U.S. POLICY TOWARD RUSSIA, PART I: WARNINGS AND DISSENT

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U.S. POLICY TOWARD RUSSIA, PART I: WARNINGS AND DISSENT

WEDNESDAY, OCTOBER 6, 1999

HOUSE OF REPRESENTATIVES,
COMMITTEE ON INTERNATIONAL RELATIONS,
WASHINGTON, D.C.

The Committee met, pursuant to notice, at 10:10 a.m. In Room 2172 Rayburn House Office Building, Hon. Benjamin A. Gilman (chairman of the Committee) Presiding.

Chairman GILMAN. The Committee will come to order.

It is clear that the path that the Administration has followed over the past few years with regard to Russia is rapidly approaching a dead end. The pattern is clear: Top American officials have repeatedly described Russian President Boris Yeltsin as advancing the objectives of democracy and economic reform in Russia. Yet, for years now, his commitment to those objectives is a bit questionable at best. In fact, some of Mr. Yeltsin's actions have been inconsistent with those objectives and his personal engagement in the day-to-day governance of Russia now seems to consist largely of his routine hirings and firings of prime ministers.

Over the past few years, top Administration officials have pressed the International Monetary Fund to provide bigger and bigger loans to the Russian Government. But witnesses before this Committee, public commentators, and events in Russia itself have shown that providing more loans only leads to the need to provide more loans later on.

Huge amounts of money have flooded out of Russia and are being laundered in non-Russian banks, including American banks, and yet nothing truly meaningful has been done to halt this flood.

If they weren't themselves stolen, IMF moneys have only replaced in part the moneys that have been stolen from Russian industry and from the Russian government. Meanwhile, the Russian economy sinks deeper into a morass while our top officials call for patience and point to few successes.

It is hard to ignore the dismal characteristics of life for many Russians today: life-threatening poverty, contagious diseases, a rising mortality rate, the theft of government pensions and salaries, renewed anti-Semitism and a possible new fascism on the horizon. It is hard to see how Russia will gain the stability we want for it if these circumstances continue to prevail.

In foreign policy, Russian officials tell us one thing and do the other, whether it involves a new Russian military operation in the region of Chechnya, Russia's recent surprise deployment of peace-

keeping troops in Kosovo, or what appears to be continued Russian proliferation of weapons technology to Iran.

Our Committee on International Relations today will begin a new review of our Nation's policy toward Russia and how it has been implemented over the last few years. Today, we will be reviewing warnings that may have been ignored or disregarded over the past few years, warnings that have come from within executive branch agencies as well as from outside. Today's hearing will be followed by a hearing tomorrow morning during which our Committee will gauge the extent of corruption within the Yeltsin government.

That hearing will be followed by a closed briefing for the Committee next week by the Director of Central Intelligence, who will discuss the Intelligence Community's record of analysis and reporting on corruption in Russia.

Our Committee has also extended an invitation, almost 3 weeks ago, to Secretary of State Madeleine Albright or Deputy Secretary Strobe Talbott to appear before the Committee on the issues of our policy toward Russia and corruption in Russia. We expect to receive a positive response to that invitation within the next few days.

Finally, there have been a number of troubling articles and allegations regarding the Administration's willingness to disregard alleged Russian malfeasance. There are questions about the State Department's handling of an alleged assault on a U.S. Naval officer who believes that he was blinded by a laser device while observing a Russian cargo ship near our shores.

In 1996 American businessman Paul Tatum was murdered in Russia, and his family members have expressed their concern that a proper investigation of that murder may never have been carried out due to the possible impact on our relationship with Russia.

There are stories going back to 1995 alleging that an intelligence program was closed down after questioning the extent of Russia's control over its nuclear materials.

Finally, there are questioned about the removal of AID officials who openly questioned events in Russia and the character of President Yeltsin. At this point, I ask unanimous consent to insert in the record statements submitted by Lieutenant Jack Daly, U.S. Navy, and Ambassador Richard Armitage, former coordinator of assistance to Russia with regard to two of these incidents.

Chairman GILMAN. Before I recognize our Ranking Member, Mr. Gejdenson, for any opening remarks he would like to make, I would like to briefly introduce our witnesses. Our first panel consists of two witnesses with experience in the policymaking and analysis that underlies our policy toward Russia.

Ambassador David Swartz is retired from our U.S. Foreign Service, having served in the region of the former Soviet Union. His last post in that region was as our first Ambassador to Belarus. We welcome you, Ambassador Swartz.

Mr. Fritz Ermarth is retired from our Central Intelligence Agency where he worked on intelligence analysis matters. Mr. Ermarth has also served on our National Security Council staff.

Our second panel includes Mr. Mike Waller, Vice President of the American Foreign Policy Council, who has written extensively on

U.S.-Russian relations and our policy toward Russia, as has Mr. Kenneth Timmerman, who is Contributing Editor to Reader's Digest. They will be joined by Mr. Martin Cannon, a member of the Board of Directors of the U.S.-Russia Business Council and the Managing Director of CIS Operations for the firm of A.T. Kearney.

I now recognize Mr. Gejdenson, our Ranking Minority Member, for any opening remarks that he would like to make. Mr. Gejdenson.

Mr. GEJDENSON. Thank you, Mr. Chairman.

Anybody who thought there was going to be a smooth transition from 50 years of totalitarian rule in Russia to an open and free democracy must have never read or observed any history at all. But we have made some progress, and while there is a tendency in the Congress to almost nostalgically go from Port-au-Prince to Moscow, reciting the lower crime statistics and quieter days under dictatorship, the reality is that we have had some stunning successes.

There is no question that the law governing business, the financial irregularities, and even democratic institutions are far from perfect in Russia. But when I look at the situation, I frankly think that the Clinton Administration took a policy that was basically without form and gave it some form and made some progress.

If we take a look at what has happened, we have deactivated 1,500 nuclear warheads. When you compare that to the enormous and proper response in this Congress to one missile from North Korea where there is no evidence of a nuclear warhead at this point, and we hope there never will be, and the destruction of 300 missiles, we have made progress. Nuclear weapons are currently not targeted at American cities. We have denuclearized the Ukraine, Kazakhstan and Belarus. The Russians have withdrawn their troops from the Baltic States, they joined our peacekeeping mission in Bosnia in 1995, and they joined our peacekeeping mission in Kosovo in 1999.

We have a lot of bumps in the road with the Russians. We have bumps in the road with our allies, the French, British, and Israelis at almost every corner. These are countries that have had democratic institutions for decades. We need to do a better job of managing the programs that go into Russia, without any question. We have to demand tougher accounting, better collection of taxes, better enforcement of laws. Do we want to see less crime and less organized crime in Russia? I think we would have the same hope for this country. Are there businessmen who are killed and women killed on the streets of the United States? Yes. Is there more crime in Russia now that there is no longer a totalitarian government? Absolutely, yes.

The process of building a democracy in Russia will be a difficult challenge. Unlike most of the Eastern Bloc, there is no precedence for a civil, democratic and free economy in Russia. There is no history. They went from the medieval days of the czars to the Communist revolution, and they have lived under totalitarianism for 50 years.

At the end of World War II, the United States tried many of the same things. We tried a Marshall Plan that in today's dollars would be $90 billion, and we tried everything we could, from hiring Nazi scientists who had just finished trying to exterminate the

Free World, and we put them under our contract because we didn't want them to go elsewhere. I have witnessed in this Congress an assault on Nunn-Lugar funds which are used to get rid of nuclear weapons and fissionable material that is a danger to American national security.

It sometimes seems to me there is a nostalgia: Gee, if we only had this dictatorship that we knew how to confront, rather than the unsure future of dealing with a country trying to become democratic. Nobody in his right mind would nominate President Yeltsin for head of the League of Women Voters. Frankly, I wouldn't nominate some of the Senators and House Members we have here, when we look at what we have done for campaign finance reform, for the President of the League of Women Voters either. But we are going to have legislative elections in Russia, we are going to have a free Presidential election in Russia. Perfect?

Even some of our elections are not perfect. But let me tell you something, there is not a Member of this Congress or I hope anybody in this country that would prefer the stable, Politburo-run country that used to exist in Russia to the turmoil we are facing today. We ought to focus these hearings on the financial institutions, the International Monetary Fund, and other organizations. What happens to the money? The same problems that happen in every poor country with bad laws. Capital flight, undermining the economy, places a terrible burden on average citizens as wealthy individuals are freed from inflation and the ups and downs of the economy by taking their money out of the country.

Let's work together to embolden our policy in dealing with Russia; let us work together to make sure it works. Let us not argue, as some have, that we ought to stop meddling, that we ought to somehow hope that it is all going to get better without our help.

If we had left Europe alone, it would have been in a much worse situation. If the United States disengages from Russia, it will create a disaster, and we will face in a decade either a left-wing or a right-wing totalitarian government again. There is no guarantee in what we do that there will be success; but there has definitely been proven success when you look at warheads, when you look at missiles, when you look at denuclearized states, when you look at the progress of free economic competition. Not perfect, but it is not perfect anywhere, and they have a lot further to go.

Thank you for holding this hearing, Mr. Chairman.

Chairman GILMAN. Mr. Leach.

Mr. LEACH. Thank you, Mr. Chairman.

There is a lot of truth in both the opening statement and the statement of the Ranking Member, but the big picture is that for all of the pluses and some of the positives occurring in Russia, Russia is also going backward and is subject to forces that appear to be beyond the control of the American people. Instead of the United States responding with a Marshall Plan, it is clear the institutions of the West have helped facilitate the marshalling of the wealth of Russia for it to be recycled to the West as stolen social assets.

This country has no choice but to be very, very much alarmed and very much supportive of the Russian people against the new institutions of wealth-stealing that have developed. Today is a signal day in that three exceptionally minor indictments have been

brought in New York, but they are minor indictments with major implications. The crimes that are suggested in our scope are rather small, but it can begin to lead to the unwinding of our greater crimes that are involved in the accumulation of the money that has been laundered in contrast with the money laundering itself.

In any regard, my own view is that if things are going askew in our relations with Russia, there is some degree of accountability within the executive branch, lack of vigilance perhaps in all branches of the U.S. Government. But the issue is not so much finger-pointing, but what we do to correct the situation and how we look to the future. In that regard, I think that the bottom line of this Congress should be concern for the Russian people, concern for the rule of law, and to try to develop a system of accountability in Russia that is based upon help that we can provide in insisting that our laws are upheld and the kind of corruption we see there is not brought to our shores.

In any regard, this hearing that the Chairman is bringing forth is very timely and much appreciated.

Chairman GILMAN. Thank you, Mr. Leach.

Chairman GILMAN. Mr. Lantos.

Mr. LANTOS. Thank you, Mr. Chairman. I want to commend you for holding this hearing. I would like to commend my good friend from Iowa, who is conducting important hearings on the Russian banking system with his customary integrity and objectivity.

I would like to take a bit of an historic view of where Russia is in 1999.

I first made my visit to the Soviet Union in the summer of 1956, Mr. Chairman, and my last visit to Russia was last month, in September. I must say that while I certainly see probably as many problems as difficulties in Russia, as any of us in Congress and any of our witnesses, I also believe it is absolutely critical to put Russia in 1999 in some kind of historic perspective.

Russia is still enjoying a free press. Russia is looking forward to free and democratic elections for the Duma in a few months, and to a free Presidential election next year. Every Russian has a passport. Russians are eager for American investment, for American tourism, and the dialogue between American academic institutions and Russian academic institutions, between our Library of Congress and their libraries, are full and fruitful and flourishing.

Since I suspect these hearings have somewhat of a partisan angle, as your opening remarks clearly indicated, let me remind you, Mr. Chairman, that the historic change in the Soviet Union came in the period 1989 through 1991. The dramatic opportunity the West had in that period took place during an earlier Administration, if I am not mistaken, the Bush Administration. So if we are to explore seriously what has gone wrong in Russia, it is extremely important to realize who was in charge when the cataclysmic changes in the Soviet Union unfolded. It was not this Administration.

Let me also say that it was one of the tragedies of the West that there were no great political giants in power in any of the western countries at the time of this historic moment. There was no Adenauer, no Jean Monet, no Churchill, no Paul Anrespok, no Archita deGustery. The great leaders at the end of the Second World War

in the West created a framework and we played the pivotal role in that framework, the Marshall Plan, NATO. One would have hoped that when the Third World War of this century ended, which we label the Cold War, there would be equally farsighted vision and creativity and courage on the part of western leadership to deal with this historically incredible new opportunity.

That, clearly, did not happen. The responses were timid, half-hearted, puny, and unimpressive.

The Russians had high expectations of working with us closely. When we had a bipartisan leadership delegation go to Moscow, as you may recall, 2 weeks after Yeltsin and President Clinton had their first meeting in Vancouver, British Columbia, we were greeted with tremendous enthusiasm and great expectations. Every subsequent visit was greeted with much less enthusiasm, much less excitement, and much lower levels of expectation.

Nevertheless, the Russians have cooperated with us and are cooperating with us in Bosnia; they have been pivotal in bringing to a close the Kosovo military engagement, and our relations with them are far better than anyone had any right to expect in the fall of 1999. I had a long session with the Foreign Minister of Russia, Mr. Ivanov, less than a month ago, and there is no doubt in my mind that the Russians are still hoping of building a constructive, cooperative and useful relationship.

Now, I also would like to make one final point if I may, Mr. Chairman. You were highly critical of our government's treatment of Boris Yeltsin. Allow me to remind you that there are many Boris Yeltsins. The first Boris Yeltsin that we got to know was the man who was the first democratically elected President of Russia in 1,000 years. Well, it is not unreasonable that we dealt with him. It is not unreasonable that the Government of the United States established as best it could relations with the first democratically elected President of Russia. It is not unreasonable that Vice President Gore was designated as our point man with the Prime Minister of Russia, Mr. Chrnomyrdin for a period of 5 years to work on a horrendous range of issues. You should read, Mr. Chairman, if you haven't yet, the agendas of the Gore-Chrnomyrdin Commission and the very constructive and positive and many-splendored results of the Gore-Chrnomyrdin Commission.

Now, it is obvious that Yeltsin has undergone a major change mentally, physically, and in many other ways during the course of the last few years, but it is still important to realize that our alternatives were the lunatic fascist Zhirinovsky or the equally evil Communist leader Girgonov, or perhaps the would-be military dictator Lebed. So I think it is important to realize that when we are so highly critical of having dealt with Yeltsin and his government, our alternatives were not Mother Teresa. Our alternatives were singularly less desirable counterparts who, by the way, were not elected President of Russia.

