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Russia

Russia postpones plans for tax reforms to energy sector. Russia for several years now has been discussing a makeover of its policies on oil sector taxation. The current system based on charges based on production and export volumes would be replaced by taxing profits to encourage higher production levels and boost investment in exploration and development of new capacity. Russia faces the challenge that many of its largest current oil fields in production are in decline, while new oil and gas deposits are geographically remote and hard to access. Bringing new fields on stream is crucial for the sector's development.

Russia charges two different taxes on crude oil: a natural resource extraction fee and an export duty. The oil export duty, which has been applied since 1999, is calculated based on export volume and the prevailing world price of crude oil. The export duty schedule was made sharply progressive in 2004. The principles of resource extraction fees have remained essentially unchanged since they were introduced in 2002. The extraction fee, which is also progressive, is based on oil production volume and the prevailing world price for crude oil. Since 2007, the state has adjusted the extraction fee based on e.g. production conditions and location of the production site.

Oil companies and the energy ministry have proposed shifting to a tax scheme that targets operating profits. This would encourage companies to invest in development of new fields (including deposits with daunting technical and logistical challenges), as well as trying to squeeze more oil out of mature fields where production has become increasingly expensive. The current system tries to achieve these same goals by fashioning customized tax breaks.

Last week, the government took up changes in the taxation regime. Due to opposition from the finance ministry, however, none of the proposed changes are likely to be implemented any time in the near future. The finance ministry's main objection is that the move would reduce tax revenues. The energy ministry and oil companies are striving to introduce the new taxation model as a pilot project at select sites to evaluate the model's performance.

Given Russia's bleak fiscal outlook, the government decided this autumn in its draft version of the 2014 budget to raise resource extraction fees incrementally over the next three years. Export duties on oil and petroleum products, in contrast, would be lowered as part of the finance ministry's long-term goal of reducing export duties on the oil sector and shifting the tax emphasis to resource extraction.

Russia's taxation of its oil sector is extremely severe by international standards. The state currently captures over 80 % of any rise in oil prices. The gas sector, in contrast, enjoys a much lighter tax burden. About half of federal budget revenues come from oil and gas taxation.

Russia to liberalise gas export rules. Late last month, the government approved a draft bill allowing companies other than Gazprom to export liquefied natural gas (LNG) from the start of 2014. Fast passage in the Duma is expected.

Gazprom has had the sole right until now to export natural gas. The government says its decision should help increase Russia's share of the global gas market, which has seen demand for LNG increase much faster than demand for gas transmitted by pipeline.

In the government's draft law, several demands are placed on LNG exporters related e.g. to the scope of company operations and ownership base. In practice, there are just two companies at the moment that meet the requirements: state oil company Rosneft and Russia's second largest gas producer, the privately held Novatek. The decision to allow others to export LNG means both companies could eventually become major competitors of Gazprom. Even more important, perhaps, would be that other companies could gain easier access to Gazprom's gas pipeline grid. At the moment, Gazprom has the sole right to export gas via pipeline.

The liberalisation of LNG exports is a significant step in weakening Gazprom's gas monopoly.

Russia creates separate ministry for construction, housing and public utilities. Last Friday (Nov. 1), president Vladimir Putin announced that the federal agency handling services for construction, housing and utilities, Gosstroi, will now be elevated to ministry status. Gosstroi, established last year, failed in its tasks of moving ahead on stuck reforms in the municipal service sector and eliminating bureaucracy related to construction.

The problems facing the new ministry remain huge. The quality of housing and level of municipal services in Russia is extremely low. Much of Russia's housing stock is old and in poor shape. Two-thirds of apartment buildings need basic repairs and the situation worsens every year. Money set aside by the state for basic repairs is insufficient and residents lack the funds to finance necessary major repairs themselves.

About a quarter of all district-heating networks and about 40 % of water and wastewater networks are in need of complete overhauls. Consumer rates for heat, water and gas have risen rapidly in recent years as part of the government's efforts to bring rates up to a level where they cover production costs. Rising rates, however, have not translated into improved quality of service and have become a source of general dissatisfaction among the populace. Part of the problem is that housing and utilities are among the most corrupt sectors in Russia.

The government says one solution to improving municipal services would be to attract more private investment into the sector.

