

Managing the Crisis | Russia Country Report

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1. Risk Exposure at the Outset of the Crisis

- What was the structure of demand (e.g., share of private/state consumption, gross capital formation, exports and imports in GDP/GNI)?
- To what extent was the economy exposed to macroeconomic imbalances (e.g., foreign debt, trade or fiscal imbalances)?
- Was/is the financial system primarily bank- or market-based?

Economic structure and macroeconomy

The pre-crisis period saw rapid growth in the Russian economy: the GDP growth rate was close to eight percent in 2006 – 2007, and the unemployment rate was on the decline, reaching 5.6 percent in mid-2008. These developments were driven primarily by investment demand (volume rose by 19% and 21% in 2006 and 2007 respectively), and consumer demand (real growth amounted to 11% and 14% in 2006 and 2007). Both items outperformed GDP growth. Booming domestic demand was fueled by a favorable external environment in the form of skyrocketing oil prices and capital inflow.

The composition of demand had shifted gradually in recent years, with investment accounting for an increasingly higher share. The share of gross investment in total demand grew from 16.5 percent in 2005 to 20.9 percent in 2008. This growth was compensated for by the declining contribution of external demand, which decreased from 29 percent in 2005 to 25.4 percent in 2008. High prices for exported commodities did not result in a more substantial share for external demand, as investment grew even faster, supported by capital inflows. Shares of both private and government consumption remained relatively stable, at around 40 percent and 14 percent of GDP respectively.

The country's trade surplus totaled about 10 percent to 11 percent of GDP, and the current account surplus stood at around six percent of GDP in 2007 – 2008.

Before the crisis, Russia's budget had been deficit-free since 2000. The federal budget showed a considerable surplus, consolidated regional budgets were balanced (since 2004), and even the extra-budgetary (social) funds had a small surplus due to the accumulation of pensions savings, though the pension fund had a deficit of about 0.2 percent – 0.4 percent of GDP, covered by transfers from the federal budget.¹

¹ Budget execution reports by the Ministry of Finance, 2000 – 2008, see <http://www.roskazna.ru/reports/cb.html>; <http://www.roskazna.ru/reports/fb.html>

The sustained fiscal surplus resulted in a decline in the value of outstanding public debt to just six percent of GDP. External debt (public and private) grew rapidly in the pre-crisis period (on average by more than 30% per year in 2005 – 2007, in U.S. dollar terms) due to substantial private borrowing. Still, it was moderate by international standards, amounting to 35 percent of GDP at the beginning of 2008.

The major imbalance in the Russian economy on the eve of the crisis was excessive demand growth. As a matter of fact, the economy was overheated, resulting in a high level of imports and inflation. The growth was imbalanced, as export volumes lagged far behind import volume growth. This problem did not show itself in a deteriorating current account due to a marked improvement in terms of trade. However, the overheated nature of the economy clearly manifested itself in inflation (which increased beginning in 2007 and reached an annualized rate of 13.3% in December 2008) as well as a boom in the stock and real estate markets. At the outset of the crisis, the nation's financial system was rather bank-based, though the role of external market borrowing by large companies was gradually increasing.

- What was the government's economic record (e.g., growth, unemployment rate, inflation and fiscal position) prior to the crisis?
- What was on the economic agenda prior to September 2008 (e.g., anti-inflation, efficiency-oriented, redistributive, supply vs. demand-side policies)?

Policy priorities
prior to crisis

Russia's federal budget surplus amounted to 7.4 percent of GDP in 2006, 5.4 percent of GDP in 2007 and 4.1 percent of GDP in 2008, though the revenues in the second half of 2008 were relatively lower and expenditure higher due to the end-of-year budget expenditure peak and the first stimulus measures. The positive budgetary balance in 2008 was attributable to the very high oil price and associated oil revenues in the first half of the year. The general government budget surplus amounted to 6.1 percent of GDP in 2007 and 4.8 percent of GDP in 2008.²

The top priority in the nation's economic policy was apparently given to enhancing economic growth, while restraining inflation and ensuring long-term macroeconomic stability were regarded as secondary objectives. Diversification of the economy was also included as a major objective in government programs, but efforts in this direction were not very successful. Policymakers gave considerable importance to the goal of retaining competitiveness through restraining real appreciation of the ruble, thus avoiding the so-called Dutch Disease. To this end, policymakers saved considerable quan-

² Budget execution reports by the Ministry of Finance, 2006 – 2008, (<http://www.roskazna.ru/reports/cb.html>; <http://www.roskazna.ru/reports/fb.html>, in Russian only)

tities of oil windfall gains in a Stabilization Fund (later transformed into the Reserve and National Wealth Funds), while the central bank also engaged in substantial foreign exchange market interventions. However, the central bank had limited capacity to sterilize interventions not compensated for by accumulation of fiscal revenues in the oil funds; hence, interventions had only limited effect, as growing commodity prices resulted in real appreciation via high inflation.

The main priority of fiscal policy prior to the crisis was budget sustainability, and an effort to lessen budget dependence on commodity markets, especially on oil and gas prices.³ The Stabilization Fund was established in 2004 to store excessive oil revenues associated with oil prices higher than the long-term average. By the end of 2007, 3851.8 billion rubles (\$157.4 bn) had been accumulated in the Stabilization Fund.⁴ In 2008, this fund was transformed into two successors, the Reserve Fund and the National Wealth Fund. The Reserve Fund was created to maintain medium-term budget stability in case of sudden decline in oil and gas prices, while the National Wealth Fund was designed to maintain the long-term stability of the pension system.⁵

- How stable was the executive branch in the years/months prior to September 2008 (e.g., credibility/legitimacy of leaders/parties in government, cabinet stability/reshuffles, parliamentary/electoral support)?
- How much room did fiscal conditions provide for a major stimulus (e.g., budget surpluses/deficits, conditions for issuing additional treasury bonds)?
- How much room was there for monetary policy initiatives (e.g., pre-crisis level of interest rates, required reserve ratios, flexibility of foreign exchange rate regime)?

Executive, fiscal & monetary capacities to respond to downturn

Before the outbreak of the crisis, the government received quite strong public support. In the December 2007 parliamentary elections, the United Russia Party, which is headed by Vladimir Putin and calls itself the “Party of Power,” won 64.3 percent of the vote. By comparison, the Communist Party of the Russian Federation (CPRF) gained 11.6 percent, the Liberal Democratic Party of Russia (LDPR) 8.1 percent and the Russia of Justice party 7.7 percent.⁶ In the presidential election, “Party of Power” candidate Dmitry Medvedev, who had been designated the official successor to Vladimir Putin, won 70.3 percent of the vote (his nearest rival, CPRF leader Gennady

³ Russian Ministry of Finance, *Guidelines for fiscal policy 2008–2010*, <http://www1.minfin.ru/ru/budget/policy/> (in Russian only); A.Kudrin “The Mechanisms of Forming of Russia’s Non-Oil-and-Gas Budget Balance,” *Voprosy Ekonomiki* 8 (2006): 16.

⁴ Ministry of Finance reports, <http://www1.minfin.ru/en/stabfund/>

⁵ See *Guidelines for Fiscal Policy 2008–2010*

⁶ Central Election Commission of Russian Federation, “On the Results of State Duma Election,” Resolution no.72/591-5, December 8, 2007, <http://www.gzt.ru/politics/2007/12/08/154015.html> and <http://www.cikrf.ru/newsite/postancik/2007/72/Zp070591.jsp> (in Russian only, accessed November 20, 2010).

Zuyganov, attracted just 17.7 percent of the vote).⁷ At that time, polls conducted by independent think tanks made it possible to assert that these results reflected genuine electoral sentiment. Shortly before and immediately after the election, there were some reshuffles in the cabinet (Michail Fradkov was initially replaced by Victor Zubkov as prime minister, while Putin took this post after the presidential election; some other ministers were also changed). This shake-up raised the cabinet's approval rating. According to polls conducted by the Russian Public Opinion Research Center (VCIOM) in June 2008, Prime Minister Putin and President Medvedev respectively ranked first and second in terms of popularity (receiving a respective 61 percent and 40 percent of the respondent votes).⁸

Prior to the crisis, Russia had a strong fiscal position. Since the beginning of 2007, fiscal reserves had exceeded the size of the public debt, and by the end of 2008 reserves accumulated in the Reserve Fund and National Wealth Fund amounted to more than 10 percent of GDP.⁹ Thus, Russia could afford a stimulus package totaling about 5.8 percent of GDP in 2009,¹⁰ including tax and export duty cuts and additional spending aimed at supporting industry and distressed social groups. This package would be partially extended into 2010.¹¹

Overall, accumulated reserves allowed Russia to project financing of federal budget deficits expected to be 8.3 percent of GDP in 2009 and 6.8 percent of GDP in 2010 with only marginal use of external borrowing.¹²

However, there was limited room for monetary policy stimulus. The tightly managed exchange rate combined with an open capital account left the central bank only a minor capability to affect interest rates.

