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**JUNE 20–22, 2013**

**CNBC Televised Session**  
**MANAGING THE FUTURE OF FINANCE**

**JUNE 20, 2013 — Thursday 16:00–17:00 Pavilion 4, Conference Hall 4.2**

**St. Petersburg, Russia**  
**2013**

**Moderator:**

**Geoff Cutmore**, Anchor, CNBC

**Panellist:**

**Anton Siluanov**, Minister of Finance of the Russian Federation

**Front row participants:**

**Aleksei Kudrin**, Dean of the Department of Liberal Arts and Sciences, St. Petersburg State University

**George Magnus**, Senior Economic Adviser, UBS Investment Bank; Author, 'Uprising'

## **G. Cutmore:**

Ladies and gentlemen, welcome to this CNBC session. We are very pleased to have the Minister with us for the meeting. My hope is that we will have a fascinating and a frank discussion about Russia and the global economic context, and then, moving forward, perhaps we can talk more specifically about some of the issues here that face Russia as far as my audience, largely, is concerned: that is, an international investor audience, those who would like to come and put money to work in this economy. So that is roughly the direction of travel we are going to take.

I would also like to welcome Alexei Kudrin, who I think is very well known to all of you, Russia's former Finance Minister, of course, and George Magnus, who is with us from UBS and is going to help to give us an economist's take on the bigger picture, and perhaps some insight on where the BRICS economies currently sit and what challenges they face.

Just one point that I need to make to you: we are going to be filming this discussion that we are having and, as I always say to people, if you are here with someone that you would rather not be seen on camera sitting next to, now might be the time to swap seats or move somewhere else, because we would not want there to be heartache at home later on. I think we all understand what I am saying.

So, once we are ready – how are we doing, Adam? Yes, OK. Adam is the director who will be running the show in the gallery for us.

Good. I hope that you have all got interpreting devices if you need to have the Russian interpreted into English or vice versa, because my understanding is that the Minister will not be tempted into English: we will conduct our conversation in Russian. Given that my Russian is not so great these days, I am a little rusty, it is probably better that I continue in English and you answer in Russian.

So, it is very nice to have you in these very intimate surroundings, you can take it from me that everything you say will be just between us. Or not. Obviously we have already had a few noises from mobile phones, so if I could just ask you, maybe, to turn down the sound or put them on mute? Everybody in this room is important and busy here at this event, so I will not ask you to turn them off, because I know that is

like dying in cyberspace, but if you could just turn down the volume a little bit so that we do not have too many interruptions.

Well, let us kick off if everybody is comfortable and everybody is ready.

Minister, it is very good to have you with us, and thank you very much for giving us so much of your time for this CNBC Special Programme. I wish to start by asking you to give us your view and share with this audience where you think we are with the global economic recovery since the financial crisis. Today, we are talking about the fact that the Federal Reserve is starting to talk about easing back on some of its accommodative policy; we have other central banks which are being quite active, but we do see patchy signs of green shoots and recovery. So, your analysis of where we are in the global economic recovery is welcome.

**A. Siluanov:**

Good afternoon, colleagues. The questions currently under rigorous discussion concern the path that Russia is taking and what possible consequences the Federal Reserve System's decision to taper quantitative easing may have on Russia and other world markets. During a recent panel discussion on financial regulations, we were confronted with the idea that we might need to prepare for another financial crisis. We cannot say that the present economic situation is on the whole stable; indeed, economic growth trends suggest a general decline in the world economy. As a result, there is a great deal of discussion around how each individual country can prepare to take measures to stimulate economic growth in order to prevent a repeat of the most acute period of the 2008–2009 financial crisis. You have just asked the question, "But what will happen to the Russian and world financial markets if quantitative restrictions are reduced in the US by 2014?" I want to reassure you that I do not foresee a particular problem for Russia. First and foremost, this will affect developing markets that have seen a rise in speculative capital. The US assets will increase in value, creating a spillover of capital into the US from other countries. That is why we must apply joint efforts in different spheres (including at the G20) to coordinate the financial regulation process. This is

