

AFTERMATH OF THE FINANCIAL CRISIS IN RUSSIA¹

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Abstract

The Russian economy has a raw orientation. This fact affects features of financial crisis in Russia. While central banks worldwide decreased refinancing rates, the Bank of Russia, in contrast, increased it. In Russia budgetary expenses increase, despite of set of internal problems. In Russia we have both the highest inflation and the deepest economic slump. An increase in retail prices and the some time declined wholesale prices. The "rich" Russian regions have appeared among most suffered from crisis. At the same time the "poor" regions "have not noticed" the crisis, as their budgets exist due to grants from the federal budget, and their own revenue are little.

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1. Introduction

As before, Russia remains a unique enough nation which has evolved in a special way, its economy largely dependent on energy carrier prices. It is unique in many ways, indeed. Thus the financial crisis in Russia was triggered by the bringing of troops into Georgia in August 2008 as distinct from the rest of the world struck by crisis after the US mortgage system collapsed.

This step of the Russian leadership urged most of the investors dominating in the country's stock market to revise the country risk by changing it upwards. As a result, the discount rates of domestic companies' assets were revised as subsequently was the basic cost of the domestic issuers' securities, which decreased.

Had it not been for this military campaign, Russia's financial sector could have for a couple of months remained a safe haven for investors. This has actually been the case over

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the last five to six years thanks to the soaring oil cost that brought high income to the country's state budget – the nation's key investor. It was not until September-October that energy carrier prices plunged, the national budget suffered a dramatic reduction in revenue and the Russian economy faced growing problems. These included, above all, the problem of providing liquidity since the interbank credit market saw a credibility crisis break out between banks.

2. Anti-crisis measures

Basically, crisis control boiled down to the following. The Russian financial authorities increased the amount of resources allocated to the banks as loans and deposits. Three major banks, in which the government had a stake, received the funds earmarked for redistribution in the interbank credit market. Reduction of mandatory banking provisioning rates also enabled the banks to increase the amount of cash. The state budget provided a substantial sum of money to purchase the stock of the most significant companies. This measure, however, proved inefficient as the money spent did fail to prevent a decrease in the capitalization of such companies. As the government reduced taxes for feedstock exporters, it turned out beneficial for Gazprom in the first place. Actually, the leadership was initially intent on providing financial support for the big business only, which included 275 major companies.

Of special interest are refinancing rate transactions conducted by the Central Bank. While central banks worldwide decreased refinancing rates, the Bank of Russia, in contrast, increased it in a deliberate effort to contain inflation processes.

The Central Bank's ruble exchange rate transactions are as well worth mentioning. During a few months, until January 2009, the Bank of Russia's cash interventions helped maintain the ruble-USD exchange rate. Over that period the country's gold and foreign exchange reserves reduced by about \$200 billion [9]. The major Russian companies which were to repay large external debt amounts in December 2008 did it at the previous exchange rate thereby saving some \$10 billion. We can thus compare the nation's losses (\$200 billion) and the resulting savings obtained by some companies (\$10 billion) and assess efficiency of the exchange rate support transactions.

It should also be noted that while many governments worldwide undertook efforts to cut budget expenses, the Russian Government increased them despite the crisis. While the draft 2009 budget allowed for anticipated income reduction, it provided for an increase in expenditure [10]. The authorities wanted thereby to underscore that all commitments (both

social obligations to population and investment project commitments to lobbyists) would be met.

The main Russian problems were reduction of budgetary inflow of taxes. The inflow under the profit tax and surtax were most of all reduced. In some regions they were reduced up to 90% (the Chelyabinsk and Kemerovo areas). As a result the "rich" Russian regions have appeared among most suffered from crisis. At the same time the "poor" regions (republics of Northern Caucasus) "have not noticed" the crisis, as their budgets exist due to grants from the federal budget, and their own revenue (which could be reduced) are little.

In those regions where crisis develops into social protests the federal center was compelled to solve local problems. A bright example is the crisis in the city of Pikalevo (Leningrad region). To force the owners of three largest local enterprises to start again manufacture and to give people work Prime-minister Putin was compelled to interfere personally in the conflict.

The basic tools of struggle against crisis are in the federal center hands, and the regional authorities has a little of powers. Therefore they should strain very strongly imagination to think up. So, for example, mayor of one of cities (the Moscow area) has published the law, that prohibit in territory of its city to say word-combinations «financial crisis». The matter is that some successful local enterprises have ceased to pay taxes, deceitfully approving, that they have become a victim of financial crisis. Having forbidden a word "crisis" mayor expects to stop practice of concealment of taxes.

3. Results of anti-crisis measures

Over the year since the onset of the crisis the most adverse crisis manifestations have been largely neutralized. Yet this is mainly due to the increased feedstock prices in global markets rather than to the governmental measures: liquidity of banks quickly recovered as did operation of the interbank credit market. According to some official sources, we have passed "the bottom of the crisis". However the seeming recovery is deceptive.

In the second quarter of 2009, Russia saw its GDP reduce 10.9 percent on an annualized basis [4]. None of the countries which are universally viewed as world leaders have suffered such a disastrous slump. For example: BRIC: China – growth 7.1%, India – plus 4.1%, Brazil – minus 1.6%. The Big 7: France – minus 2.6%, USA – minus 3.9%, Germany – minus 5.9%, Japan – minus 6.5%. But never 10.9%. As the crisis emerged, prices either froze or began declining in most of developed countries, which is absolutely logical: a decline in demand must result, at least, in slashed inflation. With Russia it is

almost a 12% price growth. India comes next with inflation amounting to 9.3%, yet its economy is growing. In Russia we have both the highest inflation and the deepest economic slump. The reduced production outputs lack any logic whatsoever, given Russia's huge gold and foreign exchange reserves and Reserve Fund. All the more so because physical oil and gas outputs have not decreased.

