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## GLOBAL TURMOIL: CHALLENGES FOR RUSSIA<sup>1</sup>

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Speaking on contemporary world economical–financial crisis, we, in fact, are speaking on the first general crisis of the era of globalization. At the same time this is the first crisis, which Russia experiences being market reformed national economy, on the one hand, and the real component of the global market economy, on the other.

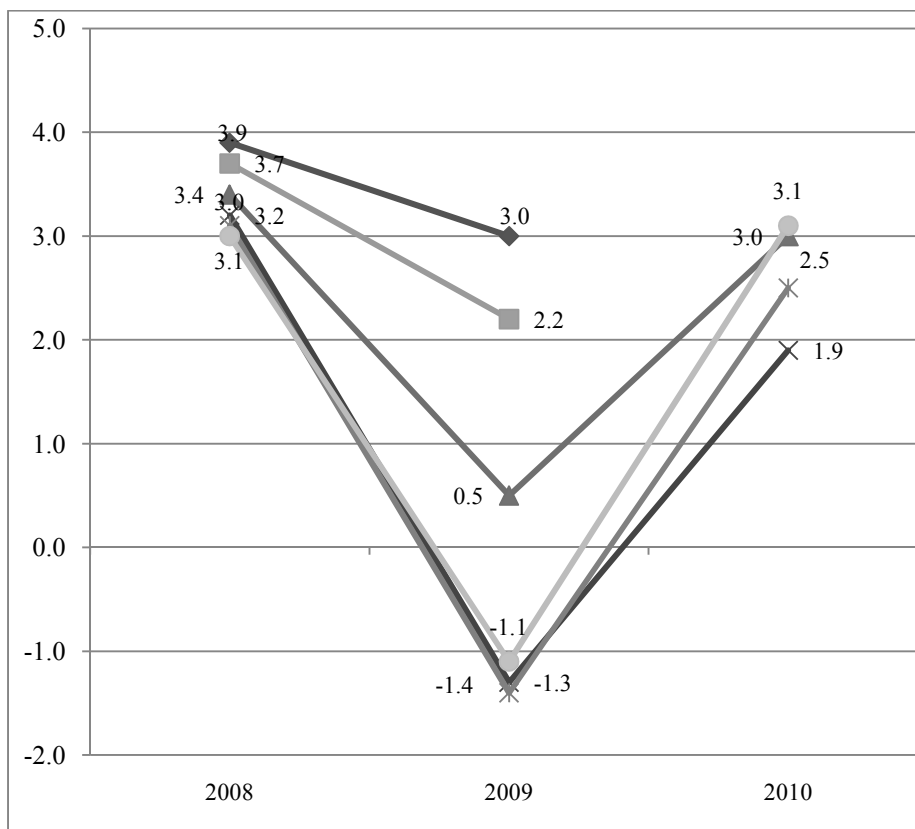
Such combination produces additional uncertainties, putting Russia in the face of two main kinds of challenges – of general global and specific national nature. The national dimension of the global turmoil to a considerable extent determines the crisis' trends as well as anti-crisis policy of the Russian government. Nevertheless the trends of the global economy dominate and forecasts of the Russian economy development generally follow the changes of estimations of the world one. Lately IMF and a few other international organizations and banks informed that the bottom of the crisis was already achieved. Practically simultaneously the Russian Minister of Finance (practically responsible for macroeconomic anti-crisis measures) declared that our economy is coming out of recession. He didn't precise the duration and form of that process. But one thing is now completely clear – recovering and further growth of the Russian economy is closely interdependent (maybe even dependent) on convalescence of the global one, especially of the economy of Russia's main trade – investment partners (the EU, China, Republic of Korea). But there remain

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<sup>1</sup> The article is based on presentation made at Korea Foundation Forum Lecture (October 7, 2009).

many uncertainties. If we look at the past, one year ago, every new forecast of international organizations was more pessimistic than previous one (see graph 1).

**Graph. 1 Forecasts of World Economy Growth Rate in 2009 (rates of growth, %)**



◆ 08.10.2008    ■ 06.11.2008    ▲ 28.01.2009  
 ✕ 22.04.2009    ✖ 08.07.2009    ● 01.10.2009

Source: The forecasts of IMF published from October 8, 2008, till October 1, 2009

One can see, how the IMF forecasts have changed. Practically each month their estimates decreased and decreased quite substantially. Certain exceptions were the last two, but with the improvement measured by parts of percentage point only (compared in fact with statistical error). That is unprecedented for prognosis-makers' reputation. What reveals uncertainty is confusion—if not perplexity—incomprehension of the causes and real depth of the current crisis.

That is why we have to be very cautious regarding forecasts for the future. Much vagueness preserves. When credit markets will recover? What will happen with the toxic assets? What will be recovery of the American economy like?; quick or lingering? What will happen to the Chinese economy? It is obvious already, that China, notwithstanding high growth rates, dumped into difficult social and political problems and challenges. Suffice to say that there is 25 million of migrating workers from rural areas who cannot find jobs in the cities, but nobody looks for them in the villages anymore. With 1 million unemployed university graduates of the last year and 5 million more of year 2009 it can create the problem at labor and consumer markets serious even for 1,300 million people China. Can new leading emerging economies (known as BRICs group) replace the USA and the EU as the world economy “locomotives”? It’s clear that in 2009 expected economic growth of China by 8.5% and India – by 4.2% (accompanied by estimated economic decrease of Russia by 7.5% and Brazil – approximately by 1%) would be insufficient to compensate economic slump in the developed economies. The comparative analysis of the current and previous world scale economic crises may help in seeking the answers.

