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IMF's Russia deal is no fix for global bubble

by Rachel Douglas and Konstantin George

On Monday, July 13, after a weekend of round-the-clock discussions in Moscow, the International Monetary Fund and the Russian government announced a two-year, $22.6 billion so-called "stabilization package" for Russian state finances. Cheers went up in Western financial capitals, over the eleventh-hour prevention of a Russian meltdown. IMF Managing Director Michel Camdessus proclaimed his hope to "fundamentally improve the financial situation of the Russian government." The Russian stock market, in a free fall since the beginning of May, surged by 28% in the first three days of the week, July 13-15.

The Moscow market's rush of vigor, brings to mind the poet Pushkin's lines about a tuberculosis-stricken girl, near death:

> There's on her face more crimson light than sorrow.
> Today she lives, as yet, but not tomorrow.

The emergency mustering of new money pledges was not a bailout for Russia, as such, but for its Western creditors, and the whole of globalized finance. Camdessus and his subordinates have caught sight of the handwriting on the wall. The same Camdessus, who on July 2 admonished *EIR*'s correspondent Bill Engdahl, to "avoid having catastrophe scenarios" in connection with Russia (see *EIR,* July 17, p. 5), on July 13 issued a lengthy press release to justify the new package, as required to avert catastrophe.

"Given *the systemic nature of the problem,*" wrote Camdessus, "the size of the additional financing, and the IMF's liquidity position, I have initiated consultations with the participants in the General Arrangements to Borrow (GAB) to activate the GAB, to secure most of this additional financing for Russia" (emphasis added).

It was the first time since 1978, that the IMF resorted to the GAB, an emergency provision that allows the Fund to borrow from certain member countries at commercial rates. At a press conference in Washington on July 13, simultaneous with the package announcement in Moscow, IMF Deputy Managing Director Stanley Fischer and his assistant, David Williams, detailed the rapid fall of the Fund's "liquidity ratio," the proportion of its lendable resources, to the level of contributions that IMF member-nations—such as Australia, Fischer cited by name—might suddenly have to take back for emergency use at home. Fischer said, "After these loans [to Russia], our liquidity ratio is below the number that we feel comfortable with, even drawing the $8.4 billion from the GAB. . . . If we didn't draw on the GAB, we'd be $8-10 billion below the point at which we feel comfortable." Asked about the "ability to move quickly when the next flashpoint rises, be it Venezuela, Pakistan, whatever," Fischer replied, "We are entering a region, in terms of our financing, where we are in grave difficulties."

Of the $22.6 billion in 1998-99 funding for Russia, the largest portion is supposed to come from the IMF: $11.2 billion new credits this year, on top of a previously pledged $1.3 billion, and 1999 loans of $2.6 billion. The other sources are the government of Japan and the World Bank, with $1.7 billion during the rest of this year, and "up to $6 billion" for the next two years, in the words of World Bank Moscow office head Michael Carter. On July 13, Prime Minister

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Sergei Kiriyenko flew straight from the marathon negotiations with the IMF, to Japan, which is lending Russia $1.5 billion as part of the package. By the time he landed, Prime Minister Ryutaro Hashimoto was a lame duck, having resigned after his party's resounding electoral defeat, due also to the financial crisis.

Because the IMF is so drained, nearly 80% of its new $11.2 billion is to be provided by GAB participants, the Group of 10 countries plus Switzerland. Created in 1962, the GAB is restricted to activation in the event of an acute money shortage at the IMF and a crisis that threatens the entire world financial-monetary system, which criteria the IMF now officially admits to exist. As a senior European banker told *EIR* on July 14, "The fact that the IMF had to resort to the GAB to aid Russia is indication of the level of panic."

While preparing for a July 20 board meeting for the purpose of approving the Russia deal, the IMF's executive committee met late into the evening already on July 15, deciding on a vote to release the next $1 billion tranche of its $41.2 billion package to Indonesia. A combination of multilateral institutions and 20 countries will also patch together another $6 billion in stand-by credits, although Indonesian President B.J. Habibie and Economic Coordinating Minister Ginandjar Kartasasmita announced, as the IMF committee was meeting, that the country urgently needs an additional $10-11 billion to prevent its budget deficit from ballooning out of control.

