CHAPTER IV

FALL FROM GRACE
"Half starved teachers and factory workers voted for Yeltsin, not because they were scared of the communist but because for hundreds of years such people in Russia have had instilled in them a love of the authorities. The elections of July 3, 1996 marked a historic triumph for social apathy, for the traditional love of bosses and fear of freedom, for conformism and for an authoritarian political culture," writes Boris Kagarlitsky, a well known Russian sociologist and political commentator.1

In the presidential elections of 1996, the communist party of Russian Federation (CPRF) proved incapable of presenting itself as a modern dynamic alternative. The calculation that hostility to Yeltsin would lead decisive numbers to support Zyuganov proved quite false. The CPRF ended up in a political ghetto having no experience to work with socio-economic groups that did not share traditional communist values but were anti-establishment.

Political cross dressing by endorsing the ideas and style of Yeltsin's regime did not improve their respectability but rather strengthened Yeltsin's position Communist presidential candidate Gennadi Zyuganov stopped criticizing the war in Chechenya and sought to establish their reverence for private property. Spokespeople of the Yeltsin's regime also borrowed the opposition planks for election speak. Thus, while the left wing majority in the Duma pledged to strengthen the power of the Russian state, Yeltsin and his associate lamented the collapse of the Soviet Union, promised integration with former fraternal republics and stated that there was no reason to be afraid of nationalization.2

The first round of the presidential elections did not bring victory to any candidate. As per the constitutional stipulations if no candidate secured more than 50 per cent of the votes polled there would be a second round between the lead contenders. In the first round Yeltsin gained 35 per cent of the overall vote and Zyuganov received 32 per cent. The communists fared well in industrial centres- the red belt and by lesser margins in the

Agrarian districts of southern and western Siberia. General Alexander Lebed finished with 14.7 per cent, Grigori Yavlinsky with 7.4 per cent and Vladimir Zhirinovsky with 5.8 per cent.\(^3\)

Surpassing Zyuganov by only 3 per cent in the first round, Yeltsin could not feel confident of his prospects in the runoff. After the June 16 vote, Yeltsin shifted his focus to personnel changes aimed at attracting additional votes and consolidate his electorate. On June 18, 1996 he appointed Lebed to the post of national security advisor. Lebed, who had based his entire campaign on exposing the regime, was transformed before the eyes of journalists into one of the regime’s leading supporters. For the benefit of Lebed, Yeltsin sacked the general’s long time Foe Defense minister Pavel Grachev. General Alexandr Korzhakov, the head of the president’s security services, General Mikhail Barsukov, the head of the Federal security service and Deputy prime minister Oleg Soskovets were also purged to accommodate Yavlinsky and Liberals associated with Anatoly Chubais.\(^4\)

Paradoxically the strengthening of the government’s authoritarianism and the purge in the Kremlin lent the regime a certain attractiveness. It responded to a significant proportion of Russian population's yearning for the Iron fist. The communists were no longer the embodiment of order for many people and government linked a prospective communist victory with the beginning of discord, chaos and political anarchy.

Lebed’s first role was to manage the defeat of rebels in Chechenya. He successfully took state nationalist rhetoric together with demagogic criticism of democrats, communists and racist attack on southern nationalists into his own political arsenal.\(^5\)

One of the most crucial factor in the presidential elections was the government’s domination of the mass media.\(^6\) The president’s propaganda machine created an anti-Communist hysteria which undermined the positions of not only communists but other democratic leaders as well. On the other hand, the incumbent was promoted during rock

---

\(^3\) Remmik, David. “Can Russia change,” Foreign Affairs Vol. 76 No. 1 Jan/Feb 1997 pp-35-49
\(^5\) Ibid, pp 69
\(^6\) ABC News, May 26, 1996
concerts, televised astrological forecasts, entertainment, cultural programs. The praises were varied and refined and the posters aesthetically pleasing benefiting from professional design and the use of western materials. A small lead for Yeltsin in the first round was transformed into a substantial majority on July 3, 1996 when Yeltsin was reelected with about 54 per cent of the vote. While Zynganov received around 40 per cent.7

Yeltsin’s victory broke a pattern observable across almost all the post communist democracies of Eastern Europe in which disenchanted voters rejected the first crop of reformer when they stood for reelection. The conventional wisdom had the explanation – as after any unexpected victory- that the candidate conducted an extremely intelligent and professional campaign.

Handicapped by internal feuding, run at one point from five competing power centres and lavishly overspending on advertising, the campaign continually seemed to risk falling into the over confident, patronizing or office exploiting style that had undermined pro-government blocs in previous Russian elections. Nor could Yeltsin’s victory be attributed to favourable economic trends. During his first term GDP fell 50 per cent, income inequality and unemployment grew, and hyperinflation wiped out many families saving.8

Most observers explanations – economic performance, television advertisement, Lebed’s appointment on Chechenya, anti-Communist scare tactics, or effort to reintegrate the former Soviet republics cannot easily account for the rise. The aspect of the campaign that seems to have figured most prominently in the crucial rise in Yeltsin’s popularity was promises of and an outright increase in social spending.9 Indeed Yeltsin, won the election in large part through state largess.

