

**IMPLEMENTATION OF THE HELSINKI ACCORDS**

# **Doing Business in Russia and the NIS: Opportunities and Obstacles**

**June 1994**

**Briefing of the  
Commission on Security and Cooperation in Europe  
Washington, DC**

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# Briefing on Doing Business in Russia and the NIS: Opportunities and Obstacles

Friday, June 3, 1994

Commission on Security and Cooperation in Europe

Washington, DC

The briefing was held in room 2359 of the Rayburn House Office Building at 10:30 a.m., Jane Fisher, Deputy Director, Helsinki Commission, presiding.

Present: Dr. Richard Rahn, Mr. Edward Chow, Mr. Joseph Barker

Also present: Bill Richard, Elka Lewis, Barry Wood, Matt Gersner, Adam Rappaport, Shannon Uplinger, Joe Lukich, Katrina Mazingi

Chairwoman **Fisher**. Good morning. I'm Jane Fisher. I'm Deputy Staff Director of the Helsinki Commission. We're very pleased to be sponsoring this briefing on trade in the NIS. This is the third in a series of briefings we have been doing on NIS. We've had one on Partnership for Peace. One on Ukraine. We're having this one trade and we'll be having a fourth briefing on Crime and Corruption in the NIS. The Helsinki Commission is probably best known for its work on human rights. Our mandate, however, is to monitor compliance with the Helsinki Accords in their entirety.

The Helsinki Accords cover human rights, security, and economic cooperation. And now that the countries of the former Soviet Union are making the transition to democracy, we are putting a greater emphasis on trade and economic cooperation. Russia and the newly independent states have a great potential market we feel. They have enormous natural resources, large consumer markets, and an enormous potential for trade and investment. Companies, large and small, are exploring this new market which, regrettably in spite of its potential, is not without its problems. Some firms have been successful. Others have run into the oft cited impediments such as, the absence of a coherent legal infrastructure, the lack of a physical infrastructure, grossly inefficient distribution system, arbitrary tax laws, limited working capital, rampant crime, and a difficulty in trying to identify who it is one should be working with in the NIS countries.

We're pleased to have with us today a distinguished panel of experts who have been directly involved in business development in the former Soviet Union. Our speakers will describe their experiences and share with us their views on the opportunities and hazards of doing business in Russia and the NIS.

Dr. Richard Rahn is President and Chief Executive Officer of Novecon Limited and Novecon Management Company. These companies operate businesses in Russia and Bulgaria. He is the former Vice President and Chief Economist of the U.S. Chamber of Com-

merce. Dr. Rahn has directed and participated in economic growth projects and studies in a number of countries including Estonia, Hungary, Mexico, the Philippines, and Thailand. He served as the U.S. Co-Chairman of the Bulgarian Economic Growth and Transition Project in 1990 and is currently a member of the U.S. Committee to assist Russian reform. Dr. Rahn received his B.A. in Economics at the University of South Florida, an M.B.A. from Florida State, and a Ph.D. in Economics from Columbia.

Mr. Edward Chow is the Director of International Affairs for Chevron Overseas Petroleum. Chevron is an integrated energy company with operations in over 100 countries with an annual revenue of 37 billion. Major international operations take place in Canada, Indonesia, China, Nigeria, Australia, U.K., Kazakhstan and, I'm sure, a lot of other countries. Mr. Chow joined Chevron in 1976. Prior to assuming his position in Washington, in 1991, he was Chevron's Manager in Beijing and has also been involved in Chevron's operations in South America, Europe, the Middle East, and the Far East. Mr. Chow received a Bachelor's degree in Economics and Government and a Master's degree in International Affairs from Ohio University. He was also a research fellow at the School of International Service American University.

And Mr. Joseph Barker is Vice President of Ryland Trading Limited and serves as the Executive Operations Manager for the international business activities of the company. Prior to joining the Ryland group, Mr. Barker was the Director of Manufacturing for the home building operations of the Boise Cascade Corporations. He later organized and managed the International Housing Division, Boise International, which exported and erected single and multi-family housing worldwide. Mr. Barker also managed the Factor Division of MA—

**Mr. Barker.** Kharafi.

Chairwoman **Fisher.** Kharafi, thank you, Kuwait which manufactured and erected factory-built work camps and housing throughout the Middle East. Mr. Barker is a graduate of the University of Richmond and did graduate work at the Harvard Business School and Lehigh University.

I think, then, I will open it up to statements from our speakers and I think we'll go left to right starting with Mr. Chow.

**Mr. Chow.** Thank you, Ms. Fisher, for this opportunity to brief the Helsinki Commission on doing business in the newly independent states of the former Soviet Union. Although Chevron has been actively engaged in crude oil and petroleum product trading with the Soviet Union for quite some time, it was only in 1987 that we first started looking for traditional oil and gas exploration and production opportunities. That effort culminated in the signing of a Foundation Agreement at Blair House here in Washington on May 18, 1992, for joint venture development with the Republic of Kazakhstan of the super giant Tengiz oil field which is on the northeast shore of the Caspian in Central Asia.

The joint venture began operations on April 6th of last year and is just beginning to tap the potential of one of the 10 largest oil fields ever discovered in the world. Estimated to contain 25 billion barrels of oil in place, Tengiz is believed to have 6 to 9 billion barrels of recoverable reserves. Current production is restricted to about 30 thousand barrels per day because of the lack of infrastructure to take oil to market. But, we hope to increase production to 500 to 700 thousand barrels per day by the year 2010. In order to achieve this, the joint venture will be investing at a rate of \$1½ billion over the next

3 to 5 years or about \$20 billion over the 40 year term of the Joint Venture Agreement. Already the Joint Venture TengizChevroil have about 38 hundred employees over 90 percent of whom are national employees and about 200 western expatriots seconded from Chevron.

There are over 2,000 contract workers at Tengiz right now. We are serving about 20,000 meals per day in the barren steppes of Central Asia to both our employees and contractors. That gives you an idea of the scale of operations that are involved. It is because of this scale and the size of the investment and also the length of time that Chevron has devoted to pursuing oil and gas opportunities in the former Soviet Union that, in some ways, make Tengiz a bellwether project for the potential success of western investment in the oil and gas sector of the former Soviet Union. It is from this perspective that I would like to share some of Chevron's experiences in facing challenges that an international oil company operating in the former Soviet Union is confronted with.

First of all, the opportunity. Clearly, we, are in a natural resource business and we have to go where the resource is. The former Soviet Union was then and Russia is still today the largest oil producer in the world. In addition to that, there are numerous untapped, under-explored, or yet-to-be-producing regions that can be more fully exploited with western investment, western technology, and western management. However, the conditions are often very harsh. In Tengiz itself, we face, for example, temperatures that range from minus 30 degrees Fahrenheit to 125 degrees Fahrenheit. The reservoirs at Tengiz are deep, high pressure, and contains quantities of hydrogen sulfide that needs to be removed from the gas before the oil can be produced.

The technical challenges are precisely the reason why, even though the Soviets discovered the field in the late 70's, they were not able to fully exploit those fields. We, in the international petroleum industry, however, are used to facing technical challenges. That's nothing unusual. However, there are a number of non-technical challenges that are somewhat unique in working in the former Soviet Union. If you think back that we started negotiating some agreement in 1987, and think back through the history of the Soviet Union and the number of political changes that have happened since then, you can imagine the number of governments, political jurisdictions that we've had to deal with since we started in 1987.

Decision making and who has the right to make those decisions is a rather interesting process that we have yet to fully understand and it's always evolving, of course. You have, I'm sure, heard of export taxes that have been placed. Export taxes being canceled. It's one thing to have harsh economic terms. It's another thing to have unstable economic terms on which you have to base your business planning. That's a problem. Ownership of the natural resource, particularly in Russia, with the devolution of central power is also a problem.

Who has the right to make a deal with you? Is it the local authority? Is it the central authority? Or, is it a combination of both? That's often not clear. Do they really want us? This is an interesting question, particularly in the case of Russia. After all, Russia is still a very large oil producer and probably believes that it has the capability to continue operating on its own without western help. And, that's a reasonable case from their point of view to argue. Maybe all they really want is western capital but not western technology and management that we also bring.

We are not bankers, of course, but an oil company that takes equity risk in order to make an equity return on that investment. If you look at the terms, and now I'm going

to focus specifically on Russia, that the Russians offer the oil and gas sector, it's some of the worst terms in the world. Petro Consultants, which is a well respected international oil and gas consulting firm, does an annual review of petroleum fiscal terms around the world. In 1994, in ranking 70 countries, based on the size of government take, the net present value, and internal rate of return an investor would make from a venture looking at marginal fields, economic fields, and fields with big up-side potential, Russia ranks variously as either 67th or 70th out of 70 countries. That gives you a perspective of how much they really are trying to attract western oil and gas investment.

Poor infrastructure, Ms. Fisher referred to earlier, which is certainly true. The lack of telephones, transport, banking, a legal infrastructure are all problems. The other problem that's relatively unique or that's different about working in Central Asia is under the former Soviet Union all the logistical systems for oil and gas all went through the Russian Republic. So, there is no independent way of getting oil to western markets, at least, without first going through Russia if you want to use existing infrastructure. A better understanding of western economic concepts is also lacking. Simple concepts that are second nature to a western investor or businessman such as the time value of money, opportunity costs. Chevron as a company not only goes to where there's a resource but has to compare the relative returns from investing say a billion dollars in Russia versus Nigeria versus Indonesia versus elsewhere. And this lack of a sense that they are competing in an international market place is a problem in negotiating to us, favorable terms.

The relative value of petroleum products is also not recognized. For example, it's typical in Russia to have ton for ton petroleum crude oil exchanges. Whereas in the west, we trade oil in barrels not only because that's the physical volume that we deal with but because lighter crudes generate the higher value products, such as, jet fuel, gasoline, and kerosene in a typical refining structure. While the Soviet exchange penalizes those people who produce light crude oil at the expense of people who produce heavy crude oil. This is not particularly discriminatory to just western producers, they do that to their own producing associations as well. It's a lack of recognition of economic value in a pricing system that prices products according to the value that it generates. That is a problem. Also, the political system is not yet mature enough to distribute general economic well-being or benefit of a western investment throughout the country or in its various sectors.

In order to somewhat take care of that, in our own case, we have set aside 50 million dollars as a local community fund for local community development projects in the Atyrau Oblast where we're working in Kazakhstan. Because it is important for us as good corporate neighbors to show an immediate benefit to our neighbors in whose midst we're working in and not just wait for the central government to distribute that economic well-being. We may make a deal with the Petroleum Minister and that may accrue to the Central Treasury but the Railroad Commissioner may ask what have you done for me? Because the system doesn't really distribute that across the board. There's also a need to value true partnerships. And, in the former Marxist thinking, value was determined more by input than by output.

In the first year of our Joint Venture, the local partner is much more interested in the rate that we are spending money as opposed to the rate that we are making money even though we are half of a 50-50 Joint Venture. That kind of conceptual problem reminds me a little bit about a Joint Venture story that I believe I first heard when I was working in China. Which is a chicken and a pig walking down the road. And the chicken saying to the pig, why don't we get into the bacon and eggs business and have

a breakfast stand? And the pig says to the chicken, that's easy for you to say. You're making a contribution. I'm making a commitment. Better—more commitment and contribution from both sides would certainly contribute to the potential success of western ventures in the former Soviet Union.

Thank you, Jane.

Chairwoman **Fisher**. Thank you, Mr. Chow, that was very interesting. There are some seats up here in the front row if anybody would like to take a seat.

And, now, we'll hear from Mr. Barker.

Mr. **Barker**. Thank you very much for allowing me to address you this morning. I am with Ryland. We are one of the largest home builders in the United States. We have four manufacturing plants which makes us different from competitors like Centex and Poulte. In 1990, we were approached by Rosagromstroi, which is the Agriculture Ministry, or the construction arm for the Agriculture Ministry in Russia. And we were invited to go to Barnaul, which is in the Altai region in Siberia and look at one of their factories and make recommendations as to how this factory can quickly produce 2,000 houses a year. It had been purchased earlier—an adjacent factory had been purchased earlier from the Swedes with the capacity of 1,500 houses and it had never produced over 700 houses in 18 years. The solutions to the problem were basically technical. But, as I pointed out to them, you've got a building season of maybe six months in the area that you're trying to build.

So, why don't we figure out how to build 2,000 houses a year and then worry about the factory. The mentality that I faced then and still face now is what I call "the field of dreams" mentality about a factory. If we build a factory, somehow or other these houses will pop up. I've been into housing for 30 years. I've been in international housing for 22. I haven't been able to figure that one out yet, but that's what I'm constantly up against. By the way, that project went on. We negotiated that for two and a half years. We went through the Putsch. Through techno-export. It was approved by Ex/Im Bank. It was in the Federal budget. Gaidar stamped it. It never happened for a multitude of reasons. But, on that trip, we became very interested in the potential of Russia. I spent some time in Moscow and spent some time in St. Petersburg. And, at that time, I had the capacity of being the Manufacturing Manager for Ryland.

Also, at the same point in time, there was the immigration of Russian Jews to Israel and we became very active in that. We built 1,300 houses in about 9 months and shipped them into Israel. And we were profitable in what we did. And, our Chairman, at that time, decided what we needed to do is become an influence in worldwide housing and let's branch out and begin to develop. Our strategy or our tactics, at that time, were to go in-country and become in-country builders in a multitude of places. We have approached Argentina, Mexico, Poland, Germany. I've just finished a project in Senegal and we're actively building in Africa right now, I mean in Russia right now. To go in-country means that you have to know what's going on. The approach that we took was the Joint Venture approach.

