

## ECONOMIC CRISIS AND GLOBAL RESPONSE

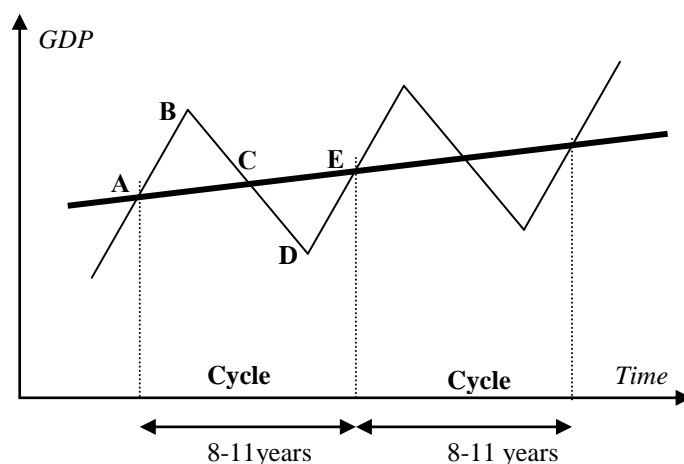
**In recent years, we hear various expressions like "global crisis", "financial crisis", "economic crisis"... It is necessary to learn this phenomenon from the general economic and ideological points of view, to understand how the economic crisis affects the regional economic policy and realize the nature of its influence on global actors in the sphere of politics and economics.**

### **1. What is the regularity of economic crises?**

From the point of view of economists, the crisis in the global market economy (just that very type of economy) is a quite objective and even predictable phenomenon. This is due to economic cycles, including economic crises. What is the matter of it?

The economic cycle is a periodic fluctuation of business activity level, represented by the real Gross Domestic Product (GDP). GDP embraces everything we produce in our country, including goods, services, etc.

It is obvious, that GDP is constantly growing (see "bold" line in Fig. 1), but its rate is not permanent. That is why we see from time to time either economic growth (rising line in the graph in Fig. 1) or recession (descending line in the graph in Fig. 1)<sup>3</sup>.



**Fig. 1 Scheme of the economic cycle in a country with market economy (GDP, cycle, time, 8-11 years).**

Different economists define different duration of economic cycles, which is due to their various interpretations of the reasons for recurrence of some of the macroeconomic situations.

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<sup>3</sup> Novichkov N.V. World financial crisis: between the past and the future // Modern Europe. - M.: Europe Institute RAS. 2009, №3.

What are the reasons for cyclic recurrence? Here we find various preconditions. The most famous one consists in consumption features that are the fundamental principle of the modern market economy. What is the current economic model? The entrepreneur wants to produce goods and earn money. He or she raises a credit in a bank (the second fundamental principle of modern market economy) and invests it in the production. The company manufactures a product, and the consumer buys it. The earned money is received by entrepreneur, bank, company employees (for consumption and savings), and is also invested in the production of a new item, etc. The basis of all the economy consists in the need (someone's unfulfilled vital desire), which provides the demand (economically active desire), which, in its turn, gives rise to the supply (option to meet a demand). Paraphrasing a classical writer, we can say, "We consume therefore we exist". This is the main point, the essence and the fundamental principle not only of the economic development of all countries and nations, but certainly also of economic downturns, crises and depressions.

The matter is that sooner or later the consumption growth becomes impeded, then impossible or can be changed into overproduction crisis.

Certainly, the crisis is not perpetual, sooner or later it will give place to the economic growth. In Fig. 1 the segment AB represents economic growth, the segment BC - recession or crisis, the segment CD - depression or deepening of economic crisis, the segment DE - recovery, rehabilitation, or beginning of a new economic growth.

As we can see in the figure, the duration of all the business cycle is 8-11 years. These are so-called mid-cycles (conditioned by technical and technological re-equipment), but there are short-term (related to the peculiarities of economic conditions), and long-term cycles (e.g. Kondratiev's cycles, associated with the change of technological structures).

There is a question, why economic crises became a reality just the last 200 years, and why crises are financial by nature?

We will speak in a roundabout way. All objective processes in the world around us are oscillating (or waving) by nature, and the social life is not an exception, of course. J.B.Clark, the patriarch of American economic thought, described the cyclic recurrence quite figuratively: "In the modern world, economic cycles are considered in the same way as ancient Egyptians considered flooding of the Nile. This phenomenon appears from time to time and is essential for everyone, but its real reasons are hidden". A well-known Russian economist Mikhail Tugan-Baranovsky in his book "Principles of Political Economy", wrote about the laws governing the functioning of the market: "The most mysterious and destructive feature of capitalist development is its recurrence. The growth of capitalist production does not follow a straight line but a wavy one, and successive rises and falls of the waves occur with such regularity that resembles the phenomenon of not a social, but biological and even inorganic order. There were even attempts to bring this periodicity into connection with the periodicity of astronomical phenomena".<sup>4</sup>

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<sup>4</sup> Novichkov N.V. World financial crisis: between the past and the future // Modern Europe. - M.: Europe Institute RAS. 2009, №3.

