How should the devalued savings at Sberbank be compensated?

A proposal

Executive summary

Several millions of Ukrainian depositors of the former state savings bank „Sberbank“ are still waiting for compensation for their deposits that lost their value following the breakdown of the Soviet Union and hyperinflation in the early nineties. A final settlement of this issue would be extremely important for social, political and economic reasons. But solving this problem is not an easy task. Total debt to depositors amounts to over UAH 130 bn, equivalent to almost 60% of GDP or to 260% of annual revenues of the central budget.

Recently, a special committee of Verkhovna Rada, the people’s deputy Gavrish and the Cabinet of Ministers put forward alternative proposals to solve this problem. After discussing these three proposals, we present our own solution to the problem. We suggest first to significantly cut the amount of debt. Second, repayment of the debt should be spread over a period of 25 years. Third, we favor a differentiation of the compensation level according to the size of the deposit. Fourth, compensation bonds should be issued to settle the debt. The implementation of our proposal would re-install justice for depositors and improve their economic situation, without jeopardizing monetary, fiscal and political stability in Ukraine.

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1. The problem of devalued savings in Ukraine

The problem of devalued savings in Ukraine originated in 1992. During USSR times households heavily invested their savings in state financial institutions. The savings were held mainly in Sberbank (Savings Bank)\(^1\). Following the breakdown of the Soviet Union, depositors were not able to withdraw their deposits, which lost most of their value due to high inflation\(^2\). In 1997 the Ukrainian government acknowledged its liabilities and adopted the law “On state guarantees on renewal of Ukrainian citizens savings”\(^3\). According to the law, the state has to compensate these savings. As of today, the total amount of debt is equal to UAH 131.96 bn\(^4\).

Between 1997 and 2002 government repaid through Oschadbank almost UAH 1 bn\(^5\). Out of it, almost half was repaid it 2002, when 10 million depositors received UAH 50 for each. There were recorded numerous cases of agiotage during repayment, especially among elderly people. Oschadbank, through which payments were conducted, had to work seven days per week, still people had to wait in lines. In 2003 it is planned to continue current practice of repayment, budget foresees UAH 500 m for depositors and UAH 120 m for heirs.

Although existing practice of paying around UAH 500 m per year allows to depart from the dead point and make some repayments, it can hardly be the real solution of the problem of devalued savings. First of all, total amount of the debt is in fact very high comparing to the capacities of Ukrainian economy. The debt is equal to more than 60% of GDP or 260% of planned central budget revenues for 2003. Self-understood, that it is unrealistic to repay the debt quickly without putting dramatically high pressure on the budget. On the other hand, current method and level of repayment is insufficient to clear off debt even to holders of small deposits. At this rate, it would take more than 250 years to finish

\(^1\) Besides Sberbank, savings were held in State Insurance Fund and in state bonds.

\(^2\) According to those-time regulation, at the beginning of each year all money in Sberbank branches had to be transferred to the central office of State bank in Moscow and was returned back by the end of the year. By the end of 1990 deposits of population in Sberbank branches, located in Ukraine, composed around 84 bn soviet roubles and in January 1991 money was routinely transferred to Moscow. December 1991 was marked by the breakdown of USSR and its common financial system; as a result, Ukraine did not get back Sberbank deposits. In 1992 CIS countries signed an agreement, according to which each former USSR republic acknowledged its portion of Sberbank deposits to be its national debt. Ukrainian government was not able to repay Sberbank deposits to population, while hyperinflation (around 100 000 times since independence) severely reduced their real value.

\(^3\) According to the regulation in Soviet times, state accepted liabilities concerning savings in Sberbank of USSR and State Insurance Fund of USSR in Ukraine as well as concerning savings in state bonds made before January 2, 1992. Also, Ukraine accepted liabilities concerning savings in Oschadbank of Ukraine and State Insurance Fund of Ukraine made during 1992-1994. Compensation can be made only in monetary form by the funds of the state budget. Starting point is 1997. Savings have to be repaid, depending on availability of funds in the state budget. Initially, the law stipulated that depositors could get money gradually, according to their age, amount of savings and other circumstances, but in 2001 the Constitutional Court revised this procedure. The Court pronounced a final decision that defines payment “according to age” and “other circumstances” as violating human rights and unconstitutional.

