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# AGENCY FOR INTERNATIONAL DEVELOPMENT
## WASHINGTON, D.C.

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USAID

U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

FEB 28 1994

ACTION MEMORANDUM FOR THE ASSISTANT ADMINISTRATOR FOR ENI

THROUGH: Barbara Turner, DAA/ENI BT

FROM: Laurier Mailloux, ENI/PSI

SUBJECT: New Independent States: Amendment of Authorization for the NIS Enterprise Fund Project (110-0011)

I. PROBLEM:

Your approval is requested to amend the Project Authorization for the Enterprise Fund Project in the New Independent States, as follows:

A. (1) To establish and support two new enterprise funds: the Central Asian-American Enterprise Fund ("CAAEF") and the Fund for Large Enterprises in Russia ("FLER"), (2) to revise the Project Authorization to authorize a West NIS Enterprise Fund that will focus on Ukraine, Moldova, and Belarus and will supersede the authorization of the Ukrainian-American Enterprise Fund, and (3) to provide support to two multilateral funds to which the U.S. Government has committed to contribute as part of the Tokyo G-7 Summit in July, 1993: the multilateral Russia Small Business Fund to be established and supervised by the EBRD ("EBRD Small Business Fund") and a multilateral equity fund to which the U.S. Government will contribute as part of the G-7 Special Privatization Restructuring Program ("G-7 multilateral equity fund").

B. To increase the planned life-of-project funding from \$400 million to \$741 million, subject to the availability of funds. As amended, the life-of-project funding for the Project shall now include the Russian-American Enterprise Fund (\$340 million LOP), the Western NIS Enterprise Fund (\$100 million LOP), the Central Asian-American Enterprise Fund (\$150 million LOP), the FLER (\$100 million LOP), the EBRD Russia Small Business Fund (\$2 million LOP to the Pilot Program and \$28 million LOP to the full-scale Fund), and a G-7 multilateral equity fund (\$21 million LOP).

c. Invoke the "notwithstanding any other provision of law" authority provided in Section 201(c) of the Support for East European Democracy (SEED) Act of 1989 (PL 101-179) to waive the statutes and rules specified in annex A that might otherwise apply to the Enterprise Funds under this Project.

Planned obligations in FY 1994 funds will be up to $331 million, as follows: $120 million for the Russian-American Enterprise Fund, $45 million for the Western NIS Enterprise Fund, $30 million for the Central Asian-American Enterprise Fund, $100 million for the FLER, $15 million as the U.S. contribution to the EBRD Russia Small Business Fund (which will include the $2 million contribution to the Pilot Program and will be commingled with other donors' contributions), and $21 million for the G-7 multilateral equity fund.

## II. BACKGROUND

Section 498B(c) of the Foreign Assistance Act (FSA) provides for establishing one or more Enterprise Funds in the NIS. It states that if the President determines that one or more Enterprise Funds should be established and supported under the FSA, the provisions contained in section 201 of the Support for East European Democracy Act of 1989 (SEED Act) shall apply. Under this authority, USAID plans several Enterprise Funds in the NIS.

In addition, the President also has committed the U.S. Government to participation in several other investment funds in the context of the G-7 Special Privatization Restructuring Program that emerged from the July, 1993, Tokyo Summit.

- **Russian American Enterprise Fund.** President Clinton announced the formation of the Russian-American Enterprise Fund at the Vancouver Summit in April 1993. The RAEF was established and a Grant Agreement was signed on September 28, 1993. Under that Grant Agreement, USAID obligated $20 million of FY 1993 monies to the RAEF. USAID intends to obligate $120 million to the RAEF in FY 1994.

- **Central Asian-American Enterprise Fund.** In December, 1993, Vice President Gore announced the intention to establish the Central Asian-American Enterprise Fund ("CAAEF").[1] Although

[1] On or about December 10, 1993, the Department of State Coordinator of Assistance to the NIS made the formal determination, pursuant to Section 498B(c) of the FAA, to establish the Central Asian-American Enterprise Fund and the Fund for Large Enterprises in Russia. Authority to make that determination was delegated by the President to

the CAAEF may invest in small and medium-sized businesses in Kazakhstan, the Kyrgyz Republic, Tajikistan, Uzbekistan, and Turkmenistan, it will primarily focus its initial efforts on Kazakhstan and the Kyrgyz Republic, in recognition of their greater commitment to and progress toward economic and political reform. Once established, the CAAEF will open its offices in Almaty and Bishkek; offices in the other Republics will be deferred pending progress toward reforms. The CAAEF is expected to begin operations in FY 1994, commencing with the naming of a Board of Directors by the President. USAID intends to obligate $30 million to the CAAEF in FY 1994.

- **Western NIS Enterprise Fund.** In January, 1994, President Clinton announced that USAID will establish and support an Enterprise Fund to serve Ukraine, Belarus and Moldova ("Western NIS Enterprise Fund"). The Western NIS Enterprise Fund is expected to have offices in each of the three countries in which it will operate. A key issue determining the effectiveness of the Western NIS fund, particularly the potential for productive private investment, will be progress on economic reform, particularly in Ukraine and Belarus. The Western NIS Enterprise Fund is expected to begin operations in FY 1994, commencing with the naming of a Board of Directors by the President. USAID intends to obligate $45 million to the Western NIS Enterprise Fund in FY 1994.

- **Fund for Large Enterprises in Russia:** In developing a package of technical assistance support for Russia, the G-7 nations created the Special Privatization and Restructuring Program (SPRP), which includes both bilateral and multilateral initiatives.[2] As the principal bilateral component of the U.S. contribution to the SPRP, USAID will manage the Fund for Large Enterprises in Russia (FLER).

  The FLER is aimed at meeting the special needs of medium to

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the Coordinator in an Executive Order, dated December 1, 1993.

[2] The SPRP is the multilateral initiative that emerged from the July, 1993, G-7 Summit in Tokyo. The U.S. Department of Treasury manages the U.S. Government's role in the SPRP. For FY 1994, Congress has appropriated $125 million as the U.S. contribution to the SPRP. That contribution will be divided into two distinct amounts: (i) the FLER (LOP: $100 million), which is the U.S. government's bilateral contribution to the SPRP and is to be managed by USAID, and (ii) a $21 million USG contribution to a multilateral equity fund.

large enterprises (1,000 to 10,000 employees) in certain reform-oriented regions in Russia by offering comprehensive financing packages -- equity, loans, and technical assistance and training.

Like the Enterprise Funds, the FLER will be incorporated as a U.S. not-for-profit corporation and will be run by a Board of Directors appointed by the President.[3] President Clinton announced in January, 1994, that W. Michael Blumenthal, the former Treasury Secretary in the Carter Administration, will be the Chairman of the Board of Directors for the FLER. The FLER is expected to begin investment activity in mid-1994. USAID intends to obligate $100 million to the FLER in FY 1994.

- **EBRD Russia Small Business Fund:** At the Tokyo Summit in July, 1993, G-7 members and the EBRD decided to create a Russia Small Business Fund ("SBF") to provide newly created small and micro enterprises in Russia with access to urgently needed capital. The SBF will provide equity capital, loans, and loan guarantees, primarily for the purchase of fixed assets, although in some cases it may provide working capital. In doing so, the SBF will attempt to improve lending practices in existing financial institutions, create small finance companies to on-lend to micro-enterprises, and establish regional investment companies which will make small-scale equity investments.

  As an initial step, the EBRD will initiate a $10 million Pilot Program in order to determine the appropriate structure and operation for the full-scale SBF, given the rampant inflation and underdeveloped state of financial institutions in Russia. The program will use the same approach as the SBF but will concentrate on three specific regions: Tomsk, Nizhny Novgorod, and Tula.

  Total funding for the SBF will be $300 million, half of which will be provided by the EBRD and the remainder to be provided by the G-7 nations, including the U.S. The USG, through USAID, plans to contribute $30 million LOP to the SBF ($15 million in FY 1994). Initially, USAID will contribute $2 million to the establishment of the $10 million Pilot Program under a Grant Agreement that will be concluded between USAID and the EBRD. Following completion and satifactory assessment of the Pilot Program, USAID plans to make a contribution to the full-scale Russia Small Business Fund, which will also be made under a Grant Agreement to be concluded between USAID and the EBRD.

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[3] See fn. 1.

- **G-7 Multilateral Equity Fund:** The other significant component of the U.S. contribution to the SPRP would be to a multilateral equity fund that may involve the G-7 members and international lending institutions like the EBRD, the IFC or the World Bank ("G-7 multilateral equity fund").[4] One model for a multilateral equity fund, now under discussion, would be managed by the IFC and would provide capital to small and medium sized enterprises that have recently undergone privatization and that show reasonable prospects for operating successfully on a commercial basis.

  The structure, management and administration of the G-7 multilateral equity fund is still under discussion. Prior to obligation of any funds as the U.S. contribution to a multilateral equity fund, USAID will provide a clear and detailed description of (i) the structure and focus of such a fund and (ii) the terms and conditions that govern USAID's contribution. Assuming resolution of issues concerning the structure and focus of the G-7 multilateral equity fund, USAID plans to obligate $21 million to the fund in FY 1994. Your approval will be obtained in a subsequent memorandum prior to any such obligation.

With the exception of the EBRD Russia Small Business Fund (and Pilot Program) and the G-7 multilateral equity fund, the grant agreements (Agreements) between USAID and the Enterprise Funds will contain essential terms and conditions to implement the FSA authorities governing Enterprise Funds. These terms will provide that the Funds' policies and procedures, on certain matters (such as employee compensation, cash management, and environmental rules) will be reviewed and approved in writing by USAID. The Agreements will also require USAID written approval of amendments to such policies and procedures.

## III. DISCUSSION

A. Project Description: The Enterprise Fund Project is designed to accommodate Funds in select New Independent States of the former Soviet Union. The characteristics of Enterprise Funds are described in greater detail in the initial Action Memorandum authorizing the Enterprise Funds Project, dated August 11, 1993, and the Amended Project Memorandum that is included as Attachment B to this Memorandum.

