

The IMF's geopolitics ruined the economies of eastern Europe

by William Engdahl

The following is abridged from a study that appeared in EIR's Special Report "Russia's Future: Dictatorship, Chaos, or Reconstruction?" published in August 1994. EIR published an abridged version of the report's Chapter II, by Lyndon H. LaRouche, under the title "A Science-Driver Program to End Russia's Depression," in our April 22, 1994 issue.

In October 1993, former British Prime Minister Margaret Thatcher released her political memoirs, *The Downing Street Years*. In her account of the events surrounding the opening of eastern Europe at the end of the 1980s, Thatcher was remarkably blunt. She wrote: "The German question and the consequences of reunification were my chief preoccupation when, in September 1989, I decided during my return trip from a conference in Tokyo, to pay a brief visit to Moscow in order to talk with Mikhail Gorbachov." Thatcher added, "I told him quite frankly that while we in Europe traditionally acknowledged the goal of German reunification, in reality this caused us great concern. This I added, was not only my own opinion; I had also discussed this question with another top political figure, by which I meant President Mitterrand. . . . This [discussion with Gorbachov] strengthened my own resolve to slow the already hectic tempo of developments."¹

Thatcher's hostile view of the transformation possibilities in eastern Europe, and most emphatically against German unification in 1989-90, is thus a matter of public record. Such a response from Britain at the end of the twentieth century would be astonishing only if one were ignorant of the long-standing British doctrine of "balance of power" or "geopolitics," in which British politicians and diplomats have been schooled at least since the 1815 Congress of Vienna.

Sir Halford Mackinder and German unification

To understand the way the Group of Seven industrial nations, beginning in 1989, responded to the potentials of changing economic structures in eastern Europe and the former Soviet Union, it is best to begin with a brief review of

1. Margaret Thatcher. *Downing Street No. 10: Die Erinnerungen*, Econ Verlag, Düsseldorf, 1993. Sir Halford Mackinder, "The Geographical Pivot of History," in *Geographical Journal*, No. 23, 1904. Royal Geographical Society, London.

a seminal policy thesis first presented to the British Royal Geographic Society in January 1904. This policy thesis forms the ideological underpinnings for Britain's determination to orchestrate the events which led ineluctably to World War I, as an attempt to destroy the influence of the German empire in continental Europe. But the essay has also shaped British diplomacy to the present day.

The paper, "The Geographical Pivot of History" was authored by Sir Halford J. Mackinder, a Reader in Human Geography at the University of Oxford. His theses can be summarized briefly as follows:

- "Who rules eastern Europe," meaning German-centered Central Europe "rules the Heartland," meaning Russia-centered Eurasia;
- "Who rules the Heartland, controls the World Island, meaning the Eurasian landmass from Vladivostok to the Atlantic; and,
- "Who controls the World Island, rules the entire World."

But the corollary to this doctrine of geopolitics is the British stance toward this geopolitical view of Eurasia. Britain as a global empire and an "Island Power" separated from continental Europe by the English Channel, in Mackinder's view, must do all in its power to hinder any successful convergence of economic and political cooperation between the nations of Central Europe and Russia.

Thus, the prospect of a German-dominated group of European states, including France and Italy, extending industrial and financial cooperation to construct modern industrial economies in Poland, East Germany, Hungary, and especially Russia, was anathema, not only in the view of Prime Minister Thatcher, but also of leading figures in the City of London, the Foreign Office establishment, and the U.K. media.

In the United States, this view was most explicitly echoed by former Secretary of State Henry Kissinger, who spoke out from his position as head of his private international consultancy, Kissinger Associates. He drafted numerous newspaper columns after 1989 openly warning of the dangers of a strong Germany.

Kissinger was very influential at the highest levels of the Bush administration. Two intimate collaborators, both formerly with Kissinger Associates, held key positions with-

in the Bush administration: National Security Adviser Brent Scowcroft, and then-Undersecretary of State Lawrence Eagleburger, who later replaced James Baker, as in 1992, as full secretary.

President Bush himself appeared at best ambivalent about German unification. When reporters asked the President for his comment when the Berlin Wall came down on Nov. 9, 1989, a solemn Bush replied, "Well, I don't think any single event is the end of what you might call the Iron Curtain." Privately, Bush reportedly told aides, "I'm not going to dance on the Wall!" Only when German unification was clearly unstoppable did Bush appear to support German developments in the face of U.S. popular approval.

In 1989, there was a policy accord among the governments of Britain, France, and the Bush administration, to ensure that economic events in eastern Europe did not lead to the kind of industrial transformation boom and construction of economic infrastructure at which German industry would surpass all others. This explains the rigid insistence of those three governments that the International Monetary Fund (IMF) should be at the center of the post-1989 transformation in eastern Europe.

Soros brings in Sachs and the speculators

Conveniently for those circles in the West determined to undermine or delay successful industrial development in eastern Europe, the two countries in the region with the greatest debt obligation to western banks and governments—Poland and Yugoslavia—were both already members of the International Monetary Fund, and were the first two countries of eastern Europe forced to take the IMF's medicine. Significantly, the western advisers who prepared the inexperienced new governments to impose IMF "shock therapy," were the same in both cases: New York-based financial speculator George Soros introduced a 34-year-old Harvard University economics professor, Jeffrey Sachs, to members of the Polish "roundtable" discussions even before the formation of the coalition government of Tadeusz Mazowiecki in August 1989.

Soros gave Sachs a base of operations in Poland by employing him in Soros's Warsaw-based Stefan Batory Foundation. Among those whom Soros and Sachs cultivated was Leszek Balcerowicz, the man who became shock therapy finance minister under Mazowiecki, and virtual economic czar of Poland after 1989. Balcerowicz's shock therapy program had been drafted by Sachs, a man whose only previous government advisory experience had been four years earlier, advising the Bolivian government of Paz Estenssoro. In Bolivia, Sachs ended hyperinflation by destroying the state industry sector, and linking the currency to the U.S. dollar.

Sachs even admitted that his program to link the Bolivian currency to the dollar most benefitted the cocaine barons, whose coca plants were sold in dollars. Sachs described the effects of his shock therapy in Bolivia on workers in the state tin mine company, Comibol. "Comibol has reduced its

employment from about 30,000 workers in 1985 to just 7,000 as of 1987. Although fiscally necessary, the results are stunning and indeed reflect a social tragedy. Many of these workers are still unemployed or have gone to the coca-growing regions to find work." This from the man who was to be a key adviser in Poland, slated to be the model for eastern Europe.

Soros was very well connected in both Washington and London, which meant he could get the ear of the highest government levels in economically desperate eastern Europe. He also introduced Sachs into Yugoslavia, where Soros was also present through his "philanthropic" foundation. Both Poland and Yugoslavia introduced Sachs-IMF shock therapy on Jan. 1, 1990.

Soros later boasted of his and Sachs's success in Poland: "Balcerowicz presented a radical program of monetary stabilization to the International Monetary Fund meeting in Washington [September 1989]. The IMF approved, and the program went into effect on Jan. 1, 1990. It was very tough on the population, but people were willing to take a lot of pain in order to see real change." There was change, but not what the Poles had hoped to see.

Then, Soros introduced Sachs to leading Moscow circles. In late November 1989, just after the opening of the Berlin Wall and days before President Bush was to meet Mikhail Gorbachov at the Malta summit, Soros met with Undersecretary of State Lawrence Eagleburger to discuss Soros's strategy for Russia. At that time Bush was reportedly cautious about proposing drastic shock therapy for the Soviet Union. But in August 1990, Soros assembled a team of economists including Jeffrey Sachs, former senior IMF official David Finch, and Ed Hewett of the Brookings Institution (who later became Bush's principal Soviet affairs adviser). Sachs, Soros, and the others went to Moscow in September 1990, where they established direct contact both with the group around Mikhail Gorbachov, as well as that around the newly elected parliamentary leader of the Russian Republic, Boris Yeltsin. Yeltsin had already established himself as an opposition to Gorbachov.

