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Russian Political Turmoil, August 1998

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Summary

Russian President Yeltsin's dismissal of Premier Kirienko and his nomination of former Premier Chernomyrdin mark an intensification of political turmoil. This was triggered by a financial crisis and underlying economic depression. These political and economic developments have serious implications for Russia's stability, the post-Yeltsin succession, and U.S. interests in and policy toward Russia. This report will be updated if warranted by developments in Russia.

The Issues[1]

Yeltsin's Reshuffle of the Government

On August 23, 1998, Russian President Boris Yeltsin dismissed Premier Sergei Kirienko and his government and designated former Premier Viktor Chernomyrdin to succeed him. The Russian Duma has one week to either confirm or reject Chernomyrdin's nomination. Chernomyrdin is negotiating with legislators and prospective cabinet ministers. This political turmoil, the latest in a series of unsettling developments in Russia, heightens concerns about Russia's political, economic, and social stability and reform prospects.

Russia's Financial Crisis

Kirienko's dismissal was triggered by a severe financial crisis which led his government to announce a *de facto* 50% devaluation of the ruble and a temporary suspension of repayment of, and a restructuring of, commercial and government debt — which amounted to a technical default on billions of dollars of foreign debts. The devaluation and suspension of repayments were precipitated by the government's inability to service its rapidly growing domestic and foreign debt and by the immediate prospect of the collapse of the banking system — despite a $22.6 billion IMF-led bailout loan agreement in July 1998. The causes of Russia's financial crisis predate Kirienko's brief tenure as head of

[1] Information for this report is taken from a variety of sources, including Radio Free Europe/Radio Liberty (RFE/RL), Reuters, Tass, and the Internet website, Johnson's Russia List.

government, and can be traced to Chernomyrdin's premiership (December 1992 to March 1998) and ultimately to Yeltsin. By many accounts, the Yeltsin team fears that devaluation of the ruble and the price inflation that is expected to follow will be seen by the public as negating the most significant economic achievements of the regime, under whose stewardship the GDP has contracted by about 50%, accompanied by economic distress worse than the Great Depression of the 1930s in the United States for most of the Russian population. To many observers, dismissing Kirienko appears to be an attempt to shift responsibility for the financial crisis to the ex-premier. The Kirienko Government had been hailed by the Clinton Administration as the most competent and reform-oriented Russian government in years. Some observers expect Chernomyrdin to take a more statist approach, possibly slowing Russia's economic transition to a functioning market system.

U.S.-Russian Summit[2]

In July 1998, the Clinton Administration agreed to a Clinton-Yeltsin summit meeting in Moscow, now scheduled for September 1-3. Following Kirienko's dismissal, Administration spokesmen announced that the summit would be held as scheduled. Some critics of the Administration question the wisdom of proceeding with the summit amidst such political and economic uncertainty in Moscow. Others argue that cancellation or postponement might be seen as a U.S. vote of no-confidence in the Russian government, further undermining its parlous economic situation, Yeltsin's presidency, and the prospects for reform. Economic issues will undoubtedly be high on the summit agenda.

Political Turmoil

The Yeltsin regime seems to lurch periodically from one political crisis to the next. For example, during the 1996 presidential election campaign, Yeltsin's sudden alliance with Gen. Aleksandr Lebed helped bring victory. Yeltsin's reelection was followed by his prolonged illness and an open succession struggle. In October 1996, Yeltsin fired Lebed. In March 1997, Yeltsin's appointment of the "young reformers," Anatoly Chubais and Boris Nemstov, seemed to eclipse Chernomyrdin. In the winter of 1997-1998, Yeltsin backed Chernomyrdin's downgrading of Chubais and Nemstov. In March 1998, Yeltsin amazed observers by dismissing Chernomyrdin and the entire government and provoking a bitter confrontation with the Duma by insisting on the appointment of the little-known 35-year-old technocrat, Kirienko, as premier. Five months later, amid deepening financial and economic crisis, Yeltsin fired Kirienko and reappointed Chernomyrdin.

