

MONITORING OF RUSSIA'S ECONOMIC OUTLOOK:

TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

No. 11(49) June 2017

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MAIN TRENDS AND CONCLUSIONS

It seems that the widely held notion that developments in the global economy are becoming increasingly less predictable has been constantly finding new proofs.

Today no one can reliably forecast the political future of the current US president – which means that the future of his initiatives that will inevitably produce a significant impact on the global economy cannot be accurately forecast, either. For example, his decision that the United States should withdraw from the Paris climate accord is clearly capable of spoiling, for a long time to come, the investment climate in the ‘green sectors’ of the economy, which have already attracted colossal investments. But if it turns out that this decision is likely to be short-lived (‘today we leave, tomorrow we return’), the feeling of unease over the reputed geopolitical and geo-economic instability will only intensify. Even in those markets where all market participants have been making coordinated efforts to increase forecast accuracy, the results of all these efforts are rather disappointing and the forecasts are clearly alarming. By all appearances, everything must be shipshape on the oil market: OPEC has agreed to extend its production cuts into next year, and discipline within this organization has not been broken. However, despite all these unprecedented efforts, oil prices have dropped, against all expectations. Moreover, there has emerged an additional risk – that of unpredictability, related to the forthcoming expiration of the oil production cut agreement scheduled to take place in the spring of 2018.

The expert overview of both the current and the expected risks facing the global economy shows that some positive indicators, including optimistic expectations currently predominant in the global oil market, may obscure the emerging risks. On the one hand, India’s GDP is undoubtedly growing, maybe even at an accelerated pace, while Brazil’s leading indicators have suggested that her economy is finally emerging out of recession. On the other hand, the sharp rise of the indicators characterizing the degree of capitalization in the developing countries’ securities markets ‘can testify to the emergence of bubbles’. Growth in demand for high risk assets under the conditions of considerable uncertainty related to negative forecasts for China’s economy, the price situation in raw material markets, the possibility of the developed countries toughening their monetary policies, and the economic and political situation in the USA, is fraught with the risk of huge capital outflows from the developing economies.

Practically all of the afore-listed factors are capable of influencing the situation in the Russian economy, although to a varying extent. And the experiences of the past two years have demonstrated that their influence may be very strong indeed, including the ruble’s exchange-rate pass-through effect on the prices of imports. From the expert analysis it follows that ‘on the average’, a 1% change in the nominal exchange rate of the ruble produces a 0.67% change in import prices (the prices of imported goods at the RF border less customs changes). However, in reality this influence is shaped by the combination of many factors – the various properties of the imported items, the importer firms, and other variables. These variably factors are, among

other things, the frequency of price adjustment, swings in the currency value as stated in the contract, the market share taken up by the importer firm, the particular sector of the economy where it operates (because demand elasticity differs depending on the sector where a given product has been manufactured), and product processing degrees (the higher the processing degree, the less sensitive the price of an imported product to fluctuations in the exchange rate of the ruble).

Corporate borrowers are likewise sensitive to any changes in the exchange rate of the ruble. The experts who have analyzed the behavior of corporate loans taken by non-financial borrowers point to the increasing number of bond issues denominated in foreign currencies that has been observed in Russia's domestic market since late 2015. They explain this state of affairs, firstly, by the trend towards replacing foreign loans by domestic ones, and secondly, by changes in the behavior of the national currency's exchange rate, which have made ruble-denominated loans more attractive. Judging by the year-end results of 2016, it can be said that corporate issuers have become significantly more active in the domestic bond market, while growth in the bank lending market was halted. Over the period 2014–2016, the share of bond loans in the total debt volume increased from 13% to 21%, the principal growth factor in that segment being forex loans, while growth in the ruble-denominated segment occurred in the main due to the Rosneft share sale. Nevertheless, in Q1 2017, growth was revived in the corporate lending segment.

The logical question to be asked in this connection is as follows: can the reliance on borrowed funds translate in any significant changes in the investment activity of Russian enterprises, or perhaps it only reflects their intention to refinance and restructure their old debts? Or, to put it another way, will they prefer to abstain from any action and just to wait for better times, once their financial situation has relatively improved?

The results of calculations performed by the by the Gaidar Institute's experts point to the persistent presence of the same trends as were observed in late 2016: slight increase in production volumes and close to zero rates of growth displayed by most of the branches of industry. At the same time, they advise that 'it is necessary to be extremely cautious when interpreting the industrial production statistics.'

They administer caution because, from 2017, Rosstat has been relying on the new versions of the All-Russian Classifier of Economic Activities and the All-Russian Classifier of Products by Type of Economic Activity when releasing its industrial production indices. Meanwhile, for some industries, the new indices are incomparable with data based on the 'old' classification. As a result, the trend component of the industrial production indices cleared of calendar and seasonal factors can be derived either only for data for the period 2013–2017 (based on Rosstat's new classification), or only for data based on the old classification that was applied for the period 2000–2016. In the case of the former, it is impossible to obtain quality time series properly cleared of calendar and seasonal factors, while in the latter case it is necessary to add own calculations based on 2017 data (in accordance with Rosstat's methodology), which is fraught with errors.

Eventually, the Gaidar Institute's experts derived the trend component for sectoral production indices based on both types of statistics (for reference, the data prepared by the NRU HSE were also included in the study). The con-

clusion based on the results of all these calculations is that, as before, the slight growth observable in a number of industries since late 2016 (the food industry, machine-building), can be explained, with few exceptions, by direct subsidies allocated by the government, and that so far it cannot be treated as a general trend.

Production growth in the agricultural sector appears to have been more impressive, although here it has also occurred for the most part thanks to government aid. Our experts thoroughly analyzed the conditions and rules for the subsidizing on loans taken by the agro-industrial complex, and according to their estimations, no positive changes had occurred with regard to the allocation of subsidies. Thus, the following quotas were established for small businesses: 30% for short-term loans, no and 10% for investment loans, to the total value of nearly Rb 5bn. However, the existing bureaucratic barriers have resulted in a situation where such loans are only rarely used by relative. In fact, as far as formal documentation is concerned, similar requirements are established for loans in excess of Rb 1bn and for those amounting to only one hundred thousand rubles. The list of required documents to be attached to a loan agreement takes up four pages, and some of these documents, once issued, are valid for no more than two-to-four weeks, which means that the procedure itself envisages that part of the documentation should be outdated prior to its completion.

As before, subsidies are generally granted to «selected targeted owners». As far as the process of subsidizing of investment loans is concerned, these were not allocated between RF subjects – our experts believe that this happened because otherwise, it would have become obvious that big loans were planned only for some selective RF subjects. As for short-term loans, it would be logical to distribute these in proportion to the total agricultural output in each region; however, the allocation plan ‘is based on some other principles’, and so as a result, the amount of subsidy per unit of output received by some regions is several times higher than that received by the others. Our experts believe (and in this, they rely on world best practices) that limits should be imposed on subsidies paid to big companies, otherwise other agricultural producers will be reducing their output and face financial ruin, thus expanding the economic decline areas. As for the mechanisms of preferential loans to small businesses, these need to be fundamentally changed. ●

1. GLOBAL ECONOMY: NEW RISKS

A.Kiyutsevskaya, P.Trunin

Global financial markets are being dominated by upbeat sentiments in the face of official statistics that show major economies are slowing. Market volatility in developed countries is on the slide as the attractiveness of developing countries' assets is on the rise. However, economic agents' excessive optimism may be a signal of developing risks on the back of high political and economic uncertainty that comes primarily from the USA, UK and China. There is a series of factors that may lead to capital outflows from emerging markets and to a correction of the value of financial assets.

