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December 3, 1993

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A STRATEGY TO GENERATE HARD CURRENCY FROM RUSSIA'S FOREIGN DEBT AND INCREASE EXPORTS

I. The Need for Hard Currency to Stimulate the Production of Goods and Provision of Services for Export.

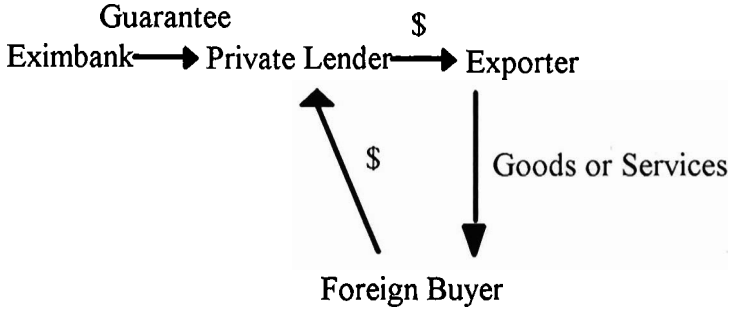
When the United States economy slumped into a recession in 1990 and 1991, American buyers' of goods and services, already heavily in debt and fearing a rise in unemployment as well as a decline in business, drastically reduced their purchases, which left many businesses looking for new customers. In response, the U.S. Administration expanded Government export programs to assist businesses in selling overseas to make up for the decline in sales in America. Today in Russia buyers, which includes consumers, businesses, farms and the government, have also dramatically reduced their purchases. As a result, inventories have increased, production and services continuously decline and people survive on less. If Russia instituted or expanded programs similar to those in the U.S. for stimulating export trade, then the production of goods and provision of services and the flow of hard currency into Russia would increase.

In America, the U.S. Export-Import Bank ("Eximbank") conducts the key programs for facilitating the export of U.S. goods and services. Eximbank helps U.S. exporters secure credit for their foreign buyers. Often private lenders (banks, trading companies, etc.) will not provide financing to a foreign buyer because the perceived risk of non-payment or only partial payment is too high. Eximbank encourages private lenders to extend credit to a foreign buyer by providing a private lender with a guarantee that in the event the foreign buyer does not repay the private lender, Eximbank will. While the foreign buyer repays

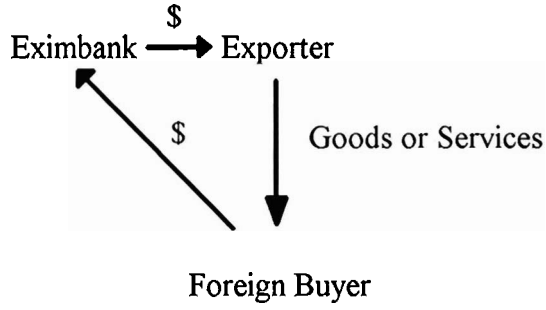
the loan over a period of time, the actual dollars provided by the private lender are paid directly to the exporter and not the foreign buyer. This way the exporter is assured of obtaining payment for the goods or services it provides a foreign buyer. Only Eximbank has to worry whether the foreign buyer repays the loan. Under another program, Eximbank provides direct loans for the purchase of American goods by a foreign buyer. Under the direct loan program, Eximbank transfers dollars directly to the U.S. exporter, not the foreign buyer, and then the exporter sends the goods to the foreign buyer. The foreign buyer has to repay Eximbank over a period of time the amount Eximbank paid directly to the exporter plus interest.

Both programs assure the U.S. exporter will obtain value for the goods or services sold overseas. Eximbank ultimately assumes the risk that the foreign buyer will not pay. (In such a case, Eximbank can sue the foreign buyer and alert companies worldwide not to deal with that buyer.) Perhaps a couple of diagrams will help:

Guarantee Program



Direct Loan Program



Eximbank also provides American exporters with insurance against loss should a foreign buyer default on its obligation to pay the exporter for political or commercial reasons. Many foreign buyers are unwilling to assume a loan obligation under Eximbank's Guarantee or Direct Loan programs because commitment fees and interest payments increase the cost of the goods or services bought or the time to consummate the transaction is so short that a loan or guarantee does not make sense. Under the Insurance program an exporter can ship the goods or provide the services immediately and receive payment later. If the buyer does not pay, then the insurance will

