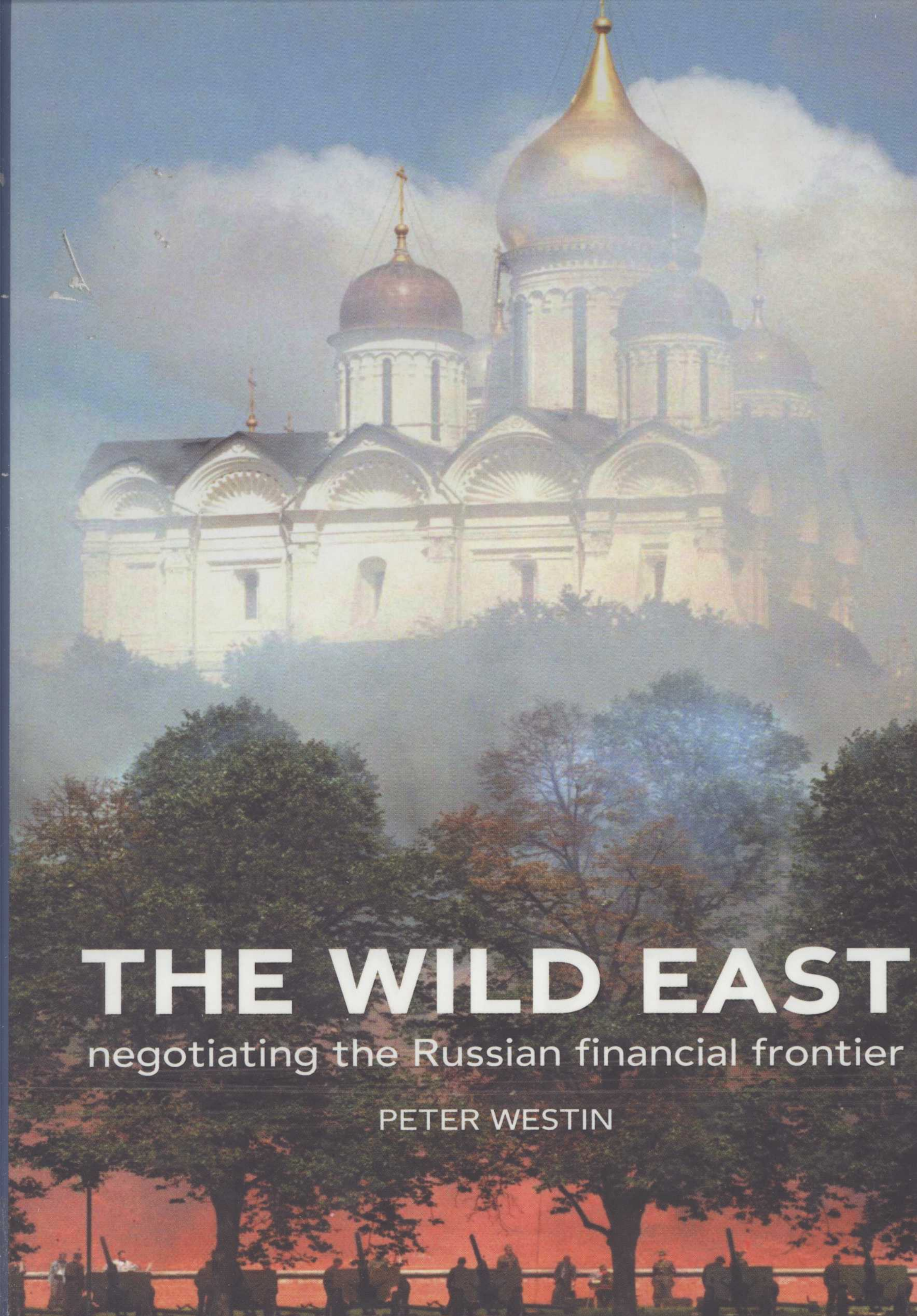

THE WILD EAST

negotiating the Russian financial frontier

PETER WESTIN

REUTERS

THE WILD EAST

Negotiating the Russian financial frontier

PETER WESTIN

REUTERS

Published by **Pearson Education**

London · New York · San Francisco · Toronto · Sydney
Tokyo · Singapore · Hong Kong · Cape Town · Madrid
Paris · Milan · Munich · Amsterdam

