

# THE UNITED STATES AND RUSSIA, PART II: RUSSIA IN CRISIS

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## HEARING BEFORE THE COMMITTEE ON INTERNATIONAL RELATIONS HOUSE OF REPRESENTATIVES ONE HUNDRED FIFTH CONGRESS SECOND SESSION

SEPTEMBER 17, 1998

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# CONTENTS

## WITNESSES

	Page
The Honorable Strobe Talbott, Deputy Secretary of State, U.S. Department of State .....	5
The Honorable Lawrence Summers, Deputy Secretary, U.S. Department of the Treasury .....	9
The Honorable George P. Schultz, Former Secretary of State .....	21
Dr. Dimitri Simes, President, The Nixon Center .....	36
Dr. Ariel Cohen, Senior Policy Analyst, Russia & Eurasian Studies, The Heritage Foundation .....	38
Professor Janine Wedel, Associate Research Professor, George Washington University .....	41

## APPENDIX

### Prepared statements:

The Honorable Benjamin A. Gilman, a Representative in Congress from New York and Chairman, Committee on International Relations .....	47
The Honorable Christopher H. Smith, a Representative in Congress from New Jersey and Chairman, Subcommittee on International Operations and Human Rights .....	56
The Honorable Lee H. Hamilton, a Representative in Congress from Indiana .....	58
The Honorable Lawrence Summers .....	61
Dr. Dimitri Simes .....	70
Dr. Ariel Cohen .....	74
Professor Janine Wedel .....	85

### Additional material submitted for the record:

Letter to the Editor, <i>Moscow Times</i> , from Anatoly Chubais, submitted by the Department of the Treasury .....	106
An address by the Honorable Strobe Talbott given at the School of Humanities and Science, Stanford University, November 6, 1998, "Gogol's Troika: The Case for Strategic Patience in a Time of Trouble" .....	108
Questions submitted by the Committee on International Relations answered by The Honorable Strobe Talbott .....	118
Questions submitted by The Honorable Lee H. Hamilton answered by The Honorable Strobe Talbott .....	142
Note: The International Relations Committee did not receive answers from The Honorable Lawrence Summers	

## **THE UNITED STATES AND RUSSIA, PART II: RUSSIA IN CRISIS**

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**THURSDAY, SEPTEMBER 17, 1998**

**HOUSE OF REPRESENTATIVES,  
COMMITTEE ON INTERNATIONAL RELATIONS,  
*Washington, DC.***

The Subcommittee met, pursuant to notice, at 10:09 a.m., in room 2172, Rayburn House Office Building, Hon. Benjamin Gilman (chairman of the Committee) presiding.

Chairman GILMAN. [presiding] The Committee will come to order. This morning, we'll be finishing our two-part series on U.S.-Russian relations. Since our earlier hearing on this subject, held on July 16th, much of what our witnesses at that hearing warned against regrettably has come to pass.

Since then, we have seen a huge bailout for the Russian Government approved by the International Monetary Fund (IMF) and the World Bank. Then we saw the first installment of the IMF's loan turned over to the Russian Government, almost \$5 billion, and saw how that money essentially disappeared without any visible benefit to the Russian people. We've witnessed since then the near collapse of the Russian economy, and we've seen the rise to the second highest office in the Russian Government of a man who, as Foreign Minister, seemed to make it his business to find ways to make it more difficult for our Nation to exert leadership on important global issues, such as a proliferation of weapons of mass destruction in places like Iraq.

As the Committee heard at its July hearing, anti-Americanism appears to now be on the rise in Russia, with average Russians equating the quasi-reforms of the government of President Yeltsin with the true reforms that our Nation has wanted to see, and rejecting the idea of such so-called reforms and the corruption that has flourished in their wake.

I'd like to note to our witnesses this morning that I believe our government has not only been lied to by high-level Russian officials, but has ignored important signals over the last few years that all is not well, both in Russia and in our relationship with its government. Russian President Yeltsin has told President Clinton many times that he support reforms, but then has done little, if anything, to ensure their success.

A former high-level Russian official, Anatoly Chubais, has now admitted that the Russian Government had outright lied to us and to the IMF to obtain the most recent bail-out package. Over the last few years, many high-level Russian officials have denied that

a commerce in missile technology is being conducted with Iran, yet it appears to continue and flourish.

And while the Russian Government's pursuit of a so-called "multi-polar world" clearly appears intent on obstructing American foreign policy goals, no Russian official that I know of has ever made an admission of that fact. Instead, for example, President Yeltsin has made references to Europe's getting rid of its "uncle" when it arranges its future security.

And while our Nation seeks democratic reforms in all of the states of the former Soviet Union, Russia finds the financial means to support the Soviet-style dictatorship of Alexander Lukashenko in Belarus. Huge amounts of money have poured out of Russia into foreign bank accounts over the last few years, but no one in our government seemed to take any concrete action to try to halt that, let alone acknowledge the seriousness of the problem. President Yeltsin instead announced several campaigns to fight such corruption, none of which have amounted to anything.

And IMF, World Bank, and European Bank money continued to flow to the Russian Government, then followed by private investors' money. And now it appears that much, if not all, of that money may be lost. Russian journalists and citizens who have stood up to that corruption have risked their lives and indeed some of them have lost their lives.

The mass privatization program in Russia, a process that our government directly supported, contributed to the rise of unregulated, so-called "investment funds" that scooped up citizens' vouchers and then left them with nothing. The United States stood silent while a subsequent "loans for shares" privatization by the Russian Government appeared to turn over to its new "tycoons" some of Russia's richest industries.

A World Bank loan program for the Russian Government to begin compensating average Russians for the loss of their privatization vouchers did little but pay for the salaries of high-priced western consultants. And we wonder why the Russian people, after 7 years of massive depression, object to more reforms at this point and suspect America's motives toward their country.

Given all of this, and much more that I'll not go into for reasons of our limited time this morning, we have to ask whether the Administration was ignoring all of this or simply wanting it to go away.

How can Russia change from the success story of our foreign policy by which it was portrayed by our Administration just 2 years ago, into the dismal failure of our foreign policy that it appears to be today?

I wrote to President Clinton before his recent summit in Moscow, stating that I doubted that the assurances we've received from Administration officials about developments in Russia and in its foreign policy in recent years have truly reflected the reality of the situation.

In fact, Congress and many of its Members have not been silent on their doubts over the success of our policy toward Russia. This Congress overwhelmingly passed our "Iran Missile Proliferation Sanctions Act", and, despite the President's veto of that measure,

Members remain concerned over Iran's access to Russian missile technology.

I publicly stated a long list of concerns over our policy toward Russia in an op-ed piece that was published by *The Washington Post* in June, asking the President not to move forward with the most recent IMF bail-out until those concerns were addressed.

Members of this Committee, including our Vice Chairman, Mr. Bereuter, and leading Members of the other body, have publicly stated their concerns as well, including concerns with regard to Russia's interaction with Iran, with Iraq, and China, its intimidation of its neighbors, and its internal corruption that have been expressed by Members of Congress for several years now.

I submit that now, as our policy toward Russia appears near collapse, it's time to move away from "bumper sticker" slogans, as some observers have uncharitably characterized the content of current U.S. foreign policy in recent months.

Ladies and gentlemen, having stated my critique of our government's policy toward Russia, let me commend it for not shying away from this hearing this morning. Instead, two officials, who I believe have been the key influences on our policy toward Russia for the last 6 years, have agreed to join us this morning to take our thoughts and questions, and explain how we have arrived at this point and what the future holds.

So I want to welcome our Deputy Secretary of State, Strobe Talbott, and our Deputy Secretary of the Treasury, Lawrence Summers. We welcome you, gentlemen, to our hearing and we thank you for taking the time to be with us. We're pleased to see you. We'd be most pleased to see you on a more frequent basis in the future, and we hope that we can arrange that. Also joining us today by video link from California will be former Secretary of State, George Shultz.

I hope our Members and the audience will bear with us as today will mark the Committee's first use of this new video link and it may be a little difficult at times.

Finally, we will take testimony from a panel of three witnesses who spent years following developments in Russia and who have written extensively on the political scene there, including the implementation of economic reforms. Those witnesses will be: Mr. Dimitri Simes of the Nixon Center, Dr. Ariel Cohen of the Heritage Foundation, and Professor Janine Wedel of George Washington University.

I want to welcome all of our witnesses this morning. At this time, I recognize our Ranking Minority Member, Congressman Hamilton, for any opening remarks that he may wish to make.

[The prepared statement of Mr. Gilman appears in the appendix.]

Mr. HAMILTON. Thank you very much, Mr. Chairman. I certainly want to join you in welcoming our two very distinguished witnesses this morning, Mr. Talbott and Mr. Summers. I've greatly admired their work, as they've taken on some very difficult tasks.

This hearing comes at a time when the Congress is not inclined to be very helpful to Russia. The mood in the Congress, as the Chairman's statement very clearly suggests, is sour toward Russia. There's deep concern about the direction, especially the economic

policies, of the new Russian Government. Many question whether any government in Russia can prevent corruption and cronyism from derailing efforts to pull Russia out of its economic crisis.

Russia today faces a difficult and dangerous crisis. It's exactly the urgency of this crisis that makes U.S. policy toward Russia so important. The United States has a strong interest in keeping Russia on the path to reform. What happens in Russia will profoundly affect the world's security and economic environment. We want the Primakov Government to implement reform and to resist the temptation to slide backward, undoing the progress already achieved.

I think all of us can agree on what Russia needs to do—control its budget deficit, money supply, overhaul its tax code, break up monopolies, reduce corruption, enforce bankruptcy laws, and enforce private property rights. We want Russia to implement the IMF package it agreed to in July.

But of course, there's considerable doubt whether Russia will pursue this course. Reform in Russia has suffered a serious setback. Those of us who support U.S. and international efforts to advance reform in Russia are deeply disappointed with the events of the past several weeks. But I'm really not discouraged.

In the 7 years since the collapse of the Soviet Union, Russia has made important progress on both political and economic reform. That progress has been slow, but it has been significant. 70 percent of the Russian economy is in private hands; military spending is  $\frac{1}{7}$  of what it was a decade ago; there's been a dramatic demilitarization of the Russian economy; Russia has held several elections at the national, regional, and local level; their troops are out of Germany and the Baltic states; and they work side by side with NATO in Bosnia.

We cannot expect reform to proceed in a straight line. We cannot expect reformers to be deaf to the plight of the Russian people, who have paid a high price for reform. The future of reform in Russia is by no means certain, but the United States has too much at stake in the outcome of the current crisis simply to walk away. Our national interests demand that we continue to engage with the Russian Government, and at every opportunity, push for continued progress on reform, and support the reformers. Russia still matters.

Given what happened in recent weeks in Russia, we need to rethink our policy toward Russia. It appears to me that the western liberal economic model has faltered in Russia. If we want reform to take hold in Russia, we're going to have to deal with Russia more on Russia's terms. We have to ask ourselves what we can reasonably expect from Russia.

We are right to push and prod reform, but we have to expect that reform in Russia is going to be more gradual, more mixed, and more Russian than we expected and hoped 7 years ago when the reform process began.

Russia will carry out reform in a Russian way, and my question for our distinguished witnesses is what do we do about it? How do we encourage Russia to return to the path of reform? How does the United States promote reform in Russia when the politics in Russia, at least for the moment, point in the opposite direction?

Mr. Chairman, I commend you for convening this hearing. It comes at an important time. We could not have two better witnesses than we have before us now, and I of course look forward to hearing from Secretary Shultz in a few minutes, one of our most distinguished public servants. And I look forward to the testimony of all. Thank you, Mr. Chairman.

Chairman GILMAN. Thank you, Mr. Hamilton. Are there any other Members seeking recognition? If not, we'll proceed with our testimony.

Before we do that, we're pleased to welcome to our Committee this morning, three members of the House of Commons who are visiting the United States. Allow me to introduce Mr. James Gray of North Wilshire—Mr. Gray, would you just be kind enough to stand up? Thank you. Tim Collins of West Berlin in Lundsedale. And Edward Gardier Harboro. All are conservative MP's from the House of Commons, and we welcome you to our Committee.

And now we'll proceed with our first witness, Strobe Talbott, Deputy Secretary of State. From April 1993 to February 1994, Mr. Talbott served as Ambassador-at-Large and Special Advisor to the Secretary of State for the New Independent States. He was *Time* magazine's editor-at-large from September 1989 until March 1993, and prior to that he had been its Washington Bureau chief for 5 years. His early assignments for *Time* were as diplomatic correspondent, White House correspondent, State Department correspondent, and Eastern European correspondent. He certainly has had a good background. He's been a trustee of Yale University and Hotchkiss School, and has served on the board of directors of the Carnegie Endowment for National Peace.

We welcome Strobe Talbott. You may put your full testimony in the record, or summarize, whichever you deem appropriate. Please proceed.

#### **STATEMENT OF STROBE TALBOTT, DEPUTY SECRETARY OF STATE, UNITED STATES DEPARTMENT OF STATE**

Mr. TALBOTT. Thank you very much, Mr. Chairman, for the chance to be here with my friend, and colleague, and traveling companion, Larry Summers, this morning. I cannot imagine a more appropriate time for you to convene your colleagues and us for a discussion of this important subject.

If I may, Mr. Chairman, I'd like to add my own welcome to our friends from the mother of Parliaments, and through them, to thank their government for the extraordinary job that it did earlier this week at a meeting of the G-8 in London, which both Larry and I will have occasion to refer to.

I also want to congratulate you, Mr. Chairman, for your technological innovation over here, even though I don't see George Shultz. I see where George Shultz will be sitting.

Chairman GILMAN. He'll be arriving a little later.

Mr. TALBOTT. I have high hopes for this technology for selfish reasons. Maybe if it advances, Larry and I won't have to spend quite so much time dashing around the world, and maybe in the future, we'll even be able to appear before this Committee, when we are dashing around the world, on television screen.

Chairman GILMAN. We should take greater advantage of this technology.

Mr. TALBOTT. Mr. Chairman, if I could respond to the very bleak picture that you painted of Russia in your own opening comments. I understand the objective reasons for your high degree of pessimism. I do want to say, however, that the only statement you made that I'm quite sure is not true, is that this is the end of this Committee's deliberations on this subject. I think that your own efforts to come to grips with the problem of Russia are going to continue for a very long time into the future. Larry and I and other colleagues from the Administration look forward to participating in the deliberations of this Committee on that subject.

And that goes to a larger point. The drama of Russia's transformation from a dictatorship and an empire into a normal, modern state is not over. It is going to continue. As Mr. Hamilton said, it's going to be a rough and rocky road. We have known that all along. We have certainly been reminded of that in recent weeks.

I've been to Moscow twice in the last 4 weeks, including with the President 2 weeks ago. I returned last night from Europe, after consultations in London, along with Larry, with our G-8 partners, and was then in Brussels for consultations with our allies. I can assure you, Mr. Chairman, that just as this Committee is seized of this issue, so is the alliance, so is the G-8, and we will be talking about that.

I'm sure you agree, Mr. Chairman, that there is no foreign policy and national security issue on which it is more important to have consultation between the two branches of the U.S. Government than on this one. And there is no issue on which it is more important to have the highest possible degree of bipartisan consensus. And it's very much in that spirit that Larry and I come before you this morning.

Now Larry will be addressing the economic situation, which is absolutely critical, since the current changes and uncertainties that have been triggered by the economic crisis must be addressed both in terms of understanding them and also in terms of our response. In my brief opening remarks, I'm going to speak to two issues, the internal political situation and the foreign policy situation.

Starting with the internal situation in Russia. It is important to see both the positive and also the more disturbing and problematic aspects of what is going on. Russia today is a democracy. It's a constitutional democracy. It has not been that for most of its long and troubled history.

Moreover, Russia today has a government, which it did not have as recently as a week ago. It got that government because the President of the Russian Federation and the Parliament played by the rules of the Russian constitution. That is not the way that Russian politics have worked in the past, to put it mildly. In the past, Russian politics have tended very often literally to come out of the barrel of a gun; that is, Russian politics have very often meant blood in the streets, knocks on the door at midnight, executions in the dungeons of Lubyanka, and the Gulag Archipelago.

Also, Russia has a Prime Minister who has a mandate from both the President and the Parliament. This Prime Minister is well known to us. He's somebody with whom we have worked closely

and often well over the past several years. Secretary Albright and Mr. Primakov, in his capacity as Foreign Minister, have developed early on in their relationship a very high degree of candor on issues like NATO enlargement, Iraq, Kosovo. They have developed an ability to constructively identify areas where U.S. and Russian interests converge, and also to work seriously on managing issues where we differ.

I spoke to Secretary Albright, who sends her greetings to you and the Committee, Mr. Chairman, immediately before coming up here this morning, and she asked me to make one point about Mr. Primakov. And that is, that in their very first meeting, as Secretary of State and Foreign Minister, she feels that they were able to take the measure of each other and each could see in the other someone who was extremely capable and forceful in representing, and advocating, and advancing the interests of his and her national interest.

Now let me go to the more somber side of the picture. The initial appointments that Mr. Primakov has made, particularly in the economic area, and Larry will expand on this, have been cause for concern. This is not an issue of personalities. It's not really even an issue of party affiliation. Rather, it's an issue of affiliation with certain policies in the past. The policies, that if they were to be harbingers of policies to come, would auger badly for Russia's ability to pull itself out of its difficulties.

Now Larry will speak to the principle concerns in the economic sphere. I would just say this about the political dimension of Russian economics. Further economic decline, deterioration would carry with it the danger of political turmoil and drift within Russia and on the part of Russia as a whole in a direction that we would regard as wrong and dangerous, and that I think would be very much contrary to Russia's own hopes for a better future.

Now I want to emphasize that I'm not making a prediction here. I do not think that the worst outcome or even very bad outcome is in any way fore-ordained; it is not certain. It is, however, a possibility that we and the Russians must keep in mind and do everything we can to work against. And Larry will lay out the precepts and parameters of what we can and cannot do.

Let me, Mr. Chairman, turn to the foreign policy and national security side of the picture. Again, it is very mixed. It's clouded, but it is not unremittingly bleak. In terms of its international behavior, Russia today is a much different country than it was 10 years ago. And let me, echoing Mr. Hamilton, touch on a couple of those differences.

There are today no Russian troops in the Baltic states. There are no nuclear weapons in Ukraine, Kazakhstan, and Belarus, which is a credit to the statesmanship of Russia, as well as to statesmen past and present in those other three governments. Russian troops are serving side by side with the United States and others to keep the peace in Bosnia. Russian officers are working with our allies at NATO headquarters in Mons. A Russian diplomat met just yesterday with the allied permanent representatives in Brussels for discussions on CFE, Kosovo, civil emergency planning, all under the rubric of the cooperative NATO-Russian relationship. Meanwhile, other Russian diplomats are working with the United States

and the Europeans to bring peace to the South Caucasus, while others still are working also with us and the Europeans to stop the violence in Kosovo.

Now let me turn to the clouds that unmistakably have gathered on the horizon of Russian foreign policy and of U.S.-Russian relations. Mr. Hamilton spoke of certain sourness in the mood of the U.S. Congress. Let me say a word or two about the mood and the inclinations of the Russian Parliament.

The Yeltsin-Primakov Government is going to be under continuing pressure from the Duma to shift the emphasis and Russia's interaction with the United States and our allies from cooperation and partnership toward assertiveness, opposition, and defiance for its own sake. This pressure is likely to mount during a time when the Russian executive branch feels that it must make accommodations with the legislative branch in the realm of economic and social policy, much along the lines of what Mr. Hamilton anticipated in his own comments.

Now if, and I stress here if, that were to happen—that is, if the Russians were to move in their foreign policy in the directions that we feel already they are moving in their economic policy, it would portend a double disaster for Russia.

First, because helping Russia to help itself in the economy, which Larry will be talking about in a minute, will, from our standpoint, go from being merely very, very difficult to being absolutely impossible.

And second, the kind of drift or trend that we have to consider a possibility in Russian foreign policy would be contrary to Russia's own interest. It would put out of reach the solution to problems that Russia desperately needs to find.

Now some in the Duma have depicted the unresolved issues on the U.S.-Russian agenda as concessions that the West is trying to ring out of Russia, or as favors that the United States is trying to get Russia to do for us. Nothing could be further from the truth. Russia needs an effective global non-proliferation regime. Russia needs strategic arms reduction. Russia needs an updated CFE treaty. Russia needs good relations with its neighbors. Russia needs a Europe without dividing lines. Russia needs peace in the Balkans, and it needs a tamping down of ethnic conflicts especially on its borders. And Russia needs a strong cooperative relationship with NATO.

Now Secretary Albright asked me to stress that the United States wants and needs these things too. And if, again I stress *if*, Russia's new leaders can see those needs as clearly as we do—that is, mutually beneficial—as mutually in our interest—it should be possible to continue to develop the agenda that we've pursued with some significant accomplishments over the past several years. Specifically, in strategic arms control, non-proliferation in general, and to pick up on a point you made, Mr. Chairman, on the cessation of the transfer of dangerous technologies to Iran. And also, in common diplomatic efforts to strengthen European security and settle regional conflicts.

My final word would be this, Mr. Chairman. Particularly when there is uncertainty about the direction that Russia is going to take, there must be all the more certainty about what we stand for

and what principles will guide our policy. There must be all the more clarity on our side—clarity of purpose, clarity of interest. Our message to the Russian leaders at the Moscow summit and since is that the United States has a continued stake in Russia's ultimate success, and that means democracy and the market economy, and it means reform in the sense of greater political and economic freedom.

We are willing to work together with them to advance our common interests. How much we can do together depends upon the choices that they will make for themselves. And on that, Mr. Chairman, if you would permit, I would ask Larry to address the important economic dimension of the problem.

[The prepared statement of Mr. Talbott appears in the appendix.]

Chairman GILMAN. Thank you, Secretary Talbott, for your very extensive review of where we stand with some of our policies with Russia.

We're now pleased to welcome Deputy Secretary of the Treasury, Lawrence Summers. Lawrence Summers, as Deputy Secretary, is the second highest ranking official at the Treasury Department. He takes a leadership role in the Department's work on international policy issues; on tax policy issues; and issues relating to the financial system, domestic policy issues, and enforcement issues. Mr. Summers continues to serve as the American deputy in the G-7 international economic cooperation process. From 1993 to 1995, Mr. Summers served as Under Secretary of the Treasury for International Affairs. From 1991 to 1993, he served as vice president of development economics and chief economist at the World Bank. He was also a National Rhodes professor of political economy at Harvard from 1987 to 1993. We're pleased to welcome Secretary Summers.

You may summarize or put your full statement in the record, whichever you deem appropriate.

#### **STATEMENT OF LAWRENCE SUMMERS, DEPUTY SECRETARY, UNITED STATES DEPARTMENT OF THE TREASURY**

Mr. SUMMERS. Thank you very much, Mr. Chairman. And like my colleague, Strobe Talbott, I am very pleased to have this opportunity to testify before this Committee at what is surely a critical juncture in the Russian situation.

What I'd like to do today is discuss three issues: Russia's evolution over the past 7 years and what went wrong; the considerations that have guided the U.S. policy approach during this period; and the main policy challenges going forward.

Russia's economic policy framework collapsed in the middle of last month, as the Russian authorities, in the face of severe market pressures, decided unilaterally on the enormously risky course of simultaneously devaluing the ruble, imposing a debt moratorium, and restructuring government bonds.

This decision has been followed by a very substantial breakdown in the functioning of Russia's economy, with a dramatic decline in the value of the ruble, a breakdown in the payment system, evidence of extremely rapid inflation, hoarding and shortages, and substantial disruption of production relations.

In a proximate financial and economic sense, the cause of these developments was an inability on the Russian Government's part to control the budget deficit, which led to excessive borrowing, and what came in the face of greater and greater uncertainties to be excessively high interest rates on excessively short-term debt, which they then proved unable to roll over, partly as a result of the difficulties created by their overall monetary policy framework.

When they were unable to roll over their government debt, their exchange rate came under very substantial attack, resulting in substantial depletion of reserves, creating reduced confidence, which in turn led to higher interest rates, more attacks on the exchange rate, larger budget deficits because of the higher interest rates, and brought them to the point where their policy framework collapsed.

This was the proximate cause in an economic and financial sense. In a deeper sense, while this is a question that will be studied and debated I'm sure for many years to come, it would be a judgment that the breakdown in the framework reflected its unsustainability in the wake of two broader problems—problems that we had very consistently stressed in both our dialog with Russia and our public comments on the Russian situation.

The first was a basic difficulty at the government level of reconciling the needs the government felt it had to meet with its capacity to generate revenue. The central Russian Government was only able to raise 9 percent of GDP in cash tax revenues during 1997, and so their needs created an enormous pressure, which in the short run was met not by printing money, but by going deeper into arrears, creating the strains that that led to by borrowing on markets on increasingly less favorable terms.

In a still deeper sense, I think it is fair to say that Russia's breakdown in the policy framework was a result of what is the great irony of this problem of post-Communist transition. That the state was too weak, not too strong. That the state lacked the capacity to regulate banks, lacked the capacity to collect revenues on a fair and equitable basis, lacked the capacity to fully establish the rule of law in commercial relations, lacked the capacity to regulate large concentrations of financial power, lacked the capacity to provide a stable framework in which commerce could operate.

Such a system could not go on. It was always a race between the forces of construction and the underlying strains that were associated with the weaknesses in that state system. And it was our policy to support the forces of construction, the forces of strengthening the state, so that it could do what it needed to do.

To be sure, while no one should minimize the extent to which Russia's economic policy framework was shattered in mid-August, the Russian economy is in a very different position than it was some years ago. Russia's military spending is now only  $\frac{1}{7}$  of its peak level in 1998, and  $\frac{2}{5}$  of its level in 1992; 70 percent of all economic activity is in the private sector; and Russia is now open to the world, open in the sense that tariffs are down and trade is up, but open in a much more profound sense that Russian citizens are in touch—they see what is going on in the rest of the world in a way that they did not earlier.

To take just one example, it has been said that this is the age of the information revolution. When I visited Russia in 1992, a per-

sonal computer cost 24 years' wages for the average Russian worker. That situation has changed fantastically in the last 6 years, as a consequence of the greater openness that has gone along with the process that has taken place.

Russia's challenge now is to reconstruct an economic framework, building on this progress that works for Russia. Let me now say a few words about our policy approach during this period.

Starting with the rise of the Russian Government in the early 1990's, and accelerated with the Vancouver summit in 1993, the United States, along with its partners in what was then the G-7 process, has played an important role in seeking to help Russia develop the institutions and policies of a functioning market economy, not out of any motive of charity or comity, but because of our belief that the lessons of history suggest that the stable evolution toward integrated prosperity of Russia very much serves our deepest national security interests.

Those efforts have proceeded on two tracks. The track involving direct assistance on the ground—technical assistance, exchange programs, and the like—to create in a very long-run sense the kinds of institutions that can knit a society together—a particularly important imperative when, after 7 years of communism, all of the institutions that knit a nation together, churches, and choirs, and athletic teams, and associations, and Rotary Clubs, were not present.

And during this period, it was our approach, working through the international financial institutions, to provide conditioned assistance to Russia. Conditioned and measured with the pace of reform. And it was that assistance that played a crucial role in bringing Russia from hyperinflation in 1992, down to a situation where, for the last several years, inflation rates were quite low. It was that assistance that played an important role in supporting the transformation of Russia from an economy where most people worked in the public sector to an economy where most people worked in the private sector.

Chairman GILMAN. Secretary Summers, if I might interrupt, I see that former Secretary Shultz has joined us. We welcome you, Secretary Shultz, to our Committee and we look forward to your testimony later today.

Please proceed.

Mr. SUMMERS. And on behalf of the witnesses, let me welcome you also, Secretary Shultz.

The reform process then had significant results. The reform process involved substantial conditionality. At a number of points, the IMF support to Russia was cut off. The pace of World Bank support never reached the levels that were originally announced, because of difficulties in the structural policy area and because of difficulties in conditionality.

The reform process made an effort to support the Kiryenko Government, because the Kiryenko Government had recognized perhaps more forthrightly than its predecessors the fiscal and broader institutional failures that threatened Russia's economic stability, and because we recognized that it was caught between, on the one hand, the forces that opposed reform in the Duma, and, on the other hand, the forces of concentrated economic power that favored

a kind of reform but not a kind of reform that was directed at maximizing the prosperity of the vast majority of Russian citizens.

And it was in an attempt to support that reform process, recognizing all along that there were great forces colliding here and enormous uncertainties about the outcome, that the international financial institutions, with the support of the G-7 and the United States, continued on a conditional basis to support the process of reform.

In the event, with the difficulty that the Kiryenko Government had in carrying out its hopes because of pressures from the Duma, because of the very substantial financial strains imposed by events in Asia and other parts of the world, because of the large accumulations of debt that took place in the process, market confidence could not be achieved and the framework collapsed, and has to be rebuilt.

We were taking a calculated risk in providing support. The international financial institutions were taking a calculated risk. I believe that it was the right calculation, that it was the right attempt to make, that it showed significant results, and one can only wish that the reform process in Russia had been more effective and that the international environment had been more congenial.

Where do we go from here? It is enormously in this country's interest that Russia become a functioning economy and join the community of nations. And we will, through the international institutions, be prepared to provide support when we can be confident that support will be well used.

It is, I think, as Congressman Hamilton suggested in his comments, important that Russia chart its course forward and chart forward a course that works for them. Fortunately, it is also important to recognize that the laws of economics, like the laws of physics, do not respect political constraints. Too much money anywhere will create too much inflation. Price controls anywhere will create substantial shortages and hoarding. Lack of secure property rights anywhere will inhibit investment. And so as they craft their approach, we believe it will be important for the Russian authorities to recognize that it must reflect the basic constraints of economics.

We know that this will not be an easy process. It was never an easy process and it is much more difficult in light of the problems that have surfaced in the last month. But it is one in which this country has an enormous stake.

Let me conclude, if I could, with just two observations. First is that the Russian Government asked very clearly at the London meeting to be judged by its actions, and that is how it or any other government should be judged, and it is the approach that we will take and that we will urge the international financial institutions to take. And we will look for a pragmatic Russian-owned course that moves toward an economy that will function well.

Second, we are enormously mindful, as are the international financial institutions, of the crucial issue posed by corruption in Russia. It is a problem that I think as we go on in the economic reform in international development area more generally, will rise in importance on the agenda. It is why Treasury, through our financial crimes enforcement unit, is in substantially greater contact with the Russians to cooperate on these issues.

But I would leave the Committee with this thought. A crucial part of fighting corruption is building a market economy. When you have price controls, you have black markets and you have corruption. When you have quotas, you have bribes to the people who allocate the quotas. When you have directed lending, you have gifts to the people who direct the lending.

The process of economic reform is enormously important in building an economy that reduces the incentive, and the means, and the capacity for corruption. And that is yet another reason why it is important that we, based on Russian choices, be prepared to support the process of economic reform.

Thank you very much, Mr. Chairman.

[The prepared statement of Mr. Summers appears in the appendix.]

Chairman GILMAN. Thank you very much, Mr. Summers. Gentlemen, a two-part question to both of you. Given the current Congressional concern over the increased funding for the IMF, should the IMF go ahead and disburse the next installment of its July loan to Russia? And second, given the disappearance of the first \$4.8 billion disbursements to Russia, what additional assistance should Congress supply to the IMF to go to Russia? I welcome both your comments.

Mr. SUMMERS. Thank you, Mr. Chairman. First, the economic framework in which Russia had been operating, as I said, has collapsed. And so, for the IMF to be in a position to make a further disbursement, it would have to be rebuilt on a basis that reflects current reality. And if it can be rebuilt, and it can be made convincing and credible that those resources will be well used, then the IMF should be prepared to support Russia. But that must depend upon a rebuilding of a credible economic framework, not any arbitrary schedule that existed from the previous framework.

Second, the IMF, Mr. Chairman, as you know, is critically short of resources at an extremely difficult time in the global economy. There is a great deal that can be debated about how the IMF should operate, and certainly this is a matter of very great importance. It needs to become much more transparent and accountable in its operations.

But now at a moment when contagion is having a major effect on global financial markets, I believe that it is essential that the United States support the system that is in place for containing these pressures, even as we are open to the most far-reaching consideration of what kinds of systems should be put in place.

We are in a situation where there are now fires burning in many places, and it is important to keep the fire department in place, even as we go to the very critical issues of making sure that this does not happen again.

I would say finally, Mr. Chairman, that it is in the nature of a fixed exchange rate economic policy that governments meet the obligation to hold the exchange rate at a given level, and therefore they provide hard currency, transact back and forth at that level. It is very regrettable that it was not possible to maintain the fixed exchange rate, and that Russia chose to devalue. But that is inherent in the use of reserves to defend a fixed exchange rate.

Chairman GILMAN. Thank you, Mr. Summers. Mr. Talbott, would you please comment on the questions.

Mr. TALBOTT. I think Secretary Summers has fully and clearly answered the questions, Mr. Chairman.

Chairman GILMAN. And you feel that we should be continuing our tranches of IMF funds to Russia?

Mr. TALBOTT. I think Larry has put it very, very well. The IMF continues to be an extremely important mechanism for dealing with Russia, as well as other problems in the world. But everything depends on decisions that Russia has to take itself.

Chairman GILMAN. Wouldn't it be far better for the IMF to step aside and leave the Russian Government to negotiate for its foreign loans on a market basis with private commercial lenders, paying interest rates, as necessary, to get such loans, instead of bolstering them up continually with further tranches from the IMF?

Mr. TALBOTT. I'll take a first crack at that, Mr. Chairman. I'm sure Larry will have more to say. The short answer is I would not agree with that advice. I think the magnitude both of the challenge that we face and the magnitude of the stakes that we have in the outcome of the situation there, requires us to use all instruments that are available to us, both in terms of the international financial institutions, bilateral instruments, and of course, as you correctly point, the private sector is also very important too.

