

# Securitizing Russia's Debt

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Getting Russia's foreign debt right is crucial to Western security. More than IMF programs, cooperatively dismantling nuclear weapons, or meeting terrorist threats, forging the basis for constructive Russian international integration will serve Western (and Russian) national interests. Instead of stubbornly refusing to renegotiate Russia's foreign debt, Western countries should use a deal to create the opportunity for Russia's leadership to get its policies right.

Russian officials say that the country cannot fully pay its foreign debt. They warn of social and economic disaster if the Russian government is forced to meet its obligations. Pensions and wages may go unpaid, social services will fail, and the government will have to give up the strict spending responsibility that has finally put the economy on a sound footing. They claim that at the very least, Russia needs generous rescheduling of the \$48 billion Paris Club debt it owes to Western governments. They are right.

Officials in Western creditor countries warn that Russia must live up to its international financial obligations if it hopes to attract international investment, something a Russian economy in need of \$2 trillion in investment over the next decade cannot do without. They say that with Russian government budget surpluses from last year's high oil prices, and with a growing economy, Russia can afford to meet its payments due this year. They are right, too.

## **Can and Should Russia Pay its Debt Now?**

How can they both be right? Because while the Russian economy looks good now, the next few years do not. Huge government tax and export fee surpluses mean that Russia can well afford the \$3.5 billion it owes in 2001. Russia's economy grew nearly 8% last year, but will slow to 4% this year. Since energy accounts for one quarter of the Russian government's receipts, the surpluses of 2000 were due almost entirely to high global energy prices. Every \$1 fall in the price of a barrel of oil means a \$1 billion fall in Russian government receipts, and oil prices have already fallen over \$12 per barrel since late 2000. Russian capital flight was up 30% in 2000, further starving the country of the resources it needs for robust long-term growth.

Furthermore, the fall in energy and tax receipts will coincide with a huge increase in repayment obligations. In 2003 Russia will owe over \$17 billion to Paris Club creditors.

The overall government budget for 2001 is about \$42 billion: even assuming reasonable growth over the next two years, debt servicing alone would absorb over one-third of all government spending in 2003.

### **Considering Western Interests**

Of course, these are Russia's obligations and the international community has the right to demand Russia meet them. Yet the question is whether forcing Russia to meet those demands is in our own interest. The Russian government has only just managed to settle wage arrears and inter-enterprise debt. These achievements are in Western interests: they contribute to the social stability and economic soundness necessary for Russia's achievement of market economic conditions. Insisting that the Russian government pay its debts at all costs in the next few years could undermine the very conditions we have hoped the Russian economy could achieve on its way to market reform.

This is why Western refusal to renegotiate Russian debt is short-sighted and self-defeating. Right now, while the economy can handle it and the government is looking for a solution--as opposed to the default it faces in two years--Western countries should get an agreement from Russia that insures short-term payment and medium-term relief.

Why should we care whether Russia's economy can survive its debt obligations? Because in today's Russia, economics and security are closely linked. The Russian defense establishment is in the midst of a battle over its allocation of resources. Russia's failed economy produces policies of security-on-the-cheap through reliance on aging Soviet-era nuclear weapons. Russia's new military doctrine relies heavily upon the threat of nuclear use and escalation at all levels to deter potential attack or political coercion, particularly from NATO. Reports this month that Russia may hold tactical nuclear weapons in the Kaliningrad region between Poland and Lithuania may be just the first indication of the kinds of desperation choices a resource-starved country makes. We have security interests in Russia's evolution to a reformed, professional, and substantially smaller conventional military force structure. But this choice will be expensive, far more expensive than relying upon Russia's aging nuclear stockpiles.

Furthermore, a smart debt deal can have positive ripple effects throughout the Russian system. A deal should be based in part on the debt-for-equity swap now the subject of negotiation between Russia and Germany (which holds some 40% of the Paris Club debt). Swapping debt for holdings in Russia's successful industries would have substantial benefits beyond mere debt relief. It would further the goal of entangling Russia's national interests with those of the international community, an achievement that proved so successful in Germany's postwar rehabilitation. Moreover, if the deal required Russia to implement proper standards of corporate governance, international accounting, and transparency, it could help achieve what is most needed to launch future foreign direct investment in the Russian economy. Failing to tackle Russia's bleak investment environment has been the single biggest shortcoming of the Putin leadership's economic reforms to date.

## **Conclusion**

In the end, we do not owe Russia debt forgiveness. But we do owe it to ourselves to encourage the Russian leadership to establish the conditions necessary for a real market in the globalizing economy. In doing so, Russia is likely to focus its national priorities on positive relations with the West, which may make security problems easier to manage in the next few years. A debt solution that goes beyond mere finances to encourage structural economic reforms and international integration would marry strategic vision with economic liberalism in a way appropriate to the realities of globalization.

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