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The review provides a detailed analysis of main trends in Russia's economy in 2014. 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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## 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 accrued 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

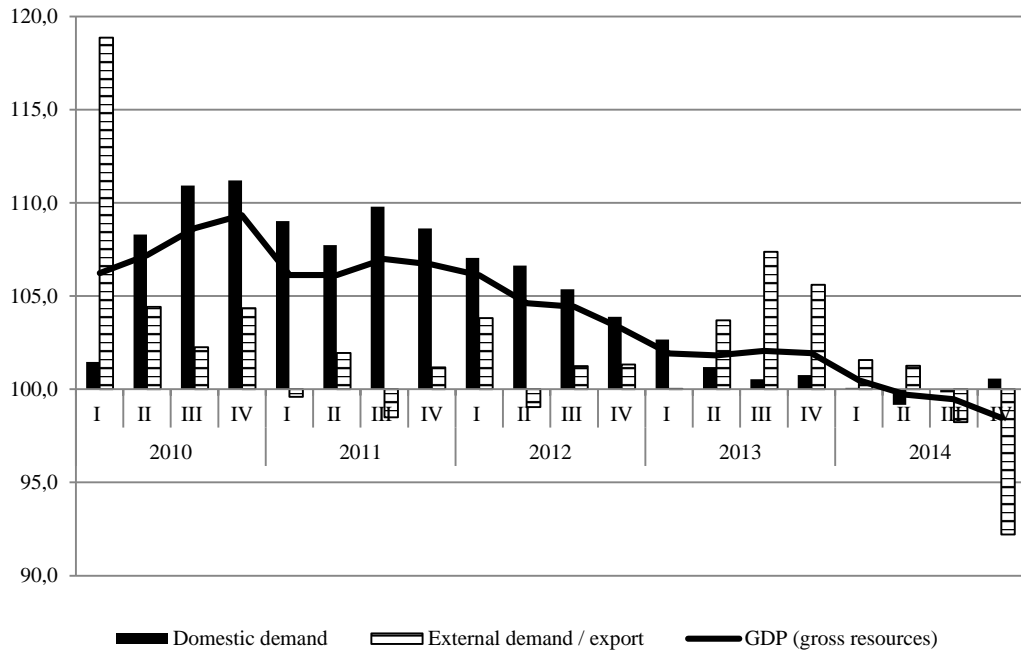
Source: Rosstat (Russian Statistics Service).

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

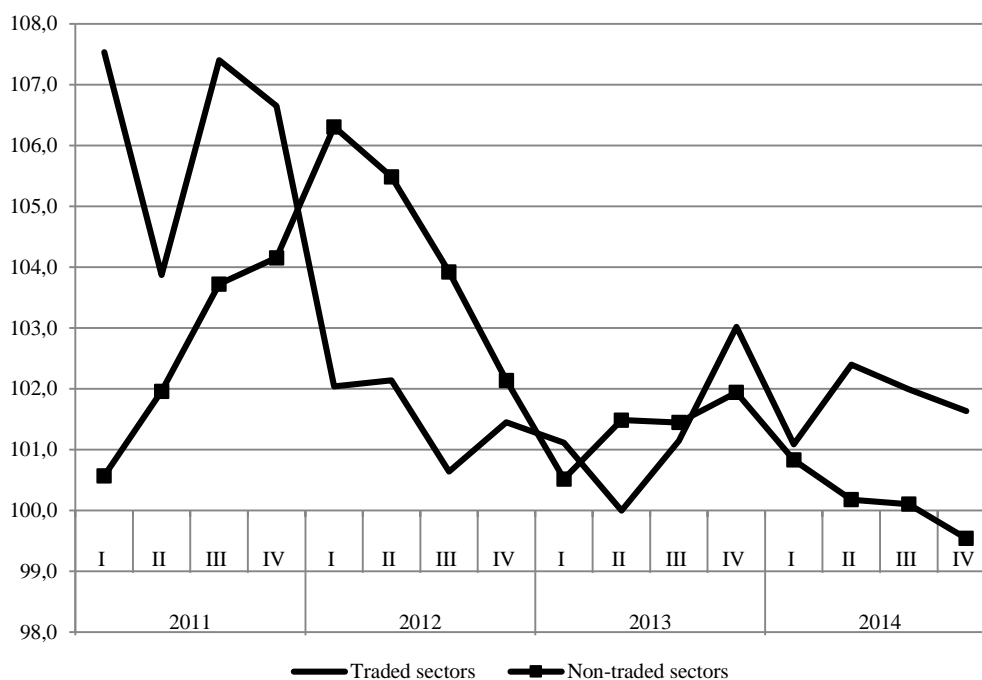
consumption, supported by an increase in the domestic supply of goods and services. Therefore, overall, the results of 2014 showed a GDP growth of 100.6% with a reduction of external demand by 2.0% and a stabilisation of domestic demand (*Fig. 1*).