Yet it is not only the economy that matters. Actually, we can now see three crises going on in Russia simultaneously: business crisis, state crisis and society crisis. It is the combination of these that gives rise to the effects that can be hardly accounted for, like an increase in retail prices with declined wholesale prices.

One of the most important aftermaths of the crisis was a reduction in innovation activities, given that 70% of businesses faced a declined demand for traditional products and only 37% saw their innovative products become less in demand. Moreover, in the crisis the businesses with a considerable innovation output gained a certain advantage because of innovative products being in growing demand [3]. One upside to the crisis is that it has opened up opportunities to businesses of a certain size. Thus major companies employing more than 5,000 staff have gained more advantages thanks to eased competition with imported goods and the current opportunities of import substitution.

The crisis helped debunk some Russian myths about crises. For instance, the one that "every crisis is special" or that "the crisis will bury the US financial system and will put an end to dollar domination". The opinion that "the Russian authorities shouldn't have saved oil dollars in the Reserve Fund" proved unsound as well. It turned out they should, as oil prices falling to \$40 per barrel actually put the nation on the brink of collapse and it was the use of the Reserve Fund resources that allowed the country to avoid a disaster in the fall of 2008 [1].

4. Current condition of the Russian economy

In the late fall of 2009, Russia is facing a shaky balance situation. Thus, for example, companies are planning to lay off the least number of staff over the last year. Most of manufacturers intend to preserve the current staffing level, 12% plan to raise it and 21% consider redundancies [7]. Such an intention to preserve personnel may be attributed to the year's highest value of the parameter "satisfaction with demand" (35%) and to the fact that utilization of capacity has grown to 60%.

The proposed scope of funding for new projects is small as well. Entrepreneurs who had sold their business before the crisis are now biding their time to start a new business [6].

The 2009 trend is “the safety cushion” in the form of cash and a dragged out search for new business. While some entrepreneurs do venture to invest in new projects, they do so spending no more than one-third of their capital.

It may have to do with increased economic crimes. A survey among managers of more than 3,000 companies globally, including 86 leading companies in Russia, found that 71% of companies suffered from economic crimes in 2009 [5]. This is the highest level in the world. The world average figure is 30%, for Central and Eastern Europe and BRIC countries it is 34%. Russia leads the world in the number of economic crimes and frauds have grown in number since the onset of the crisis. Most of fraudsters are employed with major financial companies and the most typical crime is misappropriation of assets.

In 2009, most of Russian companies have suffered from at least one serious economic crime. Bribery and corruption are common for all the industries of the national economy. 48% of all the surveyed companies have faced these crimes in 2009. This figure is twice the average world level. When attempting an offence, criminals believe they are unlikely to be seriously punished. Thus in 2009, 57% of Russian fraudsters were just fired, 23% got off with a warning, while 3% of offenders escaped punishment all together.

In 2009, however, the Russian financial sector has seen the pre-crisis bubble reappear. In the period from January through November 2009, Russian stock indices grew from 624 to 1,324, i.e. by 2.12 times [8]. This may entail new hardships for the financial sector of the Russian economy that has yet not only to overcome the crisis but also to get rid of the negative features that it had as the crisis broke out. And that at the time when the financial crisis itself is burdened with a variety of specific problems aggravated by the crisis. Here are some of them.

5. Conclusions

There was long-standing debate in Russia about what exactly financing model should be adopted as the basic one: either the Anglo-Saxon model based on the priority of financial institutions and shared financing or the German model based on the priority of banks and debt financing. This debate eventually resulted in a duplicated and fragmentary infrastructure of financial markets and a conflicting market regulation system.

The course adopted by the financial authorities gave rise to a symbiosis of a fixed currency exchange rate, super-high profitability of financial assets inside the country and open capital account. Such a structure makes the Russian financial markets rigidly dependent on the world financial environment, including foreign system risks.

The financial sector is not saturated enough with money, financial instruments and institutions. All this leads to Russia's greater reliance on nonresidents' short-term investments, weakened financial resource base and excessive cost of capital. A two-digit cost of capital for businesses and population is exorbitant with the cost of capital in the interbank market of up to 5-7% [9]. The high interest rate restricts access of business to credit resources. The Russian banks' interest margin is one of the highest in the world [2].

Mainly of a nonmonetary nature, domestic inflation remains irresponsible to the traditional instruments. It is extremely high even though it was for a long period of time that Russia had a proficit budget, growing exchange reserves (world's third reserves by the size), positive foreign balance, large-scale national reserve funds and a fixed exchange rate of the ruble that only was issued in response to a currency influx.

And finally, there are some nonfinancial aspects of the financial crisis in Russia and its aftereffects that are worth mentioning. In their response to the crisis, the authorities set a number of very ambitious objectives that are aimed not only to upgrade the country's financial system but also to encourage the state machine to enhance its efficiency [13, 14]. First, a world financial center will be formed in Moscow. Second, the ruble will be given the status of a world reserve currency (regional reserve currency of late). Third, Russian raw materials and power resources will only be sold for rubles. Regretfully, these initiatives are undertaken against the backdrop of the media becoming increasingly unfree and transparency of the financial sphere remaining as low as before.

It is obvious that the financial crisis in Russia remains yet to be overcome; moreover, it has aggravated the previous problems. Given this, an intensive influx of short-term investments, alongside the growing feedstock prices, provokes professional players to undertake extremely risky speculations in the stock market. The latter has no self-regulation traditions, that is, the instinct of self-preservation. The Russian financial sector is most likely in for a long period of very high volatility.

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