In firing Chernomyrdin in March, Yeltsin cited chronic economic failure and the need for a more dynamic team to accelerate economic reform and revival. Many, however, believe that Yeltsin was troubled by Chernomyrdin's open assumption of the role of Yeltsin's successor and needed a scapegoat for past economic failures.[3] Yeltsin further humiliated

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[2] See CRS Report 98-704, *U.S.-.Russia Summit, September 1-3, 1998, A Preview*, August 24, 1998.

[3] Kremlin spokesmen pointedly left open the option of a third term for Yeltsin, despite the constitutional limit of two terms for the president. Yeltsin supporters argued that since his first (continued...)

Chernomyrdin by publicly criticizing the ex-premier's announcement of his candidacy for president in 2000. With no political base of his own, Kirienko was expected to be dependent upon and obedient to Yeltsin.

Kirienko, with Yeltsin's approval, assembled a western-oriented economic team and pursued economic policies supported by the Clinton Administration, the G-7, and the IMF. But economic conditions and the government's and Yeltsin's approval ratings continued to deteriorate. Strikes and labor protests, including blocking major railway lines, grew in frequency, as did public calls for Yeltsin's resignation. In June, the Duma began formal impeachment proceedings against Yeltsin.[4] After four months in power, Russia's financial crisis and the ruble devaluation and debt rescheduling — that Yeltsin approved — brought Kirienko down. On Friday, August 14, Yeltsin assured the public in a televised statement that the ruble would not be devalued. Devaluation, which a few days earlier he had said would negate the regime's most hard-won economic accomplishments, was not a possibility. On Monday morning, August 17, *de facto* devaluation was announced. The parliamentary opposition, the news media, and the public reacted with ridicule and scorn. One popular refrain was that Yeltsin and the government had devalued not only the ruble but themselves. Yeltsin's public approval ratings, as low as 4 % *before* these events, fell to near zero. Yeltsin said little in public for a week. Then, on August 23, he made a terse announcement of Kirienko's dismissal and Chernomyrdin's nomination.

Some believe that in firing Kirienko, Yeltsin sought to shift responsibility for the politically unpopular devaluation to the former premier. Such scapegoating has been a common Yeltsin tactic in the past. A variation on this theme has it that Yeltsin is ill, politically out of touch, and was manipulated or forced into dumping Kirienko by his Kremlin coterie. Another theory is that Kirienko was brought down by banking oligarchs who convinced Yeltsin — through his daughter and his chief of staff — to sack the premier, who was resisting their plan for a government bailout of their endangered banks.

Some see this pattern of recurrent crises as a direct result of Yeltsin's leadership style, distancing himself not only from day-to-day governance but from major policy decisions, becoming personally engaged only at times of crisis. The Constitution, shaped by and for Yeltsin, tips the political balance overwhelmingly toward the president. But Yeltsin has repeatedly shown himself either unwilling or unable to exercise that authority on a routine basis. He has also consistently refused to allow the emergence of a powerful subordinate who could wield power effectively. He may view such a development as a threat to his power. In this view, Yeltsin seems to be motivated above all by a personal will-to-power. The result has been ineffective leadership characterized by rivalries among competing subordinates, conflicting policies, and, sometimes, political paralysis. While some admire Yeltsin's tactical acumen, his strategic position seems greatly eroded.

"The Great Game"

[3](...continued)
term began under the old Soviet Constitution, it did not count under Russia's new Constitution.

[4] The Duma's action may be mainly symbolic. Yeltsin's Constitution makes impeaching the president extremely difficult.

There is another confusing dimension to Russia’s political turmoil. What appears on the surface to be “normal” competition among politicians and parties, factions, and movements of varying ideological hues, is believed by some to mask a deeper underlying contest — “The Great Game.” In this view, party politics and the purported ideological differences among political rivals is largely a charade concealing a venal competition among rival elites to seize ownership of vast, previously state-owned, assets. Proponents of this interpretation see privatization as a combination of outright theft and the biggest fire sale in history. Rival elites are seen as using political power to carve out economic empires for themselves. The stakes are so immense that most “ordinary” political considerations, even on national security issues, are eclipsed by “The Great Game.” Chernomyrdin, the former head of the giant, still partly state-owned gas monopoly, Gazprom, is widely believed to be a major player in this game. He is strongly and openly backed by one of the most aggressive and outspoken financial oligarchs, Boris Berezovskii. Some suggest that the replacement of the technocrat, Kirienko by the “player,” Chernomyrdin, may be partly a manifestation of “The Great Game.”

