

# **The Reasons, Development and Consequences of Economic Crisis in Russia**

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## **Abstract**

In the present article the basic channels and mechanisms of penetration of world financial and economic crisis to Russia are considered. Taking into account the analysis of the internal factors promoting strengthening of the crisis phenomena in national economy, features of an anti-recessionary policy are analysed, the reasons its realisations negatively influencing process are designated.

**Key words:** Global financial and economic crisis, anti-recessionary measures, the monetary policy, budgetary expenses

Global financial and economic crisis has mentioned to Russian economy, compare to developed and developing countries, most seriously. The sharpest phase of the crisis covering manufacturing and social, was at the end of 2008 – the beginning of 2009. But also now the situation remains heavy and in many respects unpredictable.

**I. The Basic channels and mechanisms of penetration of world financial crisis to Russia.** Among the basic channels and mechanisms of penetration of world financial crisis to Russia it is necessary to allocate the following.

*1) Falling of the world prices and demand for the basic goods of the Russian export (oil, metals, other raw materials).* Falling of the world prices for the basic goods of the Russian export: has sharply lowered receipts in the budget; has essentially worsened the country balance of payments; inflow of currency to the country was reduced. It has led to devaluation of a rouble exchange rate to US dollar and other currencies; created problems in payment of external corporate debts.

Falling of demand for the basic goods of the Russian export has negatively affected dynamics of development of industrial sectors. In turn, falling of profits in raw production companies has caused revision of their investment programs towards decrease. It has caused decrease of production in other sectors of economy connected with maintenance of declared investment programs.

- The dollar exchange rate from 16.07.2008 to 19.02.2009 has grown from 23,12 to 36,42 rbl./dollars, 57,5% – devaluation.
- The euro exchange rate during the same period has grown from 34,08 to 46,84 rbl./€, 37,4% - devaluation.

*2) The Collapse of the world financial markets and a problem with liquidity.* As a result of financial crisis, a problem with liquidity, have completely blocked possibilities to attract financial resources by Russian companies from the foreign financial markets. It has limited at once possibilities of crediting in the country, has caused increase of interest rates for credits. and made impossible to return old debts at the expense of attraction of new credit resources.

Necessity of repayment huge external private debt has put many business and banks in a heavy economic situation.

**3) Exit of foreign capital from emerging markets.** As well as in the conditions of the Asian crisis in 1997 exit of foreign capital has begun with emerging markets, including from the Russian.

In a combination to bad news about financial difficulties of “blue chips”, their impossibility to acquire new external loans and necessity to repay old debts is promoted a collapse of the Russian stock market by 4.5 times.

- Russian stocks index (RTS) has fallen from the maximum values – 2450 (in the end of May, 2008) to 550 (in the end of October, 2008).

Falling of the stock market has led to sharp reduction of capitalization of large corporations, to reduction, is frequent in times, the sums of pledges under which foreign credits, and to even bigger aggravation of problems in relations of borrowers with creditors stood out.

The combination of these factors started to start at first local, and then extending chains of consequences: restraint of demand → occurrence of financial difficulties → economy effort prompting (reduction of investment programs, personnel reduction) → reduction of salaries → a new wave of reduction of demand → manufacture decrease → reduction in demand on consumed commodity-material assets → growth of the direct and latent unemployment.

## II. Inside-Russian factors of strengthening of the world financial crisis

There is no doubts that the crisis has been introduced to Russia from outside. However it is necessary to mention variety of factors which have defined purely Russian threats and promoted strengthening of influence of world crisis on our economy. There are several of those.

**1) Large presence of foreign capital on stock market of Russia.** Actually financial crisis has been initiated by outflow of foreign investors speculative capital of in August 2008. During the conflict in South Osetia the outflow was about \$35 bln. and that has caused the most essential loss to the financial markets of Russia. The total outflow of the capital in 2008 was about 130 billion dollars.

Net inflow/outflow of foreign capital in Russia in 2008 (billions of US dollars)		
	Net inflow	Net outflow
I quarter	—	– 23,1
II quarter	+ 41,1	—
III quarter	—	– 17,4
IV quarter	—	– 130,5

**2) Absence of considerable amounts of «long» money.** The lack of modern pension, insurance and invest fund system in Russia have caused insufficient volumes of financial resources.

Prevalence of «short» money in economy generates, deficiency of liquidity, the general instability of a financial system and real sector.

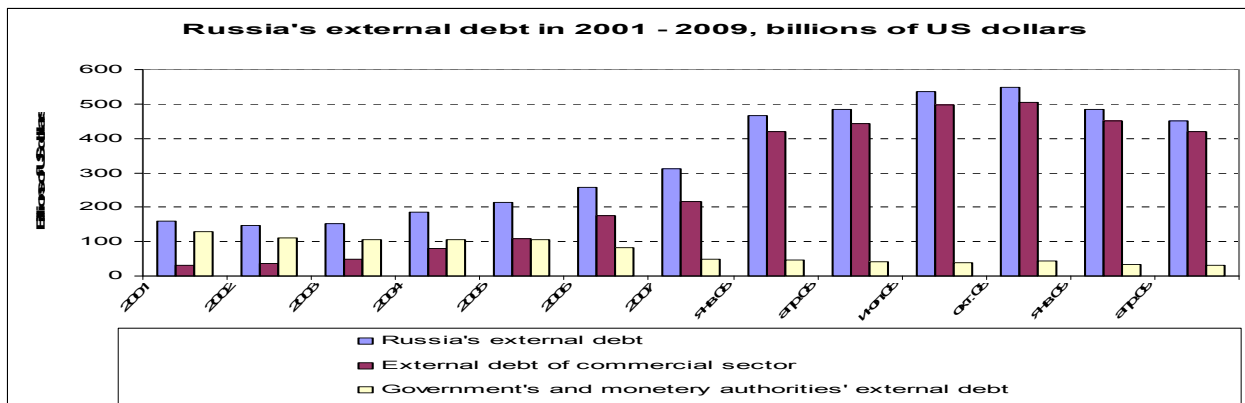
But the most important problem of the Russian financial system is its small scale. Relatively to gross national product (1.01.08) assets of bank system is about 61%, and in developed countries over 100%.