We bring to the table three things. We bring a marketing and design concept. We bring a manufacturing concept. And we bring a field operations construction concept. What I tried to find were partners who could bring 1, 2, 3 of the same things as opposed to Joint Venturing with a bank that didn't really understand what was going on. We were fortunate in both St. Petersburg and the Moscow Oblast to find partners of that capacity.



All of them were builders. None of them had marketing experience as we currently know. Some of them had—two of them had on-site construction experience. Two of them were manufacturers.

Let's jump to the end of the story. We now have, in Moscow, a truss operation. Those little pointy triangles that go on top of roofs. And we're the only truss operation in Russia west of the Urals. We are beginning to introduce a technology. To give you an example. It takes, now, on a house that's approximately 9 meters, I mean, yes. 9 meters by 9 meters. It takes 4 men about a month to put a roof on. The Russian way. Using modern—not modern. But, using truss technology, they can do it cheaper and they can do it in about two days. In St. Petersburg, we have just completed a townhouse project. Now, as we were approaching the market and this was pre-Putsch, there was no mortgage program. There were—these alleged people with briefcases of dollars or rubles did not appear at our door so we had to figure the best way to finance this.

So, we built for the expatriate market, the western market. The strategy was we would learn our trade by building in-country for the expatriate market. And we have just completed a project and this advertising piece is out front if anybody wants a townhouse, I can negotiate a deal now that'll do that. I sent American supervisors and trainers over. I did not send American crews because you can't become a builder in-country if you do all the work. So, to build our townhouses which are the exact same townhouses we are building in Montgomery and Prince George county up here, we have used Russian plumbers, Russian electrical, Russian carpenters and everything. It's been bumpy along the way but I will tell you right now the finished product is as good as anything that's standing in this area. I'm very, very, very pleased with it. In fact, we had our grand opening two weeks ago and I hosted the Housing Committee from the Consulate and I was standing in the other room as the committee people were in the dining area. And two women said to each other, I believe we have just entered the twilight zone which was very, very complimentary.

A couple of side issues. There is a difference. Home building around here is not rocket science. It's not high technology but there are some basic rules that you have to follow in order to make the house stand up and be of reasonable quality. And we understand hollow wall timber frame technology because we all live in one. In Russia, they do not understand it because they don't live in one. The dachas that are there are basically log cabins or they're basically cobbled together and dacha literally means second home. The primary buildings are all cement and stone and it's not unusual to have a cement wall 18 inches thick with a styrofoam block in the middle of it for high thermal efficiency, which I haven't understood yet either. So, when it came time to build, we had to begin at the very, very basics. For example, our first foundation, now we're building a two-story townhouse.

Our first cement foundation is 24 inches wide. Here, in the United States, it's 6 to 8 inches wide. We built the second phase of our project with a major technological compromise. We are now using a 12 inch foundation. And it's because there's not an understanding. The same thing in plumbing. The same thing in electrical. But, I will give everybody credit that I have worked with. They are like sponges to this new technology. They have this—one hand is out saying no, we can't do it. But, the other hand is out taking the technology from you. And we have had a very, very good time.

At our dedication, the Fire Marshall was there. Two chief people in a construction industry over there are the Health Officer who handled sewer and water and the Fire

Marshall who handles everything else. We had a hard time convincing him that wooden buildings were safe. I finally did. During the dedication, the caterer in the kitchen caused a small degree of smoke while he was warming up the hors d'oeuvres and the fire alarms in the building went off. And I mean I could have not planned it better. We were successful after that. Infrastructure was a comment that was made. When we began with all of the good faith cooperation of the city of St. Petersburg, this was pre-Putsch. With the Putsch that came along, suddenly all of their resources went away. So, we had to run our own sewer one kilometer. We had to run our own gas. We had to run our own water. We have to now negotiate strongly for telephones. And, getting it done is still a series of blue stamps on a piece of paper and a long, long time, and education all along the way.

The land issue remains a major, major problem in Russia. We hear, we read, we see in the paper where they now have the right of land ownership. Well, it reads well in the paper but when it comes down to being a practical experience it's very, very difficult. We are opening up our townhouses with "we have the right to build" and now we have the "right to occupy." And this is still on a long-term lease, a 49 year lease, with the city of St. Petersburg. They tell us in several years that we will then have the right to buy. And at that time we will do it. We have in our structure, legal structure there, set everything up on a fee simple basis. But fee simple means absolutely nothing in Russia at this point in time. Hopefully, it will come along. Hopefully, we'll be able to move to it. In summary, it has been—we've been building there three years.

It has been an enjoyable but very, very difficult experience. It's been very rewarding. It's been personally and professionally rewarding to this date and by the end of this year, it will be financially rewarding for Ryland as we move over our project. But, it's taken a long time to get there. I encourage all of my builder friends to go to Russia to look. But, to go to Russia (one), with a very long term perspective in everything that they do; and, be very, very careful with whom you associate. And I don't mean that you're going to associate with people that are going to be dishonest. I mean they're going to be associating with people that are going to commit to things that they cannot deliver, particularly in the building area. So. I found Russia to be very, very successful and we were glad we were there and we're beginning to move into our next phase.

Chairwoman **Fisher**. Thank you, very much, Mr. Baker. Dr. Rahn?

Dr. **Rahn**. Well, thank you. It's a pleasure to be here today. We're doing things a little bit differently. We established the Novecon company's, basically to establish joint ventures, between American business enterprise and the new private enterprises in Eastern Europe and the former Soviet Union. We've got two companies now operating profitably in Russia. We have a helicopter company called Novecopter where we sell American helicopters and other high tech equipment. And we have a technology company called Novecon Technologies. We acquire Russian technology and market it here in the U.S. We are working on a number of other projects in Russia. I've listened to my colleagues here and I can identify with the trials and tribulations of all of them.

Now, to get into Russia, all of us who are doing this, you have to be optimistic by nature and a lot of people think we're a bit foolish but I think that we are overcoming many of the impediments. And they are enormous. First of all, the Russian economy. For those of us who have been going there for a number of years, it is astounding in the rapidity of the progress. Right now, more than 50 percent of the Russian economy is private. More than 50 percent of the people are employed in private enterprise or cooperatives. This has virtually all happened in eighteen months. It has been the most rapid tracked

transition in economic history. You read the production statistics on Russia and you figure oh, the GNP and national income must be falling very rapidly. Well, the reality is quite a bit different. In a former life, I was an economist and I understood the difference between value subtracting and value adding industries.

Much of Russian production was value subtracting and by shutting down many of the enterprises, many of the military enterprises, and a lot of the industrial enterprises, even though this causes decline in production, it really means an increase in national income because the subsidies were greater than the value of the production. And as bizarre as that may seem, you actually increase national income in much of Russia by these production decreases. It's the judgment of the IMF people who are there who are good friends of mine and our own observations, that Russia probably has been experiencing real economic growth for more than a year. The economic growth, however, is highly disparate. If you're in the new private sector, if you're an entrepreneur, you've got a good business or are working for a private sector company, your real income has probably increased a very high rate. On the other hand, if you only work for an old state industry, if you earn a pension, you've had an enormous drop in your real income and you're suffering extreme hardship. So, there has been this big divergence. In a city like Moscow, a couple years ago, you could drive around easily. There wasn't that much traffic. Now, it's like New York and most of it jammed up primarily with foreign cars.

It's exciting. It's unpredictable. And I thought I'd just go through a few of the areas here of concern. One, is the problem of lack of the rule of law and property rights protection. In theory, they have private property. I enjoyed Mr. Barker's comments about that in terms of land and everything else. In theory, again, you can buy everything. But, trying to hold on to something. Trying to protect it. There is no real, functional court system for protecting commercial property. I mean they don't have things like property registers and all of the normal things that we go through. There is not insurance, for instance, home owner's insurance and all the rest that you're used to. Just in terms of property disputes, contract disputes, there are few means of settlement. And one reason you have, probably, a lot of these gang shootings in Moscow, if you don't have a functioning court system and you have a dispute over a contract, if you can't go to court you shoot the other fellow. And that happens. The Mafia and official corruption. Fortunately, our companies have not encountered quote what we read about in the newspaper as the Mafia. I do worry about having helicopters there and I'm afraid some day somebody's going to come up and say, Mr. Rahn, would you like your rotor back? We haven't had that happen yet. But, in terms of official corruption, we're trying to set up a series of investment funds in Russia where we would acquire Russian and American capital. And I've been told that well, it's not permitted now but certain payments, of course, can get permission to do this. We have refused to pay any form of bribe not only for the Foreign and Corrupt Practices Act, but practically, I think, that any American or foreign firm that starts that, you quickly end up like bribery any other place in the world. They'll escalate and it's never ending. And so, we just say no. And there's a number of things we haven't done because of that problem.

The inflation. Monetary instability. The inflation problem, of course, is extremely severe over the last couple years. However, it has been not well reported that since the end of January, there's been virtually no new monetary creation in Russia. And that's one reason you've seen the stability in the exchange rate. The crunch is going to come this summer because what they've done is cut off the subsidies to many of these factories who

were receiving the subsidies. Now, they kept operating on this credit system assuming that the Central Bank was eventually going to give in. And neither IMF nor none of the rest of us were expecting the people in Russian government know to the extent that they will give in. But the pressure is increasing. And you now are having a struggle between the Red managers and the Red workers because, I think, people who are now in control in Russia, which are basically the factory managers, realize that inflation was self-destructive to their own interests and they have been far tougher on it than anybody expected. But, it's going to be interesting. Another problem, of course, is accounting standards and language. Mr. Chow's comments I rather enjoyed hearing. I have—since I have the occasion to wear the hat as an economist and also we are trying to teach Russians basic accounting standards. We're trying to teach them tax law. In the Russian language there is no differentiation in the word for revenue versus profit. And you run up enormous translation problems. You get very bizarre tax law because there is not an understanding of the difference between revenues and profits among large numbers of people along with present value and discounted cash flow and all the other kinds of things that we have to deal with. And this has been a never ending struggle for us. Price controls have been, at least for us, a rather minor problem at the moment. They don't seem to be well enforced. But, the trade and tariff regulations, again, capricious. When we brought our helicopters, first we had a 20 percent tariff. Then it went up to a 50 percent tariff. Now, it's supposed to be cutting back. But, if you were a state agency, you didn't have to pay the tariff. And, it is just endless. Getting certification. The helicopters we've been flying in there have—in fact we brought in the first U.S. civilian helicopters ever to come into Russia. They've been flying in this country for ten years. FAA certification. No problem. But, they insist upon their own certification which had nothing to do with the fly-ability of the helicopter. It really came down to how many people we were willing to bring over to the World Cup matches this summer. You get into this kind of thing and it's endless struggles and we basically refused to play the game and they hold us up.

Taxes. You never know from one moment to the next what the tax rates are. What they are going to be applied to. Early this morning I was dealing with a problem of registration of one of our companies and it really came to what kind of registration did we want versus various types of taxation that would be applied. But, that was this week's set of decrees. Securities and financial regulation in obtaining financing. There's not yet a securities law. A group from the FCC and U.S. Treasury have been over there working with them and, in fact, one of my former lawyers is working on this problem. But, they do not have a securities law which means the good news is you can float anything, the bad news is they can stop you from floating anything. We actually have a policy of only investing in things where we have Russian partners who also invest. Because going back to the property rights problem, unless you've got collateral outside the country, how do you protect yourself? Well, we have found—we've been successful, at least to date, by requiring—well, again, with our helicopter company. The Russians own 50 percent of it. And I basically said we're not sending any parts or helicopters to Russia until the Russian side comes up with hard currency and we get it deposited into our banks here in Chicago and elsewhere.

All our sales. We do insist upon getting the hard currency payments in full before any product goes out. Too many companies have tried to extend credit and there's no way to enforce credit there. Personal travel and telecommunications. This is an endless problem. It's getting better in Moscow with these telecommunications. Those of us and every-

body here has had to fly Aeroflot ought to know now that the official warnings are not to fly Aeroflot. And I try to avoid it anytime I can. There's a nice new, private airline called Transaero which flies between Kiev and Moscow that I always use. They fly 737's as good as any western airline. But, Aeroflot—it's not only the safety problems which you've all read about. But, such beautiful little things as having chicken served to you and it still has pin feathers on it. When I was flying back and forth between Moscow and Novosibirsk. I do not kid you. Boiled chicken tossed on a little plastic tray with pin feathers on it. I'm sure my colleagues here have seen such things. It's not fun after a while. The first time is an adventure and quickly it gets very old. Transporting goods you've got the same types of problems. One of our Bulgarian companies, a trucking company, trucks into Moscow and our people have been shot at, constantly held up for bribes, blah, blah, blah, but it's a problem. And you've got to have a number of people. When we bring goods into the port of St. Petersburg, we have a team of our own people, it involves, again, with helicopters or anything else, with the goods from the time it arrives to the time it goes to the final customer. But, that runs up your cost. Personal safety. So far, we've been fortunate in our company that nobody's had a problem. But, it is a concern. We now have a rule that we do not travel around the countries alone. We try to go at least in pairs and keep a Russian speaker with us. Protecting investments. Again, you've got to have collateral outside the country. You've got to have some way of holding it down. And, I was listening to my colleague there from Chevron and I can imagine the anxiety they must go through because they can't have collateral for everything they have.

