Monetarist Anatoly Chubais, head of the Presidential Administration, is overseeing the takeover of Russian finances by foreign speculators.

tary of the Security Council; their monetarist co-thinker Anatoli Chubais runs the Presidential Administration.

Once hooked to the insatiable appetites of the greatest financial bubble in world history, the international markets, Russian finances have been subjected to minute supervision by foreign agents, in a fashion that insults the country's sovereignty and infuriates its patriots. Thus, not only does the IMF send a delegation to Moscow each month, to dole out—or, as at present, withhold—tranches of an IMF credit to the Russian Federation, but now, as Finance Minister Livshits confessed in a Nov. 12 press conference, "they have brought along some specialists on taxation, the technique of taxation, organizations, and so on, [who] will be meeting with our people at the Tax Commission." These "technical experts on taxation will be here for a fairly long time," Livshits said. When Chubais, Potanin, et al. set up a Temporary Emergency Commission (VChK) to collect taxes, the IMF representative in Moscow held a press conference to applaud.

Every month, London School of Economics professors, working quasi-officially for the Russian government, brief the Moscow press corps about the performance of their pupils. The latest theme of Profs. Peter Boone and Richard Layard is that Russia had better slash spending on housing and pensions, the better to meet GKO and other debt service obligations. Surely, some percentage of Russian pensioners don't really need those stipends, and families could do without rent subsidies, says Layard, so that the really poor could be helped better. This is in a country, where tens of millions of people—over 70% of families with more than two children—live below the official poverty level. Sixty percent of the population of Siberia and the Far East does not even live to pensionable age! According to Layard, if subsidies for home heating were reduced, households would be more frugal and efficient. (It so happens that in Vladivostok, there was no heat at all for several November days and cold nights, because a steam pipe in the city's aged system burst.)

The Makarevich report on Russia's banking crisis

This summary was prepared by Konstantin Cheremnykh and Rachel Douglas.

Since the Russian Presidential elections, the situation of the commercial banks has worsened. As of Aug. 1, 1996, 161 credit institutions (banks or financial groups) had lost their licenses, as against 150 in all of 1995. In October, 130 more banks were slated for "execution." Every fourth bank is losing money. The volume of overdue loans, with interest, had reached almost 40 trillion rubles ($8 billion), or more than triple the volume of bank reserves, as of September. Bank assets have fallen by one-third during 1996.

The current banking crisis is unlike the crisis in the United States during the Great Depression, when all credit institutions were closed for two weeks. Nor is it comparable to October 1994 or August 1995 in Russia, when the freely convertible currency and interbank credit markets crashed simultaneously, burying dozens of banks. We do not have a crisis-spreading medium, such as the stock markets they have abroad, nor the interbank currency and credit markets. The dollar is in its currency "corridor," so its behavior is predictable at least till summer 1997. There is a certain danger from the GKO "pyramid," but the Ministry of Finance and the Central Bank have agreed to keep printing enough rubles to support the trade in government bonds.

The majority of banks, impaled on the "needle" of the GKOs, were unprepared for the decline of their yields, from 360-400% annual rates, to the present 50-70%. But that is not the main reason for the bank failures, including of some major banks. The banking crisis is due to the coincidence of several other systemic, cyclical, and conjunctural crises: budget, payments, investment, production, central management, structural-legal. Their close interweaving accelerates the mass extinction of credit institutions.

The budget crisis

The total failure of the 1996 budget damaged the banks involved in federal and regional programs, and in financing budget accounts or government operations. The financial catastrophe, expressed in the inability of the government to collect even half the taxes, forced the IMF to deny release of the October $340 million tranche of its loan to Russia.

For the first seven months of this year, the 1996 budget targets were met at the levels of 39.6% for revenues, and 43.3% for expenditures. The deficit was 4.3% of GDP (as against a planned 3.8%, agreed to by the IMF). By the beginning of November, it was clear that the maximum possible result for the year is to achieve 70% of the budget targets, with a deficit of 4.6%.

This is the third budget, drafted on the model used during the period of highest inflation. A base level of revenues and expenditures is assumed, without considering their real content. Then, deflationary coefficients (as a rule, less than the real growth of prices) are factored in, and the IMF is allowed to approve outside limits for inflation, monetary emission, etc. On the basis of those agreements, all planned expenditures are sequestered, except for several protected items, without any qualitative analysis of the real situation in the economy.

