Withdrawal/Redaction Sheet
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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. memo	Robert E. Rubin to Vice President Gore re: Economic Reform Themes for Visit by PM Chernomyrdin (1 page)	01/26/96	P5
002. memo	Larry Summers to Secretary Rubin re: Your Meeting with President Clinton Today to Discuss Russia (1 page)	05/20/96	P5
003. memo	Robert E. Rubin to POTUS re: Meeting in Helsinki (1 page)	03/19/97	P5
004. memo	Karin Lissakers (IMF) to Larry Summers & David Lipton re: Russia & IMF (5 pages)	11/03/97	P1/b(1) Unclass.
005. talking points	re: RER Points for Camdessus Call on Russia (1 page)	circa April 1999	P5

COLLECTION:

Clinton Administration History Project

OA/Box Number: 24124

FOLDER TITLE:

[History of the Department of the Treasury - Supplementary Documents] [6]

jp35

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P1 National Security Classified Information [(a)(1) of the PRA]
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PRM. Personal record misfile defined in accordance with 44 U.S.C. 2201(3).
RR. Document will be reviewed upon request.

Freedom of Information Act - [5 U.S.C. 552(b)]

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BACKGROUND ON RUSSIAN ECONOMIC REFORM

Economic Developments in 1995: Last year was Russia's most successful year of economic reform. For the first time it refused large-scale subsidies to failing state industries, maintained a sound budget and fully met the conditions of its $6.5 billion IMF program. The budget deficit was held to about 4% of GDP, inflation fell from 18% monthly in January to 3% in December, and the ruble closed the year 10% above its level at the end of April. Those successes were reflected in the bottoming out of the real economy, as output fell only 4% last year after a 15% drop the previous year. Outside observers such as the OECD and IMF expect Russia will join Eastern European reformers and resume healthy economic growth in 1996, provided reforms continue. To put it simply, Russia is now poised to reap the true fruits of reforms.

Prime Minister Chernomyrdin played a central role in last year's success, intervening personally to secure the IMF loan and strongly backing the reform policies of First Deputy Prime Minister Anatoly Chubais.

Prospects for 1996: Before the Communist gains in the Duma elections and Yeltsin's dismissal of Chubais, Russia's strongest and most effective reformer, prospects for reform looked good. Those events dented the climate of optimism and raised fears that Yeltsin would resort to populist spending measures in an attempt to buy the June presidential elections. But there are realistic prospects that the successful policies of last year may continue. Despite Chubais' dismissal, both Chernomyrdin and Yeltsin seem to understand low inflation and a stable ruble are good politics as well as good economics and have pledged to continue reforms. The old Duma passed a solid 1996 budget in December, which Yeltsin signed into law. It calls for a 3.9%/GDP deficit and 1.9% average monthly inflation -- figures acceptable to the IMF. Although the Communist gained in the Duma, it is a weak institution and the Communists remain a minority.

Relations with the IMF: Russia earned its first IMF standby program last April, which provided $6.5 billion. It met all program targets through December, and final review and disbursement is scheduled for late January or early February. Russia is presently negotiating with the IMF on an Extended Fund Facility (EFF) program to succeed the present program. The EFF is a 3-year loan of about $9.5 billion to support macroeconomic and structural reforms, including tax policy, energy taxation, and banking sector reform. Before Chubais' departure, Russia and the IMF appeared to be on the verge of agreement on the EFF. It is still not clear how Chubais' dismissal will effect the timing of an EFF, though there still appear to be realistic prospects for approval in the near term. The IMF is presently in Moscow negotiating on the EFF.

Debt Rescheduling: Russia owes official creditors about $55 billion, of which $44 billion is old USSR debt that is eligible for rescheduling. Last year, the Paris Club agreed to negotiate a comprehensive rescheduling instead of the one-year deals of 1993-95, provided Russia stayed on track with its 1995 IMF program. The first round of discussions between Russia and Paris Club creditors took place in November and a second round is expected in February. Negotiation of a comprehensive rescheduling is contingent on Russia concluding an EFF program with the IMF.

UNDER SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

96-154584

January 26, 1996

Extended Funds Facility being negotiated
Clinton spoke to Yeltsin this morning

MEMORANDUM FOR SECRETARY RUBIN

ACTION

THROUGH: Lawrence Summers
Deputy Secretary

FROM: Jeffrey Shafer
Under Secretary

SUBJECT: Memo to Vice President Gore on Economic Themes for Visit of Russian Prime Minister

ACTION FORCING EVENT:

Prime Minister Viktor Chernomyrdin will be in Washington January 29-30 for the sixth meeting of the biannual "Gore-Chernomyrdin Commission" (GCC). He will meet extensively with Vice President Gore and various cabinet officials, and you and/or Larry Summers are scheduled to meet him to discuss macroeconomic issues.

The attached memo from you to the Vice President highlights key themes in Russian reform and Western support.

RECOMMENDATION:

That you sign the attached memorandum to Vice President Gore.

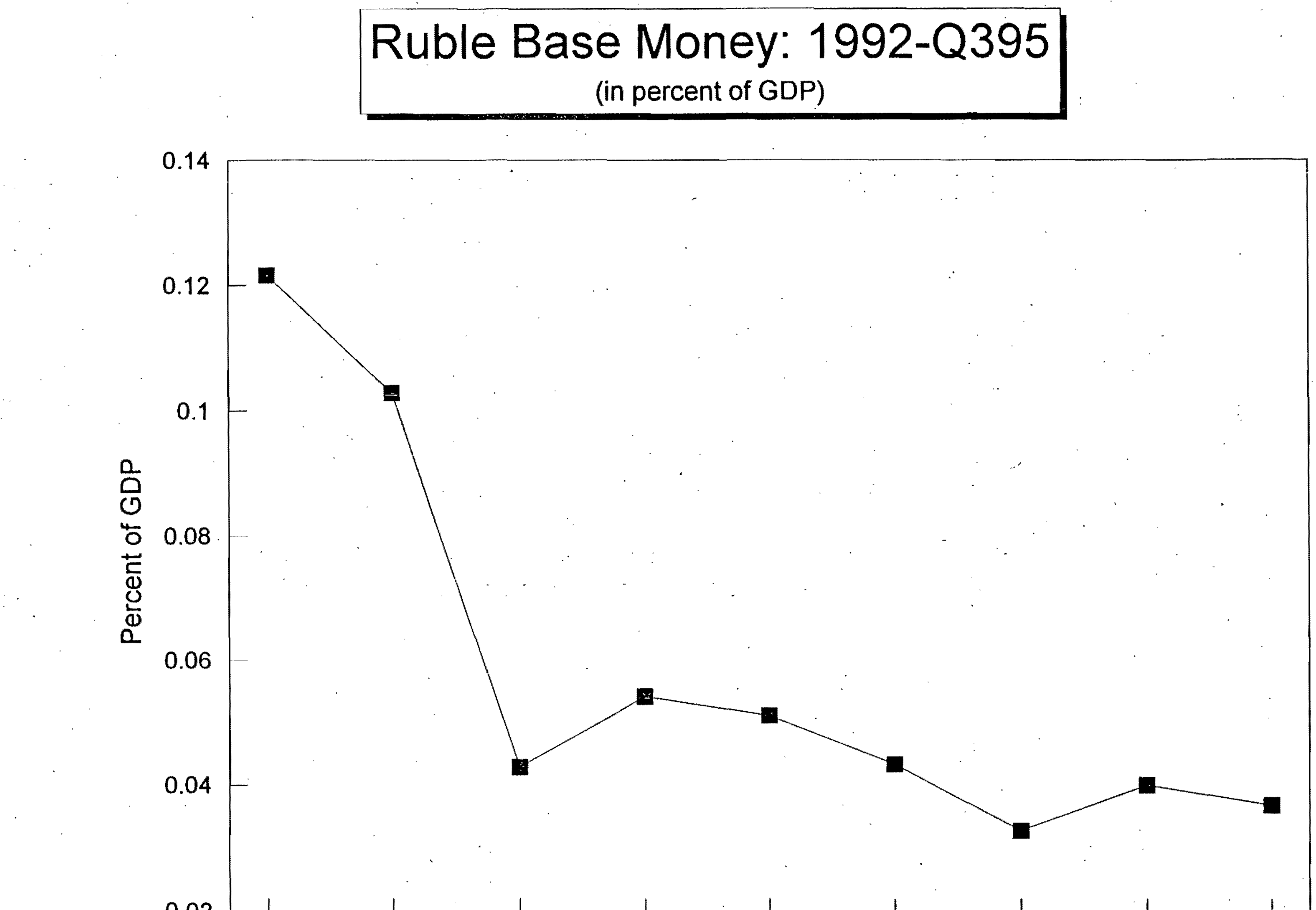
Agree __✓__ Disagree _____ Let's Discuss _____

BACKGROUND:

Prime Minister Chernomyrdin's visit comes at a key point. President Yeltsin's dismissal of First Deputy Prime Minister Anatoly Chubais, other GOR personnel changes, and statements by Yeltsin have created uncertainties about Russia's commitment to economic reform. Meanwhile, Russia and the IMF are negotiating on a comprehensive three year IMF agreement that would deepen Russia's reform program.

The agenda for the Gore-Chernomyrdin Commission meeting covers bilateral trade and investment issues, science and technology, space exploration, defense conversion, health and the environment, and nuclear energy.

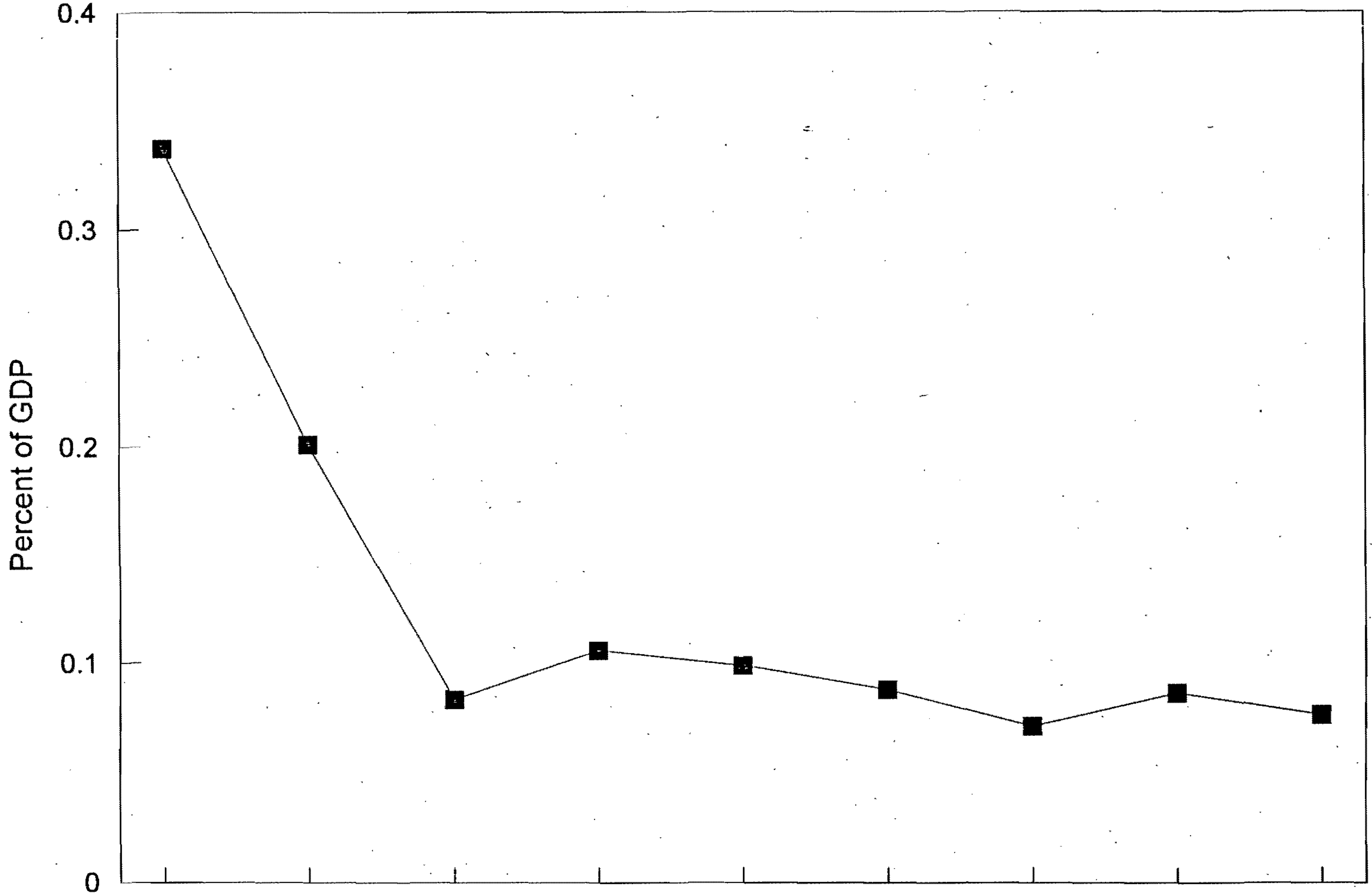
EXECUTIVE SECRETARIAT



	1992	1993	Q194	Q294	Q394	Q494	Q195	Q295	Q395
Base Money	12.2%	10.3%	4.3%	5.4%	5.1%	4.3%	3.3%	4.0%	3.7%

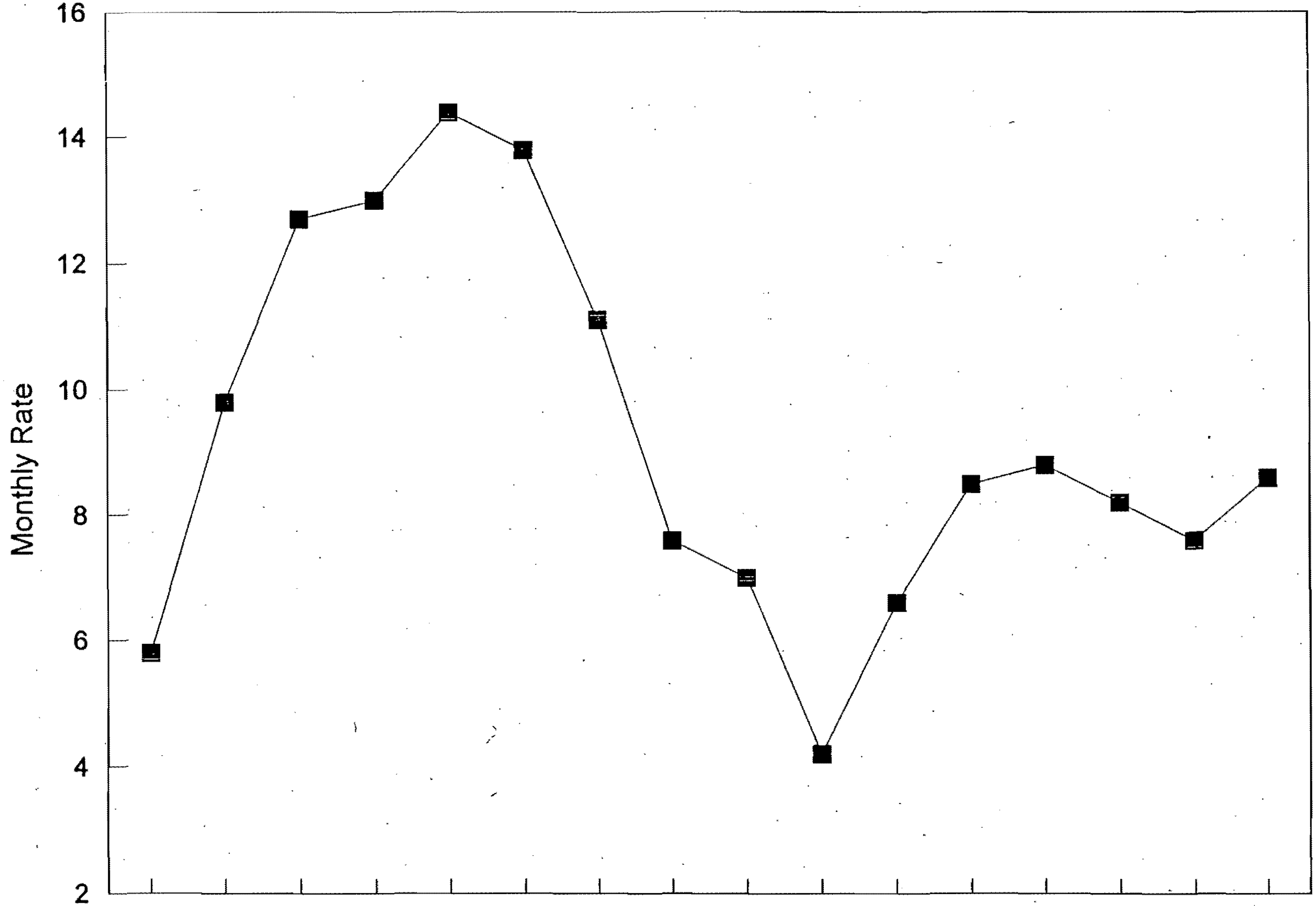
Ruble Broad Money: 1992-Q395

(in percent of GDP)