However, with the addition of the CAAEF (which may invest in all five of the Central Asian Republics but will focus in the more reform-oriented republics of that region: Kazakhstan and the Kyrgyz Republic) and the Western NIS Enterprise Fund (which will operate in Ukraine, Belarus and Moldova), the Project will be focused on a broader geographic area in the NIS than was

[4] As part of the SPRP, the U.S. will also contribute to a Support Implementation Group office that will seek to ensure effective coordination among bilateral and multilateral donors in Russia. That contribution is not a subject of this memorandum.

initially authorized in August, 1993. Also, with the addition of the FLER (which will concentrate on medium- to large-enterprises), and the EBRD Russia Small Business Fund (which will focus on micro- and small-enterprises), the target group of the Project will expand to encourage the creation and expansion of private enterprises other than just the small- and medium-sized enterprises that are the principal target group of the Russian-American Enterprise Fund.[5]

B. Funding: The preliminary FY 1994 budget for the Enterprise Fund Project is $331 million, which includes $120 million for the Russian-American Enterprise Fund, $45 million for the Western NIS Enterprise Fund, $30 million for the Central Asian-American Enterprise Fund, $100 million for the FLER, $15 million for the EBRD Russia Small Business Fund (including the $2 million contribution to the Pilot Program), and $21 million to the G-7 multilateral equity fund. LOP funding for the Enterprise Funds Projects is projected to be $741 million. FY 1994 levels may change, depending on funding availability.

Regarding the Russian-American Enterprise Fund, the possibility of a Russian Far East-American Enterprise Fund was specifically raised in context of the assistance package for Russia that was announced at the G-7 meeting in Tokyo. In the fall of 1993, Congress also discussed whether or not to establish a Russian Far East Enterprise Fund, but opted not to include an earmark in the 1994 appropriations bill that would have required a separate Fund. The Conference Report urges, however, that $40 million "be provided for enterprise activities in the Russian Far East." As a result, rather than establishing a separate Russian Far East Enterprise Fund, USAID has told the RAEF that it is expected to undertake significant investment activity in that region.

Should additional funds become available for existing or additional Enterprise Funds, this Project will be amended accordingly.

## IV. CONGRESSIONAL NOTIFICATION

A Congressional Notification was submitted on November 22, 1993 advising of a new life-of-project amount of $740 million, and an incremental fiscal year obligation of $98 million. The notification is on hold only for the CAAEF pending receipt of further information regarding those funds. When the hold is lifted, fiscal year obligations may not exceed $98 million, unless a further CN has cleared Congress without objection.

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[5] Like the Russian-American Enterprise Fund, the Western NIS Enterprise Fund and the Central Asian-Enterprise Fund are targeted primarily at small- to medium-sized businesses. Those Enterprise Funds may assist larger enterprises and smaller firms if commercially justifiable and an important demonstration effect will result.

## V. LEGISLATION AND AUTHORITY

The Freedom Support Act (FSA) and the FY 1994 Appropriations Act (P.L. 102-391) contain several provisions that limit assistance or require the Executive Branch to take into consideration certain factors in providing assistance. Section 907 of the FSA bars United States assistance to the Government of Azerbaijan (GOA) unless the President determines and reports to Congress that the GOA is taking demonstrable steps to cease all blockades and other offensive actions against Armenia and Nagorno-Karabakh. Thus, the GOA will be eligible for assistance under this project only after the determination has been made. Assistance may still be provided to the people of Azerbaijan, so long as it is not provided to or through the GOA.

Section 498 A (a) of the Foreign Assistance Act of 1961, as amended, sets forth a number of matters that are to be taken into account in providing assistance to NIS countries such as progress toward democracy and economic reform, human rights, peaceful resolution of ethnic disputes and restraining arms transfers. State has taken these matters into consideration in its annual report to Congress submitted on January 31, 1994. Section 498A (b) prohibits aid to any NIS country that violates any of a number of restrictions relating to matters such as human rights, arms control, nuclear proliferation and, with respect to Russia, withdrawal from the Baltics. The annual report to Congress concludes that assistance to the NIS is not prohibited under this provision.

Section 547 of the Appropriations Act sets forth restrictions on assistance which could have an adverse impact on U.S. employment or on workers' rights in the recipient countries. GC and PAC have developed standard clauses which are incorporated in PIO/Ts for all grants and contracts and in Interagency Agreements to ensure compliance with this section.

Section 577 of the Appropriations Act bars the use of NIS funds for Russia unless the President makes a certification of "substantial progress" on Baltic troop withdrawal. On December 7, 1993 the President signed a memorandum certifying that substantial progress has been made. The President must recertify such progress every six months.

Section 560(e) of the Appropriations Act states that no funds shall be transferred to the Government of Russia (GOR) unless it is making progress on market principles, private ownership, negotiating repayment of commercial debt, respect of commercial contracts and equitable treatment of foreign private investment. That section also bars transfers to the GOR if it "applies or transfers United States assistance to any entity for the purpose of expropriating or seizing ownership or control of assets, investments, or ventures." Section 573 bars assistance to the government of any country that "provides lethal military equipment" to certain terrorist countries as designated by the Secretary of State. State will advise if these provisions should become effective and thereby prohibit assistance to the GOR.

Section 560(g) prohibits funding for any government that "directs any action in violation of the territorial integrity or national sovereignty" of any other NIS country. Section 560(g) also states that if the President determines it to be in the national interest, then the Administration may make available assistance without regard to this restriction. On December 7, 1993 the President signed a formal determination that the provision of assistance in the NIS is in the national interest.

Pursuant to General Notice No. 1 of October 1, 1993, the AA/ENI has been delegated all authorities with respect to Europe and the NIS held by the former Associate Administrator for Operations (AA/OPS). Pursuant to Delegation of Authority No. 400 dated August 16, 1991, AA/OPS was designated project approval authority, and therefore you, as the Acting AA/ENI, have authority to approve, authorize and amend projects.

VI. RECOMMENDATIONS:

That, by your signature below, you approve:

A. (1) Establishment of and support for two new enterprise funds: the Central Asian-American Enterprise Fund ("CAAEF") and the Fund for Large Enterprises in Russia ("FLER"), (2) revision of the Project Authorization to authorize a Western NIS Enterprise Fund that will focus on Ukraine, Moldova, and Belarus and will supersede the authorization of the Ukrainian-American Enterprise Fund, and (3) provision of support to two multilateral funds to which the U.S. Government has committed to contribute as part of the Tokyo G-7 Summit in July, 1993: the multilateral Russia Small Business Fund to be established and supervised by the EBRD ("EBRD Small Business Fund") and a multilateral equity fund to which the U.S. Government will contribute as part of the G-7 Special Privatization Restructuring Program ("G-7 multilateral equity fund").

B. An increase in the planned life-of-project funding from \$400 million to \$741 million, subject to the availability of funds. As amended, the life-of-project funding for the Project shall now include the Russian-American Enterprise Fund (\$340 million LOP), the Western NIS Enterprise Fund (\$100 million LOP), the Central Asian-American Enterprise Fund (\$150 million LOP), the FLER (\$100 million LOP), the multilateral Russia Small Business Fund to be established and supervised by the EBRD (\$2 million LOP to the Pilot Program and \$28 million LOP to the full-scale Fund), and the G-7 multilateral equity fund (\$21 million LOP).

C. Invocation of the "notwithstanding any other provision of law" authority provided in Section 201(c) of the

Support for East European Democracy (SEED) Act of 1989 (PL 101-179) to waive the statutes and rules specified in annex A that might otherwise apply to the Enterprise Funds under this Project.

Approve: Thomas A. Dine

Disapprove: ____________________

Date: 2/28/94

Annexes to Action Memorandum:

A. Amended Notwithstanding Authority

Attachments to Authorization Package:

A Project Authorization Amendment No. 1
B. Amended Project Memorandum
C. Amended Environmental Examination

ANNEX A

## USE OF "NOTWITHSTANDING" AUTHORITY - AMENDED

Proposed use of "notwithstanding" authority to delete or modify standard USAID rules with regard to the following four general categories:

Various Requirements for Grantees,
Nature of Project Activities,
Pre-Award Actions, and
Eligible Goods and Services and Source/Origin Requirements.

### Various Requirements for Grantees

1. Non-applicability of the requirement that interest earned on grant advances be remitted to USAID (HB 13, MP § 3(q); OMB Circular A-110, App. D).*

2. Non-applicability of any requirement relating to cost sharing and matching imposed on grantees (HB 13, OP § 24; OMB Circular A-110, App. E).

3. Non-applicability of any requirement that grant advances only be made to the grantee on an as-needed basis (HB 13, OP §§ 2 and 3; OMB Circular A-110, Apps. I).

4. Modification of the requirement that advanced grant funds be deposited in banks with FDIC coverage and the balance of the advances that exceeds the FDIC coverage be collaterally secured to allow a more commercially sound alternative. (31 CFR Part 205).

5. Non-applicability of all requirements prescribing how the grantee shall manage property acquired with USAID funds (HB 13 OP § 21; OMB Circular A-110, Apps. N and D.

6. Non-applicability of the requirement that the grantee certify that it has not been debarred or suspended, and that its principals have not been convicted of certain crimes, etc. (HB 13, MP § 8).

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* Parenthetical references following each item are (i) to the relevant section of the mandatory standard provisions (MP) or the optional standard provisions (OP) to Handbook 13 (HB) 13), (ii) to the relevant statutory provision of the Foreign Assistance Act of 1961, as amended (the "FAA"), or another relevant act, or (iii) to any other relevant source of rules or regulations, such as a circular from the Office of Management and Budget (OMB).

7. Non-applicability of the required undertaking by the grantee regarding the actions of its employees in the NIS (HB 13, OP § 15).

8. Non-applicability of restrictions on the conversion of dollars into any other currency (HB 13, OP § 26).

9. Omission of any undertaking by the United States Government to permit the use of its pouch facilities (HB 13, OP § 25).

