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## Swapping Soviet Debt for Russian Progress

by Augusto Lopez-Claros

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Russia's 2003 budget, now before parliament, includes nearly \$3.5 billion of debt payments on Soviet-era debt to the Paris Club of government creditors. This is a huge sum for Russia, equivalent to 1% of annual GDP—the equivalent sum in the United States would be \$100 billion.

The Soviet debt problems have been the subject of numerous debates over the last several years. In the waning days of the Soviet Union alone, Moscow racked up debts of \$40 billion, just to the Paris Club of official debtors. While creditors obviously want Russia to fulfill its obligations, they don't want the debt to be a millstone around the Kremlin's neck. Now add in the need to avoid a solution that creates a quagmire of moral hazards.

Fortunately, there is a way for the West to recoup what it is owed, while at the same time continuing to invest in Russia's future. The Paris Club and Russia can establish a fund that will transform Russian debt payment into an aid program in its own right. In essence, the Paris Club could create a new bank account to receive Russian debt payments. However, Russia would then "withdraw" the money to finance a variety of development projects within Russia, in such areas as education, the environment and public health.

For example, at the recent G-8 summit in Canada promises were made to Russia to deliver \$20 billion over the next 10 years for weapons decommissioning programs. But the financing is still unidentified. This is precisely the kind of project that might instead be offset against Paris Club debt in such a framework—a sort of debt-for-“do good” swap deal.

Or take education. The annual cost of educating 10,000 bright Russian university

students in top U.S. and European schools would come to about \$200 million, 6% of the amount being repaid by Russia this year. This kind of investment benefits not just the Russian public from the know-how that would later be applied inside Russia, but, in this particular example, institutions of higher education in the creditor countries as well. Coming up with a list of such mutually beneficial projects requires only a bit of imagination.

Obviously, the rules for the operation of such a fund would have to be transparent and oversight clear; the program would have to balance legitimate creditor interests with Russian development objectives in a way that safeguarded against some of the abuses associated with the original debt disbursements.

There are many benefits to this approach. Among the most significant, Russia would be actually repaying the debt. Unlike traditional debt forgiveness, this is not a "get out of jail free" card. The necessity of making regular deposits into the fund would impose the same fiscal discipline on Russia that the current system of repayment does. This minimizes, or even eliminates, the serious problem of moral hazard that inevitably accompanies debt cancellation.

Meanwhile, the existence of such a system would reduce the opportunities for the Western members of the Paris Club to renege on the aid promises they have made to Russia over the years, most recently at the G-8 Summit in Canada. Since the money would never actually enter the pockets of the creditors, they would not have the opportunity to divert any of it away from Russian development. Additional Western outlays of aid would be limited merely to insuring that

the money in the fund was used for development projects.

Neither of the alternatives—debt forgiveness or full repayment—are as attractive. Following nearly a decade of economic decline, the Russian economy is on the mend. Growth in the last couple of years has been strong, the budget is in surplus, and so is the balance of payments. President Putin's economic team is not only reasonably competent, but it is working effectively with parliament, where a handful of thoughtful, reform-minded deputies have taken a leading role in helping shape an ambitious legislative agenda.

Against this favorable background, it would be difficult indeed for the IMF to present persuasive financing scenarios which showed that Russia was in need of the kind of debt relief that is normally provided by the Paris Club. Outright debt forgiveness, proposed by many, has never been a promising option. In addition to the usual moral hazard issues, giving a break to Russia begs the question of what to do with other worthy candidates, and such issues of precedent cannot be simply dismissed.

On the other hand, repayment of the full debt could suffocate Russia in years to come. To be sure, the Russian government has continued to serve all Soviet-era official debts, including the share of the 14 other former Soviet Union republics (including future NATO members Estonia, Latvia, and Lithuania) which it agreed to take over in early 1992.

Yet the amounts are astronomical. This year alone \$3.3 billion are being paid out from the Russian budget to Germany, the U.S. and Italy, among others. Payments due during the period 2002-10 on export credits disbursed to the Soviet Union amount to \$31 billion, roughly 11 times the total annual sum spent by the Russian government on

social transfers, or more than 6 times the yearly amount spent on law enforcement and the courts. Annual debt payments on Soviet-era debts actually rise after 2010 and peak in 2015 at \$4 billion.

The bottom line is that a fund such as the one I propose, which reinvests Russian debt payments into Russia, presents an opportunity for ordinary Russians finally to experience some of the benefits of all the Western money that flowed into the Soviet Union and its successors. The Soviets used the money, which came in the form of bilateral export credits, to prop up failing state-run enterprises, with no discernible benefit for Soviet citizens. When the Soviet state finally collapsed, all that remained was the debt.

Finally, my proposal would provide a solution to one of the major sticking points to developing ever-warmer relations between the Kremlin and the West. Post-September 11, the issue of Soviet debts came up in the context of discussions about areas of possible reciprocity, given Russia's strong support for the war on terrorism. The issue surfaced again in bilateral negotiations with the US during the Bush-Putin summit last May. These discussions, however, have gone nowhere.

My "third way" would significantly strengthen mechanisms of cooperation between Russia and its partners in the West. It could lead to greater receptivity on the part of the Russian government in areas of strategic importance (e.g. proliferation of weapons of mass destruction). In the end, it could help usher in a new era of cooperation based on trust and fairness. It would also do away with a nasty legacy of the Cold War, a legacy which remains a heavy burden on the average Russian taxpayer.



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