Another crucial Eximbank program for stimulating foreign trade is the Working Capital Program. The program expands U.S. exports by encouraging private lenders to make working capital loans to U.S. businesses for export-related production and marketing activities. Small and medium-sized enterprises are often unable to obtain loans from private lenders needed to produce or market goods or services overseas. (This is especially true in Russia today where small struggling private firms cannot obtain financing because, among other reasons, they do not have the same extensive contacts with commercial bank executives as do large enterprises.) Eximbank will guarantee repayment of a loan provided by a private lender to an exporter when the loan is used to purchase finished goods, materials, services and labor to produce goods or services for current or future export sales, to market export products or services, to participate in trade fairs or conduct other promotional activities aimed at developing new overseas business. All loans, however, must be secured by the exporter's collateral which can be inventory and other goods purchased with the loan or accounts receivable that result from transactions generated by the loan. Under the Working Capital program, the exporter and not the foreign buyer is liable for repayment of the loan.

Eximbank's programs clearly stimulate exports, but since one major aim of Russian exports is to acquire hard currency, a Russian Eximbank that provided similar programs would need hard currency for a Guarantee, Direct Loan, Insurance or Working Capital program. (Section II of this paper will provide a suggestion for obtaining hard currency for a Russian Eximbank's operations.) A Russian enterprise trying to earn hard currency from its exports is unlikely to accept rubles from a Russian Eximbank as payment for its exports but may accept rubles to finance its working capital. Since a Russian Eximbank will have to deal largely in hard currency, Russian exporters must have the right to hold hard currency accounts without having to convert their profits into rubles; otherwise, the safety of using Russian Eximbank financing may not be sufficient to overcome the risk of

present exporting methods that result in exporters keeping hard currency overseas. In addition, the tax system would have to be reformed to eliminate the bias against hard currency income.

In addition to increasing exports, a Russian Eximbank, adequately financed with hard currency, might reduce a further increase in the billions of dollars already placed in offshore accounts by Russian exporters. Some Russian exporters will choose the certainty of payment and financing from a Russian Eximbank rather than the risk of non-payment from a foreign buyer. Since the Russian Eximbank and the private lenders it guarantees pay the Russian exporter directly and then collect from the foreign buyer, these hard currency payments made by the Russian Eximbank will not be secreted in offshore accounts unless the exporter, after receiving the funds in his bank account, requests the bank to transfer the funds overseas. Appropriate banking legislation can keep track of where the money goes, which will probably be an account the exporter has already illegally made deposits into from export revenues.

Furthermore, the export transactions that involve a Russian Eximbank's programs will provide valuable information. Included in this information will be the identity of the importers the Russian exporter deals with. For a Russian exporter to hide funds overseas usually requires the assistance of the importer to set up an account with a financial service company in which the funds are deposited. In America, a financial service company will not set up any account unless provided with an employer identification number ("EIN") that is issued by the U.S. Internal Revenue Service. In addition, a deposit of over $10,000 in any account will be reported to the U.S. Treasury Department, indicating the depositor and the account name. With the names of importers sold to by Russian exporters who use the Russian Eximbank's program, the U.S. Treasury Department through its agency, the Internal Revenue Service, could discover any accounts set up by the importer where the importer used its EIN or deposited more than $10,000 into an account that has a different EIN, which might occur where the importer or Russian exporter set up an American corporation in whose name it acquired an EIN in order to set up an account without using the importer's EIN. In the situation where the U.S. importer has agreed to transfer its payment to a bank located outside the U.S. but in a jurisdiction with bank secrecy laws, any transfer of over $10,000 must still be reported to the U.S. Treasury Department. Of course the U.S. Government would have to agree to provide assistance in tracking down these overseas accounts, but I am sure this could be worked out, providing the Russian Government was serious about repatriating flight capital.

II. Generation of Hard Currency for a Russian Eximbank's Operations.

Russia's recently stated willingness to assume the foreign debt of the former Soviet Union means it will owe official creditors about $68 billion and private creditors, mainly commercial banks, over $18 billion (some estimates place the private debt at over $25 billion) for a total of $86 billion.

