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The Aftermath of the Russian Debt Crisis

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Elmar Koch and Iikka Korhonen

The Aftermath of the Russian Debt Crisis

Abstract

In August 1998 the Russian Federation was forced to devalue the rouble and declare a moratorium on its debt servicing. Russia was badly hit by unfavourable external conditions, but the main reason for the crisis was the inability of the fiscal authorities to bring the budget deficit under control. When the rouble was devalued, the Russian Federation was unable to meet its domestic or external obligations. The holders of Russia's domestic debt were forced to accept unfavourable restructuring terms, and now also some holders of the old Soviet debt instruments have accepted a significant reduction in the value of their holdings. However, Russia has been willing and able to honour the debts incurred after the Soviet period. Russia's relations with its creditors and international financial institutions have been quite strained in the aftermath of the crisis, and it remains to be seen whether the recent restructuring deal with London Club creditors will mean Russia's re-entry into the international financial markets.

Key words: Russia, government debt, financial crises

1 Introduction

In August 1998, the Russian Federation floated the rouble and declared a 90-day moratorium on its debts. The ensuing crisis led to a significant depreciation of the rouble and insolvency of most of the Russian banking system.

The basic shortcomings that led to the August 1998 moratorium included an unfavourable external environment for Russian raw material exports, especially oil and gas, as well as a range of real and financial weaknesses on the domestic side. In particular, the federal budget deficit remained high as the collection of taxes was poor and revenues could not be adjusted accordingly. The IMF and other lenders, under the impression that some monetary and price stability had been achieved, agreed in July 1998 to provide Russia with USD 22.5 billion in loans to help stabilise the country's finances. After the first tranche was disbursed, the Russian government declared a moratorium on its domestic debt and prevented private sector institutions from servicing certain foreign currency obligations, including non-deliverable forward FX contracts.[1] The rouble/dollar peg and debt prices collapsed. IMF credits were frozen, domestic banks went insolvent and foreign banks scrambled to cut their exposure (see Appendix 1: Chronology of the Russian financial crisis).

This paper assesses questions related to the debt moratorium. First, we look at the debt situation immediately following the crisis and then how payment arrears mounted. We next turn to Russia's oft-strained relations with its creditors and briefly survey the debt situation of Russian regions and cities. One commonly overlooked aspect of the Russian crisis was that Russia is also a creditor nation. In the sixth section, therefore, we look at Russia's financial relations with other CIS countries. Russia's default on its domestic debts and restructuring of its debt instruments are surveyed in section seven. Section eight looks at issues that surfaced in the aftermath of Russian moratorium and the possible lessons for Russia taken from the Polish and Mexican experiences. The last section concludes.

2 Economic developments since the crisis

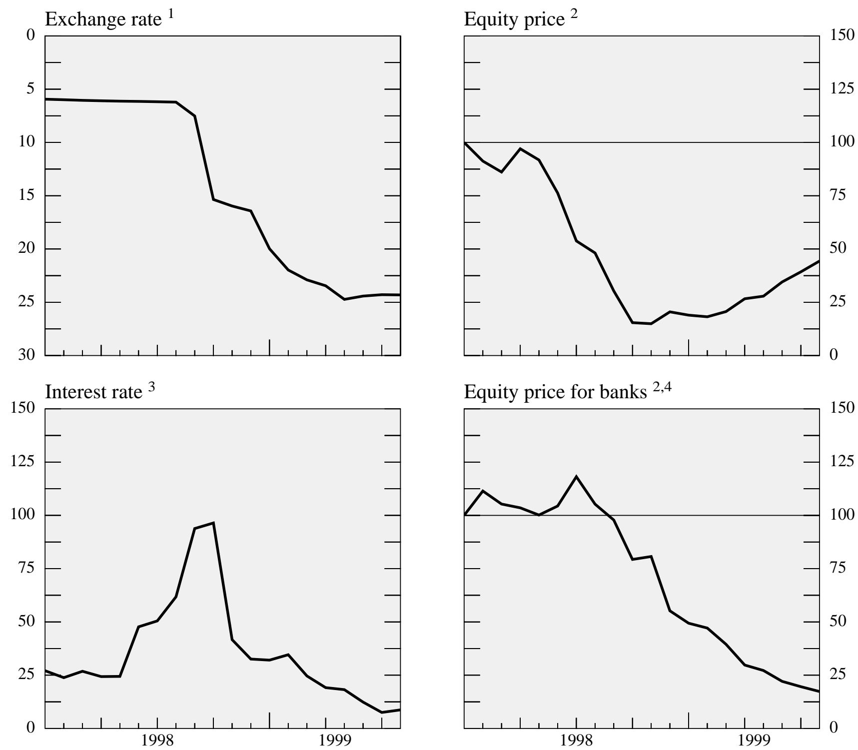
At the time of the Russian default, many capital market participants viewed it as a catalytic event. It forced them to rethink the reliability of the official safety net they took for granted when purchasing emerging market debt (or at least the debt of geopolitically important countries). Moreover, it induced investors to question the willingness of major countries and international organisations to support credit-strapped sovereigns.[2] The resulting deleveraging of portfolios in autumn 1998 had a global impact.

In 1999, Russia's government faced an external debt servicing obligation of around USD 20 billion. Because liquid foreign exchange reserves dropped to a level of about USD 7 billion, successful debt servicing had to rely on improved tax collection, higher commodity prices and/or financial support from external (official) creditors. The March-April 1999 budget plan for the same year envisaged payment of only about USD 9.5 billion for principal and interest on foreign-currency-denominated debt. In addition, as the year's total debt payments equalled the entire revenue of the 1999 federal budget (USD 19 billion), additional budget allocations to meet external debt payments seemed unlikely. Critically, there was no provision for payment of inherited Soviet-era debt. The budget further assumed that foreign financing would be forthcoming. In the contingency of no foreign funding, complete restructuring or default on Soviet-era debt seemed obvious outcomes.[3] Nevertheless, Russia chose not to draw on its already low reserves. Its ability and willingness to pay was seriously constrained.

By summer 1999, the stock markets recovered somewhat, the exchange rate more or less stabilised, inflationary pressure receded and fiscal balances showed improvement. Towards end-July, the IMF approved the long-awaited credit of USD 4.5 billion earmarked in a special account for payment of funds due to the IMF. Although the improvement in the trade balance was mostly due to import compression, it meant that Russia enjoyed a substantive current account surplus in 1999. However, the large capital outflows also meant that Russia's foreign exchange reserves remained low during 1999 (Graph 2). At end-1998, Russia's foreign exchange reserves (excluding gold) stood

Graph 1

Financial indicators in Russia

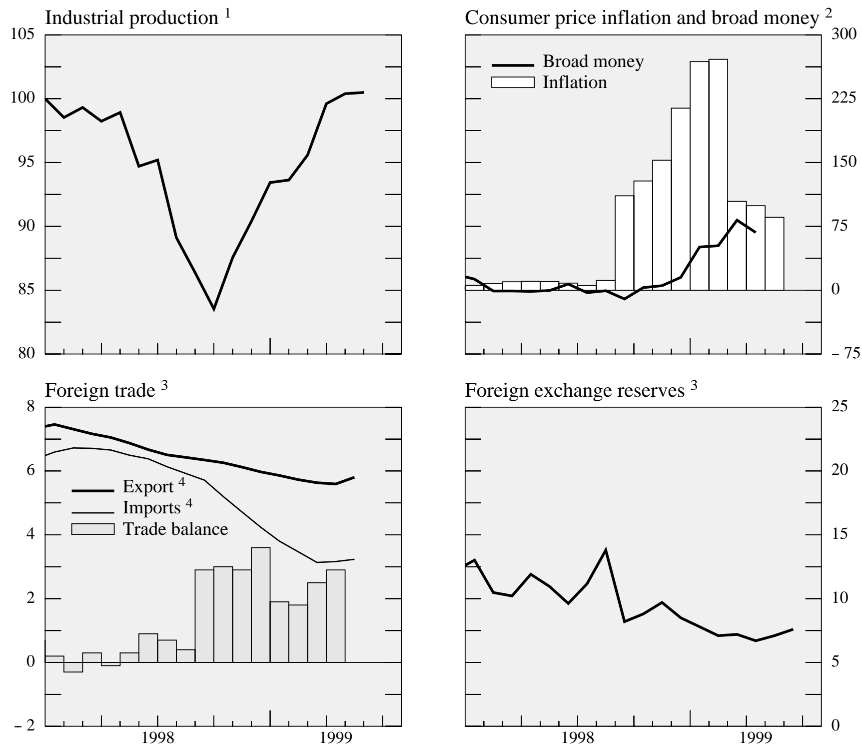


[1] Rouble/US$; inverted scale. [2] End-1997 = 100; in US dollar terms. [3] Overnight rate. [4] Relative to total index.