⁷ Central Election Commission of Russian Federation, "On the Results of Election of President of Russian Federation," Resolution No.104/777-5, March 7, 2008, <http://www.cikrf.ru/newsite/postancik/2008/104/Zp080777.jsp> (in Russian only, accessed November 20, 2010).

⁸ Russian Public Opinion Research Center, "Confidence in Political Leaders," June 2008, <http://wciom.ru/novosti/reitingi/reiting-doverija-politikam.html> (in Russian only, accessed November 20, 2010).

⁹ Ministry of Finance, Reports, <http://www1.minfin.ru/en/stabfund>; *Rosstat data*, http://www.gks.ru/wps/portal/OSI_NS# (in Russian only, accessed November 20, 2010).

¹⁰ Government of Russian Federation, "Government Anti-Crisis Program," March 2009, <http://premier.gov.ru/eng/anticrisis/> (accessed November 20, 2010).

¹¹ Guidelines for Fiscal Policy, 2010–2012

¹² Ibid; Ministry of Finance, Federal Budget Law 2009 (with amendments) http://www1.minfin.ru/ru/budget/federal_budget/ (in Russian only, accessed November 20, 2010.)

- To what extent has the country been exposed to global financial market risks, particularly contagious/toxic financial instruments (e.g., open capital account, floating or pegged/fixed currency)?
- How important was/is the financial sector for the national economy? What was/is the extent of interdependence between the financial sector and real economy?
- To what extent was the economy integrated into regional/global trade flows? How dependent was the economy on foreign demand for manufactures and commodities?
- Did property, equity or other markets display excessive growth and a bubble-like situation prior to September 2008?
- In what condition was the banking sector (e.g., size/structure of banking sector, non-performing loans, capital adequacy ratios of major banks, if available)?

Exposure to specific market and trade risks

Holdings of toxic financial instruments by Russian banks were negligible. Combined with the country's fiscal and current account surpluses, small public debt and large reserves, this fact made authorities optimistic as to the vulnerability of Russia's economy to global crisis. But in fact risks were quite high. First, exports were dominated by commodities, with a correspondingly highly volatile value. Second, the national economy was dependent on the inflow of short-term capital.

The role of the financial sector formally appeared relatively unimportant. The sources of investment were dominated by investors' own funds. However, incremental consumer and investment demand was fuelled mainly by bank loans. In addition, loans were highly important as a source of working capital for companies.

Exports totaled 31 percent of GDP. In addition, oil prices exerted significant influence over domestic demand.

An excessive supply of loans, capital inflows and fiscal expenditure resulted in apparent bubbles in the equity and property markets.

The size of the banking sector was relatively small by international standards, though rapidly growing. By the end of 2007, bank capital amounted to just 8.1 percent of GDP, while total assets stood at 60.8 percent of GDP. Growth in bank size slowed in 2008, but remained high: Aggregate bank capital grew by 43 percent that year (as compared with 58 percent growth in 2007), while assets increased by 39 percent (as compared with 44% in 2007).

- Did policymakers/executive agencies have any experience in handling financial crises? Did this experience play a role in the 2008-09 policy response?
- Were there independent regulatory institutions or prevention/response schemes in place to contain financial risks?
- Were there internal veto players (e.g., federalist powers, courts) or international obligations that thwarted swift action on the part of the government?
- Have executive powers been extended in times of crisis? Has this been based on formal or informal mechanisms?

Structural or policy advantages and disadvantages

Before the crisis of 2008 – 2009, many government and central bank leading figures had taken part in the crisis of 1998, when the government defaulted on bond payments and the ruble was sharply devalued. Minister of Finance Alexei Kudrin, Chairman of the Central Bank of the Russian Federation Sergei Ignatiev and many others belong to this cohort. Their experience was vital in responding to the shock of the crisis in autumn 2008, when the central bank took prompt actions to stabilize the country's banking system. At the level of Russia's political leadership, recognition of the need to sustain macroeconomic stability also can be considered a lesson from the crises of the 1990s. This was a matter of great importance in making decisions on anti-crisis management.

A number of institutions in the national governance system held responsibility for controlling risks, and subsequently enjoyed great autonomy in making decisions. Along with the central bank proper, this function was carried out, for instance, by the Deposit Insurance Agency. This agency had inherited most of the staff of the State Corporation Agency for Restructuring Credit Organizations, which effectively rehabilitated banks after the crisis of 1998. The succession of middle managers and experts was a positive factor in the formulation of anti-crisis measures in the banking sector. For instance, concerted actions by the central bank and the Deposit Insurance Agency made it possible to overcome a panic by commercial bank depositors after the collapse of key Russian securities market indicators in October 2008. At the same time, the crisis revealed insufficient central bank control over external borrowings made by banks and the nonfinancial sector, along with a lack of proper assessment of the risks related to such borrowings (in 2006 – 2008, the external indebtedness of the Russian corporate sector was growing at a record pace, reaching about \$500 billion by autumn 2008, \$200 billion of which reached maturity before the end of 2009).¹³

¹³ S. Aleksashenko, "Crisis-2008: Time to Set a Diagnosis," *Voprosy Ekonomiki* (in Russian), 11 (2008): 25–37.

The system of national governance that took shape in Russia at the outbreak of the current crisis had no real veto players, and gave the president and the government considerable freedom of action. In addition, Russia had no significant external (international) obligations serving to restrict the government in its anti-crisis measures. In particular, Russia had not joined the WTO before the crisis, despite repeated declarations that talks were soon to be completed.

Moreover, government functions and powers were actually expanded under the crisis. For instance, the governmental Commission on Sustained Economic Development took numerous quick response decisions to support the real sector. The State Duma greatly accelerated the pace of its deliberations over bills submitted by the government. At the same time, the expansion of executive powers was largely based on informal mechanisms, such as the personal contacts of Prime Minister Putin with top managers of major corporations and the heads of some regional administrations.

- How strongly has the national economy been hit during the period under review? Where has it been hit most severely thus far (e.g., growth rate, production, trade, employment)?

Initial impact of economic downturn

Initially, Russia experienced two simultaneous shocks: a terms of trade shock and a “sudden stop.” The collapse of prices in international commodity markets resulted in a sharp drop in aggregate prices for Russia’s exports. In the first quarter of 2009 they were two times lower than in the third quarter of 2008. Lower import prices served as only slight compensation, so the terms of trade index fell by 46 percent in just two quarters. Export prices grew 15 percent in the second quarter of 2009, but import prices also recovered; thus, the terms of trade remained almost unchanged. The total value of exports was also affected by a decrease in volume (though this component contributed far less to overall decline than did the fall in prices). The value of exports (goods and services) fell by 56 percent in the first quarter of 2009 as compared to the third quarter of 2008.

Foreign capital inflow in the private sector amounted to an average of \$50 billion per quarter in the first half of 2008.¹⁴ In the fourth quarter of 2008, Russia instead faced an outflow of \$29 billion. In addition, outflow of Russian capital from the private sector increased. A substantial proportion of this net change in capital flows was attributed to loans (63% of the total), followed by portfolio investment (18%) and FDI (15%).

¹⁴ Net of cash foreign currency.

As a result of these circumstances, Russia found itself financially constrained, and consumer and investment demand both contracted sharply. Banks froze loans not only due to a lack of foreign funding, but also due to large uncertainty as to the new composition of demand and production. Lower export prices also affected domestic demand negatively by means of the wealth effect. It was clear that some sectors (such as construction, in which demand was strongly overheated and was fuelled by mortgage lending) would experience huge contractions, and that the negative impact of lower external and domestic demand would spread through all sectors.

A sharp production decline occurred in November 2008 – January 2009. GDP contracted by 9.5 percent year-on-year in the first quarter of 2009. The volumes of exports and gross investment also experienced large declines (-14.5% and -16.3% respectively). A sharp fall in imports (a year-on-year fall of 34% by volume) almost compensated for these declines. The largest decline was seen in inventories, so overall gross capital formation dropped by 44 percent. In other words production fell more than final demand (with substantial overshooting as a result).

