

Follow the Money

In 1973 when two American reporters investigating Richard Nixon could not figure out the intricacies of Nixon's shady dealings, their confidential source told them to "follow the money". That was good advice then as now to understand the recent devaluation, so lets follow the money from the International Monetary Fund to see what it reveals.

So far the IMF has lent the Russian Government \$4.8 billion of a \$22.6 billion financing package in which the IMF is the main lender. Now, if you had billions of dollars, would you lend it to your government? If you had thousands of dollars, would you lend it to the government? Probably not. The men at the IMF are just as smart as you. They know, as you all do, the problems with the government and this economy. So why did they lend the money? One reason is that it is not their money. The money comes from other governments, mainly the United States, which in turn acquires the money from its citizens and corporations. In the US, unlike here, virtually every working person and corporation pays income taxes. In fact, most of the US Government's revenues come from income taxes. In effect, the US government reaches into the pockets of its workers and businesses and sends billions of dollars to the IMF.

The IMF then sends these billions of dollars to the Central Bank of a country like Russia when it appears that Central Bank may run out of hard currency. The IMF refills the Central Bank's coffers in order to prevent wealthy, foreign financial institutions, such as investment banks, from losing money on their investments caused by a devaluation of the local currency. For example, when American investment banks bought securities in Russia, say debt issued by the government, they had to change dollars into rubles. Think of them as having paid, for instance, \$1 to get 6 rubles. Investors then bought securities with their rubles because debt instruments, stocks and other securities in Russia are sold for rubles, not dollars.

When investors believe, for various reasons, that the price of stocks, bonds and other securities will go up in Russia, they change lots of dollars into lots of rubles and buy lots of securities. When they believe that prices will go down, for various reasons, they sell their securities, which causes prices to go down, and take the rubles from the sales to a bank to get dollars. The bank may pay the dollars from its own pockets or sell the rubles for dollars provided by the Central Bank. The Russian banks pay dollars for rubles because months earlier they entered into contracts agreeing to make such payments. The American investor then sends his dollars home for investment after having made a nice profit.

In 1996 and 1997, wealthy American and other foreign financial institutions paid billions in hard currency for rubles in order to buy Russian securities, which helped the markets go up. But then some of these investors became worried, for various reasons, or simply decided to sell at the high prices for a gain. As they sold, the market prices began to drop because there were more sellers than buyers. When these wealthy investors started taking their rubles to the banks to get dollars, the banks' dollar accounts began to shrink,

so the banks exchanged rubles for dollars from the Central Bank. Naturally, the Central Bank's amount of dollars started falling.

Other investors then began to fear that when they sold their Russian securities or when their Russian Government bonds matured there might be so few dollars left with the banks and the Central Bank that, despite bank agreements, the banks would pay fewer dollars for rubles. That is, when investors took their rubles to the banks to buy dollars, the banks would not give them \$1 for 6 rubles, but \$0.66 or \$0.33 or some other rate for 6 rubles. So an investor who put in \$1 million and made a \$200 thousand profit would only receive back \$800 thousand or \$400 thousand—a big, big lose.

All of this has happened over a period of time because it takes time for many large investors to leave a market. Most large investors reduced their ruble investments and transferred into dollars or dollar investments before the devaluation. The ruble was devalued because these investors could then make money from the devaluation instead of losing money, which would have happened if the ruble was devalued earlier.

Foreign financial institutions were not the only ones who played this game. The large Russian commercial banks, such as those controlled by the famous oligarchs, also benefit from the IMF loans. They too invested in the markets, needed time to pull out and change their rubles into dollars provided, in part, by the IMF.

The oligarchs' banks also received another benefit from the IMF loans. As previously mentioned, when foreign investors initially paid dollars for rubles, Russian banks agreed to buy those rubles back at a future date with a certain amount of dollars, probably around \$1 for 6 rubles. Without the IMF loans, Russia's Central Bank would not have had enough dollars to keep the ruble from falling in value before the rubles were bought back and the banks had time to change those rubles into dollars. To maintain the ruble's value, the Central Bank used its dollars to buy rubles in the market. This kept a balance between the amount of rubles bought and the amount sold, so the value did not decline before the banks wanted it to.

An earlier fall in the value of the ruble would have hurt the banks because were the banks to live up to their contracts and sell, for example, \$1 for 6 rubles, those six rubles would only be able to buy perhaps \$0.66 or even \$0.33—a big, big lose and possibly bankruptcy for the oligarchs. On the other hand, the banks could have defaulted on their contracts. However, many Russian banks received dollar loans from Western institutions and these institutions would have demanded payment that the banks could not have made because they did not have the dollars. Either way, the banks would have gone under financially. To prevent the oligarchs and other large banks from violating their agreements with foreign investors and from going bankrupt, the IMF quickly agreed to a loan package for Russia's Government.

So, the money lent to your government by the IMF came from Western taxpayers and flowed into the pockets of wealthy foreign and Russian financial institutions. Who then is going to pay it back—YOU ARE, whether in new taxes, increased tax collection,

unemployment or a devalued ruble. You are going to pay, just as Western taxpayers paid.