

The first experience of Russia in the WTO: the banking sector

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Abstract. Russia's accession to the WTO has changed socioeconomic conditions and financial terms, legal regulations in various sectors of country's economic activities and individual business entities. The article is dedicated to the analysis of the consequences of this step and the evaluation of the changes in Russian economy on the whole and the banking sector in particular. Special consideration is given to the competitive recovery of domestic banks in the long run.

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Introduction

August 22, 2012 can be considered the starting point of a new stage of the development of the Russian Federation as it has become the 156th official member of the World Trade Organization (WTO). Presumably a one- or two-year period is not the model one to sum up, but still the most important conclusions for the Russian economy can be drawn today. The urgency and importance of these findings cannot be disputed, because there are still five years of transition, during which our country, regions, production, business will have to rearm and start a "new life" competing with foreign producers in the Russian and international market. It should be noted that the given analysis of the banking sector and financial services considering Russia's accession to the WTO was carried out thoroughly: from the point of view of Russian banks [1], foreign banks [2], regarding the interests of consumers of banking services [3]. This work identifies and formulates a set of priority guidelines providing financial and economic stability of the banks in a globalizing world.

Thus, the obligations incurred by Russia owing to WTO accession can be divided into 4 groups:

1. The reduction of rates of import duties and import quotas. The average weighted rate of fees amounted to 9.6% in 2011, to 9.5% in 2012, to 7.4% in 2013, it will amount to 6.9% by 2014, and to 5.9% in 2015 [4]. Thus, the reduction will make up about 30% and will apply to all industries, except fuel and energy raw materials production where competition with imports does not threaten Russia.

2. The removal of administrative burdens to admit foreign companies to domestic markets. Russia enters into commitments to facilitate the access of

foreign companies to the market for 116 of 155 service industries.

3. The reduction of export duties. Russia has pledged to cut rates for 700 items. Oil and gas exports will not be affected, and the maximum effect will be reached for ferrous and non-ferrous metals, where export rates will drop to 0%.

4. The obligations for reformation of legal and public administration systems. That is, in the field of state procurement system reform, statutory regulations' transparency, liability for discrimination of foreign companies and so on.

Therefore, the Russian economy has accessed to the World Trade Organization with a higher level of protection of its economy compared with developed countries, but yielding to the majority of the developing countries (Figure 1). The rates of import duties upon the WTO accession had reasonable values [5], but at the end of the turn-over phase, Russia will have a comparatively low level of tariff shelter.

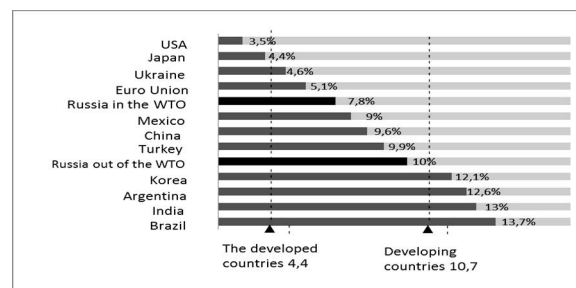


Figure 1 - The average level of import duties Russia and some other WTO members in 2010

The accession to the WTO on these bases showed that the Russian economy during the first years demonstrated the following results: closing up of businesses, reduced investments, the growth of

unemployment, falling profits of industrial enterprises and population; virtually all sectors of the economy are experiencing some problems: the hampering of budget performance, decline in exports, import growth, the shrinking surplus of merchandise trade balance and the current account balance of payments, increased capital outflows, continued price rise of imported goods.

Moreover, arrears of wages in July 2012 made up 2 billion roubles, and in August 2013, the rate has increased by 25% and amounted to 2.5 billion dollars. Therefore, the enterprises face difficulties not only with profitability, but also with payroll payment. The unemployment figures are the following: August, 2012 -5%, in the summer of 2013 the unemployment rose to 8% [6].

As for the banking sector, its WTO accession was under preferential conditions. Two main features of Russia's WTO accession, which refer to the banking market, are a ban on the opening of foreign banks' branch offices in Russia and the imposition of quotas for the participation of foreign capital in the Russian banking sector at the rate of 50%.

