S. Hrg. 102–822

FORMER SOVIET UNION DEBT RESCHEDULING

HEARING

BEFORE THE

SUBCOMMITTEE ON DEFICITS, DEBT MANAGEMENT AND INTERNATIONAL DEBT

OF THE

COMMITTEE ON FINANCE UNITED STATES SENATE

ONE HUNDRED SECOND CONGRESS

SECOND SESSION

MAY 1, 1992

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE
58–036—CC WASHINGTON : 1992

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-039385-X

COMMITTEE ON FINANCE

LLOYD BENTSEN, Texas, *Chairman*

DANIEL PATRICK MOYNIHAN, New York
MAX BAUCUS, Montana
DAVID L. BOREN, Oklahoma
BILL BRADLEY, New Jersey
GEORGE J. MITCHELL, Maine
DAVID PRYOR, Arkansas
DONALD W. RIEGLE, Jr., Michigan
JOHN D. ROCKEFELLER IV, West Virginia
TOM DASCHLE, South Dakota
JOHN BREAUX, Louisiana

BOB PACKWOOD, Oregon
BOB DOLE, Kansas
WILLIAM V. ROTH, Jr., Delaware
JOHN C. DANFORTH, Missouri
JOHN H. CHAFEE, Rhode Island
DAVE DURENBERGER, Minnesota
STEVE SYMMS, Idaho
CHARLES E. GRASSLEY, Iowa
ORRIN G. HATCH, Utah

Vanda B. McMurtry, *Staff Director and Chief Counsel*
Edmund J. Mihalski, *Minority Chief of Staff*

Subcommittee on Deficits, Debt Management and International Debt

BILL BRADLEY, New Jersey, *Chairman*

DONALD W. RIEGLE, Jr., Michigan
ORRIN G. HATCH, Utah

CONTENTS

OPENING STATEMENTS

COMMITTEE PRESS RELEASE

PUBLIC WITNESSES

ALPHABETICAL LISTING AND APPENDIX MATERIAL SUBMITTED

FORMER SOVIET UNION DEBT RESCHEDULING

FRIDAY, MAY 1, 1992

U.S. SENATE,
COMMITTEE ON FINANCE,
SUBCOMMITTEE ON DEFICITS, DEBT MANAGEMENT
AND INTERNATIONAL DEBT,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:00 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Bill Bradley (chairman of the subcommittee) presiding.

Also present: Senator Hatch.

[The press release announcing the hearing follows:]

[Press Release No. H-21, April 18, 1992]

SUBCOMMITTEE TO EXPLORE DEBT CRISIS IN FORMER SOVIET UNION, BRADLEY SEEKING FEASIBLE, EFFECTIVE RESPONSE

WASHINGTON, DC—Senator Bill Bradley, Chairman of the Senate Finance Subcommittee on Deficits, Debt Management and International Debt, Tuesday announced a hearing on the debt crisis in the former Soviet Union.

The hearing will be at *10 a.m., Friday, May 1, 1992* in Room SD-215 of the Dirksen Senate Office Building.

Bradley (D., New Jersey) said the purpose of the hearing is to examine the debt crisis in the newly independent states of the former Soviet Union.

"I hope to explore the issue of whether debt deferral is an adequate means of permitting economic restructuring or whether rescheduling coupled with debt forgiveness would be a more feasible and effective response," Bradley said.

"We will also focus on how IMF resources will be used by the new states, with particular emphasis on whether these funds will be used primarily to pay off old Soviet debt or will be used for creating new market opportunities," Bradley said.

OPENING STATEMENT OF HON. BILL BRADLEY, A U.S. SENATOR FROM NEW JERSEY, CHAIRMAN, SUBCOMMITTEE ON DEFICITS, DEBT MANAGEMENT AND INTERNATIONAL DEBT

Senator BRADLEY. The hearing will come to order. This is the second in a series of hearings held before the Subcommittee on the problem of international debt owned by the Soviet Union, the former Soviet Union. It is difficult to make that shift, but we are doing our best. It is a pleasant shift.

I welcome the witnesses who came on very short notice, some traveling great distances to testify here today.

In October of last year, just 2 months after the failed coup attempt, the Subcommittee held a hearing that confronted directly the administration's desire to manage the Soviet debt issue with central government structures under the control of then-President Mikhail Gorbachev. In December Gorbachev resigned, the central government of the Soviet Union collapsed and the fallacy of the administration's approach—i.e. depending on the central government—and the inadequacy of that approach, I think, was exposed.

World events continue to press down hard upon all of us. The issue of Soviet debt has become more urgent and no less important. The tense debate in Congress of People's Deputies on the Russian Government's economic reform program ended last week and the meetings this week of the International Monetary Fund's Interim Committee and the G–7 Finance Ministers to try to deal with the integration into the world economy of the 15 republics of the former U.S.S.R.

The rapidity with which the administration is attempting to enact its proposed assistance legislation, the so-called Freedom Support Act of 1992, all of these things—Congress, the Party of Congress, the Peoples Deputies, IMF, Interim Meeting, G–7, the administration's proposal—all point to the need to resolve the outstanding Soviet debt issue quickly, decisively and effectively.

We cannot afford further misguiding of the administration policies on this issue. Russian, the largest of the republics by far, has already undertaken major steps towards democratic and market reforms that warrant support from the international community. More reform is planned.

The American taxpayer will appreciate the value of lending support that consolidates and advances these reforms. The American taxpayer, I believe, will understanding technical assistance and educational programs that aim to spread knowledge to a receptive audience about our way of life, our democracy, our economy.

I also believe that the American taxpayer would accept the need to reduce the burden of debt imposed by the former Soviet Government on these new states, especially those that are least able to pay.

The American taxpayer would, I believe, be shocked to learn that the administration plans to recycle its pledges of assistance to bail out governments and international banks that made bad loans to the predecessors, the Communist predecessors.

The American taxpayer would, I believe, be shocked to learn that the scarce resources that could otherwise be available to construct democratic and free-market institutions in these newly independent states might instead be diverted to old creditors. I think the American taxpayer would, in addition, be shocked to learn that the newly independent states are being forced to divert their energy, their savings, their investments, not toward building new infrastructure and new economies for the future but towards satisfying a legacy of debt that their old Communist repressors incurred with the assistance of these old creditors.

Such ill-advised funding to an unreformed economy during the Gorbachev years increased the Soviet Union's indebtedness from an estimated $30 billion to $70 billion or more. That is one of the numbers we are going to be searching for from this astute panel here today, exactly how much is this external indebtedness.

No one knows where this money went. Thankfully American banks, reeling from the Third World debt crisis and recognizing the risk, extended limited credit relative to their European counterparts.

Future loans to the newly independent states should accord with standard lending practices and contain performance conditions so that we can see in concrete terms what we are getting for our money.

The subcommittee called this hearing on such short notice to highlight the importance of the Soviet debt issue and to ensure that views on debt rescheduling and relief are aired before the debate and vote on the President's assistance package. I, myself, just returned from a fact finding mission to Russian, Ukraine and Lithuania.

We challenge the panel today, and I hope that you would be, not to just educate the Subcommittee but to explain to the American people why they should be interested in the Soviet debt problem. We encourage you to be provocative, thoughtful, gutsy in answering our questions.

The purpose of the hearing is to explore policy options available to the administration, G–7, and international financial institutions and the implications of these options in terms of our own security interests, economic recovery of the former Soviet Union and the broader subject of international debt.

We should explain that the administration is not represented on the panel because of simple scheduling difficulties occasioned by the short notice of this hearing. I did not want to delay the hearing for reasons of urgency that I have already mentioned. The administration has no shortage of forums in which to present its view, but experts who can present us independent assessments of the administration's policies may have some of those limitations. So in other words, take advantage of it when you have it; and I have you today.

I feel very fortunate that all four of you consented to be here. I think it's a distinguished panel. Roger Robinson, President of RWR, Inc., former Senior Director of an International Economic Affairs at the National Security Council from 1982 to 1985; Karin Lissakers, director of international business and banking studies at the School of International and Public Affairs at Columbia, previously serving as Deputy Director of the Policy and Planning Staff for the Economic Affairs in the State Department; Donald Green, managing director of PlanEcon Capital Group. Mr. Green served as executive vice president of the Mercator Corp. from 1988 to 1991 and before that worked at Chase Manhattan Bank; finally, Peter McPherson, executive vice president of Latin American and Canadian Division of the Bank of America. Mr. McPherson previously served as Deputy Secretary of Treasury from May 1987 to 1989 and Administrator of the AID program at the State Department from 1981 to 1987.

Let me welcome all four of you to the subcommittee. I do appreciate you taking the time to share your thoughts with us today. The way I would like to proceed is I'd like each of you to take maybe about 10 minutes to summarize your statement and then we'll move to questions as quickly as possible. Hopefully, we'll have about an hour and a half to make this hearing produce some important information.

So let me begin maybe with Mr. McPherson. Oh no, let me given with Ms. Lissakers and move from right to left. If you want to, all of you, when you speak pull the microphone in front of you, that would be very helpful. Again, I am deeply appreciative that you'd take the time to share your views.

[The prepared statement of Senator Bradley appears in the appendix.]

STATEMENT OF PROF. KARIN LISSAKERS, DIRECTOR, INTERNATIONAL BUSINESS AND BANKING STUDIES, SCHOOL OF INTERNATIONAL AND PUBLIC AFFAIRS, COLUMBIA UNIVERSITY, NEW YORK, NY

Ms. LISSAKERS. Thank you, Senator.

I commend the Committee and Senator Bradley for taking up the subject of Soviet debt because I think it has been neglected in the debate about how much aid and what kind of aid to give to the former Soviet republics.

Indeed, I would say that Western policy on the debt issue has undermined our broader policy objectives in the former Soviet Union. The republics should have as their top priority now to rebuild and modernize their economies and to halt the plunge in living standards which is undermining support for democratic reforms and leading to social unrest.

Instead, under heavy pressure from Western lenders, they have been forced to give priority to somehow garnering the hard currency necessary to continue servicing the external debt of the former Soviet republic.

So at a time of extreme shortages of even the most basic goods for domestic consumption, the former Soviet republics have actually been running a trade surplus in the last 2 years, to earn hard currency for debt servicing.

They were warned that unless they did so they would lose all access to Western credit—lose "credit-worthiness." The regime has also been required to exert drastic measures to try to get government's hands on hard currency and to centralize control over hard currency flows.

Moscow has imposed heavy export duties on raw materials and put heavy taxes on new private enterprises. They have required enterprises that earn hard currency on exports to sell 40 percent of those hard currency earnings to the State at a very artificially low exchange rate. The result, not surprisingly, is that exports have declined. And the new private sector enterprises for which access to Western goods and Western credit is essential if they to are to grow and prosper, and get out from under the State, are suffocating. These enterprises are being choked off as a direct result of the pressure on the debt front.

Not surprisingly, another result of the debt squeeze is massive capital flight. The bankers that I have talked to say it is rampant, anybody who can get his hands on hard currency is as quickly as possible putting those hard currencies outside the country. That, of course, worsens the balance of payment situation.

The pressure on hard currency is also discouraging Western investment. Any foreign investor who looks at the situation and says this is an economy that has an acute shortage of hard currency and is likely to have it for an extended period until this issue is resolved says, where am I going to get the hard currency to convert any profits I may make on my investment to repatriate them back home. If I cannot repatriate my profits, what is the point of making the investment?

So the desperately needed capital flow from the private sector of the West which would play a major role in the revitalization of this economy is being deterred, again, because of the debt situation.

Now despite all these drastic measures, of course, we have seen in recent days from the IMF reports that the hard currency situation is desperate. I think Russia has reported hard currency reserves at $12 million.

Senator BRADLEY. Twelve?

Ms. LISSAKERS. $12 million, according to the Financial Times the other day.

Now last November the Western creditors agreed to a short-term moratorium on principal repayments. The Soviet republics were supposed to continue paying interest. They have been unable even to maintain interest payments. The Institute for International Finance, which is the multinational banks' arm here in Washington reported that interest arrears on their claims on the Soviet republics amounted to $400 million just for the months of January and February of this year.

There are also other huge arrears that have been less visible. Because in this effort to get enough hard currency for the center to pay its medium term bank and other obligations, the Vnesheconom Bank, which was the only funnel for hard currency payments to the West, apparently plundered the accounts of enterprises that had bought exports from the West on supplier credits.

Senator BRADLEY. Who did?

Ms. LISSAKERS. Vnesheconom Bank, which was the Soviet bank for foreign trade and investment, which was the only official arm authorized to make financial transfers, hard currency transfers, to the West.

Any enterprise that wanted to pay its bills from the Western supplier had to pay through Vnesheconom. I was told when I was in Moscow last summer that payments made by Soviet enterprises into their accounts at Vnesheconom for on-payment to Western suppliers were disappearing. And the strong suspicion on the businessmen's part was that the funds were disappearing into the government accounts so the government could say that it was staying current on its payments.

Consequently, there is a huge build-up of supplier credit arrears on the order of $5 to $7 billion. The result is, of course, that no Western firm will extend new suppliers credits and most of the Western government export credit guarantee agencies have cut off coverage because of these huge arrears.

Now, of course, the West has committed in principle to a substantial aid package. And clearly the creditors, particularly the banks, hope that this aid will facilitate the payment of debt servicing. The IIF issued a statement a week and a half ago saying, "Access to the resources of the international financial institutions should be contingent upon clearance of existing arrears and maintenance of full and timely payment of debt service to all creditors."

Well, I have to say that we have been down this road before, and Congress has been down this road before. It seems to me we are replaying the Latin America scenario to a tee and making all of the same mistakes.

Congress voted more funds for the World Bank and for the IMF to help Latin America and other developing countries service their debt. If you look at the World Bank numbers for the period from 1982 to 1988 developing countries paid out to commercial banks $183 billion more in debt servicing than they received in new loans from those banks. A big chunk of those interest payments to banks came out of the so-called development aid funds.

At the end of this period where were we? Were those countries credit-worthy? No. Their debts had doubled. Their economies had been depleted of investment capital. Foreign investment had completely dried up and the banks, of course, were not lending them a penny because they were still not credit-worthy.

This is a black hole. If you open the tap of official aid without simultaneously dealing on a comprehensive and long-term basis with the debt issue you are just pouring money down a hole. It will not solve anything.

I think there should be a long-term debt restructuring that would cover both official loans, which are now substantial when you include the commercial loans that are guaranteed by governments, Western governments, and the commercial debt. I also think the debt should be broken up ~~according~~ to individual republics. I think it is folly to try to maintain a centralized debt structure when the Soviet Union is broken up into sovereign entities.

I do not think the smaller republics, given their hostility and suspicion toward Moscow, that they will pay in the hard currency, even if they have it, for debt servicing through Russia. And I think that if we put them in a situation where they do not pay then, of course, all the republics, the republics who may be able to pay the bills, will be damaged by the inability or the unwillingness of other republics to pay. So that everybody will suffer if one fails to pay.

I think this is a formula for increased tension in the region. What will happen is the smaller republics will hide behind the Russian skirts. The Russians then will be in a position of having to put pressure on them to pay up which will only exacerbate the political and social tensions in the region.

I think it would make sense to convert this debt into bonds as was done with Mexican and other Latin debts and to break up the bonds so that you allocate the debt according to the formula that I gather already exists for payment. And you have Kazakh bonds and Kirghizian bonds and Russian bonds etc. That way both the secondary debt market and the creditors can identify who is paying and who is not. And those that are paying can be rewarded and those that are not can be sanctioned.

I think that Congress should take a firm position on this and not repeat the mistakes that were made with Latin America, and simply insist that if there is going to be more—if you are going to vote more resources for the IMF and the World Bank it should be contingent on a comprehensive restructuring.

Senator BRADLEY. Thank you very much, Professor Lissakers. I appreciate your comments very much. I think they are right to the point, very precise, and exactly within the 10-minute limit.

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

Senator BRADLEY. Mr. Robinson, you have a very good example to follow.

Mr. ROBINSON. Too good, I am afraid, on time.

STATEMENT OF ROGER W. ROBINSON, PRESIDENT, RWR INC., WASHINGTON, DC

Mr. ROBINSON. Mr. Chairman, I, too, think you deserve substantial praise for your ongoing attention to the critical issue of Western capital flows to the former U.S.S.R., particularly your concerns over the lack of discipline, conditionality and transparency associated with such flows during the Gorbachev period.

Your unanimous Senate resolution of June 15, 1988 calling for this issue to be prominent on the agenda of that year's G–7 Toronto economic summit is illustrative of that visionary concern. Had the industrialized nations listened to your advice we might not now be confronting this financial disaster, the consequences of which, as usual, will be primarily shouldered by American and other Western taxpayers.

I also strongly associate myself with the insightful remarks of Dr. Lissakers and indeed appreciate the opportunity to again appear before the Committee.

In the interest of time I will skip a summary of my prepared testimony and instead use the time to address specifically the questions you posed in your very thoughtful letter of April 24. They concern the crushing debt burden the democratically-minded Soviet successor states have inherited from Mikhail Gorbachev and what we should do about it.

As you know, one of the principal stumbling blocks in the effort to assess how best to manage the tragic legacy of financial mismanagement of the Gorbachev era is the lack of data on the precise amount of debt owed to Western and other creditors—that is, including hard currency owed to Soviet entities and East European countries.

Similarly, there is no accurate accounting of assets, at home or abroad, of the former U.S.S.R. Not surprisingly, therefore, Western and Russian estimates of total debt, for example, owed by the former Soviet Union vary by as much as $20 billion. What I think we do know is that the long-term restructuring and growth of democratic governments and market-based economies in the former U.S.S.R. would be severely impeded if not actually derailed in the absence of multi-year debt rescheduling of virtually all principal and interest due official Western creditors and at minimum the principal amounts owed to commercial banks over the next 4 to 5 years, probably longer.

In addition, the banks should be encouraged to make significant reductions in interest rates on past loans on a voluntary basis or pursue the concept just expressed of converting the debt to bonds of the individual sovereign nations, also a very fine idea.

To date, the administration has focused its attention on mobilizing new money flows and a ruble stabilization fund with only a meager serving of debt relief. This approach is exactly the opposite of what should be the case. It is essential to allow qualifying Soviet successor states to retain the bulk of their hard currency earnings annually so that they can finance priority, growth-inducing imports and maintain the overall momentum of reform.

At present, however, of the some $16 to $20 billion in principal and interest owed to Western creditors this year only roughly $5.5 billion in such repayments are earmarked for debt rescheduling. That means, notwithstanding past denials by the Secretary of State Jim Baker and other Bush administration officials, that new bilateral or multilateral money flowing into the front door of the former Soviet Union will quickly exist the back door, primarily sluicing to European governments and banks.

To illustrate this point Harvard economist Jeffrey Sachs recently argued in a letter to the New York Times that of some $15.6 billion in Western assistance flows to Russia in 1990–91 about $13.1 billion was paid out to creditors. In short, the administration's current debt relief strategy is woefully inadequate and should be rejected by the Congress.

The G–7 nations, including the Bush administration, have repeatedly demonstrated their nostalgia for the Gorbachev days of one-stop-shopping with Moscow Center. Not coincidentally, such actions as have been taken to date on debt rescheduling remain highly centralized. For example, the G–7 has sought to designate one Moscow-based institution to handle all debt service activities and demanded joint and several guarantees binding one former republic to the other.

This shortsighted approach is neither desirable nor, as a practical matter, possible under present circumstances. Each successor state faces unique economic and financial circumstances, not to mention the sovereignty issue, which simply must be taken into account by Western governments and banks.

For example, debt rescheduling may be adequate for resource rich nations like Russia and Ukraine, but still beyond the means of certain Central Asian republics which may eventually require even select debt forgiveness.

It is also essential that the desire of the G–7 countries to transfer the primary responsibility for economic and political transformation of the former Soviet landscape to the IMF and other multilateral institutions not merely facilitate the payout of commercial banks at the direct expense of U.S. and Western taxpayers.

Instead, to the extent possible debt rescheduling should be undertaken on a pari passu or equal treatment basis between official and private creditors. Not surprisingly, if the commercial banks are going to consider offering Soviet successor states access to private Western credit markets and permitting them to establish stand-alone credit-worthiness, such lenders will be far more sensitive to receiving periodic interest payments on past debts than sovereign lenders need be.

The smaller the disparity, however, between the rescheduling terms reached by Russia and other Soviet successor states with Western governments on the one hand and banks on the other, the less likely we are to be reading disturbing stories about a "bank bail-out" at taxpayer expense in the near future.

In terms of the priority and pacing of aid flows, conditioned debt relief should be undertaken at once, even before the structuring of a ruble stabilization fund. The fact is that economic reform measures required for a successful stabilization fund have not yet been fully implemented with the most glaring example being the continued printing of money to meet misguided social, safety net "objectives."

In parallel with such debt relief, a related initiative requires priority attention. You hear almost nothing about it. The G–7 nations respective intelligence services should be tasked to work cooperatively in coordination with the Russian Government to identify and locate the billions of dollars reportedly transferred to secret accounts in the West and possibly Eastern Europe by the August coup plotters and the Communist party during the Gorbachev era.

Such funds estimated to be in the range of $4 to $14 billion are urgently needed to alleviate the hard currency liquidity crisis now afflicting the former U.S.S.R. as reserves are virtually exhausted. Their immediate return to the successor governments could also dismantle a possible war chest of secret funds which could be used by Gorbachev or some other authoritarian figures to finance a return to power.

In conclusion, the G–7 strategy to date for managing the untenable debt burden of the former Soviet Union embodied in the Memorandum of Understanding with a group of creditor countries has fortunately been overtaken by events. It remains appropriate that the debt be equitably divided among the former republics along with what little remains of the hard currency assets of the ex-Communist state.

Individual rescheduling arrangements should proceed on the basis of each sovereign state's ability to repay and in light of its progress and needs in affecting wrenching structural transformation. Any final attempts by the G–7 to resuscitate "unified" repayment and guarantee mechanisms should be abandoned, including the notion of joint and severable liability.

The narrow self-interests of Western governments and commercial bank creditors must instead be subordinated to the construction of democratic and free-market societies in the territory of the former Soviet Union. After all, Mr. Chairman, you and some others of us pleaded with these same Western creditors for greater caution and discipline during virtually all of the Gorbachev years, only to be dismissed by those who bet on continued authoritarianism and disastrous central control.

Thank you.