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*).



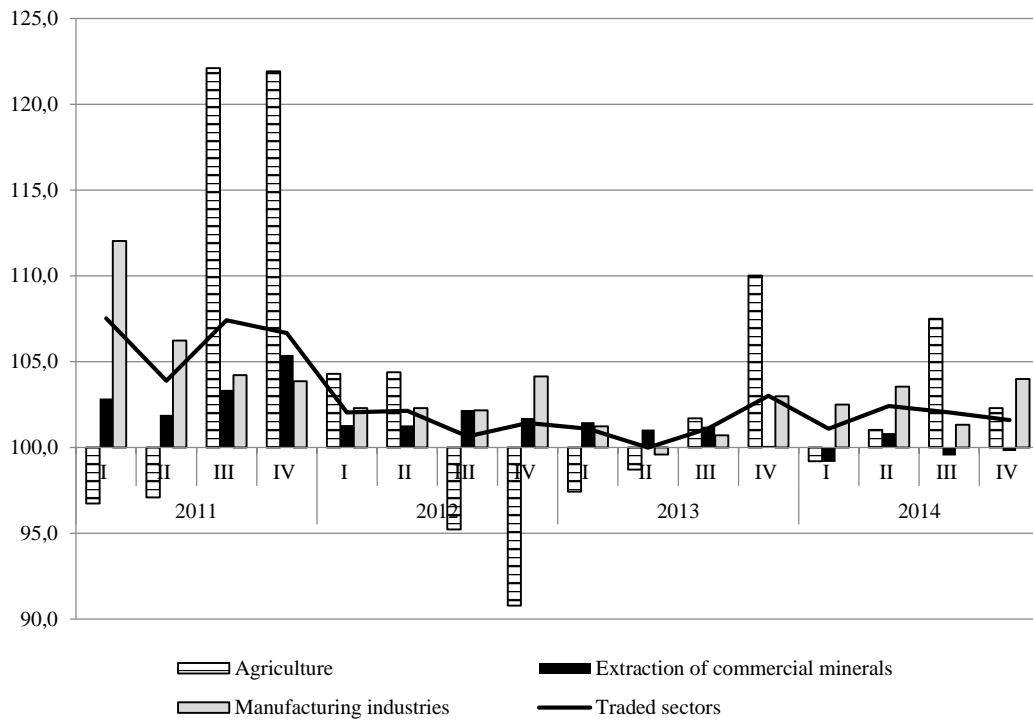
Source: Rosstat.

*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.

