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This Crisis Isn't So Bad After All

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The most common way of formulating an economic forecast is to compare current events to similar cases in the past, analyze how those historical events unfolded and then base the prediction on that model. All of today's economic forecasts are constructed in this way.

The question of how the U.S. recession will progress is important to answer because Russia, like all developing economies, will probably not experience economic growth until it picks up in developed economies. The answer to that question depends on which past U.S. event we base our comparisons. If we take as our model the economic panic of 1907, when the stock market and production fell at a pace that is similar to current declines, then the economy will recover in about one year. But if we conclude that a closer match with today's crisis, given its severe credit shortages, is the Great Depression, the recovery might take a few years.

We can also draw lessons from comparisons with other recessions. The 1970s recessions in developed nations taught us that aggressive monetary policies could lead to growth coupled with inflation or inflation without growth. Recessions of the 1980s demonstrated that running a fiscal deficit is not a problem as long as the economy is growing. And Japan's recession in the 1990s showed that an economy might stop growing when a government allows banks not to write off their bad assets.

Russia's history of capitalism is very short -- a little less than 20 years. The catastrophic decline that began in the first six months of 1990, which ultimately brought down the Soviet Union, occurred under a centralized, planned economy. Privatization of state enterprises, despite all of the fanfare, was just one step leading to a market economy. Lessons can be learned from the attempt at macroeconomic stabilization from 1995 to 1998, the reaction by the economy and the government to the Asian crisis of 1997 and the collapse of the fixed exchange rate in August 1998.

In fact, if you compare the current economic crisis to the one in 1998, this could be a cause for optimism. True, the drop in industrial output was worse last November (and December as well, if the preliminary data is correct) than during fall 1998, but it is important to put this into perspective: The 2008 declines were from a far greater height after nine years of growth, while the 1998 crisis hit the country after eight preceding years of declining production (with a brief period of low growth in 1997).

Furthermore, production declines in late 2008 were worse than in the catastrophic year of 1990, but manufacturing constituted a far greater percentage of the gross domestic product during the Soviet era than it does now. Against these backdrops, the recent decrease in the industrial production and a dramatic drop in the GDP growth rate does not look quite so alarming.

But the main cause for optimism today lies in comparing contemporary businesses and employees with those of 10 and 20 years ago. Today's firms and workers are more energetic and better able to ride out rapidly changing market conditions. In fact, the widespread layoffs in certain industries and salary cuts instituted in the third and fourth quarters of 2008, which were of a much larger scale than a typical economics textbook would have predicted under similar circumstances, actually testify to the resilience of today's businesses. Even with all of the handwringing currently going on, Russia's companies and work force today are much healthier than they were in 1990 and 1998. Now isn't that a reason to be optimistic?

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