# EIR Economics

# Russia's borrowing binge may not buy social peace

by Rachel Douglas

There was a moment of psychological truth on Russian television the other night, when Viktor Shenderovich's influential "Kukly" ("Puppets") satire show portrayed President Boris Yeltsin on an outing with the young first deputy premiers, Boris Nemtsov and Anatoli Chubais. Calling each other "Anatole, Bob, and Big Bob" for the occasion, the puppets representing the three decided to "go to the source"—meaning, to London! To the accompaniment of the Beatles' song "Yesterday," they went boating on the Thames. Nemtsov recited Byron, and Yeltsin rhapsodized about his good relations with Scotland (standing for Ukraine).

In the skit, the boat smashed into a bridge (*most,* in Russian, perhaps an allusion to scandals connected with Moscow's Most financial group, yet to break over the head of Chubais) and capsized, but the episode brings to mind a real-life boating adventure: the little dinghy of Russian state finances, foundering in rough seas, encounters a big ship and is saved. The crew happily climbs aboard the ocean liner of the international monetary system, the *Titanic*.

Briefing Moscow reporters on Russia's participation at the Summit of the Eight in Denver, Colorado, Yeltsin's economics aide Aleksandr Livshits proudly told how the meeting's communiqué recognized Russia for "taking bold steps to finish transformation into a country with a market economy." While Yeltsin, with Chubais and others, was in Denver, the Russian Federation on June 19 sold its third issue of Eurobonds. The total sale brought in $2 billion, First Deputy Finance Minister Aleksei Kudrin boasted, "one of the largest issues of Eurobonds. No growing economy has issued such a large amount so far."

Far from representing a possibility for investment into physical economic recovery in Russia, the cash infusion will be spent, fire-brigade fashion, on attempts to secure social peace for some more months, paying overdue wages and stipends to retirees, state-sector workers, and the military.

## The debt grows

"Russia is similar to a vacuum cleaner, sucking up all available resources on the market," Russian Central Bank First Deputy Chairman Sergei Aleksashenko told a June 5 cabinet meeting, according to Interfax. He said that by next year, 25% of all federal spending will go for current payments on state debt, including the foreign debt and the huge mass of state bonds.

In a June 9 interview with Ekho Moskvy radio, Economics Minister Yakov Urinson, part of the Chubais team, defended the borrowing as the core of Russian economic policy. Asked what he thought about being in a government that meets "its obligations to its creditors, but at the same time does not meet its obligations to pay wages to its own people," Urinson replied that the borrowing was the solution: "The fact that we meet our obligations internationally, enables us to borrow the cheapest money available in the international financial market and this money goes above all into the payment of pensions! The fact that our arrears to pensioners . . . will be entirely paid back by July 1, owes largely to the fact that we sell our securities in Europe, in Germany, and other countries."

In fact, what Russia got was not exactly "the cheapest money available." It had to offer an annual coupon interest rate of 10% on the ten-year bond issue, which was managed by J.P. Morgan and SVC Warburg banks. Though far below last year's triple-digit interest rates on ruble-denominated state bonds sold on the domestic market, this is higher than the 9% and 9.25% Russia is paying on its first two Eurobond issues, each about half the size of this one. It compares unfavorably with the rates on ten-year bond issues, sold the same week as Russia's, by Lebanon (7.5%) and even Mexico (9.875%). Russia has become one of those "emerging markets" whose excessively high risk, by comparison with the amount of funds pouring in, was cited by the Bank for International Settlements in its latest, alarmed, annual report.

Chubais himself warned, at an early June government session on the 1998 budget, that at the point "when 30% of the federal budget expenditure is consumed by internal debt servicing [just a little bit higher a level than now], it implies the country goes bankrupt, and one has to prevent such an outcome." On June 10, he told the Federation Council that finances are more important than any questions of production: "We consider that order in the state must start with finances, and especially with the state's own finances."

The key, according to Chubais, is ruthless tax collection. The government has begun to impose bankruptcy on tax-debtors. On June 18, Interfax reported that the government refused to restructure Nizhnevartovskneftegaz's tax debts, and initiated bankruptcy proceedings against the huge Siberian oil company.

