

# Russia prioritizes credit for recovery

by Rachel Douglas

Along with the financial explosion in Brazil, the New Year brought renewed anxiety about Russia's ability to service a foreign debt of \$150 billion. Its sheer unpayability, given the devastation of the Russian economy by the policies of the International Monetary Fund (IMF), is compounded—to the chagrin of a global financial oligarchy that thrives on speculation and brute-force collection—by the Primakov government's determination not to sacrifice the population and the national security of Russia on the altar of the debt.

Interest and principal due on Russia's debt in 1999, including state-to-state (Paris Club) and commercial (London Club) debt inherited from the Soviet Union, is \$17.5 billion. The 1999 federal budget law, currently in the process of approval by the State Duma, provides less than \$5 billion direct funding for debt service. To reach a level of \$9.5 billion in debt service spending, which government officials last year suggested could be managed if the Soviet-era debt categories were restructured, Russia would have to count on new loans from abroad. But, those are by no means guaranteed to be forthcoming.

In several year-end statements, Prime Minister Yevgeni Primakov reiterated the position of his government: The debt obligations of the state will be honored, but Russia cannot pay just at the moment. Visiting Kazakstan on Dec. 23, Primakov said, "Russia will not declare default. Russia will pay all debts, both internal and external. Russia is interested in debt restructuring." Addressing the State Duma during the Dec. 24 budget debate, he clarified "the fundamental difference between the present government and our predecessors," namely that the latter had addicted Russia to foreign borrowing, as if to a narcotic, borrowing money to plug holes in the budget (more and more of which was then consumed by debt service).

"We have departed from this for reasons of principle," Primakov said, but "we do need relations with international financial organizations." He stated that Russia's payments to the IMF should certainly be made on time, but said that would require the IMF to issue a loan tranche to Russia. He noted that bilateral loans from Japan, as well as potential restructuring of the London Club and Paris Club debt, were contingent on agreement with the IMF for the release of such funds.

## Payments missed

Russia did make several multi-hundred-million-dollar interest payments on its Eurobonds, which are recent dollar-denominated borrowings by post-Soviet Russia, in the last days of December. Other types of debt are in limbo.

*London Club debt.* On Dec. 29, the grace period expired on a \$362 million interest payment on PRINs, the restructured bond form of the ex-Soviet debt. The state-owned Vneshekonombank had offered London Club creditors new IANs (Interest Arrears Notes) in lieu of cash, to which 72% of the creditors agreed. Jan. 19 is the date given by the lead London Club creditor, Bank of America, for official determination of whether or not Russia is "in default" on PRINs. The Russian Ministry of Finance, in a Jan. 9 statement, said there was no basis to declare default or to seize Russian assets abroad, as Moscow press had rumored. On Jan. 14, Fitch IBCA downgraded the total outstanding PRINs debt, which is \$22.4 billion, to DD, a default rating.

*Restructured GKO.* Not officially part of the foreign debt, the ruble-denominated GKO/OFZ state bond pyramid collapsed in August. On Jan. 18, according to a Russian Finance Ministry official speaking at the beginning of the month, the government intends to resume talks with the representatives of foreign holders of the GKO/OFZ bonds.

*IMF loans.* An International Monetary Fund delegation is due in Moscow on Jan. 20, after failure to come to terms with Russia at the end of last year. On Jan. 14, the Fund's Moscow representative Martin Gilman was quoted by Interfax, saying that the long-delayed next tranche of last summer's \$22.6 billion IMF-led package is now a dead letter, and that any new monies will be a new program. (How the first \$4.8 billion tranche was spent—to save whose investments—is now one of the subjects of a criminal investigation of former Central Bank chief Sergei Dubinin and others.) First Deputy Prime Minister Yuri Maslyukov met with IMF officials, during a short visit to the United States Jan. 13-14.

*The Russian financial oligarchs' banks.* On Jan. 9, Interfax news agency circulated a wire, reporting that five out of Russia's ten largest banks are insolvent, unable to meet their debts to creditors, or to service customers. The five named by Interfax are Inkombank, SBS-Agro, Oneksimbank, Rossiysky Kredit, and Menatep. These five have been on various "dead duck" lists, repeatedly, after the Aug. 17, 1998 financial breakdown. The Russian banks were among the biggest players in the GKO pyramid scheme; they functioned less as normal lending institutions, than as vehicles for that speculation. They do, however, have obligations abroad, so their ongoing demise can have an impact on the global debt crisis. There have already been cases of London authorities freezing the foreign assets of some of these banks, in an attempt to force honoring of foreign currency forward contracts and other obligations. As of Nov. 16, Itar-TASS

reported that Menatep, Alfa Bank, SBS-Agro, and Promstroibank were in negotiations with foreign creditors over unfulfilled forward contracts.

