

Conditions and Capabilities of Russian Monetary Competitiveness on Adhesion to the WTO

The adhesion of Russia to the WTO gives rise to an absolutely new operating environment for Russian entities: the real sector and banks that now have to do business in a much tighter competition.

'Equal Competitive Conditions'

To keep competition 'pure' and ensure actual competitive equality, the WTO normally keeps an eye not only on direct, explicit ways to influence competitive environment and on compliance with the 'letter of the law', but also on implicit ways that affect the real, actual competitive environment. (These principles were previously defined in the scope of some approaches used by the WTO's predecessor: the General Agreement on Tariffs and Trade (GATT) and the North American Free Trade Agreement (NAFTA)).

Note:

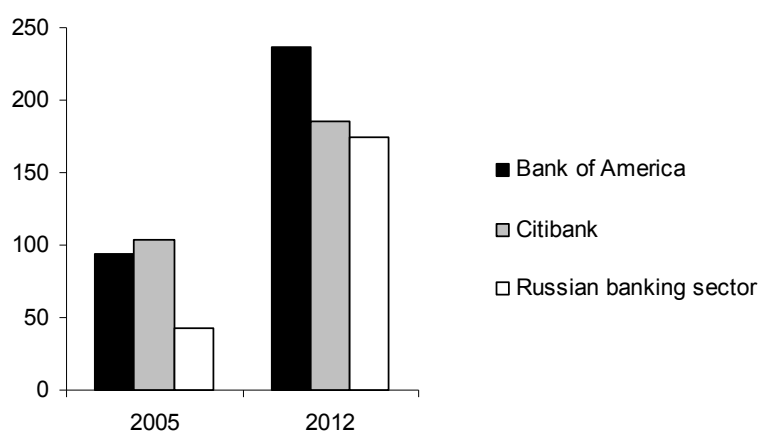
In the mid-2000s, one of large-scale trade disputes between the U.S. and the E.U. emerged. It resulted in extra duties imposed by the European Union on U.S. goods. This was caused by tax allowances granted by the U.S. to its exporters. Moreover, the support was given in a rather implicit, indirect way and actually represented hidden subsidies. Under the U.S. Export Trading Company Act, U.S. exporters could, under certain circumstances, recur to their offshore facilities allowing transfer of export revenues to the accounts of such offshore facilities to evade thereby taxation in the U.S. This put U.S. companies in a more favourable position as compared to European firms and was recognized as sufficient reason for the E.U. to take necessary compensatory measures.

To put it otherwise, not only direct, but also indirect, implicit measures of support are taken into account. In this connection, further development of integration processes within the WTO needs to capture a number of issues of both - general as well as particular, technical nature related to the maintenance of actually equal competitive conditions.

* The article reflects the personal opinion of its author.

1. E.g. how to interpret the tremendous differences between Russian and international companies and banks. Globally, Russian companies (save for rare exclusions in the commodity sector) are still insignificant: there are only 20 Russian companies in top 2,000 businesses from FORBES 2012, while only 4 Russian companies have made it to top 100. For comparison, top 2,000 comprises about 530 U.S. (31 in top 100), about 140 Chinese (8 in top 100) and about 100 German companies (7 in top 100).¹ Likewise, the same is true for the banking sector whose aggregate capital currently stands at about USD 180 bln, which is just a fraction of the capital of any single major Western bank (Fig. 1).

Fig. 1. Capital of major banks and the Russian banking system (USD bln)



Source: Built based on data of the Bank of Russia and US Fed

Once provided with broad access to the Russian market of financial and banking services, such banks will obviously be able to have access to their parent bank's funds and its international banking infrastructure. Russian banks have no comparable capabilities.

It is clear that access to necessary financial resources is a pre-requisite for market players (real sector businesses and banks) to carry out their economic functions and maintain their positions in the market.

In general, financial resource availability of the Russian economy and banks is also lower than in countries-competitors: the share of banking assets in GDP is about 80% for Russia, while in most major economies (Germany, Japan, euro area countries) this assets to GDP ratio is 200% to 300% (Table 1).