### **THE GLOBAL ECONOMY: ENTERING INTO THE END OF CHANGES IN THE WORLD ORDER?**

It is likely that we have entered into the next crisis era, era of changes in the world order. We know, that the future grows out of the present, while the present – out of the past. After each serious crisis, reshuffles the balance of power in the world and in international relations. This is the case with the Great Depression following the crisis of 1929~1932 and the reshuffling of international economic order after the crises of 1969~1970. The Second World War was triggered by the first case, resulting in a “bipolar world”. In the second case, the crises were conducive to the mobilization of American society and economic renewal. As a result the United States managed to take up a position of the sole superpower. It is likely that new global changes in international politics will take place now as well.

Meanwhile I categorically disagree with the thesis that the crisis of 2008-2010 can be compared to the Great Depression of 1929~1930. The framework of this article gives no space for detailed argumentation. But one can see the principal differences – basically less developed productive forces, absence of the global trade, financial and information spaces, authoritarian political and autarkian economic regimes in a number of main world economic actors (Germany – Italy economically dominated part of Europe and Japan dominated part of Asia not to mention the Soviet Union of that time)

On the contrary analysis recently made in IMEMO RAS demonstrates significant parallels between current geo-economic and geopolitical situation and the one, which the world lived through in the 1970s (see table 1).

**Table 1. Modern period compared with the 1970s**

	<b>Crisis period of the 1970s</b>	<b>Crisis period of 2008 – 2015</b>
1.	The Vietnam War of the USA (1965 – 1972, occupation of South Vietnam till 1975)	The Wars of the USA in Afghanistan and Iraq (since 2002 in Afghanistan, since 2003 in Iraq)
2.	Financial Crisis in the USA, Increase of State Debts (1969 – 1971)	Financial Crisis in the USA, Increase of State Debts (2008 – 2009)
3.	Changes in the World Financial System  Abolition of Bretton-Wood golden standard, devaluation of dollar in 1971 and in 1973	Changes in the World Financial System  Discussions about the new financial architecture, new world reserve currency, possible devaluation of dollar.
4.	Relative Weakening of the American Position in the World, Relative Strengthening of the Position of the USSR and Japan and EU (1970s)	Relative Weakening of the American Position in the World, Relative Strengthening of the Position of China and India (since 2007)
5.	Changes in American Society, Anti-War Movement, Social and Economic Reforms (since 1968)	Changes in American Society, President B. Obama, Social and Economic Reforms (since 2008)
6.	Disequilibrium of the world order: - Growing impact of Chinese factor (Nixon in Beijing) - Iranian factor (1978-1979) - Middle East and Israeli-Arab problem	Disequilibrium of the world order: - Growing role of China, a new competition for China - Iranian factor - Middle East and Israeli-Palestinian problem (Obama in Cairo)
7.	Basic arms control treaties negotiated and signed: ABM (1972 – US ‘left’ the treaty in 2002) SALT-1 (1972) and SALT-2 (1979)	New chances for arms control agreements: START-2 (expires in Dec. 2009) and antiballistic missile defense
8.	Strengthening of the energy levers: OPEC (stable. 10-14/10/1960) introduced oil embargo in 1973 against US and European states, who supported Israel in Israel-Arab “October war” - Oil prices up?	Strengthening of the energy levers: - Competition for resources Discussions over ‘gas OPEC’ (since 2006) Gas and oil transit scandals - Oil prices down?

This comparison brought us closer to the right picture of reality, but questions still remain. Will a new world order be more stable? What will a new world order be like? How the leading positions of the US in the world will change? We may come closer to the answers to these questions by analyzing political consequences of the crisis of the beginning of the 1970s. Of course, all historical parallels are relative. Their uncritical usage is dangerous. Nevertheless, the researches have practically no other possibilities for the analysis and prognosis, but comparison with the historic precedents.

It is well known that financial crisis, which shook the United States and other countries in 1969 – 1970, was preconditioned, on the one hand, by the increased competition between the United States and Japan and Germany, on the other hand, by overstrain of the American economy during Vietnam war. The current crisis of 2008-2009 in many respects is also caused, on the one hand, by economic rivalry of the United States with China and other Asian countries, but on the other – by financial overstrain of the US in the course of lingering warfare in Afghanistan and Iraq. Still, as well as in the 1970s, nobody can seriously contend American economic, political and military leadership. But today, as almost 40 years earlier the American Administration seems to run of cash.

Violent economic development of China and gradual growth of its political impact is an important factor. But in the 1970s the situation was more or less similar: on the one hand it was rapid, based on exports, economic growth of Japan, and then the Republic of Korea, on the other hand and the growth of political and economic might of the Soviet Union. Nevertheless, after temporary decrease of American political role in the world in the 1970s, we saw recovery of the US might. Of course, it was achieved by mobilization and reforms in different spheres of social life, but nowadays, American society seems also to be ready for implementation of new set of important reforms.

