The IMF Changes its Rules to Isolate China and Russia

By Prof Michael Hudson

Global Research, February 06, 2016

Guns and Butter 5 February 2016

Theme: Global Economy

Dr. Hudson discusses his paper, The IMF Changes Its Rules To Isolate China and Russia; implications of the four policy changes at the International Monetary Fund in its role as enforcer of inter-government debts; the Shanghai Cooperation Organization (SCO) as an alternative military alliance to NATO; the Asian Infrastructure Investment Bank (AIIB) threatens to replace the IMF and World Bank; the Trans Pacific Partnership Treaty; the China International Payments System (CIPS); WTO investment treaties; Ukraine and Greece; different philosophies of development between east and west; break up of the post WWII dollarized global financial system; the world dividing into two camps.

Playing track

Current track: The New Global Financial Cold War – Michael Hudson , #339

The New Global Financial Cold War – Michael Hudson , #339

A nightmare scenario of U.S. geopolitical strategists is coming true: foreign independence from U.S.-centered financial and diplomatic control. China and Russia are investing in neighboring economies on terms that cement Eurasian integration on the basis of financing in their own currencies and favoring their own exports. They also have created the Shanghai Cooperation Organization (SCO) as an alternative military alliance to NATO.[1]And the Asian Infrastructure Investment Bank (AIIB) threatens to replace the IMF and World Bank tandem in which the United States holds unique veto power.

More than just a disparity of voting rights in the IMF and World Bank is at stake. At issue is a philosophy of development. U.S. and other foreign investment in infrastructure (or buyouts and takeovers on credit) adds interest rates and other financial charges to the cost structure, while charging prices as high as the market can bear (think of Carlos Slim's telephone monopoly in Mexico, or the high costs of America's health care system), and making their profits and monopoly rents tax-exempt by paying them out as interest.

By contrast, government-owned infrastructure provides basic services at low cost, on a subsidized basis, or freely. That is what has made the United States, Germany and other industrial lead nations so competitive over the past few centuries. But this positive role of government is no longer possible under World Bank/IMF policy. The U.S. promotion of neoliberalism and austerity is a major reason propelling China, Russia and other nations out of the U.S. diplomatic and banking orbit.

On December 3, 2015, Prime Minister Putin proposed that Russia "and other Eurasian Economic Union countries should kick-off consultations with members of the SCO and the Association of Southeast Asian Nations (ASEAN) on a possible economic partnership."[2]Russia also is seeking to build pipelines to Europe through friendly secular countries instead of Sunni jihadist U.S.-backed countries locked into America's increasingly confrontational orbit.

Russian finance minister Anton Siluanov points out that when Russia's 2013 loan to Ukraine was made, at the request of Ukraine's elected government, Ukraine's "international reserves were barely enough to cover three months' imports, and no other creditor was prepared to lend on terms acceptable to Kiev. Yet Russia provided $3 billion of much-needed funding at a 5 per cent interest rate, when Ukraine's bonds were yielding nearly 12 per cent."[3]

What especially annoys U.S. financial strategists is that this loan by Russia's National Wealth Fund was protected by IMF lending practice, which at that time ensured collectability by withholding credit from countries in default of foreign official debts, or at least not bargaining in good faith to pay. To cap matters, the bonds are registered under London's creditor-oriented rules and courts.

Most worrisome to U.S. strategists is that China and Russia are denominating their trade and investment in their own currencies instead of dollars. After U.S. officials threatened to derange Russia's banking linkages by cutting it off from the SWIFT interbank clearing system, China accelerated its creation of the alternative China International Payments System (CIPS), and its own credit card system to protect Eurasian economies from the threats made by U.S. unilateralists.

Russia and China are simply doing what the United States has long done: using trade and credit linkages to cement their diplomacy. This tectonic geopolitical shift is a Copernican threat to New Cold War ideology: Instead of the world economy revolving around the United States (the Ptolemaic idea of America as "the indispensible nation"), it may revolve around Eurasia. As long as global financial control remains grounded in Washington at the offices of the IMF and World Bank, such a shift in the center of gravity will be fought with all the power of an American Century (and would-be American Millennium) inquisition.

