

Preparing for a Crisis, But in the Wrong Way

By [The Moscow Times](#)

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So the crisis has finally reached us. President Vladimir Putin's budget address last week states the facts of the onset of the crisis and acknowledges that we face at least three difficult years ahead.

"We need to establish an effective system of risk management," Putin said. "It is not enough to simply respond to a crisis that has already arisen. We need to learn to predict and prevent such crises. Mechanisms and instruments for an anti-crisis government policy should be worked out in advance."

This is perhaps the first time in history that the government is preparing for a crisis in advance and not in haste. A preliminary anti-crisis plan was approved at a meeting chaired by Prime Minister Dmitry Medvedev last week. The plan consists of four parts. The fiscal policy measures include restructuring expenditures and tapping into a reserve fund (up to \$500 billion); supporting banks, which includes providing additional capitalization

and liquidity support; supporting the nonfinancial sector, including easing rules for the granting of state guarantees; and implementing social support measures.

In addition to the main budget, the Finance Ministry is also preparing a reserve in which the price of oil is set at \$60 a barrel. But is this really enough to allow us to sleep peacefully at night?

To answer this question, let's recall the situation we had four years ago. The pace of economic growth at that time plunged from 8.5 percent to almost minus 8 percent. The stock market didn't simply crash; it ceased to function. In a matter of weeks, the influx of capital changed into mass outflow. Against this background, as well as a sharp drop in oil prices and other Russian exports, the debt crisis began to spread, primarily through companies.

How did we wriggle out of that mess? The Central Bank rescued the banks, flooding them with liquidity. Companies coped with the debt problem mainly with the help of the state, borrowing money and giving it to foreign and domestic creditors. Incidentally, much of the restructured debt from that time still has not been repaid. Last time, the state was actually better-prepared for the crisis. It had accumulated substantial reserves, which then went on to support the corporate sector. To fight the 2008-09 crisis, the state spent 1.2 trillion rubles, 440 billion of which was used to subsidize companies.

This time around, everything is different. The state itself has become the most vulnerable economic agent. This makes a huge difference. Over the past few years, the government has spent a considerable portion of its reserves. The Central Bank still has its reserves, but the Reserve Fund and National Welfare Fund will no longer be much of a safety net. They just won't last long enough. On the eve of the 2008 crisis, the volume of the reserves was 8.5 percent of GDP, while now it is only 3.3 percent of GDP. On top of that, the budget's dependence on oil prices has increased exponentially. In April 2008, the deficit, excluding oil and gas revenues, was 2 percent of GDP, compared to the current 12.4 percent of GDP. The share of oil revenue in the income budget four years ago was 45.6 percent, and now it's 52 percent.

There is yet another stressful circumstance to be considered. Rescuing the country from the crisis four years ago, the government often made long-term instead of short-term fixes to support the economy, unlike many other countries, and got especially carried away with social commitments. As a result, the state is tackling the new crisis with a very risky budget. Expenditures in 2008 amounted to 15.7 percent of GDP, whereas the state now has taken on obligations of 23.5 percent of GDP. It will be very difficult to cut these costs. But Putin doesn't even want to try. "The adopted budget commitments cannot be significantly reduced due to their social orientation," he said. This is precisely why his budget address has done nothing to save us from economic turbulence. It lacks the most vital thing: a list of budget expenditures to be reduced or postponed until better times.

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