Rationale:

Most of these requirements relate to the way in which a normal grantee can manage its grant funds. Since the Freedom Support Act and the SEED Act establish a different pattern for the Enterprise Funds (i.e. to receive monies in advance of actual need and to earn interest thereon) most of these procedural requirements are per force inapplicable. The others are just not relevant to the investment orientation of the Enterprise Funds.

A further rationale for not applying these limitations is that conditions in the NIS are unique in that the purpose of our assistance is to help build a market economies in countries that have been dominated by 40 years of central planning.

## Nature of Project Activities

10. Non-applicability of the restrictions on financing commercial or agricultural activities that compete with United States businesses, as specified in part in the Bumpers and Lautenberg amendments to the Appropriations Act for fiscal year 1993 (§ 520 of the Appropriations Act; and § 620(d) of the FAA).

11. Non-applicability of 22 CFR 216: Environmental Procedures.

12. Non-applicability of any requirements applicable to participant training programs and research activities (HB 13, OP § 15 and §§ 17 and 18).

Rationale:

The Freedom Support Act and SEED Act provide specific objectives for the activities of the Enterprise Funds. The Funds are private entities, which require the flexibility to respond to market signals on a timely basis. Transactions are not expected to result in competition with U.S. businesses in major U.S. or world markets. To the contrary, the result should be to open and sustain new markets for the United States. With respect to environmental procedures, the Funds will develop their own rules and procedures for ensuring the environmental soundness of loans and investments. USAID will approve in writing these rules and procedures before the Funds begin operations.

## Pre-Award Actions

13. Non-applicability of the requirement for a grant proposal and budget. (HB 13, Chapter 4).

14. Non-applicability of the requirement for a pre-award audit. (HB 13, Chapter 4).

15. Non-applicability of the determination that the funds have a performance record, an acceptable financial accounting system, and adequate funds to carry out the program (HB 13, Chapter 4).

16. Non-applicability of the review of the adequacy of grantee policy and procedures for travel, procurement, and property management (HB 13, Chapter 4).

Rationale:

The Enterprise Funds are new organizations with no operational history to examine. The legislation directs USAID to make grants to these organizations. USAID will review and approve personnel rules and policies, including those determining levels of compensation and benefits for employees of the Funds and any subsidiaries of the Funds.

## Eligible Goods and Services and Source and Origin Requirements

17. Non-applicability of standard restrictions on the acquisition of the following goods:

    (a) luxury goods (HB 13, OP § 8(a)(1));
    (b) weather modification equipment (HB 13, OP § 8(a)(1));
    (c) agricultural commodities (HB 13, OP § 8(a)(3));
    (d) vehicles (HB 13, OP § 8(a)(3));
    (e) rubber compounding chemicals and plasticizers (HB 13, OP § 8(a)(3));
    (f) used equipment (HB 13, OP § 8(a)(3));
    (g) U.S. government-owned excess property (HB 13, OP § 8(a)(3));
    (h) fertilizers (HB 13, OP § 8(a)(3)); and
    (i) any commodities appearing from time to time on the Commodity Eligibility list regarding ineligible goods (HB 1B, chapter 4, and HB 15, App. B).

18. Non-applicability of any requirement that United States maritime insurers be used by the Grantee (FAA § 604(d); HB 13, OP § 8(c)).

19. Non-applicability of cost principles for nonprofit organizations.

20. Non-applicability of any restrictions regarding local cost financing (HB 13, OP § 10).

21. Non-applicability of all statutes and restrictions on the source or origin of goods and services or nationality of suppliers, except for the exclusion of Libya, Vietnam, North Korea, Iran, Cuba, Iraq, Syria, Serbia, Cambodia, Laos, China and Afghanistan as a permitted source or origin for goods and services or nationality of suppliers including:

    (a) the requirement for the procurement of goods from the United States, NIS countries, or from developing countries (FAA § 604(a) and § 498B(h) of the Freedom Support Act; HB 1B, Chapter 5); and

    (b) restrictions on acquiring construction and other technical services from advanced developing countries (FAA § 604(g)).

22. Non-applicability of the requirement that at least 50% of USAID-financed goods be shipped on United States flag vessels (§ 901(b) of the Merchant Marine Act of 1936, as amended; HB 13, OP § 8).

23. Non-applicability of the preference for using United States flag air carriers (International Air Transportation Fair Competitive Practices Act, 1974; HB 13 OP § 5).

24. Non-applicability of the requirement that motor vehicles be of U.S. source and origin (FAA § 636(i)).

<u>Rationale</u>:

In most cases, we don't expect the Enterprise Funds will finance transactions of the type normally prohibited, but we do not want to impose the administrative burden of having to ensure that a proscribed procurement won't happen. One of the beneficial by-products of the Enterprise Funds will be the development of indigenous credit and venture analysts who will be scrutinizing proposals for Fund financing. The tasks of teaching them good business and accounting principles will be difficult enough without the overlay of USAID peculiarities. The reasons for worrying about whether a business plan might include, e.g., rubber compounding chemicals of the type normally proscribed by USAID, are not sufficient to overcome this basic principle. Nor do we want the commodity procurement office to have to preview proposed transactions.

In other cases, e.g., passenger cars and luxury goods, we accept that procurements may occur with at least some portion financed by the Enterprise Fund but believe that the market (i.e.

price) mechanism will be the best arbiter of whether a Russian or Ukrainian company, for example, should buy such items or not. It is important to keep in mind that to the end-user these funds are not "assistance" but are investment capital with the concomitant risks of using them for non-essential requirements.

The rationale for eliminating or modifying source/origin requirements is very much tied to the market orientation of the Enterprise Funds. Moreover, competitively-priced American products are already being introduced in the NIS; those that are able to establish a presence, particularly with maintenance and spare parts capabilities, should expect to do well.

The program of assistance for the Enterprise Funds is not commodity-oriented. Monies may be use to purchase equipment or raw materials, but may also be used for in-country costs such as buildings and salaries. At this stage, the delays and paperwork associated with source/origin requirements do not seem justified in light of the overall purpose of the Enterprise Funds and the likely orientation of the Funds in supporting U.S. joint ventures and investments in NIS countries. As required by the SEED Act, the Funds will have to take into account United States economic and employment effects in managing and investing their portfolios.

ATTACHMENT A

**PROJECT AUTHORIZATION - Amendment 1**

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|---|---|
| Name of Country: | New Independent States (NIS) |
| Name of Project: | NIS Enterprise Fund |
| Number of Project: | 110-0011 |

1. Pursuant to Section 498C of the Foreign Assistance Act of 1961, as amended (FAA) and in relation to the Project Authorization, dated August 11, 1993, I hereby amend the authorization of the NIS Enterprise Fund Project involving planned obligations from not to exceed $400 million to not to exceed $741,000,000 over a five-year period from the date of the first obligation, subject to the availability of funds in accordance with the USAID OYB/Allotment process, to help in financing foreign exchange and local currency costs of the project. The planned life of project is through June 1, 1997.

2. The Project will establish and provide support to nonprofit capital funds to meet the demands for equity and loan capital of emerging businesses in the New Independent States, assist in the development of joint ventures, attract foreign investment, encourage U.S. private sector partnerships, and provide technical assistance to such businesses.

3. The Grant Agreements, which may be negotiated and executed by the Officer(s) to whom such authority is delegated in accordance with USAID regulations and Delegations of Authority, shall be subject to the following essential condition, together

with such other terms and conditions as USAID may deem appropriate:

a. Source and Origin of Commodities, Nationality of Services

The source and origin of commodities, nationality of suppliers of commodities, services and ocean shipping may have their source or origin in any country excluding only: Libya, Vietnam, North Korea, Iran, Cuba, Iraq, Syria, Serbia, Cambodia, Laos, Montenegro, China, and Afghanistan.

Thomas A. Dine

Thomas A. Dine
Assistant Administrator
Bureau for Europe and New Independent States

2/28/94
Date

ATTACHMENT B

# I. BACKGROUND

## A. Challenge and Constraints

Assisting the transformation of the economies of the New Independent States (NIS) from command to market-driven, competitive systems is one of the greatest challenges facing the U.S. and other Western donors. The United States has a vital interest in the success of this transition to help ensure a more peaceful and stable international order. It will also open to competitive international trade and investment the world's largest untapped market and natural resource base.

Yet transforming the Soviet-style command economies of the NIS republics faces numerous constraints. The legal and regulatory framework to create the new systems is not yet complete. State-owned enterprises, particularly defense-related industries, continue to dominate and have an important influence in the economy and in macroeconomic decisions. There are also few citizens with entrepreneurial experience, even fewer with any experience operating a private business in a competitive market economy. Most individuals have no exposure to western management, accounting, or marketing concepts. Conversely, American firms which could assist in the transformation process have been reluctant to make financial commitments, despite a considerable amount of general interest, to a political and economic environment that faces many uncertainties.

Most recent investment in the NIS has been undertaken by companies that already had a stake in specific NIS republics prior to the political and economic reforms of the past few years, or by firms investing in safer, hard currency-generating ventures such as those related to energy and minerals. Western banks have been slow to move into the NIS with full commercial/retail banking operations--in particular, lending to new private enterprises. A handful of private, public and mixed investment/venture capital funds have been established but these are reaching only a very small segment of the emerging private sector. Public and private banks in the NIS have severely curtailed and, in many cases, completely eliminated lending to private enterprises given the opportunity to generate a safer return in other investments such as hard currency speculation and real estate. For the typical NIS entrepreneur, the result is a dearth of equity and loan capital which severely curtails opportunities for initiating or expanding new ventures.

Another major constraint is the gap between resources available from western donors and the vast financial and managerial requirements of assisting in the transformation process. For USAID and the USG, a major challenge is the allocation of relatively scarce financial and managerial resources among complementary, mutually-reinforcing, yet diverse and resource-competing private sector assistance initiatives: privatization, policy reform, development of private businesses, micro enterprise development, training, and investment activities.