necessary in order to improve control and supervision over each financial institution and prevent the creation of economic bubbles that will simply burst as a result of the decrease in quantitative restrictions. Otherwise, we would face the same consequences as we did in 2008, when problems in the financial sector spread over to the real sector. The situation is indeed far from stable, and we must therefore be prepared. We have to implement a whole host of reforms in financial regulations, and this applies to all parties involved. It is necessary to improve oversight mechanisms for all financial institutions, not only for banks. This is especially relevant in Russia, where a very large segment of this market has been poorly regulated. In particular, I am referring to insurance companies and pension funds, which until recently did not have the means to participate in their own insurance operations. Russia is in the process of creating 'mega-regulators' in order to improve the quality of oversight of such institutions. When discussing other countries, we should pay special attention to the most influential financial institutions, such as, for instance, the 'too big to fail' system, where large companies that dominate the market undergo close scrutiny. So far, the International Monetary Fund has singled out 28 companies to be subjected to special regulation. I believe that this policy should also be implemented in local markets featuring companies that likewise warrant close attention. To return to Russia, it must be noted that our government policy is determined by only three or four of the country's financial institutions or federal banks. Whenever Sberbank or VTB Bank decreases their rates, the whole market follows suit, and vice versa. And so, when it comes to financial regulation, the Russian Federation, as well as all other countries, is faced with the task of regulating those influential financial organizations. I think I will stop there, as much has already been said. I would like to finish by emphasizing the need to coordinate efforts to improve financial oversight and financial regulation. On the one hand, this will help to prevent arbitration between countries, and on the other, it will avoid a repeat of the situation we faced in 2008.

**G. Cutmore:**

Minister, a very comprehensive answer and you raised so many more questions than we are going to have time to deal with here, but let me follow up by asking you this: we have seen central banks in other countries embracing very loose monetary conditions. The Japanese are now aggressively engaged in this, we have seen it from the Bank of England, there is some talk still that Mr. Draghi may take a further step if a crisis starts to rear its head again here. And yet in Russia, it seems that you are unwilling to work with the Central Bank to pursue a more lax monetary policy.

Do you think it is time that the Russian Government and the Central Bank were prepared to engage in borrowing to pursue growth here? The growth rate is slowing, you have had five quarters of weaker growth, and the inflation rate remains troubling. For structural reasons, is it not time that Russia embraced its own monetary activism to turn the story around?

**A. Siluanov:**

As you know, this issue has already been discussed by the Russian government. We are dealing with a slightly different situation than countries where quantitative easing is being carried out. Why are those countries adopting this policy? The answer lies in the reduction in the M2 money supply, as banks are cutting lending and are generating less money. Accordingly, in order to furnish monetary circulation with sufficient liquidity, central banks transfer liquidity to the economy. Where does that leave us? Our lending activity is sufficiently high, especially on the consumer market. In fact, credit in the real sector is growing not by 15%, but by 40% and higher, if we take into account the consumer market. That is why when implementing a policy of quantitative easing, whereby the Central Bank buys stock from the state and issues more roubles, the effect will be that of added inflation. And, of course, increased inflation leads to an increase in credit costs and instability in the credit market. That is why we currently deem quantitative easing policies absolutely inappropriate for Russia. On the contrary, we should be focusing on tackling inflation and developing new capacities. We are currently enjoying high

capacity utilization and low unemployment. In other words, we need a completely different kind of growth. Simply pumping money into the system will lead to more money in circulation, not growth in capital. That is why, in my opinion, it is completely ill-advised to compare the situation in Russia with the situation in other countries. It is important that we carry out our own policies in this sphere.

**G. Cutmore:**

Can I bring in Mr. Kudrin at this point, because he has been a vocal critic of the process of reform that we have seen so far in Russia, and this dependence on oil and gas revenue? I wonder if I could just invite you into this conversation. What else could be done at this stage to turn around the growth problem?

