V. Mau*

A TURBULENT DECADE

The global crisis: experience of the past and challenges of the future[1]

"Everything now is struggling along.
The empire is like a trireme
in a canal that is too narrow for a trireme.
The oarsmen bang their oars against the land,
and rocks scrape harshly along the side.
No, don't say we are completely stuck!
There is movement, we are moving.
We're still afloat, and no one
is overtaking us. But alas, how little
this resembles our former speed!
And how can you fail to sigh for those times
when everything used to go quite smoothly.
Smoothly."

I. Brodsky, *Post aetatem nostram* (1970)[i]

Dangerous hopes

"Preserving the status quo in the belief that oil prices will move higher and that fiscal policy[ii] can be tightened later… Moscow is trying to live through this crisis without visible reforms in fiscal policy, banking, natural monopolies or any other areas."[2] That was the assessment of the situation by J.P. Morgan analysts who visited Russia in June 2009, which gave a fairly accurate picture of the mood prevailing among the political elite and large sections of the public. There's nothing surprising about this: the prevailing view linked the economic upsurge of 1999–2007, just as much as the start of the current crisis, with the performance of hydrocarbon (oil and gas) prices. Naturally, the way out of the crisis is associated with a rise in the prices of energy resources, and accordingly

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i Editor note: the translation of the Brodsky poem is the translator's own and has not been taken from any published source.

ii Editor note: I endorse the following comment made by the translator of the article — "The first sentence in the article was already in English but refers oddly to '"fiscal" as a noun rather than an adjective. I have changed this to "fiscal policy", but I do not have access to the original source so cannot confirm this is correct

2 *Russia. Emerging Markets Research*, J.P. Morgan Securities Inc, 12 June, 2009.

this index is attracting increased attention from absolutely everyone — "from the workman to the minister" as people used to say. The hope that soon "everything will be sorted out" and that we will again return to the policy of "managing the growth of prosperity" continues to prevail for the time being.

The problem is not that the role of the fuel and energy sector in Russia's economic growth in the past decade has been over-exaggerated. The favourable export situation has of course made a marked contribution to the high rates of the Russian economy's performance. Export earnings strengthened the revenue base of the budget and made it possible to stimulate growth with the aid of even faster growth in state demand, i.e. through more and more fiscal injections. In order to understand the current situation and the future growth trends of the economy, however, it is important to recognise that high global prices for fuel was just one of the factors determining economic growth, and moreover a factor which had a positive effect only in conjunction with and dependant on other circumstances.

First, the high prices for oil and gas occurred against the background of an unprecedented global economic boom. It was global growth and the global demand it engendered, and the low interest rates on the financial markets linked with it, that formed the basis for the Russian growth. We must, however, draw attention to the uniqueness of this phenomenon — the rise in prices for raw materials (fuel and metals) followed the global growth and did not constrain it, as was the case, for example, in the 1970s.

Second, an important role was played by domestic political factors, and above all by the macroeconomic and political stabilisation which occurred towards the end of the 1990s. A revolutionary transformation was completed, the elite was to a significant extent consolidated, and the country received an important inoculation against financial populism. A conservative fiscal policy became the foundation of a new economic policy, which for almost a decade was the basis of the country's economic policy.

It follows from the above that oil and gas prices cannot in themselves be a factor or criterion for assessing the prospects for Russia's economic development. A favourable economic situation outside the country can of course help to increase the stability of the fiscal system, which is important in itself (especially for ensuring social and political stability). However, it does not follow at all from this that the resumption of high rates of Russian economic growth is inevitable. High prices for the produce of the fuel and energy complex can (and very likely will) depress economic growth in the majority of developed countries, which will also have a negative effect on the Russian economy, for the development of which dynamic global demand, not just excise revenues for the budget, is important.

The present crisis is systemic in nature. It cannot be reduced to cyclical market fluctuations, when a recession is automatically followed by a recovery. A recovery, of course, will follow a recession, but in order for this recovery to happen substantial changes need to take place in the technological and organisational basis of the global economy and of individual countries. A country's profile and place in the post-crisis world depend precisely on how it manages to transform its structure and adapt to the new global challenges. Waiting for the pre-crisis *status quo* to be restored is the most dangerous policy at the present time.

Unpredictable features of great crises

The modern crisis is justifiably compared with the biggest crises of the past. Its predecessors include:

- The crisis of 1857–1858, or the first global economic crisis. Naturally, it was a global crisis on the scale of its time, i.e. affecting the countries in which the capitalist system prevailed. This crisis is sometimes called Marx's favourite crisis[3], in that this was the one that provided a decisive argument for constructing the economic model of the inevitable breakdown of capitalism; the first volume of *Das Kapital* was published ten years later.
- The crisis of 1907 — the first large-scale financial crisis, which did not resolve itself but was overcome with the help of specific deliberate actions. True, this was not so much by governments as by J.P. Morgan and the group of financiers linked to him. Before this, as a rule the reaction to crises was passive: it was a matter of waiting until everything sorted itself out. It was effectively in 1907 that people began to understand the possibility of devising and carrying out anti-crisis measures, which paved the way for the theoretical and practical research in the field of economic policy in the twentieth century. The creation of the USA's Federal Reserve System was a direct consequence of this crisis.
- The crisis of the 1930s, or the "Great Depression", which essentially gave rise to the modern model of state regulation of the economy and even to modern economic

[3] See Anikin, A., *A history of financial upheavals,* Moscow: Olympus Business, 2000, p. 72.
The 1857–1858 crisis was also characterized by unprecedented financial speculation in the preceding few years. This is when the following popular expression appeared: "Just a few years ago I didn't have a penny, but now I have debts of five million."


