



MONITORING OF RUSSIA'S ECONOMIC OUTLOOK:

TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

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РАНХиГС
РОССИЙСКАЯ АКАДЕМИЯ НАРОДНОГО ХОЗЯЙСТВА
И ГОСУДАРСТВЕННОЙ СЛУЖБЫ
ПРИ ПРЕЗИДЕНТЕ РОССИЙСКОЙ ФЕДЕРАЦИИ

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TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

The repeated refusal of the US Department of the Treasury to launch an attack against RF government debt securities has, most probably, really calmed down the Russian market. However, the collapse turned out to be rather deep and unexpected, thus providing an excuse for less than optimistic forecasts.

Although the recent anti-Russian sanctions were in part a replica of the previous ones, they much more brutally and specifically targeted certain companies, with the rather obvious goal of removing them from the market. Even given the predictable government assistance to the affected companies, their losses can hardly be compensated in full; but it will be even more difficult, if at all possible in the foreseeable future, to reassert their previously held positions in the global economy. Meanwhile, the economic sanctions mode has been king of infiltrating even those sectors that have nothing to do with strategic markets, dual use technologies, etc. One example is the intention of the National Hockey League to apply to the US authorities for a special permission to hold two regular-season games in Finland as the co-owners of the hockey arena in Helsinki are certain Russians placed on the US economic sanctions lists.

However, against the background of these anomalous developments it has become obvious that Russia's partners are not going to halt the projects that they consider to be strategically important for their business plans. At the peak of a new geopolitical crisis, Germany once again demonstrated her explicit support for Nord Stream 2, i.e., the project that can potentially increase natural gas supplies from Russia. In such a context, the periodically voiced threats of a total ban being imposed on purchases of oil and natural gas from Russia do not appear to be very realistic.

The rising prices of energy carriers, as well as metal prices, ensured growth of Russia's exports to the EU, and this fact has been noted by the experts who analyzed Russia's presence in the markets of the European Union's member states as demonstrated by the year-end results of 2017. Imports from the latter to Russia increased over the past year from € 119 billion to € 145 billion, while Russia's share in EU imports increased by 0.9 p.p. to 7.8%. Russia's share in EU exports likewise increased – by 4.6% relative to 4.1% a year earlier. However, these developments have largely been the upshot of the low base effect relative to 2016. It should be added that $\frac{3}{4}$ of growth of imports from the RF (by € 26.2 billion) was produced by the increased supplies of Russian mineral fuel.

Nevertheless, the favorable situation in the global oil and gas markets is not viewed in the current forecasts as a locomotive of sustainable economic growth. Usually, it is investment growth that has been viewed as a serious future source of economic growth.

Experts analyzing the behavior and the sources of investments in capital assets note that after having fallen for three years in a row, they increased by 4.4% in 2017. To be more specific, they have found that the beginning of the economy's exit from the so called investment pause was related to a considerable increase in the volume of investments on the part of small businesses,

recalculated by Rosstat, and also in the volume of investments not discerned by means of direct statistical methods. However, if the rate of inflation had remained unchanged, real growth of investments would have been minimal (within 1%). The decisive factor which determined their growth was a decline in the rate of inflation (and correspondingly, an almost double dip of the investment deflator).

The proportion of investments in capital assets, materialized at the expense of large and medium-sized enterprises' own funds, was once again on the rise in 2017 (up to 52%), while the corresponding investments grew by RUB 518 billion, to RUB 6.2 trillion. At the same time, the financing of investments by loans from Russian banks and non-financial organizations, as well as through allocations from the federal budget and off-budget funds, declined. It is noteworthy that the enterprises' own investment potential (depreciation + disposable profit) has been growing in recent years at an average rate of RUB 0.5 trillion per annum. According to Gaidar Institute's experts, the enterprises' penchant for self-financing is unlikely to increase any further, while continuation of investment growth in the small enterprise segment is unobvious, and the existing geopolitical confrontation gives no grounds for optimism with regard to attraction of resources at world markets. The conclusion is as follows: it is reasonable to expect that the growth rates of investment will be low (or even declining), and that the exit of the economy from the investment pause will be slow.

The researchers analyzing the state of the Russian healthcare system's infrastructure note that as far as this sector is concerned, the period 2014 – 2016 saw a decline of real investment in capital assets. As seen by the final year-end results of that period, investment stabilized at slightly above RUB 180 billion, which amounts to just 50.4% of its record high achieved in 2012. The deepest plunge took place in the budget investment sector, the main source of investments due to the predominance of state budget-funded institutions in the healthcare sector. Investments done at the expense of medical institutions' own funds and attracted resources experienced a lesser decline; however it should be said that the role of these investments is incomparably lower than that of the aforesaid ones. Having considered existing practice, including international practice, the authors put forth a number of measures designed to increase the efficiency of investments in the field of healthcare and to upgrade Russia's investment model.

The role of investment risk, the quality of human capital, the administrative burden, the crime situation and other factors comprising the institutional environment are much more important for small (and micro) enterprises than for medium-sized ones. Medium-sized enterprises are more stable face to face with the specificities of the institutional environment; the factors of paramount importance for them are the size of a region's population, the size of its market, and the access to financing. That is the main conclusion made by the RANEPА experts on the basis of the results of their research. ●

1. RUSSIAN EXPORTS TO EU IN 2017: GROWTH OWING TO RAW MATERIALS AND METALS

A.Knobel, A.Firanchuk

In 2017, Russia extended its market share in the European Union. EU imports from Russia went up from 119 to 145 bn euros, while Russia's share in the overall European imports rose to 7.8% (+0.9 p.p.). Such growth was due to rising prices on principal products of Russian export – fuel raw materials and metals. At the same time, the rising volume of natural gas deliveries hit 12% while deliveries of crude oil moved down 7%.

Russia's share in the EU trade turnover

In 2017, Russia's imports and exports substantially grew (imports – 24.5%, exports – 25.0%) as well as the EU's share in Russian trade stabilized¹. Thus, Russia's role as EU's trade partner has strengthened: Russia's share EU imports (without trade between EU members taken into the account) hit 7.8% (6.9% a year earlier), while exports share – 4.6% (4.1% a year earlier). Such growth reflects a low base effect: Russia's share in the EU trade turnover in 2016 was at the bottom during the decade – 5.5%, which is 1.5-fold below the average share during the previous 10 years – 8.7% (Fig. 1).