Yeltsin issued a dramatic series of socially oriented measures and decrees in April and early May. Yeltsin doubled the minimum pension and ordered compensation for those whose saving had been devalued by the 1992 hyperinflation. on June 10, 1996 six days

before the first round of the elections, the first set of payments was made to those over
the age of 80. 10

The scope of Yeltsin’s handouts to different social and geographic group was spread out
in the months preceding the presidential elections. In January, February, March, the
president issued seven or eight decrees each month allocating benefits to particular
geographic, social or economic constituencies. In April he signed 22 decrees and in May
and first two weeks of June, another 34.11

Students, teachers, medical workers, pensioners, war invalids, veterans, children, single
mothers, scientists, the formerly repressed, small businesses, the Cossacks the
unemployed, the military patriotic youth organizations all benefitted from at least one
decree during the last ten weeks of the campaign.

So did the agro- industrial complex and the defense, aviation and space industries.
Decrees between April 1, 1996 and the election day singled out for benefits along with
Siberia central Black Earth, far north, Far East, and Baikal regions, the republics of
Tatarstan, Udmurtia and Komi, provinces like Belgorod, Sverdlovsk, Vologda,
Chelyabinsk, Rostor and Kemerovo oblasts.

The president’s office became a “glorified social services and janitor’s office combined”
that was working hard to make Yeltsin “look kind and fair like Robin Hood come
alive.”12

Further, unpaid wages had become one of the major irritants for voters in pre-election
months. By February 1996 the backlog had reached $ 4.9 billion. Yeltsin declared war on
the problem, by instructing the tax police and even security services to investigate
enterprises whose directors ran up wage arrears. He fired regional officials accused of

10 Specter, Michael, “Yeltsin Hits campaign Trail telling voters of forget past,” The New York Times, April
26, 1996 pp-1
11 Ibid.
12 Specter, Michael, “Yeltsin Hits Campain Trail Telling voters to forget past,” The New York Times, April
26, 1996 pp-10
directing payroll funds to other purposes and transferring additional funds from the central budget to pay overdue wages in the state sector.¹³

The policy succeeded in diverting public indignation from the federal authorities to the local officials and enterprise directors who were widely accused of holding up wages for their own profit or political purposes.

In order to muster support, Yeltsin undertook an energetic series of trips to different parts of Russia. These visits were almost always combined with offers of largess. Such federal aid along with careful preparation by local governors who often doubled as Yeltsin’s regional campaign managers usually created a receptive crowd at Yeltsin’s public meetings.

This in turn created a positive image and a sense of momentum for the national news shows. Viewers saw an energetic, confident president listening and responding to ordinary people’s concerns and being greeted with respect.

Yeltsin’s trips demonstrated that he was physically sound, in touch with ordinary people and willing to listen. The stamina and high spirits of a president who had suffered two bouts of ischemia impressed the accompanying press corps, “Everyday Boris Yeltsin dances better, kisses ladies hands more skillfully jokes with girls in the streets more freely.”¹⁴

However, inspite of the apparent efficacy few observers had anything positive to say about Yeltsin’s “Santa Claus” strategy in the last months of his campaign. Many accused him of populism and pointed to the very real economic costs of such a strategy. Boris Nemstov, governor Nizhny Novgorod said the election campaign was “a nightmare for the Russian economy because it has caused a surge in federal spending, while scaring away foreign investors.”¹⁵ Gaidar, head of the reformist Russia’s Choice party demanded a condition for his support that “budget must not be made a hostage to the election

¹³ Treisman, Daniel -Ibid.
campaign".\textsuperscript{16} An editorial in New York Times had even cautioned Yeltsin against "recklessly trying to spend his way back to popularity, thus undermining economic reform and causing lasting damage to the economy in a vain effort to save his own skin."\textsuperscript{17}

Between March and May, the central Bank had to issue more than 25 trillion rubles and sell $3 billion of its reserves to support the ruble. The federal budget deficit shot up to 9.6 per cent of GDP in April, from 5 per cent in the first quarter. Electoral consideration also softened the federal government’s resolve in collecting taxes and enterprises underpaid a total of about $15 billion in six months.\textsuperscript{18}

Not only was Yeltsin’s approach criticized as economically dangerous both Russian and western analysts also thought that it could not work politically. According to one Russian political commentator, the strategy of “trying to beat the communists on their own playing field and at their own demagogic logic was doomed to fail.”\textsuperscript{19}