¹forbes.com/global2000

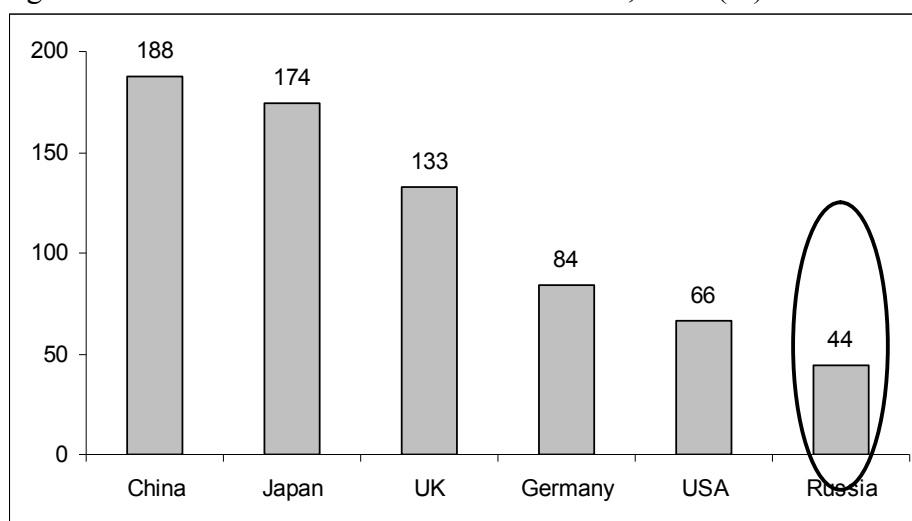
Table 1**Banking assets to national GDP, 2012, %**

| | Russia | Germany | Japan | Euro area |
|------------|--------|---------|-------|-----------|
| Assets/GDP | 79 | 313 | 177 | 253 |

Sources: Bank of Russia, Bank of Japan, IMF, Deutsche Bundesbank, Eurostat, ECB

Similarly, the monetization level of the Russian economy is also among the lowest (Fig. 2).

Fig. 2. M2 to GDP ratio in a number of countries, 2012 (%)



Source: Bank of England, Bank of Japan, US Fed, Bundesbank, National Bureau of Statistics of China, Bank of Russia

2. How to interpret the fact that the terms for Russian banks to maintain their day-to-day operations are clearly tighter than for most their potential and existing competitors? For example, reserve requirements in Russia are currently 4.25%, while in most other countries reserve requirements are either insignificant (1% in the ECB), or zero (Australia, Canada, Denmark, Mexico, New Zealand, Norway, Sweden, U.K. and Hong Kong).²

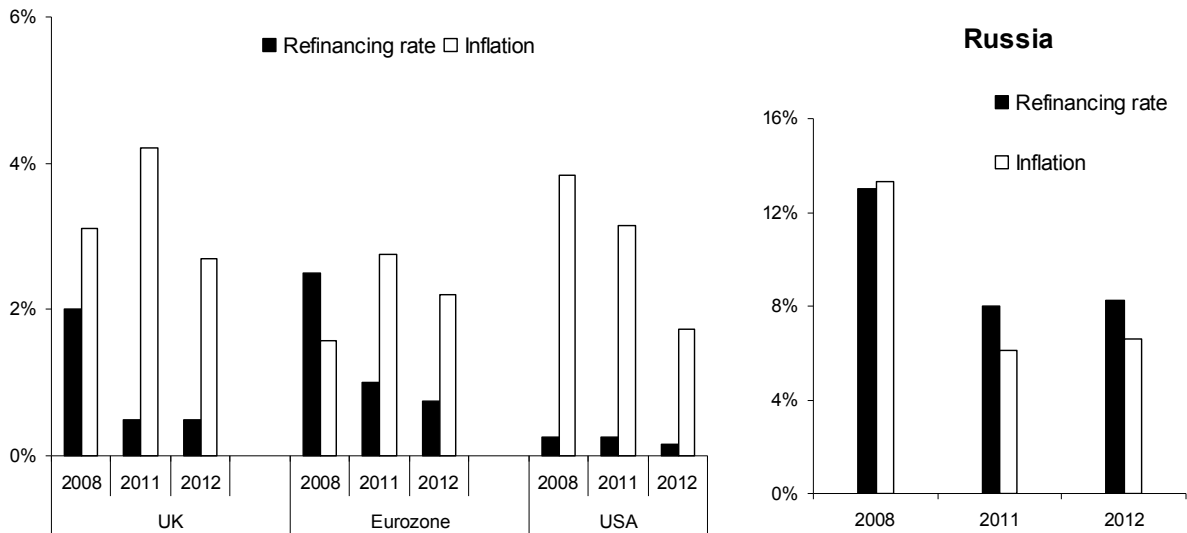
Moreover, in a number of countries banks may use money from reserve accounts with the central bank. In some cases, interest accrue on reserves placed with central banks (e.g. in the U.S. and in Europe). Such terms make cash mobilization for foreign banks operating in the Russian market even easier. Russian banks have no such capabilities.

