

**ROY DEN HOLLANDER**  
COUNSELOR AT LAW

545 East 14th Street - Suite 10 D  
New York, New York 10009  
(212) 982-5836  
Fax Number: 212-982-5943

---

July 24, 1992

Mr. Alexander Posadsky, Director Executive  
ACEM  
20/12 Podossensky Per.  
Moscow, 103062, Russia

Dear Alexander:

In accordance with our meeting in Moscow, I am providing you with a written critique of the European Community's ("EC") proposed Technical Assistance Program for the USSR, which is now presumably for the CIS. I have also enclosed a copy of a brochure from a private organization, Financial Services Volunteer Corps, that works closely with the U.S. Department of State in providing technical assistance. The U.S. Government is still developing its Technical Assistance Program. The enclosed USAID Factsheet lists the only projects authorized thus far. As you can see, the U.S. Government has decided so far on only the broad general objectives. When I receive more information, I'll let you know.

**CRITIQUE OF THE EC TECHNICAL ASSISTANCE PROGRAM**

This critique follows the format of the EC document in that my comments are organized to refer to each section and subsection in the order that they appear in the document. Any section or subsection that is not addressed means I do not have any criticism of those proposals.

**1. Technical Assistance for Economic Reform**

U.S. Government and business leaders at the U.S.-Russia Business Summit (which I attended on June 17) also emphasized the development of Russia's financial services, energy, transportation and food distribution sectors. Such sectors are important and need to be developed, but they should not be developed in order to mainly facilitate U.S.-European exports and the extraction of Russia's raw materials.

U.S.-European interests want a banking system that permits the use of hard currency investments to extract natural resources from Russia. A foreign extractive enterprise needs to transfer funds by wire into a Russian bank from which funds can be drawn to buy mineral rights, service equipment and pay its workers and other operating costs. A foreign extractive enterprise needs a banking system that can provide reliable and fast transfers of funds and execution of payments. The U.S. and Europe's primary interest, therefore, does not include developing a banking system that provides financing for indigenous manufacturing or service enterprises.

The "free world's" largest and most powerful enterprises are energy companies. These companies are constantly searching for more oil and natural gas at inexpensive prices. Today they see Russia as a source of inexpensive oil and gas. Russia needs money. The large energy companies, therefore, believe Russia will allow them to maximize profits by not requiring investment in environmental safe guards, not paying Russian workers a salary comparable to oil workers in other countries and not requiring a significant share of the profits. One way for Russia to profit from foreign operations is to construct a deal similar to the Chevron oil deal with Kazakhstan. That country wisely acquired a 50% ownership interest in the project that entitles it to 50% of the profits and another 30% of the profits as compensation for the oil extracted. An even better deal would provide Russia a percentage of a project's revenue. This would avoid "creative" accounting by American corporations that diminishes a project's profits as reported in the financial statements.

One reason the International Monetary Fund (IMF) wants Russia to raise prices on energy is because the IMF knows Russians could not afford the increased prices and would cut consumption. This would increase the amount of oil and gas available for the Western companies to sell around the world, which would, of course, add to their profits.

The West wants a transportation system in Russia similar to that in Europe and the United States -- a sprawling system of concrete highways, paid for with taxpayers dollars and over which trucks and cars can transport goods and people using gasoline as fuel. The larger the highway system, the more cars and trucks, the more fuel used, the greater the profits for the automobile and oil companies and the greater the pollution. On the average, trucks use six times more energy to transport goods than railroads. That means the oil companies can sell six times more fuel to the trucking industry than the railroad industry. Presently, trains that run on solar energy are being developed, so the consumption of fuel may be even less in the future. Russia would be better served with an expanded railroad system. The amount of oil

needed to be extracted or imported would be less, pollution would be less and large portions of your country would not be covered with concrete.

The opening to foreign vessels of riverways for transportation of goods and people should require strict environmental controls so these foreign vessels do not rinse the residue of their delivered goods or human waste into Russia's waterways. New York's Hudson River had such a pollution problem before the enactment of environmental laws.