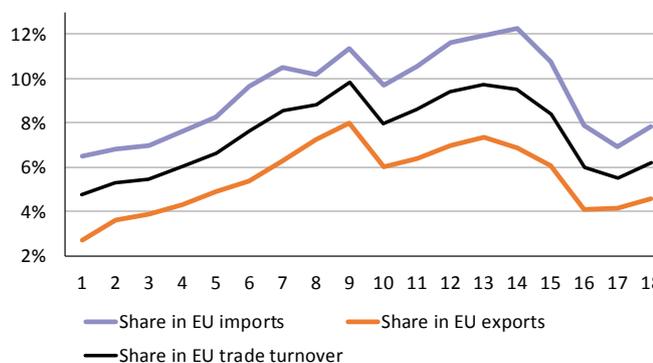


Fig. 1. Dynamics of Russia's share in EU trade 2000 – 2017
Source: own calculation based on the data released by Eurostat (URL: <http://ec.europa.eu/eurostat/web/international-trade/data/database>).

Commodity composition of European Union imports from Russia

An increase in total trade turnover with EU in value terms was triggered by a recovery of price on energy resources (mainly regarding Russian imports). Exports of goods from Russia to the EU in 2017 constituted 145.1 bn euros² (Table 1), two thirds of which (97.6 bn euros) accounted for imports of a commodity group “mineral fuel, oil lubricants and similar materials”. That said growth of EU imports from Russia (26.2 bn euros) by three quarters was due to a rise in mineral fuel imports (19.5bn euros.)

Despite a notable rise in fuel deliveries denominated in value terms from Russia (up 25%), Russia's influence on the EU energy market has not strengthen. Russia's share in the aggregate volume of imports of the above mentioned commodity group to the EU in 2017 decreased by 0.7 p.p. (down to 28.8%). It should be noted, that in the past decade Russia's share in EU imports of this commodity group ranged between 27.4% (2008) and 32.1% (2013).

¹ Dynamics of the EU share in the Russian trade turnover see: A. Knobel, A. Firanchuk. Russian external trade in 2017. Russian economic developments. 2018. No. 3. P. 6 – 13.

² Hereinafter Eurostat data is used (shown in euro). <http://ec.europa.eu/eurostat/web/international-trade/data/database>

EU imports from Russia of “*food products, live animals, beverages and tobacco products*” commodity group constituted 1.56bnl euros. Russia's share in EU total imports of this commodity group constitutes 1.39%, which is above the previous decade indicators¹.

EU imports from Russia of “*nonfood raw materials, except fuel; butter and vegetable oils, fats and wax*” in 2017 went up to 4.32bn euros, while Russia's share rose 0.3 p.p., up to 5.5%, which is still below the average long-term index.

EU imports from Russia of “*chemical substances and similar products*” in 2017 reached 4.90bn euros, while Russia's share (2.5%) surpassed the all-time low recorded in 2016.

Volume of EU imports from Russia of “*manufactured goods; variety of finished products*” in 2017 reached 17.7bn euros, while Russia's share constituted 3.7% which is the highest indicator since 2012.

EU imports from Russia of “*automobiles and transport equipment*” in 2017 declined to 2.23bn euros. Russia's share in EU imports of this commodity group is traditionally insignificant – 0.38% (since 2000 the share varied between 0.28 and 0.44%).

Table 1

 DYNAMICS OF EU IMPORTS FROM RUSSIA
 BY EXTENDED COMMODITY GROUPS

| Extended commodity group – Standard International Trade Classification code (SITC) | Total worth of EU imports from Russia, euros bn | | Changes in total worth in 2017, as% of 2016 | Russia's share in EU imports,% | | |
|--|---|---------|---|---------------------------------------|------|-------|
| | 2016 | 2017 | | Average value in 2006 – 2015 | 2016 | 2017 |
| Food products, live animals, beverages and tobacco – 0 and 1 | 1.59 | 1.56↓ | – 2 | 1.23 | 1.46 | 1.39↓ |
| Nonfood raw materials, except fuel; butter and vegetable oils, fats and waxes – 2 and 4 | 3.53 | 4.32↑ | +22 | 5.6 | 5.2 | 5.5↑ |
| Mineral fuel, oil lubricants and similar products – 3 | 78.12 | 97.58↑ | +25 | 29.9 | 29.5 | 28.8↓ |
| Chemical substances and similar products – 5 | 4.44 | 4.90↑ | +10 | 3.5 | 2.4 | 2.5↑ |
| Manufactured goods, variety of finished products – 6 and 8 | 15.22 | 17.68↑ | +16 | 3.6 | 3.4 | 3.7↑ |
| Automobiles and transport equipment – 7 | 2.33 | 2.23↓ | – 4 | 0.39 | 0.42 | 0.38↓ |
| TOTAL (including group 9) | 118.87 | 145.10↑ | +22 | 10.3 | 6.9 | 7.8↑ |

Source: own calculations based on the Eurostat data (URL| <http://ec.europa.eu/eurostat/web/international-trade/data/database>).

Markets of Commodity items

Volumes of (pipeline) *natural gas* deliveries from Russia to EU in 2017 rose by 12%² and constituted around 155 bn cub. m. (according to Gazprom³ de-

1 Russia's shares in EU imports for the previous years see: A. Knobel. External trade: exports decrease determined trade surplus contraction. Russian economic developments. 2006. No. 5. P. 16 – 18.

2 DG Energy, European Commission “Quarterly report on European gas market”// Volume 10 Q4 2017 ec.europa.eu/energy/sites/ener/files/documents/quarterly_report_on_european_gas_markets_q4_2017_final_20180323.pdf

3 <http://www.gazpromexport.ru/statistics/>

1. Russian Exports To EU In 2017: Growth Owing to Raw Materials and Metals

liveries volume constituted 158.4 bn cub. m.). EU total purchases of natural gas went up by 10%. That allowed Russia to build up her share in imports of (piped) natural gas by the EU (minus trade inside the EU) to 43% (compared to 40% in 2015 and 42% in 2016). Taking into account the fact that gas extraction fell by 3% in the EU in 2017, Russia's share in the EU natural (pipeline) gas consumption reached 32%.

According to the European commission¹ (DG of Energy), in 2017, 44% of the overall supplies of Russian natural gas to the EU were through Ukraine (up 1 p.p. against 2016), Nord Stream – 30% (+2 p.p.), and Belarus – 24% (-2 p.p.). In 2017, flows of pipeline gas through Ukraine increased by 14% compared to 2016, through Nord Stream – by 17%, and through Belarus – by 6%. Pipeline deliveries to the EU countries through Ukraine (69 b cub. m) almost reached 2011 indicators (around 70.4 bn cub. m). Deliveries to the EU through the Yamal pipeline (Belarus territory) reached 37 bn cub. m., which considerably exceeded the amounts seen in the previous years, while gas flows through Nord Stream reached 47 bn cub. m². That said Gazprom gradually switches to contracts with prices pegged to those at the gas hubs and oil prices³.

