Russian financial system nears collapse

by Konstantin George

The outgoing head of the Presidential staff of Russian President Boris Yeltsin, Nikolai Yegorov, has warned that unless emergency economic measures are adopted, Russia will plunge into an "economic and political catastrophe" this autumn. The warning took the form of a "farewell document" by Yegorov to Yeltsin. The document, which broke the veil of regime censorship concerning economic statistics, was published July 19 in the dailies *Segodnya* and *Nezavisimaya Gazeta.* What was presented in detail was the imminent prospect of a blowout of state finances.

The crisis for the government of Prime Minister Viktor Chernomyrdin was compounded on July 22, when the International Monetary Fund (IMF) announced that it was withholding payment of its July monthly tranche of $330 million that Russia was slated to receive under the terms of the $10 billion, three-year standby credit it was granted in March. The withholding was in response to the report issued by an IMF team, which stated that it had not been able to complete its monitoring of Russian compliance with IMF "targets." The conflict seems to have arisen over the demand by Russian Energy Minister Shafranik for taxes on energy exports, a revenue-earning measure desperately needed by Russia, which the IMF has banned. In addition, the government had submitted an official request with the IMF, pleading for an easing of conditions.

The IMF is counting on the profile of the Chernomyrdin group to do whatever is asked, so as to receive both the July and the August tranches before all hell breaks loose on the Russian government bond market. In any case, it will be settled in August whether there will be another IMF "quick fix" for the comprador faction of Russia. In its July 22 announcement, the IMF said that its delegation will again be in Russia in early August, and will then present a final, detailed report to the IMF executive in Washington. The IMF executive will then decide whether to grant the tranches. The IMF decision will be timed with the expected official announcement of the new Russian cabinet.

Chubais replaces Yegorov

In his document, Yegorov emphasized that the crisis will be spearheaded by a collapse of the Russian financial system, including state finances. If the replacement of Yegorov as head of the Presidential staff by the notorious "Mr. Privatization," Anatoli Chubais, is any yardstick for Russian economic-financial policies over the next few months, then the chances for timely corrective emergency measures are slim. The Yegorov warning has placed all the relevant facts on the table, so that no one in the Russian elite can claim not to have had advance notice of the impending disaster.

Yegorov's warning has confirmed the warnings to the same effect by Lyndon LaRouche and *EIR.* Unveiling the statistics known to, but kept secret by the government, Yegorov reported that the decline of Russian production heavily accelerated at the close of the second quarter. In June 1996, industrial production was 8.3% lower than in June 1995. For bigger companies, it was 11% lower, and for machine production, it was 20% lower. Investments in the industrial sector had fallen by 20%, with productive investments made impossible by a regime policy of what he termed "hyper-profitability" for speculative financial operations. On top of that, as he documented, Russia had sold off 50% of its gold reserves and taken several billion in dollar holdings from the Central Bank. This was to enable the regime to meet the first wave of electoral campaign wage and pension payoffs to voters, without causing an immediate budget blowout.

Yegorov further disclosed the awesome dimensions of the crisis of state indebtedness, when the government must pay back 15 trillion rubles (about $3 billion) in the Russian equivalent of treasury bills coming due, and raise 30 trillion rubles in new notes to cover wages, pensions, and ballooning national debt-servicing costs. In the first quarter of 1996, some 15% of the budget was allocated for servicing the state's debt. This figure increased to 25% during the second quarter. During August, it is expected to be at least 40%.

Chernomyrdin's 'about face'

On several counts, the Yegorov bombshell was very well timed. The regime could could no longer deny the reality that had been confirmed to the Russian public. Two days earlier, on July 17, Chernomyrdin himself was finally forced to concede that state finances were closer than ever to a crash. As cited by Itar-Tass, he warned of the "consequences of the country's precarious financial situation." He declared, "We are standing before great, serious problems," adding that the government will do "everything possible" to prevent a "further worsening of the economic situation." He did not reveal, though he knows perhaps better than anyone else, the details as to why the financial situation is so precarious. He also did not say that the regime's methods employed to date to put off the day of reckoning, are being exhausted.

What are these methods? The Russian financial crash has been averted so far by a budgetary triage of entire sectors of the real economy. The latest example of this "robbing Peter to pay Paul" policy to meet IMF budget conditions, is the energy paralysis in the Russian Far East. The region's thermal power plants are unable to pay for fuel, because their customers, mostly state-owned enterprises and government agencies, have been cut off from budget funding since last autumn. The Russian Far East and Siberia had already experienced a daily pattern of loss of electricity supplies throughout this year. Then, on July 17, the Far East's main thermal power plant, Dalenergo, with a 1,400 megawatt capacity, ran out of fuel, and the region's smaller power plants were producing at only a fraction of capacity. This left the entire region of about 2 million people, including its two main ports of Vladivistok and Nakhodka, virtually without electricity. Besides the suffering of households, the industrial production of an entire region has all but come to a standstill.