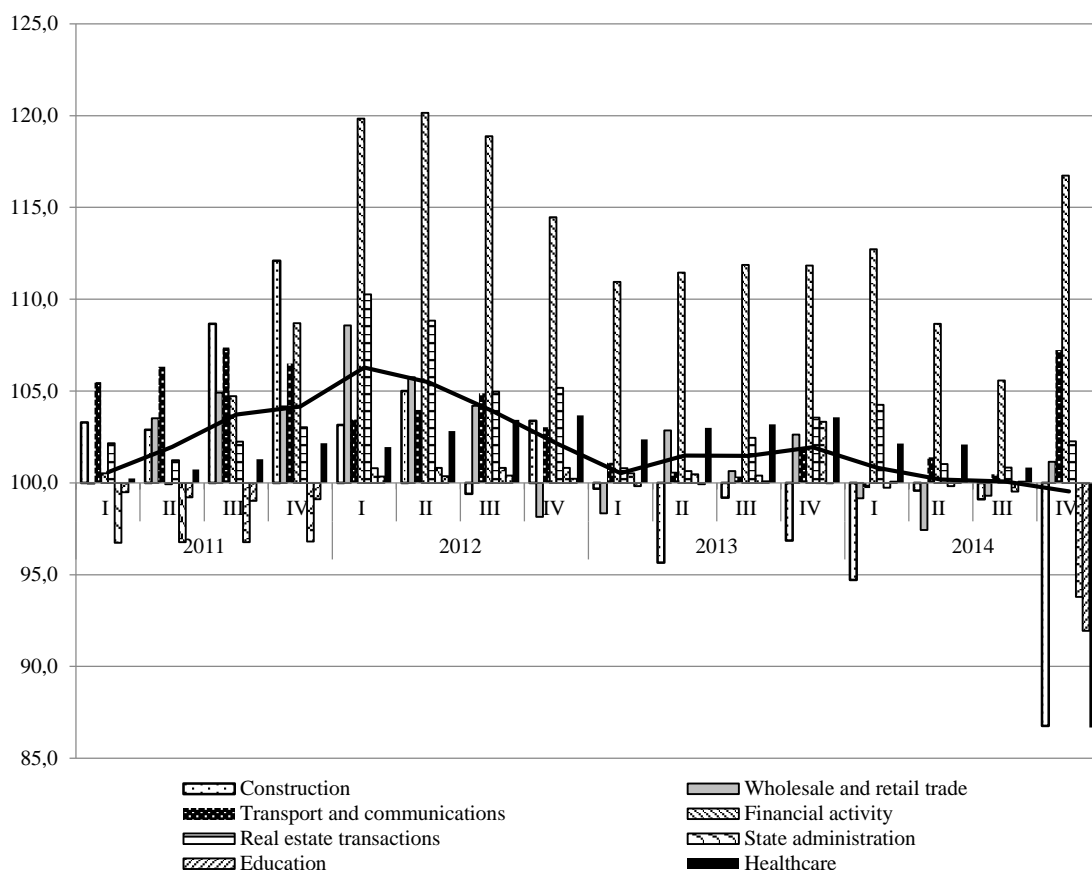


Source: Rosstat.

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.

