Comrade, can you spare a rouble?

COUNTRY

Emerging Markets - Russia

Even the most optimistic Russian observers would admit that Russia has an intricate payments web where everyone seems to be desperate for cash - the government, almost all enterprises with the exception of those in the service and telecoms sectors and workers. The analysis of Russian corporate accounts, whether compiled according to Russian or international accounting standards, is made much more difficult by the lack of cash in the economy.

While waiting for Russian companies to have adjusted international accounts, the investor needs to keep in mind that:

- Rome, not to mention Moscow, was not built in a day; Russia remains a very young emerging market.
- New government reformers are a breath of fresh air in a country known, until recently, as having some of the worst bureaucrats.
- The Russian government is making positive strides to implement a streamlined tax code, to improve tax collection enforcement and to present a realistic 1998 budget.
- Russian company managers are operating as logically as possible in an often illogical environment.
- The pipeline of ADRs, syndicated loans and Eurobonds demonstrates increasing commitment to improving companies' financial health and transparency.
- Russians have an almost infinite capacity to endure against the odds. We believe that their legendary tenacity will enable Russians to bring their country into the 21st century.

ANALYSTS

Mayra Rodríguez Valladares
44 171 375 5577

mayra-rodriguez.valladares@nwmarkets.com

Table of Contents

NatWest Securities Limited
incorporating
Wood Mackenzie & Co Limited

Regulated by
The Securities & Futures Authority
and a member of the London Stock Exchange.

London
135 Bishopsgate London EC2M 3XT
Telephone 0171 375 5000
Fax 0171 375 5050 Telex 882121

Edinburgh
Kintore House 74-77 Queen Street
Edinburgh EH2 4NS
Telephone 0131 225 8525
Fax 0131 243 4434 Telex 72555

NatWest Securities

Executive summary

Russia is in a cash crisis. Russia is surviving on in almost incomprehensible system of barter and *veksel* (promissory notes) where few entities or individuals ever see what Russian State Tax Service Head Alexander Pochinok calls "live money." Minister without Portfolio Yasin announced in mid-September that in the first half of 1997 total non-payments in the Russian economy were RUR 700 trillion (26.8% of GDP), in comparison to RUR 400 trillion (16.7% of GDP) in 1996. He also stated that barter transactions accounted for as much as 70% of enterprise payments to each other and to government authorities. Yet, cash shortage can be seen as being rather selective, since cash does not seem to be in short supply in the informal private sector which is dominated by service industries, for individuals who deposit money abroad, nor is cash in shortage with the Russian population who saves 24% of their household income.

What caused this purported cash "shortage"? The collapse of the CMEA (Council for Mutual Economic Assistance), the communistcommon market in 1989, two years before the disintegration of the Soviet Union, created for the USSR almost overnight a breakdown in the tight production and supply links which characterised the centrally planned system. This disarray in the payments system intensified even more dramatically when the Soviet republics split and the Russian economy collapsed. It is very difficult to know whether a Russian company is profitable for its Russian shareholders, or even to know what profitability really means in an environment which has several "currencies", each with its own valuation, none completely convertible. The increasing adaptation of accrual accounting has only made matters worse for the moment as company financial statements are a combination of non-cash, half-cash and quasi-cash, without any clear differentiation. Now, arguably, Russia's tight monetary policy, which has caused dramatic declines in inflation, has also contributed to a shortage of cash.

Investors in Russian equities are affected directly by the payments problem. It is not surprising that the investor might be confused and cautious. Gazprom (US$25.5) and UES(US$0.39), not only the largest but probably two of the cash-poorest operations in Russia, estimate that only 50% and 15%, respectively, of their reported revenues come in the form of "live money." The rest takes the form of bartered goods, promissory notes and accounts receivable**.** Rather than simply assuming that Russian accounts mean nothing and that all companies are not profitable, it is important for the investor to attempt to decipher the Russian payments system. If one were to believe that today's money hardly matters for investors who are most interested in tomorrow, it may seem superfluous to analyse the non-cash economy in some detail. The effort, however, is necessary, since a clear sense of the financial pressures should help investors extract as much information as possible from the published accounts. The proximity of real economic profits can only be gauged if there is some sense of the real cash needs of the government and companies.

What is to be done? Analysis of the non-payments problem will help the investor realise that Russian enterprises are actually working as logically as they can given their largely illogical environment and that they, along with the government, are committed to ameliorating the cash crisis. In addition, it is important to realise that, particularly as cash is in shortage, we must monitor Russian fiscal and monetary developments, potential rouble and foreign currency earnings, and management personnel and their strategy even more carefully than perhaps we would with other countries.

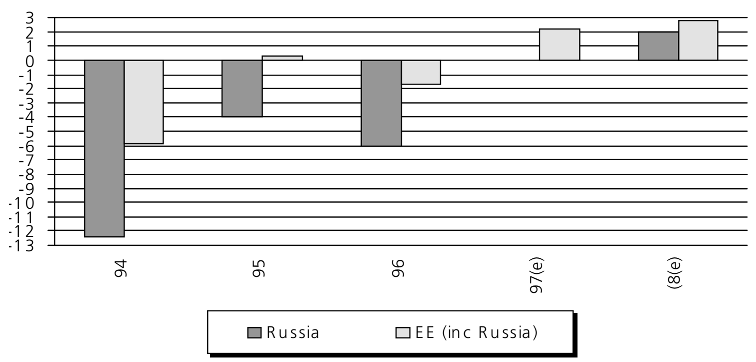
The Payments Problem

Still too much Communism

The non-payment problem can be seen in two ways. The clearer but less practical approach is to see the current system for the distribution of goods as the degenerate, even the mutant descendant of tight production and supply links which characterised the centrally planned system of the Communists. In central planning, each factory management was responsible for production, while a web of committees took charge of the allocation of both supplies and distribution. A proper price mechanism, using market information, had no role in allocating resources. The system had many practical weaknesses — it was technologically conservative, simplistic (spare parts were often ignored), prone to break downs, and increasingly inefficient in the allocation of both labour and capital. On the other hand, in its own crude way it worked reasonably well. Russian factories were able to produce goods, partly with the help of informed contacts between factories by passing the central planning system.

The end of the Communist Common market in 1989 took eastern European production, probably about 25% of the Eastern bloc total, out of the system. The break-up of the Soviet Union removed another 15-20%. All east European markets suffered from the breakdown, **but fortunately recovery is underway**.

Russian and East European GDP (% change, yr-yr)

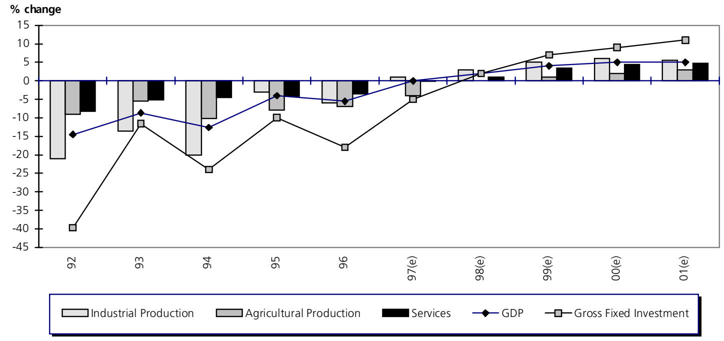


Source: Goskomstat, EIU and NWM forecasts

In the decline of the Communist state organisation which followed, all of the key economic interchange points deteriorated or collapsed. Central planning all but disappeared. Farmers found it increasingly difficult both to distribute their products into the cities and to acquire chemical inputs. Factories, particularly those located in isolated regions, could find supplies only with difficulties. As survival and necessity become more important, investment declined sharply.

The result has been a sharp decline in industrial production. The official estimates suggest a 50% decline, but any measure depends on a common currency for the comparison of disparate goods. Such a currency never really existed in the Soviet Union and is exactly what is missing in Russia. The decline of the military market and the growth of the black market make matters worse for the statisticians. All that can be said is that production has fallen sharply since the fall of Communism, and direct investment has fallen even more.

Economic Growth & Sectorial Output



Source: Goskomsrat; EIU and NWM Forecasts

The basic physical components of the economy, however, have not changed significantly. Industrial producers continue to produce and distribute. They hope that their suppliers will be able and willing to continue in the same way. To a surprising extent, the chain continues unbroken in Russia. When the traditional lines of supply break down — whether through broken equipment, lost international connections, or the decision of one producer to break out of the chain — new arrangements are made. Unfortunately, in an economy lacking clear commercial channels these arrangements tend to be convoluted and imperfect.

Consider a simple example. The farmer has wheat but no fertiliser. The fertiliser producer can take the wheat, but can only give away some to its own workers. The rest has to be exchanged for ammonia from the ammonia supplier. Thus, the ammonia worker and the fertiliser worker are fed, but the physical problems of delivery are significant, and the wheat-fertiliser exchange ratio is somewhat arbitrary, since the production has a large degree of independence from the payment. The fertiliser factory accountant can declare the 'unpaid' fertiliser to be an account receivable, but the farmer is unlikely ever to have enough wealth, in wheat or cash, to satisfy the fertiliser maker.

This sort of barter actually stands behind any economy. The workers at one production unit make a tiny part of the goods, and they and their dependants consume a different little part. The trade of goods — production into consumption — is just as real in a cash as in a command economy. The difference is one of efficiency. The indirect "barter" of goods into cash is a great deal simpler and more efficient than the direct barter of a command economy, and the directed barter of a working command economy has an almost equally great advantage over the varied and arbitrary arrangements of the decayed command economy in Russia today.

The current Russian economic system is a curious hybrid of the old command and the new cash. Cash, in the form of hard foreign currencies, rules at the borders with non-former Communist countries. Old command production arrangements continue almost unabated in core industries such as gas and electricity production. As goods become more luxurious, or more likely to be imported, cash becomes more common.

From the perspective of the old command economy, it seems quite likely that the conventional economic order of cash for everything eventually will prevail. The government's emphasis on reducing inflation probably has slowed the transformation process, since the government's policy has consisted largely of substituting non-payment for money creation, a change in policy which is probably only possible in a former command economy. The problem for Russia is that the delay in establishing a logical and efficient exchange system has an economic cost in lost production, lost output, and declining economic enthusiasm. The problem for potential investors in Russian equities is that they will have to wait for an accurate cash measure in order to determine the real economics of the companies whose shares they are buying.

Five kinds of payment

The other approach to the non-cash economy is to disentangle the different types of cash through detailed analysis. This technique is necessary and possible, but complicated and tentative, particularly as reality can change quickly. In effect, there are five ways of paying in Russia today:

Dollars — A great deal of the Russian economy is denominated in dollars, or more accurately in hard currency. All international commerce is priced in foreign currency, and the domestic confidence in the rouble as a medium of exchange is still low, despite a considerable reduction in the inflation rate. Dollars are eagerly sought, and dollar prices are used to denominate all-Russian transactions. The government is very anxious for foreign currency, because foreign currency is a much better source of roubles than taxation.

Roubles — The decline in inflation should make the rouble more attractive; a great source of pride for Russian monetary authorities should be that it has kept the rouble relatively stable in the rouble corridor. Whether the government can bring about a real cash economy without another major bout of monetisation is perhaps the greatest uncertainty in the Russian financial riddle. Mutual debt cancellation could do the job, but the task would challenge governments which are significantly more secure and sophisticated than the Russian one. In a move to strengthen the rouble and to increase faith in the Russian currency, the Russian Central Bank announced that from June 1, 1997, no new permits would be issued to businesses wishing to accept payment in hard currency; the central bank also plans to begin revoking the licenses of 2,000 companies in Moscow which accept payments in foreign currency. Also as of November 1, the government will ban the use of hard currency for cash and credit-card payments.

***Veksel* (Promissory notes)** — In western economies, paper money was originally at the edge of the official gold currency, more or less under government control. In Russia, roubles are far from gold in their solidity, but they do resemble the former hard currency in their scarcity. The natural process of creating softer currencies — fungible units of value to denominate exchanges — has started up, with all the normal risks of lost value and fraud. The growth of promissory notes, both private and government, is a real sign of monetary progress. Promissory notes tend to be for maturities of 3-6 months and are issued by the regions, enterprises, and banks. They are hard to value, but they do at least have a cash-like value. If these instruments can be made more secure and more regular, they could form the base of a solid monetary economy.

Goods — The Soviet logic favoured goods over any sort of paper. The lack of commercial trust, still a major problem in Russia, also promotes a reliance on barter. Some of the barter in Russia is almost an accident of the economic logic of production — for example, the exchange of gas for electricity — but genuine payment in kind is still amazingly common. Cash has been drained almost entirely from the agricultural economy, and isolated and uneconomic factories are quite prone to pay their workers in the goods they produce, a grim parody of Marx's desire for the worker to have unmediated control over the fruits of his labour.

