Economic Crisis in Russia: Experts' Assessment

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The Economic Crisis in Russia: Experts’ Assessment:

The study lays out the authors’ perspective of how the economic crisis is unfolding in Russia and offers potential state economic policy scenarios. It also proposes some anti-crisis measures as well as an agenda for a public dialogue, which should be pursued to both resolve the current crisis and build the future, post-crisis economy for the country.
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INTRODUCTORY REMARKS

The Russian economic crisis has become significant in scale and requires serious analysis and forecasting. It can now be asserted that the crisis should be viewed as neither an “infection” contracted from Western economies nor a purely Russian cyclical crisis. A combination of significant foreign and domestic factors is casting it in a prominently unique light. Nevertheless, by considering to similar examples from world practice, we can improve our understanding of the ongoing processes, formulate the proper monitoring parameters, identify measures for mitigating crisis occurrences and develop approaches to activate the still “dormant” forces that can be transformed into a locomotive for subsequent economic modernization in Russia.

A series of INSOR roundtables, held in November and December of 2008, was dedicated to these very issues (their topics and participants are listed in the appendix). Among other sources, this report is largely based on the outcomes of those discussions.
Executive Summary

By early 2009 a full-fledged crisis had engulfed the Russian economy, with serious problems emerging in the real sector, financial market and social sphere. The country has entered an industrial recession, accompanied by ruble devaluation, unemployment growth and the suspension of investment programs. Russia’s financial system proved unprepared to cope with the global economic shock of 2007–2008, and Russia followed in the steps of more developed countries, sliding from an acute financial crisis into a true industrial recession.

In the real sector, industrial and investment activity has dropped sharply due to the deteriorating export environment and credit crunch. Restructuring projects in major companies have been put on hold. Delays in payments are accumulating, and prices are falling along with demand. There are increasing tensions in the socio-political sphere with regard to all kinds of obligations, including in budgetary policy, in labor relations, in and among the ruling elite. Expectations and even the values of various social groups are undergoing transformation. Since the end of 2008, the Russian economy has been in a transition to a qualitatively new operating regime. This period’s key parameters will be associated with relatively low oil prices (“the loss of rent from natural resources”), falling industrial production and rising unemployment.

And even though the current processes were sparked by events on the global financial market and the recession affecting developed countries, the degree to which these external forces had an influence was linked to domestic factors. The brunt of the global financial crisis hit the Russian economy just as it was about to engage on a path of modernization. The natural resource industries’ heavy dependence on exports, the fundamental weakness of Russia’s private financial system and its dependence on foreign lending, accompanied by an accumulation of enormous state financial reserves and substantial export of capital, exacerbated the economy’s susceptibility to external shocks. All of these problems could have been partially dealt with during the preceding period of economic expansion, but that opportunity was squandered.

The fallout from the world economic crisis that Russia has experienced so far is likely to continue deepening. It could prove more devastating for Russia than for the developed Western economies due to the country’s high level of dependence on world commodity and capital markets. The Russian economy is facing a full range of challenges, some of which it did not have to deal with in the aftermath of the 1998 crisis and some of which come at a scale unprecedented in Russia’s modern history. Among the most acute are a fall in internal demand, depletion of the state’s financial resources, the upsetting of the balance in inter-budgetary relations, de-institutionalization and increasing state control of the economy, emergence of social instability, etc.
The economic crisis in Russia is quickly turning into a management crisis. The patterns of decision-making established during the period of stable development and massive influx of oil rent are failing in the new conditions. Financial resources are quickly being depleted. The influence of these factors will make the crisis of the stability-based social contract evident as early as the summer of 2009. Furthermore, in an atmosphere of growing uncertainty there is less and less understanding of what the short- and medium-term goals and priorities should be. The price of managerial mistakes is growing, driven by the increased need for “hands-on control” of the economy for which there is neither sufficient experience nor effective implementation tools. On the contrary, the shift itself from market institutions towards “hands-on control” spurs opportunistic behavior by economic entities, and makes the system of state control more arbitrary and chaotic.

The government’s initial attitude adopted between August and October of 2008 was based on confidence in Russia’s ability to survive the crisis and continue sweeping programs without suffering significant losses, thanks to the country’s partial isolation and substantial reserves. This attitude resulted in the government attempting to continue development without introducing serious adjustments to its economic policy, budget or strategic plans. The global crisis, capital flight and devaluation of the ruble required changes to macroeconomic policy and amendments to the 2009 budget (introduced in January 2009).

The set of urgent anti-crisis measures adopted by the government generally passes muster, but in some cases its effectiveness is dubious. The scale of the “anti-crisis package” and quick depletion of hard currency reserves have been met with concern by the world financial markets and have weakened the position of both Russia and the Russian companies in the global market.

Since December 2008 and especially starting in January 2009, consolidation of regulatory measures, along with their systematization and organization, has been taking place. The Russian anti-crisis program is in line with similar measures around the world. From the outset, this presented a “fork in the road”, a key pivotal point with, on the one hand, the clearly defined risks of state regulation and, on the other, the understanding that the contours of the post-crisis economy will depend on the contents of the anti-crisis program. Operating singularly in the “first-aid mode” increases the danger of structural immobilization, and the contraction of the potential for necessary and urgent structural changes. It is vital to retune the system of state regulation and direct it towards designing the conditions for future economic growth. The task is to build a bridge out of the current situation towards the new economic paradigm that will take shape at the end of this crisis.

“Excessive” reaction by the Russian market reflects the fundamental problems of the country’s financial system, its insufficient “adequacy”. Today there is an opportunity to use the current situation to modernize the financial system and increase its ability to withstand external shocks.
Social stability and the unleashing of the modernization potential in the current circumstances could be facilitated by transparent and open dialog between the state, business and all (including the “uncomfortable”) political and social forces in the country. The dialog’s agenda should not be solely focused on anti-crisis measures – dealing with urgent steps to improve the situation in the country – but must also address post-crisis realities. The latter entails modernizing key Russian social, political, financial and economic institutions such as the political system (elections, norms of registration and functioning of political parties), non-profit and self-regulated organizations, federalism, local self-government, the judicial system, and the state’s role in the economy. It is only on this basis that Russia can start building a truly national (and not nomenklatura-driven) program for overcoming the financial and economic crisis that will have a real chance of success.
1. Key impacts of the Russian crisis

The results of 2008 force us to acknowledge that Russia was unable to “survive the storm in a safe harbor.” The full-fledged crisis has affected all spheres of our economy, with serious problems emerging in both the real sector of the economy as well as the financial and social spheres. By the start of 2009, the Russian economy entered an industrial recession that was accompanied by ruble devaluation, unemployment growth and the interruption of investment programs. The national financial system proved unprepared to cope with the global economic shock of 2007–2008, and Russia followed along the path of more developed countries – moving from a financial crisis to an industrial recession. It appears that the Russian economy is experiencing its first full-scale market crisis, which was aggravated by a weak financial system that easily “imported” the shock from abroad.

Since the end of 2008, the Russian economy has been undergoing a transition to a qualitatively new working regime. This period’s key parameters will be associated with relatively low oil prices (“the loss of rent on natural resources”), falling industrial production and rising unemployment. And even though the current processes were sparked by events on the global financial market and recessions in developed countries, the relative weight of its influence was linked to domestic causes and the structure of the economy: the resource extraction industries’ heavy dependence on exports, an underdeveloped private financial system and unresolved economic policy problems.

The government’s initial attitude adopted between August and October of 2008 was based on confidence in Russia’s ability to survive the crisis and continue sweeping programs without suffering significant losses thanks to the country’s partial isolation and substantial reserves. This attitude resulted in the government attempting to continue development without introducing serious adjustments to its economic policy, budget or strategic plans. The global crisis, capital flight and a quick decline of the ruble exchange rate required changes to the macroeconomic policy and corrections to the 2009 budget, which were introduced in January 2009.

The financial sector. Russian’s economic surge of 1999–2008 was based on a reliance on primarily old production capacities and a certain reserve of labor power, which ensured conditions for high rates of growth at low rates of capital accumulation, which stood at 18–19 percent of GDP (only reaching 21 percent in 2007—2008). A reliance on self-financing, the banking system’s low level of capitalization and underdevelopment of the corporate bond market all prevented national savings to be used on a larger scale. Both state and private savings were moving abroad, with these
later recouped through the issue of eurobonds and bank loans that were used to invest in Russian companies.

The main requirements for modernization were not supported by a pragmatic combination of private business and development institutions. In the coming years, a substantial portion of equipment installed in the 1970s and 1980s will become obsolete. This, in combination with the decline in labor resources that is expected in the coming years (the working-age population will shrink by 3.5 million people between 2008 and 2011), makes it essential that investments in the country’s economic modernization are given a substantial boost.

Resources for financing these investments may be raised through both the banking system and its lending mechanisms, as well as directly on the capital markets. These functions are not being accomplished particularly well by the Russian financial system, which is especially evident in cases of complex major projects, which are still moving forward with the help of state or state-company resources.

A number of financial system problems that were first brought up five or six years ago were never resolved during the period of economic expansion. The time for creating institutions and instruments of development, as well as for consolidating national banks and the corporate bonds market, was largely squandered.

Instead of implementing a financial markets model that was aimed at developing the country by focusing on its real problems, instead a system developed that involved the export of private direct investments, the accumulation of states reserves, and the borrowing of portfolio capital abroad (eurobonds and syndicated loans). Rising oil prices ensured higher ratings for Russian companies and banks and a lower a cost for borrowing abroad. Revenue growth was supported by the self-financing of investments and foreign loans. The situation in no way promoted a serious improvement to the financial sector’s institutional base or the development of tools for developing critically important sectors of the economy, including the insurance of access to credit for small and medium-sized businesses.

One of the main imbalances here involves the fact that the non-financial sector’s savings are smaller than its domestic debt. Up to mid-2008, this imbalance was financed thanks to an inflow of capital from foreign markets. But this inflow was soon followed by its outflow. As a result, problems emerged with the banking system, liquidity and financing. In other words, the “forced growth” model that was supported in Russia between 2006 and 2007 sputtered out, as it was based on a “pyramid” structure.

This system flourished as the country’s revenues grew, even further increasing the scale of the national investment process’s “globalization.” Of course, the difficulties of making portfolio borrowings abroad while having no national mechanisms for reinvesting the export revenues made
the country’s accumulation system relatively unstable. Foreign borrowings made through eurobonds and syndicated credits alone reached 100 billion dollars by 2007 – exceeding the amount of capital raised from domestic capital markets by a factor of five.

Unresolved problems of financial system development have already made themselves apparent during the yearlong period in which the crisis was only unfolding. **On the whole, Russia encountered the global financial crisis with large state reserves and a weak financial credit system.**

The opportunities for raising resources to finance investments made in fixed capital fell sharply while the risks of project financing grew substantially. First of all, a financial cycle that was based on the inflow of cheap money failed to stimulate a simultaneous search for efficient utilization alternatives. This resulted in institutions that service speculative money growing at much faster rates than those that service goods and investments made in fixed capital. On the whole, this promoted the creation of Russian economic “bubbles,” although they never had time to grow excessive in size.

Second, Russian big business’s growing integration in the world’s commodity and financial markets resulted in a rapid rise in capitalization. This not only promoted the inflow of cheap money into big business but also the import of “bubbles” that had accumulated in the global financial system.

As a result, as the financial crisis reached an apex, the country’s largest financial groups became completely dependent on the state, having become bogged down by short-term foreign borrowings that were secured by shares, which were rapidly plummeting in value. **The country’s leadership was faced with a stark choice: to either allow the foreign holders of debt to gain control over a vast share of Russian assets or to cover the debts of private businesses.** The choice in favor of the second option gave the state enormous control over the national economy – much larger than any proponents of re-nationalization could have ever imagined.

The exacerbation of the global financial crisis caught the Russian economy in the midst of its transition to modernization. The fundamental weakness of Russia’s private financial system and its dependence on foreign lending, accompanied by an accumulation of enormous state financial reserves and a substantial export of capital, intensified the Russian economy’s susceptibility to external shocks.

Unexpectedly to many, the global financial crisis had an extremely negative effect on the Russian economy. The stock market’s fall was one of the most severe, even among the emerging market economies. The package of anti-crisis measures rapidly adopted by the government involved the infusion of vast sums of money into the economy. However, in some cases, its efficiency remains in question. Moreover, the size of the “anti-crisis package” and the rapid
depletion of the country’s currency reserves sparked concern on global financial markets and resulted in a weakening of Russia’s and Russian issuers’ position on world exchanges. We believe that this “excessive” reaction of the Russian market reflects fundamental problems affecting the country’s financial system, including its incomplete “adequacy.” The current situation must be used to modernize the national financial system and improve its resistance to external shocks.

The Russian stock exchange’s weakness and dependence on speculative foreign capital were first reflected by the indexes’ continued growth through May 2008, and then by its nearly uncontrolled fall the following autumn. There is nothing unusual in this for a country that relies on commodity and energy exports. But when combined with the extremely small trade volume enjoyed by the country’s leading companies, and the absence of national class of individual shareholders who could make long-term investments, neither foreign nor even our domestic investors could be expected to withstand such an unfavorable environment for long.

Amid a yearlong liquidity crisis, our banks never were able to obtain resources from the country’s financial authorities that could compensate for the “lost” cheap resources from abroad. Only the need to rescue the payment and lending system forced the government to make wide-scale cash infusions. Combined with a higher rate of deposit insurance, these infusions helped stave off a mass outflow of cash resources from the banks. Nevertheless, the quiet rehabilitation of several weak banks with the help of state banks was an expensive undertaking. By the end of the year, the number of loans issued to private citizens and the country’s businesses was falling, paving the way for an economic recession.

The real sector experienced a sharp drop in both production and investment activity across most sectors of the economy in the fourth quarter of 2008. A deteriorating foreign economic climate and difficulties in obtaining debt financing led to production plan and investment program cutbacks. Major company reorganization projects were grinding to halt. The country began to encounter late payments, falling demand and lower prices.

Foreign demand shrank and a substantial part of the country’s metallurgy, timber-processing and other export-oriented industries reduced their production volumes. The greatest price shock was experienced by the country’s metallurgy and chemical industry enterprises – in a span of three months (September-November), their prices fell by a factor of 1.5–2. Construction, automobile manufacture and retail trade began to encounter difficulties resulting from reduced financing, including a drop in consumer lending. A rise in the price of these industries’ products, which was seen in the preceding years, was largely spurred by the inflow of cheap money into the economy. To a certain extent, this rise in prices bore the characteristics of an inflating “bubble,” although it...
never had the time to balloon out of proportion. As a result, one of the first reactions experienced by the real sector of the economy involved a sharp drop in the price of its products.

Table 1. Industrial Production Activity by Industry, 2001–2008

(% of previous year’s activity)

![Graph showing industrial production activity by industry from 2001 to 2008.]

Source: Federal State Statistics Service of the Russian Federation, the Institute for Energy and Finance

What should be expected of enterprises amid a drop-off in production demand? Surveys of company executives show that they are ready to reduce costs – which represents the most adequate and progressive response – and accept barter trade, promissory notes and a cross-cancellation of debts. They are also ready to lower prices and production volumes, search for new sales markets and reduce wages. **For now, matters of serious business reorganization are being delayed, despite the fact that only such measures can ensure post-crisis development.**

We have also witnessed a palpable crisis of confidence. Interest rates for all types of lending are on the rise. There are appreciable problems associated with an interruption of payments for orders, a shortage of working capital and an accumulation of debts before both contractors and suppliers. Expectations of further staff reduction remain high. Meanwhile, many irrational – and, in many cases, even rational – expenses are being rolled back. On the other hand, one important observation involves the fact that this process has “overshot” somewhat: much of what is being said
about the crisis is actually an exaggeration. Economic agents are altering their obligations before their partners “on the sly,” citing the crisis in order to hoard their liquid resources and assets with the aim of finding their bearings, preserving resources to get through the difficult times and later enjoying subsequent growth.

Using the guise of the financial crisis, many enterprises are eliminating their so-called “staff ballast.” Enterprise executives are unilaterally reviewing their collective bargaining agreements, cutting back their social guarantees and various incentive payments, and putting pressure on trade union activists.

However, the main problem involves investment. During years of strong economic growth, the price of investment goods rose at almost the same pace as economic expansion. This meant that there was almost no real investment growth. And now, this trend is only growing worse.

The economy has not been functioning efficiently in recent years, as inefficiency was easily financed by the inflow of natural resource rents. For this very reason, during times of crisis, the options are either to spend more money to ensure that the economy recovers and revives, or to otherwise redouble efforts toward improving economic efficiency (which would be required in either case, but which are unable to achieve fast results).

**Excess real sectors costs were being paid for and stimulated by the inflow of cheap capital.** The negative influence of cheap money became further manifested through the mothballing of institutions of small and medium business development that are associated with judicial reforms, transparency measures and financial control. Moreover, during the past four or five years we witnessed the outpaced development of institutions that supported the expansion of big business into the world economy, which in turn promoted relative discrimination against businesses that operated on the domestic market.

