Sovereign Debt and the New Global Economy:

An analysis of Russian and Polish debt treatments in the post-Soviet era

by

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Abstract

Critics have alleged that the process of negotiating sovereign debt relief is unduly politicized and favors a global capitalist elite over national and democratic interests. This study evaluates the legitimacy of these criticisms by analyzing the cases of Russia and Poland in the six year period after the end of state communism in the 1990s. An alternate hypothesis, that the words of state leaders both in public and in meetings with influential global capitalist agencies determine the outcomes of key negotiations, is advanced through a careful analysis of video recordings of key speeches as well as other sources. A comparison of these cases is used to develop insights into the political role of transnational financial institutions and global capitalism.

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I. Introduction

The consequences of financial crises, and the opacity of their causes, have made them an object of popular fascination and fear, as well as a great deal of scholarly research. The sovereign debts which accompany them, and the regimes which use those debts to justify devastating austerity measures, have lent greater urgency to this research. This thesis identifies a tool which is well positioned to address this problem: sovereign debt relief through reduction, rescheduling, or default. It then investigates how the potential of this tool is hampered by a transnational political process which serves the interests of western and transnational financial institutions to the detriment of democratic and humanitarian interests.

This assertion has been made most prominently by Greek Prime Minister Alexis Tsipras. After Spanish Prime Minister Mariano Rajoy demanded at an EU meeting that Greece pay all its debts in full, Tsipras said “some people, and also Prime Minister Rajoy, see a potential success of the Greek government as a political problem for them.” (Papapostolou 2015) Tsipras was suggesting, and others have claimed forcefully, that Mr. Rajoy opposes Syriza because its successes would validate an anti-austerity path also being offered by left-wing opposition parties in Spain and across Europe. Pablo Iglesias, the leader of the Spanish left-wing party Podemos, spoke after Tsipras and declared that “what's destroying Europe is financial totalitarianism.” (Seguin & Faber 2015) This totalitarianism is especially evident in the opaque, undemocratic, and informal proceedings of the Troika and the Paris Club which sometimes dictate national budgets in indebted states with negotiations that have been called “old-fashioned” and “surreal,” and reputedly include the use of “duress and subterfuge” as negotiation tactics. (Caplen 2000)

To demonstrate this, the project will consider two cases that predate the Eurozone crisis: Poland (1989-1993), and Russia (1992-1998). Though both faced many similar challenges due to the end of central planning and Communist Party rule, each takes place in a unique context. In both cases debt

relief of some kind was agreed to. To account for the differing contexts, process tracing methods are used to determine what events led to the context in which relief was sought, how they compare across cases, and what other variables might intervene. The value of the relief achieved is determined with this context in mind. Careful comparisons of these events and the outcomes achieved will allow weighing the effect of the discourse of state leaders, the dependent variable which I chose to represent ideology in this research. I employ discourse analysis methods to leadership statements, either formal or informal, which address the state's relationship with transnational financial institutions and their agents, along with any statements those agents may make towards the debtor state. The hypothesis to be evaluated is that a treasury official en route to a Troika or Paris Club meeting might be well informed of the debtor state's economic and legislative history, but their behavior is primarily determined by any anti-capitalist or anti-western statements made by his debtor state counterparts.

Treasury officials and academics have begun to coalesce around the theory of a "global savings glut" at the root of the 2008 financial collapse and its consequences, many of which are still with us. Famously identified by Ben Bernanke in a 2005 speech, even he did not appreciate its full significance at that time:

> "Fundamentally, I see no reason why [the reversal of capital flows] should not proceed smoothly. However, the risk of a disorderly adjustment in financial markets always exists... we probably have little choice except to be patient as we work to create the conditions in which a greater share of global saving can be redirected away from the United States and toward the rest of the world--particularly the developing nations." (Bernanke 2005)

Also identified as an investment dearth or as a condition of chronic oversupply, the savings glut persists to this day for a combination of economic and political reasons. As an explanation for a low rate of savings in America and peripheral Europe, interest in the thesis was merely academic at the time. However, with the US still mired in recession ten years later and the periphery of the Eurozone on the brink of default, unwinding the credit glut which has resulted from the savings glut should be treated

with the urgency which, regrettably, was not attached to the savings glut thesis until after the financial crisis in 2007.

In normal conditions, devaluation of national currencies would serve as a ready mechanism for deleveraging those economies that are plagued by debt overhangs. However, those countries most affected are members of the Eurozone, where monetary policy has been dominated by more prosperous northern European economies. As such, no single mechanism can do more to spur economic growth for the most depressed economies than forgiveness of sovereign debt. While returning the global economy to its growth potential might also benefit from student loan and mortgage forgiveness are also increased, in a capitalist paradigm either project would likely entail governments assuming some part of these debts, rather than inflict large losses on powerful financial interests. This, along with the exponentially larger debts sovereigns can place on the chopping block and the relative strength of their negotiating position, points back to sovereign debt relief as the only way to reduce the savings glut.

Relief and rescheduling of sovereign debt have traditionally taken place within the Paris Club of state creditors, the London Club of private creditors, and the World Bank. Since the International Monetary Fund began to fill the role of international lender of last resort in the second half of the 20th century, striking an agreement with the IMF has become a precursor to agreement with these other institutions. The role of the IMF is even more paramount within the Eurozone, where a near total identity of interests and values with the European Commission and the European Central Bank, and the optics of the three arriving at negotiations in lockstep, has led observers to refer to them as 'the Troika.'

According to the IMF's mandate, the Fund is not ideological. The institution's charter declares the Fund's purpose as:

> “(i) To promote international monetary cooperation... (ii) To facilitate the expansion and balanced growth of international trade... (iii) To promote exchange stability... (iv) To assist in the establishment of a multilateral system of payments... (v) To give confidence to members by making the general resources of the Fund temporarily available... without resorting to measures destructive of national or international prosperity... (vi) ...to shorten

> the duration and lessen the degree of disequilibrium in the balances of payments of members." ("Articles of Agreement," 1944)

Yet the negotiations the IMF has conducted with debt-stricken sovereigns are not only highly politicized, they are also conducted by small groups of state officials and representatives of the global financial elite. The interpersonal nature of these proceedings, together with the unwritten, informal nature of the proceedings, mean they are as likely to be influenced by rhetoric and emotion as by an objective assessment of economic data, or of the financial difficulties faced by individuals in debtor states. (Caplen 2000)

This is essentially the claim advanced by Syriza, which had traditionally existed on the margins of Greek political life. With a mandate to oppose austerity (now synonymous with IMF conditionality) that has now been reaffirmed several times over, there can be no question that representing the Greek people requires that Syriza bring about the end of austerity. Yet it has been strongly suggested that the other leaders of the EU oppose Syriza for fear that their success could inspire left-wing opposition at home.

This project seeks to evaluate that claim. It will do so through qualitative analysis of states which have engaged in this process, focusing primarily on the discourse of their leadership. While this may not be the most accurate way to assess party ideology, it is the superior method where, as here, the analysis focuses on the impact of perceived ideology on a small group of individuals who determine the wealth of nations.

II. Methodology

The methods to be employed in this thesis fit under a broad definition of comparative historical analysis. The accumulation and maintenance of debt is a historical process, and in the case of states an extremely long one. Both cases focus on a six year period after the end of state communism. Our study of Russia concludes with the Russian financial crisis of 1998, while the Polish case concludes

less decisively with the country entering a period of prosperity in 1996. The short duration of the study derives from the individuals who participate in the negotiating process, who identify less with the historical origins of state debts than with the short term profit motives of the interests they represent.

The study is based on research units on three levels: individual actors, state and institutional agencies, and transnational agencies. These levels interact in many ways. Transnational agencies may seem abstract enough to address on the level of ideologies, but it is important to remember it is represented by both a series of concrete institutions, and a small population of individuals. The Troika can be analyzed on all three levels: the individuals who work under the name are themselves members of the global financial elite, they interact with (and sometimes are) heads of state, and the states and institutions they run play a transnational role as both creditors and debtors.

In the cases of Poland and Russia, I do not analyze the Troika at all, not because the events in question predate the popularization of the term, but because neither state (at this point in history) was a member of the European Union. Despite this, the theory of the transnational capitalist class suggests that lessons learned from analysis of the transnational actors involved in these cases will be useful in future analyses of the Eurozone credit crunch.

While the European Central Bank and the European Commission played no part in this narrative, the International Monetary Fund played a leading role in both cases, as did the G7 and the Paris Club. The G7, it should be noted, refers to summits which include the leaders of the seven leading industrialized nations of the world, while the Paris Club refers to meetings of the finance ministers and other top economic officials from those same nations. G7 summits often include these economic officials as well as state leaders if economic issues are on the agenda. In reading the following analysis, it will be helpful to recall that it is the role of the Paris Club only to make decisions about rescheduling or forgiving existing debts, not to offer new loans or aid. The Paris Club thus represents the G7 (and briefly the G8) group of states, but operates similarly to the London Club, a

group which negotiates with leaders of indebted states on behalf of commercial and private creditors.

In each of the two cases studied here, process tracing methods are used to analyze the sequence of events which led to crisis within each case, as well as cross-case comparisons to establish causality. The causal variable in this analysis is the rhetoric of state leaders in each of the two states. Hawkins (2009) provides a valuable example of using discourse analysis to evaluate ideology. However, there is a difference in ends that must be considered. In that project, researchers identified several strands of populist rhetoric, searched for key words related to those strands in a number of speeches delivered by Hugo Chavez and other world leaders, and their presence or absence was itself seen as an indication of ideology. This project uses a similar methodology, except that the key to testing the hypothesis is in whether or not the kinds of discourse identified correlate with outcomes of international debt relief proceedings. In other words, assigning labels to world leaders is of no interest. Indeed, I remain skeptical of the proposition that an individual's ideology can be divined from even a careful selection of their discourse, as the position of a leader often requires making palliative statements for the benefit of opposition blocs. What is relevant is the reaction of the global political and financial elite, even where they may not be the intended audience of the discourse in question, and may or may not have a sense of the rhetoric's intended audience or effect.

Failure to initiate relief proceedings in a situation where they are desirable is one of the most interesting possible outcomes. A prime example is Cuba. After the recent move toward rapprochement with the United States, Cuba was able to reach an agreement with the Paris Club on debts which had been in default for nearly 30 years. (Gamez Torres 2015) Long considered a necessary antecedent for normalized relations with the United States (without which full participation in the global economy would be impossible, especially given the geographic proximity of the two states), it is no coincidence that these negotiations began only after Raul Castro softened the harshly anti-capitalist tone struck by his brother and predecessor Fidel. The mere fact that Cuba will be allowed to reenter global financial

markets is a gain for Cuba, as it is better to have options than to not have them; on the other hand, the failure of Cuba to thrive as a "tax state", if an awkwardly communistic one, and to begin to restructure itself as a "debt state" might not be positive. It might, in fact, be a sign of the reach of those forces instituting what Wolfgang Streeck has termed the 'consolidation state.' Normally a deal with the IMF is a precursor to Paris Club negotiations. In the case of Cuba, the Paris Club deal could lead directly to membership in the IMF. A comparison to other countries would have to evaluate whether any financial concessions were made by the Paris Club, but the mere fact that a deal allows Cuba new access to global markets is significant.

While official rhetoric is of primary importance, the causal potential of discourse which takes place outside the public eye is also highly relevant. Thus while a vociferously anti-capitalist stump speech would be sure to grab the attention of creditors worldwide, so too could a frank comment over the phone or in a personal meeting. While global politics may be more transparent than ever in the information age, communications within the world's political and financial elite (as opposed to rhetoric that is intended for the masses) are partially insulated from the public record. Official state speeches and other rhetoric captured by the public record may provide a sufficient window into the ideological leanings of debt state leaders to suggest robust conclusions, but this analysis also includes cases where phone calls or meetings in person appear to impact outcomes, even if what was said can only be speculated about.

The qualitative nature of this project acknowledges that there are many ways ideas can be communicated, and many of them are difficult to capture and analyze. As such while I attempt to highlight the causal impact of anti-capitalist statements, the impacts of other factors with strong ideological properties, such as policies advanced or opposed, appointments to state offices, and electoral positioning, will also be considered.

A major methodological challenge to the analysis of rhetoric in international politics is the

language barrier. Though translating text to a familiar language is simple in the information age, this actually amplifies the problem of potential loss of meaning through idiom, sarcasm, and malapropism. In this study, video was chosen instead of text as much as possible to enrich our understandings by paying attention to tone of voice, cadence, body language and audience response. This introduces the further complication of a translator attempting to perform his duties in a live setting. In the course of this study I discovered these methods are far easier to apply when the speaker is addressing an audience which does not understand his language, at least not universally, because in such circumstances the speaker will pause to allow the translator to speak to the audience. When a speaker is at home, the challenge to the translator is impressive, especially if it is a lengthy address. Not only does the potential for mistakes increase (mistakes which are unlikely to be quickly identified), but the translator is unable to use their own cadence and tone to mimic the speaker's meaning.

In this study, this challenge was amplified by the particular speakers I chose to analyze. The Polish politician Lech Walesa is by reputation a vulgar, poorly educated speaker whose grammar was occasionally an issue with voters. None of this is evident in his translated remarks. The Russian politician Viktor Chernomyrdin, on the other hand, was such an interesting speaker that he coined many popular Russian aphorisms. Gaddy and Ickes (2002) begins with the epigraph, “We hoped for the best, but it turned out as usual.” Some other favorites are “I'm not going to say anything, or I'll say something again,” and “wine we need for health, and the health we need to drink vodka.” (“Viktor Chernomyrdin: The Aphorism Master.”) In the case of such a gifted speaker, it is very likely that any analyst reliant on a translator faces a difficult task in capturing the fullness of his remarks, if in fact it can be done. There is simply no substitute for an intimate knowledge of the language being spoken.

A separate methodological challenge in this project is the evaluation of outcomes: the comparison of renegotiated payment schedules to those dictated by the original bond issue. Once a deal has been reached, if there is sufficient information about its terms available, our first preference is

to make a net present value (NPV) calculation to assess how much the real debt burden has been reduced. Sturzenegger and Zettelmeyer (2008) provide a carefully considered framework for discounting payment streams at the appropriate interest and exchange rates to evaluate the "haircuts" agreed to by creditors. Their study includes an application of their methods to the Russian default episode, and their methods can be applied to other situations when the requisite data is available.

While in some cases financial inquiries can be solved in their entirety with such a simple quantitative assessment, this will not be the case for this project, even where data is readily available. For example, debtors are as likely to be concerned with the timing of debt payments as their overall volume. In the parlance of international finance, this would indicate the need for a "flow" treatment rather than a "stock" treatment. Identifying such a case requires looking beyond reductions in NPV to consider potential benefits of rescheduling that do not necessarily reduce the volume of debt.

