THE COMMONWEALTH OF INDEPENDENT STATES: ECONOMIC OPPORTUNITY OR DISASTER IN THE MAKING?

A Report Based on the Proceedings of the Third
ASPEN INTERNATIONAL FORUM

International Center for Public Administration and Policy
Graduate School of Public Affairs
University of Colorado at Denver

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Preface

The First Aspen International Forum involving Russian and American leaders occurred in late August 1991, just a few days after the failed coup attempt in Moscow. The forum was a heady, wonderful, stimulating experience. Buoyed by the victory of the democratic reformers, anything seemed possible. The dialogue focused on strategies to build democracy and free markets in the then Soviet Union.

Participants talked about ways to strengthen still-struggling, newly-freed institutions like the press and political parties and how to build private businesses. They considered the kinds of aid that could be offered by the West and that would facilitate the transition. A central issue was the relationship between the "center" and the republics. Participants debated whether the forces driving decentralization were so strong as to make maintenance of the union impossible. They expressed concern about the ethnic, nationalistic and religious tensions surfacing within and between republics. But over all, the atmosphere was one of hope. After all, they had just beat back an attempt to return to the Communist era. Despite recognized problems, the future looked bright.

Much has happened since the initial Forum. The old Soviet Union has vanished permanently from the world's political landscape. Its substitute, the Commonwealth of Independent States, is struggling to define itself. It appears unlikely to survive as a meaningful political entity.

All of the republics of the former Soviet Union have declared their independence. None, however, have been able to convert their newly won freedom to economic, social and political stability. The transition from a centralized command economy to a decentralized private market economy has been difficult. Ethnic, religious and nationalistic rivalries, once kept in tow by a strong communist party and central government, have led to bloodshed in some areas. Western aid has been slow in coming and seemingly of marginal impact.

The atmosphere and dialogue at the third Aspen International Forum held in October 1992 reflected these new economic and political realities. The topic for the meeting was: *CIS -- Economic Opportunity or Disaster in the Making*. Politicians, policy makers, businessmen and scholars joined together to debate the options. All but one member of the CIS delegation hailed from the Russian Federation.

Gone was the romance and optimism which pervaded the first Forum. The discussions were directed at making the difficult choices and developing hard strategies concerning Russia's economic policies and programs. Delegates debated macro-economic issues and identified the economic, legal and political changes required to support the emergence of private business and increase levels of foreign investment. Questions were raised by all delegates concerning the wisdom, type and magnitude of Western assistance.

Agreement was reached after several days of vigorous, and sometimes testy, discussion concerning future directions. The protocol, presented at the end of this report, envisions efforts to lessen the importance of inefficient state enterprises while increasing the pace of privatization. It supports options to reduce hyperinflation while recognizing the need for a predictable supply of credit. It conditions the size and extent of western aid on Russian willingness to initiate significant economic and political reform. It recognizes the magnitude of the task faced by the Russians and respects their need for some flexibility in fashioning reforms to maintain political stability. The programs and policies endorsed in Aspen will be difficult to implement, but they are important. The protocol has been distributed to policymakers throughout the Russian Federation and the West.

Change continues at a rapid pace in the former Soviet Union. Under pressure from the Parliament, President Yeltsin dismissed Yegor Gaidar, the minister who framed the economic policies discussed at the Forum, from the government. As this document goes to printing, the tensions between the President and the Parliament are growing more intense and the outcome is unclear.

I was privileged to facilitate the sessions of the Forum. The insights of the delegates -- both American and Russian -- and their commitment to a significant and honest dialogue made the Forum a success. German Malski and Konstantin Lakshin provided able translation, allowing us to understand each other despite differences in language. Dr. Peggy Cuciti served as the conference rapporteur. She has transformed over fifty hours of dialogue into a very readable report.

An event like the Aspen International Forum requires the input of many individuals and organizations to succeed. I am grateful to my colleagues Jay Ambrose and Cliff May of the Rocky Mountain News and Jean Galloway of K*USA Channel Nine for their advice and support in organizing the Forum.

Funding was provided by U S WEST; The Aspen Foundation; The Aspen Skiing Company; Unisys; Newmount Gold Company; Fischer Imaging Corporation; Martin Marietta; Shearson Lehman Brothers; Arthur Andersen & Company; Boden, Oppenhoff, Rasor, Raue; Holme, Roberts & Owen; Norwest Bank; St. Mary Parish Land Company; Davis, Graham & Stubbs; The Harris Foundation; Hale and Dorr; D & Z, Inc.; Miller International; and Marvin Levy.

The Aspen Institute and its President, David McLaughlin, graciously permitted us to use their facilities in Aspen for the conference. Madeleine and Karl Larson, Bonnie and Tom McCloskey, Sherry and Warren Ryan, and Noel and Tom Congdon all opened their homes to us. Their hospitality was wonderful. Nora Kimball and Jill Rulon provided logistical support before and during the forum.

Last but not least I wish to acknowledge the efforts of my friend and colleague Konstantin Zatulin, Director General of the Association of Chief Executive Officers. He organized the Russian delegation and helped me assure a solid, necessary discussion. He shares my commitment to continuing the Aspen dialogue. Together, we will do so.

Marshall Kaplan
Dean, Graduate School of Public Affairs
University of Colorado

Delegation Membership

The Commonwealth of Independent States

Alexander Titkin, Minister of Industry for the Russian Federation
Mark Masarski, President, International Association of Chief Executive Officers. Winner of the CIS entrepreneur of the year award.
Konstantin Zatulin, Director General, International Association of Chief Executive Officers; Member Moscow Commodity Exchange.
Vladimir Semenov, Head of Russian Industry Minister's staff.
Nikolay Travkin, Head of Administration of Shakhovskoi District of Moscow oblast; Chairman of Russian Democratic Party.
Iouri Miliukov, Chairman of the Board, Moscow Commodity Exchange.
Oleg Kiselev, Chairman of the Board, MOSEXPO Joint-Stock Company.
Iouri Kotov, President, Moscow Chamber of Commerce and Industry.
Eugene Cherniak, President, KHARBROK Brokerage Firm, Ukraine
Aslanbi Tsev, Director, Maikop Confectionary Factory.
Lioudmila Savro, Director General, LAGUNA Trade Compnay.
Solomon Smoliarzh, First Vice President, STALKER Joint Stock Company.
Elena Kolesnikova, Editor, Economic News Department, STOLITSA Magazine.
Vladimir Lepehkin, Director, Russian Institute
Vladimir Liapin, President Arkhangelsk Branch of International Association of Chief Executive Officers.
Nina Belyaeva, Lawyer
Michael Borukhov, First Deputy Director General, International Association of Chief Executive Officers.
Pavel Chekhutov, Director International Affairs Bureau, International Association of Chief Executive Officers.

United States and Germany

Jay Ambrose, Editor of The Rocky Mountain News.
George Anderman, President, Anderman/Smith International.
Robert Brown III, Managing Director of Public Finance, Lehman Brothers.

Richard Callahan, President of U S WEST International.
Sarah Carey, Steptoe & Johnson
Michael Cheroutes, Principal, Davis Graham and Stubbs; Chair of Governor Romer's Committee on CIS Linkages.
Dr. Rudolf Colle, Boden Oppenhoff Rasor Raue; Advisor to Treuhandanstalt.
Tom Congdon, Director, Anderman/Smith International; Chairman and CEO of St. Mary Parish Land Company.
Jean Galloway, Vice President, K*USA Channel Nine (ABC Affiliate).
Gary Hart, Attorney, Davis, Graham and Stubbs; formerly U.S. Senator.
Bill Hartman, Vice President for International Operations, Paramax Systems Corp.
David Hatcher, Special Assistant to Ambassador Armitage, U.S. State Department.
Timothy Hauser, Under Secretary, International Trade, Dept. of Commerce
Edward Hess, Managing Director, Capital Markets Group, Arthur Anderson & Co.
Don Hoagland, Former Assistant Administrator of AID for Development of Finance and Private Enterprise.
Marshall Kaplan, Dean of the Graduate School of Public Affairs, University of Colorado at Denver.
Richard Kirk, President of American Bankers Association.
Marvin Levy, CEO, Miller International.
David Lipton, Fellow, Woodrow Wilson Center; Economic Advisor to the Russian Government.
Dave Lougee, K*USA Channel Nine.
Cliff May, Associate Editor, The Rocky Mountain News
Don McCall, Vice President for Project Development, Newmont Mining.
Bruce McCandless, Program Manager, Martin Marietta.
James Moore, CEO, Ameritrade; Former Assistant Secretary of Commerce for President Reagan.
John Morton, Esq., Principal, Hale & Dorr; Senior Editor, East/West Executive Guide.
Darin Narayana, U S WEST.
John Nelson, Chairman of the Board and CEO, Norwest
Morgan Nields, CEO, Fischer Imaging Corp.
Judith Roberts, Holme, Roberts & Owen
Wayne Robins, President, U S WEST International Network.
Roy Romer, Governor, State of Colorado, Chair, National Governors Association.
Edward Sardella, News Anchor, K*USA Channel Nine.
Alan Schwartz, Attorney, Myler, Stuller & Schwartz; Member, Advisory Board of the International Center for Public Administration and Policy, CU-Denver.
Oltmann Siemens, Director, Division I, Heavy Machinery, Engineering and Plan Construction, Treuhandanstalt, Berlin

Current Economic Situation

Introduction

Russia is undergoing multiple revolutions at the same time. It is creating new democratic political institutions, building new coalitions and creating new protections guaranteeing individual freedom. At the same time, it is transforming its economic system from communism to capitalism. Finally, with the breakup of the Soviet Union, it is redefining its nationhood; new territorial boundaries are being drawn. National and ethnic identities are reviving, causing tensions and occasional violent confrontations within and across republics.