*The social and political sphere* is also beginning to encounter growing pressures across the entire range of existing obligations, particularly those concerning the budget sphere and labor relations; relations both between and among the elites are changing, as are the expectations and even the value reference points of the various social groups.

The difficult financial crisis (which has included inflations and a drop in the ruble exchange rate) provoked several additional negative impacts at the early stages of the economic downturn. This not only involved mortgage rollbacks, which began in 2007 and were quite apparent even before the first financial shock of September 2008, but also the undermining of consumer loans and flight from the national currency. In the fall of 2008, this become manifested in Russia through a **flight to goods** – for a certain period of time, consumers still kept up their level of purchases even once their incomes were undergoing an obvious and substantial decline. This effect continued for a
short period while families tried to use up their devalued savings to make purchases before inflation sets in. The rise of unemployment and fall in family incomes will become more pronounced in the future. In Russia, this consumer “flight” into durable goods, which was accompanied by both a switch in consumer demand in favor of domestic sources as well as state cash infusions, resulted in almost no change in industrial production in December 2008, which is a very rare occurrence under such conditions.

The crisis has already begun to affect regional budgets. Revenues forecasts are not being met in many regions due to the onset of declines in production. Revenue growth rates began to decline in August and had fallen sharply by November. The regions believe that they are facing a very serious risk of budget revenue shortfalls in 2009 that could reach 20 to 30 percent of projected revenues.

Unemployment is beginning to grow while the number of job vacancies announced by employment services is starting to fall. But for now, employers have expressed a preference for switching to part-time employment. Wage arrears are beginning to grow. Enterprises are switching to double-shift and single-shift operations. Workers are being sent on unpaid or partially paid vacations, transferred to reduced workweeks or assigned to other types of part-time labor. Bonuses and other rewards are being cut back, with companies further deciding against staging corporate holidays.

It is likely that the economic crisis will lead to a rise in labor code violations. At the same time, one must keep an important feature to the Russian labor market in mind: the non-payment of wages is punished much less severely by the law than improper firings.

The situation on the labor market has not turned acute yet. Enterprises are in no hurry to release workers. This is associated with the fact that employers encountered serious problems hiring workers in 2005—2007, in other words, in a period of stable growth. They fear wasting this potential today. It is tremendous difficult to assembly a new team from scratch – this requires time and enormous expenses. Moreover, according to surveys, enterprise managers still believe that they are paying their workers low wages.

In the future, Russia could see an outflow of labor forces from the regions due to the labor market crunches experienced in Moscow, Saint Petersburg, Novosibirsk and other cities that are attracting workers.

Most of the world’s crises began with a deterioration of consumer expectations, which were accompanied by cutbacks in consumer spending. Very often, these were followed by wage growth outpacing productivity. This leads to a rise in individual labor costs and a drop in the profit margin. The same thing happened to our economy in recent years – the outpaced growth of wages, in hard currency terms, when compared to labor productivity. Individual labor costs, meanwhile, grew at
unprecedented rates: when expressed in euro-dollars terms (50/50), these went up by about 20 percent a year. This had never happened before in any other country in the world, including the Commonwealth of Independent States (CIS) nations. In this respect, a crisis was brewing: it was quite expected.

Citing other causes of the crisis, one may also highlight the inflow of cheap money into the Russian economy. It was thanks to this cheap cash that the government was able to easily build up its expenditure commitments to budgets at all levels. Big business, meanwhile, exhibited heightened demand on the domestic market, which led to an overpricing of wages and accelerated consumer demand. The skyrocketing demand for household products was further supported by aggressive loan offers, which in turn were fuelled by an infusion of cheap financial resources. Accordingly, the maximum potential effect of the crisis on the social sphere is about the same as for the previous items – a rollback to the level of fulfillment of social obligations provided some four or five years ago.

For many, the crisis came as a surprise, prompting a chaotic response. This makes everyone now interested in forecasts – what is going to happen next, how will the events unfold, what are the possibilities.

The behavior of all economic agents – the state, business groups, households and regional authorities – is currently being built on a deep uncertainty about how the crisis is going to further develop. First and foremost, this concerns uncertainty about when the “crisis climax” will finally arrive and how difficult it will be. There is also little clarity about how a “chain reaction” may spread across the economy. Different agents develop very different and rapidly changing expectations concerning potential crisis scenarios. Strategies and adaptation instruments are not being calculated in advance, which is exacerbating the already grave uncertainty.

Most of the crises that have affected the world economy were linked to so-called “bubbles” on the various markets. Global markets, particularly the financial and natural resources markets, have developed these “bubbles” today as well. The scale of these “bubbles” has not yet been assessed, but neither have they disappeared on their own. The risk of future collapses in the global economy is fairly high. This is the main factor responsible for the uncertainty of any forecast.

The global crisis has only just begun. But it already looks systemic. Over a period of just a few months, the Western financial system experienced more serious changes than it had in the previous 20 years. The stationary regime in which the Western cycle was operating after the 1974–1975 crisis is crumbling. This will be a new system, new finances – it will operate differently. It is unclear whether a stop can be put to the spread of protectionism. How many countries will suffer from the current events is also unclear. There are already examples of the
crisis progressing to the fatal stage in several countries. Negative annual GDP growth in 2008 was witnessed in Iceland, Hungary, Ukraine, the three Baltic republics, Pakistan – and this is far from the full list.

Moreover, **global economic agents are in essence becoming incapable of reaching an agreement on what anti-crisis measures they should now take.** No matter how much we may implore the global economy against taking protectionist measures, the financial authorities of the world’s largest nations will still be trying to resolve the crisis on their own. Some others are trying to coordinate their policies, but have still failed to build any consolidating financial institutions. Potential measures approved by the Group of 20 (G20), the United Nations or the International Monetary Fund are losing value from an absence of mechanisms requiring these measures’ implementation. Neither has the United States adopted any action plan as of yet, which means that we cannot rely on foreign solutions to the financial system. Any serious global economic system reform projects will only be under discussion for now. **Real changes can only begin once the world economy resolves the current crisis. As a result, we probably really are entering a very serious and extended recession, and we should be expecting two difficult years ahead.**

On the whole, there is a sense that we have not yet reached the bottom of the crisis. Estimates of potential losses and additional expenses are being reviewed. And the budget “holes” are growing accordingly.

The following fundamental questions have been left unanswered thus far:

- How will the crisis unfold in the West? Has the West already reached the bottom (as some are trying to argue) or are other collapses still ahead (for example, in February or March)? What will the epicenters of such implosions be? Will it be the financial sector with its overheated derivatives market, the US auto industry, emerging market stock exchanges, or something else?
- How will the competitive advantages of domestic producers – first and foremost those that depend on exports or are tied to such producers – change in the mean time? How will the subsequent global economic collapses affect the Russian economy?
- Which factors of the Russian economic crisis that have domestic rather than foreign “origins” are only about to manifest themselves – those in the field of social and political obligations, those regulating big business, linked to excessive corruption, or perhaps the poor efficiency of our market institutions?
- How fast will the bottom of the crisis be reached – in two or three months, or closer to yearend 2009, and what forces will turn into the engine of the subsequent
modernization of Russian economic institutions, its medium-sized businesses, the judicial system, private property regulations, or the state sector of the economy?

- Furthermore, how fast will the new regional elites consolidate, creating new horizontal inter-regional links?
2. Challenges facing state regulation

2.1 Risks related to anti-crisis measures


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*Source: Ministry for Economic Development, Central Bank of the Russian Federation

Forecasts are distinguished in crisis conditions by their so-called “active” nature. The fact of the matter is that the “realization” of announced figures becomes directly dependent on the efficiency of both the already-adopted anti-crisis measures, and those that are still to come. At the same time, an obvious allowance is made for the fact that all of the required decisions will be reasonable, will meet the needs of both the banking systems and the real sector, and have an at least an “average rate” measure of efficiency.

It should be noted that the measures themselves, for now, look fairly abstract. In keeping with a well-known Russian tradition, these are probably general directions rather than a specific roadmap. Only a few of the proposed measures are accompanied by quantitative specifications. First and foremost, this concerns cutbacks in the growth rates of tariffs on the goods and services of our natural monopolies. A more gradual increase in the gas rates is planned for 2009: five percent as of January 1, seven percent as of April 1, seven percent as of July 1, and 6.2 percent as of October 1. The average annual growth of regulated tariffs on rail shipment is limited to 12.4 percent in 2009 (compared to the previously suggested 18.7 percent). They will be adjusted twice this year: January 1 and July 1. Thermal power rates, for their part, will be adjusted upward by 18 percent.

The banking sector also came out lucky, with large-scale financing offered to prop up liquidity and capitalization. By the end of 2009, the volume of resources allocated toward the
subsidization of loans, the staging of unsecured loan auctions and the issue of bank assistance will correspond to 11.2–11.5 percent of GDP (or up to 4.7 trillion rubles).

Limits have been set on guarantee extensions (of up to 300 billion rubles), the volume of additional support assigned to small businesses (10.5 billion rubles from the state budget and 30 billion rubles from Vnesheconombank), as well as the authorization of additional capital for Rosagroleasing, the state agricultural leasing company, (at 25 billion rubles) and Rosselkhozbank, the state agricultural bank (at 45 billion rubles).

All other regulatory assumptions of the annual forecast are drafted on a “verbal” basis. Among other items, these include tax incentives, housing sector assistance, custom tariff increases aimed at protecting the domestic market, changes to meat import quotas, greater subsidies for industrial production exports, agricultural sector credits and defense industry subsidies. The social assistance measures are meant to include “higher benefits for the unemployed and active employment promotion programs.”

The list of planned regulations is quite vast. It includes the capitalization of strategic enterprises, the allocation of state financing to banks that offer loans to the agricultural sector (at the same time, for individual types of loans, it allows for up to 80 percent of the interest rate to be subsidized), as well as support for small and innovative business loans and investment programs, the purchase of “bad” debts and distressed assets, and many other items. At times, it feels like we are dealing with the table of contents for a textbook on state regulations.

A certain degree of certainty is, however, contained in a proposal on the need “not to reduce the total volume of expenditures.” State investments are due to stabilize in 2009 at around four percent of GDP.

Substantially more clarity for understanding what makes up the Russian anti-crisis program is offered by the Government of the Russian Federation’s “List of High-Priority Measures Taken to Fight the Consequences of the Global Financial Crisis.” Adopted over the past four months of 2008, its solutions are contained in 18 sections. Six of these concern measures of a general systemic nature (exchange rate policy, banking system support, financial market support and protection of Russian entrepreneurs against hostile takeovers, tax and budget policy, tariffs policy, and employment assistance). The section on “Support for Business Activity in the Real Sector of the Economy” reveals the structure and contents of state assistance programs to 295 strategic enterprises.  

Another section is dedicated to institutional support for the anti-crisis measures’

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1 The list of 295 strategic organizations, approved by a Government commission on improving the stability of Russian economic development, includes 36 electric power industry enterprises, 30 transportation companies, 34 agricultural and food industry enterprises, 32 metals companies, seven retail trade chains, 10 structures representing the oil and gas sector, 18 communications enterprises, 17 petrochemical and chemical industry companies, almost the entire automobile industry, most companies from the space and missile industry, six housing construction enterprises, seven from the radio and electronics industry, five forest industry complex firms, and 11 pharmacy chains and pharmaceutical
implementation. Finally, the remaining 10 sections feature various industry-specific measures (housing construction and citizens’ housing market assistance, the oil industry, auto construction, agricultural engineering, the military-industrial complex, small and medium business, air shipments, retail trade, the agro-industrial complex, and infrastructure projects).

Some 10 trillion rubles have been reserved for the implementation of these anti-crisis measures in all. This total is made up of federal budget (around three trillion rubles), reserve fund (more than two trillion rubles) and Central Bank finances (nearly 4.6 trillion rubles). A detailed enumeration of expenditure items and their sources of financing are outlined in the subsequent section.

According to Prime Minister V. Putin, “the most urgent measures have been adopted… The government does not intend to throw all of its available reserves at the fire of the crisis without (first) thinking about the effectiveness of their utilization… Moving into the forefront is the problem of improving the efficiency of sate spending, the preservation of macroeconomic stability… The general logic of (our) actions consists of a combination of systemic measures and targeted solutions.”

The designated priorities are impossible to contest. The preliminary assessment of the balance of payments for the Russian Federation in 2008, published by the Bank of Russia in early January 2009, provides a quite demonstrative example of why this is the case. *The flight of capital for the fourth quarter of 2008 reached $130.5 billion, with this outflow reaching $50 billion in December. This is an absolute record since this figure was first published in 1994.*

*From the standpoint of the procurement of foreign capital, the economy has as the very least retreated to the levels of 2006. For 2008 results as a whole, banks reduced their capital raising abilities by a factor of 7.9, while the non-financial sector of the economy – by a factor of 1.6. The current account balance remains positive for now, but now stands at 8.1 billion rubles – just a third of the figure for 2007.*

As a direct consequence, it is necessary to adjust the parameters of the already-adopted budget for 2009. These examples alone are enough to conclude that the program of projected anti-crisis regulations will inevitably be subject to changes.

A bifurcating “fork” first began to emerge in this program by the turn of 2008. The system of its “coordinates” on the one hand consists of quite clearly signified risks of state regulation, while on the other – of an understanding of the post-crisis economy contours’ dependence on industry enterprises. The total volume of finances reserved for state supports (state guarantees, interest rate subsidization, tax debt restructuring, state orders, customs and tariffs policy measure, and others) is estimated at 3.5 trillion rubles. In addition, when required, the government will step in to minimize the negative social and economic consequences from discontinuations of such enterprises’ operations. At the same time, inclusion on the list does not automatically guarantee future financial support.
the contents of the anti-crisis program. Both of these “pivotal” circumstances are fundamental in nature.

The regulatory measures followed a largely unbridled course in the autumn months of 2008, in a keeping with a spontaneous “firefighting” mode of operations. For the most part, this is only legitimate. Almost every anti-crisis program known to economic history (including the New Deal adopted by Roosevelt during the Great Depression) was created in a similar manner. This phase has reached no unequivocal outcome, but a certain and quite important positive achievement has been reached – the banking system has, on the whole, survived, preserving its familiar performance levels. On the other hand, it continues to remain clogged up, with banks in no hurry to give their money to the real sector of the economy (while at the same time building up their Central Bank deposits, which had quadrupled by September of 2008, reaching more than 300 billion rubles). Meanwhile, this refusal by banks to extend loans (which remain barely accessible), which only exacerbated the industrial decline, provoked so-called “shadow/write-off” assistance to strategic enterprises at the federal and regional levels. Universal liquidity-infusion measures were thus continued through the disbursement of individual means of anti-crisis protection.

Something resembling a consolidation of the regulations, with their streamlining and systematization, began to emerge by the end of December 2008, and especially in January 2009. The government began to systematically “track” the consequences of its actions. The results were just as what could have been supposed. According to Russian President Dmitry Medvedev, no more than a third of the adopted measures are being directly enforced.

This “inefficiency” during times of crisis, however, is not new. The state’s role in the economy is inherently patched together from contradictions that arise between its numerous functions and conflicts of interest that exist between those for whom these measures are being adopted, and which have numerous diverging qualities. The sluggishness of regulations is also quite apparent. Understandably, the very first decisions (and some subsequent ones, as well) are adopted on the basis of technologies used to conquer previous crises.

In our case, the first “one hundred days” came yesterday. We have already gained new experiences and an understanding of how the first full-scale crisis to affect a truly global economy is not similar to anything that has happened in world economic history before. Perhaps slowly, but there is a conscientious measure of reserve also emerging concerning our own distinctiveness and the so-called nation-specific nature of the anti-crisis measures. In other words, we have all the grounds for understanding the progress rate and direction of the steps we have already taken, and for making a more precise alignment of our subsequent course. Among other things, this may also be prompted by the concern displayed by many market players and experts about the fact that together with the national reserves (which have already dropped by one third), the country is
running out of time to retune the economy to attain a new quality of post-crisis growth. The problem rests in the fact that by containing obvious risks, the anti-crisis regulations do not have a neutral effect on our development prospects. First and foremost, this concerns the enormous expense carried by the adopted measures. The finances already earmarked for the economy come to at least 15 percent of GDP figure expected in 2008. Those assigned to support banks and the real sector represent at least as much. With the 2009 budget deficit expected to come in at 7—7.6 percent of GDP, measures of state support will have to be especially discriminate. It is also fundamentally important to established terms for its provision.

It is these terms that must reduce the risk of the markets giving an incorrect readings to signals such as the provision of state financial assistance. The idea that the crisis will be able to “write off” any past inefficiencies and mistakes in corporate governance is starting grip the “masses.” This is especially the case since state money is being contested by both the obvious “losers” and those whom circumstances have prevented from staying at the peak of their previous successes. It is still unclear when adequate selection processes will ever be put in place, which means that some believe that the louder and more often they call for assistance, the more likely they are to receive something in the long run.