In June 1991 Yeltsin was elected President of Russia with 57% of the popular vote, and within weeks of Yeltsin's emergence over Gorbachov following the failed August 1991 putsch, President Yeltsin announced in November 1991 his appointment of an economic team headed by Yegor Gaidar, by then a close collaborator of Jeffrey Sachs. IMF shock therapy had also come to Russia, and the way was now clear to maximize economic chaos from Warsaw to Moscow to Belgrade.²

2. George Soros, *Underwriting Democracy*, MacMillan/Free Press, New York, 1991. Details on Jeffrey Sachs's Bolivian reforms and the impact on the coca cultivation are taken from the book *Bolivia: 1952-1986*, by Jeffrey Sachs and Juan Antonio Morales, International Center for Economic Growth, San Francisco, 1988. Details on aspects of the White House reactions to German unification can be found in Michael Beschloss and Strobe Talbott's *At the Highest Levels*, Little, Brown & Co., Boston, 1993.



A single mother demonstrating in front of the Russian government building, the "White House," in November 1992. Her sign reads "I demand an effective decree by Yeltsin on the social protection of single mothers." Her son's reads: "Gentlemen of the White House! We want to live and to have a happy childhood."

At the June 1990 Houston economic summit of the heads of state of the Group of Seven—U.S.A., Britain, France, Italy, Canada, Germany, and Japan—a proposal had been advanced by the Bush administration, with the strong backing of France's François Mitterrand and Britain's Margaret Thatcher, to put the IMF in control of the entire economic process in the Soviet Union, as it had been since 1989 in Poland and Yugoslavia.

Certain western heads of state were so eager for the IMF role in the U.S.S.R., that they waived IMF membership requirements, and granted the U.S.S.R. special "associate member" status, which meant they could receive IMF dictates, but none of the money the IMF holds out as incentive. Jeffrey Sachs, architect of shock therapy together with the IMF, was coordinating policy in all three countries. From time to time, Sachs sought to maintain his credibility with host governments wary of the harsh IMF dictates, by occasional criticisms of IMF tactics; but in reality, Sachs's shock therapy was IMF policy.

The significance of placing the IMF at the center of economic policy changes in Poland, Yugoslavia, and the U.S.S.R., is not well understood by most people. In fact, it was the essence of British geopolitics, the extraordinary effort after 1989 to hinder major western industrial and technological investment into eastern Europe, in which German industry would have played a crucial role.

A brief history of the IMF is in order before examining the results of IMF shock therapy for the former Warsaw Pact. When the true nature of the IMF is known, it becomes clear why Thatcher and leading Kissingerian elements around the

Bush administration, were adamant on the IMF's prime role in eastern Europe after 1989.

The IMF came out of the negotiations between the British and U.S. governments held at the famous 1944 conference in Bretton Woods, New Hampshire. The chief British negotiator was Lord Keynes; his U.S. counterpart was U.S. Treasury Undersecretary Harry Dexter White. These two men largely dictated the postwar IMF and World Bank monetary order. The resulting institutions, the IMF, its sister the World Bank, and, later, the General Agreement on Tariffs and Trade (GATT), were the product of strong British pressure on the United States to give Britain a determining role in the post World War II economic order, despite Britain's second-rate industrial status.

This British influence was confirmed in the fact that, although a bankrupt, former Great Power by 1944, Britain got the United States to agree to give it the second strongest voting power on the IMF's board, which has remained in force up to the present day, despite Britain's degeneration into a has-been industrial nation. It was not until 1993, following a bitter contest, that Germany and Japan finally got a larger voting share on the IMF Executive Board than Britain, despite the vast superiority of both countries' economies.

The British role through the IMF or the U.N. Security Council, is vastly more influential than any formal designation might indicate. The content of IMF policy has been thoroughly shaped by the radical monetarist dogma of Margaret Thatcher and her key financial advisers, such as Sir Alan Walters, who has been a senior official at the World Bank.

The IMF and the agenda of Thatcherism

Thatcher's economic policies were an updated version of late eighteenth-century British "economist" Adam Smith, with his "invisible hand" of the marketplace, often termed radical "free market" policies. As prime minister from 1979-90, Mrs. Thatcher pursued a fanatical economic dogma promoted by a secret elite group, the Mont Pelerin Society, whose president was U.S. free market economist Milton Friedman. Thatcher adviser Karl Brunner was a leading member of the Mont Pelerin club of radical free market economists.

Friedman's influence in the United States led to the destructive domestic economic policies of deregulation and *laissez faire* during the 1980s, which contributed to "junk bonds," corporate bankruptcies, soaring unemployment, and a tripling of the U.S. government's deficit, up to \$4 trillion by the time Bush left office in 1993.

In Britain, the only sector of the economy enjoying substantial growth during the 12 years under Thatcher was the financial services sector. Unfortunately for the majority of British citizens, Thatcherism imposed the most regressive tax burden on those least able to pay, and contributed to industrial decay, as government investment in long-term infrastructure projects was ruled out on ideological grounds. The real reason such needed investment was banned, was that Mrs. Thatcher's friends in City of London banks and investment houses preferred to reap huge profits in real estate, stock, and other speculation. A band of legal and illegal financial pirates was allowed to dictate British economic priorities.

The IMF leadership has always been in the hands of the most rigid Anglo-Saxon monetarists, regardless of nationality. There is a convention that the Fund's managing director must be French, usually from the monetarist Bank of France, whose priorities hold a strong French franc above the nation's needs for a growing employment economy. The IMF director now is former Bank of France chief Michel Camdessus. A previous Bank of France head, Jacques de Larosière, also former IMF managing director, is today president of the London-based European Bank for Reconstruction and Development.

The key policy posts within the IMF bureaucracy are also held by monetarists. Director of IMF economic policy today is Michael Mussa, a former student of Milton Friedman at the University of Chicago and a former university colleague of Thatcher's adviser Karl Brunner. Mussa is a radical monetarist who, in several personal interviews with this author, expressed no interest whatsoever in the economic well-being and development of eastern Europe. He showed more excitement over the technical aspects of financial derivatives speculation, and the probability theory behind that, than over the fate of the transition in former communist economies. Little wonder that the Fund recipe in eastern Europe, Russia, and other transitional economies, has been equally as destructive as it has been in the Third World.

But it is also notable that the man who has direct responsibility for the IMF's European Department, which oversees all eastern European IMF policy, is also a Thatcher monetarist, John Odling-Smee, who spent years in Thatcher's U.K. Treasury before coming to the IMF in 1990. Odling-Smee, like Britain's Lord David Owen, is a graduate of the elite Cambridge University.

Who stands behind the IMF?

Behind the IMF are the powerful financial global banks of the City of London and New York, and speculators such as George Soros of Quantum Fund, and Jeffrey Sachs. For the Ibero-American debtor countries, the 1980s were an unmitigated hell of IMF-imposed austerity. The IMF recipe was always to demand that a debtor country cut imports dramatically to bring a "balance of payments equilibrium." No matter that imports of machine tools and other industrial technology was vital for the development of the economic growth of the country, which could have enabled it to repay its debt without sacrifice. The goals of the IMF have no concern for a healthy, growing national economy.

The IMF mandate also includes savage cuts in government spending, and a heavy devaluation of the national currency. The argument is that the victim country must have a cheap currency value in order to make exports attractive, to earn hard currency, so it can repay its foreign debt. At the same time, the cheap currency, a form of "dumping," makes imports from the West prohibitively expensive, and ensuring zero long-term economic growth.

