Russia and the IMF: A Sordid Tale of Moral Hazard

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The first summer of the new millennium was marked by renewed controversy around the issue of Russia's relation to the International Monetary Fund (IMF). As Swiss prosecutors pressed on with their probes into alleged Russian money laundering, suspicions again came to the fore that billions of dollars of IMF funds intended to support the ruble had been illicitly diverted via a maze of accounts in Western banks, notably the scandal-ridden Bank of New York.

Although allegations of this type constitute a serious embarrassment to those concerned, there appears to be little danger of anyone's actually having to accept personal blame. Given the massive amounts of money involved, the investigations are likely to drag on for many years, as are the debates on what really happened. But few if any significant truths or admissions of guilt are likely to come on record. There is, quite simply, too much high-level politics involved for truth or justice to prevail.

However, there may be some benefit in mapping, as far as possible, the story of IMF involvement in Russia, how it unfolded, and how it was brought to such an embarrassing end. I argue that there have been significant problems of moral hazard involved that should have been taken into account from the outset.

The merits of the argument should be sought in a different direction from simply looking for the trail of a few billion dollars that are missing. At stake is the very essence of Western relations to Russia, at a crucial point in that country's development. And, as I argue below, the role of the IMF in shaping these relations has been a highly unfortunate one.

Storm Clouds

The first wave of criticism against the IMF was triggered by the series of financial crises that erupted in Thailand in summer 1997 and then spread via Indonesia to Russia and on to Brazil. The simple fact that several of the subsequent cur-

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rency collapses (most notably the Russian one) occurred in cases that were under intensive IMF bailout supervision did little to enhance the standing of the Fund, and its critics, some of long standing, came out in force.

At first, the discussion was mainly technical, concerning the modus operandi of the IMF. Some, such as Milton Friedman, argued that the Fund itself was the problem and that it should quite simply be abolished. Others saw the task as saving the Fund, rather than burying it. Taking the discussion all the way, we could find George Soros arguing that the IMF should be transformed into a lender of last resort for the global economy, coupled with firm controls over the financial markets. This wide spread of opinions reflected the fact that there was an underlying problem, one that had involved economists in harsh debates for quite some time. The issue, still unresolved, concerns the relative merits of fixed versus floating exchange rate regimes.

When the IMF was established in 1944, it was designed to operate in a postwar world of fixed exchange rates. In 1973, however, when the U.S. administration decided to decouple the dollar from the gold standard, that world came to an end. Some would argue that the IMF has been struggling ever since to adjust. But my focus is not the technical dimension of IMF operations but the political economy of faulty policy advice and of financial blackmail, both in the specific Russian case. The simple fact that even people who served in senior IMF positions have begun to admit in public that the Fund botched its Russian mission makes it rather urgent to investigate what it was that went wrong.

One of the voices in question belongs to Augusto Lopez-Claros, who served as head of the IMF Moscow office from 1992 through 1995. During that time, the Fund issued about $4 billion in loans to Russia, money that few would now argue was spent in the intended manner. Referring to the variety of murky Russian schemes that were devised in those years, under the very nose of the IMF, to promote insider privatization deals and tax exemptions for favored groups and organizations, Lopez-Claros asks (and answers) the pertinent question: "Should the international community have continued to support Russia in the presence of these non-transparent schemes? My own private view is that, no, they shouldn't have."[1]

In the following I shall map out how the IMF got involved in a mission that it really should have stayed well clear of, and look at the consequences both for the Russian side and for the IMF and the West in general. Has the West "betrayed" Russia by doing too little, as some of those who have been involved in high-level policy advice have argued rather aggressively? Or is it perhaps the case that the West has betrayed Russia by doing *too much*, in the wrong ways, and that the latter may have far more sinister repercussions than having failed to help at all?

Let us begin by looking at the most immediate evidence, in the form of the Russian financial meltdown that occurred in August 1998.

The Crash of August 1998

In retrospect, it seems predictable. From the very beginning, in 1993–94, Russia's financial markets (GKO and OFZ state securities) were set up to function as a giant Ponzi game, and such games all collapse in the end. How then was it possible for so many to get so badly burnt by the dual decision taken on 17 August 1998 to devalue the ruble and to freeze parts of the foreign debt? In a comment after the fact, Stanley Fischer, the IMF's first deputy managing director, found it "hard to credit that sophisticated investors who had earned an average of 50% a year on GKOs since 1994 really believed these investments were safe."[2] These remarks came close to adding insult to injury. Many investors must have realized that the game was eventually unsustainable, but there was also the question of timing.

Given all the hype about Russia simply being too big for the world to allow it to fail, and all the scary, overblown scenarios about a possible communist or nationalist backlash, or even civil war in a nuclear superpower, that had accompanied speculation about a possible ruble devaluation, it was rather logical that investors held out. After all, following the run on the ruble that took place in May–June 1998, the IMF did come through with a giant rescue package. So, based on the expectation that further bailouts would be undertaken if needed, who wanted to forego the seemingly guaranteed fantasy returns on Russian paper? When offered in July 1998 to trade ruble-denominated GKO debt for lower yielding dollar-denominated Eurobonds, most investors logically refused.

In August, however, the IMF made an abrupt about-face. Having failed for years to raise even a warning finger about the long-term viability of Russia's slash-and-burn economic reforms, the Fund suddenly decided to let everything go. The costs to those involved (including the Russians) were substantial, putting it mildly.

The most obvious reason for directing anger at the IMF is linked not to the fact that it got tough in August 1998, but to its role in causing faulty expectations. One may recall, for example, the standard rituals at the frequent Moscow meetings between the Fund's managing director, Michel Camdessus, and Russian president Boris Yeltsin, where the two men heaped praise on each other. Being courteous is one thing. But there is also a distinct risk that by overdoing the courtesy bystanders may be lured into believing that at least some of the praise does have some foundation in fact. Rather than joining in the chorus of praise for a coming Russian boom, the IMF would have been well advised to keep a low profile, to stay out of the limelight, and to adhere to its main task of financial rule enforcement.

Following the August collapse, it seemed for a while that the myth of Russia's being "too big to fail" had been effectively killed and was not likely to be resurrected. By spring, however, pressures for renewed financial support were mounting and the arguments were strikingly familiar. The consequences of allowing Russia to declare a full sovereign default would simply not be acceptable. The main problem with this type of attitude lies in the influence it has had over the way in which the money games have been played. In particular, it served to reinforce the complacency with which the Russian players reacted to the first phases of the Asian crisis. Let us therefore take a closer look at the string of events that were played out during the fateful year between the outbreak of the Asian crisis and the final Moscow meltdown.

Prelude

The prelude to the Russian crash began, as mentioned above, in Thailand, in summer 1997. The collapse of the Thai baht triggered a regionwide financial crisis, which for Indonesia in particular would have dire consequences indeed, and which soon would begin to infect more distant economies such as Hong Kong, Japan, and South Korea. Although the situation in Asia was deteriorating at a pace that was fueling fears of a global recession, on the Russian front all was quiet. Expectations were that the reform process had reached such a degree of stability that the Russian markets would be able to withstand contamination from Asia.

At a joint meeting with the World Bank in Hong Kong, in early September, the IMF characterized its lending to Russia as an act of "historical justice" and went on to talk about an expected Russian real GDP growth of 1.5 percent for 1997 and 4.9 percent for 1998.[3] In November, the Russian government was still optimistic, posting a 0.3 percent growth in GDP for the first ten months of 1997,[4] and as late as December the OECD was hoping for a 3 percent positive growth in 1998.[5] Meanwhile, Russia's financial situation was deteriorating at increasing speed.

In retrospect, it is fairly obvious that at the time the real crisis erupted in Indonesia the Russian situation was so combustible that even a small spark would have been sufficient to set it off. And Indonesia, as we know, was no small spark. Compounding the underlying weakness were a number of key actions taken by the Russian government that (if anything) served to increase Russian vulnerability and thus to exacerbate the impact of the crisis when it did strike.

The main action taken was President Boris Yeltsin's decision, on 23 March 1998, to dismiss the Chernomyrdin government and thus trigger a constitutional crisis. The ensuing political battle over the nomination of Sergei Kiriyenko as prime minister bore great resemblance to a "chicken game," with both sides providing ample illustration of what post-Soviet Russian politics really has been about, namely, total confrontation and complete disregard for the needs of Russia. Although in the end young Kiriyenko did win the nomination, and although he was instantly hailed by a chorus of Western voices as a worthy and respectable successor in the lineage of pro-Western "young reform economists," entrusted with the task of rapidly building a Russian market economy, he never really stood any chance of success.

By mid-April, Kiriyenko was forced to announce that a continued deterioration in tax collection would necessitate further cuts in expenditure (about 26 percent of all budget expenditure was said to lack corresponding revenue). On 29 May, a cut of 40 billion rubles (8 percent of expenditures) was announced, and an additional 22 billion rubles in cuts was said to be needed during the remainder of the year. That was bad news for all those whose wages and pensions were not being paid.

The first round of serious trouble from Asia struck Russia on 13 May, when the government for the first time in that year failed to place the whole issue of GKO treasury bills planned for that day. With the ruble also coming under pressure, on 15 May the Central Bank raised its refinance rate from 30 to 50 percent. The latter measure, however, would be far from sufficient.

The real storm broke on 25 May, when GKO yields were pushed above 50 percent. Investors began selling both stocks and securities, and the ruble came under intense pressure. With the government being slow in reacting, 27 May saw panic strike the markets. An attempt to auction off 8 billion rubles of GKOs failed miserably, and average yields were pushed up to a twenty-two-month high, touching 90 percent.

Equities were also being pummeled, with the *Moscow Times* index sliding to a low of 137, erasing all gains since December 1996. Some blue-chip stocks lost up to a quarter of their value in that one day. Moscow-based market analysts were worse than gloomy: "We are seeing a meltdown. . . . Everything has been shot down." All was seen to hinge on a massive foreign bailout: "The writing is on the wall: only a big, fat foreign loan will save the ruble from a devastating collapse."[6] Even World Bank president James Wolfensohn was talking of "a crisis."

