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The Global Crisis As Seen from Russia[2]

Abstract

It has become popular in Russia to speak about the crash of the Western economic model and liberal capitalism and this talk may make some sense from the political point of view. All of economic history shows that however harsh a crisis may be and whatever stage of capitalism's decomposition is attributed to it, market economies have always survived crises, and emerged from them stronger, tougher and more competitive.

The global economic crisis is rapidly growing and it is difficult to say yet how long it will last. Forecasting the future of this crisis is as senseless as forecasting crude oil prices. When they were high, the only thing one could say confidently was that prices would eventually fall some day. In much the same way, one can be sure now that the crisis will end one day, although neither when that will happen, nor the amount of damage, nor the layout of the post-crisis economy are known yet.

The crisis Russia went through in 1998 had domestic roots – a weak government incapable of conducting a responsible macroeconomic (budgetary, in the first place) policy. The current situation is markedly different: for the first time ever, this country is coming to grips with a world crisis as part of the global economic and financial system. This signifies that Russia is gradually turning into a normal market economy.

One must take account of two important circumstances. **First,** the current crisis is bigger than just an ordinary cyclic one that occurs once every few years. Unfolding right in front of our eyes are deep-lying tectonic shifts in the financial –and possibly economic – architecture. Talk about the need for revamping the global financial model that took shape in the second half of the 20th century has been in the air for quite some time, yet this model continued to function and showed fairly good economic results until recently, although everyone – politicians and experts alike – could see a growth of systemic risks. It is obvious now that the post-crisis landscape will change considerably, as some financial organizations and entire kinds of institutions will be gone.

Second, in spite of a fair macroeconomic situation (recall the two-fold budget revenue surplus), the Russian financial market has found itself in the hardest-hit category together with the Chinese. This may be a penalty for achievements as soaring indices attracted too much speculative capital. When the crisis broke out, this capital started to flow out as quickly as it had arrived.

The ongoing developments must be a subject of incessant analysis and discussion, as it is only in this way that an anti-crisis policy can be formulated. Special attention should be given to an in-depth analysis of the causes of this crisis, the mechanisms for interaction between its economic and financial aspects, priority measures for preventing an economic and financial collapse, the risks inherent in such measures, and the long-term consequences of a withdrawal from the crisis. Countries with emerging markets require special attention too, as their problems are vastly different from the problems faced by developed economies.

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The nature and mechanisms of great economic upheavals are always enigmatic and hard to fully comprehend. Even many years later, economic historians are sometimes unable to understand them. The phenomenon of the Great Depression of the 1930s has still not been resolved: discussions continue on both its causes and the effectiveness of Franklin D. Roosevelt's countermeasures.

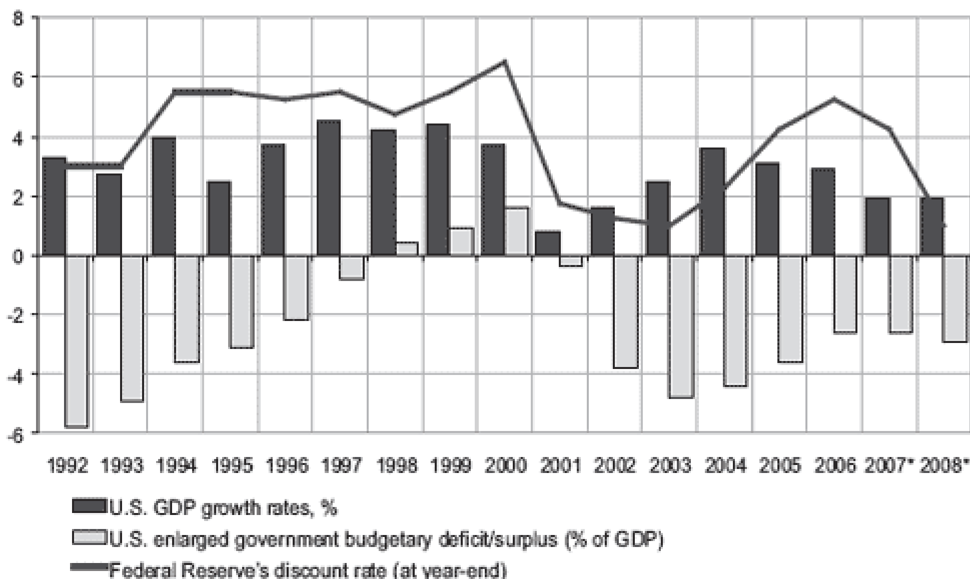
This clearly means that the reflections featured in this article are tentative and its conclusions cannot claim an all-time validity.

THE ROOT CAUSES OF THE CRISIS

As we analyze the unfolding crisis, it is worthwhile examining separately three groups of factors that predestined it: first, the specific problems of the U.S. economy; second, fundamental problems of today's economic development; and, third, the specific Russian circumstances. These factors may produce different results, and therefore counteraction to the crisis requires taking into account all the three groups.

It has become customary while discussing the causes of the crisis to level criticism at the U.S. administration's inappropriate budget and monetary policies. In the first place, the critics point to the pro-cyclic policy pursued after the recession of 2001, when the country continued accumulating budget deficit amidst economic growth, instead of reverting to Clinton's strategy based on budget surpluses. This was manifest, above of all, in the policy of keeping low interest rates that remained unrevised for a long time in spite of the economic growth (see Graph 1). Naturally, one can hear complaints about the deficiencies of the system of supervision over financial markets and, consequently, its regulation, which did not make it possible to take appropriate measures on time. A proof of this can be found in Alan Greenspan's statement at the hearings in the Congress where he spoke about his superfluous confidence in the market's ability for self-regulation.

