

The Global Crisis and Russia

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World crisis of year 2008 has come next to the outstanding economic boom of 2003-2008 – world real GDP had risen by a third during this period. On this basis appeared a hope to solve the critical problems of humanity: lower the poverty level, save the climate and protect the human rights. Resolution of these and many other issues demanded huge long term capital investments at the level of a few percent of the world GDP. As the world community was trying to solve these problems it became obvious that solution based on strictly liberal methods is not feasible. Capital flows have continued to follow short term profit opportunities, like on the world financial markets, and not fighting poverty. Jumping commodity prices demonstrated a shortage in extraction and refinement capacity, and, together with dangerously rising food prices at the end of the booming stage, the global imbalances characteristic of pre-crisis situation have appeared.

In this situation only a trigger was needed to switch to the crisis – stock market crash, oil crisis or a significant bankruptcy – something from the arsenal of the recent centuries detonators. Oil prices hike took place following the start of the crawling financial crisis in the USA since August 2007. Before that huge profits of the oil exporters returned to the industrial producers (especially Germany and China) as a form of export demand. It ensured the support of the boom for a few more years and demonstrated the insufficiency of the models that predicted the decline in the growth levels based on the experience of the 70-80`s. In essence it was a hidden devaluation of Dollar and Euro (and Renminbi and Yen) – relative to the barrel of oil it was necessary to sell more industrial goods. But imbalances in the economy due to overpriced oil still came in the form of strong pressure of the price on the oil consumption in transportation. Attempts of the governments of the developed countries to break out of the dependence (from OPEC and Russia) using renewable energy sources have played their roles, trying to solve a number of economic and political problems. Energy and political conflicts have worsened the situation at the end of the boom.

Mortgage crisis in the USA for a year – from August to August – appeared quite dangerous, but few have suspected that the foundation of the financial system is melting. The beginning of the world financial crisis will most likely be dated the day the “Lehman Brothers”

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filed for bankruptcy. It was a bright demonstration of the old wisdom: the road to hell is paved with good intentions. Heavy liquidity crisis, prolonged credit crisis, worldwide stock market crash, soft nationalization of many of the most important institutions of banking and insurance in the USA and in other countries, beginning of the bankruptcies in the financial sector – here is the trigger for the world recession.

With the addition of China, Russia and the former planned economies to the market world has gotten the first global recession. Thanks to the world price, energy and financial shocks, by the autumn of the 2008 recession in Russia has turned out to be not only deep, but also concurrent with the rest of the world. Evidently, this very concurrency will bring additional impact to the depth and the speed of the recession. Informatization and short term electronic contracts have lead to the increase (as compared to previous recessions) of the speed of the industrial production decline caused by the drop of the demand in real estate construction and automobile markets. Concurrency simultaneously hits the demand for the commodities, prices of which have rolled back to the levels of 2005-2006. Naturally, countries with the high concentration of commodities in exports – especially Russia – have been hit first. Industrial production in the developed countries is still falling but commodity exporters are already facing “commodity cycle”. It may be assumed that its “harmful” role (that was expected) was also played by the globalization – in the modern legal and informational world it is much easier to cut back the orders. Crisis is spread more quickly and economic agents in fear for their interests produce the domino effect, severely strengthening the (late) “flight to quality”, thereby narrowing the horizons of the decision making. Sudden rise of the dollar in the wake of the financial crisis in the autumn of the 2008 in the USA demonstrated simultaneously the reliability of the american capital protection and fear over the capital in the world – inflow was at a negative interest rate.

By the 2009 the world was facing three possible scenarios: a) moderate recession with GDP declining by 1-2% in the USA, EU and Japan and slowdown of the growth in China with the decline in world trade; b) severe crisis, accompanied by the 3-4% decline in GDP in the number of developed countries; c) catastrophic development of the situation, including the loss of socio-economic stability in China. First scenario has already been “passed” - crisis is following the second scenario. In all of the scenarios Russia is facing a difficult situation with exports (both in volumes and in prices), accompanied by the competition with a number of producers together with a significant devaluation (as in the Ukraine). In these circumstances it is necessary to switch to the domestic demand, creating the models of growth whose development is dampened by the high prices and inadequate development institutions.