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thinking. “We are today in the middle of the greatest catastrophe — the greatest catastrophe due almost entirely to economic causes — of the modern world. I am told that the view is held in Moscow that this is the last, the culminating crisis of capitalism, and that our existing order of society will not survive it,” said J.M. Keynes in the summer of 1931, emphasising the systemic nature of the crisis, which went far beyond the actual economy. Keynesianism was a reaction to this crisis and was essentially an attempt to prevent global economic catastrophes from happening in the future.

Finally, the crisis of the 1970s, which gave the world a previously unseen phenomenon — stagflation, or the combination of low (or negative) growth rates and high inflation. An innovative measure of economic difficulties also emerged — correlating the unemployment and inflation rates. The way out of this crisis was linked with large-scale deregulation and a rejection of financial populism — initially in the most developed economies and later in many developing countries (including post-communist countries).

Detailed analysis of the aforementioned crises (we shall call them, with a certain degree of conditionality, “systemic crises”) falls outside the scope of this article. Here we should emphasise only the presence of certain general characteristics in these crises. What they have in common is not the particular depth of the slump in production or the financial market, nor the parameters of inflation or the budget deficit. What links them generally is not figures but certain qualitative characteristics which have a substantial influence on the future development of political, economic and intellectual processes in the world’s leading countries.

The following general features of systemic crises can be identified.

First, such a crisis entails a major intellectual challenge which requires a fundamental rethink of its causes, development mechanisms and the ways of overcoming it. Just as generals always prepare for the wars of the past, so politicians and economists prepare for past crises. For a while this works — for the time being we have to deal with the economic cycle, that is with the recurring problems of economic trends. Initially, therefore, we try to combat a systemic crisis by applying the traditional methods that we know from the past. In the case of the 1930s this was the attempt by the government of President Herbert Hoover (and above all his Treasury Secretary Andrew Mellon) not to interfere in the natural course of events, to strictly balance the budget and reinforce the monetary system based on the gold standard. The experience of the preceding hundred years showed that crises usually sorted themselves out within approximately a year and no special policy was required to achieve this. Similarly, in the 1970s, at the beginning of the crisis people tried to initiate what were then the traditional methods of Keynesian regulation (fiscal stimulus in conditions of slowing growth rates and even state control of prices in the case of Richard Nixon’s Republican administration), which resulted in a leap in inflation and the start of stagflationary processes.

In other words, the economic policy methods developed in previous decades are not really applicable (or to be more precise, are not at all applicable) to these crises. There are too many new problems, and the mechanisms by which the crisis develops and for getting out of it, as well as its scale and duration, are not clear.

In the twentieth century it took something like ten years to overcome systemic crises. This is exactly what Paul Volcker was pointing out when he spoke in his capacity as Chairman of the Federal Reserve Board in June 1979, at the height of the previous systemic crisis: “We are face to face with economic difficulties really unique to our experience. We had lost that euphoria…, that we knew all the answers to managing the economy.”

Second, during a systemic crisis a change takes place in the model of regulating socio-economic processes. The 1930s marked the end of the transition to the industrial stage of development and the consolidation of the ideology and practice of “big government”, accompanied by a growth in taxes, fiscal expenditure, state ownership and planning, and in certain cases even government price control. Conversely, the crisis of the 1970s led to large-scale liberalisation and deregulation, tax cuts and privatisation — in a word, to everything required by a transition to a post-industrial technological phase.

Third, a systemic crisis is simultaneously cyclical and structural. It is linked to serious institutional and technological changes, to a change in the technological base (the “technological structure”), which takes the economy to a qualitatively new level of efficiency and labour productivity. The systemic renewal of the technological base from the point of view of the latest achievements in science and technology is one of the most important conditions for successfully moving out of a crisis.[4]

[4] A number of economists examine the issue of a change in technological basis using the logic of N.D. Kondratiev’s “major business cycles” — the long-term waves that occurred in the 1950s and 1960s. (See Kondratiev, N.D. Major business cycles. Issues of market trends, vol. 1, 1st edn., Moscow, 1925). This is an interesting and potentially productive hypothesis, although there is no firm evidence of its validity and there cannot be, given the lack of an adequate number of statistical observations — and the author himself regarded his own conclusions merely as a hypothesis.