The severe slump in output and commodity prices induced a dramatic fall in tax revenues for all levels of government, while the oil price trough deprived the federal budget of a fundamental income source—export duties and natural resources extraction taxes. As a result, total federal budget revenues in 2009 decreased by roughly 33 percent as compared to the initial federal budget law for 2009. Oil and gas revenues for the same period decreased by about 36 percent, while non-oil and gas revenues fell by 30 percent.¹⁵

¹⁵ Ministry of Finance, Initial Federal Budget Law 2009–2011, Budget execution report, 2009 <http://www.roskazna.ru/reports/fb.html> (in Russian only, accessed November 20, 2010).

2. Agenda-Setting and Policy Formulation

- When did state organs (e.g., government, central bank) begin setting a crisis response agenda? How long did it take to adopt the first crisis measures?
- Who were the driving forces (e.g., government, central bank, foreign actors, media, trade unions, employers' associations) in getting stabilization/stimulus policies started?
- Were these measures launched as executive orders or parliamentary laws? How closely did constitutional bodies (e.g., executive, legislative, central bank) cooperate?
- What kind of role did sectoral or regional lobbies play in policy formulation?

Agility and
credibility

The first moves to overcome the crisis were made by the government and the central bank as early as September – October of 2008. These included support of the Russian securities market, injections of public funds into commercial banks' capital supplies, and the lending of public funds to a number of banks and financial institutions. However, until the middle of November 2008, government leaders regarded the crisis as a solely financial event, although they were informed about a drastic decline in demand and reduced output in a number of industrial sectors. They believed that the problems of Russia's financial system had been triggered by shocks in global financial markets and had no internal sources, and would thus be controlled quite soon. Due to the lack of feedback from ordinary businesses, top officials considered the crisis to be primarily a problem facing the country's biggest companies, to the extent they were integrated into the global market. The government officially recognized the real economy-wide scale of the crisis only in December 2008.

The government and the central bank were the key actors in design and implementation of anti-recession policies. However, top managers at major companies had great influence on the choice of priorities and on the shaping of anti-recession policies. They had personal access to important government figures, and suffered heavy losses at the outbreak of the crisis (particularly from margin calls on their outstanding loans). The influence of foreign companies, trade unions and the mass media on anti-recession decisions was minimal. Among business associations, two nationwide business lobbies were the most active and were relatively successful in defending the interests of their members: the Russian Union of Industrialists and Entrepreneurs (RSPP), representing mostly big businesses, and the All-Russian Non-governmental Organization of Small and Medium Business ("OPORA RUS-SIA"), acting on behalf of small and medium-sized enterprises (SMEs).

Anti-recession policies were carried out mostly by decisions of the government. However, to carry them out, the State Duma passed many fast-track amendments into active laws. In general, the interaction between executive and legislative authorities appeared to be very close, though the government played the dominant role.

To specify the contribution of industrial lobbyists to the formulation of anti-recession policies, we can point to the activities of the oil and gas and the defense establishments, the construction sector, the automobile industry, and agriculture and transportation concerns (for a detailed account of industry-wide priorities with respect to anti-recession policies, see “targeting and coverage of policy tools”). Nevertheless, we must note that in the cases of the automobile and housing construction industries, a slump in demand caused a real danger of severe social problems, and the government acted mainly in response to these problems rather than in reaction to pressure by industrial lobbyists.

In the relations between the central and regional levels of government, the crisis brought about redistribution of funds to regional budgets. This redistribution was in a lesser degree related to pressure exerted by the individual regions. Regional authorities’ positions were undermined by a reform of intergovernmental relations carried out in 2002–2003, and by the introduction of a system of appointed governors introduced in 2005. Meanwhile, politically motivated projects retained their budgetary priority in spite of the crisis. For example, the Winter Olympics in Sochi in 2014 and the 2012 Asia Pacific Economic Summit in Vladivostok remain top government concerns. The usual budgetary practice entails a redistribution of resources from regions with budget surplus to the regions in deficit, implemented by federal authorities. In 2009, almost all regions had a budget deficit; this is why transfers from the federal to the regional budgets rose substantially (see Table 1).

- Did policymakers actively consult domestic and/or foreign experts outside of government?
- Did the government actively seek collaboration with other governments or international organizations?
- Did the government participate in multilaterally coordinated rescue efforts?
- Was the government curtailed in its response through IMF support programs?

Consultation with external experts and openness to international collaboration

In autumn 2008, decisions on crisis counter-measures were made so rapidly that they took place largely without consultation with domestic or foreign experts. Later, however, an Expert Council was formed under the governmental Commission on Sustained Economic Development, tasked with making a preliminary examination of decisions earmarked for consideration by the Commission.

In March 2009, the Anti-Crisis Program of the Government of the Russian Federation was submitted for public discussion, and leaders of the government traveled to the regions for presentation and discussion of the program. At that time, the first projects aimed at the assessment of anti-crisis measures were carried out.¹⁶ However, actual involvement of experts in the design of anti-crisis measures remained quite low. One of the objective reasons is that government activities are highly centralized (becoming still more so under the crisis), so that capacities, responsibilities and information flows are concentrated at high levels of executive power. As a result, key ministers and government leaders simply have no spare time for consulting with experts or engaging in more careful elaboration of the decisions they make.

At the initial stage of the crisis (though the end of 2008), there was only limited cooperation and coordination between the Russian government, other governments and international organizations. Later, Russia became an active participant in consultations within the framework of the G20 (including summit meetings in Washington in November 2008, London in April 2009 and Pittsburg in September 2009). Russia also introduced initiatives to reform the IMF and to enlarge the Financial Stability Board. According to the “Russian Proposals to the London Summit” document published by the presidential office on March 16, 2009,¹⁷ Russia suggested drafting and adopting an international agreement that would set global standards of control and supervision in the financial sector—a so-called Standard Universal Regulatory Framework (SURF). In addition, Russia called for reforming the international currency and financial system, with the aim of strengthening its own stability and control. In that respect, President Medvedev proposed a reconsideration of the IMF’s role, and an evaluation of the practicality and necessity of measures that would allow Special Drawing Rights (SDRs) to become a super-reserve currency recognized by the world community.

However, these international consultations had no direct influence on domestic decisions. During the crisis, Russia remained one of the world’s biggest holders of foreign currency reserves, accumulated during the boom of the 2000s, and did not apply to the IMF for help.

¹⁶ See in particular the report conducted jointly by the University Higher School of Economics and the Interdepartmental Analytical Center, “Compensation of Losses,” *Expert* no.15 (654): April 20, 2009, http://www.expert.ru/printissues/expert/2009/15/kompensaciya_poteri/; Yuri V. Simachev, Andrei A. Yakovlev, Boris V. Kuznetsov, Michael Y. Gorst, Aleksandr V. Daniltsev, Michael N. Kuzyk, Sergey N. Smirnov, “Assessment of Policy Measures to Support Russia’s Real Economy,” *Voprosy Ekonomiki*, 5 (2009): 21-46 (in Russian only); Forschungsstelle Osteuropa Working Paper no.102, June 2009 <http://www.forschungsstelle.uni-bremen.de/images/stories/pdf/ap/fsoAP102.pdf>; Yuri Simachev, Boris Kuznetsov und Andrei Yakovlev, “Das Konjunkturpaket der russischen Regierung,” *Russland Analysen*, no.182, May 8, 2009:12-14.

¹⁷ Office of the President of Russia, “Russian Proposals to the London Summit,” April 2009 <http://eng.kremlin.ru/text/docs/2009/03/213995.shtml> (accessed November 20, 2010).

3. Policy Content

- How large is the stimulus package as expressed as a percentage of GDP (including compensations to those hit particularly hard by the crisis through social/labor policies)?
- The stimulus is spread over a period of how many years?

Scope of stabilization and stimulus policies

The structure of the fiscal stimulus package (according to the version contained in the government stimulus program of June 2009,¹⁸ World Bank and Economic Expert Group (EEG) estimations) is presented in the table below.

