Russia's Economic Crises in Comparative Perspective

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LUKE CHAMBERS, APR 10 2010

Russia's Economic Crises in Comparative Perspective: Exogenous and Endogenous Routes to Recovery

In attempting to determine whether the most recent economic crisis or that of 1998 is more damaging for the Russian economy it is important to acknowledge, preliminarily, that these two crises are different. The international economic, political and strategic contexts in which they occurred were different; the origins were different; the triggers were different; aside from the front-line victims of all major financial crises, the indirect victims are different; and, most importantly for this analysis, the recoveries were and will be different. Therefore it may not be fair simply to pitch the same indicators against each other, because the diffusion of economic and financial damage has occurred differently, even if the damage sustained by GDP growth is comparable.

It is necessary to briefly illustrate the main attributes of these crises, to temper any comparison of their damaging effects. According to the World Bank:

"Russia's 1998 [crisis] was a classic fiscal and currency crisis that resolved itself in a currency crash, debt default, deep devaluation, and a steep, export-led recovery from an extremely low base in a broadly benign international environment."[1]

In 2009, the crisis originated from the private sector: an overinflated housing bubble, easy credit thanks to masses of cash from the Far East, sub-prime lending and excessive risk, speculation and complexity in financial transactions. While governments may share blame for their deregulatory policies, it was not unsustainable government debt that *unleashed* the crisis in the first place. Furthermore, the international climate is far from benign. The global economy registered negative growth of 2.2 per cent in 2009,[2] while according to the WTO, the global economy grew at a rate of 2 per cent in 1998.[3] In short, the two crises show distinct differences.

With these points in mind, however, it is clear that the current crisis may possess deeper threats to the Russian economy than the 1998 crisis. The recent crisis will take longer to recover from, is perpetuated by a deflated international consumer demand, and strikes deeper into Russian society due to its all encompassing – macroeconomic/welfare and private sector debt – implications. In short it is, and will be, observable that the 2008/09 crisis is more damaging to the Russian economy, in its short-, intermediate- and long-term effects.

The first important factor in determining how damaging this crisis will be for the Russian economy is the international context. The sweep of this crisis is truly global, with negative growth tabled in the US, the Eurozone, the UK and Russia. There have been substantial decreases in international trade, increases in unemployment and volatile commodity price fluctuations. European banks have collapsed, equities markets have lost huge amounts of value, and a currency crisis has consolidated trade into a small number of "safe" currencies. Not even so-called "emerging" markets are immune from the effects of the crisis[4] and losses across the often fiscally impervious Arab world have amounted to $3 trillion.[5] In short, as Philip Hanson avers: "The economic crisis has hit every country in the world. Even such nearly-autarkic economies as North Korea and Burma are not untouched."[6] This global context is bleak for Russia's prospects, as it is dependent on a buoyant market given the nature of its resource economy.

It is important to remember that while the 1998 crisis had origins outside Russia, namely East Asia, the damaging effects of its own crisis were due to the dire state of its own public finances and internalized problems. The origins of this crisis have come from abroad, having been triggered by a collapse in the American housing market and the subsequent damage done to American mortgage-backed securities. But how damaging it will be for Russia may depend more on the international economic and financial climate than its own domestic measures, unlike in 1998. In other words, it has less control over its recovery. Steadily increasing oil prices since record lows have not been sufficient to pull the Russian economy out of its slump.[7]

This may be problematic because, as Philip Hanson has noted, Russia's economy is "rather strongly engaged in international business."[8] It is well linked to external trade: its exports are 30 per cent of GDP, second only to China among BRIC countries, and its inward FDI is comparatively equal to China's; correspondingly, its external debt is the highest of the BRICs.[9] This kind of relationship with the global economy, under healthy economic conditions, is undoubtedly a positive indicator of Russia's integration to the world market after the Soviet era. But, as Hanson further stresses, this engagement leaves Russia extremely vulnerable to crises that emanate from elsewhere.[10]

In sum, Russia's improved engagement and interaction with the globalized world economy, while desirable under normal circumstances, will constrain the recovery of the Russian economy and help to determine the damage it will sustain in the coming months and years.

The second major factor that must be considered is the overall macroeconomic policy of the Russian central government. Here, economic and fiscal policy has largely been prudent in acting as a "cushion" for the worst effects of the crisis.[11] But, as with the international context, we must discern what is different about this crisis for the domestic context. For macroeconomic policymakers, unlike the 1998 crisis, the vast majority of the problematic debt in this crisis is located in the private sector.[12]

It should be noted that before the recent crisis, Russian economic performance showed significant promise. Growth reached a peak of 8.1 per cent in 2007 and only slowed to 5.6 per cent in 2008.[13] Looking at Russian GDP from 1992, the clear dip and upward curve can be credited largely to the post-Yelstin era leadership, but this surge upwards began almost immediately after the 1998 crisis. Admittedly, the entire post-Soviet region has shown similar growth. But under Putin, Russian GDP rose to the eleventh largest in the world economy. In short, the policy workspace, capabilities and instrumentation are entirely different in handling this crisis than the last. For a start, Russia in 2010 is a functioning economy with a powerful state; it could be argued that neither of these things existed at the time of the 1998 crisis. Ellman, for example, notes that "Russia at the end of the [Yeltsin] era lacked a state that could reasonably be seen as the defender of the public interest."[14] Things are clearly different now, and it could be assumed that this would ensure a smoother ride through the crisis.

