

CHAPTER III

DYNAMIC OF BORIS N. YELTSIN AS THE FIRST GOVERNMENT OF RUSSIA

The carrier of Yeltsin in Kremlin was started in 1989 where he became the People's Congress of Soviet Union. He was elected chairman of Supreme Soviet in May and held until July 1991. Yeltsin was the elected president of Russian Soviet Socialist Republic with 57.3 percent of the votes, defeating Mikhail Gorbachev's preferred candidates, Nikolay ryzhkov, on June 12, 1991. He automatically became the president of Russian Federation after its independence. As a president, Yeltsin pursued rapid privatization of the economy. The policy known as 'Shock Therapy' was strongly favored by his closer adviser, Yegor Gaidar.²³

A. Yeltsin's Policy in Handling the Russia's situation.

In 1990s, Borist Yeltsin was chosen as the first man to lead Russian Federation. In the beginning of his era, the Russia's situation had not yet been stable. It was caused by the transition process in Russia still running in long time. The chaos happened in Russia that a legacy of the collapsed Soviet Union and it made the confusion of economic and politic.

²³ *Boris Yeltin; Government.* Accessed on February 6, 2012. Available on http://www.themoscowtimes.com/mt_profil/boris_yeltsin/433796.html

Yeltsin took the first step to fix the condition of Russia by changing system. He thought that Gorbachev system was not properly applied in Russia, moreover Russia's situation was in emergency state which needed economic handling sooner. Yeltsin was very serious in changing the Russia's economic system from perestroika into a system used by liberalist, that is, free market mechanism.

Yeltsin also requested Russian Central Bank (RCB) to limit in giving credit subsidy for companies and print the currency in great number to pay Russian debts. These policies did not cure Russia's economic depression, but these policies triggered the inflation growth to be hyperinflation.

In the beginning of his carrier, as the president of Russian Federation, he could not maximize his role, because during 1991-1993, there were two authorities in Russia, the president and the parliament. It also resulted in confussion in policies applied between president and parliament policies. Therefore, In September 1993, Yeltsin disbanded the Sumpreme Soviet and the Congress of People's Deputies, prompting a constitutional crisis that culminated in the dramatic seizure of the White House (Kremlin) by troops loyal to Yeltsin. With the hard discussion, in December 1993, the new constitution was realesed that gave more power to the president.²⁴

Yeltsin was very optimistic in handling Russia's economic depression by IMF formula, namely 'Shock Therapy' program. The IMF study was released on December 19, 1990, by the IMF, theWorld Bank, the Organization for Economic Cooperation and

²⁴ *Ibid.*

Development, and the European Bank for Reconstruction and Development.²⁵ In Russia, it was introduced by Yegor Gaidar, Yeltsin's adviser, in 1992.

The fundamental components of shock therapy that were chosen by Yeltsin can be explained as 1) Liberalization, 2) Privatization, 3) Macroeconomic stabilization, and 4) Institutionalization.²⁶

1. Liberalization

Price and trading liberalization were aimed at freeing both retail and wholesale prices from state control, with the result to erase obstacles for trader, such as quota, export and import, and tariff. This aimed at making equal the local price into international price, therefore it was easy to exchange into foreign currency. Price liberalization allows the structure of relative prices in transition economies to adjust and move toward that characterizing market-oriented economies with similar levels of per capita income.²⁷

The price liberalization was implemented on January 2, 1992.²⁸ Yeltsin decided to make Ruble to be a convertible currency in 1992, which available in international exchange. This liberalization failed because the fact that after it was applied, Ruble stability was in bad condition.

²⁵ Konstantine George. *How IMF Shock Therapy was Imposed on Russia*. EIR Volume 25, Number 32, August 14, 1998.

²⁶ Drs. Bambang Sunaryono. *Op. Cit.*, Pg. 31-32.