The authorities have lost all their levers for budget management, beginning with taxes. In October, tax collection was only 45% of the planned level. In seven months of 1996, 59% of value-added taxes (VAT) were not paid; 13% of income taxes; 12% of excise taxes. The non-payments equal almost half the state sector wage bill.

These non-payments are determined by unsustainable taxation levels. Through fiscal and other measures, the government seeks to collect 35% of GDP (in other countries, it's 20-25%). For honest taxpayers, this is too heavy a burden, so everybody who can, conceals income. Payments to the treasury for January-September were only 8% of GDP.

In October, some 70% of non-payments involved the large monopolies in the fuel and energy complex, the steel and non-ferrous metals industry, petrochemicals, transport, and machine building. Many tax exemptions were granted for political reasons, during the election campaign. Exemptions on 1995 and 1996 taxes due this year, total R 32 trillion ($6 billion). More tens of trillions were granted in government guarantees and commodity credits. Meanwhile, GKO (state short-term bonds) operations, barter deals, black-market cash transactions, and many other instruments, are untaxed and are used as tax shelters.

Another trap for the budget has been the conversion of inflation into state debt, through the manipulation of the ruble supply for purposes of keeping prices down. The main driver of inflation, the shortage of goods and uncompetitiveness of the Russian economy, was in no way remedied.

Unwilling to finance its spending officially, through changes in the budget that the parliament would have to ratify, the government does so by building up the state debt. For each ruble extracted from the market, the treasury has to pay seven! This suicidal approach is preserved in the 1997 budget, with far greater sums involved. At the same time, late payments and non-payments by the government are not considered state debt.

The payments crisis

Monetary circulation has been disrupted, once and for all. Payments are being made neither to the treasury, nor on bank loans, because of the huge volume of debts (accounts receivable) in the economy—over R 800 trillion ($160 billion) in October. The monetary system went out of control, after raw materials capital attempted to take it over. The budget is planned and implemented in paper money, backed up by nothing. It services only one-tenth of the real economy, while nine-tenths uses other monetary units, whose circulation the government is powerless to control.

The ruble is a fiction, useless as a measure of value. Four-fifths of all assets are outside the system of commodities exchange; the ruble services a measly one-fifth of all assets, and has thousands of exchange rates, depending on the region, branch of industry, sphere of circulation, and concrete owner. The ruble's official rate is defined in the interests of raw materials capital on the basis of foreign trade operations with three or four commodities, exceeding its real purchasing power dozens of times over.

The authorities' boast that, by strict monetarism, they reduced inflation from 4.1% (monthly) in January to 0.2% in August, is self-deception. Inflation in Russia is not monetary, but is expressed in the growth of production costs, commodities shortages, delayed demand, loss-making foreign trade, the gigantic state debt, the budget deficit, and the immense quantity of monetary surrogates in use. Therefore, the economy, investments, finances, industry, and the people's welfare do not react to the lowering of prices.

Russia's GDP is the least monetized in the world. In 1991, it was 70% covered by the M2 money supply; in October 1995, 8.5%. In the West, this level is 80%; in the U.S., 120%. Actual monetization in Russia is not lower than the American rate, and perhaps higher. But the official ruble is replaced by surrogate instruments. The government started this, issuing vouchers, treasury bonds, treasury tax exemptions, guarantees and references, "Crops-1990" vouchers, and so forth, for circulation. All economically active entities promptly began to issue their own monetary surrogates. That is how the real economy, in self-defense, compensated for the raw materials firms' monopolization of the ruble supply.

Today, money surrogates include not only foreign currency, barter, and indebtedness, but a swarm of other financial instruments: promissory notes, shares, bonds (including state bonds), vouchers, receipts, postal transfers, coupons, stamps, cards, tickets, passbooks and other kinds of books, deposits, deposit receipts (American, global, and Russian), contracts (commercial, trust, realtor, and agent), and many other securitized obligations. For some investment banks, this is not bad feed. For the budget and tax collection, it's a gallows noose.

The volume of ersatz money emission is mind-boggling. Planned GDP for 1997 is R 2.3 quadrillion ($460 billion), while the illegal money supply will reach at least R 1.5-2 quadrillion ($300 billion) in immobile, poorly convertible quasi-money. Even in the legal economy, the rate of circulation of the ruble varies from several dozen times in the financial sphere, to nil in several branches of the economy and regions.