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China

Beijing tries again to subdue investment craze at local level. The central administration has worried for years about overcapacity in many industries that has been mainly driven by the desire of local administrations to sustain growth and improve their own chances for managerial advancement. Unfortunately, central government demands that locals do something about their excess capacity problems have fallen on deaf ears. This month, the central administration again warned again local authorities not to challenge government restrictions on investment. This time the government specifically named steel, glass, cement, aluminium and shipbuilding as branches which, in its opinion, suffer from excess capacity.

Excess capacity and low capacity utilisation have repeatedly been cited as potential problems for China. In addition to the branches mentioned by the state, excess capacity and falling prices have recently plagued such industries as copper fabrication and solar panel production. Construction of additional capacity has been fuelled by the availability of cheap bank financing due often to active involvement by local administrators. The drop in prices due to overcapacity and eroded profitability may lead to debt-servicing problems that affect the entire economy through the financial system.

A lasting solution might be to change incentive systems and switch to market-based pricing and financing. These issues will no doubt be touched on at the third plenary session of the central committee that starts tomorrow (Nov. 9). The party gathering will focus on economic reforms. Whatever resolutions come out of meeting, it is clear that many industries in China will face some sort of consolidation in coming years.

Car sales continue to boom in China. Car sales in the world's largest market for passenger cars have remained brisk this year. The number of new cars registered in January-September was up 14 % y-o-y. If the pace continues, it puts China on track for registering 17 million new cars this year. In 2012, China registered nearly 15 million cars.

Competition is fierce in the passenger car market, which in the first nine months of this year saw the registration of over 100 different car brands. The popularity of foreign brands continues to rise, and currently foreign brands account for about two-thirds of all registered passenger cars. Sales of several European, American and Korean brands have grown rapidly this year. China-Japan relations seem to have affected Japanese car sales as registration of major Japanese brands has either declined or remained at the same level as last year.

The most popular make by far is still Volkswagen, which has maintained a strong market presence in China since the 1980s. About 15 % of all registered cars in China are VWs. The next most popular makes are the Chinese Wuling, which concentrates on multi-purpose vehicles, and the Korean Hyundai. Both have market shares of about 6 %. The Japanese Toyota and the American Buick each have market shares of about 5 %.

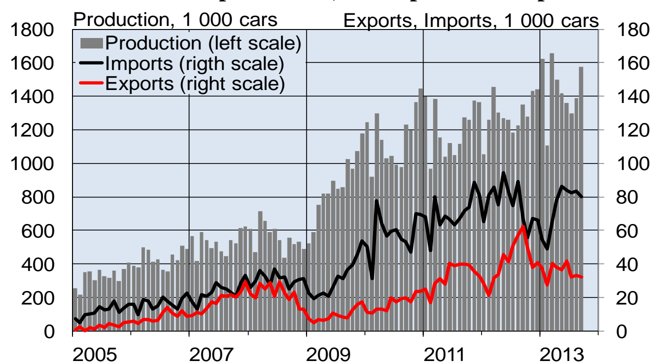
Most of the cars sold in China are also manufactured or assembled there. Nearly all large international carmakers have production in China. Chinese rules require production plants be held as a joint venture with a Chinese car manufacturer and cannot be fully foreign owned. China has used this approach to promote transfer of technology and business skills to domestic car manufacturers.

900,000 passenger cars were imported to China last year. The volume of imports this year is likely to be slightly lower than last year. China also exports passenger cars. This year China will export about 400,000 cars, about 100,000 fewer cars than in 2012. Most exported cars are reportedly Chinese brands.

There were about 90 million passenger cars on the road in China at the end of 2012, a roughly ten-fold increase from 2000. It is estimated that every fourth Chinese household has a car. Most are small passenger cars, which have been popular recent years partly because they have enjoyed special tax breaks. China's highways are further clogged with about 20 million lorries and trucks. The numbers of large vehicles has not risen as fast as the number of passenger cars.

The rapid increase in the number of cars on the road has created epic traffic jams and increased vehicle emissions. Big cities are now trying to rein in the growth the number of cars on the road by e.g. limiting car registrations. Since 2011, in Beijing license plates have been offered only by lottery and the amount has been limited to 240,000 plates per year. The city will reduce the number of plates issued by a third from the start of 2014. About 1.5 million people have participated every month to license plate lotteries this year. License plates are auctioned in Shanghai, with the lowest winning bid exceeding 80,000 yuan (€10,000) in October.

China's domestic car production, car imports and exports



Sources: China Association of Automobile Manufacturers and CEIC

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