According to the preliminary data released by the Organization for Economic Co-operation and Development (OECD), OECD member-countries' economic growth rates slowed in Q1 2017 to 0.4% over the previous period compared with 0.7% a quarter earlier. The UK and USA suffered most of the production cuts, the UK GDP increased 0.2% in Q1 2017 compared with 0.7% growth a quarter earlier, and the US GDP rose as little as 0.3% over the previous period (up 0.5% in Q4 2016). Only a few major developed countries – Germany, Italy and Japan – saw their economy grow in Q1 2017 (Table 1).

Table 1

**GDP GROWTH RATES, % CHANGE OVER PREVIOUS PERIOD,
SEASONALLY SMOOTHED**

	2015				2016				2017
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
OECD countries	0.7	0.5	0.5	0.3	0.4	0.4	0.5	0.7	0.4
G7	0.5	0.4	0.4	0.2	0.4	0.3	0.6	0.5	0.4
Australia	1.1	0.2	0.7	0.5	1.1	0.8	-0.5	1.1	n/a
UK	0.3	0.5	0.3	0.7	0.2	0.6	0.5	0.7	0.2
Germany	0.2	0.5	0.2	0.4	0.7	0.5	0.2	0.4	0.6
Italy	0.3	0.4	0.1	0.2	0.4	0.1	0.3	0.3	0.4
USA	0.5	0.6	0.5	0.2	0.2	0.4	0.9	0.5	0.3
France	0.4	0.0	0.4	0.2	0.6	-0.1	0.2	0.5	0.4
Japan	1.2	-0.1	0.2	-0.3	0.6	0.4	0.2	0.3	0.5
Developing countries									
Mexico	0.6	0.8	0.6	0.4	0.4	0.1	1.1	0.7	0.7
Turkey	2.1	1.5	1.3	1.1	-0.3	1.7	-2.1	3.8	
Non-OECD countries									
Brazil	-1.3	-2.3	-1.4	-0.9	-1.0	-0.3	-0.6	-0.6	1.1
India	1.7	2.2	2.0	1.8	2.3	1.4	1.6	1.5	1.5
Indonesia	1.2	1.2	1.2	1.3	1.2	1.3	1.2	1.2	1.2
China	2.0	1.7	1.8	1.5	1.3	1.9	1.8	1.7	1.3

Source: OECD. www.oecd.org.

China continues to rank first among developing countries in terms of posing the highest risk for the global economy. China's economic growth rates, steadily decelerating during three quarters, dropped in January–March 2017 to 1.3% over the previous period compared with 1.7% growth a quarter ear-

lier. Mounting economic problems in China prompted Moody's decision of 24 May 2017 to downgrade China's sovereign credit rating to A1 from Aa3. The last time Moody's cut China's credit rating was 1989.

According to Moody's, mounting debt burden amid considerably shrinking People's Bank of China's foreign exchange holdings poses a threat to the national financial sustainability. Furthermore, according to Moody's analysts, China's economic growth rates may decelerate to 5% year-on-year in the five years to come on the back of not only slowing investment activity but also aggravating demographic issues related to the decline in the share of working-age population since 2014, as well as the deceleration of labour productivity growth. According to the IMF's April Forecast, China's economic growth in 2017 is expected to slow to 6.6% compared with 6.7% a year earlier, and to 5.7% in 2019. The World Bank offers less downbeat forecasts for China's economy, projecting that the economy will stop declining in 2019: GDP growth rate will remain at the level seen in 2018, that is, 6.3%.

An argument for further economic downturn in China in 2017 is the continuing fall of the business activity index (Caixin), down to 49.6 points in May compared with 50.3 points a month earlier. In addition, and most importantly for China, in Q1 2017 the balance of foreign trade surplus hit the lowest of USD 94bn since Q2 2014. The growth in the value of imported goods in China in Q1 2017, 9.6% over the previous period, was found to be not only the G20 highest but also much higher than the exports of goods from the country. Further, exports of goods increased in terms of value by 3.9% in Q1 2017 compared with 1.7% a quarter earlier.

Brazil took the lead in terms of growth rates regarding foreign trade turnover in Q1 2017, when the growth in the value of exports and imports of goods accelerated to respectively 21.5% compared with 1.8% a quarter earlier and to 9.1% compared with 0.1% a quarter earlier. Further, the first quarter saw positive trends emerge in other areas, too. First, in Q1 2017, after two years of recession, Brazil's GDP was up 1.1% over the previous period (down 0.6% in Q4 2016). First, inflation decelerated consistently. In April 2017, consumer prices increased 4.1% year-on-year compared with 9.3% in April 2016. At the same time, the Bank of Brazil has the 2017 target price growth set at 4.5%, with an allowance of 1 p.p. on either side. The national bank, faced with the foregoing, embarked on a policy of sharp monetary easing by cutting the key interest rate to 11.25% p.a. from 12.25% p.a. in April, and then to 10.25% p.a. in May. As a result, after the 3.6% fall in 2016, Brazil's GDP, according to IMF's estimates and World Bank's projection, will increase 0.2% and 0.3% respectively at 2017 year-end.

India is expected to retain its leadership in terms of economic growth rates among major global economies in 2017, India's GDP is expected to accelerate to 7.2% compared with 6.8% in 2016, according to IMF and the World Bank.

However, there are a series of indicators that show mounting risks for the global economy. First, J.P. Morgan's global business activity index fell to 52.6 points in May from the March 2017 peak level of 53 points since Q2 2011. Second, with the record low decline in volatility indices in global financial markets, rapid growth of MSCI's indices that reflect security market capitalization in developing countries (EEM) may give evidence of developing market bubbles (*Fig. 1 and 2*).

Increasing demand for high-risk assets amid material uncertainties associated with possible tightening of the monetary policy of the FRS, Bank of Eng-

land, ECB, with economic and political situation in the United States, China's economy is fraught with further rapid capital outflows from developing countries. According to CME Group, the probability that the federal funds rate will be raised 0.25 p.p.s after the upcoming Fed's meeting is more than 95.8%. The UK consumer inflation acceleration in April 2017 to 2.7% from the corresponding period previous year (2.3% in March) suggests that the Bank of England may soon cut back on its quantitative easing program. At the same time, the deceleration of euro-zone's consumer prices in May to 1.4% from the corresponding period previous year (1.9% in April), which, according to ECB President Mario Draghi, was driven by slow recovery of wages, may be a strong evidence to suggest that the ECB will keep up its ultra soft monetary policy.

