The Economic Crisis in Russia: Fragility and Robustness of Globalisation[1]

Satoshi Mizobata

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KIER (Kyoto Institute of Economic Research), Kyoto University

Yoshidahonmachi, Sakyo, Kyoto, Japan Tel:+(81)75 753 7144; Email:mizobata@kier.kyoto-u.ac.jp

Abstract

It is now clear that the global economic crisis has hit the Russian economy. The resulting shock clearly shows not only the global economic imbalance but also the distinct characteristics of emerging Russian markets. The Russian economy already changed its structure under the high economic growth of the early to mid-2000s, and has since then become too sensitive to the global market and the oil price. However, the Russian markets involve the strong hand of the government, and the anti-crisis policy gives this hand constancy. The crisis process and the anti-crisis measures characterize the Russian market institutions. The current paper investigates the characteristics of the Russian markets under both the economic growth period and the crisis period, and offers perspective on the market transition.

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Introduction

The global crisis from the U.S. sub-prime loan has proven contagious to emerging markets, including transition economies. These transition economies have achieved high economic growth during the early to mid-2000s and, at that point, may well have been regarded as having already finished their transitional period. However, the financial crisis made the European economies unstable (EBRD, 2008). Although the East-Central European economies have adopted the export-led reorganisation and technological upgrading through the foreign capital and achieved the 'miracle transformation', and although they built westernised market mechanisms by joining the European Union, the crisis has kept tight hold of them. According to the last *Eurostat*, euroindicators (117/2009, 13 August2009), in 2009 Q2 the Baltic states (Latvia, Estonia and Lithuania) recorded the worst GDP decline (minus 17-23%) compared with the previous quarter, and Slovenia, Romania, Czech and Hungary followed them.

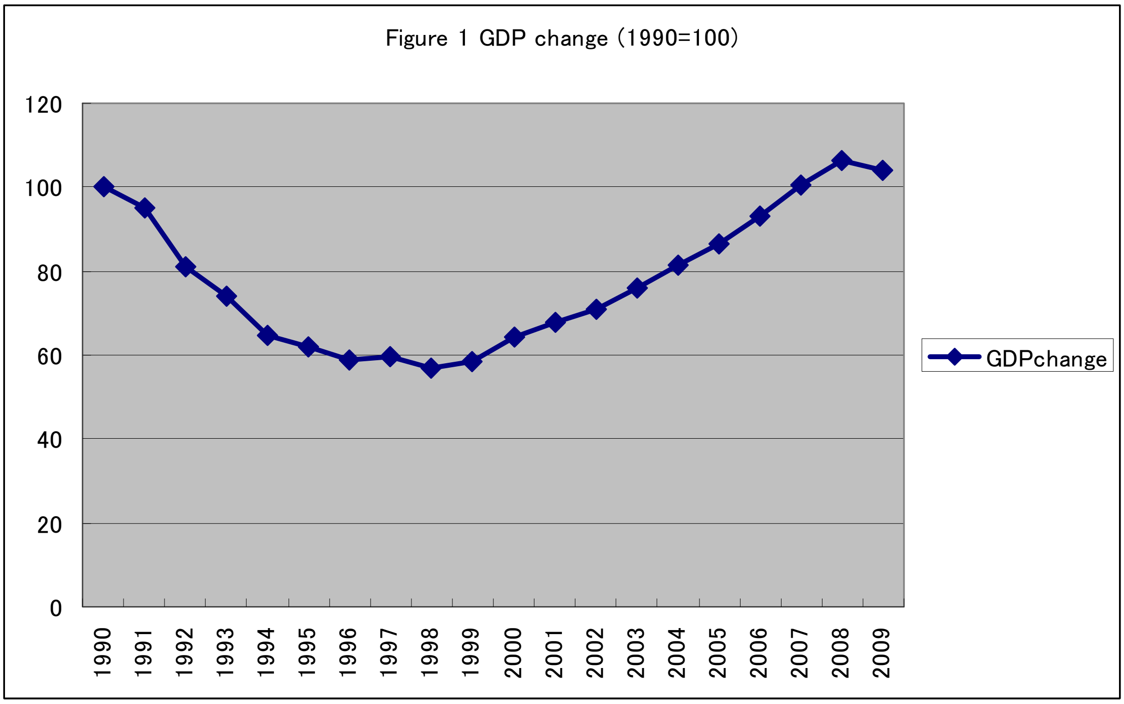
Russia also could not escape the global shock, and in 2008, the Russian economy hit both its peak and its nadir. 'The global crisis has put a sudden end to the strong recovery of the Russian economy since the financial crisis of 1998' (OECD, 2009, p.9). One of the most distinct phenomena was a stock index of the Russian stock markets, and even though in Q2 2009 the stock price seemed to improve, Russia may be regarded one of the most critical economies among the above transition economies and Japan. Paradoxically speaking, if we acknowledge that the global business cycle involved the Russian economy, it is not an exaggeration to say that the Russian market transition is over. At the same time, the global crisis shock permeates Russia's national economy, based on the domestic factors. Therefore, the investigation of the Russian crisis produces sufficient data for the reconsideration of Russian market institutions' characteristics.

The current paper investigates the characteristics of the Russian markets under periods of economic growth and crisis, and examines the perspective of the market transition. Particularly, I focus on the changes of the economic structure under the growth and the crisis, and examine the institutional norm and the relationship between the government and business.

1. Reconsidered economic growth in the 2000s

When we investigate the transition economies, the initial conditions cannot be neglected. Similarly, in order to clarify the economic crisis in Russia, while the global impact is remarkably strong, the nation's pre-crisis economic structure must be sufficiently taken into account.

Thus far in the twenty-first century, the Russian economy has achieved ambitious goals for economic growth and has improved the market institutions under the stable political situation (the Putin government). Figure 1 indicates the fluctuation of GDP after the transformation, and indicates the stark contrast between the dark 1990s (with a decline and the 1998 crisis under Boris Yeltsin) and the bright 2000s under Vladimir Putin.



Note: The year 2009 is estimate of the Russian government (-2.2% decline).

Source: Rosstat, 1997, 2000, 2008.

While sustainability of economic growth has been a controversial issue, the growth involved the following structural features, which determined the growth path of the Russian economy. In short, Russia after the growth is completely different from Russia before the growth.

First of all, Russia achieved high economic growth, and energy and resources occupied the centre of that growth. The Russian economy has changed into a pure oil-producing region, like the Middle East. The oil and gas reserve and production steadily increased in the 2000s. Oil production increased from 313 million tonnes in 2000 to 488 million tons in 2008 (an increase of 56%), and gas production increased from 555 billion cubic meters to 663 billion cubic meters (an increase of 19%) in the same period[2]. The oil reserve increased from 45 billion barrels in 2001 to 79.5 billion barrels in mid-2008 (Ia.Lisovolik, *Vedomosti*, 21 April 2008), and Gazprom increased its supply ability owing to an enlargement of purchase in Central Asia. Table 1 shows a dramatic increase in gas and oil exports. The share of oil and gas in the total export increased from 34.9% in 1997 to 65.8% in 2008. Particularly, the drastic increase of export price after 2005 expanded the share and value of oil and gas exports. As a result, exports accounted for around half of crude oil and petroleum products and for a third of natural gas. Moreover, Russia exports various kinds of natural resources: coal,

2 Sakaguchi (2009) criticises a rapid increase of oil production during 2000-2004 as a speed-up of exhaustion of west Siberian resource.

mineral fertiliser, cellulose and paper, rolled iron, nickel, cobalt, aluminium, titan, zinc and others. It is easy to estimate that more than 80% of exports consist of natural resources and that during the economic growth in the 2000s, Russia stimulated the energy and resource (oil and gas) dependent economy.

Table 1 Export of oil and gas

		1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Crude oil	tonnes million	114	118	116	144	165	190	228	260	253	248	259	243
	$ billion	13.4	8.8	12.9	25.3	25.0	29.1	39.7	59.0	83.4	102.3	121.5	161.1
Oil products	tonnes million	60.2	57.5	53.9	62.6	63.3	75.5	77.7	82.4	97.1	103.5	112.3	118
	$ billion	7.0	3.9	5.1	10.9	9.4	11.3	14.1	19.3	33.8	44.7	52.2	79.9
Natural gas	Cubic meter billion	121	125	131	194	181	186	189	200	209	203	192	195
	$ billion	10.7	11.1	11.6	16.6	17.8	15.9	20.0	21.9	31.7	43.8	44.8	69.1
Total	$ billion	31.1	23.8	29.6	52.5	52.2	56.3	73.8	100.2	148.9	190.8	218.5	310.1
Share of export (%)		34.9	31.8	39.1	50.0	51.2	52.5	54.3	54.7	61.1	62.9	61.7	65.8
Crude Oil export price	$/barrel				23.9	20.8	21.0	23.8	31.0	45.2	56.3	64.3	90.7
Gas export price	$/ m^3 thousand				85.8	98.3	85.7	105.5	109.1	151.4	216.0	233.7	353.7

Source: 7 September 2009, http://www.cbr.ru.

This structure cannot be non-influential to the Russian economy as whole. The government increased receipts via foreign reserves and tax revenue, and thanks to high tax revenue, the fiscal balance continued to be at a surplus in the 2000s. According to Table 2, tax on the corporate profits, VAT, and tariffs on the natural recourses and customs (which are related to oil and gas) accounted for a majority of receipts. It is no exaggeration to say that the state budget has become subordinate to the flexible oil price. Because the oil price is based on the global financial markets with short-term funds, Russia has become sensitive to global finance (Mau, 2009, p.6). In short, the authority and the economic role of the government heavily depend on oil and gas, and global finance.

