

MONITORING OF RUSSIA'S ECONOMIC OUTLOOK:

TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

No. 9(111) May 2020

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Monitoring of Russia's Economic Outlook

Monitoring has been written by experts of Gaidar Institute for Economic Policy (Gaidar Institute), Russian Presidential Academy of National Economy and Public Administration (RANEPA).

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1. RUSSIA'S BALANCE OF PAYMENTS IN Q1 2020

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The first quarter of 2020 saw the positive Russia's balance of trade to plunge on the back of contraction of exports value amid plummeting crude oil prices with stabilized imports volumes. Due to the decline in foreign liabilities and growth of assets in foreign banks and enterprises, net capital outflow was observed in the private sector. In the contexts of negative external shocks, ruble's exchange rate against dollar plunged by more than 20%.

According to preliminary estimate of the balance of payments released by the Bank of Russia, current account balance in Q1 2020 stood at \$21.7bn down by 35.4% against current account balance reported in Q1 2019 (\$33.6bn).

The balance of trade reached \$32.1bn, posting a decrease by 31.7% (in absolute terms – by \$14.9bn) against \$47.0bn registered in Q1 2019. This plunge is explained by shrinkage of export proceeds mainly from sale of hydrocarbons (crude oil, petroleum products, and natural gas) due to the nosedive of global price on crude oil (Fig. 1). Liquefied natural gas (LNG) remains an exception whose 1.5-fold physical volume shipments allowed to maintain previous volumes of export receipts in value terms (around \$2bn) despite the slide in price. Herewith, it should be noted that the average price of crude oil shipments for exports in Q1 2019 still stood at a rather high level – \$35-30 per ton (in January-February – \$443 per ton) as well as due to the fact that March shipments were partially carried out under contracts concluded some weeks or months before.

The first quarter of 2020 saw the non-hydrocarbon exports to stay practically unchanged compared to Q1 2019 with an uptick by 1.8% from \$39.4bn to \$40.1bn. From now on exports will continue decreasing due both to declining prices on hydrocarbons and to falling prices and global demand for other basic commodities of Russia's export (coal, ferrous metals, fertilizers, non-ferrous metals, and timber).

The decline in trade of balance in commodities amid falling exports was also accompanied by stabilization on spending on imports that demonstrated an uptick by 0.2% from \$55.6bn seen in Q1 2019 to \$55.7bn reported in Q1 2020. This imports dynamic is due both to stability of disposable income (in Q1 2020 incomes still did not fall compared to the same period of 2019) and to average quarterly ruble exchange rate values: according to Bank of Russia the real ruble's exchange rate growth to USD in Q1 2020 relative to Q1 2019 came to +0.3% (March weakening of the ruble did not result in the decline in the average quarter value).¹ In subsequent quarters imports contraction will

¹ On the influence of the exchange rate on trade see: Knobel A.Yu. Estimate of demand function on import in Russia // Applied Econometrics. 2011. No. 4(24). P. 3–26; Knobel A., Firanchuk A. Russia in global exports in 2017 // Russian Economic Developments. 2018. No. 9. P. 17–21.

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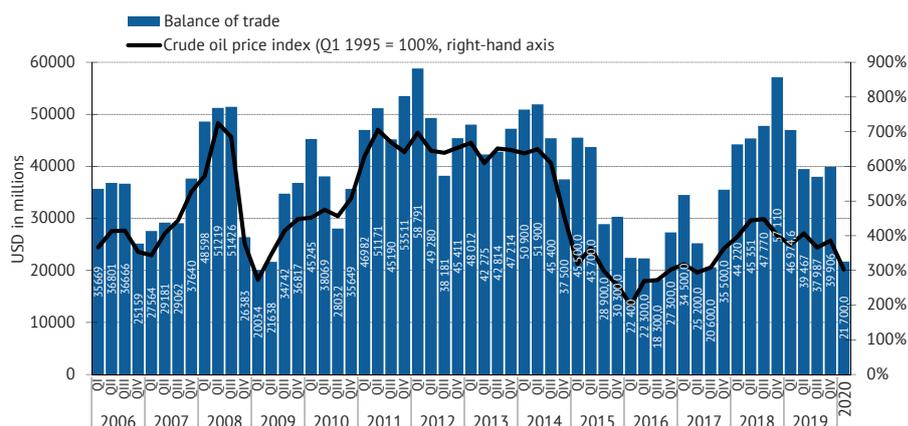


Fig. 1. Trade balance and crude oil price dynamic

Sources: Bank of Russia, IMF.

be observed due both to the fall in disposable income and to the growth on relative prices on shipments of imports on the back of the ruble's depreciation.

The balance of trade in services in Q1 2020 came to -\$5.5bn, which in absolute terms down by 8.3% against the same index seen in Q1 2019 (-\$6.0bn). Both exports and imports of services decreased in Q1 2020 compared to Q1 2019, however, imports fell more markedly both in relative and in absolute terms. Contraction of exports constituted 5.1% (from \$13.8bn to \$13.1bn), and imports fell by 6.1% (from \$19.8bn to \$18.6bn). Hereafter, one can expect improvement in the balance of trade in services due to severe contraction of imports of services due both to a reduction in the number trips abroad and to a decline in imports of transport and other types of services on the back of depreciation of the national currency.

The investment income balance improved in Q1 2020 compared to Q1 2019 by \$1.8bn (from \$4.1bn to -\$2.3bn), and the balance of remuneration for labour fell by \$0.1bn (from -\$0.7bn to -\$0.8bn).

The financial account balance also posted deficit in Q1 and amounted to -\$15.7bn (Q1 2019 saw deficit totaling \$12.3bn). Net capital outflow was mainly due to a reduction in foreign financial liabilities (-\$5.9bn for Q3 2019) and growth of foreign financial assets (\$5.9bn for Q1 2020).

Both banking and other sectors were reducing foreign liabilities. In Q1 2020, banks satisfied obligations to the tune of \$4.1bn (\$3.2bn in Q1 2019). In Q1 2020, contraction of foreign obligations of other sectors hit \$4.7bn, meanwhile in Q1 2019 other sectors ramped up foreign obligations totaling \$5.7bn. Portfolio investment obligations decreased by \$2.4bn (-\$0.4bn in Q1 2019), raised loans—by \$2.0bn (-\$2.1bn in Q1 2019), other obligations—by \$0.5bn (-\$2.1bn in Q1 2019), increment in direct foreign investment constituted \$0.2bn (+\$10.3bn in Q1 2019). Decrease in foreign liabilities of the private sector apparently was due to heightened risks and uncertainty, outflow of capital from emerging markets amid unprecedented spread of coronavirus.

The state administrative bodies ramped up foreign obligations in Q1 2019 by \$1.2bn (\$7.2bn in Q1 2019). As a result, as on early March 2020, non-residents' OFZ market share was 34.9% which corresponds to an all-time high for the entire period of monitoring commenced from January 2012.

