ASYMMETRIC RESPONSE TO SANCTIONS

Russia Debates Dirigist Credit-Creation Plan

by Rachel Douglas

April 28—A proposal by Academician Sergei Glazyev, advisor to President Vladimir Putin, for measures to protect the Russian economy in the face of U.S.-EU sanctions, surfaced in the financial daily *Vedomosti* on April 25, and quickly became the subject of intense discussion in Russia. The 15-point plan, as is apparent even in the summary given by *Vedomosti* (see box), goes beyond short-term protective steps. It implies an escalation of Putin's announced policy of moving Russian finances out of offshore jurisdictions, and raises the possibility of new, state-guided approaches to generating credit for real economic investment—an idea whose time has come for every country, not only Russia.

According to *Vedomosti*, the proposal took the form of a letter from Glazyev to the Ministry of Finance, requesting deliberation on it by the National Financial Council—Russia's so-called financial mega-regulator, operating under the Central Bank. The daily reported that Minister of Finance Anton Siluanov had instructed his staff to prepare a response.

Within Russia itself, the situation is ripe for a proposal such as Glazyev's for two reasons. One is the specter of financial warfare in the form of punitive sanctions, imposed against Russia by the USA and the EU over the conflict in and around Ukraine, which was precipitated by the U.S./NATO-backed violent coup there in February. Secondly, the Russian economy, especially manufacturing, was already slowing drastically before the Ukraine crisis, and is in danger of slipping into negative growth. Capital flight in the first quarter of 2014 was in the range of $60-70 billion, equivalent to the average annual level in recent years. How to revive economic activity is currently the subject of fierce debate within the Russian government, although the approaches of the sparring Ministry of Economic Development and Ministry of Finance both remain in the universe of monetarist techniques.

But, in a larger sense, this is a moment when all mankind stands to benefit from the sudden attention to Glazyev's proposals. In view of the utter bankruptcy of the trans-Atlantic financial system dominating the globalized economy, there's not a single nation on Earth, which is not in need of a credit policy to make the real economy flourish.

There are multiple ironies here. The bankruptcy of the trans-Atlantic system is driving the danger of war. One of the foremost among an array of geopolitical motives for the demonization of Russia and Putin, is the potential for Russia to play a leading role in the emergence of a pro-growth Eurasian counterthrust to that collapse. Sergei Glazyev, personally, is on the Obama Administration's first-round sanctions hit-list, because of the role the Ukraine-born economist, whose roots are in the high-tech industry of that country's Dnieper Bend region, had played in seeking to bring Ukraine into closer economic cooperation with Russia and the nascent Eurasian Union, thus potentially saving what survives of Ukraine's industrial design and production capacities, which are otherwise slated for annihilation under a free-trade pact with the EU. Yet, the attacks on Glazyev, Putin, and Russia as a whole, have propelled Glazyev's most advanced proposals to the center of attention.

Economist and Putin advisor, Academician Sergei Glazyev, with President Putin, at a July 2013 conference in Kiev.

Targeted Lending

The most open-ended and potentially momentous of Glazyev's proposals (Point 12), is for the Russian Central Bank to issue money, channeled through the large state-owned VEB Bank, to enable Russian companies to replace their foreign debt with ruble-denominated Russian loans. The bulk of Russia's $723 billion external debt (a little more than half of which is sovereign debt and the debt of state-owned banks and corporations) is in the form of private and state-owned corporate obligations, on which payments constantly fall due. In recent weeks, Russian corporations have been unable to roll over their borrowings on foreign markets. Since Jan. 1, Bloomberg reported April 22, there have been only two Eurobond issues by Russian companies: one by Gazprom and one by Sberbank, the country's biggest bank, for $1 billion each, compared with $13 billion in such issues in the same period of 2013.

Russian entities have canceled several Eurobond issues, because the interest rates likely to be demanded were too high, and the issues could have failed. Russian borrowers are in a position of having to pay off their debts, rather than roll them over. The country thus faces a situation similar to that which President Abraham Lincoln's U.S. administration faced in 1861, when it began to implement the greenback sovereign currency and credit policy.

So far, Russia has refrained from steps equivalent to Lincoln's. But on April 25, following a week of high-level deliberation on these issues, the Central Bank did announce "a new mechanism for refinancing credit institutions": three-year loans, to be available to banks for lending for purposes that qualify for state guarantees.

Glazyev's proposal goes further than either the Bank of Russia moves or even *Vedomosti*'s summary of his points. The daily *Moskovsky Komsomolets* (*MK*) reported that, on April 24, Glazyev addressed an expanded leadership meeting of the Business Russia group, a forum much promoted by Putin, with a "programmatic speech" in which he expounded in more detail his ideas on the sources of "long-term and inexpensive internal credit." In this presentation, *MK* reported, Glazyev said that domestic credit availability should be doubled or tripled. The proposed mechanism is one Glazyev has promoted before: Central Bank refinancing of the banking system, earmarked for lending to real-economy sector companies.