Table 1: Stimulus package for 2008 – 2009

	2008	2009	2008	2009	2008	2009
	ruble (bn)	ruble (bn)	\$ (bn)	\$ (bn)	% of GDP	\$ of GDP
Revenue side (decrease in revenues for the consolidated budget)	220	377	7.9	11.5	0.5	1.0
Decrease of corporate income tax (federal budget)		282		8.6		0.7
Increase in annual amortization rate		56		1.7		0.1
federal budget		6		0.2		0.02
regional budgets		50		1.5		0.13
Cut in the crude-export duty	220	30	7.9	0.9	0.5	0.1
Other changes		8.8		0.3		0.02
Expenditure side	521	1906	18.8	58.3	1.3	4.9
Financial sector support	439	495	15.8	15.1	1.1	1.3
Recapitalization of different banks and institutions	439		15.8		1.1	
Subordinated debt		495		15.1		1.3
Social policy and labor market	82	696	3.0	21.3	0.2	1.8
Industry support		379		11.6		1.0
Export support		6		0.2		0.02
Agriculture and fishery		63		1.9		0.2

¹⁸ See "Government Anti-Crisis Program"

	2008	2009	2008	2009	2008	2009
Automobile industry (incl. agricultural machinery)		90		2.8		0.2
Financial support of defense industry		70		2.1		0.2
Transport		150		4.6		0.4
Other industries		0.3		0.01		0.001
Small business support		36		1.1		0.1
Support of regions		300		9.2		0.8
Total	741	2283	26.8	69.8	1.8	5.9
GDP	41668	38997				

We can see in Table 1 that the stimulus package is mostly implemented in the current year (2009), during which additional spending amounts to about 4.9 percent of GDP and total revenue decreases were estimated at about 1.0 percent of GDP. By the end of 2008, anti-crisis spending amounted to 1.3 percent of GDP and revenues decreased by 0.5 percent of GDP due to early stimulus implementation.

At the time of writing, the government stimulus program had been approved for 2009. Some of the stimulus measures will most likely be extended into 2010. This includes social and labor market support policies, support for regional budgets, and financial system support. While the outline of the stimulus package for 2010 had been defined, not all the measures had yet been specified.

- How is stimulus spending distributed across sectors? How and to what extent is the financial sector supported (e.g., through loans, guarantees, capital injections)?
- Which industrial and structural policies (e.g. corporate tax cuts, subsidies, company bail-outs) can be observed?
- What kinds of measures target the expansion of public spending on infrastructure? Which ones are designed to sustain business and consumer spending?
- Are policies in support of businesses adequately targeted and delineated (e.g., at creating employment, supporting competitive firms)?

Targeting and coverage of policy tools

At the end of 2008, stimulus spending was mostly aimed at supporting the financial sector, to avoid banking sector collapse. Support was implemented both by the government and the central bank. Anti-crisis measures could be divided into three primary goals:

- addressing the acute liquidity shortage;
- enhancing bank capital and addressing the solvency problems of some banks; and
- enhancing confidence in the banking system.

Measures aimed at increasing banking liquidity included:

- a cut in central bank reserve requirement ratios in September 2008 (equivalent to providing RUB 300 billion to banks);
- an increase in the amount of central bank credits provided to banks via repo auctions (providing additional liquidity of around RUB 430 billion).
- temporary placement of government budget funds in commercial banks' accounts, for a short-term increase in bank liquidity of RUB 1.5 trillion;
- an expansion in the list of securities accepted by the central bank as collateral, and the provision of uncollateralized loans by the central bank;
- a cut in the rates of contributions to the deposit insurance system;
- government provision of subordinated credits to banks (a total of RUB 950 billion in 2008 and RUB 1055 billion in 2009);
- government provision of RUB 60 billion to the State Mortgage Agency, aimed at preventing problems in the mortgage market;
- delegation of power to the Deposit Insurance Agency authorities to implement preemptive rehabilitation of banks at risk, and a government provision to this agency of RUB 200 billion for these purposes;
- an increase in the deposit insurance ceiling from RUB 400,000 to RUB 700,000.

Fiscal support of the financial sector by means of recapitalization of major banks and other institutions was combined with the central bank's support measures. Total budgetary support of the financial sector by the end of 2008 can be estimated at about 1.1 percent of GDP (here and below, see Table 1). Only 0.2 percent of GDP was spent on labor market support and social policy in that year.

The structure of stimulus spending changed in 2009, evolving into five primary components:

- financial sector support via subordinated loans (1.3% of GDP).
- social policy and labor market support (1.8% of GDP), including additional pensions and the indexing of other social benefits.
- industry support (1.0% of GDP), including support for exports (0.02% of GDP), agriculture and fishery support (0.2% of GDP), automobile industry support (0.2% of GDP), defense industry support

(0.2% of GDP), transportation industry support (0.4% of GDP), and more.

- small business support (0.1% of GDP).
- support of regions (0.8% of GDP), including financing regional spending on social and infrastructure programs.

It is worth noting that the structure of federal budget spending changed substantially during reconciliation of the budget law. The government had to cut some planned spending to provide room for new stimulus spending.

State administration spending was cut by 15 percent to 20 percent, though wages were not decreased. National defense and law and order spending was cut. There were also small cuts in spending on education, medicine and housing. At the same time, spending on the national economy increased by 70 percent due to anti-crisis measures, while social (particularly pension) spending grew by about 20 percent.

The change in the structure of federal budget expenditure was aimed at shifting spending to areas deemed most deserving of crisis (stimulus) spending, while at the same time avoiding excess budget deficit. This is why some previously approved programs and other spending were cut in 2009 and replaced by stimulus spending.

Russian anti-crisis measures have been multiple and diverse. Anti-recessionary measures designed for support of the real economy can be provisionally divided into the following main categories: (1) Expansion of access to financial resources for business companies; (2) Provision of incentives to expand domestic demand; (3) Reduction in tax and administrative burdens on businesses; (4) Support of small and medium-sized enterprises; and (5) Development of the labor market. However, there have been comparatively much fewer infrastructure projects in the Russian crisis-reaction package than in the stimulus packages of other large economies.

During the initial stage (October – December 2008), a set of extensive measures was carried out promptly:

- Urgent help was given to the largest Russian companies (the Bank for Development and Foreign Affairs (Vneshekonombank) granted credits to Russian borrowers for refinancing their foreign loans, in return for a pledge of assets in the Russian territory. Between October 27 and December 1, 2008, nine large entities were supported by the Vneshekonombank, for a total amount of \$9.78 trillion).
- Tax burdens on companies were reduced (the tax rate on profits was lowered from 24% to 20%, incurring an estimated revenue loss of 282 billion rubles in 2009; depreciation premiums for certain types of

fixed assets were increased from 10% to 30%; and the maximum level of interest rates was increased on liabilities recognized as costs). In addition, procedural changes were made in the calculation of certain taxes in order to alleviate a shortage of funds (for example, companies were given the right to deduct VAT from advances, were relieved from the obligation to transfer VAT in cash when a settlement was non-monetary, and were given an option to pay their corporate tax on the base of actual profits before the end of a year).

- Measures were taken to protect domestic markets (customs duties on imports were increased, and preferential prices were introduced for Russian suppliers of goods to state and municipal entities).

During the second stage (January – April 2009), a special focus was placed on structural and industrial policies.

As the major components of crisis management, we must distinguish between support for systemically important (large and super-large) companies on the one hand,¹⁹ and measures for the development of small and middle-sized enterprises (SMEs) on the other. Public aid has been selectively given to systemically important enterprises, on the basis of individual decisions, and has included assistance allowing borrowing on favorable terms, the provision of government guarantees of loan repayment (up to 200 billion rubles), and capitalization of individual enterprises through the injection of government funds.

Public support of SMEs as a whole is a systemic program that includes a comprehensive set of measures such as the reduction of tax burdens on small businesses (constituent entities of the Russian Federation were given a right to modify tax rates under a simplified taxation scheme within a range of 5% to 15% in 2009); the expansion of a federal funding program for small and middle-sized businesses up to 10.5 billion rubles (including grants of support to new entrepreneurs, subsidization of interest rates on loans to SMEs, support for microfinancing, and the extension of a system of guarantee funds); the expansion of lending programs for SMEs from the Vneshekonombank up to 30 billion rubles; the extension of the right to use the mandatory quota for municipal procurements (under 20%) to purchases from small and middle-sized enterprises; the reduction in payments for technical connection to

¹⁹ At present, the list of systemically important enterprises includes 304 entities. These must satisfy three key criteria: They must have shown an annual turnover in 2007 of more than 10 billion rubles (about \$400 million), total tax payments during 2006 – 2008 must have been more than 5 billion rubles, and they must have more than 4000 employees. Additionally, the government took into account some qualitative criteria including technological potential, influence on regional social stability, participation in important investment projects, important roles in value chains, and international obligations.

power networks; and the offer of the right of priority to SMEs in buying public and municipal real estate.