The experience of Ukraine under former President Yanukovych is also instructive in this regard. The vast personal fortune he took into exile with him suggests that, while the Ukrainian nation may not have benefited from the Russian loans he negotiated, this was not due to Russian reluctance to negotiate. Corruption can turn favorable circumstances into a national disaster. A quantitative analysis which assumes Yanukovych's priorities were in alignment with those of the Ukrainian state might falsely conclude that there was either an ideological divide, or some other cause for Russian reluctance to lend. In fact, Russia did provide a great deal of capital, it simply did not remain in the national account as it should have. It is also worth noting that while the $15 billion in bond purchases initially agreed to by Russia were referred to as a bailout, the interest on those bonds was the market rate. The actual "haircut" was the favorable pricing on Russian energy, which was promptly rescinded after Yanukovych's ouster. ("Ukraine Expects Remaining," 2013)

Finally, a common practice is to judge any deal based on the movement it spurs in national stock markets. If stock prices jump, this is taken to be suggestive of a favorable deal, and vis versa.

While such deals are always big enough news that it is perfectly reasonable to assume a causal relationship to the price movement, to treat this scientifically would at best require a strong belief in market rationality, and at worst be no better than crowd-sourcing an answer to a question most investors know relatively little about. Not only can large groups of people be entirely wrong, but large groups of people can also be manipulated by individuals who are in a position to pass along self-serving, incomplete data. Longer term changes in market valuation could be telling and will be considered in this project, but the single day rise or fall in stock prices after a deal is struck will remain the province of the daily newspaper. In the cases studied here, where the states involved are transitioning from communist to market capitalist economies, the creation of a stock exchange and the rules that govern it are of more interest than any movement in prices.

III. Literature Review

This project is an attempt to contribute to the extensive literature on financial crises and financial globalization by emphasizing their political aspects. Aguiar and Amador (2013) have a valuable review of the state of economic research on sovereign debt. Of particular interest are Krugman (1988) and Sachs (1989) who concluded that debt overhangs create Pareto inefficiencies: that both creditor and debtor would fare better if part of the debt were forgiven. Aguiar and Amador contest this, but their analysis "begs the question of why so many countries stagnate in a heavily indebted state."(Aguiar and Amador 21) The possibility that all parties benefit from forgiving excessive debts rather than refinancing them is intriguing, but it is enough for our purposes to note the consensus opinion that overhang stifles growth in debtor economies. Aguiar and Amador refer questions about what level of debt constitutes an overhang to Reinhart and Rogoff (2012), which I analyze below.

Though economists have shown the potential benefits of forgiving debt to eliminate overhangs, few studies have considered the political structures which keep stagnating states indebted. One exception is Maskivker (2010), who seeks to justify debt relief as a redistributive measure on

normative, ethical grounds. Maskivker's discussion of the unfair terms of interaction between creditor and debtor has a limited focus on underdeveloped states based on the presupposition that they have the weakest terms of interaction. This is far from obvious, since the size of those economies relative to the global economy is such that debt stocks far in excess of 100% of GDP may be unimportant in the eyes of creditors. Couple this with the lower costs of lost access to global financial markets for those with little capital to invest abroad, and the plight of middle and high income states becomes more compelling. Most discussion of debt forgiveness follows Maskivker in focusing on poorer states, perhaps because this is where debt forgiveness occurs most often in the current institutional framework. The IMF's HIPC (Heavily Indebted Poor Countries) initiative in 1996 institutionalized a process which promises "100 percent relief on eligible debts" for more than thirty states from the global south. ("Debt Relief Under the Heavily," 2015)

Any effort to analyze modern financial crises, whether it be their genesis or mechanisms for recovery, must begin by confronting the prevailing policy environment. Schmidt and Thatcher (2013) edited a compilation which seeks to explain how neo-liberalism has not only survived, but thrived, despite what they describe as a poor performance record capped by the events of 2007. Quoting Joseph Stiglitz, they note that skeptics of the ideology in question had hoped "the fall of Wall Street [would be] for market fundamentalism what the fall of the Berlin Wall was for communism." (p. 14)

Rather than a sudden loss of "ideational resilience", neo-liberalism advanced, its advocates unperturbed by the proximity of unregulated financial markets to the epicenter of the catastrophe. They pursue five avenues of explanation for this remarkable resilience: the amorphousness and generality of neo-liberal ideas, the gap between neo-liberal rhetoric and a reality in which it is not necessarily implemented (neo-liberalism as "normative philosophies and not positive theories that might be falsified by contrary observations,")(p. 29), the strength of neo-liberal ideas in debates independent of whatever weaknesses it may have in policy, promotion by powerful interests who benefit from neo-

liberalism even as the economy suffers, and the existence of institutions created in, and thus in service of, the neo-liberal image. In their concluding section they maintain that each of the five contributes to the strength of neo-liberalism, but it is the institutional analysis that proves strongest, not least because it captures the powerful interests argument “by emphasizing that actors and their interests are created by and operate within wider structures.”(p. 420) Paramount in this institutional analysis are the institutions which enshrine neo-liberalism at the heart of the European Union, as well as transnational financial institutions like the IMF and World Bank.

Eric Jones's contribution on the Eurozone shows how monetary union for political purposes, in an environment most economists agreed was not an optimal currency area, has exacerbated the problems of the most vulnerable member-states. In a passage that demonstrates the argument about the gap between neo-liberal rhetoric and reality, Jones notes that 'excessive' deficits and debts are proscribed but not defined, even though “'excessive' has obvious heresthetic qualities: no one would advocate fiscal excess.” (Schmidt & Thatcher 2013) As such what is excessive becomes a political determination rather than an economic question. Even the same state can cope with different debt levels in different contexts, and as our discussion of Reinhardt and Rogoff will also demonstrate, even in the abstract there is no clear consensus as to what financial excess looks like or what its consequences are.

Although they do not single it out explicitly, the authors of *Resilient Liberalism* may well have had Reinhardt and Rogoff in mind when they formulated their third explanation for the continued relevance of neo-liberal thought: that neo-liberal ideas can appear to offer “clearer and more 'practicable' ideas for solutions,” allowing them to win debates even with a body of supporting evidence that has at best been mixed. (p. 411) In 2009, the pair of Harvard economists published *This Time Is Different*, a broad historical study of debt, crisis, and default. This entailed the construction of a database covering episodes of sovereign default in more than 60 different countries, with some data

points coming from as far back as the Renaissance.

The conclusions drawn in this volume are modest. While the tome carries an extensive appendix of data from historical banking crises and default episodes, they find that more systematic data collection is necessary for further research, in particular “cross country data on debt that covers long spans of time.” (Reinhart et.al. 2008 p. 278) They propose that the IMF or some other transnational financial institution would be ideally placed to collect such data. Individual countries have strong incentives to avoid transparency, but a rigorous accounting standard put in place by an external institution could create an environment where “failing to follow the rules might be seen as a signal that would enforce good behavior.” They also propose that some transnational institution should be either created or adapted to “enforce regulations related to leverage”, but the political difficulties of instituting a global financial order that many would characterize as a loss of national sovereignty are not taken up. (p. 282)

Despite the acknowledged limits of the available data, they also conclude that sovereign default has been a common occurrence throughout the relevant portions of history, especially when defaults on domestically owned debt are also considered. In the words of the authors, “the ability of governments and investors to delude themselves, giving rise to periodic bouts of euphoria that usually end in tears, seems to have remained a constant.” As they frame the issue, sovereigns throughout history have persistently assumed unsustainable levels of debt secure in the belief that, for whatever reason, “this time is different.” In the case of the 2008 collapse, they find that it was faith in strong financial institutions and their ability to control inflation that led nations to overborrow, but that “in hindsight, it is now clear that a single-minded focus on inflation can be justified only in an environment in which other regulators are able to ensure that leverage (borrowing) does not become excessive.” (pp. 291-2) What exactly constitutes excessive or unsustainable, terms which no prospective borrower would embrace (most lenders would also avoid making loans they would characterize as such, since they

decrease the likelihood of full payment), is not made explicit here.

Conclusions that forceful were left for a subsequent journal publication, *Debt in a Time of Growth.* Referencing the same data set (though the subset analyzed here "incorporate[d] data on 44 countries spanning about 200 years,") Reinhart and Rogoff (2010) claimed an effective threshold on public debt levels at 90% of GDP. Beyond this threshold, "average (mean) growth rates are several percent lower" in developed economies; in emerging economies, "when gross external debt reaches 60 percent of GDP, annual growth declines by about two percent; for levels of external debt in excess of 90 percent of GDP, growth rates are roughly cut in half." (p. 572)

Such clear, practicable parameters for pinpointing productive levels of borrowing, particularly coming from a pair of respected economists from one of the most prestigious universities in the world, became a rallying point for the austerity movement. The article's publication at a time when the entire periphery of the Eurozone seemed on the brink of default was a tidal wave that devastated the position of those calling for a Keynesian approach to the problem. The economists were even mentioned by name, and their findings given central importance, in the budget proposed by former Republican Vice-Presidential candidate Paul Ryan. That document, which called for massive cuts in public health and other forms of social support, "may have redrawn the battle lines for the 2014 election." (Weisman 2014)

These strong findings would soon be debunked. Reinhart and Rogoff shared their data set with a group of economists who sought to replicate their results. However, what they found was that the original authors had created a set of "stylised facts" through "selective exclusion of available data, coding errors and inappropriate methods for the weighting of summary statistics." (Herndon et. al. 2014) These findings were published more than a month before the election, but failed to "redraw the battle lines" as forcefully as the original paper. Four years of winning policy debates meant that austerity was already entrenched in the EU's approach to its most indebted member states. Even in

America where Democrats retained the Presidency, popular opinion had swung far enough away from Keynesian policies, and Republicans had been sufficiently empowered in the legislature, that a new commitment to stimulus to help private entities deleverage was politically unfeasible. In an impressive display of the resilience of neo-liberal ideas, neither Representative Ryan, nor anyone else who had wrapped themselves in Reinhart-Rogoff, made any substantive alterations to their policy proposals.

Martin Wolf, an institution at the Financial Times and one of the world's most respected economic commentators, piled on. While defending Reinhart-Rogoff for demonstrating an association between rising debt and decreased growth even after correcting the errors in the original, he finds that the causation runs the other way, from low growth to increasing debt, and without the sharp plateau at 90% which was the highlight of the original study. His column reacting to Herndon, Ash and Pollin ran with the telling headline, "Austerity loses an article of faith." (Wolf 2013, a)

His own book, *The Shifts and the Shocks*, demonstrates the difficulty of operating outside the neo-liberal paradigm, as he was unable to draw any conclusions that were as clear and practicable as 'public debt should not exceed 90% of GDP.' Following Bernanke's famous 2005 speech which introduced the concept, Wolf (2014) describes three vectors which converged to create the savings glut: the aging populations of wealthy nations, who needed to save for retirement; emerging economies that had been previously burned by the withdrawal of foreign capital and become credit averse; and a high price of oil leading to increased savings among oil-exporting states, including Russia and the Middle East. The resulting savings glut can also be conceptualized as an investment dearth, or "a condition of chronic excess supply." (p. 154) The most convincing evidence of the glut, per Wolf, is persistently low interest rates and persistently weak demand. As Wolf put it in an earlier column, this combination signals that "there were more savings searching for productive investments than there were productive investments to employ it." (Wolf 2013, b)

As even casual observers of global politics will note, this is a slightly misleading statement;

those who study politics might remark that it is a typical error for an economist to make. There are no shortage of productive investments that are desperately needed, everything from updating electrical grids and rebuilding roads and bridges to converting to a low carbon economy, or at least making efforts to mitigate those impacts of climate change which can no longer be prevented. The issue is not a lack of productive investments, but an inability to make those investments due to political constraints. The world's surplus savings are on the balance sheets of self-interested individuals and corporations who lack a self-interested motivation to make those investments. Additionally, the modern state is politically barred from diverting these savings towards these sorely needed investments using its taxing powers; more on this when I review Wolfgang Streeck and the idea of the debt state below. Wolf is correct in calling the savings glut the root of the crisis and the credit glut, the explosion of debt on both private and public balance sheets, as its symptom. However, his work tends to underestimate or avoid the political difficulties inherent in resolving this imbalance.

In fact, Wolf advocates radical changes to the financial system. Wolf endorses the Chicago Plan, a proposal which dates back to the Great Depression but which has generated new attention recently. Advocates of this plan would take private banks out of the money creation business by ending the practice of fractional reserve lending entirely, rather than limiting the leverage of the banking sector with higher reserve requirements, as more modest proposals have suggested:

> "A system that is based, as today, on the ability of profit-seeking institutions to create money as a by-product of often grotesquely irresponsible lending is irretrievably unstable... far too much credit and money are created in good times and then far too little in bad times." (Wolf 2014, p. 350)

Instead of attempting to manipulate the money supply by increasing and decreasing core interest rates, central banks would take full custody of the money supply and exercise a monopoly over the creation of money, at least in those nation-states which are able to institute such a radical change. Of course, Wolf concedes that "today, nobody has the nerve to try such a radical scheme." (ibid)

Instead, Wolf declares that the post-2007 economy is governed by a "new orthodoxy"where central banks, in addition to maintaining low inflation, are empowered to limit the size of the institutions to which they serve as lenders of last resort, and are entrusted with a set of tools, termed "macroprudential policy" by Wolf, to maintain financial stability. (p. 202) Wolf declares the new orthodoxy insufficient to the task at hand. What is most significant about the new orthodoxy and the Chicago Plan is that both acknowledge that while excessive leverage has sustained the Great Recession, deleveraging will not fix the system. Deleveraging without accompanying alterations to the way the economy is structured would simply wind events back to 2006.

Wolf also believes that the failure of financial, intellectual, and political elites to either anticipate the problems of financial liberalization, or to resolve them in an equitable manner, is damaging to the democratic legitimacy of western capitalism. He writes that citizenship, "the glue that binds democracy," has suffered due to "the emergence of a globalized economic and financial elite that has become ever more detached from the countries that produced them." This trend is exacerbated by a new orthodoxy in which these elites take an even bigger share of economic growth than they did prior to the crisis. (p. 352)

Although he does not engage any of the literature, these comments are evocative of those who have theorized the emergence of a "transnational state." Leslie Sklair's *The Transnational Capitalist Class* (2001) represents the first formulaic account of the titular class. Sklair followed the work of Mann (1997) who asked whether the nation-state was strengthening or weakening in the wake of the USSR's collapse. Mann also problematized the "broad class identities which were traditionally handled by the nation-state" in an era of increasing globalization. Where Mann remained critical of the notion that the current trends were either strengthening or weakening the nation-state, Sklair theorized that a newly emergent transnational capitalist class had transcended the boundaries and the normative influence of the nation-state, enabled by both technological advancements and an immense

accumulation of wealth. Together, these forces allow transnational capitalists to live a transnational lifestyle, neither domiciled in nor confined in their activities to a single nation, and transnational capital to have "almost frictionless movement of capital in its money form through the arteries of the global economy and society." (Robinson 2014, p. 22)

An important concept in this project is the idea of the 'debt state.' Inspired by Joseph Schumpeter who first described the 'tax state' in the early 20th century, Green (1993) defined the debt state as "those modern economies where the build up of peace-time debt is sufficiently great as to become a controlling factor in both the micro and macro aspects of fiscal policy, in both decisions on the supply of public goods and services and in the way in which stabilization policy is conducted."