²⁷ *Price liberalization and inflation dynamics in transition economies*. Accessed on February 10, 2012. Available on <http://www.allbusiness.com/public-administration/national-security-international/536577-1.html#ixzz1lyXGjiDa>

²⁸ Leon Aron. *Russia's Revolution; Essays 1989-2006*. Washington D.C.:The AEI Press, 2007. Pg. 47.

2. Privatization

President Yeltsin changed the Russia's economic system into liberalism. He privatized state assets as one of shock therapy components advised by IMF. The beginning of privatization half a year later it was undertaken in haste and with an urgency after the implementation of price liberalization that left neither time nor energy to engineer, test, and deploy even rudimentary structures and institutions of liberal democratic capitalism.²⁹

The private entrepreneurs were mainly black marketeers or corrupt officials who had stolen state property.³⁰ On the other word, definately, this new system became soft target for 'new nomenklatura'. Actually, Nomenklatura existed since Gorbacheve era, but at that time it was unofficial, and under Yeltsin, they dominated Russia's economy. They paid employee salary with their pleasure, therefore they got the highest profit with the lowest capital. It was unfair.

The task of privatization in Russia was surpassed by far the scale of privatization of certain branches of industry undertaken in some Western capitalist countries, such as Britain under Prime Minister Margaret Thatcher. Russia had inherited an economy in which the share of state property was the highest in the world – 95.4 percent.³¹

²⁹ Leon Aron. *Op. Cit.*, Pg. 47.

³⁰ *The New York Times*. *Russia: Shock Therapy Isn't the Way to Promote Democracy*. Accessed on February 6, 2012. Available on <http://nytimes.com/1992/05/12/opinion/12iht-edme.html?page...>

³¹ *Creep Privatization*. Accessed on January 28th 2012. Available on http://www.allrussias.com/rf/privatiz_1.asp

There are two stages of privatization applied in Russia. Namely:

- **Voucher Privatization**

The first stage began in October 1992 and was completed by the end of 1994. It was called “people’s privatization” or “voucher privatization” and was associated with Anatoly Chubais, the minister in charge of privatization in Gaidar’s government.³² This system was applied that every person in Russia, from new born babies to old-age pensioners, which made this program balanced and fair.

Yeltsin hoped from this privatization that all of society can give support to his government in political and reformation system. Yeltsin gave voucher as free, with the same nominal and then after some mounts that voucher can be sold. Subsequently, 144 million privatization “vouchers” were distributed (one to every Russian man, woman, and child), to be exchanged for shares in any privatized enterprise.³³

Picture 1:
Russia, Privatization Voucher, 10,000 rubles, 1992.



Source: Freewebs

³² *Voucher Privatization*. Accessed on January 28th 2012. Available on http://www.allrussias.com/rf/privatiz_2.asp

³³ Leon Aron. *Op. Cit.*, Pg. 50.

In 1995 and 1996, there was a survey of Russian managers. The result was two-third of polled said that they and 'their workers' would oppose selling a majority of the shares of their enterprises to outside investors even if an outsider would bring all the capital necessary to modernize and restructure the firm.³⁴

This program was expected to show the result in 1993 but the fact was up site down from the expectation. In the begining the value of voucher was ten thousands Rubles to the value of a half price popular car in Russia, but at the end of 1993, the voucher was worthless. It could now buy just three bottles of vodka. This caused the inflation in Russia run rapidly.

- **Loans for Shares**

In increasing the currency of Russia and decreasing inflation, Cubais released an continuing system of 'voucher privatization' that was ended in 1994. The second stage that was offered by Cubais to private state assets is 'loans for shares' system. This second stage of privatization was implemented in 1995-1996.