An increase in exports has gone hand-in-hand with an increase of imports. Table 3 shows that in the 2000s, an increase of import exceeded that of export. In practice, consumption and investment have become driving forces behind the growth, and they grow higher than the GDP growth rate. The automobile sector expands its sales in the domestic market, and the foreign companies (including those in Japan) may well have great interest in the Russian market. The development of the retail commercial companies also indicates an increase of consumption (Mizobata, 2009). An increase of production and growth leads to an enlargement of employment and an increase in real wages, and is followed by an increase of consumption and the raising of the living standard. And then, consumption leads to an increase in investment and production. In the 2000s, while the export sector shows a bias, there exists a virtuous circle in the Russian economy, and consumption raises its dependence on import[3].

Table 2 Integrated government finance (%)

	1995	1998	2000	2004	2007
Financial deficit and surplus	-11.2(-5.2)	-22.6(-3.0)	12.6(1.9)	14.0(4.5)	23.1(6.0)
Tax on the corporate profits	26.9	14.5	19.0	16.0	8.2
VAT	21.9	24.8	21.8	19.7	29.1
Tariffs on the natural resources use	2.8	3.3	3.7	10.7	14.9
Customs and others	5.7	5.0	10.9	15.8	31.0

Note: deficit and surplus is % in the total federal finance, and % in GDP. Others are % in the federal bugedt.

Source: Rosstat, 2000, 2007, 2008.

Table 3 Foreign trade of Russia ($ billion)

	1995	2000	2001	2002	2003	2004	2005	2006	2007	2008	Change 2000-2008
export	78.2	105.0	101.9	107.3	135.9	183.2	243.8	303.6	354.4	469.0	347%
import	46.7	44.9	53.8	61.0	76.1	97.4	125.4	164.3	223.5	292.5	551%
balance	31.5	60.1	48.1	46.3	59.8	85.8	118.4	139.3	130.9	176.5	-

Source: Central bank Russia, 25 August 2009, www. cbr.ru.

Therefore, the economic growth has changed the Russian economy, making it sensitive to the global economy and its business fluctuation. Oil price and the exchange rate, in particular, have become very sensitive to the macroeconomic growth of the Russian economy. The Russian economic growth accompanies a twin surplus -- i.e., budget surplus and foreign trade surplus --

[3] Imported food occupied 36-50% of domestic food consumption. The share in Moscow and St. Petersburg is regarded as 70-80%. Particularly, medicine and food for children heavily depend on import. The food reserve was 100 days in 1970-1985 USSR periods, and these days declined to 48 in 1996, 31 in 2001, and 32 in 2005. (See E.Lar'kin, and N. Mikhailova, *Profile*, No.18, 18 May 2009, pp.12-15)

which represents a complete contrast with the US economy during 1980-2008[4].

The economic growth in the 2000s, however, cannot be regarded as a simple economic boom. Overheating of consumption and successive high inflation remind us of the bubble economy, although the Russian banks do not play sufficient intermediating functions to make a direct comparison. At the very least, in the 2000s, the stock price and the real estate price increased drastically under the economic boom, and excessive money flowed into the markets. According to MICEX Index (2009)[5], MICEX index (stock index) increased parallel to GDP growth. In addition, we can confirm a drastic price-jump in real estate by the Index of Real Estate in the 2000s[6]. 'Profitability and transaction volumes of the Russian stock markets changed after the oil price, and from the middle of 2006, stock bubble began to be created. After the stock market, bubble spread into the real estate market. A rise of securities' quotation stimulated stock owners to attract large amount of money, and money was invested to more expensive projects… Heated price increase in the initial resident market brought about speculative interests in investment in this sector. The real estate market organised the specific "exchange" where players earned 100% profits. Thus, the stock bubble supported another bubble, residential bubble' (Zamaraev, Kiyutsevskaya, Nazarova, Sukhanov, 2009, pp.6-7).

Secondly, in the 2000s, credit grows and 'rapid money supply growth in Russia has often resulted in excess liquidity, in particular in 2001, 2004-05 and between 2007 and the first quarter of 2008' (OECD, 2009, p.80). The CBR's (Central Bank Russia) monetary policy became too accommodating with domestic real interest rates remaining negative, and foreign borrowing became favourable as US and other western interest rates were very low. In short, 'the government and the CBR could not restrict an excessive money supply from the high oil price and capital inflow. This situation enlarged the aggregate demand of the economy and lead to the credit boom[7]' (Kudrin, 2009, p.20). Under the boosted domestic boom and inflationary pressure and permission of free capital flows[8], cheap access to credit or existence of cheap money has flowed into emerging markets, including Russia. Particularly, as long as oil money flowed into Russia, a surplus of money supply may be created with no trouble.

However, the process is not so simple. The balance of payments in Russia (Table 4) indicates a specific structure. Although trade balance continues to be at a surplus and increases in the 2000s, services record constant deficits. Changes in reserve assets are linked with trade balance, and in the 2000s, it is obvious that Russia increased foreign reserve. Capital and financial accounts indicate an

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4 US almost constantly recorded a twin deficit: fiscal deficit and trade deficit. In the 2000s, foreign trade deficit was between \$400 and \$700 billion, and the federal budget deficit was between \$160 and \$410 billion (US Census Bureau, 2009).

5 26 August 2009, www.micex.com.

6 26 August 2009, www.irn.ru.

7 The credit to construction increased by 85.8% on 1st October 2007 than the previous October, and increased by 81.5% on 1st October 2008 (Kudrin, 2009, p.20).

8 On 1 July 2006, full ruble convertibility was introduced.

increase of outflow and overseas assets. At the very least, trade balance accompanies dynamism of capital and financial account and changes in reserve assets.

Table 4 Balance of payments in Russia

year	Current account	Trade balance	services	Capital and financial account	Changes in reserve assets	Errors and omissions
1992	-0.1	3.7	-3.1	2.4	-1.9	-0.4
1993	9.0	12.6	-2.1	-4.4	-3.9	-0.7
1994	7.8	16.9	-7.0	-10.2	1.9	0.5
1995	7.0	19.8	-9.6	12.1	-10.4	-8.7
1996	10.8	21.6	-5.4	-6.4	2.8	-7.3
1997	-0.1	14.9	-5.9	10.8	-1.9	-8.8
1998	0.2	16.4	-4.1	3.8	5.3	-9.4
1999	24.6	36.0	-4.3	-14.4	-1.8	-8.5
2000	46.8	60.2	-6.7	-21.5	-16.0	-9.3
2001	33.9	48.1	-9.1	-16.2	-8.2	-9.6
2002	29.1	46.3	-9.9	-11.7	-11.4	-6.1
2003	35.4	59.9	-10.9	0.1	-26.4	-9.2
2004	59.5	85.8	-12.7	-8.4	-45.2	-5.9
2005	84.6	118.4	-13.8	-15.2	-61.5	-7.9
2006	94.9	139.3	-13.6	3.3	-107.5	9.5
2007	77.0	130.9	-19.6	84.8	-148.9	-12.9
2008	102.4	179.7	-25.1	-135.2	45.3	-12.6
2009 Q1	9.1	19.1	-4.1	-31.8	31.1	-8.3

Source: Central bank Russia, 25 August 2009, www. cbr.ru.

From the beginning of the transformation, international finance did not play a main role in the Russian markets. In 1994, more than 90% of finance came from domestic capital, with the global financial markets provided just 8% of funds. However, after the opening of state bond markets, the situation changed significantly. In 1998, the ratio shifted to 42% domestic and 58% foreign. The international financial markets provided the domestic funds. In 1994, two thirds of the government deficits were supplied by the funds of the central bank. The government offered state bonds, and the foreign funds flowed into Russia through domestic commercial banks with forward transactions. Mizobata (1999) considered the monetary stabilisation policy and characteristics dependent on state bonds and external debts as the 1995 structure, and concluded that the 1995 structure became a direct factor in the 1998 crisis. The following points should not be neglected in our attempts to understand the external balance: 1) two thirds of the external debt was a legacy of the USSR (Table 5); and 2) due to a cheap petroleum price, not only foreign reserves but also internal funds of enterprises and banks were not sufficient with respects to the outflow of foreign funds.

After 2001, Russia increased private external borrowing during times of economic growth. Although enterprises also increased internal reserves and the government significantly increased foreign reserves, the non-state sector is eager for financing. Therefore, external debts to the government decreased, and enterprises and banks increased their debts, up to around $500 billion. (Table 6) As a result, the international position[9] became worse (Table 7). External borrowing was based on short-term loans. Until the 1998 crisis, the average maturity date was 150 days. In 2008, the maturity shortened and more than 30% of debts were in a period shorter than one year.

Table 5 International balance and external debts ($ billion, the end of the year)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Current balance	-0.08	0.2	24.6	46.8	33.9	29.1	35.4	59.5	84.4	94.3	77.0	102.4
Trade balance	14.9	16.4	36.0	60.2	48.1	46.3	59.9	85.8	118.4	139.3	130.9	179.7
Export	86.9	74.4	75.6	105.0	101.9	107.3	135.9	183.2	243.8	303.6	354.4	471.6
Import	72.0	58.0	39.5	44.9	53.8	61.0	76.1	97.4	125.4	164.3	223.5	291.9
Foreign direct investment	4.9	2.8	3.3	2.7	2.7	3.5	8.0	15.5	12.9	29.7	54.3	58.7
External debts (to the state)	149.9	158.4	148.9	128.6	111.1	104.3	106.0	97.4	71.4	48.6	46.4	32.8
Ex-USSR	95.1	98.2	96.8	65.8	61.0	55.9	58.3	56.1	34.5	9.4	7.1	4.6
External debts (to the private)	33.0	30.0	29.2	31.4	35.2	48.0	80.0	108.9	176.2	261.9	419.2	450.7
External debts per GDP (%)	44.4	67.8	93.3	65.1	50.5	43.8	39.4	33.5	30.9	31.4	36.0	28.8

Source: 9 September 2009, www.cbr.ru.

