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# Russia and the Crisis of the Global Economy

**A report of the Institute of Globalisation and Social Movements**

In the early weeks of 2008 virtually all Russian and foreign experts viewed the situation in the world economy favourably. Warnings from a few analysts that a major economic crisis lay ahead were not taken especially seriously by optimistic-minded populations.

On 22 January the stock exchanges were shaken by the first slump, followed by a series of new collapses. The world's share markets were destabilised. Inflation accelerated, with food prices beginning to rise sharply. A number of American and European banks announced colossal losses in their results for 2007. The scale of the economic problems in the US became evident. A new world crisis had begun. The emergence of its first symptoms provoked numerous questions concerning the nature of the crisis, the reasons behind it, and the logic shaping its probable development.

## 1. Major Conclusions

### The Development of the Global Crisis

1) At present the world economic crisis is at an early stage, manifesting itself primarily in the area of finance (destabilisation of stock markets, bank losses, growing inflation, and rising interest rates);
2) The worst effects of the crisis have been felt by the economy of the US, where a commercial crisis and a decline in industrial output are in prospect;
3) Following the fall in demand on the American market, the crisis will spread to the "new industrial countries", where production will start coming to a halt;
4) The contraction in sales and in world industrial output will lead to new collapses on the world's stock markets and a shift from inflation to stagflation. Oil prices will fall, the number of unemployed will rise, and a massive decline in consumption will take place;
5) The crisis will affect all countries that are part of the world economy, and will usher in a prolonged depression. The global economic destabilisation will have enormously destructive consequences;
6) The likely time-frame for the development of the crisis is as follows. The year 2008 will see a recession in the US and the beginning of an industrial downturn in other countries. The peak of the crisis (the most severe decline) will be experienced in 2009 and 2010, while the years from 2010 to 2013 will see depression and a restructuring of the world economy for new development;
7) The governments of the countries of the world do not have strategies for overcoming the crisis, and because of their underestimation of the crisis and their lack of interest in carrying through indispensable changes, the likelihood of their developing such strategies before the crisis reaches its peak phase is extremely remote;
8) There is no reason to expect that the crisis will pass quickly, and its drawn-out character will aggravate political and social conflicts in most countries of the world;

## The Nature and Consequences of the Crisis

9) The world economic crisis which has now begun is systemic in nature. It is conditioned by the contradictions of the neoliberal model of capitalism, with the world economy unable to develop further in the old manner. The potential of economic policies based on systematically lowering real wages while stimulating consumption has been exhausted;
10) The decline of consumption in the "old industrial countries" has brought about a loss of effectiveness of the economic model based on exploitation of cheap labour power in the Third World. Further reductions in commodity prices through the superexploitation of labour power are impossible, since the scope for intensifying this exploitation has been almost exhausted;
11) Inflation is one of the manifestations of the global crisis, and arises from changes in the relationship between the volume of commodities and of money in the economy. Housing is being devalued, as are many shares. With the American mortgage crisis, the buying power of the population has fallen;
12) The crisis heralds the replacing of a downward trend in the development of the world economy with an upswing; as a crisis of shifting waves, it will be severe and drawn-out;
13) The crisis will not be overcome until the contradictions that caused it are resolved, and until the development of the world economy receives a new technological impulse (above all in the area of industrial innovation, which will bring about a cheapening of commodities);
14) As a result of the global crisis world energy consumption will grow. New sources of energy will be developed, and the importance of hydrocarbons will decline;
15) The crisis will lead to the breaking down of isolated labour markets, and will expedite the formation of a single world market for labour;
16) The crisis will help to strengthen global monopolies, and will increase their role in the world economy. The importance of medium and small business will decline still further;
17) The crisis will lead to a resurgence of the policies of protectionism, which will become a powerful tool of global corporate competition;
18) The international division of labour will become more marked. It is logical to expect reindustrialisation in the "old industrial countries";

## Impact of the Crisis on the Russian Economy

19) For the present, the impact of the crisis on the economy of Russia remains insignificant, affecting primarily the financial sphere;
20) The economy of the Russian Federation is continuing to grow, but the country's consumer market is under pressure from inflation. This is preparing the way for national commercial and mortgage crises;
21) The advent of the global crisis in Russia will be delayed, probably occurring later than in the "new industrialising countries" and in the European Community;
22) Under the impact of world-wide economic trends, Russia's economy may experience a serious weakening even while oil prices on the world market remain high;
23) The decline of world oil prices will lead to a crisis in Russia's national economy, to a collapse on the share market, to a fall in industrial production and an increase in unemployment, to a strengthening of inflation, and to sharply reduced consumption;

24) The global crisis will be especially severe for Russia due to the orientation of the country's economy to raw materials exports;
25) The emergence of the country from the crisis will be associated with major structural changes in the economy, with social unrest, and with a decline in the role played by the raw materials corporations.

# 2. The Systemic Crisis of the World Economy

## 2.1. The First Signs of the Crisis

News of a sharp drop in the profits of the Citigroup banking group led on 15 January to a fall on the New York Stock Exchange. The Dow Jones index of industrial activity declined by 2.2 per cent and Standard & Poor's by 2.51 per cent, while the Nasdaq Composite lost 2.45 per cent. On 21 January a dramatic fall in share prices occurred in all the major world markets. Trading on the stock markets of Frankfurt, London and Paris ended with falls of 7.16 per cent, 5.5 per cent and 6.83 per cent, the largest for six years. In Russia the figure exceeded 8 per cent. A negative role in the unfolding of the stock market crisis was played by the tax cuts, the "Republican panacea", which had been proposed by President Bush, and which were incapable of improving the economic situation in the US. The announcement by the administration that taxes would be lowered merely heightened the stock-market panic.

The crisis that seized hold of the world's leading stock exchanges on 21 and 22 January arose from the discovery of a divergence between the profits of companies and their capitalisation. The fall on share markets was sparked by reports of low profitability, and also of large losses suffered by leading banks. Share prices tumbled, with prices falling even for the securities of "healthy companies" for which there was no news on the markets of losses or reduced profits. Even Russian corporations such as Gazprom suffered serious losses. The stabilisation that followed the declines of late January was not to be long-lasting. The share markets entered a phase of instability which immediately found a reflection in the markets for commodities. Governments and economists promptly sought to reassure the public, explaining that all that had happened was a "share price correction". But after no more than a week, falls were again being observed on the world markets.

On 28 January declines on numerous share markets were again noted. On 5 February a massive fall took place on American and European stock exchanges. Then came another period of calm, followed by a new slump on 17 March.

On the London stock exchange on 5 February, the all-up value of quoted shares declined by 2.3 per cent. On the Frankfurt stock exchange the fall amounted to 3.36 per cent, in Brussels to 3.17 per cent, in Milan to 3.07 per cent, and in Amsterdam to 3.34 per cent. In Paris prices dropped by 3.96 per cent. In Madrid the fall on the stock market was even greater, amounting to 5.19 per cent. The greatest price losses were suffered by the shares of banks and of European car firms. The French company Renault lost 7.4 per cent of its value. Shares in Peugeot were cheaper by 6 per cent, and in the Italian company Fiat, by 6.5 per cent. Shares in the European aerospace firm EADS lost 6 per cent.

The stock-market slump in Russia was also significant. The RTS Index, one of the main Russian share price indicators, fell by 3.38 per cent. The MMVB dropped by 4.04 per cent. Major losses were taken by Sberbank Rossii, whose shares lost 5 per cent on the MMVB, and by the corporation Rosneft, which lost 5.7 per cent on the RTS. The overall decline in the price of Russian blue chips was in the region of 5.7 per cent. The recovery after the collapses of 21, 22 and 28 January was short-lived, showing the extent to which the share markets had lost their previous dynamism.

In the US on 5 February the Dow Jones index, calculated on the basis of the overall share prices of thirty leading American corporations, fell by 2.53 per cent. The Standard and Poor's 500 index lost 2.67 per cent. The IT index NASDAQ was down by 2.54 per cent. It is significant that the fall in the US was less marked than in the countries of the European Union and in Russia. The myth of the independence of national economies, a myth holding sway above all in Russia, suffered another blow. The difference showed how strongly any weaknesses in the US economy are felt in the world as a whole.