Larry, do you want to add anything on that?

Mr. SUMMERS. Russia faces critical challenges, Mr. Chairman, in working out the problems associated with its past debts, and we hope and trust that the new Russian Government will choose a co-operative framework for working with its creditors to deal with that large volume of debt.

I don't think, Mr. Chairman, that it is realistic at this point, or in the near future, to anticipate Russia's ability to access private markets, in the wake of what has happened—I don't think that is a realistic prospect at all. And indeed, in important respects, the difficulties that Russia found itself in were a consequence of excessive borrowing on an excessively short-term basis.

Chairman GILMAN. And one more question. My time is running out. How can the Russian Government itself, in a state of fiscal collapse, afford to supply off-budget subsidies to the Soviet-style government of Belarus and maintain reported intelligence facilities, for example, in Cuba, for which it reportedly pays a considerable sum? Have we brought that to the attention of the Russian Government? What are your thoughts about that?

Mr. TALBOTT. First of all, you mentioned in your opening statement, the issue of Belarus. Belarus may at some point be the subject of a separate hearing and a separate discussion. Events and trends in that country have been disturbing, notably including from the standpoint of the long-suffering Belarusian people for a very long time. Some commentators have said that Belarus offers a—what shall I say—a cautionary or warning example of the worst—or at least, the bad—direction that could occur with respect to Russia. Russia cannot afford to prop up a Belarus that is lurching backwards both in terms of re-adopting the policies of the past, and also isolating itself from the rest of the world, and certainly from Europe.

I would prefer in this setting, Mr. Chairman, for reasons you can understand, not to get into intelligence matters, but I don't think there's any question that the greatest challenge that Russia faces today is an internal challenge—it's a domestic challenge, and it's an economic challenge. And I would also say that many of the Russians with whom we have been dealing, including those with whom we have some significant disagreements, would accept that basic proposition.

Chairman GILMAN. Thank you. Mr. Hamilton.

Mr. HAMILTON. Thank you, Mr. Chairman. There are obviously a lot of doubts among all of us about the Primakov Government. But I suppose one thing that can be said in its favor is that it will bring some political stability to Moscow and to Russia.

Do you think we now have a stable government for a period of time in Russia?

Mr. TALBOTT. Mr. Hamilton, the short answer is I think, yes. Stability is a desirable characteristic of any society or any government. I would say, however, it is necessary but not sufficient for Russia to be able to move forward in the direction that the Russian people want and deserve.

Mr. HAMILTON. But obviously, if you didn't have a stable government, you couldn't make tough economic decisions.

Mr. TALBOTT. That's correct. But it remains to be seen whether this government will make the tough and right economic decisions.

Mr. HAMILTON. Well, I'd just like to get your opinion of that. Mr. Summers says that Russia faces a choice—to restart, accelerate, and deepen reform; or, drift in a dangerous policy direction. What's your guess? Which way will it go?

Mr. TALBOTT. Let me start by looking at the words that we're using. The word reform has become problematic in several respects. It's problematic because there is not agreement within Russia, not to mention between Russians and others on exactly what it means. And insofar as it either loses definition or acquires multiple and ambiguous definitions, it's not entirely useful.

Moreover, and we have to be very candid about this, to many ears in Russia, reform has become a dirty word. Many Russians, which is to say average Russians, who now are enfranchised as a part of fledgling democracy and therefore who can vote their fears and their frustrations, as well as their hopes, in sending people to be your counterparts in the Russian Duma, have come to associate reform with hardship, uncertainty about whether they're going to get paid, uncertainty about whether they're ever going to get their pensions, uncertainty about quality of life issues, crime on the streets, and that kind of thing.

Mr. HAMILTON. What I'm after is to get a sense from you—look, both of you have just spent a lot of time with the Russians. You're very familiar now with all of the leaders of this new economic team. There are a lot of doubts up here about Russia. Mr. Gilman, the Chairman, a moment ago was making a statement that many people agree with: hands off, just let them go, let them sink or swim on their own; that should be our policy. You've argued the other way now.

But are you optimistic? I pick up the paper and I hear they're going to start printing a lot of money, and you're going to get

hyperinflation very soon. And I see all of these economic advisors, none of whom look very impressive to me. And as I look at all the factors that I've read about, I'm inclined to think I might agree with Mr. Summers, and say, Russia's more likely to go in a dangerous policy direction than it is to go toward reform.

Mr. TALBOTT. Mr. Hamilton, I will try to be as concise as possible. Bear with me while I try to answer the earlier part of your question about reform. What the Russians are doing now is redefining the word reform. President Yeltsin continues, including in his conversations with President Clinton, to say we are 100 percent for reform, and we're going to keep moving forward. But now the hard issue becomes how are they going to define it in practice. How are they going to define it particularly in the areas that Larry has been talking about.

You said in your opening statement that Russian policy across the board is going to be, among other things, more Russian. That is correct. But Russia is still on the planet earth. In other words, we're not talking about a political and economic entity that doesn't follow the rules that our economy follows. They are part of a global economy. And what we are going to both see and help them with, is an effort to reconcile the imperatives of their politics, which includes some things that all of you as elected representatives would appreciate. And that is, making sure that your constituencies feel that the future has some hope for them with the basic rules and laws of a global economy.

Now, I don't want to be incomplete in answering the tough question you've put before us. The reason we should stay engaged is because, while we don't have decisive influence, you could even say that our influence is more at the margins, it is still nonetheless significant. And I think to disengage would be to give up on them. To brace ourselves for a crash of Russia would be to increase the chances that the crash would occur. If we were to adopt what I might call strategic pessimism as the basis of our policy toward Russia, that pessimism could become self-fulfilling.

Mr. HAMILTON. I know my time's expired. I've asked the Chairman if I can ask one more question. I'd like to get some sense of the game plan from our standpoint. I assume you are saying at this time there will be no new money flowing to Russia for some length of time, until we get some sense of how that government is going to move on some of these key economic reforms.

But, what does that mean? Does that mean in a few months, the IMF is going to sit down and measure what Russia has achieved or not achieved? What are going to be your guiding principles there? When is it likely and under what circumstances that Russia would receive additional support from the IMF?

Mr. SUMMERS. Congressman Hamilton, in a situation in this much flux it is difficult to speak, difficult to predict with great accuracy, and while we are obviously an important shareholder in the IMF, it is not for us to speak for what the IMF's policy and its board's policy will be.

But, I would sidestep slightly this question of whether to maintain a posture of optimism or a posture of pessimism, and suggest instead that we should maintain the posture that I think the Russian authorities have asked us to, which is judge by our actions,

not by our words. I think we should continue to watch very carefully what the actions are and if the actions are such that a framework is brought into place in which assistance can be constructive, I think we should support.

Mr. HAMILTON. What are you looking for? You can't bring about all of these reforms that you and I would agree on very quickly in a matter of a few weeks, or months, or even a year. So what are you going to look for, and how quick are you going to make a decision here?

Mr. SUMMERS. I think the things that are crucial are a basic budget framework that respects the laws of arithmetic, and doesn't make unsustainable resort to the printing press essential. Second, a clear set of controls and rule of law, so that one would know where any funds that were lent were going and for what purpose they were being used. Third, a basic set of controls over the banking system that allowed for the movement toward the normal working of the economy.

If Russia had solved all the problems that we've identified in these discussions, nobody would be speaking about assistance for Russia. On the other hand, I think it is very important that conditionality be imposed in a very strong way, so as to level reform, so as to ensure that resources are well used, and so as to maintain the capacity to support reform. Because if Russia accumulates further large debts in support of policies that are not working, there will not be the capacity for them to borrow when policies do work.

Chairman GILMAN. The gentleman's time has expired.

Mr. SUMMERS. But at the same time, I think the prospect of support does have to be there, and just how it will work is something the IMF will have to work out in conjunction with its shareholders, the G-7, and so forth.

Chairman GILMAN. The gentleman's time has expired. Mr. Sanford.

Mr. SANFORD. I'll go back to what you were saying, Mr. Summers, earlier, and that was you'd made the remark that the black markets and price controls don't work. And yet it strikes me that if you look at an IMF loan or a World Bank loan in its conventional structure, basically it's a loan under price controls. What I'm getting at is if you were to pull up Bloomberg right now, and look at the cost of—the pricing—on emerging market debt, you wouldn't exactly see the rates at which you'd be looking at with World Bank or IMF. Would you agree with that?

Mr. SUMMERS. I guess I would answer your question in two ways, Congressman. First, I think at most what it is, is the difference between a subsidy and a price control. So at most what I think's being suggested is that it's a subsidy. Second, the international financial institutions have traditionally functioned as a kind of preferred creditor in our system, and have a rather different capacity to collect than do private creditors.

So, for example, in all the historic cases, such as those in Latin America, in which it was ultimately necessary to reduce private debts, the international financial institutions were serviced in full. And so in that context, the appropriate interest rate for them, given their seniority, is not the interest rate that you would look

at on a Bloomberg terminal. But I think your principle is an important one.

Mr. SANFORD. The bottom line of what you're saying though is that an IMF loan is a subsidized loan.

Mr. SUMMERS. No, no, no. No, Congressman.

Mr. SANFORD. That's what you just said.

Mr. SUMMERS. I think not. I think what I said was that it would be if it was on the same terms with the same capacity to collect as a standard private investors' loan.

Mr. SANFORD. So you think that a taxpayer ought to have this lower classification. In other words, in essence, it's the taxpayer that's paying for these loans.

Mr. SUMMERS. No, Congressman. These loans operate as a kind of senior credit. They are repaid even in situations where other loans are defaulted. That's why it is appropriate for them to have a different interest rate—because they have a different degree of risk—than other loans that are provided.

But I think your principle is an important one, and we led an effort at the IMF to move in this direction by providing for premium interest rates in the case of large, risky programs, so that there was more of a market-based element and an incentive for countries to repay. And that was what I think was a very important change in the way the IMF does business; the United States led the effort to bring about the so-called SRF.

Mr. SANFORD. Don't you think it would be a lot clearer for the taxpayer if we had a conventional IMF or a World Bank loan, and taxpayers are on the tab for a portion of that, rather than in essence subsidizing that loan and indirectly costing the taxpayer here at home money? Why don't we make a separate case for a real market-rate loan, and then direct aid to Russia, if that's what we say we would do.

Mr. SUMMERS. Congressman, I would respectfully reject that view for two reasons. One is the loans have different risk because of the traditional preferred creditor status that the international financial institutions—

Mr. SANFORD. But that's not been the case. I mean, all they've been doing is rolling over debt.

Mr. SUMMERS. No. In fact, I think if you look at the record of the IMF, Congressman, over the last 50 years, you would see that there has not been a default on a major loan during that 50 years.

Mr. SANFORD. Because they've rolled over the debt.

Mr. SUMMERS. No, no. In many, many cases, the exposure of the IMF to countries has been very substantially reduced and there have been net payments from the countries to the IMF. Second, from the point of view of American—

Mr. SANFORD. Are there other IMF loans still outstanding?

Mr. SUMMERS. There are now IMF loans outstanding, certainly.

Chairman GILMAN. The gentleman's time has expired.

Mr. SUMMERS. If I could just make one last point. The IMF has over \$30 billion in gold reserves. And so, before there was any loss to American taxpayers, the IMF's gold reserves, which represent a value-to-loan ratio of about 40 percent, far higher than almost any other financial institutions, are an additional bit of protection for American taxpayers.

So I think that as the Congressional Budget Office has recognized, and many others who have looked at this have recognized, the risks to American taxpayers associated with our contributions to the IMF are very remote.

Chairman GILMAN. The gentleman's time has expired. I've asked our witnesses and audience to bear with us as we work through our first video testimony conference with Secretary Shultz. By agreement with our Ranking Member, after our next Member speaks, we will ask Secretary Shultz to make his opening statement. Then Secretary Shultz will be available to answer questions directed to him, and he'll continue to participate in our conference. I apologize for any change in procedure.

Mr. Lantos.

Mr. LANTOS. Thank you, Mr. Chairman. Mr. Chairman, allow me to take a bit less apocalyptic view of what is happening in Russia than some we have heard so far. Let me begin by saying had Secretary Shultz not been so successful during the 1980's in his policies that are largely responsible for bringing about the collapse of the Soviet empire, we wouldn't be having this hearing and we wouldn't be having these problems.

Let me also say that we are enormously fortunate to have, in Secretary Talbott, one of the most universally recognized experts on Russia, guiding this policy, and in Secretary Summers, an internationally recognized economist of stature.

But I would like to approach the issue a bit differently from the catalog of difficulties we have had so far. Russia today is an open society, it has had three elections, there is freedom of speech, freedom of media, freedom of religion, freedom to travel, private ownership, and if we had seen this 15 years ago, we would be rejoicing at the incredible accomplishments that have come about. I think it's critical not to lose sight of this.

We have been tiptoeing through an issue that I think explains much of our difficulty. When we won the cold war, we wanted to move on on the cheap. And while at the end of the Second World War we created the Marshall Plan, at the end of the Third World War, which was the cold war, we thought we could expect the Soviet Union to evolve into a democracy and a market system without any assistance from the West. So if we are looking for culprits, the culprits are all of us in the West who failed to lubricate this incredibly complex process.

There is one other observation I would like to make. Every society functions on the equilibrium of centrifugal and centripetal forces. Now the centripetal force in the Soviet Union was the dictatorship, and then the dictatorship was removed. We did not replace it with anything, and they did not replace it with anything. The rule of law, respect for private property, all of the things that we here take for granted. And I think it's only reasonable to expect that Russia's evolution will have some setbacks and at the moment we are turning a windy corner of history.

I think it's extremely critical that we do not lose perspective. The single most important thing to bear in mind with respect to U.S. policy vis-a-vis Russia is that, while Russia may be an economic basket-case, it is still a nuclear super-power. And to try to continue the policy of not spending any money for our own national security,

then a disintegrating Russia could represent enormous security threats to the United States as nuclear weapons are sold, or stolen, or somehow misappropriated by rogue nations.

This is not a time for the green eyeshade accountants. This is to recognize we are at a critical juncture. We have to provide the leadership that should have been provided in 1991 by lubricating the process of the gigantic, historic change. I'd be grateful if our two guests would comment on my observations.

Mr. TALBOTT. Mr. Chairman, maybe I could start. I think to economize time, I can simply say that with the notable exception of his exaggerated and overly generous comment about me, I agree with everything that Congressman Lantos has said.

I don't think that we need to wring our hands either in despair about the future or too much about missed opportunities in the past. Secretary Summers may want to, in more detail, recall for all of us the efforts that we have made since 1993 under the auspices of the G-7 and the international financial institutions.

But I basically agree with the thrust of way you say, Congressman, and I'd like to relate it to something that Larry said in his opening statement. And that is that Russia today is open to the world. It has, I think, left behind a period of its own history when it can rely on autarchy, that is, complete self-dependence, cutting itself off from the world, except for purposes of exerting its will by force. It has, we hope, left behind a period when force is the ultimate arbiter in relations among human beings, and civil society, and international relations.

Larry's anecdote about the increasing availability of personal computers is important. I think that the coming of the fax machine, the Internet to Russia means that Russia is now, for better or for worse, plugged into the world economy. But I do not for a moment dispute that we could be looking at a period of some retrenchment or attempted retrenchment.

And the reason that we must stay engaged is first of all to use what I think are remaining powers of persuasion and resources to make sure that they see both the positive and the negative alternatives, and that we are there to help them when they make the right steps, if they make the right steps.

Chairman GILMAN. The gentleman's time has expired. But, if you would be brief, Mr. Summers.

Mr. SUMMERS. Scholars will analyze this period for many, many years and reach their judgments. I would just say that I think the lesson of this part of the world is that where there has been more committed reform, and more support as in Poland, the success has been much greater than where there has been less reform, less receptiveness to reform, and less support.

And so the idea that they should be abandoned to follow some distinctively national model and we should step away, seems to me to be a strategy that has been attempted in a way in some of the states of the former Soviet Union, and in the southern part of central Europe, without conspicuously successful results.

Chairman GILMAN. The gentleman's time has expired. We're on a roll call vote, but we'll continue right on through that roll call.

We now want to welcome George Shultz to our panel, and I'm going to ask if you wouldn't mind while we bring the television set forward.

George Shultz has had a distinguished career in government, academia, and in the world of business. One of the handful of men in our country who've held four different Federal cabinet posts, he's taught in three of our Nation's greatest universities. For 8 years, he was president of a major engineering construction company.

George Shultz served as Secretary of Labor under President Nixon. He became Director of the Office of Management and Budget in 1972. He was named Secretary of the Treasury, a post he held for several years. He's held two key positions in the Reagan Administration, Chairman of the President's Economic Policy Advisory Board and Secretary of State from 1982 to 1989.

As Secretary of State he played a key role in implementing a foreign policy that led to the successful conclusion of the cold war and the development of strong relationships between our Nation and the countries of the Asian Pacific region, including China and Japan.

We welcome you, Secretary Shultz, and thank you for taking the time to join us. If you would hold up a moment, we're trying to get the volume taken care of. Mr. Secretary, we're unpracticed with regard to this technology, so please bear with us just a moment. Alright, I think you can proceed.

#### **STATEMENT OF GEORGE P. SHULTZ, FORMER SECRETARY OF STATE, UNITED STATES DEPARTMENT OF STATE**

Mr. SHULTZ. Am I coming through?

Chairman GILMAN. Yes, you are now. Thank you very much. Please proceed, Secretary Shultz.

Mr. SHULTZ. Mr. Chairman, thank you very much for the privilege of appearing once more before your Committee. I've appeared a great many times, and long since learned how important it is for this kind of interchange with Members of the Congress.

I particularly welcome the chance to appear now when there is so much turmoil around the world, and especially in Russia, and to join your distinguished panel about Russia.

I have enormous respect for both of the witnesses before you, and they are far better informed than I am. What I have to say is based on knowledge I acquired over the years, and reading the newspapers. I have not been to Russia lately, and I have no access to the flow of information that I know almost inundates the State Department, or the Treasury Department, or the CIA. I'm just a guy sitting out here in California scratching my head about the problem.

I have had the experience of dealing with the Russians—we called them Soviets then—in the early 1970's, during Nixon's Presidency, when I was Secretary of the Treasury, and then very extensively during the Reagan period, and of course that conditions my thinking quite a lot.

Mr. Chairman, I think that we must realize that we're at the end of an episode, or an era, or a period, or whatever you want to call it, in which our policy toward Russia boiled down to support for Mr. Yeltsin on the one hand, and a very extensive process of finan-

cial engineering and arrangements in an effort to get them to change the way they manage their economic policy. Our policy, and theirs, has failed. And so we need to take a deep breath, as the Russians seem to be doing, and see where we go from here.

What I will do is tell you what I think has gone wrong and why, and describe a few characteristics of Russia today as I see them, and say how I think we should approach the situation today.

First of all, I think that the Administration has made a conceptual error in how to think about and deal with Russia. Back in the early days in 1993 when the Administration first came into office, they promoted through the G-7 process a very large package—as I recall, it was in the range of \$40 billion—that was designed as potential aid in various forms for Russia. There was lots of talk around about a so-called grand bargain in which lots of money would flow from the West, and in return, the Russians would rearrange their society.

I think when we did that, and we were after all in a very strong position, we sent four powerful messages to the Russians. No. 1, that we knew what to do about Russia; No. 2, that we could take a strong part in implementing those goals; No. 3, that large-scale money from outside Russia would be a key ingredient in their successful transformation; and No. 4, that this money was readily available from the West.

I just might note parenthetically that the transmission belt for this money would be through international organizations, so that Members of Congress did not have to get up and say, I voted \$20 billion to send to the Russians, and I'm here before you, my constituents, to defend that vote. Nobody got put in that position. That's kind of what I would call politically irresponsible money.

By this conceptual error, plus the very large nuclear arsenal in Russia, we set ourselves up for a kind of continuing blackmail on the one hand, and resentment and blame on the other. How many times have I read that it has been more or less, if you don't provide funds for this, that, or the other thing, Yeltsin will be embarrassed, the Communists will come back, and also not subtly, somehow or other the Russians will sell nuclear weapons. That threat has been there all the time and so we have in a sense blackmail without end.

Vast sums have been spent. There has been some success. There was a period in which they successfully dealt with their rampant inflation. And where it has been given a chance, the market has worked, and they can see it in many respects.

But what we see today are more or less chaotic conditions, a leadership that is very uneasy as far as its legitimacy is concerned, and ideas for managing Russia that have been identified as Western ideas have been quite discredited in Russian eyes.

So that's what I think has happened. Now what is Russia like today, at least as I see it from a long distance. First of all, Russia is decentralizing; Moscow is becoming less important; people leading various regions more important.

Second, what people do in government is less important; what the views are of these various oligarchs, who seem to have seized a very large array of the assets in Russia, is more important. So there's a change in the structure of power.

The economy, as I understand it, is at least 50 percent an underground economy. That is, almost by definition, not a very efficient economy, but nevertheless it's there and it works. I understand that a very high proportion of large transactions take place in dollars outside the country, and that the Russians have in their mattresses fairly large amounts of dollars—up in the tens of billions of dollars worth. To put it another way, they are drifting toward a combination underground economy with a dollar economy.

The ruble economy, which has utterly collapsed apparently, is not the majority of the economy. But when the ruble collapses, Mr. Primakov may pay off debts, pay back wages, and so forth. But the only way he can do that is to print more money, which will cause inflation. So the ruble will decline further in value, and again, I think people will be pretty cynical about that. At any rate, the ruble economy has collapsed, but that doesn't mean that the whole Russian economy has collapsed.

Chairman GILMAN. Secretary Schultz, I'm going to ask your indulgence to recess for about 3 or 4 minutes.

Mr. SHULTZ. I can't hear, Mr. Chairman.

Chairman GILMAN. I'm asking your indulgence while we recess for just a few minutes, so that the Members may vote and come back. Some of the Members are already voting and will return quickly. With your indulgence, we'll recess the hearing for about 3 or 4 minutes. Thank you.

[Recess.]

Mr. BEREUTER. [presiding] This is Doug Bereuter, I'm the Vice Chairman. Chairman Gilman has asked me to proceed. He will be returning from the vote shortly. Secretary Shultz, I apologize for the intermission here in your testimony, and the Members are filtering back now. We would like to have you continue, and Chairman Gilman will be back as the Chair very shortly. Secretary Shultz.

Mr. SHULTZ. Thank you, Mr. Chairman. I had just finished saying what I thought went wrong and then described very briefly a few characteristics of Russia today. And I was about to say what I think we should be doing.

First of all, let me say that I certainly feel that diplomatically we should stay strongly engaged with Russia. And I thought that the summary of what has been learned, particularly from looking at the former Soviet satellite states, such as Poland, and Hungary, and the Czech Republic, was right on the mark. And it seemed to me it came down to supporting countries that devise programs for themselves that make sense, rather than trying to impose our ideas on them.

So I think what we should do is to start by getting the concept right. So we say to the Russians, we regard you as a big important country. We respect you. You have a large population. You have a literate population. You can even see on the TV in these troubled times pictures of children very neatly dressed, going off to school. They respect education. They have first-class science, first-class engineering. After all, it was their Sputnik that woke us up on the space matter. They have immense natural resources. So they are inherently a major power, and we should regard them that way.

They're in a bad patch. And it's up to them to figure out how to get through it. I think we want to say to them we have ideas, we have experiences, they're open to you, but basically this is your problem and we respect you to deal with it.

I think we have to make a realistic appraisal of just what happens to money right now. Money just flows out. There is tremendous capital flight. To consider putting more money into Russia right now, given the crime, corruption, the mafia-like situation, would be a total waste. It would just be building up the wrong people. I think that the Nunn-Lugar money is about the best money we have appropriated in a long time, and it seems to me we should keep that very much in play. And if there are opportunities to expand and do more with that, we should be ready to do it.

So I think, Mr. Chairman, that our stance should be that we're there, we're engaged with Russia across the board, there are some things that we can collaborate with them on in foreign policy areas and we're doing so, there are others where we have sharp disagreements. We've had those disagreements directly with Mr. Primakov. We have to stand our ground. And we should certainly cease, to the extent that we were doing it, we should cease pulling any punches out of regard for the standing of Mr. Yeltsin and his country.

The Russians are smart people, they're tough diplomats, and they will take care of themselves, and what we have to do is take care of ourselves, and at the same time be ready to engage constructively with them. Thank you, Mr. Chairman.

Mr. BEREUTER. Thank you, Secretary Shultz. We'll now continue with our Members' questions in orders of attendance.

Mr. SHULTZ. I can't hear you; you're muted at that end.

Mr. BEREUTER. Thank you, Secretary Shultz. We'll now continue with our Members' questions in order of attendance, and I thank our official Administration witnesses as well, for working with us on this. I remind Members to direct their questions separately to either the official witnesses from the Administration, or to Secretary Shultz with us in California. And I note that our Administration witnesses need to leave by noon.

And our next Member, this time on the GOP side, the gentleman from California, Mr. Campbell, who's recognized for 5 minutes.

Mr. CAMPBELL. Mr. Chairman, thank you. Secretary Shultz, thank you, Secretary Talbott and Summers, a special thanks, because—

Mr. SHULTZ. I can't hear. I can't hear.

Mr. CAMPBELL. Is this any better? Is it clear to you in San Francisco? It's perhaps my San Jose accent. George, can you hear me now?

Mr. SHULTZ. Now I can hear you.

Mr. CAMPBELL. OK, great. I was beginning by thanking you, and a special thanks to the Administration witnesses for allowing the normal protocol to be dispensed with, to allow us to have a dialog. And I'm going to devote my 5 minutes, which is all I've got under the rules, to an interchange among you, which I would be very benefited from.

Secretary Shultz has advised that it is better for the United States not to proceed with IMF. We will have a vote today on that. A middle ground has been proposed that if we go ahead with IMF,

that there be a conditionality imposed, and I think that's probably the debate that will consume most of our time.

The conditionality that's been urged upon me by Andre Illarionov, more than any other, is that other banks—international banks—be permitted into the Russian banking system. If you will, aggressions law—that the good banks would drive out the bad. That's it.

I want to hear if, first of all, my description is inaccurate in any way, please correct me, Secretary Shultz. But, I take it your advice to us is not to proceed with IMF, and then to allow the Administration spokespersons to respond. Am I correct, Secretary Shultz?

Mr. SHULTZ. I would say with respect to that suggestion that it is once again trying to tell the Russians what they should do. We should say to them, it's up to you to figure out how you want to govern yourself, how you want to manage your economy. It's obvious that your banking system really isn't a banking system. So if you think that you want to make it more of a banking system, one way to do it is to make the arrangements such that banks from other countries can come in there and do business. But that's up to you.

I think it is a mistake to think that Russia will be comfortable working under an IMF program of some kind, which people read as a U.S. program of some kind. They should be working under a Russian program. I think everywhere, when people work under an IMF program, it is almost an insult to their political processes. What kind of a country is this that's governed by the IMF?

We should say to them, govern yourself, and if you want to have sensible banking practices and you think that the Western banking practices can help, they're available to you. But you've got to structure yourself so that they want to come.

Mr. CAMPBELL. Thank you. Secretary Summers.

Mr. SUMMERS. Let me respond to your question, which I'm not sure I fully understood, by making three points. First, I think it would be enormously in Russia's interests to allow foreign financial institutions to operate more freely in Russia, and that is something that we have advised them of repeatedly. It is something that in a context of discussions of Russia's access to the WTO we have discussed extensively.

Second, there is I think a very difficult dilemma Secretary Shultz recognized in his comments. There are occasions in the face of substantial elements of a financial panic or crisis when external financial support can make an enormous difference in allowing a country to stabilize itself. It is difficult to provide that finance without some assurance that it be used wisely, and that is the basis for conditionality.

And there is a very difficult set of tradeoffs that have to be managed in any case between imposing conditionality so as to assure that resources are well used, and doing what Secretary Shultz is absolutely right about, which is always remembering that it is a country's program, not the IMF's program. And I think that that is a crucial part of managing this going forward.

Third, I couldn't tell, Congressman, whether you were referring to a debate about IMF specific support for Russia, or the more general question of support for the IMF. I would only say with respect

to IMF support for Russia, that I think it is something that has to await a Russian program, a Russian description, and a judgment as to whether there's a framework in which the money is well used.

I would say that, in light of the financial contagion that has spread, I would very much share the judgment of Chairman Greenspan and Secretary Rubin, that to effectively dismantle the apparatus that has traditionally been available to provide this finance at this moment would be a very dangerous act. And it seems to me that that is the case, regardless of the view that one has about how one should address these problems over the longer run.

Chairman GILMAN. [presiding] The gentleman's time has expired. Thank you, gentleman. Mr. Clement.

Mr. CLEMENT. Thank you, Mr. Chairman, Secretary Shultz, Secretary Talbott, Secretary Summers. Secretary Shultz, I'd like for you to comment on this first. I'm Bob Clement from Nashville, Tennessee, and I was in China not too long ago, and been to Russia as well.

There seems to be a lot of success stories right now about China versus Russia, even knowing that both of them have been Communist-ruled dominated countries for a number of years, even though maybe it was a different type or form of communism being practiced in each country.

Yet, China seems to have moved in a more rapid pace toward so-called market-oriented society, even though they have sort of a two-track system. Whereby Russia seems to have had tremendous problems when it comes to making that transformation. And does it have something to do with the lack of foundation, or did we in the United States and the West push Russia too fast when they did not have a foundation to move toward a market-oriented society? Secretary Shultz.

Mr. SHULTZ. Mr. Clement, I think the contrast that you point out is a very sharp one. And of course one way of describing the difference between the two is that in China, whatever they have done, and they have done a tremendous amount of changing of their economic system, it has been unmistakably a Chinese program. There has been no IMF, there has been no sense that somehow or other this is our program; it was Deng Xiaoping's program and his successors. So it's China. There are lots of things wrong with it. They have immense problems out ahead of them, but it's a Chinese problem and they're Chinese solutions.

And on the strength of what they've done, they have attracted an immense flow of foreign direct investment. I believe I'm correct in saying that next to the United States, they've attracted more foreign direct investment than any other country. That's private investment. That's responsible money.

Russia, on the other hand, has been kind of—I don't want to say nurse-maided—but we've been there all the time telling them what they ought to do, instead of standing back a little bit and saying, what do you think you should do. And if you do things that are sensible, we're ready to be helpful, and thoughtful, make suggestions, and so on. So I think there is that very sharp contrast.

I did have the occasion of visiting with Deng Xiaoping in my last visit to China as Secretary of State—it was in July 1988—and I asked him what he thought about Mr. Gorbachev's reforms, and he

laughed, and he said, Gorbachev got it backwards. He let go of everything politically, and didn't know what to do about the economy. And the result is, he's got a mess on his hands in the economy, and he's sort of opened it up politically, and it will get out of control. Deng was, of course, complimenting himself on having started with economic reform, and having it be successful, and therefore people wanting more of it, and so on.

Unfortunately, at least during his time, the political situation was not loosened up. There are all kinds of indications now, however, that it is loosening up some in China. I might say, the President's performance in Tienanmen Square I thought was a very good one.

Mr. CLEMENT. Secretary Summers.

Mr. SUMMERS. Let me just make two points. One, I think you have to take note of the very difficult transition process in China. China had enormous gains to make from liberalizing what was near subsistence agriculture, gains that weren't available in Russia. And, it is worth remembering that per capita income, even today in Russia, is depending upon whose numbers you take, two or three or four times per capita income in China. And so China benefited enormously from having a very low base.

Let me also say that in my judgment, Secretary Shultz misstates the extent to which somebody outside of Russia has set the path of Russian economic reform over the last 5 years. We have always said that Russia's future will be shaped in Moscow, and that it is for them to make choices. The programs are programs that are designed by the Russian Government. There have been enormous difficulties that the reformers have had, as I remarked in my earlier testimony, being squeezed between the Duma on the one hand, and the oligarchs on the other.

I think that there is a position that nobody should ever receive financial support, and if one takes that position, then everybody can chart their own course. If there is to be financial support, I think there is little alternative but to predicate it on some reason to believe that it can be used effectively, and inevitably that draws you into the conditionality question.

And I think the record around the world actually is that a large number of countries have stabilized themselves with external financial support, and that when there was no external support available and simply market forces were allowed to operate as they were in the late 1920's and early 1930's, the consequences can be very, very unfortunate.

Chairman GILMAN. The gentleman's time has expired. We will recognize one more Member. I know our witnesses have to go after that. Mr. Rohrabacher.

Mr. ROHRABACHER. Thank you very much. Mr. Shultz, I'm Congressman Dana Rohrabacher. It's nice to see you again. I think it's important for us to understand that under Mr. Shultz' leadership and under the leadership of the Bush Administration, we saw a hostile Soviet Union with no hope of reform, turned into a society where they had free elections and ruled by people who wanted to be friends with the United States.

And that positive scenario was turned over to this Administration, and now we see a dangerous collapse going on in Russia, and

a return of the hardliners like Mr. Primakov, who has spent his career as head of the KGB and the head of projects aimed at hurting the United States of America.

First and foremost I want to say that I think this Administration has shown incompetence to the degree that it has endangered the American security in dealing with this opportunity that we had with the former Soviet Union, and what is now, not an opportunity, but a threat to our own national well being.

Some specific questions. Should the United States insist that the Russian Government refrain from spending its own money on very costly military technology, which it continues to do, before we provide any type of assistance, either through the IMF or directly? And that would be first to Mr. Shultz, and then to our other panelists.

Mr. SHULTZ. I think we have to look at the totality of what the Russians are doing, including their military capabilities and continuing efforts in that regard. And to the extent that they project themselves forward in a hostile way, certainly flows of money from us to them don't make any sense.

Now I would always make a big exception with Nunn-Lugar money. I think that is really money very well spent. And the degree to which we can work with them in getting some sort of a handle on the nuclear area and other weapons of mass destruction, I think we should be very openhanded about that.