Any inquisition needs a court system and enforcement vehicles. So does resistance to such a system. That is what today's global financial, legal and trade maneuvering is all about. And that is why today's world system is in the process of breaking apart. Differences in economic philosophy call for different institutions.

To U.S. neocons the specter of AIIB government-to-government investment creates fear of nations minting their own money and holding each other's debt in their international reserves instead of borrowing dollars, paying interest in dollars and subordinating their financial planning to the U.S. Treasury and IMF. Foreign governments would have less need to finance their budget deficits by selling off key infrastructure. And instead of dismantling public spending, a broad Eurasian economic union would do what the United States itself practices, and seek self-sufficiency in banking and monetary policy.

Imagine the following scenario five years from now. China will have spent half a decade building high-speed railroads, ports, power systems and other construction for Asian and African countries, enabling them to grow and export more. These exports will be coming online to repay the infrastructure loans. Also, suppose that Russia has been supplying the oil and gas energy for these projects on credit.

To avert this prospect, suppose an American diplomat makes the following proposal to the leaders of countries in debt to China, Russia and the AIIB: "Now that you've got your increased production in place, why repay? We'll make you rich if you stiff our adversaries and turn back to the West. We and our European allies will support your assigning your nations' public infrastructure to yourselves and your supporters at insider prices, and then give these assets market value by selling shares in New York and London. Then, you can keep the money and spend it in the West."

How can China or Russia collect in such a situation? They can sue. But what court in the West will accept their jurisdiction?

That is the kind of scenario U.S. State Department and Treasury officials have been discussing for more than a year. Implementing it became more pressing in light of Ukraine's $3 billion debt to Russia falling due by December 20, 2015. Ukraine's U.S.-backed regime has announced its intention to default. To support their position, the IMF has just changed its rules to remove a critical lever on which Russia and other governments have long relied to ensure payment of their loans.

The IMF's role as enforcer of inter-government debts

When it comes to enforcing nations to pay inter-government debts, the IMF is able to withhold not only its own credit but also that of governments and global bank consortia participating when debtor countries need "stabilization" loans (the neoliberal euphemism for imposing austerity and destabilizing debtor economies, as in Greece this year). Countries that do not privatize their infrastructure and sell it to Western buyers are threatened with sanctions, backed by U.S.-sponsored "regime change" and "democracy promotion" Maidan-style. The Fund's creditor leverage has been that if a nation is in financial arrears to any government, it cannot qualify for an IMF loan – and hence, for packages involving other governments. That is how the dollarized global financial system has worked for half a century. But until now, the beneficiaries have been U.S. and NATO lenders, not been China or Russia.

The focus on a mixed public/private economy sets the AIIB at odds with the Trans-Pacific Partnership's aim of relinquishing government planning power to the financial and corporate sector, and the neoliberal aim of blocking governments from creating their own money and implementing their own financial, economic and environmental regulation. Chief Nomura economist Richard Koo, explained the logic of viewing the AIIB as a threat to the U.S.-controlled IMF: "If the IMF's rival is heavily under China's influence, countries receiving its support will rebuild their economies under what is effectively Chinese guidance, increasing the likelihood they will fall directly or indirectly under that country's influence."[4]

This was the setting on December 8, when Chief IMF Spokesman Gerry Rice announced: "The IMF's Executive Board met today and agreed to change the current policy on non-toleration of arrears to official creditors." Russian Finance Minister Anton Siluanov accused the IMF decision of being "hasty and biased."[5] But it had been discussed all year long, calculating a range of scenarios for a sea change in international law. Anders Aslund, senior fellow at the NATO-oriented Atlantic Council, points out:

The IMF staff started contemplating a rule change in the spring of 2013 because nontraditional creditors, such as China, had started providing developing countries with large loans. One issue was that these loans were issued on conditions out of line with IMF practice. China wasn't a member of the Paris Club, where loan restructuring is usually discussed, so it was time to update the rules.
The IMF intended to adopt a new policy in the spring of 2016, but the dispute over Russia's $3 billion loan to Ukraine has accelerated an otherwise slow decision-making process.[6]