On 14 March, signs of another fall began appearing on the American stock exchanges. In order to forestall the looming catastrophe, the US Federal Reserve System (FRS) the refinancing rate to 3.25 per cent. But the lowering by 0.25 per cent of the discount rate at which US banks receive credit did not have a positive effect. Among the factors helping to cancel it out was a decision, unprecedented since the Great Depression, to grant credits directly to large financial corporations. The FRC's decision to provide financial assistance to the bank J.P. Morgan Chase & Co. in order to purchase the investment bank Bear Stearns for $236 million caused the share prices of other large US banks to tumble. On 14 March the price of shares in Bear Stearns fell by 47 per cent. Not even a trace remained of the firm's once-impressive capitalisation. Only a year earlier, Bear Stearns had been worth $20 billion.

On 17 March, evidence of the deplorable state of the American banking industry sparked a world-wide panic. With no basis for the high share prices of companies that were in trouble, traders began unloading shares in these firms on a massive scale. Falls ensued in all of the world's large securities markets. The Russian RTS dropped by 4 per cent, and the losses on European markets were similar. The British FTSE 100 index fell by 2.93 per cent. The Japanese Nikkei 225 dropped by 3.71 per cent. From Asia to the US, not a single stock market held up.

Simultaneously with the chain of initial falls on stock markets around the world, inflationary processes began to accelerate markedly. This was reflected primarily in a growth of food prices which affected virtually every country on the planet. According to official figures, between the beginning of the year and the end of March 2008 the prices of vegetables and fruits in Russia increased by 23.5 per cent and 14.9 per cent respectively. Grains and bread products were more expensive by 6.9 per cent. On world markets, numerous food commodities rose in price by 40 or even 60 per cent. More than a billion people were forced to reduce the quality of their diets, cutting out essential foodstuffs. In many regions of the globe, the problem of hunger grew markedly worse. The first mass protest actions occurred.

## 2.2. Anti-Crisis Measures and Recession in the US

Drawing on their experience of the crises of 1998-1999 and 2001, the governments of leading countries prepared to beat off the new economic destabilisation by creating massive financial reserves.

Russia formed a Stabilisation Fund of $548.1 billion. China had huge reserves of gold and foreign currency amounting to $1.68 trillion, 70 per cent of it in dollar-denominated form. The Eurozone had more than $500 billion at its disposal, and Japan $1.02 trillion. The reserves of gold and foreign currency of the US were relatively small, a fraction of those of Japan. Meanwhile, by the end of 2007 the US national debt had reached almost $10 trillion, while the total indebtedness of the federal government, of the states and of US corporations amounted to $40 trillion. For purposes of comparison, world GDP in 2007 amounted to $61 trillion, after annual increases of 4 per cent in 2001-2005 and of 3.1 per cent in 1991-2000. In order to service its debts and cover its budget outlays, the US government was forced each year to attract some $400-500 billion in foreign funds, through the sale of long-term FRS bonds.

As an anticrisis strategy, all countries proposed to give financial aid to corporations that had got into difficulties, helping to restore their normal functioning. Governments also planned to direct financial resources to maintaining stable currency exchange rates and securities prices.

As the first months of the new global crisis demonstrated, however, none of these measures were effective. They aided in the short-term stabilisation of stock markets, and temporarily restored the solvency of corporations, but did not relieve the causes of the crisis. The result was merely to postpone shifts in the phases of development of the crisis.

In the US, steps to lower refinancing rates, financial bail-outs of companies and the temporary stimulating of demand through returning a portion of tax revenues to the population (the "Bush plan" to return $168 billion to consumers) could not save the national economy from entering the crisis zone. Unemployment in the US is increasing. For lack of credits, 28 million Americans are using food stamps (in 2007 this figure was 26.5 million). In March the US economy shed 81,000 jobs, followed by another 20,000 in April. The number of officially recognised jobless in May rose by a further 5 per cent. The total number of unemployed in the US amounted to 5.5 per cent of the able-bodied population, the highest figure for twenty years. Of 8.5 million jobless, only 3.1 million were receiving benefits. According to official data, the average monthly increase in the number of unemployed has now reached 5 per cent, which does not include immigrants or large numbers of US citizens.

For the first time in five years, economic activity by companies in the service sector has declined. In the sectors of retail trade, transport, finance, property and health care, employers are cutting their staff numbers. Consumption is also declining. According to economists, demand remains stable only for foodstuffs. In all other categories, the volume of sales is down. The US is also suffering from a significant problem of inflation, which according to various calculations has been running since the beginning of the year at between 4 and 7 per cent. The banking industry is in a parlous state. Vast sums from throughout the world have been thrown into saving it, but the financial transfusions have not yielded firm, positive results. The banking group Citigroup, which was the first to suffer from the crisis, has been selling assets and is trying to strengthen its position through share issues.

Over the past six months, industrial production in the US has shrunk by between 1.2 and 1.5 per cent. There is every reason to suppose that in the coming months problems in disposing of goods will have a stronger effect on the productive sector. In the first quarter of 2008 US GDP grew by only 0.6 per cent on an annualised basis, compared to 2.2 per cent in 2007 and 3.3 per cent in 2006. In the view of United Nations analysts, there are two likely scenarios for the American economy. In the pessimistic scenario, US GDP contracts in 2008 by 1.2 percent, while the optimistic one has it rising by 1 per cent. Such assessments, however, are based on the extrapolation of trends characteristic of the current state of affairs. This is fundamentally wrong, since the crisis in the global and US economies is developing in definite stages. At present it is in an early stage, affecting mainly the financial sector. Soon, the crisis will appear more fully in trade and services; later, it will make its effects felt in industry. The result for the US economy will be that the year culminates in a noticeable fall in GDP. At a minimum, this decline could amount to 4 or 5 per cent, while at a maximum it could be much higher. Meanwhile, no-one should count on 2008 being the worst year of the crisis, or the year which sees it surmounted, since the fundamental contradictions which gave rise to the global destabilisation will not have been resolved.

In the mid-1990s the share of financial services in the GDP of the US surpassed that of industry. Between 1973 and 2008 the share of manufacturing in GDP fell from 25 per cent to 12 per cent. The portion represented by financial services rose from 12 per cent to 20-21 per cent. Some 4-5 per cent of the growth of GDP in the financial sector between 1990 and the first decade of the new century was linked to the mortgage boom. Between 1987 and 2007 overall indebtedness in the US grew from $11 trillion  to $48 trillion, most of it in the private financial sector. The bursting of the consumer “soap bubble” will lead inevitably to an unprecedented number of bankruptcies, most of them in the financial sector.

Contrary to the general view, the negative US trade balance is not playing an important role in the development of the crisis, since it is covered by the repatriation to the country of corporate profits. The foreign goods that enter the US market are often produced in enterprises belonging to American firms. The huge retail network Wal-Mart thus owns more than 700 factories in China. While making big profits in the American retail market, however, US corporations for many years have pursued a policy of reducing their spending on labour power, spending that has been directly responsible for creating that market.

Other countries, including Russia, are entering the world crisis only after a substantial delay compared to the US. This tendency is evidently going to persist throughout 2008. At the same time, it is possible to predict that the fall in oil prices will hold off until 2009, in practice until the global crisis passes into the phase where it will afflict industry. The crisis on the financial markets is spurring investors to engage in speculative operations involving the purchase and sale of oil, returns from which are considered more reliable. During the first five months of 2008, while demand for oil remained effectively stagnant, prices grew by more than a third. In tactical terms this trend might appear advantageous for Russia, but strategically it increases the risks for the country that are associated with the crisis.

