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SUMMARY

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Russia's Economic and Political Transition: U.S. Assistance and Issues for Congress

The adoption by Russia of a democratic political system and free market economic system is an objective of U.S. foreign policy facilitated by the foreign aid program funded under the New Independent States (NIS) account of the foreign operations appropriations. Since 1992, an estimated $2.3 billion has been obligated to assist this transition.

The history of the aid program has been characterized by a declining amount of resources, multiple objectives, implementation problems, and mixed results. Some programs have had little positive impact and others have been affirmatively appraised by many observers. Most assistance activities have exposed many Russians to previously inaccessible U.S. ideas and information.

In 1997 and 1998, there were several important developments in Russia. The 89 regions of Russia became increasingly decentralized and adopted reforms at their own pace. Small and micro businesses grew rapidly, and non-government organizations also grew and began to take on greater advocacy roles. In response, the State Department's NIS Coordinator introduced the Partnership for Freedom (PFF) and the Regional Investment Initiative (RII). The former stressed support for grassroots partnerships between U.S. and Russian business and NGOs, while the latter selected three regions for focused U.S. assistance to improve the business and investment environment.

In 1999, Congress may consider several issues. First, what is the impact of the August 1998 financial crisis on the aid program and how might the program change to meet new demands? Second, what are the lessons of the PFF and the RII experiences that may be continued or applied more widely in the Russia aid program? Third, what legislative conditions on assistance might affect continuation of the transition aid program?

The August crisis has caused the State Department to reexamine the program. More funds are being targeted on helping non-governmental organizations survive this difficult period. The PFF and RII were both active in Novgorod and this experience suggests a number of lessons applicable to the whole Russia program. These include that assistance should be designed to meet local needs and to focus on reformers to create models of success, that aid for economic growth and civil society complement each other, that exposing Russians to the United States is a positive force for reform, and that change at the federal level is necessary to make reform work at the local level. It should also be noted that some legislative conditions on assistance—for instance that Russia should end the sale of nuclear reactor technology to Iran—would cut or terminate the aid program in any form.

Abstract

The adoption by Russia of a democratic political system and free market economic system is an objective of U.S. foreign policy facilitated by the foreign aid program funded under the New Independent States (NIS) account of the foreign operations appropriations. Since 1992, an estimated $2.3 billion has been obligated to assist this transition. This report reviews the history of the program, focusing on the more recent Partnership for Freedom and Regional Investment Initiative. It considers several issues of possible interest to Congress, including the impact on the aid program of the August 1998 financial crisis and of legislative conditionality. This report will not be updated.

Introduction

The economic and political future of Russia, a priority concern of U.S. policymakers since its emergence from the ashes of the former Soviet Union at the end of 1991, has been placed in sharp relief as a result of the August 1998 financial crisis currently threatening its national stability. The belief remains widespread among experts and politicians that the adoption, in some form, by Russia of a democratic political system and a free market economic system would be the best possible outcome for the United States and the world community. To that end, the United States has supported an array of programs under the New Independent States (NIS) Account of the annual foreign operations (foreign aid) appropriations, providing financial and technical assistance—an estimated $2.3 billion worth obligated for Russia programs to date.[1] The current crisis suggests, to some, that this work has been unsuccessful and, to others, that there is much more work to do.

From the beginning, the United States government recognized that the resources it was willing to provide on a bilateral basis alone would be unequal to the task. When the 1992 FREEDOM Support Act legislation, which authorizes the bilateral aid program, was first announced, the Bush Administration presented it in the context of a larger multilateral effort. The division of labor has remained the same since—the United States, as with other bilaterals, provides mostly grant technical and humanitarian assistance. Like other bilateral donors, it also issues commercial export credits and guarantees (through the Export-Import Bank, the Overseas Private Investment Corporation, and the Department of Agriculture) to serve the dual purpose of supporting U.S. jobs and Russian economic development. The international financial institutions, led by the International Monetary Fund (IMF), provide larger-scale financial aid, to encourage significant structural and fiscal economic policy reform.[2]

Because the bilateral economic aid program allows the United States to influence the course of Russia's transition, it has been a major focus of congressional interest. This report, based partly on extensive interviews conducted in Russia in 1998, looks at the status of the aid program and

[1] In addition, a number of U.S. agencies have used their own budget resources—$3.6 billion worth in obligations to the end of September 1998—to fund programs tied to more narrow purposes. These are mostly composed of 5 programs: Department of Defense Nunn-Lugar Cooperative Threat Reduction Programs ($1 billion); Department of Agriculture food aid ($1.3 billion); Department of Energy nuclear safety and materials protection ($484 million); the NASA space station ($662 million); and USIA's educational and cultural exchange program base budget ($115 million). The latter works closely to support the democratic and free market objectives of the NIS program and receives additional funds as well from the NIS account.

[2] Russia currently owes the IMF $18.7 billion, the World Bank $5.7 billion, and the EBRD $4 billion (the latter funds provided to both public and private sector).

discusses issues relevant to ongoing congressional discussions on the consequences of the financial crisis and the efficacy of the assistance program.

