

# The Causes and Consequences of the Global Financial Crisis

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**Keywords:** Global financial crisis; The causes and factors of the crisis; Measures to overcome the crisis

**JEL classification numbers:** D460, G120, G130

The news of the global financial crisis has been observed on the TV screens and exists in the newspaper headlines ever present in recent months. We are witnessing that the governments of various countries are beginning to plan periodically an anti-crisis release of the next portion of cash infusion into the economy to overcome the challenges of the crisis. However, it is unclear on what basis decisions on cash injections are taken, how the authors of these solutions work the mechanism of the cash inflows in the economy and what we can expect from them. It appears that the effective response to overcome the crisis would necessitate, first of all, an understanding of the main driving forces and factors affecting both the global economy and the economies of individual countries and regions. We will take a closer look to understand these causes. According to the author of this paper, the causes of the crisis in general, including the present one in particular, are the following factors:

1. Due to an imbalance of supply and demand between the different sectors of the economy the structural deformations in the economy occur quite frequently. In fact, everyone understands that the rapid growth of prices for the products in one sector is possible only for a limited period of time. The market economy is called "market" because it uses a negative feedback mechanism which is capable of leveling off the imbalance of supply and demand and when there are prerequisites for boom in some sectors subsequently grows the number of people willing to "make money" in these sectors, which usually increases the supply of goods or services in the sector, and restrains the growth of prices. Another option is possible when the market actually reinforced barriers to bring them high enough to entry of new players. In this case adjustment to the market demand would be turned off and the length for phase of growth increases. But sooner or later this growth phases out due to the lack of effective demand. As a result of fewer transactions on the market the latter stops, bringing down a significant correction to price levels. One detail is worth noting that with other things being equal, the longer and the more significant the previous growth, the more profound the market correction. Such a scenario can be observed in the Russian stock market and in real estate (for the latter, I must say, the key events are yet to come). The above-mentioned structural crisis is typical for all times, not only at the time of the current crisis.

2. Another factor in most of the crises that have happened since the 80s. of the last century is engrafted by mass media cult of consumption and quick profit. A perception has taken a root associated with a positive attitude towards fast enrichment in the public consciousness of citizens in many developed countries. Men are shown movies with scenes of bank robberies, fights with mafia clans, smart combinations of hackers breaking into bank computer networks. Women are offered Cinderella scenarios in which milkmaids come to the capital and marry millionaires. As a result of this "cult-fire" media less and less people see opportunities to make money and the sense of righteousness, doing legitimate activities related to socially useful work. The result is a reorientation of attitudes to the cult of high consumption similar to

the effect of drug abuse as you want more and more, as soon as there is a possibility of running out of a painful break-up. One observation to that is the cult of consumption sweeping the consciousness of the majority of inhabitants of Americas, Europe and Russia.

3. As a consequence, the dominance of consumerism led to a reversal of the pendulum of the world economy towards Asia/Pacific. It's very simple: in the long run the standard of living is growing higher in countries, where the most of population works a lot with a little consumption. If there is a majority working, then it makes a lot. And if it agrees to work for a lower fee, it is advantageous for investors to move the capital there. This explains to the great extent the development of post-war Japan, South Korea and China.

4. The crisis of the US economy model. It seems to me that the current financial crisis in the US is primarily due to three reasons:

- The cult of consumption practiced to make perfect as described above (with 20% of US share in global GDP, they consume 40% of the product), which is made possible by the fact that the US dollar is the world currency and by the fact that the United States is well developed market for government debt. The US government has never defaulted on its bonds. Investors around the world are aware of this, as well as the fact that in case of any problem with its servicing all the debt previously emitted by the US Treasury may simply induce the printing press and reprint lacking dollars to pay off the bonds. As a result, over the last twenty years, a situation when, first Japan, and then China, in fact, in exchange for supplied products to the United States was compensated for the most part in the form of a virtual entries in the accounts (dollars and bonds). In the beginning the formation of this lopsided trading system gathered key players and the United States were able to increase their consumption relatively cheap, while Asian/Pacific countries had the opportunity to develop their own production. Getting in return for their produce US dollars, Asian countries could use them in the trade with other countries, buying the raw materials and goods they needed. This is because when you try to use even very small amount of accumulated reserves in trade with third countries there can be a situation of rapid depreciation of the dollar just because that third country will not be able to provide within certain time period the cover for these commodity dollars (due to the fact that the growth rate of the economies of third countries has been lower than the growth rate of Asian countries). Recent statements by the Chinese leadership on the introduction of an above-national currency may serve as a confirmation of fears in China, as the country with the largest

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Received June 22, 2015; Accepted June 27, 2015; Published July 07, 2015

**Citation:** Kozyr YV (2015) The Causes and Consequences of the Global Financial Crisis. J Pol Sci Pub Aff 3: 163. doi:10.4172/2332-0761.1000163

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foreign exchange reserves denominated in US dollars with regard to the purchasing power of the US dollar.

- Again, the cult of consumption in developing mortgage lending in the United States contributed to the ease of reaching good living conditions for many Americans. But here, too, it was important not to “overreact” when chasing the shares of the credit market with an increasing number of customers it was easy to cross the line which separated the solvent customers from the insolvent borrowers. In general that is what just happened.