The decision of oil-exporting countries, including Non-OPEC exporters, to prolong the oil cut accord dated 30 November 2016 for another nine months from 1 July 2017 was an important factor that determines prospects for the development of developing countries, including Russia. However, the average OPEC basket price dropped more than 4% to USD 49.2 per barrel in May, driven, among other factors, by not including Nigeria, Libya and Iran in the oil cut deal. Further, crude oil exports from Libya in May hit an all-time high in 2.5 years, according to Bloomberg. Nigeria's oil production was on the rise, too: 1508 thousand bbl/d in April, according to OPEC, (1457 thousand b/d in April). However, mounting US oil production amid a small increase in global demand is the strongest headwind for increasing world crude oil prices. According to OPEC's forecast in May, global oil demand in 2017 is expected to increase 1.3% to 96.38 million b/d (95.12 million b/d in 2016, 93.68 million b/d in 2015). Further, according to the U.S. Department of Commerce, the US economic growth in Q1 2017 amid weakening of consumption was driven up by the increase in investment primarily in the mineral extraction industry, including the production of oil and gas, which, considering the increase in fossil fuel prices, suggests that the US oil production has potential for growth.

Thus price trends in commodity markets is another factor that feeds uncertainties regarding prospects for the development of the global economy. The worst-case scenario may show a strongly tightened monetary policy in developed countries, which can result in capital outflows from developing countries. A drastic downturn in China's economy that may result in fall of global prices of raw materials, as well as deceleration of the world trade and economic growth rates, may give rise to new, not less dangerous, developments. ●

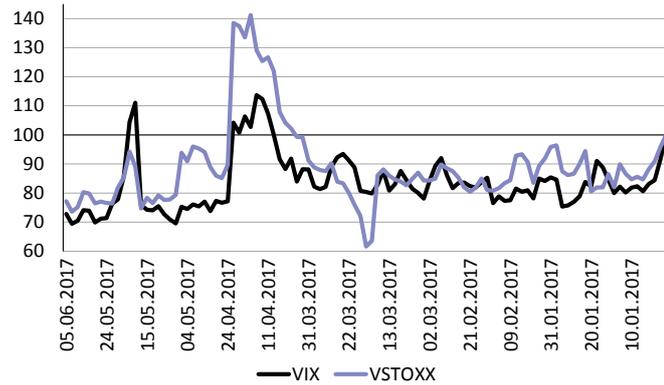


Fig. 1. Market volatility indices for the USA and Europe

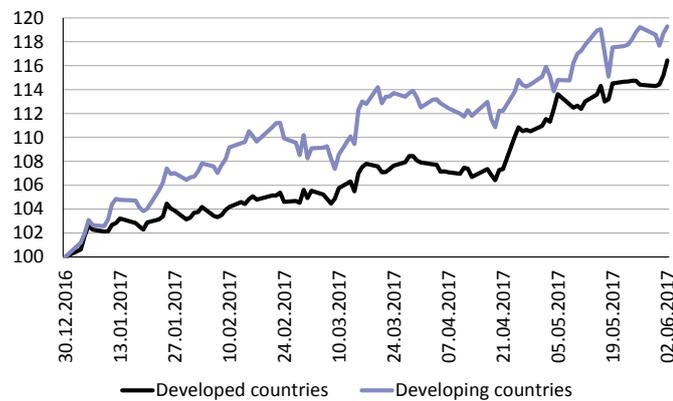


Fig. 2. MSCI's indices for developed and developing countries' securities markets

2. EXCHANGE RATE AND IMPORT PRICE RIGIDITY IN RUSSIA

Yu.Ponomarev, Yu.Pleskachev

The rouble depreciation in H2 2014 and in 2015 led to a substantial rise of prices in the Russian economy amid sanctions. Those and related changes (e.g., foreign trade shocks and related updates of importers' strategies) also influenced price sensitivity (rigidity) to rouble exchange rate fluctuations. Despite the fact that the rouble exchange rate stabilized and appreciated in 2016–2017, understanding the degree of import price rigidity according to various characteristics of importing firms amid exchange rate fluctuations is critical for implementing efficient monetary and trade policies.

Import price characteristics is the first and important link along the chain of intermediate and ultimate consumer goods pricing. The law of one price (which posits that identical goods must sell for the same currency in various countries and ideally for the same price) is the mechanism underlying the exchange rate pass-through to import prices, which often fails to work in practice. Characteristics of goods and of importing firms, and foreign trade operations parameters (contract currency, frequency of deals, possibility to adjust intermediary margins, etc.) are the import price factors that induce maximum deviations from the law of one price. Considering these factors dictates the need for micro level assessments (at the level of imported goods) that previously were not practiced in Russia.

On the whole, according to our analysis, the key factors that induce deviations from the law of one price can be structured as follows.

A. Characteristics of importing firms and parameters of foreign trade deals they enter with: including price change frequency; currency for which import price is denominated under the contract; firm's import market share.

The price change frequency in a foreign trade contract can influence the degree of import price rigidity in two ways. The first one is the so-called menu costs (in this particular case, costs related to price change, reputation costs, etc.). Firms that change their prices more frequently can less painfully pass exchange rate changes through to import prices, whereas firms that change prices for whatever reason (e.g., they may wish to retain customers) will pass a smaller exchange rate swing to import prices. The second one is that firms that change prices of their products on a more frequent basis can be in a position to pass exchange rate changes incompletely to prices through a small price change. Conversely, firms that change their product price on a less frequent basis have to "catch up with" big exchange rate changes and pass them almost fully to their prices, thereby making them less rigid.

The effect of contract currency on the rigidity of import prices (provided that prices are not changed instantly) is driven by the following mechanisms. Firms that are reluctant to pass exchange rate fluctuations to prices tend to opt for national currency (pricing mechanism based on national currency). Firms that wish to pass exchange rate fluctuations through to their own prices tend to opt for exporter's currency or for the U.S. dollar (pricing mechanism based on exporter's currency).

The effect of firm's import market share is driven by the following mechanism. A firm with a small market share has no room for manoeuvre and therefore has to pass exchange rate fluctuations fully to import prices. On the other hand, a firm with bigger market share does have room for manoeuvre to somehow retain the captured market share;

B. Characteristics of goods. Characteristics of goods can influence the rigidity of import prices regarding exchange rate fluctuations, depending, for example, on the degree of product refining. Less refined products are closer to goods of the same kind or almost identical, and therefore price competition is of higher importance. Highly refined products are more sophisticated and therefore closer to differentiated products. Less refined imported products tend to have a lower degree of price rigidity than that of highly refined products;

C. Industry-specific variance. The rigidity of import prices varies from industry to industry. The degree of rigidity can be accounted for by diverse elasticity of demand for products manufactured by various industries. Industry and production specifics also can influence the degree of rigidity.