The history of IMF shock therapy across Africa, Ibero-America and other developing economies is one of the greatest unacknowledged criminal acts of our era. IMF "conditionalities" in Mexico, Brazil, Argentina, Peru, Venezuela, Algeria, Sudan, Egypt, and elsewhere over the past decade, have created only social misery and a handful of very rich people. The aim of the major banks and powerful financial interests in the City of London and elsewhere who stand behind the IMF, was to use the IMF threat to force "neo-colonialism" on less powerful economies around the world, for the benefit of the big banks and corporations of primarily the Anglo-Saxon world. This form of colonialism, they reasoned, was far cheaper than the nineteenth-century British version, with its costly occupation armies and civil servants. What these powerful Anglo-Saxon financial interests have been able to accomplish, using the IMF as their "policeman," has been to destroy entire nation-states.

But in recent months, an even more sinister agenda of the IMF debt restructuring process has emerged. Using the IMF austerity demands, coupled with the threat of IMF credit embargo against any victim country that refuses to bow before Fund conditionalities, the politically powerful banks of London and New York have been able to smash protectionist trade policies of debtor nations, and to force open their economies for asset-stripping and other forms of looting on a scale never dreamed possible, a process termed "globalization."

The recent stock market boom in Istanbul, Lima, Mexico City, or Kuala Lumpur and other so-called emerging markets, is an example of this globalization process. Foreign investors swooped into a defenseless and deregulated home market with large sums of dollars, boosting local stock market prices artificially, often with the cooperation of friendly local news media. They make profits of 60-80% or more in a weeks or months. Then, the hot money flees as fast as it came, usually taking the profits with it, at the expense of the local or national economy. Or if the investors remain, they buy up local industry dirt-cheap after IMF-dictated devaluations have made them attractive to the foreign predators.

In sum, there is no nation submitting to IMF conditionalities, which has seen a real per capita improvement of that its overall standard of living as a result. Had Germany or the United States in the nineteenth century followed IMF-type rules, rather than the nationalist economic policies of Friedrich List and Henry Carey, they would be today British colonies.

It can only be termed criminal, given a decade of IMF dictates in Ibero-America and Africa, that the Group of Seven governments decided, after communism collapsed, to insist that the Fund play the leading role in the economic reconstruction of the nations of eastern Europe and the former Soviet Union. What Stalin could not accomplish in four decades of bloody terror, the IMF has done in four years in many countries.

At the time of the opening in the East, the United States under Bush and Britain under Thatcher dominated IMF policy. A third major voting IMF member, Mitterrand's France, backed the decision to make the IMF economic dictator of eastern Europe and the former Soviet Union. The consequences have been horrendous, as we shall now indicate.

Market reforms, when there's no market

In the 1980s, Poland, Yugoslavia, and the Soviet Union were quite diverse, with different economic problems and potentials. Culturally, Poland and Yugoslavia were much closer to western Europe, with decades of labor exchange in the West, as well as a more recent experience with capitalist forms of property than Russia had. Russia had been under communist rule since 1917, and had been far more isolated internationally. The industrial requirements of the three were also vastly different, despite superficial similarities of central planning.

Into this situation, entered the arrogant IMF officials, together with Jeffrey Sachs, to dictate economic policy, using the blackmail that IMF approval was a prerequisite for any future western investment. Despite willing submission, however, almost no western investment has been forthcoming, other than looting the resources of those three nations.

In each case, the IMF demand was the same:

- massively cut state budget outlays, by eliminating subsidies to the economy, whether for bread or coal, then, privatize state industry;

- fire "redundant" workers;
- devalue the national currency against the dollar, to make exports "attractive" in western markets, and maximize hard currency earnings, so that foreign debt can be serviced. That foreign debt was sacred, more than human life, even if it was made unbearable by politically motivated unilateral interest rate hikes by the U. S. Federal Reserve.

But the problem was deeper, and far more ugly. It was not as if Sachs and the Fund were unprepared for the enormity of the task of transforming former communist economies into so-called market economies. IMF specialists and the leadership knew exactly what they were triggering. They had more than 10 years' experience in Ibero-America and Africa doing precisely that.

The intent of IMF shock therapy from the outset was to minimize significant industrial restructuring, especially suitable modern transportation and communications infrastructure. Instead, shock therapy measures mandating that domestic prices be adjusted to something termed "world market price" were imposed.

Sachs and the IMF sold their bill of goods on the promise of "six months' pain, then recovery along the right path." In Russia and the rest of the former U.S.S.R., this policy was aimed at balkanizing the region into many small, weak client states, each with its own national currency, dependent on whatever western multinational investors it could attract. In Yugoslavia, it had the effect of providing an added economic and social crisis, around which the Serbian communist Slobodan Milosevic could justify his brutal seizure and war against Slovenia, Croatia, and Bosnia-Herzegovina. In Poland, it ensured misery and chaos for a country that could potentially provide a crucial support to the industrial transformation of all eastern Europe, including most especially Russia.

The entire premise of the IMF in eastern Europe was based on a calculated fraud: that the goal of economic life must be to create "free markets," i.e., self-regulating markets, controlled and directed by "world market price." All production in a society would exist only for sale, and all income comes from such sales; further, the state can do nothing to inhibit formation of markets, or to correct for external shocks which disrupt those market mechanisms.

One of the most destructive fallacies of postwar economics teaching in universities has been that capitalism's success in the West in creating great wealth was a direct result of unfettered operations of free market mechanisms. This strain of radical monetarism, typified by Milton Friedman's "Chicago School" and the dogma of Friedrich von Hayek, the co-founders of the Mont Pelerin Society, shaped economic thinking during the 1980s. The bankruptcy of the major economies in the English-speaking world in the 1980s, a direct result of such free market policies, should have served as a strong warning to the nations of eastern Europe.

"Markets" do not exist free in some primordial nature, as self-evident entities. Markets are entirely the product of

man's efforts to regulate his economic life. Just as there never was Marx's utopian world socialism in the Warsaw Pact, there has never been a "world market price" for any specific goods or commodities, except, roughly, for crude oil, and that, because it is under iron-tight control by the multinational oil cartel. To a lesser extent, there is a world grain price, controlled on international markets by a cartel led by four giant U.S.-based trading companies: Cargill, Archer Daniels Midland, Continental Grain and ConAgra. Thus, when the IMF tells Moscow to price its oil at "free market" world prices, this is an utter fraud. In reality, there exist tens if not hundreds of thousands of local, regional, and occasionally international "market prices" for goods, depending on the specific buyer and seller.

No advanced industrial economy on Earth has succeeded in creating a stable, healthy, growing economy by applying such free market dictates as demanded by the IMF for Russia and eastern Europe. The emergence of the United States in the nineteenth century as an industrial giant was directly tied to application of dirigist state policies under President Abraham Lincoln and his economic strategist Henry Carey, who was trained in the American System of political-economy established under U.S. Treasury Secretary Alexander Hamilton, founder of the First National Bank of the United States. Germany transformed itself into the technological leader of the industrial world by the end of the nineteenth century based on application of the economic nationalism of Friedrich List. And Meiji Japan borrowed from the relevant

experience of Germany and the United States to modernize its economy beginning the 1870s.

Even in Britain, site of the first Industrial Revolution, economic progress was based on decades of trial and error in which regulation and market developed in parallel, beginning about the time of the 1601 Poor Law, as well as various anti-enclosure land policies of the Tudor and Stuart rulers to protect the peasantry from mass starvation. It took two centuries, in which land and money were first organized, before the organization of labor to the industrialization process began on a large scale, with the 1795 passage of the so-called Speenhamland Law. That law was intended to assure a minimum living standard to all wage laborers, based on the price of bread, and other laws easing parish feudal restrictions on labor mobility. Poland and the former Warsaw Pact countries were being told by Jeffrey Sachs and the IMF to do the same in six months.

