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BOFIT Weekly

42 • 21.10.2011

Russia

Russia pushes for intensified economic cooperation among CIS members. At the CIS summit for heads of government in St. Petersburg this week, the participants agreed on establishing a free-trade area within the CIS. The free-trade area was initially created in 1994, but it never got off the ground as several countries, including Russia, never ratified the treaty.

Talks on a free-trade area were reinvigorated in 2009, when Russia began to push for closer economic cooperation among states of the former Soviet Union. The signatories of the new free-trade agreement made this week in St. Petersburg include Russia, Belarus, Kazakhstan, Armenia, Kyrgyzstan, Moldova, Tajikistan and Ukraine. Economic cooperation is most advanced in the case of Russia, Belarus and Kazakhstan as the three countries launched their own customs union last year. Ukraine signed on to membership in the free-trade area, although it continues to fend off Russian pressure to join the customs union. Azerbaijan, Turkmenistan and Uzbekistan, which still have certain open issues concerning the free trade area, were given until the end of December to decide whether they will pursue membership.

A free-trade agreement would replace the jungle of bilateral trade agreements currently in force among participating countries. It would unify foreign trade practices and largely conform to WTO rules. Import duties and quotas would be incrementally phased out for free-trade area participants, although the agreement includes several waivers and transition periods. In principle, the parties would also eliminate or lower export tariffs. The parliament of each signatory country must ratify the free-trade agreement before it enters into force. There was no proposed date yet for launch of free-trade area operations.

Cooperation within the free-trade area is expected to increase with expansion of the Russia-Belarus-Kazakhstan customs union. Kyrgyzstan and current customs union members agreed in principle at the summit to admit Kyrgyzstan and formed a working group on Kyrgyzstan membership. Kyrgyzstan is already a member of the WTO, so integrating its WTO commitments with custom union demands could lead to a lengthy membership process (e.g. Kyrgyz customs duties presently are substantially lower than customs union duties).

From the start of 2012, customs union member states will form a "common economic space" intended to intensify economic cooperation among customs union members. The common economic space will provide a framework for coordinating e.g. foreign-exchange policy, energy policy and transport policy. Moving to such a regime will require major changes in national legislation, which is a lengthy process.

In the longer term, Russia's economic unification ambitions extend to transforming the CIS into a Eurasian Union, an entity with supranational bodies and operations modelled on the European Union. Prime minister Vladimir Putin presented the idea in a speech earlier this month.

Russia's new international tax agreements seek to ban tax avoidance. Over the last couple of years, Russia has negotiated amendments to double taxation treaties with countries where Russian companies are domiciled to minimise their tax obligations. The changes comply with the OECD's Model Tax Convention on Income and Capital.

At the end of September, Russia and Switzerland agreed to changes in their tax treaty so that the Swiss now promise to provide Russian tax officials with information on accounts held by Russian citizens in Swiss banks when legitimate grounds exist to suspect that the money in the account is the product of illegal activity such as tax evasion or money laundering. The agreement, yet to be ratified by either country, would enter into force at the start of the year following the year of ratification.

Changes to the 1998 Double Taxation Treaty with Cyprus agreed in October 2010 moved this summer to the Duma for ratification. The amended treaty calls for increased information exchanges on e.g. corporate tax violations and bank information. Under the changes, a Cyprus-registered Russian firm must demonstrate a reason for registering in Cyprus other than avoiding taxes before it can avail itself of Cypriot tax benefits.

The change in the Russia-Cyprus tax treaty is important as Cyprus is the most popular off-shore domicile for Russian firms. Of all foreign-registered Russia firms, 40 % (70,000–80,000) are estimated to be domiciled in Cyprus.

The Russian cabinet is currently examining a change in the Russia-Luxembourg Double Taxation Treaty. The change would ease exchange of tax information and improve the possibilities for tracking operations of Russian-Luxembourgian holding companies that have recently become popular.

The above-mentioned treaty changes may not necessarily achieve their intended effect. Getting information about suspect companies requires that the investigating agency provide a highly specified request, which may often be rejected for failing to comply with minor formalities. Moreover, Russian companies can quickly shift domiciles as needed. For example, during the past two years as the Russian-Cyprus agreement has been drafted, thousands of Russian firms have pulled out of Cyprus and headed for other tax havens.

It is common for large Russian firms to operate through subsidiaries registered in tax havens. Ownership in firms is also often organised through complicated chains of tax haven domiciled companies.

