

# *Ethical Standards in Economic Relations: Relevant Aspects of Development of Russian Regions*

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**Abstract**—The availability of financial infrastructure is an important component for development of Russia and its regions since its functional characteristics ensure economic growth. However, according to studies of Russian economists, not all regions of the country have established regional banks. In this regard, the issue of regional banking sector stability and the search for effective tools ensuring that stability remain relevant. It is important to increase effectiveness and efficiency of investments into economy of regions of the Russian Federation at the expense of preservation and development of regional banks, forming a relationship with the real sector of economy of Russian regions. In this regard we need to consider aspects of use of ethical banking instruments that are positive for economic development of Russian regions. An investment basis of Islamic banking – the main tools and groups of methods of financing the real sector of economy – are presented. "Negative" aspects of the functioning mechanism of the financial and economic sphere are shown. The limitations of using the Islamic economic model as an institution of ethical behavior in Russia and its regions are revealed. A comparative analysis of traditional (Western) and Islamic banks is carried out. Examples allowing one to judge about the experience of ethical banking application in Russian regions are considered. The main vectors of use of this institution to improve sustainability of Russian regions economic development are identified.

**Keywords**— *ethics; regions of Russia; Islamic economic model; economic relations; ethical banking; savings account*

## I. INTRODUCTION

Economic relations in society are formed under the influence of a set of factors, among which ethical norms play an important role. In Russia, as in any other country, scientists, studying such norms, pay attention to the religious, historically rooted in a particular territory traditions. In the modern economic literature, studies of the so-called ethically oriented models of development are becoming increasingly important, and one of them is the Islamic economic model. The world crisis of 2008 forced to pay close attention to such system of financial relations.

The question of use of Sharia provisions that do not accept the charging interest on loans has long been raised in the financial sphere beyond the problems of development of a particular region. The term "Islamic" in European financial circles is not perceived as religious, it gave way to the definition of "partnership", and "Islamic economy" is the economy of participation, not the economy of debt [15]. As clients, commercial banks consider any investors (not only Muslims) seeking to act on the basis of partnership. That is why the term "Islamic banking" is changed to "ethical banking", the principles of which correspond to more equitable distribution of resources [6, p. 6].

In Russia accumulation and redistribution of large amounts of money, maintenance of economic entities accounts, implementation of calculations and many other aspects of banking sector allow it to play a significant role in the formation of regional financial base. To date, the process of small and medium-sized banks withdrawal from financial market has accelerated, that is associated both with the action of market mechanisms of competition and concentration, and with the Bank of Russia's strategy of enlarging banks and increasing their own capital.

Russian experts, basing on the data of sociological studies, note the concern of business not only with non-tax payments, but also with methods of public administration, goals of the Central Bank of the Russian Federation, state of the Russian financial sector. The professional community of Russian Industrialists and Entrepreneurs (CCI of the RF) is trying to develop a consolidated position of recommendations to improve the competitiveness of Russian economy. According to provisions of Main directions of the unified state monetary policy for 2019, 2020 and 2021, the priority of the policy of the Ministry of Finance for the next three years is not development, but stability. However, according to the May decree (2018) of President of the Russian Federation, Vladimir Putin, "About national goals and strategic objectives of the Russian Federation for the period up to 2024", the budget should ensure the acceleration of economic growth. Against the background

of the current contradiction, the Russian government is developing a plan of measures aimed at accelerating the rate of investment in fixed assets and increasing their share in Russia's GDP to 25%. Ways to stimulate the real sector are united into three groups: stimulating demand, stimulating supply, improving economy's structure. Experience of certain countries shows specific national characteristics and preferences of choice among them.

Prerequisites for accelerating economic growth, based on Main directions of the budget policy of the Russian Federation, are a stable structure of capital sources. It implies a drastic reduction in dependence on "unreliable sources of external debt capital", as well as a reduction in the debt burden of the non-financial sector (improvement of the financial system). In the future, redistribution of Federal budget expenditures in favor of investment and implementation of infrastructure construction projects with the involvement of private investors, as well as creation of conditions for growth of investment activity of the private sector will be added to these sources.

According to Russian experts, with the reduction of foreign investment as external resources, the processes of domestic investment can be activated by reducing consumption. However, according to Rosstat, the share of income of the population of Russia, directed to the purchase of foreign currency, savings in general is constantly decreasing in recent years. Bank deposits with a regional focus should be noted as a possible investment resource. By 01.06.18 more than 40 trillion rubles (15 trillion rubles on deposits of legal entities and 27 trillion rubles on deposits of individuals) were put in Russian banks. These funds are partially used for lending, but mainly of large companies. Among the regions-"rentier" we should mention (according to the research of the Plekhanov Russian University of Economics) Tyumen, Sakhalin, Moscow, Republic of Bashkortostan, Leningrad and Moscow regions, Khanty-Mansi Autonomous region - Yugra, Samara region, St. Petersburg, Chelyabinsk, Kemerovo, Sverdlovsk regions.

