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## The Crisis of 2009 – Is it Back to Subsistence Living for Russians?

By Elena Agarkova

**I**RKUTSK—"Let's drink to the crisis avoiding regular people like us and hitting only the oligarchs!" Kolya raises his glass and everyone follows, clinking their wine glasses.

Kolya's grey v-neck sweater sits tightly on his biceps. A big Popeye on his right sleeve adds an unexpected touch of childishness—or perhaps I'm behind on Moscow fashions. Kolya and his wife Svetlana are visiting relatives for New Year holidays, which last for ten days in Russia.<sup>1</sup> Kolya investigates crimes that involve precious metals. This in reality means that he not only works for the Federal Security Bureau (FSB is the post-Soviet successor to KGB), but that he is in the business himself. He doesn't give any details but it appears that he owns or co-owns jewelry stores. Svetlana works as a notary. She has her own business in the center of Moscow, supervising seven or eight employees.

The economic crisis has already affected them. When she leaves the room, Kolya mentions that Svetlana recently lost about 13 million rubles because a bank where she invested clients' funds went bankrupt. The bank was in Russia's "top-100." The Russian government does not provide FDIC-type insurance that would guarantee bank deposits, so when a bank goes bust, regular investors lose everything. Now the couple needs to figure out how to pay off Svetlana's debt, plus the money they borrowed to buy real estate abroad.

This past summer's signs of the economic

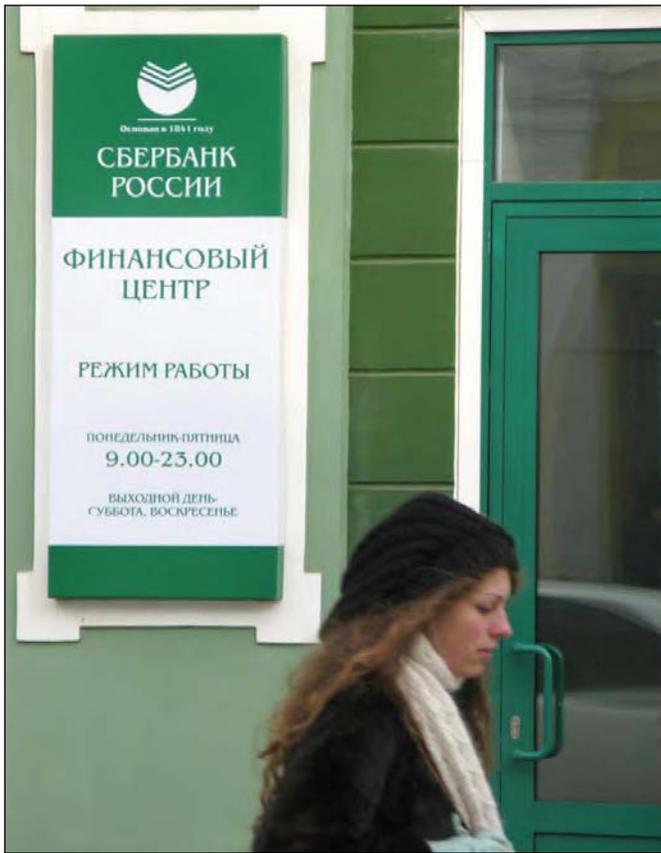
meltdown came to Russia from the United States, but Russians ignored them at first. The government felt sure that foreign investors thought the Russian economy as attractive as ever for capital placement, and that the government-controlled Central Bank had more than enough money in its coffers to prop up the economy, if necessary. In the past year Russia benefited greatly from rising oil prices, which, at an all-time high of \$147 per barrel in July of 2008, allowed Russia to amass more than \$600 billion in state coffers.<sup>2</sup>

The summer of 2008 was the height of several indicators of the Russian economy's health, albeit, as it appears in hind-sight, short-lived health. The ruble had strengthened significantly against the dollar, from a low mark of 32 rubles to a dollar in 2003, to just 23.16 rubles to a dollar in June 2008. According to public polls, the vast majority of Russians, or 92 percent of those polled, preferred to keep their savings in the national currency. This was an enormous achievement for a country that just ten years ago experienced an economic crisis of devastating proportions. In August of 1998 the ruble crashed, undergoing a devaluation of 71 percent against the dollar, sliding as much as 29 percent a day. Russia defaulted on \$40 billion of its external debt. People saw their savings evaporate overnight, triggering runs on bank deposits and sparking hyperinflation.

