

Table of Contents

'Civil Unrest And The Politicisation Of The Russian Masses?' By Andrew Pospelovsky	2-6
The Future of the Russian Banking System: Liquidation or Mergers? By William Tompson	7-25
Russia's Systemic Transformation: Possible Security Implications By Dr Graeme P Herd	26-35
Praetorian Guard or Wooden Horse: The Military Response to the Crisis By Steven J Main	36-48

'Civil Unrest And The Politicisation Of The Russian Masses?'

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During the last six years the Federation of Independent Trade Unions has led the organisation of seven 'nation-wide' protest actions, to demand the elimination of wage arrears and indexing of wages to inflation. Each action was accompanied by growing tides of concern that the wage debt and impoverishment of large sectors of the Russian population would spark mass civil unrest. More recently this concern has been accompanied by warnings of government overthrows and revolution that would sweep away the post-soviet market orientated order.

What this revolution would bring in remains undetermined. Speculation includes the collapse of the Russian federation, re-establishment of the Soviet order, or anarchy. Each of these tides has, however, petered out in protests that can be best characterised as anti-climaxes with little impact on political stability.

In the spring of 1998 even Russia's most respected newspapers such as Izvestiya and Nezavisimaya Gazeta were drawing comparisons between the then current situation and that in 1917. On the eve of the latest nation-wide day of protest of 7 October, Communist and union leaders were publicising apocalyptic visions of millions of disgruntled citizens flooding the streets forcing Yel'tsin out of office. Gennady Zyuganov, leader of Russia's Communist Party, warned that "The day of reckoning is approaching ... for those barbarians in power in this country who have been trying to build criminal-racketeering capitalism", predicting that 40m would take to the streets to demand Yel'tsin's resignation. He also warned that "If the protest actions of 7 October do not produce results, then we will pursue a campaign of civil disobedience."¹

Leader of the Movement to Support the Military (Dvizhenyie Podderzhku Armii - DPA) and chairman of the Duma Committee for Public Safety, Viktor Ilyukhin (a member of the Communist faction) called on the 7 October demonstration to be turned into a general strike². The populist governor of Krasnoyarsk and former general Alexander Lebed thundered that Russia's economic collapse had created a more volatile situation than in 1917³.

These visions, as in the case of previous expectations, have fallen flat. Perhaps a million to a million-and-a-half, a tiny minority of those affected by wage-debts, actually took to the streets nation-wide on 7 October and the demonstrations were orderly and peaceful. Aside from Moscow and St Petersburg most of the demonstrations were small. In Vladivostok 4,000 took to the streets, in Krasnoyarsk 3,000, in Yekaterinburg 6,000. Even in Moscow the turn-out was disappointing, totalling perhaps under 100,000, with the Communist Party and several radical splinter groups having to shelve their plans of holding separate rallies for a lack of demonstrators⁴.

While it is very difficult to make sound predictions in the case of Russia, a scenario of mass civil unrest leading to a revolution of whatever form can, for the time being, be ruled out.

Certainly the potential for mass civil unrest appears to exist. A recent independent survey, conducted by ISM research, estimated that 57% of Russians are not receiving their wages and a further 25% are being paid irregularly, with only 18% of those surveyed being paid regularly⁵. The wage debt as of 1 September was estimated at RUB88bn (approximately USD7bn) and after the rouble's devaluation in August 1998 average wages have fallen to USD70/month. Devaluation and the accompanying inflation have also sent figures for those living below the official subsistence level rocketing. According to Goskomstat, the figure had been steadily trending downwards from 35% of the total population in 1992, to a low of 19.6% in June 1997. Through the first half of this year, the figure was hovering around 21-22%. But since devaluation the percentage of all Russians living below the subsistence level has jumped up again, reaching 30.1% in September. In September Goskomstat put the subsistence level at RUB552/month per person (under USD50)⁶.

Russians as a whole, however, remain un-mobilised, apolitical, with a low level of militancy, their weary patience intact, and presenting a low threat to political stability. While this may appear to be self-evident, it is more difficult to rationalise. Perhaps the simplest method for deriving possible arguments is by following up the comparison of the present day situation with that in February 1917. Without entering into a discourse on the relative merits of the arguments surrounding the causes of the revolutions in that year let us consider some of the differences.

Among the first things to spring to mind is the fact that the worst affected areas are far from the political centre. The working population of Moscow has benefited significantly from market reforms and has seen large improvements in living standards. Moscow Mayor Yuri Luzhkov's maintenance of the 'propiska' or residency permit has also ensured that the city is not overwhelmed by the nation's disgruntled dispossessed.

This argument can be extrapolated - the paternalistic relationship that has evolved between enterprises and their labour force helps keep workers put and passive. As benefits such as access to health care, nurseries, housing, and even cheap goods via special stores are linked to the place of employment, even if wages are not paid, workers still have not only a stake in maintaining the present order, but also a reason to stay put. Staying put also often means maintaining family links and obligations that can act to moderate behaviour. This helps prevent the concentration of alienated volatile unemployed in urban centres.

The paternalistic relationship extends to local governmental structures. While the central government may claim that in some cases provincial governors have exacerbated the situation by diverting funds intended to pay wage arrears⁷, there is a far greater popular perception of local government as defenders of local interests than in 1917. In 1917 governors frequently found themselves the targets of popular hostility and mass violence as representatives of central authority. In the present day, however, local government officials are often seen supporting the demands of their constituents⁸. Conversely, this may also have the effect of dampening the escalation of civil unrest by depriving demonstrators in the regions of an immediate feasible target on which violence can be meted out.

E101

Similarly, while morale among large sectors of the military may be low, unlike Petersburg in 1917, Moscow and Russia's major cities are not filled with discontented recruits, free to roam the streets with easy access to arms. The mass of soldiers are kept in bases, concentrated outside major urban areas. Although there are questions as to what extent the military as a whole may be willing to suppress civic unrest, the transition of street protest into armed demonstrations featuring large contingents of military personnel is not an immediate prospect. There also appears to be an adequate number of MVD units and special forces with sufficiently high levels of discipline to contain and limit any public unrest.

Unlike in 1917 the government is also all too weary of the danger of civil unrest and does make attempts, however futile, to address the situation. The current government of Prime Minister Yevgeny Primakov has officially declared the clearing of payment arrears a priority. On the eve of the 7 October day of protest Primakov appeared in a televised address to promise the payment of arrears, maintenance of food supplies, and employment security through the clearing of debts between industry.

The government is also taking precautionary steps. Unlike Nicholas II in February 1917, who departed Petersburg on the eve of demonstrations, Defence Minister Igor Sergeev cancelled his scheduled visit to Greece in the first week of October, in order to be at hand should matters get out of control. Similarly select military units were placed in a state of readiness⁹. On 20 October, President Boris Yel'tsin also signed a decree barring "mass protests" in Moscow between the hours of 10 p.m. and 7 a.m. and limiting them to a maximum of five days. This provides a legal basis for the break-up or arrest of protesters.

In addition in 1917 there was a general consensus encompassing all sectors of society on the need to remove Nicholas II, now there are sufficient numbers of interested parties eager not to unleash the force of angry mobs. These include Russia's new entrepreneurial rich, large sectors of the intelligentsia, and even the same Communist Party and trade union leadership that has been issuing the calls to demonstrate and demand Yel'tsin's resignation.

The Communist Party is no longer a revolutionary party and has rejected this path. Its leader, Zyuganov, now cites figures such as Charles de Gaulle and Alexander III as his role models. On the eve of 7 October Zyuganov promised that his party would not incite violence and would prevent provocateurs stirring up trouble. Zyuganov is probably also aware that a nation-wide wave of civic unrest is just as likely to sweep him aside as Yel'tsin.

The Federation of Independent Trade Unions (FNPR) and its constituent unions, with some 45m members, uniting the bulk of Russia's adult population, is also no Solidarnosc. It is the direct descendant of the Soviet era All-Soviet Union of Trade Unions (VTsSPS) structure and unites not only Russia's workers, but also represents the "Red Directors" of Russia's enterprises. Since the 1920s, the unions have been as devoted to maintaining production and worker passivity as to defending worker interest and this tendency continues to the present day.

As the descendent of the VTsSPS, the FNPR has also inherited the considerable property of the Soviet-era trade unions. This property includes sanatoriums, holiday complexes, sports facilities, hotels and houses of culture, frequently in prime city centre locations. This portfolio was conservatively valued at RUB20-30 trillion old

roubles in 1997 and currently generates considerable income and influence for the union leadership¹⁰.

The union's property portfolio offers the government a powerful lever over the trade union leadership as the legal basis of the unions' ownership of the property is not steadfast¹¹. The property portfolio has attracted the interest of proponents of privatisation and provides the government with a means of 'punishing' union leadership for any 'disloyalty' by threatening to deprive it of its assets. This was the case after October 1993 when the leadership of the time, headed by Igor Klochkov, supported the Supreme Soviet. In the aftermath the government threatened to disband the FNPR and transfer its assets to the government for subsequent privatisation. The FNPR avoided this fate by replacing its leadership, with the moderate Mikhail Shmakov taking over from Klochkov. Shmakov's advocating 'social partnership' with the government, and the subsequent loyalty of the trade unions has led to the indefinite shelving of the government's plans¹². The union leadership thus finds itself treading a fine line between maintaining government support by attempting to keep discontent under control, and responding to the pressure from below from its membership to seek resolution of workers' grievances¹³.

Focusing on the moderation of the leadership is, however, perhaps too simplistic and narrow an analysis. There are, after all, uncompromising radicals such as Viktor Anpilov, leader of Labouring Russia (Trudovaya Rossiya), who do call for militant action and encounter a minimal response¹⁴. Perhaps seven decades of Soviet rule, seven decades of the most concerted government-led political mobilisation and class-conscious indoctrination known in the history of mankind, has succeeded in de-politicising, 'de-ideologising', and de-classing the population. Certainly the Soviet period has ingrained political scepticism, apathy and powerlessness into the Russian mentality.

Perhaps the crucial difference with 1917 is thus an ideological matter - the fact that presently there is little popular conception of possible alternatives. Little hope appears to exist that any change could bring about improvement, while there is great uncertainty as to what civil unrest will accomplish. The efforts of most disgruntled Russians are now focused on sheer survival through self-reliance, whether it be by retreating to subsistence farming of allotments, or trying to find alternate sources of income.

The belief in the need to pursue alternatives in 1917 was also fuelled by the most obvious difference that has so far been ignored - the presence of war. The war physically threatened the existence of Russia and the continuation of the existing order became popularly linked with failure in the war effort. Hence, in 1917, there not only existed conceptions of alternative socio-political orders, but also a universal perception that failure to institute change would endanger the very survival of Russia. This sense of urgency now appears to be absent.

Against this context, the prospects for the politicisation or radicalisation of the Russian masses needs to be considered. Certainly this winter will be a difficult one and will exacerbate popular discontent. This discontent could become a potent force for anyone capable of mobilising it, particularly in the next presidential elections. It could also be a potent force for local or regional leaders to exploit in the event of a de facto fracturing of the Russian federation. On its own, however, it is unlikely to threaten political stability.

ENDNOTES

1. Reuters 4 & 6 October 1998.
2. Segodnya, 3 October 1998.
3. Reuters, 5 October 1998.
4. Izvestiya, 7 & 8 October 1998, Segodnya, 8 October 1998, Radio Free Europe/Radio Liberty Newslines, 7 and 8 October 1998, Reuters, 7 October 1998.
5. As cited in the Economist, 3 October 1998, p 58.
6. As cited in Inter-fax Statistical Report, Vol VII, No 44 (319), 24-30 October 1998.
7. On 8 December 1998, for example, ITAR-TASS reported that the Finance Ministry had released a list of regions whose government it accused of misdirecting central funds that had been allocated for payment of wage arrears. The list included the Chukotka Autonomous region, Kemerovo and Magadan provinces, and Arkhangel. See also Trud, 6 & 27 November 1996.
8. See, for example, Nezavisimaya Gazeta, 4 April 1998.
9. Segodnya, 3 October 1998.
10. Nezavisimaya Gazeta, 23 April 1997.
11. In July 1992 the FNPR and the General Confederation of Trade Unions officially replaced the VTsSPS. The two unions concluded an agreement which divided the former property of the VTsSPS between them. This agreement constitutes part of the FNPR's charter which was registered with the Russian Ministry of Justice - see Nezavisimaya Gazeta, 23 April 1997.
12. Nezavisimaya Gazeta, 27 March and 23 April 1997.
13. See, for example Nezavisimaya Gazeta, 23, 27 & 29 March and 3 April 1997; Izvestiya, 9 April 1998.
14. See, for example, Nezavisimaya Gazeta, 26 March 1998, and Obshchaya Gazeta, 8-14 October 1998.

The Future of the Russian Banking System: Liquidation or Mergers?

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The devaluation of the rouble and the *de facto* liquidation of the domestic government securities market announced on 17 August 1998 threatened the survival not only of individual banks but of the Russian banking system as a whole. Six days later, the Kiriyenko cabinet was dismissed by President Yel'tsin, and the financial crisis was compounded by a governmental one, which lasted for more than three weeks, paralysing government decision-making at a critical time. The payments system froze, bank runs occurred and the rouble plunged. The confirmation of Yevgenii Primakov as prime minister on 11 September did little to improve matters; Primakov took three weeks to produce a government and did not unveil anything resembling an anti-crisis plan until the very end of October—and even that amounted to little more than a statement of aims and objectives which were, in any case, subject to continuous revision.

With governmental decision-making virtually paralysed, the future of the banking sector has depended above all on the actions of the Central Bank of Russia (TsBR), of the banks themselves, both local and foreign, and of provincial and republican administrations, who were far more active in the wake of the collapse than the federal government. Their responses to the crisis therefore constitute the heart of this paper. The following section considers briefly the position of the banks prior to devaluation and sketches out the main elements of the package announced by the authorities on 17 August. The succeeding sections consider the responses first of the TsBR and then of the other major players involved—Russian and foreign banks and regional authorities. This is followed by a brief conclusion.

The Banks' Exposure and the August Collapse

As the pressure on the rouble mounted after October 1997, the TsBR found it ever more difficult to reconcile its two principal objectives: maintaining the stability of the banking system and the stability of the rouble. These two aims were closely interlinked, for failure to achieve either would raise the risk of failure with respect to the other. On the one hand, a sharp rouble devaluation would almost certainly provoke a systemic banking crisis; on the other hand, the liquidity injections required to avert or address a serious banking crisis would jeopardise the relative financial stability achieved after 1994. A banking crisis would trigger a flight not only from the banks but from the rouble itself. However, if the pursuit of these two goals was closely linked in principle, it was fraught with contradictions in practice: steps taken to protect the rouble aggravated the banks' problems, while any measures aimed at shoring up the banks would undermine the rouble.

The banks themselves were likewise aware of the problem: while they regularly complained about the costs which the rouble's defence imposed on them, they knew

E101

the sector as a whole to be seriously exposed in the event of any rouble devaluation. The extent of this exposure is impossible to quantify exactly, owing to doubts about the completeness and accuracy of the banks' reporting of their positions to the TsBR and to the fact that much of their exposure was off balance sheet anyway (chiefly in the form of rouble-dollar forward contracts). Moreover, the TsBR publishes several different data series which include varying estimates of commercial banks' foreign assets and liabilities without explaining the differences.¹ All the series agreed, however, that the banks' foreign liabilities exceeded their foreign assets by the end of 1997, perhaps by as much as \$7.2bn.² By 1 July this figure had reached nearly \$8.1bn — a very large exposure for a sector with total capital of only about \$25.3bn as of the same date. There was, in addition, the off-balance sheet exposure arising from an estimated \$6bn worth of rouble-dollar forwards.³ This may have been as little as half the total forward exposure, which was, moreover, concentrated among the larger banks. Shortly before the devaluation of August 1998, the rating agency Fitch-IBCA estimated that the 16 largest Russian banks held over \$1bn in syndicated loans from western banks, with some \$250m in payments due by mid-November and most of the rest due by late January.⁴

The banks' worst fears were realised on 17 August, when the authorities, which had for several weeks been effectively unable to roll over the short-term rouble-denominated government debt, gave up on their increasingly expensive defence of the rouble exchange rate. The government and the TsBR announced a package of measures including:

- a 90-day moratorium on the repayment of most private, non-sovereign foreign debt;
- a freezing of the GKO-OFZ debt, which was to be restructured according to terms the government would announce in a few days' time;
- a ban on foreign investment in short-term rouble-denominated treasury bills;
- limits for non-residents on currency exchange operations of a capital nature;
- a new rouble fluctuation band of 6.00 to 9.50 to the dollar for the rest of 1998, which sharply moved the ceiling of 7.13 to the dollar that was to have been maintained until 2000; and
- an end to the TsBR's policy of trying to maintain a daily rouble corridor.

