
Interview: Sergei Glazyev



‘The Russian economy can become a miracle’

Sergei Glazyev, doctor of economics, heads the Information and Analysis Department of the staff of the Federation Council, the upper house of Russia’s parliament where the country’s regional governors sit. Formerly the Minister for Foreign Economic Relations, he has also worked as chairman of the State Duma’s (lower house) Committee on Economic Policy (1994-95) and at the Security Council (1996-97). Dr. Glazyev was interviewed by Jonathan Tennenbaum on July 8.

EIR: It’s now nearly one year since the famous crisis of Aug. 17, 1998. What is your evaluation of the economic situation in Russia and what has happened since then?

Glazyev: Since that time the situation has improved dramatically. During the period beginning October last year, the growth of industrial production was about 25%, which is the absolute record for the last several decades. It means that, each month, industrial production grew by between 3 and 4%. In May, the level of industrial production reached 6% above the level of May last year. Thus, the damage inflicted by the financial crash on the industrial sector had been overcome by May. If the situation continues to be stable, I think that the level of industrial production this year will be about 6-7% higher than last year—a growth of 6-7%, which will be the first time since the beginning of the reforms. And, at the same time, we had success in stabilization. The inflation rate decreased from about 34% per month in September, to 2% in May. So, we have both industrial growth and decline in inflation.

This was achieved for several reasons. The most important one is the increase in competitiveness of Russian products because of the devaluation of the ruble by a factor of three in August-September. During the previous period, starting from 1993 until 1997, the real exchange rate of the ruble appreciated about eight times. That means that the competitiveness of Russian products, due to the exchange-rate policy alone, decreased by about a factor of eight in the previous period. So, what happened in August-September, is just that we reached an exchange rate which is more or less adequate to the competitiveness of the Russian economy.

Import substitution due to the devaluation was a major source of growth, but not the only one. Another important factor was the design of economic policy measures. The government succeeded in keeping the prices of energy and natural

monopoly inputs stable. So, the attempts of the energy monopolies to increase prices just after the ruble devaluation were resisted by the government, and the government pushed the energy sector to keep the prices stable.

EIR: You are speaking of the Primakov government?

Glazyev: Yes, this was the period of September-October. And they could keep prices stable until the beginning of May, when the government crisis started. By the way, immediately after the government crisis started, the natural monopolies, and especially oil-producing companies, increased prices sharply. We now have a rather serious threat to the stabilization of the macroeconomic situation, because the pressure of the monopolies increased during the last few months.

Another very important factor of growth was the interest rate policy and monetary policy as a whole. Contrary to the proposals from the IMF [International Monetary Fund]—which came in immediately after the crash with the idea to increase interest rates, to introduce a currency board, and to switch to a very restrictive monetary policy again—the Central Bank refused to do this, and did the opposite instead. So, the interest rate was kept stable at a comparatively low level. For the first time during the period of the reforms beginning 1993, we have low interest rates; in real terms, they were about 5-6%. And, simultaneously, the Central Bank started to organize new channels to refinance the real sector of the economy through the commercial banks. It started to discount promissory notes of the companies in the real sector, which gave an opportunity to those companies having a good financial situation to get very cheap credits to increase their production. And, keep in mind that at the beginning of autumn last year, the level of capacity utilization of production facilities was only 30%. So, 70% of the production facilities were not being used. But, due to the improvement of the competitiveness and due to the newly created channels for refinancing the real productive sector, the companies started to increase the level of capacity utilization. This was the real major source for economic recovery. The level of use of production facilities increased to 40%.

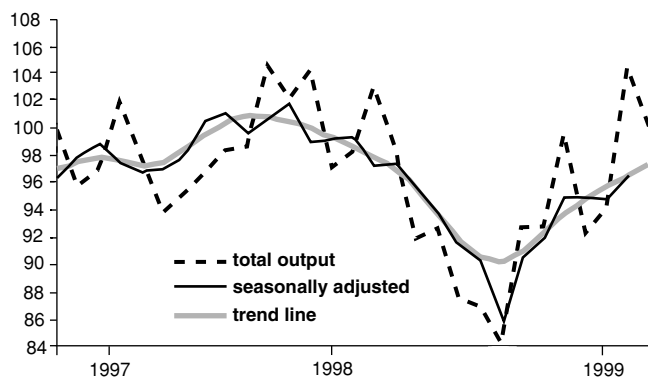
EIR: So there was not yet so much new investment?