The contemporary relevance of the concept is aptly demonstrated in the work of the German sociologist Wolfgang Streeck. Streeck places the transition from tax state to debt state in the 1980s, and at the feet of a neo-liberal movement that drove out the successful regime of post-War capitalism. According to this account, the rise of public deficits and debt has nothing to do with a surfeit of unrestrained democracy and excessive appropriations, and everything to do with the gradual reduction of tax revenues provided by the capitalist class. This process was enabled by an explosion of private credit, which allowed for a rising standard of living, and thus popular acceptance of tax cuts, even as public coffers were beginning to diminish. Streeck diagnoses a "political *emasculation* of mass democracy," meaning that not only is the lower class not guilty of drawing excessively from the "common pool" without regard to its limits, but it has also been unable to prevent the upper classes from drawing on that same common pool and framing the lower classes as the culprit. (Streeck 2014, p. 52) Successful opposition by the capitalist class to state tax regimes (whether in the form of derailed tax increases or legislated tax cuts) has transformed the tax state, a form of administration which replaced the feudal domain state centuries ago, into the modern debt state.

This means that the state, as currently constituted, is structurally reliant on debt markets to

finance budget deficits. This contradicts the rhetoric which accompanies austerity: excessive indebtedness is cast as a failure of popular responsibility, a consequence of a social safety net that is exceedingly generous. That these claims are made in the face of both statistical and observable evidence of a continuously widening gap between the rich and poor does little to deter or embarrass those who advance them. Streeck draws the genesis of the debt state like so:

> "As the state would face growing resistance in a capitalist society of possessive individualists against being made to contribute to the common pool (while continuing to draw on it), a new relationship between the public and the private would have to be established that would no longer be capitalist... the debt state was an attempt to postpone the moment of truth, by filling the gap between the costs of public provision for private profit and the limited revenues that a capitalist economy was prepared to supply to government. Of course, this could not last forever, and it ended when financial markets imperatively demanded fiscal consolidation." (Streeck 2015)

The result of this demand, which was first expressed in the wake of the 2008 financial collapse, is what Streeck terms the 'consolidation state,' a continuation of the debt state which seeks to preserve public debt as a stable vehicle for profitable investment without rolling back any of the tax resistance gains which led to its creation. Streeck explains that the impetus for the creation of the consolidation state came from two sides: a state worried about the increasing cost of buying time from the financial sector, and a financial sector concerned with the ability of the state to service its growing mountain of debt. That the classical tax state would have seized these funds from the capitalist class as taxation is of no consequence, since the mechanisms of the tax state are in the control of the capitalist class. Rather than retreat to the former state of affairs, in the emerging consolidation state, the 'moment of truth' is postponed even further by cuts in social spending known today as austerity regimes. In this way, states can continue to increase their debts, and capitalists can remain confident in the safety of their investment, as long as there are pension funds, public health investments, and education budgets to slash.

Streeck formulates this expectation as p>g: growth in public provision, or social expenditures,

exceeds the rate of growth of the capitalist economy. (Streeck 2015) This terminology is meant to correlate with Piketty's famous observation, r>g: the rate of return on capital in a capitalist economy is greater than the rate of growth of the economy. (Piketty & Goldhammer 2014) Streeck notes that p>g is also embodied in Wagner's law, a relatively unspecified theorem which has survived since the late 1800's only because "long-term developments in most advanced capitalist countries seemed to bear it out." (Streeck 2015) This law in fact has much in common with the "surfeit of democracy" theory advanced by austerians, with the notable exception that it is claimed as a law, a fact of capitalism and the modern state, rather than an error of valuation and judgment to be placed at the feet of the working classes and the politicians who court them. The anticipated result is that state spending will continue to increase as a share of GDP until there are so few opportunities for the profitable investment of private capital that capitalism as we know it will no longer exist, having given way at some unspecified plateau to some sort of socialist economy. Austerity might be framed as an attempt to break Wagner's law, thereby relieving the tension these two laws place on the capitalist system and maximizing the potential growth in the rate of return on capital.

Streeck focuses on devaluation of national currencies as the ideal way for nations to thrive, and for the domestic *staatsvolk* to maintain democratic control over the state against the pressures of the external *marktvolk* (a distinction which again recalls Sklair's theory of the transnational capitalist class). Rather than urging the ECB to devalue the Euro (an imperfect solution given that it would devalue currency in Germany and France as well), Streeck contemplates the return of national currencies parallel to the euro. (Streeck 2014, p. 187) The model is plausible, as suggested by Keynes' proposal for an international anchor currency, and perhaps proven by the United Kingdom's maintenance of the pound in parallel to the Euro. However, the political and technical barriers to the re-emergence of other national currencies are immense, as evidenced by Greece's dalliance with, and ultimate rejection of, the return of the drachma. Streeck refers to devaluation as a recognition of

"special communities involving a shared life and destiny." (p. 182) Given that the political motivation for European monetary union was always to create a shared European life and destiny in place of national identities that bear the scars of centuries of European wars, it is easier to contemplate the total failure of the European Union than the return of the lira, franc, and deutsche mark alongside the euro.

IV. Case Studies

One of Mikhail Gorbachev's final acts as the last leader of the Soviet Union was to fly to Houston, Texas, to ask for help from the leading industrial powers of the western world. He was sent

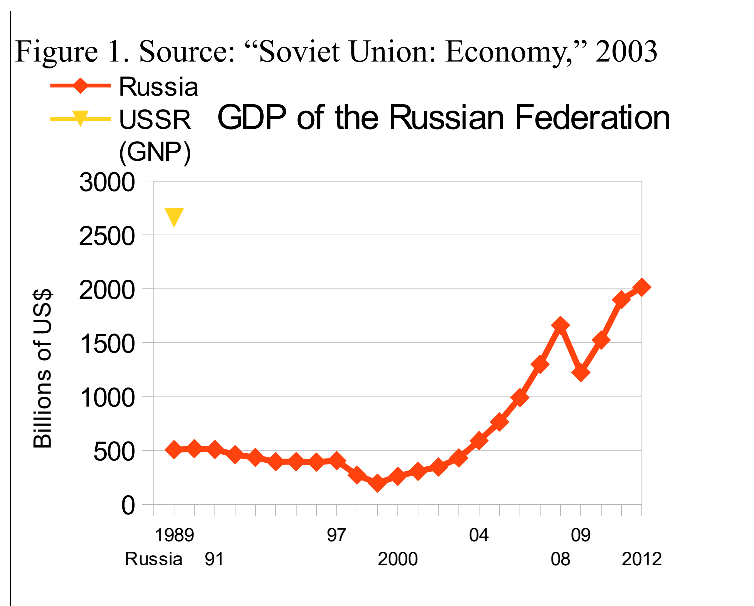


Figure 1. Source: "Soviet Union: Economy," 2003

home with nothing. (Rosenbaum 1990) Soon after, the Soviet empire would crumble, giving independence to the 15 republics of the union, and freedom to the nominally independent states in the Soviet-dominated Warsaw Pact. By the accounting of the Russian press, the abrupt dissolution of the USSR had left behind $77 billion in foreign debt, with $60 billion owed to Western governments, $17 billion to Asian and Eastern European states, and no settled mechanism for determining how these debts would be assigned to the newly independent states.

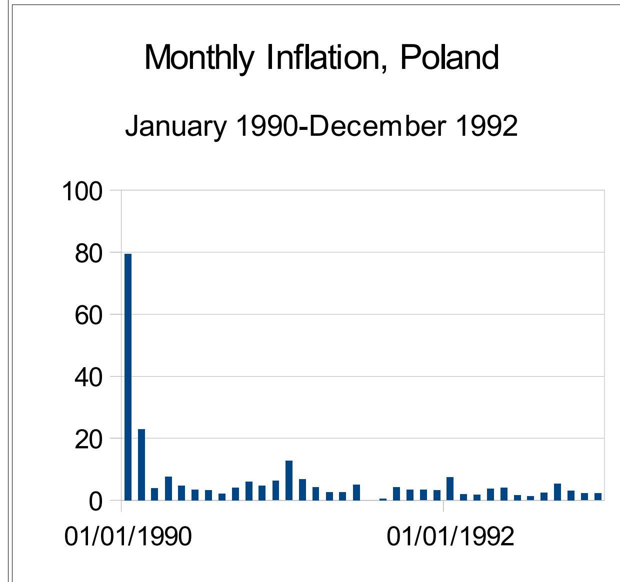
A conference of representatives from each republic would recommend only that negotiations be held with key creditors to seek deferral of all payments due from 1991 through 1994. (Berger 1991) A

1991 Memorandum of Understanding signed by 8 post-Soviet republics initially assigned only 61.34% of Soviet debts to the Russian Federation. However, these debts were assumed by Russia in their entirety in 1993, after the other states failed to make payments. (Nadmitov 2004)

While the situation appeared grim, recent history supplied some cause for optimism for supporters of Yeltsin and the marketization of the Russian economy. The dissolution of the Soviet Union was preceded by the gradual lifting of the 'Iron Curtain' which had imposed mandatory compliance with the Soviet model of single-party communist rule and a centrally planned economy on the states of Eastern Europe. The force of this mandate was made brutally obvious when the Soviet Union occupied Hungary in 1956 and Czechoslovakia in 1968 to support Communist Party rule.

The gradual easing of this mandate, and its eventual disappearance with the Soviet Union's demise, meant different things for different countries. The shining example of what was possible from convergence with western capitalism was in Poland, where “rapid economic growth spurred in part by the development of the new private sector helped to finance fairly generous transfers to the dependent sector of the population.” (Frye 2010)

Figure 2. Source: “Historic Inflation Poland,” 2016



Poland

Two individuals can be singled out for their great contributions to the success of the Polish reform effort. As chairman of the National Bank of Poland, Leszek Balcerowicz drafted and implemented the Balcerowicz plan, a raft of privatization, anti-inflation and other market reforms signed into law at the conclusion of 1989. These reforms would serve as an important model for Russia, and the Harvard economist Jeffrey Sachs would be invited to work with Yeltsin's economic team in part because of his role in helping craft the Balcerowicz plan. The plan was a set of “sweeping economic reforms... that liberalized foreign and domestic trade, cut subsidies to industry and agriculture, and removed many obstacles to the creation of small businesses.” (Frye 2010) The plan is perhaps most notable for its successful implementation of 'shock therapy', a combination of the rapid removal of state sanctioned price controls and policies to reduce the supply of money. Though the term has also been used to refer to “the dismantling of all government intervention in the economy in order to establish a “free-market” economy... also sometimes called 'neoliberalism'”, Sachs says that the aims of the programs he worked on in Poland and Russia were more limited in scope, with the goal of

establishing supply-demand equilibrium and low, stable inflation. While both countries would eventually move to privatize many state-owned industries, neither attempted to create an economy with no role for the state. In Sachs' opinion, “a pure “free-market” economy is a textbook fiction, not a practical or desirable reality.” (Sachs 2012)

Equally important was the charismatic leadership of Lech Walesa, a founder of the Solidarity labor union which swept Poland's first free elections in 1989, and the President of Poland from December 1990 until 1995. Walesa won a Nobel Peace Prize in 1983 and close to folk hero status in the west for his part in organizing workers and leading strikes at the Polish shipyards. When President Bush spoke at a monument to fallen Solidarity workers in July 1989, Walesa introduced him by declaring that Poland's success came “thanks to our conviction that we were not alone, that we can count on our friends”, before going on to insist that “changes [in the political and economic spheres] must occur... at the same time and equally.” In his response, Bush declared to the Poles that “when you hurt we feel pain, and when you dream we feel hope, and when you succeed we feel joy. It goes far beyond diplomatic relations, it's more like family relations.” (“Excerpts from Remarks by Walesa,” 1989)

In November of that year, Walesa was invited to speak before a joint session of the American congress. It is worth noting that Walesa held no public office at this time other than his leadership of Solidarity, a fact he acknowledges when he refers to himself during the speech as “the third foreign non-head of state” to be asked to address Congress in this format. Regardless, he receives a hero's welcome, with the audience standing to applaud his appearance in the chamber for three minutes and thirty eight seconds. Upon reaching the podium, he responds to this positive reception with the spread armed double peace sign, likely unaware that in American politics this gesture is forever linked with the disgraced ex-President Richard Nixon. Before his speech begins, his introduction by the President pro tempore of the Senate brings them back to their feet for another fifty three seconds, followed by

another twelve seconds of applause when he opens his speech with the words, “We the people.” ("Polish Solidarity Leader," 1989)

The first three words accurately presage much of his speech's content. He refers to the institution he is addressing as a globally revered “beacon of freedom and a bulwark of human rights.” He claims that Abraham Lincoln, the Founding Fathers, and all the founding documents of the United States are continuing sources of inspiration to Solidarity, and says that the American people “are idealistic but at the same time practical people, endowed with common sense and capable of logical action. They combine these features with a belief in the ultimate victory of right over wrong.” One might falsely conclude that Walesa had been a salesman in his previous career rather than a shipyard electrician.

Walesa goes on to give a brief history of Solidarity and his own role in the movement, peppered with a few well-received jokes about his increasing age and weight since the story began. After losing his job at the shipyard for attempting to organize workers against the management, he jumped the shipyard wall to get back in, and was quickly appointed leader of the strike. “Now others jump fences and tear down walls. They do it because freedom is a human right.” This remark gets the full house back on its feet for nearly a full minute.

This fact is worth pondering. In any other circumstance, a Republican controlled legislature would never give a standing ovation to union organizers or the leaders of workplace strikes. Indeed, Simpson's (1996) detailed account of Walesa's rise and fall as a political dealmaker claimed that “for [Walesa] the problem was not between democracy and communism but between workers and elites.” (Simpson 1996) However, after the East German authorities decided just days earlier to open the crossing to West Germany, the assembled politicians had spent the intervening days watching televised footage of crowds of Germans tearing down sections of the Berlin Wall. (“This Day in History,” 2016) The imagery of Walesa jumping another wall to lead the opposition to communism was powerful

enough to overcome the more politically challenging aspects of his story. The resulting optimism that the Cold War was ending peacefully surely contributed to Walesa's rockstar reception in the Capitol, and to his “triumphant” speech leaving “many [members of Congress] with tears in their eyes.” (“Poland, Hungary Aid Launched,” 1990) Walesa played into this masterfully with the content of his speech.

“If there is something threatening European stability today, it certainly is not Poland,” Walesa went on. ("Polish Solidarity Leader," 1989) This might be interpreted as a slight against the crumbling Soviet Union or the emerging Russian authorities. Elsewhere in the speech he is more direct, particularly when he mentions the thousands of Poles who disappeared into the Eastern reaches of Russia during the second World War. He cements the tie between this era and the current state of affairs by noting that “it is only now that we are discovering [] bones in unmarked graves” from the Polish resistance against Nazi occupation. When other nations were celebrating the end of the war, he says Poland went into mourning, “especially when they realized their allies had abandoned them.” This is the closest Walesa comes to blaming the West for his state's current condition.

It was Stalin, Walesa says, who forbade Poland from participating in the Marshall Plan.

“It is worth recalling now this great American plan which helped Western Europe to protect its freedoms and peaceful order. And now is the moment when Eastern Europe awaits an investment of this kind, an investment in freedom, democracy and peace, an investment adequate to the greatness of the American nation.”