Along with the US, European countries including France, Great Britain, Ireland, Switzerland, Luxembourg and Spain have also begun experiencing economic problems. The 2007 profit figures of one of the largest French banks, Crédit Agricole, fell short of projections by 16.8 per cent. The company’s losses on the US mortgage market during the first quarter of 2008 came to 1.2 billion euros. Another French bank, Société Générale, announced that it had written off 1.18 billion euros in credit instruments, and that net profits during the first quarter had fallen by 23 per cent to 1.1 billion euros. The largest Swiss bank, Crédit Suisse, announced losses of $2.85 billion. Still greater losses were suffered by Europe’s largest bank, UBS AG. In the fourth quarter of 2007 these losses came to $13.7 billion. In connection with the American “popular default” (massive non-payments on housing mortgages), the banks of the world have already written off a total of more than $320 billion. Merrill Lynch and UBS have almost completely run out of capital. Morgan Stanley, the Mizuho Financial Group, Citigroup and Washington Mutual have suffered losses amounting to a third of their capital. Aggregate losses in the mortgage market and in the debt securities market associated with it have been put by the IMF at $565 billion. This figure was reduced under pressure from the US; earlier, the IMF assessed potential losses at $945 billion. Reports are continuing to appear of losses borne on the US mortgage market. The size of the gradually crumbling pyramid of mortgage credits is put at $10.7 billion.

The collapse on the US property market has left house prices dramatically cheaper. The Case-Schiller Index, which measures the cost of property in the United States, has dropped to its lowest level in twenty years. On a national scale, the index of housing prices for the first quarter of 2008 fell by 14.1 per cent compared with the same period of 2007, reaching its lowest point since 1988. The market is saturated with houses and apartments repossessed from borrowers. In 2008 there have been foreclosures on more than a million homes as a result of failure to meet mortgage payments. Housing, which makes up a colossal segment of the American market, is continuing to be devalued. Over the coming months the decline in the value of housing could reach from 10 to 25 per cent.

The victims of the continuing “popular default” in the US have also included commercial institutions in Japan and Thailand. The American mortgage crisis has had an indirect impact on the entire world banking system, resulting in a shortage of cheap credit. Without constant financial transfusions, the banks of the world periphery have finished up in difficult circumstances, as “local” problems with debtors have begun to pile up for them. The first difficulties have appeared with servicing credits provided by foreign banks. There has been an outflow of bank investments. Following immediately on the global stock market crisis, a financial crisis has arisen; it is simply a new manifestation of the general world economic crisis. Faced with a shortage of bank liquidity, governments have used diverse measures to provide companies with the funds needed to bail them out.

In Russia, the authorities have placed money from the Pension Fund on the books of problem banks. Of the countries of the former Soviet Union, it is Kazakhstan that has finished up in the worst position. Kazakh President Nazarbaev has acknowledged that the economy of his country is in a profound crisis. The reason is financial problems, or more precisely a banking crisis, caused by the impossibility of servicing cheap foreign credits. Money has started to flood out of Kazakh banks, whose ratings have fallen sharply. The government of Kazakhstan has allocated $4 billion to help the banks, out of the country's overall financial reserves of $40 billion. But neither this sum, nor Kazakhstan's holdings of gold and foreign currency, will suffice for long. The strict austerity measures of which Nazarbaev speaks will likewise have little effect. For the governments of other countries to apply such measures will also lead only to a deepening of the crisis. Obtaining a reprieve for the corporations through cutting consumption further will not only fail to relieve the contradictions responsible for the crisis, but on the contrary, will exacerbate them.

US officials maintain that the negative trend can still be overcome, and a global spread of the crisis averted. American analysts who early in the year had agreed with the government's optimism are now more pessimistic. The refinancing rate has been lowered to 2 per cent without significant effect. The stock market is in a state of limbo. Since May, citizens have been having tax revenues returned to them. The payment process will take two and a half months, and depending on the size of their incomes, taxpayers will receive back sums from a few hundred dollars to $2400. The maximum payments will be received by families earning around $150,000 per year and who have three or four children. So far, however, the hopes of the officials that financial stimulation will help to increase consumer activity have not been borne out. People are preferring to spend their money paying off debts and on creating stockpiles of food. US firms are still trying to cut costs by attacking the work conditions of employees, which is doing nothing to encourage an increase in consumption. Returning the debts of the population to the banks through the mechanism of tax benefits might reduce the pressure on US financial institutions to some extent, but is not doing away with the general crisis trend in the consumer market.

The calculation in Washington is that through combining low-cost credit for corporations with temporary measures to stimulate demand in the domestic market, enough time can be bought to allow an economic recession to be avoided and the crisis period to be successfully negotiated. The assumption is that the crisis is a temporary inconvenience that will pass of its own accord. But the standard responses being implemented by the authorities are not making an impact on the cause of the crisis, which for the world economy is of a systemic character.

There is no reason to think that a new lowering of the refinancing rates will be more effective. Nor are there grounds for supposing that a one-off subsidy to the population will increase its effective demand, which has declined for objective reasons. In conditions of falling demand, providing companies with financial bail-outs will not restore them to effective operation. The upshot is that the anticrisis measures now being applied in the US are failing to stop the development of a whole range of negative trends in the economy, and are merely providing a temporary respite. This is capable of lasting for a few months, but by early autumn new symptoms of the crisis developing in the US can be expected to appear.

### 2.3. Origins of the Global Crisis

Of the analysts who toward the end of 2007 were denying the likelihood of a crisis, most are now explaining the negative processes in the world economy as consequences of the mortgage crisis in the US. In the view of neoliberal economists, the crisis is simply the result of collective errors committed by the executives of a series of corporations, and will come to an end as soon as the situation in the financial arena improves. Virtually all governments hold to an analogous position. The authorities in Russia have repeatedly expressed confidence that the financial crisis will not affect their country's economy, but on the contrary, will have a positive impact on it. Studying the origins of the global crisis shows, however, just how superficial such evaluations are, along with the naivety of national-messianic hopes.

Throughout 2007 there was growth on virtually all the world's stock exchanges. It was only toward the end of the year that the US share market, the largest and most important in the world, began encountering setbacks related to the mortgage crisis. Vigorous growth was a permanent condition on the German share market; the DAX index recorded an outstanding result of 22 per cent. British shares rose by 3.8 per cent, and French by 1.3 per cent. The Russian share market developed successfully last year, with the securities of electrical generating firms showing particularly strong growth. In the course of 2007, however, the world economy showed increasing signs of weakness, which analysts for the majority of corporations ignored in their public statements.

A whole series of facts bore witness to the approach of a world economic crisis. The increase in output in the "newly industrialising countries" was supposed above all to service consumption in the wealthy US and European Union. But as a result of the departure of numerous industries from these "old industrialised countries", real wages in these parts of the world were steadily declining, strengthening the trend to partial and unstable employment. "Good jobs" in the First World were replaced by low-paid jobs in the countries of the periphery, where neither trade unions nor social and labour legislation existed. During the "welfare state" period from 1949 to 1973 government employment policies, together with high unemployment benefits, had ensured strong demand along with stable living standards. But in the modern Western economies, the trend was toward irregular incomes even in families where members held jobs. In the early 1990s the average American had spent 25 per cent of his or her income on housing, but by 2005 this proportion had risen to 50-60 per cent. The workers' organisations of the West, which in the period from 1949 to 1973 had guaranteed people relatively high living standards, had been weakened (in the case of the trade unions) or had degenerated (in that of the social democrats). Meanwhile, the social base of these organisations had narrowed as a result of the export of whole sectors to the countries of the periphery.

The ideal place to which industries could be transferred was China, which allowed transnational corporations a 20 per cent "discount" on the price of its labour power. The industrial boom in the Third World proceeded in tandem with the initial proletarianisation of hundreds of millions of peasants. Tearing themselves away from the natural economy, they became hired workers and consumers (for the most part very poor ones). Production became concentrated increasingly in the "countries of the South", while the principal sales markets remained in the "zone of the North". Declining demand in the US, Great Britain, the European Union and a series of other countries could not be made up through consumption by the middle layers on the global periphery. The reduction of consumption in the centre turned inescapably into a halt to production on the periphery; this led to sackings, and automatically undermined the buying power of the local middle classes.