Graph| 1. Indicators of Economic Growth and U.S. Budgetary System



This policy, aimed to artificially whip up growth, has been quite fashionable in the first decade of the 21st century. As the leading international players watched China's double-digit growth, they did not want to lag behind the future superpower, and that is why the governments of many countries made steps to stimulate growth. Remarkably, the hard lessons of an overheated economy looked outdated – the Great Depression had long become a thing of the past and it seemed that we had overgrown it intellectually. The same logic was behind the task of doubling the GDP within a period of ten years that was set forth by the Russian government. It mostly concentrated on quantitative achievements and parameters of volume. However, while the Russian version of the whip-up policy relied on spare facilities that became available after the crisis of the 1990s and on a powerful inflow of cash from crude oil, the American economy had to develop in the conditions of two simultaneous wars – in Iraq and Afghanistan – which the U.S. administration could not finance without a budget deficit.

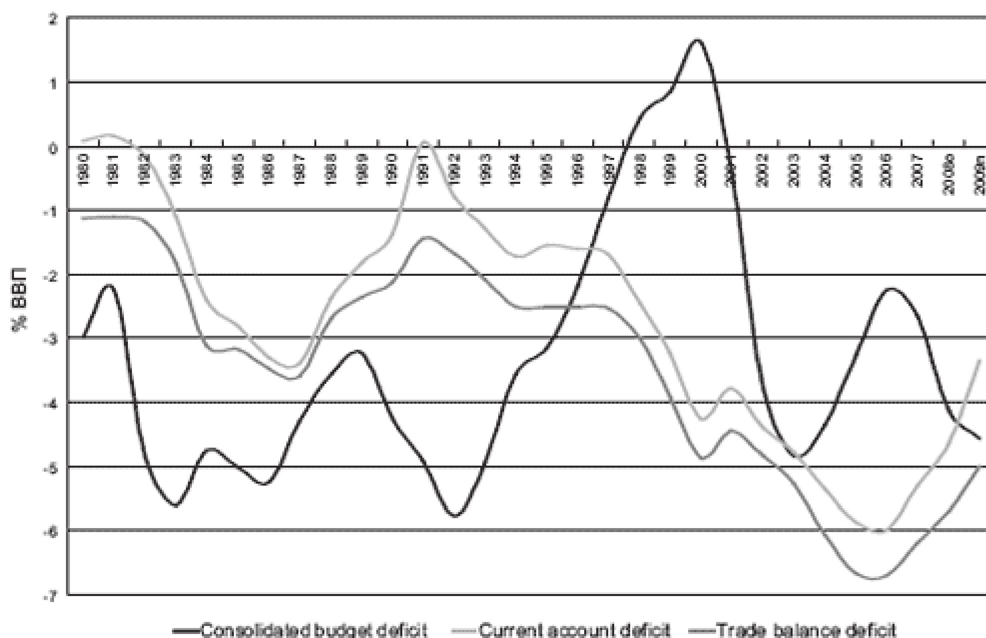
However, there are also deeper-rooted causes of the crisis. They are linked to the general characteristics of the world economy and do not boil down to erroneous economic policies.

First of all, one must point out the unprecedented rates of economic growth that permitted to increase the global GDP by one-fourth over the past five years. A rapid rise inevitably brings up systemic contradictions veiled by growing welfare. But the main thing is that, even if you realize these contradictions, it is difficult to interfere in the process and adjust anything in it. Why on earth should any restrictions and corrective measures be imposed when everything looks perfect? Each time anyone begins to voice warnings or doubt the correctness of a course amidst an economic boom, confident voices are heard: “This time it’s different.”

This applies perfectly well to the U.S. economy’s triple deficit and current account (see Graph 2). It was clear to absolutely everyone that a triple deficit did not signal economic health and could bring detrimental results. But the hope that “this time it’s different” persisted.

Naturally, these hopes did not grow on a wasteland. They sprouted out of a rethinking of the new (innovative) approaches brought up by globalization. We have been speaking much in recent years about the importance of innovations and transition of the economy to an innovative pathway of development, and so the crisis that has burst out can be viewed as a truly innovative one. One can find at its basis a fast spread of financial innovations – new instruments of the financial market that, as some people would think then, would be able to create conditions for an endless growth and which, as it turns out now, the financial world pundits had a vague idea of. As a result, the volume of the CDS reached almost $60 trillion, or four times the size of America’s GDP (see Graph 3). Thus, the crisis appears to be “a rebellion of financial innovations against their creators” – a thing that is unpleasant by not infrequent in history. As one can see now, the situation with the Barings Bank that went broke in 1995 through the solitary activity of Nick Leeson, a young trader from its Singapore branch, was just a harbinger of the crisis, a message to the financial word, which was never heeded.