Mr. ROHRABACHER. We should be encouraging them actually to spend less money in those areas. And I might also add that I remember when people were saying that President Reagan's zero option and these reductions in the forces wouldn't ever work. And thus we had to support a nuclear freeze movement, and I applaud the success that you had.

One last note, Mr. Shultz. And that is, I recently returned from Russia myself, and your observations about the underground dollar economy are right on target. There were no Russians in the banks when I was in Russia, because nobody has any rubles in the bank. Would you agree that no matter what we do, and no matter what is done through the IMF, that unless the confidence to the people themselves in Russia who have their money outside the country, unless that confidence is restored, there's no way that outside money is going to bring any semblance of responsibility and growth back to Russia?

And Mr. Talbott, you can answer some of those questions too. Thank you.

Mr. SHULTZ. I think it is a good general rule that when you see large scale capital flight from any country, you have to think twice before you put money in. And certainly private money doesn't go in, responsible money doesn't go in under those circumstances. So I doubt that among the panel here—and I believe Secretary Summers said that this is not the time to be putting more money into Russia, they've got to reconstruct themselves before it's even something to consider.

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Mr. ROHRABACHER. Mr. Talbott, I know, go right ahead.

Mr. TALBOTT. Thank you, Congressman, and Mr. Chairman. Larry has already addressed the very real, sensible, and stringent

economic conditionalities regarding our ability to continue assisting Russia in its transformation.

Before you got here, Congressman Rohrabacher, I did outline some conditionalities, or let's call them facts of life and realities, with regard to the security in the foreign policy area. The essence of what I said was that only if Russia remains on a course in its international behavior, and the way it defines its role in the world, and the way it acts toward its neighbors, and certainly in the way that it handles both the development and deployment of force—only if it stays on a course that we regard as responsible, will we be able to do anything to help them in the economic sphere. And Larry has already made pretty clear that that's going to be tough enough in and of itself for economic reasons.

Mr. Chairman, since we're coming to an end, I would like to just make one other observation, if I could, about Secretary Shultz' earlier presentation. First let me say what a novel and indeed weird experience it is to be sitting at a witness table, not only with my friend, Larry Summers, but with a television set. Secretary Shultz, I really looked forward to seeing you in person before too long. But the audio works terrific, and I listened attentively to what you had to say.

It will not surprise you, Secretary Shultz, or anybody else in the room that I would not subscribe to everything that you said by way of critique and analysis of the policies of the last 5½ years, although I do subscribe to virtually everything that's been said about your own tenure, and indeed that of our predecessors with regard to handling Russian policy.

But, I want to accentuate a positive point. And that is, at the end of your very thoughtful remarks, you laid out what you think our posture ought to be; what our message to the Russian Government and people ought to be. I subscribe to it. I think it is absolutely consistent with what we are doing and will continue to do. And when I get back to my office, I will get the text of a speech that Secretary Albright is 20 minutes into at the Carnegie Endowment for International Peace, where she will be addressing these subjects. And I think you will be struck by the harmony between her message and the one that you recommended to us.

Chairman GILMAN. Thank you very much. And I know that your time is limited, Secretary Summers and Secretary Talbott. We appreciate your being here.

Secretary Talbott, I know that from an early date—and I'm not going to ask for a response now—you've been an active and committed participant in the formulation of our policy toward Haiti. The Committee would appreciate it if, at a future time, you'd be willing to outline your thoughts and report on the development of our policy toward Haiti, detailing the execution of the Administration's policy goals for Haiti from the post-coup era to the present. And again, we thank you very much for being here. Given the time constraints—

Mr. SUMMERS. May I just make one remark.

Chairman GILMAN. Yes, Mr. Summers.

Mr. SUMMERS. Mr. Chairman, the question of certain allegations with respect to deception in connection with the IMF program was raised in your opening statement. Mr. Chubais has prepared a let-

ter to a newspaper in Russia making clear his view that *The Los Angeles Times* had misrepresented what he had said. And, if I could, I'd like to submit that for the record.

Chairman GILMAN. Yes, I'd be pleased—and if you would send me a separate copy of that, and it will be made part of the record. [The information referred to appears in the appendix.]

Mr. SUMMERS. We will do that.

Chairman GILMAN. Given the time constraints of our witnesses, we thank you for being here, and we allow you to go. We will continue with our questions to Secretary Shultz. Mr. Davis.

Mr. DAVIS. Well, I had a question for Mr. Summers, but perhaps Mr. Shultz would like to comment on it.

Chairman GILMAN. I will reserve the opportunity for our Members to be able to submit any questions in writing to our panelists. But go ahead, Mr. Davis.

Mr. DAVIS. Let me first say that what I heard from Representative Hamilton was that the issue here was not one of optimism or pessimism, it was really one of being realistic in our expectations going forward.

And the question that I'll have the chance to discuss with Mr. Summers later, and perhaps Secretary Shultz can comment on, is if and when we revisit IMF support with the stipulations to reform attached to it, how are we going to measure success? Because as I read through some of the ways you've measured success in the past, given the attitude that prevails there, the resistance to measure success in terms of the passage of a law as opposed to understanding the real practical implementation of that law to me is more important to me.

In other words, I'm concerned about how we're going to be able to measure success in terms of implementation of true reform attached to future IMF support. Again, perhaps the Secretary might have some comments on that, based on his prior experience.

Mr. SHULTZ. One fundamental way of judging success—can't hear?

Mr. DAVIS. I cannot hear, Mr. Secretary. And I'm Jim Davis from Florida, by the way.

Chairman GILMAN. We'll adjust the volume. Just a moment.

Mr. SHULTZ. Can you hear me now?

Mr. DAVIS. Yes, sir.

Chairman GILMAN. Please proceed.

Mr. SHULTZ. Thank you for your very thoughtful question. I think there is one sure way of judging, and that is to ask whether money owned by Russians is leaving the country or coming back. And right now, I understand there is some \$150 billion or so of Russian money that has fled the country since the breakup of the Soviet Union. And to be putting money in—\$3 billion, \$4 billion—doesn't make any sense if the people who know the country best are taking their money out. So that's one test.

And it seems to me right now, though, that the thing to do is recognize that all of the financial engineering that's been going on over the past 2 years has just not worked out. Congressman Hamilton who I respect tremendously—he spoke about reality. That's the reality.

So let's see what the Russians do with their situation, and then consider what kind of support is appropriate under the circumstances. And if there's really important money going to flow, it's going to be private money. Some combination of private money that's responsible money, and Russian money that comes back to the country.

Mr. DAVIS. Secretary Shultz, I appreciate your response, and would ask for you to have the same observation with respect to private dollars flowing from other parts of the world into Russia.

Mr. SHULTZ. The private money has the same kind of test all the time. Of course there's been a tremendous flow of money into Russia from all around the world, particularly Germany. And you remember when the deal was made, and very skillfully I might say, to have East Germany join with West Germany and be part of NATO, the German Government just paid over a lot of money to Russia, and insofar as I know, nobody knows whatever happened to it. But there's been a lot of money flowing in.

Mr. DAVIS. Secretary Shultz, one last question. I believe earlier you may have made the comment that we should leave Russia alone. And I guess my question to you is to the extent that we have supported some base for reform within Russia, shouldn't we try to maintain some continuing relationship with the true reformers in there to try to bolster their efforts and rebuild the total level support for reform in that country?

Mr. SHULTZ. I don't think we should leave Russia alone; on the contrary. I think we should be engaged very actively with them diplomatically. I think we should not only be talking to people in Moscow, but we ought to be talking to people in these various subordinate governmental units. We ought to be engaged with Mr. Lebed in Krasnoyarsk, and so forth, and be talking to all these people. And very, very active involvement on that scale. So I would advocate a very strong, active diplomacy with respect to Russia. It's a big important country, it has 20,000 nuclear weapons, and you just can't walk away.

Mr. DAVIS. Secretary Shultz, one final question. Apart from the conversation you referred to, do you think it behooves us to consider taking some action as well in collaboration with true reformers in Russia, again to rebuild the reform movement there?

Mr. SHULTZ. Well, I don't think we should be taking sides, so to speak, in the Russian debate about how they want to govern themselves, and say we're going to give money to support this faction, but not that faction. I thought we made a gigantic mistake in the billions of dollars apparently we spent on Mr. Yeltsin's election campaign. Votes were bought right and left, and to a very considerable extent, with our money.

We are going through contortions about the possibility that the Chinese might have tried to spend a little money influencing our elections. By contrast, the amount of money that we spent substituting our judgment for the judgment of Russians was tremendous. And I don't think it's a good idea.

People keep saying, well, you might get Lebed. And I don't know Mr. Lebed, but I've read and watched, and I say, well, is that so bad? At least he's the one who had the guts to go in and settle the Chechnya atrocities and get that settled down. Nobody else would

do that. So he's not so bad. Why not let the Russians choose, and then deal with their choice?

Mr. DAVIS. Thank you, Mr. Secretary. Thank you, Mr. Chairman.

Chairman GILMAN. Thank you, Mr. Davis.

I know the Secretary's time is limited and that he has to wind up by 12:30. I have just two questions for Mr. Shultz, and I see Mr. Lantos is back. Perhaps he may have some questions as well.

Secretary Shultz, Andrei Illarionov, a Russian economist, believes the Russian Government is technically bankrupt. Would you agree with that proposition?

Mr. SHULTZ. I don't know enough, Mr. Chairman, but it seems as though they are unable to pay anything in the way of dollar-denominated debt. They pay ruble debt by printing them. That's not really paying debt.

Chairman GILMAN. Mr. Secretary, in late August, the former Treasury Under Secretary for International Finance under President Clinton, Mr. Jeffrey Schafer, was quoted by *The Washington Post* as stating, "The resources that were made available to Russia earlier have been squandered. I don't see that there's much that the West can do for Russia, given the present lack of economic discipline." Would you agree with that proposition?

Mr. SHULTZ. Well, it does seem to me that the resources have largely been squandered. But I do think there is a powerful message that needs to be delivered. Namely, that country after country around the world that has taken responsibility for itself, and organized itself along lines of market principles and enterprise principles, and the rule of law, and open government, have succeeded. And it is important to have respect for them, as well as the expectation that Russia will write its own history. We have to respect that.

Chairman GILMAN. Mr. Secretary, given the tremendous underlying economic weaknesses in Russia, do you think the U.S. Government should have included Russia in the G-7 group of advanced economies and the Paris club of creditor countries, particularly since in the latter case, it's far more of a debtor than a creditor state?

Mr. SHULTZ. It's always seemed a little bit of an anomaly to me. That happened, of course, after I left office. And I think at first Mr. Gorbachev, who was quite a figure, was a kind of observer. And I don't know whether they have become fully a member of the G-7 or not. I don't hear it referred to as the G-8. But it certainly is a different kind of a country from the rest.

Right now, with all of the turmoil in Russia, I would think it's the wrong time to stop that practice, and it's one way of keeping in communication with them. So I wouldn't abandon the practice that seems to have grown up right now.

Chairman GILMAN. Thank you, Mr. Secretary. Mr. Lantos.

Mr. LANTOS. Thank you very much. Let me first say what a pleasure it is to see Secretary of State, George Shultz. While you were waiting for the testimony of the earlier witnesses to unfold, I made the comment that had your policy vis-a-vis the Soviet Union not been as successful as it has, we wouldn't be having this hearing. Because we would still have the Soviet Union, and we would have other problems to deal with. So I want to publicly pay

tribute to your tenure as our Secretary of State, which was remarkable for its achievements, George.

Mr. SHULTZ. Thank you very much, Congressman, and I know that in many areas, most especially in the work we did on human rights, you were, among others on the Committee, very, very instrumental in bringing about the good results we were able to achieve.

Mr. LANTOS. Thank you. Let me deal with an issue that I understand has not yet been dealt with. And I apologize. I was at a press conference on child labor in agriculture, which I had to participate in.

My impression is that the role of Moscow is diminishing dramatically and the role of the regions is in the ascendancy. There are 89 administrative regions in Russia. About 12 of these contribute more to the central government than they get from the central government. The others are subsidized by the central government. Now the ones that are wealthy are increasingly showing the disinclination to transfer resources to Moscow. And the ones that have been subsidized in the past are resentful of the fact that their subsidies have diminished.

So what we find, Mr. Secretary, is a very powerful centrifugal force in Russia—everything moving away from central control. How do you view this? First of all, do you agree with this trend that I'm describing, and if you do, do you think that this is desirable in terms of economic developments, and do you think it is dangerous in terms of maintaining control over Russia's nuclear stockpile?

Mr. SHULTZ. My impression, and I said in my opening statement, I haven't been there and my knowledge is based on reading papers and talking to people who have. But as I said in my opening statement, I think the power is flowing out of central Moscow to the regions, and also to the oligarchs. So that the central government isn't as strong as it has been in times past.

As far as decentralization is concerned, I don't consider it anything to be alarmed about. After all, we talk about federalism in this country. And what seems to be emerging is a kind of federalism. It can be a problem if it isn't thought through; it's just happening.

And so probably what's happening is that people who lead these various regions are getting some practice in the art of governance. I mentioned Mr. Lebed a few minutes ago. He's now the head man in Krasnoyarsk. He's gotten elected, and he's responsible, and so we'll see what he does, and people will see what he does. It's a good thing. Just as in this country, we have people serve in various political posts throughout our country, and when they get good enough, maybe they get to go to Congress or something like that. So you have trial places. I think that's good.

Now as far as the nuclear arsenal is concerned, I understand in some of the regional areas they're saying that the central government isn't paying the armed forces, so they'll pay them. In other words, you're going to have armed forces that will pay attention to the people who pay them, and get some disbursal that way.

So I think we have to be very much engaged diplomatically with all of that. It's one reason why I said in response to an earlier question, not only should we be vigorously engaged diplomatically,

but we ought to be talking to all of these emerging centers of power throughout the country, in order to know what's going on. We should do everything we can to encourage control of weapons of mass destruction, and employ the Nunn-Lugar money creatively. If we need more of it, provide it. I think that's money very well spent.

Mr. LANTOS. If you'll allow one more question. I find some historical parallel between what is going on in Russia today and what went on in Germany during the Weimar Republic. It's obvious that the new government will start the printing presses, and the rubles will be printed by the billions without any basis. There will be inflation. There is no social safety net. A very large segment of the Russian population is living under the poverty level, which in Russia is an extremely low level.

How do you rate the probability that this combination of social disenchantment, coupled with accelerating inflation, no strong central government could bring about a phenomenon leading to a Russian form of fascism, similar to what we saw following the Weimar Republic in Germany?

Mr. SHULTZ. Well, it's a deep, and difficult, and important question. I think it must be that the Russian population had their fill of fascism. That is, communism as it emerged and fascism as it was practiced—they're the same really. Very intrusive, spying, control of private lives, and so on. I don't need to go through the horrible litany of all that. I think that's different from a somewhat more authoritarian structure of a government, which may very well emerge.

I would hope that the tradition, if you want to use the word tradition, of a more open government that has taken place will survive. Some of these leaders that are leading segments of Russia, the mayor of Moscow is one, Lebed is another, there are others, have experience and will come in and on the basis of that experience, perhaps will become the people who will give some coherent leadership.

But it's a hard question that you ask. I do think that as contrasted with the Weimar Republic period, the ruble economy today, as I understand it, is only a fraction of the Russian economy. There is a huge underground economy that's basically barter, and there is a growing dollar economy in various ways. Now unfortunately, what you said is likely, and that does seem likely—namely when they do print rubles to pay back wages, and debts, and so forth—they'll create inflation.

That inflation is in the ruble section of the economy, but I think, unfortunately, that's where the older people, where the pensioners, where the military, where the poorest people in society will be the most affected. And so it's going to be a real problem. I can't see anything ahead there except real problems.

Mr. LANTOS. Mr. Secretary, if I may conclude on a personal note, this past weekend I reread I believe for the fourth time, your memoirs of your years as Secretary of State, "Turmoil and Triumph". And I hope, as a fellow resident of the San Francisco Bay area, that you're devoting some time to writing your memoirs, this time as an outsider of the 1990's. Because your description of what happened in the 1980's as the Soviet empire imploded will be studied

by students and historians for generations to come, and we are all in your debt.

Chairman GILMAN. Thank you, Mr. Lantos. Mr. Secretary, the Committee's indebted to you for taking the time and engaging in this innovative method of conducting our hearing across long distance. It's been very successful. We hope that now that we've started this, we can continue with it in the future, and we hope to have you back before our Committee in the not too distant future. We wish you well, and we thank you again for being part of our hearing today.

Mr. LANTOS. May I just ask one final question?

Mr. SHULTZ. Thank you, Mr. Chairman. It's a privilege to appear before you once more.

Chairman GILMAN. Thank you.

Mr. LANTOS. Mr. Secretary, the heat here is oppressive beyond belief. What's the temperature in San Francisco?

Mr. SHULTZ. I couldn't hear that.

Mr. LANTOS. What's the weather like in San Francisco today?

Mr. SHULTZ. Oh, it's cool, a little bit cloudy; it's going to clear off later on; it's going to be a lovely day here.

Mr. LANTOS. I'm coming home.

[Laughter.]

Chairman GILMAN. Thank you for the weather report, Mr. Secretary. We'll now proceed to our next panel.

Our next panel will consist of Mr. Simes, Dr. Cohen, and Professor Wedel. If the panelists would take their place at the table.

Dimitri Simes is a founding president of the Nixon Center, a bipartisan Washington public policy institute, established by President Richard Nixon shortly before his death. Mr. Simes was selected to lead the center by President Nixon, to whom he served as an informal foreign policy advisor, and with whom he traveled four times to Russia and other former Soviet states, as well as western and central Europe. Before establishing the Nixon Center, Mr. Simes served as chairman of the Center for Russian and Eurasian programs at the Carnegie Endowment for International Peace, where he was also a senior associate. Earlier, he was the director of the Soviet-East European Research Program, and a research professor of Soviet studies at the School of Advanced International Studies at Johns Hopkins University.

Prior to emigrating from the Soviet Union in 1973, Mr. Simes graduated from the School of History of Moscow State University, and from 1967 to 1972, he was a research assistant, and later a research associate, at the Institute of World Economy and International Affairs in Moscow. Mr. Simes has authored and co-authored two books, "Detente in Conflict in Soviet Foreign Policy" and "Soviet Succession and Leadership in Transition." We welcome Mr. Simes.

Dr. Ariel Cohen is a well-known Russian and NIS, Central, and Eastern European area specialist. Currently, he is a senior public analyst and Salvatori Fellow in Russian and Eurasian Studies of the Heritage Foundation. Dr. Cohen has worked for the U.S. Agency for International Development (USAID), the World Bank, the governments of the U.S. and Russian Federation, and the U.S. Sen-

ate, and the government of Georgia, and Radio Liberty/Radio Free Europe.

Dr. Cohen frequently testifies before the committees of the Congress and regularly appears on CNN, NBC, BBC-TV, and other major TV networks. In addition to his work at Heritage, Dr. Cohen serves as a commentator for the Voice of America and writes as a guest columnist for the *Journal of Commerce*, *The Washington Times*, and other newspapers, both in the United States and abroad.

Dr. Cohen has worked in Russia, Ukraine, Bulgaria, Romania, Hungary, Poland, Turkey, Pakistan, Kazakhstan, and Israel. He's a native level speaker of Russian and Hebrew and has working proficiency in French, Ukrainian, and Belarusian.

With regard to our good friend, Dr. Janine Wedel—she is an Associate Research Professor and a Research Fellow at the Institute of European, Russian, and Eurasian Studies at the George Washington University. She also serves as an adjunct professor at the Graduate Public Policy Institute at Georgetown.

A three-time Fulbright Fellow, and a recipient of awards from the MacArthur Foundation, National Science Foundation, Woodrow Wilson International Center for Scholars, and the U.S. Institute of Peace, Dr. Wedel has studied Eastern Europe's evolving economic and social order for nearly 20 years. She is a social anthropologist from the University of California, where she received her Ph.D.

She's published two books on central and Eastern Europe. Dr. Wedel details her analysis of aid to central and eastern Europe in the former Soviet Union in a work entitled, "Collision and Collusion, the Strange Case of Western Aid to Eastern Europe," forthcoming from Saint Martins Press in November 1998.

We welcome our distinguished panelists to our Committee. Mr. Simes, if you'd lead off with your statement, and we will follow with statements by Dr. Cohen and Professor Wedel. You may put in your full statement or summarize, whichever you deem appropriate.

#### STATEMENT OF DIMITRI SIMES, PRESIDENT, THE NIXON CENTER

Mr. SIMES. Thank you very much, Mr. Chairman. I will make my full statement available to the Committee.

Chairman GILMAN. Without objection.

Mr. SIMES. I would like to offer some very brief comments about the current Russian situation, and then to present several recommendations.

My first point, Mr. Chairman, is that as I was listening to this exchange between Secretary Shultz and Administration officials today, I was listening with a certain sense of embarrassment. I am in overwhelming agreement with Secretary Shultz that it was a profound mistake for the Clinton Administration to try to micro-manage the Russian reform process. It was a mistake to try to tell the Russians not only how to conduct their reforms, but even who should be in the Russian Government, and who should be appointed to key positions in the Russian Presidential Administration.

Some of the responsibility obviously rests with the IMF. But, there is no question in my mind that during these years, the IMF very often was essentially a proxy for the Clinton Administration.

The Administration officials who testified today were not only principal architects of the Clinton Administration Russian policy, but had a very considerable influence over IMF decisions. That is why I was surprised and disappointed to hear Secretary Summers denying the obvious fact that the Clinton Administration had a paternalistic attitude to Russia, that it has not prepared to allow Russia to be Russia and to accept the consequences. He claimed that the Russians were making the fundamental decisions. That, Mr. Chairman, is not what I know as fact.

We did not have enough power, enough resources, enough will, and enough wisdom to make the Russian experiment turn out right, and a lot of things went sour. They would probably go sour without any contribution of the Clinton Administration, and obviously the Russians should be principally responsible for consequences of their decisions. But to the extent that the Clinton Administration was a major participant in that experiment, it should also bear some responsibility.

The trouble with the Clinton Administration's attitude was that despite receiving approximately \$100 billion in all kinds of foreign assistance, Russia is in a remarkably ungrateful mood. Mr. Talbott is often vilified by Russian officials as pro-Consul Strobe, because they believe that while he loves his Russian friends, is a real expert on Russia, and certainly has good intentions, when he talks to them he gives only old answers, and they have to accept his indispensable guidance on how to run their own country. These proud people are a little bit irritated.

The problem is not limited to Mr. Talbott, Mr. Summers, or even the Clinton Administration, the problem is that by giving Russia billions of dollars, we are killing them with our love, and simultaneously contributing to an anti-American syndrome in Russia, for which we may have to pay dearly, particularly if Mr. Shultz is right and Russia recovers.

Accordingly, Mr. Chairman, without any further introduction, I would like to propose a few policy recommendations which I believe may be useful in the deliberations of your Committee.

First, recognize that the Clinton Administration's policy toward Russia so far has been fundamentally flawed, and that a considerable change of course is necessary.

Second, organize Congressional hearings, request cables from the U.S. embassy in Moscow, and hear assessments of developments in Russia to determine what President Clinton and his advisors knew about the situation there and when they knew it. I'm saying it for a reason, Mr. Chairman. I am aware of some CIA assessments. I was a consultant to the National Intelligence Council, I have talked to people at the U.S. embassy in Moscow. In my forthcoming book, I quote one excellent cable sent by then U.S. Ambassador to Russia, Tom Pickering, to Secretary Christopher. It is abundantly clear that the Administration had a good opportunity to know what was really happening in Russia. For whichever reason, it did not believe this account and did not want to share it with the American people.

Third, put an end to the Administration's obsessive support for Boris Yeltsin and other Russian political personalities, and start dealing with the Russian Government on the basis of its policies. Treat these people as if they were mature adults. They happen to believe that they are.

Fourth, identify and assertively promote U.S. priorities in Russia, such as political stability, democracy, and a non-aggressive foreign policy. Leave the rest to Russia. Stop trying, as the Administration continues to do, to formulate exactly how Russia should run its economy, and even to define Russia's national security interests on Russia's behalf.

Demand from Moscow a full accounting for previous IMF and other international assistance, and insist on fair compensation for all foreign investors before releasing the new tranche of IMF funds. Consider the creation of a new London Club-type structure to protect the rights of foreign investors affected by Russia's de facto default.

Let me mention, Mr. Chairman, that this is not just a favor to foreign investors. In my view this is very important for the Russian economic recovery. If foreign investors do not come back, either the Russian economy will collapse, or we will have to keep it on life support from IMF and others indefinitely.

Insist on IMF reform, including the dismissal of the current IMF management. The IMF has correctly been compared to an international fire brigade. It is inconceivable that we should retain in its leadership individuals with a record of misusing the IMF and acting like unwitting arsonists, starting political fires, contributing to the crises in Russia and Indonesia, rather than putting the fires out.

Give the G-7 a greater role in developing strategies to deal with the Russian crisis, including the criteria by which Russia's reform should be judged. Support for Russia's reform process is too important to be left to unelected financial bureaucrats.

Finally, be aware that even if we do everything right, our ability to affect developments in Russia is limited. Accordingly, while trying to offer a helping hand, we should be prepared to refuse to throw good money after bad. We should start developing an exit strategy. I hope that we will not have to disengage from Russia, but we have to face the facts and be ready for any eventuality, as unpleasant as it may be.

Thank you very much, Mr. Chairman.

[The prepared statement of Mr. Simes appears in the appendix.]

Chairman GILMAN. Thank you very much, Mr. Simes. Dr. Cohen.

**STATEMENT OF ARIEL COHEN, SENIOR POLICY ANALYST,  
RUSSIA & EURASIAN STUDIES, THE HERITAGE FOUNDATION**

Mr. COHEN. Thank you, Mr. Chairman. I will summarize my statement. My full statement is available for the Committee.

Chairman GILMAN. Without objection. Thank you.

Mr. COHEN. Mr. Chairman, the restoration of the Communist-dominated government in Moscow led by the anti-Western spy master, ~~Eugeny Primakov~~, is an historic shift in Russian and world politics, comparable to Boris Yeltsin's victory against the Communist putsch in 1991, though in the opposite direction.

This is a triple policy fiasco. First, for Boris Yeltsin himself; second, for the U.S. Administration led by President Clinton; and third, for the IMF Russian team: Managing Director Michel Camdessus, First Managing Director Stanley Fischer, and the executive with line responsibility for Russia, the Director of the European II Department, John Odling-Smee.

The Yeltsin failure is a failure to de-communize the country in the way the Czech Republic did under President Vaclav Havel and Prime Minister Klaus; to implement a comprehensive economic reform, such as again, the Czech Republic or Poland, under Leszek Balcerowicz, succeeded to implement; to provide a macroeconomic policy that would not create wage arrears that severely undermined the Yeltsin Administration.

The laundry list of failures by the Yeltsin Administration is long, but the bottom line was that this was the failure to establish a market economy and a truly democratic society. In fact, what happened in Russia was that the crime and corruption undermined the initial trust of the Russian people in the democratic system.

The failure of the U.S. Government, which is obvious, despite what previous witnesses have said, is that the Administration believed the reforming slogans fed to the U.S. diplomats and other gullible Americans by their Russian Government counterparts. After all, this was the country which 200 years ago invented the original Potimkin Village, of freshly painted facades and crumbling buildings.

The evidence that things were going awry was there; however, the Administration's top Russian decisionmakers chose to disregard it, thus misleading the Congress and the President.

The macroeconomic policy failure of the Clinton Administration in Russia was first and foremost of focusing on price liberalization and privatization, while neglecting the institution building necessary for creation of a modern market economy.

Furthermore, the Administration failed to address the huge knowledge gap that exists in Russia. Russian entrepreneurs, politicians, and managers severely lack modern economic and business skills. Instead, the population resorted to Soviet era behavior of stealing from and cheating off the state. Embezzlement and corruption became rampant. Historic Russian and Soviet era "business practices" caught up with post-Communist Russia. Our assistance programs had a very hard time addressing this anti-market behavior.

The Administration further undermined the American prestige in Russia by supporting Boris Yeltsin during the war in Chechnya, in which over 90,000 soldiers and civilians—all of them Russian citizens—were killed. Partisan support of Boris Yeltsin through thick and thin in the 1993 confrontation with the Parliament, during the Chechen war, and in the 1996 elections, served to convince the majority of Russian body politic of America's partisanship.

We also disregarded the violation of our national security interests, while providing bilateral aid and supporting multilateral financial aid to Russia. This is a continuation of military modernization, including the modernization of the nuclear weapons, missile and nuclear technology transfer to Iran, and support of Saddam Hussein.

Mr. Chairman, the scenarios for the future are dire, being of the strategic pessimism school. I am with Secretary Shultz. If the Russian Government is going to do what it says it's going to do, which is print money, hyperinflation will ensue. There will be growing discontent on behalf of the military which has not been paid, the security apparatus, and broad masses of the Russian public. This is the Weimar Republic syndrome.

The weak ruble will be a curse in a country which imports over 60 percent of its food for the cities, and about 80 percent of its food in Moscow. With insolvency, unemployment, and possible food shortages aggravated by poor crops in Russia today, two scenarios are possible.

One is disintegration and ungovernability, and two, is a fascist-style dictatorship. In the second case the extremists, racists, anti-Semitic, and anti-Caucasian forces in Russia unite. The second scenario occurring against a backdrop of popular discontent and despair, may emerge simultaneously or after the first scenario, which is un-governability.

With both Communist and free market political forces discredited, fascism may become the only third way left for the Russians. This is the hope of the extremist forces playing the ethnic hatred card. And after all, Mr. Chairman, the racist, anti-Semitic, and anti-Moslem sentiment is quite overt in Russia and can be tapped into by some political groups when the going gets rough.

The government, and especially the security forces, have supported and nurtured the extremist right in Russia. First, they used ultra nationalists as a bugaboo for the West and local voters—"see how scary these people are. If you won't support us, they may come to power." Second, to justify their own law and order function. And finally, in some cases, out of sincere, ideological sympathy to the messages of Slavic supremacy and the possible establishment of the "new order".

Both scenarios must preoccupy American and other Western decisionmakers as Russia still harbors the second largest nuclear arsenal on the planet, as well as tremendous stocks of chemical and biological weapons, and technology and expertise to produce more.

Mr. Chairman, to conclude, the Clinton Administration in my opinion should conduct a full re-examination of the U.S. policy toward Russia, including its economic, diplomatic, geostrategic, and national security aspects. We cannot continue with business as usual. It is obvious that key decisionmakers in charge of policy have failed. All aspects of the new policy need to be seen as a whole, and the resultant approach should be balanced.

For example, Russia's anti-American behavior vis-a-vis Iran, in the Middle East, as well as its chronic stalling of START II agreement, cannot and should not be rewarded with international economic assistance. And the Communist "dream team" in Moscow should not be encouraged with new bailout packages from the United States, the G-7, or the IMF.

On the other hand, Russia's playing a tremendously important role as a main test case for transition from communism to democracy and market economy. If it fails, many other societies may turn away from the rule of law, participatory government, and competitive, private sector based economy. If it becomes either unstable or

authoritarian, it may emerge as a destabilizing force in Eurasia and threaten its neighbors in the former Soviet Union and eastern and central Europe.

The United States should continue to be engaged in trying to turn Russia around, but we should do it while relying on incisive economic and political analysis and creative solutions; not the failing policy of throwing money at Russia's economic black hole under the Communist-dominated cabinet.

Thank you very much.

[The prepared statement of Mr. Cohen appears in the appendix.]

Chairman GILMAN. Thank you very much, Dr. Cohen. We'll now proceed with Dr. Wedel, and please let me congratulate you for your good work on the Harvard Institute issue we've been so very much involved in. And we thank you for your work in that direction. Dr. Wedel.

#### **STATEMENT OF JANINE WEDEL, ASSOCIATE RESEARCH PROFESSOR, GEORGE WASHINGTON UNIVERSITY**

Ms. WEDEL. Thank you very much. It's an honor and indeed a pleasure to have the opportunity to testify before this Committee.

The main point that I want to make is that the United States has been asleep at the switch of aid policies toward Russia, and that there have been many signs of trouble along the way which have been ignored by the Clinton Administration, and largely overlooked by Congress.

Our challenge is to foster friendship with the Russian people, after having facilitated bad policies and stimulated anti-American sentiment, and to act before we are faced with further international crisis.

Over the past 7 years, the Clinton Administration has embarked on a fairly consistent course of economic relations with Russia that basically consists of three planks.

The first has been to provide millions, indeed billions, of dollars in U.S. and other Western aid, subsidized loans, and rescheduled debt. The second has been to urge radical economic reforms, including privatization. The third has been to back a handpicked political-economic group, or what Russians now are calling a "clan", to perform these so-called reforms.

The United States has consistently supported Boris Yeltsin and a cadre of self-styled Russian "reformers". We have consistently supported Anatoly Chubais and the so-called Chubais Clan, and bolstered the status of this Clan as the major brokers with the West and with the international financial institutions. The record shows that the Chubais Clan, not the Russian people or economy as a whole, has been the chief beneficiary of economic aid from the USAID.

Anatoly Chubais, as we know, has served in many positions since 1992. He presided over privatization as head of the State Property Committee. He was First Deputy Prime Minister, head of Yeltsin's successful reelection campaign, Chief of Staff for the President, First Deputy Prime Minister, and Minister of Finance. Most recently, he was special envoy in charge of Russia's relations with the international lending institutions.

The Chubais Clan has worked very closely since 1992 with Harvard University's Institute for International Development, or HIID. This Harvard-Chubais partnership controlled, directly and indirectly, millions of dollars in U.S. aid through a variety of organizations and institutions that were set up to ostensibly perform economic reform activities. This group was awarded some \$57 million, until May 1997, when the last tranche of the aid was cut off by USAID after its Inspector General cited evidence that the Harvard directors were engaged in "activities for personal gain."