I look forward with great pleasure to hearing our witnesses, both today and tomorrow, but I think it is important if we are to make good use of these hearings that we shy away from partisan political denunciations of this Administration, because the new Russia unfolded under the Bush and Clinton Administrations and the great historic moment was in 1989–1991, not in 1999. Not in 1999.

Second, we take a balanced view of the achievements and of the failures that our governments under the Republican and the Democratic Administrations may have committed. Thank you, Mr. Chairman.

Chairman GILMAN. Thank you, Mr. Lantos.

Does any other Member seek recognition? If not, we will get on with the panelists.

Ambassador David Swartz entered the Foreign Service in 1967, and during his career with the State Department, he served in our American embassy in Moscow in the early 1970's, in the consular office that predated our current Embassy in Kiev, Ukraine established in the late 1970's, and as Deputy Chief of Mission in Warsaw from 1984 to 1988. Ambassador Swartz was our first Ambassador to the newly independent state of Belarus from 1992 to 1994, a vantage point from which he was able to closely view our policy toward the entire former Soviet Union and its largest successor state, Russia. Ambassador Swartz retired in 1995 and has most recently served as a Visiting Professor at Lawrence University in Wisconsin.

Chairman GILMAN. Ambassador Swartz, you may summarize your written statement, which, without objection, will be inserted in full in the record. Please proceed.

STATEMENTS OF DAVID SWARTZ, U .S. FOREIGN SERVICE, RETIRED, FORMER U.S. AMBASSADOR TO BELARUS

Mr. SWARTZ. Thank you, Mr. Chairman. I am grateful for the opportunity to be with you today and I appreciate you having invited me to come along and appear this morning. As you pointed out, I did provide a written statement, and I now propose to spend just a few moments summarizing the main points of that statement, if I might.

Certainly I believe that all of us who consider ourselves Sovietologists or experts or specialists in the field of the Soviet Union and the post-Soviet Eurasia were caught off guard, to be frank, by the events beginning in the late 1980's and culminating with the end of the Soviet Union in December 1991. I think that is an important point that needs to be highlighted. I think myself, as a career Foreign Service Officer, a retired career Foreign Service Officer, that things got underway quite effectively from a policy point of view. From a specific concrete action point of view in the first post-Soviet months which, in fact, was the last year of the Bush Administration—certainly a consideration of the subject that we are looking at today, which is basically retrospective—must look also at the performance of the Bush Administration, as has been correctly pointed out already.

I would submit to you that already before December 1991, Administration figures under President Bush clearly understood, as did the President himself, and were responding to centrifugal forces that were already well at play before the demise of the Soviet Union. I would submit that there was a strong degree of bipartisanship that reflected American foreign policy toward that region in those days and months.

In particular, I would cite the Freedom Support Act that was, I think if not a model of bipartisanship, certainly a strong dem-

onstration of it in 1992, which set the framework for a concerted effort and assistance that was intended, of course, to have significant political as well as humanitarian and economic benefits.

The Bush Administration strove, even before the Freedom Support Act was conceptualized and enacted by Congress, to embark on a significant program of immediate humanitarian assistance. Ambassador Armitage no doubt has or will speak about that subject, with a view toward getting the peoples of the region through the crisis of those months and days.

A critical point I think about the Bush Administration at that time was that it immediately established new embassies in all of the countries of the former Soviet Union, so that by February 1992, scant weeks after the Soviet Union ceased to exist, we had operating embassies in all of these places. I have personal experience in that regard, of course.

I believe that the final year of the Bush Administration saw a strong understanding of the challenges, let's say, that the post-Gorbachev leadership was going to pose for American policymakers. Gorbachev was someone we had dealt with and understood and had effective relations with, but Gorbachev was no longer there. Yeltsin was a different kettle of fish, as has been cited already in various statements. I believe the Bush Administration understood those nuances. It managed to, I believe, successfully conceptualize a reform strategy intended to lead toward democratization and market economics in the former Soviet space, not just in Russia itself, but elsewhere. Perhaps most crucial for American interests, the Bush Administration immediately seized upon the issue of centralization of nuclear weapons and denuclearizing in the circumstances surrounding the end of the Soviet Union. That program was begun in that last year of the Bush Administration. It did not come to full fruition until later, but it was begun during that period, and I think it is impossible for us to ignore these facts which are, of course, on the record.

Now, the question is, what would have happened had the Bush Administration continued in office? I am not prepared to sit here and assert for you—and I am not a politician anyway, but even if I were—I would not be sitting here and asserting to you that the Bush Administration would have had great huge successes in its post-Soviet Russia policy in contrast to what we might say are failings of the current Administration's policies in that region. Maybe that would have been the case, maybe it wouldn't have been. But since the question is moot, I don't really think that we can address it and don't need to.

Now, turning to the first year of the Clinton Administration, which was my last year in service in Belarus, I would say that even allowing for a traditional settling-in period for a new Administration, things got off to a pretty confusing start. That was kind of odd, I thought, in view of the fact that the incoming Clinton Administration claimed to have someone with enormous and deep Soviet expertise leading the policy team. From my vantage point as a holdover Ambassador in those first months and with lengthy experience in the region, I felt that the new Administration was too willing to take at face value punitive reformists and white head sorts of credentials of Yeltsin himself and people around him.

Chairman GILMAN. I am sorry to interrupt, Mr. Ambassador. We will continue right through the hearing. I have asked some of our Members to go over and come back to conduct the hearing while we are voting. So if any of the Members wish to go over and vote and come right back, we will continue with the hearing without interruption.

Please continue.

Mr. SWARTZ. Thank you, Mr. Chairman.

I felt that the new Administration was unnecessarily russocentric in its approach to the region, giving rise in Moscow, in my opinion, to the impression that the United States would not oppose and might even support reimposition of Soviet-style hegemony, which I felt then and feel now was contrary to American interests. I felt that the new Administration did not make sufficient internal executive branch linkages between strategic policy and tactical policy implementation, specifically in the technical and economic assistance areas.

I found the Administration taking some astonishingly naive actions; in particular, an event in Belarus involving President Clinton during his visit there which had, in my opinion, the exact opposite effect that was intended by holding the event.I believe that the new Administration seemed not to understand that societal transformation is a very long, arduous proposition and to act accordingly.

The sum total of all of this, in my view, was a creation of a climate in Moscow of political and economic promiscuity, where the impression reigned of a high U.S. tolerance level for these activities across a broad spectrum of the unofficial and official Russian community.

On frequent occasions when I was Ambassador in Belarus, I spoke out in written communications with high-level figures in the State Department and the National Security Council staff in Washington on these matters and others, and typically got nowhere with them; which is, perhaps, not unusual for Ambassadors in the field, but it was a new experience for me. The most vociferous policy disputes that I particularly was engaged in had to do with assistance matters: Food deliveries where they weren't needed, no support for private higher education where it was needed, too little transformational assistance in general, leading the local populace frequently to ask, as they still do, "Where is the beef?" Eventually I decided to resign my post over these policy disputes, so it will come as no surprise to the Committee that I express the views that I already have expressed.

With that, I would like to thank the Chairman for this opportunity.

Chairman GILMAN. Thank you, Mr. Ambassador.

Chairman GILMAN. Before I proceed, I would like to submit for the record a statement by our distinguished Subcommittee Chairman, Mr. Royce, with regard to U.S. policy toward Russia. Without objection, we will make it a part of the record.

Chairman GILMAN. We are pleased to have with us Congresswoman Marcy Kaptur of Ohio, a Member of the Appropriations Committee and a Ranking Member on the Agriculture Subcommittee who wants to submit a statement. Ms. Kaptur.

Ms. KAPTUR. Thank you very much for allowing me to sit with your Committee. I will submit for the record a statement that details the $1 billion shipment of food aid to Russia during this fiscal year and raises some concerns regarding its accounting, as well as the Administration's disconnected approach to handling this food aid shipment relative to other foreign policy goals. We would just ask the Committee, and thank them very much, for including this in the record.

I noted in the summaries that have been provided the word agriculture is not really mentioned. In this fiscal year alone, we will provide more in food aid to Russia than we do in all of the other foreign assistance programs. I thank you for allowing me to sit in.

Chairman GILMAN. Thank you for bringing this to our attention. Your statement will be made part of the record, without objection.

Chairman GILMAN. We will continue with our hearing.

Now I would like to call our second panelist, Mr. Fritz Ermarth. Mr. Ermarth retired from the Central Intelligence Agency in 1998. During a career of more than 30 years, Mr. Ermarth served as a Soviet Affairs Analyst at Radio Free Europe and the RAND Corporation, as well as with the CIA. Mr. Ermarth has served as Special Assistant to the Director of Central Intelligence, the National Intelligence Officer for the Soviet Union and East Europe, and Chairman of the National Intelligence Council. He has also served twice on the National Security Council staff under Presidents Carter and Reagan, and recently, Mr. Ermarth has written on the problem of corruption in Russia and its impact on U.S. policy toward that nation in both the "New York Times" and the "National Interest."

Mr. Ermarth, you may summarize your written statement which, without objection, will be inserted in the record. You may proceed.

STATEMENT OF FRITZ ERMARTH, U.S. CENTRAL INTELLIGENCE AGENCY, RETIRED, FORMER MEMBER, NATIONAL SECURITY COUNCIL STAFF

Mr. ERMARTH. Thank you, Mr. Chairman. I am deeply grateful to you and to the Committee for this opportunity to testify on your very important agenda. As the previous speaker, I will just offer some brief summarizing remarks, with apologies to Representative Leach who has heard some of them before during the hearings that he chaired, and to the Chairman whose opening remarks indicate he is way ahead of the power curve on much of what we are discussing.

First, it is extremely important to realize, as several speakers have already emphasized, that the roots of the crime and corruption problem that have brought us here today in Russia go back into the Soviet past, as do many of the problems of Russia today, like the environmental crisis, the public health crisis, the decay of infrastructure. It is particularly important with respect to the lack of the rule of law. We have to understand that the plundering and laundering, the organized crime and the authorized crime that dominate the Russian economy today have their origins in the activities of the KGB and the Communist leadership in the late 1980's, not under the Yeltsin regime, although they escalated under Yeltsin.

The second big point is that what we call economic reform in Russia has really not created a market economy or capitalism, that most hoped for. Rather, it created a kind of crony capitalism without much capitalism, or I would call it phony crony capitalism where insider privatization, in alliance with corrupt officialdom, has produced a system dominated by a few powerful individuals or entities who strip wealth out of the country and send it abroad rather than investing to create wealth and prosperity at home. The result has been impoverishment for the people and profound instability of a political and social system which we should all recognize poses serious dangers for our most important security interests in Russia, particularly nuclear stability and security.

Now, organized crime interacts with these phenomena with this plundering system, both as a beneficiary and a facilitator, through such activities as protection racketeering and money laundering.

These realities that I have tried very briefly to summarize have been completely visible from the start, and aptly reported by a host of Russian and western observers in the English language for that matter. You didn't have to read Russian to follow this saga. No failings of American intelligence can be blamed for a failure to see these realities. There were, however, some failings of American intelligence which, in my view, deserve some analysis and correction.

Mr. Chairman, your staff asked me to spend a few minutes on this topic of intelligence, and I will briefly summarize my view, especially in the early to mid-1980's.

Chairman GILMAN. I am sorry to interrupt, Mr. Ermarth. I am going to turn the Chair over to our Vice Chairman, Mr. Bereuter, while we go to vote. Please continue.

Mr. ERMARTH. Thank you, Mr. Chairman.

On the subject of U.S. Intelligence in this area, I did see some difficulties in the early to mid-1990's, in particular, in developing a fully integrated big picture of what was going on in Russia's troubled forums. First, as has been noted in some press and referred to in an article that I published to which the Chairman alluded, there was some political distaste in the top ranks of the current administration for reporting an analysis about corruption in the Yeltsin regime. Second, a reduced work force, preoccupation with current intelligence, and preoccupation with current support requirements limited the efforts of intelligence analysts to get a deep, big-picture view of Russian reforms. There was bureaucratic compartmentalization. People wanted to look at different aspects of this elephant and not bring the pieces together.

Finally, economic analysis didn't adequately appreciate the impact of crime and corruption on Russian reforms, taking the view that while their robber barons are like our robber barons and they will all go legitimate in the end, not recognizing that the absence of the rule of law made it impossible or extremely difficult to impose the discipline of fair market practices that we imposed on our robber barons, things like that.

Now, some of my former colleagues think I am unfairly critical about our intelligence record here, because I may not have seen everything that was going on. Other colleagues, on the other hand, who were very much in the thick of it, don't believe I am critical enough. But let me repeat my basic point. You did not need official

intelligence to see the toxic mixture of corruption, insider business, organized crime and capital flight that undermined Russian reforms and the effectiveness of our support. They were entirely visible in the Russian press, even in English, and any attentive observer could see them.

The historic failing of American policy in this period was that it gave support too uncritically and for too long to this phony crony capitalism in Russia. It did so rhetorically, politically, and financially, chiefly through the IMF. The result has been the prospects for true economic reform in Russia have been made, in many ways, more difficult than they were initially. Worst of all, we have lost much respect and admiration among the Russian people, as have the very ideas of capitalism and democracy.

Now, this in no way ignores what has been achieved under such programs as Nunn-Lugar, but as I have already said, the failures of Russian reforms very much endanger those achievements.

The problem with the IMF has been more one of perversion, I would say, than diversion of funds. Rather than encouraging the stabilization and growth of the Russian economy, the IMF has served to legitimize the extraction and the flight of wealth, of capital. But there does, in fact, seem to have been something like diversion in the summer of 1998, and I would be happy to summarize the evidence, if the Committee is interested, in response to questions.

Why the Administration pursued the policies it did for so long in the face of these realities is still not entirely clear because I find its belated explanations not terribly persuasive, particularly the reference to our security interests. While we have achieved things during the course of the 1990's, positive things, I believe our security relations with Russia are in worse shape today than they were in 1992, 1993 when we enjoyed great admiration of the Russian people.

The influx of vast sums of Russian money into our economy during this period, probably amounting to hundreds of billions of dollars, poses serious questions for law enforcement and regulation, which is one of the reasons we are here, to witness the indictments of yesterday. Whether that money was stolen by crime or by corrupt business, laundered or just deposited, it inevitably created American stakeholders in the process that brought it here. Whether such stakeholding exerted an influence on U.S. policy that embedded the process is a valid question that this Congress should address.

