A STUDENTS' JOURNAL OF SHRI RAM COLLEGE OF COMMERCE

VOLUME 1 ISSUE 1 2016-17

STRIDES

A STUDENTS' JOURNAL OF SHRI RAM COLLEGE OF COMMERCE

STRIDES

A STUDENTS' JOURNAL OF SHRI RAM COLLEGE OF COMMERCE

Volume 1 Issue 1 2016-17

WEB LINK
Visit: http://www.srcc.edu/publications/students-publications

All correspondence relating to publication of the journal should be addressed to :

The Principal
Shri Ram College of Commerce
University of Delhi, Maurice Nagar
Delhi - 110 007 (India)
e-mail: principaloffice@srcc.du.ac.in

Principal's Message

The mission statement of the College, signifying the existence and its road map to the achievement of its vision, reads as:

"To achieve and sustain excellence in teaching and research, and enriching local, national and international communities through our research, the skills of alumni, and the publishing of academic and educational materials"

To achieve and promote excellence in publications and applied research, the College has taken the initiative to launch a new journal exclusively to publish students' research papers and articles. It will be an add-on to the enriched catalogue of College publications and academic literature.

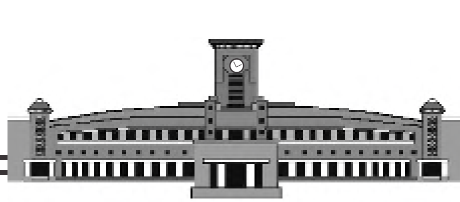
The journal has provided an opportunity to the students of our college to focus on research at the undergraduate level. Since the students were not opened to the research methodologies at the undergraduate level, they were mentored by *experienced senior faculties* of our College. Simultaneously, their articles were also reviewed by the referees and tested for plagiarism before publication. After reporting all the suggestions recommended by the referees, the articles were revised and then finally published. The College is successfully releasing the foundation issue of the journal i.e. *STRIDES – A Students' Journal of Shri Ram College of Commerce, Volume 1, Issue 1, 2016-17* on the occasion of 91st Annual Day of College held on 13th April 2017. The Journal is released by Shri Prakash Javadekar, Honb'le Minister of Human Resource Development, Government of India.

The college has already applied for *International Standard Serial Number* (ISSN) for the Journal. The application for ISSN is still under process.

I would like to congratulate the students whose papers are published in the foundation issue of the journal and simultaneously, encourage all the students to contribute their research papers and articles for the successive issues of the Journal.

Best wishes for their future endeavor.

Dr. R.P. Rustagi
Principal (Officiating)



Editor's Message

Shri Ram College of Commerce is well known for its academic excellence and dedicated approach towards dissemination of knowledge in the academic world. The College appreciates the role of research in education and is committed to developing an inclination towards research in both faculty and students. In this pursuit, the College has taken the initiative to launch a new Journal named 'STRIDES – A Students' Journal of Shri Ram College of Commerce' to encourage students to pursue research under the guidance of the faculty of Shri Ram College of Commerce.

It is an annual journal launched exclusively to publish academic research papers and articles by students on contemporary topics and issues in the area of commerce, economics, management, governance, policies etc.

In order to maintain high standards of publication, a Committee on Publication Ethics (COPE) has been constituted. The COPE shall be the apex authority to take all decisions related to publication of research papers and articles in STRIDES. The decision of the COPE shall be final and binding.

To maintain the *academic standards, academic ethics* and *academic integrity*, a rigorous process of blind review of articles is followed after screening for plagiarism of each manuscript received by the college for publication. The research work published in STRIDES is original and not published or presented at any other public forum.

The foundation issue of the Journal i.e. *STRIDES – A Students' Journal of Shri Ram College of Commerce, Volume 1, Issue 1, 2016-17* is successfully released on 91st Annual Day held on 13th April 2017 by Shri Prakash Javadekar, Honb'le Minister of Human Resource Development, Government of India.

Successive issues of STRIDES will be released every year on the occasion of College Annual Day.

