MONITORING OF RUSSIA'S ECONOMIC OUTLOOK:

TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

No. 10(71) May 2018

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

Editorial board: Sergey Drobyshevsky, Pavel Kadochnikov, Vladimir Mau and Sergey Sinelnikov-Murylev

Editor: Vladimir Gurevich

Monitoring of Russia's Economic Outlook: trends and challenges of socio-economic development. 2018. No.10(71). May / Knobel A., Tishenko T., Uzun V., Firanchuk A., Tsukhlo S. Edited by: V. Gurevich, S. Drobyshevsky, P. Kadochnikov, V. Mau, and S. Sinelnikov-Murylev. Gaidar Institute for Economic Policy, Russian Presidential Academy of National Economy and Public Administration. 23 p. URL: http://www.iep.ru/files/text/crisis_monitoring/2018_10-71_May_eng.pdf

The reference to this publication is mandatory if you intend to use this material in whole or in part.

The makeup of Russia's new Cabinet of ministers has unsurprisingly eclipsed the economic agenda in recent days, against the backdrop of record oil prices since 2015 (leading to an abnormal price rise in Russia's retail sector, thereby forcing the new government to bring down motor fuel excise taxes) as well as trade talks between the world's two biggest economies.

The trade talks ended with China's agreement to increase imports of U.S. products by $200bn a year (in response to the U.S. promise to not to create new tariff barriers on China's products). The bilateral agreements, if observed, would definitely affect the interests of third countries whose companies are or wish to be present in the Chinese market.

Russian suppliers are potentially sensitive to U.S. plans to increase considerably the presence of its agricultural produce in China and, most importantly, to an alleged agreement to ramp up massively its energy exports. While this implies that Russian farmers will, at least, not lose their today's position (China grudgingly let Russian agricultural produce into its market), it also means, as one can easily guess, that U.S. liquefied natural gas (LNG) will actively compete, including with Russia's LNG, in the energy market. While such competition is still unlikely in Europe due to price advantages of Russian pipeline gas, U.S. LNG will actively compete with Russian LNG in the Asian market, particularly with regards to multibillion projects yet to be kicked off in Russia's northern and eastern regions. A comparison between them and their U.S. counterparts is pointless here: China will now compare hundreds of millions of dollars worth of potential advantage of purchasing Russian gas with half-trillion dollar sales of Chinese goods in the United States. Given the privileges that China is prepared to confer on the United States, U.S. shale gas in the market will enjoy political advantages which Russia cannot afford to ignore in its energy, budget and economic strategy as a whole.

This is relevant from various perspectives as well as due to the undying reliance of the Russian economy on oil and gas revenues. According to our experts' analysis of the Russian federal budget Q1'18 execution, oil and gas revenues increased to 45.6% (compared with 41.8% in Q1 2017). The revenues contributed largely to the growth in the federal budget revenues (adding 0.5 p.p. to what was reported in January–March of 2017). At the same time, oil and gas revenues contracted from 10.3% to 9.9% of GDP with a Rb 100bn rise in nominal terms. The federal budget expenditure dropped both in nominal terms (by more than Rb 150bn) and as a percentage of GDP. In the end, a federal budget deficit – 0.9% of GDP in the first three months of 2017 – gave way to a surplus representing 1.8% of GDP. The surplus, however, was driven exclusively by an excess of the actual oil price over the base oil price: excluding extra oil and gas revenues, the federal budget would have run a deficit of 1.5% of GDP.

The structure of federal budget revenues also reveals the reliance on resource-based industries and foreign trade trends. Revenues from the mineral extraction tax make up the majority of the federal budget revenues, and almost the same amount comes from foreign trade revenues as well as VAT and excise duties on imports. A positive foreign trade balance determines largely a positive balance of payments. The balance of services (representing one fifth of Russia's total foreign trade), however, is negative in the foreign trade turnover.

Overall, Russia's foreign trade position was partly on its way to recovery in 2017: exports of services climbed 14% (to $57.8bn) as imports of services were up 19% (to $88.9bn). The pre-crisis values, however, are yet to be reached: exports and imports at 2017 year-end stood at 82% and 69%, respectively, compared with 2013. EU countries – accounting for 47% of imports and 39% of exports – remain Russia's key partners in the services market. The share of Ukraine in the turnover was declining as that of Turkey increasing.

When analysing the objective of increasing exports of services to $100bn by 2024, as set out in a presidential executive order of May, our experts point out that it can be achieved through an annual average growth rate of 9%. The experts point to the fact that the previous year's growth was mainly a recovery growth, concluding that the sought-for growth rates can hardly be achieved if exports of all kinds of services are evenly increased. Analyzing the structure of exports, the experts classify, conventionally, exports into conservative services (a possible below-average growth), baseline services and progressive services (above-average growth). Conservative services refer to financial and insurance services (facing growth constraints induced by sanctions) as well as transport services (linked to heavy investments), and baseline and progressive services refer to telecommunication services, intellectual property fees, etc. The predicted estimate is that the sought-for result can be achieved through an annual growth rate of 9% for exports of baseline services, 4–5% for exports of conservative services and 12–15% for exports of progressive services.

Gaidar Institute researchers have analyzed the data of surveys of industrial enterprises' preferences and plans regarding imports of machinery, equipment and materials. While mentioning an extensive list of Russia's Ministry of Industry and Trade, containing products which state-owned companies are not allowed to purchase abroad without consent of the governmental import substitution commission, the researchers note a positive response of Russian manufacturers of the goods on the list. With or without such administrative measures in place, the Russian industry is showing or has to show an increased interest in buying domestically manufactured machinery and equipment, as evidenced by the findings of surveys in 2011 and 2018, according to our experts.

Despite rouble's devaluation and sanctions, Western Europe keeps the lead in supplying machinery and equipment for Russian enterprises (77% of purchases in 2011 and 71% in 2018). The position of Russian suppliers, coming in second after Western European ones, was not improved during that time. However, the share of enterprises purchasing U.S. and Japanese equipment dropped from 33 to 22%. The share of suppliers from China and India increased from 19 to 35%. The share of suppliers from CIS countries fell, mostly in response to curtailing of Russia-Ukraine trade relations.

The foregoing data, however, show what was actually purchased. With regards to Russian enterprises' preferences, half of them reported in 2018 that they would like to purchase Russia-made equipment (their number has nearly doubled over the past seven years), whereas the share of enterprises wishing to buy U.S. and Japanese products fell from 40 to 27%. West European machinery and equipment remained the most preferred products (among 69% of enterprises). The least preferred products (among 8% of enterprises) were products from China and India (the same holds true regarding products from CIS countries), and also there was a clearly serious disconnect between products that Russian enterprises would like to buy and what they ultimately purchased.

