

Russian financial crisis essay sample

[Finance](#)



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1. Introduction

1. 1 Financial crisis

Financial crisis can be referred to as interruption to monetary markets in which ethical risk and unfavorable choice become bad hence economic markets are unable to competently organize funds to those who have favorable industrious investment opportunities. (Morten, 2004) The financial crisis usually impairs a remarkable segment of banking systems resources. This causes the relevant institutions to fail to supply the necessary liquidity because of a less cash encountered.

1. 2 Transitional economy

This is an economy that is changing to a free market economy from those ones that are centrally planned. Such an economy lowers trade barriers and also lets the market forces set the prices of the products. Under transition economies, macroeconomics is employed to deal with the organization, presentation and activities of a national economy which helps in calculating instantaneous high inflation. It also causes privatization and reformation which creates a monetary sector hence moving from communal to confidential possession of resources.

1. 3 Objectives

This research paper aims to bring out the lessons that can be derived from the Russian financial crisis of 1998. These lessons will be arrived at by scrutinising the root causes of the financial crisis. The parameters that are imperative to arriving at the conclusion are world oil prices, the GDP per

capita of Russia, its foreign direct investment/GDP, the stock prices, Russia's export growth, and real exchange rates as well as the real interest rates.

2. Data and Methodology

This dissertation has employed the use of economic indicators to arrive at the final conclusion. The indicators that have been intensively analyzed are the exchange rate of the ruble in comparison to the US dollar, the GDP, tax measures, foreign exchange, export and import. Records of such macroeconomic indicators as provided by the IMF were of immense help. The statistics provided by these sources have been gauged against the trends of the indicators over the years.

3. Empirical Review

The success of this dissertation is made possible through extensive consultation with prior works done by various researchers. John, P. (2002) carries out a vivid analysis of the causes of Russia's financial crisis and gives a projection of uncertainty for the economy if the situation. He posits that one major cause of the Russia's economic tribulation had a lot to do with the malfunction of the tax system as well as the slack insolvency laws and measures. The position he takes in his study is of immense help in analyzing the indicators that economies in transition should observe and thus be in a position to stabilize economically whenever there is such fallout. Conway urges that economies in transition should be prepared for stabilization and growth

On the same platform, Gonzalo Pastor and Tatiana (2001) argue that by examining the prevailing economic conditions in Asia at the time when

Russia experienced the financial crisis reveals that these economic conditions (of Asia) had strong contribution. These conditions, they argue, tightened the situation further by exerting more pressure on the Russian foreign exchange markets. They further look at the macroeconomic indicators like domestic investment, tax to GDP ratios, government spending, and Russian external capital flow. After the analysis they make a conclusion the financial crisis that hit Russia in 1998 has a lot to offer economies in transition in that it had both direct and indirect impact on the economies of such countries' (more so central Asia) exports and imports.

4. A Brief Literature Survey

In order to gather sufficient facts and data that are capable of allowing the drawing of conclusion and deriving lessons exhaustively, it is imperative to take a short and succinct survey of the contributions made by various individuals. This literature will be helpful in backing up the solutions offered to the economies in transition.

John, P. (2002) “ Russia’s Uncertain Economic Future: With a Comprehensive Subject Index,”

4. 1 Russian financial crisis in 1998

The 1998 Russian financial crisis was a major cause for the call for the economic transformation as it uncovered many of the weaknesses of the Russian financial policies. The crisis was realized in august 1998 due to the government abandoning its defense of a well-built ruble. In the previous years, Russia was dealing with the deficits via money creation. In the year 1995, the government of Russia introduced the issuance of government

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bonds as an alternative of money creation to deal with deficits which comprised of GKO bonds denominated in rubles and the practice was trendy amongst the shareholders in Russia. Due to the popularity of these bonds, the interest rate existing on them was towering causing an increasing pressure on the interest rates from corner to corner in Russia.

The major events and causes that saw the start of the Russian financial crisis are highlighted. These causes include attrition of human capital caused by demographic decline; maldistribution of power (specifically political power as well as that involving decision making), persistent growth of monopoly in various industries like agriculture and energy, heightened distortions arising from corruption and lastly the wanting infrastructural inadequacies. The author relates those events to the present state of Russia and sounds an alarm to the economies in transition that there is an indication of uncertainty for the future of the Russia's economy if the same trend persists.

