Anti-Russia sanctions have earth-shaking backfire potential

By Rachel Douglas

26 Mar.—The sweeping economic sanctions imposed on Russia by the USA and its allies after Moscow moved military forces into Ukraine may backfire in more ways than one.

Recent *AAS* articles outlined the scope of the sanctions—from cutting major Russian banks' access to the SWIFT payments-clearing system to freezing several hundred billion dollars' worth of the country's foreign currency reserves held in banks abroad—and the fears voiced by dozens of financiers about "unintended consequences".[1] A Russian default on its government bond payments nearly collapsed the global financial system once already, in 1998 when a foreign speculator-driven bubble popped and major hedge funds could not cover their bets (derivatives contracts) on that bond market.

The money-centre financiers' nervousness intensified 10 March, when Finance Minister Anton Siluanov announced that Russia's foreign debt payments would be made, if necessary, in Russian rubles. Creditors were invited to convert the ruble payments to foreign currency by drawing on Russia's frozen reserves. In the event, the Russian government first sent payment instructions for US$117 million in interest, due 16 March on foreign-held dollar-denominated bonds, to be paid in dollars from the frozen assets. The US Treasury blinked: It approved unfreezing that sum, to avoid testing what the repercussions of a Russian default would be.

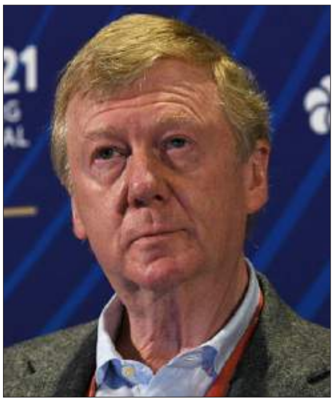
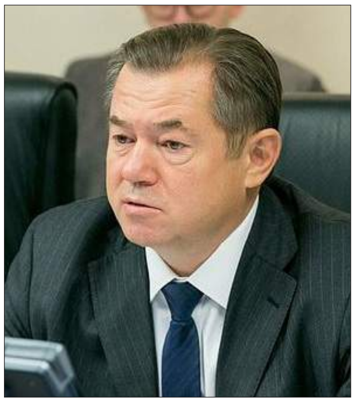
Next, on 23 March, Russian President Vladimir Putin upped the ante by announcing at a cabinet meeting that "unfriendly" countries, the ones that have unleashed the new sanctions, will be required to pay rubles for the Russian natural gas they import. Existing delivery contracts will be honoured, he added, but the customers will have to buy rubles in order to make their payments. The ruble, which had fallen by 40 per cent against the US dollar when Russia's reserves were frozen, quickly recovered almost half that loss. The Moscow stock exchange reopened the following day, for the first time in a month, and rose by 11 per cent; changes instituted in its rules include a ban on short-selling (speculative transactions that anticipate a drop in the price of the shares) and the temporary exclusion of foreigners from selling Russian stocks and government bonds.

Emergency measures

The 10 March government meeting at which Siluanov spoke unveiled an array of emergency measures in response to the economic warfare against Russia, besides those related to foreign debt payments and to controls to prevent capital flight (foreign currency assets being taken out of Russia). "Mandatory surrender of foreign exchange proceeds" has been introduced, meaning that exporters must turn their foreign currency-denominated earnings over to the Central Bank.

Businesses belonging to foreign companies that are departing Russia will be put under "external management", by Russians, and kept in operation.

In line with Putin's demand that businesses be given "maximum freedom" to operate under the present difficult conditions, Prime Minister Mikhail Mishustin promised to give IT companies tax breaks and relieve them of "inspections by regulatory bodies". He pledged to reduce the burden of bureaucratic procedures like permitting and compliance reports, for businesses throughout the economy. Minister of Industry and Trade Denis Manturov said that "excessive restrictions" would be eliminated for trade fairs, street markets, kiosks, and mobile retail businesses, to support the retail market for consumer products and farm output.