Senator BRADLEY. Thank you very much, Mr. Robinson, for your testimony. Again, right on the money—9 minutes.

[The prepared testimony of Mr. Robinson appears in the appendix.]

Senator BRADLEY. Dr. Green?

Dr. GREEN. I get his minute I hope.

STATEMENT OF DR. DONALD W. GREEN, MANAGING DIRECTOR, PLANECON CAPITAL GROUP, INC., NEW YORK, NY

Dr. GREEN. Thank you, sir.

What I would like to do is shift the direction a bit and just initially report on some analysis that PlanEcon staff has been doing in the last month. We have been endeavoring to prepare an objective outlook for the next 5 years for the territory of the former Soviet Union. In that we have had to reconsiaer our own assessment of the different republics and their prospects, the reform programs in place, and also how the assistance program is going to work out.

I have submitted into the record a summary of the major conclusions of that report. Let me just summarize a few points.

The first is that regardless of how much Western assistance flows to the territory of the former Soviet Union we are going to have a dramatic decline of measured economic activity in all of the republics. In some of the republics we will see particularly acute adjustments in 1992 and 1993 and we are thinking particularly of Ukraine, Belarus and the Baltic, where the price shock and the dependency upon deliveries in the inter-republican account from Russia are most crucial to the operations of the industrial sectors.

Even though this decline which may be 30 percent in our estimates over 2 years—and that is on top of 10 to 15 percent decline already observed in the area—that sounds like a tremendous amount and it is. But the point with respect to consumer welfare is that then those numbers are really exaggerations. They do not represent a comparable decline in the standards of living of average citizens on the territory of the former Soviet Union.

What is quite likely to be the case is that the impact on real incomes of particular segments of the population will be much greater than that; and that the capacity of those societies in their present transition to an affect protect their own endangered citizen groups is probably going to be inadequate without considerable technical assistance from the West.

The second point is that we really should feel fairly fortunate about developments in Russia, that the position of the Russian Government and its prospects for economic reform are actually not that bad in the near term and that situations both with regard to the position of this largest republic and with the character of its government, we could have come out much worse in 1992 than we have.

That, in fact, this Russian Government has been highly courageous in terms of moving to tough decisions; and it is learning the process of trying to politically compromise with certain segments of its own society, and particularly the large enterprise sector and the large collective farm sector, those elements that are strongly represented in the Parliament today.

But that the important thing about Russia is that its external account position is likely to be much stronger than most people recognize, not only that its export position with regard to the world economy is likely to be stronger than most of the projections that we have seen elsewhere, but its position on the inter-republican accounts is also going to be strong.

As the trade between Russia and other republics moves to world market prices, partially or completely in the next several years, in fact, there is going to be considerable assistance which will be required to support other republics in dealing with the energy shock they face on the external accounts and a lot of the revenue is going to pass through in effect to Russian accounts, to the Russian official reserves and Russian banking agencies.

So we should not wring our hands in gloom about the prospects for Russian ability to restore credit-worthiness by the mid-1990's. In fact, I would think that that is really our objective here as we talk about what Western assistance and what the international organization should be doing. They should really want to see Russia emerge in the mid-1990's as an evolving, emerging market with embryonic democratic institutions that is in fact restoring credit-worthiness; and it cannot do that without maintaining a relatively secure external account and rebuilding its official reserves which will enable it in effect to stabilize its own internal currency.

The prospects for the non-Russian republics are much more severe in the near term; and I would just comment that we think Ukraine, in fact, will be one of the most severely affected in 1992 and 1993. This is partly because of the way in which it has postured itself with respect to the Russian republic, but it also because of its objective circumstances. It, in fact, is not resource rich. It, in fact, has an agricultural base which produces goods which the world market really is not too interested in absorbing.

We have agricultural surpluses in the world market for almost everything Ukraine can supply Russia. Its coal base is declining. It is coal that is going to have to be contracted over the next several years.

And in this process Ukraine external accounts are going to be severely affected in 1992 and 1993 in our view.

Let me move to the issue of the scale of Western assistance. I really think the important issues here, we have looked at this to what we think will unfold in the coming years. In that context the sort of megabillion packages that get talked about by officials of Western governments by international organizations really are unrealistic. They are not accurate as to what, in fact, will be the net resource flows.

The point was made earlier that many of the developing countries in Latin America in effect had reverse net resource flows as they were working out of their debt and as they were working out of their statism and into more market-oriented economies.

In fact, we may well see that net resources to Russia will not be on the tremendous magnitudes of $20–$25 billion a year. We think they will be less than $10 billion a year over the next 3 to 5 years. And that the more acute needs will be for finance provided to the non-Russian republics who are adjusting under this transition.

I have spoken elsewhere about the issues of resolving Soviet debt and I have submitted another position paper which was done earlier on the principles that I think underlie that. I think we have in effect missed an important period for acting with respect to resolving the debt.

We have moved ahead with IMF membership and World Bank membership and that is in order to establish stabilization programs and begin the process of releasing funds to those republics that are desperately needy on their external accounts.

Again, I would stress I do not regard Russia as being desperately needy at the present moment or in the year to come. This process of resolving the debt was not really placed on a high priority during this membership process and a lot of leverage has been exhausted by virtue of moving ahead with membership without facing that issue of actually resolving and separating the debt at the republican level and dealing with the reverse problem which has to do with the restructuring of the obligations to the creditors on this side, not only on how much debt relief that there will be.

I would agree with Roger, there was a lot that should have been done with regard to the structure of debt relief that would be conditional upon reforms and performance over the next several years But I think also we need to restructure the composition of the obligations outward from the former Soviet Union, from the republics back to the creditor community in a way that will meet the practical objective of returning as many of those republics to credit-worthiness by the mid and late 1990's as we can through the effect of coordinated policies.

I do not regard that still as a hopeless task. I think there is a need now that membership is an accomplished fact and the international institutions that, in fact, we can still connect the separation of the debt and the redocumentation of obligations to the actual stabilization programs that proceed beginning the mid-year for Russia and the programs that are already on the horizon for the Baltics.

But I think we ought to really address that practical objective, rather than deciding which creditors do we gore in this process. I really think that would be the wrong objective. We are not talking about commercial obligations that are of a tremendous magnitude outstanding. In fact, the banks moved aggressively during the Gorbachev period, toward the end of the Gorbachev period, in effect to cut their own losses substantially in this market.

But I think the objective really is what are the most practical steps to restore Russia first of all, the Baltics, those other republics that look like they can become credit-worthy in the second half of this decade and structure our policy toward that objective.

Thank you.

Senator BRADLEY. Thank you, Mr. Green.

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

Senator BRADLEY. Mr. McPherson, the floor is yours.

Mr. MCPHERSON. Thank you.

STATEMENT OF M. PETER McPHERSON, EXECUTIVE VICE PRESIDENT, BANK OF AMERICA, SAN FRANCISCO, CA

Mr. MCPHERSON. Let me first of all say that Bank of America, the bank for whom I work for, has had a little exposure in the U.S.S.R. a few years ago, cut back substantially, and then we eliminated all that exposure, let it all run off. With the merger of Security Pacific last week we picked up some small amount of exposure and in connection with that merger, in fact, wrote down that debt further.

So we had very little debt, but nevertheless we became the American bank on the Bank Advisory Committee working with Russia and the other republics and, in fact, are the chair of the Economic Subcommittee of that committee. In part, I think, because we were viewed by the European/Japanese banks, the big creditors, as a neutral party because of our small exposure and because of our long experience in the Brady plan negotiations. So that is a background of our own bank.

Let me make a few quick comments and then obviously get into this question of how you handle the debt itself. First of all, I support the U.S. Government's position in the IMF, which is basically a thrust to Russia concerning deficit reduction, controlling money supply, more market exchange rates, rapid privatization and so forth.

I think there is this balance that has been hard to work through between an immediate hard adjustment program versus hardship to the people of that country. Nevertheless, there frankly was not much option since the outside resources were not to subsidize a more gradual adjustment. Moreover, the 1991 rapid printing of money to finance a slower adjustment was a used up option, as by that time inflation in 1991 climbed to 3 percent a day.

So hard as it is, I think this rapid adjustment is really the only option, and I think the G–7 government putting in a fair amount of food is an appropriate measure. In short, I think what is attempting to be done is wise.

I would make a comment about the Stabilization Fund. I am a little uneasy about how it will actually go into operation because I think that before it is put into use deficits and money supply must be better under control, and that there has to be significant movement toward market prices on exchange rates. Only when the underlying economics are moving toward more or less some degree of stabilization will the exchange rate stabilization fund provide the further insurance or stabilization that we are after, instead of just allowing the money to run through the Fund and going on to speculators.

I think the experience in Czechoslovakia and Poland, for example, suggest how to handle this. I think we know a lot about it, but I just would caution that that fund should not be a kind of a subsidy but rather should be handled with great care and only come into play when things are a lot more together.

Let me talk about debt reduction. I guess I am the only banker here this morning. So I may have somewhat distinctive views on some of this.

Senator BRADLEY. But that is why we wanted you to be here.

Mr. MCPHERSON. I appreciate that, Senator.

Senator BRADLEY. Because we know how articulate you are.

Mr. MCPHERSON. I appreciate that you have been interested in this topic for a long time. I hope I can help this morning.

We have had a lot of experience with this debt reduction program. The debt reduction activities, and the restructured debt, have been one of my major responsibilities since I went to Bank of America in 1989. Our bank was a principal developer of the Par-bond option under the basic Brady plan context; and I personally chaired the subcommittee in the Venezuela negotiations that did the debt reduction options there.

I think that it is important to look at this as a question of not which creditor or group the creditors to gore, whether it be official creditors or banks or suppliers or whatever, as my colleague to the left mentioned a moment ago, but really to think through how we can handle the situation so as to best provide market access for capital because, in fact, we all know that the official sector can no-where near provide the capital requirements that are going to be necessary.

I saw that first-hand again and again when I ran the U.S. foreign aid program. We were just a mere smaller component of the bigger picture of capital requirements which are necessary. So with the goal in mind of providing capital liquidity in these markets, and again stating that we, Bank of America, have a very small stake as an institution in this, let me go into it.

First of all, I think what we have in the Soviet Union and Russia at this hour is a liquidity problem at a minimum. Clearly, it may be much else, but at least we know we have a liquidity problem. We know, for example, that a very few years ago that the Soviet Union was producing about 12 million barrels of oil a day, exporting 3 or more of those. Now they are down to 9 million or so of production. Exports are down substantially. There probably would be substantial conservation in the country because higher costs are being passed on to the consumer.

Nevertheless, it would appear that because of organizational problems, structural problems within the country, there is a massive reduction of export earnings and great potential for higher export earnings in the oil sector. This contributes to the fact that there just is not a lot of money available for the central government to do things, as my panelists have commented upon.

Indeed, there is real danger that Russia is moving towards sort of a Peru-style 1980's "hand to mouth" gridlock. You can only purchase things when you have cash in hand. That has just a decimating impact upon businesses which cannot buy the part for the rig that they need to drill the oil and on and on. A hand to mouth situation will have a big impact upon growth rates.

The lack of current ability to pay things and not paying them is evidenced in a lot of places. For example, the German Government last year provided 5 billion Deutschmarks through the commercial banks in Germany, but basically it was a German Government loan to clear up some supplier credits—not banks, but supplier credits—in Russia. This month the Russians were unable to make a payment of interest on that DM5 billion loan. This was the Hermes, their export/import bank, which was involved in all this. And there is a DM5 billion additional Hermes loan that may be held up because of the inability to pay interest on this loan of last year.

You are seeing that all over the world. We are beginning to approach or we could approach a kind of gridlock in finance. So I would say first of all we have a liquidity problem.

Now what do we do about the longer term situation? My observation frankly is that debt deals for permanent solutions are best negotiated when an economic program is in place, has been in place at least a little bit. You have some stability. You know what you have at hand.

It is for the same reason that it made a lot of sense to negotiate a deal with Mexico in 1989 when the economic program was in place and underway; and it made very little sense to negotiate something in Argentina for that year and the couple years thereafter. It took until 1992, more or less, where as to the economy, you knew what you had. We then could structure a long-term program that the country could afford, that was reasonable for the banks given the difficulty of the country, and we gave a 35-percent reduction on that deal just a few weeks ago.

So I would suggest that this liquidity issue is a matter of major focus and for a longer term approach we need to see more what we have.

Now what kind of contributions do I think the banks could make to the current liquidity situation? The banks are owed substantial interest month-by-month, none of which is being paid at this juncture. But I think that we might think about a very different approach than has been done previously. That might also help the liquidity situation. In fact, I would suggest this is an idea that has not been talked about publicly.

Indeed, I guess I would think might be my major contribution to your hearing this morning, Senators.

Senator BRADLEY. This is the news.

Mr. MCPHERSON. This is an idea which I think has some value.

Senator BRADLEY. Okay.

Mr. MCPHERSON. That is that we should consider——

Senator BRADLEY. We are not going to cut you off at this point.

Mr. MCPHERSON. Thank you, Senator.

The banks, I think, should look at the possibility of receiving some portion of their interest, past due or current, in the form of local currency with the obligation understanding that that would be lent on directly by the banks to entities in Russia or alternatively lent on to the new Russian private banks who would in turn lend it to their customers.

We would think in terms of getting paid back ultimately, over a number of years probably, in hard currency. We would want to be sure we have an exchange rate agreement, so that we would know what that soft currency is worth to begin with. But in short, it seems to me that banks have a contribution to make in terms of credit judgment and skills deciding who should get money, who can use it efficiently for greater productivity. There is a need for liquidity in that market. And such an approach of payments in soft currency would be helpful.

In addition, it seems to me we ought to look at the possibility of receiving some of our interest payments in the form of equities.

In short, Senator, I think that there are some contributions that can be made. These will be largely made by non-U.S. banks because the U.S. banks, including Bank of America, have such a small amount of total exposure.

Thank you.

Senator BRADLEY. Thank you very much, Mr. McPherson, for your usually thoughtful testimony.

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

Senator BRADLEY. Before we begin questions I would like to recognize Senator Hatch for any comments.

OPENING STATEMENT OF HON. ORRIN G. HATCH, A U.S. SENATOR FROM UTAH

Senator HATCH. Thank you, Mr. Chairman.

I am happy to welcome all of you here. I am happy to be here and listening to your testimony. I would like to ask that my statement be placed in the record. So far it seems to me that there are some grounds for encouragement because the Yeltsin economic team has put a shadow economic reform plan in place this year.

To me, the results were impressive, a lot better than I thought. The budget deficit according to what I understand fell from 20 percent of GNP in 1981 to 8 percent at the present. The last quarter's budget was in balance as the country delayed cast disbursements on low priority items. The price liberalization which the entire West had challenged the government to launch crossed what I believe to be a major threshold, causing retail prices to rise 500 percent before beginning to settle.

But I also notice there is a restlessness among the Russian people. Last evening I had the privilege of having supper with Mayor Subchuk of St. Petersburg. He was very optimistic. But he also said that they have a year, year and a half, 2 years and if they do not get inflation under control and spending under control and the economy under control that the Democrats could be very easily voted out.

We asked him what the alternative was and he said it would be dictatorship. He could not even speculate as to what form of dictatorship that might be. So it is in the best interest of all of us to understand these problems.

Therefore, I want to compliment the Chairman for being willing to hold these hearings and to invite you to come and testify to enlighten us so that we can at least help the American people to know what we need to do; and that it is in everybody's interest to do whatever is best under the circumstances to help this country, this commonwealth of independent states out so that we do not have a dictatorship, so that we do not have this loss of democratic principals that so many of us have fought so hard to achieve.

Also, at that dinner last night was the head of the Democratic Institute under the National Endowment for Democracy. They have been working over there for a number of years. I want to compliment them for the work that they have done, as well as the Republican Institute, all over the world because that is what has helped to bring about these democratic changes.

So again, Mr. Chairman, I am grateful to you for holding these hearings. I have to leave in just a few short minutes, but I want to listen as long as I can.

Thank you, Mr. Chairman.

[The prepared statement of Senator Hatch appears in the appendix.]

Senator BRADLEY. Thank you very much, Senator Hatch.

Well, I found your comments extremely interesting. I detect in your recommendations a sense of urgency about the issue of debt and a sense of the direct importance of the resolution of this issue to the possibility of success in all of the other economic issues. I think that interconnection is really an important point to make.

I would like to, if I could, kind of ask each of you a series of questions and then all of you a series of questions, if I could.

Let us start with Mr. Robinson. What do you make of the recent setback in reforms that occurred in the last several weeks in the Congress of People's Deputies, in particular the decision to increase pensions, the decision to subsidize certain sectors of the economy and to make credit much more loose?

How do you think that affects our discussion on the issue of debt?

Mr. ROBINSON. Well, first, Senator, I think that——

Senator BRADLEY. Whenever I ask any one person a question, if others have a pressing need to contribute to the discussion, just raise your hand and we will get you to chime in.

Mr. ROBINSON. I think, Mr. Chairman, that it reflects the very uneasy dynamic that Mr. Yeltsin struggled with just a fortnight ago when many of us in the West sat very tensely watching whether a Communist-dominated parliament was going to succeed in derailing or substantially slowing the Yeltsin political and economic reform effort.

Yeltsin and his colleagues did, in effect, beat back that effort to some extent. But there, as you just noted, was significant slippage in terms of reform milestones. Not only did we witness new subsidies to inefficient state-owned enterprises but we still did not see the institutionalization of private property. We have not seen the massive privatizing of government monopolies. The money supply is still not under sufficient control. And the military-industrial complex has not been dismantled as quickly as it should be.

So leave it to say that the Parliament did do damage, in my judgment, to the Yeltsin pace of reform. I saw today in the Washington Post an article that had Yeltsin suggesting that a national referendum is urgently required to replace that failed Communist legacy with a presidency of the kind we have in this country.

I support that effort as soon as Yeltsin feels he is strong enough to go to the people of the former Soviet Union and make that happen. Otherwise, he remains in a very precarious situation.

I would only conclude by saying, this is a warning to the West, as I made clear in my full testimony, that the reform effort remains fragile and more reversible than many people assume. If you listen to the Bush administration, they will declare the reform effort irreversible. I fundamentally disagree with that observation and we have to watch it carefully.

Senator BRADLEY. And its connection to debt?

Mr. ROBINSON. Well, the fact is that we still have witnessed insignificant progress on debt relief relative to what is required. When you look at the very parsimonious approach to rescheduling principal only for 1992, almost going quarter-by-quarter, no visionary multi-year approach is evident of the kind that would give a lease on life to the beleaguered hard currency cash flow needed for imports and other reform measures.

That is the single greatest failing of the G–7 aid package.

Senator BRADLEY. How much debt relief is enough in your view?

Mr. ROBINSON. I think 100 percent of principal and interest on government debt, remembering that this is something that the governments can do. In the case of private banks, as Mr. McPherson and other bankers I am sure would attest—and I was formerly an international banker myself with Chase Manhattan with responsibilities for this particular portfolio of the former U.S.S.R. and Eastern Europe for a 5-year period—there will need to be some periodic interest payments in one form or another probably required, but on a substantially reduced basis. All principal on the commercial bank debt should likewise be rescheduled for a minimum 4 to 5-year grace period. This would permit the bulk of that $16–$18 billion due this year and next to be dedicated to preserving and advancing the reform effort, not going into the pockets of undisciplined official and private bank creditors.

Senator BRADLEY. Let me ask Dr. Lissakers, you made the very clear point that you should go from debt to bonds. I mean, is this time frame the time frame that you would like to see the debt transferred to, to a 5-year period, or would you like to see a much longer period?

Ms. LISSAKERS. It may be that one would have to structure the rescheduling to differentiate among the republics. I mean, I think that is the consensus of people who know more about the Soviet economy than I do. It seems to me that Russia's payment situation could improve quite rapidly and quite substantially in a shorter period of time. Other republics might need, you know, a 20-year restructuring.

I think what is important is as we saw in the case of Latin America debt restructuring is really the psychological side—that is to say that both the debtor countries and the outside world have to believe that the restructuring is adequate for the medium term.

I think it is a tremendous mistake just to do a year-by-year moratorium. Because you can say, all right, we have taken care of this year and the numbers are going to work out. But the private sector in particular will look at those numbers and say, okay, that takes care of this year, what about next year? I am not making a 1-year investment. I am making a 20-year investment.

Senator BRADLEY. Right.

And your point was that in the 1980's the developing countries poured $183 billion net above any loans from banks back to the commercial banking sector.

Ms. LISSAKERS. Yes.

Senator BRADLEY. And in the absence of debt relief when you provide aid it simply comes right back to banks and that is why you need the restructuring?

Ms. LISSAKERS. Yes.

In this case, obviously, you have a much larger official component. I absolutely agree with Mr. McPherson, the issue is not who are we bashing but the question is how do you put these countries on a sustainable payment path. I think the idea of converting payments into local currency may be a very interesting one because you would be putting—particularly if you put the resources back into the local economy and particularly into the new private sector in that economy. I think that would be highly desirable.

I think it matters a lot how we do this. It is not just a question of how do we help them pay their bills, but it is also a question of what the long-term structural consequences of Western aid flows are. I think that debt relief is much to be preferred in a sense because if you were giving cash aid you would necessarily have to give it to the government and then you are reinforcing the centralization and strength of the state vis-a-vis the private sector.

What you really want to do is free up resources in a way that nurtures the private sector and encourages Western private sector involvement and contribution to the economic recovery.

Senator BRADLEY. Now, Mr. McPherson, your idea of the ruble fund has received a positive nod from Professor Lissakers. But I need to understand what you are saying. You are Bank of America. They owe you $100 million. You are saying you do not want to be paid in dollars, you will take 50 percent of that in rubles, but you keep it in an account in Moscow or St. Petersburg.

What is your exchange rate?

Mr. MCPHERSON. You would have to have more or less a market exchange rate. You would be paid "X" number of dollars. Let's not take Bank of America. Let's take a German bank. Because I want to emphasize how little we have. But let's take a——

Senator BRADLEY. No. But I'm trying to understand. Give me the discipline of your recommending. So how is this useful to you?

Mr. MCPHERSON. Okay. The bank is owed $1 million in dollars. You would receive some portion of that $1 million, not in dollars, but in local currency. You would have to agree upon an exchange rate that is more or less at approximately current market. Obviously, a difficult issue.

Senator BRADLEY. On the day the deal was done?