In the period between 1982 and 2008 the number of working women in the "old industrial countries" expanded, and unlike the situation in the 1950s and 1960s, it became a family norm for women to be employed outside the home. Workers were more often forced to work long hours or to hold several jobs in order to maintain an adequate standard of living. For some time, average family incomes thus continued to rise in the US and many other Western countries, even though average individual wages were declining. By the late 1990s, however, the percentage of people belonging to the middle class had gradually begun to decline.

Making up for the falling incomes of First World workers for some years after 2000 was an increase in consumer credit. But as the end of the decade approached, the indebtedness of families in the US and Great Britain was reaching a critical point. In 2007 a crisis of non-payments - a "popular default" - broke out in the US. Individuals who lacked sufficient means delayed or ceased repayments on their bank loans. This crisis was superimposed on the extreme financial weakening of the American state, which was less and less able to cope with the role of global hegemon. The policy of lowering taxes, pursued systematically both by Democratic and Republican administrations, ensured a redistribution of funds to the private sector, stimulating its activity, but at the same time undermining the ability of the government to aid the economy when this aid became necessary. The dollar emissions through which the Bush administration sought to cover its military spending merely accelerated the process through which the US consumer market was being weakened. By 2007 the potential for maintaining consumption through bank credits was virtually exhausted; the population was no longer able to pay even minimal interest. The banking sector was engulfed in crisis. News of the losses suffered by corporations in the previous year led to the first crashes on the stock markets, and then to the destabilisation of all the world's share markets. For some time, the negative impact on inflation in the US was cancelled out by the ability of the growing world economy to swallow the excess of US dollars. But this could not continue indefinitely.

Faced with growing problems during 2007, the corporations failed to find a solution. They concealed losses and overstated their profits. The sale and purchase at ever-higher prices of shares in companies that were masking their growing difficulties gave rise to contradictions that sooner or later had to burst to the surface. The problems on the share markets were a manifestation of the concealed problems of the entire world economy, including in the functioning of the banking sector.

It is significant that the consumer credits extended in the new century were often at interest rates incapable of covering the sums which the banks lost to inflation. The granting of credits to the population at low rates of less than 3 per cent was a direct consequence of an unprecedented global overaccumulation of capital. There was nowhere else that this capital could be invested. In the world economy, a situation had arisen in which the possibilities of the market had been exhausted. Corporations were allocating resources to increase production, but extracting profits was becoming more and more difficult. With demand falling in North America and Europe, the importance of countries with large internal markets - above all Russia, Brazil and India - grew correspondingly. In these countries, economic growth might continue even for a certain time after the crisis began. Now that consumption in the US was down, the "new giants" turned into a centre of attraction for capital, a growing proportion of which was speculative.

For two decades not only consumption in the US, but also the growth of the world economy had been maintained through the granting of credit to the population, above all to the Western "middle class". The availability of credit underpinned the high profits of corporations in the US and other countries. A contradiction arose between the producer and consumer markets. The transferring of productive capacity from the First World objectively lowered its capacity for consumption, but the profits obtained in the Third World made it possible to extend credits to the middle layers of Western society, above all in the US and Great Britain. The inevitable strengthening of this contradiction as industry was increasingly transferred from the centre of the world economy to its periphery could not fail to set off a global crisis, more severe and more complex than the usual crises of overproduction (recessions) that occurred every decade or so. The US became the first country to feel the initial blow of the global systemic crisis.

### 2.4. Inflation

For the world financial system, an unexpected development in 2008 has been an acceleration of inflation, expressing itself mainly in growing prices for foodstuffs and fuel. As the cause of the inflation, most analysts point to the higher prices for food products and energy sources, that is, to the inflation itself. Quite apart from the inadequacy of such explanations, world inflation has objective causes, linked to the general crisis of the model of the global economy. The growth of commodity prices is not the cause of inflation, but its consequence.

Even though the tempo of inflation was rising even before the chain of stock market crashes in January and March, these collapses allow us to better understand the reasons for the price rises.

A characteristic feature of international inflation is its global character. It affects all countries to one extent or another, lowering the buying power of all monetary units to varying degrees. At present, the fastest price rises are for goods of primary necessity that are constantly consumed - food and fuel. In the US, retail chains and small shops run sales campaigns when they are overstocked with unsold industrial products; as soon as the surplus is sold off, the prices of industrial goods rise in line with the general trend.

If we reflect that consumption around the world is not rising by leaps and bounds (the condition of most of the planet's population is worsening), the reason for inflation must lie in a violation of the balance between the volume of commodities and money in the global economy. The volume of money in the world economy has grown substantially, while that of industrial products has remained almost unchanged. The provision of money to purchase this mass of products has increased; the quantity of money in the economy per unit of goods has become greater. Inflation has started to accelerate because money has begun to lose its backing in the share market and the American property market, as shares and houses have been devalued. The volume of money in the market has remained as before, but the sum of commodity prices that corresponds to it has diminished as a consequence of the first signs of global crisis. As a result, the buying power of workers has fallen because of the devaluing of their wages. Consumption has started to decline, and demand has become concentrated on goods of primary necessity.

This process is now continuing to develop, opening the way for a commercial crisis which will inevitably be followed by fresh declines on the stock exchanges. This in turn will make the situation still more difficult; inflation will accelerate, industry will start shutting down, and unemployment will increase. The prices of foodstuffs will fall relative to other goods; notwithstanding the hunger in the world, food consumption will decline. The illusions of countries with favourable agricultural conditions (in particular, Ukraine, Hungary and the countries of the Balkans) in the possibility of benefiting from the global crisis will disappear. Oil prices will remain high, until the peak of the crisis causes them to crumble. The fall in production will bring an even more radical change in the relation between the volume of money and the quantity of goods. The global economy will enter a phase of stagflation.

One of the results of the massive stock market collapse, now reflecting a general economic crisis, is that there may not be a single monetary unit in the world that retains its stability. Most likely, it will be the euro whose losses will be least. Even the euro, however, could lose a significant portion of its buying power in the market. The flight of capital from the currencies of the global periphery to the euro (or to the dollar, which for the present is not very likely; the US currency is losing ground, even though 65 per cent of the world's payments are still denoted in it) will strengthen inflation in the Third World, increasing the requirements for reserve currency and transferring the problems of this currency to the national monetary units. In a multi-currency system, the law which holds that the sum of the prices of all the goods on offer is equal to the mass of money in the economy does not act in straightforward fashion. In their relation to one another, currencies are also commodities which compete for the backing represented by the mass of goods - that is, for positions within the system of economic exchange.

The governments of the US and of other countries have shown a complete unpreparedness for resisting global inflation. The Prime Minister of Russia has denied responsibility for the effect of inflation in lowering the incomes of the population. At present, no measures capable of dealing with the problem are being undertaken. In view of the profoundly systemic causes of inflation, as one of the manifestations of the crisis of the world economic model, there is no basis for expecting it to be overcome in the current year. So long as the anti-inflationary measures employed as part of the anticrisis strategies fail to address the causes of inflation, there is no way that inflation can be halted.

### 2.5. The Nature of the World Crisis

From the trends of the unfolding global crisis that are appearing at present, it is evident how much more severe this crisis threatens to become compared with the recessions of 1991, 1998-1999 and 2001. At the same time, it is clear that the global crisis which began in 2008 is not linked solely to the overproduction of commodities, but is a consequence of the systemic contradictions of the world economy. The developing crisis cannot simply cast off the accumulated mass of goods, after which the economy will once again quickly set off on a growth curve. The selling off of the goods that have overfilled the markets in the US will not restore the American and global economies to health. As a result of the crisis, several contradictions in the world economy must be resolved. This is tantamount to changing the neoliberal model for a new one.

By virtue of its nature, conditioned by the contradictions which called it forth, the crisis is destined to bring about fundamental changes in the world economic system, restoring its effective functioning.