There are numerous problems to be solved -- most attributable to the bankruptcy and breakdown of the old regime, but some also due to the sheer difficulty of managing such tremendous change.

The challenges facing the leaders of Russia and the other states of the former Soviet Union are daunting. The exuberance exhibited by Russian leaders at the first meeting of Aspen Forum held just days after the successful defeat of the August coup has died down. It has been replaced by a new realism. Now, the focus is on overcoming problems and meeting challenges. The commitment to political and economic reform remains strong, but there is also a fear that fragile political coalitions could easily break down and chaos could emerge.

The economic situation in Russia and the other newly independent states that once comprised the Soviet Union is very difficult. Much of the Aspen International Forum was devoted to analyzing the current economic situation and the policies put in place by the Yeltsin government.

In describing the current economic situation, delegates cited a number of key negative economic factors facing Russia. They include:

- production declines;

- an imbalanced economy;
- breakdown of distribution channels;
- inter-enterprise arrears;
- rising prices and declining purchasing power for the ruble;
- weakening balance of payments;
- difficulty in controlling money supply;
- impending unemployment;
- lack of understanding of market economics.

There was considerable consensus regarding this description of circumstances, but differences of opinion regarding the relative importance to assign to these different factors, to cause/effect relationships and to policies that ought to be pursued.

Production Declines

Output has declined by some 20 - 30% over the last year. The biggest impact has been felt in the larger industries, particularly those that are a part of the military-industrial complex.

An Imbalanced Economy

Overall, the Russian economy is imbalanced relative to Western experience. The industrial sector is very large while the trade (wholesale and retail) and services sectors are underdeveloped. For example, in the U.S. in 1986, the trade and distribution and service sectors accounted for approximately 70% of employment. In the U.S.S.R. in 1988, these same sectors accounted for 32% of employment..[1]

The Soviet economy was disproportionally based on the military-industrial complex. With the fall of Communism and the rise of a democratic regime friendly to the West, there is less need to maintain such a large military complex.

The military-industrial complex has been dependent on a range of subsidies, including cheap access to energy and other raw materials, access to rationed foreign exchange and

[1] David Lipton and Jeffrey Sachs, Prospects for Russia's Economic Reforms, Paper Prepared for the Brookings Panel on Economic Activity, September 16, 1992.

heavy budgetary resources for investment projects. With the fall of communism and the shift to a market economy, these industrial enterprises face a lose of orders for production as well as a squeeze on the supply side as they lose their privileged access to resources.[2]

Disruption of Supply and Distribution Channels

Another reason for production declines is the breakdown of the command economy and the break-up of the Soviet Union into separate states. Supply and distribution channels have been severely disrupted.

The command economy was highly centralized. Responsibility for supplying parts or components to the entire country was often assigned to single locations. These supply channels no longer function well. First, supply networks that were once fully "domestic" are now international as the former Soviet states have declared their independence. As shortages emerged, various levels of government restricted exports, seeking to keep scarce supplies at home. This, of course, made problems worse.

> Economic indicators suggest a decline of more than 20% in total output. The biggest impact has been felt in the larger industries. In part, this was due to the decline in the budget for military equipment. We undertook price liberalization prior to structural change. This has made it hard for our factories to sell the goods already produced. The break-up of the Soviet Union has hurt production as it was designed to work as an integrated whole. Typically, there was but one supplier of any given part or item. Now some of the parts necessary to the production sequence are produced outside of our borders. There have been interruptions in the flow of materials. Factories are used to receiving orders from the center, telling them what to produce, when and where to deliver it. This has broken down. Some materials that have an outside market have been pulled out of the system, causing shortages within the system.
>
> Alexander Titkin

The break-up of the Union has resulted in other barriers to trade among the republics. There are tensions among the republics regarding the distribution of the old Soviet Union's assets and liabilities. Early on, an agreement was reached regarding the appropriate division of responsibility for servicing the international debt accumulated by the Soviets, although carry-through on commitments has been limited. Furthermore, disputes continue regarding control of assets -- for example, the Black Sea fleet and embassy

[2] Ibid. pp. 7-8

> Trade relations among the former Soviet republics are very difficult. This is partly due to currency issues. My business is in the Ukraine. We are shifting from rubles to our own currency called coupons. I also have found it difficult to transfer funds to my partners in Russia. When the funds go through the Central Bank, they choose to keep them rather than pay them to my partners. They say it is the Ukrainian share of Soviet debt repayment. Hence it is easier for me to do business with anyone but Russia.
>
> Eugene Cherniak

properties abroad. These disagreements have sometimes interfered with payments for cross-border business transactions. This translates into shortages of key parts or other inputs to the production process.

Supply and distribution channels have also broken down because, with the choice implicit in a free market, some have chosen to buy or sell their goods in different places. Enterprises with products in demand on the world market will export them to gain access to hard currency rather than supply them domestically.

Inter-Enterprise Arrears

Many enterprises have significant debts, usually to other enterprises that supply them with parts or finished products. Many also have money owed to them because they in turn have shipped product without receiving payment. Even enterprises that have balanced their books on paper (that is, being owed as much as they owe) face a liquidity crisis.

Given weak or non-existent laws on bankruptcy and no system for collecting interest on money owed, enterprises have little incentive to clear up arrearages.

Rising Prices, Declining Ruble

Prices for most goods at both the wholesale and retail level have risen dramatically as a result of the Yeltsin/Gaidar decision to remove price controls in January 1992. Within three months after decontrol, wholesale prices rose approximately 900%. For many people, particularly pensioners, growth in incomes has not kept pace.

Balance of Payments Problems

For several years, a balance of payments problem has been developing. Natural resources have been the primary export yielding foreign exchange. But oil and gas production and consequent dollar earnings have declined. To maintain imports in light of export declines, the Soviets depleted foreign exchange reserves and accumulated substantial foreign debt, which it has been unable to make payments on.

Another factor in declining exports has been the breakdown of trade relationships with the Eastern European countries. As they asserted their independence, trade became a matter of choice and it shifted to a hard currency basis.

The scarcity of foreign exchange makes it difficult to import goods, some of which are critical to production processes in the former Soviet Union.

Difficulty in Controlling Money Supply

During 1991, each republic established its own central bank. With each having the authority to issue credit, it is extremely difficult to stabilize the currency.

Within Russia, the central bank reports to the Parliament. It has been pursuing easier credit policies than Yeltsin's economic team would prefer, causing considerable political tension.

Impending Unemployment

Unemployment is still low in Russia -- under 1% according to official estimates. While official unemployment is low, many workers have been asked to work reduced hours. They remain on the payroll but are receiving less than full pay.

Everyone fears that large state enterprises will soon begin to shut down causing mass unemployment (as high as 30 - 40%) and social unrest. Even without shutdowns, employment in existing enterprises is expect-

> My company has been assisting with the privatization process. We see whole divisions of large companies that are not competitive. Some have 70% more employees than are needed. Within the same companies we see other divisions that would be very competitive in the world market.
>
> Jim Moore

ed to drop as they begin to make staffing decisions based on market cues. Several of the Americans and Europeans who have looked at communist enterprises noted a consistent pattern of over-staffing relative to Western businesses.

Lack of Understanding of Market Economics

A lack of understanding of markets also accounts for decline in production. For years, enterprises were told by the state what to produce and where to send it. Now they must adjust their production to something that will sell on the open market. Even managers anxious to embrace the new system lack knowledge of accounting, pricing, marketing and personnel management.

