

LIVING ON BORROWED MONEY

Moscow is in debt, that's why they're well dressed

Churchill said that the prestige of a state is defined by how much it can allow itself to borrow. These words are applicable to cities as well. Not only has Moscow borrowed half a billion, the amount that is not possible for every country, but it repaid the whole of it by the due date (30th of May, 2000). Chairman of the Committee for Municipal Debt, Securities and Capital Market Development of the Moscow Government, Sergey PAKHOMOV, discusses the problems of foreign debt

Mr Pakhomov, financiers feel that after August 1998, Russia experienced a crisis of confidence in the state as a borrower. Not only that, but it was the collapse of an economic model based on borrowing. Today, all hopes are with the investment model. Do you agree?

There are no clear cut models in real life. Regardless of a specific situation and country, debt is the greatest achievement of civilization. This is the wheel that turns around the economy.

On its own the debt is a neutral issue. For it to have a use, you have to go through the banality of observing a few simple rules: borrowed funds should be directed to investment in the manufacturing sector and towards projects that secure the growth of budget revenues, and which return a profit on the investment. In an ideal situation, loans should be taken over a minimum period of 7-10 years, the cost, and other conditions should not be crushing or one-sided, and the amount should be limited according to the capabilities of the budget. This is the model-1 don't even know whether it is borrowing based or investment - that we applied in Moscow despite all the negative circumstances.

Is it not possible to be debt-free? Like in a good family: not wearing silks, but more simply-living within your means.

Possible, but what for? Somebody else's money should work within the country. Free capital is looking for investment opportunities all over the world. We don't borrow, somebody else will take this money that could be ours. All developed countries are in debt. Berlin's debt, for example, is 80 billion marks, and is continuing to grow. That aside, you can see how the city keeps changing for the better. It will be unrecognizable a year or two from now. Moscow has also been transformed in the same way over this last decade, and much of that is due to loans. In 1997-98, the city attracted around \$1.5 billion of foreign capital in investment. This money came from abroad just through borrowing.

Debt is a powerful management tool. And on top of this, it is a thorny political and economic issue for Russia. A lot depends on how it is resolved: will external debt be a pain in the neck because it deprives a country of its independence and threatens its sovereignty, or does it find its own strength again by repaying the debt?

How was Moscow indebted? Because, unlike the federal budget, the Moscow budget did not have any debts before.

During 1992-96, Moscow's borrowing was occasional-Russian banks made short-term credits to individual departments in the capital's administration. The real accrual of debts began in February 1997, when the Moscow government, with the approval of the City Duma began to use loans to develop the economy, modernize the city's services, and the social infrastructure.

It has been said that Luzhkov ordered that Moscow's debts should be kept a secret. Or is this just a rumor?

Utter nonsense. The volume of debt and limitations on new borrowing are regularly published under the law on the Moscow budget. In 2000, this amount came to around 23 billion rubles for the domestic debt, and \$1.75 billion for the foreign debt. Luzhkov could not have done that-it was not in his power or in his nature to do that. That order would have been contrary to Russian law, and besides, creditors and investors would have stopped dealing with us, particularly from abroad where they require maximum transparency in financial matters.

On November 1, 1999 the debt carried by the Committee was \$920 million in the form of eurobonds, 1.6 billion rubles -in domestic bonds, \$390 million in currency credits from Russian and foreign banks, and 7.6 billion rubles in credits from Russian banks. On May 10, 2000, it was reduced: \$600 million in eurobonds, \$420.7 million in currency credits from Russian and foreign banks, 2.8 billion rubles in domestic bonds, and 7.5 billion rubles in bank credits. In June, it came down further by \$180 million. The internal debt hardly grew at all.

What guarantees can Moscow give against debt?

Our loans and credits have no security except for the guarantee of the budget. That is how the rest of the world works. From the very beginning, Moscow borrowed money against its general obligations. The only guarantee is budget revenues and city property. Now we even have a legal system in place, which can block placement of new debt with extra or additional collateral or lien on property.

Is the credit risk not too high in this case? What if the debt exceeds the total of its security, i.e. the size of municipal budget?

Moscow's debt has a long way to go to its permissible maximum set by the Budget Code. In 2000 revenues of 138 billion rubles are expected, total debt together with guarantees and underwriting as of the end of 1999 was 69 billion rubles, or less than half of that sum.

How will the debts be repaid-do you have a programme in mind?

Of course. The key is the professional management of Moscow's debt. In all the time the Committee has existed, there has not once been an incident where we put too much trust in someone for solving our problems. It is because of the Committee's working apparatus-the Financial Agency of Moscow, in which professionals of the highest level work-that we were able to reduce the debt and significantly relieve the problems we had with simultaneous maturities in May. Our largest debt of \$500 million was reduced to \$180 million through offsetting, buying back bonds from the market, and by following the standard procedure for taking them out of circulation.

