

Abdumalikova Busalima Abduvali qizi

2nd-year students of the “Management” faculty

Tashkent State University of Economics

Baxtiyorova Sarvinoz Baxrom qizi

2nd-year students of the “Management” faculty

Tashkent State University of Economics

ABSTRACT

On 17 August 1998, the Russian Federal Government announced the largest sovereign default in its own history — and one of the largest in world history at that time: it suspended payments on GKO (short-term government securities) amounting to 281 billion roubles for a period of 90 days and allowed the rouble to float freely against the US dollar. The rouble depreciated by 60% within a single month, annual inflation rose to 86% in 1999, and real GDP contracted by 5.3%. This article provides a systematic analysis of three core dimensions of the crisis: the mechanism and economic consequences of rouble depreciation; the GKO pyramid and the failures of public debt management; and the differentiated impact of the crisis on member states of the Commonwealth of Independent States (CIS). The analysis is based on primary data from the Central Bank of Russia, the IMF, the World Bank, and the OECD.

Keywords: Russian crisis 1998, sovereign default, GKO, rouble devaluation, public debt management, CIS, transition economy, high-yield bonds.

INTRODUCTION.

The dissolution of the Soviet Union in 1991 confronted Russia with the unprecedented complexities of transitioning from a planned to a market economy. The “shock therapy” policy — rapid price liberalisation, privatisation of state assets, and sharp cuts to the budget deficit — brought structural reforms alongside severe economic hardship. The results, however, proved far more painful than anticipated: between 1992 and 1998, Russia lost approximately 40% of its real GDP on a cumulative basis. By 1996–1997, signs of economic recovery had begun to emerge:

inflation was falling, the rouble had stabilised, and foreign investment was flowing in. Yet this "stability" was considerably more fragile than it appeared — it rested on elevated oil prices and cheap inflows of foreign capital. In the second half of 1997, the ripple effects of the Asian financial crisis, and in early 1998 the collapse of crude oil prices to USD 10 per barrel, brought to the surface the latent vulnerabilities of Russia's financial system. On 17 August 1998 — a date known in modern financial history as "Black Monday" — the Russian Federal Government declared a moratorium on GKO obligations and released the rouble to float freely. GKO default volume: approximately 281 billion roubles (\approx USD 38.5 billion, at August 1998 exchange rates).

RESEARCH METHODOLOGY.

In methodological terms, this study employs a strategic case-study approach combined with institutional risk analysis. The research utilizes historical-comparative methods to trace the evolution of governance failures and integrates systemic risk assessment models to evaluate the macroeconomic impact of public debt mismanagement on both Russia and the broader CIS region.

LITERATURE REVIEW ON THE TOPIC.

The 1998 Russian financial crisis and its systemic consequences have been extensively analyzed by leading global economists and international financial institutions, highlighting critical failures in strategic risk management. The analysis of the GKO debt pyramid is heavily informed by Hyman Minsky's Financial Instability Hypothesis. Researchers later applied this framework to Russia, classifying the GKO market as a classic "Ponzi finance" structure, where the government made a fatal management error by continuously issuing new short-term debt simply to pay off older investors. Concurrently, Charles Kindleberger cited the Russian default as a textbook example of a "panic and crash" driven by the sudden reversal of hot capital, showing that the leadership failed to anticipate the psychological behavior of international investors.

Regarding the mechanics of the sovereign default, Carmen Reinhart and Kenneth Rogoff argued that Russia's collapse proved a crucial macro-governance thesis: even resource-rich nations default if domestic debt management is flawed. They pointed out that Russia's core mistake was accumulating short-term, rouble-denominated debt while its institutional tax collection system was completely broken.

The monetary and contagion dimensions are examined through modern crisis theory. Paul Krugman demonstrated that Russia fell victim to a "third-generation currency crisis" model, where the rigid defense of the rouble corridor while running huge fiscal deficits was a strategic contradiction. Ben Bernanke highlighted that the

sudden freeze of the banking system paralyzed the domestic credit channel, transforming a fiscal crisis into a deep real-economy depression. Furthermore, Nouriel Roubini emphasized the systemic risk and regional contagion, proving that the “Russian virus” caught neighboring CIS member states completely off-guard due to a severe lack of regional risk-monitoring and macroprudential safety nets.

