

Financialization and authoritarian state: the case of Russia

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Abstract

Using Russia as an example, the paper argues that financialization takes on certain forms as a global trend in an emerging country with authoritarian-like state characteristics. The authoritarian state can use some development of financial and information technologies in accordance with its logic and goals, adopting and enhancing some financial practices and innovations from the experience of developed countries while rejecting, distorting or slowing down others. As a result, the country, on the one hand, is witnessing the development of the financial sector and the financial activity of households and non-financial enterprises, financial relations and innovations. On the other hand, some aspects of financialization in such a country look different than ones in developed countries or turn into opposite ones. Thus, in developed countries, financialization is typically associated with neoliberalism in economic policy, "regulated deregulation" as more market-oriented regulation, privatization, competitive development of financial markets and instruments that facilitate access to financing various private players. In Russia, one can observe opposite trends, despite some signs of deepening financialization (digitalization, increasing financial inclusion). In the paper, we illustrate these theses mainly by the evolution of the Russian banking sector in the last two decades.

1. Introduction and literature review

In developing economies, the phenomenon of financialization may have specific features while it is extremely important for their development. Financialization, broadly defined as "increasing role of financial motives, financial markets, financial actors and financial institutions" (Epstein, 2005) is largely predetermined by the local specifics, institutions and historical backgrounds of the countries and may be of unique nature that differs from financialization in developed countries (Rethel, 2011, Ashman et al., 2013, Sawyer, 2013, Bonizzi, 2013, Karwowski et al., 2017, Karwowski and Stockhammer, 2017, Karwowski, 2020). Financialization can have different strength in various economic sectors of one country and manifest in different ways, and in this regard, differences between countries are also significant (Karwowski et al., 2017).

The role of the state in financialization attracts the natural attention of researchers (Wang, 2020, Jain and Gabor, 2020, Karwowski, 2019, Mikuš, 2019a). In this regard, the ambiguity of the phenomenon is emphasized (Bonizzi, 2013). Financialization can distort the motives of government and performance of its core functions (Karwowski, 2019).

The so-called "digital financialization" as a merger of the digital and financial sectors is a relatively new phenomenon that can completely change the financial system of the countries and the role of state in financialization. This is a new and underdeveloped field for research (Jain and Gabor, 2020, Mader et al. 2020).

In emerging countries, financialization, while proceeding under the influence of external global trends, is closely linked to internal political and economic processes and involved in social and political goals of the state. On the one hand, there is an important role of government initiatives and interventions, but on the other, neoliberal and market-oriented changes can occur in some aspects (Bonizzi, 2013). This combination of neoliberal reforms in some areas and constant state intervention in other ones is closely linked with the interests of the countries' elites and their rent seeking. However, in general, financialization may contribute to a certain departure from crony and state capitalism, which is often inherent to emerging countries towards a greater market orientation, as described in Rethel (2011) for Malaysia. There is an interesting paper on financialization and its consequences in the context of a poorly diversified resource oriented economy with the dominance of large and state corporations in highly concentrated and monopolized economy as in South Africa (Ashman et al., 2013). These features resemble the case of Russia.

We analyze the interaction of financialization with a state that has signs of authoritarianism. Authoritarianism means the rule of authoritarian political norms, state and/or oligarchic control over key political institutions and elements of national economy. The degree of authoritarianism may be characterized by a share in national economy that is under control of state, ruling elite or authoritarian leader.

In an authoritarian state, an extensive state or quasi-state sector usually coexists with the market economy and is using market mechanisms for the benefits of authoritarian elites. The same thing happens in the financial sector in the process of financialization and development of new financial technologies. The new financial technologies and instruments in their nature are market-oriented and becoming available to wide categories of users. Numerous companies are engaged in fintech development in the world, mainly outside the perimeter of the public sector. The authoritarian state is tempted to extend its monopoly rules and institutional norms to this new sector and use it for the benefit of limited ruling elite. Financial development is encouraged in some aspects, while in others it is slowed down. Although there is an adoption of technologies and some institutions from outside, financialization as a whole takes country-specific forms.

In this paper, we explain these theses using the example of the Russian financial sector, at which core is the banking system. This fact predetermines the focus of the article. Therefore, we consider the financialization in Russia mainly via analysis of the banking sector that fully reflects the current state of affairs in the country's financial sphere as we are arguing later. Here we do not consider the country's involvement in the international financial flows but concentrate exclusively on the dynamic, internal aspects of financialization with almost no cross-country comparisons.

The literature on financialization in emerging countries with authoritarian political regimes is quite limited and just emerging. For example, the works on the case of Turkey show that the financialization in such country is quite specific and deeply interconnected with political processes and state involvement (Yilmaz, 2020, Yeşilbağ, 2019). The key features are macroeconomic stabilization, inflation targeting, liberalized capital account. The state-led financialization took place largely through the domestic and international banking sector and the expansion of credit to households

as a financial inclusion mechanism. At the same time, mortgage market and its securitization remain underdeveloped. As we will argue later this partly resembles the case of Russia.

The emerging literature on the case of China illustrates well the specific path of financialization in this authoritarian state. While China's financial system is dominated by a few large state-owned banks, recently emerging non-bank credit intermediation and digital financial services also have experiencing explosive growth. The state exerts control over, actively manages and shapes financialization with the crucial role of state-owned securities exchanges. These stock exchanges facilitate the authorities' ability to control markets and direct their outcomes towards state policies. Financialization is used to facilitate social stability, to reform and improve management of state-owned enterprises and state assets, to increase the capability for monitoring and supervision of digital financial activities (Wang, 2015, Petry, 2020, Gruin and Knaack, 2020). Financialization is thereby decoupled from a neoliberal policy paradigm, and rather than a break with China's authoritarian capitalism, the stock exchanges and fintech facilitate state control within and through financialization. While the Russian case resembles the Chinese one in many aspects, here we do not explore Russian securities market, stock exchange and non-bank financial institutions in details and how the state conducts its interests through them, leaving this extremely interesting topic for future research. Here we point how similar goals Russian authorities are trying to achieve via banking sector.

There is not much research devoted to financialization in post-socialist countries while the post-socialist context constitutes a unique terrain for frontier research on financialization (Sokol, 2017). In this regard, the topic is underexplored (Karwowski and Stockhammer, 2017). However, there is some recently emerging literature.

Thus, in recent studies on eleven East-Central Europe post-socialist countries Mikuš (2019a, 2019b) explores state financialization as increasingly growing financial practices, modes of operation and motives in performing state functions, that is manifested in monetary, fiscal and investment policies, public services provision and regulation. The analysis corroborated a likely presence of peripheral financialization in these economies in particular on the basis of more deficit-prone financial account, high FX trading volumes, inflation-targeting monetary policy, mainly upwards real exchange rate dynamics, increasing international reserves, fast pace of growth of sovereign debts, financialization of pension systems, etc. It is obvious that when comparing with these countries Russia has some features of such peripheral financialization but not others, due political regime and commodity exporter status. But here we do not elaborate this issue due to limited size of the paper and the focus on the internal financialization processes.

In the studies of Bobek (2019, 2020) on household's financialization in East-Central Europe post-socialist countries the author claims that these economies are quickly catching up with developed countries in terms of household's indebtedness and involvement with different financial products and institutions, including pension funds and mortgage markets. In Russia, there are similar processes in general but the development of private pension funds and housing lending remains problematic, as we will argue later.

In the paper of Pataccini (2020), financialization of three post-soviet Baltic States was explored through the dynamic of their banking sector and penetration of foreign banks. In Russia, the banking sector also lies at the heart of the financialization while the processes within the sector are quite different.

There are studies on real estate financialization in post-socialist, characterized as semi-periphery, economies (Büdenbender, 2017, Büdenbender and Aalbers, 2019). These studies consider the nexus between subordinate position of these countries in the global financialization process and their local specifics and post-socialist legacies. As far as Russia is concerned, Büdenbender (2017) finds that "Russia has experienced very little and discontinuous financialization of its real estate markets in the past three decades. Here, real estate-financial relations are defined by strong involvement of domestic capital and state actors..." (p. VII) in relative isolation from the dynamics of global financial markets. The role of political regime is crucial in the process. We totally agree with these theses and here in this paper investigate internal, domestic aspects of the financialization process in Russia more deeply and not only in the context of real estate.

2. Financialization in Russia: what statistical data say

The development of Russia's financial sector over the past three decades are predetermined by the state evolution. At the same time, Russia as a developing country is included in the global process of financialization. The financial system of Russia is developing in the course of complex interaction with global processes in the world's financial sector. Available official statistics, mainly from websites of Central Bank of Russia (CBR) and Rosstat (the country's main statistical agency), allow us to assess the pace and scale of the process.

