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The Russian Banking Sector: Unsolved Problems Seven Years after the Crisis

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The Russian foreign exchange and financial market crisis of summer 1998 was caused by international movements of capital following the Asian crisis, and it plunged the Russian commercial banks into major difficulties. Practically the entire banking sector was hit by acute liquidity shortage. The main cause of the banking crisis must be seen in the banking sector regulation, which was defective if not lacking altogether. This encouraged the banks to take big exchange rate risks on liabilities in foreign currencies, and to lend with little risk diversification, which proved fatal in the crisis.

The method used by the Russian authorities to deal with the crisis was also unorthodox by western standards. The crisis was overcome without major restructuring in the banking sector and accomplished at astonishingly little cost to the economy as a whole. However, the success in the form of good growth rates in every year since 1998 only seemingly justifies this neglect, for the relatively weak constitution of the banking sector in Russia – compared with other transition economies – has certainly hampered even better economic development. Although some more recent legislative initiatives do give reason to hope for improvement here, powerful interests are still preventing the optimal restructuring of the banking scene that is necessary for the economy as a whole.

Undesirable developments in the early years of transition

The end of the socialist mono-banking system came in 1988 with the decision by the Soviet government to allow five specialist banks to operate beside the central bank. They were the Agroprom bank, the Promstroibank, the Sberbank, the Vnesheconombank and the Zhilsotsbank, and they were intended to take over financing certain state programmes. In the same year the law on cooperatives opened up for the first time the possibility of founding 'null banks' financed with private capital, and the opportunity was then eagerly seized, especially by companies. Under liberal conditions for market access the number of licensed banks rose to more than 1300, even before the Russian state was founded.

After the establishment of the Russian Federation the task of banking supervision and regulation fell to the Russian central bank (RCB), although it retained numerous links with the commercial banks. A large number of commercial banks were set up by converting former central bank branches, while the biggest banks remained in state ownership, either directly or through the RCB.

The highly volatile situation in the economy as a whole in Russia in the early 1990s would have faced even a well developed banking sector with considerable problems. The situation was made more difficult for the new Russian commercial banks in that the laws on private enterprise were constantly being changed, so that lending to the private sector bore additional risks. Consequently, the banks scarcely operated as had been intended, namely as mediators between savers and investors; instead they developed other ways of extracting profit. According to estimates by the World Bank the hyper-inflation of 1992 and 1993 alone flooded assets of the order of 6 to 9% of the gross domestic product (GDP) into the banks – while their capital amounted to less than 1% of GDP.[1] Negative real interest rates on bank deposits while the banks themselves were lending at considerable interest spreads in itself guaranteed lucrative earnings.

However, the banks made a veritable fortune by investing their rouble liabilities in dollar securities, which rose considerably in value as inflation caused a steep devaluation of the rouble. The extraordinarily high profits helped to cement the power of the lobby of banks and big industrial groups (which hold the majority in most of the private banks) and in the mid-90s they began to influence political decision-making in their favour.

The Russian commercial banks also manoeuvred with skill in the 1990s in their financial transactions with the public sector. One example were short-term government bonds (Gosudarstvennye kratkosrochnye obligazii – GKO), which the government issued from 1994 to finance the public debt. Between 1994 and 1998 the government received the countervalue of around 15 billion US dollars for these bonds, but the nominal value of the GKO on the primary market, which the banks dominated, and from which foreigners had been excluded after successful lobbying, was 70 billion US dollars.[2] Another source of funds lay in the banks' responsibility for administering public funds, from which, according to an estimate by the State Hearing Chamber of the Russian Federation, the banks earned more than 1.3 billion US dollars in 1995 and 1996 alone.[3]

With earnings prospects of this order it is hardly surprising that 'normal' banking business held little attraction, nor is it astonishing that the banking lobby opposed any steps to introduce more stringent regulation on the model of proven western standards, if this would have meant lower earnings.

