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THE EFFECT OF REGULATORY INSTITUTIONS ON MACROECONOMIC GROWTH IN RUSSIA

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Abstract:

The paper analyses common Russian practice. The structural changes in the Russian economy are further stimulated by the improvement of the government regulation policy. The paper examines the factors and effects of the general economic growth and the integration processes. The paper examines the institutional changes in the government policy of economic regulation aimed at improving the country's performance in the world financial system.

Key words: economic growth; government regulation; integration processes; institutional changes

1. The Evaluation of Relationship of the Activity of the Central Bank and the Government of the Russian Federation.

In spite of the tremendous effort to achieve economic growth, Russia has not yet been able to reach the level of both capitalization index and people's living conditions in the Soviet times over the period of 1960-1985. Today the investment volume on GDP does not exceed 20 percent compared to the 25 percent threshold established by the Center for Financial and Banking Research of the Institute of Economics of the Russian Academy of Sciences, which is critical to the country's

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economic stability. It is not until 2018 that the index is expected to reach 27 percent.

It is generally believed that the low incomes and savings of the bulk of the Russian population show low dynamics which does not allow to develop the inner potential sufficient for investment. Nearly 70 percent of Russians have no savings. Under these conditions borrowing abroad and foreign direct investment become the vital sources of economic growth in our country. By the forecast of the Ministry of Economic Development and Trade the year 2013 expected a 6,5 percent increase in investment. The investment has been showing the tendency to decrease since 2008 and has not yet come close to the pre-crisis level. According to statistics the government share in the total investment steadily decreases to account for less than 18 percent, while the private capital share has increased to around 60 percent.

Table 1

The Overall Investment and Savings Indices in the Russian Federation

Indices	2005	2008	2009	2010	2011	2012
1. Capital investment as percent of GDP	16,7	21,3	20,4	20,4	18,7	20,2
2. Gross savings as percent of GDP	28,9	30,2	20,9	25,4	28,3	25,9
3. The ratio of gross savings to capital investment, in percentage points	1,73	1,42	1,03	1,25	1,51	1,28

The analysis of the structure of industrial production indicates a major share of the fuel and energy complex and a small share of engineering and metal-working needed for modernization, the renovation of fixed capital and ensuring the competitive growth of Russian enterprises. By comparison in 1990 engineering and metal-working accounted for 30 percent of industrial output .

Table 2

The Structure of Industrial Production in Russia, as Percentage of Total[4]

[4] Calculated on the basis of the data provided by the Russian Federal State Statistics Service : in terms of the volume of own-produced shipped goods, work and services performed with one's own resources : http://www.gks.ru/bgd/regl/b12_48/Main.htm

Industry	2005	2006	2007	2008	2009	2010	2011	2012
Industrial output, total	100	100	100	100	100	100	100	100
Mining operations	22,5	21,8	21,8	21,3	22,7	21,6	22,9	22,3
Manufacturing	65,1	65,5	67,8	68,3	63,9	65,6	65,1	66,0
Including:								
metallurgy, machinery and equipment, transportation manufacture	26,9	27,3	28,4	27,2	22,8	25,2	25,5	30,1
Electricity, gas and water supply and production	12,4	12,7	10,4	10,4	13,4	12,8	12,0	11,7

In addition, from 2004 till 2012 there was a disproportionate growth of monetary base and money supply relative to Nominal GDP, which was inevitably reflected in the economic growth. In 2004 the money supply contraction relative to GDP caused the bank liquidity crisis. The analysis indicated that in the following years the higher rate of GDP was prompted by the expansion of money supply by the Bank of Russia. On the other hand, as the result of the government's major spending at the end of the year the uneven money supply has an adverse effect on the economic growth. Not only the value of nominal money supply but also the money supply index adjusted for inflation is vital to the macroeconomic analysis. A more powerful influence was the bank (monetary) multiplier capable of increasing the efficiency of the Central Bank's transmission mechanism. However, the prospects are not bright here either. By comparison not only with advanced economies but also with many emerging economies the low value of this index reflects the low issuing ability of commercial banks to create extra money for crediting.