Nothing (accounts receivable) — As just discussed, non-payment in Russia is not like non-payment in a conventional economy. A Russian who does not pay either does not have the cash or the habit of giving something in exchange for the goods received. Western accountants interpret goods delivered against nothing as deferred or at least owed cash, but most of this hypothetical money will never exist. As the prime victim of non-monetisation, the government has every interest in getting cash into the system. Unfortunately, the government is also the largest source of the cash-free economy, and from that perspective it has every incentive to muddle through.

What are profits in a Russian company?

A detailed discussion of each type of payment has a great deal of investment relevance, because investors eventually want cash dividends. While waiting for the cash in hand, they want to know if the company has the cash, or the prospects of cash, which could pay a dividend. If a company runs largely on half-cash and non-cash, this sort of profit analysis is very difficult.

Investors in Russian securities often seem to miss the importance of this analysis. They welcome the publication of IAS accounts without questioning just what lies behind the rapidly growing accounts receivable and payable. The scale is crucial. In almost any quoted Russian company, the reported profits are a small fraction of the trade and tax non-payments. A small adjustment in expected recovery rates, or in the assumed cash value of barter, or indeed in the rouble cash value of promissory notes or hard currency, can wipe out or magnify the reported figure.

Profits, it should be remembered, are what is left over for the shareholder after all other claims have been paid off or allowed for. The simplest measure of profit is the cash the owner takes home to spend, that is, dividends. That measure is full of economic risk, since the owner may be running down the company, improving the company, or forgetting about payments which will soon come due. To move beyond a cash-in-the-pocket measure of profit, however, some notion of a stable social and economic situation is required. If historically disproportionate claims by workers or the government are possible, then any accrued measure of profit will likely be too uncertain to have much value.

It is debatable whether Russian companies meet the prerequisites for conventional accrual accounting. The country seems to be gaining political stability, but the fights over taxes and inter-enterprise debts are virulent enough to suggest that a radical solution is still quite possible. Perhaps more important, the Russian corporate form is still in development. The final extent of their social liabilities is highly uncertain. Will it extend to worker pensions, as in the UK, to worker and former-worker health care, as in the US, or all the way from nursery to cemetery, including education and free lunches, as in the former USSR? The answer to that question will obviously have a major effect on the correct level of accruals.

In such uncertainty, we believe that investors should start their analysis of current Russian profitability with a very basic and crude analysis. For example, an oil or gas company is breaking even if it can keep its reserves and production flat without the need for outside funds. A manufacturing company or a utility is at break-even when if its own revenues are sufficient to keep output flat and equipment at the same average age. It is very hard to figure out when a bank is breaking even.

Clearly, by this basic economic standard few quoted Russian companies are profitable, whatever numbers may be printed in their accounts. In particular, many Russian oil companies are largely doubly unprofitable — both reserves and production are declining, and both are likely to decline more without substantial external infusions of real capital. **Whilst these real economic losses are of concern, their seriousness should not be exaggerated. In the Russian circumstances, lack of economic profitability, like reported profitability, means something different than what it would mean in the West.**

When a western company in a mature business reports a loss, it usually means that the company's position in the market is weak. A Russian company's loss can reflect this type of structural economic problem, but it can also reflect an unfavourable position in the national struggle for cash. That sort of problem is as often much political as it is technological or economic. The technical condition of the Russian oil companies is generally poor, but probably not nearly as bad as the crude profit analysis would suggest.

What are Russian profits for international investors?

International investors do have to worry about economic profits, but their position as outsiders gives them a somewhat different perspective. Even if a company is holding its own within the Russian context, the hard currency funds for dividends may not be available. Conversely, hard currency revenues provide a greater sense of security for foreign investors, even if the Russian economics are rather doubtful.

Obviously, in a troubled and shrinking economy, large companies which need capital most are not generally those in which capital providers would naturally like to invest. The discrepancy is particularly great for foreign investors. A company which can generate enough foreign currency to fund its necessary imports from operations would not need to turn to foreign equity investors. In this sort of company, a foreign currency return on the invested cash has to be considered a distant prospect.

Russian liabilities and resources by payments method

The investor will soon see, if he has not already, that the government and enterprise payments problems are extremely intertwined. Whilst a company may raise funds through internal cash flow means or through the issue of equity or debt, proceeds often end up with the government as tax payments or as wage arrears payments. Or when funds are received from privatisations, the money is for the benefit of the government and some times the company. Nonetheless, wherever possible, cash resources of the two entities are separated so as to examine how successful both are in revenue raising measures.

DOLLARS

The government

In countries with convertible currencies and large private capital transfers, the government's domestic and international financial situations can be considered together. The Russian government has only limited access to foreign currency, and the private need and desire for foreign currency dwarf the current ability to supply it. In this environment, the international balance of the government is only imperfectly and indirectly related to its domestic cash-generating ability. The Russian government's hard currency problem is best studied with the economy's hard currency problem, not with the government's domestic cash problems.

The international equity investor has to look at the Russian government with a particularly wary eye. Equity owners eventually will want a hard currency return for their hard currency contribution. In that search for real money, the equity investor will have to compete with the lenders to all of the various Russian government or quasi-government organisations which have taken advantage of the foreign willingness to contribute investment capital into the country. The government will be looking at essentially the same pool of hard currency as the corporations. Much of the capital raised by governments has been used for current domestic expenses, rather than for anything which would naturally generate a hard currency cash flow for the government.

Economic Indicator	*1995*	*1996*	*1997**
Trade Balance, US$ bn	*20.2*	*28.1*	*na*
External Debt, % of exports Jan 1	*176.0*	*158.0*	*156.0*
External Debt Service, % of GDP	*1.0*	*0.9*	*1.5*
Domestic Debt, % of GDP at year end	*3.5*	*10.5*	*23.0*
Consolidated Budget Revenue, % of GDP	*26.2*	*23.0*	*na*
Federal Budget Revenue, % of GDP	*13.9*	*12.5*	*15.9*
Federal Budget Deficit, % of GDP according to MinFin	*3.0*	*3.3*	*3.5*
Federal Budget Deficit, % of GDP according to IMF	*5.4*	*7.7*	*-*

**Sources: Goskomstat and 1997 data are from the 1997 Law on the Federal Budget*

Liabilities

To start with, the Russian government is still paying off the old and rescheduled debts from the Soviet era. Under the Paris and London Club deals, Russia is required to pay principal and interest, covering US$38 and US$25.5 billion, respectively; these amounts are 53% of what the Soviet Union owed governments and banks, with the remainder being written off. The government has continued to fulfil debt obligations acquired or guaranteed since January 1992 as well as Vneshekonombank bonds (Soviet era Foreign Economic Bank). The late Soviet loans were certainly not an economic success; overall, the losses for the banks on these loans were significant since the total foreign debt of Russia was over US$120 bn. Viewed in light of exports and local hard currency reserves, Russia's debt remains high. If Russia had not rescheduled in 1995/96, Russia's foreign debt servicing ratio would have been approximately 20-25%. Due to the rescheduling, the debt servicing ratio is about 8.1%.

Thus far, Russia is paying in full accumulated interest arrears since 1991. The repayment of principal is not a current issue for lenders. The banks may have some private doubts about their forced bet on national solvency, but Russia is receiving the typical treatment of cash-short borrowers — all short-debt is being converted to long-term debt, leaving Russia with moderate foreign currency debt ratios. Debt service is now quite regular — not surprisingly, considering the relatively easy access to new foreign currency loans.

In addition, the Russian government is responsible for settling unguaranteed creditor claims of Soviet era debts owed to CMEA countries. Other foreign debts that Russian government entities have are those from Soviet state-owned foreign trade organisations (FTOs). These entities used to be very reliable customers, but defaulted on uninsured credit purchases of goods or services from western suppliers at the time of the Soviet Union's collapse. According to the U.S. Department of Commerce's International Trade Administration, these entities have arrears of approximately US$ 7bn to firms worldwide. Russia assumed responsibility for most trade debt in October 1994 and urged private sector creditors to form "trade creditor groups" (TCGs) to negotiate settlement of their debts. Losses have been significant — negotiated settlements of Soviet FTO Debt have returned creditors between 19 - 50 cents per dollar of debt.

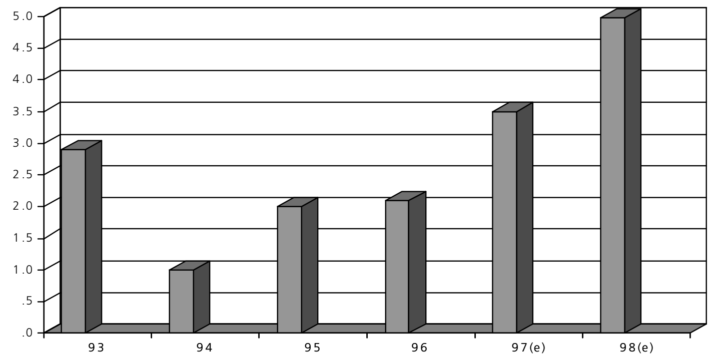
Resources

The Russian government has engaged in a variety of attempts to earn foreign currency revenues. The following, in ascending order from least to most successful, describe a number of revenue raising sources in which the government has attempted to engage.

Foreign Direct Investment (FDI)

Unfortunately, attracting foreign direct investment continues to be hampered by tax and legal obstacles. Despite the approximately 40 private and EBRD, OPIC or USAID backed funds which exist to invest fully or partially in Russia, very little direct investment has actually materialised. Since 1993, yearly FDI levels have been less than 0.5% of GDP.

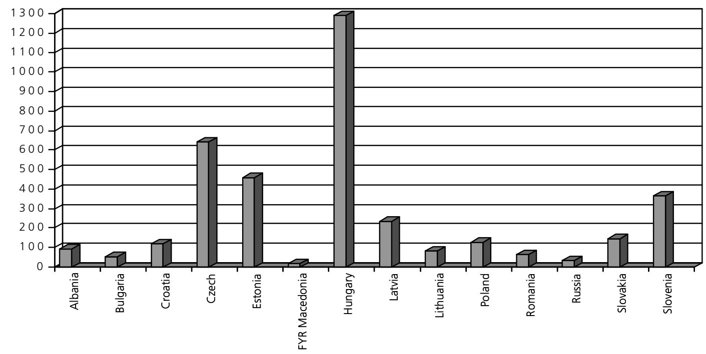
Foreign Direct Investment 1993-1993



Source: Goskomstat and NWM estimates

According to the EBRD, Russia's FDI per capita from 1989- 96 was US$34. When compared with eastern European countries, which according to the EBRD also includes the Baltics, **only Macedonia had smaller per capita levels of investment than Russia**.

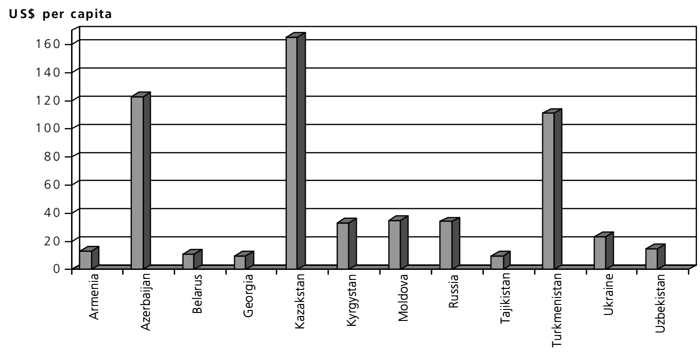
Comparable EE FDI 1989-96 (US$ per capita)



Source: EBRD, April 97

When compared to its Commonwealth of Independency State (CIS) neighbours, even there Russia does not top the charts of per capita FDI.

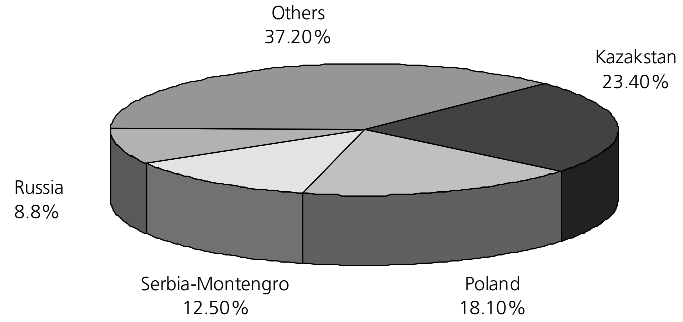
Comparable CIS FDI 1989-96 (US$ per capita)



Source: EBRD, April 1997

Although figures are incomplete for 1997, Russia is the fourth largest recipient of FDI in 1H97, with approximately 8.8% of the US$8.5 bn FDI to eastern Europe and the FSU, whereas Hungary, the country which has usually been a high FDI recipient, has only received 5.2%. Given that last year investors held back due to political uncertainty surrounding the Russian elections, it is not surprising that this year's levels should be significantly higher. Although about US$ 4 billion has been expected for 1997, as of the end of 1H97, not even US$1 billion had come in. In July, the Svyasinvest privatisation took place, raising US$1.9 bn; if the entire sum comes into Russian authorities' coffers those proceeds will be reflected in year end figures.