\(^4\) The savings were indexed on the scale 1 soviet rouble = 1.05 UAH, as of October 1, 1996 (or 1 soviet rouble = USD 0.6). Further indexation has to be done during repayment of the savings. In this paper we do not touch upon mechanism of indexation.

\(^5\) Repayment schedule was as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Repayment, planned in the budget, UAH m</th>
<th>Actual repayment, UAH m</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>60</td>
<td>18</td>
</tr>
<tr>
<td>1998</td>
<td>60</td>
<td>8</td>
</tr>
<tr>
<td>1999</td>
<td>80</td>
<td>10</td>
</tr>
<tr>
<td>2000</td>
<td>200</td>
<td>200</td>
</tr>
<tr>
<td>2001</td>
<td>200</td>
<td>200</td>
</tr>
<tr>
<td>2002</td>
<td>500</td>
<td>511</td>
</tr>
</tbody>
</table>
repaying the debt, which is completely unacceptable. As a result, existing method of repayment is put under severe criticism from many sides: households, politicians, and economists. Not surprising, that this problem became also hot point at issue for political speculations. One can frequently hear populist promises to repay this debt in 3 or 4 years, but such pledges in reality just threaten economic stability.

As shown in Box 1, other CIS countries face similar problems with compensation of devalued savings and also try to find the way out. So far none of CIS countries managed to repay the debt.

Box 1. CIS experience with compensation of devalued deposits

In **Russia** total amount of debt concerning devaluated savings is equal to USD 266 bn (80% of GDP). The debt was officially acknowledged in 1995 by the presidential decree. Taking into account large volume of the debt, Russian government did not make any significant repayments and postponed payments for later periods, depending on budget resources. So far it was decided to hold so-called “preliminary compensation”. Such compensation is done to the elderly people and invalids, depending on the amount of their savings. Repayments are indexed to the inflation rate each quarter.

**Belarus** in 1998 decided to repay debt not by cash money, but to issue certificates that could be used for the purchase of durable goods and real estate.

In **Moldova** at the end of 2002 parliament approved law on indexation of the savings. In compliance with the law, repayment has to be done according to the size of the deposit. Government decided to apportion around USD 130 m (9% of GDP) for the repayment of the debt. Initially it was planned to repay the debt in 15-20 years, but later on no concrete timing was set.

In **Kazakhstan** repayments started in 1996, primarily to elderly people and invalids. Recently president sighed a decree, foreseeing issue of bonds with maturity 1 – 3 years. Again, elderly people will get bonds with shorter maturity.

**Azerbaijan** did not start repayments, but government works on this problem. So far it is planned to reserve around USD 1 bn for this purpose (15% of GDP). Payments have to be done according to the age of depositors and amount of their savings. For instance, if person deposited in Sberbank not more than 2 000 soviet roubles, he/she will be repaid at the equivalent 1 soviet rouble = 1 US dollar, from 2 to 5 thousand roubles = 2 soviet roubles = 1 US dollar, etc. Government of Azerbaijan plans to finance repayments by revenues from oil sales.

We think that it is very important to find credible and final solution of this problem, first of all due to social reasons. Well-being of Ukrainian population dramatically reduced in the aftermath of breakdown of USSR, while compensation of savings in Sberbank would turn this situation to the better. Second, a working mechanism of repayment would enhance confidence of the population in government and its policy. Besides that, an efficient solution would improve trustworthiness of state financial institutions and financial sector as a whole.

In this paper we evaluate existing suggestions for solving this issue (Part 2) and present our proposals (Part 3).

### 2. Current proposals to solve the problem of devalued deposits

Presently there are several proposals to solve the problem of devalued deposits. Below we would like to turn to three of them, which are discussed most intensively.