The target was not only Russia and its ability to collect on its sovereign loan to Ukraine, but China even more, in its prospective role as creditor to African countries and prospective AIIB borrowers, planning for a New Silk Road to integrate a Eurasian economy independent of U.S. financial and trade control. The Wall Street Journal concurred that the main motive for changing the rules was the threat that China would provide an alternative to IMF lending and its demands for crushing austerity. "IMF-watchers said the fund was originally thinking of ensuring China wouldn't be able to foil IMF lending to member countries seeking bailouts as Beijing ramped up loans to developing economies around the world."[7] So U.S. officials walked into the IMF headquarters in Washington with the legal equivalent of suicide vests. Their aim was a last-ditch attempt to block trade and financial agreements organized outside of U.S. control and that of the IMF and World Bank.

The plan is simple enough. Trade follows finance, and the creditor usually calls the tune. That is how the United States has used the Dollar Standard to steer Third World trade and investment since World War II along lines benefiting the U.S. economy. The cement of trade credit and bank lending is the ability of creditors to collect on the international debts being negotiated. That is why the United States and other creditor nations have used the IMF as an intermediary to act as "honest broker" for loan consortia. ("Honest broker" means being subject to U.S. veto power.) To enforce its financial leverage, the IMF has long followed the rule that it will not sponsor any loan agreement or refinancing for governments that are in default of debts owed to other governments. However, as the afore-mentioned Aslund explains, the IMF could easily

change its practice of not lending into [countries in official] arrears … because it is not incorporated into the IMF Articles of Agreement, that is, the IMF statutes. The IMF Executive Board can decide to change this policy with a simple board majority. The IMF has lent to Afghanistan, Georgia, and Iraq in the midst of war, and Russia has no veto right, holding only 2.39 percent of the votes in the IMF. When the IMF has lent to Georgia and Ukraine, the other members of its Executive Board have overruled Russia.[8]

After the rules change, Aslund later noted, "the IMF can continue to give Ukraine loans regardless of what Ukraine does about its credit from Russia, which falls due on December 20.[9]

The IMF rule that no country can borrow if it is in default to a foreign government was created in the post-1945 world. Since then, the U.S. Government, Treasury and/or U.S. bank consortia have been party to nearly every major loan agreement. But inasmuch as Ukraine's official debt to Russia's National Wealth Fund was not to the U.S. Government, the IMF announced its rules change simply as a "clarification." What its rule really meant was that it would not provide credit to countries in arrears to the U.S. government, not that of Russia or China.

It remains up to the IMF board – and in the end, its managing director – whether or not to deem a country creditworthy. The U.S. representative can block any foreign leaders not beholden to the United States. Mikhail Delyagin, Director of the Institute of Globalization Problems, explained the double standard at work: "The Fund will give Kiev a new loan tranche on one condition: that Ukraine should not pay Russia a dollar under its $3 billion debt. … they will oblige Ukraine to pay only to western creditors for political reasons."[10]

The post-2010 loan packages to Greece are a case in point. The IMF staff saw that Greece could not possibly pay the sums needed to bail out French, German and other foreign banks and bondholders. Many Board members agreed, and have gone public with their whistle blowing. Their protests didn't matter. President Barack Obama and Treasury Secretary Tim Geithner pointed out that U.S. banks had written credit default swaps betting that Greece could pay, and would lose money if there were a debt writedown). Dominique Strauss-Kahn backed the hard line US- European Central Bank position. So did Christine Lagarde in 2015, overriding staff protests.[11]

Regarding Ukraine, IMF executive board member Otaviano Canuto, representing Brazil, noted that the logic that "conditions on IMF lending to a country that fell behind on payments [was to] make sure it kept negotiating in good faith to reach agreement with creditors."[12] Dropping this condition, he said, would open the door for other countries to insist on a similar waiver and avoid making serious and sincere efforts to reach payment agreement with creditor governments.

A more binding IMF rule is Article I of its 1944-45 founding charter, prohibiting the Fund from lending to a member state engaged in civil war or at war with another member state, or for military purposes in general. But when IMF head Lagarde made the last loan to Ukraine, in spring 2015, she merely expressed a vapid token hope there might be peace. Withholding IMF credit could have been a lever to force peace and adherence to the Minsk agreements, but U.S. diplomatic pressure led that opportunity to be rejected. President Porochenko immediately announced that he would step up the civil war with the Russian-speaking population in the eastern Donbass region.