PEARSON EDUCATION LIMITED

Head Office:
Edinburgh Gate
Harlow CM20 2JE
Tel: +44 (0)1279 623623
Fax: +44 (0)1279 431059

London Office:
128 Long Acre
London WC2E 9AN
Tel: +44 (0)20 7447 2000
Fax: +44 (0)20 7240 5771
Website: www.financialminds.com

First published in Great Britain in 2001

© Pearson Professional Limited 2001

The right of Peter Westin to be identified as Author
of this Work has been asserted by him in accordance
with the Copyright, Designs and Patents Act 1988.

ISBN 1 903 68409 9

British Library Cataloguing-in-Publication Data
A catalogue record for this book is available from the British Library.

All rights reserved; no part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise without either the prior written permission of the Publishers or a licence permitting restricted copying in the United Kingdom issued by the Copyright Licencing Agency Ltd, 90 Tottenham Court Road, London W1P 0LP. This book may not be lent, resold, hired out or otherwise disposed of by way of trade in any form of binding or cover other than that in which it is published, without the prior consent of the Publishers.

10 9 8 7 6 5 4 3 2 1

Typeset by Pantek Arts Ltd, Maidstone, Kent.
Printed and bound in Great Britain by Biddles Ltd., Guildford and Kings Lynn

The publisher's policy is to use paper manufactured from sustainable forests.

ACKNOWLEDGEMENTS

The idea to produce this book first came to me during my time in Moscow as editor of *Russian Economic Trends.* Despite the piles, stacked atop my collage of a desktop, of books, journals and articles devoted to the ills and shortcomings of Russia's transition economy and featuring innumerable tales of investors' woes, I discovered that no single volume brought together the voices of the frontline. I mean the market makers: the ones who have spent hours stuck in bureaucracy, fighting for their rights as shareholders, reaping huge gains and suffering staggering losses. But also, the ones who pulled through the crisis of August 1998 and felt the winds of change.

I am most grateful to the contributors for taking their time away from (often, but not always) much more profitable activities, and sharing their perspectives and experience, in effect making this publication possible.

A special tribute goes to Professor Erik Berglöf who, during my sojourn at the Stockholm Institute of Transition Economics (SITE), allowed me the time to develop this book. I am also grateful to Jody Lanfrey at SITE for her advice on the structure and concept of the book. Ben Hooson contributed his excellent editing skills to the project. Furthermore, I would like to thank my friends and colleagues at SITE and the Centre for Economic and Financial Research (CEFIR) in Moscow for providing an outstanding intellectual environment.

Peter Westin

THE AUTHORS

Kasper Bartholdy. *Chief economist for emerging markets in Europe, the Middle East and Africa at Credit Suisse First Boston.* Kasper Bartholdy started his career as a management consultant in 1984 after graduating from the Universities of Copenhagen and Aarhus with degrees in Economics, Computer Science and Journalism. After a five-year spell as an economist with the IMF in Washington, D.C. (1986–91), he was a lead economist at the EBRD (1991–6). He joined CSFB in January 1997 and became a managing director in January 2001.

Erik Berglöf. *Director of the Stockholm Institute of Transition Economics (SITE) at the Stockholm School of Economics.* Erik Berglöf is a research fellow of CEPR and the William Davidson Institute at the University of Michigan. He was previously assistant professor at ECARE, Université Libre de Bruxelles, and has held visiting positions at Stanford University.

He has written extensively on financial contracting and corporate governance. In particular, he has applied theoretical insights to the study of differences between financial systems, and specific ownership and control arrangements. More recently, his work has focused on bankruptcy. He has also been involved in several capacity-building initiatives in transition countries, including as director of the Center for Economics and Financial Research (CEFIR) in Moscow and the Baltic International Center for Economic Policy Studies (BICEPS) in Riga.

Mr Berglöf has served as special advisor to the prime minister of Sweden, the Russian government, and on several government commissions and EU-related panels. In addition, he is a consultant to the World Bank and the IMF.

