

SOVIET DEBT

HEARING

BEFORE THE

SUBCOMMITTEE ON DEFICITS, DEBT MANAGEMENT
AND INTERNATIONAL DEBT

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED SECOND CONGRESS

FIRST SESSION

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OCTOBER 21, 1991
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SOVIET DEBT

MONDAY, OCTOBER 21, 1991

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

The hearing was convened, pursuant to notice, at 10:05 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-27, Oct. 17, 1991]

SUBCOMMITTEE TO FOCUS ON SOVIET FINANCIAL SITUATION, HEARING WILL EXAMINE
PROBLEMS, POLICY OPTIONS

WASHINGTON, DC—Senator Bill Bradley, Chairman, announced Thursday that the Finance Subcommittee on Deficits, Debt Management and International Debt will hold a hearing next week on the financial implications of recent political and economic developments in the former Soviet Union.

The hearing will be at *10 a.m., Monday, October 21, 1991* in Room SD-15 of the Dirksen Senate Office Building.

"The central Soviet government's institutions and mechanisms have been stripped of their legitimacy and power by the failure of the coup, and we must now look to decentralized political and economic structures," Bradley (D., New Jersey) said.

"The Western response to Soviet needs has been an important issue at the World Bank/IMF meetings in Bangkok this week and I hope that, in addition to exploring the decisions reached in Bangkok, we will also be able to enter into a comprehensive discussion of alternatives to the direction outlined in Bangkok. We need to understand, for example, how international organizations will respond to applications for membership from republics that have declared their independence," Bradley said.

"The changes in the Soviet Union will have an impact on U.S., European and multilateral financial institutions. It is important that we get a clear picture of their exposure to Soviet debt. I hope that this hearing will help us develop a policy that avoids a repetition of the mistakes of the Third World debt crisis," Bradley said.

OPENING STATEMENT OF HON. BILL BRADLEY, A U.S. SENATOR FROM NEW JERSEY, CHAIRMAN OF THE SUBCOMMITTEE

Senator BRADLEY. The subcommittee will come to order. I would like to thank all the witnesses for being here today. This hearing is intended to explore the relationship between the devolution of economic and political power in what used to be the Soviet Union, the economic revival in the former Soviet Union, and Western financial relations with the Soviet Union and the Republics, especially economic relation as it has to do with debt.

Each of the witnesses before the subcommittee today will present, I think, a different aspect of those issues. I would especially like to thank Secretary Mulford who has come directly from the World Bank IMF meetings in Bangkok this weekend, and I greatly appreciate him being here today. And anything he would like to correct in the record after the course of the discussion we will attribute to jet lag.

I also would like to thank Tom Niles, who is the newly-appointed Assistant Secretary of State for European/Canadian Affairs, for being here today as well.

We will have, after the two administration witnesses, a panel of witnesses from outside the administration. Oleh Havrylyshyn, who is a George Washington University Professor, and presently at the Institute of International Economics; Bob McConnell of Ukraine 2000; Roger Robinson, formerly at the National Security Council and now in charge of his own consulting firm; and finally, Jeff Sachs, of Harvard University.

I am really very pleased that these hearings would be possible today. I have been interested in these issues for a number of years. I remember back in October of 1990, about a year ago, we attempted to have a hearing on this subject. Unfortunately, the administration was not available for that hearing and it did not come together.

In the letter that was sent a year ago, the questions that I wanted to address were such things as, is there reason to think that the USSR is too big, diverse, and cumbersome to manage a successful transformation of its failing Socialist System?

Second, might individual republics or groups of republics prove more adept at initiating and sustaining radical, systemic change?

And third, if so, what are the implications for the United States and Western approaches to supporting such changes, and to integrating the USSR and/or its constituent republics into multi-lateral institutions.

Those were the questions that were asked last year, and we hoped to move to a hearing. Unfortunately, that hearing did not take place.

In November of 1990 I raised many of these same issues in a letter to the National Security Advisor, Brent Scowcroft, and the Deputy Secretary of State, Lawrence Eagleburger.

Their responses went to great lengths to demonstrate the breadth and depth of the contacts between the administration and leaders of the Baltic States and the Republics. But they also demonstrated a reluctance to give credence to those leaders' successes in moving their republics toward reform and democracy.

Then on the issue of Soviet indebtedness and Western exposure, I remember talking to Ivan Ivanov, who was then the Deputy Chairman of the Commission on International Economic Relations in 1988. And he described the growing Soviet debt burden, and his concerns about the impact of external debt on Soviet reform. He told me about the lack of control over external debt and the growing chaos in the Soviet economy. That was 1988.

When I returned from Moscow, I testified in September of 1988 before the House Banking Subcommittee on International Finance,

Trade and Monetary Policy. And in the testimony, I expressed my own concerns about the build-up of Soviet debt.

The net debt was not unmanageable, but it seemed to me that at the time, no one was thinking about the implications of Soviet economic relations with the West; what economic policies foster economic reform in the Soviet Union, and what economic policies hinder it.

My concern grew, really having watched what happened in Latin America in the 1980s, and having seen that crisis explode before the policy-makers had developed adequate response.

Not long after the hearing—that was the hearing before the Banking Committee—and at a time when the Congress was working on several pieces of legislation expressing concern about the issues of Soviet economic relations, the administration put together a task force on Soviet debt—a joint task force of Treasury and CIA, I think—leading the roles and drafting a study which was released November 8th of 1988. And that study presented a rosy picture of Soviet economic relations with the West.

It noted that much of the nominal increase can be explained away by adjustments for inflation and currency devaluation, and it placed faith in Soviet re-deposits in Western banks and Soviet gold reserves, which it placed 70 million ounces, valued at \$30 billion.

As a post-script to this history—and I go through this simply to lay the context for today's hearings and to state that this is an issue that I have personally been interested in for a long while—when I returned to the Soviet Union in 1989 after having had the conversation with Ivanov in 1988, I saw him again. And the decree allowing enterprises and ministries to borrow directly from the West had just passed. And for Ivanov, this was the last straw. He explained that enterprises and their Western lenders assumed that the debt would ultimately be guaranteed by the central government. But he went on to say that the central government was not even able to keep track of the debt, much less consider repaying it.

I say all this, as I said, to give a sense of history to the issue. The events of the last months have forced all of us to re-evaluate our understandings of how the Soviet Union works and how it does not work.

I am looking forward to hearing how the collapse of Communism in the Soviet Union, indeed, the end of the Soviet Union as we have known it, has changed perceptions of these issues. I hope that through the course of these hearings we will also come up with some alternatives.

So, our agenda is rather ambitious today, and I think we do have quite a good panel. I am extremely pleased that we have Mr. Mulford and Mr. Niles to open up today. I welcome their testimony and look forward to hearing what the latest thinking is in the administration on this very critical issue. So, Mr. Mulford.

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

**STATEMENT OF HON. DAVID C. MULFORD, UNDER SECRETARY
FOR INTERNATIONAL AFFAIRS, DEPARTMENT OF THE TREASURY**

Secretary MULFORD. Thank you, Mr. Chairman. During the course of last week, we prepared some rather extensive testimony, which I would like submitted fully for the record, please.

Senator BRADLEY. It will be fully in the record.

[The prepared statement of Secretary Mulford appears in the appendix.]

Secretary MULFORD. And I would like, for a few minutes this morning, to summarize that testimony, Mr. Chairman.

First of all, I would like to thank you, Mr. Chairman, for having this hearing. I think it is timely. I am delighted to be here today to review the economic implications of change and decentralization in the Soviet Union.

During the recently concluded annual meetings of the IMF and World Bank this past week in Bangkok, the Finance Ministers and Central Bank Governors of the Group of Seven met with Soviet representatives to discuss current economic conditions in the Soviet Union, center/republic relations, external indebtedness, economic reform, and assistance. And I would like to review these issues this morning, if I may.

It would be hard, Mr. Chairman, to overstate the magnitude and scope of the change that is sweeping the Soviet Union today. The effort to build a new system encompasses four difficult and overlapping challenges.

The first is reaching agreement on new union/republic economic and political relations. The second is easing the immediate economic crisis. The third is building over a period of time a market economy. And the fourth, in the meantime, is avoiding a politically and economically destructive disintegration of the country.

Unfortunately, the interdependence among these issues means that neither the Soviets, nor we ourselves, have the luxury of addressing these issues one at a time. Certainly, the United States cannot stay on the sidelines until these issues are resolved. The stakes are too high for that.

As President Bush has repeatedly stressed, our first priority must be to support Soviet economic reform efforts, that is, the comprehensive effort to shift from a command economy to a market-based system. The transformation to a market system is the only lasting way to strengthen economic performance. To a large extent, the reform effort will have to be pursued at the republic level where much of the policy-making authority is likely to reside.

As you know, the Soviets are now attempting to reach agreement on a treaty for an economic community which defines relations between the center and the republics. The fate of this treaty is still uncertain, but we feel it would lay some of the groundwork for a viable, economic union. Much work needs to be done before the general principles set forth in the treaty can be translated into specific, binding commitments in separate, detailed agreements.

Center/republic relations are a matter for the Soviet people and their leaders to decide. But from the perspective of accelerating the transformation of the Soviet economy, we would hope that the

treaty and detailed agreements produce a politically stable arrangement with a workable division of economic responsibilities.

Negotiations to establish a new political and economic union are, of course, severely complicated by the sharply deteriorating economic environment. Our discussions with the Soviets, both in Moscow and in Bangkok, have revealed wide recognition that the command system is in collapse. Soviet output is expected to drop 15 percent or more in 1991.

The gravity of the budget situation really cannot be overstated. The budget deficit will probably run as high as 25 percent of GNP for 1991, and is being financed almost exclusively by the printing of money. As a result, prices rose 95 percent in the second quarter of this year, and are expected to accelerate sharply in the future.

The balance of payments has also deteriorated sharply. Hard currency debt has risen to \$65-70 billion. Foreign exchange reserves available to service centrally-held obligations and access to short-term credit lines from Western banks are shrinking rapidly.

During the G-7 Ministerial meeting in Bangkok, the Ministers and Governors and the Soviet representatives discussed the Soviet external payment situation in some detail. Several key considerations were emphasized during this exchange, and essentially agreed to by both sides:

First, the importance of working with the international financial institutions on comprehensive economic reforms; Secondly, the necessity to honor external financial obligations in order to maintain access to new credits;

Third, in the context of the evolving center/republic relations, the need for a framework to govern the ongoing financial relations between the Soviet Union and its many creditors;

And fourth, the further need for full disclosure of Soviet economic and financial data.

The Soviet representatives reiterated their request for assistance in addressing their immediate external payments difficulties. In recognition of this problem, the G-7 Ministers and Governors accepted the invitation by Soviet representatives to send the G-7 Finance Deputies to Moscow in order to explore specific approaches to the Soviet external payments problem and discuss broader financial and economic concerns.

Bilaterally, the United States has substantially increased its assistance to the Soviets in the form of support for food and medical needs. In addition, the Administration is continuing to work on removing restrictions on bilateral economic relations to promote mutually beneficial trade and investment.

The external assistance effort, however, will have to extend well beyond short-term measures to address shortages and liquidity problems. This does not mean large-scale official financing of the kind which has been given priority in the media. I believe the Soviets understand that the private sector must be the principal source of financing to build a market economy, and that market reforms are essential to mobilize such private flows.

What is desperately needed is assistance in the formulation of a comprehensive program for the transformation to a market economy. Once the republics establish basic economic relationships, they will have to implement a broad range of reforms to achieve macro

economic stabilization, a market price system, a legal system protecting private ownership, and trade and investment liberalization.

Moreover, in the Soviet case, the systematic destruction of private enterprise over 70 years has created even more fundamental needs. They need help on such matters as building basic economic institutions, learning how to run profitable private businesses, and operating a sound fiscal system.

In a word, there has to be a complete change in the orientation towards private initiative and competition. Attitudes towards the creation of wealth—

Senator BRADLEY. Mr. Mulford, just go ahead. You can take all the time.

Secretary MULFORD. Attitudes towards the creation of wealth need to be changed to release the dynamism of the private sector. From the start, this Administration has sought to tap the expertise of the IMF and the World Bank in helping the Soviet Union chart a course to a market economy. In December 1990, President Bush proposed a Special Association of the Fund and the Bank with the Soviet Union as a means to initiate the relationship and get the advisory process moving.

After the coup, the President and Secretary Brady pushed hard for the IMF to initiate Special Association to meet the pressing Soviet need. On October 5th, an agreement for Special Association was signed by the Soviet Union and the IMF, and consultations have now begun. We do not view Special Association as an end in itself, but we think it is the best way forward for the time being. We welcome this agreement and urge that no effort be spared to work intensively in the days ahead. Special Association will help clear the way for full membership in both the IMF and the World Bank.

In the immediate future, the two institutions will provide policy and technical assistance to further the process of reform. In his speech to the Annual Meetings, the Secretary urged the IMF and the World Bank to take on a new role in the Soviet Union and in Eastern Europe to address some of the more fundamental needs of economies which must create the basic institutions, attitudes, and skills necessary for a successful market economy.

The IMF and World Bank are expected to work closely with other institutions, such as the EBRD and the OECD, in coordinating their efforts. The EBRD itself has already established a program of technical assistance and project financing for the Soviet Union.

We in the U.S. Government are also engaged in extensive technical assistance efforts to advise Soviet officials about policy-making and regulation. And Secretary Brady has proposed tapping the expertise of the U.S. private-sector through a professional corps to train Soviet entrepreneurs to run successful businesses in a market environment.

In closing, Mr. Chairman, I would like to restate the overriding objective of our economic relations with the Soviet Union: to encourage a complete transformation to a market system and to integrate the Soviet Union firmly within the world economy.

We now have the mechanisms in place—Special Association with the IMF and the World Bank, the G-7 coordinated effort, other

multi lateral efforts, and bilateral assistance—to provide crucial support to the Soviets. But we must guard against unfocused schemes for throwing money at the problem, particularly in an era of competing demands for scarce global resources. All of our efforts, financial and non-financial, must be carefully structured and targeted to promote the goal of transformation and sound economic policies in the Soviet Union.

Thank you, Mr. Chairman.

Senator BRADLEY. Thank you very much, Mr. Mulford. Mr. Niles.

STATEMENT OF HON. THOMAS M.P. NILES, ASSISTANT SECRETARY FOR EUROPEAN AND CANADIAN AFFAIRS, DEPARTMENT OF STATE

Secretary NILES. Thank you very much, Mr. Chairman. I, too, am delighted to be with you this morning, and look forward to working with you and the committee on this very important issue.

I have submitted for the record a statement, which I will not read at this time. I would like to make just a few brief comments. Obviously I associate myself with what Under Secretary Mulford has just said regarding the Administration's position.

Senator BRADLEY. Your statement will be in the record in full.

[The prepared statement of Secretary Niles appears in the appendix.]

Secretary NILES. Thank you very much. We are, as you suggested, Mr. Chairman, witnessing the collapse of the totalitarian structures in the Soviet Union. That is clear. What is not clear is what will come afterwards. We are in a period of great uncertainty. Power is shifting away from the center to the republics very rapidly. The location of the final locus of power, the relationship between republic and center, and whether there will be a center as we have known it since the 1920s, remains very much to be seen.

This is happening in the economic area; it is in the political area as well, with major implications for the United States on the subjects of concern to the subcommittee, and other issues as well.

For the Soviet Union's foreign economic relationship, whether we are talking about debt or trade, the future remains very uncertain. We, of course, have a major stake, as Secretary Baker and President Bush have made clear, in the triumph of democracy in the Soviet Union and in the republics.

Secretary Baker has outlined our position in five points—which we have restated on a number of occasions—which we will use to follow in judging and evaluating events in the Soviet Union and in the republics.

As I say, the outlook is very uncertain. The Supreme Soviet as newly reconstituted met today in Moscow for the first time. Seven republics were represented. A couple republics had observers there. The Ukraine will decide, I think, on the 23rd of this month whether to send representatives to the Supreme Soviet.

As you noticed, I am sure, Mr. Chairman, on the 18th, the agreement that was originally reached in Alma Ata on the second or third of October was signed. The Ukraine did not sign, but was represented by an observer.

This raises, I think, significant questions about the future of that economic agreement. We will have to see, perhaps, after the Ukrainian referendum on the 1st of December and the Presidential election, whether the government of the Ukraine will be prepared to participate, and if so, in what kind of an economic relationship with the center.

To me, in my mind, one of the key ways in which we can influence developments in the Soviet Union—because it is not simply a question of the United States observing and reacting—is through the cooperation which Under Secretary Mulford described in the Group of Seven and other groups. I think the IMF is going to play a very important role in encouraging development, a new form of economic system in the Soviet Union based on privatization and free market.

I am pleased that the agreement was reached earlier this month between the IMF and the Soviets on a Special Association status. And I understand now that there is already an IMF team working in Moscow with the Soviet, and I assume also with some of the republican authorities.

Thank you, Mr. Chairman.

Senator BRADLEY. Thank you, Mr. Niles. And thank you, Mr. Mulford, for your testimony. You have just come back from the meeting in Bangkok, Mr. Mulford. And, as I understand it, there were several representatives there from what used to be known as the Soviet Union.

And they were representing different groups or different republics. Then we had our own discussions on the side of the West—the U.S. and Europeans.

How would you characterize the difference between the European position on assistance to the former Soviet Union, and our position?

Secretary MULFORD. Do you mean direct financial assistance, or—

Senator BRADLEY. Generally. I would like you to generally, and then specifically address the question of debt.

Secretary MULFORD. Well, it is true that we met for what turned out to be a quite extensive period—over a period of some 3 days we had meetings. Some of those meetings were with the Soviet representatives, who were both from the center and from two or three of the republics.

Senator BRADLEY. That was the Ukraine and Russia?

Secretary MULFORD. Yes. And Byelorussia.

Senator BRADLEY. Yes.

Secretary MULFORD. And Mr. Yavlinky was there from the Soviet Union.

Senator BRADLEY. So that you had the Soviet Union, Russia, Ukraine, and Byelorussia represented.

Secretary MULFORD. That is right. And then at the center level, we had representatives both from the Central Bank and the Vneshekonombank, the foreign economic and trade bank.

I think there are two levels to that question. One is the continuation of humanitarian assistance—food and humanitarian assistance, which I think Mr. Niles should probably speak to. There were

certain announcements made in the past week by the EC and there was some brief discussion of those items.

On the question of the external debt, which is where we focused a lot of the time, there was an extensive discussion about the balance of payments condition of the unit, as it was formerly called, the Soviet Union, but the sort of geographical unit which would now contain whatever is left of the union and the various republics.

There was a discussion about the magnitude of external debt. There were discussions about the imminence of potential balance of payments problems and/or liquidity and payment problems.

There were discussions about the problems connected with the centralization of liabilities in an atmosphere where foreign exchange is not being surrendered by the various republics and enterprises to the center for the purpose of servicing those centrally-held liabilities. And there were discussions about the status of the five banks in Western Europe that are owned by the Vneshekonom bank as subsidiaries in various markets in the West.

Senator BRADLEY. Those five being?

Secretary MULFORD. Those banks are located in Britain, France, Germany, Austria, and Luxembourg; the three largest being in Britain, France, and Germany.

And finally, there were discussions about economic reform, about broad policy directions, about the relationship with the IMF and the World Bank, the need to get those relationships under way, and to make some progress in general.

And there was also, of course, an extensive discussion by the Soviets of the economic agreement which has been under discussion and negotiation for some time and recently was signed by eight of the republics.

Obviously, we were attempting to learn more about how that agreement will work, and what the subsequent more detailed developments might be that flow from that, in particular, as they relate to economic relations with the outside world.

Senator BRADLEY. I saw one report that the United States suggested that there be a moratorium on payments, and the Europeans resisted. Is that correct?

Secretary MULFORD. That is not really an accurate report, Mr. Chairman. There has been discussion for some time about ways and means of addressing a liquidity problem, if such a thing should occur. And we have spent a lot of time within the G-7 group discussing that issue and making certain preparations and thinking about various options for addressing it.

In fact, we have taken that line because we believe the Soviet Union should avoid a moratorium on payments, which would then lead to a full Paris Club rescheduling in due course.

Of course, there is no IMF program in place that would support that process at this time. But we think it would be very, very damaging to the Soviet Union to engage in a full-scale moratorium, because that would have the effect of cutting off external credit, which still is flowing to the Soviet Union from governments.

So, the purpose of the exercise was to discuss ways and means to provide some temporary breathing space for a situation that may

be quite tight in terms of liquidity. That was the focus of the discussion.

Senator BRADLEY. For how long a time is this proposed "breathing space"?

Secretary MULFORD. Well, I think the details are issues that have to be discussed further in the light of what we learn about the Soviet situation. I think it is fair to say that if you were to take that route, you can only do that for a limited period of time—perhaps a year, or something like that—before you have to acknowledge that it is more than a temporary liquidity problem, it is a long-term solvency problem.

Senator BRADLEY. Well, you also then have to set aside reserves, do you not? I mean, you cannot say that a loan is forever good.

Secretary MULFORD. That is right.

Senator BRADLEY. How long is that under United States law?

Secretary MULFORD. Well, there is not a clear hard and fast answer to that. But I think if I were to summarize the consensus in the group, the feeling is that you probably would look at a breathing space of something like 6 months to a year to try to sort the situation out. And there is a case for that, because the volume of debt that the Soviets have in relation to their total economy is not particularly large compared, for example, to the bodies of debt that existed in certain of the big Latin American countries in the 1980s.

Senator BRADLEY. But certainly debt service to exports, for example, is a much smaller percent than in places like Brazil.

Secretary MULFORD. Yes.

Senator BRADLEY. I assume that is what you are referring to.

Secretary MULFORD. That is right. And there is a hump in payments. I mean, they have a substantial number of principal payments coming due soon.

Senator BRADLEY. So you are basically saying that the discussion was how the Soviet Union, or whatever the entity is, would not make its debt service payments for 6 months to a year.

Secretary MULFORD. More precisely, the idea was to consider a deferral of principal payments only during that period, but to continue making interest payments.

Senator BRADLEY. Yes. So, the deferral of principal for up to a year with continued interest payments to the institutions that hold the debt. Is that correct?

Secretary MULFORD. That is right.

Senator BRADLEY. Now, how much of the debt is held by American institutions?

Secretary MULFORD. Well, we have very small exposure in our banking system. Probably less than \$300 million. The Federal Government's exposure is around \$2.5 to \$2.8 billion, something like that.

Senator BRADLEY. And those are primarily agricultural grain credits?

Secretary MULFORD. Primarily.

Senator BRADLEY. So, are we deferring payment on those agricultural grain credits?

Secretary MULFORD. Well, the details of a deferral, Mr. Chairman, are very technical and I would like to make it clear here that a deferral of principal payments might not provide enough to fi-

nance the situation. There might have to also be some emergency financing. That was the other part of the formula that we discussed. But that is a very—

Senator BRADLEY. New money.

Secretary MULFORD. This would be temporary money, secured by gold.

Senator BRADLEY. And it would come from where?

Secretary MULFORD. That is what was explored. I am not saying we will do that. These are the ideas that we explored.

Senator BRADLEY. Well, but what were the sources in the ideas that are explored?

Secretary MULFORD. Well, the bridge financing or temporary financing that is contemplated as a possibility, if gold were available and if it were free and clear for that purpose, would be done as those operations have been done in the past with a group of leading countries taking up a share in an overall financing amount, including the United States.

Senator BRADLEY. So, the U.S. Government would advance the money to the Soviets to pay their debts, in exchange for holding as collateral, gold?

Secretary MULFORD. Well, you would need to look at various options together. You have a problem of a certain magnitude; we do not know how big that could be. That problem might be partially or fully met by a deferral of principal payments for a period of time. The numbers are not clear at this point.

If that deferral exercise was insufficient in its product, then one would have to look at other options to supplement it. One of those could be a short-term bridging or financing mechanism which is secured. And obviously, one of the things to use for security would be gold. So, these are not concrete and firm proposals at the moment. These are among the options under consideration.

Senator BRADLEY. All right. Then let me ask you. Do you think you have a good idea of how much external debt there actually is? Reflecting back on my conversation with Mr. Ivanov that I started the hearing with where he said, that in '988, they said, all right, any enterprise can go out into the world capital markets and get loans, very much like in the 1980s in Latin America where the parastatals that were all loaning, and who knows who got what. I mean, do you feel confident that there is only \$65 to \$70 billion in external debt?

Secretary MULFORD. Well, I think it depends on your definition of a good definition. But I think we have a rather general idea; between \$60 and \$70 billion. But I am certainly sensitive to the point you make, and it is entirely possible that there could be more debt there than we believe is the case at the moment.

Senator BRADLEY. Is it not a fact that we really do not know how much debt—

Secretary MULFORD. I do not think so.

Senator BRADLEY. I mean, even the Soviet government does not know.

Secretary MULFORD. I do not think so. Because I think the bulk of the debt has always been concentrated at the center in the Vneshekonombank. So, I do not think the amounts beyond that, out in the republics and in the enterprises, are very large. But I am not

prepared to say there is none. But I do not think there is a large unknown amount out there.

Senator BRADLEY. All right. The press quoted Secretary Brady, saying that, "there could not be Western assistance without an economic agreement among the republics." Is that correct? I mean, I think that is what I heard you say as well.