The special committee of **Verkhovna Rada** on devalued savings proposed repaying the debt by printing money. The NBU should in their view issue fresh money equivalent to 2%

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<sup>6</sup> We would like to separate from the very beginning calls to pay back all debt in short period of time. It is clear that if such proposals were realised, this would lead to nothing more than hyperinflation and economic recession. Be believe that policymakers do not consider seriously these suggestions and will not come back to such calls in our paper.
of GDP each year and provide this money for the compensation of depositors. The committee claims that such a money emission would not be inflationary, because depositors will use the funds for the purchase of durable goods and for real estate.

In our view, the implementation of this proposal would endanger monetary and exchange rate stability in Ukraine. Issuing 2% of GDP per year for compensation purposes would leave the NBU with almost no room left for banking lending and foreign exchange interventions. In 2003, for example, almost UAH 5 bn would be used for compensation out of a total planned emission of UAH 6 bn. Thus, this proposal would inevitably lead to over-emission of money and to higher inflation. The problem of devalued deposits was caused in the past by over-emission of money, which was followed by hyperinflation. Thus, the implicitly proposed over-emission of money can hardly be seen as the way to solve the problem in the future. For this reason, we strictly reject this proposal.

Another proposal was put forward by people's deputy S. Gavrish. According to his project of the law it is suggested to exchange current debt into government bonds. Maturity of these bonds varies from 5 to 25 years. Bonds are interest-bearing, yield is supposed to be linked to inflation (inflation rate for the previous year + 2%). Project of the law proposes to repay debt depending on age of depositor and amount of money at deposit. Also, it is foreseen that bonds will be traded at the stock exchange and government should be able to buy bonds back before maturity at lower price, hence, reduce its debt payments in the future. Authors of the law project estimate that considerable amount of the debt will be repaid in 15-25 years (see Table 1).

<table>
<thead>
<tr>
<th>Years</th>
<th>Payment per year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 – 5</td>
<td>UAH 0.5 - 1.0 bn</td>
</tr>
<tr>
<td>6 – 15</td>
<td>UAH 2.0 - 4.0 bn</td>
</tr>
<tr>
<td>16 – 25</td>
<td>UAH 6.0 bn</td>
</tr>
</tbody>
</table>

We think that central idea of issuing bonds has several advantages, major of them being that the process of repayment would become clear for everybody, and credibility of repayment would significantly increase. Nevertheless, this proposal has a significant drawback: the problem will be just shifted to the future. Initial repayments are planned to be relatively low, but will considerably increase in several years. Nevertheless, postponement of payments to the future does not give answer how they are supposed to be financed; in some time Ukraine would face the same problem and will be looking for solution again.

Finally, Cabinet of Ministers recently approved project of the law, aiming at reduction of the due debt by more than 4 times. It is suggested to set volume of the debt as UAH 28.55 bn instead of current UAH 131.96 bn. Repayment is supposed to be held during next 20 years by cash. As we see, this proposal tries to put amount of repayment in correspondence to the real abilities of Ukrainian economy and is looking for realizable volume of compensation. We consider that proposal of Cabinet of Ministers has following major pitfall: in contrast to issue of bonds mechanism of cash payments is too uncertain and not credible. Without clear obligations government can change amounts and timing of payments from its short-term standpoint, households will not be confident in the government and fulfilment of its obligations.

3. Our proposal to solve the problem

As we pointed above, current volume of due debt is radically high and equals to 260 % of Ukraine’s yearly budget. It is quite clear that such amount cannot be repaid in full even in several decades, while present mechanism of repayment is unsatisfactory for all sides. The only possible way to solve the problem of devalued deposits is through debt restructuring. Debt restructuring should include such measures as 1) reduction of total amount of debt, 2) prolongation of repayment, 3) differentiation of repayment according to the size of deposits, 4) introduction of new mechanism of repayment. Below we present our view of applying debt restructuring mechanism to the problem of devalued savings.
3.1. Reduction of total debt

First of all, we would like to raise the question of the total amount of debt that can be realistically repaid. In order to make solution to this problem pragmatic and credible, reduction of the debt should be the first condition. Ukraine has to take into account real capacities of its economy, which unfortunately do not allow repaying full debt. In such situation it is better to specify achievable amount of debt that can be repaid in tangible future than to give unrealistic promises.

