Russia and the IMF

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> In these situations [the authorities] must [have the right to lie]. They *absolutely* must. So now in the international financial institutions, despite everything we have done with them—we conned [*kinuli*] them out of US$20 billion—there is an understanding that we had no other way out.
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> Anatoly Chubais, chief Russian negotiator with international financial institutions, *Kommersant*, 8 September 1998

In August 1998 Russia's economic policy collapsed, and with it many Western hopes for stability and economic reform in Russia. An eight-year Western strategy of assistance and advice seemed to have come to naught. In the words of a prominent free-market Russian economist: 'The largest financial assistance package in the IMF [the International Monetary Fund] history has failed in less than a month, international and domestic investors have borne multibillion losses, while Russia has fallen into one of the sharpest and deepest financial, economic and political crises in history.'[1] The collapse of Russia's exchange rate and its default on debt and bond obligations have dragged the country into even deeper economic crisis, raising profound questions about the role of external assistance.

The West became deeply involved in Russia's domestic economic and political transition at the end of the Cold War, when the West's worst fear was that domestic weakness would breed political extremism and disorder in the nuclear superpower. A successful transition to a market democracy was seen as the best guarantor of a benign and stable partner. And so a strategy of economic advice and assistance emerged, its many strands including bilateral, multilateral and private institutions' assistance in the areas of trade, debt management, investment, credit and aid. However, the IMF soon emerged in a leading role.

The IMF became the spearhead of Western support for several reasons. First, such a position was in the interests of the United States, which had enormous influence in the institution—well beyond its 18.5 per cent portion of votes and

[1] Andrei Illarionov, Testimony before the General Oversight Subcommittee to Examine the Russian Economic Crisis and the International Monetary Fund (IMF), 10 September 1998.

contribution to the IMF budget. The United States was particularly keen to take a prominent role in the formulation and management of Western support for Russia because the Group of Seven (G7) had chosen the European Union to coordinate aid to eastern Europe. Yet bilateral assistance from the United States would be costly and require the agreement of Congress, which would be politically difficult to secure. The IMF, by contrast, provided both a less controversial and a less expensive route. The institution's assistance is highly leveraged since successful negotiations with the IMF are almost always a prerequisite for agreements with the World Bank, the London Club and the Paris Club. It was also believed that, as an international organization, the Fund would be less likely than any direct US assistance to evoke concerns in Russia about infringement of sovereignty.[2] Finally, the IMF itself was actively searching for a new role and so was eager to take the lead in policy towards economies in transition. In the four decades since its creation, the Fund had lost much of its *raison d'être*. Its responsibility for managing a fixed but adjustable exchange rate regime had come to an end in the early 1970s. Its other major role, to provide assistance to states facing temporary balance of payments imbalances, had brought the institution to centre stage as the international lender of last resort in the first phase of managing Latin America's debt crisis in the early 1980s. However, by the middle of that decade the debt crisis had been redefined, leaving the IMF with a less central role.[3] The IMF's managing director, Michel Camdessus, was quick to seize the new opportunity afforded by Russia's need—and indeed to cast it as a historical imperative, even in face of the obvious risks.[4]

There were, however, problems inherent in the IMF's new role from the outset. The Fund had no more experience than any other institution in supporting transitions from communism to capitalism, raising the question as to how well suited the IMF's intellectual capital would be to this task, and how quickly it could adapt and learn from the novel challenges of systemic reform in Russia. Furthermore, the strength of the Fund's claim to do the job—its technical capacities and mandate, its strict adherence to purely economic expertise, research and indicators—would be brought into potential conflict with the larger political concerns driving Western policy towards Russia. Finally, the IMF's effectiveness would depend not only on its own policies but also on domestic conditions in Russia.

2 Of course, the IMF does provoke nationalist reactions and criticism that it infringes its members' sovereignty. Nevertheless, it has a defence against such criticisms, in the words of managing director Michel Camdessus (to the Russian press): 'We don't impose conditions on governments. Russia is a great country, but if you were a small country, my attitude would be the same. If a program were to be imposed from outside, its chances to be fulfilled, to be implemented, would be minimal. For a program to have its chances, it has to be seen as really the program of the country, elaborated by the country. But it also has to be credible to the international community.' Michel Camdessus, *IMF Survey*, 22 February 1993, p. 51.

3 Harold James, *International monetary cooperation since Bretton Woods* (Oxford: Oxford University Press, 1996).

4 In his words: 'Our role at the IMF is not to wait for all such risks to be eliminated before taking action, but even in chaotic circumstances of history to sit down with the authorities of a member country and see how we can help'. Michel Camdessus, 'Russia's transformation efforts at a turning point', address to the US–Russia Business Council, *IMF Press Release 95/5* (29 March 1995).

The subsequent IMF-led strategy towards Russia has generated a much wider debate as to whether the West has helped or hindered transition.[5] This debate has crystallized around three positions. First there is the 'we lost Russia' view: that reform has failed in Russia because the West has done too little to help it. This assumes that the West could have exerted a beneficial influence on Russian development but failed to do so.[6] A second view argues that 'we messed up Russia', by pressuring successive governments too rapidly to adopt radical measures ill-suited to local conditions.[7] Finally, there is the view that 'there was little we could do', that Russia's problems are primarily of its own making and that foreign assistance can have little influence on domestic outcomes, especially if poor policy choices are made. In other words, Russia was simply not the West's to lose.[8]

In this article we define five phases of Russia's relationship with the IMF during 1988–98 and find some evidence for each of the above views. In the early phases, we argue that the IMF could have done more to assist reforms and reformers in Russia. However, the Fund was constrained both by its own objectives and mandate, and by the policies and preoccupations of its principal shareholders. At the same time, in both these early phases as well as in later periods, we find some evidence that the IMF's policy advice was at times poorly suited to Russian conditions and failed to foresee longer-term effects of advocated reforms. Finally, the analysis highlights the limits to external influence, especially on a sovereign superpower, since in every phase Russia's domestic political and institutional context have greatly influenced the country's receptivity to, and implementation of, IMF recommendations.

Phase one: advice but no money (1988–July 1991)

The last years of the Soviet Union were marked by political liberalization with only halting and partial attempts at economic reform. In spite of being presented with as many as a dozen different reform programmes and a clear need for reform, Gorbachev was unsure and indecisive about how best to proceed. At the same time, as Russia's foreign debt mounted in 1988, the Soviet leadership began

[5] For an overview of the transition see European Bank for Reconstruction and Development, *1997 Transition Report* (London, EBRD, 1997); Anders Aslund, *Russia's economic transformation in the 1990s* (London: Pinter 1997). For the IMF's account of the 1998 crisis and its roots, see: IMF, *World economic outlook: financial turbulence and the world economy* (October 1998), pp. 66–73.

