Russia re-regulates finances; can it revive production?

by Rachel Douglas

Abrupt actions by the Russian government on Aug. 17, including the imposition of capital and exchange controls, dealt the second blow in the space of a week, to the axioms of the post-1971 world bubble economy. Like the Hong Kong Monetary Authority's "departure from our free-market philosophy"—its intervention in stock and futures markets to trip up the hedge funds operating there (see article, p. 8)—Moscow's step in the direction of re-regulation of its financial affairs carries some promise, that at this late hour a concert of governments might act to save nations and their people, instead of killing both in a futile attempt to save the bubble.

Prime Minister Sergei Kiriyenko announced joint action by the Russian government and the Central Bank, to defend vital financial functions, which were paralyzed on Aug. 13 as the country's stock and bond markets crashed. The value of the ruble would now be defended at the level of 9.5 to the dollar, an effective devaluation of 34%. Kiriyenko called this measure not strictly a devaluation, but "a new approach to our currency policy," which would "make it possible to react more flexibly to developments on financial markets," without wiping out foreign currency reserves, which otherwise "continue to be depleted."

The Premier's language was strikingly similar to that of economists at the Russian Academy of Sciences, and in parliamentary circles, where the question of carrying out a managed devaluation of the ruble, *in combination with* measures for the resuscitation of the Russian economy, has been under discussion for some time. In connection with arguments over the role of the currency in such rescue projects, Academician Leonid Abalkin and others had been attacked by government economists, as advocates of "devaluation" and "inflation." Dr. Sergei Glazyev, currently adviser to Federation Council (upper house of Parliament) leader Yegor Stroyev, has presented a package of measures known as an "alternative program," at such locations as the St. Petersburg Economic Forum, held in June. One written version was Glazyev's "Key Measures for a Transition to Economic Growth in Russia," which appeared in *EIR* of March 27, 1998, together with Lyndon LaRouche's "Russia Is Eurasia's Keystone Economy," and is currently accessible at www.larouchepub.com. Under Point 2 of his "outline of the principal elements of an economic growth policy," Glazyev argued in favor of restructuring the domestic debt, in such a way that the majority of GKO (government bonds of less than one year's term) obligations would be "written off, or transformed into long-term, interest-free bonds." In coordination with such a debt restructuring, Glazyev wrote that "it makes sense to introduce mechanisms to counter destabilizing influences on the part of big speculators, which would include a procedure to halt the free repatriation of capital, a temporary cessation of foreign currency sales, flexible devaluation of the ruble, and so forth."

Components of the package

Not only the "flexible devaluation" of the ruble, but also equally dramatic other components of the Aug. 17 Russian package, followed those guidelines: the rescheduling of all GKOs and OFZs (Federal Loan Bonds, with tenors of greater than one year) coming due through Dec. 31, 1999, as long-term obligations; temporary restrictions on large-scale exchange of foreign currency; a 90-day moratorium on payments by Russian banks and companies to foreign creditors; pooling of resources among 12 of the largest Russian banks, to protect liquidity for settlements within the country. There was *not* a moratorium on servicing the sovereign foreign debt.

The moratorium on foreign debt payments by non-government institutions is a form of exchange control, which speaks to the disaster that struck on Aug. 13, when Russian banks were being hit by foreign creditors' margin calls on credits secured by stock and bond assets, which were devalued as the markets crashed.

The limitation of large-scale currency exchange by nonresidents was expressly motivated, in a second official statement, as "needed in the present circumstances, in order to protect the Russian market from the destabilizing effects of the global flows of short-term speculative capital." In this statement, Kiriyenko and Central Bank Chairman Sergei Dubinin exempted currency exchange for purposes of trade, saying that they "reiterate the international obligations assumed . . . in 1996, with regard to abandoning any restrictions on ruble convertibility in current balance-of-payments transactions."

U.S. Treasury Secretary Robert Rubin welcomed the Russians' "extraordinary measures," with a statement that more instructed the International Monetary Fund (IMF) to be cooperative with Moscow, than the other way around. "Going forward," said Rubin, "we urge the IMF to work with the Russian authorities to find appropriate ways to support Russian policies that enhance the prospects for economic recovery." Undersecretary of the Treasury for International Affairs David Lipton had been in Moscow as the market's liquidity crisis peaked.

