

IMF protected US banks in Russian bailout

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Fears that a major devaluation of the rouble would bring about a collapse of the Russian banking system, resulting in losses of billions of dollars for foreign, and especially US, banking and financial interests, were behind the extraordinary Russian bailout organised by the International Monetary Fund last week.

Under the terms of the agreement announced July 13, Russia will receive an additional \$17.1 billion in loans over the next two years which, combined with existing international commitments, will bring total lending to Russia to \$22.6 billion this year and the next.

The government, in turn, will halve the budget deficit from its present level of 5.6 percent of gross domestic product to 2.8 percent next year. If the Duma and the Federation Council fail to approve the necessary measures, they will be implemented by presidential decree.

The loan was only secured after a decision by the IMF to draw on emergency funds supplied under the General Agreement on Borrowing (GAB) to finance \$8.4 billion of the additional \$12.6 billion in loans to be made available this year.

Having already supplied \$35 billion of the \$117 billion in rescue packages to South Korea, Thailand and Indonesia, and with the US Congress stalling on a request for an additional \$18 billion in funds, the IMF did not have sufficient resources to cover the Russian bailout.

At a press conference to announce the bailout, the IMF's first deputy managing director Stanley Fischer said that even with the emergency funds from the GAB, IMF liquidity was still 'below the number we feel comfortable with.'

Asked what would happen 'when the next flashpoint arises' Fischer said the fund was 'entering a region in terms of our financing where we are in grave difficulties.'

IMF managing director Michel Camdessus said that the turn to the GAB was necessary because of the size of the financing operation, the liquidity position of the fund and the 'systemic nature of the problem.'

In the world of banking and finance so-called 'systemic problems' are those which affect not only the institutions immediately involved but also threaten the stability of the whole financial mechanism. The Russian crisis was certainly

one of these.

The immediate cause of the crisis centred on the market for short-term Treasury Bills, or GKO's, through which the Russian government has been financing much of its day-to-day operations. But with the onset of the Asian crisis, and the slump in world commodity prices, the rouble has come under increasing devaluation pressure.

In order to try to maintain currency stability, the government has been forced to lift interest rates to unprecedented levels. Earlier this year, when the government failed to find a buyer for the Rosneft oil company, interest rates were raised to 150 percent. They subsequently declined to between 60 and 80 percent. But on July 8, the Russian government was forced to lift rates to over 100 percent in order to attract funds in the GKO market.

Urgent talks were held with the Clinton administration during which representatives of the Russian government warned that unless an agreement was rapidly reached to provide a major loan, the rouble would have to be devalued, with disastrous consequences for the stability of the Russian banking system. And not only for the Russian banks but for American banks and financial institutions as well.

Of the total GKO market of \$70 billion, at least \$20 billion is held by foreign investors, many of them American. Fearing the possibility of a rouble devaluation, they have hedged their investments with Russian banks. A devaluation of the rouble would have presented the Russian banks with massive debts, and possible default on their commitments, leading in turn to billion in losses for foreign investors.

In others words, had the IMF not intervened, the Russian authorities would have been forced to devalue the rouble, leading to an international financial chain reaction and a 'systemic' crisis.

The crisis scenario was set out in a question directed to Fischer at his press conference.

'You will definitely correct me if I am wrong,' one reporter began, 'but as I understood it, the GKO debt was ... effectively dollarised by hedging activity, that when a US bank, for instance--they are very active in the GKO market--when a US bank went in and purchased GKO's, they offset their exposure in roubles through dollar hedge

positions, and often, those dollar hedges were with Russian banks--as a matter of fact primarily with Russian banks, big Russian banks.

'Now, if the Russian government were to devalue the rouble, that would really stick, and with these hedge positions in place, Russian banks effectively could collapse. Is that a concern, or is that another reason why you had to move quickly to ... avoid a rouble devaluation and then, secondly, sanction what is now officially a dollarisation of the GKO by the conversion?'

(Under the conversion plan, the Russian government will transform short-term investments in the GKO market into long-term dollar denominated bonds, using funds provided through the IMF bailout.)

Fischer did not deny the scenario presented in the question but merely replied, 'there are more reasons.'

According to Harvard economist and one-time IMF adviser Jeffrey Sachs the reason for the new loans to Russia was to 'insure that the earlier loans are repaid and that the rouble keeps its value long enough for speculators to get their money out without large losses.'

All reports of the events surrounding the bailout point to pressure from the US administration, and above all the US Treasury, in pressing the IMF for a rapid resolution and the provision of a substantial package above previous expectations.

In the days leading up to the bailout, there were reports of an imminent currency collapse and warnings of its political consequences. An article published in the British magazine *The Economist* at the beginning of this month described the rouble as 'on the edge of a precipice,' with foreign investors 'close to panic,' and warned that there was the possibility of a 'fascist' regime being imposed if the economy completely collapsed.

Russian Prime Minister Kiriyenko was being spurred on, it said, by 'dread of an abrupt devaluation, which could lead to a collapse of confidence in the economy, not only among foreign investors but among Russian citizens. This could spell doom for the banking system (on which much of Moscow's superficial prosperity is based), bring down the Kiriyenko government and, as one American diplomat put it, 'signal the end of liberal Russia.'

An article in the *Financial Times* of July 15 posed the question as to whether 'the deadly mixture of economic chaos, public anger and sense of national humiliation that fuelled fascism in Weimar Germany flare up in Russia now?'

'Such fears,' it continued, 'appear to have been taken seriously enough in Washington for the US administration to deem the situation in Russia to be a global strategic threat.'

At the same time, the Russian emergency and bailout is another manifestation of the global crisis of the capitalist

economy.

One of the main factors behind the collapse of the rouble has been the impact of the Asian meltdown. Since the devaluation of the Asian currencies last year, Russian financial authorities have used up around \$14 billion in currency reserves in an attempt to defend the value of the rouble.

While the immediate pressure has been lifted by the bailout, the factors which produced it remain. In particular, the fall in world commodity prices is set to continue.

In the first quarter of this year the total volume of Russian exports declined by 14.5 percent compared to the same period in 1997. Oil export revenues fell by 24.5 percent due to the contraction of prices, while the export revenue from natural gas declined by 15.2 percent. Low international oil prices--now down to 1973 levels in real terms--mean that about one-third of the 140,000 oil wells controlled by the six largest oil companies in Russia are not making a profit.

The Russian economy is also being hit by the fall in metal prices. The price of nickel is down 40 percent from this time last year, the price of copper 37 percent and the price of aluminium 18 percent. According to a mid-year analysis by the US investment bank Merrill Lynch, the decline will continue.

The IMF bailout has prevented an immediate collapse of the Russian financial system, but none of the conditions which produced the crisis have been alleviated. And by stretching its own resources to the limit in order to bail out Russian and, behind them, US banks, the IMF has added to the instability of the world financial system as a whole.

See Also:

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