The designation of a special role for VEB Bank, the large state-owned institution used for bailout operations during the 2008 phase of the global crisis, is noteworthy in connection with recent proposals by Russian Federal Drug Control Service (FDCS) head Victor Ivanov and his colleagues. At a March 25 conference on a crash development plan for Afghanistan, to wipe out the narcotics-based economy, FDCS Deputy Director Oleg Safonov called for a Central Asia Development Corporation to carry out large infrastructure projects and industrialization in that region, with VEB Bank as the obvious choice for financing it (*EIR*, April 4, 2014).

Glazyev, *MK* wrote, is a type of economist scientifically termed a "dirigist." Such people "are not against the market, but they believe it must be strictly regulated, and the state comes first." Indeed, Sergei Glazyev has campaigned for the revival of a national economy approach for 20 years. In June 2001, he sponsored State Duma hearings on protecting the national economy under conditions of global financial crisis, at which American economist Lyndon LaRouche was the primary foreign guest witness (*EIR*, July 20, 2001).

Dedollarization and Deoffshorizaton

Several of Glazyev's proposals, as reported by *Vedomosti*, come under the heading of "dedollarization," which a broad array of Russian officials have called for in the weeks since Washington began to impose sanctions against Russian officials and financial institutions. These include the transfer of Russia's own assets and dollar-denominated accounts from NATO countries to banks in neutral countries (Point 1); selling off the government bonds of NATO countries (Point 3); rapid reduction of Russian reserves held in the currencies of countries party to sanctions against Russia (Point 11); and a public campaign on the disadvantages of holding funds in dollar accounts (Point 13).

Especially important is Point 8, for restrictions on the foreign currency operations of Russian banks, especially targeting non-trade-related (i.e., speculative) transactions, and a requirement that large currency trades be announced in advance. These measures constitute capital and exchange controls, which are classic protectionist measures. In 2008, a large portion of the bailout funds issued to banks from the government's Stabilization Fund disappeared into currency speculation by those banks.

When the first round of U.S. sanctions against Russia was announced in March, for allegedly "annex-

Vedomosti's Summary of 'The Glazyev Plan'

1. Move dollar- and euro-denominated state assets and accounts from NATO countries to neutral ones.

2. Repatriate all state-owned valuables (precious metals, works of art, etc.) to Russia.

3. Sell the bonds of NATO countries before the imposition of sanctions.

4. Halt the export of gold, precious metals, and rare earth elements.

5. Arrange a credit and currency swap with China in order to finance critical imports and shift to settlement in national currencies.

6. Create our own interbank information exchange system, analogous to SWIFT, for payments and settlements within the Customs Union[1] and the CIS,[2] and with other partner countries.

7. Create a payment system for bank card settlements within the Eurasian Economic Community,[3] which would incorporate and fully process settlements made using Visa or MasterCard.[4]

8. Limit the foreign currency positions of banks and require prior declaration of major non-trade currency transactions. Subsequently introduce a tax on capital export and financial speculation.

9. Shift to settlement in national currencies in trade within the Customs Union and with other countries. Denominate new hydrocarbon export contracts in rubles.

10. Arrange credit and currency swaps with individual countries to finance trade.

11. Rapidly reduce the portion of our reserves held in dollar-denominated instruments and bonds of countries supporting sanctions.

12. Replace the dollar and euro borrowings of state corporations and state-owned banks with ruble loans on the same terms, making a targeted monetary emission for this purpose and utilizing VEB Bank to float the loans.