It should be noted, that total natural gas flows through Ukraine, including consumption outside the EU peaked 93 bn cub. m⁴.

For the first time liquefied natural gas (LNG) was delivered to the EU market from Yamal LNG (principal shareholder – Novatek) in late December 2017. That delivery marked a new route to the EU market for Russian natural gas. Total share of liquefied natural gas in EU natural gas imports reaches 14%: Qatar is the main supplier with 41%. Novatek's first delivery came to 0.7% of all LNG deliveries to the EU in the fourth quarter of 2017.

As to *crude oil*, according to the European Commission (DG of Energy)⁵, deliveries from Russia to the EU in 2017 down to 1,115 m. bbl., or by 7.0% compared to 2016. In 2017, Russia's share declined to 29.0% (by 2.8 p.p. against 2016) of total deliveries of crude oil to the EU (excluding trade within the EU). Dynamics of Russia's volume and share in crude oil supplies to the EU are presented in Fig. 2.

Dynamics of grain, fertilizers, and metals supplies is given in Table 2. Note, that the EU average import prices (in 2017 against 2016.) from Russia agree well with price dynamics of Russian ex-

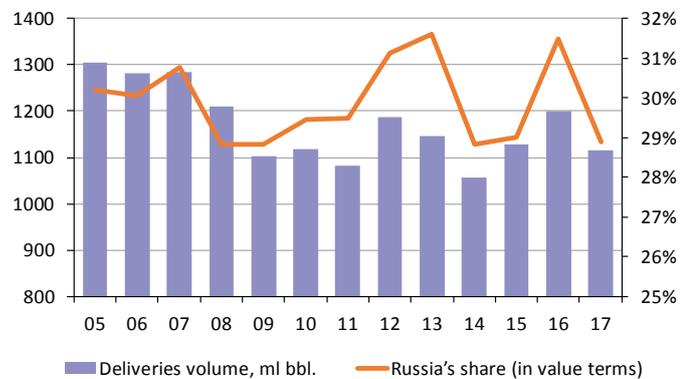


Fig. 2. Dynamics of volume and share in crude oil supplies to the EU in 2005 – 2017

Source: own calculations based on data released by DG Energy, European Commission.

1 DG Energy, European Commission "Quarterly report on European gas market"// Volume 10 Q4 2017ec.europa.eu/energy/sites/ener/files/documents/quarterly_report_on_european_gas_markets_q4_2017_final_20180323.pdf

2 Statistics from DG Energy, European Commission. Nord Stream operator quotes a rate of 51 bill cub. m general pumping.

3 http://www.gazpromexport.ru/files/021117_EVB_EAGC_Milan252.pdf

4 RBC: The European Commission explained request to preserve gas transition through Ukraine. 6 April 2018.

5 DG Energy, European Commission "Registration of crude oil imports and deliveries in EU" <https://ec.europa.eu/energy/en/data-analysis/eu-crude-oil-imports>

Table 2

EU IMPORTS DYNAMIC FROM RUSSIA BY CERTAIN COMMODITY ITEMS

| Commodity group name – HS code | EU total worth of imports from Russia, m euros | | Changes of total worth in 2017, as% to 2016 | Changes in volume 2017, as% to 2016 | Change in average price in euros in 2017, as% to 2016 | Russia's share in EU imports, % | |
|---|--|-------|---|-------------------------------------|---|---------------------------------|-------|
| | 2016 | 2017 | | | | 2016 | 2017 |
| Wheat and meslin – 1001 | 114 | 100↓ | -12 | -19 | +8 | 9.0 | 8.8↓ |
| Nitrogen fertilizers – 3102 | 496 | 496 | 0 | -5 | +6 | 28.7 | 29.6↑ |
| Potassium fertilizers – 3104 | 239 | 210↓ | -12 | -9 | -4 | 38.6 | 29.6↓ |
| Mixed fertilizers – 3105 | 547 | 632↑ | +16 | +26 | -8 | 39.1 | 37.9↓ |
| Ferrous metals – 72 | 3611 | 4263↑ | +18 | -15 | +39 | 15.3 | 13.8↓ |
| Ferrous metals products – 73 | 216 | 1192↑ | +452 | +309 | +35 | 1.0 | 4.8↑ |
| Copper – 74 | 1719 | 1815↑ | +6 | -17 | +28 | 18.5 | 16.8↓ |
| Nickel – 75, including | 753 | 679↓ | -10 | 16 | -22 | 20.7 | 16.8↓ |
| Matte and other nickel based intermediates – 7501 | 228 | 497↑ | +118 | +134 | -7 | 26.0 | 56.2↑ |
| Crude nickel – 7502 | 508 | 164↓ | -68 | -70 | +9 | 29.7 | 8.3↓ |
| Aluminium – 76 | 2602 | 3021 | +16 | 0 | +16 | 13.8 | 14.0↑ |
| Lead – 78 | 82 | 92↑ | +12 | -11 | +26 | 11.6 | 10.6↓ |
| Other non-precious metals – 81 | 362 | 470↑ | +30 | +6 | +22 | 10.7 | 11.0↑ |

Source: own calculations based on Eurostat data.

port to all countries¹ (adjusted to euro-USD exchange rate fluctuations). Considering this, dynamics of deliveries for certain commodity items vary notably. Fall in wheat and meslin deliveries to the EU markets took place against the background of total grain export growth from Russia.

Deliveries of mineral fertilizers to the European Union member states showed mixed dynamics, although total Russia's share in imports of this commodity group fell, which was especially noticeable for potassium fertilizers.

Decline in deliveries of ferrous metals to the EU was more notable than their total exports, (-15% against -2%). At the same time, quadruple rise in ferrous metals products is noted and even more than fivefold rise value volumes of this commodity group deliveries on the EU market. Consequently, deliveries of ferrous metals products from Russia to the EU rose, which was followed by redistribution of shares in ferrous metals and iron-based products in the favor of the latter.

Russia's share in supply of copper to the EU decreased from 18.5 to 16.8% and that of nickel – from 20.7 to 16.8%. There was a significant shift in commodity composition of nickel supplies. More than 97% of which can be attributed to two groups: matte and crude nickel. In 2016, crude nickel amounted to two thirds of all supplies of Russian nickel to the EU, while in 2017 – merely one fourth.

Russia's share in aluminum supply and other non-precious metals rose while Russia's share in lead deliveries decreased. ●

¹ Analysis of Russian export dynamics of principal products in 2017 see: A. Knobel, A. Firanchuk. Russian external trade in 2017. Russian economic developments. 2018. No. 3. P. 6 – 13.