**3) Dangerously increased private external debt.** The result of attraction of large financial resources from abroad debts of corporate sector began to grow fast. For past three years Russia state external debt was essentially reduced and the debt of corporate sector during the same time has essentially increased. At the beginning of crisis (1.10.2008) a debt of corporate sector was \$505,5 billion which is 34% of gross national product (volume of the Russian export to 2008 has made \$522,9 billion).

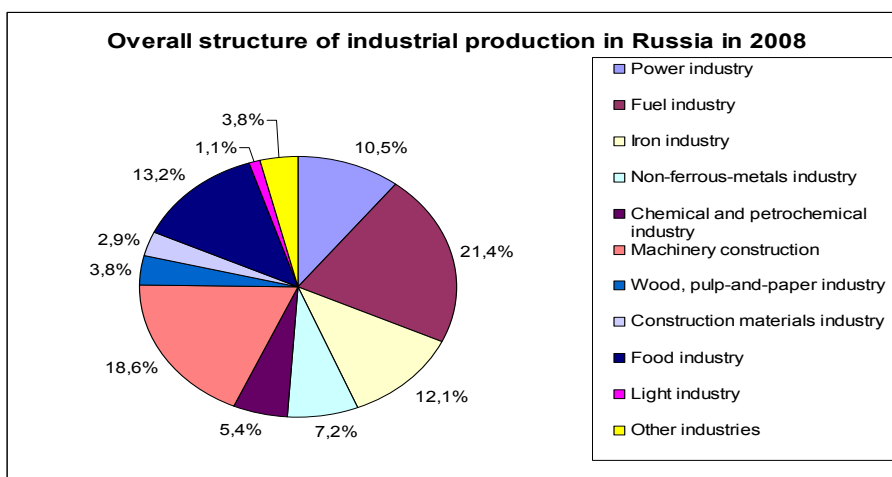
Banks and the enterprises, usually returned credits and percent on external debts at the expense of new loans that in crisis conditions is impossible.

As a result the private external debt became the basic detonator of influence of world crisis on the Russian economy, putting corporations and banks to bankruptcy level and made government to help those.

Till the end of 2009 Russian corporations have to return more than \$160 billion.



4) *Structural disproportions of real sector of economy.* The analysis of industry structure shows that raw resources, including industries connected is more than 60% of production. The volume of industrial products is less than 20%.

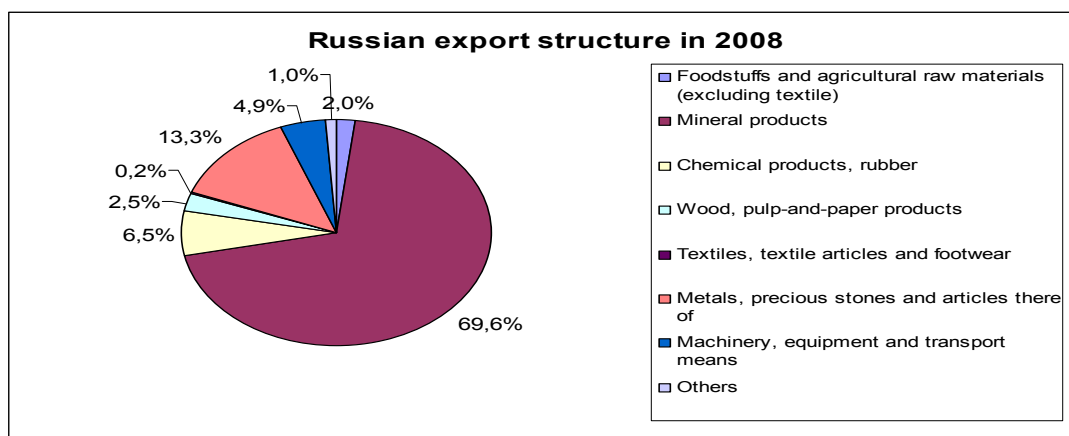


Russia is first in manufacturing of natural gas and an oil; third on melt of pig-iron and manufacture of timbers; fourth in extraction of brown coal, manufacturing steel, ready hire of ferrous metals, mineral fertilizers; fifth in extraction of iron ore and wood (Table 1).

**Table 1**  
**Places, which Russia occupies in the world in producing some types of industrial and agricultural commodities**

	2009 год
Natural gas, oil extracted (including gas condensate)	1
Building brick, potatoes	2
Cast iron, saw timber, milk	3
Electricity, brown coal, steel, rolled metal of ferrous metallurgy, mineral fertilizers, cotton textiles, grain crops and leguminous plants, sugar beet	4
Iron ore, merchantable wood	5
Coal, cement	6

Structure of industrial production corresponds with foreign trade structure. Over 2/3 national export is mineral raw materials and half-finished products. The main exports there are power resources, black and nonferrous metals, fertilizers, wood.



Russia wins first place in the world on export of natural gas, natural diamonds, aluminum, nickel and nitric fertilizers; the third-fourth places on export of oil, mineral oil, the electric power, potash fertilizers and hire of ferrous metals (table 2).