This carefully worded request for money is greeted by thirty seconds of applause. Walesa states that it is Communist Party rule which “led the Polish economy to ruin, to the verge of utter catastrophe.” But this is not a uniquely Polish problem; the entire eastern bloc is bankrupt, and “communist economies have failed in every part of the world.”

It is this “absurd” economic system which Walesa holds accountable for both the state of his economy, and for the reputation of Polish workers.

“One hears sometimes that people in Poland do not care to work well... Poles work well and effectively if only they see the sense and usefulness of their work. The working people know their arithmetic too. They are working much harder, and in worse conditions, than their opposite numbers abroad, and on top of that are paid much lower wages... This system has to be changed, and the Poles took it upon themselves to change it.”

Here again we see signs of Walesa the union organizer, but the chamber continues to respond to Walesa the anti-communist. This is due not only to his reputation as an anti-communist, but to his amiable tone and soft body language. His speech is matter-of-fact rather than plaintive, even when discussing the worst ravages of communism and occupation. He closes again with requests for assistance that are constructed both as compliments, and as a promise that it is those he seeks assistance from who will reap the greatest benefits from a resurgent Poland.

“I know that America has her own problems and difficulties, some of them very serious. We are not asking for charity, we are not expecting philanthropy. But we would like to see our country treated as a partner and a friend. We would like cooperation under decent and favorable conditions. We would like Americans to come to us with proposals of cooperation bringing benefits to both sides. We believe that assistance extended to democracy and freedom in Poland and all of Eastern Europe is the best investment in the future and in peace, better than tanks and warships and warplanes, an investment leading to greater security... Poland's efforts are viewed with sympathetic interest by the West, and for this thanks are in order. We believe that the West's contribution to this process will grow now. We have heard many beautiful words of encouragement. These are appreciated, but, being a worker and a man of concrete work, I must tell you that the supply of words on the world market is plentiful, but the demand is falling.”

This last remark elicits laughter, followed by applause. Again, one wonders how many listeners understand that Walesa is not only soliciting funds, but mildly rebuking them for not having delivered the funds already. In closing, Walesa expresses thanks “with special warmth” to the American people, thanks to whom “the people of Solidarity were never alone.” He then thanks the Congress and, in a final sign of his trade union pedigree, the AFL-CIO for its support. ("Polish Solidarity Leader," 1989)

Also in his closing remarks, Walesa thanks the Congress for its recent decision to grant economic aid to Poland, referring to two bills with a combined headline number just under $1.5 billion. President Bush had opposed these bills because an enthusiastic Congress had appropriated larger sums of money than Bush had asked for, but he would sign both before the end of the month. (“Poland,

Hungary Aid Launched," 1990) As is often the case with bilateral aid packages, the headline number was an agglomeration of several distinct funds intended to incentivize the Polish authorities, such as an "enterprise fund" to provide loans to emerging small businesses and $12 million to support the formation of "democratic institutions." This led the New York Times to describe the package as "long on incentives, short on dollars." (Pear 1989)

While Walesa was the outspoken leader in publicly soliciting aid for Poland, Balcerowicz was also careful to say the right things in his relatively few public appearances. When asked, in a May 1990 C-Span appearance, why investors should have confidence in the Polish economy, Balcerowicz responded that "I would like to tell them not to worry too much, to show them enterprising spirit which is so typical for America which forms the basis for the growth, I think in Poland we've got this enterprising spirit too." Only after this compliment does he explain that investors should be encouraged by Poland's young, well educated population and its advantageous location allowing it to export to both east and west. Finally he acknowledges that "what is more, the level of wages in Poland is rather low so far, so we are competitive." ("Economic Development in Eastern," 1990) It is also worth mentioning that Poland's relative openness compared with much of the eastern bloc had allowed Balcerowicz to become a well regarded academic with many contacts in the West. In fact, Balcerowicz had to be convinced to abandon his plans to spend the year as a visiting professor in England to enter the Polish government and administer the plan's implementation himself. (Boughton 2001)

After the Balcerowicz Plan was enacted in December 1989, Poland's creditors moved quickly to support the program. A $1 billion stabilization fund was announced on January 3 by the United States with funding also coming from Japan and Europe. (Sachs 1990) In an even more remarkable show of speed, the IMF announced an agreement on a standby arrangement on February 5th. (Boughton 2001) By the end of the month, the World Bank followed suit with a loan of $360 million and the possibility of another $2.5 billion to follow. ("Poland Signs Accord," 1990)

The rapidity of the IMF's actions in particular might be attributed to longstanding contacts and negotiations between the two parties. Poland was initially a member of the IMF, but had left the organization under Soviet pressure in 1950. Their bid to rejoin in the early 80s was held up by the United States to protest the imposition of martial law and the suppression of the Solidarity movement, acts which also drew economic sanctions from the NATO bloc. The end of martial law and release of political prisoners in 1984 led the Reagan administration to drop its opposition to Poland's negotiations with both the IMF and the Paris Club; however, when Poland's membership in the IMF came to a vote in 1986 with a communist government still in power, the United States abstained from the vote, and prevented Poland from actually borrowing from the Fund. The Reagan administration "let it be understood that it would not support a request for a stand-by arrangement, and the Fund's management discouraged the Polish authorities from pursuing the matter. Meanwhile, financial discipline continued to worsen in Poland." (Boughton 2001) Thus while agreement on a standby arrangement was implemented with astounding speed after the enactment of the Balcerowicz plan, much of the groundwork for the deal had in fact been laid years before.

These positive developments came despite an economic situation that was not quickly improving in response to the reforms. Inflation at the time the reforms were enacted was about 50% per month. ("Poland: Economic Policy," 1989) Balcerowicz's economic reforms would bring this number down, but it would not happen right away. In January, the monthly rate of inflation spiked to almost 80%, "the greatest price shock in Poland's post-war history", before retreating to 29% in February. Even with the reforms in place, the government still set about 14% of prices at this time, including the prices of "energy, transportation, housing, medicines and the cheapest sort of milk." Despite continuing government interference in the energy market, the retail price of electricity quickly doubled, the price of gasoline quadrupled, and the price of coal increased "overnight by up to seven times!" (Kolodko 1991) Minutes from the February 5, 1990 IMF meeting show that the Polish

government convinced the Fund's staff that, while the price of coal would need to be increased even further for production of coal to become profitable without state support, “moving prices farther than that in a single step would have put the program in danger.” (“Republic of Poland – Staff Report,” 1990)

The minutes show the Directors also discussed the inflation rate for January, which was not yet precisely known but was reported to be above target. This concern was ultimately dismissed, because:

> ...the Government had informed the staff that it was sticking with the incomes policies that had been adopted—that was clearly a sign of the Government's determination to deal decisively with inflation... Directors unanimously expressed their admiration of the Polish authorities for their courage, imagination, and determination in introducing an unprecedented program of radical transformation of the economy.” (“Poland – 1989 Article IV,” 1990)

The Balcerowicz plan had included the 'popiwek', a tax on excessive wage increases, which is believed to have contributed positively to the end of the hyperinflation of the 1980s. However, it did not include a full wage freeze. (Kolodko 1991) Despite the Fund's confidence, the government acted to increase wages in late 1990, which led the IMF to declare that the program had gone off track and suspend its lending before the last 40 percent of the initial loan was delivered. This was not considered overly significant, as the IMF entered negotiations on a multi-year deal in November 1990. By late February, Balcerowicz and the Fund had agreed to an “extended arrangement” promising loans worth $2.6 billion and $325 million delivered immediately. More importantly, a multi-year deal with the Fund was considered a prerequisite to serious negotiations with the Paris Club. (Boughton 2001)

In March of 1991, a mere 15 months after the Balcerowicz plan was signed into law, the Paris Club announced that it had agreed to “extraordinary terms” for the reduction of the $33 billion Poland owed to the G7 states. (Greenhouse 1991) In language meant to discourage other states from thinking such generous treatment would be the norm going forward, the group announced it would ”reduce the net present value of Poland's debt by 30 percent. If Poland successfully carried out its commitments under the three-year Fund supported program, official creditors would reduce those debts

by another 20 percent of their initial value, for a total reduction of 50 percent." (Boughton 2012, Sachs 2012) Nearly half this sum had been owed to Germany. The United States, which had been pushing to further Poland's interests at the IMF since the Solidarity movement had removed the Communist party from power, forgave 70% of its $3.5 billion in Polish debt. (Boughton 2001)

The week after the Paris Club announcement, an additional $800 million in forgiven repayments to the United States was presented as a welcome gift on the occasion of Walesa's visit to the White House. Though he spoke only Polish, Walesa managed to respond to President Bush's announcement with the English phrase "God Bless America," to which the President replied "Beautiful, thank you, so sweet." That same day, "the two leaders took a stroll through the Rose Garden, where Mr. Bush offered Mr. Walesa a flowering bud from a dogwood tree." (Krauss 1991)

Negotiations with the London Club of commercial creditors stalled for a time, due in part to turnover in the Polish government. Prime Minister Tadeusz Mazowiecki had been the first man to hold the office, but resigned after losing to Walesa after the first Presidential election. He was succeeded by Jan Bielicki in 1991, who was succeeded by Jan Olszewski for five months, Waldemar Pawlak for one month, Hannah Suchoka for fifteen months, then Pawlak again for another fifteen months. (Simpson 1996)

During Olszewski's premiership, the IMF had approved "with disgust" a budget with a 5 percent deficit. (Engelberg 1992) After Walesa nominated Suchoka in July 1992, she argued that the debt reduction deal, which would not be fully phased in until 1994, necessitated a continuing commitment to the IMF program and budgetary discipline, especially with inflation still not under control. According to Balcerowicz (1994b) inflation dropped from 249 percent for the year 1990, to 60.4 percent in 1991, to 44.3 percent in 1992. Even the 37.6 percent rate of inflation in 1993 was "clearly still too high," but did not cause the IMF or the Paris Club to withdraw their support. (Balcerowicz 1994b)

In fact, disagreement among the splintered factions of Solidarity led to the rejection of

Suchoka's budget by the Solidarity caucus. Walesa, who had not publicly backed the pro-IMF position during this fight, surprised many by dismissing the parliament and calling new elections which, due to the deep splintering of the Solidarity party, were dominated by the Democratic Left Alliance or SDP. This party represented the ex-communist managers and politicians, who had been allowed to remain in the political arena thanks to the “thick line” policy enacted by Mazowiecki and adhered to by his successors. (Simpson 1996)

Once the negotiations began in earnest, there was disagreement over how far the London Club should go in forgiving Polish debts. The London Club's position was that it should assess the viability of the debts at current market conditions; that is, that in evaluating Poland's ability to repay its debts, it should account for the massive amounts of debt that had already been forgiven by the Paris Club. The IMF backed the Polish government “in arguing that the benefit of the Paris Club offer should go to Poland, not to the foreign bank creditors.” (Boughton 2012) By March 1994 the size of the debt had grown to $14.4 billion, and the Polish economy was “shifting into high gear.” (Boughton 2012) However, under pressure from the Fund, the London Club offered “a similar degree of debt reduction” to the Paris Club deal. (Balcerowicz 1994b) In the same month, the Paris Club wrote off the final 20 percent of debts it was to forgive. (Boughton 2012)

The Polish economy would recover so quickly that it repaid all its loans from the IMF by July 1996. This sum peaked at roughly $1.3 billion, 90 percent of its 1994 IMF quota, and just 4 percent of the amount forgiven by the Paris Club alone. (Boughton 2012) Between the Paris Club and London Club deals, Poland had seen its debt load reduced by $38 billion in 1991 dollars. While the United States had (and maintains) a geopolitical interest in Poland, and the American elections might have encouraged western politicians to pander to the Polish-American constituency, the close, friendly relations between Walesa and Bush helped secure massive debt relief without which Poland's rapid transition to a growing market economy would have been far less likely.

Russia

Figure 3. Source: "Historic Inflation Russia," 2016

The Russian Federation began its existence burdened by a contradiction. Russian nationalism led to the emergence of the new state and the dissolution of the union, with the full transfer of Soviet debts to Russia eventually to follow. Yet the same nationalism that drove the Russians to seek independence from the Ukrainians and the Kazakhs made it difficult for the new regime to seek help from America or Germany. This prospect was even less attractive to the main political opposition to reform, the "old guard" of Soviet-era officials and the Communist Party of Russia. Even a healthy Russian state would have had an economy a fraction the size of the Soviet Union, and at this time .

Like Walesa, Yeltsin is known for the friendly relations he helped forge with the West, and with western leaders. Though Yeltsin was a populist, he was hardly an ideologue, and he entered the presidency with his eyes open to the gravity of the state's financial position. Addressing the 5th Congress of People's Deputies in 1991, Yeltsin displayed his willingness to work openly with the foreign and international institutions with the capacity to lighten Russia's burdens, declaring that his administration was "prepared, in cooperation with foreign specialists, to immediately disclose the strategic data necessary for admission into international organizations and to accept the basic principles

set forth in the charter of the International Monetary Fund."(Gould-Davies & Woods 1999, p. 5)

While hardly the last such statement Yeltsin would make, his favorable comments about capitalism or the west would always be tempered with a measure of defiance. In February 1992, Yeltsin met President Bush at Camp David in a meeting meant to signify a formal end to the Cold War. When it came time to address the press, Yeltsin said, "I consider I would be very lucky in life, both as a political person and just as a man, to have met George Bush. I'm just tremendously impressed by his wisdom. I think he has incredible qualities not only as a political person but also as a person, as a really great political figure of the United States." For his part, President Bush would say that he had "a very warm feeling in my heart about what he has done and is trying to do, and I consider him my friend."

But the meeting was not all smiles and sunshine. Speaking of his country's financial woes, Yeltsin was quoted as saying:

"I didn't come here just to stretch out my hand and ask for help. No, we're calling for cooperation, cooperation for the whole world, because if the reform in Russia goes under, that means there will be a cold war. The cold war is going to turn into a hot war. This is, again, going to be an arms race."

Yeltsin also met with congressional leaders at that time. Representative Richard Gephardt said Yeltsin "delivered a loud, clear message that if there's going to be help, it needs to come now." Said Senator Bob Dole, "He may be the last hope. That's the message he gave us. This may be the last chance." (Wines 1992)

Soon after, the first negotiations would begin between the IMF and the Russian Federation. The Soviet Union had a long history with the Fund, though it was not a member; it would have been a founding member, had Joseph Stalin not gone against his own advisers and refused to join "an organization that would force him to disclose basic data about the Soviet economy and that would likely be dominated the the United States and its western European allies." (Boughton 2012) Decades later, letters from Gorbachev would persuade President Bush to propose in 1990 a 'Special Association' with the Soviet Union. Though lending would remain out of the question, the first contacts and sharing

of data and expertise between Moscow and the Fund would begin to take shape at this time.

Boughton, an historian employed by the IMF, says that “this initiative came from within the U.S. Government and does not seem to have been discussed with the IMF or others before the president's announcement.” (Boughton 2012) It should be noted that Boughton's history of the period, entitled “Tearing Down Walls,” includes only scant references to the massive Soviet-era debts; even more egregiously there is no mention of the severe social crises with which the Russian parliament had to manage.

