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BOFIT Weekly

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Russia

Russian municipalities get most of their funding from federal and regional budgets. A recent brief from the finance ministry notes that about 60 % of revenues to municipalities last year were provided in the form of transfers and subsidies from federal and regional-level budgets. The rest was raised through taxes, fees and other forms of revenue. Tax revenues as a share of total revenues varied tremendously from municipality to municipality, however. The aggregate budget of local administrations was slightly in the red last year.

The most important source of tax revenue for municipalities was Russia's 13 % personal income tax. The tax, which has a flat rate set by the federal government, last year accounted for 70 % of municipal tax revenues. Revenues from personal income tax initially go to regional budgets, after which at least 20 % must be transferred by the region to its municipalities.

The most significant municipal taxes are the land tax and the tax on personal property. These two taxes last year accounted for about 15 % of the tax take of municipalities on average.

Municipalities are responsible for providing basic services such as primary schools and heath care, as well as certain social services. The largest expenditure category for local governments is education, which last year accounted for 41 % of total spending. Other major spending areas included housing (15 %), administration (9 %), social policy (9 %), health care (5 %) and culture (5 %).

Gazprom refunds $3.3 billion to European customers after readjusting its pricing scheme. Gazprom's revenues from gas sales to its non-CIS customers amounted last year to $47.3 billion after export duties. The refunds on gas supplied in 2010 and 2011 are part of negotiated price settlements for long-term supply contracts between European gas buyers and Gazprom.

The German E.ON and the Italian Eni reached deals with Gazprom on reducing their gas prices last spring and summer. Gazprom also agreed to lower prices by about 10 % for its French, Slovak and Austrian customers. Some other gas importers such as the Czech RWE preferred to haul Gazprom into arbitration court to ask for modifications to what they see as unconscionable contract terms that require them to pay for a specified amount of gas for a given supply period even if they do not need the full amount stated in the contract. The RWE-Gazprom case is pending.

Gazprom had to refund less than it had initially expected because some of its customers had swapped lower prices for more flexible payment terms or smaller supply volumes.

Analysts expect Gazprom this year will again be on the hook for a similar amount of refunds.

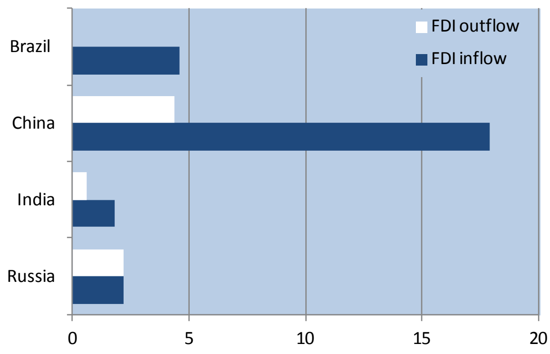
Russia accounted for about 2 % of global FDI flows last year. The latest OECD figures on investment flows show that just over $30 billion in foreign direct investment flowed into Russia last year, a slight decline from 2011. Russia's share of global FDI inflows has declined in recent years by about half from its 4 % pre-crisis peak in 2008.

The biggest destination of global FDI flows last year was again China, which surpassed the US in 2011. Nearly a fifth of all global FDI flows went to China last year. Direct investment inflows to Brazil in 2012 were about double that of those going to Russia, while FDI to India was slightly less than the amount going to Russia.

The OECD also noted that Russia's FDI outflows amounted to just over $30 billion, a substantial decline from 2011. Russia's share in global outward FDI has declined slightly in recent years and was about 2 % last year. Outward FDI flows from China rose to represent around 4 % of global investment. The United States remained the world's top source country of FDI, accounting for about a quarter of all global FDI outflows.

Unlike most mid-income countries, FDI outflows from Russia have exceeded FDI inflows to Russia in recent years.

BRIC shares of global FDI flows in 2012 (%)



Source: OECD

Central Bank of Russia figures show that the biggest net FDI inflows to Russia last year came from Luxembourg, the Netherlands and Ireland. Investment inflows from Cyprus, earlier Russia's top provider of FDI, contracted sharply.

The biggest destination for Russia's FDI outflows in the first nine months of 2012 was still Cyprus. Turkey's status as a Russian FDI destination rose to second place for the first time.