[6] See e.g. Jeffrey Sachs, 'Why Russia has failed to stabilize', in Anders Aslund, ed., *Russian economic reform at risk* (London: Pinter, 1995); Jeffrey Sachs, 'The Reformers ' Tragedy', *New York Times*, 23 January 1994.

[7] As Russian economist Oleg Bogomolov put it, 'The policy of the West was mistaken and in part it will have to pay. It gave recommendations that didn't work and it gave credits that went to prolong a political regime rather than solve our economic problems': *New York Times*, 15 September 1998. See also Georgii Arbatov, 'Neo-Bolsheviks of the IMF', *New York Times*, 7 May 1992.

[8] Vladimir Yevstigneyev, 'Russia and the credit policy of the IMF and EBRD', *Mirovaya ekonomika i mezhdunarodnye otnosheniya* 6 (1996). Peter Rutland, 'The IMF: savior or sinner?', *OMRI Analytical Brief*, no. 10 (1996). Stanislav Gomulka argues both that external assistance can only play a marginal role, and that the IMF's policies have on balance benefited transition economies: 'The IMF-supported programs of Poland and Russia, 1990–1994: principles, errors and results', *Journal of Comparative Economics* 20:3, June 1995.

to discuss membership of the IMF.[9] Yet the West was very reluctant to grant the USSR full membership: it was clear that the country would want to draw heavily on the organization's resources, and it was argued that the USSR had not met the necessary criteria of membership. Accordingly, in October 1991 'associate membership' was granted, limiting the Soviet Union to technical assistance and advice without conferring the right to call on the IMF's funds.[10]

Nevertheless, in this early period, the IMF became closely involved in constructing a programme of reform for the USSR. In mid-1990 the managing-director of the Fund flew into Moscow to launch a major study for the G7 on how to reform the Soviet economy and the criteria under which Western economic assistance could effectively support such reform.[11] The report advocated a radical programme to be implemented in close coordination with the IMF. This included immediate and rapid stabilization through spending cuts, tax increases and price liberalization. It also recommended the privatization of small and, after reorganization, large enterprises. Many of these recommendations were later included in the Russian government's own reform programme launched at the end of 1991. In the meantime, however, the retreat from reform conducted by the government of Prime Minister Valentin Pavlov from January 1991 made it unlikely that a Soviet administration would satisfy the criteria for admission to the Fund.

The USSR finally applied for full membership of the IMF in July 1991, as its foreign debts spiralled, contrary to the express preference of the United States. The Bush administration feared that Congress would be reluctant to approve a 50 per cent increase in IMF quotas (agreed within the IMF the previous year) if the USSR were eligible to take loans. In the event, Russia's full membership came through in June 1992, by which time the reticence of both Congress and the IMF board reticence had been superseded by more immediate concerns.

Phase two: first attempts at stabilization (August 1991–September 1993)

The failed coup attempted by hardliners in August 1991 marked a watershed in both the fate of the USSR and the prospects of economic reform. His prestige greatly enhanced by his role in defeating the coup, the Russian President Boris Yeltsin moved decisively to seize the policy agenda from a discredited

9 Between 1986 and 1989 the Soviet Union's foreign debts rose from $30.7 billion to $53.8 billion: World Bank, *World Debt Tables*, 1990, pp. 92–3.

10 The 'IMF Institute' was expanded to provide courses for officials concerned with transition to the market, and staff in the Monetary and Exchange Affairs Department, Legal Department, Fiscal Affairs Department and Statistics Department were made available to provide technical assistance. By December 1991 it was estimated that between 120 and 130 (or one in six) IMF economists were now working on countries in transition and the IMF announced it was creating a new department to deal with the former USSR: Michael Prowse, 'IMF creates section to deal with Soviet republics', *Financial Times*, 14 December 1991, p. 2.

11 Later published as IMF, World Bank, European Bank for Reconstruction and Development and Organization for Economic Cooperation and Development, *A Study of the Soviet Economy*, vols 1 and 2 (Washington DC: IMF, 1991).

Gorbachev and a dying Soviet Union. On 28 October, in his address to the 5th Russian Congress of People's Deputies, Yeltsin laid out an ambitious programme of privatization, liberalization and stabilization designed rapidly to create a full market economy. With it came an explicit role, and indeed an appeal, for external assistance: 'We are prepared, in cooperation with foreign specialists, to immediately disclose the strategic data necessary for admission into international organizations and to accept the basic principles set forth in the charter of the International Monetary Fund. We will make an official appeal to the International Monetary Fund, the World Bank and the European Bank for Reconstruction and Development, inviting them to work out a detailed plan for cooperation and participation in the economic reforms.'[12]

By this time, the Soviet Union was descending into economic crisis which by December 1991 saw shortages of basic staples. Urgent action was needed and Yeltsin was mandated to undertake it. Four days after his 28 October speech, the Congress granted him broad powers to rule by decree for a year, and he promptly appointed a government of young reformers led by Yegor Gaidar as deputy prime minister with responsibility for economic policy. For the first time, Russia had a government fully committed to radical economic reform which, in the atmosphere of post-coup euphoria, enjoyed broad popular support. This was a propitious moment for the West to act, and indeed by the end of 1991 Russia was pressing the IMF for large-scale support, suggested at $15 billion a year, and a ruble stabilization fund.

At the time, many advisers in the West were arguing that the Soviet Union needed substantial foreign assistance in order for reforms to succeed: Graham Allison, Grigory Yavlinsky and Jeffrey Sachs, for example, proposed a 'Grand Bargain' of $100 billion of support over four years for reform of the Soviet Union, to be given alongside an orthodox IMF programme.[13] By December, Sachs and Richard Layard, both advisers to the government, were calling on the West for massive and immediate aid to the new reformers. However, amid many promises, little actual assistance was forthcoming, even though in the United States policy-makers were becoming increasingly worried about Russia's prospects.[14] At this stage, the West's assistance was limited to a G7 debt relief package which required the USSR to undertake economic reforms recommended by the IMF even though the USSR was not yet a full member of the organization.

[12] *Current Digest of the Soviet Press* 43: 5,1991.

[13] Jeffrey Sachs, 'The Grand Bargain', in Anders Aslund, ed., *The post-Soviet economy: Soviet and Western perspectives* (London: Pinter, 1992). The figure of $100 billion was calculated as the equivalent per capita value of aid to eastern Europe from 1989 to 1991. By extension, assistance to Russia alone would be about $48 billion. At the end of 1991 Sachs called for $15–20 billion in assistance to Russia the following year. 'Goodwill is not enough', *Economist*, 21 December 1991. For a critique of Sachs's view see Peter Reddaway, Prepared Statement to the Hearing before the Committee on Banking, Housing and Urban Affairs, United States Senate, *Impact of IMF/World Bank policies toward Russia and the Russian economy* (8 February 1994: S.HRG. 103–508), pp. 76–8.

