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Russia

Duma approves federal budget for next year with a slight deficit. The budget calculations, based on the economy ministry's 2013 forecast, assume a rise of 3.7 % in GDP, a drop in the average price of a barrel of Urals oil to $97 and inflation at end-2013 at 5–6 %.

Public sector revenues next year are projected to grow 7–8 % in nominal terms. Accounting for inflation, real growth would be around 2 %. Revenues should decline slightly to less than 38 % of GDP. Spending will increase about 10 %, rising to more than 38 % of GDP (a level still below pre-recession levels). The public sector budget deficit is expected to come in at around 0.5 % of GDP.

Federal budget revenues next year are expected to be nearly the same as this year, while growth in expenditures will slow to a couple of per cent. The lower spending growth reflects the fact that transfers to regional budgets are being cut, although a third of the federal budget spending will still consist of transfers to regions and contributions to social funds. Hikes in federal budget other spending are intended to keep pace with inflation.

Defence is the fastest growing category of federal budget spending, rising 15 % next year and nearly 20 % a year in 2014 and 2015. Defence constitutes about a tenth of all public spending and over 3.5 % of GDP. Actual defence spending exceeds the budget figure, and the Stockholm International Peace Research Institute (SIPRI) puts it at about 4 % of GDP in 2011. Defence spending in 2011–2020 will be boosted by a massive upgrade in hardware and weaponry. While annual spending on armaments, equipment and facilities are not published, they are estimated to constitute about half of defence spending last year and this year. The federal budget deficit next year should stay below 1 % of GDP.

Regional and municipal budget revenues are expected to rise over 10 % next year on higher revenues from key taxes and despite cuts in transfers from the federal budget. Some observers see current regional and municipal budget estimates as very optimistic. Regional and municipal spending growth will accelerate to 13 % next year due to factors such as public sector wage hikes promised by president Putin.

Revenues of social funds (Pension Fund, Social Security Fund and Health Insurance Fund), nearly 45 % of which comes out of the federal budget, will rise over 10 % next year. Rapid expenditure growth will continue (at 13 %), reflecting increases in pension and other social spending. Social spending will remain at over a third of public sector spending, and correspond to about 13 % of GDP.

Duma approves changes to the pension system introduced in 2002. The changes were motivated by the persistent deficit of the Pension Fund. Nearly a quarter of public sector spending currently goes to funding pensions.

Reform of the pension system has been the major topic of public discussion in Russia this autumn. The labour ministry in October presented a long-term strategy for development of the pension scheme that included measures to improve funding. The cabinet failed to agree on the changes, however, as they pit economic and social ministries against each other.

In accordance with instructions from president Putin, the Duma last week approved partial reforms to the current pension system as presented by the labour ministry.

Russia's pension system was fundamentally reformed in 2002 according to internationally accepted practices recommended by various expert agencies, with the Swedish pension system taken as a model. The reformed system introduced a partial shift from a pay-as-you-go arrangement to a funded scheme that allocates part of current contributions to funding of pensions of younger generations. Older workers and current pensioners are paid out by the pay-as-you-go system, i.e. pensions are paid out of the contributions of working people. The employer's mandatory pension contribution is 26 % of the wage bill. Of that 6 percentage points goes to the funded scheme and the rest to cover running pension costs.

The change approved by the Duma rolls back the 2002 reforms by reducing the funded share of the 26 % from 6 percentage points to 2, while shifting the other 4 percentage points to covering current pension costs. The change, which goes into force in 2014, is a short-term fix to finance current pension costs but doesn't help in creating a long-term sustainable footing for the pension system.

The move has received sharp criticism from the finance and economy ministries, as well as expert agencies that see no justification in butchering the funded component of the pension system. To resolve long-term underfunding of the pension system, Russia must consider e.g. raising retirement ages, increasing the length of time a person has to be in the workforce to earn a full pension and elimination of the early pensions offered in many branches.

Reform of the pension system will remain topical as Putin has tasked the government with drafting more amendments to pension laws in the first half of next year.

An aim of the shift to a self-funded pension system has been to support growth of Russia's capital-starved securities markets and boost the functioning of pension funds so that they can engage in long-term financing activities. In the view of capital market proponents, the roll-back implies weaker development of the sector and postponement of making Moscow a major hub of global finance. On the other hand, pension funds have not been very successful at preserving the value of paid-in contributions; the average return on invested contributions has failed to even keep up with inflation over the past ten years.