Finally, let me make a point that very much agrees with that of the Ranking Minority Member. Russia is not lost but stuck in a swamp between the Soviet past and alternative future possibilities that range from bright and friendly to dismal and threatening. Our task is to assay the past, reassess our policies, and get ready for the possibility that a window of real reform in Russia will reopen if—and I underscore if—they get through the impending elections. I wish I and, for that matter, Russians could be as confident as the Ranking Minority Member is that they will, in fact, hold those elections. In fact, Russia is in a profound crisis, a two-headed one involving electoral politics on the one hand and the crisis in Chechnya on the other.

There are better paths available to the Russians and to our own policy toward Russia. If this Committee can illuminate those paths, both Russia and America will be grateful. Thank you, Mr. Chairman.

Mr. BEREUTER. [Presiding.] Ambassador Swartz, Mr. Ermarth, thank you very much for your testimony.

Mr. BEREUTER. We will begin questioning under the Committee's 5-minute rule.

I would begin by saying I am interested in knowing your opinions as to how we modify our current policy, which is not successful with respect to Russia. I am not interested, frankly, in a partisan discussion about who is responsible for what in the Bush or Clinton Administrations as I am in understanding what we ought to do now with the situation that is obviously not good.

If you were to be given an eight by four block of granite and you were to know that your advice to us would have to be chiseled on that block, what principles should underlie our policy with respect to Russia now to give us a positive Russian-American relationship and serve our national interests? Ambassador Swartz, do you want to try first?

Mr. SWARTZ. I think the most important principle that would be chiseled on that block of granite is pursuit of our national interests, and that might sound like a cheap shot, it is not intended to be. Really, everything that we should be doing in our diplomatic relations with anybody is pursuit of U.S. national interests.

Mr. BEREUTER. That should be on a banner in the back of the room here: What are our national interests? That question ought to be facing Members of this Committee every day. I understand that is where we start.

Mr. SWARTZ. As far as Russia is concerned, I believe the period of deep crisis that was alluded to a moment ago is certainly a characterization that I would agree with. I would suggest also that our relations are in something of a holding pattern now because we do have impending elections to the Duma, and we do have impending Presidential elections. Really, the outcome of those contests will, to a large extent, be determinant as to what our policies are going to be with regard to Russia.

Mr. BEREUTER. Ambassador, remember that block of granite. I am looking for those principles.

Mr. SWARTZ. Again, the principles should be following pursuit of our national interests, should be encouraging whoever those leaders are to establish as swiftly and as comprehensively as possible rule of law in civil society; to move us as swiftly as possible to achieve an appropriate nexus between private capital and government in terms of how business operates, regulation, tax collection and so on. These are the things that we should be fostering.

You can say well, we have perhaps have been fostering those, but without wanting to be too retrospective, I think more needs to be done.

See who wins the elections, pursue our national interests in terms of those critical elements, and then of course in the Third World, the broader world, do things that we need to do to encourage the Russians to stop providing nuclear technology where it is

being provided and to do other things that are consonant with our own national interests, and to challenge them when they don't.

Mr. BEREUTER. Thank you, Ambassador.

Mr. Ermarth, the Ambassador had to go first, so you had a whole 2 or 3 minutes to think about it.

Mr. ERMARTH. Yes, sir, Mr. Chairman. I would put some things, some of the same things on that block. First, we have to start with a thorough audit of our policy. Now, these hearings constitute such an audit, but there are a lot of things down in the weeds—details. For example, in Nunn-Lugar, we have achieved a lot, but a lot of money has been spent and there needs to be a thorough investigation of where exactly it was spent and how. The IMF Program obviously needs to be gone over very thoroughly.

Second, we need to assure that in the future, we have full honesty, transparency, and accountability, on our side as well as theirs. I mean, a great deal of the problem over the last 6 or 7 years is that we refused to be honest with any of the essential constituencies about what was obviously going on over there.

Third, we need attention to all elements of the political spectrum that have influence in Russia, especially in the political arena. Congressman Weldon has emphasized the importance of paying attention to the Duma. I think that is a very wise consequence of the general principle. We shouldn't restrict our policy connectivity to Russia to a few cozy relationships among people who speak English and IMF-ise.

Fourth, most of the assistance ought to be targeted in a very practical, grassroots way, and that includes things like building civil society and rule of law.

Mr. BEREUTER. Thank you very much.

The gentleman from Connecticut, the Ranking Member, is recognized for 5 minutes.

Mr. GEJDENSON. Thank you.

It seems to me that what you outlined, both of you, although it be a big chunk of granite and there is a lot to do here, is exactly what all of our bilateral relationships are aimed at doing—the Gore-Chrnomyrdin and the followup. The agendas are designed to try to get the Russians, who have no private property, no due process, no review systems in place of any serious nature, to evolve into a free and open society. So I think frankly we don't have a big debate here.

The auditing—I think every Member on this Committee wants to follow every penny that American taxpayers pay to make sure we are getting the maximum return on it.

I guess what I am saying is, so that we can highlight this, let's assume I have seen one report that says that the IMF did an audit and that they know where their money went and where it wasn't supposed to have gone. Some people claim it is IMF money, but I have seen no evidence of that. Some people claim it is other Russian money in flight and illegal moneys that violate Russian laws. I don't think there is anybody in this town from Pennsylvania Avenue to Capitol Hill or anywhere else who wants to see our money misused or not spent for what it is supposed to be spent. So we all agree on that and we would like to see those audits.

What in the programmatic sense ought we add or take away from what we are doing? It seems to me that I think we all basically agree we have to engage the Russians, we have to get them to do the basic hard work of government. We have to have ethics in government, we have to have oversight, we have to have transparency, economic transactions. We want to make sure that when we deal with issues like nuclear proliferation, there isn't somebody selling nuclear material out the back door. This is even tougher in societies in chaos.

I remember being briefed by the people who run the Ukrainian nuclear power plants, that they hadn't paid some of their workers for 6 months at one point. When you are not paying your workers for 6 months, you know what they are doing; they are stealing something out the back door or they are not the most dedicated workers at that point. Obviously, you have big problems. What would you add or take away from what we are doing today? You can do it in pencil or granite, whatever your choice is.

Mr. SWARTZ. My answer to that is that the devil is in the details, and the details I think haven't been paid sufficient attention.

I am a strong advocate of small concrete actions, baby steps, if you will. Let us do this in this town, let's do that in that town, let's do this project that will have this result. Not only will this achieve greater accountability and results, I would submit, but also individual Russians who, after all, are the ones who are going to be voting for these people that we talked about a minute ago, will be able to see what America is doing in their town, in their factory, in their whatever.

Mr. GEJDENSON. I think we have general agreement, even within the Administration as well, they are moving things back into the provinces. I think Eximbank, frankly, is a better way to go from my position than the IMF. You have a specific project, you do something, it is concrete, you can follow the dollars. I think we have a real international monetary problem, and I hope the Chairman of the Banking Committee will figure out how to deal with it; but I think you are right, specific projects.

Mr. ERMARTH. I would endorse the specific projects business, but I would also stress we have to put our action programs, our money, as it were, behind what we say. We have talked about law and order, building a civic society, but we have behaved in ways, for example, supporting the IMF funding, that suggested we didn't really mean it.

Mr. GEJDENSON. Let me ask you this: What would you have changed on the IMF funding?

Mr. ERMARTH. Starting most recently, I would have, in the summer of 1998 said, this GKO pyramid or casino you have going over here is thoroughly responsible. It should have been shut down a year ago; let's shut it down now.

Mr. GEJDENSON. Explain that to me again.

Mr. ERMARTH. I mean, working back in time——

Mr. GEJDENSON. Right. The most recent one you have no complaint with.

Mr. ERMARTH. Which?

Mr. GEJDENSON. The refinancing tranche that stays——

Mr. ERMARTH. To avoid default.

Mr. GEJDENSON. To avoid default, you won't disagree with that.

Mr. ERMARTH. Yes, I certainly do.

Mr. GEJDENSON. So you would allow them to default?

Mr. ERMARTH. I am not sure which is the best way to go right now, politically or economically.

Mr. GEJDENSON. So you are unsure about default, and now we go back to the previous tranche of funds.

Mr. ERMARTH. We shouldn't have lent the money on the terms that we did in the summer of 1998.

Mr. GEJDENSON. What would you have added for conditions?

Mr. ERMARTH. Shutting down the GKO market on some soft landing strategy.

Mr. GEJDENSON. What would that soft landing strategy be?

Mr. ERMARTH. I am just not able to sit here and create one. But I think we have a whole history of buying into policies on the part of the Russian regime that were thoroughly flawed, and we could see those flaws emerging, and we should have said so.

Mr. GEJDENSON. I think lots of people said so. I think that trying to get the particulars to go from their system to our system is a pretty rough road. Again, if you can't do it today, I would appreciate any additional proposals—because my time is up—on what we ought to do from here on in, and I agree with more specific projects. I am a big believer in Eximbank. We have some problem with our colleagues in the other body and sometimes in this body as well, but thank you very much.

Chairman GILMAN. [Presiding.] The gentleman's time has expired. Thank you.

Ambassador Swartz, what do you predict to be the future for Russia and our relationship with them if our current policy does not change?

Mr. SWARTZ. Mr. Chairman, in your absence I spoke about that, a little, but let me say a bit more. I believe that first of all, we have to understand that our ability, even as a great power that we are, to affect events abroad is a limited ability. So we are talking about incrementalism. That is the first thing that I would say.

Chairman GILMAN. Talking about what?

Mr. SWARTZ. Incrementalism. Yet, at the same time, I think that we have opportunities, programs, that have not been maximally utilized for advancing American national interests. The future, though, of Russian-American relations, and this is what I said a minute ago while you were gone, seems to me to be dependent at this stage of the game on how the elections come out. I am reasonably confident that these elections are going to be held; they may even be free and fair elections. What worries me very much is that the ordinary man in the street is, quote-unquote, mad as hell and not going to take it anymore, because many of them live worse now than they did in the Soviet period. This is not good.

So I don't mean to deflect your question, but I think we are going to have to wait and see how the elections come out, and then vigorously pursue with whoever wins our agenda for advancing our own interests.

Chairman GILMAN. Thank you, Mr. Ambassador.

Mr. Ermarth, as a retired intelligence analyst and also an expert in the field of Russian affairs, do you believe that it was necessary

for our policymakers to have access to sensitive intelligence information on corruption in Russia and in the Yeltsin government in order to realize the extent of the problem? Or could they have assumed from the many reports in credible, open, press publications in both Russia and the West, that this was a serious problem?

Mr. ERMARTH. Mr. Chairman, there is no question in my mind that the publicly available information coming out of Russia made it very clear what the dimensions of the problem were. At the same time, of course, policymakers should have access to the best intelligence available. Being careful not to go beyond what is appropriate to say publicly on intelligence here, I can say that what was available through intelligence sources and methods would serve largely to amplify and to provide rich detail to what was thoroughly presented in the public domain.

Chairman GILMAN. Mr. Ermarth, in your "National Interest" article earlier this year, you make reference to Russian official Anatoly Chubais' statement last year that with regard to a loan to the Russian Government that went through the IMF with U.S. support, that the Russians had "conned" the IMF. You then went on to point out that our foreign policy regarding Russia involves such large sums of money as that IMF loan and that dealings with Russian officials and others can involve a "thicket of insider relationships" where there is room for "the wasteful, the dangerous and the sinister," again your quote.

Am I correct in interpreting your remarks as a warning that support for large loans to the Russian Government, and other forms of financial support for it in recent years, may not just stem from American policy prerogatives, but from the self-interest of some in the United States and elsewhere? If so, can you expand on your comments?

Mr. ERMARTH. You have interpreted my comments correctly. I can, indeed, expand on them. But what is, in fact, going on in this dimension is something that the hearings of this Committee and other Committees ought to explore. I believe that the enormous sums of money that have come out of Russia into our economy and others in the western world have created stakeholding interests that have exerted political influence to keep the IMF funding going and so forth.

There have been other kinds of, you might say, insider dealings. As Ambassador Tom Graham has pointed out in testimony before another Committee, much of the economic policy support through the IMF was decided in a very small group of American and Russian English-speaking officials in which context Mr. Chubais was speaking. It was not just the Russians that conned the IMF, it was this little group of Russians and Americans that conned the IMF into believing that things were better and more promising than they looked.

Finally, as another Member of this Committee, or I believe the visiting Member pointed out, there is the very open stake of various American contractors and businesses in various kinds of Russian aid, like our farmers today. But is it really wise to support our farmers by sending to Russia food that they may not need, the proceeds of which end up in corrupt private hands? All of these are

questions that have gotten into the public record and I believe need to be examined, Mr. Chairman.

Chairman GILMAN. One last question, Mr. Ermarth. In your article in the "National Interest" earlier this year, you referred to money laundering done by the KGB at the instruction of the former Soviet Communist Party Central Committee. According to your article and several other reports in recent years, foreign accounts and front companies were set up by the KGB in the process.

What is your best estimate of the amount of money involved, who do you believe now has control of such front companies and accounts, and do you believe that officials in the Kremlin have control over these accounts?

Mr. ERMARTH. The best estimate that I know as, I wrote in the "National Interest", was about $20 billion. There have been other estimates of what the KGB sent out of the country between around 1985 and 1992: around $20 billion. All of that money, all of the networks, all of the companies, all of the associations that were set up then have blended imperceptibly into the vast, plundering, laundering apparatus that we see at work today.

Who controls exactly what is very difficult to tell from a distance? I don't believe the Kremlin lost control of these funds; in fact, some of the wealth at the disposal of the Kremlin's quartermaster, Mr. Boradin, derives from those funds or activities like that. On the other hand, it didn't retain the old kind of control. As I said, the old money, the old organizations, the old connections that the KGB set up, blended imperceptibly into this new toxic mix of crime, corruption, and insider business.

Chairman GILMAN. Thank you very much, Mr. Ermarth. My time has expired.

Mr. Lantos.

Mr. LANTOS. Thank you, Mr. Chairman.

I find the two testimonies remarkably different. As I read yours, Mr. Swartz, it seems to me that you express almost pathological hatred for Strobe Talbott, and that is your privilege, but that really is not helpful in understanding our policy toward Russia. You talk about Mr. Talbott being a self-proclaimed expert on Russia. Unless I am mistaken, he is the translator of Khrushchev's memoirs, he is the author with Presidential historian Michael Beschloss of a brilliant book called "In the Highest Places," which is a discussion of U.S.-Soviet relations during the last years; he has devoted much of his life to understanding Russian literature, culture, history, government, politics, and is one of the few high-ranking American officials with a very deep understanding of Russian society.

