



Executive Memorandum

No. 597

May 18, 1999

REASONS TO OPPOSE NEW IMF CREDITS TO RUSSIA

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On April 29, amid deteriorating relations between the United States and Russia over the bombing of Yugoslavia, International Monetary Fund (IMF) Managing Director Michel Camdessus and Russia's First Deputy Prime Minister, Yuri Maslyukov, announced a preliminary agreement to lend Russia \$4.5 billion over the next 18 months. There are strong reasons to oppose the new bailout for Russia. The chances of these funds' being repaid would be close to nil. The credits would increase the IMF's outstanding liabilities and do little to help the Russia's ailing economy. Moreover, the new credits to Russia would politicize the IMF. The credits are being driven primarily by the Clinton Administration's desire to secure Russia's cooperation in resolving the Kosovo crisis and to prevent an economic collapse in Russia before the parliamentary elections scheduled for December 1999.

Before receiving the loan, Russia's government would need to meet IMF requirements to boost tax collections and overhaul the banking system, and the State Duma (the lower house of Russia's Parliament) would need to pass a new bankruptcy law. In view of the current political turmoil, there is little chance that these conditions will be met. The Communists, the largest faction in the Duma, have already promised to oppose these measures.

NO MORE CREDIT

Although the IMF Executive Board will not make its final decision on the loan until early June, the

United States should voice its opposition *now* to the new credits to Russia. Russia currently owes the West almost \$150 billion, and it has repeatedly defaulted on its loans since devaluing the ruble in August 1998. The IMF refused last December to release a tranche of its \$4.3 billion loan to Russia because the government had failed to put in place the required comprehensive, market-oriented reform package. On April 21, 1999, Russia defaulted yet again, this time on \$1.3 billion in Soviet-era bonds.

Russia claims it needs the new IMF credits to pay at least a portion of the \$17.5 billion in principal and interest due in 1999 on its previous loans. U.S. and IMF officials, however, now admit in private conversations that the new loan application is politicized. Some have depicted the loan as political payoff for Russia's cooperation in finding a solution to the Kosovo crisis. But, according to officials at the U.S. Department of State, the new loan may also be an attempt to prevent Russia from destabilizing before the December 1999 elections to

Produced by
The Kathryn
and Shelby Cullom Davis
International Studies Center

Published by
The Heritage Foundation
214 Massachusetts Ave., N.E.
Washington, D.C.
20002-4999
(202) 546-4400
<http://www.heritage.org>



Parliament and June 2000 election to the Presidency. The decision to extend new credits to Russia for these political reasons is fundamentally wrong, especially because the IMF has always justified granting credits in economic, not political, terms.

House Majority Leader Richard Armey (R-TX) and Representative Jim Saxton (R-NJ), the vice chairman of the Joint Economic Committee, declared in March 1999 their opposition to new loans to Russia and are asking for a full accounting of the tranche the IMF released in August 1998. These concerns are justified. New credits or massive bailouts by multilateral financial organizations alone cannot alleviate Russia's situation or cure its problems.

To alleviate payment pressures, Russia is trying to get its \$100 billion Soviet-era debt forgiven. Despite Russia's bad credit history, First Deputy Prime Minister Maslyukov was expected to ask the members of the Group of Seven (G-7) industrialized countries meeting in Germany in June to forgive 75 percent of the Soviet-era debt and to approve Russia's application for new loans and the rescheduling of its massive debts. Ironically, Mr. Maslyukov, the last chairman of Gosplan, the mammoth Soviet central planning agency, is largely responsible for the accumulation of these debts. Forgiving Russia's debt or pouring more money into Russia to cover its existing payments, however, would create what economists call a moral hazard: Well-connected private investors who went after the early astronomical yields in Russia's stock and bond markets would be bailed out and avoid staggering losses on their risky investments. This then would encourage other investors to take risks they normally would avoid. And it would force Western taxpayers, who earned nothing on the lucrative deals, to pay the costs to cover Russia's debt.

Extending new loans or debt forgiveness are faulty lending practices that would reward Russia for severe economic mismanagement and corruption in its financial bureaucracy. According to Russia's Prosecutor General, Russia's Central Bank

between 1990 and 1998 allegedly siphoned up to \$50 billion, including some IMF funds, into an off-shore entity called the Finance Investment Management Company (FIMACO). Moreover, it allowed insiders to take advantage of the exorbitant yields on the short-term bond market, which it controlled. Although U.S. Secretary of the Treasury Robert Rubin has expressed grave concerns about the FIMACO affair, he apparently backs the IMF on its decision to extend the new credits. It is imperative that U.S. and IMF officials get to the bottom of the FIMACO affair, and that Russia's Central Bank and Treasury become more transparent and accountable.

To prevent another futile bailout to Russia, Congress should request the Clinton Administration to direct the U.S. Executive Director of the IMF to oppose unconditionally any additional assistance to Russia, including loans or debt forgiveness. Members should demand special hearings on the FIMACO affair in the Senate Banking and Foreign Relations Committees and the House Banking and International Relations Committees. And Congress should request that the G-7 countries and the IMF collaborate in hiring an international auditing firm to investigate prior disbursements of Western financial assistance to Russia.

CONCLUSION

Russia's economy faces severe challenges of mismanagement, corruption, the lack of vital business and administrative skills, and long-delayed industrial restructuring. Additional IMF loans, which in the past have failed repeatedly to spur reform, would do nothing to solve these economic problems. And politicizing the credits to secure Russia's cooperation in solving the Kosovo crisis and contribute to Russia's internal political stability would be inappropriate. The IMF would be providing yet another bailout to Russia for the wrong reasons.

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