

Editorial introduction to the article by Yegor Gaidar “WORLD ECONOMIC CRISIS AND RUSSIA”

YEGOR GAIDAR
(1956–2009)

The Russian economist Yegor Gaidar, who died on the 16th of December last year, remained largely an obscure figure for the European society. He is remembered by being the agent of Yeltsin’s reforms, the Vice Prime Minister for half a year and from May until December 1992 the acting Prime Minister of Russia (never approved in this position by the Congress of People’s Deputies of that time).

Ye.Gaidar, who had been in power for a short period of time over twenty years ago, became in his country an iconic figure, the symbol of the 90-s, of the democratic transitions and market reforms, condemned by some and admired by others.

First and foremost, Gaidar was an economist. But even in Russia his books were not widely read, and in the West they were almost unknown. His books “State and Evolution”, “Days of Defeat and Victory”, “The Anomalies of Economic Growth” have been translated into other languages, but his main works of the last years – the fundamental book “The Length of Time” – the history of the transformation in Russia in the context of world economic history; “Collapse of an Empire” about the deep-seated reasons of such rapid collapse of the Soviet Union – still remain unknown to the Western reader. His last work published in Russia – “The Murky Times and Institutions” – is dedicated to the comparative analysis of degradation and disintegration processes of traditional institutions and the emerging of new ones.

In these books Yegor Gaidar appears as a deep analytic, raising a wide range of untouched problems related to economical and political transformations of post-totalitarian and authoritarian societies, new tendencies of the world economy dynamics. His last works are dedicated to the exploration of reasons, underlying the modern economic crisis, which he had been one of the first to identify, and the search for ways out of this crisis.

In May this year the President of Russia Dmitry Medvedev issued a decree eternalizing the memory of Yegor Gaidar, in solidarity with those, who place a high value on Gaidar’s role in history.

* * *

Our magazine regularly publishes Gaidar’s articles, who had been the member of the Editorial Board since the magazine was established. Being a highly-moral, conscientious and consistent person, Yegor Gaidar was very attentive and responsible about everything he did. This also applies to his publications. In this issue of our magazine we present the article, which Gaidar had sent to us several days before he passed away. ■



THE CRISIS AND RUSSIA

Yegor GAIDAR

The magazine *Ekonomicheskaya Politika* has already published articles that I have written on the influence of cyclical global economic growth on Russia's economy and politics.¹ The economic crisis is not over yet, and analyzing it is a dangerous undertaking for one's professional reputation. Nevertheless, the influence of the crisis on the country's life is too serious for us to leave the analysis of what is taking place to the economic historians of the future.

The Institute for the Economy in Transition has prepared and published two books on the influence of the slowdown in global economic growth on Russia.² The World Bank made a similar decision, and in November 2009 it launched a book devoted to the effect of the crisis on economies with emerging markets. Originally it was envisaged as a book on the twenty-year transition period, but the severity of the problems caused by the crisis forced the authors to review their priorities.³

A global economic crisis, especially one as deep as the current one, is a dynamic process. The economic situation is changing, and it is not easy to predict it. I should like to address once again the issue of how what

is happening in the global economy is affecting Russia.

For most of the expert community, the economic crisis was a complete surprise and could not have been predicted. This is not because the economists did not make sufficient efforts or are lacking in qualifications. Rather it is the natural result of the radical changes in the global economy which occurred as far back as the turn of the eighteenth and nineteenth centuries, and which Simon Kuznets called modern economic growth. The world's economy today is changing rapidly (and often unpredictably). The rise in per capita GDP growth rates and the changes in social indicators linked to this are followed by new challenges. One of these is the influence of the cyclical nature of economic development in some countries which are leaders in economic growth on the situation in the global economy as a whole. The other is the transformation (above all the globalisation) of the world's financial system, which has determined the nature of recent crises.

The Bretton Woods system which was set up in 1944 has proved to be unstable. It assumed a high level of responsibility on the part of the country that possessed the dominant global reserve currency — the

¹ Gaydar, E. Dizzy with success. // *Ekonomicheskaya Politika*, August 2008, No. 3, pp 5–19; Gaydar, E. The global economic crisis: consequences for Russian politics. // *Ekonomicheskaya Politika*, August 2009, No. 4, pp. 37–46.

² The financial crisis in Russia and the world. / Ed. E. Gaydar. M.: Prospekt, 2009; The global financial crisis: historical parallels and ways out. / Ed. E. Gaydar, B. May. M.: Alpina Publishers, 2009.

³ Mitra P., Selowsky M., Zalduendo J. Turmoil at Twenty: Recession, Recovery, and Reform in Central and Eastern Europe and the Former Soviet Union. Washington: The World Bank, 2010.

USA — for the quality of its budget policy. Against a background of expanding social commitments, the war in Vietnam and an easing of monetary policy, it proved impossible to maintain a level of confidence in the dollar comparable with the trust in gold before the First World War.

At the beginning of the 1970s, following the US authorities' rejection of a fixed exchange rate against gold for the dollar, a new monetary regime was effectively established in the world. Although the Bretton Woods system had not formally been dropped, its basic characteristics were seriously changed. It is now based on floating rates for the leading world currencies and on open channels for capital flows. This organisation of the financial world emerged recently, and its set-up is not clear. The number of points which make it possible to understand how it works and that are accessible to analysis is limited.

In the first decades after the Second World War the nature of the periods of deceleration in the economic growth of the countries that were leaders in economic growth was generally understood. What was happening in America to a large extent determined the economic situation in every country in the world, in so far as the USA's role in the global economy at that time was dominant (see Fig. 1).

A serious role in the development of the world economic situation was played by the expansion of the USA's social commitments, the easing of monetary policy, the rise in inflation rates, followed by anti-inflation measures, a rise in unemployment, and then a new easing of fiscal policy.

Following the opening of many countries' capital markets and the globalisation of the world economy, it became even more difficult to forecast changes in the

situation, including crises. Qualified experts working in the US Treasury and the International Monetary Fund in the 1990s failed right up to the last moment to predict the 1994 Mexican crisis or the 1997–1998 crisis that began in South-East Asia and then spread to the CIS countries and Latin America.⁴

At the end of the 1990s and the beginning of the first decade of this century works were published which expressed concern at the rapid growth in share prices of US high-tech companies.⁵ But few people imagined that when this bubble burst (see Fig. 2) it would cause recession in the USA and a general slowdown in global economic growth.

The blow to the American economy caused by the collapse of the high-tech share market was made worse by the economic consequences of the terrorist acts of 11 September 2001.

It is virtually impossible to predict such a combination of events. At the same time the slowdown in the American economy's growth rates had a serious effect on what was happening in the world (see Fig. 3).

The 2008–2009 crisis also proved to be a surprise for the leading international financial institutions (see Fig. 4).

At the end of 2007 and the beginning of 2008 there was a widespread impression that there would not be a recession in America, and that if it did happen it would not have a serious effect on what was happening in the world, and that the world would continue to develop dynamically.⁶ Even at the end of summer 2008 many people in Russia were convinced of this.⁷

These hopes proved to be illusory. In the autumn of 2008, when the Lehman Brothers bank collapsed, and the US National Bureau of Economic Research announced

⁴ DeLong, J.B., and Eichengreen, B. Between Meltdown and Moral Hazard: The International Monetary and Financial Policies of the Clinton Administration. University of California at Berkeley and NBER, July 2001; *Crafts N.* East Asian Growth Before and After the Crisis. IMF Staff Paper Vol. 46, № 2, June 1999; *Berg, A.* The Asia Crisis: Causes, Policy Responses, and Outcomes. IMF Working Paper, 1999; *Kochhar K., Loungani P., Stone M.R.* The East Asian Crisis: Macroeconomic Developments and Policy Lessons. IMF Working Paper 99/28, August 1998; *Balino T.J.T., Ubide A.* The Korean Financial Crisis of 1997 — A Strategy Financial Sector Reform. IMF Working Paper 99/28, March 1999. Obviously this did not mean that none of the experts drew attention to the problems building up in South-East Asia. (See for example: *Krugman P.* The Myth of Asia's Miracle. // Foreign Affairs. Nov/Dec 1994. Vol.73, P. 62–78.) However, neither the markets nor the majority of the expert community believed that a profound crisis in South-East Asia was likely.

⁵ Warren Buffett: 'I told you so'. BBC News world edition. Tuesday, 13 March, 2001. <http://news.bbc.co.uk/2/hi/business/1217716.stm>; IMF world economic Outlook (WEO). Recessions and recoveries. April 2002. <https://www.imf.org/external/pubs/ft/weo/2002/01/index.htm>

⁶ Chandra S. U.S. September Retail Sales Rise More Than Forecast. <http://www.bloomberg.com/apps/news?pid=20601087&sid=ajcgcopCXqkA&refer=home>

⁷ 'Above all, the mortgage crisis in the USA seems to be drawing to an end. It peaked in February of this year, and for the past four months the situation has been gradually improving. Moreover, there is no recession in the USA and in all likelihood there will not be one in 2008. When Gaydar started talking about recession in January 2008, the futures market estimated it as 80 per cent likely. At that time I risked expressing my disagreement with Gaydar's forecast and suggested that there would probably not be a recession. There has been no recession for the last 6 months.' See: As liberal to a non-liberal, interview by A. Illarionov and L. Telen, 1 August 2008. <http://www.izbrannoe.ru/43508.html>

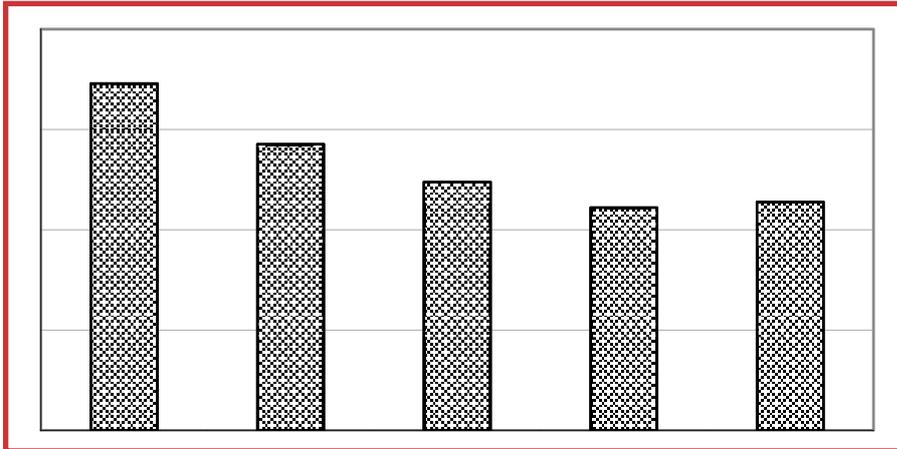


Figure 1.