Secretary MULFORD. One of the things that is required, I think, before any kind of emergency exercise or deferral, or anything else could be undertaken, would be to clarify the relationship between the republics and the center with regard to the servicing of external obligations.

Senator BRADLEY. And what do you see as the desirable characteristics of such an accord, what should it cover?

Secretary MULFORD. Well, I think it should cover, first of all, existing debt. It should cover the arrangements that will exist between the centrally-held liabilities and the republics with regard to the provision of foreign exchange to the center to service existing debt. It should also concern itself with new debt acquired by either the center or the republics, because obviously that has a bearing on the capacity to service existing debt.

Senator BRADLEY. Yes. But anything else? I mean, this is the general economic agreement. In other words, it should not just cover debt.

Secretary MULFORD. No, no. Certainly not.

Senator BRADLEY. It should cover other things as well.

Secretary MULFORD. Sure.

Senator BRADLEY. So, what other things?

Secretary MULFORD. Well, the economic agreement does speak to the other essential features of taxation powers, fiscal policy, central banking authorities, currencies, monetary policy, trade relations between the various groups. All these things need to be addressed in any kind of comprehensive economic agreement.

Senator BRADLEY. And the idea is that until all of this is addressed, basically, we would not advance economic assistance?

Secretary MULFORD. No, I do not think that is true. Because, as I said in my testimony, we do not have the luxury of waiting for all of the pieces to be dealt with and fall into place.

Senator BRADLEY. So that we want an economic agreement among the republics, but it will not be a pre-requisite for advancing money. Is that what—

Secretary MULFORD. Well, I think that it is already clear that credits are being advanced for food purchases, for example. With regard to external debt, I think I have outlined already what we need there.

Senator BRADLEY. Yes.

Secretary MULFORD. That piece is something that might be resolved fairly soon and put into place, and give enough comfort so that one could enter into a deferral or enter into short-term financing which is secured.

Senator BRADLEY. Yes.

Secretary MULFORD. But not into the provision of large amounts of direct financial assistance. That, I think, would have to wait for a further clarification.

Senator BRADLEY. Yes.

Secretary MULFORD. And progress on economic reform.

Senator BRADLEY. Yes. So, in terms of the deferral, what amounts are we talking about?

Secretary MULFORD. Well, again, that depends on the definition of the size of the problem, first of all. And secondly, on the structure of the deferral that is agreed. That is a very technical question, because you have to set a cut off date, and where you set that date generates how much relief you provide.

Senator BRADLEY. Right. Let me ask you again, coming right from Bangkok, and then I would yield to Senator Hatch for questions, if he would like.

Could you tell me what you see as the differences in the positions of, say, the Russians, Ukrainians, and Soviet delegation? What do you see as the differences of opinion?

Secretary MULFORD. Well, I think, as has been reported, they have a substantial difference of opinion about how strong and comprehensive the center should be. The republics tend to take the view that they want to be fully independent economically and have all the trappings of economic independence. And yet, they do make it clear they also want the benefits of economic linkages.

The center, on the other hand, I think, makes the judgment that economic linkages maintaining a community is absolutely key for a variety of obvious reasons. And they make the assumption that that is, perhaps, a more important ingredient than what they might say is excessive amounts of independence out in the republics.

My view is that there is a lot of rhetoric in those discussions, and probably not such fundamental differences in economic areas as the press reports might suggest.

Senator BRADLEY. So, do you think Ukraine will have its currency after December?

Secretary MULFORD. I cannot pre-judge that, but they seem to have a strong drive to independence, and they will want some independent currency. But how independent the currency is from all other currencies in the grouping is, I think, very unclear; even in their own mind.

Senator BRADLEY. Senator Hatch.

Senator HATCH. Thank you, Mr. Chairman. We seem to be having difficulty persuading the other G-7 members to defer Soviet debt payments. And it may be that others, like Germany, hold so much of it. As I understand it, Germany has about \$23 billion out of the \$65 to \$70 billion. Am I right about that?

Secretary MULFORD. Their total exposure, my guess, is around \$20 billion.

Senator HATCH. You are scheduled to be in Moscow later this month, as I understand it.

Secretary MULFORD. That is right. Yes.

Senator HATCH. Or early the next month. And you are going to discuss debt issues with the other G-7 deputies.

Now, I would like to know first if you have any new arguments to convince them of the need for debt deferral, and secondly, how does the Soviet central government plan to allocate the debt among the various republics?

Secretary MULFORD. Well, first of all, I think that the press reports of the meeting in Bangkok about a difference of opinion between the Europeans and the United States is greatly overblown. There obviously are differences of view about the right tactics and timing, and what things should come first. But there is a general consensus that we may face a situation of illiquidity, or temporary illiquidity that may require an approach that involves a deferral of principal payments. On that there is agreement.

So, we do not have the deep disagreement that is being portrayed in the press. There are differences in views, for example, about how comprehensive the agreement might be that you have to put in place between the center and the republics before you engage in that process.

There are nuance differences there, and those have been played up. And obviously the Europeans are very anxious not to commit themselves before they feel comfortable about those various elements. I do not have any problem with that, and I do not think that means we have a substantial disagreement with them.

On the question of the allocation of debt, I do not think allocation of the debt is really visualized at this point; that is to say, carving it up and handing it out to the various republics, because that would produce a different obligor and a different credit-worthiness for each piece of it.

The objective is to keep the debt centralized, but to have an agreement whereby all the parties would jointly agree to make sure that that debt is serviced and provide the foreign exchange necessary to carry that out. And that is what we want to see put in place before we proceed.

Senator HATCH. Well, we might need maybe a more creative strategy to get debt deferral. Because it seems to me that we are—and correct me if you disagree—that we are using kind of a Latin American approach to a totally different Soviet problem.

At least for Latin America, there was a legacy of understanding market economies, and some understanding of how democracies can and do operate, and the responsibilities that governments have in those processes.

And it seems to me we have to be very careful about encouraging an economic relationship that strengthens Soviet control over the various independent republics.

I cannot see them accepting a union like that, and the Ukrainians have already criticized the Gorbachev proposal as to “colonial.”

Secretary MULFORD. Yes.

Senator HATCH. So, I hope that your meetings in Moscow take all of these matters into consideration as well. And at the same time, any debt settlement program should consider the debt owed by the Soviet government to private U.S. corporations. As I understand that, that is about \$150 million right now. Maybe I am wrong on that, but that is what I think, more or less.

Secretary MULFORD. More or less. Somewhere between there and \$300 million, depending on how you quantify the short end of it.

Senator HATCH. Yes. All right. Do you have any comments on that?

Secretary MULFORD. But we will keep the points you have made in mind. I think it is fair to say that we are proceeding differently than we did in Latin America.

One of the questions the Chairman asked in his letter was what we had learned from the debt crisis. And I think that there are two things that are important here. One, not to provide a flow of credit solely for the purpose of servicing ourselves and growing a body of debt into some unmanageable future amount.

We are clearly aiming to avoid that particular development. And one of the ways to do that is to not go for a full moratorium and rescheduling, or not try to string out an impossible situation by making available credit solely to make sure that interest is current. But to try to address the problem right now by facing the fact that there is a liquidity problem—if it develops—and attempting to deal with that without the country going into the total moratorium and rescheduling scenario of the 1980s where it is cut off from all sources of future credit. This, we hope, is a very temporary problem, if it occurs. And we are approaching it on that ground.

Secondly, with regard to the center versus the republics, we are not proposing a strong center politically, or necessarily economically, in order to create support for the debt. What we are saying is all the republics, even those that have not signed the agreement, have said they intend to service the external debt.

What we want to do is sit down with them, as well as with members of the center, and try to discuss and craft a system that will allow them to carry out their stated intention, which is to stay current on existing debt so that all of them can continue to have access to credit.

Because if there is an interruption of payments at the center, there is likely to be adverse fall-out on the republics and their ability to command credit. They will not get away scot-free.

Senator HATCH. Well, thank you. Thank you, Mr. Chairman.

Senator BRADLEY. Thank you, Senator Hatch. Let me, if I can, ask just a few more questions. You mentioned the role of the IMF and the World Bank. You think they have an important role to play, I assume.

Secretary MULFORD. Yes.

Senator BRADLEY. How soon do you think individual republics, or collections of republics, or the Soviet Union, would be eligible for full membership in the IMF and the World Bank and, therefore, eligible for all of the things that come with full membership, including balance of payments, financing, project loans, debt restructuring, and all of the other aspects?

Secretary MULFORD. I could not really give an estimate on that, because I think that the best way to answer that question is to say that membership will come sooner because Special Association is in place and these problems are being worked on in an comprehensive and rational sense than otherwise would be the case. Because although there has been an application from the center, the center is very much in doubt as a continuing economic proposition.

There have not been applications from republics yet, and it is clear that the membership approach would have to assess exactly how independent these various entities are, and how much control they have over their fiscal and monetary policies, currencies, and

so on, in order to engage in a membership process. I cannot answer how quickly all that will develop, Mr. Chairman.

Senator BRADLEY. Well, let us say December is the vote. Ukraine votes for independence, and the week after they vote for independence, there is an application for Ukraine to become a full member of IMF and World Bank. What is our position on that?

Secretary MULFORD. Our position on that is that we will address that when it happens, first of all. And secondly, the mere act of sending in a letter to say "we would like to become a member" does not establish, for the purpose of membership, that the Ukraine would have control over its fiscal policy, its monetary policy, and the other necessary attributes that would allow for a membership negotiation to proceed.

Senator BRADLEY. Yes.

Secretary MULFORD. I do not know how long it would take to set those things up, but in due course, if they were set up, there would then be a negotiation. However, I do not think you can look just at one entity or republic in a vacuum, because there are the rest of the republics and there is also the center which has an application in.

And, finally, there are all the other related issues of membership that would have to be reviewed with such a large potential arrival on the doorstep of aspiring members, such as the relative quota levels of all the other members, and who is on the executive committee. Those very complicated negotiations would also have to be carried out, because this would be a quite substantial change for the Fund to absorb.

Senator BRADLEY. But do you agree that it would be easier to deal with this problem in all its complexity through existing international institutions than it would be to try to duplicate many of the same things that would flow through existing international institutions through kind of ad hoc meetings, such as Bangkok and other places, where you try to patch together the same kind of things that are available now under existing international institutions?

Secretary MULFORD. I think it is much more orderly and effective to use existing international institutions.

Senator BRADLEY. All right. Let me ask you. In this advancing of emergency help to the Soviet Union, and given the fact that, as you pointed out, the Soviet deficit is now 25 percent of GNP—

Secretary MULFORD. That is their internal—

Senator BRADLEY. I mean, that is an amazing number.

Secretary MULFORD. That is an amazing number. That is right. That is the—

Senator BRADLEY. I mean, here we are talking about our problems here in this country, and we are at five, 6 percent of GNP. They are 25 percent of GNP, their inflation rate is 95 percent in the last quarter, which implies if no change, 400 percent inflation annually, and their debt is like \$70 billion this year. Now, in that kind of environment, does it make sense to extend further grain credits to the Soviet Union?

Secretary MULFORD. Well, I think that this is really the heart of the issue for all the major countries. Because when I spoke earlier about the debt problem and the potential payment strains, I was

really saying that it is very, very important as an objective of the United States for the Soviet Union to continue to have access to external credit. For that purpose, the country needs to continue to be able to meet obligations. It is presently current on its payments to foreign governments.

So, if the problem is one of temporary liquidity caused by a heavy concentration of interest payments and principal payments in the near term—in other words, a hump that goes something like that—then a temporary solution that gives them time to rationalize their situation would work. I think everybody agrees the foreign exchange earning capacity of the Soviet Union and the various republics is certainly sufficient to service its debt.

The question is, is the foreign exchange in the right places to do that job? It is not being surrendered to the center, for example. We know that. So, the center, which holds the liabilities, is being starved for foreign exchange. This has got to be resolved. If it is resolved, and there can be a temporary suspension of principal payments, but interest continues to be paid, then I think one can make the case that the Soviet Union is still meeting its obligations, it is sorting through a temporary problem which is the result of very positive developments. There are important developments taking place in terms of democracy. I think you would agree with that, Mr. Chairman.

But in this process of institutional reorganization, certain problems are tossed up that are very difficult to deal with, such as the temporary payments problem.

So, our approach is to try to keep them credit-worthy instead of putting them into a default that would then put them out of commission for ten or twelve years. We have learned this from the Latin American situation.

So, the object here is to try to deal with the problem, and we are certainly aware of all the difficulties. But we do think it is a rather serious issue that needs to be faced, and sooner rather than later.

Senator BRADLEY. Well, I agree strongly with your last statement. It is better to face it sooner than later. But I do not know if I agree with your statement of describing it as temporary. I mean, my fear, of course, is if you defer for six months to a year, you get to the end of 6 months to a year and suddenly the deficit is now 50 percent of GNP, and inflation is now 800, and you have not really improved the situation.

I mean, Mr. Niles, do you have any opinion about this from the vantage point and wisdom of the State Department? Does the State Department feel this prospect of stabilization in the Soviet Union is sufficient enough that they will become good debtors?

Secretary NILES. Well, it is possible, but not certain. The Soviet Union, as Under Secretary Mulford suggests, is going through a liquidity, not a solvency problem. They have tremendous resources, tremendous capabilities for earning foreign exchange.

There are ways in which—if they were able in short-term and I think they could—they could bring their oil production back from 10.6 to 12.6 million barrels a day. That would solve a great many of their problems very quickly. And we believe that with Western technical assistance, that could happen. So, there are things that could be done.

Now, whether they will be done, and whether the Soviet Union and the union and the republics will be able to get together on a viable agreement certainly remains to be seen. But I do think that there are things that we can do from the outside to encourage that sort of development.

Senator BRADLEY. What would be the State Department position after December when the Ukraine votes for independence? I mean, do we recognize Ukraine?

Secretary NILES. It would be very much the same way Under Secretary Mulford described the hypothetical Ukrainian application to join the Fund and the Bank. I think we would want to look at what actually happens, what are the attributes of this Ukrainian state, what do they claim, what authority do they have?

Are they, for example, following the five principles that Secretary Baker set out when he was in Moscow in September at the CSCE meeting? What kind of a government is this? We do not purport to try to tell the Ukrainians or the other peoples of the Soviet Union how to run their affairs, but we do have certain principles we would follow in deciding our own policy toward that government.

Senator BRADLEY. Well, President Kravchuk told a hall of 800 Ukrainian Americans in New Jersey three weeks ago that they were going to have independence. And he was strongly behind independence.

Secretary NILES. Well, President Kravchuk is also in an election campaign in the Ukraine, Mr. Chairman. It could be that following the election he would take another look at his position. I am not sure. He and his principal opponent, Mr. Chornavil, have both come out strongly during the election campaign, which is under way right now in favor of sovereignty and independence.

But there are some considerations, certainly economic considerations which would encourage an eventual Ukrainian government to cooperate with the other republics. And what form that might take remains to be seen.

The Ukrainian economy is a very important component of the union economy, but the Ukrainian economy also depends, to a large degree, upon trade with the other republics. For example, most of the Ukraine's oil and gas comes from the Russian Federation, or from Azerbaijan. They have some internal production, but mainly they import hydrocarbons, except for coal. So, they have some important interests in remaining linked in some way with the other republics. And, what those links might be remains to be seen.

I personally do not believe that during the election campaign the government of the Ukraine—President Kravchuk's government—would be prepared to sign the agreement that was signed in Moscow by the other republics on Friday last—the economic agreement.

They probably will wait until after the 1st of December before doing it, since the election campaign makes the question of independence and sovereignty such an important issue.

Senator BRADLEY. Well, I mean, I hear what you are saying. I do not know if you have convinced me that President Kravchuk is so—I do not want to use the word cynical, but, I mean, that he is

running for election and he says, support me, we will have independence and sovereignty. And then the assumption is in your remarks that that is just an election ploy, and as soon as he is elected, he will sign the agreement and—I mean, I do not know. It just strikes me as being just a little bit—

Secretary NILES. I am not suggesting that the President of the Ukraine is being cynical, or that this is an election ploy. It is just that the issue of relations with the other parts of the union—the union and the other republics—is a very big issue in the election campaign right now. And I doubt that any big decisions will be taken by the Ukrainian government until after the election.

Senator BRADLEY. Yes.

Secretary NILES. It is not a question of cynicism. It is just a question of practicality.

Senator BRADLEY. Yes. I take that back on cynicism to say political—I do not quite find the word right now to replace cynicism—
[Laughter.]

Secretary NILES. Just call it politics.

Senator BRADLEY.—but I am sure I will.

Secretary NILES. Politics as usual.

Senator BRADLEY. Well, let me thank both of you for your testimony. Mr. Mulford, do you have any final statements?

Secretary MULFORD. Could I just say one more thing on this issue, Mr. Chairman, as I listen to you speak. It is possible, it seems to me, that the center/republic relationship could go through a process of definition not unlike the kind of process that we have seen in Europe and the EC where you have a clear case where sovereign nations are engaged in cooperative arrangements economically that they see to be to their benefit, including currency arrangements which peg their currencies pretty close together, even though they have independent currencies. I think it is possible as we go forward, if we have some patience and we work with these various groups, that the rhetoric may be set aside, to some extent, and it may be possible that we will see sovereignty emerge in these various republics, but with some limitations on it.

For example, they may have their own currency, but it may be pegged directly to a central group of currencies with a central institution which carries out central banking functions, and yet there still is the impression of an independent currency. So, I think we have got to be very careful in giving these people time to work their problem out. That is why I think that addressing the temporary payments problem could be one of the most important issues to do successfully in order to give them that time.

I agree with you that it may be a year from now, that it has not been enough and more time is required. But I do not think you are any worse off for having taken the initiative now and addressed the problem. And that is really what we are proposing and that is what we are asking our European colleagues to do with this.

Senator BRADLEY. Would you say that if it were American banks who were primarily exposed?

Secretary MULFORD. Yes, I think I would.

Senator BRADLEY. All right.

Secretary NILES. Could I make one other comment, Mr. Chairman?

Senator BRADLEY. Yes, Mr. Niles.

Secretary NILES. I think it is important, as you suggested a little at the opening of the hearing, to take a look at the historical context. I think it is also important to keep in mind that the center has collapsed before in that part of the world. In 1917 it collapsed and there was a period of instability and independent republics grew up, Independent Ukraine, Independent Georgia, Armenia, Independent Central Asia, and, of course, the Baltic States established independence; Finland established its independence permanently. But after several years, unfortunately, under the aegis of Lenin, the center was re-established.

And that has happened before in Russian history, so I do not think we have to assume necessarily that the trend—which is very clear today of authority and power and sovereignty moving away from the center to the republics—is necessarily the last word.

And, as Under Secretary Mulford suggested, it could be that a year from now, or two, or three, the situation will have stabilized and we would see a new kind of an economic relationship. Obviously, we would hope, much less centralized, and certainly, we would hope, democratic, replacing the one that existed up until 1991.

Senator BRADLEY. Well, do you think it is in the United States' interest—do you think that we should have a clear view of whether we want to have the old Soviet Union as we have known it maintained, or whether we want the individual republics to go their own way? Does it—

Secretary NILES. I think it is important that we state the principals, those that we have stated, against which we would evaluate developments and to state what is important to us: respect for democracy, human rights, free economy; and respect also for the principal that it is up to the republics, and of the center, the former Soviet Union, to decide what kind of an arrangement they will have.

But it is very much up in the air right now, and there are, as I say, some historical precedents that suggest that at some point there could be a coalescence or a re-coalescence of some sort of an organization around a center.

We would expect, or we would certainly hope that would be a democratic center without the repressive qualities of governments that have existed in that part of the world hitherto.

Senator BRADLEY. Or it could be a further fragmentation.

Secretary NILES. It certainly could be. Certainly could be.

Senator BRADLEY. It could be this, or it could be that.

Secretary NILES. Well, that is right.

Senator BRADLEY. In either case, it is whichever republics adhere to the five principals, then we are all right.

Secretary NILES. Well, that is right. We have some important interests, even beyond the economic, notably in the security/defense area, the security of the Soviet nuclear arsenal and things of that nature.

Senator BRADLEY. Right. I know that one does not like to do this, but we will take a shot anyway, Mr. Niles. If you would speculate, look out 5, 10 years from now, do you expect—say 5 years, even, do you expect the Soviet Union to look more like the Soviet Union that existed prior to August, more like the British Commonwealth,

oriented around Russia, or more like Africa, with 50 or 60 smaller States and autonomous regions? I mean, which of those do you think is the likelihood?

Secretary NILES. Those are three kind of restrictive choices and alternatives. I would pick a fourth, which is the one that——

Senator BRADLEY. A combination of all three? [Laughter.]

Secretary NILES. Under Secretary Mulford suggested that the pattern of the European community, which I have been working on for the last couple of years, would be a good one. And if one's hopes can influence your thoughts, then I would hope that that would be something that the Soviet Union might come up with.

Senator BRADLEY. Who is Jean Monet?

Secretary NILES. We have not come up with a Soviet Jean Monet yet, but we hope that they will find one.

Senator BRADLEY. All right.

Secretary NILES. Thank you.

Senator BRADLEY. Thank you very much. Our next panel consists of Oleh Havrylyshyn, Robert McConnell, Roger Robinson, and Professor Jeff Sachs. Let me welcome all three of you to the committee. You have had the benefit of listening to Secretary Mulford and also to Mr. Niles from the State Department. You have heard their views. As they leave, they take the crowd with them, but we are still here to listen to you. And I know Senator Hatch and I are very anxious to hear your views. I would like to go in the following order: McConnell, Sachs, Havrylyshyn, and Robinson. Let us begin with McConnell. What I would like you to do is limit your opening comments to seven minutes, if you can, so that we can get into questions.

I really am very pleased that all of you have come, because I think that you can give us a little different perspective on some of the things that we have heard this morning. I look forward to your testimony. So, let us go with Mr. McConnell first.

**STATEMENT OF MR. ROBERT A. McCONNELL, OF COUNSEL,
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Mr. McCONNELL. Good morning, Mr. Chairman. Thank you. I have a fairly substantial statement that I hope would be placed in the record.

Senator BRADLEY. It will be in the record, and it will be read thoroughly.

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

Mr. McCONNELL. As you indicated earlier in the hearing, I am Chairman of Government Relations with Ukraine 2000, and today testify in that capacity. We appreciate the opportunity to appear here.

In fact, I would be remiss if I did not take this specific opportunity to thank you and Senator Hatch, and the other members of this subcommittee, for the interest that each of you have expressed over the years in relation to Ukraine, to the democratic movement in Ukraine (Rukh) and, indeed, to individual members of Rukh. Your interests and efforts have been very greatly appreciated, and the time of your staffs, as well.

Mr. Chairman, you invited me here today to focus primarily on Ukraine. I know that Mr. Odavenko, Ukraine's permanent representative to the United Nations, testified before the full committee in September. These opportunities are very important because, as a practical matter, the American public and the U.S. Government have only recently seem to become aware of Ukraine.

In some ways, Russification of Ukraine was more effective in the United States than it was in Ukraine itself. Throughout the Cold War, our government, our media and our schools treated "the Soviet Union" and "Russia" as synonyms. More distressing, as the Iron Curtain has come down and the republic-specific issues have become ever more important, parts of our governments seem to remain in intellectual apathy.

As the Soviet Union collapses and the myth of a "Soviet people" crumbles, our government cannot seem to turn loose of the term or the concept of a Soviet Union. It is critical that the Congress focus on the republics, and we thank you for doing so.

Ukraine has extraordinary potential. It is engaged in a democratic nation-building process, and it is most interested in becoming an active and responsible member of the international community and the international financial organizations.

Before quickly discussing the issues that you raised in your outline, I want to make one overriding observation.

As important as the economic issues are to the republics of the former Soviet Union and to the international financial community, the fact is that the economic problems must be addressed within a political environment.

Economics cannot be dealt with in some hermetically sealed atmosphere. The politics and policies of the center, its past and its current inclinations, are very much a part of the problem and, at least for Ukraine, very much a part of its approach to the future.

You ask in your invitation about the advantages and the disadvantages of the centralized political/economic structures. In our view, there are no advantages to the central structure. Economically and politically, Moscow's central structure has always led to ruin. The center is incapable of meaningful reform. Its only purpose is domination. Allowed to coordinate, the center will seek to control. Allowed to control, the center will oppress. Ukraine is poor because it is not free. The center has extracted extraordinary costs from Ukraine in human life and exploited resources. The center's command economy has required that Ukraine ship to the center the vast majority of its production. Up until just a few years ago, 95 percent of Ukraine's production was required to be sent to Moscow. Under Gorbachev, that figured declined to 88 percent.

After having to produce and ship its production to the center, Ukraine has to petition for goods to be returned for the needs of her people. The producers become beggars. My formal written statement provides more figures further defining the situation.

My statement also sets out in some detail political significance of the Chernobyl disaster. There seems to be little understanding in the United States for the extraordinary political impact of the 1986 Chernobyl explosion and its handling by the central government. It is at the core of the independence movement. It united the people of Ukraine. They view Chernobyl's invisible poison, its invisible

and silent death, as a product of the center. I cannot express within the human limitations of our language the rage, the terror, the commitment one hears and sees in the people of Ukraine when the raw nerve of Chernobyl is exposed.

There are no advantages to the central political and economic structure. The environment for reform is more brittle in Ukraine. Democracy is on the rise; the political environment is favorable.