The IMF's new monies for Russia, if approved, are supposed to arrive in the depleted coffers of the Russian Central Bank with lightning speed. Central Bank Chairman Sergei Dubinin announced on July 14 that the first half of the new funding, $5.6 billion, would be extended to the Central Bank as a credit line by July 22 or 23.

Chain reaction feared

With the failure of one weekly GKO (treasury bill) auction after another, Russian currency reserves were draining away at the rate of $1.5 billion per week. On July 3, the gold and currency reserves were stated by the Central Bank of Russia as $15.1 billion (of which close to $5 billion is in gold). By July 10, according to the bank's announcement on July 14, the reserves had fallen to $13.5 billion. An attempted placement of one-month GKOs at 118% annualized interest yields, at the July 8 auction, failed to draw bids for more than one-third of the offering, and the Central Bank spent $725 million to redeem maturing issues, in one day.

Had the Russian state defaulted on its bonds, a total collapse of the GKO market, sending the ruble into a free fall and calling into question the maintenance of Russia's $140 billion in official foreign debt, and a chain reaction collapse of nearly all Russian banks, including most of the top 20, was set to follow. The magnitude of the shock wave that would then have hit western Europe, is expressed by one figure: The great majority of German banks' $30 billion, at minimum, exposure to Russia, is in the form of loans to Russian banks.

What the "Asia" crisis had so far failed to do, the "Russia" crisis could have accomplished: the puncture and deflation of the overbloated Western markets. An added dimension for Europe, is that a functional collapse of the Russian energy sector, as a result of financial meltdown, would lead to energy emergency in Germany, and throughout Central Europe.

Not surprisingly, German commentators were far ahead of the American media, with regard to the systemic threat from the Russian crisis. Klaus Engelen, chief editor of the economics daily *Handelsblatt,* wrote in his July 15 column, that "a collapse of the Russian economic reforms could have negative implications regionally, as well as globally, and could in particular trigger a geopolitical collapse of the political climate." Assistance to Russia was also important, he suggested, "to keep up the levels of euphoria on U.S. and European stock markets."

GKO swap: shades of Mexican tesobonos

A key component of the IMF's deal with Moscow, is a scheme to convert part of the GKO bond pyramid into Eurobonds, and pay off the rest. The ruble-denominated short-term state bond market, which exploded from nothing to the equivalent of nearly $70 billion in the space of four years (see *EIR,* July 3, pp. 26-32), is supposed to be phased out, which Finance Minister Mikhail Zadornov told the State Duma (Parliament) was nothing short of a "historic milestone." Zadornov, negotiator Anatoli Chubais, and IMF officials John Odling-Smee and Stanley Fischer, posed the conversion in terms of "easing pressures on the GKO market," replacing high-interest, short-term obligations with long-term ones.

The announcement of the "voluntary" conversion of (ruble-denominated) GKOs into long-term (dollar-denominated) Eurobonds, is reminiscent of the notorious debacle of Mexico's *tesobono* project of 1994, which ended with that country's debt blowout in December 1994.

In February 1994, there were $54.7 billion of peso-denominated Mexican treasury bonds (*Cetes*) held by foreigners, and just $5.3 billion of dollar-denominated *tesobonos*. Under foreign financial assault, Mexico's currency reserves fell from $29 billion to $16 billion, between February and June, while *Cetes* interest rates doubled from 8 to 16%. Former Bush administration Deputy Treasury Secretary David Mulford, at the time with the First Boston investment bank, travelled to Mexico to instruct Finance Minister Pedro Aspe, that the only way to keep international hot money inside Mexico was by offering to convert maturing *Cetes* into dollar-denominated *tesobonos*. By November 1994, foreign *Cetes*

holdings had dropped by more than $30 billion, while *tesobonos* outstanding skyrocketed from $5.3 billion to $53.8 billion—the vast majority of them short term (at least the Russians are trying to issue long-term Eurobonds). Then, when Mexico was hooked on these new *dollar* obligations—which increased the country's de facto foreign debt by nearly $50 billion in nine months!—the bottom fell out. During three weeks in December 1994, Mexico's reserves were drained from $16 billion down to $5.5 billion. With Mexico teetering on the edge of sovereign default on *tesobonos* and other foreign obligations, the IMF hustled together the famous $50 billion bailout package, which ensured that the foreign bond holders emerged unscathed.