The debt default and the devaluation together constituted a double-whammy which left even the strongest banks reeling. The survival of the great majority of Russian banks was very much in doubt.

The TsBR's Response

Given the failure of the government to respond to the crisis in anything like a coherent fashion, the actions of the TsBR during the months since the devaluation have been particularly important. While the politicians have dithered, the central bank, for better or worse, has acted. As the crisis intensified in the run-up to 17 August, the TsBR was pushed towards a choice between protecting the banks and defending the rouble. It chose the former, supporting the sector even at the expense of price and exchange-rate stability. In broadest terms, the central bank's campaign to help the sector through the crisis has consisted of three major elements: a straightforward bailout financed by an inflation tax on the rest of the

economy, a series of exercises aimed at unblocking the payments system, and a plan for restructuring the sector.

The Bailout

The bailout came first; indeed, it began even prior to 17 August. Monetary data for the first three weeks of August show a net issue of Rb33bn in credits by the TsBR.⁵ It is not known where these credits went, but it was almost certainly to commercial banks, which used them largely to buy dollars, thereby adding to the pressure on the rouble in the first two weeks of August. In principle, such credits would have been issued to help banks facing liquidity squeezes to service their obligations;⁶ in practice, much of the money probably ended up in offshore accounts to hedge against a possible devaluation and to ensure that the banks had funds safely abroad, out of reach of the Russian authorities, in the event that they lost their licences. These credits were issued in roubles, leaving the TsBR with rouble-denominated claims on the banks, the real value of which dropped sharply after 17 August: the TsBR effectively helped the banks to sell the rouble short.

The bailout effort intensified after devaluation. Reserve requirements were cut twice in the ensuing fortnight, each time leading to sharp falls in the exchange rate as banks used the newly released resources to buy dollars.⁷ Some of these funds will indeed have been used to ease the banks' liquidity problems, but much of the money is likely to have been transferred to offshore accounts very quickly. The TsBR also undertook expensive interventions on the foreign exchanges in order to protect banks with heavy exposures on the rouble-dollar forwards. The banks were to execute \$1.0-1.5bn worth of rouble-dollar forward contracts on 15 September, on which they stood to lose anywhere from \$200m to \$570m, depending on the exchange rate at which the contracts were executed.⁸ The rouble rebounded strongly during the first half of that day, reaching 7.50 to the dollar at 11.00am before falling back to close at more than 9 per dollar. This made for an average SELT exchange rate of Rb8.2555/\$1; the CME/EMTA rate used by many foreign banks in their transactions on rouble forwards reached an even more favourable Rb7.619/\$1.⁹ Deputy Prime Minister Aleksandr Shokhin subsequently confirmed that the rouble exchange rate had been manipulated in order to secure a more favourable rate for the banks' execution of their rouble-dollar forward contracts. Once the 15th was past, the TsBR allowed the rouble to plunge: within a week it reached 18.11 at the close.¹⁰ This pattern was repeated when the next lot of forwards came due the following month: the rouble strengthened markedly in the run-up to 15 October, reaching an average of Rb13.556/\$1 on that date. The following day it dropped to 15.5145. In the event, these exercises achieved little. Almost all the banks defaulted — it was clear beforehand that they would — but it was understood that some settlement of the forwards issue would need to be reached in due course, and the mid-month exchange rates were expected to provide a basis for any negotiations on the subject.¹¹

The most controversial elements of the rescue effort concerned the handling of the GKO-OFZ debt which the authorities had frozen on 17 August. The punitive terms announced in late August for the restructuring of this debt¹² fell below the markets' already low expectations and, in the view of many observers, treated resident investors better than non-residents. By early September it was clear that a revision of the terms would have to be negotiated with foreign creditors. In the meantime, the government insisted that it had observed, and would continue to observe, the principle of equal treatment of resident and non-resident investors. However, the TsBR, faced with the need to get the payments system functioning again and prevent a complete banking collapse, thought otherwise. This was first publicly

E101

acknowledged on 15 September, when TsBR Chairman Viktor Gerashchenko stated that some commercial banks might be given preferential rescheduling terms. His words provoked much criticism, especially when it emerged the following day that such treatment was already a reality: on 14 September, the TsBR had issued three series of short-term zero-coupon bonds (KBOs) to selected commercial banks and had accepted frozen government securities as payment. The bonds were issued without public notification.¹³

Allowing the selected banks to use frozen government securities to purchase the new paper, which carried yields to maturity of 60% per annum, violated the commitment to equal treatment of investors in the debt restructuring and left the TsBR accepting virtually worthless paper in return for bonds which would in due course be redeemed for money.¹⁴ The arrangement also contradicted the purported purpose of launching KBOs in the first place: when organising the first KBO auction at the beginning of September, the TsBR had said it was trying to create a market in a rouble-denominated instrument to give banks a reason not to buy dollars.¹⁵ With the GKO-OFZ market frozen and the stock market in free-fall, banks had nowhere to turn but to the foreign exchange market. Yet for the KBOs to provide them with a 'suitable' rouble-based activity, they would have to be sold for roubles, not frozen government paper. The controversy was further aggravated when the TsBR unveiled plans for unblocking the payments system which also provided for the use of frozen government securities.¹⁶

The exact cost of the TsBR's rescue operation is impossible to determine: the bailout is still under way as of this writing (November 1998), much of the TsBR's activity has been untransparent, and official statements on the scale of support for the banking sector have been vague and sometimes contradictory. Gerashchenko stated that the TsBR had issued Rb72.5bn in credits to the banking sector between 17 August and 8 October 1998. It was far from clear what this figure included, but it certainly did not include the reductions in reserve requirements, the interventions in the forex market or the sale of KBOs for frozen government paper (which would appear on balance sheets as banks *lending* to the TsBR!). It probably also excluded the liquidity injected into the system by allowing banks to 'dip into' their remaining mandatory reserves to make payments. On 2 November, Gerashchenko said that total liquidity of Rb55bn had been supplied to the banking sector, but the breakdown he gave added up to Rb62bn, including Rb14bn in direct credits, Rb13bn in released mandatory reserves, and Rb 35bn in obligations to retail depositors 'taken on' by the TsBR.¹⁷ It is not at all clear how these numbers relate to the earlier figure of Rb72bn. In any case, TsBR officials admitted that support for the banks would be financed via straightforward emission if necessary: TsBR First Deputy Chairman Andrei Kozlov said on 17 September that the banks would be allowed to draw on their mandatory reserves to help clients make payments and that the TsBR would later ask them to sell frozen government paper to replenish the reserves. Asked where the money for such purchases would come from, he replied, 'Emission, of course, emission.'¹⁸

Nevertheless, the scale of the bailout should not be exaggerated. Base money in September-October rose by 16.4%, as against an 8.8% increase in official reserves (both gold and foreign exchange), which scarcely suggests an uncontrolled resort to the printing presses. Nor was the TsBR eager to accelerate the monetary expansion. Gerashchenko stressed the need to increase foreign exchange reserves in order to facilitate an easing of monetary policy without allowing the rouble to enter an inflationary free-fall.¹⁹ The TsBR leadership resisted parliamentary

pressure to revalue its official gold reserves upwards in line with market prices, an exercise which — on paper — would have added about \$1.5bn to the headline value of official reserves and thus provided a pretext for an expansion of the monetary base by around Rb24bn. Kozlov persuaded deputies that such a transparent accounting fiddle would ultimately weaken the rouble and hurt the budget.²⁰

More aid to the banks is in prospect, however: Kozlov has estimated that the TsBR's restructuring plan (see below) will require some Rb37bn in stabilisation credits by April 1999, and the total costs of the restructuring exercise will be significantly higher.²¹ Since hopes for foreign investors to provide much of the money needed to recapitalise the sector are highly likely to be disappointed, the state's role will be all the greater. Given the federal budget's anticipated fourth-quarter revenues of (at most) Rb70bn, this will clearly require either external financing, which is unlikely to be forthcoming, or monetary emission. The authorities were also increasingly clear about their willingness to cover the banks' forward obligations, which by mid-October were being included in the talks with western banks on the GKO-OFZ restructuring terms. The TsBR's preferred scenario involved the provision of hard-currency-denominated government securities to foreign investors as compensation for both the GKO-OFZ debt and the forwards.²² Foreign investors resisted this, and the forwards were excluded from the outline restructuring agreement reached on 6 November,²³ but it remains to be seen whether this means, as some suggested at the time, that the Russian authorities have concluded that they cannot afford to protect the banks from their creditors.²⁴

Tackling the non-payments crisis

Broadly speaking, there were two major justifications for the TsBR's bailout of the banks in the wake of the 17 August package. The first was that the combination of devaluation and default had constituted a major exogenous shock to the banking system and threatened to destroy banks that were systemically important and that — but for the government's actions — would have been perfectly viable. The second, and more immediate, concern was the need to unblock the payments system, which had seized up after 17 August, bringing the processing of payments throughout the economy to a standstill. This disruption threatened otherwise viable banks and real-sector enterprises, and, in view of the authorities' reliance on the payments system to collect taxes, the state budget. It was thus essential that the liquidity being injected into the sector by the TsBR be accompanied by steps to get the payments system working again and by measures to identify and liquidate failing banks.

On 17 September, therefore, TsBR First Deputy Chairman Andrei Kozlov unveiled the central bank's plan to resolve the banking sector's non-payments crisis through a series of centralised clearing sessions organised and run by the TsBR. These involved the netting of mutual payments, with priority being given to taxes, duties and other mandatory payments to state budgets and off-budget funds. Participation in the clearing sessions was mandatory, and the TsBR promised to penalise banks which failed to present all their payment orders to the Clearing Centre. This was particularly a danger with respect to banks whose payments would exceed their mandatory reserve funds, since the overdrafts which remained at the end of the processing were to be covered by the TsBR from the banks' mandatory reserves. These were then to be replenished by each bank using either its own funds or, as noted above, frozen GKOs and OFZs with maturities of 31 December 1998 or earlier, which the TsBR would accept at their *nominal* value.²⁵ It was not difficult to guess which option banks holding frozen government paper

E101

would choose. For all practical purposes, the central bank was offering to redeem this paper and to finance the redemption by credit emission. While this involved a *de facto* emission of new credit to the banking system, Kozlov and his colleagues argued that it held the volume of the new credit emission to the minimum necessary to resolve the non-payments crisis.

The TsBR's proposed use of frozen government paper in the scheme attracted much criticism, as it violated the equal treatment principle with respect to the debt restructuring. However, given that the freezing of the GKO-OFZ debt made it virtually impossible for the commercial banks to recover their liquidity, it was difficult to see how the rouble payments problem could be addressed without somehow bringing the frozen debt into the picture. The solution was to revise the terms of the restructuring, not to starve Russian banks of liquidity. The restructuring issue was basically within the competence of the government, which moved very slowly and clumsily in addressing it; the liquidity issue, however, was the TsBR's, and it chose to move quickly rather than waiting for the government to sort itself out on the matter. Nor were other holders of frozen securities (both non-residents and non-banks within Russia) the only ones angered by the proposed violation of the equal treatment commitment: it effectively penalised Russian banks which did not have substantial GKO-OFZ portfolios. Since no secondary trading in the frozen paper was permitted, these banks would have to use real money to replenish any reserves they had drawn down. In any case, the TsBR backed away from this element of its plan and has not, for the time being at any rate, accepted frozen government securities to replenish the reserve funds. In order to avoid disrupting the government's on-going negotiations with foreign investors over the fate of the frozen debt, the central bank is simply allowing banks to put off replenishing their mandatory reserves until early 1999.²⁶

The TsBR conducted three clearing exercises in a fortnight (18 and 25 September and 2 October). The initial results were moderately encouraging. The volume of payments made at the first was twice the recent average, and only 13-14% of the banks' mandatory reserve funds were spent, as against an expected 30%. The operation saw total debts reduced by Rb9.5bn, of which Rb5bn went to the budget. However, the exercise also involved the injection of Rb3.2bn into the sector, so most of the budget's gain was the product of *de facto* monetary easing.²⁷ During the second netting exercise, on 25-26 September, Rb10.6bn out of a total of Rb23.6bn worth of outstanding payments was executed. State budgets at all levels and off-budget funds were again the major beneficiaries, taking in almost Rb9.5bn. The banks tapped their FORs only to the amount of Rb1.96bn.²⁸ The third session was the largest: Rb11.1bn of a total Rb23.6bn worth of outstanding payments were executed. Budgets of all levels took in a total of Rb8.5bn.²⁹ It also appears that the banks made much greater use of their FORs in the third exercise: Gerashchenko reported on 14 October that the TsBR had injected Rb10bn into the sector during the clearing exercises, which means they drew on their mandatory reserves to the tune of Rb5bn in the third session.³⁰

Restructuring plans

The inflationary impact of these exercises was a high price to pay if all they achieved was a periodic reduction in the volume of outstanding payments. Whether the price was worth paying depended on whether the clearing sessions led to measures designed to address not merely the stock of outstanding payments but also the source of the crisis itself — the insolvency of large numbers of banks. This in turn depended on the extent to which the clearing sessions made it easier to

identify non-viable banks and on the willingness of the TsBR to move rapidly to wind such banks up. In principle, at least, the central bank was and is committed to doing just that. Practice may turn out to be another matter.

On 14 October, *Kommersant-Daily* carried details of the TsBR's restructuring plan, which has since been submitted to the State Duma.³¹ Under the plan, the banks are to be divided into four groups based on liquidity, solvency and systemic importance:

- banks 'having a sufficient capital base and not experiencing significant difficulties in managing current liquidity' (around 500 mainly small and medium-sized banks — about one-third of the total number);
- banks having adequate capital but facing liquidity problems;
- banks which are both illiquid and insolvent, which have no real prospect of recovery and which are not systemically important; and
- large, systemically important banks which have lost capital and are unable to continue operations without assistance, but which ought not to be liquidated 'because the social and economic costs would be too great'.

Only the third group is slated for rapid liquidation. The most promising of the first and second groups (around 200-300 banks) are to become the core of the new banking system. Banks in the second group may receive support from the state (at the federal or local level) in raising their capital, attracting new investment and personnel, and restructuring their operations. Plans are to be drawn up for them individually. Until these banks are restored to financial health, they are to be prohibited from accepting retail deposits or engaging in certain types of investment activity.

The plan stipulates that the restructuring of systemically important banks should be accompanied by changes in their management and by the reduction of previous shareholders' stakes by the amount of losses incurred prior to restructuring. Many banks are to be recapitalised under the plan, although it is not clear how this will be financed — state funds will have to play a role, as few serious investors, whether Russian or foreign, will be eager to participate. The authorities estimate that raising the top 20 banks to international standards of capital adequacy would cost \$10-12bn, but the finance ministry denies that the 1999 budget will include provisions for financing bank restructuring, apparently because the TsBR still hopes to negotiate multilateral credits to support the restructuring programme.³² Inclusion in this fourth group, however, does not, at least in principle, mean that a bank will be saved at any price. In some cases, a bank's balance sheets are to be divided into good and bad assets, with the former being transferred to a newly created bank in which the state and the bank's creditors will hold stakes. The old bank will hold a stake in the new institution but will itself retain all assets and liabilities connected with 'insiders' — legal or physical persons holding shares in it, companies in which it holds stakes, and firms linked to it by indirect ownership ties or common membership of a financial-industrial group. Thus, the insiders in a failed big bank could face loss of control over their best assets, a reduced ownership share in a new bank, and the burden of sorting out the remainder of their balance sheet problems within the framework of the old bank.

Finally, the TsBR has proposed the creation of a Centre for Bank Restructuring to take over banks' bad assets and restructure them. The experience of such institutions in other transition economies suggests that such a centre is likely to achieve little restructuring, although by relieving the banks of non-performing

assets it will free them to resume operations. Moral hazard, therefore, is a concern. It is also proposed that the new agency be given the right to acquire controlling stakes in banks ‘for their real value’ for a maximum of three years. In short, nationalisation (or, in some cases, re-nationalisation) — a prospect much feared by some banks and strongly desired by others — is to be a temporary measure and a prelude to (re-)privatisation.³³

Much, of course, depends on the TsBR’s implementation of the plan, which will meet resistance from those banks threatened by it — and, in many cases, from the political and commercial interests aligned with such banks. The question of which failing banks are classified as ‘system-forming’ and therefore worthy of some sort of rescue is highly politicised, and it already appears that almost every one of the large Moscow-based banks will be included.³⁴ While Gerashchenko initially suggested that only ten banks might fall into the fourth category, Deputy TsBR Chairman Aleksandr Turbanov’s comment that the central bank regarded 104 banks as being of ‘strategic’ importance reinforced fears that the TsBR would try to rescue too many banks.³⁵ The TsBR’s decision to ask the government to join it as a co-founder of the Centre for Bank Restructuring partly reflects a desire to avoid being the sole target of lobby pressures and to share responsibility for the success or failure of the restructuring with the government.³⁶ Implementation of the plan will also stretch the TsBR’s personnel resources to the limit: the expertise needed to evaluate banks and determine what to do with them is in short supply, and this cannot be remedied overnight. The need for legislation on a number of key points³⁷ means that there will be delays in even getting started, and because many banks are still not disclosing the full extent of their payments problems, it will be some time before mass bankruptcies can begin. Even given the political will to clean out the sector quite ruthlessly, resource constraints, both financial and human, will ensure that the restructuring does not proceed as rapidly as planned.

