VII External Financial Assistance: The Record and Issues

Eduard Brau[1]

The subject of external financial assistance to the Baltic states, Russia, and other states of the former Soviet Union raises many questions that are of continuing policy and operational interest and that are difficult to do justice to within a reasonably condensed format. This chapter makes an attempt, however, by addressing, in turn, the following issues after a presentation of the record in the two years 1992 and 1993: Is financial assistance appropriately conditioned and timed? Is it adequate in size? Is the right financial assistance being provided? Is the assistance repayable? And, last, what is to be done about the financing problems between the states in the region?

The Record, 1992–93

Since the dissolution of the U.S.S.R. at the end of 1991, three influences have dominated balance of payments developments and financing flows of the Baltic states, Russia, and other states of the former Soviet Union. The first is the assumption by Russia of all external assets and liabilities of the U.S.S.R., with the result that Russia has acquired a large stock of indebtedness on which it has received debt relief from official and commercial bank creditors. It has also inherited sizable claims mainly on developing countries that, for the most part, are not being realized. A further consequence is that all the other states began independence free of external liabilities (and claims)[2] and all assistance to them has taken the form of new credit flows. The second major influence is the differentiation in trade balance positions and financing requirements among these states, principally as a result of the movement of prices of energy products in their mutual trade to world levels. Net energy importers (Ukraine, Belarus, the Baltic states, Armenia, Georgia, the Kyrgyz Republic, Moldova, and Tajikistan) experienced a very sharp terms of trade deterioration and trade deficits, while Russia and Turkmenistan benefited from the change in relative prices. For the most part, however, the trade surpluses of the latter two with other countries in the region have been financed in a disorderly manner by the accumulation of external payments arrears—by Ukraine, Belarus, Georgia, and Armenia, in particular—although they have been settled in an orderly fashion in the Baltic states, since 1993. The third major influence is the dominance in most countries of official financing among net capital inflows and the large size of net private capital outflows, including capital flight. Exceptions have been the Baltic states, where foreign direct investment has been significant and capital flight negligible. These influences are reflected in the estimates presented in Tables 1.8, 7.1, and 7.2 for each of the countries in the region.

As has been clear for some time, the transition of these countries toward market-based economies is going to be long and difficult. All have to adjust to the impact of the disintegration of the Soviet Union; they also have to face a rapidly changing economic environment, confronted with large declines in output, high inflation rates in most instances and balance of payments problems, and eroding living standards. To help alleviate these economic difficulties, external financing was provided generally in support of efforts to stabilize and reform. In addition to the financing provided by the IMF and the World Bank, bilateral credits were extended to Russia mostly from seven major industrial countries, along with a comprehensive debt relief package for Russia by official creditors under the auspices of the Paris Club, and debt deferrals by commercial bank creditors.

Altogether, during 1992–93 the Russian government benefited from external financing estimated at about $61 billion. Although a current account deficit (excluding grants) of nearly $6 billion was recorded in 1992, it is noteworthy that external assistance did not continue to finance a deficit in 1993; rather, it is estimated that Russia generated a surplus of over $2 billion in that year. The external

[1]The author wishes to thank Patrick Lenain and Michael Buchanan for their assistance in the preparation of this chapter. The paper was presented at the Conference on "Marketization of the former Soviet Union: The Banking and Finance Sector," organized by the Adam Smith Institute, London, October 26–27, 1994.

[2]The events leading to this result are well described in Christensen (1994).

Table 7.1. The Baltics, Russia, and Other States of the Former Soviet Union: Financing Requirements, 1992–93, Cumulative
(In millions of U.S. dollars)

	Current Accounts, Excluding Grants	Official Reserves	Amortization to Abroad	Other FSU[1]		Rest of World[2]			Errors and omissions	Total
				Arrears	Correspondent accounts	Commercial banks	Disbursements to abroad	Other short-term		
Armenia	–339	–5	—	—	—	—	—	–72	–174	–590
Azerbaijan	372	–26	—	—	—	–47	–6	—	–738	–445
Belarus	–311	–33	–2	–150	—	—	—	–104	–911	–1,511
Estonia	–106	–435	–12	—	–28	–75	—	–4	–74	–735
Georgia	–637	–2	–9	—	—	–7	—	—	–315	–970
Kazakstan	–1,847	638	—	–657	—	–154	–100	–80	–286	–2,486
Kyrgyz Republic	–363	–17	—	—	—	–17	—	—	–107	–504
Latvia	142	–407	–22	—	–28	–98	—	—	–45	–458
Lithuania	–121	–339	—	—	–41	–24	—	30	–161	–655
Moldova	–169	–77	—	—	—	—	—	2	–64	–308
Russia	–3,400	–6,900	–23,000	–2,500	–6,700	–6,300	–1,300	–5,200	–6,241	–61,541
Tajikistan	–282	–3	—	—	–78	—	—	—	86	–278
Turkmenistan	1,954	–836	—	–1,059	—	—	—	—	–875	–817
Ukraine	–800	–194	–130	—	—	–3,000	—	—	–3,901	–8,025
Uzbekistan	–669	–816	–186	. . .	. . .	. . .	. . .	–14	102	–1,584
Total	–6,576	–9,451	–23,361	–4,361	–6,875	–9,722	–1,406	–5,442	–13,705	–80,905

Source: International Monetary Fund.
[1] Financing for countries of the former Soviet Union includes bilateral loans, arrears and correspondent accounts for the Baltics, Russia, and other states of the former Soviet Union.
[2] Rest of world includes all countries other than the Baltics, Russia, and other states of the former Soviet Union.