Lastly, there are representative data regarding enterprises' investment plans – the countries in which they planned to purchase machinery and equipment in 2011 and in which they plan to do so in years to come. While West European products used to rank way ahead of those from other countries (72% vs. 50% of enterprises intending to buy Russian equipment), there was an equal division of preferences (65%) among enterprises in 2018. The authors note that this suggests that the Russian policy of import substitution of investment goods has been successful, at least in terms of quantity. The share of enterprises planning to buy equipment in China and India has doubled (to 35%), thereby indicating they are moving towards a cheaper, available, albeit lower-quality, equipment. Furthermore, enterprises are well aware of the disconnect between what they want (prefer) and what they plan to buy – 35% of them plan to buy a cheaper equipment while only 8% would like to do so (18% and 4% in 2011). There is also, albeit far less evident, a distinction between preferences and plans with regards to Russian products.

The greater presence in foreign markets and less addiction to agriculture imports are among those many positive signs reflected in the National Report on the 2017 implementation of the Agriculture Federal-State Program 2013–2020. According to the experts, however, not all of the reported benefits seem to be substantiated and, likewise, not all of the eligibility criteria for providing government support to agricultural producers are transparent enough.

The experts believe that the program's indicators are very difficult to achieve in industries where "a crumbling private subsidiary farms sector" is the key producer. However, instead of making a serious incisive analysis, the Report confines itself to traditional references to weather conditions, delays in preparing regulatory documents as well as comparisons with corrected indicators. The experts opine that the federal-state insurance program against bad crop years has been a total failure, although the problem has long been recognized. The Report's analysis of the implementation of the federal-state milk production program's indicators seems odd: while milk production has been nearly halved since 1990, facing low-level stagnation in recent years, the program's target indicator has reportedly been achieved at 100.1%. This happened because the 2017 indicator was corrected. The target indicator of the original version of the program adopted in 2012 has been achieved at 88%.

In the past year, the federal-state program received nearly Rb 250bn worth of federal budget appropriations (the Report does not cover the spending of regional budgets' agricultural appropriations). Not all (around Rb 15bn) of the appropriations were spent. Around Rb 10bn were allocated to support agribusiness small enterprises. Small enterprises, however, received credit subsidies nearly five times less than in 2015, and their share in such subsidies tumbled devastatingly to 2%, 10 times lower than the share set by the government. This was explained by "authorized banks' failure to deliver registers of potential borrowers to Minselkhoz (Russia's Ministry of Agriculture)" and by other alike reasons. Both credit subsidies and subsidies to recover a part of investment were obviously concentrated around some big agribusiness holding companies. Lastly, according to the authors, it was odd enough to see lack of action, when no grain purchases were made into the State Intervention Fund in 2017 amid a record crop and price fall, but instead the grain was sold from the Fund and no support was provided. The experts note that the Report explains those measures were taken due to concerns that further accumulation of reserves could have led to an increase in federal budget expenditure.

1. EXECUTION OF THE FEDERAL BUDGET IN JANUARY–MARCH 2018: THE SHARE OF OIL AND GAS REVENUES UP

T.Tishenko

In Q1 2018, the federal budget revenues exceeded the revenues seen during the same period of 2017. Oil and gas revenues rose while oil and gas income fell. Budget expenditure decreased against January–March 2017 which ensured the federal budget surplus.

According to the data released by the RF Treasury that the federal budget revenues went up by 0.5 p.p. or by Rb 441.9 billion (*Table* 1) compared to the same period last year. This was due to oil and gas revenues Rb 341.8billion or by 0.9 p.p. reflecting rising oil prices on Urals from 52 USD/bbl up to 65 USD/bbl. Oil and gas revenues seen in Q1 2018 constituted 33.9% of forecast annual volume.

In accordance with the new budgetary rules coming into effect, additional oil and gas revenues for January–March 2018 were computed as a difference between actual revenues and the estimated one that was based on the marker crude hit 734.8 billion rub.

Dynamics of non-oil and gas revenues in the federal budget in January–March 2018 is negative compared in shares of GDP to the same period of the previous year. Revenues shrank from 10.3% of GDP to 9.9% of GDP on the back of growth in nominal terms by Rb 100.1billion (cash execution – 22.7% of the forecast annual volume). As a result, the revenue structure of the federal budget underwent changes in favor of the oil and gas component from 41.8% in Q1 2017 to 45.6% in January–March 2018.

Table 1

MAIN PARAMETERS OF THE FEDERAL BUDGET IN JANUARY–MARCH 2017–2018

	January–March 2017		January–March 2018		Changes in 2018 compared to 2017	
	Rb billion	% of GDP	Rb billion	% of GDP	Rb billion	In p.p. of GDP
Revenues, including:	3 633.3	17.7	4 075.2	18.2	441.9	0.5
oil and gas	1 517.9	7.4	1 859.7	8.3	341.8	0.9
non-oil and gas	2 115.4	10.3	2 215.5	9.9	100.1	-0.4
Expenditures, including:	3 825.5	18.6	3 671.0	16.4	-154.5	-2.2
interest	192.6	0.9	205.2	0.9	12.6	0.0
non-interest	3 632.9	17.7	3 465.8	15.5	-167.1	-2.2
Surplus (deficit) of the federal budget	-192.2	-0.9	404.2	1.8	596.4	2.7
Non-oil and gas deficit	-1 710.1	-8.3	-1 455.5	-6.5	254.6	1.8
GDP (in current prices, Rb billion)	20 550		22 351			

Sources: Ministry of Finance, Federal Treasury, Rosstat, own calculations.

The federal budget expenditures in Q1 2018 contracted against January–March of the previous year both in nominal terms (by Rb 154.4 billion) and in terms of share in GDP (by 2.2 p.p. to 6.4% of GDP) due to a decline in non-interest spending.

The federal budget surplus at 2018 Q1-end constituted 1.8% of GDP against 0.9% of GDP in the same period of 2017. At the same time, the non-oil and gas deficit decreased – from 8.3% of GDP to 6.5% of GDP. However, without the additional oil and gas revenues, that is, at the target crude price, the budget deficit in the first three months of the current year would have constituted Rb 330.6 billion or 1.5% of GDP, and the non-oil and gas deficit – Rb 2190.3 billion or 9.8% of GDP. Therefore, the federal budget surplus in Q1 2018 was achieved only due to the effective oil price increase over the target price. Such situation indicates the necessity to widen measures aimed at increasing the non-oil and gas revenues.

As a whole, in January–March 2018 tax revenues (*Table 2*) grew by 0.7 p.p. of GDP or by Rb 458.2 billion relative to the first quarter of the previous year. The largest growth in tax revenues is noted to proceed from the mineral extraction tax MET) – 0.7 p.p. of GDP. Revenues generated from domestic and import VAT also increased in the first quarter of 2017 with 0.1 and 0.2 p.p. of GDP, respectively. Receipts generated by the corporate profit tax also grew by 0.2 p.p. of GDP. Receipts generated by foreign economic activity increased by 0.1 p.p. of GDP to 3.2 p.p. of GDP in January–March 2017.