> To move forward, we need to change not only structures but also our people and our culture. We need to change our psychology to develop concepts of individual responsibility. We must change attitudes towards work.
>
> Iouri Kotov

While all of the Russians attending the meeting were very supportive of a shift to a market economy, many felt that considerable changes in attitude among the Russian people were required before a full transition could occur. A shift in culture is required within the workplace. Managers have been rewarded for meeting production quotas not for identifying niches in the marketplace. Indeed, many have a distaste for preferences revealed in the open market. Rewarding workers for productivity has not been the norm and inefficient staffing patterns and work habits have been tolerated.

Among the broader public, there is a wariness of capital and capitalists. This is not surprising given the ideological message that had prevailed in Russia for so long. For many years, it was a crime to engage in commercial "middleman" operations.

Russian Policy Under Yeltsin's Leadership

During 1992, Yeltsin's government under the leadership of Yegor Gaidar pursued a number of economic policies designed to move the economy to a market basis. The policy had a number of elements, which for simplicity are grouped in two categories.

1. **Monetary and fiscal stabilization efforts** including price liberalization to bring supply and demand into better balance and signal where production ought to occur; and tight monetary and fiscal policies to limit inflation.

2. **Steps to encourage the development of a market-based economy and encourage foreign trade and investment** including privatization of state property and creation of institutions and a legal framework needed to support private business activity and trade.

General Assessment of Reform

Both Russian and American delegates agreed on the need for and desirability of developing a free market economy in Russia and the other newly independent states. They all agreed there needs to be a shift in the economic base -- away from heavy industry and towards consumer products and services. Likewise, they agreed it was necessary to encourage the development of new private businesses and proceed with the privatization of state enterprises. Prices and production levels must be determined by market forces rather than administrative fiat.

> Everyone agrees change is necessary. The real question is how to determine the practicality and timeliness of any action. We differ on how and when to implement change. We have differences of opinion as to how we should increase productivity. Some want to focus on our existing large enterprises -- to create a favorable environment for them to change. Others want to focus on new small enterprises.
>
> Konstantin Zatulin

While there was clear agreement regarding goals, there was disagreement on how to go about achieving them and what is the appropriate pace of reform. Many among the Russians felt that the approach to reform must be altered to prevent the wholesale destruction of Russia's productive capacity and avoid serious social unrest. Others (mostly westerners) felt that "shock therapy" remained the best course of action. Backing off from tight monetary and fiscal policies and propping up inefficient enterprises would lead to hyperinflation, which they argued was an imminent danger, that could destroy the social, economic and political fabric of the nation. Russian and American supporters of Gaidar argued that calls for restructuring were really veiled requests for protection by the old nomenklatura, fearful of losing their formerly privileged position.

Monetary and Fiscal Stabilization Efforts

David Lipton, an American economist who has advised the Yeltsin government, defended the tough policies that have been adopted including of price liberalization, reduced budget deficits and tight controls on credits. The first task of the Yeltsin government had to be financial stabilization, he said. During the waning years of Communism, steps had been taken to prop up the regime that caused financial chaos. The money supply had gotten out of hand. The budget deficit approximated one fifth of GNP, financed by money issue. A substantial foreign debt was incurred in just a few years and foreign exchange reserves were depleted. Wage payments had outstripped official prices -- a legacy of decentralizing decision-making to the enterprises without market disciplines in place.

Production was stable or declining and demand was spurred by wage adjustments, but prices remained subject to controls. By January 1992, there were serious shortages of goods in the markets, long queues and a money system that was breaking down. Transactions increasingly involved barter rather than currency. That situation could not last without risking instability.

Price liberalization, in Lipton's view, had the desired effect. Prices rose, but goods reappeared in the markets and currency once again became the basis for transactions. Rising prices have been wrongly accused of causing a decline in living standards. In fact, Lipton argued, the reforms merely "restored real wages to historical levels justified

by productivity. ...restored wage-price relations that had prevailed before the 1987 communist-led changes in enterprise autonomy."[3]

The gains from the price liberalization could be lost, however, if money supply is allowed to rise through the liberal issuance of credits (through inter-enterprise loans and the central bank) and the rise in budgetary deficits. Russian policy is mistakenly moving in that direction, Lipton argued. Under pressure from Industry and Parliamentary leaders, the government agreed in July, 1992 to a 300 billion ruble credit expansion to deal with inter-enterprise arrears. That money is being allocated by the deputy minister of finance. In July and August, the central bank gave another 420 billion rubles of credit to commercial banks. Government got 370 billion to support the budget during the third quarter. In addition, the bank was providing credit to other republics to support trade.

Lipton argued that the credit expansion might not be such a problem if it were supporting the investment required for economic restructuring. Rather, he argued, the money is allocated to the politically powerful, goes into wage adjustments and maintaining inefficient enterprises. The country is at risk of hyperinflation and destabilization, Lipton concluded.

Several of the Russians were more skeptical of policies affecting prices, the budget and money supply. Their arguments regarding price liberalization were as follows. In the long run prices have to be set by the marketplace. But so long as the economy is dominated by state enterprises, the prices that emerge are not the result of market forces, but rather are administratively determined by monopoly producers. Consumers are uninterested in or unable to afford many of the goods produced at the prices charged.

> Price liberalization in our circumstances made little sense. Only owners can establish real prices in response to supply and demand. With the state remaining the sole owner of most goods, all we have is higher state-determined prices. With such arbitrarily-set high prices, no one wants to buy. A private owner would discount the price to move inventory and a self adjusting process would start. The director of a state enterprise cannot adjust prices readily, He needs to go to the ministry. We've had goods go sour at the dairy rather than discount the price to move the product. The problem is bureaucratic control. Higher state prices help the enterprises balance sheets look good. The inventory is valued at these higher prices. This allows them to justify more debt.
>
> Iouri Miliokov

[3] Lipton and Sachs, Prospects for economic Reform, Sept 16, 1992 p. 11

I must correct some common misconceptions regarding the Russian economy.

The first misconception is that Russian industry is not competitive. Competitiveness is determined by several factors including the technological base, the skills of employees and managers and market knowledge. We operated in a system in which there was no incentive to compete. We never had a chance to sell our product on the market -- to redesign it to meet preferences established int he market place. We shouldn't dismantle our enterprises until we've given them a chance to try competing.

The second misconception is that the fittest will survive and the weakest will die. Given the tight interdependence among our industries and the pattern of single suppliers for most goods, when a weak firm dies it will bring down stronger enterprises with it. It will cause these others to go under because there are no alternative sources of supply.

The third misconception is that our salvation lies in small enterprise. We should not confuse issues of size and ownership. Big companies are the base of every economic system -- they are the skeleton. The smaller companies exist around them, within their sphere of influence. Small companies can start and die with little consequences to the overall economy. But when large companies get shaky, it is very dangerous.

The final misconception is embodied in the term creative destruction. I recognize that our economy is imbalanced and that we need to readjust. We have too many resources and too many people working in state enterprises, particularly those serving military needs. We need to convert existing enterprises, not simply destroy them. To allow them to die will entail too many social problems.

Alexander Titkin

We agree we should not be concerned if the drop in production only involved tanks. However, it involves a wide range of our industries. In the West you have numerous players. The death of one is not serious for the role will be rapidly filled by another. Your economic environment is like a tropical rain forest. A tree may die, but the conditions are prime for a new seedling to emerge. My country is like a tundra. Tracks will remain thirty years because the environment is so harsh, new growth is slow. We are a country made up of monopolists. If a firm is lost, it will be difficult to replace.

Mark Masarski

Price liberalization would be a more effective policy if greater attention is paid to the context in which prices are set. "The free market is a matter of law as well as economics." argued John Morton. "In the west we have laws prohibiting enterprises from conspiring to set prices. In Russia there are several factors that militate against the rapid liberalization of prices including the influence of organized crime, problems of monopoly, and problems of high demand. You need policies that address these issues."

It would have been better, some of the Russians argued, if the government had focused first on developing a private sector and privatizing enterprises. Then enough of a market apparatus would have been in place to ensure that prices would reflect market considerations. According to several of the Russians, this was the approach Gorbachev favored.

Creative Destruction or Creative Maintenance?

More generally, the Russian delegates expressed a great deal of concern that large state enterprises would be forced to shutdown as a result of price rises, inability to access credit and efforts to balance the state budget. The ramifications of shutdowns would be serious for the economy, political stability and Russia's long-term position in the world.

> I disagree with the statement that there is too much money. The real issue is that we do not produce enough goods.
>
> Mark Masarski

> I object to the idea of shutting down our industries and selling our raw materials. We will transform our productive capacity.
>
> Lioudmila Savro

The state enterprises, argued the Minister of Industry, were not given time to restructure themselves so as to adapt to market signals. This means some continue to produce things for which there is no current market. Goods that sold easily at artificially low prices are less attractive to consumers when sold at higher prices allowed under new economic policies. This leaves state enterprises with inventory they can't move and a need to restructure themselves very quickly. Obviously this is inefficient and must change. The issue, the Minister argued, is time and access to the resources needed for restructuring.