Editor-in-Chief Seija Lainela

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

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China

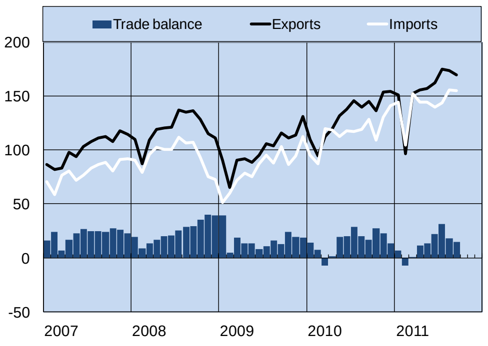
Economic growth remained strong in third quarter. GDP figures for the third quarter eased concerns that the European debt crisis would lead to a rapid deceleration in growth of the Chinese economy. GDP growth, however, did slow slightly in the third quarter to an on-year rate of 9.1 % and 2.3 % from the previous quarter. The numbers were close to consensus expectations.

Agricultural output provided a positive surprise, posting growth of nearly 3 % y-o-y for the third quarter. The National Bureau of Statistics estimates that China's overall grain harvest this year will exceed that of 2010, despite last winter's exceptional drought in central and northern China and major flooding in eastern China last summer. Primary production (i.e. agriculture, forestry and fisheries) increased about 4 % y-o-y in the third quarter.

Manufacturing, mining and construction activity all rose 11 % y-o-y in the third quarter. The highest growth among specific branches in September was registered in manufacturing of mineral products (up 18 % y-o-y) and lowest in the textile industry (8 % y-o-y).

The statistical data failed to provide strong indications that Chinese consumers had suddenly developed an appetite for shopping. Increased consumption would be in line with the Chinese official five-year plan, and hopes have even been expressed that the Chinese consumer could help save the global economy. Nevertheless, growth in retail sales was robust (up 18 % y-o-y), a pace that matched the growth of late spring and early summer. Growth in service sector output was 9 % y-o-y in the third quarter.

Trends in China's foreign trade, USD billion



Source: CEIC

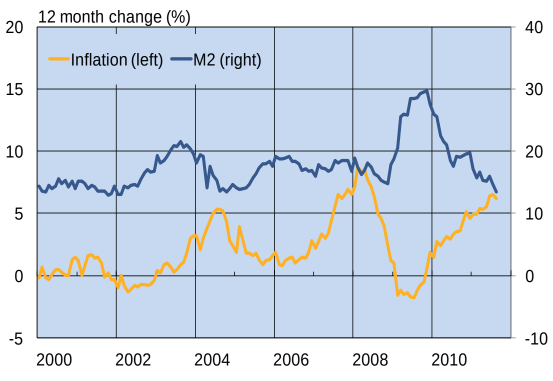
China's foreign trade has yet to be significantly affected by turmoil in the global economy, even if on-year growth in exports slowed in September to 17 % (enough to spook international financial markets). Import growth slowed in September to 21 % y-o-y.

3Q inflation remained high as housing prices plateaued. Consumer prices rose 6.1 % y-o-y in September, a rate only slightly lower than in August. Prices of nearly all consumer goods rose, led by a sharp spike in food prices (up 13 % y-o-y in September). The NBS sees the rise in food prices moderating towards the end of the year as the autumn grain harvest, which was larger than in previous years, makes its way to market. In addition, the 12-month rise in producer prices seems to be abating. Despite a slight diminution in inflationary pressures, consumer price inflation continues to exceed the central bank's 12-month target of 4 % by year's end.

Official measures to halt soaring apartment prices have begun to take effect. The average price of apartments in three of China's biggest cities (Beijing, Shanghai and Guangzhou) has been flat since June. The Chinese themselves have been sceptical of official statistics of apartment prices, and the statistical system has been significantly modified over the past year. There is anecdotal evidence to support the view that the apartment market is cooling. For example, Beijing real estate brokers have announced plans to cut back their operations and the volume of apartment sales in some markets have dropped sharply.

Much of the recent rise in prices echoes the massive government stimulus of 2009 that exploded the money supply through an aggressive expansion of bank lending. The effects of changes in money supply growth typically lag inflation. Although money supply growth has slowed since 2009 and economic growth has subsided a bit, the People's Bank of China is still expected to maintain a tight monetary stance as long as high inflation persists.

Changes in money supply (M2) and consumer prices



Source: Bloomberg

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