"The continued ban on the opening of branch offices in Russia - it is too much, it is a matter of principle," said the economist Mikhail Delyagin. The expert explained that "If the overseas bank opens a subsidiary in Russia, then an offshoot has to obey Russian laws and it becomes a pro-Russian Bank, just with a foreign owner. If there is a branch of a foreign bank, then this branch becomes the part of the overseas bank, and the capital flow within the same bank can be different [1]". Of course the opening of overseas banks' branches is quite risky for the national economy. And it is evident from the banking system of Latvia and Estonia which have lost their sovereignty.

At the same time this condition still releases the domestic banking sector from competition. Therefore there is no hope for improving the efficiency of the banks under the pressure of direct competition with foreigners and depreciation of loans for the industry. At present the cost of long-term credits (in roubles) for industrial enterprises amounts on the average of 10.5% per year, while the interest payments on loans make up 2 billion rub. per year and create approximately 9% of product cost of the industrial sector.

According to the World Economic Forum Russia ranks 127 in the world on the development level of the financial sector. The efficiency of labour management in Russian commercial banks is four times lower than, for instance, in the American banks. Unreasonably heavy expenses still compensate high rates on credits and low interest

rates on deposits and are carried onto the shoulders of the public and businesses. At the same time the level of wages in the times financial sector is the highest one compared with other industries and exceeds the average of 2.4 in the economy (Figure 2).

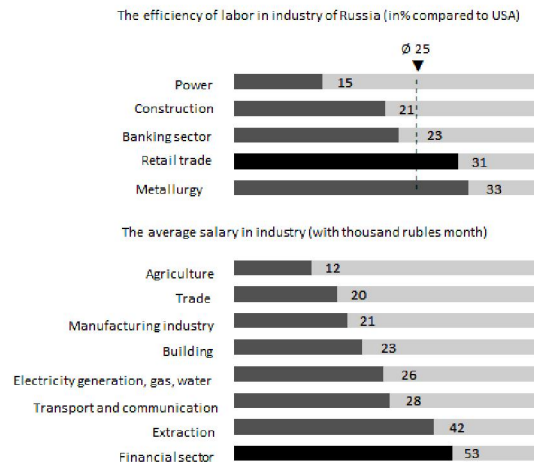


Figure 2 - To compare the effectiveness of labor and wages in the banking sector and other industries

At least a partial opening of the sector by admitting foreign banks' branches to the Russian market, apart from the competition and easier access to capital markets, would quickly develop best practices and processes of the banking business. Thus, the branches of foreign banks are less subject to control by the Central Bank (regulations, reservations, accountancy) and could therefore provide a much more efficient activity [3].

If we consider the second characteristic of Russia's accession to the WTO on the banking sector-50% share of overall quotas for the participation of foreign capital in the total bank capital - it is estimated unacceptable by many experts. Since foreign banks which are obviously stronger will start working with Russian banks on parity basis. For the domestic banking system, especially for regional banks it could lead to grave consequences due to the fact that overseas banks, first of all, provide a wider range of services, and secondly, they offer better service and more financial possibilities.

The largest financial institutions in the world (private banks, investment banks, investment trusts) are so great and globalized, that in the long run any serious competition is hardly possible on equal terms with them [7]. Therefore, the main threat of liberalization in this area is the loss of sovereignty over your own finances, and it is as a matter of fact, one of the key strategic outposts of any country's sovereignty. We can make a parallel here with the

insurance market. Many Russian insurers believe that Russia's accession to the WTO will ruin the insurance industry simply due to the fact that the major international giants will appear driving the domestic players out of the market [8].

As for the terms under which the citizens will be able to get credits, we cannot seriously expect any improvements in this area, because the terms of credits do not occur at random. Rates on credits mainly depend on the rate of inflation in the country and other objective conditions, rather than on the wishes of any given party. Neither domestic nor foreign banks will give loans under interest lower than the rate of inflation. Moreover, there are graduated rates for different categories of borrowers according to their credit record and the level of reliability. There are few people in Russia having long-term credit records that is why no major changes are expected in this area.

If we investigate the situation with overseas banks, than we should note that they have a number of barriers to enter the Russian market [2], one of which is a notorious "investment climate of Russia" (Figure 3).