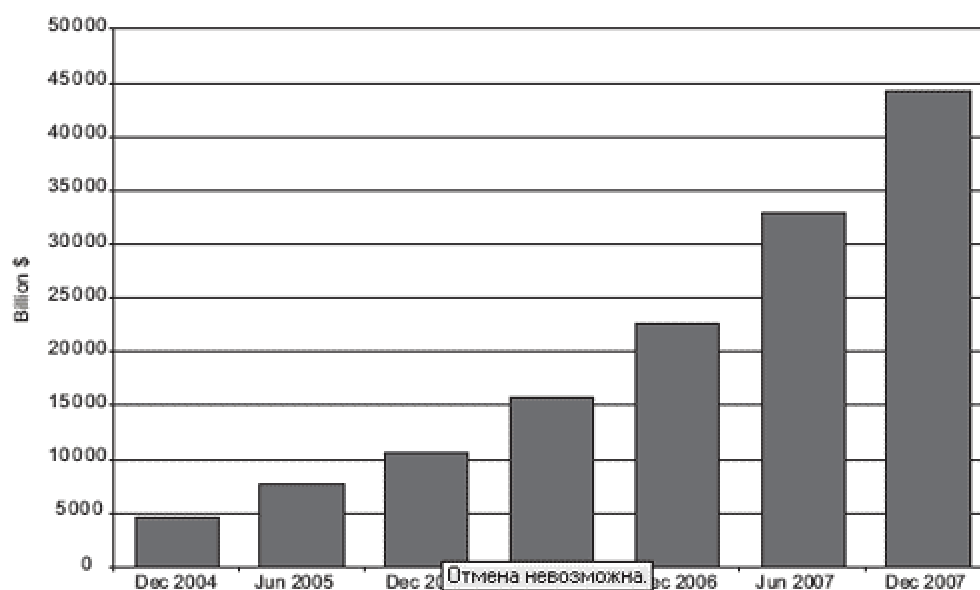
Graph 2. Imbalances in the U.S. Economy



Source: Bureau of Economic Analysis

Still, there exists another aspect of globalization that was also – besides new instruments – seen as a source of endless financial success and steady growth. Niall Ferguson called this phenomenon ‘Chimerica,’ meaning a combination of China plus America. The case in hand is the rise of a global imbalance that was for decades looked at as a source of well-balanced and steadfast economic growth. This resulted in a regime that stood in opposition to the model of globalization that existed at the turn of the 20th century: whereas a hundred years ago the monies would flow from the core countries (developed economies) to the periphery (to the then emerging markets), now the developing market economies have turned into centers of savings and the U.S. and other developed countries have mostly become consumers.

Graph 3. The Volume of World Market of CDS



Source: Bank for International Settlements

Here is what Ferguson wrote in his book The Ascent of Money: “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 U.S. inflation. Chinese savings kept down U.S. interest rates. Chinese labor kept down U.S. 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, U.S. 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 were able to borrow money left, right and center to finance leveraged buyouts. And Chimerica – or the Asian ‘savings glut,’ as Ben Bernanke called it – was the underlying reason why the U.S. 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.”

Finally, the unfolding crisis has one more fundamental prerequisite, and the most important one. I am referring to the target-oriented function of the development of business that has undergone a serious transformation over the past fifteen or so years. It has turned the growth of capitalization into a touchstone. This criterion drew the topmost attention of shareholders and is chosen as a benchmark for assessing the efficiency of management these days.

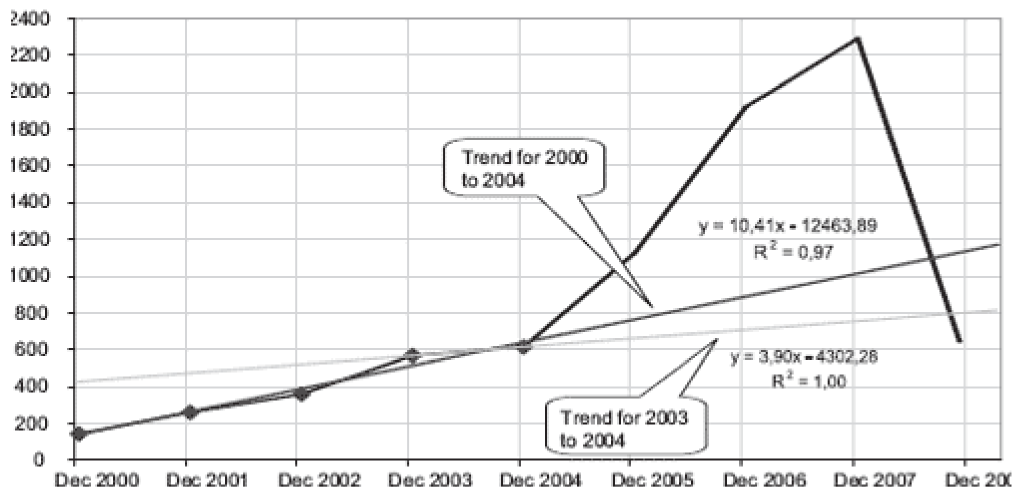
In the meantime, the craving for maximum capitalization develops a sharp contradiction with the fundamental aspect of social and economic progress – the growth of labor productivity. The increase of capitalization is linked to the growth of productivity, indeed, but only in the final count. Meanwhile, executives have to make reports to shareholders annually. Hence, to get a nice report and ensure a current growth of capitalization, one needs things that differ from the factors stimulating labor productivity. Nice reports require mergers and takeovers, since the volume of assets helps to build up capitalization. And of course one shouldn’t shut down outdated production facilities, since their closure slashes current capitalization. As a result, many large corporations keep up old inefficient production facilities and technologies.