## Chubais sees surge in manufacturing *and* unemployment

Chubais lives deep enough in a virtual reality of "finances," that he forecasts a simultaneous surge in industrial production, and in unemployment. On June 5, NTV reported, he told Duma (parliament) members that "it is now possible to talk of prospects for growth in domestic manufacturing this year," because there has already been a "halt in the slump in manufacturing."

The government's own figures gainsay this assertion, showing a 2% decline of industrial output in the first quarter of 1997, over the same period in 1996, and even a 2% drop in Gross Domestic Product, which refutes the government's claims that the continuing plunge of industrial activity has been compensated by the service sector and the "gray," quasi-legal economy. Analysts of the production figures note that GDP for that quarter was, moreover, pulled upwards by a 6% increase in non-ferrous metals production for export, during a period of particularly high prices for metals. Nationwide electricity output, a more reality-linked indicator of economic activity than GDP, fell by 6% from first quarter 1996.

At a May 29 cabinet meeting, Chubais promised that if his economic policies *succeed,* 1998 will be the year when unemployment sharply rises in Russia! "Starting from 1998, we are in for a serious worsening in unemployment rates," he was quoted by Interfax. Since his and Nemtsov's "natural monopolies" reform, affecting large employers like the railroads and the electricity grid, is modelled on the "restructure and retrench" pattern of Britain and New Zealand, this is true. Dr. S.M. Belozerova has analyzed the erosion of productive employment in Russia already, on top of which this "serious worsening" will ensue (see accompanying article).

## Protests from Duma, warnings from military

The State Duma went out of session for the summer on June 24, pursued by government threats of its dissolution upon return. The parliament did pass the regime's revision of the tax code, but voted 220-112 against the government's "sequestration" (cut) of 108 trillion rubles, or $19 billion, from legally mandated spending during 1997. The cuts are in effect, anyway; "If the Duma is not able to take decisions, we will live by our own decisions," said Chubais.

Deputy Prime Minister Oleg Sysuyev, at a June 25 press conference, threatened dissolution of the Duma, which the Constitution allows only Yeltsin to declare.

More ominous for the regime than the political sparring with the Duma, is a sudden warning about rebellion by the military. It came not from any rogue officer in an outlying district, but from Gen. Lev Rokhlin, chairman of the Duma's Committee on Defense Policy, who is a member of Premier Viktor Chernomyrdin's Our Home Is Russia group.

In an open letter to Yeltsin, released on June 24, Rokhlin accused the President, personally, of having "done nothing over the past six years for the country's military security." He said that "foreign agents" on Yeltsin's team—which had to mean Chubais and his predecessor and mentor, Yegor Gaidar, among others—had allowed the International Monetary Fund to direct the reform of the Russian Armed Forces. "You have condemned the Armed Forces to eventual ruin," said Rokhlin. "With your attitude to national defense, in the first 20 years of the next millennium, Russia could lose its Far East region and Siberia right up to the Urals."

Rokhlin appealed to the Russian officer corps to resist the government plan for further military force reductions, and to hold meetings in each military unit, to draft legal claims and to send them to the President, the government, the parliament, and to the Supreme and Constitutional Courts. *Nezavisimaya Gazeta,* in a June 25 article about Rokhlin's bombshell, reported on a renewed organizing drive at many garrisons, for convening an officers' assembly in Moscow. The daily *Segodnya,* owned by the Most Group, headlined, "With Rokhlin's Voice, the Army Is Called On To Riot."

Russian Defense Minister Gen. Igor Sergeyev, whom Yeltsin appointed on May 22 to implement the rapid reduction and reform of the Armed Forces that his predecessor, Igor Rodionov, would not, said on June 11 that state funds for the military reform have still not been issued. On June 14, Air Force Commander Gen. Pyotr Deinekin, told Interfax that the dearth of resources has also hit procurement: "No money at all remains for buying new weapons or equipment, least of all for research and development."

Writing in *Rabochaya Tribuna* of June 4, Rokhlin warned that the defense industry was also near "collapse."