EIR Economics

Bush feared to have a chaos scenario for Russia

by William Engdahl

Over the weekend of March 7, the Russian government of Boris Yeltsin formalized the final part of its "price shock" economic policy, by freeing from state regulation prices on bread, milk, sugar, and even oil and gas. The controversial move was taken in consultation with a senior delegation from the International Monetary Fund (IMF), which had been in Moscow for the previous three weeks monitoring the "progress" of the Russian economic reform since economics czar Yegor Gaidar imposed the first phase of the price float on Jan. 2.

The latest action escalates an economic and social crisis to unheard-of dimensions, and threatens even the quasi-stability of neighboring CIS states such as Ukraine, who are forced to follow Russia's price policy, as rubles printed by Moscow remain their only currency.

The Russian government's statement of intent is contained in the March 4 Memorandum on Economic Policy, which formed the basis of what the International Monetary Fund calls a "shadow agreement" between Russia and the IMF. In detail, it amounts to the patient's agreement to commit systematic economic suicide, in return for an indication from IMF officials that they will grant Russia the green light for accelerated IMF full membership at the coming April meeting of the IMF Interim Committee in Washington.

Terms of memorandum

The details of the March 4 agreement are draconian to the extreme. Following two months of free float in prices for crucial commodity and other goods, which raised prices by 10-12 times their December levels, according to Russian eyewitness estimates, now as of March 31, prices for such vital items as bread and sugar will be allowed to rise without limit. The price of oil and gas inside Russia, as of April 20 when the winter heating season ends, will rise from R 350 at present to as much as R 2,500 per ton, a whopping sevenfold rise.

Further, as part of the IMF austerity "reform" demands, worked out in recent weeks in consultation with Harvard's "shock therapy" advocate Jeffrey Sachs and Swedish economist and Sachs business partner Anders Åslund, credit is being choked at the source. The result, by government admission, has been an increase of Central Bank interest rates from 2% in 1991 to 20% today. The rate commercial banks may set has also been set free. The result, as Russian economist Shmelev noted at a recent forum in Davos, Switzerland, has been a "confiscation of private savings by the government beyond anything Stalin would have dared."

In addition, under Gaidar the government has removed all restrictions on exports with exception for the moment of oil and gas. One result, according to Scandinavian businessmen, is that ships from Sweden, Norway, and other Western ports have gone empty to Russia in recent weeks, loaded only with dollar currency, returning full of Russian timber and other products which the desperate Russian exporters are reportedly selling at prices so low that the Scandinavian traders cannot believe it.

All this "reform" has been done in the desperate hope and vague promise from Sachs and others that the IMF will come in with billions of dollars in bridge loans, stand-by credits, and other emergency hard-currency stabilization funds, which would then, so goes the argument, open the floodgates to the billions of dollars in western capital eager to invest in the new Russia.

But there is something horribly wrong in this entire scenario.

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No money from the IMF

Even assuming, as Russia appears willing to do, that she continues rigid adherence to the IMF shock therapy program, in all likelihood there will not be any IMF money for a compliant Russia for the foreseeable future.

In May 1990, the IMF Interim Committee adopted a proposal for an increase of the IMF membership quota, on which basis the IMF is allowed to extend emergency and other loans to member states, of an added 50%. The U.S. share of this quota increase is to be $12 billion additional contribution to the IMF. But Washington is the only major capital which has yet to approve the IMF funding increase. Under IMF rules proposed by Washington, unless 85% of the total voting shares of IMF members agree to the new quotas, the quotas stay at the old levels. The United States has the largest IMF voting quota, 19%, enough to block the new funds. And the Bush administration to date has refused to wage an active campaign for the new quota, while the U.S. Congress has refused to vote billions for the IMF when jobs are disappearing at home.

This ensures no approval for the new IMF funding until, at the very earliest, the end of 1992—nine months from now—or even well into 1993. Without new money the IMF will soon run out of funds and will not be able to extend more than a token to Russia. Moreover, Washington's refusal is blocking an increase in funds for the World Bank which also could be used in Russia.