The surrogates comprise a parallel monetary system in the shadow economy, which does not pay taxes. They enable the shadow economy to attract unlimited quantities of legal rubles (converting them to hard currency and hiding them abroad), without abandoning its own, illegal monetary circulation. Essentially, any economic entity (including banks) can privatize monetary circulation, deriving emission revenues at an annual rate as high as 240-500% (for promissory notes), of which the state treasury is deprived.

The monetary surrogates also entail disadvantages, such as a short lifespan, which makes them useless for long-term investments in industry. The issuer has to do his business in various segments of the financial markets (currency trade, interbank credits, etc.), and when a given market plunges, or the GKO market takes the upper hand, banks dealing in these promissory notes and other obligations perish. The state has to assume responsibility for hundreds of thousands of depositors of such bankrupted institutions.

The investment crisis

The paralysis of the budget and payments triggered a crisis in the investment sphere. The total volume of basic capital investments decreased 10% in the first quarter of 1996, 18% in the second quarter, 20% in the third quarter, and the annual rate will be close to the last figure. The level of capital investment has shrunk four- to tenfold since 1989. Of the 358 facilities that were supposed to come on line in 1996, under the federal investment program, only four were completed during the first eight months! The government's much-touted plan of attracting four private rubles into investment for each state ruble (the 1:4 scheme) failed. Of the R 278.2 trillion loaned to the economy by the banks, only R 18.1 trillion (6.5%) was for long-term investments.

Because of mutual arrears that reached R 860 trillion in October, the government's hopes that 60% of investments next year will be provided by the enterprises themselves, are groundless. Russian industry has reached the boundary where there will be mass withdrawal of capacities, due to obsolescence or physical deterioration, including of modern technologies, which have been artificially rendered useless. This means the disappearance of internal sources of investment, and the final destruction of infrastructure.

The GKOs are continuing to murder industry, above all the military industrial complex. In October 1996, the volume of the GKO market exceeded R 200 trillion (it approached the total supply of rubles, R 271.9 trillion). By the end of the year, the government will have to pay off R 244 trillion in GKOs, out of a total emission of R 259 trillion, leaving not more than R 15 trillion net income from GKOs, or less than the monthly state sector wage bill.

Banking investment in the real sector is impossible, in such a self-cannibalizing economy. Yet, in 1997 the government plans to issue another R 360 trillion in bonds, increasing the internal state debt to R 630 trillion ($120 billion).

The manner of privatization made two-thirds of Russian joint-stock companies unattractive for investment. The stock market is deformed, lacking normal share valuation standards. As a rule, shares are purchased not for income, but to seize control of a company or for resale. The Russian banks are very far from being able to function as significant direct investors. They are, furthermore, hindered by the steadily expanding shadow economy, the clearest indicator of mistrust in the government and the state as a whole. A once unified economic space continues to be fragmented into isolated segments and enclaves with their own surrogate money systems, with no movement of capital among them. The relationship between taxes and investment is broken. Agricultural producers were freed from all taxes, while small businesses got a fiscal holiday, but this brought no growth of production. Everybody escaped into the "shadow."

Investments in industry will get going, only when the cost of credit is lower than profitability in the real sector. So far, this holds only for the financial market, whereas *all* Russian industry may be considered bankrupt by FUDN (Federal Department of Insolvency and Bankruptcy Cases) criteria.

The banks are pessimistic about the prospects for foreign investment. By the end of 1996, it will total only $2.8 billion, while a minimum of $60-75 billion is needed.

How can there be effective investment, if Russia's foreign debt service is to equal its borrowing, in 1997 ($9.2 billion)? Nobody believes in the "stabilization," the arrival of which has been proclaimed. Evidence of this doubt is the continued flight of savings into foreign currency, and abroad. Everybody, from the bag lady to the government, prefers to keep his savings in freely convertible currency, which means investment not in the Russian economy, but in the West.

The other method of insurance against risks in Russia (such as a Great Caucasus War, military coups, or general economic breakdown), is capital flight. In all, from $700 billion to $1 trillion of Russian capital, if not more, has fled to the far abroad. In effect, the West is lending to us and investing here, with our own money! And, charging more for it than is paid there on deposits and credits; and, lending us less than what has been received. These figures may even be understated. Nobody has delved into the 100-year history of capital export from Russia in all its forms. During some periods of time, it exceeded our GDP. Nobody has really assessed the size of Russia's shadow economy, or its monetary system, which is now tightly interfaced with the world system. There is, as yet, no desire on the part of this flown capital, to return home and cooperate with the current state authorities, and this has a direct impact on the situation with investments.