The Russian Banking Association opposed efforts in this direction by the central bank in 1994 and 1995, and it also succeeded in forcing a change in the management of the central bank in its favour. That the Russian legislature allowed the banking lobby to direct it away from regulatory reforms that were meaningful and necessary for the economy as a whole is only one example of the state's co-responsibility for defects that have been characteristic of the development of the banking sector in Russia since the collapse of the Soviet Union.

Little interest in the role of financial intermediaries

The banks ignored their real task. Companies outside the big industrial groups were largely excluded from lending or were only given loans at extremely high interest rates. This strengthened the classical problem of adverse selection[4] which was to play a big part in the crisis. However, in summer 1998 the influence of the state, which was still undiminished, also hampered the development of a banking sector dedicated to its role as financial intermediary, and it must be held partly responsible for the vulnerability of the sector.

Table 1 lists the 15 biggest banks in Russia. The majority shareholder of by far the biggest, Sberbank, is the RCB. Under a law passed in July 2002 to limit the extent of the RCB's holdings in commercial banks, ownership of the second largest bank, Vneshtorgbank, passed to the state.

Sberbank's dominant position – its assets amount to around one quarter of the Russian banking sector's total assets – is based on its considerable competitive advantages. As a state bank it enjoys a state guarantee on deposits, and as successor to the Soviet Monobank it has branches all over Russia.

Thanks to these advantages the bank still dominates the deposits market. In 2002 it still held around 75% of

[1] William Easterly and Paulo Vieira da Cunha: 'Financing the Storm: Macroeconomic Crises in Russia 1992-93', in: *Economics of Transition,* vol. 2, no. 4, 2004, pp. 443-466.

[2] Timothy Frye: 'Governing the Banking Sector in Russia', New York University Draft, New York 2002.

[3] Juliet Johnson: 'A Fistful of Roubles: The Rise and Fall of Banking in Russia', Ithaca 2000.

[4] The higher the interest rates, the smaller is the share of borrowers whose calculations are soundly based and the bigger the share of 'speculators' of questionable standing.

Table 1
The 15 Biggest Banks in Russia[1]
In million US dollars

	Assets	Capital
Sberbank	69 453	6 254
Vneshtorgbank	15 251	2 038
Gazprombank	12 746	1 386
Alfa-Bank	7 391	916
MDM-Bank	6 271	476
Bank of Moscow	5 509	599
Rosbank	4 989	480
International Moscow Bank	3 625	373
PSB	3 253	322
MeshPromBank	3 065	962
UralSib	3 041	392
Raiffeisen-Bank Austria	3 006	316
Promsvjasbank	2 116	202
Petrokommerz	2 009	263
Nomos-Bank	1 642	200

1 By assets as per 1 January 2005.
Source: Russian Central Bank.

total deposits and around 90% of deposits by private households.[5] So its competitors had little access to the bank deposits of private savers as a main source of financing, and that is still the case. As the domestic capital markets are still under-developed many commercial banks can only finance their lending by borrowing in foreign currencies from international banks and on foreign capital markets. The exclusion of the private banks from the Russian deposits markets following privileges granted to Sberbank, combined with the lack of regulation of borrowing in foreign currencies, must therefore be seen as one of the main reasons for the vulnerability of the banking sector to the 1998 crisis.

Serious structural weaknesses the main cause of the banking crisis

In the years before the foreign exchange and financial market crisis Russia profited from the interest of international investors worldwide in maintaining deposits in newly industrializing countries. Stabilizing the currency by fixing the exchange rate to the US dollar in July 1995, the greater political security after Yelzin's re-election in 1996 and the opening of the GKO market to foreigners in the same year set favourable conditions for investment in Russia. The Russian share index rose by 142% in 1996 and by 184% in the first eight months of 1997.

However, from the end of 1997, with the Asian crisis and the collapse of the Russian share market, fears grew that Russia could suffer a similar fate to the southeast Asian tiger economies. International investors hedged against a collapse of the currency, in some cases with forward contracts with Russian banks, and increasingly shifted their investments into safer havens. The Russian government experienced increasing difficulties in extending its borrowing and in supporting the currency. Then in August the rouble was finally freed and operations on the bond market suspended.