Dr. Santosh Kumari
Editor

STRIDES

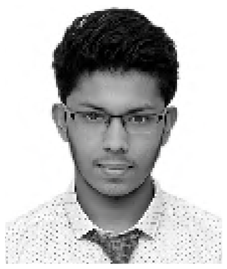
A STUDENTS' JOURNAL OF SHRI RAM COLLEGE OF COMMERCE

Volume 1 | Issue 1 | 2016-17

CONTENTS

ARTICLES

Parth Verma
B.A.(Hons.) Economics – Ist Year
Shri Ram College of Commerce
University of Delhi



Prajwal Gupta
B.A.(Hons.) Economics – Ist Year
Shri Ram College of Commerce
University of Delhi

Mentor

Mr. Avinash Kumar Jha
Assistant Professor,
Department of Economics,
Shri Ram College of Commerce

Structural Changes in The Russian Economy

The article critically examines the factors that've worked together to influence the interest rates (lending and borrowing) in Russia. The data set contains data from 2011-2015 on various economic parameters such as GDP, external debt, imports and exports etc. that have been analyzed to examine their influence on the movement of interest rates and the regression analysis has been performed for the same. Variation in movement of interest rates in an economy owes to its characteristic features and economic indicators. We also then discuss how the Russian economy has possibly set itself on the path of export intensive growth and its possible implications as well as the application of Policy Trilemma in Russian context.

INTRODUCTION

Russia is a major player in the oil market recording largest daily oil production for the past three years. Due to lack of diversification, Russia has become a commodity intensive economy with oil and natural gas driving its growth. Its revenues are majorly dependent on the oil exports. In 2015, the revenues from oil and gas made up to 44% of the federal budget. Also with the current oil rout, fiscal deficit and inflation have seen an upward movement in the Russian federation. Being heavily dependent on oil, the economy is exposed to the risks of crude-price dynamics as well as exchange rate movements. Since dollar is traditionally acceptable means of payment for oil related sales and purchases, Russia's export earnings have been exposed to the risk of fluctuations in dollar/ruble exchange rate. Therefore, the policy makers decided to reduce the dependency on dollar. With increased accumulation of USD denominated debt and growing foreign exchange reserves, the latter was used as a means to reduce the former.

Throughout this research we observe that various changes in the geopolitical factors and events related to the oil like the introduction of the shale technology by the USA have deeply impacted the Russian exports and revenues. Hence in order to reduce its dependency on a single currency, Russia decided to reduce its US dollar reserves and accepted local currency as a payment towards its exports. It repaid its US denominated external debt in staggering amounts using Non-residents deposits, entering into forward contracts of foreign currency swap (ROUBLE/USD) and foreign exchange reserves.

THE GAMEPLAN

Like any typical emerging market, consumption expenditure has played a central role in supporting the economic growth in Russia. But this consumption expenditure may not support growth forever due to lack of diversification in the economy and thereby leading to uncertainty in employment and incomes of the masses. So, it seems plausible to assume that policy makers might be looking for some reliable model of growth. After the collapse of Soviet Union in early 1990's due to increased government control in the economy (leading to rising fiscal deficit, skyrocketing inflation and stagnant wages), Russia adopted a conservative monetary and fiscal policy. With limited access to international financial markets, Russia focused on hard-to-provide incentives to international lenders in order to attract foreign capital. Reduction in fiscal deficit and debt repayment are often instrumental in attracting global finance. Inflow of capital would also provide the policy makers some room to do away with stringent austerity measures.

As far as an emerging market like Russia is concerned, an important task before government was to restructure the economy in order to provide it enough flexibility to switch between different growth models i.e. consumption driven and export driven.

To facilitate the growth of a vibrant export intensive sector, a series of measures were required. Increasing competitiveness of local currency and fulfilling the capital requirements of this sector were the most significant among them.These requirements were fulfilled by incentivizing global finance through debt repayment. Debt repayment would also reduce dollar dependency which was a much needed reform for this commodity based economy.

The Russian economy decided to reduce the dependency on dollar due to growing risks of a downturn in the ruble exchange rate because of renewed slump in global oil prices due to US oil production (shale technology) in 2013. Expectation that the US Fed's interest rates will rise further have led to strengthening of the US dollar against global currencies, which, together with the increase in supply and weak demand, was a factor underlying the fall in commodity prices in the global market which contributed towards Russia's falling export income. So the gateway of achieving this motive was paying off their exorbitant external debt.