Table 3

The Dynamics of the Ratio of the Money Supply to GDP in Russia

in 2004-2012 .[5]

[5] The table uses the data from the official websites of the Central Bank of Russia – www.cbr.ru и Росстата – www.gks.ru

Indices	2004	2005	2006	2007	2008	2009	2010	2011	2012
GDP, in billion rubles	17027	21610	26917	33248	41277	38786	44939	54586	62357
Money supply M2, in billion rubles	4353	6032	8970	12869	12975	15267	20011	24543	27405
Money supply to GDP, in percentage terms	25,6	27,9	33,3	38,7	31,4	39,4	44,5	45,0	43,9
Cash in circulation M0, in billion rubles	1534	2009	2785	3702	3794	4038	5062	5938	6430
Share of cash in money supply in broad sense, in percentage terms	35,3	33,3	31,0	28,8	29,2	26,4	25,3	24,2	23,5

The maintaining of the refinancing rate at 8,25 percent at the same level in 2013 (given the official inflation at 7 per cent) along with the well-established policy of the economy's monetization creates the crediting system with the bank interest exceeding the economy's profitability level. Rather, the interest rate is set at the export-oriented manufacturers' return level significantly higher than that of other manufacturers. Certainly, the high cost of bank loans is explained not only by the rate of inflation, but also by the high margin rates of banks with the government participation.

On the other hand, when prices and energy tariffs rise, the inflation leads to capital flow and income redistribution to the natural monopolies sector, which has a negative effect on the competitiveness of producers in manufacturing industries. According to the study of the Centre for Macroeconomic Analysis and Short-Term Forecast [6] the poor see the inflation rise at a quicker pace, which creates social and economic problems. As a result, this leads to the imbalance of the Russian economy imbalance, and, consequently, triggers price rises.

The key interest rate introduced by the Bank of Russia in 2013 diminishes the role of the refinancing rate and points to the expansion of the instruments of

[6] The Russian economy in the context of global challenges// the official website of the Centre for Macroeconomic Analysis and Short-Term Forecast is www.forecast.ru

monetary and credit regulation. The key interest rate is intended to be used for liquidity support and liquidity-absorbing operations through an auction for a period of one week at the rate of 5,5 percent per annum for the 13th of September 2013. At the same time the interest rate band was set with the cap at the rate of 4,5 per cent per annum and the floor at the rate of 6,5 percent per annum , being proportionate to the key interest rate. In the event of the Bank of Russia's decision to change the key interest rate level, the cap and the floor will automatically shift according to the change amount, with the width of the interest rate band being 2 percentage points. This band width is considered as the optimal value to restrict the volatility of interest rates in the money market, while maintaining the incentives for the reallocation of funds in the interbank money market

Today scores of studies are devoted to the possible ways of achieving macroeconomic equilibrium, as well as to how imbalances, deficits and contradictions may occur. The suggestions to tackle these problems arise from the efficient financial market in modern economics. In this study we proceed from the assumption that macroeconomic equilibrium is nonlinear and that it is vital to establish the functioning economic and social system focused on economic growth and social strain relief.

The Central Bank works in close cooperation with the Government of the Russian Federation, each using their own specific instruments to promote the economic growth and social development of the society. The government extends public budget loans and credit support in the form of financial institutions' loans to enterprises. The Central Bank extends credits to the real economy indirectly via the banking system. The government also makes an impact through the state development institutions, interest rate subsidies and the financial aid to the banking system. The role of the Central Bank is to extend stabilization loans to commercial banks, conduct the interest rate policy, etc. The discussed expansion of the state's mediation activities, particularly during the period of the global financial crisis of

2008 is partly explained by the tight monetary policy of the Bank of Russia, and represents the non-market form of allocating financial resources.

Table 4

The Appropriations of the Federal Budget for 2008-2011[7]

Item of Expenditure	Total, in billion rubles				The departure of 2011from 2008 , %
	2008	2009	2010	2011	
National issues	827,8	885,9	1087,4	777,6	-6,2
National defence	509,1	619,2	678,4	793,0	55,8
National security, law enforcement	521,8	707,4	726,9	819,8	57,1
National economy	702,3	1920,8	1366,1	1702,3	142,4
Housing and public services	54,6	127,9	103,0	196,5	260,1
Environment protection	9,3	12,8	12,3	16,8	80,3
Education	307,2	387,9	386,4	495,8	61,4
Culture, cinematography, mass media	83,8	110,1	107,3	81,9	-2,3
Public health service, physical culture and sports	211,7	323,9	325,1	453,8	114,4
Social policy	270,9	320,3	328,8	453,8	67,5
Inter-budgetary transfers	2281,6	3443,9	3725,4	569,7	-75,0
The undisclosed sections of the budget бюджета	1240,9	985,3	1040,0	2991,4	141,1
Total	7021,9	9845,2	9886,9	9352,4	33,2