Table 2

MAIN TAX REVENUES IN THE FEDERAL BUDGET IN JANUARY–MARCH 2017–2018

	January–March 2017		January–March 2018		Changes in 2018 compared to 2017	
	Rb billion	% of GDP	Rb billion	% of GDP	Rb billion	In p.p. of GDP
Total tax revenues. including:	3361.3	16.4	3819.5	17.1	458.2	0.7
Profits tax	147.8	0.7	208.3	0.9	60.5	0.2
VAT on products sold in RF territory	854.8	4.2	954.7	4.3	99.9	0.1
VAT on products imported into RF territory	421.3	2.1	505.9	2.3	84.6	0.2
Excises on goods produced in RF territory	273.0	1.3	158.7	0.7	-114.3	-0.6
Excises on goods imported into RF territory	14.2	0.1	16.8	0.1	2.6	0.0
Mineral Extraction Tax	1016.3	4.9	1262.2	5.6	245.9	0.7
Revenues from foreign economic activity	633.9	3.1	712.9	3.2	79.0	0.1

Source: Federal Treasury (updated information), own calculations.

Revenues generated by excise duties on domestic products significantly shrank in Q1 2018 compared to the same period of 2017 due to a fall in revenues from tobacco products (Rb 127.2 billion). The fall constitutes 0.6 p.p. of GDP or Rb 114.3 billion. Dynamic of revenues generated from import excise duties demonstrates no change. Dynamics of the federal budget cash execution for Q1 2018 is positive regarding main revenues, except excise duties. Budget execution constituted: corporate profit tax – 25.8%, domestic and import VAT – 28.7% and 22.1%, respectively, exports customs duties – 24.1%, domestic and import excises – 16.5% and 18.2%, respectively from estimated annual volumes.

The federal budget expenditures in January–March 2018 decreased by 2.2 p.p. of GDP against the same period of 2017 (*Table 3*) due to a decrease both in "social policy" financing by 2.2 p.p. of GDP or by Rb 368.0 billion, and in line item "pension provision" by Rb 419.8 billion. Decrease in the federal budget expenditures on pensions was triggered by the Pension Fund own income growth, including insurance contributions up to Rb 123.9 billion, and decline in inter-budgetary transfers amounting to Rb 340.0 billion.

Table 3

EXPENDITURES OF THE FEDERAL BUDGET IN JANUARY–MARCH 2017–2018

	January–March 2017		January–March 2018		Changes in 2018 compared to 2017	
	Rb billion	% of GDP	Rb billion	% of GDP	Rb billion	In p.p. of GDP
Total expenditures including:	3 825.5	18.6	3 671.0	16.4	-154.5	-2.2
Nationwide issues	195.1	0.9	243.3	1.1	48.2	0.2
National defense	729.2	3.5	756.3	3.4	27.1	-0.1
National security and law-enforcement	372.7	1.8	396.8	1.8	24.1	0.0
National economy	341.6	1.7	356.4	1.6	14.8	-0.1
Housing and utilities	16.8	0.1	34.7	0.1	17.9	0.0
Environment protection	34.8	0.2	27.5	0.1	-7.3	-0.1
Education	135.5	0.7	171.3	0.8	35.8	0.1
Culture and cinematography	15.4	0.1	22.1	0.1	6.7	0.0
Health care	61.1	0.3	82.2	0.4	21.1	0.1
Social policy	1520.7	7.4	1152.7	5.2	-368.0	-2.2
Physical culture and sports	6.6	0.0	7.0	0.0	0.4	0.0
Mass media	11.4	0.1	13.1	0.1	1.7	0.0
Government debt servicing	192.6	0.9	205.2	0.9	12.6	0.0
Inter-budgetary transfers	192.1	0.9	202.4	0.9	10.3	0.0

Source: Federal treasury (investigative information), own calculations.

In comparison with the first three months of the previous year, dynamics of the budget expenditures in Q1 2018 correlate with the budgetary policy priorities aimed at increasing financing line items health service and education (growth by 0.1 p.p. of GDP), amid holding back the defense spending (decrease by 0.1 p.p. of GDP) and law-enforcement activities. Increased financing on budget line "Nationwide issues" by 0.2 p.p. of GDP or by Rb 48.2 billion was driven by the increased spending on fundamental and applied research (by Rb 16.6 billion), election campaign (by Rb 12.9 billion), international co-operation (by Rb 5.2 billion), support of financial, fiscal and customs authorities and financial services authorities (by Rb 5.2 billion). Regarding other items of the federal budget expenditures budget allocations over Q1 2018 changed in the range of 0.1 p.p. of GDP or remained at the levels of the same period 2017.

Dynamics of cash execution of the federal budget expenditures at 2018 Q1-end constituted 21.5% which is by 1.7 p.p. less than the budget constraints seen in the same period 2017. Federal budget funds were most generously spend on the following budget lines: "Cinematography" (62.8%), "Migration policy" (56.6%), "Sampling, processing, storage and protection of the donor blood and its components» (39.2%). Significant arrears in cash execution of the federal budget is noted in the following lines: "Other issues of the national security and law enforcement" (1.5%), "Economic preparedness activity" (1.7%), and "Preschool education" (2.5%).

Flow of the federal budget funds taken as a source to cover budget deficit over January–March 2018 the following dynamic was noted:

- volume of securities placed on domestic markets constituted Rb 472.3 billion or 32.6% of annual volume, amid redeemed securities amounting to Rb 461.4 billion or 73.1% of annual volume.
- volume of bonds placed on foreign markets constituted Rb 229.6 billion amid redeemed volume amounting to Rb 175.5 billion;
- budget loans were not extended. Meanwhile, repayment of budget loans came to only 3.2% of the fixed annual volume in the amount of Rb 39.6 billion;
- budget loans extended to fill accounts balance of RF constituents amounted to Rb 186.5 billion, repayment of previously extended loans to regional budgets constituted Rb 42.9 billion.

By the end of Q1 2018, the state domestic debt decreased by Rb 13.9 billion and by 1 of April 2018 amounted to Rb 8675.7 billion while the volume of the external debt grew by $ 1565.9 million up to $ 51393.2 million.

On the back of the debt market participants view, the Finance Ministry of Russia in April 2018 decided not to have auctions on federal loan bonds because of the increased financial volatility on the markets. The Finance Ministry projects that the high financial volatility is not going to last long[1], while the demand for the sovereign Russian debt will be secured by the Russian borrowers. Nevertheless, judging by the results of the federal loan bond auctions, from 18 April to 15 May 2018, a decrease in demand can be observed for certain categories of bonds.