Table 6 External debts of enterprises ($ billion)

1993	1994	1995	1996	1997	1998	2003	2004	2005	2006	2007	2008
2	4	8	14	33	30	80	108	175	262	417	488

Source: Ershov, 2008, p.14.

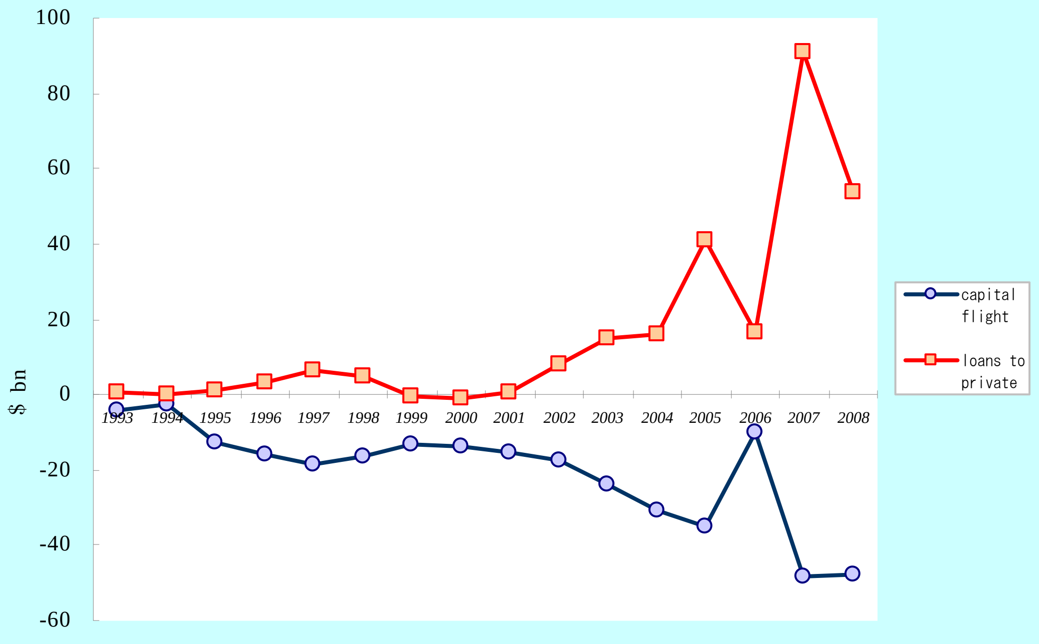
[9] Foreign assets – debts.

Table 7 Net international investment position (end of the year, $ billion)

	2003	2004	2005	2006	2007
Nonfinancial companies	-56	-117	-202	-307	-513
Russia, total	+4	-11	-32	-36	-127

Source: 19 February 2009, www.cbr.ru, Ershov, 2008, p.14.

Figure 2 Capital flight and external loans ($ 10bn)



Note: Capital flight is estimated as the sum of the two line items from the CBR's balance of payment: (1) exports receipts overdue + imports paid for and not received + transfers for fictitious operations in securities, and (2) errors and omissions.
Source: 8 September 2009, www.cbr.ru, Hanson, 2007, p.873.

The Russian private sector satisfied its insatiable thirst for money with foreign borrowing. A large monetary inflow accompanied the following characteristics. Capital inflow constantly accompanied capital flight (Figure 2), and they show a symmetrical trend. The Russian money flowed out via various kinds of paths. For example, purchase of Shibneft by Gazprom (domestic acquisition) was transacted through the international settlement, and offshore (tax haven) areas are often used as the intermediation. Therefore, some parts of money inflow are closely connected with the return of domestic money. The close linkage of foreign money and domestic money is called ‘parallel economy' (Kheifets, 2007).

The economic growth in the 2000s has caused the drastic changes in the Russian economy, and Russia has constantly maintained a twin surplus. However, it is fragile. The economy intensified its export dependence and foreign capital dependence, and the domestic economy regards the global economy as indispensable for continuous growth. The changes mean that the Russian economy intensified its sensitivity to the global economy and the global price (oil price). In short, once the crisis happened, Russia had a predisposition to be seriously affected and contagious.

2. The global crisis hit

The economic crisis began surfacing in September 2008, following the government bailout of the U.S. investment bank Lehman Brothers. While the Russian invasion of Georgia caused a drop in stock prices, it did not directly lead to crisis (Hanson, 2008). Rather, the global stock price decline of September brought about major shock in Russia, and the RTS (the Russian stock exchange) index plunged 17.7% during a week in late October; and the MICEX index also dropped 20% in November and remained down for a month. As of December 19, the RTS fell 74%; and Japanese stocks declined 40%, U.S. stocks 30%, Shanghai (Chinese) stocks 30%, and German stocks 30%. The global crisis spread rapidly. Leading companies like Gazprom marked down their stock prices, and many financial institutions recorded a deficit. The crisis also became evident in financial accounts, which quickly switched from surplus to deficit. The crisis started from a sharp drop in the stock price, which reminds us a collapse of bubble economy. At the same time, the real estate price also declined, and developers and construction companies suffered.

All the economic indicators showed a sharp decline after September 2008. To make matters worse, the crisis penetrated widely, from the financial sector to the real sector.

First of all, repo markets[10] have rapidly grown in the short-term financial markets. Figure 3 shows a vivid increase of repo markets among the financial markets[11]. In the stock market, the share of repo grew rapidly -- more than 300% in the time period from 2005 to 2008. An increase of repo can be observed in all the obligations: stocks, corporate obligations, regional obligations and municipal obligations (Table 8). An increase of repo markets was a natural response to austerity fiscal policy of the government (Delyagin, Sheyanov, 2009, p.95). The speculative economy became a product of the economic growth in the 2000s.

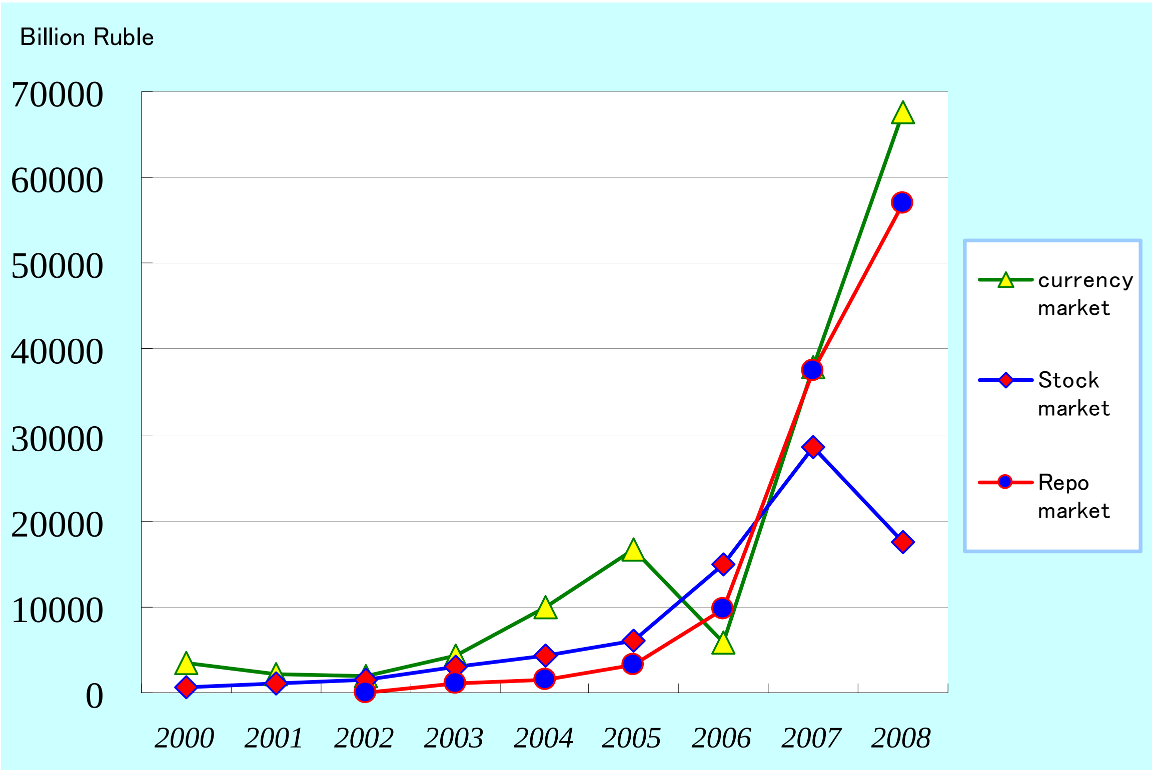
However, the lack of liquidity blew repo markets off in an instance. During 8-15 September 2008, dishonoured Repo markets reached 7.2 billion rubles, of which 7.1 billion rubles were due to ‘KIT-finance’ (Zamaraev, Kiyutsevskaya, Nazarova, Sukhanov, 2009, pp. 9-11). ‘As a result, a chain

[10] Repo is a shortened form of the English phrase ‘Repurchase agreement’, and it means financing based on buying and selling obligations in the definite period. One party lends obligations with money as collateral. One party gets money and the other gains obligations. Repo includes two types: special collateral trade (needs to lend specific obligations), and general collateral trade (needs money with obligations he has).