There is a heated debate among the Russian economists on the budget balance in terms of budget surplus or deficit. The budget deficit supporters believe that this is the right way to encourage investment, ensure economic growth and accomplish social tasks. The advocates of budget surplus argue that the economic growth model should be based on deficit reduction and an excess of revenues over expenditures. At the same time the theory and practice of many foreign countries emphasize that budget surplus undermines domestic consumption and impedes

[7] The table is based on the data related to the Federal laws on the federal budget of the Russian Federation.

social and economic development. With the growth of budget surplus it is economically feasible to increase government spending on science, education, healthcare and other kinds of social spending.

The government policy aimed at the minimization of government spending and the increase in the Stabilization fund of the Russian Federation, excludes from the economic turnover the funds that could otherwise be allocated to modernizing the Russian economy and stimulating innovation-based growth. However, according to the point of view expressed by Kudrin A., Dvorkovich A. and others, the use of the Stabilization fund would increase inflation[8]. Nevertheless, the inflation could be avoided, if the "stimulating" fiscal policy, while triggering higher inflation, could be offset by the higher rate of GDP growth.

2. The Government Regulation of the Integration Processes in the Russian Economy and Financial System.

It is obvious today that in modern global economy the strong positions, held by some country or a group of countries in the primary commodity markets or the engineering, metal-working, aerospace engineering or any other final products market, do not permit to exercise self-checking control over the global financial market. Russia's integration into the global economy occurs not only due to foreign trade but also owing to the flow of capital and participation in the global financial system. While having some established traditions in the global commodity markets, Russia's markets in the financial sphere have only just started to gain momentum and at present may attract only some of the CIS countries.[9] Indeed, Russia keenly desires to increase its involvement in the global financial system. During the 90s the Russian Federation joined the IMF, IBRD, APEC, replaced the former USSR in the EBRD membership and became a member of the

[8] Senchagov V. The Fiscal Policy and its Role in Economic Growth.// Economic Issues. 2007. – № 5. – P 71.
[9] Vasilyonok V.L., Aleksashkina E.I. Business Development and its Key Determinants// The Journal of Saint Petersburg State University of Low Temperature and Food Technologies. Economy and Environmental Management Series (electronic journal). - 2013. - №1.

Paris Club. In 1997 the Agreement on Partnership and Cooperation between Russia and the European Union went into effect. In 2012 following the lengthy negotiations the Russian Federation joined the WTO. Continuous work is carried out to solve the external debt issue of the Russian Federation, etc.

While the study of the position and role of Russia and its financial market in the global economy focuses mainly on the external factors, it nevertheless becomes evident that the integration problems are rooted both in the Russian economy and in the development of the national financial market. Simultaneously with the privatization process the Russian banking system, which depended upon joint-stock commercial banks, was established within a short period of time. The stock market gradually developed and the foreign exchange market started to operate. The Russian government and Russian companies came into the global capital market for the purposes of attracting financial resources. On the other hand, the domestic stock market (initially in the form of the government bond sector) was open to foreign investors who found bonds popular due to their high yield and a less risk. This laid the groundwork for integrating the Russian stock market into the world bond market, with the national financial system becoming a part of global finance.

However, it should be noted that the rapid development of the integration processes in the financial market, which tended to increase the market prices of Russian companies' stock and the government bonds in domestic and foreign stock exchanges, was not accompanied by corresponding changes in the Russian economic situation. Furthermore, these developments took place not so much due to the inflow of foreign capital as to the flight of Russian capital abroad. As the result of such uneven development of the financial system and the economy, the public finance activity declined, while the dependence of the Russian financial system on the global financial system and the behaviour of foreign participants who often pursued speculative purposes, increased.