Closures would have terrible consequences, the effects of which would be hard to contain. In a capitalist economy, one Russian private entrepreneur argued, the closure

of any one firm is not so serious. There would be others ready to step into the gap, supply the same product and potentially employ the displaced workers. According to several of the Russians, it would be different there. Very likely, there would be no alternative supplier of the part or product in question and it would take time for new companies to emerge. Hence all of the other firms dependent on that part or product would also fail.

> What happens if large enterprises lay off large numbers of workers? I fear a total breakdown of law and order. . . . If we go more slowly, we can restructure our industry and retrain our workforce.
>
> Aslanbi Tsev

Dislocated workers would have a very difficult time finding new jobs. Relocation within the country is still difficult, given serious shortages of housing. Within their own communities, the private sector is too small to absorb the displaced workers. Furthermore, the enterprises are the underpinnings of their communities. They organize many of the services available to community residents, that in the United States would be the responsibility of government or voluntary associations.

In addition, some Russians argued that the large state enterprises have many strengths including a sophisticated technological base and a skilled work force. What they lack is an understanding of market economics. Given some time, they could learn about markets and restructure themselves to be productive and competitive. There was a fear that if enterprises go bankrupt, Russia would lose its advantags and emerge as a second rate economic power. The Minister of Industry argued that small businesses are essential and must be built, but that large companies are the base of every strong economy. Russia, he argued, needs to restructure and privatize its large enterprises, not destroy them.

> Large enterprises are the backbone of the Russian economy.
>
> Alexander Titkin
>
> In the American economy, the role of large businesses has been waning. Small businesses create most new jobs. They are the drivers of growth.
>
> Marvin Levy

Other Russians were critical of Gaidar's tight monetary and fiscal policies although for somewhat different reasons. Several private entrepreneurs and politicians expressed the view that the combination of policies now in place was deterring investment in productive capacity and hurting the emergence of new private sector businesses. Mark Masarski,

winner of the CIS entrepreneur of the year award, expressed concern about high levels of taxation and difficulty in obtaining credit. "A certain level of budget imbalance and inflation must be accepted at this time... Our first priority must be investment in the economy. .... Yeltsin and Gaidar are building capitalism without capitalists. I am a capitalist and I don't seem them representing my interest. They say they love me but they are good at hiding their love."

Nikolai Travkin, a leader of the centrist reform coalition known as the Citizens Union, suggested that "we had a better climate for the emergence of small private enterprise under Gorbachev than Gaidar." Current policies, he said, do not effectively promote business development or provide a stimulus to work harder or produce more.

Other Russians argued that current government policies discriminated against private enterprises. "Government has plans to refill operating capital and to settle inter-enterprise arrearages. But neither plan extends to or applies to private enterprises. Aid is not getting to many of the enterprises that need help. Instead of nurturing private enterprises, government is ignoring them." argued Iouri Kotov. "I am ready to write my request to go back to the state system because there is more benefit to being in that system than as a privatized structure."

Several of the Americans suggested that some number of enterprises must fail because they are inefficient and/or do not produce products demanded in a free market. The process is one of creative destruction, they said. The only way to correct the imbalance in the Russian economy -- to reallocate resources from heavy industry to light manufacturing and the service sector -- is to let the large and inefficient state enterprises fail.

Yes, there would be pain. And yes, some provision would have to be made

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To prop up collapsing industries , particularly those producing unnecessary military goods, goes against our view of common sense and is against our interest. It simply postpones the day of shutdown and restructuring and increases the price tag.

John Morton

Maintaining unproductive enterprises is the most costly approach to dealing with unemployment. You produce goods that cannot be sold. The labor cost associated with those goods is only 10 - 20% of the total. If the raw materials associated with those products were sold on the open market, you could probably raise sufficient funds to pay unemployment compensation and retraining.

David Lipton

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to help displaced workers. But this could be done through unemployment insurance, retraining and re-location assistance. More importantly, it could be done more cheaply that way than by propping up inefficient state enterprises that continue to produce products for which there is no market.

"Unemployment must be dealt with." agreed Othmann Siemens, a key figure in the East German privatization effort. "But it should be outside of the company. If you deal with unemployment by maintaining production, you pay the full range of production costs on top of your labor costs."

If you double the money supply, prices will rise. If your currency is unstable, you will not get either domestic or foreign investment. ..... if you prop up industry to avoid unemployment, you will have serious destabilization of your currency and hyperinflation. It is these conditions that led to Hitler's rise in Germany. Hyperinflation in your country could lead to equally bad consequences -- to increased regional strife and a loss of legitimacy for the state. There is a clear tradeoff here -- incur the costs of unemployment or the costs of financial chaos.

David Lipton

Interest rates almost always exceed inflation rates. Therefore 100% interest rates in Russia are no surprise. Depreciation in the value of a free currency is almost always greater than the inflation rate. Serious decline in the value of the ruble is therefore expected. The tragedy is that we think both these factors will continue to get worse because of our expectation of more inflation.

Darin Narayana

The policies that might save the state enterprises would wreak havoc on the economy, argued many of the Western economists attending the meeting. If the policy is to save state-owned enterprise, it is almost inevitable that the private sector will suffer. Discriminatory policies will be followed.

Furthermore, when credit is extended to the state enterprises and massive budget deficits are incurred, it expands the money supply and causes hyperinflation. Once the process starts, it is very difficult to stop. Hyperinflation will defeat efforts to build a new productive private sector because no one will be willing to invest capital. It causes as much pain to the populace as unemployment and will undermine the reform movement.

Creating a Supportive Environment for Private Enterprise, Foreign Investment and Trade

> It is necessary for us to create opportunities for private investment. Only when we have numerous normal business relationships with lots of different firms in lots of countries will we be integrated into the world economy.
>
> Alexander Titkin

To successfully reform its economy, Russia must develop a strong private sector and attract foreigners to buy its products and invest capital. The Russian government has stated its commitment to the development of a market-based economy and full integration of the Russian economy into the capitalist west. Although it faces considerable opposition and has had difficulty in implementtion, the government is pursuing privatization of state enterprises and is trying to build the necessary legal and institutional infrastructure required to support private business activity, foreign investment and trade.

The second part of the Aspen International Forum focused on these elements of Russian policy -- how successful it has been in creating conditions in which private enterprises -- foreign or domestic -- can prosper.

Privatization: What, When and How?

A major change under Gorbachev and continued by Yeltsin was a lifting of the prohibitions on free enterprise. Private businesses can form. The doors to foreign investment appear to be open.

The Yeltsin government has announced procedures for privatization of existing state enterprises but the pace of implementation has been slow. The task of privatization is bigger in Russia than in most of the East European nations. The state dominated the Russian economy to a greater extent and for a longer period than elsewhere. Until the mid 1980s, more than 95% of production was in state hands.

The procedure for privatization involves the formation of joint stock companies. Companies may pursue either of two options. The first option allows employees to get 35% of shares free or at discounted value and managers to get 5% of shares. The remaining 60% are reserved for the Russian government, which in turn will sell them to a strategic investor and/or to citizens under the voucher program. Option 2 allows managers and employees to buy 51% of the enterprise outright but at 1.7 times the book

value of the shares. As of October 1992, about 40% of large firms (with more than 1000 employees or fixed capital valued at more than 50 million rubles) had submitted plans for corporatization. Half had chosen the first option.[4]

Whiles plans are underway, the actual pace of privatization has been slow. Many small enterprises engaged in retail and service activity have been privatized, but very few of the larger firms.

Many of the Russians were critical of the privatization effort. State enterprises are becoming "private" but with no shift in the locus of control. Decisionmaking remains with existing managers and the labor collective, none of whom have a real understanding of capital or market economics. Rather than restructure the enterprises, they are "bleeding" them of resources until they fail.

Several Russians argued that control of the former state enterprises must shift to new investors -- to people with an understanding of capital. The existing labor collectives should get an ownership stake, but not control decisionmaking.

Most were also critical of a Yeltsin plan for vouchers, implemented in Russia while the Aspen meeting was occurring. Each person in Russia will be given a voucher for 10,000 rubles (equal in value to $50 or less) allowing them to purchase stocks in privatizing companies. Most saw the plan as a crass political move, with little meaning for theeconomy and no benefit for the Russian people. Some argued that the people are being cheated since the value of the vouchers was based on an assessment of fixed capital as of January 1992, prior to price rises and substantial inflation.