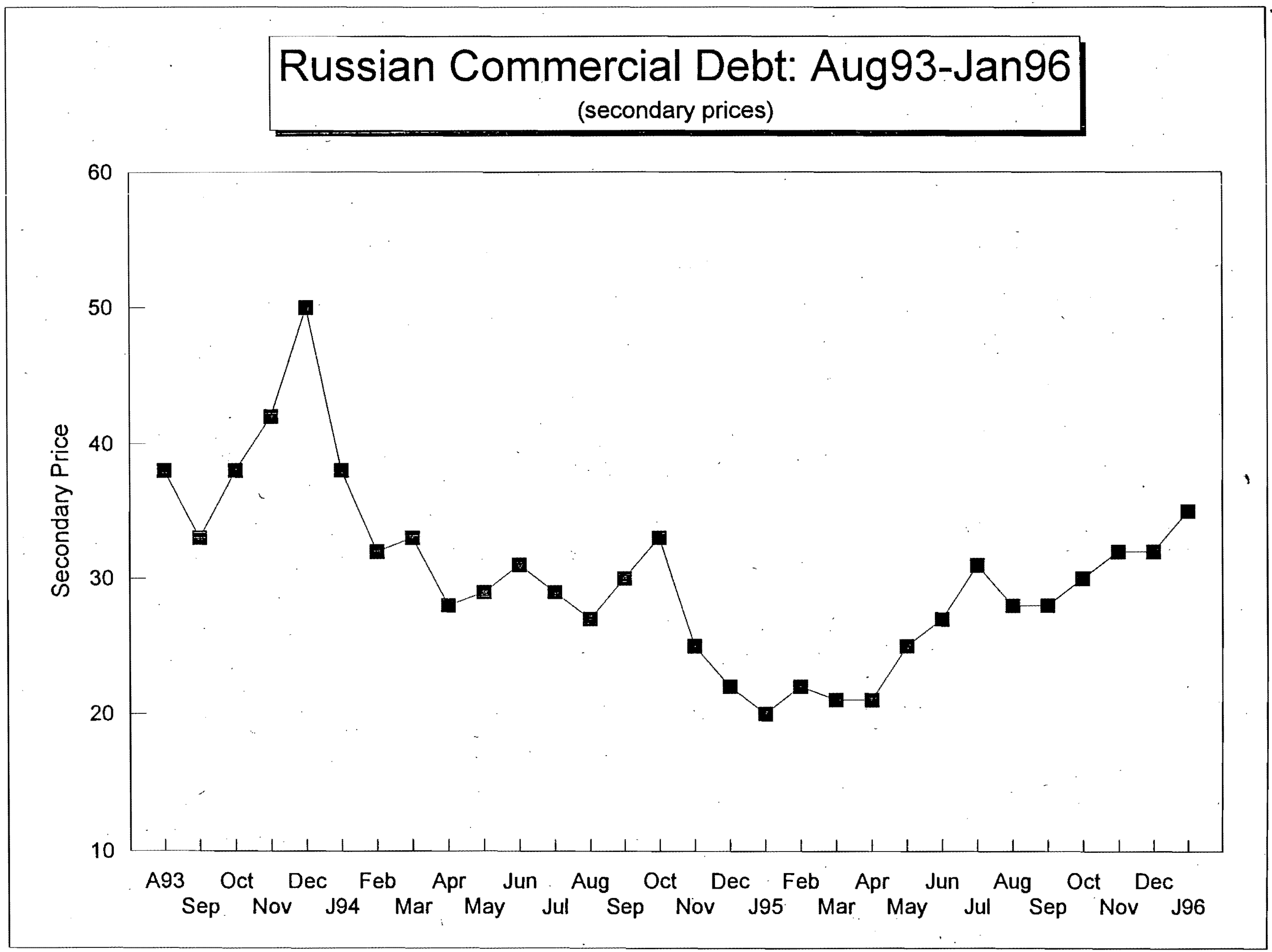


	1992	1993	Q194	Q294	Q394	Q494	Q195	Q295	Q395
■ Broad Money	33.7%	20.1%	8.3%	10.6%	9.9%	8.8%	7.1%	8.6%	7.6%

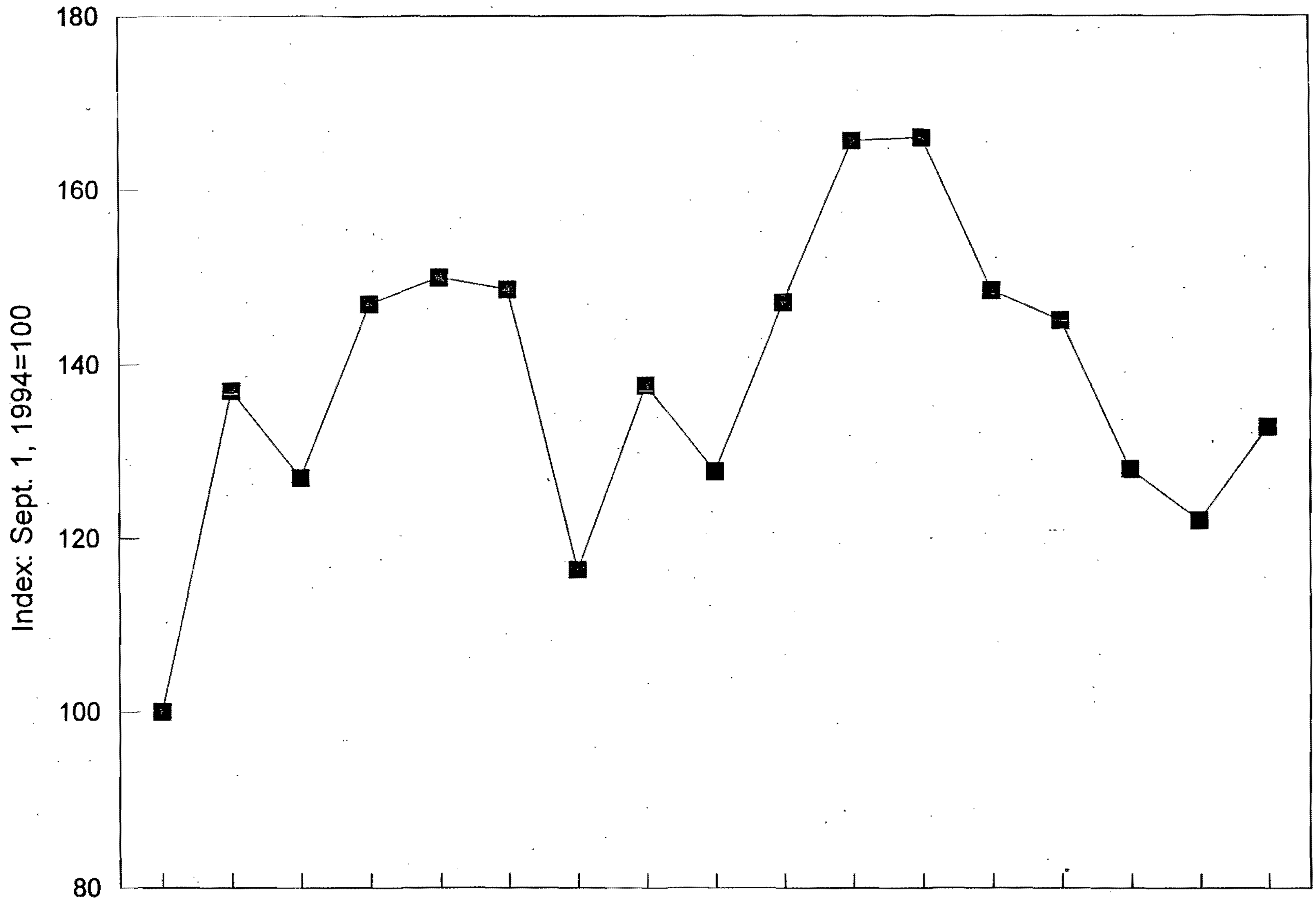
3-month GKO Rates: Sept. '94 - Dec. '95



Month	S94	Oct	Nov	Dec	J95	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
■ 3-Month GKOS	5.8	9.8	12.7	13	14.4	13.8	11.1	7.6	7.0	4.2	6.6	8.5	8.8	8.2	7.6	8.6


Russian Commercial Debt: Aug93-Jan96
(secondary prices)
Secondary Price
60
50
40
30
20
10
A93
Sep
Oct
Nov
Dec
J94
Feb
Mar
Apr
May
Jun
Jul
Aug
Sep
Oct
Nov
Dec
J95
Feb
Mar
Apr
May
Jun
Jul
Aug
Sep
Oct
Nov
Dec
J96

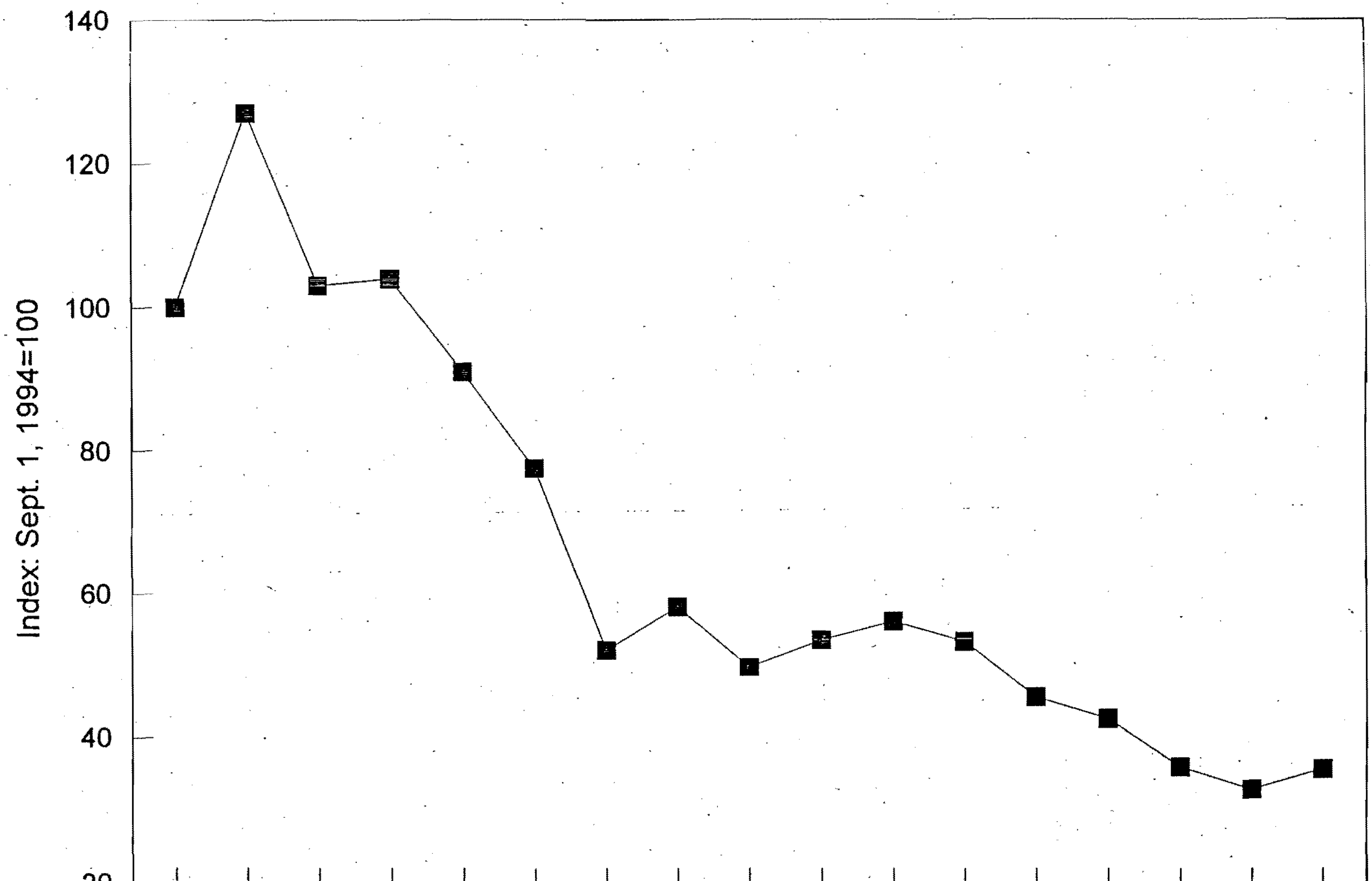
Moscow Times Index: Sep94-Dec95



	A94	Sep	Oct	Nov	Dec	J95	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
■ MT Index	100	137	127	147	150	149	116	138	128	147	166	166	148	145	128	122	133

Real Moscow Times Index: Sep94-Dec95

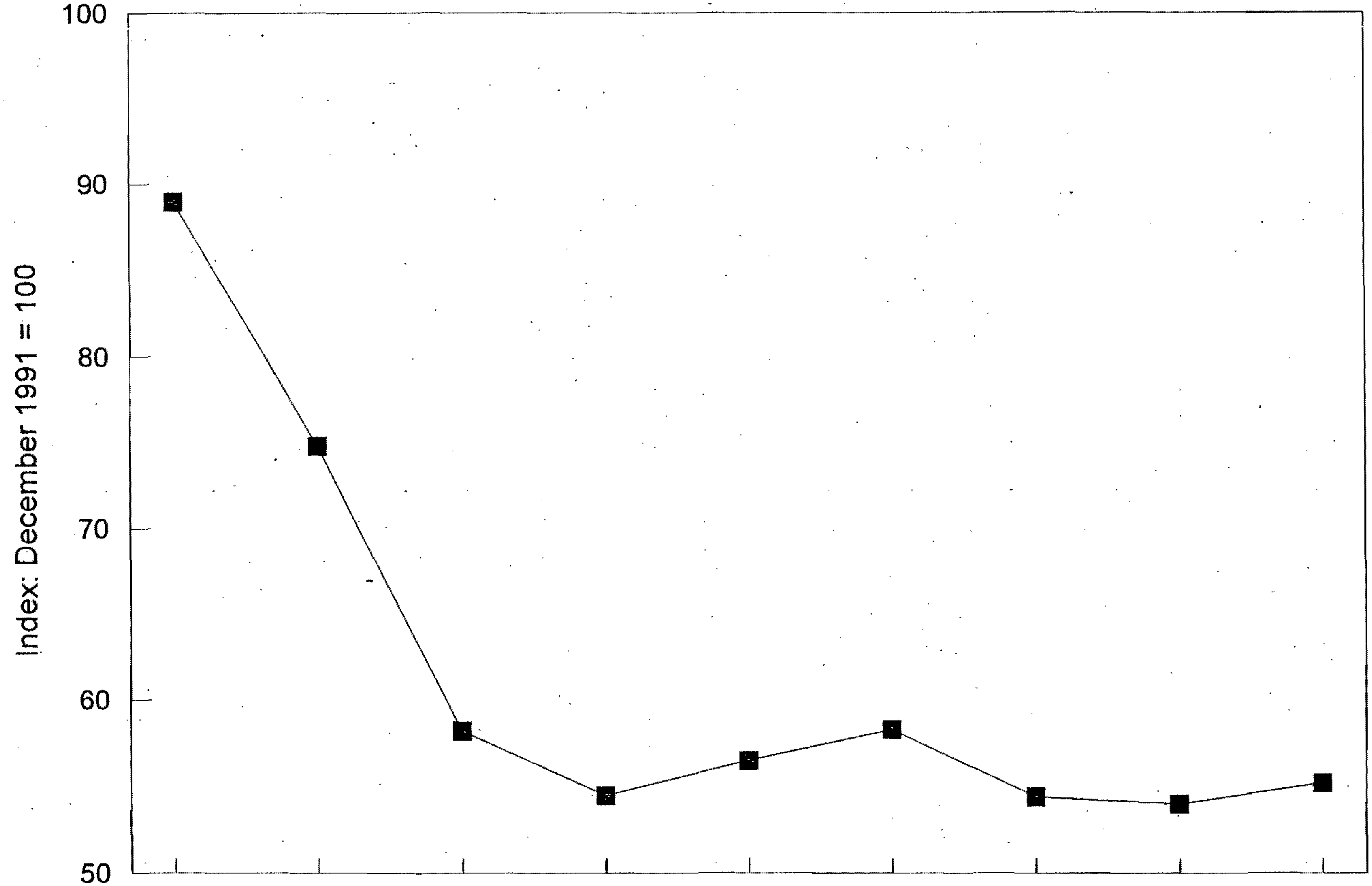
(deflated by CPI)



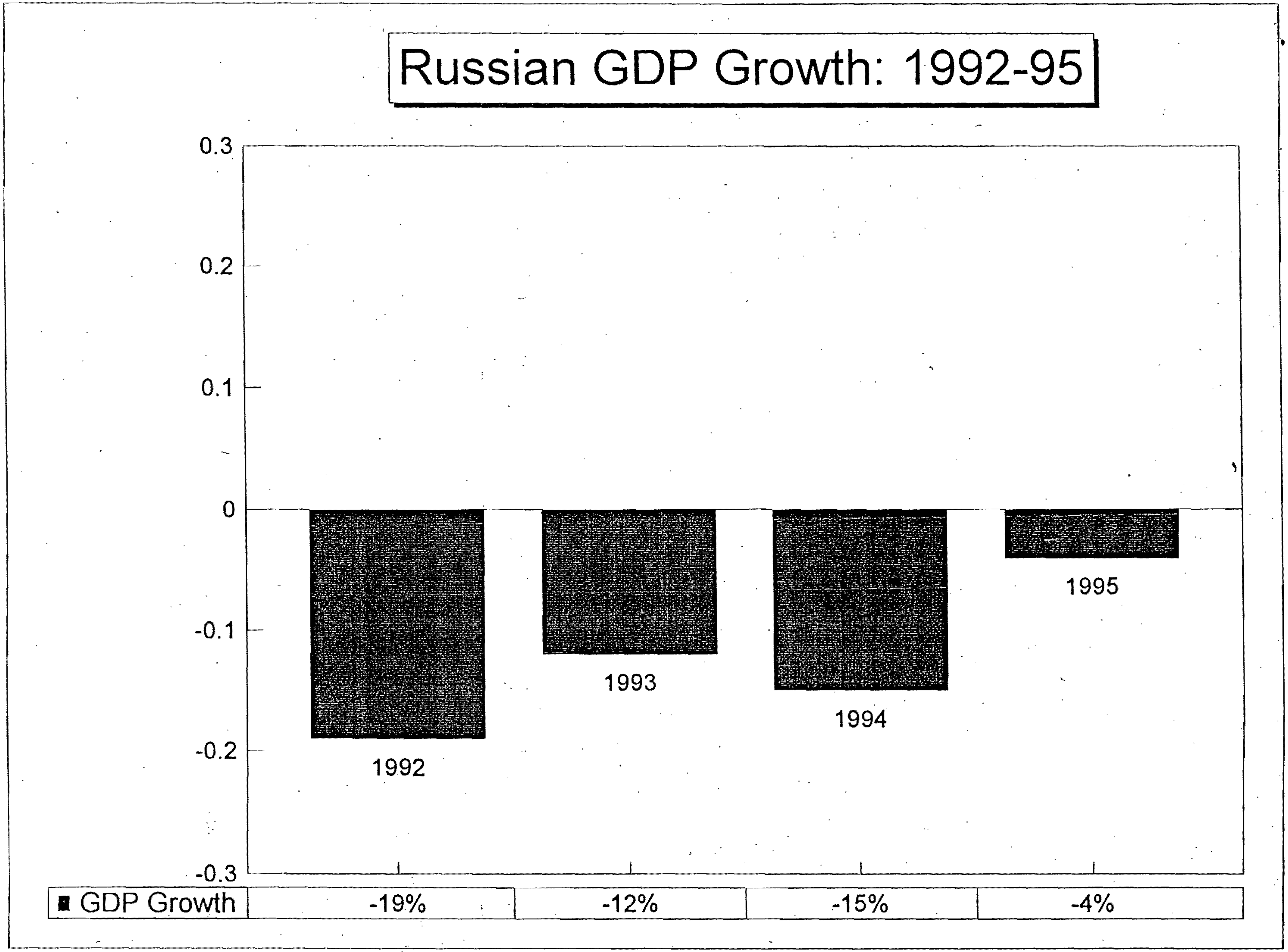
	A94	Sep	Oct	Nov	Dec	J95	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
■ Real MT Index	100	127	103	104	91	78	52	58	50	54	56	53	46	43	36	33	36