The scheme was simple: the state was transferred into temporary ownership of major commercial banks its controlling interests in attractive companies, such as Norilsk Nickel and major oil companies. In exchange for state shares, the banks were to give loans to the government to finance budgetary expenses. After an agreed period of time, the government had to return the loans to the banks; failing that, the state shares would become the property of the lenders.³⁵

³⁴ *Ibid.*

³⁵ *Loans For Shares Auction.* Accessed on January 28th 2012. Available on http://www.allrussias.com/rf/privatiz_5.asp

Therefore, government pledged the shares of huge state companies, such as energy, telecommunication, and mine companies to get some loans from bank. The consequence is the shares will be owned by creditor if government could not repay the loans. As prediction, the Russia's economic could not be restored because in reality, this was a sale of choice assets. The debts could not be repaid by the government.

This first and second phases of privatization in 1992-1995, determined a great deal for years, perhaps decades.³⁶ Even the implementation was quite apart from the errors, but it is a big step for Russia into the liberalization.

3. Macroeconomic Stabilization

This element was also focused by Yeltsin and it was aimed to decrease the inflation and and control the currency. The inflation blocked the economic stability. If the inflation growth up, it could destroy the economic recovery that was run and also could be end the Yeltsin era.

The macroeconomic stabilization that be used by government at that time consisted of two main elements: firstly, the reduced or limited of state budget to achive a balanced budget. The result in, the governmnet limited the subsidies for society. In this section, there was needed the balancing of budget. The measurement of macroeconomic policy is arranged to create national stability well. This was concern in some policies that was taken to configure new policies, such as alcohol tax policy and subsidy limitation policy. Alcohol tax policy was determined by government because of

³⁶ *Ibid.* Pg. 49.

the increasing of alcoholic consumers. It also was affected by Russia's economic attack which made people to be depression and frustration. The limited budget and monetary policy were very needed to press the inflation growth.

Secondly, the government were strict limited of money growth and credit. This policy blocked the investment growth and production activities. It means that no money, no investment, and it resulted no production, and the empty of state reserves because no profit and income. Those two main elements that was applied by Yeltsin were failed in reducing the inflation, but those increased the inflation bigger than before.

4. Institutionalization

The new institutions were very needed to develop the new economic sistem. The market mechanism system needs reformation steps such as constitution, system of law, political institutions, fiscal administration, and banking system.

During the implementation of IMF formula in Russia, there was not the restructuring of institutionals that supports this program. The constitution that was used in Yeltsin era is limited on the 1993 constitution which is only to explain clearly for the Yeltsin's authority. Actually, the regulation detail of privatization and liberalization were needed to accomplish the way into a success in Russia. This regulation was aimed at protecting and regulating the private property, and preventing the monopoly and corruption practices.

This step was overlooked by Yeltsin because he needed the implementation of IMF formula as soon as possible. The regulation changing and rearranging the

institutional staff are in long process, therefore Yeltsin run this program at glance; did not press in this step.

Yeltsin was not totally in institutional reformation. There changed the status of company, from state asset into privatization, but in fact, the managemen and staff were still the same men and doing the same job; or the same man in the same position. This shaped a fragile regulation.

B. Yeltsin and Oligarchs

According to Anne Wiliamson in her book entitled "The Rape of Russia", the Russia's destruction was the impact of oligarchs' actions who was had close relation with Yeltsin's familiy.³⁷ The 'clan political' was also presented with Yeltsin and his family. On the other words, Yeltsin created a new oligarch. Two of his daughters included in this group. They also took a part in government system. Even, they controlled political aspects of Russia based on their pleasure. Yeltsin could not do anything because it was difficult to watch their activities by him self.