### B. Rationale for the Enterprise Funds in the NIS

Enterprise Funds ("EF" or "Fund"), which are investment organizations that will be established in selected NIS Republics, will specifically address many of the constraints highlighted above.[1] The Enterprise Funds will fill an important vacuum that exists in the NIS Republics with respect to the incubation of a broad range of private enterprises. As noted above, some U.S. and international investment houses have begun NIS operations. In particular, very few, if any, of these organizations are focusing on the middle market and smaller range of companies that do not necessarily generate foreign exchange or which do not have proven track records.

There is a significant need for an investment organization--indeed for many investment organizations as the needs are considerable--to meet the demands of equity and loan capital of emerging private businesses in the NIS. Beyond capital, however, there is even a greater need to attract the U.S. private sector to work within the NIS and specifically to assist in the emergence of the private enterprise sector. While the use of consultants is one approach to meeting this need, experience to date in Eastern Europe and elsewhere indicates that jointly investing with local entrepreneurs is a very effective approach to maximizing the contribution that western businesspersons can make in disseminating western business practices and market oriented approaches.

Inter alia, the Enterprise Funds (EFs) in the NIS will:

- provide badly needed loan and equity capital to a wide-array of NIS entrepreneurs and businesses;
- promote business transactions that will serve as a model for the private sector by providing substantial business know-how and expertise;
- help incubate new businesses;

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[1] Section 498 (c) of the FY 93 Freedom Support Act permits the establishment of one or more Enterprise Funds in the NIS, under the authority of Section 201 of the SEED (Support for Eastern European Democracy) Act.

- support the crucial privatization and defense conversion programs[2];

- enhance the viability of the financial system by supporting domestic financial institutions and encouraging commercial and investment banking activities;
- assist in the development of joint ventures and attracting foreign investment;

- offer an excellent opportunity for a USG-U.S. private sector partnership; and,

- maximize the impact of USG resources by leveraging additional funds: potentially the USG's most effective investments will reinforce private investors who are willing to put up their own capital.

The Enterprise Funds will be a key component of the USAID private sector strategy in the NIS Republics. By focusing their efforts on private enterprise development, the Funds will complement and in many cases support other USAID efforts such as privatization and policy reform. The Enterprise Funds will permit USAID to support a number of private sector initiatives, while limiting considerably the significant management burden which would be required of transaction-oriented private sector programs administered by USAID field missions.

With a limited field and Washington staff, USAID resources will be very thinly stretched in promoting substantive private sector programs in more than a few areas. With the EFs (which may eventually include multilateral equity funds in which the USG participates) focused on enterprise development, USAID field and Washington staff will be able to focus on policy reform, micro-enterprise development, strengthening local business groups, privatization, and other key elements of a comprehensive private sector program. Demand for private sector programs in the NIS is great. The ability to consolidate enterprise development in an EF will be an extremely important USAID asset. For example, it is anticipated that the EFs will be an important conduit of

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[2] For purposes of this project, "defense enterprise" means any organization having a significant volume of or capacity for military production. "Military production" includes production of machinery, equipment, military weaponry, materiel, or technology, designs, research results, software, intellectual property, or other articles or services having substantial military application. "Defense conversion" means a substantial increase in non-military production accompanied by a substantial decrease in military production, or activities clearly designed to lead to such increase and decrease.

assistance in many cases to the large number of U.S. businesses that seek investment support from USAID/Washington and field missions. With a mandate to promote joint ventures, the EFs will in many cases be in a good position to provide required assistance, including assisting local partners wanting to enter into joint ventures with U.S. companies.

Finally, it is expected that the Enterprise Funds will provide a demonstration effect that goes far beyond the mere provision of capital. Even more than most developing countries, the NIS is severely lacking in business experience and know-how. The provision of that experience and know-how, coupled with concrete examples of successful enterprises, are expected to be a major contribution of the Funds. This has been demonstrated in Eastern Europe where the Funds are playing important roles as the incubators of businesses and of western business practices, both of which are viewed as critical in forging private enterprise in the respective Eastern European countries. This issue is addressed in the Risk Analysis (section VII).

## II. Program Description

### A. Purpose

The purpose of the Enterprise Funds is to encourage the creation and expansion of private businesses in the NIS. This will be accomplished through transactions that assist in the initiation and expansion of a wide array of private enterprises and that promote and disseminate western business know-how and practices, and demonstrate to other potential investors that investments in specific activities can be undertaken profitably in the NIS.

In addition, an important element of the Enterprise Fund concept is to flag for the host governments and the private sector specific policy reforms which are needed to make private investment profitable.

### B. The Enterprise Fund Concept

#### 1. USG-Sponsored Enterprise Funds

Enterprise Funds are investment organizations financed with USG capital.[3] Enterprise Funds currently exist in Eastern

[3] The U.S. government is planning on contributing to multilateral funds that are part of the Special Privatization Restructuring Program ("SPRP"), which resulted from the Tokyo G-7 Summit held in July, 1993. Such multilateral funds are likely to differ in their structure and operations from the Enterprise Funds

10

Europe: Hungary, Poland, the Czech and Slovak Republics, and Bulgaria. All Funds have their headquarters in the U.S. with offices in the capitals of the host country. In addition, USAID established the Russian-American Enterprise Fund in September, 1993. In FY 1994, USAID is planning to establish Enterprise Funds for the Western NIS (Ukraine, Belarus and Moldova) and the Central Asian Republics in the NIS, as well as a Fund for Large Enterprise in Russia ("FLER").

Enterprise Funds, including those in the NIS, generally have three important characteristics that set them apart from traditional USAID programs.

a. The Boards of Directors of the Funds, selected by the White House with input from USAID (including field Missions) and the State Department, and the management executives hired by the Board to run the Funds on a day-to-day basis, will be recruited from among top U.S. businesspersons and NIS experts. Host country persons of internationally recognized stature may also sit on the Board.

b. The Boards and management will have maximum flexibility in the manner in which the Funds are structured and in strategic and operating decisions. Following the principle that these types of decisions should be left to investment professionals, neither the USG nor the host government will have a role in strategic or operational decisions. Nonetheless, Fund management will abide by the guidelines and mandate that USAID and the USG will incorporate in the Grant Agreement with each Fund (see Section C 2 below).

c. In line with the Freedom Support Act, the Enterprise Funds will not be bound by the traditional rules that govern U.S. assistance, with the exception of USG policies relating to, defense conversion/military assistance, the exportation of U.S.jobs/enterprise zones/labor practices (599), abortion, subsidiaries, conflict of interest and compensation (See Section IV B - H). In hiring staff, awarding contracts, and making investment decisions, Fund managers will follow accepted business norms and due diligence practices, but they will not be subject to government regulations normally applicable to USAID-financed activities, other than those noted above and in the Grant Agreeemnt with each Enterprise Fund.

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that the USG is establishing in the NIS. This memorandum only specifies the characteristics of the Enterprise Funds created by the USG.

21

The EFs will be registered in the U.S. as non-profit corporations. Non-profit means that the Funds do not have capital stock or distribute dividends to members. Profits generated by the Enterprise Funds will be retained and reinvested in new projects, subject to the sunset and wind-down provisions which will be detailed in the Grant Agreement.[4] As a matter of operating philosophy, however, the Funds will be run as investment corporations and will generally be expected to make a reasonable return on investments.

The Enterprise Funds will have offices in the United States and in the host country. For example, the Russia office will be located in Moscow and the principal regional office for the Central Asian-American Enterprise Fund will be located in Almaty, Kazakhstan. The management of the Enterprise Funds may give consideration to opening other regional offices when Fund operations so justify. Based on the Eastern European experience, it is likely that the Chief Executive Officer (CEO) of each Fund and support staff, including investment analysts, will initially be based in the United States (by being in the U.S., the CEOs of the EFs can stay in touch with U.S. capital markets, U.S. businesses, USAID, the Congress and other Fund stakeholders). A staff of able professionals will likely be placed in the field, headed by a senior managing director. The exact structure and staffing requirements of each Fund will be determined by Fund management.

The Fund's field management director should be a U.S. citizen with extensive business experience, preferably in the specific NIS republic and who, if at all possible, is fluent in the local language. Although institution building is not a program objective, Fund management should seek to employ and develop local staff for the Fund from the start of operations.

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[4] A termination commencement date for each Fund will be established by A.I.D. no earlier than ten years and no later than 15 years from incorporation, except as otherwise may be agreed to in writing by A.I.D. and the Fund. After the termination commencement date the Fund shall not make any new commitments or investments and shall commence the winding up of its affairs and sale of its assets on an orderly basis. In certain instances (e.g., violation of the Grant terms or valid foreign policy grounds), A.I.D. may establish the termination commencement date at any time. The Fund must consult closely with A.I.D. with respect to the preparation of its proposal for a winding up and liquidation plan, and its implementation of the plan approved or imposed by A.I.D. The proceeds derived from the winding up and liquidation shall be distributed either to (1) a non-profit entity or entities for the purpose of providing assistance in Russia, (2) the United States Government, or (3) a combination of (1) and (2).

42'

Local staff know indigenous business and political contacts and how to surmount administrative obstacles.

Each Enterprise Fund will have a Board comprised of at least five U.S. citizens and may include citizens from the host country. A majority of the members of the Board of Directors of each Enterprise Fund will be U.S. citizens. Section V.A provides additional information on the Boards and guidelines for the selection process.

**2. USG Contributions to Multilateral Funds**

In addition, USAID may contribute to a multilateral Small Business Fund in Russia that will be supervised by the European Bank for Reconstruction and Development ("EBRD"). That Fund will be composed primarily of contributions by the EBRD and the G-7 members, including the U.S. government; its life-of-project funding is projected to be $300 million, half of which will be provided by the EBRD's own resources.