The United States needs to abandon its myopic focus on the center. It is in our interest for our United States relationships with the reformist republics to evolve rapidly. The future is with the republics. Hope for democratic and economic change is with the republics.

After Ukraine's December 1st referendum on the declaration of independence, the United States should recognize Ukraine and officially welcome her into the family of nations.

The United States should support and encourage Ukraine's interest in IMF and the World Bank. The international stumbling and fumbling over the Soviet Union's membership is, indeed, a needless distraction, and it is counterproductive to real reform.

From what I understand of last Friday's economic treaty between some of the republics and the center, the center cannot bind the republics to any obligations. Certainly, neither Gorbachev, Yeltsin, or Yavlinsky speak for Ukraine.

As Rukh economist, Mr. Sovchenko, has written in *The Wall Street Journal*, the republics have their own plans for market transition that do not require Western taxpayers to pay hundreds of millions of dollars that Gorbachev and Yavlinsky estimate.

Ukraine is committed to economic transition, reducing its military spending, and changing the nature of the military within its territory. It is within the republics where hope lies for democracy and market reform.

As far as international institutions and their role, part of the legacy of the Soviet Union is the isolation and limitations its Iron Curtain placed around the perspectives and scope of its people. It was like living on the intellectual dark side. Assistance should go to the republics. Ukraine needs and wishes technical assistance. We need to provide technical training, opportunities to learn, and options. We need to provide help and provide the basis for Ukraine to make its own judgments. Large amounts of money would be ineffective.

Ukraine needs help to be able to make those decisions itself. It does not need a pre-fabricated economy created in a test tube; it needs the ability to make its own decisions and to see what the market economy is all about.

As far as the Soviet debt, I do not know the status and exposure. I learned a little bit from the previous panel. I do not know all of those things, but I make several observations. Ukraine will not avoid its just obligations. Second, given the concern that—

Senator BRADLEY. I am sorry. I did not hear that.

Mr. McCONNELL. Ukraine will not avoid its just obligations. Given the concern over the current Soviet debt, the second point I would make is that the United States should cease its suicidal rush to provide direct and indirect credit to the center that has fallen. For its part, Ukraine has made it clear that the center does not

speak for it. Dealing with the center now is dealing at one's own peril. Third, the extent institutions grapple seriously with the question of Soviet debt, I think it is imperative that weight be given to the salvo of breast-beating statements by Russian officials that the Russian republic is the heir and the descendent of the Soviet Union. If Russia is to inherit the wealth of the union, let it inherit the debt.

And the last comment on debt, I would say, is that if there are going to be negotiations contemplating the republics bear some obligation, per capita distribution is unsupportable.

My last point is—and I will make it very brief—I am very concerned about whether the messages that our government is sending by its steadfast support of the union and its constant speaking out for some kind of a center in light of the center's past acts—the quotes of Mr. Gorbachev in relation to Ukraine's position on the economic treaty; Yalinsky's statements in Bangkok about bloodshed if people do not sign—I think the combination is very dangerous.

We saw what happened when, even after threats were made at Lithuania when we went forward with the Moscow summit last summer, with President Bush in Moscow, border guards were assassinated. What kind of symbol and signals are we sending to Moscow, and how far and how brazen will they be in relation to their prize, Ukraine?

I think it is important that we repudiate any indications and threats of violence toward Ukraine. I look forward to this committee and this Congress asking questions of the administration and urging and pushing support for the republics.

Senator BRADLEY. Thank you very much, Mr. McConnell. Professor Sachs, welcome to the subcommittee. I do not think there is anybody around that knows more about these big restructuring issues than you. Welcome. I am anxious to hear what you have to say.

STATEMENT OF PROF. JEFFREY SACHS, DEPARTMENT OF ECONOMICS, LITTAUER CENTER, HARVARD UNIVERSITY, CAMBRIDGE, MA

Professor SACHS. Thank you very much for the invitation. Excuse my laryngitis, also.

Senator BRADLEY. Pull the microphone a little closer to you.

Professor SACHS. I just returned from an extended trip in Eastern Europe, and unfortunately do not have prepared testimony this morning because of that. Oddly enough, I testified on this issue a month ago and I am surprised to find that the testimony still stands after 1 month. So, I would like to make available to the committee my testimony to the Senate Foreign Relations Committee.

If I could beg your indulgence, I would like to take one minute on another issue that is of direct relevance to the committee, and that is Poland and the Polish debt, which is of significant consequence for Poland's own success in stabilization.

What I would like to inform the committee of is that following the break-through agreement of the Paris Club for debt relief for

Poland—an agreement which was strongly supported on an analytical basis by the IMF, and the World Bank, and the Paris Club, as to its need—the commercial banks have engaged in what is the absolute, and classic, and cynical free rider problem that now that the official debt has been relieved, the commercial banks are claiming, well, why not just start paying us?

And we had what I regard as the most extraordinary and inappropriate remarks of Mr. Shulman of the Institute of International Finance in Washington last month, where he said that “the banks are not a charitable organization, therefore, they are not going to engage in comparable relief to what the Paris Club offered.”

But this is a totally phoney characterization of what has transpired with Poland because the debt relief for Poland was based on an absolutely meticulous and professional assessment of balance of payments needs and capacity to service debt.

And, as the IMF showed conclusively, Poland will be straining mightily even to pay a reduced 50 percent burden over the next decade. The IMF professionally showed that the agreement that was reached with the Paris Club could only be successful if the banks matched on a comparable basis. And it seems to me that the U.S. Government is a signatory to the Paris Club agreement, and all of the other official creditors who signed an agreement that stated absolutely clearly and with great detail, as a matter of fact, Senator, that Poland should seek comparable terms of relief from its other creditors that our government now should lead strongly in insisting that the commercial banks exercise their comparable responsibility in this overall reduction.

Otherwise, we have a precedent here where really taxpayer money is directly going to bail out commercial bank claims. And I think that would be a most unfortunate precedent to establish, first of all. And second, I know that it would be of grave consequence for Poland's overall stabilization efforts.

So, I wanted to draw that to your attention, the fact that the commercial bank negotiations have not moved forward, the German banks have expressed their willingness of comparability, but American and British banks have remained reluctant and we have not gotten a settlement. I thank you for that moment, but it is relevant to the committee's work.

To turn to the Soviet issue, I should start by pointing out that I was a co-author with Mr. Yavlinky in late spring of an economic reform program that had, as its basic concept, radical reforms matched by large-scale financial assistance from the West.

I believe that on the broadest terms, that conception remains appropriate now. The Soviet republics, or the individual republics that constituted the Soviet Union should, in my view, undertake as radical economic reforms as the sort now under way in Eastern Europe.

And, as in the case of Eastern Europe, the success of those reforms will depend on large-scale financial support. Not just technical assistance, not goodwill, not just open markets, but yes, real money coming in from a variety of sources, including the international financial institutions. And I can discuss at length why such financial support will, in fact, be needed.

And with all due respect to the Ukraine, I hope they get it also. They will need that financial assistance. Whether it is comfortable to think so or say so right now, it is the fact that they will need it.

Now, at the time, our proposal called for a quite radical devolution of power to the republics. At least it looked radical back in June. But it did maintain a central structure, a so-called inter-republican committee, that would coordinate various facets of the reform. It was radical enough that the central institutions—mainly the Communist authorities—fought hard against it. And in the end, Gorbachev did not back it.

The point I would like to make to the committee is that following the coup, I think it is no longer a radical proposition on the central point of the responsibility of the union and the republics. And I do not think that it really stands up any more in the specific details of the allocation of responsibility between center and republics that was in that document back in June.

I would like to make clear that while the general principles apply, I think we are far beyond that document in terms of the narrow mechanics of how to move forward right now. And I do believe very strongly that the central responsibilities have to lie with the republican governments without any question, and that the need for a single currency, for example, which has been stressed by Yavlinsky, is not a fundamental economic need at all. It was part of our program, but it was not a fundamental part.

And given the events that have transpired and the most proper political devolution to the republics, I think that I would like to make clear at least that, in my own assessment, the general principles now have to be augmented by a very different framework in which this kind of radical reform is backed by financial assistance that is extended directly to the republics, not through a central institution.

Coordination might be useful. Free trade is very important, I think. Eliminating or maintaining no tariff barriers among flows of resources, but maintaining a single, centralized monetary system is not a fundamental economic pre-requisite for success and transformation, nor is coordination of fiscal policies of the individual republics a fundamental economic need.

And, in that sense, I think that the basic outline of that program should not be understood as still being applicable in the current circumstances. I have a great deal that obviously I would like to say, and hope we can come back in questioning. The main points I would like to make are that at the core, the essential need right now is for Russia, as a government, and for the Ukraine, to start a process of radical reform, with or without any agreements among the other republics. You know, these two republics constitute 80 percent of the non-Baltic Soviet economy. And they can do what has to be done if they just get started on their own. The fundamental responsibility lies not in signing an inter-republican agreement right now, but in Mr. Yeltsin putting together a team—a government, in fact, a prime minister and government which will start to carry out within the Russian republic the financial and monetary measures that are absolutely essential. Where I disagreed most fundamentally with Secretary Mulford was his assertion that just getting over the debt hump and giving the republics time to sign

something is really an inappropriate response. There is not time in one sense; the financial clock is ticking. And we are on the door steps of a financial explosion, true and open hyper-inflation, whose end result is quite unpredictable in both economic and political terms. There is no time for Russia to delay in getting started on its fundamental reforms.

And, as a logical consequence of that, in my view, there is no time for the U.S. to delay in going directly to the Russian government and making direct assessments of financial needs for the success of Russian reforms and Russian membership in the IMF and World Bank, and getting started on that basis.

And naturally, with the Ukraine as the second-most important and enormous republic, the same will apply. We do not have time to wait to sort out more pieces of paper right now which are only going to be of tangential significant.

The key is to get true macroeconomic stabilization and liberalization programs in place. And for that, we will have to address directly the new governments in the republics. Thank you.

Senator BRADLEY. Thank you very much, Professor Sachs. Professor Havrylyshyn. Would you please bring the microphone close to your mouth?

STATEMENT OF PROF. OLEH HAVRYLYSHYN, DEPARTMENT OF ECONOMICS AND INTERNATIONAL AFFAIRS, GEORGE WASHINGTON UNIVERSITY, WASHINGTON, DC

Professor HAVRYLYSHYN. Thank you. Thank you, Senator Bradley, for this opportunity to make some remarks on this exciting situation. The exhilarating speed of changes we have seen in the former Socialist bloc might deter one from making predictions of an economic nature.

Senator BRADLEY. If you could even bring it a little closer, I think.

Professor HAVRYLYSHYN. Closer.

Senator BRADLEY. That is good.

Professor HAVRYLYSHYN. The exhilarating speed of changes in the former Socialist bloc might perhaps deter one from making predictions about future economic arrangements in the Soviet Union, but I think the risk may be less in predicting the direction of change and more in being too late with the prediction.

Even a recent study that I completed with John Williamson of the Institute of International Economics speaks of not an economic union, but an economic community. I noticed that the Alma Ata agreement no longer uses the word "union."

Moscow has clearly lost already a great deal of its economic and political powers to the republics, and how far this process will continue to go on is undetermined. But a definite agreement on any kind of economic arrangement will certainly not come easily.

One should read not to the comments in the press by Mr. Gorbachev and Yavlinsky—which are understandably self-congratulatory—and look at what even Yeltsin has said about not being euphoric. There are 20 very substantial technical agreements to be signed before the agreement in principal is implemented.

This year's cycle of positive reports in the press that an agreement has been signed or is about to be signed then followed by denials of various republics that they have agreed and clarifications that this was only an initialling of statements of principle could also make us skeptical about the real implementation of anything that has already occurred.

And, in the meantime, while one, in effect, dithers both there and here in trying to reach some kind of new arrangement for what was the former Soviet Union, the economic situation deteriorates rapidly.

Production has declined by Mr. Yavlinsky's estimate at least 13 percent—I suspect probably more—inflation reaching well over—800 percent annually, and threats of disruptions of food availability, at least in some localities, continually coming to the fore.

Western observers conventionally have viewed this situation as a chaotic disintegration of the economy, which can be arrested only by reaching quickly an economic agreement based on a single currency, an autonomous central bank, central coordination to avoid trade restrictions among republics, and central coordination of market reforms.

There are two fundamental flaws in this conventional view. National aspirations of republics simply preclude an agreement with strong centrist character. And, more important, as an economic analyst, I would add that a single currency unified system—and I am happy to see that I am joined by my colleague, Jeffrey Sachs, on this question—may not be the only, or, in fact, the best economic arrangement to stem the deterioration of the post USSR economies.

The interest of the West in this should not be in a particular form of coordination of economic arrangement or single currencies, but in promoting the attainment of four fundamental objectives.

Monetary and fiscal stabilization of the situation; prevention of a complete break-down of trade among republics; an early implementation of economic reform; and fourth, good, solid currencies and not necessarily a single currency.

To have a strong monetary discipline in the situation presently—for example, it is not enough to write laws that the central banks should not cover deficits of governments.

Most countries, including those of Latin America, have such laws. It will take much more than legal acts and a handful of voted staffers of the Central Bank to transform Gosbank into a clone of the Bundesbank. That is simply unrealistic.

The decentralization of fiscal taxation and spending power to the republics, which everyone recognizes, combined with the lack of financial markets for borrowing by governments, provides an incentive for each republic to run not the smallest, but, in fact, the largest possible deficit and race each other to Gosbank's printing presses.

This is already attested to by what is happening and very nicely and succinctly captured in an article about three weeks ago by Steven Mufson in Moscow of *The Washington Post*, and I quote, "The Soviet Union has been brought to the brink of hyper-inflation by rivalry among its republics, and Moscow's own desperate poli-

cies. Popular steps are being taken by the republics governments, who treat the Central Bank as some sort of cookie jar."

This is good economic journalism, except for one missing item. As frequently is found in economic journalism, the problem is attributed to individuals, motivations of governments and persons. It is not. It is a matter of the system. That kind of a system will inevitably lead to what Mr. Mufson describes.

The alternative of separate currencies, I will emphasize, is not, of course, free of the populist risk, by no means. But it is free of the multiplicative effect of the race to the central printing presses. By placing the ultimate responsibility for monetary policy with the same political unit that pulls the fiscal trigger of inflation, there is a better chance of achieving the required fiscal discipline sooner.

If one is, in the West, to think of setting the republics in a race with one another, it is far better to dangle in front of them not Gosbank's printing presses, stabilization funds for separate currencies, from Western governments and Western institutions, conditioned upon a serious stabilization and reform program.

An additional risk is the potential disruption of existing trade links, which has been mentioned by many that have testified here. But, again, a single currency, and central coordination are not necessarily the best solution.

The fear of trade barriers amongst republics, the export restrictions that one sees, are not based on traditional autarchic tendencies to protect local industry and jobs, which may come later. For the moment, the motivation is the lack of monetary stability of the present situation. And until this stability is achieved, the export protectionism will prevail.

Furthermore, too much attempt to centrally coordinate existing trade links risks a tremendously important delay in restructuring of the economy. Past trade was based on central planning dictates and will need to change substantially. One should not impose restrictions upon that change.

As the historical experience of the EC shows, a single currency is far from essential in order to have free trade, which is critical. The analogy, furthermore, of a single currency EC in the year 2000 is a very poor one for the former Soviet Union today. A far better one is the late 1940s EC with a damaged economy, a regulated environment, and inflationary tendencies.

The early creation of an Eastern economic community from the former component parts of the Soviet Union may be the most reasonable reconciliation of the inelectable national aspirations and the economic efficiency of open borders in a single space.

But one should not expect this to happen over night, and one may need to go through the process that one saw in Europe, which took 40 years.

Centrist-oriented plans have one element which are absolutely correct: the stress on early implementation of reform program, stabilization, price liberalization, privatization, convertibility.

But their problem is two-fold. They place an undue confidence in the ability of a weakening political center to implement such reforms. And their insistence that only a single currency area can achieve the monetary discipline is economically faulty.

It is frequently stated by Western politicians that until the republics agree to a new form of union, no serious reform can take place, and no significant credits can be expected. This appears like a neutral position of the West. But when Western leaders and policy-makers go on to underline the need for single currency and other coordinating roles, they may be unwittingly contributing to the postponement of economic reform by strengthening the centrist position, which, for political as well as economic reasons, is unlikely to prevail in the end.

It is theoretically correct to point to ideal economic arrangements, such as the single economic space of the U.S., or the multi-nation space which Europe will perhaps become in the year 2000 a single currency, but neither the U.S., nor the EC are former empires that have just rid themselves of a failed economic experiment with all this implies: the need for rapid changes in economic structures; replacement of old, mistrusted institutions; legitimate aspirations for nationhood—which, if unsatisfied, can turn explosive, and wide disparities in development which imply the former Soviet Union is simply not an optimal single currency area.

In such an historical context, a single nation state may not be the best model to propose. Rather, a rapid acceptance by the West of possibly several new nations bound by EC-like agreements into an economic community, may, in fact, speed up and enhance the prospects of economic reform and improvements in the miserable plight of 350 million people. Thank you, Mr. Chairman.

Senator BRADLEY. Thank you very much, Professor Havrylyshyn. Mr. Robinson.

STATEMENT OF MR. ROGER ROBINSON, CENTER FOR SECURITY POLICY, AND PRESIDENT, RWR, INC., WASHINGTON, DC

Mr. ROBINSON. Thank you, Mr. Chairman. It is a privilege to appear before this committee to discuss the strategic and financial implications of the rapidly escalating Soviet financial crisis—a subject I think that is particularly intriguing, in light of the coincidence of this crisis with the de-centralization of economic and political power that has begun in the former Soviet Union.

As you recall, I served as Senior Director for International Economic Affairs at the National Security Council between 1982 and 1985.

Prior to coming to government, I was a Vice President in the International Department of the Chase Manhattan Bank in New York, 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 also looked after the Polish debt rescheduling in 1981.

In my prepared testimony, which I would now ask, Mr. Chairman, be submitted for the record of the hearings—

Senator BRADLEY. It will be in the record in full.

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

Mr. ROBINSON.—I focused on some of the origins of the current Soviet financial crisis, and commented on the controversy surrounding the true value of Soviet strategic gold reserves.

In addition, I explored how current G-7 policies, particularly those of Germany, are both inordinately jeopardizing the equities of Western taxpayers, and risk undermining the near-term restoration of Soviet and republic credit-worthiness in private financial markets. Third, I discussed briefly the role of multi-lateral institutions in managing Moscow's financial misfortunes.

I finally offered some thoughts on differentiating between the pre-coup Communist debt and post-coup new money flows to those republics which qualify for such assistance, and reacted to several G-7 proposals and other developments currently unfolding.

The period of Mikhail Gorbachev's stewardship as leader of the USSR which began in early 1985, in my view, has been marked by an inexorable march toward the financial crisis now gripping the former Soviet Union.

The free-fall in Soviet credit-worthiness and Moscow center's resulting inability to attract meaningful private-sector trade and credit flows from the West—that is, flows not fully covered by Western taxpayer guarantees—were the inevitable result of the combined effect of developments like the nine points I outlined at the beginning of my prepared testimony.

In 1985, total Soviet indebtedness was estimated to be only about \$30 billion, primarily a product of the legacy of caution with respect to foreign borrowing. Today, by contrast, total Soviet hard currency indebtedness is estimated to be, in my judgment, in the range of \$70-\$75 billion.

For the reasons I enumerate in my testimony, nobody in the West has any definitive information concerning the true level of Soviet indebtedness, notwithstanding some of the comments of this morning. This uncertainty is simply another powerful argument for demanding that Moscow provide immediately a complete and transparent picture of its financial portfolio.

Not surprisingly, uppermost now in the minds of Western government officials and commercial bankers is the question, can the Soviets manage this large hard currency indebtedness in view of total annual hard currency income, typically in the range of only \$32 to \$37 billion and falling? Here I tend to disagree with administration witnesses who implied that after the former USSR gets over a payment hump, they will somehow be fine.

In fact, the hard currency income of the USSR is—overall, now—declining fairly sharply, not just due to the withholding of remittances to the center. With no near-term turn around by any means assured.

In the past, the manageability of Soviet debt has generally been answered affirmatively, thanks, in part, to a presumption that the Soviet Union had large strategic gold reserves. These reserves were believed to provide a kind of bottom line safety net for Western private and public-sector creditors.

Today, of course, such confidence has been sharply eroded by recent, often conflicting, Soviet statements to the effect that their gold reserves are a trivial fraction of what conventional wisdom held they were just a few months ago.

Soviet claims and counterclaims concerning their gold reserves, not to mention the massive gap between even the most optimistic of such estimates and those long relied upon in Western financial

circles, should serve as a cautionary tale for those inclined to provide financial assistance to a reconfigured Moscow center.

Although I provide a number of details concerning the present controversy swirling around the level of Soviet gold reserves, in the interest of time I will slash to the bottom line on that. My basic view in this debate is that for several years, the Soviet union was content to inflate artificially its gold reserves by nodding in the affirmative toward Western estimates in the \$25 to \$32 billion range.

For reasons like those that I mention in my testimony, I believe some all-union Soviet leaders—possibly Gorbachev himself—may have encouraged Mr. Yevlinsky to go public with an artificially low gold reserve figure, hence, the huge disparity in estimates which emerged virtually overnight. Based on an historic analysis of unexplained Soviet hard currency funding gaps, and admittedly incomplete market information concerning Soviet gold sales, it is my belief that Soviet reserves probably remain in the range of \$6 to \$12 billion, or some 520 to 1,040 metric tons.

I respectfully suggest, Mr. Chairman, that this committee should be both amazed and deeply disturbed that the leaders of the industrialized nations are now, under these kind of circumstances, engaged in financial decision-making likely to involve the disbursement of billions of dollars in U.S. taxpayer funds to Moscow center between now and the Munich Economic Summit next July, at a time when the liability and asset sides of the Soviet balance sheets are arguably murkier than ever.

During the recent IMF/World Bank annual meetings in Bangkok, the G-7 nations publicly feigned consensus on providing emergency financial aid to the former USSR to help avoid a foreign debt payments crisis.

Notwithstanding Mr. Mulford's view expressed here earlier, sharp divisions have emerged on the specific question of what form such emergency aid should take. Soviet hard currency shortfalls for the last months of this year were calculated by the G-7 to be more than \$7 billion. Importantly, it is the lack of adequate remittances by the republics to the center, along with "bunched" repayments that are viewed by the G-7 as the principal reasons for the immediate Soviet liquidity crisis.

The Soviet delegation to Bangkok, led by Yevlinsky and Geraschenko of Gosbank, communicated to the industrialized nations that Moscow's coffers only had sufficient hard currency available to meet their debt repayment obligations for, at most, the next 2 months. Geraschenko went so far as to state that Soviet hard currency reserves as "close to zero."

There are a number of ingredients to the financial package envisioned for Moscow that are contemplated by the G-7. Some of those were touched on this morning. We can perhaps get back to those in the questions.

If I may, in their upcoming visit to Moscow, the G-7 appeared to have agreed to play the role urged upon them by the Soviet central authorities, namely, that of the enforcer of Moscow's demands that the republics continue to provide the center with sufficient hard currency remittances to permit it to meet, among other things, the former USSR's past and future foreign debt obligations.

In other words, the G-7 mission that is upcoming this week is designed, in part, to preserve the facade of Soviet credit-worthiness until statutes in countries—like the United States, Japan, and Canada—which make a favorable credit rating a pre-condition for sovereign borrowing can be, perhaps, waived or eliminated.

Not surprisingly, Germany has taken the lead among European countries in strongly opposing U.S. intentions to go public with a specific debt deferral plan for the former Soviet Union.

After all, Germany has a radically different interpretation of allied financial burden-sharing in the context of the Soviet financial crisis than that of Washington. It is not difficult to assay Bonn's motivations in this area. All one need do is glance at the estimated respective shares of Soviet debt held by its G-7 partners.

In my prepared testimony, I also explore the underlying factors which are probably driving the German policy agenda with regard to the Soviet financial crisis that I commend to your attention, Mr. Chairman, and that of the committee.

The G-7 partners have already begun to recognize that it will only be a matter of time before the U.S. Congress and other nations' legislative bodies awaken to the German game plan.

Once they do, such parliaments are most unlikely to agree to allow Moscow to use their taxpayers' money to pay off profligate European lenders—lenders who had chosen in the pre-coup period to extend credit to a Soviet regime which remained committed to the preservation of a fundamentally unreformed militarized Soviet economy, and costly global empire.

For the moment, the Bush Administration is exhibiting a virtually unprecedented and refreshing degree of prudence in its handling of this potentially explosive issue and appears, for the moment, determined to resist the gratuitous creation of additional Soviet indebtedness.

Fresh financial flows from the West will only deepen Moscow's debt crisis and hobble further the prospects for the genuine transformation of the Soviet economy.

To put it bluntly, a bridge loan—BIS originated, or otherwise—envisioned by most G-7 partners would represent a bridge to nowhere under current circumstances. Indeed, what is needed is a Western policy of clear-cut differentiation between pre-coup Communist debt and post-coup new money flows to those republics which qualify for such assistance.

The bottom line is that the Soviet Union should reschedule its debt now rather than have such a rescheduling artificially staved off at the expense of Western taxpayers. This is particularly the case when the only certain beneficiaries of such a postponement are European banks and governments, not the beleaguered Soviet economy and those of the republics.