[11] The year 1997 indicated an extraordinary increase in stock markets and repo markets.

of mutual closed obligation collapsed, and Repo markets started to fall down' (Zamaraev, Kiyutsevskaya, Nazarova, Sukhanov, 2009, p. 11). The crisis set off a chain reaction in various financial markets.

Figure 3 Annual trading volumes in financial markets



Source: MICEX, 9 September 2009, http://www.micex.ru.

Table 8 Repo markets grow (share of repo to the total: %)

	2005	2006	2007					2008		
			Q1	Q2	Q3	Q4	year	Q1	Q2	first half
Stocks	18.3	25.6	32.6	47.6	58.1	56.5	50.5	58.0	62.4	60.3
Corporate obligations	28.0	50.9	64.3	69.7	74.6	72.5	71.2	77.9	77.9	77.9
Regional obligations	28.0	60.0	73.7	77.7	84.5	82.2	79.9	83.8	86.1	85.1
Municipal obligations	31.5	42.1	58.5	67.8	73.9	63.3	66.5	72.2	74.6	73.3

Source: Zamaraev, Kiyutsevskaya, Nazarova, Sukhanov, 2009, p.10.

Moreover, Russian enterprises and banks have largely increased their borrowing from abroad during the period of economic growth; this is accomplished through an increase in the price of petroleum. Their foreign borrowing reached approximately $500 billion, of which $160 billion had to be redeemed by the end of 2008 with an interest of $45 billion. The major enterprises and banks had become debtors: Gazprom ($60 billion), Rosneft ($26 billion), VTB ($21 billion), UC Rusal ($14 billion) and Sevelstal' ($6 billion), among others. Almost all of the large enterprises and banks were financed from abroad, and most of them have financed an M&A transaction and have had a closed connection with the government.

In effect, they borrowed money on their own stocks. For example, Alfa Group was financed via a Deutsche Bank with the stocks of Vimpelcom (44%) as collateral. Seventy-five percent of stocks in SegimoiContinent (supermarket) were held as collateral (*D'Shtrikh*, No.22, November 2008, p. 8). However, when the stock price fell, collateral values dropped in a single stroke. Debtors were obliged to enlarge their collateral or sell their stocks, and margin calls occurred (Shastitko, 2008, p.134). The crisis brought about arrears of banks (bad loans), and the first victims were KIT-finance and Svyasibank (*Profile*, No. 36, 6 October 2008, pp. 26-27). While KIT-finance was bought up by RZhD (45%) and G Alrosa (45%) at a price of 100 rubles, its goal was to prevent the transfer of Rostelecom stocks (40%) owned by KIT-finance to the 'unfavourable' owner. In the end, Alfa Group received finance ($2 billion) from the government, and could evade its loss of Vimpelcom's stocks through margin calls.

The financial institutions were ultimately exposed in this crisis. The crisis in the banking sector can be divided into the following phases: threshold of the crisis in July to15 September 2008, liquidity crisis in 15 September to the end of October 2008, managed devaluation in November 2008 to the end of January 2009, and involvement of bad loans in February 2009 and beyond (*Ekspert*, No. 20, 25-31 May 2009).

At the beginning of November 2008, the total deposits of customers decreased from 78 billion rubles to 39 billion for a month, and depositors withdrew 42% of their deposits. Withdrawn deposits (Table 9) were quickly converted to foreign currency to prepare for the crisis. Such behaviour was similar to that in 1997. In October 2008, the composition of residents' expenditure was as follows: 74% in purchase of goods and service, 15% in compulsory payments and taxes, 0.3% in ruble saving, and 10.2% in foreign currency, where foreign currency doubled during the January-September period in 2008 (5.6%). (*Vedomosti*, 4 December 2008)

Total bank losses were $6.7 billion, and credit to corporations decreased from $93.8 billion to $80 billion from September to October and overdue liabilities (bad loans) reached $8.2 billion, a tenfold increase. Retail credit also decreased by $3 billion (a drop of one third), and bad loans increased by 13 times during the same period.

'The crisis certified failure of the business model in the bank *SvyzInvest*. This bank used the short-term borrowing in the inter-bank markets for the transaction in stock markets and short-term credit to the customers in stock markets' (*Vedomosti*, 28 November 2008). The banks themselves actively participated in the stock markets, and they borrowed money on their own stocks as collateral. Therefore, a decline in stock price was directly connected to bad loans. The crisis hit the banking sector directly. The low ratio of owners' equity, the immature financial markets, and long-term loans using short-term borrowing have amplified the crisis.

Table 9. Changes of saving

	2004	2005	2006	2007	2008（estimate）
An increase of saving (billion Ruble)	468	790	1047	1347	1026.3
An increasing rate (%)	30	39	38.2	35.6	20

Source: *Vedomosti*, 27 November 2008.

Generally speaking, the accurate judgment of bad loans is difficult due to lack of the able evaluators. According to Gref and Yudaeva (2009, p.12), only 26% debtor firms responded that they could pay back debts. As some banks credited the developer, the potential risk loans simultaneously accumulated in the process (Kuznetsova, 2009, p. 9). Even though the Russian banks are generally reluctant to give a loan, the crisis is more severe than its appearance.

The banking sector diffused the crisis. In September 2008, the banks decreased their credits not only to enterprises but also to consumers (retail banking), and a credit crunch emerged. Suspensions of credit led several enterprises into bankruptcy[12], especially those sectors heavily dependent on external communication and manufacturing (*Profile,* No. 40, 27 October 2008). Housing loans and car loans occupied the main part of consumer credits, and a reduction of loans brought about a fall in demand for residences, offices, automobiles and other sectors. Prosperity suddenly turned into an economic slowdown.

The Russian crisis should be considered not only as financial but also as economic. The global crisis caused a global deterioration in demand, and a sharp decline in petroleum price also occurred. Dual pressure of demand (shrinking foreign borrowing and price down of export) functioned in Russia (Delyagin, Sheyanov, 2009, pp.88-93). The Russian economy, with its high dependence on natural resources, is sensitive to the petroleum price, and a decline of that price is linked directly to the business recession and the crisis. The crisis fermented in sectors apart from finance.

The production was diminished by three waves. The first wave was caused by reduction of speculation and expensive credit, and the production plan was forced to stop. Developers had to

[12] Concerning the bankruptcy law, Russian law does not hold article 11 of the USA law, guarantee of creditors in court, rescue of companies by transfer of credit to stocks. (*Vedomosti,* 8 December 2008)

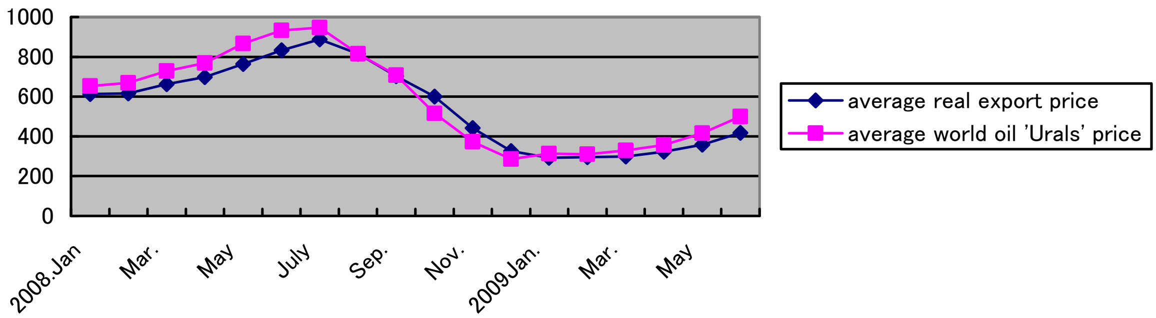
discontinue construction work. A decline in employment and income led to reduced production (demand), and a chain of reduction affected whole the economy. The second wave came from reduction of export profits and the cessation of exporting resources. In succession, the third wave was caused by a decline in the state budget, which started in September 2008 (Delyagin, 2009, pp.188-189).

Table 10 Petroleum price and export tariffs ($/barrel)

	Petroleum Price	Export Tariffs
1 August 2008	121.61	63
1 October 2008	90	59
1 November 2008	59.15	39.4

Source: *Vedomosti*, 27 November 2008.

Figure 4 Changes of export prices in Russia ($ per ton)



Source: *Ekonomika i zhizn'*, No.33, August 2009.

As a result, in December 2008, the positive GDP growth became negative, and the recession is believed to continue in the medium run. In the first quarter 2009, GDP declined by 9.5% (annual base), and was estimated to decline by 8.5% in 2009[13]. Russia is regarded as a case of 'hard landing' (Aleksashenko, 2009, p.4). The crisis from petroleum prices has extended to the real sector and the state sector, which is deeply dependent upon natural resources. The government also reduced export tariffs (*Vedmosti*, 5 December 2008). The price in December 2008 fell to the level not seen since July 2004[14], and this case would bring about financial difficulties in 2009. Petroleum revenue decreased in the third quarter of 2008, and the oil companies experienced a decrease in profits and export values. Moreover, the change in price was too swift to coordinate with export tariffs (*Vedomosti*, 8

[13] A.Kudrin estimated this decline and he considered Russia recovers to the pre-crisis level in 2012 (8 September 2009, http://news.yandex.ru).
[14] Export prices declined from July 2008, and increased from March 2009.

December 2008). (Table 10, Figure 4) In the end, the state budget changed from surplus to deficit (6-8% in 2009).