As early as February a leading western analyst accused Yeltsin of “giving in to the communist on virtually all fronts apart from cleaning up corruption.”\textsuperscript{20} Such an approach, he added, “makes no sense as an electoral strategy. To communists, he remains a traitor. to liberals, he has abandoned all the values that made him popular.” Another argued that for reformer like Yeltsin and Grigori Yavlinsky to appeal to the communists voters by making lavish promises to pensioners or by firing liberals from the government would be self-destructive\textsuperscript{21}: “To appeal to potential swing voters, a reformist candidate must convince them of virtues of reform and the dangers of radically altering the status quo. Attempts to sway these voters by acting more like the opposition not only will fail, but at the same time will alienate the core supporters of reform.”\textsuperscript{22}

\textsuperscript{16} Ibid.
\textsuperscript{17} Ibid—Jan 5, 1996, p-A12
\textsuperscript{20} Aslund, Anders- Ibid.
\textsuperscript{21} Ibid
\textsuperscript{22} McFaul, Michael, “Russia’s 1996 Presidential Election pp-110
Surprisingly, the strategy seems to have been viewed with a certain understanding by the IMF, which agreed to keep disbursing monthly tranches of its $10.2 billion loan negotiated in February. In part, this was because, despite the additional spending and ineffective tax collection, the government for the most part avoided inflation by selling over more government bonds on the state securities market. As a result lavish promises could be combined with a steady fall in monthly inflation rates.23

This was not the first election in which state financial aid appeared to have improved the performance of incumbents. In the 1995 parliamentary election, regions that had enjoyed larger increases in net fiscal transfer from the center voted significantly for the most pro-government bloc, Our home is Russia.24 And in 1993 parliamentary election the vote for the most pro-government bloc, then Russia's choice, was higher in the regions, where regional state spending was increased the most.25

Thus, while Yeltsin's strategy of polarizing the electorate and raising the fear of a return to communist repression helped him beat out "Third Force" centrist candidates, his campaigning with populist promises, generous social policy initiatives and regional aid, played a crucial role in securing majority support.

The economic costs of such a campaign strategy were significant. Soon after the election result were announced, Yeltsin's economic aide, Alexander Livshits, signaled a new approach to policy making announcing that "the all-Russian cashbox for paying out money to the regions had been closed for stock taking."26

Kremlin watchers feel that in electing Boris Yeltsin, president, Russians endorsed various pathological developments in Russian society and invited the Kremlin to continue the policies that were responsible for them. Yeltsin's election sent a signal to the political and economic elite that corruption and crime, the colonial character of the Russian economy,

---

23 Rutland, Peter, "Russia's unsteady entry into the Global Economy", Current History, October 1996 Volume, 95, NO. 603 pp-322
26 Treisman, Daniel – Ibid.
the country’s technological decline and many other negative developments are acceptable.\textsuperscript{27}

The appointment of Anatoli Chubias in July 1996, as chief of administration inspite of his strong association to the mismanagement of privatisation programme signaled that Yeltsin’s second coming would with some superficial patching continue business as usual.\textsuperscript{28}

Russia’s privatization programme was based on two presumptions. First, private ownership was always superior to state ownership second, once the country’s properties and business were privatized- especially if shares of properties were distributed widely to the general public- it would become considerably more difficult for the communists to gain support for a return to communism. The result, state monopolies ended up as private monopolies and like good monopolies they raised prices and cut production.

The reformers were so focussed on overcoming resistance to their privatization efforts that they devoted only minimal attention to facilitating the state up of new business. The lack of emphasis on new business formation had devastating consequences for the reform effort. It affected the operational practices and behaviour of Russian business institutions which were more likely to view themselves as above law and the public interest than their counterpart in the west.\textsuperscript{29}

Amid the general gloom there are some sectors of the economy that are booming due to increased involvement with foreign business world. Russia’s metal industry despite the collapse of military industrial complex, has struck it rich. With the loss of its major customer, the metallurgical industry suffered initially but gradually found export opportunities. Russia’s trade surplus stems from the non-ferrous metal category like

\begin{flushright}
\textsuperscript{28} Ibid
\textsuperscript{29} Goldman I. Marshall, “What has made Economic Reform in Russia so difficult?” New York: Norton 1996, p-25-30
\end{flushright}
Aluminium along with exports of oil and natural gas. In 1995 and 1996, the United States imported almost $1 billion annually of Russian Aluminium.\(^{30}\)

Foreign investors have also become keenly interested in Russia. It is regarded as a potentially rich emerging market, and American investment funds, investing in Russia have had excellent growth records. However, Direct Foreign Investment in Russian companies and Russian manufacturing has been much more modest. Excluding the energy sector, in 1996 foreign investors put as little as $2 billion into Russian operations.\(^{31}\)

Infact the rise in Russian exports has not been accompanied by a revival of Russia’s domestic economy. On the contrary many critics suggest that this growth has come at the expense of Russia’s economic development. The trade boom has been driven by export of oil, gas, and metals. Russian nationalists call this the Kuwaitization of economy and complain that their country has become a “raw materials appendage” of the imperialist west. On the other hand consumers goods MNCs have expanded their export operations to Russia and achieved good sales turnover. Companies like Proctor and Gamble, General Electric, Mars, Polaroid, Kodak, Otis Elevator, Coca-cola, Pepsi-Cola McDonald’s and all tobacco companies have expanded their operations in Russia.\(^{32}\)

What emerges is that Russia’s incorporation into the global economy has taken the form of shallow integration a rise in trade with the developed capitalist economies and not deeper integration which would involve structural change such as increase in foreign investment.