As we are out of time, I will have to pass over the emerging role of multi-lateral institutions, but I certainly offer some views concerning why they are being eagerly brought into the game by this administration and other G-7 governments. They are faceless institutions that make it a little easier to deal with the potential downsides of this crisis, in particular.

With that, Mr. Chairman, I think that, again, so that we might get on to questions, I will stop there. Perhaps we can pick up some

of the other issues. I do, in conclusion, have ten specific policy recommendations offered at the end of my prepared remarks that react to the G-7 proposals currently on the table, and other related developments. Thank you very much.

Senator BRADLEY. Thank you very much, Mr. Robinson. And let me thank the whole panel for their testimony. I know it was real concise, and I appreciate the thought that went into the drafting your entire statements. The entire statements will be available for the committee, and I personally appreciate it, and have read them and feel they are really excellent.

Let me ask you now. Among the four of you, how would you deal with existing Soviet debt? This is the question that is troubling Mr. Mulford these days, as well as others at the G-7 meeting.

Professor HAVRYLYSHYN, I am not sure how, under your proposal, existing debt would be handled. How would that work?

Professor HAVRYLYSHYN. Our proposal as such, and the study you mentioned, does not address the question. But I do have a view on that.

The view starts with the fact that the republics' main interest is not the attributes of economic independence, but political independence. And the sooner that they feel that they have attained the political independence they desire, the sooner they are more likely to speak sensibly about economic issues, including the debt.

Therefore, I do not think there is going to be a resolution of how the debt burden is solved until there is a resolution of the political problem. Once one gets to—

Senator BRADLEY. So, constitutional order has to precede any economic—

Professor HAVRYLYSHYN. Constitutional order may inevitably mean that recognition of political independence on those most strongly insistent on it—obviously, Ukraine—is going to be put on the Western table very quickly.

Once one gets to seriously discuss the debt, I think one needs to bring to the surface a question of dividing up things. When you break up—breaking up is hard to do, but you have to divide not only what everybody owes, but what everybody owns. And very little discussion has gone on in the West about the division of the assets.

The republics, understandably, are not going to be very keen on saying, sure, we will pay our 5 percent of past debt, or 16 percent of past debt, or so on, until such time as they are satisfied that we will get our 5 percent and 16 percent respectively of existing remaining assets, which may be dwindling quickly.

Senator BRADLEY. So you say it has to be related to the other economic negotiations between the republic and the center.

Professor HAVRYLYSHYN. Up to and including the point that there may be no willingness to undertake other economic arrangements, but there is a willingness to say, all right, we will divide up the debt as long as we also divide the assets.

Senator BRADLEY. Mr. McConnell, what did you say? I know in your testimony you said you wanted a just settlement.

Mr. MCCONNELL. Well, as a practical matter, exactly what we have just heard is something that I subscribe to. I think that first the political has to be resolved. Certainly in the case of Ukraine,

that is going to be—they are going to look at everything else contingent upon resolving that.

Secondly—and I had made more extensive remarks on this in my written testimony—that as far as deciding what is the just debt; both the debt obligation is clearly defined, and the assets—what is owned—the same point Mr. Havrylyshyn just made—is going to have to be there for resolution. And that is going to go everything from the assets across the current boundaries of the Soviet Union to the multiplicity of buildings in the city. These are assets Ukraine has an interest in as well. If they are going to divide something up, they are going to divide up both sides of the equation.

Senator BRADLEY. So that Ukraine would have certain claims on assets that are now owned by the Soviet central government located in Ukraine and elsewhere?

Mr. McCONNELL. I believe so.

Senator BRADLEY. And before Ukraine would agree to what percent of the \$70 billion it is prepared to come up with, they would have to resolution on the assets that were under Ukraine's sovereign control.

Mr. McCONNELL. Correct.

Senator BRADLEY. Mr. Robinson.

Mr. ROBINSON. Well, first, Mr. Chairman, I disagree fundamentally with the way the administration's witnesses this morning characterized the nature of the problem.

In my opinion, this is not a short-term liquidity problem with a set of bunch repayments coming up over the next 12 months, and the bad old republics that are not sufficiently remitting hard currency to the newly configured center.

In fact, I see it as a longer term structural crisis. Again, Moscow's hard currency income, even independent of the republic question, has been falling rather precipitously and is not going to be necessarily a near-term exercise to turn that falling hard currency income around.

As far as the existing debt goes, I think it should be, as I mentioned, rescheduled forthwith. The fact is that Moscow is admittedly coming to a period where it can no longer service its debt. We are faced with the very unsavory prospect of this rescheduling being artificially staved off with new money flows.

They are almost by definition going to be at some level, recycled by Moscow to pay off those Western governments and banks that have heretofore had the greatest credit exposure in the country.

I think that if we are faced with the circumstance where debt is going to be allocated—that is, Moscow's debt is going to be allocated among the remaining republics—I think that for those republics exhibiting the greatest commitment to democracy and free-market reform, we should make sure that they have a long-term, generous debt rescheduling; both to permit them to achieve economic growth, and also some stand alone credit-worthiness in private Western markets. We also have to be careful that we do not use debt relief and other forms of Western assistance—and I am specifically speaking to the G-7's attitude right now—as a kind of club to bludgeon republics into signing all union economic and political

agreements and treaties that may not at all be in their perceived national interest.

Now, right now, that is the kind of rather heavy-handed tactic that I am hearing, in both the press, and also this morning.

So, those are just some quick thoughts. But I also, finally, agree with my colleagues here that if we are going to divide up the liability side of the Soviet balance sheet, we certainly should not neglect the asset side.

And once we do find that furtive figure of Soviet gold reserves, let us see those assets—just, for example, as well as hard currency deposits in Western banks—proportionately distributed to the republics to help them service debt even in a rescheduling scenario.

Senator BRADLEY. Professor Sachs, what about the existing debt? What do we do about this existing debt?

Professor SACHS. Let me also start backwards for the long-term. I do not have very much doubt that this debt can be paid in full in the long run. It is not a lot of money. The fact that this is such a deep crisis is testimony mainly to the insanity of the Soviet economic system rather than anything else. You know, this is a country whose manufactured exports are less than Poland's right now.

So, we are not getting any measure of long-term capacity to service what we see as an economy which was an economic system which was so fundamentally anti-export biased that they cannot even manage a relatively tiny amount of debt. And that can turn around in the course of a few years when realistic exchange rate and open trade policies are pursued.

So, first thing, I think it is absolutely fair to say that for the long-term, we are not in the business of debt reduction unless circumstances or views change so fundamentally that that has to be reconsidered. I would very much doubt that that is a problem.

Second, I do not see any reason for us not to bludgeon republics into agreeing on general terms that they have a joint responsibility for the debt. It is a very far cry to insist on that, versus insisting on a full economic agreement.

Full economic agreement, I think, is not something we should be pushing for. It is vague commitments to all sorts of things that they cannot know or might be very dangerous for their own future. Whereas, a commitment on the debt is something which is quite concrete and seems to me to be eminently responsible for us to be pushing and for them to agree to.

The third thing is that our choice is not new money versus formal rescheduling. There is a third option, which is arrears. And that is generally the best thing to do when you do not know what the situation is, and when, perhaps, in a few months, things are going to clarify.

Now, I think the first point that many of us have made—and you have made also, Mr. Chairman—is that we do not really know what the situation is. I do not think that it is only a matter of the Soviets not showing us the books. I am quite sure that they do not know exactly what the situation is, either. But I do think that the first requirement for the short run is that the Soviets open up every book that is available to, say, a Paris Club designated, or G-7 designated team of experts. Not one that is going to go there for a few days, but one that is going to go there to try to sort out what

these responsibilities are. And that is going to take some weeks or months even to get a full picture.

Second, in the immediate term, I do not think we should regard timely debt service payments as the most important thing in the world. It may well be true that they cannot manage them in the short run.

And if that is the case, then insisting on timely debt service payment seems to me to be putting a relatively unimportant consideration in the face of something which is of worldwide and historic significance, and that is helping to prevent this current instability from exploding into something very unhappy.

Third, putting in new money in such a circumstance, I think, risks all sorts of adverse outcomes, not the least of which is a public bail out of private funds. And I would like to be assured that any new money that goes in at least has a balance of public and private responsibility so that both sides are bearing their weight. Then the question of whether to allow open arrears rather than some more formal short run bridge loan that is at least balanced between the public and the private sector is a more delicate question.

My own guess is it would be too complex and not necessary to arrange. And just living with the facts right now that the Soviets are already in arrears to trade creditors of \$3-\$4 billion and they may get into arrears of another \$5 billion before the end of the year with a lot of other creditors, does not seem to me to be the worst thing in the world when you have a revolution on your hands and a group of republics that are on the edge of hyper-inflation. You know, worse things could happen.

And maybe they really need the remaining reserves to buy grain. To pre-judge this issue to say that the timely debt servicing is the most important thing seems to me to be a very peculiar response.

As for formal rescheduling, I just think we are far from having the data, the knowledge, the will, the pre-conditions that we would like to associate with that in place. That is something that can be re-visited next spring or next summer.

The Paris Club agreement is, quite appropriately, an arrangement that has lots of ancillary features to it, usually in economic program, for example, and I think we ought to stick with that basic principle.

So, if there is a balance of payments crisis, so be it; let arrears grow. I do not think we have to do somersaults to prevent that from happening.

Senator BRADLEY. What is the difference, in your view, between arrears and a moratorium?

Professor SACHS. A formal moratorium in which we agree should be—a formal moratorium would be more like a Paris Club rescheduling.

And I think a moratorium where we officially agree in some legal basis should be predicated on steps on the other side and clear commitment to economic change, clear formal commitment of the republics to their obligations, and so forth.

I think the time for that may well come within the next six months. I am talking about the next 3 months.

Senator BRADLEY. You see arrears as really just the temporary cushion that was alluded to, essentially, by Mr. Mulford. It is a kind of temporary cushion, do not be too worried about it.

Professor SACHS. That is right.

Senator BRADLEY. All right.

Professor SACHS. In fact, one very real possibility which I would like the Secretary to dispel from my, perhaps, too active imagination, is that this BIS loan would pay off short-term bank creditors.

Now, that, I think, would be a most unfortunate use of BIS funding. So, it is not clear to me from the Secretary's discussion exactly what he has in mind and whose debts are going to be serviced by which money.

Senator BRADLEY. All right.

Professor SACHS. If I felt that there was an absolutely clearer set of responsibilities, public for public, private for private, and that there was not going to be a crossing over, I would feel a little bit more comfortable about putting in "new money to service old loans."

Senator BRADLEY. Right.

Professor SACHS. But in any event, arrears seem to me to be a perfectly natural way to respond to a deep crisis. I should say, Senator, that if we find unwillingness on the side of the Soviets, and bad faith in showing the real situation, or if we uncover substantial assets that really could be used, then I think that arrears should carry with it the full stigma that would be deserved in that situation. I do not want to totally pre-judge the situation.

My guess is that they do not have the money, and that is on the general theory that Communist governments spend everything they can get their hands on to clean out the cupboards before they give up power, because they are totally irresponsible and they will sell the family jewels, and they probably have.

Senator BRADLEY. All right.

Professor SACHS. So, my guess is that it is not there. But if it is there, then we should not tolerate the arrears.

Senator BRADLEY. All right. If I could, Mr. Robinson, you have one minute.

Mr. ROBINSON. Yes. Very quick.

Senator BRADLEY. Very quickly. I want to go over four or five other points.

Mr. ROBINSON. All right. As far as arrearages, speaking as a banker, I have a different view of the light-hearted attitude taken toward arrearages.

Senator BRADLEY. No further comment necessary. [Laughter.]

Mr. ROBINSON. All that just goes by saying that the Soviets have been in a piecemeal debt rescheduling, really, since 1991. And the symptoms have been, of course, the accumulation of those arrearages and the phenomena whereby you have multi-billion dollar Western credits offered fully backed by taxpayers like our German friends that were specifically earmarked to cleaning up the arrearages of their national firms. Speaking as a banker, I view that as a piecemeal debt rescheduling.

Senator BRADLEY. Do all of you agree that there should not be trade barriers among and between republics?

Professor HAVRYLYSHYN. Yes.

Mr. McCONNELL. Yes.

Mr. ROBINSON. Yes.

Professor SACHS. Yes.

Senator BRADLEY. Everybody agree? Everybody nodding their head.

Professor SACHS. And that is also something we can appropriately press for, I think, without—

Senator BRADLEY. Do you see any problem for Ukraine not putting up trade barriers in their trade with Russia or Byelorussia or Kosikstan?

Mr. McCONNELL. I think certainly the goal is not to have trade barriers. I mean, as a practical matter at the moment, there is great de-stabilization efforts taking place by the center in anticipation of the December 1st referendum.

Senator BRADLEY. What are they doing?

Mr. McCONNELL. What I have been told there, and since I came back last month, is everything from cutting of supplies—tools and so forth for the harvest—to movements of money to de-stabilize the Ukrainian's own ability to buy things; cutting off supplies to factories where parts are coming in from Russia to factories that need those parts to finish the manufacturing process so that the workers see critical inventories going down and the burning of harvest in this.

It is absolutely extraordinary to hear this when you are there. But pictures and people coming in and testifying before committees of the Supreme Rada about the—I do not know what they call it. I have not gotten this translation. But what is left of what was the Communist Party burning fields to provide, in certain Eastern Oblass the impression of food shortages that will be very severe to make the population be fearful of what independence would mean before the referendum. All of that is going on now.

Senator BRADLEY. It seems to me like that is all counterproductive.

Mr. McCONNELL. I think it is counterproductive. But what Mikhail Hoyn said to me, you have to remember, you Americans look at things logically. And, as a practical matter, we have many people and a percentage of our population is affected by 70 years of being told what to think and what to do.

Senator BRADLEY. Yes.

Mr. McCONNELL. But, as a practical matter, you know from your conversations with Horen and others, that well before all this happened, the democratic movements were, in fact, going out and creating horizontal agreements—shadow agreements, and trying then, once they got into power or having an influence on the elements of power, being able to enter into trade agreements back and forth, horizontal, between the republics, to keep in line all the economic structures. They just feel they do not need the virtual center.

Senator BRADLEY. Professor Havrylyshyn, I found your testimony particularly interesting on the point that you think that it would be advantageous to have separate currencies.

Professor HAVRYLYSHYN. Yes.

Senator BRADLEY. If you could go over that once again—

Professor HAVRYLYSHYN. All right.

Senator BRADLEY.—because all we have been hearing from the center is, well, we have got to have one currency— only one currency. Otherwise, how can we have economic relations? So, once more, what is your argument for separate currencies?

Professor HAVRYLYSHYN. All right. If I could take maybe 30 seconds to give, shall we say, an idealized argument for why a single currency is best.

As in the case of Europe today seeking to move towards a single currency area, the economic efficiency of the transaction operations that occur mean in a single currency area that you have certain gains.

This is conditioned upon the fact that all of the different component parts of this union first of all maintain a fiscal discipline and there is some mechanism for maintaining it. And secondly, that they are not so largely diverse in development that a single currency is harmful to a backward area.

One of the best ways for developing countries we know of fixing up their lagging economies is to devalue their over-valued currencies. A single currency for Tajikistan with the rest of the Soviet Union will not give them this tool, for example.

More important in the short run, however, is that separate currencies may help avoid the hyper-inflation threat. The hyper-inflation is coming from the following mechanism: as long as there is a single currency, every single republic is motivated to try to increase its expenditures, its budget—and right now, budgets mean more than just an administrative budget of a government, it also means paying all of the workers and all of the enterprises. They are motivated to run the biggest possible deficit and have it simply monetized by the Gosbank printing presses.

This occasions in the current situation, lots of threats and allegations and counter threats in the Ukraine, for example, that Russians are running big deficits and Gosbank is printing rubles for Russia, but is not doing so for Ukraine. Whether this is or is not true, it is an indication of the messiness of the system and the implications of trying to run a single currency.

It is impossible in the short-run, it seems to me, to expect a solid discipline from the center like one might be able to have in Europe in ten years, or like one has in Europe today with a currency arrangement of separate currencies fixed in some relation and held tight disciplined by the monetary discipline of one very disciplined bank, namely, the German bank.

I do not see a Bundesbank amongst the republics, and I certainly do not see a Bundesbank in the phoenix-like conversion of the present Gosbank.

Senator BRADLEY. So, you feel that it would be easier, because you then would not have this temptation to spend wildly and send the bill to the center, because they would have to send the bill to Kiev, or—

Professor HAVRYLYSHYN. Exactly. You have much less of a temptation. This does not mean that populism does not prevail. Populism prevails in Kiev, I think, at least as much as it does in Washington, and Lima, and the Kremlin, and many other countries. This is a generalized problem. But one has to pay one's own debts eventually.

Senator BRADLEY. If you were then saying you wanted to have republics with separate currencies and you would have stabilization funds—

Professor HAVRYLYSHYN. Yes.

Senator BRADLEY.—has anybody done the work to tell me how big the stabilization fund would have to be?

Professor HAVRYLYSHYN. A very rough calculation has apparently been made by some economists and analysts in Ukraine. I have made some of my own very rough calculations based on export projections, debt obligations, and so on. And in the case of Ukraine, this ranges in estimates from about \$1.5 to \$3 billion.

Senator BRADLEY. Does anyone have any other figure on stabilization funds for Russia?

[No response]

Senator BRADLEY. No. All right. Let me ask you—Oh. You do?

Professor SACHS. I had used a number earlier this summer of \$8 billion for the whole region. These are really not—

Senator BRADLEY. Usable numbers.

Professor SACHS. Not very precise of which Russia was—

Senator BRADLEY. These are the Foreign Relations Committee numbers.

Professor SACHS. That is right; exactly. For them, it was all right, you know.

Senator BRADLEY. All right.

Professor SACHS. And for Russia, it was about \$5 billion. For the Ukraine, \$1.2 billion. For the others, \$2.0 billion.

Senator BRADLEY. All right.

Professor SACHS. Everything about stabilization funds is somewhat vague, it has to be said.

Senator BRADLEY. Yes.

Professor SACHS. How large they have to be to do their job.

Senator BRADLEY. Well, you know, as I see the situation, we are in a potentially hyper-inflationary environment in the Soviet Union.

Professor SACHS. Yes.

Senator BRADLEY. And in each of the constituent republics. I do not know a single republic that has a low inflation rate. Does anyone here know? I mean, it is basically the Soviet Union with the hyper-inflation. And we all know what happens when hyper-inflation really sets in. I mean, totally unpredictable political ramifications.

So, if you were to advise either the Republic of Russia, Ukraine, Khazakstan what they could do to protect themselves from incipient and growing hyper-inflation, what would you advise them to do? Two or three things.

Professor SACHS. If you were other than Russia, so you are on the outside and you are outside of the core and you are trying to decide what to do, one possibility certainly is to introduce your own currency and get your own budget under control. And that can, in principle, suffice to shield you from this tidal wave of monetary instability, which is emanating from the other republics. Since all the republics are running large deficits, introducing your own money is no guarantee that you are going to escape. You may just have your own hyper-inflating currency. It is interesting—and I

should note that Slobvenia last week introduced its own money to try to escape from the developing hyper-inflation in Yugoslavia, or the former Yugoslavia.

And immediately, its new currency traded at a premium relative to the Yugoslav dinar of quite a considerable proportion, showing that it had far more confidence in the public.

Senator BRADLEY. So, one possibility is you have your own currency.

Professor SACHS. Now, if you are Russia, you have to get the ruble stabilized, basically. And that means undertaking a quite radical stabilization program and doing it—

Senator BRADLEY. So, but let us be specific. All right. Let us say you are Russia. What do you do to get this hyper-inflation down five points?

Professor SACHS. Well, the most fundamental thing is first price liberalization.

Senator BRADLEY. De-control prices, let the prices skyrocket even more.

Professor SACHS. Yes. Yes.

Senator BRADLEY. All right. Next?

Professor SACHS. Second is a very substantial increase in the real price of energy to your own users, and to all the other republics.

Senator BRADLEY. All right.

Professor SACHS. That is going to be a major revenue raiser.

Senator BRADLEY. Next.

Professor SACHS. Third is a substantial cut-back in almost all kinds of subsidies. By devaluing you will be able to eliminate a vast array of implicit and explicit export subsidies, but also consumer subsidies and producer subsidies across the board will have to be cut.

Fourth, obviously, very substantial cut-backs in military spending—that is an absolutely core pre-condition of stabilization—on all military procurement, and a phased and very significant reduction of the armed forces, even though that is going to raise other kinds of substantial costs.

Senator BRADLEY. All right. Now—

Professor SACHS. Senator, I should say that under any circumstances, even with the best policies, this region is in for a very profound crisis. And I would say that even under the best policies, the political outcomes of managing this crisis are very uncertain and very dangerous. We are beyond the point of any easy solutions. We are beyond the point of a non-explosive way out of this in terms of crisis.

Senator BRADLEY. Well, let us say that none of these things are done and you have a hyper-inflation. How do you then get things back under control? Anybody.

Mr. ROBINSON. Well, Senator, I think one of the things you would have to do is you would have to move to working with the most reformist of the individual republics. They have, in my judgment, a better chance of pulling their act together on the economic and political fronts than working with an all-union circumstance. I tend to agree with—

Senator BRADLEY. Oh. Smaller unit, better able to control their destiny in trying to move—

Mr. ROBINSON. I think so. I think so.

Senator BRADLEY. All right.

Mr. ROBINSON. And I think that there can be a competitive process catalyzed between the various republics to, in effect, compete for Western credit and investment flows that you would see them creating investment clients and climates far more conducive to those developments, and the successful models, presumably, would proliferate across the landscape of the Soviet Union. Today we find the G-7 that is interested in top down, almost exclusively.

Senator BRADLEY. Professor Havrylyshyn, quick.

Professor HAVRYLYSHYN. Yes. I would put it this way. If hyperinflation goes on, then this will push more and more republics to go it alone.

The risk is that if we do not step in with the sort of suggestion Mr. Robinson has just made to put them into a competition with each other through sensible economic policies, that at first, some of them will go it alone and have equally inappropriate and bad economic policy as we now see from the center.

Senator BRADLEY. Are you speaking only of private capital, Mr. Robinson?

Mr. ROBINSON. No. I was thinking of government policy as well.

Senator BRADLEY. How much money would there have to be out there to attract this competition?

Mr. ROBINSON. It seems to me that you could be dealing with funds that are roughly the same level as those envisioned for the United States in an all-union exercise. For example, I think the American taxpayer right now is exposed about \$2.8 billion in pledges of assistance to the Soviet Union since December of last year.

My own view is that there is going to be at least another \$3-\$5 billion in such taxpayer guarantees offered between now and next July at the Munich Economic Summit. Of course, this is just one country's contribution—the United States.

But given the fact that we are syndicating this effort—you see this in the Japanese and others meeting roughly our equivalent expenditures—we are talking in the area of \$12 to \$15 billion. But this time, have a republic-directed policy as opposed to continuing to try the untenable, which is to prop up a failing center.

Senator BRADLEY. I wish I could stay all afternoon. I am sorry, I cannot. I have to end the hearing this morning. I think that it has been extremely helpful. I think that this has given me, and I know the whole committee a whole range of possible ways to look at the problem and a sense of urgency about what is on the horizon. I cannot tell you how much I appreciate your willingness to come in and share your views. The subcommittee is adjourned.

[Whereupon, the hearing was concluded at 12:25 p.m.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED

PREPARED STATEMENT OF SENATOR BILL BRADLEY

I'd like to thank all the witnesses for being here today. This hearing is intended to explore the relationship between the devolution of economic and political power in what used to be the Soviet Union, economic revival in the former Soviet Union and Western financial relations with the Soviet Union and the republics, especially economic relations that has to do with debt. Each of the witnesses before the Subcommittee today will present a different aspect of those issues.

I'd especially like to thank Secretary Mulford, who has come directly from the World Bank/IMF meetings in Bangkok this weekend. I greatly appreciate him being here today and anything he would like corrected in the record after the course of the discussion we'll attribute to jet lag.

I'd also like to thank Tom Niles, the newly appointed Assistant Secretary of State for European and Canadian Affairs, for being here as well.

We will also have a panel of witnesses from outside the Administration:

- Oleh Havrylyshyn of George Washington University and the Institute for International Economics.
- Bob McConnell of Ukraine 2000.
- Roger Robinson, formerly at the National Security Council and now in charge of his own consulting firm.
- And finally, Jeff Sachs of Harvard University.

I am really very pleased that this hearing could be possible today. I have been interested in these issues for a number of years. I remember back in October of 1990, about a year ago, we attempted to have a hearing on this subject and unfortunately the Administration was not available for the hearing. And it didn't come together.

In the letter that was sent a year ago, the questions that I wanted to address were such things as:

- "Is there reason to think that the U.S.S.R. is too big, diverse, and cumbersome to manage a successful transformation of its failing socialist system?"
- Might individual republics or groups of republics prove more adept at initiating and sustaining radical systemic change?
- If so, what are the implications for the United States and Western approaches to supporting such change and to integrating the U.S.S.R. and/or its constituent republics into multilateral institutions.

Those were the questions that were asked last year that we hoped would move to a hearing but unfortunately that hearing didn't take place.

In November 1990, I raised many of the same issues in letters to national Security Advisor Brent Scowcroft and Deputy Secretary of State Lawrence Eagleburger. Their responses went to great lengths to demonstrate the breadth and depth of the contacts between the Administration and the leaders of the Baltic states and the republics. But they also demonstrated a reluctance to give credence to those leaders' successes in moving their republics towards reform and democracy.

