1. Background

In recent years there has been much debate over how to increase international trade in national currencies and expand the basket of reserve currencies. Increasing the share of settlements in roubles and enhancing the status of the rouble internationally have been important pillars of Russia’s foreign trade policy. In his address to the 12th St. Petersburg International Economic Forum in June 2008, Russian President D. Medvedev set out the new domestic economic goal for Russia of “establishing Moscow as a powerful global financial centre and the rouble as leading regional reserve currency — this is the key to the competitiveness of our financial system” (Kremlin.ru, 2008).

Russian authorities have been looking at strengthening the international status of the rouble since the mid-2000s. The possibility of switching to the rouble as the settlement currency for Russian gas supplied to CIS countries was first raised by ex-President V. Putin in 2006 in his address to the Federal Assembly. Shortly thereafter, the Government began to examine the status of the rouble in official documents. For example, the Concept of Long-term Socioeconomic Development until 2020 envisages “establishing the Russian rouble as a leading regional reserve currency in the Commonwealth of Independent States”.

There are very important reasons for pursuing this goal. The CIS is a non-uniform regional bloc with a high degree of trade asymmetry caused by the presence of a large member (Russia) whose economy exceeds those of all the other members put together (Eurasian Economic Integration, 2009: 92). Trade with Russia accounts for 44% of total trade between CIS countries. The desire to increase foreign trade payment in roubles is being widely discussed because CIS countries other than Russia use this currency so heavily. For example, rouble settlements make up about one-third of total payments transacted between Belarus and Kazakhstan (The CIS Interstate Bank, 2009).
Reserve currencies enjoy the highest status in the global currency hierarchy. The lowest level in this hierarchy is made up of closed or non-convertible currencies. Transactions in such currencies are subject to numerous restrictions. Non-convertible currencies are mainly those of developing countries, and in many cases their non-convertibility is the result of strict state control over citizens’ economic and commercial activity. Buying foreign currency in such countries is often difficult or impossible. According to the IMF, in early 2008 strict limitations on certain currency transactions existed in 35 countries including India, Bangladesh, Columbia and many African countries (IMF, 2008). Currency transactions are also restricted in China and some North African and CIS countries (Moiseyev, 2008).

The next level up in the currency hierarchy is local currencies. These may be partially or even fully convertible, but are not used in international transactions. The main feature of a local currency is that demand for it exists only on the internal market of the emitting country. There may only be limited demand for a local currency from non-residents who need it for transactions in border regions. Local currencies are not used in the issuing country’s foreign trade or for forming private or public reserves in other countries. Local currencies form the largest category of currencies.

The next, relatively new layer in the currency hierarchy is made up of international currencies. An international currency can perform one or more monetary functions (measure of value, means of exchange or of saving) outside the issuer’s jurisdiction. The Swedish krona, the Norwegian krone, the Canadian dollar and the Australian dollar are all examples of an international currency. These currencies may be used in foreign trade settlement or for citizens’ savings. However, the extent to which these international functions are performed is rather limited.

Finally, the highest level in the currency hierarchy is reserve currencies, which perform most functions of money internationally and on a large scale (BUTORINA, 2003). To date, this category includes only the dollar and, to a lesser extent, the euro.

The Russian rouble moved from being a closed currency to a local currency in the 1990s, and in recent years is approaching the status of an international currency. This process may take several decades, subject to effective economic policy. Once the rouble is elevated to this level, which is a complex process in itself, this means that it will also have become a “regional reserve currency”.

Until now the rouble has demonstrated only minimum potential to reach the status of a reserve currency. Progress towards this is hindered by rapid inflation (a much more significant factor from the point of view of investment than from the point of view of foreign trade payments) and reduced...
liquidity in domestic financial markets. On international capital markets the rouble is a typical raw material currency – i.e., is influenced to a degree by oil prices. This was best illustrated in the autumn of 2008 when a drop of oil prices was followed by an exodus of capital. Despite a considerable export surplus, this capital outflow resulted in a substantial devaluation of the rouble. Therefore, demand for the rouble to create reserves will be very limited. The international debate on reserve currencies is principally focused on the need to restrict the prominence of the dollar in favour of other world currencies. China in particular has continued to call for an expansion in special drawing rights (SDR), which are linked to a basket of four currencies (U.S. dollar, euro, yen, and pound).