Apart from the general factors, there are specific reasons for the fast unfolding of the crisis in Russia. At first glance, the situation looks paradoxical: the crisis sweeps a country that has had an especially favorable macroeconomic situation and a double surplus (of the budget and of the balance of payments). Yet the reason is explicable: this is the reverse side of the favorable environment when double surplus attracts capital flows into the country and actively widens opportunities for borrowings. Naturally, this process took the opposite

direction with the start of the crisis – an abrupt contraction of opportunities and the consequent fast shrinkage of the stock market.

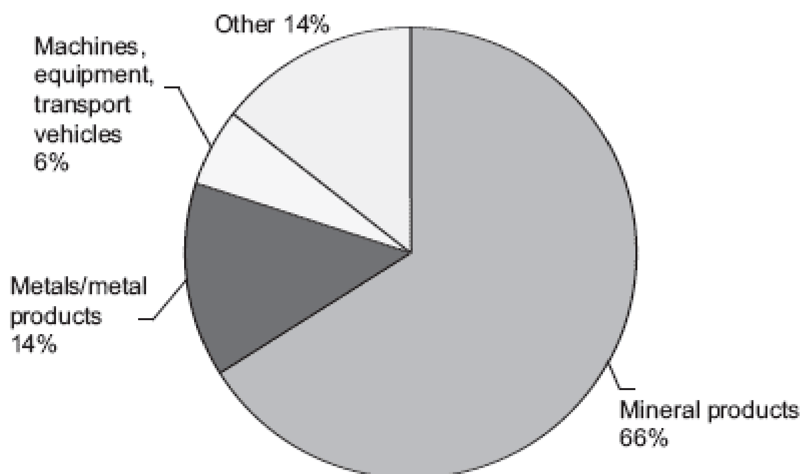
Simultaneously, it turned out that the Russian stock market was still in the phase of budding in spite of a huge growth from 2004 through 2007. Now it may deflate to the minimum parameters, which however have an internal logic. As shown in Graph 4, the stock market fall brought the indices to a point where they could have stayed if the 2005 hike had never occurred. The triangle-shaped figure shown in Graph 4 graphically reflects the financial market bubble that resulted from the disproportion-breeding boom.

Graph 4. RTS Index Dynamics (at closure)



The ineffectiveness of the current structure of the economy and exports also had a telling effect. In conditions of the domination of raw materials and investment commodities in exports, the country's balance of payments is more heavily dependent on cyclic fluctuations than in a diversified economy. A slowdown of growth and flagging activity of investors in importer countries can be a drag on the economy and trigger a hard landing scenario. This is a mirror-like effect of the phenomenon that Russia had to tackle after the crisis of 1998. As the world economy kept growing then, it generated a demand for Russian products and bred a boom when energy resource prices began to grow. Much was said about the importance of structural diversification, but no one would take up the issue seriously amid the boom (see Graph 5).

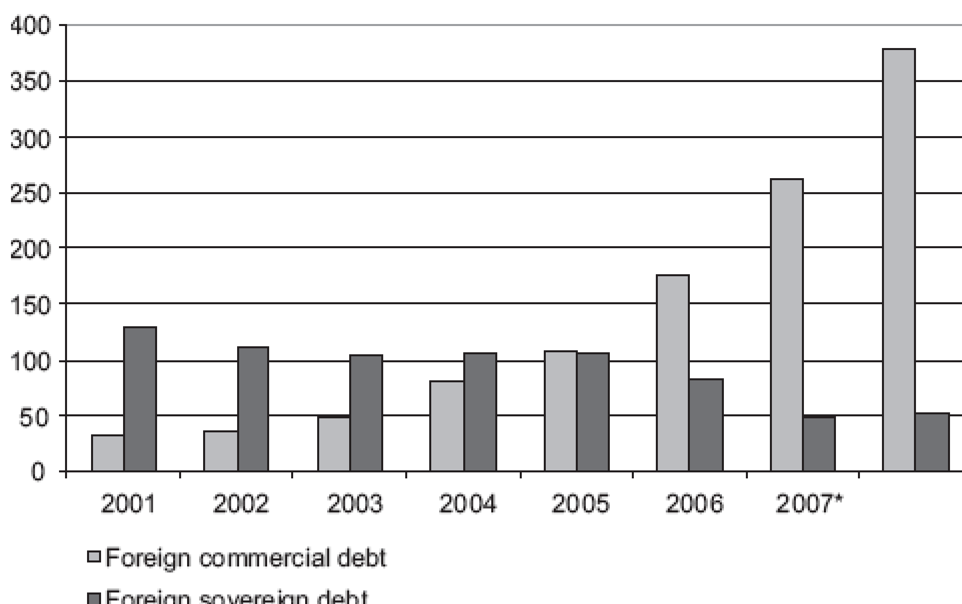
Graph 5. Structure of Russia's Exports in 2006



A growth of corporate borrowings abroad posed a most serious problem, especially due to the quasi-state nature of most of them. Many borrower companies have close connections with the government and act according to the principle of "privatizing the revenues and nationalizing the losses." This is how they are perceived in the financial market, too, where the agents understand that large Russian borrowers will always be able to lean against the federal budget. Thus the situation known as 'moral hazard' emerges, as was the case

with the Asian economic crisis in 1997. It means that the borrowers borrow irresponsibly and the lenders lend rather groundlessly, while the government has to rescue the debtors in case of an economic crisis. One can speak here of a tendency towards cheabolization among the leading Russian companies if a reference is made to South Korean cheabols that are controlled by the state de facto and abide by the principle of "privatization of profits and nationalization of losses."