Mr. MCPHERSON. Yes.

Senator BRADLEY. Is that what you are saying?

Mr. MCPHERSON. Yes.

You would then loan that local currency either to a local bank or business directly in Russia.

Senator BRADLEY. You mean, Bank of America?

Mr. MCPHERSON. Yes.

Senator BRADLEY. Would have a little branch there and it would have its money in rubles that would available to loan to entrepreneurs or private farmers or whomever?

Mr. MCPHERSON. Or to multinationals that may want to go into Russia.

Senator BRADLEY. Right.

Mr. MCPHERSON. All over the world, banks make loans in the country where they do not have a physical presence occasionally. So you would make a loan to a company or alternatively there are now a few private banks that have sprung up in Russia that are sound institutions, that appear to be sound institutions, with very short track records obviously.

But they would have a capacity being there in the country with some idea of what is happening obviously to make perhaps smaller loans. So you would loan the money in local currency to that bank, and in turn they would make the loans. Now you would have to have an agreement with whoever you loaned it to that they would pay you back in hard currency. Moreover because you would want to be paid back in hard currency, and it would be a few years probably, you would want to have the activity that they were going to use the money for be an export or hard currency generating activity.

Senator BRADLEY. Now, Ms. Lissakers, you are one of the world's leading experts on the German banking system. Tell me, how do you think the German banks would react to this ruble fund idea as a part of an overall debt structuring? And then basically, what is your assessment of the ability of German banks to write off or restructure a sizable portion of their debt?

Ms. LISSAKERS. Well, the numbers I have indicate that approximately 65 percent of the $22-odd billion the German banks are owed by the former Soviet republics is guaranteed by the German Government or other Western official entities. The German banks moved very quickly. Deutschebank, I think, announced more than a year ago that it was taking a very substantial provision against its Soviet exposure, the non-guaranteed exposure. And I believe——

Senator BRADLEY. How much?

Ms. LISSAKERS. I think they initially said 70 percent. By now, if they are following the pattern they did with Latin America, it is probably close to 100 percent.

Senator BRADLEY. So that in 1 year they wrote off essentially all of their Russian and Soviet debt.

Ms. LISSAKERS. And I think that Dresdner has done the same and perhaps Commerz Bank. Now Commerz Bank was said to have the most unprovisioned exposure. But they have probably followed suit as well. So they are in pretty strong shape. Now there are obviously other banks, state banks and smaller banks, that may still not have provisioned exposure.

But I do not think there is the systemic risk here that Latin America posed to the banking system. Now French and Japanese banks have the second largest exposure. British banks have substantial exposure. And Italian banks——

Senator HATCH. Aren't the Japanese banks not secured at all?

Ms. LISSAKERS. I am sorry?

Senator HATCH. The Japanese banks are not secured at all in any way.

Ms. LISSAKERS. Probably not, because their tax system discourages loan loss provisioning and that may be the biggest problem. It is hard to know.

I do not know—I have not seen any reliable information on the extent to which Japanese bank loans are secured, guaranteed by the Japanese Government.

Senator BRADLEY. But your point is that if the German banks have already written off the bulk of their debt they view any repayment as kind of gravy? In other words, things they had not anticipated and it is going to be that it is going to come in.

So then how would they respond to this ruble account?

Ms. LISSAKERS. I think that they would probably be fairly positively inclined. They have long-term and very broad commercial interests in the East And their clients, indeed, the companies in which they own substantial shares—banks have substantial shares in German industries—and West European exporters and manufacturers are suffering greatly from this payment situation.

Because that is a big market for them which is now lost because the Russians cannot pay and the other republics cannot pay. I think that the German banks have the capacity and a very strong interest in resolving this situation in a way that allows these republics to start importing from European companies.

Mr. McPHERSON. Mr. Chairman, we have advanced this within the Bank Advisory Committee a few weeks ago. While I do not feel free to express the views of individual banks of that committee we have found at least some interest.

Senator BRADLEY. Good.

Now there is a little problem before we get to that, of course. I think Mr. Robinson kind of focused in on the issue, which is joint and several liability.

Would you explain to the Committee how you think the existence of joint and several liability impedes debt reduction?

Mr. ROBINSON. First, Mr. Chairman, as we have talked about, differentiation between these new sovereign nations is essential from several perspectives, not the least of which is the political dimension. Focusing on financial capability, the ability to repay the level of debt that, too, will vary across the former Soviet landscape with Russia being by far the strongest and most of central Asia being the weakest.

A joint and several guarantee—and Don Green is also very well versed on this particular point—tends to create a lowest common denominator feature. That is, the one least able to repay presumably would set the terms. Otherwise, the joint and several guarantee would create sharp divisions among the former republics.

It also tends to be a recentralizing feature. It is akin to the desperate effort of the G–7 to maintain the viability of the former Soviet Bank for Foreign Economic Affairs. They want a unified payments mechanism and the joint and several guarantee is part of that recentralizing trend.

They are not accepting the fact that assets and liabilities have to be equitably divided and that there needs to be individually tailored arrangements.

For example, you could see ridiculous repayment obligations for the destitute central Asian republics who will not see the light of day on economic recovery for a long time. Russia is a far more optimistic case. But we should be in the business of recognizing the new political and economic realities in the former Soviet Union and take advantage of them.

Senator BRADLEY. Dr. Green, do you want to comment on joint and several liability?

Dr. GREEN. Yes.

Let me comment on it in the practical sense again. I do not think it is going to have a substantive effect upon actual debt repayment or interest service in the next 2 years. Because I think from a practical standpoint it is not likely that creditors in effect will be serviced for at least a year and probably 2 years, regardless of what people decide in some room somewhere.

But the point about what goes forward is that what we would like to do is to have Russia see it in their interest to move towards market access, as my colleague from Bank of America says.

When will it be in their interest? It will be in their interest in certain categories of debt sooner than others. It will be in their interest, I think, for Russia to move unilaterally as it has done to save Moscow Narodny Bank in London. I think there are certain aspects of the external situation that can be perceived in Russia's national interests today that to move toward a reasonably quick restoration of servicing on Euro-bond obligations, for example. This would be important for Russia to do. It is a small amount of exposure.

If Russia wishes to utilize the bond market and wants to issue bonds itself, then it should want existing Soviet bonds to trade reasonably close to par. What is left over from the Soviet period is about $1.7 billion in Euro-bonds.

On the issues of other Soviet assets abroad which we have not come back to, this is one of the murkiest aspects of the resolution. As Roger mentioned a lot of assets went in all sorts of places. I would suggest we will never find them. The examples elsewhere in the world of tracking down where capital flight went, and who particularly parked it where and how, are not encouraging. There is a political need to go through that process, but I do not think that helps the liquidity issue.

So in terms of the other assets that the Soviet Union had I expect that title will be gained by Russia, not from simply asserting they own the embassies and they own other things. But, in fact, the title will be cleared in a practical sense with the other republics by virtue of credits extended now on the bilateral trade accounts.

So I would see it in Russia's interest. And that is what we want to do—to set up the incentives correctly so that Russia moves practically and pragmatically to restore its own credit-worthiness for its own long-term national interest. That will make creditors better off than they actually would appear today.

I think if you regard 60 or 65 percent of the Soviet in effect being Russian obligations the ultimate recovery out of that for taxpayers and for commercial creditors is probably far above what the current discount is in the market—30 cents on the dollar.

So the ultimate recovery that will come from this, even though there will be a debt servicing interruption here—will be better than the market currently values the debt and that is as it should be. That is as we have observed everywhere else in the Mexican case and other Latin American cases that the market at a certain stage discounts too heavily the ultimate value of those obligations; and that we should begin to see this as a Russian program takes form, takes command of its own domestic finances, and so forth, and it restores its external accounts. Then we will see the market begin to value those obligations more highly.

Thank you.

Senator BRADLEY. Senator Hatch?

Senator HATCH. Thank you, Mr. Chairman.

As I look at it Russia also has about $32 billion in debts owed to Russia, mainly in North Africa and the Middle East, I guess, about 40 or 50 percent of those debts. But they also have a lot of other debts with Third World developing countries that are unlikely to be paid, too. Or do you think some of those could be paid?

Mr. ROBINSON. Well, my take on that, Senator, is that the answer is no. I mean if we are talking about the value of hard currency debt owed the former Soviet Union by the Third World.

Senator HATCH. That is talking in U.S. dollars, too, probably, isn't it, about $32 billion? Or at least a good 80 percent of it is in U.S. dollars.

Mr. ROBINSON. Yes. I have seen figures that were as high as $60 billion in hard currency owed the former Soviet Union.

Senator HATCH. All right.

Mr. ROBINSON. That was some time ago.

But leave it to say that I think the chances of that debt being repaid are remote, that it would be at most a few cents on the dollar. We know the bulk of that debt was attached to arms sales, which were for obvious political purposes, to destitute entities like Cuba, Vietnam, Ethiopia and the like.

People are talking about this as an asset of the Soviet Union. I think it has been a greatly overvalued asset the way it has been treated and I think it should be heavily discounted.

Mr. MCPHERSON. I would not recommend you buy this in the secondary market, Senator. [Laughter.]

Senator HATCH. I tend to agree with that.

Most of the Soviet Union's debt is short-term debt, mainly less than a year. Is that correct?

Ms. LISSAKERS. Well, as I think we have all agreed, nobody really knows—neither the bankers nor the government lenders nor the Russians themselves. I understand the Russians have hired a Western auditing firm to try to figure out how much they owe.

Senator HATCH. I am talking about the external debt.

Ms. LISSAKERS. My understanding is that the balance is very short-term. Because as with the Latin American borrowers as lenders became more concerned about the debt profile they shortened and shortened the maturities. And, of course, there is this big lump of supplier's credits that were supposed to be repaid in 90 days.

Senator HATCH. Yes.

Ms. LISSAKERS. But simply are not.

Senator HATCH. Well, I said most of the debt. It is really somewhere between 16 and 30 percent of the external debt would be short-term, which puts even more pressure on the Soviet Union under the circumstances.

In your opinion, will any of these reforms that have been suggested, will they lead to a quick departure away from the barter economy that really is taking over the Soviet Union?

Ms. LISSAKERS. I am sorry, would debt relief——

Senator HATCH. Will it lead us away from the barter economy.

Ms. LISSAKERS. Well, I think yes. I think that if one looks at the pattern of the last year and a half where the country basically stopped importing oil drilling equipment, for example, and machinery, I mean crucial for the economy and particularly the industrial sector, that were absolutely crucial to not even raising but maintaining production then that this extreme lack of hard currency has contributed greatly to the break down, to the collapse of this economy.

It is absolutely essential that whatever hard currency they have be used for importing capital goods from the West, not paying debt servicing at this point.

Mr. MCPHERSON. I would like to talk to you about that a little bit. Because first of all they largely have not been paying their debts and I am not sure that it has improved their situation much. You know, Brazil, for example, for years did not pay debt service, to bankers or many others. And frankly it did not help them any. They had the ultimate debt relief.

Peru stopped its payments entirely for years. I think the idea that debt relief is somehow or other a panacea is outside the context of the fact that people do not extend credit to the guy that stiffs them. I mean the reality is that we are moving into a near gridlock of this economy, a hand-to-mouth economy in Russia, and it seems to me that we have got to figure out how to get liquidity in this market.

I think we do not know enough about the situation in Russia to have a long-term permanent program. I think we have to do something about the short-term situation. But we just do not know enough. And frankly, they have not yet established that their economic program is far enough along the line. I mean they have been pretty well moving along in belt-tightening. And belt-tightening politically, as hard as it seems, is a lot easier than the restructuring.

They are not nearly as far along in privatization. I think the lack of debt relief, if you will, in the early 1980's, helped move the Latin countries toward the economic restructuring that we are now seeing in many countries of the continent. And at this juncture Russia has belt-tightened, but not really privatized or restructured. Only then I think can we look at what kind of relief to provide. And there is going to be a big difference as people pointed out here between Russia and some of the other republics. There are going to be dramatic differences.

I think we also need to be careful about chopping off suppliers, for example.

Senator HATCH. Well, if you do not do something to stabilize the ruble and back it, then you are going to have more and more bartering. Would this suggestion for a currency stabilization fund would that, Peter, do you feel that that might be partly the answer?

Mr. MCPHERSON. Well, I think, Senator, that it is important to put it on the table, to get it ready. But I think it should not be used, in my judgment, before there is some greater control over deficits, over the money supply, and that they have allowed the exchange rate to move closer to the market. Otherwise, the money will go right through to the speculators. You could use up a $6 billion stabilization fund in a matter of weeks.

Senator HATCH. Yes.

Mr. MCPHERSON. I think your concerns about the stabilization fund are sound. If on the other hand you can have those economic underpinnings roughly in place, and so by market forces the exchange rate has begun to stabilize, then the operation of the stabilization fund can, in fact, push it a step further.

Senator HATCH. Ms. Lissakers?

Ms. LISSAKERS. Yes, I agree with Mr. McPherson that we are dealing with an extremely complex situation here. Obviously, the debt is not the only or perhaps even the major economic challenge facing these republics. But we do know from the Latin American experience that it is not the failure to pay in full that disrupts the new flow of credit, but it is the lack of a settled and credible arrangement.

It is the illegality of the situation rather than the lack of payment in full. As we have seen with Latin America, once you have a deal, even a debt reduction deal, suddenly Mexico looked creditworthy. Why? Because it had a long-term deal. New investors and lenders can say, okay, that problem is now behind us. It is taken care of and we believe the deal that is there is going to work. It remains to be seen whether it will.

Senator HATCH. Yes.

Ms. LISSAKERS. But nevertheless, there was credibility and there was legality. The problem with the Russian situation now is that there is total uncertainty and there is an expectation that there will be future disruptions in the payment. That is what has to be taken care of. That is what is crucial for them at the moment to regain access to export trade, as someone mentioned, these perhaps $10 billion worth of German credit lines that cannot be drawn because of arrears and disruptions on payments on the previous loans. That has to be settled. And that flow is very, very important now.

Mr. MCPHERSON. This is a very important point to engage in. It is essential to a lot of discussions here. The economic stability——

Senator BRADLEY. Mr. McPherson, can we go to Mr. Robinson? He had his hand up.

Mr. MCPHERSON. Sorry.

Mr. ROBINSON. I just wanted to underscore what Professor Lissakers just said. It is not about unilateral nonrepayment. I mean that is default and there are severe penalties. Commercial banks would instantly cut off credit. We would have the Hermes problem greatly compounded and other adverse consequences.

In the absence of a multi-year cooperative rescheduling arrangement, those debt obligations will still weigh heavily on the leadership of these new fledgling democracies from not only the economic and financial point of view, but I want to insert one other very critical issue here. That is, the need to engage in massive weapons proliferation worldwide.

Remember, if you look at the hard currency earnings of the Soviet Union, 80 to 90 percent is traditionally comprised of oil, gas, arms and gold. We know what happened to oil production. It is in sharp decline, great trouble. Gold, 90 percent of the reserves were announced by Yavlinsky in the summer of 1991 as having disappeared from the scene.

Let us be clear about where the former USSR is going to go, indeed where they are going—massive weapons proliferation—including chemical, biological and even nuclear technologies. This country has recognized the danger when the pockets of nuclear weapon scientists are empty and what it would mean if they are recruited by the Libyans, Syrians, Iranians, and North Koreans. The same is true at the macro level. Countries that get in financial trouble will sell arms to state sponsors of terrorism and this is another reason why debt relief leads directly into a safer world.

Senator BRADLEY. So your argument is the distinguishing characteristic between all the arguments opposed to debt relief for Latin America and the arguments for the former Soviet Union, and that is the massive potential for arms proliferation in order to get hard currency in order to make payments on the debt?

Mr. ROBINSON. We are——

Senator BRADLEY. Is that basically it?

Mr. ROBINSON. Yes.

Senator BRADLEY. Absent debt relief, you have people out there selling arms all over the world to get money to pay banks.

Mr. ROBINSON. That is a hard currency cash flow fact in my judgment, Senator. Right now the G–7 and the Bush administration are in effect begging for larger scale and more dangerous weapons proliferation in the future than we are experiencing today.

Senator BRADLEY. Mr. McPherson, you had your hand up. Would you want to address that?

Mr. MCPHERSON. Well, it seems to me that if there are public policy reasons, and I am not sufficiently close to the subject raised there to know, but if there are public policy reasons why Russia should have additional outside resources, either by debt forgiveness or by official sector flows, then that is the government decision in connection with their own resources.

If on the other hand governments are saying that for political reasons there should be a bank debt reduction, then I think what you are doing is talking about appropriating bank resources. I do not think that is in the spirit of the market economy toward which you are trying to move.

Senator BRADLEY. But you do not take that position in principle do you?

Mr. MCPHERSON. In what sense?

Senator BRADLEY. Well, I mean you don't say never in the circumstance.

Mr. MCPHERSON. In debt reduction? No, I don't.

Senator BRADLEY. So you accept the principle of debt reduction?

Mr. MCPHERSON. I accept the principle. In fact, I have been an aggressive leader of it in several contexts.

Senator BRADLEY. Right.

So at the time that debt reduction occurred, did you not have whatever you said about the bank resources take place?

Mr. MCPHERSON. Well, the reason that you would give a debt reduction——

Senator BRADLEY. Yes, but whenever Mexico occurred what you just decried happened with banks, right?

Mr. MCPHERSON. Not really because it was not an in effect appropriation of resources. It was bankers and the debtor getting together and realizing the economic reality. And you had a debtor who had gone through serious economic reforms who we realistically thought would not come back, or was unlikely to come back for a second dip, who we thought would be in a better position to pay back the remaining debts because of that relief.

Now that is in contrast to Russia right now, where frankly if you made a permanent debt deal—let's take a better example—Argentina 2 or 3 years ago. If banks made a permanent debt deal with Argentina 2 or 3 years ago, I would have thought that it would not have added much stability to the financial markets in Buenos Aires, because the markets would not have believed that was a permanent debt deal, that the Argentines would have been back for a second dip in 2 or 3 years.

Senator BRADLEY. Yes. Well, this is the old argument that what we have is a liquidity crisis and not a more serious crisis.

Mr. MCPHERSON. No, I am not saying we do not have a more serious crisis. What I am saying is we do not yet have——

Senator BRADLEY. No, I am not even saying serious crisis in terms of the military proliferation, which is a very real problem out there.

Mr. MCPHERSON. Yes.

Senator BRADLEY. The ignoring of which is placing the interests of certain institutions above what is a very serious worldwide problem.

Dr. Green?

Dr. GREEN. Yes. I think the point is that when debt reduction is taken by commercial creditors it is taken really because they think that enhances their shareholder value, that they accept those steps and do so.

We are seeing in the case of Poland particularly now, that a politicized debt reduction package of a magnitude in Poland that was deemed appropriate for official creditors, because they have reached a collective judgment of what they have done, has in fact impaired private credit flows to Poland. And, in fact, has made those institutions who have been involved in Poland for 20 years as active commercial credits in effect hesitant.

They have had bank resources appropriated by forcing them to move or attempting to force them to move pari passu with official creditors. I do not think that is a healthy way to go. Where the objective in the case of Russia is eventually to restore market access, then we should recognize that commercial creditors—and it is the commercial creditors that have been there for 20 years—will be the principal lenders in the next 20 years.

They need to feel that they have worked out with the debtor the best situation for their own shareholders as well as for the debtor's interests.

Senator BRADLEY. So you do not see the U.S. banks playing a significant role in Russia in the next 20 years?

Dr. GREEN. I think U.S. banks at times have played significant roles. In Roger's and my tenure we played a significant role at certain times in the borrowings of the former Soviet Union.

I think there will come a time, in fact, when Russia, in fact, borrow in the U.S. domestic market.

Senator BRADLEY. Right.

Help me understand this joint and several issue, because I do not quite understand it and it seems to me to be a relevant point.

If you have joint and several liability you have the total debt of the former Soviet Union and it is apportioned under the agreement to the various republics that this has already taken place—Ukraine, 16 percent of the debt; Kazakhstan, "X" percent and so forth.

Now under joint and several liability, as I read it, if they chose not to pay then Russia would have full liability for all of the former Soviet Union's debts. Is that not correct?

Dr. GREEN. That is correct. Or Lithuania has full responsibility.

Senator BRADLEY. Or Lithuania?

Dr. GREEN. Yes.

Senator BRADLEY. Or Katakhstan?

Dr. GREEN. Yes.

Senator BRADLEY. Now is it your view that we have to alter this so that either in Dr. Green's case based upon what I think I read in your testimony, Russia assumes all the debts and Russia gets all the assets or apportion it with the new agreement where countries agree to take on a percent of that total debt as a part of an official debt reduction package? Isn't that the way it works?

Dr. GREEN. That is right. I think that is the one or the latter case is more realistically. It may end up that Russia takes on 80 percent or more of the former Soviet Union's debt. But what is important from the Russian Government standpoint is that its liability be limited, that it know clearly that if it meets its obligations it will, in fact, regain access to credit markets over time and they can see a deliberate path that they can follow Venezuela, Mexico to recovering their ability to borrow commercially in the marketplace.

Senator BRADLEY. Right.

And either one of those would achieve that, either taking on all the debt or taking on a portion of the debt under a newly constituted agreement?

Dr. GREEN. I think the problem with asking or expecting Russia to take it all on is that in effect you are appropriating Russian resources. You are appropriating Russian standards of living for interests that were served by other peoples of the former Soviet Union.

Senator BRADLEY. So basically your preference would be to apportion it?

Dr. GREEN. Yes.

Senator BRADLEY. Roger?

Mr. ROBINSON. I just want to get back to—I mean, there have been a number of comments and I think someone should——

Senator BRADLEY. But deal with the joint and several question.

Mr. ROBINSON. Nothing to add to that. My understanding and Don Green's are basically the same.

Senator BRADLEY. All right. I would like to just focus on that for a minute.

Mr. ROBINSON. Please.

Senator BRADLEY. What, in your view, should be the institutional setting in which this takes place? Right now you do not have what you would like and you see it as essential to any form of debt relief as well as market access for any of the one republics, Russia in particular, because you think Russia has the greatest possibility of getting a return to market access. So what is the institutional setting in which you see this reapportionment taking place?

Mr. ROBINSON. I would offer the view that the IMF/World Bank deliberations would be a logical one because these institutions are going to have to come to take a proper inventory of the assests and liabilities of that country. It is tragic it has not happened to date.