The political will to carry through a genuine restructuring of the sector in any case appears to be lacking. The immediate post-devaluation bailout will probably turn out to have been an alternative to restructuring rather than a prelude to it. By early November, there was increasing evidence that the TsBR and the government alike were reluctant to liquidate major banks. While the TsBR has promised that the evaluation of most banks would be based on ‘objective criteria’ based on their balance sheet data for October 1, ‘a more subjective approach’, which would be ‘individual for each bank’ is to be adopted with respect to the largest banks. In Russian conditions, a ‘subjective’ approach is certain to be a highly politicised one. Many observers suspect that the TsBR’s restructuring agenda is as much political as economic, a suspicion reinforced by the non-transparent character of much of its rescue activity.³⁸ Thus, on 29 October, the TsBR withdrew the licence of Inkombank but announced that it was not withdrawing the licence of Tokobank, which had been in serious difficulties since the spring. This prompted suspicions that the rough treatment of Inkombank was politically motivated rather than a reflection of a new, tougher line on the handling of troubled banks.³⁹ Inkombank is closely linked to the gas monopoly, Gazprom, and Gazprom’s interests on the Inkombank board are represented by Gerashchenko’s predecessor as TsBR chief, Sergei Dubinin. Neither factor is likely to have endeared Inkombank to the new leadership of the central bank. Ironically, Inkombank, along with SBS-Agro, had fought off a TsBR attempt to take them over only a few weeks earlier.⁴⁰ In any case, the more general reluctance of the TsBR to withdraw licences is a major problem for creditors: under current Russian law, bankruptcy proceedings cannot be initiated against a bank until it has lost its licence. Allowing failing banks to keep their

licences gives bank insiders longer to strip assets before creditors can press their claims.

Particular attention has also been focused on the TsBR's treatment of the state savings bank, Sberbank, and the foreign trade bank, Vneshtorgbank, in which the TsBR holds majority stakes on behalf of the state.⁴¹ Concern for the balance sheets of these two state-owned banks may have prompted the interventions on the forex markets ahead of the forwards execution dates: Sberbank and Vneshtorgbank held the bulk of the forward contracts, perhaps as much as 60-65% in the case of the forwards to be executed on 15 October. Propping up the rouble may have saved them well over \$100m.⁴² The TsBR's unilateral attempt to move retail customers to Sberbank provoked a firestorm of criticism and fierce resistance on the part of all the banks involved except Inkombank, which was in due course rewarded for its acquiescence with the loss of its licence.⁴³ This was perhaps no coincidence: holding substantial retail accounts and/or the accounts of politically sensitive sectors, such as SBS-Agro's agricultural clientele, makes it easier for a bank in trouble to lobby for support rather than liquidation.

Suspicious of favouritism were reinforced by Gerashchenko's remarks to the Federation Council concerning the cost of bailing out the banks. Gerashchenko stated that the TsBR had issued Rb72.5bn in credits to the banks during the period from 17 August to 8 October, including Rb10bn injected during the three payments clearing sessions and Rb25bn in Lombard and overnight loans. However, he also claimed that seven of the largest commercial had received Rb12bn. Since the balance is unlikely to have gone to smaller banks, the chairman's words prompted suspicions that most of the remaining Rb60bn had been channelled primarily to Sberbank and Vneshtorgbank.⁴⁴

The final reason for scepticism about the restructuring of the banking sector has little do with the actions of the TsBR or the banks. As more than one transition economy has learned the hard way, financial sector restructuring cannot be pursued in isolation. The present government's manifest lack of interest in any serious structural reform of Russian industry and agriculture therefore imposes limits on what even a well designed and aggressively implemented banking sector restructuring plan could achieve. Imposing hard budget constraints on banks will be difficult if not impossible unless real-sector firms are also subject to them.

The Banks' Response

Russian commercial banks were not idle during the months following devaluation, nor were their foreign competitors or regional authorities, who, in contrast to the central government, quickly became actively involved in the restructuring of the sector. With the exception of foreign banks, which grew increasingly frustrated at their inability to take effective action against bad debtors, the responses to the crisis were overwhelmingly predicated on the assumption that massive state support would be forthcoming and that what the banks must do was to position themselves so as to receive that support. This is hardly surprising. Although it is regarded by some as the sector 'most advanced as far as the progress of market reforms is concerned',⁴⁵ the banking sector has a strong claim to being the most subsidised in the Russian economy. The subsidies it has received from the state have generally not been acknowledged as such, taking the form of privileged access to state funds, sweetheart privatisation deals and regulatory favours, and they

E101

have, partly for this reason, persisted even as state support for many other sectors has dried up.⁴⁶ Thus, when the crisis hit, the capitalists of the banking sector looked to the state for protection.

Mergers and alliances

The major banks' immediate reaction was to merge and form alliances in order to enhance their chances of securing official support and surviving the collapse. On 24 August, Inkombank and National Reserve Bank (NRB) — stakes in both of which are held by gas giant Gazprom — announced the formation of a new banking group. This quickly became known as the 'Gazprom syndicate', although Gazprombank refused to join it for fear of losing business as a result of a redistribution of Gazprom's accounts. They were joined some days later by Alfa-bank, Avtobank and Mezhkombank. On 25 August, Oneksimbank, Bank Menatep and Most-Bank announced a merger under the leadership of Oneksimbank, setting aside the bitter political and commercial rivalries of the last several years. A number of other groupings in Moscow and the regions formed alliances and 'pools' to help them weather the crisis.⁴⁷ While the ostensible aim of these alliances and mergers was the consolidation of financial resources, in many cases the real motivation appears to have been the consolidation of political resources: the calculation was not that the balance sheets of the merged banks would be stronger but that large banks would prove more difficult to liquidate than small ones: the aim was to create, more or less overnight, banks that were too big to fail.⁴⁸ It was explicitly stated from the outset that the participants in the Gazprom syndicate, for example, would remain separate legal entities and would therefore not answer for each other's liabilities.

The crisis thus initially seemed to be accelerating the consolidation of the sector, which the central bank has been trying to foster for several years — but at a high price. The speed with which the mergers and alliances were announced left little doubt that they had not been carefully prepared and that many might never happen. Subsequent developments quickly bore this out. Within 24 hours of joining the group, Alfa-bank, which seems to have weathered the crisis better than just about any other large private bank,⁴⁹ announced that it was not inclined to enter any alliances, and while NRB and Inkombank were negotiating the terms of an exchange of shares (which never in fact took place), Avtobank and Mezhkombank decided to form an integrated holding company on the basis of which they proposed to create a single banking structure. In the months that followed, NRB proved unable or unwilling to shore up Inkombank, which lost its licence in late October; NRB did, however, emerge as the leading candidate to take over what was left of Inkombank after it failed. Fears that more viable banks would be dragged down by the burden of supporting weaker partners thus proved largely unfounded for the simple reason that none of the banks were seriously committed to supporting one another. Nonetheless, proponents of the rapid regrouping of the leading banks argued that if they helped to keep the payments system functioning in the near term, they would serve an important purpose whatever their longer term fate.

The most significant of the post-crisis mergers was that announced by Oneksimbank, Most-Bank and Bank Menatep. In terms of assets, the banks occupied sixth, eleventh and fifth places respectively in the sector prior to devaluation, and each brought its own specialisation to the merger: Oneksim's base of large corporate clients and its involvement in foreign trade-related activities,

Menatep's focus on interbank transactions and financial market operations, and Most's retail business.⁵⁰ Their total assets at mid-year amounted to around Rb66bn (around \$10bn at the July exchange rate). Officially, these long-time antagonists were committed not merely to an alliance but to a merger. Things initially looked quite promising for the trio of 'oligarchic' banks. The utterly unprecedented speed with which the newly formed Rosbank received its licences⁵¹ suggested that it was viewed with favour by the authorities and could look forward to a privileged future. Its formation was welcomed by the TsBR, the finance ministry and prominent Duma deputies, including representatives of the left-wing opposition.⁵²

In this context, government and TsBR promises that any new monetary emission would be 'controlled', so as to minimise its inflationary impact, took on new meaning. They appeared to mean that new emissions would be channelled through selected banks, whose activities would be monitored by the authorities. In this way, the government hoped to ensure that soft credits were channelled into the payment of wages and support for industry and not into financial speculation. That, at least, was the argument being put forward by proponents of monetary relaxation. In practice, such monitoring was likely to be ineffective, but it appeared for a time that Rosbank and a select group of its rivals were to play key — privileged — roles in just such an arrangement. The alternative explanations put forward for the unlikely alliance generally concerned some arrangement for using the new structure to enable the three banks to shed unwanted liabilities and non-performing assets in one of three ways: by transferring the best of their portfolios to Rosbank while allowing the old banks simply to sink without a trace; by transferring the *worst* of their portfolios to Rosbank; or by using Rosbank to channel unwanted assets and liabilities to a bank which would be gutted and sacrificed, probably MFK.⁵³

By October, however, the situation was far more muddled. The participating banks were in disagreement about the terms of the merger, which had been complicated by the addition of Oneksim's traditional partner, MFK, to the group, and both Oneksimbank and Menatep had expressed their determination to remain in existence on their own, a view endorsed by the chairman of Rosbank's executive board, Igor Antonov, who also happened to chair Oneksimbank's executive board.⁵⁴ There was as yet no evidence that the new bank was being used to free the old ones of their liabilities, nor had Rosbank been assigned any special role in the government's plans for a monetary emission. Antonov's comment that the completion of the merger could, owing to its complexity, take 'five, seven, ten years' suggested that all involved were losing interest.⁵⁵ The appointments of Primakov and Gerashchenko may have reduced the appeal of the whole Rosbank project, as neither was particularly friendly with Russia's 'oligarchs' and neither was likely to accord Rosbank the kind of privileges its founders may have been anticipating.

The role of foreign banks

The authorities have indicated that they expect foreign banks to play a significant role in the recapitalisation and restructuring of the sector, not least through debt-for-equity swaps. Gerashchenko has spoken of foreign stakes of up to 50% in some major banks. Such proposals have met with understandable scepticism from both Russian and foreign observers. Foreign banks' role in the sector's future is likely to be limited, for several reasons. First, most foreign banks will be warier than ever of Russia in general, in view of the high degree of political and economic uncertainty, corruption, the weak rule of law and poor corporate governance. Secondly, the costs and risks of engaging in conventional banking activities in Russia are high compared to the potential gains. Thirdly, the Russian banking sector has been

strongly insider-oriented throughout the 1990s, and neither the bailout of selected banks since August nor the authorities' manifest reluctance — so far, at least — to allow foreign creditors to bankrupt major Russian banks will make the sector more attractive to outsiders. Finally, although some have suggested that it might be lifted, Gerashchenko has confirmed that the 12% cap on the foreign share in the sector's total capital is to remain in force. This is not much of a restriction on entry, given that the foreign share has been around 4.5-4.7% in recent years, but it reflects a more general commitment to limiting foreign penetration of the sector.⁵⁶

The most likely outcome will be for western banks in Russia to continue to focus on relatively sophisticated, highly profitable niche activities and the servicing of foreign clients and a handful of the most promising Russian corporates. Given the overheads involved in creating large branch networks, they will probably remain concentrated in Moscow, St Petersburg and a handful of other cities, and they are unlikely to move seriously into the retail market, partly because of the high overheads involved and partly because of Sberbank's privileged position in the retail market. Some western banks will no doubt take equity stakes in Russian banks, but most will be reluctant to do so. Those acquiring part ownership of Russian banks will be strongly inclined to press for controlling stakes, fearful that Russian insiders will otherwise thwart their attempts to restructure the banks' operations.

In any case, debt restructuring may keep many western banks more involved in Russia than they might like. The outline agreement on the GKO-OFZ debt reached on 6 November left western banks accepting new rouble securities for the frozen paper, as well as an initial cash pay-out also in roubles. It remained to be determined when and at what exchange rate they would be able to repatriate the cash and how quickly they might liquidate and repatriate the new rouble paper they were to receive. Some foreign creditors criticised the deal arguing that the lead negotiators were western banks with a substantial presence in Russia which they could not quickly abandon and that the leaders therefore accepted a rouble settlement, something most non-resident GKO holders will not welcome.⁵⁷ Defenders of the deal reply simply that, as the original debt was in roubles, it is difficult to insist on a hard-currency settlement. A second London Club restructuring could further tie western banks to Russian activities. By mid-November, the government had admitted that it would need to restructure much of its foreign debt.⁵⁸ In practice, this was all but certain to mean the debt inherited from the Soviet regime which is owed to the Paris and London Clubs.⁵⁹ Vneshekonombank chief Andrei Kostin raised the possibility that Russia might offer creditors shares in privatised companies as part of a restructuring package, citing the success of such swaps in dealing with debt problems in some Latin American countries.⁶⁰ In Russia, however, debt-for-equity swaps would be fraught with problems arising from the dearth of assets that would really attract investors, the fact that many of the most attractive ones are in politically sensitive sectors, the poor quality of Russian corporate governance, and the poor record of the Russian state in protecting foreign investors' property rights.⁶¹ Investors would in many cases want to insist on controlling stakes, which might be more than the Russian authorities could or would offer.

Finally, the issue of the Russian banks' rouble-dollar forwards is still to be resolved. Most Russian banks simply defaulted on them in September-October, despite the fact that their foreign counterparties doubted both the legality of the debt moratorium and the claim that (whether legal or not) it constituted a valid excuse for default.⁶² Indeed, many western bankers fear that the moratorium has simply

provided Russian bankers with 90 days in which to strip the assets of their banks before creditors can take action against them.⁶³ In an effort to strengthen Russian banks' claim to *force majeure*, the TsBR issued an order stating explicitly that forwards involving non-residents were subject to the debt-service moratorium and should not be executed.⁶⁴ Suits were filed in Russia and the United Kingdom over the issue, with the Russian side winning the first round in Moscow, where Tokobank was being sued, and losing in the UK, where Lehman Brothers seized the UK accounts of Inkombank and Oneksimbank.⁶⁵ The Moscow ruling, if upheld, is particularly disturbing to western banks: it held that the forward contracts were 'wager-type contracts' as defined by the civil code, and that they are therefore only subject to litigation in the event of fraud. Litigation in Russia is likely to be of limited use to foreign creditors even if the Russian courts do show greater willingness to uphold the contracts. This is because the forwards suits are likely to trigger the bankruptcy of the affected banks, which raises problems for the foreign plaintiff. First, under current law, further movement on the case will depend on the TsBR's willingness to remove a bank's licence and thus allow it to be bankrupted.⁶⁶ Secondly, Russian bankruptcy law compensates unsecured creditors only after the costs of the bankruptcy are covered and the demands of a range of other creditors are satisfied, including the state, employees and secured creditors. Thus, western banks which are not able to reach negotiated settlements with their Russian counterparties will have little recourse unless the latter hold assets abroad for which the foreign creditor can sue in a foreign court.

