
Explaining current Russian economic crisis (Reflections)

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Prepared for the Tokyo workshop, 19 March 2009

I propose to discuss the following topics

- Preliminary remarks
 - Questions arising from the crisis

 - Crisis typology
 - Different theoretical explanations

 - Some historical illustrations
 - from Russia
 - Developing the theory – some suggestions
 - Conceptual issues
 - Applied and technical issues
-

Preliminary remarks

Explanations (**positive science**)

- General opinion
 - **Trichet (ECB)**- excessive risk appetite, perverse risk distribution, short-termism and procyclicality of FS, lack of transparency....
 - Lack of regulations of FS/bad accounting (valuation M to M etc...)
 - Lax Greenspan monetary policy
 - Confidence issues on money market
 - **Market failure**, market inefficiency, the era of market is over etc.. (Roubini, Soros etc.)
 - rarely - Global disequilibrium, saving glut, Chinararely state guarantees (mortgage agencies)

Not clear model, but close to **Austrian interpretation...** (Taylor)

■ Policy actions (**normative, prescriptions**)

- **National**
 - Monetary stimulus (ECB balance sheet + 40%) and public guarantee of money market ...
 - Fiscal stimulus
 - Nationalization (banks/business)
- **International/global**
 - Financial architecture
 - Financial supervision/accounting
 - Fiscal coordination/exchange rate policy?

Back to **Keynes** (Minsky)

John Taylor (2009)/monetary excess/crisis – is du to **counterparty risk** rather to liquidity problems

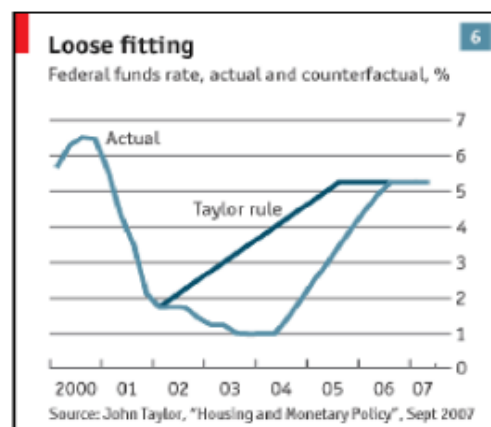


Figure 1. Chart from *The Economist*, October 18, 2007

Questions arising from the crisis

- **Why again crisis?** Why the crisis was not prevented?
- **Was this crisis specific?** If not why the people did not learned from the past? **Why the theory (generally) overlooked the crisis?**
- Who is responsible – politicians, technocrats, theorists, etc.

- **What specificities of deferments countries, the case of Russia?**
- **How to improve** the policy making in the future, if possible ?

- How the theory could ‘use the crisis as engine’, what should be the improvements of today, revival of old, or probably building of new theories?
- **Hayek** – economic crisis is fruitful for economic and particularly monetary theory ...
- If revival of old theories, **why again Keynes winner?** Etc.

Crisis typology (remembering old issues)

- Part of economic cycle, fluctuations, waves, oscillations etc...
 - Short business cycle, conjuncture (Kitchin)
 - Inventories, seasonal
 - Standard Juglar business cycle
 - Sectoral (agriculture, building, Kuznets...)
 - Longue waves (Kondratiev, Schumpeter ...)
 - Super longue Jenny Gritziotti - Kretchman...(medieval, mercantilist, capitalist, plan ...)
 - Crisis accumulation (superposition) of different cycles....

- System crisis (meta-, societal-)
 - Marx (socio-economic formation, meta-, specific methodology)
 - Schumpeter, Sorokin, Polanyi (the Great Transformation etc.), Eucken...
 - German historical school

Theoretical Explanations

- According to the **primary impulse** (original cause)/ Haberler (1937)
 - **Monetary**
 - **Real** (consumption, saving, investment...) ... **over-, under-**
 - **Synthetic**
 - **Non economic** (climate, population, harvests, wars, techniques, entrepreneur, physiology, culture etc.)

