

The Secret of a World Financial Center

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At his meeting with the director of the Hong Kong Stock Exchange on Sunday, President Dmitry Medvedev said half of the work had been completed toward transforming Moscow into an international financial capital.

That task has something in common with putting a man in space or landing a probe on Mars:

The final result is not as important as the steps involved in the process. For example, it is difficult to imagine that the ruble will become one of the world's reserve currencies, a development that would require at least several decades without monetary reforms or high inflation. Just the same, the president is right to shoot for that goal.

Like a shot at space, the plan to turn Moscow into an international financial center faces a series of hurdles. Ideally, Russian firms would conduct initial public offerings at home rather than abroad.

But as Medvedev mentioned at his weekend meeting, several major Russian companies are planning to hold their IPOs on the Hong Kong stock exchange this year. The reason is simple: Potential investors have more confidence in the London and Hong Kong exchanges than in

Moscow's because they offer greater guarantees on the integrity of the firms doing business there. As a result, investors are willing to pay more for shares offered in Hong Kong than for the same shares in Moscow. That gives companies a powerful incentive to hold their IPOs in Hong Kong.

While the IPO issue is an obstacle that can be overcome, establishing a good reputation requires time and sustained effort.

The main difficulty in turning Moscow into an international financial center lies in the fact that such cities are not only the physical location where IPOs are staged, but places where companies know they can resolve disputes with shareholders, business partners and government regulators and authorities.

Why do Russian companies write clauses into their contracts stating that any future disputes will be resolved by courts in New York, London or Stockholm?

The reason is not only that Russian courts are ineffective and insufficiently versed in economic matters — problems that can be surmounted with time. But the courts also are controlled by political interests. Only 15 years ago, a judge could issue a court summons for a government minister and threaten him with arrest if he did not appear. But now, after the case against former Yukos CEO Mikhail Khodorkovsky and the dismantling of free regional elections, the authorities hold complete control over the judicial system. Knowing that, any Russian company doing business with an entity linked to influential political forces is sure to stipulate that conflicts must be decided in foreign arbitration courts and not in Moscow.

Russia can never become an international financial center until it develops an independent judicial system. However, setting that as the goal and marking out the objectives that must be achieved along the way is a worthy start.

Having done so can even be called a halfway point. But now it must be acknowledged that the second half of the process will be far more difficult.

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