The country's economy has recovered since then, growing on average at a remarkable seven percent annually over the last eight years. For-

1 The government instituted the 10-day holiday in 2004. Since then, Russian newspapers keep reporting the people's dissatisfaction with the holiday. Most citizens, in contrast to Kremlin employees and well-to-do businessmen, cannot afford to leave their cold motherland for a vacation on a tropical beach. They complain of boredom, short light day, and lack of alternatives to work. The popular sentiment seems to be in favor of exchanging some of the January holidays for time off in May, when people go to their dachas (summer houses) to plant carrots and potatoes.

2 The government kept this money in three different funds. The international capital reserves accounted for the bulk of the money (almost \$516 billion as of October 2008). The government split the remainder between the National Welfare Fund and the Reserve Fund.



*(left) Sberbank, pictured, is one of Russia's biggest state-owned banks. (above) The top graffiti, which I found on an old building in a courtyard in the center of Irkutsk, uses Sberbank's logo and urges people to withdraw their deposits. The bottom graffiti appears to be an anti-fascism symbol.*

Foreign investors saw Russia as a profitable market. The country's growing economy provided between seven to eleven percent in annual interest rates. Russia's economic success led president Medvedev to promise, in June of 2008, to make Moscow a world financial center, and to make the ruble into a regional reserve currency. Some analysts argue that the global financial crisis started at least 1.5 years ago, but because at the time most natural resources kept going up in price to their historic highs, the Russian government could refer to the Russian market as "an island of stability in the ocean of financial passions." Echoing this sentiment, as late as last September Prime Minister Putin, speaking at an investment forum in Sochi, said the crisis in Russia was over.

But oil prices, affected by the American economic downturn, kept going down. In the last quarter of 2008 the Kremlin had to deal with the fact that the price of oil, the main foundation of Russia's recent economic growth, plummeted well below its expectations, sometimes as low as \$32 per barrel.

In the middle of January of this year Putin ordered the Russian Ministry of Finance to revise the federal budget for 2009, based on the new forecast of \$41 per barrel of oil. That's less than half of the previous estimate used for the budget, \$95 per barrel. (By comparison, the Russian ministry of finances calculated the 2008 budget based on the estimate of \$53 per barrel of oil.)

Other factors in addition to falling oil prices proved the Russian government's optimism wrong. Since the summer

of 2008, Russia has experienced massive capital flight. Foreign investors, whether scared by the Russian-Georgian war, or no longer willing to entrust their money to a developing country during a global financial crisis, began to withdraw their funds from the Russian market. According to some estimates, about \$270 billion in foreign investment have left Russia since the beginning of August 2008. In a recent interview Putin dismissed this outflow of capital as connected to "speculative capital," or "portfolio investment," saying that such investment always aims at getting a quick income, "so it's easy come, easy go for the economy."

