

World financial crisis reveals vulnerability of Russia's economy

Vladimir Volkov
1 October 2008

Shocks throughout the world financial system, centered in the financial meltdown in the US, led by mid-September to a sharp fall on the Russian stock markets. The country is facing its greatest banking crisis since the default of August 1998, demonstrating the enormous vulnerability of the Russian economy to fluctuations on the world markets.

Russia's financial crisis reached a high point on September 16-17, after the indexes of the two leading stock exchanges, the RTS and the MMVB, fell by 13-14 percent on the first day, and then by 6 and 3 percent, respectively, on the second.

On September 17, the Federal Service for Financial Markets decided to stop the trading of shares on both exchanges. They were only reopened two days later, on September 19, and then just for a few hours.

"This has been something absolutely irrational," declared Sergei Grechishkin during the rush of events. He is president of the "KIT-Finance" bank, which was threatened with bankruptcy and began negotiations over the sale of its shares to a strategic partner. "We are witnessing completely senseless closing quotes, since, if you look at several indicators for the companies, the good news is phenomenal, but nobody wants to buy these shares, everyone wants to sell them."

The crisis has entered a phase, he continued, "when no one is making rational decisions anymore."

"The current prices cannot be adequately explained," Andrei Kilin, assets manager at "Alfa Capital," told the newspaper *Kommersant* September 17. "Many companies are trading lower than their actual capital, and the capitalization of several is even lower than the monetary resources of the companies' own bank accounts."

In response to the initial panic, the Russian government announced several wide-ranging emergency measures aimed at temporarily stabilizing the situation. It announced unprecedented aid to the banks in the amount of 1.5 trillion rubles (\$60 billion). As a whole, the Ministry of Finance and the Bank of Russia are prepared to pour up to 3 trillion rubles into the financial system.

The Central Bank made the decision to sharply lower the standards of obligatory reserves for credit organizations, which would allow them to free up as much as 500 billion rubles (\$20 billion).

At the same time, the Central Bank compiled a "red list" of 15 banks that are experiencing the most serious problems in meeting debt obligations and that need immediate financial assistance. All 15 banks are on the list of the country's 50 biggest financial organizations.

The Russian stock exchange indexes reached their height in May of this year, after which they have steadily fallen.

While the RTS grew by approximately 250 percent from 2006 through May 2008, over the last four months it has lost more than half of its value, and the capitalization of the RTS has fallen by more than \$100 billion.

Several foreign and domestic factors have prompted these developments.

As the *Financial Times* of London reported September 18, the election of Dmitry Medvedev as the new president of Russia raised the hopes of foreign investors for the regime's liberalization. However, by the end of May, problems began for the oil company TNK-VR, half of which is owned by British investors. Following pressure organized by Russian shareholders, the main director of the firm, Robert Dudley of Britain, was forced to leave Russia, and control over decision-making in the company passed into the hands of Russian partners.

This event was seen by Western capital as evidence of increased political risk involved in remaining in Russia.

Fear intensified after Prime Minister Vladimir Putin met with magnates of the metallurgy industry. He accused Igor Ziuzin, owner of the Mechel company, of manipulating prices. Moreover, Putin threatened to send a physician to his home to treat him, since the latter did not appear at the meeting, citing ill health as an excuse.

Mechel, whose shares are traded on the New York Stock Exchange, lost half its capitalization because of fear that the company is doomed to failure.

Then Russian anti-monopoly officials began to investigate the manipulation of prices in the major metallurgical companies; soon the investigation was widened to include the producers of fertilizer and cement. Investors began to fear that, because of government regulations, these companies are losing part of their profitability.

Finally, the war with Georgia increased fears that the Kremlin is acting capriciously. Figures about international reserves published by the Bank of Russia indicate that, from September 12-19, at the height of the crisis, the flow of private capital out of Russia reached about \$10 billion, and from August 8--the moment that war began in South Ossetia--from \$20 billion to \$50 billion.

"Such a massive outflow [of capital]," wrote *Kommersant* on September 26, "can justifiably be seen as the main cause of the crisis on the Russian financial market."

Edward Parker, head of the Fitch analytical group, told the *Independent Gazette* on September 19, "The harmful combination of instability on global financial markets, the lowering of oil prices, war in Georgia and concern over corporate management reduces the interest of investors in Russia and increases pressure on the banking sector."