So this is not a self-proclaimed illusion; this is the product of a lifetime study of Russia, and it rarely happens that people high in the policymaking apparatus have the degree of scholarly understanding that Mr. Talbott has so clearly exhibited. Now, you are still free to hate him, but I don't think that is helpful in our understanding of what has gone on.

I find Mr. Ermarth's observations more analytical; and allow me to agree with some of them. You are suggesting several things with which I agree. You are suggesting, for instance, that in the early period, 1992, 1993—and I was in Russia in that period several times—there was tremendous admiration on the part of the Rus-

sian people for the United States, the American people. You are absolutely correct that this has been largely dissipated. The reason is the profound, perhaps naive disappointment and disillusionment on the part of the Russian people in expecting western aid to lubricate this historic transformation.

When I was in Russia in 1992 and in 1993 and in 1994, as probably you were, you probably recall that they had high expectations of what the West will do for them in lubricating their transformation from a totally totalitarian police state and a dysfunctional economy into a democratic society with a functional economy. This hasn't happened. It hasn't happened for many reasons, but let me tell you what in my view is perhaps the single most important reason, and I apologize for using statistics.

When Germany was unified, the 17 million people of East Germany every single year received $100 billion in transfusion from West Germany. The 150 million Russian people received approximately $1 billion in transfusion. Now, I am not recommending it should have been 100 times that or 50 times that, but I simply think that it is wholly unrealistic to look away from the economic realities. The West hoped that they could facilitate the transformation of Russia from a totalitarian police state with a dysfunctional economy into a vibrant democracy with a functional capitalistic economy, without any help. This was an incredibly naive, childish, ludicrous view, and to a very large extent, we are now paying the price of having, finally, come face to face with this new reality.

I also think you are correct, Mr. Ermarth, in deploring, if I may quote you, the great weakness of the rule of law in Russia. You are totally correct. Wee were not running Russia in the last 8 or 9 years. We were not in charge of the Kremlin. It is a very naive assumption to say that we could have created a system of laws which are transparent, respected, universally applicable, admired, which would have created, I fully agree with you, an infinitely more likely framework for the transition.

But, unlike the Second World War where we defeated Germany and defeated Japan, we ran those two countries with our military occupation forces, Lucius Clay and Douglas MacArthur, and what we said happened. We did not defeat Russia in the Cold War, in a military sense. This was a Russian government horrendously flawed, horrendously incompetent, horrendously corrupt, but it was not our government. To blame the lawlessness of the Russian system, which is so self-evident, on us is an absurdity. We were not in charge in the Kremlin, and everybody in this room who has the slightest understanding of who called the shots clearly knows that.

Finally, whatever leverage we did have, and we did have considerable leverage at the time of the collapse of the Soviet empire in the Bush Administration, vanished when the Russians became aware of the fact that they were getting nothing from the West. They got minimal assistance, minimal assistance from the West, not only from us but from our western allies and Japan. So our leverage, whatever it was in 1990, 1991—and it was considerable—it vanished when the Russian people and the Russian Government understood that they were getting very little from us.

As a matter of fact, one of the most dangerous consequences of our reduced leverage was that when we quite properly attempted to stop the flow of high-tech weaponry to countries like Iran, they told us to go fly a kite. They told us to go fly a kite because we had no leverage with them. Their high expectations of 1989, 1990, 1991, and 1992 went up in smoke.

So while you are perfectly correct in saying it is a largely lawless society, it is a largely lawless society because given the realities of Russia's chaotic political criminal system, respect for laws, transparency of laws was not going to be forthcoming and it hasn't been forthcoming. That is why we are confronting a lawless society.

Thank you, Mr. Chairman.

Chairman GILMAN. Thank you, Mr. Lantos.

Mr. Rohrabacher.

Mr. ROHRABACHER. Thank you, Mr. Chairman. I thought Mr. Lantos might want to give them some time to answer the question.

Mr. LANTOS. I will be happy to have them answer, Mr. Rohrabacher, if the Chairman is gracious enough.

Chairman GILMAN. I will be pleased to, on Mr. Lantos' time, if you might want to respond to Mr. Lantos' comments.

Mr. ERMARTH. Mr. Chairman, inasmuch as Representative Lantos found my remarks so agreeable, I am very reluctant to rebut him, but I have a couple of points of qualification.

While inadequate funding, if you will, contributed to Russian disappointment, there are other factors involved. The Russian reformers went through a series of strategic steps from decontrol of prices to voucher privatization to loans for shares, which quite apart from the amount of money we supported—we supported—that led to the impoverishment of the Russian people. I am glad we didn't put more money behind the policies we were supporting in Russia. I would have been happy to put more money behind better policies.

As to rule of law, of course we couldn't create it from abroad, but we could have been more explicitly and consistently supportive of Russian efforts to create the rule of law as a condition for our support: for example, the Duma-passed money-laundering bill last year, which Yeltsin vetoed ostensibly on human rights grounds because it would interfere with capital flight actually, and our protests were quite mild.

We did have leverage, it is true, at the beginning. I am sorry that the Bush Administration wasn't more active, but it didn't have a lot of time and was, in my opinion, somewhat fatigued by the previous 3 years. This didn't mean, however, that the Clinton Administration was without leverage, as the Congressman suggested, when it took office in 1993.

Chairman GILMAN. Thank you, Mr. Ermarth.

Ambassador, did you want to comment?

Mr. SWARTZ. Yes, Mr. Chairman. With due respect to Representative Lantos, I would like to respectfully disagree in his assertion that I have a pathological hatred for Mr. Talbott. First of all, I don't hate anybody, pathologically or otherwise. Second, Mr. Talbott and I have always been on friendly terms and I believe we still are and will continue to be in the future.

The point, though, is—and that is what I was trying to make—if you have someone who is the point person and identified as such

at a very high level of the American government for Russian policy at the outset of a generation, then the simple rules of accountability mean that as problems arise and you go down the pike and you are 6½ years into that Administration, that perhaps that same individual should be the one who would answer under these accountability rules that we operate under. That was the only point I was making.

Mr. LANTOS. You didn't use the word "point person"; you said "self-proclaimed expert." Well, if you are an expert, you are not a self-proclaimed expert. If you have spent a lifetime studying Russia, then it is not unreasonable that people look at you as one of the many experts.

Mr. SWARTZ. Expertise can be both proclaimed by yourself and by other people.

Mr. LANTOS. You state that it is self-proclaimed.

Mr. SWARTZ. That doesn't mean that other people don't acknowledge his expertise. I am in no way denying his expertise.

Chairman GILMAN. The gentleman's time has expired. We are pleased to have two experts before us.

Mr. Rohrabacher.

Mr. ROHRABACHER. Mr. Chairman, thank you very much and thank you for holding this hearing today. I think it is a long overdue account of what has been going on in Russia. Although I agree with my colleagues on the other side of the aisle that we should try to look for solutions, I also think that holding people accountable for the policies that they have presented to the American people as something that would work, yet haven't worked, they should be held accountable for presenting these policies and instituting those policies that haven't worked.

First, let me, before I ask my question, salute my friend, Fritz Armitage, who has had a long and distinguished career in American intelligence and in fact, worked with me during the Reagan White House days. I believe that he made a major contribution to perhaps the most historic achievement in my lifetime, which was the disintegration of Communist power in Russia, which was, after all, this great achievement of the Reagan Administration, this legacy that I believe has been squandered.

I, unfortunately, believe that when Reagan left office and when George Bush was entering office, it looked like the world was just ready to remake and to create these wonderful new opportunities for all of humankind and especially there in Russia. That legacy has, unfortunately, as we can hear today and as is clear just from reading the newspaper, that legacy has been squandered. Hopefully, it can be recaptured, but I don't know.

First of all, Mr. Ermarth did answer the question about more aid, and I do believe, just to take more trucks of money and shovel it out of the back into Russia certainly would have resulted in the loss of more money.

But Mr. Ermarth, could you tell us, and in fact both panelists, before the current administration came to power and we had policies of the Reagan Administration and policies of the Bush Administration, were there changes in policy that took place when President Clinton came into power that has contributed to this; policies that were changed from what they were before?

Mr. ERMARTH. I think the posture of the Bush Administration in 1992 vis-a-vis aid to Russia was one of skepticism and caution and a sense of doubt about how to proceed, which wasn't perhaps surprising given the novelty, the extraordinary novelty of the situation presented to them. In that situation, you may recall that President Nixon came back to Washington from a trip to Russia in the spring of 1992 urging a more generous, visionary, bold venture, some approach which obviously would have cost more money. The Bush Administration, for a variety of reasons one can go into in another setting, wasn't ready for that.

Unlike Congressman Lantos, I don't believe the opportunity for that kind of boldness disappeared with the end of the Bush Administration.

Now, as to changes of policy, I think there was definitely a change in the sense that the new Clinton Administration was far less skeptical, far more ready to basically sign up to what the team around Boris Yeltsin was prepared to do, than the Bush Administration in its brief time with this post-Communist situation demonstrated. It just got much less skeptical with the new Administration.

Mr. ROHRABACHER. With what Mr. Ermarth just pointed out, Mr. Chairman, we are here to find solutions as well as to fix responsibility; but as far as I can see, this Administration has a pattern throughout the world of getting involved in supporting people who are not necessarily committed to the same values and the same principles that some of us would like them to be. What you just described—let me say that I don't believe that the Russian people were looking for aid from the United States. I think what they were looking for when Communism collapsed was honest government and good leadership. Perhaps one of the solutions to our current dilemma and the current situation is for the United States to commit itself to finding honest and good leaders in the Russian people and get behind them 100 percent, rather than trying to work more closely with people who just happen to have leverage at the moment in dealing with them.

Mr. SWARTZ. May I offer a comment also?

Mr. ROHRABACHER. Yes, and after that, I have used my time, but go right ahead.

Mr. SWARTZ. I certainly agree with what you have just said, but I think it is important that we remember, at least in my view, when the Soviet Union collapsed, the thing that ordinary Russians wanted above all—or ordinary Soviet citizens, ex-Soviet citizens wanted above all else—was to improve their living standards. I think that to the extent that they were interested in rule of law, in private market economics and so on, to the extent that the concepts of democracy and governance, that they cared about that at all, it was because of their exigencies of daily life.

Now, democracy has changed things from the Soviet period. It has now allowed these people to vote, to vote and express their views, and they have done so and we will see now what they come up with again. So I think that that is an important thing that we have to keep in mind.

I would just like to offer a comment on leverage. It seems to me that leverage as a potential instrument for American policy contin-

ued well into the mid-1990's and, to a certain extent, exists even today but in greatly diminished form. In fact, I would say that the relative existence of leverage as a concept in implementing our policy toward Russia is directly proportional to the amount of concrete results that ordinary Russians who I am talking about could see in their daily lives.

So as that doesn't go up, leverage goes down, but I do think leverage continued to be a significant factor well into the mid-1990's and to some extent, even today.

Mr. ROHRABACHER. Thank you, Mr. Chairman.

Chairman GILMAN. Thank you very much.

Mr. Berman.

Mr. BERMAN. Thank you very much, Mr. Chairman.

Ambassador Swartz, you may well not have intended it that way, but your testimony did come off as an ad hominem attack on Deputy Secretary Talbott. Talking about dilettantes in the salons with the literati as sort of the essence of his understanding of Russian culture and life, it seemed a little personalized. But the problem I have is that I hear your general assertions of the quote "Talbott policy," but I don't see in your testimony the specifics to back it up. I read your testimony; I don't know what happened in Belarus that destroyed, presumably at least, an aspiring democratic leader and brought back a neo-Stalinist into leadership, and that you had the right idea and Clinton screwed it up. You don't bring it out, you just assert it.

You talk about Clinton's and Talbott's russocentrism, and I see your point. All I remember is in the late 1980's and early 1990's, there was a bipartisan policy. George Bush and Democrats in Congress had a lot invested in Gorbachev, and it was on the right of American politics that the drum beat grew and grew and grew, that Gorbachev is a Communist, always will be a Communist, and that the true, pure Democrat, the force for liberation, the force we should be banking on, that is coming from the right of American politics, was Boris Yeltsin. Boris Yeltsin, the opportunistic, drunk, shallow intellectual Communist forever, who stood on the tank and stopped the coup against Gorbachev—I don't know whether you in your historical perspective think that that was an important and brave act that in the end helped serve the interests of peace and stability or not; but, given your general assessment, it seemed to me somewhat one-sided in that regard.

I understand under pressure from a Congress that wants the farmers to be able to ship food anywhere, that perhaps the commodity provisions didn't serve the interests. But I read Leon Aaron's article and he says, after pointing out just where the Soviet Union was in the last year of the Soviet empire, he writes a paragraph which says, "While it is true that millions of people, especially retirees, collective farmers, and workers and the mammoth military-industrial complex were impoverished by galloping inflation and cuts in State spending,"—and by the way, galloping inflation, when we went there in April 1993, Clinton in office less than 3 months, hardly enough time yet to ruin American policy toward Russia, there was galloping inflation, and those crypto-pseudo Democrats like Gaidar and Chubais—Gaidar was gone, and Chubais was very much in favor of his voucher programs—these

were the people that I remember the previous Administration were investing a great deal in that you now, after the fact, seem to cut at the knees.

But Aaron continues to say, "For the first time in Russian history, there was a sizable middle class and an intelligentsia, outside State employees. Before the crisis of April 1998, almost one-fifth of Russians surveyed said that the economic situation of their own family was improving. Between 1990 and 1997 car ownership increased by 72 percent, from 18 per 100 families to 31. Of the total population of 150 million, 20 million Russians were estimated by tax agencies to have traveled abroad in 1997. In a country-by-country ranking of top-spending tourists in 1996, the Russians came in eighth.

"The new Russian middle class suffered greatly in the crash of 1998 and it will take a few years for the standard of living to return to pre-crash levels. Yet there is no reason to doubt that this will happen. It may currently be the rage in Russia to speak of Russia's virtual economy, but we are suddenly discovering that a Russian market economy does exist after all, and despite its deep distortions, responds to economic stimuli much as any market economy would. In full accordance with supply side theory, the continuing absence of price controls, a cheaper but stable national currency and drastic reduction of imports have unleashed domestic productions," and it goes on and on.

I have a lot of concerns about our policy, the investment in a Yeltsin family, a small group of oligarchs who seem to me have done much to bleed much of Russia dry here. I do think in that last election, the choice at that particular point was Yeltsin versus Zhyuganov.