## II. MATERIALS AND METHODS

The situation of economic instability mostly hits regional banks which assets decrease. A way to preserve such banks would be to form a close relationship of banks with the local sector of real economy (small and medium-sized businesses). And in times of crisis, these were regional banks (according to the experience of 2008) that maintained financial stability due to the fact that their share of investments in production was relatively higher and, accordingly, less in speculative operations. Regional banks have not yet been established in 13 regions of the Russian Federation.

In those countries where ethical banking instruments are used, special attention is paid to risk management: more stringent conditions when distributing losses between partners lead to a qualitative assessment of potential risks. Such instrument proved to be effective against the financial bubble that caused the global crisis in 2008.

In ethical banking, there are three main tools.

1) Allocation of funds under the revenue share of the profits.

2) *Leasing scheme*: A bank buys a plant or equipment and sells it to the borrower in installments.

3) Joint participation of bank and client in business when the bank is a co-founder of the project.

Banks operating on ethical principles do not have one of the main sources of profit that ordinary commercial banks have - the difference between interest on loans and interest on deposits [4, p.135]. Other operations are their source of income, for example, when applying for a mortgage, a bank can purchase housing itself, and then sell it to a client in installments at a higher price [5]. Equity financing is actively used instead of debt financing, when profits and losses are divided between bank and its customers who are the participants of the joint project.

The Islamic bank's liabilities consist of customers' funds on current, savings and investment accounts. The difference between current and savings accounts in ethical banking is the same as in traditional banking. When opening a current account, a client, without claiming any remuneration from the bank, has the opportunity to freely dispose of funds in the account. For the bank, the main goal when opening and maintaining current accounts is to attract funds of small depositors who use such accounts to make payments. When opening a savings account, a client primarily claims to receive remuneration, but not as a fixed percentage of the deposit amount, but as a part of the profit earned by the bank with the participation of the client's capital.

Clients' funds for current and savings accounts can be attracted in two ways [6; p. 92-94]:

1) In the form of non-repayable loans.

2) On the terms of safekeeping, when the bank is not entitled to dispose of the object of storage and can only carry out instructions of the deposit owner, charging a certain fee for it.

Ethical standards of Sharia prohibit the use of traditional credit cards because it involves the collection and payment of interest. If the credit card is used for cashless payments, when the issuing bank does not charge the cardholder, any additional payments, except for commission for the use of it, the use of such "credit" card is considered permissible [16].

Unlike traditional banks, Islamic bank transfers credit basis of financial business to investment. Depositors' money, which is deposited by clients to a special investment account, is invested by the bank in various financial projects. Profit that the account holder will receive depends solely on investment results. Islamic banks open joint (common) investment accounts for their clients, place investment deposits with limited/unlimited validity, as well as specialized deposits. Investment accounts are also referred to as joint accounts, or accounts based on a profit and loss sharing system. Their profitability depends on the profitability of investment projects [17].

In case when the bank is not completely Islamic and carries out part of operations on the basis of traditional methods of financing, it must maintain separate accounts for interest and interest-free transactions. Commercial banks in European cities act according to this principle.

Islamic methods of financing can be divided into two groups [8].

1) *Methods based on profit and loss sharing mechanism or investment methods:*

a) Fiduciary financing, involving bank's investments in any investment projects; at the same time, all the risks associated with the financed project, its implementation and profitability fall on the bank's shoulders.

b) A partnership or a property partnership, when two or more persons combine their contributions to a common project and create a company on the principles of equity participation for a long term. Losses are distributed between the parties in proportion to the share of capital invested.

2) *Methods based on debt financing:*

a) Purchase and sale at an agreed price, as a type of contract of sale of goods between one party (seller) and the other party (buyer) at an agreed price, which includes the seller's allowance to the value of the goods. In a broad sense, it is financing by buying and selling an asset. The described financing method is characterized by short duration, in contrast to mechanisms for the profit and loss sharing system, it is characterized by low risk. Banks enter into additional agreements, according to which the client's refusal to purchase goods entails penalties [18].