Glazyev: Yes, the economic growth we had was low-investment growth. The growth achieved was only due to the im-

FIGURE 1

Russia: industrial production

(December 1996=100)



Source: Dr. Sergei Glazyev.

provement of the financial situation of the companies because of low interest rates, a good price structure for the real sector, a comparative decline of prices of inputs in comparison with prices of final goods, and, of course, the devaluation of the ruble, which gave new opportunities for the sale of the products.

These were the major factors of economic growth during the last half-year. According to our calculations, Russian industry has the potential to grow by about another 20% on the basis of the improvement of the financial situation of the companies, by restoration of their working capital. The key problem of the last couple of years was the outflow of working capital from the real sector. Working capital simply disappeared during the period of the high inflation, and was channeled through the banking system into financial speculation. So, to restore the working capital, we need to continue the soft monetary policy with low interest rates, and the key problem is to avoid currency speculation, to avoid capital flight. In order to avoid capital flight in a situation of soft monetary policy, the Central Bank introduced several measures of currency control. So, the possibilities to buy currency for speculation were restricted.

EIR: Did the IMF approve of these measures?

Glazyev: No. The IMF criticized this from the very beginning and insisted that all these measures should be abolished. And their key argument, their key idea was first of all to abolish the currency control measures. But strengthening currency control was the only means to avoid capital flight, to avoid speculation against the ruble, to avoid further devaluation of the ruble, and to avoid a wave of inflation. The Central Bank succeeded in this. Capital flight decreased by about a factor of three. During the last couple of years, capital flight has been about \$1 billion per month. Due to the introduction of capital and currency control measures, capital flight de-

creased to the level of \$300 million, and there is an obvious trend of decline of capital flight.

But now the IMF, by blackmailing the Russian government on the issue of the servicing of the foreign debt, pushed the Central Bank to abolish those currency control measures which were introduced recently. The IMF is also pushing the Central Bank to abolish the schemes for refinancing the real sector through discounting the promissory notes of the producing companies. It, again, is insisting on a restrictive monetary policy, and it insists that bankruptcy procedures should be used as a major tool in dealing with the arrears crisis between companies. I am sure that the results of all these measures, if they are implemented, would be to stop economic growth and create a new depression in the Russian economy.

The key bottleneck for further economic growth, which we have at the moment, is the lack of demand. After the financial crash, the real incomes of the population decreased about one-third, and this created a major bottleneck for further economic growth. So what we need at the moment, is to create conditions for growth of the real incomes of the population, and it would also be fruitful to stimulate final consumption through government expenditures, especially through government investment programs and government promotion of innovation activity.

EIR: The Primakov government also planned to establish a new bank.

Glazyev: Yes, this was another issue. Another serious bottleneck for economic growth is the lack of investments. The low-capital growth could continue maybe for another year or year and a half, on the basis of increasing the level of capacity utilization. So, at the moment, we have a rate of use of production facilities of about 40%. According to our estimates, this rate could be increased another 20%. So, we have the potential to continue low-capital-intensity growth at about 2-3% per month, for maybe one more year. Then the key bottleneck will be the lack of investments.

The majority of industrial production facilities are rather obsolete, only 30% are up-to-date. Reconstruction is needed. At the same time, during the period of reforms the investment rate declined by about a factor of five. In order to stabilize the production base we need to increase investment activity by about four times, now. Of course, that is a difficult problem, but at the same time there exist opportunities.

The key source to increase investment activity is the savings of the population. In spite of the decline of income, the Russian population still saves a lot. About 25% of the current income is saved. However, they do this not through the banks, but by buying dollars in cash; which means that 75% of the investment resources are not used, because those savings are not used in the banking system and are not used for investments. If the dollarization of the savings of the population continues, investment activity will be impossible. To avoid the dollarization of savings, we need again currency controls: currency controls, some limits on ruble convertibil-

ity, which should be limited to current account foreign trade operations.

This is one source of growth of investment. Another source is the savings in the natural monopolies sector. This sector was formerly controlled by the government, which kept the controlling shares in major gas and electricity supplies, and oil supplies as well. But the problem is, that those people who are in charge of government property in the natural monopolies and energy, are in fact not controlled by the government. So they use their position for their own needs, for their own profits, for their super-high salaries, and nobody knows how the monetary flows inside the natural monopolies are circulated. Just the amortization in the natural monopolies alone could provide a possibility to increase investment activities by about two times in comparison with the present level. The amortization is simply consumed now, instead of being reinvested. There are some other opportunities for investment growth, which include stimulation of investment activity through tax reform, through government guarantees and so forth.

