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BOFIT Weekly

30 • 29.7.2011

Russia

Deposit insurance agency to pay out biggest settlement ever. Last week, the Central Bank of Russia pulled the licence of AMT Bank for abuse. AMT Bank invested in high-risk assets without setting aside sufficient reserves and hid the true situation in its books. The CBR's concrete reason for the pulling of the bank's licence was inadequate capital.

Although it ranks 83rd among Russia's approximately 900 banks based on its balance sheet, AMT Bank is relatively small. Russia's banking sector is highly concentrated; the five largest banks control almost half of total banking sector assets and top 30 banks control nearly 80 % of total deposits.

AMT holds about 15 billion rubles (€375 million) in household deposits, of which the deposit insurance agency will remunerate some 12 billion rubles to depositors. It is the largest settlement the agency has ever had to pay for a single bank. The remaining 3 billion rubles will be collected in the bank's winding down process.

Last year, the deposit insurance agency dealt with the fallout from the de-licencing of 16 banks, which resulted in a total compensation of 15 billion rubles. The largest settlement for a single bank was 5 billion rubles. The number of banks having their license pulled has returned to pre-crisis levels. In 2008 and 2009, there were about 30 licence cancellations a year. The related compensation amounted to 6 billion rubles in 2009, and 16 billion rubles in 2008.

The deposit insurance scheme was introduced in 2004. Deposits of up to 700,000 rubles (€17,500) are covered. At the end of 2010, some 99.7 % of bank accounts had deposits below the ceiling limit. About 70 % of the total sum of deposits is covered under the deposit insurance scheme.

Sberbank, the traditional choice of household depositors, held 48 % of total deposits at the end of last year. Most Sberbank accounts fell below the coverage ceiling, while in smaller banks that more often serve well-heeled clientele more than 50 % of accounts exceeded the deposit insurance ceiling.

The use of banking services in Russia is still lower than in advanced economies. Last year, some 73 million people (about 66 % of Russia's adult population) used banking services. Some 45 million people, or about 40 % of the adult population had a bank deposit account.

OECD: Russia's innovation policy in need of a makeover. An OECD review on innovation policy in the Russian Federation released in June finds that innovation policy still suffers from overemphasis on state research bodies rather than private companies. In most OECD countries, the private sector is the principal driver of innovation. In Russia, the leading role is still played by state research institutes and engineering offices. The effectiveness of these institutions is crippled by the fact that as a Soviet-era legacy they function in isolation from production and markets. User needs are not known, and commercialisation of innovative products is restrained by missing links to industrial producers.

Innovation and modernisation are the new taglines in Russia's current economic policy. The OECD criticises this policy for excessive focus on high-tech innovation, when the economy would actually benefit more from more mundane innovations. They would be important in particular for Russia's regions, where production capabilities are at modest technical levels.

Russia spends a relatively small amount on R&D. In 2008, Russian spending on R&D amounted to over 1 % of GDP, compared to an OECD average of over 2 %. The Russian state provided 65 % of R&D funding in 2008 while in OECD countries, the corporate contribution averages 65 %. The review noted Russian R&D funding is often distributed without clear targets or oversight.

In order to encourage innovation activity in the private sector, companies need to aim for long-term gains. This requires a more stable economic environment in Russia. Innovation, like most private corporate activities, is victim to e.g. bureaucracy, corruption and poor property protection. According to the OECD, increase in innovation activity is impossible without gains in these areas.

Recommendations in the OECD report include development of existing state research facilities by connecting them more closely to industrial production, improving protection of intellectual property and boosting competitiveness. The OECD further suggests increasing funding for innovation.

New law imposes stricter limits on alcohol sales and advertising. An important distinction in the new legislation approved last week is that beer is now regarded as alcohol. Hence, restrictions concerning alcohol now cover beer, too. E.g. the sale of beer to persons under 18 years of age is now banned.

Under the new rules, sale of alcoholic beverages in places other than restaurants is forbidden between the hours of 11pm and 8am. Alcoholic beverages may not be sold at kiosks, currently one of the most popular places for buying beer. Beer kiosks and night selling of beer, however, will be phased out at the end of 2012.

Alcohol ads may not use human or animal images, and ads for beverages with alcohol content above 5 % will be forbidden on tv, radio and billboards from next summer.

Consumption of alcohol is banned in public places such as public transport, train and bus stations, market squares and parks.

Work on the new law started after president Medvedev suggested alcohol restrictions in 2009.