Increase of investments in foreign financial assets in Q1 2020 was mainly secured by operations carried out by the private sector. For instance, banks'

1. Russia's Balance of payments in Q1 2020

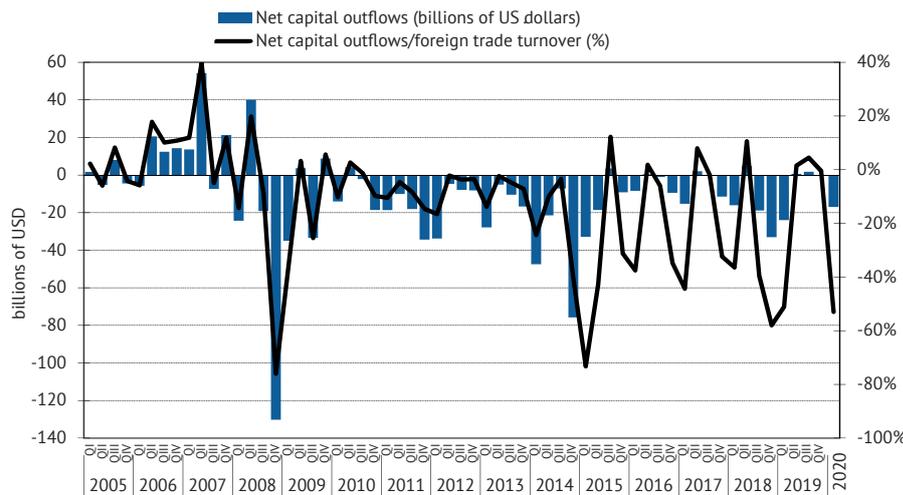


Fig. 2. Private sector's net capital outflows in 2005–2020

Sources: Bank of Russia, Gaidar Institute's calculations.

foreign assets went up by \$5.2bn (+\$9.2bn in Q1 2019), and foreign assets of other sectors—by \$2.1bn (\$15.0bn in Q1 2019). Outbound foreign direct investments totaling in Q1 2020 \$4.9bn (\$9.1bn in Q1 2019) have contributed the most in the growth of foreign assets of other sectors. Increase in outbound portfolio investments and other foreign assets of other sectors constituted \$1.8bn and \$1.5bn, respectively (\$0.5bn and \$9.3bn in Q1 2019). The state administrative bodies have decreased foreign assets by \$1.3bn (+\$0.1bn in Q1 2019).

On the whole net capital outflow from the private sector in Q1 2020 came to \$17.0bn (\$24.0bn in Q1 2019) (Fig. 2). This being said, net export of capital by other sectors in Q1 2020 hit \$7.7bn (\$11.7bn in Q1 2019), and by banks – \$9.2bn (\$12.3bn in Q1 2019).

Russia's international reserves increased \$5.0 in Q1 2020 (\$18.6bn in Q1 2019) whereby they amounted to \$563.5bn. A point to note, at February-end of 2020 international reserves hit a new all-time high of \$570.4bn. This dynamic was triggered first of all by the Bank of Russia purchase of foreign currency to the tune of around Rb 679.2bn in the period from early January to March 10, 2020 (Rb 801.3bn in Q1 2019) on the domestic forex market within the fiscal rule. However, in March 2020 foreign reserves decreased to \$563.5bn on the back of the plunge of crude oil prices below cut price and sale of foreign currency by the Bank of Russia within the fiscal rule on domestic forex market to the tune of Rb 143.5bn for the period from March 11 through 31, 2020. Besides, decrease of foreign reserves is due to sale of foreign currency of the National Wealth Fund (NWF) to pay for the government's purchase of Sberbank's packet of shares. A point to note, daily volume of foreign currency sale related to the payment for the deal varies depending on the Urals crude oil price fluctuation below \$25 per barrel. There is no sale of foreign currency when the price is above that benchmark. This mechanism will be in force through September 30, 2020 and the total volume of foreign currency sale on domestic forex market can come to Rb 2.1 trillion. In Q1 2020, the foreign reserves dynamic is also explained by a negative currency revaluation amounting to \$7.4bn.

In Q1 2020, ruble depreciated against dollar by 23.4% to Rb 76.4 for one dollar (as on early April 2020). Slowdown of the world economy on the back of rapid spread of coronavirus was fraught with heightened uncertainty and

outflow of capital from emerging markets. Apart from that, the world crisis triggered crude oil price plunge which was fueled by the breakdown of the OPEC+ deal on March 6, 2020. As a consequence, Urals crude oil price plunged by 3.4-fold from \$61.75 per barrel in early January 2020 to \$18.3 per barrel as on early April 2020. It should be pointed out that in such circumstances Bank of Russia's measures aimed at propping up financial stability including foreign currency sale from the NWF within the fiscal rule as well as operations on the forex market related to the sale to the government of controlling stake of Sberbank allowed to maintain ruble's exchange rate close to equilibrium values and balance the currency market. Our calculation demonstrate that fundamentally justified ruble rate to dollar under crude price in the range of \$25-30 per barrel constitutes about Rb 75 per dollar.¹

In 2020, changes in crude oil prices, decrease in the global demand for basic commodities of Russian exports, decline in prices on non-hydrocarbon exports, real and nominal devaluation of the ruble will severely impact the balance of current account positions. As a result, the balance of current account positions which equaled \$64.6bn in 2019, according to our estimates, will decrease severely and can amount from around \$2bn to negative values (about -\$10bn) at year-end of 2020.

This being said, the negative balance of financial account is unlikely to reach values reported during previous crises (-\$130bn in 2014, -\$140bn in 2008) and will not surpass \$50bn. Foreign debt of Russia's economic agents has significantly decreased, which reduces demand for currency for its refinancing and propensity for assets dollarization has declined. Russia's foreign debt at Q1-end of 2020 (\$450bn) is 1.6-fold below than that reported on the eve of currency crisis of late 2014 (\$732.8bn).

The Bank of Russia will be conducting operations of currency sale within fiscal rule and operation of controlling stake in Sberbank. In case crude oil prices go down in Q2 2020 to \$20-25 per barrel and their stabilization in the range of \$30-35 per barrel in H2, the volume of currency sales by the Bank of Russia within fiscal rule should amount to around Rb 1.3-1.4 trillion at year-end of 2020. Total sale of foreign currency on domestic forex market taking into account Sberbank shares can amount to about Rb 2.1 trillion. This means the sale of international reserves to the tune of \$45bn, which will suffice for stabilization for the ruble's exchange rate at the level of indicated fundamentally justified values.

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1. Knobel A., Firanchuk A. Russia in global exports in 2017 // Russian Economic Developments. 2018. No. 9. P. 17–21.
2. Knobel A.Yu. Estimate of demand function on import in Russia // Applied Econometrics. 2011. No. 4 (24). P. 3–26. 

¹ Calculated on the basis of econometric model of ruble fundamental rate designed in Gaidar Institute and RANEPa.

2. MEASURES OF FINANCIAL AND NON-FINANCIAL SUPPORT TO SMALL AND MEDIUM-SIZED ENTERPRISES (SMES) IN THE WAKE OF COVID-19

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Small and medium-sized enterprises (SMEs) are more exposed to pandemic risks compared to large businesses. To support this sector during the crisis, it is necessary to implement measures of financial (direct funding, tax incentives, etc.) and non-financial support.

OECD recommendations and the situation in member-countries

Small and medium-sized businesses constitute 99% of all companies in OECD member countries and provide from 50 to 60 percent of the value added in the economy. According to the organization estimates, micro and small enterprises employing less than 50 people account for 43% of all employees in OECD countries. The share of the population working at medium-sized enterprises with the number of employees from 50 to 250 people account for 16%. SMEs constitute 75% of all jobs in the sectors directly embraced by support measures compared to nearly 90% in Greece and Italy.

On March 16, 2020, the OECD published a report on measures aimed to support small and medium-sized businesses.

A survey of SMEs conducted in China in February 2020, showed that a third of them had sufficient funds to cover fixed costs for only a month, the other third had funds for two months, and this put millions of Chinese SMEs at risk. According to the information of March 14, 2020, 60% of Chinese SMEs were back in business, however, this time they faced new challenges due to lower demand.

A survey of SMEs conducted early March in Italy showed that 72% of the 6000 respondent companies were affected by declining demand or problems in the supply chain and logistics. Businesses operating in the field of transport, tourism, fashion and the production of agricultural foodstuffs were affected most of all.

The share of small and medium-sized businesses in some regions and sectors that most of all experienced the impact of the pandemic is significantly higher than the average indicator for the global economy as a whole. For example, SMEs are widely represented in such sectors as tourism and transport, which are largely susceptible to the negative effects of the virus and measures taken to prevent it, as well as in the fashion and food sectors, where short delivery times are critical.