As is typically the case, negotiations with the IMF were understood to be a prerequisite to any dealings with the G7, the Paris Club, or the London Club. While a standby arrangement with the IMF covering multiple years was the ultimate goal, first Russia needed to be accepted as a member. This process began on January 3 1992 with a letter from Yeltsin to the Fund's managing director, written less than a week after he became the undisputed sovereign of Russia. (Boughton 2012) Apart from sharing economic data, the process of which had already begun under the Special Association (which Russia inherited), admission to the Fund required agreement on the size of Russia's quota. The quota assigned to a state determines the amount of funds a state is required to deposit with the Fund, the amount of loans which the state can receive from the Fund, and the number of votes a state has in Fund leadership. Ordinarily the Fund's staff would derive a quota by applying standard formulas to the available economic data. However, with the data from Russia considered unreliable, “political considerations guided the quota discussions.” (p. 290) A range was constructed from the available data that would place Russia somewhere between China at the low end and Italy, the smallest of the G7 economies, at the high end. The sitting directors at the Fund favored a number at the low end of the range to preserve the status quo, while Russia felt it deserved an even higher quota than the suggested range based on the quota the Soviet Union had been offered at the Fund's inception. In order to resolve the resulting impasse on relatively favorable terms, Yeltsin “took the quota case directly to U.S.

President George H.W. Bush," and "with the White House now behind him, Kagalovsky [the Russian negotiator] lined up enough support to pressure the Fund to raise the quota offer to 3 percent," near the high end of the suggested range. Russia's acceptance was formalized at a meeting on March 30, 1992, at which time Kagalovsky stated that "we do not want to find unique ways for our approach. Rather, we want to use the traditional economic approach of stabilization and liberalization of the economy." (Boughton 2012, p. 291)

A mere two days later, the G7 would announce a one year $24 billion assistance package. However, the details of this package were unclear. (Horvitz 1992) With the delivery of the assistance package hanging in the balance, negotiations on the standby arrangement intensified as a July 6th G7 summit in Munich approached. Just before the summit, Yeltsin would deliver a sharper message for the IMF than his negotiator had three months earlier. Speaking at a press conference before departing for the summit, Yeltsin said of the IMF's proposal, "to force us to our knees for this loan, no! Russia is still a great power." (Englund 1992) On the day the summit opened, Yeltsin stated that his administration was "not satisfied with the IMF position and cannot work in accordance with its standard program." The Russian press labeled this a "verbal concession to populists," and predicted that the statement was meant to temper the expectations of anyone expecting the imminent arrival of foreign aid. (Berger 1992) On July 8th, the final day of the summit, Yeltsin declared that he would refuse IMF demands to freeze energy prices and wages, moves which would lower the standard of living of the Russian people even further, even at the cost of losing the $24 billion: "They don't know our situation, but we know it." (Bekker 1992)

The change to a more confrontational tone might be attributed to a change in Yeltsin's job description. After initially serving as his own Prime Minister, in June of 1992 Yeltsin appointed his deputy Yegor Gaidar to the post of acting Prime Minister. Only 36 years of age at the time of his appointment, Gaidar had been a member of the Communist Party before joining Yeltsin's government.

He studied Economics at Moscow State University before becoming the economics editor of the journal *Kommunist,* and then a writer at *Pravda.* (Leontyev 1991) While still a deputy, Gaidar had led in the crafting of the state's reform plans, and on January 2 1992 he oversaw the end of government price controls "on all but a few prices." (Boughton 2012) Unlike his Polish counterpart Balcerowicz, Gaidar was far from achieving international renown as an economist. While he had earned his doctorate, he had studied economics in Soviet-era Moscow where "textbook economic analysis had been suppressed for decades... Exceptionally, Yegor Gaidar reportedly had obtained a copy of Paul Samuelson's economics textbook, which he studied carefully and then shared secretly with fellow would-be reformers." IMF officials considered Gaidar a reliable partner, and even after his short stint in government he remained "one of the most frequent and helpful contacts for senior IMF officials throughout the 1990s." (Boughton 2012)

More importantly, behind his rhetoric lay the reality that Yeltsin had already secured an agreement which met these requirements, though it was not without its drawbacks. With progress proving difficult between the IMF's negotiators and their Moscow counterparts, Gaidar sought help from the German deputy finance minister Horst Köhler, who contacted the Managing Director of the IMF, Michel Camdessus,

"to urge him to go to Moscow and meet with Yeltsin to break the impasse. Camdessus replied cautiously, saying that he could not go without an invitation from the Russian government. Köhler then escalated it further by getting Chancellor Kohl to ask Yeltsin to invite Camdessus. Yeltsin phoned Camdessus, who agreed..." (Boughton 2012, p. 298)

The private meeting between Yeltsin and Camdessus yielded an agreement which allowed the Russian government to continue subsidizing energy, but which would not be considered a standby arrangement for purposes of unlocking the $24 billion. Only $1 billion was made available to Russia, and despite IMF rules which state that a "first-tranche" agreement should come with no formal policy conditions, they were barred from drawing on this loan "given the real risk that the authorities would be

frustrated in their attempts to carry out even the small reforms they had promised." When Russia had not bothered to draw on these funds some months later, 32 U.S. Senators wrote a letter to the IMF protesting the "excessive conditionality" attached to the funds. (Boughton 2012, p. 299)

Despite his personal involvement in this deal, the idea that Yeltsin ceded the initiative on international finance to Gaidar is supported by Jeffrey Sachs, who would later recall that:

"two meetings with invited foreign economic advisers took place with the President, on December 11th and 13th [1991]. President Yeltsin was extremely coherent and engaged in these two meetings, asking detailed questions and taking extensive notes... Yeltsin received the two briefings with great interest and asked the group to continue to work with the Russian Government as economic advisers... I did not meet again with Yeltsin all during 1992, except at a couple of social events (including a soccer game played by the Government senior officials!), so that almost all my advising went through then-Acting Prime Minister Gaidar. Yeltsin seemed to have no detailed interest in the economic issues." (Sachs 2012)

In December of 1992, with C-Span taping and translating his remarks, Gaidar addressed the Russian Congress of People's Deputies. As the introduction to the video notes, the body of more than a thousand representatives included many members of the Communist Party and the old guard of the Soviet Union opposed to reform and unlikely to confirm Gaidar as Prime Minister. ("Russian Federation Economic," 1992) With the benefit of hindsight we can add that within a year of the speech, not only would Gaidar be voted out of the position, but that Yeltsin would resort to military force to dissolve the entire Russian parliament.

Given this historical context, it is unsurprising that Gaidar begins his remarks in an overtly confrontational way. Leaning on the podium with his arms spread wide, Gaidar immediately castigates the parliament for falling victim to "the paralyzing influence of fear of responsibility." They have had long discussions, he says, about what to do first and how to do it; the result of this talk is "107 privatized stores, 58 privatized cafes and restaurants, [and] 36 privatized service enterprises" in all of Russia. It is due to this slow pace of reform, he says, that

"the President decided to take responsibility for finally beginning the real process of reform and took on additional powers... as a specialist I can assure you that we have a theoretically proven answer to

what must be done first to ensure the success of reforms. The basis of our work is a simple principle: if the old system of management does not work, at every moment we must do everything in order to launch the market mechanism into motion."

While he acknowledges that the implemented market reforms have not yet yielded a functioning, competitive market economy, he insists this is because the country is "burdened with the holdovers of the traditional administrative command system." Still, he notes that one year prior, the conversation was not about marginal differences in production and output, but rather famine and societal collapse, which he feels have been avoided.

"It is becoming harder and harder to coax people out to meetings and demonstrations and protests," Gaidar says. He pauses as this remark elicits a dissatisfied rumble from the audience, then repeats himself, without breaking eye contact. In this and other changes, Gaidar maintains the confident tone and posture of a man with the data on his side. Later, he will castigate his opponents for relying on data which he says are demonstrably falsified. "All the real difficulties are so serious," he says, "that I cannot understand why the adviser to the esteemed chairman decided to use numbers and figures which do not accurately reflect reality."

Apart from a vigorous and forceful defense of his domestic reform agenda, Gaidar also unflinchingly defended his position on international financial markets and the state's debt obligations.

"We were forced to begin reform with no currency reserves, with an unmanageable soviet debt, with an obligation to repay in 1992 about $20 billion in debt for which we had no money to service... as a result of negotiations with the international financial community, we have managed to obtain a real deferment of the $20 billion. We will actually pay $1.5 billion of this debt, and we have done this without stopping import or the flow of new credits."

Gaidar goes on to explain that it is because of this agreement that they were able to maintain access to global financial networks, allowing them to finance imports of grain and medical supplies which were crucial in averting a humanitarian crisis.

The veracity of the $20 billion figure is difficult to establish due to the perplexing reluctance of the entire international community to provide consistent details about sovereign debt. Gaidar refers

here to a deferral from the Paris Club agreed to in January of 1992 and a continuous series of three month roll-overs obtained from the London Club. However, Schmemann (1991), Nadmitov (2004), and Christensen (1994) tell us that the agreements were simple reschedulings at par. In other words, payments on principle were deferred through 1992, but interest continued to accrue not only on principle, but also on any scheduled interest payments Russia did not make on time. The breathing space thus acquired was invaluable in light of Gaidar's claim that there was "no money to service" the debts at the time, but Russia paid for this extension in full. The only relief Russia received at this time was that it was not made to declare itself in default. In fact this was a self-serving decision by foreign creditors, since Russia at the time had few assets a foreign court could seize to make good on the debts.

Gaidar admits to several mistakes made by his government, among them the "crisis of payments." This term refers to the phenomenon where firms not only failed to pay taxes to the government, but resorted to barter and mutual nonpayment in transactions between firms to avoid incurring taxes. This is a problem about which we will have more to say below, and one which Gaidar says "became like an avalanche, uncontrollable... we had to take extremely difficult, painful, and pro-inflation decisions in order to resolve this crisis." Gaddy and Ickes (2002) coined the phrase "virtual economy" to include both the avoidance of taxation through barter and fictitious pricing, and the use of these and other methods employed by loss-making enterprises to survive in spite of efforts at reform. (p. 4-5) This problem would only get worse as the decade wore on, particularly once the infamous loans-for-shares program of 1994-95 resulted in the bulk of Russia's resource wealth being transferred to the new oligarchy. According to the virtual economy theory, the primary obstacle to tax reform was the "sheer scope of loss-making enterprises" that would be forced into closure without support from the federal budget. (p. 220) Under the Soviet model, these enterprises "owned housing, kindergartens, sports centres, hospitals and polyclinics and, especially in the mono-cities, operated public transport... one in five citizens [lived] in housing owned by his or her enterprise." (Jeffries , p. 119) The social

cost of rapidly shuttering these enterprises without establishing a social safety net of some kind would have been immense.

The government's failure to rein in inflation is also discussed at length. Though Gaidar asserts that they were meeting their inflation target and had nearly recorded a primary surplus for the first half of the year, by October he says the rate of inflation was 25% per month; “we have no doubt that this is one of our great failures, and it is dangerous for today's situation and the prospects of reform.” ("Russian Federation Economic," 1992) Not only is low, stable inflation necessary to attract foreign capital of any stripe, it is of primary and explicit concern to the IMF. In its application for IMF membership, Russia committed to reducing inflation to 1-3% per month. (Gould-Davies & Woods 1999, p. 6)

While Gaidar frequently confronts the old guard directly, he does manage to connect with his audience on nationalist grounds. Discussing the continuing search for a definitive way forward, Gaidar cites an opponent as having said, “there are two models, the monetarist American model and the socially oriented European and Scandinavian model, and we supposedly must choose which society we want to live in. And based on this...” Gaidar trails off, and receives a chuckle from his audience. This comparison, he says, suggests an ignorance of “the difficult practical problems which we must solve on a daily basis in the Russian economy.” This inversion of Yeltsin's claim that only Russians understand the problems faced by Russia makes the same point without voicing defiance to those foreign and international actors who are, according to the theory, impossibly misguided in seeking to dictate Russian policy.

There is little animosity in the speech, and at no time does he seem agitated or dismayed. Rather, he appears resolute, confident in his vision and in his position. Here it is worth noting that before a 1993 speech at The Heritage Foundation, Gaidar's presenter recalls him saying upon his promotion to acting Prime Minister that “he understood his function, his historic role, which was to

make the necessary reforms, to take the responsibility, and when the time came to take blame and be pushed aside.” ("The Economic Future," 1993) Gaidar's ability to speak frankly to the parliament even as he forced through reforms most of its members opposed likely derived, at least in part, from the knowledge that he would in any event not be Prime Minister for long.

Yeltsin's turn to populist rhetoric and a more confrontational negotiating stance with the IMF and the G7 must be viewed in tandem with his appointment of a man who, though a relative unknown in the west prior to 1991, pushed to rapidly implement deep market reforms perfectly in line with IMF demands and Western preferences. Though frequently referencing social catastrophes that have been averted, he identifies the IMF's priorities as those of his government. Where those targets and commitments were not met, as in the case of the primary deficit and the level of inflation, he mostly takes responsibility for these failures. When he does not take responsibility himself, he cites the opposition of the very domestic opponents he is addressing, and in both cases he insists that the government must continue on the course of shock therapy until it has achieved a successful capitalist revolution.

“Our main priority,” he says, “in the near future and for 1993, is of course the foreign economic sphere. Without opening our economy, without gradually earning our place in the world economy, we will have no place in the future world.”("Russian Federation Economic," 1992) This rhetoric of openness and convergence, paired with an ambitious course of reform aimed at creating a real economic convergence between east and west, makes Gaidar the exact kind of politician the IMF would view as an ideal partner to lead an indebted state. Moreover, his remark that he, as a “specialist”, had a “theoretically proven answer” for Russia's economic woes heralds the 'technocratic' leadership global financial institutions would call for almost two decades later.

His only flaw was the untenable nature of his position. Less than two weeks after this speech, the body he addressed would fail to confirm him as a sitting Prime Minister. The aforementioned

Chernomyrdin would eventually be confirmed as a compromise between Yeltsin and the parliament. Gaidar would remain a Yeltsin ally, but neither Yeltsin nor any of his top deputies would speak in favor of reform with the firmness of conviction Gaidar had, or be as willing to confront domestic political opponents.