Cutback of debt of course means that households (or some households, depending on specific mechanism of debt reduction) will not get all their money and will be hurt. Thus, it is needed to find the balance between repaying the considerable amount of debt to depositors without jeopardising monetary and fiscal stability.

Defining realistic volume of total debt we have to start from yearly capacities of Ukrainian budget. According to our analysis, current flow of repayments can be intensified and it is reasonable to proceed from flow of payments at the amount of UAH 1 bn per year. Also, we have to take into account that Ukrainian economy has prospect of economic growth in the future, hence, there is an opportunity to increase payments with the time, but keep them constant comparing to GDP or budget.

3.2. Prolongation of repayment

Also, we advocate for prolongation of repayment over some time. This period should be neither stretched for too long, nor too short. Long time of repayment will make the process not credible, value of repayments in the far future will be rather low for the households. At the same time, short period will not allow to repay considerable part of the debt. We think that it is worth to choose 25 years period.

Taking together arguments of reducing debt and prolonging repayment, our calculations show that it is realistic to repay debt approximately at the amount of **UAH 40.5 bn within the next 25 years**. As we can see, our estimations show that it is possible to repay UAH 12 bn more than it is proposed by Cabinet of Ministers. Below in the Table 2 we illustrate how the flow of payments can be done during this period, assuming payments will start in 20047.

**Table 2. Payment schedule**

<table>
<thead>
<tr>
<th>Years</th>
<th>Payment per year (in real terms)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004 – 2008</td>
<td>UAH 1.0 bn</td>
</tr>
<tr>
<td>2009 – 2013</td>
<td>UAH 1.3 bn</td>
</tr>
<tr>
<td>2014 – 2018</td>
<td>UAH 1.6 bn</td>
</tr>
<tr>
<td>2019 – 2023</td>
<td>UAH 1.9 bn</td>
</tr>
<tr>
<td>2024 – 2028</td>
<td>UAH 2.3 bn</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>UAH 40,5 bn</strong></td>
</tr>
</tbody>
</table>

3.3. Differentiation of compensation according to the size of deposits

Naturally, the question arises how to reduce the debt: proportionally to everybody disregarding amount of deposit, reduce only for large deposits, or repay certain level of deposit and than share of it. As we see it, repayment should not be considered as a full redemption of debt, but actually as a compensation for the lost value of deposits. Such compensation is most vital for people with low income and we assume that such persons in general have small deposits; hence, compensation should be aimed first of all to these households. We propose to foresee full or near-full repayment of deposits up to certain small amount, and then only a share of deposit should be repaid; the larger deposit

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7 Calculations methodology: We suppose that government can start in 2004 from UAH 1 bn payment and than each consequent year increase payments by the rate of GDP growth. Average GDP growth is assumed to be 4% yoy.
becomes, the less should be the share for repayment\(^8\). In such way guaranteed limit for repayment would fulfil social role and provide funds for living to the low-income persons, payments to larger depositors would allow for partial compensation of their savings. Besides that, it is logical to foresee faster rate of repayment for small deposits, since prolonging repayment of really small deposits over 25 years will not help much owners of such savings.

3.4. Issuance of compensation bonds

Very important aspect of repaying compensation for devalued savings is specific method how it should be done technically. The method should be simple enough and comprehensible for households, credible, convenient for both sides.

We think there are two major options of repaying the debt: via cash payments or by issuing compensation bonds for this purpose. As we noted earlier, method of cash payments is too uncertain and not credible enough. Without sharply defined obligations, the government can detain payments, prolong them over longer period of time or arbitrary change volume of payments. Population, knowing this, would have little trust in such method of payment. An excellent way to avoid such problems is to issue compensation bonds.

