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Russia

No consensus yet on social security contribution amounts. The government was initially scheduled to submit to the president by June 1 a proposal on ways to lower the mandatory social security contribution of employers back to a level nearer last year's 26 % of the wage bill. Companies have been less than complacent about the government's decision to raise the social security contribution of employers to 34 % from the start of this year. The contribution is regressive; the base rate applies to the part of the wage below a certain annual limit. The current limit is 463,000 rubles (€11,400). Wages exceeding this level are subject to a lower percentage. The regressivity built into the social security payment is designed to encourage firms to reduce under-the-table wage payments.

In January, prime minister Vladimir Putin tasked the government with identifying ways to reduce its just-hiked social security charge. In March, president Dmitri Medvedev followed up by asking the cabinet to come up with ways to get back to the lower social security contribution. The reduction is seen as concession to firms in order to leave them with more money e.g. to invest in keeping with the president's campaign to modernise the economy.

The problem is that a 26 % social security payment per se is insufficient to cover social security costs, particularly pensions. Every year a substantial amount of the federal budget is used to cover the pension fund deficit. Indeed, the pension fund has been in the red ever since 2005, when the base rate was lowered from 36.5 % to 26 %.

The finance ministry, economy ministry and the health and social affairs ministry have yet to reach agreement on how the social security contribution could be lowered. The finance ministry proposes that the reduction in the payment percentage be compensated for with an increase in the wage limit, below which the base rate is applied. The proposal would lift the limit from the current 463,000 rubles a year to 1−2 million rubles (€24,500–49,000). This would increase the social security contribution of sectors paying the highest wages, e.g. oil & gas and the financial sector. The economy ministry criticises the proposal, because it would also increase the tax burden of high-tech branches.

The ministries could only agree that from the start of next year the social security payments of small enterprises (excluding retailers) would drop to the old level. The payment of other sectors would be reset in a couple years after the impacts on the pension system are clear.

For its part, the presidential administration wants social security payments for all firms to drop from the start of next year. To make up for the lost income, the presidential administration has suggested e.g. boosting the corporate tax rate back to 24 % (it was lowered four percentage points to 20 % in 2009 as companies struggled with the recession). Other proposals include hikes in e.g. excise taxes on alcoholic beverages and tobacco. Putin's stance, however, is that consumers should not have to pay for the reduction in social security payments.

After the government and president Medvedev discussed the situation on Wednesday (June 8), Medvedev gave his cabinet two weeks to choose from two alternatives. Under the first choice, the social security payment would remain at 34 % for large firms, for mid-sized firms it would drop to around 26 % and for small firms to 16–20 %. Under the second alternative, the payment for large and mid-sized firms would drop to 30 % and small firms to 16–20 %. The cabinet still needs to consider how the loss of revenue would be made up to the pension fund.

The cabinet decisions would remain in force only for two years, after which a complete reform of the pension system would be carried out.

Debate over raising the retirement age reignites. Reports of the pension reform working group in Russia's upcoming economy development Strategy 2020 project find that raising the general retirement age is inevitable if the pension system is to remain solvent. The working group says the pension age should rise starting in 2015. An often-mentioned solution would be to raise the retirement ages of both men and women to 63 by 2030. The current retirement age is 60 years for Russian men and 55 years for Russian women. Furthermore, the number of years in the workforce to be eligible for a full pension should be increased from the current five years to 15 or 20 years.

The proposed changes are not sufficient to put Russia's pension system on a steady footing. In addition to the current financing problems, the stability of the pension fund will be affected by a decline in the number of people paying into the pension system. The size of the Russian labour force has already started to shrink with the diminished size of cohorts entering. At the same time, the pensioner population is growing. Thus, renewal of the pension system is inevitable, even if it has been less than ten years since the last major pension reform.

Pensions are an important income source for the bulk of Russian households. According to a survey by the Moscow-based Independent Institute for Social Policy, nearly half of Russian families are entirely or partly dependent on pension income. More than a quarter of the Russian population receives a pension, and pensioners often help out their children and family members with their pensions. Over a quarter of pensioners are still working after reaching retirement age, and pension income is an important supplement for low wages. Hence, from a social perspective, raising the retirement age is an extremely touchy subject.

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China

China finds supervision of credit markets challenging as deregulation proceeds. The power of officials to determine bank lending policies and thereby macroeconomic behaviour such as investment and housing purchases has long been a cornerstone of Chinese economic policy.