The most important IMF condition being violated is that continued warfare with the East prevents a realistic prospect of Ukraine paying back new loans. The Donbas is where most Ukrainian exports were made, mainly to Russia. That market is being lost by the junta's belligerence toward Russia. This should have blocked Ukraine from receiving IMF aid. Aslund himself points to the internal contradiction at work: Ukraine has achieved budget balance because the inflation and steep currency depreciation has drastically eroded its pension costs. But the resulting decline in the purchasing power of pension benefits has led to growing opposition to Ukraine's post-Maidan junta. So how can the IMF's austerity budget be followed without a political backlash? "Leading representatives from President Petro Poroshenko's Bloc are insisting on massive tax cuts, but no more expenditure cuts; that would cause a vast budget deficit that the IMF assesses at 9-10 percent of GDP, that could not possibly be financed."[13]

By welcoming and financing Ukraine instead of treating as an outcast, the IMF thus is breaking four of its rules:

1. Not to lend to a country that has no visible means to pay back the loan. This breaks the "No More Argentinas" rule, adopted after the IMF's disastrous 2001 loan.

2. Not to lend to a country that repudiates its debt to official creditors. This goes against the IMF's role as enforcer for the global creditor cartel.
3. Not to lend to a borrower at war – and indeed, to one that is destroying its export capacity and hence its balance-of-payments ability to pay back the loan.
4. Finally, not to lend to a country that is not likely to carry out the IMF's austerity "conditionalities," at least without crushing democratic opposition in a totalitarian manner.

The upshot – and new basic guideline for IMF lending – is to split the world into pro-U.S. economies going neoliberal, and economies maintaining public investment in infrastructure n and what used to be viewed as progressive capitalism. Russia and China may lend as much as they want to other governments, but there is no global vehicle to help secure their ability to be paid back under international law. Having refused to roll back its own (and ECB) claims on Greece, the IMF is willing to see countries not on the list approved by U.S. neocons repudiate their official debts to Russia or China. Changing its rules to clear the path for making loans to Ukraine is rightly seen as an escalation of America's New Cold War against Russia and China.

Timing is everything in such ploys. Georgetown University Law professor and Treasury consultant Anna Gelpern warned that before the "IMF staff and executive board [had] enough time to change the policy on arrears to official creditors," Russia might use "its notorious debt/GDP clause to accelerate the bonds at any time before December, or simply gum up the process of reforming the IMF's arrears policy."[14] According to this clause, if Ukraine's foreign debt rose above 60 percent of GDP, Russia's government would have the right to demand immediate payment. But President Putin, no doubt anticipating the bitter fight to come over its attempts to collect on its loan, refrained from exercising this option. He is playing the long game, bending over backward to behave in a way that cannot be criticized as "odious."

A more immediate reason deterring the United States from pressing earlier to change IMF rules was the need to use the old set of rules against Greece before changing them for Ukraine. A waiver for Ukraine would have provided a precedent for Greece to ask for a similar waiver on paying the "troika" – the European Central Bank (ECB), EU commission and the IMF itself – for the post-2010 loans that have pushed it into a worse depression than the 1930s. Only after Greece capitulated to eurozone austerity was the path clear for U.S. officials to change the IMF rules to isolate Russia. But their victory has come at the cost of changing the IMF's rules and those of the global financial system irreversibly. Other countries henceforth may reject conditionalities, as Ukraine has done, as well as asking for write-downs on foreign official debts.

That was the great fear of neoliberal U.S. and Eurozone strategists last summer, after all. The reason for smashing Greece's economy was to deter Podemos in Spain and similar movements in Italy and Portugal from pursuing national prosperity instead of eurozone austerity. "Imagine the Greek government had insisted that EU institutions accept the same haircut as the country's private creditors," Russian finance minister Anton Siluanov asked. "The reaction in European capitals would have been frosty. Yet this is the position now taken by Kiev with respect to Ukraine's $3 billion eurobond held by Russia."[15]

The consequences of America's tactics to make a financial hit on Russia while its balance of payments is down (as a result of collapsing oil and gas prices) go far beyond just the IMF.

