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FINANCIAL PROBLEMS

Comparing the Banking Models in China and Russia: Revisited[1]

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Abstract—In 1999, the *Studies on Russian Economic Development* published an article by T. Speranskaya who compares the Russian model of banking with the Chinese one [1]. The author looks at government banking and the relevance of banks for the non-financial economy and concludes that banking models in China and Russia are different. Since the time of that publication, the Russian government has increased its presence in the credit system as regulator, strategic planner and service provider. The authorities have pursued the industrial policy aimed at nurturing a few "national champions" [2] and increased the degree of interference in the lending decisions of banks. The new evidence suggests reverting to the question raised by T. Speranskaya, namely whether Russia really abandoned the Chinese path of state capitalism in the banking sector as opposed to the industrial sectors. We look for typological similarity or dissimilarity between the two banking systems. The object of the study is restricted to commercial banks, leaving beyond the scope of analysis development or "policy" banks and non-banking financial institutions.

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Our main hypothesis is that the institutional models of banking in China and Russia are essentially coherent. These models gradually converge as the differences are eroded or do not become broader, while coherence grows, not least via institutional imports from China to Russia.

THE SIZE AND THE INSTITUTIONAL STRUCTURE OF THE BANKING SYSTEM

The size of the banking system. Both countries have developed a bank-based financial system. Commercial banks prevail over other types of financial intermediaries. In China they possess 78.5% of total assets and 75.9% of all employees of financial institutions; in Russia commercial banks own over 90% of all assets of financial institutions[2]. There are altogether 3.949 financial intermediaries in China, of which commercial banks make up only 1/6 [3, p. 137]. Bank loans are the main external source of financing for the non-financial sectors of the economy in China and Russia. Banks, however, might be losing market share to shadow banking institutions in China: by 2012, nearly one-half of the financial intermediation was taking place outside the formal banking sector, as compared to just 10% in the early 2000s [4, p. 3].

China is ahead of Russia in terms of financial depth measured through the ratios of depositary institutions' assets to GDP, whereas the gap in bank deposits to GDP has shrunk (Fig. 1) [8].

The bank loan-to-deposits ratio grows gradually in Russia and declines in China. It might suggest that the Chinese banking industry is moving from the risky initial ratio of 3.5/1 towards more sustainable levels, while the Russian banks have been learning how to use the deposit base more efficiently that investing in non-loan assets.

The number of commercial banks is falling in Russia and growing in China, having reached 829 and 673, respectively, by the end of 2013[3]. The Chinese authorities have approached conservatively the establishment of new banking entities, especially until recently and except non-banking financial institutions. In Russia, conversely, a *laissez-faire* stance was adopted at the turn of the 1990s that led to the mushrooming of new businesses claiming to be "banks". China's banking industry grows numerically mostly thanks to rural commercial banks, whereas the number of other types of banks (large commercial banks, joint stock commercial banks and city commercial banks) has stabilized. After the system of rural commercial banks has been shaped it is likely to undergo mergers and consolidations. The number of banking entities (bank branches, sub-branches and other types of offices) keeps growing in both countries, having reached 85.358 in China [10] and 45.603 in Russia [9, p. 13]. Population density is higher in China, which explains

[1] This research was supported by the Russian Foundation for Humanities, project No. 14-02-00422.

[2] The author's calculation based on data from CBR [5] and the China Banking Regulatory Commission, CBRC [6]; for more detail see [7].

[3] In the case of China we count as commercial banks the 5 "large commercial banks" (the core state-controlled banks), 12 "joint-stock commercial banks", 145 city commercial banks, 468 rural commercial banks, 42 foreign-controlled financial institutions [5, p. 137] and the Postal Savings Bank of China.

