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Russia

Strategy 2020 programme released. A year ago, prime minister Vladimir Putin ordered the drafting of a medium-term programme to guide Russia's economic and social development policies. "Strategy 2020" comprises contributions from over a thousand experts serving in two dozen working groups. It presents a range of development scenarios and gives concrete policy recommendations to the new president and cabinet. President Dmitri Medvedev has already begun to hold meetings with working group representatives to consider proposed measures.

The need for a revised economic policy become evident during the 2008–2009 recession, from which the Russian economy failed to bounce back to the pre-recession pace of high growth. This forced government circles to revisit measures to reduce the economy's heavy dependence on energy exports and identify new sources of economic growth.

The basic policy framework of Strategy 2020 has already been in place at least in practice. Pursuit of low inflation and a conservative budget policy are cornerstones of the Strategy 2020. It sets a fairly rapid pace for slowing inflation: the 12-month inflation should be below 5 % by the end of 2013. The conundrum for policymakers is that efforts to subdue inflation require tight monetary policy, hence foregoing higher economic growth over the next two years. The drafters of the strategy assure that the initial low growth will be made up in the out years as investment rises in a environment of stable prices. The strategy's medium-term goal is to achieve sustained GDP growth averaging 5 % a year, which would put Russian growth higher than in advanced economies and on a path to catching up with the advanced world.

Once inflation is under 5 % p.a., the Central Bank of Russia would shift its monetary policy focus away from exchange-rate targeting to inflation targeting. Russia's inflation target would be the average EU inflation rate plus 1.5–2.0 percentage points. Russia has already begun to abandon exchange-rate targeting in practice as the central bank has allowed the ruble to move in an ever widening fluctuation band since 2009.

Strategy 2020 seeks get beyond the policy paralysis engendered by Russia's "resource curse." Many critical economic and social reforms have been postponed as prices of crude oil and other commodities have always been quick to recover and boost budget revenues after a couple of years of lower prices and smaller revenues. Areas most acutely in need of reform include education, health care and development of transportation infrastructure. These structural reforms are unavoidable if Russia is to achieve sustainable economic growth. Such reforms will require money, yet it is increasingly difficult to boost budget expenditures given Russia's burgeoning budget in recent years and the need for fiscal restraint.

The strategy concedes that Russian budget policy lost its way during the 2008–2009 recession when the budget rules adopted in 2002–2004 were neglected. Under the rules, public spending could not be increased as fast as tax revenues, and any revenue surplus had to be transferred to reserve funds. Other significant revenue increases in recent years include growth in spending on pensions, defence and national security, as well as political stunts such as hosting expensive events that involve massive public investment such as the 2012 APEC summit in Vladivostok, the 2014 Olympics in Sochi and the World Soccer Championships in 2018.

Strategy 2020 emphasises a return to spending discipline to allow Russia to achieve a sustainable fiscal balance. It is proposed that new budget rules to limit spending be established, so that annual expenditures would be limited to an amount that balances the budget at a "base level" world oil price. Base level is defined as the average price of Urals-grade crude oil over the previous ten years. The strategy also presents a more lenient budget option, whereby annual budget deficits of up to 1 % of GDP would be permitted. Under this rule, Russia's public sector debt could rise from around 10 % at present to 25 % of GDP by 2020 (still low by international standards).

The drafters of the strategy note that it is up to policymakers to choose between these two policy lines. The first is to seek a rapid balancing of state finances, an approach that limits the possibilities of implementing structural reforms. Alternatively, policymakers can opt for a gradual increase in public debt that would allow better funding for needed reforms. Both options, however, call for significant repurposing of spending in order to leave resources for reforms. For example, Russia spends 1.5–2 percentage points of GDP less on education than the OECD average, and 2–4 percentage points less on health care.

As a third cornerstone of economic policy, the strategy tackles elimination of institutional barriers to economic growth. The importance of this subject has been repeatedly stressed at the highest government levels over the past couple of years. The strategy suggests improving Russia's business environment through e.g. significant reductions in public regulation and restrictions, reforming incentives to motivate civil servants and cutting their oversized number.

The strategy emphasises a new approach to social policy. Social policy will continue to focus on providing the poorest and weakest members of society with a safety net, but with an emerging middle class it today also needs to align with their expectations, e.g. environmental and housing policy, as well as professional advancement. Russia's new middle class will have a special role in economic transformation as it provides the drivers of creativity and innovation, the basis of new forms of economic growth.