The USA's share of global GDP in 1950, 1960, 1970, 1980, 1990 (%)

Source: A. Maddison. Historical Statistics of the World Economy: 1-2006 AD, March 2009 (<http://www.ggd.net/maddison/>).

Figure 2.

NASDAQ-100 index performance, 1 January 2000 — 1 March 2000

Source: www.nasdaq.com.

[Note: caption within figure is: 'Index value at close of trading']

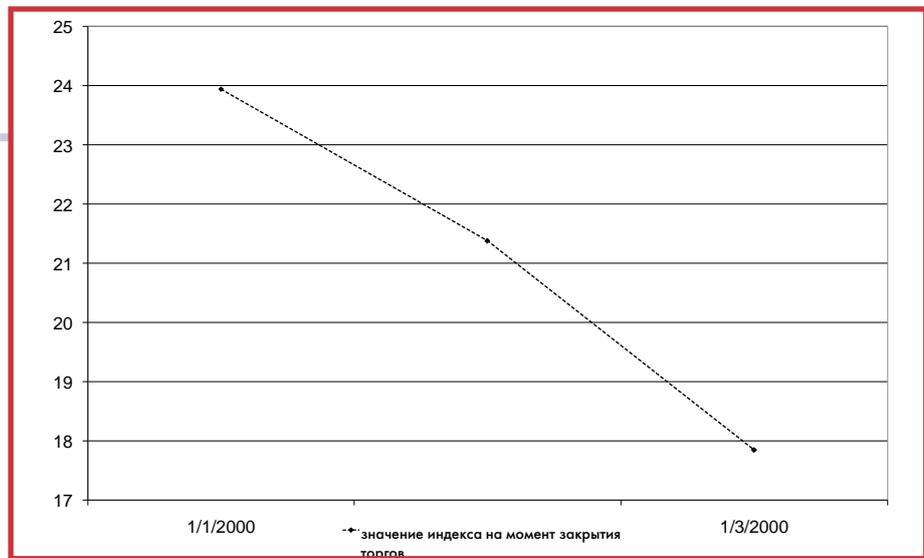


Figure 3.

Year-on-year growth in global GDP, 2000–2002 (%)

Source: IMF World Economic Outlook, October 2009 (<http://www.imf.org/external/pubs/ft/weo/2009/02/weodata/download.aspx>).

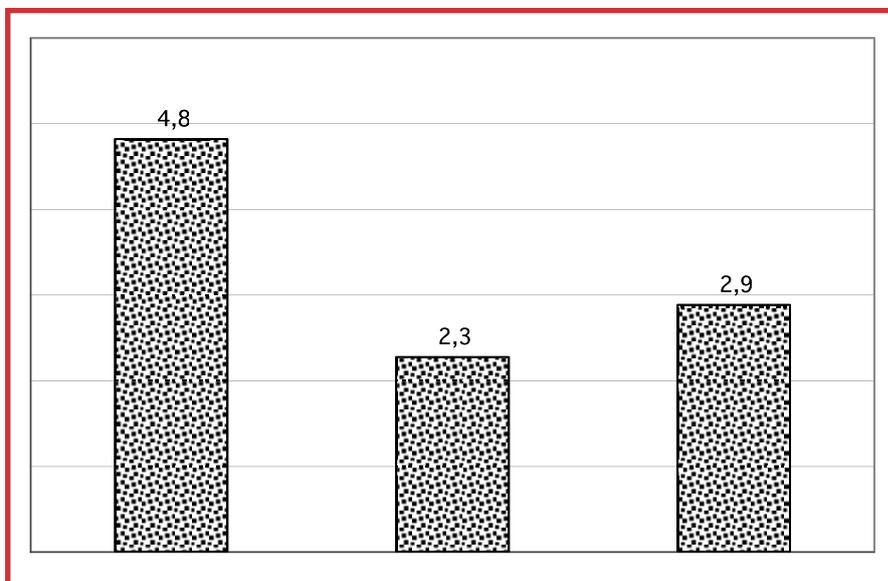


Figure 4.

Corrections to IMF forecasts for global economic growth in 2009 (% of previous year)

Note: horizontal axis shows dates of forecasts.
 Source: IMF, World Economic Outlook for various months in 2008–2009 (www.imf.org).
 [Note: captions within figure are: April 2008, July 2008, October 2008, November 2008, January 2009, April 2009, July 2009, October 2009.]

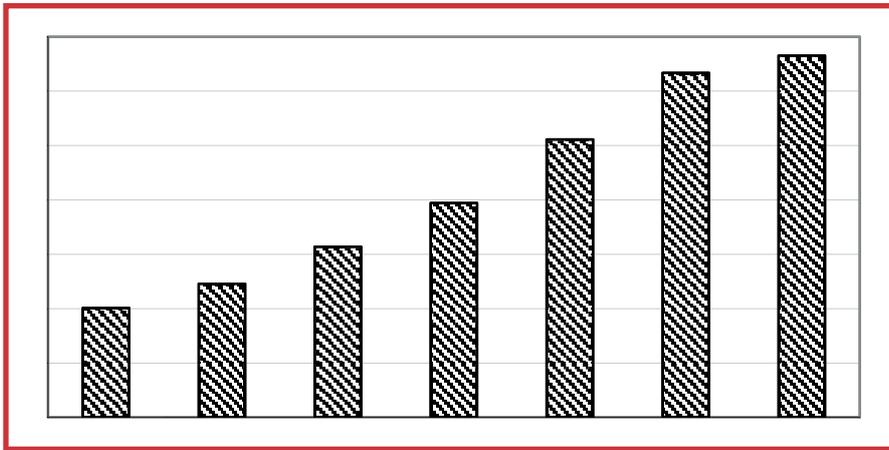
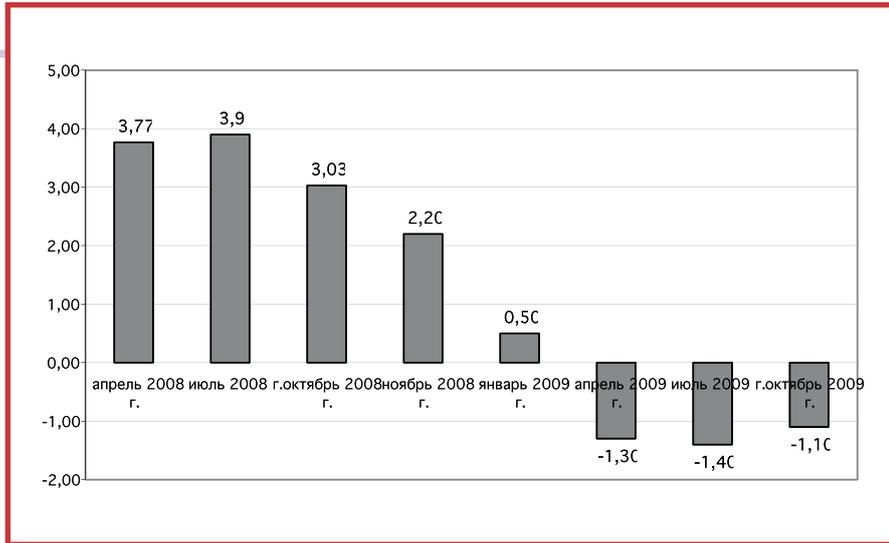


Figure 5.

Unemployment in the USA*, Quarter 1 2008 — Quarter 3 2009 (as % of population)**

* Seasonally adjusted.
 ** Quarterly data calculated as arithmetic average on the basis of available monthly indices.

Source: Federal Reserve Bank of St Louis (<http://research.stlouisfed.org/fred2/series/UNEMPLOY/downloaddata?cid=12>).

[Note: captions on horizontal axis are 1st quarter 2008, 2nd quarter 2008, 3rd quarter 2008, 4th quarter 2008, 1st quarter 2009, 2nd quarter 2009, 3rd quarter 2009]

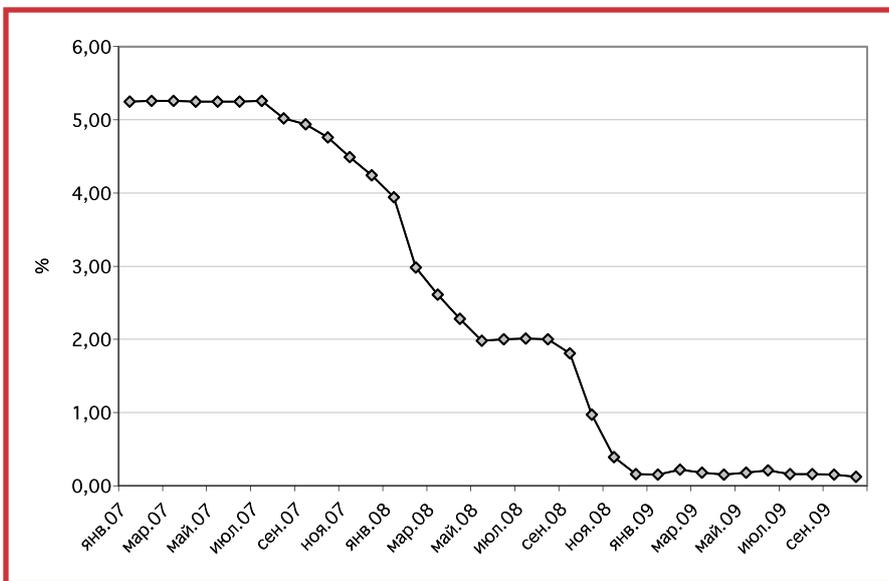


Figure 6.

US federal funds base rate, January 2007 — October 2009 (%)

Source: Federal Reserve, Federal Reserve Statistical Release (<http://www.federalreserve.gov/releases/h15/data.htm>).

[Note: captions on horizontal axis are: Jan. 07, Mar. 07, May 07, Jul. 07, Sep. 07, Nov. 07, Jan. 08, Mar. 08, May 08, Jul. 08, Sep. 08, Nov. 08, Jan. 09, Mar. 09, May 09, Jul. 09, Sep. 09]

Figure 7.

Package of budget and financial stimuli proposed by the G. Bush administration in 2008 and the B. Obama administration in 2009 (% GDP*)

* Due to the absence of data on the volume of GDP on a monthly basis, February 2008 represents GDP in quarter 1 of 2008, and October 2008 and 2009 GDP in quarter 3

Note: the package of budget and financial stimuli proposed by the G. Bush administration in February 2008 amounted to 168 billion US dollars; it was increased to 700 billion US dollars in October, and again to 787 billion dollars by the B. Obama administration in February 2009.