Industrial policy

On the eve of "Black Thursday," the paralysis of the Russian payments system on Aug. 13, Kiriyenko was on tour in the provinces with his new Minister of Trade and Industry, Yuri Maslyukov. In the defense industry center of Perm, accompanied by Economics Minister Yakov Urinson, they stopped at the aircraft engine plant Permskiye Motory, which also makes equipment for the natural gas industry, and visited Motovilikha Military Works. ORT television sneered that the military industry was going to be conveyed "from liberal minister Urinson to communist minister Maslyukov," referring to Maslyukov's party affiliation. Maslyukov is chiefly known for his commitment to save some of Russian industry. It happens that Urinson used to work under him, in the Soviet Gosplan.

At the next stop on his tour, Kazan, Tatarstan, Kiriyenko himself stated, "No fiscal measures, no financial stabilization, can solve the existing economic problems. It is necessary to develop production in the country, to overcome the crisis." Kiriyenko lamented Russia's inordinate reliance on imported goods, even though Russian enterprises can produce similar products, noting that imports account for 70% of the food products sold in Russian regions, and 90% of the food sold in Moscow. "Inordinately increasing imports, we subsidize foreign producers instead of Russian farm producers," said Kiriyenko.

The Premier stuck a note of dirigism, declaring that "the state should not be denied the coordinating role in the economy, due to reliance on the market." Kiriyenko said that Maslyukov was to present a task-oriented program for Russia's industrial development, by September.

On Aug. 13, perhaps with the intention of poisoning such an appointment, *Izvestia* wrote about a high probability that Maslyukov would name Glazyev as his deputy at the Ministry of Trade and Industry. Going to press on Aug. 12, *Izvestia* opined that Kiriyenko had no use for people like Glazyev, who "promotes direct involvement of the state into the economy, which contradicts with the ideology of the present cabinet."

'Black Thursday' for the IMF

"Black Thursday," when Moscow's interbank clearing system froze up, came one month to the day, after the IMF's announcement of an emergency $22.6 billion two-year package of IMF, World Bank, and other credits to Russia, intended to stabilize the ruble. By Aug. 19, Central Bank Chairman Dubinin had to confess that the entirety of the $4.8 billion tranche of IMF funding, received in July, which was supposed to be a stand-by credit line for supporting the ruble, had already been spent. One billion dollars was spent on "budget" outlays (namely, to redeem GKOs), and $3.8 billion in a vain effort to support the ruble.

At his Aug. 17 press conference, Kiriyenko was asked, "In preparing this program did you clear it with international financial organizations? The IMF mission is arriving today. What matters will be discussed with it?" The Prime Minister did not answer the first part of the question directly, saying only that "the situation on the international and Russian markets will be discussed with the mission," and that the new measures "can be described as our second line of defense." He explained, "The deteriorated situation forced us to retreat to the second line of defense in order to fulfill the program that we adopted. It is this that will be discussed with the international financial organizations." In other words, the IMF was to be told, not asked.

IMF Managing Director Michel Camdessus issued a statement that sputtered, as if he were taken by surprise by Moscow's measures. He said, "As a preliminary reaction, I am of the view that, in the new context created by these measures, it will be especially important for the Russian authorities to take all necessary steps to strengthen the fiscal position," and went on to call for rapid parliamentary endorsement of the austerity measures, previously worked out with the IMF.

The State Duma (lower house of Parliament), slated to convene on Aug. 21 to act on the government's new measures, might have other ideas. On the eve of that extraordinary session, leaders of the various Duma factions made their statements concerning the so-called "Russian questions," or "eternal questions," that is: "Who is to blame?" and "What is to be done?" The leftist factions proclaimed their intention to start the impeachment of the President. Communist Party of the Russian Federation leader Gennadi Zyuganov called President Boris Yeltsin "incapable of governing the state."