ANALYSIS AND RESULTS.

From 1995 onwards, the Central Bank of Russia maintained the rouble within a “currency corridor” against the US dollar. At the start of 1998, this corridor was set at 5.25–7.15 roubles per dollar. The system minimised currency risk for importers and foreign investors, but at the same time provided a clearly defined target for speculative attacks. To defend the currency corridor, the Central Bank of Russia spent large quantities of foreign exchange reserves. Reserves that stood at approximately USD 24 billion in January 1998 had fallen to USD 14 billion by July — a loss of USD 10 billion. It subsequently emerged that a significant portion of these reserves had been misappropriated or diverted through dubious transactions.

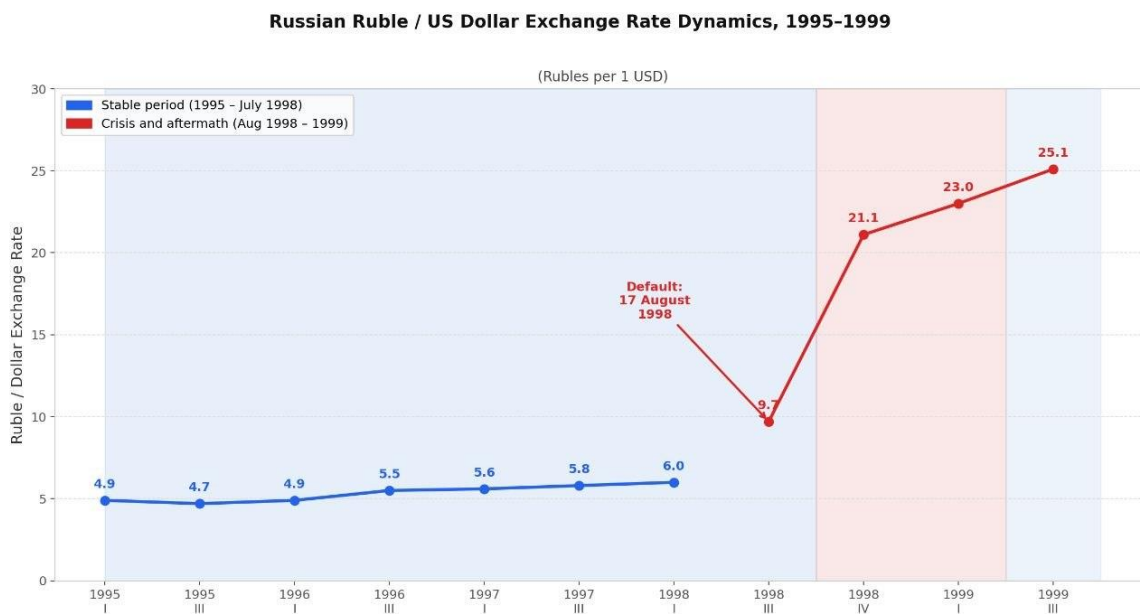


Figure 1. USD/RUB exchange rate dynamics, 1995–1999.¹

As Figure 1 clearly shows, from 1995 to July 1998 the rouble was held relatively stable within the range of 4.9–6.0 roubles per dollar. From August 1998 onwards, however, the rate fell sharply: to 9.7 roubles per dollar in the third quarter of 1998, 21.1 roubles by year-end, and 23–25 roubles per dollar in early 1999. Rouble depreciation:

¹ Central Bank of Russia; IMF International Financial Statistics.