### **A budget for real investment**

The 1999 federal budget was passed by the State Duma in the first reading (out of four reviews), on Dec. 24. Minister of Economics Andrei Shapovalyants addressed the Duma on its policy content, asserting that the government is confident it can achieve a turnaround to economic growth, including the growth of industrial output, by the second half of 1999. He provided detailed projected schedules for major industries.

“What makes us confident that we will achieve the results that I have presented?” asked Shapovalyants. Four factors: “tax policy, improvement of finances in the real sector, targeted financing, and organizing the investment process.” Factors three and four will be the functional area of Russia’s new Development Bank.

Shapovalyants said, “The focus of attention in 1999 will be on targeted financing of the real sector. In the conditions in the economy after August 1998, targeted financing may enable us to fill the niches formed in the domestic market in the food and light industry markets, in the forestry complex, metal-working and chemistry. In connection with this problem and the related problem of building up investments in the Russian economy the government has separated, within the federal budget, the current expenditure and investment expenditure. In other words, as part of the 1999 budget it has isolated a Development Budget. This includes all the investment resources, including military conversion programs and financing of high efficiency projects. This would make it possible next year not only to patch up holes, but to start building up an investment and industrial policy.

### **A development bank**

“A key element of infrastructure to ensure effective crediting of projects similar to the ones referred to above, will be the Russian Development Bank. Its analyses and the priorities of government industrial policy will provide the basis for the final choice of investment projects, monitoring the returns on investments, including returns that go into the federal budget.”

The creation of the Development Bank brings a national banking component into Russian policy, while the government is also attempting to unwind the mess surrounding the defunct mega-speculator banks.

In November, the Central Bank revealed its plan to segregate banks into four categories: 1) 600 banks, representing 15% of bank assets, which could survive without assistance; 2) 190 stable regional banks, with 10.5% of bank assets, which need help to develop; 3) eighteen banks with 41% of bank assets, considered important in social and economic terms, which need help to survive; 4) banks that will not survive.

There are ongoing deliberations, over which banks should come into the third group—how much of the failed investments of the oligarchs’ banks the state should assume.

Moscow Mayor Yuri Luzhkov, for instance, said in October, “I do not think that the oligarchic banks can be restored as commercial structures,” but he added that “banks . . . for instance, such a bank as SBS-Agro, should not be liquidated. It would be inadmissible for the state to liquidate SBS-Agro.” SBS-Agro and Most Bank, after the state-owned Savings Bank (Sberbank), have the largest percentage of citizens’ savings deposits in Russia. SBS-Agro has an extensive network of branches.

Central Bank Chairman Viktor Gerashchenko has also spoken about SBS-Agro as a “system-forming” bank that needs to be supported. First Deputy Prime Minister Yuri Maslyukov said in November, “Only a small number of banks can be nationalized and not until the potential of all the other instruments has been exhausted. The Central Bank’s program will help put the banking system on its feet. It will ensure a differentiated approach to banks depending on their financial status and it includes nationalization of a few structurally important banks. So far, I can name only one such bank—SBS-Agro.”

The plan for a new “development bank,” incorporating elements of the post-war German Kreditanstalt für Wiederaufbau and comparable Japanese institutions, was broached by Maslyukov, shortly after formation of the Primakov government last autumn. On Dec. 29, Itar-Tass reported that Maslyukov will preside over a working group to draft a medium-term program of Russia’s social and economic development. Its members include Shapovalyants, First Deputy Minister of State Property Aleksandr Braverman, Chairman of the Federal Commission for Securities Dmitri Vasilyev, Deputy Finance Minister Oleg Vyugin—and, two strong advocates of state-directed incentives for investment in the real economy, Director of the Russian Academy of Sciences Institute of Economics Academician Leonid Abalkin, and chief of the Information-Analytical Agency of the staff of the Federation Council (upper house of Parliament) Dr. Sergei Glazyev.

Policies are also changing at the Russian Central Bank, which on Jan. 11 announced new rules for managing export earnings, requiring any Russian exporter to repatriate 75% of foreign currency revenues, instead of the previous level of 50%. That is, the exporters must bring that portion of their foreign currency earnings back to Russia and exchange them for rubles. The conversion must be effected within seven working days, as opposed to the previous 14-day limit.

On Jan. 4, Primakov signed a resolution, restricting exports of some commodities by means of a 10% export tariff. The tax is imposed on the export of copper, nickel, aluminum, lead, zinc, cobalt, and titanium, and several agricultural products.