Background

Significant changes in the U.S. aid program during the past two years can best be understood in terms of its prior evolution.[3] Key aspects of the program's history might be characterized in broad terms as follows:

Availability of Resources

Responding to arguments that the Russia program was underfunded in its first two years, the Clinton Administration proposed a significant boost in funding for FY1994. Competing for the same pool of funds as other NIS countries and subject to congressional disapproval of its government's behavior, Russia's allocation then declined. In FY1998, with the Administration arguing strongly for an increase, Congress approved sufficient regional amounts to make modest Russia increases possible. Nevertheless, since FY1996, each year Russia has received less than the Administration requested—53% of the FY1996 request, 55% of the FY1997 request, and 53% of the FY1998 request. In FY1999, however, 77% of the FY1999 request for Russia programs was met.[4] The FY2000 Administration request would maintain the transition program at roughly current levels.[5]

Table 1. NIS Account Assistance for Russia

(in $ millions)						
FY92-93	FY94	FY95	FY96	FY97	FY98	FY99
350	1,300	341	137	95	129	172

[3] Previous analyses of the aid program are in two CRS reports: 95-170F, *The Former Soviet Union and U.S. Foreign Aid: Implementing the Assistance Program, 1992-1994*; and 96-261F, *Russia and U.S. Foreign Assistance: Issues in 1996.*

[4] Amounts appropriated for Russia for FY1999 and previous years may be eroded, however, if the emergency supplemental appropriations currently under consideration is signed into law. The Senate-approved version, S. 544, cuts unobligated Russia aid by $10 million and FY1999 NIS aid by another $2.3 million, while House-approved H.R. 1141 cuts aid to the NIS account by $25 million.

[5] The Russia NIS account request is for $295 million, $122 of which, however, is dedicated to the Expanded Threat Reduction nonproliferation security initiative.

The large FY1994 pool of funds, spent out over several years, is now depleted, and the number of individual activities conducted has been reduced substantially. In the past two years, USAID has phased out or closed 40 projects. As a result, many argue, the amount of assistance provided to support transition programs in Russia remains insufficient for a country of such signal importance to the United States. How much is enough is a question annually faced by Members of Congress, who must weigh competing foreign policy requirements against domestic budget constraints.[6]

Multiple Objectives and Targets

Although there is general agreement among policymakers that the chief overarching purposes of the NIS account program are to facilitate democracy and a free market economy, the program has been highly atomistic, supporting numerous objectives, from health to energy efficiency to nuclear nonproliferation. The FREEDOM Support Act specifically authorizes activities in some 13 broad sectors, further legislation and congressional report language has supported or earmarked dozens of projects in diverse sectors, and both the Bush and Clinton Administrations have introduced projects that meet short-term political ends, sometimes as showpieces or just to "get something on the ground."

Further, the program has sought to affect a vast nation of 148 million people, at the federal, regional, and local levels in government, as well as grassroots non-governmental sectors. Although budget cuts have focused the program to some extent in recent years—with health and environment more prominent, agriculture cut, etc.—it remains diffuse. In addition, pressures to expand programs continue to exert themselves.

Table 2 provides an indication of the breadth of sectors covered under the NIS account program. Most of the USAID programs listed were composed of numerous projects implemented by hundreds of contractors and grantees. Today, the USAID private sector project, with vastly reduced resources from a few years ago, consists of over 30 sub-activities run by more than two dozen organizations.

Difficult Implementation

The assistance program has been an experiment, with long odds and obstacles constraining successful accomplishments. Initially, government aid implementors had little understanding of Russia, only a few contractors had experience in the country, and no one had a proven formula for successful transitions from communism. Many pilot demonstrations never led to or merited follow up activities. There were few connections between projects, and little sharing of information and lessons learned among implementing contractors and grantees. There was considerable squabbling among the more than 18 U.S. government agencies involved in the program. Aid was supposed to "follow reform," but, while waiting for these reformers and reforms to emerge, projects were funded that had inconclusive or unsatisfactory results.

[6] Looking at all U.S. programs in Russia, the funding priority given democracy and free market reform has diminished greatly relative to security issues. In the period FY92 to FY98, transition objectives represented 35% of all U.S. activities in Russia. In FY98, they account for only 20% and are projected at even less in following years.

Table 2. NIS Account Programs in Russia: FY1992-1998

(obligations in $ millions)			
USAID Programs			
—NIS Special Initiatives (Humanitarian, etc.)	55.4	—Energy Efficiency and Market Reform	85.3
—Environmental Policy and Technology	60.5	—Health Care Improvement	87.9
—Private Sector Initiatives	544.5	—Food Systems Restructuring	46.1
—Democratic Reform	133.5	—Housing Sector Reform	202.8
—Economic Restructuring and Financial Reform	77.6	—Eurasia Foundation	21.4
—Enterprise Funds	266.0	—Exchanges and Training	87.4
—Energy and Env. Commodity Import Program	59.5	—Farmer to Farmer Program	16.8
U.S. Department of Commerce			
—Business Information Service for NIS (BISNIS)	4.2	—Business Information Service in Russia	1.0
—American Business Centers (ABCs)	10.2	—SABIT Business Intern Program	11.3
—Commercial Law Development Program	1.8	—Business Development Committees	0.7
—Consortia of American Businesses in NIS	4.5		
USIA Freedom Support Act Exchanges			194.2
U.S. Department of Energy			
—Nuclear Reactor Safety	88.6	—Initiatives for Proliferation Prevention	30.7
U.S. Department of State			
—Humanitarian Assistance (Transport Costs)	57.8	—INL Anti-Crime Training and Tech Asst.	23.1
—INR Title VIII Research Program	7.5	—Science Centers	28.5

(obligations in $ millions)			
U.S. Department of Justice Criminal Law Asst.			1.3
U.S. Trade and Development Agency (TDA)			42.7
Peace Corps			13.5
U.S. Nuclear Regulatory Commission (NRC)			11.9
Environmental Protection Agency (EPA)			15.5
U.S. Department of Agriculture Exchanges			
—Cochran Fellowship Program	2.4	—Faculty Exchange Program	0.7
—Collaborative Biotech Research Program	1.0		
U.S. Department of the Treasury			
—G-7 Support Implementation Group	2.7	—Technical Advisors	7.6
Congressional Research Service Parliamentary Support			1.9
TOTAL CUMULATIVE OBLIGATIONS			**2,310.5**

Source: Office of NIS Coordinator, Department of State

These and many other problems associated with the early years of the program have been addressed to varying extent by the State Department's NIS Coordinator and USAID, the chief U.S. government implementing agency. In particular, it is worth noting that diverse efforts have been made, including the designation of coordinators in several regions, to bring the various programs together for information exchange and collaborative activity. The duplication of many different exchange programs has been somewhat ameliorated by housing most in USIA. Inter-agency disagreements seem to be resolved with less rancor, due, in part, to the NIS Coordinator. The decline in funding, although too precipitous for some, may have had the effect of weeding out unsuccessful and poorly designed programs.