- According to the impulse (related to the position at the **system position**, how you define economy), according to distortions ...
 - Exogenous
 - Endogenous

- According to **the solution**
 - Market
 - State
 - Mixed

Vertical (temporal)
 Horizontal (spatial)
 Synthetic (time + space: Hayek)

Austrian explanation(s)

- Why choosing Austrian model(s)?/FT-”Keynes offers the best way to think about the FC...” **but even Taylor (2009)**
 - Possibilities for synthesis and development, for “universal” model ...
 - Flexible and open (but marginally used and improved, despite some revival..., implicitly present IMF ... Oppers (2002)



Austrian school (basic postulates) 1

Austrian school

Structural and micro-issues are crucial.../ relative P

Good differentiation

Money is medium of exchange
(not store of value)

Money is not capital, not investments

Money should be covered, **real**

Money arise from **preliminary S**

Discretionally management is bad,
private issues according to some
rules....

$$MV = P (C+I_1+I_2+I_3+I_4+I_5+\dots + I_{N-1}+I_N)$$

Mainstream school
(simplification)

High level of aggregation, macro- / general P level

Not differentiation of goods, not
temporal aspects (or ... short time)

Money is store of value and unit of account, measure (unit of value)

Money is a form of capital, sort of
investments...

Should be managed **discretionally**

Money are not covered, fiat, **state**,
ideal etc... (Keynes was against the
gold standard ...)

$$MV=PY \text{ (Hawtrey) или}$$

$$MV = P (C+I) \text{ (Keynes)}$$

Austrian school 2

Austrian school

Interest rate

Natural interest rate: $i^* = (C_t/C_{t-1}) - 1$; $i^* = S/I$

Preferences change slowly

Monetary rate: $i = i^* + \text{money market } (M^D/M^S)$

Changes discretionally by CB, she creates shocks
and uncertainty via ΔM

Disappearances $i > i^*$, $i < i^*$,

Impact on the structure of production

$S = S(i^*, i)$, i^* is secretly substituted by i

$M^D = M^D(Y)$, not i^* , i ...

Economic growth is not a goal it itself

Essential is to fit the preferences about C, S, I ...

Growth is saving-induced, not credit and money
(they only create illusion of growth and income)

**Crisis – from supply side of loanable funds,
lake of S and over-C...**

Booms is bad, crisis is good.

Mainstream school

Interest rate

There is not clear separation between natural and
money rate

**Interest rate is mainly monetary, or
decomposed differently (real...)**

Does not have influence on the structure of
production, but on the total level....

$S = S(Y-C)$, saving is residual

$M^D = M^D(i)$

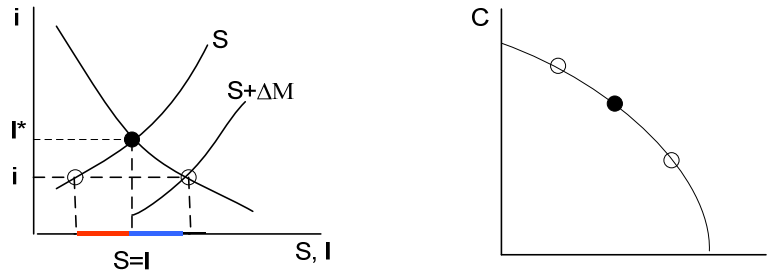
Economic growth is crucial goal

**Could be induced by credit, or money or
public expenditure, debt etc... but in any
case not strictly related to S...**

**Crisis – from demand side of loanable
funds, lake of I and under-C..**

Booms is good, crisis is bad.

Market for loanable funds and production possibilities frontier



When $i < i^*$: $S < I$ and under given resource constraint, less S (more C) and over (mal) I ...

(-S_t) became (+C^D_t) and (+I_{t+1})... ; I_{t+1} is future anticipated C

Derived demand and time discount effect....

Austrian school 3

- Mechanics of the crisis:
 - **Start: monetary injection**, creation of credit money (without preliminary S), market interest rate goes below its natural level ($i < i^*$), liquidity raises and deforms the trajectories of consumption, saving and investments ..., **cumulative process (Wicksell)**...
 - **Destruction of relative prices**, price signals (**forced S**, part of the S became current C^D, i.e. $C^D > C^S$)
 - **Over-Investments and (mal-Investments)**, $I^S > I^D$... I financed by credit money...
 - Technically **the turning point** is crisis when change the directions of interest rate, from $i < i^*$ to $i > i^*$...



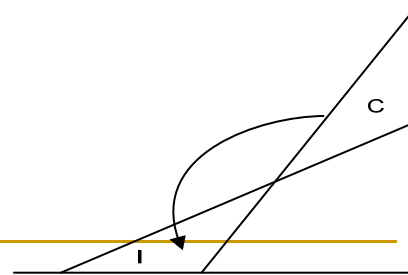
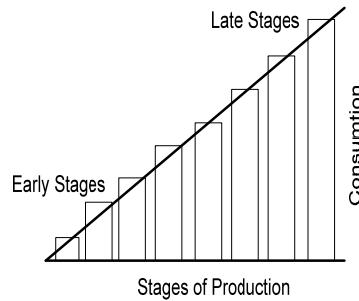
Hawtrey: instability of credit system , pure monetary cycle, gold standard, CB could ...