Ostensibly to undo the damage that had been done by the preceding Yeltsin governments including the problem caused by the privatization campaign and tight money policy designed to curb hyperinflation, Yeltsin brought Boris Nemstov, the young mayor of

\(^{30}\) Ibid. \(^{31}\) Ibid. \(^{32}\) Ibid
Nizny Novgorod who had managed privatization in his city, by breaking monopolies-and created thriving service and manufacturing sectors as first deputy Prime Minister.\textsuperscript{33}

Nemtsov and his associates placed primacy on revenue collection. Gazprom the energy major had to cough up its dues amounting to $2.6 billion inspite of close links with Prime Minister Victor Chernomyrdin.\textsuperscript{34}

Nemtsov's staff also began to restructure UES, the county's monopoly electric utility. It announced that it would give 30 percent discount to those who paid electric bills on time and cut off electricity to those who fail to pay with rubles.\textsuperscript{35} Apart from meeting the revenue requirements of the state to fund social programmes the reformers were faced with the uphill task of restoring credibility to the privatization programme, to make the bidding process more transparent so that it could not be rigged and fair competition rules be established.

However, given the enormity of the cynicism and the warped, dysfunctional patterns of behaviour that earlier reforms had generated, redressal seemed elusive.

Yeltsin's policies to create a market economy based on private property stimulated the emergence of a new set of economic interest group and challenged economic groups from the Soviet period. The centralized legacy of the Soviet command economy, in combination with the sequence of liberalization and the kind of privatization undertaken during the first years of Russian economic reform, has produced a small and concentrated economic elite that has dominated the state and has pushed other lobby group and civic organizations to the margins of Russian policies.

Through the transition, the oil and gas sector has sustained its dominant role in the economy, of all the economic entities from the Soviet era Gazprom has weathered the

\textsuperscript{33} Ibid.
\textsuperscript{34} Ibid
\textsuperscript{35} Ibid
transition to the market least scathed. The company has preserved its monopolistic control over the transport and distribution system of all of Russia’s natural gas, making it the most profitable conglomerate. In fact, each of Russia’s dozen major oil companies ranks among the 20 most lucrative companies in the new Russian economy.\textsuperscript{36}

Other natural monopolies such as electricity, communications, transportation and precious metal extraction have also fared well in the new market order and emerged as the core of blue chip companies on Russia’s stock exchange. So did new banks, fueled by inflation, ruble devaluation, and state budgetary transfers, thrived during the transition.

Having amassed cash assets in the first two years of liberalization, new banks such as Alpha Bank, Menatap, Inkombank and Oneksimbank moved into acquiring productive properties during the sale of most lucrative assets in a programme called “Loans for shares” in 1994. Under this plan virtually every major bank acquired an oil company, a precious metals mine, or a national television network.\textsuperscript{37}

Bank acquisition of resources extraction enterprises marked a new phase in the organization of Russia’s economy as a small handful of actors acquired a phenomenal proportion of Russia’s productive assets. These new financial actors formed financial industrial groups (FIGS): vertically integrated corporate structures in which a large financial institution with close ties to the state anchors an array of trading companies and industrial enterprises. Experts in 1996, estimated that Russia’s eight largest FIGS controlled between 25 and 30 per cent of Russia’s GNP.\textsuperscript{38}

A concentrated, centralized capitalist class intimately tried to the state does not nurture the development of liberal and pluralist political institutions. Moreover, presidential systems tend to privilege big business lobbies and disadvantage mass based organizations that are better equipped to lobby legislatures than executives. Russia in no different.

\textsuperscript{36} Goldman I, Marshal, “What has made Economic Reform in Russia so difficult”?-pp-105-110.
\textsuperscript{38} Report in The Financial Times, November 15, 1996.
In return, for financing Yeltsin's elections campaign in 1996, these plutocrats obtained direct "representation" within the Russian government without having to work through intermediary organizations such as parties or the legislature.\(^{39}\)

Prime Minister Chernomyrdin was the former Chairman of Gazprom. With Chernomyrdin at the helm of government, the state rarely acted against the interest of the oil and gas sector. Russian bankers were also well represented in the government with Anatoly Chubais as their ally. Appointed as Yeltsin's chief of staff after the 1996 election and then re-appointed as first deputy prime minister in March, 1997 Chubais had been closely tied up with Russia's new financiers since he headed the state privatization committee during Yeltsin's first presidency. Boris Berezorsky, the head of the trading company Logovaz was given the position of deputy Chairman of the security council.\(^{40}\)