The repayment of external debt involved huge amount of USD outflows. Its demand was met by-

1. Using non-resident deposits
2. Entering into foreign exchange swaps with NRI's
3. Using their foreign exchange reserves

Russian government set itself on a debt repaying spree. Debt liabilities of the government saw a considerable reduction by $11.1 billion and a substantial portion of this reduction came in the segment of foreign currency denominated securities. Banks' external liabilities also shrank by almost a quarter in the aftermath of liquidity flush in the banks. External debt of other sectors fell by $39.7 billion. Reduction in the share of short term liabilities and rise in the share of long term liabilities are indicative of the fact that the government is preparing itself to invest in long term projects probably infrastructure and manufacturing and fiscal deficit will probably see a rise along with a control over revenue expenditures of the government. This change could be attributed to Mr. Putin's call for further diversification of Russian economy in response to global oil crisis in 2014.

After repaying its external debt, the government increased its internal debt by issuing Treasury bills and also used its pension fundin order to arrange requisite funds to honor its liability to non-residents (swaps and deposits). It was the only source that could provide a huge sum of money at a short period of time. Large flow of people's funds into the banks and government treasuries through Treasury bills and pension fund savings led to a deep liquidity crunch in the domestic economy. Also, 2015 saw a slight reduction in consumer activity in the domestic foreign exchange cash market compared with 2014.

The amount of foreign exchange cash purchased by households from authorized banks fell by 48% compared with 2014, to $37.1 billion. Moreover, the amount of foreign exchange cash sold to banks dropped by 20%.

This crunch led to a shortfall in imports as well as consumption of goods and services leading to stagnancy in the economy with low demand and production. In order to provide the lost stimulus, the government released money into the economy through the budgetary policy. The Central Bank of Russia printed about one trillion rubles. This amount was larger than the debt on treasury bills. Hence, supply of money exceeded its demand resulting in high inflation. With this increased money supply, the already plummeting domestic demand, due to liquidity crunch, was further hit by rising inflation. Troubled demand in the home country was an added incentive for firms to export. Now, in order to export, firms would require global competitiveness for their products as well as capital to meet the rising expenditures associated with expanding their businesses. This created a sentiment in the corporate sector to repay its debt as repayment of external debt by corporate sector would enhance their profits and consequently their competitiveness and interest expenditures in foreign currency which were steadily depreciating tends to fade away with debt repayment. Also, the additional capital requirement was met by directing private fund towards export intensive sectors, through the investment banks, by reducing the deposit rates. Now, as the deposit rates were kept low by the Central Bank for a sustained time period, private fund started looking for other avenues of investment. Low deposit rates coupled with high lending rates turned the direction of local as well as global funds towards investment banks. With depreciating currency and government's push for exports, the export intensive sectors were expected to generate more than normal returns. Hence, the capital inflow in investment banks was concentrated in these sectors. This way exports were allowed to grow at the cost of private consumption expenditure. Rising government expenditure through monetary expansion and incentive structure created by the policy makers indicates that Russian federation is aiming to pursue an export led model of growth. This will provide the necessary boost to the domestic firms. The Russian economy is ostensibly restructuring itself by protecting domestic firms through ban on imports of some goods, restrictions on FDI and encouragement to FII. This movement from primarily a commodity driven to a more diversified economy is possibly the result of tattering government finances due to global oil rout. The intriguing fact is how monetary policy has been used to bring this so-called structural change.

The Russian model of growth has traditionally focused on oil exports coupled with conservative monetary and fiscal policies and strict austerity measures. But the recurrence of oil crisis and resulting implications on the economy have compelled the government to come up with a more concrete action plan to drive growth. A manufacturing revolution along with an export centered approach to growth sounds promising especially after witnessing the rapid growth emanating in East- Asian countries like China, Japan and South Korea due to exports. Probably this is the reason why Russian government is pouring enormous subsidies in auto manufacturing sector with firms executing the highest number of sales taking a major chunk of subsidies. This provision of subsidies makes the goods more competitive in the international market and allows them to produce enough surplus to export. In fact, subsidies provided by the government have been steadily rising over time. The government has planned on subsidizing auto industry, aerospace and textile industry. Growing subsidies will signal the investors about government's seriousness in developing infrastructure and boosting exports which will prevent capital outflows which have been plaguing Russian economy. Investor confidence is important in securing inflow of capital. In order to develop a vibrant manufacturing sector which will be expected to produce surpluses to export, it makes sense to provide subsidies, increase investments by attracting foreign capital and making necessary changes in monetary policy at times. Consequently, exchange rate will fluctuate. As the industries start growing and producing enough surplus, Russia may adopt a relatively stable exchange rate as China has done so that exporters are not in the dark about their earnings.