The crisis directed attention to serious structural weaknesses in the Russian banking sector. Among other things Sberbank's quasi monopoly meant that its commercial bank competitors were borrowing abroad. At the same time the banks had a big incentive to acquire foreign currency on international markets. Even after deduction of the high inflation rates yields could be obtained on loans in Russia that were far above the rates at which funds (mainly US dollars) could be borrowed abroad.

This arbitrage business offered a secure source of income, assuming that the exchange rate remained stable. And in fact just before the crisis broke the International Monetary Fund (IMF) promised the Russian government a loan of billions precisely to stabiles the exchange rate. Evidently the Russian commercial banks interpreted this as an invitation to continue to work the fertile field. Again owing to the lack of appropriate regulation all the big commercial banks' liabilities in foreign currencies in summer 1998 exceeded their assets many times over. 75% of the liabilities in foreign currency were concentrated in the 20 biggest Russian banks, where they accounted for a total of 20% of total liabilities.

The banks were also particularly exposed to risks from forward contracts they had entered into in case, as seemed ever more likely from the end of 1997, the rouble would be devalued. In numerous cases the volume of forward contracts was many times greater than the bank's total assets.

The lack of risk diversification in lending is another structural problem which, in fact, is still not satisfactorily solved. A few customers still dominate the lending business of their favourite banks. In 2001 the ten biggest loans granted by smaller banks accounted on average for 80% of their total loan portfolio; the figure for the

[5] Cf. Alfred Steinherr: 'Russian Banking Since the Crisis of 1998'. Centre for European Policy Studies, *Working Document,* no. 209, Brussels 2004, p. 3. The trend is declining. At the end of 2004 the Sberbank's share of deposits by the private sector only amounted to around 60%.

Table 2
Number of Banks and Liquidations in Russia 1997 to 2005[1]

	1997	1998	1999	2000	2001	2002	2003	2004	2005
Total number of banks registered with RCB	2 562	2 481	2 376	2 124	2 004	1 826	1 666	1 516	1 482
Year-on-year change	x	–81	–105	–252	–120	–178	–160	–150	–34
Number liquidated	52	73	100	258	144	216	178	153	37

1 At end of each year; 2005 30 April.
Source: Russian Central Bank.

medium-sized banks was around 60%, and it was still as much as 45% for the big banks.[6]

Finally, the loss of customer confidence and the resultant withdrawal of deposits amounting to between 14% and 45% in summer 1998 started a crisis throughout Russia in which the biggest commercial banks were particularly affected.[7] And although the IMF argued during the crisis that the entire banking sector was largely insolvent the authorities in the Russian government and the central bank treated the difficulties as a typical liquidity crisis. One must ask whether its awareness of the regulatory and structural problems in the Russian banking sector should not have induced the IMF to pursue a different policy in regard to the exchange rate earlier.

The government imposed a 90-day moratorium on foreign debts, so enabling the Russian banks with precarious forward positions to keep their losses within limits.[8] Accounts with commercial banks threatened with insolvency were, upon request, transferred by the RCB to accounts with Sberbank in order to prevent the escalation of withdrawal of deposits.[9] And finally liquidity to the amount of 46 billion roubles was provided at rates well below the market rate. It was astonishing that ultimately relatively few banks were closed, as table 2 shows.

Experience in other countries that have had to cope with a comparable banking crisis suggests that up to half the commercial banks fall victim to the subsequent restructuring. One of the main reasons for the low number of closures in the Russian crisis can be seen in the inadequacy of the capital of the Agency to Restructure the Organization of the Banking Sector (ARKO) which began work in 1999 – its capital was 10 billion roubles, less than half a percent of the balance sheet total of the banking sector in 1997, and not nearly enough for its task.

