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# Global crisis: past experiences and future challenges [1]

These days there is so much friction
The Empire is like a *trirem* in a narrow strait
The oarsmen scuff their oars against the bank,
Rocks bang against the hull
No, I do not mean that we have run aground!
We do have some momentum and we forge ahead.
Despite it all we're sailing on and no one overtakes us.
But, this is not the speed we used to have!
And we can only pine for times
when things went rather smoothly.
Rather smoothly.

*Joseph Brodsky, Post Aetatem Nostram (1970)*

## 1. The specific features of great crises

The current crisis has been justifiably compared with some of the greatest crises of the past, for example:

• the first "global" economic crisis of 1857–1858. This was perceived as being "global" at the time, in that it encompassed those countries where the capitalist system was prevalent. This crisis is sometimes called 'Marx's favorite crisis'[2] because it provided a decisive argument in favor of an economic model predicated upon the inevitable collapse of capitalism. Ten years later the first volume of *Das Kapital* was published;

• the crisis of 1907 was the first large-scale financial crisis that did not come to its own conclusion but was dealt with by the application of targeted measures. In this instance, it was not governments that intervened but G. P. Morgan and associated groups of financiers. Until then the typical response to a crisis had been to wait passively until matters found their own resolution. It was in 1907 that the possibility of formulating and implementing anti-crisis measures was first realized and steps were taken that influenced theoretical and practical research in economic policy during the later 20th century. One direct outcome of the crisis was the creation of the US Federal Reserve System as a regulator of the monetary market;

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[2] See Anikin A. *Istoriia finansovykh potriasenii* [A history of financial shocks] M.: Olimp-Biznes, 2000. P. 72. The 1857 – 1858 crisis was also marked by unprecedented financial speculations in preceding years. It was at that time that the famous saying was coined: 'A few years ago I had not a single penny, but now I have five millions in debt'.

• the crisis of the 1930s, or the “Great Depression”, which gave rise to the contemporary model of state economic regulation of the economy and is one of the foundations of modern economic thought. ‘We are today in the middle of the greatest catastrophe – due almost entirely to economic causes in the modern world. I am told the view is held in Moscow that this is the last, the culminating crisis of capitalism, and that our existing order of society will not survive it’[3], – John Maynard Keynes declared in the summer 1931, underlining the systemic nature of the crisis. The theory of “Keynesianism” was formulated as a reaction to that crisis and offered ways of avoiding global economic catastrophes in the future;

• finally, there was the crisis of the 1970s which presented the world with a new, previously unknown phenomenon: stagflation, that is the combination of low (or negative) growth rates with high inflation. There even emerged a rather original index for describing the severity of economic problems: the sum of the rates of unemployment and inflation. The exit from this crisis was associated with large-scale deregulation and the repudiation of financial populism, in the first instance in the most developed economies followed by many of the developing countries (including the post-Communist states).

A detailed analysis of all these crises (we shall describe them, with some qualification, as ‘systemic crises’) exceeds the scope of the present article. Here, we shall highlight only some of their common features. What they have in common has nothing to do with the extent of the decline in production or of the collapse of financial markets or with the parameters of inflation or budget deficit. The similarities cannot be measured in statistical terms but reside in a number of qualitative features that exerted a significant influence on the later development of the political, economic and intellectual processes of the leading countries of the world.

Here are the common features of systemic crises.

*Firstly*, such a crisis presents a formidable intellectual challenge because the causes and mechanisms of evolution of the crisis and the ways in which it can be overcome have to be fundamentally re-examined. Just as generals are always preparing to fight the last war, so politicians and economists are invariably preparing to tackle the last crisis. Up to a certain point, their methods can work – in so far as they are applied to economic cycles or to problems of recurring economic dynamics. This is because, initially, every systemic crisis is dealt with

[3] *Keynes J.M.* An Economic Analysis of Unemployment / Harris Foundation lectures. University of Chicago, 1931.

according to the tried and tested methods of the past. If we take the 1930s as an example, the methods applied were those of the Hoover Administration (and primarily of Treasury Secretary Andrew Mellon). These methods entailed a laissez-faire approach, a rigid balancing of the budget and a strengthening of a monetary system based on the gold standard. The experience of the previous century seemed to show that crises would usually be 'resolved' in about a year's time, without the need to pursue any specific policy. Similarly, in the 1970s, from the outset of the crisis attempts were made to apply the (by this time) well established methods of Keynesian regulation (budgetary stimulation in conditions of decelerating growth and even the kind of price control that was implemented by the Nixon administration). These methods resulted only in an upsurge of inflation and in the beginning of stagflation.

In other words, the methods of economic policy that are applied in preceding crises are seldom applicable (it would be more correct to say are absolutely inapplicable) to later crises. Too many new problems emerge, the evolution of the crisis and means for overcoming it are unclear, as are the scale of the crisis and its duration. In the twentieth century it would usually take a decade to exit from a systemic crisis. This particular circumstance was emphasized by Paul Volcker when, in June 1979, in the midst of the last systemic crisis, during his swearing-in ceremony as Chairman of the US Federal Reserve System he said: "We are confronted with economic difficulties really unique to our experience. We have lost that euphoria…, that we know all the answers when it comes to managing the economy."