At the end of the Primakov government period, in order to provide a channel for investment activity in the real sector, the government decided to establish the Russian Development Bank. The idea of the Russian Development Bank is to use government guarantees to attract private capital to the real sector. The budget, and the Law on the Budget, gives the government the opportunity to use government guarantees in the amount of 50 billion rubles to attract private capital to the real sector, which could work.

At the same time, as you know, the Russian commercial banks are still not in a position to work with the real sector. After the bankruptcy of the banking system, after the financial crash in August, the majority of the banks still suffer from lack of liquidity, and at the same time they have no experience and have no incentives, really, to move to the real sector. The Russian banking system was mainly designed for speculation purposes. It worked not as a transformer of savings into investments, but vice versa: It took cheap money away from the real sector and put it into financial pyramids, into financial speculation, and transferred it abroad. The banking sector pumped capital away from the real productive sector into speculative operations and abroad, in the amount of 14% of GDP per year. So, it means that almost half of all the investment potential of the economy was not used. Or it was used in the opposite way, not to finance economic growth but as the basis of capital outflow from the real sector. The banking system was a main channel for this capital flight from the real sector.

Our proposal was to restructure the banking system in such a way, to restore the key role of the banks in the market economy, as major transformers of savings into investments. The idea was, that the government should help those banks to survive, which are ready to work with the real sector, which are responsible, and which agree to be controlled by the gov-

ernment and the Central Bank in terms of active operations. It should work from both sides. On the one side, the government should introduce guarantees for personal bank accounts, in order to attract peoples' savings back into the banking system. But from the other side, it should impose controls on those commercial banks which use government guarantees for peoples' deposits, to be sure that the population's savings which come into banking system are used, not for financial pyramids, but for real investments. The construction of the Development Bank was a part of the whole program of restructuring of the banking system.

At the moment, according to the data of the Central Bank, we have about 50 billion rubles of free liquidity in the market, which is about 15% of the whole money mass in the economy. This amount of rubles is not used; the commercial banks just keep this money in the Central Bank at a negative interest rate, but do not use it as investments or credits to the real sector. So there are no channels of real-sector finance. Because the risk is rather high—you have about half of the companies insolvent, in the real sector; in order to overcome this high risk, you need exactly those instruments of investment activity promotion which I have mentioned: First of all, the government guarantees, then the Russian Development Bank and other development institutions which could help banks to avoid high risks and help to establish channels for capital delivery to the real sector.

The IMF, unfortunately, makes quite opposite proposals. It insists that the Central Bank should remove all capital control measures, which means that we have a threat now, to the financial system, that a huge capital flight will re-emerge again. And those 50 billion rubles which are liquid, which are now free in the market, could move to the currency market and be played against the ruble. So, in fact the IMF is opening up opportunities to speculate against the ruble. And there are a lot of incentives for the banks at the moment, when the situation is rather uncertain, just to buy hard currency in order to avoid the risk of further devaluation.

In order to avoid this, the IMF proposes for the Central Bank to issue Central Bank bonds. But the problem is, that in order to use Central Bank bonds as an instrument to stabilize the money market, to avoid a huge growth of demand for dollars, the interest rates on Central Bank bonds should be at least positive, which means, according to the present situation in the Russian economy, that the Central Bank should issue these bonds with an interest rate of at least 40%. At the same time, the profitability in the real sector is about 15% at the moment. So, if the Central Bank starts to issue bonds with such an interest rate, it means immediately that all the incentives to invest in the real sector will be undermined. Because the investors will receive a very profitable instrument, which they could use without any risk. So, we shall get another financial pyramid which will be financed through monetary emission, through money creation, since, of course, the only source for the Central Bank to pay an interest rate is to create

new money. So, it will be a self-reinforced mechanism of financial pyramid.

[Under this condition] nobody could control the Central Bank. The Central Bank has already played the role of a major commercial player in the GKO financial pyramid. The Central Bank was the main winner in financial speculation in government bonds in the previous period, and contributed a lot to the financial crash. And now we come to the same problem. If the Central Bank starts another financial pyramid, you can forget economic growth, you can forget about investments, and again we shall have a high probability of a new financial crash in the very near future.