Construction, development and retail are regarded as the most critical sectors in Russia. According to the government (*RBKdaily*, 20 November 2008), while overdue liabilities accounted for 38% of the total in manufacturing, construction recorded the highest (73%). Moreover, the global crisis has already negatively affected almost all economic sectors: mineral resources, machine-building and metallurgy, chemical, food production, furniture, transportation and others. In the following sectors, the critical shock has been relatively small: telecommunications, cheap goods, financial institutions receiving state support, and big businesses capable of purchasing bankrupt companies. Except mineral resource, the price shock covered metallurgy and chemical production (INSOR, 2009, p.7)[15]. Investment was also discouraged in 2009. For example, oil companies diminished their investment by 25% in 2009 (*Ekspert*, No.20, 25-31 May 2009).

Defaults indicate the critical situation (Table 11). The number and the scale of defaults increased under the crisis[16]. In 2008-2009, there were 125 defaults and 8 defaults of Eurobonds. Particularly, we can observe many cases in the following sectors: commerce, construction, transportation, manufacturing, financial sector, agriculture and others.

Table 11 Defaults of corporate bonds (cases)

	2008	2009.January-April	Total
Defaults total	56	77	133
Refinanced loan	8	18	26
Technical defaults	25	14	39

Note: Defaults of Eurobonds were included.

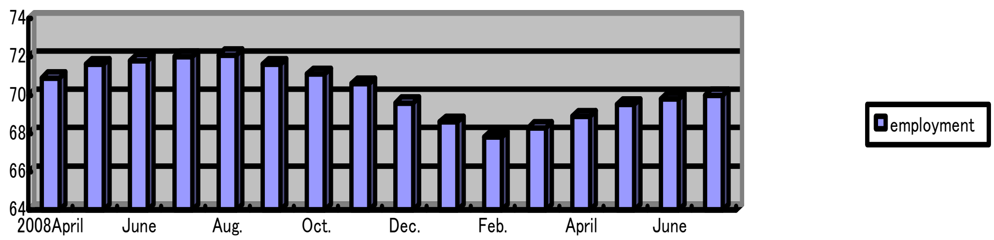
Source: Gnedovsky, 2009, p.27.

The economic crisis extended to labour markets as well. In August-November 2008[17], 11% of large enterprises reduced their personnel, and 34% more were also planning a reduction. At the end of October 2008, the unemployed reached 4.6 million (6.1%) and it reached 6.4 million (8.5%) in February 2009. The labour market shifted from one that was understaffed to one that was overstaffed. Banks cut employee numbers on a large scale, particularly in investment branches where reduction was greater. The MDM bank is planning to cut staff by 40%, and this trend extends to the entire banking sector and investment companies (*Vedomosti*, 1 December 2008). Figure 5 clarifies a sharp decline of employment from August 2008 to February 2009, and Figure 6 indicates a sharp increase

15 The price declined by 33-50% (INSOR, 2009, p.7).
16 Here I show official data, and there were quite more defaults in reality.
17 Ernst & Young (*Ekonomika i Zhizn'*, No.48 1 November 2008).

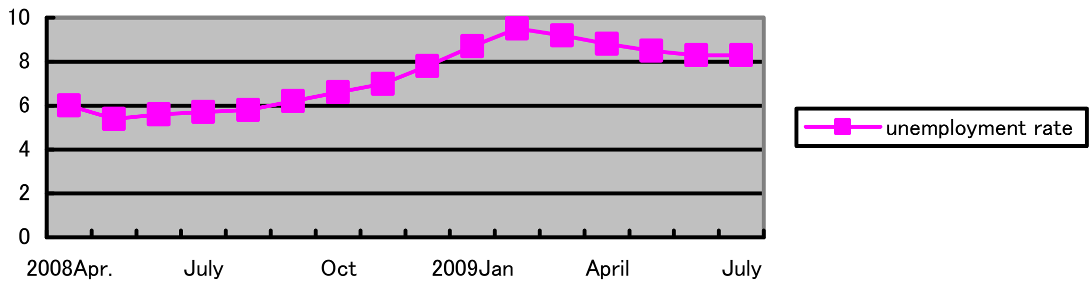
of unemployment in the same period. The social strain worsened by a wage decline, inflation, wage arrears, constraints of consumer credits and others. The collective contracts were revised for the worse, and there was no resistance within the firm. At the very least, the recent shock is estimated to continue for two years (INSOR, 2009, pp.7-9)[18]. As a result, the crisis deteriorated the living standard[19].

Figure 5 Trend of employment (million)



Source: Rosstat, 8 September 2009, http://www.gks.ru

Figure 6 Unemployment rate (%)



Source: Rosstat, 8 September 2009, http://www.gks.ru

The crisis also involves regional gaps. In the company town centred on the metal industry, the corporation crisis extends to a regional crisis. Ural and Siberia are the most critical areas, while the

[18] Unemployment cannot be overvalued as a crisis phenomenon. Unemployment is insufficient to show the business cycle, and the unchanged employment and an increase of informal sector have continued to function (V. Gimpelson, *Vedomosti*, 18 March 2009).

[19] The population with less than subsistence (5083 rubles in the first quarter of 2009) increased from 23 million (16.3% of population) in the first quarter of 2008 to 24.5 million (17.4%) in the first quarter of 2009. Rosstat, 8 September 2009, http://www.gks.ru

southern area is regarded as relatively less critical. Particularly, the enterprise town was regarded as serious for survival in the crisis.

However, after the first quarter of 2009, we can observe some symptoms which signal the end of the panic period. A.Kudrin, the Minister of Finance, considered Russia got out of the crisis in August. I.Shuvalov, the first vice-prime minister also announced a recovery of the economic growth (8 September 2009, http://www.nr2.ru). Oil price increased after May 2009, and the ruble exchange rate seems to be stabilised. Many corporations are restructuring and servicing their debts. The resident house price began to increase. In July 2009, almost all economic indicators were better than in June. Unemployment also declined to 6.3 million (8.3%). In order to judge the perspective of recovery, we need re-examine the content of the crisis in the Russian markets.

3. Outcomes of the crisis: A collapse in the growth factors

The economic crisis is greatly influenced not only by the global economy but also by national specificities. Further, the crisis was contagious among not only the weak economies but also those showing strong macroeconomic performance; as a matter of course, the transition economies and emerging markets became the main target. Therefore, an investigation of the outcome of the crisis in Russia, which had a twin surplus, helps us understand the impact of the crisis on the growth factors (changes under the growth in the 2000s) and the response of economic actors.

Although at the beginning of the crisis, the government did not take any serious measures to address the crisis, when the economy entered into a critical phase, the government changed its attitude. The subsequent dismal economic performance seems to have led Russian economists to describe extreme scenarios. These often included the 'hard landing' scenario[20], which played out as follows: The dominant position of Russia's resource exports would worsen the balance of payments, and a decline in the developed countries would further worsen the performance through a multiplier effect. The deteriorated economy would then result in a large deficit in the state budget, and the government would be unable to rescue the economy. The actual situation is steadily approaching this scenario.

Russia experienced an economic crisis in 1998. The crisis was caused by the issuance of short-term bonds by the government (the so-called GKOs) and worsened by the East Asian currency crisis. The current economic crisis in Russia has some characteristics in common with the 1998 crisis, namely, the impact of a global crisis on the economy and the fragility of domestic markets. In particular, in 1998, non-monetary transactions such as arrears and barter prevailed under a policy of austerity and stabilization, and the government financed the deficit using short-term state bonds (GKOs). In 1996, the sale of state bonds to foreigners was permitted, and the inflow of speculative money triggered the crisis. However, there is a vast difference between the situations in 2008 and

[20] See Aleksashenko (2009) and Mau (2009).

1998: in the 2008 crisis, Russia had a twin surplus and showed a strong economic performance.

Figure 7 International financial flows (1998 crisis)

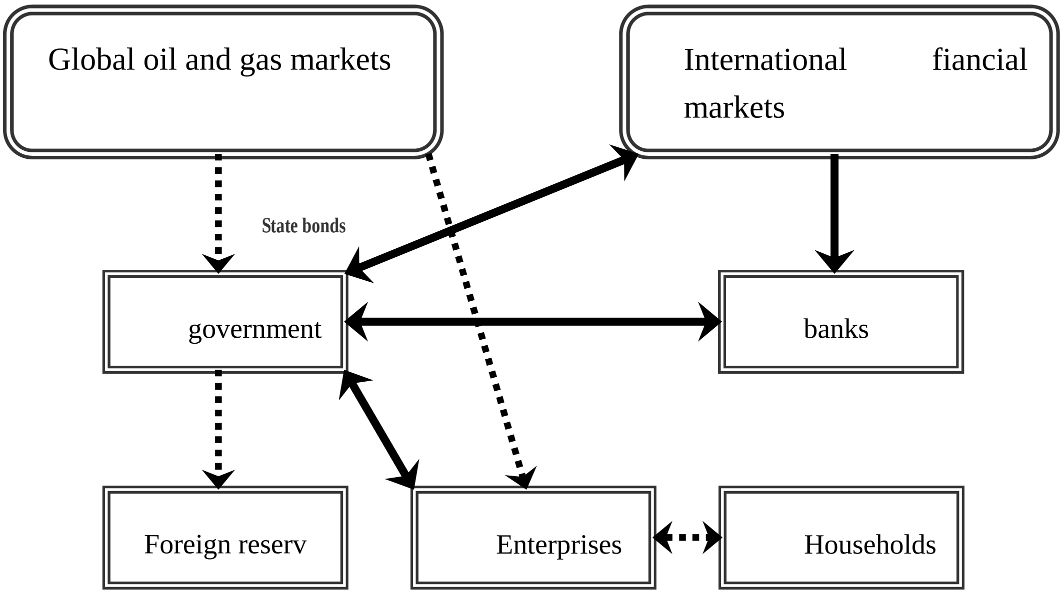
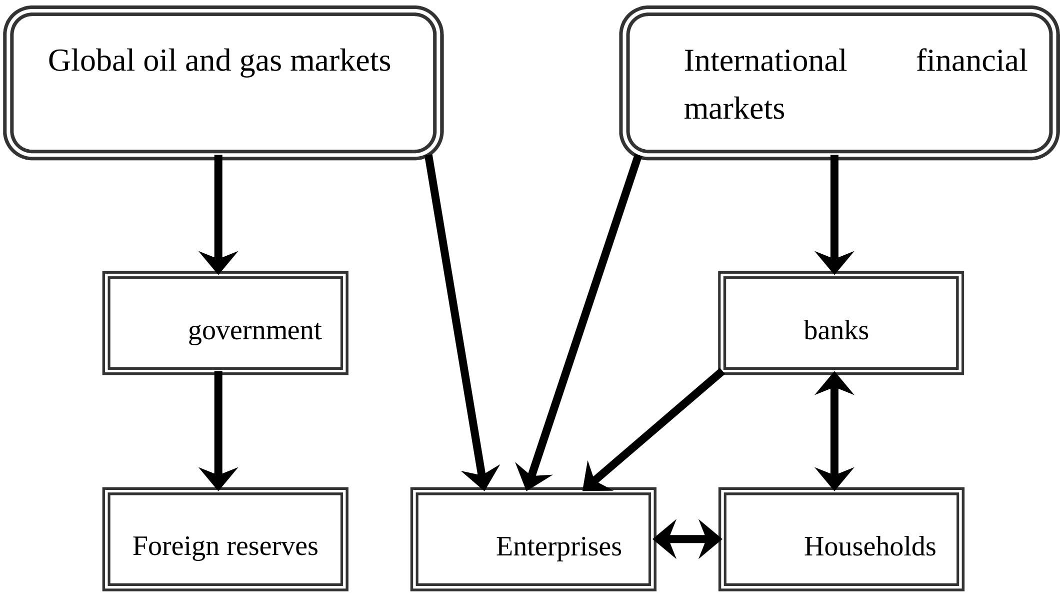