[14] The US Secretary of State James Baker was warning of a possible 'fall toward fascism or anarchy', *Financial Times*, 13 December 1991, p. 18.

The ambitious programme of reform began on 2 January 1992 with a range of measures designed to liberalize the economy, including the removal of control of over 90 per cent of consumer prices and 80 per cent of producer prices, the freeing of internal trade and the floating of the ruble. The immediate effects were a plunge in the value of the currency and the release of hitherto repressed inflation in an economy suffering chronic macroeconomic imbalance. The reformers then sought to achieve stabilization by drastically cutting the budget deficit, estimated at 20 per cent of GDP in 1991.

It was at this point that Yeltsin formally requested the $6 billion ruble stabilization fund mentioned above; the IMF began to act in response, and in late February the government approved a detailed memorandum on economic policy which had been prepared with IMF assistance and sent it to the Fund in the hope that it would expedite their application for full membership. Among the commitments set out by the document were the unification of the exchange rate by mid-April, the elimination of export quotas and licences except on energy-related and strategic goods by July, and the reduction of inflation to 1–3 per cent per month and the elimination of the budget deficit by the end of the year.

Meanwhile, against a background of lavish but largely empty promises of Western aid,[15] the government pressed on with the cutting and sequestering of expenditure to such an extent that a small primary budget surplus was recorded in the first quarter of 1992.[16] Politically, however, opposition to reform was emerging, with nationalist voices calling on the government not to accept external assistance.[17] The first skirmishes took place at the 6th Congress of People's Deputies in April 1992, which the government survived remarkably unscathed, boosted by the timely announcement of Russia's membership of the IMF with a quota larger than that originally offered. President Yeltsin at the time announced strong support for his new IMF-sympathetic team. But it could not resist the growing political pressure indefinitely.

In June 1992 a government reshuffle brought Viktor Chernomyrdin and Georgii Kizha, representatives of the industrial lobbies, into government. The following month Viktor Gerashchenko was appointed chairman of the Central Bank of Russia (CBR). The significance of this latter move was twofold. First, this former head of the old Soviet Central Bank was far more ready to issue credit than his predecessor, Georgii Matyukhin, had been. Second, he was accountable to parliament rather than to the government, and so constitutionally responsive as well as politically sympathetic to the industrial interests represented there. The consequence of the developments in June and July was a

[15] See Appendix and Table A.1 to Jeffrey Sachs's 'Prepared Statement' to the United States Senate, pp. 74–5. *New York Times*, 2 April 1992, 28 April 1992.

[16] *Russian Economic Trends* 1: 1, 1992, p. 10.

[17] As early as April 1992 chairman of the Supreme Soviet Ruslan Khasbulatov was dismissing the potential of IMF help and calling for 'adjustments' to economic policy: *Izvestiya*, 4 April 1992 in *Current Digest of the Post-Soviet Press* 44: 14, 1992, p. 12. Gaidar cited the need for IMF funding when defending unpopular budget proposals: Keith Bush, 'Russia: Gaidar's g*uidelines', *RFE/RL Research Report*, 1:15, 10 April 1992.

larger budget deficit, financed by credits issued by the Central Bank—a highly inflationary measure that derailed stabilization.[18]

Ironically, over this period the IMF's involvement in Russia strengthened as the position of the reformers weakened. Following the country's formal admission on 1 June, a communiqué between Gaidar and Camdessus was signed in early July which led to the disbursement of Russia's first $1billion of external support a month later. Fully seven months after the reforms had begun, the IMF began its lending to Russia—at the very moment when political events had put those reforms under threat. Furthermore, this money could not be used to finance the budget deficit. The government did not even bother to draw it down until the end of the year.

Economic policy became the battleground of a series of struggles for supremacy between president and parliament, with industrialists weighing in on the side of parliament in order to press for more credits. The conflicts were exacerbated by an ambiguous Constitution The result was an incoherent policy environment that made stabilization impossible. Nonetheless, a brief opportunity for reform was opened up in April 1993 when Yeltsin succeeded in appealing directly to the population in a referendum which endorsed his presidency and, remarkably, the course of reform.

This new opening was seized upon by the West. In June, the IMF offered its second credit to Russia—a $3 billion loan from a new Systemic Transformation Facility (STF). The STF was a new experiment for the IMF, created expressly for members 'experiencing severe disruptions in their trade and payments arrangements due to a shift from significant reliance on trading at nonmarket prices to multilateral market-based trading'. Unlike other facilities, the STF carried no standard conditionality, merely requiring that the recipients not 'intensify exchange or trade restrictions'.[19] Half of this STF credit was initially extended, with the remaining $1.5 billion to follow after talks on providing more support through a standby arrangement.

On 19 September the IMF suspended its lending programme to Russia due to the government's failure to cut its inflation rate and carry out important measures in the budget field. Two days later Yeltsin dissolved the legislature by decree, precipitated a bloody showdown and then inaugurated a new political order. The emergence of this order, its policy consequences and their external implications, marked a new phase in the relationship between Russia and the IMF.

The record of the IMF in this initial phase of post-Soviet Russian reform is at best mixed. In spite of requests for support from radical reformers of whose goals it could only approve; of the estimates of Russia's needs by foreign experts; and of the precedent for aid to transitional economies in eastern Europe (notably

[18] The Central Bank should not be held solely responsible for the inflation. The government also significantly expanded off-budget credits: see Jerry F. Hough, Evelyn Davidheiser and Susan Goodrich Lehman, *The 1996 Russian presidential election* (Washington DC: Brookings Institution, 1996).

[19] IMF, *Annual Report 1993*, p. 60.

Poland, which received debt forgiveness and currency stabilization support), the Fund was slow in giving meagre support on stringent terms.[20] By mid-1992, when the Fund finally began to engage with Russia, the domestic political conditions for successful stabilization had eroded. Furthermore, the Fund's technical advice to Russia proved wrong in some respects. Most notably, it urged Russia to retain the ruble zone rather than accept the creation of national currencies for the Soviet successor states. This exacerbated inflationary pressures, hindered efforts to stabilize the ruble and led to a net outflow of funds, in the form of credits and implicit trade subsidies, to the other members of the ruble zone that exceeded one-fifth of Russia's GDP.[21] Furthermore, it failed to foresee the collapse in output that would result from the first phases of reform.[22]

The IMF did show some flexibility over this period, for example in releasing the first US$1 billion before a standby agreement had been reached. It was unfortunate, however, that when the IMF did decide to innovate, it was too late. In creating the STF, the IMF recognized that the former republics of the USSR needed more than tough stabilization measures. However, as mentioned above, by the time the STF was drawn upon the political conditions for reform had already begun to deteriorate.