> Private investors won't come unless they have confidence that state enterprises are being phased out. They fear that the state has more muscle and more access to money. It would be unfair competition unless the state side is out of business.
>
> Othmann Siemens

Some Westerners argued that there must be evidence of a clearer commitment to privatization and a speeding up of the process before foreign investors would be willing to take an equity position in former state enterprises. So long as a state sector is maintained, there is a perception that competition will not be fair. The

[4]Celestine Bohlen, "Russians to Share State's Wealth in Start of a Shift to Capitalism," New York Times, October 1, 1992 p.A1,A6

state will protect its own, giving its enterprises preferential access to supplies, distribution channels, and credit.

Other Westerners insisted that the concept of private property had to be broadened. While Russian law calls for privatization of enterprises, the status of land is uncertain. Yeltsin favors private ownership of land but has not yet secured Parliaments support on this issue. Several Russians seemed confident that private enterprises would gain title to the land. Others, however, suggested that local authorities were likely to move very slowly on this issue.

The Need for Conditions Conducive to Business

Tremendous economic opportunities exist within Russia and the other newly independent states, agreed members of both delegations. On the other hand, uncertainty and risk are also very high. Not surprisingly, Westerners tended to focus on the problems associated with doing business in Russia while the Russians tended to focus on the need for a pioneering spirit and the high rewards to risk takers.

Forum participants described numerous impediments to doing business including an uncertain legal framework; an onerous tax system; unclear ownership and jurisdictional disputes; currency and banking system problems; weaknesses in supply and distribution networks; lack of protection for intellectual property; and a weak physical infrastructure.

Uncertain Legal Framework

The laws necessary for a market economy to function have not yet been adopted or systematized. Some important steps have been taken, however. Legal forms for doing business with limited liability have been defined. Western firms can work in conjunction with Russian enterprises (through joint stock companies) or they can establish wholly owned subsidiaries. The Russian Federation has offered guarantees against expropriation of property.

Even so, many other aspects of law pertinent to commercial dealings remain uncertain. The law itself is skeletal. Details are filled in by regulation, decree or actions of individual bureaucrats. These are issued frequently as governments try to "fix" problems that arise. There are numerous contradictory laws, decrees and regulations at any given level of government and across levels. Many things are decided as "exceptions" to the rules. Known laws are applied or enforced unevenly.

There is no one place where relevant laws and regulations are available and no officially endorsed translation of laws. Russian officials also have difficulty keeping abreast of applicable law and regulation.

Without well-established laws, contract negotiations are protracted. Many things must be detailed in the contract that in other settings could be appended by reference.

> You can't get clear answers in Russia right now on many of these issues. There are flaws in our legal base. The rules of the game have not been fully elaborated. Under these circumstances, Western investors should reduce risks by finding a stable partner who is willing and able to take on the burden of responsibility for protecting their interest.
>
> Iouri Kotov

The Russians generally agreed that the legal framework is somewhat confusing and changeable but noted the positive aspects. They argued that a reliable Russian partner can help foreigners weave their way through the system. In effect, they can secure what is needed to make a deal work.

According to Russian lawyer Nina Balaeva, "There are ways of resolving conflicts in law. The skeletal structure of the law may be to your advantage. Through negotiation of individual contracts, you can fill in the blanks and help to establish the rules of the game. You should view it as an opportunity." Rather than establishing law as a matter of administrative fiat, the Russians hope to build a new body of law from the bottom up. Eventually, the practices agreed to in contracts will be codified and a more stable framework established.

Westerners tended to object both to the "personalization" and the "adhocracy" that characterize the business environment. The uncertain legal framework adds time and cost. Uncertainty makes planning difficult and increases the risk that something in place today might later be overturned.

Tax System

The tax system was criticized on two grounds. First, tax rates are very high. Specifically noted in discussion were import and export duties and personal income taxes

imposed on foreigners living and working in the country (marginal rate of 60%).[5] As onerous as taxes are on foreign investors, they are harder for Russian businesses since tax incentives have been offered to spur foreign investment.

> I am reminded of a time in our history. Alexander I is said to have asked one of his generals who had been victorious on the battlefield: "How can I reward you?" The answer he got was: "Make me German, it will decrease my taxes." History often repeats itself.
>
> Mark Masarski

Another concern is that the tax system has been subject to continual change. Deals that make good economic sense under one regime may become unprofitable under another.

Unclear Ownership and Jurisdictional Disputes

Under the Soviet system, the state was the owner of most real property. Under the reforms, the individual enterprises have the rights to control their production but the state is still the owner of the land, plant and equipment. Different levels of government have an interest depending on the type of industry. Western firms interested in making a deal have a difficult time knowing who needs to be on the other side of the table. Do they deal with the enterprise, the Federation-level ministry, or the regional authority?

There is also a concern that a shift in power could lead office holders to repudiate previous agreements. Several companies that had negotiated with the Soviets effectively had to start over with the shift in power to the Russian Federation.

Some Westerners suggested that the Russians have to move beyond their existing commitment to private property. Now there can be private ownership of plant and equipment and of business interests but not necessarily of land. Clear title to land was viewed as essential by many in both delegations while others felt that a

> In the western world, there is a feeling that land ownership is critical to free enterprise. Privatization of industry will be difficult if no provision is made for land ownership.
>
> Rudolph Colle

[5] In Russia, businesses must pay a 28% value added tax, 32% profits tax, 37% payroll tax, 15% tax on investment income, variable export duties, a property tax and a locally set tax on land use. See Holger Jenson, "Russia stumbles toward capitalism" Rocky Mountain News October 3, 1992

system of law could be developed that secured sufficient rights to use but kept ownership with the state.

Currency Inconvertibility, Lack of Hard Currency and Other Banking System Reform

The ruble is not readily convertible to hard currency. Multiple exchange rates exist and rules governing movement and use of currency keep changing. This makes it difficult for foreign firms to plan investment and repatriate profits.

There is a shortage of foreign currency reserves within Russia. This makes it difficult for Russia to import foreign goods and forces consideration of barter arrangements -- an awkward approach for modern business transactions.

The shortage of foreign reserves led the Central Bank to freeze hard currency deposits of firms in Russian banks. This kind of illiquidity is not acceptable to foreign investors.

The banking system is ill-prepared to support a market economy. Under the old Soviet system, there was a distinction between cash money and non-cash money -- the former used for wages and retail purchases and the latter for everything else. The banking system hasn't yet moved beyond this. Enterprises with bank deposits cannot count on being able to withdraw those deposits in the form of cash.

Overall, the payment system is inadequate. It can take months after a transaction for payments to be made (explaining in part the inter-enterprise arrears discussed earlier). In the West, commercial banks arrange for money payments through a system of correspondence accounts. The central bank doesn't have to be involved. In Russia, one legacy of the old centralized system, with its interest in control rather than efficiency, is the requirement that the central bank be involved in and keep a paper record of all payment transactions. This is a cumbersome and time consuming process.

There are none of the conveniences that businesses expect in making transactions and keeping track of funds. At the consumer level, there are no checking accounts, credit cards or consumer debt.

The Russians suggested that the banking system is improving. Episodes of freezing dollars should stop soon partly due to the involvement of the IMF and World Bank. Also private banks offering a fuller range of services are developing.

Source and Distribution System

Foreign investors worry they will be hurt by the same breakdowns in source and distribution systems that are hindering production by Russian enterprises. It is hard to get raw materials and or/distribute finished products in the former Soviet Union.

The Russians simply responded that the emerging private sector includes lots of "middle men" activities. With a reliable Russian partner, it is possible to overcome these problems.

Intellectual Property

There is inadequate protection of intellectual property rights for patents, copyrights and trademarks. This makes foreign firms unwilling to bring specific technologies or products into joint venture arrangements.

The Russians agreed this was a problem and one suggested that at least in the short run "It is better to invest dollars than ideas."

Infrastructure Problems

A final impediment to doing business in Russia and the other CIS countries involves weak transportation and telecommunications infrastructure. The old Soviet Union did not wish its citizens to communicate freely with the rest of the world. All long distance phone lines were channeled through Moscow and the service is clearly below the level expected by modern businesses. Likewise, the transportation system does not provide extensive linkages with foreign countries.

Balancing Opportunity and Risk

The Russians acknowledged that many of these problems exist but expressed frustration at how much attention was being paid to them. They viewed Russia and the other newly independent states as pioneer territory -- a new frontier. Uncertainty and risk characterizes such an environment, but so too does opportunity. With an adventurous spirit, inventiveness, persistence and a trustworthy Russian partner, most problems could be overcome.

Furthermore, the Russians argued, many benefits would accrue to the foreign investors who got there first. A Russian stockbroker suggested: "It is to your advantage to enter our markets early. Russian people like stability and tradition. They form loyalties. The

first products on our market will retain an advantage even after competitors enter the market and offer greater choice."