approximately 74% (July to December 1998). The rouble depreciation affected every sector of the economy. First, import prices rose sharply: Russia was a major importer of basic foodstuffs, and inflation rapidly assumed the character of “imported inflation.” Food prices increased by 130% between August 1998 and January 1999. Second, for Russian companies and banks that had borrowed in dollars, the rouble-denominated debt burden nearly quadrupled. This triggered a wave of mass bankruptcies: in August–September 1998, major Russian banks — SBS-Agro, Menatep, Inkombank, and Rossiysky Kredit — declared insolvency. Third, paradoxically, currency depreciation also produced one positive outcome: Russian exporters — oil and gas companies — incurred costs in roubles but received revenues in dollars. The fall in the rouble therefore significantly enhanced their competitiveness. This “devaluation effect” became an important driver of Russia's economic recovery from 1999 onwards. The collapse of the banking system and rampant inflation wiped out the savings of an entire generation of depositors. In August 1998, depositors queued at ATMs in a desperate attempt to salvage their savings. Commercial banks other than Sberbank (the state bank) suspended repayments to depositors. According to official statistics, real monetary incomes in Russia fell by 37.5% in August 1998 compared with the previous year. The poverty rate rose to 23.4% by the end of 1998 — a significant increase from 20.8% in 1997. The crisis effectively wiped out the “middle class” that had formed during the preceding reform period.

Budget Deficit and Tax Collection Problems.

Russia's federal budget carried a structural deficit throughout the 1990s. The core problem, however, lay not only in the level of expenditure but in the dysfunctional operation of the tax system.

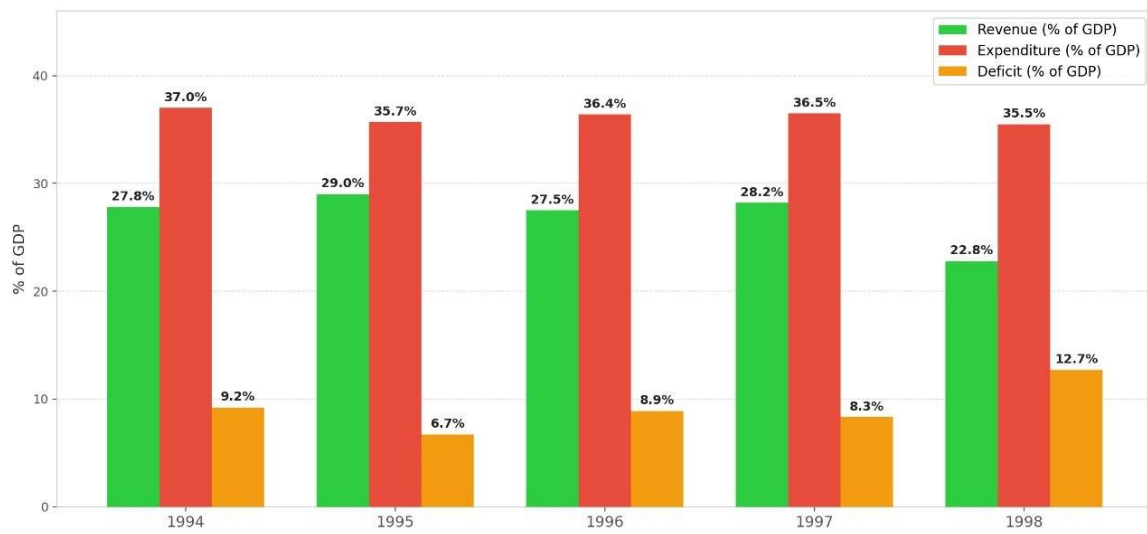


Figure 2 (labelled Figure 3 in original). Federal budget revenues and expenditures as a share of GDP, Russia 1994–1998 (%).²

As Figure 2 clearly illustrates, expenditure exceeded revenue by a considerable margin in every year examined. In 1998, budget revenues amounted to 22.8% of GDP while expenditure stood at 35.5% — a deficit of 12.7% of GDP.

Russia's tax collection problem: in the mid-1990s, major corporations — notably Gazprom and other energy monopolies — paid a portion of their taxes in “barter” form (goods in lieu of cash). The federal government’s cash tax revenues fell far below what the official size of the economy would imply. Some estimates suggest that “lost” cash tax revenue amounted to 5–6% of GDP in 1997.