The theory of international economics has the concept of «the impossible triplicity» which implies the impossibility of achieving the fixed exchange rate, free floating of capital and the independent monetary policy aimed at curbing inflation. At that time a similar situation was created in Russia, where in response to the high exchange rate of the Russian ruble to the US dollar, a heavy speculative attack was launched on the currency. In these circumstances much pressure was put on the government short-term bonds market (GKO) with high interest, which failed to keep pace with the inflation rate. As the result, the decreasing foreign reserves forced the Russian Federation Government to devalue the Russian currency and to default on domestic debt. This method of riding out the crisis won approval, because it was considered unacceptable to print money in order to satisfy GKO's debts, which would have set the mechanism of the inflationary spiral going. Nor was the nonpayment of foreign debt regarded as an option.

It is evident that the default on domestic debt announced on 17 August 1998 led to severe erosion in foreign investor confidence of the Russian state securities market reputation. Massive transfer of Russian citizens' capitals to foreign banks followed. At that time the International Monetary Fund failed to find sufficient funds which could have a beneficial effect on the stabilization of the financial and economic situation in Russia. In fact, the decision made by the IMF and other international financial organizations to provide financial aid to Russia was greatly influenced by the Corruption Index of national economies, which made Russia one of the "world leaders".

It took the Russian government a long time to reach the domestic debt agreement known as the "novation scheme". The corporate sector in general and the banking sector in particular searched painstakingly for the way to «import» financial resources from abroad, as there were no well-developed processes of transforming domestic savings into investment. Under the circumstances it became vital to create a proper institutional environment to adjust the financial system to other industries in the national economy and also to ensure the harmonization of this development. Breaking up the financial market monopoly in such sectors as the foreign exchange market, the credit market, the bank deposit market, the market of stocks and bonds may significantly contribute to the solution of this problem. In the Russian financial market there are relatively few active operators with the largest share of trading. The main characteristic feature of the financial market is the concentration of trading in government securities primarily in stock exchange markets, while the major trading activity in currency, corporate securities and bills is performed in the over-the-counter market. To a large extent the activity of the participants of the financial market in the different sectors is largely determined by the strategy of the Central Bank of Russia both over the control of the dollar exchange rate and achieving the targets of the refinancing interest rate policy.

The situation in the municipal and corporate bond markets largely depends on conditions of the federal borrowing market. There was no intense competition between the municipal and corporate bond markets, partly attributed to the municipalities' reluctance to come into the bond market for financial resources. However, from the start of the crisis to May 2009 the technical and real defaults [10] on 105 corporate bonds of 85 issuing companies occurred in the domestic corporate bond market. A large number of issuing companies were saddled with debt burden, although the acceptable threshold value for high-leverage companies was 3:1, i.e. when debt is thrice as much as the company's operating profit. Therefore, from 2010 onwards the corporate issuers' participation in the financial market has dramatically declined.[11]

The development of the self-regulating function in the financial market in the form of insurance funds in self-regulatory organizations is acknowledged to be a big improvement. It stimulated the self-regulatory organizations to set more rigorous requirements for the activity of the market participants. The current legislative regulation provides broader opportunities for the securities market

[10] The technical default typically occurs because of the payment system failure or personnel errors which cause the failure to perform operations within the time limit. It happens against the will of the issuing company due to the failure to perform debt obligations. The real default means the issuing company's inability to make payments because of financial squeeze.

[11] Sergeeva I.G. The Relationship of the Financial and Real Sectors of Economy in the Post-Crisis World// The Journal of Saint Petersburg State University of Low Temperature and Food Technologies. Economy and Environmental Management Series (electronic journal). - 2012. - №1.

professional participants who work in self-regulatory organizations and adhere to more demanding standards of professional activity. They engage in assisting untrained investors by providing underwriting services for the public offering of securities and the placement of companies' securities with a higher risk. The changes in the regulation system also took the form of the transfer of regulation functions with regard to private pension funds and insurance companies initially to the Federal Financial Markets Service (FFMS) and later to the Central Bank of Russia to create a major regulator and give it the functions earlier performed by the FFMS.

While evaluating the merits of this step, it should be emphasized that it will enable to come to grips with the problem of the joint regulation of financial institutions engaged in similar activities. In this respect the approaches to estimating the equity funds of credit institutions could become the basis for estimating the equity funds of all other kinds of financial institutions, which conforms to the world-wide standards. In the long term, it is critical to develop national requirements for assessing capital adequacy, bringing them closer to the international standards, more adequately reflecting the financial institutions' risk activity. The creation and development of diversified financial holding companies in Russia make it necessary to address the specific issue of their multipurpose regulation, which is easier to implement from the single centre.