First Half 1997 Foreign Direct Investment Levels

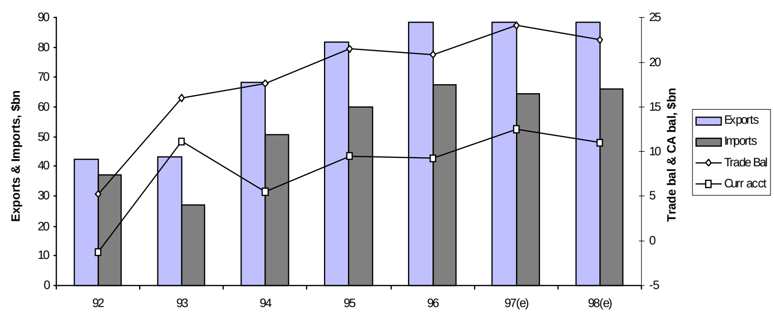


Source: EIU

Exports

Russia continues to have a current account surplus, but its trade surplus did narrow slightly in 1996 as exports grew approximately 8.2% and imports rose 7.4%.

External Balance



Source: Goskomstat and NWM Forecasts

Specifically, it is worth noting the geographic composition of Russia's exports and imports. In 1996, exports to Commonwealth Independence States and non-CIS countries increased from 1995, but as a proportion of total exports, exports to non-CIS declined slightly. Imports from the CIS and non-CIS countries increased from 1995, but the increase from CIS countries was substantially larger than the increase from non-CIS countries.

To/From	Exports US$ bn	% of Total	Imports US$ bn	% of Total	Surplus/Deficit US$ bn
CIS, 95,	17	21	16	27	1
CIS, 96	18	20	20	30	-2
%,change	**8**		**22**		na
Non-CIS, 95	64	79	43	73	21
Non-CIS, 96	70	80	47	70	23
% change	**9**		**9**		10
TOTAL, 95	81		59		20
TOTAL, 96	88		67		21
% change	**9**		**14**		**5**

Source: Goskomstat data

Eurobonds and syndicated loans

Given minimal FDI levels, the most important source of hard currency for the Russian government has been borrowing. Russians have returned to the international debt markets, both at a national, a regional and local level. For the moment, these loans must be included in the list of sources, rather than of uses, of hard currency. As long as the momentum to lend continues, the quantity of money flowing in far exceeds any requirements for paying interest. In due course, however, these new loans could become a problem, if they do not fund, directly or indirectly, capital investments which can generate reasonably steady government hard currency revenues. In addition, inflows of foreign funds may actually delay fiscal and corporate restructuring because government authorities can continue to run large budget deficits and enterprises can borrow abroad while continuing to lend to moribund enterprises. Given that these markets are nascent, we will not know immediately whether the loans are positive or negative for the borrowers.

A short-term and increasingly popular mechanism to raise finances has been Eurobond issuance. In August, Russian monetary authorities announced that as they are comfortable with revenue raising measures they would withhold issuing any more sovereign Eurobonds until 1998. Whilst Eurobonds thus far have been extremely popular they cannot take the place of serious Russian fiscal reform. In addition, since the Russian Sovereign authorities fear being left with city or regional defaults, they have begun to place requirements and limitations on municipal and regional Eurobond issuances. President Yeltsin signed a law on Eurobond requirements April 8, 1997; thus far the law is only for Moscow, St. Petersburg and Nizhny Novgorod, but it is likely that more cities and regions may also have to comply with the law. A proposed law in parliament would limit government international borrowing to US$9.8 bn, of which US$3.5bn would be for the sovereign. As such, it is questionable how many city and regional governments will be able to actually issue Eurobonds.

Net Eurobond borrowings, US$ mm	1996	1997(f)	1998(e)
Sovereign	1,000	3,500*	3,400
Municipal		1,900(e)	
Regional			1,920
Total	**1,000**	**6,400**	**2,920**

** (For more details on government Eurobonds, please see Appendix I)*

In terms of syndicated loans only the city of Moscow has received such a loan, US$ 300m priced at 3.5% over LIBOR. The city is reportedly petitioning for another loan.

Foreign loans to Russia

Since the demise of the Soviet Union in 1991, Russia has received approximately US$40 billion in foreign aid, of which 50% is in officially guaranteed foreign trade credits. The largest lenders to the country have been the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (World Bank). The following table highlights some of the largest pledges of aid from multilateral agencies to Russia; by no means is the table conclusive and it only accounts for about 60% of the loans and aid to Russia.

Agency	Amount (US$ mm)	Purpose
Germany	**848**	Volgograd development
EBRD	**1, 700**	Privatisation and management training
EC	**1,800**	Pledged at Tokyo Summit
IBRD (World Bank) (as of 1H97)	**7,633**	General economic rehabilitation
IFC	**393**	20 projects-capital markets development, post-privatisation restructuring, agribusiness & oil & gas investments
IMF	**10,000**	encourage tax and collection reform, along with control of budgetary spending
Japanese Eximbank	**500**	Infrastructure projects-oil, telecoms and aviation
OPIC	**1,000**	Guarantees for business activities with Russia
Turkey	**350**	
US Eximbank*	**132**	
TOTAL	**24,356**	

**This only covers recent loans.*

Thus far, the entities which have worked on lending money to Russian companies have not reported serious defaults. The EBRD, for example, has stated that 99% of the bank-extended loans to small Russian businesses have been repaid in a timely manner.

Despite the levels of FDI and aid pledged to Russia, it is important to realise that Russians continue to export significant levels of cash outside of Russia. Given the nature of these activities, estimates vary greatly as to the levels of capital flight. Russian Interior Ministry officials have stated publicly that the country's capital flight since 1991 has been in the range of US$50 - 150 billion. Russian central bank officials estimate that capital flight has been about US$37.5 bn and that about US$25 bn is kept in dollars by Russians who do not want their holding in roubles or in banks. For 1997, central bank officials estimate that about US$1 billion is leaving the country every month. **Regardless of which estimate is correct, either source indicates that the amount leaving the country far exceeds the amount of aid and foreign direct investment going into Russia**. Capital flight has taken place in simplistic forms such as taking money out in luggage and cars or by some companies such as Norilsk Nickel (US$11.6) which allegedly did not repatriate its export earnings (approximately US$ 600 million in 1996). More sophisticated means of tax avoidance are the creation of shell companies and schemes which involve presenting one balance sheet which has promissory notes and barter while the balance sheet which has cash revenues is put under an intermediary's name.

US$ denominated securities

Fixed income securities have been a very significant source of external financing. Investment in Russian fixed income securities has been mainly in GKOs (discussed under domestic sources), Ministry of Finance bonds (MinFins), and Eurobonds. There are approximately US$ 3.5 bn in new issues of dollar-denominated MinFins, with a total of US$ 11 bn outstanding, and US$3.4 bn in US$ and DM Eurobonds.

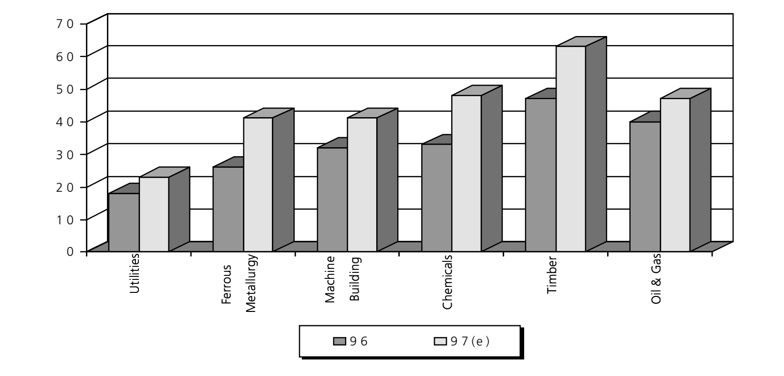
Summary of the government hard currency position

In sum, the Russian government's international cash flow position can be seen in two radically different ways. The optimists see a large country with reasonable economic potential, troubled but on the mend. The pessimists see a troubled government which has the classic problems of the governments of the developing world — inadequate control, imprudent borrowing, and a fundamental confusion between political survival and the national good. **To judge from the recent cash flow, the optimists clearly have the upper hand today.**

Enterprises

Russia's economic problems have had severe economic consequences on enterprises. According to August data from the State Statistical Committee of the Russian Federation, there is not a single region in Russia where the number of loss-generating enterprises is below 30%; in 74% of the regions the losses are actually over 40%.

% of Loss-making Companies by sector



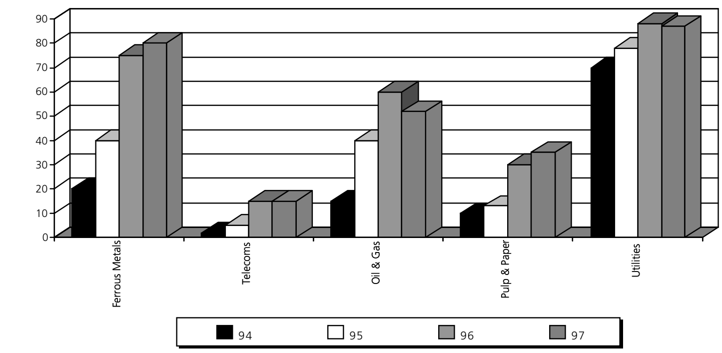
Source: Tax Arrears Enforcement Department, September 1997

Liabilities

Given this state of affairs, it is not surprising that a non-payment crisis has resulted. The enterprise non-payment crisis has its roots in the Soviet regime. First, since all enterprises received subsidies to varying degrees, there was no history of honouring business contracts in a timely manner or even at all. Second, since the primary goal of enterprises was to produce goods and preferably to overfulfil a five-year plan, many managers continue to feel that economic details are a petty nuisance which eventually will work itself out. The break up of the CMEA market and of the FSU left a significant but almost unquantifiable chain of enterprise arrears.

To determine exactly how much and in what Russian companies are paid could be considered an art. Given conversations with company representatives and extensive reading of published materials, a reasonable "guess estimate" is that companies in the following major sectors are paid as follows:

Barter and Promissory Notes (% of collected sales)



Source: Major RU CS accounts and press sources

Resources

Given the difficulty in attracting cash from local debtors and the low levels of FDI, companies have begun to focus in the last two years on how to access international capital markets. This section analyses the various foreign currency resources to which companies have access.

ADRs

Since the fall of 1995, 18 companies have issued ADRs and GDRs; LUKoil (US$24.2), Menatep and Surgut also have ADRs on their preferred shares. Sun Brewing and UES (US$ 0.39) have GDR facilities. While many companies have declared their intentions to issue ADRs this year, it is more likely that they will issue in 1998. (Appendix II) The fact that Russian companies are issuing ADRs is not only a financing source for the companies, it is also good for the Russian equity market in general as ADRs give access to investors who otherwise might not be able to trade Russian equities. In addition, as more Russian companies issue higher levels of ADR this will be a sign that they are becoming more transparent in terms of the disclosure they are willing to share with the public.

Company	Sector	Stock	Level	Date effective	% in ADR form
Inkombank	Banking	Ordinary	I	1.97	
Menatep	Banking	Preferred	I	4.97	
Menatep	Banking	Ordinary	I	1.97	
Vozrozhdeniye Bank	Banking	Ordinary	I	1.97	
Rosneftegazstroi	Construction	Ordinary	I	8.97	
Sun Brewing*	Food	Ordinary	I	1.97	
Sversky Pipe Plant	Metals	Ordinary	I	2.96	15
Chernogorneft	Oil and Gas	Ordinary	I	3.96	17
Gazprom	Oil and Gas	Ordinary	I	10.96	1.2
LUKoil	Oil and Gas	Preferred	I	2.97	20
LUKoil	Oil and Gas	Ordinary	I	12.95	
Surgutneftegaz	Oil and Gas	Ordinary	I	12.96	1
Tatneft	Oil and Gas	Ordinary	I	6.96	5
GUM	Retail	Ordinary	I	6.96	10
TsUM	Retail	Ordinary	I		
Uralsvyazinform	Telecoms	Ordinary	I		
VimpelCom	Telecoms	Ordinary	III	11.96	21
Irkutskenergo	Utilities	Ordinary	I	1.97	12
Mosenergo	Utilities	Ordinary	I	9.95	24
UES*	Utilities	Ordinary	I	5.97	

*Note: *GDR, Blanks have been left where information has not been confirmed publicly*

Corporate and convertible bonds

While Russian companies have been issuing ADRs, they have also concentrated on a variety of bond issues. Unlike Czech companies which have been extremely active in issuing koruna and foreign currency corporate bonds, Russian companies have been much slower. At the end of January 1997, Uneximbank, one of Russia's largest private sector banks, led the country's debut into the corporate bond market with a private placement which raised US$50 million; the bond had a three-year maturity and was priced at 300 basis points above LIBOR. VSM, the high speed railways, is issuing government-backed bonds to be traded on MICEX. In a move to increase corporate bond issuances, the Russian Central Bank announced that is making serious efforts to insure that all legislation is in place for corporate bond trading to begin by year end.