2. FIXED INVESTMENT IN 2017: GROWTH ONSET

O.Berezinskaya, A.Kosarev

After three-year contraction, fixed investments in 2017 moved up by 4.4%. At the same time, Rosstat revised downwards 2016 data – fixed investment contraction constituted merely 0.2% (previously 0.9%).

According to the revised statistics, fixed investment dynamics over recent years is as follows (Fig. 1.)

After the crisis slump of 13.5% seen in 2009, which was left behind during two years, fixed investments hit the relative maximum in 2012 – 2013. 2014 – 2015 saw adaptation of the investment process to significantly changed conditions – demand compression, rise in prices of imported equipment triggered by the ruble exchange rate hike, and sanction restrictions. Over two years, fixed investments contracted by 11.4%. In 2016, they practically stopped falling, and in 2017 commenced their corrective growth. New and updated data released by Rosstat reveal officially declared end of adaptation period and commencement of growth.

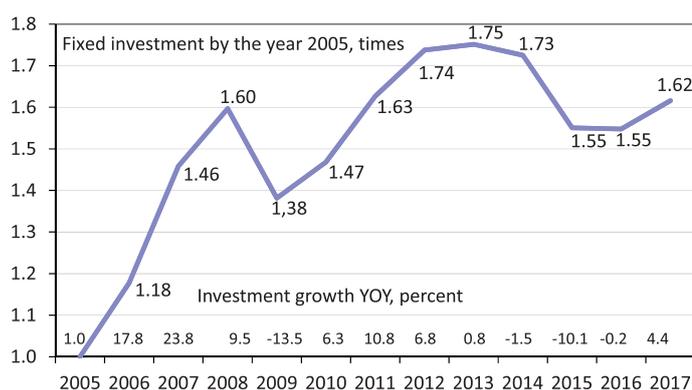
First steps taken towards ending the investment pause of 2014–2016 represent a positive sign. Fixed investments growth in 2017 were low for the first year of exit from the investment pause – previously investment revival in the Russian economy was at a much higher pace. Main problem consists not in the investment slump depth (in 2009 it was deeper) but in the restrictions that hamper its overcoming.

In this context, it is expedient to mention principal features for the rise of the investment pause and for the onset of investment activity revival in Russian economy.

Real fixed investment contraction by 11.6% seen in 2014–2016 was happening under:

- Acute slowdown of nominal growth of investment made by large and medium-sized enterprises (to annualized 3.9% after 13.6% seen in 2010–2013);
- Stagnation of investment made by small businesses and investments unobserved by direct statistical methods;
- Retention of accelerated price growth on goods and services at the implementation of investment projects despite an investment slump was observed in the economy; investment deflator both in 2012–2013 and in 2014–2016 constituted around 7.4% annually.

The onset of the investment pause exit in 2017 was triggered by a significant increase of adjusted by Rosstat volume of fixed investments made by



Note. In constant prices.

Fig. 1. Dynamics of fixed investment in Russian economy in 2006 – 2017

Sources: Rosstat, own calculations.

small businesses and investment unobserved by direct statistical methods (up 13.7%) as well as by a moderate 6.6% rise of fixed investments made by large and medium-sized enterprises. However, aggregate 8.3% expansion of fixed investments in current prices under the existing inflation context would indicate minimal (within 1%) real growth.

Decisive factor that determined investment growth was decline in inflation and correspondingly fall in investment deflator – by half to 3.7%.

Thus, revival of the investment growth in 2017 was mainly linked with the expansion of the small businesses segment as well as with slowdown of inflation reported in the Russian economy. Upon that, investment dynamics showed by large and medium-sized enterprises was still weak, which determined low fixed investment growth rates across full circle of enterprises. So far, they provided the level of investment equal the pre-crisis 2008 level.

Resource limitations regarding financing investment projects still represent strong negative factors hampering investment activity in the Russian economy.

At 2017 year-end, the share of fixed investments made by large and medium-sized enterprises from their own funds rose to 52%. Such levels were registered in the Russian economy solely during the crisis year of 1998–1999 and during the best for the investment activity years constituted around 40%. Increment of this share was due not so much with the buildup of self-financing of the investment projects by enterprises as with the lower potential of financing through raised funds.

In 2017, fixed investments made by enterprises (less small) from their own funds rose by Rb. 518 bn totaling to Rb. 6.27 trillion. Investment from the borrowed funds were notably less (by Rb. 226 bn to Rb. 5.76 trillion).

Table 1

STRUCTURE AND SOURCES OF FINANCING FOR FIXED INVESTMENT*

| Fixed investment, total, billion rubles | 2013 | 2016 | 2017 | Investment growth for the period, Rb billion | |
|--|--|-------|-------|---|----------------------|
| | 10066 | 11283 | 12026 | 2017 against 2013 | 2017 against 2016 |
| | Structure by sources of financing, % ,% | | | | |
| Fixed investment, including | 100 | 100 | 100 | 1960 | 743 |
| Own funds | 45.2 | 51.0 | 52.1 | 1718 | 518 |
| Borrowed funds, of which: | 54.8 | 49.0 | 47.9 | 242 | 226 |
| Russian banks loans | 8.9 | 7.5 | 5.4 | -243 | -192 |
| foreign banks loans | 1.1 | 2.9 | 5.4 | 547 | 326 |
| borrowed funds from other organizations | 6.2 | 6.0 | 5.1 | -15 | -63 |
| foreign investment | 0.8 | 0.8 | 0.7 | 7 | -3 |
| budget funds | 19.0 | 16.5 | 16.4 | 50 | 110 |
| funds of state extra- budgetary funds | 0.3 | 0.2 | 0.2 | -2 | -2 |
| funds of organizations and households for cost- sharing construction | 2.9 | 3.0 | 2.7 | 26 | -20 |
| Other | 15.6 | 12.2 | 12.0 | -129 | 70 |

* less small businesses and investment volumes unobserved by direct statistical methods.

Sources: Rosstat, own calculations.

Downward trend of fixed capital financing from credit resources provided by the Russian banks (down by Rb. 192 billion against the previous year) and

2. Fixed Investment in 2017: Growth Onset

from the loans made by non-financial entities (down by Rb. 63 billion) continued. Budget financing of fixed capital was very small and predominantly made from the local and regional budgets. Meanwhile, aggregate fixed investments at the expense of the federal budget and extra-budgetary funds contracted by Rb 57 billion. Investment made from organizations' funds and made by households on cost-sharing construction decreased by Rb 20 billion.

By contrast, foreign banks increased fixed capital financing of Russian enterprises through their loans. When in 2014–2016, foreign banks' loans went up twice, then in 2017 – more than twice and this ensued fixed investments financing growth by Rb 326 billion. Upward dynamics of foreign investments took shape and their share in the structure of investment financing sources remains at the bottom level.