The IMF's slowness to respond to Russia reflected the slowness of the West (the IMF's major shareholders) more generally, whose munificent promises were not, due to a combination of recession, electoral cycles and weak leadership, for the most part honoured.[23] At the same time, however, in dealing with Russia the IMF was limited by its narrow interpretation of its mandate: providing temporary balance of payments support for a country taking active measures to correct the imbalance, and ensuring currency stabilization. The institution was supposedly spearheading Western assistance for transition, yet it had no experience of planning or implementing the kinds of deep structural reform which it would later admit were crucial to Russia's transition.

[20] Such complaints were made even by Russian reformers. See Yeltsin's criticisms of the Fund, *Isvestia* 6 July 1992 in July 1992, in *Current Digest of the Post-Soviet Press* 44: 27, 1992, p. 3; and the comments of Economics Minister Andrei Nechayev, 'IMF Delegation in Moscow', *RFE/RL Research Report*, 1:36, 11 September 1992, p. 67.

[21] Anders Aslund, *How Russia became a market economy* (Washington DC: Brookings Institution, 1995), ch. 4; Marshall I. Goldman, *Lost opportunity: why economic reforms in Russia have not worked* (New York: Norton, 1994), pp. 108–12; Philip Hanson, 'The end of the ruble zone', *RFE/RL Research Report* 1:30, 24 July 1992.

[22] The managing director of the IMF later admitted: 'No one foresaw the scale of the collapse in output that occurred in these economies, or the extent of the erosion of fiscal revenues that stemmed partly from it': IMF, 'Supporting transition in central and eastern Europe: an assessment and lessons from the IMF's five years' experience', Second Annual Francisco Fernandez Ordez Address, by Michel Camdessus, managing director of the International Monetary Fund, Madrid, 21 December 1994 (delivered in Spanish).

[23] See Sachs, 'Prepared statement', p. 74. Sachs argues that in 1992 the West promised Russia $24 billion but gave only $15 billion, and in 1993 promised $26 billion but only gave $8 billion.

Phase three: reform and political change (October 1993–March 1995)

Yeltsin's dissolution of parliament came after a year of simmering constitutional crisis, and was motivated primarily by fiscal concerns. In his televised address announcing the measure, Yeltsin criticized 'anti-people' decisions taken by the parliament: 'The most flagrant is the so-called economic policy of the Supreme Soviet. Its decisions on the budget, privatization and many other areas compound the crisis and inflict huge damage on the country.'[24] This was a reference to the budget passed by the Supreme Soviet in July, with a projected deficit of 25 per cent that would have led to hyperinflation. Between the crushing of the parliamentary rebellion on 3–4 October and the election of a new legislature on 12 December, the government was briefly able to conduct an economic policy of its choosing, and to renew the impetus of reform. It brought the Central Bank under executive control; brought the deficit down to 10 per cent; broke up the ruble zone; and finally abolished most export quotas and licences that had been lucrative sources of rent.

To the shock of their Western supporters, the reformers suffered a major setback in the December elections. The burst of reform had led to a renewal of wage arrears which cost them dearly. Both ultra-nationalists and communists made substantial gains, prompting a debate in the West about its strategy of its assistance. Ironically, since it had just suspended its lending, the IMF was not available to offer support that might have mitigated the economic, and electoral, consequences of stabilization. Having begun to provide assistance just as conditions for reform were becoming less favourable in July 1992, the Fund had withdrawn it just as more propitious conditions were re-emerging.

The elections, however, were held concurrently with a referendum that narrowly approved a new constitution which gave enormous powers to the President. Though it still had to approve the annual budget, the role of the new Parliament was greatly diminished. This high degree of executive insulation from legislative control represented a more favourable institutional environment for pushing through unpopular economic reforms; it was a design that closely approximated the condition of 'authoritarian transition' without wholly discarding democratic mechanisms.[25] The new powerful executive, however, would take some months to begin such reforms.

Indeed, 1994 was a lost year for reform. As a consequence of the Chernomyrdin government's loose budgetary and monetary policy, inflation had risen sharply from 4 per cent to 15 per cent a month, precipitating a 21 per cent fall in the ruble on 'Black Tuesday' (11 October 1994). By January 1995 inflation was up to 18 per cent, the same rate as twelve months earlier. However, the economic ravages of 1994 carried important (albeit painful) lessons. The

[24] *Economist*, 25 September 1993, p. 41.

[25] Adam Przeworski, *Democracy and the market: political and economic reforms in eastern Europe and Latin America* (New York: Cambridge University Press, 1991).

political centrists learnt the costs of using easy credit to resolve economic problems. The government became determined to find a non-inflationary way to finance the budget. This led to a new relationship with the IMF.

The Fund had been facing growing criticism of its Russia policy, which sharpened after the December 1993 parliamentary elections. The attacks came primarily, and most significantly, from its chief member, the United States. Vice-President Gore publicly called for a relaxing of conditionality in lending to Russia, and the Senate held hearings out of an explicit concern that conditionality policies may have been adversely affecting Russia's economic stability and transition to democracy.[26] Among the most potent critics of the IMF was Jeffrey Sachs, one of the principal foreign advisers to Russia until his resignation in January 1994. While his earlier 'Grand Bargain' proposals had embodied orthodox IMF prescriptions, he had now developed a critique of the Fund's demands for drastic budget cuts. Sachs argued that IMF credits should be used not just to build up reserves, but to assist in the non-inflationary financing of the deficit.[27]

The political pressure and technical critique was not without effect: the STF of May 1993 had been provided, on easier terms, to assist budget financing, and the delayed second tranche of it was finally dispensed in April—paradoxically, just as the country was returning to inflationary policies.[28] And there was merit to the IMF's own response that Russia's failure to meet its promises on macroeconomic performance ruled out external assistance. Nonetheless, even the leading reformer Yegor Gaidar, who was both ideologically sympathetic to the IMF's principles and had worked with it while in the Russian government acknowledged that 'the IMF was only a passive onlooker in the polemics on the crucial issue of choosing the 1994 economic and political course'.[29]

By the end of the year the Russian government's resolve to pursue a stricter fiscal and monetary policy had been strengthened by the failures of that year. At the same time, the IMF was searching for more effective ways of helping Russia. For the first time, internal and external conditions had emerged for a more stable and effective relationship.

Phase four: stabilization and the rise of the oligarchs (March 1995–November 1997)

This period marked the high tide of Russia's economic policy success and of its collaboration with the IMF. Having attempted a new form of lending with less conditionality (the STF) in 1993–4, without much success, to some degree the Fund recoiled to its more traditional approach, namely strict, non-concessional

[26] This concern was made explicit in the introductory remarks of chairman Donald W. Riegle in the United States Senate, *Impact of IMF*, pp. 1–3.