It is well known that the crisis of 1969-1970 caused significant changes in international financial system, in particular, the refusal of the United States from dollar-gold exchange and the abolition of Bretton Woods System gold-exchange standard. But no dramatic shifts in financial system happened: dollar has remained the world reserve currency. It is likely that nowadays the world is moving rather to the bi-currency (dollar, euro) system, than to a new supranational world reserve currency. The situation on the world financial markets won't change radically, if, of course, nothing extraordinary happens.

It is true, anyway, that this time the situation is more dangerous, than in the 1970s. Terrorism has obtained global scale; the “arc of instability” has extended from Northern Africa and Palestine to North Korea, Indonesia and the Philippines. The biggest concern causes the activities of terrorists in Afghanistan and Pakistan and eventual conflicts in the countries of Central Asia. The economic and social crisis in Central Asian states may already in the nearest future lead to the situation, when many young unemployed people become members of international terrorist networks. In Russia, in the Northern Cauca-

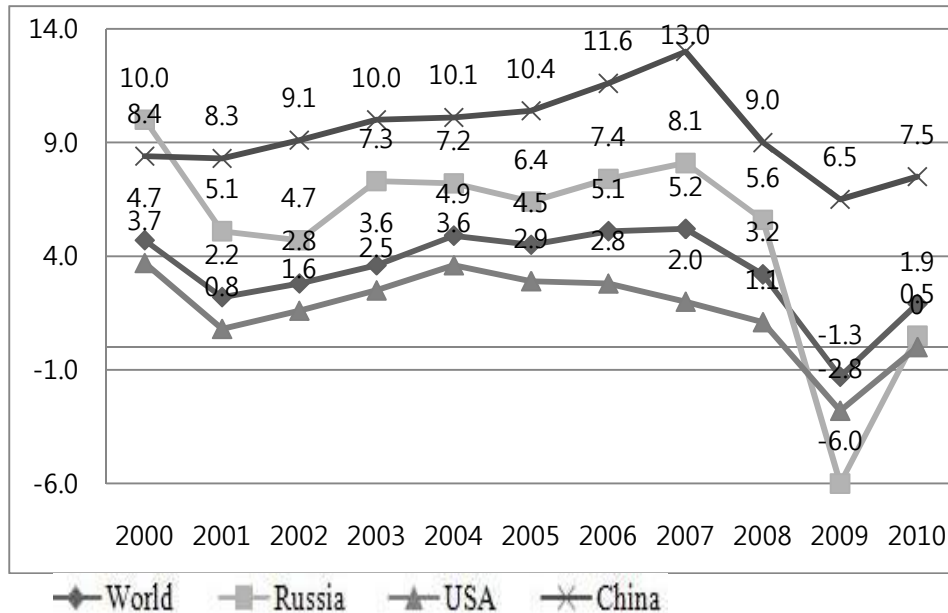
sus the situation also worsens. Probably, we already hear the first shots of the civil war between valiant Islamic fundamentalists and moderate Muslims, supporting Moscow. All these factors make necessary more close cooperation between all market democracies: the United States, European Union, Russia, Japan and Republic of Korea to rebuff terrorists and to stabilize the situation in the world.

Moreover, whatever paradoxical, notwithstanding all shifts and changes, the arrangement of the main political forces in the world in 2000s reminds in a way the 1970s. International revolutionary communism has been in fact replaced by Islamic fundamentalism. The role of the second superpower – instead of the USSR – plays China. The ambitions of Germany and France are implemented by European Union. While for the role, which in 1970s was played by rapidly developing Japan, nowadays aspire South Korea, India and Brazil. This trend is strengthening. Like current global crisis “guru” Nouriel Roubini noted, the composition of the club of major emerging – market economies are revising constantly by widening it from BRICs (Brazil, Russia, India, China) to BRICET (adding Eastern Europe and Turkey) or BRICKET (the former plus Republic of Korea). Moreover the BRICs index inventor Goldman Sachs is introducing the new term “Next –11” (adding to BRICs, Bangladesh, Egypt, Indonesia, Iran, Mexico, Nigeria, Pakistan, the Philippines, South Korea, Turkey). Naturally, the world has become more complex, globalized, interdependent and transparent, than in the 1970s. But political *mise en scene* remained mostly the same, though the actors have partly changed. That witnesses for a certain conservatism (or continuity) in the development of the very structure of international relations and world politics.

### **RUSSIA – “THE SICK MAN” OF BRICs?**

The global financial crisis hit the Russian economy breaking its most prosperous period of development since 1991. Since 2000 till the autumn of 2008 the Russian economic rate of growth was about 7% at the annual level positioning the country among the most dynamic economies in the world

Russian budget surplus was about \$80 billion. Russia in 2008 had a record export (\$468 billion) and payments balance (\$200 billion). Its international reserves in August 2008 were equal to \$597 billion. The exchange rate of the ruble rose steadily since 2001. At the end of the year the situation dramatically changed (see graph 2). Nevertheless even in the end of 2008 Russia kept 3rd position in the world by reserves of foreign exchange and gold, 5th – by current account balance, 7th - by GDP, 9th by export and 10th – by stock of direct foreign investment, while only 22nd by external debt and 117th by public debt.

**Graph 2. GNP rate of growth, %**

Such sharp economic fall especially obvious in comparison with other BRICs member states was determined mainly by specific features of the Russian national economy. Russian financial institutions did not fall for the game with financial derivatives. Thus, the impact of the crisis differs from what is taking place in the advanced market economies. Starting from August 2008 the Russian economy has suffered from three simultaneous shocks.