*Secondly*, during a systemic crisis the prevailing model of regulating socio-economic processes is replaced by a new one. The 1930s were marked by the completion of a transition to the industrial phase of development and by the consolidation of an ideology and practice of the 'big state' that looked favourably upon the growth of taxation, budget expenditure, state property and planning, and in some instances also state price formation. The crisis of the 1970s, by contrast, led to widespread liberalization and deregulation, a reduction in taxation and to privatization – in short, to all of the developments that were essential for a transition to the post-industrial technological phase of development.

*Thirdly*, a systemic crisis is at one and the same time a cyclic and a structural crisis. It entails serious institutional and technological changes during which the old technological base (or 'technological mode') is replaced and the economy is raised to a qualitatively new level of efficiency and labor productivity. 'State of the art' science and technology, a systemic upgrading of the technological base is a fundamental precondition of any successful exit from a crisis.[4]

Out of these changes emerges the possibility of a fundamental shift in the international balance of political and economic power. This is not the inevitable outcome of a systemic crisis, but the probability of such an outcome is fairly high.

Applying the terminology that has currently become popular, we can describe systemic crises as *innovative* –in terms of the emergence, before, during or after the crisis, of new economic and political institutions; in terms of the ascent of new cohorts of politicians, entrepreneurs and experts; and in the sense that a new technological base replaces the one that was formed during the previous systemic crisis.

All of this is manifestly true of the current global crisis.

That there is a serious new intellectual challenge, and that the economic paradigm of the past decades is no longer applicable, is apparent. New instruments have appeared in the financial market that states have not yet learned to cope with. Economic debates on ways of dealing with the crisis still revolve around issues that belong to the twentieth century: Keynesianism *vs.* monetarism, liberalism *vs.* dirigisme; and for every argument indicting a 'collapse of the market' there is an equally persuasive counter-argument indicting a 'collapse of the State'. Anti-crisis economic polices have also been shaped by these two models even if, in practice, these policies have at times comprised a combination of Keynesian methods of demand management (through budget stimuli) and monetary methods of influencing supply (the relaxation of monetary policy).

The need for a new model of regulation, this time on a global scale, is increasingly under discussion, but there has not yet been any advocacy of the need to regulate production in other words to revert to a model that belongs to the mid-twentieth century (prior to the neo-conservative revolution). The lesson of the last century's experience of nationalization – which in some cases went as far as total nationalization of the economy – has been learned, and none of the current responsible political parties is contemplating a repetition of this, even if Keynes is the most popular economist of the moment. At present, a model involving the regulation of financial markets is being considered. One of the variants applies regulation on a global scale, and this

[4] Some economists view the change of the technological base in terms of Kondratiev supercycles or long waves, sinusoidal-like cycles in the modern economy ranging from 50 to 60 years in length. See *Kondratiev N D. The Major Cycles of the Conjecture // Voprosy kon"iunktury [Problems of the Conjuncture]*. Vol. 1, Issue 1. M., 1925). This is an interesting and potentially productive hypothesis, although there is no proof of its validity owing to an absence of sufficient statistics. Besides, the author himself regarded his conclusions as being hypothetical

would be an innovation whether such regulation was implemented at the level of the state or by a union of several powerful states.

And finally, the prospects of a transition to a new technological basis are increasingly being discussed. If the 1930s witnessed the end of the transition to large-scale industrial production (the introduction of assembly lines and other industrial technologies) and the 1970s the introduction of microelectronics and modern computer technologies, then in the present day, according to some researchers, the conquest of more complex aspects of nature, with the help of biotechnologies, nanotechnologies, IT and communication technologies has already begun and these will be the principal fields in which we shall witness intense competition and development[5].

It is hardly surprising, therefore, that the need for fundamental restructuring has been recognized not only in the countries of the "catching-up" development group but also in the most advanced countries. In the latter group the élites are well aware that to ignore the challenge of innovation at a time of crisis risks jeopardizing their leadership position and invites strategic defeat in global competition. Significantly, the US Administration is constantly emphasizing the need to create a qualitatively new situation in the country once the crisis is over, by which it means modernization not only of technologies but also of socio-economic institutions. Larry Summers, when Director of the National Economic Council (January 2009 to December 2010), has expressed the hope that that "this new American economy… will be "more export-oriented" and "less consumption-oriented"; "more environmentally-oriented and less energy-production-oriented"; more bio- and software- and civil-engineering-oriented and less financial-engineering-oriented"; and, finally, "more middle-class-oriented" and "less oriented to income growth that is disproportionate towards a very small share of the population"[6].

### 2. The contours and risks of crisis development

Taking the view that the current global crisis is not so much cyclical as structural, we draw the following conclusions:

Firstly, the current global crisis will be protracted. Its end is usually conceived in terms of a

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[5] S. Glaziev is one of the most active proponents of this interpretation of the crisis (see Glaziev S. Yu. *Vozmozhnosti i ogranichaniia tekhniko-ekonomicheskogo razvitiia Rossii v usloviiakh strukturnykh izmenenii v mirovoi ekonomike. [Russia's technological and economic development in conditions of current structural changes* in the world economy. *Prospects and impediments*] M.: GUU, 2008).