The Oil Price Shock.

In the second half of 1997, the impact of the Asian crisis on oil demand, compounded by OPEC’s decision to increase production, drove oil prices sharply downward. The Brent price fell from an average of USD 18.7 in 1997 to below USD 10 by end-1998 — the lowest level since 1986.

² Russian Ministry of Finance; IMF Russia Country Report 1999.

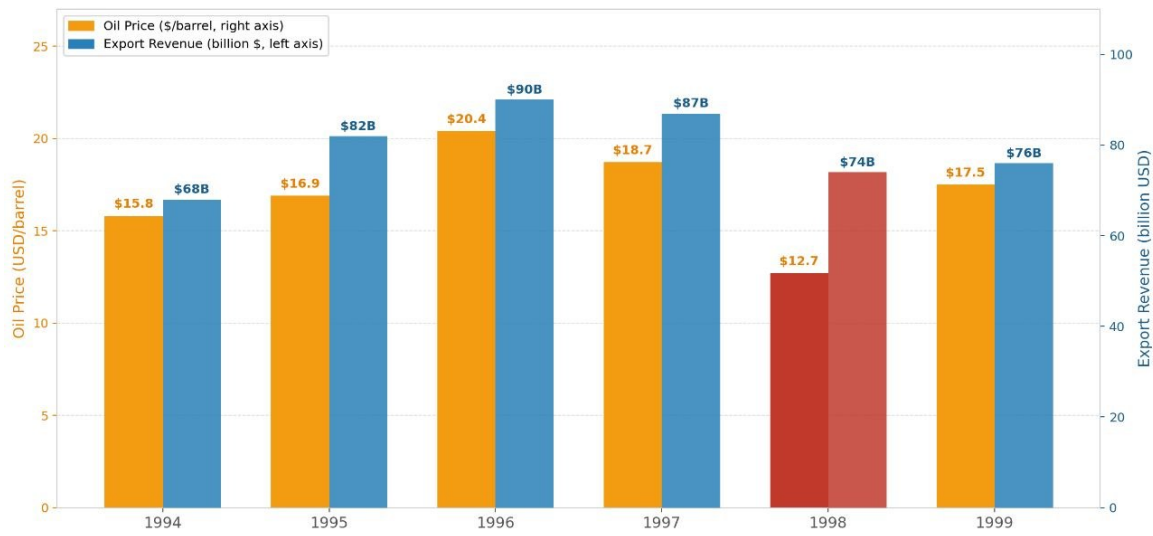


Figure 3 (labelled Figure 4 in original). Brent crude oil price (USD/barrel) and Russian export revenues, 1996–2000.³

As shown in Figure 3, the decline in oil prices from USD 18.7 in 1997 to USD 12.7 in 1998 (a fall of 32%) reduced Russian export revenues from USD 86.9 billion to USD 74.4 billion. Given that oil and gas exports accounted for approximately 40% of federal budget revenues, it is not difficult to envisage how this “external shock” amplified the budget deficit.

In July 1998, the IMF approved an expanded rescue package for Russia totalling USD 22.6 billion. The first tranche — USD 4.8 billion — was disbursed immediately. Yet even these funds proved insufficient to defend the rouble. Subsequent research revealed that the USD 4.8 billion disbursed in the IMF's July tranche was spent defending the rouble in foreign exchange markets within that same week — that is, the funds effectively passed into the hands of foreign speculators.

The economic logic underlying the Russian government's “final capitulation” — the decision to declare a moratorium and devaluation — was straightforward: either the state would attempt to honour all its obligations and drive the economy further into the ground, or it would declare default and start afresh. The Yeltsin government chose the latter course.

³ EIA; Russian Federal Customs Service; IMF.

Macroeconomic Portrait of the Crisis: GDP, Inflation and Recovery.