Private creditors include: commercial banks, which are private banks and other private financial institutions; foreign manufacturers, exporters, and other foreign suppliers of goods; and export agencies that provide payment guarantees, loans and insurance. Russia's debt to official creditors includes: multilateral loans that came from international organizations such as the World Bank, regional development banks and the International Monetary Fund ("IMF") and bilateral loans that came from governments, their agencies, autonomous bodies and governmental export credit agencies. For 1992, Russia owed $20 billion in total debt service but paid only $2 billion. In 1993, it will owe $30 billion but estimates it can only pay $3 billion. Through September 1992, Russian exports totaled $37.2 billion and imports $35.5 billion, a surplus of $1.7 billion: not even enough to offset Russia's payments on its foreign debt for last year. At this rate, Russia will soon deplete itself of hard currency reserves that will leave it without a reliable medium for exchanging value.

Foreign governments and businesses will not accept rubles as payment for necessary goods such as agricultural products (flour, bread and pasta production did not decline in 1992 because of Russia's grain imports) or services such as technical assistance. Without sufficient hard currency, Russian banks and enterprises will no longer be able to store or exchange value through dollars, which will leave a rapidly depreciating ruble as the only medium of exchange, other than barter, for business transactions. A similar situation occurred in Latin America where some countries' savings and investing fell drastically because it made more economic sense to spend currency immediately for tangible goods before the currency's value depreciated further. Without savings or investments, businesses lack capital to finance production and services.

There is a lesson that can be learned from Latin America's debt problem of the 1980's -- simply refuse to pay anymore interest or principal on foreign debt. Such a default by Russia would free up hard currency for the operations of a Russian Eximbank and can

even provide Russia with the opportunity to make money buying and selling its own debt owed to foreign banks.

III. Economic Opportunities Arising Out of Russia's Default on it Foreign Debt

Once Russia declares it will no longer pay interest or principal on its foreign debt, its economic relations with the West and the rest of the world will not end. Mexico began the Latin American defaults in 1982 when it said it would not be repaying its international bankers for a while. The key phrase is "for a while." Mexico and other Latin American countries did not renounce the debt, they admitted they owed the money but the debt services repayments would be needed to aid their economies and peoples. Mexico, Venezuela, Chile and other countries continued their on-again and off-again talks with private and official creditors in an effort to resolve the debt issue. Then in 1988, the Latin American countries and private creditors (mostly commercial banks) began resolving the default issue through buy backs.

Russia could follow the Latin American pattern by defaulting and then exhibiting a good faith effort to resolve the debt issue but resolve it differently than was done with Latin America in order to assure that any resolution benefits Russia and not just Western governments or commercial banks. Such a policy would ultimately lead to buy backs and other transactions to resolve the debt owed to private creditors. Buy backs and other transactions can be accomplished in the smart way, as presented below, or the foolish way as Latin America did -- foolish for Latin America that is. I want to emphasize that the following solutions apply only to the approximately $18 or $25 billion dollars Russia owes commercial banks.

Buy Backs: Open Market and Negotiated

There are two major types of buy backs: **open market**, where purchases are made in the secondary market at whatever price the market has placed on the debt, and **negotiated**, where a defaulting country or its representatives would negotiate to purchase some of Russia's debt from commercial banks. In negotiated buy backs, lenders (the commercial banks) agree to concessions so that a country can effectively repurchase its debt at below face value. The old debt is usually repurchased with new debt issued by commercial banks, essentially a restructuring of the old debt.

The secondary market, where open market purchases are made, consists of trading debt securities (new issues, Brady bonds and distressed bank debt) in over the counter markets, primarily in New York and London. Fourteen (14) commercial and investment banks account for most of the trading. J.P. Morgan, Citicorp, Chase Manhattan, Bankers Trust, First Boston and Chemical Bank are among the biggest traders of such debt in the secondary market. Some securities houses are also involved. The substantial majority of transactions are still accounted for by commercial banks wishing to dispose of claims. Trading houses indicate, however, that non-bank institutional investors seeking high-yielding assets and capital gains are increasingly active in the market as are wealthy Americans, foreigners and professional traders. (Institutions include corporate treasuries, pension funds, and other financial institutions -- including 20 to 30 insurance companies.) In 1990, the trading volume was $100 billion. Wall Street firms are now trying to structure deals in the secondary market to offer something for the risk preferences of all investors. One type of security is to repackage bank debt and Brady bonds into a multi-part security in which some parts have investment-grade status and others do not but have a higher yield. Citicorp recently issued a three-tiered Eurobond based on Mexican Brady bonds. So the secondary market in private creditor country debt continues to expand with numerous securities houses able to purchase Russian debt in the secondary market.