Companies have also been slow to issue convertible bonds. Thus far, only LUKoil has issued these bonds. Reportedly, other companies would like to follow suit, but to date information has not been confirmed.

Eurobonds

Corporations, as well as government entities, have begun to tap Eurobond markets in an attempt to fulfil their significant financing needs; as with government entities, this solution is short term. Whilst there are many companies interested in issuing Eurobonds, thus far only four banks and one oil and gas company have issued Eurobonds worth US$925mm.

Company	Amount, US$ mm	Tenor, yrs	Issued	Sector	Lead
Alpha Bank	175	3	7.97	Banking	Alpha*
Rossiisky Kredit	200	3	7.97	Banking	Indosuez
SBS-Agro Bank	200	3	7.97	Banking	JP Morgan
Uneximbank	250	3	7.97	Banking	Merrill Lynch
Sibneft	150	3	8.97	Oil and Gas	Salomon Brothers

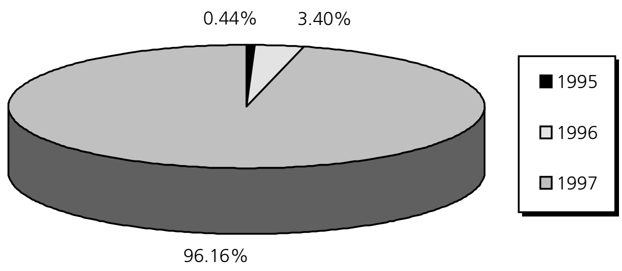
** Alpha issued through its subsidiary in Holland.*

For the remainder of 1997 and next year, approximately 20 companies have expressed interest in issuing Eurobonds. (Appendix III)

Syndicated loans

The Russian loan market started October 1995 when Mosbusinessbank tapped the market with a US$20 mm facility. Since then, 19 banks, two oil/gas and one telecom companies, have obtained approximately US$4.6 bn in syndicated loans from the international community. (Appendix IV) Most activity took place in the first 8 months of 1997.

Syndicated Loans (4.6 bn, 1995-97)



Not only has the market been growing rapidly, but also the type of loans have become increasingly sophisticated. Gazprom has received the largest foreign currency loan, US$2.5 bn from Dresdner Bank on February 1997. This loan was not guaranteed by the sovereign and its stated purpose was to finance construction of a 4,200 kilometre gas pipeline to western Europe.

Roubles

Government liabilities

Domestically, Russian government estimates are that by September 1, 1997, the government owed approximately 20% (US$ 1.6 bn) of the US$7.9 bn in wages owed to Russian employees, including military personnel; the rest is owed by Russian enterprises. How soon the government can fulfil its domestic obligations is contingent largely on how quickly and efficiently it can recuperate funds it is owed by foreign countries, FSU republics, and domestic tax debtors and how the pattern of domestic debt issuance continues. Whilst government authorities have announced triumphantly on a number of occasions that it is making good in its obligations to workers, frantic efforts to send money out to the regions are only stop gap measures. During President Yeltsin's campaign, for example, workers, were paid but soon after the election wage arrears spiralled again.

Resources

It is clear that the government needs to cut spending. Yet, fear of mass strikes and unemployment has made this process very slow. Even when cutting perks such limousines and corporate jets to Duma members, resistance has been great. In terms of Russia's proposed plans to fill the coffers, many of them, unfortunately are short term in nature. This section outlines a variety of sources of revenue in ascending order of their current level of success.

Debtors

Russia is actually a net foreign currency creditor, if the debts owed to it by former client countries in Eastern Europe and the developing world are included in the balance. The financial calculation of these debts can be misleading. First, the debts and credits of the former Soviet Union were never meant to be set against each other. The government lent instead of giving only out of respect for international practice and the sensitivities of the foreign countries. Repayment was expected in political and military loyalty, not cash flow. The political return to Russia is subject to debate, but the economic result can hardly be questioned. Recovery of these debts is unlikely ever to be more than minimal, largely a legacy of the totally inappropriate nature of Soviet style economic management for poor countries.

Second, a major problem with the debt is evaluating its true size. According, to the European Network on Debt and Development, Moscow has been trying to apply Soviet-era exchange rates to the debt, which would put it around US$300 billion. Russia is a member of the Paris Club as of mid-September; Russia will have to write off part of the debt, defined by the Paris Club as US$150 bn, by approximately 30-80%. This would include military debt write-offs. The Paris Club agreement does not include countries which do not have "regularised international financial relations." This would mean that the US$30 bn and US$13 bn which Cuba and North Korea each owe, respectively, would not be covered in any agreement which Russia might conclude to join the Paris Club. The table highlights some of Russia's major debtors.

Debtor	US$, bn
Cuba	30.0
Mongolia	17.0
Vietnam	16.0
India	13.0
North Korea	13.0
Syria	11.4
Afghanistan	8.2

Closer to home, the FSU republics, as of the end of 1996, owed approximately US$ 6 billion worth of the total foreign debt to the Russian government. Most of the debt is denominated in roubles as they are debts best understood as more financial fallout from the Soviet command economy. What are now seen as regional economic subsidies were once merely parts in the complex cultural-political-economic which the central authorities set up — aiming (generally not very successfully) at regional solidarity, full employment, grandiose accomplishments and economic efficiency.

Debts for fuel and energy supplies are the highest, as seen by the largest debtors below.

Debtor	US$ mm
Belarus	660
Georgia	35
Kazakstan*	475
Latvia	3.5
Lithuania	40
Moldova	400
Ukraine*	4,300

** Kazakhstan owes more than this figure in electricity, but figures are unknown*

The Russian government has tried to pressure debtor countries and FSU republics to repay, but these attempts have not come to much. The failure is not surprising. Russia itself has hardly adopted the logic of cash economics, and with neighbouring republics, there is still substantial political interest in keeping the "near-abroad" tied to Russia. Besides, the rouble is generally treated as a relatively hard currency in the countries of the FSU. Russia is unlikely to gain real hard currencies. Between the politics and the economics (can't pay, won't pay), Russia rarely gains in these transactions.

Privatisation

From 1992 until the end of 1996, the percentage of privatisations from the total filed has increased from 46% to 81%. Yet, these efforts have raised very little for state coffers; **since 1992, Russia has raised less than one percent of GDP from privatisations on a yearly basis.**

Budget Law, RUR bnFederal*

	Budget Law, RUR bn	Federal* RUR bn	actual** % GDP	Consolidated RUR bn	actual % GDP
1993	54	66	0.04	319	0.19
1994	329	116	0.02	748	0.12
1995	8,800	3,407	0.21	4,641	0.28
1996	12,387	825	0.04	2,527	0.11
1997	4,179	n/a	n/a	n/a	n/a

Source: Russian European Centre for Economic Policy

** Revenues are net of payments to employees after privatisation.*
***These figures do not include share transfers to regions.*

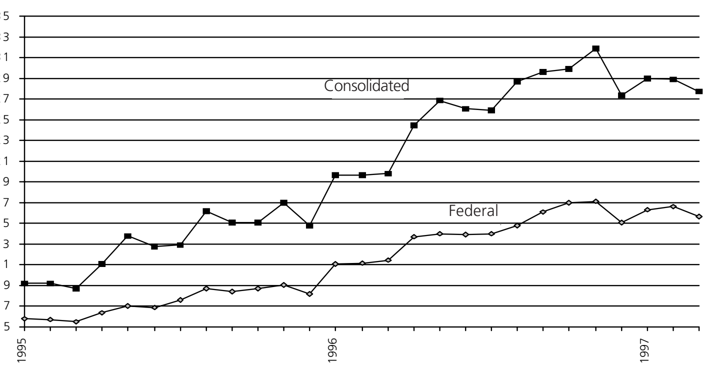
At the end of 1996 the government presented an ambitious privatisation schedule for 1997 of which the majority planned are in the oil and gas sector; to date, however, although 1,341 enterprises were privatised, the only major enterprise was Svyasinvest. (Appendix V) Unless the GKI (Russia's State Property Fund) is incredibly active this fall, it is unlikely that even half of the companies will come to market the remainder of this year. **Moreover, regardless of the sum raised, raising current cash by selling assets that are long term in nature does not significantly add liquidity to the economy.**

Tax Collection

One of the sorest points of friction between the government and enterprises remains, unsurprisingly taxes. Enterprises point out that their clients do not pay them money and hence the government demands too much in taxes. In reality, Russia's tax burden is not excessive, at about 32% of GDP, it is slightly lower than in the US and considerably less than most western and central European countries. Companies, however, tend to receive most of the brunt of the taxes since Russian authorities have found it easier to pursue them. Moreover, the current tax system is intensely complex, with about 1,000 separate and often conflicting sovereign, regional and municipal laws. It is not surprising then that wilful tax evasion is a serious and well-known problem in Russia. Despite domestic and international pressure, tax collection efforts in Russia until recently have been relatively unsuccessful. The problem is also compounded by the fact that some regions allow companies to pay taxes with *veksel*.

The State Tax Service announced that by August 1, 1997 corporate tax arrears had risen 53% to RUR 55 trillion (US$9.41 bn) from RUR 43 trillion (US$6.14bn) on January 1, 1997.

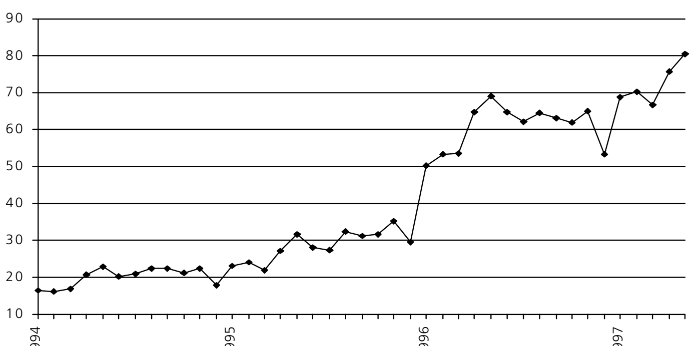
Total enterprise arrears to the budget *(RUR, trln in Aug 94 prices)*



Source: Russian Economic Trends

Looking at the chart which shows total enterprise arrears to the consolidated and federal budget might delude one into thinking that enterprise arrears to Russian authorities are declining; whereas a percentage of GDP, arrears in fact continue to be a significant portion of GDP.

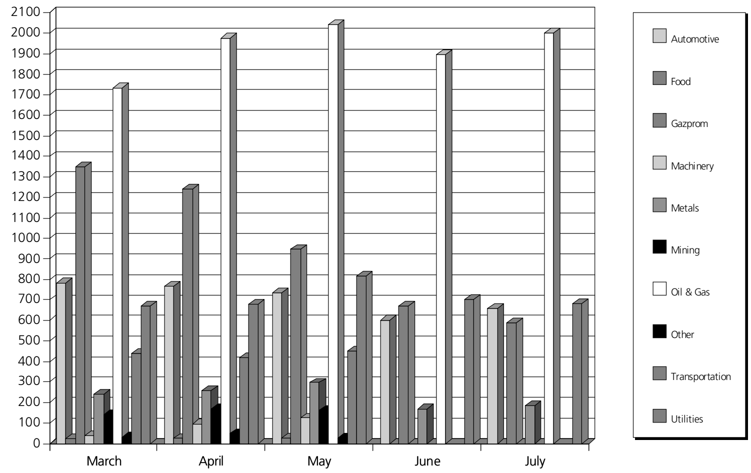
Enterprise arrears to the Consolidated Budget *(% of monthly GDP)*



Source: Russian Economic Trends, Aug 1997

As of August 1, 60 companies qualified as the highest tax debtors, that is, companies which owe more than RUR 100 bn (US$ 17.3 mm). (*Appendix VI*) They account for 44% of total enterprise arrears. From March - July inclusive, when the state tax service began publishing lists of high debtors on a monthly basis, we can see that oil and gas, Gazprom entities and the utilities sectors are amongst the highest debtors.

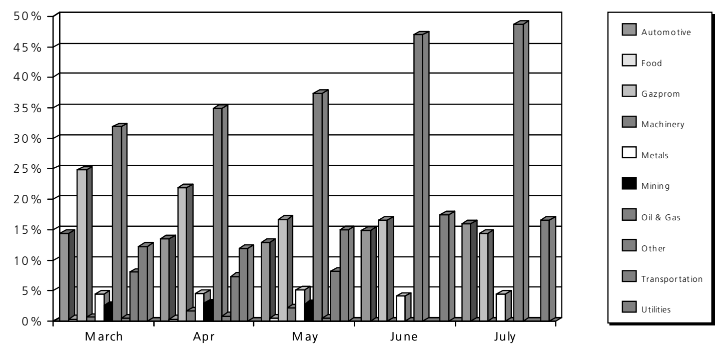
Highest Tax Debtors by month *March-July 1997*



Source: State Tax Service

By August 1, high tax debtors were in the automotive, metals, oil and gas utilities sectors. Gazprom entities have been separated out, since Gazprom debts are larger than those of many sectors.