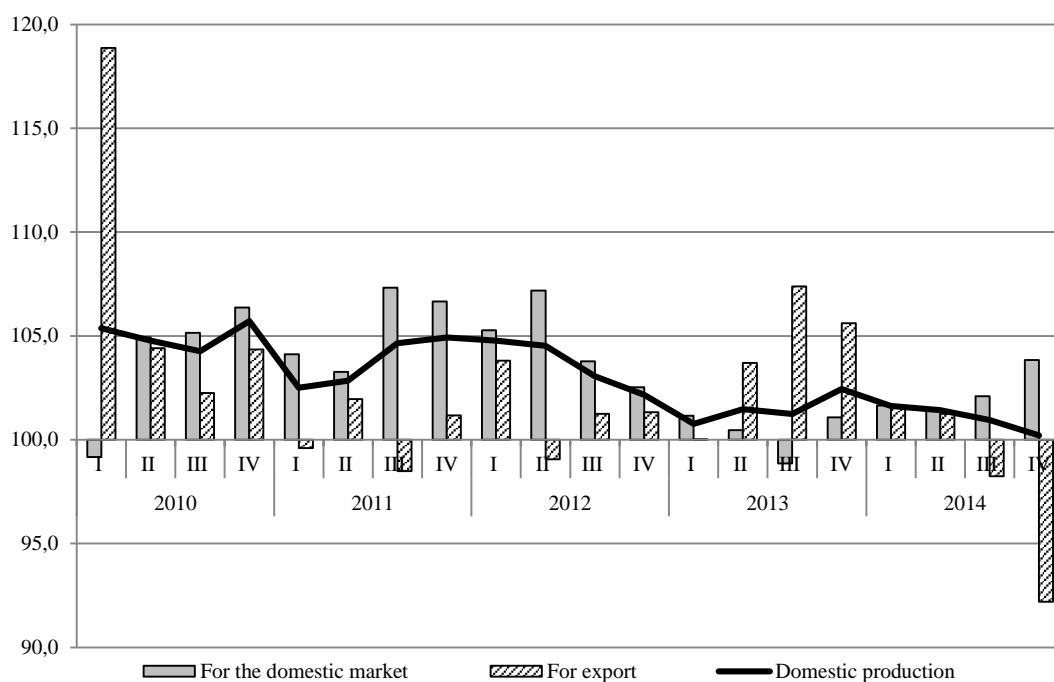


Source: Rosstat.

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 reorientation 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).



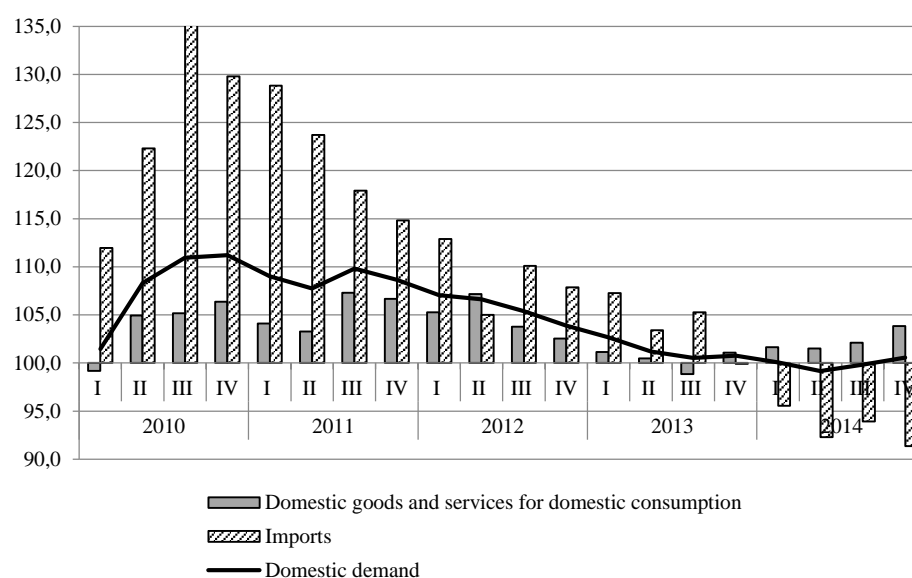
Source: Rosstat.

*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*

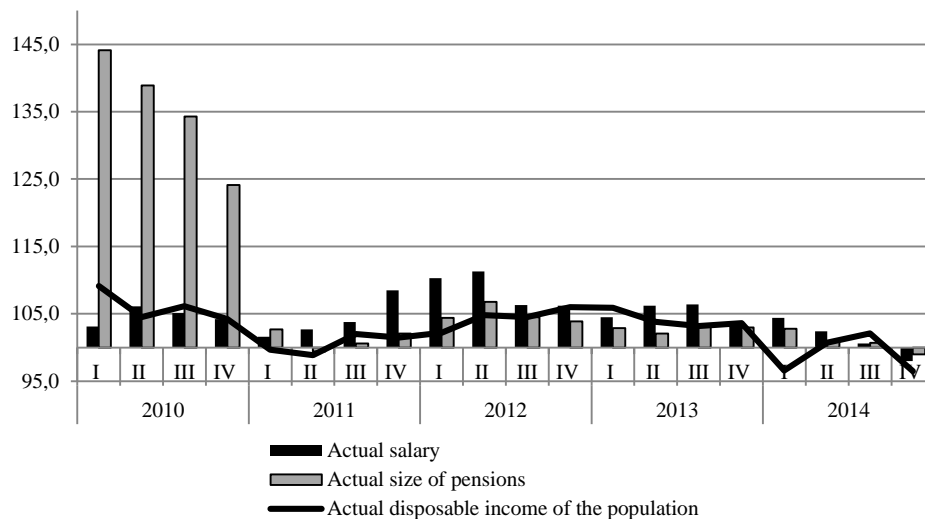
#### **Structure of GDP used in 2010–2014, % of total, at current prices**