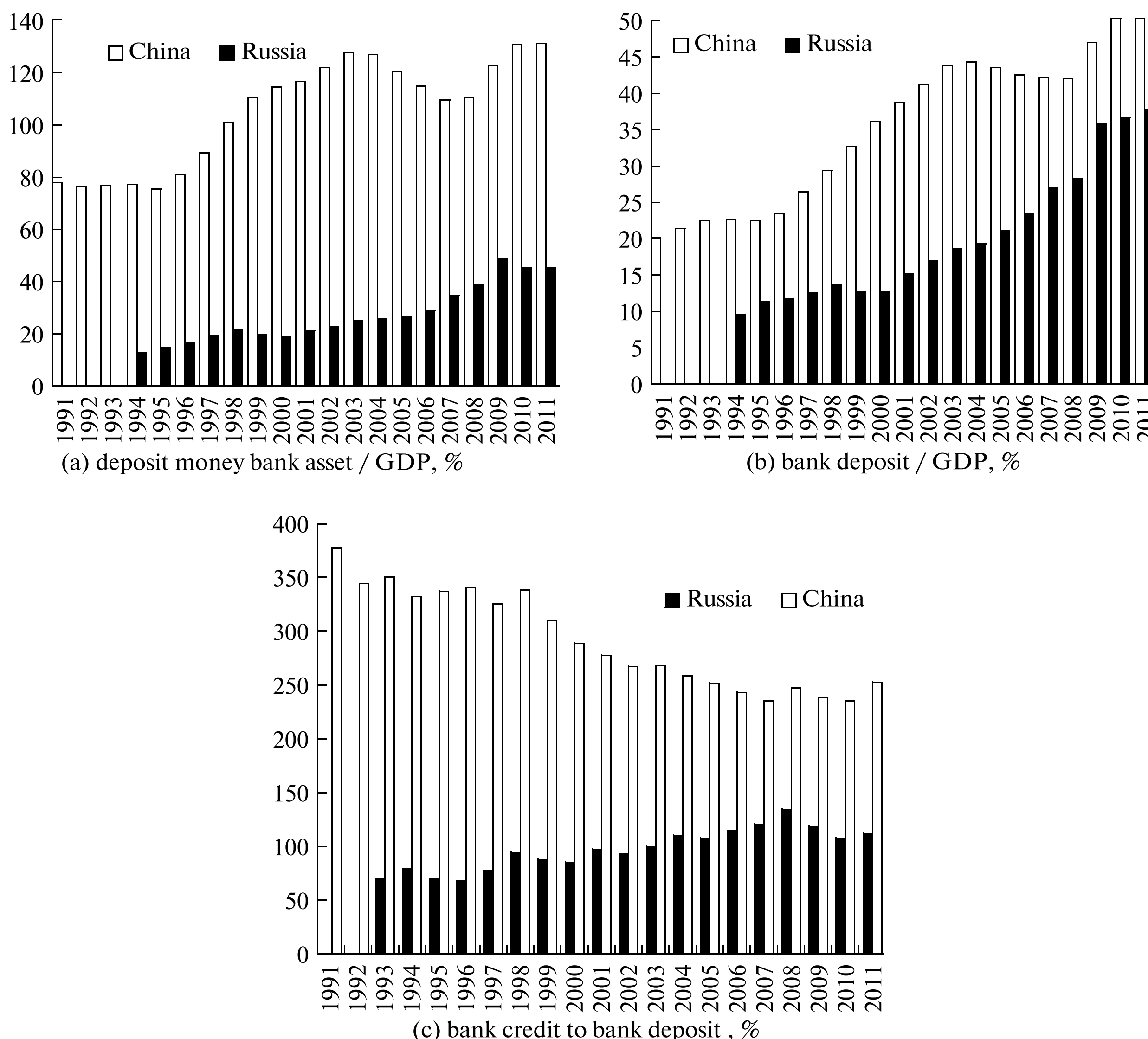


Fig. 1. Financial depth in China and Russia. Source: [8].

why China has 9 bank offices per 1.000 km^2 of territory as compared to less than 3 bank offices in Russia. Conversely, Russia exceeds China by the order of five in terms of bank offices per 100.000 adults, 38.2 and 7.7, respectively [10].

The tiers of the banking system. A two-tier banking system separating the central bank from all other banks nominally exists in both countries. In Russia all commercial banks are nominally equal as the banking law does not differentiate among them. The Law of the People's Republic of China on Commercial Banks (2003, Art.13) establishes 3 different tiers in terms of minimum charter capital: RMB 50 million for a rural commercial bank, RMB 100 million for a city commercial bank, and RMB 1 billion for a "national commercial bank". In fact, both countries have a complex multi-tier banking system that is designed hierarchically. One can distinguish three main tiers, namely the core state-controlled institutions, commercial banks of a national scale, and all other commercial banks (Fig. 2). Each tier embraces banks of a certain type that have different scope of business and client base and play a different role in the transmission mechanism of the monetary policy.

In Russia, the largest state-controlled banks have emerged from the general population of commercial banks to constitute a separate tier of the banking system [2]. On average they have assets exceeding an average of the top-20 non-state-controlled banks by an order of 12.4 times (author's calculation), which is similar to the gap between the two leading tiers in China. The gap between this tier and the next one (all other banks less 23 leading ones) is 38-fold. The CBR as the top regulator admits the heterogeneity of the banking system by focusing on the SIFIs (systemically important financial institutions) among the second-tier banks.

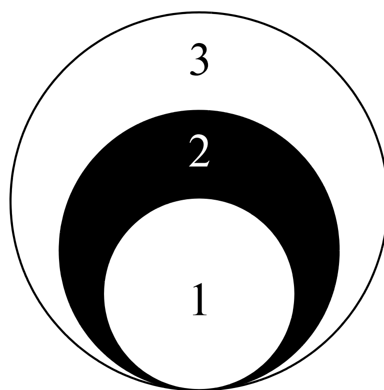


Fig. 2. Banking system design.

China 1. large commercial banks (5); 2. joint stock commercial banks (12); 3. City commercial banks (145); rural commercial banks (468); foreign financial institutions (42).

Russia 1. the core state-controlled banks (3); 2. other systemically important banks (~30) and «second-tier» banks (~150); 3. all other banks (~650)

Likewise, in China a "large commercial bank" (i.e. one of the 5 core state-controlled banks) has on average 12.7 times more employees and 6.1 times more assets than an average joint-stock commercial bank. In their turn, the joint-stock commercial banks exceed by an order of magnitude the size of the remaining commercial banks (for more details, see [7]). Stratification implies that only large banking entities operate nation-wide, whereas many of the urban and particularly rural commercial banks operate within the boundaries of their home city (district, province).

The market structure. Market structure by the form of ownership denotes the lead of the *public sector*. In Russia the market share of state-controlled banks [11, 12] reached almost 60% (Fig. 3 and Annex 1) [3, 5, 13–15]. As far as China is concerned, the insufficient transparency of the ownership structure impedes the computation of the precise share of state-controlled banks. However, the majority of joint stock, city and rural commercial banks were set up by state agencies and enterprises and funded by public capital. They remain closely related to the authorities.

