Russian foreign debt: The banks blink

by Rachel Douglas

The pyramid scheme of Russian government bonds with double- and triple-digit returns, also known as GKOs and as the "world's hottest emerging market" in 1996-97, died on Aug. 17, 1998, when the Russian government froze payments on that ruble-denominated debt. August 17 marked phase two of the terminal stage of collapse of the post-Bretton Woods world financial system. Deep into early 1999's phase three, with its epicenter in Brazil and new storms sweeping world bond and share markets, the ghost of the GKOs has risen as a reminder of how fragile and desperate major international financial institutions are.

During the last week of February, Deutsche Bank, followed on March 1 by Crédit Lyonnais and Chase Manhattan, broke ranks with other members of a London-based committee of banks, representing foreign holders of GKOs. Deutsche Bank had headed the negotiating committee for talks with the Russian government. These institutions accepted the Russian offer to restructure the GKO debt, while Crédit Suisse First Boston (CSFB) and some British banks wanted to keep up the demand for better terms. When the GKOs were frozen, foreigners held approximately $15 billion of a total stock of GKOs priced at 250 billion rubles, or $40 billion at that time. The restructuring offer includes a phased payment of 10% of the GKO face value in cash, 20% conversion into investment bonds that may be used to purchase shares in Russian companies, and 70% conversion into new, long-term rubled-denominated bonds. The offered workout has been estimated at between 2¢ and 20¢ on the dollar, return on the speculatively invested funds.

Sources at the banks that accepted the Russian GKO terms said they were resigned to the impossibility of "a better deal." They also happen to be institutions with a longer history in the Soviet Union and then Russia, as opposed to the whiz speculators from CSFB, who specialized in scooping up assets during post-1992 privatization, in speculation, and in derivatives operations with Russian underpinnings. Chase has invested in Russian oil and gas extraction since the 1970s, while Deutsche Bank was a major German lender to the Soviet Union. The judgment by these banks that they could have an investment future in a recovered Russia, if they have any future at all, evidently played a part in their decision, as did the possible implications of a refusal of the GKO terms, for restructuring of the Soviet-era (London Club) debt that they hold. During February, ex-Premier Sergei Kiriyenko visited Germany for talks with German bankers, during which, Russia media described him as an unofficial emissary of the Primakov government. On Feb. 8 in Bonn, Kiriyenko called for writing off up to one-half of the Soviet-era debt.

The London *Financial Times*, among others, rang alarm bells that the GKO situation could lead to "a comprehensive restructuring package," in which post-Soviet Russian Eurobonds would be included, as well as the Soviet-era debt. The paper claimed on March 2, that a current sell-off in Russian Eurobonds "was sparked by demands by the Paris Club of government creditors that Pakistan restructure the terms of its international bonds as part of an overall foreign debt reorganization," which move "was seen as presaging a similar demand on Russia, which has $16 billion of outstanding bonds."

Apocalyptic scenarios for a global Russian default were circulated also inside Russia, as in a March 3 *Izvestia* article that said the West had no choice but to continue debt talks with Russia, "otherwise the Russian government may simply refuse to pay at all."

IMF bluffs

The other Russian debt matter looming over international finance is the nearly $5 billion Russia owes this year on International Monetary Fund loans. Premier Yevgeni Primakov and First Deputy Premier Yuri Maslyukov have both emphasized, that the only source for making those payments will be new loans from the IMF—which, in turn, will not be used for any other purposes, such as covering current budget spending, as was the case under previous governments. The Fund, however, has evidently not grasped the new rules of conduct with Russia.

Bankrupt though he may be, IMF Managing Director Michel Camdessus struck his customary pompous posture, in a lengthy interview in the Feb. 16 issue of the Russian newspaper *Novyye Izvestiya*. Among other things, Camdessus said that "the IMF has never done anything bad to Russia," and lectured the interviewer, that "your main problem is that you accomplished only partially some of the things that should be accomplished on the path of market reform, and on some things you have drawn a blank."

Camdessus raised the scenario of Russia's being declared an *outlaw state:* "You haven't completed real market reforms. It is a big mistake to stop mid-way when so much has already been done. Even if the IMF weren't by your side, forget about everyone and move forward. There are voices in Russia which say that you should renounce cooperation with the IMF and you should build a fence between yourselves and the whole world and follow 'your own way,' as is Russia's tradition. Practice shows that such a course is wrong. *(I personally don't want Russia to become a Cuba or North Korea.)*" (Emphasis added.)