The Harvard project's two main people remain under investigation by the Inspector General of USAID and the case is currently under civil and/or criminal review by the U.S. Department of Justice.

Now let me just say two things about these awards. The first highly unusual aspect of the awards to Harvard was that it got most of the money without competitive bidding. This was very unusual, and competition had to be waived at the highest levels of the Clinton Administration. The top officials of five government agencies—many connected to Harvard—signed off on the waivers. Two of the leading agencies were, of course, Treasury and the National Security Council. And from Treasury, the Harvard-linked Secretary Larry Summers—and David Lipton, who made his career with Jeffrey Sachs, as vice president of Jeffrey Sachs Associates, were instrumental. Jeffrey Sachs, of course, is now head of the Harvard Institute for International Development. All these people promoted and supported Harvard projects.

Another important and highly unusual aspect of these waivers is that they stated that the awards were being given to Harvard for "foreign policy considerations". In other words, U.S. officials signed waivers saying that it was in the national security interest of the United States to give awards to Harvard.

Another highly unusual and highly damaging aspect of this U.S. arrangement with Harvard is that the United States essentially delegated foreign policy in this key area of Russian economic reform to a private entity, Harvard University. And in addition to receiving the \$57-some million directly, Harvard also presided over about \$300 million, which was essentially the entire U.S. economic aid portfolio to Russia that encompassed not only privatization, but also legal reform, capital markets, the development of a Russian security and exchange commission, etc. The Harvard group was also involved in directing and promoting World Bank projects.

So in other words, the United States put Harvard in this unique position of recommending USAID policies, while being a chief recipient of the aid, and also overseeing other aid contractors, some of whom were Harvard's chief competitors.

But more important is the fact that economic reform was often *not* the driving agenda of this Harvard-Chubais Clan partnership. Members of the Chubais Clan—this is the very group that Deputy Treasury Secretary Summers called a "dream team" were consistently under investigation in Russia. There are many reports of personal enrichment from public and foreign monies that have been convincingly substantiated.

Similarly, Harvard managers had their own corruption problems that resulted in USAID's cancelation of the last \$14 million that

had been earmarked for Harvard. USAID cited evidence that the project's two managers had allegedly used their positions as advisors for "personal gain". In other words, they had used the information that they got from being advisors, to profit from investments in the Russian securities markets and other private activities. These men remain, as I said, under investigation by the U.S. Department of Justice.

It is telling that the General Accounting Office report that the Chairman ordered concluded in 1996 that USAID's management and oversight of Harvard was "lax." This was in 1996. Nevertheless, the United States continued to support this agenda.

Most important for the Russians and for U.S. relations with Russia, is that this U.S. strategy of reform through aid has totally failed. Millions of dollars have been wasted through aid to one group. And the transparent accountable institutions so critical to the development of a democracy and stable economy have yet to be developed.

There are three main problems with U.S. aid to Russia which has resulted in frustrating true market reform and democratic processes. The first is the way in which privatization was carried out. It's important to keep in mind that privatization was actually mandated by the Supreme Soviet of the Russian federation well before Chubais and USAID came on the scene.

But the program that Chubais eventually implemented contained very few safeguards, and instead, encouraged the accumulation of property in a few hands and opened the door to widespread corruption. The program was so controversial that Chubais had to rely on Presidential decrees for implementation. The program that had been earlier designed by the Supreme Soviet was intended to preclude much of this corruption.

The second main problem is that U.S. economic aid promoted and worked largely through decree. Decrees were sometimes written by Harvard principals, and instead of encouraging market reform, rule by decree in fact frustrated many market reforms, as well as the building of democratic, inclusive institutions. There were some reforms, like price controls, that could be achieved through decree. But many other reforms, including privatization and economic restructuring, depended on changes in law and public administration, and required working with a full spectrum of market participants.

There are a couple of case studies that I point to in my testimony that show how we actually frustrated market reforms through this style of operating.

The third major problem with U.S. economic aid is that it set up an entire network of organizations to bypass the government and democratic processes of the state. In my written testimony I report the results of some case studies.

There are a lot of signs that the U.S. strategy was not working. Again, there was a 1996 confidential report commissioned by the State Department's coordinator of U.S. assistance, that called the Russian Privatization Center "substantially over funded and largely an instrument in search of a mission." The report also said that the Center suffers from "imperial overstretch". The Russian Privatization Center was set up with U.S. aid and received literally billions of dollars in foreign assistance, much of which cannot be ac-

counted for, according to Veniamin Sokolov, head of the Russian Accounting Chamber, who was here recently and reported this.

Anyway, despite so much evidence of corruption and lack of Russian public support, many Western investors and U.S. officials embraced this way of operating, and viewed Chubais as the only man capable of keeping the nation heading along the troublesome road to economic reform. U.S. officials embraced this method of operation. As one told me, "If we needed a decree, Chubais didn't have to go through the bureaucracy."

This approach may have sounded efficient in principle, but it was a lot less convincing in practice, because it was inherently a political decision disguised as a technical matter. Harvard and Chubais readily acknowledged this. In a 1995 book, the publication of which was funded by Harvard, several so-called reformers said that, "Aid can change the political equilibrium by explicitly helping free market reformers to defeat their opponents. Aid helps reform not because it directly helps the economy, but because it helps the reformers in their political battles."

USAID coordinator Morningstar stood by this approach, and similarly told me, "If we hadn't been there to provide funding to Chubais, could we have won the battle to carry out privatization? Probably not. When you're talking about a few hundred million dollars, you're not going to change the country, but you can provide targeted assistance to help Chubais." It's telling that Chubais was placed on the Harvard payroll at one point, a show of loyalty that U.S. officials said they supported.

Chairman GILMAN. Dr. Wedel, we're being called to the floor for a vote. If you could summarize, maybe we could wind up our testimony.

Ms. WEDEL. Very well. I have five recommendations.

Chairman GILMAN. We'd welcome hearing them, if you could briefly state them.

Ms. WEDEL. I will say them briefly. The first thing we should do is to accept that the future shape of Russian society will be determined largely by the Russian people and the United States should try to adhere at least to some of the principles that it preaches, such as participatory democracy, and the rule of law, or even no taxation without representation.

Second, I think we need to recognize that a healthy economic system can't arise without a revival in production and distribution in the real economy. And we need to use our influence with the IMF and the World Bank to reduce the pressure on Russia to pursue suicidal policies.

Third, I think we need to launch a high-level drive to try to help the Russians recover monies from aid organizations and international financial institutions that have ended up in private, unregulated bank accounts outside of Russia. This would show concern for the Russian people, and it also would demonstrate a commitment to the rule of law.

Fourth, I think we need to embark on a broad-based policy to encourage governance and the rule of law, and it's essential that we support a variety of people, and adopt a pro-democracy stance that encourages, first and foremost, institution building.

And finally, U.S. officials need to establish contact and ties with a wide cross-section of the Russian leadership, politicians, economists, and social and political activists. Although a reversal of policy requires a long and resolute process of diplomacy, we can take steps by meeting with members of the Duma and a diversity of Russian elite. We can do people-to-people exchanges and programs. Some of these have been useful, and have created good will among the Russian people.

And finally, given the unfortunate record of U.S.-Russian relations today, exchanges that involve a broad section of the Russian population, especially at the local and the regional levels are now crucial.

Thank you very much.

[The prepared statement of Ms. Wedel appears in the appendix.]

Chairman GILMAN. Thank you, Dr. Wedel. And I want to thank our panelists, and I regret that we're being pressured to run to the floor for a vote at the moment. Without objection, an opening statement by Congressman Chris Smith will be inserted in the record at the appropriate point.

[The prepared statement of Mr. Smith appears in the appendix.]

Chairman GILMAN. Allow me to ask just a couple of questions. We'll try not to keep you too long. Andrei Illarionov, a Russian economist, believes the Russian Government is technically bankrupt. Does the panel disagree with that? And go ahead, Dr. Cohen. If you could be brief.

Mr. COHEN. Mr. Chairman, technically by defaulting on payments due to Germany and by defaulting on the internal ruble denominated debt, or should we say today, rubble denominated, securities, the so-called GKO's, the Russian Government does not have the cash flow to meet its obligations.

Whether it is, from the accounting point of view, a bankruptcy or not, sir, it's hard for me to state, because I'm not an accountant. But it is pretty obvious that there's a huge gap between the obligations to the internal and external creditors, and the ability of that government to raise revenue.

Chairman GILMAN. Thank you. Anyone else want to comment on that? If not, let me ask another question. How would you compare the economic depression of the last 7 years in Russia with our great depression of the 1930's? Do you believe Russia will soon enter an economic tailspin, similar to what Bulgaria experienced just 2 years ago? Anyone want to comment on that?

Ms. WEDEL. Well, just briefly. I believe the depression in this country was a drop in GDP of what—30 percent—and the depression in Russia is—I mean the figures of course are terribly problematic—but I believe the figure is 40 percent.

Chairman GILMAN. And Mr. Simes, in late August, a representative of a large western European investment firm stated that, "robbery is going on in Russia," and further stated, "the central bank has provided liquidity to commercial banks, which are using it to get their money out. It seems Russian oligarchs are engaging in big-time capital flight, undermining the ruble, and fleeing the country. For the central bank to say they can't control it, is a total abdication of what is central bank's responsibilities." Do you agree with that characterization?

Mr. SIMES. Yes, Mr. Chairman. I actually was in Moscow in July and had an opportunity to see the then central bank chairman, Sergei Dubinin. He was very bitter about being "under pressure" from Yeltsin's Presidential administration and the ministry of finance to subsidize the banks. There was quite a conflict.

It is very clear that the ministry of finance decided to side with Russian oligarchs.<sup>1</sup> The first tranche of IMF loan, which was supposed to stabilize the Russian economy, was used strictly to avoid the already inevitable ruble devaluation, and to provide money to Russian banks for the benefit of the Russian oligarchs.

Chairman GILMAN. Dr. Cohen, do you expect the Russian Prime Minister, Mr. Primakov, to continue the investigation into Russian missile technology commerce with Iran that was begun by former Economic Minister Yuretsen?

Mr. COHEN. Mr. Chairman, Mr. Primakov is a great supporter and architect of the Russian rapprochement with the Islamic Republic of Iran, and its leadership. He stonewalled on his visit to Israel in the fall of last year—on the Israeli inquiries on the Russian technology transfer to Iran that endangers American allies in the Middle East, and eventually may endanger our mainland.

Back to your question on Bulgaria, yes, I believe the Bulgarian scenario is quite possible. The problem in Russia is that those forces that pulled Bulgaria out of crisis, which were market oriented forces, are discredited in Russia today.

Chairman GILMAN. I'm regrettably being called to the floor to vote. My time is running out. I want to thank our panelists for being here today. Without objection, the chair will submit to our panelists written questions that other Members may have for an expeditious response. Thank you again for being with us.

The Committee stands adjourned.

[Whereupon, at 1:13 p.m., the Committee adjourned subject to the call of the Chair.]

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<sup>1</sup>To protect them from the consequences of the devaluation and default, which were felt disproportionately by foreign investors and ordinary Russian citizens.

## **A P P E N D I X**

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Page 1

**Chairman Benjamin A. Gilman  
Opening Statement  
House International Relations Committee Hearing on  
"The United States and Russia, Part II: Crisis in Russia"  
Thursday, September 17, 1998  
10 A.M. 2172 Rayburn Building**

**The Committee will come to order.**

**This morning we will finish our two-part series on  
U.S.-Russian relations.**

**Since our earlier hearing on this subject, held on  
July 16<sup>th</sup>, much of what our witnesses at that hearing  
warned against has come to pass.**

**Since then, we have seen a huge bail-out for the  
Russian government approved by the International  
Monetary Fund and World Bank.**

**Then, we saw the first installment of the IMF's loan  
turned over to the Russian government — almost  
\$5 billion — and saw how that money essentially  
disappeared without any visible benefit to the Russian  
people.**

**We have witnessed since then the near collapse of the  
Russian economy.**

**We have seen the rise to the second highest office in the Russian government of a man who, as Foreign Minister, seemed to make it his business to find ways to make it more difficult for the United States to exert leadership on important global issues – such as the proliferation of weapons of mass destruction in places like Iraq.**

**As the Committee heard at its July hearing, anti-Americanism appears to now be on the rise in Russia, with average Russians equating the quasi-reforms of the government of President Boris Yeltsin with the true reforms that the United States has wanted to see – and rejecting the idea of such so-called "reforms" and the corruption that has flourished in their wake.**

**I want to say to our witnesses this morning that I believe our government has not only been lied to by high-level Russian officials, but has ignored important signals over the last few years that all was not well – both in Russia and in our relationship with its government.**

**Russian President Yeltsin has told President Clinton many times that he supports reforms, but then has done little, if anything, to ensure their success.**

**A former high-level Russian official - Anatoly Chubais [ " ANN - AHH - TOE - LEE    CHEW - BYES " ] - has now admitted that the Russian government had outright lied to us and to the IMF to obtain the most recent bail-out package.**

**Over the last few years, many high-level Russian officials have denied that a commerce in missile technology is being conducted with Iran, yet it appears to continue.**

**While the Russian government's pursuit of a so-called "multi-polar" world clearly appears intent on obstructing American foreign policy goals, no Russian official I know of has ever admitted that.**

**Instead, for example, Yeltsin has made references to Europe's getting rid of its "uncle" when it arranges its future security.**

**While the United States seeks democratic reforms in all of the states of the former Soviet Union, Russia finds the financial means to support the Soviet-style dictatorship of Alexander Lukashenko [ " LUKE - AHH - SHEN - KO " ] in Belarus.**

**Huge amounts of money have poured out of Russia into foreign bank accounts over the last few years, but no one in our government seemed to take any concrete action to try to halt that – let alone acknowledge the seriousness of the problem.**

**President Yeltsin instead announced several campaigns to fight such corruption, none of which amounted to anything.**

**And IMF, World Bank and European Bank money continued to flow to the Russian government – then followed by private investors' money – and now it appears that much, if not all of that money may be lost.**

**Russian journalists and citizens who stood up to that corruption risked their lives – and some of them indeed lost their lives.**

**The mass privatization process in Russia – a process we directly supported – contributed to the rise of unregulated, so-called "investment funds" that scooped up citizens' vouchers and left them with nothing.**

**The United States stood silent while a subsequent "loans for shares" privatization by the Russian government appeared to turn over to its new "tycoons" some of Russia's richest industries.**

**A World Bank loan program for the Russian government to begin compensating average Russians for the loss of their privatization vouchers did little but pay for the salaries of high-priced western consultants.**

**And we wonder why the Russian people – after seven years of a massive depression – object to more "reforms" at this point and suspect America's motives towards their country??!!**

**Given all of this – and much more that I will not go into for reasons of our limited time this morning – we have to ask whether the Administration was ignoring all this or simply wishing it away.**

**I have to believe that we have not been honest about the negative trends in Russia over the last few years.**

**How can Russia change from the "success story" of our foreign policy by which it was portrayed by this Administration just two years ago into the dismal failure for our foreign policy that it appears to be today?**

**I wrote to President Clinton before his recent summit in Moscow stating that I now doubted that the assurances we had received from his Administration's officials about developments in Russia and its foreign policy in recent years had truly reflected the reality.**

**In fact, Congress and many of its Members have not been silent on their doubts over the success of our policy towards Russia.**

**This Congress overwhelmingly passed my "Iran Missile Proliferation Sanctions Act," and, despite the President's veto of that measure, Members remain concerned over Iran's access to Russian missile technology.**

**I publicly stated a long list of concerns over our policy towards Russia I hold in an op-ed published by the "Washington Post" on June 19<sup>th</sup> – asking the President not to move forward with the most recent IMF bail-out until those concerns were addressed.**

**Members of this Committee – including our Vice Chairman, Congressman Bereuter – and leading Members of the other body have publicly stated their concerns as well, and some of those concerns with regard to Russia's interaction with Iran, Iraq and China, its intimidation of its neighbors, and its internal corruption, have been expressed by Members of Congress for several years now.**

**I would submit that now, as our policy towards Russia appears near collapse, it is time to move away from "bumper sticker" slogans – as some observers have uncharitably characterized the content of current U.S. foreign policy in recent months.**

**Ladies and Gentlemen, having stated my critique of the Administration's policy towards Russia, let me commend it for not shying away from this hearing this morning.**

**Instead, two officials – who I believe have been the key influences on our policy towards Russia for the last six years – have agreed to join us this morning to take the Members' questions and explain how we have gotten to this point.**

**I want to welcome our Deputy Secretary of State, Strobe Talbott, and our Deputy Secretary of the Treasury, Lawrence Summers.**

**Welcome, Gentlemen.**

**We are pleased to see you — and will be most pleased to see you on a more frequent basis in future.**

**Also joining us today — by video link from California — will be former Secretary of State George Shultz.**

**I hope our Members and audience will bear with us, as today will mark the Committee's first use of this new video link.**

**Finally, we will take testimony from a panel of three witnesses who have spent years following developments in Russia and who have written extensively on the political scene there — including the implementation of economic reforms.**

**Those witnesses will be:**

**Dr. Dimitri Simes of the Nixon Center;**

**Dr. Ariel Cohen of the Heritage Foundation; and**

**Professor Janine Wedel [ " WADE - EL " ] of  
George Washington University.**

**I want to welcome all of our witnesses this morning.**

**At this time I would invite our Ranking Member,  
Congressman Lee Hamilton, to make an opening  
statement.**

**Mr. Hamilton.**

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**Would any other Members wish to make any opening  
remarks?**

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OPENING STATEMENT  
REP. CHRISTOPHER SMITH  
House International Relations Committee  
Hearing: U.S.-Russian Relations  
September 17, 1998

Mr. Chairman, thank you for holding today this second hearing on U.S. - Russia relations. I am looking forward to the testimony by our distinguished witnesses, Secretaries Talbott and Summers, and our other experts. It will also be a pleasure to hear from Secretary Schultz whose able leadership at the State Department under President Reagan played such an important role in bringing the Cold War to an end.

Mr. Chairman, while our attention has been focused here at home on personal failings in high places and momentous achievements on the baseball diamond, the world beyond our borders did not go on vacation in August. An economic experiment in Russia - an experiment both noble and flawed - appears to be in serious trouble, if not collapsing. The ruble has declined precipitously against the dollar. Millions of Russians have gone for months without a full pay check, and soldiers are begging in the streets. A few days ago, the International Red Cross and International Red Crescent stated that the economic collapse in Russia and the onset of winter threaten "devastating" consequences for millions of Russians.

Meanwhile, several Western financial institutions are writing off millions of dollars in bad loans. Analysts at the London-based Fitch IBCA have stated that up to \$100 billion of at least \$125 billion in outstanding private foreign claims have been written off as a loss. This may be, according to Fitch, the largest single credit loss ever taken by the international community.

Mr. Chairman, I realize that the Russian Government, its democratically elected representatives, and Russian citizens are primarily responsible for what happens in their country. We don't need to debate a "who lost Russia" scenario. But, I do believe that the present Administration cannot avoid some responsibility for the situation in Russia today. Time and time again, the Congress heard from the Administration that Russia was headed toward a market economy, that the government was keeping inflation under control, and private enterprise was developing. At the April 1996 summit in Moscow, President Clinton stated that "the U.S. is now the largest foreign investor in Russia."

Well, something went wrong. What happened? Millions of taxpayer dollars were spent either in bi-lateral or multilateral aid to assist Russia to integrate into the Western financial and political community. It now appears that a good deal of the money that the U.S. Government extended to Russia through grants or loans was stolen, mis-appropriated, or has simply disappeared without explanation. Russia was supposed to become a viable market for the United States, which would in turn create jobs in this country. Instead, the primary benefactors appear to have been the corrupt Russian ruling circles and some USAID contractors. I realize some of the money did reach its destination and was used conscientiously, but I believe our taxpayers deserve better.

When this committee met on July 16 last, we discussed the Administration's policy toward Russia – at that time the policy sought to rescue the Russian economy with another dose of IMF funding. It seems that every time Russia faces economic difficulties, we are warned that if the West doesn't send money, the "fascists and nationalists will take over."

Well, the IMF sent more money – a 4.8 billion dollar loan – but the Russian economy sank. We didn't exactly get the fascists and nationalists – not yet, at least – but we got Mr. Primakov, whose economic plans and personnel appointments indicate that we'll see less reform, a lot more "muddling through," and an infusion of rubles into the economy to keep the social discontent within manageable limits.

Many Russians have apparently welcomed Mr. Primakov's appointment, if only for the stability he brings. I certainly wish him well if he can help the Russian people feed and clothe their children. Surely, they deserve much better than they have benefitted at the hands of their leaders.

In any case, the recent events in Russia indicate to me the Administration's policy toward Russia has been based on false assumptions, and the policy has failed. Perhaps our witnesses from the Administration can illuminate my understanding on this subject. I look forward to hearing what they have to say, and I will have some questions.

Thank you, Mr. Chairman.

**Statement of the Hon. Lee H. Hamilton  
Before the Committee on International Relations**

**The United States and Russia: Russia in Crisis  
September 17, 1998**

Thank you, Mr. Chairman. I would like to welcome each of our distinguished witnesses and thank them for appearing today. In particular, I want to thank Deputy Secretary of the Treasury Lawrence Summers and Deputy Secretary of State Strobe Talbott for taking the time this morning to testify about what the United States is doing, and can do, to keep Russia on the path to reform.

- This hearing comes at a time with the Congress is not inclined to be very helpful to Russia. The mood in Congress today toward Russia is sour.
- There is deep concern about the direction -- especially the economic policies -- of the new Russian government. Many question whether any government in Russia can prevent corruption and cronyism from derailing efforts to pull Russia out of its economic crisis.

**I. Why Russia Matters**

- Russia today faces a difficult and dangerous crisis. It is exactly the urgency of this crisis that makes U.S. policy toward Russia so important.
- The United States has a strong interest in keeping Russia on the path to reform. What happens in Russia will profoundly affect the world's security and economic environment.
- We want the Primakov government to implement reform and to resist the temptation to slide backward, undoing the progress already achieved.
- I think we can all agree on what Russia needs to do: control its budget deficit and money supply, overhaul its tax code, break up monopolies, reduce corruption, enforce bankruptcy laws, and enforce private property rights.

- We want Russia to implement the IMF package it agreed to in July.
- But there is considerable doubt whether Russia will pursue this course. Reform in Russia has suffered a serious setback. Those of us who support U.S. and international efforts to advance reform in Russia are deeply disappointed with the events of the past several weeks. But I am not discouraged.
- In the seven years since the collapse of the Soviet Union, Russia has made important progress on both political and economic reform. That progress has been slow, but significant:
  - o 70 percent of the Russian economy is now in private hands;
  - o Military spending in Russia is one-seventh of what it was a decade ago;
  - o Russia has held several elections at the national, regional and local level;
  - o Russian troops are out of Germany and the Baltic States, and work side by side with NATO troops in Bosnia.
- But we cannot expect reform to proceed in a straight line. We cannot expect reformers to be deaf to the plight of the Russian people, who have paid a high price for reform.
- The future of reform in Russia is by no means certain. But the United States has too much at stake in the outcome of the current crisis simply to walk away.
- Our national interests demand that we continue to engage with the Russian government and, at every opportunity, push for continued progress on reform -- and support those who reform. Russia still matters.

## **II. Rethinking U.S. Policy Toward Russia**

- Given what has happened in recent weeks in Russia, we need to re-think our policy toward Russia.
- The western liberal economic model has faltered in Russia.
- If we want reform to take hold in Russia, we are going to have to deal with Russia more on Russia's terms.
- We have to ask ourselves: What can we reasonably expect from Russia?
- We are right to push and prod reform. But we have to expect that reform in Russia is going to be more gradual, more mixed – and more Russian -- than we expected and hoped 7 years ago, when the reform process began.
- Russia will carry out reform in a Russian way. My question for our distinguished witnesses is what do we do about it? How do we encourage Russia to return to the path of reform? How does the United States promote reform in Russia when the politics in Russia, at least for now, point in the opposite direction?
- Mr. Chairman, I thank you for convening this important hearing, and once again welcome our witnesses. I look forward to your testimony.

EMBARGOED UNTIL 10:00 A.M. EDT  
Text as Prepared for Delivery  
September 17, 1998

**DEPUTY SECRETARY OF THE TREASURY  
LAWRENCE H. SUMMERS  
HOUSE INTERNATIONAL RELATIONS COMMITTEE**

Mr. Chairman, I am glad to have this opportunity to address the economic situation in Russia. I know that this has been of considerable interest to this committee and other members of Congress.

I have recently returned from a meeting in London with representatives of the G8 countries where recent events in Russia were analyzed and their implications discussed. There is no question that the United States has enormous national security and economic interests in what happens in Russia. Already the country is facing a deep financial crisis that threatens to strengthen opponents of further political and economic reform and encourage a lurch backward to past strategies of inflationary finance and protectionism. A prolonged crisis would call into question the spread of open market policies in other emerging nations. And it would raise important concerns for our broader national security, given Russia's pivotal and continuing role with respect to nuclear security, the battle against terrorism, the stability of Eurasia, and conflict resolution in global hot spots like the Balkans. Of course, these issues take on an even graver aspect against the uncertainty and instability we see today in global financial markets.

My colleague from the State Department has already addressed the broader security issues relating to Russia's current situation. I would like to begin my remarks with a few words about Russia's evolution over the past seven years and the problems leading up the crisis. I will then describe the considerations that have guided the United States approach to Russian economic reform throughout this period and the main policy challenges going forward.

RR-2686

## **I. Russia's Transition Since 1992**

Mr. Chairman, since the dissolution of the USSR, Russia has been struggling with the profound challenge of creating an entirely new kind of economy, a new kind of politics, and a new geo-political setting. While recent events will have very severe consequences for Russia and raise a great many uncertainties, it is important to begin any discussion with a recognition that Russia is already a very, very different country than it was seven years ago:

- Russia has a democratic leader and a democratic system, even if it has also experienced the uncertainties that democracy can bring with it.
- Russia has been greatly demilitarized and is no longer channeling one fifth of its national resources into the maintenance of military forces directed at America. Last year Russian military spending was only 1/7 of its peak in 1988 and 2/5 of its level in 1992.
- Around 70 percent of all economic activity is now generated by the private sector, prices move freely to reflect market forces. Russia has private banks and private capital markets.
- Russia is now a country that is open, whose people know what happens in the markets and systems beyond their borders and have access to all the ideas and products that the rest of the world has to offer.

Bringing about change on such a scale is enormously difficult in any country and uniquely challenging in a country with 150 million people, countless ethnic and nationalist groups, ten time zones --and 3/4 of a century of communism to overcome. Russia is now a functioning democracy and a market economy. But it is widely recognize, by outsiders and Russians themselves, that the new Russian economy is also seriously flawed. It is these flaws that helped sow the seeds of today's crisis.

## **II. Roots of the Crisis**

Russia's economic policy framework collapsed in the middle of last month as the Russian authorities --in the face of severe market pressures-- decided on the enormously risky course of simultaneously devaluing the ruble, imposing a debt moratorium and restructuring government bonds. This was the Russian government's decision and not one which we supported. In this regard, as in so many others, Russia is a unique case and should in no sense be viewed as a

precedent or guide for other emerging markets under pressure. Indeed, the government's actions served to undermine confidence still further, unleash spending, lending, and inflationary pressures, and prompt a change in government. The result is an economic and financial crisis as serious as any since the reform process began.

The immediate problems leading up to this crisis are simply stated: an inability to control the budget deficit, an excessive reliance on short-term debt and —partly as a result — enormous difficulties with maintaining a fixed exchange rate peg. During the past ten months investors had become increasingly doubtful that Russia would be able to maintain the fixed exchange rate while paying its mounting debt service costs. This led to ever-higher interest rates, and a rapid depletion of foreign reserves —a vicious cycle which culminated in the very unfortunate events I have already described.

Thus, at a purely financial level, this crisis was caused by the usual problem of too much borrowing, creating too little ability to repay. But at a deeper level, the crisis can be traced to two broad political problems that have dogged Russian reforms since the beginning.

The first problem has been the failure to resolve a basic mismatch between the government's spending needs and its available resources —a mismatch in many ways inherited from the previous regime, but exacerbated by political stalemates and disagreements of the transition period. At 9 percent of GDP, the tax revenues the federal government was able to collect last year is at odds with the role the government and its electorate envision for the state, indeed, it cannot credibly sustain the operations of the most minimal state. Yet there has been a repeated political failure, either to increase sufficiently the supply of revenues to the center or to reduce sufficiently the central government's spending commitments.

The second problem that Russia has failed to overcome is the fundamental weakness of post-Communist institutions. This weakness has come through particularly in the inability to collect sufficient tax revenues and, critically, in the failure to build and institutionalize a favorable investment climate and the rule of law.

The broader consequences of these failures are severe and wide-ranging. The Russian private sector has been starved of the private capital it needs; large parts of the economy have been left off-the-books, under-monetized, vulnerable to crime and dependent on barter; the financial sector is poorly regulated and a poor intermediary funds for investment; the terms of privatization have frequently been noncompetitive, and private ownership often failed to improve company management. Worst of all, corruption remains pervasive and fundamentally undermines peoples' faith in the legitimacy of the political and economic system. And social payments are not adequately targeted and, as a result, the truly needy often receive little or no support.

While it was possible for such a flawed system to go on for some considerable time, in the end it was Russia's inability to service the most basic institutions of an effective state that led to the financial collapse that occurred last month.

### **III. The Approach of the United States and the International Financial Institutions**

Mr. Chairman, starting with the Vancouver Summit in 1993, President Clinton has made clear that the United States would take a leading role in international efforts to help Russia develop the institutions and policies of a functioning market economy. We have done this because we believe that a successful market transition in Russia is critical to American interests —and because we believe that, when policy makers themselves are committed to reform, IMF and World Bank programs can raise the chances of it being achieved.

Recent events have not altered this judgment. Indeed, since 1992, the IMF and the World Bank have played an important role in achieving many of the positive changes in Russia that I have described and have helped to underpin a valuable period of exchange rate stability after the costly hyperinflation of the early 1990s. What the crisis has underlined, however, is that international support cannot succeed where domestic policy makers have failed.

In light of increasing uncertainties in Russian markets —and emerging markets more generally —both the United States and the international financial institutions had been increasingly aware that Russia's situation was becoming more problematic. These concerns were expressed to Russia both bilaterally and in the Russian authorities' ongoing contacts with the IMF.

In the worsening market climate the IMF —backed by the United States —decided to support the Kiriyenko government because that government had begun to address the fiscal and broader institutional failures that threatened Russia's economic stability and because we believed that the risks of inaction far outweighed the risks of action. An additional \$22.6 billion multilateral financing package was mobilized in July to provide tightly conditioned assistance to the government so that it would have financial breathing space to press on with these reforms.

The first element of this support was a \$4.8 billion tranche from the IMF on July 20. The disbursement of these funds was based on completion of a long list of prior actions. These steps included: to streamline the tax code and reduce tax rates; to reform tax administration procedures and a budget code; to have a more uniform application of the VAT, including application to barter transactions; and reductions in federal subsidies.

Cutting the deficit was not the extent of the Kiriyenko government's reform horizon. Additional IMF and World Bank financing was to be made available to support important structural reforms that would help tackle corruption and support private sector growth and investment. For example, as part of this program Russia was urged to make the privatization process more transparent and open; cut

substantially the number of "strategic firms" exempted from privatization; accelerate reform of the banking and energy sectors; eliminate non-cash payments for utilities and infrastructure; increase capital market transparency; strengthen measures to enforce minority shareholder rights; and improve bankruptcy legislation and enforcement.

With important actions already taken, and firm commitments of more to come, the United States supported the disbursement of IMF funds for Russia because we believed there was a reasonably good chance –not a certainty, but a reasonably good chance –that reform would move forward in the period ahead.

In the end, opposition to the Kiriyenko reform agenda and the deterioration in market conditions helped fuel great market scepticism. This culminated in a comprehensive breakdown in confidence in the first weeks of August.

Of course, it would have been vastly preferable if the Kiriyenko government had been able to forge a broad political consensus in favor of the full program of fiscal restraint and deeper structural reforms to strengthen state institutions and tackle corruption. But the reality is that there was, and is, strong opposition in the Duma and elsewhere from powerful special interests and from those who seek a return to communism. It was this opposition that helped fuel great market skepticism, and the breakdown in confidence that followed. But if the IMF had not acted quickly to support key elements the government's anti-crisis program, it and we would have been rightly criticized for timidity and for a failure to seize a critical opportunity to support reform and stabilize Russia's economy.

The failures of Russian reform –and their culmination in the present crisis –have led some to argue that the international institutions and the United States have been overly forgiving in their support for Russian reform. On this view, international financial support has merely lined the pockets of corrupt officials and oligarches while weakening the incentive to carry out deeper reform. The facts of the international community's support for Russia tell a different story –of support given only on the basis of concrete reforms and reform commitments, many of them expressly designed to tackle the scourge of corruption.

IMF support has consistently been delayed or cut when the Russian government has not made good on its commitments. And since 1992, Russia's persistent failures to achieve solid reform in some areas have led to ever tighter conditionality. For example, Russia was the first country to have monthly tranching as part of its IMF program. As a condition for disbursing the first tranche of official funds in July, the IMF required more than legislative proposals: it required laws passed or actions that had the force of law. Because two actions were not taken – a rebalancing of personal income tax revenue sharing and closure of the pension fund deficit – the IMF Board cut the disbursement from \$5.6 billion to \$4.8 billion.

As I have already stressed, we very much share the concern in Congress about corruption in Russia and so do the international financial institutions. It is a fundamental threat to Russia's stability, democratization, and prospects for a broadly-shared rise in living standards. But let there be no doubt: the world's best antidote to corruption is economic reform.