Since the Great Depression of 1929-1933 the world economy has passed through several stages of development, several rising and falling Kondratieff waves. The years from 1933 to 1949 saw a declining wave. After the crisis of 1949, an upswing continued until 1973. This was characterised by rising prices for labour power and capital, and also by an active technological renewal of production. During this period the growing European and American industry experienced a need for labour power, which was brought in from the countries of the periphery. In Western society a Keynesian approach prevailed, and the principles of the welfare state were implemented. The educational level of the population rose sharply, and higher education became a mass phenomenon. By the early 1970s, however, the global economic system had finished up in a dead end. To a considerable degree the new crisis had arisen out of the alarm felt by the business elite at the growing strength of organised workers, now including professional people who until recently had been privileged. Major roles were played by the events of 1968 in France, and by mass demonstrations in the US. Meanwhile, the modernisation occurring in the former colonies was opening up broad possibilities for using the resources of the periphery in a new fashion.

It is evident empirically that the rising and falling waves in the world system have specific features. The duration of the waves in the interval from 1790 to 2008 varied between 16 and 30 years. The declining waves encompass periods of extensive appropriation by the capitalist centres of the resources of the world periphery. During declining waves financial operations take priority over investments in production, subordinating production to their interests. Because of the vigorous accumulation of capital, interest rates have a tendency to decline. Labour power also grows cheaper, or does not increase in price, since supply exceeds demand on the labour market. Food prices show a tendency to fall. Declining waves are characterised by progress in communications, including transport, and by slow development in the technologies of production.

Upswings, by contrast, are typified by the rapid technological progress of industry. Labour power becomes more expensive, since the demand for qualified experts is growing. Capital is also expensive, stimulating growth in the productivity of labour. The social value of knowledge increases. Rising waves are replaced by downswings when the large-scale, relatively wasteful use of resources by the world system loses its effectiveness, and only maximum rationality in their use can yield positive results. The shift from one wave to the next in the global economy proceeds by way of severe economic crises (one or several), during which the systemic contradictions of the world economy are superimposed on overproduction. The impossibility of a further evolutionary development of the world economy is expressed in an overaccumulation of capital, which can no longer be invested on favourable terms.

In the course of the four economic crises of 1969-1971, 1973-1975 (notable for the leap in oil prices and for high inflation), 1978-1980 and 1981-1982, qualitative changes took place in the world economy. As a result of the two latter crises, which hit the developed industrial countries especially hard, industry began to be transferred on a massive scale to the zone of the world periphery. By 2008 this was no longer a raw materials periphery, but an industrial one. At the same time the policy of technological re-equipping of industry, with a reliance on highly qualified workers, was replaced by an orientation to cheap labour power in the countries of the Third World. The success of the new policy was ensured by the rapid development of communications technology, above all those elements of it - computers, the internet, and satellite communications - associated with management. The speed with which capital could be relocated increased dramatically, and electronic money appeared. National monopolies from the First World were transformed into transnational corporations. The ideology of Keynesian development was replaced by the neoliberal doctrine of the open economy. The new economic epoch received the name of financial globalisation.

As a result of the globalisation of 1975-2008, a new stage in the development of the world economy, whole regions of the earth were transformed. No longer agrarian in nature, they became industrial. Hundreds of millions of people were forced to abandon the traditional natural economy and to become hired workers. Proletarianisation occurred on a scale unprecedented in world history. The realm of market relations expanded, and labour power became cheaper than industrial technologies. In the “old industrial countries”, governments began pursuing a policy of “throwing ballast overboard”. Gains of working people were liquidated, state assets were privatised, and spending on education and other social provisions was cut.

At its basis, the neoliberal economic model contained contradictions whose development made its end inevitable. The goods produced in the countries of the periphery had to be sold in the centre, in the developed countries of Western Europe and North America. But as productive capacity was transferred out of these countries, the buying power of their populations diminished. The “new economy”, the area of services and information technology, could compensate for this only to a limited degree. Growth in the consumer markets in the countries of the industrial periphery could not make up for the growing lack of demand.

During the period of globalisation capital began to move freely from one region of the planet to another, but labour power was shut up artificially within national boundaries. Corporations were able to choose any of a multitude of labour markets. Closed state borders and harsh anti-migration laws prevented workers from leaving zones where labour laws and social welfare legislation did not operate, and where people had no rights. Even if workers managed to get into the European Union, the US and other countries (including, for some time now, Russia) in defiance of the law, they remained almost without rights. These policies made it easier for corporations to cut wages for citizens of the “old industrial countries”, and also to roll back social welfare and labour legislation. The upshot was that in a whole range of sectors of the American and European economies the Third World finished up within the first. The destabilised social systems of the periphery continually threw millions of emigrants onto the labour markets in the countries of the centre. During the 1960s and early 1970s emigration from the former colonies to the West was linked to growing demand there for labour power. By the end of the 1990s, however, the mass migration was operating from inertia, spurred on by the social crisis in the South and by people’s desire to join the consumer society. In the North, these demographic and social shifts aided the growth of racist, ultra-right and neofascist political forces.

While it ensured the growth of corporate profits, the neoliberal model of the global economy could not offer the system a way out. In order to develop further, the world economy needed qualitative changes. The high corporate profits obtained through savage exploitation of defenceless workers in the Third World ensured a cheapening of capital, which in 2001 made it possible to postpone the systemic crisis through an unprecedented distribution of consumer and mortgage credits. But this was sufficient to maintain economic growth in the global system only until late in 2007.

The new world crisis began with the collapse of the credit pyramid in the US, the consumer centre of the planet (the US accounts for as much as 40 per cent of global consumption). On incomes which had been shrinking since the early 1980s, the American masses were no longer able to acquire the previous quantity of goods. The US population was also unable to pay for even the cheapest credits. Analogous problems appeared in Great Britain and elsewhere in the European Union. A new crisis had opened up in the global economy, signifying that one big economic wave was being replaced by another. The world economy could not continue developing in the old fashion.

Throughout the entire period from 1975 to 2008, corporations and states had deliberately sought to reduce the cost of labour power. Companies transferred production to the Third World, causing the terms of employment in the first to deteriorate. For more than thirty years hourly wages did not increase, while the length of the working week grew.

Following the crisis of 2001, states increased their emissions. The European Union put 500 euro banknotes into circulation, and in Russia 5000 ruble notes were issued. The most active policy of emissions was in the US. During the last declining wave, the doctrine of cheap labour power had held sway in the business world. It was considered that the competitiveness of enterprises and of national economies depended directly on the size of wages and the cheapness of national currencies. The lower these indices, it was argued, the more efficient the economy. But when currencies were undergoing global devaluation, the fall in the price of labour power entered into contradiction with the consumer function which this price played. Because of the crisis, the cheapening of labour power that was occurring in the world economy had become uncontrolled, and the production of goods in the earlier quantities and at the previous technical level had been rendered loss-making. If this contradiction were to be resolved, a leap in the productivity of labour was required, signifying a technical revolution in industry.

## 2.6. The Logic of the Systemic Crisis

Through analysing the origins and nature of the global crisis, we can predict its development. It is also possible to define the changes which the system needs to carry through if the world economy is to enter a new stage of development.

Two scenarios for the crisis will be examined, one of them “soft” (presupposing a deliberate reordering of the world economy), and the other spontaneous, based on the elemental development of the process.

In theory, a crisis involving a shift from one wave to the next can pass off according to the “soft” scenario. There is no basis, however, for supposing that the essential changes can occur through a conscious intervention by global political institutions. Such an intervention would require replacing the policy of cheapening labour power with a policy of raising wages and improving the educational level of workers, which would inevitably entail a reduction in the working week. The policy of doing away with “social costs” would have to be replaced by a broadening of social welfare provisions, including free medical care and education. In this scenario, spontaneous inflation could readily be halted through the restoring of consumption. Implementing this strategy would make it possible to prevent the crisis from wiping out accumulated wealth on a colossal scale, but would require the redistribution of this wealth, and also the carrying out on a world scale of agreed actions to overcome the crisis, including decisive intervention by international institutions in the affairs of private companies. Almost inevitably, it would need to be accompanied by a change of "managerial personnel" in the form of political elites, and by a radical change in the dominant ideology. There is no society where this could occur without resistance.

On the geoeconomic level, it would be necessary to remove the barriers to the relocation of labour power. Local markets for cheap labour would have to be done away with, and the shortage of highly qualified workers in certain regions made up out of the excess in other areas such as Europe, North America and Japan.