Wicksell: pure credit economy, cumulative principle...



Austrian school 4

- Investment triangle (Concertina effect Hayek 1; Garrison, Sraffa and Kaldor critics, Hayek 2 ...)
- When $i < i^*$, **triangle became longer**: long term I are over developed (new productions) and productions close to C... so the two ends are pulled aside, **and the middle stay underdeveloped** (machines ...) ...
- Wicksell + Bohm Bawerk
 - Boom: elongation $\Delta I > \Delta C$
 - Bust: shortening $\Delta I < \Delta C$
 - **Concertina effect**
 - Ricardo effect (from the fall of real wages)....



Austrian school 5

Garrison model
 ($i < i^*$) and consecutive restoration of preferences

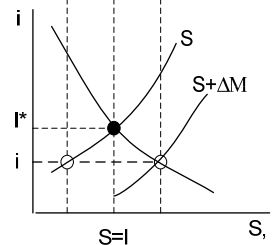
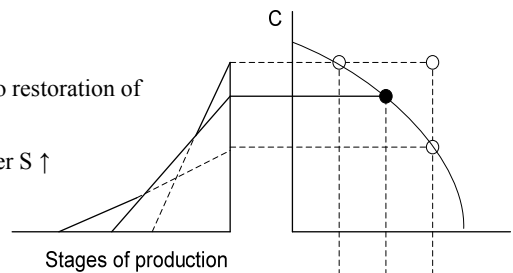
Natural boom when fall of $i^* \downarrow$ under $S \uparrow$

Artificial boom
 (Bubble) when $i \downarrow$ under $M \uparrow$ (OMO, RR) ...

Chart:
 Market for loanable funds +
 Production possibilities frontier (resource constraint)
 +
 Structure of production ...

Reversing arrives when people realize the change of i^*/i , when $i \uparrow$, and PV of I decline...

I consider this explanation consistent with debt deflation, Fisher, Minsky etc...



Russian history

■ Russia now (1998 - 2008)

- The first capitalist crisis in Russia since end of XIX centuries (no Great Depression)
- Monetary creation (**oil driven**), low interests rate, over and mal investment... (homes, pipelines ... without gas)
- After 1998 crisis **monetary stance changed** from strict to laxity...
- Credit, mortgage and stock market booms, **corporate debt** raise (almost 100% of GDP, 150% F), 80 % of the debt 15 corporations..., state protection...
- Lack of competition at the banking system (3-5 state banks); the energy sector (Gazprom)
- Deposit over insurance
- Very sophisticated stock market

■ Stalin forced

industrialization in 30th

- Forced (not voluntary) mode of **S mobilization**, ... (inflation, debt domestic and foreign, deficit, ...)
- C restrictions, over and mal I..
- At 70s and 80s oil prices helped Russia
- But postponed the adjustments and preferences restoration
- (difference with Poland, Hungary and others...)

Why Russia is important?

- The first capitalist crisis, since 1900
- 1998 transformational crisis

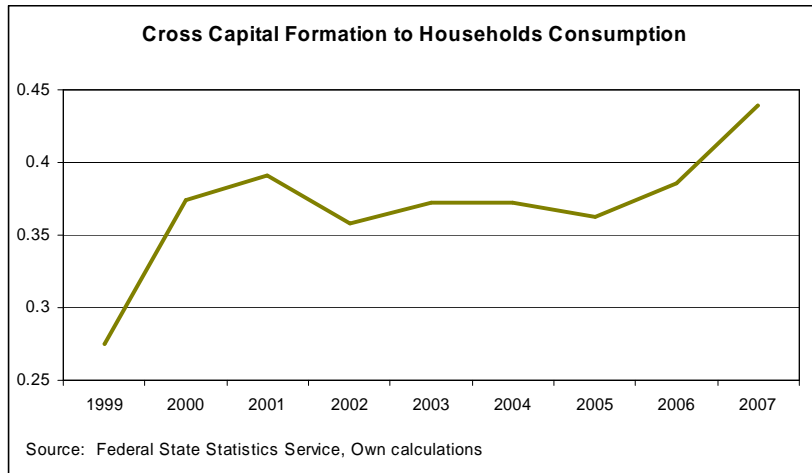
And because...