Table 7.2. The Baltics, Russia, and Other States of the Former Soviet Union: Ratios of Capital Inflows to GDP, Imports and Per Capita, 1992–93, Cumulative

	GDP 1992 Only[1]	Population End-1992[2]	GDP Per Capita (1992)[2]	Imports (1992–3)	Inflows from Rest of World (1992–93)[3] In percent of 1992 GDP[4]	In percent of 1992–3 imports	Per capita (1992–3)
	(In millions of U.S. dollars)	*(In thousands)*	*(In U.S. dollars)*	*(In millions of U.S. dollars)*			*(In U.S. dollars)*
Armenia	2,718	3,677	739	741	6.7	49.0	161
Azerbaijan	5,432	7,370	737	1,390	3.1	24.5	60
Belarus	30,125	10,296	2,926	6,523	1.0	8.8	147
Estonia	4,289	1,554	2,760	1,488	8.6	49.4	473
Georgia	4,660	5,466	853	1,367	3.2	22.0	177
Kazakstan	28,580	17,038	1,677	9,921	2.1	12.3	146
Kyrgyz Republic	3,655	4,493	816	883	3.5	29.2	112
Latvia	5,081	2,640	1,925	2,124	4.4	20.9	173
Lithuania	4,922	3,756	1,310	3,109	6.3	20.0	174
Moldova	5,637	4,360	1,293	1,448	2.0	15.6	71
Russia	387,476	148,986	2,601	90,067	7.9	68.0	413
Tajikistan	3,793	5,552	683	900	2.0	16.5	50
Turkmenistan	4,744	3,857	1,230	2,602	2.3	8.2	212
Ukraine	94,831	52,126	1,819	28,528	0.8	5.1	154
Uzbekistan	14,875	21,458	693	4,909	2.5	15.4	74
Total	600,828	292,629	1,471	156,000	5.7	44.2	276

Source: International Monetary Fund.
[1]World Bank data; GNP for Turkmenistan and Estonia.
[2]World Bank data.
[3]Rest of world includes all countries other than the Baltics, Russia, and other states of the former Soviet Union.
[4]Average annual inflows in 1992–93 as percent of GDP in 1992.

financing was accompanied by a replenishment of reserves of nearly $7 billion (from insignificant levels at the end of 1991), the granting of financing to other countries of the former Soviet Union and other countries in transition amounting to over $10 billion (including arrears), refinancing of amortization payments to creditors of around $23 billion, refinancing of short-term obligations to banks and repayments to suppliers for a total of $11 billion and the flight of capital as recorded by the "errors and omissions" item of the balance of payments (over $6 billion).

External financial assistance was also provided to the other countries in the context of programs supported by the IMF and World Bank and under the auspices of the European Union and Group of Twenty-Four creditor countries and Consultative Groups organized to pledge additional financial support. Moldova, Kazakstan, and the Kyrgyz Republic benefited from the pledges made in the context of Consultative Groups, and Estonia, Latvia, and Lithuania received European Union and Group of Twenty-Four financing for their programs. Expressed in relation to GDP, the Baltic states received the largest relative amounts of foreign assistance—consistent with their greater commitment to and more rapid progress in reform and stabilization. Ukraine received among the smallest relative amounts of foreign financing—also consistent with the lack of economic reform and stabilization in 1992–93. Kazakstan received pledges of over $1 billion in early 1994 a substantial part was pledged by Japan as financing complementary to the stand-by arrangement of Kazakstan with the IMF and rehabilitation loan from the World Bank.

The economic hardship of many countries was exacerbated by the decline in the large explicit and implicit transfers that they had been receiving from Russia. These included fiscal transfers to the poorer states from the former union budget, which disappeared in late 1991, and the subsidy for net energy importers implicit in the underpricing of energy and raw material exports (relative to world prices), which was reduced significantly as interstate prices for these goods were raised. The effect of these changes was partially alleviated by new financial transfers extended by Russia, mostly by the Central Bank of Russia through its correspondent accounts during 1992 and early 1993, and by a buildup of unpaid claims by Russian and Turkmen enterprises on companies in other countries of the former Soviet Union. Altogether, the recipient countries received about $12 billion during 1992–93.

These disbursements and arrears have led to a rapid accumulation of debt both among states of the former Soviet Union and between them and the rest of the world. Obligations between the states are not documented comprehensively at this time, but arrears to Russia and Turkmenistan on payments for energy deliveries amounted to well over $3 billion in the third quarter of 1994, for example. The trend in debt to the rest of the world is clear from Table 7.3.

Is Financial Assistance Conditioned and Timed Appropriately?

The most important issue concerning official financial assistance is the effectiveness of the conditionality attached to it. If debt-creating official assistance is not conditioned on implementing policies to achieve sustained growth in the recipient economy, its purpose will be lost and its repayment will quickly become a burden. In particular, official financial support over an extended period will be neither appropriate nor available on the scale that helped finance the 1992–93 magnitude of capital flight in many countries in the region. Thus, such assistance makes economic sense only to the extent that it supports policies that lead to sustained growth, minimizes net private capital outflows, and creates conditions for net private inflows and equity capital. Evidence in central and eastern Europe suggests that where a bold reform program is adopted, private capital inflows may begin to pick up substantially within two to three years.

By the criterion of conditionality, the record in 1992–93 may be judged to be favorable, on balance. The clearly favorable evidence is that official support was relatively highest in the countries achieving early success in stabilizing currencies and adopting deep market-oriented reforms (Estonia, Latvia, Lithuania) and relatively lowest in countries at the opposite end of the spectrum (Ukraine, Belarus, Uzbekistan). The mixed evidence comes mainly from Russia; while official support was substantial relative to Russian GDP and relative to other countries, policy success was more uneven and fragile and not sufficient to prevent massive net private capital outflows in 1992–93. Reflecting the less ambitious policy commitment during that period, support for Russia was not as high as it could have been, including from the IMF.