I don't quite know how we do what Mr. Rohrabacher suggests, hold an American endorsing convention and then have our PAC give the true candidacy of the Russian people the kind of support that that person needs in order to win, but your effort to differentiate between Bush policies and Clinton policies, and the failure, at least in your testimony, to specify the specifics of what was wrong, rather than general allegations, does concern me.

Mr. SWARTZ. First of all, I would be happy to give you as many specifics as you would like as time permits this morning. On the food question, though, since you raised that one, that is a matter of specific concern both with regard to Russia and the other countries. With regard to my own experience and things that I saw and commented on and was involved with in a policy sense, namely grain shipments to Belarus, clearly there are two issues. One was that the Belarussians did not need the grain. The second one is by shipping grain and distorting the market, thereby our general policy of trying to foster economic transformations in the agricultural sector, eliminating collective farms, making them productive and so on, would have been and in fact was undercut by those activities.

Mr. BERMAN. Did the shipments start with Clinton? I truly don't know.

Mr. SWARTZ. Well, could I just answer the Bush-Clinton differentiation by way of answering that question?

Mr. BERMAN. Tell me what happened on that fateful day in Belarus where you said one thing and Clinton did something else which caused the fall of democracy.

Mr. SWARTZ. Many fateful days during the Bush Administration shipments took place, yes, of a limited number of food commodities and of medicines, because in that immediate post-Soviet period, there were great distortions and there was simply food unavailable in many areas. I would draw a distinction between a crisis situation and then a more normal situation when grain is planted, seeds are planted and grain is harvested and grain is produced and so on. So that is that point.

On the Bush-Clinton dynamic, as I said in my testimony, who knows what would have happened during the Bush Administration. Maybe things would have gone down the tubes completely for all we know. We can't say. All we can say is that certain policies and certain policy frameworks were put in place during the Bush Administration, which I think held us in good stead in 1992 and beyond. Frankly, I think that the Clinton team that came in kept up with most of those policy sort of concepts. For example, the denuclearization which the Administration takes such great pride in saying that is the great success of Clinton diplomacy, in fact began during the Bush Administration. But you are wrong if you say that I am being partisan, because I criticize basically both of them, but we only had a year of Bush to be able to assess, and we have had 6½ years of the Clinton Administration.

As far as the personal attack, or alleged personal attack on Talbott is concerned, I can only repeat what I said before: which is, if someone is going to be posited as the public point person, the leader of our Russia policy, then simple rules of accountability demand that that person be the target of an assessment of how that policy works. That is all I am trying to say on that.

Yeltsin and the tanks, sure, a great act of bravery. But the Russian persona and especially the Soviet persona is a very complicated thing, and we can't say that X is good and Y is bad; all I can say is that both X and Y are gray, and that certainly holds true for Yeltsin.

Mr. BERMAN. You would say that X was good and Y was bad.

Mr. SWARTZ. No, not at all.

Chairman GILMAN. The gentleman's time has expired.

Dr. Cooksey.

Mr. COOKSEY. Thank you, Mr. Chairman and thank you for being here to testify today.

Ambassador Swartz, in September 1993, Russian President Yeltsin reportedly gave President Clinton an hour's notice that he was going to dissolve the Russian Parliament. During the May 1995 summit with Clinton, Yeltsin stated that there were no ongoing military operations in the region of Chechnya, even as the forces were attacking the Chechnyan villages. Through most of this decade, while the Yeltsin government has been denying that Russia was allowing any proliferation of dangerous weapons technology to Iran, it appears that there has, in fact, been proliferation.

In June of this year, Russian peacekeeping troops suddenly deployed from Bosnia into Kosovo, while Yeltsin and the other Russian leaders are saying no, it is really not happening; and then

Yeltsin later, I think even publicly, commended the general that did it, did the surprise move.

Finally, recently the Russian Government said that they had no intention of mounting a military operation in Chechnya, but in fact they did so.

My question to you, Mr. Ambassador, is why have these apparent lies been overlooked by the Administration and by this government? Is everyone naive, or is it lack of sophistication? What is the reason now? That is my question.

I have just been on this Committee for a short period of time. I have to do a lot more reading than probably other Members who have so much institutional knowledge. This is a book that I read recently written by a U.S. Berkeley professor, "The Soviet Tragedy: The History of Socialism in Russia, 1917 to 1991," by Martin Malia. But after reading this book—and I was in the military 30 years ago or 30 years ago plus 30 days when I got out—I was reminded that there were some really bad people running the Soviet government over a period of many years, and they did some really bad things, lying being the least of all of what they did. That was just routine for them. Has anyone read this book? Is anyone aware of the fact that they do, in fact—their leadership lie and cheat and steal? I think there are some wonderful Russian people, but their leadership has been bad.

My question is, why have these lies been overlooked by our government? Thank you.

Mr. SWARTZ. Well, Congressman, you appreciate that I can't speak for the Administration. They don't seek my advice very much these days, and I say that with tongue in cheek. As I say, I have lots of friends in the Administration. But, my own view on the question that you have posed is that Russian governance is a very nuanced sort of a situation. There are very significant questions as to the extent to which Yeltsin is personally involved in decisionmaking, even on matters of critical, critical mass, in many cases. We don't know, at least I don't know, not being privy to the latest intel briefings and so on.

The Russian military move into Kosovo at the very moment that it was being denied by the civilian leaders of the Russian Government raises serious questions as to where are the power loci here, who is in charge, who is calling the shots and so on. This is a very nuanced situation, and my guess would be, although I again have no particular inside information into how this Administration is reacting to these things, they are probably somewhat flummoxed as well when things of that nature happen, and probably are just trying to figure out as well and to continue to engage as effectively as possible in a situation where there may be different loci of power and of decisionmaking, and it may be a moving target. That would be my guess.

What the American response should be to these situations is another story altogether, and I again say that we are going to have to wait and see how the elections come out and see if there is some sort of true governance that starts to take place in today's Russia. As things stand right now, I think there are too many imponderables and too many nuances for us to be able to go to somebody, the Foreign Minister, the Prime Minister, or President

Yeltsin himself and say, "Why did you lie to me?" Because it may well be that they didn't. It may well be that they just didn't know what another arm of government was trying to do. That is kind of how I would answer.

Mr. COOKSEY. That is a plausible explanation, I would presume. Did you have any comment?

Mr. ERMARTH. I would underscore what Ambassador Swartz said about the lack of coherence in a lot of Russian policymaking over the years, particularly as time has gone on. But on our side, I do think the Administration can be, must be, faulted for signaling to the Russian regime, to the Yeltsin regime, not just to Yeltsin personally, but to that group of people that constituted the Kremlin. It wasn't just with what we said, it was kind of what we supported, what we—when we agreed to send the money—what we criticized, but not very strongly. By body language, basically, we were saying we are in your corner, with a couple of big exceptions like proliferation to Iran. We are pretty well ready to back what you think is really important to you.

Hence, the different economic reform moves that didn't look all that good at the beginning and mostly turned out badly from the point of view of the public, and things like the Chechnyan war and Yeltsin's showdown with the Parliament in September and October 1993. Not only did the Yeltsin regime get the message, but the Russian public got the message. They said, OK, the Americans are supporting this about which we are increasingly alienated: economic reform that is impoverishing us, and so-called democratization that is becoming more authoritarian and unpredictably authoritarian. What is going on here? Are the Americans blind or do they have a plan? They concluded eventually it is planned, it has been so consistent.

Chairman GILMAN. The gentleman's time has expired.

Mr. COOKSEY. Thank you, Mr. Chairman.

Chairman GILMAN. Mr. Hastings.

Mr. HASTINGS. Thank you very much, Mr. Chairman.

Mr. Chairman, I appreciate very much your holding this hearing, but I must admit some serious reservations regarding everything that I have heard here. I think the focus is wrong. Who did what when, or what was right, or which Administration—the Bush Administration or the Clinton Administration—has done something, ignores what our immediate responsibilities are in my view.

Gentlemen, I appreciate your testimony, but I would tell Mr. Martin Cannon, although I don't think I will be here when he testifies, that I was appreciative of many of his comments, but among them was that Russia is in generational transition.

Now, listen. At the beginning of Russia's transformation, we knew that it would be a long-term endeavor, unprecedented in history, with successes and disappointments on the way. A transformation of this magnitude is going to take decades, even generations, to complete.

A mere 7 years out, regardless of whether it was Bush or Clinton or any combination thereof, criticism of Russia's transition ignores the fact that it is still in midstream. Mr. Cannon, for example, referenced that maybe, maybe we are a third of the way. Amidst all

the problems, the transition continues, and Americans in my view, at least insofar as Russia is a threat, are perhaps safer than ever.

I think it is ignorant of us to ignore that we have completed over 71,000 exchanges from the NIS since 1993, 35,000 from Russia. People don't know things that Members of Congress have done. I have been to Uzbekistan myself, twice. Stayed there a week. I have been to Kazakhstan, Turkmenistan, Kyrgyzstan, Azerbaijan, and Georgia, and last year was in Russia for a week in St. Petersburg, and what I witnessed was a change in progress and in recognizing how hopeless and helpless some of us may be in order to conduct the kinds of changes that we would like to see take place immediately.

We helped draft post-Communist legislation on the civil code and the criminal code, as well as bills on money laundering and corruption. I have heard nothing here regarding the cooperation of the FBI and the NVD, and they have had extremely successful undertakings in targeting criminal elements that have been pursued. We created legal clinics, we gave grants to NGO's and created programs that highlight the successful efforts at combating corruption. We worked directly with local law enforcement on specific cases to help them build the capacity to deal with widespread crime and corruption.

We provided technical training, we have allowed for enhanced or local TV for people. When you are a novice as I am, and perhaps a bit naive, and you can walk the streets of St. Petersburg and you can see a vibrant society, albeit with a gray and a black market still operating there, then it is foolish for us to sit up here and try to pinpoint somebody who did not have a handle on something as slippery as this.

The questions ought to be what must we do, what should we do, what can we do to help create a stable Russian society? Our continuing disengagement will allow for a destabilized Russia or a destabilized Europe and the costs will be insurmountable insofar as global consequences are concerned.

There has only been $7 billion of direct aid offered by the United States. Two-thirds of that has gone to the nuclear demilitarization process, another $7 billion to try to help American businesses has been offered there. I think our strategy of engagement, establishing among other things the U.S.-Russia Binational Commission, which has an extraordinary agenda, is not to be frowned upon.

Let me ask you all this question: Ignoring who failed and who succeeded, what, gentlemen, the two of you, would be your top three priorities that we should exercise as our next steps? Enough of who was at fault about what.

Mr. SWARTZ. Thank you very much for the chance to answer that question. Speaking for myself, my top three priorities would be education, education, and education.

As you have correctly pointed out, Congressman, all kinds of activities have been taken that allow for the process of rule of law in police cooperation, et cetera, et cetera, et cetera to take place. What you said earlier about the generations, years and years needed to achieve these societal transformations is something that certainly resonates in my own analysis and my own thinking, because

transformations means you have to transform what is in people's minds, right?

The people who are out there, who are looking for their meat and potatoes and are unhappy about the economic situation today and remember all too well the Soviet period, with time they are going to die away. The thing that has to be done, starting with the youngest children and right up through higher education, is to inculcate the value systems that we hold so dear in Judeo-Christian society into those generations of upcoming Russian and Belarussians and Ukrainians and so on. That is what we have to do. I think the more effort and money and concrete projects that can be put into education is where the return is going to be paid in terms of our own national security interests down the line.

Mr. ERMARTH. Mr. Congressman, my response to your challenge would be three things. I am speaking to the present environment, which is between our elections and their elections, when I don't think a lot of terribly important programmatic initiatives ought to even be attempted because they don't really have a functioning government, and we just have to kind of face that.

I would lay down three requirements for us over the next 18 months. First, a thorough audit of our policy, not to find fault, but to establish what worked and what didn't work; because without that, we might be unable to protect successes, and there have been some.

Second, a package of policies, administrative measures, maybe even laws in such areas as money laundering, that assure transparency of the interactions that take place.

Third, we have to make very, very clear to the Russians that everything depends, everything depends on their getting through those elections; that there should be no notion on the part of any part of the political spectrum that we will turn a blind eye or somehow, gulp and find acceptable some cancellation or disruption of those elections.

Mr. HASTINGS. Thank you, Mr. Chairman.

Chairman GILMAN. The gentleman's time has expired. Thank you, Mr. Hastings.

Mr. Campbell.

Mr. CAMPBELL. Thank you, Mr. Chairman. You may have covered this earlier, I couldn't be here, so if you have, I don't wish to impose on my colleagues, just say you have; and I can read the record, and will. But my focus is on the IMF extension of credit in last early summer, early summer of 1998, followed rather precipitously in my view thereafter on the default of the Russian obligations. So let me just interrupt to say, have you already discussed this?

Mr. ERMARTH. No.

Mr. CAMPBELL. Great. Then my question is directed to both gentlemen. To the extent you know, and if you don't, just tell me, that is fine, but to the extent you know, I want to find out what IMF knew. That concerns me, about the extension of credit prior to what appeared to be—must have been, I would say—a predetermined decision to default on bonds. It looked to me as though we were either took, I mean IMF was took—bad English, but you get my drift—or were hopelessly incompetent. I hope you have a third

option, but those are the two I can think of. I would be happy to hear the answer of either gentleman.

Mr. ERMARTH. Mr. Campbell, I have a response to that. It is still a subject that is getting more and more light shed on it, it is still a subject that requires continuing investigation: What happened in the spring and summer of 1998 with respect to the IMF money? Well, as the Chairman has pointed out in reference to something I wrote, the architect of the reform policy in Russia, Mr. Chubais, said we conned the IMF. I take him to mean not just we Russians, but we Russians and our American partners who prettified the situation to the point where the IMF could rationalize another round of lending.

Now, much turned on this bazaar that they set up called the GKO market or the government short-term bond market. It was kind of a casino to start with, which by presenting a market in which there wouldn't be any losers, everybody could make the big profits. They began to create a pyramid which by the spring of 1998 was soaking up most of the Russian Federal budget. This was bound to collapse, and eventually it did.

What the IMF—and into the teeth of this reality, the IMF lent—and I believe the total sum for that tranche was about $4 billion, ostensibly for the purpose of supporting the currency in the budget. What it basically did was support a process in which Russian and probably some western speculators in the GKO market could convert their ruble-denominated GKO's into dollars and scoot the money out of the country.

Now, if that wasn't diversion, I don't know what the word means. Something like that seemed to be very likely to happen and was obvious to a lot of people who were wringing their hands at the time.