> I thought that businessmen,by definition, take risks. If everyone had always focused on pre-conditions and having all of the necessary legal, economic and physical infrastructure in place, no western european would ever have come to America. No American would have moved west to your frontier. Russia is the new klondyke. Yes the conditions are primitive and there are dangers. But there are also opportunities. Where is your pioneering spirit?
>
> Iouri Miliokov

The Russians felt the Americans were unrealistic in their expectations as to the speed at which the transition to a market economy could occur. They felt that foreign investment was an important input to the achievement of a successful transition. Instead, they were being told to accomplish it all and investment would follow.

Some of the American delegates were comfortable with the approach laid out by the Russians. They agreed that opportunities outweighed risks and that the best approach was to find a trustworthy Russian partner. Mutual interests can be found and investment can yield profits. ***(See box on page 24 for statements by American businessmen expressing these views.)***

There are a number of reasons why western firms find Russia an attractive place for investment. First, there is a large potential consumer market. Second, Russia is very rich in natural resources needed in the rest of the world. Third, Russia has a number of high technology products that were developed in secrecy and in support of the military or space operations, but that could have other applications. Western firms are interested in licensing some of these technologies. Finally, Russia has a very skilled labor force available at relatively low cost.

Different companies will be interested in one or the other of these factors. Several westerners discussed their business activities in the former Soviet Union. A number -- such as Tom McCloskey of McCloskey Enterprises , Don McCall of Newmount Mining and George Andermain of Andermain/Smith International indicated they are involved in developing natural resources. Bruce McCandless of Martin Marietta indicated his firm is exploring the licensing of certain technologies in the aerospace arena. Dick Callahan of U.S. West spoke about several of their contracts to provide telecommunications services. Various infrastructure development projects are being assessed by Gary Hart

of Davis, Graham and Stubss and Jim Moore of Ameritrade. Morgan Nields said Fisher Imaging is selling high technology medical equipment to the Russians. It is also contracting with a Khazak facility to manufacture some lower technology products at a much lower price than can be done here.

No one disagreed with the assessment that great opportunities exist, but many Americans felt their Russian counterparts were not taking the problems that had been discussed seriously enough. Finding a trusted local partner is important, but it is not enough. The structure and environment must also be conducive. Without major efforts at restructuring, several of the Americans suggested, foreign investment will not occur in large amounts. Investors calculate the cost of putting together a deal and they assess risks. If transaction costs and risks are too high, they will invest their money elsewhere.

> I am concerned with the Russians' response to our identification of impediments. We have heard why it's not all that bad and how, with a pioneering spirit, everthing will be all right. . . .I am not suggesting that law can substitute for a relationship of trust. I am telling you that uncertain law and an unstable economic situation increases the level of effort to make a deal. That influences investors' decisions to go elsewhere. ... Unless you focus on the impediments we have identified, you will not get the level of investment you need to realize the potential that we all agree exists.
>
> Judith Roberts

Despite high levels of interest and broad agreement that tremendous potential exists within Russia, businesses are holding back on investment. Thus far, American businesses have invested only about $400 million in the CIS. American investment in Russia and the CIS lags behind investment in East Europe.

Several Russians and some Americans claimed that American businesses have been overly cautious. They suggested that investors from other parts of the world have been more willing "to deal" despite the problems. According to the U.S. Dept. of Commerce, however, only two countries have higher levels of investment in the former Soviet Union than the United States --Germany and Finland.

Several Americans suggested that small deals would go through in this environment, but not large ones. Likewise, private closely-held businesses might be able to move forward while publicly-held companies, with greater demands for accountability, would have difficulty. Others suggested that until greater stability and certainty are achieved, Russia would attract foreigners, but they would be of the wrong type -- speculators anxious for a quick profit rather than investors committed over the long haul.

I do business in Russia. I consider my investment to be very high risk. But I also see the potential for very high returns. ...We purchased an American company that had made a substantial investment in Russia but lost it all. They had not succeeded because they took a corporate approach to investment. They tried to establish a full corporate structure on the ground. We are taking an entrepreneurial approach betting on the jockey not the horse. When we purchased the bankrupt company, we were primarily purchasing a bundle of relationships that they had established with Russians. We view our role here is to act as a support system for our Russian partners. We provide all sorts of support, some not so closely related to business activity but all of which have value because they cement a relationship of trust and mutual responsibility. The lack of legal structure in Russia means I have little security for my investment. If my partner chooses to keep my money there isn't much I can do about it. But the relationship is built on trust and mutual benefit, not contract and law. In effect I am betting on my partner's acumen and honesty and on the potential value of being the ones who got there first.

Tom McCloskey

I believe business-to-business relationships are possible with mutual interest on both sides. The key to success is finding the right partner -- one that is honest, sincere and willing to work hard. You need a sense of humor and a lot of patience. You need to structure the deal right so that you minimize the exposure of capital and maximize training at the management level. You also have to be prepared to break the rules on occasion or nothing gets done. .... I visited several factories before I found one I could deal with. Mostly it differed from the others due to the quality of its management. The machine shop and injection molding was very near western standards. They offered a price equal to 10% of what we would have paid for the part in this country. ...The product shipped has met our quality standard 97% of the time.

Morgan Nields

The mineral industry has proceeded with a number of joint ventures. Perhaps circumstances in this industry have forced us to have a higher tolerance for risk. We would welcome a reduction in the number of obstacles but deals can be made now in Russia.

Don McCall

U.S. West decided there were good opportunities in Russia and we are pursuing them. We have entered into three contracts to provide international gateway services ...With these efforts the total capacity to call in and out of Russia will increase 400 - 500 percent. We are also installing a mobile cellular phone system in Moscow and St. Petersburg. We are filing license applications for a digital cellular system. We are also talking with the Ministry about building inter-city networks. ... All of our projects are going well. We expect them to be effective and profitable."

Dick Callahan

Western Assistance

Delegates to the Aspen meeting explored at great length the role that Western governments ought to be playing in assisting Russia in its transformation to a market economy. Everyone agreed that financial assistance programs were less important in that transformation than private investment -- by Russians and others outside the country.

Government programs, nevertheless, can play an important role in helping Russian leaders manage the transition and in setting signals for private firms considering trade or investment. The actions of the G-7 nations were described and assessed by delegates from Russia, America and Germany.

> Government institutions -- both international and country-specific institutions -- must provide the catalyst for private entities to conduct business.
>
> Jim Moore

The G-7 Aid Package

In the spring of 1992, after repeated requests from first the Soviet and then the Russian government, the G-7 nations committed to provide $24 billion in financial assistance to Russia. The aid package has four components.

The IMF and World Bank have promised $4.5 billion in balance of payments support loans but only a portion has been disbursed due to various strings that were attached to the money. The second part of the aid package involves $2.5 billion in loans, associated with the rescheduling of outstanding Russian debt.

Part three of the package involves a $6 billion stabilization fund. This will be made available to the Central Bank when stabilization is at hand and an exchange rate is established for the ruble. The money will supplement Russia's very low foreign exchange reserves and will be used to defend currency convertibility at a stable exchange

rate. Finally, individual western countries have offered $11 billion in bilateral credits and credit guarantees.

In addition to the financial package, the G-7 nations have offered to provide technical assistance under a variety of auspices.

The U.S. has an "indirect stake of roughly 20% of the total in the $ 6 billion stabilization fund and the $4.5 billion in contributions of the international financial institutions." Almost none of this involves a budgetary appropriation. As part of the bilateral aid package, the U.S. will provide $620 million in direct budgetary assistance and $2.5 billion in various kinds of credit guarantees from the Eximbank, Commodity Credit Corp and other agencies.[6]

Critique

Russians and Westerners were generally critical of the assistance effort. The program was seen as offering too little, too late, premised on too many conditions. Several delegates noted that the G-7 nations were all somewhat pre-occupied with their own economic problems. Furthermore, domestic political circumstances and election schedules meant that none had leadership in place willing or able to move aggressively on the issue of aid.

Too Little

The size of the aid package was based on an IMF analysis of financial help needed by Russia to maintain critical imports despite shortfalls in export earnings. The aid package offered exceeded IMF's initial estimates of the dollar amount required. Several delegates, however, were critical of the IMF for assuming large declines in Russian GNP and therefore a relatively low need for imports.

Several delegates compared the aid package with the United States' effort following World War II to rebuild the European economy. The Marshall plan provided aid in an amount equal to 2% of GNP in the U.S. Were the same level of aid, measured relative to GNP, offered to Russia today it would amount to $120 billion. Several delegates indicated that the magnitude of the problem was equivalent and the need as important as

[6] Jeffrey Sachs, "Western Financial Assistance to Support Russia's Reforms" Paper prepared for the Council on Foreign Relations, May 14, 1992. pp. 39-40

rebuilding Europe in the late 1940s. There was a consensus that the West ought to be willing to commit more funds to helping Russia although no one expected a Marshall plan level commitment.