**A. Kudrin:**

Thank you. I agree with Anton's main arguments. Now is not the time to be introducing fundamental changes to our monetary policy. Moreover, dwelling on this matter only distracts us from taking real measures to support economic growth. It must be understood that today's economic growth depends on a set of circumstances that are radically different from those that were in place 10 years ago. We have completely lost the ability to augment growth by increasing oil production and raising oil prices. Over the past decade, the increase in oil reserves made up approximately half of our growth. Therefore, we should focus more attention on making the economic climate more conducive to business and all major industries. What they need is low interest rates and long-term financing for modernization. Currently, high inflation and high economic risks do not permit banks to hand out long-term loans at low interest rates. This is a key issue hindering the flow of investments and the introduction of additional capacities. Therefore, I agree that it is important to reduce inflation in order to achieve a subsequent market-driven decrease in lending rates. The government is undoubtedly in a position to take additional measures. First and foremost, the state (the Ministry of Finance and the

government) has not outlined the main economic solutions for different industries. We are yet to streamline a cohesive strategy, and the recently announced government forecast also raises a number of questions. We are currently waiting on the issuance of the Financial Strategy of Russia for the Period until 2030, which will provide us with an additional reference point. However, this strategy must be in keeping with the forecast and reflect the government's consolidated vision, which would give business a serious boost. On that note, I would recommend executing a budget manoeuvre commonly referred to as 'Plus Three, Minus Three' in other words, increase spending in certain areas – such as infrastructure, education and healthcare – by 3% of GDP and lower it in others – primarily, in defence, security, and in economic subsidies – by 3% of GDP. Our security spending is by no means normal. Despite dispatching very large resources on security, we do not see adequate results. There is room for improvement in regards to efficiency, and certain programmes can be spread over longer periods of time. For this to happen, we need to make state tariffs more comprehensible and decrease state regulation of tariffs. This would affect the manufacturing industry most of all. While deregulating the tariffs for the population, we will have to exercise extra caution. Such structural measures will prove beneficial. Furthermore, there is the issue of the Pension Fund, where large transfers stunt the possibilities of growth. These are the major problems in the Russian economy.

**G. Cutmore:**

Thank you. It is always easier when you are outside government than when you are inside government, I think, with some of these issues.

But I want to perhaps broaden this a little bit. Clearly, there is competition for capital going on globally, and many of the things that we have talked about here will change Russia as an attractive destination for capital. What is the trump card in Russia in the near term that you think will bring back the money that has been ebbing away?



## **A. Siluanov:**

Let me quote some figures on capital flight. This year saw a decline in the outflow of capital. Capital outflow amounted to just USD 29 billion this year thus far, compared to USD 79 billion for the same period last year. It is worth noting that the statistical system of calculating capital flight is such that overseas investments by our companies (for instance, asset purchases) are also accounted for in outflowing capital. This possibly also includes state companies, which currently do not record their activities. The more our companies are integrated into foreign markets, the greater the capital flight. There is no need to be apprehensive over the volume of financial resources leaving Russia; there is no cause for concern, as this is business as usual. On the other hand, we must resolve the question of Russia's key priorities for the near future. With regards to the Ministry of Finance, we are striving for an intelligible budget policy that is consistent with our tax policy. We have already stated that we will not raise taxes, but on the contrary, will create more favourable conditions and provide tax incentives to regions in need of growth. Secondly, we intend to limit expenses and reduce budget dependence on oil and gas revenues, thereby decreasing the dependence on oil prices and on world market conditions. Thirdly, we must develop an adequate borrowing policy, so as not to drain liquidity from the budget. Finally, we are in the process of carrying out financial regulations and are actively developing reforms to stimulate the flow of financial capital into Russia. By improving the tax environment and making our domestic financial market as attractive and navigable as any foreign one, we are creating conditions to encourage local investors not to move to foreign markets, but invest here in Russia instead. As regards the financial and budgetary spheres, we will do everything to earn the trust of investors and provide transparent policies. And I must say that we are presently succeeding. We have been ranked ninth in the world for budget openness and are currently on our way to creating a favourable tax administration system. In other words, the government has outlined a whole range of structural

measures to enhance the attractiveness of the investment climate in Russia. In fact, I have only mentioned a few of the measures concerning the financial sector.