[27] 'Betrayal', *The New Republic*, 31 January 1994; Sachs, 'Prepared statment', pp. 69–70.

[28] See IMF Press Release 94/29 and IMF Press Release 95/21 (11 April 1995): by the end of the year inflation was twice as high as had been envisioned in the programme, the net international reserve target was missed by a wide margin, and fiscal policy had moved 'significantly off track'.

[29] Yegor Gaidar, 'The IMF and Russia', *American Economic Review* 87:2, 1997, pp. 13–16.

Table 1 First- and second-generation reforms

First-generation reforms include:	Second-generation reforms include:
aim at macroeconomic stabilization	aim to produce equitable growth
tight monetary policy and control of inflation	appropriate regulation and oversight of financial sectors
privatization	transparency of fiscal policy
price liberalization	professional and independent judicial system to uphold the rule of law and property rights
removal of subsidies and protection within economy	positive role of state in the economy
trade liberalization	improved quality of public expenditure
	flexible labour markets

standby arrangements with tight monitoring. However, the Fund's understanding of the reforms necessary for Russia's economy was undergoing an important change. The IMF was beginning to recognize that macroeconomic stabilization would not lead to sustainable long-term growth unless deep institutional changes were also carried out. More broadly, this reflected a new orthodoxy in the Fund about 'second-generation' reforms (see Table 1). In Russia, this translated into a new slant on conditionality which was brought to bear in the context of much larger loands to Russia during 1995–7. As a result, the relationship between Russia and the IMF, although naturally not without friction, was closer, more stable and continuous, more financially significant and more politically attuned than before. At the same time, this period also saw the consolidation of a new political and economic order in Russia which created problems of its own for economic policy and, by extension, relations with the IMF, whose weaknesses would be exposed by the crisis that erupted in summer 1998.

The first manifestation of the new Russia–IMF relationship was the one-year \$6.8 billion standby agreement announced on 11 April 1995. This was the largest IMF loan to date with the exception of the Mexican bailout. The agreement set out not only targets for typical indicators—inflation was to fall to 2 per cent a month by December and the budget deficit to 8 per cent of GDP—but also commitments reflecting the above-mentioned institutional or 'second generation' reforms. Some measures—'prior commitments'—were required of Russia before any money was disbursed. Overall, the monitoring of the standby arrangement would be closer and tighter than ever before: monitoring was conducted on a monthly rather than quarterly basis, by a working group (comprising representatives from the Russian ministries of finance and economy, and the Central Bank, as well as IMF staff), and their conclusions would also be reviewed by the IMF's executive board. Finally, in this period the loan itself could be used to help cover the budget deficit in accordance with the government's new strategy of non-inflationary financing. In effect, the IMF was doing what Sachs had been advocating in his increasingly trenchant polemics against the institution.

Russia's new relationship with the IMF was made possible in part by the strong insulated executive which had been created by the 1993 constitution. The President now had much greater powers. During the course of negotiations with the IMF, when Parliament tried to double the minimum wage (thus raising expenditure) and introduce tax exemptions on energy exports (thus reducing revenue), the President simply vetoed the bills. He also issued a decree forbidding the government to spend off-budget funds without presidential authorization. Not until the summer of 1998 would the government encounter effective legislative resistance to its fiscal policy, and thus to its attempts to meet IMF conditions.

With a powerful Presidency, the political commitment and external incentives to do so, the government attained considerable success in achieving macroeconomic stabilization of the economy in 1995. A ruble corridor was established in the summer, preserving the value of the currency within a target band set by the Central Bank. Tight monetary policy cut inflation to only 5 per cent a month by the end of the year. And the government succeeded in covering the deficit with internal and external borrowing. In addition, large rent-seeking opportunities were eliminated, completing a process repeatedly urged by the IMF but only haltingly begun in 1993. Principally this involved cutting back on the provision of subsidized credits and trading subsidies and privileges, which had been enormously costly to the Russian economy: one informed estimate valued gross rents in 1992 at 80 per cent of GDP. [30]

The IMF applauded these achievements. Russia, it would seem, was finally moving away from its old political economy dominated by Soviet-era enterprises, in which inflationary demands for cheap credits were channelled through a powerful parliament. Critically, however, the new political economy towards which Russia was moving was not quite as the IMF had planned. Beneath the happy results of tighter efforts at stabilization, a new order was emerging in which a small number of oligarchical financial–industrial groups (FIGs) exerted influence through the 'court' politics of a powerful presidency. Nearly all were based around banks that had sprung up in or after the late Soviet period and were engaged in a range of highly profitable activities, none of which resembled the intermediation of private savings and commercial investment that are the core of traditional banking practices. They had no need for industrial or agricultural credits (though their handling of them as 'authorized banks' brought in handsome profits).

The results of stabilization greatly benefited this new economic and political elite. The stable exchange rate, while cutting profits on currency speculation, allowed them to offer forward contracts in the dollar market to foreign investors hedging against currency risk. Most important of all, the positive real exchange rate, which first appeared in November 1993, made lending to the government

[30] Anders Aslund, 'Reform vs. "Rent-seeking" in Russia's economic transformation', *Transition* 2: 2, 26 January 1996.

extremely lucrative at precisely the time when the government was looking for alternative sources of deficit financing to monetary expansion.

Like the rent-seeking enterprise economy, this oligarchical capitalism had its own deleterious consequences. As the oligarchs' position became stronger, the privilege they sought and defended with growing ferocity was not the provision of credits, but avoidance of taxes, and this put new pressure on the budget—from the revenue side. For example, in the 'shares-for-loans' scandal of November–December 1995, the banks gained control of many of the most valuable raw-material companies for a pittance in rigged auctions that the banks themselves had in many cases organized. Among its many flaws, this scheme led to a once-for-all loss of potential state revenue that a competitive procedure would have netted. More serious over time were the demands for tax exemptions and non-payment of those taxes for which the FIGs were liable. Gazprom, for example, continued to hold billions of rubles in a tax-free 'stabilization fund' for investment.[31] These flaws in Russia's emerging political economy would be revealed in due course.