Clearly, judgments, such as the above, raise the issue of whether greater assistance would have created greater policy success (see below). It is also difficult to make fair judgments because much of the official bilateral financial assistance is motivated by considerations not related to support of economic reforms in a direct sense. Humanitarian assistance, political support, financing for denuclearization and a variety of other purposes are of varying importance in each recipient country. The support from multilat-

Table 7.3. The Baltic States, Russia, and Other States of the Former Soviet Union: Debt and Debt Service, 1992–94
(In millions of U.S. dollars)

		External Debt Due: *(Stocks, end of period)* Rest of world[1]	Total Debt Service to Rest of World, Scheduled			
			Interest	Amortization	Total	Percent of exports to rest of world
Armenia	1992	. . .	0.7	—	0.7	5.8
	1993	66.7	1.5	—	1.5	5.1
	(est.) 1994	. . .	. . .	. . .	. . .	. . .
Azerbaijan	1992	—	. . .	. . .	. . .	. . .
	1993	52.0	. . .	. . .	. . .	. . .
	(est.) 1994	239.0	. . .	. . .	. . .	. . .
Belarus	1992	398.0	. . .	. . .	. . .	. . .
	1993	961.0	12.0	2.0	14.0	1.6
	(est.) 1994	1,530.0	. . .	. . .	. . .	. . .
Estonia	1992	64.0	0.1	4.2	4.3	1.8
	1993	143.0	6.6	7.8	16.4	3.5
	(est.) 1994	288.0	. . .	. . .	. . .	. . .
Georgia	1992	. . .	. . .	. . .	. . .	. . .
	1993	178.9	10.0	3.9	13.9	6.2
	(est.) 1994	264.3	. . .	. . .	. . .	. . .
Kazakstan	1992	—	. . .	. . .	. . .	. . .
	1993	1,700.0	12.0	—	12.0	0.8
	(est.) 1994	2,747.0	. . .	. . .	. . .	. . .
Kyrgyz Republic	1992	5.0	. . .	. . .	. . .	. . .
	1993	138.0	0.4	—	0.4	0.3
	(est.) 1994	277.0	. . .	. . .	. . .	. . .
Latvia	1992	69.0	0.2	17.0	17.2	3.9
	1993	241.0	7.0	5.0	12.0	2.6
	(est.) 1994	469.0	. . .	. . .	. . .	. . .
Lithuania	1992	99.0	. . .	. . .	. . .	. . .
	1993	309.0	13.4	—	13.4	1.9
	(est.) 1994	580.0	. . .	. . .	. . .	. . .
Moldova	1992	60.0	. . .	. . .	. . .	. . .
	1993	168.0	2.5	—	2.5	1.4
	(est.) 1994	360.0	. . .	. . .	. . .	. . .
Russia	1992	78,700.0	5,500.0	8,900.0	14,400.0	34.6
	1993	83,700.0	4,900.0	14,700.0	19,600.0	42.3
	(est.) 1994	84,800.0	. . .	. . .	. . .	. . .
Tajikistan	1992	43.2	. . .	. . .	. . .	. . .
	1993	96.7	(4.2)	—	(4.2)	1.3
	(est.) 1994	270.6	(9.4)	(1.7)	(11.1)	2.7
Turkmenistan	1992	. . .	. . .	. . .	. . .	. . .
	1993	143.2	. . .	. . .	. . .	. . .
	(est.) 1994	375.0	. . .	. . .	. . .	. . .
Ukraine	1992	386.0	14.0	—	14.0	0.2
	1993	834.0	57.0	123.0	180.0	2.8
	(est.) 1994	1,428.0	. . .	. . .	. . .	. . .
Uzbekistan	1992	167.0	—	20.0	20.0	2.3
	1993	990.0	—	190.0	190.0	13.2
	(est.) 1994	1,341.0	. . .	. . .	. . .	. . .

Source: IMF, *World Economic Outlook*, May 1994.
[1]Rest of world includes all countries other than the Baltics, Russia, and other states of the former Soviet Union.

eral agencies is more directly correlated with reform progress (Table 7.4).

In countries where conditions were not conducive to private credit inflows or to larger official bilateral support, official export credit agencies have sought to establish security arrangements in the form of offshore escrow accounts. To allow the establishment of these arrangements for the financing of public sector investments, the World Bank and the European Bank for Reconstruction and Development (EBRD) changed their negative pledge clause policies in 1993 to permit waivers of the clause in certain circumstances. To date, waivers have been granted for Kazakstan, the Russian Federation, and Uzbekistan. Escrow-secured lending has not yet become a major element in the financing of these economies largely because of resistance by the debtor country governments to authorize the setting up of these arrangements, though some large deals have recently been concluded on this basis. The export credit agencies of Italy, Japan, and the United States have reached agreements with Russia on financing packages totaling some $7 billion for the oil and gas sectors, to be secured by exports channeled through offshore escrow accounts. Disbursements from these financing packages are expected to be made over several years. Further deals are under discussion.

Escrow-secured financing is problematical. While it has the potential to generate additional foreign exchange if targeted closely toward the rehabilitation of enterprises in the export sectors and the development of new sources of exports, a proliferation of escrow accounts can encumber a large part of foreign exchange earnings. Extensive reliance on escrow-secured financing could reduce access to nonsecuritized lending over an extended period, even with improvements in policies in the recipient country. Such a proliferation would also raise serious concerns for the multilateral institutions, including the Fund, at a time when these institutions are being called on to provide a growing share of the financing for the countries in this region.

As far as the timing of official assistance is concerned, two issues have attracted attention. One is whether a major opportunity for success was missed in Russia by not making available in 1992 a currency stabilization fund of $6 billion to help build confidence in a fixed ruble exchange rate, alongside more substantial balance of payments and budgetary support. The participants in the General Arrangements to Borrow (GAB), the Group of Ten countries, and Switzerland stated in 1992 that they were prepared to make such a fund available to Russia, through the IMF, once fiscal and monetary policies were in prospect that would make feasible and sustainable a pegging of the ruble exchange rate to help bring down high inflation. These conditions did not exist in 1992–93. It is useful to recall that a currency stabilization fund would not make available balance of payments financing, but it would provide resources for strictly temporary intervention by the central bank. The central bank would then be able to support the currency at the chosen exchange rate against speculative pressures, which arise even though monetary and fiscal policies remain broadly appropriate. The offer to make available a currency stabilization fund in support of a bold stabilization program has not been withdrawn.