Despite all of this, the IMF delivered just $1 billion in loans to Russia during Gaidar's tenure, arriving a full seven months after his government had put an end to most price controls. To this point, the London Club and the Paris Club had done little more than decline to push Russia into default, as no formal rescheduling had yet been agreed to. The World Bank pitched in with a $600 million loan for the financing of imports. This was the sum total delivered to Russia in 1992 of the G7's much publicized $24 billion package. The delivery of the bulk of the aid was conditioned on “the conclusion of a full-scale IMF stand-by program,” an agreement which for years would prove elusive. (“Fact Sheet: Russia,” 1994) Even the IMF's own history of the period concludes that $24 billion “was just a headline number” which included a $6 billion ruble stabilization fund that never was delivered, “the estimated potential value of loans that might be extended by the IMF and the World Bank,” a Paris Club debt rescheduling which had not in fact been agreed to, and $11 billion “in the form of bilateral assistance from the G7 countries, but much of that was not yet budgeted or specifically committed, and all of it depended on” the conclusion of the standby arrangement. (Boughton 2012, p. 7)

However, while the promised aid was delivered much too slowly (if in fact it was coming at all) to give the reformers the leverage they needed over their political opponents, it is significant that for two years, the G7, the IMF and the World Bank collectively agreed to aid packages that exceeded the Fund's calculation that the Russian economy would need $17 billion in external financing to avoid an unacceptable level of economic collapse. The membership agreement developed jointly by Russia and the IMF envisaged a “50% drop in output over three years... before an anticipated recovery in the second half of the 1990s.” (Boughton 2012) The sums even exceeded Sachs' own estimates of the

necessary financing. In 1991 he called for $15 to $20 billion in aid the following year, with “similar sums … needed for three or four years of reforms. (Sachs 1991) However, at this point Russia had not formally taken responsibility for all Soviet debts. In light of this development, a more appropriate estimate is his 'Grand Bargain' which had called for $100 billion in assistance to the Soviet Union over four years, “to be given alongside an orthodox IMF programme.” (Gould-Davies & Woods 1999, p. 5) While the $100 billion figure may seem extreme, it was derived from a per capita comparison to the aid already delivered to Eastern European countries. As such it is in fact a very conservative estimate of what was necessary to emulate the successes achieved in Poland and elsewhere; the Russian population in 1992 was just 148.7 million, roughly half the total population of the Soviet Union before it disintegrated. (“Soviet Union: People,” 2003)

1993 would see the G7 follow the $24 billion announcement of the prior year with an even larger $28 million package. However, while the headline number exceeded what the reformers deemed necessary, only “about $5 billion was actually delivered.” (Jeffries 2002, p. 286) As was the case with the previous package, it was a mixture of bilateral aid which was unlikely to arrive, savings due to anticipated reschedulings, and interest-bearing loans. The IMF, which was meant to supply $13 billion of this total, delivered just $1.5 billion, from the IMF's new “Systemic Transformation Facility” or STF. As Boughton (2012) explains, the facility was designed based on “the experience with the Russian Federation and other transition countries in 1992,” and was only a short term project intended to assist states struggling to transition to market capitalism. The loans carried “lighter and much less detailed” conditionality, and repayment would not start for ten years instead of the usual five. (p. 199) Nevertheless, the second tranche of $1.5 billion was postponed due to the September 1993 decision to suspend all lending as a consequence of a rate of inflation which, though it had dipped briefly below 20 percent in the winter, came in at 23 percent that month. (Gould-Davies & Woods 1999, p. 7)

In a dramatic display of the different time frames at work, it took just two days for Yeltsin to

respond to the IMF's decision by using force to dissolve the parliament, beginning a new era in Russian politics. However, the high point of the reformers' influence in government came even earlier. In June of 1992, Yeltsin responded to internal political pressures by shuffling his cabinet, bringing into government Viktor Chernomyrdin, Gaidar's eventual successor as Prime Minister, along with other “representatives of the industrial lobbies.”

The Duma also appointed Viktor Gerashchenko, the head of the old Soviet Central Bank, to take over the Central Bank of Russia. Under Gerashchenko, the budget deficit exploded, financed by an expansion of credit by the Central Bank. This almost certainly was the “extremely difficult, painful, and pro-inflation” policy Gaidar lamented. (Gould-Davies & Woods 1999, p. 6) This statement is an example of Gaidar taking responsibility for the nation, even though he opposed what had been done. Appointing the head of the Central Bank was at this time a function of the Duma, meaning that neither Yeltsin nor Gaidar could have done much to prevent it, yet Sachs notes that Gaidar “received most of the blame for this wrong-headed policy, since Gaidar was the visible leader of the reform.” He concludes that inflation was the result of a lack of discipline in monetary policy rather than of reform or the pace of reforms. (Sachs 2012)

However, it should be noted that this deficit spending was partially a response to the “growing social crisis” which was of great concern to Sachs himself. Outbreaks of various diseases, fueled by a shortage of crucial drugs and an inability to import them, led Sachs to meet with the World Bank's health mission, who told him that institution “planned to take its time to get help to Russia, since there was apparently a need for the Bank to study the situation for some years first.” (Sachs 2012) The IMF's published account of its actions in this period makes no mention of this or any other internal Russian difficulties.

For his part, Gaidar would conclude that governments facing similar financial predicaments in the future must above all else maintain budgetary discipline in their monetary policy: “Whatever

serious political reasoning is used to justify softening of such requirements, the result is the same, namely, a capital outflow, at the expense of the external debts." (Gaidar 2007) Such a mandate would either entail acceptance of a public health catastrophe, or require offsetting capital inflows. Without meaningful levels of foreign assistance, it is difficult to see how a state with even weak democratic institutions could maintain such a high level of budgetary discipline.

The Chernomyrdin Era

A year of conflict between Yeltsin and parliament would culminate in a new constitution, approved narrowly by a referendum in Yeltsin's favor at the end of 1993. This is the constitution observers of modern Russia will be familiar with. Among the most important changes was an increase in the President's ability to select the head of the government. Three failed nominations for Prime Minister would automatically trigger new elections in the Duma, the lower house of the Russian legislature which is responsible for confirming the President's nominee. (constitution.ru) The President also secured from the Duma the ability to appoint the head of the central bank. However, Yeltsin would not use these new powers to bring Gaidar or another strong reformer back into office; Chernomyrdin would remain Prime Minister until early 1998.

In 1993, Chernomyrdin's government would be the beneficiary of several positive developments in its financial standing. Shortly after an April referendum was decided in Yeltsin's favor, the IMF's new Systemic Transformation Facility extended Russia a $3 billion loan. While the facility was meant to eschew the IMF's usual conditionality, only half the loan was delivered, with the other half held until the conclusion of the standby arrangement. (Gould-Davies & Woods 1999, p. 7) The aforementioned gap in time frames supports the possibility that this development was a response not only to a display of Yeltsin's continued grip on power, but the favorable rhetoric which issued from the Gaidar government along with the removal of price controls and other fundamental reforms.

The government also began in 1993 to issue bonds for the first time since the Soviet Union's

dissolution. Starting in 1993, domestic investors were able to purchase GKOs, ruble-denominated treasury bonds with short-term maturities and subject to Russian law. This practice would greatly aid the government in keeping inflation at reasonable levels for a few years. Eventually this market would be opened to global investors, and by the time of the government's default in 1998, the government would have 272 billion rubles in GKO debt, approximately $45 billion at the prevailing exchange rate at the beginning of that year. As we will see, the ability to issue debt in its own currency and law gave Russia security from foreign creditors. (Nadmitov 2004)

In a March 8th speech in front of the new Federal Assembly (in the same old Kremlin), Chernomyrdin presented both Yeltsin's 1994 budget, and his own vision for the Russian economy in the coming years. Chernomyrdin, appearing less an outsider than Gaidar did two years earlier at the same podium, begins by insisting on continuity with the government of the previous year, despite the turmoil and street fighting which had occurred. The government's reform plans would remain in place, and the inflation targets would not be reopened for debate; however, “we absolutely don't accept the dangerous theory of laissez-faire.” This comment well signifies the overall message of Chernomyrdin's remarks, that the government will not be bullied into reneging on its commitments, but that it otherwise is sympathetic to opponents of reform.

Indeed, where Gaidar was willing to rebuke parliament for failing in its duties, Chernomyrdin is not inclined to throw stones, even at a much weakened parliament. He identifies the crisis of nonpayments as one of the state's major obstacles, declaring that his first goal is “to strengthen state control and bring order to all spheres of the economic life and the life of society,” but has only this weak rebuke for parliament:

“...severe is the problem of nonpayments. I say all of this not to ignite the atmosphere... I must directly state that we often cannot keep up with events simply because of the low quality of the work of the ministries and departments. It is for more than one year that we speak of destructive repercussions of nonpayments... I won't say that the problem is simple, but sometimes we gain the impression that neither the Ministry of Finance... nor the central bank consider these problems to be their own.

Meanwhile the situation day by day becomes worse." ("Russian Parliament," 1994)
Similarly, while stating that he did not want to return to the past and "everything resulting from the role of government," he emphasized that it should be the governments role "to avoid chaos and to achieve elementary goals and natural love for civilized state." He does mention using the "arsenal of market methods" to achieve these goals, and declares that for all its flaws, there can be no denying that a market economy has been created in Russia. Still, calls for greater order and control stand in contrast to the initial goal of liberalizing the economy and freeing the entrepreneurial spirit of the workers.

He goes on to attribute the government's continued resort to deficit spending beyond what is agreed to in the government's budget to an "elementary lack of desire to explain" the situation of the government's finances to the industries lobbying for credits, and tells the Ministry of Finance that "I know the work here is extremely difficult today, but yet after all it is not the economy for the Ministry of Finances, but the Ministry of Finances for the economy." Later, addressing claims that he personally was complicit in delivering 34 trillion rubles in subsidies to the agricultural sector, Chernomyrdin is emphatic for perhaps the only time in his speech. "It is not so, but I would give it, if we had it," he says, pausing and giving the audience sustained eye contact for the first time in nearly twenty minutes of speaking. "But there is nothing to give. We must do with what we have." Again the message is delivered: Chernomyrdin is one of you, he chafes at these restrictions as much as you, but there is simply nothing to be done right now.

Gaidar had strongly identified inflation as the state's top priority, in line with IMF demands. Chernomyrdin, on the other hand, declares that they should pursue "prudent, moderately rigid monetary policy," but also says that "in the battle with inflation we have become overly preoccupied with the flow of budget expenditures when living organisms were cut into without concern." It is a fair point, but one which Sachs' experience at the World Bank suggests does not necessarily qualify as an excuse for transnational institutions that value financial stability. Further, he expresses concern about how

different sectors of the economy have responded asymmetrically to the rigid monetary policy of previous years, and claims that a decrease in the growth of the money supply:

"does not influence the dynamics of prices, causes a severe decrease in productivity, increases tension in financial conditions of companies, and this we received as a result of strong bridling of currency volumes. As a result one must admit... that these means themselves and rigid monetary policy are clearly insufficient for these goals."

This is an explicit rejection of both the previous Prime Minister's methods and, more significantly, the standard policy of the IMF. Later, he expresses hope that ratifying and sticking to a budget "will allow us to approach the orienteer of 3-5% inflation by the end of the year," the target set by the President. Somewhat paradoxically, he then describes this as "unconditionally a rigid boundary."

It is also noteworthy that Chernomyrdin, who founded the Russian gas monopoly Gazprom out of state assets prior to serving as Prime Minister and who would return to serve as its chairman after leaving office, spoke at some length about the need to address the nation's rising levels of income inequality. He declared that it must be the role of government to see that:

the burden is carried not only by laborers, but by those who in market conditions have advanced in prosperity as well. We can't permit that the rift in the levels of income between the most low revenue receivers and the high revenue brackets would be ten or eleven times. Russia would enter world records in this indicator... reforms must not only be economically effective but socially just.

Even by 1994 standards, a factor of ten between the working poor and the wealthiest members of society would hardly be a world record. In 1995, the CEO-to-worker compensation ratio in America was 122.6 to 1. (Davis, A. and Mishel, L.)

Not long after this speech, Russia would receive another loan from the IMF, in the form of the second $1.5 billion from the STF. A first round of negotiations saw IMF officials on a mission to Moscow return home with nothing. On their next trip, they were joined by Michel Camdessus, who made much more progress by engaging directly with the Prime Minister.

The Managing Director arrived in time to spend the weekend hunting with Chernomyrdin, after which they traveled to Sergiev Posad, where they visited the historic monastery and met with church leaders. This bonding experience, coupled with Camdessus's infectious optimism and empathy with the Russian

culture, helped to force a compromise, and Camdessus and Chernomyrdin were able to announce an agreement on the main policy issues on March 22." (Boughton 2012)

Formal approval and delivery of the loan would come the next month. With no sign of the imminent arrival of Western aid and the STF loan's relaxed conditionality, the Chernomyrdin government continued financing the government with deficit spending. As a result, inflation remained high, and spiked in the Fall of 1994. This culminated in "Black Tuesday," when the ruble plunged 21 percent against the dollar on international markets.

The shock of this event led Yeltsin to once again strengthen the hand of reformers in government. He fired Viktor Gerashchenko from the central bank, and gave a promotion to Anatoly Chubais, one of the most well-known reformers at the time. (Boughton 2012, p. 305) This shake-up in the cabinet gave some hope that 1995 would see better progress towards macroeconomic stabilization than 1994.

Yeltsin began 1995 by declaring in his State of the Nation address that his country must have an "equitable" relationship with NATO, and that the global community needed to embrace a principle of "mutual respect for legal rights and interests of nations" rather than "a battle of egos" driven by the media. While mostly avoiding the technicalities of economic reform, Yeltsin discusses relations with the West in typically blunt terms:

"Sometimes, we hear people say that it is premature to discuss partnership with the new Russia. As a rule, this kind of talk conceals an intention to oust a potential rival. If such sentiments gain the upper hand in the west, then all efforts to build a new, fairer, and more secure world order will be thwarted. Mankind will not then stride toward the 21st century, it instead will be thrown back into the 19th century... A solution can always be found as long as both sides strive for partnership and in the long term cooperation. That is our choice. We're working on that with the United States and other countries..." ("Russian State of the Nation," 1995)

The topic here is the eastward expansion of NATO, but the broader message is that Russia cannot cooperate without a willing partner. On the topic of economic reforms, Yeltsin's remarks focused on the high social cost, "as is illustrated by the appearance of new paupers, people who in their work

receive degradingly low wages." ("Russian State of the Nation," 1995) Despite the aggressive rhetoric of his foreign policy, Yeltsin had by this time forged a friendly working relationship with his American counterpart, Bill Clinton. The two met eighteen times in person, and it was with Clinton's backing that Russia eventually joined the World Trade Organization, the OECD, and the G7 (the G8 for as long as Russia remained a member.) (Office of the Historian) In a memorable joint press conference in late 1995, Yeltsin reduced Clinton to hysterics with his opening statement:

Dear journalists: I want to say, first of all, that when I came here to the United States for this visit at the invitation of the President of the United States, Bill Clinton, I did not at that time have the degree of optimism with which I now am departing. And this is all due to you because, coming from my statement yesterday in the United Nations, and if you looked at the press reports, one could see that what you were writing was that today's meeting with President Bill Clinton was going to be a disaster. Well, now for the first time, I can tell you that you're a disaster! ...This proves that our partnership is not calculated for one year or for 5 years but for years and years to come—tens of years, for a century; that we're friends, and that it's only together, together we're going to be trying to solve not only our joint bilateral issues but issues affecting the whole world. ("The President's News Conference," 1995)

Once they stopped laughing, both Presidents were effusive in their praise of each other and the working meeting they had just concluded. This had mainly revolved around foreign policy, with Bosnia and the disposition of NATO evidently at the forefront. Meanwhile Chernomyrdin had taken the lead in the international financial negotiations, and had developed a strong working relationship with the IMF's director Camdessus. After a February 1995 summit of the G7, the group's finance ministers (effectively, the Paris Club) issued a statement which said they had "noted with concern the recent rebound in inflation and a substantial risk for the budget," and declared that "further debt rescheduling for Russia will depend on the introduction of a comprehensive reform program that will merit IMF support." ("Excerpts from the 7 Summit," 1995)