One may thus conclude there is incomplete pass-through of exchange rate fluctuations to both import prices and internal ultimate consumer goods in the Russian economy¹. The resulting assessments of the degree of import price rigidity regarding exchange rate fluctuations show that:

1. At the aggregate level, a 1% change in the nominal exchange rate results in a change of import prices by an average of 0.57% (Russian border prices before taxes/duties).
2. For prices of certain groups of products under consideration: a 1% change in the nominal exchange rate results in a change of import prices of 0.45% to 0.95%.
3. The degree of import price rigidity regarding exchange rate fluctuations depends largely on various characteristics of importing firms:
 - a) in the case of firms that change their product prices on a more frequent basis, a 1% change in the nominal exchange rate results in a 0.55% change in import prices, whereas in the case of firms that change their product prices on a less frequent basis, a 1% change in the nominal exchange rate results in a 0.95% change in import prices;
 - b) in the case of firms that denominate border prices of their products in U.S. dollars and Euros, a 1% change in the nominal exchange rate results in a change in import prices by 0.95% and 1.05% respectively; in the case of firms that denominate their product prices in roubles, a 1% change in the nominal exchange rate results in a change in import prices by only 0.05%;
 - c) in the case of firms with below-average import market share, a 1% change in the nominal exchange rate results in a 0.9% change in import prices. In the case of firms with above-average import market share, a 1% change in the nominal exchange rate results in a 0.6% change in import prices. In the case of firms that make up 25% and 5% of importing firms with the largest market share, a 1% change in the nominal exchange rate results in a change in import prices by 0.5 and 0.4% respectively;

¹ See, for example, Ponomarev Yu., Trunin P., Ulyukhaev A. The effect of exchange rate pass-through to prices in Russia // *Voprosy Ekonomiki*. 2014. Vol. 3. P. 21–35.

4. The degree of import price sensitivity tends to decline with growth of the product refining degree. In the case of mineral and agricultural raw materials, a 1% change in the nominal exchange rate results in a 0.9% change in import prices, whereas for low and highly refined industrial products, a 1% change in the nominal exchange rate results in a change in import prices by 0.77 and 0.64% respectively.

Thus promoting foreign trade contracts denominated in national currency and thereby lowering the share of foreign trade contracts denominated in foreign currencies, as well as gradual change in the foreign trade pattern toward increasing imports of highly refined products, may result in further decline in the effect of exchange rate pass-through to customs border prices of imports and therefore in higher rigidity of prices of goods and services in the forward links along the value-added chain of the Russian economy. This, in turn, will contribute further to lowering inflation. ●

3. CORPORATE BONDS: BOND MARKET FUNDRAISING GAINS MOMENTUM

M.Khromov, E.Khudko

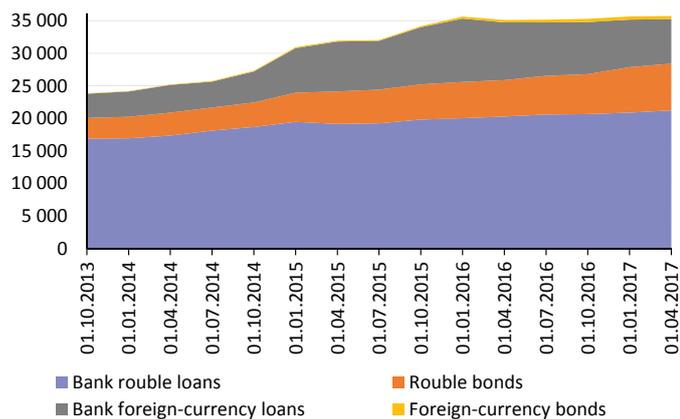
The bank lending market stalled in 2016, giving rise to fundraising through the domestic corporate bond market. The market growth was driven up primarily by increase in foreign-currency loans. Like in previous years, about 25% of new bonded loans in the rouble bond segment were issued by Rosneft. The share of bonded loans in the total debt almost doubled to 21% from 13% over the past three years.

Bank lending to non-financial entities almost stalled in 2016. It would be a mistake, however, to argue, using solely analysis of bank lending dynamics, that real economy financing was stopped. This article is intended to expand our analysis as far as to examining the situation in the domestic bond market in the period between 2014 and 2016.

The dynamics of corporate customers' outstanding bank loans has been decelerating gradually since 2014. In volume terms, it increased Rb 2.6 trillion¹ (+13%) in 2014, rose slightly Rb 1.3 trillion (5%) in 2015, and remained almost unchanged in 2016 (*Fig. 1*). Further, foreign-currency loans contributed more than a half (56%) to the debt increase in 2015, while in 2016, conversely, zero dynamics of bank lending was made up of comparable in absolute volume (about Rb 0.9 trillion) growth of debts in roubles and the decline in debts in foreign currencies. This was presumably because Russian borrowers have been shut out of foreign financial markets since late in 2014, and therefore a series of major players had to refinance their overseas financial commitments through the domestic market.

Despite a spike in late 2014 (*Fig. 2*), corporate issuers² fundraising through the domestic bond market remained relatively stable on a year-on-year basis until 2016, and the volume of outstanding bonds issued in the domestic financial market increased Rb 1.2 trillion a year in 2014 and in 2015. In 2016, the outstanding bonds rose to Rb 1.6 trillion.

The marked increase in foreign-currency bond issues in the domestic bond market since late in 2015 is most likely accounted for by the continuing trend toward replacing foreign loans. In addition, the change in the rouble exchange rate made this instrument



Sources: Bank of Russia, own calculations.

Fig. 1. Dynamics of non-bank entities' outstanding financial obligations in the domestic financial market, bn Rb.

¹ Growth in debts is hereinafter assessed with allowance for the revaluation of figures expressed in foreign currencies.

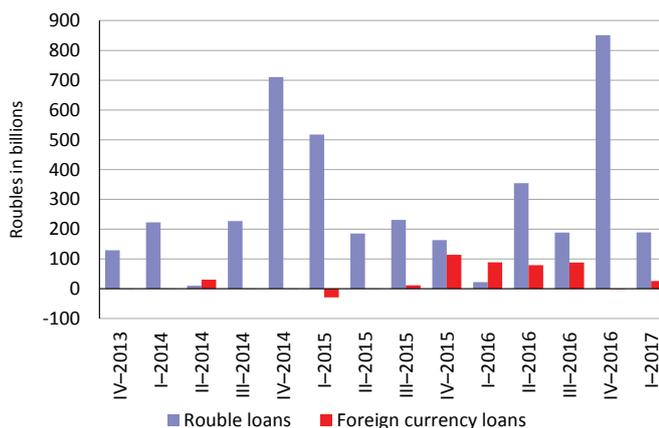
² Excluding credit institutions.

more appealing for end borrowers. It is since that moment that the rouble began strengthening steadily against the U.S. dollar. Bonded foreign-currency loans became the key tailwind propelling the market in 2016.

In addition, there are two peak values that come under notice in Q4 2014 and in Q4 2016 regarding growth of corporate bonded loans. Overall, the dynamics could be accounted for by the seasonal factor (analysis of a longer retrospective period tends to reveal clearly the increase in volumes of placed bonds in December of each year). Such an analysis, however, is deemed to be incomplete, unless the yield dynamics and the IPO pattern is considered from the perspective of issuers. Fig. 3 shows bond yield dynamics and volumes of new rouble bond issues of financial and non-financial issuers.