3. It is noteworthy that regulators in other countries are taking unprecedented crisis management measures that have never been used before. Not only have they arranged and keep on providing large-

² IMF, 2010

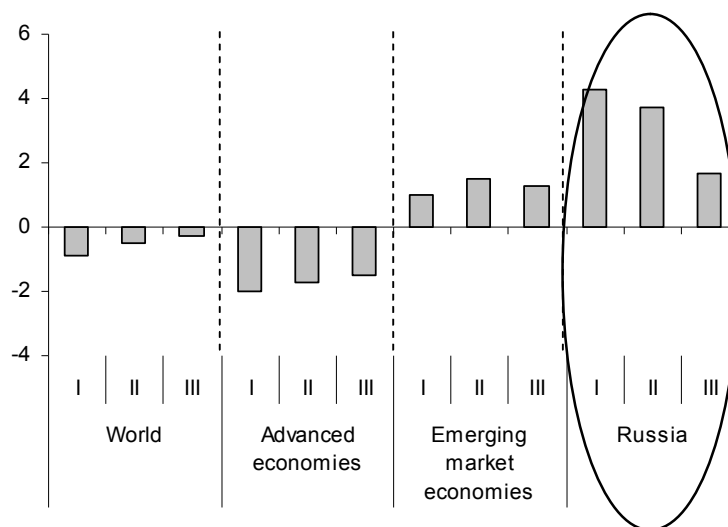
scale liquidity injection in their economies, but they also often keep their funding costs below the inflation level to make such funding more available³ (Fig. 3 and 4).

Fig. 3 Refinancing rate and inflation in some countries, %



Source: Bank of England, Bank of Japan, ECB, US Fed, Bank of Russia

Fig. 4 Real refinancing rates (by group of countries) in 2012, %



Source: BIS, June 2012, Bank of Russia

Similar approaches (from standpoint of making resources cheaper) were used in the U.S. before. E.g. in the 1960s – early 2000, the U.S applied below-market rates when using adjustment credit, one of their refinancing tools. Subject to compliance with certain conditions, where necessary, market players had access to cheaper-than-market resources (moreover, this measure was applied

³ As such, the ‘liquidity trap’ becomes more and more widespread, while demand boosting for economy recovery becomes a priority.

both - in prosperous years as well as during high inflation periods). In 2002, the country abandoned such approaches for a number of reasons. It is noteworthy, however, that the world's strongest banking and financial system had access to such important support tools for almost 40 years! This has, naturally, contributed to the strengthening of the country's financial system.

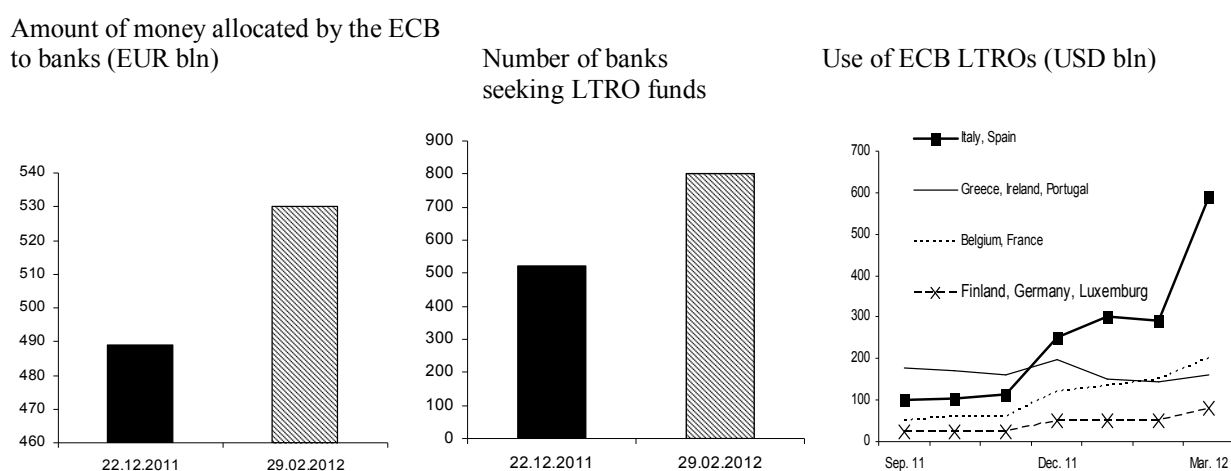
Moreover, the U.S. Fed has for the first time in history announced, **in advance** and **for several years ahead**, the level of federal funds rate: until mid-2015, the rates will stay flat between 0 and 0.25% (their actual level is currently about 0.15%), which surely makes the situation more predictable and facilitates doing business.