Real Industrial Production: 1992-Q395

(annual and quarterly data)



	1992	1993	Q194	Q294	Q394	Q494	Q195	Q295	Q395
■ Real Ind. Prod.	89.0	74.8	58.2	54.5	56.5	58.3	54.4	54.0	55.2


Russian GDP Growth: 1992-95
0.3
0.2
0.1
0
-0.1
-0.2
-0.3
1992
1993
1994
1995
GDP Growth
-19%
-12%
-15%
-4%

DEPARTMENT OF THE TREASURY
WASHINGTON

96-155153

ASSISTANT SECRETARY

February 9, 1996

INFORMATION

To: David Lipton
CC: Summers
~~[illegible]~~ Shafer
From: Bob Rubin

MEMORANDUM FOR SECRETARY RUBIN

THROUGH: Jeffrey R. Shafer
Under Secretary for
International Affairs

FROM: David A. Lipton
Assistant Secretary for
International Affairs

This note, which did not get to Larry Summers before his departure today, is to inform you about a meeting he and I had with Strobe Talbott this morning to discuss Russia.

After some discussion about the low probability that the Russian elections produce a result favorable to U.S. interests, we focussed on three operational issues.

First, Strobe raised the apparent Franco-German effort to give Russia full membership in the G-7 in Lyon, saying he suspected that Kohl was driving the process. He suggested that State, Treasury and NSC communicate to our German counterparts why we thought this was a bad idea, and that we state an absolute refusal to agree. I agree.

Second, Larry explained that IMF Managing Director Camdessus, who will travel to Russia February 21 to seek high level political commitments to continued reform, is likely to conclude agreement on the $9 billion IMF loan. The terms, however, will call for 15 policy actions (tax, regulatory, and spending measures) and monitoring of monetary developments through the end of the first quarter as requisites for formal IMF approval of the loan in early April. This approach is aimed at lowering the chance of program deviations before the Russian elections. Disbursements will be monthly for six months and noncompliance will lead to nondisbursement. Strobe seemed comfortable with this approach and this timetable.

I will Let me know if there is something I can do.

Third, Larry argued that we ought to rethink our earlier plans to follow the IMF loan with a comprehensive Paris Club debt rescheduling. If the Russian elections turn out badly, negotiating over debt rather than IMF loans will likely be our source of leverage, and one we would not want to have given up.

I think I agree

Strobe was ambivalent, asking if we could not go ahead with the rescheduling in a way that would permit revocation or interruption if Russia turned away from reform. He also wondered whether the U.S. would want to be seen as stopping both Russia's efforts to join the G-8 and the debt deal. Larry warned that interruption, while possible, could be problematic, and explained that we could wait until March or even April to make a final decision, by which time the G-8 issue might be behind us.

Let's discuss

Why. They'll have their ~~debt~~ deal.

EXECUTIVE SECRETARIAT

February 15, 1996

NOTE FOR DAVID LIPTON

FROM: BOB RUBIN

First
I agree. Let me know if there is something I can do.

Second
Why. They'll have their deal.

Third
I think.

Last Paragraph
I agree.

Let's discuss.

Attachment

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002. memo	Larry Summers to Secretary Rubin re: Your Meeting with President Clinton Today to Discuss Russia (1 page)	05/20/96	P5

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Russia's Finances

Summary: As his election draws close, Yeltsin wishes to increase spending to maximize his political prospects. If he does so, however, he runs a significant risk of breaking the budget and causing a negative reaction in the government bond and foreign exchange markets. This would likely have a more harmful impact on his political prospects than any benefit he hopes to gain from increased spending. Facing this dilemma, Yeltsin is looking for Western financial support both to allow him to increase spending and as political cover which could help calm the markets. We have explored possible financing options, both from the U.S. and from the international financial institutions, and have determined that there is no mechanism for significantly increasing the financial support that might be made available to Russia prior to the election:

-- Direct support from the U.S. would require Congressional approval, which is not feasible.

-- Similarly, additional money from the IMF is a non-starter. Any modification of the IMF program which would lead to an increase in planned disbursements prior to election -- either by increasing Russia's access under quota or by further frontloading payments due the second half of 1996 -- would have to be approved by the IMF Board. Given its overtly political motivation, this would not likely get the support of the major shareholders, even with high level pressure.

-- The Fund has taken a creative approach in a number of areas to help Russia stay on program in order to continue providing the financial support envisaged under the EFF. Further flexibility may be required to accommodate Yeltsin's expenditure plans in the run-up to the election.

Yeltsin's Message: Yeltsin's bottom line is straightforward: the stakes in the upcoming election are so profound that he must spend more to counter Zuyganov's appeal. Chernomyrdin reiterated this position in a call and letter to the Vice President; Deputy Prime Minister Davydov underscored this theme in a meeting with the Vice President and in two meetings with Deputy Secretary Summers. Some political realism from the Russian Embassy in Washington may have dampened Yeltsin's initial effort to seek a \$2.5 billion credit directly from the U.S. Davydov is now pitching for our help to get the IMF to add \$2-3 billion to Russia's recently approved \$10.2 billion loan and to disburse the full increase in May and June.

Economic Realities: The IMF has confirmed that the pension funds are currently fully funded, although they may come under pressure later this year if enterprises run arrears in their payroll taxes. Our dialogue with the Russians has not altered our view that Russia has the resources to stay current on wages and pensions. Indeed, Davydov noted that the only "emergency" at hand was not economic, but the election itself. With or without additional financial support from the West, Russia has ample foreign reserves -- and can raise more from private foreign sources -- if it is intent on increasing spending. The Deputy Minister of Finance acknowledged this, adding that Russia would prefer to increase spending with Western finance -- a tacit signal of Western approval.

Russia's Constraints: Yeltsin cannot afford a radical departure from reform that would cause a ruble collapse just before the election. Not only would it damage Yeltsin, it would strengthen Zuyganov's contention that he offers a credible economic alternative, as his rivals would cast a break with the IMF as a Yeltsin failure. Moreover, there is the economic reality that Russia is barely meeting program targets despite significant flexibility from the IMF. Most obvious options to give Russia greater room for spending have been tapped, making it all the harder to press the IMF further.

Western Realities: U.S. efforts to raise money for Russia will result in a bruising and probably futile domestic debate. Congress, including many Democrats, will not vote for a capital infusion for Russia in the midst of our domestic budget battles. We have blunted criticism of our support for Russia's IMF program by arguing that the loan is based on monthly monitoring of strict performance criteria. Any overt effort by the U.S. to mobilize financing for Yeltsin's campaign promises -- directly or by modifying the IMF program -- would open the Administration to criticism here at home.

IMF Efforts: In the past two months, the IMF has taken a number of steps to provide Russia with greater flexibility within the program:

-- In the first quarter, when Russia's cash tax revenues fell to less than 70 percent of projected levels -- and significantly short of the 85-90 percent revenue floor called for in the program -- the IMF agreed to count tax offset vouchers issued late last year and in the first quarter of this year as revenue. (The IMF learned only recently that the GOR issued an estimated $4 billion in these vouchers in lieu of paying contractors.) This allowed the GOR to meet its revenue targets under the program, given its poor revenue collection performance.

-- The Fund increased Russia's deficit target in the second quarter by $1.6 billion in order to allow Russia to use the $2.4 billion German and French loans to pay off wage and pension arrears.

-- This week, the Fund staff told us informally they plan to propose to increase the budget deficit targets by $1.5 billion over May and June to take into account higher than expected interest costs on government debt. (In the first quarter of the year, the Russian government had to offer more that 150 percent yields on its T-bills in order to meet finance its debt.)

Conclusion: Our best hope is to continue working quietly with the IMF to encourage it to take as flexible as possible an approach in the run-up to the election. This will increase the prospects that Russia will be allowed to draw the two $340 million tranches planned for end-May and end-June.

If Yeltsin chooses to increase spending, he has access to sufficient resources to do so. It is important that we underscore with the Russians the possible risks -- financial and political -- associated with this course of action. However, if they choose to increase spending, we can discuss with them mechanisms for channeling resources in a manner that makes the most sense. (For example, Russia should remove restrictions on foreign participation in its T-bill market, which would attract additional foreign reserves and bring down interest costs which are cutting into the GOR's discretionary spending.)

TREASURY CLEARANCE SHEET

NO.______
Date______

MEMORANDUM FOR: X SECRETARY ☐ DEPUTY SECRETARY ☐ EXECUTIVE SECRETARY

☐ ACTION X BRIEFING ☐ INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH
☐ TESTIMONY ☐ OTHER ______

FROM: Lawrence Summers, Deputy Secretary
THROUGH: ______
SUBJECT: Your Meeting with President Clinton Today to Discuss Russia

REVIEW OFFICES (Check when office clears)

- ☐ Under Secretary for Finance
  - ☐ Domestic Finance
  - ☐ Economic Policy
  - ☐ Fiscal
    - ☐ FMS
    - ☐ Public Debt
- ☐ Under Secretary for International Affairs
  - ☐ International Affairs
- ☐ Enforcement
  - ☐ ATF
  - ☐ Customs
  - ☐ FLETC
  - ☐ Secret Service
- ☐ General Counsel
- ☐ Inspector General
- ☐ IRS
- ☐ Legislative Affairs
- ☐ Management
- ☐ OCC
- ☐ Policy Management
  - ☐ Scheduling
  - ☐ Public Affairs/Liaison
- ☐ Tax Policy
- ☐ Treasurer
  - ☐ E & P
  - ☐ Mint
- ☐ Savings Bonds
  - ☐ Other

NAME (Please Type)	INIT.	DATE	OFFICE	TEL. NO.
INITIATOR(S)				
Wes McGrew	wm	5/20/96	ICC	622-2876
REVIEWERS				
Mike Froman	wm for	5/20/96	IC	622-0770
David Lipton			I	622-1270
Jeff Shafer			U	622-0060

SPECIAL INSTRUCTIONS

☐ Review Officer ______ Date ______ ☐ Executive Secretary ______ Date ______

DO F 80-02.1 (04/89)

1996-SE-004999

Department
of the Treasury

Departmental Offices

Assistant Secretary for
International Affairs

to: Secretary Rubin

room: date: 6/17/96

Attached are some draft materials on Russia and Bosnia which we plan to provide to the White House for use in the President's Lyon briefing materials. We will be providing you separately with briefing materials for the Russia and Bosnia related discussions at Lyon.

cc: Larry Summers
Jeff Shafer

David A. Lipton

room 3430
phone 622-1270
Fax 622-0417

RUSSIA ECONOMIC SITUATION

Suggested Points:

- o Commend you for success in reducing inflation to low levels, stabilizing the ruble, and implementing your IMF program, despite election pressures.

- o A victory in the second election round will provide a renewed mandate for economic reform and offer new opportunities. Confidence will return to financial markets and domestic and foreign investment will be poised to accelerate. Encourage you to seize that opportunity.

- o A key task will be to restore tax revenues so that you can fund needed state spending while further advancing financial stability.

- o Want you assure you we will continue strongly to back IMF and World Bank support for your economic reform.

Background:

Russia made strong progress on economic reform over the past year, as inflation fell to a new low of 1.6% monthly, the ruble stabilized, and output bottomed out. The past few months have been difficult as Yeltsin tried to meet critical expenditure needs in the face of falling tax revenues, and at the same time to maintain financial stability and stick to Russia's new IMF program. Yeltsin has so far managed to do both, by slashing non-essential spending, using loans of $2 billion from Germany and $400 million from France, and selling off foreign exchange reserves to keep the ruble stable. The IMF also showed unusual flexibility, twice modifying Russia's program to allow temporary increases in the deficit.

The financial situation will likely remain fragile in the few weeks between the two election rounds, due to continuing nervousness in financial markets. We have asked the IMF to monitor the situation closely and explore every possible mechanism for reacting in the event of financial market instability. If Yeltsin wins the second round, financial strains should recede and investor confidence return. Russia will then need to work hard to restore tax revenues so it can meet legitimate state spending needs while maintaining financial stability. A victory will offer Yeltsin a mandate to intensify economic reform.

THE STATUS OF ECONOMIC REFORM IN RUSSIA

Russia's economic performance strengthened last year as it stuck to its ambitious economic reform program supported by the IMF. Progress continued in 1996 under Russia's new $10 billion three-year IMF program, which calls for deeper reforms.

- o Inflation dropped from 18% monthly last January to a new low of 1.6% this May. The ruble stabilized last year, allowing the Central Bank to boost reserves $10 billion. After adjusting for inflation the ruble has risen 65% over the past year.

- o The 1995 budget deficit was slashed in half from its 1994 level of 10% of GDP, a cut of $8 billion. Russia's economic program calls for a 4% of GDP deficit this year and 2% in 1998. In past years, the deficit was financed by printing money. Last year and early this year, nearly 60% of the deficit was financed by non-inflationary treasury bill sales.

- o Real GDP fell 4% last year, after dropping 15% in 1994. Many sectors are now growing and GDP growth may be positive this year. The average monthly wage is nearly $160, a post-reform high. Unemployment is just under 9%.

- o About 70% of the economy is now in private hands, though privatization has slowed this year, and land privatization in particular has lagged.

Recent Developments: Russia stayed on its reform program and met IMF monthly targets through early June. But the financial situation has been very difficult in the past few months. Tax revenues have fallen sharply, the market for government debt has plummeted, and the ruble has been under pressure. Russia has weathered those difficulties by cutting spending, using German and French loans to pay off wage arrears, and selling foreign exchange to support the ruble. The financial strains are largely related to political uncertainties and should ease once the elections are over.

Relations with the IMF: The IMF loaned Russia $4 billion in 1992-94 and $6.5 billion in 1995. This March the IMF approved a $10.2 billion three-year program, called an EFF, and has disbursed $1 billion. The EFF calls for cutting the fiscal deficit and reducing inflation to Western levels. It also intensifies structural reforms across a broad range of areas including tax reform, trade, banking and capital markets, agriculture, and social programs.

World Bank: The World Bank has approved $5.6 billion in loans to Russia since 1992, and disbursed about $1.6 billion. The Bank will likely approve a $500 million loan in late June to support coal sector restructuring and may approve a $500 million social sector loan in the second half of this year. The annual lending pipeline for Russia is about $1.5 billion.

Debt: The Paris Club agreed this year to reschedule $40 billion in Russian official debt over 25 years. It was the biggest Paris Club rescheduling ever and was on exceptionally generous terms. The deal should free Russia from the need for further reschedulings. Russia reached agreement in principle with private bank creditors last November on rescheduling $32 billion over 25 years. A final agreement will likely be signed in the second half of the year.

ECONOMIC RECONSTRUCTION IN BOSNIA-HERZEGOVINA

Objectives

Our objectives on Bosnian economic reconstruction issues at the Lyon summit are:

- o To highlight improvements on the ground and the contribution of the international community's efforts to the reconstruction of Bosnia over the past year.

- o To endorse the World Bank priority reconstruction program in 1997 and beyond, and to call on the Bosnians to do their part to create the institutions necessary for a viable economy and for the effective disbursement of foreign assistance. Specifically, the Bosnians must satisfy the necessary institutional and stabilization preconditions for Bank/Fund policy-based loans, which were previously committed to at the Blair House meeting of the Federation Forum and in earlier agreements.

- o To commit to specific steps to improve 1996 reconstruction efforts, including expediting disbursements of pledges (e.g., 50% disbursement of 1996 pledges by end-1996); strengthening donor coordination through the 13 sector task forces on the ground to ensure that donor assistance meets the priority needs of the Bank's program (i.e., to fill the $700 million financing gap in the $1.4 billion worth of 1996 projects developed by the Bank) and the institutional and policy reform goals identified by the Bank and the Fund.

- o To commit G-7 governments to provide sufficient resources to help Bosnians help themselves on reconstruction and transition to a market economy and specifically those needs identified in the World Bank's 1997 priority program.