From our point of view, in many respects the future development of Russian financial markets will depend on the federal government bond market, namely its size, liquidity and yields. After the recovery in 2002 after the crisis of August 1998, the federal government bond market started to gain momentum, contributing to the growth of domestic bonded debt of the Russian Federation, i.e. the higher-than-anticipated growth in revenues from the government securities sale as compared to the money volume spent on federal government bond interest payment.. The Central Bank of Russia (CBR) monetary policy of the stabilization of the ruble exchange rate and a decline in inflation created favourable conditions for growth in the issue of government bonds. Apart from this, the massive issue of government bonds, with yields below the inflation rate, was explained by maintaining the high level of surplus financial funds in the banking system and the emergence of the Pension Fund of Russian Federation (PFR) as the major institutional investor.

At the same time keeping interest rates at the negative level in the situation when the inflation exceeds the interest rates of borrowed funds creates high risks in the financial system, which may result in the bankruptcy of a number of financial institutions and the local financial crises. Moreover, the negative level of an interest rate may have a depressing influence on the national financial markets, prompting the slowdown in the growth rate of private and corporate bank deposits, or their nominal decrease.

As for the increase in the real exchange rate of the ruble, other things equal, it may not only have a depressing effect on Russia's exports, in particular on non-oil and gas exports, but also appears as an anti-inflationary measure. The CBR «real targeting» policy-making is capable of either reducing inflation or stimulating exports. According to the ruble strengthening scenario, investment for the support of the fuel and energy sector's competitiveness will require far more considerable funds than the ruble weakening scenario.

The policy of currency liberalization pursued by the CBR over the past few years stimulates the growth of interest of foreign banks or non-resident banks in accumulating rubles and in financial and banking operations with this money stock. The same interest will be pursued by the free-floating ruble policy, which by 2015 will have provided for the full abandonment of the current trading band for the currency, with the corridor adjusted depending on the currency intervention by the CBR. It is believed that the abandonment of the currency band will not affect the Russians and the ruble exchange rate will increasingly reflect the costs of the economic agents. In addition, the events showed that the elimination of the trading band (set at the beginning of 2009 within a corridor of 26-41 rubles) for the dollar-euro basket fluctuation did not lead to the ruble fall. It must be noted that all of these institutional changes occur against the backdrop of dramatic events in the world markets where a full-scale war is being waged.

As for the availability of the banking services at the regional level, the analysis shows that Russia's current banking infrastructure is not balanced and well-developed. A large proportion of assets in the banking sector falls on the Central Federal District, while the shares of other regions, most often having the same population level, are significantly lower. At the same time the regional banks continue to reduce in number. Demand for the banking services in the Russian economy is far from being satisfied. The major problems faced by the national banking system, which became apparent during the 2008 world economic crisis, include low liquidity, a shortage of long-term financial resources and high risks. As regards the population, there is a growing number of the Russian Federation citizens who use banking services on a regular basis. However, less than half of Russians have banking accounts and less than 50 per cent of the population are bank card holders.

The decision of the Government of the Russian Federation on the allocation of 1,2 trillion rubles for the recapitalization of lending institutions , which includes 400 million rubles on buying out shares from private banks, was taken to strengthen the country's banking system. Many other countries took the same route, but in the case of Russia this decision is of greater consequence. In the conditions when the state has control over around 60 percent of the market, there is a high risk of a decline in the system's efficiency, the weakening of market competition and monopolization. It is more advisable for the state to grant subordinate loans to private banks and to provide their capitalization support through federal loan bonds in order to maintain healthy competition.

The phenomena of globalization and integration require that the Russian banks come up with financial innovations and technology advancement in order to keep the present clients and to attract new ones. Retail banking appears to be the crucial factor for inner development, as it has a really high potential for providing the banking system with long-term sustainable resources, for creating opportunities for the acceleration of capital turnover as well as for meeting people’s demand for high-priced goods through moneylending. In accordance with the instructions of the President of the Russian Federation, the CBR is carrying out work to improve the legal basis for the financial and banking services accessibility to the population in the regions of Russia where the network of banking institutions is inadequate.