The privatization was applied violented and arbitrary. Moreover, the role of oligarchs extended into corruption practices. During the implementation of privatization in Russia, the existance of oligarchs was predominant in political area. All of the government policies about privatization were being soft target for them to take charge the state's assets. The deals were effectively giveaways of valuable state assets to a

³⁷ *Pasal 33 UUD 1945 sebagai Orientasi Kebijakan Publik; Membebaskan Rakyat dari Ancaman Bencana Sosial.* Accessed on February 5, 2012. Available on www.simpuldemokrasi.com/download/.../68-ir-hadi-prasetyo-me.htm

small group of tycoons in finance, industry, energy, telecommunications, and the media.³⁸

The names of oligarchs that existed in Yeltsin era are Boris Berezovsky, who controlled major stakes in several banks and the national media, emerging as one of Yeltsin's most prominent backers. Along with Berezovsky, Mikhail Khodorkovsky, Vladimir Potanin, Vladimir Bogdanov, Rem Viakhirev, Vagit Alekperov, Alexander Smolensky, Victor Vekselberg, Mikhail Fridman and a few years later Roman Abramovich.

When the popularity of Yeltsin became bad, he was forced to resign from his position, and finally he left the Kremlin. The oligarchs were more to play their role by recovering yeltsin image in society. The oligarchs supported Yeltsin until he came back to Kremlin, but nothing comes for free. Yeltsin re-elected as president of Russia again in 1996. The mass media that powered by the oligarchs covered the Chechen War News to keep the good image of Yeltsin. The oligarchs requested some repayment for their support. What they want when Yeltsin comes back to Kremlin, was they can get power in Kremlin and become independent source of political power in Russia and were able to wield vast influence over public policy.

The mechanism of the confluence of high officialdom with the oligarchs was simple: the magnates arranged foreign vacations, gave credit cards for the use of government officials or members of their families, and bribed them with gifts of

³⁸ *Boris Yeltsin*. Accessed on March 15, 2012. Available on http://en.wikipedia.org/wiki/Boris_Yeltsin.

expensive cars, houses, and even luxurious vacation homes abroad. In return, the oligarchs were able to exercise influence over appointments in the government and state companies, to control key financial decisions, and to use the power of the state to fight competitors and political opponents.³⁹

The oligarchs felt that they are the owner of the state assets, as a debt gratitude Russian society to them because they could save state assets in crisis situation, but actually they plundered the assets from society. The important assets which produced much money were under their control. The financial of oligarchs was growth rapidly, into they entered the richest man in the world. The oligarchs also took the important roles in foreign and domestic policies making process, that surely gave them benefits.

C. Russia was Trapped in IMF Aids Under Yeltsin

According to Dr. Ariel Cohen (staff of Heritage Foundation, United States), the plan for economic reform in 1992-1998 under Ex-President of Russia Boris Yeltsin worsened. The transition process was done frivolously and got worse by corruption practices. The technocrat only did little things to prevent the decline of economy and another sectors.⁴⁰

Yeltsin's decision to take an action in curing the economic depression by opening relation and cooperation with IMF was the beginning of depressing of Russia's

³⁹ *Characteristics Of The Oligarchs*. Accessed on January 28th 2012. Available on http://www.allrussias.com/rf/privatiz_6.asp

⁴⁰ Simon Saragih, *Bangkitnya Rusia: Peran Putin Dan Eks KGB*, Jakarta: Kompas, 2008. pg. 17

economy into deep hole. The IMF formula was believed to cure and give solution for Russia's economic depression. IMF also lent funds to Russia. The IMF loans means to whip Russia in economy developing. On the other hand, the loans were diverted. The missing of IMF loans proved that Yeltsin did corruption by money laundering.

For Russia, the IMF loans were very important, but its did not lighten the economic problem in Russia. It increased the Russia's debts instead. Moreover, the loans were not used effectively and sincerely. A part of IMF loans was used to fulfill the Russian needs, but some of them were corrupted by oligarchs.

When the crisis attacked Russia, the IMF came to rescue with \$4.8 billion in July 1998.⁴¹ The Russia's debts were more in foreign currency and less in rubles. This was chosen by government because the interest rate of dollar was lower than rubles interest rates, therefore Russia could save the money. In fact, their idea was wrong, because the ruble devaluation was happened after that. Therefore, Russia found it difficult to repay the debts in dollars.