The problem with open market and negotiated buy backs is that unless the market price is sufficiently low, the debtor country would be better off using its money to increase consumption and investment rather than buying back its debt. For example, a country that already owes three times as much as it is likely to repay in full is unlikely to benefit from buying back its debt in the open market when the debt is selling above 33% of face value. There is a complicated formula that can determine a range of prices that will benefit the debtor country whether it buy backs debt in the open market or negotiates its buy backs. Furthermore, contrary to popular belief, it is unclear that buy backs (open market or negotiated) stimulate investment; therefore, any premium paid in any buy back may not be offset by additional investments or the economic benefits flowing from the reduction in a country's debt. The price for open market buy backs depends on the secondary market. If the market, which is largely the commercial banks, believes that a country only intends to pay back a small portion of its debt or perhaps none at all and was not going to engage in any open market or negotiated buy backs, then the price of that country's private creditor debt would drop. This is not the case with negotiated buy backs because the moment a country starts negotiating, the price of its debt goes up.

Negotiated buy backs may or may not use the Brady initiative. U.S. Treasury Secretary Nicholas Brady introduced the initiative in 1989. Commercial banks may accept a large reduction in principal owed them by a debtor country. In return, the debtor country would exchange some of its remaining old overdue debt for new debt at a longer term and reduced interest or banks could accept a new debt at the same amount but also with a longer maturity and a greatly reduced interest rate. The new debt (called "Brady" bonds) would be collateralized by U.S. Treasury Zero Coupon bonds and possibly guarantees from the U.S. Export-Import Bank with the interest backed by the World Bank for a period. For example, the Argentina accord calls for banks to exchange old loans for a new 30-year bond equal to 35% of the loan amount, with principal payments backed by Treasury securities and an interest rate equal to the London interbank rate plus thirteen-sixteenths of a percentage point. Alternatively, the banks may take a new bond equal to the face amount of the old loan, also collateralized by Treasury securities, but with a lower interest rate that would rise from 4 to 6% during the first six years of a 30-bond and remained at 6% for the remaining life of the bond.

The Brady bonds trade in the secondary market at a higher price than the old debt traded because they are collateralized. This is a problem for the debtor countries because any attempt to buy back more of their debt after a Brady transaction either in the open market or negotiated deal will cost them more per unit of debt, although there may be less debt to purchase.

Another problem for a debtor country, whether before or after a Brady transaction, is that the moment the commercial banks hear of a plan to restructure a developing country's debt, they raise the prices at which the debt trades in the open market and the price at which they will negotiate a buy back.

Were Russia to stop payment on its debt altogether and refuse to make good faith efforts to resolve the problem, its debt instruments would drop in price significantly because many banks would be selling the debt. The more the market believed Russia would not engage in steps to resolve its debt problem, such as a Brady buy back, the further the price for its debt would fall. (Traders who had sold Russia's debt "short" would make large profits in such a situation.) Speculators, generally the commercial banks, would only begin buying Russia's debt again if they believed Russia would engage in buy backs or sell its assets to pay down its debt. Once the speculators, however, realized Russia was not going to further increase the burden on its people by exchanging its assets or money for debt at

overvalued prices, the speculators would sell their debt holdings causing the price to drop again or simply mark down the value of the debt if no buyers were available at the lower prices. This cycle of the price of Russia's debt rising and falling would depend solely on whether the market believed Russia would engage in buy backs or sell its assets to pay down its debt.

Once prices have dropped, one possible strategy for Russia would be to purchase some of its debt (then trading at reasonable and not overvalued prices) by quietly providing environmental groups with the funds for debt for nature swaps. The groups would buy the debt in the open market and exchange the debt for Russian bonds. In addition, brokers or bankers in various jurisdictions could be used to discreetly purchase Russia's debt for Russia's account. Russia could also engage in commodity-linked financing and debt for equity swaps since Russia probably would still be acquiring more in face value of debt for its assets then when everyone was expecting it to repay its debt or engage in a Brady or other type of buy back. Russia could retire the debt it acquired when prices were low or hold on to it and, when economically appropriate, initiate a Brady restructuring, which would cause an increase in value of its debt in the open market. Russia then could sell the portion of debt it is holding in the market for a gain to be used to service some of its existing debt. Professional speculators in the sovereign debt market expect to realize 50% returns when a country does a Brady restructuring.