The regional dimension

The post-crisis position of the country's small and medium-sized regional banks differs markedly from that of the large Moscow-based banks which dominated the sector prior to devaluation. The freezing of the payments system, the insolvency of a number of major banks and the population's loss of faith in the rouble and the banking system hit all Russian banks hard, regardless of size and location, but other aspects of the crisis impinged less directly on the regional banks. Because they had far less access to international markets, banks outside the capital generally had little in the way of foreign liabilities, on or off balance sheet. The devaluation thus did not have such an immediate and direct effect on their financial health. They also tended to hold less government paper and therefore were less affected by the freezing of that market.⁶⁷ Indeed, the large banks' problems after 17 August were so severe as to prompt fears that a mass shift of corporate accounts to relatively healthy medium-sized banks might actually overwhelm the latter, leading to a deterioration in the quality of service to clients and problems in formulating financial policies. Moreover, the impact of the crisis on the real sector will in due course feed through to the regional banks: they did not immediately lose their liquidity on 17 August as did their larger rivals, but the quality of their lending portfolios has deteriorated markedly, a fact which will become increasingly evident in the coming months.⁶⁸

There is a double irony in this situation. First, the banks with the closest links to the federal government have suffered the greatest losses. Indeed, their political connections cost them dearly in the run-up to devaluation: as GKO yields soared and the rouble came under attack, the leading banks came under increasing pressure to carry on lending to the government. In some cases, state officials reportedly assured the bankers that neither devaluation nor default were in prospect, that the banks would therefore earn handsome returns on their GKO-OFZ investments and that the government would remember their willingness to help it through the financial squeeze, as it did after the 1996 presidential elections. Such

comments left many leading bankers feeling betrayed on 17 August.⁶⁹ The second irony in the situation is that, under the TsBR's regulatory regime, many of the least-affected banks were headed for extinction prior to 17 August. This is because the minimum capital requirement for Russian banks was to rise to Ecu1mn from 1 January 1999 for a limited licence and to Ecu5mn for a general licence. By mid-1998 it was clear that the great majority of Russian banks were unlikely to reach these levels. If they failed to raise even the lower figure, they would face a choice: reorganisation into a non-bank credit institution, liquidation or merger with another bank. In the wake of the crisis, however, the TsBR pushed the requirement back two years to 1 January 2001.⁷⁰

In these circumstances, it is hardly surprising that regional banks and regional governments alike viewed the big banks' problems with more than a little *schadenfreude* and were sharply critical of the centre's commitment to bailing out the largest banks at almost any price.⁷¹ The Samara provincial administration accused the TsBR in early September of trying to channel financial resources from the regions to the centre, resolving the problems of the central government and the Moscow-based 'federal' banks at the expense of provincial Russia.⁷² Not only local banks but also the local branches of Moscow banks were instructed to follow the administration's orders rather than the TsBR's. Such resentment is nothing new, of course, and it has not stopped governors from simultaneously lobbying the TsBR for credits for their banks.

Yet if their problems were far less severe, regional banks' responses to the crisis were similar to those of the Moscow-based giants in everything save scale. Their first reaction was to form alliances and regional 'transaction pools', particularly in provinces like Samara, which have emerged as important financial centres for surrounding regions. (Other such regional financial 'hubs' are Novosibirsk, Yekaterinburg, Vladivostok and, of course, St Petersburg.) A regional response was evident even in Moscow, where access to the GKO-OFZ market meant that middle-sized banks had suffered more than most. A 'Moscow banking pool' was formed under the leadership of the Bank of Moscow⁷³ and including Mosbiznesbank (of which the Bank of Moscow has since taken control), Moseksimbank, the Moscow Industrial Bank, Ogni Moskvyy, Mosvodokanalbank and Zenit. The banks declared their aim to be supporting the payments system in Moscow. In Moscow and in many other regions (perhaps most), this process was actively promoted by provincial and republican administrations anxious to ensure that the processing of payments continued, at least locally.

Many regional authorities have gone much further than this, imposing restrictions on financial flows across provincial borders, taking over *de facto* control of the operations of the payments system and, in some regions, taking minority or even majority stakes in prominent local banks, something the latter seem in most cases to have welcomed, not least because 'nationalisation' by regional authorities holds out the prospect of handling regional accounts.⁷⁴ There has also been talk of regional currencies circulating in parallel with the rouble, but it makes more sense to think of these as simply the latest proposals for using monetary surrogates in transactions with regional budgets.⁷⁵ Reliance on surrogates is likely to increase even in regions where the authorities refrain from provocative statements about provincial currencies. Since such surrogates will inevitably be less liquid than the rouble, they will trade at a discount to the national currency (however weak the latter may be), offering taxpayers an easy way to discount their tax bills. The danger is that, under the iron working of Gresham's law, regional governments will

soon be receiving most or all of their income in the form of their own 'IOUs'. Restrictions on the circulation of such surrogates (especially on secondary trading) could help prevent, or at least delay, this, but only by making regional 'money' still less liquid and thus reducing its role in facilitating local payments. Such activities also represent a serious risk of disruption to interregional economic ties.⁷⁶

Regional banks will play a crucial role in the resurrection of the interbank market, which, like the payments system, must be reconstructed if the sector is to function. The most likely path will be for both payments and interbank lending to revive first within the (mainly) regionally based pools which have been forming on the basis of a combination of mutual trust and administrative pressure/support.⁷⁷ In the short term, the involvement of regional governments is crucial here, for it greatly reduces the perceived risk of cooperation among banks in the everyday processing of payments, as well as in riskier operations such as interbank lending. Regional authorities are also likely to play a key role in facilitating the integration of these transaction and lending pools across regional boundaries. The risks here are noticeably greater. Banks A, B and C, for example, may be closely connected and comfortable dealing with one another. However, C's desire to do business with bank D from another region indirectly exposes A and B not only to the risk of dealing with the unknown D but also to the problems which might afflict other banks to which D is closely connected. The involvement of regional governments can reduce the demand for trust among the players and thus facilitate the re-establishment of links across regions. The problem with this scenario is that the implicit guarantees which facilitate the reconstruction of ties across the sector are being extended by entities which are primarily interested not in the soundness of the system but in protecting their own banks and industrial enterprises.

Conclusion: Liquidation or Mergers?

A short answer to the question posed in the title of this paper might run as follows: altogether too little of both. TsBR First Deputy Chairman Andrei Kozlov's 12 November prediction that almost half the country's banks face closure over the coming months⁷⁸ might suggest that a tougher line toward the banks is in the making. However, Kozlov cited lack of funds as the reason so many banks would not be saved. More generally, the present survey of responses to the crisis suggests two closely related, and rather depressing, conclusions. First, it is increasingly clear that too many banks will be rescued and that choices about which banks are to be saved will be made largely on political grounds. Secondly, it is equally clear that, politics apart, the authorities' restructuring drive is not focused on the need to create a safe, sound banking system. They are far more concerned with the smooth functioning of the payments system than with virtually anything else connected with the banking sector. This has been the mantra of policy-makers from President Yel'tsin on down since 17 August, reflecting a more general tendency to see the banking system primarily in terms of its Soviet-era role as the state's 'paying agent and "financial policeman"'.⁷⁹ The two are closely linked, of course: the government relies heavily on the banks to enforce tax collection via the payments system; the breakdown of that system is thus a direct threat to the budget's revenue base. This combination of political favouritism and state priorities means that the current restructuring of the sector is unlikely to foster the development of institutions capable of acting as effective financial intermediaries, one of the principal requirements of any successful market reform.

ENDNOTES

¹ It appears, for example, that some estimates are based on hard-currency claims on and debts to non-residents, while others concern all hard-currency assets and liabilities, including those owed to Russian physical and legal persons. Some are also based on IMF data, which may not correspond to those compiled by the TsBR on the basis of commercial banks' reporting of their positions. Vneshekonombank is also excluded from some series.

² Unless indicated otherwise, all data concerning the external exposure of the banks are taken from the TsBR's web site (<http://www.cbr.ru>); Vneshekonombank is excluded from the data.

³ *Financial Times*, 13 November 1998.

⁴ Agentstvo Marketing i Konsalting, 28 August 1998.

⁵ The monetary base rose by Rb1bn while reserves fell by \$5bn. *Russian Economic Trends Monthly Update*, 4 September 1998, p. 12.

⁶ This was the TsBR's official justification for issuing the credits; it explicitly, though unconvincingly, denied that they would be used to purchase dollars. Agentstvo RosBiznesKonsalting, 31 August 1998.

⁷ For details of the cuts, see *Vremya MN*, 3 September 1998 and 10 September 1998; *Finansovye Rossiya*, 10 September 1998; and Ukazanie TsB RF ot 01.09.98 № 335-U. While the first cut, which took effect on 24 August, was a uniform one percentage point reduction, the second, from 1 September, cut requirements for banks based on their exposure to GKO and OFZs. Mandatory reserve requirements were cut from 10 to 5% for banks with 40% or more of their pre-devaluation assets in GKO and OFZs, and to 7.5% for those with 20-40% of their assets in GKO/OFZs. Reserve requirements remained unchanged for banks with less than 20% of their assets in the now-frozen government paper.

⁸ United Financial Group, *Russia Morning Comment*, 14 September 1998, p. 3.

⁹ United Financial Group, *Russia Morning Comment*, 16 September 1998, p. 4.

¹⁰ ITAR-TASS, 22 September 1998.

¹¹ *Reuters*, 16 September 1998. In fact, forward contracts concluded with non-resident counterparties fell under the 90-day debt-servicing moratorium (Ukazanie TsB RF ot 4.09.98 № 344-U), and the TsBR on 12 October ordered that the execution of forward contracts among residents be delayed until the new year. See Ukazanie TsB RF ot 12.10.98 № 380-U, and *Segodnya*, 13 October 1998. However, it was clear that foreign banks were not convinced that the moratorium constituted a valid reason for default and that some were likely to sue their Russian counterparties, whether in Russia or abroad. The exchange rate on the 15th of the month thus remained important to the banks.

¹² For the original terms of the debt restructuring, announced in late August, see Postanovlenie Pravitel'stva RF ot 25.08.98 Shch1007 'O pogashenii gosudarstvennykh kratkosrochnnykh besкупonnykh obligatsii i obligatsii federal'nykh zaimov', and the accompanying *porjadok*. As of this writing, negotiations on the revision of these terms have been under way for a month but have yet to bear fruit.

¹³ There was a precedent of sorts for this: the finance ministry had sold 'special' OFZ issues to the TsBR prior to the 1996 presidential election.

¹⁴ There were three such secret issues (211002, 211003 and 211004) worth Rb3bn each and carrying terms of 30, 58 and 86 days respectively. All were issued on 14 September.

¹⁵ *Finansovye Izvestiya*, 1 September 1998.

¹⁶ See below for details of the scheme.

¹⁷ The meaning of the Rb35bn was particularly unclear, since Sberbank had taken on only Rb9bn in retail deposits from commercial banks. United Financial Group, *Russia Morning Comment*, 3 November 1998.

¹⁸ *Reuters*, 17 September 1998.

¹⁹ ITAR-TASS, 14 October 1998.

²⁰ *Kommersant-Daily*, 16 October 1998; Agentstvo Finmarket, 16 October 1998.

²¹ ITAR-TASS, 22 October 1998.

²² *Finansovaya Rossiya*, 15 October 1998.

- ²³ *Financial Times*, 6 November 1998.
- ²⁴ *Moscow Times*, 7 November 1998.
- ²⁵ Full details of the clearing scheme were set out in Ukazanie TsB RF ot 17.09.98 № 351-U, which appeared in *Biznes i banki*, 2 October 1998. See also *Vremya MN*, 8 October 1998.
- ²⁶ *Vremya MN*, 8 October 1998.
- ²⁷ Agence France Presse, 25 September 1998.
- ²⁸ *Vremya MN*, 6 October 1998; United Financial Group, *Russia Morning Comment*, 29 September 1998, p. 2.
- ²⁹ Agentstvo RosBiznesKonsalting, 5 October 1998; Agentstvo Finmarket, 14 October 1998.
- ³⁰ IPR Strategic Business Information Database, 15 October 1998.
- ³¹ For discussion of various aspects of the plan, see also *Segodnya*, 22 October 1998; and Konstantin Levin and Vadim Bardin, 'Lechenie po metodu Gerashchenko', *Kommersant-Vlast*, 20 October 1998, pp. 16-18; *Finansovye Izvestiya*, 20 October 1998.
- ³² Bardin, pp. 16-17; ITAR-TASS, 22 October 1998; Agentstvo Finmarket, 23 October 1998.
- ³³ For discussion of the nationalisation issue, see *Finansovye Izvestiya*, 27 August 1998 and 21 October 1998; *Russkii Telegraf*, 1 September 1998; *Kommersant-Daily*, 1 October 1998; and ITAR-TASS, 13 October 1998.
- ³⁴ *Segodnya*, 14 October 1998; and United Financial Group, *Russia Morning Comment*, 23 October 1998, p. 3.
- ³⁵ Bardin, p. 17; Economist Intelligence Union, *Russia Country Forecast* (4th quarter 1998), p. 12.
- ³⁶ *Finansovye Izvestiya*, 20 October 1998.
- ³⁷ The TsBR cannot under current law begin seeking to raise funds from investors for the recapitalisation of the sector and it cannot take ownership stakes in commercial banks other than those it already holds. The agency which the TsBR proposes to create, the Centre for Restructuring the Banking System, also requires a legislative basis for its operations, whilst amendments to the banking law and the law on joint-stock companies will also need to be adopted.
- ³⁸ See, for example, *Segodnya*, 14 October 1998.
- ³⁹ United Financial Group, *Russia Morning Comment*, 30 October 1998, p. 3. On the battle over Tokobank's future, see *Vremya MN*, 21 October 1998.
- ⁴⁰ *Izvestiya*, 2 September 1998; *Russkii Telegraf*, 2 September 1998; ITAR-TASS, 28 August 1998.
- ⁴¹ *Finansovye Izvestiya*, 25 August 1998.
- ⁴² *Reuters*, 16 September 1998; United Financial Group, *Russia Morning Comment*, 16 October 1998, p. 5.
- ⁴³ The other banks involved were SBS-Agro, Menatep, Mosbiznesbank, Most-bank and Promstroibank. Vladimir Stupin, 'Vkladoiskateli', *Kommersant-Vlast* 35 (15 September) 1998, pp. 54-5; *Izvestiya*, 2 September 1998, and 5 September 1998; *Ekonomika i zhizn'* 37 (September) 1998, p. 8; Pis'mo TsB RF ot 24.09.98 № 245-T.
- ⁴⁴ ITAR-TASS, 14 October 1998; IPR Strategic Business Information Database, 15 October 1998; United Financial Group, *Russia Morning Comment*, 15 October 1998, p. 3.
- ⁴⁵ Elena Zhuravskaya, 'The First Stage of Banking Reform in Russia is Completed: What Lies Ahead?' in Jacek Rostowski (ed.), *Banking Reform in Central Europe and the Former Soviet Union* (Budapest: CEU Press, 1995), p. 167.
- ⁴⁶ The forms and terms of state support for the banks are considered at length in William Tompson, 'Old Habits Die Hard: Fiscal Imperatives, State Regulation and the Role of Russia's Banks', *Europe-Asia Studies* 49:7 (1998); and *idem*, 'Service Providers or Servants of the State? Russian Banks in the Nineties', *Society and Economy in Central and Eastern Europe* 20:2 (1998).
- ⁴⁷ On the Menatep-Most-Oneksim merger, see *Izvestiya*, 27 August 1998; United Financial Group, *Russia Morning Comment*, 26 August 1998, p. 3; and *Vremya MN*, 14 September 1998. Yuliya Panfilova argued that the organisers of Rosbank aimed to dump

their bad debts onto MFK, which was not included in the merger, and let it go bankrupt; see *idem*, 'Odin za vsekh i vse bez odnogo', *Kommersant-Vlast* 36 (22 September) 1998, pp. 50-1. On the other groupings which formed, see *Finansovye Izvestiya*, 1 September 1998 and 27 August 1998; *Vremya MN*, 10 September 1998; *Izvestiya*, 26 August 1998 and 27 August 1998; and ITAR-TASS, 28 August 1998.

⁴⁸ *Finansovye Izvestiya*, 1 September 1998 and 15 September 1998.

⁴⁹ *Vechernyaya Moskva*, 28 August 1998.

⁵⁰ *Izvestiya*, 27 August 1998.

⁵¹ ITAR-TASS, 9 September 1998.

⁵² ITAR-TASS, 25 August 1998 and 9 September 1998.

⁵³ Panfilova, p. 51; and *Vremya MN*, 14 September 1998.

⁵⁴ *Moskovskii Komsomolets*, 12 September 1998; Agentstvo RosBiznesKonsalting, 12 October 1998.

⁵⁵ RosBiznesKonsalting, 12 October 1998.

⁵⁶ See *Ekspert*, 19 October 1998; *Trud-7*, 16 October 1998; and *Delovoi Ekspres*, 20 October 1998.

⁵⁷ *Financial Times*, 7 November 1998 and 11 November 1998.

⁵⁸ *Reuters*, 5 November 1998.

⁵⁹ The government would prefer to restructure debt owed to sovereign and multilateral lenders rather than to commercial creditors and also to draw a distinction between inherited Soviet debt and debt taken on by the Russian Federation. Honouring the latter is far more of a priority. However, it may not be enough to restructure Paris Club debt. A second London Club restructuring would be less attractive, but still preferable to a restructuring of, or a default on, Russian Federation Eurobonds, which the authorities are keen to service.

⁶⁰ *Financial Times*, 6 November 1998.

⁶¹ One of the striking things about the whole GKO-OFZ imbroglio was the failure of the Russian authorities to grasp that it was a property rights problem.