- Crisis +

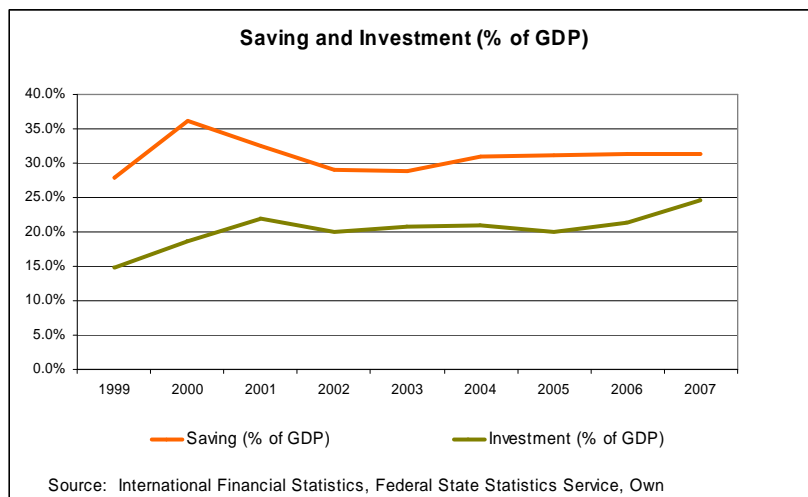


= dangerous combination ?

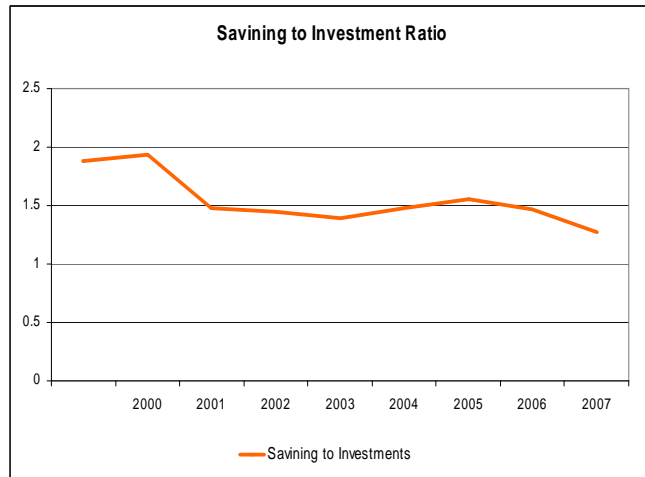
Russia (after 1998):
Overinvestment and rising “Investment/Consumption “ratio



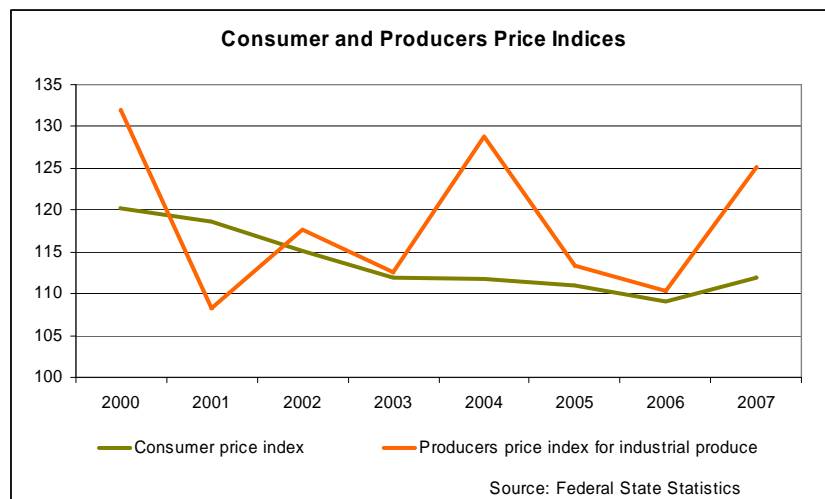
Russia: private saving and investments



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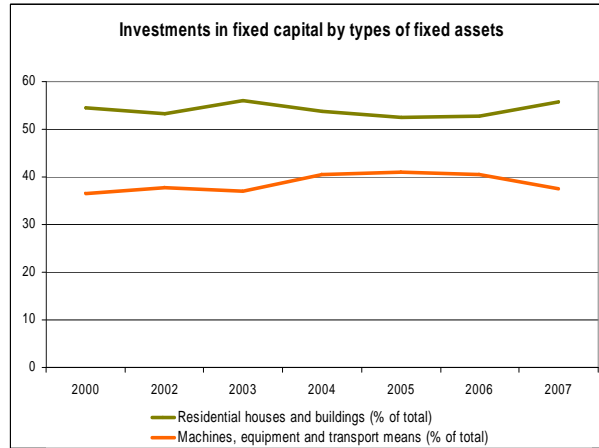
Russia: higher producer price volatility



