

U.S. INVESTMENT AND TRADE PROGRAMS IN THE RUSSIAN FAR EAST¹

Lysbeth Rickerman

Consul General, U.S. General Consulate, Vladivostok

With the discussion at this and other conferences about the difficulties of doing business in Russia and the barriers to trade and investment, people might surmise that the business outlook and potential is poor and not likely to change much. This in fact is far from the case. While individual dealmakers may encounter both delays and challenges, taken from a broader perspective, the economy of the Russian Far East is in the process of rapid evolution. With this evolution come rapid changes in the best prospects in trade and investment. Let me offer some historical perspective. The Soviet Union dominated a largely closed, command-driven economy that reached from Eastern Europe to the Pacific. This economic bloc controlled access to Western products for nearly a century. Even before the Soviet era, Imperial Russia was far from fully integrated into the 19th century world economy. The first parts of the Eastern bloc to enter into major market reforms and international trade were the Eastern European countries in the late 1980s. The three Baltic states followed in the early 1990s. Russia officially became a country in 1991 and its process of privatization and transition to a mature market economy is still underway. It was only in 1992 that Vladivostok, the largest city in the Russian Far East, was opened to foreigners except for the professor, of course, who visited prior to that.

There are patterns to the transition to the market and if we look at the experiences of Eastern Europe, the Baltics, and Moscow and St. Petersburg, we may get some idea of what is happening and will happen in the Russian Far East. In Russia's major cities, trade and investment have followed a roller coaster, multi-phase process. We can generally observe four major phases to economic transition. Each of these phases has its own best trade prospects.

First is the trading phase. Western consumer goods entering through shuttle traders, street vendors, kiosks and, later, more Western-style retail stores are usually the first announcement of the coming of the market economy. During this early phase, key Western service firms (accountants, attorneys and shippers), establish outposts to serve early Western clients following the established pattern: suitcase to walk-up to walk-in to full service office. A few of the larger consumer product firms began to establish distribution networks and pilot manufacturing plants. Consumer product supply flows remain erratic in the Russian Far East and whether you can get diapers depends literally on which ship has come in that week. Challenges continue in shipping, customs, product certification and within-country distribution. An even more serious challenge is the lack of financing available for consumer goods imports.

Second is the fix up phase. This is the most visually dramatic phase that I have witnessed firsthand. One day you see what looks like an old Soviet city, drab, grey and decaying. Then, perhaps a few months later, you walk down streets with newly opened shops, restaurants, and cafes. You see new signs, new menus, and new furniture. Traders and kiosk owners have earned enough money to move to shops, street vendors and cafe owner have earned enough money to buy new chairs and print new menus. Let me give you a few estimates of when this change has happened. In Estonia, in the spring of 1994; Latvia, winter 1995; Moscow, summer 1996; and Nizhny-Novgorod, 1997. This phase has already begun in Vladivostok and I predict

¹ Transcribed by Kevin Orfall and edited by Tsuneo Akaha.

that the city of Vladivostok, one year from now, will look very different from the city today. Merchants once sold from the backs of their trucks. Today, many have walk-in stalls. In Vladivostok's center, dozens of once battered storefronts have new signs, new doors and new furniture.

The third phase is industrial renaissance. During this phase, Western firms enter the market to begin manufacturing and local firms begin to acquire new assembly lines and new equipment. In the Russian Far East, this will probably mean Western participation in the rejuvenation of the key Russian Far East natural resource industries: oil and gas, mining, timber and fishing. Let me predict the obvious. The local content requirements of the Sakhalin Island oil and gas projects will be the driving force behind the industrial renaissance of the Russian Far East. The progress of Sakhalin, fast or slow, will determine the progress of this renaissance. In looking at Sakhalin, we have mentioned some of the problems with moving forward in Sakhalin. However, if we don't move forward in Sakhalin, this will spell a very slow progress through the Russian Far East. It is quite important for Khabarovsk, for Primorskiy Krai, that the gas be available for industrial growth in those areas. Gasification of the Russian Far East will lead to a better environment throughout the Russian Far East so that if we do not solve the problems in moving forward in Sakhalin, if problems like the mud discharge issue is an obstacle, then we will not have incomes rise in the Russian Far East which allows you to promote environmental protection of the Russian Far East. It will continue to be an area which is just moving along and going through its resources in order to have a lifestyle that is not as good as could be the case if gasification and developing goes forward in Sakhalin. The 1998 ruble devaluation, by making Russian exports inexpensive on the world markets, is propelling the Russian Far East into the third phase.