Although the initial lack of experience in Russia has partly been addressed by time, the "Russification" of the program has also aided implementation. This has involved the widespread hiring of Russian professional staff by USAID and USAID-funded contractors and grantees. In addition, there are increasing numbers of Russian indigenous organizations that have the capacity to manage U.S. funded programs in ways that meet U.S. standards of accountability and openness. For example, in 1995, a corps of Russian professionals who worked on Urban Institute-managed housing policy projects left to create their own Institute for Urban Economics, which is now expected to become a prime contractor for USAID.

Mixed Results

The multiplicity of goals, difficulties in implementing them, and shortage of resources have affected the results of the assistance program. Amidst a scattershot and multi-sector approach, the program's impact was significant in some areas and marginal in others. It was instrumental in encouraging change, but also came up against barriers to change in Russia itself. In judging program results, many observers caution that such programs at best can only hope to influence the course of change that is primarily domestic-driven.

There are many examples to illustrate possible successes and failures of the assistance program, but such characterizations are subjective and prone to critical interpretation. For example, privatization of the state controlled economy was one area of reportedly substantial U.S. influence. The United States provided extensive technical advice, equipment, and other help to the Russian Privatization Center that organized the privatization of more than 15,000 medium to large state-owned enterprises from 1992 to 1996.[7] However, a number of observers have criticized the way in which the Russian government chose to privatize, using a voucher system that ultimately may have allowed national assets to pass into the hands of a few oligarches.[8]

The U.S.-Russia Investment Fund (TUSRIF), one of many enterprise funds set-up in central Europe and the former Soviet Union since 1990, is another example of a project suggesting both positive and negative features. Like the other funds, TUSRIF, a private sector entity whose operational and working capital comes from the U.S. government, provides loans, equity capital, and technical assistance to businesses of all sizes. It emerged in 1995 from the ruins of two earlier regional Russia enterprise funds that had been plagued by management difficulties and poor investments. TUSRIF, itself, has had its own management problems and high operational costs. It was slow in fulfilling its original primary mission of making equity investments—a mission, some argued, made irrelevant because of the more than 60 private sector equity funds in Russia with which it competed prior to the August 1998 financial crisis. In addition, the U.S. government originally promised TUSRIF $440 million, a high proportion of the total aid program, preventing other, perhaps more worthy, programs from receiving funds. On the positive side, however, TUSRIF has, with the encouragement of USAID, shifted its emphasis from making equity investments to lending capital to small businesses and helping pioneer home mortgage and auto lending in Russia.

A more affirmatively appraised program is the Eurasia Foundation which helps grassroots organizations and individuals build democratic and free market institutions. The Foundation, whose Russia activities received $13.5 million in FY1997, conducts a competitive small grants program in which an average of $17,000 is provided to help recipients conduct specific activities. These activities encompass the purchase of textbooks by an education business training institute, the conduct of seminars on legal issues for newspaper representatives, a voter education project, support for a small business newspaper to expand its coverage to include business legislation, and help to set up a website on Russian agriculture that includes current crop prices for the benefit of local farmers. In addition, several other programs, funded separately, target a specific geographic region and/or sector—crime and corruption, NGOs (non-governmental organizations) in the

[7] According to the GAO, $58 million was spent on these mass privatization activities. In addition, USAID supported a wide array of programs to reform the policy and regulatory environment in which the private sector functions.

[8] See for example, Janine Wedel, "The Harvard Boys do Russia: How the Best and the Brightest Helped Destroy the Russian Economy," *The Nation*, June 1, 1998, and Government Accounting Office, *Foreign Assistance: Harvard Institute for International Development's Work in Russia and Ukraine*, November 1996, NSIAD-97-27. For a contrary view, see Daniel Kaufman and Paul Siegelbaum, *Privatization and Corruption in Transition Economies*, Journal of International Affairs, Vol. 5, No. 2, 1997.

Novgorod region, and small agriculture loans in the Saratov region. From its Washington office, Eurasia runs a partnership program through which U.S. institutions provide expertise. Harvard University, for example, helped the Moscow City Administration develop mortgage law and procedures. Women, Law, and Development International, a Washington-based NGO, conducted a year long training program for Russian lawyers who defend women's legal rights.

In addition to facilitating specific projects, one of the Foundation's main aims is to build local institutions. Through the grantmaking process, it works to show organizations how to achieve their goals, meet financial reporting requirements, and assess their own progress. Even for those who don't receive grants, efforts are made to explain how they could improve their chances of receiving future awards. As a result, the Foundation, almost entirely staffed by Russians, is very much in touch with grassroots activities throughout the country. Its support of innovative activities generates much goodwill toward the United States. Further, it provides grants too small for USAID to manage cost effectively itself, and it leverages $2 from private donors and grant recipients for every $1 from USAID.