Sources: Datastream and national data.

Graph 2

Economic indicators in Russia



[1] End-1997 = 100. [2] Percentage change over 6 months at an annual rate. [3] In billions of US$. [4] 3-month moving average; seasonally adjusted.

Sources: IMF, International Financial Statistics and national data.

at USD 7.8 billion. At the end of November 1999 they were USD 7.6 billion. In the first three quarters of the year, the current account surplus was USD 14.6 billion, and probably rose to around USD 18 for the year. Industrial output grew 8.1% in 1999, and forecasts for Russia's GDP in 1999 were also constantly revised upwards.

3 The external debt of Russia

While estimates of the external debt of Russia vary, Table 1 likely reflects the magnitudes involved at the end of 1998. The nominal value of sovereign debt incurred after 1991 stood around USD 55 billion, while Russia's outstanding debt inherited from the Soviet Union amounted to USD 102 billion. This yields a total debt stock of around USD 158 billion. In addition, non-sovereign debt (virtually all incurred by banks and corporations) amounted to approximately USD 32 billion. (See Appendix, Item 2 "Taxonomy of Russian debt instruments").

Table 1. Estimated debt stock of Russian Federation at end-1998, USD billion

		Debt
Russian era	IMF	19.4
	Other IFIs	6.6
	Official creditors	9.7
	Eurobonds & MinFins	19.6
	Other	0.2
	Total	55.4
Soviet era	Paris Club	40.0*
	COMECON	14.7
	Other official creditors	4.7
	Commercial creditors (mainly London Club)	35.2
	MinFins	7.6
	Other	0.5
	Total	102.8
Total		**158.2**

Note: Above does not include forward contracts (estimated at around USD 5-7 billion) of Russian banks. The liabilities of the former GDR (transfer rouble) amount to about USD 14 billion.

* Of which, an estimated USD 18 billion is owed to Germany.

Source: Various non-Russian sources.

The terms of Russian moratoria on the domestic and external debt were opaque at the time they were declared on August 17. With time it became increasingly clear that around USD 40 billion in domestic Treasury debt was not to be serviced[4] as well as all Soviet-era for which the 1999 budget had not made explicit provision. Thus, servicing debts outstanding to the London and Paris Clubs was skipped. Servicing of interest on some of the MinFin bonds was also skipped (see Item 2 "Taxonomy of Russian debt instruments").

Technically, Russia defaulted on is Soviet-era debt to the London (commercial creditors) and Paris (sovereign creditors) clubs some time ago. At stake were some USD 35 billion owed to commercial creditors and USD 40 billion owed to Paris Club countries (Table 1). The Russian govern-

ment missed a USD 362 million Prins (see Item 2 in the Appendix) payment to the London Club on 2 December 1998. By June 1999, Russia had missed another payment of USD 855 million, so that arrears to the London Club banks amounted to about USD 1.2 billion.[5] Already in August and September of 1998, Russia skipped interest payments of DM 751.5 million and USD 49.8 million due to Germany as part of the Paris Club agreements. By mid-1999,[6] Russia was slightly over USD 2 billion in arrears to the Paris Club. Because neither creditor group was ready to declare Russia officially in default, Russia had some breathing room to agree on a compromise.[7] In August 1999, the Paris Club creditors agreed to postpone Russia's debt payments of some USD 8 billion until the end of 2000, by which date the exact terms of restructuring would be negotiated. In February 2000 Russian Federation and the London Club creditors reached an agreement on the restructuring of Russia's debt. Under this agreement the Prins issued by Vneshekonombank will be changed to eurobonds of the Russian Federation at 37.5% of their nominal value. The IANs (see Item 2) will be changed to eurobonds at 33% of their nominal value. The payments terms of these eurobonds ensure that Russia will receive approximately 50% debt reduction on this part of the old Soviet debt, if at least 75% (by value) of the holders of these debt instruments accept the deal.

MinFin dollar-denominated bonds were issued to cover foreign currency deposits frozen by Soviet banks and amount to about USD 14 billion. Private Western creditors hold about USD 8 billion of this total. Russia missed a USD 1.3 billion payment on MinFin principal due 14 May 1999. Additionally, some USD 300 million on MinFin interest was due at that time. In December 1999, the Russian government offered holders of a specific MinFin tranche (the one which Russia did not pay in May) a chance to convert their bonds into rouble-denominated four-year bonds or dollar-denominated bonds with a maturity of two years.

Table 2. Russian eurobond amounts and interest payments as of June 1999,[1] (USD million)

Issuer	Amount	Due	Payment dates 1999				Next payment[2]
Central government							
Russian Federation	1000	2001	27 Nov	27 May			46
Russian Federation	1250	2003	10 Jun	10 Dec			73
Russian Federation	2500	2028	24 Jun	24 Dec			159
Russian Federation	2969	2005	24 Jul	24 Jan			130
Russian Federation	3467	2018	24 Jul	24 Jan			191
Russian Federation [3]	1069	2004	25 Mar				95
Russian Federation [3]	668	2005	31 Mar				63
Russian Federation [4]	405	2003	30 Apr				36
Russian Federation	2400	2007	26 Jun				240
Local government							
City of Moscow	500	2000	30 Nov	31 May			24
City of St. Petersburg	300	2002	18 Jun	18 Dec			14
Region of Nizhny Novgorod	100	2002	3 Oct	3 Apr			4
City of Moscow [3]	267	2001	9 Apr				24
City of Moscow [4]	216	2001	18 May				21
Banks							
Vneshtorgbank	200	1999	26 Jun	26 Sep			4
Alfabank	175	2000	28 Jul	28 Jan			9
Uneximbank [5]	250	2000	1 Aug	1 Feb			12
Rossiisky Kredit [5]	200	2000	29 Sep	29 Mar			10
SBS-Agro	250	2000	21 Jul				26
Companies							
Sibneft	150	2000	15 Aug	15 Nov	15 Feb	15 May	3
MGTS	150	2001	19 Sep	19 Mar			9
Lukoil	230	2002	6 Apr				8
Mosenergo	200	2002	9 Oct	9 Apr			8
Irkutskenergo [3]	67	2001	20 Apr				8
Tatneft	300	2002	29 Oct	29 Apr			14
LUKoil	350	2003	3 Nov				4

[1] Including Eurobonds held by residents.
[2] Amount due.
[3] DM-denominated bond, valued at current exchange rate.
[4] Italian lira-denominated bond, valued at current exchange rate.
[5] Restructuring, missed most recent payment

Source: IIF; Russian Federation Economic Report, 11 June 1999

IIn the debt restructuring talks in Paris concerning sovereign debt an inclusion of MinFin bonds[8] may be one way for the private sector to be included in the adjustment costs (see section on bailing-in), as a large portion of MinFins are held by institutional private investors.

On June 10 1999, Russia did meet an interest payment of USD 73 million on its eurobond series maturing in 2003 (Table 2), and the Russian Federation has been current on its interest payments on eurobonds ever since. While Fitch IBCA and Standard and Poor's warned in mid-January that Russia's deteriorating finances threatened its ability to service its post-1992 eurobonds,[9] the Russian Federation has so far diligently serviced its eurobonds. This approach clearly stressed the difference between the old Soviet debt and debts incurred by the Russian Federation. The schedule of eurobond interest payments is displayed in Table 2. However, one prominent financial group, Uneximbank and the Rossiisky Kredit bank, have missed the latest payment on their eurobonds.