However, keeping our observations to countries in similar situations – namely the BRICs – it is clear that Russia is suffering more. The steepness of the fall in its activity and its "deterioration in economic performance" is indicative of what Philip Hanson describes as some kind of "specifically Russian problem."[15] In the run-up to 1998, the choices of central government went a long way to cause the crisis where, Sakwa notes, "severe fiscal imbalances undermined monetary stability" and Russia's entire economic vision "depended on the West in the form of debt restructuring and stabilisation funds."[16] Without oversimplifying the complex nature of economic policy and activity, it is fair to suggest that the government recovered from the 1998 crisis because, in part, it had caused it; the recent crisis is arguably more multifaceted and its problems are not as eradicable in the same manner. It seems clear that up until August 1998, the rouble was considerably overvalued and that by correcting this imbalance, macroeconomic policy would be able, however painfully, to correct this problem with an injection of short-term trauma.[17] But unlike 1998, Russia cannot extricate itself from this crisis, or significantly determine the path of its recovery, by a twist of macroeconomic policy.

The continuing malaise, despite sound government policy and strong preceding growth, is evidence that this crisis is deeper than that of 1998. The period following the 1998 financial crisis was defined by what Hanson refers to as "nine years of rapid growth, [...] eight years of budget surpluses and the third largest foreign reserves in the world."[18] It seems clear, then, that despite this advantageous position going into a crisis, the fact that Russia has suffered substantially is an indicator of the seriousness of the recent crisis for the Russian economy. Indeed, according to the World Bank, "the current crisis is likely to be deeper (in terms of growth deceleration) and longer than the 1998 crisis."[19]

In sum, this crisis may be more damaging for the Russian economy because while the 1998 crisis was corrective, and may have taught policymakers a lesson, this one occurred even when they seemed to be doing everything right.

The final factor indicating that the recent crisis will produce potentially deeper and more damaging effects than the 1998 crisis is the recovery path. While it is too early to accurately evaluate the full nature of the recovery from the current crisis, there is enough data to distinguish it from its predecessor.

The 1998 crisis was undoubtedly disastrous for the Russian economy but most would agree that it represented the culmination of a disastrous economic era. In many ways, Richard Sakwa is correct to credit the 1998 crisis as the "turning point" in Russian post-Soviet economic development; he also notes that by 2001, "the World Bank had taken Russia off the 'crisis list'. Russia had become a market economy."[20] The transformational role of the 1998 crisis is difficult to dispute.

But as Rudiger Ahrend has noted, few expected the Russian economy to bounce back with such vigour, and even until 2005, estimates were consistently below the resultant figures: in some cases GDP growth was twice the predicted rate.[21] Between 1999 and 2004, average growth was 7 per cent.[22] This is formidable, and suggestive that the Russian economy had been strengthened by the 1998 crisis, as macroeconomic policy became more prudent and society became perhaps more conventional (recognisably capitalist) in the autonomous dispersion of resources and wealth, on average. So it is clear that the intermediate term recovery was robust, though we cannot accurately and fairly compare this record with the recent crisis as we do not know enough yet.

The short-term recovery indicators of the 1998 crisis were also relatively positive. While Russia's deepest contraction in 1998 was 9.1 per cent in the fourth quarter, by the second quarter of 1999, growth had already reached 3.1 per cent, and nearly 10 per cent by the end of 1999.[23] In contrast, according to World Bank figures, Russia's "economy has already contracted by an estimated 10.03 per cent in the first nine months" of 2009; the overall contraction for 2009 is estimated to be 8.7 per cent, which is "worse than [was] projected".[24] While these figures are tenuous in explaining the grand process of recovery, they are evidence that even the face-value numbers show that more damage has been incurred in 2009 than in 1998. It is safe to assume that although the situation will improve marginally, Russia will not return to the growth rates of the early 2000s for quite some time. The World Bank also stresses in their November 2009 report that, importantly, "weak global demand, compressed consumption, and tight credits will continue to constrain economic recovery in Russia."[25]

In terms of indicators of "social" recoveries, the current crisis also appears to have a bleak outlook in comparison with 1998. While the 1998 crisis may have represented a turning point for the ailing Russian economy and dire social conditions in the 1990s, the effects of the recent crisis are projected to be deeper. According to the World Bank, "the expected modest recovery of the economy during the second half of 2009 is unlikely to have [a] significant impact on social indicators."[26] Incomes will continue to fall, unemployment will rise further and, crucially, poverty may not recede back to pre-2009 levels for three years, despite improvements in labour markets.[27]

In conclusion, from general indicators it would appear that the recent global economic crisis will produce more damaging effects for the Russian economy than its own 1998 crisis. This is largely due to the fact that the origins of this crisis were in the private sector and that the Russian economy is much more integrated to the global economy than it was in 1998. The recent crisis was not, as in 1998, triggered by macroeconomic and monetary policy. This means that the effects of the crisis will spread through the world of private exchange, which has grown considerably in Russia since 1998. While the 1998 crisis occurred in an international climate that was largely "benign", according to the World Bank, this crisis has shown itself to be systemic, bringing the entire architecture of market capitalism into question. Another indirect observation is that the 1998 crisis may have been a necessary trauma for Russia to emerge as a market economy: its effects included a normalization of the value of the rouble. The recent crisis will produce few such positive outcomes, except perhaps the lesson that Russia should diversify its economy. A major conundrum for Russian policymakers will concern how to integrate into the global economy and emerge as a good citizen of the globalized world, and yet vigorously protect its own interests.

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Written by: Luke Chambers
Written at: Oxford University
Written for: Dr A. Chawluk
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