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China

Sacking of Chongqing party leader Bo Xilai stirs debate on China's development options. Although the Secretary of the Chongqing Municipal Committee of the Chinese Communist Party Bo Xilai recently suffered a loss of reputation due to offences and revelations of his former subordinate, his removal from office at the end of the National People's Congress last week came as a surprise. The events, however, have precipitated an interesting and diverse discussion on how decisions get made in China, alternative reform strategies and the growing role of the media.

The firing of Bo, who had at one time been seen as a possible pick for the premiership, was seen as exposing rifts in policy within the party. The dust-up takes place ahead of the next autumn's power transition – typically a difficult process for China's one-party political system. Indeed, the selection and instatement of current president Hu Jintao and premier Wen Jiabao in 2002 stands as the only instance in modern Chinese history of a leadership change implemented without drama. The sacking of Bo has also reminded the public of the closed nature and capriciousness of China's political decision-making process.

Bo built his reputation on the "Chongqing Model," which is founded on the elements of rapid economic growth supported by massive public investment, reducing income disparities between the countryside and cities, fighting corruption and other criminal activity…all blended with Maoist nostalgia. In the view of many, the model is best characterized by populism and notorious political campaign approach. Moreover, it lacks transparency and encourages questionable bending of the law in fighting crime. Premier Wen went so far as to compare the Bo's policy with the much-despised Cultural Revolution when discussing Chongqing's failures.

Although Bo's sacking is in many respects a remainder of old features of the Chinese policy making, a new element is the increased role of social media. Bo himself has a reputation for media savvy, but it has been no match for the debate concerning recent events ignited in social media. The growing role of social media is evident and is likely to have an ever increasing impact on policy formation.

The pro-reform talk and the disparaging of the Chongqing Model at the National People's Congress, as well as the growing role of social media seem to suggest that there is a rising demand and willingness on the part of the public and leadership to adopt market reforms.

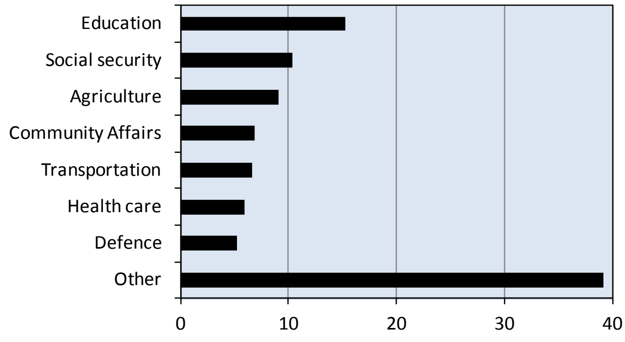
Over a quarter of public sector activities off-budget in 2011. China's public sector can be divided into two parts: the central administration and local administrations. The finance ministry's 2011 budget report notes that revenues of central and local administrations were roughly equal and together amounted to 10.4 trillion yuan (€1.15 trillion, 22 % of GDP). Public spending amounted to 10.9 trillion yuan (€1.21 trillion, 23 % of GDP). The bulk of tax revenues collected by the central administration is transferred to local administrations, and they accounted for 85 % of the total public spending last year. Due to higher-than-expected growth in revenues, the public sector deficit was smaller than budgeted, about 500 billion yuan (1.1 % of GDP).

The budget report found that off-budget revenues last year reached 4.2 trillion yuan. Most of that came from sales of land-use rights by local administrations. A small share of off-budget revenue is derived from management of state property (including corporate profits, income from sales of state assets and dividends). Most off-budget revenues are spent on construction projects.

Public sector revenues in the 2012 budget are expected to increase 10 % and expenditures 14 %, thereby increasing the deficit slightly. Spending on education, health care and social security should increase far more than average. Off-budget revenues are expected to decline to 3.6 trillion yuan, mostly due to reduced revenues from sales of land-use rights. Off-budget revenues this year will again mainly be used to fund construction.

Although China has improved its budget reporting substantially in recent years, many public sector activities are still poorly tracked. For example, about 30 % of public spending in 2012 has not a designated application in the report and it is unclear how much funds are allocated for domestic security. Another example is the implementation of the 2008–2009 economic stimulus programme, which was left largely to local administrations. Under the law, local administration budgets need to be in balance, which means they cannot run into debt. To implement the stimulus policies, local administrations took massive amounts of debt off budget, which is currently estimated to be 30–60 % of GDP. A few local administrations were granted the right to issue bonds last year. If the trial is expanded, local administrations will have to subject to greater market scrutiny, which will require increased transparency on their part.

Main budget spending categories in 2012, % of spending



Source: Ministry of Finance

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