An important change of the tendency in the dynamics of foreign indebtedness took place in 2007 – the aggregate debt burden (sovereign and corporate) that had been decreasing began to grow. This heightened the dependence of Russia's economic position on fluctuations in the global financial market and pushed up a full-scale economic crisis (see Graph 6). One more mistake committed by Russian borrowers was that they easily subscribed to collateral schemes, although the successes of the Russian economy made it possible to do without collaterals in the recent years. The crisis activated the margin calls mechanism that sharply devalued their collaterals and put up sizable risks for their assets.



This situation affected the budgetary and exchange rate policy. On the one hand, the presence of a big number of influential players – including those having access to the budget – who often have strategically important assets, limited the opportunities for lowering the ruble's exchange rate, which would have sent the cost of servicing their debts up. On the other hand, a need arose to use state financial resources to help the borrowers cover or buy out their debts.

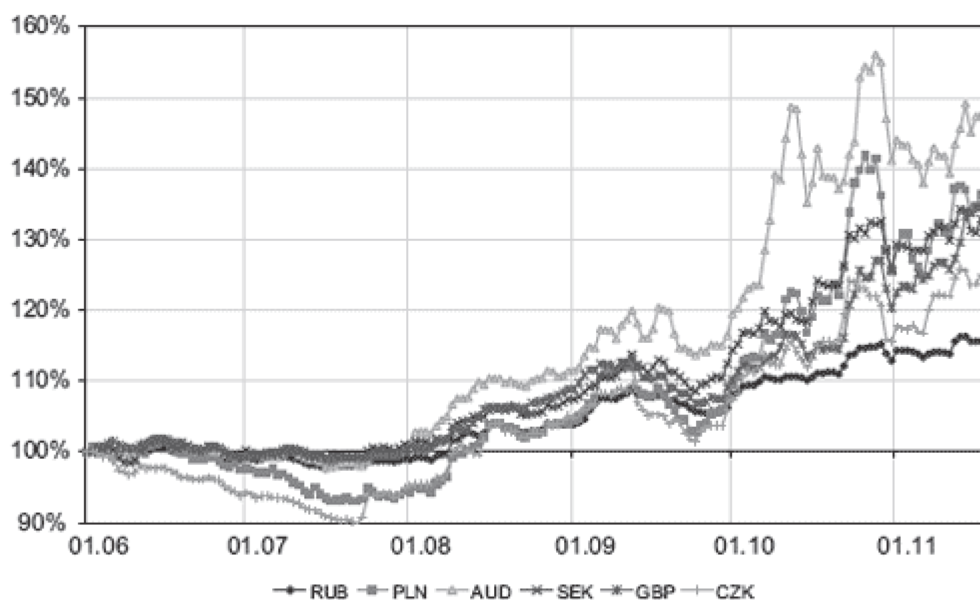
Last but not least, there was a lack of expertise among the political and business elite that had to – for the first time in its life – come to grips with a full-scale cyclic crisis (previous crises were transformational ones). Of course, the elite will get experience over time, but this will require many more years – and a variety of economic crises.

FIGHTING THE CRISIS

The crisis came as a shock to the economic and political elite worldwide. No one expected either such depth or speed. Economically developed countries, apprehensive of a collapse of the banking system and a deflation shock, took resolute steps to support the banks and stimulate production activity. The list of crucial measures included provision of liquidity, broader guarantees for bank deposits of private individuals, buyout of certain banks by the state, aggressive lowering of discount rates, and adoption of 'stimulation plans' (budget injections for stimulating demand in the real sector). Simultaneously, the governments of many countries cut down the exchange rates of their national currencies against the U.S. dollar (see Graph 7). This measure was meant to help preserve international reserves and to serve as an additional factor for stimulating domestic production. An analysis of the logic and efficiency of these measures lies beyond the format of this article, yet it should be noted that the key problem is that these measures can provoke a major macroeconomic destabilization.

From the very start, steps were taken to avert a collapse of the lending system, and this was a natural consequence of the lessons learnt from the 1998 crisis. The banks received substantial financial resources for overcoming the liquidity crisis. On the one hand, these measures were aimed at supporting production activity, as the availability of lending resources, not the stock market, is a source of growth in the real sector in Russia. On the other hand, stability of the banking system is directly linked to the task of maintaining social and political stability in the country. The loss in bank deposits of private individuals will be much more painful and politically dangerous than any losses in the stock markets.

Graph 7.



Russian authorities have taken resolute enough measures to alleviate the impact of this crisis, partly copying the moves taken in the developed countries and yet acting differently in some points.

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Dubious schemes, quite naturally, cropped up, too. The banks that received liquidity money from the government preferred to convert as much of it as possible into foreign currency so as to secure themselves against currency risks or to use it as an instrument of reducing their debts to foreign lenders. Such conduct was economically grounded yet ran counter to the intensions of the monetary authorities which issued the money. Also, there were situations where the redistribution of the money issued by the government was effectuated with the aid of bribes, which cannot but cause astonishment given the fact that a resource in short supply was distributed at a discounted price. (Unlike primary borrowers, second-tier borrowers were supposed to get the money at a price that would be slightly bigger than the interest at which the primary money was distributed.)