Russia applies the strictest approaches even if compared to developing countries. Indeed, in Russia the refinancing rate plays rather a fiscal than monetary role. But even in Russia the refinancing rate serves as a benchmark for other rates and the market on the whole (otherwise why would we need to change it on a regular basis? Surely not just for fiscal adjustments?!). As such, a milder monetary policy could help Russia be more efficient in overcoming crisis consequences while bolstering growth.

Global large-scale long money creation

To maintain stability and improve predictability of day-to-day operations of its banks, the European Central Bank launched a long-term (3-year) refinancing operations (LTRO) programme,⁴ under which 2 auctions along attracted more than 1,200 participants who raised more than EUR 1 trillion (Fig. 5).

Fig. 5 Euro area: ECB long-term refinancing operations (LTRO)



Source: ECB, BIS, June 2012

⁴ Long-term refinancing operations

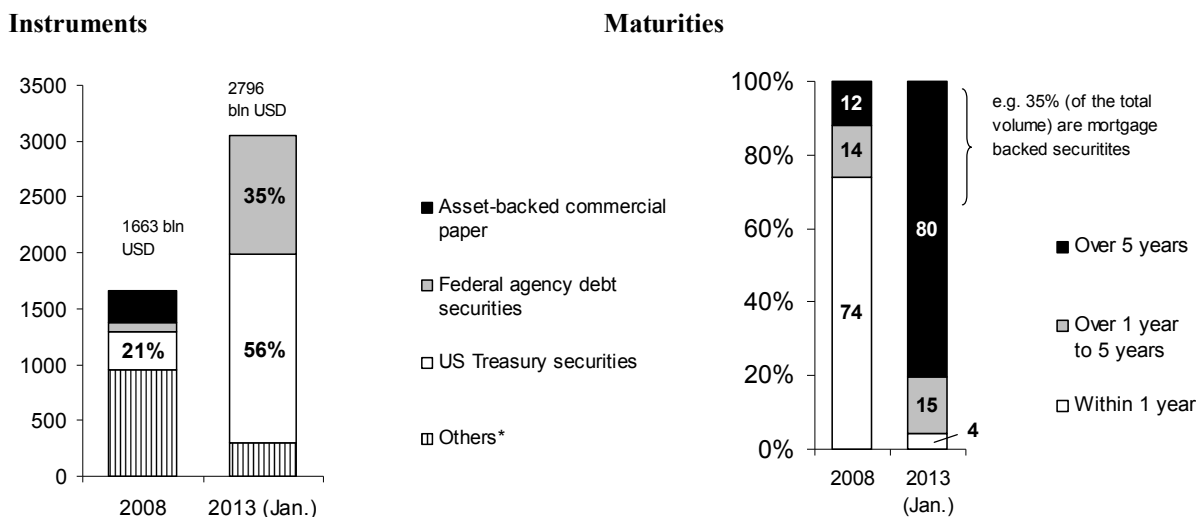
We would also note the differences in the ‘ideology’ of approaches used in the euro area and in Russia: the same amount of liquidity that was derived by the Russian economy from crude exports over 10 years (!) was raised in the euro area by running two rounds of pure money creation within several months (that, by the way, were not accompanied by depletion of a non-renewable resource base).