Small businesses and start up companies have been most hurt by the kind of capitalism emerging in Russia. Exorbitant taxes, inflation, the last of liberalization at the local level, the mafia and the consolidation of large financial groups occupying monopoly control over many markets have combined to create an unfriendly environment for small businesses.\(^{41}\)

The Russian economy has evolved towards western style capitalism on one hand and the consolidation of corporatist criminal style capitalism on the other, writes Grigory Yavlinsky.\(^{42}\) The markets of corporatist states are driven by oligarchs whose highest goal is increasing their personal wealth. Personalities, contacts and class count more than institutions and laws in such a system. The robber baron mentality of many Russian business leaders has come in for sharp criticism from western investors. As George Soros put it, first "the assets of the state were stolen, and then when the state itself became valuable as a source of legitimacy, it too was stolen."\(^{43}\) The European Bank for Reconstruction and Development ranks Russia as the most corrupt major economy in the world.

---

\(^{39}\) Rutland, Peter, "A flawed democracy" Current History, October, 1998 Pp-313-317

\(^{40}\) Ibid.

\(^{41}\) Ibid.

\(^{42}\) Yavlinsky, Gingory- Current History Oct. 1998 pp 69

\(^{43}\) Ibid
These developments have managed to become trends because Russian political system of superpresidentialism provides for an extraordinarily strong president and relatively weak legislature.

In a superpresidential system, the president enjoys the power to legislate by decree, to determine the composition of the government and to shield the executive branch from parliamentary scrutiny. Yeltsin not only enjoyed constitutionally derived power, he also lorded over a sprawling multi-layered, and multi-faceted bureaucratic apparatus.

Because a superpresidential system lodges most of the powers of control and expenditure of state resources in the executive branch and provides little or no oversight of the executive by the legislature, the system creates ample opportunities for corruption.

In this system, most of the custodians of the states' resources are answerable only to the President. Unless the president is extraordinarily capable of and dedicated to monitoring subordinates government officials can wreck havoc on state resources. 44

Yeltsin was scarcely a consistently effective figure. His enfeeblement often left him sidelined and incapable of asserting leadership. His illness created an impression that the presidency is virtually vacant. The system being such, the debilitation of the chief executive leaves the polity rudderless and creates a popular perception that no one is in charge or that no one who is in charge is actually accountable to any elected official.

Yeltsin's lack of personal dynamism not only sapped public morale, but also undermined the effectiveness of government. Yeltsin's formidable powers on paper dissolved into fecklessness in practice since his decrees were often simply ignored by those implementing them. Signing decrees drawn up by the presidential staff required little imagination or personal involvement in policy matters. However constructing an apparatus to enforce those decrees and monitoring its operation requires a high level of presidential engagement which Yeltsin was not capable of providing. 45

---


Besides the realm of economic policy weakness and ambivalence also characterized the foreign policy specially in the neighbouring former Soviet republics besides movements of secession from within. The 1993 and 1995 Duma election had revealed that national elite and public opinion favoured engagement with former Soviet republics, characterized as the Near Abroad by Russian foreign policy makers.

Predictably, Yeltsin’s election platform had stated that the two top priorities of Russian foreign policy were “the achievement of the utmost integration of the CIS on a voluntary and mutually advantageous basis and the active protection of the rights and interest of fellow countrymen in the near abroad.” In contrast, the improvement of Russian-American relations was not even mentioned among his priorities if elected. The near abroad was clearly marked out as the national security zone. “The sphere of Russia’s economic, political and humanitarian interests extends to the entire post Soviet space,” Yeltsin claimed.

The campaign started with institutionalization of stronger ties with Belarus. The treaty on the foundation of community signed by Yeltsin and Belarus President Alexander Lukashenko envisaged setting up of a political and economic community co-ordination of foreign policy, creation of unified monetary, credit, and budget system between Russia and Belarus, and conditions for the introduction of common currency. However, no timetable was mentioned for uniting the two currencies. There was widespread belief that like the previous agreements monetary Union signed in April 94’ and customs Union 95’ the 1996 treaty would not go beyond stationing of Russian troops.

The reason being the economic costs for integration were too high for Russia. Belarus was dominantly a statist economy requiring huge doses of subsidy and was pinning its hopes on integration, for a cancellation of its energy debts and a continued supply of Russian oil and gas at reduced prices.

---

46 Dawisha, Karen “Russia Foreign Policy in the Near Abroad, Current History Vol. 95, NO. 603 October 1996, pp-330-334
48 Ibid.
Russia's primary interest is Belarus was the right to keep troops stationed at the country's early warning missile bases and the ability to maintain an avenue for exports, including energy to the west. Belarus had little to offer beyond that in Kremlin's calculation.

The signing of the treaty for close integration took place, at a time when presidential election loomed and a communists hard liner Gennadi Zyuganov was favored to win over the incumbent. Under pressure to score points with the conservative section of the electorate Yeltsin had to be projected as the reintegrator of the former Soviet states. Agreements of close integration with Kazakhstan, Kyrgyzstan, and Belarus were thus signed. The long delayed friendship and co-operation agreement with Ukraine was also set in place.