A few largest state-controlled banks constitute the core of the credit system in China and Russia. The combined market share of Russia's Sberbank, VTB and Rosselkhozbank reached 42%. The market share of China's 5 "large commercial banks" has been on a gradual decline throughout the past years and dropped to 53% of total commercial banking assets (Fig. 4) [3, 5, 13, 14] and 63% of all bank employees, which created the illusion of state withdrawal from the banking sector. The different directions of change since 2000 reflect the fact that in Russia, the system of state-owned specialized banks (*spetsbanki*) had collapsed in the preceding period, as opposed to China where that had not happened.

The nominal share of state ownership explains some developments in the banking sector of China and Russia, but not all of them. The state has many tools other than direct equity participation, to influence banks and companies. Those tools range from public procurement, liquidity allocation, access to national projects and award of service contracts for public sector entities to the nomination of bank chief executives by the authorities. Nominally private or foreign banks can be encouraged to act in concert with the government bodies or selected clans of civil servants. There are also opposite examples, of nominally state-owned banks that fall under the control of their managers and other insiders and change the operational regime (e.g., Bank Moskvy prior to its takeover by VTB).

The market share belonging to *domestic private capital* in Russia can be estimated within the range of 25% and 31%. In China, it hardly exceeds 3%. Official Chinese sources have mentioned a 12% share of private capital in banking, but it includes primarily the minority participations in the equity of large banks without access to control. Among the joint-stock banks, only *Minsheng Bank* is deemed private. In March 2014 the authorities announced an experiment aimed to produce five banks fully owned by private industrial companies [16].

The market share of *foreign-controlled* banks in China has stabilized at about 2%, including foreign bank branches and the locally incorporated banks with foreign equity. In Russia, the corresponding indicator reached its peak of almost 19% in 2008 and then went into a slow decline to 15.3% in 2014.

GOVERNMENT POLICY TOWARDS COMMERCIAL BANKS

Banks' involvement in the financing of the real economy. The main point of difference between China and Russia that Speranskaya (2009) emphasizes is the functional role of banks in the economy, their relevance and the lending decisions criteria [1].

We compute that the share of domestic bank loans in the *total* fixed assets investment of non-financial

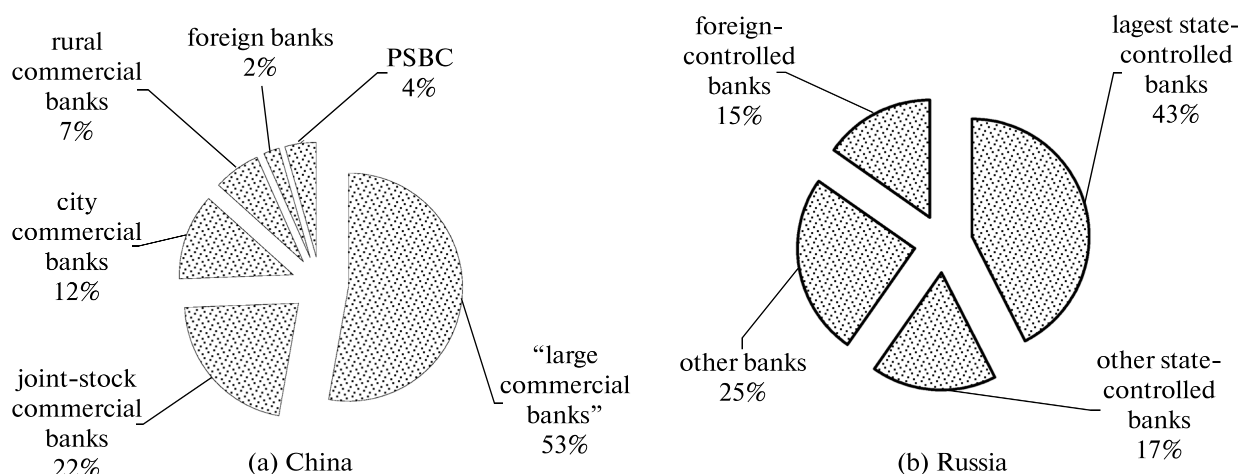


Fig. 3. Market structure in China and Russia (end-2013, percentage of commercial bank total assets).
Source: author's calculation based on data from: [3]; *The Banker*, July 2014; CBR; RIA-Rating (http://riarating.ru/); PSBC.

companies is between 13% and 15% in China and 7% and 8% in Russia; the gap tends to shrink (Fig. 5a) [17, 18].

Domestic bank loans constitute an essential, but not a prevailing, part of all *external* resources[4] for investment into fixed assets, their share varying from 40% in China and 14%–16% in Russia (Fig. 5b and Annex 2). The share of the state budget as a source of funds for fixed assets investment is higher in lower in China (4%–5%) than in Russia (20%). The total budgetary expenditure in China also looks more modest than in Russia, at 24.8% of GDP vs. 37.1% of GDP [19, p. 74]. Out of the context, these facts could be interpreted as China's departure from centralization and re-distribution of financial resources. Our hypothesis instead suggests that state budget financing is replaced by lending from state-controlled banks. We compared the flow of budget funds into fixed assets of non-financial companies with the flow of loans disbursed by the core state-controlled banks (expressed through a change in the loan portfolio year-on-year)[5]. From 2000 through 2013, the combined flow of funds from both sources averaged 9.4% percent of annual GDP in China and just 4.8% in Russia. Budget funds and loans from state-controlled banks complement each other (Fig. 6) [3, 17, 18].