The government tried to prop up stock market indicators to a certain degree, but it had to give up the idea very soon. Although the dynamics of the stock market indicators is always impressive and stirs dramatic passions, it is not the sphere where the state should concentrate its resources. Supporting the stock market in this situation meant only one thing – helping fleeing investors withdraw money from this country by selling securities. True, devaluation of shares is unpleasant for shareholders and creates problems with margin calls, but the solution of this problem lies in a different plane.

The latter problem was especially painful, as the debts of Russian companies to foreign loaners posed a real threat of an outflow of Russian assets – into the hands of those who were crisis-stricken themselves.

The fast economic growth in the past few years was largely due to the availability of inexpensive money resources in the world market. Russian companies borrowed them eagerly. But the inexpensiveness of money does not make investing more efficient, especially when one looks at companies linked to the state. The understanding that the state will not let these companies die at a critical moment lubricates the issuance of loans to them.

The situation has changed, however. There are no easily accessible loans any more, while the securities collateralized against loans are devaluating. (This was another mistake made by Russian borrowers who easily agreed to collateral schemes, although the Russian economy's performance over the recent years made it possible to do without collaterals in many cases.) A total of $43 billion was to be paid off on these debts before the end of the year, and the state said it was ready to make available the funds of around $50 billion through Vneshekonombank (VEB) to get out of the situation. Still, a question is looming: Was the mechanism of utilization of the funds correct? Allocation of money to debtors for repayment of their debts is far from the most efficacious way of resolving the problem. It would have been much better if the VEB had bought up these debts. Steps of this kind would help these companies, above all, to increase their capitalization in the future and reduce the spreads on these debts.

The exchange-rate policy was dubious, too. The authorities did not venture – obviously for political reasons – to fully give up support for the ruble's exchange rate, which resulted in a sharp slimming of foreign exchange/gold reserves. The reasons for the cautiousness are quite clear: devaluation of the national currency – a third over the past twenty years – would not facilitate the growth of trust in the government. But the opposite situation, i.e. the exhaustion of resources, looks no less risky. I believe that prevention of considerable devaluation of reserves has a much greater importance for ensuring stability of the Russian economy than the steadiness of the national currency. More than that, gradual lowering of the ruble's rate would serve as a lifeline for domestic producers, defend the Russian market against imports, and create additional incentives for an inflow of foreign direct investment in the future.

And yet a policy like this naturally invites resistance of those who have sizable debts denominated in foreign currencies. A weakening of the ruble is synonymous with a hike of the price of their debts. These powerful forces have enough clout for lobbying their interests. The issuance of money for buying out their debts should have made them mitigate their stance. In a word, apart from being an important economic indicator, the dynamics of the exchange rate will also be a political indicator in the next few months, as it will create a real balance of forces between the main economic players.

Finally, the government offered a package of incentives, above all taxation ones, for supporting the development of the real sector. There are serious doubts as to the efficiency of this package, as the shortage of money is not the main problem in the manufacturing sector. The core problem is the faulty functioning of economic mechanisms and, as a result, the inefficiency of many producing industries. Although bountiful money injections can make the current social problems less intense, they will not resolve the problem of making production more efficient and renovating the structure of the economy. And without this the crisis will only get more dragged-out.

SLOGANS OF THE DAY: SOCIALISM AND POPULISM

An analysis of the current crisis in the context of long-term historical trends and in retrospect of the past 150 years vividly shows swelling manifestations of two critical trends in 20th-century economic history, namely, socialism and populism. Political demand for these trends is always heightened during economic crises and social cataclysms, and today's situation is no exception.

Both models were tested in the past century and both failed to live up to the great expectations that had been pinned on them. Socialism was mostly an experiment in Europe and Asia, while populism was tried in Latin America. The results are well known – both experiments flopped. Socialism solved the task of industrialization with enormous sacrifices, but it did not find internal resources for further development. Populism showed an enviable consistency in driving flourishing countries, beginning with Argentina under Juan Peron, into economic and social disaster.

"In the UK everyone is a social democrat now," read a headline in The Financial Times (October 7, 2008. p. 11). It shows graphically that the public at large buys into socialist ideas like hot cakes when the financial system is about to collapse and people are apprehensive about diminished incomes. A fiasco of market-oriented ideology and market values in the mentality of a big part of the elite and society is as clear as daylight.

Apart from rare exceptions, both the rank-and-file and government appear to be ready to "buy" socialism immediately to maintain their quality of life, however imaginary. Everyone agreed that the proposed measures were "essential and the only possible ones."

It was the authorities, and not the market at all, that began to make decisions on who should be guillotined or pardoned. The situation surrounding Lehman Brothers, on the one hand, and with Bear Stearns and AIG, on the other, does not stand interpretation in market terms. The government simply decided to sort out relations with one corporation and to help the other, the way it happens in a centrally planned economy. And of course all of this was wrapped up in the appropriate rhetoric.

A much greater problem is posed by the policy of socialization (or nationalization) of risks. As the government saves debtors, replenishes banks with money (recapitalizes them) and sharply increases guarantees on private deposits, it assumes the risks inherent in the decisions of all major economic actors – bankers, investors and borrowers (all the more so that they are often the same people). This undermines the fundamental principle of capitalism – personal responsibility for decision-making. If one takes Russia, one can be sure that nationalization of the losses unavoidably leads to nationalization of the risks. This process begins in the banking sector and spreads to other corporations and sectors through bank guarantees.

