

## Russia

**Russia announces ratification of the Paris climate accord.** Russia is the world's fourth-largest emitter of greenhouse gases (GHGs) after China, the United States and India. Russia signed on to the Paris climate accord in 2015, but dragged its feet on legislative ratification. This week, the government finally announced it will ratify the agreement. The additional legislation supporting the Paris accord could be debated in the Duma even before the end of this year.

Russia's targets include an unimpressive 25 % reduction in GHG emissions from 1990 levels (1990, the year before Soviet industry collapsed, is used as the base year for Russian emissions). Russian emissions have since fallen so far that the country can actually increase its emissions through 2030 and still hit the 25 % reduction target – even overlooking the carbon sinks of its forests (LULUCF activities). The ratification and formulation of national legislation should be integrated into Russia's "Ecology" national project.

**Russia discusses how to invest government reserve fund assets.** The discussion has focused on investing liquid assets in the National Welfare Fund (NWF) when the liquid assets exceed a targeted limit. Budget legislation says that when NWF liquid assets surpass 7 % of GDP, the excess can be invested in such purposes as lending to domestic investment projects, but not to cover budget spending.

Part of NWF assets have already earlier been tied e.g. through project lending, so while the fund's total assets presently amount to 7.5 % of GDP, the liquid assets are about 6 % of GDP. The 7 % liquid asset limit should be met next year as finance ministry accounts already hold a more than sufficient amount of sc. excess oil & gas tax revenues that have piled up this year and are waiting to be transferred to the NWF. Under the rules of the NWF, the excess oil tax earnings of each year must be deposited in the NWF no later than October 1 of the following year. In 2018 and 2019, the transfers were made in summer. The federal budget rule says that excess oil tax revenues are generated when the actual price for Urals crude exceeds the computational (base) price set by the rule. The base price increases automatically at 2 % a year, so this year's base price is over 42 dollars a barrel.

The Central Bank of Russia has assessed the economic impacts from a couple of options for investment of NWF assets. In addition to investment in domestic projects, the assessments cover lending to foreign entities that would then commit to using the money to purchase Russian products. The options, however, do not represent any CBR view on the matter. CBR governor Elvira Nabiullina recently noted that a clearer choice would be to raise the budget rule's base price of oil and thereby impact the flow of excess revenues channelled to the NWF.

The finance ministry stressed there are no plans to modify the budget rule, noting that moneys invested from the NWF are to be paid back to the fund. Related to that, the NWF

should invest together with other financiers. One co-investor could be the Russian Direct Investment Fund. Its operations have raised the possibility that foreign sovereign state funds might be interested in participating in Russian project financing if Russia's own reserve fund (NWF) took part.

Economy minister Maxim Oreshkin said the economy ministry would like to see NWF assets lent for the purpose of expanding exports of Russian firms. Russia's Union of Industrialists and Entrepreneurs (RSPP) has also proposed that option in such a way that NWF assets be deposited with banks who would lend the funds onward to support exports.

**Chinese premier talks up trade during his Russia visit.** The Chinese premier Li Keqiang visited Russia on September 16–18. Russian and Chinese prime ministers envisioned doubling the value of mutual trade to 200 billion dollars a year over the next five years. The countries see opportunities for trade and cooperation in agriculture, energy and military technology. Currently, most Russian exports to China are basic commodities, while most Chinese exports to Russia consist of machinery or consumer goods.

Regarding food supplies, particular emphasis has been put on basic crops. China's trade war has radically reduced soybean imports from the United States, making it a natural topic of discussion. The Chinese have sought soy sources elsewhere, especially South America, but soy is being produced closer to home as well. China's soy-growing areas are located in the northeastern parts of the country, and the climate band where soy cultivation is optimal extends into Russia. However, the border currently complicates shipping of Russian-grown soybeans to Chinese markets. In any case, Russia cannot match American soy production as the current amount of land in Russia dedicated to soy can only meet a tiny fraction of Chinese demand and there is not much uncultivated arable land left in Russia. Large-scale conversion of land used for cultivating other crops into soy production also seems unreasonable.

The countries are investing in energy trade. The Power of Siberia gas pipeline, which runs from Siberia to China, is set to be completed by the end of this year. In addition, China has invested in gas liquefaction facilities in Russia. Asia is the most important market for liquefied natural gas.

In recent years, China and Russia have criticised the dominant role of the dollar in the international financial system. While politicians in both countries have talked of harmonising payment systems, no big changes have happened. In spring 2018, the Central Bank of Russia shifted 15 % of its currency reserves into Chinese yuan.

Russia and China also engage in military cooperation. In conjunction with Li's visit, China participated in military exercises in Russia's southern regions. Other participants in the military exercises included India, Pakistan, Kazakhstan, Kyrgyzstan, Uzbekistan and Tajikistan. In the 1990s, China emerged as one of Russia's most important arms buyers. The arms trade with China has since diminished as China has increased its own arms production.