A large share of corruption and illicit behavior in Russia —below-market-value sales of government assets to favored buyers, protection payments extorted from firms in the "informal" sector, the prevalence of barter rather than cash payments to avoid the punitive tax system, violations of minority shareholder rights, crony bank lending to clients with ownership ties, and bribes extorted by government officials —can be traced to policy or regulatory failures. It is precisely these problems that the IMF has been trying to correct, through its support for competition, tax reform, improved corporate governance, more firm and government transparency and disclosure, stronger bank supervision, and restraints on the discretion and scope of government regulation.

Moreover, on a bilateral level, legal reform and the battle against corruption have long been a central focus of Vice President Gore's work with the Russian Prime Minister and President Clinton's dialogue with President Yeltsin. To cite just one Treasury-related example, we are working with Russia to curb money laundering through promoting passage of legislation which criminalizes money laundering and consulting on the creation of a financial intelligence unit.

#### **IV. Prospects for the Future**

It would be difficult to exaggerate the uncertainties of a moment such as this one. Until there has been a resolution of the direction in which the Russian political authorities will go it is difficult to calibrate an appropriate international response. The United States has a strong stake in Russia successfully overcoming today's crisis and laying the grounds for a more stable future —by carrying out the kind of macroeconomic and structural reforms included in the IMF program. We will strongly support a Russian government that is determined to carry out these changes and continue the process of democratization. But international programs have always to be built on the recognition that countries shape their own destiny: the Russian authorities and the Russian people themselves have to choose their own path.

With this basic warning in mind, let me just make three basic points that will guide the approach of the international community going forward.

First, it is critical in the present climate of mistrust that the Russian government present a coherent economic strategy and that the strategy be Russian-"owned". The new government of Russia has asked to be judged on its actions. And so it will be. But Russian commitments must precede its actions. A

critical step toward regaining the confidence of Russians themselves and winning the support of the international community will be for the government to explain its approach to restoring stability and fulfilling its international obligations --and to describe clearly how this approach is to be implemented.

Second, while any plan must be pragmatic and respond to the political conditions facing the government, it has also to recognize that Russia cannot repeal basic economic laws. Russia has its own unique history and traditions and it will have to make its own decisions about specific institutions and market arrangements. Yet, as President Clinton said in Moscow earlier this month, if the past year has taught anything it is that no country can escape the imperatives of the global marketplace. Money cannot be printed in excess without causing inflation. And an exchange rate peg that is not combined with appropriate monetary and fiscal policies will not hold.

By devaluing and restructuring debt, Russia has taken drastic measures to cope with failed policies. Russia's authorities urgently need to clarify those steps and begin a cooperative dialogue with official and commercial creditors. They must resist pressures to spend and lend which will doom the economy to another bout of high, perhaps hyper-inflation. Just as important, they need to take on the failings of the financial system and finally put in place the core institutions and policies of a private market economy.

The broader long-term challenge that Russia faces in the wake of this crisis is finally to create an environment in which business and investment can flourish. That means sound money, the rule of law, fair tax laws and enforcement; private ownership and free land markets; independent courts that enforce laws and contracts; strong banks that safeguard peoples' savings and channel those savings to productive private investment; securities markets that deter fraud and protect legitimate investor rights; social spending targeted to those really in need, and it means the prevention of hidden, anti-competitive ties between government and business interests.

Finally, let me add that to the extent that international finance is used to support Russia we will and must work to ensure that they reach the parts of the population that need help --not just enrich off-shore bank accounts. Our confidence in making this judgment will speak to the Russian authorities' commitment to rooting out some of the underlying flaws of Russia's reform process that have held it back for so long --not least, the growing popular belief that only those with poor connections play by the rules.

Many will argue that the present crisis and politics make the chances of Russia taking this course remote. But if the greater connectivity within the world economy and more rapid flow of capital around the world has meant that these kinds of problems come to the surface more quickly --it can also mean that where they are addressed, capital and growth can return that much faster. And while it is true that

reforms can cause economic dislocation of workers that may have negative consequences for reform-minded governments, the economic political consequences of a failure to reform —and continued decline in the economy —would be graver still.

Russia faces a choice, to restart, accelerate and deepen reform, or to drift in dangerous policy directions. As President Clinton said, "There is no shortcut to developing a system that will have the confidence of investors around the world. These are not American rules or anybody else's rules. These are [the rules] in a global economy." We all have an interest in Russian economic success and the President made clear that the Administration is ready to offer further assistance if Russia stays with the path of reform. But the choice is for Russia, and Russia alone, to make."

Thank you. I would now welcome any questions.

**Testimony Before the House International Relations Committee**

**By Dimitri K. Simes  
President, The Nixon Center**

**September 17, 1998**

**Russia is in the midst of a severe crisis which goes far beyond mere financial and economic difficulties. It is nothing short of a major systemic crisis which poses a serious threat to the fragile institutions of the market and democracy established since the collapse of the Soviet Union in 1991.**

**Russia's crisis was triggered by events in Asia and by declining oil prices. But it was caused by fundamentally unsound policies. The Russian bubble economy was bound to burst sooner or later because what was portrayed as a genuine effort to build a capitalist democracy was to a large extent a charade, covering up the continuing influence of the old Soviet nomenklatura, the development of new undemocratic practices, the near contempt with which the all-powerful Russian executive branch treated the parliament and the courts, pervasive corruption reaching into the highest echelons of the Russian government including Boris Yeltsin's inner circle, and the substitution of foreign loans for growth of the Russian economy.**

**The Russian government was up to now run by President Boris Yeltsin, who -- after his illegal dissolution of the old Congress of People's Deputies -- arranged for the approval of a new constitution in a referendum which many observers consider to have been fraudulent. That constitution gave the Russian president authority far beyond what is known in any democratic society. Moreover, it was known for many years that Yeltsin abused alcohol, had a history of prolonged, unexpected disappearances, behaved erratically, showed little regard for the opinion of anyone else in his country, and acted in general as an elected monarch. After his 1996 heart surgery, Yeltsin's drinking slowed somewhat, but there is abundant evidence that his physical and mental faculties were damaged beyond repair. The problem is not only that Yeltsin is incapable of serving as a strong chief executive, but also that by his nature he is unable to delegate authority to others. Disloyal in defeat and envious in victory, he has repeatedly undercut his own government and entered into unnecessary confrontations with the parliament. Polarization and crisis are his principal techniques of government.**

**How could a regime like this survive for so long without provoking a major upheaval when, in addition to Yeltsin's own failings, his government is widely criticized in Russia for bringing about the disintegration of the Soviet Union without protecting Russian interests, for the brutal and humiliating war in Chechnya, and for a severe decline in the living standards of its population? The legendary patience of the Russian people is only a part of the answer. Another part is that by the time Yeltsin lost his original popularity, he had consolidated his control of the military and security services -- and demonstrated that he was willing to spill blood to achieve his political objectives. At the same time, the collapse of the totalitarian Soviet system allowed the Russians new opportunities to become the masters of their own destiny. Although limited to the**

stronger, younger, more educated, and unfortunately often more ruthless part of the population, these opportunities were sufficient to give many people in the more dynamic part of Russian society a stake in the system.

Relatedly, and also important, was the emergence of a new group of oligarchs from among the old nomenklatura, organized crime groups, and Russia's financial speculators. After redividing the huge Soviet economic pie among themselves -- and finding themselves unable to manage it -- the oligarchs became dependent upon the continuation of the Yeltsin regime for their survival.

Last but not least is the support of the outside world, which amounted to up to \$100 billion by some estimates. Foreign loans, ranging from IMF credits to investment in Russia's GKO's, allowed the Russian government to stay afloat and even to create the appearance of prosperity in Moscow and a few other major cities despite a decline in GNP far exceeding that seen during America's Great Depression.

During the last several years, the Clinton Administration has become the Yeltsin regime's principal foreign patron. While American assistance *per se* is relatively modest, senior officials clearly used the IMF and, to a lesser extent, the World Bank, as proxies for U.S. foreign policy -- and not just to support Yeltsin, but to micromanage the Russian economy and even to influence top-level appointments in the Russian government.

The administration justified this by arguing that despite its shortcomings, the Yeltsin government was on the right side of history and that the alternative was a communist/nationalist comeback with severe negative implications for U.S. interests. But that was false from the start. First, Yeltsin's constant conflict with the Congress of People's Deputies and then the Duma was at least as much a struggle for power as a battle of competing political and economic strategies. Yeltsin's nemesis in the fight with the Congress of People's Deputies, former Vice President Aleksandr Rutskoi, is now a moderate governor in Kursk. In the current Duma, the Communist Party and its allies control less than 40% of the seats and the most consistent opposition to Yeltsin is from the pro-democracy pro-reform Yabloko party. It was the fact that Yeltsin's policies lacked any real public support that encouraged his authoritarian rule. The alternative to Yeltsin's authoritarianism was not a communist comeback but dialogue with the parliament which could have led to important legislation protecting property rights and reforming Russia's tax system -- without which a genuine transition to a market economy is impossible. Foreign and even domestic investors simply have not been satisfied with Yeltsin's efforts to make these historic changes through presidential decrees of questionable legality.

Looking at Yeltsin's rivals, while Communist leader Gennady Zyuganov has always led in the polls, his support never exceeded 35%. For a number of years, the credible candidates to replace Yeltsin have not been Zyuganov or the discredited (and increasingly obedient) Vladimir Zhirinovskiy but more moderate politicians such as Moscow Mayor Yuri Luzhkov, Krasnoyarsk Governor Aleksandr Lebed, or Yabloko leader Grigory Yavlinsky. In supporting Yeltsin and particularly his proteges among Russia's radical reformers, the Clinton Administration put tight monetary policy over economic growth and its understanding of economic efficiency above Russian democracy. U.S. policy toward Russia was determined by personal and tactical concerns

rather than our lasting national interests.

The new government of Prime Minister Yevgeny Primakov is a coalition of diverse and sometimes conflicting voices. It must face an economy near collapse and a society whose patience is almost expended. Still, more than previous governments under Yeltsin, it can hope to enjoy the support of the parliament both in economic matters and with respect to important foreign policy actions, such as ratification of the START II treaty. We have received encouraging reassurances from President Yeltsin and Mr. Primakov regarding the government's commitment to reform and a responsible foreign policy. Only time will tell.

At this point, it would be a wise strategy to give the new Russian government the benefit of the doubt as long as possible while being prepared to cut our losses and disengage if it becomes clear that there is no room for a constructive American role.

Following are several specific recommendations for U.S. policy at this late date, when Russia's crisis is already in full force and the Clinton Administration is considered by many to be guilty by association for Russia's failures:

- Recognize that the Clinton Administration's policy toward Russia so far has been fundamentally flawed and that a considerable change of course is necessary;
- Organize Congressional hearings and request cables from the U.S. Embassy in Moscow and CIA assessments of developments in Russia to determine what President Clinton and his advisors knew about the situation there and when they knew it;
- Put an end to the administration's obsessive support for Boris Yeltsin and other Russian political personalities and start dealing with the Russian government on the basis of its policies;
- Identify and assertively promote U.S. priorities in Russia, such as political stability, democracy, and a non-aggressive foreign policy. Leave the rest to Russia. Stop trying -- as the administration continues to do -- to formulate exactly how Russia should run its economy and even define its own national interests;
- Demand from Moscow a full accounting for previous IMF and other international assistance and insist on fair compensation for all foreign investors before releasing the next tranche of IMF funds. Consider the creation of a new London Club-type structure to protect the rights of foreign investors affected by Russia's *de facto* default;
- Insist on IMF reform, including the dismissal of the current IMF management. The IMF has correctly been compared to an international fire brigade. It is inconceivable that we should retain in its leadership individuals with a record of misusing the IMF and acting like unwitting arsonists, starting fires, such as the crises in Russia and Indonesia, rather than putting them out.

- Give the G-7 a greater role in developing strategies to deal with the Russian crisis, including the criteria by which Russia's reform should be judged. Support for Russia's reform process is too important to be left to unelected financial bureaucrats.
- Finally, be aware that even if we do everything right, our ability to affect developments in Russia is limited. Accordingly, while trying to offer a helping hand, we should be prepared to refuse to throw good money after bad. We should also develop an exit strategy.

## **How the West Lost the Battle for Russia's Future**

**Ariel Cohen, Ph.D., Senior Policy Analyst, Russian and Eurasian Studies**

**The Heritage Foundation**

**Testimony before the House International Relations Committee**

**September 17, 1998**

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### **Introduction**

The restoration of a communist-dominated government in Moscow, led by anti-Western spy master Evgeny Primakov, is an historic shift in Russian and world politics, comparable to Boris Yeltsin's victory against the communist putsch in 1991, though in the opposite direction. This is a triple policy fiasco, the result of strategic errors on the part of the Russian government and President Yeltsin personally, the US Government led by President Clinton, and the international financial organizations, especially the IMF and its "Russia team"—Managing Director Michel Camdessus, First Deputy Managing Director Stanley Fischer, and the executive with line responsibility for Russia, Director of the IMF's European II Department John Odling-Smee.

Russia's economic collapse and the communist restoration were not inevitable. In fact, Members of Congress, officials of former administrations, and numerous experts, both Russian and Western, warned of the dire consequences of previous policies. Their warnings went unheeded. The administration was preoccupied with championing its own slogans about "support of Russian democracy" and "reformers" – while some of these "reformers" were busy conning Western investors, embezzling from the Russian population and government, and going on a borrowing spree that crashed the Russian economy in one year.

### **Boris Yeltsin's failure**

The Yeltsin administration had a unique opportunity to dismantle communism, to examine its evil nature and the historic price that Russia and the world were forced to pay for the Leninist experiment launched amid the crisis of a weak authoritarian regime in Russia in the fall of 1917. After his victory over the hard line communists in 1991, Yeltsin enjoyed a vast reservoir of trust and support among the Russian people. This was the time for considered, deliberate, and sweeping action. However, no serious "de-communization" was attempted, nor a serious effort to think through and repent the violence, the violations of human rights, and the empire building which had accompanied the Soviet experience. Many former communist apparatchiks remained at the core of the Yeltsin regime. No serious reforms of the military or the security services were undertaken.

The communists had bankrupted the USSR's treasury, stolen its gold reserves and generated hyperinflation. Some Russians were ready to learn how to function in the market. However, a huge knowledge gap existed.

One area in which "young reformers" initially seemed to be making some headway—economic reform—soon deteriorated into a mesh of crony capitalism, corruption, opaque privatization, capital flight, and in some cases, murder-for-hire. The reforms never had the sophistication, scope or discipline of the Leszek Balcerowicz program in Poland or the Vaclav Klaus reform in the Czech Republic. There was neither the efficiency of the German privatization, nor enthusiasm and gusto for economic liberalism demonstrated by the Government of Estonia. No serious, concerted attempt was made by the Russian government to explain the rationale of the reforms to the people. Instead, there was an overall failure to move toward a market-oriented legal and dispute resolution system and the rule of law, a debilitating absence of functioning bankruptcy and anti-monopoly mechanisms, poor protection of shareholder rights and inadequate measures concerning corporate governance. The combined result was in an atmosphere in which corruption and crony capitalism of the worst kind flourished, complete with backroom swaps of lucrative state-owned enterprises in return for campaign financing and media support during presidential elections. Small wonder that needed foreign investments largely failed to materialize, or that capital flight became rampant.

The Yeltsin administration, despite its victory over the communists in the presidential elections held in the summer of 1996, has lost its credibility in the eyes of the Russian voters. The Government of Russia, including the Duma, failed in the following areas:

- macroeconomic policy—by creating wage arrears in the public and private sectors, in the military and among law enforcement agencies and pensioners; by conducting irresponsible borrowing at home and abroad to the tune of over \$70 billion and then defaulting on its obligations
- fiscal and budget area—by failing to create a workable and realistic budget or a viable tax system
- regulation—by generating numerous opportunities for governmental corruption on the national, regional and local levels, as the level of arbitrary licensing and government regulation remained high
- law enforcement—by failing to prosecute even the most blatant cases of high level corruption, by failing to maintain minimal levels of physical security for the population, and by failing to solve the high profile murders of popular TV personalities and businessmen
- rule of law—the Duma's abysmal legislative record and the Yeltsin administration's failure to launch an effective court and alternative dispute resolution system which could mediate disputes in the private sector alienated the people from the government. Instead, organized crime now plays the role of judge, jury and executioner in resolving business disputes

•federal, inter-ethnic and regional relations—by starting and ineptly prosecuting the war in Chechnya (1994-1996) which led to the loss of 100,000 lives

Thus, the Yeltsin government completely discredited itself, allowing the equally unpopular Duma to force upon the ailing President Yeltsin an anti-reform government in August-September, 1998.

### **The U.S. Government's Failure**

The chief mistake of the Administration was to believe the reformist slogans fed to the U.S. diplomats and other gullible Americans by their Russian government counterparts. After all, this was the country which – 200 years ago -- invented the Potiomkin village of freshly painted facades and crumbling buildings! The evidence that things were going awry was there; however, the Administration's top Russian decision makers chose to disregard it, thus misleading the Congress and the President.

The macroeconomic policy failure of the Clinton administration was, first and foremost, in focusing on price liberalization and privatization while neglecting the institution building necessary for creation of a modern market economy. Furthermore, the Administration failed to address the huge knowledge gap that exists in Russia. Russian entrepreneurs, politicians and managers severely lacked modern economic and business knowledge. Instead, the population resorted to Soviet-era behavior of stealing from and cheating the state. Embezzlement and corruption became rampant. Historic Russian and Soviet-era business practices caught up with post-communist Russia. Our assistance programs had very hard time addressing these.

The U.S. policy makers effectively blinded themselves to corruption plaguing the Yeltsin administration. Administration's attempts to send two FBI officers to Moscow as legal attaches (legats) and providing training to the unreformed Russian Interior Ministry (MVD) were too little, too late. At the same time, despite widely available polling data, the Administration continually underestimated the degree to which rampant crime and corruption were eroding the Yeltsin government's legitimacy.

The Administration decided to support Boris Yeltsin during the war in Chechnya, in which over 90,000 soldiers and civilians—all of them Russian citizens—were killed. This misguided act of mayhem undermined Yeltsin's authority. Supporting it made the US appear grossly callous to the majority of Russians, who opposed the war. It also rendered the Administration's declarations in support of human rights cynical and hypocritical as far as the Russian public was concerned.

Partisan support of Boris Yeltsin through thick and thin—in the 1993 confrontation with the Parliament, during the Chechen war, and in the 1996 elections, served to convince the majority of the Russian body politic of America's partisanship. The uncritical endorsement and encouragement of even the most outrageous practices of the Russian government has succeeded in bringing many among the Russian political elites and the population to perceive the United States as a malevolent foe. The Administration made almost no attempt to reach out to those who disagreed with Yeltsin,

or to establish a dialogue with them, thus helping to create a situation in which the increasingly unpopular president of Russia now appears in the eyes of many Russians as an American tool.

Finally, the Clinton administration repeatedly swallowed Russia's often egregious anti-American behavior, continuing its economic and moral support of the Yeltsin regime in the face of Russian policies clearly leveled against US interests. This last deserves separate treatment.

### **National Security and International Aid to Russia**

To date, the Clinton administration has attempted to decouple national security issues involving Russia and IMF assistance to that country. It claimed that the IMF lending to Russia is a strictly economic issue, and should not be influenced by foreign policy and national security considerations. However, the Administration has more eagerly supported lending to Russia than to other countries in similar predicaments, such as Ukraine; and the reason that the Administration put pressure on the IMF to bail Russia out is indeed national security. There are 20,000 nuclear weapons, over 6,000 missiles, chemical and biological weapons and the technology and experts to manufacture them located in Russia. If it collapses or becomes anti-Western, these weapons may be used to threaten or harm US interests—either directly, or by being sold to rogue regimes.

But this is not the only problem the U.S. is facing in Russia. Moscow is involved in strategic cooperation with the Islamic Republic of Iran and is supplying it with ballistic missile and nuclear technology. It supports Saddam Hussein and Slobodan Milosevic. It has refused to sign the START II treaty yet insists on U.S. compliance with the obsolete ABM treaty, which denies America the ability to deploy anti-ballistic missile defenses. This anti-Western policy package, termed "the Primakov Doctrine",<sup>1</sup> is irreconcilable with Russia's repeated calls for financial bailouts. Moreover, the combination of pursuing nuclear modernization, maintaining its huge military and pursuing anti-American policies are costing both the Russian and Western taxpayers who pay taxes and support the IMF billions of dollars a year. These wasteful policies make very little sense considering the dire economic straits Russia is in.

The following are issues that Russia needs to address if it is to continue to receive support and co-operation from the West.

- **Reducing military expenditures and size.** Almost ten years after the end of the Cold War, Russia is still attempting to retain the paraphernalia of a superpower and on occasion trying to behave like one. In its current economic predicament, this could become suicidal. Russia's military, estimated at 1.5 million persons, is above and

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<sup>1</sup> Ariel Cohen, "The 'Primakov Doctrine': The U.S. Should Beware". Heritage Foundation FYI, December 29, 1997.

beyond what a country with a GDP equivalent to the Netherlands or Indonesia can afford.

- **Abandoning nuclear modernization.** The Kremlin is implementing an expensive nuclear modernization program, including research and construction of the next generation of intercontinental ballistic missiles TOPOL-M2 (SS-27), building new, fifth generation *Borei*-class nuclear subs, modernizing its submarine-launched ballistic missiles, and launching the nuclear powered missile cruiser *Peter the Great* (formerly the *Yurii Andropov*). Moscow is also involved in building the largest bunker facility in the world, believed to be necessary for the prosecution of nuclear war.
- **Stopping ballistic missile and nuclear technology transfer to Iran.** Despite numerous promises by President Yeltsin and Prime Minister Chernomyrdin to the contrary, Russian companies have supplied vital components for the Iranian ballistic missile programs in violation of the H.R. 2709 Iran Missile Proliferation Sanctions Act vetoed by President Clinton on June 23, 1997. It has also supplied two civilian nuclear reactors which have potential military uses. Thousands of Russian engineers are working in Iran.
- **Abandoning support of Saddam Hussein.** Russian help and support in the United Nations Security Council is vital to Saddam Hussein's continued arrogance and bullying. This support stems from the personal friendship between Saddam and the Russian Foreign Minister Primakov that goes back decades—to the 1960s.

Other important foreign policy issues include arming China, supporting Serbian nationalist/socialist leader Milosevic, and supplying advanced anti-air missiles to the Greek side of the tinderbox of the Cyprus conflict. The U.S. and G-7 should insist that in order to ensure Western support and cooperation, Russia must behave responsibly both in the economic and national security spheres. The administration will be well advised to include these issues in all future discussions with the Russian leadership.

### **The IMF Failure**

Once the scope of the financial crisis became clear in May of 1998, the Government of Russia and the Clinton administration commenced intensive lobbying of the IMF Board to approve new funds and bail Russia out. These funds were to come in addition to the \$11 billion package approved by the IMF in 1996.

On July 13<sup>th</sup>, the IMF Board announced "in principle" a new package that amounted to a \$22.5 billion dollar international bailout; and which included the previously committed funding from the IMF, the World Bank and the Government of Japan. On July 20<sup>th</sup>, the IMF Executive Board approved its portion (\$11.2 billion) of the \$22.5 billion dollar loan. The intention was to provide foreign currency reserves to defend the ruble for long enough to enable Russia to implement the reforms needed to achieve long-term stability. Indeed, the IMF plan—detailed in an IMF press release—specifically stated that the "exchange rate policy should remain broadly

unchanged during the remainder of 1998." Many, including this witness, doubted it would work. In fact, the lull in the Russian market purchased with IMF credits lasted only two weeks.

On August 17<sup>th</sup>, just three days after President Boris Yeltsin unequivocally stated that the ruble would not be devalued, then-Prime Minister Kirienko announced that the government would allow the ruble to devalue 34 percent by the end of the year. He also declared a 90 day foreign debt moratorium, and announced a de-facto default on the government's domestic bond obligations. On August 23<sup>rd</sup>, Kirienko was fired, and Chernomyrdin was brought back on the scene. On August 26<sup>th</sup>, the Russian Central Bank announced that it would not be able to support the ruble any longer. In less than a month it collapsed three hundred percent, from 6.2 rubles to the dollar to over 20. Inflation shot up 15 percent in August versus .2 percent in July and has continued to climb to 30 percent in the first week of September. On September 7<sup>th</sup>, the Chairman of the Russian Central Bank, Professor Sergei Dubinin, who together with Chernomyrdin was the architect of the recent economic policy, resigned.

On September 6, the former head of the Soviet and Russian external espionage, and the member of the last Soviet Politburo, Foreign Minister Evgeny Primakov was offered the job of Prime Minister. He immediately appointed the former chief of the Soviet Central Planning, the GosPlan, Yuri Maslyukov, as First Deputy Prime Minister in charge of economic policy, and the former Chairman of the USSR and Russia's Central Bank Viktor Gerashchenko as the Chairman of the Central Bank.<sup>2</sup> Gerashchenko proceeded to declare repeatedly that the economic salvation of Russia lies in printing money. This "dream team" won immediate and ringing endorsement of the communist-dominated Duma (lower house of the Russian Parliament). Thus, the IMF and Clinton Administration have significantly contributed to the restoration of the communist rule in Russia.

An examination of statements by IMF officials indicates that they apparently had little, if any, knowledge what was coming:

- During Moscow press conference on May 29<sup>th</sup>, the top Fund official with line responsibility for Russia, Director of the IMF's European II Department John Odling-Smee, stated, "The IMF management and staff believe that ... a devaluation of the ruble can and should be avoided. With the reestablishment of confidence in the currency, we hope to see stability return to the financial markets.."
- When asked at a July 13<sup>th</sup> press conference why the IMF intervened to prevent the devaluation of the ruble, IMF First Deputy Managing Director Stanley Fischer

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<sup>2</sup> Gerashchenko was dubbed "the worst central banker in the world" by the *Economist* magazine. A career international finance man for the Soviet government, he served in the Narodny Bank in London in the 1960s, in Beirut, Lebanon in the late 1960s-1970s, and in Singapore. Based on his career track, he may have been connected to the Soviet funding of espionage and terrorist operations. He became the USSR's Chairman of the Central Bank, presiding over the 2,000 percent inflation in 1992. He supported the anti-Yeltsin communist rebellion led by the Supreme Soviet in 1993, and was fired in October 1994 when the ruble plunged 27 percent in one day. He supports the printing of money to finance wage arrears and plug government budget deficits.

responded, "[T]he problem with the devaluation is more than anything else that it doesn't solve the underlying problem. The underlying problem is the budget and the financing needs. So if you devalue, you sort of relieve the pressure on the markets for a while, causing difficulties, but unless you get the budget in shape—and the devaluation wasn't going to do anything for the budget—you would be back in this situation."

- In a July 20<sup>th</sup> press release, Fischer said, "The enhanced policy package represents a strong and appropriate response to overcome Russia's current difficulties."
- Commenting on the Russian devaluation and debt moratorium on August 17<sup>th</sup>, Michel Camdessus, the Fund's Managing Director, stated, "Implementation of [Russia's economic] program has been satisfactory. Despite this, confidence in financial markets has not been re-established and as a result Russia has continued to lose reserves, and asset prices have fallen sharply." In other words, the operation was a success, but the patient died.

It is now painfully clear that the IMF and its \$22.5 billion bailout failed to rescue Russia. Investor confidence was not bolstered, the stock market continued its free-fall and interest rates on government bonds again climbed above 200 percent.

If the goal of the bailout was to support economic reform in Russia, nothing could have been further off target than a new infusion of funds. Additional IMF loans could only have prolonged the systemic disorder afflicting the Russian economy. Despite having the dubious honor of being one of the IMF's largest borrowers, Russia remains economically weak because it refuses to implement the fundamental reforms which are the only cure for its economic ills. Prior to the decision to go ahead with the \$22.5 million bailout, both the IMF and the G-7 governments were aware of the problems and had repeatedly demanded the implementation of reforms to no avail. There was no basis to assume that providing additional loans would have proven any more effective than it had in the past.

The devaluation and debt moratorium amount to an expensive policy debacle for both the IMF and the Russia leadership. Russia's dollar exposure was increased while the national currency was devalued, making it three times more expensive to repay the debt. Devaluation and the resultant price hikes may still create devastating social and political consequences for Russia.

Since 1992 (before the most recent \$22.5 billion bailout), the IMF gave Russia over \$18 billion. In each case, the IMF demanded that Russia adopt the necessary economic reforms. But despite defaulting on its promises, Russia continued to receive tranche after tranche. In other words, the cheap credits allowed Russia to delay reforms, while the IMF was effectively rewarding Moscow for not reforming. In the meantime, Russia, under Foreign Minister Primakov, was pursuing foreign policy which in some cases was inimical to the U.S. interests.

### **The Triple Policy Failure in Russia**

Even if one ignores national security matters, the Russian financial crisis demonstrates the failure of the IMF toward Russia on three levels. First of all, an inadequate risk assessment was clearly conducted concerning the loan beneficiary. Risk assessment is something every banker undertakes even when disbursing a much smaller loan. The IMF has overestimated the growth rate of the Russian GDP every year since 1994. Secondly, the IMF committed to the lending package, betting that the Russian government would put policies in place that it either could not or would not implement. This is equivalent to misreading the business viability of a loan applicant by a banker. Finally, the IMF made deals with individuals, such as the former Prime Minister Sergei Kirienko and debt negotiator Anatoly Chubais, who then proceeded to disappear from the political scene—without the IMF being able to secure their stay. This was as if a large company lost its top management immediately after a bank loan had been made. Thus the IMF failed in its due diligence procedures and violated its fiduciary duty to the shareholders—its member governments, and to taxpayers who finance these governments, which fund and support IMF lending policies.

Russia is left now in an economic morass. The only achievements of the Yeltsin administration—stable currency and a low inflation rate—have gone down the drain. The political price for the future of democracy and open markets in Russia will be tremendous, as millions of workers and pensioners have not been paid for months. Prior to the August 17<sup>th</sup> devaluation, Russia had asked if the international community was prepared to provide some additional financial support beyond the \$22.5 billion promised on July 13<sup>th</sup>. The G7 has thus far has refused to provide additional assistance—but now there is increasing talk about new bailouts.

There is certainly enough blame available in the Russian fiasco to go around. However, the reasoning—or lack thereof—behind certain key decisions at critical periods in the development of the current crisis needs serious reconsideration. When asked at a July 13<sup>th</sup> press conference if the relatively low liquidity of the IMF would prevent the organization from engaging in new lending, IMF Treasurer David Williams responded, “[A]s Mr. Fischer said, we never say no.” This policy lies precisely at the heart of the problem.

It is up to the Russian leadership and the Russian people to resolve the multiple crises it finds itself in. Only facing reality and administering the necessary, albeit bitter, medicine—not the IMF’s anesthetics—holds out any hope for Russia’s economic revival. As Dick Arney, the Majority Whip in House noted in the June 2 “Dear Colleague” letter, by not approving the IMF supplemental, the U.S. Congress may help break the bailout psychology. In addition, the West can and should help with advice and support. This includes academic and professional training, the support of institutional development of markets and civil society, pro-market and pro-democracy policy work by business associations, think tanks and universities, exchanges and conference activities. Russia’s integration into the international economic community should remain an important goal for the West, with the hope that Russia will become more stable, more supportive of the international status quo and more prosperous if it succeeds.

### **The threats ahead**

The new Russian government is highly unlikely to resolve the gigantic economic problems their country is facing. First, this team has already had its chance: most of its top decision-makers were part of the Gorbachev administration. The remaining reformers were part of the Yeltsin-Chernomyrdin team. Secondly, their policies of printing money, subsidizing decrepit industries and manipulating ruble exchange rate have not saved anybody yet. If the money supply is inflated, the Russians will feel as cheated as the Germans did under the Weimar Republic. A weak ruble will be a curse in the country which imports over 60 percent of its food. In addition, Russia is facing a major crop failure, which will further restrain the domestic food supply. According to the Russian economic observers and the media, Russia may face the possibility of near-famine this coming winter.

With insolvency, unemployment and food shortages, two scenarios are possible: disintegration and a fascist-style dictatorship. Both are imbued with threats to the West. The first scenario is that of protracted ungovernability and chaos. Russian regions have already started to erect their own protective walls, refused to pay taxes to the federal budget, applied unauthorized taxes and customs duties. With shortages of fuel, train and airline connections may be interrupted, and local military units will start reporting to those who would feed them; a quasi-feudal system may ensue.

The second scenario, occurring against the backdrop of popular discontent and despair may emerge simultaneously, or after the first one. This is the Weimar Russia syndrom, in which the disparate ultra-nationalist and racist political groupings and parties come under one leader. With both communist and free market political forces discredited, fascism will be the only «third way» left for the Russians. This is the hope of the extremist forces playing the ethnic hatred card. After all, the racist, anti-Semitic, anti-Moslem and anti-Caucasian sentiment is quite overt in Russia, and can be tapped into some more when the going gets rough.

The government, and especially the security services, have supported and nurtured the extreme right. First, to use as a bagaboo to the West and local voters: see how scary these people are. If you will not support us, they may come to power. Secondly, to justify their own «law and order» function. And finally, in some cases, out of sincere ideological sympathy to the message of Slavic supremacy, and the «new order». All this pragmatic calculus will be thrown out the window if the economy collapses further and food shortages appear. Fascists may attempt to seize power in a bloody, messy coup which may or may not be put down by the underpaid, demoralized and sometimes hungry army, and fraying security services.

Both scenarios must preoccupy American and other Western decision makers as Russia still harbors the second largest nuclear arsenal on the planet, as well as tremendous stocks of chemical and biological weapons, and technology and expertise to produce more.