**Table 2**

**Places, which Russia occupies in the world in export of some types of industrial commodities**

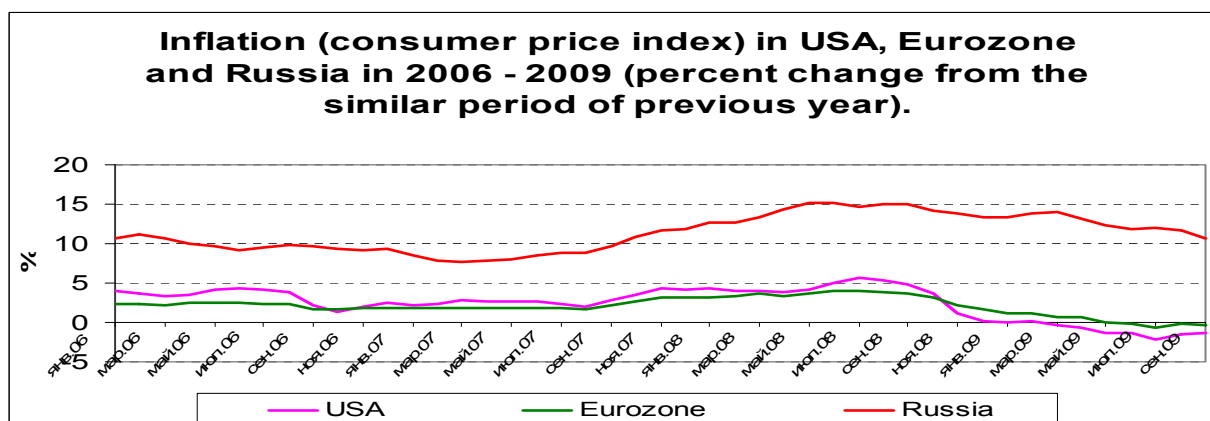
	2008 г.
Natural gas, raw diamonds, aluminium, nickel and nitrogen fertilizers	1
Oil, oil products, electricity, potash fertilizers and rolled metal of ferrous metallurgy	3-4

Present economy, especially export, with prevalence of fuel, raw materials, half-finished products, absence of a diversification raises vulnerability of social and economic development from level of the world prices and demand.

Reduction of oil and raw materials prices is still the basic risk to the economy of the Russian Federation. Oil dependence already led us to crash twice. Disintegration of the USSR (1991) and crisis of 1998 in certain degree have been caused by the low prices for oil – about 12 dollars/barrel.

At the end of 2008 the price of Russian oil dropped down from \$130 dollars to \$40 dollars for barrel, more than in 3 times.

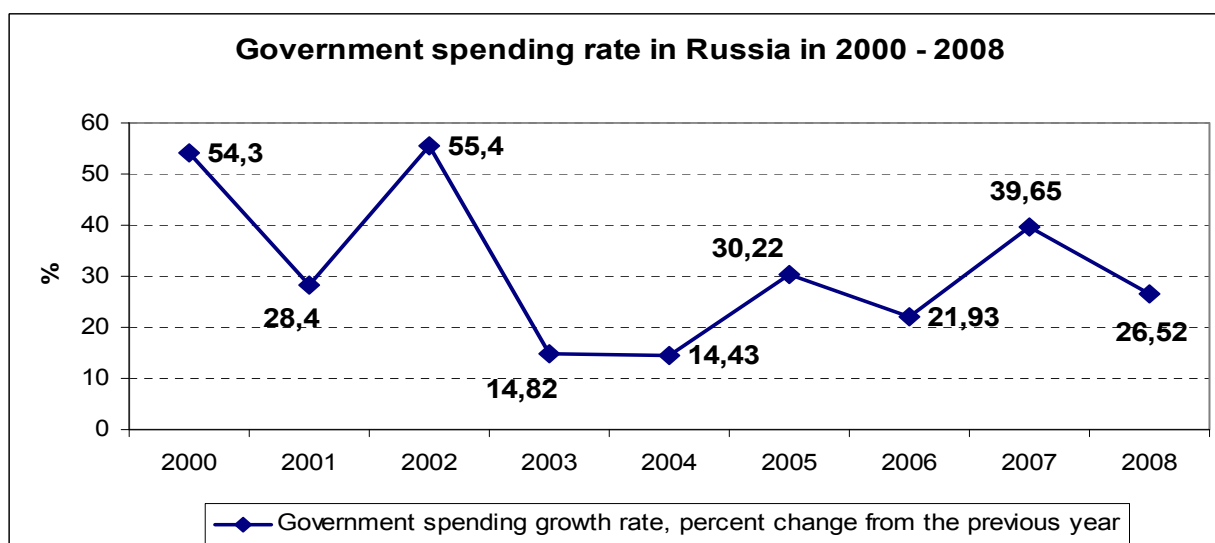
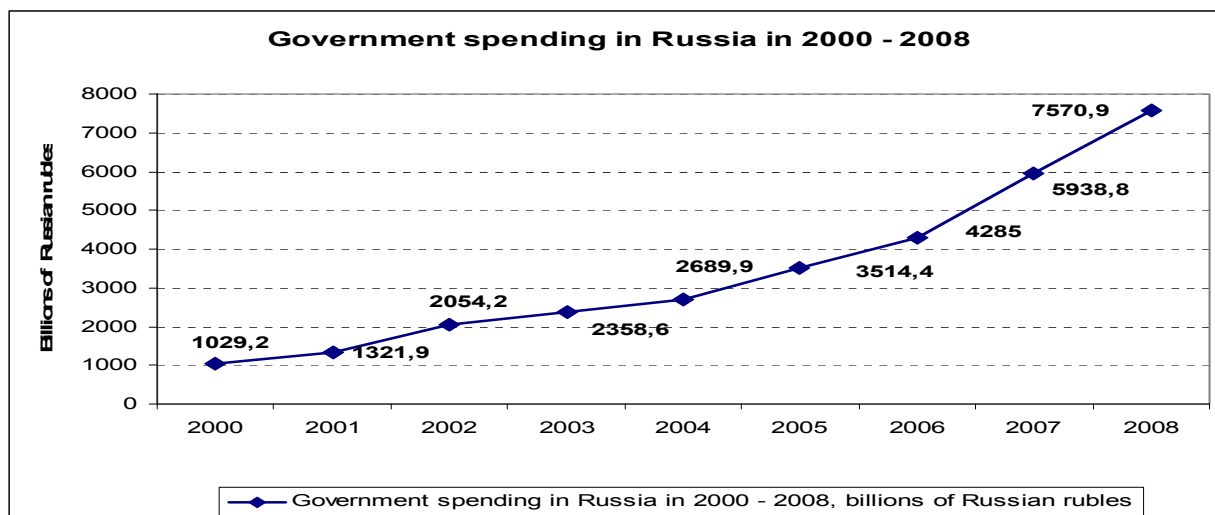
5) *High inflation compare to developed countries.* Russian inflation reached 13%, against 1–3% in the developed countries. The monetary policy and sterilization of currency didn't help.



