Russian economy
Crisis management lessons

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Economic importance of Russia

• Russia - biggest state in the world by territory (June 07 new discovery: Lomonosov ridge, running across N. Pole, - extension of the continent=1 m km2 territory under Arctic ocean).

• Lots of land for living, economic activity, lakes, forests and farmland for food production - 403m hectares.

• Irrespective of low agricultural productivity, the world’s 4th-largest grain exporter – 70m tons of wheat in 2011-12 crop. (27 export)

• Water resources - 31 000 m³ per capita (France – 3.3, Germany – 2.2, China – 2.3).
Russia - rich in natural resources

• Nearly all existing mineral resources available!
• 20,000 industrially significant fields of natural resources ready for extraction.
• Only 37% of them are industrially developed = huge development potential.
• Together with Saudi Arabia Russia is the biggest world oil exporter
• Russia is the 2nd biggest natural gas producer (after the USA shale gas 2009 rise in production) and the 1st largest natural gas exporter
• + economy in transition
Unexpected 1998 crisis

• Transition to market economy = more efficient economy
• Money allocated from inside and outside
• ($190bln from IO)
• B. Eltzin statement of 14 August 1998 «There will be no national currency devaluation».
• Next week ruble devaluation from 6r/$ to 21r/$! Banks insolvencies, thousands cos. went bankrupt
• = Economy in crisis
Reasons: the start of the GKO state short-term liabilities/ bonds

- Emitted by the Ministry of Finance
- General agent – CB of RF
- Several months to 1 year maturity
- First issuance – 18 May, 1993
- Trust in a new instrument, as a trust in transition to the new market economy
GKO – a growing pyramid value

• 1993 – not popular

• Issued and sold amount for 1994 – 12,8bln.ru ($2bln.)

• 1997 — 32 bln.ru ($5bln.)

• By Jan. 1, 1998 total nominal amount of GKO in circulation – 272. 6bln.ru. ($45bln.)
GKO bubble

• At an initial point – no relative importance
• By 1996 – early 97 about half of the state budget deficit was covered by GKO
• Since end 1997- beginning 1998 - GKO turned out to be the main financial instrument to finance the state’s budget
Reasons for a build-up. Yields

- Trust in the new instrument
- Non payments among enterprises versus guarantees for payments by the state
- High yields
- 1993 - 1998: up to 140% 1998!
Consequences

- Instead of injecting money into national economy – hovering it out
- Part of it stolen
- Part – non-efficiently used
- GKO fever wiped money away from the industries
Default

• The government stopped paying on GKO on August 17, 1998
• When not paid = crisis.
• Technical default resulted in the deepest economic crisis since WW 2
Paradox of transition to market economy

• Associative thinking: economic crisis occurred after liberalization, thus liberalization was thought as the reason for the crisis.
• Market economy reforms did not bring well being to the nation
• Free market was blamed for the sins of the crisis
1999 - 2008 – a decade of reanimation and steady growth

1998-2002 GDP grew 32.8%. Since then - about 7% a year

- Since 2000 the budget was positive balanced
- Public debt lowered from 85% of GDP in 1999 to 28% at the end of 2003.
- From 1999 to 2008 investments grew about 10% a year.
- Inflation decreased from three-digit numbers to two-digit ones.
- Real incomes rose since 2000 about 10-12% a year.
Russia enjoyed a decade of strong growth…
Indicators: GDP growth (%)

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Forecast of Russian politicians: by 2020 Russia will be the 5th world economy.

Pre-crisis per capita GDP on PPP in RF - $12,000, France – 30,000, UK – 35,000, USA – 43,000.

Russia comes 15th in the GDP volume - $1.4trln., but in the GDP per capita Russia was only 57th ($8,377 in 2004)
Fiscal policy had a golden decade…
Spectacular financial results

- Budget surplus since 2004 (0.6% of GDP - r74bln)
- 2003 - CB gold & hc reserves - $65 bln.
  2007 - over $400 bln.
  August 2008 - a record of $600 bln
- =The word’s 3rd largest. (China - $1,200 trln)
- (By end 2009 - $444bln) (China 3,0 trln in 2011)
- Stabilization fund – r3,0 trln=$117 bln
  (in search of beneficial and safe application)
2d paradox of transition: Russian seemed immunity to the world crisis

- Immunity to the crisis after the state comeback
- Russian leaders started to speak about immunity of Russian economy to crisis. Even when it started…
- Putin 29 October 2008: “Russia has no economic crisis at all…….”
- A week later… hardest crisis ever
New economic paradigm

• International debts paid to IMF, WB, London and Paris Club
• No new governmental borrowings
• U – turn
• Earning and saving
• Irrespective
10 years after: 2008 financial crisis

- RTS $1600 bln immediate loss = 73%. (MT 16.09.08)
- GDP decline – 9.5% - deepest among G-20
- Net capital outflow from Russia was $26 billion in September. (Central Bank Chairman S. Ignatyev confirmed 30 Oct 2008. MT 01 November 2008). $60bln - till Nov 08; about $140 bln by 2009 (BNP Paribas estimate)
- Reserves have fallen by more than $116 billion since reaching a peak of $600 billion in August. Fitch estimated that they lost a total of $160 billion by the end of 2009, or a quarter of their value.
- Budget deficit – 7% GDP
- Irrespective of financial pillows
economic impact was unusually severe

Change in seasonally adjusted quarterly growth between Q3 and Q4 2008
The shock which hit was huge

An unprecedentedly sharp fall in oil prices

And a massive turnaround in capital flows
Anti–crisis measures. China

- $584 bn for 2 years
- 74 m people supported by subsidies 1st half 2009
- 5 times raise in pensions
- 12 m teachers salary rise
- Car tax
Anti – crisis measures. USA

• Feb 2009 $787 bn
• Consumer support
• 36% - tax cuts
• 64% - infrastructure projects
Anti – crisis measures. Russia.

International context & comparisons
Around 6 trln. r. assistance

1. Finance Ministry initially provided more than $210 bln to financial sector. 3 trln. r. direct state assistance to fin sector (budget, 360 bln + CB) (close circle of banks & list insight..)

2. Was supposed to help real sector

3. Red supervisors in banks – red “party colonels”

4. Consumers not reached
Two different strategies – which lead to severe crisis

- Liquidity
- Borrowings versus savings
- Weak middle class – low consuming capacity
- No structural reforms
- High level of speculation
Lessons to the world economy

• Financial speculations effect on economic development
• Allocations not used for structural reforms
• High level of protection of the market turned out to be counter-productive both in financial sector and in majority of industrial sectors
• Modernization is a slogan of the day