Russia: Structure of Investments

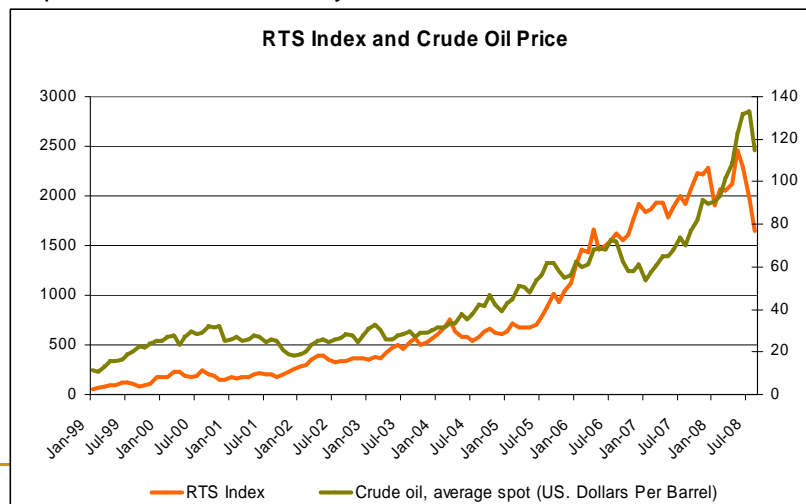
January 2008

50-70 %
of the
machines and
equipment
are totally
amortized

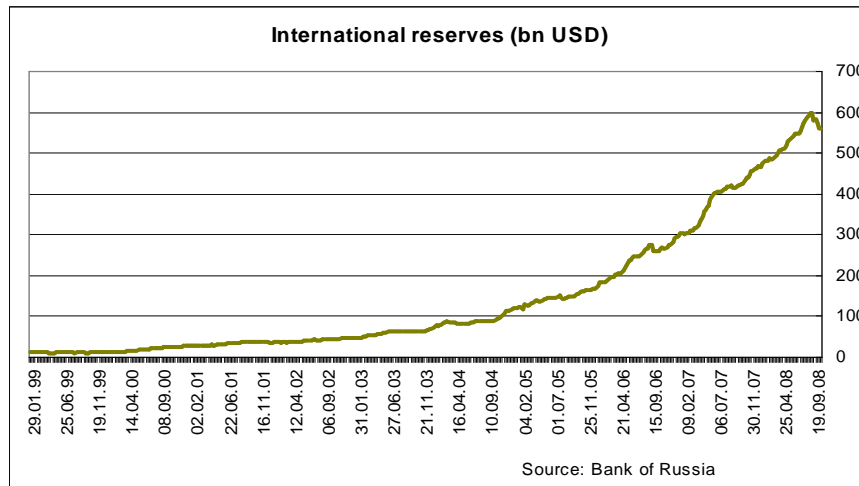


Russia: exogenous shock and oil dependence

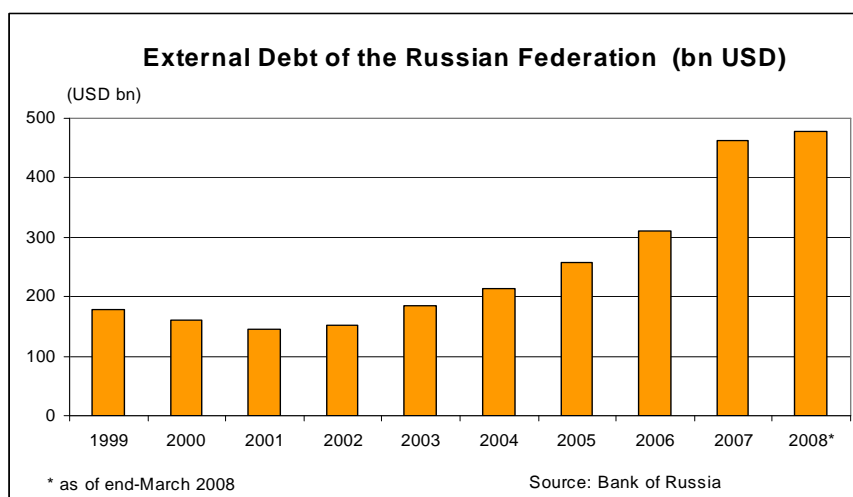
- Monetary creation + constant saving preferences
- Oil price and stock market dynamics