International Financial Support

The international financial community has engaged in an extraordinary effort to produce a visible peace dividend in Bosnia. In response to a request from G-7 Finance Ministers, the Fund and the Bank developed a preliminary needs assessment and a medium term financing scenario. The Bank developed a $5.1 billion priority reconstruction plan for a 3 - 4 year period. The financing scenario identified $6 billion of total financing needs over the next three years for import reconstruction needs, debt service, officials reserves buildup and exports. The $6 billion is to be financed notionally as follows: $1.5 billion in IFI support and some private flows toward the end of the 3 year period; $1.5 billion in Paris and London Club debt reduction; and $3 billion in bilateral donor support, largely concessional. The U.S. has as its goal to contribute 20% ($600 million over 3 years) toward the bilateral donor support. Two donors' conferences co-hosted by the Bank and EU raised $1.8 billion for the first year of the Bank's $5.1 billion priority reconstruction plan.

The World Bank has already approved $550 million in projects for 1996, $170 million of which could be disbursed by the elections in September. USAID estimates that, by year-end, it could disburse $15-20 million under its Municipal Infrastructure Services Project and $45 million under its Reconstruction Finance Facility. Disbursements and coordination could be improved. To ensure that the Bosnians enjoy the greatest peace dividend prior to the conclusion of IFOR's mandate and, ideally, prior to the election, the Leaders will call on their governments to disburse at least 50% of 1996 pledges before end-1996. For the $1.4 billion in 1996 projects it has prepared for approval, the World Bank has identified only $700 million in financing thus far and, therefore, the Leaders will encourage donors to meet the priority reconstruction needs identified by the Bank and to fill this gap. They also will encourage the donors to strengthen their coordination through the 13 sectoral task forces operating in Sarajevo. Finally, the Leaders will endorse the World Bank's 1997 plan for Bosnia's reconstruction, which will set the stage for pledging conferences later this year. (We would reiterate its intention to seek $200 million for 1997 and $200 million for 1998.)

Economic Structure/Policies

The Dayton Accord envisages a highly devolved fiscal structure. Since there is to be a modest role for the state (e.g., service debt, and conduct monetary and foreign trade policy), only about 5% of public expenditure is expected to occur at the State level, compared with 25% at the entities level. This relatively small function for the State was designed at Dayton to allay Serb fears that the Muslims would use a more powerful State government to raise revenues from the Serb area to pay for social expenditures in the Muslim area. Within each entity, newly-created cantons and existing municipalities are expected to provide local services such as health, education and social expenditures; together the cantons and municipalities are expected to account for the remaining 70% of total public expenditure.

One of the goals of the Summit is to reinforce the message that the Bosnians need to do their part to build the necessary institutions and to adopt the appropriate policies to facilitate economic reconstruction within and between the entities. The World Bank conditioned its $110 million adjustment credit on the Bosnians creating a Federation banking agency and a Federation privatization agency, ensuring that customs revenue (the main source of revenue currently) is transferred to Federation accounts, and establishing a unified payments system to facilitate transactions throughout the Federation. The Bosnians appear to have met all but the last condition, which is hung up on the opposition of the Central Bank governor. To secure an IMF agreement, the Bosnians will have to take further action to create a Federation budget and budget process and a Federation tax administration, as well as adopt a sound fiscal policy framework.

Following the election, the Bosnian parties must, in addition, establish institutions and pursue policies to strengthen interaction between the Federation and Srpska, including creating a single Central Bank and national currency, linking payments systems, removing customs checkpoints, and harmonizing customs and other economic policies. At Dayton, there was distrust that the Muslims would cause rapid inflation by monetizing budget deficits to pay for social expenditures and transfers to loss-making state-owned enterprises. To allay such distrust, the Parties adopted a rule that the new central bank (to be created after the election) would operate as a currency board for the first 6 years with a foreigner (nominated by the IMF) as governor and the local ethnic representatives as deputy governors. There would be no possibility of bank financing of the deficit under this arrangement.

IFI Support/Conditionality

The World Bank has effectively used its conditionality to secure important institutional developments in the Federation in exchange for a $110 million adjustment credit. It is important that the Leaders support that conditionality, particularly if the Bosnians fail to establish a unified Federation payments system (the outstanding World Bank condition) prior to Lyon.

The IMF will have some additional conditions that the Bosnians must meet before it is prepared to come forward with a program. In contrast to the Bank, however, the Fund has remained rather general in its discussions, rather than defining specifically the conditions under which it would be prepared to go forward with a program. Once the World Bank's conditions are fully met, it would be useful for the USG to press Fund management to be less distant (e.g., to make the possibility of a Fund program seem within grasp) and creative (e.g., to consider ways in which the Fund could structure a program with the Federation alone if it proves impossible to incorporate Srpska).

Assistance to Republika Srpska

The international community faces a dilemma on assistance to Republika Srpska, which is still dominated by indicted war criminals Karadic and Mladic. On the one hand, we want to show a peace dividend to the people there, both to strengthen the desire for peace and also to enhance the chances for economic recovery throughout Bosnia and the neighboring region. On the other hand, we do not wish to do anything that strengthens the positions of Karadic and Mladic. We also face a statutory requirement that the Administration oppose assistance (bilateral or multilateral) to states harboring war criminals.

In general, we are supporting humanitarian assistance throughout Srpska and limited reconstruction assistance if it is decentralized in nature (vs. large infrastructure projects) and does not strengthen the Karadic/Mladic regime. Some of our partners (e.g., Britain, France and Russia) favor much more extensive assistance to Republika Srpska and argue that denying support could cause a popular backlash in the Srpska elections in favor of the hardline regime. For the near term, the issue is temporarily muted, because the Karadic regime has refused to sign loan documents with the Bosnian state which are required for the Bank to lend through the State to Srpska, and the State has refused to assume responsibility for loans to Srpska.

BACKGROUND ON BOSNIA-HERZEGOVINA

Economic Decline and Recovery

Bosnia's GDP per capita plunged to about 1/4 its pre-war level, to about $500 in 1995. At war's end, industrial production in the Muslim majority area was less than 10% of pre-war levels. Some 75% of the Federation's workforce is unemployed, although there is a growing gray economy of small private sector service firms that is not captured in the data. About 80% of the Federation population received at least some humanitarian food aid in 1995. During reconstruction, we expect strong economic growth, as an estimated 300,000 soldiers are demobilized and employed in the civilian economy, with real GDP forecast to grow 35% in 1996 and 21% per annum in the 1996-2000 period. Even with the return of some refugees from abroad, per capita income is forecast to climb almost 40% in 1996 to about $725. There appear to be large income disparities at present by ethnic area, with monthly wages averaging about DM30 in the Muslim majority and Serb majority areas, compared with about DM350 in the Croat majority area.

Structural Issues

Bosnia inherited Yugoslavia's brand of socialism, whereby "socially-owned" enterprises were de facto state-owned but effectively controlled by enterprise management and company unions, who sought to maximize wages and salaries rather than profits. In turn, the enterprises owned bank subsidiaries, which had highly concentrated loan portfolios of subsidized loans to their parent companies. Bosnia urgently needs to privatize these enterprises and banks to create a private sector competitive economy, although there is tremendous domestic pressure to increase support for state enterprises as tools for employing demobilized soldiers. There appears to have been some new private sector development in the service sector (e.g., in banking) in the Muslim and Croat majority areas during the war. In contrast, the Serb majority area appears to be very much an old-line state-owned economy.

Political Situation

Following three years of war and ethnic cleansing in Bosnia, the U.S.-brokered Dayton Accords were signed in December 1995 in Paris. Dayton provides for a highly devolved state (Republic of Bosnia and Herzegovina), where most of the functions generally associated with central government (e.g., defense policy) are instead the domain of two constituent entities: the Federation (Muslim-Croat) and Republika Srpska (Serb). Prior to the elections, which aim to create a unified state presidency, parliament, and constitutional court, there is a climate of tremendous political uncertainty and distrust, both within the Federation and between the Federation and Srpska.

The political climate is quite polarized. Elements of the Bosnian Serb community do not wish to interact with Bosnian Muslims, as illustrated by the burning of Serb-held Sarajevo suburbs before the Federation took them over. The Federation has been plagued by deep divisions between Muslims and Bosnian Croats which has, for example, plagued efforts to create a unified payments system. Moreover, political extremists tend to be winning out over moderates: indicted war criminals Karadic and Mladic remain in power in Bosnian Serb entity, Muslim gangs and police are intimidating Serbs who remained in Sarajevo, many Bosnian Croat leaders want independence from the Federation or to join Croatia, and none of the parties is permitting the full freedom of movement or return of displaced persons.

National and local elections are to be scheduled for no later than September 14, provided conditions exist for free and fair elections. In the face of limitations on freedom of movement, freedom of assembly, and independence of the media, and the retention in power of indicted war criminals Karadic and Mladic in Republika Srpska, the U.S. is perceived to be putting pressure on the Organization for Security and Cooperation in Europe (OSCE) to make the determination that those conditions exist.

1996-SE-008440

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

September 5, 1996

David -
Thank you.

MEMORANDUM TO SYLVIA MATHEWS

FROM: David Lipton DL

SUBJECT: Secretary Rubin's Questions Regarding Russia

The Secretary asked whether Treasury was represented at the meeting between Vice President Gore and World Bank President Wolfensohn. Larry Summers and I attended this meeting. The Vice President delivered a message urging the Bank to take a lead role in helping Russia to carry out its structural reform plan (Treasury had prepared the Vice President's talking points). Larry Summers was asked to supplement the Vice President's presentation with details on the types and amounts of support which we hope the Bank would provide. [Larry's talking points are attached, for your information.]

Larry and I both have followed up with the Bank and the IMF on intensifying the support for reform in Russia, including, most immediately, support for Russia's ailing banking sector. We will discuss support for Russia further with the G-7 in the Deputies' meetings in September and anticipate doing so in the Ministers' meeting at the Bank/Fund annual meetings as well. The Russians will again be invited to participate in one part of the G-7 Ministers' meeting.

Please let me know if you wish to discuss this in more detail.

cc: Jeff Shafer
Larry Summers

The Secretary of the Treasury

September 10, 1996

NOTE TO DAVID LIPTON

FROM: Bob Rubin

Thank you.

1996-SE-009226

DEPARTMENT OF THE TREASURY
WASHINGTON

September 30, 1996

ASSISTANT SECRETARY

MEMORANDUM FOR SECRETARY RUBIN
DEPUTY SECRETARY SUMMERS

THROUGH: JEFFREY SHAFER
Under Secretary

FROM: DAVID LIPTON
Assistant Secretary (International Affairs)

SUBJECT: Crime and Corruption in Russia

You asked about Russia's economic prospects, given the widespread crime and corruption in that country. In sum, Russia's crime and corruption problem reflects the fact that there is simultaneously too much and too little government in Russia today:

-- Too great a burden on the private sector, which drives legitimate economic actors underground and provides ample opportunity for individuals to manipulate economic activity through non-market mechanisms; and

-- Too little presence in arenas where governments must act to create the legal regimes and institutions necessary to establish and enforce basic economic rights.

In the context of Russia's economic reforms to date (e.g., privatization, deregulation), there has been some progress in the first area. However, there has been little progress in the second, which is likely to remain a longer-term challenge.

The USG and the international financial institutions are engaged on this issue, both directly and indirectly. The IMF is pressing for significant structural reforms (e.g., tax simplification, privatization) to complete the economic reform agenda, thereby reducing the opportunities for corruption. The World Bank also is working to facilitate structural reform and to strengthen Russia's legal system. In addition, various USG agencies are providing technical assistance on economic reform and are working with Russian institutions to enhance their capacity to crack down on financial and other crimes.

<u>Relationship between Crime/Corruption and Economic Progress</u>

Crime and corruption may not preclude economic progress (c.f., post-war Italy), but they do discourage economic activity in the same way high taxes do. They extract a particularly heavy penalty on activities with a long-term payout and encourage capital flight. In some cases (e.g., Zaire, the Philippines under Marcos), corruption has retarded an entire economy.

Crime and corruption in Russia has its roots in the central planning era, when working "around" the system was the only way for workers to provide basic goods for the families, factory managers to obtain needed inputs and party bureaucrats to earn the influence and luxury goods they craved. After 70 years of life under Communist rule, it is probably overly-sanguine to expect the transformation of Russia into a rule-of-law state to occur in less than a generation.

Still, there has been a certain degree of progress, particularly in addressing the problem of too much government in the economy. With the deregulation of the economy, there are fewer opportunities for government corruption. For example, with the liberalization of the trading sector, there are fewer requirements for approvals and licenses and less opportunity for bribery. (As a mid-level official of the Ministry of Economics was recently quoted, "There is no more bribery because there is nothing left to sell.") In addition, a number of state-owned financial institutions (e.g., Sberbank, the largest bank in Russia) have been turned over from corrupt apparatchiks to reform-minded managers. Finally, with the privatization of entire sectors of the economy (e.g., minerals), some indices of crime (e.g., the murder of managers) have declined.

Or course, serious problems remain. The Finance Ministry still has the power to grant tax exemptions and, therefore, is potentially susceptible to bribery. In addition, there is widespread crime among private economic actors which reflects the weakness of the government's legal regime and enforcement capabilities.

Too little government

-- Lack of well-defined property rights, including ownership and control (e.g., absence of land ownership rights, weak shareholder rights).

-- Absence of adequate enforcement institutions (e.g., to enforce basic contract rights), encouraging actors to seek private enforcement mechanisms.

-- Unregulated monopolies, collusion and anti-competitive behavior (e.g., absence of antitrust legislation and enforcement).

Too much government

-- Non-transparent and over-burdensome tax system (e.g., up to 34 different taxes with marginal tax rates in some cases exceeding 100% of profits), driving economic activity underground and encouraging otherwise legitimate economic actors to seek protection from the tax system.

-- Need to acquire permission from multiple government entities to engage in normal business practices (e.g., non-market mechanisms for assigning exporters access to oil pipelines), opening the door to bribery and manipulation.

-- Provision of products at below world market prices (e.g., coal subsidies), creating an opportunity for illegal trade and arbitrage.

-- Non-transparency and favoritism in law and governance (e.g., non-transparent cash privatization auctions).

Efforts to Address this Problem

The structural reform elements of Russia's IMF program will take significant steps toward addressing the incomplete reform picture which creates opportunities for crime and corruption. Specifically, Russia is expected to take the following actions:

-- **Taxation:** Produce legislation to reform value-added and profits taxes.

-- **Privatization:** Produce audits of major state-owned enterprises; offer major state-owned assets for sale with foreign participation.

-- **Monopolies:** Establish procedures to reform the pricing of natural gas to reflect costs.

-- **Budget:** Produce legislation on government procurement policies.

-- **Capital markets:** Produce legislation on securities regulation.

In addition, the World Bank has launched a $58 million legal reform project to draft the necessary commercial laws for a market economy and to strengthen the ability of Russia's legal institutions to enforce those laws.

Finally, the USG is engaged in a number of efforts to address issues that impact crime/corruption, including the following:

-- Treasury is providing highly-qualified technical assistance to develop a new, rational tax code and to strengthen Russia's tax administration.

-- Other U.S. agencies have programs concerning the rule of law, commercial law development (including the drafting of a new civil code), land privatization and capital markets development.

-- In addition, a number of U.S. agencies, including the IRS, ATF, Secret Service and FBI, are working with Russia's Central Bank, Finance Ministry and State Tax Policy to strengthen Russia's ability to deal with money laundering, counterfeiting and other financial crimes.

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003. memo	Robert E. Rubin to POTUS re: Meeting in Helsinki (1 page)	03/19/97	P5

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004. memo	Karin Lissakers (IMF) to Larry Summers & David Lipton re: Russia & IMF (5 pages)	11/03/97	P1/b(1) Unclass.

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

UNDER SECRETARY

FEB 06 1998

MEMORANDUM FOR SECRETARY RUBIN
DEPUTY SECRETARY SUMMERS

FROM: UNDER SECRETARY LIPTON DL

SUBJECT: RUSSIA

Current market anxiety about Russia presents a significant near-term risk to reserves and the exchange rate peg. Russia is clearly vulnerable: foreign exchange reserves of around $9-11 billion are exceeded by the roughly $15 billion in foreign holdings of Russian GKOs (short-term ruble-denominated government bonds). One factor fueling anxiety is limited central bank transparency on reserve levels and the exposure of the banking sector. A deeper problem is the perception that the Russian leadership either does not have, or will not spend, the political capital needed to fix the fiscal situation. Lack of a clear message from President Yeltsin on the urgency of the reform agenda has only exacerbated doubts about Russia's economic health and prospects.

Since December, the central bank has demonstrated its commitment to the peg through decisive interest rate hikes (GKO yields are now around 45%). But without swift, resolute action on the fiscal side, the CBR at best will be blamed for another year of no growth due to high rates and at worst could be forced to push rates to truly painful levels and/or fail to sustain the peg, destroying confidence in Russia's inchoate macroeconomic stabilization. The boost on the fiscal side must come from three politically difficult sources: (1) much higher 1998 tax collection (up from 9%/GDP in 1997 to 11% in 1998), (2) steeper cuts in 1998 **non-interest** expenditure levels (to perhaps 11% of GDP), and (3) passage of a sound Russian tax code.

To be fair, the negative perception is partially lagging the reality of a rising level of competence and shared objectives in Russian politics and government. Deputy Assistant Secretary Mark Medish and Eurasia Office Director Nancy Lee just returned from a visit to Moscow and report that on a number of key reform issues -- including the tax code, pension reform and other social sector reform -- a pragmatic consensus is forming on the basic parameters of what needs to be done. It helps that the current system is so broken in highly visible ways (public wages and pensions go unpaid) that gradualism is not perceived as a credible option. The government is exerting real leadership by producing coherent plans, while Duma opposition, though still formidable, is becoming more responsible. Policy battles are increasingly focused on the familiar democratic problem of balancing competing interests rather than on the fundamental merits of reform. And the fate of individual reformers has become less central to prospects for success. Mr. Chubais and others have groomed what may well be a critical mass of competent, effective agents of change sprinkled throughout key agencies.

