

The Housing Crisis in Russia and Reasons for its Emergence

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ABSTRACT

The following article presents theories of recurrence of business activities in the housing and investigates the Russian housing markets. Using institutional and neoclassical methodology and provides insight into the reasons for its emergence by the means of principles of economic and institutional factors which prevail in the Russian regions. It finally reveals the influence of a housing crisis on efficiency of the functioning of a regional economy.

Keywords: *housing sector, business cycle, housing market, housing crisis, state regulation, institutes, Russia, the Volgograd region*

1. INTRODUCTION

The housing market is a system of economic relations between sellers and buyers of housing which is regulated by the mechanism of cost-based pricing. The housing market is submitted to the laws of cyclic development. The housing cycle develops at varying pace, depending on the level of participation of economic actors in a certain form of ownership.

Upon transition from phase one to another, values of the following indicators change substantially: the initial price level; the ratio of primary and secondary housing markets; the supply and demand ratio; the market behavior of sellers and buyers; the degree of the market activity; institutional provision and the development of the market infrastructure.

2. RELATED STUDIES¹

Theories of economic cycles in the housing sector

1. **Monetary theory (Friedman M.)** [1]. According to provisions of the monetary theory we consider influence of money and credit policy tools on the economy of the housing sector. If the rigid credit policy works, the banking percentage grows. Such a situation promotes an increasing cost of housing capital for the consumer. The increased expenses lead to a reduction on the demand of housing. Reduction of prices of housing reduces investment activities and increases the volumes of construction in progress.

Reduction of housing construction has a massive impact on the social and economic sphere. Housing investments make a considerable share of gross investments. A decrease in investment leads to a reduction of the income of real estate development companies and subsequently to a reduction on the demand in the sectors connected with the housing sector.

High interest rates for mortgages lead to a decreasing demand for real estates as mortgage payments grow more quickly, than actual salaries do. Under these conditions, creditors can take the decision not to deal out

any credits. Such a situation leads a decreasing demand for housing.

2. **Real business cycle theory.** Housing is a durable good (i.e. of long-term usage), thus compelling all economic actors to take probable changes of future market into account. A change of activities in the housing sector can precede (provoke) a change of general economic activities. The housing market can not only react to already occurring events, but tries to outstrip them [2].

When subjects wait for a decline in business activities, volumes of construction of housing can decrease. The housing sector is the indicator of economic recurrence: recession or growth. Real dynamics of the markets of housing can be explained as consequences of the credit policy, and influence of real business cycles. The housing market does not only come under the influence of credit and monetary factors (change of monetary weight and percent rates), but also of other sectors of economy.

3. **Evolutionary and institutional theory.** Recurrence represents a form of progressive, evolutionary development, movement on a spiral. The reason of cyclic change is discrepancy of formal rules (laws, institutional providing) and informal norms (culture, behavior codes, traditions, habits). Informal norms change more slowly, than formal rules. On each new cycle rules, norms evolve and become complicated, quality of institutes grows.

In the process of cyclic development institutions play different roles: the passive part responsible for the ability to inherit (traditions, codes of conduct), active is for his ability to change. Active part form innovative institutes, they are capable to change qualitatively tendencies of development of the housing sector. In Russia in regions with high investment activity the role of innovative components is strengthened, it is explained by influence of dominating technological way and the regional competition. And therefore the present condition of the institutional environment in such regions remains short time. On the contrary, in low-active regions of Russia passive elements at the expense of conservative change of traditions and institutes dominate, they influence reproduction of active elements (innovative institutes).

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Expediency of behavior of economic subjects is explained by regulation of formal and informal institutes. Quality of institutes influences economic growth more than the correct macroeconomic policy. Formal rules are usually created purposeful or substitution of rules in the general compiled laws which evolves by little changes. Informal norms underlie formal rules and at the same time them supplement and do them complete, and are an important source of artificial selection of formal rules.