The creation of long money in developed economies is even more affected by the *mondustral policy* that became most pronounced during and after the crisis and implies implementation of monetary approaches in conjunction with industrial priorities: its sectoral and corporate elements.⁵

It is clear that long-term resources lay basis for economic development. In major economies, budgetary tools play an important role in the creation of the monetary base in general and particularly in its long components.

Central banks of all developed countries without exception continued creating long financial resources and on the whole expanded the long money supply in their economies (see Fig. 6 and 8 to 10). For instance, in early 2012, the US announced an approach that provided for an increase in the already high share of long treasury bonds in the Fed balance sheet. As a result, more than 90% of the total amount of USD injected into the economy was created by the Fed purchases of long treasury bonds (up to 30 years).⁶

Fig. 6 USD monetary base (USD bln, %)



Source: US Fed, calculated based on data of US Fed.

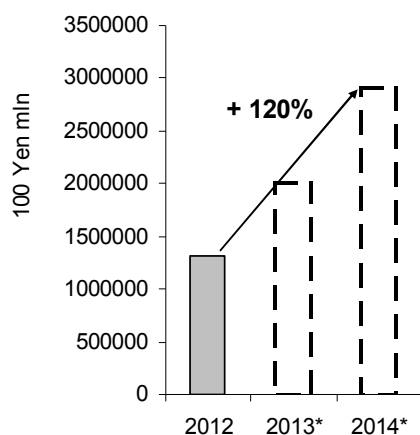
⁵ www.investopedia.com

⁶ For more details see: Ershov. ‘Global Financial Crisis. What’s Next?’ - M.: Ekonomika. 2011.

The policy run by the Bank of Japan is no less aggressive. According to its former Governor M. Shirakawa, the Bank will continue ‘its policy commitment on the duration of powerful monetary easing including the virtually zero interest rate policy’⁷ and will increase its asset purchase, which will include not only Japanese treasury securities, but also risky private instruments (corporate bonds, etc), which is extremely unusual for a central bank.⁸

The new management of the Bank has been even more radical in applying the above approaches. For instance, the new Governor of the Bank of Japan H. Kuroda estimates that the coming two years will see the current level of JPY monetary base double and the share of long-term instruments (up to 40 years) in the Bank’s portfolio will increase (Fig. 7).

Fig. 7. JPY monetary base (JPY 100 mln)

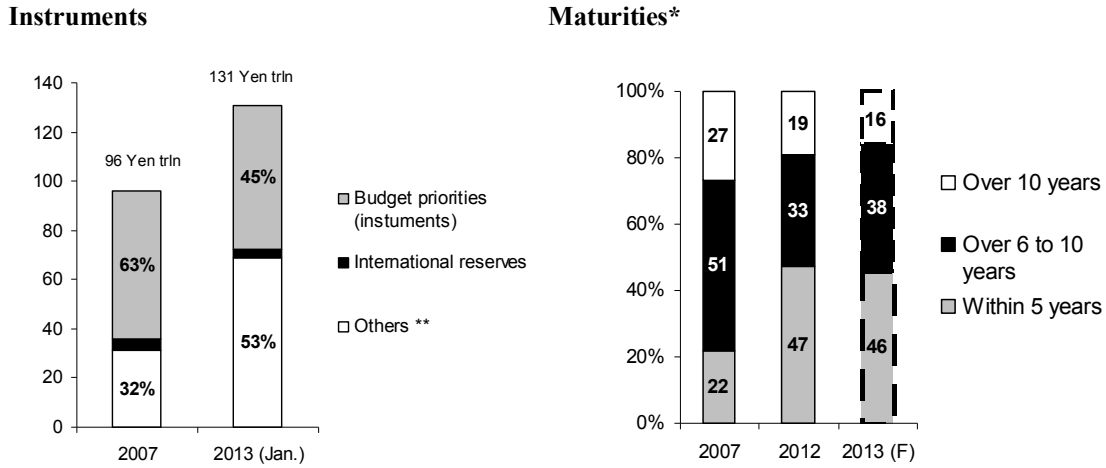


* Forecast. Built based on the Japanese Government bond purchase programme of 4 April 2013
Source: Bank of Japan

⁷ Shirakawa M. // The Japan National Press Club. Tokyo, Feb. 17, 2012.