2. Trade Flows and Trade in Roubles

Increasing the use of national currencies, particularly the rouble, as a means of settlement in foreign trade between CIS countries is a fundamental precondition for the creation of regional currency. Empirical analysis shows that a key consideration when selecting a currency for foreign trade transactions is the long-term stability of the currency’s basic macroeconomic indices and the currency risk associated with that (Donnenfeld, Haug, 2003). Undoubtedly, the global economic crisis has affected the perception of the rouble as stable currency. Devaluation of the rouble and other national currencies in the post-Soviet space caused a wave of partial dollarisation of national economies. However, this makes the task of creating a strong regional currency even more urgent and more complex. Increasing the use of the rouble in trade with non-CIS countries whose economies are largely orientated towards trading with the CIS is also clearly desirable.

Countries strongly oriented towards trade with Russia include the CIS countries, Mongolia, Finland and Turkey. Russia also trades intensively with the Baltic countries, Bulgaria, Syria and Poland. Accordingly, the policy of encouraging the use of rouble must be pursued primarily in respect of these countries. In countries which are highly dependent on trade turnover with Russia, any increase in rouble settlement may have tangible economic benefits, not least by reducing transaction costs. It was during the 2008–2009 crisis that the benefits of using national currencies in international trade became apparent to CIS countries. Reluctance to use CIS national currencies, relying instead on dollar and euro, results in higher transaction costs and less beneficial terms of settlement. It also persuades the trading parties to maintain additional foreign currency reserves, exposing them to further currency risk. The economic crisis highlighted the need to abandon such practices. The interdependence of CIS economies and their largely synchronous economic cycles means that their financial systems are similarly affected by external shocks. During the crisis, CIS currency fluctuations vis-à-vis one other were not nearly as significant as their fluctuations against dollar or euro. Whereas
the rouble-tenge exchange rate fell by just 1% between August 2008 and August 2009, dollar and euro exchange rates against tenge grew by 26% and 23% respectively. Over the same period, rouble and dollar strengthened against Ukrainian hryvnia by 25% and 65% respectively. A similar situation developed with other CIS currencies. These observations would suggest that trade partners in CIS and EurAsEC countries could benefit from switching to national currencies for their transactions. Cooperation between regulated organised markets raises their liquidity, curbs the magnitude of exchange rate fluctuations and increases their resistance to destabilising influences (Mishina, 2010).

Rouble-based trading is gradually shifting from a political ambition into an economic reality. Using national currencies in foreign trade transactions applies not only to CIS countries but also to their most important non-CIS trading partners. Since 2003, Russia and China have been piloting a project to use national currencies in border trade. According to the People’s Bank of China, 99% of all transactions in border regions are in roubles; border trade in national currencies as a proportion of total Russian-Chinese commodity turnover grew from 0.5% in 2003 to 7.3% in 2008. The economic crisis