The other issue concerns the timeliness of disbursements once external assistance is committed. The financing provided by other creditors in support of Fund-supported programs has very often been disbursed more slowly than expected. This has caused tighter-than-needed budgetary and balance of payments conditions under some programs. The delays in disbursements have country-specific causes, but a common element appears to be unfamiliarity between recipient country authorities and creditors, and administrative weaknesses on the part of recipient governments. Experience suggests by now that disbursements will occur considerably slower in many of the countries in this region than is customary elsewhere.

Is Financial Assistance Adequate in Size?

Whether multilateral and bilateral official financing for reform in the transition economies is adequate in size requires answers to political questions and to questions of political economy. Among the political questions is whether the countries of the Organization for Economic Cooperation and Development as a group have made, and are making, public budgetary resources available to aid the reform of the former communist countries in an amount commensurate with the historic opportunity and challenge. Some observers have answered in the negative, citing the resources previously employed in the military confrontation, and the gains to all concerned from the success of transition. Among the political economy questions is whether the available external official resources have allowed individual reforming countries to achieve a tolerable balance between reduced macroeconomic imbalances and temporary exceptional financing of remaining imbalances.

These issues of adequacy may be examined from several perspectives. The approaches popular in the public debate have been to compare the scale of assistance to the Baltic countries, Russia, and other states of the former Soviet Union with that of the Marshall Plan for European Recovery provided by the United States between 1948 and 1951, and to compare actual assistance to Russia with announce-

Table 7.4. Commitments and Disbursement to the Baltics, Russia, and Other States of the Former Soviet Union: 1992–June 30, 1994, Cumulative

				International Monetary Fund				IBRD/IDA				EBRD[1]			
				Commitments		Disbursements		Commitments		Disbursements		Commitments		Disbursements	
	Quota (In millions of U.S. dollars)	Effective Date[2]	Expiration Date	(In millions of U.S. dollars)	(In percent of quota)	(In millions of U.S. dollars)	(In percent of quota)	(In millions of U.S. dollars)	(In percent of quota)	(In millions of U.S. dollars)	(In percent of quota)	(In millions of U.S. dollars)	(In percent of quota)	(In millions of U.S. dollars)	(In percent of quota)
Armenia	98.6							40.0	40.6	4.0	4.1	57.4	58.2	4.1	4.2
Belarus	409.4														
STF		07/28/93		102.3	25.0	102.3	25.0	170.2	41.6	37.4	9.1	145.0	35.4	7.4	1.8
Estonia	67.9							80.4	118.4	26.2	38.6	88.6	130.5	29.0	42.7
SBA (1)		09/16/92	09/15/93	40.7	60.0	40.7	60.0								
SBA (2)		10/27/93	03/26/95	17.0	25.0	3.4	5.0								
STF		10/27/93		17.0	25.0	17.0	25.0								
Georgia	162.1							10.1	6.2	—	—				
Kazakstan	361.4							273.7	75.7	117.3	32.5	120.0	33.2	1.2	0.3
STF (1)		07/23/93		90.3	25.0	90.3	25.0								
STF (2)		01/26/94		90.3	25.0	90.3	25.0								
SBA		01/26/94	05/31/95	180.7	50.0	18.0	5.0								
Kyrgyz Republic	94.2							155.0	164.6	39.3	41.7	9.4	10.0	—	—
STF (1)		05/12/93		23.5	25.0	23.5	25.0								
SBA		05/12/93	04/11/94	39.6	42.0	17.0	18.0								
STF (2)		09/20/93		23.5	25.0	23.5	25.0								
ESAF		07/20/93	07/19/97	103.6	110.0	13.8	14.7								
Latvia	133.6							70.0	52.4	34.9	26.1	52.3	39.1	10.8	8.1
SBA (1)		09/14/92	09/13/93	80.2	60.0	80.2	60.0								
STF (1)		12/15/93		33.4	25.0	33.4	25.0								
SBA (2)		12/15/93	03/14/95	33.4	25.0	14.5	10.8								
STF (2)		07/15/94		33.4	25.0	33.4	25.0								
Lithuania	151.1							86.4	57.2	45.9	30.4	98.5	65.2	48.0	31.8
SBA (1)		10/21/92	09/20/93	83.1	55.0	83.1	55.0								
STF (1)		10/22/93		37.8	25.0	37.8	25.0								
SBA (2)		10/22/93	03/21/95	37.8	25.0	7.6	5.0								
STF (2)		04/08/94		37.8	25.0	37.8	25.0								
Moldova	131.4							86.0	65.4	76.2	58.0	—	—	—	—
CCFF		02/05/93		19.7	15.0	19.7	15.0								
STF (1)		09/16/93		32.9	25.0	32.9	25.0								
STF (2)		12/17/93		32.9	25.0	32.9	25.0								
SBA		12/17/93	03/16/95	75.6	57.5	31.8	24.2								
Russia	6,297.1							2,990.0	47.5	586.7	9.3	950.0	15.1	119.4	1.9
SBA		08/05/92	01/04/93	1,049.7	16.7	1,049.7	1,049.7								
STF (1)		06/30/93		1,574.3	25.0	1,574.3	25.0								
STF (2)		04/20/94		1,574.3	25.0	1,574.3	25.0								
Ukraine	1,456.1							27.0	1.9	0.8	0.1	62.6	4.3	1.9	0.1
Uzbekistan	291.3							21.0	1.4	0.5	—	112.6	7.7	50.3	3.5
Total[3]	9,654.0			5,464.7	56.6	5,082.9	52.7	4,009.8	41.5	969.2	10.0	1,696.4	17.6	272.1	2.8

Note: CCFF = compensatory and contingency financing facility; EBRD = European Bank for Reconstruction and Development; ESAF = enhanced structural adjustment facility; IBRD = International Bank for Reconstruction and Development; IDA = International Development Association; SBA = stand-by arrangement; STF = systemic transformation facility.

[1]EBRD commitments and disbursements are converted at the European currency unit (ECU) rate on June 30, 1994.

[2]The date approved by the IMF's Executive Board.