### **Conclusion**

The Clinton administration should conduct a full re-examination of the U.S. policy towards Russia, including its economic, diplomatic, geostrategic and national security aspects. It is obvious that key decision makers in charge of this policy have failed. All aspects of the new policy need to be seen as a whole, and the resultant approach should be balanced. For example, Russia's anti-American behavior vis-à-vis Iran, and in the Middle East, as well as its chronic stalling of START II, cannot and should not be rewarded with international economic assistance. And the communist "dream team" in Moscow should not be encouraged with new bailout packages from the U.S., the G-7 or the IMF.

Russia is playing a tremendously important role as the main test case for transition from communism to democracy and market economy. If it fails, many other societies may turn away from the rule of law, participatory government and competitive, private sector based economy. If it becomes either unstable or authoritarian, it may emerge as a destabilizing force in Eurasia and threaten its neighbors in the former Soviet Union and in Eastern and Central Europe. The U.S. should continue to be engaged in trying to turn Russia around. But we should do it while relying on incisive economic and political analysis and creative solutions—not the failing policy of throwing money at Russia's economic black hole – under the communist-dominated cabinet.

**U.S. AID TO RUSSIA:  
WHERE IT ALL WENT WRONG**

**Testimony before the  
Committee on International Relations  
U.S. House of Representatives**

by

**Janine R. Wedel  
Associate Research Professor,  
Department of Anthropology; and Research Fellow,  
Institute for European, Russian, and Eurasian Studies  
The George Washington University  
2110 G Street, N.W., Washington, D.C. 20052  
Phone: 202-994-6346 Fax: 202-994-6097  
E-mail: jwedel@gwu.edu**

**September 17, 1998**

Wedel  
Page 1

**U.S. AID TO RUSSIA:  
WHERE IT ALL WENT WRONG**

by Janine R. Wedel

The United States has been asleep at the switch of its aid policies toward Russia. There have been many signs of trouble, but these have been ignored by the Clinton administration and largely overlooked by Congress. Our challenge now is to foster friendship with the Russian people after having facilitated bad policies and anti-American sentiment and to act before we are faced with an international crisis.

The United States, over the past seven years, has embarked upon a fairly consistent course of economic relations with Russia. Three interrelated policies characterize this course: 1) the provision of billions of dollars in U.S. and other Western aid, subsidized loans and rescheduled debt; 2) the urging of radical economic "reforms," including the privatization of state-owned assets; and 3) the backing of a hand-picked political-economic group, or "clan," to perform these so-called "reforms." The United States has consistently supported President Boris Yeltsin and a cadre of self-styled Russian "reformers" to conduct Western aid-funded reforms and negotiate economic relations with the West. U.S. support for Anatoly Chubais, Yegor Gaidar, and the so-called "Chubais Clan" (dominated by a decade-old clique from St. Petersburg), bolstered the Clan's standing as Russia's chief

Wedel  
Page 2

brokers with the West and the international financial institutions. The Chubais Clan -- not the Russian economy as a whole -- was the chief beneficiary of economic aid from the U.S. Agency for International Development (USAID).

Throughout the 1990s, Anatoly Chubais was a useful deputy for Russian president Boris Yeltsin. In November 1991 he headed Russia's new privatization agency, the State Property Committee (GKI). He then also became first deputy prime minister in January 1994, and later was a useful lightning rod for complaints about economic policies after the communists won the Russian parliament (Duma) election in December 1995. Chubais made a comeback in 1996 as head of Yeltsin's successful reelection campaign and was named chief of staff for the president. In March 1997, Western support and political maneuvering catapulted him to first deputy prime minister and minister of finance. Although fired by Boris Yeltsin in March 1998, Chubais was reappointed in June 1998 to be Yeltsin's special envoy in charge of Russia's relations with international lending institutions.

Working closely with Harvard University's Institute for International Development (called HIID), the Chubais Clan controlled, directly and indirectly, millions of dollars in U.S. aid through a variety of institutions and organizations set up to perform privatization, develop capital markets, form a Russian securities and exchange commission, and related activities. Between 1992 and 1997, the Harvard group received \$40.4 million

Wedel  
Page 3

from USAID in noncompetitive grants for work in Russia and was slated to receive another \$17.4 million<sup>1</sup> until USAID suspended Harvard's funding in May 1997, citing evidence that Harvard principals were engaged in "activities for personal gain."

The first highly unusual aspect of these awards is that Harvard secured most of the money without competitive bidding.<sup>1</sup> Competition had to be waived at the highest levels of the Clinton administration. Top officials of five U.S. government agencies, many connected to Harvard, including the Department of Treasury and the National Security Council (NSC) -- two of the leading agencies formulating U.S. aid policy toward Russia (and Ukraine) -- signed waivers. From Treasury, the Harvard-linked Lawrence Summers and David Lipton backed Harvard projects. The waivers stated that awards were being given to Harvard for "foreign policy" considerations -- that is, the national security of the United States.

Another highly unusual -- and highly damaging -- aspect of the U.S. arrangement with Harvard is that the United States, under cover of economic aid, delegated foreign policy in a crucial area, involving complicated and controversial choices, to Harvard University -- a private entity. In addition to receiving millions of dollars in direct funding, Harvard and the Chubais Clan helped steer and coordinate USAID's \$300 million economic reform portfolio, which encompassed privatization, legal reform, capital markets, and the development of a Russian securities and exchange

Wedel  
Page 4

commission.' In other words, the United States put Harvard in the unique position of recommending U.S. economic aid policies while being a chief recipient of the aid as well as overseeing other aid contractors, some of whom were Harvard's competitors.

Further, economic reform was not necessarily the driving agenda of the Harvard-Chubais Clan partnership. Members of the Chubais Clan -- the very group which Deputy Treasury Secretary Summers called a "dream team" -- were consistently under investigation in Russia, and many reports of personal enrichment from public and foreign monies have been convincingly substantiated.' The Harvard group appears to have been similarly engaged: USAID cancelled most of the last \$14 million earmarked for Harvard, citing evidence that the project's two managers had allegedly used their positions as advisers to profit from investments in the Russian securities markets and other private enterprises. These men remain under review by USAID's Inspector General and the U.S. Department of Justice. In 1996 the U.S. General Accounting Office (GAO) concluded that USAID's management and oversight of Harvard was "lax." Clearly, the United States failed to adequately monitor the Harvard group.

Much more important, the U.S. strategy of reform through aid to one group has totally failed. Millions of dollars have been wasted, and the transparent, accountable institutions so critical to the development of democracy and a stable economy for this world power have yet to be established.

Wedel  
Page 5

#### Under Cover of Reform

There are three main problems with U.S. economic aid to Russia, which resulted in frustrating true market reform and democratic processes in Russia.

The first problem is the way in which privatization was shaped and promoted by U.S. aid-paid consultants. Shortly after Boris Yeltsin became the elected president of the Russian Federation in June 1991, the Federation's Supreme Soviet passed a law mandating privatization (after several privatization schemes were floated). The program that the Supreme Soviet passed was intended to prevent corruption. But the program Chubais eventually implemented contained few safeguards and instead encouraged the accumulation of property in a few hands.' This program opened the door to widespread corruption and was so controversial that Chubais ultimately had to rely largely on presidential decrees, not parliamentary approval, for implementation.

The privatization drive that was supposed to reap the fruits of the free market instead helped to create a system of tycoon capitalism run for the benefit of a corrupt political oligarchy that has appropriated hundreds of millions of dollars of Western aid and plundered Russia's wealth. Part of the Russian public came to associate the terms "market economy," "economic reform," and "the West" with dubious activities that benefited only a few people while others experienced a devastating decline in their standard of living -- a far cry from their secure, albeit staid, lives under

Wedel  
Page 6

socialism. In a 1997 nationwide public opinion polls, 70 percent of those surveyed said that Chubais's privatization policies had a "bad" effect.' It was a grave mistake for the United States to embark on severe measures that would cause untold suffering without political support.

The second main problem with U.S. economic aid is that the United States promoted rule by decree: the preferred method of economic reform was top-down presidential decree orchestrated by Chubais. Instead of encouraging market reform, this rule by decree frustrated many market reforms as well as the building of democratic, inclusive institutions. Some reforms, such as lifting price controls, could be achieved by decree. But many other reforms advocated by USAID, the World Bank, and the International Monetary Fund (IMF), including privatization and economic restructuring, depended on changes in law, public administration, or mindsets, and required working with the full spectrum of legislative and market participants -- not just one group.

A case in point was USAID's showcase efforts to reform Russia's tax system and to set up clearing and settlement organizations (CSOs) -- an essential ingredient in a sophisticated financial system. Those efforts failed largely because they were put solely into the hands of one group, which declined to work with other market participants. In Moscow, for example, despite millions of USAID dollars, many of the Russian brokers were excluded from the process and declined to use the Moscow CSO.'

Wedel  
Page 7

Thus, since 1994, when consultants working under USAID contracts totalling \$13.9 million, set out to design and implement CSOs in five Russian cities, very little evidence of progress has emerged. After an investigation into Harvard activities in Russia, the GAO issued a report calling the CSO effort "disappointing."<sup>10</sup>

The third main problem with U.S. economic aid is that it set up still other means of bypassing democratic processes, including a network of aid-funded "private" organizations controlled by the Chubais Clan and the Harvard group. These organizations enabled reformers to bypass legitimate bodies of government, such as ministries and branch ministries, and to circumvent the Duma.

The Russian Privatization Center (RPC) was the donors' flagship organization. The Center epitomized the operations of the aid-sustained Harvard-St. Petersburg coterie. The Center was closely tied to Harvard in myriad ways, only one of which was characterized by a USAID supplied explanation: that Harvard provided management support to the Center.<sup>11</sup> The Center's documents state that Harvard is both a "founder" and "Full Member of the [Russian Privatization] Center," which is the "highest governing body of the RPC."<sup>12</sup> Andrei Shleifer, the director of Harvard's Russia project, served on the board of directors.

With Harvard's help, the Russian Privatization Center received some \$45 million from USAID,<sup>13</sup> millions of dollars more in grants from the EU, the governments of Japan<sup>14</sup> and Germany, the British Know How Fund, and "many other governmental and non-governmental

Wedel  
Page 8

organizations," according to the Center's annual report.<sup>13</sup> The Center also received loans both from the World Bank (\$59 million) and the EBRD (\$43 million) to be repaid by the Russian people.<sup>14</sup>

The largesse that flowed through the Russian Privatization Center appears to have been much greater than the sum total of all these figures would indicate. The Center's CEO, Chubais Clan principal Maxim Boycko, has written that he managed some \$4 billion from the West while head of the Center, according to Veniamin Sokolov, head of the Chamber of Accounts of the Russian Federation, Russia's rough equivalent of the U.S. General Accounting Office. The Chamber has attempted to investigate how some of this money was spent. According to Sokolov, a report issued by the Chamber in May 1998 shows that the "money was not spent as designated. Donors paid hundreds of thousands of dollars for nothing...for something you can't determine."<sup>15</sup>

A 1996 confidential report commissioned by the State Department's Coordinator of U.S. Assistance to the NIS called the Russian Privatization Center "substantially over funded and largely 'an instrument in search of a mission.'"<sup>16</sup> The report also said that the Center suffers from "'imperial overstretch.'"<sup>17</sup> And there were many reports by aid-paid consultants that the Center (and its network of Local Privatization Centers) were used for political purposes.<sup>20</sup> Still, U.S. aid officials looked the other way.

Wedel  
Page 9

### Political Aid Disguised as Economic Aid

Despite evidence of corruption and lack of popular support, many Western investors and U.S. officials embraced the reformers' dictatorial modus operandi and viewed Chubais as the only man capable of keeping the nation heading along on the troublesome road to economic reform. As Walter Coles, a senior adviser in USAID's Office of Privatization and Economic Restructuring program, said, "If we needed a decree, Chubais didn't have to go through the bureaucracy," adding, "There was no way that reformers could go to the Duma for large amounts of money to move along reform."

While this approach sounds efficient in principle, it is less convincing in practice because it is an inherently political decision disguised as a technical matter. As Andrei Shleifer, Harvard's Russia director, and Maxim Boycko, a Chubais Clan principal, themselves acknowledged in a 1995 book funded by Harvard and published in the West: "Aid can change the political equilibrium by explicitly helping free-market reformers to defeat their opponents....Aid helps reform not because it directly helps the economy -- it is simply too small for that -- but because it helps the reformers in their political battles." U.S. privatization aid, the "reformers" added, "has shown how to...effectively...alter the balance of power between reformers and their opponents."

In a 1997 interview, U.S. aid coordinator to the former Soviet Union, Ambassador Richard L. Morningstar, stood by this approach:

Wedel  
Page 10

"If we hadn't been there to provide funding to Chubais, could we have won the battle to carry out privatization? Probably not. When you're talking about a few hundred million dollars, you're not going to change the country, but you can provide targeted assistance to help Chubais." U.S. assistance to Chubais continued even after he was dismissed by Yeltsin as First Deputy Prime Minister in January 1996. Chubais was placed on the Harvard payroll, a show of loyalty that USAID Assistant Administrator Thomas A. Dine said he supported."

Much of this feels familiar to Russians raised in the Communist practice of political control over economic decisions--the quintessence of the discredited Communist system. While professing simply to support reform, U.S. policies afforded one group a comparative advantage and allowed much aid to be used as the tool of this group. Ironically, far from helping to separate the political and economic spheres, U.S. economic aid has instead reinforced the interdependency of these spheres. Indeed, the activities of Harvard in Russia provide some cautionary lessons on abuse of trust by supposedly disinterested foreign advisers, on U.S. arrogance in assuming it knows best and on the entire policy of support for a single Russian group of so-called reformers.

The July 1998 IMF bailout of Russia represents an intensification of the very policies that have produced such abuses. The \$11.2 billion aid package for 1998 (with another \$7.8 billion funds over three years pledged in Russia "stays on track")

Wedel  
Page 11

was supposed to put an end to Russia's financial crisis. Yet only a very few certain political-economic players -- not the population at large, including those workers who have gone without wages for months -- stand to reap any benefits.

Among those who spoke out against the bailout was Veniamin Sokolov, head of the Chamber of Accounts of the Russian Federation, Russia's rough equivalent of the U.S. General Accounting Office. Sokolov, who has investigated the destination of some previous monies from international lending institutions and aid organizations, argued (in a visit to Washington in May-June 1998<sup>13</sup>), that "All loans made to Russia go to speculative financial markets and have no effect whatsoever on the national economy."<sup>14</sup> And it is the Russian people who are responsible for repaying those loans. Chubais, the West's chief Russian "reformer," and chief negotiator of the bailout, recently admitted that he had "conned" Western countries out of the money, according to the *Los Angeles Times*.<sup>15</sup>

The very call for an IMF bailout is a commentary on the failure of previous economic aid to Russia: If aid had been effective, why were billions in IMF loans needed to prevent the country from falling into crisis? Further, the swiftness of the bailout's failure surprised even its critics. The IMF loan and accompanying hype were intended to revive confidence in Russia's plummeting markets and give the government time to get its financial markets under control. However, just a few weeks after

Wedel  
Page 12

the IMF deal was approved, investor confidence hit a new low and the Russian government was forced to devalue the ruble.

For its part, USAID, which provided Russia with \$95.7 million in economic aid in 1997 and another \$129.1 million estimated for 1998, is requesting from Congress \$225.4 million in economic aid for Russia in 1999.

#### **Toward a New Foreign Policy**

Given the continuing socioeconomic deterioration of Russia, what should the United States do? If the U.S. government wants to adhere to its own declared objectives and help promote in Russia sound economic development and equitable growth as well as viable and transparent democratic institutions, it has no option than to reverse its current policies and practices.

The U.S. role in creating a system of tycoon capitalism and the current economic meltdown, coupled with military policies such as NATO expansion, have fueled anti-American sentiment in Russia. The first thing we should do, as Joseph Stiglitz, a leading World Bank economist, correctly suggests, is to adopt "a greater degree of humility...(and) acknowledgement of the fact that we do not have all of the answers." Washington must also accept that the future shape of Russian society will and must be determined by the Russian people. U.S. policy should at least try to adhere to some of the principles that it preaches, such as participatory democracy and the rule of law or even "no taxation without representation." In

Wedel  
Page 13

line with this, the U.S. must stop its policy of support-at-all-costs for Yeltsin and the Chubais Clan, not only in USAID targets but also in U.S. influence in IMF and World Bank lending.

Second, the U.S. government should recognize that a healthy banking and financial system cannot arise without a revival of production and distribution in the "real" economy. Measures that emphasize increases in tax collection and reductions in government expenditures under the current extremely depressed conditions simply guarantee accelerated decline of the real economy and social-political chaos. The United States should use its great influence on the IMF and World Bank to reduce their pressure on Russia to pursue such suicidal policies.

Not only did the IMF bailout fail to restore confidence, but the international aid has been fundamentally ill-conceived. As Veniamin Sokolov warned: "Giving more loans to the Yeltsin government is comparable to giving a drug addict a fresh supply of narcotics. Any new loans will only go to the realm of financial speculation and to prop up support for Boris Yeltsin. Russia does not need any further such lending."" In sum, further aid will go to the same corrupt niches and is likely to make the situation worse, not better.

Third, the United States should launch a high-level drive to try to recover monies from aid organizations and international financial institutions that have ended up in private unregulated bank accounts outside of Russia. This would show concern for the

Wedel  
Page 14

Russian people, who otherwise would be held responsible for paying back loans from which they did not benefit. It also would demonstrate U.S. commitment to the rule of law.

Fourth, the United States should embark on a broad-based policy to encourage governance and the rule of law. It is essential that the United States discontinue support of non-inclusive organizations and the bypassing of democratic process through decree. Some U.S. aid funds have gone for "democracy building," including strengthening and revamping the judiciary. However, these efforts have been a low priority and have been undermined by the practice of U.S. encouragement of the Chubais Clan to enact swift "reforms" without approval of the Duma, Russia's popularly elected legislature.

The United States needs to adopt a pro-democracy stance that encourages institution-building and as broad a range of democratic positions as possible. We must cease to select specific groups or individuals as the recipients of uncritical support, which both corrupts our "favorites" and delegitimizes them in the eyes of their fellow citizens.

Fifth, U.S. officials and advisers need to establish contact and ties with a wide cross-section of the Russian leadership -- politicians, economists, and social and political activists -- and not only Yeltsin and his allies. How Russian elites perceive the efficacy of U.S. aid programs and politics should be a source of

Wedel  
Page 15

concern, especially because many Russians have questioned American intentions.

Although a reversal of policy will require a long and resolute process of diplomacy, Clinton administration officials can take steps, by, for example, meeting with members of the Duma and a diversity of Russian elites. Some aid-funded people-to-people exchanges and programs to develop the economy from the bottom up have been useful and have created goodwill among the Russian people. Given the unfortunate record of U.S.-Russia relations, exchanges that involve a broad section of the Russian population, especially at local and regional levels, are now crucial.

Wedel  
Page 16

# NOTES

1. According to USAID's Deirdre Clifford (interview of June 11, 1996), since 1992 HIID received \$40,373,994 in noncompetitive grants under the First Cooperative Agreement. Another \$17,423,090 was designated for HIID under the Second Cooperative Agreement (a three-year agreement that began on September 30, 1995), of which \$4.5 million was obligated. Source: USAID documents and interview of June 11, 1996.

2. Letter from U.S. AID to HIID director Jeffrey Sachs, May 20, 1997. and U.S. AID press release, "USAID Suspends Two Harvard Agreements in Russia," Washington, D.C.: USAID Press Office, May 20, 1997. For details of abuses by HIID principals, see Carla Anne Robbins and Steve Liesman, "How an Aid Program Vital to New Economy of Russia Collapsed," *Wall Street Journal*, August 13, 1997, and Janine R. Wedel, "The Harvard Boys do Russia: How the Best and Brightest Helped Destroy the Russian Economy," *The Nation*, June 1, 1998.

3. U.S. government procurement officers and GAO officials, including Louis H. Aanardi, who spearheaded GAO's investigation of Harvard activities in Russia and Ukraine, have said that this is highly unusual.

4. U.S. General Accounting Office, *Foreign Assistance: Harvard Institute for International Development's Work in Russia and Ukraine*, Washington, D.C.: U.S. General Accounting Office, November 1996, pp. 4 and 18.

5. Lawrence Summer's speech printed in *Russia Business Watch*, vol. 5, no.2, Spring 1997, p. 19.

6. See, for example, Peter Reddaway, "Questions about Russia's 'Dream Team'," *Post-Soviet Prospects*, vol. 5, no. 5, Washington, D.C.: Center for Strategic and International Studies, September 1997; and Janine R. Wedel, "The Harvard Boys Do Russia: How the Best and Brightest Helped Destroy the Russian Economy," *The Nation*, June 1, 1998.

7. For details, see Lynn D. Nelson and Irina Y. Kuzes, *Property to the People: The Struggle for Radical Reform in Russia*, Armonk: NY: M.E. Sharpe, Inc. 1994, and *Radical Reform in Yeltsin's Russia: Political, Economic, and Social Dimensions*, Armonk: NY: M.E. Sharpe, Inc. 1995.

Wedel  
Page 17

8. Data from the Centre for International Sociological Research, Moscow (based on 1,000 respondents across Russia) reported in *The Economist*, March 15, 1997.
9. For details, see Janine R. Wedel, "Clique-Run Organizations and U.S. Economic Aid: An Institutional Analysis," *Demokratizatsiya: The Journal of Post-Soviet Democratization*, vol. 4, no. 4, Fall 1996, Pp. 592-593.
10. U.S. General Accounting Office. *Foreign Assistance: Harvard Institute for International Development's Work in Russia and Ukraine*. Washington, DC, U.S. General Accounting Office, November 1996, p. 8.
11. Interview with USAID's Cecilia Ciepiela, 5 August 1996.
12. U.S. General Accounting Office, *Foreign Assistance: Harvard Institute for International Development's Work in Russia and Ukraine*, Washington, DC: U.S. General Accounting Office, November 1996, p. 60.
13. U.S. General Accounting Office, *Foreign Assistance: Harvard Institute for International Development's Work in Russia and Ukraine*, Washington, DC: U.S. General Accounting Office, November 1996, p. 57.
14. Japan is currently the largest contributor among the G-7, according to Ralf-Dieter Montag-Girmes, director of post-privatization support with the Russian Privatization Center in an interview of 12 June 1996.
15. *Russian Privatization Center 1994 Annual Report*, Pp. 5, 24.
16. The World Bank figure was provided by Ira Lieberman (interview of July 23, 1996), while the EBRD figure was supplied by Renae Ng (conversation of September 24, 1996).
17. Documents and information from Veniamin Sokolov, head of the Chamber of Accounts of the Russian Federation (interview of May 31, 1998 and talk at American University of June 2, 1998). In 1994 both the Duma and the head of the GKI requested a detailed accounting from the RPC. They got nothing. (Sergei Zavorotnyi, "The Traces of 'Privatization' Go Overseas," *Komsomolskaya Pravda*, April 8, 1997.)
18. Source: Confidential Report to The Special Adviser to the President and Coordinator of U.S. Assistance to the NIS (S/NIS/C), U.S. Department of State, and The Assistant Administrator for Europe and the NIS, U.S. Agency for International Development, on *USAID Programs Supporting Commercial Law and other Legal Reform in*

Wedel  
Page 18

the Russian Federation. Prepared by Mark C. Medish, September, 1996, Washington, D.C., p. 6.

19. Source: Confidential Report to The Special Adviser to the President and Coordinator of U.S. Assistance to the NIS (S/NIS/C), U.S. Department of State, and The Assistant Administrator for Europe and the NIS, U.S. Agency for International Development, on USAID Programs Supporting Commercial Law and other Legal Reform in the Russian Federation. Prepared by Mark C. Medish, September, 1996, Washington, D.C., p. 17.

20. See Janine R. Wedel, "Clique-Run Organizations and U.S. Economic Aid: An Institutional Analysis." *Demokratizatsiya: The Journal of Post-Soviet Democratization*, vol. 4, no.4, Fall 1996, pp.571-602.

21. Interview with Walter Coles by Janine R. Wedel, June 6, 1996.

22. Maxim Boycko, Andrei Shleifer, and Robert Vishny, *Privatizing Russia*, Cambridge, Massachusetts: The MIT Press, 1995, p. 142.

23. Interview with Ambassador Richard L. Morningstar, U.S. Aid Coordinator to the former Soviet Union, by Janine R. Wedel, February 11, 1997.

24. Interview with Thomas A. Dine by Janine R. Wedel, August 16, 1996.

25. Information from Veniamin Sokolov (interview of May 31, 1998 by Janine R. Wedel) and talk at American University, June 2, 1998.

26. Anne Williamson, "Russia's Fiscal Whistleblower: Chief Auditor Venyamin Sokolov says Western Loans are Hijacked by the Corrupt Yeltsin Government," interview by Anne Williamson, *MoJo Wire*, June 16-22, 1998.

27. *Kommersant Daily*, September 8, 1998, and *Los Angeles Times*, September 9, 1998.

28. Anne Williamson, "Russia's Fiscal Whistleblower: Chief Auditor Venyamin Sokolov says Western Loans are Hijacked by the Corrupt Yeltsin Government," interview by Anne Williamson, *MoJo Wire*, June 16-22, 1998.

Wedel  
Page 19

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## BIO - JANINE R. WEDEL

Janine R. Wedel is an associate research professor of anthropology and a research fellow in the Institute of European, Russian, and Eurasian Studies at The George Washington University. She also serves as an adjunct professor in the Graduate Public Policy Institute at Georgetown University. A three-time Fulbright fellow and recipient of awards from the MacArthur Foundation, the National Science Foundation, the Woodrow Wilson International Center for Scholars, and the United States Institute of Peace, Dr. Wedel has studied Eastern Europe's evolving economic and social order for nearly 20 years. A social anthropologist (Ph.D. from the University of California, Berkeley), she has published two books on Central and Eastern Europe: The Private Poland (1986) and The Unplanned Society: Poland during and after Communism (Columbia University Press 1992).

Dr. Wedel has been following aid efforts in Central and Eastern Europe since 1989 and in Russia and Ukraine since 1992. Her analyses of aid issues have been published by the Joint Economic Committee of the U.S. Congress, the Atlantic Council, the OECD, The New York Times, The Wall Street Journal Europe, The Nation, and others. She also writes for the Christian Science Monitor, the Boston Globe, and scholarly and policy journals. Dr. Wedel has been an invited participant at National Research Council and National Academy of Sciences conferences and workshops. She served as a commentator for four Polish ex-prime ministers and an associate producer for PBS documentaries on Eastern Europe.

Dr. Wedel details her analyses of aid to Central and Eastern Europe and the former Soviet Union in Collision and Collusion: The Strange Case of Western Aid to Eastern Europe 1989-1998, forthcoming from St. Martin's Press in November 1998.

So what's the problem? Clinton left his Clinton workshop — George Bush didn't tell lies and womanize? Are you sure? And what about some of these other powerful presidents — Al Gore, Newt Gingrich, Colin Powell — how any of them ever lied or committed adultery?

Perhaps you should hire a team of investigators, just to make it certain. Check out all of these people. Check out their wives, too, for that matter. Find out what sort of sexual props George liked then, whether he prefers to be on top or on the bottom, what sort of noises he makes during intercourse, write it all down in a lengthy report and then publish it across the length and breadth of the land.

These are, after all, issues of character. Other matters can wait. Campaign finances? Who wants to read a spreadsheet of political contributions, when there's all this

U.S. members that killed 21 people in Afghanistan and Sudan? Not interesting, you say. We Americans bomb people all the time these days, and as you say they were terrorists. Or at least, the White House said they were terrorists, even if no one else seems to agree.

America does have a law preventing the state from engaging in assassination attempts in foreign lands. It was adopted after the nation embarrassed itself by attempting to blow up Fidel Castro with exploding cigars. (No, not a mutual prop, a regular cigar)

But of course a cruise missile does not constitute an assassinating attempt because, well, it kills a whole lot of people at once.

And anyway, no point in getting bogged down in policy tactics. A great democracy is defined neither by the quality of its political participation nor *of how* it treats wealth or nations, but by *who* can work up the most indignation about what he saw when he went off into the next bedroom.

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Last week the Los Angeles Times reported that Ramsey Clark, who had Reagan's resignation this summer, had interviewed a Navy reservist, 231, William, between July 1968 and August 1969, and that he had frankly admitted to lying to the INP about the state of the nation's economy during those negotiations. The Los Angeles Times article, which the Monroe Times reprinted Sept. 10 and editorialized about on Sept. 12, cited an interview with Clark's publisher in Kommunist Daily on Sept. 8. Below is an open letter written to the author of the Los Angeles Times by Clark in response to the article.

Dear Father

I cannot help but express my categorical disagreement with the Los Angeles Times' treatment of my Sept. 8 interview with the Russian newspaper Kommunist.

I consider the interpretation of my position on relations between Sergei Kiriyenko's government and international financial organizations as having been absolutely distorted.

The article attributes to me a statement in the Kommersant Daily interview that the Russian government asked the IMF and the World Bank by concealing the severity of the country's budgetary problems in order to receive credits from them. In point of fact, I was speaking of something quite different.

Currently, there is discussion about whether Kirgizstan's government was justified in using its right to resources to support the ruble and to meet its external and internal obligations. Despite these efforts, the government was nevertheless bankrupted on Aug. 16 as announced by the new ministers of the government and the Central Bank, which were in a state of panic, primarily for foreign inaction. Would it have been better to have a large number of analysts agree to have implemented these measures back in the spring? Authors writing about this Ruble should be very familiar with the content and urgency of this discussion.

In the interview I addressed this matter as follows, and my opinion remains unchanged:

"A devaluation of itself on our obligations with respect to CROK [Croatian] will in May mean a loss of its already meagre position in the world. By not doing so now at the time, we threaten that the government was fighting to the end, that it was making every conceivable and even irreconcilable effort to meet the expectations of our partners both at home and abroad." And further: "Had we done what [secretary Andrej] Biserich proposed [and devalued the ruble in the spring], they would have ended their dealings with us for good. In other words, they would have said to the same as it is now, but in addition you would have lost all hope that investors would return."

It was precisely in this connection that I observed the same thing on the 10th of May.

them out of \$30 billion. (a reference to the moratorium on repayment of \$16 billion in loans by Russian banks and \$4 billion by other commercial structures — note by A. Chubais), there is an understanding that we had no alternative."

As you can see, this passage has nothing to do with the commitments of Russia to the IMF in conjunction with the first tranche of \$1.2 billion, which the article said had not been met. As far as the commitments themselves are concerned, your newspaper must be aware of a statement made by IMF Managing

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- I was precisely this position of the IMF that I emphasized in my interview, noting: "That's exactly why the IMF supported us, because we did

... I would like to comment specifically on the assertion ascribed to me to the effect that the Russian leadership had shown the instability of the fiscal system, and that I saw this as a defensible position.

Without starting a debate, I would again like  
to quote myself:

"You can criticize the [Russian] president: as much as you want for saying [the evening before the devaluation] that there would be no devaluation, but not so publicly otherwise. In his said, A few sincere-minded politicians will tell you that this is the only way the authorities can behave in such extreme situations. Authorities when vague and vacillate may say anything and then another only begins to believe in it. Economic prescription is reality. Perceptions, expectations, fears and hopes are not there: are the realists that deal with the economy extremely poor financial scientists, the authorities have no right to say, 'We don't know whether we can cope or not. Everyone would flee at once.' (foreign investors are menial here — note by A.B. Chubukov)

In the Los Angeles Times article, this quote is given in the form of an assertion ascribed to me to the effect that "had the government spoken the truth the Russian economy would have collapsed last spring."

I cannot attribute this and other occurrences solely to the authors' or translators' poor knowledge of the Russian language and its idiomatic expressions.

Given the extensive repercussions which the article in the Los Angeles Times has caused in the world press, I am forwarding this letter to the foreign mass media. I trust that you will publish it.

### Lonely Clubs

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**Dear Editor,**  
I cannot help but express my categorical disagreement with the Los Angeles Times' treatment of my Sept. 8 interview with the Blacks newspaper Kodomo Daids.

I consider the interpretation of my position on relations between Sergei Kiriyenko's government and international financial organizations as having been absolutely distorted.

The article attributes to me a statement in the *Kommersant* Daily interview that the Russian government misled the IMF and the World Bank by concealing the severity of the country's budgetary problems in order to receive credits from them. In point of fact, I was speaking of something quite different.

Currently, there is discussion about whether Kiriyenko's government was justified in using all its resources to support the ruble and to meet its external and internal obligations. Despite these efforts, the government was nevertheless compelled on Aug. 17 to announce the new well-known measures of the government and the Central Bank, which were so painful, primarily, for foreign investors. Would it have been better, if a large number of analysts acted, to have implemented these measures in a more gradual way? We are writing about Russia should be very familiar with the contents and urgency of this document.

In the interview I addressed this matter as follows, and my position remains unchanged:

"A devolution of default on our obligations with respect to GKOs [treasury bills] in May would have prompted an extremely negative reaction in the world. By not doing so at that time, we showed that the government was flexible and even inconvertible effort to meet the expectations of our partners both at home and abroad." And further, "Had we done what [economist Andrei] Illarionov proposed [and devalued the ruble in the spring], they would have ended their dealings with us for good. In other words, the disaster would have been the same as it is now, but in addition we would have lost all

It was precisely in this connection that I expressed the view that even despite the enormous damage suffered by investors "and we checked

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Russian boats and 34 hollow Ayutla reconstructed structures - note by A. Chubuk there is an understanding that we had no observation."

As you can see, this passage has nothing to do with the commitments of Russia to the IMF in conjunction with the first tranche of \$4.5 billion, which the article said have not been met. As far as the commitments themselves are concerned, your newspaper must be aware of a statement made by IMF Managing Director Michel Camdessus on Aug. 17, 1998. It was quoted in his statement that Russia's commitments under the IMF's program were being met "satisfactorily." His statement also includes an appeal to the international community to show solidarity with Russia and an understanding of its prob-

I would like to announce specifically on the assertion ascribed to me to the effect that the Russian leadership lied about the instability of the social system, and that I saw this as a defeatistic position.