A corollary effect of Brady debt restructuring is that equity markets in the debtor country generally go up. Prior to restructuring its debt, the government of Russia could invest in some of its viable businesses after privatization. Assuming the market rises following the restructuring, the government could sell its holdings and use the gain to service its debt.

It makes no sense, however, for Russia to engage in a Brady or non-Brady negotiated buy back, debt equity swaps, commodity linked financing, debt for nature swaps or interest rate reduction bonds until Russia's debt price hits bottom. Otherwise, Russia would be paying out more to retire the same amount of debt because it would be overvalued having been driven up by speculators betting on a debt restructuring.

IV. Additional Methods for Relieving Russia's Foreign Debt

The following details the methods that Russia can take to ease its private creditor and in some instances official creditor debt.

1. Direct Foreign Investment

   Encouragement of direct foreign investment into Russia will increase economic growth and attract foreign currency which in turn can be used to buy back or service some of Russia's external debt whether owed to private or official creditors. In addition, Russia's access to foreign technology in management expertise and markets will increase with direct foreign investment. The key to encouraging direct foreign investment is to remove obstacles to potential foreign investors, such as restrictive regulatory regimes. Mexico, for instance, overhauled its regulatory framework for foreign investment in the mid-1980's. In 1991 foreign investment, including repatriated flight capital, roughly doubled in Mexico over the previous two years.

   Thailand in 1987 simply changed the implementation procedures of its legal framework for foreign investment. It streamlined the numerous administrative rules, guidelines and standards into a more systematic framework that is now administered by a single government bureau that is directly under the authority of the prime minister. Foreign investors save much time and effort because they can now complete the application procedures in one department. Rules on the provision of incentives and the imposition of restrictions for foreign investors were also clarified.

   The creation of a country mutual fund through an investment banker or brokerage house in a Western country allows investors in the world's major equity markets to conveniently invest in a country such as Russia. The country fund would receive money from investors and its manager would decide what businesses to invest in or bonds to buy in Russia. For a country fund to be successfully launched, the country to be invested in should have a well functioning domestic capital market (stock and bond exchanges) and standards on information disclosure and accounting. The International Finance Corporation, part of the World Bank Group, assists in the structuring and offering of country mutual funds.

   Another form of direct foreign investment in developing countries is the ADR, which is a security issued against a deposit of non-U.S. company shares in a trust account.

ADRs are traded on stock exchanges in Western countries. Recent ADR offerings include the Chilean Telephone Company and Mexico's Telmex privatization. Telmex hired an investment banker to arrange for the sale of its ADRs in several major country stock markets, including the United States, Japan and England. Over $2.3 billion was raised in 1991 by privatizing Telmex. The Chilean Companea de Telefonos used the same method of privatization and raised $98 million. The danger in selling privatized companies overseas, however, is that foreign investment pools will buy enough stock to effectively control a privatized enterprise. A solution is to limit the number of shares sold to foreign interests.

A third form of portfolio investment is outright foreign purchase of particular domestic equity shares. Typically investors are concerned about adequate settlement procedures as well as information disclosure and accounting standards. Domestic financial market reform has, therefore, the potential to increase considerably this type of flow, since developing country stock markets often offer high returns and considerable diversification potential.

2. Bond Collateralization

New capital can be raised by Russia at reasonable rates by collateralizing bonds and then selling them in the bond markets. The funds raised by these bonds can go for debt service payments on both private and official creditor debt. The security backing for these bonds can include receivables, bank accounts, real estate and any other assets of a public or private Russian entity. The Mexican private copper company, Mexicana de Cobre, raised $165 million in 1991 through a five-year loan secured by copper export receivables and hedged by copper swaps. Mexico and Venezuela issued more than $2.4 billion in 1990 international bonds, denominated in U.S. dollars and deutsche marks, sold in the Euromarkets and collateralized with telephone or credit card receivables.

3. Debt-Equity Swaps

In debt swaps (which are a form of buy back), the creditor commercial banks exchange a portion of a country's debt in return for an amount of the country's currency which is then used to invest in the country's businesses. Another method is where a country privatizes a national industry and exchanges a part ownership in that industry for part of its debt held by the banks. Debt-equity swaps offer foreign finance, an inflow of foreign technology and access to foreign markets.