[4] We compute the amount of external resources as the difference between the total amount of investment into fixed assets from all sources and the amount of self-financing of that investment by the enterprises themselves.

[5] In the absence of more reliable proxies, we assume that a change in the size of the loan portfolio features the investment activity of the core state-controlled banks. For the sake of compatibility with yearly volume of budgetary expenditure, we transform stock indicators (assets or loans outstanding for a given date) into a flow indicator (growth or contraction of the loan portfolio that occurred within one period of observation. For Russia it was feasible to compute the share of loans that goes to the non-financial enterprises; for China it was not. Data for China therefore include all bank loans, including consumer loans.

In Russia the flow of budget funds is more sizeable or equal to the flow of loans. During the period of financial crisis of 2008–2009, lending collapsed. In China, we see the opposite: lending by the "large commercial banks" exceeds budgetary investment. During the financial crisis of 2008–2009, the Chinese banks swiftly expanded their lending instead of cutting it. Unlike many other countries, the Chinese economy did not contract during that period.

Government interference into bank lending decisions. According to Speranskaya, China's state-controlled banks issue directed loans provided for in the national budget and the strategic economic programs, whereas in Russia presumably refrains from interference in the banks' lending decisions [1]. Chinese banks are indeed a part of a closed system and serve as levers by which the government can control the economy [20]. The banks serve as transmission mechanism for monetary policy. In 2009–2010 the authorities considered that the economy needs an injection of liquidity to prevent depression that had struck other countries, and banks responded by increased lending. That refers to banks controlled by the government directly as well as to nominally private or publicly floating banks [21, p. 25]. CBRC and PBC disclose in their reports that banks receive guidance regarding the desirable amount of credit creation and credit allocation among sectors and regions. That guidance stems from the targets of the 5-year development plan (the 12th 5-year plan is under implementation from 2011 through 2015). Each of China's provinces also has its priority sectors and areas. Every lending institution of relevance is expected to contribute to national targets by allocating credit accordingly.

The top managers of Russia's largest banks have declared that financial performance and market capitalization are their main objectives. That is changing now. The official Strategy for the banking sector development until 2015 indicates that Russian banks are expected to play a greater role in financing innovations

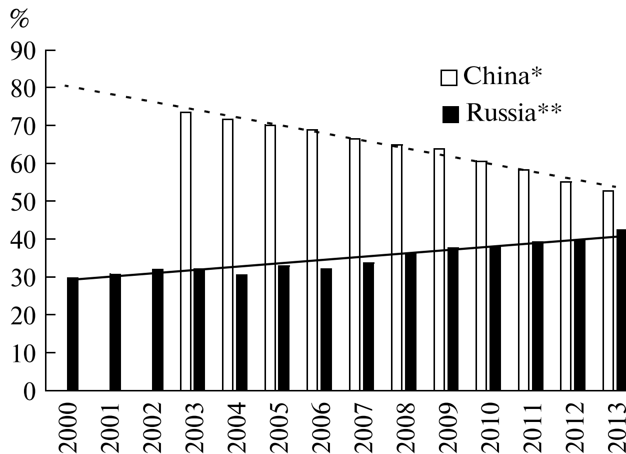


Fig. 4. Market shares of the core state-controlled banks (% of commercial bank total assets).
* Industrial and Commercial Bank of China, Agricultural Bank of China, Bank of China, China Construction Bank, and Bank of Communications. ** Sberbank of Russia, Bank VTB, and Rosselkhozbank, excluding subsidiaries thereof.
Source: author's calculation based upon data from: [3]; *The Banker*, July 2014; CBR; RIA-Rating (http://riarating.ru/).

in the real sector of the economy [22, p. 8]. The core state-controlled banks need to combine commercial banking with the implementation of the investment and structural policies [2]. The government gradually builds up its influence on the resource allocation by the core banks such as Sberbank, VTB, Rosselkhozbank or Gazprombank. Government bodies now regulate the involvement of the core banks in investment projects, including those with foreign policy implications[6]. Many of those projects happen to be too costly or unnecessary. In the run-up to the 2014 Winter Olympic Games in Sochi, the state-controlled banks lent to construction projects related to the games. In view of weak commercial viability of those projects the banks have to request government assistance to cover the potential loan losses.

Thus the scope of directed lending is on the rise in Russia. We refer to the lending decisions taken under exogenous interference and with regard to factors beyond financial efficiency and the borrower's creditworthiness. Evidence of directed lending should be identifiable in the lending policies of the state-controlled banks and their specific risk-taking behaviour. Empirical studies on Chinese and Russian banks provide proof to this hypothesis. Large state-owned commercial banks do not differentiate the pricing of the credit risk nor take into account the borrower's profitability when making lending decisions [23, 24]. Interest rates that banks quote for credit products of strategic importance or social sensitivity (e.g., mortgage loans) may occasionally reflect the influence of the government. During financial turmoil they reduce lending to the national economy to a lesser degree than banks representing other forms of ownership [25].

Apart from lending state-owned enterprises and state-sponsored projects, there are also quasi-fiscal operations aimed at discreet financing of the government. The Chinese banks were pushed to lend large amounts to so-called Local Governments Financing Platforms, or LGFP, that used most of the funds to finance real estate and development. The indebtedness of regional, provincial and local governments on LGFP financing has become a threat nation-wide and no solution is in sight. Russia has also announced plans to engage state-controlled banks in the financing of regional budget deficits. This financial innovation is similar with China's bank loans to LGFP. Despite the negative experience in China, Russia is set to try it. In May 2014 the government ordered the largest banks (VTB, Sberbank and Rosselkhozbank) to engage in lending to regional budgets to cover their deficits. The cost of funding should not exceed the CBR key rate plus 1.25%, and the proceeds would go to refinance earlier loans [26].