试读结束，需要全本PDF请购买 www.ertongbook.com

Stephan Boven. *Principal banker at the Group for Small Business, European Bank of Reconstruction and Development.* After completing his university studies, Stephan Boven became a staff member of a Frankfurt-based consultant company concentrating on micro and small enterprise (MSE) lending. From 1995 to 1997 he worked as a bank advisor in Siberia and Moscow in the framework of the Russia Small Business Fund, in both the micro loan component and the small loan component, followed by a series of short-term missions in Eastern Europe targeted at the preparation and implementation of MSE lending projects.

In 1999, Mr Boven joined the European Bank for Reconstruction and Development where he is mainly responsible for projects targeting the establishment of commercial micro-finance banks.

Al Breach. *Russia economist, Goldman Sachs.* Al Breach studied maths and philosophy as an undergraduate at the University of Edinburgh, after which he completed a Masters in Economics at the London School of Economics and worked briefly in the City of London before travelling to Moscow via Beijing in the summer of 1996 to write *Russian Economic Trends* at the Russian European Centre for Economic Policy (RECEP). In late September 1998 he joined Goldman Sachs, first as a consultant and then as staff, working as the company's Russia (and other CIS and East European countries) economist based in Moscow.

Roman Filatov. *Vice president, investment analyst, Templeton Asset Management Ltd.* Roman Filatov joined the Templeton organization in 1996. As an investment analyst he is responsible for equity research of Russian companies. Prior to joining Templeton, Mr Filatov worked at Deloitte & Touche CIS, where he audited several large Russian institutions, and before that was an analyst at Mezhcombank (Moscow). Mr Filatov holds a Master of Science degree from the Moscow Institute of Physics and Technology and is a Level II Chartered Financial Analyst (CFA) candidate.

Yevgeny Gavrilenkov. *Deputy head of the Bureau for Economic Analysis.* Yevgeny Gavrilenkov is one of Russia's leading macroeconomists. In this capacity, he has advised several Russian heads of government. He has played, and continues to play, a key role in the drafting and further development of the Russian government's macroeconomic programme, and was responsible for the macroeconomic part of the economic strategy adopted by the new government.

Professor Gavrilenkov is also Professor in Applied Macro economics at the Higher School of Economics in Moscow. He has international experience as visiting scholar to institutions such as the IMF and the Bank of Finland. He has published extensively, both in Russia and internationally, and is concluding a book on the Russian economy and the new economic strategy, co-authored with Niclas Sundström.

Peter M. Halloran. *Executive chairman, Aton Capital Group, president of Pharos.* Peter M. Halloran is the founder of Pharos Russia Advisors Ltd. Pharos was established in 1997 has been an active investor in equity, private equity and fixed-income opportunities in Russia and the CIS. Pharos has also acted as an outside advisor to portfolios valued in excess of $500 million. In July 2000, Peter Halloran joined the executive board of Aton Capital Group as chairman.

Since 1994, Mr Halloran has been a leading participant in the Russian market, bringing more than $7.5 billion to Russia through equity, debt and private placements. He was the principal contributor towards building the CSFB equity, fixed-income and investment banking businesses in Russia and the CIS. During his tenure, CSFB established a dominant market position as measured by trading volume, research rankings and profitability. In August 1997 he left CSFB to start Pharos Russian Advisors.

Mr Halloran has also acted as an advisor to Soros Fund Management, among others, on their activities in Russia. From 1986–95 he worked in New York for CSFB, Salomon Brothers, and CJ Lawrence, Morgan Grenfell.

He has lived in Moscow since 1995 and also maintains an office near Geneva. Mr Halloran graduated with a BA in History from Yale University in 1984.

Goohoon Kwon. *Senior sovereign strategist for emerging Europe, Middle East and Africa, ABN AMRO.* Goohoon Kwon is responsible for the formulation of fixed-income investment strategy in emerging Europe as well as economic analysis of emerging European countries both for fixed-income and equity markets at ABN AMRO.

Dr Kwon worked for the IMF for five years before joining ABN AMRO in mid-August 1998. At the IMF he worked on former Soviet Union countries including Russia and Ukraine as a team member and was also a resident representative in Ukraine, focusing on monetary, fiscal and structural issues. Before joining the IMF, Dr Kwon worked in Moscow to help the Russian Privatisation Ministry with its mass privatisation. He has ten years of work and research experiences on transition economies, including four years of economics Ph.D work at Harvard.