Of course, due to the growing influence of nation-states, international institutions, as well as full range of non-economic (political, military, technological, environmental and other) factors, and scientific and technological progress the “correctness” of cycles’ course was confused. However, we cannot deny the objective character of their existence.

I will assume that the cycles always existed and appeared with the advent of mankind. However, in the beginning of XIX century, just after the end of the Napoleonic wars, the world changed fundamentally. It became capitalist from the point of view that capital, money and finance defeated military power and became the major factor of power. Before the Napoleonic Wars, strong was the one who had the most powerful army. Wars were a source of enrichment – the winner plundered the defeated. The defeat of Napoleon - the most outstanding general of that time, which possessed the strongest army in the world - demonstrated a simple truth: the richest one, rather than the one with best soldiers is most powerful. The war between France and England’s manufacturers ended with the absolute victory of capitalists. Since then, the world in which we still live has had a financial nature, and therefore – the pros and cons of financial world influence us. Even wars are no more a source of enrichment; they have become an instrument of competition for markets distribution, resources, infrastructure, etc.

Since then, finances concern everything, they are essence of all phenomena and events of our life, and it is still also an objective reality. Our Soviet strategists did not take into consideration the priority of financial issues and got the Soviet Union involved in the arms race. The country with the largest and, without exaggeration, the most powerful army, was completely defeated by the West because of economic backwardness and the failure to provide an equal financial power.

It came, particularly for historical reasons, that actually money is the main source of everything, and its deficit means the collapse of the world economy.

## **2. Were there economic crises before?**

We can refer the starting point of cyclic development of the market economy to the 1825, when England met the first crisis of overproduction. It initiated periodic fluctuations of economic situation, which repeated quite regularly during the XIX century, with an average interval of 8-11 years. With the development of capitalism other capitalist countries were gradually getting involved in cycling channel. In 1836, the crisis hit already both England and the USA. The crisis of 1847 raged already in the United States, Britain, France and Germany, the next crisis of 1858 was, in fact, the first global cyclical crisis<sup>5</sup>. The deepest global economic crisis of 1873-1878 became the deepest and the longest one in the XIX century.

In the twentieth century the global crisis of 1929-1933 (the so-called "Great Depression") broke all records for economic recession. During this crisis the total volume of industrial production in capitalist countries decreased by 46%, the foreign-trade turnover - by 67%, the unemployment reached the level of 26 million people

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<sup>5</sup> Novichkov N.V. World financial crisis: between the past and the future // Modern Europe. - M.: Europe Institute RAS. 2009, №3.

(almost a quarter of all people employed in the sphere of material production) and real incomes declined by 58%<sup>6</sup> on the average.

It was during the "Great Depression", when the state charged itself with the situation in the financial market and created conditions for the economy recovery for the first time. The basic anticrisis plan, proposed by President Roosevelt ("New Deal"), included the following steps:

- Establishment of state control over the financial system to channel financial resources to the development of the economy,
- Creation of new jobs, including those, created with the help of the Institute of Public Works,
- Stimulating domestic demand and private investments of citizens.

All these points provide an effective demand and economic growth.

These measures were theoretically grounded by the famous American economist John Maynard Keynes in his "General Theory of Employment, Interest and Money." The basis of the keynesianism consists in the concept of state regulation of the economy, which significantly increases the role of public institutions of investment promotion and effective demand.

It is obvious, that all of the mentioned measures from "New Deal" of Roosevelt and Keynes's concepts are still relevant nowadays and are used in modern Russia.

After the Second World War financial crises made themselves felt, for example, in 1957-58, 1973-75, 1980-82 etc.<sup>7</sup>

Nowadays, the global financial crisis of 1997-98 that concerned Asia ("Asian crisis"), Latin America and Eastern Europe, including Russia, is the closest one. Among developed countries, Japan that is closely linked with its Asian neighbours was damaged the most severely. At the same time leading European economies and North America have been affected by the crisis to a much less extent. The current financial crisis is the first in the new millennium. The world economy has not known such large-scale disturbances in the new century yet.