The measures noted here would aid in the planned technological re-equipping of industry, and in making the transition to its intensive development.

Because this scenario is in total contradiction to the interests of corporations, and signifies a complete rejection of the earlier neoliberal policies, it is purely theoretical in nature and cannot be regarded seriously at present. This does not mean, however, that its elements cannot be realised in part if the pressure from below is sufficient. Ultimately, and despite the conservative resistance of the world elites, the world economy under the impact of its internal contradictions will develop in the direction of the changes sketched above.

The second path is elemental in character and flows logically from a failure to enact, in the immediate future, the measures indicated. In line with the logic of the global crisis, inflation will continue and after a certain time will be superimposed on a fall in the volume of industrial and agricultural production. The breakdown of trade will lead to the halting of a significant section of world industry. Massive falls on the stock exchanges, together with the collapse of national property markets, will also aid in the transition from inflation to stagflation. Financial help from the state will not be able to support the functioning of corporations for any prolonged period, and will not revive the consumer markets. Nor will protectionist measures yield the desired results, since the international division of labour in the modern world operates on a massive scale. Governments will finish up exhausting their material resources. The artificial division of the world labour market into segments with different wage levels, and subject to different social relations, will lose its earlier significance as the incomes of citizens of the First World collapse. The structure of social consumption will also change, with far-reaching consequences.

The economic collapse will turn into a prolonged depression, in the course of which systemic changes to the world economy will also occur. Technologies which the global monopolies have prevented from being implemented since the 1960s will start to be introduced, and will allow production costs to be cut substantially. The flip-side of cheaper goods will be an increase in the demand for highly qualified labour power. Corporate competition will grow more intense. Managing companies will become more complex, and will demand great technical expertise. A second "technical revolution" will occur, and to a significant degree will do away with the privileged positions of the elites that took shape in the first. The participation in management decision-making of highly qualified production experts may also become commonplace as early as the first post-crisis upswing (extending over some five to eight years between 2012 and 2019). In the economy, developing production will also take priority over trade and financial speculation. After contracting during the crisis, energy consumption will resume its growth. The importance of hydrocarbons, however, will probably decline markedly. Biofuels, it appears, will not come to play a widespread role. The economy will need cheap energy, produced in greater quantities than before. It is logical to expect that under the impact of the crisis there will be major breakthroughs in this area.

Irrespective of the scenarios, the crisis will lead to a revival of protectionism, both in the rich countries of the West, and also in the states of the periphery. Policies will be enacted so as to avoid affecting, as far as possible, the productive operations of countries' own corporations that are carried on in other states. The new protectionism will become a weapon of global corporate competition.

Transnational corporations that control the productive and commercial markets of particular countries will defend these markets against encroachments by the capital of other countries. For many states of the periphery, "national protectionism" will thus take the form of defending the interests of the transnational capital that holds sway in the marketplace. Meanwhile, mutual dependency between economies will increase; the "old industrial countries" will see the beginnings of a reindustrialisation aimed largely at creating means of production for the industries of the periphery. The sharpening of corporate competition will lead to growing international conflict, since breaking into markets will require political or military intervention.

As a result of the crisis, the world economy will become increasingly monopolised. There will be numerous corporate takeovers. Most small enterprises will be unable to survive the change of conjunctural waves. Because the implementing of practical measures to overcome the economic slump will be delayed, accumulated wealth will be wiped out by the crisis on a colossal scale. This can be stated with a high degree of certainty if we proceed from the strategies that are now being applied and from the experience of the crises of 1900 (with the depression that lasted until 1903); 1929-1933; and 1969-1982, that is, four crises. During the nineteenth century, the changes from one economic wave to the next were also painful; the crisis of 1847-1849 engulfed all of Europe and in many countries led to revolutions, while the crisis from 1873 to 1878 became the most prolonged in history.

It was only during the crisis of 1929-1933, and during its final stage, that a number of governments adopted effective anticrisis measures. Where the degree of intervention by states in the affairs of private companies was great, as in the US, the economies recovered more rapidly from the destructive effects of the collapse. During the Great Depression, however, the US authorities resorted to increasing the role of the state in managing the economy only under pressure from below, and only at the last moment of the crisis. The measures taken earlier to restore the financial strength of companies, and the simple act of providing them with state orders, had not yielded the expected results. The crisis of 1948-1949, which also marked a shift from one long wave to the next, followed on immense wartime destruction and hence did not do the world economy such great harm.

The world crisis will pose the question of the socialisation of migrants, and will exacerbate the problem of the irrational use of the world's resources of labour. Social inequality will increase, but inequality of incomes between workers in the old and new industrial regions of the earth will lessen. Accordingly, the degree of their mutual solidarity will grow. The loss of vast quantities of capital as a result of the global economic slump will bring a significant rise in the cost of credit, which will also stimulate the rapid technological renewal of industry. Obtaining high profits will depend directly on the technological outstripping of competitors.

It is logical to expect that even before the autumn of 2008 the crisis in the US will pass from its financial stage, affecting the banking and stock-market sectors of the economy, to its commercial stage. In July and August the first serious reports could appear of the failure in the US of the policy of returning $168 billion to taxpayers. Demand will not have been restored, and the retail chains and small enterprises will begin to acknowledge the losses they have suffered. The selling off of stock will obviously continue, and purchases of new goods will come to a halt. Meanwhile, analogous trends will appear in the European Union and other regions where consumption levels are relatively high.

Following reports of the crash in the American commercial sphere, the crisis will begin inescapably to hit the world industrial sector. By the end of the year, production will have started to decline not only in the US, but also in a series of "new industrial countries". Above all, the freezing of orders will affect China and other "Pacific tigers". The economies of the countries in the North American free trade zone (NAFTA), which are closely tied to the US, may also suffer during the current year. Unfavourable reports on the state of the US economy will lead to a series of fresh collapses on the world's share markets, bringing an end to the period of stock market stabilisation over the spring and summer. The first sign that an end to the pause is in the offing came on 6 June with a sharp fall on the US stock market. This was prompted by the publication of figures showing a deterioration in the US economy during May. The Dow Jones index lost 3.13 per cent. The fall in the US share market was quickly reflected on all of the world's leading stock exchanges.

As a result of a chain of future stock market collapses, the capitalisation of numerous companies will fall. Inflation will again accelerate. The flight of capital into gold will increase, and the price of the precious metal will rise. The first falls in oil prices are likely before the end of the year, but may turn out to be insignificant. The main oil collapse will probably occur in 2009.

Next year will probably see the whole world enter into crisis. The economic decline (stagflation) is likely to be most severe during the period 2009-2010. Despite the unity of world economic processes, the industrial shutdowns will occur unevenly and at different times in various countries. A belated and chaotic return by governments to traditional Keynesian policies will not put an end to the negative processes in their economies. If systematic measures to resolve the contradictions responsible for the crisis are not taken in 2009 and 2010, the collapse will be followed by a depression that could last until 2013. As a result of the extreme downturn in the global economy, a worldwide contraction in the volume of industrial production and agricultural output of 25 to 45 per cent or more can be expected.

As the experience of earlier structural crises has demonstrated, such a course of events will inevitably result in political instability both in international relations and within individual states. In such conditions, sharp changes are possible in established political institutions. New forces and leaders, who not long before appeared secondary and marginal, can be expected to come to prominence. For the forces of the left such a turning of history creates a whole series of promising opportunities, but in similar fashion, extreme right-wing organisations and politicians can use the phenomena of the crisis to further their own interests.

## 3. The Impact of the Crisis on Russia

Despite the world economic crisis which is now beginning, economic growth in Russia has continued. As in the past, the country's market is attractive to foreign investors. During the first quarter of 2008 direct investments in the Russian economy amounted to $5.585 billion, some 42.8 per cent lower than in 2007. The volume of portfolio capital investments was down by 37.5 per cent, coming to $123 million. Early in the second quarter the situation improved. In May the net inflow of capital was estimated at $15 billion. On a yearly basis it is calculated at more than $40 billion, which is comparable to the results in 2006, when investments came to $41 billion.