This has been speculated about even in August and September 1998 in Russia and some western articles, but since that time, Mr. Skuratov, the Russian General Prosecutor, a commission of the Upper House of the Russian Parliament, and now a journalist who wrote an article that I brought to the attention of the Committee just before these hearings, have laid it all out: Yes, we were conned, and your suggestion of the different choices pretty much brackets the possibilities.

Mr. CAMPBELL. Thanks, I guess.

Mr. Swartz.

Mr. SWARTZ. I have nothing to add to what he said.

Mr. CAMPBELL. Thank you, Mr. Chairman. I yield back.

Chairman GILMAN. Thank you, Mr. Campbell.

Mr. Sherman.

Mr. SHERMAN. Thank you, Mr. Chairman.

I think that one concern I have about American policy is that it gives inadequate consideration to the pride of the Russian people. Here is a country that a few years ago was one of two superpowers, and now we are telling them what to do about almost everything. It seems that this situation is not really analogous to the post-World War II period where Germany and Japan were occupied and remade, but maybe has some analogous aspects to the period after World War I where Germany ceased to be a superpower not because it completely lost on the battlefield, but because after a long

conflict, its system imploded and it raised the white flag in the first World War of our century. Perhaps the Cold War was the Third World War of our century.

It seems as if there is nothing that goes on in Russia about which we Americans do not have an official and public position. Now, some of this is understandable. We insist on promoting democracy around the world, and I think the Russian people and other peoples respect that, but there is no area about which countries get more sensitive than their own territorial integrity.

I wonder whether we are rubbing Russia's nose in it when we decide to have an opinion on what they should do in Chechnya. Here you have a part of the Russian Federation which then not only establishes its quasi-independence, but then wages a war of aggression on other Russian areas and appears to be somewhat responsible for terrorism in the Russian capital.

I wonder if you gentlemen could simply comment on whether we are perhaps planting the seeds for a backlash against America, and a wave of potential nationalism supported by nuclear weapons, if not an adequate economy, when we start scolding the Russians for their policy in Chechnya. Not that it is necessarily good policy, but simply one that perhaps we shouldn't have an opinion on.

Mr. ERMARTH. Mr. Chairman, we have agreed that I will go first on this one.

The point you make is an extremely important one, and what it leads one to is to recognize that whatever we say about Russia's development as one country and one government to another, we have to be very careful about the style in which we speak. It is easy for us to come across to other countries as not just a superpower but a Nazi, and this is resented.

At the same time, we have to recognize our obligation to decide. I mean, the Russians want and need a variety of help from the outside world. Some of it is just money, and some of it is a welcome mat into the western economic community. We can't avoid deciding for our own policy when it is and how it is that we have met the conditions. This is an unavoidable task that we decide what our policy is. What will be the conditions under which we send American taxpayer dollars into that country? We are going to have to make those decisions.

I think an extremely important point to keep in mind when doing so is that we should ask the Russians more broadly than this favored little team, this dream team or whatever it happens to be, empowering the Kremlin, ask across the political spectrum in the Duma, look at public opinion. Had we consulted alternative views about what the Yeltsin regime was doing on the question of territorial integrity, for example, when the Chechnyan war, the first Chechnyan war started, we would have been much more careful about seeming to endorse this very unsuccessful war against a province of Russia, because most Russian were opposed to it.

We have to listen better to different sources before making up our mind what they think works and what they think they want.

Chairman GILMAN. The gentleman's time has expired.

Congresswoman Kaptur.

Ms. KAPTUR. Mr. Chairman, I thank you again very much for allowing me to sit in and listen to this important hearing and to sub-

mit for the record testimony that I offered concurrently this morning at the House Agriculture Committee. I thank my colleagues just for giving me a couple of minutes here on the agenda.

I have one of the duties in the Congress of trying to integrate the work of our Agriculture Committee—.

Chairman GILMAN. Ms. Kaptur, your statement will be made part of the record, without objection.

Ms. KAPTUR. Thank you, Mr. Chairman. I have a summary and a complete statement and some relevant documents to submit for the record on the subject of our agriculture policy relative to Russia.

I appreciated Ambassador Swartz's comments here this morning where he references some of his own thoughts regarding the implications of current U.S. food aid to Russia and past food aid to Russia. Mr. Ermarth made some rather probing statements in his testimony of how things aren't working.

The reason I came over here today is to try to indicate that one thing I have learned in Congress. We cannot succeed alone in the Agriculture Appropriations Committee in getting focus on food commodity shipments to Russia, which this year alone will dwarf in value any other foreign assistance program we have. The latest shipment totals over $800 million, and its largely monetized proceeds go to the Russian Pension Fund. There is now an application for an additional amount that the Government of Russia has asked us for.

The reason I am here this morning is to try to stress to my colleagues, and to anyone who is listening, that the United States has to have a more coherent policy that begins in the State Department, involves the National Security Council, and links to our Commodity Credit Corporation. Because what is happening is that the value of these food commodities—which is enormous and growing—when it gets inside that economy, ought to go at least to help with the privatization and reform efforts that we know we need to make in transitioning the collective farms. Were it not for the intervention of our Committee trying to get auditors over there and accountants and field managers and, really, the cooperation of Ambassador Collins to a level that I did not expect and am most grateful, the dollars in my opinion would not get where they need to be.

This is not happening fully. The majority of food aid dollars that have gone there now have gone into the Russian Pension Fund. One of the questions, and my testimony documents this for the record, I really think is that we need some type of separate monitoring mechanism for who audits the Russian Pension Fund. Even though we can trace commodities going from the Port of Vladivostok to certain oblasts, when those commodities are monetized and dollars flow to the Russian Pension Fund, the U.S. Department of Agriculture and the Commodity Credit Corporation do not audit those funds.

So I have a legitimate question as to what happened to hundreds of millions of dollars this year, and we are on the verge of another such sale in 2000. I think the general sales operations of the Commodity Credit Corporation have to be tied to the work of this Committee and the deliberations that occur inside the Executive branch.

I hope I haven't made too long a statement there, but I wanted to ask both gentlemen questions, if I might. I have been totally frustrated by the lack of focus, I suppose, because agriculture seems warm and fuzzy, and nobody worries about it. But the whole system over there, as I understand it looking at history, was premised on the production of the collectives and the distribution of their proceeds to social welfare concerns within the State. When the Soviet system collapsed, there was very little attention given to the transformation of the collective structure in the agricultural countryside and, in fact, no credit system exists today. The teeny credit system we were trying to develop through ACDI/VOCA collapsed last August; it was only $20 million. Only $1 million has been restored through this recent food sale to Russia, which means largely we haven't done anything.

We have through this food aid largely supported the parastatal entities that still control the production. Since 70 to 80 percent of the diet of the ordinary citizen of Russia now is bread and potatoes, and the caloric intake is going down there, the entire structure remains so wed to agriculture. I am perplexed as an American and as a Member of Congress as to why we as a country can't get a coherent agricultural reform policy built into these food shipments, as well as the other policies that we try to implement toward Russia.

Could you comment on why that might be? I have been very frustrated with the State Department. I can not get them to even spell agriculture.

Mr. ERMARTH. Why the lack of coherence that the Congresswoman observes exists? There are just so many stakeholders in this game; I am afraid that is what accounts for it. But this food aid program, certainly to Russia, which I know a little something about, requires the most thorough, penetrating and skeptical investigation. It has had two negative results that have been widely reported in the Russian press and in some American reporting as well.

First, it undermined the competitiveness of Russian agriculture itself at a time when, from a public health and dietary point of view, it wasn't all that necessary. Now, maybe there is a tradeoff that has to be made there that I don't know that much about. But it hurt Russian farmers at a time when the objectives, economic, overall, and privatization of agriculture that we have for Russia want us to move in another direction. The other thing I am sorry to say is that money didn't go into the pension fund. That money was stolen. That is what the Russian press is saying.

Ms. KAPTUR. How do we get—how do we use the tools of this government to get proper accounting of that money?

Mr. SWARTZ. If I could offer an additional comment, let us say for the sake of argument that the money was not stolen, which I agree that it was—or in part, at least, because that is nature of the culture over there. But in addition to that, your real question is, how do we establish structures that will allow us to assure ourselves that the accountability factor again, that I have talked about several times today, is maintained in this particular area of endeavor. The answer is that you obviously have got to achieve a level of bilateral agreement with the Russians that will allow more

intrusiveness than they currently would like to give into the area of accounting, bank accounts and this sort of thing.

It could be done by an organization like VOCA. You mentioned VOCA. VOCA is one of the best things going out there I think. It is right there in the forefront of the privatization effort in Russian agriculture and the other Newly Independent States. They have a lot of credibility with Russian farmers, with Russian farm cooperatives and with Russian agricultural officials. So use of VOCA might be one way to do it.

But certainly in the final analysis—and this is a bigger, broader question admittedly—again we have to come back to what is the American national interest in all of this. If it is pushing grain, then I submit to you we ought to push it somewhere where it is more greatly needed than it is in Russia and where, under current arrangements, the proceeds are going—are very dubious, and cloudy and murky as to where they are being sqirreled away and who is getting them.

Chairman GILMAN. I want to thank the gentlelady for her very cogent observations, and I think she has given our Committee some food for thought. We will attempt to pursue her suggestion to a greater extent than we have in the past.

Ms. KAPTUR. Thank you, Mr. Chairman, very much.

Chairman GILMAN. Thank you for taking the time to appear Ms. Kaptur. Just one last question and then we will conclude with this panel.

Mr. Ermath, in your testimony you said that the total amount of capital flight out of Russia since the late 1980's might be between $200 and $500 billion, with a capital "B." Is that an accurate estimate? If so, where is this money now?

Mr. ERMARTH. It can't be an accurate one because it is at best a guesstimate. I got it from John Void who wrote a "Who Lost Russia" article for the "New York Times" a couple of months ago. I think 200 billion is a conservative estimate for the whole period from 1985, roughly, when the CPSU and the KGB escalated their capital flight operations basically. It is probably a good deal higher than that.

On the basis of what I know and what other estimates out there might be, or have been lately, I think $200 to $300 billion is in the right ballpark. Where is that money now? Well, it has probably made its way out through a variety of channels, most of it not through laundering at all, but just export.

Chairman GILMAN. Mr. Ermarth, could we have been able able to track much of that through the international banking system?

Mr. ERMARTH. I think it is technically possible to track it, but I don't think it is technically possible to reconstruct where all that money went. One has to make some reasoned judgments. It didn't stay in Cyprus, it didn't stay in Switzerland. It went to productive places.

What is the most productive, safest, accessible economy in the world in this period?

Chairman GILMAN. The U.S.

Mr. ERMARTH. That is where it went.

Chairman GILMAN. Thank you very much.

I want to thank our panelists for your very cogent observations and for being able to spend the time with us.

We will now proceed with the second panel. Our thanks go to both of our witnesses on our first panel.

Mr. ERMARTH. Thank you, Mr. Chairman.

Chairman GILMAN. We will now proceed to Panel Number two.

Mr. Mike Waller is Vice President of the American Foreign Policy Institute, a nonprofit educational foundation where he publishes, as well, "the Russian Reform Monitor" bulletin. He holds a doctorate from Boston University in international security affairs and serves as editor of the journal "Demokratizatsiya: The Journal of Post-Soviet Democratization".

He has also written on the problems of Russia's transition in the "Wall Street Journal" and other leading periodicals.

Mr. Kenneth Timmerman is a contributing editor for "Readers Digest" and has written regularly for the "Wall Street Journal". He has written investigative reports on the arms trade, on terrorism, and on technology transfer for media organizations such as "Time" magazine and the "New York Times", spending much of his career in Europe and the Middle East. Mr. Timmerman also worked on the staff of our Committee in 1993. Welcome back, Mr. Timmerman.

Mr. TIMMERMAN. Thank you, Mr. Chairman.

Chairman GILMAN. Finally, Mr. Martin Cannon serves as a Member of the board of directors of the U.S.-Russia Business Council here in Washington. He also serves as managing director of CIS operations for the firm of A.T. Kearney.

Chairman GILMAN. Gentlemen, you may summarize your statements which, without objection, will be inserted in the record. Please proceed, Mr. Waller.

STATEMENT OF J. MICHAEL WALLER, Ph.D., VICE PRESIDENT, AMERICAN FOREIGN POLICY COUNCIL, AND EXECUTIVE DIRECTOR, DEMOKRATIZATSIYA-JOURNAL OF POST-SOVIET DEMOCRATIZATION

Mr. WALLER. Thank you, Mr. Chairman for inviting me here and for holding this hearing.

Chairman GILMAN. Mr. Waller I might interrupt, I am being called to another meeting at the moment. I am going to ask Mr. Campbell if he could be kind enough to chair the hearing at this time.

Mr. Campbell, if you will please take over, and if you would please proceed, Mr. Waller.

Mr. WALLER. In a nutshell, the U.S. policy toward Russia, regardless of its good intent, has been tailor made for exploitation by the gangster bureaucrats, oligarchs, ascendent militarists and the secret police officials like the Prime Minister ruling Russia today.

One of the problems has been that the Administration as part of its policy has discouraged early warning of this. A pattern, reporting on the deteriorating condition of Russia shows a calculated policy to prevent decisionmakers in the Executive branch, in Congress and in the public from learning the truth and taking early corrective action. This was something I had a hunch about, but never dared say because I had no proof of it as an outsider until some

retired diplomats and CIA officials came forward confirming this is what they saw.

From the U.S. Embassy in Moscow we had two senior officials, Mr. Ermarth and others, who have repeated in recent weeks that they were instructed, or other Members of the embassy or Treasury Department officials were instructed, not to write cables, not to send cables already written, and not to report to Washington even within State Department channels certain things concerning crime and corruption within the Russian Government and the failures of certain economic reform policies.

I have got a very blunt assessment here in my written testimony, but point number five was the policy to "ignore or suppress opinions and facts indicating that the policy might be failing," to blind decisionmakers, to blind appropriators and authorizers, to have the CIA and the State Department censor itself; and among AID contractors, of which I was a consultant for a very brief time, to instill a climate of fear among them that if you see a problem, don't talk about it or you will get your livelihood cutoff.

This isn't a partisan issue; it has been raised by Members of both parties of this Committee. It was raised 5 years ago by Senator Bill Bradley and others.

It is not an America versus Russia issue. Some of my best sources have been Russian officials, journalists, former officials, lawmakers, some of whom were corruption fighters, who are now dead because of their anticorruption fighting activity. One is Dmitri Khodolov, a Moscow journalist, and Galina Starovoitova, a member of the state Duma, who were both assassinated.

