

Regional banks and institutions: the case of Russia

We examine the regional distribution of Russian banks and bank branches in 2000-2016 to show that the institutional features of Russian regions along with the economic factors such as a size and the structure of the regional economy and the population are important factors for location of regional banks. At a time when a significant reduction of the number of banking institutions have been observed outside the capital, Russian regions, having the certain specifics, keep the number of banks and branches relatively large and unchanged. The conclusion of our study is that regional specifics related to institutional factors (i.e. a republican status, significant share of non-Russian population, federal district center status, and diversity of active political forces) impact on the number of regional banks, multi-branch banking, and their location. We present the quantitative evaluations of how these factors impact on the number of regional banks and multi-branch Moscow banks.

Russian regional banks have gone into liquidation or replaced by branches of Moscow banks. Some regional banks remain independent but formally, in fact being the subsidiary structures of Moscow banks. We focus on what factors could (or could not) contribute to fact that non-capital regions of Russia keep their banking structure relatively unchanged. Our hypothesis is that along with pure economic factors these factors are the regional institutional factors such as a region's status in the federative structure of the country, national-ethnic characteristics, and political processes. We show that a generally accepted link between a socio-political sphere and economy could be visible on the example of Russian regions, including financial sectors.

To understand why regional banking business shrinks, we analyze the distribution of regional banks and branches in the regions outside Moscow. We will explore the dynamics of the number of institutions in banking sector in all Russian regions using data concerning the number of independent credit institutions and branches existed from 2000 to 2013 in Russia (Central Bank of Russia website¹) except Crimea and Sevastopol (due to a lack of most data) and Moscow and Moscow region (due to our interest in regional processes taken place outside Moscow). St. Petersburg and Leningrad oblast are considered together. Chechnya and Ingushetia are excluded because of a lack of data of the early the 2000s.

For our purposes, we have divided the factors, which could determine the state of a regional banking network, into two groups: economic and institutional.

- *Economic factors:* real GRP and real GDP per capita; population in a region and conglomeration of population in the largest regional city (usually, it is a capital city of the region), i.e. a share of the total regional population residing in the largest regional city; structure of the regional economy – its diversification/concentration and shares of major important sectors (such as mining, manufacturing industry, services, trade, construction, and etc.) in total regional production; availability of qualified labor (the quality and scope

¹ Central Bank of Russia. <http://www.cbr.ru>

of the higher education system in a region – we use the number of university students per 10,000 people in 1990);

- *Institutional factors:*

1. Political standing and political status of a region and its capital city. Our hypothesis is that political standing of a region could strengthen the positions of their banking institutions in the context of the increased governmental pressure on the Russian banking sector.

2. The linguistic, cultural, and national features of a region – our hypothesis is that in Russia a republican status is much more significant than national and ethnic peculiarities of the regions, which are republics.

3. Diversity factor and factor of the competitive the political forces and elites in regions – we use the ranking of democratic regions presented by the Carnegie Moscow Center in 2001-2011 (Petrov N., Titkov A. (2013))

We estimate the dependence of the number of banking institutions (banks and branches) in regions on the above factors using the panel data. In the long run the amount of population and especially GRP potentially could depend on banking sector development so there is a possibility of endogeneity problem. To test the problem we run two-stage LS method using population size, structure and size of industrial production and extraction of natural resources in 1989-1991 as instruments. The demographic, industrial and natural resource inheritance of the Soviet period is exogenous and it to the large extent determines population, size and structure of regional economy during the postsoviet years. We also control for heteroskedasticity and multicollinearity.

Our calculations show that there are more regional banks in the regions which have the republican statuses and large population of the titular nation than in others. Such regions (republics) have their local features and specific relationship with the federal government that makes them more survivable and attractive to regional banks, despite their modest economic potential.

The number of regional banks positively depends on the diversity and competitiveness of the regional political forces – such dependence could be observed up to 2009. However, since 2010 branches of Moscow banks, which had the less noticeable democracy index up to 2009 than regional ones, captured this dependence. It is likely that the replacement of regional banks by branches Moscow Bank has a political dimension. A democracy index can be regarded significant even if such factors as population, a large city, republics with dominated ethnic population, capital city of the federal district, and GRP are included in the analysis. For example, a status of the region being the republic with the dominated ethnic population makes the size of the regional banking network higher, while the low democracy index, which is characteristic of such regions, makes it lower.

In the period up to 2009 a status of the region as a center of the federal district was considered by regional banks as important. Since regional banks played a prominent role that time, the status which a region had within the federative structure impacted on its position. Later, however, the beneficiaries of such a status became branches of Moscow banks while regional banks lost such benefits.

‘The invasion’ of branches of Moscow banks into banking markets of regions (republics) with the dominated ethnic population was less noticeable up to 2009. To some extent, these regions remained a

home territory of local banks. Later, since 2010, numerous Moscow branches have been observed in other republics too. As expected, the distance from Moscow can constraint such an invasion to some extent.

Since 2010 the factor of availability of a capital of the federal district in a region started working to the benefit of Moscow branches, but not to independent regional banks. Such status seems to provide benefits to business, including banking. Our results show a high significance of this factor. Although the role of the institution of plenipotentiary of the President in federal districts could not be considered economically significant, our assumption is that public financial flows being extremely important for the Russia banking business are higher in capitals of the federal districts.

Since 2010 the number of Moscow branches has begun to depend on the diversity and competitiveness of regional political forces. This reflects the fact that local elites move their business to branches of Moscow banks. The number of Moscow branches is relatively smaller both in republics (up to 2009) and "undemocratic" regions (since 2010). The local institutional environment impacts on virtually irreversible, as is already clear now, process of the substitution of local banking institutions for outside banking networks.

Thus, we have shown that institutional factors determine where regional banks and branches of Moscow banks are located. Regional banks tend to be located in the regions which have a republican status, relatively independent regional authorities, prominent national and ethnic characteristics, its own local labor market, and potential of qualified labour. Until 2009 the number of local banks positively depended on availability of a federal district center and diversity of political forces in these regions. Since 2010, the latter two factors affect the number of branches of Moscow banks as the role of regional banks keeps decreasing. The current structure of regional banks indicates the increasing concentration of power in Moscow. Currently a republican status and local features do not impede the expansion of Moscow banks too as it happened earlier.

Despite the fact that the replacement of regional banks by Moscow banking networks is almost an accomplished fact, further evolution of the regional banking structure raises many questions. To what extent is the disappearance of the regional banks, which are most often small, inevitable and economically expedient? Although the future of the Russian regional banking sector depends mostly on the ongoing policy pursued by federal authorities, we have shown that political and institutional features of regions are still significant. The differences in the banking sector of the different subunit of the Russian Federation supports our conclusion that historical, cultural and national characteristics that all together make up so-called specific regional features, are of significance. To obtain new results requires an additional search of specifications of institutional variables.