Sources: http://www.rian.ru:80/us_news/20081124/155800218.html; <http://top.rbc.ru/economics/14/02/2009/280613.shtml>.

[Note: vertical axis label is % GDP. Horizontal axis captions are: Bush — February 2008 (provisional); Bush — October 2008 (final); Obama — February 2009]

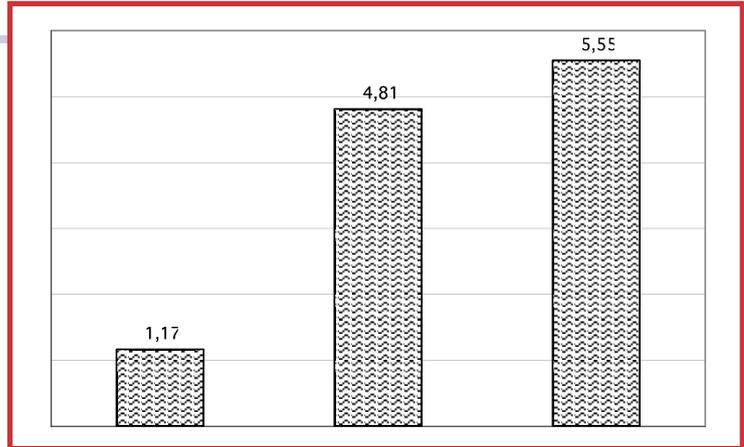


Figure 8.

US national debt* 2007–2011 (% of year-end GDP)

* Gross federal debt.

** Forecast.

Source: Federal Office of Management and Budget: Budget of the US Government Fiscal Year 2010, Updated Summary Tables (<http://www.whitehouse.gov/omb/budget/fy2010/assets/summary.pdf>).

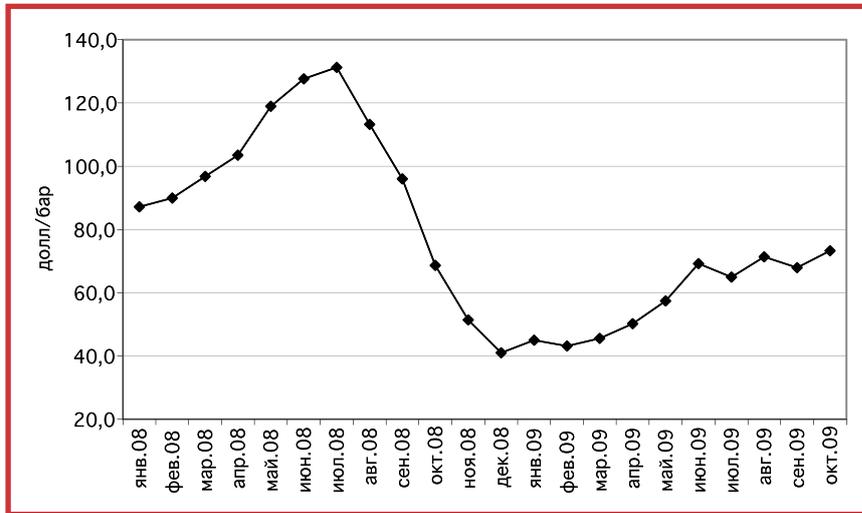
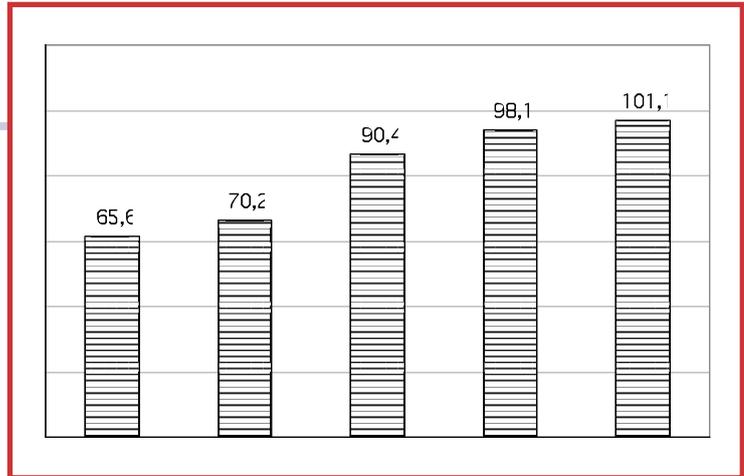


Figure 9.

Brent oil effective price, January 2008 — October 2009 (dollars per barrel)

Source: IMF.

[Note: vertical axis label is: dollars per barrel. Horizontal axis is month labels: Jan. 08, Feb. 08 through to Oct. 09]

Figure 10.

Global metals market prices index, January 2008 — October 2009 (2005 = 100)

Source: IMF.

[Note: vertical axis caption is: Index: 2005 = 100. Horizontal axis is monthlabels: Jan. 08, Feb. 08 through to Oct. 09]

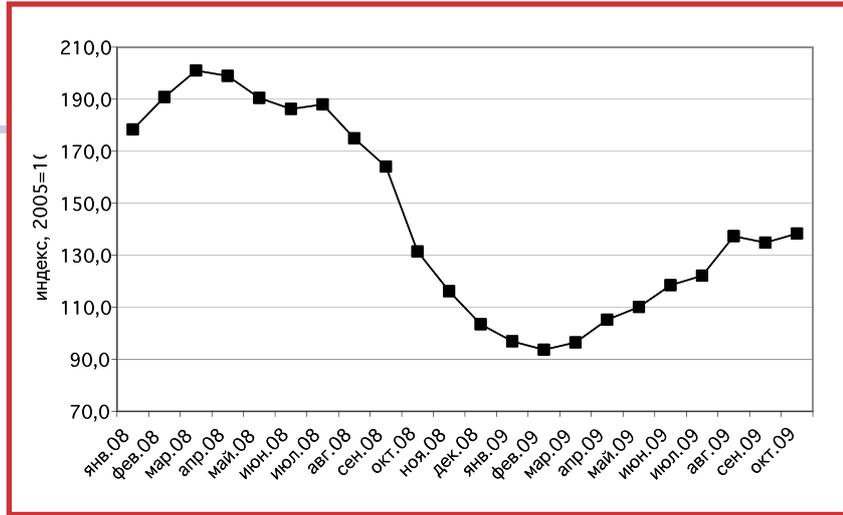


Figure 11.

Balance of capital inflow and outflow, Russian Federation, quarter 1 2007 — quarter 3 2009 (\$ billion)

Source: Central Bank of the Russian Federation

[Note: labels are: Quarter 1 2007, Quarter 2 2007, Quarter 3 2007, Quarter 4 2007, Quarter 1 2008, Quarter 2 2008, Quarter 3 2008, Quarter 4 2008, Quarter 1 2009, Quarter 2 2009, Quarter 3 2009]

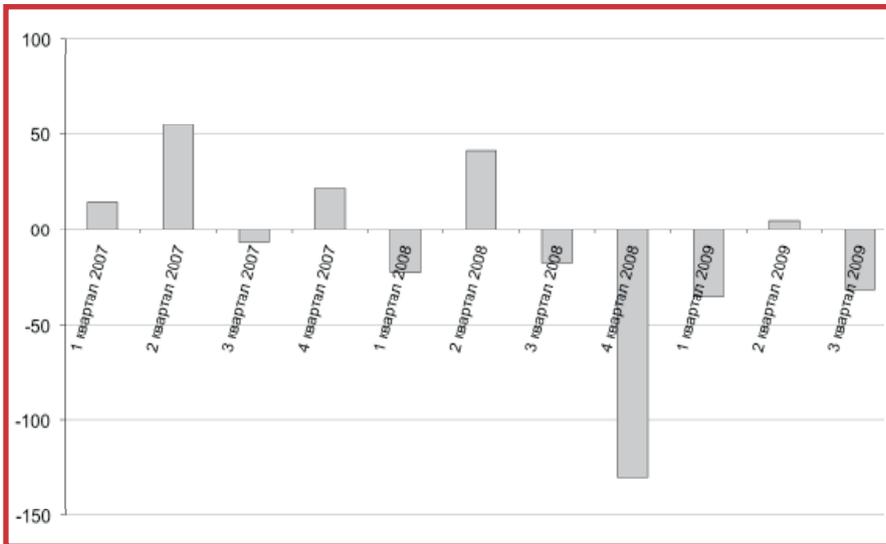
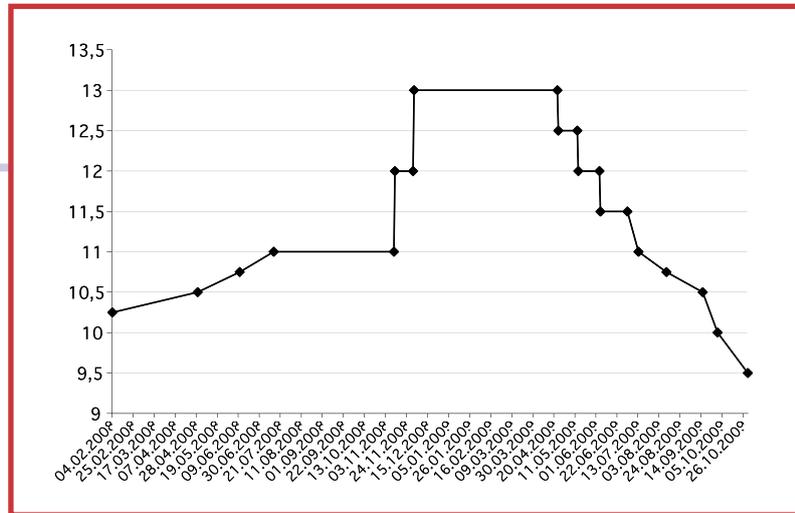


Figure 12.

Refinancing rate, Central Bank of the Russian Federation, January 2008 — October 2009 (%)

Source: Central Bank of the Russian Federation (www.cbr.ru).



that the American economy had been in recession since the end of 2007,⁸ the realisation that we seemed to have run into the deepest crisis in the global economy since the Great Depression became widespread⁹ (see Fig. 5).

In January 2009 the well known American economist N. Roubini, one of the first to speak about the likelihood of a deep economic crisis, wrote that the United States was certain to experience the strongest recession of recent decades, that there was a high probability of a profound and prolonged fall in production which would last at least until the end of 2009, and that even in 2010 economic recovery might be extremely weak — a rate of one per cent or close to that.¹⁰ Since then his forecasts have become more pessimistic. He talks about the likelihood that the recession will last until the end of 2010.¹¹

The reaction of the American monetary authorities to what was happening was rapid and energetic.¹² The base rate was sharply reduced. However, the possibilities of easing monetary policy in the context of a crisis are not unlimited. By January 2009 they were exhausted (see Fig. 6).