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China

US stand on China's exchange rate policy softens. United States legislation requires the US Treasury Department to twice a year assess international economic and exchange rate trends, and specifically determine if any US trading partner is pursuing an exchange rate policy to gain an unfair competitive advantage. In recent years, the focus of the Treasury Department's report has been on China – and the latest report continues the tradition. Some members of the US Congress continue to demand that China be declared a "currency manipulator," i.e. artificially undervaluing the yuan, which would allow Congress to move ahead with preparations of reprisal measures against China. However, changes in China's exchange rate policy in recent years have taken the steam out of the criticism. So, as expected the Treasury Department refused again to accuse China of manipulating the yuan's exchange rate.

Since June 2010, when China ended its re-imposed peg and allowed the yuan to resume its appreciating trend, the Chinese currency has appreciated 9 % against the dollar in nominal terms and 12 % in real terms. The Treasury Department assessment notes that the IMF estimated last summer that the yuan's exchange rate was undervalued by about 5–10 % against a basket of currencies of China's main trading partners. However, the choice of words used by the Treasury Department suggests that the US government still believes there is more room for further yuan strengthening.

The report finds that the role of exports in China's economic growth has declined slightly. Evidence of this can be seen in China's shrinking current account surplus, which has fallen from over 10 % of GDP in 2007 to below 3 % this year. China has also taken steps in recent years to free up capital movements, which has eased adjustment process in the global economy. These factors, along with yuan strengthening, have lowered estimates of yuan undervaluation. However, sustainable changes in China's growth model call for further yuan appreciation as well as reforms in the foreign exchange and financial markets.

The report gives great weight to the fact that growth in China's foreign currency reserves has slowed substantially this year. This was seen as an indication that the People's Bank of China sees a reduced need to intervene in currency markets and that the yuan's exchange rate increasingly reflects supply and demand. Unlike central banks in most large countries, China's central bank does not publish information about currency interventions. In this respect, the US hopes that reform of China's finance and forex markets will lead to greater transparency than at present. In this and many other issues, the Treasury Department refers to China's commitments to the G20 group.

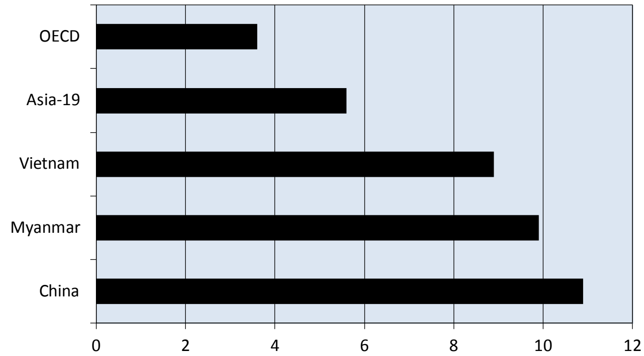
China's health care costs rising rapidly. The latest OECD Health at a Glance: Asia/Pacific 2012 comparative study finds China's annual public spending on health care last year was $379 per person. While that was only about a tenth of the OECD average, it is well in line with neighbouring East Asian countries. Chinese life expectancies have risen to 75 years for women and 72 years for men, or about the average of Southeast Asian countries. Japan and Hong Kong boasted the longest life spans in Asia (86 years for women).

China's health care system has evolved rapidly since the early 1980s, when the country's economic lift-off began. As a sign of this, maternal deaths during childbirth and deaths of newborns are today about a third of what they were three decades ago. The death rate for newborns in 2011 was 1.6 per thousand births and maternal deaths during childbirth about 0.4 per thousand births. There is still plenty of room for improvement as China's infant and maternal mortality rates are still about four times the OECD average. Another issue to note is China's relatively high incidence of cancer deaths; China has Asia's second highest rate of cancer deaths after Mongolia.

During the outgoing administration of president Hu Jintao, health care spending rose more than 10 % a year in real terms, slightly outpacing China's GDP growth. Coverage of the health insurance system was expanded, and currently it covers about 95 % of Chinese. Access to health care services has also improved, which can be seen e.g. in the large number of doctors. In mainland China there are 1.8 medical doctors per 1,000 residents, which is a higher ratio than in Hong Kong and nearly as high as in Japan and South Korea.

A recent McKinsey study found that dissatisfaction with China's health care system is still fairly widespread. Nearly a third of respondents reported that their access to health care was poor, even if the survey was directed at relatively well-to-do households by Chinese standards. Two routinely noted problems with Chinese health care were the low salaries of medical doctors and the poor quality of rural health care. As in many countries, China's ageing demographic trend poses huge challenges for the health care system.

Growth in health care spending, 2000–2010, % per year



Source: OECD

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