[6] Financial Times. 2009. July 10 (http://www.ft.com/intl/cms/s/2/6ac06592-6ce0-11de-af56-00144feabdc0.html#axzz1evoKve00).

halt in the decline of output or of a recovery in the stock market. This is why as early as mid-2009 there was talk of the appearance of “green shoots”. However, in reality, things are much more complex.

Certainly, neither the loss of production nor decline in the stock market can continue forever. By these measures alone, the world economy already seems to be regaining some equilibrium. However, the real problem is that this equilibrium will remain unstable – just as any return to economic growth will be unstable. This was the case during the 1930s and the 1970s, when almost a decade elapsed before there was a return to sound and stable economic growth, notwithstanding occasional interruptions by crises of a straightforward cyclical or sectoral (banking, financial) nature.

A trajectory of new and stable economic growth can only be achieved when a government proves capable of tackling the root causes of the crisis. These root causes are technological, economic, regulatory, social and, quite possibly, geopolitical. The changes that are required are slow to take effect, and it is practically impossible to speed them up. By contrast, the process can be held back by adherence to obsolete economic practices and modes of technology.

Even an anti-crisis policy can engender additional problems and create additional risks that will impact upon the ongoing crisis – or upon post-crisis conditions. *The most important of these risks we believe to be those of macroeconomic destabilization, substantial growth of the public sector (extensive nationalization) and moral hazard (the risk of irresponsibility), all of which tend towards conservation of existing economic structures*. Let us examine these three groups of problems more closely.

*The key problem is the growth of macroeconomic instability, which can give rise to political instability.*

In this respect, the most important error would be to introduce an expansionist budgetary and monetary-credit policy with a view to combating deflation and forestalling the kind of destructive dynamic that built up during the Great Depression. Policies of cheap money and budgetary injections into the economy will inevitably result in a significant growth of the sovereign debt of most of the developed market economies and will increase the risk of steep inflation in the future[7]. That is why the need for an *exit strategy* – for ways and means of achieving disinflation and reducing state debt – is periodically raised in discussions amongst politicians and economists. However, the steps that need to be undertaken by the authorities are quite obvious – raising taxes, cutting budget expenditure and increasing interest rates.

The political and economic problems associated with such a policy are no less evident and these will result not only from the adoption of an *exit strategy*, but also from its implementation. On the one hand, politicians in developed countries (primarily in the USA) urge their colleagues to persist in providing budget incentives on the grounds that too early a return to budgetary conservatism might result in a failure to restart the 'economic engine', which, if the inflow of cheap money is discontinued, might begin to stall yet again. However, it is sometimes very difficult to judge exactly when the currency printing press should be turned off. Moreover, a protracted and over-generous injection of money into the economy will inevitably have the long-term effect of engendering high rates of inflation in some of the developed economies[8]. As the experience of many countries (including developed countries during the 1970s) has demonstrated, it can become increasingly difficult to escape from this trap.

It is even more difficult correctly to assess the political and economic circumstances that will impede the implementation of a post-anti-crisis policy. A policy of reducing budget expenditures while increasing interest rates will have painful consequences under any régime, but is even more dangerous in immature democracies – that is, in countries where voters because of their poverty are highly susceptible to populist slogans. There have already been examples, during the run-up to elections, of governments succumbing to the temptation of populism – even when they had hitherto been opposed to this. [9] Politicians capable of resisting the expansion of state

[7] Some economists argue that current monetary policies are inflation proof (see, for example, the articles of Paul Krugman and Robert Skidelsky published in the *Financial Times* in May - June 2009. For a detailed argument in support of this point of view, see Richard Koo: a Personal View of the Macroeconomy / Nomura Securities. 2009. July 30).

[8] The Annual Report of the Bank for International Settlements "highlighted two main risks: first, that not enough will be done to ensure a durable recovery from crisis; and second, that the emergency action to stabilize the financial system will undermine efforts to build a safer system" (See: Giles Chris, BIS calls for wide global financial reforms // The Financial Times. 2009. June 30. p. 3).

[9] One typical example is the career of Angela Merkel who used to be the principal proponent of free market values, insisted on restricting the budget deficit and rejected a monetary policy that was too soft. In June 2009, in advancce of the September election, she proposed some new initiatives with regard to federal budget expenditure, albeite with a qualification concerning the need to revert later on to a more balanced budget: "Of course, we will have to come back to a situation where we don't spend more then we earn. But in the order to get there, we need to do two things: we must invest in the future, that is in education and the environment" ( Financial Times. 2009. June 30. P. 2).

expenditure are, in fact, extremely rare[10].

There is clearly a danger that developed countries will become trapped in a vicious spiral of populism – and that they will do so again and again. The process is, in fact, quite straightforward – and is well understood following the experience of Latin America during the twentieth century. Budgetary and monetary expansion stimulates the revival of the economy, but at the same time makes for an increase in government debt, an increase in inflation and a growth of interest rates. This is followed by de-stimulation of investment in production – either because of the accelerating depreciation of money, or because investment in government securities has become the most attractive form of investment. The next step is to tighten budgetary and monetary policies, which leads to recession. Recession may again be followed by a relaxation of macroeconomic policy – and so the cycle continues. One especially unpleasant consequence is that such fluctuations inevitably result in undermining the stability of institutions of state authority and in reducing their efficiency. In countries with weak institutions the economic cycle of populism is often accompanied by political upheavals in the course of which power is seized in turns by populist and conservative dictatorships[11]. Of course, one should not take the experience of the twentieth century to be all-explanatory, but this experience does shed some light on the potential course of events.