In the course of anti-recessionary industrial policy measures, the following industries were given a top priority:

- Automobiles and industrial machinery (among the most important measures were: support given to the AVTOVAZ Corporation in the form of an interest-free loan of 25 billion rubles, drawn from the federal contribution to the State Russian Technologies Corporation; an increase in the capital available to the State Agro-Industrial Leasing Corporation by 25 billion rubles, with the new funds earmarked for purchase of domestically produced agricultural machines; federal financing for a regional and municipal transport pool renewal program, up to 20 billion rubles; the allocation of 12.5 billion rubles for the purchase of automobiles by federal government agencies; and an increase in import customs duties on new and used automobiles and combine harvesters).
- The defense-industrial sector (in particular though federal funding of individual enterprises, for a total of 52 billion rubles; subsidization of interest rates, for a total of 15 billion rubles; and credit guarantees worth 100 billion rubles).
- Agriculture (including 45 billion rubles in new capital for the Russian Agricultural Bank earmarked for expansion of lending, and subsidization of interest rates for a total of 17 billion rubles).
- The transportation sector (including 50 billion rubles in new capital for the Russian Railway Corporation worth, 21 billion rubles in subsidies to banks for reimbursement of the costs of lending to airlines, and 5 billion rubles in subsidies for air carriers).
- Housing construction (including 80 billion rubles in new capital for the Agency for Housing Mortgage in 2008 – 2009; a federal loan of 40 billion rubles to the mortgage agency and another loan of 83 billion rubles to the State Housing and Utilities Reform Fund Corporation for buying low-cost apartments; 21 billion rubles used to provide dwellings for World War II veterans; a 26 billion ruble program enabling families possessing government maternity capital certificates to use this money for improvement of their housing conditions ahead of schedule; and a change in the allowance for personal income tax deductions associated with the purchase of housing units, from 1 billion to 2 billion rubles).

Standard policy instruments for the support of high-priority industrial sectors include: partial subsidization of interest rates on repayment of loans, recapitalization of corporations in return for government equity stakes, and

recommendations to commercial banks drawing public support to issue loans to priority industries. A limitation of average annual increases in regulated tariffs for railroad transportation, gas and heating supply in 2009 can be also attributed to industrial policy measures.

The stimulus package includes a boost in transportation spending of about 0.4 percent of GDP. Though some federal infrastructure investment programs were postponed till 2010–2011, the most important programs retained financing in 2009 according to the approved plan. The initial budget law projected federal infrastructure expenditure of 470 billion rubles. The amended budget law projects an increase in infrastructure spending to 480 billion rubles (about 1.2% of GDP).²⁰ Such a minor increase in infrastructure investments can be explained by several factors. First of all, as was mentioned above, some projects were postponed and replaced by new projects of high priority. So in fact new spending on investments is higher than 0.4 percent of GDP. Nevertheless, infrastructure projects remain quite inefficient in Russia (due to the high level of corruption); this explains in part why the government has chosen other methods to support the economy such as social benefits and support for the financial sector and enterprises.

Some anti-crisis measures were characterized by poorly defined goals, and vagueness both of principles and of procedures used to identify eligible support recipients. This was particularly true of support targeting systemically important enterprises. Such measures fall most strictly into the category of those requiring “manual oversight,” but were accompanied by the announcement of wide-ranging goals that were in practice hardly consistent with each other (to preserve jobs, to ensure stability, and to maintain technological potential). Initially, support of systemically important enterprises had no clear link to better performance; rather, the prime considerations were to ensure social stability and orderly payments to suppliers. However, in April–May 2009, attention was shifted to utilizing state support for the creation of incentives. Thus, eligibility for support was limited to those systemically important enterprises that had programs for financial rehabilitation, showed relatively better performance, used advanced technologies, showed higher energy efficiency, and which also had sharply cut premium pay and bonuses for top managers, made their financial and production activities more transparent, completely fulfilled liabilities of employers to laid-off workers and streamlined their relations with suppliers and contractors.

Also poorly defined were measures aimed at providing banks receiving government support with incentives to increase lending to certain high-priority economic sectors. These put banks at risk of administrative pressure to lend

²⁰ See “Government Anti-Crisis Program” and Initial Federal Budget Law 2009-2011.

to individual enterprises, with unclear distribution of risks between the banks and the state and little transparency associated with the state recommendations.

- Are stimulus measures influenced/limited by pre-crisis development strategies (e.g., industrial policies) or have novel/additional (e.g., environmental) policy objectives been inserted?
- Is the response to the crisis grounded in a broader developmental perspective (i.e., crisis as development opportunity) or predominantly short-term political constituency logic?
- Do stimulus policies address prevailing structural deficits and future growth potential?

Development as an objective of stimulus policies

A number of measures were related to pre-crisis strategies, and their inclusion in crisis management programs helped accelerate their implementation. The following measures can be included in this category: some changes in taxation (an increase in premiums; granting tax holidays for commercial development of new mineral deposits; improvements in tax charges and tax administration); lowering of unreasonable administrative barriers to businesses (limitation on inspections of business enterprises; protection of legal entities' and individual entrepreneurs' rights in the course of state and municipal supervision); improvement in the legal foundations of corporate governance and development of the market for corporate bonds; and a set of measures designed to help small and medium-sized businesses grow.

However, the bulk of the anti-recession package is focused on new objectives: support aiming at the creation of domestic demand and the protection of domestic markets is given to those industrial sectors most dangerously exposed to the crisis; support is granted to large-scale systemically important companies and to enterprises that form the core of company towns; and much help is designed to preserve or create new jobs. Essential innovations in the anti-recession package include the encouragement of consumer demand (such as interest rates subsidies for consumer loans used for new automobile purchases); state guarantees for loans to systemically important companies; preferential treatment for domestic producers in government and municipal procurement processes; and the disbursement of grants to entrepreneurs starting their own businesses.

At the first and second stages, these policy steps were mostly of compensatory nature, and lacked incentives for companies to become more competitive or introduce advanced technologies. The few exceptions were a decline in profit tax rates, an increase in depreciation premiums, and an exemption from VAT for imports of technological equipment that had no domestically produced counterpart.

In designating recipients of support, the focus was to ensure social stability and preserve jobs, thus enabling firms that were far from competitive and companies planning deep restructuring to benefit. This policy was largely aimed at letting large companies, which were most battered by the crisis, stabilize in anticipation of a fast recovery in the global economy. However, the creation of incentives took a larger role in the anti-recession policy of May –September 2009 (including encouragement for innovation, energy conservation, establishment of technological modernization priorities, and infrastructure development).

During the period of our observation, Russian crisis management as a whole was primarily oriented toward present-day problems of financial and social stability, and was poorly related to such strategic goals as diversification of the economy, improvement of long-run competitiveness or technological modernization.

In practice, the issues stressed by anti-crisis management efforts add up to the following:

- support of the fuel and energy complex for the sake of fiscal stability.
- support of natural monopolies' investment programs in order to stabilize domestic investment demand, with no serious measures to improve their management.
- support of manufacturing in order to diversify the economy, but with stress in practice on selective assistance to large companies that are often uncompetitive in the global market.
- support for small firms, with an emphasis on increasing their number and their employment levels rather than on growing and transforming small businesses into middle-sized ones, or on increasing the number of innovative firms.

This approach tends to lead to the redistribution of resources in favor of traditional sectors, preservation of an obsolete technological infrastructure and distortion in regulations, and threatens to impede the recovery of high economic growth after the crisis is over.

- Has the stimulus included “buy national” clauses? Have import-restricting mechanisms been newly established or re-established?
- Has the country’s executive/central bank manipulated the exchange rate or intervened in the foreign exchange market (if so, in which direction)?
- Have there been measures to prop up export industries (e.g., tax rebates, direct export subsidies)?

National bias and protectionism

Measures aimed at expanding domestic demand or protecting domestic markets have been given a high priority in Russia’s crisis management. Demand-focused measures have included the partial subsidization of interest rates on consumer loans used for purchase of new, domestically made automobiles; federal cofinancing for a regional and municipal transport pools renewal program; and support for the leasing of domestically made equipment (by providing new capital to the State Agro-Industrial Leasing Corporation, earmarked for purchases of domestically produced agricultural machines, and through the creation of the State Joint-Stock Transport Leasing Company).