Camdessus and Chernomyrdin met in Paris the next month. The IMF had grown concerned about the continuing crisis of nonpayments, and argued that the only way to address deficits on a long term basis was to pass and implement a stronger system for the collection of tax revenues. Chernomyrdin convinced Camdessus that, while there was no way such a bill could get past

parliament, Yeltsin and his deputies could take administrative action to keep real expenditures below the budgeted demands of the parliament. In return for Camdessus' acceptance of this unusual stipulation, Chernomyrdin agreed to allow the IMF tighter monitoring of the government's compliance. (Boughton 2012, p. 307)

After the meeting, Camdessus flew to Moscow to make his case directly to Yeltsin. This understanding led to a new standby arrangement in April 1995 worth $6.8 billion, the IMF's largest such loan to date, and more than the $4 billion it had lent to Russia across all its previous programs. (Boughton 2012, p. 305) In addition to tighter monitoring, the agreement also stipulated that inflation be brought down to 2 percent per month from April's 8.5 percent, and the annual budget deficit be reduced to 8 percent. (Gould-Davies and Woods 1999, p.11, "Historic Inflation Russia," 2016)

The government was allowed to use the new IMF funds to cover the deficit, which would help suppress inflation. With Chernomyrdin as his chosen Prime Minister and a constitution granting him greater powers, Yeltsin was able to pursue the IMF targets against the wishes of the parliament. When laws were passed to double the minimum wage and provide tax exemptions to energy exporters, Yeltsin vetoed the bills. By the end of the year the monthly inflation rate was down to 5 percent. (Gould-Davies and Woods 1999, p. 12) However, the crisis of nonpayments continued unabated. Even with his broad powers, Yeltsin could not force parliament to pass tax reform legislation or even to limit its proposed spending. Yeltsin and Chernomyrdin delegated the task of undercutting the parliament's spending measures to Chubais. (Boughton 2012, p. 307)

This was enough progress for the IMF to approve a $10.2 billion Extended Fund Facility in March 1996, which would run through 1999. The new agreement imposed even more stringent targets: inflation reduced to 1 percent per month, and deficits of 4 percent in 1996 and 2 percent by 1998. This deal replaced the previous understanding about the impossibility of passing tax reform legislation with specific minimums for tax revenues in each quarter, a condition which "had not been used by the Fund

before," and a sign that the IMF was growing deeply concerned with the ongoing crisis of nonpayments. (Boughton 2012, p. 316)

However, a deal with the IMF covering multiple years helped Russia secure a much desired long-term rescheduling with the Paris Club. Far from a Polish style write-down, the 1996 agreement merely did away with the need to reach a new deal every year to postpone principle repayments. Under these "ad hoc" terms, repayment of principle would not resume until 2002, but interest payments would continue, with a $2 billion payment to be made in 1996. (Jeffries 2002, p. 278, "Russia's External Debt Rescheduling," 1996) The following year saw a similar deal struck with the London Club, with $24 billion in principle repayments to be postponed until 2002, along with $8 billion in overdue interest payments. A $3 billion interest payment was made in cash at the time the deal was signed. (Jeffries 2002, p. 278)

The Communist Party of Russia had strengthened its grip on the Duma in the December 1995 elections, but the IMF was apparently unperturbed by this. (Jeffries 2002, p. 27) Yeltsin himself largely dropped out of the public eye during this period. Yeltsin was first taken to the hospital for heart trouble on Ju1y 11, 1995, and would remain under medical care until the 26th of December, after the election concluded. (Jeffries 2002, p. 480, 485) The swing in the legislature was not necessarily significant given the vast powers afforded the Russian president, but with a presidential election to be held the following year, this result led Yeltsin to distance himself from the reformers. One of his first moves after returning to the Kremlin was to fire the reformer Chubais and replace him with Vladimir Kadannikov, who had been the state director of automobile manufacturing at the end of the Soviet Union. (Boughton 2012, p. 314)

At about this time, officials started to sound alarms over the possibility of an economic crisis in Russia. One Fund Staffer who had worked on the Russian case for years wrote to warn management that "a crisis could unfold fairly quickly" owing to a number of developments. (Boughton 2012, p. 307)

The aforementioned “loans-for-shares” deal enhanced the power of the oligarchs and cemented the crisis of nonpayments, with many observers believing the episode “was linked to the campaign financing for President Yeltsin's re-election.” (Sachs 2012) Russia failed to meet the IMF's conditions on revenue collections during this time, but the IMF held off on suspending its lending until after the election was over. (Gould-Davies & Woods 1999, 14) In an even more remarkable show of support, just months before the election Mr. Camdessus declared to the Russian press that he had “no objection to the government's making policy adjustments in the direction of a greater emphasis on social needs.” (Bekker 1996) In exchange he secured a promise to remove export duties on oil and gas, a promise Russia fulfilled on April 1st. (Jeffries 2002, p. 242) The declining price of oil further eroded the state's revenue base,[1] and by the summer of 1998 it would reach an all time low in real terms. (Jeffries 2002, p. 201)

As 1996 drew to a close, Yegor Gaidar, who was no longer part of Yeltsin's government, even phoned the IMF to warn that “everything will blow up in one-and-a-half years” if nothing was done to close the deficit. (Boughton 2012, p. 319) To convince the IMF to resume lending, Chernomyrdin met Camdessus for dinner at the Jules Verne restaurant in the Eiffel Tower. After a meeting that went on into the middle of the night, Chernomyrdin “seem[ed] to have convinced the Managing Director that matters were about to improve.” (Boughton 2012, p. 319) Camdessus campaigned publicly for a renewed commitment to reform, declaring in Moscow that Russia was “in a state of crisis... a crisis of the state” and, weeks later in Washington, that it faced “a major risk of anarchy.” (Boughton 2012, p. 321) The comment in Moscow appealed to Russian nationalism in the name of reform, while the comment in Moscow appealed to the Western fear of an insecure Russian nuclear arsenal. Yeltsin responded to the pressure by bringing Chubais back into government, and Boris Nemtsov, a popular

1 See Gaddy and Ickes (2002) for a thorough explanation of how crucial the “value pump” of Gazprom was to the entire Russian economy.

reformer who "set about challenging the oligarchs' interests on a range of issues."[2] (Gould-Davies & Woods 1999, p.15)

Yeltsin also accepted the IMF's recommendation that restrictions be removed on foreign purchases of GKOs, Russian treasury bills, so that the budget deficit could be financed with foreign capital. (Boughton 2012, p. 323) While the bonds carried a high rate of interest to attract sufficient demand, investors were comforted by the fact that no nation in history had defaulted on bonds denominated in their own currency. Under normal circumstances a state can always repay these debts with an expansion of its money supply, but circumstances in Russia were far from normal.

While the Russian economy had a number of serious issues, the the crisis was set in motion by the financial crisis which began in Southeast Asia in the summer of 1997. The events there sparked a global "flight to quality;" in other words, global investors became more risk averse, began speculating about the possibility of currency devaluations and default episodes in other weak economies, and started pulling out capital. Russia attempted to stem the outflow of capital by raising interest rates. In some cases, foreign investors who stayed were able to earn interest in excess of 100% per year. (Nadmitov 2004) At the height of the crisis, servicing these debts would cost the government 140 percent of its monthly revenue collections. (Gordon 1998)

In an attempt to signal to both the IMF and the bond markets that he was determined to end the crisis of nonpayments, Yeltsin fired Chernomyrdin in March 1998. He replaced him with the reformer Sergei Kiriyenko, though his nomination was not approved until the critical third vote. (Boughton 2012, p. 326) Soon after, he sent the well regarded Chubais to Washington for a series of meetings with administration and treasury officials, and to attempt to secure a $100 billion dollar pledge from the IMF. (Easter 2012, p. 141) He secured a a public statement from President Clinton encouraging "additional conditional financial support from the international financial institutions," and the IMF

2 More recently, Nemtsov, a vocal opponent of Vladimir Putin and the Ukrainian conflict, was assassinated within sight of the Kremlin. (Amos and Millward, 2015)

responded to the pressure with an announcement that they expected to resume lending after a meeting in mid-June. The announcement was intended to calm markets, but when the date of the meeting arrived and the Fund decided the reformers had not done enough to increase tax revenues, they postponed both the meeting and the funds. Not only did Russia sorely need the funds, but the spectacle forced interest rates even higher. (Boughton 2012, p. 327)

Kiriyenko was determined to find a way to weather the crisis without devaluing the ruble. When Nemtsov recommended that that they begin gradually decreasing its value, Kiriyenko replied that "the IMF opposed it and that devaluation would be seen as a sign of weakness." (Hoffman 1998) Not only would a weaker ruble increase the cost of importing goods, it would reduce the value of any investments made in Russia by foreign capitalists. At a public meeting on June 23rd, with IMF negotiators in town, Kiriyenko told the assembled legislators that Russia was "confronted with the result of our indecisiveness in carrying out reforms... Russia's problems lie not in Asia, but in Russia itself." Coal miners organized outside the event to protest unpaid wages, another tactic the government had used to keep deficits down without official borrowing. Yeltsin declared his intention to rule by decree if the parliament did not pass his budget. As the Communist leader and defeated presidential candidate Gennadi Zyuganov put it, "Yeltsin performed his usual repertory. He opened the meeting, started threatening the Duma, was rude, insulted us and then left." (Gordon 1998) The IMF responded by resuming its scheduled lending, but not without a stern warning that this would be the last offer of help ""if the authorities do not proceed forcefully against the largest tax delinquents after July 1." (Boughton 2012, p. 329)

Soon after, the Duma voted the budget down despite Yeltsin's threats. Turning to face the west, Yeltsin placed a phone call to President Clinton, warning him that the loss of Fund support would mean "the end of reform and basically the end of Russia." (Boughton 2012, p. 330) Despite a lack of confidence that any meaningful reform of the tax system could be carried out at this stage, essentially

because the West shared Yeltsin's fears. The result on July 13 was the biggest assistance package promised to Russia since 1993, $22.6 billion in new loans, with $14 billion to come from the Fund and the World Bank and Japan contributing the rest. To come up with the cash, the Fund had to activate the General Agreements to Borrow for the first time since 1978, a mechanism for calling in additional deposits from the Fund's other members. $5.6 billion was supposed to be delivered by the Fund immediately, but internal doubts about the viability of the loan led to a reduction to $4.8 billion at the last minute. This was the only part of the package to arrive. (Gould-Davies & Woods 1999, p. 17)

The agreement of course entailed demands about deficit reduction and enforced collection of tax arrears, but in August, the parliament refused to even convene to consider Yeltsin's proposals. (Boughton 2012, p. 334) In a column in *The Financial Times,* well known financier George Soros declared that "the best solution" would be a 15-25% devaluation of the ruble. (Jeffries 2001, p. 203) With Kiriyenko's assurances that this would not be necessary, the following day Yeltsin declared, "let me say it firmly and clearly. There will be no devaluation of the ruble in Russia." (Hoffman 1998) Three days later Kiriyenko moved to devalue the ruble, and the following week he was dismissed from his post by a furious Yeltsin. Yeltsin briefly replaced him with Chernomyrdin, but parliament rejected is nomination; ultimately he was forced to nominate a government of ex-Soviets including the central bank head he had fired four years ago, Geraschenko. (Gould-Davies & Woods 1999, p. 18) Meanwhile, the central bank revealed that the $4.8 billion IMF loan was already gone, with $3.8 billion spent in a failed defense of the ruble and $1 billion spent paying off debts. The police and the interior minister began an investigation almost immediately amid allegations that the funds had been misappropriated. (Jeffries 2001, p. 204)

The government also immediately announced a "unilateral rescheduling," a default, on GKOs and other domestic bonds, though the details of the rescheduling would take time to work out. (Jeffries 2001, p. 202) Foreign creditors had invested about $17 billion in the GKO market by the time the

government defaulted. (Nadmitov 2004) Together with a government decree freezing the foreign exchange market (which hedge funds had used to hedge their potential losses in the GKO market), this imposed massive losses on foreign bondholders. One American hedge fund, LTCM, was so exposed to this market that the Federal Reserve, afraid that the fund's collapse would set off a domino effect, had to organize a bailout. Several other well known investment banks had losses exceeding $1 billion. (Kirshner 2005)

No payments were due on the Soviet-era debt until the following spring, so they waited until then to announce their intention to unilaterally reschedule those as well. The only debts to be maintained during this period were Eurobonds and other debts which were accumulated in the mid-nineties and denominated in foreign currencies. It would take a while for the details to be negotiated, but in the end, domestic bondholders lost 49.1 percent of their investment, wile foreign bondholders lost 59.1 percent of debts issued by the Russian Federation. The Soviet-era debts held by the Paris and London clubs were split between two instruments, the MinFin3 which lost 63.2 percent of its value, and Prins/IANS notes, which lost 52.6 percent compared to their pre-crisis valuation. (Sturzenegger & Zettelmeyer 2008) The London Club's holdings had been worth $28 billion before the crash, and the Paris Club, $42 billion. (Jeffries 2001, p. 273) The effected GKO and OFZ bonds were worth about $40 billion. (Jeffries 201, p. 206)

All told, foreign capitalists saw roughly $50 billion wiped off their balance sheets, with Russian citizens losing about another $13 billion in 1998 dollars. Six years after ending price controls and submitting itself to IMF monitoring, Russia had to take the world to court and force investors to accept a level of debt relief comparable to the 50 percent haircut it had offered Poland as a gift. The IMF, on the other hand, saw all its loans repaid in full, even the ones rumored to have been stolen, and ahead of schedule no less. (“Russian Federation Completes Early,” 2005)

V. Discussion

The outcomes in Poland and Russia run counter to the Syriza supporters' claims of a bias against the left in the process of negotiating debt reduction with transnational creditors and financial institutions. While both states emerged in the context of the retreat of global communism, it was Russia which was led by a right-wing, anti-communist president. Walesa, the trade union organizer who favored workers over elites even within the labor movement, was able to secure massive financial concessions from the Paris Club and the London Club, with significant and swift assistance from the IMF and the G7. Under Poland's “thick line” policy, ex-communists were able to retain power in politics and business, and by 1993 Walesa was partnered with a legislature dominated by this bloc. Russia did not enact lustration policies either, and the Communist Party remained a force in the Russian parliament throughout Yeltsin's presidency. However, Yeltsin's government was staunchly anti-communist, especially in the crucial early years of reform, at which time he took extreme, violent, but ultimately effective actions to reduce the power of the legislature.

After the Communist's success in the 1993 elections, Yeltsin began to compromise with this bloc despite his increased constitutional powers. At around this juncture we can observe a change in the treatment of Russian debts by transnational capitalist institutions. Instead of big financial concessions which never came entirely to fruition, Russia received only modest loan agreements with the IMF mostly subject to the standard conditionality, terms which Poland frequently avoided on its way to a much more generous assistance package, and Paris Club reschedulings which did little to decrease the burden of Soviet debt. The timing of this perceived change in attitudes is somewhat consistent with the Syriza claim, as Chernomyrdin was closer than Gaidar with the ex-communists and industrialists (a group which, in this context, we would designate as left leaning, due to their opposition to globalization and market capitalism). Only the comparison to the case of Poland suggests that the change was not about ideology as such, but rather about rejection or acceptance of global market

capitalism as reflected in both policy and rhetoric. With the Berlin Wall down, why would capitalists spend their money on a purveyor of gloomy threats at the head of a weakened state when they could instead help fund Walesa's charm offensive?

