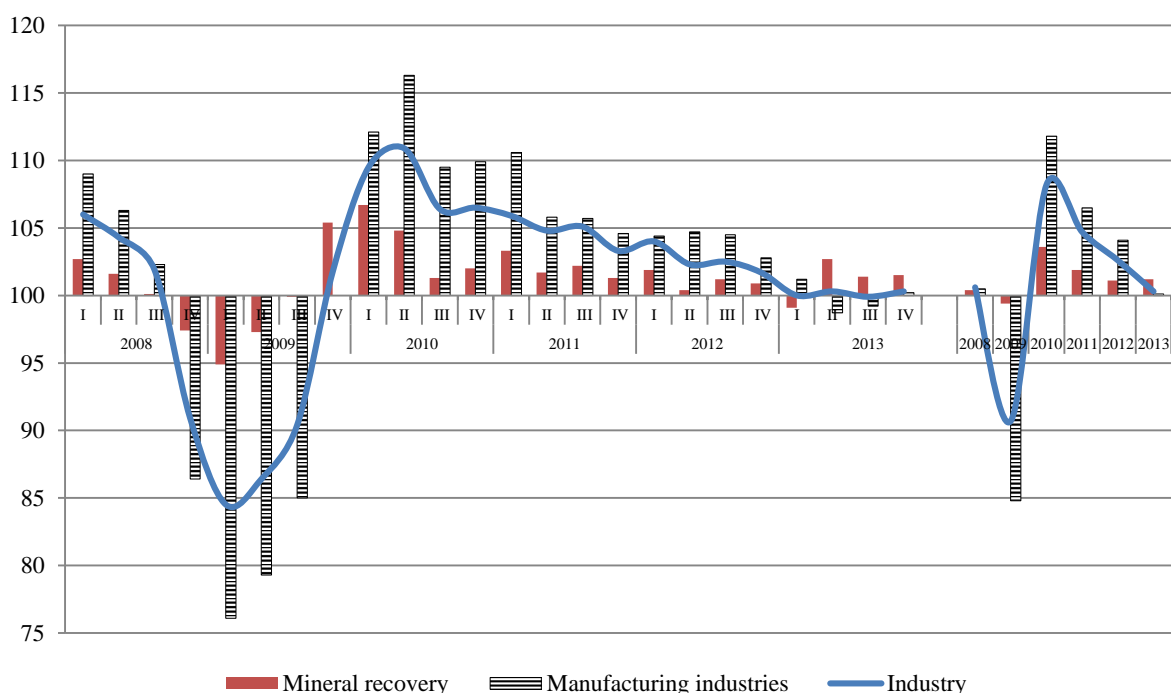
Higher-than-anticipated growth of investment in fixed assets compared with the dynamics of entire output during the period of 2005-2012 and an increase in capital costs per unit of labour did not lead to a corresponding change in labour productivity and, ultimately, increased the tendency to lower the output per unit of capital. Thus, we can assume that irrational investment policy led to a decrease in production efficiency factors and had a negative impact on financial performance.

Dynamics and structure of production by type of economic activity

When analysing the trends and factors in industrial post-crisis recovery several stages can be highlighted:

- Restoration of the positive dynamics of industrial growth in Q1 and Q2 of 2010 versus the corresponding period of the previous year, in the light of a dynamic growth of manufacturing activities until March 2011;

- Weakening of the dynamics of industrial development in the second half of 2010 with a sharp slowdown in mining;
- A slowdown in manufacturing production from Q2 of 2011 until Q4 of 2012;
- Stagnation of industrial production in Q1 of 2013 under the influence of the reduction of mining and slight growth of manufacturing;
- Decline in manufacturing volumes in Q2-Q3 of 2013 and in the production and distribution of electricity, gas and water relative to the same period of the previous year, compensated by positive dynamics in the mining sector;
- Stabilisation of manufacturing activity in Q4 of 2013 with amplification of the downturn in the production and distribution of electricity, gas and water relative to the corresponding period of the previous year.



Source: Federal State Statistics Service.

Fig. 13. Dynamics of industry in 2008–2013, as % of the corresponding period of the previous year

The Russian industry crisis of 2008-2009 was characterised by a deep recession in the manufacturing sector with relatively restrained cuts in the production of fuel and energy mineral extraction. If the slowdown in extractive industries under conditions of the crisis of 2008-2009 can be explained by short-term factors within the international raw materials markets, the sluggish dynamics of domestic production for domestic consumption and the growth of imports can be linked to domestic problems. The nature of the manifestation of the crisis by type of economic activity indicates a lack of domestic business restructuring aimed at creating new competitive markets for domestic products. Once the protection of the domestic markets associated with the undervalued exchange rate began to weaken, it became clear that no positive changes in the competitive environment had occurred. The Russian economy resumed the

proportions of production and imports typical of the period before the financial crisis of 2008-2009.

Furthermore, in 2009-2013 we can observe increasing gaps in the growth of industrial product prices by type of economic activity, as well as in the prices and tariffs for products from the natural monopolies.

The industry output to growth pattern in 2010-2011 was accompanied by an increase in the impact of the extractive industries with only restrained development of the manufacturing industries. It should be noted, that overcoming the crisis was determined by factors within the external economic environment which resulted in advancing growth of the extractive industries compared with manufacturing.