Conway, P. J. (2001) "Crisis, Stabilization and Growth: Economic Adjustment in Transition Economies,"

4. 2 Disparities in the Real Returns for the Foreign and Domestic Investors

The increased popularity of bonds was caused by the foreign investors who received real returns ranging from 20 to 30 percent yearly whereas domestic investors received lower amounts of the real returns. As a result, there were increased interest rates caused by the dissimilarity amid the two real returns. This crisis caused the failure of many banks in Russia which were holding government debt. It also caused the president to fire Prime Minister
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Kiriyenko and replace him with Primakov as he was linked with the cause of the crisis for announcing that the ruble would be allowed to vary between 6 and 9.5 up to the end of that year in comparison to the dollar.

4.3 Symptoms of the Financial Crisis

There were various symptoms that signified the presence of the crisis. Tumbling of the value of ruble- the ruble lost about 60 percent of its ostensible worth in terms of dollars between the months of July and September 1998.

Dropping of the real GDP- after a diffident rise in 1997, real GDP decreased with 4.9 percent in 1998 raising the inflation rate from 11.0 percent to 84.4 percent from the year 1997. (Ibid)

Rising of the interest rates- between the months of August and September 1998, the CBRs inter-bank loaning rate shot up from the average of 45.3 percent to 135.5 percent. Its rate of refinancing also rose from 30 percent to 150 percent between April and May. Declining of the foreign reserves- the country's reserves declined " from \$18.4 billion to \$12.5 billion" between July and August 1998 (Ibid) This was mainly facilitated by the fall of price of oil internationally which was the main earner of the foreign exchange for Russia.

Values of the stock market plunged- from April to August 1998; " index of stock prices" had gone down by 79 percent according to the Moscow Times (Ibid)

Gonzalo P. and Tatiana D. (2001) “ The Russian Financial Crisis and its Consequences for Central Asia ”

4. 4 Causes of the Financial Crisis

There are various reasons that may cause financial crisis like interest rates, exchange rates, budgetary policies or bad policies by the central banks or the governments among others. It can also be caused by an unexpected or striking loss of shareholder and financier assurance. When banks fail to fulfill their customer's demands for currency, this might cause the customers to lose confidence with the bank. This is because they fear to lose their money as a result of their deposits getting frozen.

Due to the rapidly increasing budget deficits, there was a need to finance it which led to the buildup of the Russian government short-term arrears as bonds and the GKO's. The Russian government kept the ruble stable by servicing its debts by managing to uphold large budget shortfalls without sustaining inflation. Russia experienced the financially susceptible state in 1998 due to various forces that affected it including:

- Asian financial crisis which in turn caused the investors to be mistrustful of investing in the hazardous short-term securities like the GKO's (also Dominic, et al, 2002).
- The global declining prices on commodities and reducing demand for Russian sort-term debt put a pressure on the ruble which in turn made it expensive for Russia to service the foreign debts.
- Most of the commodities which Russia depended on for its earnings of the foreign currency were badly affected by the world prices for oil.

This in turn put a pressure on the foreign currency capital which made it hard for Russia to service the debt hence was unable to defend the ruble. The government bonds that Russia had in the year 1998 consisted of 34 percent of the government disbursement (Conway, 2001; Dominic, et al, 2002).)

- The gross domestic production in Russia had declined whereby the national debt was 44 percent of the domestic production.
- Another cause of the crisis was by the government, due to its malfunction to draw any favorable amount of bidders for a fundamental privatization arrangement, a 75 percent state within the oil corporation.

There were also tribulations with the Russian economic structure and its economic structure like its malfunction to establishment of assets rights, insolvency laws and measures and tax restructuring.

5 Impacts of the Financial Crisis

As a result of the crisis, the Russian government made two big innovative matters of dollar-denominated Eurobonds in June which were availed at reasonably advanced interest rates. This caused a serious repayment problem to the government resulting to a build up of its debts. In some cases, according to (IMF 1998, 18), coupon expenses and redemptions would sum up to some high levels of \$1 billion per week by May 1999. This caused the Russian government to seek some foreign financial assistance due to its fallen reserves which had declined harshly to very low amounts. Chaos in the financial markets had activated a great assets flight in the Russian economy. The government then came up with some plans that were meant to check on <https://assignbuster.com/russian-financial-crisis-essay-sample/>

the Russia's economic crisis. These plans were summarily criticized by the United States and the IMF. Since the government was determined to curb the crisis, it accomplished a new agreement with the IMF that was entered in 1999 by engaging itself to a reasonably conformist tight financial and monetary strategy. This agreement was a major beginning for a more stable economy in Russia since the crisis.