Then on the issue of Soviet indebtedness and Western exposure, I remember talking to Ivan Ivanov, who was then the Deputy Chairman of the Commission on International Economic Relations in 1988. He described the growing Soviet debt burden and his concerns about the impact of external debt on Soviet reform. He told me

about the lack of control over external debt and the growing chaos in the Soviet economy. That was in 1988.

When I returned from Moscow, I testified in September 1988 before the House Banking Subcommittee on International Finance, Trade and Monetary Policy. In my testimony I expressed my own concerns about the build-up of Soviet debt. The net debt was not unmanageable, but it seemed to me at the time that no one was thinking about the implications of Soviet economic relations with the West. What economic policies—foster economic reform in the Soviet Union and—what hinder it? My concern grew from having watched what happened in Latin American in the 1980s. And having seen that crisis explode before the policymakers had developed adequate response.

Not long after this hearing, that was the hearing before the Banking Committee, and at a time when the Congress was working on several pieces of legislation expressing concern about issues of Soviet economic relations, the Administration put together a task force on Soviet debt. A joint tax force of the Treasury and CIA, who played leading roles in drafting a study which was released on November 8, 1988.

The study presented a rosy picture of Soviet economic relations with the West. It noted that much of the nominal increase can be explained away by adjustments for inflation and currency devaluation. It placed faith in Soviet redepósitos in Western banks and the Soviet gold reserves, which it placed at 70 million ounces, valued at \$30 billion.

As a postscript to this history, and I go through this simply to lay a context for today's hearings, and this is an issue that I have been personally interested in for a long while. Again, as a postscript, when I returned to the Soviet Union in 1989 after having the conversation with Ivan Ivanov in 1988, I saw him again. The decree allowing enterprises and ministries to borrow directly from the West had just passed. For Ivanov, this was the last straw. He explained how enterprises and their Western lenders assumed that the debt would ultimately be guaranteed by the central government. But he went on to say that the central government wasn't even able to keep track of the debt, much less consider repaying it.

I say this in order in order to present a sense of the history of this issue. The events of the last months have forced all of us to reevaluate our understanding of the how the Soviet Union works, and how it doesn't work.

I am looking forward to hearing how the collapse of Communism in the Soviet Union, indeed the end of the Soviet Union as we have known it, has changed perceptions of these issues, and I hope that through the course of these hearings we will also come up with some alternatives.

So our agenda is rather ambitious today and I think we do have quite a good panel. I am extremely pleased that we have Mr. Mulford and Mr. Niles to open up today, and I welcome their testimony and I look forward to hearing what is the latest thinking in the Administration on this critical issue.

PREPARED STATEMENT OF SENATOR ORRIN G. HATCH

Mr. Chairman, I want to commend your timely action in holding hearings on the important topic of Soviet debt. We have assembled a panel of distinguished witnesses, all of whom are directly engaged in this issue and who can at least offer approaches to finding workable solutions.

I am very happy to see representatives from the Ukraine. This republic has the attention of the world focused on it, especially since it recently rejected the Soviet economic treaty. This action, of course, has raised a lot of questions. As for myself, I wonder if the former USSR will break up into "fortress economies," as I would call them. If so, what will be the responsibility of the republics for their share of the massive Soviet debt, now in the range of \$70 billion, as well as for private debt owed western companies, estimated to be as high as \$3 billion?

And how can the republics manage trade with the Soviet Union, or with the rest of the world without a credible currency?

Of course, I recognize that rejecting Soviet economic leadership is a matter of sovereign pride. And, in many ways, the republics can easily attest that they have paid a "psychic debt" through years of Soviet repression—in the case of the Ukraine, over 300 years of repression.

But there remains the underlying economic and more practical problems that all nations, especially new ones, must face in the rapidly globalizing economy.

Again, Mr. Chairman, today's session will uncover much helpful information on some of these basic issues. I want to welcome the distinguished members of our panel.

PREPARED STATEMENT OF ROBERT A. MCCONNELL

Good morning Mr. Chairman. My name is Robert McConnell. I am chairman of the Government Relations Committee of Ukraine 2000: The Washington Committee In Support Of Ukraine. Ukraine 2000 is one of twenty-three committees in twenty-three cities across the country that have formed to support The Popular Movement In Ukraine (Rukh). Ukraine 2000, like its sister committees, is made up of area residents who have a deep interest in Ukraine and the democratic principles of Rukh. My statement is on behalf of Ukraine 2000.

We appreciate this opportunity to submit our views on the financial implications of the decentralization of economic and political power in former Soviet Union. However, before I address these issues I take this opportunity to thank you and the members of this subcommittee for the interest each of you have expressed toward the democratic movement in Ukraine in general, and toward individual members of Rukh in particular.

While I may be unaware of all of your individual efforts, I do know that both Senator Riegle and Senator Hatch spoke up in support of People's Deputy Stephan Khmara when he was illegally incarcerated earlier this year. Senator Riegle recently cosponsored S. Con. Res. 65 calling for United States recognition of Ukraine after the December 1, 1991, referendum on Ukraine's Declaration of Independence. As for you Mr. Chairman, you have become known in Ukraine. Not only have you been a forceful spokesman for the republics of the former Soviet Union, you have focused your attention and energies on issues of concern to Ukraine dating back at least to the establishment of the Ukrainian Famine Commission. Consistently, you and your staff have been most generous in giving time to meet with members of Rukh who have come to Washington, Volodymyr Yavorivsky, Mykhailo Horyn, Oleksandr Savchenko, Sergie Koniev and others.

I emphasize your interest and support not only because it is appreciated, but because I must encourage you to continue. In the face of overwhelming efforts to revive and prop up the center it is critical that people in high office listen to and hear the voices of the republics.

Naivete' of the United States

As a practical matter the American public and the United States government have only recently become aware of Ukraine. In some ways the Russification of Ukraine was more effective in the United States than it was in Ukraine itself. Throughout the Cold War our government, our media and our schools treated "the Soviet Union" and "Russia" as synonyms. The people, the cultures, the languages, the nations that were overwhelmed by the Communist Russian empire were generally ignored by our institutions.

More distressing, as daily headlines record changes within the former Soviet Union and republic-specific issues become of greater importance, parts of our government seem to remain in intellectual atrophy regarding the republics. While the myth of a "Soviet people" crumbles before the world, our government can not seem to turn loose of the term or the concept. A good report on this sad situation by Robert Greenberger was published in The Wall Street Journal on September 23, 1991.

American business generally has no interest in the republics as republics. Markets or resources are their interests, multiple languages and governments are confusing and inconvenient. Business' predilection is not malicious but, as part of the western mosaic, it adds to an environment that runs against the republics' democratic goals.

Given this situation it has been critically important that Members of Congress have opened their offices and given of their time to listen to and support the people of these nations. As indicated below, I believe events inside the former Soviet Union and policies of our government will require even more attention from those who have begun to learn about the republics. We thank each member of this subcommittee for their interest and support.

I turn to the subject of today's hearing. First, I address the issues in your invitation. In addition, I will discuss Ukraine's rejection of the economic agreement or treaty entered into last Friday by Gorbachev and eight of the republics of the former Soviet Union, I warn of what may be United States encouragement of force and violence by the center, and I urge that this committee and the Congress actively follow events in the former Soviet Union. I encourage the Administration to support democratic reform, not thinly disguised imperialism.

ADVANTAGES AND DISADVANTAGES OF DECENTRALIZED POLITICAL AND ECONOMIC STRUCTURES

Our view is that from Ukraine's perspective there are no advantages to a central structure. Economically and politically Moscow's central structure has always led to ruin. No aspects of financial, monetary, tax, banking, or trade policy should be coordinated by the center. The center is incapable of meaningful reform, its only purpose is domination. Allowed to coordinate the center will seek control, given control the center will oppress.

Ukraine as a colony

Perhaps a few comparative charts will illustrate the plight of Ukraine under Moscow's central control. Olekandr Savchenko, Rukh's economist, was published in a 1990 edition of the newspaper What Needs To Be Done. In his article, "How to Come out of the Crisis?" he included the following:

Quality of Life

	Ukraine	RSFSR	USSR
Median Worker's Salary Rubles per month	200	235	220
Median Collective Worker's Salary Rubles per month	168	200	182

Economic Potential

	Ukraine	RSFSR	USSR
Per capita capital investment	569	938	761
Per capita capital investment into housing construction	94	145	124

Intellectual Potential

	Ukraine	RSFSR	USSR
Number of doctors of science per 10,000 population	1.3	2.3	1.8
Number of candidates of science per 10,000 population	14	21	18
Per capita spending on the development of art, literature, radio, and television	3.8	12.8	9.9

From: "A Study of the Soviet Economy"

IMF, World Bank, OECD, EBRD

Income Per Capita: 1975-1988 (% of USSR average)

	1975	1980	1985	1988
RSFSR	109	110	109	110
Ukraine	92	91	96	96

Monthly Salaries, 1989 (% of USSR average)

RSFSR	108
Ukraine	91

In the center's command system these numbers are dictated by the center. Production belongs to the center. Ukraine pays 100 billion rubles annually to the center. Ukraine annually pays 8 billion rubles in "turnover" taxes, and 20 billion rubles for the center's army. Ukraine sells products to 120 countries but Moscow receives the hard currency payments. For Ukraine these are the statistics of a colony. They do not reflect Ukraine's contribution or potential. This year The National Gazette (of Ukraine) published an article, "Ukraine: A European State In Possibility, A Moscow Colony In Actuality," showing comparisons between Ukraine and other countries.

HOW WE WORK: Per capita annual production of basic products

	Ukraine	Germany	France	Italy
Energy (kw)	5700	7200	7400	3600
Oil (kg)	104	60	60	80
Gas (cubic meter)	607	26	59	302
Coal (kg)	3400	3900	2390	2000
Steel (kg)	1060	691	344	430
Cement (kg)	454	489	469	690
Grain (kg)	1033	445	1058	295
Potatos (kg)	378	118	85	42
Meat (kg)	155	96	112	63
Milk (kg)	469	4450	519	204
Sugar (kg)	118	50	67	18

WE PRODUCE AT THE LEVEL OF A EUROPEAN COUNTRY

Readiness for Economic Independence (on a 10-point scale)
Deutsche Bank Study

	Ukr	Balts	Russia	Caucus	Byel	Mol	CentAsia
Industry	9	10	8	4	8	2	3
Agriculture	10	8	6	4	5	9	3
Nat Resources	8	0	10	5	11	0	4
Market Psych	3	10	2	6	3	5	1
General							
Readiness	7.5	7	6.5	4.8	4.2	4	2.8

WHAT WE HAVE

Median Monthly Salary and Buying Power

	Ukraine	Germany	France	Italy
Monthly Salary:		4200m	6000f	15mil l
In rubles:	210r	1400r	670r	750r
Purchasing Power				
Meat	40kg	180kg	100kg	110kg
Suits	1	8	6	7
Boots (pair)	1.5	10	7	12
Socks	40	800	900	700
Color TV	.25	3	2	2
Refrigerators	.7	2	1.5	2
To Buy One Auto Must Work:	4yrs	10mts	10mts	9mts

Ukraine is poor because it is not free.

Mr. Chairman, in September, 1991, you met with Mykhailo Horyn, one of the founders of Rukh, a former political prisoner, an elected Deputy to the Supreme Rada of Ukraine (parliament), and he related to you a perspective of Ukraine's history that is important to remember. It is a perspective that is on Ukraine's mind, a perspective the United States should understand. Horyn told you that in 1654 the Ukrainian Cossack Nation signed a mutual defense agreement with Moscow. He said that under the agreement Ukraine was to conduct its own foreign policy and was to have its own army, but after four years some of its autonomy was lost, and after 120 years Ukraine was a colony of Russia. Horyn went on to say that an independent Ukraine again signed a confederation agreement with Russia in 1922. This time it only took 7 years for Ukraine to be forced into a Russian colony. He told you that Ukraine would not put itself in the position of the village farmer who steps on a rake a third time.

From Ukraine's perspective there are no advantages to a central structure. We take this position mindful of the propaganda of the center. We have heard the center's self-serving pronouncements that Ukraine has benefited from its membership in the Union, that Ukraine cannot just walk away from its debt to a union that has protected it and subsidized it all these years. We summarily reject such claims of benevolent paternalism. Whatever the Moscow center's self image, reality is that it has plundered and savaged Ukraine.

Abuse by the center

The center has extracted extraordinary costs from Ukraine in human life, and the exploitation resources. The center's command economy has required that Ukraine ship to the

center the vast majority of its production. Up until just a few years ago 95% of Ukraine's production was required to be sent to Moscow. Under Gorbachev that figure declined in 1989 to 88%. This aspect of central control required that, after producing and shipping its production to the center, Ukraine had to petition for goods to be returned to Ukraine for her people's needs. Producers became beggars.

A simple comparison might make a point. We in the United States are proud of our accomplishments in space. NASA is proud of the "spin-offs" that have come from space technology. Everyday our lives are effected by advancements made in the United State space program and shared with our population. Certainly one area where major advancements have been made is medicine. NASA had to be able to monitor the astronauts from space and breakthroughs were achieved. Well, the Soviet Union has had a space program that has been as advanced as ours. They have had a space station. Their people have lived in space for considerably longer periods of time than our astronauts. They clearly have made many, if not all, of the same medical advancements. However, the center has not shared its scientific advancements with the people. New public hospitals in Kiev are primitive by our standards.

The center has been a taker, a pillager. It has taken everything from the people and their land, it has returned little and shared almost nothing but the unwanted trappings of its military might.

Under the center's command economy Ukraine became a site for major industrial centers - industrial centers where motivation was destroyed and human beings were reduced to mere tools of production; human concern was irrelevant. By example I note that the center constructed atomic power plants in Ukraine that not only meet the needs of Ukraine, they export significant power to elsewhere within the former union and to central Europe. These "atomic power stations" are centrally controlled and, like many other elements of the center's machine, have supported the center's international position and military superpower status. But, the people of Ukraine know that these power stations were built without regard for the people. In retrospect the best we can say that Chernobyl was an accident. The center's response of silence, denial, minimization and coverup, followed by Russification of the human tragedy was immoral but representative. Human lives have never been the center's focus, Ukrainian lives have meant nothing. Production with no conscience. Ukraine and her people were pillaged to support the imperial designs of the central government.

Chernobyl - the Kremlin's downfall

Mr. Chairman, there have been many articles and much discussion about the breakup of the Soviet Union and certainly many complex and interrelated circumstances played a role. However, in the context of this hearing I think what I have learned about the birth of Ukraine's independence movement is quite relevant. It is Rukh that has commanded Ukraine's political agenda and, whatever the outcome of the December election, it will be the reformers of Rukh and other democrats who will move Ukraine's public consciousness, they are the individuals who carry the vision of the future.

I have asked the founders of Rukh and I have asked people on the streets of Ukrainian cities what led to Ukraine's drive for independence. Nationalism? Economic woes? The answers I have found include elements of these things but much

more. Uniformly there is an undertone of emotion, anger, resentment and common strength in the significance of Chornobyl. We in the United States have not appreciated the political significance of that terrible event, Moscow never will.

The explosion of 1986 and its handling by the central government symbolize for all of Ukraine what was wrong with the empire. It was careless with human life, it was secretive, it was corrupt. What a forced famine, purges, wars and prisons could not do, Chornobyl threatens - the destruction of a people. Not just Ukrainians but all of the people of Ukraine: Ukrainians, Russians, Jews, Poles. They all breathe the same contaminated air, they all drink the same contaminated water, they all eat the same food. They all view Chornobyl's invisible poison, its silent death, as the product of the center. I cannot express within the confines of our language the rage, terror, and commitment one hears and sees in the people of Ukraine when the raw nerve of Chornobyl is exposed. You do not see people debating the quality of life, you experience the emotion of a struggle for survival.

I cannot forget the peasant woman who waved her arm out over the rich land of Ukraine. She said she could understand and accept her country being poor and she being poor herself if she lived in a poor country. But, she said, Ukraine is rich in resources and ability, it is poor because the center takes from Ukraine for its empire, its adventures in Angola, Cuba and Nicaragua. This was a peasant woman who was driven to think about her lot and her country's future, and her children's future, in an empire that virtually ignored Chornobyl until untold but avoidable damage was done. She summarized the feelings of the people of Ukraine.

The consequences of Chornobyl continue to unfold. Deformities, death, sickness, radiation readings, and little is done. The Chornobyl power station still operates.

There are no advantages to the central political and economic structures.

INTERNATIONAL RELATIONSHIPS WITH THE REPUBLICS

Your invitation asks what type of relations the United States and international institutions should have toward republics like Ukraine that have declared their independence. Our belief is that the United States should have direct and formal relationships with independent nations, and the United States - in its own interests - should encourage peaceful, democratic reform like that underway in Ukraine. Unfortunately, with fleeting exceptions, that is not what we (the United States) are doing. In fact the United States is supporting the center's efforts to rise from its ashes. The propenderance of our country's efforts are supportive of Gorbachev and the center. In fact, as more evidence comes in I fear just how far this Administration may be willing to go or, perhaps more appropriately, how far it is willing to let the center go to hold Ukraine.

The United States supports the Center

On September 10 the Senate Committee on Finance was told in testimony from the Department of State "that with the exception of the three Baltic nations, the Soviet Union remains an entity, a legal entity, that we have diplomatic relations with, that we recognize, and with which we are able to sign

international agreements." The witness went on to say we do not have a role in the efforts of the republics to change or redefine their relationship with the center. That testimony was during a hearing on the Administration's trade agreement proposing Most Favored Nation trade status for the Soviet Union.

Later in September the Administration increased government guarantees on \$211 million worth of agricultural export credits to the "Soviet Union" to 100% of principal and the full value of the prevailing interest. The Administration supports legislation to repeal limits on the center's access to United States Treasury resources through the Export-Import Bank.

Our government does this despite the failure of the center, the collapse of the Union. Instructive was Gorbachev's September 10 opening statement to the Conference on the Human Dimension of the Conference on Security and Cooperation in Europe. Recovering from the coup, his resignation from the Communist Party and rocked by a chorus of declarations of independence, Gorbachev welcomed CSCE member states on behalf of all of the republics that used to make up the Soviet Union and that might come together to form a new union. This was the so-called President of the Soviet Union talking of his empire in the past tense. The very day Gorbachev spoke these words, the Senate Finance Committee was told the Administration sees the center as a legal entity and wants to grant it MFN status. We are recognizing a center that ceased to exist.

What are we doing? We are backing the center, we are supporting its claim to legitimacy. To the world, to the republics, we paint the picture that the center must be real - the United States keeps talking to it, negotiating with it, supporting it.

Mr. Chairman, by comparing the United States' \$3.5 billion of exports to the "Soviet Union" and our \$5.3 billion in exports to Costa Rica at the September 10 hearing, you clearly made the point that Most Favored Nation status to the Soviet Union was "more a kind of political badge" than anything that is going to have economic effect. We appreciate your point. We do not appreciate the Administration's absolute commitment to pin the badge of legitimacy on the center, continuously thwarting the republics through dealings with the center. We consider such policies against the best interests of the United States and, certainly anti-Ukrainian.

It is outrageous that the United States would align itself with the center instead of pursuing a policy of expanding direct relations with reformist republics. The nuclear "hot line" seems to remain some type of umbilical cord to the Kremlin. It is time to remember why there is a "hot line" in the first place; because the Kremlin's imperial empire has nuclear warheads aimed at our cities.

The United States needs to abandon its myopic focus on the center. It is in our interest and the interest of peace that our relationships with the reformist republics evolve rapidly. The future is with the republics, democratic and economic change is with the republics. At this point we are behind the curve and standing on moral quicksand.

Since World War II and the establishment of the Iron Curtain we have focused almost exclusively on Moscow. Even when the curtain began to come apart revealing a vastly different world than we had understood, we were slow to respond. Our government's institutional ability to deal with national languages, to understand history and critical relationships has been, at best, wanting. Our media rushed to come up with maps and graphics to educate itself and its audience to a forgotten

world. Gradually American reporters are finding their way around "the circuits" of the former Soviet Union. An American legacy of neglect must be overcome rapidly. The Congress can help.

The United States should establish close relationships with Ukraine and the reformist republics

Last March the United States opened for the first time a consulate in Kiev. I must say here, what little was done was done right. Jon Gundersen and John Stepanchuk have moved into Ukraine with extraordinary energy and enthusiasm, and with sensitivity; They are doing a masterful job that is recognized and appreciated in Ukraine. But, Mr. Chairman, they are not enough. Their physical situation is desperate, their assignment overwhelming. Two people to study, track, report and advise on a nation of 52,000,000 people simply is not realistic. They need help; the United States needs a greater commitment to learn what it does not know, to observe and report on what is happening, and to identify and play to opportunities to provide constructive influence. We need to give Mr. Gundersen the resources to do the job he was sent to do.

An Ambassador to Moscow, the center or the Russian republic, is not an Ambassador to Ukraine. After Ukraine's referendum of December 1, the United States should recognize Ukraine and officially welcome her into the family of nations. The United States should provide direct technical assistance to Ukraine; programs ranging from economic, monetary and banking advise and counsel, to environmental advice, legal assistance in addressing the overwhelming complexities of privatization, to how to institutionalize civilian control over the military. In Ukraine we have a nation of 52,000,000 people with a land mass equal to that of France engaged in nation building. United States interests rest in having an early and close relationship with this emerging nation.

The United States should support Ukrainian membership in the IMF and the World Bank

You asked about the IMF and the World Bank. In this context I raise the public statements of the Secretary of the Treasury and Ambassador Robert Strauss before the annual meeting in Bangkok. These officials put forward their view that an economic agreement between the center and the republics would be central to financial aid from the West. The message was that the world's financial institutions only will deal with the center. Such a position, if it was actually pursued, would be outrageous. Such an approach would have to be attributable to the inherent lack of political perspective suffered by the institutions of our government, and a predisposition toward the convenience of one-stop shopping.

Ukraine is not opposed to horizontal economic and trade agreements between the republics of the former Soviet Union. As you know, Ukraine has negotiated and entered into many such treaties including a major agreement with the Russian Republic. Ukraine is opposed to vertical control by the center.

Ukraine is very interested in membership in international financial institutions such as the IMF and the World Bank. It would be in the interests of Ukraine and the international financial community for there to be direct relations with Ukraine. I do not believe that Ukraine is seeking direct financial grants, but it does need assistance in adjusting and revamping its economy. Part of the legacy of the

empire is that 70% or 80% of Ukraine's manufacturing sector is oriented toward military production. Ukraine seeks to change that orientation. Ukraine will institute its own currency, it seeks to privatize, it will seek private investments to reorient the military focus of its manufacturing sector. But it needs technical help and guidance.

The United States should support and encourage Ukraine's interest in the IMF and the World Bank. The international stumbling and fumbling over the "Soviet Union's" membership is a needless distraction and it is counterproductive to real reform. The center can not bind the republics to any obligations. Neither Gorbachev, Yeltsin or Yavlinsky speak for Ukraine. They are not representatives of Ukraine nor agents for it. The world situation has changed. International institutions negotiate with the center and its agents at their peril. Their efforts are wasted, their time is wasted; neither Gorbachev or Yavlinsky offer collateral for assistance. They can not commit Ukraine.

Last June, Olekandr Savchenko wrote an op-ed piece published in The Wall Street Journal. He made the point that supporting the republics is the cheaper alternative for the West. The republics have their own plans for market transition that do not require or request Western taxpayers to pay the hundreds of millions of dollars Gorbachev and Yavlinsky estimate. He reminded readers that the center's record of implementing promised radical economic reform has been a dismal one. The Abalkin and Shatalin plans were all abandoned soon after the Soviet Union received over \$30 billion in aid from Europe, Japan, Saudia Arabia and the United States. The rejection of the Shatalin plan coincided with a sharp turn toward repression in the Baltics.

The latest plan is based on the preservation of what was the Soviet Union as a federative state. The plan is given significant consideration and attention even though the people in the various republics have demonstrated a desire for the peaceful creation of independent nations.

Ukraine, certainly Rukh and the Narodna Rada (democratic bloc in the parliament), believe that Ukraine can manage its resources better than the Moscow center and no opposing case can be made responsibly. Ukraine is committed to economic transition, to reducing military spending and changing the nature of the military within its territory.

In his June article, Savchenko predicted the collapse of the Soviet government, followed by a collapse of the Communist structures in the republics. Then, he wrote, "the new democratic governments in the republics can begin to deal with the devastating economic and political legacy of Soviet communism, including not only impoverishment and environmental destruction, but also the unwanted nuclear weapons stationed on their territory." It is in the republics where the hope lies for democracy and market reform. The center offers nothing constructive, it is against our interests to provide it credibility and aid.

ROLE OF INTERNATIONAL INSTITUTIONS

Part of the legacy of the Soviet Union is the isolation and limitations its Iron Curtain placed around the perspectives and scope of the people. Cut off from the world of ideas engaged, theories debated, living in the Union in many respects was like living on the intellectual "dark side." The

emergence of the people of the former Soviet Union into the light of options and risks is exhilarating and promising, but the reality is that they need help.