Figure 8 International financial flows (2008 crisis)



Figures 7 and 8 indicate the contrast between Russia's international financial flow and final debtors. In 1998, state bonds became an object of speculation, and the international flow naturally compensated the government deficits. Enterprises increased profits not by bringing about growth in the real sector but by appealing to the government (rent-seeking behaviour) or by purchasing stocks and bonds. The funds did not reach the real sectors, and monetary circulation within the domestic market deteriorated drastically.

In the 2000s, international funds financed the Russian market through IPOs or loans, and the volume of cheap money that poured into the M&A market matched that in Japan. The money was primarily used not for productive investments but rather for speculation and the acquisition of ownership. It stands to reason that the repo markets grew. Credit (including repos) provided to the private sector, excluding bank credit, increased by 18.9% in 2006, 75.1% in 2007 and 124.8% in 2008[21]. In Russia, there were numerous M&As in the energy and metal sectors. Only 20–30% of the M&A funds were internal funds, and external funds became the primary source. The external sources of funds included, among other sources, IPOs, bank loans, financing from investment funds and corporate bonds; the international market supplied funds in demand because of high domestic financial costs. Syndicated loans and Euro bonds increased as well. Moreover, the number of IPOs increased from five in 2004, involving a mere $600 million, to 25, involving a total of $23.64 billion in 2007[22]—a 40 fold increase in the amounts raised. The increase in the number of IPOs also increased stock trading. Moreover, the main major IPOs raising funds were not necessarily from the pure private sector alone. For example, in 2008, the largest IPOs were issued by the electricity company Gazprom and related companies like Gazprombank and Sibur. That is, the debtors were part of the semi-state sector or organizations in which the state participated.

Again, I trace the external debts by debtor type. According to Tables 5 and 6, the pure government sector reduced its debts and the non-government sector increased its debts. This raises the question of who borrowed the money. Table 11 provides a different picture. In 2008, the pure government sector reduced its share and the non-government sector increased its share to more than 90%. However, although the private sector grew in 2006–2008, it still had a smaller share than the non-government sector. The state sector (in Table 12) covers the government, monetary-credit regulation institutions (monetary sector), banks and non-financial companies in which the government and the monetary sector hold more than 50% stake or exercise direct or indirect control. Further, the pure private sector indicates the external debt of the domestic actors, which, in the broadest interpretation, is equal to the total minus the state's share. In addition, large-block shareholders of the state strongly affect the decision making of the private sector. Thus, the pure private sector's share in external debts will further diminish.

[21] From 2007, the repo market was included.
[22] Data from IPO in Russia, Russian market IPO, offering.ru (13 February 2008).

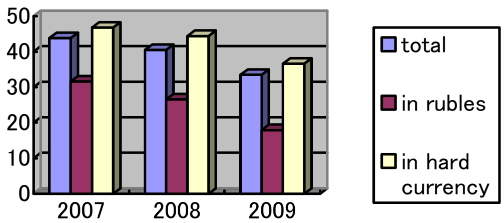
Table 12 External debts of Russia

	Jan. 2006	July 2006	Jan. 2007	July 2007	Oct. 2007	Jan. 2008	July 2008	Oct. 2008	Jan. 2009	April 2009
Total	257.2	288.8	313.2	399.2	437.8	471.0	535.7	548.2	483.5	450.8
State sector	150.7 (58.6)	153.8 (53.3)	137.1 (43.8)	175.5 (44.0)	188.4 (43.0)	190.8 (40.5)	198.0 (37.0)	191.2 (34.9)	161.8 (33.5)	147.2 (32.7)
State organisation	82.1	78.9	48.6	49.0	52.5	46.4	38.9	42.8	32.7	30.1
Banks	19.4	27.4	32.0	54.2	59.2	65.5	78.2	71.2	61.7	54.4
Other sectors	49.3	47.6	47.1	72.3	76.7	78.9	81.0	77.2	67.4	62.7
Private sector	106.4 (41.4)	135.0 (46.7)	176.1 (56.2)	223.7 (56.0)	249.5 (57.0)	280.2 (59.5)	337.7 (63.0)	357.0 (65.1)	321.6 (66.5)	303.6 (67.3)
Banks	30.8	39.3	59.8	76.1	87.7	96.9	113.1	125.2	102.9	90.6
Other sectors	75.6	95.6	116.3	122.5	136.0	156.4	191.8	199.0	186.0	179.7

Note: State sector is defined from the wide meaning which includes not only the state organisations but also banks and firms owned by the state.

Source: 9 September 2009, www.cbr.ru.

Figure 9 Share of state secor in external debts (beginning of the year, % in total debts)



Source: 9 September 2009, www.cbr.ru.

The problem enterprises, which were mostly determined as private sector, must be regarded as the quasi-state, and the government rescued the state sector in practice. Indeed, Mau stated as follows: 'Many debtor enterprises are closely related with the government and behave on the logic of "privatization of profits and nationalization of deficits". In the financial markets, the actors know well that the private debtors can be based on the support from the federal budget in the crisis' (Mau, 2009, p.10). In short, the moral hazard is shared between business managers and state bureaucrats in the sense that the private sector is under state control and follows the principle of 'privatization of profits and nationalization of deficits'; Mau has termed this structure 'Chebolization' (Mau, 2009, p.11). Moreover, since the main debtors control strategic assets—such as energy and natural resources—that are strongly affected by the exchange rate, the state is motivated to support the quasi-private sector. This is why the government intervened when margin calls occurred. Thus, the crisis under the twin surplus was connected with the specificities of the Russian enterprises and markets.

While the anti-crisis policy may well be Keynesian in nature, the emergency measures have taken on a socialist character[23] or dirigisme character[24]. The anti-crisis policy of any country is unique to the country's situation and has different outcomes for the economic actors. The policy in Russia was based on the strong hand of the government, and is in continuity with that of the pre-crisis period.

The anti-crisis measures in Russia can be divided into two stages. In the first programme of November 2008, the goal was to stabilize the financial situation, and the main focus of the policy was on issues such as accessibility to financial resources, relaxation of business burdens, improvements in social results, stimulation of labour markets, stimulation of domestic demand and support to SMEs; the total outlay was estimated to be 9,024 billion roubles (17.5% of the GDP). The most striking measure was the support provided to big businesses, particularly those in sectors such as automobile, agricultural machines and oil and gas. Protectionist measures that were based on populist principles—for example, an increase in custom duties—were also adopted.

In the second programme of June 2009, the government placed emphasis on social responsibility and the linkage between the anti-crisis measures and long-term projects[25]. This is why the programme is regarded as an anti-crisis modernization programme. The total outlay was estimated to be 9,692.2 billion roubles (24% of the GDP)[26]. The government prioritized the following issues: (1) social security, including employment, pension system, housing, etc.; (2) the development of production and technological potential by increasing efficiency; (3) the activation of domestic demand for Russian products using state investment and state order; (4) the stimulation of innovation and structural reorganisation; (5) the creation of an advantageous condition for economic growth by reforming market institutions and promoting SMEs; (6) the formation of reliable financial markets and (7) macroeconomic stabilization and reliance on domestic and foreign investors. Because the measures focused on providing support to minimise risk, there exists the risk that inefficient enterprises will survive (soft-budget constraints)[27].

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[23] Mau (2009) discusses the following three concepts, which are related to each other: dirigisme, which includes central management of bailed-out banks; socialism (socialization of risk), where the government assumes the risk of the private sector; and populism, which includes support to manufacturers.

[24] INSOR (2009) divides the policy into three basic types (dirigisme with direct governance, liberal scenario by natural selection and liberal-dirigisme scenario); the first type was regarded as the real policy.