Obtaining skilled and honest people. Resumes from Russians don't do you any good. Nobody had a job in the private sector up to about three years ago. And it is—we have the same problem in Bulgaria and elsewhere. You take a look at their resume. You can't tell much. You know, people come in. They're often very charming. They seem to be honest. They tell you how they were always really were a capitalist. If they know me they say, you know, I was always a supply-sider. And, of course, they're all democrats and you hear these great stories but a lot of people survived the old system by lying and theft. And all of us have had bad experiences. There's people we've trusted we've had to let go. On the other hand, you do get a lot of people who are as honest as any American. As hard working as any American. And they're trying very hard. But, a lot of it's trial and error. And we try to minimize the up-front risk until we've tested people out. But, that is one of the biggest and toughest problems. One of my partners in Moscow just went bankrupt. He was a very honest man. He had been a former minister in the Gaidar government and he was so honest he sort of did himself in. But, he didn't understand western business practices. And I kept trying to teach him things like depreciation, accounting, and financial concepts. He didn't understand and has basically driven himself out of business because of lack of business skills and expertise even though he's a smart and honest man. Well, in conclusion, I think Russia provides the ultimate in low-wage, high-skilled growth market but the moment's fraught with danger.

It is not for the faint hearted or the risk adverse. It's for the bold, or perhaps, what's you call the foolish. Our bet, and obviously everybody here, is that Russia will succeed in becoming a high growth, free-market, democratic country. But, just think back. In 1984, if anyone of us had come before you and said within ten years Russia would go through a largely peaceful revolution, reject Communism, and not only embrace free market democratic capitalism but put it into practice, you probably would have escorted us politely to the door. I thank you.

Chairwoman **Fisher**. Thank you. That certainly puts the situation in perspective. We'll open the floor up now for questions. And I would ask that you use the microphones or if you can't access them because you're in the middle, if you would, when you stand up, please identify yourself and who you are with. I would just take the Chair's prerogative and start out with a question of my own for Mr. Chow. I was interested in the comment that you made, Mr. Chow, that your Kazakh partners didn't seem to be interested in acquiring the technology, as opposed to Mr. Barker who said that his folks were absorbing it like a sponge. And I would think in the high industrial sectors, such as the oil business, that they would want our technology with the view that eventually we would then leave and they would have the technology.

Mr. **Chow**. Well, let me first distinguish between my reference, I think, more to Russia than to Kazakhstan because Russians do have a long history of petroleum production and they have a different view of their own technical capability than Kazakhstan, which is a new, infant Republic. But, even in the case of Russia, they often believe that technology is something that they can buy and there's a cookbook of that and all they have to do is import Western equipment as opposed to a Western management system to continue to use technology in a process rather than as a product they can purchase off the shelf. And I think that's the distinction that I was trying to draw between continuing involvement in a project together and something that you can go to a store and buy and take it home and plug it in and it will start working.

Chairwoman **Fisher**. Do you think that Russia politically thinks they will be able to manage the obvious competition that's going to develop between Kazakhstan and some of the other Republics that are coming into competitive areas in the oil industry?

Mr. **Chow**. I think that's a difficult one for anyone to assess. For one thing, it's not clear there is one Russia today.

There are many Russian agendas that may be going on simultaneously and how that's going to be sorted out and what impact it would have in its external relations particularly to what they call the near abroad it's a question that probably will have to—the answer to which will have to evolve over time rather than something that we can take a point forecast on right now.

Chairwoman **Fisher**. Thank you. I have other questions but I see that people are anxious to ask theirs. So, please, go ahead.

Mr. **Richard**. Thank you, Ms. Fisher. My name is Bill Richard. I'm with Congressman Oberstar of Minnesota.

I have a question for Mr. Barker. I assume from your remarks that if your market is the expatriate market, that you, like Mr. Rahn, only accept hard currency. Is that correct?

Mr. **Barker**. Our starting market was a hard currency market because we could control that and I had a tremendous training and equipping bill. Our ultimate goal is to build—manufacture in Russia. Build in Russia for Russians. Now, to your question. Even today we would accept some payments in rubles. Obviously, most of our expense has been in dollars so we have to repay that in dollars. But, every month I send dollars in which are converted to rubles. So, I will accept some payments in rubles to make my ruble payments. But, the expatriate project that we have right now is primarily dollar-financed and it's got to be dollar repaid back.

Mr. **Richard**. So, then, you're paying your work force in rubles.

**Mr. Barker.** Yes.

**Mr. Richard.** That's a pretty nice hedge to be able to take payments in hard currency and pay that local expense anyway in rubles. I would think that by and large, most American businesses attempting, especially on a smaller scale, to do some business in Russia wouldn't have that comfortable hedge. So, is there some time in the future when you foresee that there would ever be a convertible ruble on an international basis? Is that just a pipe dream? Or is that possible at some time?

**Mr. Barker.** Today you can take your rubles to the auction. You lose about 40 rubles to the dollar in conversion. But, today, you can take—I mean if you have 10 million rubles, you can take it down to the auction, place it through the auction, and get a convertible currency, marks, dollars, or whatever, today. Now, whether or not in the future, you'll be able to bring your rubles to the United States and convert them here at the, you know, Riggs Bank, I don't know about that at all.

**Dr. Rahn.** Let me add one thing to that because that's an area we are heavily into. It is true. You can convert into rubles. And actually we send more dollars into Russia than we bring out and so we don't have any problem accepting rubles for certain things and keeping ruble balances in Russia. We try to minimize that. You can get paid now without any problem for services, management consulting fees, accounting, legal services, those types of things and there's been no real problem in bringing that kind of money back.

Where you have problems if you accept rubles, convert them into dollars for payments for goods, the Russian banks have, through the government, put on taxes. There was a situation—what does it go back, a year and a half or so ago? If you were transferring dollars into Russia, they suddenly slapped a 35 percent tax on it in the bank. That discouraged you from sending many dollars into Russia for payment. You can do wire transfers now and at the banks it's 3 percent or a bit less. But, it's still an underdeveloped financial system. But, things are changing very rapidly. And, finally, this year the western banks are beginning to get in there and some of the Russian banks are beginning to put in more modern types of payment systems.

**Participant.** Is it possible to purchase a lease instead of purchasing the property itself? And if so, can you do so at different prices? Did you find when you were negotiating your property contracts, or however you go about doing that, that the price adjusts for what you're getting so that even if you can't buy the property you can pay something that's roughly what you think it's worth?

**Mr. Barker.** My experience has been in the Moscow Oblast and in the city of St. Petersburg, primarily. And I have generally come up there is no concept of value of land or of building. So, when you ask how much is it, you get either a very ridiculously low number or a very ridiculously high number. And then it becomes an issue of whether or not you can get it at all. And then when you get into the issue of lease, it depends on what you're bringing to the table.

If, for example, I am bringing a housing plant that will produce 1,000 houses a year, they want that. So, I have a very favorable lease right now. There's not real understanding of land value or building value because it was all built under the former system.

**Participant.** (Inaudible: participant did not use a microphone.)

**Mr. Barker.** Everything we've done so far has been on the lease and there is a rate on the lease.

**Ms. Lewis.** Do you experience enormous difficulty in bringing in American management teams. Do you encounter immigration restrictions, particularly in Russia, in terms of time limitations on visas, or other restrictions?

**Mr. Chow.** Not for us in Kazakhstan.

**Mr. Barker.** We have not experienced that problem except this very day my construction manager happens to be in New York City getting an entry visa to go back into Russia. Because he's been there for like 9 months and you get a 3 month visa. It was stamped twice and it would not be stamped the third time because there was no space on the paper to put the next stamp. So, he had to exit the country. We had to get a special exit visa to exit the country to get an entry visa to come back into the country. But, other than that, no, there are no problems.

**Dr. Rahn.** This is the whole craziness with mechanical paperwork with the visas and in Russia it's nowhere near as bad as Ukraine. Getting out of Ukraine, you really feel like you're in prison because when you arrive in the country, they put your bags through an x-ray machine. And then they go through maybe three x-ray machines in leaving. And you show your passport a dozen times. And there's all these little currency papers you've got to fill out. And most of us lose them because they are on like pieces of toilet paper and we're not used to carrying these things around. And then they say you can't take out your currency. And every time I go in and out of Ukraine on the way to Moscow, it seems like we always have a hassle about some stupid little form.

**Mr. Barker.** But you only lose the form once. Then you remember it from then on. Some of us are more absent-minded than that. We know we're not supposed to lose our form and I'm almost panicky where's my form, you know.

**Participant.** Since various companies are doing business in Russia and the NIS, I was wondering what would prompt employers to talk their companies into a discussion of starting to invest and develop in some of the other countries? What makes investment interesting in some of the other Republics?

**Mr. Chow.** Well, in the case of Kazakhstan, I think, one of the things that we've found very favorable is the speed at which political decisions are made on mega-projects like ours. You have to remember that Kazakhstan did not exist as an independent country until December of 1991. And on May 18th we signed an agreement which the Kazakhs have honored. And that kind of speed is hard to imagine for a project of this size in either the former Soviet Union or Russia today. So, that is definitely an advantage from our point of view. We do have to go where the resources are and the resources are not only in Russia but also in various countries of Central Asia around the Caspian, particularly.

**Mr. Barker.** In our business, we have a risk-reward philosophy ratio that we go through. I don't care whether we're going to Topeka, Kansas or whether we're going to Moscow. You'd look at the risk and the reward and in international it's got to be over a much longer period of time. So, to answer your question, profit motivates us to take this risk and then the ease of entry into a market. We are building in St. Petersburg because we were able to work with the city government very, very quickly. We are not building in Moscow because we were never able to work with the city in Oblast government.

**Dr. Rahn.** I come down pretty much the way. We've got operations in Bulgaria. In Bulgaria, you do have a functioning court system and the risks are far less.



There's still a lot of problems and the opportunities are not as great. We're also working on a couple of ventures in Ukraine which is the ultimate in the high-risk countries. Ex/Im and OPIC won't even give you sovereign guarantees—they won't give sovereign guarantees or accept the sovereign guarantees of the government. So, there's virtually nothing you can do on credit. We're trying to do an aircraft project in Kiev and I'm told that they will pay us beforehand, which I'm absolutely insistent upon. Inflation rate, at times, has been a percent an hour. You can't calculate that, really, at an annualized rate. And, the Ukraine is a total mess. But, there's also enormous opportunity. Asset prices are almost nothing. You can buy large, productive facilities at really minimal prices. Now, what you have once you've purchased it and whether you can hold to it is a whole other story. So, it all comes down to risk/reward and sort of who you can deal with and who you can negotiate with.

With our aircraft deal, the government wants it very badly. It makes a lot of sense for them so we're hopeful that that will come through. And, there are ways to minimize our risk and put the burden on them. But, it's tough.

**Chairwoman Fisher.** Thank you. The gentleman back there has been patiently waiting and I've been asked to ask that everyone come to the microphone so that our television viewers can hear the questions. So, if you can wend your way around—thank you.

**Mr. Wood.** Barry Wood. Voice of America. I'd like to ask Mr. Barker and Mr. Rahn to assess the voucher privatization method. Is it on the one hand, the great panacea for creating a market, to quickly getting these assets into the hands of the public or, as Mr. Solzhenitsyn and the Mayor of Moscow say, a disaster? Because it is not believed in by the public and is giving these assets to the Mafia for nothing. And I'd like to ask Mr. Chow, how are you going to get that oil out even if you build the pipeline to the Black Sea, are the Turks going to let supertankers go through the Bosphorus?

**Mr. Barker.** Go for it.

**Mr. Chow.** Give me the easy one first, huh? The fact of the matter is we're getting oil out today. We're getting the oil out through a crude exchange with Russia. There is no physical way of getting Tengiz oil to Western markets today so what we're doing is piping the oil into the Russian system and exchanging it in return for Urals blend. Most of the oil today, I think since last Summer, almost all of the oil has gone through the Friendship Pipeline into Eastern Europe rather than to the Black Sea. So, there are physical ways of getting the oil out. Some oil. Whether it is an exchange or otherwise. Out today. It is not ideal, of course, because we hope to be producing a lot more than the current level of production.

We also lose quite a bit on the quality exchange. We are producing a very light oil and we are getting Urals blend which is a much heavier crude oil and of much less value in the international market. So, it's not ideal and it clearly requires an export solution and it will take time to resolve that.

As to the Turkish Bosphorus problem, there are various ways of taking care of choke points in the transportation system. At a sufficiently high volume of oil, there are ways of by-passing the Bosphorus. For example, we, in the United States today, by-pass the Panama Canal in shipping Alaskan North Slope crude from Alaska to the Gulf Coast by building a pipeline that parallels the Panama Canal. And, therefore, you have tankers shuttling on both sides. Similarly, the Suez Canal is also by-passed. So, there are ways of tak-

ing care of the problem at a certain volume and, therefore, a certain level of economic feasibility.

Chairwoman **Fisher**. There was a gentleman there. Did you wish to—

Dr. **Rahn**. But, this isn't—

Chairwoman **Fisher**. Oh. I beg your pardon.

Dr. **Rahn**. We didn't finish this, the other part of his question, the privatization program. By any objective measure, I think the thing has to be looked at as an overwhelming success. Even though there has been lots of corruption. Things haven't always been done fairly. The factory managers, in many cases, have basically, one way or another, stolen the properties. Having it privatized, getting it in the private sector as rapidly as they did was a monumental effort.

Chavbias and his team, I have the highest regard for. They are a bunch of very smart people and I don't know how any group of people could have privatized Russia any better and faster in 18 months than they have done. And by July 1st, the voucher program will essentially be up. 70 percent of the economy will be privatized. That's a phenomenal record. Nobody in any other country—look at the trouble Margaret Thatcher had privatizing a relatively few things. And we privatized virtually nothing in this country even though we should with the Post Office and others. And they have done it. And it's been imperfect, yes, but things will get better because even in corrupt hands it will be managed better than it was in State hands.