But the sheer size of the agenda awaiting action this year gives rise to major investor doubts, particularly in view of the evident power struggles among key Kremlin players. The recent power shift away from Chubais and Nemtsov in favor of Chernomyrdin has, at least temporarily, weakened two critical engines and spokesmen for reform. During these pendulum swings, there is a tendency for progress to stall unless and until Yeltsin intervenes. On a positive note, Yeltsin began to show his hand this week with a publicly reported call on Chubais to push the draft tax code through its first of three readings in Parliament by end-March, convene a commission to protect investors' rights, take a harder line with major corporate tax delinquents, and keep spending within the government's limited means in the first quarter (no new borrowing).

Finally, in two key areas, Mark and Nancy report that it is not clear that the Russians even have a coherent strategy: (1) raising tax collections this year, and (2) pursuing competitive, transparent privatization of remaining large state-owned enterprises. Recently, in the bellwether case of ROSNEFT (the last big state oil company), the GOR has waffled on both the share of the company offered to private investors and whether foreign oil companies can participate. These uncertainties raise suspicion that the oligarches are positioning themselves to win more victories this year, keeping Russia squarely on the path of crony capitalism -- but without East Asia's offsetting track record of long-term macroeconomic stability, high domestic savings rates, sizable FDI inflows, and dynamic export orientation.

Next Steps

Our immediate objective should be to raise the level of awareness among the Russian leadership of the current market perceptions and risks. We have to raise their sense of urgency. I would pick five areas where they need a concerted, high-profile push to achieve prompt progress: tax collections, the tax code, the budget/spending control, privatization, and shareholders' rights.

I propose as first steps that Larry call Mr. Chubais and the central bank governor, Mr. Dubinin, to urge him to take a firm stand with the GOR; Dubinin should make clear that he will not take on the entire stabilization burden. You are also likely to see the Finance Minister, Mr. Zadornov, in London on February 22. And, as events unfold, we should also consider the follow-on step of a Vice Presidential call to Prime Minister Chernomyrdin to reinforce the message that: (a) markets are seriously concerned and (b) the situation is unlikely to improve and could deteriorate sharply without clear signals and real action in these five areas.

1998-SE-003843

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

UNDER SECRETARY

MAR 26 1998

MEMORANDUM FOR SECRETARY RUBIN
DEPUTY SECRETARY SUMMERS

FROM: **UNDER SECRETARY LIPTON** PL
(International Affairs)

SUBJECT: Russia: Markets Calm Amidst Cabinet Reshuffle

Summary

Russian President Boris Yeltsin fired his PM and dismissed his entire cabinet on Monday. Accusing the cabinet of lacking dynamism and initiative, Yeltsin said Russia needs "a new and strong government" to restore impetus to economic reform. Fuel and Energy Minister Sergei Kiriyenko has been appointed Acting PM and asked to put together the new cabinet. It is hard to say what this week's cabinet reshuffle will mean for economic policy management, but there is a reasonable chance that reformers will still be in a position to make policy. Key issues for the new team will be unchanged: fiscal austerity, revenue collections, tax reform, and improving bank supervision and transparency. So far, the markets have reacted calmly to the shakeup.

Who's in, Who's Out, and Next Steps

Yeltsin issued separate decrees firing PM Chernomyrdin, First Deputy PM Anatoly Chubais, and Interior Minister Anatolia Kulikov. Chubais is expected to become chairman of the board of Russia's electricity giant Unified Energy System, a post from which he can continue to influence the reform agenda.

Many other cabinet members are expected to be reappointed. One day after sacking the government, Yeltsin praised the work of Foreign Minister Yevgeny Primakov and Defense Minister Igor Sergeev, seemingly indicating that they will stay on. Yeltsin also is expected to keep First Deputy PM Boris Nemtsov, a leading reformer, in the Cabinet. (Nemtsov is Kiriyenko's former boss and political mentor.)

The new cabinet is expected to be announced before Yeltsin's trip to Japan scheduled for April 11-13. A presidential spokesman stated that Acting PM Kiriyenko is the most likely candidate for Prime Minister. The 35-year-old Kiriyenko already has come under fire from many corners of the Duma. However, Yeltsin holds a Damoclean sword over the Duma: if it fails to approve the President's nominee in three tries, the Duma will be dissolved and new elections called. (Of course, if the Duma fails to blink, Russia could head for a prolonged period of political uncertainty that it can ill afford.)

Prelude to the Shake Up

A presidential spokesman has stated that the decision was Yeltsin's alone. But several observers have asserted that "oligarch" Boris Berezovsky instigated the dismissal of the government. Berezovsky was a long-time antagonist of Chubais and recently turned against PM Chernomyrdin, particularly after the PM approved the upcoming sale of 75 percent plus one share in Rosneft. In addition, Berezovsky has questioned whether the uncharismatic Chernomyrdin would be electable in the 2000 presidential ballot. At the same time, leading reformers like Chubais and Nemtsov, too, had been at loggerheads with Chernomyrdin in recent months, for example when Chernomyrdin tried to reduce their portfolios. Thus, in a sense, Yeltsin deftly capitalized on a common denominator between the oligarchs and the reformers -- their growing dissatisfaction with the Prime Minister -- and reasserted his own supremacy.

Yeltsin's gambit is that Berezovsky and his fellow oligarchs will be pleased with the dismissal of the unpopular Chubais and the underwhelming Chernomyrdin but that the reform agenda can still be carried out effectively under the guidance of Kiriyenko, Nemtsov (by many accounts, Yeltsin's favorite) and Yeltsin himself. As always, a key variable in this scenario for Russia is Yeltsin's own stamina.

Markets Calm So Far

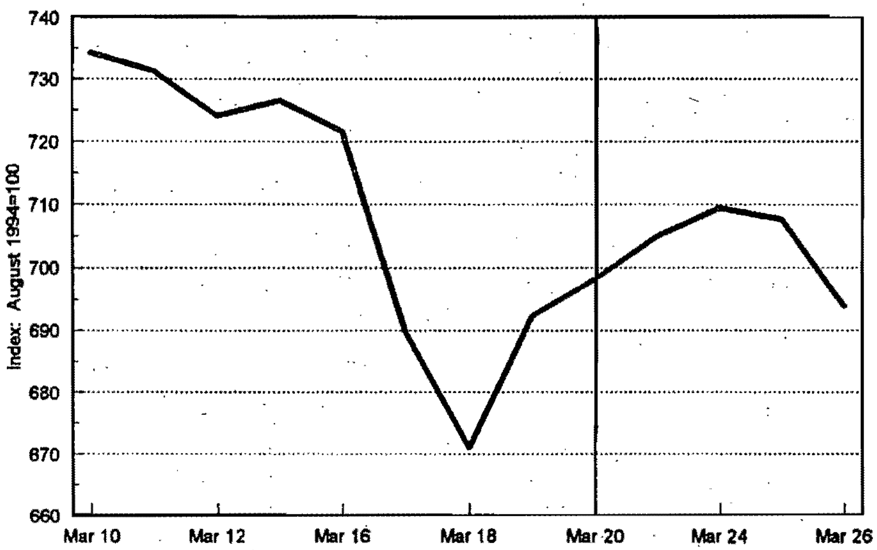
Equities and Currencies Unfazed: The equity and currency markets have shown little effect from the political shakeup. The Moscow Times equity index is down 0.6% for the week though Thursday and the Ruble is off 0.14% for the week through Thursday at 6.09R to the dollar.

T-bill Rates Down: Yields have fallen slightly on the secondary GKO market this week, down to 25.3% on Thursday. On the primary market, yields rose to 29.0% on weaker demand for one-year GKOs on March 25, up from 27.8% on March 18.

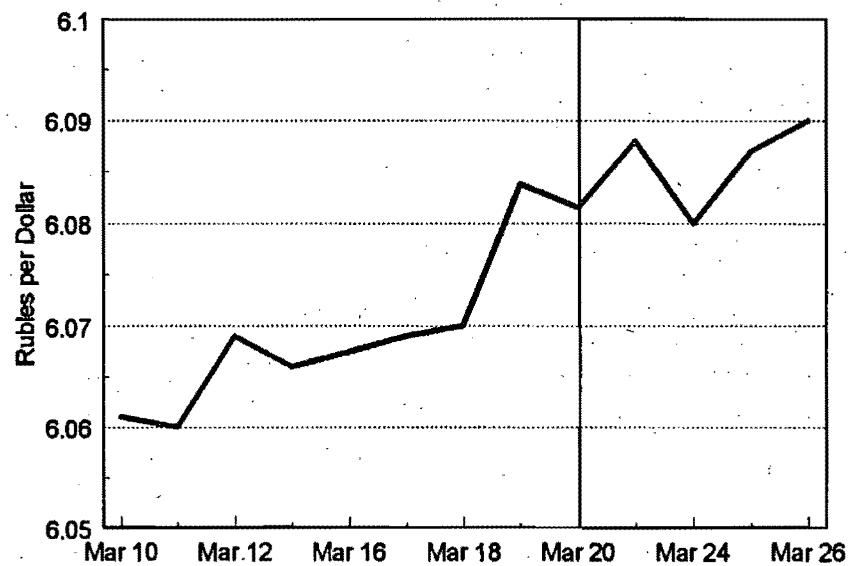
Bond Spreads Up Slightly: Yields on the secondary market for Russia's 10-year $-Eurobond are up 21 b.p. for the week through Thursday to 10.67%, with its spread over US Treasuries rising from 483 b.p. last Friday to 494 b.p. Thursday.

Russia Floats Eurobond: Another indication that the market is not overly concerned about the political situation was Tuesday's robust Eurobond auction, marking Russia's return to international capital markets. Originally scheduled for Monday, Russia floated a 7-year, DM 1.25B ($685M) Eurobond at 475 b.p. over German bonds. The bond pays a 9.375% coupon. The oversubscribed issue (initially planned at DM 500M, then raised to DM 1B and finally DM 1.25B) attracted far greater interest than had been expected, and the yield was only moderately higher than the secondary market rate on the DM bond floated last March, which is now trading at about 450 b.p. over German bonds.

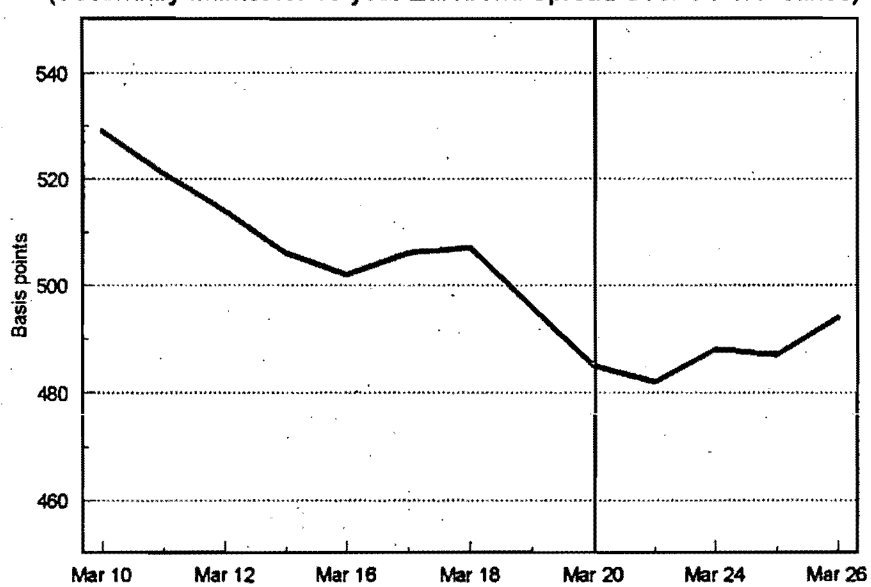
Stocks Market Trend Unclear
(Moscow Times Equity Index)



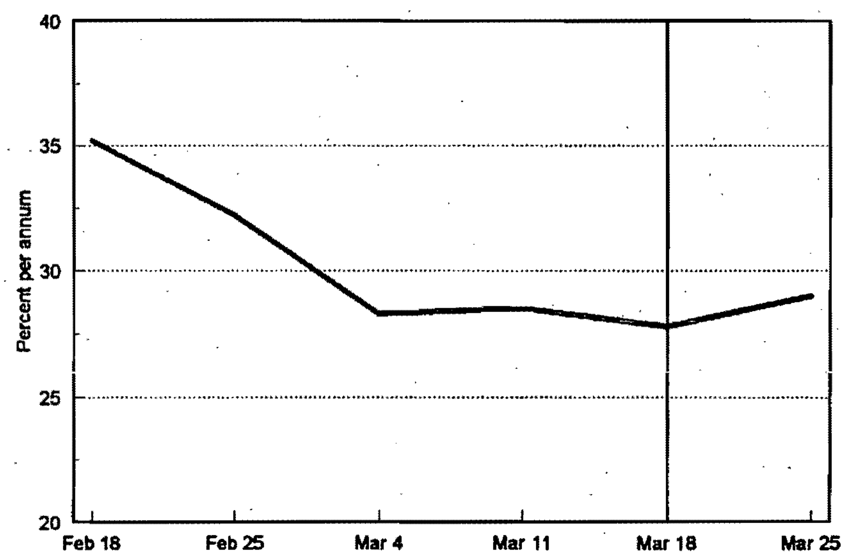
Ruble's Rate of Depreciation Unchanged



Eurobond Spread Climbing Slightly
(Secondary Market for 10-year Eurobond Spread Over US Treasuries)



GKO Yields Increase Slighly
(Primary Market Rates)



1998-SE-007435

CM/AM

DEPARTMENT OF THE TREASURY
WASHINGTON

UNDER SECRETARY

6/2/98

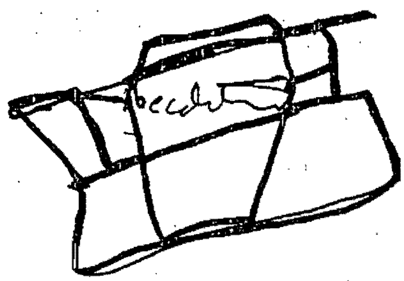
MEMORANDUM FOR SECRETARY RUBIN

FROM: Under Secretary Lipton DL

SUBJECT: Russia: Phone Call to Mr. Wolfensohn 458-5120

Attached are proposed points which urge Mr. Wolfensohn to: (1) actively consider accelerated disbursements to Russia supporting structural reform as part of possible additional conditional financing, and (2) make a public statement that the Bank is doing so. The points also reiterate our concern about financing a swap of ruble debt for foreign currency debt with public money.

ATTACHMENTS



Rubin Call to Wolfensohn on Russia

Key Issues:

- As you know, President Clinton on Sunday endorsed further conditional support, as necessary, from the IMF and Bank to support stability, reform, and growth in Russia.

- I followed with a public statement yesterday that we are working actively with the Russian government and the IFIs with respect to the financial situation, the reforms that Russia would need to continue taking in order to be successful, and additional financing.

- Markets have reacted positively today to these developments and other G-7 signals (stock market up 13%, GKO yields down 5-10%).

- Continues to be concern, however, that the IFIs oppose, and are not working on, supplemental financing based on statements from last week. A public statement from you that these issues are actively being considered would be helpful. We are making same request to Fund.

  (FYI: We understand that Wolfensohn does not plan a statement now, but will consider saying something later in the week. Hard for Bank to get out front of the Fund at this juncture.)

- Russia needs help in a number of areas in which the Bank has particular expertise, including:

  -- public administration reform,
  -- social sector reforms, including pension reform,
  -- demonopolization and regulation of natural monopolies
  -- financial sector reform.

- I understand that the Bank has already engaged with Russia on a number of these issues.

- We may well have reached the limit on what we can expect from Russians on fiscal adjustment this year (assuming they implement Fund program and cut deficit to 5%/GDP).

- But believe we can push Russians to do more on structural reform (Chubais suggested to Larry on Saturday that this should be emphasis now).

- Assuming Russian willingness, what World Bank policy lending could be accelerated and brought to the Board quickly? (Our most recent update from Bank is that they could accelerate the SALIII, $600 million, to the Board in the fall and would consider something "more ambitious" later in the year.)

- Have you spoken recently to the Japanese about prospects for Japanese Ex-Im co-financing for the Bank's loans. We understand that Japan's Ex-Im has approved as much as $1.5B for co-financing. How much could be disbursed in the near future?

<u>Debt Swaps (Wolfensohn still reportedly interested in refinancing Russia's expensive, short-term ruble debt with longer-term, cheaper fx debt)</u>

- Understand debt management appeal of this idea to Russians.

- But it generates 3 kinds of negative signals:

(1) creates perception that Russia is generating a tesobono-like vulnerability (despite longer-term maturity of proposed Russian fx borrowing);

(2) diverts official financing from reserves, which is the principal vulnerability markets are focused on;

(3) already eliciting very negative reaction in Congress (which will affect the IMF funding debate): Congress sees this as substituting public exposure for private exposure and bailing out Western bondholders.

World Bank Program Status

Summary: The World Bank achieved its stated goal of disbursing $3B to Russia last year, in part because of an end-of-year flurry of loan approvals. **The Bank has planned to scale back disbursements slightly this year, to about $2.5B, because of concerns about the vulnerability of the fiscal situation and difficulties in implementing structural reforms.** The Japanese Ex-Im Bank, however, plans to bolster WB support to Russia by providing $1.5B in matching funds to Bank loans during the next 18 months.

1997 Results: The Bank disbursed about $2B in adjustment loans last year, including:

- $600M of SAL in June and $400M in December covering fiscal management, public sector reform, private sector development, and banking,
- $550M of the Social Protection Adjustment Loan (SPAL) focusing on pension reform, social assistance reform, and unemployment benefits,
- $400M of the Coal SECAL II,
- almost $1B in investment loans including: oil sector rehabilitation, oil spill management, urban transportation, legal reform, and housing.

1998 Outlook: The Bank plans to disburse about $2.5B to Russia this year, including about $800M from ongoing investment projects. These projects continue to perform well. As of late February, the Bank judged that 84% of its ongoing investment loans were proceeding satisfactorily (up from 69% last year).