Policies aimed at limiting imports were also put in place. Customs duties were increased on a wide range of goods (most substantially on used and new automobiles, combine harvesters, buses, pipes and rolled metal), tariff quotas for imports of poultry and pork were reduced, and maximum terms for the temporary imports of combines were curtailed. The introduction of preferences for purchases of Russian-made goods through public and municipal procurements represented a new tool for the restriction of imports (a 15% cost advantage for Russian producers was set for a certain range of goods).

Despite marked deterioration in fundamental factors and in access to external financing, the central bank was reluctant to let the ruble depreciate. Thus, it implemented large-scale interventions in the foreign exchange market to support the ruble. The overall amount of interventions from August through December of 2008 can be estimated at \$28 billion, while in January 2009 alone the bank spent an additional \$25 billion in foreign exchange operations. The total sum of the interventions was the equivalent of 11 percent of initial reserves, or of 3.2 percent of GDP for the year 2008.

It appears that the central bank’s exchange rate policy during this period was aimed at preserving confidence in the ruble in order to evade bank panic. This policy may have made sense in the first few months of the crisis. But by December 2008 and January 2009, when the ruble was gradually allowed to depreciate, the main result was a conversion of ruble assets into foreign currency-denominated assets by banks, the corporate sector and even households.

Support for industrial exports consisted of a combination of customs policies (changes in customs duties on imports) along with widening exporters' access to financial resources (such as subsidized interest rates and government credit guarantees). Under the framework of the anti-crisis package, customs duties on exports of certain goods (unalloyed nickel, copper cathodes, nitric and combined fertilizers, and liquefied hydrocarbon gases) were abolished or fixed at zero. In addition, customs duties on exports of crude lumber were kept unchanged (before the crisis, this level was slated to rise).

At the same time, the volume of federal funds allocated to interest rate subsidies for loans taken out by exporters of Russian-made high-value-added goods (mostly machinery makers) was expanded from 3 billion rubles in 2008 to 6 billion rubles in 2009. Procedures for granting government guarantees for export credits were also simplified to some extent.

- Which labor market policies have been enacted (e.g., unemployment benefits, rise in public-sector employment)?
- Which social policies have been included (e.g., expansion of support, additional investment in health and education system)?
- Which measures have been taken to support purchasing power (e.g., consumer checks, tax cuts, cash transfers)?

Social protection

In December 2008, to address the social consequences of the crisis, the government substantially raised minimum unemployment allowances (up to 4,900 rubles) and allocated funds for expansion of a network of retraining centers. At the same time, oversight of labor legislation compliance was toughened, to the point of criminal prosecutions for top managers who had placed their workers on mandatory leave or compelled them to work part-time.

In addition, pension indexation was implemented in several steps, so that levels will be doubled between autumn 2008 and the end of 2009.²¹ Before the start of the crisis, the government implemented indexation of wages and salaries in the public sector (beginning in February 2008), and declared its intention to raise the minimum wage in Russia to 4,430 rubles as of January 1, 2009. These measures were not a part of the anti-crisis package, but were designed to stimulate the domestic market.

The government has declared that financing for the national projects dubbed “On Healthcare” and “On Education,” which commenced in 2007, will be

²¹ The decision regarding the first indexation step was announced and approved in early 2008 -- before the crisis. During the crisis, however, the government not only refused to cut these plans, but even expanded the scale of indexation.

continued. Government family benefits and programs aimed at raising the birthrate were expanded. In particular, the government allowed recipients of so-called maternity capital (financial aid to women who give birth to two or more children, with payments of 250,000 rubles per mother in 2008 and about 300,000 rubles since 2009) to use the funds for mortgage repayments. In total, 26.3 billion rubles were allocated to these ends. By April 2009, this right had been used by 12,500 families, and the total repayment of mortgage loans amounted to about 3.3 billion rubles. Measures for expansion of domestic demand also included tax concessions to individuals for housing purchases, subsidies to the Agency for Housing Mortgage, and partial interest rates subsidies for consumer auto loans. However, results of the latter measure were limited, because its administration was too complex and costs were too high to justify the rather small amounts of real subsidies.

As early as February – March of 2009, the government faced a substantial decline in tax revenue. The budget approved in November 2008 (on the basis of oil price forecasts of \$95 per barrel) was seriously cut across the board. However, planned expenditures on wages and salaries remained practically unchanged. The budget reduction was focused on procurement of goods and services, as well as capital investment. As a result, the declared intention to expand demand in the public sector was largely unrealized. Moreover, the budget funds for government procurements and investment that were kept intact arrived in the real sector only mid-year, due to revisions of governmental programs resulting from the budget reductions.

A decrease in tax revenue (for instance, revenue in January – July 2009 was just 60% of the level seen during the same period in 2008) was responsible for the rejection of plans to index public sector wages and salaries in 2010.

4. Implementation

- Does the government actively communicate and justify the rationale/goals of its stimulus policies to the public?
- Over time, how has the public responded to the government's management of the crisis (e.g., consumption/investment trends, public opinion polls)?

Political
communication

Until spring 2009, the government disclosed a minimum of information to the public about its anti-crisis management efforts, and offered little in the way of argument supporting individual measures. In March 2009, after the draft Anti-Crisis Program of the Government was published, government leaders made a number of trips to the regions. However, discussions were rather formal. The government offered no real support to experts' offers to

monitor anti-crisis measures and assess their effects. In August, the mass media published a series of stories accusing managers at the largest private companies of having used government subsidies for the withdrawal of their assets abroad rather than for rehabilitation of their companies.

Nevertheless, despite a deep economic recession and relative lack of transparency on the government's part, indicators of consumer activity and public sentiments showed only slight deterioration. For instance, the Social Sentiment Index (ISN) calculated by the Levada Center declined by about one-fifth, from 129 points in June 2008 to 106 points in March 2009.²² As a result, it fell back only to the level seen in 2006 – 2007.

During 2008 – 2009, in spite of the crisis, the personal approval ratings of the president and prime minister remained virtually unchanged. In September 2009, according to the VCIOM, 75 percent of survey respondents approved of President Medvedev (as compared to 73% in June 2008), and 78 percent approved of Prime Minister Putin (as compared with 81% in June 2008).²³ The approval ratings of major state and social institutions (the government, the parliament, the court of law, the army, political parties and trade unions) also remained largely the same.

- How large has the time lag been between adoption and implementation of selected major stimulus components?
- What are the reasons for delay in implementation (e.g., legal barriers, insufficient capacities, corruption)?
- Have sectoral or regional interest groups influenced the workings of policy implementation in any way?

Modes and time frame of implementation

The most promptly realized policies were focused on the banking system and on tax and customs tariff support (protection) of the real sector of the economy. However, there was considerable delay in taking measures that required direct funding from the federal budget (such as public procurement projects, subsidies, budgetary investment, government guarantees and inter-governmental transfers). Several factors were responsible for the delay. Firstly, a number of anti-recessionary measures were related to cofinancing regional programs through federal budget disbursements (support of small and middle-sized enterprises; promotion of employment; modernization of municipal motor transport). These measures implied that selection of relevant regional programs should be made in advance, and their implementation could begin only after the selection. Secondly, a number of measures were

²² For details, see Levada Center, *Index of Social Sentiment*, March 2009, <http://www.levada.ru/indexisn.html> (in Russian only, accessed November 20, 2010).

²³ Russian Public Opinion Research Center, "Confidence in Political Leaders," September 2009, <http://wciom.ru/novosti/reitingi/reiting-doverija-politikam.html> (in Russian only, accessed November 20, 2010).

designed without a clear understanding of economic agents' real needs. For instance, the initial terms of government credit guarantees turned out to be unattractive to banks, and the terms for interest rate subsidies on consumer auto loans had little appeal to actual consumers. In the third place, a considerable proportion of the measures aimed at supporting systemically important enterprises required individual decisions, and were subject to lengthy examination by special panels under the ministries of Industry and Trade, Regional Development, Finance, and Economic Development, and in some cases required subsequent examination at the Government Commission on Sustained Economic Development.

In general, the measures' delayed implementation should be largely attributed to overconcentration of resources at the federal level and to imperfections in public administration.

Representatives of major companies (particularly those that are critically important to their regional employment situation) and banks have had the strongest influence on execution of anti-recession measures. Attention to big businesses has increased, particularly to the less efficient ones, because institutions of interaction between government and businesses are imperfect.

- Beyond emergency stand-by programs with the IMF, has the government collaborated with other governments or international organizations in implementing its response to the crisis?