Not surprisingly, after Yeltsin's re-election the Belarus president began complaining about the non-implementation of the treaty.

Clearly the imperatives of growth rates, increased foreign investment and a bullish stock market dominated the agenda.

Though ministry level changes had been undertaken Viktor Chernomyrdin had continued as the Prime Minister through 1997. In spring of 1998, he was replaced by a young banker, Sergei Kiriyenko. Labeled a reformer he was expected to secure "a transition from unlimited semi, bandit capitalism, where rules are dictated by those who are trying to take control of state property, to a situation where the rules are dictated by the state."

The plans for radical economic reforms were never realized. Instead, throughout the summer and fall of 1998, Russia was mired in it most serious financial crisis since the break up of the Soviet Union. The reasons were fall in international prices of oil, reduced revenues anticipated for the Russian budget which were grossly over projected, continuation of tax payment in kind to the federal government and decrease in projected inflows of foreign capital into the country due to Asian financial crisis.

---

49 Ibid.
50 Ibid.
52 Ibid
Given these revenue shortages, Russian government was compelled to borrow heavily through the international bond market by issuing short term domestic treasury bills known as GKO's. However, buyers of the government debt became scared as there was doubt about the government's ability to honour its debt commitments. This doubt was generated by the foreign and domestic holders of GKO's. Reflecting this lack of confidence, the interest rates of GKO's soared. The stock market continued to fall and western analysts predicted that by August the government would be bankrupt and would face the difficult choice of devaluing the ruble or defaulting on outstanding debts.\(^{53}\)

In a bailout package, the IMF in cooperation with the world Bank and the Japanese government offered new loans amounting to $17.1 billion.

The bailout package involved commitment on part of the Russian government to undertake several reform policies. This package of reforms included over 20 new draft laws that would streamline and rationalize the tax code, decrease the profit tax, raise individual income taxes, create a national sales tax and land tax raise taxes on imported goods as well as on alcohol sales and previous metals exports, and cut government expenditure to bring the deficit under 2.8 per cent of GDP in 1999.\(^ {54}\)

The bailout package failed. The first transfer of IMF funds under the new agreement totaling nearly $5 billion disappeared almost immediately as investors converted their rubles into dollars to get their money out of Russia.\(^ {55}\)

In a desperate measure the Kiriyenko government surprised the world by pursuing a policy of both default and devaluation. On August 17, 1998, the government announced a compulsory conversion of short term GKO's into longer term debt instruments. The Russia debt market immediately collapsed as investors became convinced that the government would never pay back the borrowed money. The government also imposed a 90 day moratorium on payments of all hard currency loans owed to western commercial banks. Simultaneously, it announced a new trading price for the ruble. The two major

\(^{53}\) Ibid.


achievements of the Yeltsin era, control of inflation and a stable transferable currency, were eliminated.\textsuperscript{56}

Responding desperately to a desperate situation Yeltsin fired Kiriyenko and his government and nominated Viktor Chanomyrdin again as his candidate for prime Minister. After the Russian parliament rejected his candidature twice, Yeltsin nominated his foreign minister Yevgeni Primakov as a compromise candidate.\textsuperscript{57}

Again the main issue was left untackled: microeconomic policy. The policy involving rights and institutions capable of clarifying and enforcing these rights, competitive and transparent privatization policy.\textsuperscript{58}

Instead, the pattern was developed by Yeltsin to launch major government reshuffles once or twice a year in an effort to deflect attention from political and economic crises. Often with the goal of reassuring the west that the reforms were on track. Ministers and advisers were promoted and demoted with bewildering rapidity. Some were switched from Kremlin to White House and back, and some were plucked from the ranks of the hostile Duma in a bid to appease or, more to the point to disorient the opposition. The key qualification for promotion was personal loyalty to Boris Yeltsin rather than commitment to any particular political philosophy.

Yeltsin elevated favoritism to the key operational principle of his administration. He became the sole unchallenged source of authority in the Russian political system. All key decision were taken by the president and communicated to the government through network of aides.

By 1996, Yeltsin’s personalistic leadership style had resulted in a curious patchwork of political figures and interest in his administration. Macro economic policy making was

\textsuperscript{57} Ibid
\textsuperscript{58} "Privatization, conversion and Enterprise Reform in Russia", Boulder, Colorado: Western. 1995, p 175-200
dominated by reform minded liberals, industry policy by the energy lobby, and security issues by the top security leaders who persuaded Yeltsin to launch the invasion of Chechenya in 1994.

As of 1998, his key courtiers included his former press secretary, Valeptin Yumasher, and his daughter Tatiana Dyachenko. They controlled access to the leader and communicated his wishes to the outside world. In such a system, importance was determined not by who held which formal position but by who had access to the sovereign’s ear.  