The 1998 adjustment lending is planned to come from:

- $400M from SAL II (disbursed in January),
- $250M from last tranche of Social Protection Adjustment Loan,
- $600M from SAL III, and
- $400M from Coal II.

The Russians are not interested in World Bank support in several other key areas. In particular, the GOR is not interested in World Bank support for restructuring state administration and/or pursuing civil service reform. Also, the Central Bank has rejected the Bank's offer to develop a Financial Sector Adjustment loan for the banking sector.

The Bank is having little success in stepping up its loan guarantee operations in Russia. In May 1997, the Bank approved its first partial risk guarantee in Russia for commercial bank loans for the Sea-Launch joint venture involving Boeing and firms from Russia, Ukraine, and Norway. The Bank is working with the GOR on a list of additional projects that could take advantage of the IBRD guarantee facility, but with minimal payoff so far. Meanwhile, MIGA has approved over $160M in guarantees under its programs.

World Bank Disbursements (adjustment plus project lending):

	Amounts	Main Loans
1992:	$650M	Rehabilitation loan
1993:	$300M	Oil sector rehabilitation loan
1994:	$200M	Oil sector rehabilitation, highway maintenance
1995:	$750M	Rehabilitation II
1996:	$600M	Coal sector
1997:	$3B	SAL, SAL II, SPAL, Coal II

Total: $5.2B

planned:

1998:	$2.5B	SAL II ($400M disbursed in January), Coal II ($400M), SPAL ($250M), SAL III ($600M)
1999:	NA	Ag SECAL

TREASURY CLEARANCE SHEET

NO. ____________
Date: June 2, 1998

MEMORANDUM FOR: X SECRETARY ☐ DEPUTY SECRETARY ☐ UNDER SECRETARY
☐ ASSISTANT SECRETARY ☐ ACTION ☐ BRIEFING ☐ INFORMATION
☐ LEGISLATION ☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION
☐ SPEECH ☐ EXECUTIVE SECRETARY ☐ TESTIMONY

FROM: Under Secretary Lipton (International Affairs)
THROUGH:
SUBJECT: Russia: Phone Call to Mr. Wolfensohn

REVIEW OFFICES (Check when office clears)

☐ Under Secretary for Finance
☐ Domestic Finance
☐ Economic Policy
☐ Fiscal
☐ FMS
☐ Public Debt
☐ Under Secretary for Int'l Affairs
☐ International Affairs

☐ Enforcement
☐ ATF
☐ Customs
☐ FLETC
☐ Secret Service
☐ General Counsel
☐ Inspector General
☐ IRS
☐ Legislative Affairs
☐ Management
☐ OCC

☐ Policy Management
☐ Scheduling
☐ Public Affairs/Liaison
☐ Tax Policy
☐ Treasurer
☐ E & P
☐ Mint
☐ Savings Bonds
☐ Other ____________

NAME (Please Type)	INITIAL	DATE	OFFICE/ROOM NO.	TEL. NO.
INITIATOR(S)				
A. Baukol	A for	6/2/98	ICC	2-0164
REVIEWER(S)				
N. Lee	A for	6/2/98	ICC	2-2916
M. Medish	A for	6/2/98	IC	2-0770

SPECIAL INSTRUCTIONS

☐ Review Officer ____________ Date. ____________ ☐ Executive Secretary ____________ Date ____________

1998-SE-006877

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

UNDER SECRETARY

June 5, 1998

MEMORANDUM FOR DEPUTY SECRETARY SUMMERS

FROM: Under Secretary Lipton

SUBJECT: Russia: external flows/financing, including notional numbers for additional IFI financing

The attached table shows an external financing scenario for Russia for the remainder of 1998. The notional supplementary financing package is $9.5 billion. It is comprised of:

-- **$6.4 billion in additional Fund financing**, over and above 3 planned tranches of $2.0 billion,
-- **$1.6 billion in additional World Bank financing**, over and above planned lending of $1.3 billion, and
-- **$1.5 billion in Japanese Exim money**. (This has already been pledged but for disbursal over 18 months; we include it in supplemental financing on the grounds that it will be disbursed on an accelerated basis in 1998.)

The Fund financing could be a combination of a $3.1 billion increase in access under the EFF (to bring Russia up to the 100% annual access limit) and $3.3 billion in SRF or CCFF financing (another 57% of quota). (CCFF financing probably entails the least conditionality.) Additional World Bank financing could come from augmenting SALIII (from $600 million to perhaps $1.4 billion) and accelerating a loan which the Bank is considering for regional development, including housing, of $800 million.

The most critical assumption is no major change from current patterns with respect to foreign GKO and equity holdings in June-August. That is, 70 % of foreign holdings of GKOs will be rolled over and foreign equity holdings will fall by 10 %. Also, foreigners will not exit through GKO sales in secondary markets. These assumptions can be justified as fairly conservative because they suggest that even supplementary IFI financing will not increase foreign participation in these markets much in the summer. On the other hand, there are obviously more pessimistic scenarios one could envision if there were another serious episode of Asian contagion or a serious GOR misstep.

In the last 4 months of 1998, we assume, again probably conservatively, that as confidence strengthens GKOs will be fully rolled over by foreigners and foreign holdings into equity markets will increase moderately above current levels.

You will note that the foreign exchange reserve level at the end of the third quarter remains low, $10.4 billion, even with a big up front infusion of supplementary financing. The Fund's view is that Russia can monetize (borrow against) a substantial share of gold holdings. Therefore, we have added a usable reserve estimate that assumes monetization of $2 billion of Russia's roughly

$4.8 billion in gold holdings. By the end of 1998, reserves would rise to roughly 3 months of import cover (monthly imports are $6.4 billion).

The capital flight/$ cash purchases number is obviously one other critical assumption. This is essentially capital flight stemming from firms moving money abroad and individuals converting savings into dollars. Our numbers for the two periods are derived from Fund and CBR estimates.

ATTACHMENT

Russia: Sources and Uses of Foreign Exchange

Notional Supplementary Financing = $9.5B *

		$B Jun-Aug/98	Sep-Dec/98	
Forex Reserves (start of period)		9.0	10.4	
Usable Reserves (start of period) **		11.0	12.4	
Inflows		10.7	6.8	
IMF		6.4	2.0	***
EBRD		0.1	0.2	
IBRD		0.9	2.0	***
Bilateral (Japanese)		0.9	0.6	
GOR borrowing from private sector		2.5	2.0	
Outflows (positive # is inflow)	Assumptions ****	-9.3	0.4	
Foreign GKO/OFZs	rollover: 70%/100%	-1.6	0.0	
Domestic GKO/OFZs (non-Sberbank)	rollover: 80%/100%	-1.2	0.0	
Foreign equities	10% out /15% in	-1.6	2.2	
Domestically-held equities	5% out/10% in	-1.2	2.3	
Cap flight/$-cash purchases		-2.5	-2.5	
Syndicated loans/bonds of banks/firms	rollover: 75%/100%	-0.2	0.0	
GOR official debt (principal)		-1.0	-1.5	
Other Flows (positive # is inflow)		0.0	0.0	
Current Account		-1.5	-1.5	
FDI		1.5	1.5	
Net Inflow of Foreign Reserves		1.4	7.2	
Forex Reserves (end of period)		10.4	17.6	
Usable Reserves (end of period)		12.4	19.6	

* Elements of $9.5B Supplemental Financing package are:

$3.1B of IMF/EFF
$3.3B of IMF/SRF (and/or CCFF)
$1.6B of World Bank
$1.5B of Japanese Ex-Im (already planned, but accelerated pay-out)

** Usable reserves includes $2B of the $5B in gold reserves, based on IMF's judgment that GOR can monetize a substantial share of gold holdings.

*** Table numbers include previously-planned EFF disbursements of $2.0B and World Bank disbursements of $1.3B.

**** Assumptions include:

- Foreigners roll over 70% of GKOs maturing in Jun-Aug and 100% maturing in Sept-Dec
- Domestic (non-Sberbank) holders of GKOs roll over 80% and 100% respectively.
- Neither foreigners nor Russians sell GKOs on secondary market for early withdrawal
- Foreigners withdraw 10% of their equity in Jun-Aug but boost holdings by 15% in Sept-Dec
- Russians withdraw 5% of their equity in Jun-Aug but boost holdings by 10% in Sept-Dec
- Other capital flight plus net $-cash purchases equal $2.5B per period
- Russian banks/firms roll over 75% of synd. loan principal in Jun-Aug and 100% in Sept-Dec

Elements of Short-term Vulnerability

		Maturing:	
	Latest Data	Jun-Aug/98	Sep-Dec/98
GKOs/OFZs -- total stock	70.0	17.0	20.0
Foreign held (31%)	21.7	5.3	6.2
Domestic held (69%)	48.3	11.7	13.8
non-Sberbank/CBR (35%)	24.5	6.0	7.0
Equities - total market cap	40		
Foreign held (40%)	16		
Domestic held (60%)	24		
Private ForEx Debt (short-term)			
BIS exposure (Jan 1 1998)	32.4	NA	NA
Trade finance	NA	NA	NA
Non-BIS exposure	NA	NA	NA
S-T debt of Russian banks (CBR data)	14.5	NA	NA
Syndicated loans--principal maturing		0.9	1.3
Eurobonds principal maturing		0.0	0.0
S-T debt of Russian non-banks (CBR data)	1.5	NA	NA
Syndicated loans--principal maturing		0.0	0.0
Public ForEx Debt (short-term)			
Debt repayment (IMF data)	10.5	1.0	1.5
To IMF		0.3	0.5
Trade credits (to be restructured)	8.0	0.0	0.0

Financial Indicators (as of April 1998)

		at 6.2 R/$:	
	B rubles	$B	% of GDP
M2 (ruble-only)	360.4	58.1	12.4%
Base money	152.9	24.7	5.3%
NIR	14.1	2.3	0.5%
NDA	138.8	22.4	4.8%
Federal budget deficit (primary)	10.0	1.6	0.3%
Federal budget deficit (overall)	152.0	24.5	5.2%
GDP (1998)	2909	469.2	100.0%

Monetary Comparisons

	Base money, $B	Base/GDP	M2/GDP
Indonesia (Sept 1997)	13.7	6.6%	110%
Thailand (1997)	13.1	8.9%	86%
Korea (Nov 1997)	19.0	4.3%	40%
Russia (Apr 1998)	24.7	5.3%	12%

DI to LS (READING) 6/5/98

cc: MF
SS
NC/DI/PA/AK

PLEASE LOG IN

1998-SE-006980

From David Lipton

6/5/98

ACTION

Rubin Call to Camdessus on Russia

Key Issues:

- Russia's financial stability is of key importance to the U.S. as well as to the Fund. The new Russian government represents the best chance yet to move ahead with key reforms before the election cycle begins in 1999 and 2000.

- What is your analysis of the steps that Russia can take to improve the current financial situation? What can the Fund do to help this process?

- Given the importance of Russia, it is imperative that we all take steps to create the conditions necessary to successfully resolve the current situation.

  -- This would include encouraging the Russian government to accelerate needed reforms in fiscal and structural areas.

  -- It could also include consideration of additional, conditional financing, to the extent it becomes necessary.

- I realize that both you and the Russian government have recently said that additional support is not necessary at this time. It would be helpful to markets, however, if you also said that the Fund is working actively with the Russian government to assess Russia's reform agenda and the possible need for additional conditional financing, if it becomes necessary.

<u>Russia's Slow Action on Prior Actions for EFF</u> (if raised):

- We have heard that Russia is moving slowing in implementing the agreed-upon prior actions for disbursement of the current EFF tranche (scheduled for mid-June). We will support the Fund's insistence that Russia abide by its commitments.

EXECUTIVE S...

6/8/98

— very good note

Russia: Economic Briefing Note

Russian financial markets have been volatile in recent months as investors have grown increasingly concerned about the country's chronically weak public finances. While the central bank has made significant progress in stabilizing the economy over the last several years by implementing tight monetary policy, the government's failure to support the central bank by tightening fiscal policy threatens the country's nascent economic stability.

Until recently, foreigners were willing to finance Russia's deficits because the government promised fiscal reforms. Foreign investors accumulated substantial volumes of domestic debt, but Russia's failure to follow through on reforms is now causing some investors to quit the market. This outflow pressured the ruble several times during recent months and has squeezed Russia's budget, forcing the authorities to accumulate payments arrears, which in turn has frustrated the IMF and caused the Fund to delay disbursements. To defend the ruble, the authorities hiked interest rates to as high as 150%. Investors believe Russia also needs to obtain emergency financing from the IMF or G-7 in the next several weeks in order to stabilize markets. To convince investors to commit longer-term funds, however, the government needs to strengthen revenue collection and expenditure controls, cut the cancerous knot of interenterprise arrears, and strengthen oversight of the financial system.

Recent economic and political developments

- Until financial market turmoil threatened its trajectory, Russian economic performance showed signs of improvement after seven years of painful reforms. Real GDP grew by 0.4 percent in 1997, marking its first increase since 1989. Growth is likely to remain flat in 1998, however, as a result of ongoing financial turmoil, very high interest rates, and government spending cuts.

- Tight monetary policy has brought inflation down to under 8 percent from 131 percent in 1995, but a sudden adjustment in the exchange rate could reignite more rapid inflation. The Central Bank of Russia had stabilized the ruble within a narrow, steadily depreciating band, but the country's persistent fiscal problems have fueled recurring rumors since December 1997 that the central bank may need to devalue the ruble.

- Negative investor sentiment about the ruble's prospects has also been exacerbated by sharp commodity price declines. Oil and gas prices have fallen by 40 percent since January 1997, and this softness has constrained fiscal revenues and hurt Russia's balance of payments position. A current account deficit emerged for the first time during Russia's transition during the third quarter of 1997.

How large are these shipments?

- Devaluation rumors and financial market jitters have caused shipments of US currency to Russia to rise in late May and early June. So far, currency shipments remain below peak levels achieved during the market turmoil in December, when Russians purchased dollars to hedge against a possible botched redenomination of the ruble.

- External debt rose sharply in 1997–by about \$20 billion–as Russia raised a net of \$9 billion via sales of domestic debt to foreigners, \$7 billion on the Eurobond market, and \$4 billion via borrowing from BIS banks. Russia now holds about \$10 billion in foreign exchange reserves, compared to the country's \$49 billion in short-term external debt and foreign holdings of an additional several billion dollars in portfolio equity investments.

source? breakdown to banks?

- Investors argue that the transition to a new government has cost the government precious time in addressing its fiscal problems. President Yeltsin surprised investors and political analysts by dismissing his government on March 23, arguing that Russia needed a younger team to develop a fresh approach to reform and improve living standards for average Russians. The new team has not yet changed the direction or pace of economic reform, however, and many previous cabinet members have remained in the government.

Fiscal Challenges

Large fiscal deficits--equal to 7 percent of GDP in 1997--threaten Russia's stabilization effort. Investors have forced the country to the brink of an exchange rate crisis; current interest rates of 54% on government securities are unsustainable as they further erode the government's already weak fiscal position. The financing squeeze has prompted the government to resume incurring wage and pension arrears, a practice that undermines the government's legitimacy. Furthermore, government payment delays have fostered the growth of a complex web of interenterprise arrears that undermines the effective working of financial and goods markets.

- Russia was able to narrow its deficit to the equivalent of about 3% of GDP in the first two months of 1998, but this reflects a shortage of financing rather than a fundamental improvement in revenue collection or spending control. The 1998 budget calls for a deficit equal to 5% of GDP.

- Improving tax collection is one of Russia's most pressing challenges. During 1997, Russia collected only 65% of targeted taxes. The government has proposed a new tax code that will eliminate prevalent contradictions and encourage compliance by reducing the number of taxes from about 200 to 30. However, the parliament failed to pass the code in time for 1998, and investors are beginning to worry that the new code may not be in place in 1999.

  - Tax compliance is poor partly because tax rates are high and applied arbitrarily. Poor accounting leads many inspectors to assess taxes on the basis of revenues, rather than profits, and firms complain that the combination of steep value-added, profits, and social security tax rates often leads to tax bills that exceed profits.

  - Weak accounting standards also allow firms to hide earnings. Firms commonly use barter transactions in order to minimize cash flows that might be seized by the tax police.

  - In 1996, the government began to threaten companies in tax arrears with bankruptcy proceedings. In response, several firms adopted the potentially costly strategy of borrowing in international markets through bond, loan, and equity placements to repay these obligations. In the aggregate the policy has not improved tax compliance, largely because bankruptcy laws are unenforceable.

  - Russia renewed its bankruptcy threats in May 1998 in an effort to scare up badly-needed revenues.

- Russia also needs to improve its execution of spending plans. Government payment delays have fueled a proliferation of tax arrears and interenterprise arrears as firms withhold payments until government receivables are collected. Interenterprise arrears totaled 28 percent of GDP in 1997, compared to bank claims on the economy, which equaled only 19 percent of GDP. Interenterprise arrears are particularly problematic because these "credits" are allocated according to non-market mechanisms.

- The Finance Ministry acted to improve its administrative control over both revenues and expenditures in 1997 by moving some of its accounts to the central bank, and by cutting the number of private banks that are authorized to manage government accounts. However, critical accounting and control problems remain.

- The IMF has periodically delayed disbursements under Russia's $9.2 billion extended fund facility because of Russia's failure to comply with fiscal targets. The Fund is now thought to be planning to release Russia's most recently-delayed $670 million tranche despite its continued dissatisfaction with fiscal performance. While Russia has not formally requested additional assistance, the Fund is also thought to be preparing contingency plans for augmented financing, including a Supplemental Reserve Facility or Compensatory and Contingency Financing Facility.