First of all, compensation bonds would neatly fix obligations of the government; any violation of such obligations would be explicitly considered as a default. Besides disciplinary effect, precise schedule of payments will allow better planning of state finances. Another benefit for the government is possibility to buy such bonds back before maturity date at price under face value. In such way, government can direct free funds for buying compensation bonds whenever it would be appropriate and reduce its debt. Proper servicing compensation bonds can increase trust to other state debt instruments. Finally, we would like to point that bonds will be more convenient in administrative terms: significant efforts are needed at the early stages of producing the bonds physically and distributing them among the households, later on administrative work concerning making regular payments, inheritance issues, so on would be considerably lower than with the cash payments.

Households would also benefit from obtaining compensation bonds. First of all, they will have clear picture concerning total amount of compensation, schedule of repayments and expected amount of payment each time. It would be much easier to solve the problem of inheritance and other cases of conceding legal rights. If compensation bonds will be circulated in the market, some people in need can use the possibility to sell them now and get money (although smaller) in the current moment, but not in the future.

Thus, we propose to issue compensation bonds that would have following features:

- Compensation bonds should be issued to the bearer. This would allow to settle problem of conceding rights and facilitate circulation of bonds.
- Indexed to the inflation rate (CPI). Even average 3% inflation rate over next 25 years will reduce value of savings by 30%, 5% inflation – by half, thus, bonds without indexation is not credible solution. Indexation can be done by inflation rate of previous payment period or previous year.
- No interest payments. If interest payments will be put above already existing debt, it will significantly increase total repayments and will endanger success of the whole process. Besides that, prime reason of debt restructuring should be compensation of devalued savings, but not the instrument for additional income.

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\(^8\) In order to give even approximate numbers, the data is needed concerning decomposition of savings by such categories as size of the deposits and number of deposits of certain amount. Unfortunately, such data was not available.
• Dates of payment in one period should be evenly distributed over the year. Payments once per year in short time will create large lines; differentiation of payments dates should reduce this effect.

Initial distribution of compensation bonds and their servicing can be done through the Oschadbank, since it has wide net of branches all over Ukraine.

We suggest that compensation bonds should be freely traded. As we pointed above, this measure should favour households (since they can prefer some money now to future payments) and government (since it can buy bonds and reduce its debt). Hence, compensation bonds should be traded at both, retail and wholesale financial markets. For instance, households should be able to buy and sell bonds through local branches of banks, while commercial banks and other large players (including state) should have the chance to deal with bonds at stock exchange market.

At the same time, compensation bonds should be positioned into different market segment then other state debt instruments. The point here is that if market participants would treat compensation bonds and other state debt instruments equally, liquidity of state debt market can go down and government would have difficulties with obtaining fresh credits.

4. Conclusions

Finding a solution to the problem of devalued deposits at Sberbank is not an easy task. Any realistic proposal is likely to be heavily criticized from different sides and misused for political purposes. But this should not be a reason to further postpone settling this long-lasting problem once and for all. A solution is badly needed for political, social and economic reasons.

The proposal by the special committee of Verkhovna Rada to compensate depositors by printing money is completely unacceptable and shows some fundamental misunderstanding of the economic role of a central bank in a market economy. The proposed solution by Mr. Gavrish is not credible, because it shifts most of the financial burden to future generations. The proposal by the Cabinet of Ministers also lacks credibility, because depositors would only receive an oral promise to be paid in the future, but no piece of paper to hold to.

In order to settle the compensation problem in a workable and credible way, we propose to distribute the fiscal burden over the next 25 years in an even manner. Besides, it is absolutely necessary to reduce the amount of debt, because otherwise the burden on public finances would be too high. Also, depositors should get an acknowledgement of their financial claims in a paper form. That is why we propose to settle the debt problem by issuing compensating bonds. The implementation of our proposals would provide a significant compensation, without endangering macroeconomic stability. It is technically not feasible to achieve more than this.

I.E., R.G., Lektor: F.P.

Kiev, April 2003