Leading neoliberal policy adviser Anatoly Chubais (left) has left the country and the pathway for a new economic policy, as formulated by Academician Sergei Glazyev (right), is opening up. Photo: AFP/Sputnik/Alexander Galperin; Wikipedia

Among other measures to defend the domestic real economy is a six-month moratorium on debt service payments for the agriculture sector, with automatic rollover of existing loans so that food-producers can function. Manturov announced measures "to secure the operation of plants and factories with an emphasis on accelerated import substitution"—cranking up domestic production of products for which Russia has been import-dependent. He said that a study has already determined the supply-chain needs for Russian manufacturers, and that makers of these goods would have access to "concessional loans for starting mass production of the products being developed."

Lending to the real sector of the economy needs to be "concessional", i.e., available at below the benchmark interest rate set by the Central Bank of Russia (CBR), because CBR head Elvira Nabiullina's first move, after Western banks froze Russia's reserves and sent the ruble into a tailspin, was to defend the value of the currency by doubling the prime interest rate to 20 per cent.

Nabiullina is a strict monetarist, whose almost single-minded focus during her decade-long tenure at the CBR has been "fighting inflation" by keeping interest rates high. Throughout the years of quantitative easing and zero interest rates in global finance, Russia's high rates have been a deterrent to investment in the country's real economy.

Some of Russia's most notorious liberal economists are now leaving the country, out of opposition to the war in Ukraine. One is Anatoli Chubais, who oversaw the destruction of Russia's industrial capacity through mass privatisation in the 1990s. But Nabiullina remains in office, prompting economist and MP Mikhail Delyagin, one of her many critics, to demand why she had not been arrested or put in a psychiatric hospital for having put at risk upwards of US$300 billion, nearly half of Russia's gold and foreign currency reserves, by keeping them in Western banks where they have now been frozen.

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1. "Russia sanctions create fissure in global financial system", 9 Mar. 2022; "More financial fallout from Russia sanctions", 23 Mar. 2022.

A revolutionary perspective

Academician Sergei Glazyev is the economist with the clearest, publicly elaborated vision of an alternative economic development policy for Russia. He is a long-time critic of the CBR, upon whose National Financial Council he sits, assailing its policies as the single biggest obstacle to the implementation of Putin's call for a "breakthrough" in Russia's economic development. In an interview on Tsargrad TV, 5 March, Glazyev pointed out that a new round of harsh sanctions against Russia had not been unexpected, and that there were precedents of Western central banks seizing the reserves of Iran and Venezuela. How naïve can one be, he asked, "to keep you reserves in the hands of the enemy"?

Glazyev has drafted the outline of his alternative program over the course of a thirty-year career in Russian institutions, beginning with his studies under the late Academician Dmitri Lvov, director of the Central Mathematical Economics Institute (CEMI) of the Russian Academy of Sciences. He served as Minister of Foreign Economic Relations in the first post-Soviet Russian government, but resigned in 1993 to protest then-President Boris Yeltsin's abolition of the Constitution and violent suppression of the Parliament, which had been blocking privatisation legislation. Subsequently elected to the State Duma, the lower house of the new Parliament, Glazyev chaired its Committee on Economic Policy in the mid-1990s and again in 2000-03. He has also worked as an advisor to the Russian Security Council, the Federation Council (upper house of Parliament), and after 2012 to President Putin on issues of Eurasian integration. He led the organisation of the Belarus-Kazakhstan-Russia Customs Union (formed 2010), forerunner of the larger Eurasian Economic Union (EAEU) that came into being in 2015. Today he is minister for integration and macroeconomics in the EAEU's Eurasian Economic Commission.

For years, Glazyev has coupled his harsh criticism of the CBR, with detailed proposals for what could be done with a change in CBR policies. At a January 2016 press conference on the publication of his book *The Final World War: The USA Is Starting it, and Losing* (published in English as "…*the USA Moves and Loses*"), Glazyev said that it was madness to minimise state investment in the economy on grounds of a lack of money for this in the budget; that budget spending is not the proper source for investment, but that the Central Bank should create new credit and direct it, through regulation, into the real economy.[2]

Now, with Russia under the pressure of an unprecedented package of sanctions, Glazyev has intensified his campaign to change the CBR's policies completely, in effect forcing it to function as a national bank.