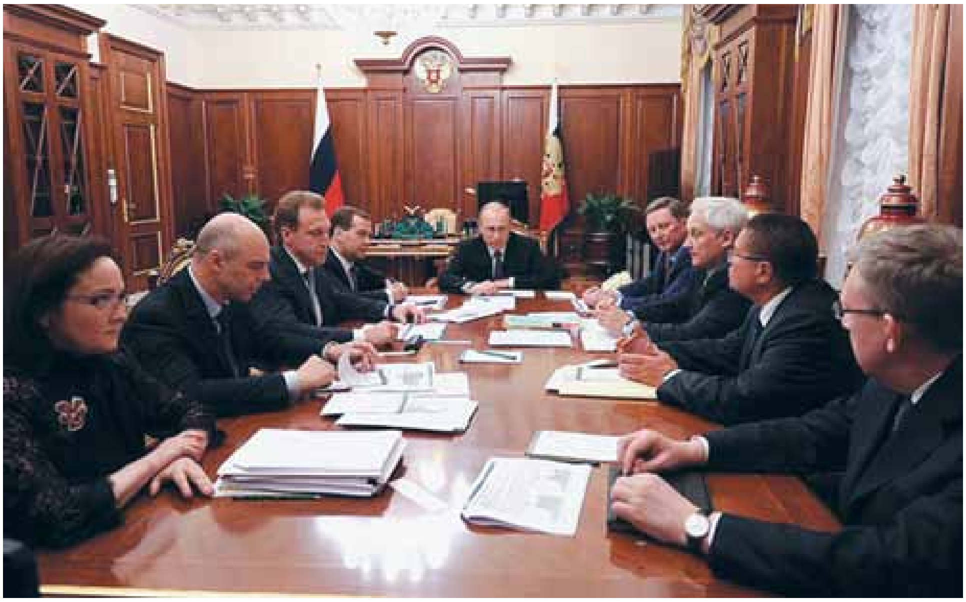
13. Conduct a publicity campaign on the advantages of shifting euro and dollar deposits into rubles. In the event that Central Bank and state-owned bank assets are frozen in the USA and the EU, freeze dollar- and euro-denominated bank liabilities.

14. In response to a trade embargo, carry out critically important operations through Belarusian and Kazakstan companies.

15. Bring the ownership of strategic enterprises, subsurface resource operations, and real estate, currently registered in offshore locations, under Russian jurisdiction.

1. CU: Belarus, Kazakstan, Russia
2. Commonwealth of Independent States: Armenia, Azerbaijan, Belarus, Kazakstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan (associate), Uzbekistan
3. EurAsEC: Belarus, Kazakstan, Kyrgyzstan, Russia, Tajikistan
4. In a March 26, 2014 interview with the Russian News Agency (RSN), Sergei Glazyev explained this function as analogous to China's UnionPay system: "You adopt a law requiring all bank card settlements within a country to go through a national operations center. Visa and MasterCard can't do anything about it. That is, within China those cards function as Chinese cards. Abroad, they work as international cards."

ing" Crimea, one of the targeted institutions was Bank Rossiya, the 15th-largest bank in Russia. Immediately after the announcement, Putin ostentatiously went to a local branch of Bank Rossiya and opened an account, where he said his salary would be deposited henceforth. On March 28, Bank Rossiya announced it would now conduct business in rubles only. A statement on the bank's website said that American and other foreign banks were being informed of the closing of correspondent accounts at Bank Rossiya. This decision was featured on Channel One Russia TV's nightly news, which said that Rossiya had "made a strong move in a difficult situation," adding, "The sanctions aimed to weaken the bank, but it turned them into a plus." Speaker of the Federation Council Valentina Matviyenko was interviewed in the segment, posing the shift as a matter of national security: "This is important, in order to get away from strict dependence on foreign countries, to minimize risks for our companies and citizens, including our core strategic industries."



Russian Presidential Press Service

A late-night economic advisors' meeting at President Putin's residence, April 22, at the height of the conflict over Ukraine. Left to right: Central Bank head Nabiullina, Finance Minister Siluanov, Deputy Prime Minister Shuvalov, Prime Minister Medvedev, Putin, Kremlin Chief of Staff Ivanov, Presidential Aide Belousov, Economics Minister Ulyukayev, and former Finance Minister Kudrin.

The Channel One Russia story said that the term "dedollarization" is being used ever more frequently. It broadcast a comment from Alexei Kostin, CEO of the state-owned banking giant VTB Bank, who said, "It seems to me that we arrived some time ago at the idea of dedollarizing our financial sector, our payments, and using the ruble more widely for settling accounts. The ruble, after all, has been a fully convertible currency for some time. Today the changes taking place at Bank Rossiya are, broadly speaking, a step in the direction ahead towards our economy and our banking sector becoming truly a national-currency sector."

Glazyev's proposals also mandate a shift of the ownership jurisdiction of strategically significant Russian companies from offshore zones to Russia. This refers to a bane of the Russian economy since the wild plunge into a globalized free market in the 1990s: The newly minted "oligarchs," owners of newly privatized former Soviet industries, would register them offshore, in British Overseas Territories like the Cayman Islands or the British Virgin Islands, or other tax havens like Cyprus, Lichtenstein, or Luxembourg. (See Lyndon H. LaRouche, Jr., "The Case of Arkadi V. Dvorkovich: Free Russia from the Pirates of the Caribbean!," (EIR, April 30, 2010).

A Late-Night Meeting

On April 22, Prime Minister Dmitri Medvedev delivered his annual report to the Russian State Duma on the performance of the government in 2013. He took stock of the "rather difficult situation" of the Russian economy, which he attributed to three factors: the instability of the global economy, the "hostile attitude of several leading countries" (the sanctions), and "our own structural limitations." The Prime Minister acknowledged that all the parties in the Duma wanted to know whether the Government "deems it necessary to change our economic policy under these conditions."