⁸ Idem

Fig. 8 JPY monetary base (JPY trln, %)



* Government bonds (account for 65% of the monetary base).

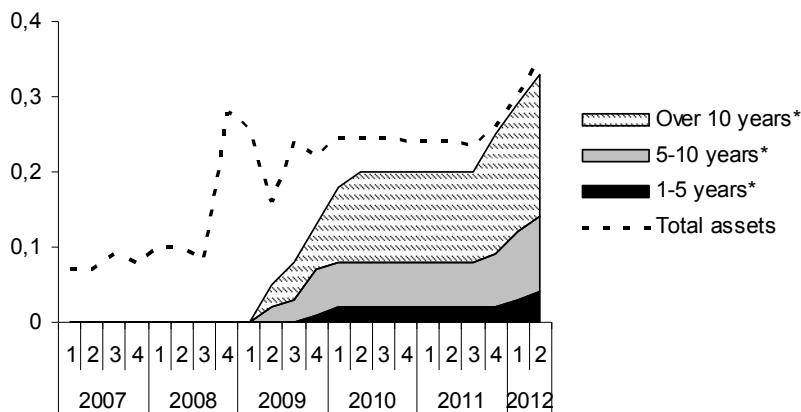
** Other include, *inter alia*, asset-backed financing (with such assets as bonds, commercial papers, etc.).

Source: Bank of Japan.

We would note that if monetary authorities actually extend a 40-year loan to its market players, then this money will multiply to spread over the rest of the economy (gradually reducing its maturity from 40 to 0 years), which in turn will give rise to a robust multi-tier layer of long resources. Instruments purchased by the central bank normally are not involved in the reverse transaction that assumes the sale of instruments in the market and sterilization of the money injected into the economy. Treasury securities purchased by the Central Bank are typically put in its balance sheet until they mature (i.e. for all 10-15, 20 years). In other words, the economy gets access to long and targeted investment resources. Moreover, once such instruments mature, a new money creation round is launched and new instruments are purchased, which, if necessary, makes the process of maintaining long resources in the economy actually endless.

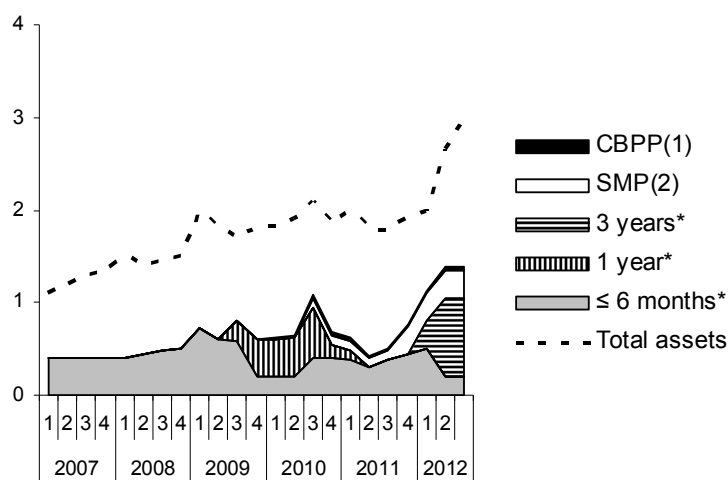
Other central banks (Bank of England, European Central Bank) are similarly relying on the creation of long money resources (Fig. 9 to 10).

Fig. 9 GBP monetary base (GBP trln)



* Gilts (government securities) holdings of the Asset Purchase Facility.
 Source: BIS, June 2012

Fig. 10 EUR monetary base (EUR trln)



(1) Covered bonds held under the Covered Bond Purchase Programme CBPP1 and CBPP2.

(2) Securities held under the Securities Markets Programme.

* REPO.

Note. Assets on the ECB's balance sheet also include gold, claims to Euro Area non-residents in foreign currencies, claims to Euro Area residents in Euro, claims to Euro Area non-residents in Euro etc.

Source: BIS, June 2012

The above approaches show a higher 'degree of freedom' that major global economies are making for themselves. In this situation, they do not face the dilemma that is thought to emerge in the Russian economy where potential capabilities for economic growth are only created by privatizing the public sector thereby diminishing its role. As shown above, the U.S. and other developed economies have no such barriers at all and where the problems arise they are resolved by increasing the public budget deficit.