[3]Ratios of total disbursements and commitments to IMF quota are based only on countries included in the table.

ments made by the Group of Seven. Contrary to widespread impressions, the assistance rendered to Russia and several other states compares favorably with the scale of Marshall Plan aid, even though assistance to Russia was significantly lower than it could have been, or than it can be in support of bold policies in the future, especially from the IMF. A key difference is that Marshall Plan assistance was mainly on grant terms, whereas most assistance to these states is not.

By modern standards, the Marshall Plan was a far-reaching adjustment program that required recipient countries to liberalize their markets, open their economies to trade, restore internal financial stability, and stabilize exchange rates. Each expenditure tranche of the Plan was negotiated with the U.S. authorities, and each dollar of aid was required to be matched by domestic counterpart funds that were to be used for approved purposes, such as retiring public debt or funding specific public investments. The $13 billion provided by the United States in 1948–51, mostly in the form of foodstuffs and raw materials, was equivalent to an annual average of 2½ percent of European GDP and some 1½ percent of U.S. GDP, certainly a large amount to be provided by one country mainly on grant terms.[3] By comparison, official new money inflows in 1992–93 (on an average annual basis) accounted for over 4 percent of 1992 GDP in Russia (nearly 8 percent of GDP inclusive of official debt relief) and for about 6 percent of 1992 GDP in the Baltic states. Because of significant measurement problems concerning the GDP estimates, these comparisons must be used with caution; nevertheless, the scale of official assistance was considerable in the period.

Assistance announced by the governments of the seven major industrial countries for the transformation and stabilization of the Russian economy totaled $55 billion in 1992–93, subject to the fulfillment of conditions necessary for using this assistance. The total new financing actually provided to Russia in 1992–93 fell short of the amount announced by the Group of Seven by $13 billion, because of lower disbursements by the IMF and World Bank (Table 7.5). Official debt relief actually granted amounted to $12.4 billion, and when deferrals of pre-cutoff date maturities of $1.6 billion are considered, total debt relief closely approximates the Group of Seven estimates of $15 billion, and bilateral sources provided almost $3 billion more than the proposed $21 billion. Disbursements by the IMF of $2.5 billion and by other multilateral creditors of only $0.5 billion were substantially below the amounts assumed by the Group of Seven, because the Russian authorities were unable to implement appropriate stabilization and structural reform policies necessary to qualify for greater multilateral support. It should also be noted that in addition to official financing, Russia benefited from $11.5 billion in commercial financing through commercial bank debt-service deferrals.

Another perspective on the question of whether the external assistance to these countries has been adequate in size is to ask whether any of the stabilization programs agreed between countries and the IMF failed for lack of foreign financing. In 1992–93, this does not appear to have been the case. The programs with Estonia, Latvia, and Lithuania received substantial external support and broadly achieved their objectives, albeit under very difficult conditions and with deeper-than-expected declines in output and real incomes. However, as mentioned earlier, delays in the disbursement of balance of payments assistance committed by creditors other than the IMF temporarily made the adjustment somewhat more difficult than it need have been, though some recipient countries also experienced problems in absorbing available assistance in a productive manner. In the Kyrgyz Republic, substantial external support was also available but support under the 1993 stand-by arrangement with the IMF was curtailed when Kyrgyz credit policy was inappropriately eased in late 1993. Substantial external support became again available in conjunction with the ESAF arrangement concluded in July 1994. In Russia, the authorities committed themselves to modest stabilization objectives under programs for 1992 and 1993 supported by a first credit tranche and a first systemic transformation facility purchase, respectively, from the IMF, and by substantial other financing. Progress was made in several areas of systemic reform, but stabilization objectives were not realized. There is no suggestion from any quarter that these programs failed in their stabilization objectives because of nondelivery of committed foreign financing.

Of course, such a statement begs the more interesting question of whether there could have been more decisive success in stabilization and reform in Russia if the commitment of official assistance had been much larger. It will never be possible to settle this counterfactual question satisfactorily. In general, one might expect larger official assistance to create a willingness to undertake tougher anti-inflation policies, as well as providing money that could be used to ease the adjustment burden. However, Russia's policies have usually been determined by other considerations, leaving little room for any adjustments in response to the availability of finance.[4]

[3] See Eichengreen and Uzan (1992).

[4] See Section VIII.

Table 7.5. Financial Assistance to Russia—Announcements and Outcomes

	1992			1993			1992–93		
							Cumulative total		
	$24 billion package[1]	First Credit tranche program	Outcome[2]	$43 billion package[1]	STF program	Preliminary outcome[2]	Packages	Program	Outcomes[2]
	(In billions of U.S. dollars)								
Bilateral creditors and European Union	11.0	12.2	15.8	10.0	10.0	8.1	21.0	22.2	23.9
Grants[3]	...	2.7	3.0	...	3.0	2.9	...	5.7	5.9
Loans	...	9.5	12.8	10.0	7.0	5.2	...	16.5	18.0
Multilateral creditors	1.5	1.0	0.01	5.3	1.3	0.5	5.3	1.3	0.5
World Bank	...	0.8	—	5.0[4]	1.1	0.4	...	1.1	0.4
European Bank for Reconstruction and Development	...	0.2	0.01	0.3[5]	0.2	0.1	...	0.2	0.1
IMF	9.0	1.0	1.0	13.1	3.0	1.5	14.1	4.0	2.5
Systemic transformation facility	...	...	...	3.0	3.0	1.5	3.0	3.0	1.5
Stand-by arrangement	3.0	1.0	1.0	4.1[6]	...	...	5.1	1.0	1.0
Stabilization fund	6.0	...	...	6.0	...	...	6.0	...	...
Debt relief granted	2.5	—	—	15.0	28.5	12.4	15.0	30.1	12.4
Official, bilateral creditors[7]	2.5	...	...	15.0	13.5[8]	12.4	15.0	15.1	12.4
Nonofficial creditors	...	...	...	...	15.0[9]	...	...	15.0	
Amounts pending settlement	...	7.8[10]	14.1	...	...	5.0	...	...	19.1[11]
Official, bilateral creditors	...	1.6	5.4	...	...	–2.7	...	...	2.7
Deferral of pre-cutoff maturities	...	1.6	1.6	...	...	...	...	...	1.6
Arrears	...	...	3.8	...	...	–2.7	...	...	1.1
Nonofficial creditors	...	6.2	8.7	...	...	7.7	...	...	16.4
Deferral from commercial banks and suppliers	...	4.2	5.6	...	...	5.9	...	...	11.5
Arrears	...	1.9	3.1	...	...	1.8	...	...	4.9
Total (excluding debt relief and amounts pending from nonofficial creditors)	24.0	15.8	22.2	43.4	27.8	19.8	55.4	42.6	42.0
Total (including debt relief and amounts pending from nonofficial creditors)	24.0	22.0	30.9	43.4	42.8	27.5	55.4	57.6	58.4

Sources: Russian Federation Ministry of Finance; Vneshekonombank; IMF staff estimates; and various press releases of Group of Seven ministerial packages.