That is the time when you can hopefully get some equitable division of assets and liabilities. And in the context of each nation's debt relief program that some realistic rescheduling or even select forgiveness arrangement could be configured for the more destitute of those nations.

The Munich economic summit is likewise a logical institutional forum for action on this issue where the finance ministers and perhaps even the OECD could be tasked.

Senator BRADLEY. Does anyone disagree with those forums?

Dr. GREEN. I would just add, I think the IMF has to do the actual process. I have looked around at the other candidates and I really do not feel there are other candidates.

But it is truly the G–7 which has to determine politically that it is going to abandon the position that it has maintained today.

Senator BRADLEY. Right.

Dr. GREEN. They have to recognize and agree among themselves that they are going to change their position and let that lead through to what the IMF does with its own activity.

Senator BRADLEY. So one position change is from joint and several to apportionment and the other position change is for both public and private debt relief, right?

Ms. LISSAKERS. Yes.

Mr. ROBINSON. And no unified repayment mechanism obviously.

Senator BRADLEY. Right.

Do you have anything to add to that?

Ms. LISSAKERS. No. I agree with both of those points and the institutional framework. Now my understanding is that when the republics agreed to accept this joint and several obligation on the debt they also agreed on an allocation formula. It may be that that formula is not realistic, but there is already a division at least on paper of this debt obligation. I do not believe the Baltic States accepted it.

Senator BRADLEY. Now Jacques Delors said the other day when he was here in answer to a direct question that he strongly supported not only public but private debt relief. I was actually surprised with how emphatic he was and recommended that that take place in the interim committee at the IMF. That is where the issue can be framed and raised.

So that is interesting because he did not want it to take place in the EBRD.

Mr. ROBINSON. Right. Good reason.

Senator BRADLEY. Is there any reason why you think he does not want it to take place in the EBRD?

Mr. ROBINSON. I would offer Jacques Attali as one good reason.

Senator BRADLEY. Okay.

Other than the obvious? [Laughter.]

No substantive reason?

Mr. ROBINSON. Well, it is still finding its way. It is a fledgling institution. It wants to make itself into something that it should not be a subsidized lender.

Senator BRADLEY. All right.

Well, this is very helpful. This is extremely helpful because it focuses, I think, a lot of the questions that I had had.

Did you have anything that you would like to add, Mr. McPherson, or not?

Mr. MCPHERSON. No. Thank you, Senator.

Senator BRADLEY. No?

58-036 - 92 - 3

Mr. ROBINSON. Senator, I have just one request, if I may. The Center for Security Policy, whose Board of Advisors I serve, has just completed a brief, but I think highly useful critique of the Bush administration's proposed Freedom Support Act that I request, along with my full prepared testimony, be submitted for the record of these hearings.

Senator BRADLEY. Okay.

[The information appears in the appendix.]

Senator BRADLEY. If I could just get some quick responses to some questions that I noted in your presentations.

Dr. Green, you said that while production was going to drop 30 percent, already dropped at 15, that would not lead to a decline in the standard of living.

Dr. GREEN. Of the comparable magnitude.

Senator BRADLEY. Okay.

Dr. GREEN. Our own estimate is that average standards of living will drop 20 percent, plus.

Senator BRADLEY. And that is why?

Dr. GREEN. That is because a lot of the measured drop in national income, using the accounts that are really based on the statistics before the transition, a lot of what is being reduced had no economic reason to be produced, which distorted all resource allocations in the entire Soviet system.

Senator BRADLEY. Okay.

Dr. GREEN. The military industrial complex, capital accumulation for capital accumulation's sake. All of that is scaled back much more dramatically than consumption.

Senator BRADLEY. Okay.

I think it was you again, Dr. Green, said what is needed to restore Russia and other republics to market access is essentially a good macro-economic plan, right?

Dr. GREEN. Yes.

Senator BRADLEY. And some form of stability a part of which would be a debt relief proposal for a longer term arrangement, those are the two components, as well as privatization.

Dr. GREEN. Yes.

Well, there are a lot of things that are critical. In fact, in the short-term probably the most critical is what their resource endowment happens to be. A republic like Turkmenistan actually has dramatic advantages if it could deliver its gas into the West European market.

So it is really very much of a haphazard situation initially. It is only with the passage of time that other resources like superior human capital in the Baltics will bring their recovery back sooner than I think we will actually see take place in Russia.

Senator BRADLEY. Now one of the proposals that IMF-World Bank is going to consider is whether there should be sectoral financing in sectors that have the greatest potential, either to deal with the domestic situation or to deal with hard currency. In particular, they want to focus on energy, agriculture production and military conversion.

Now do you think this kind of targeting of sectoral loans makes any sense and will lead to any kind of improvement in the next 5 years?

Dr. GREEN. Well, I think it varies a lot from place to place. But I think agricultural infrastructure is just such a critical need, an area that had been underinvested in for many years. So I think the payoffs in the near term from improving the storage, the distribution, the handling and processing and packaging and so on, all of those things that would be supported by development loan activity in particular regions of the republics.

Again, you cannot deal with Russian agriculture in the whole. You have to deal with specific problems in the regions.

In the case of energy I think you are going to see that if there was a resolution of the institutional framework and the property rights issue, a great deal of the necessary capital would, in fact, come from private sources.

Senator BRADLEY. Institutional framework meaning?

Dr. GREEN. It means which are the entities which have rights to produce a particular field and what is the tax regime that they will operate under with some kind of stability in Russia.

Those elements, if resolved, would bring a great deal of capital into that marketplace today.

Let me just mention with regard to conversion, I think the objectives of putting funds into conversion are really not economic objectives. I think they are security objectives.

Senator BRADLEY. It is like the military proliferation.

Dr. GREEN. That is right. And it is also a part of the social network of support for particular concentrations, of formerly secret cities which it would be perhaps easier to forget them again. But we cannot do that for security reasons and for human reasons.

Senator BRADLEY. Right.

Dr. GREEN. So some kind of support targeted on those particular areas is going to be essential, I think, to manage the transition over the next several years.

Senator BRADLEY. Tell me if you agree or you do not agree—the transition is one of many dimensions, but clearly one is a labor dimension where you have such vast overstaffing in some of these former military enterprises, former enterprises generally. And that in order to improve efficiency you have to cut work forces dramatically—50 percent unemployment in a lot of these sectors—and the answer to this problem, the range of things that I have heard, is essentially expanding service sector distribution, et cetera, and moving people from one sector to another.

Is there any other hope?

Dr. GREEN. I do not think we have found any evidence elsewhere that these large bureaucratic organizations can adequately adjust themselves with cash. So I think the point is to create an environment around them, so that people decide to leave them. They leave them voluntarily as well as the reductions in staff that are there.

Senator BRADLEY. All right.

Now we have coming before us this $24 billion package and I would like to kind of get your vote as an individual on the panel as to whether you think that prior to this package we should attempt to at least clear the issue on joint and several liability and some kind of debt stability, debt restructuring stability.

Do you think that that is better to do now or do you think that we should continue to put the $24 billion into this rat hole as Professor Lissakers stated it until it dawns on us that it would be wise to restructure?

Now that is a very unbiased question. [Laughter.]

Mr. ROBINSON. Can I offer an unbiased answer on my vote? Basically, not one dime of the $24 billion package should be appropriated prior to multi-year debt rescheduling, debt reduction and the resolution of the joint and several guarantee issue. Otherwise, the Western aid package will, in my judgment, become a fiasco. There are a number of other major limitations to that package, not the least of which is the lack of conditionality of either an economic and political variety that likewise need, to be addressed by the Congress.

Senator BRADLEY. Dr. Green, your vote?

Dr. GREEN. I do not think I would be as categorical about that. I would think that before signing up to this program, which I do not expect to amount to $24 billion of actual disbursements, I think what is important is to express the judgment that we have to break this "joint and several" fiction that we have locked ourselves into, that it is in all our best interests in the long run is to get rid of that.

But I do not think we can determine what the multi-year rescheduling will be for individual republics until, as my colleague said, we know a little bit about what they are going to do and how serious they are going to be about the programs.

But I think we should certainly express our intent that this be clear in our minds as we proceed forth in the disbursement stage by stage of those funds. But I would not resist the program itself.

Senator BRADLEY. You mean year by year?

Dr. GREEN. Year by year.

Senator BRADLEY. Mr. McPherson, vote.

Mr. MCPHERSON. Well, I think we ought to go ahead with the plan now. I have two primary concerns. One, I have expressed my concern about the stabilization fund. I think we have to be very careful on how that is structured. Because in my belief that has the greatest potential of quickly spending huge amounts of money to no end.

Secondly, I am very concerned that privatization is not moving fast enough in concert with the belt tightening and that we could well find ourselves with a lot of pain without comparable gain.

Senator BRADLEY. But on the vote. That is not the vote.

Mr. MCPHERSON. My vote is——

Senator BRADLEY. No on joint and several liability, solving joint and several liability prior.

Mr. MCPHERSON. I think they ought to push to have that settled, but I do not think that should be a condition for your voting the appropriation.

Senator BRADLEY. And no on debt restructuring? Strong no, light no, right? Light no on the joint and several; strong on the restructuring, right? That's how I read it.

Mr. MCPHERSON. I strongly believe the republic needs the money now, needs the support from Congress now on this matter without these conditions that you are speaking of.

Senator BRADLEY. Even if it comes into the republic and goes right back?

Mr. MCPHERSON. Surely I do not want it to go that way and I believe if you structure stabilization properly it will not. I further believe that if you condition it on continued economic reform, include privatization, the money should not go in and out either.

Senator BRADLEY. All right.

Professor Lissakers' last word. Vote.

Ms. LISSAKERS. Well, I think unquestionably that there should be some link between the stabilization fund and the long-term debt restructuring. That that should be an integral part of the stabilization agreement that the IMF will negotiate with the republics as a condition for their access in the aid; and that the U.S. Executive Director should simply insist.

Now exactly how Congress exerts its influence on this, I do not know. But, for example, if you look at the ruble stabilization fund, I mean that will be absolutely swamped if you have a situation where even under the current moratorium they are supposed to pay $2 billion a month on their debt servicing. That is $24 billion right there.

If you continue with that situation, the exchange stabilization funds of $6 billion when you have a perpetual shortage of hard currency will swamp the stabilization fund immediately. You cannot stabilize the ruble——

Senator BRADLEY. Without debt relief.

Ms. LISSAKERS. Without debt relief.

Senator BRADLEY. So you say before we do this package do debt relief and do the joint and several liability clarification?

Ms. LISSAKERS. Yes.

I mean, I think that is highly desirable to split up the debt. I think that is less urgent or less crucial than debt restructuring, debt relief.

Senator BRADLEY. All right.

Well, it is very helpful. Thank you all very much for sharing your views with us today. The way that I read the votes on the panel was 4–0 for debt relief and 4–0 for joint and several—No. [Laughter.]

No, I appreciate the interplay among all of you. It has been very helpful.

The subcommittee is adjourned.

[Whereupon, the hearing adjourned at 11:54 a.m.]

APPENDIX

Additional Material Submitted

Prepared Statement of Senator Bill Bradley

This is the second in a series of hearings held before the Subcommittee on the problem of international debt owed by the former Soviet Union. I welcome the witnesses who came on very short notice, some travelling great distances, to be here to testify today.

In October of last year—just two months after the failed coup attempt—the Subcommittee held a hearing that confronted directly the Administration's desire to manage the Soviet debt issue with central government structures under President Gorbachev. Gorbachev resigned in December; the central government of the Soviet Union collapsed; and the fallacy of the Administration's approach and the inadequacy of its plan was exposed.

World events continue to press down hard upon us. The issue of Soviet debt has become more urgent and no less important. The tense debate in the Congress of People's Deputies on the Russian government's economic reform program that ended last week, the meetings this week of the International Monetary Fund's Interim Committee and the G–7 Finance Ministers to deal with the integration into the world economy of the 15 republics of the ex-U.S.S.R., and the rapidity with which the Administration is attempting to enact its proposed assistance legislation, "The Freedom Support Act of 1992," all point to the need to resolve the outstanding Soviet debt issue quickly, decisively, and effectively.

We cannot afford further misguided Administration policies on this issue.

Russia has already undertaken major steps towards democratic and market reforms that warrant support from the international community. More reform is planned. The American taxpayer will appreciate the value of lending support that consolidates and advances these reforms and bolsters the security of the children's future. The American taxpayer will understand technical assistance and educational programs that aim to spread knowledge to a receptive audience of our way of life. I also believe that the American taxpayer would accept the need to reduce a burden of debt imposed by the Soviet legacy on these new states, especially those least able to pay.

The American taxpayer would, I believe, be shocked to learn that the Administration plans to re-cycle its pledges of assistance to bail-out governments and international banks that made bad loans to Russia's communist predecessors. The American taxpayer would, I believe, be shocked to learn that scarce resources that could otherwise be available to construct democratic and free market institutions in the newly independent states might instead be diverted to these old creditors. The American taxpayer would, I believe, be shocked to learn that the newly independent states are being forced to direct their energy, their savings, their investments not toward building a new infrastructure and economy for the future, but toward satisfying a legacy of debt that their oppressors incurred with the assistance of these too-friendly creditors.

Such ill-advised funding to an unreformed economy during the Gorbachev years increased the Soviet Union's indebtedness from an estimated $30 billion to $70 billion or more. No one knows where this money went. Thankfully American banks, recognizing the risk, extended limited credit relative to their European counterparts. Future loans to the newly independent states should accord with standard lending practices and contain performance conditions so that we can see in concrete terms what we are getting for our money.

The Subcommittee called this hearing on such short notice to highlight the importance of the Soviet debt issue and to ensure that views on debt rescheduling and relief are aired before the debate and vote on the President's assistance package. I myself have just returned from a fact-finding mission to the newly independent states.

We challenge the panel today not just to educate this Subcommittee but to explain to the American people why they should be interested in the Soviet debt problem. We encourage you to be provocative, thoughtful and gutsy to our questions. The purpose of the hearing is to explore policy options available to the Administration, the G–7, and international financial institutions and the implications of these options in terms of our own security interests, the economic recovery of the former Soviet Union, and the broader subject of international debt.

We should explain that the Administration is not represented on the panel because of simple scheduling difficulties occasioned by the short notice of the hearing. I did not want to delay the hearing for reasons of urgency already mentioned. The Administration has no shortage of fora in which to present its view, but experts who can present us independent assessments of the Administration's policies may.

Again I welcome this distinguished panel, consisting of:

—Roger Robinson, President of RWR, Inc.; and former Senior Director for International Economic Affairs at the NSC from 1982–85;
—Karin Lissakers, Director of International Business and Banking Studies at the School of International and Public Affairs at Columbia University; previously serving as Deputy Director of the Policy and Planning staff for economic affairs at the State Department;
—Donald Green, Managing Director of the PlanEcon Capital Group; Mr. Green served as Executive Vice President of The Mercator Corporation from 1988 to 1991, and before that worked at the Chase Manhattan Bank;
—Peter McPherson, Executive Vice President of the Latin American and Canadian Division at the Bank of America. Mr. McPherson previously served as Deputy Secretary of the Treasury Department from 1987–89 and Administrator of AID from 1981–87.

Prepared Statement of Donald W. Green

ECONOMIC OUTLOOK FOR THE REPUBLICS OF THE FORMER SOVIET UNION

PlanEcon, Inc. has recently completed an economic forecast for the independent republics of the former Soviet Union, the first time that our firm has prepared a separate analysis and forecast for each of the republics within a general framework of projected Western assistance and the adjustment of trade relations between Russia and the non-Russian republics. I have included a summary of that forecasting exercise in my submission today, but I would like to emphasize several crucial elements in this outlook.

First, the decline in aggregate economic activity for the former Soviet Union will most likely continue for another two or three years before stabilization and recovery later this decade. We project a decline in GNP of around 30% during the two-year period of 1992–93, following the decline of 10% or more already recorded in 1990–91. There will be a significant decline in the average standard of living for citizens, but this will be closer to 15% or 20% if appropriately measured, though declines in some of the most troubled republics may be 30% or more. Much of the actual decline in measured production and utilization will take place in the military sector and various branches of heavy industry geared to high defense spending and capital accumulation.

Second, the prospects for Russian stabilization and economic reform are of central importance to developments for the region. In this respect, Russia has been fortunate that the Yeltsin government has been as courageous in taking the difficult steps in economic adjustment as it was in resisting the August 1991 coup. The initial program will, of course, be modified under political pressures—both domestic and international. However, our forecast has been built upon the reasonable prospects for Russian success in stabilizing domestic finance and the price system, establishing internal convertibility for the ruble, and privatizing small and medium-scale enterprises during the next two years.

Third, Western technical assistance and progressive Russian economic policies are far more important to this successful transition than the provision of Western credit. In fact, our projection assumes that net real transfers to Russia will not average more than $6 to $9 billion annually during the period 1992–96, a level much below the scale frequently suggested by the IMF and other Western officials. The actual prospects for Russia's external accounts are quite promising in the 1990's, and this strength based on net energy exports, with supplemental assistance from the West, should contribute to the successful transition to a market-oriented mixed economy.

Fourth, the economic prospects of the non-Russian republics depend upon at least four critical factors:

Relative endowments in energy and raw materials.
Trade and monetary relationships with Russia.
Political stability and the quality of economic policy.
Foreign economic assistance and private capital flows.

Whereas the international community expects to provide greater assistance to Russia than to the other republics combined, it will soon become evident that the non-Russian republics will need much greater financial support than Russia itself during the next three years. Ukraine, the Baltics, Belarus, and many of the smaller republics will need significant financial support when faced with the terms of trade shock of Russian energy price liberalization (even to a partial extent). They will also have a more difficult time than Russia in servicing their external debts during this transitional period. Net resource transfers of $8 billion or more annually will be sought by these republics to sustain their external accounts during the economic restructuring process, even though several of them—particularly Belarus and Kazakhstan—may continue to receive preferential treatment in their trade with Russia.

IMPLICATIONS FOR THE RESOLUTION OF SOVIET DEBT

PlanEcon's effort to provide forecasts for the former republics of the Soviet Union has run into a problem which faces all commercial investors and lenders in the West—the uncertainty regarding how the external debt of the former USSR will be resolved. I have included with today's submission a copy of an earlier position paper on this issue which argues for the explicit allocation of the debt among the successor states of the USSR rather than insisting on "joint and several responsibility." The international organizations chose to defer that issue during discussions of membership for the independent republics, unfortunately.

Russia has taken recent steps to help resolve the status of the *Vneshekonombank* with proposed changes in management and charter, but a clear definition of the obligations of the other republics is essential before Russia will be willing to provide a sovereign guarantee to the remaining obligations of the bank.

In our forecast, we expect Russia to deal with its external obligations of more than $40 billion in a forthright manner given the strength of its export capacity and the longrun benefits of international creditworthiness. Rescheduling, but not debt relief, will be appropriate for Russian medium-term and long-term credits from Western governments and commercial banks. If, however, the creditor community insists on "joint and several responsibility," the disincentives for Russian debt servicing will result in a significantly lower recovery percentage for creditors.

Much more extensive debt relief and restructuring, and even formal debt reductions, may be appropriate for the poorer republics and those without favorable export prospects. But even then, debt reductions should only be determined by the creditors on a republic by republic basis, and not immediately, when those new states are still trying to assess their independent financial situation.

THE SCALE OF WESTERN ASSISTANCE

Western officials and the media have been excessively concerned with whether the assistance package for the former Soviet Union is large enough, and thus we have witnessed the sequence of mega-billion proposals that do little to address the practical tasks of supporting the difficult transitions ahead. Effective absorption of Western assistance is constrained anyway by the capacity of governments and commercial institutions in the republics.

In the next two years, the critical needs are for technical assistance that will accelerate the transition to markets in these economies, and for current finance to sustain some necessary level of imports and correct shortrun bottlenecks that restrain export earnings. Annual assistance levels of $40 billion and more are neither necessary nor practical in the present circumstances.

The proposed stabilization fund of $6 billion for the ruble should be regarded primarily as a symbolic act of the West, since the actual establishment of internal convertibility will depend on the posture of Russian financial policy and the outlook for the Russian balance of payments. The fund will help to provide backup support to official reserves during the transition to convertibility, but the success of the transition depends ultimately on policy credibility. This same fund might be more useful to assist Ukraine and the Baltics to introduce their new currencies despite large deficits in the balance of payments.

Attachment.

THE ECONOMIC OUTLOOK FOR THE REPUBLICS OF THE FORMER SOVIET UNION

EXECUTIVE SUMMARY

[PlanEcon, Inc., April 1992]

ECLIPSE OF THE SOVIET UNION

The demise of the USSR as a political unit at the end of 1991 and its fragmentation into fifteen independent states, the former republics which became the USSR's legal successors, was the climax of the nearly three years of progressive decentralization of political power unleashed by Gorbachev's political reforms. The August coup, which sought to reverse that process, instead accelerated the collapse of any vestige of central political and economic power. On December 25, 1991, Mikhail Gorbachev resigned as President and the Congress of People's Deputies ratified the end of the USSR. Consequently, critical issues such as economic reform, fiscal and monetary policy, price control and privatization no longer have major significance at the aggregate level of the former Soviet Union, despite the formation of a "Commonwealth of Independent States" (the CIS) which presently includes 11 of the 15 former Soviet republics.

Clearly, the initial impetus towards the assertion of republican sovereignty with respect to Soviet power was the desire by the Baltic republics—Estonia, Latvia and Lithuania—to restore their national independence which had been suppressed by Stalin's Red Army. This desire for national independence from the USSR was subsequently asserted by other republics such as Georgia, Armenia, Moldova and Ukraine—legitimated to some degree by historical claims of previous national independence. In fact, the drive for statehood in such republics only became possible in political/military terms because of the growing weakness in central power.

The economic objective in the assertion of republican sovereignty was to gain control over natural resources and the physical assets under central authority but located in the republic. This assertion of property rights by national groups was generally more fundamental than any local pressures for radical economic reform and private property. In many cases, moreover, assertions of economic sovereignty came from very conservative forces within the all-Union Republics and within the Autonomous Republics in the Russian Federation.

