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BOFIT Weekly

29 • 20.7.2012

Russia

Russia revises its farm subsidy formats as WTO membership looms. The government last week approved its agricultural development programme running through 2020. The programme establishes a direction for agricultural policy within the new WTO context. It includes specific production targets and stresses the importance of higher farm efficiency to enable domestic production to compete against cheaper imports following the WTO membership.

The programme calls for incremental hikes in agricultural supports paid to farmers. In next year's federal budget, 159 billion rubles (€4 billion) will be set aside for farm subsidies (slightly more than this year's amount). Supports rise to 218 billion rubles (€5.5 billion) in 2020. In addition, subsidies are paid from regional budgets. The amount of subsidies Russia can pay out is limited by Russia's WTO agreement.

OECD figures show Russian farm subsidies have been exceeding EU and OECD averages in recent years. Combined supports to Russian producers in 2010 represented 21 % of an average farm income, slightly above the OECD average of 18 %. Agricultural supports were raised sharply in Russia in 2008 and 2009 in response to the economic recession and major crop failures nationally.

Russia's agricultural commitments under the WTO agreement will be phased in gradually through 2018. Average import duties will fall from the current 13.2 % to 10.8 %. Some 60 % of these reductions on import duties will enter into force as soon as Russian membership takes effect.

The agricultural development programme also includes a significant change how agricultural supports are granted so as to bring them into line with WTO rules. One of Russia's most popular support formats, price supports for production inputs, will be phased out next year. Farm producers have been able to buy fuels and lubricants at discount prices over the past three years. Oil companies have supported the costs of these fuel discounts, which have been on the order of 20–30 % of their wholesale price.

In lieu of price supports paid to farmers, income supports based on farmed acreage will be introduced. Meat producers will enjoy larger subsidies as increasing Russia's self-sufficiency in meat production has long been an agricultural policy priority. More money will also go to regional agricultural development projects. Supports for milk producers will now be based on that amount of milk actually sold. The aim of this policy is to encourage producers to improve the quality of dairy products. According to Russia's agriculture ministry only 30 % of milk produced in Russia meets EU quality standards.

The agriculture ministry reports that last year Russia's domestic production was sufficient to cover the country's needs for 73 % of meat, 80 % of milk and 96 % of potato consumption.

The agriculture ministry this year expects the grain harvest to come in at around 80–85 million metric tons. The grain crop estimates are constantly evolving and could well decline as Russia's grain belt has been affected by bad weather. Last year's grain harvest was exceptionally good − 94 million metric tons.

The ministry currently projects grain exports from the current harvest to reach around 16 million metric tons. In the last harvest season, Russia exported a record 27 million metric tons of grain (mostly wheat).

Russian railways suffering effects of long-term underinvestment. The recently released 2011 annual report of Russian Railways reveals that the average rate of travel of freight cars between stations slowed last year to just 37 kilometres an hour. If time for loading and unloading cars at stations is added in, the average rail freight speed was just 10 kilometres an hour.

Russian Railways blamed the slowdown on its aging stock of locomotives and poor infrastructure that the state rail company is itself obliged to maintain. The situation is further complicated by the approximately 2,000 private operators now handling nearly all of the country's rail freight shipping. Russia's rail system, created during the Soviet era, is based on the assumption of a single operator for the entire country.

Delays caused by a lack of freight cars were particularly acute last autumn. In fact, the problem was not the lack of available cars per se, but rather the difficulties operators faced in managing shipments within the Russian Railways system. The situation was further complicated by the fact that private operators gave priority to the most profitable cargo, preferring to let cars travel empty rather than use them to carry less profitable cargo.

The delays in rail freight shipments last year caused large economic losses for clients. As a result, Russian Railways saw the number of reimbursement claims jump three-fold to 100,000. The company paid out over 2 billion rubles (€50 million) in compensation.

To improve the situation, Russia this year has revised certain rules on freight transport and tariff-setting mechanisms. Russian Railways is e.g. increasing the share of freight trains running according to regular schedules in the flow of rail traffic, while reducing transportation of empty cars.

The use of Russian rolling stock is relatively inefficient: Russia has far more rolling stock than, say, the US, which has a more extensive rail network and transports a larger volume of freight.