<table>
<thead>
<tr>
<th>Countries oriented towards trading with Russia ($ billion, 2008)</th>
<th>Commodity turnover (total)</th>
<th>Export from Russia</th>
<th>Import to Russia</th>
<th>Commodity turnover with Russia</th>
<th>Export surplus on trade with Russia</th>
<th>Share of commodity turnover with Russia in total commodity turnover (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Belarus</td>
<td>32.9</td>
<td>39.5</td>
<td>72.4</td>
<td>23.7</td>
<td>10.6</td>
<td>34.3</td>
</tr>
<tr>
<td>Moldova</td>
<td>1.6</td>
<td>4.9</td>
<td>6.5</td>
<td>1.1</td>
<td>0.7</td>
<td>1.8</td>
</tr>
<tr>
<td>Ukraine</td>
<td>67.0</td>
<td>85.5</td>
<td>152.5</td>
<td>23.6</td>
<td>16.2</td>
<td>39.8</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>0.8</td>
<td>3.2</td>
<td>4.0</td>
<td>0.8</td>
<td>0.2</td>
<td>1.0</td>
</tr>
<tr>
<td>Mongolia</td>
<td>2.0</td>
<td>2.8</td>
<td>4.8</td>
<td>1.1</td>
<td>0.1</td>
<td>1.2</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>6.3</td>
<td>7.6</td>
<td>14.0</td>
<td>2.1</td>
<td>1.3</td>
<td>3.4</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>71.2</td>
<td>37.8</td>
<td>109.0</td>
<td>13.3</td>
<td>6.4</td>
<td>19.7</td>
</tr>
<tr>
<td>Armenia</td>
<td>1.1</td>
<td>4.1</td>
<td>5.2</td>
<td>0.7</td>
<td>0.2</td>
<td>0.9</td>
</tr>
<tr>
<td>Kyrgyzstan</td>
<td>0.9</td>
<td>11.8</td>
<td>12.7</td>
<td>1.3</td>
<td>0.5</td>
<td>1.8</td>
</tr>
<tr>
<td>Finland</td>
<td>96.9</td>
<td>92.2</td>
<td>189.1</td>
<td>15.8</td>
<td>6.6</td>
<td>22.4</td>
</tr>
<tr>
<td>Turkey</td>
<td>132.0</td>
<td>202.0</td>
<td>334.0</td>
<td>27.7</td>
<td>6.1</td>
<td>33.8</td>
</tr>
<tr>
<td>Lithuania</td>
<td>23.8</td>
<td>31.3</td>
<td>55.1</td>
<td>4.5</td>
<td>0.9</td>
<td>5.5</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>22.5</td>
<td>33.8</td>
<td>56.3</td>
<td>4.8</td>
<td>0.6</td>
<td>5.4</td>
</tr>
<tr>
<td>Latvia</td>
<td>9.2</td>
<td>15.6</td>
<td>24.8</td>
<td>1.6</td>
<td>0.6</td>
<td>2.2</td>
</tr>
<tr>
<td>Syria</td>
<td>7.4</td>
<td>15.5</td>
<td>22.9</td>
<td>1.9</td>
<td>0.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Poland</td>
<td>141.5</td>
<td>195.9</td>
<td>337.3</td>
<td>20.2</td>
<td>7.0</td>
<td>27.2</td>
</tr>
<tr>
<td>Georgia</td>
<td>1.5</td>
<td>6.1</td>
<td>7.6</td>
<td>0.5</td>
<td>0.1</td>
<td>0.6</td>
</tr>
</tbody>
</table>

Table 9.1. Countries oriented towards trading with Russia ($ billion, 2008)
and the rouble’s fall against dollar caused border trade in national currencies to shrink to 2% of total turnover, but the stabilisation of rouble leads us to predict that the percentage of trade in national currencies will be restored.

In April 2009 one of Turkey’s largest banks, Garanti, became the first bank in the country to switch to rouble settlements with Russia. Turkish President Abdullah Gül had proposed the move to national currency payments during his visit to Russia in February 2009. Russia and Turkey are major trading partners whose commodity turnover passed the $34 billion mark in 2008. Therefore, the implementation of the above initiative is justifiably seen as a milestone in strengthening the status of the rouble. It is expected that initially about 7-15% of all bilateral trade settlements will be in national currencies. This may increase in the medium-to-long term.

In November 2008 the Ministers of Finance of Russia and Belarus agreed that the rouble would be adopted in oil and gas trading. “This will be our contribution to elevating the rouble to the status of regional reserve currency”, said Belarusian Finance Minister Andrei Kharkovets. Plans to pay for Russian energy in roubles has given rise to other initiatives. For example, the Russian Minister of Energy ordered Inter RAO UES to switch to invoicing electricity exports in roubles. A switch to rouble settlements is expected to be straightforward and beneficial for the electric power sector because, in contrast to the oil and gas sector, electricity prices are not dollar-pegged. However, electricity trading is a somewhat minor element of total commodity turnover and even switching fully to rouble transactions in this sector will have a very limited effect on overall demand for roubles. Nonetheless, these initiatives are positive and play a significant role in enhancing the status of the rouble.