I will say more: financial crises have been global never before. Even the Great Depression did not touch directly, e.g. the current BRICS countries that concentrate almost a half of the global economy. The current crisis is unique, because it is really global. It means that it concerns all regions, countries, sectors, enterprises and world economies.

### **3. What Bretton Woods system is?**

The world economy is a complex system of trade-economic, scientific and technical, monetary and financial, social and political relations of its constituent entities. The ordering of economic relations is achieved through a variety of legal forms - special agreements and institutions.

In general, the current system of multilateral regulation of world economic relations emerged after the Second World War. The beginning of this process was

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<sup>6</sup> Novichkov N.V. World financial crisis: between the past and the future // Modern Europe. - M.: Europe Institute RAS. 2009, №3.

<sup>7</sup> Novichkov N.V. World financial crisis: between the past and the future // Modern Europe. - M.: Europe Institute RAS. 2009, №3.

marked by the conference held in 1944 in Bretton Woods. During the conference a decision about the creation of the world monetary system was made. In 1945 were created special international coordinating bodies - the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD). They include more than 150 countries, and they define in many ways the principles of interstate regulation in the sphere of world trade and international credit and currency relations. In the postwar period the General Agreement on Tariffs and Trade (GATT), later transformed into the World Trade Organization (WTO), the "Group of Seven", which is now "G8" or "G12", and others were also created.<sup>8</sup>

What are the peculiarities of the Bretton Woods system?

The international monetary system came together with the global market in the XIX century on the basis of the gold standard. After the World War I, the role of gold in international transactions has decreased significantly, and there was a so-called gold standard, which provided the reserve currencies - the currencies accumulated by central banks of nation-states, along with the gold. Then only the U.S. dollar could be such a currency.

The conference in Bretton Woods in 1944 consolidated preceding trends legally and practically set the current hegemony of the dollar in the monetary system.<sup>9</sup>

This hegemony, domination, and in fact – parasitizing on the global economy of the American currency still exists nowadays. The dollar, despite the emergence of a united Europe currency - the euro - and the presence of other strong regional currencies - the British pounds sterling and the Japanese yen, remains the world's main reserve currency, in which all major emerging markets - China, Russia, Taiwan, Brazil and etc keep their gold reserves.

This situation suggests that U.S. national currency - the dollar - is provided by the entire world economy, and the global economy now, anyway, depends on U.S. monetary policy, which is formed by the government and its counterpart of central bank - the Federal Reserve System (U.S.Fed).

#### **4. What are Kondratiev cycles?**

By 1926, the great economist Nikolai Kondratiev completed the establishment of the theory of large cycles in the economy. Kondratiev's research covered the 150-years development of the leading capitalist countries - the U.S., Germany, England and France. Using the methods of mathematical statistics, Kondratiev analyzed a wide range of indicators of economic development in these countries: price indices, government debt securities, nominal wages, foreign trade, coal, gold, iron, lead production etc. Based on the statistical data, Kondratiev hypothesized the existence of the long cycles of economic situation lasting 48-55 years, along with the usual 8-11-year cycles.<sup>10 11</sup>

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<sup>8</sup> Political economy and history of economic science. Manual. – M., 2004. P.356-357

<sup>9</sup> Political economy and history of economic science. Manual. – M., 2004. P.373

<sup>10</sup> Political economy and history of economic science. Manual. – M., 2004. P.284

<sup>11</sup> Kondratiev N.D. Problems of economic dynamics. – M., 1989. P.218-226

The turnover of long cycles is due to changing technological structures, that is, depends on the way of main products and services production in the economy. Thus, Kondratiev and his followers marked out five principle cycles in the economy (see Table 1).<sup>12</sup> Formally, we currently deal with the beginning of the fifth "information and communication" technological system and the fifth economic cycle for the last 200 years. But, it is obvious that the Kondratiev's technical and economic cycles overlap each other, and we can talk only about the dominance of a particular way of life in the presence of elements of the previous and the next one.

Actually scientists incline to the view that the world economy is now "influenced by the end" of the previous, fourth techno-economic cycle, characterized by mass production and consumption of durable goods, including automobiles, household appliances and electronics. Another factor that indicates this influence of the fourth cycle, is an "insatiable" energy consumption observed in the developed world in recent years, which led to an unprecedented increase in oil prices in the spring and summer of 2008, when the price for a Brent barrel almost reached the level of U.S. \$ 150.