By design, Russian democratic institutions are fragile and unconsolidated. Though successful parliamentary, presidential and gubernatorial elections have affirmed that Russia is an electoral democracy, the system lacks the quality of a liberal democracy. The constitution gives too many powers to the president, the judiciary does not act as a third and independent branch of government, political parties are weak, mass based interest group are marginal, the rule of law is vague.

However, inspite of internal disarray the west, notably the US, sought continued engagement with Russia’s reformer, sustained promotion of Russian liberal market and democratic institution and gradual integration of Russia into the global income system and the international community of democratic states. This policy is based on the belief that neglect of institutional development in Russia will transform Russia into a security threat.  

The Clinton administration had aggressively steered the bailout package of the IMF for the financial crisis of 1998. While there had been economic agreement the Clinton administration did not involve itself in the political developments of Russia. Rather the Clinton administration’s refusal to criticize Yeltsin when he disbanded and them bombed the Duma in 1993, its silence on the federal invasion in Chechenya secured assent to a variety of agreements: Chemical weapons Convention 1993, the non-proliferation treaty in 1995 and the 1996 comprehensive Test Ban Treaty.

60 Matlock, Jack F. “Dealing with a Russia in Turmoil”, Foreign Affairs, vol 75 No.3., pp 38-62
Further the weak position of the Russian military establishment due to lack of funds led American foreign policy makers to chase expansionist goals. The resistance to expansion of NATO involving admission of former Soviet bloc nations—Poland, Hungary and the Czech republic was mitigated after considerable American pressure and the realisation that an enlarged NATO was as in Clinton’s view a question of “not if, but when”.  

Peace was brokered by the so-called “Founding Act” which gave Russia’s assurances that the NATO would not place nuclear weapons or large number of troops in the territories of its new members. In addition, the act established a joint council to give Moscow an advisory role in all NATO decisions. The new council would allow the Russians to be heard, but not to vote at alliance meetings.

While Yeltsin had previously expressed little concern over NATO enlargement, later he and chiefly Yevgeni Primakov began a campaign to stop former Soviet allies form joining. Yeltsin’s change of heart grew out of his perceived needs to insulate himself against the attacks of nationalists and communist leaders who viewed the expanded alliance as a threat.

Expansion opponents feel that “NATO is expanding in the service of its historic and continuing mission: containing Russia”.

While the first round of expansion was accepted as fait accompli the attempt by former republics like Baltic states and Ukraine to enter the alliance made the Russian political and military planners furious and amendments were sought to STARTII agreements. The amendments provided for extending the deadline for destroying warheads covered under the agreement from Jan 1, 2003 to the end of 2007.

American foreign policy initiatives forced Yeltsin to sanction a strategy of an obstructive foreign policy as was evidenced in the case of Iraq. The American preparation of an

---

62 Ibid
63 Rosenberger, Chaadeler, “Russia Ronlette,” National Reivew, Jan 26, 1998, pp 36 40
aerial attack against Iraq for not allowing UN inspectors was warded off by Primakov’s diplomatic maneuvers with Saddam Hussain. However US policy experts felt that “Russians were running interference for a bad guy.”

Inspite of differences, support to the Yeltsin regime continued. Russia watchers attributed this policy to an intelligent and cynical desire to ensure that Russia was ruled by a weak and corrupt regime, one highly dependent on the west for aid, in other words a policy to weaken Russia without running risk of actually destroying it. The text of the policy ran close to containment and closely followed the prescription of Zbigniew Brezinski, the mentor of Madeline Albright, US secretary of state.

But for Primakov, the incoherence in Russian foreign policy would have persisted. The foreign policy shift which Primakov brought about did not reject rapprochement with the west, but argued that Russian society and interests were not identical to those of the leading western nations. “Russia” Primakov argued had to be "a great power" and act by no means on the basis of current circumstances but on the basis of its colossal potential". Russia would co-operate with the west and accept IMF and other international support for its economy. Yet Primakov did not believe that such co-operation precluded Russian assertion of power even against the wishes of west and especially the US, he asserted.

Further, the doctrine stressed the recognition of Russia’s role as an integrator and unifier in its near abroad.

According to Primakov, Russia needed to pursue its own approach to questions such as middle east peace, nuclear proliferation, and UN sanctions. It had to find its own set of partners and friends including India, China and Iran. The organizing principle behind this being the need to hasten the emergence of a multipolar world. The policy had a major

68 Gannett, Sherman, W. “A nation in search of its place,” Current History, October 1999, pp 328-331
impact on the foreign policymaking of Russia and is considered to be an important framework for future policy makers.  

However, the policy had a practical limitation of creating external misunderstanding and suspicions. A measure of Russian co-operation with the US in dictated by a practical assessment of Russia interests and weakness. It is also implicit in the nature of contemporary Russian state, economy and society and above all in the interests of the ruling elite whose interests are thoroughly tied with the western economy, not by productive economic relation, but by the export of Russia’s raw materials and investment of proceeds in the western banks, property and luxury goods. Russia’s elite therefore is loath to endanger their interest by allowing Russia to engage in a major clash with the west.  