[1]Includes technical assistance.

[2]Covers calendar years and excludes technical assistance.

[3]Includes humanitarian assistance and German aid to rehouse Russian troops.

[4]Includes estimated initial disbursements of $1.1 billion under a $0.6 billion import rehabilitation loan approved in August 1992 and an $0.5 billion oil sector loan approved in June 1993.

[5]New commitments, including $0.5 billion in cofinancing of oil sector loans.

[6]The figure referred to maximum potential commitment beginning from October 1993.

[7]Debt relief is broken down by relief actually granted and deferral of pre-cutoff maturities; to compare with Table 1.3, deferrals must be added to debt relief actually granted.

[8]Excluding $1.6 billion on the principal covered by the 1992 debt deferral from official creditors, which is included in the $15 billion that was part of the $43 billion package.

[9]Included assumed debt relief of $8.7 billion with respect to the 1992 deferral and arrears.

[10]Program assumed that creditors would defer Russia's 61 percent share of the payments of the countries of the former Soviet Union of pre-cutoff principal and interest due in 1992 as well as pre-1991 commercial arrears.

[11]Amounts due to official creditors with respect to 1992 maturities of $5.4 billion are included in debt relief granted in 1993.

In 1992, the needed ambitious policies meriting large-scale IMF support could not be agreed, partly because the ruble area issue could not be settled, and Russia requested Fund support under the first credit tranche.[5] In 1993, and after substantial difficulties in policy implementation in Russia in 1992, it was precisely the absence of the prospect of sufficiently ambitious and credible policy objectives in Russia and several other states that contributed to the development by the IMF in early 1993 of the systemic transformation facility (STF), a facility that permits disbursements before policies are in place that would qualify for support by the IMF's larger and more conditional facilities. The STF is a bridge facility to allow more ambitious policies to be prepared; Russia used it in June 1993 and again in April 1994. In the fall of 1994, the IMF again urged Russia to adopt bold stabilization policies for which significant IMF support would be available.

Another perspective on the issue of the adequacy of financial assistance to states of the former Soviet Union is a forward-looking one. Here, a key challenge is posed by the size of the financing needs of Ukraine.[6] Now that coherent and determined policies are beginning to be adopted—after the period of disastrous economic drift since 1992—relatively large external financing requirements will need to be met initially by official assistance and regularization of accumulated payments arrears in order to allow Ukraine to escape from continued chaotic economic contraction. As soon as appropriate economic programs are ready for implementation, the same challenge will be faced in Belarus, and also in Armenia, Georgia, and to some extent Azerbaijan, which, additionally, have to cope with the aftermath of protracted military and civil conflicts.

A final perspective on the adequacy of financial assistance is provided by an assessment of net private capital flows to Russia and neighboring transition economies. As noted earlier, the record in 1992–93 in Russia and other countries in the region other than the Baltics is poor. It is clear that conditions must be created that allow the transition economies to raise domestic savings and to achieve the transfer of foreign savings and of technology essential to the public and private investment necessary for growth. The adequacy of foreign assistance should to a large extent be judged by the extent to which countries using official assistance create such conditions and achieve access to private foreign financing. Foreign assistance should not only be judged by the size of official flows, though a critical mass of assistance is, of course, important when reforms are begun and sizable official support can foster the needed policies. The conditions necessary to attract sizable private financing include reasonable stability of the currency, modernized commercial banking systems, a liberal exchange and trade and foreign investment regime, and greater predictability in the enforcement of private contracts. A key purpose of official financial assistance must be to bring down decisively and on a sustained basis the noncommercial risks for committing external and domestic private capital.

Such conditions are increasingly being established in the countries of central and eastern Europe and have contributed to gross private inflows of private foreign direct investment to the region of some $17 billion in 1991–93, as against a mere $3.6 billion in the Baltics, Russia, and other countries of the former Soviet Union in 1992–93. To be sure, reforms started earlier in central and eastern Europe and the difficulties facing the Baltics, Russia, and other countries of the former Soviet Union are more extensive, but so are the opportunities—especially in Russia with its vast resource base, technically skilled workforce, and low wage rates.

Is Right Financial Assistance Being Provided?

Balance of payments financing in the form of official and commercial debt relief to Russia and quick disbursing support to Russia and other countries from the IMF and the World Bank has played an important role, alongside the provision of export credits from major industrial countries. While the provision of balance of payments financing is appropriate, the very low project and sectoral financing disbursements to date are noteworthy, including those from multilateral development banks. This mainly reflects the natural delay in building a project pipeline and developing sectoral policies in the unsettled conditions in many countries and the need for careful preparation. Indeed, a significant increase in project and sectoral financing commitments by multilateral banks occurred in late 1994 in several states of the region. It is essential that this trend accelerate and spread to all these countries as structural reforms deepen and need impetus from, and support by, external financing and know-how. Unfortunately, in 1992–93, manifold administrative problems in Russia obstructed the International Bank for Recon-

[5] Purchases under the first credit tranche raised the Fund's holdings of the member's currency in the credit tranches to not more than 25 percent of quota. Subsequent purchases in three successive tranches, each equivalent to 25 percent of quota, are known as *upper credit tranches*. Conditionality rises through the tranches, and the Fund adopts a liberal attitude in making resources available in the first credit tranche. For more information on this and the Fund's facilities, see IMF (1995).