SMEs often have a limited number of suppliers. Sometimes this fact can protect them from shock (for example, German small and medium-sized businesses mostly operate in regional supply chains and, therefore, are less affected by developments in Asia). However, in other cases, SMEs highly depend on suppliers from countries heavily affected by COVID-19 and it increases their vulnerability. Given the limited resources of small and medium-sized enterprises

and the existing barriers to access the capital, the timeframe for coping with the shock is shorter for SMEs than for large companies.

Support measures in OECD countries are aimed at helping companies and employees to reduce their working hours, as well as in relation to temporary layoffs and sick leave (for example, in Belgium, France, the Netherlands, Switzerland). Some countries also introduced measures to protect the self-employed. In Ireland, in particular, self-employed were put on sick leave.

OECD countries widely use financial instruments, such as tax incentives, loans, guarantees to reduce the impact of the pandemic on SMEs. They provide companies with the option of tax deferral (for example, Australia, Belgium, France), envisage tax cuts and introduce tax privileges (Italy).

The US government qualified COVID-19 as a “disaster”, thereby, American companies of all sizes were eligible to participate in the assistance program, so that they could obtain a loan from Small Business Administration (SBA) due to economic damage. Under this program, small enterprises can get working capital loans amounting up to \$ 2 million at a low interest rate. The possibility to further lower payroll taxes is currently under discussion. On March 12, 2020, the SBA announced its intention to provide \$ 50 billion in loans to small businesses.

Several countries implement measures of direct support to SMEs. Among them are France, where state-owned investment banks issue loans to small and medium-sized enterprises, Japan practicing unsecured interest-free loans, Israel reducing time required for banks to approve a loan. Sectoral support measures focusing on touristic industry have been implemented in Australia, Chile and Italy. Austria, Japan, Korea and Israel introduced new government guarantees, and Korea approved trade credit insurance.

OECD countries take measures with regard to procurement and overdue payables. France and Belgium have suspended fines for delayed payment on government contracts. Besides, France offers mediation in conflicts between SMEs and their counterparties.

Moreover, some countries have taken measures to help SMEs to learn new working modes and find new markets. Australia launched a mentoring program and financial seminars in Queensland.

The OECD countries also implement initiatives aimed at SME raising awareness on how to help preventing COVID-19 including through agencies or associations of small and medium-sized business (the Netherlands, Luxemburg, Portugal, Great Britain, Switzerland).

Moreover, some commercial banks in certain countries have taken steps to provide loans and ease conditions for their repayment, in particular, measures to support SMEs including urgent loans to assist SME clients. For example, Korea, Singapore and Malaysia ensured flexibility for loans repayment. In Italy, the Italian Banking Association and several business associations acting with the support of the government have agreed on a large-scale moratorium on debt repayment.

Situation in Russia

The following measures are being taken to support SMEs in Russia: deferral of loans. The Reserve Fund of the Government of Russia allocated Rb 5 billion to the credit organizations to ensure deferred payment on loans issued to SME subjects¹. A procedure has been established for granting subsidies to credit

1 URL: <https://corpmsp.ru/upload/iblock/c97/ekMrmAATPSOjmlhTJygo5pFAiWrHFRXP.pdf>.

2. Measures of Financial and Non-Financial Support

organizations to ensure deferred payment on loans issued to SMEs¹, as well as regulations for providing subsidies to regions aimed at urgent measures to support small and medium-sized enterprises amid worsening situation due to the spread of a new coronavirus infection². The Bank of Russia recommends creditors to restructure credits and loans granted to small and medium-sized businesses and self-employed individuals, if the financial situation of the borrower deteriorated due to the spread of the coronavirus infection³. The Bank of Russia empowered credit institutions to avoid increasing reserves aimed to cover possible losses on loans to SMEs until September 30, if the financial situation of the borrower worsened due to the spread of coronavirus infection. Microfinance organizations and credit consumer cooperatives are allowed to refrain from increasing reserves for debts overdue as from February 1, 2020, as well as for loans restructured under similar circumstances. They are allowed to disclaim them under provisioning for possible losses.

In affected sectors, SMEs can get a loan for payment of salaries. The interest on this loan will be covered from the federal budget, while it will be interest-free for the borrower. This loan will be issued at 4% after 6 months.

Moratorium on bankruptcy initiated by creditors. The moratorium was introduced on bankruptcy petitions at the request of creditors in relation to individual debtors (systemic important companies, strategic enterprises included in the list of the most affected by the coronavirus organizations)⁴;

Deferral of rental payments to the state and municipalities. The subjects should join the lease moratorium for residents of SME infrastructure (industrial parks, technoparks, business incubators, co-working). Small and medium-sized businesses got a temporary reprieve on deferral of rental payments when providing federal property⁵. Requirements detailing the conditions and deadlines for deferring payment on real estate rental contracts have been approved and contain recommendations for legal entities and individual entrepreneurs to reduce the amount of rent⁶.

The following measures have also been implemented in Russia: lowering SME provisioning requirements if they are involved in government contracts, deferring all taxes (except VAT) for small and medium-sized enterprises for 6 months, deferring social insurance contributions for SMEs (6 months only for microenterprises, moratorium on collecting debts and fines). An instruction has been adopted to extend the permits' operation and other licensing activities special aspects in 2020.

However, direct financial support to SMEs, similar to measures taken in OECD countries, has not gained widespread use in Russia. Only on April 15, 2020, the President of the Russian Federation proposed to provide gratuitous aid to SMEs, as well as loans to companies secured by the VEB.RF guarantees. Such support should constitute at least 75% of the salary loans. The amount of support for a particular company will be calculated taking into account the total number of its employees as of April 1 of the current year based on the amount of Rb 12.130 per employee per month.

1 URL: <http://government.ru/docs/39353/>.

2 URL: <http://static.government.ru/media/files/xBPmoC1y0iX8c8F9hkeMyRAeKR94lp7g.pdf>.

3 URL: <https://corpmsp.ru/dopolnitelnye-mery-podderzhki-subektov-msp-v-usloviyakh-pandemii-koronavirusa/mery-realizuemye-pri-podderzhke-tsb-rf/>.

4 URL: <https://corpmsp.ru/upload/iblock/fdc/Postanovlenie--428.pdf>.

5 URL: <http://static.government.ru/media/files/2S8tyUY1Ev1qJrZe3zJe9s3pEpFYh1i.pdf>.

6 URL: <http://static.government.ru/media/files/2S8tyUY1Ev1qJrZe3zJe9s3pEpFYh1i.pdf>.

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The Federal Corporation for the Development of Small and Medium-Sized Enterprises, hereinafter referred to as the SME Corporation, provides links on its website to regulations adopted to minimize the negative consequences of COVID-19, however this information is not systematized and does not contain clear instructions.

Proposals for the Russian agenda

In the current COVID-19 situation, it seems necessary to take the following financial and non-financial support measures intended for SMEs:

1. The Ministry of Finance of Russia, together with VEB.RF and the SME Corporation, to develop programs for providing grants and working capital interest-free loans for SMEs most affected by COVID-19.
2. The Ministry of Labor and the Ministry of Finance to draft amendments to the Law of the Russian Federation "On Employment in the Russian Federation" and other regulations aimed at providing extended social benefits to self-employed.
3. The SME Corporation to launch online educational programs aimed at SMEs raising awareness on how to help preventing the spread of COVID-19 (taking into account the experience of the Netherlands, Luxembourg, Portugal, etc.).

The SME Corporation together with the Russian Export Center (REC), to launch online educational programs for SMEs with the aim to master new working procedures related to distance work and find new markets for the sale of their products. Companies having successful experience in changing work procedures in the wake of COVID-19 should take part in the educational programs held in the mentoring format ;

The SME Corporation together with REC to propose mediation in conflicts between SMEs and their counterparties, including outside of Russia, due to the inability to fulfill contracts as a result of the current pandemic situation and interruptions in the supply chain;

The SME Corporation to present a guide on support measures on their official website, serving as a step-by-step instruction on minimizing business risks for SMEs and including all relevant and necessary information on the implemented support measures and the mechanism for obtaining this assistance.