The West should provide technical assistance not direct aid

I cannot provide a formula for economic aid. Instinctively I am opposed generally to economic aid, at least at this time. Ukraine needs technical assistance. The challenges facing Ukraine are across the board and overwhelming. We should provide assistance that aids Ukraine in making its own choices and refining its democratic and market thinking. The systems that Ukraine chooses for itself should be Ukraine's. Theirs should not and can not be an economy created in a test tube in some Western university. Their system of commercial law cannot be copied from a western form book.

The fact is that the economic and commercial struggles of Ukraine are a part of a political struggle; perceptions and ideas regarding democratic principles and objectives can significantly influence the nature of an nation's economic and social structures. The officials and the people of Ukraine need exposure to ideas and concepts. They need to see systems at work. They are going to have to try and try again. In so many respects they are writing on a slate that is clean.

It seems to me that we need to provide technical training, opportunities to learn and weigh options and provide a basis for judgments. In Ukraine the desire for reform is present but the reference points, the research sources, the experience we take for granted are not there. Libraries, such as they are, do not have Lexis or Nexis. Surveys of comparative laws are unfulfilled dreams despite the tireless efforts of some dedicated westerners. Ukrainians have a linguistic crisis in that they have learned terms and general concepts, but critical details of understanding are lacking.

Whether it is technical assistance in the fundamental structure of transactions in a commercial law system, how a bank works, what tellers do, how hard currency is exchanged, how or whether growth should be stimulated through tax laws, whatever the issue or detail you focus on in our system, they need exposure, education and counsel.

Not only do I urge technical assistance for the republics, I feel that judgment needs to be used in the providing of assistance to the republics. I will focus on Ukraine.

I am under no illusions that the entrenched bureaucracy in Kiev is necessarily any more creative and reform minded than the entrenched bureaucracy in Moscow. Both are the products of the old command system. Ukraine does not need to replace Moscow's central common with central command in Kiev. The most productive assistance we can provide will be assistance given to those anxious to learn, those who are predisposed to reform. In Ukraine there are many pockets of reformers in a position to implement change and experiment with "pilot projects" that can test options and provide examples and incentive to others. The Lviv Oblast that has elected an entire government of reformers led by Vyacheslav Chornovil, and the Ivano-Frankivsk Oblast are obvious examples. Pockets of reform in central and eastern Ukraine are equally important.

Changes cannot take place or succeed overnight. But we should do everything possible to be as effective and

constructively supportive as we can. Our interests and the interests of the post Cold War world will be served by an independent, democratic and productive Ukraine.

FINANCIAL EXPOSURE TO "SOVIET" DEBT

The center and the international financial community worry about the "Soviet" debt. Horst Schulmann of the Institute of International Finance claims that international law requires that the debt of a predecessor state should be passed on to its successor. I do not know if he is right or, if his is, what that means in the context of the break up of the Soviet Union. I do know that Ukraine will not avoid its just obligations.

For my part the situation is not clearly defined and I do not have a solution. I do offer a few observations:

1. My understanding is that out of the Union's foreign debt of about \$62 billion, private banks in the United States are owed only about \$500 million.

a. This is basically a situation where European banks made bad loans. They took a risk with a totalitarian government that abused or broke almost every international agreement it ever entered into, and the risk turned out to have been a bad gamble.

b. Given the lesson established by the European bank experience with a Soviet Union that was under central control, the United States should cease its suicidal rush to provide direct or indirect credit to a center that has fallen. We should not ignore the fact that the former constituent republics have rejected any notion of agency resting in the center. For its part Ukraine has made it clear that the center does not speak for Ukraine.

2. To the extent institutions grapple seriously with a repayment of "Soviet" debt, I think it imperative that weight be given the salvo of breast-beating statements by officials of the Russian Republic that Russia is the heir and decedent of the Union. If Russia is to inherit the "wealth" of the union let it inherit the debt. The republics did not take this debt upon themselves - certainly not voluntarily. Ukraine did not benefit from it.

3. If it is determined that debt needs to be repaid and republics bear some of the obligation, negotiations must be reasonable. Per capita distribution of the "Soviet" debt is unupportable.

a. If Ukraine is asked to sit at a negotiating table to discuss some share of the Union's debt, that table will need to be broad enough to hold the human and economic credits in Ukraine's favor. The center's case of Ukraine benefiting from its place in the Union is a hollow one. Put forward the evidence.

b. Whether we talk about interests in the Soviet diplomatic residences in Washington, or the empire's space program, or the gold reserves, the issues of the center's debt should not be considered separately.

UKRAINE REJECTS ECONOMIC PACT

Last Friday Gorbachev and Yeltsin had hoped for the signing of a new economic agreement among ten republics including Ukraine. Ukraine refused. This should not have been a surprise.

Ukraine has not made a secret of its resistance to control from the center. A few weeks ago when a Ukrainian representative initialed the early draft of the economic agreement among the republics the record was clear. It was stated clearly and publicly that specific changes would be required before Ukraine would consider signing the final document. Not only were Ukraine's concerns ignored by the center, Gorbachev and his Ambassador to the United States, Viktor Komplektov, said that the draft laid down "the economic basis" for the republics' future "political union."

I knew when I heard the Gorbachev-Komplektov comments that Ukraine should not sign onto the center's ploy. Moscow does not seem capable of understanding that Ukraine is not Russia, that their Russification program did not destroy the nation. The Kremlin has been blind for too long, it simply can not see. Ukraine will no longer allow its views and future to be dictated by the center; Gorbachev or Yeltsin. This does not mean that Ukraine intends to sever all ties to the former republics of the Union. Ukraine has great interest in keeping and building upon its economic relations with Russia and the other former republics. As Mykhailo Horyn told you in September of 1990 Mr. Chairman, Ukraine wanted and was negotiating trade agreements between its longtime trading partners, "horizontal agreements" to affirm and maintain economic relationships once the vertical control of the center collapsed. Ukraine proceeded with those negotiations, it signed agreements, it pursued economic interrelationships. Ukraine does not reject its trading partners, it rejects central control and colonization.

Moscow's contempt for Ukraine's position and its bullying of the past will not be accepted by Ukraine today. Last Thursday morning the Presidium of Ukraine's Supreme Rada met and decided not to send anyone to take part in the signing of the economic agreement. The center's ignoring of Ukraine's requests for changes was not acceptable and the center's international and internal manipulations were seen as a "blackmail" attempt at reviving a centralized political structure.

Ivan Plyushch, first deputy chairman of the Supreme Rada and an April visitor to Washington, said the Ukraine does "not want to continue to be a colony." Mr. Chairman, we must understand the political realities that shape the changes taking place inside the former Union. The economics of the former Soviet Union are not an academic exercise plotted out in an environment hermetically sealed from the influences of history and politics.

Ukraine may someday enter into some form of agreement between the republics of the former Soviet Union. But, as Horyn told you and as other deputies - from the Communist majority and the Narodna Rada - told numerous officials in Washington last April, Ukraine intends to enter its agreements as a fully independent and sovereign nation.

What is most troubling about the reaction to Ukraine's rejection of the treaty is that many analysts seem to cast Ukraine as the villain; the "spoiler" of the center's grand

efforts. History and current reality belie this victim being made into a villain, certainly not by the likes of Moscow's center.

- IS THE UNITED STATES ENCOURAGING VIOLENCE?

In the context of the center's desperate struggle to hold Ukraine, how is the center interpreting the United States' devoted support for a continuing center? The indications from our Administration are solidly pro-Gorbachev, pro-center. The pattern of Administration statements runs strongly in favor of the republics staying together in some form of union under the Moscow center. Our government supports virtually all of the center's international moves.

Mr. Chairman, in the context of the United States government's support for the center, we raise the issue of economic sabotage and the reemergence of historical Russian imperialism toward Ukraine. These issues are particularly difficult. We do not raise them lightly and we do so knowing that popular reports suggest the passage of the Communist Party, the emergence of democratic principles and a new breed of democratic leaders in Russia. We speak over a background of stories about food shortages based upon a relatively poor harvest, stories about political leverage and power shifting to the republics and stories about Ukraine, its resources, its size and potential, and its ability to stand alone. We speak of the dark side of the current story from Ukraine.

The center has long considered Ukraine essential to its power. The Russian center has no intention of letting the people of Ukraine achieve their independence and intends to do whatever is necessary to keep democratic independence from Ukraine.

As has been mentioned in any number of articles since Ukraine declared its independence, Lenin himself said in regard to the empire that "to lose Ukraine is to lose our head." Various pieces of media analysis over the years since the Baltics began asserting their claim to independence treated Ukraine as different, as a part of some type of Slavic whole that would or should stay together. Indeed, no less a figure than Alexander Solzhenitsyn wrote a piece that showed sympathy for the independent desires of some of the republics but treated Ukraine as a part of an indivisible Slavic heartland. He did not recognize or appreciate that Ukraine is a distinct nation with its own language, culture, and religious traditions. At the annual meeting of the National Endowment for Democracy last April, participants representing the Russian "democratic" movement unceremoniously saw Ukraine differently than most of the Union's republics, like "big brothers" they indicated that they had a responsibility to look after Ukraine.

Immediately after the coup and the Supreme Rada of Ukraine declared independence for Ukraine, Russian President Boris Yeltsin said that if Ukraine persisted with its pursuit of independence Russia would have to reconsider the Ukrainian-Russian borders. Even though Yeltsin publicly backed off this assertion after strong Ukrainian and international reaction, his spontaneous declaration was most instructive. More recently, in early September, a United States congressional delegation was told by Gorbachev's ministers of defense and foreign affairs that the center would do whatever was necessary to see that Ukraine does not achieve independence and that it remain a part of some kind of a new "union" with the center.

On October 4, 1991, Arkady Volsky, one of Gorbachev's inner circle, spoke here in Washington. His remarks were designed to discredit and ridicule the republics in the eyes of American business. He claimed that the center of democracy is Moscow and that Russians living in other republics are threatened and need protection.

The center's public suggestions are that republics rushed to declare independence in a flight from totalitarianism but that the new central government is not totalitarian and the passion for independence will abate. We submit that with respect to Ukraine, the Russian center of 1991 has evidenced very troubling tendencies toward imperialism.

Russians who live in Ukraine are not Rukh's enemies. Rukh and the Supreme Rada do not seek to sever all relations with Russia. That is not a goal. The fact is that Rukh, the independence movement in Ukraine, is made up of all of the people of Ukraine, Ukrainians, Russians, Jews, Poles. Leaders in Rukh and in the Supreme Rada are of all nationalities found in Ukraine. Rukh has been very focused in its efforts to see that the rebirth of Ukraine did not result in the Ukrainianization of Ukraine to counteract Moscow's Russification efforts. Ukraine's democrats have not wanted to do to Russian speaking citizens what Moscow had done to Ukrainian speaking citizens. Ukraine has signed a treaty with Russia. Pursuant to its treaty with Russia, Ukraine has sent its ambassador to Moscow. Volodymyr Kryzhanivsky is now established in his official residence in Moscow. Ukraine's new defense minister and the new procurator of Ukraine are both of Russian background. Their nationalities were not an issue or even discussed during their selection.

Ukraine desires bilateral relations with Russia and seeks to provide and protect the rights of all citizens of Ukraine including Russians who live in Ukraine.

We would like to be able to avoid mention of the historical propensities of Russian leaders toward imperialism. But the people of Ukraine must be mindful of the evidence. The United States, too, must keep this possibility in mind. We must be mindful of the current Moscow-based campaign against Ukraine's independence referendum. The combined resources of the structure that was the Communist Party, the KGB, the ministries of the center and the Russian Republic are being used to destabilize Ukraine in an effort to sway the electorate.

To date there have been no interfronts in Ukraine. There have been no non-Ukrainian, nationality-based counter independence movements like those that were seen in other former republics. One of the greatest successes of Rukh, if not its greatest achievement, has been its truly democratic nature. Everything that the movement has stood for has been explicitly democratic. Its platform, the Declaration of Sovereignty it authored in 1990, other new laws and the Declaration of Independence are for all of the people of Ukraine.

We would like to see a situation where the nationality of the people is not an issue, where multiple nationalities simply added to the cultural richness of a pluralistic society. However, to pretend that such is that case in light of Moscow's current actions would be foolhardy.

In discussing this situation with Ukrainian officials last month, there was unanimity between members of Rukh and officials from the former Communist structures in the

government. In relation to Ukraine, they believe that there is no difference between the "center" of Gorbachev and Yeltsin. Ukrainian officials believe that both will use every means at their disposal to control Ukraine and see that it is a part of the new union that both want centered and controlled in Moscow.

As to our point about economic sabotage, it too comes from the meetings I had with Ukrainian officials from both ends of the official political spectrum in Ukraine. They were uniform in their representations that the Russian center is orchestrating a destabilization program in Ukraine. They report that the center is using extraordinary methods to destabilize Ukraine in order to make the people of Ukraine question the cost of independence before the December 1 referendum on independence.

Perhaps even more troubling and distressing given the democratic record of Ukraine's independence movement is the Russian center's singleminded determination to foster and build Russian-based interfronts in Ukraine. Over the last two years the KGB and the Communist Party apparatus have made numerous efforts to foster dissent and counter-independence movements in various regions of Ukraine. All had failed due to the honest democracy of Rukh and the independence movement seeking an independent nation that would protect and defend the individual rights of all the people of Ukraine. However, now leaders of Rukh and others tell me that it appears interfronts may be catching on in certain heavily Russified regions of the country. As Ukraine's independence movement gained great notoriety after the coup, as former dedicated Communists and servants of Moscow in the parliament left the Party and voted for independence and as Ukraine seriously began moving toward a separate and convertible currency, Moscow dedicated itself to undermining Ukraine's independence referendum.

The Moscow inspired and supported interfronts are built on manufactured fears and longtime dependence on organizational structure. Rukh leaders fear that violence is being pushed upon these organizations. They fear the potential for bloodshed. They are deeply concerned about the possibility of a center-inspired coup in Ukraine before the referendum.

Mr. Chairman, this is a very serious situation. You have not heard Rukh leaders or others from Ukraine suggest the use of bloodshed. But we have all begun to hear the possibility of bloodshed mentioned. Amid some of the early stories about the possibility that Ukraine would reject last week's agreement, Gorbachev said that he could not imagine Ukraine wanting war with Russia. The Wall Street Journal reported from Bangkok that Yavlinsky warned that the "Soviet" republics risk bloodshed if their nationalism interferes with the creation of a new economic union. "I'm afraid the course of this decentralization may be blood," he said.

The world community should take note of these statements. The West must be careful about the signals it sends. Moscow's senses are those of a predator.

Before and during the Moscow Summit last summer the center pushed its leverage in Lithuania. The President went forward with the Summit and then, with President Bush in Moscow, Lithuanian border guards were assassinated. How brazen will the center be in its attempts to hold its greatest prize - Ukraine? What concern are we expressing? What signals are we sending?

The sentiments expressed by Gorbachev and his spokesmen are dangerous and perhaps telling. As far as I have been able to learn, nothing was said to Gorbachev. Yavlinsky was not questioned or rebuked. In fact, I believe the record is pretty clear, the United States has and is indicating a preference for these people, this center.

These are not people to be encouraged and supported. Whatever our view of the August coup, the center's legacy is one of ample blood, that is part of the reason it has failed. It needs no support. The United States risks sending a terrible message if it does not reject Yavlinsky's statement. The combination of the United State's myopic support for Gorbachev and his center, and our silent response to suggestions of bloodshed are very dangerous.

CONCLUSION

Mr. Chairman, as you know, I am not an economist, I have not attempted to deal in economic details. Generally I have offered a view of the political environment within which the economic issues are being addressed. I do not believe that the economic issues and challenges faced by Ukraine and being studied by the world community can be faced effectively without an appreciation of Ukraine's perspective. Ukraine's reality did not begin this morning, or August 24, 1991, when it declared its independence.

Ukrainians know, and we must remember, Ukraine with its rich black soil once was known as the "Breadbasket of Europe." Its rich resources and reputation for production was a source of envy. It was coveted by Moscow under the Czars and under the Communists.

When Ukraine was forcibly seized by the empire in the 1920's the Kremlin sought to collectivize Ukrainian agriculture at any cost. To force collectivization the center used the artificial famine of 1932-33; a cynically diabolical operation that murdered up to 7,000,000 peasants by starvation. The center dealt harshly with dissent. The Kremlin's purges have scarred a nation with sites of mass killings; office building basements where the bodies of murdered intellectuals remain unacknowledged and lost to a nation's evolution; woods and fields where the black soil bears the center's shame, mass graves of human beings thought ill suited for the center's purpose.

If the horror of Chornobyl had faded in any way due to the challenges and distractions of these last couple of years, I guarantee last week's fire at Chornobyl's unit number two served as a chilling reminder. Midnight calls to the residents of Kiev to close their windows brought home the fact that the center still operates Chornobyl's surviving units, that the Rivne atomic power station still operates above a geological fault, and that the center is inherently the same.

Today Americans seem surprised to learn that there are 52,000,000 people in Ukraine. They are surprised to learn Ukraine is so large. Let us think what might have been. What would have been Ukraine's population had the millions murdered under the center's command had lived and been able to raise their families and make their contributions? The human cost, the cultural loss suffered under the center cannot be returned; nor can it be forgotten.

Mr. Chairman, late in your first meeting with Mykhailo Horyn you pressed him on whether he thought any type of union was possible. He responded by saying, "Remember the rake." Ukraine does not intend to step on the rake again, twice was enough. Ukraine wants to control its destiny. Rukh was born out of a passion for individual rights and the protection of human dignity. It has scrupulously adhered to its fundamental democratic goals. Its original core headed by Ivan Drach, a man of vision and quite strength, and Mykhailo Horyn, a man of conscience and insight, is still in place. And as events move on and new leaders pick up their places, the conscience of democratic reform - Rukh - bears witness to the birth of a new democratic nation in Eastern Europe.

Ukraine does not reject alliances, agreements, or economic relationships, it rejects foreign control. Ukraine specifically has not and will not try to Ukraininize the Russian population of Ukraine, anti-center does not mean anti-Russian.

The people of Ukraine need our attention and our help. I ask that the members of this committee continue to speak out and lead the growing awareness in the Congress, question the Administration, support the democratic nation building led by Rukh in Ukraine.

We in the United States have every reason to be sensitive to the legitimate passions of the people of Ukraine. We have every reason to offer support and encouragement. Ukraine's natural tendencies are toward the West and toward the United States. Our interests are served by the legitimacy of Ukraine's statehood.

PREPARED STATEMENT OF DAVID C. MULFORD

INTRODUCTION

Thank you Mr. Chairman and Members of the Subcommittee: I am pleased to be here today to review the economic implications of change and decentralization in the Soviet Union. These developments will have far-reaching global economic implications. The Soviet Union is now joining the global shift toward market-based economies. We can now envision a new era for the world economy, an era of unprecedented integration, cooperation, and prosperity.

The Soviets understand that the success of the effort to transform the Soviet economy to a market system rests primarily with them. Nevertheless, there is a clear recognition in industrial nations and the international institutions of the importance of a supportive response to this historic challenge.

During the recently concluded Annual Meetings of the IMF and the World Bank in Bangkok, the Finance Ministers and Central Bank Governors of the Group of Seven met with Soviet representatives to discuss the challenges faced by the central authorities and republics of the Soviet Union. This meeting provided a substantial opportunity for a direct exchange with the Soviets on: current economic conditions, their planned approach to defining political and economic relations among the republics and with the center, their external indebtedness problems, their thinking on longer-term economic reform priorities and the need for economic assistance. I would like to review these discussions today.

THE NATURE OF THE CHALLENGE

It would be hard to overstate the magnitude and scope of change sweeping the Soviet Union today. The center and the republics are literally demolishing one political and economic system and seeking to build another. This effort encompasses four difficult and overlapping challenges:

- (1) reaching agreement on new center/republic economic and political relations;
- (2) easing the immediate economic crisis;

- (3) building a market economy; and
- (4) avoiding a politically and economically destructive disintegration of the country.

Unfortunately, the Soviets do not have the luxury of addressing these four issues separately. They cannot institute a comprehensive economic reform program without resolving the division of economic policy responsibilities between the center and the republics, and they cannot rejuvenate production without beginning a broad program of market reform.

By the same token, we in the West do not have the luxury of standing idly on the sidelines until the uncertainties in the current Soviet situation are resolved. The stakes are too high. We have a chance, probably of limited duration, to help anchor the Soviet Union firmly and permanently in the global market system.

The challenge for the industrial democracies and the multilateral institutions is how to provide constructive and effective assistance in such a chaotic environment. We cannot and will not control developments in the Soviet Union, but we might be able to exert some influence on certain aspects of the situation.

As President Bush has repeatedly stressed, in addition to providing humanitarian aid, our first priority must be to support Soviet economic reform efforts, that is, the comprehensive effort to shift from a command economy to a market-based system. It will be essential to pursue this effort to a large extent at the republic level, where much of the policymaking authority is likely to reside. In the wake of immediate problems facing Soviet consumers and enterprises, which tend to be the focus of the media, it is easy to lose sight of this crucial long-term goal. We can take discrete measures to help address current shortages and liquidity problems. But the transformation to a market system is the only lasting way to strengthen economic performance in the republics.

As to the relationship between the center and the republics, this is a matter for resolution by the Soviet people and their leaders at all levels of society. Economic reform itself, however, will require changes at the republic level that go beyond the agreement on economic relations.

CENTER/REPUBLIC RELATIONS

As you know, the Soviets are attempting to define center/republic relations despite formidable and complex differences among the republics. Prior to the IMF/World Bank annual meetings, Secretary Brady welcomed the initialing of a treaty for an economic community by the twelve republics. The fate of this agreement is still uncertain, but we feel it would lay some of the groundwork for a viable economic union. The treaty provides a general framework, allocating responsibilities for monetary and fiscal policy and outlining the legal and regulatory principles which are to govern economic activity. Much work remains to be done before the general principles set forth in the treaty can be translated into specific, binding commitments. A number of separate, detailed agreements on such difficult issues as responsibility for Soviet debt and ownership of Soviet assets will have to be concluded.

From the perspective of accelerating the transformation of the Soviet economy, we would hope that the treaty and detailed agreements produce a politically stable arrangement with a workable division of economic responsibilities. Clear authority must be established, at some level of government, over fiscal and monetary policy if macroeconomic stabilization is to be achieved. In the fiscal case, this means that those who must control budget balances must also have the authority to tax and spend. In the monetary case, it means that there must be a workable system for limiting the supply of credit. And, as in the case of any economic community, the greater the degree of clarity and uniformity in legal and regulatory systems, and the fewer the restrictions on market forces, the greater the capacity to conduct mutually beneficial, unimpeded commerce among the constituent parts of the market.

CURRENT SOVIET ECONOMIC SITUATION

Negotiations to establish a new political and economic union are, of course, severely complicated by the sharply deteriorating economic environment. Our discussions with the Soviets, both in Moscow and in Bangkok, have revealed wide recognition that the command system is in collapse. After a decade of mediocre growth in the 1980's, Soviet output fell by around 5 percent in 1990, and is expected to drop 15 percent or more in 1991.

The gravity of the budget situation cannot be overstated. Fed by massive subsidies to consumers and enterprises, the budget deficit will probably run as high as 25 percent of GNP for 1991, and is being financed almost entirely by the printing of money. Soviet efforts to issue public debt instruments to the public have failed. As a

result, prices are rising dramatically: consumer price inflation has accelerated from 5 percent in the first quarter of this year to 9.5 percent in the second quarter. The classic symptoms of hyperinflation are becoming apparent.

The balance of payments has also deteriorated sharply, due both to declining oil and arms exports. Hard currency debt has risen to \$65-70 billion, large in absolute terms although relatively small compared to the size of the economy and Soviet export potential. Foreign exchange reserves available to service centrally held obligations and access to short-term credit lines from Western banks are shrinking rapidly.

The breakdown in center/republic relations is contributing directly to the budget deficit and to debt service difficulties. Some republic governments have been unwilling to transfer planned tax revenues to the central government. And foreign exchange earnings are no longer flowing at previous levels to the central monetary authorities who are responsible for servicing debt obligations.

Obviously, the conclusion and subsequent implementation of the new economic agreement will have significant benefits for addressing the current economic crisis, as well as for implementing longer-term comprehensive economic reforms. Crisis Assistance

During the G-7 Ministerial meeting in Bangkok, the Ministers and Governors and the Soviet representatives discussed the Soviet external payments situation in great detail. Several key considerations were emphasized during this exchange:

- the importance of working with the international financial institutions on comprehensive economic reforms;
- the necessity to honor external financial obligations and fulfill any understandings with external creditors in order to maintain access to new credits;
- in the context of the evolving center/republic relations, the need for a framework to govern the ongoing financial relations between the Soviet Union and its many creditors; and
- the further need for full disclosure of Soviet economic and financial data.

The Soviet representatives reiterated their request for assistance in addressing their immediate external payments difficulties. In recognition of this problem, Ministers and Governors indicated their willingness to consider appropriate measures in support of the political and economic transformation now taking place. The G-7 Ministers and Governors accepted the invitation by Soviet representatives to send the G-7 Deputies to Moscow in order to explore specific approaches to the Soviet external payments problem as well as to discuss broader financial and economic concerns in the overall context of economic reform.

The industrial countries are also demonstrating their commitment, bilaterally and multilaterally, to addressing Soviet humanitarian needs and to lowering barriers inhibiting trade and investment links with the Soviets.