There won't be a safe exit, this time, even if the GKO scheme is successfully launched. Its success is far from certain. The Russian government is taking applications for the conversion of GKOs, between July 14 and July 24, its agent for the new Eurobonds being Goldman Sachs. Although nearly half (47%) of GKOs are held by the Russian Central Bank and Sberbank, the national savings bank, the main prospective converters of GKOs to Eurobonds are supposed to be foreign GKO holders and some Russian banks. Mikhail Fridman, head of the Russian Alfa Bank, announced that his bank did not plan to trade in its GKOs. Chubais said that he expected between 30 and 50% of GKO holders to "accept the scheme." From London, where Deputy Finance Minister Mikhail Kasyanov briefed investors the week of July 13, wire service reports said that banking circles anticipated offers to trade in $2-10 billion worth of GKOs for Eurobonds, but that the swap would be cancelled if there were bids for less than $2 billion.

Having announced the termination of GKO issues, Russia has pledged to pay off unswapped GKOs as they come due. If the conversion plan flops, the new IMF funds could be gobbled up by GKO redemptions (used for supporting the ruble, as foreign GKO holders dump their ruble earnings from redemptions). Aleksandr Shokhin, head of the Our Home Is Russia faction in the Duma and former Economics Minister, predicted at a July 14 press conference, that "the IMF credit will be used to buy GKOs, because not all investors, residents or non-residents, will believe in the attractiveness of new currency instruments proposed by the government. . . . Many may want to withdraw from the Russian market of non-residents and move to, say, Brazil or Mexico."

Chubais stresses that, over and above the $22.6 billion in previous and newly pledged IMF, World Bank, and Japanese government loans, commercial banks in the West stand ready to lend Russia another $10 billion.

The U.S. Congress and the Russian Duma

It is an irony of history that the IMF's biggest political headache of the moment is caused by the legislatures of the present and the former superpower. The most important obstacle to the IMF has been posed by the U.S. Congress, which has stubbornly refused to vote for the U.S. contribution of $14.5 billion to the IMF quotas, and has thereby blocked the entirety of new IMF funding, since the quota increases, agreed to by the other major members, cannot go into effect until nations representing 85% of the voting shares have approved it.

The Russian State Duma and the upper house of Parliament, the Federation Council, could also throw monkey wrenches into the package, if they refused to endorse the attached austerity conditionalities. Even though the Duma was meeting in late evening sessions on July 15 and 16, in a drive to get the measures passed (they are in the form of a set of laws, called in Russia the "anti-crisis program"), IMF officials left no doubt about where "democracy" would go, if the Duma were to block the laws.

Stanley Fischer, at his July 13 press conference, replied to a question about what would happen if the Duma balked, "I see on the wire services that they say that the President has the right to do things by decree."

Another candidate for IMF bailout: Ukraine

A new financial crisis is brewing, this time in Ukraine. If no IMF bailout package is forthcoming, Ukraine could be heading for default as early as August, when a $450 million Eurobond with an annual interest rate of 39% in secondary trading, falls due.

In mid-July, Moody's downgraded Ukraine's country rating from "stable" to "negative." It is not hard to see why. From now till the end of the year, the amount of Ukrainian GKOs that have to be redeemed is more than the country's Central Bank dollar reserves, which were put at $1.7 billion in early July. What happens in the short term will be decided starting on July 21, when an IMF team arrives in Kiev, for negotiations on a new stand-by loan. Ukraine has been seeking $2-2.7 billion, a tiny amount compared to recent IMF bailouts, but, given the IMF's own precarious situation, one that could end up being a "bailout too far."

The IMF's political condition for a standby loan is that Ukraine's Supreme Rada (Parliament) pass the 1998 austerity budget. Ukraine's Parliament has been in session for less than a month, after a two-month impasse in which it failed to elect a Speaker. Whether the Parliament will, under heavy regime pressure, vote up this IMF budget in record time, is an open question.

—Konstantin George