To sum up, some 10 or 15 years ago China did differ a lot from Russia in government influence on banks' lending decisions. These days there is less of a difference. Russia apparently goes the Chinese way.

Industrial policy. China started in 1978–1984 the departure from a mono-banking system and its conversion into a plural-banking system consisting of a central bank and various kinds of financial institutions [27, pp. 7, 8]. The Soviet Union launched a similar reform a few years later, in 1987, by establishing the specialized state-owned banks (*spetsbanki*) [28, 29]. The essence of both reforms was much the same, and the names of Russia's *spetsbanki* were identical to the Big Four banks in China.

The early 1990s became a bifurcation point. In 1984 China fostered its efforts to improve the efficiency of its largest banks by converting them into state-owned commercial entities. Russia acted otherwise. Instead of corporatizing and commercializing the *spetsbanki* it abandoned them to break-up, looting and destruction. The *spetsbanki* except *Sberbank* underwent "spontaneous privatization", i.e. dismemberment and looting, and the crisis of 1998 completed the demolition of the *spetsbanki* system [30].

Several largest state-controlled banks again dominate the banking system in China and Russia. These banks lead in terms of balance sheet size, market share, number of employees, branch network and other parameters. China keeps the Big Four (Industrial and Commercial Bank of China, Agricultural Bank of China, Bank of China and China Construction Bank) plus the *Bank of Communications* (BOCOM) in the leading group. Russia now has *Sberbank*, *VTB* (jointly with its subsidiaries), *Rosselkhozbank* and (with some reservations) *Gazprombank*. The upgrading and support of the national champions is at the center of the government's indus-

[6] The Government of Russia issued on July 30, 2013 Resolution No. 1343-p containing a list of investment projects whose servicing and financing is to be carried out solely by Sberbank, Gazprombank and VTB.

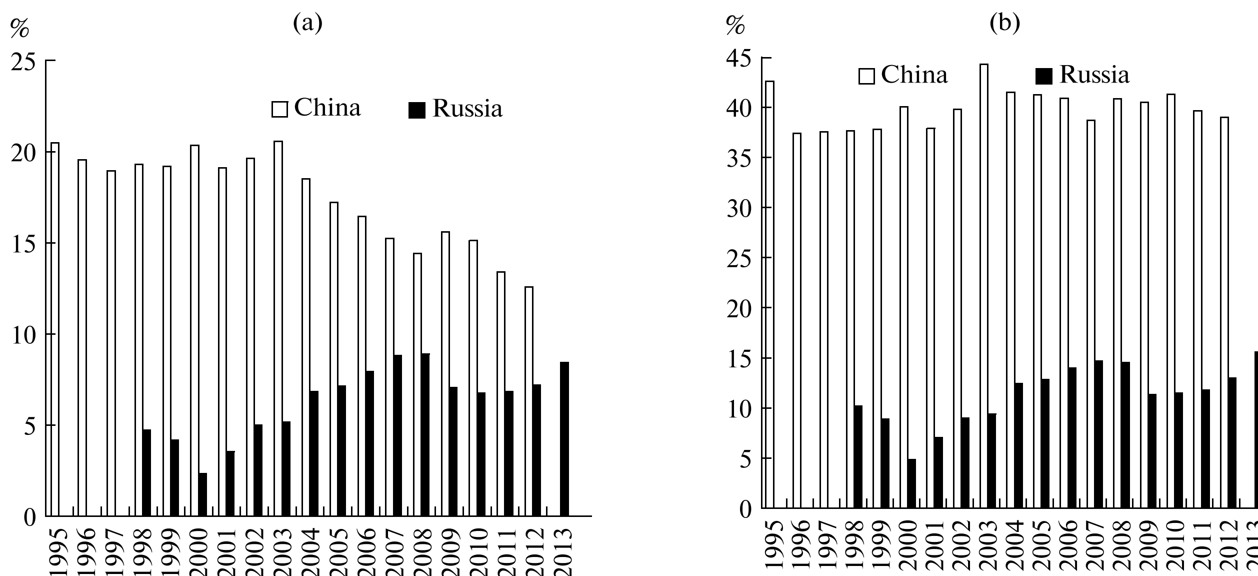


Fig. 5. Domestic bank loans as a source of non-financial company investment into fixed assets.
(a) The share of domestic bank loans in total investment into fixed assets. (b) The share of domestic bank loans in external sources of investment into fixed assets.
Source: author's calculation based on data from [17, 18].