This forced the American authorities to make increasing use of budget stimuli to increase aggregate demand (see Fig. 7).

However, the possibilities for manoeuvre in fiscal policy are also not unlimited. This is shown by the rapid growth in the relationship between US national debt and GDP (see Fig. 8).

Russia encountered the challenges caused by the global economic crisis in particular conditions. At the end of the 1980s and for most of the 1990s our country was experiencing the grave consequences of the bankruptcy and collapse of the Soviet economy. Only towards the end of the 1990s, when the basic institutions of a private and market economy were created, and when the players in the economic process had become accustomed to them, did economic growth begin in the country. Although interrupted for a short period by the 1998 crisis, this growth basically continued for 10 years. Financial stability was ensured, and budgets were in surplus. The high rates of growth in gold and currency reserves were a serious problem. This made it more difficult for the monetary authorities to pursue an anti-inflationary policy. In this situation it was easy to see how an atmosphere of aggressive optimism formed, which can be clearly seen in official documents of the early and middle years of the first decade of the twenty-first century.¹³

However, certain lessons were drawn from the collapse of the Soviet economy. At the end of 2003 a decision was taken to create the Stabilisation Fund, which was later turned into the Reserve Fund and the National Welfare Fund. Fiscal policy remained conservative. The budget was divided into two parts, one of which is independent of the fluctuations of the oil and gas market, while the other was formed of oil and gas revenues. An upper limit was set on the subsidies provided to the general budget from oil and gas revenues.¹⁴

⁸ On 28 November 2008 the Business Cycle Dating Committee of the US National Bureau of Economic Research, a most authoritative body engaged in tracking the start and end dates of recessions in the USA, decided that the peak of US economic activity was reached in December 2007. Since then the country's economy had been in a state of recession. See: Determination of the December 2007 Peak in Economic Activity. Version of December 11, 2008. <http://www.nber.org/cycles.html>.

⁹ Stanton E. U.S. Stocks Post Steepest Yearly Decline Since Great Depression <http://www.bloomberg.com/apps/news?pid=20601087&sid=a5RkfQG30k1k>; Kueffner S. Andean Region Must Integrate to Face World Crisis, Leaders Say. http://www.bloomberg.com/apps/news?pid=20601086&sid=aV1G7GcVfwew&refer=latin_america

¹⁰ Roubini Says Worst Still Is Ahead of Us: Year in Review. <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aUy55wEBqrB8> Last Updated: January 1, 2009.

¹¹ Thomas Ch. Roubini Says Recession May Continue Until End of 2010 (Update1) http://www.bloomberg.com/apps/news?pid=newsarchive&sid=ayWsl_55G8_Q Last Updated: March 6, 2009.

¹² This was possibly also due to the fact that Ben Bernanke, Chairman of the US Federal Reserve, is an expert on the Great Depression. In 1979 Bernanke received a PhD degree at the Massachusetts Institute of Technology. Bernanke's post-graduate research was on monetary economics. His thesis was on 'Long-term commitments, dynamic optimisation and the business cycle'. His best-known work is on the Great Depression. *Bernanke Ben S. Essays on the great depression*, Princeton: Princeton Univ. Press, 2000.

¹³ 'Over a ten-year period we have to double the country's gross domestic product as a minimum. Doubling GDP is a systematic and of course a large-scale task. It requires deep analysis and definition of existing approaches to economic policy. ... I am convinced that Russia is already fully capable of setting and achieving such tasks, and that it has the capability to really engage in the large-scale construction of a strong modern economy, and ultimately to create a state that is competitive in every sense of the word.' See: message from President V.V. Putin of Russia to the Russian Federation Federal Assembly on 16 May 2003. <http://archive.kremlin.ru/text/appears/2003/05/44623.shtml>; Strategy for the long-term socio-economic development of the Russian Federation, 31 October 2007. <http://www.economy.gov.ru/wps/wcm/myconnect/economylib/mer/welcome/legislation/documentsofministry/doc1193835322297>

¹⁴ See: 'Main guidelines for the activities of the Russian Federation government up to 2012'. Russian Federation Government Resolution

The fall in the rate of global economic growth affected the Russian economy in two main ways. These were, first, the fall in demand for the most important raw material products which form the basis of Russia's export capacity, and the reduction in prices for these which accompanied it (see Figs. 9, 10).

Second, the change in direction of capital flows (see Fig. 11).

The Russian authorities' response to the crisis was 6–9 months late. It was rational, but asymmetric in relation to the economic policy of the countries possessing reserve currencies: not a reduction but an increase in interest rates, and a reduction of the national currency's exchange rate against the dollar (see Figs. 12, 13).

It is not difficult to understand the causes of the asymmetric reaction of interest policy in Russia to the crisis in relation to what was done in the major world economies, primarily the USA and the EU. The rouble is not a global reserve currency, and therefore the possibilities of easing monetary policy in Russia were limited. In a situation of capital outflow from emerging markets and continuing high inflation, the most important tasks were to preserve the gold and currency reserves and to put a brake on inflationary processes.

Against a background of changing market conditions, the situation with the budget was radically worsened (see Fig. 14).

The situation was also affected by the sharp fall in taxes on mineral extraction and export duties most closely linked with the fluctuations of the raw material markets, and the fact that in radically changed conditions the authorities were not ready to implement measures aimed at limiting budget expenditure to the state's financial capability.

However, the rejection of measures which had been actively discussed at a high level, to cut interest rates or change the structure of taxes which were least dependent on the price of oil¹⁵ (VAT and income tax), made it possible to avoid a budget catastrophe. In a situation of changing external economic conditions it was these taxes that remained the basis for the stability of the budget (see Table 1).

Table 1.

Tax revenues to the Russian Federation budget system for January — October 2008 and 2009 (as % of GDP)

	January–October 2008 r.	January–October 2009 r.
Profit tax	6,56	3,29
Income tax	3,87	4,13
VAT	5,30	5,29
Mineral extraction tax	4,49	2,56
Export customs duties	6,65	4,07

Source: Russian Federal Treasury.

As a result of the measures taken, primarily to increase interest rates and substantially to reduce the rouble's exchange rate in the basket of main reserve currencies, from the middle of January 2009 it was possible to halt the fall in international reserves (see Fig. 15).

A further consequence of the change in financial and monetary policy was the reduction in the rate of inflation, the stabilisation of the national currency's exchange rate (see Fig. 13) and the prevention of panic in the banking world (see Figs. 16, 17, 18).

No. 1663-r of 17 November 2008; 'On the strategy for the long-term socio-economic development of the Russian Federation up to 2020', Russian Federation Government Resolution No. 1662-r of 17 November 2008

¹⁵ 'The first thing the President spoke about recently was the need to pass law as quickly as possible to set a transition period to a single reduced rate of VAT. In parallel with this it would be possible to continue analysing the viability of another step. And that would be replacing VAT with a sales tax, proceeding from the fact that even the most advanced EU countries have not managed to fully resolve the problem of deductions and, in essence, the theft of VAT from the budget, as a result of which our taxpayers and tax bodies suffer.' From a transcript of the speech by Dmitry Medvedev, First Deputy Chairman of the government of the Russian Federation, at the Fifth Krasnoyarsk economic forum, 15 February 2007. <http://krsk.kp.ru/daily/24049/103037/>; 'At the President's meeting with the State Duma leadership Speaker Gryzlov and President Putin exchanged opinions on the preferred level of VAT. Gryzlov proposed a reduction in VAT as the first step of the future Cabinet. "And there should be a single rate, and it should not be higher than today's VAT incentive rate, i.e. 10%. We really need to prepare to reduce the VAT rate to 10%," said the Speaker.' See: Putin proposed a "very careful" approach to reducing VAT. 11 March 2008. <http://www.newsru.com/finance/11mar2008/nds.html>; 'Arkady Dvorkovich, head of the presidential expert directorate of the president of the Russian Federation, considers that the VAT rate can be changed from 18% to 12–13%.' See: Dvorkovich: the VAT rate can be reduced to 12–13%. 8 February 2008 <http://www.newsru.com/finance/08feb2008/dvorkovitch.html>; A. Dvorkovich: A VAT reduction must be regarded as an investment project. <http://kp.by/daily/24124.4/345319/>

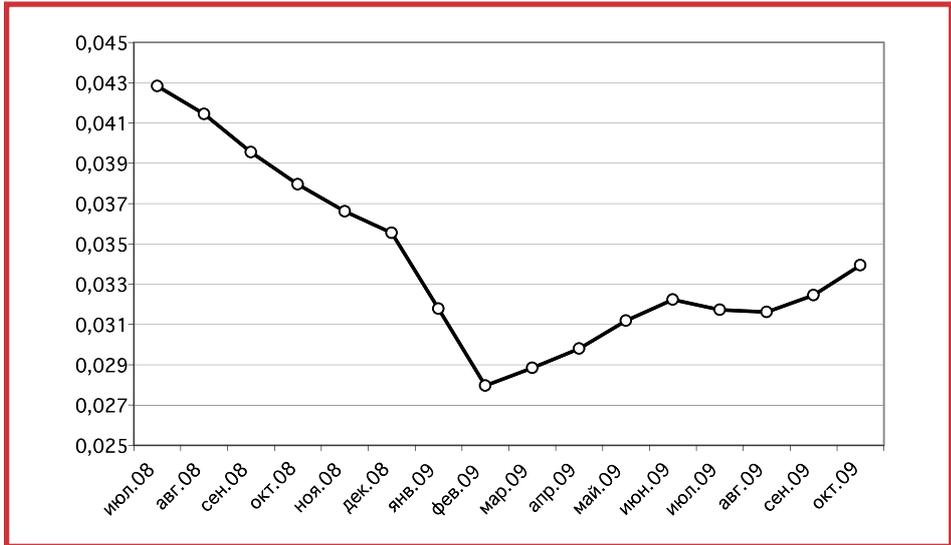


Figure 13.

Rouble nominal exchange rate against the dollar (dollars per rouble), July 2008 — October 2009 (average for the period)

Source: Central Bank of the Russian Federation.