In general, the structure of industrial recovery in 2009-2012 showed a recurrence of patterns from the post-crisis development of 1998-2000, when growth began in the manufacture of food products, mining, and the manufacturing industries associated with the processing of hydrocarbons and other mineral resources, and then spread to other industrial economic activities.

Having achieved pre-crisis levels, starting from the second half of 2012 the Russian economy began to show signs of slowing growth. This situation was greatly influenced by the inherent limitations associated with the fact that the structure of the economy had not change significantly, and that the potential impact of the factors contributing to growth proved to be virtually exhausted. Starting with Q2 of 2013 a drop in output volumes was recorded for the manufacturing industries.

The dynamics of the manufacturing industries are quite significantly differentiated by type of economic activity, with the greatest effect shown by the ratio of rates of production of capital and consumer goods. Slow recovery in investment demand determined the features seen in the operation of the engineering complex.

Table 8

**Indices of production for the main types of manufacturing industries
in 2008–2013, as % of the previous year**

	2008	2009	2010	2011	2012	2013
Manufacturing industries,	100.5	84.8	111.8	106.5	104.1	100.1
Including:						
Production of foods, including beverages and tobacco	101.9	99.4	105.4	101	105.1	102.3
Textile and clothing industry	94.6	83.8	112.1	102.6	98	104.9
Production of leather, leather products and footwear	99.7	99.9	118.7	108.6	89.9	94.7
Processing of wood and of manufacture of wood products	99.9	79.3	111.4	104	103.3	101.4
Pulp and paper industry; publishing and printing	100.3	85.7	105.9	101.8	102.1	94.8
Production of coke and refined petroleum	102.8	99.4	105	102.9	102.2	102.0
Chemical production	95.4	93.1	114.6	105.2	101.3	104.9
Manufacture of rubber and plastic products	122.8	87.4	121.5	113.1	107.4	105.2
Non-metallic mineral products	97.1	72.5	110.7	109.3	105.6	100.3
Metallurgical production and manufacture of finished metal products	97.8	85.3	112.4	102.9	104.5	97.7
Engineering industries	98	66.2	122.3	114.5	107.5	96.8
Machinery and equipment	99.5	68.5	112.2	109.5	100.4	92.4
Manufacture of electrical, electronic and optical equipment	92.6	67.8	122.8	105.1	104.3	97.2
Transport vehicles and equipment	100.4	62.8	132.2	124.6	112.7	100.9
Other industries	98.3	79.3	117.7	104.5	99.1	95.8

Source: Federal State Statistics Service.

In the acute phase of the crisis in 2009, production volumes in the engineering complex amounted to 2/3 of the 2008 level. The features of the post-crisis recovery of the engineering

industry were determined by forward growth in the manufacture of vehicles and equipment as a result of state support and stimulation of demand. Despite the dynamic development of vehicle manufacturing the engineering industry, in general, did not reach the pre-crisis level and in 2012 it was 97.7% against the index of 2008.

For the past five years the dynamics of production engineering has been highly volatile. If, in 2010, the highest growth rates for these activities were determined by the low base of the previous year, then the braking dynamics in 2011-2013 were due to the weakening of domestic demand for capital goods. In 2013, the complex of engineering industries illustrated exceptionally low rates throughout the year; and as a result, recorded a decline in output by 3.2% compared with the previous year. By the end of 2013 the production of machinery and equipment amounted to 92.4% of the previous year's indicator while the production of electrical, electronic and optical equipment was 97.2% and production of vehicles was at 100.9%.

Low investment activity determined the instability in dynamics and the on-going crisis in steel manufacturing and the manufacture of finished metal products (97.7% compared with 2012), as well as in the production of construction materials (100.3%). In addition, a significant impact on the dynamics of output had reduced the demand and prices for key products in non-ferrous metallurgy.

Compared with the pre-crisis period, in 2009-2013 for the consumer complex of manufacturing industries, there were faster growth rates in food production and the production of leather, leather goods and footwear, however in textile and clothing production the crisis remained. In the last four years of the production of consumer goods, stable positive dynamics have been recorded only in the food industry.

In the period 2010-2013, there was steady growth in the intermediate goods sector in the production of rubber and plastic products, chemical production and the production of coke and refined petroleum due to a simultaneous increase in demand in both the domestic and foreign markets for the products of this industry sector.

In general, the Russian economy, in 2013, has overcome the consequences of the crisis; however, the unstable dynamics of the main macroeconomic indicators and the slow recovery of the construction and investment sectors have become the factors limiting the development of the Russian economy in the short term. The dependence on global prices for commodity exports, low domestic demand and the sluggish development of domestic manufacturers in promising consumer markets, investment and in intermediate goods, together with a weak financial system have continued to be the dominating factors.

- eel fittings is effective for all Russian companies.

The unfair antidumping policy of the EU has been discussed during many expert consultations, but it has not led to any changes in the position of Russian major trading partner. Under conditions where all other forms of conflict management have been exhausted, the resort to the WTO procedures is an inevitable, but at the same time important, measure for restoring normal trade terms with the EU.

In accordance with the rules of the WTO, consultations were held within 60 days from the date of the request, i.e. until 22 February 2014. During this period the parties did not manage to find a solution to the problem. In one month Russia therefore has the right to initiate the formation of an arbitration panel (arbitration court of the WTO) in the course of its action against the 'energy corrections' implemented by the European Union.