Of course, anti-crisis measures do not lead inevitably to "Latin Americanization". Much depends also on the efficiency and flexibility of political institutions and there is much variation in this respect in the countries currently being affected by crisis. However, the risks of descending into the vicious spiral described above are quite real and are growing. The first – however remote – signal of such a danger has become the increased long-term yield on US

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[10] In this context, it is interesting to note that the narrow circle of politicians concerned about the potential consequences of populist anti-crisis measures has been joined by Vladimir Putin and Dmitrii Medvedev. As early as February 2009, when speaking at Davos, Putin, as Chairman of the Government of the Russian Federation warned against the danger of unlimited state expansion as regards ownership and regulation. In June, at the summit of the Big Eight Medvedev suggested that government financial injections should be terminated, and said that it was now time to discuss in earnest a post-crisis development strategy, or *exit strategy*.

[11] The classic description of the populist Latin American cycle was provided in the 1990s by Rudi Dornbusch and Sebastian Edwards: *Phase 1* – the initiation of a populist policy in response to depression or stagnation results in significant economic growth and, accordingly, of real incomes, supported by both domestic production and imports. *Phase 2* – the appearance of macro-economic bottlenecks owing to goods shortages or a deficit in the balance of payments; this is accompanied by a diminuation of foreign exchange reserves as these are allocated to supporting the exchange rate of the national currency. *Phase 3* is characterized by rapidly increasing inflation and/or by a goods shortage, a budget deficit, a flight of capital and a demonetization of the economy, which inevitably leads to devaluation, a significant decline in the population incomes and almost always to a loss of political control by the government. *Phase 4* - orthodox stabilization measures are implemented by the new authorities (not infrequently by a military régime) (The Macroeconomics of Populism in Latin America / Dorrnbusch R., Edwards S. (eds.). Chicago; L.: The University of Chicago Press, 1991. P. 11–12).

government securities, which is indicative of increasing expectations of growing inflation – the first step towards destabilization.

*Another serious risk is that of large-scale nationalization – be it implicit (hidden) or explicit (open), accompanied by increasing dirigisme in the economic policies of the leading world economies.* The experience of the last four centuries shows that it is the guarantee of private property that provides the strongest platform for modern economic growth – that is, growth capable of significantly increasing average per capita GDP. Today, the truth of this proposition has begun to be questioned. When the State comes to the rescue of debtors and injects capital into banks by strengthening the guarantees of private deposits it assumes the risks associated with the actions of all of the main participants in economic life – bankers, depositors and borrowers (who can, moreover, often be the same persons or institutions). In their struggle against the effects of the global crisis, the governments of the majority of developed countries often resort to measures that can discredit private property and undermine the fundamental principles of a market economy – the personal responsibility of individuals (and above all of entrepreneurs) for the consequences of their decisions. The State and society demonstrate that they are willing to underwrite private risks. In other words, a nationalization of losses leads inevitably in the next phase to a nationalization of risks.

The granting of financial aid to companies in difficulty leads, in effect, to their nationalization. Nationalization comes about by at least three methods: through the buying-up of the debt of companies; by recapitalization in exchange for shares; and by inflation of the value of accumulated securities. The governments are inclined to take over all the assets (securities) of financial institutions whether by providing guarantees or by direct injections of capital. Naturally, the aid provided to financial institutions is accompanied by a formal or actual dilution of the value of privately held shares. Thereby doubt is cast on the validity of private property rights.

Admittedly, present-day nationalizations are unlike those of the past in that they arise out of necessity. The nationalizations of the 20$^{th}$ century were ideologically motivated: their authors – from the Russian Bolsheviks to the British Labourites – were convinced that state property would be more efficient than private property. By the turn of the century the world had already cast off that illusion and extensive nationalizations had given way policies of deregulation and privatization. Now, however, we are faced with an entirely new phenomenon: no one (or hardly anybody) any longer believes that state ownership will guarantee efficient economic performance; but even so, throughout the civilized world anti-crisis policies are leading to a significant strengthening of the state sector[12].

Over and above statification (nationalization) we witness the spread of *dirigisme* – the number of specific decisions made by government institutions is increasing; it is they (and not the market) who decide who is right and who is wrong. Increasingly, it is the State that instructs economic agents which services they must deliver and which goods they should produce. The bankruptcy of *Lehman Brothers*, on the one hand, and the state assistance given to *Bear Stearns*, *AIG* and *CitiBank* on the other (these hardly be viewed as market measures) were the result of decision-making that followed the logic of a centrally managed economy.

The next logical step is for governments to take decisions in respect of institutions that have been, de facto, nationalized. Thus British Prime Minister Gordon Brown declared in the autumn of 2008 that he would urge banks that were now under government control to invest more in small businesses. Russian state banks are receiving similar guidance, irrespective of how this might influence the quality of their portfolios. The support of small businesses is, of course, a sacred cause – the fetish of all contemporary governments. However, the consequences of this approach is not difficult to foresee: if a government starts instructing a bank that it owns where to invest its money, it will have to provide support to that bank in the event that such politically motivated investments turn out to be a failure. In this way, government support and ineffective investments form a vicious circle.