The record of economic results since imposition of IMF shock therapy speaks for itself. The cases of Poland, Yugoslavia (until outbreak of war), and Russia, illustrate the unspeakable damage done over the past four years.

Poland: The first shock victim

At the end of October 1989, Poland became the first eastern European country to adopt IMF shock therapy, with the measures going into effect in January 1990. Under the government's "Program of Stabilization and Systematic Changes," measures put forward by Finance Minister Leszek Balcerowicz included

- punitive taxes on wage increases;
- an end to worker bonuses;
- accelerated tax payments;
- sharp cuts in state subsidies to reduce the state budget deficit;
- removal of state price controls;
- cutting credit to state enterprises; and,
- a radical devaluation of the zloty, to allow Poland to earn more hard currency by dumping its goods onto western markets.

Balcerowicz was advised by the Fund and Jeffrey Sachs on his economic policy, and the entire focus was allegedly to reduce the severe inflation, and increase the role of what the Fund called "market forces." Not all of the elements of the Balcerowicz plan were harmful to the economy. Many, such as selective ending of subsidies, cancellation of central quotas for enterprises, and a prohibition of government borrowing from the Central Bank at zero interest to cover deficits, would be desirable under any intelligent economic program. But this was not the core of Sachs's shock therapy.

The bulk of the Sachs-Balcerowicz plan was a disaster. Initially, under a program to kill inflation, Poland experienced hyperinflation, much as Russia did after January 1992. The hyperinflation resulted partly from a state budget deficit financed by new unbacked money, but mainly from the freeing of prices to "market" levels, and elimination of state

What's in EIR's special report

We summarize below the table of contents of EIR's Special Report, "Russia's Future: Dictatorship, Chaos, or Reconstruction?" The 142-page report can be ordered from EIR for \$250 at (703) 777-9451, or by writing EIR News Service, P.O. Box 17390, Washington, D.C. 20041-0390.

Foreword, by Michael Liebig

1. Russia's future: The three alternatives, by Lyndon H. LaRouche, Jr.
2. A reconstruction strategy for Russia—and the world economy, by Lyndon H. LaRouche, Jr.
3. Whither Russia: A situation report, by Brig. Gen. Paul-Albert Scherer (ret.)
4. The military in post-Bolshevik Russia, by Konstantin George
5. Have we already lost eastern Europe and Russia? by William Engdahl

budget subsidies. By January 1990, inflation reached 80% per month. But beginning 1990, the anti-inflation program was suppressing the real physical-economy of the nation. Within one month in early 1990, production fell by 31%, trade by over 50%, real wages by 30%, and prices rose by 80%. The government imposed loan interest rates of 38% *per month*, while wages were allowed to rise only 0.3% per month, and the convertible zloty was allowed to fall to 9,500 zlotys per dollar.

Industrial firms had no capital for wages or machinery; trading firms, no money to finance inventories; and individual consumers had no money to buy goods. State enterprises reacted by cutting production, as inventories of unsold products piled up, households reduced spending, farmers were unable to sell their milk, meat, wheat, and vegetables. The first 500,000 unemployed workers appeared in the early months of 1990.

But the IMF and Sachs were quite happy with the initial results. They expected it, as their goal was not improvement of production and living standards, but the development of what they called a Polish equilibrium in its foreign balance of payments, and only secondarily, to achieve internal "equilibrium."

Domestic "equilibrium" was reached, as production drastically decreased to match demand, which had decreased even more. The forced export of food to the U.S.S.R. ended in increasing domestic available supply. At first people reacted favorably, expecting it was a short-term sacrifice on the way to capitalist free market paradise. Food appeared in the shops, albeit at far higher, uncontrolled prices. People drew on their savings to live through the first months of shock therapy, clearly expecting dramatic economic improvement at any moment, as Balcerowicz and other government officials claimed.

With the forced devaluation under IMF orders, to 9,500 zlotys per dollar exports boomed while imports were prohibitively expensive. Enterprises exported everything possible, yielding a surplus on the national current account of \$4 billion by early 1990. But this surplus only fueled inflation. Goods had been removed from the domestic market while zlotys earned by exporters were pumped into the economy, allowing more zlotys to chase fewer goods.

The main impact of the Balcerowicz program was directed against domestic credit, with drastically higher bank interest rates and severe limits on credits to state enterprises. The second impact was a punitive tax on wage increases, which created a situation of radical economic deflation, or economic depression.

But when Professor Sachs first announced his shock therapy program in Poland, he predicted an "economic boom" after six months of "pain." Instead, industrial production in Poland fell by some 19% between 1990 and 1991. As shock therapy went into its second year, there was a deep decline of real (deducting inflation) wages, severe contraction of social transfer payments, and reduction of private savings.

In 1993, a United Nations International Children's Fund (Unicef) report on Polish living conditions reported that at least 20% of children in Warsaw were going hungry, that 50% of families with three or more children were below the poverty line. One-quarter of all families in 1992 had applied for welfare. And by late 1993, more than 8 million out of 38 million were forced to live by a meager state pension.

Incomes for state enterprises were cut by the IMF-dictated policy, investment levels were driven below what was needed to replace outmoded or worn-out equipment. The budget collapsed, as firms were generating no profit, and the budget deficit began to explode. Pensions were in danger, and ability of communes to invest in anything was almost nil. Poles were getting their welcome to the free market economy.

The lack of social protest was due to a general confusion as to whom to blame for the misery. Because it was government policy, and there were no clear targets of blame, the misery was blamed on "market forces," or Adam Smith's "invisible hand." By the end of 1991, Polish unemployment had reached a staggering level of 2 million. IMF shock therapy was working. The government defended itself by arguing it had signed "Letters of Intent" with the Fund which mandated the strict austerity measures. What Poland got in return was social misery, collapsing production, organized crime, a black market economy, and a debased population. Polish voters signalled their clear revolt against shock therapy in January 1991 during the elections in which Lech Walesa became President, and the IMF and U.S. Embassy delivered open threats to the Polish government, to force it to keep Balcerowicz and the IMF shock therapy program. They were told if they did not retain Balcerowicz, all western assistance to Poland would cease. Balcerowicz remained, and Walesa's first choice as prime minister, Jan Olszewski, a critic of shock therapy, was forced to withdraw under IMF pressure.

By the end of 1992, after almost three years of IMF shock, Poland's industrial production had fallen by fully 41%, to a level 59% that of 1988, according to official Polish data. Poland's Gross Industrial Output in late 1992 was down to the level of 1975. Yet, for all the IMF-imposed misery, inflation ran at 70% in 1991 and more than 42% in 1992 and 40% in 1993—hardly a model for stability. By the end of 1993, Polish unemployment had passed 2.8 million workers, more than 15.7% of the active labor force.

The most telling scars of four years of IMF economic dictatorship are visible in two critical areas: the coal industry and agriculture. The IMF and the World Bank immediately began to target Poland's most important export-earning industry, production of hard coal for electricity and coking coal for steel-making. The dimensions of what they have imposed in this sector are staggering.

In 1989, Poland was the sixth-largest producer and exporter of hard coal in the world, with 70 mines in production. Some 65 mines produced 98% of the coal, in the Upper Silesian Basin near to the Czech border. Throughout most of

the 1980s, production of Polish hard coal remained at slightly more than 190 million tons per year. Then, in the first days of the IMF shock therapy, the Polish government was pressured into an agreement with the World Bank on the following points:

- Domestic industrial prices for coal energy would be raised to world market price as observed in the OECD industrial economies by the end of 1990;

- Coal energy prices for households must reach 50% of that for industry by end of 1990, and 100% by end of 1991;

- Overall domestic coal prices must be “progressively” liberalized so that they would rise to world levels by end of 1992.