Through January–March 2018, the volume of the National Wellbeing Fund grew by Rb 19.9 billion, up to Rb 3772.8 billion or by $ 65.9 billion due to NWF currency revaluation.

By the end of Q1 2018, dynamic of the federal budget main parameters on the whole is positive. There are no risks for budget sustainability.

1 Information released by the ministry of Finance of Russian federation:https://www.minfin.ru/ru/press-center/?##ixzz5Fi556jUL

2. FOREIGN TRADE TURNOVER IN SERVICES IN 2017: RECOVERY GROWTH

A.Knobel, A.Firanchuk

Russian exports of services in 2017 grew by 14%. To achieve the export target set by the President's decree of May 7, 2018 to the tune of $100 billion over the next six years, annual growth of 9% will be required. Import of services in 2017 grew by 19% mainly due to 30% increase in traveling overseas which can be linked with stabilization of ruble exchange rate and an abolishment of all air travel restrictions with Turkey.

Summarizing the results of 2017, foreign trade turnover in services grew by 17% up to $146.7 billion (in 2016 – $125.1 billion), which is slightly less than the growth ratio of the commodity turnover (+25%). As a result, the share of services in Russia's foreign trade fell by 1.0 p.p. down to 20.1%.

If commodity turnover grew on the back of simultaneous rise of imports and exports[1], then import in trade in services (+19%) insignificantly surpassed the rise of export of services (+14%).

The share of EEU countries in regional pattern of foreign trade in services grew at the expense of Belarus and decreasing share of the commonwealth of independent states. Growth can be explained by the decreasing services turnover with Ukraine for the fourth consecutive year. Share of the APEC countries after a sharp increase recorded in 2016 adjusted in the context of falling US share. Significant increase is noticeable in Turkey's share in the wake of is connected with the abolishment of air travel restrictions.

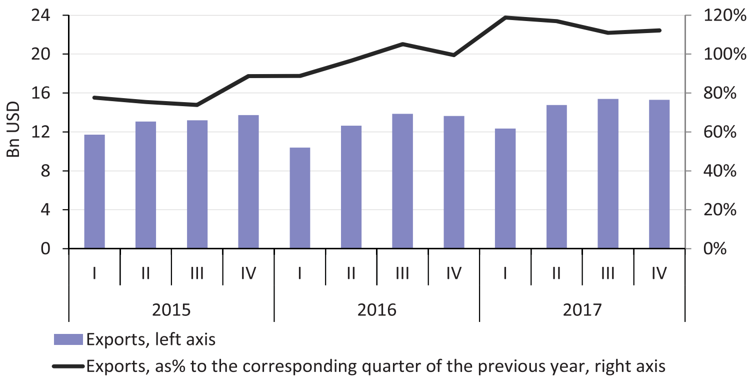

Fig. 1. Dynamic of services exports
Source: own calculations based the data released by the Central Bank.

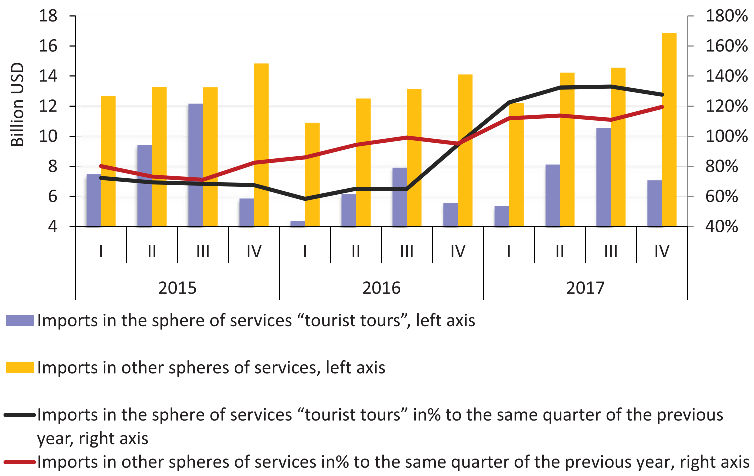

Fig. 2.Dynamics of import of services
Source: authors' calculations based on Central Bank data.

Dynamics of export and import in services.

Exports of services in 2016 stabilized after a fall commenced in 2014. In 2017 growth reco-

1 Knobel A., Firanchuk A. Russia's foreign trade in 2017. Russian economic developments. 2018. No.3 (24). P. 8–17.

vered by 14% when compared to the previous year (*Fig.1*). Volume of exports of services hit \$57.82 billion, which constituted 82% of the pre-crisis level (\$70.12 billion posted in 2013).

Dynamic of imports of services was negative from Q3 2014 through Q4 2016 (*Fig. 2*). However, in the course of all four quarters of 2017, imports of services grew by 15–22% (against the same quarter of the previous year). As a whole, imports of services constituted \$88.91 billion (+19% to the level of 2016), which is still lower that the 2013 level (\$128.4 billion).

Structures of import and export of services.

Dynamic of exports in five largest sectors of services (with shares higher than 5% from the overall exports of services) was positive. Increase of exports of "transport services" came to 16%, "other business services" – 8%, "tourist tours" – 15%, "telecommunication services" – 22%, and "construction" – 34% (*Table 1*).

Table 1

FOREIGN TRADE IN SERVICES IN THE STRUCTURE OF THE EXPANDED SERVICE CLASSIFICATION

Sphere of service	Import of services				Export of services			
	2016 , Billion USD	2017, Billion USD	Change in %	Share of services in 2017, in %	2016, Billion USD	2017, Billion USD	Change in %	Share of services in 2017, in %
Processing and tolling of commodities	0.14	0.16	15	0.2	1.61	1.53	-5	2.6
Technical maintenance and repair of goods	1.56	1.78	14	2.0	1.54	1.80	17	3.1
Transport services	11.80	14.45	22	16.3	17.12	19.81	16	34.3
Tours	23.95	31.06	30	34.9	7.79	8.95	15	15.5
Construction	3.77	4.45	18	5.0	3.56	4.77	34	8.2
Insurance and private pension funds	0.97	1.25	29	1.4	0.38	0.36	-5	0.6
Financial services	2.04	2.24	10	2.5	1.17	1.13	-3	2.0
Payments for the use of intellectual property	5.00	5.98	20	6.7	0.55	0.74	35	1.3
Telecommunications, computer and information services	5.39	5.31	-1	6.0	3.94	4.79	22	8.3
Other business services	17.45	19.37	11	21.8	11.65	12.56	8	21.7
Services for individuals and in the sphere of culture and recreation	1.02	1.44	40	1.6	0.42	0.49	17	0.9
State goods and services not applicable to other categories	1.51	1.42	-6	1.6	0.82	0.88	7	1.5
Total	74.60	88.91	19	100.00	50.55	57.82	14	100.00

Source: own calculations based on the data released by the Bank of Russia.