	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**

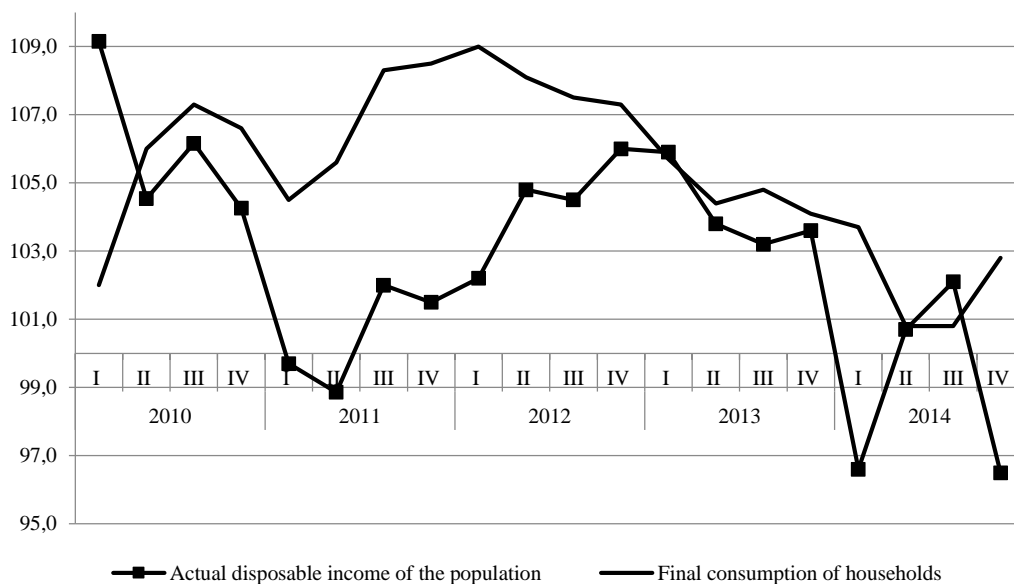
	2010	2011	2012	2013	2014
Total monetary income	100	100	100	100	100
Remuneration of labour, including hidden wages	65.2	65.6	66.0	65.3	66.7
Income from entrepreneurial activity	8.9	8.9	8.6	8.6	7.8
Social benefits	17.7	18.3	18.3	18.6	18.2
Income from property	6.2	5.2	5.1	5.5	5.3
Other income	2.0	2.0	2.0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

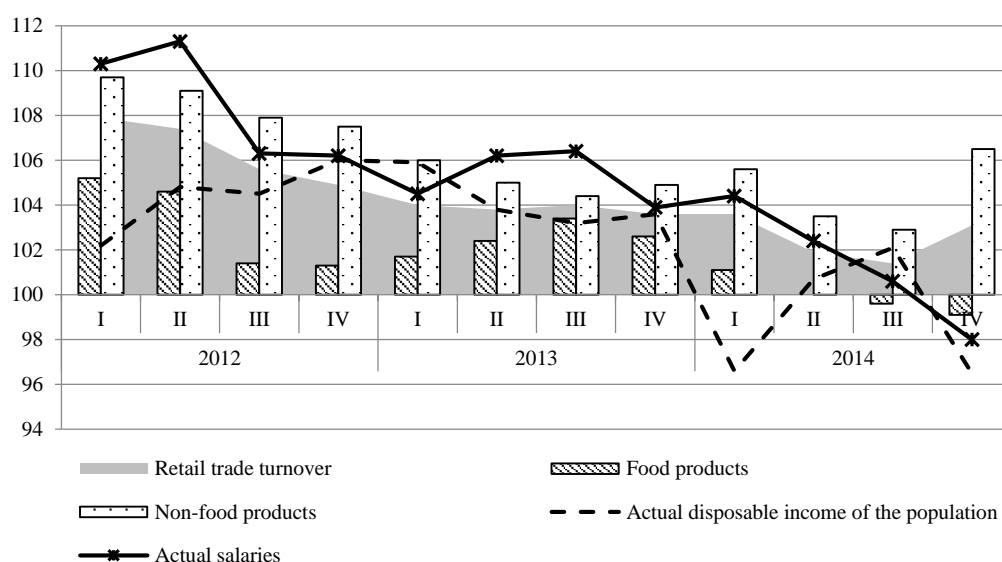
In Q4 2014, with a reduction of the actual income of the population by 3.5% and of actual salaries by 2.0% in relation to the corresponding period of the previous year, there were sharply increased inflationary expectations, along with a drop in the ruble exchange rate and the appreciation of imported 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 in deposits and securities	Purchase of foreign currency	Growth (+), decrease (-) of money in population's hands
			purchase of goods	payment for services					
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