THE PROSPECTS FOR RUSSIAN ECONOMIC REFORM

The preparation of any forecast for the former Soviet Union must begin with a careful consideration of present developments in Russia and the prospects for economic reform and recovery in this dominant economy of the region. Despite the continuing efforts of units within the Russian Federation to assert independence or sovereignty, we argue that Russia will not go the way- of the USSR—pulled apart by regional conflicts. Instead, we anticipate that a significant transfer of property to the regional level and granting considerable latitude in cultural matters to local levels—as proposed in the current Federal Treaty—will hold the Federation together as a political and economic unit.

The general economic program introduced by the Yeltsin government at the end of 1991 represents a significant step forward from previous programs under the USSR government, and we believe it will eventually provide a basis for financial stabilization, which is more likely to happen during 1993 rather than 1992. Despite the tactical retreat in the discipline of the fiscal/monetary program which is now taking place, we project a further efforts to liberalize energy prices during the next year and strengthen the budgetary position. The surplus we anticipate on Russia's external accounts during 1992–93 and the resource transfer of Western assistance should enable the Russian government to stabilize the financial system and the ruble exchange rate before the end of 1993.

In our Russian forecast, we project an end to hyperinflation by the middle of 1993. Industrial producer prices, which more than doubled in 1991, are projected to rise more than 10-fold in 1992 but the increases are significantly reduced thereafter. After again doubling in 1993, the projected average annual inflation rate is less than 20% during 1994 to 1996. The commercial exchange rate for the ruble, based on actual interbank transactions, is projected to average 175 rubles/$ in 1992—a hundred-fold devaluation over two years from the average commercial rate in 1990. More importantly, when one considers the domestic price level, this actually represents a devaluation of the real effective exchange rate by a factor of four over two years. We then expect the real exchange rate, under conditions of internal convertibility and a strong external account, to strengthen toward the mid-1990s, a pattern similar to that observed in Eastern Europe after successful stabilization.

During the forecast period, we anticipate that Belarus and Kazakhstan will remain on a Russian ruble standard—with direct circulation of rubles in their economies or with national currencies linked closely to the ruble. Ukraine and the Baltics are assumed to separate their financial systems from the ruble with national currencies linked to Western Europe (probably linked to the ecu or DM). When Ukraine firmly breaks from the ruble circulation, probably in the second half of 1992, the Russian government may decide to break from the Soviet ruble itself in order to avoid a spillover of Ukraine ruble balances into its domestic markets. This could involve an exchange of Russian currency and savings account balances for Soviet rubles in Russia itself and those republics which agree to follow Russian monetary policy (and which may also continue receiving Russian trade credits for their bilateral deficits). Such a monetary discontinuity could also involve a restructuring of enterprise, bank, and government balance sheets to remove the distortions of the price deregulation of 1991–92.

Financial stabilization, small-scale privatization and Western assistance should eventually stabilize the Russian economy and promote a firm recovery by the mid-1990s. The sharpest drop in the Russian economy will probably take place in 1992, a 20% decline in NMP, with continuing declines in 1993–94 before the recovery. The total decline in NMP of approximately 40% from 1989 to 1994 clearly overstates the actual decline in economic value which one would hope to measure (at least approximately) in national income. At least one-third of that decline will represent the termination of military activities (primarily defense procurement, R&D and operating expenses) that did not generate benefits for households. Our projection is based on the judgment that the redeployment of physical and human capital specialized in that sector will not take place quickly given various institutional barriers that are the hangover of central planning.

The large contraction in the defense sector will be part of a broader decline in the total output of heavy industry—machine-building, metallurgy, chemicals and derivative transport and construction activities—that only appeared profitable because of distorted relative prices and a structure of final demand based on centralized budgets. Declines in the production of consumer durables, manufactured consumer goods, and processed food will be much less in the period 1992–93 and some recovery should be evident in those sectors during the last part of the forecast period.

STRENGTH IN RUSSIA'S EXTERNAL ACCOUNTS

During the 1980s, Russia generated significant surpluses in foreign trade while other republics recorded deficits. The trade surpluses gained by the USSR from Russian energy and gold exports were generally used to cover the trade deficits of other republics or to finance Soviet credits extended to developing countries and client states. The structural problem anticipated in the balance of payments of the former USSR during the 1990s is likely to be concentrated in the non-Russian republics, since Russian net energy exports are projected to remain strong.

In 1991, we estimate Russia's trade surplus in convertible currency to have been in excess of $10 billion. Throughout the forecast period, Russia will continue to generate net energy exports (to the other republics as well as to the world market) in excess of 500 mmt of standard fuel equivalent, mostly in the form of petroleum and natural gas. This continuing strength in net energy exports occurs despite production declines in Russian petroleum and coal, since domestic consumption in Russia drops even more sharply given the decline in economic activity, the shift in the structure of final demand, and the rise in the relative price of energy. The volume of energy delivered to other republics will be declining sharply over the next five years as they face higher relative prices and declines in domestic economic activity. This will allow Russia to raise its energy exports to the world market. Russian energy exports outside the former USSR are projected to grow from around $20 billion in 1991 to over $30 billion in 1996.

According to this projection, the Russian government will have sufficient export revenues to maintain essential imports of critical commodities, resume selective servicing of its external debt, and to stabilize the exchange rate with the introduction of internal convertibility within the next two years. At the same time, net resource transfers from the West to Russia, which we assume will average $6 to $9 billion annually beginning in the second half of 1992, will enable Russia to both import more and establish its creditworthiness. This relatively healthy position on the

Russian current account will also enable Russia to provide transitional support to other republics without encountering strong domestic opposition.

By our estimates, Russia will begin the forecast period with perhaps $35 billion in medium and long-term debt owed to Western governments and commercial banks. In addition, there will be another $3 billion of USSR short-term debt and Eurobonds which we assume Russia will decide to service fully by the end of 1992. With annual interest costs of less than $4 billion on that debt, Russia could resume full servicing of its share of the debt of the former USSR within two or three years. It is likely, however, to take advantage of the present posture of the Paris Club of official creditors to press the banks to reschedule the remaining commercial debt through the full decade of the 1990s. Under our projections, the market value of such debt owed by Russia to the banks should rise significantly from the present deep discounts observed for all former USSR debt (30 cents to the dollar).

WESTERN ASSISTANCE

The role of Western assistance to the USSR changed significantly during the course of 1991. The principal Western governments had provided credits and direct assistance to the USSR, but largely to meet their own national objectives during Gorbachev's last year of power. While the U.S. provided additional credits in order to sustain grain exports during a domestic recession, German assistance was concentrated on relocating Red Army units to the East and sustaining exports to the USSR from enterprises in the former Eastern Germany. The proposals for "grand bargains," sometimes of Marshall Plan proportions, were discussed and debated in Western policy circles in 1991, but there was no political commitment in the West to provide massive support to a collapsing Soviet empire and system.

Once the USSR had been closed down as a centralized empire, there was a new political legitimacy in the successor republics that could attract Western assistance. The further element required to elicit Western attention was a clear policy to radical economic reform, one which was provided by Yeltsin's new government in early 1992.

Our projection does not assume that net resource transfers from the West to Russia will be as large as the figures generally announced or cited in the media. The larger numbers cited by Western officials (such as the $24 billion aid package proposed for Russia) include various categories such as debt servicing relief, technical assistance, humanitarian aid, and ruble stabilization lines that may never be drawn. Furthermore, the commitments of official credits tend not to be fully utilized by recipient nations, as we have frequently seen in Eastern Europe.

Nevertheless, part of the real transfers from the West to Russia in the forecast period will enable the Russian government to recover gold previously swapped abroad, to rebuild official reserves, and to partially repay domestic obligations in convertible currency. This will have significant benefits for a Russian market economy in the mid-1990s, however, since it will support a resumption of commercial loans and a greater flow of direct foreign investment.

Whereas Western officials expect to provide more assistance to Russia than to the other former republics combined, they are likely to discover quickly that more financial support is required for the non-Russian republics during the next three years. Significant finance will be needed to help Ukraine and other republics to pay for imports of Russian energy and raw materials, or to acquire substitute supplies such as Iranian crude oil. Our projection assumes that net resource transfers from the West to the non-Russian republics will average $8 to $10 billion annually for the next three years, and that perhaps 40% of that amount will pass through in net trade payments to Russia.

INTER-REPUBLICAN TRADE FLOWS

Whatever the depth of the economic decline in the former Soviet Union, it is certain that the breakup of the USSR will raise the measured level of world trade by more than $300 billion. While the USSR itself was not significantly dependent on international trade, there was extensive specialization among the republics and the concentration of specific production in large enterprises that served the entire domestic market. With the breakup of the USSR in 1992, developments in the trade between former republics will have a key impact on their economic prospects. In this development, Russia holds the key role by virtue of its surplus of energy and the relative strength on its total external accounts.

Once one takes into account the interrepublican trade flows, even before revaluing at world market prices, Russia was running a significant trade surplus during the last years of the USSR. One estimate prepared by the former USSR government concluded that Russia's total trade surplus would have been $50 billion in 1989 had its interrepublican trade been conducted at world market prices.

During the period from 1989 to 1991, Russia's exports to the other republics (calculated at world market prices) averaged more than $140 billion, with an annual trade surplus in excess of $40 billion. These estimates are probably high given the excess prices usually given to Soviet machinery. Still, this surplus on interrepublican trade provides Russia with additional options during the current transition. Over the forecast period, this surplus will definitely be less in real terms, but there remains a policy question of whether it collapses to zero in a brief period or whether Russia will finance a transitional surplus with at least several other republics over a period of years.

In our projection, we assume this surplus drops more than 50% in 1992 from 1991 and continues to decline steadily through 1995. We have assumed that the IMF will demand some transitional support for other republics from Russia as part of the stabilization program. Otherwise, the burden on the West to support energy import requirements and income standards in the more vulnerable republics would be much higher.

We project a decline in Russia's interrepublican exports of 35% from 1989 to 1993, or a volume decline of nearly 50%. Over the same time, Russia's interrepublican imports decline only 20% in value (30% in volume) which brings the Russian trade surplus with other republics to $12.5 billion in 1993 (or around 30% of the 1989 level). We expect Belarus and Kazakhstan to receive more Russian support in the next two years, with the Baltics and Ukraine forced to pay for Russian products with goods or cash. Republics in the Transcaucasus and Central Asia will also receive a real transfer from Russia over the next year, but not to the extent of Belarus and Kazakhstan.

The behavior of Russia with respect to the other republics in this transitional period is of great significance for economic performance in the region. There are a variety of reasons why one might challenge the policy assumptions made in our particular forecast. Why should Russia, faced with serious economic problems at home, provide such transitional support to the former republics of the USSR?

Why shouldn't Russia insist on bilateral balancing at world market prices as the USSR did with Eastern Europe in 1991?

What will Russia expect in return for such trade support?

The answers to such questions may be composed from the following observations about the present circumstances. First, Russia will credit its bilateral trade support against any remaining claims of other republics to assets of the former USSR—enterprises, banks and embassies abroad; the official gold and diamond reserves; debt owed by developing nations; military assets, etc. This transitional support will assist Russia in gaining clear title to those collective assets of the former USSR.

Second, Russia will use trade leverage to insist on protection of the rights and livelihood of Russians living in those republics. This is a particular reason for Russia providing considerable support to Kazakhstan and Belarus, and also a reason to be more reasonable with Ukraine and the Baltics. This factor was not present in the abrupt adjustment in CMEA trade last year.

Third, Russia can insist that such credits extended to the republics be denominated in convertible currency and, to the extent they exceed possible republic claims on USSR assets, be treated similarly with the repayment of official debt owed by such republics to governments of the West.

Fourth, the IMF and the Western governments will have considerably more leverage over Russian actions in 1992 than they did with respect to the USSR in 1991. The West doesn't want to provide all of its assistance to the non-Russian republics of the former USSR should they be faced with a much more severe trade adjustment. Western assistance to Russia can proceed in the next several years with an understanding that Russia is providing some support to other republics from its position of relative strength.

PROSPECTS FOR THE NON-RUSSIAN REPUBLICS

The economic prospects for the other republics of the former Soviet Union will depend upon at least four critical factors. The first is the republic's relative endowment with respect to energy and raw materials, since Soviet economic structures evolved with highly distorted relative prices and basic commodities are the most easily absorbed in the global market. The second factor is the republic's relationship with Russia in the transitional period to a market economy; this may be important because of needs for imported energy and raw materials or because of the need for access to Russian export markets for domestic products. The third factor is the degree of political stability in the republic and the capacity to implement sound policies and reforms during the transition to markets and property. The fourth factor is the scale and significance of foreign economic assistance, the contributions of international institutions, foreign governments and direct private investment.

Recent analysis at PlanEcon demonstrates the extreme vulnerability of many republics to a rapid liberalization of energy prices within the territory of the former Soviet Union. The greatest beneficiary of such liberalization in absolute terms would be Russia, of course, which would have earned $38 billion from total net energy exports alone in 1991. Somewhat more surprising, however, is that the greatest beneficiary in per capita terms would have been Turkmenistan since the $6.5 billion which would have been earned from net energy exports (nearly all in the form of natural gas) would represent annual earnings of more than $ 1,700 per capita. The only other republic which would have benefited significantly from energy price liberalization was Kazakhstan with approximately $2 billion in annual earnings from energy exports (primarily hard coal and crude oil).

The most vulnerable republics in the sense of absolute import cost of energy at world market prices include Ukraine ($12 billion in annual import costs), Belarus ($4 billion), Georgia ($1 billion), and Lithuania ($900 million). With regard to per capita dependency, the most vulnerable would be Belarus ($400 import cost per capita), Latvia ($300), Lithuania ($250), and Ukraine ($230). Price liberalization will, of course, lead to reductions in energy use and import costs because of declines in aggregate activity, shifts in the composition of national product, and conservation in the use of energy in specific processes. Still, Ukraine and the Baltics will be hard hit with the need to pay world market prices for their petroleum and natural gas requirements.

With respect to relations with Russia, it is evident to us that Belarus and Kazakhstan have sought to strengthen their relationships with Russia. Furthermore, such a development will be politically popular in Russia itself, given solidarity with White Russians in Belarus and the large Russian population in Kazakhstan. Belarus is also seen more as this natural bridge between Russia and Europe, while Kazakhstan serves as a huge buffer state to remove Russia from the complexities and mysteries of Central Asia. These two republics are expected to remain most aligned with the Russian economy during the forecast period and are expected to benefit from more favorable treatment in bilateral trade than the rest of the former Soviet Union. Belarus machinery and Kazakh hard coal and mineral ores are of considerable importance to Russian industry, and various consumer products built in Belarus are in demand across Russia. There are even important commodity exchanges between Belarus and Kazakhstan, machinery for grain, that can be restored and maintained through Russian relationships. Ukraine and the Baltics are in a quite different situation with respect to Russia. They have expressed the strongest political challenge to Russian leadership after the collapse of the USSR, and the national leaderships there seem much more concerned with political separation than with economic realities. Russia will remain concerned with Russian minorities in those republics, particularly the communities in the Crimea and eastern Ukraine and the pensioners (many retired military officers) living in the Baltics. Still, we expect the trade adjustment to be much more abrupt in 1992–1993 for these four nations than for Belarus and Kazakhstan.

With respect to the remaining small republics on the southern frontiers of the former USSR, we anticipate that Russia will seek to reduce the economic involvement that had been imposed under Soviet planning. These republics will no longer be seen as strategically important as they were to Russia under the Tsars or to the Soviet Union under the Bolsheviks. They will be seen as economic liabilities and potential conflict areas best left to Western assistance. There may be certain exceptions to that general hypothesis—the Dnestr region of Moldova and Armenia, for example—but we expect a major disengagement from those frontier regions and a gradual return of many Russians to the territory of the Federation during the decade of the 1990s. The small republics will be forced to look for support elsewhere to sustain their economies during the trade adjustment and system transition—to the World Bank, the Islamic states of the Gulf, Turkey, the major economies of Asia, and their emigre communities in the West.

THE AGGREGATE PICTURE FOR THE FORMER USSR

While the Soviet Union no longer exists as a political unit, it is still relevant to consider these new states as an aggregate economic region and compare the results in our present forecast with the economic performance of the USSR in the recent past.

After a long period of secular decline in real economic growth rates from the 1950s through the early 1980s, the USSR experienced virtual stagnation during the

Gorbachev period. The actual recession began in 1990 with an estimated decline in GNP of around 2.5%. This decline accelerated to a drop of around 7.5% in 1991, a year in which NMP fell 11%.

All the republics are in serious difficulties this year and several are in desperate conditions. When we aggregate the projections made at the republic level, PlanEcon is projecting a decline in GNP of around 30% during the two-year period 1992–93, with a 20% decline in 1992 alone. This decline could be even greater if interrepublican trade were forced to a virtual balance by Russian policy. Whereas the decline is also 20% in Russia itself, there are sharper declines experienced in Belarus, Ukraine, and several of the smaller republics. Significant restructuring of the economy and the impact of Western assistance and capital flows begins a turnaround in 1994, although we still expect to see a decline in GNP of around 2% that year. Thereafter, a strong recovery is evident in Russia and certain other republics with real growth rates averaging 4% or more in' 1995–96.

In 1991, Soviet foreign trade in convertible currency achieved a small surplus of $3 billion and we expect balanced trade during 1992 for the aggregate former Soviet Union, with Russia's trade surplus of $5 billion being offset by a comparable deficit for the remaining republics. In 1993–94 the Russian trade surplus quickly disappears while the aggregate trade deficit for other republics grows sharply to around $5 billion (not including the small trade deficit with Russia). the last two years of the forecast period we expect the annual trade deficit for the former Soviet Union to rise toward $10 billion. This will be the period when rebuilding the infrastructure becomes more significant and there is an inflow of private direct investment from the global market to the most successful and stable republics.

Prepared Statement of Senator Orrin G. Hatch

Mr. Chairman, let me again commend your leadership in initiating this hearing, the second that we have had during this session on the subject of debt obligations of the former Soviet Union.

The meeting could not be more historically appropriate: just this week, the Managing Director of the International Monetary Fund, Michel Camdessus, said that chances for a $4 billion international debt package, created under the auspices of his agency, were quite "good." The statement followed the admission to membership of Russia, Lithuania, and twelve other former Soviet republics. The very types of capitalist agencies that the former Soviet leaders once dismissed as vestiges of a moribund society are now rallying to the aid of the former communist states.

For us in the United States, the choice could not be clearer: either we prove by deed the economic virtues of capitalism, or we invite by default the return of an antagonistic ideology, and possibly reignite Cold War types of passive hostilities.

Besides the IMF, the G–7 Finance Ministers met this month with Russian First Deputy Prime Minister Gaidar to assert a commitment to economic reforms. We need to monitor the Russian commitment to foundational economic reforms without which the IMF and other macroeconomic support efforts will make little progress.

I want to applaud the Bush Administration for its efforts. The U.S. proposal for assistance to the former Soviet Union has two principal components. A multilateral financial support program to support the Russian reforms. And the "Freedom Support Act of 1992," which takes a broader approach to the problems faced by East Europe and Latin America as well. The Act, among other features, authorizes an increase in our IMF quota, and expresses the support of Congress for U.S. participation in a multilateral currency stabilization fund that could reach a $3 billion level for all fund members.

Let me turn my attention to the multilateral financial support recommendation. Here we propose a set of borrowing arrangements to close the $18 billion balance of payments gap this calendar year in Russia. This is done by borrowing from international financial institutions, like the IMF, and from bilateral creditors. But it also includes funds that are spared from a deferral of interest payments on prior debt obligations.

The second element of the multilateral support package is a currency stabilization fund—or the "CSF." This interests me greatly. It is a major opportunity for the former Soviet republic to restore a monetized trading system which I know is of great interest to this committee, Mr. Chairman, as well as to many U.S. companies that are awaiting exactly this type of development before taking more meaningful steps to trade there.

The CSF will be activated by the General Agreements to Borrow, the "G-A-B," of the IMF. Of the $6 billion proposed for the GAB, the U.S. share will be 25%, and our CSF commitment $1.5 billion.

I believe this country will get many times that amount in returns on trade. For example, a Salt Lake company, Cannon Engineering Technologies, led the way among western interests buying and converting Soviet Bloc defense industries into non-defense manufacturing facilities. In Cannon's case, the firm designs in Utah sophisticated axle and other undercarriage systems which are built into heavy construction, agricultural and warehousing equipment. The company's manufacturing facility in Czechoslovakia has orders from Russia which cannot be acted upon until a currency exchange system is in place. "All boats will rise," Mr. Chairman, if the CSF can be made to work.

I would like to end this statement on a positive note. Unfortunately, I can only express guarded enthusiasm since there will be a heavy burden on Russia to make the assistance effort work. Most importantly, President Yeltsin must maintain a tight fiscal and monetary policy.

So far, there have been grounds for encouragement. The Yeltsin economic team put a "shadow" economic reform plan in place this year; and the results have been impressive:

—The Budget deficit fell from 20% of GNP in 1991 to 8% at present.

—The last quarter's budget was in balance, as the country delayed cash disbursements on low priority items.

—And, the price liberalization, which the entire West had challenged the government to launch, crossed what I believe was a major threshold, causing retail prices to rise 500% before beginning to settle.

However, there has been some restlessness among Russians. The first adjustment shocks have been trying. And the government has altered its priorities for strict inflation control to stimulate manufacturing and other enterprise growth. If a commitment is not made to staying the course on fiscal responsibility, all bets for success are off.

Mr. Chairman, I look forward to hearing from our witnesses. I believe that Congress and the President have cooperated in providing the groundwork for launching this great experiment. Like so many other complex efforts, much will depend on the follow-up actions that we take collectively with the other G-7 and G-10 members, as well as with the former Soviet states.

PREPARED STATEMENT OF KARIN LISSAKERS

I commend the committee for taking up the very crucial issue of the external debt of the former Soviet Union, particularly this week, when Russia and other republics are being admitted to the multilateral lending institutions and the West has agreed to a large aid package. That aid, I believe, will be completely wasted unless there is a simultaneous resolution of the debt problem. The West's handling of the debt problem to date has undermined our broader objectives in the east.

The top economic priority for the former Soviet republics should be to rebuild and modernize the economy and to halt the plunge in living standards that is stirring social unrest and undermining popular support for democratic reforms.

Instead, under heavy pressure from the West during the last year and a half, the Soviet Union and its successor republics have had to give priority to servicing the large foreign debt of the old Union. Failure to pay, they have been told would result in a loss of "credit-worthiness" and hence further access to Western financing.