Dean LeBaron. *Chairman, Virtualquest.company, and founder, Batterymarch Financial Management.* Dean LeBaron founded Batterymarch Financial Management in 1969 and directed the firm's pioneering advances in the mid-1970s in the application of computer technology and modelling techniques, first in the US market and then in international and emerging markets. Mr LeBaron is recognized as one of the first foreign entrants in the nascent securities markets of Brazil, India, Russia and China. Today, Batterymarch is one of the investment management subsidiaries of Legg Mason Inc., which manages over $100 billion through several independently operating firms.

Prior to Batterymarch, Mr LeBaron was director of research at Keystone, where he managed the Keystone Custodian Growth Fund. He was also director of research at F.S. Moseley & Company. Mr LeBaron holds a BA and MBA from Harvard University. He received the Baker Scholar award at Harvard Business School and holds a chartered financial analyst designation (CFA). He is chairman of Wordworks Inc. In 2001 Mr LeBaron received the highest award of the Association for Investment Management and Research, the AIMR Award for Professional Excellence.

Identified as one of the investment futurists, Mr LeBaron's most recent investigations consider the development of new management styles using the Internet: virtual investment management. Inspired 15 years ago by his study of the application of physical science principles (such as quantum physics) to investment strategy, Mr LeBaron pursues his interest in complexity through *Complexity Digest* – or *ComDig* – a webzine which he publishes and through association with Santa Fe Institute and New England Complex Systems Institute and their linking of complex adaptive systems to dynamic social systems, including investments.

Drawing on input from 30 recognized experts (investment 'gurus'), Mr LeBaron has written *The Ultimate Investor* and *The Ultimate Book of Investment Quotations.* He is also the author of *Climbing Falling Walls,* recently renamed *Marx to Market,* which gives an account of market transformation in Russia and China.

Mark Mobius. *President, Templeton Emerging Markets Fund.* Mark Mobius joined Templeton in 1987 as president of Templeton Emerging Markets Fund Inc. in Hong Kong. He currently directs the analysts based in Templeton's 11 emerging markets offices and manages the emerging markets portfolios. Dr Mobius has spent over 30 years working in Asia and other parts of the emerging markets world. As a result of his experience, in 1999 he was appointed joint chairman of the World Bank and OECD's Global Corporate Governance Forum's Investor Responsibility Taskforce.

In 1999, Dr Mobius was named one of the 'ten top money managers of the 20th century' in a survey by the Carson Group, a leading global capital markets intelligence-consulting firm. For the second year in a row, Dr Mobius was named the number-one global emerging market fund manager in the 1998 Reuters Survey. CNBC named him '1994 first in business money manager of the year'. Morningstar in the U.S. awarded him the 'closed-end fund manager of the year' for 1993. In 1992, Dr Mobius was named 'investment trust manager of the year' by the *Sunday Telegraph* in the United Kingdom.

Before joining Templeton, from 1983 to 1986 Dr Mobius was president of International Investment Trust Company, Taiwan's first and largest investment management firm. Prior to that, he served as a director at Vickers da Costa, an international securities firm. Before joining

Vickers, he operated his own consulting firm in Hong Kong for ten years, and was a research scientist for Monsanto Overseas Enterprises Company in Hong Kong and the American Institute for Research in Korea and Thailand.

Dr Mobius holds Bachelor and Master degrees from Boston University, and a Ph.D. in economics and political science from the Massachusetts Institute of Technology. He also studied at the University of Wisconsin, the University of New Mexico, and Kyoto University in Japan.

Dr Mobius is author of *The Investor's Guide to Emerging Markets, Mobius on Emerging Markets* and *Passport to Profits.*

Roland Nash. *Chief economist, Renaissance Capital Investment Bank.* Roland Nash has been working as an economist in Moscow for six years. He is chief economist at Renaissance Capital Investment Bank where he helps head up a research department of 11 analysts focusing on Russian assets. Before moving over to focus fully on the macroeconomic and political environment, Mr Nash ran the fixed-income credit research effort, specifically overseeing the firm's research coverage of the fledgling regional and corporate debt markets.