International or regional cooperation

As already mentioned under "consultation with external experts," interaction between the Russian government, other governments and international organizations was mainly focused on carrying out recommendations on reform to the global financial system (including an increase in the number of reserve currencies). International consultations under the framework of the G20 had no direct influence on national decisions. In a number of cases, the Russian government even acted in direct contradiction to what was recommended by the G20. For example, during the general discussion of protectionist restrictions at the G20 summit meeting, Russia's government implemented a large increase in import duties, aiming at the protection of domestic producers of automobiles, pipes and other goods.

5. Funding, Tax and Monetary Policies

- Has the government initiated tax reductions/incentive schemes?
- Have these been aimed at the private and/or the corporate, domestic or the foreign sectors?

Tax policies in support of stimulus/stabilization

At the end of 2008, the government initiated several tax cut programs for 2008 and 2009. The mechanism for calculating oil export duty rates was changed. Oil export duty is defined according to oil price levels in the preceding month (previously, the average price for two preceding months was taken). This measure was very important in the period of dramatic oil price declines. The fall in revenue was estimated to be 0.5 percent of GDP for the end of 2008 and about 0.1 percent of GDP for 2009 (in 2009, oil price dynamics were relatively smooth, with a gradually growing price).

Some decisions for 2009 were also made in 2008. These included a decrease in the corporate income tax rate (or at least the portion allocated to the federal budget) by 4 percentage points (amounting to about 0.7% of GDP), an increase in the annual amortization rate (about 0.1% of GDP for the federal and regional budgets combined) and some other changes. The total revenue decline due to stimulus implementation is estimated at about 1.0 percent of GDP in 2009 and 0.5 percent of GDP in 2008 (see Table 1).

- What kind of policies did the central bank contribute to the national crisis response? Which unconventional measures were used to fight the crisis?
- If an independent national monetary policy is not feasible, were there substituting measures in the country's exchange rate policy?

Monetary and currency policies in support of stimulus/stabilization

Beginning with the onset of the crisis, the central bank had to address liquidity problems. On the one hand, private supply of liquidity dwindled, as in other countries. On the other hand, the central bank was not able to provide public liquidity in the same way as before. In recent years, the central bank supplied liquidity mainly through the purchase of foreign currency in the market. The supply provided through this channel was often excessive, so the central bank had to partially sterilize it. But in the aftermath of trade shock and the “sudden stop,” the central bank was selling foreign currency, sweeping liquidity from the economy. As a result, monetary authorities had urgent need of reviving the credit channel of liquidity provision. This was not an easy task: In particular, banks lacked securities due to relatively low levels of government bond issues in the period of fiscal surplus.

Some unconventional measures to ensure liquidity included the provision of uncollateralized credit by the central bank, short-term lending to banks by the Ministry of Finance (using its own balances and the balances of state corporations), lending to banks and companies (by the state development bank, which obtained a special loan from the central bank).

The central bank aimed at strengthening the banking system, in particular by raising the ceiling for deposit insurance guarantees. Another focus of central bank efforts was the prevention of wider contagion within the banking system by insolvent banks. Authority to deal with potentially insolvent banks at early stages was given to the Deposit Insurance Agency.

Exchange rate policy contributed to preventing bank panic. But at the same time it aggravated the liquidity shortage, as an anticipated ruble devaluation produced high implicit interest rates in the economy.

- Relative to conditions at the outset of the crisis, does stimulus funding have a solid foundation in monetary policy or in bond/credit markets?
- Is the program part of the normal budget/integrated into the budgetary cycle, or is it financed primarily from sources outside of the formal budget?
- Is there cross-level burden-sharing between center and regions (e.g., debt issuance, fund transfers)?
- Is financial aid given to banks/companies/households in a discretionary way or based on well-defined formulas (e.g., conditionalities)?
- Did the government make credible commitments to terminate its expansionary fiscal and monetary policies under (what kind of) post-crisis conditions?

Credibility of
funding
mechanisms

As mentioned above, prior to the crisis Russia had considerable budget reserves that allowed the government to finance the fiscal stimulus package in 2008 and 2009 almost without additional borrowings. By the end of 2008, total budget reserves amounted to 6612 billion rubles (\$225 bn). At the time of writing, budget reserves in two funds amounted to 5570 billion rubles (\$177 bn)—about 14.5 percent of projected 2009 GDP.²⁴ Thus, Russia still has enough reserves to finance fiscal stimulus.

The fiscal stimulus package has been included in the budget; any changes made are in the form of amendments to the budget law that must be approved separately. The final version (as of the time of writing) of the stimulus package for 2009 was approved in June of that year; the earlier versions were discussed in late autumn 2008 and spring 2009, and were included in the amended budget law passed in April. The government has the ability to make small changes redistributing the expenditure (without changing the total sum) without amending the budget law.

²⁴ Ministry of Finance reports; Ministry for Economic Development (macroeconomic forecast) <http://www1.minfin.ru/en/nationalwealthfund/>

The initial federal budget law for 2009 – 2011 was signed by the president in November 2008. As of this writing, it was absolutely clear that the document is irrelevant given the new external and internal conditions. Although the first stimulus measures were already being discussed, the law was passed and amendments to the budget law were passed only in April 2009, as was mentioned above. Such a delay in federal budget law correction can be mostly explained by the uncertainty and unpredictability of both external and internal parameters, so there were no reliable macroeconomic or budget forecasts at that moment.

However, the uncertainty over the budget led to the delay of stimulus and other spending until spring 2009, possibly deepening the recession. In fact, stimulus implementation (on the expenditure side) began only in April 2009.

During the crisis, the budget system faced a considerable fall in revenues at all levels, as was mentioned above. At the same time, there was no sharp spending cut either on the federal or the regional levels. Social benefits also avoided cuts. Rather, budget expenditures were increased, so the additional burden of providing financing was carried by the federal budget.

In 2009, additional transfers to regions were slated to total 300 billion rubles (about 0.8% of GDP, see Table 1), and were earmarked to support regions' social and infrastructure spending. The division of excise tax was also changed to increase regional revenues.

Pension and other extra-budgetary social funds faced a decline in social contributions and a simultaneous increase in social spending. This required additional transfers to the pension funds from the federal budget of about 316 billion rubles (0.8% of GDP, see Table 1).

The stimulus package has mostly been formed in a discretionary way, with each measure discussed and approved on the basis of an estimation of the recipient's real needs. There are no clear formulas or conditions for obtaining support.

There are also built-in budget stabilizers that can be considered additional stimulus measures. For example, oil extraction tax and export duties are defined on the basis of the average oil price during the preceding month, so the tax (duty) rates are automatically decreased if the price falls.

At the time of writing, there were no clear conditions for stimulus package termination. The package was approved for the whole of 2009 and included in the amended budget law, so it appeared unlikely that associated spending could be cut under any conditions.

However, some stimulus measures are prolonged into 2010, and have been included in the draft federal budget law for 2010 – 2012. In 2010, the government will continue to support labor market, regional budgets and the financial sector. Government guarantees for enterprises, support measures for the agricultural sector and continuing social support measures are also envisaged. Nevertheless, spending on the national economy is lower in the new budget law due to considerable reductions in direct support of industry.

6. Feedback and Lesson-Drawing

- Have there been revisions or additions to the original policy packages or a sequence of distinct stimulus policies in response to unexpected new developments?

Policy feedback and adaptation

The first program of anti-recession measures, the Action Plan for Rehabilitation of the Financial Sector and Certain Industries, was enacted on November 6, 2008. This plan included 55 measures, and its priorities were to ensure stability of the financial sector; to provide social support for citizens; to preserve and create jobs; to support certain sectors of the real economy; and to support systemically important companies and enterprises that formed the core of company towns.

In the evolution of the crisis management program's ideological background, public discussion and adoption in April 2009 of the Anti-Crisis Program of the Government of the Russian Federation for 2009 were major events. This program contains an impressive number of miscellaneous anti-recession measures (about 170 items). It is important that along with former priorities, the program identified some new ones, such as the encouragement of innovation and structural changes in the economy; the creation of a favorable climate for the future economic upswing by improving major market institutions; and the abolition of barriers to entrepreneurship.

Mid-course corrections were made during the implementation of certain measures. For instance, in January 2009, the Vneshekonombank called a halt to applications by major companies for help with refinancing foreign loans. Important changes were made in the implementation of the following measures: public procurement of dwellings (focus was shifted from acquisition of completed dwellings to financing new construction); government guarantees (procedures to reimburse banks for loan defaults were simplified); subsidized interest rates on consumer auto loans (the list of automobiles eligible for inclusion in the program of subsidies was expanded); support of systemically important enterprises (mandatory terms were defined for gaining

government support); and the reduction in the small business tax burden (the maximum turnover determining eligibility for the simplified taxation scheme was increased).

