A guide to the infighting.

Moscow Meltdown

By Jeffrey Sachs

If Russian politics is akin to a chess match, the reformers and the reactionaries are in the endgame. Last week's ludicrous currency reform—in which old rubles were summarily declared void by Russia's Central Bank—was a ruthless gambit by the reactionaries, as explicable in political terms as it was senseless economically.

The struggle is in many ways an economic Fathers and Sons. The old guard, epitomized in the persons of Parliament speaker Ruslan Khasbulatov and Russian Central Bank chairman Viktor Gerashchenko, continues to fight the arrival of Russia's new generation, led by the reformist minister of finance, Boris Fedorov, and the privatization minister, Anatoly Chubais, both in their mid-30s.

One of Yeltsin's remarkable traits, aside from his skill at democratic politics, has been his commitment to shielding the younger reformers from the intrigues of politicians of his own generation. Fedorov was actually Yeltsin's first finance minister when Yeltsin became head of the Russian government in 1990. At that point, Yeltsin was still under Gorbachev's thumb, and real reforms in Russia were blocked by the Soviet Communist Party. Fedorov resigned in frustration at the end of 1990 and joined the capital markets group of the European Bank for Reconstruction and Development in London. At the end of 1992 he moved to the World Bank as Russia's executive director, and then was called back to Moscow by Yeltsin at the start of this year. Chubais, the brilliant tactician of Russia's mass privatization program, is a remarkable blend of policy-maker and hands-on politician who rose to prominence in St. Petersburg's first democratic elections.

Fedorov's talents are matched only by his disdain for the ineptitude and double-dealing of Gerashchenko, his counterpart at the Russian Central Bank. In the last year of the Communist regime, Gerashchenko was chairman of the Central Bank of the Soviet Union, and with Prime Minister Valentin Pavlov (later one of the coup plotters) he summarily declared that the fifty-ruble note would be withdrawn from circulation. As with last week's action, the ostensible purpose was to control inflation by limiting the money supply. In fact, the 1991 action led to a public panic, a flight from the ruble into dollars and, in the end, no actual withdrawal of notes from circulation, since the measure was effectively overturned by later actions. But it was a chilling tremor of the tragi-comic events of last week.

Ironically, Gerashchenko's and Khasbulatov's actions were a counterattack prompted by the successes of the reformers after the April 25 referendum. Buoyed by public support shown in the referendum, Fedorov was able to assert operational control over the Russian Central Bank during May and June. The Bank remained nominally under the Parliament's control, but with the blistering rejection of the Parliament in the referendum, Fedorov found new room for maneuver vis-à-vis the Bank.

The initial results were as dramatic as they were frightening to the reactionary opposition. Fedorov quickly secured an agreement with the International Monetary Fund, imposed new operating guidelines on the Central Bank and re-established budgetary discipline within the Cabinet with Yeltsin's backing. In early June the ruble began to stabilize, and even strengthened, after two years of downward spiral. Fedorov publicly declared, as he left for a trip to the United States, that the conditions for ruble stability through September had been achieved. He jokingly offered a $50 bet to any takers that the ruble would hold firm over the summer months.

Successes came in other areas as well. Chubais won the Cabinet's support (with Yeltsin's arm-twisting) for an acceleration of the privatization program, which has so far succeeded in privatizing more than 70,000 enterprises. At the same time, Yeltsin pushed the political reform agenda by convening a constituent assembly of Russia's eighty-eight regions and autonomous republics in order to finalize a draft of a new constitution. The assembly completed work on the draft and sent it back
to regional assemblies for comments, with the intention of reconvening in Moscow in August. But most shocking of all to the political class was the confident talk by the reformers of new parliamentary elections in the fall. In the April referendum, 65 percent of the voters had called for new legislative elections, and the reformers predicted that the constituent assembly would approve a new election law in August, at the same time that it would give final approval to the draft constitution.

