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BOFIT Weekly

28 • 12.7.2013

Russia

Russia's new privatisation programme more cautious than its predecessor. The government approved the list of state companies slated for divestment during 2014–2016. The previous plan accepted in 2010 covered the years 2011–2013. The new round affects about 1,200 corporations. Just over 400 firms on the new list are debuting, while nearly 800 are holdovers. Towering over the privatisation of many smaller and medium-sized enterprises, however, are the sales of several major state companies.

Russia's privatisation plans have consistently failed to meet their targets. Part of the blame can be attributed to domestic and global economic conditions in recent years that did not favour sales. The situation was hurt generally by reduced investor appetite for risk and lower profitability projections that convinced officials that it was a less-than-opportune time to sell off state property.

Prime minister Dmitri Medvedev said at the end of June, when the proposed new programme came before his cabinet, that it had been tough earlier to go ahead with the sales given the weak economic conditions and powerful lobbying efforts from certain state organisations and specific officials against privatisation. Medvedev said the main purpose of selling state property was not simply to boost budget revenues but also to send a signal to the market about the direction of development of the Russian economy. Thus, it is critical that the programme is implemented in full.

The amount of shares offered was cut or sale deadlines postponed for several large enterprises under the current programme. Economy minister Alexei Ulyukayev blamed unfavourable market conditions. For example, the Rosneft oil company, the RusHydro power company, the Sovkomflot shipping company, VTB Bank, diamond producer Alrosa and state airline Aeroflot, which were all on track for complete divestment by 2016, will now remain partially in state ownership at least until 2016. The privatisation of Sberbank is not even mentioned in the programme.

However, the new programme brings forward the sale of state telecom Rostelekom to 2016, when it is hoped that the firm can be sold off in its entirety to private investors.

The government estimates that sales of companies or company stakes could raise over 1.7 trillion rubles (€40 billion) over the next three years. Observers see the price hopes as extremely optimistic and the likelihood all stakes and companies would be sold as very small.

Russia announces new subsidies to stimulate car sales; EU files complaint with WTO protesting old subsidies. Sales of new passenger cars and vans in Russia have been on the decline in recent months. In the first six months of this year, car sales were down 6 % from the same period in 2012. Car production fell 2 % and imports declined 8 % during January-April.

To boost the car market, the government hopes to introduce an interest subsidy programme for car buyers this month similar to the one that ran from 2009 to 2011. The plan calls for an interest subsidy on car loans of about 5.5 percentage points. The maximum price of a car eligible for the programme is 700,000 rubles (€17,500).

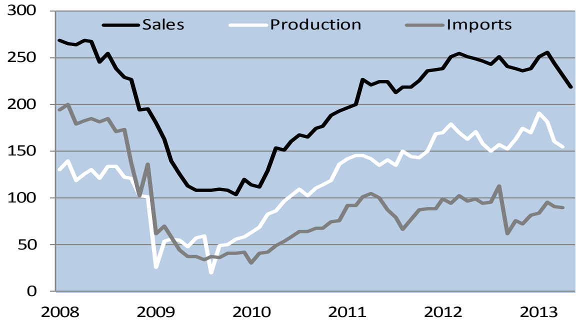
To avoid breaking WTO rules, Russia would this time make the subsidy available also for imported cars. Russia's industry ministry predicts that the interest subsidies would be used in the sales of 200,000–250,000 cars by the end of the year. Interest subsidies were granted on the purchases of nearly a half million cars during the previous programme.

Russia subsidises car assembly plants through reduced tariffs on imported components. Under Russia's WTO commitments, the reductions, which are seen as giving domestic car assembly operations an unfair competitive advantage, must be revoked by 2018 when the negotiated transition period ends. As the Duma wound up its spring session on July 5, it approved a law whereby the hike in component import duties will be compensated for the assembly industry during 2018–2020, in fact cancelling out the effect of the duty rise.

Russia still subsidises its domestic car industry with recycling fees that amount to at least 20,000 rubles (€500) on every imported car. Cars manufactured in Russia are not subject to the fee. The recycling fee went into force when Russia joined the WTO last autumn, and has ever since been criticised as a violation of WTO rules. The EU has often brought up the issue with Russia, and Russia has routinely promised to do something about it. Fed up with Russian intransigence, however, the EU filed a request for an official WTO investigation into the recycling fee on Tuesday (July 9).

In mid-June, the Russia-Belarus-Kazakhstan customs union imposed anti-dumping tariffs on vans built in Germany, Italy and Turkey. Russia's own car exports have been hurt by Ukraine's import duty hike this spring. Russia says the hikes violate both WTO rules and the CIS free-trade agreement. Many other WTO members also oppose Ukraine's duty hike.

