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# BOFIT Weekly
**46 • 15.11.2013**

# Russia

**Officials cut growth forecast on domestic economy weakness.** The economy ministry last week released its new economic projections out to 2030. The basic forecast sees Russian GDP growth slowing at the end of this decade to around 2.5 % a year. In the long-range forecast published last March, the ministry estimated the economy would grow at over 4 % a year under its most likely scenario and still exceed 3 % a year under the most pessimistic scenario. The forecasts are well below the average 5 % annual rate demanded by president Putin.

The economy ministry forecast is unchanged for the near future. It still sees GDP growing at just over 3 % a year in 2014–2016. The Central Bank of Russia's forecast is somewhat more pessimistic. In its monetary policy program published last week, the CBR projected GDP growth of 2 % next year, 2.5 % in 2015 and 3 % in 2016. The forecast is conditional on a recovery in growth of the global economy.

The economy ministry sees slow import growth in the next few years. On the other hand, the CBR does not expect extensive substitution of imports with goods and services produced domestically.

In its forecast, the economy ministry held to its earlier forecast of 1.8 % GDP growth this year. On Wednesday (Nov. 13), however, economy minister Alexei Ulyukayev announced that growth this year would fall below forecast, coming in at around 1.5–1.6 %. The revised view is based in part on Rosstat's latest preliminary data on GDP growth in the third quarter. In contrast to most forecasts, growth failed to accelerate. The 1.2 % pace of on-year growth was actually a bit lower than in the first half.

Observers have noticed that the reduced growth outlook reflects a lower estimate of authorities as to the performance of the Russian economy. This can be seen in the fact that in the latest projections of the economy ministry there is hardly any change from earlier in the assumptions about growth of the global economy and trends in the price of crude oil, which has an important role in the Russian economy. The economy ministry also expects growth to slow at the end of the decade, even if it assumes the price of oil will start to rise mid-decade from the level of around $100 and thereafter increase at nearly 4 % a year.

**Putin says harsher criminal code needed to fight economic crime.** President Putin said that the 2011 relaxation of the criminal code has failed to achieve its intended results. He noted that public officials convicted of bribery under current law usually get off with fines, which is not efficient as most of those fines are never paid.

The law was changed during Dmitri Medvedev's presidency. Many economic crime classifications were eliminated and the possibility of holding suspects in jail during a crime investigation was limited. Penalties for economic crimes were also reduced. The changes were part of reforms to improve the business environment in Russia. They are often cited as one of the major accomplishments of the Medvedev presidency.

The goal of the reform was to reduce coercive practices used on firms. It is not unusual in Russia for competitor firms or corrupt officials to haul companies into court on trumped up charges in order to push the victim firm out of a certain market, take it over or strip it of its assets. Even the mere threat of a lawsuit is often sufficient to obtain a bribe.

Especially charges for tax avoidance have been used for this purpose. The possibilities of doing so were, however, greatly reduced when the 2011 reform specified that only tax officials could file charges for tax-related crimes. Earlier it was possible also for the investigative authorities. Under the proposed amendment that Putin submitted to the Duma on October 11, charging authority would be returned to investigators. The argument for the amendment is that the efficiency in solving tax-related crime has been sharply curtailed.

The bill proposal was so out of the blue that even the economy and finance ministries were unaware of it. Russia's most important economic interest groups – the Chamber of Commerce and Industry, the Union of Industrialists and Entrepreneurs (RSPP), Delovaya Rossiya (represents medium-to-large companies), Opora (represents small firms), the Foreign Investment Advisory Council and Russia's business ombudsman – all urged the president to reconsider the proposed legislation. Even the economy ministry criticised the president's proposal, as did prime minister Dmitri Medvedev, which was exceptional.

The petitioners point out that with the proposed changes possibilities for using false accusations as a means of extortion on firms would increase again. Businesses would face a more uncertain operating environment and see further degradation of the investment climate. The economy ministry further noted that the damage to the economy from increased harassment of business would be much more costly to society than any possible tax recoveries.

Since the 2011 reform was instated, the volume of charges filed for tax-related crimes has fallen substantially while the number of successful convictions has risen. Business interest groups see this as a sign that the number of baseless prosecutions for tax crimes has diminished.

Many experts say the best way to limit tax avoidance is to make the operations of tax officials more efficient rather than increasing the power of investigative authorities. The problem of unpaid fines cited by Putin could be corrected e.g. by freezing the assets of a person suspected of tax fraud or transforming fines into imprisonment penalties.