Moreover, ARKO was not independent.[10] It used most of its capital to buy up state bonds that were not traded on the stock exchange and for a billion-rouble loan to the Alfa Bank that was not in difficulties but was evidently well connected. By 2003 ARKO had restructured 14 banks and liquidated three. The total expenditure on the restructuring measures amounted to 16 billion roubles, a very modest amount compared with the typical costs of restructuring the banking scene after a major crisis. The restructuring of the banking sector in Turkey after the 2001 crisis involved costs estimated at 40 billion US dollars.[11]

Successful growth does not justify the crisis management

Empirical studies of banking crises have identified essential conditions that should be fulfilled if a major financial crisis is to be overcome successfully.[12] A comprehensive restructuring programme needs to be set up

[6] Cf. Filippo Ippolito: 'The Banking Sector Rescue in Russia', Bank of Finland Institute for Economies in Transition (BOFIT) Online vol. 12, Helsinki 2002.

[7] Contrary to a widely held view the losses on state bonds were not the main reason for the banks' insolvencies, cf. Alfred Steinherr loc. cit., p. 5.

[8] Cf. Alfred Steinherr, loc. cit, pp. 6f.

[9] Although the transfer was voluntary on paper most of the commercial banks had little choice. In view of the fact that the RCB is the majority shareholder in Sberbank this may be a cause for some unease.

[10] The chairman of the management board of the RCB was appointed chairman of the board of directors of ARKO, and the former deputy chairman of the RCB was appointed director-general of ARKO.

[11] Cf. Alfred Steinherr, Ali Tukel and Murat Ucer: 'The Turkish Banking Sector: Challenges and Outlook in Transition to EU Membership', Centre for European Policy Studies, *EU-Turkey Working Paper,* no. 4, Brussels 2004.

[12] Cf. e.g. Cheryl Gray and Arnold Holle: 'Bank-Led Restructuring in Poland: The Conciliation Process in Action', in: *Economics of Transition,* vol. 4, no. 2, 1996, pp. 349-370; Ibid, 'Bank-Led Restructuring in Poland (II): Bankruptcy and its Alternatives', in: *Economics of Transition,* vol. 5, no. 1, pp. 25-44; Helena Tang, Edda Zoli and Irina Klytchnikova: 'Banking Crises in Transition Economies: Fiscal Costs and Related Issues', in: The World Bank, *Policy Resarch Working Paper,* Series no. 2482, Washington D.C. 1999.

that includes both solutions for non-performing loans and initiatives to improve the performance of new loans, as well as reform of internal bank risk management. The restructuring measures should be implemented rapidly, with transparent financing through tax revenue preferable to non-transparent and potentially inflationary central bank measures.

It is striking that the crisis managers in Russia did not really adopt any of these suggestions. The crisis was treated largely as a pure liquidity crisis and essential steps to improve banking regulation were not taken.[13] Nevertheless, the success appears to have justified the authorities' action. In 1999 Russian GDP increased by 5.4% in real terms, and in 2000 by as much as 9%. Since then it has settled at about 6% growth per year.

A current study by Thiessen[14] on the relation between the state of development of the financial system and economic growth, on the other hand, comes to the conclusion for Russia that the neglect to build up an efficient financial sector has very probably led to considerable loss of growth potential. Thiessen used indicators of the financial system from the study by King and Levine[15]:

1. Broad money (M4) in relation to GDP
2. The commercial banks' domestic assets in relation to the total assets of the commercial banks and the central bank
3. Share of lending to the private non-financial sector in total lending
4. The relation between lending to the private non-financial sector and GDP.

In all these indicators Russia does show more or less strong improvements between 1993 and 2002, but it still lags behind other transition economies like Poland or Hungary in all these areas. Especially the last of the indicators, the importance of financial intermediation for the economy, still shows a very low figure for Russia. In the light of the subsequently confirmed conclusion drawn by King and Levine that there are significant relations between the state of development of the financial system and the development of capital accumulation, economic growth and productivity growth, it can therefore be argued that speedy action to tackle structural reforms in the banking and financial sector in Russia would certainly pay off.[16]

[13] Concrete examples of serious neglect are given in Filippo Ippolito, loc. cit.

