The Moscow Times
30 YEARS
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How Russia Can Lead the G20

By Jingdong Hua

January 28, 2013

Russia is taking the helm of the Group of 20, and with that honor comes a unique opportunity: to lead the international community toward sustainable, inclusive growth and shared prosperity in 2013.

The Russian government has pledged to focus its G20 presidency on practical solutions to stimulate growth and jobs, manage government debt and regulate the financial sector. Russia could lead in advocating yet another significant G20 priority: strengthening local capital markets.

Deep and efficient local capital markets contribute to global financial stability. They are the foundations for long-term economic growth. They provide resilience against volatility in capital flows and reduce dependency on foreign debt. They offer investment alternatives for social security funds, pension funds, insurance companies and other institutional investors that provide safety nets.

Local capital markets provide access to local-currency finance, which is essential for financing infrastructure and housing, sectors that underpin economic growth and long-term development. This enables small and medium-size enterprises to borrow in their own currencies, protecting them from foreign-exchange risk so they can grow and create jobs.

Without strong domestic capital markets and access to local-currency finance, the private sector cannot thrive. A thriving private sector is necessary to give people the opportunity they crave most: to improve their lives.

Russia wants to become an international financial center, and it recognizes that strong, deep domestic capital markets are needed to achieve that role. This year, the country implemented a number of reforms to strengthen its domestic capital markets and increase the participation of foreign investors. The Central Bank is putting in place measures to facilitate monetary flows and enhance market liquidity. The securities supervisor approved reforms that better support cross-border transactions and better protect international investors. In parallel, as it looks to boost its ranking in the IFC/World Bank "Doing Business" report, Russia is working to improve its investment climate and stimulate growth. All these reforms leave Russia well-positioned to lead the G20 agenda on developing domestic capital markets.

International financial institutions such as the International Finance Corporation and the World Bank can be valuable partners to countries as they seek to strengthen their domestic capital markets. For example, just last month the IFC issued its first Russian-ruble-denominated bond in the domestic markets. IFC's ruble bond is innovative because it offers inflation-protected returns to investors. The bond should encourage greater investor participation and pave the way for future inflation-linked issuances in the Russian market.

The World Bank's recent report on Russia's capital market recommends various reforms that will support market development, such as creating more benchmark government bonds, reducing the cost of private issuance and improving securities distribution networks to increase participation by small and medium-size enterprises and small investors.

International financial institutions can also help increase the availability of local-currency finance to the private sector. In Russia, the IFC has invested more than 40 billion rubles ($1.33 billion) since 2005 to support important sectors such as small and medium-size enterprises, health care and infrastructure. To meet the growing demand for long-term local-currency finance in the country, part of the proceeds from IFC's debut ruble bond will be invested in the domestic private sector.

Developing local capital markets is a long-term task. Countries must implement sound macroeconomic policies, achieve price stability and realize fiscal prudence. Local regulatory and legal obstacles must be overcome. There is an urgent need for reforms in capital markets, such as the introduction of primary dealer systems, which allow firms to act as market makers of government securities. Also needed are regulations that encourage market-making in government and corporate bonds, repo facilities that help finance dealer inventories of securities, and derivatives and hedging instruments for market and credit risks.

IFC, the World Bank and other international financial institutions are helping countries overcome some of these challenges, and Russia can use its influence in the G20 and similar forums to make a compelling case for encouraging domestic capital markets to thrive.

As the impact of the global financial crisis continues to spread and as large developing economies experience slower growth rates, the need to support development of local capital markets takes on a new urgency. At the G20 meeting in Seoul in 2010, world leaders asked international financial institutions to strengthen local capital markets and domestic-currency borrowing.

Under France's leadership, the IFC and the World Bank worked with others to create the G20 Action Plan for Local Currency Bond Markets. Collaborative efforts among international finance institutions continue today, and Russia is well-positioned to provide further impetus to their efforts. Through its leadership, it can make a unique contribution to ensuring long-term growth and stability.

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