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<sup>12</sup> Glaziev S.Y. Theory of the long-term technical and economic development. – M., P.96-99

**Table 1. Kondratiev's long economic cycles according to their technological structures**

Features of a cycle	Economic cycle				
	1	2	3	4	5
Period of time	1770-1830	1830-1880	1880-1930	1930-1980	1980-2030
The main branch of technological order	Textile industry, textile machinery, iron smelting, iron processing, canalization construction, water engine	<u>Steam engine</u> , railway construction, development of transport, engineering, steambuilding, coal industry, machine-tool industry, ferrous metallurgy	Electrical, heavy engineering industries, production and rolling of steel, electricity transmission lines, inorganic chemistry	Motor and tractor industry, nonferrous metallurgy, durable goods manufacturing, synthetic materials organic chemistry, oil production and refining	Electronic industry, computer engineering, fibre optics, software, tele-communications, robot-building, gas production and processing, informational services, ???
Key factor	Textile machines	Steam engine	Electric engine, steel	Internal-combustion engine, petrochemistry	Microelectronic components, ???
Leading countries	Great Britain	Great Britain, France, the USA	The USA, Germany, Great Britain, France, Switzerland	The USA, Japan, EU	???

## **5. What was the starting point of the current global financial crisis?**

We started to talk about the crisis in 2006, immediately after the appearance of signs of the U.S. mortgage crisis.

What is the root cause of what happened? It is very important for almost each American to have his or her own house. Not apartment and cottage, which is typical for us, but the house (two - or three-storey one) with a small plot of land.

U.S. banks (all largest ones) provided mortgage loans for everyone with minimal provision for the construction or purchase of new or already constructed houses. Under these loans were given new loans and so on - a huge pyramid like Russian MMM was growing. Now imagine that the house, which was bought for the very first loan, was not built, or dropped in value, or its owner cannot more pay the loan for some reason. As a result this entire pyramid had to collapse sooner or later. A multibillion soap bubble burst at once. And this credit game involved almost all the financial systems of the world that were confident in the highest efficiency of the U.S. economy. Today, many of them, for example an Icelandic one (this small country is on the verge of bankruptcy), feel very, very uncomfortable.

The mortgage crisis, as it is known, became the only beginning of the financial crisis. Multibillion-dollar losses of financial institutions working in the mortgage market, led to the withdrawal of financial resources from other industries and markets, and then was the beginning of the so-called chain reaction, when one crisis creates another.

Investments from all over the world were made to the capital issues of these financial institutions, and therefore the mortgage crisis became a financial one and spread to other countries and continents.

## **6. What is the nature of financial market collapse?**

U.S. and international financial institutions sustained considerable losses (several hundred billion U.S. dollars) as a result of aggravating mortgage crisis. Then the prices for shares of these credit organizations plunged.

The decrease in value of traded shares make investors get rid of securities, they invested in, to minimize their losses. The shares "drop" continuing to snowball triggers further declination in their value and provokes the capital flight. Capital or investors' flight from a particular market means the curtailing of business in this kind of activity.

This thing happened first to the American financial markets and then to the world ones. For the shorter year the U.S. economy lost almost half of its value, and therefore investors all over the world suffered from multi-billion losses. Rank-and-filers with free money are among these investors.

The chain reaction caused a drop in prices on the world stock markets. Russia hasn't become an exception with drop of more than four times and a half.

## **7. How does the crisis influence on the world economy?**

According to the head of the World Economic Forum in Davos, Professor Klaus Schwab, global losses from the financial crisis amounted to 5 trillion dollars by the end of 2008. What do these losses consist in? The fact is that the world economy



began to produce less, and the money began to work less. We have already said that the stock market met fleeing investors, who withdrew their invested money from stocks and bonds of the largest companies and invested it in cash, mostly in dollars. Problems in the banking sector also led to the removal of deposits from bank accounts all over the world. The withdrawn money remains dormant, it does not work, and thus the economy produces less, people earn less, and therefore consume less and spend less money to buy different goods. It is a vicious circle: no investment - no production - no wages - no consumption - no revenue from sales of goods - no investments, etc. The lack of money in the economy is called liquidity problem, which is common for almost all sectors of the world economy.

The consumption of raw materials - oil, metals – is reducing due to the decline in production all over the world, and thus, their price is also reducing.

All the countries are victims, because there are no states detached from the international differentiation of labor. A number of countries (Greece and other European markets) are on the verge of bankruptcy because of the recession, problems in the financial sector and reduction in tax revenue, which means that they are incapable of fulfilling their financial obligations.

### **8. Economic crises in Russia and their regional assessment**

The state of the economy is the main factor that defines the income and, thus, the standards of life in a region. Economic crises that Russia survived manifested primarily in production decline and affected different regions of the country to a variable degree. To assess these differences is an important prerequisite to the understanding of the existing territorial living standards differentiation, trends and prospects of the regional development in general.