Ownership relations, the inner sanctum of any social and economic system, undergo a deep transformation. Providing financial aid to distressed corporations opens the way towards their de facto nationalization. This is done through at least three channels – the buyout of debts from certain corporations, recapitalization in exchange for shares, and inflation of accrued liabilities. Governments are inclined to take on all the liabilities of financial institutions – through guarantees and through direct injections of money as well. Naturally, aid to financial institutions goes hand in hand with formal or factual washing out of packages belonging to private owners. The rights to private ownership – above all, of financial institutions (in the West) and corporations in the real sector – are being called into question. The latter process is quite visible in Russia, especially with regard to those whom the state rescues from margin calls.

Government decisions regarding the nature of activity of the de facto nationalized institutions will be the next, and quite logical, step. Harold Brown said he would continue to stimulate the banks that had come under his control in order to invest more money in small businesses. Support for small business is a sacred cause, no doubt about it, and all contemporary governments love doing this, but the aftermath of these kinds of decisions is easy to predict. When the authorities order where to invest, they will have to render assistance to the loyal banks whenever this politically motivated investment proves inefficacious. That is, state support and ineffective investment form an endless circle. The Europeans were the first to declare this set of measures in a statement on October 12, 2008 and the Americans joined them two days later.

Finally, it is worth remembering that huge capital inflow is due to stream into the market shortly and this will whip up inflation with a simultaneous drop in production. Russians are accustomed to living with high inflation, and, as we could learn from the experience of the 1990s, it is not only a matter of monetary policy. It also has a redistributive effect. Edmund Burke was the first to point to this, discerning the paper money of the French Revolution in 1790 as an ominous token of private property expropriation.

The risks of populist policies are looming large simultaneously with socialistic tendencies. The crisis is already spreading to the manufacturing sector. As growth rates slow down, problems with unemployment may surface. The most dangerous thing in this situation would be to try to stimulate growth with the help of budgetary injections. This will only add to the burden: countries overwhelmed by crisis will have to spend vast amounts of money to support liquidity in the economy and bring stability to the lending system.

Calls are being heard in the West and in Russia to assist manufacturers. Yet doling out cheap money to them would have dangerous consequences in this situation, even though it may bring about a short-lived increase in growth. It would not produce a steady result, while more rampant inflation would put up obstacles to investment. Meanwhile, one should remember that Russia is past the phase of recuperation growth, which requires demand and political stability to a greater degree than investment. The latter is turning into a source of economic growth now, and populist policies can undermine the conditions necessary for it. It would be unforgivable to fight the financial crisis with one hand and build barriers to economic growth with the other hand.

A turn towards socialism obviously reveals an attempt to gain more time for a respite and a reconsideration of values. It is too early to say yet how long it will last, but it will certainly not last forever. Any excessive state

regulation goes against modern flexible production forces and the challenges of the post-industrial era. That is why one can hardly claim that the current etatist regulatory systems have arrived "to stand and deliver." Populism is a different story. Populism is ineradicable and its proliferation merely reflects the quality of the national elite.

RISKS OF ANTI-CRISIS STRUGGLES

A discussion of the problems of the current crisis revolves in one way or another around historical precedents and the genetic apprehensions born out of them. This refers first of all to the Great Depression, which was marked by protracted deflation and double-digit unemployment figures. It was only fully overcome thanks to World War II. References are also made to the crisis of the 1970s that gave birth to a new phenomenon – stagflation.

Measures taken by governments in developed countries today suggest that they mostly fear deflation, which may take a decade or more to cope with. In addition to the crises of the 1930s, the Japanese economic crisis in the 1990s furnishes an example, as well.

Deflation and stagflation are actually opposite ways in which a crisis may proceed and that is why they suggest radically different approaches. Fighting deflation requires stimulating demand, i.e. an active budget policy and budgetary expansionism. This helps to lower taxes and discount rates, together with huge budgetary spending. Dealing with stagflation requires a set of opposite measures, above all control over the money supply – that is, consolidating budget policy and increasing interest rates. Following the decade-long economic crisis of the 1970s, a way out of the situation was found only after the head of the U.S. Federal Reserve System, Paul Walker, dared to take unprecedented austere measures that drastically increased the discount rate. As a result, U.S. unemployment surged to over 10 percent and interest rates soared to over 20 percent. The country plunged into a deep recession, for which Jimmy Carter paid a dear price – he lost the presidency, but the country re-emerged with a revamped and dynamic economy.

Naturally, contrasting the two models is rather relative and the ongoing crisis will hardly replicate either form, but what matters for us is the understanding that the therapy depends on the nature of the illness and may require very different or even radically opposite remedies. The experience of both crises may prove handy in the current situation. Strictly speaking, developed countries now resort to policies that they found inadmissible for emerging markets (including post-Communist countries) in the 1980s and 1990s.

The powerful financial injections by the U.S. and the European Union can now actually prevent the deterioration of the economy from going beyond the politically tolerable level, but one must use caution in applying these measures in developing economies. The problem is the U.S. fiscal authorities have two distinctive features. First, they control the printing press that churns out the world's reserve currency. And, although its status has been shaken somewhat, no one seriously calls this into question.