Compare this rapid shock with the decades-long process of phasing out coal mining in Germany, France, or other western European countries. The first Balcerowicz budget for 1990 under the IMF allowed no guaranteed credit for the Polish energy sector. The hope was that with price reform, the coal industry would be able to raise the funds it so urgently needed for investment and modernization of production. Instead, coal production began falling drastically as industry was unable to pay the enormous price increases.

Coal was subordinated to the supreme goal under the IMF program of “macroeconomic reform” and combatting inflation, reminiscent of subordination to the supreme goal under communism of “fulfilling the Five Year Plan output.”

The IMF and World Bank program explicitly called for “reshaping” Poland’s energy balance by sharply reducing dependence on its high-quality, abundant coal, in favor of increasing the share of oil and gas (both of which must be imported). The results have been predictably disastrous for the Polish economy, and a major contributing factor to the economic depression which has accompanied shock therapy. From a peak production of 190 million tons of hard coal in 1988, Poland dropped to 178 million tons in 1989, when the five-day work week was introduced to quell worker unrest. By the end of 1990, production had dropped to 148 million tons. By 1992, domestic hard coal output had fallen to 132 million tons, a drop of more than 30% from the peak output.

The World Bank plan adopted by Balcerowicz in 1990 called for Poland to move from being a major coal exporter, to becoming a coal importer beginning the next decade. This could be to the net benefit of Poland’s international export rivals, British-owned mining companies such as Rio Tinto Zinc and certain U.S. coal exporters. Otherwise, it makes absolutely no sense.

But for Polish agriculture, for decades the center of economic debate, the results of the Sachs shock therapy were even more devastating. Little known outside Poland is the fact that Balcerowicz and Sachs had introduced price shocks into Polish agriculture beginning July 1989, when the government introduced “market mechanisms.” This was purely monetary, with no accompanying measures to ensure reform of the deliberately inefficient, tiny land-holdings, or the fact that under the old regime Polish families were forced to

overemploy labor-intensivity on private farms, with an average of 25 persons per 100 hectares, compared with 6 per 100 hectares in West Germany. As unemployment grew, this over-concentration of labor on the farms had no place to go, further aggravating the income pressures on farm families. But this was only part of the absurdity of the Sachs IMF policy.

In August 1989, the government eliminated state purchase guarantees to farmers, and lifted state price controls. At the same time, the state began to free most retail food prices in state shops, while dramatically cutting state subsidies for same. Before, the subsidies had kept food costs for the Polish population relatively stable. The consequence of freeing prices and cutting state subsidies was a predictable increase of overall inflation in the domestic economy. By October 1989 the monthly inflation rate began to reach explosive levels. The average cost of living increased for 1989 by 251%, and another 586% in 1990. The government was aghast, but Sachs and the IMF insisted this was merely “corrective inflation.” By 1991 the tempo declined to “only” 70% annual food cost inflation, and was still rising by 46% in 1992. But the early actions had triggered the very hyperinflation for which Sachs then claimed his shock therapy was the only cure. In short, Sachs’s policies created the problem in the first place.

Moreover, these price radicalization measures did not improve agriculture. Beginning January 1990, all prices throughout the economy were liberalized under shock therapy. Rent costs, including heat and electricity, rose an average 773% in 1990, and another 131% in 1991. This meant that ordinary households were forced to cut back on food in order to survive. Pensioners on fixed incomes were the worst off, as their relative share of income earmarked for rent, heat, and electricity, increased 44% from January 1990. Milk consumption fell 14% between 1988 and 1991, sugar by 27%, and eggs by 21%.

But when Poland’s borders were opened, and foreign trade liberalized under IMF reform and “currency stabilization” after 1990, for the first time large volumes of foreign agriculture products began to be available (the amount imported doubled from 1990-91), often costing much less than domestic products, further aggravating economic pressures. The share of domestic farm products sold to the state declined from 67% of the total in 1989 to below 48% by 1991. The share sold in direct sales to the consumer by farmers to 34% by 1991, most of it naturally outside the new state value-added tax (VAT) system, further reducing state budget revenues.

Farmers were also hit with worse terms of trade under the shock therapy, squeezed by price hikes for necessary farm inputs such as machinery, fertilizer, feed, and pesticides as state-subsidized prices were removed in 1990. Costs for inputs increased an impressive 4,273% between 1988 and 1991. But the farmers’ sale price in the same period rose an average of 1,639%. By 1990 this had already been a loss of

50% in terms of trade. According to official Polish government statistics, in 1990, some 42% of all private farmers had income "under the social existence minimum," double the level of a decade earlier.

Farmers were also unable to buy tractors. Overall, farmer investment outlays fell from 1988 to 1990 by 40%, and another 43% in 1991. Fertilizer use fell by 46% from 1988 to 1991, pesticide use by 75%, and high-protein animal feed purchases by 63%.

In commenting on the results of his shock therapy in Poland, Jeffrey Sachs, at an economic forum in Switzerland in 1992, told this author, "Look, for the first time you find food in the shops in Poland as a result of the reforms; you can find caviar, salmon." But these are imported, and only a tiny handful of the population can afford them. The vast majority of people can only window shop.³

For all this sacrifice on IMF orders since 1989, Poland has not been the beneficiary of significant net new foreign direct investment, but only short-term speculative "hot money" flowing into and again out of the new Warsaw Stock Exchange. Beginning in 1993, various western economists have been touting a slow, but clear, recovery of production in Poland as proof that the country's shock therapy has been successful. Nothing could be further from the truth. A recovery of 2% from the dramatic collapse in output caused by Sachs and the IMF, even if it were accurate, would not be a recovery. But, as anyone who has spoken with Polish government economists can attest, official Polish economic data are even less reliable than under communist central planning.

Little wonder that in the September 1993 national elections, Polish voters ousted the pro-IMF regime of Prime Minister Hanna Suchocka, and voted in a coalition of parties with ties to the former communists. But the tragedy is that, as of this writing, the new government of Prime Minister Pawlak has knuckled under to IMF pressures, and has not made an open break with IMF shock therapy.

Yugoslavia: IMF shock therapy triggers war

The same day that shock therapy was implemented in Poland, Jan. 1, 1990, it was also adopted by the government of Yugoslavia. The economic effects of the ensuing chaos and hyperinflation were a major contributing factor in driving the Serbian Slobodan Milosevic to a military "solution," with prompting by British and other western governments, not the least being George Bush's Secretary of State James Baker and his Kissingerian undersecretary Lawrence Eagleburger.

War in the Balkans has been a favorite British geopolitical trigger to destabilize Central Europe since 1910. Winston

Churchill termed this region the "soft underbelly" of Europe. The fact that two British oligarchs, Lord Peter Carrington followed by Lord David Owen, have been the European Community "mediators" in the Balkans since 1991, attests to British geopolitical interest. It is a matter public record that Lord Owen and the British government have openly backed Serbian conquest and covered over the "ethnic cleansing" genocide as part of their broader geopolitical aim of destabilizing German and continental European economic ties with Yugoslavia, one of the key economies in the south-eastern region of Europe, with the most potential to effect dramatic industrial transformation. France under Mitterrand formed a de facto new "Entente Cordiale" with Britain around Balkans policy, which has served to prevent a just resolution of that war to date.

Despite conflicts on many other issues, Mitterrand has backed every crucial policy issue from the British side in the Balkans, echoing the post-1904 "Entente Cordiale" alliance of England with France against Germany.