Russian economy survived several major shocks in about 20 years. The very first one, defining the beginning of market transformation, happened in 1992-1994. Among the main trends in production decline level we can see that it was relatively low in most northern regions. Also there is a “blot” of severe production decline in the North Caucasus, which remains in the zone of political tension even today.

In general, export-oriented regions suffered smaller production decline than the ones, oriented at the Russian market, during the first crisis. Most severely the crisis affected (besides the republics of the North Caucasus) the regions with high concentration of light industry (primarily – textile), and food industry, as well as processing industry in general (primarily – high-skill mechanical industry, including military). As it was more than once mentioned in different studies, the situation in the regions of new reclamation, specializing in fuel-and-power and raw material resources production (i.e. in the North zone) and in the main metallurgy regions the situation was relatively trouble-free.

In general, territorial differences in the level of industrial production decline are mainly defined with the existing field structure of the industry. It was in the regions, focusing mainly on extractive industries with high export potential, that the dramatic decline was avoided. Regions that specialized in processing industry with the orientation on the internal market, found themselves in a more difficult situation.

The crisis wave of 1998 was different from the “background” transactional one in the fact that it hit the market economy sectors. Sure enough, the regions of its concentration reacted fast and intensely. Moscow and other biggest cities became the epicenters of consumer panic, bankruptcies as well bank and other commercial structures staff layoffs. Moneyless province could have slept more or less well, why should the nonmonetary economy worry about the monetary crises? Besides, ruble devaluation is in principle beneficial for the export and import replacing industries, which distribute their potential much more evenly, not only in the epicenters of the market infrastructure and different speculative activities. But it’s not all that simple. The poorer in money was a region, the more noticeable and painful for its finances was the loss of the meager resources. But the crisis of 1998 was not only about finances. The first three quarters witnessed dramatic industrial decline after in 1997, which was a successful year, it nearly restored to the level of 1995 (98%). By September 1998 it dropped again (to 84%, seasonal factor excluded). The reasons are known: inflated exchange-value of ruble, unfavorable environment for the export industries, payment failure crisis, lack of investments in the real economy. The collapse of ruble led to the growth in the last quarter of the year (up to 92% of the 1995 level). In general, the actual production volume in 1998 was 94,8% of the 1997 level.

The disorganization of the federal financial after August 1998 led to failures in the transfer system. Subsidized regions got them from the Support Fund with delays and not in full volume. That’s why the crisis severely affected the poorest regions that cannot exist without federal support. Obviously, it complicated their relations with the center.

In fact, the problem of internal offshores is much older and more complicated. All 40 odd closed administrative-territorial entities of Russia de facto bore this status according to the 1992 law, concealing thousands of productions, including excisable ones, from taxes, which led to annual budget losses of 1,5-2 billion rubles according to different assessments. And military industrial sector centers were not the only ones. For example, Uglich created a free zone with unprecedented privileged regime in 1997. 1,5 thousand companies registered there (all in the same apartment in Lenin street), often anonymous, paid 3 percent of the turnover and 500 dollars fixed tax a quarter.

Regions of the Russian Federation were significantly impacted by the unequal system manifestations of crisis effects, caused by different starting economic conditions. This resulted in growing financial instability in regions – and nowadays, as we know, the majority of regions have budget deficit. The gap in certain indicators of social and economic development per capita varied from 10 to 100 times in 1998<sup>13</sup>.

The next crisis struck Russia in 2008, this time global. Modern Russian economy, just like many other economies of the world, is export-oriented. This is related to the international division of labor, when different countries of the world produce different goods and services. For example, USA and Japan produce technology; Great Britain produces bank and educational services, while China,

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<sup>13</sup> Lipina S. Russia. Results of the first decade of reforms. LAP LAMBERT Academic Publishing DmbH and Go. KG 99. 66123 Saarbrücken. Germany Dudweiler Landstr, 2011r. 11 pr. sh.

Malaysia and Indonesia are the world's assembly workshops. A wide number of countries produce tourist services. Russia at the moment, for a number of reasons, produces raw materials.

In spite of all this Russia has relatively low domestic demand. Our domestic market is incomparably smaller than those of other developed countries, which is caused by the low standards of living of our citizens.

At the same time the growth of the world economy over the last decade provided for the supreme demand for raw materials, which, combined with low domestic demand, has made Russian economy extremely dependent on energy resources and metal export.