These tactics are driving other countries to defend their own economies in the legal and political spheres, in ways that are breaking apart the post-1945 global order.

Countering Russia's ability to collect in Britain's law courts

Over the past year the U.S. Treasury and State Departments have discussed ploys to block Russia from collecting by suing in the London Court of International Arbitration, under whose rules Russia's bonds issued to Ukraine are registered. Reviewing the excuses Ukraine might use to avoid paying Russia, Prof. Gelpern noted that it might declare the debt "odious," made under duress or corruptly. In a paper for the Peterson Institute of International Economics (the banking lobby in Washington) she suggested that Britain should deny Russia the use of its courts as a means of reinforcing the financial, energy and trade sanctions passed after Crimea voted to join Russia as protection against the ethnic cleansing from the Right Sector, Azov Battalion and other paramilitary groups descending on the region.[16]

A kindred ploy might be for Ukraine to countersue Russia for reparations for "invading" it and taking Crimea. Such a claim would seem to have little chance of success (without showing the court to be an arm of NATO politics), but it might delay Russia' ability to collect by tying the loan up in a long nuisance lawsuit. But the British court would lose credibility if it permits frivolous legal claims (called barratry in English) such as President Poroshenko and Prime Minister Yatsenyuk have threatened.

To claim that Ukraine's debt to Russia was "odious" or otherwise illegitimate, "President Petro Poroshenko said the money was intended to ensure Yanukovych's loyalty to Moscow, and called the payment a 'bribe,' according to an interview with Bloomberg in June this year."[17] The legal and moral problem with such arguments is that they would apply equally to IMF and U.S. loans. They would open the floodgates for other countries to repudiate debts taken on by dictatorships supported by IMF and U.S. lenders.

As Foreign Minister Sergei Lavrov noted, the IMF's change of rules, "designed to suit Ukraine only, could plant a time bomb under all other IMF programs." The new rules showed the extent to which the IMF is subordinate to U.S. aggressive New Cold Warriors: "since Ukraine is politically important – and it is only important because it is opposed to Russia – the IMF is ready to do for Ukraine everything it has not done for anyone else."[18]

In a similar vein, Andrei Klimov, deputy chairman of the Committee for International Affairs at the Federation Council (the upper house of Russia's parliament) accused the United States of playing "the role of the main violin in the IMF while the role of the second violin is played by the European Union, [the] two basic sponsors of the Maidan – the … coup d'état in Ukraine in 2014."[19]

Putin's counter-strategy and the blowback on U.S.-European relations

Having anticipated that Ukraine would seek excuses to not pay Russia, President Putin refrained from exercising Russia's right to demand immediate payment when Ukraine's foreign debt rose above 60 percent of GDP. In November he even offered to defer any payment at all this year, stretching payments out to "$1 billion next year, $1 billion in 2017, and $1 billion in 2018," if "the United States government, the European Union, or one of the big international financial institutions" guaranteed payment.[20] Based on their assurances "that Ukraine's solvency will grow," he added, they should be willing to put their money where their mouth was. If they did not provide guarantees, Putin pointed out, "this means that they do not believe in the Ukrainian economy's future."

Implicit was that if the West continued encouraging Ukraine to fight against the East, its government would not be in a position to pay. The Minsk agreement was expiring and Ukraine was receiving new arms support from the United States, Canada and other NATO members to intensify hostilities against Donbas and Crimea.

But the IMF, European Union and United States refused to back up the Fund's optimistic forecast of Ukraine's ability to pay in the face of its continued civil war against the East. Foreign Minister Lavrov concluded that, "By having refused to guarantee Ukraine's debt as part of Russia's proposal to restructure it, the United States effectively admitted the absence of prospects of restoring its solvency."[21]