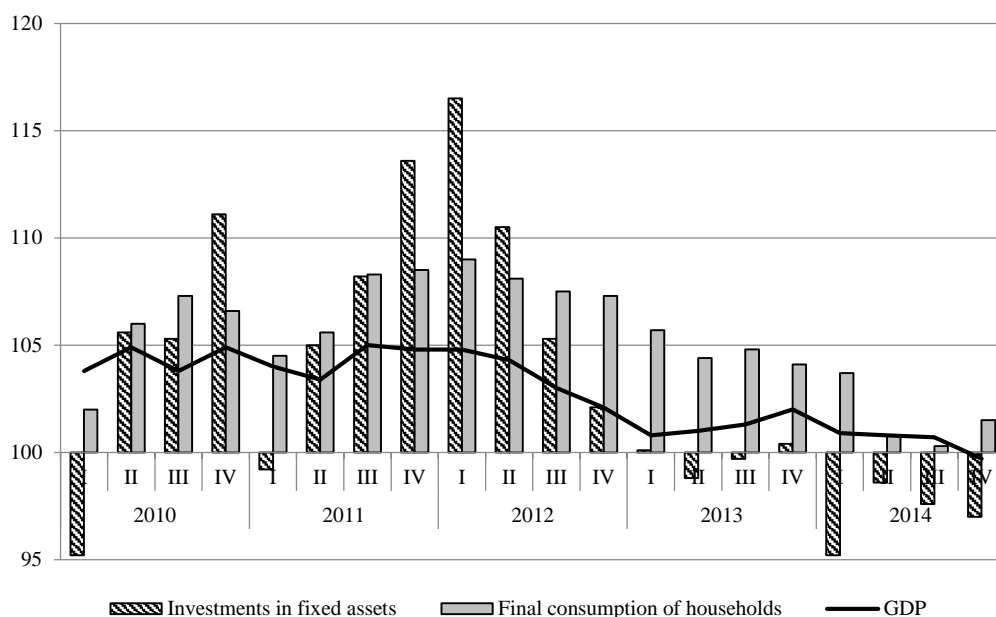
Source: Rosstat.

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.

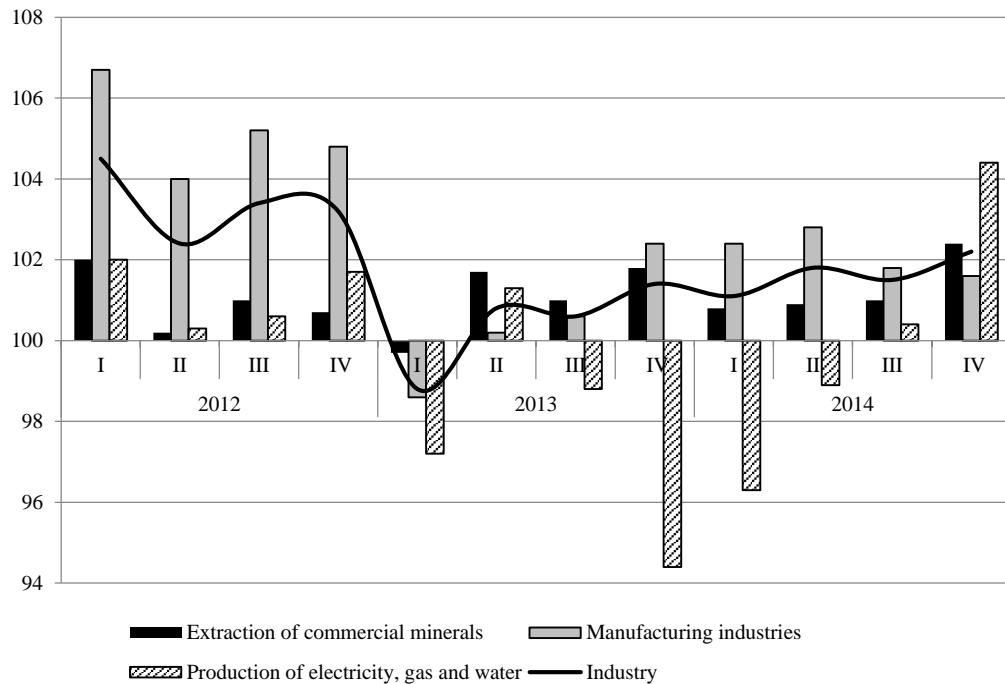
#### 4.1.4. Dynamics and structure of production by types of economic activity