By the end of 1995, the IMF was largely satisfied with Russia's progress. Despite strong political pressures leading up to the parliamentary elections in December 1995, and some policy relaxation in the last months of the year, Russia was considered to be meeting all its programme targets. The reward was a still larger drawing on the Extended Fund Facility (EFF), agreed in March 1996, of $10.2 billion, which would be disbursed monthly over the period from 26 March 1996 to 25 March 1999. The loan conditions required Russia further to reduce its fiscal deficit (to 4 per cent of GDP in 1996 and 2 per cent in 1998) and inflation (to 1 per cent a month by the end of the year), to undertake structural reforms in privatization and agriculture, and to eliminate all export duties. Significantly, it also demanded banking reform, proper auditing of the largest enterprises and improvements in tax collection. The leverage associated with IMF approval was particularly great at this point, as the agreement paved the way for a comprehensive restructuring of Russia's $38.7 billion debt with the official creditors of the Paris Club in April, which in turn led to the country's return to international capital markets as a sovereign borrower and the eventual floating of several successful Eurobond issues. However, although the Fund had leverage at this time, it also bears noting that progress with the institutional reforms it was demanding would be difficult both for Russia to implement and for the IMF to measure and monitor.

In addition to providing more money and support to Russia over this period, the IMF responded to strong Western concerns about a hostile government coming to power. Under Western pressure, the Fund showed sensitivity to the political needs of the Yeltsin government. In the December 1995 elections to parliament, the communist and nationalist forces had made further gains.

[31] World Bank, *World Development Report 1998* (Washington DC: World Bank, 1998).

However, under the 1993 constitution the President was not unduly weakened by this. The presidency itself, however, was up for election in the spring of 1996, with Yeltsin facing a strong challenge from the communist leader Gennady Zyuganov. Here, in campaigning for the presidency, Yeltsin ignored several of his government's promises to the IMF. Not only did he tour the country doling out promises of largesse, but even during the campaign itself the government resorted to various devices to evade fiscal and monetary commitments so recently made to the IMF.[32] The Fund was not unaware of what was going on. Indeed, just before the IMF executive board met in June to decide on the release of that month's credit tranche, it was informed by the government of a transfer of CBR profits to the budget, yet approved the disbursement nonetheless.[33] The first tranche was not withheld until July—after the elections had taken place. As the newspaper *Sevodnya* put it: 'Both the Fund experts who conducted the monthly review in Moscow and officials at IMF headquarters in Washington were well aware that too much was at stake at that particular time to raise an international commotion over "net domestic assets".'[34]

Paradoxically, however, the presidential election had influenced the political system in Russia in a way that would counter IMF efforts to influence reform. The funding for Yeltsin's campaign was provided largely by a group of seven leading oligarchs who, for all their differences, shared a common fear of a Zyuganov victory. Their support conferred a massive (and illegal) financial advantage on the incumbent, one that was not expected to go unrewarded. Consequently, the position of the oligarchs became further entrenched in the political order. Two of their number, Boris Berezovsky and Vladimir Potanin, were appointed Deputy Secretary of the Security Council and Deputy Prime Minister respectively.

More significantly still, tax collection fell precipitously during the campaign and was never to recover fully (see Table 2). The IMF became increasingly concerned about this problem and on occasion withheld tranches because of inadequate government efforts to improve it. Yet the problem was inherently more politically difficult, and attempts to solve it more easily portrayed as intrusive, than the earlier one of excessive credits. For the preponderance of tax revenue was withheld by a very small number of oligarch-owned companies that had not only become highly influential within the powerful executive but had gained control over most of the print and broadcast media outlets. The World Bank would later estimate that had Gazprom (formerly headed by Prime Minister Viktor Chernomyrdin) been required to pay all of its tax obligations in 1995, budget revenues would have been boosted by 2–3% of GDP, equivalent to about one third of the federal deficit.[35] However, any move by the government,

[32] *Economist*, 13 July 1996. Other devices are described in *OMRI Daily Digest*, 28 May 1996.
[33] *Sevodnya*, 25 July 1996 in *Current Digest of the Post-Soviet Press* 48: 23 (1996), pp. 9–10.
[34] *Sevodnya*, 25 July 1996 in *Current Digest of the Post-Soviet Press* 48: 30 (1996), p. 24.
[35] World Bank, *World Development Report 1998*, box 7.1.

Table 2 Russian government revenue and expenditure 1992–1998 (as % GDP)

	1992	1993	1994	1995	1996	1997	1998 (first half)
Federal government revenue	15.6	13.7	11.8	12.2	13.0	11.9	10.2
Federal government expenditure	26	20.2	23.2	17.6	22.0	18.9	16.1

Source: Compiled from IMF, *World Economic Outlook*, May 1998, p. 100; October 1998, p. 70.

and by extension any pressure exerted on the government by the IMF, to challenge these interests would inevitably evoke both direct resistance from the oligarchs and efforts to mobilize opinion in their favour—as the Kiriyenko government was to find out in 1998.

The problem became increasingly obvious to the IMF. In April 1997, while praising Russia's achievements in cutting inflation, stabilizing the exchange rate and reducing the government deficit, Michel Camdessus noted that there were still core problems to be addressed, one of which was 'the exceedingly close relationship between the government and a number of large enterprises, which allows many to benefit from explicit or implicit tax exemptions, to exploit flaws in the tax system to avoid paying taxes—and even to engage in tax evasion'.[36] In 1998 the Managing Director would in strikingly outspoken terms refer to this as 'crony capitalism'.[37] Overcoming Russia's crisis, as Fund staff recognized, required deep institutional or 'second generation' reforms. This assessment fitted within a more general view growing within the Fund that 'modernizing the state', introducing accountability, transparency, the rule of law, and an effective judiciary, at the same time as rooting out corruption, are all vital elements of ensuring growth and the efficient functioning of a market economy.[38]

The real conflict between politicians and oligarchs began to emerge after Yeltsin, determined to prove his vigour and commitment to reform after his recovery from heart surgery, appointed Anatoly Chubais and Boris Nemtsov as First Deputy Prime Ministers in March 1997. Nemtsov, a popular and reforming provincial governor, set about challenging the oligarchs' interests on a range of issues: the elimination of insider privatization, the reform of natural monopolies and the punishment of tax debtors. With the encouragement and support of the IMF, this new reformist government's conflicts with the oligarchs—whose election-time unity had now dissipated—escalated. The battle was to become more serious still, and generate growing hostility to the IMF, as global financial

[36] IMF Press Release 97/5 (2 April 1997).
[37] IMF Press Release 98/17: address by Michel Camdessus, 'Crisis in emerging market economies: the road to recovery', New York, 15 September 1998.
[38] See IMF, *World Economic Outlook 1998* (Washington DC: IMF, 1998); IMF, *Good governance: the IMF's role* (Washington DC: IMF, 1997).

instability exposed the fragility of the new Russian political economy. It is the interaction of the two problems, and their culmination in crisis, that defines the fifth and final phase of the Russia–IMF relationship.