Don't take this as boasting, but in the history of eurobonds, there has not been a case where a sub-sovereign issuer has delivered on an debt of that size in such a crisis situation exclusively by its own efforts, i.e. without the refinancing or support from the Federation. And debts like these can bankrupt an entire country-sad examples of this are Pakistan, Equador, and Ukraine.

Many have said that this operation was shining, but some said that it was not completely ethical: the Committee apparently manipulated the market and used insiders in companies controlled by the city-like Bank of Moscow and Troika-Dialog. What do you think?

I will reiterate that the operation to buy back the debt was carried out only by the Committee and MosFinAgency. We did not use any insiders. Under the terms and conditions of our eurobonds, we were able at any time to buy back bonds at any price. There are two possible routes under these conditions: either you can hold on to the bonds you have bought back, and not release them onto the market, or you can stick to the procedure and cancel these bonds -which is what we did.

The market is an open field. When the crash happened, the yield on our bonds was 150-160% p.a. We were in no way responsible for this crash. We serviced our debt by the due date and in full. We spoke of the difficulties, but never about bankruptcy or non-payment. The market, unfortunately, decided otherwise, and our bonds drifted from 'quality' investors to speculative, risky ones.

I believe that our conduct was correct. Investors who did not want to take a risk were given the opportunity to exit our debt, which strengthened confidence in Moscow, and was reflected in the prices. The buy back reached its peak in September-October 1999, when the price for bonds was still at 60-80% of the nominal price, and in March-April 2000, when it was 97-100%. Therefore, any talk of manipulating the market is sheer rubbish. It comes from those who not so long ago were gushing with predictions of Moscow's imminent bankruptcy. Now that nothing terrible has happened, they are annoyed. But still feel like saying something about the issue.

How are the borrowed funds being used, and how do ordinary Muscovites benefit from it?

All the funds were directed to the city's investment programme: building municipal housing, moving people out of the five-storey buildings, constructing new schools, hospitals, and engineering networks and transport links. Amongst these are the New Olympic village; roofing the Luzhniki stadium, which has allowed the stadium to receive a higher rating of 5 stars, making it possible to host international matches and championships; Gostiny Dvor with over 250,000 sq. m of roofed space - making it probably the biggest entertainment and exhibition center in Europe. In all, the Committee has directed over \$2.8 billion of borrowed funds to the municipal economy. \$766 million of this was returned to investors as revenue coming in from commercial projects.

The State Duma has drafted a bill prohibiting international borrowing by regions. How does this ban affect Moscow?

It only takes a few minutes to make a mistake, but it takes decades to correct one. The ban will bring much damage to the regions and to the country as a whole. It will inevitably have to be annulled or redesigned in keeping with our traditions.

Russia is experiencing an acute capital deficit. Ruble loans are expensive and short-term. Development projects cannot be financed by these loans. There are no local investors who could give us rubles for even \$1 billion over 7-10 years at 10-12%. But if there will be some -the need for foreign loans is slipping away. At the moment, they are inexpensive, and the time limits and volume are immeasurably large. They aid speedy development and overcoming stagnation, and this is a necessity of life that will break the ban.

It is naive to suppose that our loans are only working for Moscow. They include a mechanism for stimulating the economy of the whole country. In 1999, the city contributed over 30% of all federal tax revenues.

It will be worse for Moscow - everyone else will feel the effects, including the national budget, which will receive fewer taxes.

The debts need to be divided strictly. The Federal government will not under any circumstances take on any of the debts from the regions, even the foreign ones. Foreign investors should take this into account, as well as the regional risk.

Written on the first page of the documents to our eurobonds is a statement to the effect that the Russian government does not give any guarantees on Moscow's loans and bears no responsibility for them. We especially underline for our creditors that the Moscow debt is ours alone, and no one else's. We have and will manage our debts ourselves. And that is how it should be. And the markets define everything, and eliminate those who are insolvent.

Those who back the bill say that the regions cannot cope with the loans - there is no audit and control system. Do you agree?

I cannot answer for other regions, but the Law On Debt Obligations has been active in Moscow since 1997. The procedure for incurring a debt is one that is developed and strictly observed. There is a municipal register of Moscow debts-the debt book. The debt is followed closely and is audited.

Putin called Kasyanov's negotiations with the London Club a success, but many called it a failure. What is your opinion?

There is no other way out but serious negotiations with creditors. You either have to pay up or agree on the terms. You cannot refuse to pay-that leads to isolation. The state of Russian economy and government finances do not allow for the debt to be repaid in full. Russia has fiscal difficulties: the state has a low income, and the federal budget is small.

Long-term problems will only be resolved when domestic capital begins to return in Russia, the black economy disappears and taxes are paid in the proper way. And this can only be a consequence of far-reaching economic reforms, not prohibitions. For the time being we need to reach an agreement, grit our teeth, and make a stand. If we manage in this way to lower the burden of debt, then we will have succeeded.

Moscow knows just how heavy the burden of debt can be during a period of crisis. The city pays its debts in full and by the due date, but right now it requires a concerted effort and sacrifices to be made.

MARINA UVAROVA