Coping with Volatile Capital Flows

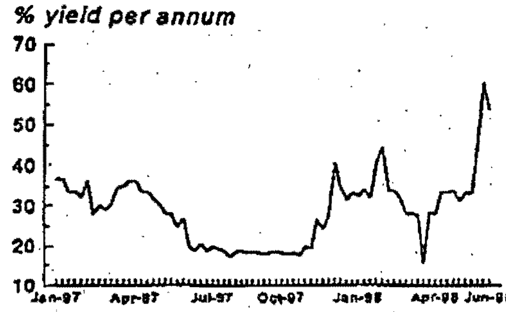
Investor appetite for investing in and trading claims on Russia surged in 1997, but much of that capital inflow was short-term and speculative in nature, and much was directed toward deficit financing and arrears repayment, rather than productive new investments. In this context, Russia's failure to make more progress on fiscal reforms, combined with global financial jitters, put the country in a particularly vulnerable position. Capital outflows have caused foreign exchange reserves to shrink 52 percent over the last 12 months to just under $10 billion. Sudden, substantial further outflows could potentially destabilize exchange rate and monetary policy, trigger a financial crisis, and undermine Russia's nascent economic recovery.

(can policy be adjusted?)

- In an effort to discourage speculative short-term capital inflows, the CBR announced plans in December to introduce more exchange rate flexibility. Technically, the ruble is allowed to deviate by plus or minus 15% from a target average rate of 6.1 rubles/$ in 1998. In practice, however, the authorities continue to maintain the ruble in a very narrow trading range; the crawling CBR miniband allows the ruble to fluctuate by less than 1%. The mid-point of the miniband has depreciated by 3.5 percent so far this year.

- Rumors of a possible ruble devaluation circulated widely in Russian financial markets in January and May 1998, causing the ruble to weaken beyond the CBR's miniband at times in May and prompting the CBR to raise interest rates. On May 27, the central bank tripled interest rates to 150%. Secondary market yields on some GKOs spiked to 200%. Rates have declined subsequently, to around 50%, but with inflation of only 7.5% in the 12-month period ending in May, real interest rates--and government financing costs--remain extremely high. Foreign investors hold $20 billion out of the $66 billion total government securities market.

GKO Yield at Auction
% yield per annum

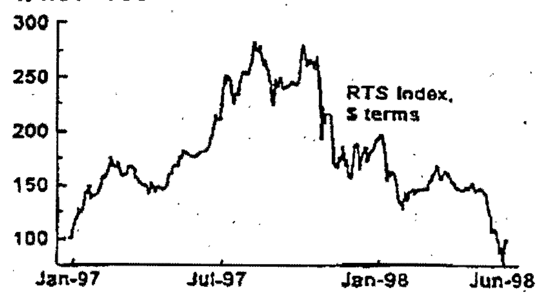


- Investor sentiment has improved somewhat since Russia's successful, albeit expensive, placement on June 3 of a $1.25 billion eurobond at a spread of 650 basis points over comparable Treasury notes, but the improvement is more closely linked to expectations that the G-7 or IMF will provide Russia with a $5-10 billion backup financing facility. President Clinton has said that the U.S. endorses additional conditional IMF assistance to Russia should it prove necessary. If such a package is not forthcoming, investors believe sentiment could deteriorate again quickly.

- The recent volatility in the GKO market has coincided with the liberalization of the market. In order to prevent sudden outflows of hot money, the central bank had previously required foreign investors to purchase forward FX contracts to repatriate GKO earnings. That requirement, an exchange restriction that contravened Russia's IMF Article VIII obligations, was abolished at the start of 1998. Also since January 1, the central bank no longer serves as a counterparty in FX contracts, so GKO investors must assume more private bank counterparty risk.

- Equity markets have also been volatile in recent months. The benchmark RTS index posted strong gains early in 1997 as Russia was added to benchmark IFC and Morgan Stanley equity indices. In October 1997 and May 1998, however, stock prices dropped sharply.

Stock Market Performance
1/1/97=100



- Standard & Poor's and Moody's may have exacerbated Russia's financial problems by moving the outlook on Russia's sovereign ratings to negative, and in Moody's case, downgrading Russia by two notches since January 1998. The agencies cited Russia's continuing fiscal problems--weaknesses that were well-documented long before these ratings actions--along with increased international financial market volatility as justifying the moves. S&P rates Russia BB-, and Moody's rates the country one notch lower at B1.

- Recent financial problems highlight Russia's vulnerability to outflows of short-term speculative capital, but Paris Club and London Club debt reschedulings have left the country with a light long-term debt servicing burden.

Kate Kisselev
Development Studies and Foreign Research
June 8, 1998

what does this mean? Did we encourage build up of foreign GKO's? were we in any way opposite to their restrictions? whats happening to interbank lines?

L

Russia: Selected Economic Indicators

	Average 1994-1996	1997e	1998p
Real GDP Growth* (%)	-7.2	0.4	0.0
Consumer Price Inflation* (%) (Dec/Dec)	122.7	11.1	6.0
Consolidated Fiscal Balance (% of GDP)	-7.3	-6.2	-5.0
Current Account (% of GDP)	2.9	0.5	-0.5
Unemployment*	8.6	9.0	10.0
Net Debt (% of GDP)	29.4	32.7	32.4
Debt Service/Exports (%)	6.8	9.2	10.2
Reserves* ($ billions)	9.9	12.9	10.0
External Debt** ($ billions)	130.3	171.7	171.7
Short-Term External Debt ($ billions)	23.4	48.7	45.0
GDP* ($ billions)	359.0	449.5	465.0
GDP per capita* ($)	2,430	3,040	3,150

*1997 figures are actual.

**External debt figures jump by about $10 billion in 1997 because of a change in US and Swiss reporting methodologies, which are incorporated in BIS aggregate data on international bank lending.

The Deputy Secretary of the Treasury

June 12, 1998

TO: OASIA

Page 1:

"Very good note."
"How large are these shipments?"
"Source? breakdown to banks?"

Page 3:

"Can pricing be adjusted?"

Page 4:

"What does this mean? Did we encourage build up of foreign GKO's? Were we wrong in our opposition to their monitoring? What's happening to interbank lines?

Larry

Attachment

Room 3326 **622-1080**

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

June 12, 1998

MEMORANDUM FOR DEPUTY SECRETARY SUMMERS

FROM: Nancy Lee NL

SUBJECT: Conference call on Russia at 4:00 PM today

Objectives:

(1) to explain the current status of Russia-Fund discussions.

Fund staff and the Russians (Vyugin) are in intensive discussions on additional reforms for additional financing (HOLD CLOSE: this would be in the form of a new, big EFF plus CCFF money if necessary). **(See attached Fund statement from last night.)** If these go well, a Fund mission would go to Russia right after the June 18 Board meeting to negotiate the new EFF.

(2) to describe a game plan for addressing likely Russia market turmoil next week. (There is every reason to believe that Monday will be a very bad day, with more ruble trading outside the daily band and GKO yields perhaps back up to 80%, above the 60% rediscount rate):

You could suggest that we will respond with an orchestrated series of public statements, the content and frequency of which will depend on market developments.

Options include:

-- another Fund statement early next week reporting on progress in the Fund-Russian discussions.
-- a Camdessus statement explaining the Fund's strategy and willingness to provide significantly expanded financing for strong measures.
-- a Wolfensohn statement that the Bank is prepared to act quickly to support structural reform. (Camdessus reportedly critical of Bank for moving too slowly.)

FYI (not for this discussion): We could seek a Fund announcement next week that it will recommend a CCFF program for Russia and will bring it to the Board quickly (2 weeks might be possible). THIS IS NOT WHAT CAMDESSUS HAS IN MIND; HIS VIEW IS THAT THE CCFF WOULD BE BROUGHT TO THE BOARD AT THE SAME TIME AS THE EFF.

(3) to put Russia's situation in the larger context of market developments in Japan and elsewhere.

ATTACHMENTS:
(1) Status of Russia-Fund discussions; Lipton-Vyugin meeting readout
(2) Russian Financial Market update
(3) Fund June 11, 1998 Press Release
(4) Treasury numbers on external financing needs and IFI financing

cc: DLipton, TGeithner, MMedish, SShah, CLowery, KBerg, ABaukol, EWeisman

Russia-Fund discussions and read-out of Lipton/Vyugin meeting:

Fund stance: Last night's Fund statement: (a) confirmed the Fund's recommendation that the $670 million EFF tranche be released on June 18 and (b) indicated that the Fund will continue an extensive dialogue with Russia and that, **"as appropriate and necessary, additional financial assistance could be made available in the context of further policy measures."**

On the Fund's view of the nature of the additional financing, David reports from Mr. Fischer that **Mr. Camdessus wants to start over again with a new EFF program with frontloaded financing. If more immediate money is needed, a CCFF operation could be done (we calculate that this could provide $3 billion quickly).** Camdessus argues that Russia does not need short-term SRF financing but medium-term money. (The Russians, however, based on Vyugin's comments, still appear to view the SRF as the relevant quick-disbursing option. More could be made available under the SRF but it would have to be in the context of an approved augmented program.)

Lipton-Vyugin discussions: Vyugin told David that the Fund and Russia are discussing a range of additional measures including: the tax code, the budget code, land reform, tax administration measures, sharper deficit cutting in 1999, and structural measures, including financial reform. He said some are doable and some are not.

-- The tax code and budget code (which has passed 2 readings) are doable.
-- Passage of a land law, at least one that includes agricultural land, is not.
-- Vyugin views the Fund's proposed deficit cut to 2.5% of GDP in 1999 (as opposed to 4.6% in the current EFF) as radical but didn't make a definitive judgment because numbers are not yet done on what the primary balance would be (given interest rate developments).
-- He described the proposed tax administration measures as difficult and the Fund's NIR target (not clear for what date) as unrealistic.
-- He also noted (somewhat lamely) that a Fund proposal that the CBR divest itself of its Sberbank shares raises the risk that the equity would be sold to a weak Russian bank (e.g., SBS Agro).
-- The Fund is apparently proposing an increase in the VAT rate by 2%. Vyugin argues that this wouldn't increase collections.

Nevertheless, **Vyugin's conclusion was that "there is a constructive basis to speedily conclude negotiations with the Fund on additional assistance."**

On recent market developments, Vyugin did not attempt optimism; he said the outlook for the GKO market could not be more gloomy.

David noted the need to ensure the Russia, the IMF, and the G-7 are making consistent public statements. Vyugin readily agreed and conceded the problems created by insufficient consistency so far. David raised 3 additional issues:

(1) CBR transparency: The CBR needs to release weekly reserve data. Vyugin affirmed that the CBR is now announcing gross reserves each Thursday but the number is for the previous

Friday. David also stressed that the CBR must also provide data to the IMF on Sberbank, and the Vneshbanks. He warned that the USG as an IMF shareholder cannot endorse additional support to Russia if Russia is not providing adequate information to the Fund. David again raised secret GOR/CBR borrowing which turned out to be highly appropriate. We heard today about two secret loans from Chase and Lehman ($200 million each) which are the probably cause of the increase in gross reserves as of June 5 to $15 billion.

(2) MinFin transparency with respect to auctions: David noted the market perception that the Ministry of Finance is rigging the auctions, with hidden MinFin bond purchases through intermediate public banks. Vyugin did not directly respond but argued that the GOR has been completely transparent about its objective of moderating yields through government purchases of the shortfall between redemptions and sales.

(3) Replacing GKO debt with fx-denominated debt: David argued that more sensible strategy is to use borrowing to build reserves which would, by building confidence, lower GKO yields and lengthen maturities over time. Vyugin said foreign banks/investment houses are advising that debt refinancing should be the top priority. David cautioned that the interests of Russia and those of these private investors may not fully coincide.

David offered to go to Russia after the June 18 Board meeting if IMF staff plan to go at that time. Vyugin said that was the plan.

<u>Russia Market Update:</u>

Russian markets are closed today for a holiday.

- **Equities** fell 15.5% during the week of June 8-12;

- **Yields** on domestic debt have jumped back up to about 60% on the secondary market, despite MinFin efforts to hold rates down;

- **Yields** on Russia's 10-year Eurobond have risen again to about 12.3%. The spread to U.S. bond is now about 670 bp;

- The **ruble** has been trading slightly outside the CBR's daily band on interbank markets at 6.2 R/$. On futures markets, the ruble is trading well outside the Bank's wide currency band, which peaks at about 7.13 R/$.

<u>T-bills</u>: Russia raised only 4.7B rubles in this week's GKO/OFZ auctions while redeeming 7.2B rubles for a net loss of 2.5B ($400M). Moreover, market rumors suggest the Finance Ministry 'rigged' the auction by purchasing t-bills itself. Russia has redeemed more t-bills than it has sold for 5 straight weeks for a net loss of 11B rubles ($1.8B). **Russia must redeem 9.5B rubles ($1.5B) on June 17, which is the largest weekly redemption in the next three months.**

<u>Reserves</u>: The Central Bank announced on Thursday that gross reserves increased from $14.6B on May 29 to $15.0B on June 5. The CBR lowered its refinancing rate from 150% to 60% on June 5. This rate cut put additional pressure on the ruble during the week of June 8-12, leading to heavy CBR intervention. As a result, the CBR may have already used up the bulk of the $1.25B Goldman Eurobond, which became available to Russia on June 10.

<u>Current Market Sentiment</u>: Markets are rife with wildly divergent rumors: a devaluation over the weekend, involuntary GKO debt restructuring, an imminent IMF/G-7 financing package. While the CBR appears to have sufficient reserves to defend the ruble in the immediate future, we expect a continued slide and more large drops in the Russian equities and t-bill markets next week.

cc: MMedish
NLee
ABaukol
TConnors
APlowman
BMarsteller

News Brief No. 98/20
FOR IMMEDIATE RELEASE
June 11, 1998

International Monetary Fund
Washington, D. C. 20431 USA
www.imf.org

Russian Authorities and IMF Reach Understanding on 1998 Economic Policy Statement

The Russian authorities and the management of the International Monetary Fund (IMF) have reached understandings on a statement of economic policy for 1998 that takes full account of the Government's policy package announced in late May. Provided that the actions to be implemented in the next few days are taken as expected, it is foreseen that the IMF's Executive Board will meet on June 18 to consider completing the seventh quarterly review under the Extended Fund Facility (EFF) for Russia. The completion of this review will immediately make available a tranche of US$670 million. IMF staff will continue to engage in intensive dialogue with the Russian authorities. If it is judged appropriate and necessary, additional financial assistance could be made available in the context of further policy measures.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

UNDER SECRETARY

June 5, 1998

MEMORANDUM FOR DEPUTY SECRETARY SUMMERS

FROM: Under Secretary Lipton ML

SUBJECT: Russia: external flows/financing, including notional numbers for additional IFI financing

The attached table shows an external financing scenario for Russia for the remainder of 1998. The notional supplementary financing package is $9.5 billion. It is comprised of:

- **$6.4 billion in additional Fund financing**, over and above 3 planned tranches of $2.0 billion,
- **$1.6 billion in additional World Bank financing**, over and above planned lending of $1.3 billion, and
- **$1.5 billion in Japanese Exim money**. (This has already been pledged but for disbursal over 18 months; we include it in supplemental financing on the grounds that it will be disbursed on an accelerated basis in 1998.)

The Fund financing could be a combination of a $3.1 billion increase in access under the EFF (to bring Russia up to the 100% annual access limit) and $3.3 billion in SRF or CCFF financing (another 57% of quota). (CCFF financing probably entails the least conditionality.) Additional World Bank financing could come from augmenting SALIII (from $600 million to perhaps $1.4 billion) and accelerating a loan which the Bank is considering for regional development, including housing, of $800 million.

The most critical assumption is no major change from current patterns with respect to foreign GKO and equity holdings in June-August. That is, 70 % of foreign holdings of GKOs will be rolled over and foreign equity holdings will fall by 10 %. Also, foreigners will not exit through GKO sales in secondary markets. These assumptions can be justified as fairly conservative because they suggest that even supplementary IFI financing will not increase foreign participation in these markets much in the summer. On the other hand, there are obviously more pessimistic scenarios one could envision if there were another serious episode of Asian contagion or a serious GOR misstep.

In the last 4 months of 1998, we assume, again probably conservatively, that as confidence strengthens GKOs will be fully rolled over by foreigners and foreign holdings into equity markets will increase moderately above current levels.

You will note that the foreign exchange reserve level at the end of the third quarter remains low, $10.4 billion, even with a big up front infusion of supplementary financing. The Fund's view is that Russia can monetize (borrow against) a substantial share of gold holdings. Therefore, we have added a usable reserve estimate that assumes monetization of $2 billion of Russia's roughly

$4.8 billion in gold holdings. By the end of 1998, reserves would rise to roughly 3 months of import cover (monthly imports are $6.4 billion).

The capital flight/$ cash purchases number is obviously one other critical assumption. This is essentially capital flight stemming from firms moving money abroad and individuals converting savings into dollars. Our numbers for the two periods are derived from Fund and CBR estimates.

ATTACHMENT

Russia: Sources and Uses of Foreign Exchange

Notional Supplementary Financing = $9.5B *

		$B Jun-Aug/98	Sep-Dec/98	
Forex Reserves (start of period)		9.0	10.4	
Usable Reserves (start of period) **		11.0	12.4	
Inflows		10.7	6.8	
IMF		6.4	2.0	***
EBRD		0.1	0.2	
IBRD		0.9	2.0	***
Bilateral (Japanese)		0.9	0.6	
GOR borrowing from private sector		2.5	2.0	
Outflows (positive # is inflow)	Assumptions ****	-9.3	0.4	
Foreign GKO/OFZs	rollover: 70%/100%	-1.6	0.0	
Domestic GKO/OFZs (non-Sberbank)	rollover: 80%/100%	-1.2	0.0	
Foreign equities	10% out /15% in	-1.6	2.2	
Domestically-held equities	5% out/10% in	-1.2	2.3	
Cap flight/$-cash purchases		-2.5	-2.5	
Syndicated loans/bonds of banks/firms	rollover: 75%/100%	-0.2	0.0	
GOR official debt (principal)		-1.0	-1.5	
Other Flows (positive # is inflow)		0.0	0.0	
Current Account		-1.5	-1.5	
FDI		1.5	1.5	
Net Inflow of Foreign Reserves		1.4	7.2	
Forex Reserves (end of period)		10.4	17.6	
Usable Reserves (end of period)		12.4	19.6	

* Elements of $9.5B Supplemental Financing package are:
  - $3.1B of IMF/EFF
  - $3.3B of IMF/SRF (and/or CCFF)
  - $1.6B of World Bank
  - $1.5B of Japanese Ex-Im (already planned, but accelerated pay-out)

** Usable reserves includes $2B of the $5B in gold reserves, based on IMF's judgment that GOR can monetize a substantial share of gold holdings.