The United States has substantially increased its assistance to the Soviets in the form of support for food and medical needs. In fiscal years 1991 and 1992, the U.S. has already committed a total of \$2.5 billion in CCC credits. Medical assistance through Project Hope will also increase in the year ahead.

In addition, the Administration is continuing to work on removing restrictions on economic relations through: urging Congress to ratify the U.S.-Soviet trade agreement, resuming negotiations on tax and investment treaties, waiving restrictions on OPIC activity, and working with Congress to remove restrictions on Eximbank activities in the Soviet Union and on the importation of Soviet gold coins into the United States.

ECONOMIC TRANSFORMATION

The external assistance effort, however, will have to extend well beyond short-term measures to address shortages and liquidity problems.

This does not mean large-scale official financing of the kind which has been given priority in the media. I believe the Soviets understand that the private sector, both domestic and foreign, must be the principal source of financing to build a market economy. They also know that the best way to mobilize and utilize private financing is to establish a market-based economic environment conducive to building investor confidence. During Secretary Brady's trip to the Soviet Union in September, and again in Bangkok, the Soviets themselves acknowledged the futility of seeking large sums of Western money at this juncture, which, as they put it, would be like pouring water on the sands of Arabia.

What is desperately needed is assistance in the formulation of a comprehensive program for the transformation to a market economy. The Soviets will partly address this task in the context of negotiating the specifics of the agreed-upon policies

within their economic agreement. The republics, as well as whatever center emerges, will also need to be prepared to address problems that emerge as new institutions and economic relationships begin to be put in place. Once the republics establish the basic economic relationships, they will have to implement a broad range of reforms to achieve economic stabilization and structural transformation. These programs must encompass the following areas.

First, stability must be achieved through a program for reducing the budget deficit and reliance on money creation.

Second, there must be a market system that permits buyers and sellers to determine prices for goods and services, as well as for labor and capital.

Third, a legal and regulatory framework is required which permits private ownership of property and diminishes the role of state-owned enterprises.

Fourth, the economy must be opened domestically and internationally to the free flow of goods and investment. There should be emphasis here on industries that generate substantial foreign exchange revenues.

Moreover, in the Soviet case, the systematic destruction of private enterprise over seventy years has created even more fundamental needs.

- They need help in building basic economic institutions, such as a commercial banking system and bond markets.

- They need basic training on how to run profitable private businesses.

- They need practical advice on the operation of a sound fiscal system: a tax code and collection system, a budget mechanism, a customs operation, and a data collection system.

- They also need assistance on establishing a legal system which ensures the enforceability of private contracts and facilitates the functioning of private enterprise.

In a word, there has to be a complete change in orientation toward private initiative and competition. The items noted above should be addressed by private individuals and companies in groups, not just by governments. Attitudes toward the creation of wealth need to be changed to release the dynamism of the private sector. Free enterprise and entrepreneurship mean that businesses and individuals are free to succeed. In such an environment, private economic players can function productively and profitably, and growth and economic transformation will follow.

SOVIET RELATIONS WITH THE INTERNATIONAL FINANCIAL INSTITUTIONS

From the start, this Administration has sought to tap the expertise of the IMF and the World Bank in helping the Soviet Union chart a course to a market economy. The Bretton Woods institutions can provide detailed, tested policy and technical advice, based on practical experience in many countries, including Eastern Europe. Such advice is crucial in an effort as complex and broad in scope as the transformation of an economic system. In December 1990, President Bush proposed a Special Association of the Fund and the Bank with the Soviet Union as a means to initiate the relationship and get the advisory process moving. The basic components of Special Association with the IMF are:

- reviews of the Soviet economy similar to those conducted in consultations with IMF members;
- technical assistance on policy reform to the center and republics;
- access to Fund documents and training courses;
- attendance at Fund meetings; and
- establishment of a Fund resident office in the Soviet Union.

For the World Bank, a trust fund of \$30 million has been approved to finance technical assistance for the Soviet Union and its republics on a wide range of economic reform issues. The Bank has subsequently developed a work program of activities for the next three months which focuses on such key areas as basic social services, private sector development, and the energy, agricultural, and financial sectors.

After the coup, the President and Secretary Brady pushed hard for the IMF to initiate Special Association to meet the pressing Soviet need. On October 5, an agreement for a Special Association was finally signed by the Soviet Union and the IMF, and consultations have begun. We do not view Special Association as an end in itself, but we think it is the best way forward for now. We welcome this agreement and urge that no effort be spared to work intensively in the days ahead. Special Association will help clear the way for full membership in both the IMF and the World Bank.

In the immediate future, the two institutions will provide policy and technical assistance to further the process of reform. In his speech at the Annual Meetings, the

Secretary urged the IMF and the World Bank to take on a new role in the Soviet Union and Eastern Europe to address some of the more fundamental needs of economies which must create the basic institutions, attitudes, and skills necessary for a successful market economy. The Fund and the Bank must help to build a real understanding of what free enterprise and entrepreneurship mean. The Secretary urged the financial institutions to pay much greater attention to the human capital component of their programs, to place knowledgeable people in-country capable of providing advice and training on a broad range of issues, and to expand in-country contacts beyond central government officials.

OTHER TECHNICAL ASSISTANCE

The IMF and the World Bank are expected to work closely with other institutions, such as the EBRD and the OECD, in coordinating their efforts. The EBRD itself has already established a short-term program of technical assistance and project financing for the Soviet Union which will concentrate on private sector development, privatization, and assistance for private sector activities in agricultural distribution and energy. It is already engaged in providing advice to the cities of Moscow and St. Petersburg on privatization.

We in the U.S. government are also engaged in an extensive technical assistance effort to advise Soviet officials about policymaking and regulation. Treasury has sent a team to several republics to advise on setting up new tax laws. The Federal Reserve, the Justice Department, the FTC, and Census have conducted seminars for Soviet officials on banking and reserve systems, competition and monopoly policy, and statistics. Other technical assistance is being provided in the areas of energy, food distribution, and defense conversion.

Secretary Brady has also proposed tapping the expertise of the U.S. private sector through a professional corps to train Soviet entrepreneurs to run successful businesses in a market environment. This would complement the Department of Commerce's ongoing Soviet-American Business Intern Training Program, under which Soviet entrepreneurs work in American corporations. During President Gorbachev's discussion with Secretary Brady in September, he expressed particular interest in the idea of setting up a business training center in Moscow. The Mayor of Moscow, in fact, has already agreed to provide land and, infrastructure.

CONCLUSION

In closing, I would restate the overriding objective of our economic relations with the Soviet Union: to encourage a complete transformation to a market system and to integrate the Soviet Union firmly with the world economy.

The transition to a market economy cannot be accomplished through a simple government declaration or by a quick infusion of Western financial assistance. It will take perseverance and many years of work for the Soviet people.

We now have the mechanisms in place—Special Association with the IMF and the World Bank, the G-7 coordinated effort, other multilateral efforts, and bilateral assistance—to provide crucial support. But we must guard against unfocused schemes for throwing money at the problem, particularly in an era of competing demands for scarce global resources. All of our efforts, financial and non-financial, must be carefully structured and targeted to promote the goal of transformation and sound economic policies in the Soviet Union.

Thank you.

PREPARED STATEMENT OF THOMAS M.P. NILES

INTRODUCTION

Mr. Chairman and Members of the Committee: I am pleased to have this opportunity to discuss with you events in the Soviet Union, especially the decentralization of economic and political power underway there. History offers few precedents for such a rapid and sweeping devolution of power from the central authority of a vast multi-national state to its constituent units. During the seven decades of Soviet power, virtually all decisions of any importance were made in Moscow and implemented at the republic and local levels. With the failure of the August coup and the collapse of the Soviet Communist Party, the republics are now moving on all fronts to give concrete meaning to their declarations of sovereignty. Indeed, it is now clear that, if new central authorities are eventually created, they will exercise only those powers that are voluntarily ceded to them by the republics. In the meantime, Acting Prime Minister Silayev working under the authority of President Gorbachev, is co-

ordinating union and republic economic policy. We continue to work with the Gorbachev government on foreign policy and security issues.

Such a dramatic shift of power, compressed into so short a time frame, has inevitably given rise to considerable political tension. The potential for turmoil is heightened by the consequences of more than 70 years of brutal, unjust, and inept communist rule. The collapse of the totalitarian structures of coercion and control has uncovered the existence of deep-seated ethnic animosities. Virtually all the republics have large minorities within their borders. Often these minorities are themselves in the majority in neighboring republics, creating the very real potential for conflict across borders. This dangerous situation puts a premium on experienced, cool headed, pragmatic statesmanship. It poses severe challenges to new leaders at the republic and local levels who have only recently replaced discredited communist elites, and who are just now experiencing for the first time the responsibility and power of independent decision making. Complicating matters enormously, these new leaders have assumed their duties in a period of deep economic and social crisis which threatens to overwhelm them. Nonetheless many of them are determined to proceed with the democratic and market reform transformation on which they are embarked. As President Bush and Secretary Baker have made clear, they will have American support.

We have not presumed to prescribe the outcome of this historic process. Only the peoples of the Soviet Union, expressing their will through genuinely democratic processes, can determine their political and economic future. At the same time, neither we nor the rest of the world can stand aloof from the momentous events underway. We all have an enormous stake in seeing democracy triumph throughout the Soviet Union. It is for this reason that we have articulated five broad principles which we believe must guide the process of Soviet political change, if it is to serve not only the interests of the peoples of the Soviet Union, but also those of international peace and security. On September 4, Secretary Baker set forth these principles as follows:

- First, the future of the Soviet Union is for the Soviet peoples to determine themselves, peacefully and consistent with democratic values and practices and the principles of the Helsinki Final Act. We call upon all Soviet leaders at all levels of government, including those of the republics, to show their support for these internationally accepted principles. In this process, there can be no legitimate place for threats, intimidation, coercion, or violence.
- Second, we urge all to respect existing borders, both internal and external. Any change of borders should occur only legitimately by peaceful and consensual means consistent with CSCE principles.
- Third, we support democracy and the rule of law, and we support peaceful change only through orderly, democratic processes, especially the processes of elections.
- Fourth, we call for the safeguarding of human rights, based on full respect for the individual and including equal treatment of minorities.
- Five, we urge respect for international law and obligations, especially adherence to the provisions of the Helsinki Final Act and the Charter of Paris.

Proceeding from these principles, we have engaged both the center and the republics on a broad policy agenda. Before turning to your primary areas of interest—Soviet relationships with the international financial institutions and management of the Soviet Union's foreign debt—let me briefly lay out our views on internal political and economic evolution of the Soviet Union.

INTERNAL POLITICAL AND ECONOMIC DEVELOPMENTS

It remains far from clear what new institutions may emerge from the sharp debate underway in Moscow and the republics about the ultimate relationship among the republics and between the republics and any reconstituted central authority. No serious central or republic leader advocates a return to anything approaching the highly centralized union that collapsed with the failed August coup. There are, however, proponents of a new union that would grant important political and economic powers to the central authorities, albeit within the framework of greatly expanded republic authority. At the other end of the spectrum, some republic leaders question the need for a center in light of the drive by republics to assert and validate their independence. Most leaders at all levels appear to recognize the need for some level of cooperation, achieved either through new multilateral treaty arrangements or through direct bilateral ties among republics.

This debate is certain to continue, and the shape of future association among the republics, if any, remain unresolved. Some tentative steps toward new cooperative

arrangements have begun to emerge. On October 2 in Alma Ata representatives of ten republics initialed a "Treaty on the Economic Community" which would establish a framework for possible cooperation and joint action by the republics. On October 18, eight republics and President Gorbachev representing the union government signed this agreement in Moscow. While deserving broad economic powers to the republics, the treaty pledges signatories to develop coordinated policies in key economic spheres including: a goods and services market; transport; monetary and banking system; finance, taxes, and prices, customs regulations and tariffs, and foreign economic relations and currency policy. The signatory republics must now negotiate and implement some twenty-five sub-agreements on detailed, highly contentious procedures to give effect and meaning to the treaty's primary provisions.

We welcome this agreement as a step toward cooperation among republics that might enable them to implement a serious and comprehensive market-oriented economic reform plan. Most economists would probably agree on the components of a suitable market-oriented economic reform plan. The plan would need to include the clear establishment of property and contract rights, privatization, competition among producers, macroeconomic stabilization, price decontrol, and opening the economy to the free flow of goods and investment. Moreover, the Soviets need to build basic economic institutions and create a sound fiscal system. Implementation of such a plan will be difficult at best and would be greatly complicated were the republics to slide into destructive protectionism.

Prospects for political union currently appear even more uncertain. Presidents Yeltsin and Gorbachev have reportedly reached agreement on the broad outlines of a new treaty that would establish a loose confederation, but it remains to be seen whether such a proposal can gain the support of other republic leaders. Organization of the interim all-union Supreme Soviet did not take place as originally scheduled on October 8, and some republics, including Ukraine, have indicated that they might not participate in its deliberations. In this highly fluid situation, it is imperative that the United States maintain effective contacts with both the center and the republics.

Over the past year, and increasingly since August, we have enriched our political dialogue with the republics.

- President Bush and Secretary Baker have met with republic leaders, including Presidents Yeltsin, Nazerbayev, Ter-Petrosian, and Kravchuk of Russia, Kazakhstan, Armenia and Ukraine.
- On his recent trip to Moscow, Under Secretary of State Bartholomew briefed republic representatives on President Bush's arms control initiative, thereby enabling them to play an informed role in the Soviet arms control decision making process.
- The President announced in late September our wish for a new economic relationship with Ukraine, including expanded trade and a Peace Corps program.
- Since February, the Administration has delivered emergency medical supplies directly to republics and local authorities, working through Project Hope.
- Department officials have met with prominent officials of all the Central Asian republics, Byelorussia, Moldova, Georgia, Armenia and Azerbaijan.

We have made clear our readiness to work with the republics, as well as central authorities, to ensure that any American humanitarian assistance delivered this winter is distributed efficiently and equitably. In this fiscal year, we intend to establish several new American consulates to provide enhanced American diplomatic presence in the republics. At the same time, we have made clear that we will continue to work with the central authorities on a full range of issues, including efforts to resolve international conflicts and accelerate the process of arms reductions.

SOVIET RELATIONS WITH INTERNATIONAL FINANCIAL INSTITUTIONS AND MANAGEMENT OF THE USSR'S INTERNATIONAL DEBT

These issues will be reviewed in detail by Under Secretary Mulford, but let me offer some general comments. The new Special Association of the Soviet Union with the IMF and World Bank, proposed by President Bush last December, was realized by the IMF on October 5. This enables reformers to intensify their work with experts to develop a reform program that meets the standards of the international economic community. The presence of a Soviet delegation at the annual meeting of the Bank and the Fund in Bangkok represented an important new step in the integration of the Soviet Union into the world economic order.

The Bangkok meeting was characterized by substantial Soviet openness in discussing the problems of the Soviet economy and possibilities for their solution. The G-7 Finance Ministers were equally frank in pointing to the continued impediments to

Western assistance, including the lack of agreement thus far on relationships among the Soviet republics and the central government.

The problems of management of the Soviet Union's international debt have also been extensively addressed, both at Bangkok and elsewhere. Total foreign debt is estimated at about \$65-70 billion, with over half owed to official creditors and most of the remainder owed to commercial banks. The U.S. share of official and commercial debt is less than \$3.0 billion. In our exchanges with both central and republic leaders at all levels, we have stressed the importance of fulfilling commitments entered into by the Soviet Government. Leaders of both the central and republic governments have assured us that they intend to fulfill those obligations. Even those republics that most vociferously assert their independence have stated that they intend to assume responsibility for a portion of the Soviet Union's international debt to be determined through a process acceptable to all the republics. This commitment was registered officially in the Alma Ata economic union treaty.

The Soviet Union has vast human and natural resources which can be the basis for a strong and independent economy capable of meeting the needs of its population, as well as its international obligations. Substantial shifts in economic policy and the development of market institutions will be required. The reform process, once begun, will take some time before a viable, efficient market-based system replaces the old command structures, and meanwhile issues such as debt will have to be successfully managed if reforms are to have a chance.

CONSULTATIONS WITH ALLIES

We have recognized throughout that only a coordinated and cooperative Western response can respond to the unprecedented challenge of the unfolding transformation of the Soviet Union. We have consulted with our Allies, including other G-7 countries, continually in a wide variety of fora. These consultations have contributed significantly to the emergence of a consensus on the need to move forward urgently with humanitarian assistance, especially with the onset of winter. We have continuously exchanged assessments and ideas with our Allies on humanitarian assistance and are confident that effective and mutually reinforcing assistance programs will be implemented. Together with our Allies, we have stressed the necessity for the Soviet Union to develop a comprehensive market economic reform program, worked out with the international financial institutions. We are confident of our ability to work closely with our Allies to bolster prospects for democracy and economic reform in the Soviet Union.

PREPARED STATEMENT OF ROGER W. ROBINSON, JR.

Mr. Chairman, it is a privilege to be asked to appear before the Committee to provide testimony on one of the most important public policy issues of our time -- the strategic and economic implications of the rapidly escalating Soviet financial crisis. These implications are likely to prove all the more significant for the coincidence of this crisis with the decentralization of economic and political power that has begun in the former Soviet Union.

My views on this subject are informed by eighteen years of involvement with East-West financial matters. As you know, I served as Senior Director for International Economic Affairs at the National Security Council from 1982-1985. Prior to my government 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 focus on some of the origins of the current Soviet financial crisis. I will also comment on the controversy surrounding the *true* value of Soviet strategic gold reserves. In addition, I intend to explore how current G-7 policies -- particularly those of Germany -- are inordinately jeopardizing the equities of Western taxpayers and risk undermining the near-term restoration of Soviet and republic creditworthiness in private financial markets. The role of multilateral institutions in managing Moscow's misfortunes also will be discussed briefly. Finally, I will offer some thoughts on differentiating clearly between *pre-coup communist* debt and *post-coup new money flows* to those republics which qualify for such assistance and react to several G-7 proposals and other developments currently unfolding.

ORIGINS OF THE SOVIET FINANCIAL CRISIS

The period of Mikhail Gorbachev's stewardship as leader of the USSR, which began in early 1985, has been marked by an inexorable march toward the financial crisis now gripping the former Soviet Union. The free fall in Soviet creditworthiness -- and Moscow center's resulting inability to attract meaningful private sector trade and credit flows from the West -- were the inevitable result of the combined effect of developments like the following:

- o As a result of continued, exorbitant levels of support for the voracious Soviet military-industrial complex accompanied by successive unworkable economic half-measures, Gorbachev and his cabinet ministers presided over a steady abandonment of traditional Soviet financial conservatism.
- o At the same time, the Kremlin remained committed to annual, multi-billion dollar expenditures on client states from Havana to Hanoi, and other expensive activities such as technology theft, disinformation campaigns and unsound arms financing to Third World customers.
- o Gorbachev's unwavering commitment to a command economic system which allowed reforms to be taken only at the margins; a resultant run-away budget deficit; the collapse both of the ruble and the Council on Mutual Economic Assistance (CMEA); falling Soviet oil production and world oil prices and a contraction of global demand for key Soviet exports -- particularly arms -- all converged to produce massive economic dislocation within the USSR.
- o Meanwhile, most Western commercial banks and governments continued to produce misguided assessments of Soviet debt-servicing capability. All too often, these assessments were based on the flawed contention that the USSR's hard currency indebtedness was no cause for concern when viewed in proportion to the overall size of

the Soviet economy. Thanks to this macroeconomic misconception, the Soviet Union remained a kind of "glamour credit" *for years* after it was evident that the USSR faced a growing hard currency cash flow crisis.¹

- o Western banks and governments were similarly oblivious to the lessons of the Latin American debt crisis. Specifically, they ignored the reality that undisciplined, largely balance-of-payments financing to a sovereign borrower whose economy is inordinately affected by volatile world commodity prices is a recipe for financial disaster.
- o U.S. executive branch agencies (and those of most alliance countries), moreover, failed to respond to two virtually unanimous Senate resolutions and other expressions of congressional concern since 1987 -- including several in which you took a leadership role, Mr. Chairman -- which pleaded for greater G-7 attention to the security dimensions of Western lending to the USSR. In particular, these initiatives stressed the importance of Western observance of sound lending practices to the Soviet Union.
- o To the contrary, Western officials apparently failed to focus adequately on the deteriorating profile of Soviet sources and uses of hard currency. Taken together with disturbing increases in Moscow's foreign borrowing activity, that profile would have provided a veritable road map to the piecemeal debt rescheduling which the Soviet Union quietly initiated in 1990 (e.g., multibillion dollar arrearages to global suppliers and Western government credits to Moscow specifically earmarked to liquidate those arrearages).
- o As a result, the G-7 nations at both the Houston and London Economic Summits in 1990 and 1991 respectively failed to forge a unified policy toward conditionality and financial assistance for the USSR. Instead, the so-called "Sinatra Doctrine" or "do-it-your-own-way" alliance strategy was adopted by the G-7 partners. By the time of these summits, it was already clear -- at least to the Japanese government -- that such an approach was having a most undesirable effect: It was *neutralizing whatever* leverage the West might bring to bear to compel urgent, systemic Soviet economic reform and a radical reordering of Moscow's hard currency spending priorities as a precondition for aid.
- o In particular, the Soviet Union was *de facto* encouraged to persist in its traditional unwillingness to engage in significant data disclosure and transparency by the abandonment of strict G-7 loan conditionality, including the insistence on such data disclosure as a minimum precondition to the receipt of Western financing. Early data disclosure would have likely revealed, for example, the steady erosion of Soviet hard currency reserves, including strategic gold stocks.

The Degree and Effects of Moscow's Non-Transparency on Indebtedness

In 1985, total Soviet indebtedness was estimated to be only about \$30 billion -- primarily a product of a legacy of caution with respect to foreign borrowing. Today, by

¹One of the only Executive Branch reports to be made public on Western lending to the USSR, entitled, Report of the Special Interagency Task Force on Western Lending to the Soviet Bloc, Vietnam, Libya, Cuba and Nicaragua, was released on October 24, 1988. This report acknowledged that the positive assessment of Western banks towards Soviet credit risk, in part, stemmed from gold reserves estimated at over 70 million ounces and valued at the time at over \$30 billion. It also made clear that Soviet borrowing from 1983 through 1987 had been largely in the form of untied (general purpose) credits. Moreover, the report concludes, "The Soviet Union's external financial position appears adequate and is likely to remain so during the foreseeable future, in the absence of severe external shocks and/or unexpected sharp changes in Soviet policy."

contrast, total Soviet hard currency indebtedness is estimated to be in the range of \$70-75 billion. When estimating Soviet debt, it is important to account for billions of dollars of interbank deposit exposure (deposits of Western banks in all Soviet-owned institutions). The difficulty in assessing *actual* Soviet indebtedness is complicated further by the concurrent withdrawal or non-renewal of Western short-term credit and interbank deposit lines to the Soviet Union. Such steps have effectively amounted to significant involuntary debt repayments, thus lowering total Soviet indebtedness.

In fact, *nobody* in the West has any definitive information concerning the *true* level of Soviet indebtedness. Similarly, there is at present no easy way for us to determine whether or not Moscow has engaged in some past borrowing from, for example, Middle East lenders which was not reported to either the Bank for International Settlements (BIS) or to the Organization for Economic Cooperation and Development (OECD).

One indication of the actual state of Moscow center's financial affairs, however, has been its persistent supplier credit arrearages -- or late payments of six months or more to Western suppliers -- since the beginning of 1990. Salomon Brothers recently estimated such arrearages to be as high as \$6-10 billion. This uncertainty is simply another powerful argument for demanding that Moscow provide data on the precise amount and status of delinquent payments. That amount, naturally, then should be added to its total indebtedness.

Can Moscow Cope with its Debt?

One question now is uppermost in the minds of Western government officials and commercial bankers: Can the Soviets manage this large hard currency indebtedness in view of a total annual hard currency income typically in the range of only \$32-37 billion -- and falling? In the past, this question has generally been answered affirmatively, thanks, in part, to a presumption that the Soviet Union had large strategic gold reserves. These reserves were believed to provide a kind of "bottom line" safety-net for Western private and public sector creditors.

Today, of course, such confidence has been sharply eroded by recent, often conflicting Soviet statements to the effect that their gold reserves are a trivial fraction of what conventional wisdom held they were just a few months ago. Interestingly, the byzantine story of Soviet claims and counterclaims concerning their gold reserves -- not to mention the massive gap between even the most optimistic of such estimates and those long relied upon in Western financial circles -- should serve as a cautionary tale for those inclined to provide financial assistance to a reconfigured Moscow center.

A TRUE PICTURE OF SOVIET GOLD RESERVES?

On 27 September 1991, Grigory Yavlinsky, Gorbachev's chief architect for economic reform, rocked the world with his assertion that the Soviet gold-cupboard was nearly bare. The CIA, PlanEcon and other research groups, after all, had traditionally put the value of Soviet gold reserves somewhere in the range of \$25-32 billion (2160-27,000 metric tons at today's prices).

Yavlinsky stunned a Moscow television audience by estimating reserves to be **only about 242 metric tons** (worth only \$2.6 billion at current prices). He contended that total reserves had been depleted by some two-thirds over *just the past year* and added that approximately 110 metric tons of gold had been "pawned" -- a term presumably referring to collateralized lending transactions known as "gold-swaps" which apparently cannot be redeemed. (Yavlinsky reconfirmed a 242 metric ton figure again to reporters in Bangkok on 12 October.)