In the two years before joining Renaissance Capital, Mr Nash worked as an economic advisor to the Russian government with the Russian European Centre for Economic Policy in Moscow. During that period he helped develop Russia's leading macroeconomic journal, *Russian Economic Trends.*

Enrico Perotti. *Professor of International Finance, University of Amsterdam.* Enrico Perotti holds the Chair in International Finance at the University of Amsterdam. He obtained his Ph.D. in Finance from the Massachusetts Institute of Technology (MIT) in Cambridge, MA, in 1990. He has since taught courses at MIT, Boston University and the London School of Economics. He has been a visiting professor at the IMF, the London Business School and the Central European University.

Prof. Perotti's research interests are in the area of corporate finance, banking and international finance. He has written about leveraged recapitalizations, equity crosslistings, strategic real options, banking reform and regulation, comparative corporate governance, the structure of the Japanese *keiretsu*, corporate transparency, emerging market development, financial integration and political risk, privatisation and entrepreneurship. His work, both theoretical and empirical, has been published in top journals such as the *American Economic Review*, the *Journal of Financial Economics, The Journal of International Money and Finance, Management Science* and the *Journal of International Economics*. In his applied work he is an authority in the area of international corporate finance, privatisation and financial reform in emerging countries.

Prof. Perotti is director of the research centre CIFRA in Amsterdam and a Fellow of the Financial Economics and of the Transition Economics Program at CEPR, Fellow at the Davidson Institute at the University of Michigan. He has worked as a consultant for the IMF, the World Bank, the European Commission, the New York Stock Exchange, the Russian Central Bank, and the EBRD as well as various private financial institutions and Eastern European governments.

Letitia Rydjeski. *Director of emerging market investments at Strategic Fixed Income*. Letitia Rydjeski is responsible for the EU 'converging' market countries, Poland, the Czech Republic and Hungary, along with Greece and South Africa at Strategic Fixed Income in Rosslyn, Virginia. She has been involved in the former Soviet/Russian market in numerous ways since 1989.

She started her career at the Baring Securities Eastern European research desk in 1990, covering the economies and nascent equity markets of Russia, Poland, the Czech Republic and Hungary. She subsequently worked as an Eastern Europe/Russia analyst at Chemical Bank, concentrating on unrestructured, defaulted debt of Poland, Bulgaria and Russia and the debt restructurings in these countries. She also worked at Scudder, Stevens & Clark during the 'heyday' of Western investment interest in Russia, when Russia and Eastern European coverage was essential to several different funds.

Niclas Sundström. *Economic-political strategist for Russia and Eastern Europe at SSSB/Citibank*. Niclas Sundström is a Russian and East European economic-political specialist, and is economic-political strategist for Russia

试读结束，需要全本PDF请购买 www.ertongbook.com

and Eastern Europe at Schroder Salomon Smith Barney/Citibank. Mr Sundström has a long background in the study of Russian economics, politics and the political economy of Russian economic reforms, and has co-authored several books and other published works on the Russian and East European economies. He has two new books under publication for 2001, the first with Professor Yevgeny Gavrilenkov from the Higher School of Economics in Moscow on Russian economic policy under the Putin regime, and the other with Vladimir Gligorov from the Vienna Institute of International Economic Studies on the launch of economic reforms in Yugoslavia/Serbia.

Peter Westin. *Senior economist, Aton Capital.* Peter Westin currently works as a Senior economist for ATON Capital Group in Moscow. Prior to that he worked at the Swedish think tank SITE (Stockholm Institute of Transition Economics) which spearheads international initiatives to build centres for research and policy advice in transition economies. At SITE he edited *Russian Economic Trends,* which is the world's leading publication on the Russian economy.

Peter assumed his post at SITE in July 1998, precisely when the severe financial crisis hit Russia. In this post he rapidly became one of Moscow's most sought-after commentators on the ups and downs of the economy, and regularly featured on Russian and international media programmes.

PREFACE: THE WILD EAST

ERIK BERGLOF

Referring to Russia as the 'The Wild East' has become commonplace in the financial world. It is meant to evoke images of the Wild West and the frontier civilization that has captured our imagination for more than two centuries.