Even though the amount promised to Russia by the G-7 nations was relatively small and could do relatively little to develop projects or assist in restructuring the economy, it could have helped the monetary stabilization effort if used appropriately. But, according to David Lipton, even that didn't occur.

Too late

One Russian commented that the delay in putting together the aid package was a factor in Gorbachev's downfall. He wondered if the slowness in disbursement will undermine the Yeltsin regime as well.

Many Americans agreed that the West was late in offering the aid. It has also been slow in disbursing it, thereby further reducing its usefulness. One delegate indicated that as little as $1 billion was dispersed in the six months following the announcement of the package.

Conditions

There was considerable discussion regarding the conditions that are attached to Western aid. IMF is insisting on close adherence to the original Gaidar "shock therapy" approach involving strict budgetary controls, price liberalization, monetary restraint and privatization. Other aid also has numerous strings of a more petty and/or bureaucratic nature.

Among the Russians, there was considerable resentment over Western efforts to dictate internal policy questions and a feeling that some of the offers of aid were paternalistic.

Westerners generally maintained that it was unrealistic to expect anyone to provide aid without conditions. Aid is not given for altruistic reasons but rather as a tool of foreign policy promoting national interests. Many in the West have embraced the idea that it is in their interest to assist its former enemy in dismantling communism and building a capitalist economy, closely integrated into the broader global economy. Such an investment they argue is in the interest of world peace. In addition, it should be in our economic interest as well if Russia's resources and markets are open to world trade.

The west should be prepared to risk some money unconditionally. But the world works on conditionality and Russia needs to accept that. But conditions must be a flexible tool. They are intended to make sure resources can be used effectively.

David Lipton

You promise funds but always with a big IF. The west must take the same view towards this package of assistance as they did the Marshall plan. Now all we are seeing is lots of bureaucratic arguing and procedure, all for insignificant amounts of money . . . .I agree in principle you have a right to specify terms, but if we accept the terms it will require serious decisionmaking and investment on your part.

Konstantin Zatulin

The easiest way to stability is a return to authoritarian government. Is that what Americans want?...We need to be cautious about laying down conditions, if meeting them might hurt the movement toward freedom.

Gary Hart

At least one IMF condition is a threat to democracy. That is the requirement to reduce the state deficit. All social and environmental programs are financed through the budget. We can't share such expenditures with civic society since there is no civic society.

Mark Masarski

Opponents of aid generally believe such a transition in Russia is consistent with American interests. They doubt, however, whether the provision of aid will make any appreciable difference in what happens in Russia.

Even among supporters of assistance, there is concern that the money will be misused or that Russian reform efforts will be derailed. To ease these concerns, a number of conditions have been attached to the offer of aid, designed to protect Western interest in its foreign policy "investment." The purpose of these conditions is to ensure that the money doesn't just "go down the drain."

Ultimately, the Russians accepted the notion that some conditions are appropriate and inevitable. They urged the West, however, to fashion the conditions in a way that is commensurate with the level of aid. The West can't expect to dictate too much in return for so little.

They also suggested that the West is undermining its own investment. If the conditions associated with the assistance package aren't realistic, the aid might never be disbursed. As a result, the reform effort might be undermined and we will all be much worse off. Generally, the American delegation accepted this line of argument.

The discussion of the substance of the conditions roughly paralleled the earlier debate over macro-economic policy. Many

of the Russians questioned the wisdom of Gaidar's policies and felt the West was wrong to condition aid on their continuation without modification.

When asked what type of conditions they would impose if they were in charge of the western aid program, the Russians suggested several things. First they said they would require a commitment to reform evidenced through the direction of change rather than demanding specific steps on a specific timetable. More flexibility had to be given to Russian leaders, recognizing the tremendous political difficulties they face in nurturing the reform movement through a very difficult period. Other reasonable requirements include a commitment to privatization and protection of ownership interests; guarantees regarding equal treatment for private owners and foreign interests relative to state enterprises so long as a mixed economy remains; and stability of policies affecting economic operations.

Mode of Implementation

The IMF was criticized for being too far removed from events in Russia. It has too little presence on site. As a result, it is not adequately communicating its intentions or the meaning of the conditions. Nor is it providing on a day-to-day basis, the level of technical assistance that is needed.

Type of Assistance

The aid package was criticized because it is not designed to support or stimulate investment in Russian productive capacity. It is oriented more towards monetary stabilization than investment and more towards government than the private sector. Several Russians noted that much of the aid was in the form of credits so they could buy Western products. There was little or no support for their building productive capacity that would increase exports. Nor was there much in the aid package that would encourage firm-to-firm relationships. Also, virtually all the assistance is in the form of loans that need repayment not grants.

> The aid is structured to help you as much as us. Aid is earmarked to repay debt to you and to buy products from your firms.
>
> Konstantin Zatulin

> Aid is not getting to many of the enterprises that need help. Instead of nurturing private enterprises, government is ignoring them. It is necessary to help these new efforts. But Americans, like our government, are not doing much. The west is only willing to help through our government structures. But we need that help too. Even more important, we need one-on-one relationships between businesses on both sides.
>
> Iouri Kotov

Both Russians and Americans spoke of the need for aid that gets funds to private companies. One proposal was that a Russian-American private enterprise fund be established, equivalent to funds established for Poland and Hungary. These funds use western money and provide loans to private enterprises. Another approach is to fund experts to go over to work with private enterprises -- to provide them with technical assistance that will help them be successful in unfamiliar market territory.

Policies Defended

> There is no unwillingness in the west to be supportive. The problem is the level of disagreement within Russia as to what they should be doing. We cannot fault the international institutions for the failure of the Russian reform process.
>
> Olin Wethington

Olin Wethington, Assistant Secretary of Treasury, defended the aid package arguing that it included the features wanted by the Russian government. He suggested that all of the international financial institutions recognize the benefits associated with Russian economic reform and view the assistance package as the beginning of a longer term commitment.

Other American officials suggested that governments were doing more to assist Russia and encourage business-to-business relationships than the detailing of the G-7 aid package suggests.

- Trade agreements have been signed and Most Favored Nation status granted to Russian, Ukraine, Moldova, Armenia and Kyrgyzstan;
- Bilateral investment treaties have been signed with Russia, Armenia and Kazakhstan.
- A tax treaty has been signed with Russia.
- Export-Import Bank programs are in operation in Russia, Ukraine, Belarus, Uzbekistan and Kazakhstan. The Ex-Im Bank extends loans, loan guarantees, and trade insurance to American companies seeking to export to Russia.
- The Overseas Private Investment Corporation's programs are available in Russia, Ukraine, Belarus, Georgia, Armenia, Tajikistan, Kazakhstan and Kyrgyzstan. OPIC offers insurance that protects American investors against

the risk of war, expropriation, and difficulties in converting their profits into hard currency.

- The Trade and Development Program is in operation in all 12 of the Newly Independent States. Under this program the U.S. pays American firms to do feasibility studies and other planning services for major projects which are economic development priorities of host countries.

In addition, the U.S. Dept of Commerce has been spearheading activities to identify and resolve obstacles to business relationships; to expedite commercial projects; and to conduct matchmaking activities.

Several delegates suggested that the actions listed don't amount to much in practice. In addition, former Senator Hart suggested that other policies continue to impede joint ventures. He pointed explicitly to outmoded provisions outlawing the export of certain high technology products.

Governor Roy Romer noted that states were also taking initiatives to foster relationships. Colorado is working hard to strengthen its economic and cultural ties with the former Soviet Union. At his urging, the National Governors Association is opening a business relations office in Moscow to put the strength of all the states behind closer ties.

Russian Minister of Industry Titkin indicated that steps were also being taken on the Russian side to facilitate partnerships.

Conclusion

There seemed to be consensus that a broader type of aid package is appropriate, including:

- humanitarian aid (in the form of grants as well as loans) offered on an unconditional basis;
- aid for technical and infrastructural purposes conditional upon Russia implementing a phased program to achieve a range of reform goals;
- a program of debt relief and debt rescheduling also conditioned on continued Russian commitment to reform;
- specific support for private entrepreneurs in Russian;

- efforts that encourage private sector business-to-business relationships.
- reductions in existing barriers to trade;
- expanded technical assistance.

To be effective, the aid package must be premised on a several year time horizon.