The crisis has resulted in a significant fall in the value of Russia's main enterprises.

Capitalization of the Nornikel company on the RTS exchange has been cut half, from \$53 billion to \$23 billion. The market value of System company has shrunk on the RTS from April through September from \$13.7 billion to \$6.5 billion. Severstal has lost almost \$10 billion since April; Lukoil has lost almost \$25 billion in value in less than six months.

After its shares fell by 20 percent, the market value of Gazprom, the state gas monopoly, plunged \$150 billion on September 17.

Russian companies are finding it more difficult to gain access to international financial markets insofar as foreign creditors doubt they will get their money back. By the end of this year, Russian companies must refinance their foreign debts by the overall sum of about \$45 billion. In the last year alone, borrowing by the corporate sector reached \$136 billion, or 10.7 percent of Russia's GDP.

The crisis in Russia has been partially cushioned by the enormous reserves accumulated by the government on the wave of high prices worldwide for raw materials and energy resources. Since the end of the 1990s the Russian economy has demonstrated an impressive growth rate (from 5.5 to 10 percent per year), the GDP has more than doubled, and the gold reserves are now 60 times greater than a decade ago.

On September 19, the reserves of the Central Bank stood at \$559.4 billion. While this represents a loss of \$40 billion since the beginning of August, the regime still has significant room to maneuver.

Meanwhile, the astronomical sums the Kremlin is prepared to devote to plugging the holes in the financial system underscore, much like in the United States, the real class character of the current regime. Despite propagandistic rhetoric about defending the interests of "the middle class" and supposed concern about the socially deprived layers of the population, the actions of the Kremlin are fully determined by the interests of a narrow layer of the ruling elite.

The plans for budget expenditures for 2009, in which Russian education is to receive 423 billion rubles and the health system 485 billion rubles, pale in comparison with the resources that were poured into the pockets of financial parasites and oligarchs in the course of a few days.

In his speech before 50 leading businessmen on September 15, President Medvedev said: "Despite what happened in August [the war in Georgia and increased conflict with the US] ... nothing in the principles of our economic policy will change. There needs to be no shift in priorities. We need neither the militarization nor the nationalization of the economy."

"Our policy remains unchanged, there will be no change in Russia's economic model," Putin said at a meeting in Sochi with leaders of major world companies on September 18.

During the recent financial crisis, the government announced the lowering of export duties on oil and petroleum products: from October 1 they will be \$372.2 and \$263.1 per ton respectively. The savings for oil magnates

will be about \$5-5.5 billion.

Vice-Premier Igor Sechin also declared the necessity of raising the non-taxable minimum for the extraction of oil and minerals from today's \$9 per barrel to \$25 per barrel. In this case, the oil companies will save about \$13 billion per year.

There no limits to the sacrifices the Kremlin will demand of society to save the profits of the oligarchs standing behind it and the bureaucrats tied to them. The situation of the majority of workers in Russia, despite a certain increase in wages, is worsening because of the continuing destruction of the social system left over from the Soviet period, and because of the galloping surge in prices. According to conservative estimates, the rate of inflation is expected to reach 16-17 percent this year.

From January to May, the price of a minimum consumer food basket grew by almost 20 percent; by the end of the year it might increase by 36-50 percent. Prices for food in Russia grew in the first half of this year almost four times more than in the countries of the European Union.

Wage arrears are also growing. According to Rosstat, in August alone, arrears nationwide increased by more than 14 percent, including more than 20 percent in the manufacturing sector. About 200,000 people face delays in receiving their wages.

It is worth noting that, according to a poll conducted by VTsIOM in August on the occasion of the tenth anniversary of the 1998 default, 68 percent of those polled said that Russia has not emerged from the financial crisis of a decade ago.

Today's shocks on the financial markets have clearly demonstrated that the economic growth of the last 10 years has led not to increased independence of the Russian economy, but, on the contrary, to its wide-scale subordination to the structures of the world capitalist market.

This growing dependence, which threatens the wellbeing of the majority of citizens, renders impossible a return to the model of national-autarkic development that was characteristic of the policy of the Soviet Stalinist bureaucracy. This also lays the objective foundation for the rebirth in Russia of the authority of international socialism as the only viable alternative to the destructive convulsions of the world capitalist market.



To contact the WSWS and the Socialist Equality Party visit:

wsws.org/contact