Without starting a debate, I would again like to pose myself:

"You can criticize the [Russian] president as much as you want for saying [the evening before] that the devaluation [that there would be no devaluation] was a mistake, but that's precisely what he said. Any sober-minded politician will tell you that this is the only way the authorities can behave in such a delicate situation. Ambassadors who wine and dine and say any one thing and then another only hasten collapse." *Excerpt: Perestroika is reality. Perestroika, superstitions, fears and hopes*—these are the realities that drive markets. In an extremely grave financial situation, the authorities have no right to say, 'We don't know whether we can cope or not.' Everyone would flee at once." *Official directions are issued here — notes by A. Chubukin.*

In the Los Angeles Times article, this quote is given in the form of an assertion ascribed to me to the effect that "had the government spoken the truth the Russian economy would have collapsed last spring."

cannot attribute this and other occurrences solely to the authors' or translators' poor knowledge of the Russian language and its idiomatic expressions.

Gives the extensive repercussions which the article in the Los Angeles Times has caused in the world press. I am forwarding this letter to the foreign press desks. I trust that you will publish it.

**Assembly Chairman of the Board  
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## GOGOL'S TROIKA:

## THE CASE FOR STRATEGIC PATIENCE IN A TIME OF TROUBLES

An address by Strobe Talbott, Deputy Secretary of State,  
at a conference on "Russia at the End of the 20<sup>th</sup> Century,"  
School of Humanities and Sciences, Stanford University,

November 6, 1998

*Official text*

Thank you, Bill [Perry], for that introduction and for the chance to work with you for four years. I suspect that everyone here appreciates the crucial role that you played in managing U.S.-Russian relations. I'm lucky to have had him as a friend and colleague in government; the U.S. is lucky to have had him at the helm of the Pentagon; and Stanford is lucky to have him back. I say that being well disposed to Stanford. The last time I was in this building, I was courting an undergraduate who eventually said yes.

There are lots of other friends here, but I want to single out the mastermind and master of ceremonies of this conference, Grisha Freidin, who has been my friend and mentor for more than 25 years.

The topic that Professor Freidin has assigned to all of us for our homework, "Russia at the End of the Twentieth Century," is especially on the minds of President Clinton and Secretary Albright these days. That's for reasons that are obvious from the newspaper headlines.

But Russia is always on our minds, and that's for reasons that are reflected in history and literature. In the final passage of *Dead Souls*, Nikolai Gogol compared his homeland to a troika, hurtling across the snowy steppe, while other nations "gaze askance" and wonder, along with Gogol himself, where this wild ride is headed. A century and a half later, quite a few Russians think the answer is: straight off the edge of a cliff.

I'm here with a different answer. Is Russia a troika-wreck waiting to happen? Maybe, but not necessarily. More than other countries, Russia's future is in doubt, but that is not new. That was part of Gogol's point. Gloom and doom are no more justified now than was euphoria a few short years ago. Yes, much of what is happening in Russia is obscure; yes, some of it is ominous. But this much is clear: the drama of Russia's transformation is not over; its ending is neither imminent nor foreordained; and the stakes, for us, are huge.

As the Russians seek to work their way out of their current crisis, they will be making decisions that determine what sort of relationship they can have with the outside

world for decades to come. Russia's choices will have a lot to do with what kind of world Americans live in — how safe we are, and how much we have to spend on our safety. Therefore, under two Administrations — President Clinton's and what I'll call here "the Condoleezza Rice Administration" [she is in the audience] — the U.S. has been committed to encourage and assist Russia in its evolution toward becoming a normal, modern, prosperous, democratic state — at peace with itself and its neighbors, a full member and beneficiary of an increasingly interdependent world community.

For the last decade or so, despite the zigs and zags, Russia has been moving in that direction. The question of the last several months is whether Russia has, in some fundamental way, shifted course, heading at break-neck speed back to the future, or over the precipice.

That question arises because of the crisis, largely though not wholly self-inflicted, that has befallen the economy. Less than a year ago, Russia seemed to be poised for an economic take-off. But then internal weaknesses combined with outrageous fortune, especially the worldwide fall in commodity prices, to stampede the government into the devaluation of the ruble and a partial default on many of its debts. In a matter of a few weeks this past summer, Russians saw much of their savings evaporate, many of their banks go belly-up, the bottom fall out of their fledgling stock market, goods disappear from stores, and a burgeoning middle class sent reeling.

Even before Black Monday, August 17, and the crash that followed, the mood had already changed dramatically in ways that are captured by several of the papers that have been presented at this conference. For example, what Peter Holquist calls "Soviet exceptionalism" had long since given way, first, to post-Soviet relief, then to post-post-Soviet letdown — to reform fatigue on the part of the élite and to a backlash against reform on the part of the citizenry.

Another participant in the conference, Natalya Ivanova, has referred to the late '80s and the '90s as *smutnye* (dark and troubled) years. They were also, of course, *chudyasnye* (a time of miracles). They were the years when Russia won for itself unprecedented economic and political freedom — and when Russia liberated its former satellites and fellow inmates in the prison house of nations. But Dr. Ivanova is right about the perceptions, disappointments and anxieties of many Russians today.

Language itself has been turned on its head. As the '90s unfolded, "reform" and "market" went from being part of the vocabulary of triumph and hope to being, in the ears of many Russians, almost four-letter words. The noun *kapitalizm* came increasingly to be modified with the adjective *dikiy* (savage). Accordingly, "the West" went from being an object of emulation to a target of resentment. In the meantime, another word, "left," has come back into fashion. The Communist Party of the Russian Federation and its parliamentary allies have called for a "return" to a compassionate, paternalistic and pervasive state that looks out for workers, soldiers and pensioners.

The composition of Russia's new government, led by Prime Minister Primakov, is representative of this mood and of these trends. It has largely rejected what its

officials call the "Western" way of managing their economy; they are groping for a "Russian" way instead.

Let's look at this phrase "the Russian way." Oksana Bulgakowa's paper explains what the Russian way means in architecture: phantasmagoric knockoffs of Stalinist monuments, czarist palaces and pre-Christian temples, appealing to nostalgia for a supposedly simpler, nobler past. But what does the Russian way mean in economics? Part of the answer is paying wages and pensions and reviving the industrial sector, which are sensible, indeed indispensable goals. Our concern is that, in trying to reach those goals, the Primakov team is prepared to abandon a stable currency, a viable exchange rate and a sound monetary policy. It is operating with neither a realistic budget nor a credible system for collecting taxes. That means Russia is at the mercy of the printing press, cranking out rubles to meet payrolls and to keep bankrupt enterprises afloat.

The point here is that the economic rules that the custodians of the Russian economy are threatening to defy are not so much "Western" as they are a matter of simple arithmetic. Since the numbers don't add up, the intended remedies only aggravate the disease. Inflation is almost 50% higher than it was a year ago; many Russian banks are unable to meet the repayment obligations on their outstanding loans; billions of dollars in capital have fled the country since August.

There is another consequence, too: It has become all but impossible for the International Monetary Fund to weigh in with macroeconomic stabilization funds that might help in arresting and reversing the slide. Money from outside will do no good if it is inflated away or if it pauses only briefly in Russia before ending up in Swiss bank accounts and Riviera real estate.

Without external support, it is likely that the Russian government will face three disagreeable choices: 1) crank the printing presses even faster, 2) plunge deeper into default, or 3) stop paying wages and pensions and conducting basic government functions. Whatever combination of these measures the government adopts — and it's pretty clear that it will entail numbers 1 and 2, not 3 — Russia's economic situation is likely to deteriorate further.

Economic decline carries with it the danger of political drift, turmoil, and even crackup.

Why is Russia in this situation? Part of the answer is the drag of recent history. Russia's 74-year experiment with Communism is like a black hole: the Soviet system imploded eight years ago, yet this dead star, even though it emits no light, still exerts a powerful gravitational pull that threatens to suck Russia backward and inward.

But that is by no means all that is happening in Russia today. Political and economic culture are not immutable; they're not like astrophysics; the dynamics by which they operate can change — and change for the better. Over time, the tug of the Soviet experience will weaken.

That process will take a generation or more, not least because part of the process is, precisely, *generational*. There is an irony here: because the disintegration of the

Soviet system was remarkably peaceful, many of those who had been vested in, and responsible for, the old order are now shaping the new one. That's the bad news, reflected in the dismal economic statistics. The good news is in the actuarial tables. The young have certain advantages over the old in the struggle over the future.

Another factor shaping and guiding Russia is globalization. That country today is part of the world to an extent and in a way that it never was in the past. Russia's susceptibility to the Asian contagion has been a reminder of the downside of globalization. But there is an upside too: counteracting the old temptations of autarky and regression are new and powerful forces pulling Russia outward and forward, toward integration, not just integration with the global marketplace but also with what Manuel Castells and Emma Kiselyova describe, in their paper, as the global "network society." Literally and figuratively, Russia is now plugged into the rest of the world, through cellular telephones, fax machines, modems and PC's.

This trend has been under way for some time. In the '70s and '80s, Russia was Exhibit A for the proposition that George Orwell's nightmare vision for 1984 was wrong: the communications revolution weakened Big Brother rather than strengthening him. The quantum leap in the number of Russians who travel abroad and surf the Internet may yet turn out to be what Professor Castells and Dr. Kiselyova call "the dynamic core" of Russian modernization and thus constitute a hedge against the old Big Brother's ever making a comeback.

Because it has occurred against this backdrop, democratization has taken hold surprisingly quickly and proved remarkably durable. The Primakov government came into being because President Yeltsin and the Parliament played by the rules of a post-Soviet constitution that was approved by popular referendum. That is not, to put it mildly, the way Russian politics worked in the past. Russians of almost all stripes seem to cherish their new freedom and responsibility to vote freely, fairly and often; many are suspicious of grand schemes that feature an all-powerful state as the panacea to their problems.

Still, it is too early to proclaim Russian democratization irreversible. The longer the economic meltdown continues and the more serious it becomes, the harder it will be for Russia to sustain and consolidate the various institutions and habits of what might be called political normalcy: constitutionalism, give-and-take compromises, constituency politics, coalition building, all of which need for their sustenance an atmosphere of pluralism, vigorous public debate and open media.

Therefore the principal point of suspense today is whether the new cooperation between the executive and legislative branches will prove, over time, conducive to more rationality and common sense in the economic sphere — or, alternatively, whether there will be a consensus in favor of continuing economic folly.

By the same token, depending on how far and for how long the pendulum swings to the left, Russian foreign and defense policies could also come under the sway of nationalism in its more contentious, self-delusional and self-isolating form — call it post-Soviet exceptionalism. As Russia asserts its own special needs and distances itself

from the West on the economic front, we may be in for heightened tensions over security and diplomatic issues.

But, friends and colleagues, so far that has not happened. The United States and Russia today are still cooperating far more than we are competing; we are still agreeing more than we are disagreeing. And where we disagree, we are, by and large, managing our disagreements.

Whether that continuity can be sustained will depend in part on whether Prime Minister Primakov and Foreign Minister Ivanov let the policy preferences of a dyspeptic Duma and an often combative elite greatly influence the work of that Stalin-gothic skyscraper that houses the Foreign Ministry on Smolenskaya Square, where Mr. Primakov himself worked until September 11.

The pressure is likely to mount. The mood in the Duma is bilious. Many parliamentary deputies depict the unresolved issues between the U.S. and Russia in terms of concessions that we Americans are supposedly trying to extract from them or as favors we are asking them to do for us.

Nothing could be further from the truth. Virtually every issue between us can be boiled down to a matter of mutual interest and mutual benefit. Russia needs an effective non-proliferation regime since Russian cities would be vulnerable if its most dangerous technology ends up in the wrong hands. Russia needs strategic arms reduction since it cannot afford to maintain its arsenal at Cold War levels. And Russia definitely needs a collaborative relationship with Europe, including with NATO and the European Union.

Peter Holquist's paper describes how the Soviet experience deepened Russia's sense of not really belonging to Europe. Post-Soviet Russia has already gone a long way toward joining the European mainstream. It is now a member of the G-8; the Council of Europe, the Arctic Council, the Council of Baltic Sea States, the Permanent Joint Council created by the NATO-Russia Founding Act and the Contact Group on the Balkans. (And by the way, it's largely because of Bill Perry's statesmanship that Russian officers and troops are keeping the peace in Balkans today side-by-side with the forces of NATO.)

To its credit and benefit — and to ours as well — Russia has gone from being a spoiler to a joiner.

However, whether this trend in Russian foreign policy continues is also a matter of some suspense. How Russia defines its role in the world and its relations with other states will depend crucially on how it defines itself and its own statehood.

My friend and former colleague Chip Blacker led a discussion on this topic earlier today. Sergei Kortunov prepared a paper for that panel in which he raised what in some ways is *vopros vopros*, the question of questions: what is Russia's national identity? Gogol was grappling with the same question in *Dead Souls*. The quandary has become even more acute and vexing since the end of the Soviet period of Russian history, when many Russians felt that their Motherland was, virtually overnight,

deprived of its name, its flag, nearly half of its territory, its defining ideology, its governing structure and its protective alliance.

So what is the *idea* of Russia today? As Sergei makes clear, it's easier to answer that question in the negative than in the positive. "The new Russia," he says, "is not the Soviet Union; nor is she the old Russian empire." Rather, "Russia's new borders, possibilities, culture, civilization, inner development have all contributed to making Russia a new state."

Yes, but what *kind* of a new state? I gather Chip & Company reached a consensus around another negative answer: whatever Russia becomes, it will never again be a monolith, in which political power flows rigidly from the top down and from the center outward. I agree. That particular Humpty-Dumpty can't be put together again. Russia today is a crazy-quilt of regions with wildly different economic and political structures. Some parts of the country are, at least relatively speaking, oases of liberalization. For example, Novgorod, Nizhny Novgorod, Samara, Leningrad and Sverdlovsk oblasts. Other regions remain, or have become, Jurassic-like theme parks of Soviet-era policies and personalities. To wit: Kursk, Krasnodar, Belgorod, Pskov, Volgograd. A few are simply weird, like Kalmykia, where President Ilyuzhimev reigns as a kind of Wizard of Oz. Emil Pain's paper describes regionalization run amok in his Scenario 4.

The new Russia, like its predecessor the Soviet Republic, calls itself a Federation. But the term "federation" is like "reform" and "market": Russia has yet to define what it means. Grisha Freidin could help. Indeed, he *has* helped: in 1990, he translated into Russian and distributed, under the imprint Chalidze publications, this little blue book: *The Federalist Papers*. It offers a home truth that is simple, that is global, and that is more valid at the end of the 20<sup>th</sup> century than it was when Hamilton, Madison and Jay were writing their essays at the end of the 18<sup>th</sup>: a successful state — especially one that stretches the length of Eurasia — must make its diversity a source of strength; it must foster governance on a scale that allows citizens to feel connected to decisions that affect their lives.

American diplomacy recognizes the devolution of power downward from the top and outward from Moscow. Our ambassador in Moscow, Jim Collins, and his colleagues make a point of fanning out around the country, working with grass-roots organizations, developing relations with Russia's governors and mayors (more than 100 of whom are 35 or younger). We'll do everything we can, despite budgetary stringencies, to make the most of our three regional outposts — the consulate-generals in St. Petersburg, Yekatrinnburg and Vladivostok.

Mr. Primakov is also reaching out to the regions. In his speech to the Duma the day he was confirmed as Prime Minister, he said that his priority was *yedinstvo* — the unity of Russia — thus clearly implying that the matter is in some doubt, even in some jeopardy. For many Russians, angst about their future is compounded by suspicion about the U.S.'s strategic intentions. The Russian press has carried numerous articles suggesting that under the guise of "partnership," the U.S. is pursuing a hidden agenda not only to keep Russia weak but to bring about its dismemberment.

Once again, nothing could be further from the truth. The U.S. supports a unitary Russian state, within its current borders. The violent breakup of Russia would be immensely dangerous and destabilizing. When Czechoslovakia split in two in 1992, it was called the velvet divorce. But multiple divorces among, and perhaps within, the 89 regional entities of Russia would almost certainly not be velvet. The horror that has unfolded over the past several years in the Balkans might be replayed across eleven times zones, with 30,000 nuclear weapons in the mix.

This afternoon Emil Pain argued that that apocalyptic danger has receded: We must certainly hope so. The ability of Mr. Primakov and his successors to preserve unity will depend in no small measure on two issues. One is how they handle the economy in general and the ruble in particular. A nation's currency is a key manifestation and an underpinning of its sovereignty — and of its unity. This century has already shown that hyperinflation can destroy states, or turn them into monsters.

The other defining issue for Russia's *gosudarstvennost'* — the coherence and viability of its sense of its own statehood — is how its leaders, now and in the future, handle relations with their immediate neighbors. As has often been the case when empires dissolve, the ethnographic map — in this case, of "post-Soviet space" — does not coincide with the new political map. Many members of the Russian élite feel the loss of empire like a phantom pain in a lost limb, not least because the dissolution of the USSR stranded twenty-five million fellow ethnic Russians on the far side of what became, eight years ago, international borders. Those Russians now outside of Russia rightfully want to be full citizens of their newly sovereign homelands. Any grievances they have, legitimate or otherwise, play into the hands of ultra-nationalists back in Russia. That is one of many reasons why we have advocated that the Baltic states adopt citizenship laws that meet international norms of inclusive, multi-ethnic democracy.

By and large, Russia has kept irredentist impulses largely in check. Not long after the breakup of the USSR, President Yeltsin made an historic decision: he affirmed the old inter-republic borders as the new international ones. He has, at several key points, repudiated the more bellicose claims of his noisier opponents.

But just because Russia has been relatively restrained to date does not mean it will be so forever. Mr. Pain warns in his paper that the threat to Russia's future, and indeed to its integrity as a state, comes not from secessionism on the part of its own ethnic minorities — Chechens, Tatars, Yakuts, Chukchis, Kalmyks, Ingush, Ossetians, Mordovians — but from what he calls "maniacal great-power chauvinism... xenophobia and national close-mindedness" on the part of some forces within the Russian majority. He is referring to Russians who would like to make expansionist or annexationist common cause with Russian *minorities* in the so-called "near abroad." He singles out Crimea, northern Kazakhstan and Transnistria, in Moldova, as the flash points.

Georgia might be added to the list, not because of the Russian minority there (which is small), but because of a temptation on the part of some in Russia to fish for geopolitical advantage in the troubled waters of Georgian ethnic disputes and political vendettas. The short-sightedness of this sort of mischief-making is a lesson Russia should already have learned. In 1993, Russia fanned the flames of the Abkhazian secessionist movement, only to find that sparks from that conflict jumped from the

Southern Caucasus to the Northern Caucasus, contributing to what became the conflagration in Chechnya.

On the positive side of the ledger, in the last couple of years Russia has begun cooperating more with the United Nations and the Organization for Security and Cooperation in Europe in the quest for peaceful settlements in the various civil wars, secessionist struggles and ethnic conflicts in the South Caucasus and Central Asia.

Still, anxieties among Russia's neighbors about how Moscow will handle its relations with them have only grown in the last several months, now that some of the more nationalistic elements in the Duma have become partners-in-power with the executive branch. There is more skepticism than ever among the non-Russian member states of the Commonwealth of Independent States about the future of that organization. Whether it survives and prospers will depend in large measure on whether it evolves in a way that vindicates its name. If its largest member tries to make "commonwealth" into a euphemism for a sphere of influence or an infringement on the independence of its neighbors — then the CIS will deserve to join that other set of initials, USSR, on the ash heap of history.

U.S. policy will continue to focus not just on Russia but on its neighbors as well. We want to see all the new independent states of the former Soviet Union survive, and thrive, to become *old* independent states, just as we want to see Russia's own full integration into what might be called the *global* commonwealth of genuinely independent, mutually respectful states.

A final point — not so much about Russia as about the American view of Russia. Part of Russia's problem is, as Gogol put it, that the rest of the world "gazes askance" at what is happening there. The image of Russia in the mind of America is increasingly ugly. It has become a cliché of Hollywood to depict Russia not just as a failed state but as a criminal one. Here are just a few examples: "Crimson Tide," "The Jackal," "The Saint," "Goldeneye," "The Peacemaker," "Air Force One," "Ronin," even "Blues Brothers 2000." In every one, Central Casting has provided as villains Russian mafiosi, renegade generals and former KGBniks, usually trafficking in loose nukes and dirty money.

This image of feral Russia on the silver screen is mirrored in adventure comic books, on op-ed pages, in fire-and-brimstone statements on the floor of Congress and at conferences of academics and think-tank experts. According to a new conventional wisdom, *smutnoye vremya* — the Time of Troubles — is Russia's natural state; the phenomenon we have witnessed over the last dozen years, in its *chudesny* as well as its *smutny* aspect, now looks like a false spring in the midst of the endless Russian winter. Russians, it is often implied, are destined to live in a Hobbesian state of nature, exiled by the twin curses of history and geography from the civil society envisioned by John Locke; a predisposition to authoritarian rule at home and aggressive behavior abroad is encoded in their genes.

This kind of strategic pessimism, if it were to be the basis of U.S. policy, would lead, at a minimum, to disengagement with Russia — a time-out, a pull-back, a heavy dose of benign neglect. The Russians are so cranky and confused, it is suggested, that

perhaps we should give them a breathing space — a *peredyska* — even if they use it to drive Gogol's troika right off the edge of that cliff.

Some serious commentators and political figures go a step further, suggesting that it is time to dust off that old bumper sticker that summarized U.S. policy toward Russia for nearly five decades: containment. I've even heard the word "quarantine" suggested as the most prudent way to deal with what ails Russia.

This bleak view of Russia's future is, at a minimum, premature. It may turn out to be dead wrong. Or, perversely, we could make it come true, since if we write Russia off and brace ourselves for a new Cold War, our pessimism could become self-fulfilling. Russia will make its own choices and often its own mistakes, but it will make both in no small measure in response to us.

The alternative to strategic pessimism is not so much optimism, which assumes a happy ending, as it is realism about the complexity of the challenges and the uncertainty Russia faces. That is a mindset that assumes nothing, that does not prejudge the future, that is ready for anything, not just the worst. The policy that flows from realism is one of strategic patience and persistence. That means continuing engagement. Even though international macroeconomic support of the kind that we provide through the IMF must wait until the Russian government shows itself willing and able to make the difficult structural adjustments necessary for recovery and growth, we will stay engaged in four key areas:

- **THE BANKING SECTOR.** The silver lining of the collapse of the banking system is that it has created an opportunity to build, virtually from scratch, real banks that do real business, rather than just engage in speculation and arbitrage.
- **THE ENERGY SECTOR.** Russia will need close to \$15 billion a year invested in its energy sector for each of the next seven or eight years just to get back to 1988 production levels. Western energy companies want in. But they will not invest in long-term projects unless the tax regime is clear, property rights are secure and they can take disputes to international arbitration. Russia knows the laws it needs to pass. And now is the time when Russian oil companies need to make clear to their legislators that foreign investment is not selling the patrimony, but preserving it from destruction.
- **FOOD.** Russia's bad luck over the past year included the worst grain harvest in 45 years. Despite large stocks from last year, it could use up all current food supplies by the end of the winter. The far north and the east will be hard hit, as will vulnerable groups in big cities who cannot afford to pay high prices. We have told the Russians that we are willing to help, and we are discussing the options. The key factor in whether we go forward is whether the Russians have a clear strategy for distribution and accountability, and we get incontrovertible assurances exempting any food assistance we provide from customs and taxes.
- **EXCHANGES AND NON-GOVERNMENTAL ORGANIZATIONS.** These are people-to-people programs designed to broaden the base of support in Russia for open society and rule of law. We will keep using some of the money available to us under the FREEDOM Support Act to bring local politicians, entrepreneurs and NGO

representatives to the U.S. on exchanges, and to strengthen regional development. We will also continue to encourage Russia's participation in the global network society through programs like our Internet Access and Training Program, which connects libraries, universities and schools across Russia with each other and with counterpart institutions around the world.

- **COOPERATIVE THREAT REDUCTION.** The U.S. is safer today because of the investment we have made in our own security through initiatives like the Nunn-Lugar program, which helps Russia dismantle its most lethal weapons in accord with treaties like START I and the Chemical Weapons Convention. We will continue to work with the Russians to help them meet the financial costs of compliance with international arms-control and non-proliferation agreements.

By remaining engaged with Russia on all of these critical fronts in the months ahead, we will be demonstrating to the Russian government and the Russian people our determination not to give up on them, even — perhaps even especially — in a time of troubles; we will keep plugging away at the task of supporting the many passengers in Gogol's troika who long to live in what they call "a civilized country." Their aspirations and their eventual answer to the question of questions may yet coincide with our own long-term interests.

That outcome is far from a certainty, but it is not an impossible dream either. Rather it is a possibility that we must, for our sake as well as theirs, do everything we can to keep alive.

Question for the Record Submitted to Deputy Secretary Talbott  
House International Relations Committee  
September 17, 1998

1. Q: Isn't it unlikely that the financial collapse in Russia will have any significant economic impact on the American economy, given the relatively low rates of trade and investment between the two countries?

A: I suspect that similar arguments could be made regarding almost any of the countries involved in the financial crisis. When you look at each of them alone, their ability to have a negative impact on our economic well-being appears minimal. But with international trade and investment an increasingly important part of the U.S. economy, economic chaos abroad clearly has the potential to disrupt our economy (as was demonstrated in our financial markets this summer). In that sense our interest in the economic crisis in Russia is part of our well-founded concerns about global economic conditions. We also clearly have larger interests in Russia that make economic problems there of special concern to us; we seek to encourage the strengthening of democracy and constructive participation in the global political and economic arena.

Question for the Record submitted to Deputy Secretary Talbott  
House International Relations Committee  
September 17, 1998

2. Q: What effects, if any, do you expect the financial collapse in Russia to have on economic reforms in the other states of the former Soviet Union?

A: Effects of the Russian financial crisis are impossible to separate from the effects of the global financial crisis and market contraction. What is clear is that together, they have imperiled economic growth throughout the other new independent states (NIS) of the former Soviet Union. They threaten the fledgling governments' most visible economic achievements, namely stabilizing their new currencies and controlling inflation. The outcome is serious but not uniform throughout the NIS.

Georgia, Armenia, Ukraine, Moldova, and Belarus are all heavily dependent on Russia as an export market and as a primary energy supplier. Moreover, most are accustomed to running deficits financed by t-bill and bond sales and other lending.

This winter will be tough for them. The contraction in the Russian market, the main buyer of their exports until now, will coincide with unprecedented pressure on Russia to collect hard currency for the winter energy supplies they buy.

The Central Asian NIS outside the Caspian -- Kyrgyzstan, Tajikistan, and Uzbekistan -- face difficulties too. Central Asian NIS are less integrated into global financial markets than other NIS and therefore less exposed to their fluctuations. Some of these countries, however, have diversified

Best positioned are the Caspian basin energy exporters, Kazakhstan, Turkmenistan, and Azerbaijan, with greater hard currency reserves and long-term foreign investment. The financial crisis, exacerbated by low oil prices, does complicate the solution of Caspian countries' main economic challenge, finding reliable routes for their energy exports. Russia is still the transit state for all their major energy exports. The financial crisis will also limit Russia's ability to keep up routine maintenance on the Soviet-era Transneft oil pipeline system.

Question for the Record Submitted to Deputy Secretary Talbott  
House International Relations Committee  
September 17, 1998

3. Q: Given the tremendous underlying economic weakness in Russia, why did the US Government seek to include it in the "G-7" group of advanced countries and the "Paris Club" of creditor countries -- particularly since, in the latter case, it is far more a debtor state than a creditor state?

A: As I said at Stanford last week, one of the achievements of the last few years is that Russia is now a joiner rather than a spoiler in international affairs. Russia's membership in the G-8 was a significant part of this process of integrating Russia into the global economy and of starting to work with Russia on a wider and wider range of issues. It bears noting that the G-7 still exists, and meets regularly at the Finance Minister level, to address international and financial and monetary issues.

Regarding the Paris Club, Russia joined as a creditor member because it was owed substantial amounts of official debt by other creditors. We joined the other members of the Paris Club in supporting Russian membership. One of the advantages to us is that, as a creditor member, Russia cannot grant terms to any of its debtor countries on their official debt more favorable than that granted by other club members, such as the U.S.

Question for the Record Submitted to Deputy Secretary Talbott  
House International Relations Committee  
September 17, 1998

4. Q: Is a currency board arrangement feasible for Russia if Russian leaders agree to create one?

A: A currency board is an arrangement in which monetary authorities attempt to fix a country's exchange rate by maintaining dollar reserves sufficient to "back up" their own currency. This arrangement can succeed only if implemented within the context of sound macroeconomic policies. A weak banking system, questions about the credibility of political commitments, insufficient reserves, and high external debt undermine the ability of a currency board to work. Without a resolution of Russia's grave and long-standing fiscal problems, the adoption of a "currency board" would almost certainly not succeed in stabilizing the ruble.

Question for the Record Submitted to Deputy Secretary Talbott  
House International Relations Committee  
September 17, 1998

5. Q: The "Economist" magazine reported in its August 22nd issue that the World Bank has delayed disbursement of \$400 million in loan monies until the Russian government explains what has happened with \$900 million previously lent it. Is that correct? What answers have been provided to the World Bank by the Russian government? Will the U.S. oppose further World Bank loan disbursements until the Russian government answers those questions?

A: We believe that the \$900 million disbursement referred to by the "Economist" was part of the World Bank's structural adjustment loan to promote reform of the Russian coal sector. The Bank has not asked the Russian government to account for the \$900 million lent under this loan, as this money is supposed to go into the Russian government's budget. The Ministry of Finance uses the money for balance of payments purposes and to finance its own budget. This is the case for all World Bank adjustment lending around the world.

The World Bank does have concerns about Russian government spending in the coal sector. The Russian government has budget-financed subsidies to the coal sector, and the Bank is concerned about how these subsidies are managed, and what has been done with the subsidies in the past. The Bank's coal sector loan contained policy reform conditions that required the Russian government to establish a new mechanism for disbursing the subsidies. Under the loan, the Russians also agreed to use the

subsidies for certain purposes. A lack of progress in implementing these reforms is the primary (but not the only) reason why the Bank has not released the second \$400 million tranche under the Second Coal Sector Adjustment Loan (Coal SECAL II).

Also, to release funds under a structural adjustment loan, the World Bank must also determine that there is an appropriate macroeconomic policy environment in the recipient country. Practically speaking, this depends on whether or not there is an IMF program, and if the government is in compliance with that program. Although Russia has held recent talks with the IMF, no new agreement has been reached and Russia is not in compliance with its previous IMF program.

Question for the Record Submitted to Deputy Secretary Talbott  
House International Relations Committee  
September 17, 1998

6. Q: Earlier this year, Mr. Veniamin Sokolov, one of the Russian Parliament's auditors, visited the U.S and publicly listed several instances of apparent thefts of huge sums of Russian government funds.

What steps has our government -- perhaps working with the IMF -- taken to investigate those claims with the Russian Parliament's Accounts Chamber?

A: We have long acknowledged that crime and corruption are serious problems facing the Russian Federation and are among the factors standing in the way of the development of a prosperous market democracy. We have a number of cooperative law enforcement programs with Russia to address these problems. I do not believe we have received a request from the Russian government or parliament for assistance in investigating the allegations referred to by Mr. Sokolov. Were we to receive such a request, we would consider it.

Question for the Record Submitted to Deputy Secretary Talbott  
House International Relations Committee  
September 17, 1998

7. Q: In late August, a representative of a large Western European investment firm stated that "robbery is going on" in Russia. He further stated that "The Central Bank has provided liquidity to commercial banks which are using it to get their money out. It seems Russia's oligarchs are engaging in big-time capital flight, undermining the ruble and fleeing the country. For the Central Bank to say they can't control it is a total abdication of what a Central Bank's responsibilities are." Do you agree or disagree with this characterization of what is going on in Russia. Why?

A: Until August 17, the Central Bank of Russia had been attempting to keep the ruble exchange rate within an established trading band. On August 17 they announced that the exchange rate would be allowed to move out of the band - in effect a devaluation. Around the world, devaluations and fears of devaluation are almost always accompanied by capital flight as holders of the distressed currency seek to shift into more stable monetary units. Central Banks are usually unable to prevent capital flight. The Russian devaluation was preceded and followed by significant flight of both foreign and domestic capital.

The Central Bank of Russia was criticized because in the midst of this crisis it provided additional ruble liquidity to the banking system. The Central Bank was apparently attempting to fulfill its "lender of last resort" responsibilities to Russian banks. Unfortunately the new rubles

quickly moved through the banking system into the hands of individuals who used them to purchase dollars. In this sense the Central Bank decision increased pressure on the ruble. But in the midst of a monetary and banking crisis it is often difficult to make decisions that will not have some adverse consequences.

Question for the Record Submitted to Deputy Secretary Talbott  
House International Relations Committee  
September 17, 1998

8. Q: In late August, a former Treasury Under Secretary for International Finance under President Clinton, Mr. Jeffrey Shafer, was quoted by the "Washington Post" as saying: "The resources that were made available [To Russia] earlier have been squandered...I don't see that there is much that the west can do for Russia, given the present...lack of economic discipline."

Do you agree or disagree with that statement? Why?

A: As I said last week, in present circumstances it "has become all but impossible for the IMF to weigh in with macroeconomic help in arresting and reversing the slide." This does not, however, mean there is nothing we can do. For starters, we can and will maintain a dialogue with the Russian government on the type of fiscal and monetary policies and structural reforms that would make it possible and meaningful for the IMF to enter into a new program with Russia. Further, we can also continue a variety of technical assistance programs on necessary reforms, such as bank restructuring, development of the small business sector, and will continue efforts to enhance safety in nuclear reactors and reduce non-proliferation threats, among other measures. We can also offer humanitarian aid, such as our recent agreement to provide food, when needed.