On Jan. 1, 1990 the Belgrade government of Ante Markovic, under IMF pressure, adopted the shock therapy program. Wages and prices were frozen for six months to combat runaway inflation, then at an annual rate of 1,240%. Government price controls on electricity, coal for power generation, iron, and steel were all removed. Money supply to the economy for the first six months of 1990 was drastically reduced and interest rates soared. All this was an IMF precondition for negotiations with western creditors on rescheduling Yugoslavia's hard currency foreign debt. Unlike Poland, the Yugoslavian government made strenuous efforts after the debt crisis of the early 1980s to both service its debt and to reduce overall debt. By 1990, foreign hard currency debt had fallen to \$17.8 billion from a peak of \$22.5 billion in 1987, a sum that, even so, equaled the country's entire 1989 export of goods and services. The Markovic government's program was shaped by economic adviser Jeffrey Sachs, modeled on his Bolivian program described earlier. In May 1988 the government began with partial freeing of agricultural prices, as Poland had done. Then, on Dec. 18, 1989, the Yugoslav Central Government Council and Parliament approved the full Sachs shock therapy program to begin that coming January. That program called for:

- full dinar convertibility and pegging the dinar to the German mark;
- rigid monetary control of credit into the economy;
- reduction of the state budget deficit to zero via new taxes and elimination of subsidies;
- free floating of almost all prices after a brief freeze of prices to dampen inflation;
- freezing of wages at November 1989 levels;
- currency reform making 10,000 old dinars equal to one "convertible" dinar, with seven new dinar equal to 1 deutschemark.

A cornerstone of Sachs's "anti-inflation" strategy for Yugoslavia was, as in Bolivia, to force interest rates above the

3. International Atomic Energy Agency, *Energy Policies: Poland*, Paris, 1991. Elske Mohr, "Landwirtschaft in Polen: Trotz gro en Privatsektors Verlierer im Reformproze a," in *IFO Schnelldienst* No. 4, 1993, Munich. Economic Commission for Europe, *Economic Survey of Europe in 1993-1994*, Geneva, 1994; and, E. Czarny, "Die Auswirkungen des wirtschaftlichen Umbaus auf den Lebensstandard in Polen 1990-1991," in *Osteuropa-Wirtschaft* No. 3, September 1992.

existing rate of inflation, 59% per month in December 1989. But the effect of this, combined with the wage freeze, was predictably a social catastrophe. State enterprises depended on state credits to pay their employees. With frozen prices, this spelled bankruptcy to many firms. In the first months of 1990, under IMF shock therapy, the inflation rate did decline from a peak annual rate of 1,240% in 1989 to "only" 660% for 1990.

But the cost was a dramatic increase in unemployment, as firms were forced to lay off workers, and even close down. The important textile industry was devastated, and cheaper imports caused additional market losses. The pharmaceutical, agriculture, chemicals, and other industries were in deep depression by mid-1990. By September, national industrial output had fallen 12% compared with the previous year. And for the year 1990 as a whole, production was down 11%. In 1991 came an added 20% collapse in output. Wages and salaries, after adjustment for inflation, dropped by 22% in 1990 and another 13% in 1991. Business investment with astronomical credit costs fell 18% in 1990 and another 30% in 1991.

The IMF shock therapy was not the only cause of the war launched from Belgrade against Slovenia, Croatia, and Bosnia in the summer of 1991. Although that is a subject for another setting, let me say here that it provided the suitable context of exploding economic crisis and depression, which encouraged the citizens of Slovenia and Croatia to vote in non-communist governments for those parts of Yugoslavia in April 1990, proposing a loose federation structure of the various parts of Yugoslavia, in opposition to the Serbian communist government. From that point on, it was a matter of devolution of developments until Milosevic launched his military solution on July 6, 1991.⁴

Russia and the CIS: Sachs's friends loot

The Soviet leadership had refrained from the 1970s until the mid-1980s from taking on large western debt burdens, unlike many governments of eastern Europe. But that began to change as the collapse of the Warsaw Pact system drew nearer. The 1986 oil price collapse in the West and the Chernobyl nuclear accident both hit the Soviet Union with a devastating blow, when the U.S.S.R. had a total western indebtedness of \$30.7 billion—a manageable sum for the large economy, especially given its gold reserves and its ability to earn hard currency revenue from oil and gas and other exports.

By 1988 the figure had climbed to \$42 billion. But, beginning April 1989, all controls were lifted and local enterprises were free to take on western debt, often with no oversight

from Moscow. Short-term debt alone grew by \$6.5 billion that year, taking the total Soviet foreign debt to \$54 billion in 1989. At this time, Germany, through the state Hermes credit guarantee agency and other channels, began to funnel an estimated \$8.2 billion to the central Moscow government in the context of the negotiations around German unity. By 1990, U.S.S.R. hard currency debt was estimated at \$60 billion, but reporting as well as debt servicing began to go into chaos, along with the economy.

Foreign hard currency debt totaled \$67 billion by the end of 1991, when the old arrangements under the Council for Mutual Economic Assistance, or Comecon, finally collapsed, along with Gorbachov's regime and the Soviet Union itself. Capital flight out of Russia reached epidemic proportions, according to best western estimates. In 1991, Russia became a full member of the IMF, and, within minutes of Yeltsin's forming a new Russian government in November 1991, the government was in intense cooperation with the Fund and Professor Sachs. By June 1992, the IMF calculated that Russia and the former Soviet states had accumulated arrears on their foreign debt of \$9.4 billion, the first time in postwar history that Moscow had defaulted on western obligations.

On Jan. 2, 1992, the new economic team of Russian President Boris Yeltsin, under then-Finance Minister Yegor Gaidar, announced price decontrol and other steps purportedly intended to revitalize the collapsing Russian economy. The very next day, Russia formally applied for full IMF membership, Gaidar having the impression that were Russia to take the initial painful medicine, a promised \$24 billion from the G-7 countries would begin to flow into Russia's economy; that never happened.

The Fund program for Russia was also designed by Jeffrey Sachs. That Jan. 2, 1992, the Russian government reversed more than 60 years of state price controls and began to lift price controls on 90% of consumer goods and 80% of industrial goods, allowing "free markets" to decide the new price levels. For the rest, prices rose immediately by some 350%, by state fiat. By the end of January, overall consumer price inflation had increased 500%. Simultaneously, the income levels of the broad population were effectively frozen, resulting in a collapse of living standards unlike anything since 1917.

Under orders from the IMF and Sachs, to attack this state-created inflation (output of goods in industry did not increase 500% at the same time), the State Central Bank stopped printing money. This meant prices on goods soared, while the money supply in circulation contracted. The Central Bank in the first quarter of 1992 increased its interest rates to local (state-owned) banks from 2% in late 1991, up to more than 80% by April 1992, and removed interest restrictions on member banks altogether, meaning new ruble credits for investing in rebuilding industry were impossible to pay.

Next, on Jan. 29, 1992, Gaidar and Yeltsin issued Presidential Decree No. 65 which said, "Everyone has the right to

4. Jacqueline Heinz, *Jugoslawien Länderanalysen*, July 1990, Frankfurter Allgemeine Zeitung Informations Dienste. Srecko Jurdana, et al. *The War Against Croatia: A Chronology of the Aggression*, Croatian Information Service, Zagreb, March 1992. Hubert Gabrisch, et al. *Transformationskrise setzt sich fort*, June 1992, Wiener Institut für Internationale Wirtschaftsvergleiche.

trade anywhere in whatever they wish." In short, unbridled free market chaos was also unleashed, in the name of "economic reform." At the same time, Gaidar introduced liberalization of foreign exchange and foreign trade, allowing local producers to import and export at will, with the exception of oil and gas. Gaidar's program called for all export prices, including oil and gas, to rise to world market price levels by the end of 1993.