In the course of cyclic development there is an evolution of configurations of rules to which there corresponds dependence on a trajectory of previous development and frequent emergence of effect of blocking (according to D. Nort [3]). Coherence of rules configurations (system of rules according to F. Hayek, according to D. Nort) has evolutionary character [3]. The ratio between coherence of configurations and intensity in separately taken configuration depends on changeable communications between the last and evolutionary process of the housing sector or on imperfection of the sector. This ratio is at the bottom of evolution of institutes of the housing sector, but it generates crises. The last define factors of the evolutionary relations within configurations of rules, complementarities of rules and norms, their independence and contradictions between them. The institutional theory explains the institutional nature of a housing crisis.

Thus, for an explanation of the cyclic development of the housing market it is necessary to take into account interaction and interference of economic processes and institutes.

The Russian housing market is young, it started to be formed in the middle 1990th year when in the course of housing privatization there were first legal transactions on housing sale. During this period the secondary market was created: in Moscow in the middle 1990th year, in other cities – in 1992-1993. Market processes proceeded actively in regional cultural and financial centers (Moscow, Moscow region, St. Petersburg, Yekaterinburg, Samara, Nizhny Novgorod, Novosibirsk, Krasnoyarsk), the centers of high migrants number (Rostov-on-Don, Stavropol), in the resort centers, the gold-diamond and oil-gas centers. In these regions and the cities of housing price grew high rates. The lowest housing prices in the small cities, the crisis industrial cities and regions with adverse climate.

The housing cycle in Russia has two periods:

1) 1991-2000, the first cycle began from 1990th at the same time with process of liberalization and lasted 10 years;

2) 2001-2011 the second cycle covered the economic revival period after financial crisis of 1998.

Characteristic sign of the housing cycle in Russia is duration of a growth phase. Within seven years housing prices grew. The first cycle begins with rise in prices for housing: from 100-150 USD/sq.m. in 1990 to 900 USD/sq.m. in 1998 in Moscow, to 480 USD/sq.m. in St. Petersburg, 390 USD/sq.m. in the Volgograd region. The peak of a rise in prices falls on the period in 1997 before a financial crisis in 1998 (fig. 1-2).

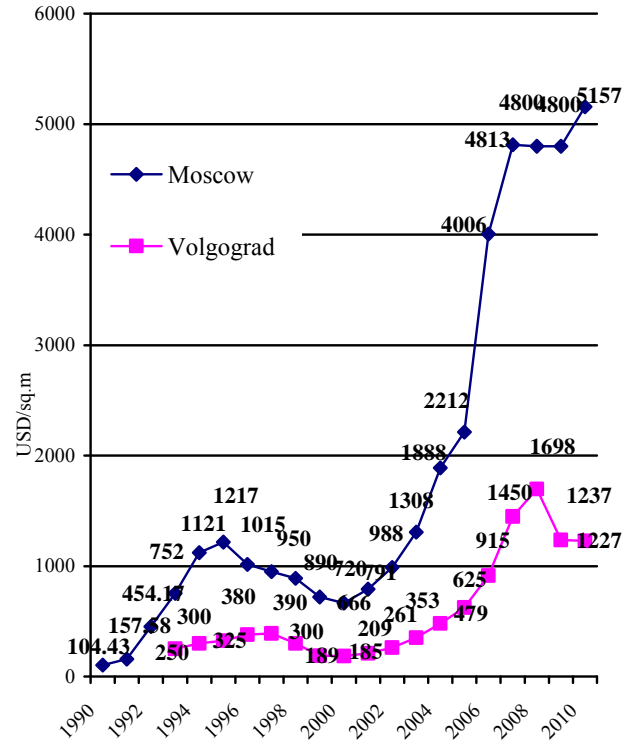


Fig. 1 : Dynamics of change of the average prices in Moscow and the Volgograd region
 It is made and calculated by a bus on the basis of sources [5] and [7]

Cyclic development of the Russian housing market represents change of an upward and downward wave which are presented by the temporary periods.

Upward wave (1990-1995).

1991-1992 – the formation of the housing market in Russia which is connected with a formation of the market relations and housing privatization. During this period there is no infrastructure of housing markets and institutional providing is created. Accepted in 1990. "The law on property in the USSR" recognized concept of private ownership. By the end of 1992 of the transaction of purchase and sale have periodic character. In capital cities (Moscow, St. Petersburg) formation of the housing market and its institutes occurs quicker, than in other regions.