4 Russia's relations with its creditors

4.1 Russia and the IMF

Russia is one of the largest debtors of the IMF, owing USD 15.9 billion at the end of November 1999 or about one-fifth of the IMF's outstanding loans.[10] Payments due in 1999 were USD 4.3 billion, but the net payments are smaller, because Russia also received money from the IMF in 1999. Russia had to pay about USD 300 million to the IMF each month except in July when payments jumped to more than USD 1 billion.[11] Since IMF loans cannot be rescheduled, receiving new credits to pay for old ones is one way to stay current on one's payments to the IMF. The new end-July 1999 IMF agreement hinged on a wide range of measures, while moral hazard for the IMF was great. This time, the new stand-by credit was clearly earmarked for repayment to the IMF and the money was kept in a special escrow account in Washington. Now, partly thanks to higher oil prices, the Russian government has been able to service its debts to the IMF (and to World Bank) despite the fact that the IMF has withheld the remaining tranches of the July debt program.

Table 3. Some of the IMF's requested prior actions

1. Increasing budget revenues
• Postpone VAT cut from 20% to 15%
• Raise taxes on alcoholic beverages
• Introduce taxes on luxury cars and gasoline stations
• Enforce better tax collection from large oil companies

2. Bank restructuring
• Pass bank restructuring and bankruptcy legislation
• Strengthen ARCO (Agent for bank restructuring)
• Withdraw licences of banks to be liquidated
• Authorise the CBR to issue its own debt paper

3. Foreign exchange restrictions
• Abolish the two-tier foreign currency market
• Lift restrictions on foreign bank participation in the foreign exchange market

Source: BOFIT, June 1999.

The IMF thus attempted this time in its negotiations from March through July 1999 to set rigorous terms (conditionality) on the release of funds to Russia. Disbursement was contingent on Russian actions that included tax hikes, a new bank restructuring law, relaxation of foreign exchange restric-

tions (see Table 3) and a special audit of the foreign reserve management of the Central Bank of Russia (CBR). By mid-July 1999, Russia had made substantial progress on most of these conditions, thereby moving closer to an IMF agreement.[12] At end-July, the IMF concluded Article IV consultations with Russia.[13]

Like many countries subject to debt negotiations, Russia's new agreement with the IMF was critical in multiple respects.[14] The agreement unlocked funds from other official lenders (the World Bank and Japan) and allowed Russia to reschedule payments on its Soviet-era debts. The Paris Club and the London Club both made the IMF agreement a precondition for negotiations on debt rescheduling.

In general, if IMF participation increases the expected value of any existing official or private debt contract, lenders benefit. This externality effect of the IMF's role not only benefits the borrower but also the rational lender as the probability of default on the external debt is reduced. While this may be true in general, however, the evidence for Russia is difficult to assess. The difficulty lies in the fact that markets invariably assess the likelihood and size of a forthcoming IMF agreement over time. The final IMF agreement is thus only one point of a sequence of events. This time sequence appears particularly difficult to assess for Russia because the conditions attached to the IMF loan were more stringent than usual and the preconditions had to be met over an extended period of negotiations with the IMF.

4.2 Russia and the Paris Club

The Paris Club took the lead in debt restructuring. While the G-8 meeting in late June 1999 urged the Paris Club to start renegotiations quickly, the G-8 had failed to agree on a firm commitment for an outright write-down of Russia's inherited Soviet-era debt.

In the run-up to the agreement with the Paris Club of 3 August 1999, payments to the Paris Club were stalled, as Russia was in arrears (see above). The total debt to the Paris Club countries is USD 40 billion of which USD 18 billion is owed to Germany (Table 1). There were some early indications that the main creditors, particularly Germany, would not agree to a general write-off of the Paris Club debt,[15] even though the official attitude appeared to have softened. This attitude was essentially conditioned by the basic principle of *pacta sunt servanda* – a deal's a deal. Debt forgiveness is warranted only in exceptional circumstances. It appears that the United States may have taken a somewhat more lenient approach to official debt forgiveness to Russia, partly perhaps prompted by the country's relatively small exposure to Russia and perhaps partly influenced by more global geopolitical considerations. On the other hand, Russia itself initially proposed a 75% reduction of its official debt.[16] However, Russian officials at the June 1999 G-8 meeting seemed to indicate that they were no longer demanding an outright write-down of this magnitude. Both sides appeared to be ready for compromise. If precedents for Poland and Egypt were any indication, debt reduction of up to 50% should have been possible. At any rate, it is clear that Russia expected a far-reaching restructuring of its Soviet-era debt. Possible compromises may include willingness on the part of creditors to accept partial payment in goods. Russia reportedly also proposed that some of the debt to the Paris Club be "exchanged" for some of its outstanding claims on other countries, which the Soviet Union had accumulated and which were subsequently inherited by Russia.[17]

One issue in the run-up to the debt renegotiations within the Paris Club was whether or not outstanding eurobonds should be part of the rescheduling of debts Russia owes. Not surprisingly, bondholders objected vehemently.[18] As long as this threat reigned, the value of eurobonds plummeted. However, by July 1999 it had become clear that the Paris Club would not allow Russia to restructure its post-Soviet dollar eurobonds.

Now the Paris Club has begun to insist on the principle of burden sharing between private and public creditors. This consensus seems fairly broad and firm, but the question on how to achieve this in a fair and equitable way for all players without creating undue volatility in the markets appears less settled. The Paris Club recently also appears to have considered that Pakistan and Turkey include eurobonds in their debt restructuring, but as yet no eurobonds have been officially included in any country's restructuring.[19]

Traditionally, negotiations with the Paris Club only start after a loan agreement with the IMF. The Russian case was no exception. As the Paris Club is only a Secretariat without legal power or the resources to conduct an independent economic assessment of a country, the current assumption of a valid agreement between Russia and the IMF as a precondition for entering Paris Club negotiations is an accepted part of debt restructuring.

Paris Club rules are differentiated and tailored to individual countries while respecting the principle of fair and equal treatment. There is no automatic mechanism for being included under Paris Club rules as the whole procedure violates the principle of *pacta sunt servanda*. Initially, the Paris Club dealt with low-income, highly indebted economies. The Houston terms of 1990 subsequently also allowed lower middle-income countries to be considered for restructuring. Egypt and Poland were lower middle-income countries when their debt was restructured. Russia falls into this income category.

In principle, Russia also had to meet two further requirements to be eligible for a Paris Club rescheduling. One requirement was that Russia would default on its external obligations in the absence of relief. One indicator of this condition is, for example, the existence of substantial external payments arrears. This situation is sometimes labelled "imminent default."[20] As shown above, willingness apart, Russia was *de facto* in a situation of "imminent default." The second requirement is that before proceeding to the Paris Club debt rescheduling negotiations, the debtor must have first accepted an economic adjustment program with the IMF.

There was also the lingering question as to how Russia's position as "creditor" nation might affect its eligibility as debtor in the Paris Club and the ensuing negotiation position. While this situation is unusual (being both a debtor and creditor at the same time) this position does not appear to have a direct bearing on eligibility to the Paris Club renegotiation process. However, as indicated earlier in this paper, Russia may have wanted to offer some credits of the other former Soviet Union countries as payment of its debt. However, as indicated later in this paper, Russia as a creditor nation may have to renegotiate some of its agreements with former Soviet Union countries depending on the outcome of the negotiations with its own Paris Club creditors. If forgiveness had been part of the Paris agreement, Russia could have been asked to pass on some of these benefits to its debtor countries.