Highest Tax Debtors by Sector, 1997 *(% of monthly total)*



Source: State Tax Service

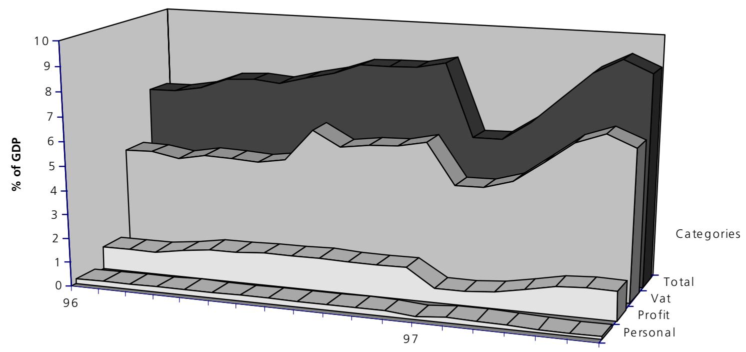
Many blame Gazprom, United Energy Systems, and the Ministry of Railroads for the growing non-payments crisis, due to their level of tax arrears. Since these entities, in turn, are creditors, the government's ability to collect taxes is further compounded. State Tax Service data, however, shows that Gazprom and UES arrears are declining and the Ministry of Railways is no longer a high debtor.

In all, 63% of the largest debtors are in the oil and gas sector. Whilst it is well known that oil and gas companies are some of the largest victims of inherited problems from the Soviet economy, many are reportedly engaged in very creative methods of tax evasion. Some schemes are simple such as transporting oil to Ukraine or Belarus for processing. The suppliers, should theoretically send the processed oil back to Russia. What often happens, however, is that products are shipped to non-existent companies in Kaliningrad, diverted to Lithuania or Latvia, and then actually sold to other European countries or the United States without paying any taxes. Some oil companies and oil trades simply sell processed oil directly to foreign companies at the refinery, while tank cars filled with sand are dispatched back to Russia. Custom formalities are settled easily, again avoiding taxes. Oil dealers are able to make about an extra US$50 dollars per ton of crude oil.

More important than the level of arrears is to examine the government's performance in tax revenue collection; regardless of the fact that estimates of tax collection rates vary significantly, they all indicate to the simple fact that the government's tax collection efforts have not been successful. **Last year Russian tax authorities were only able to collect about 50-60% of their targeted levels.**

A major issue to keep in mind is how much is being collected in "live money," as opposed to barter or promissory notes. Regions, for example, often pay their taxes through barter methods. By the end of August 1997, the State Tax Service had collected about RUR 107.2 trillion (US$18.4 bn). It is unclear how much of this was in cash, as even a public official from the State Tax Service announced that often a significant portion of taxes collected is in the form of service or goods barter. Without having to use emergency methods, on a monthly basis the (STS) collects about RUR 11 trillion (US$1.9bn) worth of cash and barter, 55% short of what the group's own estimates are for the RUR 17 trillion (US$2.9 bn) it needs to collect on a monthly basis.

Tax Collection



Source: State tax service

When analysing tax collection by type of tax, it becomes immediately apparent that personal taxes are extremely low. **Whilst the new Tax Code proposes to tax individuals based on two income brackets, enforcement of tax collection will have to be strengthened.**

To improve tax collection four major issues are critical: the implementation of the new streamlined Tax Code, budgetary provisions for improved enforcement of tax collection, removal of tax exemptions, and improvement and enforcement of bankruptcy laws. Although the new Tax Code is still being debated by various Duma committees, its implementation date is not expected until January 1, 1998, with a possible delay even into the spring. The main purpose of the Tax Code is to simplify Russia's daunting tax system by decreasing the number of taxes from 200 to 30. The government has made strides in pushing the three part code through the Duma and continues to insist that the Duma treat all four as a single entity so that the various parts of the code could be implemented all at once rather than having the Duma continue to delay further the process. The code proposes three major changes:

a. a division in personal income tax rates into two bands, 12% for those earning under RUR 60 mm (US$ 10,400) and 30% for those earning more
b. an increase in VAT from 20% to 22%
c. a unification of corporate tax at 35%, rather than at present where rates vary from region to region

Arguably, implementation of the Tax Code could reduce revenues by about US$12.5 bn, but for the longer term, it is hoped that a simplified tax code will have fewer legal loopholes and that it would encourage Russians to comply with their tax payments.

Secondly, what the government still has to accomplish is to make appropriate budgetary provisions to strengthen enforcement of the code and of tax collection. The Russian administration has empowered the State Tax Service to pursue tax delinquents, but without the necessary funds, it is not likely that neither the number of tax collectors nor the necessary safety measures for them will be increased. As is often reported in the press, being a tax collector is not the easiest of jobs given that over 20 have been killed and an unknown number have been injured. **The proposed 1998 Budget can be viewed as positive in that it makes serious attempt to increase the funding for overall legal enforcement and for improvement of the judicial system; yet given various contentious proposed cuts in the budget, it is not likely that it will pass before year end.**

Thirdly, the government has been removing certain companies' tax exemption status. Recently the government estimated that legal, state-authorised tax exemptions and offsets cost the nation approximately US$30 bn, three times the IMF loan and about 95% of the 1996 consolidated budget. Presently, the government has managed to reduce budget subsidies from 25% of GDP during 1992-1995 to 1% in the 1996 budget. Again, without enforcement, there is no guarantee that companies will pay taxes, particularly since they can argue that the subsidies were necessary for them to survive economically.

Rather than giving tax exemptions, the Russian administration is attempting a variety of incentives to encourage companies to pay their taxes. In the oil and gas sector, for example, the government recently passed Decree No. 693, "On Measures to Reduce the Indebtedness of Enterprises of the Oil Complex on Payments into the Federal Budget and State Non-Budget Funds." The decree sets up a procedure to give priority in the distribution of export quotas to oil extracting companies that are responsible in keeping current in their tax payments and which are paying off their arrears.

Fourth, clearer bankruptcy laws and enforcement thereof is necessary. The government has begun to threaten companies with Resolution 254, bankruptcy, if they do not pay their taxes and most recently is trying to force some companies to issue shares to raise funds for tax payments. Since previous threats have not worked, deliberations continue as to the potential success of government efforts. Bankruptcy threats have not worked since bankruptcy laws remain almost non-existent. In addition, given the social and economic costs involved with unemployment, government officials have been reluctant to push companies to bankruptcy. In many instances, in fact, rather than downsizing, company officials, have kept employees part-time or have sent them on vacations rather than laying them off.

Domestic Securities

In a relatively short period of time, Russia has developed a thriving domestic securities market as a source of government finance. According to Goskomstat by the end of 1996, domestic debt, defined as debt to federal and local governments and to the state Pension Fund stood at approximately 10.5% of GDP from 3.5% at the end of 1995. Russian domestic debt consists of GKOs (treasury bills, OFZs (loan bonds), OGSZs (savings bonds), KOs (promissory notes), government debt to the Russian Central Bank accumulated in 1992-94, and securitised arrears on centralised credits to agriculture and to depressed regions. Domestic debt, as a percentage of GDP, this year is expected to rise to 23%; this increase is not surprising given that the government has reiterated its interest to fund at least 50% of the federal budget deficit through domestic securities, primarily GKOs. Federal law caps 1997 Russian domestic securities issuance at US$105 billion. Declining yields in the GKO market have made these bonds less interesting to investors as some have switched into Russian equities or into promissory note trading. Nonetheless, demand in GKOs remains healthy; foreigners are estimated to buy approximately US$1 bn worth of GKOs monthly.

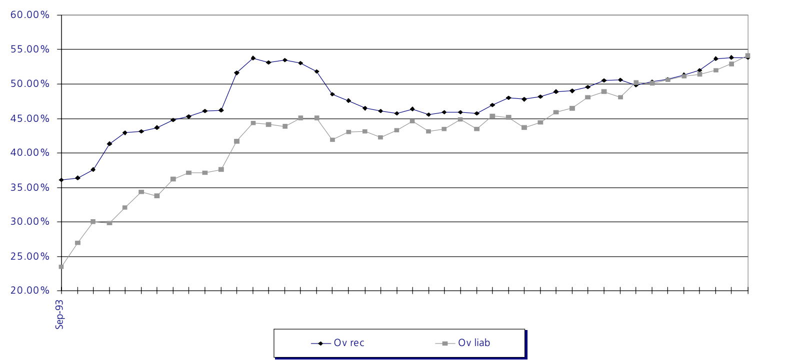
Due to economic conditions, local governments have issued municipal bonds to raise funds for their regions. Whilst the market could be more lucrative than the GKO market, it remains relatively small do to a paucity of information on regions' finances. Moreover, given that local tax regulations can be relatively confusing or contradictory with sovereign tax laws, investors have been comparatively discouraged to engage in this market.

Enterprises' liabilities

Enterprises have significant overdue receivables from customers and themselves are in arrears to suppliers and to workers. Non-payment of wages is tolerated, in particular, since it keeps unemployment down. If everyone who worked had to be paid in cash, it is likely that the current official unemployment level would be higher than 9.3%. Enterprises are also often overdue in payables to the budget and extrabudgetary funds. As part of the chain, the government is then overdue in wage payments and funds to pensioners. It is highly suspected that many Russian companies could pay their debts if they were forced to, but the Russian legal system is notoriously week. Officials can often be persuaded to look the other way and managers who shirk their responsibilities are rarely penalized enough if at all.

There is a wide range estimated of the size of 1996 inter-enterprise debt, with RUR 200 - 600 trillion (US$ 40 -120 bn) being the range often mentioned. Gazprom, itself has stated that by the end of 1996 it was owed US$6 bn by FSU republics and domestic debtors. According to the Russian Ministry of Economics, the amount of total overdue liabilities in real terms as at the end of 1996 is estimated at approximately 25% of GDP as compared to 15% in 1995.

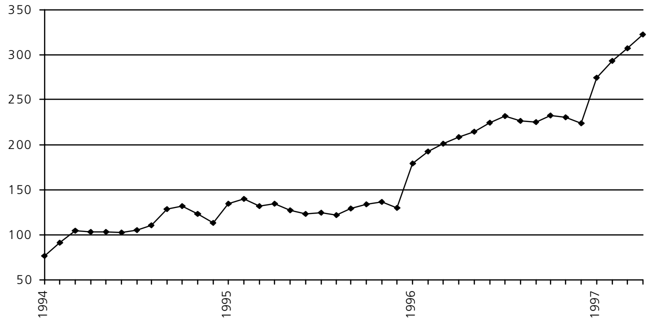
Overdue enterprise receivables and liabilities as % of total receivables and liabilities



Source: Russian Economic Trends 1997
Note: Nominal RUR trln, end period, arrears are inter-enterprise and to the budget
Sectors covered: industry, agriculture, transport, and construction

Whilst figures for this year are not complete, on a monthly basis, inter-enterprise overdue liabilities and receivables continue to be high.

Total overdue enterprise liabilities *(% of monthly GDP)*



Source: Russian Economic Trends July 1997
Note: Liabilities refer only to the industrial, construction, agricultural and transportation sectors of the economy.

In a study of 439 large and medium-sized enterprises conducted by the World Bank in 1994, the majority of liabilities were in the late categories, rather than in the bad debt portion. Unfortunately, clear information and data for 1995-present does not exist. The 1994 World Bank study on about 500 Russian enterprises' arrears problems found that there are basically three kinds of overdue liabilities, 1) those that are late but will be paid, 2) those payments which companies strategically withhold in order to receive subsidies or exemptions from the government, and 3) liabilities which will not be met and can be termed bad debts. **Although no more recent work on the subject is available, it is believed that the majority of arrears are not debts that will be defaulted.**

There have been significant changes in the structure of liabilities. During the first years of reforms its prevailing form was the mutual debts of enterprises to each other, with the proportion of total liabilities up to 80% in 1992 and 1993. Although still significant, the rate at which the volume of inter-enterprise debts is growing has slowed down; there is, however, a rapid growth of liabilities related settlements with the budget and in particular, payments to non-budget funds (this includes pensions). Despite much press coverage on wage arrears, surprisingly, the percentage of wages as part of enterprise overdue liabilities has declined; the accuracy of this figure, however, may be very difficult to ascertain due to the workers who may be receiving barter for wages.