Integration groups are expected to show great interest national currency payments. Several integration projects are being implemented simultaneously in the post-Soviet space with varying degrees of success: the CIS, GUAM, SCO and EurAsEC. GUAM and SCO are essentially political projects with economic issues only a secondary consideration. GUAM is notable as a project aimed principally at separation from one of the CIS countries, rather than integration, and was therefore doomed to fail. From the trade and economic point of view, the most successful integration project is EurAsEC: since January 1, 2010 its three member countries – Kazakhstan, Belarus and Russia – have operated a Customs Union.

According to national central banks, payments for commodities traded between Russia and other EurAsEC countries exceeded $50.9 billion in 2008. Interestingly, over 50% of these payments were made in roubles. The U.S. dollar takes second place here: dollar settlements accounted for one-

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third of all payments. The euro’s share is just 13% and the national currencies of other EurAsEC countries are practically never used in trade with Russia (except Kazakh tenge).

### Table 9.2.
Cash flows servicing trade between Russia and other EurAsEC countries in 2008

<table>
<thead>
<tr>
<th>Country</th>
<th>From Russia</th>
<th>To Russia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Belarus</td>
<td>10777</td>
<td>312</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>4378</td>
<td>193</td>
</tr>
<tr>
<td>Kyrgyzstan</td>
<td>1439</td>
<td>281</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>129</td>
<td>77</td>
</tr>
<tr>
<td>Total</td>
<td>16724</td>
<td>922</td>
</tr>
<tr>
<td>%</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

#### Breakdown

- **Roubles**
  - From Russia: 9507
  - To Russia: 8007
- **Dollars**
  - From Russia: 828
  - To Russia: 6710
- **Euro**
  - From Russia: 369
  - To Russia: 5892
- **Others**
  - From Russia: 73
  - To Russia: 38

### Notes
Rouble is the principal currency of payment for Russian imports, mainly from Belarus. More than 70% of Russian payments to Belarus are made in roubles. Roubles are used to pay for only 44% of Russian exports; the dollar and euro account for 38% and 18%, respectively.

Our comparison of central bank data on foreign trade payments and total exports and imports allows us to assess the usage of such payments and how these are shared among different currencies. Calculations suggest that the central banks’ data are fairly comprehensive. Payments recorded by the central banks cover over 90% of Russia’s commodity turnover with Belarus, over 80% of turnover with Kazakhstan and 74% of turnover with Tajikistan. Recorded payments servicing trade with Kyrgyzstan largely exceed the volume of commodity turnover registered in Russia and Kyrgyzstan. It is possible that payments from Russia exceed official import volumes by more than three times because of unregistered imports from Kyrgyzstan (e.g., clothing made of Chinese fabric) or other categories of capital outflow.
The smaller share of payments in roubles to Russia is partly attributable to the lack of this currency in the partner countries. Russia shows a positive trade balance with all CIS countries exceeding $32 billion in total (the balance of services is also positive). Total rouble payments to Russia from other EurAsEC countries exceed $15 billion, whereas payments from Russia to these countries is under $12 billion, indicating that the shortfall is made up of rouble inflows under other balance of payments items. Therefore, increasing rouble trade payments requires that Russian buyers pay more often in roubles for their imports, which in turn will enable CIS countries to increase payments in roubles for Russian exports.

Rouble-denominated capital inflow to CIS countries (principally in the form of foreign investments) will also strengthen the rouble’s status. However, the CIS region is not a very attractive proposition at the moment for Russian investment. In 2008, only 7% of direct investment and 2% of other investment from Russia were in CIS countries, and there are practically no Russian portfolio investments in these countries. The main forms of capital inflow to CIS countries (partly denominated in roubles) are wages (about $15 billion in 2008) and cash transfers (a positive balance of $5.9 billion).

Generally, we can conclude that significant progress has been achieved in expanding settlement in roubles. According to our estimates, some 67% of Russian imports from EurAsEC countries are paid for in roubles. Regarding trade with CIS countries, the Bank of Russia estimates that rouble payments now account for 60% of all Russian imports. Clearly, in the medium term, it is trade within the CIS which is the likeliest vehicle for expanding payments in roubles between Russia and other CIS countries.