In the event, Russia and the Paris Club agreed to reschedule roughly USD 8 billion of arrears of Soviet-era debt falling due between August 1998 and the end of 2000. The USD 8 billion would be repaid over 15 to 20 years. Discussions about the final fate of this debt would start in the autumn of 2000.[21]

4.3 Russia and London Club

After the debt moratorium the Russian Federation negotiated with the private creditors represented by the London Club on the restructuring of Prins ("principal notes," see Item 2) and IANs ("interest arrears notes"). Russia demanded partial debt forgiveness and offered in exchange to upgrade the remaining debt into sovereign eurobonds. Previously, these debt instruments were liabilities of the state-owned foreign payment agent Vneshekonombank. The situation was further complicated by the fact that the ownership of the debt securities is quite dispersed, making an agreement more difficult to reach. However, in February 2000 the negotiators did reach a preliminary agreement, which would reduce the value of old Soviet debt by approximately 50%, if accepted by at least 75% of the bondholders. As a part of the deal, the debt of Vneshekonombank will be exchanged for eurobonds of the Russian Federation. This deal means that private creditors are forced to bear some burden of Russia's debt restructuring, and will most probably pave way for a roughly similar deal with the Paris Club.

5 The debt situation in regions and cities

Russia's regions are also facing difficulties in paying their foreign loans. The immediate cause of these difficulties is the depreciation of the rouble, rather than excessive indebtedness. Tatarstan defaulted on its eurobonds in October 1998 and its regionally administered oil company, Tatneft, also ran into problems. In April 1999, the city of Moscow announced that it would seek restructuring of its foreign loans. The Leningrad region narrowly avoided default on an interest payment by announcing that it had negotiated a restructuring of its entire USD 50 million syndicated loan. Only after considerable effort did Nizhny Novgorod region manage to make timely repayment of interest on its eurobonds in April 1999, and in October of the same year it failed to make a USD 100 million interest payment. Subsequently, the loan was restructured. Numerous other Russian regions are currently in talks on restructuring their loans. Regions also presently do not service a considerable share of their domestic borrowing.[22]

6 Russia as creditor nation

By mid-1998, all former Soviet Union States, except the Baltics, were debtors to Russia (Table 4). These debts stemmed from credits extended by the CBR to these states after 1992. Most of these countries also ran trade deficits vis-à-vis Russia.[23] Belarus, Ukraine and Moldova, in particular, received large credits for energy (mainly natural gas) supplied. These debts can be repaid by delivery of goods, shares in industry (or other financial asset transfers) as well as in rouble or freely convertible currencies. As some countries were unable to pay, Russia agreed to restructure their debts. However, among these countries the principle also holds that new credits are only granted if the country is current on its service obligations.

In addition to the CIS countries, Russia is still a creditor to Cuba, Vietnam and many African countries. The Soviet Union extended credits to these countries, and their restructuring talks began in the Paris Club when Soviet-era debts were first restructured.

Table 4. Debt of former Soviet Union States to Russia as of mid-1998, USD million

	Total debt	of which overdue:	
		Principal	Interest
Armenia	95	0.1	1
Azerbaijan	96	43	14
Belarus	54	-	1
Georgia	181	-	0.2
Kazakhstan	1720	568	380
Kyrgyz Republic	154	-	20
Moldova	100	30	6
Tajikistan	301	-	11
Turkmenistan	150	146	-
Ukraine	2042	111	1
Uzbekistan	538	-	33
Total	5432	898	465

Source: Surubovic and Usakova (1999)

A restructuring agreement was signed with Kyrgyz Republic in 1996 in the amount of USD 128 million to be paid back from year 2000 to 2009 with 10% due each year. At the beginning of 1997, Russia and Georgia agreed that the repayment of USD 179 million was to occur in equal instalments over the six-year period from the year 2000 to 2005. Similar agreements also exist with Armenia, Moldova, Ukraine and Uzbekistan. A zero-repayment agreement was signed between Russia and Belarus in February 1996.

While the Russian policies towards other former Soviet States may be considered quite generous, they appear to be in the longer-term interest of Russia and they do not imply debt forgiveness. As payment of debt is often not of a monetary nature, they are usually not considered an important factor in boosting Russian reserves.

Debt forgiveness or the reduction in the former Soviet debt may, however, raise the issue of the old Soviet (net) debt between Russia and other former Soviet Republics. At the time of the break-up of the Soviet Union, Russia inherited all the assets and liabilities of the former Soviet Union. This agreement was based on an understanding that assets and liabilities were netted, which implied that the assets (e.g. embassy buildings abroad) were also transferred to Russia. If Soviet-era debt is to be reduced (as now seems probable), there may be grounds for other former Soviet Republics to reopen negotiations on this agreement, for example, on recovering assets on a pro rata basis.[24]

7 Payment on domestic debt

In August 1998 Russia declared a payment freeze on about USD 40 billion of GKO/OFZs of which around USD 13-15 billion were held by foreigners. The initial Russian offer to restructure these instruments in November 1998 was for around 4 cents on the dollar.[25] While the initial offer was for around USD 550 million the last offer amounted to around USD 200 million. This latter amount was to be paid in equity.[26] A subsequent new offer was even lower at around 1.5 cents on the dollar.[27] The unilateral decision by several foreign banks to accept the Russian restructuring proposals of November 1998 rendered a coordinated effort to seek improved terms unlikely.[28] By April, some 90% of Russian and 40% of foreign holders of GKOs and OFZs had agreed to the restructuring package where they received 10% of the face value of the bonds in cash, 20% in short-term debt securities and 70% in long-term debt securities. The foreign holders could repatriate their rouble holdings in special currency auctions held by the central bank. The CBR offered only small amounts of foreign exchange in these auctions (in the first auction USD 50 million) at an exchange rate that was clearly disadvantageous for the participants. Incidentally, the short-term debt securities held by the CBR were exempted from this restructuring.

While it may be difficult to allocate losses to final holders of the Russian T-bills, BIS statistics indicate that about USD 7.7 billion of these papers were held by foreign banks in June 1998 (Table 5). The remainder of the USD 13-15 billion was held by other financial institutions. About 85% of banks' holdings were concentrated in banks operating outside of London.

The CBR has been buying back some GKO/OFZs from Russian banks as part of a debt swap, under which the domestic banks received short-term central bank bonds known as OBRs. This program discriminates between investors as smaller domestic banks and some foreign creditors were excluded.[29] Meanwhile, the Russian Finance Ministry is restructuring the GKO/OFZ papers as it paid RUB 7 billion to holders of these papers on 16 June 1999.[30] At the beginning of December 1999, the Russian Ministry of Finance extended the deadline for agreeing to the restructuring terms to the end of the year.

8 Selected issues

8.1 Banks and other institutional investors

By mid-1998, when the Russian crisis broke, the exposure of foreign banks to Russia was about USD 65 billion. By end-1998, banks had reduced their overall exposure by USD 12.5 billion, a trend that continued in the first quarter of 1999 with a further retrenchment of USD 2 billion. Two-thirds of the (exchange-rate adjusted) USD 15 billion decline since mid-1998 is attributable to non-renewal of loans (including sales to hedge funds), while one-third is estimated to represent changes in the dollar price of "defaulted" T-bills and bonds dominated in roubles. The bulk of the banks' adjustment occurred immediately following the crisis in the third quarter of 1998 (Table 5).

Table 5 Banks' adjustment to the exposure in Russia* (USD billion)

	1998			1999	
	June	September	December	March	June
Amounts outstanding	64.9 (28.3)	56.0 (29.8)	54.7 (29.5)	49.1 (25.6)	46.9 (24.7)
Loans	57.2 (27.8)	52.7 (29.2)	50.9 (29.0)	46.4 (25.4)	44.4 (24.6)
Securities	7.7 (0.5)	3.3 (0.6)	3.8 (0.5)	2.7 (0.2)	2.5 (0.1)
Changes (exchange rate adjusted)	2.7 (0.7)	–10.8 (0.2)	–1.6 (–0.5)	-2.0 (-0.9)	-1.5 (-0.2)
Loans	2.0 (0.6)	–6.2 (0.2)	–2.1 (–0.5)	-1.0 (-0.6)	-1.2 (-0.3)
Securities	0.7 (0.1)	–4.6 (0.0)	0.5 (0.0)	-1.0 (-0.3)	-0.3 (0)

* Data in parentheses refer to banks in Germany.