In the entire history of Russia's economic transition (1992–1999), only 1997 recorded positive growth — and even then a mere 1.4%. The 1998 crisis brought this fragile recovery to an abrupt halt.

Russia: GDP Growth and Inflation Rate, 1993-2000
(GDP: %, Inflation: % (logarithmic scale))

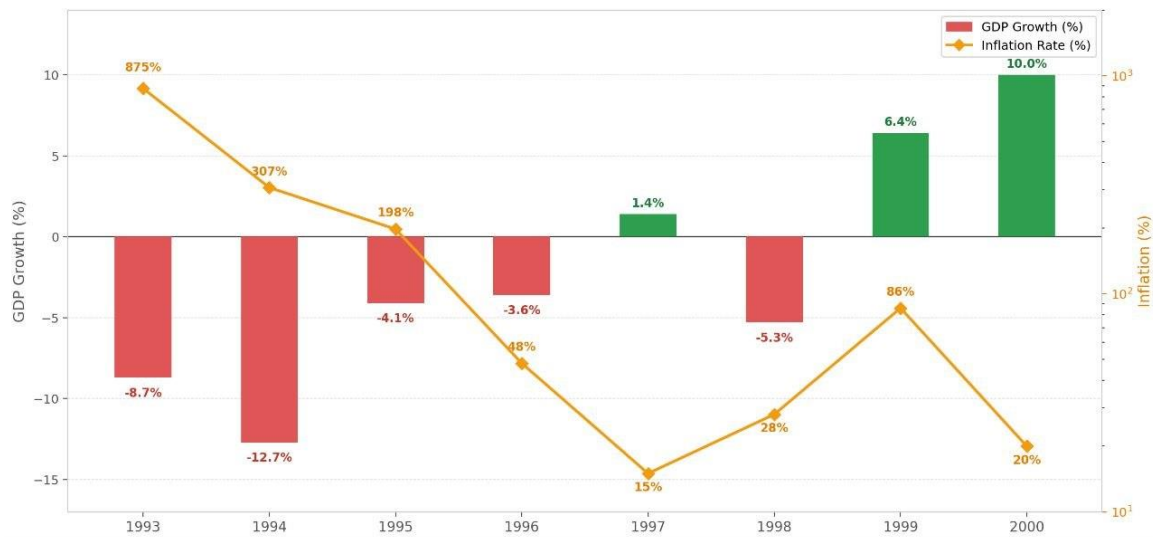


Figure 4 (labelled Figure 5 in original). Russia: Real GDP growth (%) and inflation rate (%), 1993–2001. ⁴

Figure 4 reveals the trend from the hyperinflation of 1993 (875%) through to relative stabilisation in 1997 (15%). Following the 1998 crisis, inflation surged to 86% in 1999. Simultaneously, GDP contracted by –5.3% in 1998. Remarkably, the post-crisis recovery proved faster than anticipated. GDP grew by 6.4% in 1999 and 10.0% in 2000. The principal drivers of recovery were: the export sector, which benefited from rouble depreciation; rising oil prices from 1999 onwards; and the "cleansing effect" of the crisis — the reallocation of resources away from troubled banks and companies towards more efficient uses.

Russia's economic centrality within the CIS.

Following the dissolution of the Soviet Union, Russia remained the hub of economic interdependencies within the CIS space. For CIS member states, the Russian market was the largest export destination, while Russia served as the primary supplier of

⁴ World Bank World Development Indicators; IMF World Economic Outlook Historical Database.

energy (oil and gas). Moreover, billions of dollars in labour migration remittances played a significant role in the economies of Ukraine, Moldova, Kyrgyzstan, and other countries. The dependence of CIS states on Russia transmitted the crisis through four principal channels: (1) the contraction of commodity export markets; (2) a decline in remittances from Russia; (3) the withdrawal of foreign capital flows from all CIS countries; and (4) changes in oil and gas prices and supply conditions.