**6) Large budgetary expenses.** Growth of budget expenses in the country for last years were 35% per year. These was connected with huge inflow of currency in 2003-2007 and first half of 2008, and also the high social and economic expenses, especially in pre-election year.

In 2008 expenses of the federal budget have increased by 2,2% to gross national product (from 15,9 to 18,1%).

Therefore the possible conclusion is the strengthening of populist tendencies in the policy. This threatens serious macroeconomic situation.



**7) Monetary policy.** Basic problem and the crisis reason – is the deficiency of roubles. Level of a monetization of economy is low – about 40%, at the developed countries of 80-100%. We have regions with no banks, no money situation.

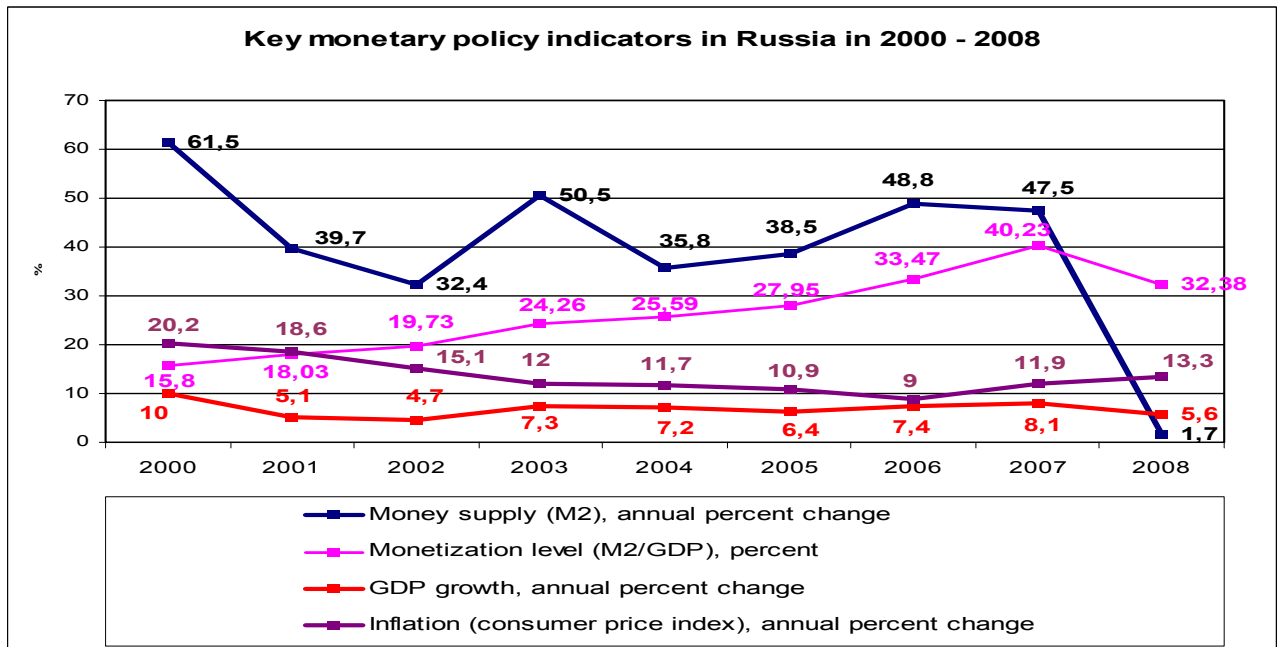
Why in Russia such low level of a monetization? How it was formed?

Here the answer to a question. The policy of the Central Bank of Russia against inflation was a reduction to a minimum of liquidity of banks and the organizations. And this with the fact that bank system of Russia is smaller compare to bank systems of other countries.

It is known that against world financial crisis the Central Banks of many countries have included «money presses» to rescue the economy. At this time our monetary authorities, having accepted close IMF «experiences», began struggle against inflation by monetary and credit policy toughening, by compression of monetary weight. As a result toughening of a monetary policy has created conditions for formation of «financial instability».