Last year the overall inflow of funds to the Russian economy was the highest of all the BRIC countries (Brazil, Russia, India and China). This year too Russia is the leader, outstripping Brazil and with India in third place. The interest shown by investors in the BRIC countries is explained above all by the exhaustion of the world's other markets.

Accumulated foreign capital in the Russia economy at the end of March amounted to $221.0 billion, which is 45.9 per cent more than at the same time in 2007. The largest share in the foreign capital accumulated by the economy consists of credits from international financial organisations. This represents 48.8 per cent and is made up primarily of the debts of large Russian companies. Since the beginning of the crisis in the US economy, the Russian share market has attracted heightened interest from foreign investors. Recent months have seen a record flow of capital into this area. In 2007 Russian companies (to a significant degree through IPOs) attracted investments of $47.3 billion on the foreign markets for stocks and bonds.

Russia's share of world GDP in 2007 reached 3.18 per cent. In 2005 it amounted to 3.09 per cent, just outstripping Italy (2.96 per cent) and Brazil (2.88 per cent). In terms of the nominal volume of GDP, Russia's economy is the tenth largest in the world, and by the end of 2008 it is expected to be in eighth place. Between 1999 and 2007 Russia's GDP grew by 83 per cent. The volume of industrial production grew by 74 per cent, and that of agricultural produce by 40 per cent. Of the various sectors of Russian industry, the strongest have been the extraction of energy sources; paper and cellulose production; metallurgy, and electricity generation. In 2007 Russia produced 491.5 tonnes of oil and gas condensate. The rise in output for the year was 2.2 per cent. In 2006 it also came to 2.2 per cent, and in 2005 reached 7.9 per cent. Russia's foreign trade turnover grew in 2007 by 25.8 per cent, to $552.2 billion. The trade surplus was $152.8 billion. Figures for 2006 put the share of crude oil and natural gas in the country's exports at 46.2 per cent. Diesel fuel accounted for a further 6.7 per cent, heavy fuel oil for 4.5 per cent, and other oil products including gasoline for 3.4 per cent. The share of metals and other raw materials for foreign industry accounted for roughly an additional 20 per cent. In the country's imports, first place was taken by machinery and equipment, accounting for 35.7 per cent, while vehicle imports made up a further 10 per cent.

The Russian economy is maintaining healthy levels of growth, with rates of increase in GDP similar to those of last year. In 2007 Russia's GDP rose by 8.1 per cent, reaching $1280 billion. Investments increased by 20 per cent, and the volume of industrial production was up by 6.3 per cent. Government plans envisage results for 2008 superior to those of last year, while the IMF predicts that Russian GDP will grow this year by 7.8 per cent. Levels of state investment are high. Russia's economic boom, however, is not only the result of high energy prices, but also of the exhaustion of opportunities in other markets. Counting on steady development over the next few years, Russian corporations are increasing their indebtedness to foreign banks. These banks in turn are eagerly providing credit to Russian corporate clients, even when they lack any clear idea of whether the businesses concerned are well run. The security for the loans consists not so much of reliable information on the prospects of a particular Russian company, as a general positive view of the prospects for the Russian market. But against the generally positive background for Russia in 2008, negative tendencies have appeared as well.

According to official figures, inflation in Russia in 2007 came to 11.9 per cent. Prices of mass consumption goods, primarily foodstuffs, rose by 25 to 50 per cent. In 2008 the growth of inflation has been even more marked, with the rates exceeding those of last year by 70 per cent. Measures taken by the government to freeze prices have had little effect. Keeping the growing inflation in check has not been possible within the national framework. State analysts have been powerless to explain the causes behind the devaluation of world currencies. The order by the new Russian president that inflation should be halted has remained unfulfilled. The result as of this summer is that the growth of consumer trade has slowed somewhat, while the growth of wages has been less than that of inflation.

According to the neoliberal understanding of the economy, these signs do not provide a basis for serious concern. Throughout the whole period of economic growth, the cheapening of labour power has been viewed by the government as one of the country's competitive advantages. In Russia new paper money, mainly in the form of 1000 and 5000 ruble bills, has been thrown onto the market and has increased the volume of money faster than the growth of production. The new money has entered the economy not through a substantial increase in wages and pensions, which would have helped boost demand and stimulated an increase in production, but through the acquisition by resource corporations of inflationary dollars. As a result, controlled inflation has helped to restrain growth of the incomes of the population. The policy of emission of the European Union and the US has been analogous. In the conditions of world economic upturn, this policy raised the profits of large companies. But while the growth of wages in Russia has been restrained with the help of emission, in the "old industrial countries" the growth of prices has helped the corporations to reduce the payment for labour. The implementing of this policy, along with the transfer of production to the global periphery, has led in 2008 to the beginning of a systemic crisis of the world economy.

Continuing to act in accordance with its earlier schema, the Russian government is ignoring the trends of the global crisis. Amid falling consumption in the US, Great Britain and the European Union, the main reason why investors are discovering attractions in Russia (and in the other BRIC countries) has been the extensive domestic market. Any narrowing of this market is capable causing Russia severe problems even before oil prices fall perceptibly. Even before the end of 2008 the first declines can be expected on the Russian housing market, due to a national mortgage crisis.

As a result of swiftly rising prices the real incomes of the Russian “middle class” have begun to fall, exacerbating the problems of paying off mortgage loans. In order to secure themselves against risks, the banks have made obtaining loans more difficult, and have begun tightening their policy in relation to debtors who are unable to meet their financial commitments on time. Interest rates have been raised. The process of issuing mortgage and consumer credits, which was stopped for a short time because of panic on the world market, was quickly renewed.

While closely linked to the world economy as a supplier of raw materials, Russia since the 1990s has remained relatively closed-off for transnational corporations. Because of this, strong Russian corporations have been able to take shape, something that has not happened in Kazakhstan or in most of the countries of Eastern Europe. Russia’s powerful economic revival of the years from 2000 to 2007 took place under conditions that included only limited access for foreign capital. The right to operate on the domestic market was bestowed by the Kremlin, often only in exchange for the opening to Russian capital of access to the markets of other countries. Large Russian companies raised capital freely on the world market, while the country’s domestic market was closed to cheap credits. Banks belonging to Russian corporations pursued a policy of speculation, granting credit to small business and the population at usurious interest rates that exceeded 7 per cent. As a result, the development of the internal market and of companies oriented to it was held back, while Russian transnational corporations were assured of additional profits. Under the present macroeconomic conditions, persisting with this policy is serving to draw the Russian economy into the global crisis. Despite the vigorous growth of the past few years, the Russian domestic market remains extremely dependent on world prices for raw materials. Any dip in these prices is instantly reflected in the state of this market. Within the framework of the Russian economy, the mortgage market is more vulnerable than the raw materials corporations.

At present, property prices in Russia are significantly higher than in Europe as a whole, if we take account of the fact that most of the apartments are still of low quality. This situation exists due to the extreme monopolisation of the housing market, something that is especially evident in Moscow. The speculative property prices are maintained with the support of the state bureaucracy, which defends the large companies that are linked to it. Existing alongside the high cost of houses and apartments in Russia are extremely inflated annual rates of interest. Obtaining loans at 3 to 5 per cent, Russian banks give credit to the population at rates several times higher (as much as 25 per cent), and often impose penalties if debts are paid off ahead of time.

The monthly incomes of families in the Russian “middle class” rarely exceed 2500 euros. In the structure of Russian society the proportion of people who earn between 300 and 800 euros is not greater than 17 per cent, while the proportion of workers who receive from 800 to 1500 euros fluctuates in the region of 7 per cent. Paying huge interest rates on overvalued dwellings, debtors are constantly on the verge of family bankruptcy. The living standards of most Russians have already been undermined by inflation. A further devaluation of the ruble along with other currencies will rob people of the ability to make regular payments. As soon as the crisis in the US manifests itself in the area of trade and commerce, there will be a new burst of world inflation, which will usher in a Russian mortgage crisis.