To a desperate Russian population, the slogans of Sachs's IMF shock therapy promised a miracle cure. The IMF and the G-7, led by the Bush administration, held out the carrot of \$24 billion in western credits as soon as Russia agreed to formalize its shock reform by signing the Fund's letter of intent. In April 1993, the size of the promised western aid "carrot" was increased to \$43 billion, even though almost no monies had gone into Russia.

Since the Yeltsin government foolishly agreed to go along with the IMF shock therapy, what happened was predictably tragic. The so-called shock therapy reforms were the boldest attempt in history to restructure an entire national economy in one fell swoop. But by December 1992, the economy was in shambles, and hyperinflation was threatening, as the Congress of People's Deputies finally forced Yeltsin to dump Gaidar, though not the reform.

Nowhere were the negative effects of IMF shock therapy so evident as in agriculture and food production. According to recent estimates by the U.S. Department of Agriculture, which has had significant advisory exchange with Russia and perhaps the world's best data on Russian agriculture, per capita consumption of essential food items in the average Russian diet has plunged. While potato consumption has increased dramatically, consumption of meat and other essential protein sources has plunged, as price liberalization under IMF dictates caused price rises to unpayable levels, threatening severe malnutrition and disease. Total meat consumption fell 29% from 75 kilograms per capita in 1989 to only 53 kg in 1993. Egg consumption fell 21%, dairy products by 29%, fish by 43%. Further, official statistics have inflated even these numbers as the government began to count lard and animal bones as "meat," in an effort to conceal the severity of the declines.

As in Poland, even the giant Russian collective farms were unable to pay for fertilizers. Despite the fact that since 1972 Russia has been the major producer of mineral fertilizers in the world, per hectare application of fertilizer dropped between 1988 and 1993 by 71%, from 113 kg per hectare to 35 kg per hectare. Shortages of diesel and gasoline for fueling tractors and other equipment have had significant effects on productivity, and farms have been unable to buy new machinery, as prices have climbed between 19 and 35 times over the past two years. Farm equipment production has dropped 60% between 1992 and 1993. Tractor prices have gone from 12,000 rubles in 1988 to 13 million rubles in 1993, a thousandfold rise. Between 1986 and 1993, tractor deliveries to Russian farms fell 67%.

The other crucial sector of the Russian economy, energy, has suffered similar consequences under IMF shock therapy. Domestic oil prices increased between December 1991 and the first weeks of 1993 by 8,467%. Oil production has also plunged. In 1988, Soviet oil output passed the level of 624 million tons, or more than 12 million barrels per day, its all-time peak, and the highest of any nation in the world. By April 1994, Deputy Fuel and Energy Minister Anatoli Shatalov announced estimates that total output in 1994 for Russia would fall to 319 million tons from 350 million tons in 1993. He cited the financial crisis as forcing wells to close for lack of paying customers, as well as lack of investment for repair and expansion of production to new areas, and acute oil industry equipment shortages. More than 70% of Russian oil equipment had been produced in Azerbaijan before 1990, which was now in a war zone and economic chaos.

One critical area affected by the IMF shock therapy focus on strict monetary change, price adjustment, and state budget austerity, has been the large nuclear power industry. Since the 1986 Chernobyl accident, and indeed after the collapse of the Soviet Union three years ago, G-7 governments were demanding that all nuclear plants in the former Soviet Union be closed immediately for safety reasons. But the West was not prepared to provide an alternative source of energy. According to experienced western European nuclear experts with detailed on-site knowledge of the Russian reactor designs, this was not only foolish, but generally unnecessary.

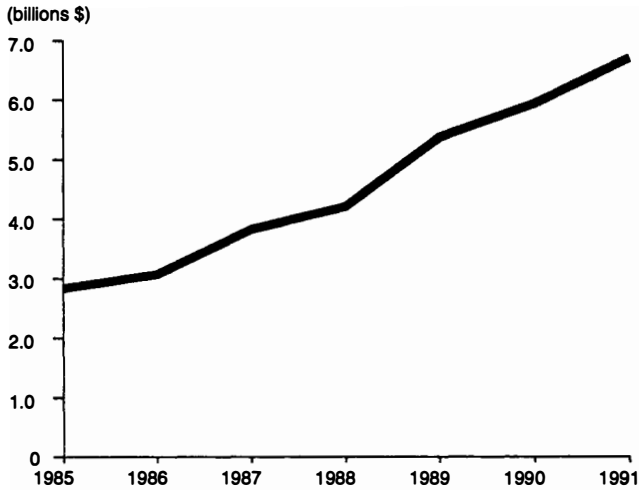
The Soviets developed two different reactor types. One, a water-cooled, graphite-moderated design, called RBMK series, is the Chernobyl type. This type does not presently exist in the West, and was clearly developed because of its dual-use ability to provide electricity for power and plutonium for weapons. As of 1991, there were 16 RBMK reactor units in operation, mostly in Russia and Ukraine, providing 16.5 gigawatts electric (GWe). This is roughly equivalent to providing all electricity requirements of two urban metropolises the size of New York City, or for 16 million people.

In addition to the RBMK series, the former Soviet Union in 1991 had 24 VVER pressurized water reactors, not entirely unlike the Westinghouse design extensively used in western Europe, especially France, and in the United States. Here the capacity is nearly 20 GWe, or enough for 20 million persons. The safety features on the VVER reactors have in many cases been modified, in some instances by Moscow after Chernobyl, to calm public anxiety, or are readily modifiable. According to impartial western experts, the VVER design features are in many ways superior to the Westinghouse design, and represent a manageable problem for safety. The RBMK design is also controllable in terms of avoiding a second Chernobyl-type accident.

But the IMF denies the importance of nuclear energy for Russia and the other republics. By permitting the radical price shocks to collapse oil, coal, and other conventional energy sources, forcing non-nuclear power plants to operate years beyond their replacement life, the Fund is putting

FIGURE 1

Total Soviet long- and short-term foreign debt ballooned, 1985-91

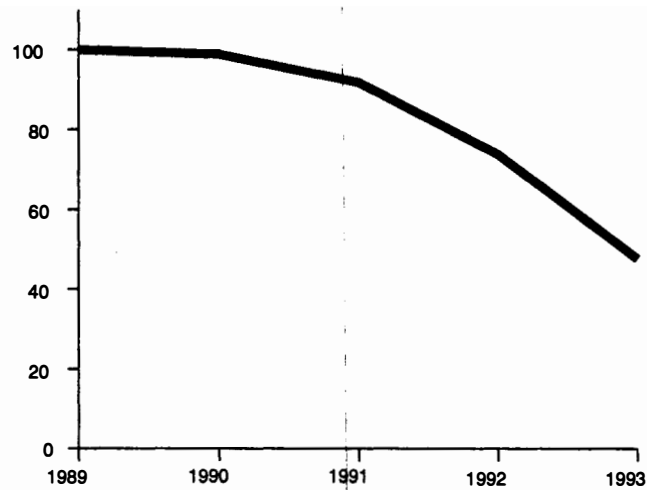


Source: EIRNS, World Bank

FIGURE 2

Russian industrial production plummeted

(change from previous year, 1989 = 100)



Source: EIRNS, Goskomstat

stresses on nuclear generation which are most unwise. While certain western media prefer to wildly exaggerate the dangers, there are real engineering and training problems that require professional support from the West. Russia alone currently has 28 nuclear reactors providing some 20 GWe of crucial electric power, with St. Petersburg getting 33% of its electricity from nuclear plants, and Moscow 22%.

The IMF also demanded as a precondition to its recommending release of the promised G-7 funds, that the Russian state first dramatically cut its budget deficit. But the Fund made no provision for ensuring that Russia had a modern functioning economic infrastructure in place beforehand, so that the underlying causes of the budget deficit could diminish along with the deficit, or any alternative "social safety net" to provide for the families previously employed in state industries, who had also received social benefits as part of their factory employment. On paper, Gaidar cut the state budget deficit. The stated goal of zero deficit by April 1992 was not reached, but the government claimed a state deficit of 3.5% of Gross National Product by April, some 50 billion rubles.