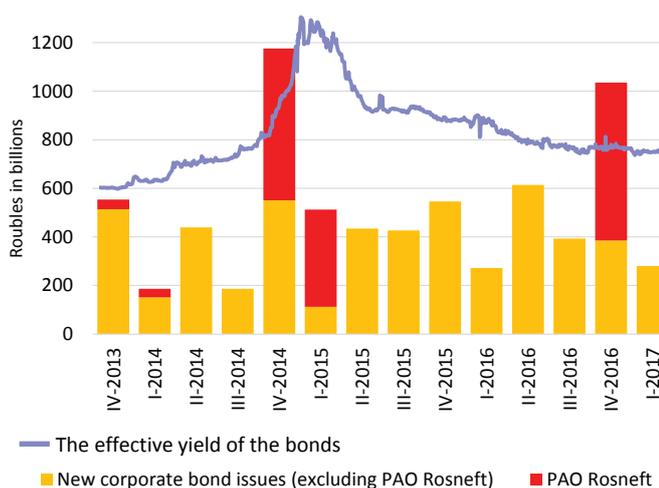
As shown in Fig. 2 and 3, peak values recorded in Q4 2014 and in 2016, as well as high volumes of bond placements in early 2015 (which is not typical of this period of the year) were spurred by PAO Rosneft, the sole major bond issuer that entered the primary bond market. During the foregoing periods the volume of Rosneft's fundraising through the bond market exceeded the total volume of bonds placed by the rest of corporate bond issuers. Thus, considering the primary market dynamics, except for Rosneft bond issues, the seasonal factor appears to be less visible and the lowest bond placement values of Q1 2015 are logically accounted for by the yield upsurge during that period (in the wake of a Bank of Russia key rate hike in mid-December 2014). However, the substantial decline in yield rates over the past two years failed to boost the corporate bond market. Furthermore, the IFX-Cbonds Index bond portfolio duration decreased despite the bond yield decline, which gives evidence of a shorter period to maturity.

There were a few other major issuers in the corporate bond market that are worth of note, namely Vnesheconombank Group, VTB Group, Gazprom Group, OAO Russian Railways. These companies placed bonds worth up to Rb 100bn and more on a quarterly basis. Additionally, there were a few major foreign-currency bond issues in the domestic market in the period under review, two of which, worth USD 2.3bn each, were placed by OAO YAMAL LNG (the only buyer in both cases was the Russian Federation represented by the Ministry of Finance), and the rest, worth USD 100m to USD 600m, were placed by Vnesheconombank Group companies.



Sources: Bank of Russia, own calculations.

Fig. 2. Growth in the volume of bonded loans issued by non-financing organizations



Sources: Cbonds Information Agency, own calculations.

Fig. 3. Effective yield dynamics of IFX-Cbonds Index bonds, and placement volumes of new rouble bond issues of financial and non-financial organisations

All in all, the non-bank sector fundraising through the domestic bond market gained momentum in 2014–2016, to 100% in 2016 from 31% in 2014 (total growth of the internal debt owing to bond issues). However, despite such a strong growth of bonded loans, bank lending still remains the prevalent fundraising tool in the non-bank sector of the Russian economy. The bank lending market resumed growth in Q1 2017, increasing almost Rb 0.5 trillion, and the volume of outstanding bonds increased Rb 0.2 trillion, (or up 32% of the total growth of non-bank sector's outstanding domestic financial instruments). The share of bonded loans in the total debt volume increased from 13% in early 2014 to 20% at 2016 year-end, and bank loans still account for about 80% of the corporate sector's outstanding domestic financial obligations.●

4. ROSSTAT'S NEW METHODOLOGY AND THE BY-INDUSTRY MOVEMENT PATTERNS OF PRODUCTION INDICES IN EARLY 2017¹

A.Kaukin, E.Miller

From early 2017, Rosstat began to apply OKVED 2 – the new All-Russian Classifier of Economic Activities, thus necessitating extreme caution in interpreting the industrial production statistics. The results of calculations performed by the Gaidar Institute point to the persistent presence of the same trends as were observed in late 2016: slight increase in production volumes and close-to-zero rates of growth displayed by the majority of industries. The growth revival observable in some of them can be explained, as a rule, by the favorable situation in world markets and by subsidies allocated by the government¹.

For Russian industry, the year 2016 became the period of complete adjustment to the new economic reality: by that time, a number of sectors had effectively exhausted their production growth potential created by their import substitution opportunities and the ruble's weakening; Russian enterprises had adjusted their business plans and investment projects; output indices had begun to stagnate in the majority of industries, while some of them demonstrated slight growth toward the year's end².

From 2017, the Federal State Statistics Service (Rosstat) switched over to the new versions of the All-Russian Classifier of Economic Activities (OKVED 2) and the All-Russian Classifier of Products by Type of Economic Activity (OKPD 2) in its releases of industrial production indices. Among other things, this means that for some industries, the new indices are incomparable with data based on the older classification: the subsections of OKVED's previous version are now split into several ones, or some of them have been augmented by a new type of economic activity. Thus, for example, Subsection DA *Production of foodstuffs, including beverages and tobacco products*³ has been transformed into three separate subsections: *Production of foodstuffs*; *Production of beverages*; *Production of tobacco products*. In the new classification, Section C *Mineral Resources Extraction* now includes one new type of activity – *Rendering of services in the field of mineral resources extraction*. For a more detailed comparative analysis of OKVED 2007 and OKVED 2, see the Annex. The indices for each of the enlarged sections are derived from weights which, as before, are calculated based on data for 2010 describing the structure of gross value added by type of economic activity⁴.

In actual practice, all these alterations have resulted in a situation where the trend component⁵ of the industrial production indices cleared of calen-

1 The author should like to thank M. Turuntseva and T. Gorshkova for their help in statistical analysis.

2 Kaukin A., Miller E. Industrial output dynamics in 2016: from stagnation to recovery – driven growth? // Monitoring of economic situation in Russia. Trends and outlooks of socio-economic development. No 3(41), February 2017.

3 As defined in OKVED – 2007.

4 On industrial production in January–April 2017. Federal State Statistics Service (Rosstat), http://www.gks.ru/bgd/free/B04_03/IssWWW.exe/Stg/d02/96.htm

5 the trend component was removed by using Demetra software package based on X12-ARIMA.

dar and seasonal factors can be removed either only for data for the period 2013–2017 (based on Rosstat's new classification), or only for data based on the old classification that was applied for the period 2000–2016. The former makes it impossible to obtain quality time series properly cleared of calendar and seasonal factors due to the inadequate length of available data sequences and the specific characteristics of the corresponding statistical procedure. In the latter case, it is necessary to add own calculations based on 2017 data and performed in accordance with Rosstat's methodology (recalculation for OKVED 2007 based on the formula provided in the Official Industrial Production Index Calculation Methodology¹). As there is no access to metadata, this approach may result in certain errors in the resulting estimates.

In order to analyze the dynamics of industrial production indices in individual sectors on the basis of these two datasets, the Gaidar Institute's experts removed the trend component of the industrial production indices for each industry. Also, for comparison purposes, the experts analyzed the results of the seasonal and calendar adjustment of the corresponding time series taken from the Joint Economic and Social Data Archive of NRU-HSE².