It follows from the above that there could be a substantial transformation of global economic and political centres of power as a result of the crisis. This is not an absolutely inevitable consequence of a systemic crisis, but the likelihood of this kind of shift is quite high.

To use the currently popular terminology, systemic crises can be fully described as ***innovative***. This is not only in the sense of the emergence of new economic and political institutions with a crisis (on the eve of a crisis, during it or after it), but also in the sense of the emergence of a new generation of politicians, entrepreneurs and experts, and in the sense of a new technological base replacing the one which came about as a result of the previous systemic crisis.

Everything we have said is obviously also applicable to the current global crisis.

We are faced with a serious intellectual challenge, and it is impossible to remain in the economic mind-set of the preceding decades. New instruments have appeared on the financial market, and it is has become clear that governments are not yet capable of dealing with them. The economic discussion of how to combat the crisis is still revolving around the traditional twentieth-century issues: e.g. Keynesianism vs. monetarism, or liberalism vs. dirigisme. Also for every argument that what has happened is a "failure of the market" there is a no less persuasive argument that it is a "failure of government". Anti-crisis economic policy is also so far revolving around these two models, in practice a combination of Keynesian methods of regulating demand (through fiscal stimuli) and monetarist methods of influencing supply (through relaxation of monetary policy).

The call for of a new model of regulation, and moreover on a global scale, is becoming ever more pressing. True, the discussion has not yet got as far as contending that we need to regulate production, i.e. return to the model of the mid-twentieth century (before the neoconservative revolution). The trend towards statism (right up to total statism) in the last century was too bad an experience for the world; so far no responsible political forces are preparing to return to it, even though Keynes is still the most popular economist in the modern world. For the time being what is being discussed is a model for regulating the financial markets on a global scale, and that would also be an innovation — on the part of a state or some alliance of influential states.

Finally, there is increasingly active discussion of the prospects for a change in technological structure. The 1930s marked the end of the transition to major mechanised production (mass-production and other industrial technologies) and the 1970s saw the creation of the base for microelectronics and modern computer technologies Some researchers believe that the transition has now begun towards a deeper level of creation: biotechnologies, nanotechnologies and information communication technologies are to be key areas of development and will prove to be an area of intense competitive struggle.[5]

It is not surprising that the task of radical structural renewal during the crisis is faced not only by countries that are in the process catch-up development but also by the more developed states. Their elites understand that to ignore the innovative challenges at a time of crisis is to risk the loss of their leading positions and strategic defeat in global competition. It is no accident that the US administration is constantly stressing the need to get the country into a qualitatively new condition after the crisis, which means modernisation not just of technologies but also of socio-economic institutions. According to L. Summers, "The new American economy will be in different and better shape than it was before the bust, it will be more export-oriented and less consumption-oriented, more environmentally oriented and less energy-production-oriented, more bio- and software- and civil-engineering-oriented and less financial-engineering-oriented, and, finally, more middle-class-oriented and less oriented to income growth that is disproportionate towards a very small share of the population."[6]

Contours and risks of crisis development

If we accept that the current global crisis is more a structural than a cyclical phenomenon, the following conclusions must be drawn.

This concerns above all the duration of the global crisis. When people talk about it ending, they usually portray it either as a halt in the slump in production or as the start of growth in the securities market. It was on this basis that back in the middle of 2009 there began to be talk of "green shoots" appearing. Meanwhile the real situation was much less clear-cut and much more complicated.

The fall in production cannot in fact continue for ever, nor can the fall on the securities market. According to these parameters it looks as though the world is entering a period of a certain equilibrium. The problem, however, is that this equilibrium will be unstable, and so will

[5] S. Glazyev is one of the most active supporters of this point of view on the crisis. (See Glazyev, S.Y., *Opportunities and limitations in Russia's technical and economic development in conditions of structural changes in the global economy*, Moscow, State University of Management (SUM), 2008).

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

the resumed economic growth. That is how it was in the 1930s and the 1970s — it took approximately a decade to resume healthy and stable growth, interrupted at times by simple cyclical or sectoral (banking, finance) crises.

It is possible to emerge onto a trajectory of new and stable growth once the government of a given country is able to resolve the issues which constitute the deep foundations of the crisis. These are technological, economic, regulatory, social and possibly geopolitical issues. These changes take place quite slowly, and it is practically impossible to accelerate them. However, it is possible to slow them down by holding on to old economic and technological forms.

The anti-crisis policy itself creates additional problems and risks, which will appear in the present crisis phase or in the post-crisis future. ***It seems to us that the most important of these risks are macroeconomic destabilisation, substantial growth in the state sector (mass (?) de-privatisation) and moral hazard (the risks of unprincipled conduct or irresponsibility), ending in the preservation of existing economic structures.*** We shall examine these groups of issues in more detail below.

The key problem is the build-up of potential for macroeconomic instability, which may be followed by political instability.