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At the end of the day, the Central Bank announced that it was raising the refinance rate from 50 to a forbidding 150 percent, to cool off speculation against the ruble. Bank chairman Sergei Dubinin also announced that the bank had spent close to $1.5 billion on its ruble defense, bringing total reserves down to just above $14 billion, from a high of $24 billion in July 1997. Markets were hoping for a further loan package of no less than $10 billion.

Then the IMF announced that it would release a previously frozen $670 million loan, which was good news, but at the same time Moody's announced a downgrade for Russia (from Ba3 to B1, or on par with Lebanon but below Jamaica), which put a real damper on potential optimists.

Seeking to restore some confidence in the country's deteriorating system of tax collection, President Yeltsin fired the head of the government tax service, Alexander Pochinok, and replaced him with former finance minister Boris Fyodorov. Major corporate tax dodgers were given until the end of June to come up with 5 billion rubles in back taxes, and about a thousand Russian jet-set celebrities were threatened with special tax revision.

The gist of the new campaign was clearly reflected in the media. While television showed Russian tax police, heavily armed and clad in black ski masks, making brutal raids all over Moscow, the *Moscow Times* published a cartoon of Boris Yeltsin wielding an executioner's ax and clad in a big apron, with the caption reading, "Let's collect some taxes."

Responding to rumors that the G7 were pondering a relief package, the stock market duly rebounded, gaining 20 percent over two days. The government also succeeded in issuing a five-year, $1.2 billion Eurobond, priced at 650 basis points above the May 2003 U.S. Treasury note, implying a yield of about 11.75 percent, up 75 points over its latest Eurobond.

It was beginning to look as though the worst was over, and the Central Bank announced a cut in the refinance rate from 150 to 60 percent. Then there was more bad news. Meeting in Paris, the G7 finance ministers produced verbal encouragement but no cash, and with the Japanese yen taking a serious nosedive, further waves of "Asian flu" began spreading.

By mid-June, the *Moscow Times* index had slid to 124.5, down 60 percent since the start of the year and touching a twenty-month low. The one-year benchmark GKO again rose to more than 70 percent, and there was a renewed attack on the ruble.

In spite of mounting pressure to undertake a financial bailout, both the IMF and the G7 seemed determined to hold out. They appear to have believed that for the first time in a long time they had the Russian government and the Russian Duma in a position where necessary and repeatedly promised reform measures would simply have to be enacted. Thus the stage was set for an international chicken game. And the markets were putting big money on Moscow to be the winner.

To improve relations with Western creditors, on 17 June Yeltsin appointed Anatoly Chubais to serve as international loan liaison officer. Although this was a serious provocation to the Duma, the "young reformer's" personal contacts in Washington would prove to be of great value. On the following day, Russia issued a thirty-year $2.5 billion Eurobond, which provided some relief, but according to Chubais, $10–15 billion would be needed to avert financial collapse.

The IMF, however, was still holding back. On 18 June, it delayed payment of a $670 million tranche of the previous $10.1 billion credit, citing problems with the implementation of needed reforms.

On 23 June, the Russian government reacted by presenting an anti-crisis plan that was directed mainly at improving tax collection. Stating that the situation had now become "so acute that there are social and political dangers," President Yeltsin called on the Duma to take rapid action—or else! Two days later the IMF released the frozen tranche, but the situation was still deteriorating. On 29 June, the Central Bank raised its refinance rate to 80 percent.

At the beginning of July, Siberian miners resumed their picketing of the railroads, and this time they were not only calling for wage arrears to be settled. Now they were also demanding Yeltsin's resignation. GKO yields were running between 130 and 140 percent and the *Moscow Times* index was falling close to the 100 level, where it had begun in September 1995, representing a drop of more than three-fourths from its high in October 1997.

On 13 July, the international lenders finally came through. Under heavy political pressure not to let Russia fail, the IMF reluctantly took the lead in organizing a joint $22.6 billion rescue package. Including previous commitments, the IMF would contribute $15.1 billion over 1998–99. The World Bank would put up $6 billion and the Japanese government $1.5 billion.

On 20 July, the IMF approved its share, and a first tranche of $4.8 billion was paid out. Markets seemed to have been right in gambling that Russia was simply too big, and too nuclear, to be allowed to fail. What they failed to reckon with was that the chicken game would continue, and that in the second round both sides would lose.

An important reason behind the subsequent meltdown was that the breathing spell that the bailout was intended to provide was put to no good use whatsoever, at least not for Russia. Most important, the Duma continued to obstruct necessary legislation. In the days immediately after the rescue was announced—and *before* the IMF confirmed its decision—the Duma gutted the government's anti-crisis plan, defeating measures that, according to Kiriyenko, would have provided two-thirds of targeted revenues.

Although the president responded by vetoing the reductions in tax cuts and by decreeing new taxes, the markets had been sent a strong signal. After a brief recovery, the situation continued to deteriorate. On 12 August, the Moscow inter-bank market was virtually paralyzed by liquidity shortages. The Central Bank imposed limits on the purchases of foreign exchange by banks.

On the following day, the *Financial Times* published a letter from George Soros saying that Russia's financial crisis had reached a terminal stage and that the ruble must be devalued by 15–20 percent.[7] At the same time, Moody's down-graded Russian sovereign foreign debt from B2 to CAA1, on par with that of many poor African countries.

The markets were now finally realizing the true nature of the pyramid games that had been played in the Russian securities market. Expectations were that Russia would either devalue the ruble or default on its debt. No one seems to have anticipated that the Russian government would in fact choose to do both.[8] In the night of 16–17 August, the last round of the chicken game with the IMF was resolved, as the latter communicated its decision to withhold further disbursements of the July bailout package. The markets had thus finally been proved wrong. Despite all of its nuclear weapons, Russia after all had *not* been too big to be allowed to fail. On the morning of 17 August, investors were informed of the price of their failure.

Meltdown

At the time of the meltdown, Russia had a domestic (ruble-denominated) debt of 240 billion rubles, then equivalent to about $40 billion, and a sovereign foreign debt of about $150 billion, two-thirds of which had been inherited from Soviet days. To this should be added commercial bank obligations,[9] including future ruble contracts worth about $6 billion that had been signed with Western investors seeking to hedge against the devaluation risk. There was an obvious fear in the markets that a massive series of Russian defaults would trigger financial shock-waves throughout the world economy.

At first sight, however, the news was not all bad. In the days immediately after the event, Kiriyenko vehemently denied that there had been either devaluation or default. And from a technical point of view, there was some truth to what he was saying. The ruble was not devalued, technically. The decision taken was to open the band of the ruble corridor, a sort of crawling peg regime that had been operating since summer 1995, so that the currency could fluctuate between a lower band of 6.3 and an upper band of 9.5 rubles to the dollar. At first, it seemed that the drop would not be all that bad, maybe 10 percent or so, maybe dropping slowly to 9.5 by the end of the year. That would still have been manageable.

Also, the default on the debt really wasn't a default—not at first, and not technically. By freezing part of its short-term sovereign debt for ninety days, and by introducing a moratorium on a large portion of the foreign obligations of the commercial banks, significantly including the future currency contracts, the Russian government provided itself with some breathing space in which to deal with a desperate situation. Had the situation been correctly handled, Russia might have come through the crisis with foreign investor confidence badly damaged but not totally destroyed.

The factor that transformed both of these potentially manageable situations into a full-scale disaster again was Boris Yeltsin. On 21 August, the Duma called for the resignation of both Yeltsin and Kiriyenko. In a characteristic response, refusing to accept any blame whatsoever, the president simply dismissed the Kiriyenko government and launched yet another chicken game with the Duma.

The president's first choice for new prime minister was Viktor Chernomyrdin, the very same Chernomyrdin who had been let go six months previously for having mishandled the economy. Arguing that a reappointment of Chernomyrdin would mean a return to the problems of crony capitalism that had caused the crisis, the Duma turned him down. Yeltsin immediately renominated his candidate, and the Duma again defeated him.

So far the stage appeared to be set for a repetition of the confrontation that had been played out in March, but in the third and final round the Duma members were in a different mood altogether. They were now bent on staying the course. By defeating Chernomyrdin they would force the president to dissolve parliament and call new elections. The Communists in particular likely expected that their position would be greatly strengthened in a new Duma.

What went on in Yeltsin's mind is, as usual, subject to speculation. The fact that leave had been canceled at several vital military formations prompted rumors of an intended rerun of October 1993, that is, a forcible dissolution of the Duma and a return to presidential rule by decree. In the end, however, it was Yeltsin who flinched. By choosing in the third round to nominate Yevgeny Primakov, who had been one of several candidates proposed by the Duma, he narrowly avoided a showdown. The price that would have to be paid for this latest round of playing chicken, however, was nothing short of terrible.

In the absence of a functioning government, there was nobody to prevent the ruble from entering a free fall, in which the Central Bank repeatedly had to invalidate trading on the currency exchange and go back to fixing yesterday's exchange rate. By the end of the year the rate had dropped not to the lower band of 9.5 to the dollar, but to below 20, representing a devaluation of around three-fourths.

The collapse of the ruble, moreover, represented not only an immediate economic loss. There are even tougher long-term implications of thus destroying the confidence in the national currency that had been so painfully built over the previous couple of years. The collapse of the banking system represented a setback of perhaps decades before Russians will again trust domestic banks to handle their money.

Accepting that Yeltsin's decision to dismiss his government was one of the most devastating actions taken in those days, we must also ponder the role of the West. On all previous occasions when Yeltsin had undertaken similar ploys, he had received applause from the West. From his point of view, dropping Kiriyenko thus was a logical move. This time, however, the impact on the economy was akin to the dropping of a neutron bomb.

It was not until 30 October that the Primakov government finally managed to place an anti-crisis program of sorts on the table, and even at that late date the product was one that found little favor with the markets. And so it would continue well into 1999, revealing that on the Russian side there really wasn't any genuine readiness to pay the price for restoring investor confidence. In the short term, it was preferable to bully for more credit rather than humbly seek to make up for past mistakes.

The disaster that followed in the wake of 17 August derived mainly from the power vacuum created by Yeltsin's decision to dismiss his cabinet. Without firm leadership and control over activities in the "frozen" financial markets, it was easy for Russia's financial elites to feather their own nests. Perhaps it was even with a view to making that possible that the crisis was triggered in the first place. Moscow rumor, at least, has it that the fall of the Kiriyenko government was orchestrated by tycoon Boris Berezovsky, the reason being that he and the other top bankers feared that the government would strike a fair deal between domestic and foreign creditors.[10] By convincing the president to dismiss young Kiriyenko and by lobbying hard for the older and more "reliable" Chernomyrdin to replace him, the tycoons could feel safe from the threat of equal treatment for Western investors.