Mr. **Barker**. I guess I share a different opinion. I work with the blue collar of Russia. They, generally speaking, do not have much faith, much belief, much trust in this and they just saw it as something that the rich get richer, the poor get poorer. As opposed to what happened in the Czech Republic. The Czech Republic, again we were building there, and they saw value to the voucher but they used it in the Czech Republic so.

The workers in the street. It may be working but the workers in the street just sort of see it happening and they don't have—

Dr. **Rahn**. Well, but clearly the Czech Republic privatization was a far better program. But remember the Czechs had been a capitalistic country, the 7th richest country in the world up to 1939. It's a very different history. And it's going to take Russians a long time to start learning and appreciating private property. This is a concept they've never had in 2,000 years for most of them and yes, I would have liked the Czech type of system but that, I think, would have been impossible in Russia and to do it that rapidly.

Chairwoman **Fisher**. I would just make one comment. I worked on the negotiations for the Bonn Economic Document a few years ago during the Gorbachev era and we had about a three-week window during Glasnost to put in the concept of private property in this new set of Helsinki Commitments. We couldn't use the word private property, the phrase private property, so we just came up with a definition of buy and sell. And that was acceptable. But, we only had a very short period politically in which to get that done. Now, I can understand what you're saying about the concept, it simply isn't there. Yes, sir. Now, you may ask your question.

Mr. **Gersner**. Matt Gersner with the Atlantic Council.

Chairwoman **Fisher**. Yes.

**Mr. Gersner.** We hear a lot today about corporate social responsibility domestically and Mr. Chow mentioned there's a 50 million dollar community development fund in Kazakhstan.

What, specifically, does that go towards? Is that for long-term infrastructure in the community for those who are indigenous to that area so that you are in a better position to work with the locals in the Republic governments? Is it purely for the benefit of your own workers or for the people-at-large?

**Mr. Chow.** No. These are community projects, medical services, clinics, schools, that sort of thing.

**Mr. Gersner.** How is it perceived by the local population? In a positive means or—

**Mr. Chow.** Well, we've only had one year but, hopefully, positive. Atyrau Oblast had a flood not too long ago and some of the initial projects are towards building housing for those people who were displaced by the flood, for example.

**Mr. Gersner.** Thank you.

**Mr. Rappaport.** Adam Rappaport with Congressional Daily. As long as we have you folks up here on the Hill, is there anything you'd like to see Congress or the Administration do to help alleviate some of the problems that you've been discussing? Any one of you three.

**Dr. Rahn.** Yes. I think a lot of our aid has been going to help the bureaucrats and particularly American contractors rather than the people out there. But, there are rather simple things we could do at virtually no cost. Ukraine has a totally dysfunctional currency. And we could help them establish a Currency Board at virtually no cost to ourselves. We could use U.S. Bonds to back the new currency. Have strict controls on them so they can't have currency emissions greater than the bond holdings. Lead them to a Currency Board. There's just a number of things like that with a little more imagination. And I look at the process for most AID stuff. It takes forever and much of it's irrelevant by the time it gets out. And if you can't make quick decisions with AID, it becomes worthless. And if you come in with a project they don't have on their list, it's years before anything will happen, if even then. And many of the projects that they do have are stupid.

**Mr. Barker.** Repeatedly, we are the leaders in the world in production housing. America is. We know how to put a good quality, thermal efficient, fire-retardant house up quickly and at a good value per peso, per dollar, per ruble, per krona, whatever it happens to be. And we know how to build factories. We know how to do mass infrastructure work. But, none of the programs that are currently being offered incent any American to do it. The first U.S. AID program for housing, which was 6 million dollars, 18 months ago, was given to six Russian companies.

**Mr. Chow.** Well, it would be nice if our own government also understood the time value of money, opportunity, discounted cash flow, and net present value. But, setting that aside, if you agree with us that private investment is the road to economic success everywhere, including the former Soviet Union, whether that private investment is Western investment or domestic private investment, it is that which we ought to be encouraging as national policy and not subsidizing the State sector. In my own industry, for example, that means that you don't necessarily have EX/IM loans for the Russian sector to buy Western oil and gas equipment because that plays into precisely the biases they already have that this is something that they can purchase. Since it is a loan from outside, that may or may not be paid back, they don't take the same proprietary interest and risk nec-

essarily that a private investor might if you have to go to the bank and know that you have to pay back that loan and, therefore, need an economically efficient project, foremost, before you make that investment.

**Ms. Uplinger.** My name is Shannon Uplinger. I'm from Uplinger Translation Services and I'd appreciate members of the panel making some comments about the commercial real estate market in Moscow. I'm getting ready to lease some commercial real estate and so I'll be going into negotiations and a lease signing. Real estate prices there are very, very high right now. I'd like your comments on whether they are likely to pull back. Also, what are the things to do and not do in the course of negotiating and signing a lease so you're not agreeing to really outrageous terms or to a lease that will not be legally binding? Thank you.

**Dr. Rahn.** I'll start off with a warning. One of my American law firms that we use there had signed a lease with, what they thought was the owner or the person who controlled a particular building. They signed an expensive lease. They renovated up to Western standards. Spent a lot of money on that. And several weeks after they were all operating, some people came in and informed them that the person they had negotiated the lease with had no right to negotiate that. And, that this group actually controlled the building. And had told them to get out in two hours or their arms or other body parts would be broken.

They left. And the problem is who are you negotiating with, given that there is no real register of real estate in Moscow? How do you know if anybody owns anything? My Board Chairman went to buy a building in Moscow that was a very nice building and he was going to renovate it. Put down his deposit, went through all the official channels and then they suddenly decided because it was a nice building built before the revolution that they would call this a historic building and not allow a Westerner to buy it. And so, he lost some money and time and trouble. It just goes on and on and on. And I expect Mr. Barker here can give you even more horror stories.

**Mr. Barker.** I'll address—I won't address the horror stories. There are several western-oriented commercial real estate companies based and operating in Moscow and in St. Petersburg. They speak our legal language. You can ask all these stories and hear all the horror stories. I recommend that you deal with them as opposed to a Russian-based, I mean the Russian law-based, company. There are also several very good western-oriented law firms over there, excluding the one he just mentioned, that I would recommend that would look over these leases. Your other question about prices. Prices are high. It's an issue of supply and demand.

The rate of increase was much greater a year ago when the stories of the Mafia and the economy going to hell was not as prevalent. It's slowing down a little bit now but as soon as they get these things under control, commercial rates are going to sky rocket again. And I would say will stay high for three to five years. And, again, it's an issue of supply and demand.

This is Moscow. In St. Petersburg, the commercial market has not even begun. The same in Ukraine and Kiev. It's not even begun. So, it's going to be a long—commercial rates are going to be forever going up.

**Mr. Lukich.** My name is Joe Lukich and I'm with the U.S. Baltic Business Council. I know Mr. Barker and I want to put him on the spot here with a little question about the recovering Baltic Republics. We had an opportunity to participate together last Octo-

ber in a Construction Symposium in Tallinn, Estonia. I wonder if your de-brief of that exercise from your Moscow people would result in any possibilities, let's say, for the Baltic countries? Either your St. Petersburg experience or your Moscow experience. Would you care to comment on either one of those?

**Mr. Barker.** Again, remember we are production builders so we want to go in and build 50 to 100 houses. That justifies the mobilization.

Tallon and Riga present the biggest opportunities to us. Tallon far away from everything else. That whole part of the world, in my vernacular, is covered "with gonna do's." People are "gonna do this" and "gonna do that." And we wanted to have a success story behind us in St. Petersburg. So that, when I went to an investor or a builder or whomever, rather than promise anything, say come with me to St. Pete and I'll show you what I did under similar circumstances and now I can do it in your country. Tallon would be the place we'd go next.

**Ms. Mazingi.** Yes, hi. My name is Katrina Mazingi and I'm with the Armenian Embassy. I had a question about the size of companies that are investing in the former Soviet Union. You each represent very large companies with significant resources. Can a smaller company that, for example, doesn't have 50 million to invest in a community development project, have a chance of surviving in these environments? And, would they fare better in the smaller Republics as opposed to the larger Republics? Thank you.

**Dr. Rahn.** I represent a small company. We're all start-ups. Basically, what we did, we just put together a group of American investors, individuals, and we decided we were going to set up joint ventures. And we have been doing that and we've done things as little as, I guess, 50, 70 thousand dollars some of them starting off, into the low millions.

**Ms. Mazingi.** Did you find that issues that you faced as a smaller company might be different than some of the issues faced by the larger companies or among your other colleagues?

**Mr. Barker.** Yes. They have deeper pockets. We have to get it back quick or we go under. I have a banking joint venture for purposes of training in the mortgage area which is profitable in Moscow and my contribution to the charter capital is \$50,000.00 I have a truss operation in Moscow which is profitable and my contribution was \$134,000.00. So, I'm basically a small builder doing that. It's significantly bigger in St. Pete.

**Mr. Chow.** Speaking personally and not on behalf of Chevron, my own private theory is that there are much more opportunities for small businesses and entrepreneurship in what must be considered an under-performing economy than necessarily in the capital intensive-sectors which the Russians, after all, devoted a tremendous amount of effort in. But, in my sector, of course, the reason it's helpful to be large is not only because you have deep pockets but because you have a way of distributing risks. You know, it's very hard to distribute risk if you are a smaller company and you have to invest half a billion dollars in one country. But, with a 4 to 5 billion dollar capital spending budget that Chevron has around the world, you have a way of spreading the risk so if one of those projects go bad your company doesn't go under.

**Dr. Rahn.** The problem is not the size of the investment. The problem is being able to spend as much, the required time, due diligence, go through all the paperwork and the bureaucracy. We often spend far more time on that. The real cost is in our time. Travel and the paperwork. Not so much for the outlays for the companies we establish.

**Chairwoman Fisher.** Yes, we're running out of time, so we can have one more.

Ms. **Lewis**. I'm still Elka Lewis and I'm still with the Support Center. That hasn't changed. Mr. Chow mentioned earlier that you committed, or Chevron committed, so many millions, was it 50 million, to the community.

My question now is to Dr. Rahn and to Mr. Barker. Do your respective companies also commit a certain amount of monies to NGO's, and I have to tell you p.s. I'm in the business of NGO's? If that is the case, what is your involvement? Is it only financial or is it also an encouragement on the basis of what we do in this country but not for profits and for NGO's?

Dr. **Rahn**. We don't. We're basically creating new businesses, start-ups. Our economic contribution is by employing people, giving them higher wages, bringing Western skills in, and often our foreign partners and the people we hire we give an equity stake. And my goal over the years is to make a lot of millionaires in Bulgaria, Ukraine, Russia or any other place because if we succeed, I'm going to be richer.

Mr. **Barker**. We don't either except when you run a sewer line or you run a power line or you run a water line, you give the right to tap on to it. So, there are now probably several hundred Russians who can flush a toilet for the first time in St. Petersburg. We knew that and we had to size the pipe instead of this size, this.

Chairwoman **Fisher**. I'd like to close and follow up on one point. Members of Congress are struggling with our assistance programs to the NIS. And I've noted your comments about the tremendous work that needs to be done in the NIS and, for example, in Ukraine. And, it seems to me that at the private sector level, those of you who are training your counterparts in the areas such as accounting practices are providing a great service which the government cannot do nearly as efficiently.

And my question is with respect to AID, does AID solicit your advice on how to structure our government-paid assistance programs?

One, do they solicit it, and two, do you—are you then able to follow through in seeing that your suggestions are incorporated?

Mr. **Chow**. I don't work in Kazakhstan so I don't personally know except that the AID mission for all of Central Asia is headquartered in Almaty. And, we have a very good relationship with the Embassy so there's certainly a channel of communications and avenues that could easily be established there. On the other hand, the problem of being big is that people think of you as the rich uncle and, therefore, don't need any help or can fund projects that other people would like to do. So, I would certainly encourage more communication between AID and those of us who are working on the ground in those countries.

Chairwoman **Fisher**. It's really very frustrating because it seems to me that you've identified some areas that are desperately needed and with—

Ukraine, for example. I understand that the commercial law dimension of our AID program there may be getting short shrift and, you know—

Dr. **Rahn**. I'd like to give you just a couple specific examples. I find the U.S. Government programs are more of an impediment than a help. With one U.S. Government agency, they had asked us to do a project. We put together all the basic work. They then brought their bureaucrats in. They slowed it down a number of months. They messed it up. I mean we turned it over to them and they bungled it. In Ukraine, I was asked by the head of the Central Bank to come down and assist on monetary reform. I did it out of my own pocket or expense. Then, working with the Ukraine leadership, they said well,

can you do a project like we did in Bulgaria? And so, we have organized a project, the U.S./Ukraine Foundation, the Hudson Institute. AID and the other agencies have no mechanism for making quick funding decisions here. Basically, what we're doing, American businesses and a number of us as individuals, are just donating time and effort to get these things done. We'll be working with the top leadership in the Ukraine, members of Parliament, Kravchuk and the people running the country.

The programs are largely irrelevant if you can't make decisions in 30 days. One more example, OPIC, with our aircraft program in Ukraine. We went over, first they wanted them 10 million dollars or higher. No problem. We could do 10 million dollars. The Ukrainian's were putting up some money. So, we said, what is the cost of this credit? Well, they start off with the—I won't go through all the things added up, but, it turned out to be 12 percent money. Then it was going to take them 9 months to make a decision at the minimum after they made their preliminary decision and they wanted all the collateral outside the country. Well, this is ridiculous. I can deal with commercial bankers on better terms than that. Things are taking place very rapidly and if you can't make a decision in 6 weeks, often it's irrelevant. And basically, we stay away from the Government because we've just found it's more problems that it's worth and it's easier just for me to call up a few of my friends if we've got a worthy project and just go do it ourselves.