Monthly seasonally adjusted numbers for Russian car sales, production and imports (in thousands)



Sources: AEB, Rosstat, BOFIT.

Editor-in-Chief Seija Lainela • Email: Seija.Lainela@bof.fi

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

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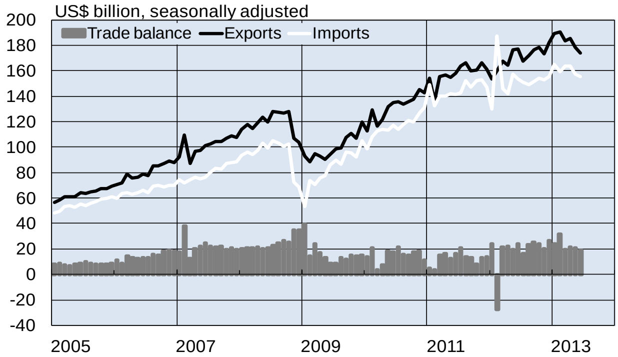
China

Chinese imports and exports contracted in June. There was a drop in exports and imports of machinery and equipment, but commodity imports continued to rise. For example, the imported volumes of wood pulp, iron ore and crude oil have continued to grow at similar pace as in previous years.

A number of company surveys have found export orders dwindling in recent months, a situation that foreshadows lower export growth ahead in coming months as well. China's foreign trade trend has raised concerns that growth of the global economy will be worse than earlier forecasts and that China's domestic economic growth could face more serious slowdown than expected. China releases its GDP growth figures for the second quarter on Monday (July 15).

The contraction in foreign trade could also signal success through intensified efforts by state officials in recent months to identify false reporting of foreign trade transactions. Chinese companies may have exaggerated their export and import figures to move money in and out of China and circumvent restrictions on capital movements.

China's foreign trade trends



Sources: China Customs and BOFIT

Inflation pressures in China remain modest. June consumer prices were up 2.7 % y-o-y, which is six-tenths of a percentage point higher than in May. Inflation, however, is still well below the 3.5 % ceiling on the government's target range for this year. The biggest driver of inflation at the moment is the nearly 5 % increase in food prices. This year's rise in housing prices has also driven up housing costs, which were up about 3 % y-o-y.

There were large hikes in pork prices in June. Prices of fruits and vegetables were down, even if they were clearly more expensive than last summer. Food has a large weighting in China's consumer price index, so changes in food prices heavily impact inflation. Hikes in non-food prices have held below 2 % y-o-y for several months now.

Producer prices fell 2.7 % y-o-y in June. Producer price deflation has continued now for 16 months in a row. Producer prices in the mining industry, for example, fell 8.5 % as the slide in world commodity prices continued. Lacklustre demand and overcapacity issues in many industries have intensified price competition, which should keep producer prices in check in the months ahead.

Higher degrees increasingly common in China. Chinese colleges graduated over 6 million students last year. This year that number is approaching 7 million. Due to China's concerted efforts during the 2000s to improve access to education, the number of students graduating with college degrees has been rising at around 17 % a year. China's ambitious national goal is for a fifth of the working-age population to have received higher education by 2020. Many international institutions, including the OECD, have advised the Chinese to put greater effort into improving the quality of education. The number of competent educators has not kept up with the rising numbers of students.

In May, McKinsey released a white paper that claimed employers see numerous problems with recent graduates. Among other things, employers said the new wave of graduates lacks the flair for innovation and critical thinking, have challenges with teamwork, inadequate English language skills and a lack of technical skills. It appears that the job market for graduates suffers from a structural problem, ie. employer hiring criteria and the areas students take their degrees don't match up despite ever-growing need for skilled workers. The expectations of recent graduates do not necessarily reflect the realities of the labour market, which is a common reason job-seekers turn down job offers.

While there are no exact figures on the number of unemployed persons with academic degrees, the China Household Finance Survey released late last year found that 16 % of 21–25-year-olds who graduated in 2011 were still without work.

China wants an educated population capable of producing its own innovations in ways that sustain economic growth as the current model based on adopting foreign technology and methods will not be generating the high growth it used to. As working-age population begins to shrink, productivity gains become ever more critical in sustaining the rise in living standards. Students, however, do not prefer as their top choice to work in private companies, especially start-ups where innovation is vital. According to the *Wall Street Journal*, two-thirds of recent graduates would prefer a secured public sector post to a private sector job, and just 4 % say they would specifically prefer to work in a privately held firm. It appears that the job market is skewed in favour of state-owned enterprises, which is not optimal for creating much-needed innovations.

Editor-in-Chief Seija Lainela • Email: Seija.Lainela@bof.fi

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