Economic and Financial Crises

The Russian financial crisis that triggered Kirienko's dismissal has many causes. Its underlying sources are discussed elsewhere.[5] Most analysts agree that the immediate crisis was precipitated by Russia's inability to collect sufficient tax revenue, a mountain of commercial and government debt that became literally unsustainable, Asia's economic troubles, and the drop in world oil prices. Many of these factors are interrelated.

Most economic analysts agree that the persistent distress in many Asian economies, especially among prominent "emerging markets," caused investors to withdraw funds precipitously from other emerging markets, including Russia. The Russian securities market, which had the world's highest growth rate in 1997, has lost about 80% of its value in 1998 as foreign and domestic capital fled. At the same time, the price of oil and gas, Russia's main exports and hard-currency earners, has fallen sharply. Russian oil was selling for less than $12 per barrel in August 1998. Russian extraction costs are estimated to be about $15 per barrel. Asia's economic problems reduced world demand for oil and helped drive down prices. Reduced oil and gas revenues in Russia, in turn, had a big negative impact on the Russian securities market, which is relatively small and heavily weighted toward the energy sector.

Since the collapse of the Soviet Union, Russia has been plagued by chronic shortfalls in tax collection. Among the reasons for this are chaotic tax laws, an inefficient and corrupt tax service, a culture of personal and corporate tax evasion, the growth of barter and debt-swaps in commercial exchanges, and the decline in profits in the energy sector. Since the disastrous 2,500 % inflation in 1992 when prices were decontrolled, Moscow — prodded by the G-7 and the IMF — has generally followed a monetarist course that emphasized stabilizing the ruble and controlling inflation, which was down to about 8% by mid-1998. These monetarist policies, combined with continued subsidies to loss-making enterprises

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[5] For a detailed analysis of the Russian economic situation, see CRS Reports 97-1013, *Russian Economic Conditions and Reform*, November 21, 1997; and 98-578, *Russian Financial Crisis: An Analysis of Trends, Causes, and Implications*, updated July 27, 1998.

and inadequate tax collection, help explain Russia's habitual problem of wage and pension arrears and made Russia highly dependent on IMF aid.

But the painful expedient of delaying wage and pension payments was not sufficient to close the budget deficit gap. Determined to avoid inflationary currency emissions, the government relied heavily on borrowing, especially domestic borrowing via short-term treasury bills, called GKOs. Large budget deficits and political instability forced the government to offer high interest rates (typically 30-50%) to attract buyers even for 90-day GKOs. The government was able to pay off these notes with the help of funds acquired from the sale of new treasury bills, supplemented by loans from the IMF and other foreign governmental and commercial lenders. As long as the government continued to meet its obligations, the GKOs were an attractive, and for many Russian bankers an irresistible, investment. As the Asian economic crisis, falling oil prices, the Russian stock market's decline, and continued political instability fed investors' anxiety, GKO rates shot up to 150%. The July 21 announcement of a $22.6 billion IMF-led loan package only calmed the markets for a few weeks.[6] By August, nearly 40% of budget expenditure went to debt service. This alarming development drove interest rates still higher, resulting in an unsustainable debt spiral that finally forced Kirienko to resort to ruble devaluation and suspension of payment on government and commercial debts.

The financial crisis, however, is not over. Russian banks, including many large commercial banks, borrowed heavily to invest in GKOs. A lot of this borrowing was from foreign lenders. Now, incautious Russian banks find themselves with large hard currency debts "secured" by devalued rubles. Most experts predict widespread bank failures — absent a big government bailout. The Deputy Director of the Russian Central Bank said that even some of Russia's largest commercial banks were likely to go under. Some fear a wholesale collapse of the banking system. Averting this is one of Chernomyrdin's top priorities. Others say the government must use its scarce resources to meet foreign debt obligations or risk losing future foreign investment.