We had early public warnings in 1994 even by the former Finance Minister, Boris Fyodorov, pleading with us; please don't send IMF money, it is only going to be used for corruption. There are top officials in our country who want to take the loans and not repay them, and it is only going to cause a lot more trouble than it is going to solve.

Few Russians dared be outspoken and it was apparent that U.S. policy was not to support them, not to listen to them and to continue to link ourselves to individuals who were the problem.

For U.S. AID contractors being under similar pressure, I was a consultant for only a month because, as a token Republican-oriented guy, they needed somebody to make them look good on Capitol Hill. So after that I left. But I found that this was the AID-funded "Rule of Law" project run by ARD-Checchi company.

In June 1994, they had hired an official at the insistence of somebody within AID, a criminologist at American University. I put the e-mail at the end of my written testimony, but I want to quote from it because it is very important; this is from 5½ years ago. Her name is Dr. Louise Shelley. The head of this AID Program said, "If I had known what Shelley was up to, I would have resisted" the AID official's "instruction to put her on the consulting contract. She is a bomb with a lit fuse. Her hobby horse is that the AID privatization program has been exploited by organized crime," and then proceeded with a way to figure out how to keep her quiet.

There is a pattern of official pressure to cover things up—whether it is CIA; whether it is the "barnyard epithet" incident regarding an assessment of some of our Russian interlocutors; whether it is

NASA and journalists reporting on corruption of NASA's space program or whether it is a cover-up of the laser incident where an American Navy officer was wounded in Washington State; the FBI's retreat from organized crime reportings and so forth—it is a pattern of these types of things to discourage and ignore this information from coming out.

I would like to have three recommendations: One is to establish a dissent channel like the Foreign Service has to allow contractors who see problem areas to be able to report this without fear of getting penalized. Ambassador Morningstar attempted such a system, but it really didn't work as well as it might have and it needs rejuvenating.

Second is, with our new public diplomacy effort at the State Department, we need a much more honest and straightforward public diplomacy effort to communicate with the people of Russia.

Third, keep those GAO reports going. Because the congressionally mandated audits have done more than anything else to promote change.

Mr. CAMPBELL. [Presiding.] Thanks, Dr. Waller, and thanks for staying within your time.

Mr. CAMPBELL. Mr. Timmerman.

STATEMENT OF KENNETH TIMMERMAN, INVESTIGATIVE REPORTER, AND CONTRIBUTING EDITOR, READERS DIGEST

Mr. TIMMERMAN. Thank you, Mr. Chairman.

It is a particular pleasure for me and an honor to testify before this Committee, where I had the opportunity to serve on the professional staff 6 years ago, doing nonproliferation and export controls. When Mr. Lantos came to France in 1993 to invite me to join the Committee, he reinforced my own conviction that issues of such monumental import for our national security were indeed bipartisan in nature. For most of the past 6 years, however, partisanship has been the rule and cooperation the exception. I hope we can begin to redress that as we look at Russia's role in the proliferation of weapons of mass destruction and the stunning accumulation of opportunities we missed to prevent that from ever occurring.

In 1992, after I had completed a study on missile, nuclear and chemical weapons programs for the Simon Wiesenthal Center, I was in Paris at a conference and Mr. Wiesenthal paid me the greatest compliment I have ever received. He said, "I have spent all my life tracking the murderers of yesterday. Mr. Timmerman is tracking the murderers of tomorrow."

Now, that is why we are here, Mr. Chairman, to track down and prevent the murderers of tomorrow, for the unchecked flow of Russian technology into Iran's missile and nuclear weapons programs and that of other countries could very well lead to the deaths of many of our fellow citizens tomorrow, as well as thousands, if not millions, of innocent people across the Middle East.

Now, I certainly concur with Mr. Lantos' remark that there was a lack of vision in the Bush Administration between 1989 and perhaps 1991. But being bipartisan does not mean we should refrain from criticism where criticism is due. We cannot rewrite the Bush Administration, but we can hope to influence the final year of the

Clinton Administration and especially events pertaining to Russian behavior.

The architect of this Administration's policy toward Russia is Strobe Talbott. He has a vision, and I would argue his vision is all wrong.

I have testified in various Committees on Iran's Shahab 3 and Kosar missile programs, which would not exist without direct assistance from the Government of Russia. The Shahab 3, in particular, which is now deployed in southwestern Iran, and is capable of targeting Israel with nuclear, chemical or biological warheads, should in my view have Mr. Talbott's name written all over it.

Let me briefly summarize the more detailed chronology I provided in the written statement of Mr. Talbott's responsibility for the Shahab 3 Missile. This is not my opinion; this is a statement of fact. It is a statement of the record.

The initial information of Russian assistance to the Shahab Missile came from Israeli agents in 1996. The Israelis felt so confident of their information they presented a detailed briefing to Mr. Talbott in September or October 1996. Mr. Talbott told them not to worry, he had the situation in Russia, quote, "under control."

When nothing happened for 3 or 4 months, the Israelis presented the same information in more detail to Leon Fuerth at the White House in late January, 1997. Mr. Fuerth briefed the Vice President, who was reportedly stunned to learn this. On February 6th, Mr. Gore raised the issue with Victor Chernomyrdin, who protested it was impossible that Russian firms were involved in such projects. He demanded that Mr. Gore supply him with specific information so he could investigate back in Moscow.

The Vice President provided what the Israelis had given to his aide, Mr. Fuerth. The Russians did nothing. Instead, some of Israel's best-placed assets on the ground in Russia went silent. They lost agents on the ground. Over the ensuing months, the Israelis met time and time again with Mr. Talbott, who rebuffed them every step of the way. In the meantime, Russia and Iran worked overtime to complete the Shahab Missile and roll up Russia's intelligence network.

I have given you much more detail in the written statement, but the crux of the matter, Mr. Chairman, is very simple. For nearly 2 years, despite having detailed intelligence on Russia's involvement with the Iranian Missile programs, the U.S. Government failed to press the Russians in any meaningful or effective way to stop it.

If we had intervened with the Russians when the Israelis first came to us in late 1996, the Shahab Missile would never have been tested successfully 2 years later. It would probably still, even today, be on the drawing board. Instead, not only have the Iranians deployed that missile, they are now working on a much longer-range missile, the Kosar, which is being disguised as a satellite launch vehicle. Both of those missiles are going to be powered by Russian-built and Russian-designed boosters. Ultimately, Russia has far more——

Mr. CAMPBELL. Mr. Timmerman, I am going to interrupt. The 5 minutes is up. We have a vote pending. So I think it is fair to let

Mr. Cannon speak for 5, at least that way he can have his opening statement.

Mr. TIMMERMAN. Let me refer to the conclusions that I made in my statement, which are some concrete things that I believe this Congress and this Committee can do to rectify the situation.

Mr. CAMPBELL. Indeed. Thank you very much. We will come back to you, no question.

Mr. CAMPBELL. Mr. Cannon.

STATEMENT OF MARTIN CANNON, MEMBER, BOARD OF DIRECTORS, U.S.-RUSSIA BUSINESS COUNCIL, AND MANAGING DIRECTOR, CIS OPERATIONS, A.T. KEARNEY

Mr. CANNON. Thank you, Mr. Chairman. The U.S.-Russia Business Council greatly appreciates the opportunity to testify on the issue of U.S. policy toward post-Soviet Russia, and we do so from the perspective of the U.S. Business community that is involved in the Russian economy. We represent over 250 enterprises from small entrepreneurs to the Fortune 500 corporations.

We don't think Russia is lost. What we think is lost is any lingering illusion about the immensity of the challenge of transforming Russia into a fully functioning democracy and market economy. Your examination of U.S. policy toward Russia comes in what we view as only the end of the beginning of a longer and more arduous process than any of us anticipated when we got involved in Russian business.

There was, we know, no prediction of the suddenness and totality of Soviet collapse. There was no blueprint to guide U.S. policy through this extraordinary event. The report card on the performance of government and business is not flawless. With an impending change of presidents in both countries, we need the debate now taking place. With our now substantial, accumulated experience in dealing with Russia, we can make it constructive and well informed if we so choose.

Our written testimony lays out comprehensively our largely positive view of the record of past U.S. government policy toward post-Soviet Russia. It allows, as we all must, for the difficulties inherent in dealing with such an unprecedented challenge. In these summary remarks, I want to highlight four areas with which we believe a constructive debate over past policy might yield the most future benefit.

First, I want to talk about the scale focus and effectiveness of programs funded directly or indirectly by the U.S. government. The majority of expenditure quite properly is focused on issues of security and on the promotion of democratic institutions in civil society. A lesser but still significant amount has been devoted to the nuts and bolts of building a functioning market economy. These include tax reform, the development of securities markets, conversion of accounting standards and many other areas critical to our economic transformation.

In only 7 years, Russian's political community has shed a condition of almost complete ignorance about the nature of the market economy and evolved a large measure of consensus about economic management, resulting, in several important areas, in draft or enacted legislation. Not all the obstacles to economic transformation

have been overcome, but thanks in large part to U.S. and other Western government support, they are far fewer today than in 1992.

Going forward, our accumulated experience raises some important and, I think, useful questions. Have we struck the right balance between investments and policy prescription and investments in enabling infrastructure? Are these programs individually or collectively at a critical mass of scale and intensity significant enough to bring about lasting change? Are we sufficiently willing and flexible to discontinue, initiate or modify programs in light of experience? Have we sequenced the efforts in ways that maximize their impact? Do they always have a political constituency in Russia that is capable of driving them to implementation? Should we link the provision of new programs more tightly to successful implementation of prior ones?

Let me turn now to the impact of the IMF on the drive for economic reform. In 1992, Russia assumed voluntarily responsibility for Soviet external debt, now standing in excess of about $100 billion. Despite the colossal latent wealth of the country that is embedded in its natural resources, the Russian government has proved unable to meet those commitments, and its public finances are in complete disarray. The effects traceable back in some degree to this problem are poverty among the dependents of the state, decaying social infrastructure, decline in control over nuclear and other military resources, further environmental degradation and diminishing public confidence in the market model.

The IMF was not designed to cope unaided with a situation of this kind. It does not have the resources to finance the Russian government out of it, and it is not equipped to direct their strategy for dealing with it. The most it can do it is doing: buying time for others to find a solution to the external debt problem.

We believe the policy debate needs to include the question of whether the U.S. and other governments of the G–7 should take a more direct role in tackling the problem of former Soviet debt. Put simply, this issue alone has the potential to derail the entire reform effort.

Third: Crime, corruption and capital flight. We believe the culture of lawlessness in much of Russia's economic life is a Soviet legacy of abuse of power by those who had it and disrespect for authority among those who didn't. We also believe that confiscatory tax regimes drive otherwise honest businesses and individuals to shelter their resources from the state through concealment at home and abroad.

Mr. CAMPBELL. Mr. Cannon, I apologize, 5 minutes are up. We are going to interrupt and proceed as follows. Because we have a pending vote, we will not be able to complete the panel before a recess is necessary.

Chairman Gilman has a question he would like me to place before you, which I will. I would ask Mr. Waller to answer it and to take, if possible, under 2 minutes. I will then yield to the Ranking Member. After that, I will then recess. Then as soon as Dr. Cooksey comes back, we will be able to reconvene.

If you gentlemen can stay—is it possible for each of you to stay? Thank you. I apologize for having to stick to the time limit.

Mr. Waller, the question—but I would be delighted to hear the answer from all three: How corrupt are the highest levels of the security and police agencies in Russia today? Do Russian police ever work in support of Russian criminal groups?

Mr. WALLER. The corruption is pervasive. There has been a problem both in the Interior Ministry, the NVD and the secret police, the old KGB, now the Federal Security Service, where they are protecting criminal rackets not just at the low level but at the higher levels as well, and in the case of the Federal Security Service, protecting criminal elements close to the Kremlin Administration itself.

I think what illustrates it is Prime Minister Putin himself who, as Federal security chief, earlier this year quashed the probes of the people around Yeltsin. He is the guy sitting on the information and he is basically sheltering these criminals and criminal organizations.

Mr. CAMPBELL. Mr. Timmerman.

Mr. TIMMERMAN. I would refer to a statement by a former CIA Director, James Woolsey. You can go to Lausanne, Switzerland, to a major hotel today and see a Russian with Gucci shoes, a Rolex watch, and a $3,000 suit. He can either be, first, a member of the Russian Mafia; second, a member of, the foreign intelligence services; or third, a Russian cabinet minister. Today, he might be all three of those at the same time.

Mr. CAMPBELL. Mr. Cannon.

Mr. CANNON. The answer to the first is, more than is acceptable; and the answer to the second is, yes.

Mr. CAMPBELL. The Committee of International Relations is recessed pending return of Members adequate to reconvene. Thank you.

I would assume we have a 15-minute vote on now, followed by a 5-minute vote, so why don't we assume we will come back at 10 or probably 5 minutes to 1:00; 5 minutes to 1:00.

[Recess.]

Mr. COOKSEY. [Presiding.] The Committee will now reconvene. We have a smaller group. Now we can really get something done. I always enjoy these meetings. I have a little game I play, trying to decide who is here from the other government, whether, it is China or Iran or Russia. I really would like to get them up, but in lieu of that, we will follow standard procedure. I am not a real politician, in case you couldn't tell.

Mr. Timmerman, you have written in an article in the "American Spectator" of April 1998 that Gordon Oehler, a career intelligence officer who headed the CIA's Nonproliferation Center and who had briefed congressional Committees on Russia proliferation to Iran, may have been forced into early retirement as a result of high-level pressure from the Administration.

Can you back up that allegation or can you explain more, sir, give us more detail?

Mr. TIMMERMAN. Thank you, Mr. Chairman.

Mr. Oehler provided in 1998 extensive testimony on Russian involvement in the Iranian Missile programs. He briefed Members of Congress on Russia's involvement in selling gyroscopes to Iraq, and

these were gyroscopes that had been taken off the SS–N–18 strategic missiles and shipped to Iraq through clandestine means.

The specific incident that triggered Mr. Oehler's decision to leave the CIA came after he testified in public session that there was no doubt of the intelligence that China had delivered M–11 missiles to Pakistan. Now, this was something that the State Department had consistently refused to acknowledge on the record. Mr. Oehler was basically told that his department would be downsized significantly days after he made that statement on the public record.

So the actual incident was involving China, but he had a record of being frank and cooperating with Congress and did not earn himself friends in the Administration for that.

Mr. COOKSEY. Thank you.

Mr. Campbell.

Mr. CAMPBELL. Thank you, Mr. Chairman. My question, first of all, is to Dr. Waller.