Phase five: the crash (October 1997–September 1998)

In economic terms 1997 has been the most successful year to date for Russia since independence. Output actually rose slightly (by 0.8 per cent) for the first time, and the stock market continued to grow impressively. The budget deficit remained worryingly high at 7 per cent of GDP, but the domestic and foreign attractiveness of government bonds encouraged officials to predict that Russia would need no further IMF funds after the full disbursement of the current loan.[39] But in October contagion from the East Asian financial turmoil forced Russia to defend the ruble by raising interest rates. This in turn increased the already heavy burden of interest repayments on loans and so began a slow spiral into a debt trap. The problem of financing the deficit redoubled government efforts at revenue collection, including the formation of a Temporary Extraordinary Commission on Strengthening Tax and Budget Discipline, which was empowered to seize and sell off the assets of tax debtors. Such actions, and IMF support for them, provoked a furious response from the oligarchs. One of those most threatened, the head of the LogoVAZ group Boris Berezovsky, had close ties to Yeltsin's family. The newspaper *Nezavisimaya gazeta*, which he owned, printed excerpts of letters from the IMF and World Bank to the Prime Minister Viktor Chernomyrdin under the headline: 'Why Does Russia Need a Government of its Own?'[40] Less than two weeks later the powerful mayor of Moscow, Yuri Luzhkov, weighed in on the same theme of national dependence on the IMF, describing it as a 'national disgrace'.[41] Powerful voices were now openly arguing that the Fund was a threat to Russia's sovereignty.

These voices were to grow stronger. In March 1998 Yeltsin once again tipped the balance of the struggles over policy in favour of reformers by dismissing the Chernomyrdin government and replacing it with one led by Sergei Kiriyenko. The new administration brought a zeal and determination to reform unmatched since the early months of 1992. Its concerted campaign of tax collection, in particular, brought it into confrontation with Gazprom and other oligarchical interests, the inconclusive outcome of which revealed the limits to the power even of committed reformers backed by the IMF.[42]

The continuing revenue shortfalls, exacerbated by falling oil prices due to the East Asian crisis and combined with the high debt service burden which absorbed 36 per cent of revenues by July, finally led to crisis in the summer of 1998. Fear of Russia's inability to maintain the high interest payments on foreign

[39] See, for example, Yeltsin's statement reported in *RFE/RL Newsline*, 18 September 1997.
[40] *Nezavisimaya gazeta*, 18 December 1997, in *Current Digest of the Post-Soviet Press* 49: 51, 1997, p. 8.
[41] *RFE/RL Newsline*, 30 December 1997.
[42] *Tribuna*, 28 April 1998, cited in *RFE/RL Newsline*, 30 April 1998. *Tribuna* is owned by Gazprom.

debt and to defend the ruble exacerbated the international 'flight to quality' triggered by turmoil in financial markets. Faced with sharp falls in its reserves, the government appealed for foreign assistance on 19 June, one day after the IMF withheld yet another monthly tranche.[43] After difficult negotiations, and under strong pressure from the US Treasury, the IMF agreed to provide $11.2 billion of new funds for currency support which, with contributions from the World Bank and Japan, made up a package of $17.1 billion of new loans. The IMF part of the package envisaged a very large call on the resources for the organization. Indeed, when the press reminded Stanley Fischer that he had previously said that $10 billion was too much for a single country to draw, the first deputy managing director replied: 'Ten billion was too much for us, and we have had to draw on the GAB.'[44] The General Arrangements to Borrow, activated for the first time since 1978, provided an $8.2 billion augmentation of Russia's Extended Fund Facility, with the remainder of the new loan coming in the form of a $2.9 billion credit under the IMF's Compensatory and Contingency Financing Facility, which exists to provide temporary compensation for a shortfall in export earnings. The final package was approved by the executive board on 20 July in a non-unanimous vote.[45]

In return, the Russian government committed itself to further tax-raising and collecting measures aimed at reducing the budget deficit from 12 per cent in June 1998 to 2.8 per cent in 1999. These commitments prompted a fresh outburst of collective criticism from oligarch interests. More importantly, the parliament baulked at key tax-raising provisions of the government's anti-crisis package, which were subsequently imposed, contrary to constitutional norms, by presidential decree. This is not the only legal question raised by the new IMF loan, which still has not, at the time of writing, been submitted to the parliament for ratification as required by Russian law. Consequently, the country is still not formally bound by its terms.[46]

The massive loan package could not stave off the banking and currency crisis. In the last weeks of July, as treasury bill rates rose and equity prices fell, massive capital outflow put irresistible pressure on the ruble. Only three days after President Yeltsin announced that such a measure would not be taken, Prime Minister Kiriyenko announced on 17 August a 34 per cent devaluation of the currency that soon became a de facto float, a 90-day moratorium on some commercial foreign debt and a forced restructuring of short-term ruble debt. The entire $4.8 billion first tranche of the new loan had been used up in a failed attempt to support the ruble that served only to assist capital flight.

[43] The tranche was approved on 25 June.
[44] Transcript of press briefing on Russia by Stanley Fischer at IMF headquarters, 13 July 1998.
[45] IMF Press Release 98/31, 20 July 1998.
[46] The key provision is Article 5 of the December 1994 law, 'On state foreign borrowing of the Russian Federation and state credits granted by the Russian Federation to foreign states, their juridical persons and international organizations'. We are grateful to Dmitri Gusev for help in finding the text of this law. The government argued in July 1998 that ratification was unnecessary because the loan was to be added to reserves rather than used in the budget.

Within another six days Yeltsin had dismissed the Kiriyenko government and brought Chernomyrdin, the preferred candidate of the oligarchs, back as Prime Minister designate. Three days later Camdessus flew to Crimea to enter into urgent talks with Chernomyrdin and make clear the dire consequences of populist measures like the printing of money or the reimposition of prices and foreign exchange controls. Camdessus argued instead that Russia must maintain monetary discipline and re-establish exchange rate stability in order to receive any further assistance from the international community.[47] As it turned out, Camdessus was talking to the wrong man.

In a move that confirmed both the resurgence of the parliament and the decline of oligarch power during the crisis, the parliament refused to endorse Chernomyrdin as Prime Minister. Yeltsin was forced instead to propose the Foreign Minister Yevgeny Primakov, who was popular with the parliament. Primakov formed a government of Soviet-era survivors like himself, notably Yuri Maslyukov, the former head of the state planning agency Gosplan, who became First Deputy Prime Minister in charge of economic policy. Viktor Gerashchenko, who had resigned as Central Bank chairman in October 1994 after the last ruble crash, returned to his old position in place of Yuri Dubinin.