[25] The Russian government protested against the pessimistic estimations of the World Bank and the OECD (*Kommersant Gen'gi*, No.31, 06–12 April 2009).

[26] The revenue in the budget amounted to 6,713.6 billion rubles, and the deficit, to 2,978.4 billion rubles (7.4% of the GDP) (*Vedomosti*, 18 March 2009).

[27] See Kornai (2009).

Among various measures, the government increased its influence through increased holdings, and this policy can be regarded as a continuing one. Until the global crisis, the government enhanced 'nationalization' by exercising strong control, and strategic industries (enterprises) were specially targeted to increase the Russian economy's growth and security[28]. In practice, 'state control over economic activity is pervasive', and the government increased its stake in strategic enterprises to a controlling or blocking level. An OECD report stated as follows: 'The number of majority stakes of the federal government increased from 25% of the total holdings in 2005 to 61% in 2008[29]. The state-owned enterprises are found in ubiquitous sectors, while banking, infrastructure, oil and gas, telecommunication, utilities and transportation sectors are dominant. A related development is the emergence of large state-controlled conglomerates, which have in some cases been established through the consolidation of existing SOEs' (OECD, 2009, p.132). Further, the government has also established 'a number of state corporations that have the special legal status of a non-commercial organization and are not subject to the Bankruptcy Law nor controlled by the Audit Chamber of the Russian Federation' (OECD, 2009, p.132)[30]. For example, Rostekhnologii acquired the stocks of 246 open joint stock companies, and at the beginning of June 2009, the debts of this corporation amounted to 800 billion roubles (*Ekonomika i zhizn'*, No.24, June 2009). The state sector increased its share of assets in the banking sector from 46.5% in September 2008 to 54.3% in April 2009 (*Ekspert*, No.20, 25–31 May 2009).

Table 13 Main indicators of VEB (end of year, billion rubles)

	2007	2008
Assets	540.5	1597.2
Credit portfolio	352.1	1061.6
Net income on interest	4.1	20
Operational expenditure	4.6	14.3
profits	6.4	6.4

Source: *Vedomosti*, 4 June 2009.

The anti-crisis policy has been implemented not only by the government but also by state organisations. The External Economy Bank (VEB: VneshEkonomBank) occupied a dominant

[28] In May 2008, the federal law on 'Procedures of Making Foreign Investments in Business Entities of Strategic Importance to National Defense and Security of the State' determined 42 strategic sectors, among which were defense-related sectors, high-technology and dual-purpose sectors and public communication sectors. Foreign ownership in these sectors was restricted to minority stakes (OECD, 2009, p.149).

[29] According to Troika Dialog, the share of market capitalization in the Russian equity market controlled by the state has increased from 24% in 2004 to 40% in 2007 (OECD, 2009, p.133).

[30] Deposit Insurance Organization (December 2003), Development and External Activity Bank (May 2007), Rosnanotekh (July 2007), Rostekhnologii (November 2007), Rosatom (December 2007), Olimpstroi (October 2007) and the Fund for Assistance in the Reform of Housing and Utilities (July 2007).

position in the financial markets and invested 155 billion roubles from the Fund of National Welfare for the acquisition of stocks (*Vedomosti*, 4 June 2009)[31] (Table 13).

After the M&A market shrank in 2008 due to a lack of liquidity, the government led the market and consolidated its shares. Above all, the banking sector acquired the largest share in the M&A market, and the main aim was not aggressive expansion but rather business survival. During the crisis, many firms were sold at token prices, for example, KIT-finance was sold for 100 roubles. Such cases were also pushed forward by the VEB (Svyaz' Bank, Globeks Bank). However, although the prices were low, buyers had to spend large amounts of money to restore many of the assets (Kuznetsova, 2009).

In addition, the government focused on the selective support of big businesses. The government designated 294 companies as System-formation Enterprises, and these companies were supported and subsidized along with approximately 1,000 defence enterprises[32]. Town enterprises had also become targets of state support. The process tells us that strong lobbying for state support was the norm and that it was difficult for SMEs to receive support[33]. The main sectors to receive state support were as follows: automobile and agricultural machines (190–200 billion roubles) and the defence-industrial complex (approximately 180 billion roubles) (GU-VSE and MATS, 2009, p.26). Therefore, as seen from procedures prescribed by the anti-crisis policy, the policy has the characteristics of an industrial policy and is mostly comprised of voluntary selective measures[34].

Through its policy, the government redistributed and consolidated enterprises[35]. Before the beginning of 2008, the government consolidated more than 40–45% of the stocks of Russian companies; through the anti-crisis programme, its share increased by 9–10% (INSOR, 2009, p.13). Faced by the global crisis, which changed a growth economy with a twin surplus to a recessionary economy, Russia enhanced the basic structure (government governance) of the twin surplus.

However, GU-VSE and MATS (2009) are sceptical of the effectiveness of the anti-crisis policy: 60% of the measures have a weak effect, and the compensation character is strong. Moreover, the policy has exacerbated the negative aspects of the economy such as the worsening of competition; the continuance of distrust between businesses and the government; an immature civic society; and the existence of asymmetric information between business, the government, and others. Meanwhile, El'vira Nabiulina—the minister of economic development—deliberately announced that the government sought economic diversification and that the economy cannot be state controlled

[31] In January 2009, the VEB carried out a third of the transactions in the financial markets (INSOR, 2009, p.13).
[32] To choose the 294 enterprises, at the end of February 2009, 144 enterprises were screened and state guarantee for automobile manufactures was determined (*Vedomosti*, 16 March 2009).
[33] The government cannot manage the enterprises due to a lack of transparency and corruption. Delyagin, Sheyanov (2009) criticized the government business and the list.
[34] The minister of finance admitted that even the system-formation enterprises bankrupt due to a lack of support (*Sliyaniya i pogloscheniya*, No.4, 2009).
[35] *Bazovy Element* sold its bank to Gazprom for a token price, and the VEB gained 20% of Rosbank (INSOR, 2009, p.13).

(*Vedomosti*, 4 June 2009)[36].

Because the crisis brought about difficulties for all economic actors, the social aspects can be regarded as a key point. Many focused on the increase in unemployment[37] and decline in regional economies. We can examine another case of nationalization (*Vedomosti*, 29 April 2009). The government recommended an anti-crisis programme including work share, reduced working hours, job support, etc.

The following phenomena can also occur: Employment shows a weak response in the face of the crisis, which reminds us of the situation in the first half of the 1990s. The informal sector expands and supports employment. Incomplete employment has increased in this crisis. In contrast to Japan, where irregular employment has become the main regulator, in Russia, the elasticity of employment is very low (*Vedomosti*, 18 March 2009). Job vacancies have been decreasing.

In practice, wage arrears increased after the crisis. The total amount of unpaid wages reached 8.779 billion roubles at the beginning of June 2009 (*Ekonomika i zhizn'*, No.24, June 2009)[38]. In the first quarter of 2009, 8,835 public organizations and 2,005 legal persons were fined for unpaid wages, which increased by 35% since the first quarter of 2008. The state inspectors disclosed 32,989 illegal cases of payment in the first quarter of 2009. Moreover, it is believed that non-monetary transactions were revived. Barter and mutual settlements emerged in the timber manufacturing, construction and distribution sectors. For example, agricultural firms paid wages in kind, and these payments were based on agreements with employees (*Vedomosti*, 18 March 2009).

The total number of cases where work hours were reduced reached 1.55 million in May 2009. Such cases were particularly found among town enterprises (*Vedomosti*, 8 May 2009). According to Rosstat, reductions in work hours through initiatives by employers jumped from 594.6 thousand in December 2008 to 1.01 million in February 2009; however, since February 2009, the number has been decreasing. At the same time, temporary holidays were also utilized to adjust work hours. Such adjustments can be frequently found in the manufacturing and construction sectors (28 August 2009, www.gks.ru).

The above adaptation and state intervention indicates the robust foundation of the Russian society, where the relationship between the state and businesses is paternalistic and the economic actors (enterprises, regions and stakeholders of enterprises) exhibit specific behaviours when adapting to a crisis.

4. Causes and the significance of the crisis in Russia

The global financial crisis has revealed itself in the form of 'subprime problems', and various factors

[36] She estimated that the share of bad loans had reached 10–30% of the total from the global standard.
[37] Vladimir Gimpelson criticized that unemployment was unnable to convey accurate information on the crisis in Russia. (*Vedomosti*, 18 March 2009)
[38] Overdue unpaid wages amounted to 6.478 billion rubles (28 August 2009, http://www.gks.ru).

have contributed to this crisis. The following factors have been pointed out: the structural crisis of the ‘New Economy (service sector, asset based economy based information technology)’ and financial deregulation; overheated investments and the housing bubble; lack of liquidity and the credit crunch among financial organizations; mistakes made by the US government and Federal Reserve Board (FRB); market failure through securitization and the increases in the securitization risk; the uncertainty associated with derivatives; credit expansion through deregulation and uncontrolled financial technology; global inflow of excess money into forward markets (deterioration of the real sector by price jumps and the outflow of funds); the linkage between uneasy psychology and panic; the real sector crisis stemming from a demand decline caused by drastic decreases in stock prices and the adverse wealth effect; a decline in investment, consumption and employment; an upturn in the interest rate from credit risk (monetary constraints); and others[39]. In addition, there is a vicious circle that links the real sector crisis to the financial crisis. Mau (2009, pp.7–10) classifies the causes of the crisis into three categories: (1) the root factor of the inadequate financial policy of the US, (2) fundamental and systematic factors such as the very aggressive growth-oriented policies of developed countries and the development of financial technology, and (3) factors specific to Russia. From the perspective of global capitalism, the flow of global finance has changed,[40] and economic growth has become a key factor in the crisis.