What are the benefits of the proposed changes

The implementation of direct financial support measures to SMEs in the form of grants and interest-free loans should be an important step aimed to overcome the negative economic impact of the pandemic (reduction in demand, suspension of activities, etc.). It is also necessary to provide supportive measures in the form of tax incentives for the self-employed, who also experience significant challenges due to a drop in demand for their services.

An information support for small and medium-sized enterprises experiencing great difficulties to navigate in the huge flow of information on the pandemic respond measures should be an important trend of the SME Corporation activities. SMEs should receive informational support in terms of organizing work processes and building business relationships to overcome the crisis. 

3. THE GUIDELINES FOR EXPANSION AND IMPLEMENTATION OF SUPPORT MEASURES FOR THE BUSINESS AMID THE PANDEMIC IN TERMS OF REDUCTION OF THE TAX BURDEN ON LABOR (INSURANCE PAYMENTS) FOR SMALL AND MID-SIZED BUSINESSES

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For economic support of small and mid-sized businesses amid the pandemic, some mechanisms as regards insurance contributions have been introduced: it was declared about the extension of the deadline for payments, provision of deferrals and options to pay by installments and reduced rates. We advise to bolster these measures by means of introduction of short-term “tax holiday” for the worst- hit small and mid-sized businesses (SMB) and reduction of the rates of insurance contributions regardless of the size of wages in relation to the minimum monthly wage amount (MMWA).

The Introduced and Proposed Measures

The reduction of the tax burden on labor (in terms of the obligation to pay insurance contributions) is among high priority measures of support to small and mid-sized businesses declared by the President of the Russian Federation in his address to the citizens of Russia on March 25, 2020. It was proposed to grant the affected micro-sized businesses the deferrals of insurance contribution payments to social funds; reduce twofold (from 30% to 15%) the size of insurance contributions for small and mid-sized businesses as regards payments exceeding MMWA with the standard level of MMWA taxation preserved [1]. The measures of reduction of the burden on insurance contribution payments are provided for in Federal Law No.102-FZ of April 1, 2020 On Amendment of Part One and Part Two of the Tax Code of the Russian Federation and Individual Statutory Acts of the Russian Federation in which the following is envisaged:

- temporary expansion (within 2020) of the powers of the RF Government in terms of the right to issue regulatory legal acts, which extend, among other things, the deadline for payment of insurance contributions and introduce additional grounds for granting deferrals (payment by installments) of insurance contribution payments;
- twofold reduction of insurance contribution rates for small and mid-sized businesses in respect of the sum of payments which exceed the MMWA during the period from April 1, 2020 till December 31, 2020 and in the long-term prospect, namely, in the period from 2021 (as the motivation guaranteed by the RF President for employers to increase wages for their employees). The reduced rate of 15% on insurance contributions is made up of the following: deductions at the rate of 10% on mandatory pension insurance (instead of 22% both within and beyond the limits of the maximum base¹) and withholdings at the rate of 5% instead of 5.1% on mandatory medical insurance. Contributions to the compulsory social insurance against industrial accidents and occupational illnesses are calculated at the rate of 0%, so the obligation to pay them in this case does not lead to the withdrawal of funds from the taxpayer’s turnover.

Overall, the abovementioned measures are aimed at releasing additional funds with employers for making the required payments to employees and retain the employment at enterprises amid the deteriorating financial situation of the business. The worsening of the situation is related to a decrease in incomes (revenues) because of the forced reduction of the volumes of activities amid the lockdown with employers still obligated to pay wages out of their own sources during the period of non-working days (extended till May 2020)². There are risks of reduction of wages, lay-offs and shutdowns which may trigger a drop in the social standard of living, growth in the rate of unemployment, reduction of the number of operating enterprises and tax revenues and decrease in the share of small and mid-sized business in GDP (which according to the plan is to increase from 23% to 30% by the year 2024 [2]).

The announced measures are meant to minimize the abovementioned risks and mitigate the negative impact on the economy of business limitations.

The procedure for extension of the deadline for payment of insurance contributions and granting of deferrals and options of payment by installments was approved by Resolution No.409 of April 2, 2020 of the Government of the Russian Federation On Measures Facilitating the Sustainable Development of the Economy. Only affected enterprises are eligible to receive the abovementioned support measures. The extension of the deadline for payment of insurance contributions for six months (calculated on the basis of payments in March-May 2020) is available only to micro-enterprises. The right to deferrals of insurance contribution payments and payments by installments is granted not only on condition that an enterprise is attributed to the worst-hit sectors, but also on condition that its performance indicators got worse in terms of the level of revenues and occurrence of losses. It is noteworthy that a taxpayer is not eligible for the deferral of payments and payment by installments if the revenues fell by 10% and less, including the case of the existence of a loss based on the results of 2019.

At the meeting with heads of regions where the issues of fighting the outbreak of the coronavirus in Russia were discussed, the President of the Russian Federation proposed to expand the scope of those enterprises which could be eligible for taking advantage of deferrals of insurance contribution payments, having included all affected small and mid-sized businesses and use at the same time the mechanisms of the tax debt restructuring [3].

The identified problems and proposals

Granting of deferrals, payment by installments and extension of the deadline for payments

If some enterprises with accumulated financial reserves can step up their activities in the cyberspace or by virtue of their operations can switch over their employees to the online mode, thus underpinning revenues, other companies which lack such market advantages encounter the situation where the reduced tariff does not actually solve the problem of expenditures on labor remuneration. In such a situation, the motivation will be the feasibility either to postpone the tax burden to a later period or reduce it substantially, rather than the reduction of the tariff. **In their turn, the measures envisaging the postponement of the deadlines for payment are aimed at affected enterprises, while the small business may experience problems working in other lines of business which are not included in the list of affected industries approved by the Government of the Russian Federation. In addition, the postponement of the deadline and**

3. The Guidelines for Expansion and Implementation of Support Measures

deferrals of insurance contribution payments do not release the taxpayer from the obligation to pay the debt in future, while there is no guarantee of complete recovery of the taxpayer's financial situation by the due date.

In this regard, the badly affected businesses should be exempted from payment of insurance contributions ("the tax holiday") provided that they retain employment during the regime of non-working days, as well as in the next few months (for example, from April till July 2020). As seen from international experience, the target exemption is completely in harmony with the latest practice of support of the small business (see *Annex 1*).

Reduction of the insurance contribution burden

Unlike the previous measures, the condition for reduction of the rate of insurance contributions is only the size of the business, namely, its compliance with the criteria by which the entities of small and mid-sized business are identified. Accordingly, this privilege can be claimed by taxpayers attributed to this segment of the economy and carrying out any type of activities, that is, it is not necessarily to be recognized as an affected enterprise.

For enterprises this privilege is important to the extent it permits actually to reduce the tax burden. It is noteworthy that taxpayers are still obligated to calculate insurance contributions on the basis of the main rate on the MMWA, so the efficiency of the reduced rate is related directly to the size of wages at enterprises. According to the data of the Federal Tax Service, micro-businesses, which account for 90% of the entities of the small and mid-sized business sector are the main beneficiaries of the privilege in question [4]. As per the data of the Rosstat, in 2018 the average wages at micro-enterprises were equal to Rb 23,618 [5], with the MMWA set at Rb 12,130 from January 1, 2020. This means that **the reduced rate will largely be applied to the value which makes up about 50% of the worker's average wage proceeding from the forecast that its size does not decrease substantially in 2020. If restrictive measures result in the reduction of workers' incomes, the share of payments taxed on privileged terms will be reduced, as well as the efficiency of the reduced rate, as an anti-crisis measure, applied to payments above the MMWA level.**

The application of the reduced rate (by 50%) on insurance contributions leads to tax savings of 25% of the standard value of obligations as regards payment of insurance contributions amid growing costs on compliance with the legislation (because of the need to divide the tax base across the line of the MMWA and adapt the automated accounting systems to the new procedure for calculation of insurance contributions). Small and mid-sized enterprises' tax savings will be higher because they pay higher average wages, but the share of such enterprises is substantially lower, so, the indicators of micro-enterprises are more representative for evaluation of the effect produced by the reduced rate (*Table 1*).