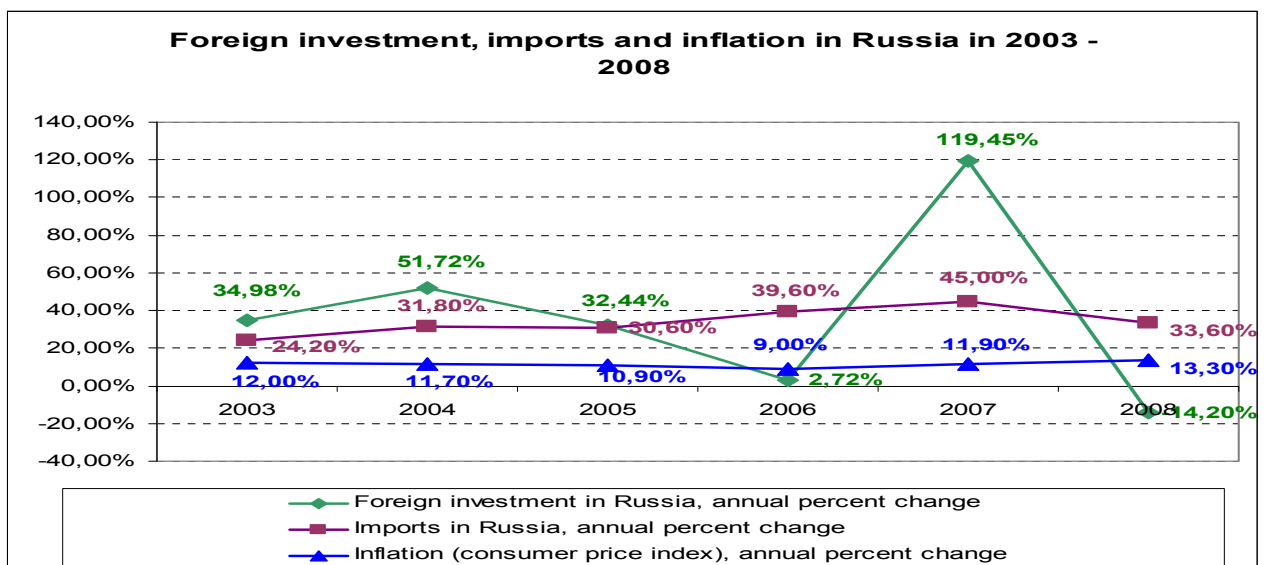
Let's address to «a monetary history» Russia. During «favorable» 2000-2008 when the economy grew on the average on 7% per year. It is easy to see that the reason of growth of economy was not only a favorable raw conjuncture, but also the active monetary policy. Average growth of monetary weight M2 was 44% a year. The average rate of increase of the State expenses has made about 32%. Level of a monetization of economy has grown from 14,2% to 40%.

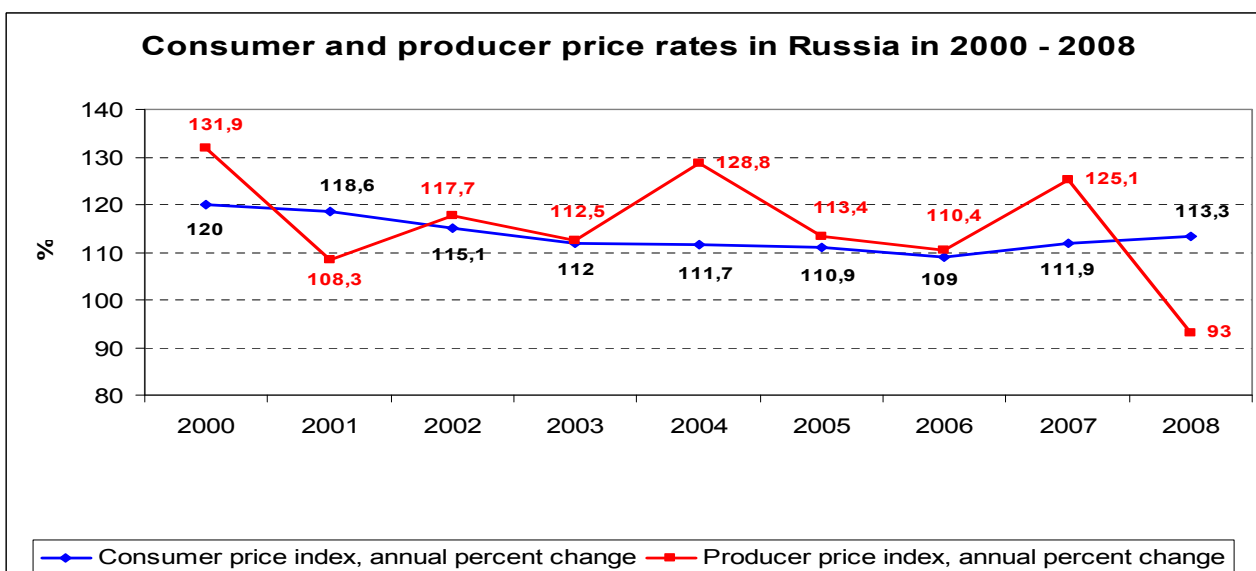
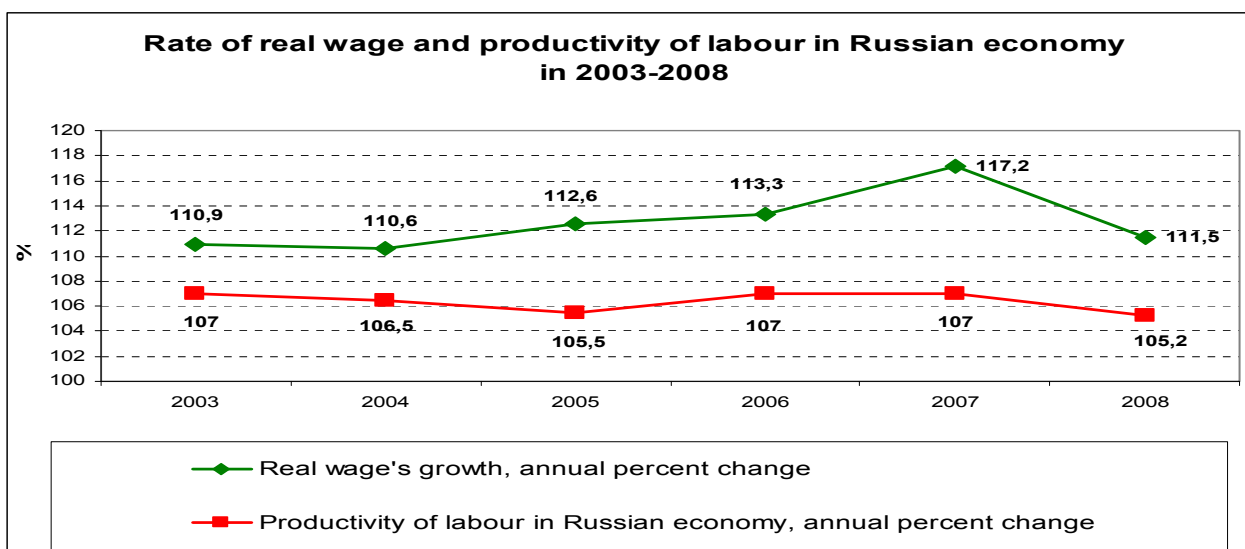
The cause of inflation is a growth of the State expenditure and tariffs of monopolies.