The conspiracy theory was given added weight by then deputy prime minister Boris Nemtsov, who claimed that the Russian government had been preparing to bankrupt some of the politically powerful but economically weak banks and oil companies, allowing others, including Westerners, to take over: "They [the oligarchs] understood that the end was near, that there might be serious changes in ownership and that the current oligarchate might come to an end."[11]

If Nemtsov is right, it is fairly easy to understand why the oligarchs pre-empted (although this understanding in no way implies sympathy for their lethal attack on the country's currency). Making things even worse, the way in which the problem of restructuring the short-term debt would be handled provided clear evidence that the Russian authorities were bent on giving Russian banks preferential treatment vis-à-vis foreign investors.

Turning now to the question of assigning blame for the course of actions that led up to the August meltdown, it is fairly obvious that the main share of responsibility must lie with the Russian leadership. If the president had been less inclined to engage in power-and-privilege games with the oligarchs, it would not have been possible to drive the country so far down the road to ruin that a collapse became all but inevitable. As argued above, however, placing the lion's share of the blame on Yeltsin also requires his foreign supporters to be placed in the spotlight. There have been a number of critical decision points where Western demands and attitudes have figured strongly in the shaping of Russian policy. One need only recall fall 1991, when for several months the G7 countries effectively were placed in a position where, although the Supreme Soviet had voted to abolish the Soviet Union, they could decide that Gorbachev should remain as president of a now legally defunct country. Subsequent U.S. promises of financial aid and economic advice were conditioned on total ideological submission by the Russians, thus serving to launch the devastating policy of "shock therapy."

To see how the IMF became involved in a mission that it would have been well advised to stay clear of, we must begin by looking at the general political situation at the time of the implosion of the Soviet Union. There were several factors at play, but one of the most important related to fears of "losing" Russia, fears that recalled the vicious debates that had erupted when the West allegedly "lost" China to the Communists, back in 1949.

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In the crucial years 1990–91, when Russia was truly at a fork in the road, Western powers were in the midst of accepting that they were about to "lose" both Gorbachev and the Soviet Union, and it is rather logical that many would be wary of "losing" Yeltsin to the Communists.

Given the stakes that were involved, there was a general willingness to do something, but it was not clear what that "something" was to be. As it turned out, the way in which the West (as represented by the G7) went about helping Russia was based on pushing the IMF into the lead position and using that cover to make a host of unwarranted promises. The role played by the Clinton administration from 1993 onward is of particular relevance here.

There emerged in the United States a tight network of people who jointly were in firm control of the Russian agenda. At the very top was Vice President Al Gore, who took a seat on the high-level Gore-Chernomyrdin commission. There was also Strobe Talbott at the U.S. State Department, who was an old friend of Bill Clinton and a promoter at large of a romantic view of Russia's future prospects.

At the more hands-on policy level, the agenda was driven by a group of Harvard-based economists led by Jeffrey Sachs. They in turn were connected to old Harvard graduates that had gone on to hold senior economic posts, such as Stanley Fischer at the IMF and Lawrence Summers at the U.S. Treasury. The patterns of influence within this powerhouse, which would control much of U.S. aid to Russia, have been described by Janine Wedel in a recent book and will not be pursued further here.[12] We may, however, note the lengths to which the Clinton administration was prepared to go to hush up disturbing information.

In November 1998, the *New York Times* published a remarkable account of how the CIA in 1995 had gathered what it held to be conclusive evidence of the corruption of Russian Prime Minister Viktor Chernomyrdin. When the classified report was passed on to the White House, Vice President Gore allegedly returned it to Langley "with a barnyard epithet scrawled across its cover."[13] If true, the signal could hardly have been made clearer. Gore did not want his work in the Gore-Chernomyrdin commission to be disrupted by politically incorrect information about Russian realities. And the rest, as they say, is history.

The G7 Pass the Buck

The role of the G7 in allegedly "helping" Russia has been subjected to harsh criticism from many different quarters, most notably from Russians who from the outset were opposed to the neoliberal slant of the reforms, and from those who did not receive financial aid. In the following, I shall argue that the G7 made serious errors of judgment, but it may be worthwhile to begin by reviewing some of the early critique, which accused the G7 of actually doing too little.

In one of his most vehement articles on the "betrayal" by the West, Jeffrey Sachs lashed out at how "the G-7 governments disgracefully pressed the Russian government to continue servicing the Soviet foreign debt, at a time when the G-7 should have been working hard to provide the new government with fiscal breathing space."[14]

Richard Layard, another of the more prominent foreign economic advisers to the Russian government, displays similar anger when he (and co-author John Parker) speaks of how the West sent in the "debt collectors." He notes how the negotiations "involved Gaidar for hour after hour when he was trying to construct his reform plan," and he adds a rather serious practical complication. By insisting that servicing of the debt should continue until a rescheduling could be worked out, the West pushed Russia into a position where its dollar reserves ran out. By mid-December 1991, payments were unilaterally suspended: "This incompetent outcome, which blocked the dollar accounts of many Russian and foreign firms, was the first notable failure of the reform government, and it was due directly to Western advice and pressure."[15]

While this line of criticism may have some justification, it should be noted that in Western attitudes to the Russian "transition," it represents a mere technicality. The real "betrayal" was failing to put up the tens of billions of Western tax dollars in support that were called for by Sachs.[16] Once we move into this dimension, the issue at hand becomes considerably more complicated.

One part of the problem concerns whether massive economic assistance was actually indicated in the first place. One might question the absorption capacity, and one might ask why a country running substantial trade surpluses should be in need of balance of payment support. Most important, however, the substantial volume of capital flight from Russia indicates a serious lack of domestic confidence in the reform process.[17] The problem would thus seem to rest on the Russian rather than the Western side.

However, we know what did happen. Of far greater importance than insufficient dollars was the allocation of responsibility for dealing with Russia's needs. Given that Russia was no traditional Third World aid recipient (economically or politically) it should have been dealt with—from day one—as a special case. The failure to do so proved to be a recipe for major trouble.

The decision point came on 6 December 1991, when President Yeltsin asked the G7 for a stabilization fund, intended to support the ruble. (This scheme was patterned on the $1 billion stabilization fund that was granted by the G7 to Poland late in 1989 to support the zloty.) Rather than dealing with Russia on a bilateral basis, under a special arrangement, the G7 governments decided to shift the burden onto the shoulders of the IMF. Layard and Parker rightly criticize this move:

> That was a fatal step, for the IMF is an organization with its own procedures and criteria, which quite naturally it wished to apply to Russia as to other countries. The basic issue for the IMF was: Did Russia qualify for an IMF loan using the standard criteria? Unless specifically instructed to do so by its shareholders (the G7) the IMF was not going to take into account Russia's critical role in world politics.[18]

The decision by the G7 to place the IMF in charge of helping Russia is certainly explicable. If it were actually going to be a question of aid in the amounts mentioned by Sachs, governments would have a hard time gathering the necessary political support. Better to do it indirectly via the IMF. There was also the complication of sour relations between Russia and Japan over the Kurile Islands, another reason for not making Japanese taxpayers directly responsible.

Although the IMF solution might thus have been politically expedient at the time, it soon turned out to entail a string of added complications. One concerned the very rationale of the organization. Since its conception at Bretton Woods, the IMF had been the world's financial policeman. It had functioned on the basis of credibility. Once an IMF team had given its stamp of approval for a country in crisis, other creditors would feel safe. Now that was set to change.

Accepting responsibility for Russia not only meant moving into an area where the Fund had little expertise and experience of its own. It also meant taking on a debtor that would not gladly accept the strong-arm tactics used by the IMF in relations to its traditional borrowers. Once set in motion, however, the process could not be easily stopped. As pressures grew and accusations of betrayal started flying, it was logical that the IMF would succumb and begin to consider what was politically correct in the capitals of the G7 countries.

Another complication was linked to the fact that the IMF was seeking a new mission. Its way of handling the debt crises in the Third World had not met with great success, and its corps of critics was growing rapidly. Further funding was by no means secure. With the fall of communism, a whole new arena for financial assistance programs was suddenly opened up. By agreeing to shoulder the main responsibility for a postsocialist reconstruction effort, the IMF was once again placed in the limelight, and Michel Camdessus became one of the world's top leaders. In both of these dimensions are problems of moral hazard, of temptations to abandon sound financial considerations and venture instead into the domain of very high level politics. We may note how the Russians very skillfully played into these Western desires.

A Russian strategy developed of presenting Boris Yeltsin as the only reliable force of "good" on the Russian scene. The essence of this strategy is captured by Bruce Clark, who went from being Moscow correspondent for the *Times* to becoming diplomatic correspondent for the *Financial Times*:

> At that time, the smugness that descended on the Western world in the aftermath of its Cold and Gulf War victories was still very much intact; it was still assumed that a Russia which was prosperous, as the West defined prosperity, would be a force for good in the world, as the West defined goodness. The Yeltsin administration would have been foolish if it had not capitalized on that sentiment for all it was worth. If Yeltsin was the repository of all the world's hope for "goodness" in Russia, it followed that helping his administration, and forgiving it any minor peccadilloes, was an overwhelming political imperative.[19]

When President Clinton met Yeltsin in Vancouver in April 1993, and when, some months later, the G7 held its economic summit meeting in Tokyo, it was already obvious what kind of political games were being played. The G7 governments were adapting themselves to a new set of rules—rules, moreover, that were being laid down by the Russians. And it was up to the IMF to shoulder the responsibility for implementation.

The adjustment was a three-stage process. In the first stage, a transformation was made from betting on Gorbachev and a preserved Soviet Union, to thinking in terms of Yeltsin and a disintegrating Soviet order. In the second stage, lasting from the August coup through much of 1992, there is confusion as to what the post-Soviet world would actually look like, and in the third stage, which took shape in 1993, the policy of "Russia first" took root.