In the end, (this is the flip side of these support measures), the “recipients” are developing their own type of “culture of excessive requests,” in which they try to make “oversized” demands. Quite often, these really are based on in-depth studies of circumstances affecting particular sectors or industries. Their arguments (for example those presented by the defense or agriculture industries) are seriously weighed. The problem is that in times of crisis, the sought-after “targeted” solution is often “stuffed” with an entire state industry (sector) stimulus program, whose implementation will require a number of years and a completely new approach to financing. These lead to a growing risk of the government spending its money in waste, since the very conditions for the government’s proposed solutions to develop into tangible results are not in place. It is this very financial intuition, which appears “fixated” on fears of weakening the budget and monetary policies and breaking out into stagflation, that may help explain the seemingly paradoxical hesitancy displayed by the Ministry of Finance and the state banks. It is both premature and irrational to engage in wide-scale spending before the economic fall reaches rock bottom.

This risk may be reduced with the help of one already-adopted decision – to support specific enterprises rather than industries as a whole. But this very move leads to a completely new area of uncertainty – what selection criteria should be used amid a very high (sometimes as high as twenty-fold) variance of performance indicators within a particular industry. However, there is no better indicator than performance. It corresponds to the positive added value created by an enterprise. It
is true that its practical implementation is complicated by a large volume of calculations involved. However, its reliability is quite capable of compensating these efforts.\(^2\)

Another manifestation of “oversized” demands involves lobbying for protective measures in customs and tariffs policy. Thankfully, protectionist measures have only been limited in scope so far. But their risks have been on prominent display. First of all, they involve the threat of undermining the trust one’s of trade partners.\(^3\) Russia signed the G20 declaration adopted in November 2008 in Washington. It specifically refers to the threat of protectionism. Second of all, if certain restrictions are inevitable after all, they particularly disagree with the conservation of the manufacturing sector. Unfortunately, the auto industry’s example has already provided fodder for this argument. Direct budget losses have already resulted from this policy: a sharp decline in demand for cars that have cleared customs threaten to leave the state budget short of $1 billion in revenues.

The Russian anti-crisis program (as it looks at the start of 2009) fits into the worldwide experience of adopting such measures. Anti-crisis regulations are objectively contradictory in nature, sluggish (in other words, drawing on past sources of inspiration) and structurally deterministic (they are determined by the economic and political interests and motives of groups that represent chains of already-existing sectoral or industrial structure of the economy). Operating in an exclusively responsive mode of emergency assistance, they heighten the risks of structural immobilization, threatening to “implode” potentially essential and long-overdue structural changes. A fundamentally important feature of anti-crisis programs involves their desire to fine-tune the operations of “orderly” market institutions. The non-optimal provision of financial assistance results in their eventual weakening.

A further threat has emerged of the anti-crisis measures draining the markets of their strength. This has already been felt on the stock exchange, which is dominated by state brokers,\(^4\) and in the banking sector as a whole.\(^5\) However, the greatest threat to economic de-

\(^2\) Other criteria may include: positive improvements in corporate governance (exhibited over a certain period, including prior to the crisis), the absence of defaults, competitive power (a measure of market share), and the correlation between growth in labor productivity and wages (including in comparison to average industry rates). Grouping enterprises according to these parameters helps to “target” the various support program according to industry “leaders” and “middlers.” Criteria used to support “outsiders,” on the other hand, must have exclusively social characteristics (companies in a one-company town, for example).

\(^3\) The Moscow mayor’s arguments about the need to take every means of protection possible – after all, we are not members of the WTO and therefore not obligations to anything before anyone – are at the very least naïve, which makes them no less seriously misguided.

\(^4\) VEB is responsible for up to one third of all the volume recorded during some sessions on the Russian stock exchanges.

\(^5\) An integral characteristic of its current condition includes the so-called negative capital incurred by the banking system. By October 2008, it had reached 20.7 billion rubles for the first time in four years. By November 2008, it had grown 2.5-fold from the previous month’s figure (to 48.8 billion rubles). At the same time, the net losses of Russian banks had reached 85 billion rubles by December 1, 2008, growing by 36.1 billion rubles over the course of November. Since the start of 2008, these losses have multiplied by a factor of 85 (from 0.907 rubles).
institutionalization involves the restriction of competition. Timely and justifiable initial anti-crisis measures could evolve into their opposite. Long-term agreements between economic agents – so popular in many ministerial offices today – as well as protective duties, “voluntary” price restrictions, the preferential treatment of Russian suppliers during state purchases, and the indiscriminate encouragement of mergers and acquisitions are all capable leading to a rise of state monopolization, the acceleration of prices, and the weakening of competition among a number of industries and local markets.

Along the same lines (as the flip side of state support measures), the expansion of state property holdings and its accumulation of a substantial volume of surplus assets upon our exit from the crisis are unavoidable. The risk of a redistribution of property (which, by the way, is quite natural in times of crisis), in our circumstances acquires additional weight – the threat of the tipping of a fundamental balance between the state and market economics in which private property begins to face unequal terms and is discriminated against in the favor of state property. And this, unfortunately, is not a theoretical problem but an extrapolation of state plans to “enter” the capital of private companies, either directly or through the purchase of securities.\(^6\)

A reinforcement of the role played by state property holdings represents one of the dominant institutional trends of the first decade of the 21st century. By the start of 2008, the state had consolidated its holdings over at least 40–45 percent of Russian company shares. According to expert estimates, this share could grow by an additional nine or 10 percent during the anti-crisis program’s implementation.

The main problem, however, does not even rest here but in the instability of relations that develops between private property holdings. This is a direct consequence of a conflict of interests in which the state simultaneously acts as both the legislator, regulator and major market player (through state corporations and state banks). In crisis conditions, as demand for financial assistance grows, there emerges a greater threat of market competition between private and public forms of property holdings being replaced by something like a “vertical construction” of relations: state property become “more equal” and higher in importance. The outcome of this “adjustment” is predictable – a progressive loss of efficiency for both sectors of the economy.

The first assessment of risks, as seen by investors (which, in turn, means from the standpoint of a post-crisis inflow of capital), has already been displayed by a downgrading of the Russian Federation’s long-term and short-term credit ratings. At first glance, there is nothing too terrible about this. Who ever looks at the “little letters” with their pluses and minuses? But the answer is

\(^6\) The public learned about new state plans to expand its property holdings in first two weeks of 2009 alone: the state may obtained a share of the joint company created from the merger of Norilsk Nickel, UC Rusal and Mettaloinvest. Basic Element is selling its Soyuz bank to Gazprom structures for a symbolic figure. VTB has acquired a nearly 20-percent stake in Rosbank as additional security for a credit previously issued to Interros.
simple – the creditor. When downgrades turn into a trend, the creditor could demand the early payment of foreign corporate loans from the property owners. And for our monetary authorities, this could turn from a passing headache into a chronic migraine.

It is extremely important for the state’s anti-crisis tactics not to “wipe out” the prospects of our social and economic development. Our country’s political leadership is keeping its hand on the country’s pulse. It has adopted the 2020 Concept, the government action-plan for 2009—2012, the strategy of financial market development through 2020, the foreign economic strategy, and is concluding preparations of a concept for creating an international financial center. These steps are both reasonable and required – a clear strategic definition of objectives is a time-tested means of delivering systemically bracing measures to the economic organism. These alone, however, are not enough. The risks that lie dormant in the anti-crisis decisions could “reintroduce” themselves, turning from a temporary topic of discussion into a genetic code of post-crisis reality.

In cases when the resource of “firefighting” measures approaches exhaustion, is essential for all intents and purposes to reformulate the system of state regulation, aligning it toward the development of conditions for future economic growth. It will be necessary to build a bridge out of the current situation towards the new economic paradigm that will take shape at the end of this crisis.

Such “bridge management” should not have too many goals. First of all, it involves adjusting Russia’s economy to a new state of equilibrium, which in turn requires a search for intelligible answers to the most pressing challenges to Russia’s economic development.

2.2 Challenges to Russia’s economic development

The aftereffects of the global economic crisis on the Russian economy, which have already become apparent, are likely to only worsen in the future. At the same time, they could turn more serious than for developed Western economies as a result of our strong dependence on global commodity and capital markets. Under such circumstances, the Russian economy ends up facing a variety of challenges, a part of which it has not faced since the 1998 crisis, and some of which are emerging in such dimensions for the first time in our history.

1) **Decline in domestic demand.** At times such as these, when it becomes extremely more difficult to access financing, the investment programs of most companies shrink sharply. For the export-oriented business, this problem is compounded by a deterioration of the foreign economic climate. A drop-off in demand for products produced by export-oriented companies also leads to a reduction in their intermediate demand for other industries’ products, which, through a chain reaction, leads to reductions there, as well. The volume of consumer lending declines at the same time, which, in this case, leads to
a reduction in demand for real estate and automobiles. From there, the trend of deteriorating consumer demand is compounded by reductions in both staffing levels and labor compensation, which in turn was caused by the drop-off in production. This in turn will lead to further declines in production and employment volumes. Therefore, what emerges is a spiraling reduction of the economy that first sparked by an external shock.

2) Depletion of state financial reserves. Excessively active measures aimed at simultaneously supporting the currency exchange rate, refinancing companies’ debt, injecting resources into the banking sector, supporting the stock market and other measures inevitably lead to a sharp depletion of both the country’s gold and hard currency reserves and stabilization fund. The 2009 budget assumes a deficit that will have to be financed. The evolution of the crisis along the unfavorable scenario will lead to a further increase in requests for state support, and to the expenditure of existing resources. In this case, the state ends up facing a choice between a drastic reduction in spending (including cutbacks in spending on social needs), the emission of a substantial supply of money, or an increase in the volume of borrowings.

3) Disturbance of the balance in intergovernmental fiscal relations. The federal center faces the threat of an escalation of its relations with the subsidized regions whenever its own financial resources drop. At the same time, deterioration in the economic performance of the donor regions leaves them striving to increase the share of financial resources retained in the region and not transferred to the federal budget. The consequence of all this is a further rise in the federal budget deficit, increased differentiation among the regions according to their levels of prosperity, and weakening of the federal center’s influence over the regions.

4) The de-institutionalization and socialization of the economy (statism). Quite reasonable and active state measures aimed at supporting the economy and mitigating the consequences of the crisis will inevitably lead to a substantial expansion of the state’s role in the country’s economic life. The share of enterprises that involve state participation is like to grow both in number and by weight of the share of GDP. The consequences of this may include a monopolization of the markets, a reduction in the efficiency of resource utilization, and the restriction of opportunities for private initiative. Many of the key market institutions that were created in Russia over the past two decades but which lacked the time to sufficiently consolidate in strength end up being at risk. For example, the stock market has already all but stopped reflecting the value created by companies, while other financial market institutions have also ceased to
achieve the full goals of their existence. Even the institution of monetary relations now faces the risk of weakening.

5) **Emergence of social instability.** Social protests have turned into something of an exception to the case rather than the rule in recent years. But the threat of an acute aggravation of the social situation is now beginning to emerge. Higher unemployment, income levels that drop as a consequence of pay reductions and persistently high levels of inflation, and difficulties in paying off old credits are all leading to a reduction of living standards and social protests, which are expressed through public rallies, strikes, as well as through other means. Increased instability will result in the revitalization of radical political movements and the drainage of additional resource on the solution of law enforcement issues. In addition, it could even further exacerbate the course along which the crisis develops in Russia.

6) **The need to change approaches to management and decision-making in crisis conditions.** The changing economic environment requires fundamentally new approaches toward economic management, decision-making and administrative skills and scopes of functions. A reliance on approaches (from the standpoint of objectives and the speed of decision-making and forecasting) that successfully worked in periods of growth may prove to be inefficient in crisis circumstances. A paradigm that focuses on accelerated development – including extensive development – when the markets are booming and the volume of resources remains considerable is inapplicable to falling markets and strictly rationed resource capacities. This is a characteristic problem at both government and business levels.

The extent to which these challenges will affect the current situation’s development will be largely determined by the model and specific measures of state economic policy used to try and minimize the consequences of the crisis.

**2.3 Potential economic policy scenarios**

A state policy that focuses on mitigating the negative consequences of crisis events can follow one of the two basic scenarios (of course, in practice, the state could potentially apply a combination of measures between the two scenarios).

1. **The dirigiste scenario: “hands-on control”**

Basic thesis:

- Direct “manual” state control over economic processes will help to minimize the losses suffered by the more strategic enterprises and sectors of the economy.
Examples of potential actions:
• the government’s creation of a limited list of significant enterprises on the basis of their size, their earnings and number of employees;
• the issue of state bank credits to government-selected enterprises;
• protectionist foreign trade measures aimed at defending individual industries.

Expected results:
• Positive:
  - abbreviation of the acute phase of the crisis;
  - limitation of negative social consequences.
• Negative (risks):
  - preservation of an inefficient market structure that existed before the crisis, absence of positive changes to competitive power;
  - substantial redistribution of assets from private ownership in favor of the state, which reduces the efficiency of these assets’ management;
  - extended period of weak recovery from the crisis, which extends the lag behind developed countries.

2. The liberal scenario: “natural selection”

Basic thesis:
• Market forces without external intervention will ensure a selection of the more efficient economic agents and quickly restore the economy.

Examples of potential actions:
• lifting of administrative restrictions to small and medium-sized business development;
• reduction of tax rates;
• refusal to provide state support to individual enterprises.

Expected results:
• Positive:
  - survival of the most economically viable, efficient and fast-adapting companies, which leads to a general improvement of economic efficiency;
  - less state spending on the implementation of economic measures (with these expenditures including the costs of corruption).
• Negative (risks):
  - wide-scale enterprise bankruptcies, which leads to acutely negative social consequences;
  - elimination of certain branches of Russian industry, which could undermine the economic security of the state;
- an immediate and severe industrial decline of potentially extended length – although most likely shorter than in the first scenario – followed by a gradual recovery.

3. The liberal-dirigiste scenario: “support and development of opportunities”

Basic thesis:

- A joint system of measures focused on minimizing the consequences of the crisis, including through the provision of state support for investment demand in key sectors of the economy, and the supply of final consumption expenditures; the creation of an incentive system for building an economy with assigned characteristics (competitive power, diversification, innovation) will help pass the crisis as painlessly as possible and emerge from it with a more efficient economy.

Examples of potential actions:

- Issue of state credits (state guarantees for loans, the subsidization of interest rates) for making investments in key industries;
- tax credits for the implementation of projects that improve efficiency;
- support for employment through state infrastructure programs (including road projects) and the construction of housing and public utilities;
- state purchases in key sectors (including potential through the creation of state reserves of individual goods).

Expected results:

- Positive:
  - maintenance of production and employment levels during times for the purpose of reducing social consequences and eliminating excess expenditures on the subsequent restoration of production, as well as the provision of support for intermediate and final demand;
  - recovery from the crisis with a more competitive economy that results from a modernization of production capacities in key sectors of the economy as well as the infrastructure.
- Problems and risks:
  - higher demands set on the competence of the state administrators of the anti-crisis measures;
  - risk of corruption entering the decision-making process, in case this process is not made sufficiently transparent.

It is presumed here that elements of social support for the most economically vulnerable segments of the population are present in all of the described scenarios, with these not being reviewed on an individual basis in this section.
Until now, the main measures adopted and implemented by the government, were primarily characteristic of the “hands-on control” scenario. These include the creation of a list of enterprises of special social and economic significance (with the criteria used for this list not being made public), decisions to support individual airlines and strategic retail trade chains, selective measures of customs and tariff protection, and other steps.

Most of the steps taken have been quite reasonable. Nevertheless, the system of “manual control” being applied by the state also contains a variety of risks. In particular, these include the danger of supporting inefficient companies that previously existed only thanks to rapidly growing demand and which are not viable under any other conditions. Under such circumstances, the state’s limited financial resources get spent at fairly high rates, with the results of their utilization not always meeting expectations. Should the crisis get dragged out (for few now believe that economic recovery could assume in 2009), the chosen enterprises could start demanding ever greater amounts of financial backing for their operations instead using the short-term support they received to adapt to the new economic environment. This delays the start of economic recover and may increase Russia’s lag behind more developed countries with more adaptive economic systems.

A separate risk involves the lack of a sufficiently systemic and exclusively situational approach to the adopted measures, which again threatens to unravel into the inefficient use of resources. The rapid rise of the state’s role in the economy and the atrophy of market institution from economic agents’ addiction to state support threaten to reduce efficiency, which occurs against the backdrop of insufficient incentives.
3. The anti-crisis program — a fresh start needed

Many measures adopted by the Russian Government came about as a necessary express-reaction to events that quickly unfolded in the global and Russian economies. However, it is already clear today that this a long-term rather than a short-term crisis, that it encompasses every sector of the economy, setting an entire range of challenges before the Russian economic system, and that fast individual measures will not resolve this crisis on their own. The volume of adopted decisions, the level of their interdependence and the decision-making process itself all need to improve. It seems appropriate to propose a number of additional measures whose implementation will help more adequately confront the detected challenges.