The information is compiled and edited from a variety of sources.
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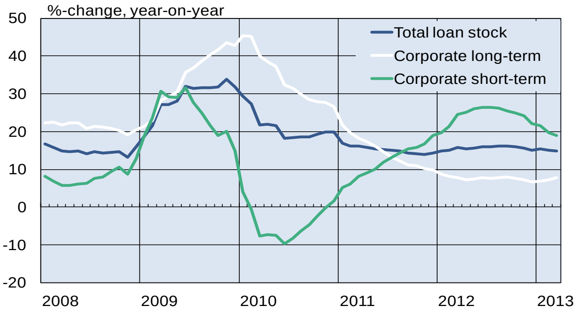
China

Structure of corporate borrowing shows signs of improvement in China. The slowdown in the growth in short-term corporate borrowing that began in 2012 has continued this year. Growth in long-term borrowing, in contrast, has accelerated slightly in recent months. Over half of corporate borrowing is in the form of long-term loans. The loan stock structure is changing, as the volume of short-term loans still continues to grow faster than long-term loans but that growth is slowing.

The persistently increasing dependence on short-term borrowing has raised questions about the sustainability of corporate finances in China. Reliance on short-term debt to fund long-term projects is risky for firms if their access to funding suddenly dries up. Thus, most observers see the current slowdown in growth in short-term corporate borrowing as a positive trend that enhances stability of the financial system and contributes to sustained economic growth. Acceleration in growth in long-term lending may also indicate a larger appetite for new corporate investment.
Growth in the loan stock remained around 15 % in April. The stock of yuan-denominated loans is now around 66.5 trillion yuan (€8.4 trillion), or 130 % of GDP. Growth of the loan stock has outpaced GDP growth in recent years. Corporate loans account for about 70 % of total lending in China.

Trends in Chinese bank lending



Sources: Macrobond, CEIC, BOFIT

Despite a challenging operating environment, most US companies in China are turning a profit. According to the 2013 White Paper of the American Chamber of Commerce in China (AmCham China), which is based on a survey at the end of 2012, most of its 325 member companies operating in China see demand for their products and services continuing to rise. Over 70 % of respondents said China's domestic markets were their main reason for being in China; only about 20 % said they produce products for export.

American firms said they planned to keep investing in China, but said slowing economic growth and barriers to market access had reduced their willingness to invest. Firms also perceived themselves to be in a weaker competitive position than local firms. State-owned enterprises, for example, receive financial subsidies and local Chinese firms have an easier time getting the required licences to operate their business.

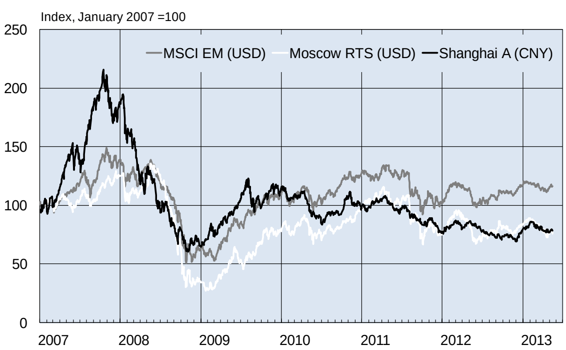
The rising cost of labour was the main reason that over 10 % of respondents cited for their decision to move their production operations out of China in 2012. In addition, US firms complained that it is getting harder to find qualified employees in the Chinese labour market. Corporate profit margins have narrowed as competition has increased, but the profit margins in China of over 40 % of the multinational respondents were still above their global average. Production in China is still profitable and nearly 80 % of respondents report that their operations are profitable.

China's goal is to create an operating environment conducive to corporate innovation that promotes productivity gains. China's new laws to protect intellectual property rights and proprietary technologies went into force last year, but over 70 % of the responding US firms felt that the laws were still ineffective (the share arose from about 60 % in 2011). Uncertainty over legislative amendments and theft of intellectual property were seen as growing threats.

Shanghai shares flat for the year. After rising in December and January, Chinese share prices began to drop in February. The Shanghai A-share index has lately clawed its way back to near the level it started the year. Shares remain depressed by lower growth forecasts for China, as well as ongoing fiscal struggles in Europe and the United States.

China's other big stock exchange, the Shenzhen stock exchange, has tracked a similar trend as the Shanghai exchange. The main indices for both rose in recent weeks but the rebound on the Shanghai exchange was more muted. Some observers see share prices in China buoyed recently by statements from the new leadership on structural reforms designed to support economic growth. The trends on China's stock exchanges this year have tended to follow stock markets in other emerging economies.

Shanghai A, Moscow RTS and Morgan Stanley Emerging Markets indices



Source: Bloomberg

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