It would be expedient to apply the reduced rate on insurance contributions to the entire tax base for boosting the effect of reduction of the tax burden and simplifying simultaneous book-keeping and tax accounting. Such a reduction of insurance contributions (without division of payments on the basis the MMWA) will substantially increase the counter-cyclical nature of the introduced measures by means of expansion of the financial aid, particularly, in the period when it is badly needed. This will lead to a faster recovery of the SMB sector in the mid-term prospect and, consequently, the employment and expansion of the base of insurance contributions. By virtue of the fact that **the measure aimed**

at reduction of insurance contributions is not temporary, but a permanent one, the elaboration thereof in compliance with the proposed scenario will lead to substantial promotion of system-based and relevant incentives for boosting the official employment in the SMB sector.

Table 1

The calculation of tax savings as a result of application of the reduced rate of 15% per worker

	Small businesses (with micro-enterprises taken into account)	Micro- enterprises	Mid-sized businesses
The share in the SMB sector	99.35%	91.68%	0.65%
Average monthly wages, roubles	27569	23618	38395
The amount of insurance contributions at the rate of 30%, roubles	8270.70	7085.40	11518.50
The amount of insurance contributions with the reduced rate applied, roubles, including:	5954.85	5362.20	7578.75
MMWA (RB 12,130) 30%	3639.00	3639.00	3639.00
Above MMWA 15%	2315.85	1723.20	3939.75
Tax savings, roubles	2315.85	1723.20	3939.75
Tax saving, %	28.0%	24.3%	34.2%

Source: the data of the Federal Tax Service, the Rosstat and own calculations.

By our estimates, in terms of implications for the budget the reduction of insurance contributions with division of payments on the basis of the value of MMWA will result in the shortfall of Rb 350bn in the budget revenues at year end 2020. Accordingly, the change of the mechanism into the proposed one (without division of payments on the basis of the value of MMWA) may lead to a twofold increase in the shortfall (up to Rb 700bn) of the budget revenues at year end 2020.

So, further lines of development of support measures in terms of reduction of the burden on payment of insurance contributions can be implemented through:

- introduction for a limited period of “tax holidays” on payment of insurance contributions to the affected small and mid-sized businesses;
- unification of the rate on insurance contributions at the reduced level of 15% for small and mid-sized businesses (with the procedure for calculation thereof simplified, that is, without division of payments on the basis of the value of the MMWA) and that will enhance the counter-cycle specifics of the introduced measure.

Sources

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3. The meeting of the President of the Russian Federation with heads of regions on issues of fighting the outbreak of the coronavirus in Russia on April 8, 2020. (<http://kremlin.ru/events/president/news/63176>)

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5. Small and Mid-Sized Business in Russia // The Rosstat, 2019. (https://www.gks.ru/bgd/regl/b19_47/Main.htm)
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7. COVID-19 Spain: Update for business in Spain regarding labour, tax and corporate matters (<https://www.xterna.es/news/2020/03/27/covid-19-spain-measures>)
8. Social protection responses to the Covid-19 crisis. Country responses in Asia and the Pacific // ILO 2020 (https://www.ilo.org/wcmsp5/groups/public/---asia/---ro-bangkok/documents/briefingnote/wcms_739587.pdf)

Attachment Exhibit

Annex

The “tax holidays” on social contributions in the international practice

Hungary – identification of the affected industries for the purpose of granting them exemptions	Taxpayers engaged in such sectors as carriage of passengers (taxi service), hotel business, public catering, sports, art, entertainments, gambling games, movie industry, TV, sound recordings, music, publishing of magazines and periodicals, software development, broadcasting, tourism and inland water transport are exempted from paying social contributions from March till April 2020. For prevention of non-target provision of privileges, a condition was introduced (a rather soft one) in respect of the main type of activities. As per this condition the exemption was granted provided that within the period between September 24, 2019 and March 23, 2020 (six months) the share of revenues from any type of activities included in the official list amounted minimum to 30% [6]
Spain – rendering of tax support owing to the impact of the restrictive measures on the business and on the basis of the size of the business	In case of suspension of labor contracts or reduction of the working time because of the government measures adopted to stop the outbreak of COVID-19 and leading to a loss of business activities by enterprises, entities with a staff of maximum 50 workers are exempted from paying social insurance contributions; other entities receive a privilege in terms of a 75% reduction of relevant withholdings. Tax support is guaranteed provided that the employer who justified the correlation between the unfavorable epidemic situation and its negative implications keeps supporting the level of employment of his/her business for minimum six months after business activities have returned back to normal [7]
China – “adjustment” of support measures with the size of the business and the territory taken into account	The local authorities (of provinces) are entrusted with powers to relieve from payment of insurance contributions (pension insurance, industrial injuries insurance and unemployment insurance) employers attributed to the category of micro-enterprises and small and mid-sized businesses from February 2020 for the period of up to five months (until June 2020 included), while in case of other (large) enterprises reduce by 50% within the period of three months the size of withholdings (until April 2020 included) [8]. In the Hubei province, the terms are more favorable because all enterprises, regardless of the size of their business are exempted from payment of the above specified insurance contributions.

4. DEVELOPMENT TRENDS OF SMALL AND MEDIUM-SIZED ENTERPRISES AMID PANDEMIC-INDUCED CRISIS

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Against the backdrop of coronavirus pandemic-induced economic crises, small and medium business sector oriented towards off-line services provision has been worst-hit. In reality, demand for services provided by catering, entertainment, tourism, hospitality, beauty-business, and non-food retail has declined several-fold amid lockdown. This being said, the need to pay wages, taxes, social contributions, rental charges, bank credit interest, and contractors for supplies and other services has remained. All types of businesses who missed the chance to switchover to online services provision or stick to business model for rendering exclusively personal off-line services to date are exposed to bankruptcy risk. Cash gap is on the rise that can lead to bankruptcy of multiple small and medium-sized enterprises (SME) unable rapidly and without losing work performance to switchover to the online regime especially in large Russian cities. In this memorandum we present assessment of the crisis impact on income, employment, lending, and the number of SMEs.

Affected businesses

According to the Order of the Government of the Russian Federation dated April 3, 2020 No. 434¹, the most affected industries are:

- Air carriage, airports, road haulage;
- Culture, recreation, and entertainment;
- Health and fitness, sports;
- Tourist agencies and other organizations rendering tourist services;
- Hotel business;
- Catering;
- Additional education organizations, private educational institutions;
- Organization of conferences and exhibitions;
- Enterprises rendering personal services to the population (repairs, laundry, dry-cleaning, barbershops, and beauty-salons).

This is an open-end list and has already been augmented: On April 16, 2020 the Government augmented the list with non-food products retail sales.²

In addition, the Bank of Russia has prepared a separate list of affected industries. In relation to these industries the Bank of Russia takes measures designed to prop up lending including for wages for employees as well as to reduce debt

1 Order of the RF Government dated 03.04.2020 No. 434 "On adopting the list of industries of the Russian economy affected foremost amid deteriorated situation triggered by spread of the new coronavirus infection."