Fig. 1 shows the by-industry movement patterns of the trend components of the industrial production index calculated using these datasets. It becomes clear that similar dynamics was already observed in the previous years: a decline in the volume of production over the course of 2015, followed by stagnation and insignificant growth in 2016. However, the three movement patterns differ in their scale: the deepest drop is displayed by the trend component calculated on the basis of data issued by Rosstat as OKVED – 2007 (93.5% in July 2015 relative to July 2014); in early 2016 it gave way to stagnation, which was followed by a slight growth from Q4 2016 onwards.

The trend component of the time series calculated by NRU HSE shows a similar dynamics, albeit with a lesser depth of decline in 2016 and a more pronounced growth over recent months. The differences between the estimates released by NRU HSE and those released by the Gaidar Institute may be attributed to the specific features of the statistical procedures used by these two research institutions, and also to the effect of 'tail-wagging' from database to database – that is, to a reduced precision in assessing the trend during the last few months of the period under consideration. The movement pattern of the trend component based on Rosstat data issued in accordance with OKVED 2 reflects only very approximately the real processes due to the shortness of the period for which the relevant data are available; the results of calculations in this case cannot be properly interpreted, and so are not applicable for an analysis of changes in the movement patterns of production indices over recent months. Below we present the results of our calculations of the trend component based on Rosstat data for 2000–2017 issued in accordance with OKVED – 2007.

According to Rosstat data³, the industrial production index in January–April 2017 amounted to 100.7% relative to the same period of 2016; in April 2017, it amounted to 102.3% relative to April 2016 (vs. 101.8% according to

1 Official Industrial Production Index Calculation Methodology Federal State Statistics Service (Rosstat),. [http://www.gks.ru/wps/wcm/connect/rosstat_main/rosstat/ru/statistics/enterprise/industrial/#]

2 <http://sophist.hse.ru/hse/nindex.shtml>

3 On industrial production in January–April 2017. Rosstat. [http://www.gks.ru/bgd/free/B04_03/IssWWW.exe/Stg/d02/96.htm]

4. ROSSTAT'S NEW METHODOLOGY AND THE BY-INDUSTRY MOVEMENT

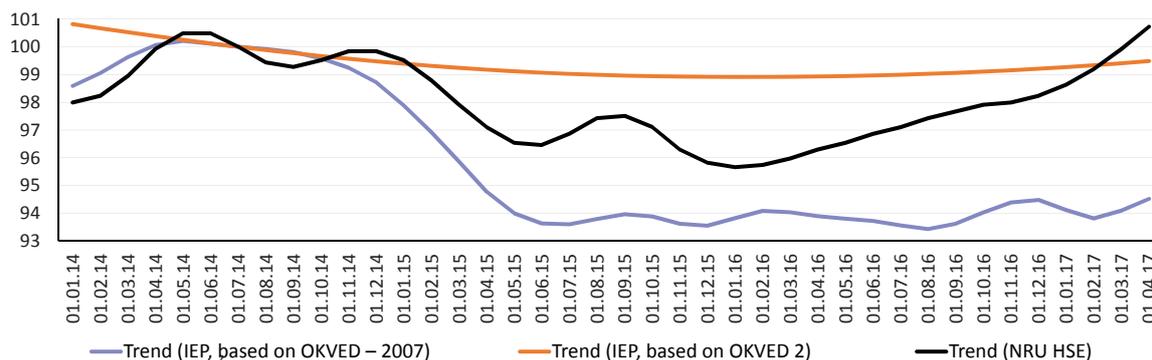


Fig. 1. The movement patterns of the trend component of the industrial production index, estimated on the basis of three calculation methodologies, in 2014–2017 (July 2014 = 100)

the Gaidar Institute’s calculations). Meanwhile, Rosstat’s calculations based on its new methodology demonstrate that in 2015–2016, there was practically no shrinkage in the industrial production volume¹. Some experts believe that the growth indices yielded by the recalculations based on the new methodology may have resulted from erroneously applied classification codes and seasonality². The Gaidar Institute’s calculations presented earlier testify to the fact that the industrial production indices, when cleared of seasonality, may indeed demonstrate an absence of decline in 2015–2016 if the relevant procedure is to be applied to the relatively short series of Rosstat data calculated in accordance with OKVED2. However, this result was obtained owing to the insufficiency of data for the relevant statistical procedure³, and thus it cannot be properly interpreted. The dynamics of industrial production indices (the ‘polarization’ of industries followed by general decline in 2015 and stagnation in 2016)⁴ described in the previous issues of our monitoring has been confirmed when the new data issued by Rosstat were included in the calculations done in accordance with a more precise methodology (i.e. an analysis of the entire dataset for the period 2000–2017).

Table 1 presents the calculated changes in the trend components of the production indices for each industry. Over recent months, slow growth of industrial production indices has been observed in every sector, both in the extractive and the manufacturing industries. One of the stably growing industries is the chemical industry, its products being sufficiently competitive due to the increased inflow of government and private investment designed to fund the modernization of old production capacities and the creation of new ones, cou-

1 All was well. Kommersant, 20 June. 2017. [<https://www.kommersant.ru/doc/3224435>]

2 Zayakin S., Perechneva I. Diamond arm. Expert, 5 June 2017. [<http://expert.ru/ural/2017/21/brilliantovaya-ruka/>]

3 In the Gaidar Institute’s calculations, the trend component was removed by using Demetra software package based on X12-ARIMA.

4 See, e.g., G. Idrisov, A. Kaukin, O. Morgunova, M. Turuntseva. The deepening industrial slump: trends have become a fact. Monitoring of economic situation in Russia. Trends and outlooks of socio-economic development, No. 9 (June) 2015; A. Kaukin, G. Idrisov. Russian industry in H1 2016: zero dynamics. Monitoring of economic situation in Russia. Trends and outlooks of socio-economic development. No. 14(32). September 2016; A. Kaukin, E. Miller. Industry in Q3 2016: close to zero. Monitoring of economic situation in Russia. Trends and outlooks of socio-economic development. No. 20(38). December 2016.

pled with the favorable situation on world markets¹. A similar growth has been noted in the rubber and plastic products manufacturing sector (it being a major consumer of products of the chemical industry: plastics, rubbers, etc.²).