INTEREST RATE MODEL

$Y = 0.05264330099 - 1.54089e^{0.6} X_1 - 1.71451e^{0.7} X_2 + 6.93913e^{0.6} X_3$

Y: Lending Rates

X_1: Imports

X_2: External Debt

X_3: GDP

Regression Statistics	
Multiple R	0.959803689
R Square	0.921223122
Adjusted R Square	0.906452458
Standard Error	0.010602691
Observations	20

TOLERANCE = $1-R^2 = 1-0.9212 = 0.0788$

Thus, there is some multi-collinearity.

Here, lending rates have been regressed with respect to GDP, imports and external debt. The model depicts an inverse relationship between dependent variable i.e., lending rates and the two variables namely, external debt and imports and a positive relation between lending rates and GDP.

This is probably because the government reduced its external debt by paying off the creditors of USD denominated loans. Consequently, there was a liquidity crunch which compelled the CBR to print 1 Trillion Rubles. This led to soaring inflation expectations due to which CBR needed to increase lending rates and therefore negative relation between lending rates and external debt.

With depreciation of Ruble against USD, export sector was given further incentive to generate promising returns. This raised GDP. The government then raised lending rates in order to defer consumption expenditure and directed the resources in export sector. To execute this, lending rates were raised. Hence, GDP is positively related with lending rates.

The major proportion of imports in Russian economy comprised of machinery and other capital intensive goods which are essential to the process of production and thereby important for export intensive sectors. Since, Ruble has been steadily depreciating in the international currency market, these imports were getting costlier for the producers, thereby raising input prices and subsequently the cost of production could also rise because of this. So, to bring down the cost of capital lending rates needed to be reduced.

Note

1. Exports have been excluded from the model due to high correlation with the GDP, thus posing the problem of high multi-collinearity.

2. The following regression analysis is based on the data from the past five years. It may not give a holistic description of the relationship between the aforementioned variables.

THE POLICY TRILEMMA

The policy trilemma or the impossible trinity is a macroeconomic theory which states that out of the following three;

- Autonomous monetary policy
- Free mobility of capital
- Fixed exchange rate

A country can choose only two. Countries which have tried to achieve all three of them simultaneously have failed. If the monetary policy is autonomous and capital is freely mobile, then exchange rate ought to fluctuate. However, if the country fixes the exchange rate, then monetary policy will move in tandem with capital flows and won't cater to the need of domestic stability, inflation and unemployment. In other words, monetary policy will not be autonomous.

The concept of policy trilemma can offer some insight regarding Russia's choice of autonomous monetary policy and free capital mobility. Russia is still an emerging market where interest rates are used as an important tool to regulate money supply. When government is reluctant to spend aggressively, monetary policy can be used as a tool to provide the necessary stimulus. Control over monetary policy and banking system becomes all more important in an economy whose access to international financial markets is constrained. In the absence of competing financial instruments, capital provided by the banking system becomes all the more necessary for businesses in such circumstances. Hence, autonomy over monetary policy is needed.

1.Autonomous monetary policy

In Russia, the government adopted the autonomy in the formation of its monetary policy. In order to fulfill its purpose of reduced dependency on USD, it repaid its external debt. It was made possible by adjoining actions of issuing Treasury bills that raised enough funds for govt. functioning. The T- Bill issue was a success as the government reduced its deposit rates that incentivized people to transfer their funds from bank accounts to government securities. The government also increased its lending rates to defer the consumption demand of its people and channelize their funds for the production sector, thereby increasing productivity to revive its depressed economy and benefit from high returns in the export sector. Thus, in these ways the government used its autonomous monetary policy to fulfill its strategy of reduced dependency on the USD and reviving its economy from that shock.