*** Table numbers include previously-planned EFF disbursements of $2.0B and World Bank disbursements of $1.3B.

**** Assumptions include:

- Foreigners roll over 70% of GKOs maturing in Jun-Aug and 100% maturing in Sept-Dec
- Domestic (non-Sberbank) holders of GKOs roll over 80% and 100% respectively.
- Neither foreigners nor Russians sell GKOs on secondary market for early withdrawal
- Foreigners withdraw 10% of their equity in Jun-Aug but boost holdings by 15% in Sept-Dec
- Russians withdraw 5% of their equity in Jun-Aug but boost holdings by 10% in Sept-Dec
- Other capital flight plus net $-cash purchases equal $2.5B per period
- Russian banks/firms roll over 75% of synd. loan principal in Jun-Aug and 100% in Sept-Dec

Elements of Short-term Vulnerability

	Latest Data	Maturing: Jun-Aug/98	Sep-Dec/98
GKOs/OFZs -- total stock	70.0	17.0	20.0
Foreign held (31%)	21.7	5.3	6.2
Domestic held (69%)	48.3	11.7	13.8
non-Sberbank/CBR (35%)	24.5	6.0	7.0
Equities - total market cap	40		
Foreign held (40%)	16		
Domestic held (60%)	24		
Private ForEx Debt (short-term)			
BIS exposure (Jan 1 1998)	32.4	NA	NA
Trade finance	NA	NA	NA
Non-BIS exposure	NA	NA	NA
S-T debt of Russian banks (CBR data)	14.5	NA	NA
Syndicated loans--principal maturing		0.9	1.3
Eurobonds principal maturing		0.0	0.0
S-T debt of Russian non-banks (CBR data)	1.5	NA	NA
Syndicated loans--principal maturing		0.0	0.0
Public ForEx Debt (short-term)			
Debt repayment (IMF data)	10.5	1.0	1.5
To IMF		0.3	0.5
Trade credits (to be restructured)	8.0	0.0	0.0

Financial Indicators (as of April 1998)

	B rubles	at 6.2 R/$: $B	% of GDP
M2 (ruble-only)	360.4	58.1	12.4%
Base money	152.9	24.7	5.3%
NIR	14.1	2.3	0.5%
NDA	138.8	22.4	4.8%
Federal budget deficit (primary)	10.0	1.6	0.3%
Federal budget deficit (overall)	152.0	24.5	5.2%
GDP (1998)	2909	469.2	100.0%

Monetary Comparisons

	Base money, $B	Base/GDP	M2/GDP
Indonesia (Sept 1997)	13.7	6.6%	110%
Thailand (1997)	13.1	8.9%	86%
Korea (Nov 1997)	19.0	4.3%	40%
Russia (Apr 1998)	24.7	5.3%	12%

1998-SE-007752

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

June 26, 1998

INFORMATION

MEMORANDUM FOR DEPUTY SECRETARY SUMMERS

FROM: Mark C. Medish MCM
Deputy Assistant Secretary
Eurasia and Middle East

SUBJECT: Answers to Your Russia Questions

1) Is the ruble overvalued? What effect would devaluation have on the trade and current account balance?

The ruble is still *undervalued* on PPP basis by roughly 25%, according to estimates of the Russian Center for Economic Reform (an EU-sponsored agency of the GOR). The ruble has been fairly steady in real terms in 1996-98. (It is slightly stronger on a trade weighted-basis, but weaker against the US$.) The IMF notes that Russian competitiveness is not of immediate concern. Russian average wages are about $175/month, well below Poland, Hungary, and the Baltic states (although Russian wages are twice the levels of Ukraine and Belarus).

Russian trade and current account balances would improve with a devaluation, but not dramatically. On exports, the impact of a devaluation would be negligible because roughly 65% of Russia's exports come from energy and metals that are already priced in US$. Russian machinery and equipment make up less than 10% of total exports while the remainder is timber, chemicals, agricultural goods and other goods. It is unlikely that a devaluation would spark significant growth in the export of these other items.

A devaluation would probably have a larger impact on the import side. Russian imports have been growing rapidly (up 19% last year and over 10% in Q1 1998). About 25% of imports are machinery and equipment. Much of the remainder is food and consumer goods, often brought into Russia through 'shuttle trade.' Anecdotal evidence suggests that imports would still be in demand after a devaluation because Russian domestic goods do not offer strong competition.

2) How would devaluation affect Russian banks?

A sharp ruble devaluation could lead to payment defaults by leading Russian commercial banks on their outstanding foreign currency obligations. Central Bank estimates suggest that Russian banks currently have $14.5-19.5B in short-term foreign currency obligations, including forward currency obligations.

We calculated this range as follows. The CBR estimated that Russian banks had short-term obligations of $15.3B as of January, excluding forward currency obligations. This figure may have fallen since then because Russian banks have had difficulty finding new foreign loans.

-- Private Russian commercial banks are scheduled to repay about $1.6B in syndicated loans during the remainder of this year. We have already seen reports that syndicated loans are not being rolled over.

-- Russian banks owe about $3.5B in trade credit to Western banks, according to estimates of the NY Fed. Russian banks are having difficulty finding new trade credit.

-- Russian banks also face exposure on open forward ruble contracts. The CBR estimates that the current net open position of Russian banks is $4.35B. Other estimates, however, have put the figure as high as $50B.

If the ruble fell by 50%, then Russian banks would face additional ruble obligations of 90-120B rubles (see table). This amount is equal to 12-15% of the assets of the entire Russian banking system, including Sberbank. Some large banks would face great difficulty paying off these obligations.

-- For example, Rossiyskiy Kredit Bank–a top 10 bank--is set to repay $146M in syndicated loans in the next two months. Its total assets, however, are only about $500M based on the current exchange rate or $250M-350M with a 50% devaluation (depending on the share of its assets held in rubles).

Russian Bank Obligations	Forex obligation	Current ex-rate (6.2 R/$)	50% devaluation (12.4 R/$)
Short-term (excluding. forward contracts, based on CBR data)	$10-15B	62-93B rubles	124-186B rubles
-- Syndicated loans (rest of '98)	$1.6B	10B rubles	20B rubles
-- Trade credit	$3.5B	22B rubles	44B rubles
-- Other	$5-10B	31-62B rubles	62-124B rubles
Forward exposure (CBR data)	$4.35B	30B rubles	54B rubles
Total	**$14.5B-19.5B**	**93-124B rubles**	**180-242B rubles**

3) Can the rate of devaluation of the ruble's crawling miniband be adjusted?

Yes, the CBR has full discretion to set the level of the miniband on a daily basis. While the wide band is flat (the ruble can fluctuate +/- 15% around the parity rate of 6.2 R/$), the miniband (with an average width of about 1%) acts as a crawling peg within the wide band. This year, the ruble has depreciated by 2.1%, roughly in line with the inflation differential between the ruble and major foreign currencies.

4) What is the exposure of foreign banks to Russian short term external debt?

According to the Fed, as of June 23:

	($ billion)
BIS short-term private cross border claims	$21.2
BIS holdings of GKOs	$7.1
Total BIS cross border claims	$28.3
Other foreign holdings of GKOs	$9.8
Short term trade credits	$3.5
Total Russian external short term debt + foreign holdings of GKOs	$41.6

The implied $16.9 figure for foreign holding of GKOs is substantially lower than the $22 billion figure we received from the CBR sources two weeks ago. It is unclear to what extent this represents an actual decline as opposed to a data discrepancy.

American banks have most of their exposure to Russia in GKOs and account for nearly all of the $7 billion in BIS GKO holdings. US holdings of private Russian debt, including banks, is minimal. European banks hold the vast majority of private sector claims, with German banks holding more than half of all BIS exposure to the Russian banking system. (Attached is a Fed note which provides more detail on foreign banks' exposure to Russia.)

5) What volumes of US currency currently are being shipped into Russia?

US currency shipments in May were $1.27 billion, slightly up from $1.05 billion in April. These levels are far below the Sept-Dec 1997 average of over $3 billion per month which were driven by fears that the January redenomination of the ruble would be botched as well as by devaluation fears.

There was an uptick in dollar shipments in the first week of June ($550 million vs $250-$300 million in prior weeks), but since then shipments have eased somewhat.

6) Has the decision to liberalize the GKO market at the beginning of 1998, urged by the IMF and the US, caused a build up of foreign investment in GKOs and led to greater volatility? Were we wrong to oppose the restrictions?

In 1996, Russia began to allow foreigners to invest in its domestic government debt market with several restrictions: they had to invest through special "S" accounts, to hedge GKO earnings with the CBR at worse-than-market forward exchange rates, limit their amount of total purchases, and not trade on the secondary market. These restrictions were gradually phased out in 1996-97, helping to spur inflows into the GKO market in 1997. There does not appear to be a direct correlation between the final lifting of the remaining restrictions at the end of 1997 and the current crisis.

However, the question remains whether foreign investors triggered the recent crisis or have contributed disproportionately to yield volatility. The answer appears to be no on both counts.

First, reports were that Russian investors, not foreigners, were the first to begin pulling out of the GKO market in May. Second, it appears that Russian non-Sberbank investors have been disproportionately responsible for the recent volatility in the market, while foreigners have played only a secondary role. The GOR reports that since the beginning of May foreigners have withdrawn $1.2 billion from the GKO market, reducing their share from 32.4% on May 1 to 31% on June 22. Since foreigners held about $20B in GKOs, they sold only about 6% of their holdings. During this same period, the GOR sold $2.8 billion less in new bonds than it paid out in redemptions, implying that residents withdrew $1.6B from the t-bill market. Since residents (non-Sberbank/CBR) held only about $8-10B in GKOs, it appears that they sold 16-20% of their holdings.

While foreign investment has contributed to volatility, it has also helped Russia lower its borrowing costs when confidence was high. For example, large inflows of foreign funds were the primary cause of the reduction in GKO yields from an average of 88% in 1996 to less than 20% by the summer of 1997. In Russia's under-monetized financial system, foreign flows have been key to financing the budget deficit.

7) What is the level of GOR manipulation in the GKO market?

There appears to be a substantial amount of unacknowledged GOR intervention in the GKO market, either through direct purchases by the finance ministry, purchases by the CBR or below market purchases by state-owned banks.

At the June 3rd auction, when GKO yields dropped to 54% from 80% several days before, sources report that the GOR secretly bought R3.3 bil ($540 m) of GKOs and had state-owned banks buy another R2.1 bil ($340 m). Combined with R2.7 bil ($440 m) which the government acknowledged covering, this means that the GOR was responsible for 95% of the funds used to pay R8.4 bil in scheduled redemptions. Through its purchases, the GOR reportedly lowered yields into the mid-50s from the mid-60s where investors were bidding. In subsequent auctions, the GOR has lowered its offerings or canceled issues entirely when it did not like the bid price.

More recently, at the June 24th auction, market players allege that Sberbank purchases accounted for nearly all of the $4.4 billion of GKOs sold. It seems fair to say that yields on GKOs are not a true gauge of market sentiment regarding Russia's prospects.

When U/S Lipton questioned Deputy FM Vyugin about rumors of GOR manipulation of the GKO market,Vyugin insisted that the GOR strategy of trying to hold yields down was transparent above board and that any GOR purchases were known to the markets.

8) Why would a CCFF (Compensatory and Contingency Financing Facility) for Russia be preferable to other options?

From the Russian perspective, an advantage of a CCFF is that it would not require a new program, and thus could be implemented immediately. Based on lower oil prices, Russia appears to be eligible for the Export Earnings Shortfall program of the CCFF but only for up to $3.0 billion (30% of Quota + a 20% optional tranche). It also could theoretically qualify for additional money under a contingency CCFF program, but this would happen only if exogenous factors caused the original policy program to go off course. However, it is worth noting that Camdessus has expressed his opposition to a CCFF for Russia before a new EFF is agreed.

A new EFF would supply cheaper funds over time in exchange for significant new conditions. An SRF would require a new EFF program and is expensive (300 bps over standby rate, rising 50 bps every 6 months) and short term (assumed 1 year/ maximum 2 ½ years).

U.S. and Foreign Bank Exposure

- Total claims of BIS banks on all Russian borrowers reached $72 billion at end-1997, consisting primarily of German bank claims ($30 billion or 42% of total claims) and Swiss bank claims ($9 billion or 13% of total claims). U.S. bank claims of $7 billion represent 10% of total claims. Overall, U.S. bank exposure to the Russian banking industry is minimal, especially compared with other BIS banks (particularly German banks).

U.S. and Foreign Bank Claims on Russia

(in millions US$)	Direct Cross-Border Claims				Total Credit Exposure*		
	Total (3/31/98)	*of which: Banks*	*of which: Public Sector*	*of which: less than 1 year*	3/31/98	12/31/97	9/30/97
Bankers Trust	$1,603	$63	$1,378	$1,245	$1,866	$1,554	$1,139
J.P. Morgan	$1,825	$1	$1,798	$1,814	$1,815	$1,513	$2,578
Chase Manhattan	$2,667	$78	$2,457	$2,254	$1,438	$1,408	$3,519
Citicorp	$1,483	$52	$850	$1,300	$763	$455	$368
BankAmerica	$649	$72	$504	$514	$536	$447	$563
Total (All U.S. banks)*	$8,820	$507	$7,113	$7,636	$7,219	$6,103	$8,960
Total BIS Exposure (12/31/97)**	$72,173	$40,292	$8,838	$32,406			
of which: Germany	*$30,452*	*$23,718*	*$604*	*$6,562*			
of which: Switzerland	*$9,009*	*$1,394*	*$6*	*$8,606*			
of which: U.S.	*$7,071*	*$392*	*$5,636*	*$5,136*			

* Source: FFIEC 009 Country Exposure Report.
"Total Credit Exposure" includes cross-border claims adjusted for guarantees, revaluation gains on FX and derivatives, net local country claims, and commitments adjusted for guarantees.
**Not directly comparable to U.S. bank data derived from the FFIEC 009 Country Exposure Report.

- Creditors' appetite for Russian bank risk began receding following the market turmoil last November and the persistent rumors at that time of major bank failures and a possible systemic banking crisis. Continued negative sentiment towards Russian financial markets and the banking system, combined with a growing concern over emerging market credits in general, has led creditors to tightly scrutinize any marginal exposure and, in some cases, to roll back their exposure.

  - While BIS semi-annual statistics show a $2 billion increase in BIS bank claims on Russian banks during the second half of 1997, these claims declined sharply in the fourth quarter. U.S. banks reduced their total credit exposure to all Russian borrowers by nearly $3 billion in the fourth quarter of 1997, but this was primarily related to a reduction in holdings of government securities rather than a significant decline in interbank or corporate exposure. This trend for the U.S. banks partially reversed itself in the first quarter of 1998, driven again by changing exposure to the Russian government securities market and also a modest increase in direct cross-border claims on Russian banks (an increase of $115 million).

- With approximately $600 million of the $2 billion in outstanding Russian bank syndicated debt estimated to be coming due this July and August, market participants are watching closely to see whether the roll back trend continues. So far in June, available information indicates that three Russian banks have been able to refinance a total of over $100 million in syndicated loans from foreign banks, despite prevailing market turmoil.

Daniel Fleishman
Financial Markets and Institutions
June 23, 1998

Restricted FR

Semi-annual International Banking Statistics
International positions of all reporting banks on countries outside the reporting area
(in billions of US dollars)

End-December 1997

Claims vis-a-vis Russia	Consolidated cross-border claims in all currencies and local claims in non-local currencies										Undisbursed credit commitments and backup facilities	Local currency positions of reporting banks' foreign affiliates with local residents	
	Total	Maturities				Sectors				Banks with head offices outside the country of residence			
		Up to and including one year	Over one year up to two years	Over two years	Unallocated	Banks	Public Sector	Non-bank private sector	Unallocated			Claims	Liabilities
Germany	30.5	6.6	3.1	18.8	2.0	23.7	0.6	6.1	0.0	0.3	4.8	0.1	0.0
Switzerland	9.0	8.6	0.1	0.3	0.0	1.4	0.0	7.6	0.0	0.1	0.2	0.2	0.1
United States*	7.1	5.1	na**	1.9	0.0	0.4	5.6	1.0	0.0	0.1	0.6	1.7	0.3
France	7.0	4.1	0.1	2.1	0.7	4.4	0.0	2.5	0.0	0.0	1.2	0.0	0.0
Italy	4.3	1.2	0.2	2.9	0.0	2.6	0.7	1.0	0.0	0.0	0.6	0.0	0.0
SUB-TOTAL	57.8	25.6	3.6	25.9	2.7	32.5	7.0	18.3	0.0	0.5	7.4	2.0	0.4
ALL COUNTRIES ***	72.2	32.4	4.3	32.1	3.3	40.3	8.8	23.0	0.1	0.6	9.7	2.5	0.7

* The data exclude local claims in non-local currencies which are included indistinguishably in the second to last column, with local claims in local currency.
** All claims over one year reported as over two years.
*** The data also cover the international claims of affiliates and branches which have their head-offices outside the BIS reporting area.

Phil de Imus

June 22, 1998

1999-SE-003588

ASSISTANT SECRETARY OF THE TREASURY
WASHINGTON, D.C. 20220

April 8, 1999

NOTE FOR SECRETARY RUBIN

FROM: Ted Truman

Larry and I suggest that you call Michel Camdessus to make the attached points on Russia. Larry has already made these points to Stan Fischer. We feel it would be worthwhile for you to reinforce them with Camdessus.

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