Firstly, there was decrease of the oil prices and in Russia export of hydrocarbons, giving up to 40 % of the budget revenues

Secondly, there existed capital outflow from the stock market. Some of Russian politicians and experts were very proud of the fact that before crisis stock market capitalization was higher than the GDP volume. Anyway, the professionals were fully aware that Russian stock market is rather shallow: the bulk of its value is set up by the shares of 15~20 blue chips, predominantly of the mining and quarrying. To that in a free float are no more than 15% of shares of each company. Such markets are notable for high volatility. The capital massively rushes to such markets in the time of boom and no less rapidly outflows when problems start. It is interesting that the number of individual investors at the Russian stock market is 850 thousand people. In contrast, in China 100 million are keen on it.

Finally, thirdly, Russian companies appeared to be very much over-credited. They have received abroad credits almost up to 600 billion dollars. When the price of loans and the value of money sharply increased, Russian companies

faced “margin calls” and rushed to the Government for support. Of course, massive borrowing abroad has been partly forced by the rigid credit and monetary politics in the country for the last years (see table 2)

**Table 2. Why has the 2008-2009 credit crunch seriously affected Russia?**

1. A high share of foreign capital in the Russian stock market has resulted in a more than four-fold meltdown.
2. Heavy debt incurred by Russian companies to foreign investors – up to US\$500 billion. US\$160 are to be returned to creditors by the end of 2009.
3. Dependence of social and economic development and national budget income on export oil prices. In the 2<sup>nd</sup> half of 2008 oil prices fell from US\$140 to US\$34-35 per barrel (Urals). Oil prices less than US\$60-70 per barrel (in 2009) would result in a budget deficit up to US\$80 billion.
4. A maximum reduction of the liquidity of Russian banks and companies on the eve of the crisis due to the Russian Central Bank’s anti inflation policy (tightening the money supply).
5. Excessive budgetary expenditures due to the huge inflow of foreign currency in 2003-2007 and the 1<sup>st</sup> half of 2008 as well as high social and economic commitments made by the government.
6. Low adaptation capabilities of industries.

Trying to neutralize these problems during the last 6 months the Central Bank sold \$210 billion of international reserves. Approximately 60% of this sum represents capital outflow. Substantial amounts of foreign currency were bought by domestic banks, non-financial sector companies and households. The raids of customers on the banks were successfully managed, though this threat was actual for a short period in October, when ruble drastically went down.

The stock prices dropped by 80%. Ruble was depreciated to the dollar since July 2008 by 60%. The recent GDP rate of growth forecast for 2009 is minus 7-8%. Budget revenues, according to the Ministry of Finance estimations, will



fall down by mostly 40%, budget deficit will be about 8%. The decline of the production up to 20-30% is expected in many sectors, including steel, non-ferrous metals, housing construction, textiles, retail, bank credits (see table 3)

**Table 3. Expected cuts in the supply of goods/services in 2009**

Industry / sector	Prior growth rate	Possible cuts in supply	Decrease of employment	Possible investment downturn
Ferrous metals	3-5% per annum Historical price peaks in 2008	20-30%	10- 30%	Investment programmes to be slashed by 50-150 %
Nonferrous metals	3-7% per annum Historical price peaks in 2007-2008	Up to 20% with prices plummeting	10- 20%	Investment programmes to be slashed
Gas	Historical price peak in 2008	Export prices to fall from the end of 2008	10-20%	Exploration of shelves, fields in Yakutia and Irkutsk Region to slow down
Oil	Production peak in 2007, price hike – in June 2008 (prices grew 3 times over 1.5 years)	10-20% (cuts in profits of US\$ 15 billion in August 2008)	10%	Some projects in eastern Siberia, northern shelves, etc. to be frozen
Automotive industry	Sales of new foreign-made cars by 40% per month until September 2008	Up to 5% with prices falling slightly	Manufacturers – 5%, Dealers and service stations - up to 20%	New investment initiatives to be abandoned
Retail, advertising, services	10-20% per annum	Up to 20% (advertising - up to 30%)	10-30%	Investment programmes to be slashed by 100-200 %
Construction construction materials	Prices multiplied 300-400% over 10 years	20-30% (prices set to fall by 20-50%)	10-30%	New projects to be abandoned and existing projects to be frozen
Banking	30-40% per annum	30-50%	30-40%	Liquidity levels to be maintained with budget monies

Unemployment became a very serious problem exceeding 7% of economic active population and causing social conflict situation in some regions, for ex-

ample, in the center of the Russian car industry – city of Togliatti, where 25 thousand of employees can lose their work.

The trade balance is still positive, as well as current balance of payments. A question of crucial importance for Russia is whether financial speculations on the oil futures will stop. Generally, at least in Russia, there were many talks about “the end of the epoch of cheap oil”. Is that true? What will be the global financial architecture and correspondingly the security architecture? Will G-20 countries manage to come to agreement and what will this consensus look like? The summits in Washington and London were not much successful. According to the World Bank data, after November 2008, when G-20 met in D.C. 17 countries of 20 (Russia included) introduced protectionist measures. Pittsburgh looks like more productive, despite disagreements about off-shore zones. Maybe the 5th meeting in Seoul will put this important grouping of leaders on track. In the IMEMO our economic outlook for 2020, published in 2008, we have made prognoses of average annual growth of world economy in 2005~2020 at the level of 4.1– 4.2%. But we made a reservation, that in case of outburst of protectionism, the tempo will be 2.1 – 2.2% lower. When I send the book to the publishing house in the very end of 2007, it seemed to me, that this reservation was abundant.