Dynamic of imports of the six largest sectors of services (with share higher than 5% of the overall imports of services) also demonstrated and upward trend, except imports of "telecommunications services" which barely changed (-1%) (*Table 1*). Out of the largest spheres of services imports of "tourist tours" demonstrated the highest growth – 30%. This was both due to the ruble's appreciation (+15.5%[1]), and the *abolishment of restrictions on air travel* to Turkey. Tourist flow to Turkey in the first nine months of 2017 grew eight times[2] compared to the same period of 2016.

Regional pattern of foreign trade in services.

Regional pattern of Russia's foreign trade in services with main partners is given in *Table 2*. EEU's share in 2016 increased insignificantly and amounted to 5.4% (+0.13 p.p.) due to Belarus's share growth (+0.18 p.p.).

Decrease of the CIS share was due to a downward trend in the service trade with Ukraine for the fourth consecutive year (-0.43 p.p.). In 2017, amid stable service exports (+1%) service imports from Ukraine tumbled by 35%. Over last years, service trade with Ukraine decreased fourfold – from $6.88 billion in 2013 down to $1.79 billion in 2017, while its share has decreased threefold – from 3.5% down to 1.2%. Similar deterioration of the economic ties with Ukraine is observed in the commodity turnover: its share dropped more than twice – from 4.7% in 2013 down to 2.2% in 2017[3].

The share of the European Union in service trade has dropped insignificantly (-0.93 p.p.), which has not affected the dominant role of EU: it accounts for half of Russia's imports of services (47%) and more than a third of exports of services (39%). Over last five years, the share of EU in Russia's foreign trade in services is in the range between 42.7 and 44.8%.

Trade of services with US has slightly increased (imports up 2%, exports up 5%). However, against the backdrop of more dynamic trade growth with other countries, the US share has dropped to 5.2% (-0.7 p.p.).

Out of all Russia's trade partners Turkey demonstrated the most dynamic recovery trade turnover in services. More than threefold growth of imports of services has been registered (+$2.8 billion). The share of Egypt remained at near zero level, as the air travel with that country was not reestablished in 2017.

Prospects for service exports growth

The RF President's May Executive Order set up a target of $100 billion of services exports to be achieved by 2024. That target would require 9% annual exports growth. This index is even lower than the same index reported in 2017 (14%), however it should be noted, that the last year's growth had a recovery trend. It is hardly possible to maintain the service exports growth at 9% based on equal growths of all spheres of services.

Russia's service exports pattern compared to EU service exports pattern demonstrates that the share of transport services in Russia's pattern is twice as high as than in EU service exports pattern (34% to 17% in 2016). Exports of transport services as a rule is in line with dynamics of trade turnover and passenger flow. Services volume growth achieved at such pace requires significant investments. Besides, with 50% share of air transport in exports of transport services, the last year growth reflects the dynamics of petrol prices,

1 Growth of the nominal effective ruble rate index in 2017 according to the data released by the ank of Russia.

2 According to data released by Rosturism, in January–September of 2017, 3,944,000 Russian tourists visited Turkey compared to 483,000 a year earlier.

3 Knobel A., Firanchuk A. Russia's foreign trade in 2017. Russian economic developments. 2018. No.3(24). P. 8–17.

Table 2

GEOGRAPHY OF RUSSIAN FOREIGN TRADE OF SERVICES

Region/country	Import of services				Export of services				Export turnover			
	2016, Billion USD	2017, Billion USD	Rate or growth in %	Share of region/country in 2017, in %	2016, Billion USD	2017, Billion USD	Rate of growth, in %	Share of region/country in 2017, in %	Net in 2017, Billion USD	Turnover in 2017, Billion USD	Share of region/country in 2017 in %	Change of share of a region/country in %
CIS:	5.26	5.73	109	6.4	6.68	8.07	121	14.0	2.34	13.80	9.4	-0.15
EAEU:	2.86	3.57	125	4.0	3.70	4.33	117	7.5	0.76	7.90	5.4	0.13
Armenia	0.25	0.29	114	0.3	0.31	0.37	122	0.6	0.09	0.66	0.5	0.00
Belarus	1.66	2.09	125	2.3	1.24	1.59	129	2.8	-0.49	3.68	2.5	0.18
Kazakhstan	0.70	0.97	138	1.1	1.85	1.98	107	3.4	1.01	2.95	2.0	-0.03
Kirgizia	0.24	0.23	93	0.3	0.30	0.38	128	0.7	0.16	0.61	0.4	-0.02
Ukraine	0.79	0.51	65	0.6	1.25	1.27	101	2.2	0.76	1.8	1.2	-0.42
Services not distributed between various CIS countries	0.69	0.75	109	0.8	0.29	0.65	220	1.1	-0.10	1.40	1.0	0.17
EU	36.20	41.90	116	47.1	19.74	22.45	114	38.8	-19.45	64.35	43.9	-0.93
APEC:	10.43	11.88	114	13.4	7.94	9.03	114	15.6	-2.85	20.92	14.3	-0.45
USA	4.02	4.09	102	4.6	3.38	3.57	105	6.2	-0.52	7.66	5.2	-0.71
China	2.01	2.37	118	2.7	1.96	2.39	122	4.1	0.02	4.76	3.2	0.06
South Korea	0.79	0.87	111	1.0	0.49	0.61	125	1.0	-0.27	1.48	1.0	-0.01
Japan	0.55	0.37	67	0.4	0.42	0.50	118	0.9	0.13	0.87	0.6	-0.19
Other countries:												
Turkey	2.16	4.92	227	5.5	1.13	1.09	97	1.9	-3.82	6.01	4.1	1.46
Switzerland	2.56	2.97	116	3.3	3.18	3.92	123	6.8	0.95	6.89	4.7	0.10
Egypt	0.02	0.03	178	0.0	0.04	0.07	184	0.1	0.04	0.10	0.1	0.02
Services not distributed between various countries of far abroad	11.24	13.56	121	15.2	6.50	7.43	114	12.8	-6.13	20.98	14.3	0.09
Total	74.38	88.91	120	100.0	50.50	57.82	114	100.0	-31.10	146.73	100.0	

Source: own calculations based on the data released by the Bank of Russia.

which constitute around a quarter of all aero companies costs (in current prices)[1].

The share of "tourist tours" (15%) in exports is in line with the same index seen in the EU exports patters (14%). This year's soccer world cup in Russia will positively affect the dynamic of exports in this sphere of services. However, most likely the effect will have a short-term effect.