*Finally, another systemic risk is the emergence among market players of companies that are "more equal than others"* or *"too big to fail"*. In contemporary Russian terminology these are described as 'a system-forming enterprises'. Of course, there have always existed enterprises, the collapse of which could entail abnormally high social and political losses. However, what has made for economic growth in the modern era is the principle that the laws of competition should determine not only which new businesses (and companies) come into being but also which companies should disappear from the scene. Competition - and the absence of 'untouchables' – are principles that constitute the very foundation of modern economic and, indeed, social progress.

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[12] "…Political labels lost all meaning. With governments of all persuasions nationalizing banks and pumping money into the economy what now distinguishes left from right, liberal from conservative, socialist from capitalist, Keynesian from monetarist?" (*Thornhill J.* A Year of Chocolate Box Politic // Financial Times. 2008. Dec. 21. P. 6).

Meanwhile, current policies are to a significant degree aimed at preserving many of the ‘giants’ that are actually remnants of the economy of the past. At least two arguments are deployed in favor of their preservation: firstly, it is held that their goods or services are very important; secondly, it is argued that their closure could have grave social (and even political) consequences. Both these arguments have some merit; but governments must seek ways of dealing with such problems other than by supporting the existence of entities that are potentially bankrupt.

At present, most governments believe that the problems of ‘system-forming enterprises’ can be resolved by regulation of their economic activity and close supervision by government authorities. Most often such methods are applied to the banking sector, though they are also entirely applicable to the production sector (and especially to infrastructure production). It is doubtful, however, whether regulation of this kind can be effective: if such methods were ineffective in the past, why should they be effective today? It would be much more helpful (although also more difficult) if government prohibited the exclusive involvement of particular firms with particular categories of goods or services – whatever the strategic importance of these goods and services or the national economy. It is the function of the State to ensure the availability of assets and technologies to economic agents that are capable of taking over from the managers and owners of bankrupt ‘system-forming’ enterprises. This is what is known as ‘the art of politics’.[13]

The socio-political consequences of bankruptcy must also be given special attention by the State. This will entail economic assistance, social restructuring and the retraining of the employees of a bankrupt company for new kinds of work. One well known instance is that of the successful restructuring of the Russian coal mining industry during the 1990 when it proved possible to close down a large number of inefficient coal mines and retrain the workforce for employment in other sectors.

Finally, it is important to emphasize the variety and complexity of the circumstances that produce risks in the era of systemic crises and enable them to proliferate. During the last three decades, a wave of criticism of the liberal model has brought to prominence the thesis that there must be more active interference in the economy by the State if the risks of spontaneous

[13] “Too big to fail – whether the claimant is a bank or an auto company – is not a status we can live with. It is both better politics and better economics to deal with the problem by facilitating failure than by subsidising it.” (Financial Times. 2009. May 27. P. 9).

development are to be contained. However, upon close analysis, the questionable nature of such an approach becomes clear, because state regulation in itself is fraught with systemic risks. As John Taylor, Professor at Stanford University, wrote recently: "Top [US] government officials…are calling for the creation of a powerful systemic risk regulator…but their government is now the most serious source of systemic risk".,[14] This is true not only of the US Administration.

## 3. Problems aggravated by the crisis

The economic crisis brought politicians and experts face to face with a number of fundamental issues concerning the functioning of modern economic systems. Resolving these issues will require an intellectual breakthrough if solutions are to be found to problems that are not, as a rule, amenable to easy solution. Every systemic crisis requires such solutions and so far answers have usually been found. It is another matter that some issues are recalcitrant for political rather than intellectual reasons. But these problems, too, will have to be grasped sooner rather than later.

Here we are going to identify the issues that we believe to be most relevant to the current crisis. There are traps that many (if not most) countries have fallen into and if the crisis is to be resolved there will have to be an awareness of these traps:

1. One of the fundamental, deep-lying problems that led up to the present crisis was a trend during the last quarter of a century for the goal of capital formation to prevail over the need to improve factors of production (that is, to improve labor productivity). A situation developed in which owners (shareholders) concentrated upon capital formation rather than upon the stability of production or volume of dividends. This indicator, having become the focus of attention, was used to assess levels of managerial performance. Thereafter, naturally enough, the goal of capital formation acquired preeminence over all other operational parameters. Indicators of labor productivity and renewal of production were relegated to secondary importance. To be more precise, these two indicators were utilized, but only when they did not impede capital formation. In practice, this made for the concentration of production in the hands of a few global players (companies) and militated against the closing down of inefficient enterprises. Rather, the opposite was the trend – inefficient enterprises were readily incorporated into big holding companies as a means of securing market expansion and capital formation,

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[14] *Taylor J.* Exploding debt threatens America // Financial Times. 2009. May 27. P. 9.

Incentivization of the managers of the biggest companies now increasingly resembled that which used to be applied to the 'Red Directors' of the Soviet Union. The need constantly to report to Party and administrative bodies on the achievement of planned targets (in roubles or units) made product enhancement impossible. Replacement with products of a higher quality was also impossible since this would have meant reduced production of existing products, which was unacceptable from both the political and administrative points of view.