If we turn to statistics, we will notice that in 2008 Russia's foreign-trade turnover totaled at \$763.5 bln, with \$471.6 bln of export and \$291.9 bln of import. The trade surplus equaled \$179.7 bln. This means that in 2008 we produced and sold almost \$500 bln worth of materials, which is not that bad after all. In 2009 Russian economy has taken a nosedive, the export totaling at no more than \$303.4 bln (which is almost one third less than in 2008), and the import totaling at \$191.8 bln, providing for a \$111.4 bln trade surplus. 2010 has been the year of the safe growth trend for the Russian economy – \$400.4 bln, \$248.7 bln and \$151.7 bln<sup>14</sup> for the export, the import and the trade surplus respectively. As we can see, Russian economy has not yet reached the pre-crisis level, which is rather difficult to achieve with the widely discussed “second wave” of world economic crisis going on. But where do these figures come from? Almost 70% of it is fuel and energy products, the bigger part of which are crude oil and natural gas. I. e. the bigger part of earnings from selling Russian commodities abroad comprise the so called petrodollars. The second place belongs to the earnings from selling metals (almost 12% of export).

With high oil prices (in the first half of 2008 the price for the barrel of Brent oil almost exceeded 150 billion dollars) this situation was one way or another suitable for our economy, but since then oil prices have dropped several times and according to the expert estimates will be decreasing in the future.

There was similar situation on the global metals market, when the price for Russian iron and aluminum plummeted, resulting in serious decrease in earnings from the export of these commodities.

The only Russian fuel and energy product, which is still in high demand, is the natural gas used not only for industrial production, but also for heating dwelling houses and other premises in many countries of the world and in the first place in Europe.

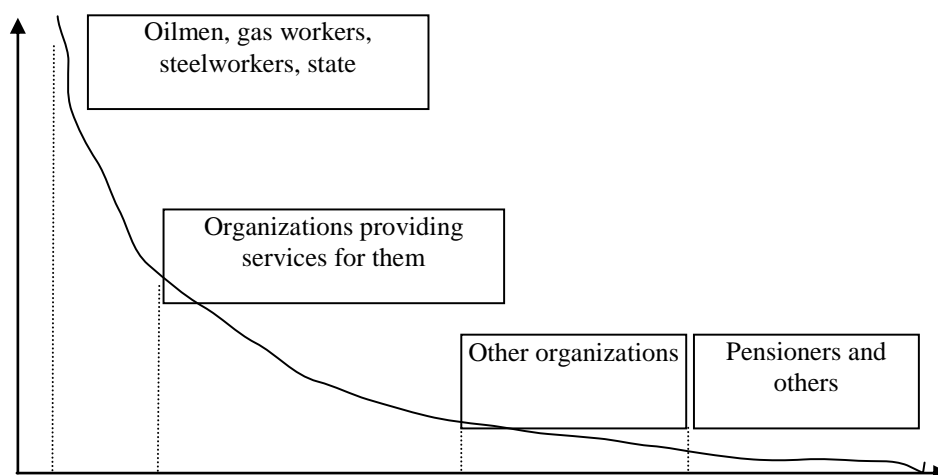
But how do export earnings influence the whole Russian economy? The answer is simple. As long as the money obtained from selling oil, gas and metals is more than 80% of all commodities we sell abroad, these “petrogasmetaldollars” after passing the mechanisms of redistribution one way or another in different parts go to the pockets of Russian citizens. The bigger part of export earnings get oilmen, gasworkers, steelworkers and the state, the much lesser part goes to the banking,

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<sup>14</sup> <http://www.gks.ru/wps/wcm/connect/rosstat/rosstatsite/main/trade/#>

trade and informational organizations, equipment suppliers, related enterprises, constructors and so on, who provide services for oil companies. These organizations pay taxes; people working in them receive salary, which they spend in shops, educational institutions, services industry etc. Pensioners and state employees receive pensions and allowances from oil money.

The export earnings are distributed in a hyperbolic arc (fig. 2)<sup>15</sup>, where the abscissa axis stands for the people and the ordinate axis represents the volumes of export earnings in "petrogasmetaldollars".



**Fig. 2 The graph of distribution of export earnings.**

The decrease in earnings from selling oil and metals results in the decrease in industrial production all over Russia and already now all the regions of our country are drawn in the financial crisis.

Another problem is that our country buys a lot of goods abroad (see above). In fact we "eat" the bigger part of our export earnings because we buy cars, equipment and means of transport (almost 53% of import), chemical products (more than 13% of import) and what is especially unpleasant provisions (almost 13% of import).

Of course in times of crisis the import will be also decreasing, but the rate of its decrease is incomparably lower than the decrease in export earnings. Unfortunately the situation when the balance of trade surplus in Russia is negative, i.e. the expenses on import are exceeding the earnings from export, can become real.

### **9. How long will the crisis last?**

According to the past experience the recession is unlikely to last for more than three years, however the world has seen more long lasting crises.