Russia: International Reserve Accumulation

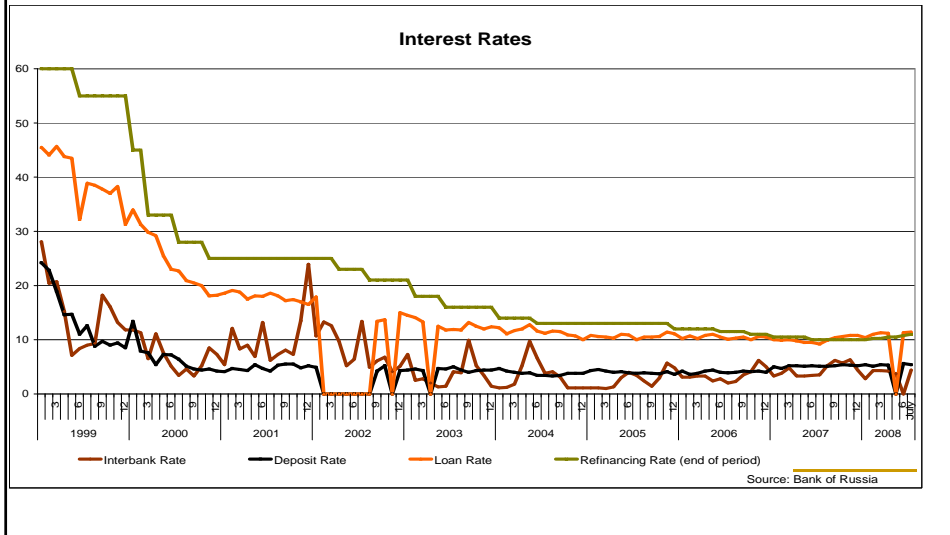


Russia: external corporate debt raise



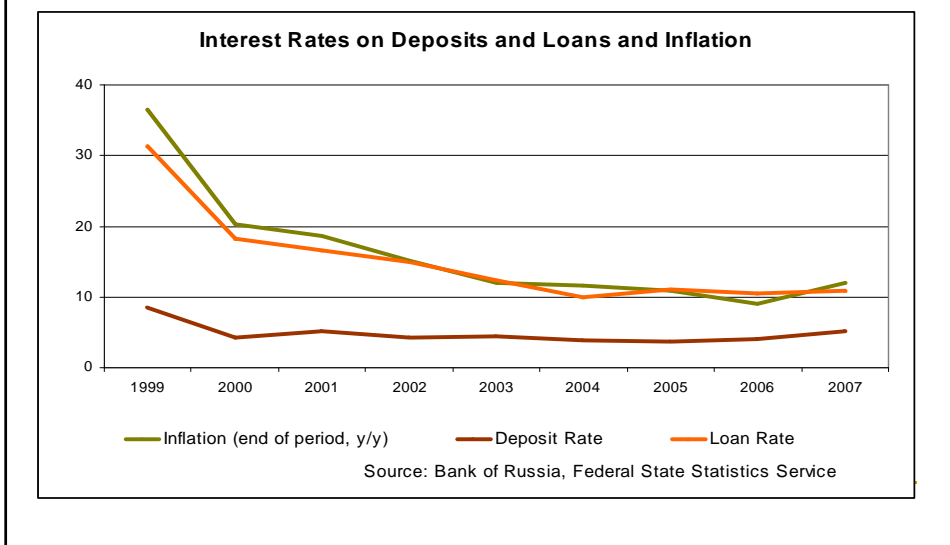
Russia: discretionary monetary policy

- Low interest rate



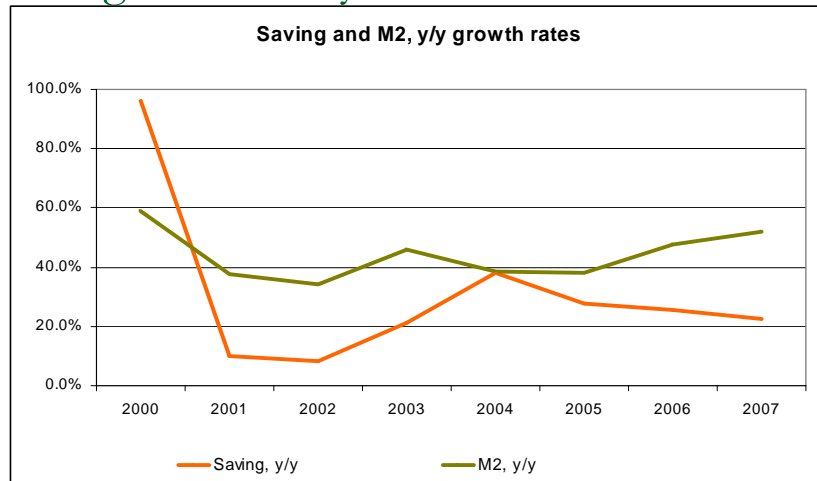
Russia: discretionary monetary policy

- Interest rate and Inflation: saving is discouraged...