The U.S. exports \$40 billion a year in agricultural products. The U.S. does not want another competitor in the form of Russia as an exporter of agricultural products to the world. Actually, what America wants is another consumer of its agricultural products. Russia's food distribution system needs development, but so does its food production. The U.S. would rather see Russia with a modernized food distribution system and an antiquated food production system. This would prevent competition from Russian agricultural products but still allow America to sell and distribute agricultural products throughout Russia.

## 2. Implementation

Since the C.U. will run the Technical Assistance Program and the C.U. reports to the coordinating authority, I would hope Russia, and not the Commission, has the final say within the coordinating authority.

## 4. Energy

### General Objectives

The EC's desire for a legal and regulatory framework that will attract foreign investors means the EC wants a free market in which oil and gas companies can maximize profits. Right now, Halliburton, an oil and gas servicing corporation, sees Siberia as wide open for business, which means they believe they can do just about what they want to maximize profits -- pay low wages, pollute, etc. If Halliburton and the other oil and gas enterprises are required to abide by reasonable environmental laws, workplace safety laws and pay a fair salary, they can still make a profit, so they will still invest in Russia. So long as there is a reasonable profit to be made, the oil and gas companies will come. I would be wary of the EC and the U.S.'s efforts to trick Russia into thinking the oil and gas companies must have freedom to do pretty much as they wish, or they will not invest.

## Sectoral Priorities

- A. The construction and rehabilitation of nuclear power plants is a very profitable business for the EC and U.S. firms. New nuclear power plants cost in the billions of dollars. The problem, not to mention environmental dangers, is that the plants are uneconomical. When the costs of construction, operating and disposal of nuclear wastes are accounted for, the power produced is not economically competitive. Just recently, the Yankee Rowe nuclear power plant in Massachusetts shut down as being uneconomical. This plant was considered by the nuclear power industry to be the most efficient of all nuclear plants in the U.S. Other nuclear plants have been shut down for a combination of financial reasons and environmental dangers. The billion dollar Shoreham plant in New York was closed before it even started operation. Southern California Edison recently closed a nuclear plant, and Washington State's nuclear facility called "Whoops" cost investors millions.

The nuclear power industry is not building new plants in the U.S. because of the costs and dangers. But the industry will try to convince Russia to risk the high costs and dangers because the industry can make large profits building or rehabilitating nuclear plants in your country. Russia would probably be better off investing in clean energy and eventually closing all its nuclear plants. For example: high technology wind mills that are currently being sold to the Netherlands, solar energy, combined cycle generation plants that use biomass as fuel and are 15% more efficient than coal plants, co-generation that uses waste products as fuel, geothermal and hydroelectric sources of energy are cheaper and less polluting.

- D. EC and U.S. producers of electricity delay investing in new forms of generating electricity (such as wind, solar, geothermal, ocean currents, etc.) because producer's costs for using coal, oil and nuclear power plants are less than the new, cleaner alternatives. The costs are less because the producers are not charged the expenses incurred in polluting the environment and causing health problems, which results in the producers gaining windfall profits.

Environmental regulations in the EC and the U.S. are beginning to shift the environmental and health costs onto those responsible -- the producers -- by requiring pollution control and abatement. Since the producers can no longer completely avoid the true costs of electricity generation via coal, oil and nuclear, they need to shift

electricity generation to an area, such as Russia, where environmental and health costs will still be paid by the taxpayers and not the producers. The EC and U.S., therefore, are encouraging Russia to build fossil-fired power stations and nuclear plants and export the electricity. Naturally, Russia's acid rain will increase, forests will defoliate as in Germany's Black Forest, waterways will degenerate and health problems will rise. But the cost for these by-products will not be paid for by the EC or the U.S. power industry but by Russia. Once again, Russia could invest in less costly means of producing electricity and export some of that electricity to the EC.