**Mr. Barker.** In the housing area, there is a U.S. AID program for 140 million dollars currently on the street. This is a result of 10 or 12 months worth of meetings in which I participated and a whole bunch of American builders participated. The requirements were we wanted 100 meter house, roughly 1,000 square foot house. It later got to 800 to 1,000, but that's fine. It needed to meet Western standards but we could modify those. And so the numbers that we all came back with is to do a house with foundation and plot infrastructure, not site infrastructure but plot infrastructure, you needed to be somewhere between 40 and 50 thousand dollars per unit.

U.S. AID program is on the street at 25 thousand dollars per unit. Now, they came to the people who know what's going on and they disregarded it. Now, they're wondering why American builders are not participating and they're saying go ahead and bid. We'll figure a way to get the price up. And I'm saying, well, suppose you don't? Yes, there are a couple of things that can be done.

**Dr. Rahn.** OPIC again. They have 1.5 billion dollars. They're supposed to spend the next 18 months in Ukraine. They've spent zero because the requirements are absurd. And, they'll never spend of this money, given the kind of requirements they have. There is a total disconnect between the realities in these countries and most of the U.S. Government programs and the bureaucrats.

**Mr. Barker.** The U.S. Baltic Foundation. Joe and I have been working about how to do things in the U.S. Baltic Foundation or in the Baltic states. This is a group that is saying this is our problem. How can we solve it? And, so far there's been nobody dictating to anybody. This has been a group effort, to get a solution. That's what its got to be.

**Chairwoman Fisher.** Well, thank you very much. I think we could pursue this topic for the rest of the day but we appreciate the time that our panelists have given us.

[Whereupon, the meeting was adjourned at 12:06 p.m.]



MALCOLM LINTON/BLACK STAR

**Russia House by Joe Barker**

*"You have to learn how to manage a project in a constant questioning mode."*

# Exporting the American Dream

*Ryland hopes nouveau-riche locals and Western expats will snap up its pricey homes in Russia. It's a crazy market, but the foundation looks solid.*

**J**oe Barker thought he knew everything about home building. After all, his company, Ryland Trading, Ltd.—a wholly owned subsidiary of The Ryland Group—is not only renowned for its design and construction; it's one of the largest homebuilders and mortgage-finance companies in America. But when he went to Russia last October to break ground on Ryland's block of homes in St. Petersburg, the vice president saw something he had never experienced before: Antifreeze being added to cement compound.

**By Karen E. Thuermer**

"We were laying the foundation in sub-zero temperatures," he says, "when our Russian partners added antifreeze to the compound to prevent the concrete from freezing while being poured." If that wasn't odd enough, they were then pouring the cement onto electrically-charged steel rods to keep it from turning to ice.

"The rods acted like an electric toaster," Barker now chuckles. "It was strange to see the cement steaming."

In March 1991, Ryland entered into a joint-venture homebuilding agreement in St. Petersburg with Russian



partners A/O Lidesm, Lenstroidetal and Fasad. Last June, the company announced a similar arrangement in Moscow with Tuchkova Amalgamation and Armatech. Under these arrangements, Ryland designs the homes, constructs the components and ships them to the joint-venture partners. Ryland also trains the Russian workers to erect and finish the homes on-site and assists them in marketing and selling the product. Ryland pays for Russian materials and labor in rubles. In exchange, its partners supply the land and acquire necessary building approvals.

One of the biggest challenges the US homebuilder has found in Russia are the basic differences in business and building methods. "These have to be accommodated," Barker explains. "You have to learn how to manage a project in a constant questioning mode. Compromises must be made, and sometimes you face an impasse."

One practice Ryland couldn't abide was the use of trowels to make grooves in the foundation for plumbing and electrical wiring. It's a common technique, since the majority of Russian homes are rough, concrete high-rise structures.

In pouring the foundation, the Russians insisted that the cement block be 24 to 30 inches thick rather than the US standard of eight inches. "Rather than argue the point forever, we compromised at 12 inches," he says. Barker admits that while difficulties constantly arise, he manages to resolve them. "The differences, however, make for meetings long into the night," he says.

There are other problems, too, such as basic communication. "When we asked workers if they install sheet rock or do interior plaster, they answered no. But when we saw them working in these mediums, we realized the problem wasn't the technology, but the language barrier."

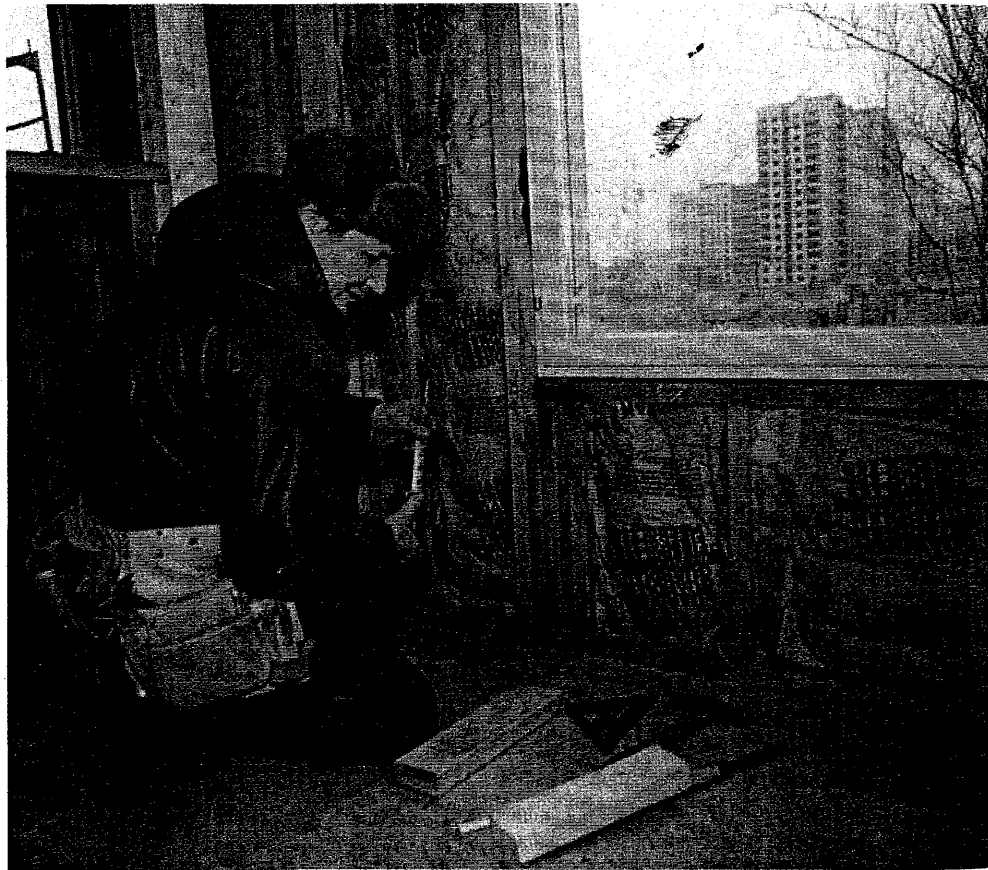
Wood, a building material Ameri-

cans take for granted, turned out to be another area of contention. "We found that Russian builders need to be educated about wood as a construction material," says Vaik O'Grady, a spokesperson for Ryland. "They need to be confident that it will stand up and not blow away, and that it's not solely for fires or cooking."

"It's not that they don't have wood," she adds. "Good wood is plentiful in Russia, but they don't have the equipment to mill it properly."

Ryland anticipates its initial phase of 23 townhomes will be ready this June, and the final phase completed by year's end or early next year.

Ryland's goal is to become the premier home builder in Russia by combining Russian manpower with Ryland technical know-how. Ultimately, the company wants to set up manufacturing plants in St. Petersburg, Moscow and perhaps Siberia. "This will take place, hopefully, within three to five years," says Barker. "Currently, there are no



### Sizing up Western building techniques

*He used to think wood was just for fires or cooking.*

Consequently, Ryland ships company-approved and rigorously tested wooden frames, beams, panels and roof joists—most of which are preassembled—from the US to Russia to construct its panelized homes. In St. Petersburg, Ryland construction managers and crews provide on-the-job training to their Russian joint-venture partners on how to use the quality materials and advanced building technology the company introduced in the US in 1982.

builders in Russia utilizing our technology." For now, Ryland's Russian-bound construction materials are fabricated in its Shelby, North Carolina factory. Once the company has plants up and running in St. Petersburg and Moscow it can erect finished homes from start to finish in Russia.

Barker is relieved that the company has had few difficulties getting its materials to Russia. "We haven't experienced any theft yet, just the normal

confusion with Russian Customs over products with which they're not familiar," he explains, "such as tubes of latex sealant." But distribution has been an enormous problem, he adds. In Russia it's essentially nonexistent. "We don't have the in-country knowledge of where the materials are. Plus, Ryland demands quality—it's part of our reputation. Everything must meet our standards."

## Ryland's goal is to become the premier home builder in Russia by combining Russian manpower with Ryland technical know-how.

The goal of building a manufacturing plant was the impetus that initially brought Ryland to Russia. In 1990, the then-Soviet Ministry of Agriculture invited Ryland to submit a proposal to build a companion to an outdated factory in Barnaul, Siberia. Both factories would manufacture construction materials used in building housing communes for Siberia's farming community. "The Ryland plant would specifically process wood for both factories," Barker explains.

"Ryland was very interested in the opportunity," he says. At that time, Russia's inflation was stable, and a strong movement towards privatization was underway. "We saw Russia and Eastern Europe as offering an opportunity to meet our marketing goals of influencing housing worldwide."

All that changed when the Soviet Union disintegrated into a patchwork of feuding republics and opportunistic bureaucrats. "The government is in flux, inflation is high and the ruble is experiencing a 7 to 1 repayment rate," Barker says. Nonetheless, the company remains committed to building homes in Russia, even in light of recent developments in the former Soviet state.

"We remain confident in the direction Russia is following," Barker af-

firms. "We believe that privatization and the momentum toward a free-market environment will continue, although we expect decelerated and accelerated variations in the democratic political movement." More than politics itself, Barker explains the company's bigger concern is how the financial markets will react to the tug-of-war between Yeltsin and the Soviet-era parliament.

Ryland has especially high hopes for its Dubravy community in St. Petersburg. "We aim to market 23 townhouses for sale or lease this June," says spokesperson O'Grady. All townhomes will feature Western technology, quality and style as well as a variety of amenities new to the

Russian market. These include GE appliances, Armstrong flooring, Aristocraft cabinetry, high-ceiling foyers, bay windows, a double sink in the kitchen, a pantry, and built-in closets, not to mention quality materials such as energy-saving triple-glazed windows, sliding doors that feature thermal break frames and removable screens, metal-clad and insulated exterior doors, copper plumbing piping and fittings, Owens-Corning Fiberglas insulation, and ample electrical outlets and localized receptacles and switches.

"Cabinets and built-in closets are luxury items for Russians," adds O'Grady. "What Russians really want is comfort, convenience, dependable electricity and plumbing, and ample private space. Most Russians don't have these."

After studying comparable homes and testing prices on potential buyers, Ryland plans to sell its St. Petersburg townhomes, which range from 850 to 1,300 square feet, for approximately \$200,000. That price might seem steep

in a country where a day's wage can barely buy a loaf of bread, but Ryland believes there's a pent-up demand for luxury homes.

"This is the first time in 70 years that single-family homes have been available to the St. Petersburg public, and an increasing number of nouveau-riche Russians can purchase them outright in hard currency by converting rubles to German marks," Barker says.

"Even if most Russians can't afford this home, our hope is they will see it and want it later," adds O'Grady. "When they can afford to purchase a home, they will already be comfortable with the Ryland name and associate it with quality."

Ryland executives believe its primary buyers, however, will be Westerners—short-term expats in Russia for less than three years, and the long-termers who've decided to make a life there. "We get calls everyday asking when the project is going to be completed," Barker reveals. "These people currently pay around \$350 per night to stay in one of St. Petersburg's Western-style hotels."

In the case of the short-termers, Barker expects corporations will buy the proper-

## The company's biggest concern is how the financial markets will react to the tug-of-war between Yeltsin and the Soviet-era parliament.

ties to house their employees. "When these executives are sent home, their replacements will move in," he says.

Barker points out that in St. Petersburg good quality housing is selling like hotcakes. "Homes are on the market for maybe all of 20 seconds."

What's next for Ryland? Last winter the company announced it will build "model home villages" in Senegal and Turkey. WIT

June 3, 1994

**COMMENTS OF  
DR. RICHARD W. RAHN  
TO THE  
COMMISSION ON  
SECURITY AND COOPERATION IN EUROPE  
CONCERNING  
DOING BUSINESS IN RUSSIA: OPPORTUNITIES AND  
OBSTACLES**

Russia may be the ultimate business challenge today. Privatization and market development has occurred far faster than almost anyone imagined it could. While at the same time there are massive bureaucratic and institutional impediments to conducting business in a normal fashion.