Editor-in-Chief Seija Lainela

Bank of Finland • Institute for Economies in Transition, BOFIT
P.O. Box 160 • FI-00101 Helsinki
Phone: +358 10 831 2268 • Email: bofit@bof.fi • Web: www.bof.fi/bofit

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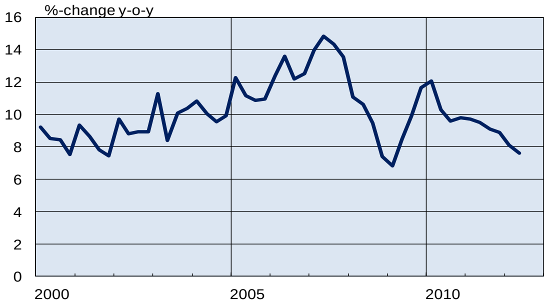
China

China returns to investment-driven stimulus measures to support growth. China's National Bureau of Statistics reports second-quarter GDP grew 7.6 % y-o-y in real terms. First-quarter GDP growth was 8.1 % y-o-y. However, NBS figures also show that on-quarter GDP growth was higher in the second quarter (up 1.8 % q-o-q) than in the first quarter (1.6 % q-o-q). The on-quarter figures raised comments about the reliability of official figures, especially when other economic information (e.g. company surveys) note no signs of a pick-up in economic activity.

12-month change in real GDP growth, %



Source: China National Bureau of Statistics

Domestic demand continues to drive economic growth in China. Consumer demand continues to climb steadily, accounting for half of all economic growth in 1H12. While the growth of investment demand has slowed from recent years, investment still accounted for half of growth in the six months of the year. However, it seems that investment growth has passed its slowest phase.

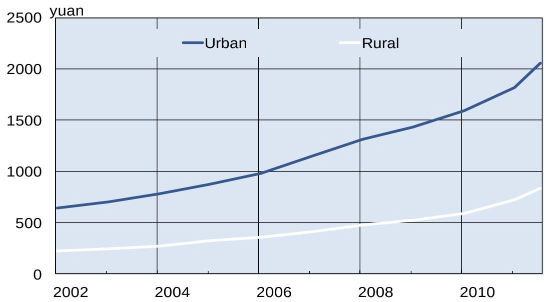
The trend in export demand remained weak. Although the value of goods trade surplus in the first half of 2012 was $10 billion larger than in 1H2011, the volume of surplus (net exports) contracted, and had a negative contribution to overall economic growth. The world economy, especially markets in Europe, are not expected to revive much during the latter part of the year, and net exports in the second half are likely to remain below the 2H2011 level.

China has reverted to familiar measures for reviving growth. Premier Wen Jiabao said last week that the government's main task was to accelerate investment growth. This summer the central bank has lowered reference rates twice and the government has speeded up permitting processes for investment projects. Also consumer demand has been supported through e.g. subsidised purchases of energy-efficient home appliances. While the stimulus measures will be more strongly felt in the second half of the year, economic growth is expected to pick up slightly.

Growth forecasts for spring and summer, however, have been revised downwards. The latest IMF forecast for China, for example, sees GDP growing 8 % this year and 8.5 % in 2013. In last March's BOFIT forecast, GDP growth was expected to come in at around 8 % in both 2012 and 2013.

Income disparity on the increase in China, even as average incomes keep rising. The NBS reports monthly per capita disposable incomes of urban households were 2,085 yuan (€255) during January-June. Real incomes climbed 11 % y-o-y in the period. Also the fact that low-income earners now constitute a smaller share of the population, while the share of high-income earners has continued to grow indicates overall enrichment of urban-dwellers. Rural households had average monthly incomes of 717 yuan (€90). The pace of rural income growth has long outstripped growth in urban incomes.

Trend in average monthly wages in 2002–6/2012, yuan



Sources: NBS and CEIC

The average real incomes for migrant workers rose in the first half of the year by 12.4 % y-o-y. As migrant workers are largely employed in labour-intense branches, the rapid income growth of migrants has eroded the competitiveness of Chinese goods exports and pushed foreign firms to transfer production to countries where production costs are lower. On the other hand, rapid income growth in China boosts domestic consumer demand.

Income disparities are alarmingly large. Although it has been over ten years since officials published a Gini coefficient (the value of 0 expresses perfect equality of income distribution and 1 perfect inequality), they have repeatedly stated that income disparity in China is clearly on the rise. Organisations such as the OECD, IMF and Asian Development Bank all put China's Gini figure well above the critical 0.4 level considered by most experts to be the point at which social unrest begins to manifest. Income disparity is becoming one of the biggest challenges facing the government.

A warning example can be found in Hong Kong, where economic inequality has already stirred social unrest. With a Gini coefficient of 0.54 (0.48 when taxation differentials and social entitlements are counted in), the area has the highest income disparity in Asia.

Editor-in-Chief Seija Lainela
Bank of Finland • Institute for Economies in Transition, BOFIT
P.O. Box 160 • FI-00101 Helsinki
Phone: +358 10 831 2268 • Email: bofit@bof.fi • Web: www.bof.fi/bofit