The share of other business services in exports pattern (22%) is slightly lower than the same index seen in EU (27%). This sphere of services is one of the principal ones. Besides that, the share of the two most technologically advanced spheres of services – "telecommunications" (8.3%) and "royalties for the use of the intellectual property" in Russia's exports (1.3%) – are considerably smaller than in the exports of the European Union (14% and 7.5%, respectively). Russia has a definite potential for growth in the aforemen-

1 In accordance with the Central Bank methodology "Export of passenger traffic in practice is understood as income generated from the sale of tickets abroad". This can result in a systematic error in exports estimates in this sphere of services.

tioned sectors due to large number of qualified personnel. Besides, those sectors have no limit of exports growth as they are least dependent on real borders of the country. Important to note, that only those two sectors have exceeded volumes of exports seen in 2013 and in 2017 – "telecommunications" by 15% and "royalties for use of intellectual property" by 0.3%.

Therefore, all spheres of services can be divided into *three categories* according to potential (desirable) growth: *conservative* (below average growth), *basis and advanced* (above average growth). Financial and insurance services can be rated as conservative, their growth is restricted by sanctions imposed by the majority of developed countries and transport services, which require significant capital investment in order to achieve growth, and their fast growth seen last year should be considered as recovery growth. The most progressive spheres of services are telecommunications and royalties for the use of intellectual property and other business services. Basic services with average growth rates are all other sectors. Therefore, with the required annual growth of 9% of service exports in order to achieve the target of $100 billion annually, it is paramount to achieve annual growth of 9% for the basic services, 4–5% for conservative, and 12-15% for progressive over the coming six years.

3. IMPORT SUBSTITUTION: RUSSIAN INDUSTRY'S INVESTMENT PREFERENCES

S.Tsukhlo

Some new features have been added to Russia's import substitution policy. Minpromtorg (Russia's Ministry of Industry and Trade) in April compiled a comprehensive list of foreign-made machinery, equipment and materials which state-owned companies will not be permitted (from 1st of July) to purchase abroad without consent of the governmental import substitution commission.

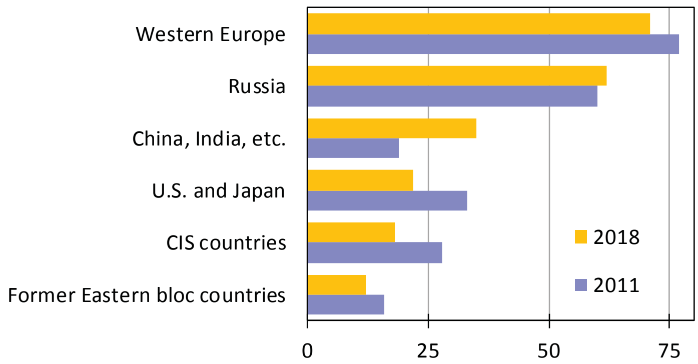

Fig. 1. Equipment which Russian industrial enterprises ultimately purchased in 2011 and 2018, %

The above initiative has been logically favoured by Russian producers whose products are on the Minpromtorg's list, particularly in the present context when it is primarily the state and state-owned companies, rather than the private sector, that can increase demand. With or without such administrative measures in place, forcing Russian industrial enterprises to switch to import substitution, the Russian industry is showing (or has to show) an increased interest in buying Russia-made machinery and equipment, as evidenced by the results of two Gaidar Institute's business opinion surveys of 2011 and 2018. The surveys were conducted when Russia's economy started recovering from the two most recent economic crises; enterprises were asked a set of questions about countries from which they purchased equipment in 2017 and whether they planned to do so in years to come, as well as about equipment which they would like to purchase.

We first take a look at countries from which the Russian industry purchased equipment in the period preceding the two surveys (*Fig. 1*). Western Europe and Russia always were the key suppliers of means of production for Russian enterprises, with minor advantage regarding imports. The rouble's devaluation of December 2014 and the 2014–2017 war of sanctions had a minor effect on the geography of purchases of machinery and equipment from the key suppliers. Western Europe remains the lead supplier to Russia in 2018, with 71% of Russian industrial enterprises preferring to buy Western European machinery and equipment, compared with 77% in 2011. However, Russian manufacturers of machinery and equipment have to date failed to acquire new buyers in Russia.

Second-tier supplying countries have undergone changes of greater magnitude. The share of Russian enterprises, which used to purchase U.S. and Japan's equipment, has contracted from 33 to 22% in the period between the two surveys, which, however, is less than what could have been expected as a result of the Russian rouble's devaluation and administrative bans on equipment supplies/purchases. Equipment suppliers from China and India, in contrast, have gained from the war of sanctions, with sales increased to 35% compared with 19% of Russian industrial enterprises seven years ago. The share of purchases of machinery and equipment manufactured in CIS countries has shrunk, mostly in response to curtailing of Russia-Ukraine trade relations.

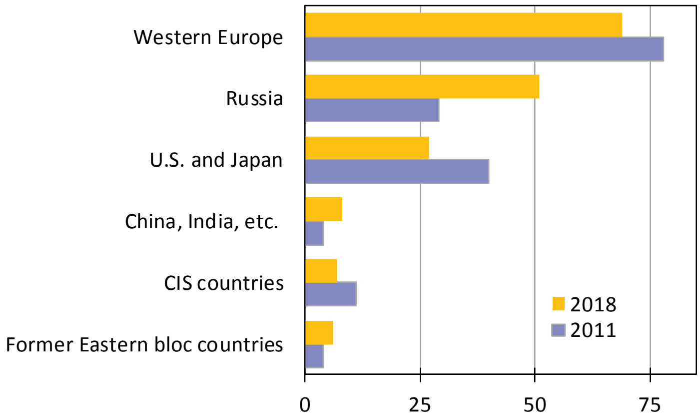

Fig. 2. Equipment which Russian industrial enterprises preferred to purchase in 2011 and which they prefer to purchase in 2018, %

We now consider Russian enterprises' investment preferences, i.e., equipment which Russian enterprises would like to buy in 2011 and in 2018. Russian enterprises' preferences have changed visibly in the past seven years, as shown in *Fig. 2*. First, Russia-made equipment is now preferred (incidence of preference) by more enterprises, moving up to second place in the 2018 preference ranking. Today, half of Russian industrial enterprises prefer to buy Russia-made equipment. Second, preference for U.S. and Japan's products among Russian enterprises has declined most steeply (from 40% to 27% of preferences) in 2018, rolling back to third place. Third, preference for Western European machinery and equipment remains greatest, regardless of the rouble's depreciation and years-long sanctions: 69% of Russian enterprises wish to buy machinery and equipment from Western Europe. Fourth, equipment from China and India is now preferred by less Russian enterprises, with only 8% of Russian buyers prepared to purchase from these countries, which is in line with the preference for equipment from CIS countries. The preference for the latter has lost several points by 2018, most likely due to the severance of economic ties between Russia and Ukraine in previous years.