[6] The reader should keep in mind that this paper was completed in October 1994 and incorporates information until that time. *Eds.*

struction and Development's (IBRD) proceeding with project preparation and disbursements in a timely manner.

The provision of official financing to the emerging private sectors in the Baltics, Russia, and other countries of the former Soviet Union by the IBRD, the EBRD, and the International Finance Corporation (IFC) has begun and should, over time, assume a large share of total official financing to the countries in the region.

Concerning the terms on which financing is provided, the large differences in the debt-carrying capacities among these countries require careful creditor practices. In 1992 and 1993, short-maturity financing on commercial terms was provided from some sources, including the European Union (EU), to the poorest among the countries of the former Soviet Union. This inappropriate activity has been coming under somewhat better control through the limits placed on nonconcessional external borrowing under IMF-supported programs. Among the countries of the former Soviet Union, Armenia, Georgia, the Kyrgyz Republic, and Tajikistan are eligible for concessional International Development Association (IDA) funds from the World Bank, and for concessional enhanced structural adjustment facility (ESAF) resources from the IMF.[7] In the future, this financing from multilateral sources will need to be matched by bilateral concessional financing and grants.

In general, financing should be provided on terms appropriate to the circumstance of a lengthy period of transition during which the balance of payments positions would be vulnerable to shocks. On the part of the IMF, this means that its financing, whenever possible, should be provided on terms requiring repayment of loans over a longer period than the three-to-five-year repayment of stand-by resources, particularly in view of the decision of the Executive Board in October 1994 to increase maximum annual access to regular Fund resources to 100 percent of quota. Repayment periods of four to ten years apply to purchases under the STF and under the extended Fund facility (EFF). A three-year extended arrangement was agreed with Lithuania to begin in October 1994, and other countries have expressed an interest in putting in place policies suitable for support under the EFF.

For bilateral official assistance, tied export credits are the main vehicle of nonconcessional financing and, given the specific features of this financing source, need to be handled with care. Such credits are tied to new imports of specific products and are expected to be repaid quite quickly. This suggests that they should not be relied on as a major source of net financing for prolonged periods. Countries that have used export credit for the bulk of their financing needs have often run into debt- servicing difficulties; of the 20 largest recipients of exports credits through 1992, only 6 have avoided substantial payments arrears or recent debt rescheduling.[8]

These limitations of export credit financing underscore the urgency of diversifying financing to tap nonofficial sources; they also caused Russia to seek to curtail and scrutinize carefully the contracting of tied export credits in 1994 and beyond. There are instances, including in some of the smaller countries in the region, where official credits have been extended on relatively short maturities and with bullet repayments that will be difficult for borrowers to honor; indeed, in one or two cases, they may well be impossible to honor. Similarly, there are a number of cases of tied export credit financing for purposes that cannot be regarded as contributing to sound economic restructuring and productivity enhancement.

A different aspect of diversification of financing sources is diversification among providers of official financing. In the near term, the share of financing from multilateral sources is bound to rise significantly as IMF and World Bank support for economic programs increases, both in countries already receiving multilateral assistance and in new ones, including Ukraine. Bilateral donors and creditors, however, will find it increasingly difficult to maintain the scale of their financing provided in 1992 and 1993 without changes in burden sharing among them. In the period from September 1990 to mid-1994, new financing commitments from the EU, its member states, and other European countries accounted for two thirds of all bilateral commitments to the Baltics, Russia, and other states of the former Soviet Union; of the European commitments in turn, more than two thirds was accounted for by Germany. The share of the EU and its member states is estimated at 49 percent of humanitarian grants, 42 percent of technical assistance, 59 percent of credits and credit guarantees, and 90 percent of assistance in connection with the withdrawal of military forces.

As mentioned, much financing has been extended for balance of payments purposes. Some observers have, in addition, called for larger amounts of direct budgetary financing. All balance of payments financing extends an economy's absorption possibilities, including that of the central government. The governments of many countries of the former Soviet Union receive official external financing directly benefiting the budget, as well as higher recourse to domestic credit financing

[7] Azerbaijan became eligible for using ESAF resources from May, 1995, after this paper was written, *Eds*.

[8] See Kuhn, Horvath, and Jarvis (1995).

made possible by the balance of payments support. Beyond this, the issue of budget support and, more generally, support of a political nature is one for bilateral creditors and could obviously be helpful if available for important expenditures such as on social safety nets and retraining, enterprise restructuring, infrastructure improvement, and others. Such external financing of budgetary expenditures helps the government achieve inflation objectives with less curtailment of those expenditures that can foster quick economic transition as may be seen from the appendix. However, the structure of budget expenditures must be conducive to reform and the need for budgetary support must be temporary, such as relating to enterprise restructuring. By contrast, support for financing subsidies and credits to existing enterprises, for example, without incentives to change, is usually counterproductive.

A large amount of financing is in support of technical assistance provided principally by the European Union, the United States, Germany, other governments, and the World Bank, EBRD, OECD, the United Nations Development Program (UNDP), and the IMF, a share of whose technical assistance is financed by grants from Japan. It is estimated that commitments for technical assistance financing in all fields amounted to as much as $5 billion by late 1994. When well coordinated by providers and effectively implemented by the recipient countries, this assistance has very high benefits to the transition economies.

Is Assistance Repayable?

Except in Russia, external debt and debt-service obligations to countries other than those of the former Soviet Union are low at present relative to GDP or exports (Table 7.3). From this perspective, most countries appeared to pose limited repayment risk at this stage. The uptake of debt, however, has already risen sharply in some of these countries that began independence in 1992 with no debt obligations. Already, particularly acute balance of payments difficulties in countries such as Georgia and Ukraine will make the servicing of post-1992 debt, as scheduled, not possible, in part as a result of lumpy repayments falling due on short maturity credits. In these countries, financing was provided on inappropriate terms and was not in step with progress in reform, and special help will be needed on repayments of credits to the OECD area as well as regularizing arrears with other states in the region (see below) when programs of stabilization and reform are launched.