Table 1

BY-INDUSTRY MOVEMENT OF THE INDUSTRIAL PRODUCTION INDEX,
BASED ON ROSSTAT'S OKVED – 2007, %

	Share in industrial production index	April 2017 on July 2014	April 2017 on December 2016	Changes over recent months
Industrial production index		98.21	100.49	slow growth
Extraction of mineral resources	33.99	105.38	101.87	slow growth
Manufacturing industries	52.50	94.51	100.04	slow growth
including:				
production of foodstuffs, including beverages, and tobacco products	17.05	107.04	101.37	slow growth
textiles & textile products manufacturing*	1.43	103.65	111.38	growth
leather production and leather products & footwear manufacturing	0.32	98.91	104.82	slow decline
timber & wood product processing	2.20	99.41	96.96	decline
cellulose & paper production*	3.92	78.64	94.77	decline
production of coke & petroleum products	18.78	97.72	100.04	stagnation
chemical production	7.46	130.14	105.37	growth
manufacturing of rubber & plastic products	2.26	103.75	101.80	growth
manufacturing of other non-metallic mineral products	4.41	84.66	99.54	slow decline
metallurgical production & finished products	17.23	101.42	111.54	slow growth
machinery & equipment manufacturing	6.24	91.74	97.56	decline
electric, electronic & optical equipment manufacturing	6.05	88.40	99.05	slow decline
transportation equipment manufacturing	7.06	75.06	93.93	decline
other industries	5.59	89.46	100.08	stagnation
Production and distribution of electric energy, gas and water	13.51	101.80	100.40	growth

Note. The trend component values in the rows marked with an asterisk (*) should be treated with extreme caution because Rosstat's data have been recalculated (aggregated), and so it is difficult to interpret the results.

The modest production growth in the food industry and the machinery & equipment manufacturing sector that has been observed from late 2016 onwards can be explained (as before) by direct government subsidies. All the other manufacturing industries have continued to stagnate.

Thus, the Gaidar Institute's analysis of the trend component removed from the industrial production index points to the presence of slight growth in some industries. However, it has not yet evolved into a general trend and, with some rare exceptions, is the upshot of government subsidies, and not of competitive products.

1 Redox reaction. Expert, 7 June 2017. [<http://expert.ru/ural/2017/21/reaktsiya-voss-tanovleniya/>].

2 Production in Russia's chemical industry: main trends. Eurasian Chemical Market, 2017, No. 5(152).

COMPARISON OF OKVED-2007 AND OKVED2¹

OKVED-2007: from 2005 through 2016	OKVED2: from 1 January 2017
Section C. Extraction of mineral resources	Section B. Extraction of mineral resources
CA. Extraction of fuel-and-energy mineral resources	05. Extraction of coal 06. Extraction of crude oil and natural gas
CB. Extraction of mineral resources other than fuel-and-energy	07. Extraction of metal ores 08. Extraction of other mineral resources 09. Rendering of services in the field of mineral resources extraction
Section D. Manufacturing industries	Section C. Manufacturing industries
DA. Production of foodstuffs, including beverages, and tobacco products	10. Production of foodstuffs 11. Production of beverages 12. Production of tobacco products
DB. Textiles & textile products manufacturing	13. Textile products manufacturing 14. Clothing manufacturing
DC. Leather production and leather products & footwear manufacturing	15. Leather and leather products manufacturing
DD. Timber & wood product processing	16. Timber & wood processing, manufacturing of wood and cork products other than furniture, straw product manufacturing and weaving materials production
DE. Cellulose & paper production; publishing and printing	17. Paper & paper product manufacturing 18. Printing activity and information carrier copying
DF. Production of coke & petroleum products	19. Production of coke & petroleum products
DG. Chemical production	20. Production of chemical substances and chemical products 21. Production of pharmaceuticals and materials for medical application
DH. Manufacturing of rubber & plastic products	22. Manufacturing of rubber & plastic products
DI. Manufacturing of other non-metallic mineral products	23. Manufacturing of other non-metallic mineral products
DJ. Metallurgical production & finished products	24. Metallurgical production 25. Manufacturing of finished metal products other than machinery & equipment
DK. Machinery & equipment manufacturing	26. Manufacturing of machinery & equipment not included in other groups
DL. Electric, electronic & optical equipment manufacturing	27. Manufacturing of computers, electronic & optical equipment 28. Electric equipment manufacturing
DM. Transportation means and equipment manufacturing	29. Manufacturing of motor vehicles, trailers and half-trailers 30. Manufacturing of other transportation means and equipment
DN. Other types of manufacturing industries	32. Manufacturing of other finished products 31. Furniture manufacturing 33. Repair and assembly of machinery and equipment
Section E. Production and distribution of electric energy, gas and water	Section D. Supply of electric energy, gas and steam; air conditioning Section E. Water supply; sewerage, organization of waste water and refuse collection and removal, water pollution cleanup

1 OK 029-2014 (KDES 2). All-Russian Classifier of Economic Activities (approved by Order of Rosstandart No. 14-st, dated 31 January 2014) (as amended as of 7 October 2016). ConsultantPlus.

5. SUBSIDIES TO THE AGRICULTURAL SECTOR: THE SMALL BUSINESS IN DISADVANTAGE AGAIN

V.Uzun

From 1 January 2017, loan subsidizing rules for the agricultural sector were largely modified¹. However, those changes have not resulted in a share of subsidies for large companies being limited. Quotas on subsidies for the small business remained unutilized due to preservation of bureaucratic barriers.

The Ministry of Agriculture of the Russian Federation has developed a soft lending plan for 2017. Under the above plan, the following two quotas were set for the small business in 2017: 30% on short-term loans and 10% on long-term loans. The total sum of subsidies amounted to Rb 4.93bn.

In the state agriculture development program, subsidies are divided across subprograms of crop production, livestock breeding and other. Short-term subsidies are divided such as envisaged by the state program. As regards investment loans, quite a different grading of subsidies was introduced. They are divided by the size of loans. In 2017, it is planned to allocate Rb 586m worth of subsidies (10%) on investment loans for the small business; Rb 1998m (34%) on loans up to Rb 1bn; Rb 2639m (45%) on loans from Rb 1bn to Rb 8bn; Rb 641m (11%) on loans over Rb 8bn. Such a distribution of subsidies explicitly suggests that there is only one recipient of funds in the last group (if it takes a Rb 8bn loan, the state will have to pay it Rb 640m worth of subsidies a year with the Russian Central Bank's key rate of 8%) and there are about eight recipients in the next-to-last group (options of 4 to 32 are possible). So, most subsidies (56%) in the plan are meant for a few privileged agricultural entities. It is to be reminded that in Russia there are about 20,000 actively operating agricultural entities which claim subsidies.

As a result, no new developments have been observed in distribution of subsidies in 2017. It happened in previous years that only individual privileged entities received subsidies. For example, in 2016 the OOO Bryanskaya Myasnaya Kompania (Bryansk meat-packing company) which is a part of the Miratorg agricultural holding received 90.7% of all the subsidized loans extended for development of beef cattle breeding (Rb 33.6bn)². Another Rb 2.3bn worth of subsidized loans was granted to three companies (one in Kalmykia, another in the Voronezh Region and yet another in the Kaliningrad Region), while the rest of the country was left without any subsidies.

In the drawn up plan, short-term loan subsidies were distributed among constituent entities of the Russian Federation, while no investment loan subsidies were distributed at all. Obviously, this can be explained by the fact that in distributing subsidies it would become clear that large loans are planned to be granted only to individual constituent entities, while others get none.

1 V. Uzun. Loans to the Agricultural Sector: Living According to New Rules. Online Monitoring of Russia's Economic Outlook. Trends and Challenges of Socioeconomic Development. No.3 (41) February 2017. P. 16–18.