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 to 101.0%, 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

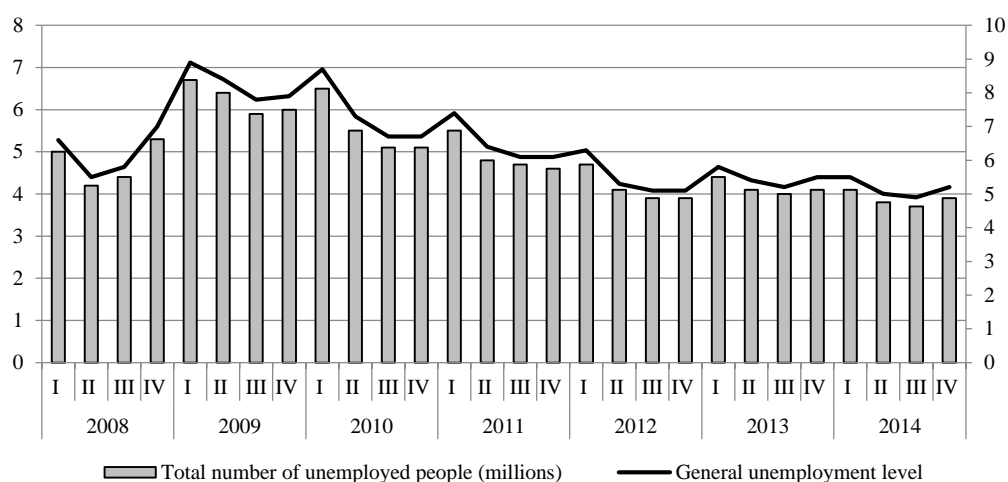
Over the past fifteen years Russian economic development has been characterised by weak growth in the level of employment, with a fairly stable trend towards an increased level of the economic activity of the population and for a decrease in total, and registered, unemployment. We should note, that the 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

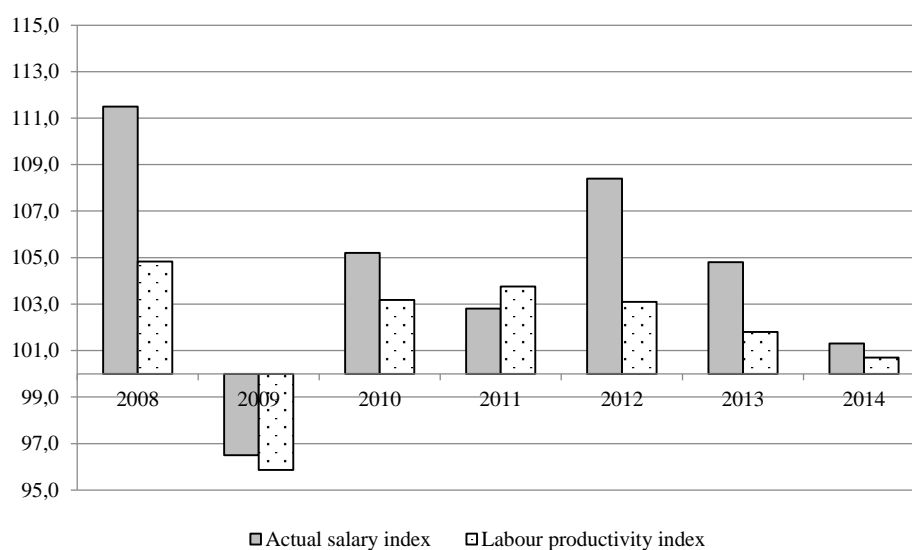
**Average annual rates of change in the number of people employed in the economy, and of their nominal salaries, by type of economic activity in 2008–2014**

	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	109.2	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.