Overdue Liabilities, %	1994	1997
To suppliers	51.0	44.0
To budget	14.0	22.0
Wages	8.3	6.0
To banks	19.0	4.0
Other (pensions, etc)	8.3	23.0

Source: World Bank and Russian European Centre for Economic Policy

A caveat for the investor when looking at company payable and receivable data, is that they may present a distorted view. First, company managers often tend to under-report receivables so as to avoid taxes. Second, if you are lucky enough to receive comprehensible data on the level of arrears a company has, managers tend to under-report the level of overdue payables they have. Third, it is important to note that payables and receivables are recorded when credit is extended, consequently, during periods of high inflation in Russia, the overdue percentage of any payable category was understated because it was usually older than the portion not overdue. As such the percentage of trade credit overdue arrears would automatically rise when inflation declines because the downward bias decreases. **Keeping the above in mind is important, but even more so is to remember that Russian enterprises until recently have had to operate in a very irrational economic system. What they do to survive is actually very rational given the circumstances.**

Resources

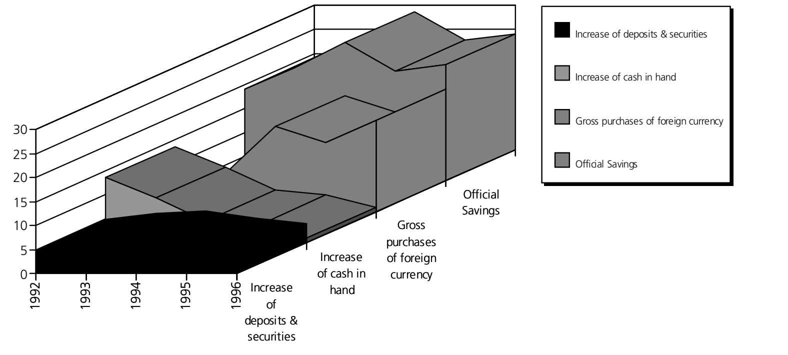
Domestic Investment

Here again is a case where the question arises, is there really a cash shortage or is the money being diverted elsewhere? Whilst many Russian companies are short on cash, others seem to be able to make profits and to even save money. According to Russian Economic Trends, undistributed after-tax profits in Russia amounted to 22.5% of GDP, compared to 12.5% in the US. Many managers, however, have preferred to invest in GKOs rather than paying their workers or investing in their own companies, particularly as the average real rate of return on new capital for most industrial enterprises is probably no more than 10-15%. In addition to GKOs, managers have exhibited a strong interest to invest abroad or to avoid taxes. In 1996, 16,000 Russian companies were registered in Cyprus alone; other preferred destinations for Russian businesses have been the Bahamas, Belize, the Cayman Islands, Liechstenstein, and Luxembourg.

In terms of receiving assistance from Russian banks for domestic investment purposes, that has also been very challenging. Russian banks and other investing entities have been reluctant to lend to local companies for four major reasons. First, as discussed previously, a significant portion of cash earning individuals and enterprises have sent money abroad or have kept it in Russia in foreign currency and undeclared to the tax authorities. Second, the actual or purported chronic shortage of foreign currency and roubles has made local entities unwilling and/or unable to invest in local companies. Third, because of the lucrative returns in the Russian treasury market, those with funds have preferred until recently to take advantage of GKO returns. Fourth, not unlike foreign investors many Russian investors have found that the companies are not transparent enough to discern whether they are worth buying. Although enterprises should benefit from declining interest rates in the sense that it may be cheaper to borrow money, the evidence as to whether banks are finally lending to enterprises is scanty at best since large Financial Industrial Groups (FIGs) have preferred buying direct stakes in companies and have begun to buy stocks in the Russian equity market. Those FIGS that buy direct stakes in companies, seem to be more occupied fighting with resistant management or with Russian courts which often have contested the legality of tenders, rather than being able to spend time and money to restructure companies.

Lack of domestic investment also does not seem to be due to lack of savings by the population. In 1997, Russians are saving approximately 23%-24% of their income. Yet, due to Russians' fear of inflation and distrust of banks and funds, they have approximately 80% of their savings in dollars and "under the mattress."

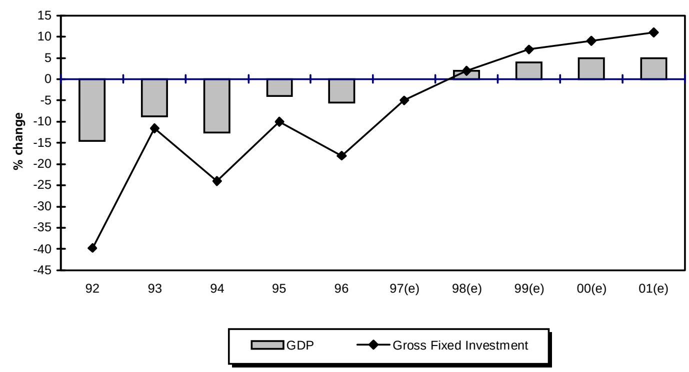
What do Russians do with their cash?



Source: Russian Economic Trends

Given that rouble household savings are 2.5% of Russian GDP, there is virtually little left for corporate investment. Gross fixed investments have been increasing relatively slowly after its abysmal decline in the early 90's. As GKO yields continue to decline, direct investment is likely to increase.

Gross Fixed Investment



Source: Goskomstat, EIU and NWM Forecasts

Enterprises' attempts to collect debt

Some companies such as UES and Gazprom have periodically threatened to cut supplies to debtor companies or countries. Yet, these threats have gone relatively unheeded. For one thing, the Russian government has stepped in to protect enterprises deemed critical to national security, such as those in the defence complex. In terms of threats to the CIS, Gazprom reportedly has recently decreased Byelorus' gas by 25%. Nonetheless, the gas giant has to be extremely sensitive about cutting supplies completely not only because of the already stressed relationship that Russia has with neighbours such as Ukraine, but also because some of these republics could retaliate by blocking Russian exports of a variety of goods which go through those republics.

As an alternative to cutting supplies, some companies have begun to sell their clients' debt to debt traders as they feel that collection of money is not likely, if at all in the near future. Gazprom announced in February that it would begin selling financial instruments representing their debts, only for cash and only at auctions. These instruments only cover debts from Russian customers; the program, thus far does not apply to CIS, Baltic or other foreign country debt to Gazprom.

Inter-enterprise debt has given rise to a significant number of debt collecting agencies in Russia. The repute of some of them is less than stellar given some of their unorthodox collection methods. Those which are legitimate, however, may actually free up cash flow in the private sector. Debt collecting business can be very lucrative since collection agencies take 10 to 60% of the debt being collected as their commission.

VEKSEL

The tremendous liquidity squeeze which government entities and enterprises are suffering has given rise to creative forms of financing, particularly in the form of *veksel*. *Veksel*, which comes from the German word *wechsel* meaning bill of exchange, have been used in Russia since the Soviet Union accepted the Geneva Convention on Promissory Notes and Bills in 1936. Until the early 90s, however, promissory notes were used only in foreign trade; since the Soviet Union had a socialist economy, there was no need for internal credit extensions or receivable securitisations. Since November 1, 1994, *veksel* were authorised to be used as a legalisation of mutual enterprise debts. Veksel are also used between government entities and companies.

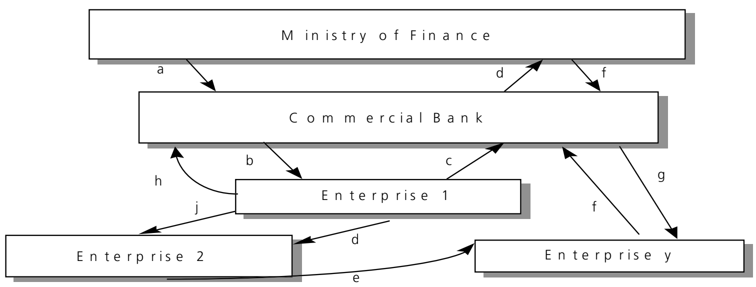
Veksel can be denominated in foreign currency or roubles. Foreign currency veksel are subject to a 1.5% reserve requirement and rouble *veksel* requirements vary between 10 -20% of principal depending on the term of maturity. *Veksel* maturity terms tend to be between 3 - 6 months, although they can be from 1 week to 1 year. One way in which companies avoid reserve requirements is by issuing veksel which are less than three months in tenor, thus never appearing in the Russian tax authority quarterly reporting requirements. Reserve requirements on rouble denominated veksel are impossible to enforce. *Veksel* interest rates on rouble *veksel* tends to be lower that on GKOs since they are subject to reserve requirements and the interest tends to be pegged to interbank and money market rates.

***Veksel* are issued mostly by:**

1. Commercial banks with guarantees from the Russian Ministry of Finance(MOF)
2. Commercial banks without Russian monetary authority guarantees enterprises
3. Enterprises
4. Local governments

The commercial banks which have MOF guarantees are Menatep, Promstroibank, Rossiyskiy Kredit, Sberbank, and Uneximbank. It is very difficult to track every link of the *veksel*. **Those with MOF guarantees are easier to track, but they do not seem to be as large in number as the ones issued by banks without guarantees or by enterprises.** Reportedly, some foreign banks are also issuing rouble and dollar denominated *veksel* in Russia.

The Life of a *Veskel*



In the best of scenarios, *veksel* function in the following concentric, costly, and time consuming manner:

a. The MOF issues a guarantee for a commercial bank loan
b. The bank gives credit to enterprise 1 with the understanding that
c. Enterprise 1 will use the credit to buy a veksel from the bank.
d. The commercial bank used the money it received for the veksel to buy GKOs from the MOF; simultaneously enterprise 1 uses its veksel to purchase goods from Enterprise 2
e. Until maturity the *veksel* is used by a number of enterprises to purchase a variety of goods and services. The chain ends at maturity when the veksel ends up with Enterprise Y
f. Enterprise Y will now present the issuing commercial bank with the veksel.
g. The commercial bank sells its GKOs and pays Enterprise Y with cash.
h. At about the same time, Enterprise 1 pays back the original credit to the commercial bank; what can often happen is that Enterprise 1 cannot pay the credit and will issue a veksel itself, beginning the chain again

The issue size of the veksel market is impossible to measure since reliable information exists only on commercial bank guaranteed issues. *Vekse*l issued by regional governments and enterprises are not tracked. According to the Central Bank of Russia, by mid-last year, authorised commercial banks had issued about US$4 billion. Yet, market participants' estimates for all *veksel* issues outstanding range as high as US$60 billion; this figure suggests that spontaneous corporate credit creation is even more significant than government borrowing through the popular GKOs (Russian treasury bills) market. A major international law firm has estimated that approximately 60% of all payments in Russia are securitised by *veksel*, which are often used to pay taxes as well as other debts. Each veksel can change hands countless of times and can be utilised to pay varying levels of debt. One of Russia's large promissory note issuers and brokerage trading house, for example, estimates that its issue of RUR 700 bn has been used to settle debts of RUR 4 trn.

Also intensifying the growth of the veksel market is the fact that not only are there regular *veksel*, but now some sectors and regions are beginning to issue their own specific veksel. The energy sector, now has an "energy rouble," a promissory note traded between energy suppliers and their debtors. Since June 1996, Ministry of Fuel and Energy issued approximately RUR 18 trillion worth of promissory notes with a 2 year maturity and rates of 18 - 20%. Regions have also issued about RUR 386 bn (US$66m) veksel to cover agricultural debts; they yield about 27-28%.

Issuers and traders of *veksel* cite a number of advantages to the veksel. First, they give companies liquidity to enable them to carry on their day to day transactions. Second, since only the issuer and redeemer of the notes are stamped on the note, any intermediary users are able to avoid tax. Most veksel are not taxed since issuers can issue veksel which are less than three month in tenor, thus never even appearing in the quarterly reports required by Russian tax authorities. Third, although a *veksel*'s function can be compared to a bank deposit, it has the advantage that, unlike that money market instrument, it can be redeemed for cash roubles and there are full re-endorsement rights since the veksel is an unconditional obligation of the issuer. For traders, veksel are more attractive than GKOs. *Vekse*l, unlike GKOs can be used as collateral. There is also no restriction to repatriating any gains on veksel trading.

Whilst some company representatives and market participants consider liquidity and tax avoidance as great advantages to the veksel system, the actual and potential disadvantages should not be dismissed lightly. The market both for issuance and trading of the veksel is highly unregulated. Regulators' major concern is a possible non-payment crisis which could be caused by the strong domino effect of collapsing business given the intertwined nature of debts. One way in which a crisis could come about is that given the nature of the market, there has been a significant rise in the issuance of counterfeit *veksel*. At the time of redemption an issuing entity could be presented with limitless multiples of the bills it actually issued, without a way to discriminate the counterfeit ones. Thus far, there does not seem to a significant level of *veksel* defaults.