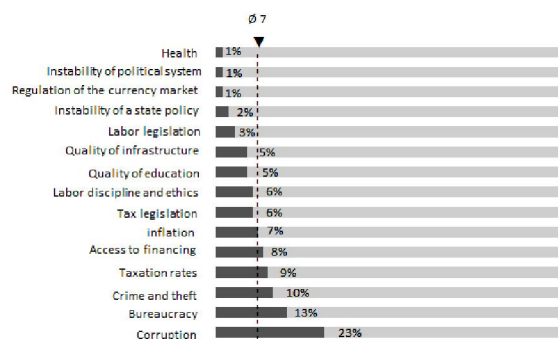


Figure 3 - Rating barriers to doing business in Russia

The banking capital flow to Russia will take place in accordance with market institutions development, reduced political risk, regulatory reforms, the increase of foreign investment and the development of a new Russian business, including small and medium-sized business, and it will take some time for foreign heavy speculators to appear on the Russian banking scene. As a rule, large international banks and insurance companies come into the country following their clients, i.e. transnational enterprises, though huge niches at market savings, insurance and pension services could also attract some foreign banks. The most advanced Russian banks will be able to take advantage of this period to reinforce the standing. Moreover, even with arrival of foreign financial

institutions Russian banks, insurance companies and pension funds still will be able to work in the market of retail services.

The WTO accession alone does not solve one of the greatest problems of the investment climate in Russia, i.e. a weak institutional environment. The given factor along with weak efficiency of financial system is the key to curbing investments to the Russian economy [9].

In the country rating of the World Economic Forum Russia ranks 128 according to the development level of institutional environment even though according to the overall level of competitiveness (Global Competitiveness Index) it ranks 66 and considering market capacity (including the availability of export sales channels) it ranks the 8th.

According to Russian Business Consulting the number of newly registered banks in Russia is very few: in 2012 there appeared only three banks and six non-banking credit institutions. Meanwhile, as of February 1, 2013 there are 896 commercial banks in Russia, while a year ago there were 922. At present within Russia there are quite a large number of banks with foreign ownership (GE MoneyBank, UniCredit, Swedbank, Deutsche Bank, Raiffeisenbank, Citibank, HSBC) [10]. The share of non-residents in the overall charter capital of Russian banks in 2011 has reached 4.7 billion roubles, and in 2012 this share has already amounted to about 5.2 trillion roubles [11].

The State Duma is preparing a number of draft laws to improve the banking system in Russia. The number of proposals has been made aiming to increase the possibility of forming long cheap resources by prolonging the terms of refinancing on the part of the Central Bank, lending institutions; by forming the so-called irrevocable deposits, by reducing risks of secured credits. If this is implemented, than credit resources will become cheaper and more available for Russian citizens and businesses, and the banks will become more financially sound and competitive.

Conclusion

Summing up, it should be noted that Russia's accession to the WTO will not resolve but will retain extensive protectionism of the banking sector of the country. In the first place, it occurs due to the integration of international banks into the Russian banking system through the opening of affiliated societies instead of branches. In the second place, poor investment climate, the imperfection of financial and institutional environment, pose serious barriers to the activity of foreign banks in the Russian market [9].

Facing difficulties in their own markets, they are unlikely to enter the Russian market on a massive scale [12]. On the contrary, some bank subsidiaries of overseas financial institutions being unable to obtain a significant market representation, are leaving Russia. The last example of such banks became Barclays Bank, which sold its banking business in Russia, except the investment banking unit [10]. On the other hand, Sberbank is actively engaged in entering the foreign markets.

We should expect increased competition from powerful overseas banks in the retail banking sector. It is most likely that they will not influence such major players as Sberbank or VTB, but in the long run may affect the activities of medium-sized banks. In the coming years we may not expect significant changes in this sector of economy.

Findings

1. The Russian economy has accessed to the WTO with a higher level of protection of its economy compared with developed countries, but being inferior to the majority of the developing countries.
2. The WTO accession for the banking sector was under the most preferential conditions.
3. Russia's WTO accession will not eliminate but will retain extensive protectionism of the banking sector of the country.
4. Poor investment climate, the imperfection of financial and institutional environment, poses serious barriers to the activity of foreign banks in the Russian market.
5. The State Duma is preparing a number of draft laws to improve the banking system in Russia which is aimed at the possibility of forming long cheap resources.
6. In the coming years we may not expect significant changes in the banking sector.

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