Initially, however, the EBRD will establish (and contribute $2 million to) a $10 million pilot program to develop and refine the format and focus of the EBRD Russia Small Business Fund ("Pilot Program"). The G-7 Members and the EBRD will contribute to that Pilot Program as part of their respective contributions to the EBRD Russia Small Business Fund. The EBRD has proposed the Pilot Program for the purpose of refining the design for the full-scale EBRD Russia Small Business Fund (i.e., the $300 million fund).

Finally, up to $21 million of U.S. government funds may be contributed to a multilateral equity fund as part of the Special Privatization Restructuring Program ("SPRP"). Such a fund may involve the G-7 members and several international lending institutions like the EBRD, the IFC and the World Bank. One model for a multilateral equity fund, now under discussion, would be managed by the IFC and would provide capital to small and medium sized enterprises that have recently undergone privatization and that show reasonable prospects for operating successfully on a commercial basis.

The structure, management and administration of a multilateral equity fund are still under discussion. Prior to obligating any funds as the U.S. contribution to a multilateral equity fund, USAID will provide a clear and detailed description of (i) the structure and focus of such a fund and (ii) the terms and conditions that govern USAID's contribution.

27

## C. Guidelines for Enterprise Fund Activities and Investment Policies

### 1. Enterprise Fund Activities

#### a. Transactions

The EFs will support a number of private sector transactions in its respective countries. The exact nature of these transactions will be determined by the Boards and management once selected. Transactions are likely to fall into two general categories: loan programs and equity/venture capital programs. Many transactions will cover the gamut of possibilities between the two, e.g., convertible debentures, a combination of equity and loan capital, etc.

Loan programs could, perhaps, be undertaken directly by the Enterprise Fund (through perhaps a subsidiary) or through existing commercial banks. Despite the considerable weakness of the financial system in the NIS, the experience of EFs in Eastern Europe suggests that the financial sector is one area where transactional activities can support significant change in policies and procedures well beyond the specific transactions financed. The Board of Directors and management of the NIS EFs should pay special attention to opportunities to make a significant contribution to initial steps in developing the financial sector.

There are several options available to Fund management. Implementing a small loan window through banks as has been done in Poland and Hungary is an option that should be strongly considered.[5] Likewise, Fund management may wish to consider taking

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[5] In Poland, the Fund's lending subsidiary works with nine Polish banks for small business lending. Three to five officers from each bank are seconded to work exclusively on these lines (some of these officers were actually hired by the Fund). The Fund provides all the capital but the banks share in 50% of the risk. According to several sources, this is the first time that Polish "bankers" have really had to perform as true bankers. The Fund developed a very lengthy 20-plus page application form which, although bureaucratic, essentially forces the potential borrower to develop a business plan (looking at cash flows, sales growth, etc.). Many potential borrowers discover in this process that they cannot afford a loan. Even entrepreneurs rejected for loans have expressed a positive learning experience from the application process. And many bankers discover that what looked like an attractive loan was more likely to result in default. Most of the banks are now using this application for all their loans and others are requiring business plans that include all requested applications. The application was developed by the South Shore Chicago Bank, which provides technical

24

a minority equity position in one of the dynamic young banks that lack adequate capital.

The EFs will also take equity participation in promising emerging private sector companies, including newly privatized enterprises and those related to defense conversion. Equity participation will permit the Funds not only to provide capital to these firms, but also to form a strategic partnership that will enhance the success of these firms and demonstrate the impact of sound business practices. It is expected the Funds will seek to hold minority ownership positions in the firms in which they invest. To the extent possible, Fund management will develop exit strategies for equity investments that enhance the business environment in their respective countries, i.e., through capital markets, bringing in a U.S. investor, etc, as well as from investments that are not earning an appropriate return.

An important issue with respect to the types of activities that the Funds will support is the mix between retail (direct lending, equity participation in individual companies, including a wholly-owned bank) and wholesale operations (credit windows through commercial banks, subsidiary organizations for different types of investments, including subsidiary joint ventures with co-financiers). As a general rule, wholesale activities may have a greater impact to the extent that they can reach more clients and may, therefore, be preferable. Many wholesale operations may not be possible in the NIS, however. While it may be possible to work with one or two banks, for example, it may not be possible to establish--at least over the short-run--a broad credit program such as in Poland. To the extent that it may be more difficult to undertake wholesale type activities, there will exist a greater burden to ensure that individual transactions have a strong demonstration effect.

b. Technical Assistance

The Funds may also provide technical assistance to support actual or potential Fund investments, but not as a general program of technical assistance (without prior USAID approval). Technical assistance costs will be managed from a separate source of funds other than the Fund's investment capital to ensure the transparency of technical assistance costs to enterprises. To the extent possible, however, it is anticipated that the costs (or at least some portion thereof) of technical assistance will be passed on to clients through loan fees and other mechanisms to ensure that the technical assistance provided is necessary and valued by the participating enterprises.

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assistance to the Fund.

25

Many firms in the NIS will require considerable technical assistance. Fund management will be alert to the risk, however, that high technical assistance costs will mask intrinsically high start-up costs in certain investments and make the investments appear profitable when they may not be--at least compared to investments in other firms that may not receive subsidized technical assistance.

Any technical assistance provided by the Enterprise Funds which does not directly support investments or potential investments must be approved by USAID.

c. Policy Reform

In policy analysis, the Fund will be in a position through its transactions to highlight for the host public sector, the private sector, and USAID, specific policies and regulations that are undermining or hampering successful business practices. This process may be formalized through periodic joint meetings (preferably on a semi-annual basis) among the Fund, USAID, the Department of State and the host government.

**2. Investment Policy and Criteria**

Fund management will abide by the following investment criteria.

**a. *Target Group*. The Funds may provide assistance to privatized or privatizing enterprises in the NIS. Fund clients will generally be small- to medium-sized firms, but may include larger enterprises as well. (An exception is the FLER, which is expected to focus on medium-to-large sized firms which have been privatized.) Assistance to smaller firms will be made if commercially justified and an important demonstration effect will result. Assistance to larger enterprises may also be undertaken if, again, it is in line with the demonstration effect**

and consistent with the diversification criteria noted below.[6] The Funds will focus its investments on transactions that:

-- increase employment opportunities, directly or indirectly;
-- develop capital markets;
-- generate foreign exchange;
-- encourage foreign investment, particularly investment by U.S. businesses; and,
-- assist the privatization and defense conversion programs.

b. *Demonstration Effect*. The sheer size and diversity of the NIS Republics, particularly Russia, suggests that individual transactions will have a limited development impact unless there are important demonstration or other systematic effects associated with the investment (e.g., assisting a private mortgage bank participation in the housing sector). The extent to which each Fund's investments and related activities demonstrate the potential of the private sector and highlight needed policy reforms will be critical to the Funds' success, and over the long-run is more important than the provision of capital. Therefore, in carrying out its program, each Fund is expected to seek opportunities to make investments which have demonstrative or other systemic effects supporting economic reform and transition to a market economy.

c. *Diversification*. Fund investments will be diversified across sectors, size of investment, and level of risk. To have the greatest impact and to minimize investment risk, the Fund will diversify its investments across different sectors. Likely sectors for Fund investment include natural resources, food processing, housing, manufacturing, enterprises emerging from the mass privatization programs, defense conversion, and services.

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[6] The definition of "small" business in Eastern Europe, as in the case of the NIS, is more comprehensive than that used in traditional A.I.D. programs given the stage of development -- at least in industrial capacity -- of the countries of the former communist block. The SBA definition of less than 500 workers and $5-7 million in gross sales per annum would cover the range of small businesses with which the Enterprise Funds are likely to work. Medium-size businesses will generally be defined as enterprises that have greater than 500 workers, but less than 2,000-3,000. Large-scale businesses may be defined as enterprises that have greater than 1,000 employees, but less than 10,000 employees. These definitions may be adjusted based on experience and discussions with the Funds.

27

i. *Size.* The Funds' mandate of reaching a wide array of firms requires that, in general, no more than 10 percent of total capital (defined as the total amount of USAID's grant to each Fund) be invested in any one venture. As a general rule, investments are likely range from $500,000 to $1,500,000 for equity (but may be for greater amounts). Loans are likely to fall in the $50,000 to $500,000 range. This target range may change over time as the Funds gain greater experience in operating in the NIS.

ii. *Risk.* Each Fund's portfolio is expected to include investments with a range of risks--including "high risk-high reward" as well as a select few of cash generators that provide a current return and help provide financial viability for the Fund and permit the Fund to finance longer-term and riskier enterprises that are nonetheless financially attractive. The Funds will be leaders in investing in companies that most other investors will find too risky to finance because of unproven track records and the fluid political and economic environment in the NIS. By demonstrating the viability of lending to these enterprises, the Fund will, over time, reduce the perceived risk of investment in the NIS Republics.

**d.** ***Regional Diversification.*** A mandate for regional diversification is not initially contemplated, unless specifically determined when the USG establishes a Fund. Unless specified in a Fund's governing documents, the issue of whether Funds should be concentrated in select areas or diversified across a broader range of areas will be determined by Fund management and will be discussed with USAID following the first annual review (see Section VI below).

**e.** ***Consistency with Market Principles.*** There is a possibility that serious microeconomic policy distortions will provide windows for investments that are profitable only because such policy distortions exist. For example, a manufacturing investment involving an energy-intensive process may be feasible only if host country energy prices continue to be a fraction of world market levels. Such investments have the effect of subtracting from, rather than adding to, real national income. Therefore, the Funds will take into account the impact of economic policy distortions on the sustainability of their investments.

**D.** ***<u>Leveraging</u>***

EF management will seek to leverage USG resources to the maximum extent possible. As a general rule, the Funds will only take a minority position in enterprises in which they invest, thereby requiring a majority contribution from the host country entrepreneurs that are being supported or other joint venture partners. The Funds will also raise additional private capital at the earliest opportunity that Fund management finds prudent.

### E. *Other Criteria*

Additional criteria with respect to defense conversion, environmental, Section 599, subsidiaries, conflict of interest and compensation concerns are addressed in Section IV B - H below.