Key among these issues is the expansionist fiscal and monetary and credit policy of the past year, which has been aimed at combating deflation and preventing the resurgence of the destructive mechanism of the Great Depression of eighty years ago. The current policy of cheap money and fiscal injections will inevitably lead to a substantial growth in the sovereign debt of the majority of advanced market economies, and makes high inflation a more than realistic prospect.[7] That is why the question of an *exit strategy*, i.e. of ways to achieve deflation and a reduction in government debt, is already arising periodically in discussions between politicians and economists. The possible options for action by the authorities are fairly obvious: raising taxes, reducing fiscal expenditure, raising interest rates.

The political difficulties of such a policy are no less obvious, and they concern both the period of transition to the *exit strategy* and the politico-economic consequences of its implementation. *On one hand*, politicians in developed countries (especially the USA) are appealing to their colleagues not to weaken their efforts to create a fiscal stimulus. After all, too early a return to fiscal conservatism could frustrate the efforts to start up the "economic motor", which might begin to stall again as a result of a reduction in the supply of cheap money. It is true that it can be very difficult to determine at what point it will be necessary to stop the presses rolling. *On the other hand*, pumping money into the economy for too long or on too large a scale can (and will) have long-term consequences in the form of the economies of the developed countries moving into high rates of inflation.[8] The experience of many countries (including the developed countries in the 1970s) shows that it can be very difficult to break out of this trap.

It is even more difficult to assess the politico-economic problems and the obstacles to implementation of a post-anti-crisis policy. Toughening fiscal expenditure and raising interest rates is a painful process under any regime, but it is especially dangerous for immature democracies, i.e. for countries whose voters, because of their own poverty, are more inclined to believe populist slogans. Even now, if we look at the governments of countries that are preparing for elections it is not difficult to notice an inclination towards populism, even on the part of those who up to now have actively resisted it[9] Politicians with a restrained attitude towards state expansion are exceptionally rare.[10]

There is a danger that the developed countries will fall into a vicious circle of populism which they will possibly have to go through several times. The essence of this is quite simple and is well known from the experience of

[7] However, some economists cite arguments about the inflationary safety of the monetary policy currently being pursued. (See, for example, the articles by P. Krugman and R.Skidelsky in the *Financial Times*, May–June 2009. The argument deployed in this position is contained in the report: *Richard Koo: a personal view of the macroeconomy*, Nomura Securities, 30 July 2009.

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

[9] A typical example is Chancellor Angela Merkel, who was the main defender of free market values and who insisted on limiting the budget deficit and not adopting too relaxed a monetary policy. However, in June 2009, in connection with the forthcoming parliamentary elections in September, she tabled new federal budget spending initiatives — albeit with a proviso that it would be necessary to return to a balanced budget in the future: "Of course, we will have to come back to a situation where we don't spend more than we earn. But in order to get there, we need to do two things: we must invest in the future, that is education and the environment" (*Financial Times*, 20 June 2009, p. 2).

[10] In this respect it is interesting to note that Prime Minister. Putin and President . Medvedev are found among the small circle of politicians who are concerned by the consequences of populist anti-crisis measures. Speaking in Davos back in February 2009, the Russian prime minister warned against the state's relentless expansion in matters of ownership and regulation. And at the G8 summit in July the President of Russia proposed that government financial injections should be limited and that there should be serious discussion of a strategy for post-crisis development — an *exit strategy.*

Latin America in the twentieth century. Fiscal and monetary expansion facilitates a revival of the economy, but at the same time leads to an increase in government debt and accelerating inflation, and a rise in interest rates. This is followed by a loss of confidence in industrial investment — either because of increasingly rapid depreciation of the currency or because investment in government bonds becomes more attractive. The next step is a hardening of fiscal and monetary policy, which brings recession. This recession may again be followed by an easing of macroeconomic policy — and so it goes round the same circle several times. It is especially unpleasant that such fluctuations inevitably lead to a weakening of the institutions of state authority and to a reduction in its efficiency. In countries with weak institutions the economic cycle of populism is frequently accompanied by political coups[11] and by alternating populist and conservative dictatorships coming to power. The experience of the twentieth century is obviously not an absolute model for repetition here, but it gives important information about the possible logic by which events may develop.

Of course, Latin Americanisation is not the inevitable outcome of the fight against the crisis: much depends on the efficiency and flexibility of political institutions, which vary substantially between the countries in the grip of crisis. However, the risks of falling into the vicious circle described above are real and are growing. The first signal, albeit very far off, was the USA's plan for an increase in medium-term yield on government bonds, which is evidence of the growing expectation of a leap in inflation — the first step towards destabilisation.

Another serious problem is mass nationalisation — de facto (concealed) or explicit (open), and also the strengthening of dirigiste tendencies in the economic policy of the world's leading countries. The experience of the last four centuries has shown that it is guarantees of private property rights that create the basis for modern economic growth, i.e. growth which ensures a significant growth in per capita GDP. This thesis has now been put in doubt. By saving the debtors and topping up the banks with capital and increasing the guarantees on private deposits, the state is taking on the risks arising as a result of the actions of all the main players in economic life — the bankers, the investors and the borrowers. (The more so since in practice these are not infrequently the same people.) In combating the global crisis the governments of the majority of developed countries are making efforts which effectively discredit private property and undermine the fundamental basis of the market economy — a person's personal responsibility (especially that of entrepreneurs) for the decisions they take. The state (but also society) is willing to take private risks on itself, i.e. the policy of nationalisation of losses makes the nationalisation of risks inevitable as the next step.