Even the *veksel* which have guarantees are not safe as was demonstrated with the fall of Tveruniversalbank in July 1996. At the time of the Tveruniversalbank's collapse, it had RUR 800 billion (US$1.5 million) worth of outstanding bills; this was 300% of its shareholders' capital. Tveruniversalbank's *veksel* were accepted as payment by 2,500 Russian companies and to cover local taxes by 42 regions. Russia's Civil Code places *veksel* holders third or fourth in line of creditors when a bank collapses; creditors may sue but it is unlikely that they would be able to recuperate their investments. The collapse of Russia's 17th largest bank triggered regulators into action. First, the Russian Central Bank took over management of the bank's activities and second, Russian authorities have begun to increase regulation of the veksel market. The Russian Central bank instituted regulations effective October 1996 requiring banks to restrict their issue of *veksel* to 200% of their shareholders' capital and to 100% as of March 1997. In addition, the central bank is trying to establish a clearing house system for *veksel*. Despite attempts by the Central Bank of Russia, the Federal Securities Commission, and the Association for Participants in the Promissory Note Market to restrict the issue and the trading of veksel, the market remains highly unregulated. **It is important for the investor to keep in mind that in the last few years there have been dozens of laws that have been heralded by the international community as steps in the right direction, but enforcement thereof has been slow to materialise if at all.**

Those more concerned with the government's tight monetary policy are focused on the potential inflationary effects of *veksel* issue. To a certain extent the uncontrolled and unregulated growth of *veksel* issuance is a form of printing money. Arguably, current levels of Russian inflation might be higher if *veksel*, barter exchanges and arrears were monetised.

In the longer term, the debt from moribund enterprises which have been kept artificially alive due to *veksel* will place a heavy constraint on the credit structure of the entire economy. So long as a significant portion of Russian companies continue to lack transparency, it will be a while before we know how weak some of them probably are.

Barter

As the payments crisis has intensified, Russian government entities and enterprises have been engaging in Soviet-style barter, a time consuming payment method whose transaction costs are very difficult to determine. Russian monetary authorities' estimates are that 30% - 70% of all domestic federal and regional government and company transactions are settled through barter. The Russian European Centre for Economic Policy, a research unit sponsored by the European Union, estimates that barter rose as a proportion of all industrial sales from about 10% in 1993 to 40% by the end of 1996; whilst the Centre has not published data for 1997, analysing statements by company management and Russian authorities, barter continues to rise. While many companies operate through barter because they are short of cash, it is suspected that barter is also a good tax evasion mechanism.

Whilst serious attempts have been made to raise US$ and rouble sources, and to decrease the issue of and regulate *veksel*, barter between enterprises, companies and workers, and government entities continues unabated. Enterprises pay each other and their government obligations by a variety of goods swaps — trucks for boots, vacuum cleaners for oil pipes, etc, and service swaps—construction companies paying for taxes by building hospitals, utility companies providing electricity in lieu of telephone payments, etc. Sometimes a number of personnel are required to determine what goods to exchange for product or services deliveries. Often when personnel, dedicated to expending long hours and significant amounts of paperwork to organising and monitoring barter deals are asked how they develop a pricing mechanism for barter transactions, they cannot give concrete answers but simply say they know how to determine the exchanges. One of the most significant challenges in analysing Russian accounts is trying to determine where, if any where, barter is accounted for. Given the current transition of Russian accounts from cash to accrual, the challenge of gleaning this information is made even more difficult.

Barter is also pervasive in the service industry. Some movie theatres in Siberia, for example, charged two eggs for admission; this became a problem during the winter when hens lay fewer eggs and movie fans, who were short of money to begin with were now having egg shortages. Ingenuity not being in shortage, the movie theatres now take empty bottles as admission.

There are no figures for what the percentage of workers' salaries are paid through barter. Press reports abound of workers receiving sausages, televisions, and a variety of other consumer goods in lieu of wages. At times the barter goods are useful because they are edible or easily traded for other items, at other times unfortunately barter's value is more limited, not to mention the many shoe soles worn out by walking to and from markets to sell barter goods. A recent example of this happened in August when the Voskhod clothing plant in the coal region of Kemerovo attempted to pay workers with coffins. Not only were workers completely opposed to this form of payment, but such an offer begs the question, why and how did a clothing plant have a surplus of coffins? The workers negotiated to take grocery carts instead because they could at least use them to cart vegetables from their land plots. Not only can an economy not sustain itself in this manner, it is difficult to measure the inevitable decline in worker morale and how it most undeniably decreases work incentive and efficiency and productivity.

Barter is pervasive not only between Russian entities, but also the government is engaging in international barter. Despite the fact that Russian authorities have attempted to reduce barter with international counterparties, it is estimated that barter deals account for approximately 7.8% of 1996 international trade; this a 6.2% from 1995. Approximately 2/3 of the barter was conducted with CIS countries, although barter is also particularly popular with China and Cuba. Usual barter transactions are Russian oil and energy products for metal and sugar. India is another example of a nation with which Russia has to continue utilising barter to recuperate some of its debt. India owes Russia approximately US$8 billion; this debt had been incurred from 1955 - 1990 for defence and civilian goods provided by the FSU. To begin repaying that sum, India signed an agreement in 1993 to export goods to Russia for ten years. Russia is pursuing similar arrangements with the likes of Angola, Cuba, and Mozambique.

As a politically potent alternative to collecting hard currency, since 1993 the government has encouraged debt-for-equity swaps with CIS republics. This campaign has been at least moderately successful, but the immediate result is not hard cash for the government. Gazprom, in conjunction with the Russian administration, is one of the major energy entities involved in these transactions such as acquiring 51% of the Moldovan gas pipeline as partial forgiveness for Moldova's debt.

International barter is not reserved only for developing nations. Russia has also resorted to try to make arrangements with countries like the US. In 1993, for example, the government promised NASA US$100 million to build a US$43 billion space project. This March, however, NASA officials began entertaining creative financing methods as there is yet to be any evidence that the Russian government can pay its bill. The space agency has begun exploring ways in which Russia could pay for its share with oil, natural gas, or by leasing advanced technology from the US. At present, US congressmen and Texas oil men are exploring a variety of ways in which this barter arrangement could be transacted.

Accounts Receivable - No Payment?

At this stage very few companies have actually defaulted on payments due to the use of *veksel* and barter. Another reason for the lack of defaults is that bankruptcy laws are not clear or enforceable . A bankruptcy law has existed since 1992, but its lack of enforcement is seen in that less than 1,000 companies have been declared bankrupt. Often government authorities, themselves, oppose bankruptcy due to the fact that they know that they cannot afford to pay unemployment benefits or cope with all the social costs associated with most Russian companies. Once laws are strengthened which allow companies to declare bankruptcy or when the government stops bailing out companies, accounts receivable turning into "no payment" could become much more prevalent.

What is to be done?

The premise behind all international equity investment in Russia is that the period of bad economic news will come to an end reasonably soon. The economy is supposed to move from shrinkage and stagnation to growth. The cash economy is supposed to become uniform and ubiquitous. In this expected better world, all the problems just discussed will disappear. Everything will be changed, and the real economic potential of the enterprises will start to be realised. The economic losses which are now generated by almost every traditional corporate structure will be replaced by quite conventional profits, to be invested in further growth or remitted to grateful shareholders.

Whilst utopia is probably not just around the corner, we believe that fundamental economic and political improvement is indeed likely in Russia. The key questions for investors now are the level of expected profits, whenever they do appear. No definitive answers are possible as we cannot really forecast the national level of profitability or the division of profits within the economy. Current financial accounts provide only limited relevant information on these questions. Reported profits are probably even less relevant than the hard currency and rouble cash flow as indicators of future profitability. Current political information is all that is available, but between here and stability, a change of the political-economic power structure is likely. Corporate social obligations are likely to change significantly, so today's major drag could be cut out completely tomorrow.

Given the purported and actual shortage of cash in the economy, the importance of monitoring various aspects of companies becomes even more salient, no list could ever be exhaustive. **In terms of macroeconomic issues, we recommend that investors continue to monitor closely issues pertaining to tax collection efforts and the 1998 Budget.** Whilst aspects of the 1998 budget are extremely positive, such as increased budgetary allocations for legal enforcement and judicial reform, the success of the Budget is highly contingent on implementation of the new Tax Code, not to mention the Budget itself. Debates in the Duma and the Federation Council over both of these proposals remain contentious at best of times. Even when the Tax Code is implemented, we should continue to monitor whether tax collection rates are actually improving. Given that companies are increasingly being pressured to devise measures to pay their taxes, we are optimistic that at least enterprises will increasing fulfil their tax debt responsibilities.

We need to see the impact of foreign loans. Fixed income markets, in particular, but also the Russian equity market tend to be well-supported when announcements are made that Russia receives a foreign loan. More attention, however, needs to be given to not only the amount of the loan but more importantly to whether we are seeing fruitful results from the loans. Whilst it is possible to track loans issued to Russia, it is much harder to track the actual results.

Observing foreign direct investment levels is not enough. Investors need to know where the investments are going in terms of region and sector, as the allocations tend to differ significantly. In terms of local direct investment, expectations remain that as GKO yields decline enterprises should be able to borrow locally. In addition, a close reading of banking financial accounts should give the investor preliminary information as to whether banks are lending to Russian enterprises.

Company management is critical. Whilst this may seem obvious, many equity reports do not give enough time, if any, to some serious analysis of the quality of management in Russian enterprises. We sometimes seem to forget that Russian companies are run by people, and that their influence on the profits that investors hope to reap is enormous. Who are the managers? What experience do they have? What is their strategy, and whom do they recruit to execute their plans? We need to analyse more carefully issues such as how much do company mangers get paid and how big is the disparity with their professional colleagues and workers. Does management have plans to have incentive or bonus schemes for their staff? How are personnel recruited, evaluated, promoted, etc? Is their training or on going education? What is labour mobility like?

There is a need to focus on basic industry economics. The cost of production in less developed countries ultimately depends more on technological and capital infrastructure than anything else. These assets are relatively slow to change and easy to understand. All things being equal, corporate profits will vary in relation with technological sophistication. Certainly, all things are not equal in Russia, but in a blizzard of monetary confusion, equipment and management provide goods points of reference.

International investors should focus on the hard currency accounts of their potential investments, rather than only the Russian accounts. In other words, they should look at the ability of the companies to generate hard currency through exports. This dollar generation is related to rouble generation, but in an economy of rouble evaporation and limited rouble convertibility, the hard cash provided is particularly important to the hard cash providers. Goods which cannot be exported and inconvertible roubles are of dubious investment value.

Rouble cash flow is also important. Whilst in previous years, confidence in the rouble was almost non-existent, that situation has changed. Russian monetary authorities are justifiably proud of their ability to maintain a stable currency in the rouble corridor. Investors should continue to observe currency movements and also the pace at which the rouble becomes fully convertible.

We should continually improve our international benchmarks. Too often, many have often argued that Russia is *sui generis*. As such initial investments into the country were made on the basis of excitement about the Iron Curtain falling and because assets were cheap. These reasons can no longer underpin sound investments. Even while accounts are muddled, comparisons to suitable domestic and international, both emerging and developed peers should be made. If more serious attempts are not made to analyse Russian companies with the same rigour one would an international company, investors run the risk of ending up with *sui generis* kinds of "profits."

Observing the intangibles is also very useful. There are some observations which could perhaps never be put into a technical valuation model which nonetheless can be invaluable to an investor. For example, often Russia observers and the media get excited that Russia has many young people running banks and enterprises, but what is the ratio of young enthusiastic reformers to experienced professionals who actually can drill oil, install electricity capacity, or who can plant crops? When managers talk about having accessed or accessing capital markets, where have the funds gone or are going? Often even counting the number of foreign cars and observing the flashy nature of new offices may tell the investor a lot; perhaps it is worth setting up ratios of cost of new cars, buildings, and furniture as a percentage of expenditures going to train personnel or to buy new useful equipment?

What about calculating the number of pictures of Stalin hanging on walls and number of hammers and loose screws lying around in an automotive factory as a percentage of car production or more importantly car sales? What can be deduced, for example, when one walks into a utility company where the lights are all out and where long distance phone calls cannot be made, because service has been cut off? In the utilities sector, a useful ratio would perhaps also be the number of pipes with leaking water (causes which cannot be explained by the head engineer) to solid looking pipes.

In addition to keeping the above in mind, it is important to keep Russia's development in perspective. The Russian government is making significant strides in this historically unprecedented economic transformation to accelerate the drivers to alleviate the cash problem - reigning in inflation, presenting a realistic 1998 Budget, pushing through a new Tax Code, creating budgetary provisions to improve tax collection enforcement, and devising methods to help companies resolve their arrears problems. Whilst we believe that the government is working to resolve this problem, to attempt to predict exact timing might be to tempt fate. Nonetheless, we are confident that Russia is on the right path to being able eventually to spare more than a rouble.