Primakov’s tenure as Prime Minister lasted till May 1999, Primakov had avoided radical changes, he had sought to maintain political stability, tinkered with the federal budget to improve revenues and expenditures and tried to renegotiate outstanding debt held domestically and intentionally. He was able to gain the co-operation of the Duma on legislation necessary to restructure debt, win additional international funding, and attract foreign investment. Reportedly, Primakov’s popularity with the public at large and in Duma did not go well with Yeltsin and he was replaced by Sergei Stepashin, a Yeltsin loyalist but with no economic background. Three months later, Stepashin was himself replaced by Vladimir Putin a KGB alumnus and a fierce Yeltsin loyalist but without economic credentials. Although Stepashin was successful in obtaining a $4.5 billion loan from the IMF, he was apparently insufficiently loyal to Yeltsin and perhaps also popular.  

The search for a loyalist became a defining principle in view of the presidential election in 2000. Limited both by the constitution and physical health, bounded by allegations of corruption, Yeltsin anointed Putin, a diehard Yeltsin clan loyalist as his successor and

---

69 Ibid
70 Lieren, Analot, op.cit.
resigned on December 31, 1999, leaving his country in the midst of disastrous economic decline and re-engagement in a furious war in Chechenya.  

Moreover, his exit came at a time when he himself, his family and associates were shrouded in exposures of financial scandals involving the President’s family had created intense panic in the ruling circles. It was in August 1999 that FBI started investigations into largest money laundering in US history, after learning that $10 billion of Russian money was churned through the Bank of New York alone ($23 million through one account every day for six months including Saturdays and Sundays). One of the persons under investigation was Konstantin Kagalovsky, Russia’s representative to the IMF between 1992-95 and currently the Vice-President oil giant Yukos, married to a senior vice president of the Bank of New York who herself was suspended following FBI investigations. This was the time when warrants were issued for the arrest of another powerful figure, Anatoly Bykov, boss of Krasnoyarsk Aluminium Works, on charges of illegal diversions of profits of Russian commodities trade and money laundering. Yukos boss Mikhail Khodorovsky alleged that billions of dollars funnelled through the Bank of New York which was controlled by Russian officials seeking to protect their personal fortunes from the August 17, 1998 ruble meltdown. USA Today, a leading US newspaper reported in the last week of July 1999 that investigators there were investigating whether five leading Russian political figures-Yeltsin’s daughter Tatyana Dyachenko, former deputy Prime Ministers Anatoly Chubais and Oleg Soskovets, former finance Ministers Alexander Livshits and Vladimir Potanin-played a role in money laundering. The avalanche of charges in the August of 1999 did not spare Yeltsin and his family. The former President and his daughters were alleged to have been given credit cards and one million dollar in “pocket money” by Mabtex, a Swiss construction company that had won lucrative contracts to renovate the Kremlin. Revenues were alleged to have been siphoned off into Swiss-owned shell companies from state-owned Aeroflot, headed by Yeltsin’s son-in-law. IMF and Russian Central Bank reserves were reportedly churned through the FIMACO shell company in the Channel Islands, extended

72 Powell, Bill and Albats Yevgenia, “The Man who would be Tsar,” Newsweek, March 27, 2000, pp-18 -23
to Russian commercial banks as loans, used to play the profitable Russian domestic debt market, or, in some accounts, even run through Bank of New York accounts.

According to suspended prosecutor general Yury Skuratov, some 780 former and current government officials including Chubais are under investigation for using insider information over the years to speculate on the Russian treasury bill market. He further went on to allege that of the IMF’s first installment of $4.8 billion (out of a total $22.8 billion bail-out package) sent to Russia in July 1998, only $471 million went to support the ruble and the rest went to bail out a handful of well-connected banks as they fled Russia’s ill-fated market for ruble-denominated short-term treasury bills, known as GKOS.  

Yeltsin’s rule has been a decade of decline, denial and decay. While other former centrally planned economics have experienced sharp and protected declines in gross domestic product, industrial production and per capita income during their transition to market, the contraction in Russia has been especially severe and prolonged.

The principal cause of transition depressions is the absence of critical economic institutions a functioning commercial bank network, a system of commercial law to project rights under contract, resolve economic, enforce bankruptcy regulations, and guarantee for rule of law in business relationship and the presence of an oligarchy in the Aristotelian sense of small propertied class ruling in its own parochial interests.

The political and economic landscape at the national and regional levels came to be dominated by large coalitions built around control of key government positions, significant financial and industrial assets, mass media and information gathering agencies and instruments of coercion. The interaction among these coalitions rather than formal institutions of government set the political and economic agenda, limited the range of policy choices, made the fundamental decisions, which were presented as outcome of deliberation of formal institutions.

As president, Yeltsin stood above these coalitions as the final arbiter who ensured that none grew too powerful to challenge the elite system or his prerogatives.