THE DEBT

CIS debt totals around $70 billion, including arrears, according to recent estimates. (Neither the CIS nor the creditors have an accurate count. The CIS has hired a Western firm to do an audit.) Perhaps ⅔ of the total is owed to or guaranteed by western governments, the rest to western banks and exporters.

U.S. government exposure is negligible, end American banks are owed less than $400 million, total. The biggest creditor by far is Germany—government, banks and exporters—followed by France, Japan and Italy. The UK and Austria also have sizable exposure.

The Soviet foreign debt ballooned in the late 1980's as the USSR, like other troubled economies tried to cover a weakening economic performance, a worsening trade balance and deep budgetary problems by borrowing abroad. Commercial banks provided the bulk of the financing. Medium-term unguaranteed bank debt surged from $12 billion in 1984 to $40 billion by year-end 1989. Guaranteed bank and non-bank trade credit was around $10 billion. Western exporters also extended billions in so-called suppliers credits, without own-government guarantees.

The Soviet Union was considered a AAA risk until late 1989. In 1990 and 1991. Western banks stopped rolling over unguaranteed loans and shortening maturities. Increasingly, banks insisted on Western government cover for new credits, thus shifting more of the risk from themselves to their governments.

In 1991, German banks were owed $22 billion, with perhaps 65% guaranteed by the German government; perhaps 80% of British bank loans are government guaranteed. French banks were owed $5.6 billion, Japanese and Italian banks $4.5 billion each. with the extent of government coverage unknown. [Data from IBCA]

THE PAYMENT PROBLEM

Until last November, Western banks and governments insisted that the Soviet Union and its successor republics continue to service the debt in full, despite growing political turmoil and economic hardship. Thus, instead of increasing imports of western raw materials and capital goods that are essential to economic revitalization, the Gorbachev and then Yeltsin regimes suppressed imports to only the bare essentials of food and medicines because the country lacks sufficient hard currency to both finance imports and service the debt owed the West.

Despite plunging domestic production, inadequate energy supplies and food for the local populace, and the disappearance of all but the most basic consumer items, the former Soviet republics actually ran a trade *surplus* in 1991. This surplus was achieved not by increasing exports but through a severe compression of imports—down 40% by IMF estimates. Imports of essential raw materials and spare parts to keep industry going were canceled, Western technology to upgrade oil production and other critical sectors could not be afforded.

The desperate payment situation and the central government's efforts to get its hands on every penny of hard currency earned has had a chilling effect on foreign investment and on the new private sector.

At IMF and G–1 insistence, the Russian and other republics have tried to re-centralize control over all hard currency resources earned by their economies to make them available for debt servicing. Enterprises are required to sell 40% of their export earnings to the central authorities at an artificial exchange rate that is much below the market rate for the ruble. They are also subject to taxes that may be as high as 60% of income. Predictably, exports have plunged.

The payment crisis is also choking off the fragile beginnings of a private sector. With no well-developed private banking sector or other non-official sources of credit, the new enterprises see business links with the West and access to hard currency as crucial to growth and independence from state control. As the government enacts new decrees to force enterprises to disgorge export earnings or joint venture funds, normal commercial relations with the West are impossible. I was told by Western businessmen in Moscow that in the last year or two, many hard currency payments paid into Vneshekonombank by enterprises for on-payment to Western suppliers have been diverted to meet the government's own debt obligations. This has left many Western exporters with unpaid bills totalling somewhere in the range of $5–$7 billion. And because of these unpaid bills, Western exporters and export credit guarantee agencies have largely cut off credit to the republics and to the new enterprises.

Those enterprises that do get their hands on hard currency understandably try to keep them abroad. Capital flight, I am told by bankers, is rampant. In March, the Russian central bank froze the bank accounts of all Western/Russian joint ventures, apparently to keep them from transferring hard currency abroad.

This situation is also driving away private Western investment the CIS desperately needs. Western bankers in Moscow say that many foreign investment projects are on hold because of the debt situation. As long as the central authorities plan to appropriate scarce hard currency resources for their own use, to service the old Soviet debt, western firms can't see any hope of repatriating profits their Soviet ventures might earn. So why invest?

THE PAYMENT OUTLOOK

Government creditors (the "Paris Club") and commercial creditors (the "London Club") reluctantly agreed late last year to a 90-day moratorium on repayment of medium-term debt coming due during the moratorium period. The CIS was to stay current on all interest payments during the moratoria. At CIS request, Paris Club have recently agreed, and commercial banks probably soon will agree to another short-term moratorium.

However, the Russian central bank told the March 26 Frankfurt meeting of bank creditors that the republics have been unable to meet the remaining $2 bill ion per month obligations, and arrears are mounting. The Institute of International Finance, which represents the big commercial banks in Washington, announced on April 22 that past-due interest on CIS bank debt in the first two months of the year totals $400 million,

The CIS authorities told the banks in March that they expect a $17.4 current account deficit for 1992 ($5.8 billion for Russia alone) if Western creditors renew the 90-day debt moratoria. With full servicing of external debts, the financing gap would be $28.3 billion for the year. ($12.6 billion for Russia) The IMF and the EBRD recently projected an even larger 1992 payment gap, of $40 billion for the CIS, $24 billion for Russia.

POLICY OPTIONS

The West can help the CIS cover the financing gap by lending them more money (which adds to the debt, of course), and/or by extending debt relief. That is, forgive or postpone more debt payments until the CIS economies have recovered the capacity to pay.

Creditors obviously hope that access to IMF and World Bank funds will enable the republics to resume debt servicing. Congress will shortly be voting on a $12 billion authorization for the U.S. share of an IMF quota increase to enable that agency to lend more to the former Soviet republics.

The commercial bankers' IIF issued a statement last week regarding the multilateral lending agencies' loans:

> "Access to the resources of the international financial institutions should be contingent upon clearance of existing arrears and maintenance of full and timely payment of debt service to all creditors."

According to Knight-Ridder, the IIF warned in a letter to the World Bank and IMF that "punctual servicing of existing obligations to banks" is a precondition for banks to extend loans to the former Soviet republics.

We have been down this road before.

In the 1980s, Congress was asked to vote more money for the World Bank and the IMF so they could help Latin America and other developing countries service their foreign debts, For seven years, Latin America and the other debtors borrowed from the IMF and the World Bank and squeezed imports to pay off bank loans as they came due and to pay rising interest costs. World Bank data show that from 1982 to 1988, developing countries paid out $183 billion more to commercial banks than they received in new commercial loans. Much of that money came from the development agencies which lent debtors $25 bill ion more during those years than they received in debt servicing.

At the end of this process, the debtors were in even worse economic shape than they had been at the beginning of the decade. By 1989 their debts had doubled, their capital stock had been depleted and real per capita income in Latin America had declined more than 10%. Foreign direct investment had completely dried up, internal capital had fled. And the banks, of course, did not consider these countries "credit-worthy."

We should not repeat this futile cycle in the former communist bloc. Providing aid *without* debt relief guarantees that Western aid will have to be used by the CIS primarily to meet interest and loan payments rather to pay for vital capital goods, raw materials and food from the West. Without these vital imports, efforts to modernize and expand the productive capacity of the country will fail.

The debt restructuring should be comprehensive and multi-year. Short-term, quarter by quarter moratoria merely perpetuate uncertainty about the balance of payments situation, making long range planning and commitment by foreign and domestic enterprises impossible. This in turn means that the private sector cannot play the role it should in the east's revitalization, and the entire burden will fall on governments, that is, on Western tax payers.

Furthermore, continued scarcity of foreign exchange because of heavy debt servicing demand will put steady downward pressure on the ruble and probably swamp any ruble-stablization fund that is put in place.

The West should be prepared to do for the CIS at least what it did for Mexico and other Latin American debtors under the Brady Plan. Under the Brady Plan, Mexico's medium term bank debt was converted into 30 year bonds carrying reduced levels of interest. A very modest reduction in total debt was also agreed. The difference here is that, given the structure of CIS debt, official loans would have to be included in the restructuring to provide significant easing of the payment burden.

I think it is also important to break up the debt and allocate it to the various republics. It is futile for the West to insist that the republics be jointly responsible for the old Union debt and pay as one. Given the deep suspicions and strong desire of the smaller republics to get out from under Moscow's thumb, they seem unlikely to pay desperately scarce foreign exchange to Russia's Vneshekonombank for onward payment to Western creditors.

Making the republics jointly responsible also puts the republics that are willing and able to pay at the mercy of weaker or less willing republics. The former's credit standing and access to the West will be contingent on the very weakest paying up. The stronger—read Russia—will have to put pressure on recalcitrant republics to pay their share. Perhaps this is what Western policy makers intend. I think it is a formula for further exacerbating an already tense and unstable CIS relationship.

The debt should instead be broken up and allocated to the individual republics. The burden-sharing formula for this allocation already exists. Loans originally made to the Soviet Union would be converted into *Russian, Kazakh, Kirghizian, Moldovan* and so on bonds.

These bonds would trade in the secondary market as do the debts of other troubled debtors, Investors could distinguish between well and poorly performing republics. More importantly, republics that do not live up to their part of the debt deal and service their bonds could be sanctioned without dragging down the republics that do. In other words, dividing and allocating the debt individually would make it more difficult for laggards to hide behind Russia's skirts. Or for Russia to blame other republics for the failure to pay.

For all the limitations of the Brady Plan, we have seen in Latin America the benefits of a reasonable and long-term debt plan. Since 1989, long term debt restructurings, combined with domestic reforms, have triggered an economic revival and the resumption of private foreign capital flows to Latin America. $40 billion in foreign capital flowed to LA last year. Modest growth has resumed. The same can result can be hoped for in the east, but only if the debt problem is confronted now.

To conclude, I would restate the IIF recommendation:

> "Access to the resources of the international financial institutions should be contingent upon a comprehensive and sustainable long-term restructuring of the old Soviet debt."

PREPARED STATEMENT OF M. PETER MCPHERSON

Mr. Chairman, Senators and distinguished guests. Thank you for the invitation to testify before this subcommittee on the crucial issue of "financing reform in Russia and the CIS." ~~I believe it is one of the most important foreign policy issues~~ facing our country today.

As background to my comments this morning, I would like to say a few words about Bank of America's relationship with the governments of Russia and the CIS, and our long term business involvement in that country. Bank of America opened a representative office in Moscow in 1973. Over the past two decades the Bank have participated in limited lending to Russia and the former USSR, primarily in support of U.S. customers exporting to that region. The Bank cut back sharply in its lending to the USSR in recent years. Prior to the merger with Security Pacific, Bank of America had no loans outstanding to the Soviet Union. Security Pacific held a modest amount of exposure, especially in comparison with the major European banks, and this was written down further in connection with the recent merger. Bank of America represents the U.S. banking community on the international bank advisory committee which is negotiating with the governments of Russia and other CIS states on the external debts of the former USSR. My bank also chairs the Economic Subcommittee reviewing the economic and financial conditions in Russia and the CIS. We have been asked to play these roles as our low exposure gives us a certain neutrality and due to our extensive experience in external debt restructuring.

My comments will focus on four areas:

1. An evaluation of the Russian economic reform program,
2. An assessment of the external financing in support of this reform program,
3. The role of commercial banks in this process, and
4. The appropriateness of "debt relief" or "debt forgiveness" in the Russian/CIS context.

Western financial support can play a key role in speeding the transition process and reigniting the engine of this giant economy. International banks have a special "commercial" role in building market economies in the CIS and Russia. I will include in my remarks some ideas about how commercial banks can provide "market oriented" financial measures to support the Russian and CIS governments during this transition to a market economy.

A. THE RUSSIAN REFORM PROGRAM AND PROSPECTS FOR RUSSIA AND THE CIS

I believe that the new government of Russia has adopted a courageous and ambitious economic reform program. It marks the start of a turnaround from the deep economic crisis afflicting the Soviet Union in 1991, which led to a 15% fall in national output and near "hyperinflation." If this program is fully implemented, the economy could show signs of real improvement in the next 1 to 2 years.

I agree with the fundamental strategy of the Russian government. Recent steps to reduce the budget deficit, the introduction of positive real interest rates, and curbs on the unlimited printing of rubles will reduce the danger of hyperinflation. The elimination of many public subsidies and the liberalization of energy, food and other retail prices—a courageous and essential step—will provide a sounder basis for the shift to a market economy, where supply and demand guide output decisions.

The structural reform program is equally important. Steps to privatize retail shops and small companies are an important precursor to broader private ownership of the large state companies which previously dominated the Soviet landscape. Reform of the banking system and the emergence of private Russian commercial banks are vital steps in building a market oriented economy. The Russians have also taken positive steps to open up the foreign trade sector and to combat monopolies. These are crucial measures to hold down inflation and introduce competition into the emerging market in Russia.

I have some concerns over the implementation of policies in specific areas. The Russian fiscal deficit is a big worry. While the government has cut the deficit from over 15% of GDP last year, it will have difficulties meeting the new target of 5% of GDP this year. Much of this is due to problems in restructuring the tax system and the need to create a social safety net. Monetary policy was recently softened as the government approved Ruble 200 billion in special credits to prevent enterprise shutdowns. Weaker fiscal and monetary policies have added to the strain on the ruble exchange rate. I have serious concerns that unless the government can implement tighter macroeconomic measures, it will not be able to defend the targeted exchange rate without an enormous loss of reserves. This raises serious questions about the operation of the Stabilization Fund. Finally, I are somewhat perplexed by the slow pace of structural reforms, especially delays in adopting a law on private property, lack of clear guidelines on foreign investment, and the absence of contract laws. Without these measures, new foreign investment and rapid privatization will be stymied.

On balance, though, I believe the trends are favorable. The Russians are heading in the right direction, and the Western governments and commercial institutions would be well advised to support this program. I have not spoken about the emerging reform efforts in Ukraine, Byelorussia, Kazakhstan and the other independent states. In most cases, these lag somewhat behind the Russian experience. I share the concerns of many about the disruptions in interstate trade, the problems of the ruble zone, and shared responsibility for the external debts of the former USSR. However, these are issues beyond the scope of my comments today.

Overall we must view these reforms as part of a long-term process, moving toward market economies. Throughout the transition process, external financing and new capital flows will contribute critically to the development of these markets.

B. EXTERNAL FINANCING FOR RUSSIA AND THE CIS

Over the next several years, the Russian economy must increase the production of essential consumer goods and products for export if the reform program is to succeed. This will build support for market reforms and accelerate the steps toward convertibility of the ruble—an important element of Russia's participation in world trade and finance. To support this longer term development, Russia will need new capital investment from Western countries, the transfer of technologies, and, most of all, technical expertise and managerial training.

In the short term, external financing will play a very different but vital role. During 1992, Russia will need to purchase approximately $11 billion in essential imports of food, medicine and spare parts. This will ease the burden of adjustment for the population and help jump-start the economy. At the same time, Russia has virtually exhausted its foreign exchange reserves. Hard currency reserves in January were less than $200 million—equal to only a few days of imports. These are the two areas where help is needed immediately.

Most of the financing appears to be identified:

- The IMF contribution is critical. The approximately $3 billion targeted for Russia in 1992 will build hard currency reserves from very low levels. These funds will provide a buffer, help normalize Russia's cash flow position, and rescue the country from a virtual breakdown in its current payments system. If the Russians adhere to the IMF program, this money will, on a net basis, remain in reserves, and not flow to banks, suppliers or official export credit agencies nor reduce outstanding debts.

- Loans from the World Bank and EBRD, estimated at $1.5 billion, will finance essential imports or support reforms in key sectors.
- Bilateral creditors are planning two major efforts:

(1) to reschedule maturing principal payments on loans extended before January 1991 (equal to about $2.5 billion).

(2) to extend new export credits or credit guarantees, estimated by U.S. Treasury at between $8.5 billion and $11 billion. These credits will finance imports of food, medicine and spare parts for key industries.

I would like to pause and note the obvious tension between the reform path chosen by the Russian government and the immediate needs of the population. Some argue that the "shock adjustment" program is too rapid, that it poses excessive hardships on the population, and that it should be phased in over a longer period. I agree that this would have been desirable, if prevailing circumstances had permitted this. However, the Russian authorities faced a deep crisis in late 1991, with an economy spinning out of control. The government had no other option than sharp adjustment measures. The Russian authorities also lacked the resources, both domestic and external, to gradually ease into a market style economy. I believe that Western governments are sensitive to the true hardships facing the population, and the large scale food assistance provided in early 1992 is one example of the type of support governments may provide to reduce the pain of rapid adjustment.

A brief word about the $6 billion stabilization fund. I have some misgivings about the possible operation of this fund. Unless the Russian authorities tighten fiscal and monetary policies further, these funds could be depleted—financing an outflow of capital from Russia—without stabilizing the ruble exchange rate. The Polish and Czechoslovak experiences show that, with appropriate macroeconomic policies and a carefully chosen exchange,,rate, the stabilization fund will not be drawn but rather serve as a backstop" or foreign exchange safety net. I support the proposed arrangement which will use the General Agreement to Borrow, allowing the funds to be drawn under IMF supervision and only in the context of an IMF standby program.

Now let's turn to the role of commercial banks in financing reforms.

C. COMMERCIAL BANKS IN THE RUSSIAN REFORM PROCESS

I believe that commercial banks have a unique role to play in supporting the transition to a market economy in Russia, both in the short term and over the next decade. I should note that the European banking community is likely to play the largest role in the next few years, both as a consequence of their relative exposure and their business orientation toward Russia and the CIS.

At the moment, it is too early to embark on a medium term restructuring of Russia's external debt obligations to bank creditors. The commercial banks cannot fashion a medium term debt solution with the Russian government until several things happen.

- The domestic economy has reached some level of short term equilibrium. This would include greater price stability, improved fiscal and monetary policy, and a predictable trend in the balance of payments.
- The government enters into an IMF Standby Program.
- The government gains greater control over the foreign exchange system. At present, the Russian authorities are experiencing severe problems in securing foreign exchange receipts from exporters due to weaknesses in the customs system, lack of bank supervision, and inadequate enforcement of existing laws. These are issues of great concern to all lenders.

Over the next few months, the banks may defer maturing principal payments to help Russia with its short term financing problems. But looking beyond the conventional steps, I believe it is time to propose creative solutions to the short term financial problems confronting Russia and the CIS. I would suggest exploring the following options:

- A portion of Russian or CIS hard currency interest payments could be recycled into a special trade facility. Commercial banks would relend these funds to Russian banks or enterprises for the purchase of essential imports. The funds would be used to bolster exports and hard currency earnings, facilitating repayment and permitting the funds to be relent several times. We estimate that this could increase the trade finance available to Russia by $0.5 billion to $1 billion—at a time when foreign credits are extremely difficult to obtain.

- Some banks might be willing to exchange a portion of the current or past due interest owed to them for local currency. This local currency would be used to provide pre-export finance, i.e. cover the local financing costs of Russian exporters. This would again bolster hard currency exports and support Russian or CIS banks and enterprises.
- Other creditors may be willing to receive a portion of their interest in local currency, with the agreement that the local currency could be used for new direct investment, conversion into existing enterprise under the privatization program, or purchase of assets in the CIS.

Local currency options would, of course, require an appropriate exchange rate, a solid legal basis for foreign investment, and appropriate macroeconomic policies.

The options should not be formalized. Commercial banks must be able to craft financing alternatives which fit with their corporate strategies in Russia and the CIS, and benefit both the banks and the country.

Over the longer term, international commercial banks can offer much to Russia and the CIS. The banks may:

1. help contain and work out the debts of the former USSR, through a medium term restructuring agreement with appropriate grace periods.
2. work with the government to help privatize the thousands of state owned companies. This could incorporate debt/equity and debt conversion elements as in Latin America.
3. train Russian bankers and introduce Western banking technologies into Russian banking.
4. supply trade finance, foreign exchange services and other valuable financing instruments.
5. in time, project finance may become available where export receipts can be used as security, especially in key commodity exporting areas.

Commercial banks can provide great benefits in bringing Western financial practices to the emerging market economies of the CIS. However, this must be seen as a commercial relationship—building business ties for the future.

This brings me to the final issue: debt relief.

D. DEBT SERVICE CAPACITY IN RUSSIA & THE CIS

I share the belief of the U.S. Treasury that it is too early to decide a full long term solution to the commercial bank debt in the CIS, and therefore too early to consider permanent' debt relief.

Russia's debt and debt service ratios are quite low compared with levels in other middle income countries. The ratio of total debt to exports is estimated at 240% in 1991, less than the level in Mexico or Greece and only slightly above such countries as Turkey or New Zealand. Interest payments currently absorb only 18–19% of total hard currency earnings of the CIS. Moreover, these static numbers fail to capture the underlying strength of this "sleeping giant." Over the past two years, Russian oil exports have fallen by half due to the lack of spare parts and absence of investment in new extractive technologies. As the Russian economy begins to recover, oil production will increase rapidly, while conservation measures will redirect petroleum into export markets. This same trend will be repeated in a wide variety of commodity and high technology industries. This will further improve the debt service ratios. It appears that the problem in Russia and the CIS is not one of "debt overhang" or fundamental insolvency. Rather, these states may face short term liquidity problems, arising out of the tremendous structural problems in the economy. It is essential to focus on the steps needed to address the liquidity problems: new external financing, appropriate adjustment measures, and steps to improve management of debt and foreign exchange.

The states of the CIS should be able to service a higher level of borrowings *if* they improve their management of foreign exchange and spend the new funds wisely. At the moment, though, they have accumulated arrears to all their external creditors: banks, suppliers, export credit guarantee agencies, and others. The interruption of interest payments has led to a halt in new credits granted by European and Asian creditors, and a block on disbursements from previously committed commercial bank funds. The Russians must reverse this downward spiral by making some payments to unfreeze credits; this will help secure new funds for their import requirements.

Russia needs to ensure that it has access to private capital markets over the next several years, as it restructures its economy. The variety and diversity of capital flows—whether trade finance, leasing, capital markets products, or basic commercial lending—are all part of a developed financial market. Russia should not handle its debt problem now in such a way that could further jeopardize its access to world capital markets at the point where its financial system might take off.

Western governments may choose to grant debt relief for foreign policy reasons, but commercial banks are motivated by commercial concerns and should adhere to this role. The two groups have different roles and responsibilities toward the CIS—ours is to help build a "market" i.e. profit-oriented economy and to make money for our shareholders.

In review, I believe:

(1) The Russian government has adopted a sound adjustment program. I hope they find it possible to accelerate the implementation of key aspects of this program.