Former Prime Minister Viktor Chernomyrdin, for the first time ever, spoke in favor of a "coalition government," a standing proposal of the leftist factions, which Chernomyrdin never supported while he was in office. Chernomydin conferred with Zyuganov on Aug. 20, about the situation in the Russian banking system, and possible principles of the formation of a coalition government, according to Zyuganov. Meanwhile, Aleksandr Shokhin, head of (Chernomyrdin's) Our Home faction in the Duma, accused the government of "undermining the authority of the President." He charged that Yeltsin was inadequately informed on the situation in the financial sphere. Shokhin said that the government, by devaluing the ruble, "had in fact admitted that its financial policies are bankrupt."

Grigori Yavlinsky, leader of the Yabloko party who prides himself as an economist, claimed that "bad management," not the global financial crisis, was the reason for the Russian crisis. Vladimir Zhirinovsky, head of the Liberal Democratic Party of Russia, said only that Central Bank

A timely LaRouche forecast published in Russia

"Perestroika for the world. And That Means Radical," was the headline of Prof. Taras Muranivsky's article, excerpted below. It appeared in the weekly Ekonomicheskaya Gazeta *on Aug. 13, the very day the Russian financial system was paralyzed by speculative financial attacks.*

The traditional international seminar of the Schiller Institute and the European Labor Committees took place July 25-26 in the picturesque village of Oberwesel, on the banks of the Rhine, in the Federal Republic of Germany. The theme was, "The Struggle to Defeat the Oligarchy's Control of the World and Establish a New, Just World Economic Order." Helga Zepp-LaRouche, president of the Schiller Institute in Germany, gave the keynote. The main idea of her report is contained in a quotation from it: "Either humanity will free itself from the unjust oligarchical institutions very soon, or civilization will be totally destroyed.". . .

The American economist and political figure Lyndon LaRouche, who forecast the current financial cataclysms early on, spoke on the problem of oligarchism, warning that in the immediate weeks ahead, the crisis could reach the point of no return. The measures that belatedly agitated strategists—beholden to oligarchical interests—are proposing or attempting to adopt, will only hasten the collapse of the world financial system. Therefore, the problem of its radical reorganization is becoming urgent.

Exploring the roots of oligarchism, LaRouche cited the French economist François Quesnay, with whose conceptions the notion of oligarchism is associated. It was Quesnay, who differentiated between the landlords and the rest of the population, on the basis of principles that later became known as "Darwinism." In the service of the oligarchical world order, Quesnay ascribed to a handful of landlords, unlimited rights, allotting to the rest of the citizens the miserable position of "working cattle."

"The essence and functional significance of all types of oligarchs," says LaRouche, "is that they are all parasites, existing thanks to various forms of usury, which are established by sacrificing people, who are degraded to the situation of working cattle." LaRouche links the problems of the financial system today, with the actions of precisely such oligarchs.

In an interview, published in the Taiwan weekly *Business Weekly* (13-19 July), LaRouche was asked the following question about the causes of the Asian financial crisis: "Was it an inevitable phenomenon of economic development under the free market of capitalism?" He replied: "The continuing observations of Malaysia's Prime Minister Mahathir bin Mohamad are correct. Although the so-called 'Asia Tigers' were ripe for such a crisis, the immediate cause of the crisis in Asia had been the willful looting of the Asian currencies through operations of 'hedge funds,' such as George Soros's operations. The deeper roots of the problem are global, not Asian. The present international financial and monetary system reached the global breaking-point during the last half of 1997. . . .

"The present crisis should not be described as a product of 'capitalism.' There are two definitions of the term 'capitalism.' One is the so-called American System of Alexander Hamilton, the Careys, Henry Clay, Friedrich List, and Abraham Lincoln, the so-called 'protectionist' system. The term 'capitalism' is also used to describe a directly opposing financial system, the 'free trade' system used by the British, Dutch, Portuguese, and French colonialists. The cause of the present global, systemic crisis, is the influence of the most extreme version of a so-called 'free trade' model.". . .

