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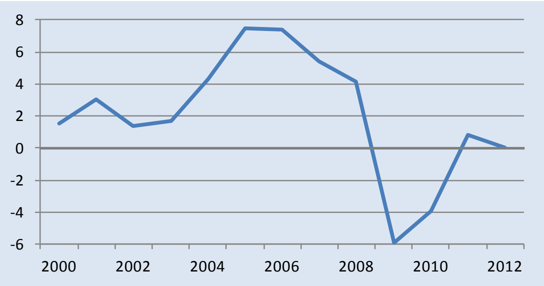
Russia

2012 federal budget in balance. Preliminary figures from the finance ministry suggest a better-than-expected budget performance last year which is due to higher oil prices boosting state tax revenues. The original 2012 budget anticipated a deficit of 1.5 % of GDP. The average price for Urals blend last year was around $110 a barrel.

Federal budget surpluses and deficits, % of GDP, 2001–2012



Source: Ministry of Finance

Government split on how to grow the economy faster. In his December policy address, president Vladimir Putin tasked the government with finding ways to boost GDP growth to a level of 5 % annually over the next ten years although the economy ministry's GDP growth forecast is just over 3 % this year and 3–4 % in coming years. Russia is currently engaged in an active public discussion over possible measures to speed up growth. Even the cabinet is divided over how this could be achieved.

The economy ministry contends that growth should be increased through state investment in infrastructure. Such investment would be funded by diverting revenues from crude oil and gas production fees and export duties normally destined for off-budget reserve funds. This approach would require a lifting of the strict budget rules just approved by the Duma in December (see BOFIT Weekly 2013/3). The selection and implementation of investment projects would be overseen by a development fund under the supervision of the economy and transport ministries, but independent of the finance ministry. The transport ministry has prepared a list of 28 potential projects that includes a new ring road for Moscow, a liquefied natural gas (LNG) terminal on the Yamal Peninsula, as well as a development project in the Urals region. The projects would be funded in part out of the Pension Fund.

The finance ministry rejects increases in state spending, noting that a wiser path to economic growth involves structural reform and improvements in Russia's investment climate. It stresses that balanced state finances and accompanying stability are key factors in improving the investment climate. Moreover, shrinking the reserve funds would increase risk if economic conditions turned bad. It was precisely the reserve funds that allowed Russian government to weather the economic downturn in 2009 with relative ease. If large infrastructure investments were to be funded with income that depends on economic cycles, there is a substantial threat that the projects would be delayed or even abandoned if the world oil price falls precipitously.

Some cabinet members, and even president Putin, have criticised the CBR of keeping interest rates too high and thereby stifling corporate investment. The CBR's main monetary tool, the repo credit rate, currently stands at 5.5 %. January 12-month inflation was 7.1 %.

Russia to reduce number of universities and institutes. The education and culture ministry last autumn performed a survey of institutions of higher education in Russia, and this year plans to reform or shut down the poorest performing schools. The survey is seen to be related to the government's current efforts to reduce the number of higher education institutions by 20 %.

Today, over 7 million students study in over 1,100 universities and institutes in Russia. While the amount of institutes has increased notably and the number of students has even more than doubled in the past two decades, educational funding has not. The number of teachers and academic posts has increased only about 60 %. The lack of resources has eroded the quality of education, and the knowledge and skills of teaching staff have not kept up with the times. Much of the curriculum has not changed since the Soviet era.

Educational standards have also been lowered by the appearance of for-profit colleges, where teaching standards in many fields are poorer than in public universities. There are significant exceptions, of course. About 40 % of schools are private and they account for about 17 % of enrolments. The general perception is that especially in private schools degrees can be bought. One reason for the popularity of university and institute enrolment is the possibility to avoid military service. Educational standards are a big issue also in distance learning, which has rapidly gained popularity. The share of distance learning has quadrupled over the past 20 years: about half of all students today are involved in it. Distance learning also offers major opportunities for abuse.

The education and culture ministry survey only covers state universities and institutes. The hope is that the survey would be conducted annually and expanded to include private colleges as well. The survey criteria have been criticised for not measuring institutional efficiency correctly. Criteria include e.g. quality of teaching, quality of research, international activities, teaching facilities and equipment, as well as the quality of students applying for admission.

About 25 % of the 500 universities and institutes participating in the survey were found to be "inefficient" at least to some extent. Schools with bad marks will have to reform their operations, merge with larger universities or close their doors.