In an unusually critical speech delivered in Washington March 11, former President Richard Nixon accused the administration of playing a "penny-ante game" regarding Russia, which risks losing all the gains of the past years in eastern Europe for possibly a half-century or more. Nixon noted that so far, Bush's only assistance to the struggling Yeltsin government was that he gave some "agricultural credits, held a photo-opportunity international conference of 57 foreign secretaries, sent 60 cargo planes of leftover food from the Gulf war, and promised 200 Peace Corps volunteers. This would be a generous action if the target of the aid were a small country like Burkina Faso, but represents mere tokenism when applied to Russia, a nation of almost 200 million." Nixon notes that the hot political issue of the 1950s was "who lost China." He says, "If Mr. Yeltsin goes down, the question, 'who lost Russia?' will be an infinitely more devastating issue."

But to date there is every indication that just such a course is unstated Washington administration policy. And not because of U.S. budget restraints, as Mr. Bush claims.

A Morgan Stanley warning

In a detailed study just issued, the London arm of the influential New York investment firm, Morgan Stanley, paints a sobering and in most respects accurate critique of Washington's present backing for Sachs's "shock therapy" for Russia, while doing everything in its power to prevent large aid commitments from Japan or western Europe going to rebuild Russia's economy.

The study, prepared by Morgan Stanley's Director of Global Strategy David Roche for a special British television broadcast on the Russian economy, projects total unemployment in Russia under the present price shock policy will exceed 40 million by the end of this decade, if not before. Further, unless western aid is "massively increased, Russia could collapse by early autumn."

The Morgan Stanley analysis of the problems inherent in the present Sachs and IMF Russian "reform" is correct so far as it goes: "Liberal economic reform, while a necessary part of the demolition job on the old system, does not put a new one in its place rapidly enough. Liberal reform alone will not create jobs, wealth and stability within a politically feasible time frame, so massive infrastructure investment funded by the West is needed."

Roche proceeds to outline parameters of essential infrastructure investment over a 5-15 year period from western governments and private companies. To modernize and increase oil and gas production requires fully $25-45 billion a year for 15 years; modernization of Soviet agriculture another $5-10 billion a year for 15 years; $15-30 billion annually to re-train and support the estimated 40 million jobless from the collapse of the old order. Further, he estimates an added $15-20 billion a year to upgrade the dilapidated infrastructure of ports, telecommunications, rails, roads, and airports. In short, the West must start providing $76-167 billion *annually* if the Russian reform is to not explode into social chaos.

But, says Roche, "current market wisdom in the West argues that the market dictates all. . . . Nothing could be less sure." He points to a "direct contradiction between extremely long-term, high-risk allocation of resources to the former Soviet Union which will be needed to create a mixed economy, and the short-term horizon of current western economic, and much of Anglo-Saxon business thinking." Given the growing instability inside Russia and the CIS states of the former Soviet Union, rather than a significant increase of western private capital investment into Russia, Roche notes that "the contribution of the western private sector to CIS reform is, if anything, on the wane."

What, then, is the realistic prospect according to the Wall Street firm? "Failure of reform in the former Soviet Union would not leave the West as economically unscathed as the Gulf and Yugoslav wars have," Roche insists. He documents the fact that western Europe, notably Germany and Austria, depend for 50% and 91% respectively on imported natural gas delivered by pipeline from Russia via Ukraine. "Trouble between the Ukraine and Russia could sever western and eastern Europe's gas artery." Unlike the loss of Russian crude oil, a mere 2-3% of European oil supply, and easily replaceable elsewhere, there is no ready alternative for Russian natural gas for much of German and other European industry and heating needs.

Full economic chaos in the CIS, Morgan Stanley con-

cludes, would "severely damage business prospects by undermining confidence particularly in western Europe." Consequences of that, Roche warns, would be a "flight of capital, higher interest rates (as political risk premiums are built into the cost of money) and deeper recessions. Western Europe would risk a swing to the xenophobic right as the small man feels the pinch of recession and immigrant labor. The consequences could be that Europe becomes less rationally governed, with serious implications for European integration and Europe's global stature and competitiveness."