⁶² For the details of the moratorium, which includes some exceptions, see Telegramma TsB RF ot 19.08.98 № 177-T, which appeared in *Finansovye Rossiya*, 27 August 1998; and Ukazanie TsB RF ot 26.08.98 № 328-U, which appeared in *Ekonomika i zhizn'* 37 (September) 1998, p. 8. For a Russian legal analysis of the *force majeure* issue, see that provided by A. V. Chernykh in *Finansovye Rossiya*, 10 September 1998.

⁶³ *Financial Times*, 13 November 1998.

⁶⁴ Ukazanie TsB RF ot 4.09.98 № 344-U.

⁶⁵ See *Financial Times*, 25 September 1998; Kseniya Kiseleva, 'Lehman Brothers po neschast'yu', *Kommersant-Vlast* 37 (29 September) 1998, pp. 34-5; and United Financial Group, *Russia Morning Comment*, 19 October 1998, p. 3.

⁶⁶ This could change; a revised version of the law on the bankruptcy of credit institutions is likely to be adopted in place of that vetoed by President Yel'tsin. However, it is unlikely to allow banks to be bankrupted if the TsBR disapproves.

⁶⁷ *Finansovye Izvestiya*, 28 August 1998; *Vremya MN*, 11 September 1998;

⁶⁸ *Delovoi Ekspres*, 6 October 1998.

⁶⁹ *Nevskoye vremya*, 1 September 1998.

⁷⁰ *Segodnya*, 20 October 1998; *Vremya MN*, 20 October 1998.

⁷¹ *Vremya MN*, 11 September 1998. This was part of a wider tendency in many of the less well off provinces to see the crisis as primarily the problem of the two capitals, whose relative prosperity was deeply resented.

⁷² Agentstvo RosBiznesKonsalting, 4 September 1998.

⁷³ Although it ranked among the country's top ten banks prior to the collapse, the Bank of Moscow is very much a regional bank. It is majority-owned and closely controlled by the Moscow municipal government, which fact accounts for its rapid rise. The financial group it leads is dominated by the city government and was formed at the initiative of Mayor Yuri Luzhkov, who had come to regard the Moscow-based 'federals' such as Most-bank as difficult partners.

⁷⁴ See, for examples, *Moscow Times*, 31 October 1998; Petr Rushailo, 'TsB raionnogo masshtaba', *Kommersant-Vlast* 42 (3 November 1998), pp. 26-7; Andrei Bagrov, 'Komandy "vol'no!" ne bylo', *Kommersant-Vlast* 35 (15 September 1998), pp. 17-21; Agentstvo RosBiznesKonsalting, 4 September 1998 and 10 September 1998. See also Graeme Herd, 'From Federation to Confederation? The Regions in Crisis' (paper presented at the SCIS/FCO 'Russia in Crisis' conference, University of Aberdeen, 23 October 1998), p. 8.

⁷⁵ For various reasons, regional authorities have anyway tended to be more willing than the federal centre to accept non-monetary settlements with their budgets. For an analysis of the reasons for this and its implications, see A. M. Lavrov, 'Nekotorye problemy mezhbyudzhethnykh otnoshenii v Rossii' (Mimeo: OECD, 1998), p. 5.

⁷⁶ There has been some discussion in several provinces, including Krasnoyarsk, of a 'gold-backed' alternative currency, which might be seen as a way to avoid these problems. This idea is a non-starter for many reasons, of which two, in particular, merit mention. First, it would require the immediate imposition of hard budget constraints on local enterprises, which is precisely what regional authorities have resisted for seven years. Secondly, a genuinely gold-backed local currency circulating alongside a weak and depreciating rouble, would, given the logic of Gresham's law, be used in transactions only where there was no alternative, so its circulation would require restrictions on the use of the rouble and the consequent disruption of economic ties to other regions.

⁷⁷ *Finansovye Izvestiya*, 28 August 1998; Rushailo, pp. 26-7.

⁷⁸ *Financial Times*, 13 November 1998.

⁷⁹ Alec Nove, *The Soviet Economic System*, 3rd edition (London: George Allen & Unwin, 1986), p. 250.

Russia's Systemic Transformation: Possible Security Implications

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Introduction

On August 17 1998 the rouble was devalued and on August 23 the government of Sergei Kiriyenko (March – August 1998) fell. Gennady Primakov was appointed Prime Minister as a compromise candidate after the *Duma* threatened to reject the President's candidate, Viktor Chernomyrdin. Throughout this period Russia appeared mired in crisis, as pillars of federal control and power were weakened by the fusion of political and economic breakdown. The cumulative impact of the disintegration of federal pillars of support has the potential to cause at the very least the restructuring of the Russian Federation, at most its collapse. As the precarious balance of power between integratory and centrifugal forces created between 1996 – 1998 is disrupted, Russia appears to have entered a period of drift towards federal transformation.

The Fragility of Federal Power Structures

The August events of 1998 have had a profound impact on federal power structures. To a large extent these events merely shed light on the weaknesses inherent within these structures. The banking system in particular came under immense pressure from rouble devaluation. The chances of economic stagnation and hyper-inflation were increased as pressures grew for 'controlled emissions' of cash into the monetary system to cover the budget deficit. Elite acceptance of a 'limited inflation regime' appeared likely with the appointment of Viktor Gerashchenko as Chairman of the Central Bank. These fears were reflected in the inflation statistics through August at 15% and September at 50%. Indeed, some reports predicted inflation at 240-290% by December 1999, with unemployment up 4.7% over the last year and currently at 11.5%.¹ The anti-crisis and stabilisation discourse of the new government's economic policy are centred on the creation of a socially-orientated mixed economy, but it is unclear how this will be achieved without finance.

The tax system has yet to be reformed and consequently tax receipts are falling and loopholes being exploited. Moreover, the external flow of capital into Russia is drying up, and 50% of the current budget is now servicing debt repayment, on current projections moving to 70% in two years. Whilst IMF aid has provided external legitimisation to the Yel'tsin regime, the implementation of IMF policies has led to a weakening of internal support for the federation and has discredited notions of 'market-democracy'. The EU represents Russia's largest trading partner, credited with 50% of Russia's foreign trade and 70% of foreign investments in the Russian economy. Whilst the EU appears prepared to discuss food aid, it is highly unlikely the EU will continue to inject funds into a fundamentally unsustainable Russian quasi-market economic system.

The core of federalism is the relationship between the budgets of the regions and the centre. The weak state of the Russian economy has raised a fundamental question: will the Primakov government be able to continue to make a virtue of this vice? Will Primakov be able to harness systemic weakness as a source of federative cohesion, or will this peculiarly Russian paradox at the heart of governance implode under the stress of systemic crisis? Primakov was the first to underscore the seriousness of systemic weakness. On 11 September he sombrely informed the *Duma* that the threat to Russia's integrity was 'not a theoretical or hypothetical issue' and that 'we are facing a very serious threat of our country being split up.'²

Russian financial and economic malaise was complemented by a power vacuum and political paralysis at the centre. As the centre of political gravity in decision-making switched to the government from the presidential administration, the new government took 'control' of economic policy decision-making.³ Throughout the crisis Yel'tsin has remained seriously physically incapacitated and unable to govern, isolated, lacking legitimacy and holding only nominal power.⁴ He has lost allies within the Presidential Administration and there are growing calls for his resignation from across the political board. Yel'tsin has also lost powerful external supporters with the retirement of former German Chancellor Kohl, former Japanese Prime Minister Hashimoto and the impeachment distractions facing Clinton. This fundamental cleavage in both political elite perception and societal psychological outlook has opened the door to a radical restructuring of Russian political architecture.

Political fragmentation, a phenomenon previously affecting party structures in the periphery, now infected the heart of Russia's body politic. Russia's largest party, the Communist Party of the Russian Federation (CPRF) came under intense pressure as internal tensions between different factions surfaced with the formation of the Primakov coalition cabinet, in which a CPRF Economics Minister (Maslyukov) and Agrarian Party Agricultural Minister (Kulik) were appointed. Victor Ilyukhin leads the 'Leninist Left' faction within the CPRF and has been extremely critical of both Zyuganov and Maslyukov, calling the latter a 'traitor'. He has argued that privatisation was a western plot devised to undermine attempts at economic reunification with the former Soviet republics and that privatisation gurus were in fact 'representatives of foreign intelligence services working under the guise of foreign experts, especially from the USA and Germany.'⁵

The new government faced a series of policy dilemmas centred upon their need to maintain the unifying and cohesive effect of budgetary federalism in a period when revenue and tax collection was halved by the combined effects of non-payment and inflation. There was, for example, a 50% fall in tax collection in September and six-fold drop in imports.⁶ As the Russian Ministry of Finance became unable to distribute federal subsidies to the eighty 'consumer' regions or collect from the nine 'donor' or 'producer' regions, budgetary federalism as a lever of federal cohesion was seriously damaged.⁷ Russian centre-periphery relations were then set to drift towards an ever deepening and vicious spiral of vice: as Federal subsidies dry up, tensions between opposing factions in dependent regions are exacerbated; competition for control of the limited handouts becomes more intense.

Moreover, as the governor of Samara noted, this represents a danger to federal survival: 'Once united, the regional leaders are capable of turning purely economic questions into political ones, whereupon the centre will be left in splendid

isolation.⁸ The Kalmyk President Kirsan Ilyumzhinov stated in mid-November 1998 that his republic is prepared to secede from the federation and rejoin a Russian confederation as an associate member or become a sovereign republic with a defence alliance with Russia. He threatened to remove Kalmykia from the federal budget and nationalise federal structures on Kalmyk territory.⁹ Although this provocative threat was designed to bring the republic's budgetary problems to the attention of federal authorities, it undermines the unity and the integrity of the federal state.

By 23 September 66 regions had entered 'austerity mode', imposing price controls on key food products. Indeed, Russia's Minister for the Regions noted that: 'Almost all constituent parts of the federation which have reasonably strong food and industry have adopted local laws banning the export of food and other commodities.'¹⁰ Such 'food separatism' through the creation of customs regimes is seen as a means of protection against the crisis in lieu of federal action. It has, however, a devastating impact on federal integrity when 57% of food is imported and 'the collapse of the banking system has put an end to settlements and payments.'¹¹ Other constituent parts were truly in dire straits. The ability of the federal government to ensure food and fuel supplies to the Russian 'Far North' was heavily questioned. It became apparent in late September 1998 that the Northern regions had received only 63.8% of oil, 58.6% of coal and 46.7% of food; in individual regions (Koryaksky autonomous district and Amursky region) the supply percentages were much lower.¹²

The seriousness of this breakdown between centre and periphery was illustrated by Primakov, whose clarion call to the constituent parts to end separatism merely highlighted the government's lack of ability to impose federal will in the periphery.¹³ This statement was made against a backdrop of extremely poor food and energy statistics. The grain harvest in 1998 was 44-45m tonnes, the worst for 45 years, and the former Soviet strategic special state food reserves are only enough for two weeks and for one-third of the country's population. Moreover, it is possible that the integrated electricity system (Unified Energy System) may suffer a collapse if fuel, coal and oil are not supplied, as reported stocks are only 85% of necessary levels. UES states that load shedding is inevitable to protect the system during peak periods in many areas (not just the RF), as currently UES operates at the lowest level of frequency (49.3-49.5 Hz).¹⁴ Russia has begun the process of cancelling energy debts from Belarus, Moldova, Ukraine and Kazakhstan and selling military equipment (eg MIGs to Hungary), in return for food imports.¹⁵

Two regions, the strategically important Kaliningrad and the economically vital Krasnoyarsk, went so far as to declare that a 'state-of-emergency' was in force. Although Gorbienko was quick to retract this declaration, Lebed has stuck to his guns. Krasnoyarsk provides in microcosm a case study of the dangers the crisis holds for the continuation of the federal system of government. Firstly, such a declaration is unconstitutional, as it is a presidential prerogative. This declaration was followed by an intensification of ongoing criminal proceedings against the outgoing counter-elite in order to neutralise them and secure his political power base. Lebed has arrested the former deputy governor, Vladimir Kuzmin, on corruption charges.¹⁶

Possible Paths to Federal Transformation

The key to understanding the nature of systemic transformation may be found in the actions of the provinces after the 'August Meltdown'. Here *ad hoc*, temporary arrangements designed to counter the immediate crisis appear to be leading to a fragmentation and a regrouping of power within the federation around a different rationale, logic, and set of principles. This process is not driven by regional elites following some blueprint for strategic renewal but rather it unfolds by default through reaction and counteraction; it is governed by contingency, rather than design. This drift makes it extremely difficult for the centre to counter the diffuse nature of 'genetic mutation' transformation. Whilst the centre is unable to impose its authority on the federation or shape the fast unfolding events which signpost the growing crisis, would the strengthening of regions lead to the strengthening of the Federation or to its collapse?

Utilising power afforded by the 'state-of-emergency', Lebed has taken control of all federal power structures in Krasnoyarsk to redistribute resources to stop social explosion in north of the Territory. In effect, by taking command of the army, Internal Troops, tax police and Federal Security Service, Lebed has usurped federal authority. He has cut vertical ties between Moscow-based federal economic, military, and security power structures and their branches or representatives in Krasnoyarsk. They have been reconstituted into a new vertical hierarchy within the region, with the governor's office at the apex and the governor as the sole representative of the Territory in its relationship to the centre. If Lebed or other governors, once having combated the symptoms of crisis turn to the causes – monetary instability – and create regional currencies, a gold-backed Krasnoyarsk rouble, for example, or a Saratov *Kirenski*, then the economic sovereignty of the federation will be breached. Financial-Industrial Groups (FIGs), which had provided an important pan-federative economic presence, would react to the formation of mini-economic regimes by instituting region by region deals, so further fracturing regional cohesion. Outside of FIG regions, feudalism and the barter economy would be in the ascendancy, indicating that the actual or formal collapse of the federation will have little real impact in many regions and hence little popular opposition.

More ominously events in the North Caucasus provide a constant challenge to the legitimacy of the Federal system of governance. Chechnya has declared itself a sovereign state, although power is contested within its borders. Dagestan appears on the verge of implosion, indicated by the collapse of the rotating presidency principle, the assassination of the religious leader and the threat of radical Wahabism, armed ethnic groups and criminal gangs within the republic. Russia has effectively withdrawn military and security structures from this region over the summer. It is argued that this *de facto* de-Russification of the North Caucasus provides the preconditions for the collapse of federal authority and control of this region and beyond: 'If fighting breaks out, the collapse of the Russian economy and consequently of all of Russia will become inevitable.'¹⁷

During this period the integrity of federal military and security structures markedly deteriorated. Andrei Kokoshin, the Secretary of the Security Council, was transferred on 10 September 1998, indicating that military reform was suspended. As the MoD's budget integrity was compromised, military units throughout the federation were starved of cash, heightening their reliance upon provincial governors. The General Staff of the Russian Armed Forces reported the psychological stress and low morale amongst troops caused by cash starvation, regionalisation and the growing criminalisation of armed structures.¹⁸ The *Duma*

Defence Committee has stated that 'the armed forces are in the deepest imaginable crisis, which is effectively full-scale disintegration, and unable, as their experts say, to carry out strategic operations.'¹⁹ This sentiment was underlined by a General Staff report that argued the Russian military was on the brink of being unable to fulfil its primary function - the defence of the Federation.²⁰ In late July 1998 personnel of the Federal Security Service were placed on 'indefinite leave' whilst reorganisation took place, so threatening the integrity and existence of the Federation.²¹

In the immediate aftermath of the August Meltdown, the political elite within Moscow began to debate the utility of rationalising power relations between centre and periphery in order to simplify governance within the federation. As if to illustrate the intensifying nature of systemic collapse, Primakov admitted: 'The idea of larger regions is worth considering. It seems to me a sound idea, because 89 constituent parts of the federation is too many.'²² In late September, he again noted that as Federal funds are insufficient, regions should consider 'once again the possibility of co-ordination and co-operation within the framework of the eight regional associations, developing your own tax base.'²³ In a similar vein, the Regional Policy Minister stated that regions would 'definitely have to' merge.²⁴ Yel'tsin has already given presidential authority for Leningrad Region and St Petersburg to hold referenda in December 1998 in order to merge, and the leading presidential candidate and mayor of Moscow, Yuri Luzhkov, promoted the idea of 12 regional economic associations.