The consequence of this type of incentivization for modern managers has been an increase in monopolism (as a consequence of mergers and takeovers), a slowdown in the growth of labour productivity and in, the final analysis, the dis-incentivization of innovative activity.

The key lesson to be learned from the current global crisis, therefore, is the need to revise the system of incentives for owners and managers, so that the qualitative aspects of a company's development can acquire more importance. In our opinion, this is a more profound problem than the regulation of financial markets. However important that might be, it is derivative problem as far as the conflict between capital formation and performance is concerned.

2. An environment engendering "*moral hazard*" is created by the kinds of anti-crisis policy that governments are adopting. These policies are aimed at maintaining socio-political stability and at preventing the kind of destabilization that can result from rising unemployment, bankruptcies, general uncertainty, and, in an event of rapid inflation, reductions in budget expenditures. But can be forgotten is that a crisis provides an opportunity for renewal, the formation of a new economy, for modernization.

At the level of practical policy these imperatives are mutually contradictory. How this contradiction will be overcome – and the extent to which it will be overcome – will depend upon the "art of politics", upon the ability of the political élite adequately to respond to current challenges. In the final analysis, everything will depend upon the flexibility, stability and effectiveness of political institutions. The experience of the twentieth century shows that mature democracies are usually more effective in breaking out of situations of large-scale crisis.

Contemporary anti-crisis policies revolve around providing state support to particular economic agents, in the first instance to banks and enterprises. In implementing these policies governments encounter a very complex problem – how to assist the development of new sectors and new businesses whilst at the same time avoiding the threat of social upheaval. This threat stems from the condition of the large, old, 'system-forming enterprises' that are actually or potentially bankrupt and that are unlikely to survive the crisis.

Another problem is how to reconcile short-term and strategic objectives. This is the problem of the US Administration as it attempts to achieve two opposing goals: to boost household consumption, and thus avoid the pitfall of deflation, while simultaneously promoting the growth of savings – that is, bringing the level of household expenditure into line with the results of household productive activity. It is this latter goal that is strategic: if the 'consumption bubble' gets out of control, it will not be possible to get the economy back on to its former path of stable economic growth.

Similar contradictions can be observed in the anti-crisis policy of the Russian Federation. In this country, we want simultaneously to prevent the growth of unemployment and to implement structural modernization. At the same time we are trying to escape from the bind of 'oil dependency'. But during the crisis of the first half of the 1990s it was clearly demonstrated that although maintaining a high level of employment does mitigate social conflict it also acts as a barrier to structural renovation and gains in efficiency.

The situation is further complicated by the fact that the root causes of the difficulties currently being experienced by many real sector enterprises are not fully understood. Consequently, their prospects in the post-crisis period cannot be foreseen. A distinction needs to be made between enterprises that suffer from illiquidity and enterprises that are insolvent. At a time when the basic outlines of the future economic system, the structure of demand and the potential for improvements in labor productivity are unknown, it cannot be foreseen which enterprises have the potential for survival and which are doomed to bankruptcy. This uncertainty, in its turn, places significant limitations on the preparedness of banks to provide the real sector with loans and to restructure existing debts.

The same processes determine the evolution of the banking sector. There is no doubt as to the need to restore it to health, to clear balances and create new credit institutions. But here, too, a lack of clarity as to which banks are illiquid and which are insolvent makes it difficult to design a consistent and conscientious government policy for the banking sector. As a result, as was noted in the Report of the Bank for International Settlements (Basel) for 'the reluctance of officials quickly to clean up the banks, many of which are now owned in large part by governments, may well delay recovery' [15].

3. There is still much to be done in order to determine an appropriate structure for the post-crisis world order - to re-distribute economic forces and allocate the roles to be played by different countries and regions. The key issue is the future of the arrangement that certain commentators (Zbigniev Brzezinski, Henry Kissinger) have named "The Group of Two" (G2)[16] and Niall Ferguson, rather provocatively, 'Chimerica' (China+America)[17] – a kind of symbiosis of an economy based on production and an economy based on consumption.[18]

What we observe is a global imbalance that has replaced relationships that for a whole decade were regarded as the foundation of a stable and balanced system of world economic growth. A system seems to be emerging that is the opposite of the world system of the late nineteenth and early twentieth centuries: if a hundred years ago capital flowed from the center (the developed countries) to the periphery (the *newly emerging markets* of that time), now it is the developing markets that have become the centers for savings whereas the USA and other developed countries have become predominantly the consumers.

In spite of a distinct trend towards the emergence of this new system of international economic and political relations, the system has not yet been definitively established. There have been too many other trends that in practice have led nowhere. However, if a "G2 system" does emerge, this will determine many things - both the methods that will be applied in designing an

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[15] *Giles C.* BIS calls for wide global financial reforms. P. 3.
[16] Brzezinski Z. The Group of Two that Could Change the World // Financial Times. 2009. Jan. 11. P. 9.