The IMF had encouraged the government to open up its capital accounts, allowing a free flow of capital. The policy was supposed to make the country more attractive for foreign investors; but it was virtually a one-way door that facilitated a rush of money out of the country.⁴²

Many people thought IMF lent funds to Russia on purpose to destroy the Russia's economic system. This statement was approved by the occurrence of FIMACO (Finance Investment Management Company) scandal in 1993. Loans from IMF was

⁴¹ Joseph E. Stiglitz. *Globalization and Its Discontents*. Great Britain: The Penguin Press, 2002. Pg. 147.

⁴² *Ibid.* Pg. 145.

diverted by FIMACO which related many governmental people of Russia, including Yeltsin. The diverted loan was used to finance the Oligarch business, including to buy the state assets and to buy GKO (Russia's government obligation buying) to get the maximum profit.

IMF knew about this scandal, but did not do anything and did not give any punishment. More over, IMF still offered loans to Russia. This action also appeared suspicions from many people. They judged that IMF wanted to trap Russia into very deep economic depression by giving funds until it does not have solution to pay debts to IMF.

The total debts of Russian Federation under Yeltsin era were around \$4.8 billions. Some people, who were suspicious about untransparancy of IMF loans, did research about the missing IMF loans. Mikhail Kasyanov (Deputy of finance Minister) and Konstantin Kagalovsky (Ex-IMF Director for Russia in 1992-1995) suspected involving and became the mastermind of this scandal.⁴³

During Yeltsin era, many corruption practices were happened by intern of government. The application of economic system that was suggested by IMF was not suitable for Russia and also created mess condition of economic system.

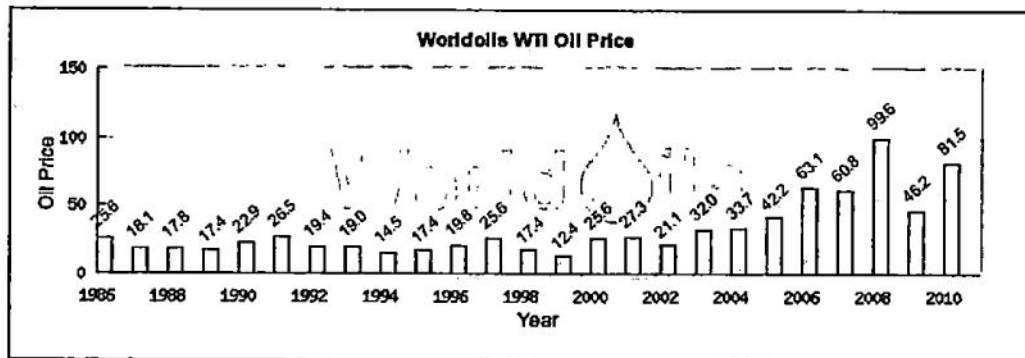
D. The 1998 Crisis as the Failure Peak of Transition Era

In July 1997, the crisis hit Asia, and it impacted the economy of Russia as well. Russia's economy depended on the oil prices to increase the state's reserves. When the

⁴³ Simon Saragih, *Op. Cit.*, pg. 31.

crisis attacked Asia, it influenced the oil prices. The resulting imbalance between demand and supply of oil turned into dramatic fall in crude oil price (down over 40% in the first six months of 1998 compared to the average prices in 1997).⁴⁴

Graphic 1: The History of Crude Oil Prices



Source: worldoils.com

The income of Russia's reserves decreased and a predictably devastating effects were following, such as the inflation up, devaluation of Ruble, and defaulting on its debts presented and the crisis really hit Russia on August 17, 1998.

Russia was in bankruptcy again and worsened. The government could not pay the salary of civil servants and also pension funds, and also the foreign debts. Yeltsin was being in frustration and changed his Prime Minister. On March 23, 1998, Kiriyenko was chosen to handle the crisis. The program that was offered by this 'new Prime Minister' was increasing the interest rates up to 150 percent. This program could not save the economy of Russia because it did not erase the investors' worryness to invest their money in Russia.