Financial crisis is fixing the paralysis of the credit and common loss of *trust*. Risk reallocation system has collapsed – it has to be rebuilt anew. This collapse is in itself important and severely strengthening the crisis in the industries that depend on the credit. Unfortunate regulatory moves, their inability to foresee such a crisis and find quick solutions at least for the problems of banking, liquidity and credit crisis added to the usual loss of confidence in other economic agents the distrust to the regulators themselves. By the real anticrisis propositions “financial 20” is currently at the square one. Developed countries not only lower taxes, simultaneously rising the outlays (questionable wisdom), but also trying to support important ways of investing into new technologies and prioritised industries. In fact western governments are letting the crisis play its “medical” role, while promising the support for everyone as a form of propaganda. It is not completely clear if the developed world will be able to sustain the peace treaty proposed in the Washington in the November 2008 and not reach the hidden protectionism of rather dangerous scale. Crisis is only beginning – the temptation to mix the two will become stronger all the time.

Financial and stock market crises by the end of 2008 became less relevant after the quantitative easing and decline of production. But bad news regarding the recession in the fourth quarter and for the year 2008 may bring back the nervous situation on the financial markets. Financial shocks after the development of the industrial recession – a normal situation, severe financial shock prior to it was unique. However, these processes now will take place together with growing unemployment and budget deficits. It is far too early to say how deep will the demand and production fall, especially in the industries most affected by the crisis. The length of the fall and its speed may create new forms of the firm behavior on markets – for example, buyouts of cheap assets instead of productive investments. In theory during the crisis old enterprises should face hardship and give their way to new, more effective ones. However, as it is a lengthy process, during the crisis this move is especially painful.

It is now too early to measure the scale of the crisis in Russia, but reaching the bottom and the cutback in the mass consumption and commodity goods in the open economy is a multifactor phenomenon. It depends significantly on the currency exchange rate relative with respect to trade partners. In future – devaluation to improve the situation of the domestic producers and crawling protectionism. In case of Russia debts of the major companies owed to western banks and fears of the population regarding the purchasing power of the savings restrict the possibility of the devaluation that looks like a simple solution to all the problems.

Equilibrium on the market for the investment projects will be slower and more difficult to reach. Financing of the long term (including international energy) projects will pass through

primitivization: project finance, state guarantees. It is safe to assume that realization of the politicised projects lacking serious commercial grounding will be postponed.

It is time to move from attempts to compensate people for the fifteen years of the transition period to the support of the small and medium enterprises, restricting the state consumption, suppressing the appetites for new grandiose projects. When the emergency part of the crisis will be passing a problem of uneven distribution of crisis costs will emerge. Middle class will suffer first, poor classes and regions will follow.

The world crisis is clearly becoming “systemic” and is accompanied by the change in the “steady state” business cycle regime that settled earlier. Previous one has lasted since the mid 70's and was characterised by a number of real issues, reflected by both theory and ideology. Wide swings of the energy prices, liberalization of the financial markets and globalization together with rather high growth rates are all parameters of the previous regime.

Character of the new boom will not be formed at once – the length of the concurrent decline and a possible stagnation in a number of countries may turn out to be more severe financially, socially and politically, than the measure of the indicators decline. Social difficulties of the West will be severe – in a quarter of century the population has forgotten about the unemployment and inability to increase the milking of the state budget. During elections pressures on the parties and governments will be increasing both from the right and the left. One or two more years and political radicalization of the world will be apparent.

Liquidation of the planned economy in the world was accompanied by the lowering of the rate of saving and accumulation together with setting ambitious global goals. But in this crisis many of the global ventures of the “fat quarter century” may find themselves under attack: Climate, millenium aims, energy security. There will be threats to the domestic social stability – one can already witness successful piracy, anarchy, national conflicts, religious terrorist frictions, left populism in roman countries.

World crisis has lowered the temper of the ideologic wars on the ways of development – everyone is rapidly becoming pragmatic with a keynesian flavor. In general the world crisis – especially if it will be delayed– will have a significant impact on the resource distribution, growth rates of different regions, development strategies especially in the energy and financial sectors. Actions of Russia and Russian government and firms were until now a reaction to the crisis. Currency reserves have played a positive role, but until now in the midst of the crisis the government has not yet decided to move from partial injection of the resources to systemic efforts towards the development of the more advanced market institutions that will have to ensure the modernization of the country. Crisis will be rather painful for all the players – from

the population to the government, but it gives a chance for the development to those who have noticed the new tendencies and ensured a way for effective actions of adequate institutions.

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