Despite the huge decline in the official production numbers, the evidence is, the real economy is growing. Many of the production declines were in industries that were "value subtracting" rather than "value adding", so as bizarre as it may seem, a drop in production means a rise in national income. There is a new real private economy that is growing extremely rapidly, but the Russians do not have the statistical infrastructure in place to measure it, thus no one knows how big it really is. What we do know is that more than 50% of the economy is now private, and more than 50% of the workers are working in the private sector. Virtually all of this has occurred in the last 18 months. It is not an overstatement to say this is the most rapid economic transition that has ever occurred in a major economy in history.

As one would expect, such a rapid transition has caused major dislocations and distortions. If you are a Russian operating in the new private sector, economically you are probably much better off. If your only job is in the state sector or if you are on a pension, you probably have suffered a severe drop in your standard of living.

To Western business, Russia offers a highly educated work force, many with high tech skills, and a very large and rapidly growing market for most everything. On the negative side, there is a lack of the rule of law, and great unpredictability concerning taxes, regulations, etc. There is also a severe lack of experienced and business trained professionals. The legacy of the communist system causes many Russians to act or see things in a very different way than most Westerners expect.

I will briefly discuss each of the following topics describing both the problem and my observations on how to deal with it.

1. The lack of the rule of law and property rights.
2. The "Mafia" and official corruption.
3. Inflation and monetary instability.
4. Accounting standards and language.
5. Price controls.
6. Tariffs and trade regulations.
7. Taxes.
8. Securities and financial regulation, and obtaining financing.
9. Personal travel and telecommunications.
10. Transporting goods.
11. Personal safety.
12. Protecting your investments.
13. Obtaining skilled and honest personnel.

In conclusion, Russia provides the ultimate in the low wage, high skill, growth market, but at the moment is fraught with danger. It is not for the faint hearted or the risk adverse. It is for the bold (or perhaps as some would say the foolish). Our bet is that Russia will succeed in becoming a free market high growth democratic country. In 1984, if I had told you that within ten years Russia would go through a largely peaceful revolution, reject communism, and not only embrace free market democratic capitalism but have put it into practice, you probably would have escorted me politely to the door.

**TCO**

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Russian Business Development Remarks  
To Maryland International Trade Association

By Paul A. Tashner, President,

TCO International, Inc.

May 19, 1994

I'd like to share with you how my young firm shipped over \$2 million in products to the Commonwealth of Independent States in the first half of 1994.

In 1991 I made my first trip to the USSR. I decided based on research, personal observation, and gut feel that the needs were great, the opportunities tremendous, and that success could be had. But the first step I saw as necessary was to develop and run business training programs for emerging CIS businessmen interested in the U.S. business model. This would accomplish 3 major goals:

1. share western business experience to help them better understand the demands and expectations of western firms;
2. expose participants to a number of successful U.S. businesses - big and small - and help them understand what it takes to compete in a free market;
3. through close personal contact over an extended time, allow an informal search for partners to evolve, with the goal of implementing strategic partnerships between my firm, other firms in the U.S., and the CIS;

In early 1992 we hosted our first group of 13 CIS men and women for 2 weeks.

I hit the road with them, driving a van, discussing America, Russia, going to meetings, and toasting until the wee hours of the morning. It was similar in many ways to the first year of college, when freshmen from different backgrounds, upbringing, and

locations are forced to create new relationships. It requires spending time together, direct interaction in numerous situations, effort, and interest.

A few of our guests were here for serious business, some were awed by what they saw and not able to grasp U.S. life, and many were here on vacation. Over the next several years it was this group of serious business men from Siberia I stayed in touch with, visited often in Russia, hosted many more times in the U.S., and with whom I have started 2 joint ventures and shipped over \$2 million of products in 1994. Not bad for a small start-up business 2+ years old.

I've been paid in U.S. dollars, and it has been a profitable and personally rewarding experience. The ventures I started should expand quickly as our partnership develops greater trust and loyalty. This is a case of "success breeds success".

How many of you know the story of the Chinese Bamboo? You plant the seed, give it water and fertilizer in year 1, without result. In year 2 you continue to water and fertilize, without result. Year 3 is more water and fertilizer, Year 4 requires more water and fertilizer - still without result. In Year 5, if you have taken care of the seeds during the preceding years, with water and fertilizer, in the 5th year, overnight the bamboo grows 90' in a 6 week period. Did it growth result from the 5th year of care? Or did it require 5 year's effort to get results? I think the latter is the case, and this directly parallels the typical American business person entering the Russian business environment.

My experience has been that those seeking quick profits should look elsewhere. Quick profits are being made every day - by Russians, Armenians, and other natives of the ex-USSR who have unique access to raw materials at a fraction of the world market rate - and the capability to export at world market prices. They also have a wide network of friends, associates, and a common background that help them expand quickly - resources most western firms don't have.

#### Where to start?

Let's take a structured look at the region:

FSU, CIS, NIS: 15 separate countries under the former USSR umbrella, 9 others under USSR control in Central & Eastern Europe. Collapse of USSR resulted in 24 countries moving from socialism to a market economy. Total population: about 450 million

I have spent about 16 weeks traveling through the CIS, from the Baltic's to Eastern Siberia to Central Asia. We have organized and hosted about 40 CIS businessmen in the U.S. for six - 2 week training programs and met hundreds more at conferences and in meetings. We organized a conference on Business Opportunities in the Former Soviet Union, and sponsored a group of CIS businessmen to attend. It has been a period of aspirin and sleepless nights, vodka and sheep feasts (complete with the sheep head for the honored guest), frustration and reasonable success.

Results: In February we opened the first authorized American auto dealership (for Chrysler-Jeep) in Central Asia. 100 Jeeps moved from Baltimore to Kazakhstan. And one week ago we shipped 7 saw mills and 5 grain mills to initiate our joint-venture in Eastern Siberia for saw mill assembly and timber processing.

Let's concentrate on Russia and Kazakhstan, and the factors that led to our success in specific business there.

There are 4 Keys to successful business in CIS:

1. **We did our homework.** We defined our project interests, and we did market research including:
  - brief, structured analysis of size and characteristics of the market;
  - analysis of competitors;
  - short-term and projected long-term buying power;
  - infrastructure strengths and weaknesses;
  - availability of supplies;
  - logistics and distribution networks;
  - local talent.
  - **BISNIS, (202) 482-4655 in the U.S. Department of Commerce, has aided us with excellent information on the CIS and is our key research center in the U.S. Without their help, our job would have been much more difficult.**

We did not spend significant time analyzing laws or worrying about political turmoil or currency fluctuations. Inherent instabilities exist in this time of transition, over which we have no control. Laws are changing, wild political swings (in Russia) are threatened, and the currency is in trouble daily. We concentrate on how to make the business happen, not worrying about what may develop.

people (10% of the world). A population well-educated, accustomed to being world leaders.

Boris Yusfin, President of BAMCredit Commercial Bank, said to me, "For all these years we were told we had the best of everything on earth, and that America was a poor country." Looking around first-hand on his first U.S. trip, he continued, "But this doesn't look so bad to me". It sums up a common feeling among first-time visitors, that life in the U.S. is easy and smoother than they ever imagined. This carries to their business expectations - that business is easy to do in the U.S. We must remember (and remind them) that over 90% of new companies fail in the first 5 years in our "easy" free and competitive market.

Of the 24 countries now in transition, some have better success, including (Poland, Czech Republic, Hungary, Baltic's, Russia, and Kazakhstan) - where either a history of capitalism or a reformist political system (and population) permitted aggressive moves toward free markets.

Some are moving slowly (Ukraine, Uzbekistan, Tajikistan, Azerbaijan, Georgia, Armenia), due to very conservative political leadership or civil war.

In the words of Yegor Gaidar, past Prime Minister and chief reformist in Russia, there is "no easy way out of socialism". Yet with the difficulties of transition from command to market economies, my personal experience is that the business situation today is more stable than it was last year, which was better than the year before. I believe it is because more and more CIS business people are seizing the opportunity to operate their business (privatization), and the lessons of the free market have taken root among a growing population of young entrepreneurs.

**Success will go to the clever, the hardworking, and the lucky.** There is the sparking of a "Russian dream" with the knowledge that a better life can be achieved...and through example it is happening all around the CIS...I firmly believe successful transition depends on getting a critical mass of young entrepreneurs owning private companies, spreading wealth (in the form of jobs with growing firms) across as many people as possible. To make this happen, we need to ensure US foreign aid programs are made accessible to this group through working capital and investment financing, business training programs, contact with American firms, and support of smaller U.S. firms in CIS business development projects.



2. **Find a good local partner.** Take time and care in this search - this makes or breaks your business. I spent a lot of time (about 30 weeks working closely together) with my potential partners. We traveled around the U.S., Russia, Siberia, and Kazakhstan on many occasions, shared meals, drinks, overnight airplane flights and long drives. It was time well spent, because we developed a good relationship and trust based on this time together.

I looked for and found in my partners the following characteristics:

- they are honest partners (willing to tell it like it is);
- they are loyal to folks they do business with, incl. employees & other partners;
- they have good, reliable contacts in government. (An alternative is to have high level contacts in mafia - It's an either/or requirement for business there.)
- they had international experience - incl. travel and international business (with one other joint-venture in Sweden and several trips to Europe, Japan, Korea, etc.);
- they worked with me to set a joint plan, and worked hard to meet our commitments (my partners meet their commitments, although it usually takes longer than expected);
- they have access to financing, facilities, and local expertise;
- they worked to establish win-win deals - I make sure both sides have good profit in an honest, long-term relationship - and my partners share this philosophy.

3. **Demonstrate your commitment.**

- I hosted my partners in the U.S. repeatedly without direct compensation. When visiting their country, they returned the favor. If I had worked for up-front fees, my company would be another statistic in failed CIS-U.S. business attempts. I invested as they invested - our time - and for the first 2 years the only folks who made money on our work were the airlines between Washington and Moscow.
- In 1992 we organized and hosted a conference on CIS business, and paid to fly 11 CIS businessmen here to speak and participate. After the conference - while they were still in the U.S., we established negotiations for the two joint ventures which have since resulted.
- I made repeated trips to their country on fact-finding and market research missions. These reassured them of my commitment, as their repeated trips to the U.S. did with me.
- I arranged meetings with our Congressional representatives. These meetings showed them we had high-level government contacts which CIS business people

respect (since in their paradigm either government or mafia contacts are required for success).

- I arrange non-profit programs during my trips, including business training seminars at the local institute for business people, government and students. In Kazakhstan we are working to stock a library with English-language business books; and putting together a sheep management training program for local farmers - all without compensation. In their eyes, this sets us apart from competitors, since most for-profits don't take the time to re-invest in the local communities in the CIS.

#### **4. Finance creatively.**

- We started small - our first ventures cost only our time. We developed test marketing programs to gain operating experience and test the infrastructure systems, including bank transfers, transportation, etc. And we carefully managed each aspect of the transaction;
- We recruited a bank as partner, and in each venture they hold equity;
- We minimized risk to our U.S. capital investment, while insuring their capital investment while in the West. In the end, they transferred \$1.7 million in advance to our account with only a contract and the trust we had developed. Since we could not find Western financing, we were forced to use their money at high interest rates - but there are no workable alternatives we have found.
- We offered alternatives to cash deals through a form of countertrade. On the sawmill project, we are working to buy and distribute lumber from the saw mills, thereby creating immediate hard-currency payback for our Siberian customers.

The Russian and Kazakh markets are very complex. Business is directly influenced by:

- national and local government,
- underdeveloped infrastructure,
- changing and conflicting legal situation,
- local business conditions,
- crime,
- psychology of people,
- cultural conditions.
- commitment of the U.S. and Russian/Kazakh partners.

All of these issues must be addressed by a joint-venture. As a rule, we let our partners handle arrangements in their country while we manage details in the West.

We offer our advice on their internal matters, but intervene only when absolutely

necessary - when progress bogs down or when results are below the high standards for quality we have agreed on.

Two final details need to be noted:

Communication is improving, but generally very bad. Not only telecommunications infrastructure (hardware), but personal attitudes. Often periods of long silence follow an outbound communiqué. Sometimes they can't translate into English - in the interior regions there are fewer interpreters than in Moscow/St. Petersburg. I am not deterred - and constantly send progress reports to keep my partners fully aware of developments here. Over time I have noticed a marked improvement in responses from my partners - due not to infrastructure improvements but to a change in attitudes.

Transportation: not to be minimized or overlooked. It doesn't follow the deal, it is integral to a successful venture. Shipping dates are crucial - especially if using Russian financing at 50 - 200% per year. Every day delay in delivery of our container of saw mills costs over \$600 in additional financing charges, and every day delay in Jeep delivery cost \$20 per Jeep per day (\* 100 Jeeps). A 5 day delay at the port of Klaipeda, Lithuania cost us an identifiable \$100,000 in sales because my customer lost money and lost his customer. The U.S. freight forwarder didn't understand or follow through with the unique requirements for doing business in the CIS market. He said he had done his job, but they didn't do theirs.

In the CIS today, a U.S. firm will be successful only if we take responsibility for making our customers successful.

**Conclusion:**

There are plenty of exciting opportunities in the CIS. (Exciting is not always at the top of a businessman's agenda.)

There are plenty of scary challenges - and no business person should enter the market without a healthy respect of the obstacles, because they are very real. Success requires good partners, dedication, and perseverance.

Good, profitable business can be done in the CIS - but only by serious businessmen who are clever, hard working, and to some degree, lucky. Thank you and good luck.

**RICHARD RAHN**

**D**espite gloomy press coverage and Vladimir Zhirinovskiy, reform in Russia is on track and almost certainly irreversible. Erratic progress should be viewed in the historical sense.