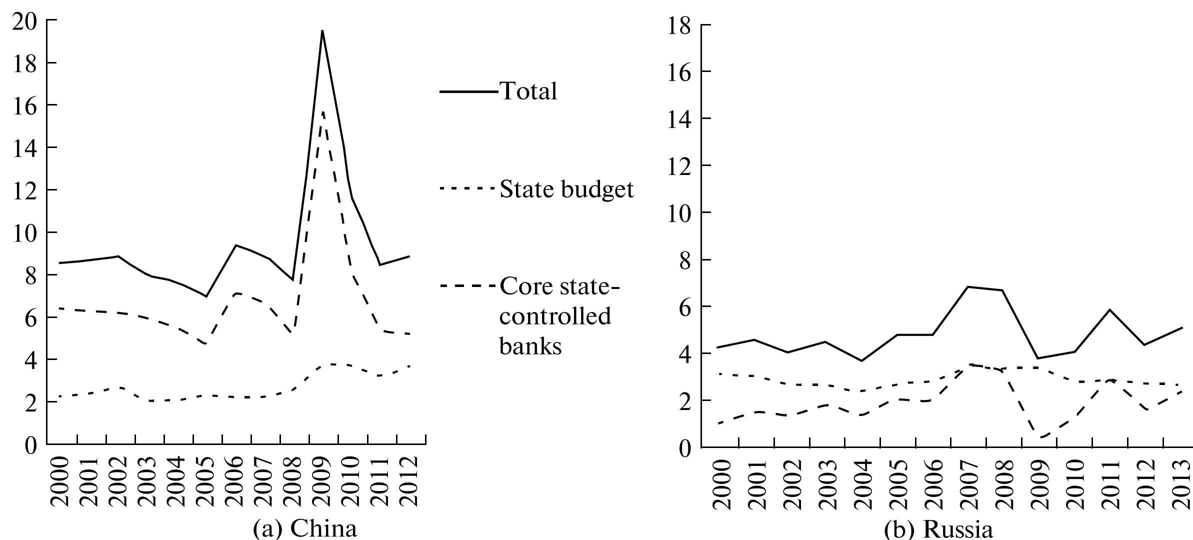


Fig. 6. The sources of investment into the fixed assets of non-financial companies (% of respective country annual GDP)
Source: author's calculation based on data from [3, 17, 18].

trial policy with regard to banks in China and Russia. The top state-controlled banks enjoy large-scale financial support by regular replenishments of capital and placements of liquidity for long tenors and at sub-market rates. The banks return the favor by lending to strategic industrial companies and by investing into high-profile project in infrastructure, industry and defense. State-owned enterprises may be receiving about a half of all loans issued by the largest state-controlled banks [21, p. 25].

As far as the comparative efficiency of banks is concerned, Berger, Hasan and Zhou argue that in 1994–2003 foreign banks were more efficient than large state-controlled banks in China [31]. Recent research admits the possibility for the state-controlled "national champions" to display financial efficiency not inferior than that of other types of market participants [32, 33]. Still, large state-controlled banks tend to have redundant staff. China's "large commercial banks" have a higher share in the banking sector total number of employees than in total assets. In terms of assets per one employee those banks appear in the middle of the ranking only.

In the banking model of China and Russia there is no clear watershed between the leading commercial banks under government control and the development banks. Both types of lenders engage in project finance, corporate finance and trade finance and take part in the national investment programs. In our opinion, the leading state-controlled banks in China and Russia, despite being nominally joint-stock companies and commercial entities, combine commercial banking and development lending.

Within the context of the industrial policy of the government, we also view the introduction of an explicit deposit insurance scheme in Russia in 2004. Via that scheme the authorities influenced the industrial organization, namely by artificially enhancing the competitiveness of one group of market participants (domestic private banks) at the expense of others (state-controlled and foreign-controlled banks). The Russian experience with deposit insurance illustrates numerous defects of such a scheme, particularly the *moral hazard*, or the erosion of moral and ethical principles and the promotion of destructive behavior, irresponsibility, opportunism, etc. by both the depositors and their banks [34]. China has no official deposit insurance system yet but plans its introduction within the period of the 12th Five-Year Plan [35].

Ownership transformation. Speranskaya sets Russia's state-influenced banks in opposition to China's state-owned banks [1]. These two distinct terms make one presume that bank ownership structure in China and Russia differs in essence. If such differences indeed existed some time ago, they have diminished. The largest banks controlled by the authorities in China and Russia have been transformed into public joint-stock companies. Most of them floated their shares through an IPO. Except for the Russian *Rosselkhozbank*, they all now have a sizeable minority participation in their equity, including foreign portfolio investors. Research suggests that even a minority participation of foreign investors increases the efficiency of a public sector bank [31].

The official rhetoric in both countries uses the term "privatization" widely and liberally to describe the bank ownership transformation. A genuine privatization, however, implies transfer of control from the government to non-affiliated private capital, which hardly ever happens to one of the leading state banks. Central executive bodies transfer ownership rights downstream to the other state entities, holdings, funds, corporations, banks, regional authorities, etc. The Russian federal authorities keep the controlling stakes of the three top banks. In China, by contrast, the national-level authorities may keep in their hands a minority stake, e.g., 39% of equity at ABC, 35% at ICBC, and 32.4% at BOCOM; and delegate the rest of the government stake to state-influenced holdings and investment funds. One of China's special features is the significant role of the regional and even lower-level authorities in the ownership and governance of banks, as compared to Russia.

Such kind of ownership transformation suggests the existence of the peculiar institution of *supreme conditional ownership* over the core means of production that has prevailed historically in this type of societies [36, 37]. It is neither public nor private ownership; its "privatization" is conditional and can be reversed.

Unbiased research fails to provide exhaustively convincing evidence of the causality between privatization and higher efficiency [38, p. 20]. Nevertheless, the government and Central Bank of Russia in their strategic blueprint for the banking sector envisage a reduction of government participation in bank equity down to the level of simple control in the medium run and below the control level thereafter [22, p. 9]. That plan is likely to materialize only partly if at all. New circumstances are slowing down the withdrawal of the government from the equity of the core banks.

