

## Russia

**Russia moves to hold federal deficit in check.** Federal budget revenues this year are forecast to remain at the same level as last year due to significant reductions in income from taxes and fees on production and exports of oil and gas.

The latest finance ministry calculations further suggest a tighter medium-term outlook. Next year's budget revenues are estimated to rise just 5 % in nominal terms, reflecting the downward revision of the GDP forecast. During 2015–2016, the growth in budget revenues is expected to accelerate only slightly with the return to higher economic growth. Also, the fairly large hikes on excise taxes on for e.g. gasoline, alcohol and tobacco products will begin to bite.

Regional budget outlooks have also tightened. Revenue from corporate tax, which last year accounted for about a quarter of all regional budget revenues, is down significantly this year. Finance ministry reports that corporate tax revenue in the medium term will also likely come in well below earlier forecasts due to reduced profitability in the corporate sector. As a result, finance minister Anton Siluanov questioned the wisdom of economic stimulus measures started this year that grant generous capital depreciation to firms and allow firms classed as small companies access to a lighter tax burden. Companies with as many as 200 workers can currently take advantage of the lower tax.

Despite the flat numbers on the revenue side, the recently approved rather tight budget rule will be implemented. The rule calls for limiting the federal budget deficit during 2014–2016 to about 0.5 % of GDP. This requires that nominal growth in budget spending remains under 3.5 % next year (nearly 4 % this year).

Siluanov mentioned three ways to limit growth in budget spending. It has been agreed with the defence ministry to postpone parts of the massive arms programme until after 2016. Also other government procurement plans will be curtailed. The growing deficit of the Pension Fund, which is covered by federal budget, is proposed to be limited by adjusting the mandatory social security contribution of employers. If Russia does manage to reform its pension system, something it has struggled with for years, it would improve the situation of the Pension Fund as well.

On the other hand, Siluanov noted the need to fund new public megaprojects, which include development of the Far East and Baikal regions, construction of the Moscow-Kazan high-speed rail line, as well as preparations for the 2018 FIFA World Cup soccer championship.

**Duma approves law on pardons for people convicted of financial crimes.** At the recent St. Petersburg international economic forum, president Vladimir Putin voiced surprising support for an economic crimes pardon bill under

preparation. On Tuesday (July 2), the Duma approved the bill in an accelerated procedure.

The scope of the pardon extends to specified economic crimes and is subject to certain conditions. The listed crimes include copyright and patent infringement, unauthorised business activities, tax evasion, money laundering, and corporate fraud. The pardon includes the provisions that the pardoned individual must not have been convicted of a financial crime earlier and that he or she pays full compensation for damages during the six months the pardon act is in force. The law covers those convicted of crimes, persons officially charged with economic crimes and those currently under investigation.

Boris Titov, Russia's first ombudsman for corporate rights, began pushing for the pardon act as soon as he stepped into his office last summer. The current legislation is much more limited than the draft proposal prepared by Titov's working group in May. Observers estimate the pardon act affects several thousand individuals.

A cornerstone of the act is the liberalisation of the criminal code in recent years, which has led to a situation where many persons now serving sentences could not be convicted under the current criminal code. There are also many cases of business people convicted on the basis of false charges laid by competitors or corrupt officials in order to prevent competition or fraudulently acquire their business.

Critics of the act include those who refuse to accept the pardons and those that think the pardon scheme is too limited. The requirement that pardoned people pay compensation within a six-month period could be difficult for individuals in prison. Payment of compensation and a pardon are technically admissions of guilt, something innocent persons convicted at trial may find hard to swallow.

Titov admits that the impacts of the compromised legislation will be marginal. In his view, however, the pardon act is at least a step in promoting a healthier business climate as it indicates that the state is ready to admit its earlier mistakes in its relations with businesses. However, property rights and the rule of law need to improve significantly if entrepreneurship in Russia is to become more attractive. It is important to change officials' attitudes that still reflect Soviet-era prejudices about economic crime, resulting in taking sides against the charged individual and court processes that assume guilt, placing the burden of proving innocence on the accused. The most important thing to do now, Titov said, is to make sure that public officials and courts comply with the pardon act.

The reform of the criminal code was started during Dmitri Medvedev's presidential term in order to reduce arbitrariness in dealing with financial crimes. The code revisions e.g. reduced the classes of financial crimes and the prosecutor's ability to hold individuals suspected of financial crimes during an investigation.