7. Tentative Economic Impact

- What do major economic performance indicators tell us about the short-term effectiveness of the crisis response (e.g., growth rate, unemployment rate, industrial output, private consumption, consumer/producer confidence, inflation, exports, bank balance sheets, credit squeezes)?
- How has the political logic of crisis management (i.e., crisis as an opportunity to broaden political support) worked out for the major decision-makers so far? How has the reputation of major government leaders at the center of the crisis response evolved (e.g., based on polls, election results, backing within their political party)?

Economic and political effectiveness of the crisis response

Anti-crisis measures prevented the collapse of Russia's banking system, and smoothed the decline in employment and income. Counter-cyclical fiscal policy supported demand. However, it appears that the impact of anti-crisis measures on the economy at large was limited. GDP fell by far more than in other BRIC or large countries. In a sense, anti-crisis policy even impeded adjustment of the economy to the crisis, as labor costs dropped less than production, hence their share in GDP rose.

The Russian government did not regard the crisis as a “window of opportunity.” On the contrary, it was considered a threat to the economic and political stability of recent years. In this context, the logic of “anti-crisis management” was mainly oriented toward compensation for possible social losses, in the form of indexation of pensions, an increase in unemployment allowances, and subsidies to major enterprises in order to preserve jobs.²⁵ Such policies had a negative overall effect on job creation and on market entry efforts for those companies that would emerge competitive from the end of the crisis.. Nevertheless, this line of policy bore fruit as measured by the short-term goals of maintaining political stability and ensuring public support for the government. As mentioned under “public communication,” in September 2009 the majority of citizens (75% – 78%) approved of the activities of President Medvedev and Prime Minister Putin, ratings that were practically the same as before the crisis.

²⁵ It is difficult to estimate the influence of anti-crisis measures on the unemployment rate. At the end of 2007, Russia's unemployment rate was 6.1%. In December 2008, the unemployment rate increased to 7.7%. But it remained less than the average level of CEE (non-EU members) and CIS countries (8.8%). In September 2009, the unemployment rate in Russia was 7.6%. However, it should be stressed that in spite of the economic boom of the last decade, Russia's manufacturing sector hired 20% fewer workers in 2008 than in 2000.

At the same time, we can confirm that the lessons from the crisis of 1998 helped push the government and the central bank to try to preserve macroeconomic stability. As a result, as the crisis unfolded and fiscal revenue declined, the political positions of tough budgetary policy advocates grew stronger (as represented by Deputy Prime Minister and Minister of Finance Alexei Kudrin and Chairman of the Central Bank of the Russian Federation Sergei Ignatiev). This approach was demonstrated in the refusal to implement wage indexation in the public sector and in a general reduction in fiscal expenditures planned for 2010.

- Is there early evidence that the structure of the economy will change (e.g., greater role of the state, changes in sectoral shares in GDP)?
- Could old structural imbalances be aggravated? Can we already identify new structural imbalances? Have previously existing imbalances been tackled?

Structural
distortions

Traditionally, the dominance of export-oriented raw material sectors (oil, gas, metals, etc.) in Russia's economy was considered one of its serious structural problems. During the 2000s, the president and leaders of the government declared over and over again that the economy should be diversified and that manufacturing and services should take the lead in economic growth. However, the government failed to achieve this goal. During the crisis, a decline in international raw material prices automatically brought down the relative weight of primary industries in Russia's economy. So far, this positive shift remains a temporary phenomenon, as business conditions have in fact deteriorated rather than improved.

At the end of 2008, devaluation of the ruble by 30 percent created a certain incentive for import substitution (in January – July 2009, the volume of imports in Russia amounted to \$98.4 billion, 40% less than in the first seven months of 2008). However, a lack of positive changes in the business climate provides no ground to regard these shifts as ultimately positive ones.

The public sector has gained much more relative weight in the Russian economy than it held even before the crisis. The Yukos case of 2003 – 2004 was the turning point, when assets of the private oil company were taken over and actually nationalized. Afterward, a number of other large companies and banks (including Sibneft, AvtoVAZ, Power Machines Company, and Gута Bank, among others) were placed under the direct or indirect control of the government. At the same time, in 2006 – 2007, a number of state-owned corporations (the Russian Corporation of Nanotechnologies (RUS-NANO), the Russian Technologies State Corporation, State Atomic Energy Corporation “Rosatom,” and others) were established for the implementation of industrial and innovation policies. They were provided with large-scale financial and physical assets.

Under the crisis, many state-controlled companies faced serious problems (AvtoVAZ is a striking example). However, the presence of the state in the economy is still expanding, because state-owned banks (the Sberbank, the VTB Bank and the Gazprombank) have lent state companies money against their equity, resulting in stakes of considerable size going to these banks. Until autumn 2009, the government had never declared its intentions with respect to the future of these stakes, creating uncertainty for private shareholders and investors.

However, as Deputy Prime Minister Igor Shuvalov declared in September 2009, the government, being a generally inefficient proprietor, has no plan to manage these enterprises directly and will make all such stakes private. Furthermore, the government's stakes in the Rosneft Oil Company and some other corporations will be reduced. As a result, from a medium-term perspective, a certain decline in government participation in the economy can be expected. It can be inferred from the change in the structure of public spending that the budget became more socially oriented due to increases in pension and other social benefits; overall, government participation in the economy has increased due to support of different sectors of the economy in a manner that has often included direct funding from the budget.

The federal budget faced a significant deficit of 5.9 percent of GDP in 2009, which was less than anticipated (8.3%) due to higher oil and gas revenues. In 2010, the federal budget deficit is expected to amount to 6.8 percent of GDP, and then decrease to 4 percent and 3 percent of GDP respectively in 2011 – 2012.²⁶ This budget unbalance is due to a high and increasing level of social (primarily pension) spending. This may lead either to public debt accumulation or to declines in other types of spending (including public investments). Either alternative would slow growth and lead to macroeconomic instability if no decisions are made to ensure pension system stability in the long term.

²⁶ See "Guidelines for Fiscal Policy, 2010–2012."

8. Concluding Remarks

Russia's authorities believed that having created a responsible system to manage oil revenue and having accumulated sizeable foreign currency and fiscal reserves, they had secured the country against external shocks, the main threats to its stability. However, the crisis has demonstrated that capital inflow can also be undermined by slumping oil prices, and taken together, these factors bring about declines in output, both in oil and non-oil sectors. Consequently, fiscal losses have turned out to be much larger than expected.

During the first stage of crisis management, the government, to all appearances, expected to be able to compensate fully for the decline in fiscal revenue and economic demand through the use of accumulated oil funds. Correspondingly, at this stage the anti-crisis policy was out of focus.

The country's strong fiscal position and considerable reserves accumulation allowed it to finance an expensive and diversified fiscal stimulus package without additional borrowing. The package includes tax and duties cuts, additional social policy spending, and support for the labor market, regions, the financial system and industry. Among the disadvantages of the stimulus package we can note the fact that almost all the measures are defined in a discretionary way, without any clear mechanism of review and without clear conditions for termination of support. The fiscal stimulus as approved has increased the burden on the federal budget due to the redistribution of revenues between the federal and regional budgets and higher federal budget liabilities concerning transfers to regional and extra-budgetary funds. This could lead to a budget deficit in the medium-term and, when accompanied by the new stage in pension reform, in the long-term.

As the crisis proved longer and deeper than expected, the government began curbing the scale of anti-recession expenditures. Some lessons (as after the crisis of 1998) belong to macroeconomic policy: For example, the central bank decreased interventions in the foreign currency market to influence exchange rates. However, the general policy direction was to return to the pre-crisis path.

Study Context

The Bertelsmann Stiftung has a long tradition of assessing the quality of governance and devising evidence-based policy strategies for decision makers.

The **Transformation Index (BTI)** monitors political management, democratic quality and economic development around the world. The BTI encompasses all 128 developing nations and countries in transition that have a population of more than two million inhabitants, and have not yet attained fully consolidated democracy and a developed market economy.

The **Sustainable Governance Indicators (SGI)** offer a complementary focus on the OECD member states. The SGI evaluate the sustainability of political action in 15 different policy fields (from economy, labor, and education to environment, research and development), the quality of democracy and questions of strategic management capability in each of the 31 OECD countries.

The study *Managing the Crisis* is a joint initiative of the two projects.

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