2 Government meeting dated April 16, 2020: <http://government.ru/news/39510/#resh1604>

4. Development Trends of Small and Medium-Sized Enterprises

burden related to servicing of current credits. The Bank of Russia submitted the first version of the list on March 27, 2020¹, which included:

- tourism;
- transportation;
- catering;
- arts, sports and recreation, and organization of entertainment;
- organization of conferences and exhibitions;
- educational services;
- lease of private or sublease of non-residential buildings or properties (exhibition halls, shopping and recreational spaces, non-food retail trade);
- non-food retail trade;
- dental practice.

Later, on April 11, 2020, the Bank of Russia augmented the list of affected industries² by including:

- housing construction (on condition that as on March 1, 2020, loans extended to companies engaged in housing constructions were classified by credit institution in I or II quality category);
- performance of bus terminals and coach terminals;
- auxiliary activity linked with air traffic;
- production and wholesale and retail trade of motor vehicles and motorcycles, their repair and technical inspection;
- provision of consumer services (repair of PC, articles of personal and general purpose use laundry and dry-cleaning, barbershops and beauty-salons).

Number of SMEs. Bankruptcies

The number of SMEs commenced to shrink long before the 2020 crisis. For instance, only from January till December 2019 it decreased by 124.3 thousand. This was due, firstly, to decrease in real disposable income of the population and, as a consequence, to a reduction in demand for goods and services rendered by SMEs; secondly, with strengthening of tax administration: deployment of online cash registers, VAT rise, Russia's FCS fight with flight-by-night firms and illegal "split" of business designed for tax avoidance.

At the same time, the number of individual entrepreneurs in Russia in 2019 went up by 62 thousand. On the one hand, this fact can be explained by the exit of businessmen from informal sector; due to the IT development and digitalization expansion it is becoming more difficult to work in informal sector: banks block accounts with shady transactions; the Bank of Russia vigorously fights with illegal cash-out transactions; tax administration becomes tougher. On the other hand, it can be due to "re-registration" of legal entities into individual entrepreneurs (tax burden on individual entrepreneurs is significantly lower) or with transfer of wage-workers into individual entrepreneurs (IE) status, which knowingly is illegal tax optimization scheme. Having said that, from 2020 it was planned to raise the amount of mandatory contributions of IE on pension and medical insurance,³ and from 2021 to rescind unified tax on imputed income (UTII) which 1.8 million of

1 Bank of Russia press-release. http://www.cbr.ru/press/pr/?file=27032020_152031d-kp2020-03-27T15_20_11.htm

2 Bank of Russia news. http://www.cbr.ru/press/pr/?file=10042020_183637if2020-04-10T18_35_05.htm

3 Fixed amount of insurance contributions has changed for IE in 2020. URL: https://www.nalog.ru/rn33/news/tax_doc_news/9470328/

individual entrepreneurs resort to (53% of the total number of IE). Undoubtedly, outlined factors coupled with the acute economic crisis will rather adversely affect dynamic of the number of individual entrepreneurs this year.

Reduction from 2011 in the total number of scheduled and extraordinary inspections¹ owing to the introduction of supervisory holidays on *some types* of scheduled inspections of SMEs and extension of this moratorium² for 2019–2020 can be considered as an indicator of partial reduction in controlling and administrative crackdown. Its further extension is being discussed on the back of coronavirus pandemic³. However, the official statistics on the number of inspections does not take into account cases of administrative offences, which are prosecuted by administrative bodies directly without inspections as well as on surprise inspections, test purchases, etc.

In 2020, the number of SMEs will unavoidably decrease further, many businesses will be bankrupt and close down. According to surveys conducted by Chamber of Commerce and Industry of Russia, by early summer every third enterprise in the SME segment can be shut down⁴. The number of court verdicts on bankruptcy of individuals and individual entrepreneurs has been growing: January–March 2020 saw an increase by 68% of such verdicts against the same period of 2019⁵. However, experts note⁶ that only a small part of them account for individuals declared bankrupt because of the coronavirus outbreak. Predominantly, they are those who was bankrupt before the crisis. Bankruptcies triggered by the crisis will be reflected in statistics later.

The crisis reveals itself in the form of breakneck demand contraction on the back of both severe decline of population's incomes and in supply collapse because many companies will go bust due to cash gap. Adverse effect can be triggered by tightening of control over enterprises aimed at combating large-scale dismissals⁷. Without resort to urgent measures designed to prop up entrepreneurs, the crisis will render null all efforts taken by authorities aimed at developing the SME sector and improvement of business environment.

On the basis of the sectoral makeup for the previous years (*Table 1*) one can assess the share of would-be most seriously affected industries⁸: it accounts for around 11% of the total number of SMEs. Taking into account industries' indicators where above mentioned multiplicative effect (simultaneous and interrelated decline of demand and supply) is revealed the most, we will have to acknowledge that extra 64.2% of small and medium-sized firms (3.4 million) will suffer from coronavirus.

1 Antonova M.P., Barinova V.A., Gromov V.V., Zemtsov S.P., Krasnoselskih A.N., Milogolov N.S., Potapova A.A., Tsareva Yu.V. The development of small and medium-sized entrepreneurship in Russia in the context of national project implementation. Moscow: "Delo" Publishers RANEP, 2020. 88 p.

2 Federal Law dated 25.12.2018 No. 480-FZ "On Introduction of Amendments in the Federal Law 'On Protection of Rights of Legal Entities and Individual Entrepreneurs During the Implementation of State Supervision and Municipal Control'" and Art. 35 of the Federal Law "On Water Supply and Wastewater Disposal".

3 Vladimir Putin supported moratorium on scheduled inspections of small and medium businesses. URL: <https://www.kommersant.ru/doc/4302091>

4 Ageeva O., CCI warned about the risk of bankruptcy of 3 million entrepreneurs due to virus, RBC, URL: <https://www.rbc.ru/economics/21/03/2020/5e7490569a7947467949c77d21032020>

5 Unified Federal Register of information on bankruptcies. <https://fedresurs.ru/>

6 Number of individual bankruptcies in Russia has gone up by 70%. URL: <https://www.rbc.ru/finances/07/04/2020/5e8b25379a794778c10ab0f3>

7 Mikhail Mishustin has warned about the inadmissibility of dismissals under the pretext of coronavirus. URL: <https://www.kommersant.ru/doc/4298985>

8 The list of the worst-hit by coronavirus sectors of economy has been determined. FTS of Russia. URL: https://www.nalog.ru/rn77/news/activities_fts/9704633/

4. Development Trends of Small and Medium-Sized Enterprises

Table 1

Number of SMEs in the most seriously affected industries

Type of activity	Number of SMEs in 2018	%
Total number of enterprises in SME sector	5 304 409	100
Worst-hit industries, of which:	591 478	11.2
Hotels and catering	135 177	2.5
Education	26 290	0.5
Culture, sports, recreation and entertainment	206 546	3.9
Other services	223 465	4.2
Industries that can suffer as a result of multiplicative effect, of which:	3 403 121	64.2
Wholesale and retail commerce; repairing of motor vehicles and motorcycles	2 081 011	39.2
строительство	458 895	8.7
Operations with real estate	356 686	6.7
Transportation and storing	493 383	9.3
Electricity, gas and steam supply; air conditioning	13 146	0.2

Source: Rosstat¹.

Simultaneously, contrary to adverse trends the number of SMEs for March 2020 went up by approximately 34 thousand according to the Unified Register of SMEs. As a comparison, over March 2019, the number of SMEs increased by 40,000 firms (Table 2). According to Anton Sviridenko², growth recorded this year is explained by the fact that the registry of SMEs is augmented with the information about those entities that by mistake has not been entered into the registry previously due to lack of information on the average number of employees in the firm. Every month information on legal entities and individual entrepreneurs that have terminated their activities is stricken off the registry and information on the newly registered firms is entered. It is rather easy for individual entrepreneur to shut down (it takes 7 working days) but it may take several months for a JSC to shut down. That is why, the succession of bankruptcies that have swept over the SMEs sector will be reflected in the register with a lag. Besides, the FTS of Russia has entered information on enterprises delivering social services³. Furthermore, the register's update happens only once a year in August, when entities that terminated their activities and failed to submit financial reporting (on average number of employees and/or on paid taxes) and stopped corresponding to the criteria for being SME are stricken off the registry.