## China

**China plans reforms to the household registration system to promote urbanisation.** The influential National Development and Reform Commission (NDRC) last week released a report on urbanisation issues that introduces steps how the *hukou* household registration system will be relaxed. The report says a first step will be the lifting of restrictions on migration to China's smaller cities. The reform will then be extended to larger cities through gradual relaxation of restrictions. The NDRC has yet to publish a timetable for the reform, but China has already been experimenting for some time with ways to phase out the *hukou* system. China's new leadership has repeatedly stressed the importance of urbanisation as part of its economic growth strategy.

The *hukou* system excludes migrant workers from access to social services such as education and health care in cities, because the social benefits of the worker in their official rural domicile cannot be transferred to the city where they work. *Hukou* has been treated as a tool for controlling internal migration and preventing urban public services from being overwhelmed. Unfortunately, it does so by restricting the free movement of labour and impedes the pace of urbanisation. Further pressure to reform comes from the ever-widening wage gap between cities and the countryside and a shrinking workforce due to China's aging population.

The hope of higher earnings, nevertheless, motivates rural residents to seek work in the city, creating tensions between unregistered migrants and officially registered urbanites. The National Bureau of Statistics reports that there were over 260 million migrant workers in cities at the end of 2012. The *South China Morning Post* reports that only 25 million rural people managed to register as official city residents during 2010–2012.

The *hukou* system reinforces the disparities between migrant workers and the rest of the population through growing discrimination, poverty and aggravation of social problems, so *hukou* reform is also important for reducing social inequality. The reforms call for large investments in public services and infrastructure that should sustain public investment at high levels well into the future.

The report also emphasises that rural residents need greater protection to the right to own land. At the moment, a rural resident who moves his or her domicile to the city surrenders their rural land rights, which reduces the incentive to move to the city.

**China increases international use of the yuan through currency swap agreements.** At the end of June, The People's Bank of China and the Bank of England entered into a

swap arrangement under which the Bank of England can swap pounds for yuan up to 200 billion yuan (€25 billion). The three-year agreement is intended to guarantee firms in the UK have ready access to yuan. In practical terms, it means that yuan denominated trading in London's market can expand significantly. Moreover, companies can pay imports from China in yuan.

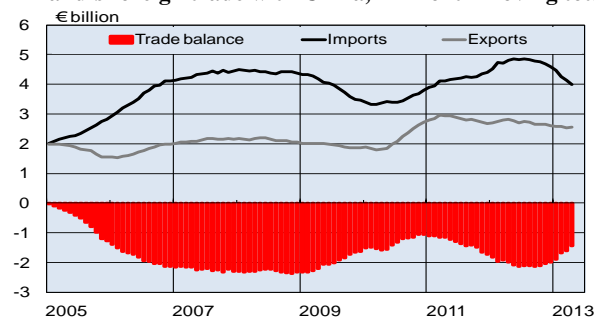
Since the financial crisis, China has signed swap agreements with about 20 central banks around the world. The motives for choosing partner countries typically include country size, proximity to China, the scale of foreign trade and whether the country has a free-trade agreement with China (see [BOFIT Discussion Paper 12/2013](#)). The size of the swap deals range from 0.7 billion yuan for Uzbekistan to 400 billion yuan for Hong Kong. China sees the agreements as a way to promote international use of the yuan. Because the yuan is not freely convertible, yuan use outside China is problematic in the absence of the swap agreements.

**Volume of Chinese goods imports to Finland drops significantly.** Finnish Customs reports that goods imports from China dropped by about a third in January–April compared to the same period in 2012. The biggest declines were registered in imports of telephones and related parts. At the same time, Finnish exports to China remained fairly stable, causing a dramatic contraction in Finland's foreign trade deficit this year.

Although China is the most important export destination for Finnish firms, operating in China is even more important for Finnish firms. Finnish goods exports to China amounted to less than €3 billion in 2011, while the turnover of subsidiaries of Finnish firms operating in China well exceeded €20 billion.

According to a [survey](#) completed this March by the Finnish Business Council Shanghai, most Finnish companies operating in China see a bright future. The majority of Finnish companies operating there expect their profits to keep rising and plan to invest more in China. Finnish firms say the biggest challenge they face is finding competent workers.

**Finland's foreign trade with China, 12-month moving total**



Source: Finnish Customs