The longest test in the history of the capitalistic economy was the crisis of 1873-1878 that spread over almost all continents. The precondition for this crisis was the credit rise in Latin America, nourished by England and the speculative boom in real estate in Germany and Austria. The Great Depression began on October 24 1929 (the Black Thursday) and finished only in 1933, while the effect of the crisis could

<sup>15</sup> Novichkov N.V. World financial crisis: between the past and the future // Modern Europe. - M.: Europe Institute RAS. 2009, №3.

have been felt up to late 1930s. The Asian-Russian crisis of 1997-1998 has lasted for almost two years. The modern global financial crisis has been already lasting for five years, considering that it began in 2008.

What can we expect from the modern economy in near future?

There are several points of view upon this issue. Some economists think that world economy is already at the very bottom and the decrease in prices for energy carriers will provide the decrease in expenses and create conditions for new economic growth. This point of view has the right to exist, but it should be considered that global economy is developing irregularly.

If the mortgage crisis that broke out in the USA at the turn of 2006-2007 is more or less coming to an end, the recession in Europe and Japan is only starting to gain momentum, and some large Asian and Latin-American economies are barely approaching the downturn. Considering the world economy is a single, yet managed from different centers, system, the improvement of the world economy is only to come after the majority of national economies make it through the crisis - which is certainly not to happen in a short-term perspective.

Other economists think that the crisis is "here to stay" as the modern economic model based on egoism and parasitism has become obsolete. It is impossible to develop further if some countries of the world "create nothing on their own" and live at other countries' expense. Indeed, the US economy, recently so oversaturated with money, has found itself in the liquidity deficit conditions. All these hundreds of billions of dollars, not so long ago circulating in the fund, mortgage, currency etc. markets of the USA - where have they all gone? Perhaps, there were no billions of dollars in the first place? Perhaps, that was, so to say, "unreal", "virtual" money, that wasn't earned (or not "labor money", according to Marx)? Perhaps it is necessary to find other ways of enrichment, that hadn't been used before.

Thus, before the election to another presidential term the American President Barack Obama asked voters for the extra time to bring the economy through the crisis.

As for Russia, the country as well as all the major emerging markets is only entering the stage of the economic downturn and, officially, the recession have recently occurred: the decline in production is not yet catastrophic, the inflation is within certain limits, the budget has enough of money.

There is much talk about the second and subsequent waves of the global crisis. Their appearance is already a reality. While the first wave, one way or another, has been associated with the U.S. mortgage lending crisis, it is obvious that the second one is primarily based on the sovereign debt of the EU members, in particular, its "southern belt" - Greece, Spain and Italy . At the same time, the large-scale financial crisis in Asia and Latin America is probably still to come.

#### **10. What were the symptoms of the crisis? When did they start to appear?**

The first symptoms of the financial crisis became apparent in 2006 with the advent in the American economy of first crisis phenomena related to mortgage lending.

Almost all the companies providing home loans in the U.S. with low lending standards reported losses. A number of second-tier mortgage operators announced their withdrawal from the market, and in some cases, bankruptcy.

Back then, few could have predicted that this would be the beginning of a global recession, and difficulties with the return of mortgage loans in the U.S. would lead to a global economic fall.

In 2007, the mortgage crisis unexpectedly spread. The crisis in the U.S. mortgage market went to Europe. The world system began to suffer from liquidity shortage.

The main symptom of the crisis became obvious, and after this, it became clear that the coming recession would be very serious. The question is about the mass exodus of investors from the stock market and their flow to other sectors, such as commodity markets.

The world economy felt such evasion first-hand, when vast resources of the speculative capital came to the oil market. Within the period between early 2007 and mid-2008, this source of energy went up by almost \$90 (approximately from 60 to 150).

In Russia, this has resulted in the flow of financial resources to the real estate market, especially in housing, which led to the rapid growth in housing prices in Russian cities.

In general, the main sign of any crisis consists in an "abnormal", massive capital outflow from one sector (e.g., financial) to another (such as commodity), and vice versa. There is nothing unusual in the capital flow; this is a normal phenomenon in the modern economy. Abnormal is the concentration of capital in any one industry.

Economic equilibrium implies that at the same time the profitability of various business activities is practically equal to the vibrations of a few percent (the economic variant of communicating vessels). Investments in real estate, mutual funds, deposits, securities, etc. should be about the same. The situation where investments in real estate or in oil speculations are several times more efficient than deposits or mutual funds, of course, is not normal, and sooner or later, leads to the crisis in the economy. This situation reminds of the ship, where all the passengers with the luggage accumulated on the deck near one of the broadsides, which inevitably complicated the further movement of the ship and could even lead to a shipwreck.