But it hasn't been easy. In September of 2008 the Russian stock market crashed, falling by more than 75 percent. In the weeks to come Russian oligarchs saw their fortunes shrink, sometimes by as much as 80 percent. This has led to unexpected redistributions of wealth. Some tycoons, like Russia's richest man, Oleg Deripaska, found themselves in a tight spot because they borrowed heavily to finance further expansion, using their Russian holdings as collateral. The stock market crash, slashing the value of Russian assets, prompted their creditors to issue margin calls, asking for more money. In an interesting turn of events, the oligarchs turned to the state for help. The government lent them money in exchange for shares and, most importantly, control of their companies. Some political commentators have even referred to these deals as a not-so-secret attempt by the Kremlin to nationalize "strategically important" companies. As an example, Deripaska asked for \$4.5 billion from the state-controlled development bank VEB, in exchange for a 25 percent stake in NorNickel, held by Deripaska's Rusal. In the end the bank guaranteed Deripaska's

stake, refinancing it in exchange for putting a state representative on NorNickel's board of directors.

Not every Russian tycoon is suffering. Some oligarchs, the ones with cash, found themselves in an enviable position of being able to strengthen their control of companies, by buying back shares. They've also used this opportunity to pick up new businesses, most often at a price much lower than that asked prior to the crisis. A banker acquaintance explains that right now it is possible to buy indebted banks for a nominal sum, a ruble or five rubles, and refinance the debts. "It's a very good business. As one of our co-owners says, during a crisis the strong become stronger, and the weak get weaker." Viable banks, including that of my acquaintance, have been doing brisk business trading hard currency. This is so because of the ruble's depreciation in the past three months. "We're making more profit on currency trades than we did providing loans to the population. If you have enough currency reserves, or can get it at the inter-bank market, you can trade at a profit of more than 100 percent."

After denying the crisis, the Russian government was spurred into action. In September of 2008 it began injecting massive amounts of capital into the markets, keeping the Russian banking system and the corporate sector afloat by effectively taking on the short-term debt-refinancing obligations of large portions of the private sector. The government did this by using its large capital reserves (the third largest in the world even at this time), built up by the profits from rising commodity prices over the past five years.



*Is this sign, saying "No lay away," on prominent display in a small store in the town of Baikalsk, a harbinger of further economic troubles? Since the Baikalsk pulp mill closed down in September, the owners laid off most of the workers. The pulp mill's owner, Continental Management, is part of Oleg Deripaska's empire of various holdings across Russia.*

These profits allowed Russia to amass a \$50 billion budget surplus at the end of 2007 and pay off the majority of its externally held government debt. But the \$600-plus billion of state reserves, which seemed a great sum of money before the crisis, drained quickly. For example, on September 29, Russia's Central Bank gave \$50 billion from the country's hard currency reserves to the state-controlled VEB. By the middle of January the state reserves lost a third of



*In the early winter morning passengers at a Siberian railroad station, clad in big fur hats, patiently wait for the train.*

their value, going down to \$396.2 billion.

When this strategy failed to reign in the crisis, the government took a different tactic, one it disavowed previously.<sup>3</sup> In mid-November the Central Bank began to devalue the ruble, allowing it to depreciate against the dollar and the euro. By January, the ruble lost 20 percent against the dollar. The Central Bank controlled the depreciation by gradually expanding the ruble's trading band, through at least 20 separate expansions. Putin stated that the devaluation has been done gradually to help not only companies but regular citizens as well. This way they could decide whether to "stay with the ruble, move to dollars or euros, or do something else, go into real estate, to consider savings." "We did not act as some countries; we did not crush the national currency overnight," Putin said. "We did all that gradually and carefully. We have consciously decided to spend gold and currency reserves, to give the possibility to participants in the economy, including citizens, to realize what is happening and to make decisions."

Most Russians, the average citizens who don't own stocks, don't work in the banking sector or for an oil company, those who have not taken out a mortgage, have yet to really feel the effects of the economic crisis. But inflation is going up and so is unemployment. As I write this, the ruble trades at 32 to 34 to the dollar, and some economists do not foreclose the possibility of it depreciating by another 20 percent in 2009. How will this affect the Russian people?