[14] Ulrich Thiessen: 'Financial System Development, Regulation and Economic Growth: Evidence from Russia', *DIW Discussion Papers,* no. 400, Berlin 2004.

[15] Robert King and Ross Levine: 'Finance and Growth: Schumpeter Might Be Right', in: *Quarterly Journal of Economics,* vol. 108, no. 3, 1993, pp. 717-737.

The Russian banking sector today: some promising developments since 1998 ...

In their assessment of the Russian financial sector in 2003 the IMF and the World Bank concluded that according to official data the Russian banks did by and large have sufficient capital, although simulations have shown that they are still vulnerable to developments similar to those in 1998.[17]

The ratio of foreign debt to GDP has fallen to around one quarter with the high level of economic growth in recent years, while the currency reserves grew from 12 billion US dollars in 1999 to 140 billion US dollars in April 2005. Total claims held by the banking sector rose during the same period from 50 billion US dollars to around to 263 billion US dollars, and deposits by private individuals with the banks rose from 10 billion US dollars to around 63 billion. Total bank deposits were most recently a good 93 billion US dollars, with about one third held in foreign currencies. The claims in foreign currencies about matched liabilities, so that the sector as a whole is no longer as vulnerable to possible exchange rate changes as it was in the crisis year.

The profitability of the banking sector has risen again, and business is concentrated more on corporate and private customers – as borrowers the private sector is growing in importance over the public sector. The banks gradually adopted the International Accounting Standards (IAS) by the deadline of 1 October 2004, and some have also adopted the Active-Passive Management guidelines. New regulations on capital adequacy have been in force since the start of 2005, obliging banks with capital of less than 5 million euros to a risk-weighted capital adequacy ratio of 10%. From 2007 this regulation is to apply to all banks, whatever their capital.

Finally, in the law to create an insurance fund for bank deposits by natural persons of December 2003 a necessary step has been taken towards more balanced competition conditions. It will limit the dominance of the Sberbank in the private deposits business and give non-state commercial banks easier access to private savings deposits for their financing. ARKO established the new fund with 3 billion roubles; participating banks pay a quarterly insurance premium of at most 0.15% of their

[16] According to an estimate by Thiessen, if the Russian financial system had continued to develop up to the level of Hungary and Poland between 1998 and 2002 Russia's long-term growth rate would have been 6.9% higher.

[17] Cf. IMF and World Bank: 'Financial Sector Assessment, Russian Federation', Washington D.C., 2003.

deposits insured during the previous quarter. As soon as the fund has reached the equivalent of 5% of the volume of deposits insured the premium falls to 0.05%, but it can also be raised to a maximum of 0.3% under certain conditions and for a period of up to 18 months. If the fund cannot meet its obligations from its own means it can ask the government for financial support.[18]

... but a number of unsolved problems remain

Despite some welcome developments in recent years considerable problems remain. The dominance of the two big state banks is unbroken. There are very few non-Russian banks in the private sector – only one of the 15 biggest banks is foreign. Moreover, the sector is greatly fragmented. At the end of 2004 only around one third of the banks had capital of more than 5 million US dollars; a further third had capital of between 1 and 5 million US dollars and the remainder had less than 1 million US dollars.

Despite the new regulations the development to a successful private banking system is very slow. Evidently the ownership is decisive in questions of support from the RCB, and nationalization, not privatization is the agenda. This is also clear from the exclusion of foreign banks from the deposits insurance fund. The measures taken by the RCB to overcome the liquidity crisis were equally questionable, and they also helped to induce many savers to shift their deposits from the commercial banks to the Sberbank; this temporarily reversed the trend to a falling market share for the state bank.[19]

The Putin government undoubtedly regards market forces with considerable scepticism – and to a certain extent that is understandable. For the Russian economy is still far removed from that social optimum which western market apologists believed would easily be achieved, even in the heartland of the centrally planned economy, after 1991 through the free play of market forces. The experience of privatizing the 'crown jewels' of Russian industry in the 1990s has left its traces, and the Putin government's reluctance to sell shares in enterprises of 'strategic importance' for the country is testimony to that experience, as is the differentiated handling of the oligarchs, as most recently in the Yukos affair.