2.1. Size of the financial sector

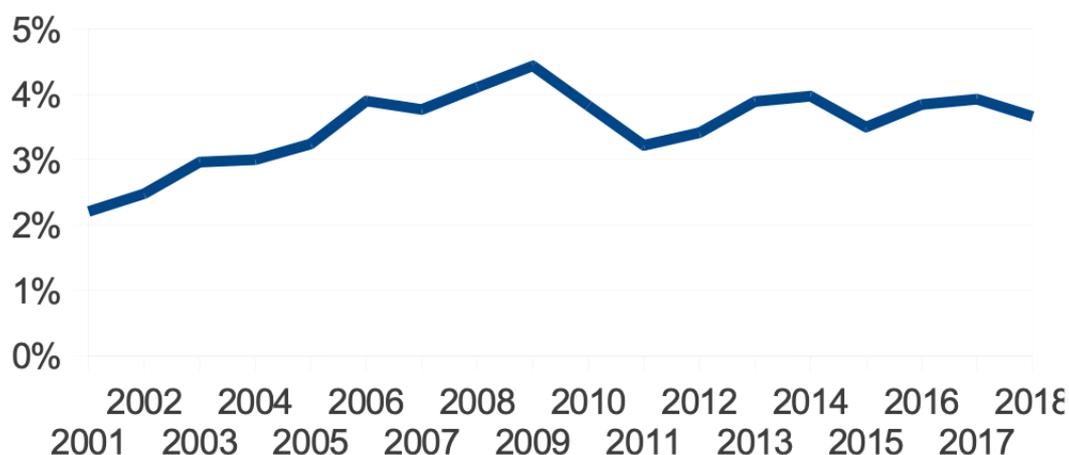
According to CBR's estimates, assets of all financial institutions in the country are constantly increasing in absolute and relative terms and in 2019 reached 105.6% of GDP (CBR, 2020). There are assets of banks, insurance companies, investment funds, private pension funds, stock exchanges, management companies and clearing organizations, microfinance organizations, trust portfolios and household investments in stocks and bonds.

The financial sector in usual meaning was absent during the Soviet period of Russian history, only afterwards it began to take shape. The financialization of the Russian economy is reflected in growth until 2009, and then by a slight decrease and stabilization of the share of value added of financial sector in GDP at about 3.5% (Figure 1)¹. On the one hand, this is a normal level for a country that does not specialize in finance. On the other hand, the structure and efficiency of the sector are more important and will be discussed below.

¹ <https://www.gks.ru/folder/210/document/12994>

2.2. Banking orientation of the financial sector

Financialization in Russia proceeds within the framework of well-pronounced bank-



oriented type of financial sector. Here we do not agree with the work (Karwowski and Stockhammer, 2017), where the authors classify Russia as a country with a medium-high level of market orientation of the financial system. For justification it is necessary to consider the situation in more depth than simple cross-country comparisons allow.

Figure 1 - Share of the financial sector in GDP, 2000-2018, in %.

Source: Rosstat website <https://rosstat.gov.ru/>, 17.08.2020

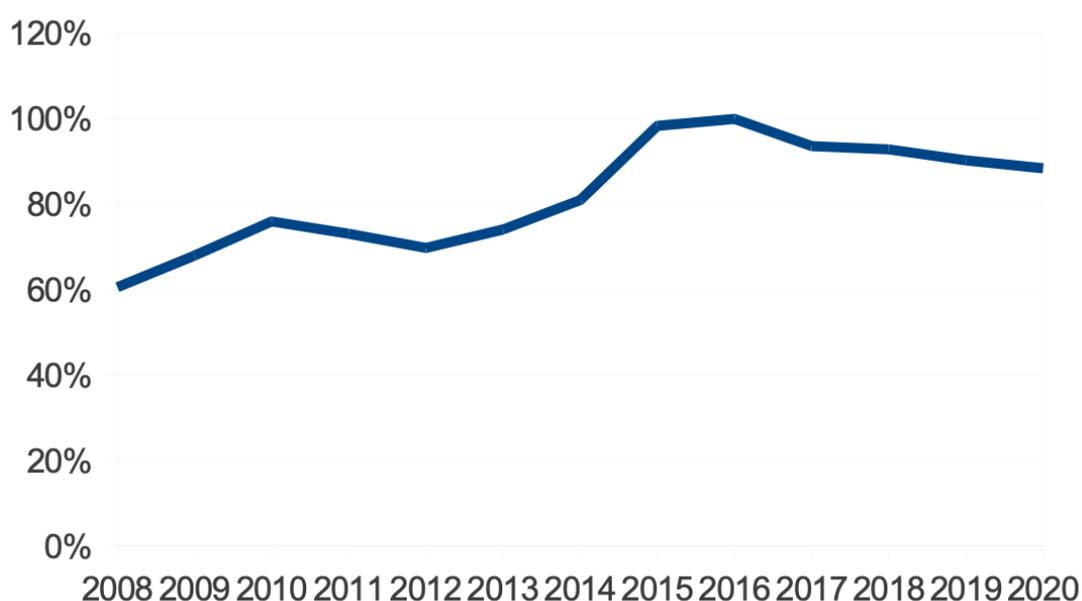
The data show that the country's financial markets are characterized by predominance of banks' intermediation with the obvious lack of development of non-banking sectors - securities market, insurance, leasing services, etc. This refers to both the bond and the equity markets. Collective investment institutions such as investment funds and non-state pension funds are poorly developed. The institutional structure of the financial system reflects this asymmetry.

The banking sector is a backbone of Russian financial sector and its assets amounted 86% and 84% of the assets of the financial sector in 2018 and 2019, respectively (CBR, 2020). Accordingly, about 80% of the assets of the financial system are formed through bank deposits of households and organizations. At the same time, there are no preconditions for any weakening in the role of banks in the financial sector. In addition, in Russia, banks essentially dominate in sectors adjacent to banking services. Other financial intermediaries exist in close linkage with banks. Insurance and management companies, investment funds are often associated with banking groups. Banks can carry out brokerage and sales of insurance, brokerage and trust services occur through banks' sales networks. Banks arrange issuance and offering of their customers' bonds and their own bonds, etc. It will be discussed below. So, Russian banks are reorienting toward functions of other financial institutions and

getting closer to the stock market. This fact is one of the characteristics of financialization (Rethel, 2011, Bonizzi, 2013, Sawyer, 2013).

Figure 2 presents the graph of the ratio of banks' assets to GDP. Some fluctuations in the ratio are related to the effect of currency revaluation due to volatility of the ruble exchange rates. But the general slowdown in the growth of banks' assets is in line with global trends (Simanovsky et al., 2018).

Figure 2 - The ratio of the banking sector assets to GDP, in %.



Source: CBR website <http://cbr.ru/>, 17.08.2020

The banking orientation of the financial sector can be demonstrated by the structure of debts of the non-financial enterprises using data from CBR website² which is available since 2013 (table 1). Debts of non-financial corporations consist mainly of bank loans (about 60%). Dynamics of their external debt substantially depends on the ruble exchange rates. The securities market is also developing, so that since 2013 the share of securities in the borrowings of non-financial enterprises has doubled from 6% to 12%.

Although financialization is often associated with a shift toward market orientation of financial systems and development of the stock market (Rethel, 2011, Bonizzi, 2013, Sawyer, 2013), the bank-oriented financial sector is also possible and compatible with financialization process, as shown in Karwowski et al. (2017).

Table 1 - Debt structure of the non-financial enterprises

Beginning of the year	2013	2014	2015	2016	2017	2018	2019	2020

² http://www.cbr.ru/statistics/macro_itm/dkfs/

Debt of the non-financial enterprises	100 %	100%	100%	100%	100%	100%	100%	100%
Bank loans	63%	61%	58%	56%	58%	58%	57%	59%
Debt securities	6%	6%	5%	6%	9%	11%	11%	12%
Loans from non-residents	31%	34%	37%	38%	33%	31%	32%	29%

Source: CBR website <http://cbr.ru/>, 17.08.2020

2.3. Increasing indebtedness of firms and households

The process of financialization shows up in increasing involvement of firms and households in usage of financial services. Based on available statistics³ since 2001 it can be shown by an increase in debt level of the non-financial enterprises and households (see Figure 3). Over the past twenty years, there is a general increase in level of bank debt of non-financial enterprises, which is only interrupted by some fluctuations associated with a currency revaluation due to jumps in ruble exchange rate in crisis periods. The size of the external debt (to non-residents) while expressed in rubles mainly depends on the dynamics of the ruble exchange rate. Data on debt securities of non-financial enterprises is available since 2013, so we can see a gradual increase in the importance of this method of financing. This is an important sign of financialization.