Argentina has achieved substantial progress in reducing its external commercial bank debt through debt-equity swaps connected to the privatization of its state telecommunications enterprise (ENTel) and national airline (Aerolineas Argentinas). Argentina obtained waivers from its creditors so as to permit commercial debt to be bought on the secondary market by foreign investors and exchanged for equity stakes in the enterprises. The total amount of commercial debt exchanged (and thus extinguished) in the ENTel's offering and for Aerolineas Argentinas was equal to about 15 percent of Argentina's commercial debt.

The United States Bank Security Pacific has gone into the business of switching debt for equity. At first it changed part of its own debt portfolio into an equity venture capital portfolio through debt-equity swaps. Through its New York office, Security Pacific now buys country debt for entrepreneurial investors and speculators, trades the debt through several countries at different exchange rates thereby adding value or finds investment opportunities in a country and converts the debt to equity. Security Pacific makes a profit by charging its investors management fees for the entire process. Russia might want to explore a potential agreement with Security Pacific, whereby Security Pacific would purchase part of Russia's debt and Russia would agree to debt-equity swaps.

Of course, whether any debt-equity swap benefits Russia would depend on the price at which Russia's debt is swapped -- the lower the better as explained earlier.

4. Commodity Linked Financing

Commodity linked financing can aid in reducing a country's external commercial bank debt, obtaining additional financing and protecting against the fluctuation in commodity prices. The United States Bank, First Interstate and London's Midland Bank have exchanged millions of dollars of Peruvian commercial bank debt for Peruvian products shipped to the United States. The banks are also trying to find new markets for Peru's products in order to exchange additional debt for Peru's goods, which are sold in the United States and Europe. Here too, it is beneficial for Russia's debt to be trading at a steep discount because the amount of Russia's products exchanged for one dollar of debt would be less than were the debt trading at a higher price.

In order to obtain additional financing, even after default, a country can collateralize further borrowing with commodities. This will increase a country's access to foreign loans at better rates than were the loans unsecured. In addition, commodity linked financing (which is used by advanced industrial countries but little used by other countries because of a lack of familiarity with innovative financing techniques) can protect against steep declines in commodity prices.

For example, in late 1990 and during the first half of 1991, Mexico used financial risk management tools to protect its crude oil export earnings (which average about 1.3 million barrels a day) against a price drop. The strategy covered a significant part of its export earnings during this period. Mexico bought put options at different exercise prices, engaged in selling of oil futures, and used short-dated (up to one-year maturity) oil swaps to hedge its oil price risk. Buying put options guaranteed a minimum price, and oil futures contracts and swaps guaranteed the seller and the buyer a specified price at some future date. By using these contracts, Mexico effectively insured some minimum price of its main export over the near future. In addition, Mexico established a special contingency fund to protect against a decline in oil prices. Mexico's overall strategy was to ensure that it received at least $17 a barrel, the price used as the basis for its 1991 budget. As explained by the finance ministry, participation in the futures markets reassured investors that, regardless of oil price movements, the economic program and the budget would be sustained. The strategy was quite successful for Mexico since oil prices fell significantly in early 1991. Not only did Mexico achieve more certainty ex ante about its oil earnings, but also it profited ex post as the gains from having ensured a minimum price exceeded the initial costs of buying the put options. There are numerous experts in risk management who could put together a hedging plan tailored for Russia's exports.

5. Debt for Nature Swaps

Under debt for nature swaps, Russia can encourage environmental organizations throughout the world to purchase some of its debt at a deep discount from commercial bank prices by simply agreeing to convert a portion of the face amount of the purchased debt into long term local currency bonds held by Russia's environmental groups. The interest on the bonds, paid in rubles, would be used by Russia's environmental groups to finance a variety of conservation projects. When the bonds mature, the principal can become an endowment fund for Russia's environmental

groups. By issuing bonds rather than cash, Russia reduces the threat of inflationary impacts.

The specific steps of a debt for nature swap follow:

The first step is to obtain approval in principle from the debtor country -- specifically, from the government, the central bank, and a private conservation organization that will receive the funds and manage the conversation program. The host country must decide what exchange rate to apply in converting debt into local currency, what condition of payment to use in exchange for the debt, and whom to designate or accept as a local agent to control the funds and dispense the proceeds. The conservation program agreed on is based on local priorities; it may include site-specific projects or a list of general conservation activities (e.g., training of park managers) to be undertaken when the local agent deems them appropriate.