1992-1995 – the formation of institute of the housing market, however did not create institute of the effective owner. Quickly housing prices grew, the market infrastructure developed, institutional and legal support was formed. In 1995 housing price reached a maximum in Moscow - 1217 USD/sq.m, in other regions and the cities the rise in prices till in 1997 proceeded. In the Volgograd region relating to the region with average investment activity, the price made 325 USD/sq.m., in 1997 increased by 20%. Capital regions are more susceptible to economic changes in the country and the world, than other regions.

Downward wave (1995-2000).

1995-1998 – the price stabilization in the housing market, were absent sharp price fluctuations. Reduction of prices began since 1995, there were first signs of crisis in the housing market. During this period there were financial and political problems in Russia which were accompanied by consequences of the economic liberalism policy. Housing price fell in 1996 and 1997 respectively 9% and 14% to level 890 USD in 1998 in Moscow. While in Moscow the prices raised, in the Volgograd region in 1996 and 1997 the price respectively was at the level 380 and 390 USD/sq.m.

1998-2000 – the crisis conditions in the housing market and reduction of price in connection with consequences of the financial crisis 1998th. From the beginning 1999 of the price in the secondary market decreased to 9% in Moscow. It is caused by coming into effect since 1. January 1999 of the Act of Russian Federation "About the state control of compliance of large expenses to the income of citizens", many citizens wanted to keep the capitals at investment in real estate, it caused increase of demand and housing prices.

The average price in 1999 made 690 USD /sq.m in Moscow. However reduction of housing prices proceeded, and the crisis minimum was reached 650 USD /sq.m in May 2000 [6]. The housing markets reached a depression in 2000. The general crisis reduction of price in Moscow made 48% in comparison with a pre-crisis maximum 1995 and 33% in comparison with pre-crisis level. In Volgograd region by the beginning 1999 housing price made 189 USD /sq.m, 2000 – 185 USD /sq.m., reduction of prices twice in comparison since 1997. The Volgograd housing market reached the crisis minimum only in 2000, however, faster rates, than Moscow.

Upward wave (2001-2008).

In Moscow since 2001 the rise in prices for real estate was observed (29, 16 and 50% in 2001, 2002, 2003), the same changes happened and in the Volgograd housing market, the prices raised on 13%, 25 and 35%. The market passed to growth stage till 2003, the prices reached pre-crisis level and a maximum of 1219 dollars/sq.m of the period 1995 in Moscow, 390 dollars/sq.m. of the period 1997 in the Volgograd region. Since 2003 the phase of lifting of an economic cycle in the housing market began, the rise in prices till 2007 in Moscow, till 2008 in the Volgograd region and other regions proceeded. In Moscow the annual rise in prices in 2004 made 21%, in 2005 – 33%, in the Volgograd region respectively – 35% and 30%. In 2007 there was a price stabilization and the housing market.

Downward wave (2008-2011).

Fall of 2008 there was a stabilization of housing prices which was caused by uncertainty of a condition of world and Russian economy. In Moscow since November, 2008 within six months there was a reduction of prices of real estate of 20-40%. The sharpest phase of falling of the prices proceeded till May, 2009, then the prices fell smaller by rates on all cities. In 2009 the regional housing market reached a crisis minimum. In 2010 housing prices did not fall, and small growth was

noted them. In Moscow began activation of the housing market in 2010, the gain of the prices made 10% while in other cities and regions price fluctuations remained. In the Volgograd market the maximum rise in prices was reached in 2008 at the level of 1698 USD /sq.m, in 2009-2010 they slightly changed respectively 1237 and 1227 USD /sq.m.