Thus, main reasons why the Russian economy has proved to be so vulnerable in the face of the crisis can be counted as follows:

- ✓ weak financial system,
- ✓ high share of foreign capital in the stock market (around 60%),
- ✓ heavy debt of Russian banks and companies to foreign investors,
- ✓ dependence of social and economic development on export oil prices; energy exports accounts for 40% of budget revenues, and 70-80% (with gas) of all exports earnings,
- ✓ extremely high reduction of the liquidity of Russian banks and companies on the eve of the crisis due to the Russian Central Bank’s struggle with inflation by tightening the money supply,
- ✓ excessive budgetary expenditures due to the huge inflow of foreign currency in 2003-2007 and the first half of 2008 as well as high social commitments made by the state,
- ✓ overvaluation of ruble. Since 2001 its real effective rate rose by 145%.

The situation in Russia resembles one in the countries with relatively developed financial markets (India, Brazil, South Africa). On the one hand, there are

many similarities with the countries highly dependent on export of limited number of commodities. In the Russian case they are energy, basic chemical, timber and metals (see table 4).

**Table 4. Export as a percentage of basic production  
(estimates for 2005-2007)**

<b><i>Energy</i></b>	
Crude oil	54-58
Petroleum products	46-48
Natural gas	28-32
Mineral coal	49-53
<b><i>Fertilizers</i></b>	
Chemical fertilizers	75-85
<b><i>Timber</i></b>	
Wood pulp	80-84
Newsprint paper	60-65
Plywood	59-63
Untreated timber	56-60
<b><i>Metals</i></b>	
Rolled iron (averaged)	45-48
Nickel	90-95
Cobalt	90-95
Primary aluminium	80-85
Titanium	70-75
Zinc	45-55
Copper	30-40

Thus the impact of crisis in Russia is also similar to many emerging and even developing economies:

- ✓ slowdown of production activity,
- ✓ domestic credit crunch,
- ✓ capital outflow,
- ✓ depreciation of the national currency and increased inflation.

On the other hand, Russia by a number of factors stays apart from the world anti-crisis trend, apart from the logic of anti-crisis measures of G-8 and majority of G-20 countries. The clear picture of these distinctions in the logic and practice of anticrisis policy demonstrates the comparison of crisis management measures in the USA, China and Russia (see table 5)

**Table 5. Russia and foreign countries: comparison of crisis management measures**

Principal measures	Countries		
	USA	China	Russia
Change of the base rate of the Central Bank	lowered up to 0.25 %	lowered from 7.6% up to 5.3% in some receptions	Raised since December 1, 2008 up to 13%. Decreased from April 2009 10%
Nationalization of banks and/or other financial institutions	No	No	No
Recapitalization of financial institutions. The repayment of control packages of troubled banks	US\$145 billion (Federal Reserve System), US\$250 billion (Department of Finance)	Recapitalization of the state Agricultural bank – US\$20 billion	Additional capitalization of the Russian Agricultural Bank (45 billion rbl.) and the Russian Agro Leasing company (25 billion rbl.)
Guarantees under interbank credits	FRS guarantees on a turn of bills of the enterprises – US\$250 billion	The question will be considered in 2009	It is limited, only on banks with the withdrawn license
Interventions in the share market	No	No	Yes 175 billion rbl.
Anti-crisis support of real sector	Automobile companies – US\$17.4 billion, the beginning of procedure of bankruptcy is considered	Still in the process of consideration	The number of recipient enterprises is increasing. The final sum is uncertain. AUTOVAZ – the interest-free 25 billion rbl. loan, subsidizing of automobile purchase crediting – 2.5 billion rbl.
Support of small and medium business	Additional FRS credits, including consumer ones – US\$200 billion; 100% insurance of current accounts of small enterprises	Easing of the control over credits for the small and medium enterprises	Refinancing of credits: additional 27.5 billion rbl. is allocated; Preferential size of a rent
Tax stimulation of innovation process	Long-term support of R&D and Innovations – primarily in the energy savings	Activization of innovation policy	Increase in amortization premiums (on 100 billion rbl.).
Decrease (including time) the VAT	No	Administrative costs of collection of the tax are lowered	Installments of payment of the VAT (nearly 500 billion rbl. a quarter)
Restrictions of payments for top-managers and of stock dividends	Yes	Yes, for the state companies	No
The general volume of expenditures, including guarantees, for 2009-2010	US\$2.5 billion. <sup>1)</sup>	US\$600 billion up to the end 2010 <sup>2)</sup>	6 trillion rbl., including credits for support of bank system. The same amount of financial resources is needed.