[17] "Welcome to the wonderful world of 'Chimerica' – China plus America – which accounts for just over a tenth of the world's land surface, a quarter of its population, a third of its economic output and more than half of global economic growth in the past eight years. For a time it seemed like a marriage made in heaven. The East Chimericans did the saving. The West Chimericans did the spending. Chinese imports kept down US inflation. Chinese savings kept down US interest rates. Chinese labour kept down US wage costs. As a result, it was remarkably cheap to borrow money and remarkably profitable to run a corporation. Thanks to Chimerica, global real interest rates – the cost of borrowing, after inflation – sank by more than a third below their average over the past fifteen years. Thanks to Chimerica, US corporate profits in 2006 rose by about the same proportion above their average share of GDP. But there was a catch. The more China was willing to lend to the United States, the more Americans were willing to borrow. Chimerica, in other words, was the underlying cause of the surge in bank lending, bond issuance and new derivative contracts that Planet Finance witnessed after 2000. It was the underlying cause of the hedge fund population explosion. It was the underlying reason why private equity partnerships where able to borrow money left, right and centre to finance leveraged buyouts. And Chimerica – or the Asian 'savings glut', as Ben Bernanke called it – was the underlying reason why the US mortgage market was so awash with cash in 2006 that you could get a 100 per cent mortgage with no income, no job or assets." (Ferguson N. The Ascent of Money: A Financial History of the World. The Penguin Press, 2008).

[18]For more details, see Mau V. Krizis na nachal'noi stadii: prichiny i problemy. [The crisis in the initial stage: causes and problems] // Ekonomicheskaia politika. [ The Economic Policy] 2008. No 6. Pp.. 56–57.

exit from the crisis and the actual configuration of the post-crisis world.

4. It is as yet far from clear what the new financial system will be and how it will be regulated. There is much talk of the failure of self-regulation in financial markets. Economic liberalism in general and Alan Greenspan in particular are held to have been responsible. Intense discussions are going on in various international fora (G8, G20, Financial Stability Forum), but no clear understanding has yet been reached of the kind of regulation model that should be adopted.

Discussions have so far been purely theoretical and conducted within the paradigm of the twentieth century: “failures of the market” or “failures of the state”; Keynesianism versus monetarism; the need for new regulatory bodies on a national (in the USA a “super-regulator”) or international level. All of this is of intellectual interest but does not bring us any closer to a new regulatory system that could cope with the realities of the twenty first century.

As we have seen, the nature of the regulatory system is the key issue in any systemic crisis. This system must reflect the realities of the modern world, be capable of dealing with the speed and global character of information and financial flows and have at its disposal some qualitatively new instruments in the financial market. But the contours of any new regulation model remain unclear.

5. A new model of economic regulation will require a transformation of the system of financial settlements, which will make for a new configuration of the world (or reserve) currencies. Much has been said on this topic since the onset of the crisis and discussions have revolved around four basic variants.

Firstly, the USD is expected to retain its leading position, whilst the roles of both the euro and several other traditional regional reserve currencies will be strengthened. Secondly, the role of the artificial currency for international settlements (SDR) as a world reserve currency will become more important. Third, a new reserve currency will appear – either as an alternative to the USD and the euro or as their equal counterpart. Many consider that the will be the Chinese yuan. Fourthly, regional reserve currencies will become more prominent and some new such currencies might emerge, for example, the Russian ruble. It is assumed that the existence of multiple reserve currencies will contribute to the overall global tendency towards multi-polarity and be conducive to greater responsibility on the part of the monetary authorities of the countries involved, in so far as the reserve currencies will be competing.

In this connection, the US dollar presents a particular problem, given the unprecedented monetary policy of the Federal Reserve System in its aim to increase liquidity. Discussions around this issue have been mainly political. However, it is well understood that a reserve currency cannot be ‘nominated’. This status is acquired naturally, when a given country pursues a responsible monetary policy with a view to increasing the international attractiveness of its currency. No sound practical solutions to this problem have yet been found.

6. Finally, there is the problem of the formation of a new technological base and new configuration of the global commodity flows. A systemic crisis creates the need for technological renewal and this will bring about a transformation of demand for many producer and consumer goods, above all for investment and fuel-and-energy products. This will naturally influence the prices for most commodities circulating in the market and create some new price equilibria, which will in turn lead to a change in political configurations.

## 4. The principal current danger: the hope of retaining the *status quo*

“Preserving the status quo in the belief that oil prices will move higher and that fiscal discipline can be tightened later…Moscow is trying to live through this crisis without visible reforms in fiscal, banking, natural monopolies or any other sphere”[19]. This is how the situation in the Russian Federation was described by the analysts of *GPMorgan* when visiting the country in June 2009. This was a fairly accurate assessment of the attitudes of the political élite and of the public at large. These attitudes are hardly surprising: public opinion associates the economic boom of 1999 – 2007 and the current crisis with the movement of oil prices (and of prices for natural gas and metals). Naturally, the exit from the crisis is also viewed as being dependent upon the growth of energy prices and it is this particular index that attracts everybody’s attention – ‘from workers to government ministers’, as they used to say in Soviet times. Society still nurtures the hope that eventually ‘things will work out for the best’ and we will return to the policy of ‘management of the growth of welfare’.

