Russian metallurgy giant Mechel faces bankruptcy

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The Russian company Mechel, one of the country's largest metallurgical firms and its biggest producer of coking coal, is heading towards bankruptcy.

Mechel's stock fell by 50 percent in recent days, as it became clear that no agreement had been reached between the firm and its creditors. The company's collapse threatens the jobs of 72,000 employees and thousands of suppliers, as well as the livelihood of workers in dozens of Russian cities in which Mechel is the primary employer. It comes alongside a raft of other negative economic news for Russia, including industrial layoffs and a sharp fall in the value of the ruble.

Mechel, which has 22 large enterprises and diverse investments in ports, rail, energy, mining, and metals production, owes $8.3 billion to Russian and foreign banks, including Gazprombank, VTB, Sberbank, Unicredit, ING and Société Générale. In 2013 the company spent $742 million servicing its debt, against a net income of just $730 million. VTB head Andrei Kostin recently told the online press outlet Gazeta.ru that Mechel's debt could not be restructured, describing it as a "burden too large to bear."

At its peak, Mechel's value was estimated at $24 billion. Over the last six years, however, the company's market capitalization has fallen dramatically and now stands at just $700 million. Declining global metal prices are the primary reason for the company's distress. Mechel first encountered difficulties during the 2008-2009 world economic crisis, when it faced margin calls from its creditors demanding that the company either repay its debts or put up further collateral. Mechel received a government bailout at the time, along with a number of other major Russian companies.

However, Mechel has continued to spiral downward, in part due to the subsequent slowdown of the Chinese economy, a primary market for Mechel's goods and services. According to *Market Leader*, international sanctions directed against Russia by the US and Europe have further undermined Mechel's chances for survival by putting a liquidity squeeze on Russian banks. It has also been more difficult for the metallurgy giant to find overseas investors.

The company's looming default has sparked anxiety within the federal government over the eruption of social discontent in those regions where Mechel's enterprises are the primary source of jobs. The Kremlin reportedly has a five billion ruble (US$129 million) fund set aside to expend on nine cities in 23 regions that will be hit by Mechel's collapse.

"In order to ease social tension and prevent a repeat of the 'Pikalevo scenario,' the government is prepared to allocate the means to overcome the crisis to these cities," wrote Gazeta.ru on September 25. "They will be directed towards programs for the creation of new businesses, and the re-training of residents and their transfer to new regions." The "Pikalevo scenario" is a reference to the violent protests that erupted in Pikalevo in 2009 over the closure of the city's aluminum and related enterprises. Widespread layoffs led to the shuttering of four out of every five shops in the small city southeast of Saint Petersburg. Residents, facing hunger and food shortages, raided the mayor's office and blocked roads to demand jobs, wages and government support.

The effects of the Mechel bankruptcy, which is expected to directly impact 23 regions in Russia, will far exceed the government's five billion ruble fund. The government's current rescue plan is only directed at helping nine of the Mechel "monotowns" (cities that depend almost exclusively on the company). In 2010, the Russian Minister of Regional Development estimated that one trillion rubles would be required to modernize just 100 of the country's single-industry cities.

In an expression of anxiety over a looming socioeconomic crisis, the Ministry of Industry and Trade

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absurdly claimed that production at Mechel enterprises would not be impacted by the company's default. He described the recent announcement by Russian Minister of Economic Development Aleksei Ulyukaev that Mechel's bankruptcy was "inevitable" as a provocation, reported Slon.ru.

There are other signs of Russia's mounting industrial and monetary crisis. AvtoVaz, the linchpin of the Russian auto industry, recently announced it will cut its workforce almost in half by 2020, laying off 25,000 workers. In mid-November of this year, 700 people will be let go, on top of 2,000 white collar jobs just axed.

The value of the ruble has fallen dramatically in recent weeks, hitting 39 to the dollar for the first time ever last Friday. The World Bank revised downward its projected growth rate for the Russian economy for 2015 from 1.5 percent to 0.3 percent and said that the country is on the brink of recession. Russian labor productivity has stagnated, with official statistics recording a slide in the labor productivity growth rate to 1.8 percent in 2013, down from 3.1 percent the previous year.

Deputy Director of the Center of Labor Research at the National Research University Rostislav Kapelyushnikov told Gazeta.ru, "The growth of wages is decreasing now and, it's entirely possible, will come to a complete stop. People's living standards, which are based not just on incomes but also on different social payments, will worsen. The prospects are not good."

The Russian Ministry of Economic Development just revised upwards the expected inflation rate for 2014, raising it to 7.5 percent from the 5 to 5.5 percent that it had estimated in June of this year. According to the Central Bank, increasing food prices, which have shot up since the imposition of Western sanctions and Russian counter-sanctions, are the primary cause. For instance, since early August, the cost of potatoes in Kaluzhsky province has risen by 43.8 percent. The price of pork in the Moscow region has risen by 37 percent over the same period.

A longstanding lag in investment in Russia's agricultural sector has meant that the country is poorly positioned to fill holes created by sanctions on imported foodstuffs with domestically produced goods, particularly meat and dairy products. This has resulted in calls for government support for an import-substitution regime that would make cheap credit available to agricultural producers.

Last week the Ministry of Finance posed one again the necessity of raising the retirement age in Russia, indicating that the government will eventually run out of money to meet pension obligations.

According to a September 25 article in Gazeta.ru, the government is working out the implications of a variety of economic scenarios, including one in which the Gross Domestic Product falls by 10 percent, the value of the ruble slumps to 48 to the dollar, and the price of a barrel of oil declines to $80. One commentator told the online newspaper, "This scenario could occur not only under conditions of a fall in oil prices, but also in the event of limits on Russian oil-gas exports due to sanctions." The Ministry of Economic Development denied that it is considering such a scenario.

In the face of Russia's deepening economic crisis and intensifying geopolitical conflict with the United States, a segment of the ruling elite is considering a major shift in economic policy.

On September 22 Sergei Glazev, a top advisor to Putin and leading figure in the ruling United Russia party, proposed that Parliament consider measures that include increasing the budget deficit by five-fold, sharply cutting business taxes, imposing a tax on capital flight and investing half of the country's gold reserves in what *Nezavisimaya Gazeta* (NG) describes as "the technological rearming of enterprises, the initiation of high-tech production, the creation of developed infrastructure in the form of high-speed motor and railways, doubling residential and social construction by 2025, [and] the development of a 'knowledge economy.'"

As NG pointed out, these measures are at odds with the current policy of Russian Prime Minister Dmitri Medvedev, which has committed itself to taxing business in order to fund the budget and maintaining fiscal discipline in relation to the country's large gold reserves.

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