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How much will it cost to overcome the crisis?

17/11/2008 MOSCOW. (Tatyana Marchenko and Marina Titova for RIA Novosti) - The methods for combating the financial crisis differ between Russia and most other countries.

Most of the government allocations in other countries are spent on state guarantees for banks, people and companies. The Russian government prefers to inject funds directly into the economy. Why?

As much as $9.4 trillion, or 15% of global GDP, has been allocated in the world to combat the financial crisis, with a spread of between 1% of GDP in Denmark and 225% in Ireland.

In September 2008, Russia launched a large-scale program of financial assistance to companies and banks, estimated at 6 trillion rubles (nearly $217 billion) or 13.9% of GDP. This assessment does not include allocations from regional budgets.

These huge investments in fighting the crisis belie the government's assurances that there is no fundamental crisis in Russia. Like in the rest of the world, the fundamental reason behind the financial crisis in Russia was the overcapitalization (overheating) of the stock market.

The government's financial stabilization program is based on four types of investment. An analysis of investment structures in the 23 richest countries, including Western Europe, shows that 49% of funds are invested in state guarantees for bank debt, 15% in refinancing financial institutions, 10% in the acquisition of ailing assets, and 21% in other measures mostly connected with stimulating economic demand, such as tax cuts, infrastructure development, and enhancement of social programs.

But Russia has invested nothing in state guarantees for bank debt and 84% in capitalization.

Why is Russia's approach different from other countries?

The current financial crisis is called "the liquidity crisis" in Russia, which is a traditional and, in our opinion, a convincing explanation.

However, an analysis of changes in the balance on the lending organizations' correspondent accounts with the Central Bank makes one wonder if there is a liquidity problem.

Until August 2008, the asset balance was growing smoothly, which means that the banking system had adequate liquidity through September when huge sums were injected into it, raising the balance to 732.4 billion rubles ($26.5 billion) due to a reduction in the obligatory reserve norms and some other methods.

In October the balance fell to 580-590 billion rubles, an amount equal to the May 2008 balance.

Doubts regarding the liquidity problem are also raised by an analysis of lending organizations' assets and owner equity. The assets of Russia's largest lending organizations, the 30 largest banks listed by the size of assets, increased by an average of 30%-50% in January-August 2008. Their owner equity grew by 20%-25%.

In other words, there was no liquidity problem in the banking system as a whole, which by itself is not necessarily an indicator of a healthy banking system. However, the Russian government decided that liquidity was the key problem and started injecting huge funds into banks.

Banks willingly accepted the money, which subsequently surfaced on currency exchanges and eventually landed in the foreign banks' accounts. Apparently, this is not what the government had in mind.

Unlike Russia, the international community quickly pinpointed the key reason behind the crisis, describing it as a crisis of confidence. IMF analysts say there is a global lack of confidence between counterparties plus an unrestrained accumulation of cash.

A crisis in confidence should be resolved with such measures as insurance, security and guarantees. Other countries are allocating huge funds to deal with the confidence crisis: $1,739 billion in the United States, $539 billion in Germany, and $393 billion in Britain. Australia, Canada and Italy have pledged to guarantee 100% of bank deposits. The German government said no one would lose a single euro of their savings deposited with the country's banks.

Russia's strategy of fighting the crisis is dramatically different. The Russian government does not guarantee deposits, but injects money into banks.

Foreign anti-crisis programs stipulate a mechanism of responsibility for one's actions. Such programs in the U.S., Australia and Western Europe imply managers' personal responsibility for mistakes. Accordingly, shareholders must not be held responsible for the mistakes of financial corporations, and mechanisms for distributing state assistance must be maximally transparent.

Other countries are setting up special control institutions to monitor the use of anti-crisis funds, while Russia thinks it has enough control mechanisms as it is.

As a result, Russia's confidence problem is being compounded by the government's strategy of combating the crisis. This means that it will take Russia more time and effort to overcome the crisis.

It must draw conclusions from the current crisis in order to avoid old mistakes in the future. It must also create a system to warn authorities about market overheating.

Businesses cannot be expected to see the dangers of such overcapitalization in time to stop the trend. The responsibility must rest with national and global regulators. And lastly, the country needs mechanisms to prevent market overheating.

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