The essence of the problem is not so much that the role of the fuel and energy sector in the economic growth of the Russian Federation during the past decade has been, as a rule, grossly

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[19] Russia: Emerging Markets Research / J P Morgan Securities. 2009. June 12.

overestimated. Certainly, favorable external conditions did significantly contribute to a high rate of growth. Proceeds from exports did indeed bolster budget revenues and stimulate growth, with the help of ever increasing rates of government demand – that is, injections into the budget. However, if we are correctly to understand the current situation and trends in the Russian national economy, we need to be aware that high international fuel prices represented only one of the factors that contributed to the economic growth rate and that this particular factor was able to have a positive effect only in conjunction with other circumstances..

Firstly, high prices for oil and gas had their effect in the context of an unprecedented global economic boom. It was the high rate of global growth and the resulting high demand and low interest rates in financial markets that laid the foundation for Russia's economic development. One particular feature of this phenomenon should also be noted – the increase in prices of basic resources (fuel and metals) followed upon world economic growth and did not inhibit that growth– as was the case, for example, during the 1970s.

Secondly, domestic political factors played an important part, primarily in facilitating the macroeconomic and political stabilization that was achieved by the late 1990s. Revolutionary transformations had come to an end; the élite had to a significant degree consolidated its position, and Russia – importantly – had been 'inoculated' against financial populism. For almost a decade, a conservative fiscal policy was the anchor of the new economic policy.

So oil and gas prices should not be the sole factors taken into account when evaluating the prospects for Russia's economic development. Favourable foreign market conditions can, of course, contribute to the stability of the budgetary system. This stability is important in its own right and in ensuring social and political stability. However, these conditions do not automatically produce a high rate of economic growth. High fuel and energy prices might (and, most probably, will) inhibit economic growth in the majority of developed countries; this will have a negative impact on the Russian economy the development of which depends to a significant degree upon a dynamic growth of global demand – and not only upon excise revenues.

The current crisis has a systemic character. It cannot be understood purely in terms of cyclical fluctuations in which decline is automatically followed by growth. The downturn will certainly be followed by growth, but for this to come about, some significant changes will have to take place in the technological and organizational base of the world economy and within individual countries. It is precisely the ability of a country to achieve structural transformations and to adjust to the new global challenges that will determine its *image and position in the post-crisis world.* The most dangerous policy would be *to rely upon expectations that the pre-crisis status quo will be restored*.

## 5. Summary

So far, all of these issues remain unresolved. And this is not surprising: time is needed not only to examine the issues but to understand the solutions. That is why a crisis like the present one represents, first of all, a serious intellectual challenge.

Only after all the solutions are available will it become possible to speak of the advent of the final phase of the crisis – the exit phase. In other words, the end of the downturn and even a return to growth may signify not so much the end of the systemic crisis, but only the completion of one of its phases.

At present, we are approaching the end of the first phase of the global crisis. We have already become fully aware of its depth and severity. We have even come top appreciate the innovative character of this crisis. However, expectations still remain widespread that the crisis will end, just as a nightmare ends and that everything will continue as before. A belief in the restoration of the *status quo* is one of the fundamental illusions that is shared by the élite and by the general public.

We have a conception of some of the ingredients of an *exit strategy* and these include more robust budget management (a reduction of the budget deficit), disinflation (if the struggle against deflation does result in a leap of inflation – which seems likely) and re-privatization (the restoration of a normal régime of private ownership). However, we have not yet evolved a mechanism for exiting from the crisis and so cannot predict how long it will last.

A rather lengthy period of instability lies ahead. The systemic risks described above and the challenges facing the economic policies of the leading countries constitute a new phase in economic development – the phase that began with the onset of the global crisis. In all probability we have entered a 'turbulent decade'[20] – a period of economic and political instability

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[20] Alan Greenspan. entitled his memoir "The Age of Turbulence"(*Greenspan A.* The Age of Turbulence: Adventures in a New World. N. Y.: The Penguin Press, 2007). Written before the crisis, it is mainly devoted to the period 1987-2002 that was characterized by rapid economic growth. It is clear today that only now, after the book was published, has the real "age of turbulence" begun.

in the development of the entire world and of individual states.

By a ‘turbulent decade’ we do not mean a steady decline or the acute anxieties that were characteristic of the autumn of 2008. Instead, there will be fluctuations in growth rates, a period of unstable growth with local ups and downs, upsurges of inflation and attempts to suppress it.

If we were to compare the present crisis with the crisis of the 1930s – allowing for all due differences – we might say that we are currently passing through the phase of the Presidency of Herbert Hoover. Drawing an analogy with the 1970s, we might say we are at the stage of the Presidency of Richard Nixon or of the government of Harold Wilson. But it would be a mistake to allow our understanding of the crisis and of the means of controlling it to remain trapped within the paradigm of past experiences. Yet this is how policy for supporting economic agents is being shaped: it is orientated more towards the salvation of ‘the heroes of the past’ – the veterans of past industrial battles – than towards support for the still feeble ‘green shoots’ of a new economy, although the latter are, at least, now being discussed.

We still await the coming of a Franklin Delano Roosevelt, a Margaret Thatcher or a Ronald Reagan – with their fundamentally new, although completely original, approaches to dealing with the systemic problems that gave rise to crisis. In the meantime, we need to recognize that the anti-crisis measures that are being adopted within the framework of traditional paradigm are ineffective and then encourage public demand for a new political course – a new “*New Deal*”, even if the contours of that new course are not yet fully visible.