We now consider Russian industrial enterprises' investment plans, i.e., countries from which Russian enterprises really plan to purchase machinery and equipment in the offing and equipment which they planned to buy in 2011. The answers show that the Russian industry has undergone fundamental changes (*Fig. 3*). While Western European equipment was clearly preferred to Russia-made equipment in 2011 (72% of enterprises planned to buy the former vs. 50% of those intending to purchase the latter), the preference for the former equalled that for the letter in 2018 (65% of enterprises have plans to buy both). This implies

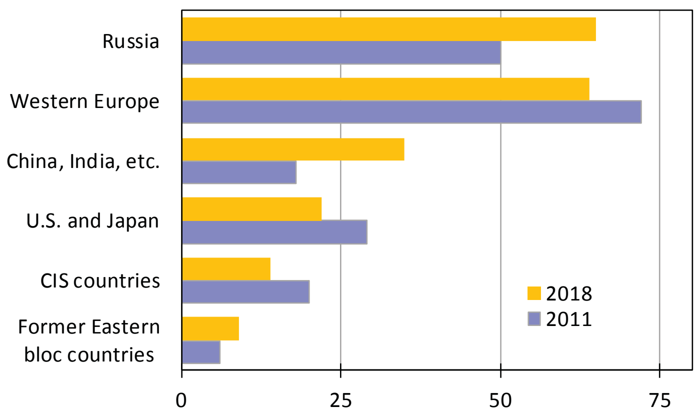

Fig. 3. Equipment which Russian industrial enterprises planned to purchase in 2011 and which they plan to purchase in 2018, %

that the Russian policy of import substitution of investment goods has been successful, at least in terms of quantity.

A question about the quality of equipment in substitution for Western European equipment can be partially answered by data showing doubled share of enterprises planning to purchase equipment manufactured in China and in India, which is rather a sign of moving towards a cheaper, available, albeit lower-quality, equipment. Furthermore, enterprises are well aware of that. A comparison of enterprises' plans to buy equipment from China and India with weather they really want to do so in 2018 gives 35% vs. 8%.

As it stands, the Russian industry has to switch to buying equipment of lower quality. A similar phenomenon was also observed, albeit to a lesser extent, in 2011, when 18% of enterprises reported they planned to purchase China's and India's equipment, whereas only 4% of them said they would like to do so. The same holds true regarding Russia-made equipment. Nearly half of Russian enterprises would like to buy Russian equipment, whereas 65% of them plan (will have) to do so in the next few years.

4. STATE PROGRAM FOR THE DEVELOPMENT OF AGRICULTURE IN 2017: WHERE DID ALL THE MONEY GO?

V.Uzun

The RF government resolution of April 28, 2018 approved the National Report on the progress and outcome of the implementation in 2017 of the State Program for the Development of Agriculture 2013–2020[1]. Not all conclusions of the report seem to be justified. Moreover, some measures of support of agricultural enterprises and family-operated farms were not outlined properly nor were transparent.

Successes in the agriculture development

National report on the results of the implementation of the State Program in 2017 turned out to be of a positive nature. Main target figures have been achieved. Agricultural production in farmsteads of all categories grew by 2.4% compared to 2016. Growth was observed in the crop farming and cattle breeding. Fixed investments grew by 3.1%, profitability of agricultural organizations including subsidies came to 14.3%, labor productivity increased by 4.4%. Threshold requirements of the Food Security Doctrine were surpassed with respect to all main products except milk and salt. Domestic production of milk and dairy products ratio hit 82.4 percent which is higher than the 2016 level, but below the threshold requirement (90%).

Production of grain, oil, sugar, meat, poultry and pork were the principal drivers of growth. The record-braking grain crop was harvested in 2017 – 135.4 million tons, which is higher than the 2016 level by 12.2%. Russia has strengthened its positions on the global grain market by increasing its exports to 43 million tons. Gross harvest of the sugar-beet moves up to 51.9 million tons, which is 13.4 million tons higher than the State Program indexes. This fact not only satisfied domestic consumption but also allowed to export more than 0.5 million tons of sugar and 1.8 million tons of byproducts (bagasse and molasses). Growth of oil-bearing-crops production ensured the increase of vegetable oil exports by 25.9% which is up to 3.2 million tons.

State Program indices of meat production have also been surpassed mainly on the back of fast annual growth rates of pig farming (5%) and aviculture (6.9%). Such fast growth rates were preserved in these sectors over all recent years. This fact allowed to substitute the main part of imports, increase per capita consumption and to take first steps towards the global markets.

Struggling sectors

Not all agricultural sectors boasted of a bright picture as those mentioned above. In dairy and beef cattle breeding, fruit growing, potato farming, vegetable farming with decaying personal small-holdings sector as main producer, it is much harder to achieve the state program indexes.

1 National Report (May 7, 2018) http://mcx.ru/upload/iblock/f6a/f6a926309485f-5008245b3dda0a9d611.pdf

However, the National Report, instead of the deep critical problem analysis of those sectors, focused on traditional references to bad weather conditions, delays in preparation of regulatory documentation and comparisons with adjusted planned indexes.

Let's quote corresponding extracts regarding two sectors. "In 2017 gross potatoes harvest in the all sectors of agriculture constituted 29.6 million tons which is 4.9% less against the 2016 level. Main reason for the production fall were the harsh weather conditions of spring 2017 which affected the sowing campaign and moved on an average by 2–3 weeks further" (p. 34 of the State report). Same conclusion was in regard of fruits and berries.

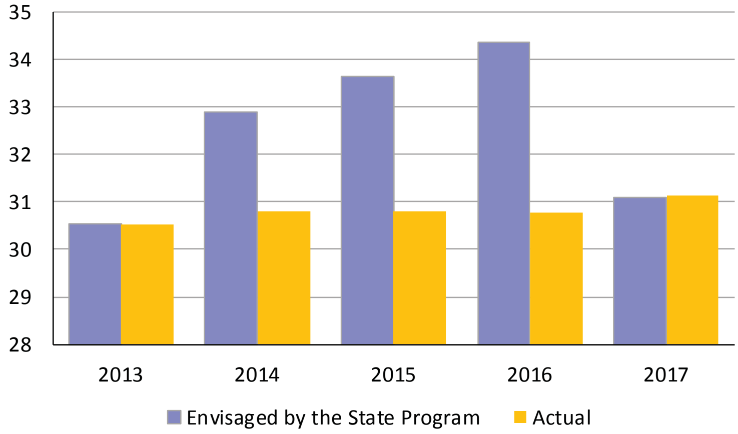

Fig. 1. Dynamic of index achievement "Production of milk in farmsteads of all categories," million tons

Source: p. 74 of the Report.