3.1 Financial sector regulations

Most of the measures adopted up to this point within the frameworks of state anti-crisis regulations relate to the provision of support for the financial sector of the Russian economy. This particular line has received the lion’s share (more than 75 percent) of resources already allocated by the Government of the Russian Federation and the Bank of Russia. And this particular field will receive most of the earmarked funds, as well.

The reasons behind this arrangement of priorities are clear. First of all, the crisis developed in the financial system before all others. The government’s first reaction, performed through a “firefighting” mode of operations, involved unprecedented measures aimed at reinforcing bank liquidity; these were followed by other decisions aimed at stabilizing the stock market, protecting investments, creating bank restructuring mechanisms, and the resolution of “clogs” in credit and other measures. Second of all, the functional “load” of the object receiving support here also plays a substantial role: the economy’s “circulatory” system is the foundation of all other foundations. Depending on the state of the generating mechanisms and the distribution of financial flows, the later can either help reignite the crisis or carry stimuli for macroeconomic stabilization. For this reason, the maintenance of a well-functioning financial system remains a priority during the acute stage of the crisis, a stage that, by the way, is not over by any extent – this priority is indisputable and justified. And this is proven by the anti-crisis measures’ first results.

First of all, it is essential to highlight the exchange rate policy pursued by the Central Bank, which reduced the ruble’s “price” (and this means all the other parameters as well) to a new equilibrium.
Having spent around $100 billion on the support for the ruble’s exchange rate between August and November (through November 10) 2008, the Bank of Russia was forced on November 11 to allow the gradual weakening of the national currency. It did so by slowly widening the band of admissible fluctuations in the bi-currency basket’s value. This band was altered 16 times between November and December 2008, with another nine changes occurring in January 2009. As a result, by January 21, 2008, the ruble’s exchange rate fell by 44.5 percent against the dollar and 17.5 percent against the year when compared to the peak recorded in July 2008. The bi-currency basket fell in the value by 29.2 percent between the two dates. The Russian Federation’s foreign currency received declined appreciably as well – they slid by third off the peak of $598.1 billion recorded on August 8, 2008. According to Central Bank head Sergei Ignatiev, foreign currency reserved stood at $397.5 billion as of January 20, 2008 (of these, $209.6 billion were being held by the various national funds, bank assets deposited in Central Bank accounts stood at $38.4 billion while the Bank of Russia itself had $148.5 billion in reserves).

On January 23, 2009, the Central Bank reported the completion of the wide-scale, gradual correction of the technical band’s boundaries determining the admissible fluctuations of the bi-currency basket’s value – the operational benchmarks used by the Bank of Russia to implement its exchange rate policies – which it had begun on November 11, 2008. The Central Bank explained the need for the stepwise devaluation by fundamental changes to the state of the global economy. For Russia, these were first and foremost manifested by Russian banks and companies losing the opportunity to raise new and refinance previously-received loans, the wide-scale flight of capital, and the sharp decline in the price of Russian commodity exports. At the same time, the gradual correction of the ruble’s exchange rate afforded agents of the Russian economy an opportunity to respond to the emerging currency risks, thus helping the economy as a whole as well as its individual sectors avoid the negative consequences of a sharp ruble devaluation.

The upper limit against the currency basket was set at 41 rubles as of January 23, 2009, which at the current 1.3 dollars per euro exchange rate corresponds to about 36 rubles per dollar. The indicated value is determined by taking account of the persisting risks of a further deterioration of the foreign trade environment for the Russian Federation. However, the Bank of Russia views these risks as moderate and does not intend to change its boundaries in the coming months. Experts note that grounds for a change in the Central Bank’s position could only come from a severe of extended drop in the price of oil. The band’s lower plant, set at a level of 26 ruble, is currently largely irrelevant.

According to Bank of Russia estimates, at current prices for oil and other Russian export commodities, the present ruble exchange rate will ensure that the Russian Federation keeps a balanced current account balance. At the same time, the actual value of the bi-currency bank will
develop within this technical band under the influence of both market forces and Bank of Russia currency interventions, and could potentially fall far below its upper boundary. In order to ensure the national currency’s stability within the frameworks of guidelines established by the Bank of Russia, in addition to currency interventions, other monetary policy tools will also be used (such as interest rates and quantitative restrictions on refinancing amounts).

In other words, the Central Bank has created itself the opportunity to manage the ruble’s exchange rate by controlling bank liquidity: should speculative attacks on the ruble resume, it will simply set restrictions on bank access to currency – in this case, banks will primarily sell rubles in order to refinance their foreign corporate loans. It should be noted that if necessary, the Central Bank could further deploy administrative measures such as the setting of mandatory reserve requirements on a portion of legal entities’ funds that they plan to move out of the country, or the mandatory sale of a portion of their hard currency export revenues. Another potential measure involves the introduction of reserve requirements, which automatically enters into force should foreign assets exceed foreign liabilities in a net currency position. Many market players note that such restrictions could be avoided should short-term currency liquidity regulations start with the government allowing banks to accrue even the smallest of interest rates from the foreign currencies they still hold on their Central Bank accounts. It would also be useful to stage auctions on Bank of Russia hard currency bonds.

On the whole, the market interpreted the Central Bank’s measures as representing a sort of medium-term guideline: attempts to stage speculative attacks on the ruble will be forcefully clamped down upon, the risks of such operations from the standpoint of earnings substantially rise, and the monetary authorities now intend to break the trend of ruble devaluation, turning banks instead toward lending to the real sector of the economy.

However, the Central Bank will have to pursue its chosen line of action amid uneasy circumstances. First of all, as an indirect result of the stepwise devaluation, the ruble’s value of foreign corporate debts grew by more than 20 percent, which – according to the VEB refinancing program for Russian borrowers – implies additional costs of some 250 billion rubles.\(^7\) Second, even though the ruble is likely to fluctuate in the coming few months around its current values without setting any new marked trends, its marked strengthening cannot be excluded. The ruble’s real effective exchange rate remained positive for the whole of 2008 (with December 2008 rates standing 4.5 percent higher than the December 2007 rate, and the average weighted rate for 2008 standing 5.1 percent up on the 2007 reading). December’s 3.6-percent drop will apparently continue in January, but industries have still not had the time to take advantage of the “export

\(^7\) The cheapest solution involves borrowers’ voluntary conversion of their hard currency obligations to VEB into rubles.
premiums” that have emerged. But this premium’s potential should not be overestimated: it could become wiped out by the monetary authorities’ need to fight inflation.

Critics of the Central Bank’s policies believe that the negative consequences of the stepwise exchange rate correction (particularly the accompanying drop in hard currency reserves and subsequent downgrading the Russian Federation’s sovereign rating) could have been avoided had the monetary authorities chosen to proceed with a one-time ruble devaluation instead. Unquestionably, this is a theoretically possible conclusion – but not a necessarily obvious one from the standpoint of Russian circumstances in the fourth quarter of 2008.

First of all, it is impossible to repeat the experience of 1998 as a matter of principle if only because the Russian industry has no free capacity. In 1998, the country encountered a simultaneous debt and currency crisis – today, however, it is dealing with a global recession and a “classic” case cyclical overproduction occurring within national boundaries. Second of all, a currency policy tactic that is based on the application of one-off measures provides absolutely no guarantees against the renewal of speculative attacks against the ruble. It is very likely that the one-step devaluation would have been followed by these same “steps,” only much larger ones (of at least 5—10 percent, instead of the current 1.5 percent), as well as by severe social consequences. Third of all, a one-step devaluation would have provoked a serious acceleration of inflation (calculations show a one-percent weakening of the ruble leads to an additional prices hike of 0.3 percent), which would have been extremely difficult to resolve. This inflationary backdrop would have created the right conditions for a new turn of the devaluation spiral.

While giving a generally positive assessment to the Central Bank’s chosen tactic for determining the guidelines for setting the new exchange rate, it should still be noted that our monetary authorities’ actions have led them to several “forks” in the road.

The first “fork.” The current exchange rate policy pursued by the Bank of Russia, which now resembles a so-called floating exchange, enables it to solve some of the most pressing problems: it gives the population time to determine what to do about its savings in relative calm, and it gives it a chance to refine (on the basis of a transition to targeting) its monetary policy and substantially weaken the pressures of monetary inflation over the medium term (two to three years, lowering it to a range of six to seven percent). It is fairly difficult to maintain a financial balance without first engaging in a consistent reduction of the rise in prices.

Since Russia differs from many other countries by having high rates of inflation, it also follows a different vector of monetary policy (which, to a certain extent, has already borne fruit: instead of the expected 14—15 percent, the 2008 inflation rate stood at 13.3 percent). But this maintenance of high interest rates that are guided by the refinancing rate still requires the insurance that 2009 at the very least brings a real zero percent return on deposits (although it
would obviously be better to have a positive one, even if it is just tiny). This problem alone is not an easy one. But its complication grows in an environment in which there is a serious threat of prohibitive curbs being set on the money supply – a condition in which excessive restrictions on the monetary base and the inhibition of growth to the supply of money eventually leads to the economy not always having its demand for money met. This de-monetization, in turn, threatens to substantially prolong the recover phase of the crisis. The monetary authorities must thus determine what “price” they are ready to pay for the reigning in of inflation, whose runaway growth could potentially cross out all the positives gained by the current exchange rate policy.

Russian banks’ ability to raise funds on the global capital markets allowed them to engage in expansion on the credit market, which led to an improvement in access to money supply and a reduction of rates on the domestic loan market. Credit organizations’ net international investment position steadily deteriorated as a result. It stood at $20.827 billion at the end of 2005. By the end of the third quarter of 2008, that figure had reached $99.651 billion.

The fall in oil prices that first began last May and restrictions over foreign money market borrowings provoked a substantial deterioration of the Russian Federation’s balance of payments in the second half of 2008. A net inflow of capital, which reached $83 billion in 2007, turned into a net outflow of $130 billion in 2008. Current account operations fell by a factor of 4.5 between the first and fourth quarters of last year – from $37 billion to eight billion dollars, standing at $99 billion for the year (see Table 1). A zero current account balance is expected in 2009.

As a direct consequence of all this, Russia has been forced to adjust the parameters of its already adopted 2009 budget. As already mentioned before, the pivotal issue now is setting an average annual target price on oil.

### Balance of Payments of the Russian Federation for 2008

**(billion dollars)**

<table>
<thead>
<tr>
<th></th>
<th>I</th>
<th>II</th>
<th>III</th>
<th>IV (estimate)</th>
<th>Year (estimate)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current account operations</td>
<td>37.4</td>
<td>25.8</td>
<td>27.6</td>
<td>8.1</td>
<td>98.9</td>
</tr>
<tr>
<td>Capital and financial instruments transactions account</td>
<td>−24.7</td>
<td>35.4</td>
<td>−9.4</td>
<td>−129.7</td>
<td>−128.4</td>
</tr>
<tr>
<td>Financial account (except for reserve assets)</td>
<td>−24.6</td>
<td>35.2</td>
<td>−9.6</td>
<td>−130.0</td>
<td>−129.0</td>
</tr>
<tr>
<td>Changes in foreign exchange reserves (“+” — decline; “−” — rise)</td>
<td>−6.4</td>
<td>−64.2</td>
<td>−15.0</td>
<td>131.0</td>
<td>45.3</td>
</tr>
</tbody>
</table>

Reference:

- Urals crude oil prices (global) dollar/barrel 93.4 117.1 113.0 54.2 94.4
- Net inflow/outflow of private sector capital −23.1 41.1 −17.4 −130.5 −129.9

*Source: Bank of Russia, “Voprosy Ekonomiki” (Economic Issues) magazine No. 1, 2009.*
The second “fork” standing before the regulators involves the transition to a new model of money supply, which is inevitable in 2009. The reduced influx of capital, which implies a smaller replenishment of net foreign reserves, and the limited capacity to use the latter on objectives not linked to the insurance of budgetary stability, mean that the main source of money supply formation must come from a higher gross credit from the Central Bank to the country’s banking system. In essence, this was already the state of affairs at the end of 2008.

The effectiveness of future steps taken by the monetary authority to replenish liquidity will first and foremost depend on the state of the banks themselves, the improvement in their stability and the regulators’ ability to consolidate the banking sector.

The Government and the Central Bank have implemented the following measures of banking system support:

- a reduction in legal reserve requirements (freeing up some 380 billion rubles);
- an easing of lending terms to include the use of individual types of security (these measures could allow the Central Bank to place up to 1.5 trillion rubles in Russian banks; around 350 billion rubles have actually been placed);
- the provision of unsecured loans (potential limit – up to 3.5 trillion rubles; actually provided – more than 1.7 trillion rubles), with the loan term increased to one year; some 143 banks have the right to use this credit, which has already been used by 124 credit organizations;
- the Central Bank has received the right to partially compensate commercial banks’ losses on the interbank credit market, is such losses resulted from the withdrawal of a license from the counterpart bank (essential for reviving the interbank loan market);
- some 950 billion rubles have been allocated for bank capitalization, with Sberbank receiving 500 billion rubles, VTB – 200 billion rubles, Rosselkhozbank – 25 billion rubles, and other banks – 225 billion rubles; the terms require the banks to raise equivalent co-financing from their shareholders (loans for the three banks have actually been approved for a sum of 17 billion rubles);
- the following state corporations have deposited funds in commercial banks and issued securities: the Russian Municipal Housing Reform Fund (200 billion rubles), the Russian Corporation of Nanotechnologies –Rosnano (130 billion rubles), as well as federal budget funds; in all, state corporation have already deposited some 430 billion rubles in commercial bank accounts;
- the insurance ceiling on citizens’ bank deposits has been raised to 700,000 rubles (from 400,000 rubles), thus protection 98.5 percent of all deposits;
- the Deposit Insurance Agency has launched a banking system reform program (involving the banks’ transition to Deposit Insurance Agency administration, and a search for investors); some 200 billion rubles have been allocated for these banks’ rehabilitation (some 60 billion rubles have actually been spent); in addition, the Central Bank has allocated more than 60 billion rubles to help support these banks’ liquidity; some 15 banks have already been put under Deposit Insurance Agency administration, with new shareholders – who are helping complete the recovery process – found for 11 of them;
- a number of banks undergoing rehabilitation programs financed by VEB (Globex and Svyaz-Bank – some 5.7 billion rubles spent) and VTB.

The first months of the financial crisis (the so-called acute stage) show that these efforts have helped keep the Russian banking system “afloat.” A weakening of the ruble exchange rate has allowed banks to create the necessary currency reserves and insure the stability of current liabilities. At the same time, while helping saturate the market with short-term liquidity, Deputy Prime Minister Alexei Kudrin has admitted that these steps have been unable to compensate for the deficit of long-term resources.

The solution of another top-priority problem – the closing of the growing gap between the volume of credits and the non-financial sector’s savings – is also nowhere in sight. According to the Bank of Moscow’s Center for Strategic Research, this structural imbalance stood at 2.2 trillion rubles in August 2007, 3.8 trillion rubles on October 1, 2008, and some 4.6 trillion rubles by November 1, 2008 (which exceeds the Russian banking system’s total capital by 1.1 trillion rubles). A sluggish forecast for 2009 implies a deepening of the “credit whole” by another three trillion rubles. It is now clear that customer bank debts will be growing, too (they had reached 4.1 trillion rubles by November 1, 2008, representing 78 percent of all deposited savings). A fundamental question remains: where to find equity for the banks – in other words, where to find funds that are need to provide future lending to the economy?

Certain steps are being taken in search of an answer. The deadline for raising the mandatory reserve requirements has been pushed back by three months, and the procedure for the creation of provisions for potential legal losses has been changed. The Central Bank has received the right from legislators to provide liquidity for bank through unsecured auctions with terms of up to one year. The Bank of Russia may stage direct repo operation and provide Lombard credit extensions for the same period. On January 19, 2009, the Bank of Russia decided to extend the terms of asset-
backed security financing to 365 calendar days, with banks receiving a lending rate of 13 percent. The Ministry of Finance is preparing to release three-year credits to finance regional budgets. A decision has further been adopted to place 10- and 15-year government bonds in 2009 worth more than 500 billion rubles. And amendments are being introduced to allow the investment of pension assets on financial market. It is clear that these efforts to “produce” long-term money (including with the help of short-term obligations) should be continued and increased.

The state plans to allocate $40 billion on the recapitalization of strategic banks (with both state ownership and fully private ones). The State Duma of the Russian Federation is considering a bill requiring banks to raise their capital assets to 90 million rubles by January 1, 2010 – and to 180 million rubles by January 1, 2012. This measure is meant to improve the banking system’s stability and encourage its consolidation.

The creation of a stable resource base for the banks (long-term liabilities), which would come about through the encouragement of long-term private savings, is no less an urgent matter. Within the coming months, the problem has to be resolved through methods that, among other things, could involve the development of a Defined Contribution Pension System, the creation of new insurance instruments, the issue of “infrastructure bonds,” and other measure.\footnote{The creation of long-term liabilities could also encourage citizens to convert their foreign currency deposits into tax-free ruble ones whose rates are set above the refinancing rate.}

Another exceptionally major and complicated problem involves insuring comfortable terms for how citizens transfer their fixed incomes obtained from financial (stock) market transaction to the Defined Contribution Pension System. At the same time, these investors should not have any ceilings set on how much money they could transfer into the pension system. It should further be insured that participants are not discriminated against according to their age.