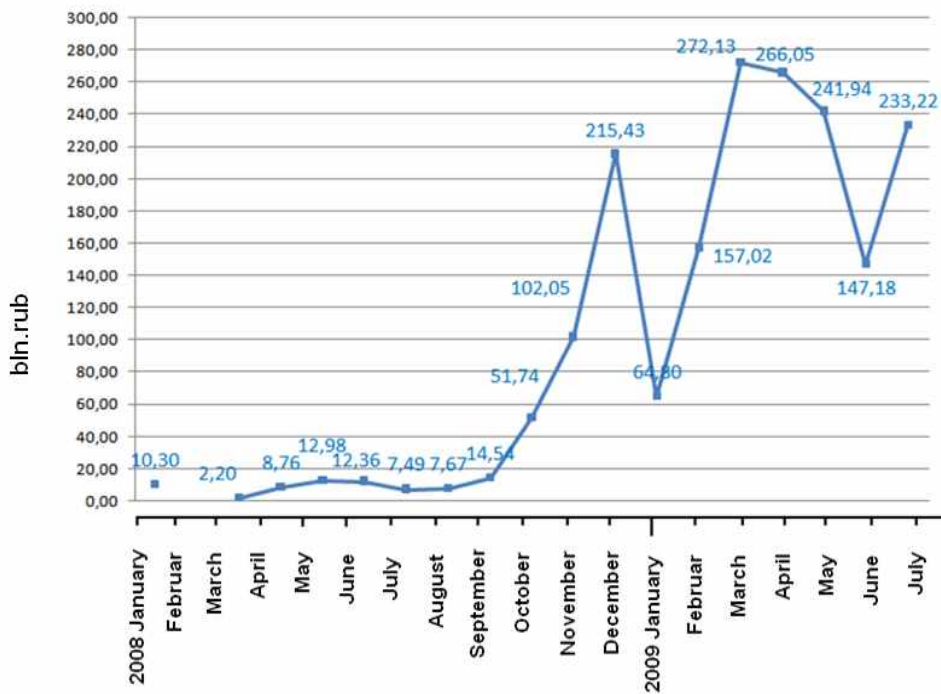
<sup>1)</sup> Without taking into account operations FRS on refinancing credit establishments. For 2008 FRS short-term crediting of American banks reached 1.7 trillion dollars

<sup>2)</sup> Besides for road and port construction from Gold and exchange currency reserves it is planned to spend 730 billion dollars until 2013

One can see that the Russian anticrisis policy was oriented rather to the stabilization (if not conservation) of the existed non - effective structure of economics than to using anticrisis regulation for the rationalization and modernization of that structure aiming to crate new technological and economic base for improvement of positioning at the post-crisis global economy.

Such a policy produced a number of serious problems. First and foremost, this is the problem of Central Bank discount rate. In Russia it is still two-digit, though it was lowered a bit. Meanwhile in the world economies dominates an obvious trend to decrease it down to the level from points of per cent (in the US, Japan, Great Britain) to 5 and few points of per cent (e.g., China and Mexico) (see graph 3).

**Graph 3. Central Bank credits (except overnight), bln.rub**



Russia in this aspect of anti-crisis measures till spring 2009, went along a way of such countries as Iceland, Ukraine, Belarus, Indonesia, Turkey, Azerbaijan. And we know where Iceland “came” along this way. Among the sustainable and big developed economies national bank interest rate increased on-

ly one—Norway (though by part of percentage point and not earlier than the end of October 2009).

The logic of such approach is simple. The increase of the interest rate restrains inflation and – by making credits more expensive and less available – impedes drawing out of capital abroad. But simultaneously such policy heavily blows an economy, limiting the increase of goods and services supply. The limitation of supply naturally aggravates the problem if inflation, which remains the most important targeted by the Ministry of Finance indicator.

The Russian economy did not manage to diversify. On this background and taking into account the fact that during the years of “oil and gas prosperity” the households accumulated certain savings, in Russia, notwithstanding crisis we see effective demand, oriented towards imported goods. Nevertheless, in the first quarter of 2009 compared to the same period of 2008 the import of plasma TV sets decreased by 75%, and the import of cars by 34%. The fall of the world energy prices caused the devaluation of ruble. At the same time more expensive imports put additional pressure on the ruble exchange rate.

As a result in Russia – unlike in the majority of the other G-20 countries, which suffered *deflationary* pressure on the economy – the crisis caused *stagflation*, that means the growth of prices along with the fall of production. The combination of the above mentioned factors gives grounds for assumption that the period of stagflation in Russian economy will last for minimum two more years.

Unlike many other countries Russia accumulated large foreign currency reserves, which now are a main source of financing for anti-crisis measures. The bulk of anticrisis financial support was channeled in the banking system to overcome domestic credit crunch. The result was not encouraging in comparison with many other countries. The banks prefer to buy dollars and Euro and draw them out abroad, instead of crediting real sector of the economy. In the situation when ruble devaluates, the non-financial sector companies, as well as households, save their actives, avoiding the falling ruble and two-digit dollar inflation. In general, bi-currency mentality is typical for the majority of economic agents and companies and households.

Simultaneously support is extended to the producers. Some production taxes were reduced. Credits were extended to large companies (mainly in energy and metallurgy sectors) with big foreign exchange denominated debts. Selective financial support is in progress approximately 300 enterprises whose activity is crucial for regional employment. Imports tariffs (automobiles, steel, tubes) were increased (not substantially). As for stimulating domestic demand, it is rather limited (some schemes were adopted for refinancing mortgage and domestically produced automobiles credits) because of the danger of inflation and import rise.

Emphasis in stimulating business activity will be made on public demand through financing large-scale projects. Thus, Russia began this year intensive

construction works in the region of Sochi where in 2014 Winter Olympic Games will take place as well as in Vladivostok for 2012 APEC summit.