These discussions on structural changes to federal architecture were supplemented by ideas to redistribute power between the executive and the legislature at the centre. By mid-November 1998 the constitutional court had ruled that Yel'tsin would not be able to stand for a 'second' term in 2000. With this decision finalised, Yel'tsin appears now to be ready to relinquish executive power, thus rendering any successor more liable to legislative oversight and control. In late November 1998 calls for constitutional reform had become widespread across the political spectrum. Yel'tsin himself instructed the presidential administration to set up an expert council to draft proposals for constitutional reform, specifically for the creation of the post of 'vice president' to ensure a smooth succession of power should Yel'tsin suddenly die.²⁵ As Lebed argued: 'If you have been unlucky with a wife once, that is no reason to give up the institution of marriage.'²⁶

Thus Russia may be in the process of systemic transformation as regional bloc formation occurs on an incremental *ad hoc* basis, driven by the logic of the crisis and the faltering heartbeat of constitutional reform, rather than elite policy choices or strategy. It is possible, for example, to foresee that net receiver provinces may be clustered round net donors. Sverdlovsk could incorporate the six surrounding regions to become the Urals republic. Such a process, coupled to constitutional reform, could prompt the creation of a new political structures - regional *Dumas* and federation or even Confederate Council at the centre, with a wide spectrum of 'state' building projects in the regions supporting 'market-democratic' to 'feudal-authoritarian' local regimes. The Presidium, an institution created in mid-September 1998, could represent a proto-confederative institution. It consists of the deputy Prime Ministers, the head of the Central Bank, president of the Russian Academy of Sciences and heads of the eight regional associations.²⁷ Foreign affairs, defence and security could then remain within the competence of the President of the (Con)Federation, as all other competencies are 'devolved' down to regions. In either 2000, or before if Yel'tsin resigns or dies, a new constitution might

redistribute power within Russia and create either a transformed federation or, indeed, a confederate system of rule. Such change would only bring the present constitution in line with existing realities.

It is clear that the implications of Russian political and economic paralysis are profound. This crisis is not a short-term phenomenon. It is systemic in nature and cuts to the heart of the nature of governance in Russia. There appears to be a convergence between the logical implications of 'state of emergency' regimes and crisis legislation in the periphery and current federal inability to enforce central control. This convergence promotes and exacerbates a drift into a weaker federation based on regional blocs or even towards a confederation, leading ultimately to the Yugoslav model post-Tito.

This outcome is the most stable, controlled and managed that can be envisaged. It does not countenance another possibility, namely, a much more unstable transformation, where the above uneasy equilibrium spills over into disorder. In the ethnic Russian heartland it is difficult to see an ideological, territorial or ethnic basis for civil war (Reds v Browns, Red-Browns v democrats?) as political apathy is so widespread. However, regional cleavages and jealousies based on economic, political, ethnic or religious grounds may prevent non-ethnic Russian provinces from maintaining their coherence or territorial-administrative integrity – Dagestan is a prime example.

Regional blocs could prove ungovernable as provinces within them compete for control of federal assets. This process would be exacerbated were FIG privatisations 'nationalised' (in other words, regionalised). The absence of a strong Moscow to mediate disputes adds another destabilising factor to the cauldron. Even in the most stable of regional blocs there would still be tensions. Indeed, some regions could, under these conditions, demand full sovereignty - Chechnya, Dagestan, Tatarstan? As the breakdown in order gathers momentum, and as more provinces attempt to leave the enfeebled federation, the less tenable the viability of existing regional arrangements will be.

Security Implications of Systemic Transformation

Western policy-makers have systematically been caught off balance by change within Russia over the last ten years. There are no certainties and precious few predictions that might light the way forward and allow policies to be co-ordinated and coherently applied. As the Yel'tsin era draws to a close and Russian federal structures continue to weaken, what will be the security implications for the west? Such considerations must form the basis upon which policy can then be formulated. The one certainty will be that the security implications will spillover into all the security sectors.

Military Security:

The ability of Federal military structures to maintain their precarious integrity as the crisis deepens over the next months can be questioned. Any failure of the military raises key questions:

- Is command and control of nuclear/chemical/strategic military assets maintained? Would they be restricted within 10-12 regional associations in a confederate system or restructured federation? Certainly the risks of

horizontal proliferation to emergent nuclear states is entirely plausible under such conditions.

- The destabilisation of energy producing enterprises, nuclear as well as conventional, would be limited, at best, to increase environmental risks of spillages and pollution.
- Does effective Russian unilateral nuclear disarmament (driven by cash starvation) allow for 35-40 Topol-M delivery systems and warheads/Yuriy Dolguruky/Tomsk Class submarines to be constructed with START-II ratification and START-III talks initiated (with conditionality clauses), or are existing stocks obsolete in ten years and proliferation the reality?
- Could we foresee SFOR-type operations in part of the RF in the future under the auspices of joint Russian-PfP humanitarian assistance? One might argue that RF weakness leads to multilevel integration into the transatlantic security community. PfP provides an interesting mechanism to co-ordinate a western security response, as would sub-federal institutions.

Economic Security:

This crisis, irrespective of whether the federal system is replaced or restructured, will intensify economic insecurities within Russia. The current crisis has seriously undermined the faith of Russians in the legitimacy and integrity of market-democratic ideals and practice. This can be amply illustrated.

- Victor Ilyukhin, the chairman of the State Duma's Security Committee, has argued that privatisation was a western plot devised to undermine attempts at economic reunification with the former Soviet republics and that privatisation gurus were in fact 'representatives of foreign intelligence services working under the guise of foreign experts, especially from the USA and Germany.'²⁸
- Galina Starovoitova was assassinated after preparing evidence on corruption within the ruling political elite, in particular through exposing the entrenched and institutionalised links between criminal and political groups in Leningrad Region and St Petersburg.
- Boris Berezovskiy, a leading FIG oligarch, openly accuses the Federal Security Service of attempting to assassinate him in late 1997 and is in turn accused of blackmailing the Russian president's family by threatening to make public materials compromising Yel'tsin if attempts were made to 'remove him from the scene.'²⁹
- It is clear that the effect of Russia's crisis on the economies of adjacent trading partners, from Finland down through the Baltic States, across the Slavic republics and into Central Asia, have already proved dramatic.

Political Security:

The weakening of the president within a presidential republic causes tensions within the political system. Political power is likely to be redistributed between the core and the periphery in a restructured Federation or confederation. The indistinct legal and constitutional position of regional associations within a confederation would create difficult foreign policy dilemmas for foreign states.

- Are adjacent Russian communities in CIS states drawn into the fallout? Does failure of continuity of power in RF mean failure in the CIS? In June 1998 the Executive Secretary of the CIS (Berezovskiy) asserted that it was suffering 'systemic crisis'.³⁰

- The core might insist that foreign affairs, defence and security remain the competence of the President - all other powers would then be 'devolved' down to the regional blocs or associations. However, as the military is already largely regionalised and this process will intensify through the winter, it is likely that future conflicts will arise between centre and periphery over the issue of command and control.
- Undue recognition or legitimisation by western states of the 'economic conglomerates' may be construed by an overly sensitive core as a threat to the integrity of the federation. These regions may enjoy economic sovereignty, but would they be able to develop their own foreign economic policy?
- Alternatively, external legitimisation of particular regions that claim full sovereignty under the stress of a failed transition to a remodelled federation or confederation may actually help stabilise the internal security of particular Russian territories. But which foreign state would risk being accused of breaking up the RF?
- This raises the related questions: 'How multi-layered can dialogue be with a collapsing state?'; 'At what level does the west continue dialogues?'; and, 'Would western response be fragmented or united?'

Societal Security:

The spillover from the security sectors outlined above would create societal security concerns and issues for neighbouring states and Russia.

- Russian exports have been severely cut, and the Russian dominated transit trade through 'Near Abroad' countries is in recession. This raises the spectre of unemployment and the consequent societal security concerns this would entail, particularly within small neighbouring states where the transit trade is 60-70% ethnic Russian dominated (eg Estonia and Latvia).
- The prospect of Russian economic refugees is real and will lead to an intensification of border regime reform, particularly in the Baltic region where the EU integration agenda influences such matters.
- Russian territory becoming a source of risks and threats without the presence of overt 'threateners' – eg Kaliningrad as drugs transit entrepot. As federal structures disintegrate, the Russian Federal Migration Service will not be able to control internal flows of refugees. At the same time, there may be much greater sub-federal integration of northwest Russia into the Nordic-Baltic region through humanitarian intervention.

Conclusions

Russia's federal transformation does now appear to be underway. There are elite pressures at both the centre and the periphery that push for constitutional reform. There is also a process of drift that has placed the reality of centre-periphery and executive-legislature relations far in advance of existing legislation. The key questions that now arise focus on the direction of the transformation and the extent to which it can be more-or-less managed and controlled.

The ultimate destination of the transformation currently gathering pace is difficult to fathom. If the trajectory of existing discussions is projected forwards into 1999 the federation may well consist of 20-30 regional blocs as opposed to 89 constituent parts. There may be a redefinition of the status of these enlarged

constituent parts around a different set of relations between the centre and the periphery. Moreover, the executive-legislative balance is set to change, with Yel'tsin prepared to place his successor under greater legislative control.

However, once the Pandora's box of constitutional reform has been opened it will be very difficult for the presidential staff to control and manage the competing demands of power structures and constituent parts of the federation. The devil will most certainly be in the detail of the various draft reform proposals that will be appearing through 1999, and these documents may well provide a key insight into the composition, power and objectives of sectoral interests within the Federation. In other words, they will represent the new pillars upon which political power and authority will rest as Russia moves into the next century.

ENDNOTES

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² 'Primakov: Russia in danger of disintegration', SWB, SU/3330 B/1, 12 September 1998 - *Interfax news agency*, Moscow, 11 September 1998.

³ 'Yel'tsin has ceded control of economic policy to government, says aide', SWB, SU/3358 B/7, 15 October 1998 - *Russian TV*, Moscow, 13 October 1998.

⁴ 'Yel'tsin's regime isolated and wielding only nominal power - newspaper' - SWB, SU/3351 B/2, 7 October 1998 - *Nezavisimaya Gazeta*, Moscow, 3 October 1998. Author's interview with Anton Surikov, Chief Advisor to Yuri Maslyukov, Economics Minister, Moscow, 9 October 1998.

⁵ 'Privatisation a western Plot to manipulate Russia - senior MP', SWB, SU/3368 B/3, 27 October 1998 - *Russia TV*, Moscow, 26 October 1998.

⁶ 'Prime Minister Primakov tells regional leaders to toe line or risk sack', SWB, SU/3345 B/1, 30 September 1998 - *NTV*, Moscow, 29 September 1998.

⁷ 'Maritime Territory's budget suffers from defaulting banks', SWB, SU/3308 B/10, 18 August 1998 - *ITAR-TASS news agency*, Moscow, 17 August 1998.

⁸ "Donor regions' warn federal centre to listen to their views", SWB, SU/3342 B/9, 26 September 1998 - *Kommersant Daily*, Moscow, 24 September 1998.

⁹ 'President Ilyumzhinov says his republic may secede from Russian Federation', SWB, SU/3388 B/5, 19 November 1998 - *Russian Public TV*, Moscow, 17 November 1998.

¹⁰ 'Deputy PM Gustov asks prosecutor to probe local bans on food exports by regions', SWB, SU/3343 B/9, 28 September 1998 - *Radio Russia*, Moscow, 25 September 1998. By way of comparison, in mid-1992 only 23 regions had instituted customs regimes.

¹¹ 'First Deputy PM Maslyukov speaks of his politics and plans', SWB, SU/3351 B/10, 7 October 1998 - *NTV*, Moscow, 4 October 1998.

¹² Northern regions received only 53% of their budget allocations and the Finance Ministry refuses to extend federal credits, as they were not paid back from the previous year.

¹³ 'Primakov calls for 'decisive end' to separatism in regions', SWB, SU/3345 B/1, 30 September 1998 - *TV6*, Moscow, 29 September 1998.

¹⁴ 'Newspaper predicts a winter of cold, hunger and 'pauperisation' for Russia', SWB, SU/3363 B/9, 21 October 1998 - *Nezavisimaya Gazeta*, Moscow, 16 October 1998. According to the fuel and energy Minister Sergey Generalov, the collapse of UES, Gazprom and the Railways Ministry, which all support Russia's integrity, would 'jeopardise Russia's territorial integrity.'

¹⁵ 'Minsk to supply farm produce for Russian gas', SUW/0562 WF/1, 6 November 1998 - *Belarusian Radio First Programme*, Minsk, 28 October 1998.

¹⁶ 'Former Krasnoyarsk territory deputy governor arrested', SWB, SU/3349 B/10, 5 October 1998 - *NTV*, Moscow, 2 October 1998.

¹⁷ 'Lebed urges peace in the Caucasus 'at any cost'', SWB, SU/3385 B/15, 16 November 1998 - *Interfax news agency*, Moscow, 14 November 1998. It should be noted that some analysts argue that Russia is merely imposing a 'different type of presence' in the North Caucasus, as opposed to withdrawing from it.

¹⁸ 'Crime undermining armed forces' combat readiness', SWB, SU/3343 SI/3, 28 September 1998 - *Nezavisimaya Gazeta*, Moscow, 25 September 1998.

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- ¹⁹ 'Yel'tsin ruined Russia's defence potential – senior MP', SWB, SU/3374 B/3, 3 November 1998 – *Interfax news agency*, 2 November 1998.
- ²⁰ "Segodnya' newspaper warns of explosive situation in the armed forces', SWB, SU/3346 SI/1, 1 October 1998 – *Segodnya*, Moscow, 26 September 1998.
- ²¹ 'Federal Security Service a victim of Kremlin mistrust – paper', SWB, SU/3380 B/3, 10 November 1998 – *Nezavisimoye Voyennoye Obozreniye*, Moscow, 9 November 1998.
- ²² 'Premier Primakov criticises previous cabinet's handling of the crisis', SWB, SU/3337 B/1, 21 September 1998 – *Russian TV channel*, Moscow, 19 September 1998.
- ²³ 'Primakov stresses economic recovery and discipline', SWB, SU/3345 B/1, 30 September 1998 – *Russia TV Channel*, Moscow, 29 September 1998.
- ²⁴ 'New regional policy minister tells paper regions definitely to merge', SWB, SU/3347 B/7, 2 October 1998 – *Kommersant Daily*, Moscow, 30 September 1998.
- ²⁵ 'Yel'tsin orders creation of council to discuss constitutional reform', SWB, SU/33965 B/2, 28 November 1998 – *ITAR-TASS news agency*, Moscow, 27 November 1998.
- ²⁶ 'Krasnoyarsk governor Lebed argues for reviving institution of vice-presidency', SWB, SU/3369 B/5, 28 October 1998 – *Interfax news agency*, Moscow, 27 October 1998.
- ²⁷ 'Paper reveals governors' confusion on role in government presidium', SWB, SU/3347 B/2, 2 October 1998 – *Segodnya*, Moscow, 30 September 1998.
- ²⁸ 'Privatisation a western Plot to manipulate Russia – senior MP', SWB, SU/3368 B/3, 27 October 1998 – *Russia TV*, Moscow, 26 October 1998.
- ²⁹ 'CIS secretary Berezovskiy dismisses allegations by former Yel'tsin bodyguard', SWB, SU/3396 B/6, 28 September 1998 – *Interfax news agency*, Moscow, 26 September 1998.
- ³⁰ 'Executive secretary says CIS suffering 'systemic' crisis', SWB, SU/3256 A/1, 18 June 1998 – *ITAR-TASS news agency*, Moscow, 17 June 1998.

Praetorian Guard or Wooden Horse? The Military Response to the Crisis

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Unlike in the events of August 1991 or October 1993, the role of the military in Russia's latest financial and political crisis would appear to have been not so much a role as a non-role. As will be shown below, despite fears that the Army would come out, either in defence of the Yel'tsin regime or in a coup to get rid of it once and for all, with a few minor exceptions the Russian Armed Forces did nothing to exacerbate the situation, remaining in their barracks and continuing to survive much as they had done before the ruble devaluation of August 17th. This apparent pacifism on the part of the men in uniform, however, should not be taken to imply that, if the situation were to deteriorate still further, sections of the military would not attempt to use brute force in order to effect radical change in the country's future. However, morally beaten as they have been ever since the disastrous war in Chechnya, there would appear to be a mood of fatalism amongst many in the Armed Forces who freely admit that, although they are not indifferent to the fate of their country, they seem to be largely indifferent concerning the fate of the ruling government, being of the opinion, as expressed recently in the Ministry of Defence's main newspaper, *Krasnaya Zvezda*, that no number of meetings and protests will do any good, "life will not become easier. We have to work. More and better."¹ Thus, it is not a question that the Army has so far done nothing because it is in agreement with the ruling power, more that its inactivity is as a result of a growing feeling that, whoever is in power, their lot will not significantly improve for the better, so what is the point in marching, demanding the resignation of the visibly ailing Supreme Commander in Chief? An examination of the central military press during the crisis further underlines the view that the Russian officers and soldiers are much more concerned with their back pay, social conditions, food and fuel reserves for the oncoming winter, than the political squabbling going on both inside the duma and elsewhere. Thus, in answer to the question in the title of this paper, the answer is neither "yes" nor "no", but "maybe"; they may have been fairly quiet to date, but there is a possibility that, with the oncoming winter, the continuing non-payment of wages and allowances (running at a staggering 16 billion rubles), as well as the continuing haemorrhaging of power from the centre to the regions, the Armed Forces may not remain on the sidelines much longer and may eventually play a much more active role than they have so far.