[Note: Horizontal axis is monthlabels: Jul. 08, Aug. 08 through to Oct. 09]

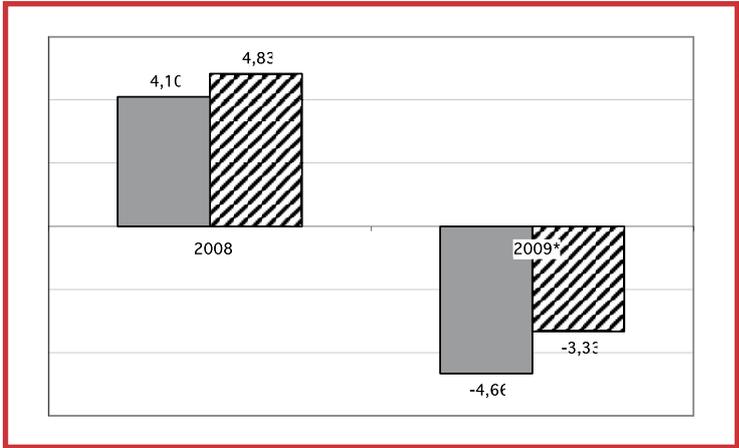


Figure 14.

Deficit (-)/ surplus (+) of the federal budget and the wider government budget of the Russian Federation, 2008–2009 (as % of GDP)

* First 9 months of 2009.

Source: Russian Federal Treasury, Russian Federal State Statistics Service.

[Note: vertical axislabel is: % of GDP. Horizontal captions are: Federal budget; Wider government budget]

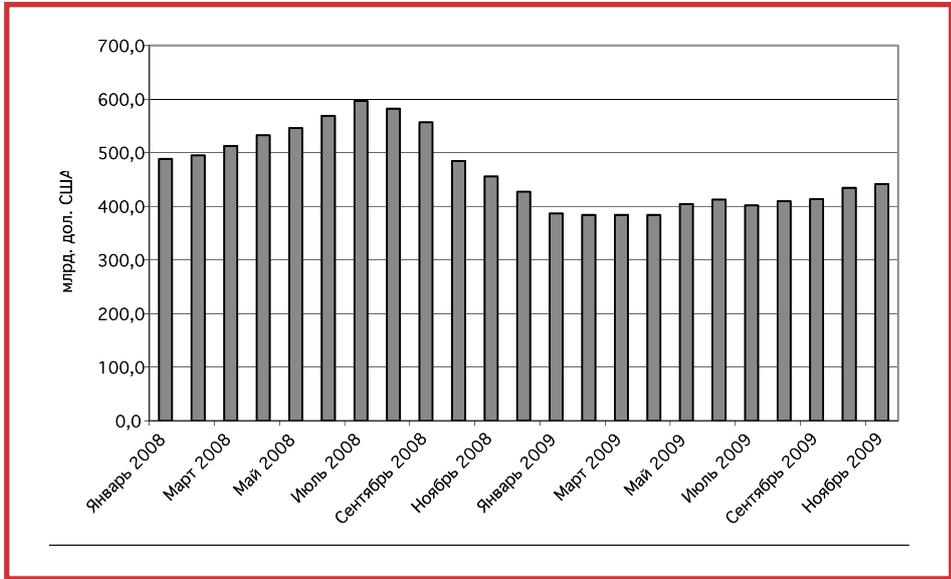


Figure 15.

Russian Federation international reserves, January 2008 — November* 2009 (\$ billion)

* As at 13 November 2009

Source: Central Bank of the Russian Federation.

[Note: vertical axislabel is: US\$ billion. Horizontal axislabels are: January 2008, March 2008, May 2008, July 2008, September 2008, November 2008, January 2009, March 2009, May 2009, July 2009, September 2009, November 2009]

Figure 16.

Inflation rate in the Russian Federation, January 2008 — October 2009 (% of corresponding period of the previous year)

Source: Russian Federal State Statistics Service.

[Note: horizontal axis labels are: Jan. 08, Feb. 08, Mar. 08, Apr. 08, May 08, Jun. 08, Jul. 08, Aug. 08, Sep. 08, Oct. 08, Nov. 08, Dec. 08, Jan. 09, Feb. 09, Mar. 09, Apr. 09, May 09, Jun. 09, Jul. 09, Aug. 09, Sep. 09, Oct. 09]

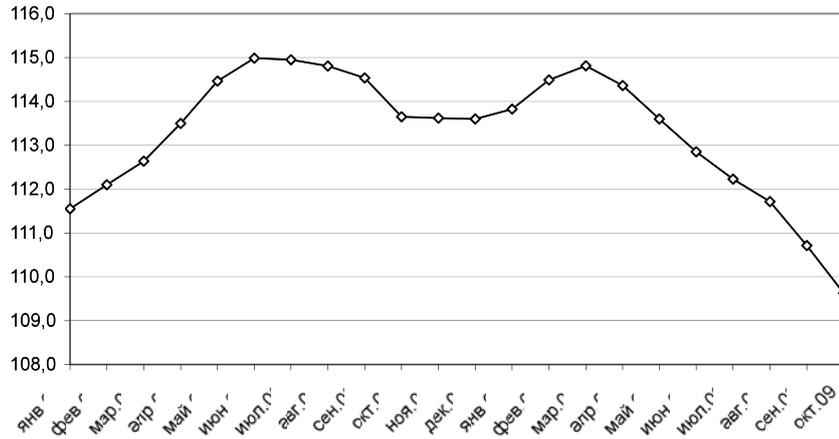


Figure 17.

Index of the nominal effective exchange rate of the rouble against foreign currencies for January — October 2009 (% of growth over the previous period)

Source: Central Bank of the Russian Federation. (www.cbr.ru).

[Note: graphlabels are: Jan., Feb., Mar., Apr., May, Jun., Jul., Aug., Sep., Oct.]

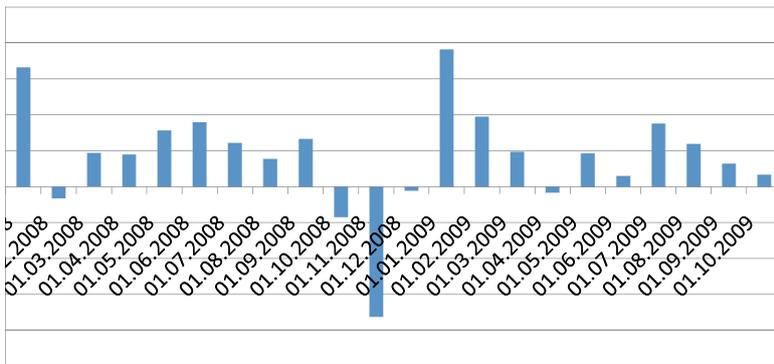
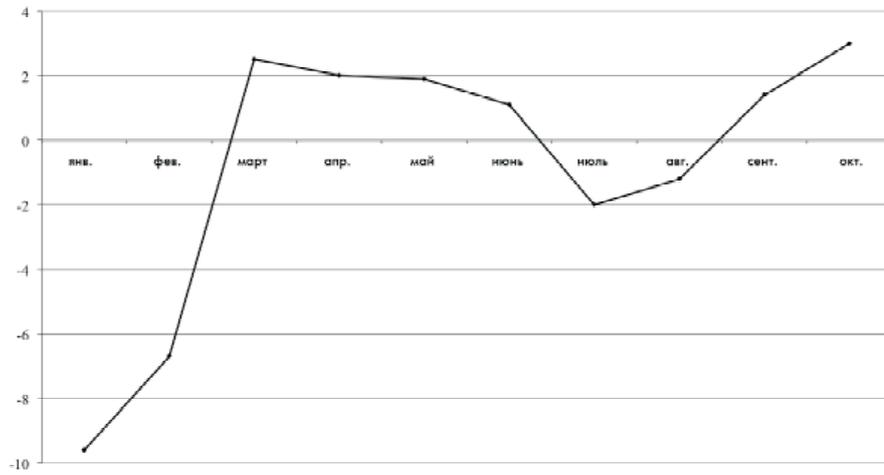


Figure 18.

Growth in personal bank deposits, Russian Federation, January 2008 — October 2009 (million roubles on first day of each month)

Source: based on data from the Central Bank of the Russian Federation

Figure 19.

Aggregate volume of the Reserve Fund and the National Welfare Fund of the Russian Federation, quarter 1 2009 — October 2009, in billions of dollars (to end of period)

Source: calculated as arithmetic average on the basis of monthly data of Russia's Ministry of Finance.

[Note: horizontal axis labels are: Quarter 1 09, Quarter 2 09, Quarter 3 09, Oct. 09]

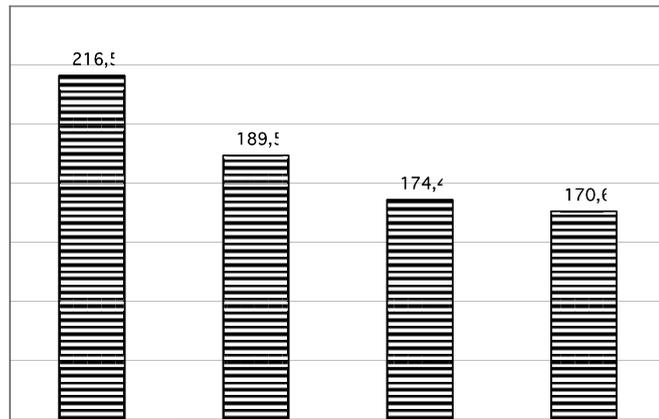


Figure 20.

Real GDP growth rates, Russian Federation, quarter 1 2007 — quarter 2 2009 (% against corresponding period of previous year)

Source: Russian Federal State Statistics Service.