Source: BIS International Banking Statistics

The exposure of German banks in Russia was much larger than any other country, and the exposure of US banks was comparatively small (around USD 7.8 billion in June 1998). By end 1998, it was clear that the banks in the US had written down the losses in the Russian market, while banks in Germany had increased their provisions but appeared more hesitant to write down their loan losses. Perhaps German banks hoped to recover part of the loans to Russia, a position held by the authorities (who guaranteed many of these loans). Although a large write-down represents tacit acknowledgement that assets could not be recovered, most international banks went ahead and wrote-down of the value of Russian domestic securities in their portfolios (USD 4.5 billion in the third quarter of 1998).[31] Some have argued that this settlement may have weakened banks' resolve to fight for better repayment terms (which in the end amounted to 2-3 cents on the dollar).[32]

Holdings of the GKOs/OFZs were more widely dispersed. Non-banks (e.g. investment and mutual funds) held about 40% of the USD 13.5 billion stock of rouble paper held abroad at the beginning of the crisis.[33] Whereas in the past, London Club banks handled such claims, the presence of non-banks has made it more difficult to implement a common approach to restructuring. By the beginning of August 1999, however a group that represented the hedge funds became known as the London Club of Portfolio Managers, apparently coordinating some actions with the traditional London Club.[34]

The devaluation of the rouble dramatically reduced the value of government paper held as part of the required capital of foreign banks operating in Russia. In response, the CBR urged these Western banks to recapitalise their subsidiaries. This pressure was resisted by the main offices of foreign banks, which proposed solutions such as revaluation of real estate investments or other assets, or a special valuation of the GKO/OFZ papers (as was done for some Russian banks). With the Russian financial system collapsing, Russian depositors fled from Russian to Western banks and Sberbank.[35]

8.2 Bailing-in calls and the role of the private sector

The bailing in of the private sector in a financial crisis of a country has been an issue for some time. In the past, it appeared that when the IMF provided new funds or the Paris Club rescheduled debt, the country often promptly used these resources to meet its international obligations, in particular, bond repayments. In the end, the international community primarily shouldered the external debt burden. Now, there appears to be broad agreement that this situation implicitly sheltered the private sector to the detriment of the public sector. The private sector was seen as implicitly taking advantage of the official sector's role as lender of last resort. One burden sharing proposal has focused on the holding of international bonds.[36] The idea of 'bailing in' bondholders in sovereign debt rescheduling was recently explicitly addressed by a report of the G-10 countries.[37] The group noted specifically that there should not be a presumption that any type of debt would be exempt from payment suspension or restructuring, and that it was desirable to develop contractual provisions facilitating cooperation between debtors and creditors. Many emerging market economies have now become

significant issuers of international bonds, which implies a shift in capital flows from the official to the private sector. Likewise, calls for including the private sector in debt rescheduling have become more persistent.

Changing the role of the private sector in sharing the debt burden involves a major rethinking of current IMF and Paris Club and London Club procedures. In the 1982 debt crisis, the IMF informally, but actively, persuaded banks to continue lending to certain countries in Eastern Europe and Latin America. It was essentially attempting to expand its role beyond "informal persuader" to prescribing involuntary lending by private banks. This expansion of the role of the IMF occurred first in November 1982, when the IMF informed bankers with major exposure in Argentina and Mexico that it would not commit its resources to stabilisation programs until the banks increased their exposure by complementary amounts.[38]

The calls for improved covenants in international bond contracts should not undermine the principle and resolve of debt repayment. The widely proposed idea that the terms for international bonds should include covenants that would facilitate rescheduling in a crisis addresses the principles of transparency and efficiency in resolving the crisis in a fair and equitable way to all concerned. Three clauses that might prove useful in this regard provide for (i) collective representation of debt holders, (ii) qualified majority voting to alter the terms and conditions of the debt contract, and (iii) the equitable sharing of proceeds among creditors.[39] While there are doubts as to the potential impact of these clauses on borrowing costs of emerging market economies, these clauses could improve the quest for transparency and render the process of foreign debt settlement more efficient.[40] Unwinding a bond contract under American law, for example, is currently a major undertaking.[41]

The above considerations would only to apply to future bond contracts, as modifying the terms of outstanding bond issues are generally rejected. Nevertheless, there were some attempts recently by the Paris Club to consider Pakistan's as well as Russia's currently outstanding international bonds in the debt renegotiation process. This quest appeared to comply with several official statements suggesting that international bondholders should, as a general rule, surrender their privileged position in debt restructuring. Although this is seen as an important step in principle, the potential impact on international bond markets (i.e. overruling existing legal covenants in current international bond contracts) has been a matter of controversy. Besides the obvious legal implications, some believe that such a strong international move would introduce uncertainty into a range of existing contracts and potentially serve to exclude high-risk emerging economies from the market. Moreover, it might be detrimental to a range of emerging market countries or lead to significant increases in risk premia.

On the other hand, many believe that the preferential treatment thus far given to eurobonds has created pricing distortions, leading to excessive debt accumulation in certain countries.[42] We have already seen recent cases of quasi bail-ins. In the fall of 1998, for example, the IMF asked the Ukrainian government for assurances that it would not use IMF proceeds to pay off the holders of expiring euronotes. The Paris Club also told Pakistan that the willingness of official creditors to reschedule debt interest payments was contingent on negotiating "comparable" arrangements with private creditors, including bondholders.[43]

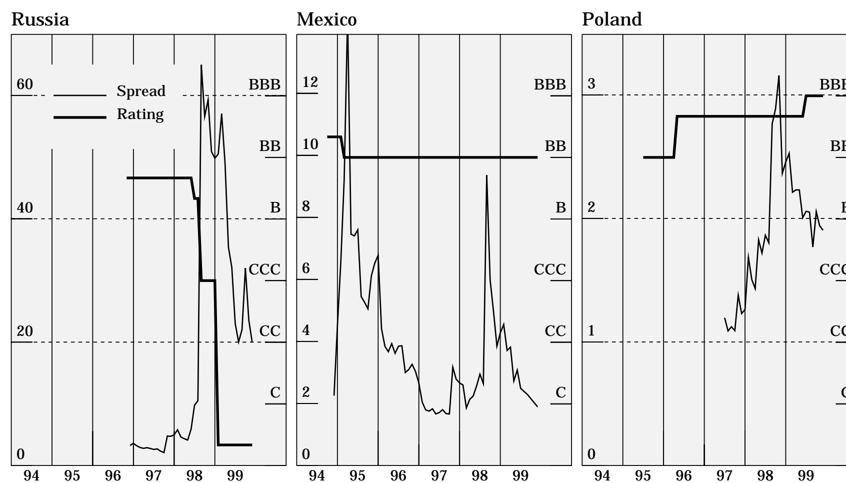
8.3 The role of credit rating agencies in the Russian crisis

The role of credit rating agencies has been particularly criticised in the wake of the Asian crisis: they were seen as cheerleaders when times were good and morticians when trouble came.[44]

In Mexico, credit rating agencies failed to anticipate Mexico's 1994-95 economic crisis. While the December 1994 devaluation of the peso rocked the world financial markets, Standard and Poor's put Mexico's sovereign debt only one notch below investment grade with a positive outlook. At that time, moreover, Mexican domestic paper had been selling as investment grade since the early 1990s. Moody's, in contrast, maintained its non-investment grade across the board. Thus, the Mexican crisis to some extent already produced the notion that credit rating agencies reacted to events rather than anticipated them.[45]

In Russia's case, credit rating agencies appear to have lagged in anticipating the sequence of events as debt arrears occurred and the markets absorbed new information. In general, downgradings occurred after the event. In June 1998, for example, Standard and Poor's cited the persistence of

Graph 3
Emerging market spreads and ratings
(in percentage points and by rating category)



Sources: Bloomberg; Standard and Poor's.

fiscal deficits and increased reliance on external finance as reasons for its downward revision from BB- to B+ (Table 6). The Duma's rejection of implementing key elements of the government's anti-crisis package agreed with the IMF prompted a further downgrade in August. A downgrade to CCC followed the debt moratorium and the default on the local currency bills on 17 August. A further downgrade in September was sparked by concerns about the impact of the central bank's intention to settle wage arrears by printing roubles and its default on Paris Club debt, paralysis of the banking system and lack of a meaningful plan for structural change.[46] In January 1999, Russia's country risk changed to selective default (SD) from a rating of CCC-. A rating of SD implies that Russia is in default on some of its obligations, but expected to meet the rest of them. It was no surprise that only at that point in time, the rating agency warned against defaults on MinFins which were payable in roubles and which were subject to Russian law. The non-servicing of MinFin bonds occurred subsequently.