The Russian Armed Forces have been undergoing a period of significant reform. Assessments of the reform process prior to the events of August 1998 have been mixed, but recently there was speculation that with men in charge like Minister of Defence, Marshal of the Russian Federation Igor Sergeev and Secretary to the Security Council Andrei Kokoshin, at long last, the reforms were not only to be so many words on paper, but were actually going to mean something. Thus, the day after the ruble devaluation of August 17th, *Krasnaya Zvezda* published a detailed interview of the man in charge of the General Staff's Operations Department, Colonel-General Yury Baluyevskiy, outlining the next part of the reform process, a new military-administrative division of the Russian Federation, reducing the number of military districts (MD) from 8 to 6. By tightening up the internal military

structure of the Federation, this was an attempt to better coordinate not only the work of the military units within the MDs as a whole, but also all the activities of the "power ministries" located within each of the MDs. Thus, Interior Ministry Troops, Railway Troops, Border Guards, etc, which had been allowed to effectively "drop out" of the overall defensive net of the Russian Federation, would now be part and parcel of the country's integrated total defensive system.² In order to further underline the importance of the measures adopted, the newspaper carried the interview under the headline, "The first since the Milyutin reforms", Milyutin being the Russian Minister of War who introduced a series of major military reforms in Russia in 1862-1864.

As the true nature of the crisis began to unfold, however, the paper's mood changed as it realised that the ruble once again was in free fall and that, more than likely, wage arrears would steadily mount up, making it even harder for the officers and men to survive the winter. In its first major comment on the crisis, one of the newspaper's correspondents wrote: "For a long time now, the people have not believed anyone, least of all the government, which is why it [the people] is going to get out of the crisis by its own method - by holding onto its foreign currency." In a further comment on the government's immediate reaction to the new financial crisis hitting Russia, the paper remarked with some irony that "it is characteristic of the government that on Tuesday morning not one of the country's representatives of power made any sort of statement, concerning the situation in the country."³ Despite this initial criticism of the government's apparent inactivity, something curious happened: for just less than a week, *Krasnaya Zvezda* itself became silent on the new crisis facing the Federation; it was not until 25th August that it returned to examine the crisis facing the country. Whether this was as a result of working out exactly what the stance of the paper should be to the unfolding events is impossible to say, but it is an interesting development and one that should be borne in mind.

Following Yel'tsin's TV address to the nation, broadcast on 24th August, and a speech by acting Prime Minister Viktor Chernomyrdin, the newspaper's correspondent Vladimir Urban was not convinced that the way out of Russia's present position was going to be as easy as Chernomyrdin had painted. Urban opened his piece by remarking that, in his opinion, the way out was going to be "a lot more difficult" than Chernomyrdin thought. In reference to the situation in the army, Urban reminded his readers - as if they needed reminding - that they had not been paid since May and with the current turmoil in the country, "Naturally, for the time being, no one remembers this. For the time being, all we hear is speculation concerning [the composition] of the new government. Of course, it is important to do this as quickly as possible, but what is more important is that proposals are put forward concerning overcoming the crisis - the financial market must receive some sort of positive signals. In the past five months, the reputation of our country has significantly cheapened."⁴

These quotes demonstrate that even at this early stage in the crisis, there was none too little criticism of the government's actions even from a source which, on the face of things, should have been one of its staunchest supporters. Part of this initial criticism of the government stems from the simple fact that the Russian Armed Forces have had to endure a lot since October 1993 and their tolerance is not boundless. Poor living conditions, non-payment of salaries, the growth in the prestige and power of other "armies" (not least being the Ministry of Interior Troops) at the expense of the Russian Army have led to the latter feeling less than valued,

despite its continuing importance in maintaining the external security of the state. With the financial crisis deepening, it is a moot point how long the Army will continue to support the government, even if passively.

As the crisis continued to develop, it was not long before the newspaper attempted to use yet another significant anniversary in the military history of the state in an attempt to remind its readers just how great a nation Russia/the USSR had been. In Russia, more than in many other states, history, especially military history, has played its role, particularly in recent years, in defining how Russians perceive themselves and how they like to be perceived by the outside world. During this particular crisis period, it so happened that the 55th anniversary of the Battle of Kursk - one of the major engagements of the Second World War and the one which effectively brought to an end any hopes that the Germans might still have had about reversing the tide of events on the Eastern Front - fell. In its own way, the commemoration of the anniversary was used to remind the newspaper's readership, young and old, of exactly what a previous generation had done in order to preserve the integrity of their nation during an even greater crisis than the one that they were going through presently. Following a number of interviews of veterans of the battle, the correspondent chipped in at the end to note that all Russians must, especially at this moment in time, show "belief in themselves, belief in their country, as necessary now as it was at the front."⁵

Elsewhere on the front page of the paper was an article, the first of a number highlighting the current difficulties facing the Armed Forces throughout this period. This one examined the fact that not enough food and fuel was being supplied to the garrisons in Russia's Far North to cope with the oncoming winter. Due to the current indebtedness of the MoD, the Ministry of Communications was, according to the report, refusing to ship any more supplies to the Far Northern garrisons until some attempt had been made to clear the outstanding debt for supplies previously transported. Thus, according to official estimates, only 73% of supplies had been shipped to the northern garrisons by the end of August.⁶ On the face of things, this may seem like a reasonable amount, but given the extreme weather conditions in that part of the world, any delay in sending supplies is potentially disastrous, as the sea begins to ice up and becomes impossible to navigate. Thus, from the date of the report, the Northern garrisons could only rely on between 4-6 weeks in order for the remaining 27% of supplies to be shipped in before the winter really set in for the next 4-5 months.

Over the next week of the crisis, although the newspaper continued to remind its readers how bad the situation was in various units of the Armed Forces, its criticism of the central political power did not abate: for instance, in reference to the decision to hold a second ballot on Chernomyrdin's appointment, the paper's correspondent sarcastically asked, "Will we survive until Monday?"⁷ By the beginning of September, growing increasingly exasperated by the lack of urgency being shown by the central power, the paper simply stated that "The country quickly needs an effective working government ...The essence of the situation is fairly clear. It is not that important who the premier is. It is [more] important that there be one, that he assume responsibility to get us out of the crisis and has a clearly defined programme to this effect. We agree on one thing, that much better off countries, least of all Russia, could not allow themselves the luxury of living such a long time without a government. In this context, the [current] position of those, on whom so much depends, is completely incomprehensible. How much longer are we going to hover on the precipice?"⁸ Further on in the article, the paper

also pondered as to whether the men in power lived on the same planet as everyone else, "Do they not hear the miner's pit helmets beating on the bridge surrounding the White House? ... Do they not understand the obvious - that the political crisis is not just about the well-being of the 'buck' in relation to the ruble, but that we have a situation when an intelligent, industrious and patient people must devote all their life energy, their strength, to the attainment of one sole objective - survival. Survival and bringing up their children...!"⁹ As if to underline the latter point, on 3rd September the paper published a small report on the number of soldiers officially allowed to work in Moscow *oblast'* to help gather in this year's crop of potatoes. The General Staff has officially detailed 12,000 men to harvest potatoes for the period 25th August-1st November 1998. They will not only include those attending military college, but also the elite units of the Russian Army, like the Taman Motor Rifle Division, the Kantemirov Tank Division, the Independent Sevastopol' Motor Rifle Brigade - all units which, according to both their recent past (1991 and 1993) and speculation in other Russian newspapers, would be the first to be called upon if the government felt threatened.¹⁰

Also in this issue, the newspaper urged the politicians to find a compromise: let Chernomyrdin become Prime Minister with the proviso that, to all intents and purposes, the *duma* be allowed a say in the composition of the Cabinet of Ministers. "Then all interests will be more or less satisfied, we will have a government which, at long last, can get to grips with the real business of the day."¹¹

Compromise was not on the cards, however, and the paper published yet another report concerning the growing impatience of the population towards the activities of the Moscow-based politicians. Under the heading, "Less trust, the deeper the crisis", the *Krasnaya Zvezda's* (KZ) correspondent, quoting the example of South Korea, made the point that when that government faced a similar economic crisis not all that long ago and asked its people to hand in precious items, its people did, because they had faith both in their government and parliament. The same could not be said about Russia: "The greater the sense of mutual trust, the weaker [the effects] of the crisis, the easier it is to overcome. The opposite is also the case."¹²

As Chernomyrdin's candidacy was rejected a second time, the following day - 9th September - the paper remarked that "the authorities live their life, the people - theirs. They have other concerns - bread, oatmeal, tinned food." It further warned that the *duma* itself could become an irrelevancy, that too much time had already been lost on "debates" when there was no time to lose.¹³ In a further sign of the growing irrelevancy of the centralised power, even in relation to the Army, a report was published in the same issue of the paper based on a statement made by the acting head of the government's apparatus, Igor Shabdurasulov, concerning feeding the units located within each of the Federation's *oblasts* by the *oblast'* authorities themselves. The report stated that, due to the collapse of the country's banking system, "a mechanism" had been worked out whereby the regions would take on the responsibility of "feeding the Army units deployed in their territory". The statement added that "this was a forced measure" and should not be taken to be "common practice."¹⁴ If regions are now expected to ensure that the military units located within their territories are actually fed, then this creates potentially a dangerous situation for the future. Unpaid and now unfed by the central power, facing yet another hard winter, where does the loyalty now lie of the underpaid officer and the poorly fed soldier?

By this time, a number of reports began appearing in other sections of the Russian press which painted a slightly different picture of the activities of the Army. At the end of August, *Komsomol'skaya Pravda* published an article by its military correspondent, Viktor Baranets, in which he outlined various meetings and steps which had allegedly been taken by both the Interior Ministry and the Army to combat the crisis should it get out of control.¹⁵ According to the report, secret instructions had already been sent to a number of units based in and around Moscow that they should be "ready for action" in an emergency situation. Ground rules had also allegedly been established in order to coordinate the work of both Interior Ministry and Army units in the city if the situation were to get out of control. At this particular point it should be noted that coordination between the power ministries in the event of an emergency situation has been one of the key elements of the reform process of the Armed Forces over the past year. Largely as a result of events in Chechnya, as well as more recent terrorist activity in the Caucasus, all the power ministries have been working together to thrash out a new set of rules and guidelines to be adopted in the event of any future internal or external military threat to the Russian Federation. Large-scale exercises, designed to test out these new work practices, were held in the North Caucasus MD in July 1998.¹⁶

Even at this time, reports elsewhere also speculated on whether Igor Sergeyev, for instance, would remain Minister of Defence: previously, he did not enjoy the best of relationships with Chernomyrdin when the latter was Prime Minister first time around and his reliability in the event of the crisis requiring a military solution was also debatable. However, the speculation proved fruitless and Sergeyev is still Russia's Minister of Defence.¹⁷

Although the speculation surrounding Sergeyev's imminent demise proved fruitless, this did not prevent the media from continuing to speculate about the future role of the Army during the crisis period. Thus, on 5th September, *Moskovskiy Komsomolets* published a highly detailed report on what the Army had really been doing behind the scenes and how it was bracing itself should the political crisis descend into a shooting match. Thus, it outlined a planned command-staff exercise, due to be held in Moscow from 7th-11th September, detailing "the army's operations in crisis situations". The report also further stated that the Commander of the country's Airborne Forces, Georgiy Shpak, was "in contact" with the president's leading representatives, Sergei Yumashev and Evgeniy Savostyanov, both of whom had played an important part in putting down the insurrection of October 1993. (Savostyanov is regularly consulted by Yel'tsin when it comes to appointing anyone to the power ministries).¹⁸

The newspaper report, however, was also quick to point out that even the Airborne Troops had not been paid "in a long time" and could not be 100% counted upon in the event of a fire fight. (Airborne Forces in the area mainly consist of a reconnaissance battalion in Sokolniki and a paratroop regiment in Naro-Fominsk. For extra cover, there is also 101st Airborne Division in Tula, situated approximately 200 km to the south of Moscow. There is also the 119th Airborne Division based near Ryazan', approximately 200 km south-east of Moscow).

The article also speculated about the other main military units in Moscow *oblast'* which had "distinguished" themselves in previous political crises, namely the Taman and Kantemir Divisions. Certainly, these units both in August 1991 and October 1993 had played a vital role in ensuring that Yel'tsin won his struggles with

political opposition. Despite reaching the official retirement age of 60, the Moscow MD Commander, Leontiy Kuznetsov, had managed to retain his position (he had also been Moscow MD commander at the time of the events of October 1993) so, on the surface, it would appear that if push had come to shove during this period, Yel'tsin would have been able to rely on these two divisions. However, even these elite units have been badly affected by non-payment of wages and morale in the units has been described as "rotten."¹⁹

Another article which appeared at this time hinted that it was possible that the central political authority might have to rely more heavily on non-Army uniformed assistance than had been the case in the past. Of course, in terms of the federal constitution, as well as more recent changes in the relationship between the power ministries, there has been a renewed emphasis on internal order being maintained and upheld by Interior Ministry Troops. Thus, the article examined not only exercises being undertaken by the elite Interior Ministry units, specifically the former Dzerzhinskiy "Iron" Division, which had its men training on how "to storm dwellings and objects of vital importance to the city", but also listed those units that it thought would be used if the situation got out of control in the city.²⁰ Whilst it was more than likely these exercises were part of a previously planned series, given the situation that existed both in the capital and in the country at large, it was left to the readers to draw their own conclusions about the true reason behind such exercises being carried out: the central political authority was simply getting ready for any eventuality. The units listed in the article (which appeared in the highly respected "*Kommersant* - Daily"), were mostly either MVD, or ex-KGB special forces units and, not surprisingly, included those that had been used in 1991 and 1993, eg "Alpha" and "Vega". Other than the Taman and Kantemir divisions, the only "extra" Army units listed included were the Independent Motor Rifle Brigade based at Tepliy Stan and a MoD security brigade.²¹ For the authors of this speculative piece, and possibly for the men in power in the Kremlin, the obvious implication was that the regime would probably have to rely more on the Interior Ministry Troops to do any fighting - if it came down to it - than regular army units, if for no other reason, than that they were better paid, better fed and probably more motivated than regular army units, even elite regular army units.