Clark summarized the essence of the new game: "Somewhere in the course of these frantic discussions, it came to be accepted by everyone that for reasons of historical necessity, Russia must be given a uniquely privileged sort of treatment by the International Monetary Fund and the World Bank."[20]

What this meant was that political considerations must be allowed to override the rules and practices that had been IMF standards for decades. What type of pressure was applied is a bit unclear—perhaps the IMF did not need too much prodding—but the outcome is obvious. Russia was more or less exempt from all the rules and sanctions that were rigorously enforced in all other cases of countries turning to the IMF for assistance. To some, the transformation was baffling:

> For the bankers and economists who worked at those institutions and had spent a lifetime schooling unruly nations in the ways of financial rectitude, it was a bemusing experience, at once comical and exasperating, to watch Russia's leaders cheerfully rewrite the rules of the capitalist club before they had even joined. High-flying bureaucrats, used to laying down the law in every semi-bankrupt finance ministry in the world, found to their astonishment that Russian officialdom treated them with condescension: the condescension of borrowers who know that their banker has no real choice, because the political cost of meanness is even higher than the financial risk of profligacy.[21]

The true reasons for this about-face remain a matter for speculation. In some quarters, there was likely a significant amount of naiveté, an expectation that soft terms for Russia really would lead to positive results, that the Russian economy would rapidly recover, and that in the slightly longer term one would actually be able to recover all the billions that were granted in credit, perhaps even with interest.

In other circles, it is equally likely that pure cynicism prevailed, that it was fully appreciated that the soft credits would neither be repaid nor perhaps even have the promised effects, but that the short-term political gains in the relationship to the Kremlin could be worth some tens of billions of dollars. This was even more likely because the global availability of aid and credit to the needy has been decreased. It is hence other poor countries that indirectly have paid the price for Western "aid" to Russia.

No matter how we choose to interpret the decision to give Russia uniquely privileged treatment, there can be little doubt as to the potentially negative long-term consequences of the decision. At the bottom lies the vital issue of credibility, both for the leading governments in the West and for the international financial institutions.

Let us now look in more detail at the game played between the Russian government and the IMF. The IMF was pushed into accepting direct responsibility for supporting the Russian reforms. As a result, what started out as a standard IMF mission soon was transformed into a cooperative, or even collusive, game with Moscow where the credibility not only of the Russian side would be put at stake.

A Reluctant Beginning

The IMF's involvement in Russia came about rather reluctantly. Russia was not a member of the Fund and was thus not eligible for emergency assistance. Maintaining its traditional strict standards, it was not until July 1992, when Russia became a member, that the IMF granted a first credit of $1 billion. As the initial expectations for a rapid Russian economic recovery began to dissipate, it became increasingly clear that any substantial (politically motivated) lending to Russia would have to be accompanied by a bending of the rules. Thus, in 1993 a "Systemic Transformation Facility" (STF) was invented to facilitate lending to post-communist economies on more lenient terms. In May 1993, the IMF reached an agreement with Russian representatives on a program of stabilization, and on 1 July Russia received a first tranche of $1.5 billion under the STF.

Implementation, however, failed to meet the agreed conditions, and the second tranche of another $1.5 billion, which was to have been released in the fall, was withheld. Russia had failed to live up even to the less-stringent conditions of the STF. According to a senior IMF official, "The May 1993 program went off track because it was not followed; and it was not adhered to because major political forces within the country refused to live by its provisions. The government was not able to protect the program from those who wanted to derail it."[22]

During the initial period, when traditional IMF rules were still being enforced, there was little money available. In 1992–93 Russia received a total of no more than $3.1 billion in untied credits from the IMF and the World Bank (see table 1). These fairly small amounts of aid should be seen against the background of the politically motivated promises that were being issued at the time. The frequent talk of a new "Marshall Plan" for Russia was unfortunate in that it deluded both sides. The Russian leadership was lulled into believing that massive amounts of aid would be forthcoming, and Western leaders were convinced that there was a policy design available that would make it possible to repeat the success of the original Marshall Plan. Neither, as we now know, had any serious foundation in fact.

Table 1 also shows a bottom line of "Headline Offers." This is the caption used by Layard and Parker to capture hollow promises of financial assistance made by the G7 on two occasions when President Yeltsin seemed to be under serious threat from the domestic opposition. The first case was linked to the April 1992 session of the Russian Congress of People's Deputies, which promised to offer a showdown between the reformers and their opponents. To strengthen the hand of the reformers, on the day before the congress opened the G7 made a public offer of a $24 billion package, including $6 billion to stabilize the ruble, once the Russian government was ready to fix the exchange rate. The second case arrived in the run-up to the crucial referendum on how the country should be governed that was held in April 1993. On 3 April, Presidents Clinton and Yeltsin met in Vancouver, and ten days later, in Tokyo, the G7 promised to put up a total of $28 billion (plus $15 billion in phantom debt relief).

Very few of these promises were made good in hard cash. Of the $24 billion promised in 1992, only $15 billion arrived, and of that sum $12.5 billion was export credits made available by Western governments to Western firms wanting to sell their goods in Russia. In 1993, as may be seen from table 1, it was even worse. The talk about a stabilization fund for the ruble remained just that, talk, for the simple reason that stabilization was nowhere within reach.

Layard and Parker are justifiably upset about the discrepancies between promises and actual deliveries, but perhaps not for the right reasons. If we look at the sums involved, if the full amounts had been delivered in hard cash, the former

TABLE 1
Official Financial Assistance to Russia (in billions of dollars)

	1992	1993
IMF	1.0	1.5
World Bank	0	0.6
Export credits	12.5	5.5
Western government grants	1.5	0.5
Total	15.0	8.1
Corresponding Headline Offer	(24.0)	(28.0)

Source: Richard Layard and John Parker, John, *The Coming Russian Boom: A Guide to New Markets and Politics* (New York: The Free Press, 1990), 90.

would have been equal to 30 percent of Russian GDP in 1992, and the latter would have been greater than total Russian imports in 1993. Is it reasonable to criticize Western taxpayers for not putting up funds of that magnitude to a Russian government that enjoyed such low credibility in its own country?

A more justifiable line of critique is advanced by Daniel Gros and Alfred Steinherr, who conclude that "it is apparent that the total amounts announced to the press were used mainly for propaganda purposes."[23] Making promises like these, which no one intended to keep but which were bound to be believed by at least some parts of the Russian population, was shortsighted Western expedience. In the longer term it may have serious Russian fallout effects.

Changing Tack

The turning point in the IMF's relations with Russia arrived in the aftermath of the disastrous December 1993 election, which brought Communists and nationalists to the fore. When the duly reshuffled Chernomyrdin government began 1994 by stating that the period of "market romanticism" was over, the foreign economic advisers decided to jump ship and unleashed a torrent of harsh criticism against the IMF for having failed to lend a helping hand. Jeffrey Sachs's article about the "betrayal" was perhaps the harshest, but it was not unique.[24]

At the beginning of February, Michel Camdessus responded angrily to accusations of the IMF's being too insensitive in dealings with Russia or too strict in the conditions imposed: "'We are the scapegoat,' he complained, insisting that if the international community wanted to 'give unconditional aid to Russia, the money should come from bilateral grants.'"[25] The IMF had a charter to follow and member states whose interests must be safeguarded.

That stance, however, soon changed, and not because of improved Russian performance. On the contrary, games of moral hazard were played on both sides, and on both sides the outcomes were negative.

The likely reason for the IMF's about-face was connected to a hunting expedition undertaken by Camdessus and Russian prime minister Viktor Chernomyrdin. Following that event, the $1.5 billion tranche was released, and from then on IMF involvement in Russia grew increasingly enthusiastic. In April 1995, the IMF granted a $6.5 billion credit, and in March 1996, in the midst of the Russian presidential election race, a three-year $10.1 billion "Extended Fund Facility" credit was agreed to, representing the second-largest credit ever granted by the Fund (after Mexico but before the Asian crisis).

The question that I will address below is not whether all this lending was undertaken according to traditional IMF standards. That had been formally excluded with the introduction of the STF. The crucial point concerns whether it was undertaken *even* according to the purposely lax standards that had been created for Russia.

It is important to note that at the time there were high-level voices warning about embarking on a program of major financial assistance to Russia. One was the Russian finance minister, Boris Fyodorov, who resigned in January 1994 and became a serious critic of the way in which relations between Russia and the West were evolving. In late March 1994, he lashed out at the plans that were under way to give Russia more soft aid: "Is it not clear that the West is being used to bury the remnants of the reforms? . . . Is it not clear that anti-Western and nationalist attitudes are becoming more and more prevalent? . . . The sooner this money is handed over, the sooner we shall see a change in policy—in the wrong direction."[26]

Notwithstanding such critique, on 20 April, the IMF released the second tranche of $1.5 billion under the STF. At first it went well. By late June, all the agreed targets had been met. Then it collapsed. In the third quarter, Central Bank credit to the government surged as a number of special interest groups were lobbying for handouts. At first, the government tried to counter the inflationary pressure by running down international reserves, but on 11 October that strategy ran into a brick wall. "Black Tuesday" saw the ruble fall by more than 20 percent against the dollar.

According to the same IMF official quoted above, the latter crisis "reflected a rational reaction of market participants, by now well informed, quick to move, and aware of the lagged but predictable effects of monetary expansion on inflation and exchange rates. It was a rational reaction to bad macroeconomic policies, and particularly to an unsustainable fiscal deficit, and the appropriate response should have been to correct those policies."[27]

That reflects the core of the problem. If the point of the exercise was to enforce hard rules in the Russian economy, and the IMF not only chose to offer soft rules, but also repeatedly gave absolution for breaking even the soft rules, there were bound to be problems.

In 1996, two issues overshadowed all others on the Russian scene. One was the ongoing war in Chechnya, and the other the presidential election campaign. Although both constituted substantial extra burdens on the federal budget, neither deterred the IMF from extending further credit. In March, the previously mentioned $10.1 billion "Extended Fund Facility" was agreed to, to be disbursed over the coming three years, initially on a monthly basis and then quarterly, following approval by IMF missions to Moscow.