Despite efforts taken by the authorities aimed at the entrepreneurship promotion, the share of start-up businesses and owners in Russia is consistently low (4–6% of workforce) in the vast majority of regions, although it has grown over last decade⁴. During the crisis that share of entrepreneurs can decline. Having said that, the proportion of reluctant entrepreneurs and self-employed who previously lost a job will increase in the structure of SMEs.

1 Rosstat. Small and medium-sized entrepreneurship in Russia. URL: http://old.gks.ru/wps/wcm/connect/rosstat_main/rosstat/ru/statistics/publications/catalog/doc_1139841601359

2 Councilor to business ombudsmen of Russia explained growth of the number of SMEs by nearly 20 thousand for a month. GKDZH <https://tass.ru/msp/8218199>

3 FTS entered in the register of SMEs information on enterprises delivering social services. URL: https://buh.ru/news/uchet_nalogi/109037/

4 Global entrepreneurship monitor. URL: <https://www.gemconsortium.org/>

Table 2

Dynamic of the number of SMEs in Russia

	10.03.2019	10.04.2019	10.03.2020	10.04.2020
Number of SMEs (legal entities and IE), thousands of which:	6107.8	6141.3	5 960.4	5 979.9
micro firms	5840.0	5874.5	5720.5	5740.8
Small-sized enterprises	249.1	248.1	222.9	222.1
Medium-sized enterprises	18.7	18.7	17.0	17.0

Turnover

The share of the SME sector in GDP for 2018 shrank by 2% (down to 18% against 22% in 2017). Furthermore, turnover of the SME sector (including price fluctuations) has been sustainably growing from 2014. However, growth was on the back of turnover increase in micro-businesses and small-sized enterprises, and turnover of medium-sized firms in 2017–2018 was lower than that seen in 2015–2016. It is expected that in 2020 SMEs will demonstrate turnover lower than that reported over recent years. Moreover, it is worth assuming that in the current year SME sector will decrease more than the economy as a whole.

There were no significant changes in turnover industrial structure over recent year. The proportion of commerce and repairs slightly declined while the share of internet services went up¹. SME's leading businesses are: wholesale and retail commerce (60.4% of total turnover), manufacturing (10.4%) and construction (7.5%). In 2020, a significant growth of internet-based services is expected because amid lockdown demand growth fell on delivery services, various on-line services, information technologies, distance learning, and telemedicine. Provision of entertainment services, services of coaches, etc. has also switched over in on-line. Payment for rendered services may not be reflected in the official statistics.

All businesses that have missed a change to switch over to provision of services and good online (or those whose business model is on the whole tied up to exclusively personal rendering of services), to date are subject to high risk of bankruptcy. Some organizations reported decrease in earnings by 90% (Table 3). Data released by online accounting service "Moe delo" demonstrate that turnover of small businesses already plummeted in March 2020. Over H2 of March customers' accounts with "Moe delo" received 31% less assets than during the same period of 2019². Having said that, experts of Sberbank registered in March a strong growth of spending on telecommunications equipment (+50.3%), drugs and medical products (+22.19%), household appliances and electronics (+21.2%), as well as alcohol (+8.9%). They also confirmed contraction of spending on entertainment (-78.1%), sports (-52.6%), and clothing (-51%). The volume of daily expenses decreased by nearly two-fold during the first non-working week in Russia³. Consequently, the average weekly turnover of small and medium businesses declined during three weeks of lockdown and non-working days by 21% compared to February-March⁴.

1 Antonova M.P., Barinova V.A., Gromov V.V., Zemtsov S.P., Krasnoselskih A.N., Milogolov N.S., Potapova A.A., Tsareva Yu.V. The development of small and medium businesses in Russia in the context of the national project implementation. Moscow: "Delo" Publishers RANEPa. 2020. 88 p.

2 Expert Online. "Imitation of support". 2020. URL: <https://expert.ru/expert/2020/15/imitatsiya-podderzhki/>

3 Russians' spending during the first week of lockdown fell by nearly two-fold. URL: <https://forbes-ru.turbopages.org/s/forbes.ru/newsroom/finansy-i-investicii/397255-rashody-rossiyan-v-pervuyu-karantinnuyu-nedelyu-upali-pochti-v>

4 Banks have assessed the decline in small businesses turnover for three weeks of lockdown. URL: <https://www.rbc.ru/finances/21/04/2020/5e9dd43b9a794702f059b271>

4. Development Trends of Small and Medium-Sized Enterprises

According to data released by Sberbank (*Table 3*) consumer demand during the week from April 6 through 12, went up only in four spending categories: digital products, foodstuffs, liquor stores and telecommunications equipment.

Table 3

Change in consumer demand in Russia

Spending category	Deviation for 30.03–05.04	Deviation for 06.04–12.04
Tourist agencies	-96.9	-97.4
Jewelry	-97	-94.7
Air tickets	-92.6	-93.7
Clothing, footwear and accessories	-94.2	-93.1
Beauty salons/Massage/SPA	-94.8	-92.4
Sports	-90.7	-91.7
Books/Cinema/Photo/Video	-74.5	-88
Hotels	-85.3	-87.5
Education	-90.6	-87.3
Parking and garages	-87.2	-85.4
Local transportation	-77.1	-75.8
Beauty and health products	-80	-74.9
Entertainment	-85.2	-72.7
Cafe/Bars/Restaurants	-75.6	-71.5
Furniture and interior items	-81	-69.2
Road tolls	-66.6	-67.6
Taxi	-70.9	-66.7
Medical services	-67.9	-66.2
Flowers and gifts	-76.3	-63.7
Stationary	-79.5	-62.1
Computers and SW	-37.1	-51.7
Repair services	-61.6	-48.5
Household appliances and electronics	-58.2	-48.1
Hobby and pursuits	-65.4	-47.6
Contract services	-75.8	-41.6
Lease of motor vehicles	-42.6	-36.9
Spare car parts and accessories	-68.5	-31.6
Fuel/Auto maintenance	-31	-26.4
Pets	-17.3	-21.2
Department stores	-32.5	-20.2
Telecommunications services	-13.9	-17.2
Drugs and medical products	15.5	-6.6
Goods for construction and repairs /DLV	-33.6	-5.2
Digital goods	17.4	1.5
Food stores	9.2	10.1
Wine stores	31	32.1
Telecommunications equipment	-3.9	36.7

Source: Sberbank¹.

Coronavirus-induced paid days-off from March 30 till April 30, 2020 with retention of full wages increases cash gap in firms. According to assessments of consulting firm “Fin Expertise”, paychecks in SME sector should amount to Rb 0.5 trillion for the period². Far from every firm has saved necessary funds during the pre-crisis period.

1 Sberbank. URL: https://www.sberbank.ru/ru/press_center/all/article?newsID=488ad48f-705b-4bd9-b3e5-b3ed502914fc&blockID=1303®ionID=77&lang=ru&type=NEWS

2 FinExpertiza. <https://finexpertiza.ru/press-service/researches/2020/predpriyatiya-poteryayut-na-zarplatakh-124-mld/>

On the basis of the SME's industrial structure of previous years one can estimate the share of the worst-hit businesses. It accounts for nearly 2.6% of SME turnover (*Table 4*). However, Turnover decline in certain businesses spreads multiplicative effect to other businesses¹. For instance, optimistic scenario envisages SME's turnover decline by Rb 1.9 trillion or by 2.6% of turnover of the entire sector. However, this estimate does not pertain to industries that will be directly affected by the crisis. However, shut down of a firm with turnover of Rb 1 mn in the worst-hit business can result in shut down of businesses in related industries with total turnover amounting to Rb 2.9 mn (on average). Consequently, taking into account aforementioned multiplicative effect, the total losses incurred by SMEs will exceed Rb 5.7 trillion or 7.5% of the sector. Having said that, branches that can suffer from multiplicative effect account for around 77% of the entire SME turnover. That is why, extension of lockdown measures for another several months can result in a severe decline in turnover of small and medium businesses.