The Wild West has two faces. On one hand, the dark image of crime-ridden, male-dominated towns where favourite pastimes were drinking, gambling and visits to the 'whore house'. The rule of law was embryonic at best, with physical strength and prowess with guns, rather than judges and juries, resolving conflicts. But there is also the more positive picture of the pioneers leaving their relatively secure, but desolate lives in Europe or the Eastern United States, to seek their fortunes in the open landscapes of the West. The Land of Opportunity held high risks and high returns. Settlers came to build new communities, and shaped a culture that is still with us today. There was a sense of mission: the Wild West had to be tamed through new institutions erected from scratch.

This book tells the stories of the settlers (some temporary) of the financial frontier in Russia. Our narrators have shared a common experience: as portfolio investors they observed and participated in the events that led up to the financial crisis of 1998. Some of these accounts, like their counterparts in the Wild West, have already made it into legend. Others are new, brought to us first-hand by investors who have had time to reflect on their often tumultuous experience of a few years back. To our knowledge this is the first book that brings them all together.

But hold on, some might say, many of these pioneers misjudged Russia then; why should we hear them out now? Like many settler accounts of the Wild West, these are likely to be partial and maybe even self-serving.

Moreover, why should we listen to portfolio investors at all? They often lack the on-the-ground knowledge of foreign direct investors. Portfolio investors usually come in late and leave early, and have neither the time nor the incentives to learn much about the institutions of the country. They manage large, diversified portfolios and are evaluated on short-term performance. They also tend to move in herds, suggesting that the views of the individual investor are less interesting.

Nevertheless, there are many reasons why we should listen to, even study, these accounts. While portfolio investors are sometimes less familiar with the intricacies of local institutions, they do have well-trained noses for macroeconomic and political vulnerabilities. They have broad international experience, in particular from emerging markets, giving them a rich set of comparisons. Moreover, the portfolio investors are important actors at the heart of the crisis; they *are* the short-term capital outflow. If we understand what makes portfolio investors act in certain ways, we are also closer to understanding the origin of the crisis.

And the contributors in this volume are not your average portfolio investors, either. The group, with some of the most experienced and highly regarded representatives of the profession, offers impressive combined experience. Dean LeBaron, for instance, even came to Russia during the *perestroika.* Many played important roles in the dramatic events leading up to the 1998 crisis. To the extent there was herd behaviour, these investors were among the leaders of the pack. Furthermore, not only do the stories of portfolio investors help us identify the problems; their experience can also help lead us to solutions. Several of the contributors here have participated actively in the economic decision-making process in Russia, as advisors and commentators, and occasionally as policymakers. Some have also taken part in privatisations and other important financial transactions. Many are still involved in negotiating the financial frontier in Russia and building the institutions necessary to establish the rule of law.

So why did many of the authors here seem to have seriously misjudged Russia? Their own answers in this volume suggest that it was the lack of understanding of the weaknesses of local institutions, in particular the poor protection of minority investors, that hurt them in Russia. Economic research has borne out this lesson: work by Simon Johnson and three co-authors suggests that it was precisely the differences in the rule of law and minority protection, not the macro-imbalances and indebtedness, that explained why some countries were hit by the Asian Crisis and others not. But more recent findings also imply that many observers did not fully appreciate the implicit contingent liabilities of the governments in these countries. In Russia these liabilities originated in a bloated market for government bonds and a fundamentally defunct banking system saddled with large amounts of bad debts and huge exposures in markets for foreign exchange and bonds.

There is also much to suggest that the crises we see today are different from those of the past, a factor that helps to explain why the portfolio investors may not have anticipated the Russian crisis. Financial and economic crises are more contagious than they were during earlier periods of high capital mobility. The new crisis pathologies provide yet another reason for why we should listen carefully to the voices in this volume.

Another related issue is that some portfolio investors, like Letitia Rydjeski, did have serious concerns but did not heed these. This leads to the deeper issue of *why* portfolio investors, and investors in general, move in herds. As Al Breach confides, 'it is hard to remove yourself from the crowd'. Obviously, in the financial industry incentives matter. It is more costly to be wrong alone than in a crowd. But there are also more subtle psychological factors that cause us to doubt our own judgement. This is the exciting new area of behavioural finance, which is rapidly changing our understanding of financial markets and institutions.

