U.S.-Russian competition in international debt markets

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The last decade has seen a steady increase in geopolitical competition between Russia and the United States. While it has been most clearly seen in Russia's 2014 annexation of Crimea and invasion of Ukraine following the Euromaidan Revolution, increasing attention is being drawn to such competition in cyberspace and other fields. Another area of competition is geo-economic, "the use of economic instruments to promote and defend national interests, and to produce beneficial geopolitical results, and the effects of other nations' economic actions on a country's geopolitical goals.[1]" I

In the case of Russian-U.S. economic competition one often features typical security studies. For example, sanctions, and their threatened application, have come to be used as a deterrent.[2] Sanctions are not driven by market forces, but rather by geopolitical competition. This is by no means limited to sanctions - trade-offs between political interests and potential investment returns are to be found in nearly every area where U.S. and Russian interests collide, such as the geopolitical conflicts over Ukraine and Venezuela.

Russian-U.S. geo-economic competition is often most clearly observable in international debt markets. This is perhaps unsurprising, after all, there has certainly long been a relationship between debt and conflict: in 2402 BC, the ruler of the Mesopotamian city of Lagash justified one of the first recorded organized conflicts by calculating that the city of Umma owed Lagash a sum Umma could never hope to pay.[3] Today, examining how Moscow and Washington compete in debt markets represents not only a key tactic in their geopolitical competition, but sheds light on their broader geopolitical strategies

Debt Financing Sanctions

Sanctions are the area of geo-economics that have received by far the most attention. They are also the area in which Russian-U.S. competition is most evident, namely through the use of the "sectoral sanctions" that were first introduced in the immediate aftermath of Russia's annexation of Crimea. Their name derives from the fact that they aimed to restrict financing for firms in Russia's financial, energy, and defense sectors.

Unlike the main U.S. sanctions designation, the specifically designated nationals (SDN) list, inclusion on the sectoral sanctions identification (SSI) list, does not bar entities named from doing business with U.S. entities. But those firms listed as subject to SSI's Directives 1, 2, and 3 are all but banned from receiving long term Western financing. For example, Russia's state oil firm Rosneft is subject to Directive 2 and has been largely cut off from Western financial markets since its 2014 listing whereas Gazprom, which is not subject to Directive 2, has continued to issue substantial debt in these markets. but the threat remains that with a stroke of the pen, the U.S. Treasury could bar it from doing so.

These sanctions also played a role in weakening the Russian ruble and the subsequent spike in Russia's baseline interest rate in late 2014, demonstrating how even tailored debt financing sanctions can have substantial macroeconomic impacts.[4] Additionally, it is notable that the sectoral sanctions have been tightened on a number of occasions since they were issued, at least in part to reign in Russia's actions in eastern Ukraine. While the jury is out on whether this was successful, it is notable that most recent Congressional proposals for further sanctions include further restrictions on Russia's access to credit. But though they are the most explicit, the sectoral sanctions are just one action in the battlefield of international debt market competition between Moscow and the United States.

The Ukraine case

Ukraine has arguably been the fiercest area of Russian-U.S. competition in recent years. Russia's attempts to retain political and economic influence in the country include the use of outright military action, as witnessed by the ongoing conflict in the Donbas and annexation and subsequent maintenance of uncontested control of Crimea. But these actions came only after it had lost control of Kyiv in the February 2014 Euromaidan Revolution.

Russia's attempts to maintain influence and control of Ukraine during the final months of the Yanukovych administration consisted largely of a geo-economic tool, the granting of bilateral state loans. Bilateral loans from one sovereign to another are frequently overtly geopolitical,[5] and this was surely the case in Ukraine. Russian President Vladimir Putin promised $15 billion in loans in December 2013, as then-Ukrainian President Viktor Yanukovych faced growing street demonstrations that called for the country to take a European and Western turn.[6] The U.S. was widely seen as backing the demonstrators.

There is precedent for Russia to engage in bilateral lending over fears of growing U.S. influence, in 2009 it offered $2 billion in credits to Kyrgyzstan in exchange for the Kyrgyz legislature voting to expel U.S. forces from the country.[7] But what made the Ukraine case so unique was that Russia offered its support – initially $3 billion, with plans for more loans curtailed by Yanukovych's ouster – in the form of a Eurobond. The bond is market-tradable instrument and such an instrument had never before been used by official bilateral creditors to loan to one another; furthermore, it included a host of terms that allowed Moscow to effectively force Ukraine into default if it so chose.[8]

The loan ultimately embroiled not just Ukraine, but the larger international financial system, in such geo-economic competition. Putin would initially claim the debt was "on commercial terms,[9]" implying it was a private loan to be considered along with Ukraine's other private loans, but by 2015, when it was clear Ukraine would not repay the note, Russia's Finance Ministry claimed it was an official loan. This was perhaps not an unintentional reversal; the dual positions served a purpose. The former argument would have given it a say in Ukraine's private market debt restructuring, which itself was necessitated by Russia's 2014 invasion. By invoking the bond's official nature, Moscow effectively blocked the Paris Club from restructuring Ukraine's official debts.