### III. RESULTS AND DISCUSSION

This method was used by one of the Russian banks: at the end of August 2006, Globex Bank announced the raising of funds on the basis of such mechanism in the amount of US \$20 million from one of the world's oldest Islamic banks Dubai Islamic Bank. Globex Bank was not the first who began to look closely at the Islamic financing methods. Earlier, the specialists of Alfa-Bank studied the possibilities of entering the Islamic capital markets, but considered mechanism of providing funds used in the work of Islamic banks unprofitable for themselves. One of the main drawbacks was a long time for registration of such transactions [11].

b) *Advance financing.* Sale of goods with deferred delivery against cash payment. In accordance with the agreement, the bank shall credit the executor, who shall bear the debt obligation, which is considered to be fulfilled after delivery of manufactured goods to the bank.

c) *Contract agreement.* The supplier of the goods is no longer the client, but the bank, and the payment for the goods is not in the form of a lump sum payment until the buyer receives the goods, but gradually with the work progress of the goods manufacturer. This method (often in financing of large-scale industrial projects, purchase of large equipment, organization of housing construction) allows to redistribute the risk from someone who does not want to take it on (the client), to those who want and can do it, expecting to make a profit (the bank).

d) Leasing has features known to the continental law system of lease agreements and leasing (financial lease). The right of ownership of the thing, which is the subject of leasing, remains with the lessor [18].

*The analysis of Islamic banks' operations leads to the conclusion that depending on the purposes of their creation they can be divided into:*

- Development banks, which aim to promote economic and social development of member states (Islamic Development Bank) [10].
- Commercial banks, the main purpose of which is to make profit through the provision of Sharia-compliant banking services.
- Specialized banks created to solve specific problems (agricultural, industrial, cooperative, etc.).

As for our country, the creation of Islamic banks is hampered by lack of relevant legislation: the Central Bank's regulations do not allow such credit institutions to operate. However, in some regions of our country Islamic business is established and now functioning: the production of Halal products, the Muslim cafe, studio on tailoring and sale of Muslim clothing, etc. But not only this: in some non-Muslim countries only Islamic banking instruments are used and not the system as a whole. Creating an Islamic bank in our country is impossible, but we can try to use some of its tools. In addition, business contacts have already been established for investment projects and possibilities of their joint implementation with the countries of the Islamic world.

Perhaps if there were Islamic banks in certain regions of the country, the global financial crisis would have dealt with a less significant blow delivered to the ability of banks in attracting investment and credit from abroad. This is due to the fact that, firstly, Islamic banks cannot borrow money from each other at interest rates, since interest rates are prohibited; secondly, and more importantly, such banks do not load themselves with non-core and high-risk assets, such as mortgage liabilities, preferring more reliable assets [7].

It goes without saying that in addition to the positive aspects in the mechanism of Islamic banks functioning, there are also negative ones, which, in particular, are expressed in the following: the service fee in such banks is higher than the service fee in traditional banks; a narrower range of services is offered than in institutions operating on the basis of continental law.

Western traditional banks (Russian credit institutions operate on such principles [1; 19]) have a much wider range of products, tools for liquidity management, as well as innovations, than Islamic banks. But the presence of at least one bank acting on ethical principles in such Russian regions as Tatarstan or Bashkortostan [13] could be a good prospect for development of both the subjects of the Federation and the state as a whole [9]. This would greatly simplify the process of cooperation with banks in the Middle East and other Muslim countries. The Islamic bank in our country (or a bank that partially uses ethical banking instruments) could become a channel through which finances come directly through correspondent accounts, without mediation of European and American banks [14].

But, as it was already mentioned above, Russian legislation does not allow the creation of Islamic banks. Therefore, in order

to talk about the formation in Russia of such institutions, the Central Bank of the Russian Federation has to revise the provision that all banks are obliged to take a loan from it at a certain percentage. The Islamic bank cannot operate under such a scheme because the Islamic economic model is based on the absence of loan interest.

In this regard, a legal framework for alternative financial institutions and products that could be submitted to various financial bodies for further consideration should be prepared.

Leading Russian banks such as VTB and Gazprombank are already working with Islamic financial products, although not in Russia. Tatarstan has established economic cooperation with the Islamic Development Bank. A positive public opinion on Islamic finance has been formed, and economic entities that seek to organize their activities in accordance with ethical principles are emerging [9].

If we talk about Russian experience, we should mention the Badr-Forte Bank, the only one that used Islamic business technologies in its work. This bank was licensed by Central Bank of the Russian Federation in 1991, and the Islamic financing methods have been used since 1997. It is noteworthy that the name of the bank (International Commercial Bank, Badr-Forte Bank) does not have the word "Islamic". However, in its regulation it was said that the Bank has the right "to carry out its activities in accordance with current legislation of Russia and international law, using Islamic economic technologies of banking, not contrary to Russian banking legislation" [15]. Badr-Forte Bank was a member of the General Council of Islamic banks under the Islamic Development Bank.

From the point of view of the Russian legislation Badr-Forte Bank was an ordinary commercial bank, observing Islamic economic principles, it did not contradict the Russian legislation in its activity [14]. This bank was a unique Russian credit institution with original products developed, taking into account the specifics of our legislation (for example, Islamic mortgage, a product designed to help Muslims in Moscow and in Moscow region in solving the housing problem in accordance with the Sharia) [5].