Companies that have got into difficulties are undergoing a process of effective nationalisation through the provision of financial aid to them. Nationalisation is taking place through at least three channels: through buying the debts of individual firms, through recapitalisation in exchange for shares, and also by means of the inflation of accumulated commitments. Governments are inclined to take on all the liabilities (commitments) of financial institutions — both by means of guarantees and by direct capital injections. Naturally, this aid to financial institutions is accompanied by formal or effective dilution of private shareholdings. Private property rights are thereby put in doubt.

It is true that the present nationalisation has one substantial distinguishing feature — its forced nature. The nationalizations of the twentieth century were ideologically motivated. Their authors — from the Russian Bolsheviks to the British Labour Party — were convinced that state-owned property was more efficient than privately-owned. Towards the end of the twentieth century the world abandoned this illusion, and mass nationalisations were replaced by the policy of deregulation and privatisation. And now the world is again running up against a fundamentally new phenomenon: no one (or almost no one) considers state ownership an institution that guarantees economic efficiency. However, throughout the civilized world anti-crisis policy is entailing a serious strengthening of the state sector.[12]

[11] The following description of the Latin American populist cycle, drawn up in the 1990s by R. Dornbusch and S. Edwards, is considered classic:

Phase 1 — The start of populist policy as a reaction to depression or stagnation results in a marked growth in the economy and, correspondingly, in real incomes, provided by both domestic production and imports. *Phase 2* — the appearance of "bottlenecks" in the economy, linked with product shortages or a balance of payments deficit at the same time as a gradual squeeze on international reserves as they are used to support the currency's exchange rate. *Phase 3* is characterized by a rapid growth in inflation and (or) product shortages, a budget deficit, capital flight and demonetarisation of the economy, which inevitably leads to devaluation, a substantial fall in personal incomes and almost always the loss of political control by the government. *Phase 4* marks the transition to orthodox stabilisation implemented by a new (often military) government. (Dornbusch, R., Edwards S. (eds.), *The Macroeconomics of Populism in Latin America*. Chicago and London: The University of Chicago Press, 1991, pp. 11–12).

[12] "Political labels have lost their meaning. If governments of various persuasions nationalise banks and pump money into the economy, what today distinguishes the left-wing from the right-wing, the liberals from the conservatives, the socialists from the capitalists, or the Keynesians from the monetarists?" (Thornhill, J., 'A Year of Chocolate Box Politics', *Financial Times*, 24 Dec. 2008, p. 6).

Apart from direct statism (nationalisation) we are seeing a general growth in dirigisme, i.e. a growth in the number of individual decisions by the institutions of power, the judgments by them (not by the market) of who is innocent and who is guilty, and also a willingness on the part of the government to point out to economic agents what services they should be providing and what goods they should be producing. The bankruptcy of Lehman Brothers on the one hand and the assistance given to Bear Stearns, AIG and CitiBank on the other, which do not lend themselves to market interpretation, are the result of individual decisions, i.e. they follow the logic of a centrally managed economy.

The next and entirely natural step is decisions by the government regarding the nature of the activity of institutions that are effectively nationalised. Back in the autumn of 2008 British Prime Minister Gordon Brown stated that he would be encouraging the banks that had come under his control to invest more resources in small businesses. The same is being demanded of Russian state-owned banks, regardless of the effect this might have on the quality of their portfolios. Supporting small business is of course a sacred cause, beloved by all modern governments. However, the consequence of this type of decision is not difficult to predict: if the authorities give the direction on where to invest money, they will have to support their own bank when these politically ordered investments prove to be ineffective. That is to say, we end up with a vicious circle of state support and ineffective investment.

Finally, the systemic risks are linked to the emergence among market players of the "most equal", those of whom it is said that they are too big to fail. In modern Russian economic language this phenomenon is called "systemically important businesses". Clearly, at all times there have been businesses whose collapse incurred higher social and political costs for the society in question. However, the phenomenon of modern economic growth itself assumes not only the emergence of new businesses (and firms) but also their departure from the scene as a result of competition. Competition and the absence of "untouchables" is the basis of modern economic and — more widely — social progress.

Meanwhile, politics in the modern world is aimed to a significant extent at preserving many of the giants that are in fact vestiges of the economy of the past. There are at least two arguments in favour of supporting them. First, because of the importance of the goods or services they deliver. Second, because of the social (or else political) consequences which their closure could entail. Both of these arguments are important, but the authorities should not try to find the answer to the problems arising here by simply keeping potential bankrupts afloat.