At a Feb. 10 press conference of the Right Cause political grouping, former Finance Minister Boris Fyodorov used the very same language. Denouncing Yuri Maslyukov for having

© 1999 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.

raised the question of "writing off debts," Fyodorov said there would "be no restructuring and no writing off debts unless an agreement with the IMF is reached. . . . So, if the government really wants to relieve the debt burden, . . . we should urgently present an economic program that will earn the trust of the IMF and consequently of investors . . . because nobody wants to see Russia as an isolated state, *a North Korea which sits there with its unpaid debts and snarls at everyone*" (emphasis added). Fyodorov, an intimate of George Soros, nearly succeeded, with the patronage of Al Gore, in reentering power in August 1998 as economics chief under the reinstated former Premier Viktor Chernomyrdin, and in imposing the British imperial "currency board" model on Russia.

On March 2, Maslyukov was quoted by Interfax: "Mr. Camdessus has pressured us so much, and is so persistent to make us accept conditions which are unacceptable, that it is just unseemly." Maslyukov suggested that the IMF's demand for the creation of new institutions to allow more foreign exploitation of Russian oil and natural gas resources would only "give birth to a new crowd of thieves." Camdessus's posturing notwithstanding, Maslyukov said on March 4 that he had "a pretty clear idea of what Russia can do to reach a compromise while honoring its commitments under the 1999 budget, and believe[d] that a real rapprochement of the negotiating positions is possible within days."

The same *Financial Times* author, John Thornhill, who emphasized the potential for the Russian debt crisis to spread to the Soviet-era debt and Eurobonds, also joined the Boris Berezovsky-owned media inside Russia, in beating the drums for Maslyukov to be fired.

Throughout the foreign debt flap, it remains clear that the Primakov government, making Russia a member of the "Survivors' Club," has an agenda that overrides its continuing diplomacy with the IMF and the foreign banks. The last days of February saw the success of Chinese Premier Zhu Rongji's negotiations in Moscow (see p. 4). Last week, we noted the formation of a State Council for the revival of Russian industry, under Maslyukov. At a press conference on Feb. 8, Finance Minister Mikhail Zadornov reported that "we have lived through the most difficult economic and political period since the August crisis. It was little noted, but during this period we have managed to approve and implement the plan of financing the fourth quarter without departing one iota from the guidelines determined in October, neither the printing of money, nor the payments on the foreign debt, nor the payments to households. Let me remind you that on Feb. 1-2 we fully paid back arrears to federal employees and we do not have budget debts. That is, all the commitments that we undertook in early October we met."

As we go to press, financial "oligarch" Berezovsky, who has campaigned relentlessly against Primakov and Maslyukov, has been removed by President Boris Yeltsin from the post of Executive Secretary of the Commonwealth of Independent States.

European farmers protest Agenda 2000

by Rosa Tennenbaum

Europe has been experiencing an upsurge of protests by farmers in recent weeks, the likes of which have not been seen since the beginning of the 1970s. In most of the 15 member-states of the European Union (EU), demonstrations, blockades, interventions into political party meetings, and so on, have been the protest vehicles against the Agenda 2000 program of the EU Commission. The high point of these actions so far was a huge demonstration of more than 50,000 angry farmers from all over Europe in Brussels, the headquarters of the EU. On Feb. 28, they besieged the city in a desperate attempt to bring some reality into the sterile world of this huge "Eurocracy," which has been dictating the agricultural policy of Europe for 34 years.

The Belgian authorities, fearing for the security of the EU bureaucrats, passed special restraining orders that forbade farmers to bring tractors or heavy machinery into the capital between Feb. 15 and March 1, while Belgian farmers were forbidden to move their tractors more than six miles from their farms; violations were punished with prison sentences! Schools and kindergartens were closed the day of the demonstration, the staff of the European institutions got a day off, and the European Parliament was shut down. The EU Commission hid behind barbed wire, and the EU Foreign Ministers preferred to relocate their meeting from Brussels to Luxembourg. All this hysteria aside, the demonstration was harsh in words, but civilized in action.

Expansion of the EU

Agenda 2000 defines the principles according to which the EU wants to integrate new member-states, such as Poland, the Czech Republic, Estonia, Slovenia, and Hungary, which are supposed to join within a few years. Before they do, however, a number of national laws have to be changed and made congruent with the regulations of the EU, and the very different national administrative systems have to be adjusted. To achieve this, in every country, an army of bureaucrats has to be trained and prepared for its future tasks of surveilling and administering the new regulations. These bureaucratic preparations will eat up several billions of dollars per year. Nobody talks about developing the run-down economies of these post-communist states or the need to invest in infrastructure that is so dearly needed; the only preoccupation of the EU is to set up similar administrative apparatuses in all countries.