Table 4

Turnover of SMEs in the most crisis-prone businesses

Type of activity	SME turnover in 2018, Rb bn	%	Multiplier per 1 mn output	Multiplicative effect in other businesses, Rb mn
Total businesses in SME sector	75782.6	100	1	
Worst-hit businesses, of which:	1963.1	2.6		5705
Hotels and catering	1169.1	1.5	2.873	3358.8
education	53.3	0.1	2.423	129.1
Culture, sports, recreation and entertainment	367.1	0.5	3.137	1151.6
Other services	373.6	0.5	2.852	1065.5
Businesses that can be affected as a result of multiplicative effect, including:	58291.5	76.9		
Wholesale and retail commerce, repairing motor vehicles and motorcycles	44802.2	59.1		
construction	6603.9	8.7		
Real estate operations	3369.9	4.4		
Transportation and storage	3133.7	4.1		
Electricity, gas and steam supply; air conditioning	381.8	0.5		

Employment

The number of employed in the SME sector in 2019 contracted compared to 2017–2018 by 0.5 mn persons (from 19.3 mn to 18.8 mn); this was done mainly at the expense of the reduction of the number of workers in small and medium-sized enterprises (and not IE or micro firms). This is an indirect demonstration by companies of their wish to minimize taxes. Moderate growth of population's incomes shown in 2014 as well as contraction of incomes reported in early 2020 will inevitably lead to further reduction of headcount in SME sector.

In March 2020, the number of employed in SMEs has contracted by 18 thousand persons (or by 28 thousand persons if we take into account individual entrepreneurs who have no hired workers). The number of employed in SME was

¹ Evdokimov D.Yu., Ponomarev Yu.Yu. Sector-wise analysis of coronavirus spread: Intersectoral relations and multiplicative effects. Moscow: Gaidar Institute, 2020. 14 p. URL: https://www.iep.ru/upload/iblock/e2a/09_111_9_COVID_19_industry.pdf

4. Development Trends of Small and Medium-Sized Enterprises

falling from August 2018 even before the outbreak of the coronavirus pandemic (Fig. 1). For comparison: contraction of the number of employed in SME in March 2019 came to 5 thousand.

In Russia a significant number of employed that could be part of the entrepreneurship sector stays in the shadow sector. According to Rosstat data, in 2019, the share of employed in the informal sector constituted 21.3% of the total number; whereby their number is growing from 14.3 mn persons in 2017 to 15.3 mn in 2019. This is due to strengthening of state and tax control. Against the backdrop of economic recession and decline of population's incomes, businessmen even more so will go to the informal sector, carry their employees to the unreported employment or to the self-employed status. If the situation with coronavirus pandemic does not improve in the near future, the number of employed in the informal sector and its share this year will presumably increase by several million persons—especially due to the potential ruin of more than 3 mn businesses. Previous periods of demand contraction also led to an increase in the number of employed in the informal sector by several million persons (11.5 mn in 2010 against 15.3 mn in 2019).

On the basis of the structural makeup for the previous years we can estimate the share of businesses that will be worst-hit due to coronavirus pandemic. It constitutes around 5.5% of the total number of employed in SME sector (Table 4). However, reduction in certain businesses will produce multiplicative effect in other businesses with the headcount of 2.36 mn persons or 12.2% of the total number of employed in the sector. And according to the most pessimistic scenario, in addition to that businesses with pronounced multiplicative effect will also suffer with the headcount of more than 57.4% (11 mn persons).

Crisis growth of unemployment this year can in large measure be explained by stuffing cuts or by termination of businesses in SME sector. Due to features of the Russian labor market model¹, in the wake of the crisis medium-sized and large companies and moreover budget organizations to a far lesser degree are ready for dismissals than to cut wages, shifting to half-pay, furloughing or even carrying to the informal sector. The major part of the population receives wages of a fixed amount and variable bonuses. Precisely these bonuses will be cut. Real employment reduction will happen in micro- and small businesses, however even wherein employment will be resurging because as was indicated above there will be forced entrepreneurs.

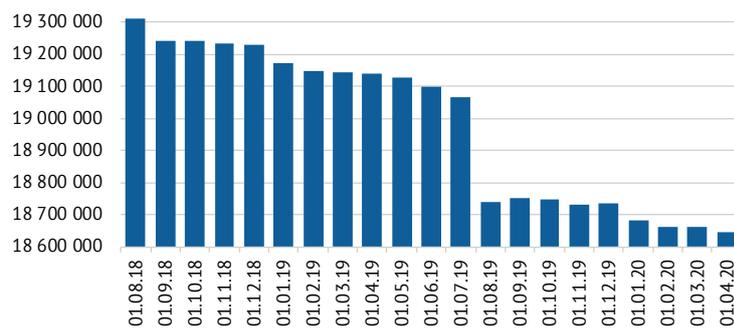


Fig. 1. Dynamic of the average headcount in SME sector in Russia

Source: FTS of Russia (FTS of Russia. Unified Register of small and medium businesses. URL: <https://ofd.nalog.ru/about.html>).

1 Gimpelson V. E., Kapelyushnikov R.I. Russia labor market model: testing by crisis // Journal of the New Economic Association. 2015. Vol. 26. No. 2. P. 249–254.

Table 5

Average headcount in SME sector in the most prone to crisis businesses

Type of activity	Number of employed in 2018, thousand persons	%	Multiplier per person	Multiplicative effect in other businesses, Rb mn
Total number of businesses in SME sector	19331.9	100	1	
Worst-hit, including:	1068.5	5.5		2358.6
Hotels and catering	720	3.7	1.896	1365.1
education	65	0.3	2.448	159.1
Culture, sports, recreation and entertainment	124.2	0.6	3.024	375.6
Other services	159.3	0.8	2.88	458.8
Businesses that can be affected as a result of multiplicative effect, including ix:	11093.6	57.4		
Wholesale and retail commerce, repairing motor vehicles and motorcycles	6516.7	33.7		
construction	1843.9	9.5		
Real estate operations	1252.3	6.5		
Transportation and storage	1316.9	6.8		
Electricity, gas and steam supply; air conditioning	163.8	0.8		

* * *

Small and medium-sized companies to a much greater extent than large ones are exposed to external shocks, react harder to growing transaction costs and in the wake of economic crisis are first to be hit. The 2020 crisis can force many businesses to terminate their activity, which, in its turn, can undermine not only economic sustainability but the ground of the long-term economic development. In Russia, the number of entrepreneurs is customary low, however they carry out paramount functions in the economy ensuring regional development¹, sustainable employment, decreasing poverty in the most depressed territories, providing consumers access to a wide specter of goods and services, promoting transfer of technologies.

Within pessimistic scenario, we can expect a severe contraction in the sector, exit of active business or final transition into informal sector of half of SMEs (around 3 mn firms and IE) and reduction of employment in the sector by several millions of persons.

Moreover, current crisis will change the employment structure in SME sector and create possibilities for its growth in certain businesses: including digital one, logistics, online-commerce, etc. The share of these businesses was growing in the pre-crisis period². There is a view that digitalization and robotization in the economy, which accelerated amid crisis and lockdown³ will significantly affect the employment structure.

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3 Zemtsov S., Barinova V., Semenova R. The Risks of Digitalization and the Adaptation of Regional Labor Markets in Russia // Foresight. 2019. Vol. 13. No. 2 (Eng).

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