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# China

**China outlines blueprint for economic reforms.** The Third Plenary Session of the Central Committee of the Communist Party of China adjourned on Tuesday (Nov. 12). The final document released after the meeting was full of references to reforms, but lacked detail or concrete information as to how reforms will proceed. While there are many questions outstanding, there appears to be several major adjustments to the economic policy framework. A special economic reform committee was established to oversee implementation of the changes.

Allowing the market economy to play "decisive" role in the allocation of resources was a basic theme in the final document. The importance of private sector in economy will be enhanced by making it easier for companies to operate and improving protections on intellectual property rights. Some price controls could also be dismantled. On the other hand, the breakup and privatisation sales of large state-owned enterprises were not announced contrary to what was speculated ahead of the meeting. The final document stated only that the operational methods of state enterprises would be modernised. Reform of state-owned firms is difficult partly because many decision-makers have close relations to state firms. Financial sector reforms will continue, and independence of the judicial system will get greater emphasis.

The final document promised to break down the barriers between cities and the countryside. This likely implies changes in the *hukou* household registration system mentioned before the meeting. In addition, changes in land ownership are on the way. According to some experts, it appears reading between the lines that further relaxation of certain aspects of the one-child policy is under consideration.

Public sector reforms include a balancing of revenue and spending streams between central and local administrations. At the moment, the central administration collects the bulk of revenues and redistributes them to local administrations, which, in turn, are obliged to do the lion's share of public spending. Budgeting processes and taxation will be developed to improve administrative transparency.

China decided to establish a national security council that brings together the country's top security officials. While no details on the council's status are yet available, it is clear that the council will pack considerable authority in setting policy. Similar security councils are found e.g. in the United States and Russia.

The markets were disappointed by the final document of Third Plenary Session. Share prices fell in China and in many other countries. The true impacts of the meeting, however, will only become apparent once further information about the decisions reached is revealed and reforms proceed.

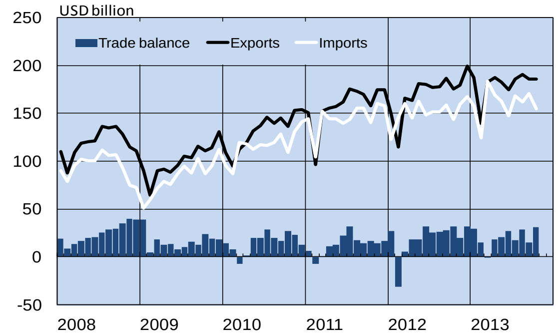
**China's economy shows stable growth in October.** China's National Bureau of Statistics reports that industrial output rose this year in October slightly over 10 % y-o-y, which was roughly the same pace as in earlier months. Business surveys, however, indicate that the situation for industry improved slightly in October.

Growth in retail sales, a proxy for private consumer demand, remained roughly the same as in previous months with retail sales rising at about 10 % y-o-y. Growth in retail sales this year has been lower than in previous years, which reflects the slowdown in household income growth.

Growth in fixed capital investment slowed slightly in September and October from the summer months, when investment growth was boosted with a "mini-stimulus."

In October, China's exports slightly beat expectations, with the value of exports rising 6 % y-o-y. Exports to Europe showed robust growth. Imports, in contrast, increased nearly 8 %, which was in line with projections. The October trade surplus hit an impressive $31 billion, keeping China on track for a slightly larger trade surplus than last year.

**China's exports, imports and trade balance**




*Source: China customs*

**China's inflation rate unchanged in October.** In October, the 12-month rise in consumer prices was 3.2 % y-o-y, or about the same as in September. The rise in prices, however, picked up from spring, when inflation was still around 2 %. Food prices went up over 6 % y-o-y, and the rise in prices of other products was below 2 %.

Growth in the broader measure of money supply (M2) remained at just over 14 % y-o-y. The volume of new finance granted by grey financing operations in October was sharply down from previous months. The shift was seen to reflect stepped up official intervention to curb the growth of the grey financing sector.

As economic growth has revived since last summer's period of uncertainty and inflation has picked up to near the 3.5 % ceiling of the government's inflation target range, central bank seems to be shifting its attention away from stimulating growth back to fighting inflation by gently tightening its monetary stance.

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