The crisis of production

The crisis of investment has caused a further decline of industry and deterioration of its technological structure. In the first eight months of 1996, Russia's GDP fell by 6% from the corresponding period of 1995; it was 43.3% of the 1989 level, which was the last year in which economic growth was registered. In six years, half the industrial capacity of Russia has been destroyed.

It is possible to project year-end declines for 1996 (the figure in parentheses is supplied by *EIR* to express the decline that the *1995* level of output of each product represented from the 1990 level):

Machine-building: 13%
Metal-cutting machine tools: 27% (77%)
Stamping presses: 48% (93%)
Tractors: 29% (90%)
Combines: 54% (94.3%)
Trucks: 12% (61%)
Refrigerators: 34% (53%)
Washing machines: 42% (75%)

The gross harvest of grain in 1996 will be 69 million tons, a little more than in 1995 but 34% less than in 1989. The most damaging effect is the continued slaughter of cattle, for lack of feed, as a result of which Russian producers have lost an estimated 16-39% of the domestic market for meat and milk products.

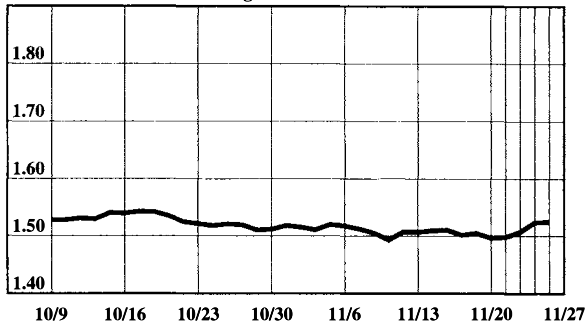
Russian industry is deteriorating. The obsolescence rate has reached 40% in agriculture and construction, 45% in transport and communications, and 50 to 80% in industry. The age of machinery is two and a half times greater than abroad.

The raw materials and basic processing industries are staying afloat, thanks to exports. As of autumn 1996, 25% of timber and gas, 40% of oil and ammonia, 50% of synthetic rubber, 60% of rolled ferrous metals, 80% of mineral fertilizers and cellulose, and 70-90% of non-ferrous metals production were being exported.

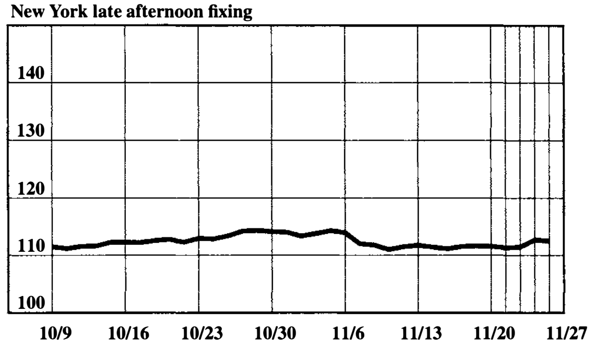
Dr. Makarevich concluded his report, with two more sections: "The crisis in relations between the center and the regions," and "The legal and structural crisis."

Currency Rates

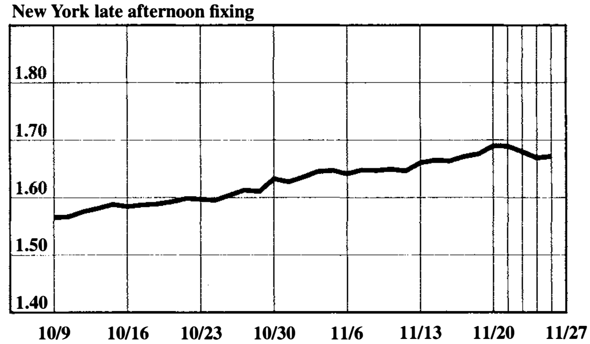
The dollar in deutschemarks
New York late afternoon fixing



The dollar in yen
New York late afternoon fixing



The British pound in dollars
New York late afternoon fixing



The dollar in Swiss francs
New York late afternoon fixing