Right now the majority of governments imagine that the problem of "systemically important businesses" can be solved by means of better regulation of their economic activity and a more attentive attitude to them on the part of the authorities. More often than not these kind of proposals are made with regard to the banking sector, although they are also fully applicable to the manufacturing industries (especially those that are infrastructure-related). The efficacy of such regulation gives rise to fundamental doubts: if it was impossible to build such a system in the past, why should it prove to be effective now? The approach of breaking a given firm's exclusive connection with the service it provides, which is essential from the national point of view, is much more productive (although more difficult too). The state must ensure the availability of assets and technology for the economic agent, which may take the place of the management and proprietors of a systemically important bankrupt, and this is where the real art of a politician lies.[13]

The socio-political risks of bankruptcy should also be the subject of special attention from the government. It should be a matter of aid in social restructuring and adaptation to new fields in which to employ labour from bankrupt businesses. Successful experience of these kinds of actions is quite well known, including that of Russia in the 1990s — the restructuring of the coal industry made it possible to close a large number of inefficient mines, while retraining and reskilling the staff who had been made redundant, who were able to find work in other sectors.

Finally, we must emphasise the complicated and ambiguous nature of the mechanisms by which risks in a time of systemic crises emerge and develop. The idea that more active intervention in the economy by the state is necessary as a way of overcoming the risks of unbridled development has become popular on a wave of criticism of the liberal model of the last thirty years. However, a balanced analysis of the situation shows that such a solution is not obvious, since state regulation per se entails systemic risks. "Top officials are calling for a powerful systemic risk regulator. But the US government is the most serious

[13] "'Too big to fail' — whether the claimant to a bank or to an auto company — is not a status that we can live with. It is both better politics and better economics to deal with the problem by facilitating failure than by subsidising it." (Kay, J., 'Why "too big to fail" is too much for us to take', *Financial Times*, 27 May 2009, p. 9).

source of risk,' wrote Stanford's Professor John Taylor,[14] not without justification, and these words are true not only in respect of the activity of the US government.

Issues raised by the crisis

The economic crisis has posed a number of big questions to politicians and experts regarding the functioning of modern economic systems. These are questions that require an intellectual breakthrough; we need to understand new realities and find ways of resolving issues that as a rule do not have simple solutions. Nevertheless, each systemic crisis forces us to seek answers to systemic questions, and up to now these answers have usually been found. The fact that it is difficult, not only intellectually but also politically, to give some answers to crisis challenges is a different matter. However, we shall have to find our position all the same — and it would be better if it were sooner rather than later.

Let us recap what are in our view the most important issues concerning the development of the present crisis. These issues are also traps into which the economies of many (if not the majority of) countries have fallen, and, at the same time, issues to which we must find answers if we are to really overcome the crisis.

1. One of the basic, profound problems that led to the crisis is the predominance of the interests of capitalisation [? i.e. the growth in market value determined by share price multiplied by the number of shares] over the interests of increasing the efficiency of production factors (or growth in labour productivity) which has emerged in the world over the last quarter of a century. A situation has arisen in which capitalisation (and not stability of production or the volume of dividends) has become what mainly interests proprietors and shareholders. Their attention has been focused on this yardstick and they have judged the performance of management by it. Naturally, a measure which has a specific function will begin to dominate with regard to other parameters of activity. In this case the measures of labour productivity and renewal of plant have been pushed into the background. To be more precise, these two last factors have played their role, but only when they were not opposed to the growth of capitalisation. In practice this meant the pursuit of a maximum concentration of production in the hands of a few global players (firms), the impossibility of closing inefficient businesses and, conversely, a willingness to incorporate them into large holding companies as a factor to expand the market and capitalisation.

The motivation of managers in major companies has become increasingly reminiscent of the motives of the communist directors of the past. The need to constantly report to party and administrative bodies on fulfilment of plan criteria (in roubles or in units) made it impossible to upgrade plant or to shift to high-quality output, since this would have led to a reduction in output of the old products, which was unacceptable from the political and administrative points of view.

The consequence of this sense of motivation among modern management is a growth in monopolism (as a result of mergers and takeovers), a brake on increasing labour productivity, and in the final analysis discouragement of innovative activity.

The main regulatory issue raised by the present global crisis is how to shift the motivation of proprietors and management towards closer attention to the qualitative aspects of the development of their firms. In our opinion, this is a deeper problem than regulation of the financial markets, which for all its importance is a by-product of the conflict between capitalisation and efficiency.

2. The approaches of modern governments to the formulation of anti-crisis policy are linked to the problem of unprincipled conduct (*moral hazard*). This policy has two aspects. On one hand, it is necessary to support socio-political stability and not allow the situation to wobble, as it is likely to do as unemployment, bankruptcies and uncertainty increase, and also, in a situation of high inflation, to reduce budget expenditure. On the other hand, as almost everyone admits, a crisis is also a time for renewal, for formulating a new economy, and for modernisation.