At the same time, this pension system’s institutions must be made to operate within a system of certain terms. First of all, it must involve a minimum return on investment guarantee of two to four percent above the rate of inflation, which in turn set a number of requirement on the structure of the investment portfolios. Second, the Defined Contribution Pension System’s pension reserves must be insured. It should be a priority to provide legislative recognition for the Association of Non-State Pension Fund’s proposal, which has been supported the Ministry of Health and Social Development of the Russian Federation, to create a Fund of Mandatory Pension Savings Insurance that covers assets transferred by citizens to the National Pension Fund.\footnote{It plan provides for the Fund’s urgent return to the Pension Fund of the Russian Federation of up to 400,000 rubles for each insured person. It is proposed that management over the Fund’s assets is handed over to a special state corporation similar to the Deposit Insurance Agency. At the same time, it is proposed that the National Pension Fund’s operational capital requirements be raised to 100 million rubles, and to introduce a requirement for all National Pension Funds to maintain a constant 1:10 ration between the Funds’ operational capital and raised pension reserve assets and accruals, including their accrued investment income.} Third, the National Pension Fund should be required to make mandatory investments in individual market assets. First and
foremost, this could involve new types of state securities whose terms are similar to long-term pension liabilities (such as infrastructure bonds, for example).

A legislative solution to tax incentives must be made as quickly as possible to ensure that citizens’ financial market returns are transferred to the Defined Contribution Pension System at consistently high rates.

The economic substance of the Defined Contribution Pension System rests it becoming a catalyst for domestic investment demand. It is therefore advisable to return to the issue of adjusting the creations of a tax base for individuals and the National Pension Fund’s Assets Management, and to review the possibility of introducing zero tax rates on incomes from invested securities. It should be remembered that the Ministry of Finance has already propose introducing an exemption in the form of a zero-rate income tax on the sale of securities that were held by individuals for at least one year. The same proposal restricts the potential income from such sales to one million rubles. But this does not seem rational at a time when we are just recovering from the crisis, since it only provides a disincentive for people’s energetic investment behavior, which is so urgently needed at this stage. It would be more useful to temporarily (until the financial market return to certain parameters) cancel the personal income tax for these types of transactions. Another alternative is also possible – to raise the size of personal income tax credit on financial market investments to 300,000 rubles a year, if these returns are transferred to the National Pension Fund (for reference: this tax credit stands at 30,000 dollars in the United States).

Also worth looking into is the possibility of reducing the income tax imposed on the National Pension Fund’s Assets Management division, as well as of private incomes, for total losses from securities and other financial instrument transactions. It is essential to review the principles of safeguarding and guaranteeing the profitability of pension reserve assets and accruals invested in long-term assets. Current legislation in essence prevents this possibility, condemning the National Pension Fund to losses at time of crisis.

The Ministry of Finance of the Russian Federation planned on January 1, 2009, to cancel the Single Social Tax on money transferred by employers to the National Pension Fund. The measure could potentially be amended to include the cancellation of the income tax on assets used by corporations to make dividend payments to the population.

Citizens should receive the right to withdraw funds from their individual pension accounts for the purpose of making (individual) investments. It appears that such transactions will be the subject of the law “On the Procedure for the Payment of the Funded Part of the Labor Pension.” At the same time, provisions should also be made to remove the VAT from funds transferred from the National Pension Fund to citizens (social service).
Since the economic substance of the Defined Contribution Pension System implies that it is, first and foremost, a part of the national financial system that generates the flows of “long-term money,” it appears expedient to move it completely outside the frameworks of mandatory social pension insurance. This approach of developing the Defined Contribution Pension System as a strictly voluntary system is a derivative of the financial market transformation that must occur during the creation of an international financial center in Russia.

Of course, the specific set of instruments allowing the investment of National Pension fund reserves is historically variable and depends on the global financial market’s development and risk profiles. The general “anchor index” should consist of the “Lombard list” that the Bank of Russia uses to refinance the banking system. The Bank of Russia’s expansion of this list would imply an automatic change of the set of National Pension Fund investment instruments.

As the banking system’s role in creating money supply grows by radical proportion, regulators are left facing the need to negotiate the third “fork”—either preserving the status quo by relying on the natural development of the crisis and assisting the weakest players, or making banking system reforms the paramount factor in the creations of a competitive national financial systems.

In addition, regulators’ decision to focus their efforts on the liquidation of the “long-term money” deficit will require an answer to the question of how it may be possible to provide long-term liquidity through the financial system while at the same time reserving a similar amount of assets for the economy through reductions to the tax burden. The swiftness and content of this answer are vital: business must receive a clear signal (up to an “action timetable” from the monetary authorities) for determining the boundaries of its own maneuvers.

It should be underscored that the anti-crisis potential of Russia’s tax and budget policies are limited. A substantial federal budget deficit in 2009 and its expected imbalance in the coming years (the deficit should exceed five percent of GDP in 2010 and three percent in 2011) will require future selectiveness in how state support is allocated. It will also demand a significant improvement in the efficiency of its utilization.

The Ministry of Finance of the Russian Federation forecasts that in 2009, the economy could receive slightly more than two trillion rubles within the frameworks of various tax and budget measures.
## Tax and Budget Policy Measures
### Aimed at Overcoming the Consequences of the Global Financial Crisis

<table>
<thead>
<tr>
<th>Description</th>
<th>Billion Rubles</th>
<th>US Dollar Equivalent (Billion)</th>
<th>% GDP GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Tax and budget policy measures, total</td>
<td>2045.3—2145.3</td>
<td>61.2—64.2</td>
<td>5.2—5.4</td>
</tr>
<tr>
<td>2. Tax policy measures, total</td>
<td>900—1000</td>
<td>26.9—29.9</td>
<td>2.3—2.5</td>
</tr>
<tr>
<td>A four-percent income tax reduction</td>
<td>400—500</td>
<td>12—15</td>
<td>1.0—1.3</td>
</tr>
<tr>
<td>An depreciation allowance increase from 10 to 30 percent</td>
<td>150.0</td>
<td>4.5</td>
<td>0.40</td>
</tr>
<tr>
<td>Changes to the oil export duty collection procedure</td>
<td>250.0</td>
<td>7.5</td>
<td>0.60</td>
</tr>
<tr>
<td>Others, including an increase of the property-related deduction on citizens obtaining housing, a reduction of the tax rate assessed on small businesses, and fishing industry support</td>
<td>100.0</td>
<td>3.0</td>
<td>0.30</td>
</tr>
<tr>
<td>3. Budget policy measures, total</td>
<td>1145.43</td>
<td>34.3</td>
<td>2.90</td>
</tr>
<tr>
<td>Replenishment of the authorized capital, total</td>
<td>439.0</td>
<td>13.1</td>
<td>1.10</td>
</tr>
<tr>
<td>Increase of Rosselkhozbank’s authorized capital</td>
<td>75.0</td>
<td>2.2</td>
<td>0.20</td>
</tr>
<tr>
<td>Increase of JSC Rosagroleasing’s authorized capital</td>
<td>29.0</td>
<td>0.9</td>
<td>0.10</td>
</tr>
<tr>
<td>Increase of JSC AIZhK’s (state-owned Agency for Residential Mortgaging) authorized capital</td>
<td>60.0</td>
<td>1.8</td>
<td>0.20</td>
</tr>
<tr>
<td>Increase of Vnesheconombank’s authorized capital</td>
<td>75.0</td>
<td>2.2</td>
<td>0.20</td>
</tr>
<tr>
<td>Property contribution to the Deposit Insurance Agency, a State Commercial Organization</td>
<td>200.0</td>
<td>6.0</td>
<td>0.50</td>
</tr>
<tr>
<td>Subordinated loans, issued to:</td>
<td>450.0</td>
<td>13.5</td>
<td>1.13</td>
</tr>
<tr>
<td>Vneshtorgbank</td>
<td>200.0</td>
<td>6.0</td>
<td>0.50</td>
</tr>
<tr>
<td>Rosselkhozbank</td>
<td>25.0</td>
<td>0.7</td>
<td>0.06</td>
</tr>
<tr>
<td>Other banks</td>
<td>225.0</td>
<td>6.7</td>
<td>0.57</td>
</tr>
<tr>
<td>Interest rate subsidies for agroindustrial complex enterprises</td>
<td>18.07</td>
<td>0.5</td>
<td>0.05</td>
</tr>
<tr>
<td>Aviation company support</td>
<td>32.0</td>
<td>1.0</td>
<td>0.08</td>
</tr>
<tr>
<td>Auto industry support</td>
<td>39.0</td>
<td>1.2</td>
<td>0.10</td>
</tr>
<tr>
<td>Support for industrial product exports</td>
<td>6.0</td>
<td>0.2</td>
<td>0.02</td>
</tr>
<tr>
<td>Small and medium-sized business development</td>
<td>6.2</td>
<td>0.2</td>
<td>0.02</td>
</tr>
<tr>
<td>Support of active labor market and promotion of employment policies</td>
<td>43.7</td>
<td>1.3</td>
<td>0.11</td>
</tr>
<tr>
<td>Unemployment compensation benefit increases</td>
<td>35.0</td>
<td>1.0</td>
<td>0.09</td>
</tr>
<tr>
<td>Military-industrial complex</td>
<td>50.0</td>
<td>1.5</td>
<td>0.13</td>
</tr>
<tr>
<td>Authorizing the use of federal subsidies for multiple-child families for the payment of the principal and interest on credits and loans, including mortgage loans, and for the acquisition or construction of housing</td>
<td>26.3</td>
<td>0.8</td>
<td>0.07</td>
</tr>
</tbody>
</table>

In addition, a decision was adopted to extend the real sector of the economy 300 billion rubles in state guarantees in 2009. Some 175 billion rubles in tax and budget policy measures are due to be implemented using what remains of the budget at the start of 2009, with the rest to be performed by redistributing expenditures within established budgetary parameters. At the same time, in the words of Alexey Kudrin, budget expenditures will not be cut in 2009; some will just be postponed until 2010. Implementation of the part of the budget dealing with the anti-crisis program, on the other hand, will be stepped up.

The fundamental principle of anti-crisis regulation states that if assets can be left with enterprises and not be redistributed through the budget system, this should be done. A demonstrative example of this is a bill currently being discussed by the State Duma proposing that the deadline for the re-registration of rights to land underneath industrial objects (without facing fines) be pushed back from 2009 to 2013. At issue are real sector savings worth tens, if not hundreds of billions of rubles.

Other measures under discussion include changes to the collateral required upon state banks’ issuing credit to strategic enterprises: instead of just the borrower’s property, it could include either state contracts, specially issued bonds, or revenues. The real sector will also be helped by the Russian Federation Ministry of Industry and Trade’s proposed 50-percent prepayments to companies working on federal target programs and state orders. To a certain extent, this money could become a substitute for long-term loans. As already noted above, the financial and banking system’s generation of long-term funds and the practice of leaving money in the economy (which would otherwise go to the budget) are two sides of the same coin.

Despite all the limitations of using tax policy instruments in times of crisis, certain reserves do remain. The tax burden on business (especially considering the recession’s spread through industry and the fall in investment and consumer demand) remains high: entrepreneurs give the government 29 kopeks back for each ruble they earn, while the oil industry gives back up to 63 kopeks. A more stable effect for insuring the incentive of investments could come, for example, from the introduction of the institution of a “consolidated taxpayer”, and the solution of the closely related issue on transfer pricing. Instead of being simply an anti-crisis regulation, this could become a matter of support for development as a whole. The Federation Council is expected to review a corresponding bill in the spring of 2009.

There are also plans to liberalize the rules for providing tax exemptions for dividends received by parent companies from their subsidiary organizations. The move envisages reducing or even eliminating the size of a parent company’s participation (the current threshold stands at 500 million rubles), while at the same time preserving the limits to the size of its share (of at least 50 percent). In 2009, Russian companies will get the right to apply for a five-year installment plan for
repayment of taxes above 10 billion rubles. This decision may be adopted by the Minister of Finance of the Russian Federation. Interest on the deferred amount would be assessed at 50-percent of the refinancing rate of the Bank of Russia. The tax authorities would be able to make preliminary conclusions on refunding VAT, and to adjust the amounts thereof, once all of the necessary documents are in place. Also, the speed at which a VAT refund is paid could become three times quicker - to no more than a month from when a tax declaration is filed.

Without doubt, these measures will have a beneficial effect on business at a time of crisis, creating necessary incentives for business activity and investment growth. Alone, however, they are not enough. Moreover, they will not complete that tax agenda for 2009.

Other urgent assignments include implementing Unified Social Tax reforms (particularly in delaying, perhaps until 2012, the introduction of insurance payments, if no other compromise is found), differentiating the Mineral Extraction Tax (depending on a deposit’s commissioning and development dates), and determining the application period for a 30-percent deprecation bonus (the Ministry of Finance does not exclude that this could be scaled back three or four years).

It is also necessary to bring clarity to the option of potentially introducing tax holidays. Business associations, for example, are proposing that enterprises be offered tax credits for VAT payments and profit tax, with payments by installments for taxes charged for the third and fourth quarters of 2008. The payments would be made over two years at the refinancing rate set by the Bank of Russia. Another option involves receiving a 10-12-percent, 7 to 10-year state credits, with companies getting back up to 30 percent of the profit tax and VAT payments made to all levels of budget for the preceding two years. Also deserving attention is a proposal to create a special sub-fund within the frameworks of Russia’s reserve funds, which could be used to compensate for budget revenue shortfalls created by the temporary tax moratorium (which, at the very least, could be offered to small companies).

It would be advisable to free staff food allowances (of at least 100 rubles per person per day) from personal income tax and Unified Social Tax payments. A concept for a corresponding bill has been prepared by specialists from the Pepeliaev, Goltsblat & Partners law firm. Offering companies tax incentives (perhaps only temporary ones) for workers’ social packages is both a justified and fair measure in times of crisis. Besides the already-existing ones, it would also be expedient to introduce additional allowances for voluntary health insurance, mortgage loan project compensation, staff training, and pension programs.

*Budget limits in 2009 and the subsequent years of 2010-2011 predetermine the need to pass yet another – the fourth – “fork in the road”, to either assign resources on, for the most part, financing the budget deficit, or to refinance corporate foreign debt (which will reach at least $120*
billion in 2009). Obviously, in actual political practice, a decision will be taken to try and achieve both goals.

No matter what path is taken, there is in fact no alternative to private business taking the center stage in overcoming the recession. Market players, however, are still far from convinced that the government is ready to actively work toward this principal goal. In the meantime, this involves the central issue of trust, whose reinforcement would be benefited by clear guidelines for removing an excessive share of state assets from the post-crisis financial system. Accentuated measures to boost competition and protect private property are of paramount importance; first and foremost they are needed to develop a business climate that motivates private businesses’ own efforts to adapt to the crisis.

3.2 Support for the real sector

From the point of view of companies in the real sector of the economy, the effect of the crisis may differ depending on their focus either on the external or internal market, the financial model they use to raise floating capital, and their amounts and structures of leverage, but on the whole, problems of companies in the real sector are quite similar and basically result from reduced demand for their products, falling prices (for export companies) and the severe restrictions on access to sources of finance.

As noted already, the current economic policy generally conforms to the first of the scenarios described, with some elements from the second. The emphasis so far has been on solving problems relating to companies’ accumulated debt and preventing their bankruptcy due to payments on their liabilities. At the same time, the policy should be aimed at solving crisis-related problems. Another task besides solving the debt problem is to stimulate demand for companies’ products in view of the growing risk of cutbacks. With this in mind, it is important to ensure the measures taken are clear and understood, and do not allow companies to use lobbying tactics to gain an advantage over their competitors.

It is important to note the uncertain role the crisis is playing in the development of the global economy. There are two essentially opposing views of what is happening. The more widespread of the two holds that the economic crisis is a natural part of the economy’s periodic development, in which the current phase of recession is proving deeper and longer than usual. In this case, active policy to support demand and prevent irreparable losses in industry (full

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10 The foreign debt of the non-state sector quadrupled in 2008 from $108 billion to $417.2 billion.
suspension of production, breakdown of operating cycles, disassembly of equipment) will fully preserve all manufacturing potential.

The alternative point of view proceeds from the long-term nature of the crisis, which is changing the make-up and structure of consumption across the world economy in the shift towards a more frugal consumer model. In this case, any attempts by state regulators to preserve demand at its former levels will have only a short-term effect and ultimately expend valuable and limited resources. In this case, the emphasis must be to “soften the landing” of the economy and adapt it quickly to the new conditions. Nevertheless, some actions would appear to be constant regardless of the development model of events. These include raising the performance of companies that are competitive or potentially competitive despite the fall in demand, modernizing outdated infrastructure, guaranteeing the development of vital industries, and preventing unnecessary drops in output due to expectations that the situation will worsen.