Figure 9.1. Share of total export and import trade payments transacted in roubles between Russia and other EurAsEC countries in 2008 (%)

Source: UN Statistics Division (Comtrade); CIS Interstate Bank; IEF assessment

The smaller share of payments in roubles to Russia is partly attributable to the lack of this currency in the partner countries. Russia shows a positive trade balance with all CIS countries exceeding $32 billion in total (the balance of services is also positive). Total rouble payments to Russia from other EurAsEC countries exceed $15 billion, whereas payments from Russia to these countries is under $12 billion, indicating that the shortfall is made up of rouble inflows under other balance of payments items. Therefore, increasing rouble trade payments requires that Russian buyers pay more often in roubles for their imports, which in turn will enable CIS countries to increase payments in roubles for Russian exports.

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3. Obstacles and Opportunities

Our research leads us to conclude that short-term trade financing in roubles for importers offers the brightest prospects for expanding trade in roubles in the CIS. Because it is currently difficult to obtain such financing, the increased demand for it would promote the “external” circulation of the rouble. For example, Vneshekonombank would organise targeted project financing for private banks, including banks in CIS countries. The resources of the Eurasian Development Bank, which manages the EurAsEC Anti-crisis Fund, would also need to be called upon.

Increasing payment in roubles for Russian exports and in foreign trade could be made easier through the establishment of an export and import agency or bank (or by assigning the functions of such an agency to existing banks). This would help to provide financing for export contracts in roubles and is seen as a particularly urgent priority in the current climate. Many countries are experiencing difficulties obtaining loans to finance foreign trade and such services will be in huge demand, even when denominated in roubles. Loan financing for export transactions are widely used throughout the world, especially in the export of mechanical engineering products (often on preferential terms). Production processes in mechanical engineering are very capital-intensive and have relatively long payback periods, so lending on preferential terms is an important element in attracting potential customers.

There is a number of factors which militate against the use of rouble as the main currency for settlement within CIS. The key issues are those associated
with rapid and volatile inflation in Russia, which limit willingness to lend in roubles. Besides the macroeconomic factors, there are also legal and technical barriers arising from the poorly developed system of interbank settlement between Russian and other CIS banks and the stringent currency and tax controls imposed on rouble transactions. Therefore, financial regulation would benefit from a major overhaul, the ultimate goal being to create a unified clearing system in the CIS.

CIS strategic documents, in particular the *Economic Development Strategy of CIS Countries to 2020*, set ambitious targets for cooperation in financial and currency operations, including multilateral liberalisation of financial markets and financial services, harmonisation of currency laws and controls, and the increased use of national currencies in foreign trade. However, given the slow progress achieved in this sphere in recent years, the focus should perhaps remain on the initial steps towards creating an efficient interbank settlement system. Action should be targeted particularly on those areas in which member countries are most interested, namely payments transacted between CIS banking systems.

This makes it important to accelerate efforts to create a fully-fledged Interstate Bank clearing system. This would initially require a reorganisation of the Interstate Bank to increase its efficiency. In the current circumstances, the Bank’s strategic goal should be to foster development of the market economies of its member states and help to increase regional trade and economic links by supporting investment and enhancing banking operations, including clearing.

The Interstate Bank should become a focus for the implementation of integration strategy, since it has a key role in improving clearing operations between CIS countries. In order to improve the efficiency of this Bank and other CIS commercial banks, favourable payment conditions need to be created; currency, tax and accounting regulations should be unified and all transaction processes must comply with these regulations. Interbank settlement procedures can be improved by adopting a single mechanism to combat money laundering and by simplifying currency controls applied to correspondent accounts set up by non-resident banks. CIS bank clearing forms should be brought into line with international standards, particularly ISO 20022\(^2\). All these measures would promote the integration of clearing systems and simplify settlement procedures between CIS banks. They would also encourage the use of national currencies in foreign trade and reduce the cost of international cash transfers made by individuals.

Presently, the rouble displays only minimum potential to become a reserve currency. In our opinion, establishing the rouble as a "regional reserve

\(^2\) **Financial Services** – universal financial industry message scheme (http://www.iso.org).
currency” would elevate its status to that of an international currency. This process may take many years. As well as the implementation of this strategy, economic measures should be taken which would bring instant and tangible benefits for CIS countries. Increasing the use of rouble and other national currencies may help to reduce currency risk and the need to create additional currency reserves in dollar or euro. Ultimately, all economic players will benefit from a more efficient clearing system in CIS.

References


