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Russia Needs Immediate Reform, Not More IMF Loans

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The International Monetary Fund (IMF) and the Clinton Administration are considering as much as $10 billion in new loans to support Russia's weakening ruble and jittery financial markets. If the goal is to encourage economic stability, however, no action could be further off target. Since joining the IMF in 1992, Russia has become one of its largest borrowers, receiving over $18 billion in loans and other assistance. Russia continues to be economically weak because it finds it hard to implement the fundamental economic reforms that are the only cures for its economic problems. Past assistance has done nothing to prevent the current crisis, and additional IMF loans will only prolong the systemic problems afflicting Russia's economy. The Administration should encourage the IMF and the G-7 governments to demand that Moscow institute these reforms instead of providing Russia with any additional loans.

WHAT'S WRONG IN RUSSIA

The Russian economy almost collapsed on May 27, when foreign and domestic investors panicked and went on a selling spree, unloading government bonds, corporate stocks, and rubles. In a desperate attempt to offset a mass exodus from the market, Russia's Central Bank hiked the interest rates on government bonds to an astronomical 150 percent a year. To support the ruble, the Central Bank also sold $1 billion in hard currency in one day, causing its hard currency reserves to dwindle to $14 billion. These measures halted the collapse, but they cannot continue indefinitely.

The near collapse of the Russian economy has several causes. The Duma (the lower house of the Russian parliament) passed legislation limiting foreign ownership of stock in the national electric monopoly, the Unified Energy Systems, to no more than 25 percent (although up to 30 percent was in foreign hands already). Foreign investors also balked when Rosneft, a huge government-owned oil company with oil reserves worth tens of billions of dollars, failed to attract buyers at an asking price of $2.1 billion. Oil prices have remained soft, severely decreasing company earnings and government receipts (oil and gas are responsible for up to 75 percent of Russia's foreign currency earnings).

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Deep pessimism continues. Stanley Fischer, IMF First Deputy Managing Director and a renowned economist, wrote in a January 1998 speech available on the IMF Web site that "a major constraint to Russia attaining satisfactory rates of growth is that the process of structural reform has not gone far enough." The main problem is fiscal and budgetary: Moscow is running large budget deficits (7.5 percent of GDP); has a complex, punitive, and arbitrary tax system; and is failing to collect taxes efficiently. Further, the tax system is corrupt and mismanaged, and the tax base is extremely narrow.

Russia has yet to experience meaningful economic growth in the post-communist era. IMF and financial experts agree that a competitive business culture must be established before economic efficiency and capital accumulation can be increased. Drastic reform of the legal and institutional framework and a restructuring of heavy industry and collectivist agriculture sectors also are necessary. Specifically, this means taking the following steps:

- **Faster, more transparent privatization** that is open to all foreign and domestic investors.
- **Restructuring, breaking up, and introducing competition to monopolies—including those in the gas, electric power, district heating, and rail sectors**—to make them efficient and competitive.
- **Urban land and real estate reform, housing market liberalization, and agricultural privatization.** The Duma is blocking a market-oriented land code. The state-owned agriculture sector, which could have been one of the world's most thriving, is a budget drain. To help remedy this, fully functioning land and mortgage markets must be created.
- **Reducing military expenditures.** Ten years since the end of the Cold War, Russia still is trying to maintain the military capability and posture of a superpower. In its current economic condition, this course could prove suicidal. Russia's military force, estimated at 1.5 million persons, is far larger than a country with a GDP equivalent to Spain's or Mexico's can afford.
- **Abandoning nuclear modernization.** Russia is implementing an expensive nuclear modernization program, including research and construction of the next generation of intercontinental ballistic missiles (TOPOL-Ms, or SS-27s), nuclear submarines, and the nuclear-powered missile cruiser *Peter the Great* (formerly the *Yurii Andropov*).

These initial reforms must be implemented quickly. Other measures include capital market development, improvements in the banking system, opening the economy to foreign investment, and earnest efforts to control crime and corruption. Prime Minister Sergei Kirienko's government is fully cognizant of these priorities. Indeed, many of these reforms have been stipulated in Russia's four previous IMF loans and assistance packages. Few, however, have been implemented. Instead of demanding that Moscow fulfill its part of the bargain, the IMF has continued to distribute funds to Russia. Moscow's deep institutional resistance to reform must be overcome if Russia is to have long-term economic growth. The record shows that IMF funding is not the proper instrument for achieving this goal.

CONCLUSION

Russia's recent problems are not the result of insufficient assistance from the IMF or other international financial institutions. Quite the opposite: Continuing assistance from these sources has allowed Russia to avoid making the economic and policy changes that would lead to economic recovery and long-term growth. Only the bitter medicine of economic reform—not IMF anesthesia—can ensure Russia's economic revival. As House Majority Leader Richard Armey (R–TX) noted in a June 2 "Dear Colleague" letter, by not approving the IMF supplemental package, the U.S. Congress can help end the dependency-promoting bailout psychology and encourage Moscow to accelerate important reforms. When those reforms have been implemented, a massive flow of foreign investment to the "final frontier" of business in Eurasia will ensue, eliminating the need for additional IMF loans.

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