Medium-term balance of payments projections prepared in conjunction with Fund-supported adjustment programs suggest difficult balance of payments positions in the next few years for many countries in the region and in particular for the net energy importers—other than the Baltic states, where the outlook is more favorable as a result of the rapid economic transition. The projections invariably suggest that two factors will be critical in containing the difficulties to manageable proportions. The first is the success of policies in stabilizing monetary conditions in the countries concerned, which should help reverse capital flight and start sustained inflows of private financing. The second critical factor is the success of policies in switching exports to world markets and increasing domestic supply capacity. The experience of central and eastern Europe and the Baltic states suggests that dramatic gains in export earnings are possible. However, with a relatively rapid accumulation of debt obligations in most net energy-importing countries, their balance of payments prospects will remain vulnerable to adverse developments in the pricing of energy imports and other shocks, notwithstanding the large increase in energy efficiency that should occur.

The rapid buildup in debt obligations in some countries is occurring in conditions in which debt monitoring and management systems are unsatisfactory. This also accounts for a relatively common tendency among countries of the region for debt-servicing payments not to be made on time—even where debt obligations are low in relative and absolute amounts—with obvious consequences for perceptions of creditworthiness. It is important that the management of external credit operations be strengthened quickly with technical assistance from the World Bank and the UNDP.

What Is to Be Done About Financing Problems Between States in the Region?

As noted earlier, Russia and Turkmenistan have been accumulating large unpaid current net claims on several countries in the region, notably Ukraine and Belarus, largely from deliveries of energy supplies. it is estimated that arrears on energy payments to Russia and Turkmenistan amounted to a total of $2.7 billion for Ukraine and $0.5 billion for Belarus by the third quarter of 1994. Periodically, mutual claims are offset and the net amounts are consolidated into state credits from Russia and Turkmenistan. Typically, however, the debtors promptly fall into arrears again, given their macroeconomic imbalances. These interstate arrears are a threat to the development of normal trade and financial relations among these countries and give rise to other frictions.[9] Moreover, unless the arrears problem is

[9]See also Section IV.

solved, it could complicate attempts to arrange programs with the IMF and to gain necessary financing support from other creditors.

The main types of arrears for which these governments must take responsibility are those relating to nonsettlement of payments due under intergovernmental agreements (credits and intergovernmental procurement) and under intergovernmental trade agreements carried out by state enterprises, notably in energy. To the extent that arrears are being built up owing to restrictions on access to foreign exchange, the governments will also have to eliminate those restrictions. In addition, enterprises not trading under intergovernmental agreements may incur arrears due to their own illiquidity, insolvency, or outright refusal to pay; these arrears, however, are part of the broader problem of interenterprise arrears that exist in many of these countries and they will have to be resolved by enterprises themselves.

IMF staff have offered to extend their good offices, if requested by all parties, to help them resolve questions over the magnitude of interstate arrears and to assist in other ways. IMF-supported programs with countries in interstate arrears require that existing arrears be regularized on terms that are sustainable and that new arrears due to the actions of the authorities be avoided. This will entail, in addition to the debtor's stabilization and adjustment effort, new balance of payments financing mobilized in the context of Consultative Groups. Regional creditors such as Russia and Turkmenistan would participate in such new financing, along with OECD countries and multilateral institutions. Any renewed failure by debtors to honor the new payments schedules will endanger the prospects of stabilizing their economies and mobilizing external financing. At the same time, all governments should take steps to remove themselves as quickly as possible from negotiating energy and other product deliveries in order to avoid the multiple moral hazards present in current arrangements.

Conclusion

Of the differentiated and complex external financing issues facing the Baltics, Russia, and other countries of the former Soviet Union, four concluding remarks may be made. First, bilateral and multilateral financing that is not linked to rapid stabilization and reform is inappropriate; this applies to all nonhumanitarian official bilateral assistance that is not extended on grant terms, and especially to export credit support. Second, the size of official support available to Russia and other reforming states appears not so far to have constrained reform success, but raising sufficient official support for countries only now beginning stabilization and reform will be a significant challenge. Third, the adequacy of bilateral and multilateral external assistance is critically affected by the extent to which that assistance supports policies that curtail the large net private capital outflows from the region that occurred in 1992–93 and, instead, establishes conditions for sustained private capital inflows. Finally, financial relations between many of these states remain disorderly and need to be normalized as soon as possible.

Appendix

How External Financing Helps Economies in Transition

From the balance of payments identity, and expressing the current account balance in terms of savings and investment balances:

$$KA = \Delta R - GS - (PS - PI) = \Delta R + GD + (PI - PS),$$

where KA denotes the external capital account balance, ΔR the change in official international reserves (excluding foreign borrowing by the central bank), GS the fiscal balance, GD the fiscal deficit, PS private savings, and PI private investment. As the fiscal deficit must be financed through net credit from the banking system (ΔDC_g), net foreign borrowing (FB_g), or net domestic sales of government bonds (GB), and as the capital account balance may be written as the sum of net foreign government borrowing, net foreign private borrowing (FB_p), and net foreign lending to the central bank (FB_c), the above equation may be rewritten as:

$$FB_g + FB_p + FB_c = \Delta R + (\Delta DC_g + FB_g + GB) + (PI - PS).$$

It is obvious that external financing to the budget can be used to finance a larger fiscal deficit without recourse to higher domestic bank credit (with its inflationary consequences), and that external private financing would allow greater noninflationary spending by the private sector. Alternatively, for a given fiscal deficit, external financing to the budget can be used to reduce bank credit to government and increase the international reserves.

Balance of payments support to the central bank also allows for higher noninflationary government expenditures since, from the following depiction of the operations of the banking system, it can be seen that it allows for higher credit to the government from the banking system without an increase in monetary expansion:

$$\Delta R + \Delta DC_g = FB_c + \Delta M,$$

where ΔM equals the change in monetary liabilities of the banking system.

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