2.Free movement of capital

Here the government also allowed the autonomy in the flow of capital in the economy. Free flow of capital means that the government removed capital controls on its financial transactions. The government required autonomy in this in order to effectively channelize the economy's funds to various sectors to ensure the working of above framework. All the actions right from using NRI deposits to issuing T-bills and increasing lending rates for investment in production sector and raising FII's, required government to remove capital controls in order to make these actions happen. Thus autonomy in the movement of capital was a pre-requisite of the government's action of reduced dependency on the USD.

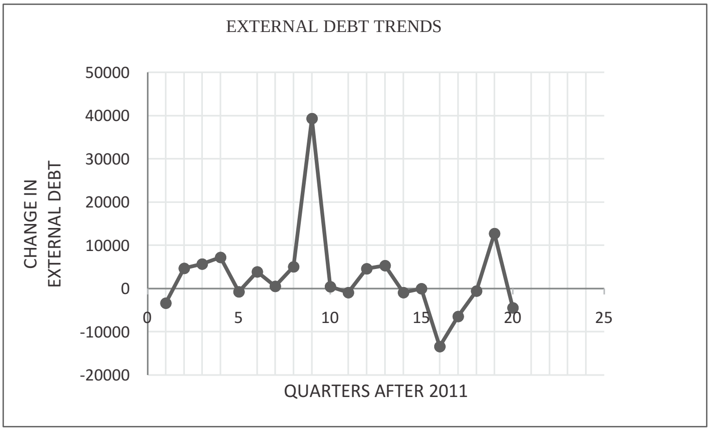
3.Fixed foreign exchange rate

However owing to the trilemma the government couldn't preserve autonomy in the foreign exchange rates. When the government repaid its external debt, due to constrained supply of USD in the market, USD/RUB fell. Also when the government, in order to regain liquidity, printed 1 trillion rubles and increased its public expenditure, the supply of ruble in the market increased as a result USD/RUB soared drastically. Thus these events prove that the government choosing autonomy in capital movements and monetary policy had to give up its autonomy in fixing its foreign exchange rates Movement in the foreign exchange ratesthus became an effect of government strategies using autonomy in other two areas.

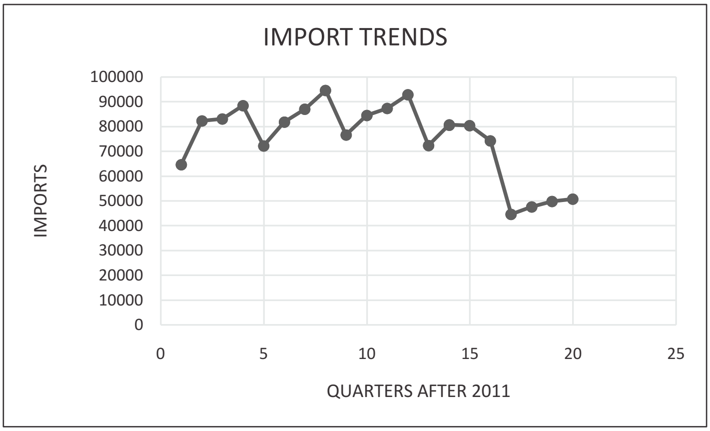
CONCLUSION

The time period of 1970's and 1980's was a period in which Asian countries exported to grow. This rapid growth was made possible by increased consumption demand for cheap foreign goods from industrial countries like America and countries in European Union. As these countries sustained massive current account deficits due to rising imports, they had to borrow in order to finance these deficits. These borrowings were financed by savings of households from the same developing countries which were exporting to pursue growth. This created massive trade imbalances with developing countries having trade surpluses and the developed ones running deficits. Thus, the exporting countries were becoming increasingly dependent on industrial countries to absorb the surplus produced by them. In this process, the developing economies created producer biased economies which led to difficulties in creating sustained domestic demand. Hence, the dependence on foreign demand continued to increase. Now, as the industrial countries are turning more towards protectionism and are facing stagnancy, the path to be followed by export dependent nations is becoming more and more uncertain as their source of demand seems to be fading. In such a world, export led growth is a distant possibility not only due to stagnancy in industrial economies and their push towards domestic production but also due to potential competition between emerging markets to export their goods. If the competition to export rises to unsustainable levels, the global prices would come down threatening the export earnings of these countries.