- E. If Russia becomes dependent on selling its natural resources for hard currency, then it will fall into the predicament of Latin America. The hard currency Latin America receives for its resources simply turns around and goes back to America in the form of purchases of U.S. consumer and agricultural products. Russia needs to emphasize the creation of wealth through the modernization of its manufacturing and service industries. Selling the family jewels at bargain basement prices does not create wealth.

## 5. Financial Services

For information and suggestions on banking operations and regulations, please refer to the SABLAW booklet that I will send to you shortly.

### B. Commercial Banks

Insufficient regulation of banks can lead to recessions and costly bailouts of failed banks. Prior to the 1930's Depression in America, commercial banks engaged in investment banking as well as making loans and accepting deposits. As investment bankers, they sold the stocks and bonds of their corporate customers. As commercial bankers, they used the money deposited into their banks by workers and enterprises to buy the stocks and bonds of their investment banking customers. Of course, a bank received a commission on all the stocks and bonds it sold. Essentially the right hand of the bank collected deposits and with its left hand gave those deposits to its corporate customers in the investment banking department and at the same time paid itself a hefty commission. Many of the investment banking corporate customers failed when the stock market crashed. When depositors tried to withdraw their money, the banks lacked the necessary funds. As a result, to this day in America, commercial banks cannot act as investment banks

and vice versa. The two different banking functions cannot be conducted by the same corporation.

Also in response to bank activities before the crash, the federal government passed a law insuring deposits up to a certain amount in not only commercial banks but also savings and loans ("S&L") banks. This law led to a problem in the 1980's. The Reagan administration liberalized the types of investments S&L's could make, increased the limit for insurance to \$100,000 and allowed S&L's to pay whatever interest rate they wished on deposits.

During the boom years of the 80's, S&L's increasingly invested in risky projects because these projects promised high rates of return. S&L's needed to make a high rate of return on the money deposited with them because they were in turn paying their depositors high rates. S&L's were competing with each other by offering higher and higher rates on deposits in order to attract more money than their competitor banks. These high rate paying deposits had to be invested in riskier and riskier projects in order for the S&L's to make a profit. At the same time, many wealthy Americans invested \$100,000 at different S&L's that paid the highest deposit rates. These Americans incurred no risk since the \$100,000 was insured for loss by the U.S. Government. (Only wealthy Americans benefitted from depositing \$100,000 in different S&L's, since most Americans did not have \$100,000 to invest.) When the 80's boom ended, the S&L's lost billions on their risky investments which went bankrupt, but wealthy Americans did not lose their deposits of \$100,000 in numerous S&L's. They were insured by the Federal Government.

The accounts of smaller depositors were also protected by the government insurance, but the chief beneficiaries were the wealthy who had deposits of \$100,000 in many S&L's that had paid high interest rates. Many S&L's went bankrupt, and the taxpayer is now required to pay the amount, up to \$100,000, lost on each deposit by the failed S&L's. The total cost is estimated at \$500 billion, which is about \$5,000 for each family in the U.S. This boondoggle could have been avoided by limiting the interest rates paid and investments made by the S&L's and by insuring deposits for a smaller amount.

D. Insurance

Recently in America a number of large insurance companies have gone bankrupt because they, like many S&L's, invested in risky securities, such as junk bonds (bonds that are rated below investment grade). A number of these insurance companies held the funds that retirees relied on for their pensions. These retirees now must survive on less than they were promised and less than they planned for. Regulations limiting the degree of risk insurance companies incur in their investments would avoid the same thing from happening to Russian retirees.

G. Transport

General Objectives

Once again, Western companies invest when they believe they can make a reasonable profit. Russia does not have to allow windfall profits by curtailing regulations in order to attract Western investment.

Sectoral Priorities

Please refer to the text in the last paragraph on page 2 of this paper.

7. Food Distribution

Please refer to the text in the second full paragraph on page 3 of this paper.

These are my written comments on the EC's Technical Assistance Program. If you have any questions, please feel free to contact me.

Very truly yours,

  
ROY DEN HOLLANDER

Enclosure