Naturally, at the level of practical policy these two approaches contradict each other. The ways and results of resolving this contradiction depend on the art of the politicians, and on the ability of the political elite to understand the challenges of the time adequately and respond to them. In the final analysis everything depends on the effectiveness of political institutions, on their flexibility and at the same time their resilience. The experience of the twentieth century shows that the mature democracies usually prove to be more effective in finding breakthrough solutions at times of large-scale crises.

The question of giving state support to economic agents, above all banks and businesses, is on the agenda of modern anti-crisis policy. And here governments should tackle the most complex task: how to help establish new economic sectors and new businesses, alleviating the growth of social dissatisfaction, which is fraught with the

[14] Taylor, John. 'Exploding debt threatens America', *Financial Times*, 27 May 2009, p. 9.

threat of a social explosion, coming precisely from the so-called *"systemically important businesses", many of which could more accurately be termed "systemically important bankrupts"* — the major old firms whose post-crisis prospects are giving rise to serious doubts.

This is also the problem of combining current and strategic challenges. The American administration runs up against this problem when it tries to tackle two essentially contradictory objectives — how to stimulate domestic consumption in order to avoid the deflation trap, and at the same time how to stimulate savings, i.e. to bring households' expenditure in line with the results of their productive activity. Meanwhile, this last objective is the strategic one: unless this is resolved, unless the "consumer bubble" is deflated, it will not be possible to return to the trajectory of stable economic growth.

Similar contradictions can also be seen in Russia's anti-crisis policy. We want simultaneously to stop the growth of unemployment and carry out structural modernisation, and start to get out of the oil dependency trap. Although the crisis in the first half of the 1990s showed that maintaining a high level of employment mitigates social conflict, it bars the way to structural renewal and increased efficiency.

The situation is further complicated by the fact that at the present time in the case of many businesses in the manufacturing sector the fundamental reasons for their difficulties and, accordingly, their prospects in the post-crisis world remain unclear. In other words, it is a matter of differentiating between the issues of insufficient liquidity and solvency. Without knowing the contours of the future global economic set-up, the structures of demand and the new frontiers of labour productivity, it is often difficult to say unambiguously which businesses have a future and which are bankrupt. And this uncertainty in turn substantially restricts the willingness of banks to provide credit to the manufacturing sector or to restructure existing debts.

Finally, similar processes also predetermine the situation in the banking sector itself. There is no doubt about the importance of its recovery, of cleaning up the balance sheets and creating new credit organisations. Here too, however, the lack of clarity in the relationship between the issues of solvency and liquidity makes it difficult to draw up a consistent and well thought through state policy with regard to the banks. As a result, as noted in the annual report of the Bank for International Settlements in Basel, "The reluctance of officials to quickly clean up the banks, many of which are now owned in large part by governments, may well delay recovery."[15]

3. The issue of the model for a post-crisis world order, the correlation of economic forces and the roles which individual countries and regions will play is far from resolved.

The key thing here is the answer to the question of the prospects for a structure which some politicians (Zbigniew Brzezinski, Henry Kissinger) term the "Big Two" (G-2),[16] and which Niall Ferguson a touch provocatively called Chimerica (= China+America).[17] It is a matter of the creation of a global imbalance which for a decade has been regarded as the basis for the balance and resilience of global growth. As a result a regime has been formed which is the opposite of the model of globalisation which applied at the turn of the nineteenth and twentieth centuries: while a hundred years ago capital moved from the centre (the developed countries) to the periphery (the (*emerging markets* of the time), now the emerging markets have become centres of saving, while the USA and other developed countries have predominantly consumed.

Despite the clearly expressed tendency towards this new structure of international economic and political relations, it must not be seen as an entity. Too many tendencies that seemed obvious have proved in practice to be unfounded. However, a lot depends, both in terms of mechanisms to get out of the crisis and of the

[15] See Giles, Chris, 'BIS calls for wide global financial reforms', *Financial Times*, 30 June 2009, p. 3.

[16] Brzezinski. Z., 'The Group of Two that could change the world', *Financial Times*, 14 January 2009, p. 9.

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

configuration of the post-crisis world, on whether this tendency will lead to a real emergence of the G-2.

4. The issues of a new financial system and the mechanisms for regulating it still remain completely unclear. Everyone is talking about the failure of the principles of self-regulation in the financial markets, blaming this on economic liberalism in general and ex-Chairman of the Federal Reserve Board Alan Greenspan in particular. Intensive discussions are underway in various international formats (the G-2, the G-20, the Financial Stability Forum). However, no clear understanding of what regulatory model should be adopted is in sight.

The discussions so far are being held at the ideological level and on the basis of the twentieth-century paradigm — about the failures of the market or the failures of the state, about Keynesianism and monetarism, about the need to create new regulatory bodies on a national (a super-regulator in the USA) or international scale. All this offers a certain intellectual interest, but does little to help move forward towards a new regulatory system which meets the realities of the twenty-first century.