The People's Bank of China seems to have recently abandoned the notion of regulating the economy via the credit channel. This year it has set no targets for growth in the stock of bank loans. Instead, monetary policy appears to be shifting to management of broader financial aggregates (although no specific targets have yet been announced).

The gradual liberalisation of China's financial markets and the emergence of regulatory loopholes have diminished the ability of officials to regulate the credit channel. Actors in the financial sector operate outside the official sphere when opportunities appear. The amount of financing activity outside the scope of regulation in China is impossible to quantify, but there is substantial evidence to suggest that the phenomenon is now widespread.

According to official sources, tighter monetary policy and thereby tighter bank lending policies have caused many firms to turn to lending sources outside the regulated loan market. Borrowing rates on the grey market are often much higher than official lending rates. Banks themselves participate in the grey markets through off-balance-sheet lending via investment companies. China's banking regulatory commission has cracked down on banks with a heavy hand. In January it ordered banks to reinstate 1.7 trillion yuan (4 % of GDP) in loaned funds on their balance sheets.

Liberalisation of financial markets and the ending of currency controls pose serious challenges for Chinese officials. As witnessed on other countries, poor handling of the transition can result in big problems such as economic overheating or a full-blown financial crisis.

Summer power shortages in China hit early this year. As a rule, China's electricity shortages and rolling power cuts are most likely to occur in July and August. Power shortages this year arrived already in March, largely due to reduced coal imports at the start of the year and pricing policies harming electrical power producers and distributors. The electrical power shortage has been worsened by the most severe drought in decades in Southwest China. The lack of water has deeply affected power production at hydropower plants. Power shortages this summer are expected to be unusually serious as the shortfall should be about 40 GW, or 1 % of total electrical power consumption last year.

Coal is an important raw material in Chinese power generation. In February, some 84 % of Chinese power generation was supplied by coal-fired plants. Coal imports fell 25 % y-o-y in January-April due to high world prices. The shift to domestic coal increased the price of coal on China's home market. The price of Qinhuangdao coal, which is considered a reference rate in China, rose in May nearly 30 % y-o-y to $145 a ton. State regulated electricity rates have not been raised enough to cover soaring coal costs. As a result, production of electricity has become unprofitable and caused halts in production. Chinese officials are now planning to lower the VAT and port fees on imported coal to boost imports.

All sorts of answers to the power shortage have been tried, with electricity use restrictions imposed on households and industries alike. For the first time in one-and-a-half years, Chinese officials are planning to increase the electricity transmission tariffs by almost 3 % to commercial, industrial and agricultural users in 15 provinces. The rate hikes will not apply to households. Officials are reluctant to rely on rate hikes to deal with the electrical power shortage as it could fuel already worrisomely high inflation and hurt industrial output growth.

Oil and gas deposits create incentive for current boundary disputes in South China Sea. This week saw the latest in a string of international incidents in the South China Sea. Vietnam again accused Chinese of damaging the survey cables of Vietnamese oil ship. On May 26 China's coast guard cut the cables of a Petro Vietnam oil and gas exploration vessel. The Chinese have also engaged the Philippines in territorial disputes in recent months. China sees in practice the whole South China Sea as its exclusive territory, while Taiwan, Vietnam, the Philippines, Malaysia and Brunei all declare claims to sea areas and islands.

One reason for the territorial disputes is a desire to take control of potential gas and oil deposits in the South China Sea. While the estimated size and locations of possible reserves vary, the US Geological Survey reports that 9 % of Southeast Asia's undiscovered natural gas reserves and 12 % of oil reserves are located on the continental shelf areas of the South China Sea. With rising energy consumption, locating and developing the oil and gas sources increase tensions among countries with territorial claims.

China has an increasing interest in South China Sea gas reserves. A recent report by International Energy Agency (IEA) sees China becoming one of the world's biggest natural gas producers. The importance of natural gas is also emphasised in China's latest five-year plan. Despite strong growth, natural gas still satisfies only a few per cent of China's total energy consumption.

In addition to its gas and oil reserves, the South China Sea is a major trade route of geostrategic importance. ASEAN has long provided a forum for discussion of the territorial disputes. Inconclusive discussions were conducted last weekend in Singapore at the Shangri-La Dialogue, a key Asian defence summit.

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