[Note: horizontal axis labels are: Q1 07, Q2 07, Q3 07, Q4 07, Q1 08, Q2 08, Q3 08, Q4 08, Q1 09, Q2 09]

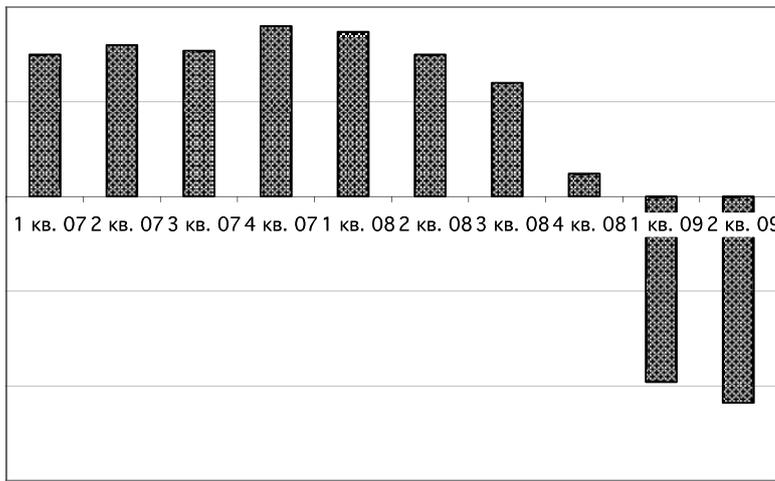
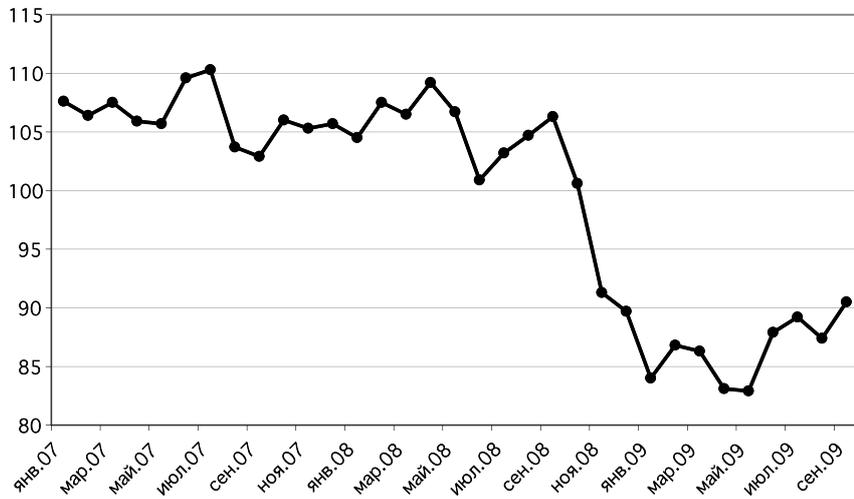


Figure 21.

Industrial production index, Russian Federation, January 2007 — September 2009 (% against corresponding period of previous year)

Source: Russian Federal State Statistics Service.

[Note: horizontal axis labels are: Jan. 07, Mar. 07, May 07, Jul. 07, Sep. 07, Nov. 07, Jan. 08, Mar. 08, May 08, Jul. 08, Sep. 08, Nov. 08, Jan. 09, Mar. 09, May 09, Jul. 09, Sep. 09]



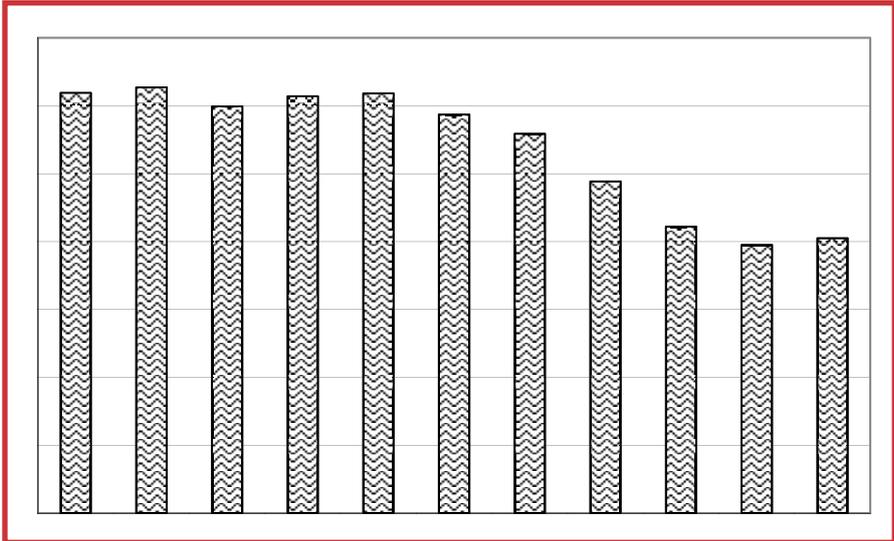


Figure 22.

Capital investment in Russian Federation, quarter 1 2007 — quarter 3 2009 (% against corresponding period of previous year)

Source: Russian Federal State Statistics Service.
 [Note: horizontal axis labels are: Q1 07, Q2 07, Q3 07, Q4 07, Q1 08, Q2 08, Q3 08, Q4 08, Q1 09, Q2 09, Q3 09]

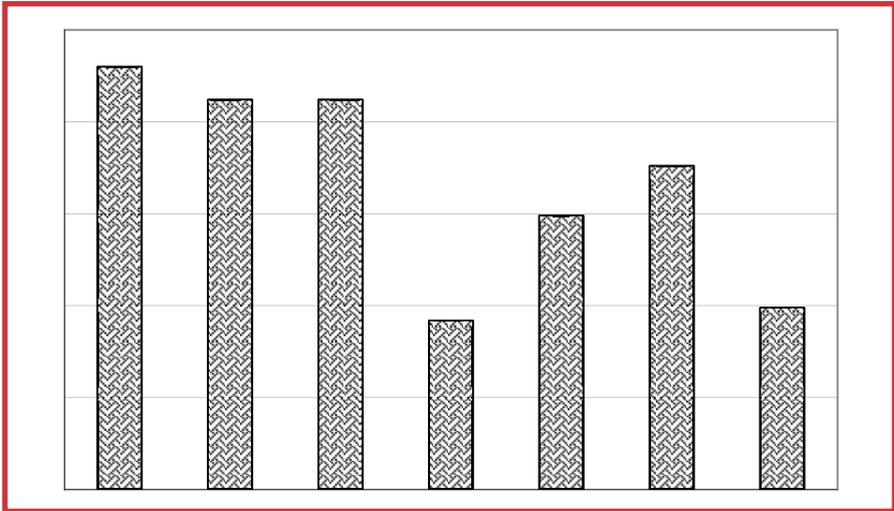


Figure 23.

Real disposable household income, Russian Federation, quarter 1 2008 — quarter 3 2009 (% against corresponding period of previous year)

Source: Russian Federal State Statistics Service.
 [Note: horizontal axis labels are: Q1 08, Q2 08, Q3 08, Q4 08, Q1 09, Q2 09, Q3 09]

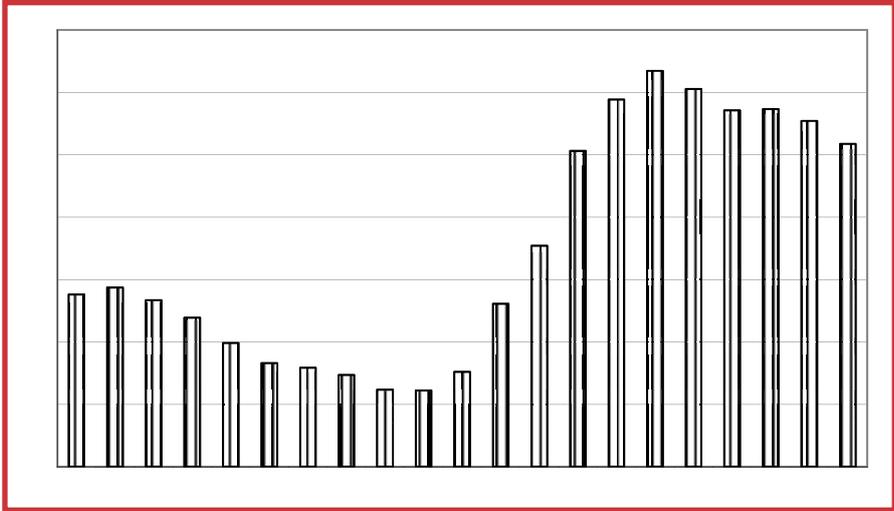


Figure 24.

Number of officially registered unemployed, Russian Federation, January 2008 — September 2009 ('000, month end)

Source: Russian Federal State Statistics Service.
 [Note: horizontal axis labels are: Jan. 08, Feb. 08, Mar. 08, Apr. 08, May 08, Jun. 08, Jul. 08, Aug. 08, Sep. 08, Oct. 08, Nov. 08, Dec. 08, Jan. 09, Feb. 09, Mar. 09, Apr. 09, May 09, Jun. 09, Jul. 09, Aug. 09, Sep. 09]



So far Russia has managed to avoid the development of the crisis according to a catastrophic scenario reminiscent of that which happened and is continuing to happen in Latvia or in Ukraine.¹⁶

The cost of preserving financial stability proved to be not inconsiderable. The development of events in 2008–2009 clearly showed how timely was the decision to create the Stabilisation Fund (see Fig. 19).

Until recently their existence ensured the adaptation of the Russian budget to the conditions of sharply reduced revenues from mineral extraction tax, profit tax and export duties.

The blow which the crisis dealt to the real sector of the Russian economy proved to be heavy (see Figs. 20, 21, 22).

Naturally, this could not fail to have an effect on personal income (see Fig. 23).

And on the situation in the labour market (see Fig. 24).

Against a background of a fall in real personal income and a growth in unemployment, society's reaction to the challenges linked to the crisis was, by international standards, calm. The number of people taking part in strikes was close to zero.

It is too early to talk about the causes of such a reaction to the changes in the economic situation or about how resilient it is. We can only formulate a hypothesis. The society which experienced the profound socio-economic crisis linked to the collapse of the Soviet Union understands what is happening better than the citizens of those countries which have been stable and flourishing for many decades. But there must be no illusions. That sort of calm does not last for ever in times of crisis. As the experience of the Soviet Union shows, when there is a severe worsening in the economic

situation it is difficult to support it, even if you have well organised propaganda. Sooner or later, if nothing changes, people may go out onto the streets repeating the words heard in the popular film *Assa*: "We want change!" The only question is whether these changes will be orderly, gradual and non-violent, otherwise we'll find ourselves up against the threat of a new revolution. This second scenario must be avoided. The two revolutions that we experienced in the last century are enough for Russia.

There is now no doubt about the depth of the crisis that began in autumn 2007. As in 1998 and 2001, it had a stronger effect on Russia than on all the CIS states together.¹⁷

In order to formulate our country's economic policy we need an answer to one important question: how prolonged will the crisis be? What is its influence on the medium-term prospects for economic growth and on the financial situation in the world?

There are experts who believe that we are through the worst of the crisis, and that the measures taken in the USA, the EU and China to stimulate aggregate demand, which are unprecedented in scale in recent decades, have made it possible to break the trend towards falling production and have created the prerequisites for a restoration of economic growth.¹⁸

This hypothesis may be correct. After the USA adopted a package of anti-crisis measures, the situation on the stock markets and the raw material markets began to gradually improve.¹⁹ (See Figs. 25, 26.)