The general view among both delegations was that western aid is important but it is no panacea. Realistically, given the size of the Russian economy, it cannot be expected to provide the level of investment needed to rebuild and restructure the economy. To accomplish that there must be increased investment by Russian entrepreneurs and foreign firms and increased trade relationships.

Too much attention to the issue of aid could be detrimental to the international relationship, which it was generally agreed had to be premised on an equal partnership and mutual respect, rather than on a superior-subordinate basis (e.g. teacher-pupil, doctor-patient etc.).

The Aspen Protocols

Delegates to the Aspen Forum felt strongly that a document should be drafted detailing areas of consensus that had emerged over the course of several days of intense, and sometimes tense, discussions. A committee was appointed to meet outside of plenary session and draft a statement characterizing the assessment of the current situation and directions for change.

At the core of the protocols is a common understanding that unless a coordinated package of change is instituted on both sides, the process of transition in Russia toward democratic, free-market institutions will be substantially prolonged and much less certain.[7]

Despite considerable debate during the meeting on the wisdom of specific policies, it became clear that there was little disagreement on the types of changes that need to occur within Russia. The major issue is the pace at which change should occur. The Russians understood that some things need to happen quickly but generally argued for a longer period of transition. They tended to talk in terms of a developmental process, with multiple stages, that could take a decade or more. Reforms must be sequenced and paced to take account of the need to maintain the support of key constituencies and social and political stability.

The Russians want involvement by American businesses and the U.S. government in this evolution. But if this involvement is not based on "mutual respect" and as equal partners, they are prepared to go it alone. No partnership is possible unless the west recognizes the very considerable achievements that were made by the former Soviet Union. Despite recent breakdowns in both the political and economic system, Russians are justifiably proud of the achievements of their country and their status as a superpower in world politics, economics and military affairs. The protocols make clear that the East and West must build a relationship on the basis of equality and partnership rather than on the basis of superior/subordinate or teacher/student or doctor/patient.

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[7] This section draws heavily on the observations of John Morton, one of the principal drafters of the protocol, as reported in **East/West Executive Guide**

Participants in the Aspen dialogue concluded that effective partnerships require that relationships be built on a base of common interest, mutual trust and a deep understanding of each others' perspectives. The Aspen Dialogue is an important part of building these relationships as its participants, through periodic meetings, have come to a deeper understanding of each others' values and behaviors in light of complex and changing circumstances.

Actions were recommended to address:

- Monetary Stabilization and Convertibility;
- Privatization of Enterprises and Land;
- Internationalization and Investment;
- G-7 Responsibilities.

They are detailed in the full text of the protocols.

PROTOCOLS OF THE PLENARY SESSION
OF THE ASPEN INTERNATIONAL FORUM
ASPEN, COLORADO
OCTOBER 5, 1992

RESPECTING the human, technical, intellectual, industrial and raw material resources of the Russian Federation.

UNDERSTANDING the need for social, legal, economic, business, and political evolutionary changes required to assure the future success and prosperity of the Russian Federation.

MAINTAINING that it is in the best interests of the United States and the other G-7 nations and of the global community of nations that the Russian Federation continue to develop democratic institutions and enjoy a future of individual liberty, economic growth and prosperity, mindful of the rights of minorities and peacefully resolving and respecting national boundaries.

APPRECIATING the enormous cultural and economic contributions which a democratic, prosperous and peaceful Russian Federation will continue to make to the global community; and

HOPING through these resolutions and recommendations to expedite, facilitate and assist the G-7 nations and Russian Federation in the rapid and successful integration of the Russian Federation into the global free market and democratic community of nations,

The Aspen International Forum met in Aspen, Colorado from October 1-5, 1992, and there engaged in extensive discussions and debates involving private citizens, government officials, entrepreneurs, economists, business people, attorneys and academicians from Russia, Ukraine, the United States and Western Europe.

On the basis of these extensive debates and discussions, the Forum reached a consensus that the G-7 nations and the Russian Federation should move rapidly to develop policies and implement programs appropriate to achieve the following objectives.

1. MONETARY STABILIZATION AND CONVERTABILITY

That the Russian Federation take immediate steps to achieve monetary stabilization; such steps to include at least:

- the assertion of exclusive control in a single entity over the issuance of currency and credits within the Ruble Area; such control will extend to the Newly Independent States (NIS) only if they volunteer to join the Ruble Area;
- the further development of a commercial banking system which will have as one of its principal goals the funding of private sector enterprises;
- the creation of a strong, politically independent central Bank involving representatives of all countries within the Ruble Area with exclusive control over monetary policy and with statutory or constitutional responsibility to adopt policies which would limit inflation, stabilize the ruble exchange rate against G-7 currencies and create conditions for currency convertibility, and
- the implementation of revenue and spending programs which will have the effect of reducing substantially the Russian domestic budget deficit.

2. PRIVATIZATION OF ENTERPRISES AND LAND

That the Russian Federation take immediate steps to implement policies and programs which will encourage further the growth and proliferation of Russian private enterprises which, we believe, will be the Foundation of Russian growth and prosperity and without which, we believe, there will be no substantial improvement in the standard of living of the Russian people. In this regard, we recommend that Russia at least:

- expand and accelerate a phased program to privatize a substantial portion of its state owned enterprises;
- adopt and implement a phased program to privatize a substantial portion of state owned land;
- adopt and implement laws, tax incentives, training programs and venture capital funds which will encourage the growth and proliferation of individually owned and managed Russian business enterprises; and
- adopt and implement antimonopoly and bankruptcy laws consistent with international commercial standards.

3. INTERNATIONALIZATION AND INVESTMENT

Understanding the need to protect many strategic Russian industries during a period of transition, the Russian Federation take immediate steps to implement phased programs which will permit international participation and ownership of land, raw materials, manufacturing enterprises and other things of value consistent with policies in effect throughout the G-7 nations, including but not limited to:

- tax laws and policies which encourage international investments and treat foreign nationals equitably and fairly;
- import and export duties that encourage international trade and commerce;
- adoption and implementation of laws to protect intellectual property;
- implementation and expansion of laws for the protection of foreign investment;
- participation in international conventions regarding commercial transactions, collateral agreements and dispute resolution; and
- definition of ownership, control and authority with respect to enterprises, raw materials, minerals, natural resources, intellectual property and land so that foreign investors can be certain of the authority of those with whom they deal in Russia.

4. G-7 RESPONSIBILITIES

The forum concluded that World Bank and IMF aid is substantial and is necessary. More importantly, however, an investment climate should be created to promote significant foreign direct investment by private business people in Russian enterprises. That, in the spirit of partnership, the G-7 nations and all other nations in a position to provide assistance to the Russian Federation, take steps immediately to provide such aid, according to the following guidelines:

- that barriers to trade among the G-7 nations and Russia be eliminated as quickly as practicable:
- that substantial, unconditional aid be made available immediately by the G-7 nations for humanitarian purposes including:
  - the importation of food, clothing and medicines to meet short term needs,
  - the construction of housing for returning military personnel, refugees and others in immediate need, and
  - for other immediate, humanitarian purposes to be determined by agreement among the participating states;
- that longer term, more substantial aid be made available for Russia for technical and infrastructural purposes upon the condition that Russia begin to develop and implement a phased program to achieve the goals of monetary stabilization and

convertibility, democratization, privatization, and internationalization described in these resolutions. The amount of aid should be related to the scope and extent of the conditions;

- that the G-7 immediately agree to programs of debt relief and debt rescheduling contingent upon a long term Russian commitment to the reforms outlined in this Protocol;
- that additional technical aid be made immediately available to develop and implement an unemployment compensation system, a financial control system for the banking sector and for local governments, and to develop job retraining and relocation programs, management information systems and internationally accepted procurement policies;
- that the G-7 nations assist in establishing and financing within the Russian Federation's private sector non-governmental venture capital funds specifically designated to support private Russian entrepreneurs through loans, grants equity investments and subsidies; and
- that the G-7 emphasize and expand programs which encourage business-to-business transactions between Western and Russian private enterprises.

CONCLUSION

It is the view of the Aspen Forum that the foregoing programs must be implemented with flexibility with the objective of creating a democratic, prosperous, and peaceful Russia which will continue to develop as an equal and respected partner in the democratic, free market global community.

ADOPTED IN PLENARY SESSION IN ASPEN, CO. THIS 5TH DAY OF OCTOBER, 1992.

THE ASPEN FORUM

By Marshall Kaplan, Co-Chairman

By Konstantin F. Zatulin, Co-Chairman

AND FURTHER ENDORSED BY THE BILATERAL PROTOCOL NEGOTIATING COMMITTEE

John H. Morton, Co-Chair

Nina U. Belyaeva, Co-Chair

Vladimir L. Lepehkin

Edward D. Hess

Clifford D. May

Thomas D. McCloskey, Jr.