Moreover, most countries keep their foreign exchange reserves in U.S. currency and are interested in maintaining its relative stability. Second, due to this very special status of the U.S. dollar, corporations and households do not have alternative instruments for hedging monetary risks – it is most unlikely that they will rush to exchange their dollars for euros or yens even if they start doubting the correctness of the steps taken by the fiscal authorities. This explains why the speed of monetary movement in the U.S. is not increasing in contrast to other countries, despite the budgetary and financial expansionism in the past few months. The reaction to financial expansion in the majority of emerging economies, including Russia, will be completely different. Weaker budgetary and monetary policies in countries where the national currency has not formed a durable credit history and, naturally, is in no way a reserve currency will most probably result in a flight from the national currency, as well as in an increase in the speed of money movement and inflation. In a global recession such developments will unavoidably mean stagflation.

Policies like these would be especially dangerous for countries where raw materials dominate exports. Those economies are extremely dependent on international markets since even a small weakening of demand there evokes a considerable slump in production in their export industries.
And if business activity in developed countries remains low and demand for commodities from developing economies decreases, depression in the latter countries may go hand-in-hand with a flight from the national currency. Budgetary interventions cannot compensate for falling external demand, and this situation breeds inflation that is not accompanied by growth in production activity.

Thus the conditions of the current crisis depict a situation where deflation in one part of the world will combine with stagflation in another part, and the biggest risk for today's Russia comes exactly from stagflation.

This leads us to a fundamental conclusion about the unfolding crisis and the ways out of it. The world may actually face two simultaneously developing forms of the crisis, which, consequently, require completely different approaches. Fighting deflation in the West will push inflation beyond its borders, i.e. to developing economies, while the latter will quickly fall into the trap of stagflation as they copy Western anti-crisis measures.

This scenario primarily concerns countries with non-diversified exports pegged to mineral resources. If business activity and demand for exported goods remain low in importer countries, depression will go hand-in-hand with a flight from the national currency and this will be manifested, among other things, in inflation. The de facto nationalization of many financial institutions and enterprises has big risks of its own too. Russia is actually reproducing the situation that emerged at the turn of the 1980s when the so-called "red directors" played an especially active role. This category of managers received broad powers to manage enterprises in the absence of owners to whom they would have had to report. The state could no longer exercise control over economic agents then, while private owners had not emerged yet. In other words, the "red directors" had de facto ownership rights without having owner motivations. History shows that businesses and the entire national economy had to pay a dire price for that.

Russia seems to be falling into the same trap today. As the state buys out debts, it actually establishes control over a sizable number of companies, which thus get management connected to the state. But due to the understandably different access to information, this manager will have obvious advantages over the officials, albeit very high-ranking ones, who put him in the post. This, in turn, pushes the moral hazard problem higher up the spiral, as the manager's personal interests start dominating over the interests of the company.

This reason alone makes it necessary to have a clear plan to re-privatize de facto nationalized companies. This kind of plan must be broadly known to the political and business elite and, above all, to the owners if they stay interested in the business.

Finally, it would be a grave mistake to consider the current crisis as a pretext for reassessing the correlation between the roles of the state and private enterprise. The crisis is often explained by the insufficient interference of the state and by its inability to exercise effective regulation when innovative financial instruments and technologies appear. Most people put all the blame on the free market and few dare defend the values of free entrepreneurship. Only a handful of individuals risk saying that "it wasn't deregulation that allowed this crisis. It was the mish-mash of regulations and regulators, each with too narrow a view of increasingly integrated national and global markets."

In the meantime, the post-industrial world – based on flexible technologies and quick renovation of all technological and economic aspects of life – will not disappear. This world resists centralized regulation and bureaucratic interference in the subtle tissues of its interests. Even if one acknowledges the importance of targeted state regulation of financial markets, it would be a great mistake to extrapolate the regulatory conclusions (and consequently the regulatory practices) to the manufacturing sector.

It has become popular in Russia to speak about the crash of the Western economic model and liberal capitalism today and this talk may make some sense from the political point of view. Yet it would be silly to fall victim to one's own propaganda. All of economic history shows that however harsh a crisis may be and whatever stage of capitalism's decomposition is attributed to it, market economies have always survived crises, and emerged from them stronger, tougher and more competitive. The crisis will end sooner or later, and then we will have to compete with economies that are not only stronger, but also hungrier and, as a consequence, more aggressive.

This will present a serious challenge to Russia and we must already start getting ready for it now. Not only does the crisis leave the need for economic, political, social, and military modernization unabated, it resolutely demands a course of modernization that should be laid out in the government's program documents, so that we can face our competitors with something bigger than state banks and state corporations when the crisis is over.

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A crisis is an unpleasant thing, no doubt, and you never know the price you will have to pay for surviving it, but it has an encouraging factor, as well – it may mark the beginning of rejuvenation, of a healthier growth, and of a cleansing from the sludge of pre-crisis agitation. The degree to which it proves to be beneficial depends on the efficiency and resoluteness of the government's actions and on the responsibility and unity of the national elite.

Last but not least, a great deal of attention must be paid on the part of the government and business community to measures for building mutual trust among market players. To this end they must make their actions clearly understandable to each other. It is important to provide information to the public about which financial institutions receive federal money, how much they receive and, moreover, how this money is being used. The crisis has shown once again that a market economy is built primarily on trust – a trust that is grounded in transparent information, not in the ability of one side to subjugate the other.
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