The *Washington Post*, in reporting on this dramatic development in a front-page article on 28 September, noted that the shock waves were felt in the highest reaches of the Bush Administration. The *Post* cited a key White House advisor -- presumably an expert on

the Soviet economy -- as estimating Soviet gold reserves to be valued at **\$25 billion less than two months before.**

Not everyone was caught as flat-footed as the White House by Yavlinsky's claims. As you may recall, I have contended for over two years -- in the face of considerable skepticism -- that Moscow had been routinely dipping into its strategic reserves since 1987 to meet short-term liquidity requirements and that this practice had intensified considerably over the past two years. Indeed, as the *New York Times* reported on 19 August 1991 (the first morning of the Soviet coup d'etat), I estimated the value of Soviet gold reserves to be as low as \$12 billion -- or approximately *half* the figure generally accepted in the West.

What Did Yavlinsky Know?

At first blush, it would appear that even my working estimate of Soviet gold holdings was too high. Subsequent to Yavlinsky's announcement, however, his claim of less than \$3 billion in gold reserves has been increasingly challenged. For example -- *leaving aside the possibility that he may have been trying purposefully to mislead Western creditors* -- there has been speculation whether Yavlinsky would have had access to the precise locations and amounts of *all* Soviet gold stocks.

In this regard, it is widely believed that Soviet reserves are divided between a special branch of the Finance Ministry and the Soviet state bank (Gosbank). According to Alexandre Doumnov, deputy managing director of Gosbank's international monetary and economic department, the bank's gold holdings total 374.5 metric tons. Doumnov and other state bank officials have implied publicly that they believe the 242 metric tons referred to by Yavlinsky may be just the gold stocks of the Finance Ministry's special branch, rather than the country's total reserves.

A Secret Hoard Spirited to the West?

The mystery surrounding Soviet gold reserves is deepened by some published reports in Moscow that as much as \$4 billion in gold was spirited out of the country in the period coinciding with the attempted coup in August. The Moscow newspaper *Kuranty* has published allegations to the effect that a "secret strategic [gold] reserve" amounting to about \$4 billion was established somewhere in the West at the specific instruction of coup leaders -- notably former Prime Minister Pavlov -- for the purpose of potentially offsetting a temporary cut-off of trade and credit links with the West likely to result from the coup.

A report by *Tass*, the official Soviet news agency, carried by the *Journal of Commerce* on 27 September stated: "The purpose of the operation [the hasty transfer of Soviet gold to locations in the West] was to create a special currency fund for supporting vital Soviet industries in conditions of dramatic political changes in the Soviet Union, and the routing of democratic forces." This story was reinforced by the British newspaper, *The Guardian*, which reportedly published details of the transfer of a large consignment of Soviet gold in this timeframe. In the period immediately following the coup, market speculation that the Soviets would be forced to engage in heavy selling contributed to a fairly dramatic decline in gold prices on the London and Tokyo Exchanges. We may never know the true story concerning secret Soviet gold shipments to the West by former communist leaders, but it is, at minimum, the stuff of a riveting future novel or film.

Did Yavlinsky Intentionally Low-Ball His Estimate?

Putting aside for the moment how much gold the Soviet Union still possesses, it is not particularly hard to understand how the revelation that Soviet gold reserves were so low could benefit the former USSR at a time when its credit rating was vaporizing. Consider the following:

First, several Western creditors -- particularly the Swiss banks -- have reportedly been demanding that Moscow increasingly provide gold collateral for short-term loans (e.g., gold swaps) or even large foreign exchange transactions. As the list of such "collateral-conscious" Western creditors grows, the Soviets have a compelling incentive to declare gold reserves inadequate to meet such creditor-demands.

Second, Yavlinsky and Viktor Geraschenko, Chairman of Gosbank, and other officials were aware that most of the G-7 nations would soon be demanding a full inventory of Soviet hard currency assets, including the details of Soviet gold stocks, as a precondition to further large-scale assistance flows. Indeed, even German Finance Minister Theo Waigel -- an official in the past not seized with this issue -- is on record requiring such Soviet data disclosure in the run-up to the recent IMF/World Bank annual meetings in Bangkok.

The purpose of such a Western inventory-taking is presumably to help decide on the appropriateness, amounts, timing and modalities of Western financial assistance to the former USSR, as well as to satisfy the requirement for substantial financial burden-sharing to be undertaken by the Soviets themselves. In this connection, Mr. Gorbachev and his associates may have felt a need to understate gold reserves to reduce the likely political demand in the West that Moscow expend a sizeable portion, if not all, of remaining reserves *prior* to further Western taxpayer exposure -- and likely losses.

Third, the reconfigured Soviet central authorities have expressed mounting dissatisfaction with the pace of Western financial assistance to their beleaguered economy and the lack of movement toward some form of debt relief. A public announcement by Yavlinsky of a drastic short-fall in remaining gold stocks may have been calculated to increase the panic level in the West concerning Moscow center's ability to service those repayment obligations coming due between now and the end of the year. Whether the Soviet announcement was specifically designed to catalyze this Western response or not, it surely seems to have had that effect. The fact is that the West is now considerably more seized with the international implications of Moscow's financial problems than at any time in recent memory.

Finally, at a time when the Kremlin and Yeltsin's "White House" seem intent on allocating shares of the onerous Soviet debt burden among all remaining republics in the union, there is substantial concern that these republics will demand a proportionate share of the *asset* side of the Soviet balance sheet. Announcement of a very low gold reserve figure presumably would also have the effect of reducing -- if not curtailing -- such republic demands.

Whatever the motivation behind the Soviet disclosure of greatly diminished gold reserves, Moscow center was apparently surprised by one of its consequences. Several Western banks which had heretofore been willing to "stay the course" in their banking relations with the former USSR were reportedly sufficiently alarmed by this latest blow to Soviet creditworthiness that they canceled remaining interbank deposit and short-term credit lines. Such decisions had the effect of exacerbating, not improving, Moscow's already serious liquidity crunch.

It is therefore not surprising that, soon after Yavlinsky's gold estimates were announced, senior officials in Soviet financial circles began to counter Yavlinsky's claims publicly. Some went so far as to dismiss them out of hand. For example, Vitaly Lipanov, deputy head of the precious metals department of the Soviet Bank for Foreign Economic Affairs termed the Yavlinsky estimates, "strange and amazing." Vladimir Goriunov, managing director of the bank's Zurich branch characterized Yavlinsky's statements as, "irresponsible" and added, "What was Mr. Yavlinsky talking about? I do not know."

Finally, as recently as 14 October, Mr. Grigory Revenko, chief of staff to President Gorbachev, stated that Western financial officials were "right" to express skepticism concerning the 242 metric ton gold figure. He was quoted in the 15 October edition of the

Financial Times as saying, "The President knows this figure and I know it." Nevertheless, he declined to reveal when it might be publicly available.

The Bottom Line on Soviet Gold Reserves

My basic view of this debate is that for several years the Soviet Union was content to inflate artificially its gold reserves by nodding in the affirmative toward Western estimates in the \$25-32 billion range. For reasons like those mentioned above, I believe some All-Union Soviet leaders -- possibly Gorbachev himself -- encouraged Yavlinsky to go public with an artificially low gold reserve figure -- hence the huge disparity in estimates which emerged virtually overnight.

Based on an historical analysis of unexplained Soviet hard currency funding gaps and admittedly incomplete market information concerning Soviet gold sales, it is my belief that Soviet reserves probably remain in the range of \$6-12 billion (some 520-1040 metric tons). Given a scenario in which Moscow ultimately stands by its estimated \$2.6 billion gold figure, such a financial strategy would preserve a few billion dollars in deep, off-line stocks for truly emergency purposes. The fairly minor increase in world gold prices since the Yavlinsky announcement reinforces my suspicion that some key gold traders in the West have perhaps received a "wink and nod" from trusted Soviet counterparts that there is actually more in the gold cupboard than is being advertized.

Accept No Substitute for Soviet Transparency

Mr. Chairman, I believe it is no accident that both the liability *and* the asset sides of the Soviet balance sheet -- not to mention the country's profit and loss statement -- have recently become even murkier than usual. After all, non-transparency and confusion about the actual state of Soviet financial affairs would work to Moscow center's distinct advantage as G-7 officials gathered in Bangkok last week on the margins of the annual IMF/World Bank annual meetings to discuss various "debt-deferral" or "bridge-financing" scenarios for the former Soviet Union.

I respectfully suggest that this Committee should be both amazed and deeply disturbed that the leaders of the industrialized nations are now engaged -- under these circumstances -- in financial decision-making likely to involve the disbursement of billions of dollars in U.S. taxpayer funds to Moscow center between now and the Munich Economic Summit next July. Such a prospect -- and the attendant losses it portends -- seem to me to demand that the Congress take careful stock of the positions and motives driving key G-7 nations in the context of the escalating Soviet financial crisis.

G-7 POLICIES: TRUTH OR CONSEQUENCES?

During the recent IMF-World Bank annual meetings in Bangkok, the G-7 nations publicly feigned consensus on providing emergency financial aid to the former USSR to help avoid a foreign debt payments crisis. In fact, sharp divisions have emerged on the specific question of what form such emergency aid should take.

Soviet hard currency shortfalls for the last four months of this year were calculated by the G-7 to be more than \$7 billion. It is noteworthy that no such specifics appeared in the communique issued following the group's meetings reportedly out of fear that Soviet republics might use such data to arrive at different calculations of their proportionate share of Moscow's near-term foreign payment requirements. Importantly, it is the lack of adequate financial remittances by the republics to Moscow that is viewed by the G-7 as the principal reason for the immediate Soviet liquidity crisis.

The Soviet delegation to Bangkok led by Grigory Yavlinsky and Viktor Geraschenko communicated to the industrialized nations that Moscow's coffers only had sufficient hard

currency available to meet their debt repayment obligations for, at most, the next two months. Geraschenko went so far as to state that Soviet hard currency reserves are "close to zero." Among the ingredients of a financial rescue package for Moscow currently contemplated by the G-7 are the following:

- o A bridge-loan to Moscow from the Bank for International Settlements (BIS) in Basel, Switzerland (whose members are Western central banks) for an as-yet undisclosed amount. This loan is to be backed by either Soviet gold reserves or -- far more likely -- simply a guarantee by the G-7 governments (i.e., Western taxpayers).
- o The "temporary" *deferral* of Soviet debt repayments coming due between now and at least the end of the year -- probably longer.
- o Accelerated bilateral loans and credit guarantees by G-7 countries in support of grain shipments, assistance to the Soviet energy sector, and other "humanitarian" loans. Some \$7.5 billion in such assistance has already been pledged by the industrialized nations in just the past few weeks.
- o The establishment of a financial "safety net" (also through the BIS) for Soviet-owned subsidiary banks located in the West. This initiative would require that taxpayers in G-7 nations bail out institutions like Moscow Narodny Bank in London even though such enterprises have long abused the hospitality of their Western hosts by engaging in an array of dubious -- if not downright insidious -- activities on the Kremlin's behalf, some of which are reminiscent of those coming to light in the BCCI scandal.
- o Active consideration of a Soviet request in Bangkok for the establishment of a \$20 billion fund to backstop ruble convertibility. Such a step could permit Moscow center to accomplish a feat that long eluded would-be alchemists -- that of turning worthless materials, like Soviet rubles, into hard currency equivalents of gold.

The G-7 Mission to Moscow

Last week in Bangkok, the G-7 finance ministers decided to dispatch their deputies to Moscow during the week of 21 October for the purpose of defining and advancing a concrete rescue plan for the teetering Soviet financial structure. Clearly, the ministers hope this mission will advance their common objective by -- in the words of the Bangkok communique establishing "an operational framework for fulfilling existing and future financial responsibilities of the center and the republics."

The G-7 appear to have agreed to play the role urged upon them by the Soviet central authorities, namely that of the enforcer of Moscow's demands that the republics continue to provide the center with sufficient hard currency remittances to permit it to meet, among other things, the former USSR's past and future foreign debt obligations.

In other words, this mission is designed -- as it is likely subsequent G-7 efforts will be -- to preserve the facade of Soviet creditworthiness at least until statutes in countries like the United States, Japan and Canada, which make a favorable credit rating a precondition for sovereign borrowing, can be waived or eliminated. For his part, Gorbachev will be strongly encouraged to fulfill his pledge to have at least eight of the 12 remaining republics sign a political union treaty by sometime in November. Interestingly, the G-7 are already interpreting the recently initialed economic union treaty as obligating the republics to meet all past and future foreign debt obligations incurred by Moscow center.

The G-7's willingness to demand a center-dominated all-union arrangement is bitterly ironic. For one thing, Oleg Bogomolov, an economic adviser to Russian President Boris Yeltsin, has predicted that the inter-republic economic treaty fashioned by Mr. Yavlinsky

will ultimately fail. He stated in the *Wall Street Journal* of 15 October, "If it is accepted [by the republic governments] it is very unlikely that it will be implemented. [Soviet leader Mikhail Gorbachev] has lost a lot of power and the republics do not want to be subordinated to the center."

For another, *even if it were to proceed* in a mechanical sense, there is little likelihood that it would succeed in facilitating the needed wholesale transformation of the Soviet economy. To the contrary, the latest version of the All-Union document is properly regarded by genuine democratic reformers in the republics as a device whereby the center can further stave off such change.

The German Agenda

Not surprisingly, Germany has taken the lead among European countries in strongly opposing U.S. intentions to go public with a specific debt deferral plan for the former Soviet Union. After all, Germany has a radically different interpretation of allied financial burden-sharing in the context of the Soviet financial crisis than that of Washington.

It is not difficult to assay Bonn's motivations in this area. All one need do is to glance at the estimated respective shares of Soviet debt held by its G-7 creditors. [Germany-36%; France-9%; Italy-7%; Japan-7%; UK-5%; U.S.-1%] According to the *Financial Times* of 16 October, combined German government and commercial bank credit exposure in the former Soviet Union increased from DM 19 billion (\$11 billion) at the end of last year to some DM 35 billion (\$20 billion) just six months later. (In fact, the current total figure may be higher.)

In part, this dramatic increase reflected the addition of repayment obligations of the former German Democratic Republic (GDR) after reunification. Like most alliance countries, the bulk of this exposure is government-guaranteed, reportedly leaving only about DM 6-10 billion (\$3.5-6 billion) in the category of uninsured, private credit risk. About half of this amount is being carried by Germany's three largest commercial banks -- Deutsche Bank, Dresdner Bank and Commerzbank. The first two have reportedly already established loan-loss provisions for the Soviet Union amounting to roughly 75% and 65% of their respective Soviet portfolios.

Were Bonn to acquiesce to the U.S. proposal simply to defer (read reschedule) Moscow's principal payments to Western creditors, it would, in effect, be formally acknowledging a *de facto* Soviet default on Moscow's original repayment obligations. Such a step would probably require a significant write-down of the value of Soviet loan portfolios. Such a development could, in turn, create a public outcry in Germany (and other European countries overexposed financially in the former USSR) over the perceived squandering of taxpayer funds urgently needed for domestic purposes.

By contrast, the German-led European demand for short-term bridge-loans by the BIS or other multilateral institutions would, at least on the surface, keep the Soviet Union current on such repayment obligations. More importantly, "new money" flows from G-7 countries, particularly those with very modest Soviet exposure like the United States and the United Kingdom, would almost certainly be recycled by Moscow to repay key creditors -- primarily the German government and banks.

The Handwriting on the Wall

The G-7 partners have already begun to recognize that it would only be a matter of time before the U.S. Congress and other nations' legislative bodies awaken to the German gambit. Once they do, such parliaments are most unlikely to agree to allow Moscow to use their taxpayers' money to pay off profligate European lenders -- lenders who had chosen in the pre-coup period to extend credit to a Soviet regime which remained committed to the preservation of a fundamentally unreformed, militarized Soviet economy and costly global empire.

For the moment, the Bush Administration is exhibiting a virtually unprecedented -- and refreshing -- degree of prudence in its handling of this potentially explosive issue. In contrast to a generally poor track record concerning financial, trade, energy and technology transfer aspects of U.S.-Soviet relations, the Administration appears for the moment determined to resist the gratuitous creation of additional Soviet indebtedness.

Fresh financial flows from the West will only deepen Moscow's debt crisis and hobble further the prospects for the genuine transformation of the Soviet economy. To put it bluntly, the "bridge-loan" (BIS originated or otherwise) envisioned by most G-7 partners, would represent a *bridge to nowhere* under current circumstances.

Instead, what is needed is a Western policy of clear-cut differentiation between pre-coup communist debt and post-coup new money flows to those republics which qualify for such assistance. **The bottom line is that the Soviet Union should reschedule its debt now, rather than have such a rescheduling artificially staved-off at the expense of Western taxpayers.** This is particularly the case when the only certain beneficiaries of such a postponement are European banks and governments -- not the beleaguered Soviet economy and those of the republics.

THE ROLE OF MULTILATERAL INSTITUTIONS

In calling the IMF's role in reforming the Soviet economy "the toughest task in its 47-year history," the *Wall Street Journal* on 15 October accurately described the problem. The *Journal* went on to describe the IMF's capabilities to undertake this monumental task as comparable to "asking a doctor experienced in setting broken bones to perform a heart transplant on a cancer patient." In short, the IMF's expertise in the area of transforming command economies is questionable at best and its macroeconomic focus is ill-suited to treating several of the Soviet Union's most intractable problems.

Having said this, the Congress should expect to witness substantial enthusiasm on the part of the Bush Administration and other G-7 leaders to off-load this emerging financial nightmare from bilateral arrangements onto the shoulders of multilateral financial institutions such as the IMF, the World Bank, the European Bank for Reconstruction and Development (EBRD), the BIS and even the Asian Development Bank. Such a strategy would have two major objectives:

First, it would reduce the potential for damaging political blow-back which would almost certainly attend any U.S. effort to lead a bail-out of the new Union with American taxpayer funds. To be sure, any lending by institutions like the IMF would also involve taxpayer funds; such lending, however, can be performed in a more politically palatable -- or at least less visible way if the Fund (or some other organization) serves as a cutout.

Second, Western leaders -- including President Bush -- are becoming increasingly and properly nervous that a potential collapse of the Soviet economy and debt servicing capability could be tied to them personally. This frightening scenario could be substantially blurred by the central involvement of faceless multilateral institutions.

For these among other reasons, a substantial portion of the new capital increase envisioned for the IMF will probably wind up being earmarked for the Soviet "stabilization" effort. **Should this occur, it will probably mean that the integrity of the criteria by which borrowing occurs at the Fund will be significantly adulterated and that other, more deserving would-be sovereign borrowers are denied the resources they urgently require.**

CONCLUSION

It seems clear from the G-7 meetings in Bangkok that there remains a fundamental misunderstanding of the nature and likely duration of the Soviet financial crisis. In a way similar to the Latin American debt crisis in the early 1980s, we are now hearing the Soviet situation characterized as a "short-term liquidity problem" rather than a more serious longer-term structural crisis. In addition, Mr. Yavlinsky attempted to sell the argument that the coup attempt in August was primarily responsible for the current Soviet financial crisis -- a good public relations ploy, but not grounded in reality.

While it is true that the former USSR retains the potential to be one of the world's richest countries thanks to its abundant natural resource base, that inherent wealth can only be unlocked over time and with proper market-oriented economic and democratic institutions in place. Even a crash Western assistance program for the strategic Soviet energy sector -- primarily to turn around declining Soviet oil production and exports -- will only prove to be a stop-gap measure, if not accompanied by radical systemic change.

The scale of Western financial assistance required by the end of this decade to improve materially the Soviet standard of living on a sustainable basis may well be on the order of \$500 billion. Clearly, to achieve anywhere near this level of total Western credit, investment and trade flows into the former USSR will necessitate a major commitment by the world's private sector *on its own risk*. Unfortunately, the steps needed to promote a climate conducive to such entrepreneurial hard currency infusions are being overlooked in the rush to advance taxpayer-underwritten loans, credit guarantees and trade insurance.

Mr. Chairman, you have been a leading protector of U.S. taxpayer interests with regard to U.S. financial and trade policies toward the former Soviet Union. I am confident, therefore, that you recognize the inadvisability of open-ended, multi-billion dollar transfers of business and credit risk onto the shoulders of the American people through a sleight of hand called "government guarantees". It has been painful enough to witness the relentless escalation of taxpayer costs associated with the Savings and Loan debacle and the international debt crisis.

In my view, it is absolutely essential that there be a dramatic shift in emphasis in U.S. financial policy toward the former USSR -- away from a reconfigured Moscow center in the direction of individual, qualifying republics. When I testified before the Senate Foreign Relations Committee on 19 June 1991, I argued strongly that a more promising approach to the economic transformation of the former USSR would be achieved through the creation of a competitive process between the reformist republics to attract Western trade and investment flows. I believe even more strongly that this is the case today.

Unfortunately, the G-7 nations still appear wedded to the notion that "one-stop shopping" -- namely a central coordinating point for Western aid and debt relief -- is the only way to assure future stability and growth. Ironically, this G-7 strategy is at cross-purposes with developments on the ground in the former Soviet Union, namely the intention of key reformist republics to steer clear of the dubious policies of even a newly configured central government. I believe, therefore, that the U.S. must work with democratic, market-oriented republics in their pursuit of independent access to Western trade and financial markets, as well as membership in major multilateral financial and trade institutions.

In the way of reaction to a number of G-7 proposals and other developments currently unfolding, I would also offer the following summary recommendations:

- o There should be no BIS bridge financing provided for the former USSR under current circumstances. To do so would only postpone the inevitable financial adjustment process attendant to debt rescheduling and ultimately increase the losses of U.S. and other Western taxpayers.

- o The allocation of portions of the Soviet foreign debt burden to the remaining republics should be accompanied by generous, long-term reschedulings for the most reformist republics in the interest of accelerating their ability to achieve economic independence and growth as well as "stand-alone" creditworthiness in Western markets.
- o The G-7 should immediately cease being used by Moscow center as "enforcers" in the latter's effort to pressure the republics into signing and implementing All-Union economic and political treaties which are not necessarily in their national interests.
- o Instead, the G-7 should help ensure that new economic and financial authority ceded by the republics to a reconfigured Moscow center should be kept to an absolute minimum -- unlike the somewhat heavy-handed proposals of Grigory Yavlinsky and other All-Union officials. After over 70 years of tragic mismanagement by central authorities, it is only natural that reformist republics will take some time before evolving in the direction of more cohesive, voluntary common market arrangements.
- o If former Soviet republics are to be compelled to assume responsibility for the liability side of the All-Union balance sheet, they should also be allocated a portion of the asset side -- namely hard currency reserves, including gold stocks.
- o The "Hunt for Red Money" should be intensified in the interest of completing a full inventory of all Soviet hard currency assets, including gold reserves, inside or outside the former USSR. It is essential that such Soviet assets be used as the first line of defense against liquidity shortfalls and dipping further into the wallets of U.S. and other Western taxpayers.
- o The United States should take the lead in preserving the integrity of the lending criteria of the IMF and other multilateral institutions to avoid the establishment of damaging precedents with regard to the former Soviet Union. In addition, it is essential that Moscow not receive preferential treatment over the more "transformed" and deserving countries of Eastern and Central Europe, the Baltic states, and our allies in Latin America and elsewhere.
- o Soviet-owned subsidiary banks located in the West should not be artificially propped up by central bankers using taxpayer resources. The failure of one or more of these questionable institutions would not be of sufficient scale to damage materially the international financial and payments system and, put simply, they do not warrant being bailed out.
- o The Congress should not permit legislation to be passed which would even temporarily waive -- much less eliminate -- the statutory requirement that sovereign borrowers like the former Soviet Union be creditworthy (e.g., Lugar/Coleman bill). To allow the U.S. Department of Agriculture's Commodity Credit Corporation (CCC) or Eximbank to pocket this kind of scandalous arrangement would undermine fundamentally sound banking practices and gratuitously endanger American taxpayers.
- o The "tenor" or maturity structure of CCC credit guarantees should be reduced from three years to 180 days to reduce Moscow's temptation (if not intention) to use these funds for other than grain purchases. (In a 13 September *New York Times* article Ivan Silayev, Chairman of the Inter-Republic Economic Committee, said in relation to such grain credits, "unfortunately [they] will have to be used to service our debt.") In addition, the United States should immediately establish modalities whereby such credit guarantees and other assistance flows can be made available directly to individual, qualifying republics.

- o German leadership of G-7 policies related to the Soviet financial crisis should be strongly resisted by the Congress -- legislatively if necessary. The excessive willingness of this Administration to acquiesce to German and other European demands in the past has contributed importantly to the highly compromising financial situation we find ourselves in today.

Finally, the coming crescendo of the Soviet financial crisis presents at least one major policy opportunity for the West which should not be missed. If an inevitable Soviet debt rescheduling is undertaken now, we can clear the decks -- albeit with substantial pain -- of pre-coup communist debt and get to the task of working closely with the most reformist republics to bring them into the Western economic and financial community.

A Soviet debt rescheduling which is specifically crafted to help catalyze systemic transformation of qualifying republics can serve as a cathartic, positive process. If, however, we continue down the present road of permitting Moscow to use Western financial assistance, including debt relief, as a kind of club to bludgeon independent, democratic-minded republics into submitting to the discredited policies of a new Moscow center we will have misjudged, at a critical juncture in history, the merits of decentralization and the abiding dangers of recentralization.