If we believe that the crisis has bottomed out, when economic policy is being formulated in countries that depend on the fluctuations of the raw material markets it is possible to change priorities: to relax fiscal policy and adopt a large-scale package of measures to stimulate demand and to finance infrastructure projects. In

¹⁶ Real GDP in Latvia fell by 18% in the first quarter of 2009. By the end of June the number of registered unemployed had grown to 11.5%, compared with 7% at the end of 2008. In Ukraine, according to IMF forecasts, GDP will fall by 14% in 2009. Ukraine's overall financial commitments in 2009 amount to approximately 41 billion dollars. Even optimistic forecasts indicate the overall capacity for mobilising financial resources to finance these commitments does not exceed 31 billion dollars. See: Republic of Latvia: First Review and Financing Assurances Review Under the Stand By Arrangement, Requests for Waivers of Nonobservance of Performance Criteria, and Rephasing of Purchases Under the Arrangement. <http://www.imf.org/external/pubs/ft/scr/2009/cr09297.pdf>; Ukraine: Second Review Under the Stand-By Arrangement and Request for Modification of Performance Criteria - Staff Report; Press Release on the Executive Board Discussion. <http://www.imf.org/external/pubs/ft/scr/2009/cr09270.pdf>

¹⁷ Gaydar E.T., Chubais A.B. Economic notes. M.: Rosspen, 2008. p. 62.

¹⁸ 'Economic activity is beginning to level out, both in the USA and in other countries. At the same time the prospects for a return to growth in the short term are looking very good.' Bernanke B. <http://globalist.org.ua/?p=22189>; 'It looks as though the recession in the USA has ended.' Bernanke B. Recession likely over in US, says Bernanke. 15.09.09. <http://www.ft.com/cms/s/0/91439968-a224-11de-9caa-00144feabdc0.html>; Kudinov V. A. Ulyukayev: The crisis has bottomed out, Central Bank rate is still going down. *Vedomosti* 25.11.2009. <http://www.vedomosti.ru/news/news/2009/11/25/434>; Illarionov A The slump has ended. What does that mean? 30 April 2009 http://www.iea.ru/econom_rost.php?id=29

¹⁹ The package of anti-crisis measures was adopted on 14 February 2009. See: <http://top.rbc.ru/economics/14/02/2009/280613.shtml>

the case of Russia it is a matter of decisions involving expenditure of tens and hundreds of billions of dollars. It is not difficult to understand: when it's about this kind of money, there are serious interests behind such proposals.

Taking these decisions would enable an improvement in GDP performance for a certain time. However, it would be dangerous to take them before there are signs of a firm improvement in the situation in the world's leading economies. Experts disagree about whether the recession will be U-, W- or L-shaped, i.e. whether the downturn will be short-term, with a switch to a rapid resumption of growth, with two humps, with two waves of crisis, or a crisis which is not followed by a resumption of economic growth. There are arguments for each side of this dispute, but they are unproved hypotheses.²⁰

The fact that the crisis could have a second wave that arrives in the first half of 2010 is being widely discussed in the expert community.²¹ It is not clear how deep the problems in the European Union's banking system are.²² In 2010 the biggest corporations are facing significant payments on fixed income securities.²³ Time

will tell whether it will be possible to make those payments in conditions of tension on the credit resource market.

China is making energetic efforts to stimulate demand. While at the end of 2007 the Chinese leadership chose to make combating inflation its most important priority and was prepared to tackle this by slowing the rate of economic growth,²⁴ in 2008 China's economic policy changed. The priority changed to maintaining the rate of economic growth and combating unemployment²⁵ (see Fig. 27).

The Chinese authorities chose the same macroeconomic policy approach as that used by the American administration to tackle the recession in 2001. It is difficult to predict whether this policy will turn into a 'bubble' crisis.²⁶

The scale of the problems in the financial and banking systems of other countries with emerging markets is also not easy to assess. As this article was going to press, it was impossible to assess accurately to what extent the risk of default on Dubai's guaranteed fixed-income government liabilities might affect other

²⁰ See, for example: *Jefferson R., Woodfield P.* Edinburgh Money Managers Forecast 'Volatile' Recovery (Update3) <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a8rCYuC10dWA>; *Authers J.* The Short View. Published: June 2 2009 The Financial Times Limited 2009. www.ft.com/shortview; *Wilson J.* 'Robust' business for Deutsche Bank. Published: May 26 2009. The Financial Times Limited 2009; *Hume N.* On London: Rally's end leaves investors at a crossroads. Published: May 15 2009. The Financial Times Limited 2009; *Giles C.* Darling gambles on growth. Published: April 23 2009. <http://www.ft.com/cms/s/0/f0846a1a-2fa1-11de-a8f6-00144feabdc0.html>

²¹ *Goodman W.* Pimco Says World Economic Crisis Faces 'Second Wave' (Update4) <http://www.bloomberg.com/apps/news?pid=20601087&sid=anA4PQ48RFhI>; *Logutenkova E.* Ackermann Says Bad Loans Are 'Next Wave' of Crisis (Update2) <http://www.bloomberg.com/apps/news?pid=20601206&sid=aUKAk1bKBVl8>

²² *Bender Y.* European banks cut access to external fund providers. Published: September 6 2009. <http://www.ft.com/cms/s/0/76abe988-9979-11de-ab8c-00144feabdc0.html?SID=google>

²³ See, for example: Erste Bank official website <http://www.erstebank.ua>; *Kommersant* No. 42 (4097) 11.03.2009 www.kommersant.ru.

²⁴ *Cao B.* Yuan to Rise Versus Major Currencies, Researcher Says (Update2) <http://www.bloomberg.ru/apps/news?pid=20601087&sid=aQYR09fjayFk&refer=home>

²⁵ Is the party over in China? Massive unemployment looms. http://www.worldtribune.com/worldtribune/WTARC/2008/ea_china_02_15.asp; *Lawrence D.* China Pledges Faster Labor Mediation as Employment Turns 'Grim'. <http://www.bloomberg.com/apps/news?pid=20601089&sid=afK0sP5rT6IY&refer=china>; *Hamlin K., Yanping L.* China Rate Cut Highlights Concern Over Slowdown, Jobs (Update1). <http://www.bloomberg.com/apps/news?pid=20601087&sid=aQrG9UlhDH0>; *Adam S.* Yuan 'Straitjacket' Risks Inflating China Bubbles (Update2). <http://www.bloomberg.com/apps/news?pid=20601109&sid=awHX2QPENKqQ>

²⁶ *Shamim A.* Yuan 'Straitjacket' Risks Inflating China Bubbles (Update2). <http://www.bloomberg.com/apps/news?pid=20601109&sid=awHX2QPENKqQ&pos=10>; *Anderlini J., Tucker S.* CIC head warns of asset price bubble. <http://www.ft.com/cms/s/0/47ac3d54-c39a-11de-a290-00144feab49a.html>; *Tasker P.* China is heading for a Japan-style bubble. <http://www.ft.com/cms/s/0/78e2eae4-c7af-11de-8ba8-00144feab49a.html>; Chinese sovereign wealth unit planning \$11.7bn bond issue. <http://www.ftchinese.com/story/001029668/en>; *Xie A.* Insight: Is China due a reality check? <http://www.ft.com/cms/s/0/1ed429aa-b99f-11de-a747-00144feab49a.html>; *Brown K.* Asia warned over emerging asset bubbles. <http://www.ft.com/cms/s/0/236ef0c2-c9ac-11de-a071-00144feabdc0.html>; *Dyer G.* Top China banker calls for urgent shift in Beijing's monetary policy. <http://www.ft.com/cms/s/0/b4217eba-bea2-11de-b4ab-00144feab49a.html>; *Authers J.* Short View: China's bubble. <http://www.ft.com/cms/s/0/ba76495c-f05a-11dc-ba7c-0000779fd2ac.html>; *Dyer G.* Top China banker urges shift in policy. <http://www.ftchinese.com/index.php/ft/story/001029313/en>; China's role in the global recovery <http://www.ft.com/cms/s/0/2df3ea66-9716-11de-83c5-00144feabdc0s01=1.html>; *Pesek W.* China Risks Bubbles With 'Bernie Madoff Data'. <http://www.bloomberg.com/apps/news?pid=20601039&sid=b99AWGFCBsU>; China Must Avert Loan-Fueled Bubbles, World Bank Says (Update1). <http://www.bloomberg.com/apps/news?pid=20601080&sid=aRi.90ENYi.s>

²⁷ <http://www.ft.com> Last updated: November 30 2009.

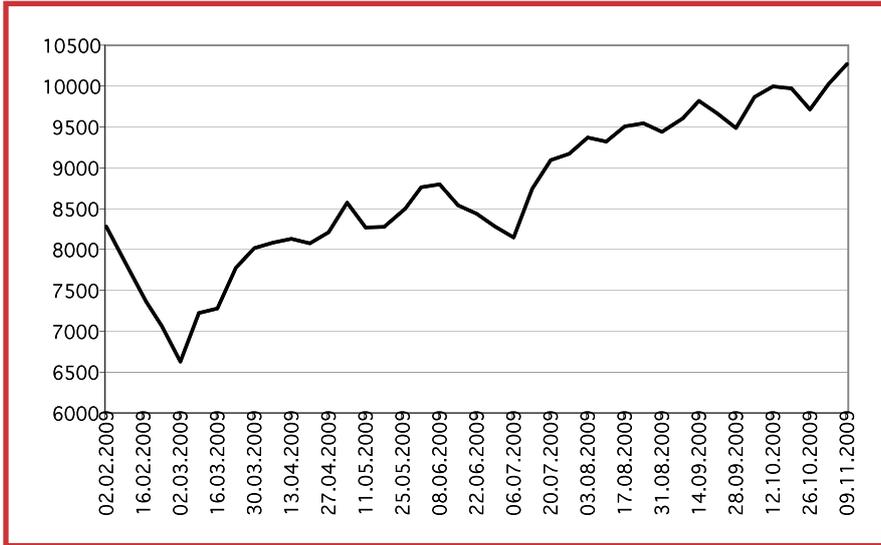


Figure 25.

US stock market performance* February–November 2009

* Dow Jones Industrial Average Index.

Source: Yahoo! Finance (<http://finance.yahoo.com/>).

