

Executive Memorandum

The Heritage Foundation

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RUSH!

NO IMF LOANS TO RUSSIA

The Board of Directors of the International Monetary Fund (IMF) is considering granting Russia a \$9 billion loan, and the U.S.-run Export-Import Bank may provide an additional \$1 billion to boost Russia's flagging civilian aircraft industry. President Bill Clinton strongly supports the IMF loan, hoping that it will bolster Boris Yeltsin's faltering presidency. But giving Russia a handout will not advance U.S. interests or help the Russian economy. The loans do not guarantee more responsible budgetary policies in Moscow. Nor do they lead to much-needed structural reforms, including agriculture and land privatization. Moreover, the loans do not secure Russia's peaceful conduct toward her neighbors, greater foreign policy cooperation with the U.S., or other American interests.

Economic reforms in Russia are faltering. First Deputy Prime Minister Anatoly Chubais, the last remaining reformer in Yeltsin's cabinet, was forced to resign on January 16, 1996. He was sacrificed to appease Yeltsin's nationalist and communist critics. Now Yeltsin has left himself without any senior political figure capable of formulating and coordinating free-market reforms. Chubais's replacement, Vladimir Kadannikov, was the protectionist director of Russia's inefficient auto-making giant VAZ, whose low-quality products have long been the laughingstock of Europe. Kadannikov is hardly the economic policy leader to steer Russia to a stable free market.

A succession of young, reform-minded economists did much to shift the Russian economy to a free-market course over the past four years. Despite their efforts, Russia's economic house is still not in order. The inflation rate in 1995 was between 120 and 130 percent. Budget deficits are very high, and privatization has failed to raise the revenues to reduce them. Moreover, election campaign pressures have forced Yeltsin to break budgetary constraints and promise billions of dollars in credits and payments to industry groups with the strongest lobbying clout. For example, about \$4 billion was earmarked for the defense industry for a state-directed conversion program, and \$2.2 billion in wage arrears has been promised to workers in the state sector. The notoriously inefficient Russian miners, who went on strike in December 1995, were promised another \$2 billion. \$3.3 billion has been pledged to the agricultural sector. Half a billion dollars went to pensioners, and over \$1 billion will be paid to officers and soldiers in the armed forces.

Instead of implementing a package of comprehensive economic reforms, attempting to balance the budget, and lowering taxes, the Russian government is following economic policies which only exacerbate the problems. These policies include:

- ☛ **Industrial subsidies.** Moscow is giving billions of dollars to inefficient state-owned enterprises. These include the military industry as well as agricultural machinery and aviation manufacturers.
- ☛ **Stalled land privatization and subsidies to the state-owned agricultural sector.** The pro-communist agrarian lobby succeeded in derailing the emergence of private farming. Despite its immense agricultural potential, Russia still needs food imports and still suffers from low agricultural productivity.
- ☛ **Lack of military reform.** Russia's armed forces are oversized at 1.5 million servicemen. They also are poorly organized and inefficient, as demonstrated by their embarrassing performance in Chechnya. The

armed forces need to be cut. Instead, the Ministry of Defense has demanded a 55 percent budget increase for FY 1996, and was granted a 16 percent real term increase by the state Duma.

- ☛ **Maintaining the bloated bureaucracy and state sector.** Russia today has more bureaucrats than the whole of the Soviet Union, which was almost twice as large. Moreover, many sectors of the Russian economy, such as health care, still are owned and operated by the state, which puts an additional drain on the federal budget.
- ☛ **Anti-investment policies.** More than \$12 billion a year leaves Russia and is deposited in foreign bank accounts. Such capital flight denies the Russian economy investment and taxable income. According to the Russian Central Bank's Hard Currency Monitoring Department, over \$4 billion a year is transferred illegally out of the country through fictitious import invoices alone. Why is this happening? Because the government's economic policies are making Russia an inhospitable place to invest, especially compared to East Asia, Central Europe, Latin America, and other emerging markets. Instead of offering a handout to the Russian government, the IMF and the World Bank ought to provide policy advice to decrease the rates of taxation, boost the rule of law, and encourage investment in order to make the Russian economy more attractive for domestic and foreign entrepreneurs.
- ☛ **Forgiving foreign debts.** While asking the IMF for loans, Moscow is forgiving an \$8 billion debt owed by Libyan dictator Muammar Qaddafi, a \$3 billion debt created by the Sandinista government of Nicaragua, and \$250 million owed by Ethiopia. All these debts were generated when the Soviet Union was exporting the revolution and supplying Marxist regimes with weapons.

Russia's problems are not only economic. They are political as well. Russia may be on the brink of a takeover by unreformed communists led by Gennady Zyuganov, former ideology department chief of the Central Committee of the U.S.S.R. Communist Party. The irony is that this may be accomplished through the ballot box in the June presidential elections. Zyuganov, who is running first in the opinion polls, has promised to restore the U.S.S.R. "by voluntary means." He is followed in the polls by ultranationalist Vladimir Zhirinovskiy, who has declared that he will restore the Russian Empire and possibly expand it even further into the Middle East.

If a hard-liner like Zyuganov or Zhirinovskiy were to win the presidential elections in June, IMF credits would be going to a retrograde regime with little or no interest in reform. Under these circumstances, IMF credits would be throwing good money after bad. Moreover, there is a chance that these loans would never be repaid, since under a communist government Russia could sever relations with the IMF and the World Bank.

Leading Yeltsin administration officials, such as Interior Minister General Anatoly Kulikov, and Communist deputies in the Duma are discussing how to reverse privatization and stop the economic reforms in their tracks. Communists and their allies control the majority of the Duma's committees and the powerful Duma Executive Council. Without a clearer picture of the future direction of Russian politics and economic policies, the IMF loans are ill-advised. It makes no sense to approve the IMF loan until the rest of the world knows what kind of regime will be using the money.

Nor does it make sense to loan Russia money while it is prosecuting the war against Chechnya. According to estimates by Russian economists, this war costs over \$4.5 billion a year. The IMF should not subsidize such a war, or any other military ventures into which a future Russian hard-line president might drag the country.

The Clinton Administration should not be lobbying the IMF on behalf of Russia. These loans will not boost the cause of reform. At best the money will be wasted; at worst, it could be abused by some future anti-Western leadership. Either way, money will be thrown at problems which cannot be solved easily and which will not go away with the stroke of an IMF pen.

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