However, in 2006, the bank's activities were suspended: one of significant drawbacks that limited its popularity among Muslims was the lack of offices. The underdevelopment of the branch network in Badr-Forte was compensated by development of such services as internet banking and GSM banking. Another factor that narrowed the bank's client base in Russia was its focus on servicing foreign trade operations and lending to legal entities, rather than on working with individuals.

In 2010, in Luxembourg an agreement on the establishment of International Islamic Investment Fund for investment in Russia and CIS countries was signed. Luxembourg has adopted certain amendments to legislation and today is one of the first in the world in terms of the number of investment funds operating on principles of the Islamic economic model. At the same time, the created fund is the first institution that is set to invest in Russia and CIS. The priority sectors were production and distribution of Halal products, creation and development of

Islamic financial institutions, telecommunications and media technology.

#### IV. CONCLUSION

The current situation in the global financial markets could not but affect the development of Russian banks, which had to revise the principles of raising funds: if earlier it was possible to attract relatively cheap credit resources from abroad, the crisis forced banks to rely more on their "home" customers. Many banks had to slow down the growth of their loan portfolios (mainly on mortgages) and start restructuring them. Regional banks in Russian regions have traditionally enjoyed trust of the local population. However, the legislative increase in the requirements for mandatory reserves of banks leads to the inevitable closure of small credit institutions.

The use of ethical banking instruments in Russian regions could promote attraction of new investments. And regional banks would be able to invest their resources in the real sector of the economy of a particular territory. The use of risk-free (or low-risk) financing methods typical for ethical banking will give stability to the banking sector, especially in the context of modern economic development.

The stability of the economic development of the concrete region depends greatly on the stability of the banking system in it. An important role is played by the factor of public confidence in the existing financial institutions, primarily in commercial banks [2]. People who regularly face the negative consequences of interaction with financial institutions, unaffordable interest rates, as well as external factors, such as frequent recent revocation of licenses from banks (the so-called reorganization), sudden bankruptcies, cease to trust financial institutions. The atmosphere of insecurity forms throughout the financial system, and as a consequence, forms the failure to perceive and examine new products, understand the nuances of certain operations [2, p. 4].

Dynamic development of the banking sector is due not only to the volume of capital of credit institutions in the region, but also the level of financial literacy and financial culture of the population. In Russia, the level of financial culture, as one of the components of market economic culture as a whole, is still low. This is reflected in the fact that the bulk of the population does not have personal experience in investment activities, as well as the lack of complete and, most importantly, reliable information about the principles of modern financial institutions activity. And, on the contrary, there is a huge acquired negative savings experience: the vast majority of check investment funds that received vouchers and cash from population in the 1990s, went bankrupt and disappeared without a trace.

Another thing is remarkable: in all regions of the country, the collapsed financial pyramids have not taught the population anything. With enviable persistence and repeatability, citizens are "included" in the newly formed pyramids. This phenomenon is due to the peculiarities of mentality, when the belief in a miracle ("money grows out of nowhere") prevails over rational arguments.

The most informed representatives about the variety of banking services, especially those who carried out on-line, are urban youth [12]. However, if we talk about the use of investment and credit instruments, not so much demographic aspects, including age, general features of Russian mentality (regardless of the region of residence) come to the fore. With regard to ethics, it should be noted that part of the population, having used banks' credit services, and is not going, by their own admission, to repay their debts. This is due not to the low level of financial literacy but to the inability to adequately calculate their potential monetary opportunities, and ethical standards of behavior [3].

Modern scientific approaches of economists, sociologists and psychologists studying economic relations between individuals are based on the fact that people are not isolated from each other; they are built into different social structures and interact closely with each other. In their financial behavior, the population does not always follow solely economic interests. That is why the relevance of scientists' research aimed at studying the impact of values, norms, customs, prevailing in society, on the economic behavior of social strata and individual. At the same time, the issues of typology of economic relations: depending on the region of residence, belonging to a certain religion, prevalence of certain entrenched norms of behavior and traditions, as well as demographic factors, are of particular interest. All these aspects should be taken into account when studying the motives for choosing a particular model of economic behavior.

Along with common features and patterns of development, Russian regional banks have their own characteristics due to their place in the system of interregional economic relations. Creation of a flexible and efficient regional banking infrastructure with today's reduced opportunities for reliable profits is one of the most important tasks of the banking sector development. In the conditions of the formed commodity and financial markets, the structure of the banking system is also complicated: there are new types of services, new tools and methods of customer service. The principles of ethical banking, actively used in many countries of the world, could become an effective tool in Russian regions.

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