A review of the entire assistance program would show numerous discrete examples of assistance, like those of the Eurasia Foundation, that many would argue help to generate private sector activity and facilitate the growth of civil society. These include an association of women providing business training and support in Staraye Russia, a business "incubator" in St. Petersburg where clients can learn the ropes of fashion design, find start-up work space, and lease necessary equipment, and, a loan to help start up one of the country's first car wash businesses in Moscow.[9] While these activities may not have an impact wider than a few dozen families, they may be building blocks of something much larger.

Some question the value of these activities in meeting U.S. foreign policy goals. They argue that only activities that help change government policies or introduce new institutions have a widespread systemic effect. Others, however, suggest that even small activities have the potential to be disseminated throughout the country if they are successful, and, as one USAID official has suggested, the cumulative impact of facilitating the growth of hundreds of businesses and NGOs may be to create demand for change at the grassroots level that cannot be ignored by the top.

At the very least, it can be said that most assistance activities—even the failures—provided exposure to new ways of thinking for people long isolated from information and ideas behind the Iron Curtain. They have exposed government decision makers to how things are done throughout the advanced industrial countries in energy, health, and economic policy, farmers to coops and credit unions, and bankers to consumer lending practices. They have also connected hundreds of NGOs to each other through the internet and seminars, trained hundreds of print and television journalists, and introduced thousands of young people to free market concepts through Junior Achievement.

Trends in Russia's Transition and U.S. Initiatives: 1997-1998

Russia's economic, political, and social life has experienced dramatic change since the country's rebirth six years ago. While the U.S. aid program has sought to influence the course of these

[9] These projects were implemented by IREX, the Center for Citizens' Initiatives, and the U.S.-Russia Enterprise Fund, respectively.

developments, several recent important trends in Russia have stimulated significant changes in the content of U.S. assistance.

Trends in Russia

Importance of the Regions

There may be a tendency to see Russia as a monolith, but it is a set of 89 regional governments. Like U.S. states, each region is quite different from the next—some with great natural resources, human resources, or prime geographical locations. Regions have become increasingly decentralized both as an intentional result of the national reform process, and, unintentionally, where the central government has been stymied by lack of reform. Regional governments are adopting free market and democratic reforms at a varying pace. Regions have been given new taxation powers, and some have been allowed to experiment with land sales that are still restricted under federal legislation. These trends have all accelerated after the August 1998 crisis. Price regulation has been introduced in 87 of the 89 regions, some regions refuse to contribute taxes to the federal budget, and some have suspended federal law.

Development of Small and Micro Business

The development of small and micro business is important to Russia's long-term economic growth as well as for the emergence of a politically stabilizing middle class. Both grew exponentially after the collapse of the Soviet Union. No one can say how many microenterprises exist, but small business is estimated to have leveled off at about one million in recent years—compared to 23 million in the United States. While there is considerable visual and anecdotal evidence of new small businesses—fashion design, car washes, bakeries, fast food restaurants—many barriers have prevented business from reaching its full potential. These include onerous taxes, payoffs of mafia for protection, license requirements (it is said that Russians need more than 50 signatures to open a business), lack of access to credit, lack of accounting and other business skills, and lack of support from government.

Growth of NGOs

Since 1991, there has been an explosion in the numbers of non-governmental organizations (NGOs) to more than 150,000 legally registered, an estimated 65,000 of which are civic-oriented. They represent mostly the interests of business, veterans, environmentalists, the disabled, and women. Most are quite weak and poorly organized, with small memberships and little financing. A number, however, are growing stronger, taking on advocacy roles, adopting fundraising techniques, and dealing directly with government. While most local governments view them with suspicion, some, such as Petersburg and Novgorod, are bringing them into the process of governance by listening to their concerns prior to making law. Novgorod has begun to open the provision of its social services to NGO contractors.

U.S. Initiatives

Over the years, the U.S. aid program has contributed to the development of regional and local government, small and micro business, and NGOs. While the highest proportion of aid spending went to policy reform in the central government in the early years, funds have shifted increasingly away from Moscow. By FY1998, more than 72% of USAID funds went to areas outside Moscow. Efforts were made to introduce land reform, health care, and energy efficiency to local and regional officials. Establishment of business training schools, credit windows, and consulting

services sought to tackle some of the leading obstacles to small and micro business growth. Institutional development of environmental and other advocacy NGOs and the linking of Russia and American NGOs characterized efforts in support of civil society.

In 1997, the State Department and USAID adopted two initiatives that sought to increase the flow of assistance to the regions and to grassroots business and NGOs.

Both approaches characterize the current assistance program in Russia.

The Partnership for Freedom (PFF)

The Administration proposed the Partnership for Freedom in its FY1998 NIS account budget request to Congress. With respect to the Russia program, the PFF sought to reverse the decline in assistance levels, make the program a longer-term endeavor, and move the program from one focusing on technical assistance for central government to one stressing people-to-people private sector business and grassroots civil society development. Specifically, the PFF emphasizes economic growth activities such as loan programs, business training, investment funds, business-oriented exchanges, and anti-crime activities. It also stresses linkages to support civil society, including support for NGOs, professional exchanges, and cooperative linkages between U.S. and Russian community organizations such as hospital partnerships and charitable organizations. The proportion of USAID assistance obligations going to support the civil and economic private sector rose from 56% of the program total in FY1997 to 92% in FY1998, from $84 million to $126 million.

Regional Investment Initiative (RII)

Announced in February 1997 by the Gore-Chernomyrdin Commission, the Regional Investment Initiative is more narrowly focused than the PFF. Under the RII, three regions—Novgorod, Samara, and the Far East—were selected to receive a special infusion of funds for programs designed to improve their private investment climate.