Against the background of limited available budget resources, ill-preparedness of the Russian banking sector to expand crediting of investment projects, reduction of accessibility to the global capital market resources the renewal of the investment activity to a large extent will depend on enterprises themselves.

Objectively speaking, their possibilities for self-financing of the investment projects expanded. If we view depreciation and disposable income as the enterprises' investment potential then in 2014–2016 its growth accelerated. During those years, enterprises' investment potential rose annually by Rb 1.8 trillion, which could determine more ambitious investment plans of enterprises in the years since. Meanwhile, fixed investments made by enterprises at the expense of their own funds grew during 2015–2017 merely by Rb 0.5 trillion. Treating enterprises' propensity to self-financing of investment projects the ratio between fixed investments at the expense of their own funds to the volume of their investment resources formed in the previous year was falling during 2017.

If in 2009–2014 enterprises' propensity to self-financing of investment projects constituted 47%, then from 2015 they decrease. In 2015, the decrease of enterprises' propensity to self-financing to 45% could be viewed as adaptation due to notable changes in economic environment seen in 2014. However, the fall of enterprises' propensity to self-financing of investment projects in 2016 and 2017 to 41% demonstrated ongoing industrial confidence slump. In 2017, taking into account enterprises' own investment potential return to enterprises' propensity to self-financing reported in 2009–2015 could determine drastically faster investment growth from enterprises' own funds with real increase of investment in fixed capital by around of 9%.

Thus, exit from the investment pause commensed with unusually low for the Russian economy pace and is developing amid retained resource limitations. Funds raised at the global financial markets and enterprises' own funds are main sources for the investment growth. Neither budgetary nor Russian banking systems failed to provide

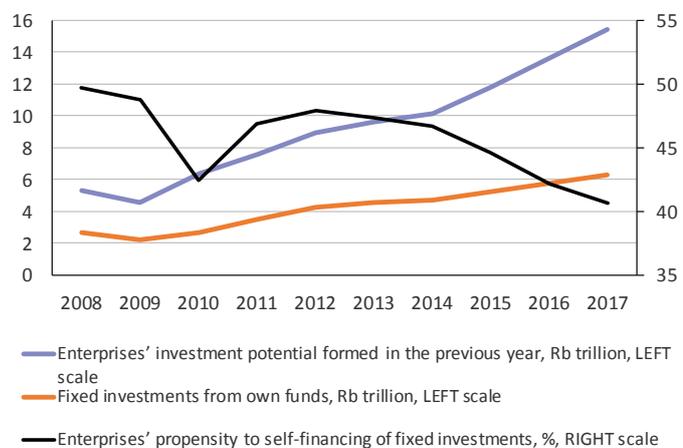


Fig. 2. Fixed investments at the expense of enterprises' own funds
Sources: Rosstat, FTS of Russia, own calculations.

increased resource base for the investment activity in 2014–2017. In 2017, investment pause exit rates turned out to be low due to restricted access to the global markets and reduced enterprises' propensity to self-financing of investment projects.

The resource issue for fixed investment in Russian enterprises will be no less acute. On the one hand, at 2017 year-end, the volume of enterprises' own investment resources (less small businesses) contracted for the first time in ten years. On the other hand, geopolitical confrontation reduces confidence regarding prospects of raising investment resources on the global financial markets. Moreover, explosive growth of fixed investments in small businesses is not obvious but is feasible theoretically. In case of the retention of low inflation the role of the price factor will decrease in the formation of real rates of fixed investments growth. These factors can determine low (or even falling) fixed investments growth rates and the time-lime for the investment pause exit. ●

3. DEVELOPMENT OF THE HEALTH CARE INFRASTRUCTURE: CHALLENGES FOR RUSSIA

N.Sisigina

In 2014–2016, total fixed investments in real terms in the health care system decreased to 50.4% against their peak seen in 2012. Budget investments reported the highest drop (in 2016 – 43.7% of the maximum). Dynamics of fixed investments at the expense of own funds of the medical institutions and raised funds demonstrated weaker magnitude of dynamics variation.

Termination of regional health care programs in 2011–2013 and subsequent economic crisis resulted in a sharp contraction of fixed investments in health care. Prior to 2015–2016 investments volume in nominal terms stabilized at Rb 181.8–182.0 bn (Fig. 1).

According to OECD, total per capita capital investments in Russia (\$32 at purchasing power parity) are in line with Chile and Mexico indicators (Fig. 2). Regarding the Rosstat data, per capita investments denominated in monetary terms go up (\$50.7 at purchasing power parity) which does not change Russia's rank.

Budget funds remain main source of fixed investments (70.9–82.9%), which explains a predominance of state institutions in health care and especially in the most capital-intensive sector – hospitals. Budget financing represents for state institutions the only available source of funds for capital investments. The use of other sources is restricted by:

- Budgetary institutions profile features (dispose of their property, no recourse to credit funds);
- Separate regulation of income-generating activity (closed list of allowed paid service rendered to the institutions participating in the implementation of the Program of State Guarantee of Free Medical Care to the Citizens of the Russian Federation);
- Striking of the largest investment lines (construction and total building renovation, purchases of equipment in excess of Rb 100,000 per unit) off the list of tariffs for covering medical services by mandatory medical insurance (MMI).

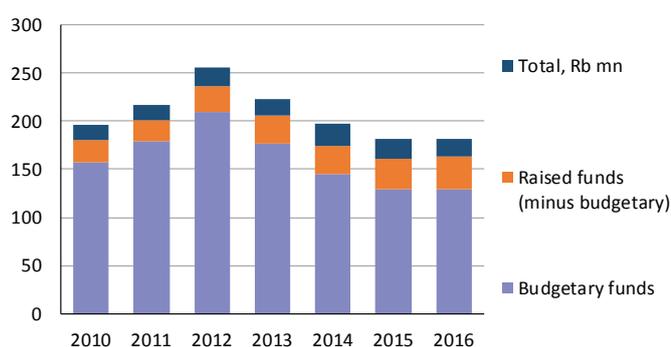


Fig. 1. Dynamics and composition of fixed investments aimed at the development of health care in 2010 – 2016, Rb billion (current prices)
Source: data released by Rosstat.