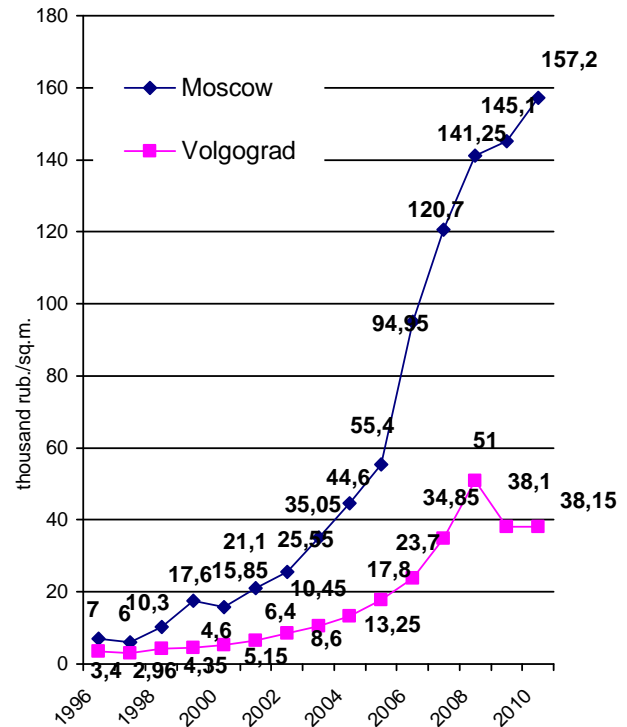


Fig. 2 : Dynamics of change of the average prices in Moscow and the Volgograd region, thousand rub./sq.m [7]

Difference of capital cities (Moscow, St. Petersburg) and regions with high investment activity from other regions is that the period of price fluctuations in Moscow made 2,5 years, in other cities and regions – 2,5-3,5 years. It is caused by excess of growth rates of housing prices over growth rates of solvent demand. In the Russian regions the change in price almost similar to a situation in capital regions, however there are distinctions at rates and asymmetry of the change in price. It is caused various by level of social and economic and investment development of regions, efficiency of infrastructure (social, production, institutional), level of industrial production, transport remoteness from capital cities, etc.

The analysis of cyclic recurrence of the Russian housing market showed that the growth phase of the market is 7 years, cycle duration about 10 years (in the 1990th and 2000th). Such time period is characteristic and for the foreign markets of housing. In functioning of the Russian housing market a lot of things changed for two decades: institutional providing, average per capita income, market infrastructure, housing provision.

The author marks out regularities of cyclic development of the Russian housing market:

- the consecutive change of phases of an economic cycle under the influence of external and internal factors;
- the entry of the housing market in phases of an economic cycle happens quicker in capital cities and regions with high investment activity, than in regions and the cities with average and low investment activity;
- the rise in prices in phases of revival and growth occurs in segments of housing of average quality; in a phase of recession the prices of low-quality housing fall quicker, than prices of high-quality housing;
- value of multiplicative effect changes on various phases of an economic cycle;
- change of indicators on various phases of a housing cycle;
- the housing crisis is an incentive for creation of the new quality standard of housing conditions and new housing model.

On an upward wave the income of citizens grows, the state reduces a base rate, the credits become cheaper. Naturally also demand for housing increases, so, the housing price increases. And, on the contrary, during the periods of economic contraction the prices fall. Such situation is characteristic for the European markets. However cycles in the regional housing market not always coincide on time, duration and depth with all-economic cycles. The real estate market as a whole differs from the markets of other assets (the equity market, a bond market). During the periods of economic contraction of real estate price are usually less elastic.

The housing crisis is the characteristic of development of real estate market.

The economic essence of a housing crisis consists in balance violation between supply and demand. Market mechanism through the supply and demand law, the law of the competition, an investment form a network of feedback which do system capable to adaptation. Hansen E. about the theory of construction cycles [8] which 17–18 years with an amplitude of fluctuations of 16-20 years proceed on the average. The mechanism of fluctuations is the following. Let's assume that at a given time in the market deficiency of housing was formed. The market reacts a rise in prices for housing and housing services. Investments into housing construction increase sharply to satisfy demand in the future. But while houses are unfinished, therefore, housing prices continue to grow. So, there are conditions for construction boom. At some point the part of houses is on sale, the prices fall. Other houses also are completed, and then there are an overproduction and crisis of construction branch.

The institutional essence of a housing crisis consists in low efficiency of former institutes, informal norms and formal rules, and also in need of institutes change (stereotypes, culture of behavior). The modern housing crisis is a crisis of consumer behavior, crisis of existing rules and norms. The behavior of subjects has to change towards ecology and rational consumption of economic resources. In Russia there is no evolution of

stages of formation of institutes, the state tries to realize at once all set of institutes, however development of informal norms lags behind development of formal rules, such situation leads to decrease in efficiency of all institutes of housing sector.