8) *Economy «Overheat»*. Stimulation of economic growth has led to economy «overheat» problem:

- large State expenditure;
- high inflation level combined with high rates of economic growth;
- growth of pure inflow of the capital from abroad;
- accelerated increase of average salary, compare to labor productivity;
- jump of the prices of manufacturers of an industrial output, more than in 2 times in 2007.



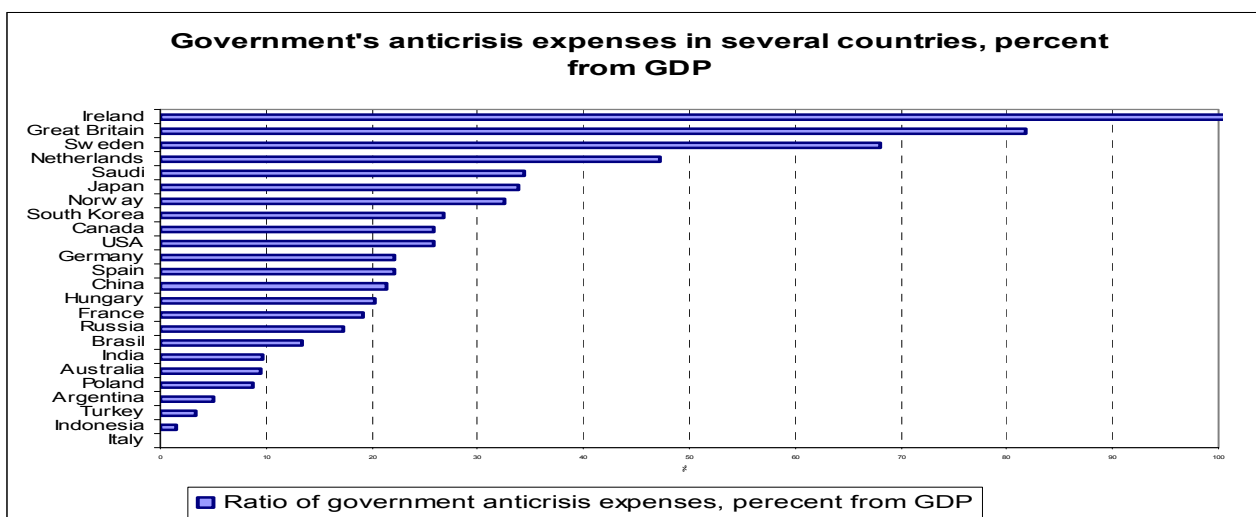


### III. Problems of realization of the anti-recessionary program

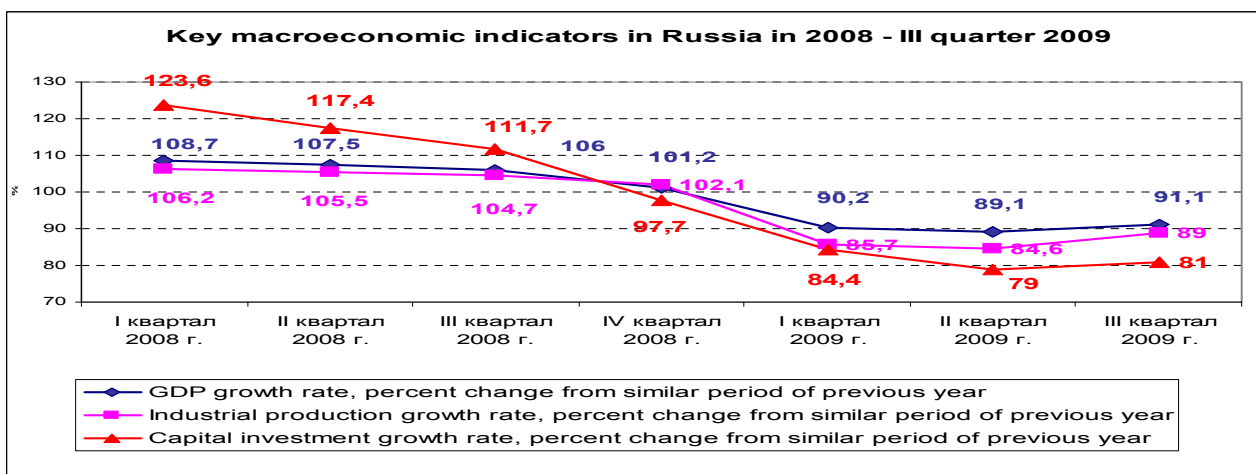
The government tries to work operatively, making efforts and means for a conclusion of a national economy from crisis.