In response, the IMF ruled the debt official, thus facilitating Ukraine's private debt restructuring by removing consideration of the Russian-held bond. This also meant the IMF had to change its rules to allow it to continue lending to a state in arrears to an official creditor,[10] a move Moscow argued was proof the Fund is beholden to the U.S.[11] While Washington has been hesitant to offer Ukraine overt military support, on the debt battlefield it did match Russia's action – guaranteeing $3 billion in Ukrainian-government bonds. The story is not over, however: the spat continues before Britain's Supreme Court, as the bond was issued under British law. Should the court rule in Moscow's favor, the Kremlin may still be able to force Ukraine into default.

CITGO and Venezuela

Another area of such competition is Venezuela. The government of President Nicolas Maduro has the Kremlin's support, while since the beginning of 2019, Washington has recognized Juan Guaido as the rightful president. Notably, just after recognizing Guaido, the Trump Administration also issued an executive order effectively freezing trading of Venezuela's foreign debts. This is a clear example of geo-economic action as it not only weakened the Venezuelan economy, but also complicated the economic relationship with the Maduro regime's remaining supporters, including Moscow.

The Kremlin's close links with the Venezuela's government dates back more than 15 years, an effort largely driven by Rosneft CEO Igor Sechin and his interest in securing access to the country's bountiful oil reserves.[12]The continued functioning of Venezuela's state oil firm, PDVSA, is necessary to doing so. But while it has denied skirting U.S. sanctions to do so, it too has employed novel geo-economic tools in Venezuela. The most prominent of these is Rosneft's December 2016 loan of $1.5 billion to PDVSA.

Any observer of Venezuela's nearly unprecedented collapse over the last few years can see that Russian support has be unsuccessful in mitigating PDVSA's decline. The December 2016 loan was the last that Rosneft has offered publicly and since 2018 Rosneft has detailed the amortization of its loans to PDVSA. However, it appears the December 2016 loan is the bulk of PDVSA's outstanding $1.8 billion in debt still due to Rosneft. The loan has a crucial difference from Rosneft's other loans, namely that it is secured over a 49% stake in the U.S. oil company CITGO.

There has been much speculation as to whether Rosneft intends to hold onto the CITGO-secured loan, as well as the extent of its willingness to underwrite the Maduro government further. However, it does seem that the loan at least in part forced the U.S. to consider Moscow a player in Venezuela, embarrassing for a White House attempting to invoke Venezuela as proof of the Monroe Doctrine's continued vitality.[13] Even if the loan is not paid back, $1.5 billion is an investment the Kremlin seems happy to make in exchange for such a geopolitical gain and which may also help ensure Rosneft maintains some of its valuable oil concessions in Venezuela even if a pro-U.S. regime comes to power there.

Venezuela's extensive foreign debts, primarily owed in dollars and to U.S. creditors, are a key U.S. interest in the country. Caracas has prioritized repaying Rosneft rather than its foreign private creditors, whose bonds have been in default for nearly two years. Washington is interested in reversing this scenario, whereas Moscow aims to retain it – although as its debts amortize while the prospect for future gains from the Maduro administration dissipates, its incentive to strike a deal will increase.

Conclusion

The use of loans as a geo-economic tool in Russian-U.S. competition is not new, as the aforementioned Kyrgyz example demonstrates. What is notable is the rate at which such competition has escalated over the last decade. Sanctions may receive significant attention, but an understanding of the relationship between this area of competition and other arenas of Russian-U.S. competition and conflict is only beginning to be developed.

Russia's actions in the Ukrainian Eurobond case show it is a knowledgeable player willing to exercise strategic patience, which stands in contrast to the prevailing narrative that paints Putin's Kremlin as a master tactician with little long-term strategy. [14] As aforementioned, a ruling in Russia's favor in the ongoing legal spats over the bond could enable Moscow to push Ukraine into default, though it may again chose not to do so. How Rosneft's CITGO-secured loan plays out will also shape understandings of the Kremlin's geo-economic tactics and strategy in Venezuela. Based on the amortization rates Rosneft has reported over the last 18 months, one would expect repayment of the principal on the CITGO-secured loan to begin this quarter, or next at the latest. Rosneft's next steps with regard to the loan will offer insight into Russia's strategy regarding Venezuela going forward.

New geo-economic instruments in the field continue to be developed. Russia's most recent such effort is the inclusion of "alternative currency payment event" clauses in its sovereign Eurobonds. These aim to deter the U.S. from introducing the most extreme form of debt financing sanctions, a ban on Russian sovereign debt issuances. If triggered these clauses could inflict substantial losses on foreign bondholders.[15] Such sovereign debt bans are found in a number of Congressional proposals introduced over the last year. For example, the DETER Act of 2019, would see such sanctions enacted if Moscow is found to interfere in the U.S. 2020 elections, which Washington self-evidently wishes to deter. Russia wishes to deter such sanctions in part because of its renewed access to cheap Western financing and because of the myriad difficulties they would cause for its trading relationships, but part of its motivation also likely relates to a desire to avoid becoming dependent on Chinese financing.

Meanwhile, Washington is expressing explicit concerns about Chinese action in this field, with U.S. Assistant Secretary of State Kimberly Breier stating in April 2019 that "Beijing uses debt diplomacy to create dependencies, which may seem negligible today but will eventually constitute a very real leverage over governments and societies and pose a challenge to state sovereignty.[16]" Further examination of Russian-U.S. debt competition will help develop understanding not only of Russian-U.S. geopolitical competition but the global geopolitical environment as well.

Endnotes

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