Implications

The political and economic turmoil in Russia has serious implications for Russia and the United States. It is as yet unclear whether, or under what conditions, the Duma will confirm Chernomyrdin or what the makeup and policies of a Chernomyrdin government might be. Russian news media report that Chernomyrdin has agreed to form a coalition government representing the main Duma factions. Communists and ultranationalists are in the majority. This is an old Duma demand that Yeltsin has previously ignored.

Recent political and economic turmoil casts a shadow over Yeltsin’s future, the post-Yeltsin succession, and beyond that, over Russia’s political stability. Many commentators argue that Yeltsin is gravely wounded, has no chance of winning reelection in 2000, and may be forced to resign or to continue as a figurehead. Others caution not to underestimate Yeltsin's will-to-power or his ability to overcome seemingly hopeless odds. Yeltsin's televised nomination of Chernomyrdin on August 24 referred to the necessity of "ensuring

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[6] The initial $4.8 billion infusion was almost entirely expended by the Russian Central Bank in 2-3 weeks of defending the ruble.

the succession of power in 2000." While Chernomyrdin may now be Yeltsin's chosen successor, he is regarded as a lackluster leader and a poor campaigner who has never won an election. Other prominent presidential aspirants are Yuri Luzhkov, the Mayor of Moscow, Aleksandr Lebed, now Governor of the Krasnoyarsk region, and Gennady Zyuganov, head of the Communist Party. Most observers agree that Russia's democratic reformers have been further discredited and weakened politically.

Some critics of U.S. policy toward Russia charge that it is too closely linked to Yeltsin and is seen by ordinary Russians as endorsing Yeltsin and the unpopular economic policies that they blame for leading the country to ruin. Defenders of U.S. policy reply that Yeltsin has steered Russia on an essentially correct, though painful, course. Russia's current turmoil raises anew the question of whether it serves U.S. interests to have a weakened President Yeltsin remain in office at least through 2000 — at the possible cost of prolonged political and economic instability. The converse might be a stronger and more stable, though perhaps more authoritarian and nationalist Russia, with a different hand on the helm. These are not the only possible outcomes, but it seems useful to look at some national security implications of these two commonly juxtaposed alternatives.

A weak and unstable Russia may be less likely to pose an aggressive military threat to its neighbors. Russian conventional military capability, already greatly diminished, might continue to deteriorate. On the other hand, instability probably heightens the risk of various "loose-nuke" scenarios and increases the probability of proliferation of weapons of mass destruction (WMD). Also, continued political and economic instability increases the risk of some wrenching upheaval with possibly violent or radical outcomes.

A more stable, though more authoritarian and nationalistic, Russia might be more effective in countering WMD proliferation. But it might also be inclined toward more assertive, possibly imperialistic policies, especially toward some of the other former Soviet states. Its ability to do so effectively, however, and to revive its armed forces, would depend in large part on its economic status. Most experts agree that any realistic plan for rapid Russian economic recovery requires a low defense burden. Hence, even an authoritarian and nationalistic Russia might not be able to *rapidly* reconstitute its armed forces.[7] A long-term threat, of course, would be a distinct possibility.

Finally, foreign banks and governments have an immediate economic interest in what the new government will do about debt rescheduling and repayment. On August 17, Kirienko suspended repayment for 90 days on an estimated $40 billion in treasury bills and bonds (of which $11 billion is held by foreigners) coming due by the end of 1999. The new government plan, which would reduce Russia's debt and shift some of the cost to foreign investors, calls for creditors to exchange their notes for new obligations that will offer a longer term of repayment and/or substantially lower interest rates. This threatens foreign investors in Russian bonds with heavy losses. German lenders are believed to be most heavily exposed, a factor that could weigh against the reelection of Chancellor Helmut Kohl in the German national election on September 27, 1998.

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[7] CRS Report 97-820, *Russian Conventional Armed Forces: On the Verge of Collapse?* September 4, 1997, p. 47-48.