



## Aid to Russia

by Janine R. Wedel, George Washington University

When the Soviet Union abruptly ceased to exist on December 25, 1991, it seemed that the West, particularly the U.S., finally had what it had always wanted—the opportunity to introduce quick, all-encompassing economic reform that would remake Russia in the West's own image. To this end, the U.S., 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 urging of radical economic "reforms," defined largely as the privatization of state-owned assets, to restructure the economy; 2) the backing of a particular political-economic group, or "clan," to do so; and 3) the provision of billions of dollars in U.S. and other Western aid, subsidized loans, and rescheduled debt.

The United States has consistently supported President Boris Yeltsin and a Russian cadre of self-styled economic "reformers" to conduct Western aid-funded economic reforms and negotiate economic relations with the West. U.S. support for Anatoly Chubais, Yegor Gaidar,

and the so-called "Chubais Clan" (a group of savvy operators dominated by a clique from St. Petersburg) has bolstered the Clan's standing as Russia's chief brokers with the West and the international financial institutions. This support continues to the present. And, the Chubais Clan—not the Russian economy as a whole—has been the chief beneficiary of economic restructuring funding from the U.S. Agency for International Development (USAID).

Throughout the 1990s, Chubais has been a useful figure

for Russian president Boris Yeltsin: beginning in November 1991 as head of Russia's new privatization agency, the State Property Committee (GKI), then additionally as first deputy prime minister in January 1994, and later as the 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 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 (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, economic-restructuring, and related activities. Between 1992 and 1997, HIID received \$40.4 million from USAID in noncompetitive grants for work in Russia and was slated to receive another \$17.4 million until USAID suspended HIID's funding in May 1997, citing evidence that HIID principals were engaged in "activities for personal gain." In addition to receiving millions in direct funding, HIID and the Clan helped steer and coordinate USAID's \$300 million economic reform portfolio, which encompassed privatization, legal reform, development of capital markets, and the creation of a Russian securities and exchange commission.

The preferred method of economic reform was top-down presidential decree orchestrated by Chubais. Shortly after Yeltsin became the elected president of the Russian Federation in June 1991, the Federation's Supreme Soviet passed a law mandating privatization. After several schemes were floated, the Supreme Soviet passed a program in 1992 intended to prevent corruption, but the one Chubais eventually implemented contained none of the safeguards and was designed to encourage 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.

Instead of encouraging market reform, this rule by decree frustrated many market reforms as well as democratic decisionmaking. 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. The "reformers" set up still other means of bypassing democratic processes, including a network of aid-funded "private" organizations controlled by the Chubais Clan and HIID. These organizations enabled reformers to bypass legitimate bodies of government, such as ministries and branch ministries, and to circumvent the Duma.

### Key Points

- Since 1992, the U.S. and other donors have provided Russia billions of dollars in aid for radical economic "reforms," largely defined as privatization of state-owned assets.
- The chief beneficiary of these reforms has been a small clique of political and economic powerbrokers.
- The Chubais clique typically instituted reforms through top-down presidential decree and a network of aid-funded "private" organizations which has circumvented Russia's legislature.

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.

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 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 good in principle, it is less convincing in practice because it is an inherently political decision disguised as a technical matter. As Chubais Clan member Maxim Boycko himself acknowledged in a 1995 co-authored book on privatization, "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."

In a 1997 interview, U.S. aid coordinator to the former Soviet Union, Ambassador Richard L. Morningstar, stood by this approach: "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 HIID 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 HIID in Russia provide some cautionary lessons on abuse of trust by supposedly disinterested foreign advisers, on U.S. arrogance, 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 if Russia "stays on track"), is 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 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 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, "All loans made to Russia go to speculative financial markets and have no effect whatsoever on the national economy." And it is the Russian people who are responsible for repaying those loans.

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? 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 weeks after 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.

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## Key Problems

- US officials and a team of Harvard advisers have embraced the "reformers'" dictatorial political methods, arguing they alone are capable of instituting swift privatization and other economic restructurings.
  - While professing to support simply economic reform, U.S. policies have consolidated political and economic power in the hands of one clique.
  - The \$11.2 billion IMF bailout in July 1998 will intensify these abuses and has failed to stem Russia's financial crisis.
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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 Russia 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 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 which emphasize increases in tax collections 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 business of 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 U.S. 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 compromised and undermined by the practice of U.S. economic advisers encouraging the Chubais Clan to enact swift economic reforms without approval of the Duma, Russia's popularly elected legislature.

The U.S. 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.

Fourth, President Clinton himself, other U.S. officials, and economic 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 with Yeltsin and his allies. How Russian elites perceive the efficacy of U.S. aid programs and policies should be a source of 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, making efforts to meet with members of the Duma and a diversity of Russian elites.

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## Key Recommendations

- In order to support its stated objectives of fostering sound economic development and democratic institutions, the U.S. needs to reverse its current policies and practices in Russia.
- The United States must accept that the future shape of Russia must and will be determined by the Russian people and adhere to its basic principles such as participatory democracy and the rule of law.
- Washington should recognize that a healthy banking and financial system depends on a revival of production and distribution within Russia and should use its considerable influence with the World Bank and IMF to promote policies that address these fundamental problems.

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# Statistical Background

## Aid to Russia, 1992-1997

U.S. Bilateral — \$4.9 billion

World Bank — \$9.8 billion

IMF — \$14.4 billion\*

\* IMF deepened its financial commitment to Russia with an \$11.2 billion loan in July 1998 and possibly another \$7.8 billion starting in 1999.

## What the Donors Say

- USAID: "Privatization and economic reform are particularly important, since this combination offers the best prospects for achieving economic prosperity—a cornerstone for building a stable democracy. In fiscal year 1999 USAID will focus on helping to remove the impediments to trade and investment."
- World Bank: "Strongly supports Russia's efforts to restructure its economy according to free market principles. Emphasizes the vital role of the merging private sector and importance of maintaining financial stability in transition to a market economy."
- IMF: "Lays the basis for sustained growth by lowering inflation and achieving medium-term viability of the balance of payments while removing structural impediments to growth through restructuring of natural monopolies, reform of the tax system, privatization, and reforms of the legal and institutional framework to support the functioning of a market economy."

Sources: World Bank release, March 1998; IMF release, August 1997; Table 6 in Janine Wedel, *Collision and Collusion* (forthcoming from St. Martin's Press); USAID, Freedom Support Act Report, 1996.

## Sources for More Information

### Organizations

#### Johnson's Russia List

Center for Defense Information  
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