⁴⁴ Joseph E. Stiglitz. *Op. Cit.*, Pg. 145.

The inflation rates in 1998 reached 84 percent. The foreign exchange reserves was dried up to pay the welfare costs, but on one side there was no income for the state because of the fell down of oil prices and the unwillingness of tax paying. The IMF aids brought Russia into dependency and addicted with the foreign aids and it appeared the lack of self-confidence of Russia to solve it without foreign intergency.

Yeltsin period was so confusing. Many cases happened that brought Russia into sufferage in financial state and brought Russia into the damaging gate deeply. The economic crisis worsen and there was no enlightenment for solving.

Voices of rebellion and opposition of Yeltsin's reformation appeared. Slowly but surely, Russian society awakened with the failure of economic system that was applied by Yeltsin. The Head of Economic Committee of Duma in 1998, Yury Maslyukov, said " The longer time we are in destruction, the bigger that concequence will be faced. We have to take different action, do analizing that ever and will happen."⁴⁵

Those kinds of voices resulted in spirit of Russian society to get up from destruction. The belief of free market economic concept was unrespectable again for Russian society. They thought the concept of market economic mechanism was a solution for some people that want to make them-selves rich.

At the same time, the condition of Russian society was in misery. Ruble explodes, authority and assets of Russia were powered by rich people of Russia, and

⁴⁵ Simon Saragih, *Op. Cit.*, pg. 38

black market came back and increased. The life of Russian society showed sadness and suffering.

The concept of market reformation which was applied by Yeltsin was totally failed and in threat. In 1998, we could see the increase of poverty and inequality sharply. In 1989, only 2 percent of those living in Russia were in poverty. By late 1998, that number had soared to 23.8 percent, using \$2 a day standard. More than 40 percent of the country had less than \$4 a day, according to survey conducted by World Bank.⁴⁶

On the crisis peak, Yeltsin was sick. He could not give solution and solve the crisis. Therefore, Yeltsin was discribed as stagnation and frustation symbol than advance. Many opinions which asking about Yeltsin's reformation concept, until in the end of 1998. Yeltsin lost his control on Russia's political process.

Yeltsin could not make any decision anymore to limit economic crisis. The state income from tax decreased and economic system failure and foreign investors afraid of investing their capital in Russia that caused the opposing reformist and communist in Russia

When Yeltsin lost his prestige, suddently he gave solution for the economic mess in Russia. Yeltsin asked all of parties, regional leaders, labors, and corporations in Russia for uniting to increase the economic of Russia for national interest. Yeltsin's solution was stucked down by decline of oil price. Strikes happened by labors that asked Yeltsin to resign from his position.

⁴⁶ Joseph E. Stiglitz. *Op. Cit.*, Pg. 153.

Government faced the great economic crisis until it could not pay the salary of civil servants and another government employees. Russia could not pay debt. On the other side, government still continued to ask for loans from foreign countries to pay the salary of civil servants.

On October 7, 1998, the huge demonstration was held in many cities in Russia. They wanted Yeltsin to be responsible with Russia's condition and situation, and also with the poverty and hunger in Russian social life that worsen day by day.

Yeltsin was powerless, because of his illness and pressures from opposition and society who felt he was failed. On December 31, 1999, Yeltsin decided to resign from his position as the president of Russian Federation. In his speech, he apologized to Russian society about the failure under his era. He also pointed Vladimir Putin, his Prime Minister, to become his successor as the president of Russia in until March 2000.⁴⁷

⁴⁷ *Boris Yeltsin Mengundurkan Diri; Presiden Rusia, Boris Yeltsin, mengundurkan diri, 31 Desember 1999.* Accessed on February 10, 2012. Available on http://dunia.vivanews.com/news/read/18613-boris_yeltsin_mengundurkan_diri.