**G. Cutmore:**

Can I ask you about leadership? We have seen in the United States and in the EU questions over the strength of leadership in taking difficult political decisions and part of the conversation that we have had about central bank activism has been where central banks have been forced to step in because in the US, they did not deal with their public spending issue, and in Europe, equally, we have seen governments that are very reluctant to take the harder road.

When we look at Russia, leadership has been a constant. We have had President Putin and Mr. Medvedev in power for some years now. And yet, when I speak to Western investors, they still talk about policy uncertainty as a reason why they do not put money to work here.

Could I ask you this: is there a way that Mr. Putin and Mr. Medvedev could settle this issue once and for all, and allow Western investors to feel that there is no dispute at the heart of the government here, and that actually there is stability, and that they should feel comfortable that there will be policy certainty?

**A. Siluanov:**

It is strange to hear mention of political stability, as it does not even appear on the agenda. Perhaps Mr. Kudrin will disagree, but my colleagues and I personally think the question of leadership and political stability in Russia is not on today's agenda. We must decide how to more effectively take advantage of the situation we are in now and on how far we are able to advance on the path of reforms, including some that are not altogether popular. When it comes to reforms, we probably need to act more vigorously. And I repeat: we are ready to act. The government has begun to enact pension reforms aimed at the gradual reduction of Pension Fund subsidies. We are also preparing reforms in the real sector, and the course of financial reforms

is being developed. While these reforms may not please everybody, we know they are necessary. Such reforms would not be possible without trust in the government. Therefore, political leadership is not at all in question here. We have the support of society necessary to carry out those reforms, which contribute to economic growth as well as mobilize more targeted support for the social sphere.

**A. Kudrin:**

I would like to add to Anton's response. In fact, we are not talking about power, risks, or instability. We need to focus our discussion on what investors consider political risks. These risks are quite a bit more specific. Investors are concerned with the following questions: how predictable will be the changes to the tax system? Will the exchange rate control undergo changes? Will limitations be introduced (for example, on individual operations)? Should they anticipate changes to the administrative balance of power between the government and the Central Bank? Such changes, when they remain vague and incomprehensible to investors, carry political risks. In other words, will the trend towards economic liberalization stay consistent, or will it change? That is precisely the point in question. If state institutions and companies are fortified, if previous plans for privatization and industry reform are cancelled, if the anti-Western rhetoric intensifies, affecting those market participants engaged in information gathering (for example, if the corresponding legislation is also toughened) and, consequently, the reporting to foreign investors, then investors will surely perceive a change in course. Investors are troubled by such prospects, and associate them with political risk. They want to see us progress towards further economic liberalization and growth, with the continuation and implementation of the international approaches and standards found in those conventions that Russia has been part of. And that is exactly what they expect. Concerning your question, I have to say there is no clear answer. The decisions that have been taken are contradictory. It is clear that we are witnessing an intensification of the policy of

*dirigisme*, or a level of state interference that may not afford sufficient liberalization for implementing reforms.

**A. Siluanov:**

I would like to add to that as well. The government of the Russian Federation understands perfectly well the risks posed by a continuation of Russia's previous economic policy, as well as all associated political risks, which is why it is increasing liberalism to a degree. We are not debating whether to turn the reform process in its tracks and begin to move backwards. On the contrary, we plan to move forward with our reforms. As regards taxes, the taxation processes will be stabilized, and there will be no increase in the tax burden. In terms of the liberalization of the exchange rate and currency transactions, we will stick to the adopted policy. As for privatization, we understand perfectly well that it not only increases intakes in revenue, but also reduces the government's part in the economy so as to increase competition. This is the only way that economic openness and an increase in investments can be achieved. That is why we are confident that all the positive gains of recent years will be consolidated and expanded.