On 25 February, the day after Russia began its "special military operation" in Ukraine, Glazyev's article "Sanctions and Sovereignty" appeared in the influential economic weekly *Expert*.[3] He wrote that the damage from earlier rounds of economic sanctions against Russia had been "significantly enhanced" by the CBR itself. By Glazyev's calculation, the CBR's 2014 decision (under Nabiullina) to let the ruble float generated more than 35 billion rubles (almost $6 billion by the prevailing exchange rate) for financial speculators, who drove the currency's value down, thus depreciating ruble incomes and savings. "This happened not because of sanctions", Glazyev wrote, "but rather because of the complicity of the CBR, which left the exchange rate to the mercy of international speculators".

If the CBR now "replaced the loans withdrawn by western partners with its own special refinancing instruments", Glazyev argued, "this would increase the capacity of the Russian credit and banking system by more than 10 trillion rubles. It would fully compensate for the outflow of foreign financing of investment, preventing a decline in investment and economic activity without any inflationary consequences."

Glazyev followed up that article with several broadcast interviews. In his Tsargrad TV talk with economics reporter Yuri Pronko, he cited the measures Russia took in 1998-99 under the government of Prime Minister Yevgeni Primakov and First Deputy PM Yuri Maslyukov, a defence industry expert; international speculators had just forced Russia into its August 1988 government bond default. Victor Gerashchenko, CBR head in that government, instituted strict foreign exchange controls: Commercial banks (the biggest speculative market players) were allowed to buy and sell foreign currency for daily needs only, but were barred from playing the market. The Primakov-Maslyukov government achieved 10 per cent GDP growth and a 20 per cent recovery of industrial production in one year. This can be done again, Glazyev insists.

Today, he said, "It is necessary to stop speculative operations that are not supported by import contracts"—no selling rubles, unless for the purpose of buying foreign currency to make payments for specific tangible products being imported.

Glazyev continued: "What is required of the Central Bank today? Special refinancing instruments. That is, credit lines for targeted investment projects, for import substitution, for government guarantees, if you like, for special investment contracts. All this, to fill idle production capacities…. Give enterprises earmarked loans at 2-3 per cent per annum for three to five years, and they will flood the country with a huge amount of goods. What we cannot produce on our own, we will do in cooperation with China, and by building production chains within the Eurasian Economic Union."

An 18 March conference of the Russian Chamber of Commerce and Industry (TPP)'s Council on Industrial Development and Russian Economic Competitiveness confirmed that there is widespread support for Glazyev's approach. A similar program, for a "New Industrialisation", was worked up by the Council's leaders at sessions of the Moscow Economic Forum (MEF) in 2015-17. "The New Industrialisation—now, or never", was the headline of the MEF website's report on the latest meeting.

Konstantin Babkin, an agricultural implements manufacturer who heads the TPP Council, said that "Russia has all the pre-conditions for an economic miracle, and a realistic recipe for achieving it". The key elements, he summarised, are moderate protectionism, a stimulative credit policy for real-economy producers, and a tax policy that incorporates investment tax credits.

Other participants in the Council's conference were MPs, economists, and businessmen from a variety of companies—manufacturers of everything from machine tools to shoes. Several speakers agreed that Nabiullina's 20 per cent base rate will block manufacturing investment.

On 18 March Putin reappointed Nabiullina to head the CBR for a third term, evidently not wishing to change horses in midstream. Debate of her candidacy by the Duma, expected on 21 March, was postponed for at least one month. It remains unclear if she will have unanimous support from the majority United Russia party.

The Eurasian and broader international dimensions of Russia's anti-sanctions response will be the subject of a future article.

2. "Russian economist Glazyev slams Central Bank for helping speculators", *AAS*, 10 Feb. 2016.
3. "Black Box Defence for the Russian Economy", a 27 Feb. post by John Helmer in his blog http://johnhelmer.net, includes Helmer's English translation of the article.