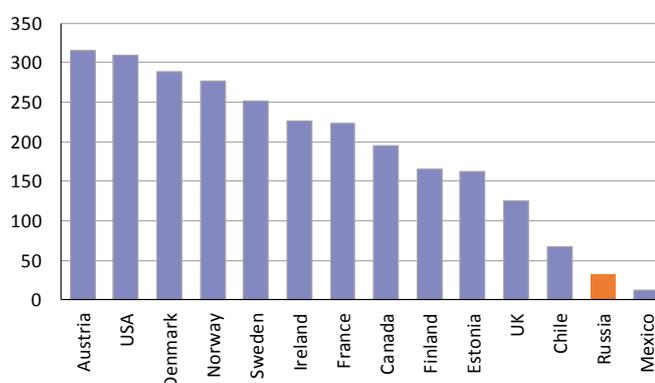


Fig. 2. Fixed investments of health care in certain OECD countries and Russia in 2015, in USD at per capita purchasing power parity
Source: OECD Statistics.

Total share of investment at the expense of the medical institutions of all forms of ownership own funds varied during the period under consideration in the range of 6.8-12%. The share of raised investments demonstrated stable growth from 10.3 to 18.8%.

Total contraction of capital investments adjusted for inflation amounted to around 50% in 2012–2016 (Fig. 3). Contraction of investments was due to budget financing recession triggered by completion of large regional health care upgrading programs in 2011–2013 and subsequent budgetary crisis. The volume of budgetary investments were progressively contracting both absolutely (from Rb 209.2bn to Rb 128.9bn in current prices), and in relative terms (from Rb 82.9 to 70.9%). Total slump adjusted for inflation hit 56.3%.

Investments at the expense of medical institutions' own and raised funds was more stable with the difference between the maximum and minimum indicators during the entire period under consideration in the range of 33.2 and 14.4%, respectively.

At present, the state remains the principal investor in health care system. Its leading role has been confirmed by a legislative restriction regarding independent investment powers of state health care institutions and striking off reimbursement of costs from mandatory medical insurance. However, case studies demonstrated that the effective model of direct state financing not always is capable to ensure sufficiency, regularity, and efficiency of investments. For example, sample audit of the largest investment project, regional programs of health care upgrading, revealed many cases of lingering downtime of expensive equipment entailed by mistakes made in planning and acquisition (lack of suitable facilities, specialists of required qualification or patients who need medical assistance; purchase of equipment which fail to meet the requirements regarding quality and safety of rendered services)¹.

Listed issues regarding budget financing of capital investment in health care system are not unique for Russia. Analysis of foreign experience has demonstrated that the majority of developed economies faced similar challenges at a certain level of state guarantees of free medical services.

Direct state financing of health care infrastructure (usually as targeted budgetary grants) historically was the first way of securing state guarantees of free medical service required funds (including territories without private medical service market). Centralized planning and budget investment also

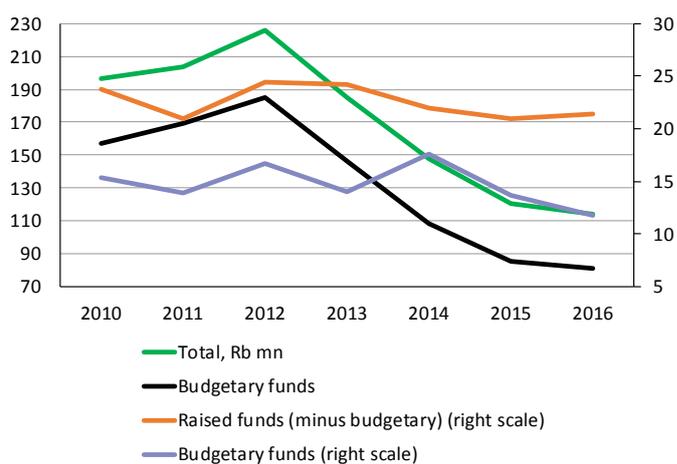


Fig. 3. Dynamics of fixed investments aimed at health care development, by source of funding in 2010 – 2016, Rb bn (in constant prices, minus small businesses)

Source: data released by Rosstat.

¹ A Filipenko. 2014. Report on the results of "Audit of effective use of budget funds from the Federal fund of mandatory medical insurance allocated in 2011–2013 on the implementation of programs and projects on health care upgrading". Bulletin of Auditing Chamber of the Russian Federation. No.9 (201). P. 200–280.

3. Development of the Health Care Infrastructure: Challenges for Russia

helped to eliminate losses entailed by unjustified duplication of fixed-capital stock between institutions or bankruptcy of organizations due to prohibitive loan debt burden.

However, transition to the external investment regulation, which denied the medical institutions any investment responsibilities incurred new risks. Although the state investor, as a rule, disposes of better provisions for hiring qualified experts and more powerful negotiation potential, it to a greater extent is subject to making mistakes linked to distortion in collection and transfer of information regarding needs of population and existing funds. Moreover, the state investor can deliberately adopt inefficient decisions under pressure from public opinion or budget constraints. Favorable attitude of the population towards budget expenses growth on health care system lay the groundwork for excessive capital assets. Meanwhile, the need for drastic reduction of budget expenses coupled with restrictions imposed on debt financing imperils termination of vital projects in the wake of a crisis.

When the state meets all investment expenses and expenses on maintenance of assets health care institutions are not interested in optimization of capital assets and raising investments or saving allocated funds while implementing new investment projects.

In order to resolve centralized budgetary financing issues foreign countries redistributed responsibilities for the raised funds and implementation of investment projects between state, health care institutions, and private investors. Analysis of experience of Germany, France, Great Britain, and the Netherlands reveals transition of these countries to mixed models of financing, which have a number of similar features.

Socially desirable projects (for example, construction of new hospitals) and projects implemented in unfavorable external conditions (for example, hospital equipment for scarcely populated regions) still receive targeted budgetary grants. This case has various approaches – meeting all long-term capital investment corresponding to the forecast needs of the population (Germany), provide a grant solely for university hospitals facilities (Netherlands) or in isolated cases (Great Britain).

In case of shortage of public funds required for lumpsum project financing (Great Britain) or disaffection with the efficiency of direct state management (Portugal), financing of large investment projects can be done by public-private partnership.

Funds for relatively small investments, where mistakes in planning and implementation do not threaten the performance of health care institutions and the maintenance of capital assets are usually included in the tariff for delivery of health care services (so-called single-source financing system). In certain countries (Great Britain, Netherlands) a single-source financing system represents the main tool for meeting capital expenses including spending on large long-term investment. Commercial or state grant represents the original source of funds in this case. Such grant will be paid off by tariff.

Key advantage of the single-source financing system is increased efficiency of expenditure due to the increased commitment of health care institutions in optimization of existing capital assets and new investment projects. At the same time, transition to a single-source financing system is accompanied by real financial risks for health care institutions, which is unacceptable for certain countries (in particular, Germany, France). Regular budget payments to health care institutions when the latter independently determine the way

of spending can serve as a compromise system (Germany, implementation is being discussed in Great Britain). Regular payments restore incentives to efficient spending of funds. However, they do not create significant financial risks for health care institutions.