#### **DESPITE THEIR RECENT FINANCIAL LOSSES,**

Kolya and Svetlana brought a big basket full of champagne, duck pate and other luxury goodies, for the holiday table. The crisis didn't affect Kolya's penchant for living large and sharing some of his wealth with others. Kolya and Svetlana represent Russia's upper middle class of today. They have a big house outside of Moscow, with a sauna, a pool room, and a wine storage room that they say they never use except when their guests want a tour of the house. They have a 3-year-old daughter and a 10-year-old son. Recently they bought an apartment in Moscow in the same building where Svetlana's mother lives, nearby a good kindergarten. They know it's a good place because the mayor's grandkids attend it. Buying the apartment was just one of the prerequisites for their daughter to get into the kindergarten. "Can you imagine buying an apartment just so you could bribe the head of the kindergarten to allow you to pay attendance fees?" Svetlana asks rhetorically. I tell them that moving to a certain district for the sake of a good school is a common phenomenon in the States. But it is still a new concept to Russians, and I doubt

it made its way anywhere outside of Moscow.

By way of digression, of course not all schools that existed in the Soviet Union were created equal, even though all education was free. Some schools had a bad reputation because, for example, the kids who attended them were considered "hooligans," kids who started drinking and getting into trouble with the law early on. These kids stayed up late in the courtyards of tall Soviet cement-block houses, passing cheap liquor bottles around and keeping the neighbors up with their rowdy, loud conversation. Their future, in the best scenario, consisted of getting into a "technical college," where they could study to become a plumber or an electrician.

Other schools existed too. In those schools kids began studying foreign languages from first or second grade, fights were rare, and students obeyed the teachers. To get admitted, you usually had to 1) pass strict entrance exams, 2) be a child of a party functionary, a diplomat, or someone else of social importance, 3) bribe the school administration or, sometimes, 4) all of the above. Kids who graduated from these schools had a much better chance of getting into one of the top universities (which also had a small quota for the "proletariat," children of workers and peasants, a kind of socialist affirmative action). They went on to join the ranks of Soviet elite.

Not much has changed since the Soviet Union broke up. Having connections, or "blat" in Russian, is one of the surest ways to get ahead in life. Kolya and Svetlana's story illustrates this seemingly eternal Russian principle. Being a notary, like Svetlana, is a profitable, prestigious profession and is therefore hard to get. The government strictly limits the available number of licenses—there are about 700 notaries in Moscow—the hopefuls have to graduate from law school, and then pass a rigorous examination. It goes without saying that if you don't want to wait until one of the existing notaries stops practicing, you need to "know someone," someone who could help you navigate your way through the process. When Kolya and Svetlana got married, Kolya was just starting work in the militia, Russian police, as a regular policeman. Svetlana's father, who occupied a high post in the militia, helped Kolya join the prestigious precious metals unit in the FSB. When Svetlana graduated from law school, Kolya, who by now had plenty of connections of his own, returned the favor. He helped his wife get a notary license and bought her an office in the center of Moscow.

For this couple, the past ten years have been so successful that, in addition to a house outside of Moscow they recently bought an apartment in Montenegro.<sup>4</sup> Last year

3 The government has not finished injecting liquidity into the market, however. As of the end of January the Russian government announced a plan to inject \$27.4 billion into commercial banks hit by the crisis. Government sources indicated in the media that state-controlled lenders were set to receive the largest share.

4 Montenegro became a sovereign state in May 2006, when its people voted for independence from Serbia. Because of its location on the Adriatic Sea, rich historical and cultural heritage, and relatively inexpensive prices, it became a popular vacation spot for Europeans. Montenegro is also an extremely popular real estate market for newly rich Russians, along with Cyprus, which has very few restrictions on property purchases by foreign citizens.