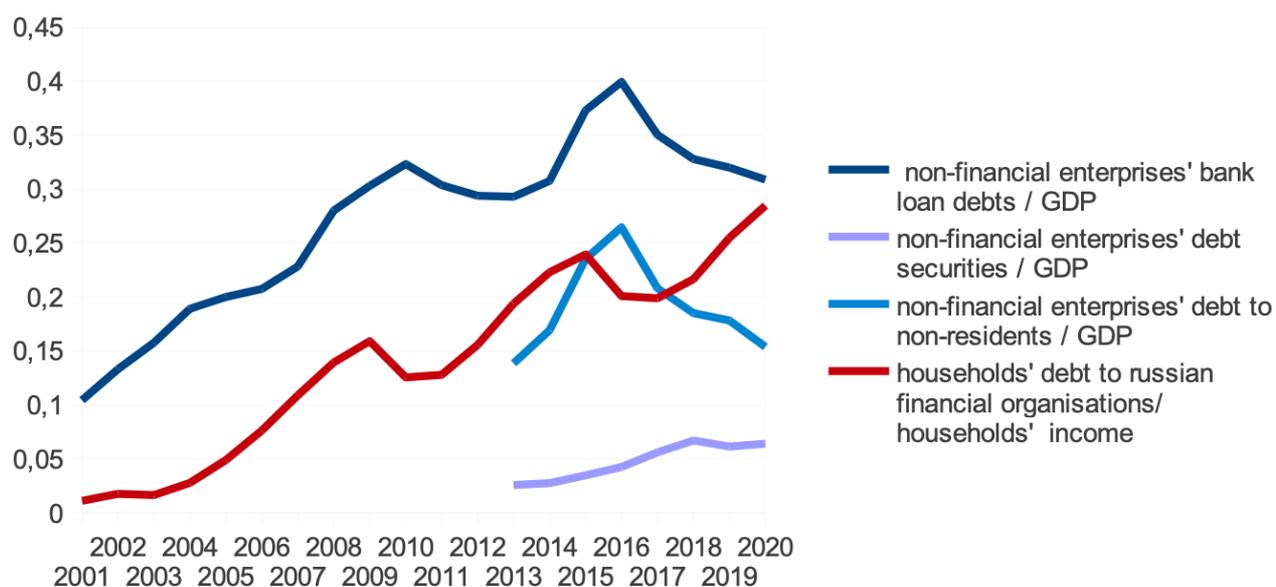
In these years households' debt in relation to their incomes hugely increased that was interrupted only by two crisis periods (Figure 3). The increase in household debt is a strong sign of financialization (Rethel, 2011, Bonizzi, 2013, Karwowski and Stockhammer, 2017). In Russia, we see only a trend in this direction. Data from 2013 (for earlier periods data are absent) say that household debt consists of loans from Russian financial institutions for 95-98% and remaining 2-5% are external borrowings.

The share of households' loans in the banking sector assets is also increasing, but it is still about two times lower than the share of loans to non-financial enterprises (about 13% and 40% at the beginning of 2016 and 18% and 35% at the beginning of 2020)⁴.

Figure 3 - Financialization of non-financial enterprises and households in Russia: the ratio non-financial enterprises' debt to GDP and households' debt to income

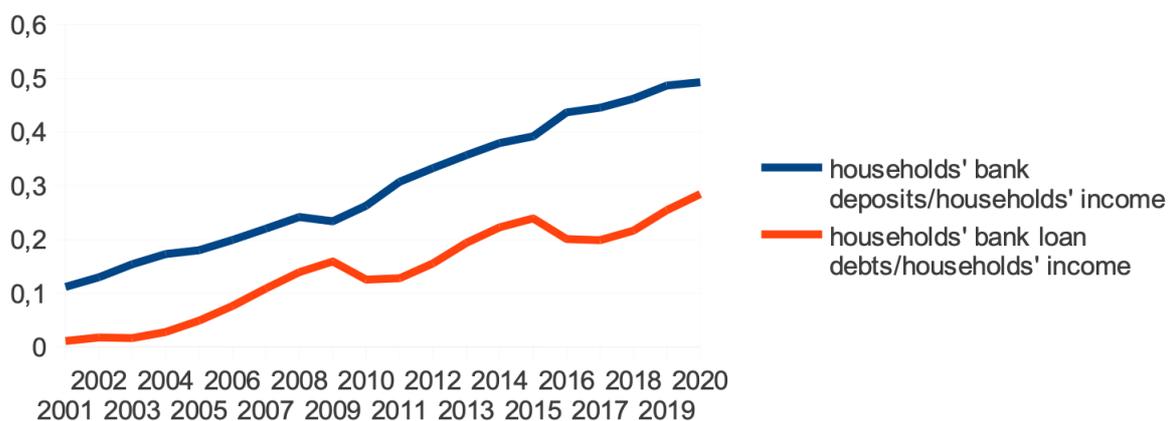
³ https://www.cbr.ru/banking_sector/statistics/; <https://www.gks.ru/folder/210/document/12994>

⁴ https://www.cbr.ru/statistics/bank_sector/review/



Source: CBR website <http://cbr.ru/>, 17.08.2020

Figure 4 - The ratio of households' bank deposits and households' bank loan debts to households' income.



Source: CBR website <http://cbr.ru/>, 17.08.2020

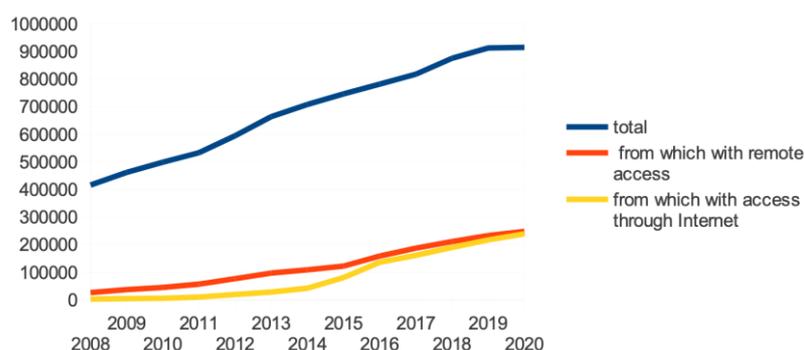
The financialization of households can be shown by the fact that the size of households' deposits in banks is also constantly growing (Figure 4). Now Russian households still prefer bank deposits rather than loans. So there is not debt-led demand because interest rates on loans in Russia are quite high, even when inflation is taking into account. At the same time, however, and in comparison with developed countries these figures of financialization still look modest, especially households' debts⁵.

⁵ <https://stats.bis.org/statx/toc/CRE.html>

2.4. Increasing financial inclusion

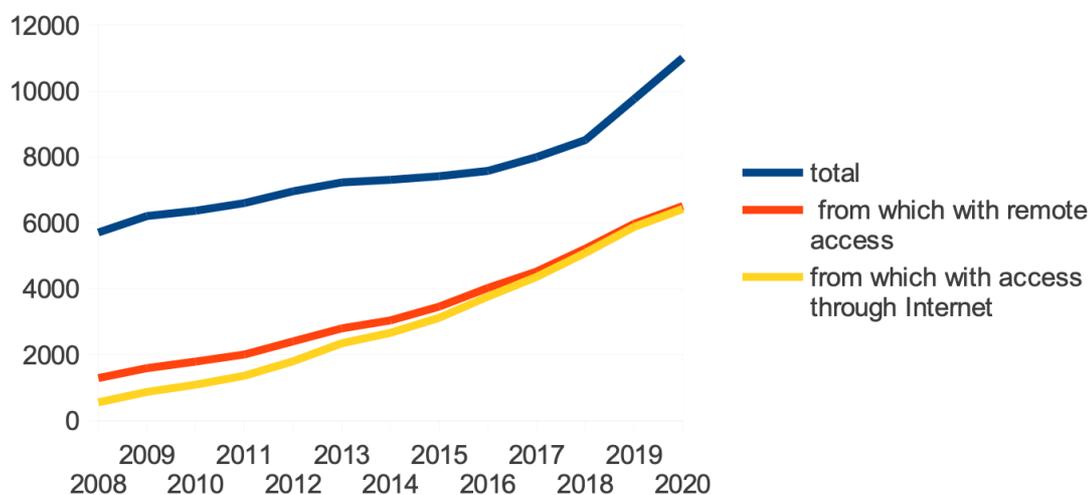
The increase of households' involvement in financial activity can be seen through a twofold increase in the number of ruble bank accounts since 2008, with an almost ten times increase in the number of active accounts with remote access and almost hundred times increase in the number of bank accounts with access through Internet (Figure 5)⁶. A similar picture can be observed in the number of bank accounts of firms and organizations (without banks) (Figure 6).

Figure 5 - The number of households' bank accounts, in thousands.



Source: CBR website
<http://cbr.ru/>,
 17.08.2020

Figure 6 - The number of bank accounts of firms and institutions, in thousands.



Source: CBR website <http://cbr.ru/>, 17.08.2020

Financialization is expressed in increasing financial accessibility and increasing households' involvement in usage of not only banking services but also other financial instruments. While banking financial products are the priority for Russian households, CBR conducts special surveys of Russian households and calculates various indicators showing a significant increase in the use of other financial

⁶ <http://www.cbr.ru/statistics/nps/psrf/>

services in recent years⁷. For example, according to these surveys' results, in the period from 2014 to 2019, the proportion of adults using at least one bank loan increased from 18 to 34%, loan in another financial institution (microfinance organization, credit cooperative, pawnshop) - from 5 to 8%. The share of population using voluntary insurance increased from 6% in 2014 to 23% in 2019.