Although to a certain extent understandable, the attitude of the state is a considerable obstacle to the development of the banking sector. Clear and reliable legal conditions, especially in ownership law, are essential for a well-functioning financial system in which people can have confidence. Cases like Yukos, and examples of the arbitrary taxation of withdrawals or ignoring creditors' rights in banking transactions do not help to increase confidence in the 'dictatorship of the law', which Putin likes to evoke, they play a major part in the continued capital flight from Russia,[20] while the amount of 'mattress money' ordinary people are keeping is estimated at 40 to 80 billion US dollars – compared with 63 billion US dollars in private bank deposits.

Solutions need to be adapted to Russian conditions

Proposals to improve the situation in the Russian financial sector need to take account of Russia's special relation with the market economy system as well as other factors that are characteristic of the country. These include the geography. Like the United States, Russia, with its huge land mass, needs a large number of banks. The number may seem very high to Europeans, but most of these banks are very small, and they are providing banking services for outlying rural areas. In the United States as well there are enormous productivity and efficiency differentials between the big banks in the major centres and the little Savings & Loan Associations in the provinces. So just as for the United States there are no convincing reasons why all the banks in Russia should be universal banks on the continental European model, as is now the case. In Russia, too, smaller banks should be limited to the deposits and lending business to minimize problems of conflicting interests and insider information, which occur more frequently in universal banking systems.[21]

One meaningful step would be to introduce a two-tier banking system.[22] Banks in the first segment would have to meet the directives on capital adequacy and lending, they would use the electronic payments system and would be members of the deposits insurance fund. They would have access to refinancing facilities at the

[18] Cf. Alfred Steinherr, loc. cit., p. 14

[19] Cf. Alfred Steinherr, loc. cit., p. 7.

[20] According to figures from the RCB the capital flight from Russia reached 7.8 billion US dollars in 2004, four times the 2003 level. So the declining trend (24.8 billion US dollars in 2000, 15 billion in 2001, 8.8 billion in 2002 and only around 2 billion in 2003) was reversed again last year.

[21] Cf. Alfred Steinherr and Christian Huveneers: 'Institutional Competition and Innovation', in: Andy Mulineux (ed.): 'European Banking', London 1992, pp. 130-147.

[22] Cf. Daniel Gros and Alfred Steinherr: 'Winds of Change: Economic Transition in Central and Eastern Europe', London 1995.

central bank, and in return would be obliged to maintain deposits with it. The RCB would act as 'lender of last resort' for them. The majority of the Russian banks, which still number more than 1300, and which can only meet these requirements – if at all – with great difficulty, should be licensed for the second segment. They would be subject to less stringent directives, but they would not enjoy the privileges granted to the banks in the first segment. Potential customers should be made aware, beyond any doubt, of the resultant differences in risk. Banks in the second segment would thus have to offer higher interest rates on deposits and they would tend to invest in more risky projects. But any payments difficulties that arose for these banks would no longer constitute a risk to the sector as a whole.

This procedure would certainly be preferable to the threat of closure that would face several hundred inefficient and scarcely profitable banks. For the banking sector will de facto be divided into two segments by the introduction of the deposits insurance fund – on the one side the banks that are members of the fund and on the other those that do not fulfil the conditions and are thus practically excluded from the deposits business.

A new role for Sberbank

In this context the possible future of Sberbank also needs to be discussed. As already mentioned, Sberbank has a full network of branches throughout Russia and is therefore ideally placed to provide banking services outside the densely populated areas as well. But privatizing the biggest Russian bank is out of the question for the government, as is giving greater access to foreign banks, which has been practised in other transition economies with good results.