If in early 1988 you were told that as early as 1994 most of the Soviet Union and Eastern Europe would be free, noncommunist democratic countries rapidly privatizing their economies, and that this transition would have occurred for the most part peacefully and with less loss of life than we have annually from crime in the United States — you would probably have rejected the assertion as a highly improbable fantasy. Yet, despite the miraculous, positive events of the last six years, from the time of the Russian elections in December, the international press has been filled with never-ending doomsday articles concerning Russia.

Disaster is always possible, and it is easy to build scenarios about the many things that could go wrong. But it appears that the worst is clearly over for most of the countries of Eastern Europe and the former Soviet Union, including Russia. (Ukraine at the moment is the exception, but one can hope that after their elections two days ago, they too will begin serious economic reform.) The reason is quite simple: The government sectors of these economies, correctly measured, are rapidly shrinking as a percentage of national product. The evidence from around the world is overwhelming that when the relative size of government declines, the economy begins to expand rapidly. In 1994, Poland, as it did in 1993, plus the Czech Republic and Hungary are all likely to have growing economies for this very reason.

The real story of what is happening in Russia has largely been ignored: The world's most rapid and complete, albeit imperfect, privatization program is continuing at full speed. The chief architect of the privatization program, Anatoly Chubais, remains as privatization minister. By July, at the current rate of privatization, as much as 70 percent of the real Russian economy could be at least nominally private. Already, more than 50 percent of the working population is employed by private firms or cooperatives. The irony of this is that the Russians could end up with a smaller state sector as a percentage of their gross domestic product than most of the developed nations, including the United States.

Public opinion polls as well as much economic evidence indicate that the economic decline probably bottomed out in Russia last summer and that economic growth has begun. The official statistics will

## Finding success in Russia's tea leaves



Illustration from Newsday by Bob Newman

*Moscow and other Russian cities are increasingly looking like cities in the rest of the world.*

show decline in output for some months to come, but they largely ignore the new private sector because they have yet to develop a full set of economic measuring tools. In fact, much of the decline in the state sector is a net plus because many of the industries in most rapid decline were value-subtractors rather than value-adders. The problem with the declining industries is not so much a loss of needed output, but a loss of jobs for people without adequate alternative economic safety nets. It is the fear of the loss of the safety net that explains much of the vote for Mr. Zhirinovskiy and other hard-liners, more than a desire on the part of the Russian people for a return to communism or for military adventures.

There is no doubt that the economic transition has caused extreme hardship for large num-

bers of people. The hardship is largely a result of pensions and wages of many state workers not keeping up with inflation. However, a side benefit of the new inflation tax has been to drive the young and the most productive workers into the new private sector, with its higher and growing real wages, at a more rapid rate than would have occurred with less inflation.

The failure of American and the European nations to deliver much of the financial aid they promised, while providing so many government experts with bad advice, did undermine the more radical reformers like Yegor Gaidar and Boris Fedorov. It wasn't that the foreign aid would have done the Russians so much good, but unkept promises always hurt. The result has been for Russians to begin to pursue a bit more nationalistic course, while at the same time becoming more aware that their economic salvation depends largely on themselves. This in turn is encouraging them to seek more private joint ventures and capital rather than government aid, which is all the better.

Even more damaging than the lack of aid has been the hypocrisy of the Western politicians, particularly the Europeans, in denying the Russians and Eastern Europeans

reasonable access to Western markets. All this has played into the hands of Mr. Zhirinovskiy. Fortunately, many Russians are well-educated, intelligent and increasingly well-informed about the world. Thus, it is unlikely that Mr. Zhirinovskiy's star will rise much higher, unless the West through ill-considered policies fuels the resentment of the Russian nationalists, or if President Boris Yeltsin allows reform, and thus economic progress, to be derailed.

There has been much speculation that inflation will accelerate again, given the departure of Deputy Prime Minister Gaidar and Finance Minister Fedorov. Some of the important economic reformers in Russia have the view that the big wage increase given to state workers just before the election will shortly cause inflation to accelerate, and thus the departure of Messrs. Gaidar and Fedorov was a shrewd move to make Central Bank governor Viktor Gerashchenko the scapegoat. Whatever the truth, it is unlikely that Russia will allow itself to follow Ukraine into near-hyperinflation. The Russian banks can now hold gold and issue gold and other real-asset-denominated securities, which will enable them to offer money-like instruments to replace a hyperinflationary ruble if that should occur.

Those of us who have the opportunity to watch the reform process both at the policy level and on the streets are amazed at the rapidity of the transition. Moscow and other Russian cities are increasingly looking like cities in the rest of the world. There are shops that now sell everything, there is advertising, and you no longer need to go to McDonald's to find helpful, smiling salespeople. An orientation toward meeting the wants, needs and desires of consumers is far from complete, but the month-to-month progress is both significant and noticeable. Even Aeroflot seems to be responding to the competition of the new private Russian airlines. Traveling to Novosibirsk from Moscow last month on Aeroflot, we had reasonably on-time flights, clean aircraft and helpful attendants, and even seatbelts that work (on a number of my Aeroflot flights last year, the airline seemed intent on proving that you won't die if you lack a seatbelt or have a broken seat).

Those who wait to enter the Russian market until all is peaceful and easy will have waited past a lot of profit.

*Richard W. Rahn is president of Novecon Ltd., which operates several businesses in Russia and Bulgaria. He is former vice president and chief economist of the U.S. Chamber of Commerce and is a member of U.S. Committee to Assist Russian Reform.*

# Yeltsin Moves to Cut Business Taxes

By STEVE LIESMAN

Special to The New York Times

MOSCOW, May 25 — In an effort to revive Russia's flagging economy, President Boris N. Yeltsin signed a series of decrees this week that would cut taxes on foreign and Russian companies and eliminate restrictions on exports.

Western business executives, weary of a series of recent tax rises and confusing laws, have responded so far with cautious optimism, but wondered whether the decrees would go far enough to alleviate a tax system that has become increasingly burdensome.

"Clearly it's a good solid message," said George Reese, managing partner of Ernst & Young in Moscow. "I see for the first time an attempt to link business interests to changes in the tax code."

## Decrees Are Vague

But Mr. Reese said the decrees were "even more vague than I've normally seen." It was unclear, for example, which decrees will come into force immediately and which require enactment by the Duma, the lower chamber of the new Parliament.

Mr. Yeltsin, in one of six decrees issued Monday, ordered the Government to reduce basic taxes on all businesses in Russia by 10 to 20 percent. He cited a 13 percent national tax on profits and a 23 percent value-added tax as among those that should be lowered to ease the financial burden on businesses as the nation moves from a socialist to a free market economy.

In another move intended to encourage Western investors, Mr. Yeltsin eliminated the tax on profits for two years for companies registered this year with at least 30 percent foreign ownership and more than \$10 million in start-up capital.

Such companies would pay 25 percent of the profits tax rate in the third year and 50 percent in the fourth year. Taxes on profits set by regional governments, which range as high as 12 percent, were not affected by the decree.

The revenue lost from the tax breaks should be made up by an increase in Russian income taxes, according to Mr. Yeltsin's decree.

But Ruth Cook, a tax specialist with Price Waterhouse in Moscow, questioned the benefit of a reduction in the profits tax, saying that most foreign ventures were unprofitable in their first year.

"They are promising a tax holiday for people least able to benefit from it," Ms. Cook said.

## High Duty on Oil Exports

Oil industry executives are also waiting for a promised Government decree that would cut in half the duty imposed on oil exports from foreign joint ventures, which many oilmen say has stifled investment in the country's oil sector. On Tuesday, the Economics Minister, Aleksandr N. Shokhin, said Mr. Yeltsin would issue a decree "within days" to reduce the tax to \$17.50 a ton from \$35.

Other decrees issued by Mr. Yeltsin, who chastised Prime Minister Viktor S. Chernomyrdin last week for moving too slowly to reform the economy, would clamp down on tax evaders and close down Russian enterprises that do not pay their bills.

Mr. Yeltsin's economic adviser, Aleksandr Livshits, explained today that the decrees were the start of as many 30 economic measures that will be signed this year as the Russian President grapples with the country's worsening recession.

The decrees were issued amid growing calls for action by business

and political leaders who expressed concern about statistics earlier this month showing that that industrial production fell by more than 25 percent in the first four months of 1994. It was one of the sharpest drops since the Soviet Union broke up three years ago.

Western business executives said the decrees constituted welcome evidence that the Government was using taxes to help carry out policy rather than just raise revenue.

"What that tells me is the Government is listening," Mr. Reese said. "They are hearing the complaints of the business community and realize

## A flurry of vague decrees may help companies stay afloat in Russia.

they have to get some of these things through the Duma."

Since the beginning of the year, foreigners have been hit by a series of tax increases that have led some to wonder about the wisdom of their Russian operations. They have complained that the current tax system makes almost any legal business venture unprofitable.

An undetermined number of Russian and foreign companies have avoided paying taxes, in part because the rates are so high. Mr. Reese said the measures announced this week could help the Government broaden the tax base and eventually reduce taxes further.

"If they can increase compliance, they would not need these high rates to balance the budget," Mr. Reese said.

The gap between policy and implementation has become so wide in

Russia that tax specialists said the Government could adopt a law and an agency like the State Tax Service might not enforce it or might do so in a different way than the law intended.

## Concern Over Export Quotas

"Quite often, you have good intentions in a decree and when it gets down to actually putting it into action, a lot of benefit gets lost," Ms. Cook said.

There was concern that a decree eliminating export quotas, a measure intended to bolster Russian trade, might also reduce foreign investment in the country's oil sector.

Like all Russian oil companies, foreign joint ventures producing oil have been given quotas that allow them access to the country's pipeline system, whose capacity is limited to about two million barrels a day. Without quotas limiting exports, the foreign companies might have to line up to send out oil or could lose their access to the pipeline.

"It's difficult to see how the Government will eventually regulate the system if there is open access to exports," Robert Tornstrom, president of Occidental Petroleum C.I.S., said.

A furor erupted last month in the foreign business community when the State Tax Service imposed a 23 percent value-added tax on loans that foreign companies provide their Russian subsidiaries to pay for operating expenses.

A clarification on the law issued this month failed to exempt the loans, despite promises by the Finance Ministry.

A joint statement by the Finance Ministry and the State Tax Service said the value-added tax would not apply to loans from international financial institutions like the World Bank and the European Bank for Reconstruction and Development.

But World Bank officials wanted the law rewritten before releasing up to \$1.2 billion in pending loans to the Russian oil industry.

INTERNATIONAL

## Pro-Worker Bias of Russian Law Fuels Foreign Worries About Doing Business

By MARYA FOGEL

Staff Reporter of THE WALL STREET JOURNAL  
MOSCOW — It had seemed straightforward enough when managers at the partly U.S.-owned Radisson-Slavjanskaya Hotel decided to fire two women on the kitchen cleaning staff who didn't meet standards set by the hotel's "Yes I Can" training program.

But management didn't foresee the women's resistance. Nor did it anticipate the resilience of Russia's labor laws, which haven't changed their pro-worker bias since the breakup of the Soviet Union.

The two women, Larissa Gubareva and Tamara Yashchina, sued the Radisson, effectively telling the hotel, "No You Can't." And they won. Although a Moscow court awarded them just \$81 of the \$10 million each had demanded, the women have set an alarming precedent for foreign investors in Russia: They kept their jobs even though their work was substandard and their contracts had run out.

### Foreign Firms' Mounting Fears

The court ruling adds to the mounting fears of foreign businessmen, who increasingly wonder if they really are welcome in Russia. Besides this ruling, foreign investors recently have been hit by threats of a

23% tax on foreign loans to Russian companies and a 38% tax on wages higher than \$60 a month.

"This just shows that the market economy isn't here yet," says Vladimir Draltser, the American general-director of the Radisson-Slavjanskaya joint venture. "We try to bring in a new way of doing things. But it's an extremely painful process," he says.

The Russian labor code all but guarantees employees their jobs once they pass a three-month probation period. Russian law views contracts with time limits as extraordinary, to be used only for executives or in cases of special "necessity," such as filling in for a worker on maternity leave. For most jobs, if an employer retains the position, he must keep the individual worker. Investors who had hoped that the code would become more employer-friendly were disappointed in 1992 when the former Parliament made the law even more restrictive.

Most Western companies, including the Radisson, hire workers under one-year or two-year contracts that they believe conform to Russian law. Most cases of worker firings have passed without incident. Companies sometimes pay off fired workers to ward off a legal challenge. But in Russia's

fairly nonlitigious society, workers generally haven't fought back. Until now.

The Radisson case is viewed as a dangerous precedent, possibly removing from company managers the right to fire poor-performing employees.

### Dangerous Precedent

"I don't think the business community can ignore this," says Larry Anderson, a partner at the accounting firm of Coopers & Lybrand and a founding member of the new American Chamber of Commerce here. "Companies have been put on notice that they've got to be more careful about how they hire."

When it comes to labor regulations, would-be investors are dealing with one of the most heavily regulated areas of Russian law. "This is just the tip of the iceberg," says Olga Sideroyeva, a Moscow-based attorney for the U.S. law firm Coudert Brothers, as she hefts a copy of Russia's 80-page Code on Labor Laws. "There are piles of instructions that go with it."

Advocates of workers' rights already are applauding the outcome of the Radisson case. Leonid Stetskivsky, operations manager of the Russian Connection employment agency, says investors will have to pay more attention to labor. "Many U.S. companies look at Russian employees as slaves," says Mr. Stetskivsky. "Now, that will change."

Indeed, at the top end of the market, where skilled Russian employees are in

high demand, the balance of power is already shifting.