When banks foreclose on the dwellings of non-payers, this will not get them back the money spent on purchasing these houses and apartments, since the demand for property will have fallen. If such measures are resorted to on a broad scale, they will lead to a sharp fall of prices in the housing market. Not even the complete domination of the construction sector by monopolies will be able to withstand this process. In order to avoid a collapse of the housing market in Russia as a result of massive problems with servicing debts, it is proposed to introduce procedures for individual bankruptcy. Both the debtors themselves and the creditors would be able to initiate these procedures. Introducing such a law, however, would not prevent a crash of the housing market, but would merely guarantee that the banks get their money back. The upshot is that in the most difficult period of the global crisis, the middle layers will be forced to pay back large debts to the banks, at the same time as housing is devalued due to the inevitable fall of demand.

By the winter of 2008 the total value of mortgage agreements in Russia could exceed $30 billion. According to Central Bank data, the ruble indebtedness of physical individuals to the banks as of 1 April 2008 stood at 2799 billion rubles. Over the previous six months, since 1 October 2007, it had increased by 523 billion rubles. The total indebtedness of physical individuals in foreign currency credits now amounts to 390 billion rubles, or more than 10 billion euros. Over the past six months this sum has increased by 8 billion rubles. Compared to the previous period from April to October 2007, the growth rate of the indebtedness of physical individuals fell by 16 per cent. Meanwhile during the recently completed half-year (from October 2007 to April 2008), total mortgage credits increased by 221 billion rubles. From April to October 2007 the corresponding growth was 200 billion rubles.

The world economic crisis has already made an impact on the banking sector of the Russian economy. After the first stock market collapses in January and February 2008, the Russian banks began feeling a serious deficit of ready cash. The surplus of uncommitted funds in the world economy was replaced by an acute shortage. For Russian companies, the possibility of obtaining foreign credit support diminished substantially, revealing the presence of economic problems within the country. The shortage of ready cash that was afflicting the banks had become possible due to the increasing difficulties faced by debtors, especially those belonging to the middle class, in servicing their loans. The rise in prices during the period from 2005 to 2007 was combined with growth in the category of Russian citizens receiving wages from 300 to 800 euros per month, but in practice the increase in wages did not compensate for inflation. The result was that the broadening of the middle layers was not accompanied by any marked increase in their prosperity. In practical terms, the doubling of the inflation rate in 2008 strengthened the negative dynamic that had caused breakdowns in the functioning of the financial institutions.

During the winter crisis of liquidity, the banks discovered that funds were quick to depart but slow to return. The system was starting to lose its effectiveness. A large share of the credits had now taken on the character of bad debts. Meanwhile, the Russian financial institutions themselves remained debtors on the world market. As a result of the panic, foreign capital flooded out of the Russian banks, revealing how short they were of their own ready cash. To overcome the crisis of liquidity, the government resorted to placing the assets of the Pension Fund with the banks. The issuing of mortgage and consumer credits resumed, though the terms had become stricter. The profits obtained by the banks resumed growing. But the government's measures in no way affected the logic, dictated by the world crisis, behind the fall in the real incomes of the population. It was this which promised to ensure the collapse of the credit market.

The appreciable fall in debt repayments could at any time give rise to another liquidity shortage in the banking sector, and create serious problems for the payment of pensions. The beginning of a commercial crisis in the US, something that is probable early in the autumn, will signal the shifting of the global crisis to a new stage, with the potential to create a new deficit of ready cash in Russian banks. The leap in inflation that would follow would reduce the buying power of Russians still further, and could lead to a national sales crisis as early as the winter of 2008-2009.

If these developments are superimposed on a collapse of world prices for energy sources, the result in Russia will be a general economic slump. If a steep fall in oil prices occurs later, when world industry is feeling the impact of the crisis in a serious way, Russia's economy will continue entering slowly into crisis. A decline in sales will lead to a contraction of domestic production. Workers will begin to be laid off in a range of sectors not linked to exports. Growing unemployment, along with a worldwide acceleration of inflation, will undermine demand still further. At present this process is being restrained by an increase in investment activity by the state. Government plans provide for investments of the order of one trillion dollars by 2020 in infrastructure projects, building roads, ports and airports. But if the economic situation within Russia becomes more difficult, and if world oil prices fall as well, the state will not have sufficient financial resources at its disposal. The costs faced by the government will rise sharply, at the same time as its revenues will fall. The time needed for the completion of projects will lengthen, and the benefits they bring will be significantly less or will be postponed for an indeterminate period. Some projects will be frozen altogether, or work will proceed on them only at a snail's pace.

Against a background of gold and foreign currency reserves exceeding $500 billion, Russia's foreign debt as of 1 October 2007 amounted to a mere $47.1 billion. But the foreign debt of the private sector had increased by 55 per cent compared with 2006, and according to official figures amounted to $272.6 billion. The share of the Russian banks in this sum (minus debt obligations to direct investors) came to $96.9 billion, and from 2006 to 2007 rose by 63 per cent. The main international debtors in Russia are local corporations. Despite the unprecedented rise in prices for energy sources in recent years, the total indebtedness of leading Russian exporters is enormous, probably exceeding the official figures by a substantial margin. Just one of Russia's leading firms, Rosneft, has debts of $100 billion. This year, the corporation has already appealed to the Russian government for help. It is not only incapable of paying off its debts, but even of meeting its most urgent loan obligations.

Despite the high profitability of the resource sectors, Russian corporations conduct their business in a highly inefficient manner. The government and the resource monopolies are completely unprepared for a sharp fall in world prices for energy sources, which is viewed as a completely unrealistic scenario for any time before the early years of the next decade. Russia holds second place in the world for the volume of its oil exports. Oil makes up 30 per cent of the country's GDP, and revenues from oil sales account for two-thirds of the state budget. Nevertheless, the government's calculations on continued high oil prices run directly counter to the trends in the world economy. However high oil prices might rise (at present they are around $135 per barrel), they are guaranteed to fall as a result of the global economic contraction.

The result of a collapse in world energy prices will be to subject Russia to the full impact of the world crisis. There will be dramatic falls on the share market, though while oil remains expensive Russian stocks may continue to attract capital for a certain period, probably until 2009. The corporations will be unable on their own to pay off the debts they have contracted on the basis that world energy prices would hold firm. The state will take to giving financial support to the largest Russian firms, providing them with subsidies and low-interest loans. More than likely, it will also assume responsibility for payments on the urgent loans of corporations. Meanwhile, budget revenues will contract sharply. Capital will flee the country. Corporations will be forced to cut their payrolls and to cancel orders placed with other firms on the domestic market. Mass sackings will begin, and unemployment will rise. Together with inflation, this will decisively undermine the solvency of the middle layers. Sales on the domestic market will fall dramatically, a mortgage crisis will begin, and service enterprises will start shutting down. Industries oriented toward the domestic market will have to reduce their output. The economic crisis in Russia will follow the general world trend downward, and as a result of the global economic problems, will likely prove very severe.

Russia's economy is peripheral in nature and is subject to the trends of development of the world economy, trends that are determined by US and European corporations. A decline in the importance of oil for the global economy will lead to a weakening of Russia's political influence and to a decline in the power of the resource corporations. The crisis will sharpen all social contradictions, and will demand that Russia reorient its economic sectors. This will very likely have severe socio-economic impacts. The resource monopolies could lose their dominance, or be forced to concede large elements of it. When Russia emerges from the crisis, it will be a quite different country. The value of its oil resources to the world economy will have fallen. But in the conditions of an ascendant economic wave, Russia's skilled labour and intellectual resources will inevitably be in demand.

In theory, Russia still has a chance to avoid the destructive impacts of the crisis, whose effects on raw materials exporting countries will be especially severe. To achieve this, it will be necessary to reduce the vulnerability of the economy, which must be reoriented toward cutting-edge technological development. The government has all the essential resources for doing this, but will undoubtedly balk at the required changes. A structural reorientation of the economy is not in the interests of Gazprom and other resource firms; this is why it has not been carried through in the past decade, and why it is not contemplated for the present. Positive changes to the Russian economy can only implemented in spontaneous, primordial fashion, in a process that involves the country being overwhelmed by a massive crisis.

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