No secret was made of the fact that the aim was political—to save Yeltsin by helping to finance his election handouts. Although subjected to heavy criticism from the media, including specific accusations of contributing to the financing of the war in Chechnya, Camdessus laconically explained that it would have been "immoral" not to have helped out.[28]

The IMF, however, was far from being alone in providing such support. In March, Russia received $2.4 billion in foreign bilateral credits from Germany and France,[29] and in April the "Paris Club" of Western creditor governments agreed to a massive rescheduling of Russia's foreign debt. The latter was particularly important in that for the first time since Lenin repudiated tsarist foreign debt, it placed Russia in a position of commercial creditworthiness.

In October 1996, Russia received credit ratings from both Moody's and Standard and Poor's (the former being Ba2, and the latter BB–, better than Brazil and Argentina but below Poland and Hungary), implying that the doors were now open for the Russian government to venture into the Eurobond market. The first, highly successful, $1 billion issue was made in November 1996 (for five years at 9.25 percent). In March 1997, there was an equally successful DM 2 billion Eurobond (for seven years at 9.0 percent), and in June there was a further $2 billion issue (for ten years at 10.0 percent).[30]

The West had made its choice. Although there was much unease about Chechnya, and perhaps also about other aspects of Yeltsin's behavior, in comparison with Communist Party leader Gennady Zyuganov he appeared to be the lesser of two evils. And by signing off on the deals, the IMF vouched for Russia's future ability to honor its rapidly growing debt obligations.

The Moral Hazard

As noted above, if the IMF has earned criticism, the reason is not that it got tough in August 1998, but rather because it played the Russian game for so long, without giving the slightest hint of where it all was going. Although much of the general debate in the wake of the Asian crisis concerned the technical design of IMF prescriptions, in the Russian case that really is not where the main problem lies. The real trouble here concerns moral hazard and the formation of expectations.

Reinforcing Bad Habits

Given that the distinction between credits and handouts had always been weak in Russia, particularly after the Soviet ambition of demonetizing the economy, the main challenge to the IMF at the outset of its Russian mission was to play by the book, indeed by its own book, in upholding strict financial discipline. *Pacta sunt servanda.* Debt obligations are to be honored.

The danger that lurked was highlighted in spring 1994 by then former Russian finance minister Boris Fyodorov, who warned that the credits would never be repaid: "There are too many people in senior positions in the Russian government who think it patriotic to take as many loans as possible and then quietly plot to obtain debt forgiveness and debt reductions."[31]

Because such warnings were ignored by Western creditors, the Russian side willingly adapted to and aggressively demanded soft rules. This adaptation, moreover, was regrettably well attuned to the general ambition of the Yeltsin administration to impose its will on the rest of society by consistently seeking confrontation. As Peter Rutland put it, "Yeltsin does not seek a dialogue with society: he seeks to browbeat it into compliance with his populist rhetoric."[32]

The general economic strategy that the Russian government developed was to play a series of chicken games. It did so in its relations to the country's popular assembly, first the Supreme Soviet and then the (democratically elected) State Duma, with deplorable results for the passing of both budgets and necessary legislation.

The pattern became wearisomely familiar: the president intimidated the Duma, the Duma threatened to impeach the president, and the president threatened to dissolve the Duma. And the West consistently chose to take sides, supporting President Yeltsin even to the point, in October 1993, of condoning Russian tanks' shelling the Russian parliament building.

Given the Western complacency with respect to Yeltsin's domestic chicken game, it was not really surprising that the strategy that was deployed vis-à-vis Western donors and creditors was strikingly similar, with one small difference. Rather than issuing direct threats, Russian sources consistently relied on more subtle threats of the "greater evil": unless Russia gets more funds, dark forces would come to power. Thus, Yeltsin simply must be supported.

Behind the scenes, however, it was slowly becoming clear that Yeltsin, as Rutland puts it, was "the problem, not the solution."[33] There emerged in Moscow a form of implicit contract, to the effect that if the *boyars* (the oligarchs) recognized that Boris Yeltsin was the tsar of Russia, the tsar in return would grant his *boyars* a carte blanche to plunder the country and to transfer their loot to safe havens abroad. An obvious implication of this contract was that for as long as Yeltsin remained in his post the problems of predation could not be resolved.

"Western 'support' for Russian reforms has been a long series of unprecedented meddling, to the point even of raising demands and setting conditions that no other country in the world would have found acceptable."

What the IMF stands accused of here is having turned a blind eye to cronyism and systematic rule evasion. A particularly glaring example was the practice of "aggressive sequestration," of simply withholding disbursements from the federal budget when revenues fell short. A senior IMF official who was involved in the process describes how he saw it get started: "In the last months of 1993, [finance minister] Fyodorov used the only weapon that remained in his arsenal: he simply refused to pay. The policy of aggressive sequestration continued in the first half of 1994 and, coupled with a restrained monetary policy . . . it helped to achieve a significant albeit temporary reduction in inflation."[34]

The ad hoc way of running the budget, which had started in the first weeks of the Gaidar government, had a number of detrimental effects, notably the creation of a chronic arrears crisis. But none of this was ever seriously criticized by the IMF. Although the Fund was heavy-handed in its criticism of insufficient fiscal austerity, it is hard to recall its ever mentioning the importance of *pacta sunt servanda*, that the government has certain obligations vis-à-vis its citizens, and that a failure to honor such obligations may have serious repercussions for the country's social capital at large, eroding the very foundations on which the Western-style reforms were to be built.

After all, if the government sees no need to pay its bills on time, why should anyone else? And if the IMF, rather than condemning such breaches of contract, keeps the heat on for further budget cuts while it looks the other way when the oligarchs evade *their* taxes, what is there really to stop the money economy from disintegrating—short of a popular uprising?

The soft rules introduced by the IMF for Russia have been subjected to justly harsh criticism from Marshall Goldman, who points to serious moral hazard in two directions. On one hand, "The wrong message is transmitted when the Russians come to perceive that credit terms can be stretched. Given that they already tend to treat credit obligations lightly, there is a danger that they will not learn how important such obligations are and that capital flight will continue."

And on the other, "There is also a strong likelihood that, once such concessions have been made, some Western advisers will seek to obtain even more concessions—after all since an exception was made once, why can't it be made again? A problem here is that some Western advisers have come to act more as advocates than as analysts. Once they give advice, they tend to have a vested interest in that reform and therefore are reluctant to be critical of the results."[35]

These are textbook illustrations of the problem of moral hazard, and it was not long before reality proved that the early warnings had been justified. In the first months of 1995, the IMF was involved in lengthy negotiations on the new twelve-month standby arrangement for $6.5 billion. When agreement was finally reached, the Russian side had pledged to block further direct Central Bank financing of the deficit, to bring monthly inflation down to 1 percent in the second half of the year, and to liberalize further the foreign trade regime, notably with respect to oil. None of these commitments would be honored.

On the contrary, while negotiations with the Fund were under way in the first quarter, Russian money supply (M2) was allowed to increase by an average of no more than 1 percent per month. Given that monthly inflation in January was running at 17.8 percent, that was austere enough. Then the agreement with the IMF was signed, and in April M2 was suddenly free to increase by no less than 25 percent. As a result, the average increase in M2 for the first four months of the year rose to 4–6 percent.[36]

In fall 1995, Dmitri Tulin, executive director of the IMF's Russian office, responded to criticism of the Fund's Russia policy in a rather interesting way. He began by acknowledging that "Russia has failed so far to accomplish any of the stabilization programs agreed with the Fund." Then, however, he went on to state that that "places the Fund's critics in an awkward tactical position, since in such a case any unbiased observer would be inclined to attribute Russia's unsatisfactory economic performance to non-compliance with the Fund's policy recommendations, rather than to the deficiencies of these recommendations."[37]

This defense is striking in two ways. It seeks to reduce important criticism to simple tactical debating points, and it maintains that the fault rests with the Russians, rather than with the IMF. The fact that the Fund had been consciously playing along with Moscow in a game of systematic rule evasion seems to be of no consequence. As long as no critique is directed at the *technical* quality of the advice offered, whether or not it is actually implemented, or even possible to implement, is held to be an exclusively Russian problem.

The fact that none of the multitude of tricks deployed by Moscow was ever criticized by the IMF is hard to disassociate from the fact that the Fund was being drawn into a relationship of increasing mutual dependence with the Russian government. In a 1996 article in the *Institutional Investor*, published after the re-election of Boris Yeltsin, which had been indirectly sponsored by the IMF, David Fairlamb opens with a striking characterization of this relationship—"They're as intimate as lovers in a classic Russian novel"—and then proceeds to point out the inherent dangers:

> The relationship between the world's financial policeman and its biggest debtor after Mexico is now so cozy that it has become a tad unwholesome. So anxious are the Russians to please the Fund that they often agree to unrealistic financial targets that are impossible to meet. So keen is the Fund to help Russia that it often turns a blind eye when its supposedly stringent lending conditions are infringed on. . . . It doesn't take a Tolstoy to see the potential for tragedy, or at least melodrama, in this situation.[38]

Half a year after the trauma of the August crash, *The Economist* summarized how Western thinking about lending to Russia had been transformed: "In the past, IMF money was always forthcoming. Whenever Russia has been in a scrape, a word of guidance from the American government to the world's financial overseers has been enough to overrule bureaucratic scruples about wobbly public finances, the risk of theft and the slender chances of getting the money back."

Then we are taken up to the rude awakening: "No longer. Perhaps belatedly, a new consensus now unites both the international financial institutions and their political masters in Washington: that without deep changes in the way Russia is governed, lending the country any more money is useless, or even harmful."[39]

The position of the IMF was thus beginning to look rather precarious. Given that the likelihood of Russia's actually implementing the reforms that the Fund had repeatedly called for was converging on zero, it really did not have much left to show for all its efforts in lending Russia Western tax dollars.

Political Meddling

There is another dimension of moral hazard, the intensive Western interference on Russia's domestic political scene. Here, the long-term consequences may turn out to be even more disturbing than those of the financial meltdown.

Although it may be debatable to what extent foreign involvement in the Russian reform process has had an impact—positive or negative—on the evolution of the economy (the financial disaster being a special case), its impact on the political process must be beyond doubt. Western "support" for the Russian reforms has been a long series of unprecedented meddling, to the point even of raising demands and setting conditions that no other country in the world would have found acceptable.

Assume, for example, that Russian authorities had made a practice of intervening in U.S. presidential elections and of repeatedly calling on the White House (the Washington one) to make policy changes or changes of senior staff members, in both cases with thinly veiled threats regarding the consequences of noncompliance.