*More big fur hats, this time on a fashionable young couple walking into a café in the center of Irkutsk.*

they also purchased a two-story townhouse in Alicante, on Spanish Costa Del Sol. They vacationed only once at either place since then. They say they don't regret buying at the peak of real estate prices because the main reason they bought both places is to keep vacationing in the same area with their friends, who often go abroad in a group of 20 people or more. Their place in Alicante is part of new development that locals call the "Russian village." Despite their real estate holdings, in the past year Kolya and Svetlana went on vacation to Australia and Japan. When they talk about Australia, they marvel at how cheap "brand" clothing was in Sydney. Shopping is much more expensive in Moscow, even with the crisis in the air.

Kolya and Svetlana's calm may be in line with the official pronouncements, which have gotten into the habit of bringing up the Chinese word for "crisis." Kremlin spokesmen and businessmen alike keep saying lately that this word means not only "danger," but also "opportunity."<sup>5</sup> An opportunity to diversify your holdings, to make businesses more efficient, to buy up bankrupt banks... But not everyone in Russia feels as optimistically about the current state of economy.

**MY ROOMMATE'S FORMER CLASSMATE,** over for tea one of the cold evenings we've been having in Irkutsk (with temperature dipping down to -22 Fahrenheit and lower), tells me, when I say that I'm writing about the crisis, that her brother was recently laid off. When he decided to look for a new job, he went out to buy a

newspaper with job listings. He came back empty-handed. The woman selling newspapers told him they were sold out. He also said that when he went to the unemployment office, the line was "as long as the one in [Lenin's] mausoleum."

The girl's brother worked as an accountant in a private coal company. His employer asked him to resign voluntarily, instead of firing him. If fired, his company would have had to pay him a severance wage equal to his average monthly wage, plus his full salary for at least two months while he looked for work. When the brother said that he did not want to submit a voluntary resignation, his employer told him that if he didn't cooperate, they would "pin" a cash shortage on him (the brother being a "materially-responsible person," as an

accountant). He had been with this firm for only a year and a half, so he was the most expendable person. He resigned as they asked.

I keep hearing stories like this, of employers pressuring workers to resign without receiving any benefits. Even though the law is on their side (and, according to a recent press conference report, Prime Minister Putin himself has directed law-enforcement agencies to make sure that employers follow the Labor Code and do not leave their former employees without any means of support), I have yet to hear of someone putting up a fight to stand up for their rights. Instead people seem to be watching the inflation climb and bracing themselves for the worst. Despite initial restraints, supposedly per word from Moscow, on discussions of the crisis, now many Russian newspapers have a permanent column entitled "The Financial Crisis." Experts, pundits and regular correspondents weigh in on the wisdom of the federal government's anti-crisis measures. Journalists keep track of price changes for basic foodstuffs in supermarket chains. But the changes are drastic enough that customers can notice them without expert help.

A woman who works in the kitchenware stall at a small mall where I'm buying new cartridges for my water filter, says that the cartridges have gone up in price. "They say the price will go up even more soon. But it's not like they raise our salaries by the same percentage!" I mention that food prices have gone up at least 20 or 30 percent since the summer. She agrees. "I was so surprised when I went shopping before New Year's Eve, for the holidays,

<sup>5</sup> Some sinologists have spoken out against the industry that has been built around this interpretation, stating that it stems from fundamental misunderstanding of Mandarin.



*When temperatures fall below freezing, Siberians create ice sculpture gardens in public places. This one in particular is in Irkutsk, in Kirov Square. The ornate building in the background belongs to the Siberian Coal Company.*

because usually I don't buy that much food, but I had to shop for holiday parties, and everything was so much more expensive! A bag of rice used to be 24 rubles, and now it's 50, sometimes 60 rubles."

**I TALK ABOUT THE CRISIS TO another** friend, Marina, who comes from a small town about seven hours away from Irkutsk. She stays with us for a few days while she takes her exams for a second university degree in management. She is 30 and has three kids, having gotten married when she was 18. She says, "People have already gone through a crisis in the 1990s. Do you know how it was back then? They didn't pay people's salaries for more than half a year, sometimes a year. When they paid, it was often "benefits in kind." If the factory where you worked produced bricks, you got paid in bricks. If they made fridges, you got it — yes, fridges, or spare fridge parts. At some point our dad actually got his salary in flour." Marina's dad works in the local administration. He had been a member of the Communist Party for years and in 1990, just as the Soviet Union was falling apart, attended the prestigious Party Management School in Novosibirsk, getting a two-year degree in political science. Despite this, he didn't fare much better than others during the previous crisis.