One alternative that should be discussed is converting Sberbank into a 'narrow bank', with its activities limited to accepting deposits and investing in liquid, high-quality securities; it would not, however, be allowed to grant large loans.[23] In this way Sberbank could mainly be used to stimulate the lending market for small and medium-sized companies. If Sberbank were obliged to invest a large part of its assets in highly liquid financial assets this could also give a big stimulus to the development of the money market in Russia. The state would profit from this through new possibilities for short-term borrowing as would other commercial banks, for which financing through deposits is not so easy. They are currently suffering from the lack of supply on the domestic interbank market.

Beside these two major reforms a number of smaller measures could be taken relatively quickly in order to strengthen the role of the financial intermediaries in the Russian economy. The payments system, which has been greatly improved in recent years but still has shortcomings, could be developed further. Especially in real time payments and payments upon delivery it does not yet come up to international standards.[24]

The inadequacy of access to external funds for small and medium-sized enterprises has repeatedly been addressed. As well as the above measures the introduction of a credit information service would be helpful, as would a 'pledge register' for current assets. The deplorable state of much of the Russian building stock indicates the necessity of a well-developed mortgage market, which is largely still in its infancy in Russia. In western countries mortgages are an essential way of securing loans, particularly loans to small and medium-sized companies and private households. Improvements in this area would be important and they should not encounter insuperable political obstacles.

Finally, on the lenders' side strengthening creditor protection is at the top of the list, as the IMF and the World Bank stress in their latest report. That applies mainly to procedures in cases of insolvency, when the Russian legislation relies much more on liquidation than rehabilitation, and where power games between shareholders often replace seniority of claims as the decisive criterion.[25]

There is also still need for action in banking supervision and regulation. The regulations have been greatly improved since 1998, and the necessary steps to implement them have been started in financial legislation. The RCB should narrow the definition of capital without delay, and enforce the new definition, like the more stringent directives on capital adequacy. In lending, qualitative risk assessments should have greater weight. The implementation of the IAS since 2004 is a good starting point here.

Finally, within the banking sector further developments in corporate governance would be desirable. Essential progress would be achieved by breaking up the close ties between the commercial banks and the big industrial groups that hold most of the shares.

In the present situation there can be no doubt that bank managers decide according to the interests of the majority shareholders and that minority interests have little protection. One possible solution would be to limit by law the shares in commercial banks held by big

[23] The concept of the 'narrow bank' comes from Bryan and Pierce, cf. Lowell Bryan: 'Breaking Up the Bank: Rethinking an Industry Under Siege', New York 1988; James Pierce: 'The Future of Banking', New Haven 1991.

[24] Cf. Alfred Steinherr, loc. cit., p. 15.

[25] Cf. IMF and World Bank, loc. cit.

industrial corporations, as was practised in the United States after the world slump with the Glass-Steagal Act.[26]

How likely are rapid and comprehensive reforms?

The proposals put forward here to improve the development of the Russian financial sector are probably more realistic than many other demands that have been made, for instance, in regard to privatizing the Sberbank, or to opening the sector up to foreign competitors.

Nevertheless, in the light of the rather sluggish development in recent years, rapid and substantial progress in the direction indicated cannot necessarily be expected in the near future. In the past the Putin government has expressed a basic interest in improving structures as part of good governance, but the question of banking reform does not appear to be high up on the agenda.

Moreover, the key figures – beside the government chiefly the RCB and the big industrial corporations that control most of the commercial banks – are pursing their own ends, and these do not generally coincide with maximizing prosperity in society as a whole. The risk that Russia will remain the prisoner of a disadvantageous equilibrium in this sector too cannot be overlooked.

[26] The hope that self-control in the supervisory boards of the commercial banks would produce the desired results has probably not been fulfilled. At present such codes of conduct are still distinguished by vague concepts like 'good will' or 'a reasonable attitude'. Cf. Alfred Steinherr, loc. cit., p. 18.