(2) The external financing program presented by the Russian government and IMF is sound, as best we can judge today. The Administration's proposals are a well-tailored component of this overall package. These funds should be expedited to support the IMF Stand-by program, expected to be approved later this summer.

(3) It is too early to decide a long-term debt solution for the CIS, and thus too early to consider permanent debt relief.

(4) Commercial banks may consider a variety of options to support Russia's short term financial requirements including the recycling of interest payments, or ruble payments directed into pre-export finance, investment in the new privatization program, or equity in the country.

Prepared Statement of Roger W. Robinson, Jr.

Mr. Chairman, it is a privilege to be asked to appear before this Committee to provide testimony on the financial and policy implications of the former Soviet Union's debt burden in the context of the proposed $24 billion Western aid package for the Commonwealth of Independent States (CIS). I very much appreciate the opportunity thus afforded to me to discuss with you and your colleagues appropriate U.S. and Western policy responses.

My views on this subject are informed by eighteen years of involvement with East-West financial and economic matters. As you know, I served as Senior Director for International service, I was a Vice President in the International Department of the Chase Manhattan Bank, where I had responsibilities for Chase's loan portfolio in the USSR, Eastern Europe and Yugoslavia for a five-year period. In that capacity, I was the principal negotiator for Chase Manhattan during the Polish debt rescheduling in 1981. I am currently the President of RWR, Inc., a Washington-based consulting firm.

I propose to review briefly the limitations of the Bush Administration's proposed "Freedom Support Act;" my testimony this morning will address how this Western aid initiative should be reconfigured to respond effectively to the needs of the successors to the former USSR while protecting the interests of U.S. and other Western taxpayers. In this connection, I will argue that **substantial, multi-year debt relief should be the centerpiece of this aid initiative.**

Finally, I will offer some concluding remarks on how the Congress can take the lead in redressing key deficiencies of the Administration's present assistance package. In preparing this testimony, I have drawn from recent analyses published by the Center for Security Policy and which I had the principal role in drafting.

THE FRAGILITY OF REFORM EFFORTS

For several tense days over the past fortnight, the West anxiously watched as Russia's communist-dominated parliament threatened to derail Boris Yeltsin's political and economic reforms. In the end, hard-line deputies elected before the Soviet Union's collapse were unable to defeat Yeltsin and his government outright. The communists were not beaten back, however, until after they had achieved significant slippage in Yeltsin's economic reform milestones. In addition, they were successful in forcing Yeltsin to pick a new cabinet by July, an action with significant political as well as economic implications.

This slowdown in reform is especially evident in such critical areas as: institutionalizing ownership of private property; ending subsidies to inefficient state-owned enterprises; massively privatizing government monopolies; restricting the money supply; removing energy price controls; dismantling the military-industrial complex; curtailing confiscatory tax policies; and terminating hostile intelligence activities. The ease with which the pace of reform in Russia was slowed—to say nothing of how close Yeltsin came to suffering a far more serious reversal of his program—ought to serve as an important warning to the West.

In my view, Mr. Chairman, the Bush Administration and other Western governments risk making an immense strategic miscalculation—one that may equal (and would certainly compound) their earlier over-investment in preserving Mikhail Gorbachev's regime—if they ignore this reality: Most of the post-Soviet political and economic reforms (in Russia and elsewhere), if they have been implemented at all, remain fragile and eminently reversible.

The resilience and continued influence of communists and their Soviet-era institutions cannot be underestimated. All other things being equal, it is these forces who will be best positioned to succeed the reformers if the latter fail. In turn, it would be the "ex-communists" who could wind up benefitting from unconditioned or open-ended Western assistance programs intended to support democracy and free markets.

In short, the West must not make the mistake of ignoring this backdrop in the development of assistance programs for Soviet successor states. Unconditioned, undifferentiated or otherwise undisciplined aid—such as that sought in the Bush Administration's proposed "Freedom Support Act"—seriously disserves the reformers in the former USSR. It also exposes American taxpayers to potentially vast, and wholly unnecessary, new strategic and financial liabilities should Gorbachev (or some other communist or authoritarian figure) come to power in the future.

WE KNOW THAT A DISCIPLINED APPROACH MATTERS

Three qualities exemplified the West's palpably failed policy toward the Gorbachev regime: (1) a lack of economic and political conditionality as an explicit quid pro quo for Western assistance; (2) the absence of discipline in structuring aid transactions and (3) an unwillingness to demand transparency, in particular with respect to Moscow center's financial dealings. All too frequently, it was sufficient for the communists to express "a commitment to reform." Milestones were rarely, if ever, spelled out, let alone held to; and full data disclosure was not demanded. President Gorbachev was simply not made accountable for his woeful lack of follow-through on promised economic reforms and democratization. To the contrary, more often than not, broken promises on economic reforms and repressive behavior in relations with the Baltic states and other former republics were rewarded with more assistance.

Tragically, as a result, there is precious little to show for the tens of billions that flowed to Moscow center under this approach. As the National Security Council's Ed Hewett (who was, ironically, in the past among the most assiduous of those who advocated undisciplined aid to Gorbachev and who is currently a proponent of the Administration's misguided approach) put it recently: "No one is quite sure where [the money] went." What *is* clear, however, is that the legacy of Western aid to Gorbachev is that **the Soviet successor states have inherited chaotic economic conditions and a mountain of foreign debt—a legacy that severely burdens, and may ultimately thwart, needed political and economic reforms.**

WHAT'S WRONG WITH THE ADMINISTRATION'S AID PLAN?

As presently drafted, the Administration's aid program could have been written as part of the earlier campaign to prop up Mikhail Gorbachev. Whatever its genesis, it certainly reads like a wish-list for any future authoritarian regime that might come to power under his leadership—or that of some other faction.

Consider the following similarities between the present U.S. approach and that pursued prior to last December on behalf of the Gorbachev regime:

- **Political and economic conditionality is not explicitly established**—The Administration's version of the "Freedom Support Act" instead says U.S. policy *"should"* take into account requirements for reform. Even that exhortatory language only makes one general reference to the need for democratic change. There is no explicit requirement that would-be recipients of American aid in the former USSR desist from activities inimical to Western interests (e.g., continued military occupation of the Baltics states, strategic force modernization, retaining on alert nuclear missiles aimed at the United States and its allies, preserving the military-industrial complex's monopolies and pursuit of technology theft, hostile espionage activities and the construction of dangerous nuclear reactors near Cienfuegos, Cuba).

Similarly, a *"commitment* to economic reform" is wholly inadequate as a standard by which Soviet successor states can qualify for Western aid. As with its earlier effort to bail out Gorbachev, the Bush Administration has failed to stipulate precisely the steps that must be implemented if a working free market is to be established and allowed to function (e.g., institutionalized rights of private ownership, privatization of state-owned enterprises, enactment of a commercial code, restructuring of the banking and monetary systems, reasonable taxes and liberalization of foreign trade).

- **Government-to-government aid flows are emphasized**—as opposed to nurturing entrepreneurship and free-market behavior at the grass-roots and enterprise levels of the Commonwealth of Independent States (CIS). If a genuine transformation of the Soviet political and economic landscape is to be achieved, however, the emphasis must be on constructing democratic and free market institutions from the bottom-up.
- **Additional taxpayer credit guarantees**—primarily for agricultural purchases—and investment guarantees are pledged. The Bush Administration, for example, proposes to raise total U.S. taxpayer exposure in the former Soviet Union through the Commodity Credit Corporation (CCC) to $4.85 billion. It must be expected that the Export-Import Bank and Overseas Private Investment Corporation will similarly be urged to assume significant exposure. (Remember that in recent years, CCC and Eximbank were directed by the State Department and the White House to take steps leading to multi-billion losses in Iraq, part of which went to underwrite Saddam Hussein's weapons procurement program.)

Such government guarantees are attractive to the Bush Administration for two reasons: First, it wants to portray as minimal the costs of aid to the former USSR that will have to be borne by the American taxpayer. In fact, as the domestic savings and loan scandal showed, contingent liabilities can soon lead to debilitating losses.

Second, U.S. government guarantees largely serve to enrich politically influential parts of the American business community—notably agribusiness conglomerates like the Archer Daniels Midland Corporation and other exporters—even if they may not do much for the beleaguered peoples of the former Soviet Union.

- **The United States refuses to make tough political choices between would-be recipients, choosing instead to delegate decisions to faceless multilateral institutions.**—While this approach—like the use of government guarantees—serves to disguise true taxpayer costs, it amounts to transferring undue authority to institutions that have, on balance, a poor track record when it comes to transforming command economies into market ones.
- **Germany continues to exercise undue influence over the character, size and timing of aid programs.**—The United States' abdication of leadership, evident even before Germany took over the chairmanship of the G–7 last January, gave Bonn free rein to "go its own way." This so-called "Sinatra Doctrine," endorsed at the London and Houston Economic Summits, perpetuated Mikhail Gorbachev's misrule (perhaps by several years) and helped to saddle the people of the former Soviet Union with some $80-plus billion in debt—debt the Germans are loath to forgive or even reschedule.
- **The Baltic states continue to suffer from Washington's benign neglect.**—Prior to the collapse of the Soviet Union, the Bush Administration refused to recognize or materially support Lithuania, Latvia and Estonia for fear of irritating Gorbachev. Incredibly, these states are now being explicitly excluded from the benefits of the "Freedom Support Act," presumably on the grounds that they do not belong to the Commonwealth of Independent States.

This pretext does not apparently apply to Georgia, however, which is permitted to benefit from the Act's largesse despite its non-membership in the CIS. The only explanation for such a disconnect is that the Administration views it as a *sop to the region's once and future communist strongman, Eduard Shevardnadze, and his efforts at a political comeback.*

- **The Administration persists in recklessly decontrolling exports of militarily relevant technology.**—In so doing, it is making available dual-use technologies that can help the former Soviet military-industrial complex remain a going concern—despite announced budget cuts. Alternatively, these lax export policies may create an irresistible temptation to those in the old USSR desperate for hard currency and willing to transfer proliferation-sensitive technologies to malevolent pariah states and other third parties to get it.

DEBT RELIEF—WHAT THE AID PROGRAM SHOULD ENTAIL

The centerpiece of a sound aid program should be multi-year debt rescheduling of 100% of interest and principal due Western government creditors for four-to-five years. In addition, there should be, at a minimum, a "voluntary" rescheduling of 100% of principal due commercial banks along with substantial interest rate reductions. Consideration should also be given to select forgiveness of debt for those cash-poor former Soviet republics actually performing on systemic transformation (along the lines of the 50% forgiveness of Polish debt which followed a series of reschedulings).

Indeed, **a multi-year debt rescheduling would represent the single most important, near-term and affordable step the West could take to give tangible expression to its solidarity with the struggling democratic and free market reformers in the former Soviet Union.** Once a substantial debt relief program has been implemented, it will be possible for Western experts to assess the use that is made of billions of dollars of retained hard currency earnings by the Soviet successor states to advance economic and political reform—prior to the commitment of any large-scale, taxpayer-underwritten new money flows. Unfortunately, to this point the Bush Administration has evinced little willingness to lead a coordinated Western effort on Soviet debt relief.

The need to meet the interest and principal payments due on this debt in the years immediately ahead is one of the main drivers behind Russian (and other Soviet successor states') desperate bid for infusions of "new money" from the West. To **the extent that scarce hard currency resources must be outlayed to repay debt obligations, such funds are unavailable for urgently needed investment and other stimuli to economic growth.** What is more, the requirement under present circumstances to meet these obligations lest creditors (sovereign and commercial) refuse to lend further funds is encouraging the continued—and probably burgeoning—effort to earn hard currency through major arms sales overseas.

Obviously, it is not in the interest of the United States (or, that of the world more generally) to aggravate Russia's internal problems or to provide any additional encouragement to the proliferation of advanced Soviet weaponry. A coordinated allied initiative on debt relief, therefore, should be predicated on a complete inventory taken of the true assets and liabilities—both at home and abroad—of Russia and other CIS member states to help determine the economic trade-offs involved in assuming responsibility for the debt obligations of the former Soviet Union.

The Gorbachev Legacy

During Mikhail Gorbachev's disastrous stewardship over the Soviet economy, the former USSR's total hard currency indebtedness rose from roughly $30 billion to as much as $80 billion or more. The former Soviet republics had very little, if any, decision-making role in taking on the bulk of this crushing debt burden. Neither, for that matter, did they have any appreciable say in the use made of the proceeds of Western borrowings. It was very clear to those of us watching the Gorbachev borrowing binge that, in the absence of reform, this day of reckoning would inevitably come. You may recall, Mr. Chairman, that in my past appearance before your committee, I warned of the USSR's complete lack of creditworthiness and the inevitability of a rescheduling of Moscow center's debt.[1]

Indeed, most of the roughly $40–$50 billion attracted from the West by Gorbachev was used to: support the modernization and expansion of an already bloated Soviet military-industrial complex; fund bankrupt client states from Havana to Hanoi; and finance technology theft, hostile espionage, disinformation campaigns and subversive activities overseas. Only a modest fraction of these funds wound up going toward civilian economic development, health care and consumer goods.

The West's Role

Incredible as it may seem, **Western governments and banks chronically ignored established and disciplined lending techniques in their financial relations with the former Soviet Union.** They routinely eschewed the use of conditionality, transparency collateral and "specific-purpose" (i.e., tied) credits. For example, between 1985 and 1988, about 80 percent of all Western commercial bank credits to the former Soviet Union took the form of untied, balance-of-payments loans—with no effort made to identify where the money was going or how it would be used. This, in turn, provided Moscow center with substantial flexibility in the diversion of borrowed funds to finance communist party activities at home and abroad, as well as other foreign operations inimical to vital Western security interests.

In addition, **Western creditors in general acquiesced to Moscow center's refusal to engage in standard economic and financial data disclosure requirements.** This dramatic departure from normal practice with other sovereign

[1] Testimony before the Senate Finance Committee, "Western Financial Policy Toward the Former USSR: Debt Rescheduling Support for Decentralization or Recentralization," 21 October 1991. See also my testimony before the Senate Foreign Relations Committee, "The Soviet Union in Crisis: U.S. Interests and Responsibilities," 19 June 1991, and that given to the Commission on Security and Cooperation in Europe on 9 January 1992, entitled "The New Commonwealth: Problems, Prospects and Policy Implications."

and commercial borrowers has contributed significantly to the present inability of Western experts to determine the true assets and liabilities of the ex-USSR.

Western governments, particularly that of Germany, knowingly politicized financial relations with the former Soviet Union. Among other things, this was accomplished through the device of allowing their credits to be used to "purchase" narrow national objectives such as German reunification, the removal of Soviet troops and preferential treatment in cleaning up large payment arrearages to German firms. In the end, this political "purchase" scheme was successful—indeed, a bargain—for the roughly $30 billion expended by Bonn.

In short, **most European governments knew in rather precise terms what they were getting for their "loaned" money; they never really expected (or required) full repayment.** This is also true of the $3.75 billion in U.S. Commodity Credit Corporation loan guarantees. These guarantees were pledged and largely disbursed to the former USSR over the course of last year, despite irrefutable evidence that Moscow's creditworthiness had evaporated in private Western credit markets. Although this $3.75 billion is currently excluded from official debt rescheduling arrangements for 1992, **this amount and all allied debt contracted after 1 January 1991 should be immediately folded into a multi-year debt rescheduling.**

The Political Merits of Debt Relief

At a time of economic austerity—and, in some cases, recession—in the West, the idea of debt relief would seem to be highly attractive politically. The following are among the reasons why:

"New Money" Is Hard to Come By: There are relatively few options available at this critical juncture to provide reformist CIS nations with meaningful structural help—other, that is, than through debt relief. **It is hard, moreover, to imagine a more unsustainable idea than that of having such "new money" as Western taxpayers can muster going into Russian or other CIS states only to have it be substantially paid out through the back door to the German government and banks** (and other Western creditors). This is especially true given the role that such creditors played in helping to create this financial disaster by propping up the communist Moscow center with undisciplined lending practices.

The Precedent of Debt Relief is Already Well Established: It should be remembered that the former Soviet Union defaulted on czarist debt owed to U.S. citizens and never settled those outstanding obligations. Similarly, in 1974 Moscow center declined to repay U.S. Lend Lease debts after committing to do so in the early 1970s. (Together these debts are conservatively valued at about $1.5 billion.)

These facts beg the following questions: Why should Russia and other CIS members now be held to a higher standard of accountability for financial liabilities incurred by the Soviet Union than the Soviets themselves were? Specifically, since Western creditors were willing to accommodate themselves to the Soviets' refusal to take responsibility for the outstanding debt obligations of the previous czarist regime, why should they be unwilling to do so as a contribution to the success of a democratically-minded Russia and other successor states?

Without Debt Relief, More Dangerous Arms Sales Are a Certainty: Roughly 80–90 percent of the total annual hard currency income of the former USSR is comprised of exports of oil, gas, gold and arms. With oil production and exports in sharp decline and with the Yavlinsky-announced firesale of about 90 percent of strategic gold reserves in the summer of 1991, massive Soviet arms sales worldwide will be necessary to pick up the slack if Western creditors are to continue to be serviced during this wrenching transformation process.

Multi-year debt relief may not cure the problem of transfers of former Soviet weapons and technology on a cash-and-carry basis to state sponsors of terrorism and other pariahs around the world (e.g., Iran, Iraq, Libya, Syria, North Korea, Cuba, etc.) It would, however, alleviate some of the pressure that the Russian government and other CIS states might otherwise feel to engage in such arms sales.

Downside Risks and Mitigating Considerations

Inevitably, there will continue to be strenuous efforts made by the Bush Administration, other Western governments and numerous private banks to stampede the former Soviet Union into a commitment to service the bulk of all debt obligations. This was evident in the very limited rescheduling of principal payments already agreed for 1992. Some of the arguments likely to be used in this connection—and appropriate rebuttals—are as follows:

- **Risk:** Western governments and banks will threaten to deny any new credits to Russia or other CIS member states if the latter insist on substantial debt rescheduling.

Mitigating Considerations: Although this scenario is possible, it is highly unlikely that Western creditors would be prepared to follow through. Whatever risk remains, moreover, can be substantially reduced by the proper structuring and conditioning of debt rescheduling.

For example, rescheduling both principal and interest payments for Western governments but *only principle payments* for Western commercial banks (along with interest rate reductions) would keep loans reasonably current on the latters' books. Arguably, such a step would permit the relatively rapid reentry of certain CIS member states into private credit markets—*assuming structural reforms remain on track*. New collateralized loan arrangements could also be attractive to private Western creditors, despite non-repayment of most Soviet debt.

- **Risk:** The precedent established by granting long-term rescheduling or forgiveness for a resource-rich nation such as Russia will be called intolerable, and sure to lead to as many as 30 other debtor nations demanding the same preferential treatment from Western creditors.

  Mitigating Considerations: Ample precedents exist for debt rescheduling or forgiveness even in countries with considerable resources. For example, in Poland some 50 percent of official debt was forgiven to assist the transition to a market economy. What is more, the United States forgave outright some $7 billion on official Egyptian debt in exchange for Cairo's assistance during the Gulf War.

  The historic opportunity to consolidate democratic revolutions on the territory of the former USSR—and essentially to remove the horrific threat posed by thousands of nuclear warheads aimed at American cities military installations and industrial centers—should be more than sufficient justification for making conditioned debt relief the centerpiece of the West's efforts to assist Russia and other CIS member states.
- **Risk:** It will be argued that Western banks—and possibly the international financial system as a whole—will be badly damaged by any interruption in repayment of outstanding principal and interest due on Soviet debt beyond the already agreed debt rescheduling of principal-only for 1992.

  Mitigating Considerations: It is a matter of public record that the major German banks (who hold somewhere between DM 6–10 billion in uninsured Soviet debt) have already established loan loss reserves which cover *100 percent of Soviet debt exposure*. Other European banks have taken similar steps.

  Indeed, the Germans have proudly advertised the fact that their banks would not be materially affected by Soviet write-offs. Western governments have similarly resigned themselves to the fact that long-term debt relief is inevitable. They have also begun to put into place the arrangements that will make it manageable. Consequently, the proposed strategy would not cause undue strain on the international financial system.

The Bottom Line on Debt Relief

Properly structured and conditioned debt relief and possible forgiveness represents a potential savings for Russia and other qualifying CIS member states of as much as $40–50 billion over the next four or five years. There is simply no comparable, politically feasible Western assistance measure that would contribute as much to the former Soviet Union's economic revitalization, democratic institution-building and reduced arms proliferation as would conditional multi-year debt relief. It would also offset, to a substantial extent, the probable inadequacy of new and sustained financial flows from the West over the near-term.

Those Western creditors who knowingly bet their taxpayers,' shareholders' and depositors' money on an unworkable, centrally-controlled economic system—for political or commercial reasons—should be accorded little sympathy in weighing appropriate levels of debt rescheduling. Such creditors entered into these transactions with their eyes wide open concerning the dubious prospects for full repayment. It is only sensible and fair that the true democratic forces in the former USSR not be unduly penalized by those in the West who contributed so enthusiastically to propping up a repressive communist regime. Finally, it is essential to clear the decks of past Soviet indebtedness in an orderly fashion and as quickly as possible if new, private sector credit, investment and trade flows are to be resurrected for Russia, Ukraine and other qualifying CIS member states.

OTHER ELEMENTS OF A RESTRUCTURED AID PACKAGE

Beyond debt relief, there are a number of other aspects that should be emphasized in any responsible aid package for the former Soviet Union. These include:

Transparency: The Bush Administration should provide an honest and precise accounting of the likely cost to U.S. and other Western taxpayers of aid to prospective recipients in the former USSR—including any so-called "loans" which are unlikely to be fully repaid in the foreseeable future.

Conditionality: Strict allied economic and political conditionality needs to be created so that the American people can see in concrete terms what they are getting for their money. Such conditionality must include formulation of specific performance milestones—and time-tables for their achievement—in key political, military and economic categories.

Help Eastern Europe While Aiding the Qualifying Former Soviet States: The United States should work with its allies to encourage triangular trade opportunities with the fledgling democracies of Eastern Europe. This could be accomplished through Western funding of exports from these nations to the Soviet successor states.