Positive sides of a housing crisis are the decrease in the construction cost, use of new technologies and materials, intensive type of development, formation of the new quality standard of housing conditions.

The reason of cyclic development is the conflict between production conditions and sale conditions, formal rules and informal norms. Duration and depth of crisis depend on fluctuation of investments as crisis depreciates fixed capital.

The housing crisis is in the regions with low investment activity more long, than in other regions. Such situation is explained by excess of the offer over demand. The housing sector is socially significant system of regional economy for which change of "housing stereotypes" with a various speed is peculiar. In highly effective regions such change happens quicker, than in others. The reason of it are high level of the income of the subjects, more developed economic culture and institutes.

Studying of a housing crisis in Russia in 1998 and 2008 allows to reveal influence of external factors, world financial not stability (in 1997 - Asian crisis, in 2008 – a mortgage meltdown in USA and world financial crisis). Both housing crises are caused by internal problems of the Russian economy (raw dependence of the country, high inflation, corruption, low level of business development, low development of infrastructure) (tab. 2). The general tendency of the Russian regions is historical lag on housing estate square per capita, low speed of construction in the conditions of growth of solvent demand, high percent of shabby and emergency houses.

The external reasons of the housing crises in a country are:

- influence of an economic crisis on development of the housing sector;
- general economic situation in the country;
- influence of the oil prices on the housing market;
- changes in the innovative technologies, change of the technological way;
- recurrence of economic development;
- inflation;
- monetary policy;
- tax policy;
- decrease in the income of citizens.

The internal reasons of the housing crises in a country are:

- decrease in a consumer demand for housing;
- low housing availability;
- weak institutional providing;
- administrative barriers;
- high percent on a mortgage;
- double mortgages on real estate;
- low investment activity of subjects;

- low economic culture;
- high expenses of housing construction;
- low efficiency of institutes of the housing market;
- oligopoly.

The financial mortgage meltdown of 2008 was accompanied by liquidity crisis which caused in Russia the sharp growth of cost of the foreign capital, mortgage loans and reduction of volumes of mortgage lending, rise in prices in primary housing market. The similar reasons of prompt growth of the housing market in Russia and developed countries consisted in delay of growth of the financial markets and increase of investment appeal of real estate, and it caused a rise in housing prices. One more reason of a housing crisis in Russia is the disproportion of a rise in housing prices and growth of the income of citizens. The situation in the housing market in 2008 testified not about growth of a consumer demand, an about speculative demand which was caused by capital movement from one sector – financial, in another – real.

The author allocated economic and institutional factors which promoted deepening of the housing crisis in Russia.

Economic factors of deepening of the housing crisis in the Russian regions are:

- low innovative activity of subjects;
- high bank percent for physical and legal entities;
- use of old architectural projects;
- low qualification of workers;
- power consumption of construction;
- lack of the land plots for housing construction;
- high construction cost.

Institutional factors of deepening of the housing crisis are:

- weak institutional and legislative providing;
- mistrust of the population to actions of the state and the construction organizations;
- low responsibility of the construction organizations before consumers;
- poor quality of public management which creates administrative barriers and corruption;
- low efficiency of regional institutes of the housing market;
- low market culture;
- expectations of consumers in increase in the prices at inhabited objects.

The rise in housing prices in many countries more than 30% since 2005 was caused by the low cost of the financial capital in the world markets. During the post-crisis period of a tendency of development of the Russian economy are interconnected with tendencies of development of world economy.

The housing crisis influences decrease in investment activity of construction and other spheres of action (production of construction materials and designs, design, building of objects of infrastructure, road construction, agrarian and industrial complex, energy industry, mechanical engineering, etc.). In the conditions of an economic crisis at decrease in investments into

housing sector decrease investments into other economy spheres and a social infrastructure (education, health, transport). At the expense of action of multiplicative effect in the housing sector in Russia the annual increase in rates of a gain of industrial production at 3–3,5% can be reached. Multiplicative effect in housing sector of Russia are more than 100%: investment of 1 ruble in housing construction promotes a gross domestic product growth for 2–3 rubles because of low loading of construction capacities and big need of citizens in houses.