All of this has been done in the other direction. It has not been equally well liked in all segments of the Russian population, and it may at some point in time have serious foreign policy repercussions. Let us look at two different cases to illustrate two different types of impact.

The first example occurred in late 1997, when the Russian government was under heavy pressure to improve tax collection. In the midst of the political wrangling, *Nezavisimaya Gazeta* published a letter from Michel Camdessus to the Russian government. After some introductory courtesies about Prime Minister Viktor Chernomyrdin's excellent leadership, the IMF director goes on to hint that the Fund may approve releasing a promised credit—provided that Russia fulfills a set of twenty-one conditions (all listed by the newspaper).[40]

In a comment, the communist newspaper *Sovetskaya Rossiya* stated, "The question, however, is not only one of the IMF dictating its terms to Russia, because Russians are already used to this." The real point of anger was the question of who runs the Russian economy:

> As it turns out, from the Fund and the World Bank Russia can have no secrets. Messrs. Camdessus and Wolfensohn know everything that happens inside the Kremlin and the government. . . . the present government of Russia is merely an apparatus for monitoring the fulfillment of instructions from the IMF and other Western financial structures, and from them the government and the Kremlin have and can have no secrets.[41]

While it should be noted that conspiracy theories of various kinds tend to flourish in Russia, there remain some important problems in relation to this type of interference, problems that again are clearly related to moral hazard.

It is significant, for example, that in granting Russia the previously mentioned credit of $6.5 billion in spring 1995, the IMF insisted, as one of its main, although unpublicized conditions, that economic policy in 1995 be run by Chubais.[42] Although the "young reformer" was already well on his way to becoming one of the most hated men in Russia, the IMF and the G7 maintained their demands (implicit or explicit) that he play an important role in the Russian government.

Our second case was in the latter half of 1993, when the IMF decided to withhold the second tranche of the "Systemic Transformation Facility." The political process that led to that decision has a great deal of unpleasant relevance to the story told above.

The storm clouds began to gather in late August, when the IMF organized a seminar in Moscow. Here the message was spelled out clearly and simply. If the Russian president were to agree to the budget amendments that had just been passed by the Supreme Soviet, the Fund would stop all further financial support.[43]

In mid-September, pressure was increased, as the IMF warned that the second tranche of the STF would not be released until Russia "returned to the path of reform." Suddenly, there were several high-ranking U.S. officials going to bat. On 13 September, U.S. Treasury Secretary Lloyd Bentsen warned, "There has been slowing down in some areas. That is certainly a concern." On the following day, the undersecretary for foreign affairs at the Treasury Department, Lawrence Summers, arrived in Moscow, having just told the U.S. Senate Foreign Relations Committee, "The battle for economic reform in Russia has now entered a new and critical phase in which many of Russia's accomplishments on the economic front are being put at risk. The momentum for Russian reform must be reinvigorated and intensified to ensure sustained multilateral support." On 15 September, Jeffrey Sachs joined in, saying that the drift in the Russian government was "dreadful" and that "things are dead in the water."[44]

On 16 September, Yeltsin told soldiers at the elite Dzerzhinskii Division that Yegor Gaidar was back in the government as first deputy prime minister. This, however, was not enough. On 20 September, the *New York Times* quoted a senior IMF official as saying that the Fund was unhappy with recent "backtracking" on reforms, but that "Moscow might receive the loan by the end of the year if it displayed a strong and renewed commitment to reform."

On 21 September, the Russian president dissolved the country's parliament and triggered a constitutional crisis that culminated in the bloodbath on 3 October. That, seemingly, was finally enough. In spring 1994, relations between Moscow and the IMF started to improve.

What, then, may we conclude from these events? Was it by pure coincidence that the two chains of events coincided? Or was the IMF indeed instrumental in bringing the crisis to a head? Only Yeltsin himself can give a proper answer to that question, but doubts will always remain as to the wisdom of heavy Western involvement in Russia's domestic power games.

In defense of the IMF, it might be argued that it is unreasonable to accuse the Fund of being at the same time too lenient and too insistent in its relations to Moscow. That line of defense, however, would only serve to befuddle the basic issue, which is that the IMF should never have been involved in the first place, because what did follow was bound to follow.

Layard and Parker, for example, are correct in pointing out that charging the IMF with helping Russia was a strategic mistake, for the reason that conflicts of interest and rule violations were bound to arise. I agree with Marshall Goldman, who pointed out that the IMF may also turn out to be a victim: "To use the International Monetary Fund for this purpose undercuts the IMF's credibility and its work elsewhere in the world."[45]

One of the most important questions that remained to be asked, having gone through the evidence of misbehavior in 1991–98, concerned the likely consequences. Would Russia be able to somehow resurrect its relations to Western creditors, or would it be castigated as a financial pariah? In the latter case, would that also imply a transformation of Russia into a political pariah, a country whose leaders are seen to be ready and willing to do pretty much anything for money?

In the immediate aftermath of the August 1998 crash the answers to both of these questions were discouraging, conditioned by the general sense of doom and gloom. As time wore on, however, cautious optimism began to return. Because the worst case scenarios had failed to materialize, many began to entertain hope that the mess might be sorted out after all.

Almost a year to the day after the financial crash, however, all such hopes were dashed, as a new set of scandals erupted that placed the credibility of both the Russian side and, perhaps even worse, the IMF in serious doubt.

Given all that has been said above about the generation of faulty expectations for a Russian economic boom, it might be worthwhile to take a closer look at the experience gained during the first year after the August crash. Here patterns emerge that provide little hope for a happy end to the saga of Western support for Russia's neoliberal reforms.

Final Scandals?

When the Russian government's unilaterally imposed debt moratorium expired, on 17 November, three months had been wasted in fruitless negotiations. There was still no acceptable deal on what to do with the GKOs, nor were there any signs that the Russian side had any genuine desire to reach such an agreement. On the contrary, the time that had been intended to rebuild some trust in relations to foreign creditors had been spent instead on undertaking a long list of mischief. Some of those moves were so blatant that they deserve closer scrutiny.

Deliberate Abuse

The allegations of political interference from the side of the oligarchs may have served to trigger the crash. Be that as it may. Even those who might be willing to grant the benefit of the doubt on that count will have to acknowledge a number of subsequent cases of deliberate abuse, which can only serve to further exacerbate the problem of distrust, or even disgust, on the part of Western bankers and investors.

With no government in place, and with the IMF in a state of shock, the Russian Central Bank and the leading Russian commercial bankers had plenty of time to cover Russian losses at the expense of foreign investors. It began when the Central Bank allowed favored commercial banks to use their "frozen" GKOs as collateral for loans, which were promptly used to buy dollars. Over four days, from 17 August to 21 August, the Central Bank disbursed a total of 56 billion rubles.[46] Needless to say, foreign investors were excluded from these deals.

On 18 September, the bank repeated the maneuver, allowing favored banks first to borrow 27 billion rubles, with which they could settle their debts, and then to repay those loans with basically worthless GKOs.[47] Again foreign GKO holders were kept out.

Meanwhile, there was no shortage of insulting and threatening statements from senior Russian officials, indicating a clear Russian intention to continue playing the chicken game. On 25 September, Central Bank chairman Viktor Gerashchenko, once dubbed by Jeffrey Sachs as the "worst governor of a Central Bank of a major country in history,"[48] lashed out against "greedy" and "stubborn" Western banks, threatening that they would be punished by receiving nothing![49]

And Deputy Prime Minister Alexander Shokhin, one of the early "reformers," suggested that Russia's debts to the Paris Club of creditor governments should be netted out against the $100 billion Russia was owed by former Soviet client states such as Nicaragua, Angola, North Korea, and Iraq. Claiming that it had been a mistake for Russia to join the Paris Club in 1997, he went on to propose an outrageous new deal:

> I think now that we should try, within the Paris Club, to negotiate mutual offsets of the Russian obligations to the Paris Club and the obligations to Russia of the coun-

tries with which the Paris Club has conducted negotiations on rescheduling debts. I do not rule out that we may come up with a zero option.[50]

There were also allegations of serious fraud at the Central Bank. Shortly after the August crash, the Federal Audit Chamber, the Russian parliament's budgetary watchdog, claimed that part of the $4.8 billion paid out by the IMF in July as the first installment of the $22.6 billion rescue package quite simply had been stolen.

Although such allegations were denied, Prosecutor General Yuri Skuratov decided to initiate criminal proceedings. During the following months, Skuratov's investigations broadened to include a number of previous privatization deals as well as other high-level cases of alleged corruption. In early February 1999, Skuratov suddenly announced his resignation and had himself admitted to a hospital for heart trouble. Few doubted that the real disease was of a political nature, but even fewer could have anticipated what Skuratov would leave behind. In a letter to the speaker of the Duma, dated 1 February, he laid out accusations of a series of abuses at the Central Bank, which even by Moscow standards were sensational.

"In every case of crisis the standard rhetoric of the IMF and of the Clinton administration had been that the main objective must be to 'get Russia back on track.'"

Leaving some minor issues aside, the main accusation was that during the period 1993–98 the Russian Central Bank had operated a secret fund in the offshore tax haven of Jersey. The fund, called FIMACO, had been entrusted with handling a total of about $50 billion dollars (a detailed list of various amounts in different hard currencies was presented). The initial reaction was that the story simply had to be false, if nothing else because of the size of the amounts involved. Russia's Central Bank had never had more than $24 billion in reserves (July 1997), and the IMF had strictly monitored the movement of its funds. How, then, could the FIMACO scam be even technically possible?

A few days later, those who had hoped that the story would just go away were grossly disappointed, as Central Bank chairman Viktor Gerashchenko was called before the Duma to explain. He not only admitted that FIMACO existed; it had been set up in 1990 by a bank subsidiary in Paris, the Eurobank, and had a registered capital of no more than $1,000. The real stunner lay in his motives: The main reason for starting the scheme had been to maximize the return to Central Bank reserves by avoiding payment of Russian taxes! When asked to comment, Central Bank governors in other countries vaguely admitted that this was an "unusual practice."