It would be expedient to enhance or clarify measures already in progress:

1. **Stimulation of demand through more active implementation of infrastructural projects.** Expanding the chain of infrastructure projects will lead to growth in demand for products from a wide range of other industries. This will, on the one hand, simultaneously solve the tasks of raising internal demand for industrial products and creating employment, while on the other, improve the condition of infrastructure to aid the competitiveness of Russian enterprises. Given the limited financial resources and lack of a clear time frame for when global consumption and production will return to their former levels, the focus should be, primarily, not so much on increasing the volume of infrastructure in anticipation of future growth in demand, than on bringing it in line with current requirements and improving its qualitative attributes (roads, housing, energy). It is proposed that an overall program of infrastructural projects be created for various industries with a definition of selection criteria for particular projects.

2. **Modification of selection criteria of priority companies to gain access to state financing (guarantees, subsidized interest rates).** The main criterion may not be the size of the enterprise or number of employees, as is the case now (support for enterprises based on these criteria is only advisable in certain cases and must be aimed primarily at reducing the negative social consequences in the event they go bankrupt), but rather performance and competitive potential on the world or internal market. Performance criteria may be assessed, for example, in terms of positive added value, higher productivity-to-salary ratios (not by way of wage reductions), positive dynamics in respect of private investments in a company, growth in a company’s share of manufacturing and services markets, above-average indicators of profitability, etc. This will help avoid supporting large but inefficient enterprises that even in
good times failed to become more competitive and are bound to fail in the long struggle ahead. That said, some of the government's resources will indeed go towards supporting them, and not the more efficient and viable companies.

3. **Stimulation of investment demand by providing access to state financing (guarantees, subsidized interest rates).** Government financing for companies should, on the whole, be linked to the realization of investment programs aimed at updating production techniques. This will help create demand for various kinds of capital goods along the whole production chain (although, unavoidably part of the investment demand will be for Western manufacturers that make better equipment or do not manufacture in Russia) and improve performance and competitiveness for the post-crisis period. This will require a shift in focus, from the recent trend of investing in extensive development aimed exclusively at increasing production, to investments in raising productivity.

4. **Guaranteed demand for individual industries.** In some cases, it may be desirable for the government to order products from individual industries to provide temporary support with a view to restoring market demand in the near future. The selection criteria for these industries should made public and developed in collaboration with experts and the business community. Certain criteria could be:

   - difficulties in restoring production following cut-backs (equipment cannot be deactivated on a temporary basis);
   - creation of sectors with the largest interlinked chains across other key branches of the economy; and
   - how vital an industry is (agriculture, food, pharmaceuticals).

Demand created by the government must be directed not at individually assigned enterprises, but at the industry as a whole through transparent mechanisms and buying procedures. This mechanism must be used sparingly in view of the uncertainty surrounding global economic development.

A whole range of other measures aimed at solving the above tasks may also be feasibly implemented, such as internal market support and stimulation and improved economic performance. It is of fundamental importance that the system of anti-crisis measures be linked to the country's long-term economic development. The task is not only to secure a speedy recovery, but to ensure that the applied measures contribute to raising competitiveness and to use the crisis to revitalize the whole structure of the economy.
3.3 Counteracting negative social consequences

The social consequences of the economic crisis at the start of 2009 have so far been of a weak and fragmentary nature. This is because the crisis first goes through phases not directly impacting social status: stock market dips, bank liquidity deficits, and falling prices for Russian exports. Only when the crisis enters the phase of production cutbacks and standstills and serious shortfalls in regional budget will direct social consequences be felt in the form of unemployment and lower wages, which will erode the social safety net.

So far attention has been focused on unemployment. As of January 1, 2009, 1.5 million individuals were registered with state employment centers. The total unemployment figure (measured using ICL methods) was five million or 6.6% of the economically active part of the population.

These indicators are not great in absolute terms either by global or Russian standards (at the end of the 1990s they were much higher). But the dynamics are worrying, as is the concentration of problems in individual industries, regions and cities. Significant drops in employment (including shorter working weeks and forced leave) have been observed in the metallurgical, chemical, coal, machine-building and construction industries, as well as in the service economy (finance, consulting, etc.). The worst affected regions are around Chelyabinsk, Sverdlovsk, Novosibirsk, Samara, Voronezh, Vologda, Perm and the Primorski Territory. Should the trends continue, it is in these industries and regions that the level of unemployment could reach 40-50%, and even higher in certain towns supported by single enterprises.

The government is carrying through a set of measures to alleviate the unemployment situation, including:

- weekly monitoring of the situation;
- additional funds to finance training courses for the unemployed;
- incentives for moving to other localities to look for work; and
- higher rates of and easier access to unemployment benefit.

A total of RUR 54 billion has been allocated from the federal budget in the form of unemployment benefits. A simple calculation shows this is a very small sum: RUR 54 bln / 12 months / RUR 4900 (the maximum unemployment benefit as of January 1, 2009) = 918,000. This is the number of people on maximum monthly benefit that this amount could support for a year. Since the unemployment figure will go up over the year and not everyone can rely on receiving the maximum payout, some corrections are clearly needed. Nevertheless, we know that the New Year was seen in by 1.5 million registered unemployed, most of whom already receive benefit. Furthermore, the allocated RUR 54 billion must cover the cost of retraining the unemployed. A conclusion can be made that given even the most optimistic forecasts for unemployment growth
(according to the Ministry of Public Health and Social Development the figure will rise to 2-2.5 million this year), the resources are insufficient.

Government-approved funds are being allocated per region on the basis of employment support programs targeting the worst affected areas first. This gives rise to the problem of accurately predicting the economic climate, given its current variability. Therefore, some regions will inevitably receive surplus funds while others will suffer shortfalls. To avoid such distortions, a special employment fund could be set up as part of the federal budget to cover the cost of regional services and payments relating to actual unemployment.

Returning to the above-listed measures outlined by the government in support of employment, one should note the need to dramatically improve the utilization of resources allocated to professional retraining. For this purpose, the following mechanism should be used: trainees should be guaranteed a job and a special contract under which they are obliged to spend at least one or two years in the job they are given after training.

As for incentives to move to other localities, so far it is proposed that this will involve moving to permanent places of residence. In actual fact, the jobs most in demand in the near future will be temporary or shift work. Thus assistance on the part of the government will be required to ensure comfortable conditions of temporary residence (modern hostels, daily transport to work places, catering, etc.). Furthermore, government employment centers must be ready to support small groups in single enterprise-supported or small towns and rural areas to look for temporary work in large cities and their suburbs.

Finally, the decision to raise the maximum level of unemployment benefit to RUR 4900 and facilitate access to it will, along with the positive, potentially have negative consequences too. In particular, regions where the cost of living is comparatively low, RUR 4900 may be sufficient to live on (modestly) for about six months to a year without formal employment or any effort to find it. In view of the uninsured nature of unemployment benefit, it would be more effective to introduce a system of targeting (depending on family income and real estate), which is not tied to lost earnings, all the more since documents confirming such earnings are very often of dubious origin.

Private HR agencies and real estate firms should also be involved in solving the problems of unemployment. For example, government employment centers might pay private HR agencies for each person they place from the jobless list. The services of real estate firms might be used (out of budgetary funds) to arrange the relocation of unemployed persons, who could in turn be obliged to spend a minimum amount of time at their new place of work.

The next year holds two possible scenarios for the Russian labor market:
1) an insignificant increase in unemployment (from the current 6.6 to 8-10% of the economically active part of the population) with a considerable reduction in wages (at least 15-20%), i.e., a repeat of the situation in the 1990s; or
2) a significant increase in unemployment (up to 12-15%) with a relatively small reduction in wages (5-10%).

Which of the two occurs will be determined by economic and political events in the first half of 2009.

3.4 Anti-crisis regulation at the regional level

Managerial crisis

The economic crisis in Russia is quickly turning into a managerial crisis.

Firstly, the decision-making mechanisms formed during the period of stable development and huge oil revenues cease working in the new environment. They were built on a system of growing financial obligations motivated by economic agents, but as the crisis develops the number of sources for covering such obligations is rapidly dwindling, which is leading to a growing conflict of interests between the elite, business and the general population.

In addition, financial reserves are quickly drying up. Judging by the rates at which this is happening, by the middle or end of 2009 the country's gold-value reserves may come close to zero, requiring drastic short-term measures. However, it should be clear that in times of crisis all economic agents – the budget, enterprises and the population – suffer tremendous losses that are very unevenly spread - regionally, commercially and personally. The scale of such losses far outweighs any government compensation package.

As early as summer 2009 we may be witnessing a crisis of the “social contract”, which is founded upon stability. Conflict lines will appear as social mobility declines, unemployment grows, people become marginalized, corruption causes more discontent, and other similar processes start up.

Secondly, the growing uncertainty surrounding future events means there is less understanding of the priorities and tasks in the short and medium term. Moreover, depending on how the crisis unfolds, the population's perception of the priorities and means of solving medium-term tasks alters quite radically, and the gap between how different social groups perceive them widens. In this sense, Russian society is already entering a crisis of values. As a result, decisions motivated by one set of factors and events begin to contradict the newfound
circumstances; decisions made in the interests of one group of business and society run against the interests of other groups. They suddenly seem untimely, shortsighted and inconsistent.

Thirdly, as in any crisis the cost of managerial mistakes is going up, institutes are ceasing to function properly, “hands-on” management is in demand and yet there is neither the experience nor the tools to implement it. Conversely, the very act of shifting to a hands-on approach breeds opportunism on the part of economic agents and reinforces spontaneity and chaos across the whole system of government regulation. Normal coordination measures are often lacking. It turns out that the existing institutional environment is woefully ill equipped for hands-on management for the simple reason that there is no one who can take decisions independently and rationally. The bureaucratic elite is too focused on preserving itself, incapable of reacting quickly and very hierarchical; it waits for orders, cannot take independent decisions and easily changes its positions.

The main problem today in the economic sphere is the lack of a uniform anti-crisis policy. And the development of one is being hindered by both the objective uncertainty surrounding the global crisis and the subjective association of today’s events with memories of the 1998 crisis. Russia was perfectly ready to face a 1998-style crisis, but the current one caught everyone off guard. It is something completely different. However, despite the usual analogies failing to provide an explanation, there are some lessons that may be drawn in relation to 1998.

The formal start of that crisis took place on August 17, 1998, following Sergei Kirienko's announcement of a default. However, the crisis had been felt before then. In particular, it is known that Sberbank and SBS-Argo stopped making tax payments on August 1. Strictly speaking, the demise of the budget system and the “GKO” [State Short-term Obligations] internal government debt market came to an end before August 17. A meeting of the IMF in Istanbul, at which the problem of Russia’s possible default on debts was discussed, took place back in early May. Negative forecasts were given concerning the country’s economic situation, which cemented the Western banks’ intention to withdraw capital from Russia. Also, in summer 1998 optimistic statements were made by both the president and the government of Russia, and decisions were taken based on the situation being stable. In particular, just two weeks before the crisis, the RF government adopted a strategy to reform internal budgetary relations for the very first time.

The situation then was less well understood than the current situation is now. In 1998 regional statistics were of a poor quality. Monitoring back then was not compulsory and even hardly possible. The first issue of “Regions of Russia” statistical data actually appeared only in 1998 when the Ministry of Regional Development set up the Department for Regional Monitoring.

The consequences of the 1998 crisis were manifest on several levels.
Firstly, the crisis was political. The government was dismissed, twice Viktor Chernomyrdin’s candidacy for the post of prime minister was rejected by the State Duma, and until the middle of September the new cabinet was headed by Yevgeny Primakov. Viktor Geraschenko was returned to the post of chairman of the Central Bank of Russia. Similar consequences were avoided in the regions, yet two to three days later, following the central government’s lead, regional governments began announcing defaults on regional and municipal obligations.

The political reaction of the regional authorities contained a certain distancing from the policy of the federal center, which was displayed in populist acts such as the decision to adopt the Resolution “On Measures to Protect the Population from Ill-founded Rises in Prices for Goods of National Consumption”, the formation of interregional barriers, and the accumulation of financial resources in special ways. The legislative assembly of the Kemerov Oblast even adopted a resolution on the need for legislative power to be transferred to the regions, i.e., to amend the Constitution of the country. Finally, it was announced that regional taxes (more precisely, taxes collected in the regions) would no longer be paid to the federal center and certain steps were taken to that effect. Back then there was no treasury, just a system of authorized banks, and the regions were able to make such statements. Incidentally, Kalmykia was the only place where such measures were put into practice: on the orders of president Ilyumzhinov September payments were not made to the federal budget. In reply, the Central Bank abolished the status of the National Bank of Kalmykia as a structural division of the Central Bank and transferred its functions to the central administration of the Central Bank for the Volgograd Oblast. Meanwhile, the Russian Ministry of Finance curtailed all financing for federal target programs in Kalmykia, and by October order had been reestablished.

Another political consequence of the 1998 crisis worthy of mention were the national protests on October 7, which took place throughout the whole country. The protests themselves were planned before the crisis, but they acquired much greater resonance due to the crisis.

Secondly, the crisis of 1998 quickly came to resemble a banking crisis. The collapse of SBS-Agro Group offered clear proof of this. At the same time, SBS-Agro had, after Sberbank, the largest regional network in Russia, consisting of around 1500 branches previously under Rosselkhozbank and Agroprombank (since renamed). By the time the crisis began these branches had concluded about 40 cooperation agreements with the regions. Other banks in the top-20 banking ratings also suffered.

Since there was no treasury to implement the budget, regional budget accounts were held at so-called authorized banks. In 1998 Moscow banking structures were being activated in the regions and at that time many regional administrations were in the process of transferring their accounts to Moscow-affiliated banks, causing them to suffer. In connection with this, in September 1998 many
regions launched an initiative to create provincial and regional banks or special banking pools to solve the problem of payment delays. The largest pool was created in St. Petersburg, headed by the local Promstroibank.

Thirdly, the regions actively implemented a course of anti-crisis management. Over the space of one to two months many regions set up anti-crisis committees, and special resolutions were passed diagnosing the emergency or dire economic situation. There were even cases where such decisions were taken by municipal authorities. Special committees were created to control price formation. Prices became strictly regulated in many regions; mark-ups generally accounted for 10-40% of the price of all basic essential goods.

Bans were introduced on the export of essential goods outside constituent entities of the Federation. Sometimes the situation reached absurd proportions. It was September and several producers openly stated that such bans were hurting local agriculture. For instance, in the Krasnodar Territory a ban was introduced on the export of sunflower oil, despite the fact that deliveries had to be made to other regions at that particular time. Yakutia announced a ban on the export of gold out of the republic. Various anti-crisis programs were drawn up. The most forceful was the national plan of anti-crisis action adopted by the Bolshoi Ural association and signed by all governors of the Ural economic region. However, the anti-crisis measures were rather chaotic on the whole.

Undoubtedly, the situation in 1998 in many respects differed considerably from that of now. Faith in the authorities was desperately low, while today’s leaders have consistently high ratings. The crisis in 1998 came after a decade-long transitional period, not after eight years of upward trends as is the case now. On the one hand, huge debts were accumulated by enterprises from taxes and interest fines, and on the other, high debts were owed by the government to both the population and companies. The problem of uncovered mandates was so acute that even discussing it created difficulties. Nevertheless, the experience of that time has not been forgotten and must be recalled constructively.

Comparisons with the 1998 crisis show that the key problem in the area of state management is the relationship between the federal center and the regions. It is not so much a matter of top-level political obligations, as a redistribution of social and economic obligations to communities and businesses to level out and minimize the risks that are very unevenly spread across the country's regions.

Unlike in 1998, the central authorities are better prepared for the crisis than the regions. The federal budget, unlike the regional ones, is insured by multi-billion reserves and have yet to experience the difficulties faced at the regional level.
Anti-Crisis Measures of the Regions and Actions of the Federal Government

Russian Federation president Dmitry Medvedev chaired a meeting of the State Council on November 18, 2008 in Izhevsk devoted to measures aimed at enhancing national competitiveness amid the world financial crisis, where he instructed every region to develop its own plan for dealing with the crisis. Anti-crisis commissions, committees and staffs are being created today in most, if not in all, of the regions, and appropriate strategies or plans are being developed. Similar recommendations are being given to local government agencies. Anti-crisis centers are also being created in federal districts (for example, in the Ural Federal District). Many companies will be working within the framework of the anti-crisis programs approved by them.

The arsenal of measures offered in these plans and strategies is still not very diverse; it includes roughly the following aspects:

**Cost-cutting:**
- The possibility of sequestering expenditures is being discussed;
- A number of investment projects are being put on hold, while others are to proceed come what may (in particular, these include projects with high social significance that are being financed jointly with the Federal budget);
- Non-production-related expenditures are to be reduced such as on day-to-day necessities, work-related trips, fuel, and the financing of athletics clubs and teams;
- Subsidies to agricultural producers in the Irkutsk Region on the meat and milk that they sell are being reduced;
- Federal administrative expenditures are being reduced, staffing cuts are foreseen, and in the Arkhangelsk Region a planned transition to a new way of paying government employees is being postponed;
- The government of the Kaliningrad Region has put a large scale tourism advertising campaign on hold; and
- The government of the Kaliningrad Region has announced that in 2009 it will increase payouts to honored veterans of labor, wartime workers, victims of political repression and families with many children.