Well-qualified workers "are constantly fishing to find the market price and looking to see where they can get more," says Pratap Nambiar, director of marketing and advisory services for accounting firm Ernst & Young in Moscow. Even workers who have signed contracts for two or three years often simply bolt, he says, leaving their employer in the lurch.

To entice workers, Western companies are raising salaries and often offer trips and training courses in the West.

# No exits on the road to market

## Despite setbacks, Russia will not abandon its commitment to economic reform, writes Victor Chernomyrdin

In the past three months the west's view of Russian reform has undergone a significant evolution.

From the panicky statements about a "reactionary turn in the economy" to the forecasts of a burst of hyperinflation which prevailed in January, the world's media has begun to offer a more considered and objective view. And though at the beginning of the year some ultra-radicals, including some of our own in Russia, called on the west not to give a cent to the "real directors" who had taken control of the Russian government, the International Monetary Fund still took the symbolic decision to assign to Moscow the second tranche of a \$100 loan in exchange for commitments to market reform.

What happened in these first 10-12 weeks of this year to justify the IMF's decision? There was no great turnover of ministers in the Russian government. The economic reform programme adopted in August 1992 did not change. Most significantly, events themselves have refuted the unscrupulous allegation that our course would change, an allegation that proceeded simply from the political ambitions of those who made it.

The continuation of reform, financial stabilisation and structural change remain the core of Russia's economic policy. The economic evidence of the first three months of this year shows that. Between February and April, the monthly rate of inflation fell to 10 per cent. We do not expect the picture to change in May. In the planned 1993 budget, the deficit is pegged at 9 per cent of gross domestic product. By observing these parameters, we will see inflation lowered to a monthly rate of 7-8 per cent by the end of the year.

To achieve this goal we must adopt the most resolute measures aimed at limiting the budget deficit and the emission of credits. In particular, we seek a difficult decision to increase state revenues by changing a range of previously-free taxes, customs and excise duties. And we did that against the backdrop of a 20 per cent fall in production in the first quarter of this year compared to the corresponding period in 1992. At the same time we continued to carry out a tight monetary policy to which the central bank interest rate - significantly higher than the inflation rate in the past few months - bears witness.

It is vitally important that every minister of the Russian government fully understands that a strong rouble is the indispensable condition for the revival of the Russian economy, and the Russian state as a whole. Naturally, as elsewhere in the world, ministers will lobby for more resources. However as every minister of the Russian government knows, the important thing is not the amount of money they receive, rather it is that the money they get should have a real and lasting worth. It is counter-productive to have a currency which in one month alone loses about a quarter of its value, such has been the fate of the rouble.

Our common task is thus clear: to ensure that Russian citizens should know that everything their government does is directed towards protecting the purchasing power of the rouble, so that with these rubles Russian citizens will be welcomed anywhere in the world.

The question naturally arises as to why we do not introduce an even tougher financial policy and limit even more tightly budgetary expenditure so as to bring down inflation more rapidly. We are told by critics that in other countries, in eastern Europe and the Baltics for instance, the authorities have managed to achieve financial stabilisation more quickly. And when we insist, in defence, that Russia is fundamentally different from these countries, our critics insist that all countries are different but that economic laws work in the same way everywhere.

Putting the question in this way reveals an inadequate understanding of the specifics of the Russian situation. In a small state the government can follow what happens in every large enterprise and, where needed, take urgent action: in Russia, however, the geography of the country significantly reduces such a possibility.



Victor Chernomyrdin: "Russia has only one path to tread - that of reform, and it will not depart from it"

If a disaster strikes a small country and its economy grinds to a halt, the world community will come to its aid. Even Russia, in spite of its worsening economic crisis, continues to help its neighbours as it tries to overcome their poverty. Indeed Russia's donor status outside the member countries of the Commonwealth of Independent States is parallel to that of the Group of Seven leading industrialised countries vis-à-vis Russia.

In other words, while economic

**To achieve our goal we must adopt resolute measures aimed at limiting the budget deficit and the emission of credits**

laws work the same in all countries, the possibility of a government responding to them depends on that country's particularities of that country's economy.

For 70 years, the former Soviet totalitarian economy accumulated vast structural disparities. Tackling these problems demands prolonged effort and huge expenses. It is clear that we cannot sanction mass closures of our exhausted plants since that would usher in an unacceptable rise in unemployment, and sharply worsen both the political and the social situation in the country. Besides, it would be simply unscrupulous, since many enterprises have significant reserves with which to improve their financial position. All industrial enterprises should get the chance - and

their present difficulties.

Today, we can define three groups of basic industries in Russia:

• Enterprises that have successfully completed a period of adaptation to new market conditions and are already increasing turnover.

• Enterprises which have yet to undergo such a period of adaptation, but which display the necessary potential to do so and have some hope of succeeding. It is these enterprises which should get help from the government. This group is by far the most numerous.

• Enterprises which are beyond salvation and should be closed down in accordance with the law on bankruptcy. A list of such companies is already prepared. We do not, however, want to throw the baby out with the bathwater, and we cannot ignore the social consequences of each step on this road.

Imagine a provincial Russian town, built around a big defence plant set up some years ago. The entire population of the town - maybe 100,000 people - works at the defence plant, including those engaged in the service sector. Assume that the plant has long since ceased to have any social use and no longer receives orders. Should we shut the enterprise without considering the consequences for its employees?

Consider another example: a northern mining town with a population of 80,000 which was established to work the coal reserves. The extraction of the coal is carried on with huge losses, the reserves are near to exhaustion, the settlement is obsolete and the cost of transporting the coal has gone up several times. There is no other settlement for 500km. There are

and towns throughout Russia.

What should be done? We have no choice but to study carefully each case and patiently find a solution.

We do now feel there is some understanding in the west for these problems. The talks last month between the Russian government and representatives of the Group of Seven during the annual meeting of the European Bank of Reconstruction and Development in St Petersburg showed that our colleagues in the US, the UK and other countries

**The further integration of Russia into the world economy fully accords with our interests**

recognise the importance of assistance in the social sphere. They intend to take an active part in the search for a way to separate out from the enterprises the social components traditionally provided by them, such as schools and kindergartens, so as not to threaten the basic living conditions of millions of people. The lesson here is the possibility of channelling the international credit given to Russia towards the resolution of above all social problems. We can cope with the other issues ourselves.

We recently finished a round of talks in Moscow with the IMF, our approach met with understanding and support. Our relations with the IMF, to which we have furnished the most complete information both on the economic situation in what

we regard as a symbol of our new openness in economic matters. We believe that the agreement with the IMF will lay a good foundation for our talks with the Paris and London clubs of sovereign and commercial creditors on the restructuring of Russia's foreign debt which we inherited from the Soviet Union. Successful cooperation with our creditors should also assist our efforts to achieve financial stabilisation.

The further integration of Russia into the world economy fully accords with our interests. We have left behind the former artificial exchange rate of the rouble, the state monopoly of internal trade and other former obstacles and limitations. We welcome foreign investment in the Russian economy and very much count on attracting further foreign investment - even though we understand that much will depend on the success of our economic reforms and the improvement of the legal and tax regimes for foreign investors.

At the same time we will continue to insist on the establishment of equal trading relations, on the ending of the discrimination against Russian exports. In that regard, we are determined to push through Russia's application to join the General Agreement on Trade and Tariffs. In the near future Russia will take its proper place in the system of world trade and it will benefit both Russia and its trading partners.

I know that much of this appears over-optimistic. Indeed the country still to emerge from its deep economic crisis. At the same time, we see the first signs that our efforts are bearing fruit. The privatisation of small businesses - shops, restaurants, workshops - is almost complete. As a result, the look of Russian cities is changing: in place of the desolate and empty streets to which we were accustomed we see smart advertising hoardings and attractive, lively goods. We count on the privatisation of the larger companies to produce the same positive effect.

The first stage of privatisation, based on the use of vouchers issued free to every citizen, will soon be complete. From July the remaining shares in state hands will be sold not for vouchers but for money. This new approach should replenish the state budget and also strengthen the financial position of the enterprises themselves.

The strengthening of political stability is also an enormously important condition for successfully addressing the economic crisis. Last year, a new constitution was endorsed by the people in a popular referendum, marking the end of the long-drawn out and weary confrontation between the executive and legislative power. The other important step in the development of the democratic process was the holding of parliamentary elections, also in December.

There are differing views on the results of the December parliamentary elections. Yet the first 100 days of the federal assembly's work shows that the new parliament is a great improvement on the old Supreme Soviet. We count on close cooperation between the government and the parliament as a necessary condition for the creation of a legal base for the new economic environment. Political stability has been further strengthened by the achievement of a civil accord of national reconciliation, which was signed by President Boris Yeltsin and now endorsed by a broad range of Russian political parties, enterprises and associations.

In today's Russia we are seeing a new beginning, and have the ability, to do so. We are in the midst of the economic crisis. In the next few months we can make a break from the basic negative tendencies which have held back our development in the past two or three years. I am certain that we will make the break. Russia has only one path to tread - that of reform, and it will not depart from it.

The author is prime minister of the Russian Federation.

## Chevron Cuts Investment at Big Project In Kazakhstan, Hits Impasse on Pipeline

By ANDY PASITOR

Staff Reporter of THE WALL STREET JOURNAL

In a setback for oil development across the former Soviet Union, Chevron Corp. is curtailing investment at its giant Tengiz project in Kazakhstan, scaling back production plans and reducing the work force there.

Company and industry officials in the past few days also said that Chevron has reached an impasse with sponsors of a proposed pipeline needed to export crude from the huge field, which dwarfs Alaska's North Slope and is the largest field to come into production in more than 20 years.

Negotiations to complete a pipeline through Russia to the Black Sea port of Novorossiysk have been suspended indefinitely, following Chevron's refusal to guarantee the line's total \$1.4 billion estimated cost. Without an export route, the landlocked field won't ever reach its full potential.

Desperate for foreign currency, some Kazakh officials have threatened to pull out of the entire \$20 billion Tengiz joint venture with Chevron unless the financing issue is resolved quickly. A spokesman for the consortium backing the pipeline, which includes Kazakhstan, declined to comment.

All sides undoubtedly are posturing for negotiating advantages to some extent, and further discussions are likely over the next few months. The cutbacks at Tengiz reflect the difficulties of the negotiations, as well as lower-than-expected output in the short term.

At its annual meeting last week in San Francisco, which featured a film about Tengiz, shareholders were told that only nonessential work is being deferred, and that the company's confidence in Tengiz "remains high" as it continues "to work toward the dual goals of increased production and improved export capabilities."

Although Kenneth Derr, Chevron's chairman, previously described the pipeline negotiations as being "all garbled up," in a recent interview he said he remains optimistic. "So far we haven't been able to work out the details," Mr. Derr noted, but "it will get worked out. It has to."

Nevertheless, the short-term assessment inside Chevron is significantly gloomier. Immediate cash-flow problems, combined with political logjams and generally weak oil prices, raise serious questions about the crown jewel of Chevron's overseas growth strategy. In spite of the cutbacks, Chevron's total investment at Tengiz will reach about \$1 billion by the end of the year. But executives acknowledged that production is likely to remain mired at about the current rate of 30,000 barrels a day at least through December. The output is only about one-fifth of what the company projected, and is less than half of what the 1,600-square-mile field was pumping out under Soviet control using antiquated equipment.

Once touted as the vanguard for big oil projects in the former Soviet bloc, Tengiz instead is turning into a prime example of the risks oil companies face in developing petroleum reserves in remote and frequently politically unstable parts of the region. Royal Dutch/Shell Group, Mobil Corp., Agip SpA of Italy and British Gas are among the companies watching the dispute and talking with the pipeline sponsors before investing in separate oil projects in the region. Some of these companies could eventually use the pipeline for their ventures.

"If this one fails, you've got to question how anything else might work" in this part of the world, said Epsy Price, regional head of Chevron's exploration and production operations. Bob Ebel, of the Washington-based Center for Strategic and International Studies, agreed: "It's definitely a litmus test for foreign investment in Kazakhstan and neighboring countries."

The Kazakhs can't afford to see the venture collapse if they hope to entice additional investment in their faltering economy from Western firms that have signed some 400 other joint-venture deals. With promises of as much as \$400 million in U.S. aid for agreeing to dismantle its arsenal of nuclear missiles, Kazakhstan's economic development also has broad implications for nuclear nonproliferation. Chevron, for its part, doesn't want to walk away from the estimated six-billion-plus barrels of crude under the barren plains at

Tengiz, perhaps enough to double the company's world-wide reserves by the end of the next decade.

But the project's high cost is forcing Chevron to reconsider its strategy. Russia is using its existing pipeline system to transport only a fraction of the crude the company had been promised would be shipped. Treatment plants and other facilities are costing substantially more to build than expected, in some cases double what Chevron budgeted. Meanwhile, a spokesman for Bechtel Group, one of the field's main contractors, said its Tengiz work force is "in the process of being reduced substantially," perhaps by more than 30%. And the supplement to Chevron's own 1993 annual report says that pipeline negotiations "have proved to be very difficult," making it "impossible to predict the eventual outcome."

Condoleezza Rice, a Chevron director and a former Soviet expert for President George Bush, said, "Everybody knew it would be a long road" to get final Russian approval and build a pipeline serving Tengiz. "But I'm very optimistic for the long run."

Chevron's management is still haunted by a nearly \$1 billion investment it was forced to abandon in Sudan nearly a decade ago in the face of attacks by guerrilla bands. With political and financing disputes bedeviling Chevron in the former Soviet Union, "I can only hope that Russia and Tengiz will not be like the Sudan," said Lev Tchourikov, the Soviet Union's last oil minister who is now advising Chevron.