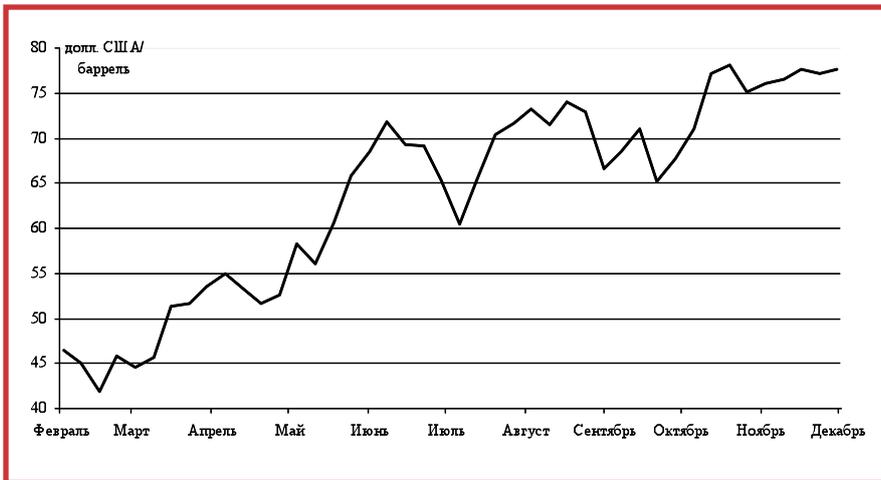


Figure 26.

Brent oil price movements, February — November 2009, weekly (US\$ per barrel)

Source: www.finam.ru

[Note: vertical axis caption is: US\$ per barrel. Horizontal labels are February, March, April, May, June, July, August, September, October, November]

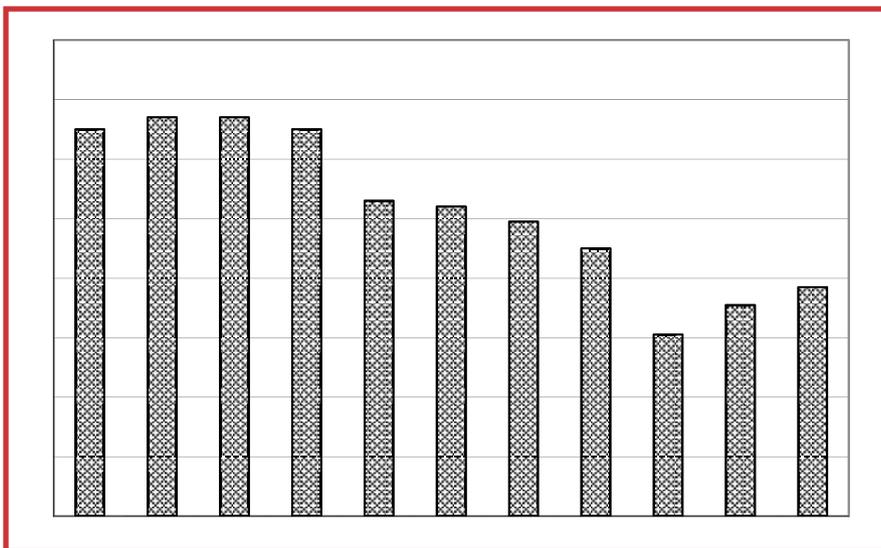


Figure 27.

GDP growth rate, China, quarter 1 2007 — quarter 3 2009 (% against same period of previous year)

Note: China's statistical service publishes data for Q2–Q4 2007–2008 only as cumulative GDP growth rate.

Source: National Bureau of Statistics of China (<http://www.stats.gov.cn>).

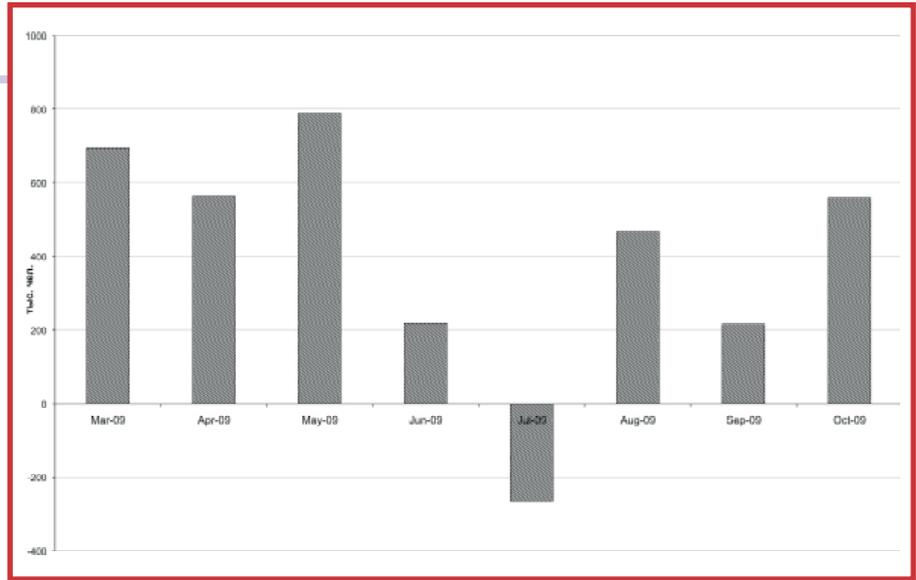
[Note: horizontal axis labels are: Q1 2007, Q2 2007, Q3 2007, Q4 2007, Q1 2008, Q2 2008, Q3 2008, Q4 2008, Q1 2009, Q2 2009, Q3 2009]

Figure 28.

Rise/fall in numbers of unemployed (seasonally adjusted data), USA, March–October 2009 ('000, month start)

Source: Federal Reserve Bank of St Louis (<http://research.stlouisfed.org/fred2/series/UNEMPLOY/downloaddata?cid=12>).

[Note: Vertical axis label is: '000 people. Captions on horizontal axis are: Mar. 09, Apr. 09, May 09, Jun. 09, Jul. 09, Aug. 09, Sep. 09, Oct. 09]



markets in the way that happened in South-East Asia in 1997–1998.²⁷ Moreover Dubai is not the only country with emerging markets that is important for the stability of financial systems and which might run into difficulties meeting its financial commitments.

US economic statistics for recent months are contradictory. They do not give grounds for confidence that the world's biggest economy is on the road to stable recovery.

The authors of a recent World Bank report on the crisis defend the thesis that even with a resumption of economic growth in the world in 2010, in the medium term this growth will be slower than in the years preceding the current crisis.²⁸

Everything we have said above may seem too pessimistic. Our country's experience shows, however, that the risks of events developing in this way must be taken into account.

An easing of monetary and fiscal policy would certainly be popular. If and when obvious evidence appears of an improvement in the world economy and of steady growth in demand for Russia's main export goods, it will not be difficult to do this. But to take such decisions in a situation of continuing uncertainty would be a mistake.

The obvious short-term priority is anti-crisis measures. At the same time the current economic crisis has once again revealed the vulnerability of the Russian economy and the extent of its dependence on

factors over which we have no control. This puts the question of diversifying the economy on the agenda as a top priority (if we are not to reduce the issue to simply putting government money into large-scale projects which do not always give a return, and which especially rarely give it in countries whose state apparatus is afflicted by corruption). People have been talking about the need to diversify the economy for two decades. This objective was set in the first government programme to deepen economic reforms (summer 1992). But we're still stuck where we were then. Perhaps the current crisis will at last force our authorities, the elite, the whole nation, to seriously get to grips with this issue?

Raw material prices are fluctuating within a wide range, and they are difficult to predict, let alone to control. Of course, a country where it is difficult to talk about a guarantee of private property or an independent and just judicial system will always find people keen to invest in oil and gas. But where high-tech sectors of the economy are concerned it's a different matter. Here guarantees of property rights, an effective judicial system and an incorruptible state apparatus are essential prerequisites for Russian and international capital to invest money in them. This is easy to say. Creating these prerequisites is more difficult. But that is the problem we must resolve if we want to see the long-term, steady development of the Russian economy.

A crisis is a period of turbulence and uncertainty. When we take decisions on key issues of economic

²⁸ Mitra P., Selowsky M., Zaldyendo J. Turmoil at Twenty: Recession, Recovery, and Reform in Central and Eastern Europe and the Former Soviet Union. Washington: World Bank, 2010.

policy in such conditions we can make mistakes, and get results which are the opposite of what we wanted. A crisis is similar to a storm. In the days of sailing ships, during a storm it was customary to take down the sails and heave to. It would be useful to remember this when we take decisions today. But the experience of the last two centuries shows that crises, even very grave ones, such as the Great Depression or the present crisis, sooner or later come to an end. We should already be thinking today about how to ensure the Russian economy is competitive after the crisis.

The post-crisis world will be tougher than it was at the start of this century. Russian companies will have to compete with the corporations that survive, and that will therefore be able to restructure their production and concentrate it on the most efficient enterprises and types of business, reduce the numbers of employees, and increase labour productivity and the quality and competitiveness of what they produce. Unless we do the same in Russia, it will not be easy to compete in this market. Two conclusions for Russia's long-term economic policy follow from this.

First: at least do not hinder Russian companies from acting in the same way as corporations that survive the crisis, get ready to compete in a tough post-crisis world, and adapt social policy to meeting this objective.

Second: make the creation of a competitive innovation economy sector in Russia a top priority.

Sceptics may say that Russia has never managed to meet this challenge, neither under the tsarist regime nor under the communists, nor since the collapse of the Soviet Union (the military-industrial complex being the only exception to the rule). But this does not mean in

any way that this is fundamentally unachievable. In the 1950s neither Finland nor South Korea nor Taiwan could have been counted among the countries with a developed innovation economy. During the last 60 years the world has built up a rich experience of policy aimed at supporting an innovation economy. Many of these programmes proved successful.²⁹ This experience cannot be copied literally. The programmes to support an innovation economy were specific, adapted to the realities of the country in question. In Russia's case this experience shows that the most important prerequisites for the success of such a policy are changes to legislation (the tax system, fiscal legislation, regulation of patent rights, and simplifying the terms of foreign economic activity for those who are involved in the innovation economy).³⁰

These measures must be accompanied by the creation of an effective infrastructure to support innovation activity. This involves active state policy to create business incubators focused on the innovation economy, to create venture funds, and to stimulate interest in innovation-related credit in the banking system.

The innovation economy is by nature very different from the ordinary economy. The risk of failure here is big. But when there is success, the results may be orders of magnitude greater than what was expected. That is why we cannot have the standard state economy policy in this sector. It requires innovative solutions. The condition in which Russia will approach the next global crisis and the long-term prospects for our country's development depend to a large degree on the extent to which Russia succeeds in pushing forward in this area over the next decade. ■

²⁹ See, for example: National Innovation System. A Comparative Analysis. R. R. Nelson (ed.) New York Oxford: Oxford University Press, 1993.

³⁰ In Russia's case, this applies to commodity groups 84–90 (according to the Foreign Economic Activity Commodity Nomenclature code).