Up to now social protection schemes are comparatively modest, but are expected to be increased in line with changes in unemployment situation.

Meanwhile the anticrisis measures adopted in Russia were quite expensive. At the end of 2009 the costs of the planned measures was equal to 15% of GNP. Within next 1~2 years their overall costs may double.

Heavy volume of anticrisis measures is explained by the fact that crisis has aggravated Russia's acute longstanding structural problems. Besides, modernization which began in many sectors (food processing metallurgy, for example) was not completed. Anti-inflationary credit and monetary policy in Russia, as I have already said, substantially differed from the world trend and only since April started the turn in the correct direction.

Apparently, Russia needs dosage use of what in the economic literature is called supply side economy. Its standard levers are: 1) cheap credits; 2) low taxes. This last point is most important.

The stimulating of supply requires changes not only in our monetary policy but in the budget policy as well. Otherwise actual depression in Russia can transform not into recovery and post – crisis growth as in other BRICs states but into long-term creeping stagnation.

## **RUSSIA - SOUTH KOREA RELATIONS: MAIN TRENDS AND PROSPECTS**

The important factors of prevention of such negative trends, potentially fraught with Russia removing from the leading group of the emerging economies to the peripheral one, are to utilize partner's experience and technological and economic cooperation. The Republic of Korea is quite a good example of such perspective partnership in bi-lateral and multi-lateral dimension (both regional and global).

There are several aspects influenced on Russia's policy towards the Korean peninsula: security issues, nuclear weapon proliferation, political activity of the great powers, and access to the markets. *Political relations* between Russia and the Republic of Korea improved significantly, especially since the beginning of the 2000s. Moscow's and Seoul's views on key issues of political and security stability on the Korean Peninsula and in North East Asia are either identical or are very close. Both sides oppose North Korea nuclear and missile program and support six party talks. At the same time Russia is ready to support inter-Korea cooperation.

During the 1990s *economic ties between Russia and the ROK* were unstable, while bilateral trade fluctuated at a point of \$3 billion. Nevertheless joint efforts and improvement of domestic economies in Russia and the ROK were the main reasons of positive trends in economic relations between the two coun-

tries after 1998, when both Russia and the ROK were under crisis. As a result, a debt problem has been successfully resolved, bilateral trade reached \$18 billion in 2008 or increased in six times since 2000. But an average trade with Russia makes up only 1.2-1.5% of South Korea's foreign trade, and trade with South Korea makes up 2.2%-2.5% of Russia's foreign trade.

Total South Korean investment in Russia in 2008 reached \$1.2 billion (70% were carried out during 2006-2008), while envisaged investment are estimated as \$3 billion. Insignificant scale of Russian investment in the ROK (estimated as \$20-30 million) is an important symbol of misbalanced economic relations between the two countries. It is an evidence of low level of Russian business involvement in Northeast Asian economies as well as in regional economic cooperation.

The regional is connected mainly with the difference in involvement of European Russia and the Russian Far East in economic exchange with the ROK. South Korean car producers, leading electronics companies and some other firms pay more attention to European part of Russia. Role of South Korea direct investments in the Russian Far East has been insignificant over the last two decades and was inadequate to the regional economic potential.

Meanwhile the Russian Far East began to play a prominent part in accumulation of foreign investments in Russia: the share of the Russian Far East increased from 7% in 1990 to 18% in the middle of the 2000s mainly because of foreign investments into Sakhalin 1 and Sakhalin 2 oil and gas projects. Hence among the main investors in the Russian Far East are Japan, the United States, European Union and India, not the Republic of Korea yet.

It is also necessary to stress that dynamic bilateral trade exchanges in 2002-2008 were closely connected with the period of high prices on oil and raw materials as well as with unprecedented growth of demand on consumer goods in Russia. World economic crisis in 2008-2009 undermined positive trend in Russia-Korea economic relations. Bilateral trade in January-June 2009 period decreased to 47.5% of the level of Russia-South Korea trade at the first half of 2008 while Russia's total foreign trade amounts to 55% of the figure of 2008. The problem is that Russia-South Korea trade is based on very limited number of goods and services. Non-ferrous metals (aluminum and nickel) and oil make up about the half of total export from Russia to the ROK. Another part of export consists of fertilizer, wood, pulp, fish, marine products, coal, and steel. Car, consumer electronics and IT products prevail in South Korea export. Besides, Russia imports some other consumer goods, chemical products, and sea ships. Russia supplies the ROK with 5 million tons of oil (4.2% of total South Korea's import in 2007), 6 million tons of coal (7.4% in 2007), 1.5 million tons of LNG (5% in 2009, preliminary estimate).

In global economic aspect the world economic crisis stimulates the two countries to find out non traditional ways of cooperation under new situation in the world economy.



During President Lee Myung-Bak's visit to Moscow and his negotiations with President D. Medvedev in September 2008 some significant projects were discussed. Thus, both sides agreed to cooperate in energy industry: South Korean company KOGAS together with Russian partners intend to take part in joint development of Kamchatka oil and gas fields, LNG production, transportation, oil refining complex, and construction of gas pipeline. Russia and the ROK also agreed to cooperate in production and export of raw materials in Siberia and in the Russian Far East. At the same time both sides intend to realize joint programs in nanotechnology, aerospace industry, protection of environment, etc. South Korean business will also participate in construction of facilities for APEC Summit in Vladivostok.