DATA AND TRENDS

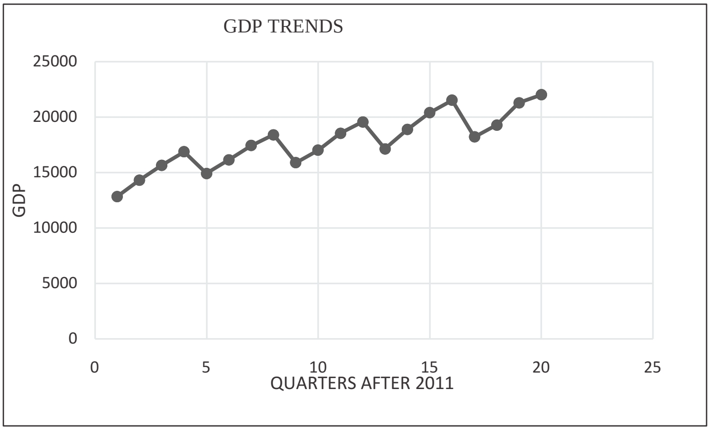


The above graph shows the payments and receipts in form of external debt in the past 5 years. Here the peak shows the government's action of raising debt through NRI deposits. The government accumulated those deposits throughout 2014 and finally paid its US denominated debt in 2015



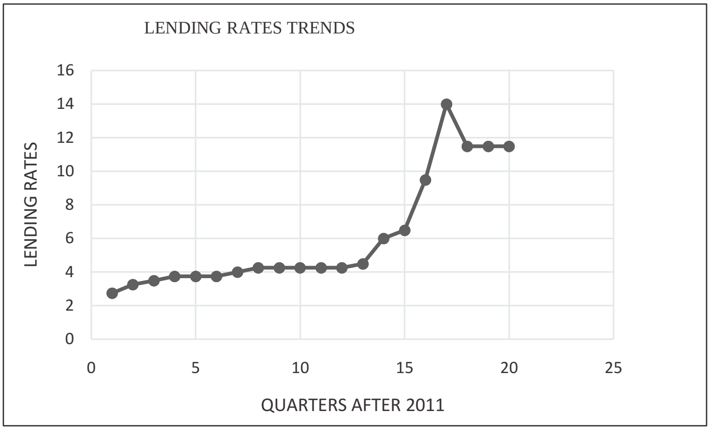
SOURCE: WORLD BANK

The above graph shows the imports by Russia in the past five years. It depicts a seasonal trend as there is dip in imports in Q1 every year. However in 2015 due to liquidity crunch owing to debt repayment led to a 42% fall in imports.



SOURCE: IMF

The above graph depicts absolute GDP over the past 5 years. It shows a seasonal trend owing to reduced demand for oil in summer season especially in Q4's every year. Also the GDP shows strengthening trend over the years. This may be due to increase in income owing to rising government expenditure, exports and investment. Exports that showed promising returns attracted massive investment that led to increased production in the economy.



REFERENCES

Andrianova Anna,&KhrennikovaDina.(2016)How Cheap Oil Is Squeezing Russia's Economy. Bloomberg. 26th January [online]. Available at: https://www.bloomberg.com/news/articles/2016-01-26/how-cheap-oil-is-squeezing-russia-s-economy [Accessed 3rd January, 2017].

Bank Of Russia (2016) Annual Report for 2015. Moscow

Kuchma Anna.(2015) Why is Russia's Central Bank planning to print 1 trillion rubles? 18th November,2015 [online]. Available at: http://rbth.com/business/2015/11/18/why-is-rusias-central-bank-planning-to-print-1-trillion-rubles_541771 [Accessed 22nd December, 2016]

Statistics Department of the Bank of Russia, Monetary statistics (2015).Available at:http://www.cbr.ru/Eng/statistics/?PrtId=dkfs.

Statistics Department of the Bank of Russia, Financial accounts and Financial balance sheets (2015). Available at:http://www.cbr.ru/Eng/statistics/?PrtId=fafbs.

SHRI RAM COLLEGE OF COMMERCE
University of Delhi, Maurice Nagar Delhi - 110 007
Phone: 11 - 27667905   Fax: 11 - 27666510