### **11. What are the features of the current crisis?**

This financial crisis is unique because this is the first financial shock that with certainty can be called global, that is capturing the entire world, all the economy of both the Old and the New World, both developed and emerging markets.

The financial crisis of 1997-98., despite its scale (and economists estimate that this crisis reduced the world GDP by \$2 trillion) was, to a large extent, regional and affected mainly the countries of Southeast Asia and Russia. Leading economies of America and Europe are generally not affected. Similarly, "The Great Depression" has not affected many major countries of the world at the time "standing on the sidelines" of the world economy. Now, the crisis involves all nations of the world,

including those who have made a major step forward in recent years. We are talking about the so-called BRIC countries - Brazil, Russia, India, China and South Africa.

The current crisis has, indeed, become global, so - for its solution we need global measures, which simply were not applied in the absence of contradictions arising now. Crisis management decisions at the level of nation states or institutions of Bretton Woods system (IMF or the World Bank), are now strongly inadequate.

It is no accident that in November 2008, in Washington, in order to overcome the economic impasse, the first meeting of the "financial twenty" - 20 countries that control almost 90% of the world economy and all of them, without exception, represent continents and the corners of the world, took place what has never happened before. "Twenty" are the U.S., Britain, France, Japan, Germany, Russia, Canada, Italy, Argentina, Australia, Brazil, China, India, South Africa, Indonesia, Mexico, Saudi Arabia, Turkey, South Korea and the European Union (for political reasons, Spain was not invited to the summit, but, of course, it is part of the "economic twenty"). These meetings have become regular, and Russia represents not only itself, but also the Union State and the CIS countries. The lack of effective mechanisms to combat the global economic crisis is also its unique feature. These tools are yet to be created and debugged.

The total character of the current crisis in terms of coverage of industries is its another feature. Now there was no "safe economy harbor", where entrepreneurs and investors could outwait the crisis, maintaining their financial resources. The flow of investments to the exchange market has led to significant (and often record) fluctuations in the dollar and the euro, what is also abnormal in terms of economic equilibrium.

The financial sector, industry, construction, mining, consumer sector, and almost all other sectors are now covered by the economic recession, and the only more or less effective way of saving funds is keeping them in a reserve currency, what, as it is known, causes further financial downturn, as it withdraws funds from the economic activity.

## **12. Is the current crisis similar to the crisis phenomena in the global and Russian economy in 1997-98?**

We have already said that the crisis of 1997-98 was not global, so it is, partly, not like the current one.

However, the Russian-Asian crisis is interesting for us because Russia and most of its citizens were directly involved in it.

What were the main characteristics of the crisis?

The Asian crisis was a consequence of the foreign investors' departure from South-East Asia due to the devaluation of national currencies in the region, and high external deficit of the countries in the region.

The following assumptions caused the crisis in Russia:

- a huge state, first of all, foreign debt of Russia,
- low oil prices, on which Russia has traditionally depended,
- pyramid of short-dated bonds, for which the Russian government has failed to pay on time.

As a result, in August 17, 1998, the government of Sergei Kiriyenko announced "technical default" of \$40 billion thus recognizing Russia's and its banks' failure to pay its credit obligations and that led to the collapse of many financial institutions that invested in short-dated bonds, the ruin of many businesses and loss of ordinary citizens' deposits in many Russian banks. Rate of the ruble against the dollar in August 1998 - January 1999 fell by more than 3 times - from 6 rubles per dollar to 21 rubles to the dollar. The prices for goods and services also rose by more than three times as the average.

Of course, now the situation is somewhat different: Russia does not have "catastrophic" internal and external debts. Moreover, there are significant gold and foreign exchange reserves and the Reserve Fund, and oil prices didn't fall to the level of, let's say, \$10 or 30 per barrel. One can say that Russia was prepared to the crisis thanks to its capacities.

However in 1997-1998 the most part of the world economy wasn't in a crisis and, in this regard, our country could count on foreign support - through foreign loans and investments. It is not by chance that 2000 became a record year for the last 20 years in terms of the volume of attracted investments into the real sector of the Russian economy which allowed Russia to gain a strong economic growth observed in the last 10 years. Now Russia should to a lesser degree rely on the help of foreign countries, international institutions and foreign investors due to the fact that now the whole world economy is experiencing an extreme shortage of liquidity and is in a great need of investments.

Another distinctive feature of this crisis is the fact that its causes lay outside Russia. The crisis events in Russia are consequence, and therefore let's hope that the depth of the economic recession in Russia will be less catastrophic.

### Notes

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