How long two weeks in Russian politics can be! As Yeltsin and Federov left Moscow in mid-July for a break, the political opposition went into action. Khasbulatov launched a remarkable wave of anti-reform legislation: the Parliament suspended privatization, tripled the budget deficit and declared part of Ukraine to be Russian territory. Although Khasbulatov himself lacks a constituency (his native Chechenskaya has seceded from Russia and has repudiated him as its representative), he was able to accomplish this feat because he runs the Parliament as a private satrap. He feathers the nests of the members with apartments, cars and travel visas, and is their best guarantee against the mortal threat of new elections. In return, he merely demands unanimous voting support.

The Central Bank’s monetary reform came just a day after the close of Parliament. On the evening of Friday, July 23, Gerashchenko formally notified the government and the president’s office of the intention to ban all pre-1993 ruble notes the following day, and to allow only a partial conversion of the old notes into new notes. The finance minister and the president were out of town, and the conservative prime minister, Viktor Chernomyrdin, convened a government meeting without even notifying the Finance Ministry. The prime minister hurriedly declared the government’s assent to the move, despite the absence of documents or independent analysis. The move was announced the next day to public hostility and panic, as millions of Russians contemplated the sudden confiscation of part of their currency holdings.

Not only is the method of money control—confiscation—as primitive as can be imagined, but the real key to controlling the money supply lies in limiting Central Bank credit to finance the budget deficit. This was being done in a careful program agreed to with the IMF and negotiated over several weeks. (During that time, the Central Bank never broached its “alternative” policy.) And after Yeltsin’s watering down of the decree, virtually all old notes will be converted to new notes anyway. Rubles held in the neighboring republics are currently flooding into Russia via black markets to be converted into 1993 bills. There will be no effect on the money supply. The only lasting effect will be a loss of confidence in economic management. It’s 1991, repeated as farce.

On Sunday, Yeltsin hurried back from vacation. Finance Minister Federov cabled Yeltsin from the United States, insisting that the Central Bank order be overturned by presidential decree and that the Central Bank governor be pressed to resign (an outcome that seemed imminent in view of the public outcry). Federov spelled out the economic irrationality of the action and stressed that it violated various international agreements between Russia and the IMF. At the last moment, however, Chernomyrdin prevailed on Yeltsin to put aside Federov’s proposed action, and merely to water down the Central Bank’s order by allowing greater latitude for the public to exchange old rubles for new ones.

It is becoming clear that the Central Bank’s action is part of the general revolt against the reformers. While there is still uncertainty about the exact nature and timing of last week’s events, it is very likely that the actions of Khasbulatov, Chernomyrdin and Gerashchenko are indeed even if not tightly coordinated. Chernomyrdin has repeatedly defended the Central Bank’s actions to Yeltsin and to the public. In the grand tradition of the big lie, Khasbulatov has taken to television to denounce Federov as the cause of the Central Bank’s actions. Meanwhile, within the government, Chernomyrdin seems to be maneuvering with conservative ministers such as Oleg Lobov, an old Communist apparatchik, to try to overtake Federov’s overall reform program.

We’re left to wonder: Can Gerashchenko really believe the nonsense he propounds? The sad answer is: Maybe. The man is economically illiterate; his background is disbursing cheap credits to Russian industrial enterprises and schmoozing with foreign bankers. But he is also a liar and a political intriguer—like so many in the Old Guard. His “real” views are always subject to doubt, and his future actions impenetrable.

What the past couple of weeks tell us is that elite politics alone will not rescue Russian reform. What’s needed for decisive progress is a breakthrough to new elections that can retire most of the old guard. Yeltsin should simply declare an election date later this fall, even without a formal legislative mandate for new elections. The public is so disgusted with the Parliament that Yeltsin would most likely prevail in setting the new election date, just as he prevailed last April in calling a referendum despite the bitter objections and maneuverings of the Parliament.

The West can do little at this point, except to spell out the stakes clearly to Yeltsin and hold back on financial aid to the Russian government until the reformers are more strongly in place. (Private sector projects should continue, however.) Most urgently, the next round of IMF money should be put on ice until the Central Bank is clearly under the reformers’ control, with Gerashchenko gone. If conditionality is to have any bite at all, it should preclude “business as usual” when the reforms themselves are under mortal challenge.