### 3. Expected Accomplishments

Since Fund management will make the ultimate decisions about the Fund's programs, it is not possible at this time to define specific quantitative measures of Project accomplishments. Based on the criteria described above, however, successful project implementation will be characterized by:

-- the successful establishment of a wide-array of firms across the different sectors of the host country economies;

-- investment by other private companies in sectors where the Enterprise Fund took an initial lead;

-- the completion of a wide array of transactions that broaden and deepen financial markets in the specific NIS republics; and,

-- development by the Fund of a number of key joint ventures between U.S. and NIS private companies.

The Funds, however, will be asked to define their objectives in a "goal statement" and will be asked to establish benchmarks.

## III. PROPOSED LIFE OF PROJECT AND PROJECT FUNDING

### A. Life of Project

The Enterprise Fund Project will have a life-of-project funding of $741 million (increased from the estimated life-of-project funding of $400 million when the Enterprise Fund Project was initially authorized), based on the availability of funds and the pace of policy reform in specific republics. In addition to the recently established Russian-American Enterprise Fund, efforts to establish other NIS Enterprise Funds are now underway in the Central Asian Republics and the Western NIS (Ukraine, Moldova and Belarus). Also, plans to establish the Fund for

29

Large Enterprises in Russia ("FLER") are nearly complete, and USAID may also contribute, on behalf of the U.S. Government, to a multilateral equity fund to which the U.S. Government will contribute as part of the G-7 Special Privatization Restructuring Program ("G-7 multilateral equity fund").

It must be emphasized that the USG sees the development of the EFs as a long-term effort that will require an implementation period of approximately 10-15 years, which is estimated to be a reasonable period of time to fully develop the program in the NIS republics. When an Enterprise Funds terminates operations, all net assests of the Fund will be returned to the USG or distributed to a non-profit entity to continue to assist the beneficiary country or some combination of both.

## B. Funding

**Illustrative Cost Estimates for Initial Obligations**[7]
($000) FY 1993 and FY 1994

| | West NIS | Russia | C.A.Rep. | FLER | EBRD | Total |
|---|---|---|---|---|---|---|
| Capital Investment | $40,750 | $124,000 | $26,750 | $90,000 | $12,000 | $293,500 |
| Technical Assistance | $4,000 | $16,000 | $3,000 | $10,000 | $3,000 | $36,000 |
| Evaluation/ Audit | | | | | | $500 |
| TOTAL | $44,750 | $140,000 | $29,750 | $100,000 | $15,000 | $330,000 |

The foregoing represents preliminary cost estimates for FY 1993 (including only the FY 1993 obligation of $20 million for the Russian-American Enterprise Fund) and FY 1994 set forth for illustrative purposes only. Depending on the circumstances in the NIS at the time of a planned obligation, these cost estimates may be modified to reflect changes in the levels of commitment of funds to the various enterprise funds in the NIS. Disbursements will depend on financing needs and a periodic review by USAID/State of the policy environment in each Republic.

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7 This table does not include a projection for USAID's potential contribution to a G-7 multilateral equity fund because the structure, management and administration of a multilateral equity fund are still under discussion. As noted above, prior to obligating any funds as the U.S. contribution to a multilateral equity fund, USAID will provide a clear and detailed description of (i) the structure and focus of such a fund and (ii) the terms and conditions that govern USAID's contribution.

Despite the weakness of the policy environment in the NIS (see Section IV A below), it is the opinion of the project committee that demand for Enterprise Fund transactions will far exceed the proposed funding. This assessment is based on discussions with government and private sector representatives in the NIS, a review of the costs related to privatization transactions in the NIS, and the operating requirements of emerging private businesses in the NIS.

## IV. PROGRAM ISSUES

### A. Policy Environment

The greatest concern regarding the establishment of Enterprise Funds in the NIS is that the policy and institutional environment may not be ready to support a transactional setting such as that associated with Enterprise Funds, i.e., can you support enough successful "deals" to warrant the costs and efforts of a Fund?

Progress in the policy reform and business institutional front has been made in the course of the last few years. In particular, groundwork has been laid to assist private small businesses and the privatization program continues to move forward. Although implementing legislation is needed and there are many gaps, groundwork has been laid by establishing numerous laws that are necessary to conduct stable business practices, e.g., anti-monopoly laws, bankruptcy, foreign investment. Institutionally, there has been an explosion of new banks in Russia, for example, although most are undercapitalized and small. More recently, there have been several joint ventures banks with foreign partners which should help to improve the financial system.

The progress that has been made aside, there is no doubt that the policy and institutional environment in the NIS is extremely weak. Moreover, in Russia and Ukraine, for example, there have been pauses in the reform process due to political changes and growing conservative pressures.

The USG recognizes that the development of the Enterprise Funds in this context represents a calculated risk. This risk is taken with the understanding that transactions and policy reform go hand in hand, and indeed, that prudently selected, investment transactions contribute directly and provide support necessary for policy and economic reform. The two are not mutually exclusive. It is also made with the assumption that the reforms that are going forward at this time, e.g., privatization, are providing a base sufficient to support investment transactions. The policy environment will continue to be monitored closely by the USG and will be an important criteria in all future funding considerations.

B. **Criteria for Defense conversion:** Assistance provided to Enterprise Funds may be used to support defense conversion but shall not be used to support production of weapons or final components of weapons. The USAID grants to the Enterprise Funds will specify the criteria to be followed for investments, loans, technical assistance or other forms of assistance, for defense conversion activities. The Funds will be responsible for demonstrating compliance with these requirements.

C. **Environmental Criteria:** The Enterprise Funds have a categorical exclusion from Section 216 requirements. Nevertheless, the Enterprise Funds will be required to develop their own environmental guidelines, which may be based on USAID regulations, host country regulations, and appropriate international regulations. Those guidelines should reflect substantial conformity with agreed-upon internationally accepted environmental standards and the expectation of responsibility embodied in Section 216 toward activities whose environmental consequences are significant. Investments and loans that involve significant natural resource utilization shall occur only where designed in order to minimize resource depletion and maximize ecological sustainability. Enterprise Funds shall be encouraged to invest in, and lend to, economically sound activities that improve environmental health and reduce industrial process and energy waste, and to incorporate these principles to the extent feasible, when they support ongoing enterprises. Enterprise Funds shall monitor environmental implications and consequences of their activities, and shall report on these on an annual basis. Environmental soundness of Enterprise Funds operations will be reviewed and approved by the Enterprise Fund Board and USAID. Moreover, USAID will monitor compliance through normal semi-annual and annual reviews and mid-term and final project audit and evaluation procedures. To advance these goals, Enterprise Funds board and managers shall be encouraged to include members experienced in environmentally-sound investment and business matters and may also access the technical assistance fund.

D. **547:** The Enterprise Funds will also comply with Section 547 of the 1994 Appropriations Act. Specifically, the Funds may not invest, grant, loan or provide other forms of assistance to business enterprises currently located in the U.S. if such assistance would induce such an enterprise to relocate outside the U.S. Furthermore, the Funds may not invest, grant, loan or provide any other assistance for purposes of establishing or developing any export processing zone. Finally, the Funds may not provide assistance for any project or activity that contributes to the violation of internationally recognized workers rights. The USAID grant to the Funds will specify the details to be followed so as to comply with Section 547 of the Appropriations Act.

**E. Abortion:** The Enterprise Funds will also abide by the statutes governing foreign assistance that relate to the use of USG funds for abortions, involuntary sterilizations, coercion of abortions or involuntary sterilizations, biomedical research on abortions and involuntary sterilizations as a method of family planning.

**F. Subsidiaries:** USAID will review and approve all significant structural changes and the creation of financial intermediaries of the Funds that undertake essentially similar activities to those of the Funds. Such spin-off Funds will operate within the same guidelines and principles to which the parent Fund must adhere, including compensation and incentive payments and transparency of personnel selection processes.

**G. Conflict of Interest:** Directors and officers of each Fund will be required to disclose actual and potential conflicts of interest to the Board of Directors. If any officer, director, or spouse/children of an officer or director has an interest in an entity negotiating or transacting business with the Fund, a letter will be submitted to the Board of Directors explaining the nature of the potential conflict. The officer or director with the possible conflict will be recused from participating in any part of the negotiations or transactions between the Fund and the entity.

**H. Compensation:** USAID approval is required on the Funds' policies regarding executive salaries and incentive compensation and in any subsidiary venture funds or banks that bring in Americans and establish their salaries and other compensation. In formulating its personnel compensation policies, the Fund will ensure that no salary of a Fund employee or employee of an organization in which the Fund owns a majority interest exceeds $150,000 per annum. This limitation will not apply to an investment by the Fund which results in the Fund owning a majority interest in a pre-existing entity which already pays its principal employees more than $150,000 per year. Compensation or profit-sharing in excess of $150,000 per annum, if any, will be paid from earnings or sources other than Grant funds.

**I. Cash Management:** The Enterprise Fund Project will adhere to cash management policies which will be spelled out specifically in the grant agreements. USAID and the Enterprise Funds will work closely together to adopt guidelines that assure effective management of the U.S. Governments's cash, taking into account the legislation governing the Funds and the Funds' operational requirements. Further, USAID will oversee the cash management practices of the Funds to ensure that federal cash is not maintained in excess of immediate disbursing needs. Finally, USAID will require the Funds to implement a system of cash reporting which will permit USAID to monitor the adequacy of the Funds' cash position throughout the life of the project.

## V. PROGRAM IMPLEMENTATION

### A. Selection of the Boards

The men and women selected by the USG to oversee the Funds, and the people that these Boards select to run the Funds on a day-to-day basis will be an important factor in project success. Accordingly, selection of the Boards is an important agenda item to be undertaken by the USG.