In recent years, there is growing households' interest in investing in securities. According to CBR⁸, the number of individuals using brokerage services in financial institutions is growing rapidly - from 1.2 million people in early 2017 to 4.3 million people at the end of 2019.

The numbers of depository services and trust management clients are also growing. CBR considers that the main factors of this massive influx of private investors into securities market is the improvement of online services and mobile applications of financial institutions that provide these services, and the emergence of new financial products. Also it makes it possible for the mass investors to receive greater profitability compared to bank deposits because of low interest rates on them in recent years.

Some efforts to stimulate and popularize investment in securities were made by the state. Thus since 2015 individual investment accounts (IIS) were introduced for individuals. IIS is a broker account or trust management account in financial organizations (banks or non-credit financial organizations) for which tax benefits are provided but also there are some restrictions. At the beginning of 2019, IIS accounts accounted for 25% of all brokerage accounts, at the end of this year - already 32%. At the beginning of 2019, only 0.5% of the adult population had such account, at the end of 2019 - already over 1%⁹.

The increasing experience of households in trading stocks demonstrate the people's willingness to participate more actively in the stock market. In the domestic stock market, the money of private investors largely replaced the outflow of foreign portfolio investments due to sanctions and geopolitical problems. Nevertheless, the amount of households' funds invested in stocks and bonds, although growing, is still quite small (at the end of 2019 it was about 4.5% of the financial sector assets while about 80% are bank deposits).

The CBR declares that it pays attention to the growth of accessibility of financial services, mainly through the growth of remote accessibility. Regular households' surveys about availability of financial services of banks and other financial institutions are carried out. The results are published on the CBR website¹⁰. For example, according to the surveys, the proportion of adults with remote access to bank accounts increased from 24% in 2015 to 55% in 2018¹¹. To develop the remote accessibility of financial services CBR focuses on expanding of online services and new financial technologies. So, the quick payment system (a service that allows individuals to transfer instantly money by mobile phone number between accounts at different banks) and the marketplace of financial services (a system of remote retail distribution

⁷ <http://www.cbr.ru/develop/statistics/>

⁸ https://www.cbr.ru/securities_market/statistic/

⁹ https://www.cbr.ru/securities_market/statistic/

¹⁰ <http://www.cbr.ru/develop/statistics/>

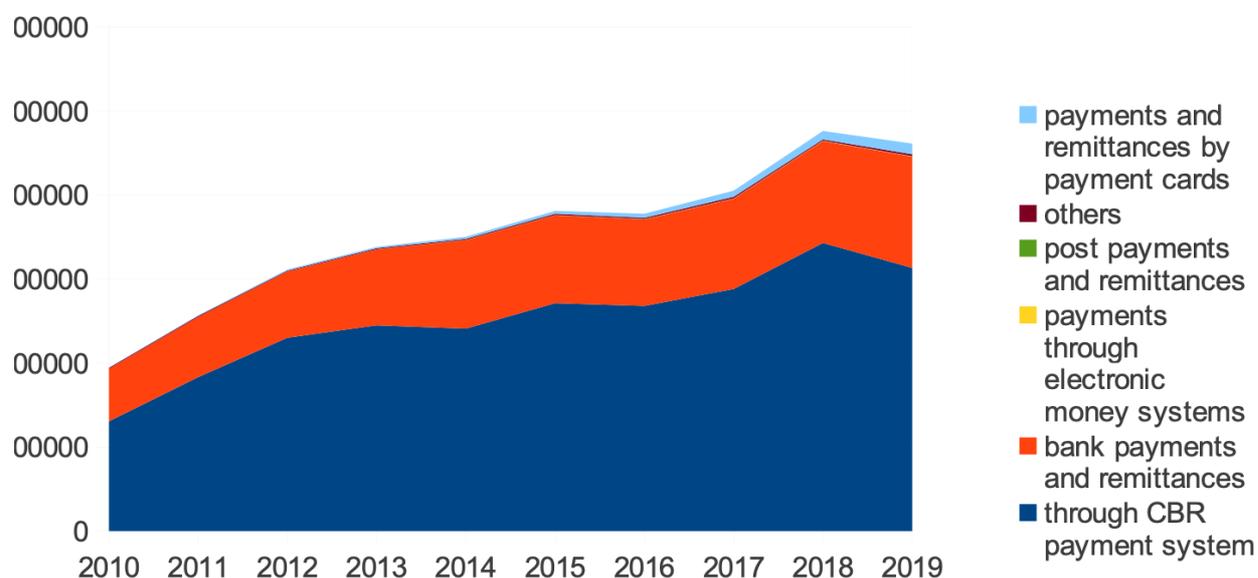
¹¹ http://www.cbr.ru/develop/development_affor/

of financial products and services) are two CBR projects, currently at the stage of preliminary testing. In the future, they are called upon to contribute to further substantial increase in financial accessibility and inclusion in Russia.

2.5. Increasing non-cash payments

An important aspect of financialization is the development of payment systems and non-cash payments. In recent years, the development of payment systems and electronic money systems proceeded rapidly. The payments with payment cards experienced explosive growth (Figures 7 and 8)¹². When we compare the dynamics of non-cash remittances and card payments in rubles and in number of transactions one can see that these methods of payment have become really widespread and popular in people's daily lives. The number of payment cards more than doubled in ten years, and now it is approximately twice as high as the country's population. The number of devices for them has grown five times (table 2). At the same time, the relative number and size of cash withdrawal operations using payment cards decreased, giving way to non-cash payments. The remittances and payments through federal postal service absolutely decreased, being an outdated way of remittances.

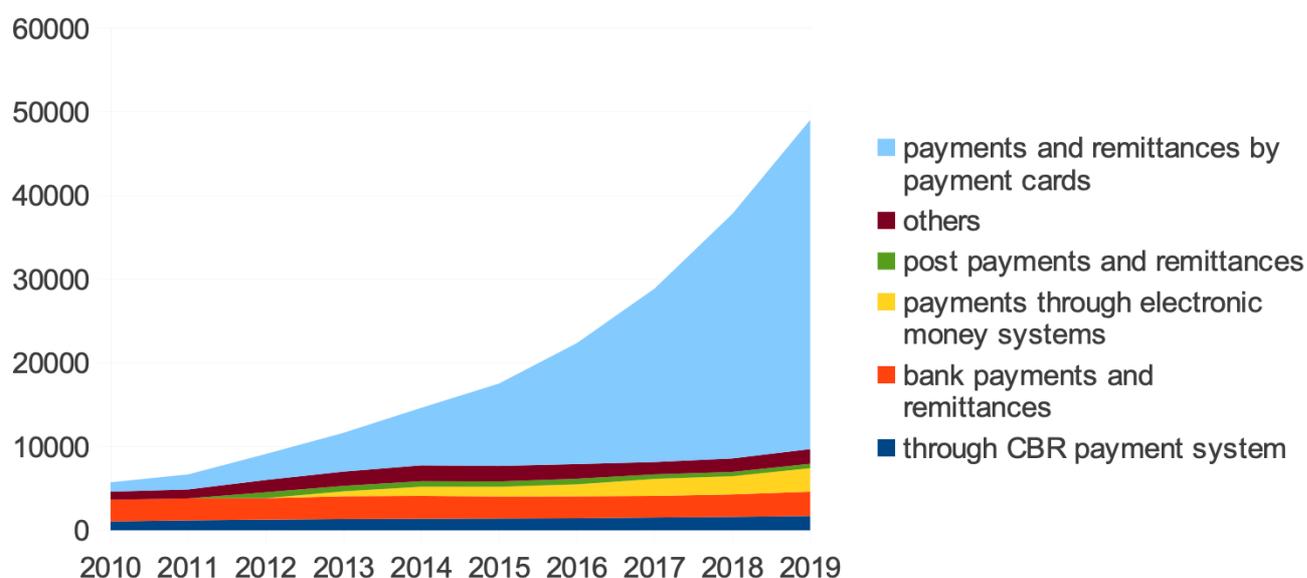
Figure 7 - Non-cash payments and remittances, in billions of rubles.



Source: CBR website website <http://cbr.ru/>, 17.08.2020

¹² <http://www.cbr.ru/statistics/nps/psrf/>

Figure 8 - Non-cash payments and remittances, in millions of transactions.



Source: CBR website <http://cbr.ru/>, 17.08.2020

Table 2 - The number of payment cards and devices.

end of the year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
the number of payment cards, in millions	137.8	162.9	191.5	217.5	227.7	243.9	254.8	271.7	272.6	285.8
the number of devices (ATMs, etc.), in thousands	682	837	1047	1329	1701	1878	2176	2585	3020	3397

Source: CBR website <http://cbr.ru/>, 17.08.2020

The decreasing role of cash is also evident in the fall in share of cash in the money supply M2 from 37% in 2000 to 18% at the beginning of 2020¹³. The financial system developments is also indicated by the fact that monetization level (the ratio of M2 to GDP) for the period 1999–2019 increased threefold up to 47.3%, although this is a much lower level than in developed countries (Russian economy in 2019).