Compared to this experience, Russian system of financing capital expenditure is characterized by notably more restricted role of health care institutions in planning and implementation of investment. Promising ways of Russian system development can be:

- Specification of requirements for the development and approval of investment projects in health care system (for example, revelation of unsatisfied demand, suitability of facility to equipment requirements, etc.);
- Reestablish health care institutions responsibility for the maintenance of their assets due to gradual doing away with the administrative distribution of paid medical services;
- Granting health care institutions the right to invest (including purchases of expensive equipment, major structural repairs and construction of building) fund balance in arrears;
- Expansion of capital expenditure categories, which are met from tariffs on paid medical services (for example, purchases of certain types of equipment, doing maintenance work).●

4. SMALL AND MEDIUM-SIZED BUSINESSES AND INSTITUTIONAL ENVIRONMENT

V.Barinova, Yu.Tsareva

A survey carried out by RANEPА experts showed that institutional factors were playing a key role in the development of small businesses and micro enterprises. Medium-sized businesses are more resilient to institutional environment features. Their number usually depends on the population size and extension of available markets.

Entrepreneurial activity development is commonly analyzed in context of institutional factors, which create environment for business development, determine volumes of transaction costs connected to carrying out standard procedures – registration, preparing documentation for partaking in public procurements, paying taxes and so on.

Measures are taken to advance Russia’s institutional environment. MSE¹ Development corporation was established in 2016. The overall purchase contracts concluded by small and medium-sized businesses by the end of 2018 should constitute 3 Rb trillion. Since February 2018, «Delovaya Sreda» platform provides a service for online business registration. There are many development institutions on the regional level.

Despite the current support agenda, the expected accelerated dynamics of MSE development is not observed. It is especially noticeable on the small business’ example. «Number of small enterprises» index is substantially lower in 2017 against that in 2008.

It should be noted, that in 2016 the number of small enterprises fell from 243 thousand in 2015 to 173 thousand, which is the lowest value during the entire period under consideration. The reduction can be partly traced to an increase of income criteria for micro enterprises up to 120 Rb mn. per year², which allowed firms that were previously considered small enterprises to move to the «micro» category. Those firms constitute the majority of enterprises in the MSE sphere in Russia.

Dynamics of small businesses in 2008-2017 is presented in Fig. 1.

If we analyze the small businesses turnover in comparable prices, then small but stable decline can be clearly noted starting from 2011. Turnover and fixed investments of small businesses from 2008 to 2016 are given in Fig. 2 and 3.

We have tested an assumption regarding a possible influence of certain

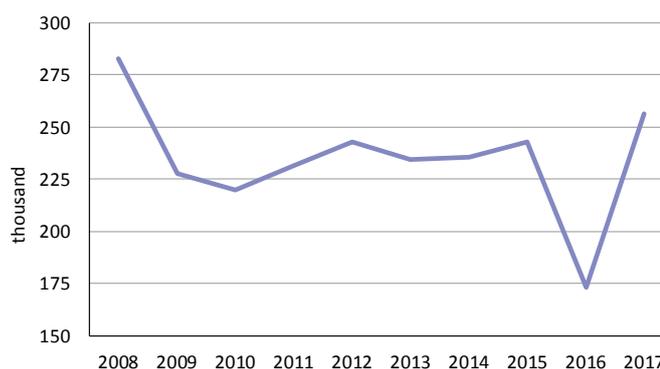


Fig. 1. Number of small businesses (minus micro-sized enterprises), in thousand units

Source: Rosstat.

1 MSE – Medium-sized and small enterprises.

2 Criterion that was effective until 2016 related to income, but established a limit of 60 Rb mn for the previous year excluding VAT. RF Government Regulation of 22 July 2008 No. 556.

institutional factors on MSE development in Russia with applying econometric models that were built for different types of MSE taking into account their features (specialization and size). It turned out, that average-sized enterprises are more enduring towards institutional environment features than smaller (including micro-sized) ones. Out of all institutional factors, the most influential one for the number of medium-sized enterprises is the access to financing (bank loans), the ratio between the number of medium-sized enterprises and region's provision with banking services constitutes 0,47. Total number of medium-sized businesses directly depends on the number of population and the volume of available markets for a given region.

Fig. 4 shows distribution of medium-sized enterprises across regions depending on the population and market potential, reflecting the volume of available markets for a certain region.

Unlike medium-sized businesses, entrepreneurial activity of small (including micro) businesses almost com-

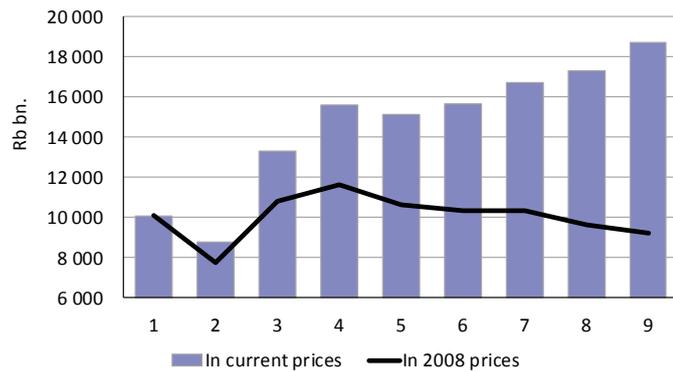


Fig. 2. Small enterprises turnover in Russia in 2008–2016 in current (Rosstat) and comparable (own calculations) prices, Rb bn. Source: own calculations based on data released by Rosstat.