It is planned to expand the network of banking institutions using the infrastructure of the federal state unitary enterprise «Russian Post». Many Russian economists welcome the idea to apply the German plan for development called the Deutsche Postbank Group to the Russian post office and banking systems. The delivery of postal and banking services is organized in such a way that the bank acts as the service producer while the post-office performs the service provider role. To put it differently, the post-office acts as a post office bank which deals directly with the customer, while the bank handles the accounting and financial reporting over these transactions. Transforming the post-office into «a financial supermarket» will allow to solve not only the Russian banking system’s regional problems, but will also create favourable conditions for using post-offices and banking institutions to implement pension and savings schemes, and financing the projects of federal importance.

3. The Plans and Realities of the Creation of the International Financial Centre in Moscow

The concept elaborated for a five-year period by the Ministry of Economic Development and Trade of the Russian Federation provides for the development of the stock market and the stock exchange infrastructure. It started in 2008 and aims to develop the Russian financial market and to open the international financial centre in Moscow. Appropriate laws have been passed to fulfill this goal. The annual plans have been drawn to carry out around fifty activities. Certainly Russia has a long way to go for reaching the desired goal. Above all, it is vital to continue the work on the structural reforms in the Russian economy to achieve the quality changes in terms of its diversification, as well as to develop the domestic capital market in order to facilitate access to long-term money (savings).

It is the Russian economy's dependence on raw materials that attracts foreign investors to its commodity markets. At present strategic foreign investors do not find the country's financial market attractive. According to Hans Rudloff, the President of Barclays Capital, as long as the Russians do not choose to live, work and invest in Russia, there is no question of attracting long-term foreign investment to the country.[12] In order to raise a savings pool, certain steps are being undertaken in Russia towards overcoming the regional imbalance of the banking infrastructure and setting up post office banks and banking institutions. Personal savings are expected to form the basis for the Russian capital market and lay the foundation-stone for establishing the Moscow International Financial Centre similar to those in New York, London and Tokyo.

Today the international economic communities estimate the Russian financial market to be average in terms of the capitalization-to- GDP ratio. In 2012 its share in GDP accounted for slightly over 40 percent, while in the EU Member States this index has reached 59 percent, in Japan - 75 percent and in the US - 108 percent. In spite of the relatively high rates of the Russian stock market capitalization growth over the period of 2003-2010, it showed a significant decline of 18,21 percent in 2011 and did not recover its previous levels, having risen by 3,06 percent in 2012.

Table 5

The Annual Growth of the Stock Markets Capitalization for Certain Countries in 2003-2010 (%)[13]

Market designation	Country	2003	2004	2005	2006	2007	2008	2009	2010

[12] The Proceedings of the International Conference «Moscow as International Financial Center, Russian Ruble as Reserve currency: Realities and Prospects» (8 September 2010). – M.:, 2010.
[13] The table uses the data from the NAUFOR website: www.naufor.ru

Hong Kong Exchanges	China	0,54	0,21	0,22	0,63	0,55	-0,50	0,73	0,12
Deutsche Borse	Germany	0,57	0,11	0,02	0,34	0,29	-0,47	0,16	-0,09
Tokyo SE	Japan	0,43	0,20	0,29	0,01	-0,06	-0,28	0,06	0,06
MICEX	Russia	1,34	0,11	0,74	2,33	0,38	-0,72	1,18	0,30
London SE	Great Britain	0,33	0,16	0,07	0,24	0,02	-0,51	0,50	-0,01
NYSE Euronext (US)	USA	0,26	0,12	0,07	0,13	0,01	-0,41	0,29	-0,26

In addition, the volume of transactions in the Russian financial market is lower than in some other countries recognized as the world's financial centres. With respect to the competitiveness index, with the financial market maturity index as its essential component, Russia has a rather low ranking. International experts rate Russia highly in terms of the cost of the company equity registration, changes in the effective exchange rate, public debt management and some other aspects. Considering such indices as financial sector liberalization, the protection of minority interest, the degree of the proper use of budgetary funds, the corruption level, the independent judiciary, the degree of protection of creditors' and borrowers' interests and some others, Russia has yet to face up to a lot of urgent tasks in order to claim the status of the country with the international financial centre. Nevertheless, many of those experts, who do not believe that the Moscow international financial centre may be established by the specified date, do agree that the changes in the Russian economy will benefit the investment climate and the financial markets development. Moreover, it will contribute to invigorating the battle for capital flows in the international market.