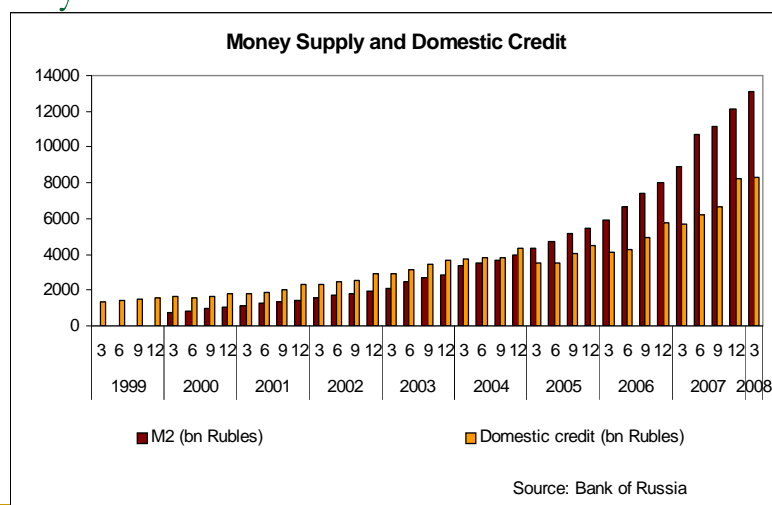
Russia: discretionary monetary policy

Saving and Money



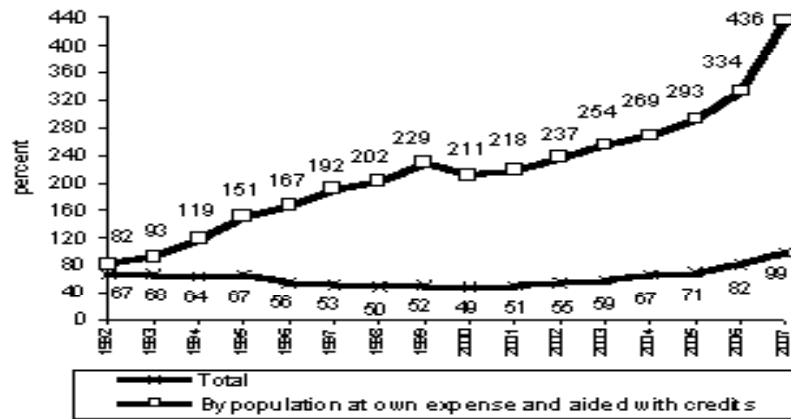
Russia: discretionary monetary policy

money and credit

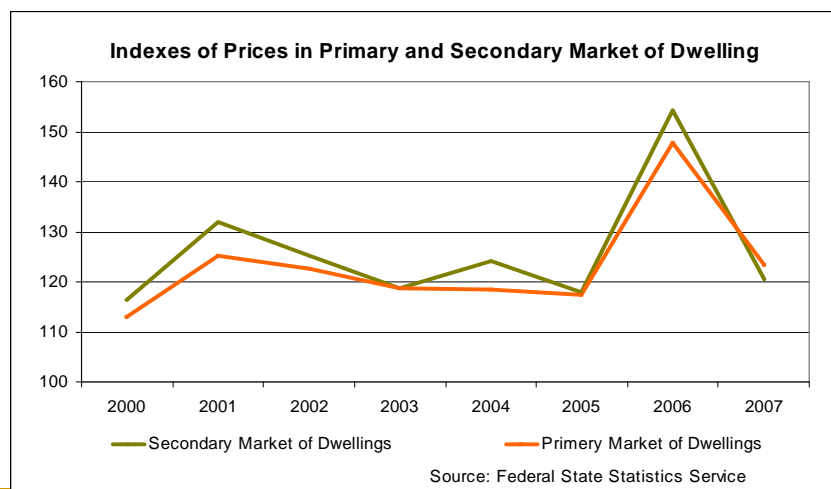


Russia: mortgage market

- INDICES OF RESIDENTIAL BUILDINGS COMMISSIONING (1990=100)