CONCLUSIONS

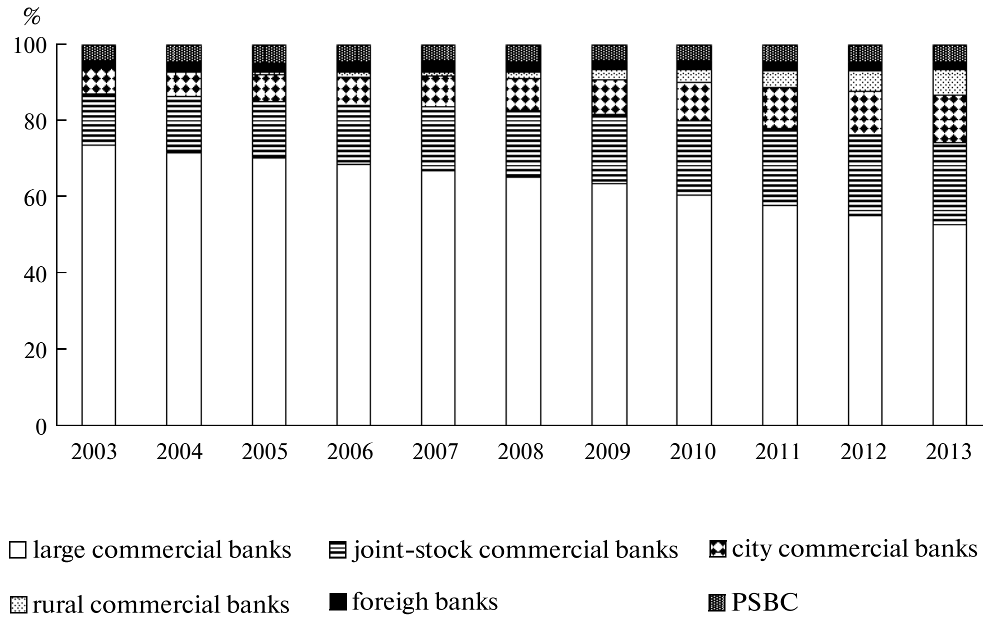
We attributed signs reflecting our subjective judgment on each element of comparison allocated among four sections: institutional structure; market structure and concentration; the industrial policy of the Government; and the involvement of banks into the lending to non-financial companies. We wondered whether statically the differences prevail over similarities, and dynamically—whether the evolution goes in the direction of greater coherence between the banking systems of China and Russia.

In the static dimension we found 14 elements of difference and 12 elements of similarity between the banking systems of the two countries. As for the dynamic dimension, the situation either changes into greater similarity (+8 elements) or remains as is (18 elements). Only one parameter displays a reverse dynamics, namely the market share of the core state-controlled banks. In the author's working paper "China and Russia: Institutional coherence between the banking systems" [7] we interpret the observed institutional dynamics with the help of the macro-sociological theory of institutional matrices, or TIM [37]. According to the TIM, both national economies feature a dominance of the institutional X-matrix that implies centralized non-market re-distribution. An X-matrix also implies the prevalence of the «state as investor» basic model of real sector financing [39].

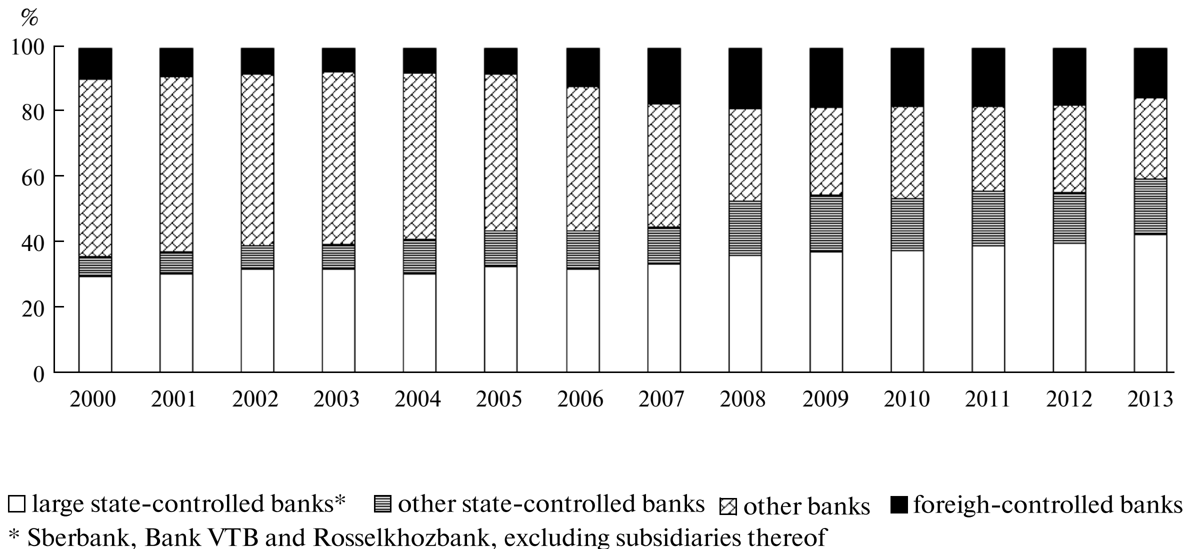
In both countries we have identified a multi-tier and hierarchically organized system of commercial banks headed by several institutions under direct control of the government. These core state-controlled banks combine commercial banking with development banking. The difference between the Chinese and the Russian system in terms of bank relevance and directed lending was highlighted by T. Speranskaya in 2009 [1], but now the growing state "dirigisme" gradually erodes that difference. We also suggest that the lending by the core state-controlled banks complements budgetary funds as a source of investment into fixed assets of non-financial enterprises in both countries.