But did these portfolio investors really misjudge Russia? To quote Al Breach, they seemed to have been 'fooled' not once but twice. Many with money in the market held their positions too long, and sold too early, before the upturn. But was this serious misjudgement, or just simple calculation? Those investors that did not manage to sell before August 1998 lost money relative to the peak of the boom. But to know whether they lost money we need to know when they entered and at what prices. Those who bought equity did so in a heavily discounted market, in some stocks by a factor of a hundred. These prices reflected fundamental concerns about the lack of institutions and macroeconomic imbalances in Russia. Others loaded up on government securities at unbelieveable interest rates, several hundred per cent on a yearly basis right before the crisis reaching 135 per cent on average in August 1998. Obviously, these rates incorporated the possibility of default. Experienced investors that bought in these markets knew what they were getting into. The risks were huge but so were the potential rewards.

In investment, timing is, if not everything, at least very important. While the collapse in August 1998 could not have been a surprise to most of these investors, the upturn in 1999 and 2000 seems to have been. Most observers had anticipated that the impact of a financial crisis on the real sector would be limited, after all very few firms relied on credits from the financial sector. It was also obvious to most that a depreciation of the rouble would give an impetus to many industries. But very few observers expected such broad and rapid growth. Manufacturing has grown by a third in three years; industries previously pronounced dead were revived, and parts of the country that had contracted for decades suddenly showed signs of life. The world oil price has helped substantially, but it only explains part of the development. After the crisis, Russia has experienced a period of renewed political vigour and ambitious reform plans; the federal state has reasserted itself. Limited progress has already been made in tax reform and administrative simplification. Critical judicial reform is now on the agenda.

Yet the vulnerabilities remain. The frontier of the Wild East, like its counterpart in the American West, is not always well-defined and does not always move forward. Negotiating the financial frontier in Russia is a long and arduous process where no gains of terrain are ever secure. The Phoenix rising out of the ashes of the Russian financial sector may have shorter wings and less vigour. This may prevent it from flying as high as it did in 1998, thus making a plunge less dramatic, but another crisis in the near future cannot be ruled out. The banking sector has not been restructured, and the rules of the game in the financial sector are far from clear. The supervisory bodies lack bite and the Central Bank and its governor, previously branded for not believing in the relationship between money and inflation, are now ignoring all international experience on bank restructuring. If nothing serious is done about the Russian banks, we may well see an eerie rerun of the 1998 crisis with an overvalued rouble and an extremely fragile and bloated banking sector.

This is one reason to be cautious about the prospects for Russian economic reforms, and there are others. The government has an ambitious reform programme, and President Putin has increasingly put his weight behind it. It is by far the most comprehensive programme to date in Russia and local ownership is stronger than it has ever been. But the programme lacks clear priorities. Together with Club 2015, a group of young Russian business leaders and policymakers, SITE and our Russian-born offspring CEFIR are trying to assist the government in setting these priorities. Transparency and broad public debate are critical to this process. In a project with the Ministry of Economic Development and Trade, and with support from the World Bank, we are developing a programme for monitoring implementation of the programme at the level of the individual enterprise. It is only when the reality facing the individual entrepreneur improves that we can hope for sustained economic growth in Russia.

Like the old frontier towns of the West, Russia has yet to establish the very foundation upon which 'rule of law' must be built: a strong, competent and fiscally sound state with clear demarcations towards special interests, and contained corruption. The problem of Russia is not an absence of laws on the book; it is enforcement of these laws. A combination of institutional reform and stronger norms helped to build the foundations for a stronger state and an unprecedented period of sustainable economic growth in the Wild West. For Russia this is the ultimate challenge.

Learning from foreign experience, and the experience of foreign investors, is important, but genuine progress will only come once the analysis and its conclusions have been internalized. Building domestic analytical capacity through a reversal of the brain drain and stronger domestic training is critical to a sustainable reform process. To this construction SITE is committed.

Erik Berglöf

Stockholm, 17 July 2001

试读结束，需要全本PDF请购买 www.ertongbook.com