Another motive was even more perplexing. Arguing that the amounts mentioned by Skuratov were way too high, Gerashchenko did admit one transfer, of $1.4 billion, that had taken place in 1994, at a time when difficult negotiations on debt restructuring were being conducted with the Paris and London Clubs. He defended the action as necessary to protect the country's "economic security." If the funds had not been hidden, the creditors might have seized them.

Explanation number three was that funds had been transferred to Jersey simply to find a good investment for moneys received from the IMF. The astounding logic of this statement is that first Russia borrowed money from the IMF to stabilize the economy. That money was then sent to earn more money (for someone) in Jersey, while Russian taxpayers paid interest to the IMF.

It is hardly surprising that the initial reaction to Gerashchenko's comments was stunned silence. Few of the media and virtually none of the world's political leaders, including the Russians, offered comments. This was all the more remarkable because there were quite a few pertinent questions to ask: How much money has been involved? Who got the commissions? Where is the money now? And how could the funds be transferred without anyone noticing?

The latter, in particular, placed the IMF in an awkward position. Could the Fund credibly argue that the FIMACO scam had taken place without its notice? If so, its oversight really leaves something to be desired. But the alternative, of course, is even worse. When asked to comment, the IMF in Washington claimed ignorance, and Martin Gilman, the head of the IMF mission in Moscow, simply refused to return calls.[51]

But perhaps there is a very simple answer. Admitting that the story was indeed true would have meant serious embarrassment both for the IMF and for the Russian side, perhaps even a form of mutually assured destruction. Better then to resort to what the *Moscow Times* chose to call "mutually convenient silence."[52]

For a change, however, the affair simply would not go away, and the realization was growing that some form of house cleaning would be in order. Thus, the Russian Central Bank commissioned a report by PricewaterhouseCoopers, which was to investigate allegations of abuse not only in relation to FIMACO but also concerning the IMF tranche from July 1998. The results of that effort did not come out the way it had been hoped they would. But before proceeding to the real scandals, let us look at the hard evidence of Russian debt management in the wake of the August crash.

Aftershocks

The August default and devaluation had two immediate effects. One was that the IMF decided to freeze the second $4.3 billion installment of the $22.6 billion rescue package, which was due to have been released in late September; and the second was that Moody's downgraded Russia's sovereign debt to CCC-, which was below Congo and Nigeria. The intended message of the latter action was loud and clear. Unless it cleaned up its act, Moscow could look forward to a protracted period as a financial outcast.

That warning, however, seems not to have been taken seriously. In the months that followed the August crash there were a number of further Russian defaults on its foreign obligations. It began on 20 August, when Germany received only DM 50 million out of DM 800 million due, and in September there was a default on a payment of $685 million to the Paris Club.

Following a visit to Moscow in November, the IMF could find no reason to release the $4.3 billion that had been frozen in September. There simply were no even remotely credible grounds on which to say that the Russian government was about to sort out its financial mess.

On 2 December, Russia defaulted on a $362 million payment to the London Club of creditors. This immediately prompted Europe's leading credit rating agency, Fitch IBCA, to downgrade Russia's Soviet-era debt to DD, which is "default," though it maintained its previous ratings of CC for the interest arrears part of the Soviet debt and CCC for Russia's $16 billion stock of sovereign Eurobonds.

To the creditors in the London Club this represented a vital decision point. One suggestion was to "accelerate" the debt, which meant calling for a full and immediate repayment of the $20 billion principal. Although that motion failed to secure the votes necessary for passage, Russian hopes for a decision on restructuring the debt into fifteen-year paper were also disappointed. The practical decision thus taken by default was to postpone any decision, accepting that Russia had ceased paying both interest and principal (but not knowing what to do about it).

By mid-January 1999, Russia had defaulted on a total of $1.5 billion in payments on its Soviet-era debt, but it had meticulously honored all payments on debts incurred after 1 January 1992. On 24 January, the Russian government transferred $320 million to cover the coupons on two Eurobonds, declaring its intention to pay the full $493 million due on Eurobonds in the first quarter of 1999. That was done during a visit to Moscow by U.S. Secretary of State Madeleine Albright, accompanied by an IMF delegation. There was an excellent reason for this joint visit. During the preceding few years, in every case of crisis the standard rhetoric of the IMF and of the Clinton administration had been that the main objective must be to "get Russia back on track." At the beginning of 1999, however, it was becoming increasingly difficult to see any tracks that were leading ahead. There was thus a dire need to find a new formula, and a new slogan, on which further lending could be defended.

There was something of a Catch-22 here. On one hand, there would simply *have* to be new lending, but on the other, there was no apparent willingness on the Russian side to put up even the semblance of an economic program that the IMF could endorse, credibly or not. The search for a way out was actively complicated by the Russian government's economics chief, former Gosplan head Yuri Maslyukov, who took the opportunity to lash out at the current activities of some of those "young reform economists" who were yesterday's Western heroes: "Some members of the previous government travel through Western countries, advising them against giving money to this cabinet. They act like swine."[53]

The strange logic of the situation was captured by Robert Devane, writing for the *Moscow Times*:

> Why is the International Monetary Fund in Moscow? Because it is as desperate to lend to Russia as the latter is desperate to borrow. It realizes that if it doesn't come up with a way for Russia to refinance its 1999 IMF debt service, default becomes

> inevitable. This will bury any hopes of progress in Russia's negotiations with its commercial and bilateral creditors. For the IMF this amounts to "mutually assured destruction." Russia would be effectively shoved back behind the Iron Curtain, and the IMF's own credibility would suffer irreparable damage.[54]

Devane was probably right in guessing that a total sovereign Russian default would have driven the last nails into the coffins of a number of high-level careers, both at the IMF and in the U.S. administration, and that for that very reason, if nothing else, "the United States and the IMF may really not have much of a choice but to grind their teeth and cut a check." A few figures will illustrate the magnitude of the predicament:

When Russia entered 1999, those in charge of handling foreign creditors were looking at a total sovereign debt service for that year that amounted to $17.5 billion. In the budget for 1999, however, only $9.5 billion had been earmarked for such purposes. Recognizing, moreover, that $8.1 billion was destined for the "Russian" and a miserly $1.4 billion for the "Soviet" parts of the debt, we can conclude that, de facto, Russia had decided to forget about its old Soviet debt.[55]

Against that background, many began to be concerned about debts incurred since 1992. Fears were substantiated when on 9 January the Russian government announced that it actually planned to spend no more than $4.6 billion on foreign debt payments in 1999.[56] This implied that further major defaults might be expected, not only on the Soviet but also on the Russian debt.

The IMF Returns

Accepting that the old Soviet debt was basically out of the game, speculations now concerned Russian priorities between honoring its Eurobonds and its debt to the IMF. The likely outcome seemed to be that the IMF would find some fig leaf making it possible to release the September 1998 tranche of $4.3 billion, which by coincidence was roughly equal to the $4.5 billion that Russia was due to repay the IMF in 1999.

The rationale of such an arrangement was that Russia would be allowed to borrow further funds to repay old debt, something that is normally frowned on in the world of serious banking. Washington was to organize procedures so that further Russian "credits" would never really leave the Fund, but merely would be transferred between accounts. This could be seen against the background of a total of $7 billion in anticipated new credits that had already been included in the Russian budget for 1999!

By the end of April, the IMF announced that it was ready to sign yet another deal with Moscow. A total of $4.5 billion was to be made available over the coming eighteen months, to which was to be added another $2.5 billion from the World Bank and the Japanese government. The deal was significant in several respects. On the Russian side, it reflected the new spirit of cooperation between the government and the Duma that had been fostered by Yevgeny Primakov, and to the international financial markets it sent a signal that a total sovereign default, if not avoided, at least had been postponed for another year.

There was only one catch, and that was Boris Yeltsin. Barely had the IMF announced its intentions when he decided, for the third time in fourteen months, to dismiss his entire government and thus to throw the country into a constitutional crisis, with the associated political paralysis. His reasons for doing so may be left aside here. The main point is that the game with the IMF yet again would have to resume from square one, with a new government, a new set of grudges in the Duma, and an even lower degree of credibility of Russia's chances of eventually clearing up its financial mess.

In the short run, the markets were relieved to learn that Yeltsin sailed through the perils of impeachment and that his candidate for prime minister, Sergei Stepashin, was accepted in a first round of voting. That relief, however, soon turned into renewed worries. On 2 June, Russia failed to meet a payment of $855 million to the London Club, provoking further debate among its members concerning what to do.

With creditor irritation growing steadily, the risk of provoking a total sovereign default was moving dangerously close. Thus the pressures on the IMF to intervene were also rising, and in late July the Fund once again came through for its favorite debtor. Following a round of negotiations with the Stepashin government, including a visit to Washington by Stepashin himself, agreement was reached on a further loan package of $4.5 billion to be disbursed over the coming eighteen months. A first tranche of $630 million was released at once, with a second installment of $640 million due in September.

Given that the IMF decision also paved the way for both the World Bank and the Japanese government to release their previous commitments, which had been frozen after August 1998, the markets reacted with great relief. Yet again, hopes for a happy ending were rising. Then came what at the time looked to be the final crisis in Russia's relations to its Western creditors.

On 19 August 1999, the *New York Times* published a story about suspected Russian money laundering on a massive scale via the Bank of New York, and on a parallel track *Corriere della Sera* was pursuing a scandal involving major bribes to the Yeltsin family from a Swiss construction company known as Mabetex. Adding to the damage were the allegations mentioned above that IMF funds had been involved in the money laundering.

The political impact of these revelations was massive, both in Russia and in the affected Western countries. Many high-level voices called for suspension of further IMF lending. The audit report by PricewaterhouseCoopers suddenly took on unexpected importance. Following pressures from the IMF, the Russian Central Bank agreed with the auditors that it might be posted (for a limited time) on the IMF Web site.

As a storm of criticism was building, the IMF took an interesting defensive position. On one hand, it argued that the allegations were taken seriously indeed and that the Fund would do its utmost to find clarity. On the other, however, it repeatedly stated that the PricewaterhouseCoopers report contained nothing to support allegations of abuse of IMF money.