The involvement of the central bank in the above mechanisms allows financing budget targets without reducing the overall liquidity of the financial market. If government securities were simply placed in the secondary market, then, subject to interest by relevant market players for such securities, they would be purchased by private companies and banks, and as such, money invested by them would be used to finance the above government programmes. In such case, the money could not be spent for other purposes in day-to-day commercial operations (lending and so on). This phenomenon is known in the economic science as the *crowding out effect*.

As a result, monetary authorities (the central bank - the ministry of finance) increasingly often build a strong layer of "targeted" long money in line with the priorities of their economic policy (mortgage, small-size enterprises, regional programmes, etc.). Eventually, other sources of long

money (pension, insurance, etc.) are added to set up a robust financial environment that substantially expands the range of investment opportunities.

Let us consider several questions given that the issue of long money has been extremely important for the Russian economy for a long time. Consider international markets where financial resources are indeed larger, cheaper and longer and where such money is, actually, created through the above mechanisms: are they the only opportunity to raise large amounts of affordable long money (which is necessary to tackle long-term challenges faced by the Russian economy). We would also highlight that by raising this money the country is also piling up its public debt.

Or perhaps we can do it the other way round? That is, start using such mechanisms involving national monetary authorities similarly to the approaches that have been applied by the strongest and most mature financial systems of the world for many years.

In discussing this matter, we would prefer hearing a detailed technical (but not abstractly emotional, with “we-will-fail” type arguments) analysis of actual opportunities offered by this process, of existing risks (that will certainly be numerous) and of the ways to minimize them. There will surely be malfunctions and breakdowns, but is it a reason to say that the mechanisms are inoperable in general? Breakdowns (and often serious ones) do occur in all countries, but such countries have in place supervisory and regulatory authorities to prevent them. It’s like road traffic – everyone can violate the rules. But does it mean that the rules must be abolished because of such violations and that the traffic in general must be terminated? The answer is obvious.

Once more about competitive risks

After the accession of Russia to the WTO, the Russian financial system now should support both its own competitiveness and appropriate funding of other economic sectors, this time against much tighter competition. We have shown above how insistently and on what scale regulators of major nations support their economies. If approaches of Russian regulators are inappropriate, and business environment (including funding opportunities, availability of necessary long money, its cost, etc.) becomes tighter, this will actually mean that each Russian company will find itself in less favourable conditions as compared to its foreign competitors. Compare to boxing: formally, the rules are the same for everybody, but you will never see a heavyweight fighting against a light-weight sportsman. Moreover, given the differences in regulation and

training opportunities, a light-weight sportsman would wear heavier shoes that limit his mobility. As such, the environment for maintaining actually equal competitive conditions and mechanisms for levelling such conditions are of paramount importance.

Even more important is that, due to essential differences in regulation, Russian market players will actually have to compete against the economic *systems* of developed nations rather than against individual foreign companies. For such foreign companies will be able to fully rely on the entire strength of their economies and on large-scale business support mechanisms, while support of Russian business by Russian regulators is more modest. The outcome of such competition is obvious.

There exist multiple measures provided by the WTO to even up competitive conditions: ‘countervailing measures’, various kinds of accessible, benevolent deviations and the criterion of maintaining market stability, etc.

It seems, however, that the most important thing is to run an adequate economic policy that would offer the real sector business opportunities comparable to those available in competing countries.

Russian regulators did manage to mitigate the crisis impact in the recent years and their steps mostly matched steps taken in other countries. But the post-crisis stabilization seems to have been achieved through strict limitations that often fail to bolster the required economic growth and diversification that are necessary to strengthen long-term competitive positions of Russia in the world. For the departure of the economy from its raw material and export profile, the country needs to build a systemic, long-term and effective environment for development of non-commodity sectors and companies. In the new competitive context, regulators must fundamentally modify their approaches that would provide Russian players and the entire economy with a actually equal competitive conditions that would match the new geo-economical conditions.

It is evident that in such conditions a robust industry and banks building the economic foundation of the country and an active economic policy of the government are even more important for sustainable long-term development of Russia in the new competitive environment emerging after the accession of Russia to the WTO.