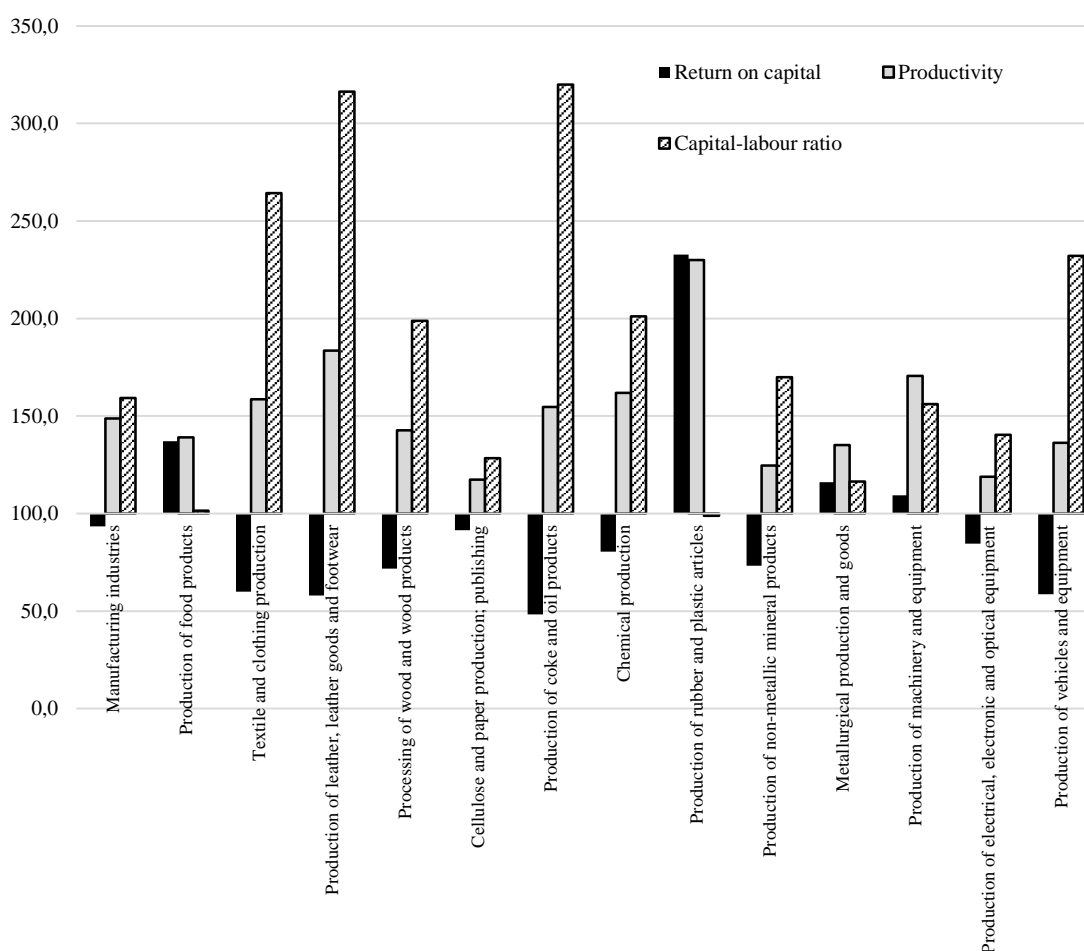
Manufacturing industry has shown a preservation of the trend towards the restructuring of employment through reducing unproductive jobs. The average annual rate of reduction of the number of employees in manufacturing industry in 2009–2014 amounted to 2.1% (during the period of 1999–2008 this index was 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.