And behind both Chernomyrdin and Gaidar, there was Yeltsin. Though he remained committed to merging Russia with the global economy, his rhetoric about the necessity of reform was always mixed with threats about what would happen if the West did not help him achieve it. We have noted that Balcerowicz was something of a known commodity in the West, and the first version of his reform plan was in fact published in 1980. (Boughton 2001, p.991) Gaidar being a relative unknown, Poland's early start on negotiating with the Fund, and possibly a longer and more positive period of extraordinary politics are all plausible reasons for the West moving so quickly to assist Poland and so slowly to assist Russia. However, the process in Russia began two years later, with a strikingly similar plan of reform that was even drafted by some of the same people, Sachs among them. Given the potential consequences of economic catastrophe in Moscow, it seems unthinkable that the West would not be prepared to act with something like the alacrity it showed in January 1990. Yeltsin's loud refusal to go along with the usual IMF program and occasionally bellicose rhetoric appear in this analysis to be valid reasons why meaningful assistance was either too slow to arrive or not sent at all.

It can also be argued that Poland's long history of reformism and relatively large private sector for an eastern bloc state added up to a much easier slate of initial conditions facing Polish reformers than their Russian counterparts. This could have given western capitalists greater confidence that they would see a return on investments made in Poland, as opposed to Russia, the center of Communist Party orthodoxy for nearly a century. Under this theory, the confidence of western capitalists led to more generous offers from western financial institutions.

This theory is convincing in certain respects, but aspects of it are problematic. As we have shown, the belief that reforming the Polish economy would be a relatively easy task is not projected by

any of the actors involved. The IMF praised the boldness of Poland's leader for tackling what they viewed as an “unprecedented” crisis, an evaluation which hardly suggests they were initially confident the crisis would be swiftly resolved. Additionally, the long history of efforts at reforms in the communist era was so unsuccessful that “the term reform itself has been worn out by the entire history of the People's Republic (of Poland).” (Przeworski 2001) This could just as easily have frightened investors.

In his own reflections on the Polish reforms, Leszek Balcerowicz claims that “the lesser magnitude of external shocks and better initial conditions are not sufficient to explain” Poland's quick disinflation or superior GDP performance compared to the rest of the region. He declares that this question requires further examination, but that “one must look, therefore, to features of the economic policy.” (Balcerowicz 1994, b). While Balcerowicz does briefly acknowledge in his papers the unparalleled generosity of foreign assistance to Poland, he does not seriously consider the impact this had on the country's swift economic rebound.

Balcerowicz points to his government's rapid implementation of both currency stabilization and price liberalization policies, along with laws which set up the longer processes of privatization and institutional change, during the period of “extraordinary politics” that follows “any great political breakthrough in a country's history.” (Balcerowicz 1994, a) By contrast, he says of reform that “in Russia it was started but was interrupted after only a couple of months in the middle of 1992.” (Balcerowicz 1994, b) Though one can argue that Moscow, like Warsaw, had just become independent for the first time in a century, it is more convincing to argue that those in the capital especially must have felt they had just seen their empire crumble. Reflecting on his experiences there, Sachs (2012) wrote “I certainly hoped, and rather expected, that Russia would feel a wave of elation at the new freedom. In this I was somewhat mistaken. The period of elation was remarkably short, and the period of political civility was even shorter.” It would be fair to wonder whether the first years of the Russian

Federation might be better classified as another kind of extraordinary politics entirely. Frye (2010) studies this phenomenon in terms of political polarization, “the policy distance on economic issues between the executive and the largest opposition faction in parliament.” (p. 3) According to this theory, the relatively small policy distance between the factions of Solidarity allowed for rapid and successful implementation of reform regardless of the sometimes intense infighting between those factions.

We can be even more specific than Balcerowicz and declare that the reform process ended in June of 1992, when the Duma reappointed Gerashchenko to head the central bank. According to Sachs (2012) Gerashchenko told him that “he planned deliberately to increase the money supply by around 30 percent per month in order to get the factories moving again.” Geraschenko halted the downward trend of inflation over the first half of 1992 and for two years inflation rarely dropped below 20 percent per month. (Gaddy & Ickes 2002, p. 14) By the time he left office, the West had largely lost faith in Russia's willingness or ability to reform its economy, and abandoned it to the IMF.

Most significantly, Balcerowicz's analysis glosses over the fact that it took less than “a couple months” for Poland to receive both a stabilization fund and a standby arrangement, and that had Russia also received these financial considerations the Russian reformers might not have lost ground so quickly to the industrialists and the Soviet old guard. Gould-Davies and Woods (1999) conclude that the IMF doomed Russia to an incomplete marketization and eventual default because it was “too slow in offering assistance to help increase leverage and consolidate the position of reformers sympathetic to macroeconomic stabilization.”(p. 18) This is an astute but incomplete account of what transpired. Reflecting on these events five years later, Gaidar himself wrote that “Russia and the IMF lived in different time frames: in Russia time was counted by days and weeks during this period; yet the IMF took nearly half a year to admit Russia to IMF membership, given even maximal acceleration of bureaucratic procedures.”(Gaidar 1997, p. 14) The prevailing atmosphere of crisis in Russia was simply not shared by Western nations which believed the Cold War had been won on their terms. For

his part, Sachs wrote that “Russia never received much in grant aid, stabilization support, or debt relief. What little did come was far too late to save the collapsing initial momentum of reforms, as most of the reformers were long gone from the scene or at least from the center of power.” (Sachs 2012)

It is understandable that many observers identify the IMF as the agency that withheld assistance from Russia, given both its usual role as a gatekeeper to the Paris and London clubs, and its unusual role in coordinating Western assistance to Russia. However Boughton suggests that the IMF's failings were at least partially due to “the G7’s controlling role over the ostensibly independent activities and decisions of the IMF in its relations with Russia.” (Boughton 2012, p. 289) This could be viewed as an IMF employee passing the buck, except that Poland's $1 billion stabilization fund was donated by nations of the G7 before any IMF lending had begun. (Boughton 2001, p. 438) By contrast, while a $6 billion stabilization fund was included in the G7's $24 billion assistance package for Russia, it was never delivered. The G7 showed leadership in assisting Poland, but hid behind the IMF while Russia faltered.

A general argument against a generous approach to debt forgiveness is that without a consequence for nonpayment of debts, borrowers will assume exorbitant amounts of debt, secure in the knowledge that those debts will be forgiven. The appearance of this kind of moral hazard is pronounced in the case of Russia because inheriting the Soviet debts also meant inheriting debts owed to the Soviet Union. Russia inherited $150 billion in debts owed to the USSR, although these debts were owed “by poor and current/former communist countries [and] will never be repaid.” (Jeffries 2002, p. 26) Its largest creditors, Cuba, Mongolia, and Vietnam, were themselves insolvent in the 1990s. (p. 275) In 2014, Russia forgave $32 billion of Cuba's debt, 90 percent of the outstanding total. (Ostroukh & De Cordoba, 2014) The crisis of nonpayments could be construed as a consequence of moral hazard if one theorizes that the oligarchs impoverished the state not only to minimize their tax bills, but also to encourage international capital to forgive part of the state's debt.

Based on my analysis of Russia, a response to the moral hazard question is that even leaders who borrow on unfavorable terms do not face the consequences of a debt overhang, the most disadvantaged citizens do after those leaders are gone. A preoccupation with moral hazard implies that while leaders and lenders both show poor judgment when initiating loans, there is something to be gained by punishing the state when those loans turn out bad, even if the only ones punished are the state's most impoverished, least politically influential citizens. As long as neither state leaders nor elites feel the pain of a debt overhang, insisting on full repayment does little to mitigate moral hazard concerns.

In the specific case of Russia, the moral hazard argument should not be applied at all, because the West was the party which insisted Russia take on the role of sole inheritor of the USSR. In fact, Sachs (2012) claims the first meetings between Gaidar and the G7 deputies in late 1991 contained "no discussion of the upcoming economic reforms," but rather centered entirely around the succession of the Soviet debt:

> "Gaidar was warned by the assembled powers that day that any suspension of debt payments would result in the immediate suspension of urgent food aid, and that ships nearly arrived at the Black Sea ports would turn around... I believe that the IMF was simply parroting the political decisions already decided by the United States, rather than making an independent assessment. This is just a conjecture... The IMF's approach was in any event just what the rich countries wanted to hear." (Sachs 2012)

All the IMF's lending is based on the quota allocated to the debtor state, and Russia had been given a quota much smaller than what would have been afforded the Soviet Union. As such, the notion that IMF lending would be sufficient for Russia to service the Soviet debts without some other form of assistance was deeply flawed.

Gaddy and Ickes (2000) analyzed impermissibility constraints, the idea that some reforms, even if passed into law, will ultimately be reversed or incompletely implemented because "the consequences of complete and proper implementation are politically intolerable." (p. 8) The term ought to be used in future studies of indebted states from all regions of the world. If the IMF continues to be the global

leader in dictating the reforms that must be implemented before debt relief is possible, they must account for the impermissibility constraints dictated by the domestic social and political realities. A dispassionate assessment of these constraints, weighed against the potential creation of perverse incentives, should inform decisions about when and how to forgive sovereign debts. Gaidar (2007) issued a similar call for adjustments to standard conditionality in response to "joint creative analysis of economic and political problems arising in the course of stabilization." (p. 16) If, as Gaidar asserts, the IMF does not have the capacity for these "essentially political tasks," then leadership in negotiating these matters needs to pass to somebody else. (p. 16) Assigning this role to the G7 could achieve more positive outcomes since the state leaders involved are at least partially responsive to democratic oversight.

The impact of the crisis of nonpayments on the divergent outcomes in Russia and Poland should also be considered. There is evidence that the IMF viewed this crisis with growing concern as Russian policymakers failed over months and years to reign in the growing gap between expected tax revenues and tax revenues collected. However, Balcerowicz (1994, b) says that tax evasion "has undoubtedly grown" in Poland during the time it was still under IMF review, and there is no suggestion that the IMF or anybody else took action against Poland as a result. He further claims that the state's inability to collect all tax revenues owed to it "is a largely unavoidable consequence of successful liberalization and the resulting growth of small, private firms, and the inevitably slower pace of the strengthening of the tax administration." (p. 89)

The Russian problem had little to do with small firms. In 1995, the World Bank estimated that if Gazprom had paid all its tax liabilities, the federal deficit would have closed by about a third. (Gould-Davies & Woods 1999, p. 14) However the effect of the crisis of nonpayments in early 1992 must have been minimal, since awareness of the crisis and its intractability could only have accrued over time.

Krugman (1989) argued that the existence of a debt overhang "may give creditors an incentive to lend at an expected loss to protect their existing claims," and that "the incentives of a debtor may be distorted by a debt overhang, and the distortion will be reduced if creditors provide immediate debt forgiveness rather than providing new [loans] and hoping for more favorable future conditions." The case of Russia shows not only how distorted incentives can become in a heavily indebted state with a complicated history, but the social catastrophe that can ensue when creditors are determined to maximize their claims by waiting for more favorable conditions in the future. If the state's creditors had extended some lesser form of debt relief (perhaps a sum equivalent to what Poland was offered) they might have received more of the remainder, saved the resources they squandered trying to create more favorable conditions, and in the long run might even have helped create a more stable Russia.

Alternate theories can to some extent account for the downward trend in Russia's dealings with the West and Poland's superior performance overall. However, only our focus on the rhetoric coming from state leaders and leading reformers can account satisfactorily for the great generosity the West showed to Poland in the first months and years of the post-communist government, and for the lukewarm position the West took towards the Russian government during the Gaidar administration. This analysis suggests the Greeks are right to wonder whether they are being treated the same as other states who have applied to the transnational financial community for assistance, but wrong to phrase this speculation as forceful accusations, because it is their rhetoric, and the underlying attitudes towards globalization and market capitalism that their rhetoric exposes, which most limits their possibilities.

VI. Conclusion

The prevailing narratives about the global economy treat sovereign debt as a consequence or a symptom. States which fail to act responsibly by encouraging growth and monetary discipline will wind up with a debt overhang, and getting out from under it will be painful. This thesis sought to reconsider this narrative. Sovereign debt is endemic, its accumulation is a function of history and the

global economy more so than irresponsible leaders or a surfeit of democracy. The politicization of the mechanism for sovereign debt forgiveness is evident, particularly in the debates surrounding quota allocations for new IMF members, but more broadly in the different actions the G7 took towards Poland and Russia. The fact that transnational institutions are so loathe to forgive these debts condemns many states to decades of economic malaise, and yet the key decisions about how to treat debt overhangs depend on frivolous things, like the willingness of state leaders to pander to key decision makers.

Two prime areas for future research are apparent. First, to what extent might Russia's default have been the fulcrum of a pivot away from convergence with global markets and the West, and towards the Russian Federation of today? This is best demonstrated by the recent return to the G7 forum 16 years after Yeltsin brought Russia to the table with support from the United States, along with the raft of multilateral sanctions which have battered the Russian economy. This analysis of Yeltsin's remarks about a return to the Cold War or even a new World War focused on how these remarks would be received by other actors, and present circumstances suggest his words should have been taken more seriously. Nemtsov, whose brief tenure as Prime Minister ended shortly after the 1998 crash, says there was an ideological struggle, but that Yeltsin "didn't understand it. He wasn't ready. He thought it was just intrigue. He always understands power as just personnel decisions. He doesn't understand; it wasn't just intrigue." (Hoffman 1998) Almost twenty years later, the surviving reformers have little place in a Russian government dominated by representatives of the oligarchy.

In addition, could this event have also been a defining battle in the formation of Sklair's transnational capitalist class? In his seminal work named after that class, he claims that "a transnational capitalist class based on the transnational corporations is emerging that is more or less in control of the processes of globalization" and that this class "is beginning to act as a transnational dominant class in some spheres. (2000, p. 5) Even the title of the IMF's official history of this period,

Tearing Down Walls, speaks to the Fund's role as an agent of globalization. The task of the IMF was to shepherd Russia through the process of becoming a market capitalist economy and a member of the global community of states, but the result was markedly different from what happened in Poland or Latin America.

Some have claimed Russia was only incompletely marketized. Gaidar stated that the capitalist revolution had been victorious, but produced a capitalism that was "terrible, criminal, and unjust." ("Gaidar: Capitalist Revolution," 1995) This is a reference to the oligarchs, who occupy similar positions in Russian society as capitalist elites in the west. The only difference is that they are not globalizing, they are Russian, by birth and by nationalist ideology. In an attempt to use network analysis to find evidence of a transnational capitalist class, Burris and Staples (2012) find that Russia is

"effectively isolated from the global interlock network. This suggests that the evidence for transnationalization thus far is more a manifestation of the process of European integration – or perhaps, of the emergence of a North Atlantic ruling class (van der Pijl 1984) – than it is of a TCC that is truly global in nature." (p. 326-327)

Had the key leaders of the globalizing institutions of the West been just a little quicker to understand and recognize as legitimate the limitations and needs of the Russian state reformers, the findings of that study might have reflected a very different world.

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