The total sum of anti-recessionary measures undertaken in Russia is estimated at a rate of \$288 billion or about 17% of gross national product.

- However Russia – it is far not the champion on expenses for struggle against crisis. There are countries which have thrown on struggle against crisis literally all forces and have spent resources much more, than Russia, – and in absolute figures, and in percentage of gross national product. The absolute leader is the first and while the main victim of world crisis – Ireland. The volume of measures more than twice surpasses the size of this economy in support of economy. It became possible because almost all these means – not a ready cash, and government guarantees under credits.



But as a whole the anti-recessionary program realized in Russia is not very successful. Following the results of III quarter 2009 the Russian economy was reduced in comparison with the similar period of 2008 to 8,9%; industrial production – on 13,3%; investments – on 18,6%, export – on 43,3%. Receipt of the foreign capital was reduced to 31%.



According to statistical data, by November, 2009 there are 7,6% unemployment (5,8 million people).

It is possible to assume that the Russian gross national product will decrease following the results of 2009 on 8,7%, even despite rise in prices for oil. Forecast deterioration is connected with deeper and long falling of internal demand, and also more long period of rigid credit restrictions.

The specified circumstances should disturb. The reasons for this situation are.

**Firstly.** Delayed reaction and underestimation of level of threats to crisis approaching by the government. In August – September, 2008 official comments concerning world financial crisis were optimistic and the opinion that it will not mention Russia.

The Russian government has «overslept» the crisis beginning. In a consequence of it the anti-recessionary program has situational character in many aspects. The package of laws forming set of anti-recessionary measures, was constantly supplemented, but also had not complete character. Have not been defined the mechanisms of reception of the state guarantees direct investment of money resources in capitals of enterprises. Anti-recessionary scheme is formed from foreign samples.



**Secondly.** From the very beginning, the diagnosis has been put incorrectly. In the West modern crisis is a crisis of overproduction in the refinanced economy. In Russia, a situation other: crisis develops in conditions «shortage economy».

«Shortage economy» is characterized by absence of possibilities for self-maintenance, consists not only in total deficiency of production of own manufacture, transformation of Russia into a commodity market of foreign goods and low level of a monetization.

Therefore in the West overproduction crisis became the sale crisis with deflation. In Russia – uncontrollable rise of prices and falling of real incomes of consumers. From the beginning of year inflation rate was 8,4%.

These unequal positions cause different approaches for anti-recessionary methods. If the developed countries actively spend financial resources, to stimulate economy, in Russia there is a high inflation (8,4%) and the high interest rate (9,0%).

The state appears in dual position: on the one hand, it is necessary to restore liquidity of economy, and with another – not to admit the worst consequences of stagflation during the further development of crisis that will seriously complicate realization of measures on an exit from it.

#### **IV. Features of a modern anti-recessionary policy in Russia**

The basic anti-recessionary actions used by the Russian government are common to steps of the most developed countries.

1) The Basic anti-recessionary measures in Russia increased the budget of 2009. The basis expenses is full maintenance of all social obligations.

2) The Government has offered a wide package of stimulus, first of all taxation, to support real manufacturing.

Decrease in taxation in 2009, is estimated in 595,1 billion rbl. (18,7% of total financial resources within the limits of anti-recessionary measures). Thus decrease in taxes is focused only on withdrawals from direct taxes, the system of the indirect taxation remains without changes. As a result the share of the direct taxation in incomes of the federal budget to be reduced from 31,3% to 26%, incomes of foreign trade activities – from 36,8% to 26,6%; incomes of state property and activity of the state and municipal organizations – from 1,8 % to 1,3%. The share of indirect taxes, on the contrary, will increase – from 26,7 % to 42,3%.

Reorientation of profitable base of the budget to indirect taxes means a rearrangement of crisis expenses of the budget on the population. As a result increase of the consumer taxes → decrease of consumer finance → reduction of a current consumption level → decrease in the investment contribution of the consumer in economy → is minimized a consumer pent-up demand. All it can make negative impact economics growth rate in the long term.

3) Active steps on prevention of a collapse of credit system Have been undertaken. Considerable financial resources for overcoming of crisis of liquidity have been given to banks. Simultaneously these measures should promote maintenance of industrial activity. Availability of credit resources in Russia is a source of growth of real sector, not stock market.

However mechanisms of control of the budgetary funds received by banks have not been worked. Banks to which the state gave liquidity, have shown a total absence of interest in support of real sector of economy and preferred to exchange as much as possible it in a foreign currency.

As a result, the problem of long-term credit resources remained unresolved. Normalization of monetary streams was not achieved and the credit became one of the bottlenecks why recession and has got such scale.

4) There are serious doubts concerning efficiency direct help to the large enterprises. The main problems of manufacture consist not so much in shortage of money, how many in badly functioning of economic mechanisms, and finally in an inefficiency of many industrial

sectors. Financial injections will not solve a problem of increase of efficiency, restructuring of economy.

Good example is the automobile industry. Measures on its support is a tracing-paper from the western anti-recessionary measures. However in West the automobile industry is an aggressive hi-tech export, in our case – preservation of the technological stagnation proceeding almost from the end of 80<sup>th</sup>.