I've heard from other friends of mine that in the 1990s everyone fell on exceptionally hard times. Even before August of 1998 when the ruble fell, within a month, from

6 to a dollar to 21 rubles to a dollar, wiping out people's life savings, life was difficult. Muscovites didn't feel the pinch as much as people out in the provinces. Around Baikal, people say they were happy if they had a bag of rice to feed a family of three for a month. Remarkably, they don't sound bitter when they talk about those times. Marina saw some pluses even in her dad's "flour" salary: "We baked our own bread. My grandma would make dough and bake four or five loaves at the time, enough to last us a few days. And you know what? That bread tasted great, much better than the bread we buy now in the store."

I never cease to be amazed by these stories of self-reliance. "We always had a lot of potatoes," says Marina. "We had mushrooms, cucumbers, cabbage... We marinated all of this for winter. We didn't go hungry." I point out that if you were to list these products for an average American, they would likely ask, mushrooms and cabbage, great, but what are we actually going to eat? Marina thinks briefly and says, "Yes, but we also had meat. People went hunting all the time, and when they came back, they shared their catch with the rest of us. And the gas was so cheap back then that driving a hundred kilometers to hunt was not at all expensive."

Will these survival skills come in handy for regular Russians who don't own houses in Spain? The experts' forecasts for Russia's economy sound gloomier with each day. Given the declining ruble, rising prices, and increasing

unemployment, people really might have to turn to growing more of their own food, like they did in the 1990s. "Of course people grow much less now," says Marina. "Once they started moving to the city and living a more European life, they began wondering, why do we need to bother with these potatoes when we can just go to the store? But we can easily learn these things again. We'll adapt. As they say in Russia, anything rather than war..."

Is it this pessimistic optimism that explains why Putin's approval ratings have not fallen (except by a negligible point or two) since the crisis began? And can the Rus-

sian government expect the same kind of loyalty and trust from its citizens even if the economic situation worsens?

**RUSSIAN VICE-PREMIER AND FINANCE** minister Kudrin recently came out with a very pessimistic forecast for the next three years. He states that external conditions for economic development will grow worse. Russia "may" run up against certain social problems, such as declining standards of living, rising unemployment, and slowing down of development in the social sector. The minister predicts a notable deficit in the 2009 budget, amounting to five percent of Russia's GDP. Experts quoted in mainstream media follow up with statements that there will be a big decline in the Russian economy, predicting a drop in the range of minus three to minus five percent.

The decline is in process already. According to the Russian State Statistics Service, Russia's industrial output went down 10.3 percent in December of 2008, as compared to the same month of 2007 (although it grew 2.1 percent that year). The December decline was recorded in all the production sectors. The Economic Ministry does not expect Russia's output to grow earlier than the fourth quarter of 2009, and even that will depend on the restoration of the global economy and accessibility of credits.

More negative forecasts exist as well. They state that if Russia is successful in its anti-crisis measures, then its GDP will drop about four percent in 2009. Otherwise, say some experts, the drop could be as terrible as the one in 1992, one of the most difficult years for Russian economy in its post-Soviet history, when the GDP declined by almost 15 percent.