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China

China's current account surplus grew in 2012. China's State Administration of Foreign Exchange (SAFE), an agency of the central bank, reports a 2012 current account surplus of $214 billion (2.6 % of GDP). China's current account surplus has been decreasing for some years, but in 2012 it was up about $10 billion from 2011. China's current account surplus was driven by the goods trade surplus, whereas services trade is deeply on deficit.

Last year there was a big red shift in China's financial account, which turned to deficit. It reflects the lifting of capital controls and incentives to take money out of the country. In addition, China's rapidly growing production costs and the stickiness of global economic growth have also reduced inflows of foreign direct investment to China. The financial account deficit further reflects changes in foreign exchange policy at the People's Bank of China, which has given the markets more power to determine the yuan's exchange rate. The PBoC last year reduced interventions in foreign exchange markets and the growth in foreign currency reserves was kept below $100 billion.

Key balance-of-payments items and currency reserves, USD bn

	2008	2009	2010	2011	2012
Current account	421	243	238	202	214
Capital and financial accounts	40	198	287	221	-117
Net errors & omissions	19	-41	-53	-35	–
Change in currency reserves	480	400	472	388	97
Currency reserves at year's end	1,946	2,399	2,847	3,181	3,312

Sources: CEIC and SAFE

At the end of 2012, China's foreign currency reserves stood at $3.312 trillion. Although China does not reveal how its currency reserve assets are invested, most observers believe the lion's share is held in the form of sovereign bonds with about 60 % invested in dollars, 30 % in euro and the remaining 10 % distributed among other currencies such as Japanese yen and British pounds. As sovereign bonds traditionally are low yield, the Chinese are on the hunt for higher returns. A share of the currency reserves was transferred in 2007 to a sovereign wealth fund, China Investment Corporation (CIC). More recently, some of the reserves were made available via the state-owned China Development Bank to domestic firms as a way to fund international operations. In December, the central bank announced that the ceiling on corporate borrowing from currency reserves would be raised. No other central bank is known to arrange such corporate loans from its foreign currency reserves.

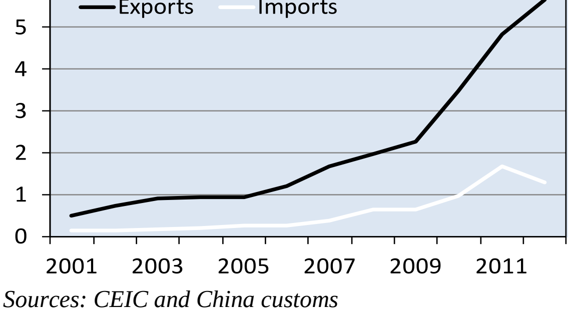
Construction of China's trans-Myanmar oil and gas pipelines could help ease strained trade relations. The 1,100-kilometre Myanmar-China oil pipeline will take tran-shipped oil from the Middle East, and a parallel gas pipeline carrying gas from fields on Myanmar's continental shelf in the Bay of Bengal. Construction of the pipelines began in 2009; only the finishing touches on parts of the pipeline in Yunnan province remain. The pipeline is scheduled for commissioning in May.

The construction work is being finished in a shifting political environment. A new era in trade relations began in 2011 when Myanmar's ruling junta allowed incremental political reforms so that international sanctions would be dropped. Before the changes, China had made big inroads into trade with Myanmar. Chinese exports to Myanmar include machinery and equipment, and Chinese imports from Myanmar are mostly natural resources such as ores, sawn timber, and precious stones. Chinese firms are engaged in huge projects in Myanmar to get at its resources. However, Chinese dominance in Myanmar's foreign trade has recently been challenged. Last year, China's share of Myanmar's imports fell by four percentage points to 30 %, and its share of exports fell by nearly half to 13 %.

Trade relations have been hurt by the poor image of Chinese businessmen in the eyes of the Burmese. Many Burmese feel that most of the benefit of trade with China has gone either to Chinese firms or corrupt Burmese officials. The Burmese also feel extensive environmental damage caused by some projects. China's state-funded Myitsone dam project has become a symbol of deteriorating China-Myanmar relations. The project was halted by Myanmar's new government when it came to power last year.

Japan, which saw its exports to Myanmar triple last year, is rapidly emerging as the biggest beneficiary of Myanmar's political reforms. Myanmar has granted Japanese firms rights to development vast land areas. Myanmar ranks among the poorest nations on earth, so there is no lack of development challenges. However, the country has vast natural resources, and is wedged between two of the biggest and fastest growing economies in the world: India and China. However, the success of commercial ventures requires political stability.

China's foreign trade with Myanmar, USD billion



Sources: CEIC and China customs

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