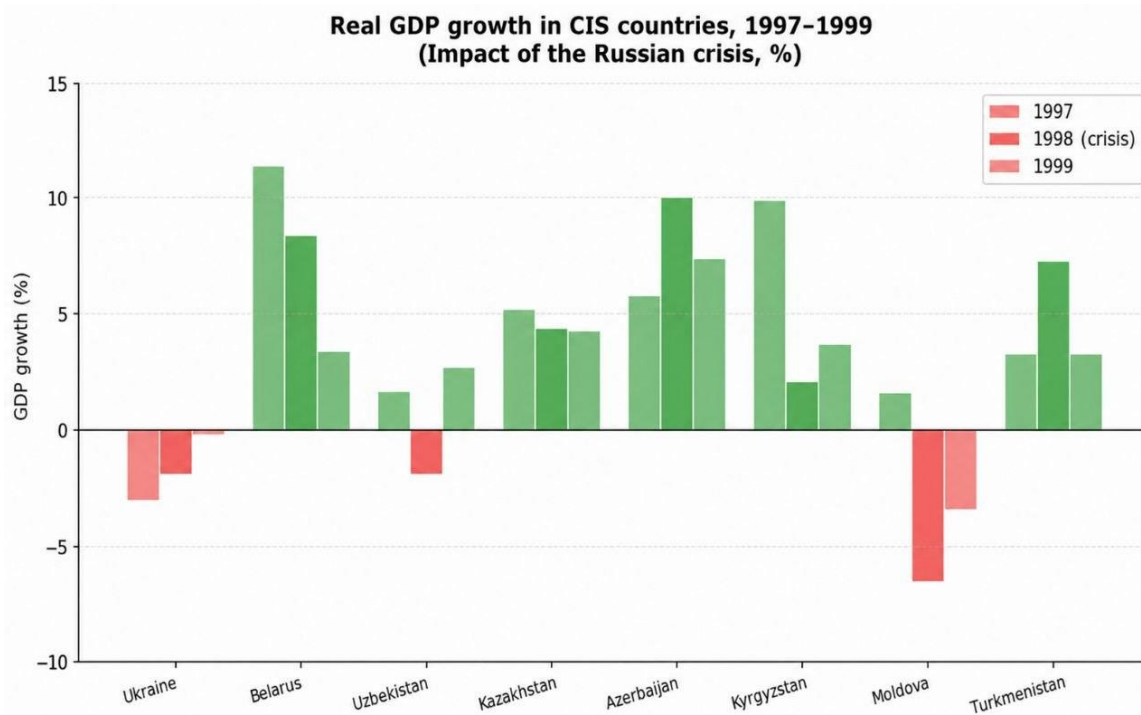


Figure 5. Real GDP growth rates in selected CIS countries, 1997–1999 (%).⁵

Country-by-Country Analysis.

Ukraine.

Ukraine was among the CIS countries most severely affected by the Russian crisis. Russia absorbed approximately 23–24% of Ukrainian exports. In the wake of the Russian crisis, the hryvnia also depreciated (losing 50% of its value against the US dollar in 1998), and annual inflation rose to 20%.

⁵ World Bank WDI; IMF WEO Historical Database; EBRD Transition Report 1999.

Belarus.

Belarus was the CIS state most closely linked to Russia, with more than 60% of its exports directed there. However, because the Belarusian government maintained price controls and capital restrictions, the impact of the crisis manifested in a distinctive form — while official indicators appeared favourable, the black market and shortages of goods intensified.

Kazakhstan.

For Kazakhstan, the Russian crisis coincided with oil-export-related vulnerabilities. Real GDP fell by -1.9% in 1998 — the first negative growth recorded during the transition period. Nevertheless, the recovery in oil prices from 1999 onwards enabled Kazakhstan to bounce back more quickly.

Central Asian States.

The impact on Central Asian states — Uzbekistan, Tajikistan, Turkmenistan, and Kyrgyzstan — varied considerably. Uzbekistan was minimally affected by the crisis, owing to its retention of capital controls and its relatively lower degree of dependence on the Russian market (recording growth of 4.4% in 1998). Kyrgyzstan, by contrast, having integrated more closely with the IMF's open capital policy, recorded growth of only 2.1% in 1998.