The Initiative was designed to address individually the concerns of target regions, while emphasizing programs in which the United States has a "comparative advantage." The Novgorod RII, for example, includes support for the development of land registration, availability of credit for small and microbusiness, consulting services for small business, and the establishment of an agency to promote Novgorod to foreign investors. The Russian Far East RII provides, among other things, an investment and finance advisor to Khabarovsk, training to government financial managers, and grants to help establish private business associations and to assist environmentally focused economic projects. In Samara, the RII includes provision of seed grants and business training to help emerging high technology enterprises, training to assist business in adopting International Accounting Standards, and training for lawyers and the local marshals's service on enforcement of contract law disputes.

The State Department hired a coordinator for each region to act as an interface between local and regional governments and the U.S. programs. In FY1998, $17 million was set aside specifically to finance RII activities. The current three RIIs are expected to be expanded to four in the near future, and the NIS Coordinator envisions that each initiative is likely to last two to three years, with more phased in as others end.

Issues for Congress

What is the Impact of the August 1998 Financial Crisis and How Might the Assistance Program Change to Meet New Demands?

Until the financial crisis of August 1998, there appeared in Russia to be a semblance of economic stability and movement toward greater reform. After the crisis, there is considerable uncertainty in the economic as well as political environment. To many observers, the Primakov government's proposed plan of action to overcome the crisis appears inadequate.

The first U.S. response to the crisis is described by officials as a humanitarian one—the offer of $885 million in food grants and loans. This assistance is coming from the Department of Agriculture program budget, not the NIS account, and is partly motivated by U.S. domestic farm price stabilization objectives. To the extent that it goes directly to vulnerable groups within Russia, it may do some good. However, some believe that it may cause harm to transition objectives if sale of food products provides profits to corrupt government officials or prevents private farmers from getting a good price for their domestic goods. U.S. agriculture officials insist that the program will be carefully monitored to avoid corruption or misuse of food aid. The first food shipments arrived in mid-March 1999.

The NIS assistance program, which is designed to deal with specific identifiable problems in the transition process, may have to change its strategy to deal with new problems emerging from the crisis. In an October 2 speech, Secretary of State Albright said that the United States was reexamining the program and "retargeting money where it can be used effectively to support economic and democratic reform."[10]

The crisis has seriously affected the efficacy of some existing programs and damaged U.S. efforts to promote change in certain spheres of activity. For instance, in the current environment, it appears unlikely that the Russian federal government is serious about the kinds of policy reform currently promoted by the aid program or that efforts to attract foreign investors under the RII are likely to be productive. As a result, the NIS Coordinator is planning on reducing further policy reform assistance on tax reform and securities markets, and is downplaying the investment aspect of the Regional Investment Initiative.

The crisis has had other immediate impacts. The freezing of bank funds prevented NGOs and independent media from drawing on accounts established with donor funds, reportedly forcing some reductions in NGO staff and programs. Advertising revenue for independent TV, radio, and newspapers, long targets of U.S. support, has also declined—by as much as 80 percent, according to one source. In response, USAID grantees have sought new banking arrangements for supplying funds to NGOs. The National Press Institute and Internews, which implement the independent media projects, are focusing on helping the media survive the crisis by directing training at cutting budgets and maintaining services in this difficult economic environment. A new program is being designed by USAID that will funnel funds to the best stations in order to help them survive in the short term. On January 25, 1999 Secretary of State Albright announced a $10 million increase in assistance to Russia's independent media, the U.S. contribution to an international effort implemented by the Soros Open Society Institute.[11]

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[10] Speech to U.S.-Russia Business Council, Chicago, Illinois.

[11] *Washington Post*, January 26, 1999, p. 13.

Reportedly, some sectors and programs have not been affected as much as might be expected. The hardest hit banks were those in Moscow. Medium-sized banks in the regions are still functioning and continue to make loans using U.S. government funds. Mortgage lending at the regional level continues to be developed and demand for training in this activity has reportedly gone up dramatically since August 1998. Whether small and micro businesses remain viable and can repay their loans in a difficult economic environment remains to be seen, but Russians have often demonstrated their ability to adapt to such situations and an expanded market for locally produced goods might stimulate new business growth. Demand for such loans reportedly remains strong and USAID intends to seek alternatives to commercial banks for microlending. Although the equity investment efforts of TUSRIF may be restricted now by lessened opportunities of finding solid investments, some argue that these efforts may be eased by the absence of competition from U.S. and other foreign private sector funds that have departed the country.

As a result of the crisis, a number of alterations to the existing aid program appear likely. As noted, the NIS Coordinator expects to accelerate the decline of assistance to the federal government while accelerating increases in the proportion of aid going to the regions. However, consideration is being given by State and USAID to provide technical assistance in the area of bank restructuring and regulation—the sector that directly triggered the crisis and may become a focus of serious attention by the Russian government. Support is also being given to alternative Russian "think tanks" that can in the long run provide economic analysis to the government. More assistance will be given in the form of exchanges—both academic and professional—independent media, bringing the internet to libraries, civil society activities like those of Eurasia Foundation, and small business credit and training.

Under consideration are responses to the humanitarian and social impact of the economic crisis, including programs targeting tuberculosis, assistance in pharmaceutical supplies, and orphans. USAID is also planning on providing technical assistance to local governments to formulate systems that will help them direct their limited resources—provision of basic services such as heating, transport, and school supplies—to the neediest families, following a model of "means testing" developed earlier that has helped municipalities determine who receives housing subsidies.