The Russian crisis expresses the contemporary crisis as a twenty-first century crisis (Hirata, 1999, p.iii). First, the international transfer of large amounts of private funds occurs on a global scale, and these transfers form a link between countries. Second, the role played by the IMF in global affairs is deteriorating. Third, liberalization and deregulation have weakened the financial system. Fourth, heavy dependence on external funds has a harmful effect on enterprises, leading to enormous debts and large-scale defaults. Moreover, the instability is amplified by the frequent transfer of short-term funds for the purpose of risk avoidance.

The crisis testifies to the fact that Russia is closely involved in the global economy and the international financial market. At the very least, price controls for petroleum did not originate in Russia, and financial transfers determine the health of the Russian economy. Cheap money easily flowed into Russian markets. The large amount of oil money with the subsequent price jumps has also resulted in surplus money in the global market, where advantageous investment destinations are constantly sought after. A synchronized recession not only prohibits decoupling of the crisis but also indicates the strong spill-over effects of the crisis. Russia experienced both success and failure as a result of not only the effects of the direct financial sector but also those of the price of petroleum.

At the same time, the crisis indicates the periodicity of business fluctuations (Aleksashenko,

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[39] Based on the following papers: Grigor’ev and Salikhov (2008) *Nihonkeizai* newspaper (16–19 December 2008), lecture of V.Kuznetsov on ‘the global crisis and Russia's economic development: key issues and implications for economic research’, KIER Research Seminar (9 January 2009).

[40] The surplus money flowed from developing countries to developed countries.

2009, p.4, INSOR, 2009, p.4), and from the perspective of the synchronization of the business cycle with global capitalism, Russia has already completed the transition period. The synchronization of a crisis is not the same as the homogeneity of a crisis. Mau regards the contemporary crisis as a reflection of both the old and new crisis. In Russia, the soft budget and financial policy has lead to inflation, and the ensuing Russian crisis is characterized by stagflation (Mau, 2008). This process differs from that in developed countries (Mau, 2009). Owing to the relationship between price changes and economic growth, the 2008 global crisis was characterized by a combination of depression under deflation with stagflation. Resource dependence strengthens the inflation trend.

As a result, anti-crisis measures are partially common to all countries. The typical measure is state intervention in the economy, which includes state control on individual enterprises and banks, socialization of risks, nationalization and capital injection and protectionist measures. The latter includes support to the consumers of domestic automobiles. Except for the strong control of the government on the private sector, the Russian measures do not have any special characteristics.

Concerning the international spillover of the crisis, the IMF has focused on not only the relationship between developed countries and emerging markets but also country-specific factors. The latter includes channels for economic and financial linkages and the fragility of domestic financial institutions. In Russia, country-specific factors cannot be ignored.

In order to investigate country-specific factors, I will start with a historical comparison of crises in Russia. In Russia, a crisis does not occur once in a hundred years but rather once in ten years. At the very least, 1992, 1998 and 2008 are memorial years of crises in Russia; moreover, the three cases have unique backgrounds and causes. In particular, the political situation vastly differs in each case. Tables 12 and 13 illustrate the differences and similarities.

First, the depth of the crisis and the economy’s adaptation to it was determined by the political situation. That is, the state’s failure triggered the crises in Russia. In 1992 and 1998, the instability of the government inadvertently introduced a global shock[41]. In 1998, the mismanagement of GKO culminated in a crisis. In 2008, the mismanagement of CBR came to light (Aleksashenko, 2009, pp.7–8). An unbalanced macroeconomic policy (which did not manage inflation or control hard currency) created an overheated economy, and ineffective financial supervision destabilized the domestic financial markets. A twin surplus reduced the significance of institutional reforms. Lacking a policy for diversification, the government restricted foreign investment in the economy.

Second, despite the striking differences between each stage, the fact that Russia is a resource- and energy-abundant country is regarded as a key factor when characterizing the causes and outcomes of the crisis. O.Dmitrieva regarded the resource based economy as the fundamental factor of the current crisis, and the business situation was inevitably influenced from the developed consumption countries (Ershov et al., 2009, p.14). A severe drop in oil prices deteriorated Russia’s

[41] See Ershov (2008), Grigoriev and Salikhov (2008), Aleksashenko (2009).

economic performance, and its dependence on the external market increased in the process of economic growth. This characteristic indicates the following similarities. First, increased capital flight made foreign currency management more difficult. There was excessive sensitivity to the global financial markets, and the exchange rate became very high. Second, the government relied heavily on the oil and gas sector for its revenues. Third, a relaxation in the restrictions on capital transfers increased dependence on foreign capital. External capital became an organic component referred to as the parallel economy (Kheifets, 2007, p.54), and a capital outflow of funds brought in by foreign investors caused the collapse of the capital markets. A heavy reliance on foreign capital destabilized the capital markets (Ershov, 2008, pp.15–16). Fourth, the supply capability of crude oil has lost its effect as a decisive determinant of the price of petroleum and petroleum-based products, and financial operations have become the main factors in price making. In particular, in the 2000s, the forward market has expanded and speculation has intensified (Gaidar, Chubais, 2008, pp.10–19). Under the financial crisis, speculative funds rushed into the crude oil forward market; in July 2008, the price reached $147, which was ten times higher than that in the 1990s. In short, the fragility of the Russian markets strengthened under a twin surplus. Finally, Russia spontaneously created and imported a distorted bubble economy based on cheap international money and oil money. In both cases, with energy dependence in the backdrop, the Russian economy had been deeply involved in global financial relations.

Thirdly, the specificities of Russian market institutions multiplied the fragility of the market. The market was segmented due to its monocultural structure, the failure to diversify and the presence of regional gaps. The fragility of the domestic financial market made financing more delicate (Grigor’ev, Salikov, 2008). The domestic monetary circulation of savings in the market has been insufficient because of the low capital rate offered by banks and immature corporate bond markets (INSOR, 2009, p.5). The strong hand of the government strengthened its monopolization. Moreover, the speculative character of business administration has been strong. Mizobata (2008, p.21) concluded that IPOs have not brought about an increase in investments; indeed, M&As and an increase in the current capitalization value have encouraged managers to speculate. For example, the enterprise group *Bazel* has adopted an enlargement policy based on M&As. This group has the following characteristics: the organization of a complex ownership structure with offshore companies, linkage with the government, a competition-restrictive M&A policy, distorted funds for M&As and a lack of transparency. Pure profits were paid to the individual owners as dividends, and they were used for funding the M&As. The above characteristics can be observed in many big businesses. Opaque ownership and speculative behaviours persist, and these may be regarded as deep-rooted characteristics of Russian corporations. In addition, the following features are peculiar to market institutions in Russia: lobbying and state-business relations, the linkages of business and region-like town enterprises and original adaptation to crises. Although the Russian market initially remained normal in the face of the global crisis, the Russian peculiarities (concentration of ownership in the hands of a few parties, resource-dependent structures, opaqueness of ownership guarantees, and fragile financial markets) clearly exacerbated the crisis and continued to work as an abnormal market factor.

From the perspective of market transition, paradoxically speaking, it can be stated that the Russian transition concluded as a result of a close linkage with the global market as well as the regressive institutional changes and regeneration of embedded institutions. However, the end of market transition does not mean that one needs to build an Anglo-Saxon-type liberal market economy. As far as the state continues intervening and businesses do not lose their paternalistic behaviour, the Russian-type coordinated market will continue to be fragile. The weak competitiveness along with profits from abundant resources becomes a catalyst for crises, and the sustainability of the market institutions is undermined by conditions such as aging equipment[42] and shortage of labour force and skills.

Conclusion

The global crisis has spilled over to transition economies and Russia. Although transition economies (emerging markets) have shown visible evidence of progress in building market institutions, economically integrating into the global market and contributing to the international division of labour, the crisis, for the most part, pushed transition economies into the hard landing scenario.

The Russian economy enjoyed high economic growth with a twin surplus in the 2000s. The government succeeded in doubling the income in a relatively short period. The growth was accompanied by a drastic and distorted economic structure. In the 2000s, the Russian economy relied excessively on exports of energy and natural resources (monoculture) and cheap international money. Superficially, the structure looks similar to that of, for example, a developing country in Africa. Fortunately or not, the global market was full of cheap and surplus money supplied by developed countries. The oil market was naturally selected due to its profitability, and Russia seemed to enjoy the blessings of this advantageous business environment. At this point, Russia was synchronized with the global capitalist business cycle. The growth, however, became a risk factor. An adverse trend in the business cycle (global recession) affected Russia instantly.

The crisis spread from the national economy to local economies and from the financial sector to the real sector. In Russia, the shock may be regarded as greater than that in developed countries, and this shock is expected to continue for a few years.

The outcomes of the crisis in Russia indicate similarities and differences in the crises faced by developed countries. A typical outcome is the strong hand of the state; in addition, some specificities

[42] At the beginning of 2008, the outdated (no longer serviceable) machines occupied 51.1% in enterprises (*Ekonomika i Zhizn'*, No.26, June 2009).

of the Russian market were revealed. As a result, the crisis has a specific significance for Russia. Russia has completed its market transition. Russia liberalized markets to allow global finance, and a parallel economy has become interwoven in its domestic and external markets. Moreover, the anti-crisis programme and adaptive behaviour of corporations were based on the market specificities.

Although after the first quarter of 2009 we can observe a positive recovery sign, the result cannot be considered as very successful. The prospects of state control are unknown, and a means to escape the monoculture (path of diversification) is yet to be discovered. Moreover, the Russian economic system has faced restrictive conditions that have hampered its development and sustainability. Even after the crisis, Russia continues to face a market that is both fragile and robust.

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