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China

China's high-speed rail network plagued by safety issues and alleged corruption. Approximately 40 people were killed and over 200 injured in a bullet train accident in Eastern China last Saturday (July 23). The crash with another train has forced a revisiting of China's ambitious plans to roll out a vast bullet train network and move into lucrative export markets. Bullet train projects have been harshly criticised for creating opportunities for corruption, while breakdowns in safety precautions have stained the image of infrastructure projects. Railways minister Liu Zhijun was dismissed last February on suspicion of bribe-taking. Bullet train connections have recently suffered from operational failures and delays. Following the accident, the shares of China's largest train manufacturers CSR Corp. and China CNR Corp. dipped about 8 % on the Shanghai Stock Exchange.

China presently has built and operates 8,400 kilometres of high-speed rail. The government hopes to expand the high-speed rail network to 13,000 kilometres of track this year and 16,000 kilometres by 2020. Cost overruns on the project are already on the record. China's Ministry of Railways now estimates the actual costs of the project will rise by about $430 billion from an initial estimate of $300 billion.

The massive investments in high-speed rail have raised concerns over the debt burden of Ministry of Railways. In its 2011Q1 interim report, the ministry showed an exceptional $574 million pre-tax loss and debts of $279 billion (60 % of total assets or 4.6 % of China's 2010 GDP). The Ministry of Railways has been financing the rail projects mostly through domestic bank loans and bond issues. For the first time ever, the Ministry of Railways failed to sell all of its issued debt at auction; out of some 20 billion yuan in bonds offered in July 21, only 18.7 billion yuan's worth were purchased.

Total railway passenger traffic for 2010 was about 1.7 billion persons, up 10 % from 2009. In the first six months of 2011, passenger traffic overall grew 12 %. The number of bullet train passengers, however, has not risen as hoped due to pricy tickets that depress bullet train ridership.

Significant difference in wage levels across provinces and job sectors. In the second quarter of this year, nominal wages rose on average over 15 % y-o-y. Real wages were up 9 %. With the pickup in inflation, real wage growth somewhat lagged the pace seen in previous years. According to National Bureau of Statistics' wage figures, the average annual wage last year was 36,500 yuan (€4,100).

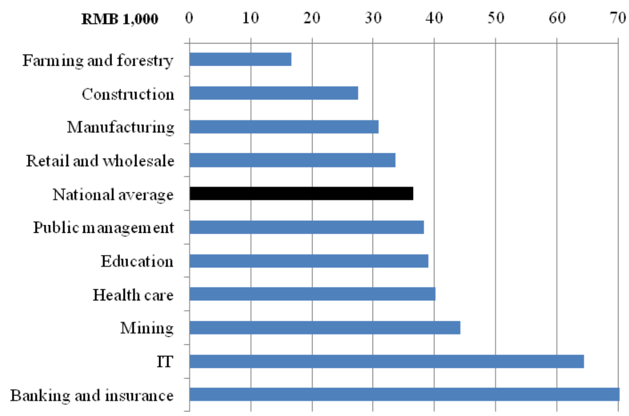
The rise in wage levels reflects new policies geared to encourage consumerism by giving Chinese higher disposable incomes and increasing purchasing power. Last year's efforts to raise the minimum wage will continue this year. In the first half of this year, minimum wage levels have been raised on average more than 15 % in 18 regions. Under the current five-year plan, officials have targeted an increase of at least 13 % p.a. for minimum wages. In addition to policy measures, companies in China's coastal provinces have been rapidly increasing wages to hang on to workers as the skilled labour shortage deepens. Such rapid wage growth is helping to fuel inflation in China.

China's highest wage levels are enjoyed by residents of China's east-coast metropolises − Beijing, Shanghai and Tianjin. In the second quarter of 2011, wages in Beijing were nearly double the national average. The average wage nationally was exceeded only in China's coastal provinces and the Tibet province.

Wage growth in coastal areas has been more modest than the national average, except for the large urban areas and lower-wage Fujian and Liaoning provinces. Wage growth this year spiked sharply in Beijing and Shanghai. On the other hand, wage development in lower-wage provinces in Central China has been above average. The trend reflects the inland shift of production away from expensive coastal areas. This impact, however, has failed to extend to Southern and Northern China, where the rise in average wage levels has been slower that the national average. The big exceptions are the Inner Mongolia and the Xinjiang provinces, which have enjoyed brisk wage growth.

The differences across various branches were also huge. Wages have risen fastest this year in retail and wholesale, and banking and insurance. Wage development in manufacturing has also exceeded the national average. Accelerating labour costs cause China to lose competitiveness vis-à-vis Asian countries that offer cheaper labour.

Average annual wages in selected branches in 2010.



Source: China National Bureau of Statistics

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