Question for the Record Submitted to Deputy Secretary Talbott  
House International Relations Committee  
September 17, 1998

9. Q: An Investor Protection Program set up by the Russian government with a large World Bank loan -- to begin compensating average Russians who lost their privatization vouchers in investment fund scams -- reportedly paid almost \$500,000 to just one American consultant, according to a member of the Russian parliament's Accounts Chamber. Has the U.S. pressed the World Bank to investigate this allegation?

Please provide to this Committee the figures for the ten highest totals for individual, combined salary, benefits and expenses paid to non-Russian citizen employees under this project -- without providing individual identification information should that prove inappropriate.

A: The World Bank's Privatization Implementation Assistance loan to Russia was approved in June 1993, took effect in December 1993, and will be completed in June 1999. Under this loan, the Bank has hired a total of 106 contractors. Most of these contracts have been signed with companies, rather than individuals. Earnings information on individuals working for those companies under the Bank's contracts is not available from the World Bank. Attached, however, is a list of all the contractors, the amount for which the contract was signed and the total that has been expended under the contract as of November 8, 1998.

If there is concern that the Bank has not followed its own policies and procedures in granting contracts, citizens of a project country have the right to request an Inspection Panel investigation. Groups of two or more citizens who believe that as a result of a violation their rights or interests have been or are likely to be adversely

affected can request an inspection. No groups within Russia have requested an inspection panel investigation of this project.



[Loan Status](#) | [Category Recap](#) | [Contracts](#) | [Special Accounts](#) | [Paid Withdrawals](#)  
[Rejected Withdrawals](#) | [Application Package](#) | [Special Commitments](#) | [Cancellations](#) | [Statement of Loan](#)

Project: RUSSIAN FEDERATION – PRIVATIZATION

Project ID: 8810

## Contract\* Recap Data for Loan Number: 35460

As of 08-NOV-1998

No. of Contract(s) : 106

Sort Option: Contract Id

Contract Id

Click on a Contract ID to get details by currency and category			Amounts in USD equivalent as of 08		
Contract ID	Contract Description	Contractor Name	Base	Available	Invoiced
<a href="#">M00001</a>	TEXTILES INDUSTRY SECTORAL STUDY	MR. MAURICE STUWART	158,332.00	158,332.00	0.
<a href="#">M00002</a>	DISBURSEMENT OF FUNDS TO KINDERGARDENS	CARNA CORPORATION	405,415.00	100,000.00	305,415.
<a href="#">M00003</a>	INTERNATIONAL EDU. PROGRAM IN SUPPORT OF ECON	PUBLISHING HOUSE LIFE AND WALL	627,773.00	294,000.00	333,773.
<a href="#">M00004</a>	DISBURSEMENT OF FUNDS TO KINDERGARDEN	COOPERS & LYBRAND	700,000.00	213,283.01	486,716.
<a href="#">M00005</a>	TV RADIO PROGRAMS PRODUCT IN SUPPORT OF REFOR	AGENCY FOR MASS MEDIA DEVELOPM	748,000.00	177,348.02	570,653.
<a href="#">M00006</a>	TRAINING OF AMX STAFF	INTERNATIONAL LAW INSTITUTE	2,000,000.00	1,000,000.00	1,000,000.
<a href="#">M00007</a>	PREPARING TOR FOR MASSIVE TA TO INVESTMENT FU	CADOGAN FINANCIAL	117,555.07	3.00	117,550.
<a href="#">M00008</a>	CASH PRIVATIZATION PR CAMPAIGN INT. ADVERTISIN	DOWE ROGERSON	740,000.00	0.00	740,000.
<a href="#">M00009</a>	CASH PRIVATIZATION PR CAMPAIGN INT. PR AGENCY	BURSON MARSTELLER	640,000.00	320,000.00	320,000.
<a href="#">M00010</a>	INFORMATION & TRANSPARENCY OF REGIONAL CASH S	IAN FREED CONSULTINGS	102,950.00	102,950.00	0.
<a href="#">M00011</a>	INFORMATION & TRANSPARENCY OF REG. CASH SALES	CRIMSON CAPITAL	25,000.00	25,000.00	0.
<a href="#">M00012</a>	INFORMATION & TRANSPARENCY OF REGIONAL CASH S	PRICE WATERHOUSE LLP	250,000.00	250,000.00	0.
<a href="#">M00013</a>	MIS DEVELOPMENT AND IMPLEMENTATION FOR AMC	CIS RUSSIA CENTERINVEST	291,354.00	233,280.97	58,273.
<a href="#">M00014</a>	PILOT PROGRAM IN BANKRUPTCY SALES & TRAINING	COOPERS & LYBRAND	1,000,000.00	0.00	1,000,000.
<a href="#">M00015</a>	LARGE SCALE PRIVATIZATION FINANCIAL ADVISORY	N.M. ROTHSCHILD & SONS	2,629,404.00	28,081.00	2,601,323.
<a href="#">M00016</a>	INTERNATIONAL EDUCATIONAL PROGRAM IN SUP OF E	PUBLISHING HOUSE LIFE & WALLET	627,773.00	0.00	627,773.

M00017	TECHNICAL ASSISTANCE	IPC INTERNATIONAL INC	225,000.00	225,000.00	0.
M00022	PUBLIC INFORMATION IN SUPPORT OF CASH PRIVATIZ	IPF GESELLSCHAFT	534,375.00	0.00	534,375.
M00023	LEGAL ADVICE	VINSON & ELKINS LLP	348,500.00	7.13	348,492.
M00024	CONSULTING SERVICES SUPPORT	MS. MARGARET M. MINICHINI	210,000.00	13,043.61	194,956.
M00025	TRAINING OF EXPERTS FROM RUSSIA FEDERAL PROPE	ACADEMY OF EUROPEA PRI NETWORK	538,500.00	0.00	538,500.
M00027	LEGAL REFORM PUBLIC RELATIONS CAMPAIGN	BURSON MARSTELLER	232,000.00	0.00	232,000.
M00029	TRAINING OF RFFI	CENTER FOR INVESTMENT BUSSINES	226,000.00	91,167.86	134,832.
M00030	REGIONAL TEXTILE INDUSTRY INITIATIVE PROJECT	PSKOOSKO VALDAY	241,120.00	58,021.72	183,098.
M00032	INFORMATIONAL EDUCATIONAL PROGRAM SUPPORT OF	PUBLISHING LIFE & WALLET	418,515.00	196,000.00	222,515.
M00033	SMALL BUSINESS COMPONENT	INSTITUTE FOR PRIVATE SECTOR	1,283,250.00	215,242.38	1,068,007.
M00034	LEGAL EDUCATION LEGAL REFORM PROJECT	MR. WILLIAM BURNHAM	35,000.00	0.00	35,000.
M00036	ASSESSMENT OF PSD ENVIRONMENT	INTER DEPT. ANALYTICAL CENTER	483,000.00	-172,794.43	655,794.
M00037	CONSULTING SER. FOR THE INT. INS. OF THE LAW	FORUM FINANCIAL GROUP.	2,468,034.00	2,070,812.00	397,222.
M00038	CONSULTING SER. FOR THE INT. INS. OF LAW BASE	PRICE WATERHOUSE, ARLINGTON	4,008,629.00	1,645,982.20	2,362,646.
M00039	PROJECT DEVELOPMENT & IMPL. OF COLLECTIVE IN	INS. FOR LAW BASED ECONOMY	4,251,394.00	272,523.32	3,978,870.
M00040	IDENTIFICATION OF UNLICENSED FINANCIAL COMPAN	THE FIRST INS. OF INDEPENDENT	1,595,069.00	6,373.49	1,588,695.
M00041	LEGAL SUPPORT OF ASSET IDENTIFI. & THE REPOSS	ARGUMENT LAW	1,858,891.20	0.00	1,858,891.
M00042	LEASE OF THE OFFICE SPACE	MPH DIALOG	3,006,578.00	1,959,168.00	1,047,410.
M00043	SMALL BUSINESS COMPONENT (WCER) MICRO FINANC	IPSSA	43,775.00	11,252.76	32,522.
M00044	REAL ESTATE POLICY DEVELOPMENT IN RUSSIA	MR. GERALD GEIGE	12,000.00	0.00	12,000.
M00045	SUPPORT FOR IMPL. OF THE INVESTMENT PRODUCTIO	MR. FREDERICK SMITH	171,600.00	78,000.00	93,600.
M00046	STUDY ON REGIONAL PROGRAM FOR BUSINESS SUPPOR	IPSSA	54,000.00	2,634.41	51,345.
M00048	TRAINING FOR THE OFFICIALS OF THE CENTER MONO	ALEX KODIAN	47,500.00	19,000.00	28,500.
M00049	TRAINING FOR THE OFFICIALS OF THE ANTIMONOPOL	SARAH J. REYNOLDS	47,500.00	0.00	47,500.
M00052	SUPPLY OF HARDWARE AND SLFTWARE FOR ANTI-MONO	GEFLOR INTERNATIONAL INC	299,998.00	1.00	299,997.
M00053	SUPPLY OF EQUIPMENT FOR ANTI-MONOPOLY COMMITT	RANK XEROX	229,280.00	205,499.38	23,780.
M00054	SUPPLY OF EQUIPMENT FOR THE ANTI-MONOPOLY COM	GEFLOR INTERNATIONAL INC	299,997.00	0.00	299,997.
M00059	FEDERAL COMMISSION ON SECURITIES MARKET	MR. DANIEL GASTEL	12,000.00	0.00	12,000.
M00060	COMMUNICATION EQUIPMENT FOR RFFI	LIMEIRA CONSULTING INC	1,500,000.00	1,500,000.00	0.

M00062	CONSULTANTS ON TEXTILE INDUSTRY PROJECT "DINE"	JAMES PEDLON	39,200.00	39,200.00	0.
M00063	CONSULTANTS ON FINANCIAL MANAGEMENT "LINEN"	DUNCAN NAUGHTER	22,050.00	22,050.00	0.
M00064	LEGAL SUPPORT TO RPC IN CONNECTION WITH THE S	VINSON & ELKINS	65,000.00	223.40	64,776.
M00065	SAT.F. ON SHARES IN RAO UNIFIED ENERGY SYSTEM	CS FIRST BOSTON	746,510.00	644.61	743,863.
M00066	BUSINESS DEVELOPMENT & PROMOTION	IPSSA	63,900.00	24,804.61	39,093.
M00068	REGIONAL POST PRI IMPLEMENTATION THROUGH RPC	SOUTH URALS PRI CENTER	94,650.00	32,277.32	62,372.
M00069	REGIONAL POST PRI IMPLEMENTATION THROUGH RPC	SOUTH URALS PRI CENTER	99,720.00	67,997.57	31,722.
M00070	CONSULTANTS ON LINEN PROJECT	GORDON MACKIE	27,550.00	27,550.00	0.
M00071	FEDERAL COMMISSION FOR THE SECURITIES MARKET	ARTHUR J FALCO	43,000.00	4,696.48	40,303.
M00072	FEDERAL COMMISSION FOR THE SECURITIES MARKET	MICHAEL BUTERA	23,000.00	2,313.79	20,686.
M00081	STAFF TRAINING & RES. OF ENTERPRISES IN THE A	CARNA CORPORATION	736,511.00	736,511.00	0.
M00083	STAFF TRAINING AND	CARNA CORPORATION	736,511.00	219,311.00	517,000.
M00086	CENTER FOR ADMIN. CONS. & ACTIVE DEV. OF ECON	CENTER FOR ADMIN CONSULTING	96,000.00	-426.53	96,426.
M00087	STATISTICAL STUDY	IPSSA	97,199.00	-650.15	97,849.
M00094	CONSULTING SERVICES	JULIA ZAGACHIN	91,000.00	36,046.00	54,954.
M00096	CONCEPT & DESIGN OF ENTERPRISE REFORM FOR A M	INS.PRISEC.STRATEGIC ANALYSIS	99,500.00	3,432.89	96,067.
M00097	TRAINING FOR THE OFFICIALS OF THE AMC	ACADEMY OF MGMT & MARKET	265,000.00	1,750.52	263,249.
M00100	CAPITAL MARKETS DEVELOPMENT	ROBERT PARDY	47,300.00	20,825.00	26,475.
M00101	INVESTOR PROTECTION PROGRAM	M. BUTERA	35,159.00	8,383.94	26,775.
M00102	DEV. OF MARKET STRATEGIES FOR INDUSTRY ENTERP	V-RATIO	299,155.00	100,985.20	198,169.
M00103	CONSULTING SERVICE	DIASOFT, INC	117,280.00	0.00	117,280.
M00104	COLLECTIVE INVESTMENT CENTER COMPONENT	FALCO, A.J	44,790.00	44,790.00	0.
M00109	INVESTEXPO-97	MID RUSSIAN LPC	24,914.00	20,035.09	4,878.
M00110	CONSULTING SERVICES	FALCO A.J.	179,100.00	95,927.83	83,172.
M00114	DEV. OF MARKET STRATEGIES FOR LIGHT INDUSTRY	V-RATIO	298,651.00	209,000.00	89,651.
M00115	COMMUNICATIONS PUBLIC EDUCATION PROGRAM	BURSON MARSTELLER	1,500,000.00	345,803.06	1,154,196.
M00116	REGIONAL BUSINESS SUPPORT PILOT PRIVATIZATION	BUSINESS SUPPORT CENTERS	1,200,000.00	-5,502.41	1,205,502.
M00117	CONSULTING SERVICES RESTRUCTURING "OSPAZ"	ROLAND BERGER	315,000.00	0.00	315,000.
M00118	REFERENCE PUBLICATIONS	IPSSA	1,500,840.00	334,773.65	1,166,066.
M00120	RESTRUCTURING OF BERATON ENTERPRISE	PRAKTIK EDUCATIONAL INS	296,000.00	547.34	296,547.
M00127	DEVELOPING INVESTMENT MARKETS IN THE URAL SECT	MID-URAL LPC	228,000.00	171,845.11	56,154.

M00128	COMPUTER HARDWARE, OFF. EQPT, FOR FUDN AND IT	DELL SYSTEMS	859,985.00	859,985.00	0.
M00132	PROCUREMENT OF GOODS	000 SCANI	57,028.00	-288.49	57,316.
M00133	RESTRUCTURING	000 CARANA	219,311.00	-774.74	230,285.
M00134	RESTRUCTURING STUDY	000 "CARANA"	269,585.00	-842.03	270,427.
M00135	RESTRUCTURING OF S & Z.	ERNST & YOUNG LTD.	408,314.00	40.80	408,273.
M00138	PROVISION OF FIN & MGT. ASSISTANCE SVCS. TO S	KPMG/PBK	393,370.00	39,337.00	354,033.
M00139	INFORMAL SECTOR IN RUSSIAN ECONOMY	IPSSA	149,678.00	82,063.02	67,614.
M00140	SOFTWARE INSTALLATION	ZAO CENTERINVESTSOFT	87,000.00	0.00	87,000.
M00143	PROFESSIONAL TRAINING FOR PUBLIC OFFICIALS RE	INTERNATIONAL UNIVERSITY MOSC	1,070,000.00	235,534.34	834,465.
M00146	MEDIA RELATIONS ADVISOR FOR MOSCOW STOCK EXCH	DMITRI K. PLESKHOV	14,508.00	0.00	14,508.
M00147	ADVISOR ON CAP MARKETS' INFRASTRUCTURE DEVELOP	ANDREW V. OREKHOV	21,762.00	0.00	21,762.
M00152	IPP PROJECT AUDIT	KPMG LIMITED (CHANNEL ISLANDS)	33,600.00	0.00	33,600.
M00155	ORG. OF PUBLICATION OF GUIDEBOOKS FOR "REFERE	ZAO CONSECO / KNIGA-SERVICE	475,350.00	143,660.08	331,689.
M00156	SUPPORT TO FCF FOR INVEST. PROTECTION ON LEGA	ARGUMENT-PRAVO & COMPANY	175,334.00	0.00	175,334.
M00157	MANAGEMENT TRAINING FOR ENTERPRISE RESTRUCTUR	IPSSA	153,088.00	14,393.60	138,694.
M00158	PROCUREMENT OF LOAN ADMINISTRATION SYSTEM FOR	IT INFORMATION TECHNOLOGY	57,777.00	-908.89	58,685.
M00159	RESTRUCTURING SERVICES TO TYVER MANUFACTURA	COOPERS & LYBRAND	198,160.00	65,948.75	132,211.
M00160	GAZETNY OFFICE FACILITY LEASE	INSTITUTE OF ECONOMY IN TRANS	424,900.00	0.00	424,900.
M00161	ANALYSIS & RECOM. FOR INCREASED SAVINGS AND IN	INSTIT. OF EUROPE OF RUS ACADSC	146,829.00	5,356.27	141,472.
M00163	ESTABLISHMENT OF DATABASES/RESEARCH/ANALYSIS	1ST INSTIT. OF APPRAISAL & AUD	782,605.00	177,368.06	605,236.
M00164	PREFARATION & PROMOTION BROCHURES FOR ERSP	G.I. CONSULTING	129,325.00	28,960.50	100,364.
M00165	RESTR. SERVICES FOR VLADIMIRSKY CHEMICAL PLAN	UNIKON/MC CONSULTING GROUP	300,000.00	195,370.12	104,629.
M00166	HARDWARE FOR LOAN ADMINISTRATION SYSTEM FOR R	ZAO CSS INTERNATIONAL	13,840.00	-65.65	13,905.
M00167	RESTRUCTURING ADVISORY SERVICES/ PLAVSKY MACH	TOO PRO-INVEST CONSULTING	272,388.00	67,533.14	204,854.
M00168	ACCOUNTING SYSTEM FOR RPC	SCALA (CYPRUS) LTD	80,145.00	31,388.28	48,756.
M00169	FURNITURE FOR COMD	BEESTYLE CJSC	64,035.00	0.00	64,035.
M00171	RESTRUCTURING OF VOLOGODSKY MACHINERY FACTORY	PRO-INVEST CONSULTING	294,110.00	146,069.23	148,040.
M00172	PRIVATIZATION OF KAMA PULP AND PAPER MILL	UNIKON/MC CONSULTING GROUP	325,338.00	-1,772.24	327,110.
M00173	PRIVATIZATION OF RUSSKI DIESEL	COOPERS & LYBRAND	332,400.00	248,799.64	83,600.
M00174	IPSSA - REFERENCE PUBLICATIONS/ORG.&PROMOTIO	RUSSIAN PUBLIC RELAT. GROUP	255,000.00	178,102.45	76,897.

Question for the Record Submitted to Deputy Secretary Talbott  
House International Relations Committee  
September 17, 1998

10. Q: Is it true that the Russian government has never achieved its IMF targets for deficit reduction during seven years of IMF programs in Russia? Also, how often in the past has the IMF correctly projected economic growth rates in Russia?

A: Russia joined the IMF in 1992. Between 1992 and 1994 it was under three preliminary IMF programs. Russia began its first IMF standby program in April 1995 and began a period of relatively successful macroeconomic policy. This period was marked by strict monetary policy and exchange rate stability. Inflation was brought down to single digit levels by early 1998. In 1997, according to official Russian figures, the economy for the first time in the post-Soviet period recorded positive output growth. The weak link, however, was Russia's persistent failure to address its budget deficit; this problem contributed significantly to the crash of August 17, 1998.

Predictions of economic growth must be based on an adequate data gathering capability. Russia still has difficulty recording economic activity and predictions undergo frequent revisions. The IMF generally was accurate in predicting trends in economic activity but precise forecasting remains impossible under Russian conditions.

Question for the Record Submitted to Deputy Secretary Talbott  
House International Relations Committee  
September 17, 1998

11. Q: What specific IMF conditions did the Russian government meet before the disbursement of its \$4.8 billion in loan monies recently?

A: I would refer you to the IMF and the Department of the Treasury for a detailed answer. However, let me note just a few of the many conditions Russia met before the July funding package was released. The Russian legislature approved part I of a long awaited new tax code, various tax rates were changed, laws were adopted bringing a broader cross-section of economic activity into the tax system, and a start was made on entitlements reform.

Question for the Record Submitted to Deputy Secretary Talbott  
House International Relations Committee  
September 17, 1998

12. Q: What specific steps should the Russian government take to reform its banking system and its private banks?

Russia needs to restructure its banking system so that it truly acts as a financial intermediary, channeling ordinary Russian's savings into productive investment in deserving enterprises.

To achieve this, and to solve the near term problem of financial paralysis, Russia should take the following types of actions as part of a comprehensive restructuring plan:

- Audit banks to identify a few to preserve as the basis for a rebuilt payments systems, as the central bank has proposed.
- Refrain from providing liquidity to remaining banks and instead restructure and/or liquidate them through a mechanism like the US Resolution Trust Corporation.
- Replace the current owners and managers of insolvent banks.
- Separate banks from large financial-industrial groups and ensure loans are made only on commercial criteria.

- Allow greater participation by foreign banks to help construct a healthy, well-managed banking system that lends to the real sectors of the economy.
- Improve prudential supervision, regulation and accounting standards.
- Increase training for loan officers and bank examiners to build the infrastructure for a stable banking system.

The Russian central bank recently proposed a plan which incorporates many of these steps. The key will be implementation. If Russia can move forward effectively on this plan, the US and the international community are ready to provide significant technical assistance in support of the bank restructuring effort.

Question for the Record Submitted to Deputy Secretary Talbott  
House International Relations Committee  
September 17, 1998

13. Q: Some observers believe that it would take \$5-7 billion for Russia to build facilities and reactors to burn plutonium under the recently announced US-Russian commitment to reduce their stocks of plutonium by 50 tons each. (It is generally expected that Russia will refuse to dispose of these stocks by cheaper "vitrification" of the plutonium.)

If this is correct, how is it expected that the Russian government will raise such funds?

A: We anticipate that the cost of burning 50 tons of Russian plutonium in nuclear reactors will cost substantially less than \$5 billion. The U.S. Government will assist Russia in constructing facilities for plutonium disposition and \$200 million has been appropriated for this purpose. Consistent with the September summit joint statement on plutonium disposition, the countries of the G-7 have been consulted and we are hopeful that they will join our plutonium disposition efforts.

Question for the Record Submitted to Deputy Secretary Talbott  
House International Relations Committee  
September 17, 1998

14. Q: Has Russia violated its commitments under the Nuclear Nonproliferation Treaty or the Nuclear Suppliers Agreement by agreeing to construct nuclear reactors in India despite India's recent nuclear test?

A: The Nuclear Suppliers Group requires that transfers of equipment (e.g., reactors), materials and technology be made only to states having full-scope safeguards agreements with the International Atomic Energy Agency. While India does not have such an agreement, Russia has maintained that its deal with India for reactor construction predates its undertakings with the Nuclear Suppliers Group. We have repeatedly objected to Russia's agreement with India and will continue to raise this subject in our nonproliferation discussions with the Russian government.

Question for the Record Submitted to Deputy Secretary Talbott  
House International Relations Committee  
September 17, 1998

15. Q: What pressure has the US put on the Russian government to return the U.S. computers and supercomputers illegally exported to Russia?

Is the Russian government cooperating to return them?

A: We have raised this on a number of occasions and at very high levels. To date, we have not had success.

However, we have taken several steps to address this problem. For example, on June 30, 1997, the Department of Commerce published a revision to its export regulations by listing a number of nuclear-weapons related end-users, including Arzamas and Chelyabinsk, as entities requiring individually validated licenses for all items subject to export controls, including computers.

Question for the Record Submitted to Deputy Secretary Talbott  
By the Hon. Lee H. Hamilton  
House International Relations Committee  
September 17, 1998

1. Q: How important has been the international community (IMF, World Bank, G-7 Countries) in shaping Russia's economic decision making?

--One hears two -- opposite sets of criticisms of western policy towards Russia:

The west was too stingy and never provided enough resources to help Russia carry through on its economic reforms; or

Russia took lots of money from the west, but never took to heart western economic advice.

--What is your analytical take on what happened in Russia over the past seven years.

A: With financial and technical assistance from the IMF, IBRD, EBRD, the U.S. and other countries, Russia made substantial progress from 1992-1997 on privatization, fighting inflation, bringing down tariffs and starting to build the legal and regulatory foundation of a market economy. But this very real progress was undercut by Russia's failure to address its persistent budget deficit, to force industrial restructuring (including bankruptcy) and its failure to finish building a modern regulatory and commercial law system. Inadequate steps in these areas, combined with general emerging market jitters and declining energy prices led to the near collapse of Russian financial system and foreign exchange regime this summer. In short, this summer's problems were more the result of inadequate

progress on structural reforms combined with external shocks than the result of inadequate international resources to support reform.

For a more detailed version of my views on what has happened in Russia over the past seven years, I have attached a copy of the speech I delivered at Stanford on November 6.

Question for the Record Submitted to Deputy Secretary Talbott  
by the Hon. Lee H. Hamilton  
House International Relations Committee  
September 17, 1998

2. Q: How do you respond to the criticism offered by Steven Cohen, among others, that given Russia's 1000 year history of authoritarian rule, and 70 years of communism, that it was just an illusion to think you could import a western-style market economic system, and make it work?

A: I can not agree with a point of view which argues that Russia is doomed to failure. As President Clinton stated in Moscow in September, Russia can build a prosperous future for itself if it chooses to complete the transformation begun seven years ago. This is not the first time some have called the Russian transition over for good. As the Secretary said in Chicago in October: "The drama of Russia's transformation from a dictatorship and an empire to a modern democratic state is far, far from over... A true and lasting transition to normalcy, democracy, and free markets in Russia is neither inevitable nor impossible. It is an open question, the subject of a continuing debate and struggle."

Russia has accomplished a great deal in its transformation in the last seven years. Governments have risen and fallen according to procedures established in the Russian constitution. In terms of basic freedoms, Russia is freer than ever before in its history, and those freedoms rest on better constitutional foundations.

Russia is going through a severe economic crisis. And there is no doubt that Russia's 74-year experience with communism makes a transition to a free-market economy a difficult one. No one is seeking to impose a specific type of market economic system, but economic realities exist that any country ignores at its own peril. Russia must take action if it wants to enjoy the benefits that increased investment (foreign and domestic) could bring. As a first step, Russia must address its continuing budget gap. One of the other obstacles has been Russia's inability to approve adequate legislation on production sharing agreements, and to create a stable, predictable tax system, which would create an environment for attracting investment. We should be supportive, but at the same time we must acknowledge it is up to the Russian leadership, together with the Russian people, to build sound economic policy.

Question for the Record Submitted to Deputy Secretary Talbott  
By the Hon. Lee H. Hamilton  
House International Relations Committee  
September 17, 1998

3. Q: One of Mr. Primakov's criticisms, which is shared by some highly respected western economists, is that the IMF has focused too much on macroeconomic stability and exchange rates, at the expense of economic growth and employment.

--Has the IMF neglected the human element in Russia?

--How can you sustain an IMF program if most people end up suffering?

--How should the IMF revise its program in Russia?

A: There is no fundamental conflict between focusing on sound macroeconomic policy and exchange rate stability and economic growth and employment. To the contrary, sound fiscal and monetary policy are entirely consistent with and necessary for sustainable economic growth, job creation and an improvement in living standards. In Russia's recent case it was increased investor scrutiny of all emerging markets, declining energy prices and Russia's failure to address the fiscal side of macroeconomic policy that led to many of Russia's current problems. I would certainly agree that one of the lessons of the global financial crisis is that reform policies must have public support to be sustainable.

Question for the Record Submitted to Deputy Secretary Talbott  
by the Hon. Lee H. Hamilton  
House International Relations Committee  
September 17, 1998

4. In his acceptance speech to the Duma last week, Primakov reasserted his support for the START II Treaty, and urged the Duma to ratify the treaty as soon as possible.

- Do you believe that Primakov has the political clout and the will to push the Duma towards ratification of START II?

- What time frame are we looking at?

- Why does Primakov support START II - is at least part of the reason that it will save cash-strapped Russia a good deal of money?

A: We are pleased that FM Primakov has given ratification of START II a high priority. However, the Treaty continues to face opposition and will require a concerted effort by the government to be ratified.

The Duma is redrafting the bill of ratification and expects to begin considering the Treaty in late November or early December. This is a promising development, but it is clear the Government and the Duma leadership need to continue to work hard to secure ratification.

The Russia Government has long recognized it would not be able to maintain current levels of strategic nuclear forces once current systems reach the end of their service life in the next few years. START II will help Russia maintain parity without investing in new strategic systems. Perhaps more importantly,

ratification of START II will allow negotiation of START III,  
which would mandate even greater reductions in strategic arms.

Question for the Record Submitted to Deputy Secretary Talbott  
by the Hon. Lee H. Hamilton  
House International Relations Committee  
September 17, 1998

5. Q. What happens with respect to U.S. policy toward Russia as that country enters a period which, according to most observers, will feature high inflation and slow progress on reform. \_

- I understand that we will be closely monitoring the Russian government's actions. What key, concrete indicators will we be looking at?

- What specific progress on reform do we wish to see before we will support additional IMF funding for Russia?  
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A. -- No matter what its economic situation, our relations with Russia remain a foreign policy priority for the United States. It is in our interest that Russia succeed in making the transition to a market economy and becoming an integrated, constructive partner in the world.

-- We have an interest in staying engaged with Russia and working on areas of common interest. This is reflected in the food aid agreement signed last week under which the U.S. will provide 3.1 million metric tons of agricultural products.

-- Our interest is also reflected in other current U.S. assistance programs in Russia, such as the control and protection of fissile materials, support for small business development, people-to-people exchanges, and continuing cooperation on democracy and the rule of law.

-- We will continue to urge the GOR to address a range of pressing economic challenges, such as restraining the budget deficit, stabilizing the exchange rate, fighting inflation, restructuring the banking sector and restarting the payments system, and finding cooperative ways to address obligations to private creditors.

-- Positive steps in these areas are the indicators of economic progress we would look for. We urge the GOR to finalize a fiscal and monetary policy program that puts Russia on a path towards growth and investment while living within its means,

Question for the Record Submitted to Deputy Secretary Talbott  
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House International Relations Committee  
September 17, 1998

6. Q. If Russia enters a period of high inflation, will the primary goal of U.S. policy be to convince the Russian government to return to a tight monetary policy or to offer advice to the Russian government on managing an inflationary economy?

A. -- We will continue to urge the GOR to address the range of pressing economic challenges it faces including: restraining the budget deficit, stabilizing the exchange rate, fighting inflation, restructuring the banking sector and restarting the payments system, finding cooperative ways to address obligations to private creditors, addressing pension and wage arrears and industrial restructuring.

Question for the Record submitted to Deputy Secretary Talbott  
By the Hon. Lee H. Hamilton  
House International Relations Committee  
September 17, 1998

7. Q: Given recent events in Russia, how will US assistance policy change?

- What ongoing programs will likely remain effective?
- What programs hold less promise in Russia's new economic and political environment?
- Do you plan any new programs given recent events?

A: In response to Russia's financial crisis and the impact it is having on the country's political direction and economic development, the US government has been reevaluating its assistance strategy over the past two months. The environment in which US assistance programs operate has clearly changed: we are providing significant humanitarian food aid for the first time in six years; many US businesses are taking a different view of the risks of investing in Russia; the Russian banking sector is in disarray; and the newly emerged Russian middle class has been particularly hard hit, with some losing their savings as a result of bank failures, and thousands losing their white collar jobs.

On the other hand, Russian citizens are remarkably resilient in conditions of adversity and adept at finding creative ways around new obstacles. Many Russian businesses, already accustomed to operating outside the money economy, have gone back to relying on barter and informal distribution networks. Some have even

managed to take advantage of the drastic decline in the availability of affordable imports by increasing production of domestic substitutes. A surprisingly large number of banks, particularly medium-sized, regionally-based banks, are back in business. In fact, the majority of banks participating in small business lending programs supported by the US government have resumed making loans, and demand for these loans by Russian entrepreneurs is reportedly high. Meanwhile, non-governmental organizations and the independent media, which have been especially affected by the financial crunch, are finding survival strategies of their own, although targeted assistance by the US and other outside donors will probably be necessary to keep these relatively fragile institutions of civil society alive.

In short, the impact of the financial crisis has been complex and requires a careful response in terms of US assistance policy. Well before the crisis, we had begun to shift away from technical assistance at the central government level toward regional initiatives to support reform outside Moscow, and toward exchanges and cooperative activities aimed at establishing lasting ties between Russians and Americans. Given the current crisis, our "Partnership for Freedom" strategy looks to be even more on target, and will continue in fiscal year 1999.

In terms of ongoing programs, we believe that our cooperative threat reduction, nuclear safety, and non-proliferation and export control activities are more needed than ever. We will be able to increase the level of our assistance for these programs in FY99. We also plan to increase dramatically the number of exchanges to bring students, scientists and entrepreneurs to the U.S. More than ever we need to encourage direct links between Russians and Americans, on both an individual and organizational level. Our ongoing economic assistance programs will focus even more on the regions outside Moscow in FY99, through such efforts as the Regional Investment Initiative, which is currently working to improve business conditions and prospects for long-term development in three targeted regions, and will soon be extended to at least one more region. We will also intensify support for the beleaguered small business sector through programs that provide training and access to credit. And we will provide targeted support to the NGO sector and independent media to ensure their survival.

Meanwhile, we are carefully reviewing current technical assistance to the government of Russia to identify areas in which our assistance is no longer welcome or can no longer be effective. These decisions will be made in the context of determining allocations for the FY99 budget. In terms of new programs, we are looking at the possibility of providing

assistance in the area of bank restructuring and improving regulation of the banking system. If we were to provide such assistance, it would be in close coordination with the World Bank and other international donors who are currently discussing reform of the banking system with the Russian government and the Central Bank of Russia.