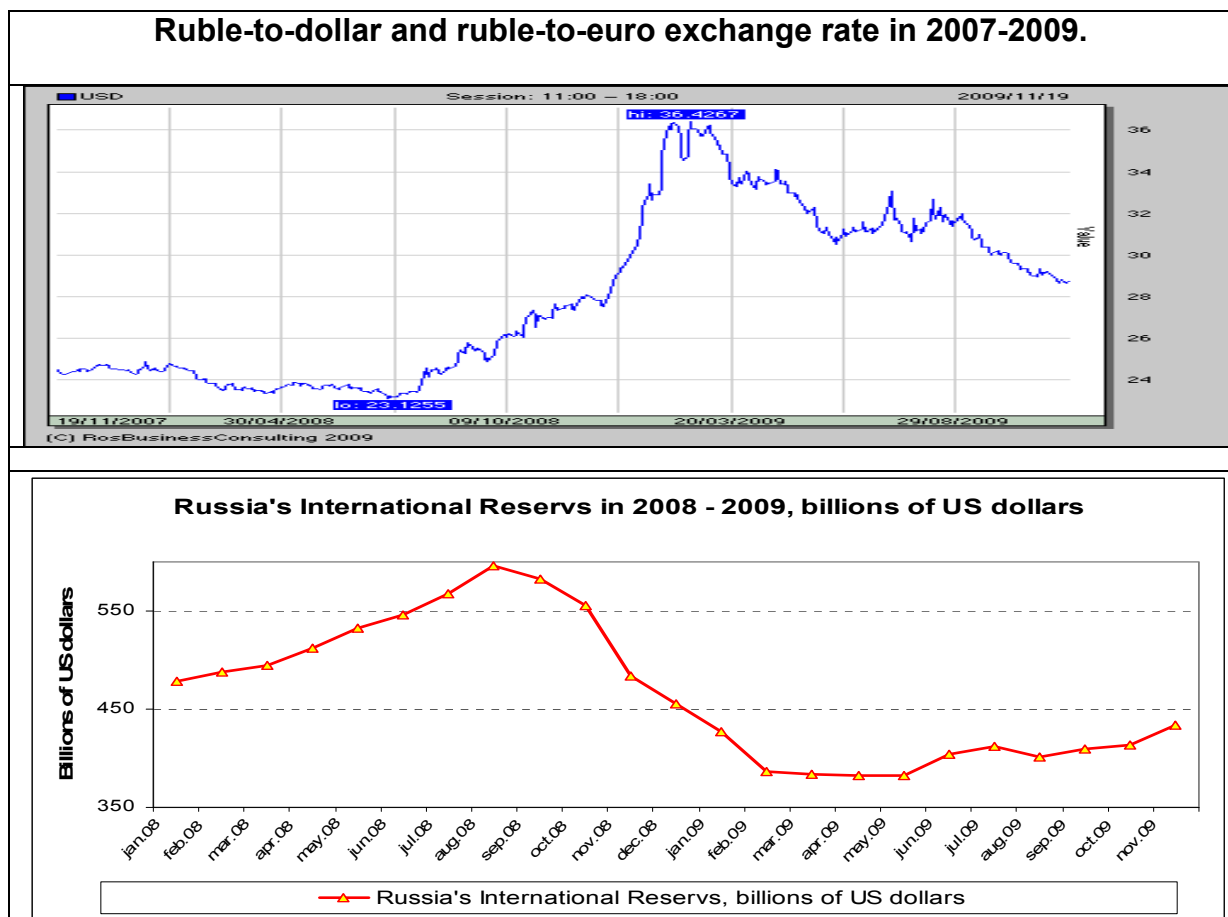
5) Currency policy was not good. For the political reasons it has been stage-by-stage devaluation stretched in time.

The positive moment is that population insured from rouble depreciation. Practically everyone who wished could exchange roubles to dollars or euro.

Smooth devaluation became the additional factor of support for manufactures, protecting the domestic market against the import goods, supported exports, and also has created additional stimulus for inflow to the future of the foreign capital in the form of direct investments.

However smooth devaluation has strengthened panic on the market and has led to considerable decrease of currency reserves.

- For the period from 1.08.08 till 1.04.09, approximately for 7 months, currency reserves of the Russian Federation have decreased by 35,7% or on \$212.8 bln. (from \$596,6 to \$383,8 bln.).



6) the Unique anti-recessionary action which is in an antiphase with world tendencies is strengthen of national currency policy. Thus, interests of importers appear above, than interests of export.

- During 19.02.19.11.2009 the rouble exchange rate in relation to US dollar has grown on 21% (with 36,42 to 28,71 rbl./dollars).

## **Conclusion**

1) Despite the active anti-recessionary policy spent by the state, with supported with a rise in prices for oil and other export-raw goods, the Russian economy will overcome consequences of crisis one more – two years. First of all, it is connected with deeper and long falling of internal demand, and also more long period of rigid credit restrictions. Besides the problem of saturation of economy long-term credit resources remained unresolved.

2) Delay with preparation and acceptance of the program of anti-recessionary measures the effect from their realisation will be noticed only in the beginning 2010. And by results of 2009, it is possible to assume that the Russian total national product will decrease for 8,7%, even despite rise in prices for oil.

3) Present economy, especially export, with prevalence of fuel, raw materials, half-finished products, absence of a diversification raises vulnerability of social and economic development from level of the world prices and demand.

Reduction of oil and raw materials prices is still the basic risk to the economy of the Russian Federation. Oil dependence already led us to crash twice. Disintegration of the USSR (1991) and crisis of 1998 in certain degree have been caused by the low prices for oil – about 12 dollars/barrel.

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