Meanwhile, as noted earlier, **the key issue concerning systemic crises is the issue of a new regulatory model**. This needs to be a model that reflects the realities of the modern world, including the speed at which information spreads, the global nature of information and financial flows, and the presence of qualitatively new instruments in the financial market. But, to repeat, the contours of the new regulatory model are really not yet visible.

5. The new model of economic regulation will be accompanied by a transformation in the system of financial accounting, which also means a new configuration of world (or reserve) currencies. Much has been said on this subject with the beginning of the crisis, and the discussion revolves around four basic options.

First, preserving the leading position of the US dollar while strengthening the role of the euro and a few traditional regional reserve currencies.

Second, strengthening the role of artificial currency for international accounts (Special Drawing Rights) as a world reserve currency.

Third, the emergence of a new reserve currency, either as an alternative to the American dollar and the euro, or as one that functions alongside them: many see the Chinese yuan in this role.

Fourth, and finally, increasing the role of regional reserve currencies and the emergence of some new ones among them (for example, the Russian rouble). It is assumed that a multiplicity of reserve currencies will reinforce the trend towards a multipolar world and will promote greater responsibility on the part of the monetary authorities in the relevant countries (in so far as the reserve currencies will compete with each other).

A separate problem here is the prospects for the dollar as they are seen as a result of the FRS's pursuit of an unprecedented monetary policy to provide liquidity.

The discussions on this issue are predominantly political. However, it is understood that a reserve currency should not be "designated". The assumption of this role happens naturally, as a result of the authorities in the country in question pursuing a responsible monetary policy leading to an increase in the international attractiveness of the relevant currency. So far there are no serious practical solutions to this problem.

6. Finally, the creation of a new technology base and a new configuration for global commodity flows. The crisis is prompting a technological renewal, which is linked with a transformation of demand for many industrial and consumer goods, and especially for investment and fuel and energy products. Naturally, this will affect the prices of the majority of goods that are on the market and the emergence of new and balanced price levels, which will also lead to a change in political configurations.

The intellectual challenge. Concluding thoughts

The questions outlined above remain for the time being unanswered. This is not surprising: it takes a certain amount of time not only to resolve them but even to grasp them. A crisis such as the present one therefore brings with it primarily a serious intellectual challenge. And only after answers are found to the questions we have outlined will it be possible to talk about the beginning of the final stage of the crisis — the stage in which we emerge from it. In other words, the end of the recession in itself and even the resumption of some degree of growth may still not signify the end of the systemic crisis, but instead only the end of a particular stage of it.

For the time being we are at the beginning of the end of the first stage of the global crisis. We have already fully realised its gravity and depth. One might even say that we have realised the innovative nature of this crisis. However, there is still too much hope that the crisis will come to an end, like a bad dream, and then everything will go on as it used to. The belief in the restoration of the *status quo* continues to be one of the main illusions both for the elite and for ordinary people ("public opinion").

We understand some elements of what should constitute the *exit strategy* for getting out of this crisis, including a fiscal recovery (a reduction in the budget deficit), disinflation (if the moves to tackle deflation lead to a jump in inflation, which is very likely), and also reprivatisation (a return to normal private ownership).

However, we do not yet know the mechanisms to get us out of the crisis, and accordingly how long it will last.

It would appear that the world is in for a fairly long period of instability. The systemic risks outlined above, and also the challenges that face the economic policy of the leading countries, are forming the basis for a new stage of economic development — a stage which was opened by the start of the global crisis. It is highly likely that we have embarked on a "turbulent decade"[18] — a period of instability in the economic and political development of the world and individual states.

A "turbulent decade" does not mean a permanent recession or the emotional roller coaster that the world experienced in the autumn of 2008. It will be fluctuations in growth rates, a period of unstable growth with local upturns and downturns, with outbreaks of inflation and attempts to suppress it.

To use a historical analogy, albeit a limited one, we could say that so far we are living at the stage of Herbert Hoover's presidency with regard to the crisis of the 1930s, or of Richard Nixon's presidency in the USA (or the government of Harold Wilson in Great Britain) if we make a comparison with the 1970s. In other words, the level of understanding of the crisis and of the instruments for countering it remain in the paradigm of the experience of the past — in our case, the crises of the twentieth century.

This is also what the policy of aid to economic agents is like: it is aimed more at saving the "heroes of the past", the veterans of industrial battles, than at helping the shoots of the new economy — although at least people have already begun to talk about these recently.

The emergence of a new FranklynD. Roosevelt, Margaret Thatcher or Ronald Reagan, with their fundamentally non-trivial, albeit diametrically opposed, approaches to solving the systemic problems which a crisis poses, is still only something that may happen in the future. For them to emerge we need to realise the ineffectiveness of tackling the crisis within the traditional paradigm and create a public demand for a new policy — a new "New Deal". And we do not yet know what that will actually look like.

[18] Alan Greenspan called his book of memoirs *The Age of Turbulence*. It was written before the crisis and was mainly devoted to the period of 1987–2002 — a period of rapid economic growth. Now it has become clear that only since the book was published has a real "age of turbulence" begun.