U.S. members of the Boards will be selected by the President of the United States. The Department of State and USAID will provide a list of candidates to the President shortly after the project is authorized. While Presidential appointment may delay selection somewhat, it gives Board members the prestige necessary to attract top-notch talent. Based on the experience of several of the Eastern European Funds, it is recommended that the Chairman of the Board be selected first to afford him or her an opportunity to identify other potential Board members with which he/she can develop a productive relationship. It is anticipated that the Board members will serve on a pro bono basis, but will be reimbursed for expenses incurred in attending Board meetings.

Board members should be a diverse group with a wide array of background and business experience. In particular, representatives from the investment banking, venture capital, commercial banking, and non-financial institutions should be represented. This diversity will ensure that the Funds' operations also take into consideration diverse approaches to business development. While international political and NIS-specific political experience is useful, the Boards should be comprised of diverse mix of men/women. Moreover, it should be balanced geographically, politically, and broadly representative of the U.S. interests in the NIS. An important criteria in the selection process, particularly for the Chairman of the Board, is that the individual should be known to the NIS business and public sectors to be able to command the attention of NIS leadership when so required.

### B. Incorporation and Subsequent Steps

As soon as the U.S. Boards are named, the first action item will be for them to incorporate the Funds and submit a proposal to USAID, thereby enabling USAID to sign a grant agreement. Concurrently or shortly thereafter, the U.S. members of the Boards, working closely with State and USAID, will select the board members from the host country. These should include one or two business leaders. The proliferation of competing business

34

groups in the NIS republics suggests that extreme care must be taken to ensure that the host country members are representative of the business community. U.S. members of the Board may wish to consider shifting or rotating membership of host country representatives to lessen the possibilities of conflicts of interests which are likely to arise in the NIS context. Public sector officials that strongly support the reform process should not be excluded.

Finally, a managing team will be hired to handle day-to-day activities. The senior directors of the managing team will be drawn from the U.S. business community and represent strong managers with extensive practical experience. The remainder of the management team will be composed of a mix between American and local employees. It will be a goal to reduce the percentage of Americans in top management positions as quickly as practicable and replace them with host country nationals.

## VI. IMPLEMENTATION DETAILS

* **Monitoring:** The Funds will develop their own mechanism for monitoring investments on a continuing basis, taking into account the means by which private U.S. venture capital companies and institutional investors monitor offshore investments. The Funds will develop appropriate means of monitoring the provision of grants, technical assistance and other forms of assistance.

The Funds will also publish annual reports which will include comprehensive and detailed descriptions of the operations, activities, financial conditions and the Funds' progress in meeting agreed upon objectives for each preceding fiscal year. The Funds will report on all items required for compliance with the SEED and FSA.

The USAID grant to the Enterprise Funds will specify the nature and format for required consultations with, and reports to, USAID The following are recommended to be included in the grant: The Funds will provide reports on a) the rate of commitment and utilization of grant funds; b) performance of investment portfolio; c) use of technical assistance funds; d) progress towards self-sustainability of the Funds; e) overhead analysis; f) cash flow analysis including investment income reflows and, g) salaries and related compensation for employees working for the Fund and its subsidiaries. Thereafter, Enterprise Funds and USAID will conduct semi-annual and annual reviews with the USAID Mission in the respective country of operation and/or USAID Washington.

* **Evaluation:** Based on the annual reports, the annual and semi-annual reviews meetings, USAID's ongoing discussions of the macroeconomic policy environment, and information derived from

audits (see below), USAID will review the effectiveness of the Funds before making any additional obligations to the organizations. A comprehensive USAID evaluation of the Enterprise Funds will be conducted after at least three years of operation. This evaluation will focus on progress toward the "expected accomplishments" detailed in Sections II-C-3. It will also assess performance against the policies and criteria in Section II-C-2.

* **Audit:** Each Fund's activities will be subject to audit by representatives of the General Accounting Office and USAID's Inspector General, and will be audited annually by an independent accounting firm. USAID will not impose federal allowable cost standards (OMB Circular A-122) but will encourage the Funds to use these standards as a guide in developing their operating policies and procedures. The Funds will develop cost standards in their policies and procedures and will submit these to USAID in anticipation of the grant. The Grant Provisions incorporate the policies by reference and require revisions to be mutually agreed upon by USAID and the grantees. The audit will be conducted on compliance with the grant terms and policies.

## VII. RISK ANALYSIS

**A. Decapitalization and Hyperinflation** - The uncertain and abnormally high rates of inflation in the NIS have raised concerns of any capital initially provided becoming significantly devalued, due to negative real rates of financial returns and exchange devaluation. Returns put back into the Fund, could suffer continuous real losses under these circumstances.

The probability for hyperinflation will be very high and perhaps unavoidable during the initial stages of implementation of these funds. However, as governments follow the fiscal and monetary policies which they are developing with the World Bank and IMF, the high rates of inflation could be significantly under control in 18 - 24 months. As reform moves forward the prospects for lower inflation rates and financial stability becomes greater.

Assessment: The main objective of the EFs is to foster long-term private sector development. Investments financed under the project will be subject to vigorous tests of market viability and should therefore be contributing to rational economic restructuring.

Moreover, it is likely that the EFs will seek to invest in domestic assets viewed as productive and/or in short supply. These assets should appreciate at the same or greater rate than that of existing inflation. Thus the EF's equity and capital invested in selective assets should march at the

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same pace as domestic inflation, thereby protecting the EF's capital investment. It will be important to avoid holding long-term substantial ruble cash accounts in the NIS. Obviously this would decapitalize the EFs.

Finally, if the assumption that progress towards stability will continue proves to be wrong, and hyper-inflation takes over, this (along with most other) projects will have to be re-appraised.

**B. Demand** - Can the NIS markets effectively absorb the capital invested by the EF? Is there a demand for the funds?

Assessment: Mass privatization efforts are underway throughout much of the NIS. For example, in Russian, many retail enterprises have already been privatized and numerous medium and large enterprises are expected to be privatized over the next three years. In order for there to be incentives for enterprises to go through the privatization process, they must be given some hope of assistance, once privatization is complete. All sectors at every stage of product development will be privatized to meet the supply and demand needs of a market driven economy. This will open up supply and distribution channels and create competition among companies, leading to the most efficient use of resources. The newly privatized companies will be seeking urgently needed capital to upgrade facilities. Furthermore, the enterprises will be in need of technical assistance, technology upgrades, and management skills transfers to cultivate a profitable venture. The Enterprise Funds provide such a mechanism and can offer the management guidance to increase the potential for success.

Studies conducted by the World Bank have determined that, for example, the Russians need $23 billion a year in savings to finance the investments needed for restructuring. The Enterprise Funds can be a catalyst in bridging the large gap between savings and investment requirements and they can help stimulate the private sector to investment in multiples of the EF's financing.

**C. Banking System and Financial Institutions** - With the reduction of state control, the emergence of small, undercapitalized banks in the NIS has resulted. Many of these small banks are owned and operated by enterprises and collectives whose objectives are to have their projects financed at uneconomic interest rates. This has resulted in preferential treatment made to select enterprises, regardless of the enterprises' ability to generate cash flow for loan payments; thus many of the outstanding loans are in default. Currently, resources are misallocated and banks are becoming insolvent. Non-performing loans are preventing the financial stabilization necessary for successful transition to a market driven economy. The financial sector lacks the technical know-how to assess the potential profitability of existing enterprises and new ventures to support the activities of the financial institution; the system must be redesigned to support the productive sector.

The World Bank stresses the importance of this issue: "the emerging private sector together with the more productive state-owned enterprises will require enhanced financial services ranging from the provision of a payments system that facilitates trading to the screening of loan applications and the monitoring of firms' performance. Thus, fostering the development of some financial institutions providing high quality financial services and behaving in a prudent manner should be a major objective."[8]

> Assessment: To overcome the present banking practices of loaning to unsound enterprises incentives need to be provided for banks to conform to international banking standards. The World Bank has proposed to establish an International Banking Standards (IBS) program that would institute a series of standards a bank must meet and would set up benefits for the banks meeting the requirements. These benefits include: recognition of being an IBS, attracting the public to a "safe" bank; lower discount rate when borrowing from the Central Bank; interest on reserves; direct access to the payments system; and lower premiums for deposit insurance. These extra privileges are aimed at reforming many of the nearly defunct banks and demonstrating that "common" banking procedures can be applied, and result in a profitable and stable bank. The IBS program is part of a World Bank financial sector loan which is still being developed.
>
> The Enterprise Funds could be an appropriate mechanism to demonstrate the financial skills necessary for loan analysis and portfolio management, while aiding the institutions to meet the high set of financial standards established under the IBS program. As the EFs move into lending, the Board may decide to work with newly created banks (as in the case of Poland) to demonstrate proper banking techniques: portfolio management, cash flow analysis, net present value assessment and ratio analysis - all skills necessary in loan processing. As these tools are applied and learned, they can be used in subsequent loan applications to enhance the financial positions of the banks. The Enterprise Funds can demonstrate to several banks these techniques, providing for a few stable financial institutions - while also with meeting the criteria of the IBS program when it comes into

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[8] Russian Economic Reform: Crossing the Threshold of Structural Change; World Bank 1992:10

place. Stable institutions are in a better position to attract capital and continue the cycle of dispensing productive loans. Overall, the EFs are one potential vehicle in laying a foundation for building a modern private financial system.

**D. Interest Rate Policy** - The interest rate environment ties in closely with hyperinflation and the overall banking system. The uncertainty of inflation has led to great uncertainty as to the appropriate interest rates. The interest rates are such that they are too low to attract savings, thereby curtailing any chance for the banking system to make new loans. However, a few elite enterprises are given loans at low rates - so low in fact, the financing does not cover the cost of the loan. In contrast, small and independent enterprises are deemed fortunate to receive loans at high rates and short time periods - long term credit is virtually non-existent.