**Federal stimulus efforts:**
- Regional stabilization funds are being created. These include five billion rubles for Sakhalin Island, 304 million rubles for the Republic of Altai, 16.5 billion rubles for the Kemerovo Region, and 11.3 billion rubles for the Novosibirsk Region;
- Guarantee funds and a guarantor system are being created. In the Sverdlovsk Region the federal government is considering providing interbank financing guarantees to the region;
- Increasing federal support for the leasing fund;
- Subsidizing the interest rate that banks pay;
- In the Magadan Region the government plans to increase the maximum subsidy on interest payments on loans while increasing the number of loans that each small business can be pay off simultaneously, with compensation of a portion of the interest rate;
- Adoption of programs to support separate industries of the economy (a 500-700 million ruble reserve fund might be created in the Sakhalin Region to support banks);
- In the Omsk Region in 2009 the government is earmarking money for the expansion of a 312 million ruble regional mortgage program; and
- It has been resolved not to increase rental payments that small businesses pay for office and industrial space owned by the regional government until July 1, 2010.

**Tax measures:**
In the Jewish Autonomous Region the government will decide whether to reduce the tax burden on companies operating under the simplified taxation system (the rate will be reduced from 15 to 10%);

In the Orenburg Region accelerated VAT returns have been introduced for companies that export; and

In the Tomsk Region a set of tax breaks for businesses that actively invest is being maintained along with mechanisms for providing federal guarantees to companies that implement high-priority projects.

**Labor market regulation:**

- Regular monitoring of the labor market will be conducted to ensure the timely dealing with possible mass layoffs. Unemployed workers will be offered retraining at the federal government’s expense in order to obtain a profession that is in demand on the labor market;
- Consulting centers are being opened and hotlines are created for the unemployed;
- Such a measure as reducing the quota on hiring foreign employees is being discussed, though no companies are currently replacing migrant workers in low-paying jobs with Russian workers, and this is not expected;
- Control over salary payouts is being stepped up in order to prevent a return of “grey” schemes and cash-in-hand payouts;
- Lists of public works projects are being created in municipalities; and
- The government of Karelia has demanded that industrial firms get government approval of any plans to reduce production and lay off personnel, promising to offer in exchange temporary government-owned space rent-free, tax breaks on property and profits, and an increase in subsidies on interest rates on loans taken out for the implementation of investment projects.

**Other measures:**

- In the Kurgan Region the government is making advance payments to government employees in order to return income tax to the treasury as early as this year and reduce the deficit;
- The quarterly share of payouts from the regional budget of transfer payments to municipalities is being changed (the shares of the first and second quarters are being reduced);
- The development of plot plans in municipalities is being postponed;
- There is a proposal to reduce the activeness of monitoring bodies;
- The government of Karelia intends to put on hold the process of optimizing the network of social sphere institutions;
- Monitoring of draw-downs of subordinated loans and other types of federal support to banks is being organized, along with the monitoring of state correspondent accounts and subaccounts of lending institutions in the region with the goal of identifying negative trends;
- A trilateral agreement has been signed between the administration of Arkhangelsk, labor unions and companies. The government has taken upon itself the obligation to assist exporters by accelerating the return of VAT and subsidizing from the federal budget interest rates on loans received from Russian banks. The rental payment deadline has been moved forward to May 2009. The possibility of the regional administration providing guarantees as additional security on loans will be considered. The regional labor union of employees of forest industries, for its part, has agreed to conduct informational outreach to labor collectives, and refrain from putting forth new requirements with regard to collective agreements and from organizing collective actions or protests. Forestry companies, for their part, are agreeing to approve measures to prevent mass layoffs by shortening the working day and week, paying two-thirds of salaries for forced downtime, providing unpaid vacation at the initiative of employees, and laying off employees at the initiative of the administration only for punishable actions. Forestry companies are also agreeing not to allow arrears of taxes or other payments owed to the regional consolidated budget to accumulate, agreeing to implement according to a calendar plan investment projects included in the priority list, using raw materials from Arkhangelsk as much as possible in production, and purchasing local products and services for their needs; and
- Federal money paid to municipalities in the form of grants will be checked to make sure it is spent correctly.
Naturally, as the crisis develops, totally different situations will evolve in each of the various regions. The ones who will suffer the most are those who have committed to large construction projects that must be put on hold after the construction phase begins. A great deal will depend on what kind of concept of assistance to the regions Moscow approves. Strong regions will most likely suffer as money is taken from them to pay weaker ones.

And finally, it is not understood how Moscow will redistribute funds among the regions, since it is physically impossible to regulate all the regions from Moscow in order to ensure their survival. **Strangely, the “crisis management” mode must be combined with giving the regions maximum freedom in achieving their survival objectives.**

The crisis will also manifest itself in differing ways within the regions. First and foremost, regional capitals should be singled out, together with ten other large cities, in which in 92% of Russia’s banks and 84% of what is customarily referred to as “office plankton” are concentrated. This is also where 84% of all the country’s construction capacity is concentrated. **Today these cities (about 100 in all) are where crisis conditions are most prevalent, and the most probable places where resuscitation will occur and the crisis will be overcome, because all the preconditions for this exist.** Layoffs of workers in these cities, both in absolute and relative terms, are several times higher than in surrounding regions, but so are the opportunities to find work.

In large cities today, homegrown programs for mitigating the crisis are beginning to be developed. The initiatives of at least 20 such cities, including Kurgan, Vladimir, Krasnodar, Magadan and Khabarovsk, are well known. Some local governments are buying up housing, which, of course, is nearsighted, while in some places they are forewarning people about possible reductions in certain state benefits. This is one of the most important anti-crisis measures - eliminating uncertainty and panic. In some cities such as Khabarovsk, local governments are preliminarily restructuring budget expenditures for social and other purposes.

**Very serious problems may arise in cities whose economies are not diverse.** There are nearly 700 cities that depend on just one or two large companies for employment, where residents have very few employment alternatives.

In rural areas, at least in the Non-Black Earth Zone, the situation has not changed much. Distinctions between the regions may be determined also by subjective causes, first and foremost the degree to which local government officials understand what is occurring. Some regional administrations as early as late 2008 assessed the prospects and complexities of the future economic situation and began to actively take corrective steps, while others are only now realizing the scope of the problem. The situation is exacerbated by the fact that the budget was already being finalized when the crisis became evident. Only those who recognized that it was a crisis were able to promptly react by recalling budgets before they were read for the first time in the legislatures, or
returning budgets to the first reading stage (we should also mention here the initiative of the Finance Ministry in Moscow, which pursued a timely policy of requiring all the regions to revise their budgets). As a result, at least ten regions had completely new anti-crisis budgets by the end of 2008. Many regional governors then understood that a crisis means a transition to a lower level of public consumption, and thus that it is necessary to reconsider not only long-term budgets but also other systemic solutions.

Uncertainty is growing for purely objective reasons as well. In the planning of spending there is no concept of the corridors within which prices will change for goods and services purchased for the government’s needs. Both domestic prices and the dollar exchange rate are changing more and more dramatically. As it turns out, as part of the mechanisms for budget replenishment, distribution of state contracts and the acquisition of goods for the government’s needs, questions with regard to the changing situation on the market have not been worked out completely. State purchasing agents do not have tools to avoid paying inflated prices for the goods and services that it could be possible to buy cheaper later in the budget year and not incur additional losses if the situation gets worse.

Governors are finding themselves squeezed from two sides: on one side - from their understanding of the inevitable social consequences of the crisis, and on the other - from the general public in the region and local legislatures. What is more, in some places the situation is exacerbated by upcoming elections (for example, in Arkhangelsk). Balancing on the brink at the regional level turns out to be very hard work.

It is impossible to quickly decide the problems listed above, particularly before the crisis reaches its culmination. However, both federal and regional government agencies must formulate a distinct position on a number of key issues:

1. The constituent entities of the Russian Federation need clear information about Moscow’s position on the following:

- The expected increase in the total amount of transfer payments for the stabilization of the revenue base, and the mechanisms and time frames in which they will be distributed (Finance Ministry of Russia);
- Changes (reductions) in the types of subsidies from the federal budget envisaging co-financing on the part of the constituent entities of the Russian Federation [the Russian Ministry of Regional Development (Minregion)];
- Possibilities (and conditions thereof) of obtaining transfer payments from the federal budget in advance (Finance Ministry and Regional Development Ministry); and
Possibilities for regions with substantial debt burdens that are incapable of refinancing their debt obligations on the market to obtain federal loans (or refinancing with federal guarantees) (Finance Ministry of Russia).

2. In order to assess the correctness of their own actions, the constituent entities of the Russian Federation need information about the situation in other regions with regard to:

- How much salaries in the public sector are being reduced compared with the 30% increases announced in autumn 2008 in the regions (regional governments do not want to reduce them by too much or too little compared with their neighbors as this might lead to political and social problems);
- Laying off public-sector employees (deciding how many to lay off, mechanisms to be used, and dealing with the consequences);
- Magnitudes of planned reductions in revenues;
- Acceptable revenue enhancing mechanisms for financing budget deficits (cooperating with lending institutions, negotiating interest rates, borrowing periods, etc.).

3. The following questions concerning methodology may be of interest to the constituent entities of the Russian Federation:

- The methodology of (criteria for) distributing transfer payments for the purpose of stabilizing the revenue base of local budgets;
- The set of subsidies to municipalities that should be maintained (approaches to determining which subsidies should be maintained and which should be discontinued); and
- The set of criteria according to which it is possible to monitor the situation in the municipalities

4. Bottlenecks worthy of special attention when organizing work in the regions in 2009 (proposals in conjunction with the anti-crisis plans).

4.1 Preventing an accumulation of payables in the regional budget for salaries, goods and services.

It is possible to propose the following measures:

- To establish additional procedures to ensure that state institutions of the constituent entity of the Russian Federation fulfill their obligations (imposing administrative or disciplinary measures if necessary); and
- To introduce monitoring of institutions’ payables, overdue payables, and to adopt measures to eliminate overdue payables (restructuring and writing off).

4.2 Preventing overdue payables from local budgets for salaries, goods and services

The following measures are proposed:
To create mechanisms for distributing inter-budget transfers that are adapted to the new conditions, including:

- To introduce in legal enactments the possibility of making transfer payments in order to stabilize the revenue bases of local budgets (or similar transfer payments) that are distributed in a way that takes into account actual changes in the revenue base of local budgets; to develop a methodology for distributing transfer payments (the possibility in relation to a number of constituent entities is specified in the laws on interbank associations); and
- To reduce the number of subsidies from the regional budget that suppose co-financing from the local budget; to reduce the requirements with regard to the level of co-financing from local budgets; to introduce terms for subsidy payments that are adequate for the needs of the time (timelines of salary payouts, the use of procedures, work with payables).

To regularly conduct informational outreach work with specialists of local government agencies about what is occurring, how to react correctly, and mechanisms of cooperation with business owners and the general public.

4.3 Clear financing priorities of:

- Investment projects;
- Infrastructure development projects; and
- Social and cultural measures directed towards stabilizing the social situation in the region.

4.4 Stimulating efficient use of budget funds by federal government agencies and state institutions of constituent entities of the Russian Federation.

The following set of measures is proposed:

- As there is no way of knowing the corridor of price changes for purchased goods and services, when placing state orders it is expedient to keep track of the reduction of average market prices for purchased goods and services, and change the initial price of the purchases;
- To stimulate institutions to economize on the goods and services they purchase, including utilities (if such economies lead to economies of budget funds), for example, by allowing institutions to keep a portion of the money it saves; and
- To try to manage the expectations of suppliers of goods and services with regard to the payment amounts they receive from the budget of purchased goods and services (within the limitations of the law on state purchasing).
4.5 Intra-regional monitoring of the situation in spheres that are directly or indirectly linked with the state of regional finances.

Monitoring requires:

- drawing up a list of indicators and problematic issues (for example, widespread arrears between organizations in the region); and
- determining possible revenue sources and how frequently payments can be received from them:
  - official statistical information;
  - gathering additional data from organizations working in an RF constituent entity (in cooperation with non-profit organizations in the same industry, labor unions and regional divisions of the “Rabochy” [Worker] Public Political Association); and
  - conducting surveys of organizations and the population.

5. The constituent entities of the Russian Federation need accurate information about Moscow’s position on:

- economically and scientifically well-grounded priorities of spatial development in the RF territories in the new conditions;
- identifying industries in which development will be considered most important in the medium term; and
- mechanisms and ruble amounts of state support to commercial sector organizations working in the constituent entities of the Russian Federation.

6. The following methodological issues may be of interest to the constituent entities of the Russian Federation:

- criteria for selecting companies, spheres and private sector industries that should be supported (promising but not necessarily socially significant ones); and
- forms and methods of non-financial support (help in securing property rights, including those to land, organizing the training of personnel, help in dealing with lending institutions, etc.).

Disturbing the balance of inter-budget relations

The system of distributing inter-budget tax sources and obligations that has evolved in Russia in the last ten years is fundamentally ill-equipped to function amid serious macroeconomic crises.

The key sources of income for local budgets are two taxes that are very sensitive to crisis situations. The first one is the tax on profits, which comprises 30-40% of the income portion of regional budgets. Revenues therefrom began to fall abruptly as early as 2008 and will probably fall
further in 2009. The second one is income tax, revenues from which have fallen in real terms and will fall more rapidly in 2009 as personal incomes fall faster than the country’s GDP.

For this reason the federal budget is in a more advantageous situation compared with the regional budgets; it has reserves of about 13% of GDP, practically no state debt, and accumulates revenue from VAT. In the constituent entities of the Russian Federation, the reverse is true. They are getting falling revenue from the tax on profits and income tax, have large debts and, finally, no reserves analogous to the stabilization fund or fund for future generations.

Moreover, according to the existing distribution of authority, the expenses of the constituent entities of the RF that will rise are the very ones directly associated with the crisis. Unemployment compensation to a large extent is financed out of the budgets of the constituent entities of the RF, expenditure on social assistance is practically completely financed out of their budgets, as is everything associated with social services, the demand for which will rise, especially in the places where the crisis will hit hardest.

The crisis is affecting the country unequally. Already in 2008 the country witnessed an enormous decline in production in a narrow group of five or six regions that account for most of the decline in industry. These are the regions where incomes are falling fastest, while the number of obligations that they must finance themselves is rising.

The regions are showing clear symptoms of imminent budget deficits. For example, in the Vologda Region they are discussing the possibility of reducing government benefits for next year. In the Moscow Region they are complaining that municipalities are not paying back loans given to them to cover cash shortfalls from reduced revenue to local budgets (this is understandable, since construction in the region is being put on hold and revenue has fallen). Revenue has fallen in Nizhny Novgorod as well, as the GAZ plant is operating only intermittently.

“Rich” regions are currently encountering a more complex set of problems. All regions with high incomes rather actively took out loans and paid them back or refinanced them, resulting in larger loans, mostly during the course of a year. Sometimes the size of the loan that one or another such region tried to obtain reached 20-30% of its budget expenses for 2008. Half or three-quarters of these funds should have been used to refinance other debts. If such borrowing stops, a corresponding “hole” in the budget will appear. About 20 constituent entities of the RF are now in a very serious debt situation, with about ten regions in a real debt crisis.

What is more, in Russia it has become common practice that the source of financing deficits in regions that borrow and those that do not borrow are often their account balances. Sometimes they amount to tens of percents of budget expenses. The results for the year 2008 will most likely be zero balances, and we will be seeing the depth of the crisis in the regions late in the first quarter of 2009.
As has already been noted, serious problems will arise with the financing of federal targeted investment program facilities. As expenses are sequestered, these will be the first candidates for reduction. Of course, procedures for selecting them per priority and social significance will arise, but as a whole, the share of such expenses in the budgets was higher for wealthier regions.

All this means that the regions that will suffer most from the crisis are the strong, “rich” regions - those that have received the tentative designation of “donors.” Those that receive transfer payments will suffer the least simply because the transfer payments are as a matter of fact intended to compensate them for their low incomes.

At the same time, the method of distributing financial assistance in Russia is ill-suited to crisis conditions. By this method the number of donors will grow.

First of all, in the period of stable growth, the number of donors in the Russian Federation fell because a few regions – the most advanced ones – surged forward and raised their average indicators, while those who fell short of these indicators received transfer payments. Amid the crisis the richest will go into decline, the Gini index will equalize, the average indicators will fall, and more regions will become donors purely statistically.

Second, the financial assistance distribution method foresees stimulating the growth of the tax base – the revenue base – so that the income potential is assessed first and foremost as the average indicator of the last three years and, accordingly, the ones who grow are stimulated. Indicators will fall during the crisis, and whereas the tax potential is underestimated in the previous case, now for every region it will be in effect reassessed, and those in need of assistance will receive less in subsidies and transfer payments than was prescribed. It turns out that the method itself cannot compensate the loss of the regions’ budget income. The question arises as to how the federal government will be able to guarantee the fulfillment of its social obligations. One could suppose that changing the formula may fail to produce the desired result, but amid uncertainty in economic changes, it is hard not to make a mistake and guess in a way that produces some sort of stimulus.