**G. Cutmore:**

George, let us bring you in on this. Russia, of course, does not operate in isolation, and we have talked a lot about the specifics for Russia. But it is one of a number of countries that are in a development phase, being buffeted and rocked by the headwinds of issues that have come from Europe, slower growth in China, the United States using monetary policy to halt growth and ultimately now talking about withdrawing back.

As we look to a long and difficult summer for capital markets, how do you think economies like Russia will be placed to weather the storm?

**G. Magnus:**

Well, of course, at the Forum here there has been a lot of discussion about the BRICS in the context of broader emerging markets, and of course each of the BRICS are very different in many ways: different characteristics, they have different economies, they rely on different things. They do share a couple of things, or several things, in common.

Mr. Kudrin was talking a great deal about what international investors worry about in Russia. Actually, they worry about similar kinds of things in Brazil, and in Turkey, and Mexico, and China, and so on. Of course the other thing that many of the big emerging markets share in common is that they are all facing a structural slowdown in their growth. The last 25 years have been fantastic for many emerging countries, including Russia, but I think we have reached a point where you can throw your spreadsheets away now, because things have changed.

You know, there are certain things you can only do once, and many of the BRICS and other emerging markets have achieved a lot of incredible progress in terms of economic development, and have become middle or high middle income countries. Russia is certainly one of them. And now it gets tougher. Now, you really have to concentrate on how to sustain economic growth in the face of global capital market headwinds, and this is really about what Mr. Kudrin referred to, and the Minister as well, about structural reforms.

These are hard issues, really hard, because they are politically sensitive and you have to win over investors' confidence and convince them that you are serious about reform. For example, I mean as an outsider, I would say that in Russia, compared with China, for example, the manufacturing base is actually very small, and although international investors like, obviously, a good tax regime, they also like good opportunities with a good return on capital. That is kind of where China has profited against other emerging countries, including Russia.

**G. Cutmore:**

I would like to move the conversation on if I might. Obviously Russia plays a significant role in the G20, and we will see the G20 hosted here, in Russia, later this year. In terms of how G20 economies can help themselves in this difficult environment, what do you think the key progress on the G20 agenda should be this year as led by Russia?

**A. Siluanov:**

During the G20 summits, the world economic situation undergoes rigorous scrutiny, and we look for measures to strengthen cooperation between countries, including through financial regulation and budgetary and fiscal policies. What is one of the causes of today's decreasing growth rates? It is the large amounts of debt that countries have accumulated in recent years as a result of the policy of living on credit. Even our colleagues would remark, "See, these countries are living on credit, and we should do the same." However, experience has shown that living in debt is not the answer. When debt exceeds all conceivable and inconceivable limits, when it reaches 100% of GDP, then it becomes extremely difficult to get out of the situation. Finding a way out of this predicament has become the major challenge for the ministers of finance of the G20 countries. The countries that issued reserve currencies have acquired a huge amount of debt, and it is unclear how to steer the situation. This creates general instability in the world economy, makes for volatile exchange rates, and has a negative impact on the world economic situation on the whole. That is why the G20 is tasked with deliberating over the current situation, developing joint measures, and identifying advanced solutions. We have secured special framework agreements that place the responsibility firmly on governments to decrease their debt, reduce their budget deficits, and so on. The task of the G20 is to coordinate efforts toward resolving difficult economic problems. The G20 meeting to be held in St. Petersburg in early September will be devoted to precisely these issues.

**G. Cutmore:**

Minister, I am told we are out of time, but thank you so much for joining us and giving us so much of your time. Mr. Kudrin, thank you also, George Magnus, thank you very much for being here. If we could show our appreciation, ladies and gentlemen.

Good, thank you very much for coming, everybody. Thank you, Minister.