2 The National Report on Progress and Outputs of Implementation in 2016 of the State Program of Development of Agriculture and Regulation of Markets of Agricultural Products, Raw Materials and Food in 2013–2020. P. 102.

All the constituent entities need short-term loans and it would be logical to distribute them proportionally to the gross agricultural output of one or another region. However, the planned distribution is carried out on the basis of other principles, for which reason on a per rouble of gross output basis some regions receive several times more subsidies than other. For example, the Belgorod Region produces only 4% of the country's gross agricultural product, but it is planned to allocate it nearly 10% of the subsidies. On the contrary, the share of the Kostroma Region in gross agricultural production is twice as high as that in subsidies.

In distributing short-term loans, in all the constituent entities of the Russian Federation small farm households were allocated 30% of the total sum of the subsidies. However, it was not specified that the role of small farm households varied greatly across regions. In 2016, peasant farms nationwide accounted on average for 12.5% of gross agricultural products; in 25 constituent entities of the Russian Federation farm households yielded less than 5% of gross production, while in some constituent entities, over 20%.

The soft lending plan was carried out as follows: the Ministry of Agriculture of the Russian Federation selected 15 large banks which in their turn picked potential borrowers applying for soft loans. The lists of potential borrowers were sent for approval to the RF Ministry of Agriculture that decided which borrowers to include in the register of soft lending recipients.

As of 31 March 2017, over 12,000 applications for the total sum of Rb 71.6bn were submitted for soft short-term loans. The sum of applications exceeded five times over the volume of the allocated funds¹. Despite numerous refusals, as regards the major lines of the state program for 2017 all the investment loan subsidies were distributed as of 23 April 2017, with only 3–7% of the subsidies remaining undistributed in respect of individual lines of short-term lending (*Table 1*)².

However, this year is yet far from being over. Apart from loans on field work in the spring, agricultural producers take loans to carry out harvesting operations and those against the next year yield, as well. For example, in 2015–2016 the Savings Bank of Russia allocated about 30% of all the short-term loans for the above purposes. Without additional subsidies being allocated in 2017, no soft loans will be available to carry out summer and autumn jobs.

Consequently, by the end of April subsidies were distributed almost completely, except for the sums meant for lending to small farm households. They managed to distribute only 30% of the subsidies as regards that line. The problem is in the point that small farm households are unable to comply with requirements set by officials and banks to subsidized loans.

Here are the following main factors that make it infeasible for the small business to secure short-term loans:

- there are faults in distribution of limits on subsidies across constituent entities of the Russian Federation;

1 The list of potential borrowers on which the RF Ministry of Agriculture took a positive/negative decision to include in the register of borrowers <http://mcx.ru/upload/iblock/761/761369efb66917df5245e6b36aaf9e37.pdf>

2 The data on applications for long-term loans are not available at the Web-site of the RF Ministry of Agriculture. As regards short-term loans, the data is provided in such a format that detailed processing thereof is infeasible, so it was impossible to check whether a limitation on allocation to one borrower of maximum Rb 1bn worth of soft short-term loans was complied with.

Table 1

SUBSIDIZING PLAN AND IMPLEMENTATION THEREOF IN 2017 (MILLION RB)

Lines	Subsidizing plan for 2017	Subsidies distributed	As of 23 April 2017	
			Outstanding balance	
			Million Rb. (as of 23 April 2017)	% compared to the Plan
Short-term lending – Total	15431	11722	3709	24.0
Including that in respect of loans to small farm households for	4377	1322	3055	69.8
crop production	4812	4736	335	7.0
livestock breeding	2359	2254	76	3.2
dairy cattle breeding	1201	1190	105	4.8
beef cattle breeding	280	269	11	3.9
Crop and livestock production processing	2401	2274	127	5.2
Investment lending – total	5865	5865	0	0
Including that in respect of loans to				
Small farm households	587	587	0	0
Loans for less than Rb 1bn	1998	1998	0	0
Loans for Rb 1bn to Rb 8bn	2639	2639	0	0
Loans for over Rb 8bn.	641	641	0	0

Source: the data of the RF Ministry of Agriculture.

- lending to small businesses is unprofitable to large banks;
- there are bureaucratic obstacles. For example, banks and officials have set the same requirements to document execution for receipt of a loan for over Rb 1bn and a loan for Rb 100,000. A soft loan agreement numbers 25 pages with the list of documents thereto printed on four pages. Some documents are valid only for 2–4 weeks and become outdated before banks and officials take a decision.

The following two important conclusions can be drawn from the above analysis.

1. *Subsidies to large companies should be limited.* Support of individual large companies makes life of banks and officials easier and contributes to production and efficiency growth. But it also has disadvantages: by creating unprecedented competitive advantages for large companies, the government brings about a downfall of other agricultural producers: they become non-competitive and have to phase down production. In agriculture now, there are pockets of explosive growth as well as distress territories where people have no jobs, land is neglected and the grass fades and can easily catch fire that devastates every year large forest areas and even villages. In individual sectors (dairy cattle breeding, beef cattle breeding and sheep breeding), the policy of development on account of mega-farms led to a crisis which prevailed for 25 years and a decrease in livestock and output volumes.

The theory of government support of farmers proceeds from the fact that farm households are small, return on unit of invested funds is lower than in other sectors and incomes are exposed to sudden fluctuations because of weather conditions. To prevent state subsidy funds from being spent on the big business alone in the agricultural sector, most countries have introduced limitations on subsidies per a single farm. For example, in the USA farmers with revenues of over \$900,000 are not entitled to subsidies, while others cannot receive over \$300,000 worth of subsidies a year (until recently the sum was limited by \$50,000). There are no such limitations in Russia. Large state-funded entities receive dozens and even hundreds of million dollars a year.

A major portion of state funds for support of the agriculture should be spent on the small and mid-sized business. To support big business, other mechanisms can be utilized. Large projects can be carried out, for example, with assistance of the Russian Private Investment Fund (RPIF). In such a case, investors would allocate funds after a detailed analysis of the expected return, carry out control over implementation of large projects, while borrowers pay out dividends to depositors and buy back their equities from them. Note that the RPIF was founded by the Vneshekonombank and extends soft loans to the OOO Miratorg. The state actually donates the company's owners subsidies which sum is equal or even exceeds the cost of investment projects, thus compensating for 15 years the main portion of costs related to payment of interests on loans.

2. Mechanisms of soft lending to the small business should be modified in principle. For that purpose, it would be expedient to do the following:

- develop a financial and lending infrastructure which is appropriate to the small business: small regional banks, municipal saving banks, credit unions and banks. As seen from developed countries' experience the level of development of the small business largely depends on the extent of the network of small financial institutions;
- include small banks and credit unions in the lists of entities which are authorized to extend soft loans to small farm households;
- grant credit unions the right to receive soft loans against guarantees of the National Guarantee System and Regional Guarantee Funds for Small Business Lending so that they could extend loans to credit union members;
- distribute subsidy limits on loans to small farm households with their actual share in the agricultural output of the RF constituent entity taken into account;
- redistribute subsidy quotas for small farm households between short-term loans and investment loans with due consideration of demand on loans. ●

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