In an exasperated tone, Prime Minister Dmitry Medvedev said on Russian television: "I have a feeling that they won't give us the money back because they are crooks … and our Western partners not only refuse to help, but they also make it difficult for us." Accusing that "the international financial system is unjustly structured," he nonetheless promised to "go to court. We'll push for default on the loan and we'll push for default on all Ukrainian debts," based on the fact that the loan was a request from the Ukrainian Government to the Russian Government. If two governments reach an agreement this is obviously a sovereign loan…. Surprisingly, however, international financial organisations started saying that this is not exactly a sovereign loan. This is utter bull. Evidently, it's just an absolutely brazen, cynical lie. … This seriously erodes trust in IMF decisions. I believe that now there will be a lot of pleas from different borrower states to the IMF to grant them the same terms as Ukraine. How will the IMF possibly refuse them?[22]

And there the matter stands. On December 16, 2015, the IMF's Executive Board ruled that "the bond should be treated as official debt, rather than a commercial bond."[23] Forbes quipped: "Russia apparently is not always blowing smoke. Sometimes they're actually telling it like it is."[24]

Reflecting the degree of hatred fanned by U.S. diplomacy, U.S.-backed Ukrainian Finance Minister Natalie A. Jaresko expressed an arrogant confidence that the IMF would back the Ukrainian cabinet's announcement on Friday, December 18, of its intention to default on the debt to Russia falling due two days later. "If we were to repay this bond in full, it would mean we failed to meet the terms of the I.M.F. and the obligations we made under our restructuring."[25]

Adding his own bluster, Prime Minister Arseny Yatsenyuk announced his intention to tie up Russia's claim for payment by filing a multibillion-dollar counter claim "over Russia's occupation of Crimea and intervention in east Ukraine." To cap matters, he added that "several hundred million dollars of debt owed by two state enterprises to Russian banks would also not be paid."[26] This makes trade between Ukraine and Russia impossible to continue. Evidently Ukraine's authorities had received assurance from IMF and U.S. officials that no real "good faith" bargaining would be required to gain ongoing support. Ukraine's Parliament did not even find it necessary to enact the new tax code and **Michael Hudson**: U.S. admits lack of prospects of restoring Ukrainian solvency," November 7, 2015, translated on Johnson's Russia List, December 7, 2015, #38.

Notes

[21] "In Conversation with Dmitry Medvedev: Interview with five television channels," Government.ru, December 9, 2015, from Johnson's Russia List, December 10, 2015, #2[22]

[23] Andrew Mayeda, "IMF Says Ukraine Bond Owned by Russia Is Official Sovereign Debt," Bloomberg, December 17, 2015.

[24] Kenneth Rapoza, "IMF Says Russia Right About Ukraine $3 Billion Loan," Forbes.com, December 16, 2015. The article added: "the Russian government confirmed to Euroclear, at the request of the Ukrainian authorities at the time, that the Eurobond was fully owned by the Russian government."

[25] Andrew E. Kramer, "Ukraine Halts Repayments on $3.5 Billion It Owes Russia," The New York Times, December 19, 2015.

[26] Roman Olearchyk, "Ukraine tensions with Russia mount after debt moratorium," Financial Times, December 19, 2015.

[27] "Violence instead of democracy: Putin slams 'policies of exceptionalism and impunity' in UN speech," www.rt.com, September 29, 2015. From Johnson's Russia List, September 29, 2015, #2.

The original source of this article is Guns and Butter
Copyright © Prof Michael Hudson, Guns and Butter, 2016

Comment on Global Research Articles on our Facebook page

Become a Member of Global Research

Articles by: **Prof Michael Hudson**

Disclaimer: The contents of this article are of sole responsibility of the author(s). The Centre for Research on Globalization will not be responsible for any inaccurate or incorrect statement in this article. The Centre of Research on Globalization grants permission to cross-post Global Research articles on community internet sites as long the source and copyright are acknowledged together with a hyperlink to the original Global Research article. For publication of Global Research articles in print or other forms including commercial internet sites, contact: publications@globalresearch.ca

www.globalresearch.ca contains copyrighted material the use of which has not always been specifically authorized by the copyright owner. We are making such material available to our readers under the provisions of "fair use" in an effort to advance a better understanding of political, economic and social issues. The material on this site is distributed without profit to those who have expressed a prior interest in receiving it for research and educational purposes. If you wish to use copyrighted material for purposes other than "fair use" you must request permission from the copyright owner.

For media inquiries: publications@globalresearch.ca