¹³ <http://www.cbr.ru/statistics/ms/>

3. Financialization and formation of "financial vertical" in the authoritarian state

In this part of the paper it is shown that although financialization is going in Russia, it proceeds under the specific conditions of "financial vertical" formation (the term is taken from Khmel'nitskaya, 2014). That means increasing nationalization and concentration, decreasing level of competition in the financial sector, dominant role of the state and state financial institutions.

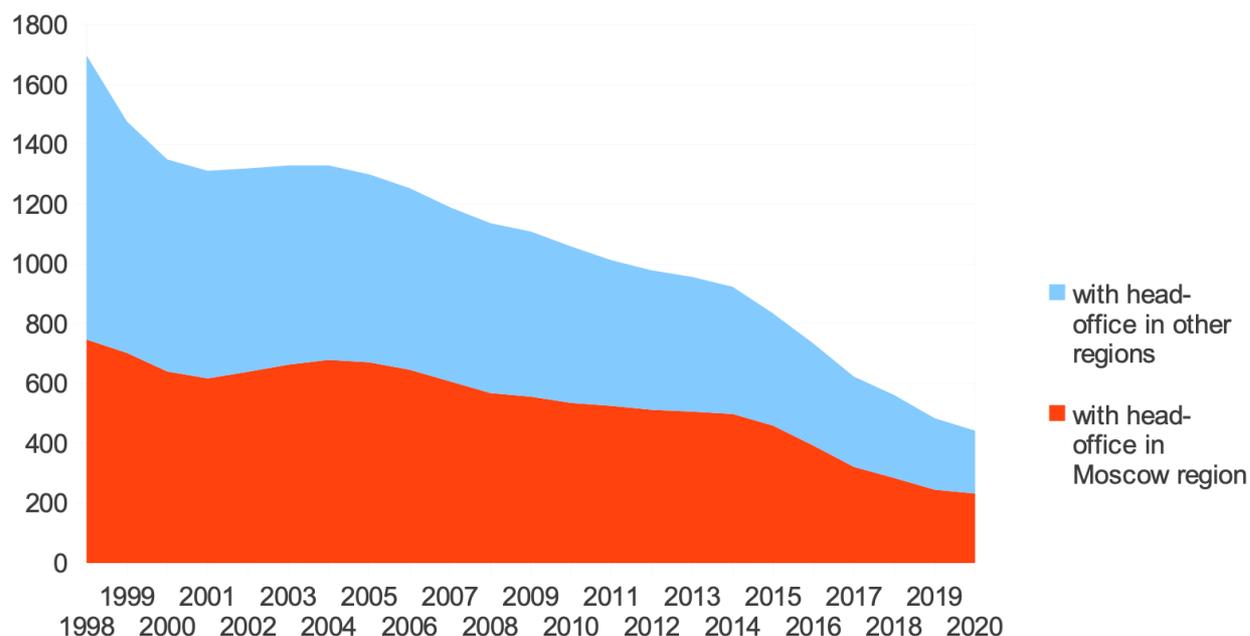
The formation of the "financial vertical" is expressed in three interdependent processes (or, rather, in the three aspect of the same process). There are:

- concentration - an increase in market share and importance of the largest banks vs. medium and small banks;
- geographical centralization - an increase in market share and importance of Moscow banks vs. regional banks;
- nationalization - an increase in market share and importance of state-controlled banks and other financial institutions vs. private banks and banks with foreign capital.

3.1. Concentration

Concentration is primarily manifested in the intensive reduction in the number of banks and other financial institutions. Figure 9 shows the dynamics of number of banks in Russia that have head offices in Moscow region or other regions. Thus, the figure shows both the increasing concentration of the banking sector and the geographic centralization (more on this below).

Figure 9 - The number of banks in Russia.



Source: CBR website <http://cbr.ru/>, 17.08.2020

The fall in the number of banks leads to increasing market share and influence of the largest banks that is reflected in various indicators calculated by CBR. Figure 10 shows the constantly increasing share of the largest five banks in the banking system assets.

The share of the 30 largest banks in various indicators of the banking system's activity — assets, loans, deposits, etc. — is constantly growing and regularly calculated by CBR¹⁴. By 2020, the share of the 30 largest banks reached 85-95% of the banking sector according to various indicators. The Herfindahl-Hirschman index for the bank assets, calculated by CBR for 2007-2017, is also constantly growing - from 0.08 to 0.11 over these years (Simanovsky et al., 2018).

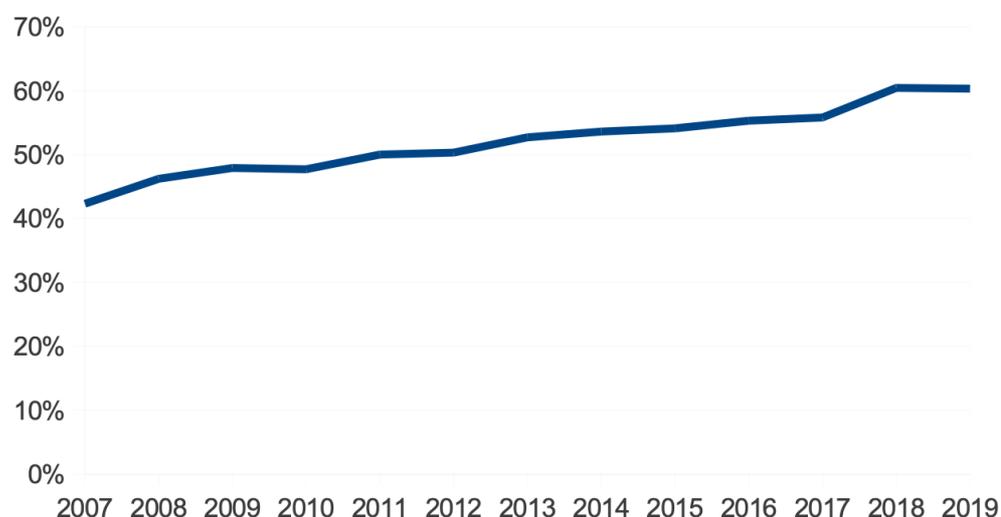
The size and activity of the largest Russian bank, which is state-controlled, Sberbank, is particularly impressive. Currently, about half of the banking offices in the country are Sberbank offices. Other available data also quite eloquently characterize the super-monopoly position of this state bank. Its share in the banking system assets is increasing and approaching 30%¹⁵ (Figure 11). Historically Sberbank used to be the main bank that services households. Since 2012, its huge role in attracting household deposits has ceased to decline, reaching 45-47%. Its share in lending to households is constantly growing, reaching 40% by 2017¹⁶. Sberbank's share in other segments of the banking service market tends to rise (Simanovsky et al., 2018).

Figure 10 - Top-5 banks in Russian banking system: share in the banking sector assets, in %

¹⁴ http://www.cbr.ru/statistics/bank_sector/sors/

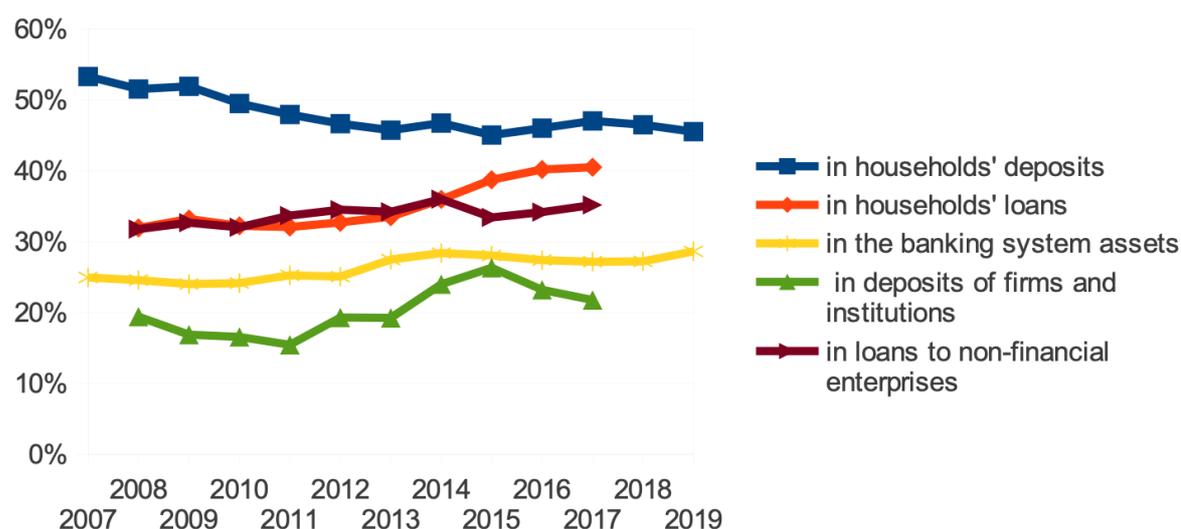
¹⁵ https://www.cbr.ru/banking_sector/credit/coinfo/?id=350000004

¹⁶ <https://www.gks.ru/folder/210/document/12994>



Source: CBR website <http://cbr.ru/>, 17.08.2020

Figure 11 - Shares of Sberbank in Russian banking system, in %



Source: CBR website <http://cbr.ru/>, 17.08.2020, Simanovsky et al. (2018).