Any decline in output means that in the following year many businesses will be forced to cut production or stop it altogether. Russian economic experts predict that "heavy" industries will suffer first. The crisis has already dealt a blow to Russian mining and steel companies. Because of a drop in demand for their goods, the machinery manufacturing and other industry sectors have built up large reserves of raw materials, which means that mining companies will need to cut production. Construction and related industries will suffer too. Construction companies already suffer from lack of financing. In addition, they have big debts. Construction companies took



(above) As part of the ice sculpture garden, the Irkutsk ice carvers made a huge ice slide. I thought my fingers would freeze off as I was trying to take these pictures. It was only -20 Celsius, or -4 Fahrenheit, outside. Balmy weather considering previous lows of -30 Celsius, or -22 Fahrenheit.... (below) Local kids slide down the ice hill using nothing more than small pieces of carton.



out big lines of credit in hopes of paying them off thanks to growing domestic demand.

Now work at many construction sites around the country has come to an abrupt halt. After the Russian stock market crashed, Mirax, Russia's biggest construction company, decided to freeze 80 percent of its projects. The construction industry, one of the fastest-growing sectors of Russia's economy, turned out to be one of the most vulnerable to the economic crisis. In addition to panic among their clients, construction companies have to deal with a threefold increase in credit interest rates in Russian banks, up to 25 percent, and shortened maturity terms.

The banks feel more reluctant to give loans to regular citizens too. Sergei Antonenko, a vice-director at the Irkutsk branch of Eastern Siberian Express, one of the top-100 Russian banks, told me that they had cut down their loan activity by 60 percent since the crisis began. The bank's foreign investors pulled out their capital, and, given the ruble's devaluation, the bank makes more money trading hard currency than it did giving out loans. But even though the demand for loans, according to Antonenko, has dropped by about 20 percent, the existing demand still exceeds supply.

Inevitably, the Russian population will suffer. Russian companies will cut down on employees to survive the crisis (often calling it "business optimization"). Those who will manage to keep their jobs will have to face inflation, which may eat up a significant portion of their income.

In the first week of December 2008 Putin announced the government's unemployment forecast for 2009. He predicted that the number of officially registered unemployed will increase to a little over 2 million. The government uses this number to calculate the amount of unemployment benefits that it will pay in the next year, as well as to predict the volume of active employment programs, such as vocational rehabilitation. The real number of unemployed is higher. For example, in October the Russian government put the number of officially registered unemployed at 1.3 million, and the total number

of all unemployed at 4.6 million. The total constituted about 6 percent of Russia's "economically active" labor force, which stood at 76.2 million as of November 1, 2008. However, even though newspapers report that the government's forecast is on the pessimistic side, the government's data does not appear very reliable. Some government sources reported that about 500 thousand Russians lost their jobs in November 2008 alone, whereas others report that slightly over 100 thousand became unemployed between October 2008 and January 2009.

Regardless, life in Russia will be more difficult for employed and unemployed alike. The experts expect consumer prices to rise because of the ruble's devaluation, which will lead to appreciation of import prices. Russia will not be able to give up foreign goods, which constitute a big part of its consumption. But no one knows how long the devaluation will last. In the mean-

time, devaluation of the national currency has contributed to further drops in the Russian stock market in the new year.

One possible plus of the devaluation is that it may actually boost domestic production, by making foreign goods more expensive, and domestic manufacturing cheaper. One of my friends in the finance industry uses a famous Russian chocolate brand as an exam-

ple. Until the crisis of 1998 Korkunov imported his chocolates from abroad. When the Russian economy crashed, such imports became prohibitively pricey. Korkunov then built a factory outside of Moscow. In 1999 the factory began producing "A. Korkunov" chocolate bars and chocolates, which became one of the most recognized brands in Russia.

No one knows how long the crisis will last or what its aftereffects will be. It may last another year; it may last three or longer. But one of Russia's big problems in dealing with the crisis is the country's lack of influence over world markets. The dollar remains the world's main currency, and most of the world works to satisfy American markets. Until those markets recover, the Russian people may well have to go back to planting vegetables on their plots of land to survive. □



*America influences Siberia in peculiar way, including unexpected tributes to American pop culture that I keep seeing around Irkutsk.*

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