The Moscow Times
30 YEARS
INDEPENDENT NEWS FROM RUSSIA

Like It or Not, Russia Is a Global Financial Power

By Martin Gilman

April 08, 2013

Sometimes a slight, even if it results from an error of omission, can have unintended consequences. A recent example of a slight to Russia occurred three weeks ago during a late Saturday night marathon negotiations between the troika — the European Union, European Central Bank and International Monetary Fund — and the president of Cyprus on March 16-17.

The Cypriot economy had thrived in the past decade on an outsized banking sector and tourism, both of which appealed to Russians in particular. Joining the eurozone in 2008, Cyprus was considered as a safe, efficient low-tax location for financial operations by those whose own countries were viewed as being inherently riskier and more costly. But its two big banks became insolvent after huge losses on their holdings of Greek sovereign bonds in March 2012. The writing has been on the wall ever since.

Going into that Saturday night negotiations in Brussels over a bailout program for Cyprus, the Germans made it clear that the troika could provide no more than 10 billion euros ($13 billion). The Cypriots would have to find the rest. In an effort to prevent the liquidation of the country's two major banks and hence the destruction of the economy's basic business model, they proposed the stunning idea of taxing all depositors in all banks, even insured deposits and even in banks which had nothing to do with Greek debt. Nobody said no, so the troika went along with the proposal.

Waking up to the news about the deal that was stuck in the wee hours on March 17, the Russians were incredulous. President Vladimir Putin reacted immediately, calling the proposed deal "unfair, unprofessional and dangerous."

It's easy to appreciate why Russians, in particular, felt indignant. Moody's estimated that Russian deposits in Cypriot banks were worth about $31 billion, out of about $90 billion in total at the end of January, according to the Central Bank of Cyprus.

Despite their obvious and direct interest in the outcome, the Russians were not consulted by the EU authorities. The Russian position had been to rely upon the IMF as the honest broker in the discussions to represent its interests as a creditor. IMF policies should have ensured that the debt problems of a country's banks should force losses on bank creditors, not the sovereign — and certainly not on the insured depositors.

Interestingly it was not just Putin who was irate. The next day, the Financial Times in an editorial noted that the deal was "destabilizing as well as morally unconscionable."

Of course, the IMF should have never allowed itself to be cornered in the negotiations. This may have been the price it paid when it appointed a person with a lot of politically savvy but little economic background to head the organization. In any case, the Cypriot parliament obliged by rejecting the deal, paving the way for the less bad outcome of sacrificing the country's two big banks, as the IMF and Russian government had originally sought.

This recent flap over Cyprus is hardly the first time that Russia, the largest external creditor of a country that was hit by a debt crisis, was excluded from the negotiations by the other minor creditors. It invites a comparison to the mid-1990s when Western official creditors grouped in the Paris Club dictated debt deals with countries like Bulgaria, Vietnam and Algeria, while Russia, having inherited the claims of the former Soviet Union, was by far the largest single creditor. Its interests were treated cavalierly, and it was assumed to accept the terms agreed by the others. Finally in the case of Cambodia in 1995, the Russians finally drew a line in the sand, and the IMF had to recognize the equal validity of Russian claims and insist that Russia be respected by the Paris Club. Russia finally joined the Paris Club as a creditor in 1997.

Ironically, the slight by the Europeans in dismissing the relevance of Russia as a creditor in the case of Cyprus is increasingly at odds with the reality of Russia's status as one of the world's largest creditor countries. After all, immediately after the Cypriot parliament refused to ratify the Saturday night deal and everyone seemed to have egg on their faces, Russia was seen as the only potential rich sugar daddy that might help. That is why Cypriot Finance Minister Michael Sarris showed up in Moscow within days, with begging bowl in hand.

Ignoring Russia as a major creditor country has a long history, no doubt associated with lingering Cold War prejudices, the recent memory of Russia's own default in 1998, and political inertia where inconvenient new facts that might disturb the status quo are brushed aside as long as possible.

In fact, in financial terms, Russia shares many of the characteristics of northern European creditor countries such as high savings, current account surpluses and large net creditor positions. Moreover, Russia has much lower debt. So it is ironic that the lingering image of Russia is one more commonly associated with the southern periphery countries of the eurozone.

Russia's status as one of the world's largest creditors, with the third-largest external reserves and extensive private and public ownership of foreign securities, needs to be acknowledged. The world may not be comfortable with the idea, but Russia as a financial power cannot be ignored. Even if Russia's claims on Cyprus were mostly held privately, the Russian sovereign has a stake in ensuring that such episodes are not repeated.

So it was not surprising that at last month's BRICS summit in South Africa, the leaders launched a development bank pledging $10 billion each as initial capital, outside the framework of the Bretton Woods institutions. If Russia and other like-minded new creditors cannot reshape the balance of power in existing global institutions such as the IMF and World Bank, then they have the capability to create their own. Political will has been lacking so far, but Europe's slight could yet boomerang.

Even then, Russia is going to have a long uphill struggle with engrained world views to get a little respect. But money talks. As the Russian government and private sector increase their net creditor positions, it will become harder to ignore.

Martin Gilman, a former senior representative of the International Monetary Fund in Russia, is a professor at the Higher School of Economics.

Original url:
https://www.themoscowtimes.com/2013/04/08/like-it-or-not-russia-is-a-global-financial-power-a23103