Ratings can provide additional information (presumably incorporated in market yields) beyond that contained in standard macroeconomic statistics. In addition, credit ratings appear to influence yields independently – over and above their correlation with other publicly available information. In particular, Cantor and Packer (1996) found that rating announcements had immediate effects on market pricing for non-investment grade issues. Larrain et al. (1997) similarly concluded that the rating announcements on emerging market sovereign bonds were highly significant in explaining the relative bond yields. These conclusions were based on short-term "windows," where the effect of a rating change was seen to have an effect on credit risk spread within a few days after the event. This effect appears to have been in place for the August 1998 period in Russia.

Table 6. Foreign currency rating histories of Russia and Mexico

Russia			Mexico		
Long-term	Outlook	Date	Long-term	Outlook	Date
BB-	Stable	4 Oct 96	Adequate		14 Nov 91
BB-	Negative	19 Dec 97	BB+		30 Jul 92
BB-/CW	Negative	27 May 98	BB+	Stable	3 Nov 92
B+	Stable	9 Jun 98	BB+	Positive	18 Nov 98
B-	Negative	13 Aug 98	BB+/CW	Negative	23 Dec 94
CCC	Negative	17 Aug 98	BB	Stable	10 Feb 95
CCC-	Negative	16 Sep 98	BB	Negative	23 Mar 95
SD	NM	27 Jan 99	BB	Stable	3 Sept 96
			BB	Positive	2 Sept 97
			BB	Stable	2 Oct 98

Source: Standard and Poor's.

It is also important, however, not to infer too much into credit ratings. After all, rating strategies tend to be conservative because credit-rating agencies must avoid being overly influenced by cyclical developments and because their credibility depends on rating stability. Hence, a country's rating naturally tends to be far more stable over time than actual domestic conditions or spreads on international bonds.[47] In addition, the level of the spread may not indicate much about the level of the ratings. Sharp movements in international bond prices, like the July/August 1998 interlude in Mexico and to a lesser degree the September/October 1998 blip in Poland underscore how spreads can vary over time without rating changes or substantial shifts in the fundamental conditions of the issuing country. The rating changes for Russia clearly indicate that the probability of default of Russian government obligations has increased during the period under review. Each downgrading was preceded by a spate of negative information.

Ratings are generally intended to address the likelihood of default, whereas yield spreads reflect a broader range of factors, including the prospects for recovery in the event of default. This can differ across classes of bonds,[48] which explains some of the movements of the Russian government

bond spreads. As bond spreads rose to over 6,000 basis points in the immediate aftermath of the crisis Russia in August 1998, the country was effectively denied access to further borrowing from the market. At end-June 1999, the spread remained prohibitively high at 2,300 basis points, yet this relative improvement may have reflected the increased probability of some repayment.

8.4 Lessons from the Mexican and Polish debt scenarios

8.4.1 Mexico

Mexico tried in 1993-94 to overcome a sudden outflow of capital by converting its national currency-denominated debt into foreign currency-denominated debt. At the end of 1993, some 94% of the Mexican government (T-bills) debts were concentrated on *cetes*, which are denominated in the national currency, the peso. In the spring of 1994 the situation on Mexican financial markets worsened as political instability and the beginning of the tightening of US monetary policy increased the vulnerability of the economy. With the Mexican current account deficit at 7.5% of GDP by early 1994, devaluation became an issue and expectations drove up interest rates on domestic debt. The government responded by beginning an exchange of its peso-denominated debt (cetes) into dollar-denominated *tesobonos* (dollar-linked securities payable in pesos) with maturities of no more than a year. By end 1993, tesobonos accounted for only 4% of government securities held by the public while this share reached 71% by November 1994. Of the purchase of USD 20 billion in tesobonos during this time, three-quarters were attributable to the adjustment of the portfolio of non-resident holders of Mexican government debt securities.[49]

The Mexican conversion may have delayed devaluation, but failed to avert it. Indeed, the large volume of dollar paper may have made the devaluation larger when it finally came in December 1994. Economists stated in May 1994 that the peso was overvalued and that Mexico needed devaluation. They proposed a devaluation of 10-20%.[50] In December, when foreign investors refused to roll over their tesobonos, Mexico had to abandon its fixed exchange rate policy, and the peso quickly lost about half its value.[51] IMF and US Treasury credit helped to stabilise the situation on the financial markets months later, but the real costs of the crisis were enormous. In 1995, Mexico's GDP fell nearly 7%.[52]

Russia tried to avoid a liquidity crunch by converting its short-term domestic debt into longer-term debt in June-July 1998. This maturity lengthening appeared possible, since at the time most Russian foreign debts were long-term with relatively low yields to maturity. Some observers thought, however, that foreigners would have been happier to exchange their risky GKOs into less risky eurobonds, which would have also been more attractive in case of devaluation. By easing market pressure, the measure would have given the government enough time to put its finances in order and devaluation would have been avoided.

Foreign holders of GKOs were reluctant to participate in the swap and only a small volume of GKOs were ever converted into long-term bonds. There were no big gains in debt servicing and market pressure increased again two weeks after the swap. Lengthening of the maturity of domestic debt may have helped postpone the devaluation, but the interest costs of the swap were large, as were capital losses arising after devaluation through the increase in the share of dollar-denominated debt.[53] Both the Mexican and Russian experiences of debt conversion suggest that structural economic problems such as an overvaluation of the real effective exchange rate or persistent budget deficits cannot be solved by financial engineering measures. In particular, the conversion of domestic debt into foreign debt can create a small time gain for government, but the costs further down the road may outweigh the benefits.

In Mexico's rescue program, the ensuing debt restructuring program supported by the IMF and US Government credit, reduced fiscal spending by 1.3% of GDP. A national accord among workers, business and government assured that wage and price increases did not cancel out devaluation, thus assuring a significant real devaluation of the peso. Structural reforms allowed private investment into e.g. railroads, opened the telecommunication sector to competition and increased foreign competition in the domestic banking sector. These measures helped Mexican firms increase their competitiveness and achieve stable growth once the crisis had abated.[54] No such support came to pass in

the Russian situation as a one-side moratorium was declared. Indeed, no comprehensive program of restructuring has yet materialised in Russia.[55]

8.4.2 Poland

Poland stopped servicing its debt to commercial bank creditors in the last quarter of 1989. By end 1993 USD 6.3 billion in arrears had accumulated. A Brady-style restructuring operation was reached in March 1994, paving the way for Poland's access to international capital markets.

The Polish situation in 1991-92 may have some relevance for the Russian case. At that time Poland had difficulty in attracting spontaneous private market capital into the real sector of the economy. The country faced large debt payments and reached an agreement with the London Club creditors after protracted negotiations in 1994 implying a comprehensive debt and debt-service reduction of the roughly USD 14 in billion commercial bank debt. In view of Poland's compliance with the IMF program, the Paris Club also agreed on official debt reduction. The debt reduction exercise significantly improved its creditworthiness and paved the way for subsequent healthy private capital inflows, at first mostly as foreign direct investment.[56] Poland gained favourable restructuring terms because of its strong, consistent macro and structural reforms.

Poland's external debt indicators improved substantially after the London and Paris Club agreements. Although the country remained moderately indebted, it appears that the constraints on policy in the years following the debt settlement were relatively small. The very favourable rescheduling terms deferred repayments for a long time, coming due in the early years of this millennium. The traditional strategy of helping the country to grow out of its difficulties appears to have worked in Poland.