But sharp cuts in government spending were the only means to cut the deficit, since company "profits" in a western sense were nonexistent, and taxation of income was not successful with falling living standards. The state performed a bookkeeping trick to try to appease the IMF: It cut state allocations to industry, and at the same time let state-owned industries run up huge new inter-enterprise debts (or credits) to each other. The "state" deficit was merely shifted to become "enterprise" debts, despite the fact that these enterprises were state-owned. Companies that suddenly had credit cut off by the Central Bank under the Gaidar shock therapy, refused to pay other enterprises what they owed for pur-

chases. Inter-company debt of state firms, both to one another and to the Central Bank, went from 40 billion rubles in December 1991 to 3.2 trillion rubles by July 1992, an 8,000% increase in some six months.

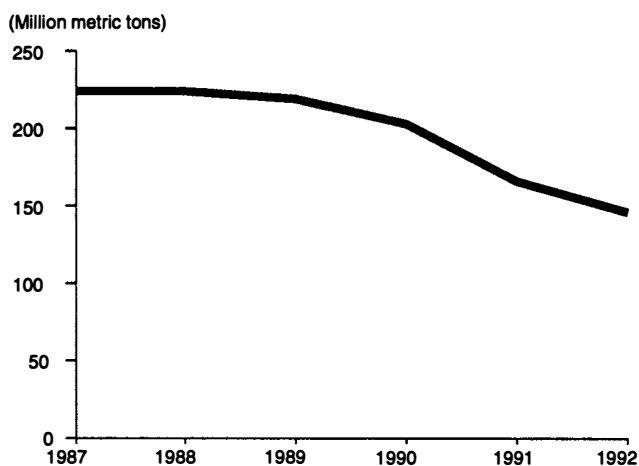
Major state enterprises at that point were forced to rely on Central Bank printing of rubles to bail them out, causing a general monetary inflation and collapsing the ruble's value for ordinary purchases, further enhancing the frantic efforts to get hard dollars at any cost.

In this situation, the possibilities for criminal "mafia" groups to loot the resources of the country and sell them at below world market prices to unscrupulous western speculators such as Marc Rich, became irresistible. Russian aluminum has been dumped onto western markets in recent months, collapsing prices in western Europe by 30% or more. So it has gone with oil exports and other raw materials such as timber, aggravating an already dramatic postwar unemployment crisis in western Europe. Here, alleged business associates of George Soros, including fugitive Swiss-based oil and metals trader Marc Rich and the Israeli arms dealer Shaul Eisenberg, moved in to reap huge trading profits, buying from these various local Russian mafias below cost of production prices because they paid in dollars and had the resources to move the raw materials out of Russia quickly.

Had the shift to ballooning of inter-company debts not taken place, given the impossible IMF conditions, one-third to one-half of all producing enterprises throughout Russia would have been forced to shut immediately down and fire all their employees, creating massive social problems, explosion, as the IMF state deficit restraints allowed no increase of social security spending for mass unemployment. Not surprisingly, local company managers and others opted to at least keep employment, however inefficient, going.

FIGURE 3

Steel output of former Comecon* countries, 1987-92



Source: EIRNS

*Comecon, or the Council for Mutual Economic Assistance (CMEA), was the commercial organization for the socialist bloc countries, until the collapse of communism.

To alleviate this unstable social situation, the Central Bank decided to extend "soft credits" to help settle inter-company debts, reducing them to a nominal 1.2 trillion rubles by September 1992; but confidence again eroded and inter-company debts rose, along with inflation, to previous levels by December 1992.

Because the Gaidar government's monetary shock recipe called for severe contraction of money supply, while a 655% consumer price inflation existed by March 1992, ruble cash for payment of employee wages was not available, and the wage arrears for workers began to balloon also. The arrears in wages exceeded 21 billion rubles, or 8% of the population's monthly income by that April, and rose to 65 billion rubles by July 1, almost one-fifth of nominal (depressed) monthly wages in the entire economy.

Faced with credit cutoff by the central government and breakdown of supply deliveries, the state-owned companies raised their own prices and cut production to meet the crisis. Industrial production in 1992 dropped an official 20%, and more than 15% in 1993. In May 1994, the Russian Economics Ministry announced that over the first three months of the year, industrial output had another 25% below levels at the end of 1993.

On top of this is a negative investment in industrial capital goods. In 1992, according to data from the European Commission for Europe (ECE), Gross Fixed Investment decreased 45% over the year before. In 1993 it fell another 50%.

The Harvard computer model of Professor Sachs and the IMF had no response to this situation, except to demand more shocks. Prof. Klaus Laski of the Vienna Institute for International Comparative Economics points out the absurdity of the demands: "There exists no precedent for the transi-

tion from a command economy to a market economy. The IMF and World Bank give the impression of having the right answers. But the outlook of these institutions is thoroughly monetarist. The prime focus of the IMF is to correct temporary imbalances in a country's national balance of payments," not to manage the most complex economic national restructuring ever undertaken.

Because of the extremely tense social situation facing the government by May 1992, Gaidar et al. decided to relax enforcement of new value-added and income taxes. The state deficit then went from 50 billion rubles in the first quarter to 301 billion rubles by July 1992. By December 1992, combining the state budget deficit with "extra-budget" credits to Gaidar's Finance Ministry, and the advance draw on expected January 1993 tax revenues, the actual total state deficit for 1992, the first full year of the IMF shock therapy, was 17% of the GNP, or 2.6 trillion rubles, rather than the IMF/Sachs target of 3.5%. By the end of 1993, the state deficit was estimated at 20 trillion rubles, some 30% more than the entire GNP of Russia.

Prices had already risen by Weimar inflation-style dimensions. In February 1992, consumer price inflation was at the level of 40-50% annually. Total price inflation in 1992 was an estimated 920% under shock therapy. By August 1993, consumer price inflation exceeded 1,250% annually. In this situation, the real economy and living standards plunged. Real wages after inflation fell by an estimated 50% according to data compiled by the Geneva-based Economic Commission for Europe. The ECE estimated a poverty level in Russia to have included "over 40% of the population" by the end of 1992.

The ruble-dollar exchange rate also collapsed in the last quarter of 1992. The government's much-publicized "vouchers," or small-share ownership certificates in state companies issued to the population by the end of 1992, was a thinly veiled political attempt by the Yeltsin-Gaidar government to calm popular discontent by giving them an illusion of ownership. The paper vouchers could be traded as a money substitute.

By May 1994 Russian officials were faced with the impossible choice of continuing with IMF budget austerity and anti-inflation measures, and thereby triggering an unemployment crisis of between 10-15 million unemployed in the coming months. Or, if they abandoned the IMF regimen and printed money to keep factories open, a new wave of hyperinflation was all but guaranteed. Shock therapy has indeed been proven to be a total failure in Russia.⁵

5. International Monetary Fund, et al. *The Economy of the U.S.S.R.: Summary and Recommendations*, Washington, D.C., December 1990. Anders Åslund, Jeffrey Sachs, et al. *Changing the Economic System in Russia*, Pinter Publishers Ltd., London, 1993. IMF Occasional Paper, "Price Liberalization in Russia," Washington, D.C., June 1993. Robert Baker, "Shock Therapy Ravages Russia's Food Production," in *Executive Intelligence Review*, Washington, D.C., March 18, 1994. The World Bank, *World Debt Tables: 1992-93*, Washington, D.C., December 1992. *Nuclear Engineering International*, 1990-94, London.