Medvedev's answer was that it's not. He said, "I do not believe it is correct to change it in any fundamental way. It would also be incorrect to start to flip-flop, trying to think up some new principles of development for our economy. Russia, of course, may have its own pathway with regard to national consciousness and values, but the laws of economics remain universal, and in the face of this unprecedented challenge, it is extremely important for us to calmly, without hysteria, continue the economic strategy we have chosen."

The business daily *Kommersant* reported the Duma's response: "The deputies sat in silence."

That night, at 10 p.m., a small-group meeting was convened at President Putin's Novo-Ogaryovo residence. Present were Medvedev and First Deputy Prime Minister Igor Shuvalov; Finance Minister Siluanov and Economics Minister Alexei Ulyukayev; Kremlin Chief of Staff Sergei Ivanov, and Putin's chief economic aide Alexei Belousov, the former Economics Minister; Central Bank head Elvira Nabiullina; and former Finance Minister Alexei Kudrin, in his capacity as a member of the Presidential Economics Council. The reason, according to *Kommersant* and other informed sources in Moscow, was that Medvedev had not addressed a controversy initiated by the Ministry of Economic Development (MED) in March.

Ulyukayev, despite his background as a member of the initial team of radical neoliberals in the Yegor Gaidar government in 1992, and years of working at Russia's Central Bank, has shown serious concern for Russia's real economy, since his appointment to the MED in June 2013. Last November, Ulyukayev rang the alarm bell about the economic slump, forecasting that 2013 growth targets would be missed by one-half—which is exactly what happened, with 1.3% growth for the year.

In March 2014, the MED proposed a set of measures, amounting to a typical monetarist stimulus package, but even these flew in the face of the radical fiscal conservatism, instituted under former head of the ministry Alexei Kudrin (2000-11), and continued under current Finance Minister Siluanov. The devaluation of the ruble in 2014 has produced 900 billion rubles (~$25 billion) in unanticipated revenue, because taxes on dollar-denominated oil sales translate into more rubles. The MED proposed to allocate these funds for economic project development. In addition, the MED proposed to relax the strict Budget Rule, adopted in 2012, which holds federal spending to 1% of GDP—thrice as austere as the EU's notorious Maastricht ceiling of 3%. (Putin himself, at a certain point, was sold on a goal of achieving a zero-deficit budget by 2015.) The relaxation would allow increasing the disbursement side of the federal budget by 3.25 trillion rubles ($90 billion) over four years. The MED published an outline of target areas for the spending: development of Russia's new region, Crimea; transport infrastructure; health care, housing, and fire-protection programs; industry-specific investment support; and support for small businesses and innovation clusters.

Kommersant reported that Siluanov presented the April 22 meeting with dire calculations, on the basis of which he termed any increased spending to be "a national security threat." He said that the current Budget Rule must be obeyed, or else Russia would lose all its reserves by 2017. If the price of oil were to drop to $91/barrel, Siluanov warned, the Reserve Fund would be wiped out by 2016. Moscow sources report that Ulyukayev had the support of Putin's aide Belousov, while Nabiullina, Shuvalov, and Kudrin lined up with Siluanov.

Ulyukayev on April 23 said tersely, "No decision was taken," *Kommersant* reported. On April 24, *Vedomosti* leaked the Glazyev memorandum. On April 25, the Central Bank hiked its benchmark interest rate 50 basis points to 7.5%, in an attempt to curb capital flight and inflation, but also took its baby step of the new "refinancing mechanism" for earmarked three-year loans.

Shuvalov was quick to tell Itar-Tass that "what Academician Glazyev set forth in his letter is not the agenda of the Russian government"—although Shuvalov himself, earlier in April, had advised Russian companies traded on the London exchange that they should consider shifting their listings to Moscow as "a question of economic security." Kudrin tweeted that "Glazyev's measures would pinch tighter than the West's sanctions," while Nabiullina declared that a total exit from the dollar was "something out of science fiction." But *Vedomosti* cited a Kremlin source who said that "Glazyev's ideas are used to test whether the liberal bloc, like Siluanov, [Sberbank CEO German] Gref, or Kudrin will be able to find convincing counterarguments, so one should not overestimate Glazyev's influence, but not underestimate it, either."

A Eurasian Summit

The ideas under debate in Russia will have a chance to be tested in the broader Eurasian and global context when Putin visits China on May 20. Glazyev's 15 points include not only a shift to using national currencies in trade with several countries, but specifically the establishment of currency and credit swap arrangements with China, in order to ensure financing for critical categories of trade.