Russia may also grow out of its external debt servicing difficulties as it has been running historically substantial current account surpluses and it is endowed with rich natural resources. Nevertheless, Russia continues to experience large capital outflows. A consistent policy package on restructuring terms would probably be advantageous here.

9 Lessons from the Russian crisis

If we learn anything from the Russian crisis, it is that prevention is the first and most fundamental element in crisis management. The best preventive measure is the pursuit of sound domestic economic policies. Unfortunately, political processes have often stymied the implementation of basic structural economic policy elements. More fundamentally, Russia lacks an overall political consensus on the general thrust of economic policy. While the attempt to lengthen the debt profile just before the crisis may have been able to buy some time, it came too late. Russia declared a one-sided external and domestic debt moratorium in August 1998. Such a dramatic step was avoided in Mexico in 1994-95 with external help. In the aftermath of the crisis, foreign private creditors incurred large losses while any attempts at "bailing-in" the private sector in official debt restructuring failed.

The current external debt process of Russia will remain on the agenda for some time. The preliminary considerations point to some compromise in the Paris and London Clubs. German banks (and German taxpayers) will have to absorb the largest part of the anticipated reduction of Russia's debt payment. The developments after the moratorium show that restructuring of the external and domestic debt remains a fairly opaque, messy process. Attempts to increase transparency into these processes or to improve the sequencing of this process have so far been unsuccessful. The preliminary deal with London Club may help Russian Federation to gain access to international capital markets at some point in time. No matter how the debt restructuring problems are ultimately solved, the Russian Federation faces sizeable external debt payments in the next few years (see Item 3 in the Appendix). This reduces its flexibility in fiscal policy after the current mild upturn in the Russian economy ends.

Rating agencies have played a subordinated role in the Russian debt scenario. Most of the time, agencies have adjusted their ratings downwards after market developments, so it seems unlikely that they exacerbated crisis. The market price of Russian debt has been highly volatile, reacting to any

relevant news immediately. In particular, the markets seem to embrace any potential positive new information with enthusiasm.

The Polish experience of the early 1990s may be relevant to further debt renegotiations while the follow-up after the crisis in Mexico argues that a fairly consistent and comprehensive economic policy package is now needed in Russia.

Appendices

Item 1. Chronology of the Russian financial crisis

1997	
November	The central bank refinancing rate is raised from 21 to 28%; a new central rate of RUB 6.2 per US dollar is announced, the intervention band is widened from ±5% to ±15% for the period 1998-2000.
1998	
May	Following liquidity problems, a large bank, Tokobank, is temporarily placed under central bank administration. The refinancing rate reaches 150% on 27 May and fluctuates widely thereafter.
July	Russia and the IMF agree on a stabilisation package of USD 22.6 billion for 1998-99. A first IMF credit tranche of USD 4.8 billion is made available on 20 July. It includes emergency fiscal measures to raise tax revenues and reduce government spending.
August	Two major banks stop payments in early August. To forestall a run on the assets of other credit Institutions, the authorities extend RUB 4.1 billion to a number of banks (using their T-bills as collateral). Limits on foreign exchange purchases by commercial banks are imposed. On 17 August, authorities allow the rouble to float to a new limit of RUB 9.5 per US dollar; payment in rouble-denominated short-term state debt is put on hold and a 90-day moratorium is declared on commercial entities' foreign debt payments. On 23 August, the government is Dismissed.
September	After spending more than USD 9 billion in July and August to support the rouble, the central bank abandons its upper limit of the rouble corridor on 1 September. Six major banks are required to transfer their retail deposits to state-controlled Sberbank and exchange controls are imposed. On 11 September, parliament confirms a new government. The rouble stabilises temporarily at around 16 roubles to the dollar. The Central Bank announces it will bail out the major Russian banks and buy back most of their Outstanding T-bills. The IMF states on 30 September that any further lending to Russia under the July agreement hinges on a strong programme of tax collection and bank reform.
1999	
January	The government debt market reopens; the central bank sets a 120% yield cap.
February	Renewed negotiations with the IMF fail.
April	Preliminary agreement with IMF to disburse USD 4.5 billion over 1½ years on conditions that include explanation of past use of IMF resources and a implementation of a range of economic measures.
May/June	The rouble stabilises at around 24 to the dollar.
July	Russia receives a USD 4.5 billion stand-by credit from the IMF. USD 640 million is immediately available.
August	The Paris Club agrees to postpone for a period of 15 to 20 years USD 8 billion in payment on Soviet-era debt falling due before the end of the year 2000.
September	The first large Russian bank, Menatep, is declared bankrupt. Menetap's debts are reported to be at least USD 1.2 billion. At the end of August, Russia had 1,390 banks, only one hundred less than the year before. IMF continues to withhold the second tranche of the stand-by credit.
November-December	Russia and London Club fail to agree on restructuring terms for the Soviet debt. At the beginning of December Russia misses another interest payment to the London Club creditors, bringing the total arrears to the London Club to USD 1.4 billion. The rouble continues to depreciate, so that at the end of November it stood at 26 to the dollar. IMF continues to withhold further tranches of the stand-by loan.
2000	
February	Russia reaches a preliminary restructuring agreement with the London Club creditors. The old Soviet debt previously handled by Vneshekonombank will be exchanged to eurobonds of the Russian Federation, and at the same time the details of the deal mean that Russia receives approximately 50% reduction in the value of this debt. The deal still requires an approval of 75% of the holders of the debt.

Item 2. Taxonomy of Russian debt instruments

Eurobonds: Payment terms being met
Russia issued its first $1 billion Eurobond in November 1996, and has since issued Eurobonds with a total dollar value of about $16 billion. Denominated in various currencies, Eurobonds are the highest class of Russian debt. Rescheduling is very difficult to negotiate, since Eurobond holders are dispersed around the globe.

London Club debt: In default
In late 1997, Russia completed a deal to restructure about $28 billion of Soviet-era debt to the London Club, which represents more than 600 Western commercial lenders. The debt was split into two types of securities. About $20 billion became "principal notes," or *Prins*, which represent loans that the state-owned foreign payment agent, Vnesheconombank, defaulted on in 1991. The remaining $8 billion became "interest arrears notes," or *IANs*, which represent interest accrued since the default. Russia effectively defaulted on the Prins by end-1998.

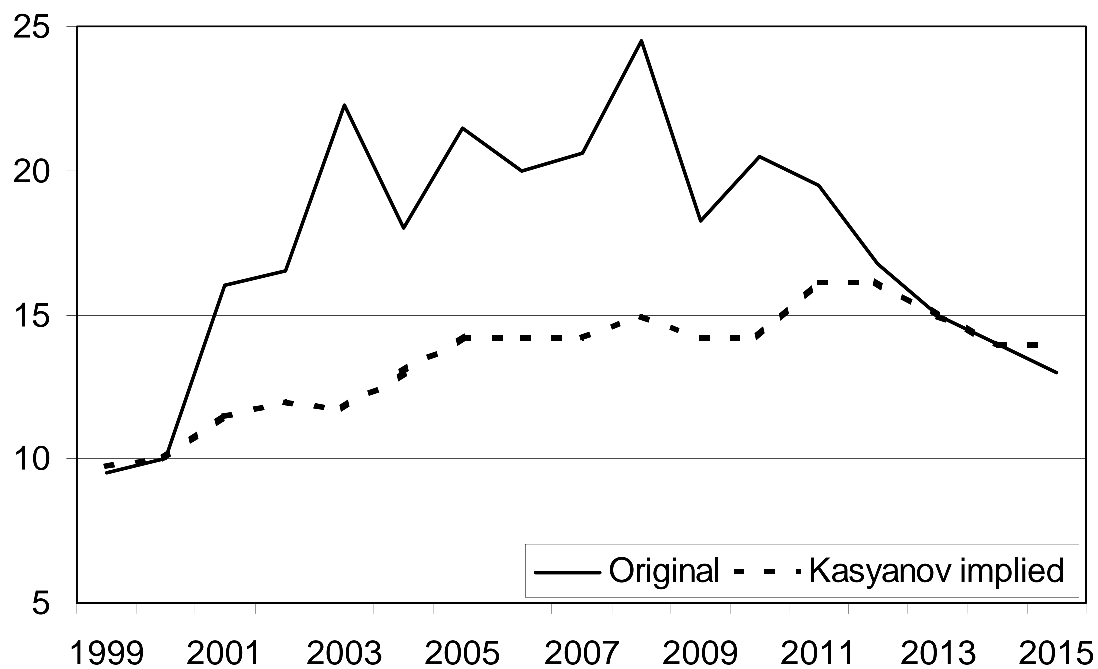
Paris Club debt: Restructured temporarily
In 1996, Russia rescheduled nearly $40 million in Soviet-era debt to the Paris Club, a group of Western governments that have lent money to emerging market economies. In 1998 Russia missed payments on this debt, but in August 1999 Russian Federation and the Paris Club creditors agreed to postpone the $8 billion in debt servicing falling due before the end of 2000. Details on the restructuring are to be agreed later.