Another IMF incentive is to eliminate government expenditures which are necessary to the economic growth policy; because, in a depression situation, to maintain economic growth you need the growth of final demand. If you cut off government expenditures, you make economic growth more difficult. You increase the barriers against economic growth. And, finally, the IMF call to use bankruptcy procedures in order to solve the problem of arrears between companies, is a very romantic and very dangerous idea, because in a situation where we have about 50% of the companies in the real sector insolvent, the bankruptcy of half the companies in the real sector would just stop everything.

EIR: The sudden removal of Primakov and the reemergence of Viktor Chernomyrdin into the Russian political situation, the trip by Anatoli Chubais to the United States just before the removal of Primakov, and so forth, are all clearly connected events. This focusses attention on the political situation and the foreign pressure on Russian economic policy right now.

Glazyev: The Primakov government resisted all those IMF ideas. At the same time, the Primakov government changed the Russian internal situation. In the previous period, the government was controlled by the financial oligarchs, who used their power first of all to steal money from the budget and to steal government property. So, the key issue of the Russian economic reform was the symbiosis between the IMF and the Russian financial oligarchs. The IMF gave political support to the radical liberal rhetoric, putting the umbrella of a liberal image over the Russian economic reform. But, in fact, they were not liberal reforms. Instead of liberalization of the market, the IMF, together with the Russian financial oligarchs, created a semi-feudal economy which has very little to do with the market. The financial oligarchs, using the IMF umbrella, which gave them political and ideological support for reducing government regulation, actually just privatized the government instruments, using the privatization campaign in order to steal the government property, and not to create private businesses. And now, competition is blocked by the pressure coming from the financial oligarchs, who use their monopoly position in government regulation to avoid any risk, to get a privileged market situation, to use the government subsidies and so forth. And so, in this symbiosis, the IMF took political

responsibility for the economic reform, and the financial oligarchs used their position close to power to have huge profits from this policy.

EIR: Many people were shocked to see how, just after the Aug. 17 Russian crisis, the huge Long Term Capital Management hedge fund in the United States suddenly went into collapse and was bailed out only by emergency measures organized by the Federal Reserve. This showed that the collapse of the GKO pyramid was not just a Russian event, but was part of the systemic crisis of the global financial system.

Glazyev: The Russian oligarchy together with the IMF created the most profitable commercial market in the world, which was based not on economic growth, but on purely speculative phenomena. The Russian government offered, on average, about 80% interest rates in real terms in dollars, taking into account the fixed exchange rate. So, they gave an opportunity to have an 80% interest rate in real terms, in dollars, for foreign and domestic investors playing with the government bonds. In comparison with the United States, where government bonds are about 4%; in Japan, where the government bonds are 2%; and in Germany, where they are maybe 3-5%, the Russian government in some cases offered more than 100% interest, doing this together with the fixed-exchange-rate policy through the currency corridor. And speculators from all over the world entered the Russian market and used this opportunity to have huge profits.

So, Russian economic policy, guided by the IMF, created a unique phenomenon. You had a decline in GDP by one-half and, at the same time, the financial market was the most profitable in the world, and without any risk. So the Russian financial market appeared to be a paradise for all the financial speculators, and because this was a purely speculative phenomenon, which was based on the creation of financial pyramids, it had to blow up, and it had a self-destruct mechanism inside from the very beginning. When the financial crash happened, those investors who did not have connections with Mr. Chubais and other guys in the Russian government, of course, lost.

We made a special investigation of how the decisions of Aug. 17 were made, and found very interesting details: The decisions to stop servicing the government debt and to stop maintaining the ruble exchange rate, were made by Chubais and Gaidar, who influenced [Prime Minister Sergei] Kiriyenko at the beginning, and the management of the Central Bank, and they did this in consultation with [U.S. Deputy Treasury Secretary Lawrence] Summers and [IMF Deputy Managing Director Stanley] Fisher. So the IMF was involved together with the Russian government in the preparation of the financial crash of Aug. 17. And the clients of the companies that were close to the Russian government, and to those people from the foreign side who played this market, got the opportunity to escape from this financial crash. They were given the opportunity to change their Russian ruble-denomi-

nated bonds into dollar-denominated bonds. A \$5 billion credit for the Russian Central Bank, given just two weeks before the financial crash, did not help to stabilize the currency. It just was used by those who were informed, to escape before the financial crash happened. And those hedge funds that became the victims of the propaganda of Russian financial stabilization, spread by the IMF, and supporters of the Russian so-called radical reformers, who believed in the miracle, invested money in the financial pyramid (and maybe did not know that it was a pyramid), and took a huge risk.