There was another change caused by the then president of Russia Boris Yeltsin, when he appointed a rather unfamiliar heir Vladimir Putin as a result of his withdrawal from politics at the end of 1999. Due to Putin's background in the government and intelligence service, it was extensively contemplated that after his win in the 2000 presidential election, he would be in a better place of governance than the others making the capacity of the Russian state stronger. On 3rd April 2001, Putin delineated a determined agenda to the federal council and the Duma, which was aimed at structural reorganization. The new president mentioned on the need to embark upon fraud, Russia's rentier financial system, underprivileged corporate domination and the past illegitimate privatizations of the natural resources of the Russian country.

The way that Putin fused the authority of the centralized government and presidency in conjunction with his well-built operational interactions with both quarters of Russia's parliament caused an improved confidence in his new government. In smoothing the progress of vital management over Russia's region, he additionally twisted seven new "super regions" whereby

he selected workforces from the intelligence bureaus and the forces to head the regions.

In his government, most of the influence and control by the oligarchs was considerably diminished. For example, despite the efforts by Boris Berezovsky to use his TV channel ORT to brutally denigrate Mr. Putin's presidential rivals and prolifically undermine him in the 2000 presidential voting, Putin went after his export dealings which due to the 1998 crisis and deflation of the money were getting promotion from the increased export earnings. His media possessions including the ORT were afterwards taken from him by Putin which caused him to go for a banish instead of facing questioning in November 2000 by the Russia's prosecutor.

However, there were other oligarchs who hanged on to some considerable control like Vladimir Potanin who preserved his scheming interests in the oil, gas, real estate among others. When Yeltsin was the president, oligarchs had noteworthy pressure over gubernatorial and presidential determination, government fiscal strategy and the government workers verdicts whereby they learned to deal in a new way under president Putin with presidency and the Kremlin (Ngaire 2006, 130-136)

Since by 1998 the Russian financial system was based on barter trade, it was very hard for the government to monitor levies. Many of the many business institutions were using barter trade as a means of payment whereby the ventures insisted on using the duty debts to haul out orders from the government. This caused an observer to conclude that Putin's mental picture when he mentioned intensification of the state in his speech was more one of

a “ corporate entity” whose main concern was to offer “ protection of life and property, and coercion services selectively to the business community under guise ‘ law enforcement.’” Putins first agenda was to enforce a wide-ranging tax modification through Duma that would cause easy tax regulations as well as finishing lots of the ambiguities that were previously encountered.

Though the IMF had stopped subsidizing Russian government by December 2000 because of the expired reserve understanding, it was very closely scrutinizing the macroeconomic goals in the country under its post-program supervising measures. Up to that time, SDR 5. 55 billion was the amount of money that was owed to the IMF by the Russian government which is approximately 10. 67 percent of the society’s whole stupendous capital. The foundations possible sway has all but vanished as Russia’s gas and oil incomes have obviated its want for the IMF sustenance either in the kind of endorsement for Paris club rescheduling or in the form of loan which has resulted to Russians repaying the IMF and its Paris club debtors.

Since the august 1998 crisis, Russia has been reported to have spectacular positive upgrading in macroeconomic results by the IMF, quoting the sturdy incentive development granted by the great genuine decline in the currency, and supported by the enhancement in the global energy costs. Another result of the international rise in energy prices in Russia is that it led to a new flow of high profits to “ Russia’s oil exporting oligarchs.” On the less positive side, the funds has caused some disappointing especially in the structural transformations, mainly in the infrastructure dominations and the banking region, where the tactics to reorganize the banking, energy, and gas regions have all been repeatedly postponed (Dominic, et al, 2002).

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6. Conclusion

From the lessons learnt due to the Russian financial crisis in 1998, other economies in transition should establish good methods of dealing with the budget deficits that will ensure that the governments disinflate as hastily as possible to avoid cases of protracted inflation. Secondly, such economies should consider hardening the financial plan control for the market mechanisms to be permitted to work as well as lifting up the budget revenues for an increased efficiency of such economies. Thirdly, any mechanism aimed at financing the budget's deficit out of a diminutive term set should be dumped. The economies in transition should also be cautious whenever there is a single macroeconomic shock in the economy. Rightful measure should be taken to ensure that credit resources are not exhausted otherwise subsequent result would be the banking system to collapse. These economies should link up with the universal financial structure and ensure that the appropriate safeguards and principles are well established and implemented. Such should include satisfactory market regulation, sufficient peril management and asset-liability organization skills, high-quality corporate control, apparent financial reporting and accurate bookkeeping.

7. References

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