- Growth shares and derivatives. In the US, most of the population owned shares in companies, as investors believed that the shares by virtue of a long growth of their market value are valuable assets. By the way, the mentality of the Americans and the British have always contributed to the selection of risky securities, which were the shares of companies (in contrast to the Germans and the Japanese, who prefer to keep their surplus funds in bank deposits). However, in the olden days when choosing stocks, investors took into the account current and expected in the near term prospects for the companies’ profits and payment of dividends. But with the advent of Microsoft, Yahoo, Google and Amazon fewer people began to pay attention to the dividend payment on the shares. Why to think about 5% or 8% dividend yield, if the stock price yields may exceed 30%? With this growth having always a snowball effect, but in reality the effect of the financial pyramid the result of which is well known. When fluctuations’ growth exceeded operating profit, the US economy had a low inflation. But then starting from a certain point in time many virtual millionaires strived to convert their assets into wealth and found that under the current stock prices the country simply lacked issues of (printed) money. Accordingly, there was a need to increase the money supply and/or “to pierce stock bubble” by reducing stock prices.

Let’s consider now the Russian economic problems. Before we talk about them, one should note that some of the above factors, including the global financial crisis, the structural crisis and the cult of consumption, are inherent to the Russian economy. At the same time Russia has distinctively Russian economic problems. To name only a few:

- Harsh climatic conditions, resulting in the lower fertility of most crops and low efficiency of businesses associated with the presence of industrial assets. When selecting microchips between Germany, Russia and Vietnam the construction site of a new plant for the production of ii was found that the Russian option loses to the others, As far as the construction of factory buildings in Russia is concerned one should provide for better insulation (wall thickness), secure large supplies of heat and electricity, workers have to be paid more (or at least, more than in Vietnam), because there should be enough money for winter clothes and more nutritious food.

- High wear tear for main production facilities in non-oil refining, metallurgy, food industry and a number of chemical plants. For many years in this country the facilities were not upgraded in the premises of many machine-building enterprises, new deposits were not developed in exploration, new aircrafts and ships were not produced and new roads were not built.

- Rapidly growing army of the unemployed (although it is also observed in other countries) due to the crisis currently underway.

The list of Russian problems could continue, but the mere listing of those concerns will have a little effect. In view of the above the economic reality requires a set of measures to facilitate overcoming the current economic turbulence and the long-term relief. What kind

of measures should they be? The author believes that these measures should be devoted:

- To return to the training practice at the national level for input-output balances (which existed in the Soviet Union until the mid-80-ies. Last century). It should take into account new realities of the economy, the production structure and the structure of export-import operations. As the current Russian economy is heavily involved in the world economy, the need for greater detail of the structure of export-import operations is more evident in the framework of the construction of input-output balances.

- To organize works financed from the state budget and regional budgets. Country requires a lot of new and improvement of old roads and bridges, as well as to complete the construction of a number of constructions in progress from the category of long-term construction. To do this, in today’s Russia there are available manpower and necessary funds. The missing funds can be issued by the Central Bank as a quality issue (for produced goods) which is much better than emissions due to a rise in prices because of the trade deficit. These works (they can be called whatever you like, for example, public) must be organized in a way that each unemployed person has a choice either to live without a job on the unemployment benefit or go on public works and get paid for it, even with a little money, but still significantly higher than the unemployment benefit.

- To recognize that in the foreseeable future Russia will not be able to produce the required volume of consumer goods and should focus on two areas, namely the production of high quality raw materials and of a limited range of high-tech products. Raw materials are already produced but they need to achieve a high level of processing. As for high-tech products, their production does not require solid human resources, and in some areas does not require big investments in fixed assets. At the same time the cancellation of some inefficient investments (i.e., support for the domestic auto industry) can release resources to strengthen its market positions in the areas where Russian products are not yet able to compete with foreign manufacturers (e.g., aircraft, or power machinery).

- To create a new system of vocational training to prepare workers and technicians of high qualification.

- To give a push to the development of high-tech products by the inclusion of 50% or 100% of R&D costs in cost of goods. Why in Singapore the cost included is 100% of R&D costs, and in Russia it is 0%? I think that this measure alone could have the effect on development comparable to the expected effect from the activities of the corporation “Nanotech”.

- To remove price and legal deformations prevailing in the economy in favor of primary industries and commerce, and infringing agricultural producers. For normal operation of agriculture it is necessary to divert final ruble revenue towards profit received by basic manufacturer of the product, rather than by oil companies, banks and retail chains. The purchase price for one liter of milk cannot cost twice as cheaper as one liter of fuel refilled in the car in which the milk is brought to the city!. Price discrimination of the village started in the 30-s. of the last century, and contributed to the rapid industrialization of the country, because at that time most of the population lived in rural areas. However, the prolonged existence of price discrimination at this moment cannot be justified as it should be stopped when the majority exploits the minority. It should be understood that the reverse side of the sparkling storefronts of the retail shops are endangered and devastated villages. To remove the above-mentioned price

deformations and to recover from the Dutch disease.

- To enforce the responsibility (supervision) on decision makers for state of “lagging behind” industries (agriculture, biotechnology and electronics) and priority sectors.

To eliminate the practice of electing to the boards of directors of Gazprom, Rosneft’ and other major structures of high-ranking officials. Representatives of the state in the raw commodity companies, of course, have to be designated, but their status should be lower than the status of the officials in charge of the development priorities and “lagging behind” industries. Otherwise, whatever they say, “things will

be there forever and ever” and Russia will remain the country with the raw resources’ structure of the economy. And finally, another measure would be to set a limit in the regulation of profit margins in the sector of construction of residential and commercial buildings. Under this control imposed on builders, developers and realtors the willy-nilly would be eradicated along with such “bad habits” as the delay in construction time and duplicate sales of apartments. The author is well aware that this list of proposed measures is not self-exhaustive (bigger than the limits set by the format of the paper), but their implementation will give a reasonable hope for a conscious and purposeful way out for the Russian economy from its current state. 28.04.2009.