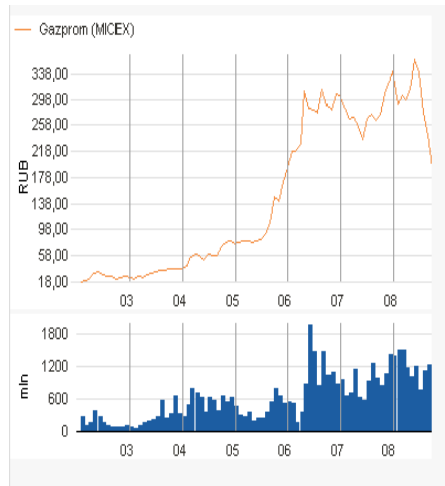


Russia: mortgage market



Russia: Gazprom (Nemcov and Milov report “Putin and Gazprom”, 09/2008)

- 7-8% of GDP
- 12-14 % of industrial production
- 16-18% of total export
- 45 % of Russian energy production, 85 % gas
- EU dependence 60-75%
- 5 world largest capitalization
- 5% of world energy production



Some news data

Some new data and facts on Russia

- End end 12/2008 F 380 mld usd
- S, I declined but S faster
- Unemployment 8-9%
- Budget deficit – 12% (2113 should be 1 %), more 600 mlrd run spending
- Mo contraction 20%
- M2 contraction 40% annual base
- idep n 5-6% (real – 5%)
- iloan n 15-16% (real 2%)
- iref 13%, raising since I/2008
- 41 uds/oil barrel not 91 (1/3 of the revenues)
- Capital flight
- Exchange rate/inflation

What to do? Что делать? (national aspects)/plus Russia

- **Laissez faire, laissez passer.** Collapse would lead to rebirth of a purified economy, + deep institutional changes...in the direction of more market ...
- **State intervention (Keynes...)**
 - **Monetary package** - liquidity management, monetary policy (separation principle ?), “new approach” (**q easing**)?, reestablishing **monetary transmission mechanism**, and lending activity (SME), **helping banks on the two side of the balance-sheet**, bank nationalization, consolidation; **Assuring money markets**, deposit insurance, **more regulation**, accounting rules...
 - **Fiscal package** – public expenditures (gigantic 1 tr. € in USA, EU, China, Brazil, ...), competition among **package of socialism**
 - Tax cut, social tax cut, green economy (probably the new bubble), energy saving technologies.....; **Multipliers** – fiscal (tax, spending ...)...
 - **3T – timely, targeted, temporary**
 - Russia – dictatorial solutions, danger of imperialism revivify ...

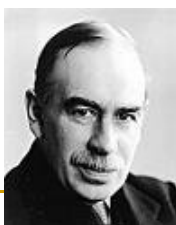
What to do?/ where the place of Russia ? International measures

■ International architecture

- Financial regulation/supervision/accounting
- Early warning / macro prudential, systemic risk...
- The **problem of reserve money** (what standard, SDR, gold, goods, clearings ...) and **world money, world issue bank, LLR**
- How to **consolidate the dollars circulating** outside USA 4-5 tr.?



- International meeting
- G 20, G 40, FCOFIN



Developing the theory – some suggestions

■ Conceptual issues

- How to explain and think the crisis? Revival of some old debates...
- **Economic/Social action (Pareto/Weber)**
- **Limits of neo-classical economics/but...measuring ?**

- **Political Economy /Interdisciplinary problems**
 - Politics, interests
 - Institutions etc.
 - Power (**triangle ...**)
- **History**. But why history ‘does not teach us anything in reality?’
- Uncertainty, trust,

Developing the theory 2

- Technical issues
 - Most critical issues
 - Eligibility of institutions and assets
 - Collateral
 - Valorization of assets, fair value accounting, MtoM or historical value
 - Risk sharing mechanisms
 - Procyclicality/ Basel 2/ rating agencies
 - Rating
 - **Separation principle**
 - Financial system and monetary policy – how to integrate
 - World money, LLR

Some conclusions

- Speculations, not firm conclusion
 - but:
 - Crisis is not something new
 - She is monetary, cheap money, lack of saving ...
 - Wrong impulses and incentives – false investments
 - Pernicious Central bank discretion
 - Destruction of principle of competition
 - Government protection – more risk, moral hazard issues
 - Lack of rules ...
 - Danger to look at the solutions exact opposite to what is needed, ... thus the crisis is postponed ... but became more dangerous
- Russia – dangers of dictatorships