These changes, most of which were presaged by the PFF in 1997, suggest the Administration is taking a longer term view of the Russian transition and U.S. objectives. The current crisis is viewed by most in the U.S. government as a step backward in a long process of bringing about a transition to a free market economy. But many observers paint a dire picture of events in Russia, making the U.S. aid program, in approach and magnitude, appear a feeble response.

What Are the Lessons of the Partnership for Freedom and Regional Investment Initiative?

The aid strategies embodied by the Partnership for Freedom and the Regional Investment Initiative have been employed for more than a year, and it may now be possible for Congress to address their usefulness in meeting U.S. transition objectives in Russia. Already, the NIS Coordinator has begun to reevaluate and refine these approaches in light of current experience.

The PFF, the broader of the two initiatives, now represents the dominant approach to U.S. assistance in Russia. It is a response to the failure of the Russian central government to act on reforms, and to trends in Congress limiting amounts of aid and aid to the government specifically. By emphasizing grassroots and people-to-people assistance, it may have a modest impact on key objectives.

If one purpose of the PFF is to establish long-term relationships between the people of the United States and Russia, then these are the types of programs most likely to accomplish that end. They create concrete linkages and are more visible to Russian and American publics than policy reform efforts. They are often less expensive than programs requiring provision of expert technical advisers from the banking, tax, and investment sectors. Under many of these programs, a little seed money is provided to local organizations, volunteer experts give business advice, and relationships are created that may later be extended at no government cost.

The drawback of PFF activities is their likely small short-run systemic impact. Were it possible, however, to blanket the country with these activities, their effect might be more dramatic. A number of experts report that the demand in Russia for such grassroots activities far outweighs the ability of the current aid program to fund them.

The RII, on the other hand, significantly increases its potential impact by focusing numerous activities on single regions. It has risked faltering following the financial crisis, because its original investment-focus objective is too dependent on circumstances outside the control of the United States and, perhaps more than the PFF, depends on the success of policy reforms at the national level. In recent months, the NIS Coordinator appears to have favored broadening the RII's narrow focus to include civil society activities, while emphasizing its regional aspect and continuing efforts to create an environment favorable at least to indigenous business. Although its middle "I" may, in effect, have been removed, the term "RII" apparently is still operative.

Strong evidence of the potential effectiveness of the PFF and RII approaches can be found in Novgorod, which served both as a PFF "pilot" and the first of the three RIIs. Novgorod is considered by many observers to be a success story. It has a pro-reform reputation as a place that has used U.S. assistance well.[12] Political and economic conditions throughout the country and in each RII region are quite different, but, as implemented to date, a number of lessons can be learned from the Novgorod experience that might be applied throughout the assistance program in Russia.

Designing Assistance to Meet Local Needs

Too often assistance programs have been adopted with a "cookie cutter" approach—if it worked in Poland, it must work in Russia. The RII and pilot PFF models in Novgorod, by contrast, were characterized by flexibility and designed to meet local needs. In Novgorod and other RIIs, local government officials were consulted at the beginning, asked what their needs were, and provided services that met both their and U.S. interests. The positive thing about the RII is that it is flexible, works closely with local government, and uses a coordinator to respond to needs as they change. Further, most Novgorod officials and private citizens who directly benefitted from U.S. programs repeatedly expressed satisfaction that the U.S. programs, particularly the exchanges, were well-tailored to meet their specific needs.

Focusing Assistance on Reformers to Create Models of Success

A U.S. strategy, implemented unevenly since the beginning of the aid program, has been that assistance focused on reformers would create "models of success" that would then be replicated elsewhere. This strategy has worked in Novgorod, where reformers, predating the PFF and RII, emerged in both the city and oblast governments. Their agenda was strengthened by U.S. programs, and the programs themselves were made more effective by the support they received

[12] See Blair A. Ruble and Nancy Popson, "The Westernization of a Russian Province: the Case of Novgorod", in *Post-Soviet Geography and Economics*, p. 433-446, Vol. 39, No. 8, 1998.

from the local governments. The success of Novgorod as a center of change and investment—in 1997, it was ranked the top region for capital investment per capita—has not gone unnoticed in Russia. Officials of regional governments throughout the country come to learn from the Novgorod experience, thereby multiplying the impact of U.S. assistance efforts and its transition objectives.[13]

Reformist attitudes are not the sole criterion for choosing an RII, however. The Far East did not have a reputation for either economic or democratic reform; Samara is economically reformist, but reportedly has shown signs of resistance to civil society. Their selection was based partly on other criteria—potential investment interest or presence of foreign, including U.S., business, and U.S. political interests. Both locales were more likely objects of U.S. foreign investment than Novgorod, with considerable industry in Samara and natural resources in the Far East. The Far East was also favored by the Gore-Chernomyrdin Commission and is a focus of congressional interest. Assistance has a positive role to play in places that are not reform-oriented—both Samara and the Far East programs include efforts to promote public-private dialogue among government, business, and NGOs. But the Novgorod experience suggests that the program should be ready to jump in wherever promising signs of reform and local government support for U.S. objectives are identified.

Complementary Economic Growth and Democracy Building

The RII was originally intended to focus entirely on growth and investment, but the case of Novgorod, which, by circumstance, also included PFF activities, provides evidence of the efficacy of combining civil society, democracy, and related programs with the more intensive business focus. For one, listening to the people has not been the practice of government in the Soviet Union or its successors. Some would argue that governments open to public views and accepting the advocacy role of NGOs may also be inclined to listen and respond to business associations and business people. In Novgorod, officials have introduced twice monthly public discussions led by an NGO representative. Secondly, Novgorod business officials are not working in isolation from their colleagues in education and other non-business fields—the synergy of one infects the other. Finally, a wealth of U.S.-sponsored activities may enhance overall U.S. influence, especially in the minds of local government officials.