The share of Sberbank in payment cards emission and payments and remittances by payment cards is also huge (about 65% and up to 94% in 2018). In this aspect one can talk about total monopoly of Sberbank (CBR, 2019). The introduction of new technologies and their network effects only strengthens the advantage of Sberbank and other large banks and creates opportunities for them to extract additional income.

On the one hand, the growing concentration and reduction in the number of banks in Russia is in line with similar processes taking place in the banking sector worldwide. On the other hand, it is the result of the CBR's "cleaning policy", which has been revitalized since the second half of 2013. This policy receives mixed opinions

from experts, and many of them note it is justified due to poor condition of many unscrupulous and even criminal banks whose licenses were revoked. CBR states that it is needed to cleanse the sector of non-viable banks and that such policy ultimately increases efficiency of the banking system and its stability. An obvious consideration is also that the fewer banks in the system the easier it is to regulate them and the supervision by the monetary authorities is more effective.

Although the concentration process is typical for the financial sector throughout the world, there is concern that in Russia this course leads to the weakening of medium and small banks and moreover - to actual elimination of private banks to the benefit of state-owned banks, and of regional banks to the benefit of the ones in the capital city.

According to the CBR's idea, the special reform of banking licensing carried out in 2018 was aimed to slow down these processes. The reform eased the administrative regulatory and supervisory burden for small banks while simultaneously restricting some of their functions. In the second half of 2018, the transition of small banks to the simplified "basic" license began (up to 149 banks at the end of 2018). However, the share of banks with the "basic" license in the sector is extremely small (less than 1% for many indicators (CBR, 2019)). The total number of banks with the "basic" license, including regional, private and small, continues to decline and so far, this reform has not reversed this trend.

The situation is aggravated by the fact that the majority of the leading Russian banks organize their business in the form of financial groups. The center of such group is an open joint stock company with a banking license. Such a bank has network of subsidiaries in all sectors of the financial system. This phenomenon is increasing. According to CBR, at the end of 2018, there were 86 banking groups, which represented 89% of the banking sector assets (CBR, 2019). In addition, there are informal groups of banks and other financial institutions that are not connected by mutual participation in capital, but have the same owners (Dubinin, 2017). Some banking groups are part of larger holdings with non-bank centers. Given such banking groups and holdings, the concentration in the sector is even higher.

Thus, although CBR declares that increasing competition in the financial markets is its priority (CBR, 2019) in fact the processes are going in the opposite direction. In this regard, obvious concerns are caused by the growing monopolization of the sector, the dominance of Sberbank and several other large banks and banking groups. As a result there are often discussed the high cost of banking services in the country that are low inflation-adjusted deposit interest rates, high loan interest rates and various fees.

Various researchers, including CBR staff, analyzed the level of competition in the Russian banking sector using methods developed in the literature and official reporting statistics provided by Russian banks to CBR (Fungáčová et al., 2010, Anzoátegui et al., 2010, 2012, Anisimova and Vernikov, 2011, Mamonov, 2010, 2012, 2015, 2016, Ushakova and Kruglova, 2018, Simanovsky et al., 2018, CBR, 2019). The authors of these researches have mainly concluded that there is a sufficient competition level in the sector as a whole, comparable to the situation in other countries. Although this level may be different in different segments of the banking services market. Concentration indicators mainly correspond to average standards of other countries and moving in accordance with global trends. Some of them argue that

in recent years there has been no decrease in the level of competition while the increase in the concentration is accompanied by an increase in the sector's efficiency due to liquidation of troubled banks. They state that stability and sustainability of the sector are growing, and its overall "sanitation" is being observed. The financial accessibility and inclusion for firms and households do not worsen (Ushakova and Kruglova, 2018, Simanovsky et al., 2018).

However, here it is necessary to pay attention to the next aspect of the "financial vertical" formation - to the geographical centralization of the financial sector in such a geographically huge country as Russia.

3.2. Geographical centralization

Figure 9 shows that the reduction in the number of regional banks is on average more intensive than the number of Moscow ones. The share of Moscow banks in the total number Russian banks since 2004 exceeds 50% and tends to increase. The assets of Moscow banks account for about 90% of the banking system assets¹⁷. The crowding out of regional banks by branches of Moscow banking networks proceeded under the influence of political and institutional factors, as shown in Ageeva and Mishura (2017a, c). As a result, now in 14 out of 82 Russian regions there are already no regional banks, and in the vast majority of Russian regions, there are very few of them. Currently, on average, in Russian regions except Moscow about 85% of firms' and households' deposits are collected by Moscow banks and only 15% by local regional banks. About 95% of loans to regional borrowers are also provided by Moscow banks¹⁸. They are mainly Sberbank and some of the largest banks mainly also state-controlled. This dominance of Moscow banks has intensified over time (Ageeva and Mishura, 2017b).

Geographical centralization of the banking sector is due to the general centralization of the Russian economy, when the head offices of large companies, actually operating throughout the country, are concentrated in the capital. It provides huge inflows of financial resources to Moscow banks, which then partially returned to other regions via lending to regional borrowers through Moscow banking networks. Such geographically centralized banking system makes regional borrowers vulnerable, especially small and medium-sized businesses, and especially in times of crisis (Ageeva and Mishura, 2019 a, b).

Furthermore, the conclusions about sufficient level of competition in the sector do not take into account this growing level of geographic centralization and geographic segmentation of the Russian economy. Currently, two-thirds of the country's banks have at least one office in the capital city, and more than half of them have their head offices there. At the same time now in other Russian regions there are much fewer banks having offices or servicing regional clients in other ways. In some regions there are very few of them. The differences between Russian regions are significant, both geographically and by the amount of banks and by the main socio-economic conditions. Therefore, it is impossible to consider the country as a single integrated

¹⁷ http://www.cbr.ru/statistics/bank_sector/review/

¹⁸ http://www.cbr.ru/statistics/bank_sector/sors/

market. It is wrong to assume that there is uniform level of banking competition in Russian regions (Anisimova and Vernikov, 2011, Anzoátegui et al., 2012).

Therefore, although for the banking system as a whole the competition level may look acceptable, in fact it is true only for the Moscow region. The banking sector of other regions is much more monopolized despite the development of remote access technologies. This is exactly what some of the available statistics indicate. It is difficult to measure competition in the Russian regional markets and to analyze the regional banking sector because in the process of centralization of banking supervision and reporting (that took place in 2017-2018) data in the "bank-region" format became practically unavailable for researchers. However, there are some exceptions.

For example, in the paper by Mishura et al. (2020) using freely available data on housing lending of Russian banks in Russian regions in 2015-2019, it was shown that in all regions and years, except Moscow in 2015, this market was highly concentrated ($HHI > 0.18$).

In some regions, the number of banks that are issuing mortgage loans to regional households is extremely small (minimum is 6, average across all regions is 35), the maximum share of the first five banks in the market is 99% (average across all regions is 89%). The maximum share of Sberbank is 89% (average is 60%). The HHI index reached 0.8 in some regions (average is 0.4). Moreover, this situation does not tend to improve. In the country as a whole in 2019, the four banks that were most active in the mortgage market accounted for over 80% of the total mortgage portfolio and all these banks were state-owned¹⁹. In this paper, the authors show that the high level of concentration in the regional housing loan markets negatively affects the dynamics of housing lending that means that the level of competition is insufficient. At the same time, the amount of mortgage lending and available housing are also clearly insufficient while mortgage rates are very high compared to other countries (Khmelnitskaya, 2014, 2015). Thus, the ratio of mortgage debt to GDP barely reached 6% by 2019 while in emerging economies, it is in the range of 10-30% of GDP and in some advanced economies, it can reach 50-80% of GDP²⁰.

This example shows that Russia has developed a highly monopolized state-led model of housing finance, or, at least, with the leading role of the state. This model has significant limitations, above of all, insufficient diversity and competition. As a result, it produces an insufficient amount of mortgages at high interest rates, despite the high demand for such loans and low amount and poor quality of housing in the country.

The history and logic of this model is described in Khmelnitskaya (2014, 2015). In general, the housing finance system is a very critical aspect of financialization (Rethel, 2011, Bonizzi, 2013, Aalbers, 2016b, Bobek, 2019). In this aspect, state can play a huge and multifunctional role while both historical context and political motives are important (Yeşilbağ, 2019). Originally, in Russia, the experience of the US in the field of state support for housing lending was borrowed. From the mid-2000s, it was

¹⁹ <http://www.cbr.ru/statistics/pdko/f316/>

²⁰ Доклад для общественных консультаций Банка России "Меры Банка России по обеспечению сбалансированного развития ипотечного кредитования", 12/2019, https://www.cbr.ru/Content/Document/File/94935/Consultation_Paper_191217.pdf

adapted in line with the strengthening of centralization and state influence in the finance sector. At the same time, alternative and more competitive approaches to housing finance (such as savings building societies and decentralized securitization via covered bonds issued by various banks) are blocked. That is because they do not fit into the “financial vertical” with leading role of the state banks and the special state agency (ДОМ.РФ) in the relevant financial flows. As a result, the Russian mortgage market remains dominated by state actors and is isolated from dynamics of the world's financial markets (Büdenbender, 2017).