EIR: I want to ask you about the present situation, the coming Presidential election and what President Boris Yeltsin might possibly do, the possibility that some pretext might be created—such as a blow-up of the Caucasus, trying to shut down the Communist Party, circumventing the Constitution and so forth. How do you see the coming situation and the perspective for implementing the policies which you are recommending?

Glazyev: The financial oligarchy is in fact losing its power, because the living standard of the population declined dramatically—more than one-third of the population has an income below the poverty level—and there is no doubt that in this election campaign the Yeltsin regime will fail. They have no chance to keep their power, and for this reason, as far as we know from investigations, the oligarchs, together with the Yeltsin family and some newly appointed people in the government, are planning measures for how to avoid the elections themselves. So there are several plans being circulated, including a military coup, including the introduction of measures to extend Yeltsin's period in power, in spite of the fact that this would violate the Constitution. There are plans to start political repressions against the opposition. The authoritarian regime which exists in Russia at the moment, and which is totally corrupt and totally against the national interest, which gives only opportunities for huge profits to the financial oligarchs, will try to protect itself.

But, if we succeed in maintaining the law and maintaining an open election campaign, then I am sure that the situation will change in the near future. The Russian economy has a huge potential for growth. According to our experience of the last couple of years, and according to our calculations, the Russian economy could grow at the rate of about 8% per year without any problem. So there is a good chance to switch to a sustainable development with high rates of growth, to overcome the depression, and to organize a restructuring of Russian industry on the basis of new technologies with high efficiency. There are plans for how to improve the investment situation. The Russian economy can become a miracle in the near future, if we change the political situation. So there is a choice. Either the economic growth policy continues and we have very good prospects for the future; or, if the financial oligarchs, together with the IMF, insist on restoring the previous monetary and macroeconomic policy, it means a new

depression in a much worse financial situation.

EIR: Just recently the issue of the so-called strategic triangle Russia-India-China was raised in the Russian press. What are your thoughts about that?

Glazyev: I think this is a very fruitful idea, because the competitive advantages of these very large economies could, in combination, give a huge impulse for worldwide economic growth. Russia has a huge competitive potential in the high-tech sector which is not used at the moment, because of the lack of demand in the Russian market; while at the same time, we have a fast growth of the Chinese and Indian economies based on cheap labor, based on the large human resources which need modern technology, need education. All this could be combined together. So, the Russian high-tech potential, research and development opportunities, together with its large mineral resources base, together with the huge labor force in India and China market and Chinese opportunities to attract more investments from the world market, could, in combination, give an opportunity for very fast economic growth for the whole continent. At the moment, the trade turnover between Russia-China and Russia-India is growing. A lot of people are going to these countries to establish contacts, to establish mutual business, and so forth. But, of course, a more systemic policy is necessary, a policy which will create proper legal and economic conditions for merging, from the one side, the Russian industrial and scientific potential, and, from the other side, the human potential of these countries. I am sure this could really work. It could give huge opportunities for worldwide development, not only of these regions, but for the whole world.

EIR: In China, in the last year particularly, there has been considerable discussion about Lyndon LaRouche's work on physical economy and his analysis of the global financial crisis. I would like to ask how you see his influence now in Russia, also in light of the recent book, published by Russia's Vice Defense Minister, focussing on LaRouche's economic ideas.

Glazyev: These ideas are very natural for the Russian economic tradition. We used national economy as a basis for elaboration of plans for economic development, both in the pre-revolutionary and post-revolutionary Russia. So, this is a very natural approach from the standpoint of all our historical experience. The Russian government created long-term plans based on the national economy approach, and the whole economic growth of Russia during all of this century was based on the forecasts and instruments of economic policy to promote the development of the real sector. So, almost all the resources were allocated through the mechanisms of real-sector development planning, and only now this tradition was lost. So, at the moment, there is a strong interest in Mr. LaRouche's ideas in Russia, and there are a lot of followers of this approach, and I am sure that it will work.