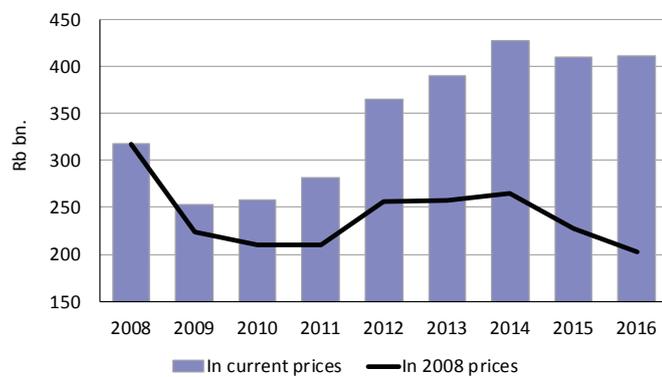
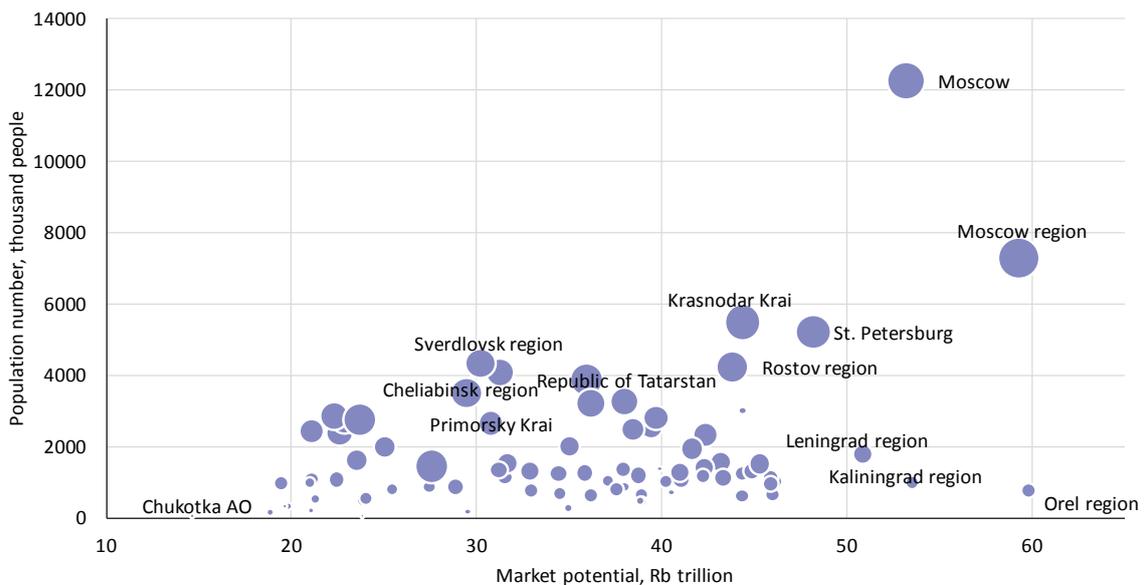


Fig. 3. Fixed investments of small business in Russia in 2008–2016 in current (Rosstat) and comparable (own calculations) prices, Rb bn. Source: own calculations based on data released by Rosstat.

Number of medium-sized enterprises depending on population size and market potential



Note. The bigger the circle, the more medium-sized enterprises are in that region.

Fig. 4. Number of medium-sized enterprises depending on population number and market potential in 2015. Source: own calculations based on data released by Rosstat.

4. Small and Medium-Sized Businesses and Institutional Environment

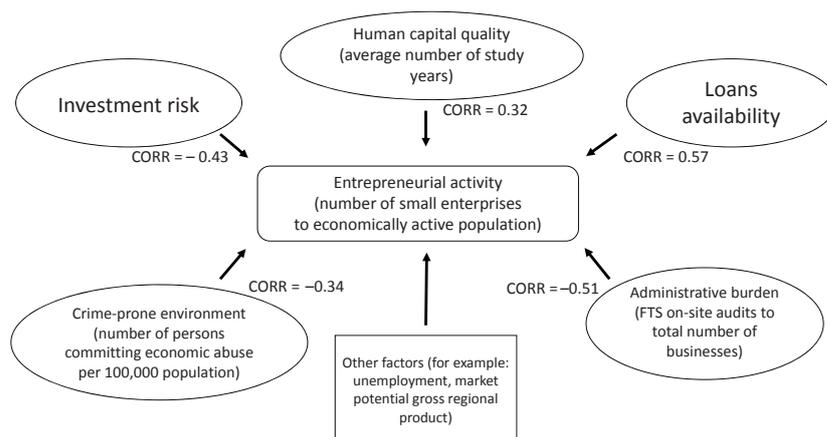


Fig. 5. Institutional factors affecting levels of entrepreneurial activity in a region, and correlation between them and entrepreneurial activity.

Source: own calculations.

pletely depends on institutional factors. The most important factors are: investment risk, availability of bank loans, quality of human capital and administrative burden as well as crime situation (Fig. 5). Small businesses performance in processing industry depend mostly on regional technological development and on the availability of bank loans. Entrepreneurial activity mostly correlates with availability of bank services index (credit availability) and the number of on-site audits carried out by the Federal Tax Service (FTS) (administrative burden) per number of businesses. Acceleration of availability of banking services index in a region by 0.1 (index ranges between 0 and 1.94) leads to a rise in small (including micro) enterprises per 1,000 of economically active population (EAP) by 2.125 enterprises. Rise of on-site audits carried out by the FTS to the total number of enterprises in a region (range between 0.15 and 10.51) per 1 audit leads to a reduction in the number of small enterprises by 0.56 of enterprise.

Presidential Address of 1st of March 2018 stated that development of small businesses represented a “broad-scale reserve for economic growth”¹. In addition, the following benchmarks were set in the Address: “halfway through next decade its share in GDP should hit 40%, while the number of employed should increase from 19 to 25 million persons”.

The survey demonstrated that creation of favorable institutional environment in regions favored in the first place small businesses. Implementation of set goals requires the support to be directed at provision of privileged loans with simple issuing procedure, lowering the investment risks, upgrading legal framework and human capital – quality of education, knowledge and skills. In the last few years, the most important initiatives for small business development are: implementation of the simplified taxation system, set moratorium on planned inspections² for small enterprises, program for promotion of

¹ Presidential Address to the Federal Assembly, 1.03.2018, <http://www.kremlin.ru/events/president/news/56957>

² Moratorium is effective from 1 January 2016 until 31 December 2018. It reaches the majority of types of government control and communal control (supervision) (list of exceptions is included in article 26.1 part 6 of Federal Law, 26 December 2008 № 294-FZ “On protection of legal bodies and individual entrepreneurs while exercising state supervision and communal supervision”) and spreads on to small businesses and self-employed entrepreneur, who are not carrying out activities in the number of fields (also see article 26.1).

lending to MSE (Program 6.5) and program Investment lift, MSE Corporation teaching programs "Entrepreneur's alphabet" and "Business School".

In addition, increase in the number of medium-sized businesses cannot be achieved only by improvement of regional institutional environment. Institutional environment that allows small businesses to grow to medium-sized businesses do not vary by region. For that purpose general regional development policy is urgent: increase transport accessibility, sustain population growth and retain qualified specialists in a region, raise Gross Regional Product (GRP).

To improve quality of MSE features, in particular, to create and maintain high levels of entrepreneurial activity of the processing companies, technological development, implementation of research and development, innovation, industrial, and economic policies¹.

High level of entrepreneurial inertia, which is revealed by situations seen in the previous periods shows the importance of the implementation of consistent and comprehensive policy aimed at the development of entrepreneurship in Russian regions. ●

¹ Research and technology development strategy of Russian Federation. Positioned by Decree by President of Russian Federation from 1 December 2016 № 642.

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