Of course, the formation of the "financial vertical", that is, the state control over financial flows through the dominance of the largest state banks and other state financial institutions can be seen not only in the housing lending sector. However, there is less information on the other banking service markets to assess the level of concentration and competition, especially in the context of the country's different regions. However, there is much reason to believe that the situation is quite similar.

Thus, the example of housing lending market vividly illustrates the most important aspect of the state "financial vertical". It is the growing nationalization of the banking and financial sector of Russia.

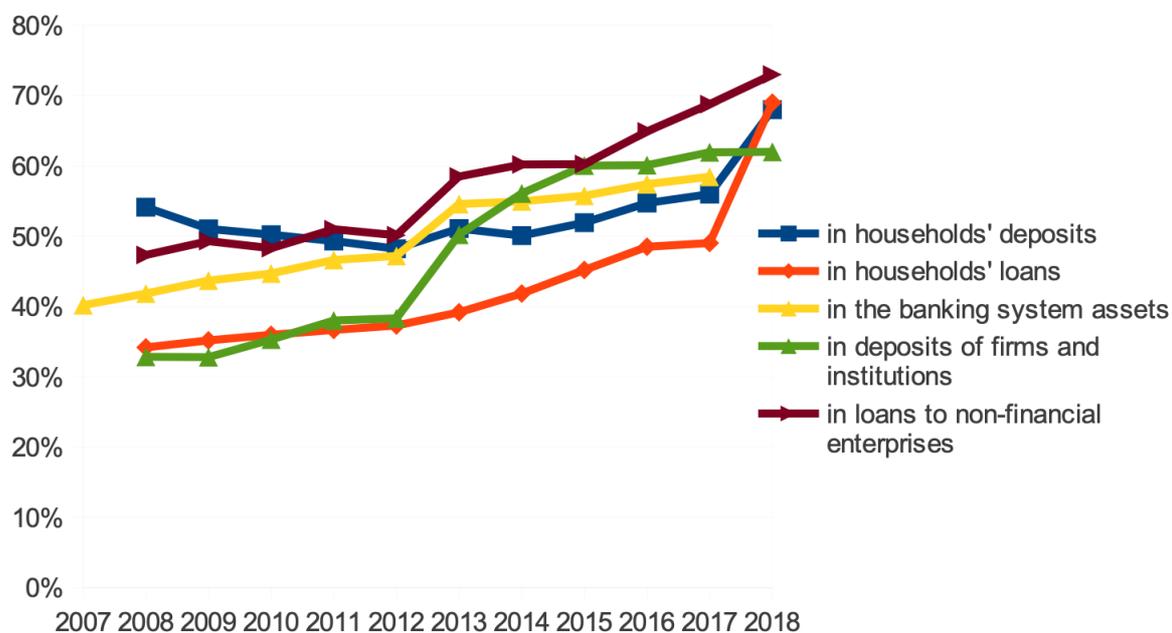
3.3. Nationalization

The role of state-controlled banks is addressed in the report of researchers from CBR examining the development of Russian banking sector in 2008-2017 (Simanovsky et al., 2018). Figure 12 is based on the data from this report and other CBR publications (CBR, 2019). In these publications the state-controlled banks include those "in respect of which the Russian Federation and the Bank of Russia exercise direct and indirect control", without specifying this concept. The data on them are not quite precise, since CBR retroactively changed the composition of this category of banks. However, the overall picture can be seen. According to CBR estimates the vast majority of banks in Russia are private, and the share of banks that can be classified as state-controlled in the total number of banks is small - 1.6% at the beginning of 2009 and 3.7% at the beginning of 2019. However, in 2007 their share in the banking system assets amounted to 40%, in 2017 - already 58%. Accordingly, the share of assets of private banks and banks with foreign capital decreased (from 11% to 8% for the latter) (Simanovsky et al., 2018). However, until the second half of 2013, many private banks, subsequently liquidated or bailed out by the state, produced false reporting, significantly overstating the real value of their assets, so that in fact their assets were less than officially indicated earlier.

The share of the state-controlled banks in almost all segments of the banking services market is also constantly growing (Figure 12). Unsurprisingly, they are also the leaders in profitability (CBR, 2019). In addition to the classification of banks by ownership forms that was made by CBR, Vernikov's (2020) influential work on the topic emphasizes the complexity and ambiguity of ownership and control in hierarchical ownership structures. He examines in details the situation with the owners of all Russian banks and offers his own classification criteria of banks by ownership. According to them state-controlled banks are directly or indirectly owned (for 50% or more) by state organizations (not only federal authorities, but also regional, municipal,

as well as other state banks and state enterprises), as well as banks undergoing the "financial recovery" bailout process.

Figure 12 - Shares of state-controlled banks in Russian banking system, in %



Source: CBR website <http://cbr.ru/>, 17.08.2020, Simanovsky et al. (2018).

According to these extended criteria (that look very reasonable), the number of Russian state-controlled banks is approximately 2.5 times higher than according to CBR estimates and reached 10% of all banks in 2019. At the same time, the share of state-controlled banks in assets and other indicators of the banking sector is not adjusted as much because the added state-controlled banks are mostly small. Thus, according to Vernikov (2020), the share of state-owned banks in the banking sector assets constantly increased, and in 2019 exceeded 70%. If we add the state corporation VEB.RF, which is not included in banking statistics, but actually performs many functions of a state bank, this figure will be larger by 2-3%. The largest banking groups are also represented by state-controlled banks and have hundreds of members.

The formation of the state "financial vertical" took place along with external adoption and adaptation of new financial technologies and institutions, actually in line with modern financialization processes, but adapted to the needs of the authoritarian state.

The above shown success in financial accessibility and new financial technologies are also decisively related to activity of the state-controlled banks. Inter alia it was done in order to strengthen their positions and increase their income. As a

rule, with only few exceptions, the state-controlled banks are pioneers in pilot projects for innovation development that are initiated by the state to achieve their goals. It allows them often not only to introduce innovations before private banks, but also to influence design of the regulatory environment. While Russian private banks, even if they are sometimes innovators in technologies and business models, have much less influence (CBR, 2019).

One example is creation of the national payment system "Мир" in 2014. It was designed to replace and crowd out foreign payment systems in Russia. The shifting of a significant part of the population, mainly the state sector employees, as well as shops etc., to "Мир" cards was carried out practically involuntarily and with active involvement of the state banks.

An interesting chapter from the history of the "financial vertical" formation is the example of adaptation in Russia of one institute from the arsenal of the advanced countries' financial systems. It is introduction of the deposit insurance system at the end of 2003. In the 1990s, Russia adopted from abroad many different institutes designed to serve emerging market functioning. The households' deposit insurance system was one of them. It was aimed to support to private banks and enhancing competition with Sberbank, to increase trust in the banking system and flows of savings to banks, to develop non-cash payment and to increase stability of the banking system. Indeed, after the introduction of the deposit insurance system, share of private banks increased slightly and peaked in the banking system assets (35%) by the beginning of 2008.

However, as a result, huge amounts of money, including state funds and money of households that had deposits in any banks, were spent on payments to depositors of weak and dishonest banks. These banks were subsequently liquidated or became part of the state-controlled banking sector. This happened together with the "financial recovery" of several large insolvent private banks bailed out at the expense of the state. All this ultimately increased the state-controlled part of the banking sector. The deposit insurance system contributed to the passivity of mass investors and depositors, weakening market discipline and slowed development of other types of financial institutions and other segments of the financial market. Moreover, in fact, the deposit insurance system has shifted the institutional balance between socio-economic institutions from market to state-led ones (Vernikov, 2018, 2019, 2020b). The above example of foreign experience adaptation in the sphere of housing lending which eventually led to the nationalization of this market, is also in line with this logic.

Thus, the obvious powerful trend towards nationalization of the Russian banking sector makes the country a leader in the state share of banking sector among European post-socialist countries (Vernikov, 2020a). There is reason to believe that other banks, that remain formally private, are also forced to fit into the logic of the state "financial vertical" and pursue an appropriate policy. Thus the recent paper of Fungáčová et al. (2020) reports that "all types of banks in Russia increase their lending before presidential elections", that "supports the view that the authorities in an electoral autocracy like Russia can influence lending of both private and state-owned banks for political reasons".

3.4. Concentration, centralization and nationalization in other segments of the financial sector

The processes of concentration, centralization and nationalization occur not only in the banking sector, but also in other segments of the financial sector. First of all, it must be said that the non-banking segments of the sector, although they are developing, are still relatively small and underdeveloped.