It may be of some concern to U.S. officials that both Samara and the Far East have been reportedly less open to the role of NGOs and programs supportive of civil society than Novgorod. But as the realization has grown that cooperative and democracy building activities help establish a positive environment for reform, the State Department Coordinator's office has noted that other RIIs may broaden their scope.

Exposure to the United States as a Force for Reform

Through partnerships linking U.S. organizations with local ones, and exchanges that bring Russians to the United States, the PFF and RII emphasize the positive impact of exposure to new ideas. Novgorod local government officials returned from study trips to San Diego, California, and Hartford, Connecticut, enthused with new ideas about how government can facilitate development of small business and improve city management. An educational exchange between officials to Boston has generated ideas and goodwill that may spill over into other Novgorod government programs. Numerous small business owners, brought to the United States on USIA Business for Russia programs, have characterized the exchange as "a life changing experience,"

[13] "The Westernization of a Russian Province: The Case of Novgorod", p.438.

which, in addition to practical knowledge of business, taught them that "through hard work they could change their lives." Although training and advice provided within Russia may be more cost effective and often more appropriate, well-prepared and tailored opportunities for Russians to travel to the United States may be powerful ways to convey the message of reform.

Assignment of RII Coordinators to Strengthen Impact

Although responsible for implementing an assistance "strategy," the NIS Coordinator has had a limited presence on the ground. In 1994, an assistant to the Ambassador was designated to report to the NIS Coordinator on all U.S. agency activities. In the RIIs, however, the State Department has created a more direct presence, appointing non-career State Department-contracted coordinators to represent the NIS Coordinator to the regional and city governments and U.S. agencies, and to convey the views of the local governments to the NIS Coordinator.

While coordinators have little direct authority over implementing agencies and their contractors, overall they appear to be performing a vital service in facilitating the program. In Novgorod, the coordinator was a person to whom both government and private sector turned for help. Through the intercession or advice of the coordinator, existing programs were utilized to meet needs, or where there was potential funding, new programs were suggested to State, USAID, or others. Candidates for exchanges were also recommended. The coordinator helped connect U.S. businessmen to appropriate local government officials. The RII coordinator's office enhanced the image of the U.S. program because it gave Russians a sense of the multiplicity and size of the program, previously somewhat invisible because of its disparate nature.

The NIS Coordinator currently anticipates that regional coordinators, at the beginning American citizens, will eventually be replaced with Russians. This has already occurred in Novgorod. One question that arises is whether the much higher cost of American personnel is not worth the benefits that might accrue from having an American represent the State Department to regional governments.

Limitations of a Regional and Grassroots Focus

Ultimately, the purpose of the RII and PFF approaches is to meet objectives of the FREEDOM Support Act by assisting the transition of Russia to a free market economy and democratic system. Where change has been slow from above, the aid program may have been more effective at helping to induce change from below. But there are limits to both regional autonomy and the impact of small-scale grassroots activities. As the August 1998 financial crisis has amply demonstrated, both are deeply affected by a political and economic environment determined at the national level. Until policy is changed at the top, long term economic growth and civil society will not meet their full potential.

One example of this is in Novgorod where officials have used U.S. support to prepare themselves for the benefits of reform at the federal level. A geographical mapping system assisted by the University of Massachusetts, for example, is readying them to take advantage of any federal land law. But local officials point out that they need, at a minimum, the right from the federal level to sell land, a stock market law, and mortgage financing before real changes can take place at the local level.

Sustainability and Longevity of Support

Two recurring questions for observers of the Russia program and for which the RII and PFF provide no clear answer are the extent to which programs are created that will remain active and

financially self-sustaining after U.S. assistance ends, and the degree to which the United States is willing to stick with programs and see them through to some productive closure. Whether because of budget cuts or a change in contractor or strategy, the United States often is involved in funding a particular organization or partnership for only one to two years. This may be insufficient time for new NGOs and business organizations to make their mark or to gain sufficient paying customers or private sector support to ensure financial self-sufficiency, if that is even a realistic possibility in the current economic environment.

Although USAID has put increasing emphasis on sustainability of project activities, they recognize that the issue is complex and there is no agreement on how to ensure sustainability. Sustainable or not, a lack of U.S. funding works to cut programs that, in the uncertain and novel environment of transition countries, might require more nurturing to succeed. Some USAID efforts do address these concerns. As noted earlier, additional funds are being provided to independent media organizations to help them over the financial crisis. Efforts have been made to "Russify" think-tank and business support organizations that can carry on USAID types of assistance. Although the RII in Novgorod is winding down, some follow-on activities are being considered that may extend U.S. involvement in the region. But it may be useful for U.S. aid implementors to assess each and every grantee and aid beneficiary with a view to ensuring that those which are making positive contributions to the Russia transition are not neglected.

What Legislative Conditions Affect Continuation of the Transition Assistance Program?

Congress influences policy directions of aid recipient countries through legislative and report language. The FREEDOM Support Act, for example, provides aid to entice behavior in various sectors, lays out broad economic and political criteria on which to judge how much aid should be provided, and specifies conditions for removal of aid if certain behaviors are pursued.

Use of aid as a carrot to bring about a specific result has been highly successful on occasion. Assistance used to construct housing for Russian officers has been credited with encouraging the Russian military to withdraw from the Baltic countries sooner rather than later.

Use of aid as a stick, however, is more complicated and more controversial. It has been criticized by some analysts and the Administration as inappropriate. First, they argue that the level of aid being provided is insufficient to provoke a change in policy—U.S. assistance is not a cash gift to the government of Russia, but arrives largely in the form of technical expertise and training, mostly for the private sector. And, second, they argue that the aid program benefits the United States by moving U.S. objectives forward, notably the manifest U.S. interest in having Russia make the transition to free market and democratic systems.