Russia's movement towards achieving the national currency convertibility does little for the ruble to be used for settling payments between countries, since the Russian economy is relatively small in size (compared to other economies) accounting for slightly over 4 percent of the world GDP. As for the ruble as reserve currency, the achievement of this task may become possible if there is at least steadily low inflation in the country (at the annual rate of no more than 2-4 percent) and if the country's economy stops depending heavily upon the world commodity prices. The piecemeal approach to setting up the world financial centre in Russia requires that Moscow create such preliminary conditions for stock flotation of the foreign companies from the CIS countries, which would be more preferable compared to the conditions in London or New York.

Even now a comfortable environment has been created in this sphere in Russia. In terms of the maturity of the financial sector which includes financing at the expense of the national capital market, venture capital availability, the degree of stock exchange regulation, Russia has certain advantages over the CIS countries. Such Russian companies as Sberbank (Savings Bank), VTB (the Bank for Foreign Trade), Renaissance Capital, Troika-Dialogue and others operate as active financial services providers in the post-Soviet space. To a certain degree this progress is determined by the countries' shared past historical experience combined with the closeness of traditions and cultures.

Judging from the foreign countries' experience, the gradual transition of the Central Bank of Russia to the inflation targeting regime might take up to 5 years. It is intended to support the country's economic growth and control inflation. Such a transition requires the development of the internal debt market and the hedging instruments against exchange risks and oil risks, as well as the harmonization of the tax regime of forward contracts. It is therefore possible that inflation targeting will be of modified nature. More specifically, in one form or another it will combine with credit targeting based on the market instruments and the exchange rate. It is believed that that expansion of the current trading band for the ruble exchange rate volatility will mean the reduced presence of the CBR on the exchange market, which will lead to the complete abandonment of the present scheme of currency intervention by 2014. If this occurs, then given the oil price of over $80 per barrel and the improvement of the investment climate in the market, one might expect an increase in the inflow of capital to Russia and the growth in the CBR account balance.

While the inflation targeting regime is difficult to implement due to the structural crisis in the Russian economy, certain amount of work in this direction is in progress. Firstly, this concerns the transparency of the CBR activity. Secondly, emphasis is placed on the creation of the central electronic interbank credit market, the elimination of regional disproportions and of the hierarchical structure of the interbank market and the development of more forward interbank market segments. Thirdly, the work involves the setting of interest rate targets (which requires «the adjustment» of the monetary instruments) and the narrowing of the interest rate band. It is vital to increase the CBR's responsibility for committing blunders in achieving the inflation targets given the fact that at present time the CBR assumes no liability for unfulfilled goals.

The relationship between the global and regional capital markets, as well as increased competition between different international financial centres for attracting capital makes Russia's adoption of IFRS a task of prime importance. The refusal to introduce the standards inconsistent with the global standards and IFRS give an edge to Russian business for providing comparable and transparent financial information in the global market.

Proper changes in legislation are being introduced related to stock market trading in order to create more favourable conditions for foreign issuing companies to place their stock on the Russian stock exchange. The MICEX Stock Exchange (the Moscow Interbank Currency Exchange) began to trade in EBRD bonds. The stock exchange has developed the listing reform for the purposes of attracting new foreign issuing companies and safeguarding investors' interests. This will result in the disappearance of non-listed stock, the minimization of defaults in the bond market and other changes. It is believed that the potential issuers on the MICEX Stock Exchange will include in the first place the Russian companies, which have placed securities abroad through the SPV mechanism, issuing companies from the CIS countries and foreign issuing companies either conducting business in Russia or making strategic plans to come into the Russian market.

In December 2010 the «RTS» Stock Exchange and the MICEX Stock Exchange began trading in the Russian depositary receipts (RDR) of JSC «RusAl». It was the first company to carry out the unlimited programme of issuing the Russian depositary receipts (RDR) for reinforcing the company's stock attractiveness and ensuring its accessibility to the Russian stock-oriented investors. The Sberbank of Russia, the RDR issuer, named such major Russian brokers as «VTB Capital», «Renaissance Broker » and «Troika Dialogue» as the market makers to create the liquidity market of Russian depositary receipts.

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