Next step, the debt to be acquired must be identified. Potential swappers must shop for debt notes that are of the right denomination, are acceptable to the debtor country government and have an acceptable maturation schedule. If the debt is not donated, it must be purchased at an acceptable discount. Once obtained, the debt must be converted into a local currency instrument by the host government's central bank, in the manner specified in the agreement. Finally, the conservation program may begin.

A twist on these type of swaps is that Russia might provide an environmental group the funds with which to purchase its debt from commercial banks. This would prevent a run up in the market price or negotiated price for Russia's debt because the banks would be unaware that Russia was providing the funding as a means to buy back its debt. Furthermore, commercial banks in the creditor countries benefit not just from the sale of debt that may never be paid but the positive public relations of preserving the environment and changing the trend of countries sacrificing their natural resource base just to meet short-sighted economic needs. The importance of such public relations to the banks is illustrated by Bank of America's recent announcement it would donate $6 million to fund debt for nature swaps in Latin America.

6. Interest Rate Reduction Bonds

   Interest arrears could be refinanced by Russia paying a percentage, say 25%, in cash and exchanging the remaining percentage for bonds. The bonds could be dollar denominated with a 10-year maturity and a 3-year grace period. They would carry a below market interest rate (rates in the U.S. are already at a 20-year low) for the first three years and a market rate afterward or a variable market rate with a cap and floor (that predetermines the upper and lower rate bounds). Any variation of the percentages, rates and maturity would depend on what can be negotiated given the markets perception of the likelihood of repayment or debt restructuring and whether it is beneficial to Russia.

V. Further Implications of a Russian Default on its Foreign Debt

Many American bankers, the ones indebted to Russia, and foreign governments indebted to Russia will argue that a more serious Russian default on its foreign debt will diminish confidence in Russia's economy and politics, which will cause foreign aid and foreign investment to decrease. Considering the impact and amount of foreign aid and foreign investment to Russia during 1992 and 1993, a further reduction would probably not be harmful and the amount of debt service saved could be used to obtain the benefits offered by a Russian Eximbank.

The West has offered Russia billions in foreign aid providing Russia met certain conditions such as reducing inflation by tightening credit available to enterprises and reducing the Government's deficit spending. The less credit available to enterprises and the lower the Government's deficit, the more money would be available to pay Russia's foreign debt. A major function of the International Monetary Fund has always been to act as a collection agent for Western governments and commercial banks in the disguise of promoting economic growth in debtor nations. The tightening of credit in a monopoly economy naturally increased prices dramatically and reduced production leading to a stagnating economy on the verge of hyper-inflation. Without competition, a monopolist will cut costs by reducing production but try to maintain its profit margin by increasing prices.

The aid promised Russia has consisted of loans that profited Western enterprises at Russia's expense. In 1992, the West apparently provided $18 billion in loans. $13.9 billion came from various governments as credits to finance Russian imports. This money was paid directly to Western exporters, which profited Western exporters handsomely, but

of course, Russia now owes an additional $13.9 billion. By the time the amount is repaid, Russia will have paid much more than $13.9 billion when interest payments are included. Other foreign aid has included mere postponement of interest payments or funds that have never been made available. Balancing the benefits of the products purchased with Western credits and the stagflation impact on Russia's economy of the conditions required by the IMF plus the burden of diverting hard currency from productive uses to servicing Western debt, Russia would be better off to forego such economic enslavement. Furthermore, the present conditions of Western economies and demands for domestic aid will dramatically hamper future loans to Russia. West Germany faces an $85 billion investment in 1993 alone to continue the rebuilding of Eastern Germany.

A more serious Russian default on it foreign debt would probably not deter private foreign investment anymore than it is already. Unclear and conflicting laws, overlapping and obstructionist bureaucracies, corruption and political uncertainty have been the main deterrents of private investments. In 1992, private U.S. investment in Russia amounted to only $400 million and much of that has gone to service industries, not to the manufacturing base Russia needs to develop. Estimates state that Russia will need $40 to $50 billion a year in private investment. Such huge sums neither the West nor East will provide given the present risks, but Russia could provide significant percentages of needed investment itself by encouraging exports, trading in its foreign debt and repatriating or reducing the amount of flight capital.