The fourth phase is infrastructure development. Often international organizations, such as the World Bank and European Bank for Reconstruction and Development, provide funding for selective early infrastructure projects. However, the wholesale and badly needed upgrade of a region's infrastructure, its ports, airports, roads and railways, often awaits the emergence of municipal finance systems. U.S. cities, port authorities, even towns, use enormous amounts of municipal debt to build schools road and ports. Russian cities are only beginning to tap this debt market and this process was severely set back by the financial crisis. Within the context of this economic evolution, the U.S. government has developed a long-term regional trade and investment promotion strategy for Russia. Originally called the Regional Investment Initiative, the program was renamed the Regional Initiative at the beginning of this year in order to reflect more accurately the broad work that the program is performing in the Russian Far East and other regions of Russia. The overarching objective of the Regional Initiative is to help select regions improve their investment climate in order to attract and maintain domestic and foreign investors. In the pursuit of this objective, the Regional Initiative focuses on the development of a strong small- and medium-sized business sector, the strengthening of civil society, and the development of a cost-efficient public infrastructure.

In the latter case, the U.S. government helped create, this year, the Sakhalin Development Agency, a facility based on the Alaska Industrial Development and Export Authority model. This program, financed jointly by the U.S. Agency for International Development, the state of Alaska and the Sakhalin Oblast government, will help Sakhalin leverage oil revenues to attract outside capital for the development of its public infrastructure and small business sector. In addition, in my opinion, one of the most exciting projects coming on-line this quarter is a new leasing operation funded by the U.S.-Russian Investment Fund and USAID. The Fund will run

its leasing operations through a newly registered and wholly owned Russian company called Delta Lease Far East, headquartered in Vladivostok with branch offices in Khabarovsk and Sakhalin. Delta Lease Far East will conclude leasing arrangements with Russian companies and will create a buffer for foreign equipment distributors and manufacturers seeking to establish or increase equipment sales in the Russian Far East. Sellers of equipment will be paid directly by the Fund's leasing company, thereby eliminating the risk of non-payment. Leasings will not be required to provide collateral but the Fund will seek client participation in the form of 25% prepayment. In addition to leasing via Delta Lease Far East, the U.S.-Russian Investment Fund continues to operate its credit and direct investment programs. For its lending operations, the Fund works through partner banks in Vladivostok, Khabarovsk, Sakhalin, and Petropavlovsk-Kamchatski, providing loans of up to \$150,000 for first-time borrowers and up to \$200,000 for repeat borrowers. In the last six months, this program has dispersed in Primorye alone, \$1.5 million of credit. The terms extend to 24 months with grace periods, in principle, of up to 3 months. The Fund continues to accept proposals for its direct investment program, which considers large-scale investments.

The Russia Small Business Fund, a program funded by the European Bank for Reconstruction and Development, of which the U.S. is the largest donor, also has expanded its operation in the Russian Far East. In addition to Vladivostok, Nakhodka, Ussurisk, Khabarovsk, and Yuzhno-Sakhalinsk, the Russia Small Business Fund is now operating in Magadan. The Russia Small Business Fund extends loans of up to \$125,000 to small enterprises for periods of up to 2 years. The Fund works via partner banks, which include Dalnevostochnyi Bank, the Far Eastern Bank, and Sber Bank. In February, the Fund disbursed 52 credits amounting to over \$500,000 in the Russian Far East. Since entering the Russian Far East in 1997, the Russia Small Business Fund has dispersed over \$8,000,000 to 700 clients.

In addition to the Russia Small Business Fund, EBRD also maintains its Russian Far East direct investment facility. Under this facility, EBRD seeks to identify qualified private sector businesses led by motivated and experienced local entrepreneurs and to provide to them equity and limited debt financing. EBRD does not require the participation of foreign strategic investors but outside participation may increase the chances of project approval. EBRD may take a maximum of 49% equity and may invest between \$500,000 and \$2.5 million in any given project. EBRD also provides trade credit facilities in the form of EBRD guarantees for confirmation of letters of credit to Russian banks and direct financing of selected large private sector companies in the form of revolving pre-export finance or working capital loans.

Finally, I am also happy to report that the National Bank of Alaska recently announced the opening of a new loan guarantee program, funded by USAID, called the Development Credit Authority. The National Bank of Alaska is the first U.S. bank approved for the Development Credit Authority. Under this program, USAID provides loan guarantees, 50 percent of the principal, to the National Bank of Alaska in order to assist in financing U.S.-Russian joint ventures developing business interests in the Russian Far East. In addition to investment and business promotion programs, the Regional Initiative coordinates educational exchanges, small business training, environmental program, and programs focused on strengthening civil society. I'll be distributing later today more information about the programs and there's a whole variety other than this including energy efficiency and the like.

In conclusion, I cannot with certainty predict the future of the Russian Far East. However, I believe the record clearly indicates that the economic evolution of the Russian Far East will follow, with a lag of perhaps two years, economic developments we have already

witnessed in Eastern Europe, the Baltics, and Moscow and St. Petersburg. The important thing in achieving success in these markets is even in the midst of the day's frustration to keep one's mind always on the bright future of this vast region and I am here to tell you that the U.S. government will be there to assure that the bright future will be one that will benefit both American and Russian companies as they build long-term relationships arching over the Pacific basin the world's most richest and vibrant market. Thank you very much.