Needless to say, no such speculation concerning the possible future role of the army ever appeared in the official Russian military press, which continued to report on the living conditions of the officers and men and the fact that no one in power seemed to care too much about them. As far as *KZ* was concerned, the gun covers still remained exactly where they were before the crisis had begun. Attempts by some leading political figures to bring the Army more into the centre of the crisis also failed: one of the leading lights of the Communist Party of the Russian Federation, Viktor Ilyukhin, tried to persuade the Ministry of Defence to hold a special All-Russian Meeting of the Officer Corps, designed ostensibly to discuss the reform process in the Armed Forces, as well as the social conditions of the servicemen, but the MoD saw it as an excuse to try to further politicise the Army in the current financial and political crisis and decided not to convene such a potentially dangerous assembly of discontented officers.²² Interestingly enough, Primakov made a point of seeing the heads of all the power ministries - including the Minister of Defence - the day after he was approved as Prime Minister by the *duma* on 13th September, and assuring them that they would all retain their posts. One other significant early move by Primakov was his decision to sack the Secretary to the Security Council, Andrei Kokoshin, a key proponent of further military reform; why he felt this to be necessary is open to speculation.²³

Around about this time, reports came through of a "mutiny" on board one of the ships in the Northern Fleet - but talk that the ship in question, "*Uragan*" could become the new Battleship "Potemkin" (of Eisenstein fame) quickly fell away, as it came to light that, in essence, the sailors had refused to obey orders not because of maggots in the food, or horrendous living conditions, or even non-payment of salaries, but because there was no Sunday afternoon video for them to watch and they were not allowed private cameras on board ship.²⁴

Without belittling the situation, the central military press did report on the growing power of the regional governors, as well as the prospect that the military Trade Unions, as well as the civilian personnel working in the MoD, were prepared to take action on 7th October, the day set aside as a national day of political protest directed against the government in Moscow. KZ also became concerned that the Federation could be on the point of break up, unless measures were quickly adopted to stop the spread of what it termed *mestnichestvo* ("localism").²⁵ The Ministry of Defence is firmly against anything that reeks of the regions gaining more control of the units deployed in their areas, fearing that regional militarism may eventually lead to the break up of the Russian Federation itself. A few days before 7th October, KZ decided to interview a major regional governor, V Chub (Rostov *oblast'*), who was resolutely against taking any financial responsibility for the military units located within his territorial remit: "I am convinced that not one part of the Federation, no municipal authority, should take on the responsibility of financing and maintaining the army. This is the direct responsibility of the Federal government and state. Any other way and we risk, in the final analysis, weakening both the army and the state, which we cannot allow under any circumstances."²⁶

Thus, on the eve of the protest action of 7th October, the Army had not been stirred into a revolutionary mass and, despite the reports of not enough food or fuel being available in the Far North, or the Far East, or that gathering in the harvest was not the work for soldiers, especially for the elite units,²⁷ the central military press, despite the speculation from other areas of the media, had not prepared the Army to take any form of direct action in the nationwide protests that broke out all over Russia on 7th October. Many officers have not been paid since the summer of this year and, despite recent promises that back pay arrears will be cleared within the next few months, many of the men are sceptical that even this new government will stick to its word. As one military observer noted the day after the demonstrations of 7th October: "Recently, many professional soldiers are inclined to the view that they are people of a lower type, that no one pays any attention to their problems and that, saddest of all, any demands concerning changing the political course, or the resignation of the president, will not change the face of the state towards the army."²⁸ Thus, by the time the paper went to press, the author had only come across one incident when 43 soldiers took a bus illegally from their base somewhere outside Moscow and headed for the capital, to take part in the demonstration. Dressed in combat fatigues, they turned out to be students attending a higher military-technical institute and were stopped on the motorway some 50 km from Moscow itself. They offered no resistance.²⁹

This is not an Army that is, as yet, willing to lead from the front and overthrow a despised and hated regime. Russia is not involved in a disastrous war with anyone and given the privations that the Armed Forces have had to endure almost since the collapse of the USSR in August 1991, it has now reached the stage, at least on the surface of things, where its patience seems to know no bounds and, as it continues

to wait for its salaries to be paid and the arrears to be cleared, its sense of patriotism seems to be the only thing that is keeping it together. Attempts to politicise the Army seem to have fallen on stony ears, as proven by Ilyukhin's failed attempt to persuade the MoD to convene an Assembly of the Officer Corps. Without being overtly cynical, it would appear that as long as the government can hold on to the loyalty of both the 250,000 strong Interior Ministry Troops and the elite airborne and military units based in and around Moscow, it will face off any internal opposition. And yet history teaches us that, especially in Russia's case, no regime should long think that it can continue to rely solely on the passivity and patience of either the population or the Armed Forces - everything has its limits.

ENDNOTES

- 1 *Krasnaya Zvezda*, 3 October 1998.
- 2 Ibid, 18 August 1998.
- 3 Ibid, 19 August 1998.
- 4 Ibid, 25 August 1998.
- 5 Ibid, 26 August 1998.
- 6 Ibid.
- 7 Ibid, 27 August 1998.
- 8 Ibid, 1 September 1998.
- 9 Ibid.
- 10 Ibid, 3 September 1998.
- 11 Ibid.
- 12 Ibid, 4 September 1998.
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- 14 Ibid.
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Post-August: The CIS After Russia's Crisis

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Abstract: This brief offers a summary of developments within the Commonwealth of Independent States (CIS) since Russia's August crisis. It demonstrates that the trends of ad hoc agreements, bilateralisation and regionalisation continue. It also shows that whilst member states have been willing to cooperate with Russia, they have also been deterred by Russia's strong-arm tactics.

Although this brief cannot go into any detailed analysis of existing CIS arrangements,¹ it begins with a synopsis of where the CIS stood at the time of the Russian crisis. It is probably fair to say that the CIS in 1998 is less than the European Union but more than the Government-7. In all three areas of the economy, security and polity, agreements on cooperation have sought to go beyond a talking-shop. But the CIS lacks the principal features of integrated association: it has no standing allied armed forces, no common currency and no Commonwealth citizenship.

The most significant agreements between member states have been in the field of economics – primarily the payments union and the customs union. But even these agreements are beset with significant inequalities. Militarily, an apparently key agreement was reached with the endorsement of the CIS Collective Security Concept in February 1995. However, to date, most CIS member countries have refused to endorse its key concept – the formation of a CIS military alliance. Among the Concept's signatories, Georgia, Kyrgyzstan, Uzbekistan and even Kazakhstan have all ruled out the creation of a CIS military bloc. Each member state is now confronted with different geopolitical concerns and domestic military reform that make for uneasy bedfellows. Politically, non-Russian member states have been the most reticent to ally, largely because they still remain unconvinced that Russia's role will differ markedly from that it assumed in the former Soviet Union.

In sum, the CIS on the eve of the Russian crisis suffered from an absence of purpose, will and rules. Because the CIS since its inception has operated on the basis of an "interested party" principle, allowing a member state to opt out of any clauses with which it disagrees, it has no mechanism to ensure compliance. Neither the CIS nor its customs union has managed to create a working military alliance, a unified economic space or a notion of political community.

As the news of the rouble crash filtered to the CIS states, several CIS members initially insisted that they were immune from the Russian crisis. Serhiy Tyhypko, Ukrainian deputy prime minister, claimed that "objective reasons" ensured that the Ukraine remained unaffected by the Russian crisis.² Kyrgyzstan's National Bank Chairman, whilst speaking of the "powerful psychological effect" of Russia's financial crisis, insisted his country "was prepared for the Russian crisis and had predicted it."³ Kazakhstan's president Nursultan Nazarbayev stated that the Kazakhstani and Russian economies were separated to such an extent that the spillover effect would be minimal.

Russia soon feared that CIS states would emulate the Baltic states by erecting border controls. Lithuania beefed up its border protection to block a pending wave of food smuggling or an invasion of illegal immigrants from Belarus and Russia's Kaliningrad Region.⁴ President Lukashenka dismissed rumours in early September that Belarus intends to close borders with Russia.⁵ He did, however, criticise Russia for failing to warn its CIS partners of the impending crisis.⁶ Ultimately, a fear of protectionism amongst CIS member states proved ungrounded.

Acknowledging their trade dependence on Russia, several member states turned instead to ad hoc agreements. President Leonid Kuchma highlighted how 32 per cent of Ukraine's exports to Russia and 38 per cent of its imports came from Russia.⁷ The National Bank of Kazakhstan and President Nazarbayev soon issued similar statements. As before the rouble collapse, the inclination was toward bilateral agreements. The Russian-Ukrainian Economic Cooperation Council met in Kiev on September 8 to expand the 27 February Cooperation Program for 1998-2007. Even Kyrgyzstan's President Askar Akayev, who was the only leader to declare on 31 August that the crisis in Russia was a crisis of the CIS (and of the Customs Union of Russia, Belarus, Kazakhstan, Kyrgyzstan and Tajikistan),⁸ he nevertheless proceeded to conduct bilateral agreements. On 16 October, Russian Premier Primakov stated that "the Union of Belarus and Russia has a most positive development on the CIS."⁹ Lukashenka confirmed that the eastern vector of Belarus foreign policy remained the cornerstone of its foreign policy. On 14 September, Nazarbayev stated that partnership with Russia was the cornerstone of Kazakhstan's foreign policy.¹⁰

To meet its country's food needs, Russia agreed to a number of major barter deals with CIS member states. On 16 September, the Ukrainian government temporarily lifted its ban on Ukrainian exporters conducting barter operations with contractors from CIS countries in the event of the latter being unable to make timely payment for the goods purchased using hard currency.¹¹ On 25 September the Ukraine decided to grant Russia and Turkmenistan 1.8bn hryvnyas worth of goods by 2007 as payment for natural gas imported from the two countries in recent years. The Ukrainian Prime Minister Valeriy Pustovoytenko stated that the arrangement was the result of "personal agreements."¹² On 2 October, Russia agreed to the Ukraine paying 50 per cent of its energy debt in the form of goods.¹³ On 21 October, President Leonid Kuchma issued a decree that will give special tax breaks to companies that reduce the percentage of output bartered for other goods rather than sold during the first half of 1999. The Ukrainian State Statistics Committee stated that during the first eight months of 1998, more than one third of the country's industrial output was bartered rather than sold. As of 1 October, Belarus owed Gazprom \$220 million. In October, Belarus Prime Minister Sergei Ling stated that Belarus will pay off about 90 per cent of this debt in goods.¹⁴ Russia also reduced the tariff for transporting food between regions by 50 per cent. Foods identified by the Ukrainians and Belorussians for trade include butter, cheese, sugar, grain, beef, poultry, eggs, potatoes and cabbage.

Russia's economic collapse gave member states some political leverage over how they wished to see the CIS develop. The Ukrainian incumbent elite consistently stressed that the CIS should be purely economic. Belarus president Alyaksandr Lukashenka has exploited the crisis to promote his own alternative vision for the CIS, namely a Slavic union. Lukashenka used the Russian crisis to insist that the Ukraine should be brought into this Slavic union, and that it should not be limited to Russia and Belarus. He accused internal and western forces of deliberately

fuelling the crisis in Russia so as to prevent the latter from exerting influence internationally.¹⁵ Like his Ukrainian counterpart, Lukashenka emphasised again that economic issues should take precedence over political ones, and bilateral over multilateral. Leonid Kuchma immediately rejected the idea of a Slavic Union.¹⁶ Ukrainian foreign Minister Boris Tarasyuk also strongly condemned Russian State Duma Chairman Gennadiy Seleznev's call for the three to form a Slavic Union.¹⁷ As recently as June, Lukashenka, criticising the CIS as a "flabby, amorphous entity", stated that "if market-oriented transformations and integration processes in the CIS countries deepen, the Commonwealth will have a real chance to become the fourth centre of power."¹⁸

Bilateralisation has been accompanied by the other main trend seen to date in the CIS integration process: regionalisation. This was witnessed not only in Belarus' call for a Slavic union, but also in Nazarbayev's bilateral talks with Uzbekistani President Islam Karimov (the first such official visit by Kazakhstan's President to his southern neighbour) and his working visit to the Caucasus to increase the security of the Eurasian transport corridor.

Ultimately, the Russian crisis has been manipulated by leaders to deflect attention from their domestic concerns. Notable here have been statements by the Kazakhstani political elite that the Russian crisis precipitated early presidential elections, which have now been re-scheduled from December 2000 to January 10, 1999. President Nazarbayev has justified the calling of early elections to avoid a lengthy campaign that is an expensive luxury in the wake of the Russia implosion. Early elections increase the incumbent elite's chances of staying in power.

It is probably fair to say that Russia has been more anxious to do business with the CIS than the reverse. As of August, it is CIS Executive Secretary Boris Berezovskiy who has repeatedly stressed the importance of the CIS. Russia's role in the CIS was "colossal", he exclaimed in October.¹⁹ Berezovskiy has resorted to psychological and political links; he stressed that the fate of the CIS economies is intimately interlinked with those of Russia - "Without continuity of power in Russia, there will be no continuity of power in any of the CIS states..."²⁰ - and that the deepening of the crisis in Tajikistan in November was catapulted by Russia's economic chaos.²¹ He has also emphasised how the crisis has highlighted the CIS' weakness and its grave need for reform.

The initial reaction to the general notion of the need for reform was lukewarm. Exceptionally and true to form, Akayev was one of the first to agree that transformation of the CIS was necessary. Nazarbayev, whose 1994 brainchild was the Eurasian Union (envisaged in parallel to the CIS) and who has been the most outspoken over the need to increase cooperation, also endorsed the need for reform, with the comment that he has been its key proponent already for some time. The Head of the Information Department of the Ukrainian Foreign Affairs Ministry, Viktor Nayachuk, stated that the Ukraine was at loggerheads with Russia and Belarus over reform of the CIS. The Ukraine insisted that the CIS should simply be transformed into an effective discussion and consultation mechanism, ensuring that economic cooperation is given top priority, with the establishment of free zones. On 23 September, President Kuchma emphasised the role of Russia in the CIS, which "is and will remain the essential element" in solving numerous problems. Kuchma proceeded to underline the ineffectiveness of the CIS, stressing that no appropriate joint measures had yet been taken to alleviate the crisis in Russia.

Berezovskiy seized September as a chance for radical reorganisation. His main plank of reform in September was the plan to empower the CIS Executive Secretariat, with himself as its helm. He mooted to move the Secretariat from Minsk to Moscow, expand it considerably (the chosen headquarters has 7,000 square meters of office space), and transform into a high-level representative body with policy-making and implementing functions. Thereafter, in October, at the rescheduled meeting of the CIS, Berezovskiy aimed to breathe life into the Coordinating-Consultative Committee (KKK), a high-level body established under the CIS by-laws in 1992. The KKK, devoid of functions, has been inactive in the past few years. Berezovskiy proposed transferring to the KKK the roles of his Secretariat and of the Interstate Economic Committee (MEK), executive body of the CIS Customs Union, which is in practice dormant. As Berezovskiy pointed out, the Secretariat and the MEK are “nonstatutory,” because the CIS by-laws do not mention them. At the meeting, Berezovskiy did not hide his ambitions to become the chief of a revived, enlarged and strengthened KKK – “not for selfish reasons, but in the general interest,” he added.²²

Every CIS member state reportedly rejected these proposals. A representative for Belarus, Syarhey Posakhaw, stated that the draft statute of the CIS KKK submitted by Berezovskiy “was removed from further discussion”. It was officially rejected on the grounds that the proposals merely mechanically united the current functions of the Secretariat and MEK. Instead, Posakhaw stated, “the submitted document lacks new ideas on how to advance towards integration”. He singled out a point in the draft statute according to which the CIS executive secretary is vested “with emergency powers”, including those of “supreme CIS official” and chairman of the KKK which consists of CIS deputy prime ministers. The document also suggests that permanent state representatives are appointed with the executive secretary’s consent.²³

Upon closer scrutiny, the key innovation suggested by Berezovskiy in September was that of enlarging membership of the CIS. In Berezovskiy’s words: “We should not confine ourselves to the members of the Soviet Union. Traditionally, Iran has been within the sphere of interest of almost all CIS member states without exception.”²⁴ In October, he invited Yugoslavia to become a member state.

The latest round of reform proposals will be discussed at the 23 November Working Committee Meeting in Moscow in preparation for the CIS December summit. Berezovskiy has already publicised his proposals in *Nezavisimaya Gazeta*, and they principally include the formation of free economic trade zones.²⁵ Berezovskiy would here appear to be taking on board some of the suggestions made by the Ukraine and Kazakhstan in September. He appears - for the moment - to have toned down some of his more radical proposals for political reform of the Commonwealth.

To conclude, the CIS once again proved incapable of mustering a concerted response or the will to proceed toward further integration. Instead, forms of cooperation that developed previously have continued – selective participation within the CIS, bilateralisation and regionalisation. Russia’s renewed enthusiasm for reform has been accompanied by Russian strong-arm tactics. Furthermore, Russian forbearance in the near abroad continues. It remains to be seen whether Berezovskiy’s November 23 working group and the December summit can rectify the ill-feeling engendered by Berezovskiy’s reform agenda in September and November’s unsanctioned intervention in Tajikistan.

ENDNOTES

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- 1 For a good introduction to the CIS, see Mark Webber, *CIS Integration Trends: Russia and the Former Soviet South*, Royal Institute of International Affairs, 1997.
 - 2 *FBIS-SOV-93-128*, 12 February 1998.
 - 3 *UNIAN News Agency*, Kiev, 28 August 1998.
 - 4 *Baltic News Agency*, 9 September 1998.
 - 5 *Itar-Tass*, 14 September 1998.
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 - 7 *Ukrainian TV First Programme*, 2 September 1998.
 - 8 *Itar-Tass News Agency*, 31 August 1998.
 - 9 *Itar-Tass*, 16 October 1998.
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 - 11 *DINAU News Agency*, 16 September 1998.
 - 12 *Interfax News Agency*, 16 September 1998.
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 - 14 *Moscow Times*, 10 October 1998.
 - 15 *Summary of World Broadcasts*, 12 October 1998.
 - 16 See Endnote, *RFE/RL*, 19 October 1998.
 - 17 *Interfax News Agency*, 30 September 1998; *Itar-Tass News Agency*, 1 October 1998.
 - 18 *Summary of World Broadcasts*, 18 June 1998.
 - 19 *Interfax News Agency*, 19 October 1998.
 - 20 *Ekho Moskvyy Radio*, 2 September 1998.
 - 21 *Interfax News Agency*, 19 November 1998.
 - 22 *The Monitor*, Jamestown Foundation, 22 October 1998.
 - 23 *Interfax News Agency*, 21 October 1998.
 - 24 *NTV*, 15 September 1998.
 - 25 *Nezavisimaya Gazeta*, 13 November 1998.