

FINANCIAL TIMES

COMMENTS & ANALYSIS

Polish model for Russian debt relief

From Prof G. W. Kolodko.

Sir, Russia is clearly unable to repay its debt, but it should not to be allowed to default. Debt forgiveness is the answer. Western advisers, international organisations, foreign governments and investors and the Russians themselves all contributed to the mistakes that have led to Russian's current plight. It is time to share the rotten fruits of ill-advised policies.

It would be much better for foreign creditors and Russian's government to agree quickly on a debt reduction programme. Otherwise, Russia will not be able to service the debt and the west will lose even more. A wisely managed debt reduction plan should be carried forward in three steps.

First, 80 per cent of the debt inherited from the Soviet Union should be written off in an exchange for a programme of market reforms. It should be designed and monitored in a similar way to the recent Polish case. When I was finance minister, I negotiated a deal with the London Club of creditors in September 1994, which reduced Poland's debt by 50 per cent. This allowed the economy to gather momentum and reassured creditors and new investors. Without this reduction Poland could not have made such remarkable progress in recent years. Reform can work only if a country is not burdened by unmanageable debt.

In Russian's case, 50 per cent of the new debt (post-1991) should be swapped for equities in companies awaiting privatisation. Such debt-to-equity swaps would be monitored by special joint body of the International Monetary Fund and the new Russian government. It would be based on strict conditionality, sequencing and international assistance towards institution building.

Third, part of Russia's commercial debt should be exchange for special certificates, maturing over the first quarter of the next century and payable in energy – mainly Russian gas and oil. The restructuring of commercial debt ought to be linked to foreign direct investments in the energy sector and infrastructure. This part of the programme could be executed by the European Bank for Reconstruction and Development.

Russia must be admitted to the World Trade Organisation now, after which further trade liberalisation measures could be worked out. The World Bank should concentrate on overhauling the agriculture sector and alleviating poverty. And, of course, the international community must support the Primakov government.

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