Moldova.

Moldova was among the most severely affected countries: real GDP contracted by -6.5% in 1998 and -3.4% in 1999. Russia was Moldova's principal trading partner, and exports of wine and agricultural products fell sharply.

Long-Term Impact of the Russian Crisis on CIS Integration.

The 1998 crisis exerted a dual influence on economic integration trends within the CIS space. On the one hand, once the risks of dependence on Russia had been made plain, a number of states intensified their economic diversification policies. On the other hand, the crisis, perceived as a shared problem, provided fresh impetus for cooperation, and discussions around financial coordination mechanisms within the CIS framework became more active.

The Russian crisis — coming just one year after the Asian crisis — sparked extensive debate within the international financial community. The G7 countries advanced a series of initiatives from 1999 onwards aimed at reforming the international financial architecture. Discussions on Sovereign Debt Restructuring Mechanisms (SDRM),

heightened attention to the risks of “noise and disorder” in the conduct of international financial institutions, and the debate over “moral hazard” — the assumption that the IMF would bail out any large country that declared default — all acquired new resonance against the backdrop of the 1998 Russian crisis. These developments laid the foundation for the concept of Systemically Important Financial Institutions (SIFI).

CONCLUSION.

The 1998 Russian crisis demonstrated how critical sound systemic financial management is in transition economies. The three core dimensions of the crisis — rouble depreciation, the GKO pyramid, and the external shock of falling oil prices — reinforced one another and brought Russia to the most acute point of its economic difficulties throughout the 1990s. In quantitative terms: the rouble depreciated by approximately 74% during 1998; real GDP contracted by 5.3%; inflation reached 86% in 1999; the GKO default amounted to approximately USD 38.5 billion; and nine major commercial banks were brought to the brink of insolvency in August 1998. Across the CIS, the crisis caused a marked economic slowdown in eight of Russia's nearest neighbours. Paradoxically, the crisis also served to “cleanse” the Russian economy: distressed assets, inefficient banks, and a portion of the “crony capitalist” structures built on political connections were swept away. The rapid recovery of 1999–2000 is explained precisely by this “cleansing effect” and the subsequent rise in oil prices. In transition economies, financial liberalisation must proceed in tandem with the strengthening of regulatory quality. Dependence on short-term foreign capital, a fragile fiscal balance, and the absence of robust defences against currency speculation together create a catastrophic systemic risk.

LIST OF REFERENCES USED.

1. European Bank for Reconstruction and Development — EBRD. (1999). Transition Report 1999: Ten Years of Transition. London: EBRD.
2. G7 Finance Ministers. (1999). Strengthening the International Financial Architecture: Report to the Cologne Economic Summit. June 1999.
3. World Bank. (1999). Anticorruption in Transition: A Contribution to the Policy Debate. Washington D.C.: World Bank.
4. World Bank. (2023). World Development Indicators. Available at: <https://databank.worldbank.org>
5. Illarionov, A. (1999). “The Roots of the Economic Crisis.” *Journal of Democracy*, 10(2), 68–82.
6. International Monetary Fund — IMF. (1999). Russia: Report on Recent Economic Developments. IMF Country Report No. 99/100. Washington D.C.: IMF.

7. International Monetary Fund — IMF. (2023). World Economic Outlook Historical Database. Available at: <https://www.imf.org/en/Publications/WEO/weo-database>
8. U.S. Energy Information Administration — EIA. (2023). Europe Brent Spot Price FOB (Historical). Available at: <https://www.eia.gov>
9. CIS Statistical Committee. (1999). Sodruzhestvo Nezavisimyykh Gosudarstv v 1998 godu [The Commonwealth of Independent States in 1998]. Moscow: CIS Statkomitet.
10. Eichengreen, B. (1994). International Monetary Arrangements for the 21st Century. Washington D.C.: Brookings Institution.