"Follow the Money": G–7 leaders should agree not later than the Munich economic summit (and preferably earlier) to instruct their respective intelligence services to cooperate in a crash effort, in coordination with the Russian government, to identify and locate the billions of dollars reportedly transferred to the West surreptitiously by the August coup-plotters and the Soviet Communist Party during the Gorbachev period. (The recent effort to track Saddam Hussein's treasure trove offers a valuable precedent for such an effort.) The urgency of this effort is clear as **such funds—estimated to be in the range of $4–14 billion—would likely represent the war-chest for a resurgent authoritarian and/or communist effort** to overthrow successor governments engaged in democratic and free market reforms.

Development of a Private Sector: Priority should be given to private sector development within the former Soviet Union through aid channels directed toward grass-roots entrepreneurial endeavors and transformation at the enterprise level. This can be accomplished through such means as bilateral enterprise funds like those now operating in Eastern Europe (e.g., the Hungarian-American Enterprise Fund). Every effort should be made to ensure, however, that such new organizations are not hindered in their work, as their counterparts in Eastern Europe have been, by the unnecessary and often inept involvement of government bureaucracies.

Use Private Talent: The U.S. government should encourage and underwrite greatly expanded exchange programs employing the talents of current and retired Western business executives, academics, environmentalists, etc. to foster highly decentralized and independent economic activity and initiatives in the former Soviet Union.

CONCLUSION

If U.S. interests—and those of democratic and free market reformers within the former Soviet Union—are to be served, the Bush aid plan must be urgently reworked. Naturally, this will require that the Congress not serve, as the Administration hopes it will, as a rubber stamp on the "Freedom Support Act." Instead, it must become directly and substantively involved in reshaping the package.

For starters, Congress must ensure that answers to the following questions are in hand—something that cannot be said at present—*before* it votes on the "Freedom Support Act" and associated legislation:

- Where precisely is the funding coming from for various components of the aid program?
- Who will be the specific end-users in the former Soviet Union?
- Which Western government agencies or multilateral institutions will be monitoring disbursements and how will this be accomplished?
- Will quarterly progress reports be required by Congress? If so, to whom on Capitol Hill will they go?

Attachment.

THE CENTER FOR SECURITY POLICY

S. 2532—The "Freedom Support Act"—An Article-by-Article Review

On 7 April 1992, the Bush Administration's legislative proposal for aiding the successor states to the Soviet Union was introduced by request in the Senate and House of Representatives. This draft legislation, designated S. 2532, is officially entitled the "Freedom for Russia and Emerging Eurasian Democracies and Open Markets Support Act" and known more informally as the "Freedom Support Act." Having dithered and dallied for months over what aid, if any, it should support for the former USSR, the Administration is now seized with the desire to obtain swift passage of this legislation.

There is evident interest on the part of leading members in both chambers to proceed rapidly at least to "mark-up" of alternative versions of the "Freedom Support Act." While swift enactment appears to be out of the question, their hope reportedly is to be able to demonstrate tangible progress on an aid plan by the time Russian President Boris Yeltsin arrives in Washington for his June summit with President Bush.

In the interest of informing these necessarily fast-moving congressional deliberations—and of ensuring that whatever legislation emerges therefrom actually provides *appropriate* assistance to democratic and free market reform in the former USSR—the Center for Security Policy has prepared the following article-by-article analysis [1] of the Bush Administration's legislative proposal. The Center believes that serious questions remain to be answered about many aspects of the submitted version of S. 2532; it strongly recommends that Congress insist upon authoritative responses to the issues identified below. **Congress must correct the numerous shortcomings of the Administration's proposal if this legislation is genuinely to support freedom and economic opportunity in the former Soviet Union.**

THE OFFICIAL TITLE

The problems with this legislation begin with its formal title. The choice of "Freedom for Russia and Emerging Eurasian Democracies and Open Markets Support Act" bespeaks an continuing preoccupation on the part of the Bush Administration with the old center. It denies the other Soviet successor states the symbolic appearance of equal treatment and unavoidably will aggravate their concerns about U.S.-Russian collusion in an effort to reestablish Russia's imperial domination of the smaller former republics.

Question:

- Is the Administration intent on singling out Russia for special treatment under this act? If so, can it address the repercussions likely to arise from such treatment in terms of U.S. relations with the other former republics?

"SECTION 3: DEFINITION"

In this section, the Administration enumerates the Soviet successor states eligible for assistance for the purposes of this legislation. There are two striking aspects to this list: First, it does not include among the "independent states of the former Soviet Union" the Baltic nations of Estonia, Latvia and Lithuania. Seemingly, this was done on the grounds that they have not joined the Commonwealth of Independent States (CIS) and that the Baltic states are eligible for assistance under the SEED II legislation.

This exclusion is made the more remarkable however, because, second, Georgia is included in the list of eligible states even though it is not a member of the CIS either. Georgia's inclusion appears to be a result of the ascendancy in political leadership of Eduard Shevardnadze, the former Soviet Foreign Minister and brutal chief of the KGB in Georgia—a favorite of Secretary of State James Baker.

Questions:

- Why should states that were, for decades, illegally incorporated into the Soviet Union be denied the opportunity to obtain aid contemplated by this act?
- Should it not be made clear that, for the purpose of this act, eligibility for assistance under its terms depends not only upon having been a part of the former USSR but also upon "qualifying" for such assistance on the basis of *tangible political and economic reforms underway?*

"SECTION 4: POLICY"

The Bush Administration's version of the "Freedom Support Act" deals with the issue of conditionality in this section. Unfortunately, it does so in a hortatory—rather than statutorily binding—way. Five criteria are identified that S. 2532 says the

[1] In the interest of brevity, this analysis addresses only those sections of the Administration's version of S. 2532 that are of special concern.

President "*should* take into account" in providing assistance to the former Soviet Union. These include the extent to which steps are being taken to: (1) establish democratic systems based on the rule of law and individual freedoms; (2) respect for human rights; (3) economic reform based on market principles; (4) respect for international law; and (5) adherence to responsible security policies.

Questions:

- Does the Administration intend to extend aid benefits pursuant to this act irrespective of whether or not the prospective former Soviet recipients meet these criteria? Could a successor state that is actively transferring nuclear technology or other military equipment to third parties, preserving authoritarian political structures and resisting free market economic reforms be equally eligible for American largesse as those that are "qualifying" by satisfying prudent criteria?
- If the answer to these questions is "No," would the intended purposes of this act not be better served by being explicit—and legally binding—with respect to behavior that will render a Soviet successor state ineligible for U.S. aid?
- Should the President not, at a minimum, be obliged to certify formally that a would-be recipient is satisfying the stipulated conditions? Given the fluid state of affairs in many of the former Soviet republics, would it not be advisable to have regular, perhaps quarterly, reports submitted that would document continued progress toward dismantling of communist political and economic institutions and their replacement with democratic and free market ones?
- Were Congress to choose to give the President the latitude to provide American assistance to a Soviet successor state even though it does not meet stipulated reform criteria, should he not be required to submit a waiver and receive explicit congressional approval to use U.S. tax dollars to assist such nations?
- Finally, should further criteria not be stipulated? These might include:

—the prompt and complete withdrawal of troops from the Baltic states and the countries of the former Warsaw Pact;
—institution of effective export control arrangements so as to minimize the danger of transfers of sensitive dual-use and military technologies;
—an end to strategic modernization and sharp reductions in defense spending as a percentage of GNP;
—in the case of Russia, termination of assistance being provided to Fidel Castro to bring on line two nuclear reactors near Cienfuegos, Cuba believed by experts to be Chernobyl accidents waiting to happen ninety miles off the U.S. coast.

"SECTION 5: PURPOSES OF ASSISTANCE"

This section enumerates the various purposes for which U.S. aid may be used. The specified purposes cover the array of areas where such assistance might be sought. Just in case anything else might arise, it stipulates that the aid may be used "for such other purposes as the President deems appropriate."

Question:

- Does the Congress really want to give the executive branch a blank check with respect to the ends to which U.S. tax dollars will be put in the former USSR?

"SECTION 7: ASSISTANCE AND RELATED ACTIVITIES"

This section complements Section 5 in that it provides programmatic authority to the President to pursue the purposes broadly defined in the earlier section. Among the programs that would receive blanket authorization under the Administration's language include: technical assistance, currency stabilization funds, defense conversion, agricultural support, energy programs, humanitarian aid, relocation of former Soviet troops, preventing the diversion of scientific expertise, nonproliferation assistance, educational and cultural exchanges, trade and investment support and information centers, an endowment for a Citizens Democracy Corps and membership in multilateral economic, trade and financial institutions, to name but a few.

This section is as audacious as it is sweeping. It not only hopes to secure Congress' formal blessing on these programs; S. 2532 also strives to insulate them from any future congressional interference. It stipulates that "Assistance may be provided and authorities may be exercised for the purposes of this Act notwithstanding any other provision of law, including any program ceilings on loan, guarantee or insurance programs . . . or in annual foreign operations, export financing, and related programs appropriations acts." In laymen's language, this translates into "Just write a blank check and trust the executive branch to spend it wisely."

Questions:

- The question recurs: In view of the ambitiousness of the initiatives the Bush Administration evidently has in mind, does Congress wish to issue a blank check for their implementation? Can it responsibly do so?

Key Issues Within Section 7 and Relevant Questions:

Ruble Stabilization Fund: The executive branch would be authorized by this legislation to furnish assistance to support "multilateral efforts to promote macroeconomic stabilization through activities such as support for a stabilization fund or funds." (N.B. Section 10 authorizes $3 billion for this purpose.) Particularly striking from the IMF's interim meeting in Washington on 26 April, however, were the large number of unanswered questions over the timing, content and likely success of such a fund.

It is worth remembering, too, that **until very recently, senior U.S. Treasury Department officials have argued that such a fund would not work absent the presence of proper economic fundamentals in-country.** *Prior to* providing a blind endorsement of this multi-billion dollar facility, the Congress should have answers to the following questions:

Questions:

- What is the probability of success for a ruble stabilization fund under the current adverse economic conditions in Russia? Is a 50 percent (or less) likelihood of success worth risking U.S. taxpayer dollars on this program?
- What are the American taxpayers' contingent liabilities in the event the convertibility fund scheme fails?
- Who are the likely winners and losers if there is a run on the stabilization fund?
- How was the $6 billion figure arrived at? Is there reason to believe that a far larger sum might actually be required? If so, do the funds now being sought represent but the first increment of a multi-year program? What is the likelihood that U.S. tax dollars will be lost if additional funds—and taxpayer liability—is not forthcoming?

Defense Conversion: This provision authorizes assistance for "the conversion of defense-related industry and equipment for civilian purposes and uses" in the former Soviet Union. While this is a laudable goal—providing it is doable—the proposed language begs a number of questions.

Questions:

- Who will determine which plants and facilities are to be converted?
- Is there not a real danger that, **if the decision is left up to those who now run the former Soviet military-industrial complex, U.S. tax dollars could wind up going to help modernize (in the name of conversion) what were the USSR's oldest and most obsolete defense production assets** while leaving untouched (and unconverted) its most modern facilities? Under those circumstances, could the potential threat posed by such capabilities not actually *increase* in the future?

Support for Agriculture Sector: The section appropriately endorses support for "improvements in the agricultural sector, including in food distribution and transportation." Ironically however, the United States and other G–7 countries may actually be undermining appropriate pricing and free market forces in the agricultural sector through its heavy emphasis on subsidized grain sales to the former Soviet Union.

Questions:

- Do subsidized sales actually serve to undermine the goal of making the Commonwealth nations more self-sufficient in basic foodstuffs?
- Could the United States simultaneously—and more efficiently—accomplish two important objectives if it were to encourage instead triangular agricultural trade between democratic states in Eastern Europe and Soviet successor states?

Support for the Energy Sector: The bill encourages support for the "promotion of investment in and increased efficiency of the energy sector" as a means for helping the former Soviet Union earn hard currency. Given the strategic significance of energy and the large-scale hard currency cash flow it could generate, the importance of democratic and free market reforms being irreversibly in place prior to such assistance cannot be overstated.

Questions:

- Should the Congress not stipulate, among other conditions, that hard currency revenues derived from enhanced energy production will not be used to support military activities?
- Even though money is fungible, would not an explicit condition of this type help justify suspension of such assistance if, for example, strategic force modernization or other threatening activities were to continue?

Preventing Proliferation of Dual-use Technology: This section endorses support for programs which will help the Commonwealth states to "establish verifiable safeguards against the proliferation of [nuclear, chemical, and other] weapons."

Questions:

- Can such "safeguards" be relied upon in the absence of effective export control mechanisms governing the transfer of dual-use technologies capable of helping countries to develop weapons indigenously? In the case of Iraq, for example, access to foreign supplies of dual-use technologies greatly assisted in the development of Saddam Hussein's weapons program.
- If not, should this legislation not require that such controls be put into place swiftly—certainly before substantial new access is accorded to Western dual-use technology (as President Bush has announced he intends to do)?

"SECTION 9: QUOTA INCREASE FOR INTERNATIONAL MONETARY FUND"

A principal defect of the "Freedom Support Act" is its heavy emphasis on adding new debt to the former Soviet Union—instead of relieving "qualifying" states of the immense burden represented by some $81 billion in old debt inherited from the Gorbachev regime: The need to meet the principal and interest payments due on this debt in the years immediately ahead (roughly $16–18 billion annually) is a major impetus behind the Soviet successor states' desperate bids for infusions of "new money" from the West.

What is more, to the extent that scarce hard currency resources must be outlayed to repay foreign debt obligations, such funds will be unavailable for urgently needed investment, imports and other stimuli to economic growth. For example, **some 84 percent of Western aid received by the former Soviet Union went to repay interest and principal due to its creditors in 1990–1991** according to figures provided by Harvard economist Jeffrey Sachs. Inevitably, the requirement to meet these obligations contributes to Russia's expanded effort to earn hard currency through potentially destabilizing arms sales overseas.

Questions:

- Would a multi-year debt rescheduling of 100 percent of principal and interest due Western government creditors for four-to-five years not have a more constructive, near-term impact on the economic recovery efforts—and the climate for political reform—in the former USSR than will initiatives that simply put the Soviet successor states deeper and deeper in debt (notably, through IMF balance of payments lending)?
- How effective have such IMF adjustment programs been in the past in helping to transform countries with command economies into market-oriented ones?
- Do **IMF and World Bank officials tend to prefer to work with established institutions in recipient states?** Would not the effect of relying upon such international bureaucrats to manage the bulk of assistance efforts be to give a new lease on life to discredited communist-era institutions in the former USSR—rather than encouraging the accelerated removal of these impediments to structural reform? Should not the latter be a principal U.S. objective?
- In any event, will the IMF and World Bank strongly support comprehensive, multi-year rescheduling of official and commercial bank debt like that described above as a precondition for new money flows from these institutions?
- Will the multilateral institutions maintain the integrity of programs for qualifying Soviet successor states as opposed to continuously moving the goal-posts so as to keep them nominally in compliance?

"SECTION 11: ROLE OF THE INTERNATIONAL FINANCE CORPORATION"

Language in this section calls for an open-ended congressional endorsement for "any increase of capital stock of the [International Finance] Corporation that may be needed to accommodate the requirements of the independent states of the former Soviet Union." This affiliate of the World Bank could be a source of substantial future capital for private enterprises in Soviet successor states where private capital is not available on reasonable terms.

Question:

- Should the Congress provide a blank check to the International Finance Corporation for its activities or insist on a specific funding request?

"SECTION 12: COCOM RESTRICTIONS"

This section "commends recent efforts that have resulted in a substantial reduction of the number of items the export of which is restricted under COCOM procedures" and expresses congressional consent for the continuation of such efforts "to reduce the number of items the export of which is restricted under COCOM procedures."

Such language appears to misconstrue the nature of national security export controls. Decisions concerning what dual-use technologies need to be safeguarded for U.S. national security reasons have, until recently at least, been made on the basis of the strategic danger inherent in the transfer of such technologies—not on the basis of the number of items on the control list.

Particularly in the face of mounting problems with proliferation of nuclear and other weapons of mass destruction—and the obvious danger that, under present circumstances, sensitive technology made available to Soviet successor states may hemorrhage elsewhere—it would seem that **the object of the "Freedom Support Act" should be not to encourage reduction in the size of the control list but to enhance its effectiveness.** Obsolete technologies should be removed, but newly-discovered technologies with critical military applications must be *added* to the list.

Furthermore, obsolescence should be defined from a national security perspective, not from an industrial one. In other words, the United States should control dual-use goods and technologies based on what they can or cannot do for America's potential adversaries; such items should not be evaluated from an export control perspective simply by their place in a product life-cycle.

Questions:

- Would U.S. national security interests be better served by specifying that the Congress supports the elimination of *obsolete* technologies from the control list, *but supports the retention of controls needed to guard against the proliferation of militarily critical dual-use technologies?*
- Can the Bush Administration give definitive assurances to the Congress that the Soviet successor states have in place sufficient export control mechanisms to prevent the pass-through of Western dual-use technologies to such former client states as Iran, Iraq, Syria, North Korea and Libya?
- Is the modernization of non-threatening industries in the former Soviet Union possible without engaging in the further emasculation of U.S. national security export controls?
- Is it not likely that the United States may have to increase its defense spending in order to offset the impact of proliferation driven by dual-use technology transfers—transfers made possible by recently announced (and prospective) control list reductions? Even with such additional spending, is it possible that such decontrol measures might result in the deaths of U.S. soldiers in future confrontations with states like Iran, Iraq, Syria, North Korea or Libya?

"SECTION 14: STATUTORY LISTS OF COMMUNIST COUNTRIES AND SOVIET-SPECIFIC RESTRICTIONS"

This section would provide to the President an extraordinarily broad grant of authority allowing him to waive **"any provision of law that would have restricted the eligibility of [the Soviet Union] to any program, benefit or treatment."** As a practical matter, such a sweeping provision would effectively provide the executive branch with a line item veto over congressional initiatives with respect to the former Soviet Union.

Section 14 would also revise the list of communist countries now proscribed from receiving U.S. foreign aid (both military and economic) and Eximbank loans, credit guarantees and insurance. Interestingly, under the Bush Administration's formula, Yugoslavia would be removed from the list of communist countries.

Questions:

- Can the Congress responsibly permit the executive branch, at its discretion, to eviscerate *any and all* laws enacted that bear on relations with the former Soviet Union—including those designed to limit taxpayer exposure to non-creditworthy borrowers?

- At the very least, can the Administration provide a complete listing of the legislation that could be affected by the authority sought under this provision?
- Given that communist-dominated Serbia and Montenegro have now named their new, truncated state to be the Federal Republic of Yugoslavia, are these two republics be rewarded for their aggression against Slovenia, Croatia and Bosnia-Hercegovina by being removed from the statutory list of proscribed communist countries?
- Is this, instead, an opportunity to establish that Croatia, Slovenia and Bosnia-Hercegovina—recently recognized as independent states by the Administration—qualify for U.S. foreign aid and Eximbank assistance but that Serbia and Montenegro do not?

"SECTION 15: ADDITIONAL STATUTORY PROVISIONS"

This section would lift all existing ceiling limitations previously imposed by Congress on commodities furnished from stocks of the Commodity Credit Corporation (CCC) during fiscal years 1992 and 1993." Essentially, this section would give the executive branch carte blanche to provide any amount of grain and other foodstuffs to the Commonwealth states. It is remarkable that the Bush Administration would propose such a step despite the waning probability that any financing accompanying these sales would ever be fully repaid. This is particularly true given the coincidence of this action with the burgeoning scandal concerning the Administration's past abuse of the CCC program, notably, in the Iraq-Banca Nazionale del Lavoro (BNL) affair.

No less astounding is language proposed for this section which would effectively authorize CCC Board members to **disregard standard creditworthiness criteria** when considering new taxpayer credit guarantees for the former Soviet Union. Instead, Board members could simply "take into account the major economic reforms that have been and are occurring in the independent states of the former Soviet Union."

Finally, this provision would have Congress extend blanket authority for "maintaining a substantial guarantee program to promote the export of United States agricultural commodities" to the former Soviet Union. As detailed above (and in a number of previous Center *for Security Policy Decision Briefs*), there is a growing consensus that adding to the already weighty foreign debt of the former Soviet Union is not a prescription for the economic health of the successor states.

Questions:

- Were the Congress to approve this authorization as submitted by the Administration, what would be the expected extent of:
  - —U.S. taxpayer exposure arising from associated subsidies and credit guarantees;
  - —Economic dislocation for East European democracies whose farmers desperately need to sell agricultural products to the former Soviet Union; and
  - —Disincentives for farmers in the CIS and the Baltic states who find themselves unable to compete with imports of subsidized grain and other foodstuffs?
- Can the Congress in good conscience waive standard creditworthiness criteria at the very moment when past CCC credit guarantees seem destined to be incorporated into a comprehensive debt rescheduling?
- Can an Administration effort to relax further subsidized CCC lending practices withstand public scrutiny at the very moment that the BNL scandal appears to be reaching a crescendo?

CONCLUSION

Until satisfactory and, where possible, *documented* answers to the aforementioned questions are provided by the Bush Administration, the Center for Security Policy believes that the "Freedom Support Act" should not move forward through the legislative process. The breathtaking transfer of authority contemplated by the Administration's draft language—if not the fact that the full ramifications of this legislation are not properly understood—demands far more rigorous scrutiny by the Congress than has occurred to date.

- What political, military and economic conditionality will govern disbursements?
- What are the true projected costs going to be to U.S. taxpayers this year and beyond?

I believe that the Congress will also have to take the lead if key deficiencies of the present package are to be redressed. Specifically, the legislative branch must:

- give appropriate priority to substantial multi-year debt relief as the principal mechanism for Western assistance to the former Soviet Union over the next several years;
- insist upon appropriate political and economic conditionality that will govern U.S. aid disbursements—or the suspension of same;
- instruct the executive branch to secure parallel alliance-wide conditionality (through such mechanisms as the Munich economic summit and the annual meetings of the IMF, World Bank, etc.) to avoid the disastrous undercutting of disciplined aid flows that prevailed throughout the Gorbachev period; and
- block further loan guarantees by the Agriculture Department's scandal-ridden Commodity Credit Corporation until a thorough investigation has been completed of past abuses of this lending agency under the Bush Administration. These include the BNL scandal and improper extension of CCC credits to the authoritarian regimes of Saddam Hussein and Mikhail Gorbachev—in the latter case, in apparent direct violation of the statutory requirements of the Farm Act of 1990.

○

ISBN 0-16-039385-X
90000
9 780160 393853