What the latter defense studiously ignored mentioning was the fact that the auditors had posted a big disclaimer regarding the contents of the report, which it warned against referring to as a proper audit: "PricewaterhouseCoopers accept no liability or responsibility to any party who may access the reports on the Internet, to whom the reports may be shown or made available or into whose hands they may come." The reasons are clear and to the point. As there had been no verification and no open access, the report reflected no more than a version of events that was presented by the party that stood accused of wrongdoing:

> The reports are based solely on financial and other information provided by, and discussions with, the persons set out in the reports. The accuracy and completeness of the information on which the reports are based is the sole responsibility of those persons. PricewaterhouseCoopers have not attempted to verify the completeness or accuracy of that information. PricewaterhouseCoopers have not carried out any verification work which may be construed to represent audit procedures.[57]

It is hardly surprising that some of the world's leading media had nothing but harsh words to spare for the IMF. *Le Monde* editorialized that "in the style of vulgar swindlers, through companies installed in distant tax havens, one of the planet's big powers . . . misappropriates the international community's money, to facilitate the enrichment of a few oligarchs."[58] The anger was prompted not only by the facts that were revealed in the report, but even more by the IMF's almost simultaneous decision to go ahead with further lending.

A couple of weeks later, the *Wall Street Journal* commented on the ensuing argument between the IMF and *Le Monde*: "The irony here is that the IMF isn't mad at Russia. It has forgiven Russia. The IMF is mad at the thinking world for not giving the IMF the same indulgence." And the paper concluded by pointing up the possible repercussions: "The IMF and the Kremlin kissed and made up but the rest of us are left wondering what the IMF's inclination to forgiveness has brought its shareholders—or Russia. As *Le Monde* put it, 'lending to Russia has become for the IMF a second nature, thus a dangerous habit. It could one day provoke the anger of the Western taxpayers.'"[58]

By summer 2000, however, Russia yet again had been forgiven. High oil revenues had allowed proper servicing of both Eurobonds and debts to the IMF. A deal had been reached with the London Club that entailed both rescheduling and a 33 percent write-off. The Paris Club still refused to write off debt, but it had agreed at least to restructure. The Russian government had revived to GKO market and was set to return to the Eurobond market. And an IMF mission to Moscow had proclaimed "pleasant surprise" at the rebound of the Russian economy.

Does all of this mean that the problems are over, and that Russia can look forward to being integrated into the world economy on what others consider to be normal terms? Or will there be more trouble around the next corner? What is the real bottom line of what has been said above?

The Bottom Line

At the beginning of 1999, Western bankers were quoted by *The Economist* as saying that they would rather eat nuclear waste than lend more money to Russia in its current state.[60] Russian bonds were trading near default levels, and the commercial sector had already written off most of its losses. The IMF found itself in a position where there seemed to be no way out. The Fund could manipulate the *timing* of when the West would have to face up to the facts of a total Russian sovereign default, but that appeared to be all.

The Russian leadership was looking at a transformation to outcast status that promised to be traumatic indeed. Having aspired for years to become a member of the G7 club of the world's wealthiest nations, Russia now risked being relegated to what *The Economist* called the "P7" club of financial pariahs, where it would have joined the ranks of countries such as Sudan, Liberia, Congo, and Somalia, "poor, war-ridden places, some barely existing as states," which had borrowed money from the IMF and failed to repay their debts.[61]

There was some substance to the pessimism that marked those months. The financial crash had presented a verdict of sorts over Yeltsin's much vaunted reforms. In the space of a few short but hectic years, a handful of Russian robber barons had been allowed to steal and export Russia's wealth, including a mountain of borrowed funds, leaving it for Russian—and Western—taxpayers to feed and house the hungry and sick back home.

Perhaps the real tragedy of the August crash was that in one fell swoop it wiped out the nascent Russian middle class, which was to have provided the basis for Russian democracy and a guarantee that there would be no going back. These mainly young urban professionals had good jobs, new cars, and refurbished apartments. They believed that Russian rubles had finally become real money and they trusted Russian banks with their savings. They looked to the future with confidence. And they were dead wrong.

Against the background of such insights, it has been rather astounding to watch the return to favor of Russia under Vladimir Putin. The financial markets are living up to their reputation of having short memories, and the Russian leadership is preparing to go on another spree of international borrowing. Meanwhile it is well understood by all those concerned that when Russian debt service peaks, in 2002, only another round of massive debt relief and debt rescheduling can prevent a further round of costly defaults. The IMF, however, has only a "pleasant surprise" to offer.

I conclude with a timely comment from former Russian finance minister Boris Fyodorov, from early October 1998: "The IMF should learn a lesson from the past five years. The IMF was pretending that it was seeing a lot of reforms in Russia. Russia was pretending to conduct reforms."[62] Two years later that comment was still a regrettably valid one.

Until lessons of this kind have been properly learned, there can be little hope for the emergence of a more balanced and constructive relation between Russia and the West. Instead, the dangers of further crises will continue to loom large. After all, from the Russian point of view, default and rescheduling appear to be a winning game.

NOTES

1. *Moscow Times*, 25 November 1998.
2. *Economist*, 3 October 1998, 24.

3. *Finansovye Izvestiya,* 11 and 18 September 1997.
4. *Finansovye Izvestiya,* 25 November 1997.
5. *Finansovye Izvestiya,* 9 December 1997.
6. Quotes from *Moscow Times,* 28 May 1998.
7. *Financial Times,* 13 August 1998.
8. The political process that lead up to the meltdown was laid out, with relevant Kremlinological details, in *Newsweek,* 18 January 1999.
9. For example, by February 1999 Oneksimbank, once among Russia's largest and most respected banks, had defaulted on a staggering $2 billion in foreign loans, its total foreign loan portfolio (*Moscow Times,* 10 February 1999). Burnt creditors may well ask themselves on what grounds those credits had been granted in the first place.
10. See, for example, *Moscow Times,* 25 and 27 August 1998.
11. *Financial Times,* 26 August 1998.
12. Janine Wedel, *Collision and Collusion: The Strange Case of Western Aid to Eastern Europe 1989-1998* (New York: St. Martin's, 1998).
13. *New York Times,* 23 November 1998.
14. Jeffrey Sachs, "Betrayal," *New Republic,* 31 January 1994, 15.
15. Richard Layard and John Parker, *The Coming Russian Boom: A Guide to New Markets and Politics* (New York: The Free Press, 1996), 84.
16. In one interview he mentioned $30–50 billion a year over five years. Marshall Goldman, *Lost Opportunity: What Has Made Economic Reform in Russia So Difficult?* (New York: Norton, 1996), 83.
17. Vladimir Tikhomirov, "Capital Flight from Post-Soviet Russia," *Europe-Asia Studies* 49, no. 4 (1997).
18. Layard and Parker, *The Coming Russian Boom,* 87.
19. Bruce Clark, *An Empire's New Clothes: The End of Russia's Liberal Dream* (London: Vintage, 1995), 208–09.
20. Ibid., 209.
21. Ibid.
22. Ernesto Hernández-Catá, "Russia and the IMF: The Political Economy of Macro-Stabilization," *Problems of Post-Communism* 42, no. 3 (1995): 24.
23. Daniel Gros and Alfred Steinherr, *Winds of Change: Economic Transition in Central and Eastern Europe* (London: Longman, 1995), 433.
24. See also *Financial Times,* 11 January 1994.
25. *Financial Times,* 2 February 1994.
26. His warning about the "dangers of Western gullibility" was published in *Financial Times* on 28 March and in the *New York Times* on 1 April 1994.
27. Hernández-Catá, "Russia and the IMF," 25–26.
28. See further J. Michael Waller, "Author's Rebuttal to the Department of State," *Demokratizatsiya* 5, no. 1 (1997): 119–20.
29. OECD, *Russian Federation 1997* (Paris: OECD, 1997), 69.
30. A. Vavilov and G. Trofimov, "Stabilizatsiya i upravlenie gosudarstvennym dolgom Rossii," *Voprosy Ekonomiki* 12 (1997): 76.
31. Michael Waller reports being told by Fyodorov in an interview that Chernomyrdin was one of the people he had in mind. (Waller, "Author's Rebuttal to the Department of State," 120.)
32. Peter Rutland, "Yeltsin: The Problem, Not the Solution," *National Interest* (fall 1997): 34.
33. Ibid.
34. Hernández-Catá, "Russia and the IMF," 24.
35. Goldman, *Lost Opportunity,* 223–24.
36. Georgy Belyakov, et al., "Poterya tempa pri potere kachestva," *Kommersant,* 23 May 1995, 53.

37. Dmitri Tulin, "The IMF and the World Bank Prevents What?" *Transition* 6, no. 9–10 (1995): 12.
38. David Fairlamb, "When Love's Too Blind," *Institutional Investor* (September 1966): 21.
39. *The Economist*, 6 February 1999, 21.
40. *Nezavisimaya Gazeta*, 18 December 1997.
41. *Sovetskaya Rossiya*, 20 December 1997.
42. Peter Reddaway, "Questions About Russia's 'Dream Team,'" *Post-Soviet Prospects* 5, no. 5 (1997): 1.
43. Lynn D. Nelson and Irina Y. Kuzes, *Radical Reform in Yeltsin's Russia: Political, Economic and Social Dimensions* (Armonk, NY: M. E. Sharpe, 1995), 25.
44. Quotes from ibid., 148.
45. Goldman, *Lost Opportunity*, 224.
46. *Moscow Times*, 29 September 1998.
47. *Moscow Times*, 19 September 1998.
48. *Economist*, 6 August 1994, 71.
49. *Moscow Times*, 25 September 1998.
50. Ibid.
51. *Moscow Times*, 11 February 1999.
52. *Moscow Times*, 9 February 1999.
53. *Moscow Times*, 26 January 1999.
54. Robert Devane, "IMF-Russia Symbiosis," *Moscow Times*, 30 January 1999.
55. The agreement that placed Russia as primary heir to the Soviet Union entailed not only assuming responsibility for all Soviet foreign debts. It also took over all Soviet assets, such as the gold reserve and currency holdings abroad. If Russia is allowed to get away with defaulting on the debts while retaining the assets, there may well be serious and legitimate resentment from the other former Soviet republics at having been short-changed.
56. AP, 12 January 1999.
57. Cited from the IMF Web site.
58. *Le Monde*, 6 August 1999.
59. *Wall Street Europe*, 20–21 August 1999.
60. *Economist*, 6 February 1999, 21.
61. Ibid.
62. *Moscow Times*, 6 October 1998.