Appendix I

Government Eurobond Issues

Entity	Amount, US$ mm	Tenor, yrs	Timing	Lead
Issued				
Sovereign				
US$	1,000	5	11.96	JP Morgan/SBC Warburgs
DM	1,300	7	3.97	CSFB/DMG
Cities				
Moscow	500		5.97	Denholm Hall
St. Petersburg				
PIPELINE				
Sovereign				
US$	3,400		1998	JP Morgan/SBC Warburgs
Cities				
Moscow	500	5-10	4Q97	CSFB/Nomura
St. Petersburg	100-300	2-5	1Q98	Salomon Brothers
Region				
Altai				
Astrakhan	100		1Q98	
Chelyabinsk	100			Morgan Stanley
Irkutsk	80-100		1Q98	ING Barings
Komi	200	5		SBC Warburgs
Krasnogarsk Oblast				
Leningrad				
Moscow Oblast	400	3-5	9.97	SBC Warburgs
Nizhny Novgorod	75-100	5		ING Barings/MC-BBL
Omsk			1Q98	
Oryol	35-40	3		Societe General
Perm Oblast	150-200		1Q98	Morgan Stanley
Samara	250-500	3-5	4Q97	Goldman Sachs
Sverdlovsk	100	5	10.97	West Merchant
Tatarstan	200	3-5	10.97	ING Barings
Yekaterinburg	20	3 mo		Inkombank
Yakutia	200-500	3-5		
Yamalo Nenets	250	1Q98	4Q98	

Note: Blanks have been left where information has not been confirmed publicly; Q=quarter, H=half

Appendix II

Pipeline of ADRs

Company	Stock	Level	Date expected	% in ADR form	Sector
Avtovaz	Ordinary	I	98		Automotive
GAZ	Ordinary	I	10.97		Automotive
Inkombank	Ordinary	II	4Q97		Banking
Babayevskoye	Ordinary	I	4Q97	10	Food
Uralmash	Ordinary	I	1Q98		Machinery
Nizhny Tagilsk	Ordinary	I	11.97		Metals
Norilsk Nickel	Ordinary	I			Metals
Bashneft	Ordinary	I	98		Oil and Gas
Chernogorneft	Ordinary	III	1H98		Oil and Gas
LUKoil	Ordinary	II			Oil and Gas
LUKoil	Ordinary	III			Oil and Gas
Megionneftegaz	Ordinary	I			Oil and Gas
Neftekhimbank	Ordinary	I	1Q98		Oil and gas
Nizhnekamskshina	Ordinary	I	1Q98		Oil and gas
Purneftegaz	Ordinary	I			Oil and Gas
Sibneft	Ordinary	I	1Q98		Oil and Gas
Sidanco	Ordinary	I	1Q98		Oil and Gas
Slavneft	Ordinary	I	1Q98		Oil and Gas
Surgutneftegaz	Preferred	I	4Q97		Oil and Gas
Tatneft	Ordinary	III	4Q97		Oil and Gas
YUKOS	Ordinary	I	1H98		Oil and Gas
Kubanelectrosvyaz	Ordinary	I	4Q97		Telecoms
Nizhnisvyazinform	Ordinary	I	98		Telecoms
Rostelecom	Ordinary	II	4Q97		Telecoms
Samara Svyazinform	Ordinary	I	98		Telecoms
Tyumentelekom	Ordinary	I	10.97		Telecoms
Aeroflot	Ordinary	I	9.97		Transport
Chelyabinsk Tractor Plant	Ordinary	I			Transport
Primorsk Shipping	Ordinary	I	9.97		Transport
Bashkirenergo	Ordinary	I	98		Utilities
Kuzbassenergo	Ordinary	I	9.97		Utilities
Mosenergo	Ordinary	I			Utilities
Sverdlovenergo	Ordinary	I	4Q97	26	Utilities
UES	Ordinary	I			Utilities

Note: Blanks have been left where information has not been confirmed publicly; Q=quarter, H=half

Appendix III

Pipeline of Corporate Eurobond Issues

Company	Sector	Amount, US$ mm	Tenor, yrs	Timing	Lead
GAZ	Automotive	100		11.97	
KAMAZ	Automotive	100			
Avtobank	Banking			4Q97	
AvtoVAZ	Banking				
Inkombank	Banking	200		11.97	Goldman Sachs
Menatep	Banking			1Q98	
Mosbiznesbank	Banking	100		1Q98	
Probiznesbank	Banking	30		1Q98	
Promstroibank	Banking	50-100			CSFB
Uneximbank	Banking	100-200			
Vneshtorgbank	Banking			4Q97	Chase Manhattan
Red October	Food	27	3	4Q97	CSFB
Almazil Rossii-Sakha	Metals	350	3-5	4Q97	SBC/Smith Barney
Gazprom	Oil and Gas	1,000		98	Goldman/ABN Amro
LUKoil	Oil and Gas			1Q98	
Tatneft	Oil and Gas	200-300		4Q97	Dresdner Kleinwort Benson
MGTS	Telecoms	150		4Q97	Salomon Brothers/GUTA
Rostelecom	Telecoms				Merrill Lynch
Aeroflot	Transport	100			Salomon Brothers
Irkutskenergo	Utilities	150		4Q97	SBC Warburgs
Mosenergo	Utilities	150	5	9.97	Salomon Brothers
UES	Utilities	200		1Q97	DMG/Renaissance

Note: Blanks have been left where information has not been confirmed publicly; Q=quarter, H=half

**Alpha issued through its own special vehicle registered in Holland.*

Appendix IV

Corporate Syndicated Loans

Company	Amount US$, mm	Pricing over LIBOR, %	Sector	Signing date
Alfa Bank	40	5 ½	Banking	2.97
Bank Imperial	25	3 7/8	Banking	3.97
	25	3 7/8	Banking	3.97
	50	3 7/8	Banking	7.97
Industry and Construction Bank, St. Petersburg	50	5	Banking	6.97
Inkombank	25	4	Banking	1.97
	27	4.37	Banking	4.97
	115	4 ¼	Banking	8.97
International Finance Co	35	4 1/4	Banking	3.97
International Moscow Bank	30	5 1/4	Banking	4.97
	50	3.55	Banking	7.97
Interrosimpex	50		Banking	4.97
Konversbank	21	4 3/4	Banking	8.97
Menatep	80	3 7/8	Banking	8.97
Menatep	25	5 1/2	Banking	12.96
Mezhkombank	30	5 1/4	Banking	2.97
Mosbusinessbank	40	4 3/4	Banking	2.97
	80	4 ½	Banking	5.97
	20		Banking	10.95
	24	5	Banking	10.96
Most Bank	30	4 1/2	Banking	7.97
Rosest Bank	30	5	Banking	6.97
Rossisky Credit	50	4 1/2	Banking	2.97
	25	4 3/4	Banking	2.97
	125	4	Banking	8.97
	21	5 1/2	Banking	9.96
Stolichny Bank	55	4 1/2	Banking	3.97
Tokobank	60	3.7	Banking	8.97
	85	4 1/2	Banking	11.96
Uneximbank	50	3	Banking	2.97
	50	4.125	Banking	4.97
Vneshtorg Bank	120	3.7	Banking	5.97
Vozrozhdenie Bank	30	5.13	Banking	6.97
Gazprom	2,500	2	Oil and Gas	2.97
	100	3 1/4	Oil and Gas	5.97
	200	3	Oil and Gas	5.97
Tatneft	90		Oil and Gas	8.97
Rostelecom	100		Telecoms	

Note: Blanks have been left where information has not been confirmed publicly; Q=quarter, H=half

Appendix V

i r P Schedule

(Highlights of major enterprises)

Company	Sector	Timing	Type of Sale	Stake for sale, %
Planned				
Aeroflot	Transport	4Q98		
Archangelsky	Pulp and Paper		Cash Auction	20.00
Artelekom				
KomiTEK	Oil and gas	9.97		21.70
LUKoil	Oil and gas		Investment tender	15.00
			options	4.97
		2Q98		6.6
Mechel		98		15.0
Nizhny Novgorod Nefteprodukt	Oil and gas		Investment tender	18.30
Nizhny Novgorod Nefteprodukt	Oil and gas		Cash Auction	23.40
Norsi Holding	Oil and gas	4Q97		40.00
Norsi refinery	Oil and gas			45.5
Novolipetsk	Metals	98		14.9
Novoship	Shipping		Cash auction	5.34
Novomoskovskvythkhim	Retail		Cash auction	20.00
Orenburgneft	Oil and gas	3Q98		85.00
Pervouralsk Tubes	Metals			.2800
Rogosstrakh	Insurance			50.00
Roslesprom	Pulp and Paper			
Rosneft	Oil and gas	8 - 9.97		51.00
Sheremyetevo Airport				100.00
Sibur				
Ural-Siberian	Oil and gas		Investment tender	36.20
Slavneft	Oil and gas	4Q97		2.17
		98		48.8
Sovkomflot	Shipping	4Q98		50.00
Surgutnefteavtomatika	Oil and gas			17.24
Svyasinvest		2Q98		25.0
TNK Tyumen Oil Company	Oil and gas	4Q97		48.70
Transneft		3Q98		50
Transneftprodukt		3Q98		
Tverenergo	utilities			
VNK				
Eastern Oil Company	Oil and gas	postponed		51.00
Vostsibneftegaz				
(East Siberia Gas & Oil)	Oil and gas	4Q97		38.00
Western Siberia Metals		4Q98		14.3

Note: Blanks have been left where information has not been confirmed publicly; Q=quarter, H=half

Appendix VI

Top 60 Debtors as of August 1, 1997*

Company	Sector	RUR bn	US$ mm	Proposed Resolution
AvtoVAZ	Automotive	2776.04	475.18	To transfer 50% of the shares to the government for sale to the public
GAZ	Automotive	445.97	76.33	
Moskvich	Automotive	265.26	45.40	
UAZ	Automotive	350.02	59.91	
Achinsky Glinozemny Kombinat	Metals	113.55	19.43	
Severonikel	Metals	143.32	24.53	
Almazy Rossi Sakha	Metals	156.66	26.81	
Norilsky	Metals	658.2	112.6	
Chernogorneft	Oil & Gas	198.99	34.06	
Kavkaztransgaz	Oil & Gas	175.76	30.08	
Komineft	Oil & Gas	408.93	69.99	
Kondpetroleum	Oil & Gas	806.89	138.1	
Krasnodarnefteorgsintez	Oil & Gas	135.23	23.14	
Kubangazprom	Oil & Gas	268.4	45.94	
LUKoil-Permneft	Oil & Gas	211.48	36.19	
LUKoil-Zapadnaya Sibir	Oil & Gas	822.75	140.83	
Moskovsky NPZ	Oil & Gas	507.02	86.78	
Mostransgaz	Oil & Gas	136.66	23.39	
Nizhnevartovskneftegaz	Oil & Gas	857.23	146.73	
Norilskgazprom	Oil & Gas	310.11	53.08	
Norsi	Oil & Gas	373.1	63.86	
Novokuibyshevsky NPZ	Oil & Gas	429	73.43	
Noyabrskneftegaz	Oil & Gas	1453.31	248.76	Issue more shares
Omsky NPZ	Oil & Gas	719.32	123.12	
Orenburgneft	Oil & Gas	629.39	107.73	
Orenburggazprom	Oil & Gas	121.41	20.78	
Rosneft-Puneftegaz	Oil & Gas	115.33	19.74	
Rosneft-Sakhalinmorneftegaz	Oil & Gas	102.47	17.54	
Samaraneftegaz	Oil & Gas	557.86	95.49	
Samaratransgaz	Oil & Gas	270.02	46.22	
Slavneft-Yaroslavnefteorgsintez	Oil & Gas	133.3	22.81	
Syzransky NPZ	Oil & Gas	133.23	22.80	
Tomskneft	Oil & Gas	337.19	57.71	
Tomsktransgaz	Oil & Gas	184.54	31.58	
Tyumentransgaz	Oil & Gas	421.02	72.06	
Uraltransgaz	Oil & Gas	835.07	142.94	
Urengoigazprom	Oil & Gas	383.92	65.717	
Tatneft	Oil & Gas	238.1	40.75	
Volgotransgaz	Oil & Gas	623.86	106.78	
Yamburggazdobycha Gazprom	Oil & Gas	513.66	87.92	
Yuganskneftegaz	Oil & Gas	1411.54	241.61	YUKOS plans to issue oil backed bonds by year-end
Varyoganneftegaz	Oil & Gas	191.74	32.82	
Tebukneft	Oil & Gas	113.18	19.37	
Altaienergo	Utilities	161.57	27.65	
Bashkirenergo	Utilities	126.26	21.61	
Irkutskenergo	Utilities	100.72	17.24	
Kolymaenergo	Utilities	123.99	21.22	
Kominenergo	Utilities	117.26	20.07	
Krasnoyarskenergo	Utilities	210.62	36.05	
Kuzbassenergo	Utilities	444.07	76.01	
Nizhnovenergo	Utilities	136.99	23.44	
Novosibirskenergo	Utilities	108.32	18.54	
Orenburgenergo	Utilities	117.24	20.06	
Permenergo	Utilities	201.33	34.46	
Sverdlovenergo	Utilities	504.16	86.29	
Tatenergo	Utilities	463.27	79.29	
Tyumenenergo	Utilities	325.86	55.77	
Saratovenergo	Utilities	144.97	24.81	
Omskenergo	Utilities	137.23	23.49	
UES	Utilities	564.46	96.62	
TOTAL		24028.35	4113.03	

Note: Companies are placed in a high tax debtor category when they owe more than RUR 100 bn(US$ 17.12 mm); Blanks have been left where information has not been confirmed publicly

Source: State Tax Service, September 4, 1997