Concluding thoughts: the prospects for the IMF and Russian economic reform

This article began by asking whether IMF assistance has helped or harmed Russia, or indeed whether it has been irrelevant. The answer is somewhat mixed. In terms of the narrow mandate of the IMF (its goal of macroeconomic stabilization in Russia), there have been some successes. Inflation was brought under control, and government expenditure and monetary policy tightened between 1995–1998. However, in the early phases of reform, the IMF was too slow in offering assistance to help increase leverage and consolidate the position of reformers sympathetic to macroeconomic stabilization—partly, of course, due to the ambivalence of the Fund's major shareholders. At the same time, the record of the Fund's staff and technical expertise, even within their narrow mandate, has not been impeccable. Early on the institution failed to foresee the dangers of insisting on a common ruble zone, and also consistently failed to foresee or to take into account in its programmes the dramatic collapse in Russian output. More fundamentally, the Chief Economist of the World Bank now argues that giving foremost priority to achieving very low inflation—the Fund's traditional emphasis—may in many cases have been 'misguided'. Indeed, in propounding solutions, he writes that today 'a greater degree of humility is called for' in both the IMF and the World Bank.[48] Likewise, other economists

[47] Transcript of IMF Press Conference of Michael Camdessus (28 August 1998).

[48] Joseph E. Stiglitz, *More instruments and broader goals: moving towards the post-Washington consensus* (Helsinki: WIDER/United Nations University, 1998).

(including several Nobel Laureates) have criticised the overall priorities and objectives of the reforms which have been so strongly advocated by the IMF.[49]

The Fund, by its own admission, must now move beyond its traditional mandate and expertise, which have focused on 'stabilization'. It has recognised that Russia needs deeper, institutional reforms including strengthened banking supervision, regulation and a stronger judicial system, rule of law and property rights.

However, while the Fund's mandate, intellectual capital and shareholder pressure influence their programmes, implementation has largely been determined by the political and institutional environment within Russia. Ironically, however, the IMF's involvement in the country may have shaped the evolution of some adverse domestic conditions. In particular, the real (if temporary) successes of the 1995–7 stabilization, achieved with large financial assistance and close cooperation from the Fund, contributed to the growth and entrenchment of the position of oligarchs. And it is these interests which have proven inimical to necessary reforms. In other words, the very reforms which the IMF now sees as crucial are being blocked by the financial–industrial groups which so benefited from the successes of 1995–7.

The broader question raised is whether the IMF should continue to lead the West's efforts to provide assistance and advice to Russia. The IMF is not an institution endowed with expertise about 'reforming' or 'modernizing' the state, even if it recognizes that this is what Russia needs. When it took a lead on Russia in 1991, it was stepping into a minefield of Western interests and aspirations—a situation which took it well beyond its traditional mandate. It must now try to stay deeply involved in Russia, not least because the country owes it so much. Yet, the Fund has not (and perhaps cannot) radically adapted to the challenges of advising and promoting the requisite institutional reforms in transition economies. It has tried, with very limited success. While it remains stuck predominantly within its traditional mandate, it is difficult to see a relevant positive role for it in Russia today.

So where does this leave the IMF? The mega-package of assistance proffered to Russia in 1998 failed to stabilize the currency or to avert the crisis of confidence in the Russian economy; furthermore, the Fund's policies are now blocked by the oligarchs and rejected by the government. In other words, in 1998 the Fund failed on two counts: both in the narrow and immediate aim to stabilize, and in the long-term goal of fostering the right conditions for reform in Russia. Unsurprisingly, the institution came under blistering criticism for its failure, coming so close on the heels of what has been widely perceived as a failure to deal appropriately with the East Asian crisis.[50] Yet it would seem that the institution will survive. As the fear of global recession, plummeting currencies and a spreading global financial crisis are reminding politicians

[49] Michael Intriligator, 'Round table on Russia: a new economic policy for Russia', *Economics of Transition* 5:1, 1997, pp. 225–7.

[50] See Martin Feldstein, 'Refocusing the IMF', *Foreign Affairs* 77: 2, March/April 1998, pp. 20-33.

everywhere of when and why the IMF was created, and why they might need such a global institution, the US Congress has finally approved the IMF's quota increase and payment of their share of it, and world leaders are talking about a role for the IMF in containing financial crises and using resources to prevent contagion. In deploying resources in this way, however, the IMF must still answer to the challenges exposed by its involvement with Russia. If it cannot focus on 'second-generation reforms' itself, it must work much more closely and cooperatively with other better-placed institutions that can—at both the regional and the global level.

Meanwhile, Russia's economic situation is bleak. The failure to restructure the economy, and its fiscal consequences, remain a long-term problem. This is exacerbated by chronic state weakness that is manifested in widespread corruption: predatory mafias, tax evasion and illegal capital outflows. The total cost of corruption has been estimated at $15 billion a year, and officials have acknowledged the misappropriation even of foreign assistance.[51] The consequences of this dismal picture are clear: the resumption of output decline and inflation, the growth of wage arrears and barter, and the demonetisation of what has been described as a 'virtual economy'.

The new Russian government is not opposed to the renewal of foreign assistance on principle, but it is playing a dangerous game. On the one hand, it desperately needs such help to cover the budget deficit. On the other hand it has been far more critical of the Fund than previous Russian governments and its tactics rather more aggressive than those of a traditional demandeur.[52] Its threats to default on loans unless international funding is restored have been described as 'a form of blackmail' by IMF officials.[53] Its proposals for tackling the economic crisis have been criticised by the IMF and the United States. With no new reform ideas, few available policy choices and foreign lenders deeply wary, this picture is in some respects worse than in 1992.

Nonetheless, it is possible that the crisis may have had unexpectedly beneficial consequences that in the long term assist the country's recovery. Most of the bank-based oligarchs were made technically insolvent by the events of August 1998. Furthermore, until now their political influence has been exerted through the presidency which is now drastically weakened. Russia's prospects will now depend to a large degree on whether or not the new government takes advantage of this situation. While the instincts of the Primakov government are

[51] For example, at least $240 million of a World Bank load for restructuring the coal industry is unaccounted for. See *Baltimore Sun*, 19 July 1998 (reproduced in Johnson's Russia List no. 2272). Venyamin Sokolov, the head of Russia's Chamber of Accounts, has included foreign funds and credits in his catalogue of corruption cases. See the interview in 'Russia's Fiscal Whistleblower', *Mother Jones*, 16 June 1998; and also *Daily Telegraph*, 21 September 1998.

[52] For example, Yuri Maslyukov has said of the Russian crisis that, 'We did not just fall into this pit by ourselves—it was also thanks to our "skilful" partners in the International Monetary Fund… [T]here is only one way out—we must be understood, and we need help. We demand that help.' *Reuters*, 5 October 1998.

[53] *New York Times*, 4 October 1998.

not radically reformist, neither does it seek a return to communism. It has yet to yet to reestablish a lending relationship with the IMF, after the Fund suspended its loans in August 1998. Should it resist the temptation to bail out the oligarchs, it may well both help rid the economy of what are essentially parasitic structures and lay the ground for a new relationship with the IMF.