Approximately one week after this seminar, a new wave of crisis engulfed not only Japan, the Asian countries, and Russia, but also Wall Street. The seminar participants proposed that statesmen and scientists consider and support a draft memorandum, for proposal to the September session of the UN General Assembly.

(The *Ekonomicheskaya Gazeta* publication continues, with the text in Russian of a "Draft Memorandum for an Alliance of Sovereign Nation-States.")

Chairman Dubinin's beard is good enough for jail, and that Finance Minister Mikhail Zadornov should go back to high school to study arithmetic.

Speculators fight back

On Aug. 19, Crédit Suisse First Boston (CSFB) threatened Moscow, with a published complaint that the debt restructuring plan would discriminate against foreign investors who "helped finance the Russian reform over the past few years." That euphemism alludes to the status of CSFB itself, which got in on the ground floor of the privatization heist in 1992-93 in Russia and subsequent speculative market scams, and today represents 40% of all foreigners invested in Russian treasury bonds.

Consultants from J.P. Morgan and Deutsche Bank flew to Moscow in a hurry, while the government's announcement of the terms of GKO-OFZ conversion was postponed from Aug. 19, into the next week. The foreign investors' interlocutor was nobody from the "industry" camp in or outside the current government, but rather newly appointed Deputy Premier Boris Fyodorov, the original Finance Minister for the disastrous reforms of 1992-93.

CSFB warned that if foreign GKO holders received only 11 kopecks on the ruble of face value, in the form of low-interest, dollar-denominated replacement bonds, while Russian bond-bolders got 31 kopecks on the ruble, then "this would permanently damage private financing of Russia reform and significantly destabilize other emerging markets." It also threatened a legal fight, to define the restructuring as a default, and trigger a cross-default on some $9 billion in Eurodollar bonds based on former Soviet debt.

Foreign holdings of GKO-OFZ bonds affected by the conversion, are approximately $11 billion. There is some $40 billion in foreign loans to Russian banks and companies, on which principal payments—including the margin calls that were draining Russian banks to oblivion, on Aug. 13—are banned now for 90 days. In addition, as in Hong Kong where at least one hedge fund mega-bet, in the wrong direction, is in the form of derivatives contracts that expire on Aug. 28, there is a futures element in Moscow. According to the *Wall Street Journal* of Aug. 20, the level of foreign investors' forward currency contracts with Russian banks is as high as $100 billion. These derivatives have been one of the just-under-the-surface explosive charges in the GKO pyramid for some time: contracts, by means of which foreign GKO-OFZ investors hedged against the devaluation of the ruble, by locking in the right to buy dollars from Russian banks at the pre-devaluation exchange rate. Up through mid-August, the triggering of such contracts would have wiped out the Russian banks that offered the forward deals, but with the controls instituted on Aug. 17, they are not allowed to be honored.

One of the world's biggest hedgers, George Soros, greeted the Aug. 17 Russian government actions as "timely and brave," in a Russian radio interview that day. It was by no means clear, that Soros would get what he had in mind, when he called for the devaluation of the ruble, in an Aug. 13 *Financial Times* of London article, which Moscow *Kommersant-daily,* among others, treated as "the trigger, but certainly not the cause" of Russia's meltdown. Soros wanted the bottom line to be the imposition of a currency board on Russia, spelling the end of sovereignty, never mind a growth policy for the real sector.

Popping up as a Soros admirer was currency-board guru Prof. Steve Hanke, who in the Aug. 17 *Financial Times* had a letter published, which began, "George Soros is on target." Hanke wrote that the ruble should be devalued, then "Russia should follow the steps contained in my 1993 book, *Russian Currency and Finance: A Currency Board Approach To Reform*." Featured elements included: Make official the dollarization of the Russian economy, allow foreign banks to operate freely in Russia, and establish a currency board (which means strict control of currency emissions by a group of foreigners—the complete abrogation of sovereignty). The nasty Hanke, who pumps himself up as the alternative to the IMF, concludes, "These were precisely my recommendations to former President Suharto in Indonesia earlier this year. If President Yeltsin fails to follow them, the ruble will end up where the rupiah is and Mr. Yeltsin will join Mr. Suharto in an early, forced retirement."