## China

### **European firms demand the elimination of preferential treatment of Chinese state-owned enterprises.**

The European Union Chamber of Commerce in China this week released its [Position Paper 2019/2020](#) with its views regarding problems of China's business environment and potential solutions. The competition-distorting advantages enjoyed by state firms were seen as the most pressing problem.

The latest annual corporate survey conducted by the European Chamber found that 70 % of responding European firms said they operated in fields that compete directly with Chinese state-owned enterprises (SOEs). Some 18 % of firms reported that Chinese SOEs controlled over half the market in their field. About 40 % of respondents believed that the status of SOEs will be bolstered at the expense of privately held firms over the next two years. Just a fifth of respondents saw the situation moving in favour of private firms.

The Position Paper notes that the increased advantage of SOEs in this decade is particularly evident in access to credit. As the share of lending to private firms has decreased, the share of lending to state firms has risen. The exceptionally long payment periods demanded by SOEs further tighten private firms' financing position. SOEs also enjoy monopoly status, looser permitting rules, preference in public procurements and direct connections to regulators and policymakers.

While SOE reform has been long discussed, the European Chamber notes that the push for reform has gone in the wrong direction in recent years. The report says that the government pursues "SOE reform with Chinese characteristics" where the authorities actually do not even try to restrict the size or status of state firms. In the words of president Xi Jinping, the goal is simply to make SOEs "stronger, better and bigger."

The European Chamber concurs with IMF recommendations that the government restrict SOE access to credit, tighten rules on dividend payments, abolish implicit guarantees, wind down unprofitable firms, open up non-strategic sectors to private firms and foreign firms, as well as improve corporate governance.

The European Chamber puts its hope on the principle of "competitive neutrality", noting that the term has recently been adopted by several major Chinese economic decision-makers. Current policy trends that aim to reinforce the Communist Party's role may, however, refute such hopes.

### **China gets rid of quotas on securities investments under QFII programmes.**

China's State Administration of Foreign Exchange (SAFE) announced this month that it was scrapping investment quotas under its qualified foreign institutional investor (QFII) and renminbi qualified foreign institutional investor (RQFII) programmes. The move is largely symbolic as the quota limits were rarely approached and effectively had little impact on investment flows. Otherwise, the programmes will continue in their current form, i.e. qualified

foreign institutional investors can still use them to invest in China's financial markets.

China's opening of new avenues of investment has reduced foreign investor dependence on the QFII schemes. The stock and bond market connections between mainland China and Hong Kong, in particular, have replaced use of QFII schemes, although volumes still remain limited.

China has made inbound investment easier in recent years, but possibilities to make securities investments from China abroad have not been deregulated equally. This arrangement has been used to support the yuan's exchange rate.

### **Despite yuan promotion policies, international use of the currency remains modest.**

The yuan (CNY), which is still not freely convertible due to China's strict currency controls, has yet to establish itself as a credible alternative in international payments and investment. As a result, the yuan has failed to establish itself as an international currency proportional to the size of the Chinese economy.

China has sought for years to increase international use of the yuan. In 2010, Chinese importers were granted permission to make payments in yuan via "offshore" banks in Hong Kong and foreigners were permitted to open yuan bank accounts in Hong Kong. Issuance of yuan-denominated bonds in Hong Kong also soared. Along with other objectives, the rationale for reduction in interest-rate regulation and slight relaxation of exchange-rate policy have been to promote international yuan use. To encourage Chinese exports and the international use of the yuan, the People's Bank of China has agreed with over 30 central banks on a system of bilateral currency swaps to develop a reciprocal credit line in participant currencies.

The Bank for International Settlements (BIS) recently released its breakdown of the volume of foreign currencies traded on forex markets during April 2019. The yuan was only the eighth-most-converted currency and its share of the global OTC currency exchange has grown slowly. Only 4 % of forex trades involve the yuan as a converted currency. The Russian ruble was on the other side in 1 % of currency trades.

The Society for Worldwide International Financial Telecommunication (SWIFT) collects information about the use of various currencies in international payments. 2.2 % of all international payments traffic last August was in yuan, raising the yuan back to fifth place among the most-used payments currencies. Yuan-denominated customer payments made and received outside China occurred above all in Hong Kong. The next largest yuan-clearing centres were in the UK and Singapore.

The IMF reports that the yuan accounts for 1.8 % of global currency reserves. In Russia, however, yuan accounted for 14 % of total reserves in December 2018. In 2016, the yuan was added to the IMF's SDR currency basket with a weighting of just under 11 %. With the pace of China's reforms slowing, the use of the yuan has disappointed the expectations.