MinFin bonds: Payment due
Also known as Taiga bonds, these dollar-denominated securities were issued in 1993 to cover about $8 billion in corporate accounts that Vneshekonombank froze after the Soviet Union's collapse. In 1996, Russia's Ministry of Finance issued two new tranches. MinFin bonds are technically domestic debt under the jurisdiction of Russian law, making it very difficult for foreigners to make claims in the event of a default. Russia has presumably paid $1.3 billion of the MinFins in 1999. In May 1999 Russia missed a payment on the MinFins. They may ultimately be swapped into equity, new MinFin series 98 bonds, or exchanged for OFZs at a sliding interest rate from 15%.

Treasury debt: Mostly restructured
Also known as *GKOs* and *OFZs*, this rouble-denominated debt has been issued by the Russian government since 1993 to finance its budget deficit. By mid-1998, the dollar value of Russian Treasury notes had reached about $70 billion. On 17 August 1998, the government stopped payment on notes set to mature before the end of 1999. Foreigners held about $13.5 billion of that debt. Owners of GKOs and OFZ had to settle for very disadvantageous restructuring terms, and their initial compensation (at market prices) was approximately 1.5 cents to a dollar.

Source: Wall Street Journal, Central Europe, and author

Item 3. Forecasts of Russian Federation's external debt servicing burden, USD billion



Source: Troika Dialog

Note: The forecast given by Finance Minister Kasyanov assumes that both London and Paris club restructure their debts. Some studies estimate the original debt burden lower than Troika Dialog.

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Notes

[1] The broad macro and micro factors leading up to the crisis are described in the IMF's "World Economic Outlook and International Capital Markets," December (1998) and Bank for International Settlements, Annual Report, June, 1999.

[2] The Report by a BIS Working Group of the CGFS (October 1999) on the events of the fall of 1998 (the Karen Johnson Report).

[3] Russian Economic Trends, 13 April 1999.

[4] The amount of USD 40 billion is based on the rouble/dollar exchange rate when the crisis occurred, i.e. 6.3 roubles to the dollar.

[5] Bank of Finland, Institute for Economies in Transition, Russian and Baltic Economies (BOFIT), Russian and Baltic Economies, the Week in Review, 18 June 1999.

[6] Wall Street Journal: " Russia's MinFin Default Leaves Only Eurobonds Sacred," 21 April 1999.

[7] See Financial Times, 25 January 1999.

[8] BOFIT, Russian and Baltic Economies, the Week in Review, 16, 23 April 1999.

[9] See Financial Times, 14 January 1999.

[10] Russia's IMF quota is about USD 8 billion.

[11] Wall Street Journal, 23 February 1999.

[12] For a status review, see JP Morgan (1999) and BOFIT, June 1999. For example, on 17 June the Duma rejected a draft law that would have imposed a new tax on gasoline stations.

[13] IMF, Public Information Notice No. 99/67 (IMF concludes article IV consultations with Russia). By end-September 1999, several structural benchmarks remain to be completed (IMF,News Brief No.99181, December 7, 1999)

[14] See Group of Ten (1996), p. 23.

[15] BOFIT, 24 June 1999: "Germany, Russia's biggest creditor, firmly opposes Russian proposals for forgiveness on Soviet-era debt."

[16] Financial Times, 22 April 1999.

[17] See Buch et al. (1999), p. 19 where the claims of the former Soviet Union are assessed as essentially worthless (see Section 6).

[18] Financial Times, 22 March 1999.

[19] A more in-depth discussion of these issues is found in the section on bailing-in.

[20] See, for example, Hackney and Shafer (1986), p. 479.

[21] Financial Times and Wall Street Journal, 3 August 1999.

[22] BOFIT, Russian and Baltic Economies, The Week in Review, 14 May 1999.

[23] This section relies heavily on information reported by Surubovic and Usakova (1999). It only deals with the former Soviet Union and not with former CMEA countries or other economies.

[24] See Handelsblatt, 8 July 1999.

[25] Financial Times, 26 November 1998. Foreigners had invested USD 13-15 billion, of which USD 550 million were to be repaid.

[26] The story has been somewhat simplified here. For more detail, see Kolleeny et al. (1999).

[27] Wall Street Journal, 22 March 1999.

[28] International Institute of Finance, Russia, March 1999.

[29] Russian Economic Trends, March 1999.

[30] BOFIT, Russian and Baltic Economies, The Week in Review, 18 June 1999.

[31] German banks did not make a large write-down initially.

[32] Merrill Lynch and Co, for example, declined to take a seat on the London Club of bank creditors involved in Russia's Soviet debt restructuring talks (Reuters, 24 June 1999).

[33] This is a rough estimate as about USD 7.7 billion of the Russian papers were held by banks (Table 5), the remainder of the USD 13.5 billion of these papers held abroad appears to be in the hands of other non-bank financial institutions (as they were not in private hands). Note that at the beginning of the crisis in August 1998 foreigners held about RUB 84 billion of GKOs/OFZs which amounted to about one-third of the total value of these papers understanding. At that time, RUB 84 billion amounted to about USD 13.5 billion at a rouble/dollar exchange rate of 6.3.

[34] Wall Street Journal, 3 August 1999.

[35] Sberbank is the dominant savings bank of Russia, holding more than two-thirds of all bank deposits. Unlike other banks, the government insures these deposits.

[36] Contingent credit facilities are another mechanism but are not discussed here.

[37] Group of Ten (1996).

[38] Hackney and Shafer (1986), p. 476.

[39] For details, see Petas and Rahmenan (1999).

[40] For some of the issues and legal complexities involved, see Group of Ten (1996).

[41] Mayer (1999).

[42] Bank for International Settlements (1999) “International Banking and Financial Market Developments,” Quarterly Review, Monetary and Economic Department, June 1999.

[43] Mayer (1999).

[44] Mayer (1999).

[45] Larrain et al.(1997).

[46] Economic Survey of Europe, 1998 No. 3, p. 120.

[47] Similarly, Bank for International Settlements (1997).

[48] Ammer (1997).

[49] OECD Economic Survey (1995), Mexico, p. 26.

[50] Dornbusch and Werner (1994).

[51] It is difficult to assess, even ex post, whether or not an “earlier” devaluation of the peso would have come at less cost and, in particular, how markets would have reacted.

[52] In the resolution of the short-term liquidity crisis which was based on a USD 48.8 billion multilateral financial assistance package, Mexico used the funds disbursed by the authorities of the United States to redeem tesobonos (largely held by US investors). Mexico was thus able to avoid default on its debt obligations. See Banco de Mexico (1996), Chapter IV.

[53] Wyplosz and Yudaeva (1999)

[54] This section ignores the close trade links between Mexico and the US and the buoyant US economy after the crisis.

[55] See also IMF Survey, August 2 1999.

[56] " Trends in Developing Economies," The World Bank, Washington, 1995.

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