The remaining option is to use a tool that was resisted for a long time during times of economic growth - transfer payments to balance out the regions. Apparently, it is this tool that must play the main role in relations between Moscow and the regions. In effect, this means abandoning severity in budget relations. Everything will be assessed sufficiently subjectively again.

Another fund, another flow of money from the federal budget - these are subsidies. They are currently being spent mainly on investment needs. Apparently, here it is necessary to switch from investment expenses to current expenses, on ensuring salary payouts to government employees and support of the social sphere.

In such conditions a special role may be played by minimum social standards, or standards for providing the government services that are being developed by the regions in accordance with
the requirement of reforming regional finances. These standards, which were adopted only for the sake of obtaining subsidies from the reformation fund and were not implemented in many places, are even less likely to be fulfilled during the crisis. And this is not to mention the fact that on the federal level, notwithstanding persistent demands of deputies, minimum social standards are not being developed, and such a process can hardly be expected to be launched in the foreseeable future. But as it is necessary to sequester the budget – and such sequestering will be done rather subjectively and, no doubt, on the basis of lobbying by recipients of transfer payments – minimum social standards can play a positive role. They nonetheless could have guaranteed a level of financing of government institutions or a relatively proportional reduction thereof.

In support of the regions during the crisis, the federal government, though late, could implement the set of measures discussed in the State Council. In particular, it is necessary to allow the creation of reserve funds (though currently there is no source of money to establish them). It is another matter that even those regions that have tried to create reserve funds under some other names have faced the problem of maintaining them. For example, money from one of the constituent entities of the RF was placed in illiquid assets such as hotels in St. Petersburg or masterpiece paintings, which would be impossible to sell for a decent price now.

The regions have great potential to reduce expenses. In recent years these expenses have quickly risen, mostly due to rising incomes. Here, of course, it is possible that the quality of the provided government services will fall. However, for the regions there is no other way, because we cannot allow debts to increase as long as there is a risk of a substantial reduction in income. The constituent entities of the RF must urgently reconsider their expenses and introduce progressive ways of compensating employees precisely with the goal of keeping the best employees and identifying other priority expenses.

The system of inter-budget relations with the municipalities must be reconsidered. The mechanisms currently in place to provide rapid assistance to municipalities are not as effective on the regional level as on the federal level. On the federal level there exist, for example, transfer payments to achieve balance, the size of which is not limited in the Budget Code. On the regional level, financial assistance in the form of transfer payments and non-targeted funds are limited. Everything that the constituent entity distributes among municipalities in non-targeted form is limited to about 10% of the budget, and this mechanism does not help much in solving the municipalities’ problems. The regions must develop alternative mechanisms, for example, subsidies for the support of municipalities’ high-priority budget items.

There is a rule in the management of state and municipal finances that says that you can do what is permitted, not what is not forbidden. And a region (municipality) can hardly be expected to spend earmarked financial resources in circumvention of the law on state purchasing; it must spend
money according to certain rules and procedures. Therefore, formalizing rules for supporting regions and municipalities while establishing strict rules governing how financial assistance is earmarked is becoming very topical.

Much also needs to be done to formalize these rules of the game and strengthen public control over government spending.

The need to adjust regional strategies

Most of the anti-crisis measures being voiced today are directed towards smoothing over the factors and mitigating the consequences of the crisis, while regional anti-crisis strategies are protective in nature. However, more and more people are realizing that the economy must undergo changes as it emerges from the crisis, and that the main task today is helping it grow.

This means that regional development strategies must be substantially reconsidered. Such work must not simply include reconsidering indicators of output, investment projects or other economic indicators. It must be done on a deeper conceptual level, including analysis (correction) of the goals and tasks of regional development, and its competitive advantages broken down by region, country and the global economy, taking into account ways to change them under this or that scenario of how the crisis will unfold. The regional goals and tasks must be structured in a way that minimizes inter-regional competition for labor, investment and other limited resources, and ensures complementarity of the strategies of the various regions and the specialization areas of their development. The possibilities for inter-regional cooperation must be used to the maximum.

To a certain extent it is the crisis that makes it possible to optimize such work, since all the regions need to adjust their strategies simultaneously and the adjustments can be implemented according to a single set of principles, identifying commonalities, with serious analysis of inter-regional “chain reactions” of the spread of the crisis.

The main questions that worry everyone are: how should the losses from the crisis be redistributed and what advantage can be derived from the crisis. While everyone understands that everything is already bad, is getting worse, but will then gradually improve, it is time to begin to optimize the medium-term strategies. This is especially important for strong regions. There cannot be a single universal solution. These times can also be used to rebuild infrastructure, restructure management and work out those measures that would make it possible to make a good start when the difficult situation is over.

All the countries of Europe, Asia and Latin America are transitioning today from purely financial ways of protecting themselves from the crisis to economic development projects, which are most relevant in the crisis.
In this sense it is necessary to be ready also to change priorities in investment and the very mechanisms of attracting it to the regions. It is necessary to cancel large-scale projects that will not lead to an improvement in the structure of the economy and an increase in labor productivity. Important criteria for leaders of all levels must be such indicators as the number of newly-created jobs, and the increase in the tax base and personal incomes.

In any case, in order to increase the investment attractiveness of the regions, their economies must be modernized. Already now it is necessary to clearly talk about the goals of medium- and long-term development of the regions and the country as a whole, about the responsibility of regional governments to find effective mechanisms for implementing economic policy and for the results of the policy.
4. Public dialogue amid the crisis: an agenda

The Russian crisis manifested itself not only in the economic and social spheres, but also in the informational sphere. The need for information is growing while information is becoming less accessible. This process is analogous to a “thrombosis” of financial channels. The circulation of information slows, its quality decreases, and this is occurring everywhere—in the information flows between government departments, economic agents, the media and the population.

The information crisis is exacerbated by the fact that information about what is occurring is becoming more and more contradictory. Even in the government and the structures that surround it, various assessments are given of possible economic policies, decisions adopted and their consequences. Attempts to give only validated and consistent information provoke accusations of filtering out information and censorship. The absence of monitoring, to the contrary, provokes fears and negative expectations. As a result, observers sense the crisis in very different ways. On the one hand, many underestimate the seriousness of the situation, while on the other, expectations that the situation will worsen overtake the real development of events.

In these conditions it is extremely important to have an information policy pursued by the state media or the media controlled by the state. Currently this policy is directed towards suppressing the growing problems or shifting responsibility for them onto external forces (the United States, Ukraine, etc.). However, the growing economic problems at the level of regions and separate families (losses of jobs or other income sources) sooner or later will create a contrast with the official information backdrop.

Information becomes an even more important resource for citizens in a period of crisis than in calm periods, but now they are suffering from a colossal shortage of it. After all, the main sources for them are the nationwide television channels, which have begun to noticeably filter out information. Sociologists are already noting a reduction in citizens’ trust of the information they receive from nationwide TV channels.

We can expect that citizens to a large degree will trust regional media. First of all, self-censorship in regional media only concerns local subject matter; they are freer to analyze foreign, federal and Moscow-based problems. Second, regional media more actively use information from the Internet.

Statistics lose their relevance quickly and are not suited to observing the crisis. Statistical monitoring is beginning to be formed, but it is still not clear how to observe what is going on and which factors to focus on. Currently both the president’s staff and the government have developed a
monitoring system that gives the regions certain information every week or ten days\textsuperscript{11}. But the regions do not obtain feedback and therefore do not know how the information is processed and cannot see the big picture, their place in it or their neighbor’s situation, though the need for timely information has indeed increased. This need is satisfied using low-tech means - telephone calls to colleagues from the neighboring region or chief executives of large companies.

Companies do not give full information to the ministries, because they have the right not to report it. Local statistical agencies also do not provide all of their information to regional administrations. What is more, they often do not have the right to report the respective information to regional governments. Some regional ministries do not share information with other ministries. As a result, we have a pyramid of bans on information. The information base for governing regions has practically been lost.

The regions themselves and separate organizations apparently have a vested interest in reducing information transparency vis-à-vis the federal center. The threat of the crisis unfolding is turning into a strong argument in relations with the federal government and other contracting parties to change their obligations, for example, as they concern budget funds and other resources distributed from the center. It is no longer a secret that the assertion that Moscow is pursuing a consistent policy with regard to inter-budget transfers is only a slogan. Many hope they will be rescued if they show shortages.

Not only have the federal and regional agencies of the executive branch begun to monitor the unfolding of the crisis, many think tanks have as well, though the big picture has yet to emerge. Indeed, it is easy to build a system for monitoring processes occurring in stable times, when you have a consistent set of indicators that must be tracked. But in a complex crisis situation, the very list of indicators starts to “float”, since the consequences of the crisis can manifest themselves in the most unexpected forms. They must be tracked according to a very broad set of facts and indicators.

Furthermore, amid the crisis the need to change the approach to management and decision-making becomes obvious.

1. **Fast reactions to events** is important to allow managerial influences to work in good time, i.e., so as not to react to a situation that has already changed. For example, measures to support the securities market are unjustified when it becomes clear that the crisis will be long-term and has already begun to affect the real sector. These measures would lead to a loss of financial resources and increase speculation on the market. It is necessary to substantially simplify the mechanisms of inter-departmental negotiations and approvals.

\textsuperscript{11} It should be noted that most of the key federal ministries have introduced their own monitoring system, which, among other things, has seriously increased the paperwork for regional officials. An enormous problem is the multiplicity of levels of bureaucracy that request information and that information is often requested from the wrong sources or is provided late.
2. A new approach is required to determine optimal actions for the economy, with a transition from development amid plentiful financial resources to a search for the most effective ways of spending resources when they are strictly rationed. For this it is necessary to include in the set of decision-making agencies people who have work experience in crisis conditions, conducting reforms on both the corporate and state levels.

3. Amid uncertainty with regard to the development of the situation in the world and Russian economy, and as discussions take place worldwide about the selection of these or those measures of state policy, it is fundamentally important to set up public dialogue between the state, business and the population. The existence of such a dialogue and feedback in response to the state’s actions will make it possible to accomplish several tasks, including providing decision-makers with accurate information about the processes that are occurring in the economy, verifying that the decisions adopted and measures implemented produce the desired results, and creating an effective communications policy that reduces social tension.

Crisis always and everywhere lead to reductions in living standards, risks of unemployment and the marginalization of separate groups of the population. This is a simple axiom, but it is not being discussed here. It is only important to emphasize that various groups of the population and the various regions will be affected by this to varying degrees.

By the end of 2008, sociological surveys (data from the All-Russian Center for the Study of Public Opinion (VTSIOM) follow) demonstrated a noticeable reduction in the indicators of social wellbeing. And various indicators demonstrate different dynamics, testifying that society is internalizing the crisis situation.

- Indicators of political stability (trust in the leaders of the state and government institutions, assessments of the political situation in the country) in recent months remain practically unchanged. Fears and negative expectations from the crisis have not yet caused citizens to doubt their trust in the government;
- A moderate fall (by 13 points) from September to the end of the year is shown for “satisfaction with the life you are leading” and current family material situation. A significant portion of society is feeling the effects of the crisis, but these assessments have changed relatively moderately. The ratings “returned” to the level of two years ago, but did not drop even to the level of 2006, i.e., the point where a linear increase in social optimism began;
- The greatest fall was seen in assessments linked more with the future than the current state of affairs. The greatest decline (by 29 points since September) is observed in the assessment of the economic situation in the country (i.e., the prospects for maintaining/raising one’s standard of living); similarly, in the forecast of families’
material situation a year from now (which fell by 25 points), and in agreeing that “things are going in the right direction” (which fell by 23 points).

Thus, in society we can see a noticeable reduction in people’s expectations from the state and the economy, which, judging from past experience, can be interpreted as a disposition to adapt and survive in the crisis.

The consequences from this clearly temporary situation with regard to societal attitudes have many facets. There is an obvious decline in optimism not only as a whole but in the area of consumer behavior (which must be taken into consideration when planning anti-cyclical policy). The reduction in expectations from the state is a strong check against protest sentiments (in all forms); however, one cannot rule out a gradual erosion of people’s trust in the state. What we are seeing now is most likely the desire of the majority of citizens to hide under the umbrella of state guardianship, but any doubt in the ability of the state to fulfill its social obligations may provoke unpredictable reactions.

Research into the August 1998 crisis revealed a pattern in the adaptation of the population to an abrupt reduction in living standards. It forced many to acknowledge a fall in living standards and resign themselves to it. However, for about a year, most people have been trying to restore their previous living standard nonetheless. This motif remains very strong in the beginning, and the population is implementing active behavior models. Though incomes are not rising as perceptibly, a person prefers to work rather than economize. These people internalize the technology of economy and acknowledge their lower living standard only three years later. And seven years later it is already practically impossible to reanimate the labor market.

Everything said above relates to Russian society’s initial reaction to the crisis as a whole. However, already sociologists can identify several typical reactions:

1. Groups of the population who see what is occurring only as a factor of social danger. For them, the crisis is a large concept of threats. People describe it as such, and it is “colored” for them almost exclusively by negative emotions, as they do not yet see future opportunities. This category of people expects a lot from the government. The transition to constructive actions, including on the labor market, will demand from them time and effort so that, to the contrary, protest behavior or social apathy could find fertile soil here.

2. Groups of the population who see the crisis as a difficult time that is necessary to nurse the social environment back to health, get rid of bad pre-crisis habits, stereotypes and consumer standards, and to create new social elevators. Here we need a concept of social ecology, a struggle against legal nihilism, lawlessness, kangaroo courts, corporate raiding, venality and corruption. Such groups are essentially a social pillar for the modernization of the Russian economy’s institutions.
3. Groups of the population that were in demand before the crisis and will remain in demand after it. As a rule, these are owners of small and medium-sized businesses as well as proactive, educated employees. For them, the crisis is more a call to adapt than to change their behavior model. In any case they will be innovative and creative - increasing their productivity, becoming more competitive, normalizing markets, and creating and mastering high technologies.

Thus, modernizing forces in the country exist. They are not consolidated and, most likely, their activeness will manifest itself only after the crisis culminates, when it becomes clear that the bottom has been reached.

It is generally acknowledged that the core of the upcoming modernization must be innovative economics, resting among other things on the reformation of the institutions of property and the court system. The absence of traditions of fulfilling obligations and monitoring such fulfillment in the labor sphere, in financial relations and in state government agencies, especially locally, also remains a serious problem.

If one assumes the need to diversify the economy and do whatever it takes to develop private (entrepreneurial) initiatives, and small and medium-sized business, it is preferable to stimulate the liberal scenario of state regulation. However, it is obvious that refraining from impeding mass layoffs as part of economic restructuring creates many difficult social problems for the state and society. It is possible to appropriately answer this challenge only by using effective financial policy, which, for its part, is impossible without a transition to another type of anti-crisis management - from “manual mode” to transparent dialogue between the state and society as equal partners.

Keeping the situation within the bounds of “manual management” may produce a short-term effect from the point of view of the accumulation of social problems, but events will nevertheless develop spontaneously according to the second scenario as the economic crisis develops and accumulated reserves dwindle. However, precious time and resources that the state could have directed towards trying to influence the situation will be lost. The political consequences in this case are difficult to predict.

This is especially true since the indirect, humanitarian social consequences of the crisis are already evident. Here we refer again to the fact that the informal public agreement of recent years – that people must turn a blind eye to greater and greater limits on entrepreneurial initiative and political freedoms in exchange for higher living standards – has nearly ceased to operate. As is well-known, official statistics show a reduction in real personal incomes already in the last quarter of 2008.

The restoration of the public agreement as collateral for the development of events in a constitutional framework demands, as was mentioned above, dialogue between the state, business
and all (including “inconvenient”) political and public forces in the country. A transparent and public nature of such dialogue will predetermine the transition to the new information policy.

The agenda for the proposed dialogue must not simply be anti-crisis, including urgent measures to rehabilitate the situation in the country, but also post-crisis, affecting the subsequent fate of key public, political and financial institutions of Russia, such as

- The political system (elections, terms of party registration and functioning);
- Non-profit and self-regulating organizations;
- Federalism and local autonomy;
- The court system; and
- Participation of the state in the economy.

Only on this basis is it possible to begin to develop a nationwide (i.e., not limited to the *nomenklatura*) program for overcoming the financial crisis that has any real chance of success.
Addendum

INSOR roundtables in November-December 2008 on the economic crisis in Russia

1. The Effect of the World Financial Crisis on Russia’s Financial Sector;
2. The Effect of the World Financial Crisis on Russia’s Real Sector;
3. The Effect of the World Financial Crisis on the Situation in Russia: the Regional Aspect;
4. The Effect of the World Financial Crisis on the Macroeconomic Situation in Russia. A Discussion of the Speech of the World Bank Representative;
5. Tax Policy Amid the Crisis;

Participants in the Institute of Contemporary Development crisis round tables in November-December 2008

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