The State Program envisages state support in the form of insurance against bad harvest aimed at tackling negative economic consequences generated by bad weather. Insurance support program turned out to be a failure. In 2017 merely 1.8 (which is 1.7%) million hectares of crops and planting were insured. Such low 2017 rate was explained by "late approval of normative legal acts". At the same time, presented data demonstrate that the problem has been existing long before and it popped up before 2017.

Even stranger looks the analysis regarding fulfillment of State Program's task of milk production. It is know that the livestock of milk cows is falling in the country and production has nearly halved since 1990s, and during last years is stagnating at the lowest level. However, the Report states that the target indicator set by the State Program has been fulfilled by 100.1%. The reader might have believed this but for *Fig. 1*, which the authors of the Report present as an argument.

The figure demonstrates that the task was achieved only in 2017 while in previous years it was not. In fact, the situation was approximately similar, while the differences are only explained by the choice of the key performance indicator: in 2013–2016 key indicators are presented in the original State Program approved in 2012 while in the 2017 one – only the corrected indicators are given. In case of the original production task regarding milk output (which is 35.15 million tons) then in 2017 it turns out that the indicator was achieved not at 100. % but only at 88%.

What is the return on Rb 248 billion of subsidies

In 2017, the Federal budget allocated Rb 248.4 billion on the implementation of the State Program. The budgets of RF subjects further allocated around Rb 120 billion on support of agriculture over earlier years. However, the Report presented analysis only of the federal funds flow, regional expenses were not given. They were mentioned only when reviewing certain measures. Part of the allocated funds (Rb 14.6 billion) was not spend. The Report as reasons for nonfulfillment gives the RF subjects' untimely submission of documents in order to obtain subsidies. However, no proposals for resolution of the situation were given.

Rb 233.8 billion of federal funds were spend on the State Program measures in 2017. Non-agricultural sectors received Rb 39.5 billion. Besides, Rb 61.4 billion were allocated for ensuring conditions for agricultural sector performance (including sub-program "management of the State Program implementation" Rb 28.2 billion). The remaining Rb 132.8 billion of the federal funds were spend on measures directly implemented by agricultural producers. Those funds were distributed between the recipients in the following way.

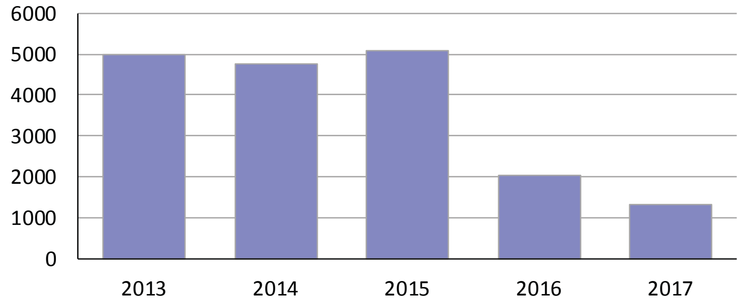

Fig. 2. Reimbursement of part of interest on long-, medium- and short-term loans taken by small forms of agricultural business, RB million

Source: p. 118 of the Report.

On support of the small forms of agricultural business were allocated Rb 10.3 billion in 2017. The funds were used for support of emerging farmers (Rb 3.8 billion), development of family cattle farms (Rb 3.7 billion), consumer's cooperatives (Rb 1.5 billion) and reimbursement of lending interest rates (Rb 1.3 billion). The first three aspects saw growth in 2017 compared to the previous years, but regarding subsidizing loans and despite centrally determined share of small forms of agricultural business of no less than 20%[1], amounts of subsidies during last years have catastrophically plummeted (*Fig. 2*). Small business in 2017 received almost one fifth of subsidies against 2015. Its share in these subsidies constituted 2% and was one tenth of amount set by the government. Small business was actually banned from subsidized loans, although the share of homesteads in the gross agricultural production almost hit 13 percent in 2017.

Failure to execute the Government resolution was due to "non delivery of potential borrowers' registers from the authorized banks to the Ministry of Agriculture and untimely conclusion of credit agreements with authorized banks approved by the Ministry of Agriculture".

According to current rules, all applicants receive distributed subsidies aimed at green box support of agricultural producers in crop growing (per 1 hectare)– b 11.3 billion and to increase productivity in dairy cattle breeding (per 1 liter of milk) – RB 8.1 billion. Agribusiness holding companies and other major agricultural companies received major funds for the remaining subsidies. Distribution of subsidies is a clear example with respect to actually made investments. Recipients are compensated in the range of 20 to 35% of costs incurred on construction or upgrade of agro-industrial complex facilities. In 2017, the federal budget appropriated funds in the amount of Rb 15.5 billion for the RF regional budgets as a part of state support measure. Overall, in the reported year 192 investment projects were chosen and financed by the Ministry of Agriculture (other 20 thousand businesses got nowhere). The funds were divided very unevenly among 192 recipients. For example, JSC "Stavropolie Vegetables" received more than one billion rubles while the majority of other chosen applicants received one tenth or even one hundredth of that amount.

1 RF Government resolution No. 358 of December 27, 2016.

The largest share of budget funds is disbursed on subsidizing of loans (Rb 58.4 billion). The budget allocated Rb 10 billion or even larger subsidies for certain major projects. It stands to reason that other applicants claimants got nowhere or very insignificant amounts of state support. It should be noted, that the trend towards issuing large subsidies to one person is observed not only in agro holding sector but in family farming sector.

The national report shows how the medium sized grants given to farmers were growing during last years. In the number of cases, they amount to Rb 20–30 billion to a single recipient. Meanwhile it is noted, that "tender is between three farmers to one grant and in the certain regions up to ten farmers to one grant." It is always easier for bureaucrats to give one subsidy to one person, rather than to go through a large number of recipients.

According to the Report, grain market regulation was implemented in a strange way in 2017. Despite the record volume of grain harvest and decline of the farm-gate prices (11.4% annually on average, during harvesting the fall was steeper) "purchasing intervention in 2017 were not held." Instead of stabilizing prices, grain was sold from the interventional fund which led to further price fall. The National Report explained those strange actions by concern for "amid record high harvest further accumulation of the interventional fund stocks could have led to increased spending of the federal budget."

AUTHORS

Alexander Knobel, Head of World Trade Laboratory, Gaidar Institute; Director of Center for International Trade, IAES, RANEPA

Tatiana Tishchenko, senior researcher, Budget Policy Studies Department, IAES, RANEPA

Vasily Uzun, main researcher, Agricultural Policy Department, Gaidar Institute; main researcher, Center for Agro-food Policy, IAES, RANEPA

Alexander Firanchuk, senior researcher, Foreign Trade Department, IAES, RANEPA

Sergey Tsukhlo, Head of Business Surveys Laboratory, Gaidar Institute

Designed by E.Nemeshaeva