The housing crisis in Russia showed need of formation of the new housing model as the inefficiency of existing model is expressed in discrepancy of quality of housing to its price, impossibility for the most part of the population to buy real estate. The housing crisis means not so much decrease of the multiplicative effect, but also decrease in social indicators, a level of living and quality of housing conditions.

The state can affect an economic cycle, change nature of economic dynamics, namely depth, crisis frequency, duration of phases and a ratio between them; to affect the mechanism of cyclic movement. Modern crises are crises of state regulation, discrepancy of goals to results of public policy.

During modern crisis the Russian state were used institutional methods and tools. The main institutes of housing policies are:

- Fund of assistance of reforming of housing and communal services. In the crisis conditions fund was financed programs on resettlement of citizens from shabby and emergency houses, purchase of objects of construction in progress, the program of provision of housing for the military personnel and other social groups of citizens ;
- Agency for housing mortgage lending. Restructuring of debt on mortgage loans of citizens was carried out which had a difficult financial position. 301 255 mortgage were given out in 2010 loans for total amount 379,4 billion rubles. The credit volume in 2010 by 2,5 times exceeded the volume in 2009, and in a quantitative ratio – more than by 2,3 times [10].
- Federal fund of assistance to development of housing construction (it is created in 2008). For 2009-2011 the fund exposed on auctions 152 land plots, is concluded contracts for 121 sites (95 - on rent, 26 - purchase and sale) [11].

The public housing policies in Russia are aimed at the development of mortgage lending of inhabited objects of average quality in primary market. It promotes achievement of multiplicative effect not only in housing construction, but also in the industry and a social infrastructure. However volumes of housing construction in Russia decreased from 64058 thousand sq.m. in 2008, 59892 in 2009, 58431 thousand sq.m in 2010, or for 9% in 2010 in comparison with 2008.

According to the federal target program “Housing” which is accepted in December, 2010 [12]: The main problems in the housing construction are:

- poorly developed competition among real estate development companies,
- excessive administrative barriers for activity of new real estate development companies in the market of housing construction,
- obtaining construction license,
- lack of the land plots, which equipped with engineering infrastructure,
- problems of private investment and credit resources in construction and reconstruction of engineering infrastructure,
- opaque and burdensome for the builder conditions of connection to systems of engineering infrastructure.

In the majority of the cities there aren't effective funding mechanisms for projects on providing the land plots with engineering infrastructure and funds for building of objects of a social infrastructure. The banking sector has no necessary tools which allow to credit projects of development of an engineering and social infrastructure. It leads to increase in terms and rise in price of cost of housing construction.

3. CONCLUSION AND FUTURE RESEARCHES

The housing policy is aimed at increase of housing availability at joint activity of commercial and individual builders, use of institutional methods, activation of housing noncommercial associations of citizens and development of the public-private partnership. Formation of the public-private models in housing sector assumes use of mechanisms on reimbursement for payment of percent on the credits, which are received in financial credit institutions on providing the land plots with engineering infrastructure (the objects providing gaz-, warm, water - power supply, cleaning and water disposal of sewage in municipality borders) for houses construction, and also use of development mechanisms of a social infrastructure of residential districts of a mass housing estate.

Creation of the market mechanisms of financing of projects of territorial development for housing construction and introduction of standards of construction of houses of average quality will allow to increase the volume of housing construction and to reduce its prime cost. Successful realization of governmental activities will allow to provide increase in total amount of housing construction to 90 million sq.m pro year; formation of a segment of construction of housing of average quality; development of the primary housing market and stabilization of the housing prices; formation of effective mechanisms of regulation of town-planning activity and development of engineering, social and transport infrastructure; increase in private investments and proceeds of credit in housing construction.

Development of the Russian housing market during the post-crisis period happens according to tendencies of foreign real estate markets and in interrelation with the international markets of the capital and change of macroeconomic indicators. Feature of the Russian housing market is the increased demand for

improvement of housing conditions quality. At the same time as in developed countries, high level of housing is available per capita and lower interest mortgage rates, the high average per capita income influence the adjustment prices.

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