ANNEX 1.

(a) China

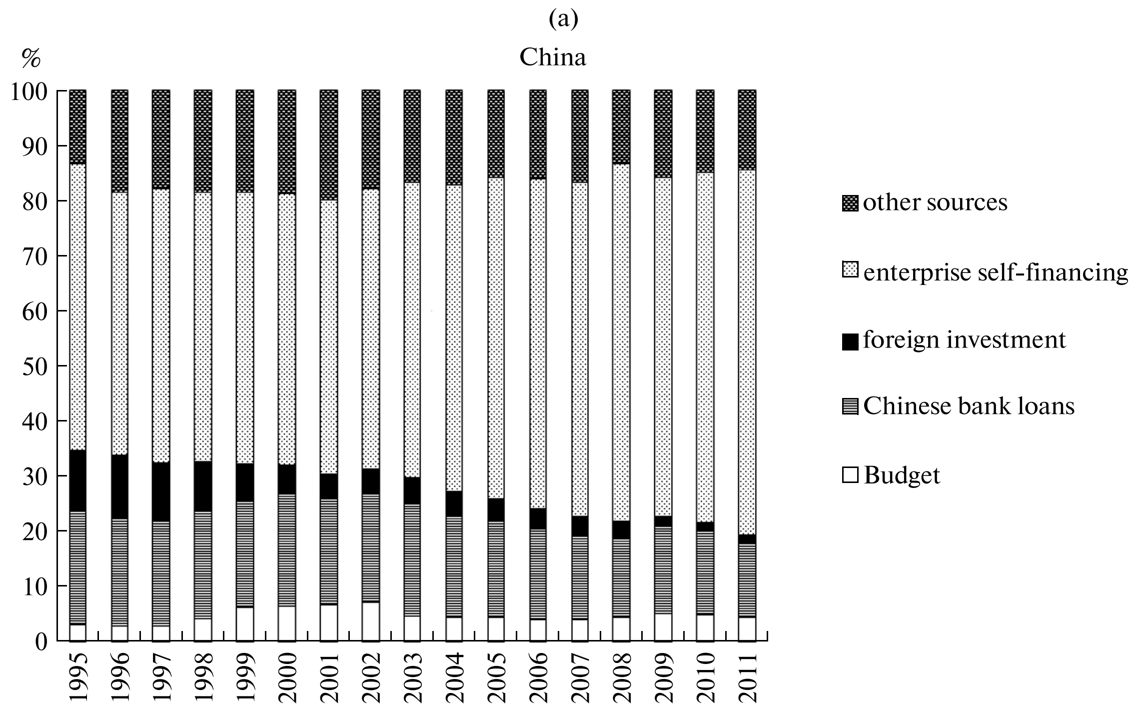


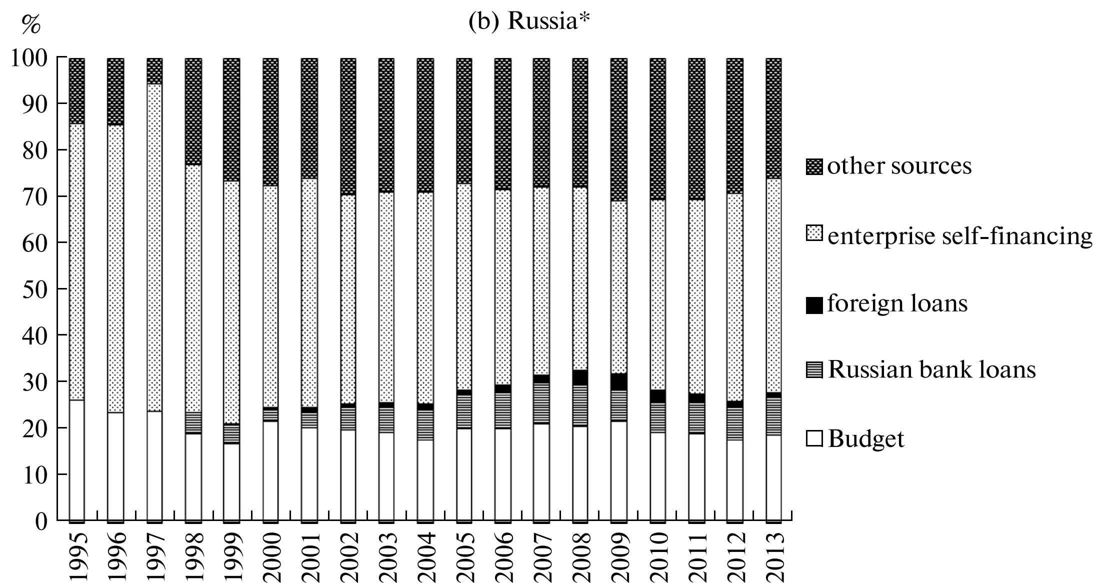
(b) Russia: breakdown of commercial bank total assets



Structural change in the banking systems of China and Russia (the breakdown of commercial bank assets).
Source: author's calculation based on data from [3; 5; 13].

ANNEX 2.





* The breakdown of investment sources into fixed assets in Russia was made compatible with the Chinese classification. 1995–1997 data on bank loans in Russia is missing.

Sources of investment into fixed assets.
Source: author's calculation based on data from [13; 18].

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