Thus, the capitalization of the Russian securities market is small relative to GDP and has not increased²¹. There is also stagnation in liquidity of the stock exchange market due to lack of activity of non-residents and institutional investors in this market as well as due to underdeveloped collective investment institutions (Russian economy in 2019).

For more than seven years, from 2013, there is a decrease in the number of issuers in the listing of shares on the Moscow Exchange. At the same time, the concentration of the stock market is also very high and growing. In 2019, about 70% of the stock market were represented by the ten most capitalized issuers while 50% were the largest five issuers. These are resource energy companies and state-owned companies, including Sberbank (Market Profile Russia, 2019). The situation in the bond market is about the same. The market concentration is high while the government bonds and bonds of state-controlled companies prevail. There is a steady increase in the share of state-controlled companies (with the state share of more than 10%) in the value of circulating corporate bonds (from 22% in 2003 to 72% in 2019) (Russian economy in 2019).

It is easier for the state-owned companies to build relationships with investors, banks and other financial institutions (among which state-controlled structures also predominate). At the same time, *ceteris paribus*, the shares of Russian companies have a lower price than shares of companies from other countries. This underestimation is chronic due to the poor investment climate and higher risks in the Russian economy, mainly related to the state activity. All these facts clearly reflect the evolution of the Russian stock market as a mechanism that primarily supports state-controlled companies. It poorly performs the key function of the securities market that is financing the development of private companies and businesses.

A specific feature of Russia's financial system is the fact that many non-bank financial institutions are part of banking groups, in fact, they are parts of banks. At the same time, services of the financial institutions that belong to the banking groups are developing on the basis of new technologies and services of the banks. They are insurance, management, brokerage services, etc. In this sense, the banks largely determine the direction of the development for the financial sector as a whole (CBR, 2020).

So, the explosive growth in 2017-2019 in the brokerage market described above was caused by activation of the several large banks in the sector. These banks used modern marketing in combination with new technologies for dealing with securities and remote sales channels. It is the reason of this huge growth in number of clients of the brokerage companies associated with these banks. These largest

²¹ https://ru.theglobaleconomy.com/rankings/Stock_market_capitalization/

banks are trying to compensate for the loss of interest margin income that they face due to lower inflation and bank rates in recent years. Therefore they are selling their new products, such as bonds, structured and insurance products, shares of investment funds and other financial instruments and services via associated companies.

Also the banks offer their customers investment products of the companies that are part of the same financial group with them, using their sales networks. So, from the five largest open investment funds (ПИФ) there are four funds whose management companies are associated with large banks. The four largest life insurance company are also associated with large banks. The banks received additional benefit from the promotion of these companies due to the fact that part of their funds generated from sold investment products was placed on their accounts (CBR, 2020).

As a result, concentration in the segment of financial institutions that provide services related to investing in the securities market (brokerage, depository, trust management) is also very high. The number of these institutions is constantly decreasing, and the segment is becoming more and more concentrated. According to CBR at the end of 2019, 75% of customers were served by only 2-5 companies and 50% of clients were served by 1-3 organizations (for different type of financial services)²². In 2019, the ten largest operators of the Moscow Exchange accounted for 82% of trading volumes in shares and for 68% in bonds. Ultimately, such concentration level is an obstacle to further fintech development where new technologies and business models are being formed.

Thus, the development of the non-banking segments of the financial sector is going in line with the search for new sources of income and strengthening the influence of the same major banks and banking groups. So the situation in the non-banking segments is similar to that in the banking sector. The numbers of management companies, non-state pension funds, insurance companies and others are constantly decreasing. The market concentration is growing while institutions associated with the largest, usually state-controlled, banks prevail.

3.5. Financial system and long-term investments

The Russian financial system is often criticized for its insufficient role in the channeling of finances to real investments (Dubinin, 2017). The role of the financial system in providing long-term real investments remains modest. According to CBR, only about 9-11% of investments in fixed real capital are financed from bank loans and this situation has not changed for many years²³. The ratio of loans for investment in fixed assets issued over any year to the banking system assets tends to decrease from 2.7% in 2008 to 1% in 2016, and in 2019 it amounted to only 1.6%. From these facts it is clear that long-term investment in fixed assets is not a priority of the banking system.

Information on the role of other financial institutions in real investment is not

²² https://www.cbr.ru/securities_market/statistic/

²³ https://www.cbr.ru/banking_sector/statistics/

available. However according to Rosstat²⁴ more than half of the investment in fixed assets in the country is financed from the own funds of enterprises and institutions. This ratio also does not tend to decrease that confirms that the role of the financial system in long-term investment is small and does not increase. Financialization does not contribute to the process maybe because one of its characteristics and possible negative aspects is the diversion of resources from long-term investments in favor of short-term investments (Karwowski, 2019, 2020).

4. Conclusion

It can be concluded that some aspects of the financialization process described in the literature are inherent in development of the Russian financial system. They are:

- the significant role of the state in promoting financial innovation, creating and developing new financial instruments and markets (Rethel, 2011, Bonizzi, 2013, Karwowski, 2019),
- the pursuit of macroeconomic stability and inflation targeting (Karwowski, 2020),
- turning the state into a player in the financial market, focused on yield generating and taking advantage of financialization opportunities in their interests (Karwowski, 2019),
- the close connection of financialization with interests of elite and upper classes of society (Rethel, 2011, Bonizzi, 2013),
- the influence of financial sector agents on state policy, lobbying their interests in government, etc. (Karwowski, 2019),
- the reorientation and change in the functions of banks (Rethel, 2011, Bonizzi, 2013, Sawyer, 2013), which more and more perform the functions of other financial institutions and penetrate all market segments, thus there is some convergence of bank-oriented and market-oriented financial systems,
- the increasing indebtedness of households and non-financial enterprises, involving them in financial transactions (Rethel, 2011, Bonizzi, 2013, Karwowski and Stockhammer, 2017, Karwowski et al., 2017, Karwowski, 2020) (in Russia there is only a trend in this direction),
- the uneven access to finance for large and state-owned companies vs small and private firms, that fact may even worsen with the financial market development (Rethel, 2011),
- the diversion of resources from real long-term investments in favor of short-term financial investments and speculations, especially in the volatile unstable economic environment of developing countries (Ashman et al., 2013, Sawyer, 2013, Bonizzi, 2013, Mertzanis, 2019, Karwowski, 2019, 2020).

At the same time, other aspects of financialization are not inherent in Russian economy. There are neoliberalism in economic policy, more market-oriented regulation and privatization, transition from state or crony capitalism to modern market economy (Rethel, 2011, Ashman et al., 2013, Sawyer, 2013, Bonizzi, 2013, Karwowski et al.,

²⁴ https://gks.ru/bgd/regl/b19_13/Main.htm

2017, Karwowski and Stockhammer, 2017, Aalbers, 2016a). Although some authors argue that these traits are not a prerequisite for financialization, giving an example of the financial development in China (Karwowski, 2019).

Financialization in emerging economies is developing not only under the influence of external factors, such as opening of financial markets, international capital flows and pressure from international organizations, but also under the influence of internal political and economic processes (Rethel, 2011, Bonizzi, 2013, Karwowski and Stockhammer, 2017, Karwowski, 2019, 2020). Institutional and political factors and state policy influence the course and results of financialization. The national financial system of Russia is developing in the course of a complex interaction of global processes in the financial sector and internal motives.

In the area of non-cash payments, remote access and digitalization, the country's financial system has made significant progress. Because it is the aspect of financialization in which the state supported the development and encouraged the penetration of new technologies. This is a demonstration of a relatively new trend that researchers have recently become aware of. In developing countries, the state - in the name of financial inclusion and accessibility or fighting with the shadow and informal sectors - is introducing cashless payments and digital mechanisms for collecting information, controlling and monitoring citizens, creating surveillance infrastructure, often using coercive means, as it is shown in Jain and Gabor (2020) for India and in Gruin and Knaack (2020) for China.

In Russia, the reason, obviously, is that the development of non-cash payments and digitalization facilitate the surveillance and transparency of economic agents for the state, create additional income for the largest banks, most of which are state-controlled, and generally does not contradict to the logic of the state "financial vertical". For the same reason, the households' involvement in financial transactions and the use of financial services and financial accessibility are growing. It is closely associated with digitalization and development of remote access technologies.

The analysis shows that such an increase in financial accessibility is in fact largely just a stimulation and promotion of the highly concentrated and nationalized financial sector within the framework of the "financial vertical". New financial technologies and technologies for remote access to financial services are actively used by the largest state-controlled banks to crowd out smaller, private and regional financial market institutions.

Financialization in its various indicators determines the availability of external financing for firms. At the same time, the lack of competition and the distorting state influence are the reasons why firms in developing economies may have limited access to financial resources (Mertzanis, 2019). The formation of the super-centralized and largely nationalized financial system can hardly be a desired result for a country with modern market economy, which Russia should become for its normal development. The constant decrease in the number of financial institutions, the increasing centralization and concentration in the banking and financial sectors, nationalization and generally growing state influence, as well as insufficient competition, are serious restraints to the healthy financial sector development, which ultimately hinder economic growth.

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