Assessment: To overcome these obstacles, differing interest rate policies can be developed and demonstrated to the respective financial institutions. For instance, the Enterprise Funds could index interest rates to an inflation index and create floating rate. An equitable interest rate can be attained by tying the interest rates to a hard currency, but denominated in the ruble. Business development could be further encouraged by providing long-term credit that is structured in such a way that the bulk of the payments are repaid near the end of the term. Enterprises can then recycle initial cash flows back into the business and make repayments when in a better financial position. These and other innovative techniques can be used to circumvent some of the problems associated with high interest rates. By instituting some of these applications through the financial institutions, know-how can be transferred and replicated.

To the best of USAID's knowledge, apparently none of these alternative interest rate policies have been discussed with the central banks in the NIS. Hence, while the policies may contribute to the financial viability of the Enterprise Funds, there is no guarantee that they will be authorized by the relevant banking authorities. Once the Boards are established for the Enterprise Funds, USAID will seek their recommendations on policy measures that should be negotiated with NIS host governments. To the extent that such policies cannot be pursued, the Enterprise Funds will need to either modify their financial strategies, or reduce the capital available for loans.

**E. Business Risk** - Common to any venture is the uncertainty of success. Enterprises in the NIS are more susceptible than most - particularly due to the lack of business management abilities.

In the United States, the number one cause of bankruptcy is lack of adequate cash flow.

Assessment: In many instances the business may be profitable on paper, but lacks the cash flow to carry the business through periods of slow cash inflow - usually at the initial stages of operation. The solution is to acquire financing to cover these deficit periods and pay back during periods of surplus. The EF would be one mechanism to finance the start up phases of viable operations and reduce the chances of failure.

The management unit of the EF will represent experienced U.S. businesspersons. This management unit will be highly qualified in assessing those business plans which possess the greatest potential for success. Furthermore, a diversified portfolio of investments will be encouraged to balance strong, high cash generating activities with those that show great potential, but require long-term development to recouping initial investment. The management team will work actively with the selected enterprises in providing management oversight to further ensure the success of the companies. In addition, the experience of the managing unit will enable them to apply innovative and creative financing techniques in maximizing the impact of the EFs.

**F. Impact of USG money in the NIS** - The question has been raised as to whether or not the amount of these funds is too little to have any impact on improving the economies in the NIS.

Assessment: The EFs are one of many tools to be applied in meeting the great capital demands in the NIS. USAID's private sector portfolio includes assistance in privatization, trade and investment, small business and agribusiness. It also supports activities in economic restructuring. OPIC provides political risk insurance and financing for U.S. investments, and the EBRD apparently plans on providing similar-type assistance. The U.S. Department of Commerce and Peace Corps are also active in the promotion of private sector in the NIS. In addition, the World Bank is providing assistance in the privatization efforts to aid private sector development. Pooled together, these activities will provide not only considerable economic support, but also enhance the perception that the West is backing reform and is willing to provide the capital that is so necessary.

The EFs will take the lead in demonstrating the viability of business opportunities in the NIS. Currently, many businesses are skeptical and unwilling to take the large

140

risk associated with the environment of the NIS regions. As succers stories become apparent and the western governments confirm their commitment to NIS reform, other private industries will be stimulated to establish a presence in the large, untapped markets of the NIS.

**G. Policy environment** - The current NIS policy environment is not overly supportive of foreign investment and private sector activities. An activity of this sort may be too early to implement given the policy constraints. The success or failure of the Eastern European Enterprise Funds, which were faced with many of the same regulatory obstacles those posed in the NIS, is indicative of the ability of the NIS Funds to meet their objective of fostering private sector development.

Assessment: Based on the ongoing experience of the Eastern European Enterprise Funds, there is a general consensus among independent businessmen, USAID staff, and other donors that the funds are meeting their objectives of catalyzing private sector investment and enhancing overall business development. It appears that the EFs are prudently taking advantage of their independence from normal USAID regulations. Fund management has been able to organize and restructure functions as required by circumstances in their respective working environment (e.g., establishing separate finance and venture capital subsidiaries, establishing a mortgage bank in Poland when other options to support the housing sector were not advisable), and have an investment portfolio in diverse enterprises. Thus, the EF's management team has been effective in developing innovative approaches to providing capital assistance and circumventing the restraining policy environment.

The EFs play an important role by providing badly needed term loan and/or equity capital. In Poland, for example, the Fund is having a positive impact by being a major player in some sectors. With a portfolio of over $25 million, the credit subsidiary of the Polish Fund is reportedly the second largest lender to small business in Poland (over 1,600 loans for medium- to long-term capital have been made) and perhaps the most influential in terms of the impact it has had on how the small- and medium-scale business market is now serviced.

The benefits of the EFs, however, go beyond the provision of capital. As in any developing country, people in Poland, Hungary, and elsewhere frequently point to the dearth of capital as a critical problem. In most cases the shortage of capital is in fact a major development constraint. But the key constraint is not only a shortage of capital per se, but a paucity of business experience and know-how. The provision of that experience and know-how appears to be the greatest contribution of the EFs in Eastern Europe. As reported by a wide range of sources, including numerous independent businessmen, the Polish fund's small business credit program is having an impact that extends beyond the provision of capital by providing a valuable model of efficient credit analysis that is being replicated throughout Poland. The EFs in all four countries (Poland, Hungary, Czech/Slovakia and Bulgaria) where programs have been initiated for more than a year are playing important roles as incubators of businesses and of western business practices that is very important in forging private enterprise in their respective economies. The EFs are also very valuable politically. They are extremely visible and, despite their arms length relationship with USAID, they reportedly generate good will for the USG. They are very highly regarded by host countries who value their ability to make an immediate investment impact in their economies.

The apparent success of the Eastern European Enterprise Fund model is tempered by the fact that the Funds are relatively new and, in many ways, untested. Moreover, the NIS Enterprise Funds will need to contend with a much more unstable financial environment than ever existed in Eastern Europe. The Eastern European Funds have not existed long enough to test their financial performance as successful venture capital firms. Fund staff are the first to admit that they do not have a clear strategy for divestiture of their holdings. They site the local stock markets as possible future vehicles for resale of their investments. But they recognize that stock markets in Eastern Europe and the NIS are unlikely to be viable for selling minority share holding of new private businesses in the near future.

Attachment C

## AMENDED INITIAL ENVIRONMENTAL EXAMINATION

| | | |
|---|---|---|
| (A) | PROGRAM COUNTRY: | New Independent States Regional |
| (B) | ACTIVITY: | Enterprise Funds Project (No. 110-0011) |
| (C) | FUNDING: | $741 million |
| (D) | PERIOD OF FUNDING: | FY 1993 - FY 1997 |
| (E) | STATEMENT PREPARED BY: | J. Moran, Project Officer, ENI/NIS/PSI |
| (F) | RECOMMENDED ENVIRONMENTAL ACTION: | Negative Determination under AID Environmental Procedures (22 CFR 216), granting a categorical exclusion under Section 216.2 (c)(1)(ii). |

(G) DECISION OF ASSISTANT ADMINISTRATOR - ENI:

______________________
Approved

______________________
Disapproved

______________________
Date

(H) DECISION OF ENI/NIS ENVIRONMENTAL OFFICER:

[signature]
______________________
Approved

______________________
Disapproved

7/1/94
______________________
Date

Attachment C

## AMENDED INITIAL ENVIRONMENTAL EXAMINATION

(A) PROGRAM COUNTRY: New Independent States Regional

(B) ACTIVITY: Enterprise Funds Project (No. 110-0011)

(C) FUNDING: $74~~0~~1 million

(D) PERIOD OF FUNDING: FY 1993 - FY 199~~6~~7

(E) STATEMENT PREPARED BY: J. Moran, Project Officer ENI/NIS/PSI

(F) RECOMMENDED ENVIRONMENTAL ACTION: Negative Determination under AID Environmental Procedures (22 CFR 216), granting a categorical exclusion under Section 216.2 (c)(1)(ii).

(G) DECISION OF ASSISTANT ADMINISTRATOR ~~(ACTING)~~ - ENI:

Thomas A. Dine
Approved

Disapproved

2/28/94
Date

(H) DECISION OF ENI/NIS ENVIRONMENTAL OFFICER:

Approved

Disapproved

3/1/94
Date

EXAMINATION OF THE NATURE, SCOPE AND MAGNITUDE OF THE ENVIRONMENTAL IMPACT OF THE ENTERPRISE FUND PROJECT (100-0011)

A. DESCRIPTION OF THE PROGRAM: The Enterprise Fund Project (100-0011) will encourage the development and expansion of private enterprises in the NIS by taking loan and equity positions in promising ventures. Once created, the Fund(s) will operate fully according to private sector principles, without operational oversight by the government. Investment provided by the Fund(s) will assist in the initiation and expansion of a wide array of private enterprises, promote and disseminate western business know-how and practices, and demonstrate to potential investors that investments can be undertaken profitably in the NIS. In addition, the Fund(s) will flag for the host governments and the private sectors specific policy reforms needed to make private investment possible. The Enterprise Fund Project will have offices in the U.S. and in the appropriate host country(s).

B. RECOMMENDED ENVIRONMENTAL ACTION: A categorical exclusion is granted under Section 216.2 (c)(1)(ii) of the USAID Environmental Procedures (22 CFR 216) on the basis that "USAID does not have knowledge of or control over, and the objectives of USAID in furnishing assistance does not require, either prior to approval of financing or prior to implementation of specific activities, knowledge of or control over the details of the specific activities that have an effect on the physical and natural environment for which financing is provided by USAID" However, in establishing the Funds, USAID requests the following actions to be implemented by the funds:

1) The Funds are required to develop their own environmental guidelines, based on our regulations, host country regulations, and appropriate international regulations;

2) These guidelines will be reviewed and approved by the Board and USAID;

3) That resources are available within the project to support staff, etc. to provide for the implementation of these guidelines;

4) USAID will monitor compliance through normal mid-term and final project audit and evaluation procedures. Review of environmental compliance shall be written into the scopes-of-work for the evaluation teams.

Action Recommended: A Negative Determination under AID Environmental Procedures (22 CFR 216) is recommended, with the a categorical exclusion granted under Section 216.2 (c)(1)(ii).