Roche, noting the current economic problems besetting leading western economies, predicts the necessary western aid won't come in time to prevent anarchy and some return to a form of dictatorial regime. It should be noted that Morgan Stanley has been among the leading American investment houses consistently arguing since 1989 against German economic prospects and in favor of the dollar as "safe haven" against what it predicted would be chaos in eastern Europe. The firm is believed to have very close ties to Washington policy circles.

Kissinger 'explains'

All of this begins to make more sense, in its perverse way, when seen from the point of view expressed by influential Washington foreign policy "gray eminence" Henry Kissinger. In a commentary published in the March 1 German *Welt am Sonntag,* Kissinger warns, "So long as the two Germanys were divided, Germany's growing economic and military strength" did not upset the balance of power in Europe. "The so-called French leadership of the EC was the result of Bonn's abstinence from the challenges of power politics. A reunified Germany no longer needs French sanction to confirm she is a 'good European.' East Europe and the former Soviet Union depend on the German economy."

But, argues Kissinger, "Germany has now become so strong that the existing European institutions alone no longer are able to maintain the balance between Germany and her partners, and even less so between Germany and the former Soviet Union. . . . But if both powers were to make closer ties, there would be the danger of their hegemony. . . . Without America, Britain and France are not in a position to guarantee the political balance of power in Europe; Germany then would have no anchor to counter possible nationalistic ambitions or possible external pressures."

In this twisted revival of the failed 19th-century British balance of power politics that were responsible for World Wars I and II, Kissinger reveals the real reason for Washington's current policy of sending Harvard professors to unleash economic chaos in Russia and eastern Europe while blocking any significant western intervention to alter the chaos. Washington apparently calculates it can only gain from the chaos unleashed across Europe in coming months. The "economics" of George Bush and Henry Kissinger, sadly, are little different from those of Castlereagh and Lord Palmerston at the beginning of the 1800s.

East Germany faces massive unemployment

by Rainer Apel

"Wherever the Treuhand is active, it buries our labor power." These words, in somewhat crude German, appeared on one of the protest banners carried on March 4 by over 3,000 shipyard workers who came to demonstrate in front of the parliament building in Schwerin, the capital of Mecklenburg in northeast Germany.

The serious economic crisis which has befallen the shipyards in eastern Germany, and which has led to a deep crisis of confidence between workers and politicians of all parties, is only the most visible expression of a dramatic worsening of the situation in the formerly state-owned industrial concerns which were handed over to the Treuhandanstalt (THA) following German reunification in July 1990. Out of the formerly 7 million workers active in the *volkseigene Betrieben* ("people's factories") which were taken over by the THA that summer, only about one-half are still working there. And of those remaining, only about 500,000 of them could draw benefit from the emergency short-work regulations adopted in 1990 to help the new German states, but which ran out at the end of last year.

The expiration of these regulations had been set for Dec. 31, 1991, in expectation of a rapid economic upswing in eastern Germany; but even the upswing did not materialize, negotiations in mid-February between the federal and state governments did not result in any extension. And so now it is up to the THA itself to come up with the short-work payments which were previously being paid by the Federal Labor Office in Nuremberg. But since the THA does not have these funds, it is expected that the great majority of these 500,000 workers will be laid off during the weeks ahead. And it can also be expected that unemployment in eastern Germany will rise from its current 17%, to 25% or more.

Large-scale industry dismantled

The THA will therefore finally accomplish what it had been seeking even while the short-work relief was still in effect: an average reduction in employment by one-fifth to one-tenth. One example of this is the SEKT corporation in Magdeburg, which once had 11,000 employees but now barely employs 5,000, some 4,000 of whom are going on short-work this April. Eastern Germany's shipbuilding industry, which before the fall of the Berlin Wall employed