In this case it is necessary to mention that President D. Medvedev and President Lee Myung-Bak agreed to upgrade bilateral relations between the Republic of Korea and the Russian Federation to "strategic partnership" level. But this kind of declarations must be confirmed by some political and economic measures.

However, some of the important projects are postponed now mainly because of financial and political reasons. Thus, project of TSR and TKR linkage as well as the project of construction of gas pipeline between the Russian Far East and South Korea can be realized successfully if only Pyongyang agrees to be involved in cooperation with Moscow and Seoul. But this triangle cooperation is closely connected with political and security issues on the Korean Peninsula. It will depend on situation in DPRK and inter-Korean relations, which are characterised since the beginning of 2008 by negative trends.

Construction of oil pipeline from East Siberia to Russian Pacific Coast is one of the most important national strategic projects in Russia. When this project is realized it will be possible to export 30 million tons of oil directly to Daqing and 50 million tons of oil from Perevoznaya to Pacific countries. There are several possible consequences of this project for Russia-South Korean cooperation: export of oil to South Korea; new investment opportunities for South Korean investors; and new demand for capital and consumer goods in Siberia and in the Russian Far East.

It is necessary to note that cooperation between two countries in R&D, education, and medicine is underdeveloped. Russia and South Korea cooperation in science and technology are developing at corporate level mainly (Samsung research center in Moscow, etc), but is still limited. One of the most urgent reasons of upgrading the level of bilateral (as a part of international) cooperation in medicine is a real danger of spread of mass diseases across the borders in NEA. Separate measures by any country are not enough to prevent the danger of "import" of such diseases as bird or pig flu. It is impossible to be sure that any diseases can be stopped at the border. Cooperation in medical care and in medical R&D may be more efficient mechanism than administrative measures. Russia understands this reality and is ready to cooperate with the ROK and other North East Asian countries.

New type of institutional, legal, administrative and information conditions would be created in order to stimulate bilateral economic, scientific, cultural and humanitarian exchanges. Coordinated measures of the two administrations are at the agenda. There is a deficit of information on economic and business of the two countries. It is necessary to determine the goal and stages of development of Russia-South Korea cooperation taking into account priorities of bilateral exchanges as well as main trend of multilateral cooperation in NEA.

Although recent trends in economic cooperation between Russia and the ROK should be characterized as *positive* it should be noted that Russia's involvement in bilateral as well as in regional trade and investment cooperation in NEA is *insignificant* yet. Russia's economic ties with the ROK and NEA countries are very traditional by nature. Although Russian companies are expanding actively in Europe and in the United States, the Russian business sector does not seem to be deeply involved in economic partnership with the South Korean, Chinese and Japanese business. Economic relations between Russia and NEA countries have not been institutionalized yet. Consequently there is a danger that trade and economic exchanges between Russia and the Republic of Korea will be stagnated in the future.

It is necessary to analyze regional economic trends and find out institutional basis for Russia-South Korea economic relations as an adequate element of the regional economic cooperation in NEA. Special studies of Russia-Korea cooperation (including government, business and academic experts analysis) should be initiated. Prospects for Free Trade Agreements and NEA economic cooperation, energy and transport projects, investments exchanges and so on may be among the primary themes.

Cultural exchanges and tourism could play an important role in bilateral relations. After the establishment of diplomatic relations cultural exchanges increased greatly, but some periods later they were not so impressive. New stimulus can be created by measures bilaterally connected with the 20th anniversary of diplomatic relations in 2010 and multilaterally with future APEC Vladivostok summit. But it is necessary to create long-term program of cultural and humanitarian cooperation in order to prevent slow-down of exchanges in the future.

Bilateral and NEA regional cooperation should also strengthen Russia's and the Republic of Korea's positions in solving the global problems of the world economy through existing international political and economical institution (UN, IMF, World Bank, FAO etc.) as well as through new legal-institutional structures aiming to coordinate national efforts in effective facing globalization challenges.

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## РЕЗЮМЕ

Мировой финансово-экономический кризис поставил Россию перед двумя ключевыми вызовами – общего глобального и специфического национального характера. Восстановление и дальнейшее развитие российской экономики в значительной степени зависит от выздоровления

на глобальной уровне, а также в странах – ключевых партнерах (ЕС, Китае, Республике Корея).

Проведенный в ИМЭМО РАН сравнительный анализ предыдущих мировых кризисов свидетельствует о существенном сходстве последнего кризиса с геоэкономической и геополитической ситуацией в 1970-х гг. Сейчас, однако, можно ожидать серьезных изменений на валютно-финансовых рынках, в системе регулирования и контроля. Адаптация к новым условиям потребует от России решения ее основных экономических проблем, прежде всего, укрепления финансовой и банковской системы, снижения зависимости экономики от ее энергетической составляющей и др. В статье рассматриваются причины и эвентуальные последствия стагфляции в России на фоне кризиса, что отличает ее от других стран Г 20. Одним из важных инструментов преодоления опасных тенденций является использование опыта партнеров. Особое внимание уделено развитию сотрудничества между Россией и Республикой Корея.

► KEY WORDS: Russia, Republic of Korea, Financial and economic crisis, stagflation

► КЛЮЧЕВЫЕ СЛОВА: Россия, Республика Корея, финансово-экономический кризис, стагфляция