Nevertheless, Congress has sometimes given precedence to seeking a specific change in Russia's behavior as a price for U.S. aid rather than to the support of broad transition efforts. Under the FY1999 foreign operations appropriations, Russia is subject to three specific conditions that carry with them the threat of aid sanctions with far-reaching consequences for U.S. economic and political transition objectives.

Iran Nuclear Reactor

Each year since FY1996, Congress has threatened to end or limit assistance if the government of Russia continues to transfer nuclear reactor or related technology to Iran.[14] In 1998, an FY1997 provision triggered a cut-off of $3 million in FY1997-appropriated aid to Russia. Under FY1998 legislation, half of all aid allocated specifically for the government of Russia had to be cut. In effect, what this meant was that of a total $48 million, $24 million was taken from programs aimed at the government and transferred to other, private sector, activities in Russia and to other countries. The FY1999 provision also withholds half of all FY1999-appropriated aid to the government of Russia unless the President determines that providing such aid is in the U.S. national interest and that Russia is taking steps to curtail the transfer of nuclear technology.

FY1998 cuts to the central government affected technical advice on how to reform the central bank, support for tax reform, and other economic policy reforms considered essential for meeting IMF loan requirements. Health reform, judicial reform and crime and corruption assistance were also cut. Efforts to prevent weapons-related scientists from seeking alternative employment in places like Iran and nuclear safety programs lost funding. Also affected were USIA exchanges to the United States targeting political leaders.

The impact of this restriction on U.S. transition assistance objectives was intensified when State Department lawyers defined the term "government of Russia" as including regional and local governments as well as the central government. Many believed it was unlikely that Members originally intended the language to affect regional and local governments, which have no control over the Iran sale and, in some cases, have been a more effective force for reform than the central government. As a result of the expanded definition, at least $8 million intended for regional and local governments was counted, meaning that an additional $4 million of cuts was needed. The cuts did not have to come from all programs equally, so the impact on local government was softened somewhat, but at least 40% of such programs were cut. Nevertheless, the cuts likely have blunted RII efforts and exchange, policy reform, training assistance, and related programs throughout Russia that target municipal, local, and regional government.[15]

For FY1999, Congress, well aware of the broadened definition of "government," approved identical language as the previous year. However, in report language, conferees excluded U.S.-Russia partnerships between hospitals, universities, and environmental institutions. Regional and local governments would continue to be affected.

Religious Minorities Legislation

Since FY1998, appropriations legislation has conditioned aid on whether the government of the Russian Federation implements legislation that would discriminate against religious groups. A law that might do this was approved in 1997, but, on May 26, 1998, the President determined that Russia had not yet implemented it in a discriminatory fashion. Although the Iran condition cuts FY1999 aid to government by half, the religion condition, again adopted in the FY1999 act, would cut all FY1999-appropriated aid to the central government of Russia. On April 15, 1999, Secretary Albright issued a determination that the Russian Federation had not implemented any

[14] For details on U.S. concerns and evidence to support them, see CRS Report 98-299, *Russian Missile Technology and Nuclear Reactor Transfers to Iran.*

[15] Available USAID data suggest a dramatic decline in assistance to the Russian government, from 44% of most USAID FY1997 program obligations to 9% of FY1998 totals. Despite the RII effort, funding for regional governments fell from 26% to 4% of the USAID program.

law that would discriminate against religious groups in violation of international human rights agreements, thereby allowing FY1999 aid to continue.

Customs and Taxes

A recurrent problem since the beginning of the aid program has been the treatment of U.S.-funded organizations and equipment for tax and customs purposes by Russian officials. While an early agreement was reached between the Russian and U.S. governments which the United States believes to be in force, it was never approved by the Duma and was never fully respected by the Russian government. An interim agreement approved several years ago has been subject to arbitrary treatment by customs and tax officials. NGOs and contractors, for example, have been charged customs duties for aid-funded equipment and their employees taxed. The Department of Energy's nuclear safety program was threatened with severe impairment when vital time sensitive equipment was held up at the border, and was only released with the Ambassador's intervention.

In response to these long-standing issues, Congress approved language in the FY1999 omnibus appropriations bill that eliminates all assistance to the government of the Russian Federation—not local or regional government—if, by April 21, 1999, agreement was not reached that ensures FY1999 funds will be excluded from customs duties or that legislation was not enacted and in force that exempts assistance from duties. The President, however, could waive this provision if he found that significant progress had been made toward resolving the customs issue. On April 15, Secretary Albright issued a determination that significant progress has been made on reaching an agreement on this issue, thereby allowing aid to continue. Negotiations on a new draft agreement that would clearly exempt almost all U.S. assistance from customs and taxes (the exceptions were certain luxury goods) were completed on March 29, 1999, and await final Russian government signature.

Although Congress has not adopted sanctions legislation with reference to the similar bureaucratic problem of visas, in its FY1999 bill report the Senate Foreign Operations subcommittee took note of a situation that has seriously affected Peace Corps operations in Russia and could raise the issue in legislation in 1999. Beginning in 1997, it became impossible for volunteers to renew their visas annually. Instead, visas had to be renewed every three months, requiring travel over considerable distances and wasting volunteer time. As a result, the June 1998 class of 44 volunteers was cancelled. Following intervention by the U.S. embassy, the Russian government has told the State Department that they would make provisions to insure the volunteers got visas, but the real test of this assertion will not occur until July and August 1999 when two new classes of volunteers are scheduled to arrive.

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