The best that can be said about the group around Chernomyrdin and Chubais, is that they recognize on an empirical basis the extreme dimensions of the current crisis. Based on all evidence available so far, the solution they are proposing is a guarantee for one of two possible outcomes: an economic-financial blowout in August-September, or, through their manipulations, an even far more devastating blowout a short time later.

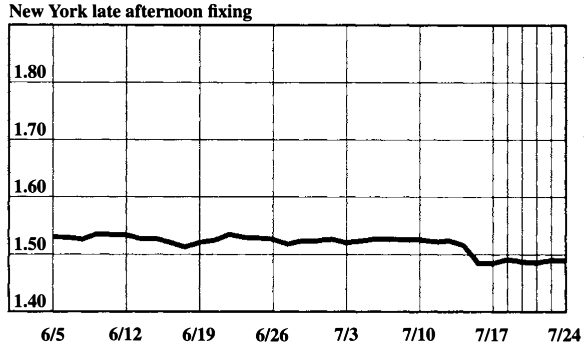
Their solution is a flight forward, monetarist approach to stave off, via a "garage sale" of choice Russian state assets, an imminent collapse of state finances. The details were revealed on July 18 by Alfred Kokh, first deputy chairman of the State Property Committee. Kokh presented plans for a new wave of privatization, meaning the sell-off of choice state enterprises. He didn't give exact dates, but said the sales would be held this year and would, allegedly, raise an anticipated 12 trillion rubles. In addition, Kokh announced the re-launching of the earlier Chernomyrdin "loans for shares" proposal, in which the top Russian banks would be enticed to buy government bonds in the amounts needed to prevent the collapse of state finances, and be rewarded through the option to convert the bonds at maturity into shares of lucrative Russian state enterprises. In short, debt for equity.

Even should these measures buy time, and that is by no means probable, the continuation of present policies will be measured in weeks or months. However, the cost of "success" is illustrated by what is happening in the Far East and other regions. As noted in the Yegorov document, the regime's triage policy against the regions, to "save the budget," has dried up the regions' financial resources. As a consequence, Yegorov wrote, Russia's regions have begun illegally issuing their own paper money, because no rubles arrive from Moscow. This phenomenon, together with the exploding debt and the collapse of goods production (given the July Far East and Siberian energy paralysis alone, the continued acceleration in this decline is guaranteed), is threatening a Weimar-style onset of hyper-inflation and chaotic breakdown. If the Chubais crowd has its way, this Weimar scenario will be reality in the near future.

Currency Rates

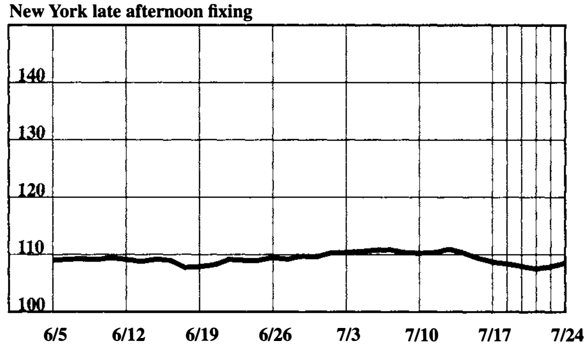
The dollar in deutschemarks

New York late afternoon fixing



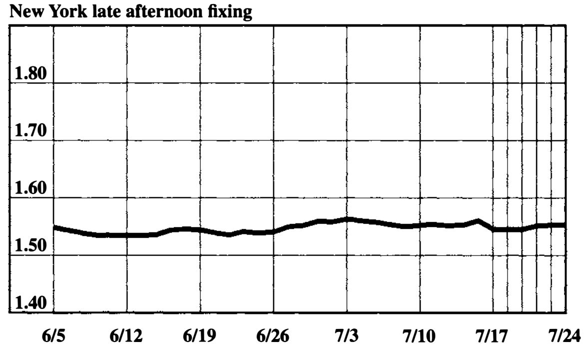
The dollar in yen

New York late afternoon fixing



The British pound in dollars

New York late afternoon fixing



The dollar in Swiss francs

New York late afternoon fixing