The Shelley e-mail that you appended to your testimony, it is possible to interpret that Professor Shelley was pursuing something that would be embarrassing to AID and inaccurate. If she was silenced because she was critical of AID, that is one thing; if she was silenced because she was inaccurate that is another. I am trying to make the case that could be used to rebut. Namely, the author of the memo, Mr. Bronheim, might say, well, we just didn't think she was right. We weren't going to have that erroneous patina put upon AID.

Can you give me any more information about what happened to Professor Shelley? What might lead you to believe that she was silenced, if you care to or can?

Mr. WALLER. Yes. In fact, maybe Mr. Henderson, who is testifying tomorrow, can explain. I haven't consulted with him on this. He doesn't even know I attached this, so I might be putting him on the spot. But she was right. She was raising concerns not to attack AID, but to say, hey, this is a problem—we have to undo this problem before it gets worse.

Mr. CAMPBELL. But were any steps taken with regard to Professor Shelley on her contract?

Mr. WALLER. No, she wasn't penalized because she had support within the bureaucracy.

Mr. CAMPBELL. You also said—I am trying to quote close to accurately, I hope accurately—that members of State and AID were instructed not to write cables concerning crime and corruption, and AID contractors were also so instructed.

Can you give a little specificity to that?

Mr. WALLER. Yes. Wayne Merry and Tom Graham, who were both at our embassy in Moscow in the early and mid-1990's, testified to that effect either before the Banking Committee or the Foreign Relations Committee, and also to Bob Kaiser in the "Washington Post" and elsewhere, so they have been pretty open from their own personal experience, especially Wayne Merry, about all this. In the August 15th, "Washington Post" in the Kaiser piece, that is detailed pretty well.

Mr. CAMPBELL. Thank you. These are my last two questions: I don't remember the gentleman's name, but the deputy mayor of St. Petersburg was assassinated. I remember he was shot by a high-

velocity rifle through the roof of his car, that he had been identified with fighting corruption. If you can refresh my memory—any of the gentlemen—it comes to mind because of Dr. Waller's testimony that advocates for reform had been assassinated in Russia, and I wonder if that instance which I am recalling probably 3 years ago was an example of that reality.

Mr. WALLER. I don't know about that particular instance. I knew Galina Starovoitova when she was on our editorial board, and she was assassinated last November. She was a human rights leader and also——

Mr. CAMPBELL. But that particular incident.

Mr. WALLER. I don't know this particular instance.

Mr. CAMPBELL. I apologize for not remembering the name. But what was remarkable about it was it was a very difficult rifle shot that killed him, doing damage to no one else. In other words, it had all the marks of professional killing about it.

Last, Ambassador Morningstar's tenure as our Special Ambassador for the Newly Independent States is of interest to me. Again, my question is directed to Dr. Waller, but I invite Mr. Cannon and Mr. Timmerman, as well, to give me an assessment. I believe you had said that he had tried to establish a dissent channel. I notice he has been moved, that he is no longer in that position. I wonder if you could enlighten me as to whether any negative career action was taken with regard to him because of his attempt to establish a dissent channel or whatever else you could shed on the change in personnel.

Mr. WALLER. No. He was there as a troubleshooter, first to coordinate and then recognize things that didn't work. It wasn't a formal dissent channel that he created, but he wanted his office to be used as a place where contractors and others could come and speak frankly. Now people in his office said it didn't work well because people had to physically go to the State Department. But he was the first senior official that was really open to this.

Mr. CAMPBELL. Is your judgment of his tenure a favorable one?

Mr. WALLER. I can say he tried in many ways, but in other areas I think he was not well served by some members of the staff in his office.

Mr. CAMPBELL. Last, Mr. Timmerman. Incidentally, unless my direction be in doubt, I happen to have high regard for his work, but I am seeking advice. If you had good things to say, they would be welcome; if truth forced you to say less than good things, obviously I would receive that as well.

Mr. Timmerman, your comment about the Shahab 3 having Strobe Talbott's name on it is chilling. I wanted to ask you if it is your belief that Deputy Secretary of State Strobe Talbott knew of the diversion of the technology, whether he could have taken steps to prevent it and chose not to.

Mr. TIMMERMAN. Yes, on both counts, Mr. Campbell. As a reporter, I came to this issue first from sources in government in the United States and sources in the Israeli military intelligence, but I was certainly not privy to the type of classified briefings to which Mr. Talbott was privy. I was not able to call up the Central Intelligence Agency and ask them to look into the case.

One of the most astonishing things that I found was that after Mr. Talbott was initially briefed by the Israelis in September or October 1996, he never once asked a question of our intelligence agencies until the Israelis came back and briefed Mr. Gore through his aide, Leon Fuerth.

After February 1997, Mr. Talbott was tasked by Mr. Gore to deal with the issue directly with the Russians. For the next 6 months he did absolutely nothing.

He was aware. He had detailed intelligence from the Israelis on the names of companies and the names of individuals involved in the transfers to Iran of Russian missile technology and did nothing. He never put it at the top of his agenda. He never pressed the Russians or used the leverage, the very real leverage that we had at that time through Aid programs, and in particular, U.S. assistance to the Russian space programs.

Mr. CAMPBELL. Again, just for the sake of getting the full story out, if he were here, he might say he undertook a lot of steps, but they were not publicly known. You categorically state that he knew, and did nothing.

On what do you base that judgment?

Mr. TIMMERMAN. For the first 3 months, I am saying between late 1996 and February 1997, absolutely nothing was done. This I have from both U.S. Government sources and from Israeli sources. Afterward, Mr. Talbott was tasked specifically by the Vice President's office and put in charge of dealing with the Russians on this issue. He had exchanges with the Russians, but he never pressed them. The reason that we know that he never pressed them is because it leaked out into the press in numerous cases of Russian transfers going to Iran. There were customs cases; customs officials in various countries blocked shipments. This came out in the press. Mr. Talbott had information about those shipments before they were stopped, and he never pressed it.

Mr. CAMPBELL. Thank you.

Mr. Chairman, thank you.

Mr. COOKSEY. Thank you, Mr. Campbell.

Dr. Waller, you have written about the bilateral commission with the Russian Prime Minister headed by Vice President Al Gore, referred to generically as the Gore-Chernomyrdin Commission. How influential a role did the Vice President have or did he play in U.S. relations under this Administration due to his leadership of this commission? That is my first question.

Second question: In a "Washington Post" article of August the 27th of this year an unnamed advisor of the Vice President was quoted as saying Gore clearly chaired this commission, but it was Administration policy, not his policy. Do you agree with this assessment of the Vice President's role? Basically both my questions are directed at Vice President Gore's influence and basically his effect on this commission and on our relationship with the the Russian Government.

Mr. WALLER. I think he and Deputy Secretary Talbott were the two primary players on Russia, Talbott with the big-picture approach and Gore on implementing a day-to-day relationship with his Russian interlocutors across the board. So he had a very strong role. He and his staff were always claiming credit for his role and

saying that he was so central to it, until things started hitting the fan this summer, when they were then saying, well, it wasn't just him, it was other parts of the Administration. So I think he was happy to accept credit when people were crediting him, but sort of shying away from some of the responsibility.

Mr. COOKSEY. Another question: Mr. Wayne Merry, a former State Department official in Moscow, has written that every program or project associated with the commission's meetings had to be deemed a, quote, "success." He argues that the commission should have been disbanded long ago, making a case that it was part and parcel of the Administration's interest to have State Department personnel tell, in his words, that its policy is a success.

Do you agree with that assessment?

Mr. WALLER. Yes.

Mr. COOKSEY. So you have no argument with that——

Mr. WALLER. No, argument at all. That is part of the issue of my testimony. The whole line across every agency involved was to only report successes and to limit or even not report on policy failures.

Mr. COOKSEY. Good.

Mr. Timmerman, in your earlier article for the "American Spectator" you referred to a "Washington Post" profile of Deputy Secretary Strobe Talbott, a statement in the article to the effect that no career diplomat should think of opposing his policy line toward Russia. What, in your view, are the sources of Mr. Talbott's influence over policy toward Russia, and does the Deputy Secretary have greater influence over policy toward Russia than former Secretary of State Warren Christopher or current Secretary of State Madeline Albright?

Mr. TIMMERMAN. I take it you are asking for my opinion, as well as what I can base my opinion on, Mr. Chairman. Certainly, I think Dr. Waller has testified that other diplomats in the U.S. Embassy, Russia, have been overruled by Mr. Talbott. I think that is credible information, and certainly from my own contacts with the diplomatic community, I think that is true.

But I do not have firsthand information of how Mr. Talbott has played the role inside the State Department. That has not been my focus. My focus has been on what he has been doing with the Russians vis-a-vis with Iran and vis-a-vis nonproliferation and his failure to stop the Russian transfers.

Let me just point out one other detail which is in my written testimony, but it hasn't come out here this morning. Mr. Talbott was instrumental in making sure that Yuri Koptev, who was the Chairman of the Russian space agency, became the principal interlocutor for this Gore-Chernomyrdin process focusing on the Russian missile transfers to Iran. It is very curious that he would choose Mr. Koptev, because our own intelligence agencies had singled out and identified Mr. Koptev as the man who was probably most knowledgeable and probably in charge of those transfers to Iran.

Mr. COOKSEY. Mr. Cannon, how much influence has the U.S.-Russia Business Council had in setting the agenda of past meetings of the so-called Gore-Chernomyrdin Commission, and how do you believe outside organizations can influence the agenda of the commission?

I will repeat that. One, how much influence has the U.S.-Russia Business Council had in setting the agenda of past meetings of the so-called Gore-Chernomyrdin Commission; and second, how do you believe outside organizations can influence the agenda of the commission?

Mr. CANNON. Mr. Chairman, the U.S.-Russia Business Council has acted as a staff and support of the business dimensions of that agenda. It is the logical place to go to get the opinion of the U.S. business community that has an interest in Russia. A substantial part of the Gore-Chernomyrdin Commission's agenda was focused on elements of the program of reform in the business environment in which all those companies have a stake. So I would say that our issues were advanced. They were, therefore, known to the staff and presumably communicated to the leadership of the commission, including the Vice President.

I think the attitude of the member companies in the U.S.-Russia Business Council was that any exposure of our concerns and views on the state of the Russian business economy and the priorities as we saw them for its modernization was valuable—didn't take a huge amount of staff time, didn't feel that it was a wasted effort. Have one or two wins to point to in which I think it is legitimate to say the Gore-Chernomyrdin Commission played a valuable role. Production sharing agreements, I think, is probably, in the oil industry, the largest single area that we would point to.

With respect to access for other organizations, I think they are very accessible. I think, a lot of these organizations frankly lacked, in some areas in the business arena within their staff structure, the necessary expertise and perspective to be able to operate in an informed fashion.

As I say, any business that had a particular gripe in the way in which its interests were being dealt with by agencies of the Russian government would tend to have gravitated toward the Gore-Chernomyrdin Commission in search of redress. Whether they were successful I don't know. Frankly, I wouldn't have myself channeled any concerns that I would have had or any comment I would have had through the Gore-Chernomyrdin Commission as the sole method of attempting to deal with it. I might do it as a pro forma matter to see if anything happened. But I think most businesses that have a significant investment in Russia and a significant concern would know where to go to deal with any problems they have, directly within the government or the counterpart businesses that they were dealing with.

Mr. COOKSEY. Good. Thank you.

I have a personal comment and then a question for the three of you. Due to my age and my past time in the military, I still have somewhat of a concern about the people that are running the government now, because they were all educated in Moscow and came with the old Soviet mentality. I feel that past political model and that past economic model have been totally discredited. But even though I have only been to one city and spent about a week there, in St. Petersburg—it is a beautiful city, the Russian people I met were wonderful, nice people, obviously a lot of them are very bright, well educated—I can't help but feel that they are not going to really put their country together and have a democracy as a po-

litical model, a market-driven economy, until this generation is off the scene.

Do you feel that that is a correct position or is there any hope that these people that were educated—part of the old problem, maybe midlevel, but still part of the old problem—do you think they can be salvaged or salvage the remnants of the Soviet Union?

Mr. WALLER. Yes. It has to be a generational approach. There are a lot of people in their forties who made good leaders in the early 1990's who have been marginalized. I am thinking particularly of former Foreign Minister Kozyrev, who doesn't have this innate hostility to the West. That generation certainly did have power for a while. We chose not to continue supporting the ideals that many of those people had and to side with the Chernomyrdins and the Primakovs and the others from the old Communist Party Central Committee.

There are more out there, but in Russia, they have always learned to talk to survive. Back in the Soviet system, they didn't always speak their minds, obviously, because there were always consequences to whatever they said.

Today, there is a similar degree of that where you have people who in private may be much more friendly toward the United States than they would be in public. I think you can see these votes in the Duma, where you have a 420–to–1 vote condemning the United States for something. Well, a good 50 of those people, at least, are of this generation of people that we are talking about, but they don't dare to vote at all, or if they do, they will vote with the opposition to the United States.

What has happened now is that our policy of just supporting the Kremlin has marginalized people who were formerly allies in the government. So now President Yeltsin's main ally in the Duma, his most reliable ally, is Vladimir Zhironovsky and his Liberal Democratic Party. Now, nobody would have dreamed of this in 1992–1993, but that is how it has deteriorated. So it is going to take a long time.

Mr. TIMMERMAN. There is a very disturbing trend inside Russia today within the military, within the intelligence establishment and in certain areas of the foreign policy establishment that are close to former Foreign Affairs Minister Primakov—Yevgeny Primakov—who is probably going to be a candidate for the presidency. They have a belief that they need to counterbalance Russia's declining military capabilities especially the conventional military capabilities, by creating strategic challenges to the United States and other parts of the world. You all remember how the Russian army made that terrific midnight dash into Kosovo the same way they had gone into Berlin in 1945.

We have also seen in this Iran and Iraq. For Yevgeny Primakov and this particular faction within the security establishment, they are consciously pursuing a policy of creating challenges to U.S. power in the Persian Gulf. They would like to see Iran and Iraq have the military power to challenge our presence in the Persian Gulf, and that is a policy of the Russian government. I think this is a very disturbing factor. This is certainly something that Deputy Secretary of State Strobe Talbott should have been focusing on, but he is not.

Mr. COOKSEY. Mr. Cannon, and really for all of you, one final question from me, What will be the future of Russia if U.S. relations continue along the same track, if we don't change the policy?

Mr. CANNON. I think there will be a widening gap between the vision and the aspirations of the reform-minded community in Russia, which I think consists of far more than a few intellectuals with a grasp of free market economic principles. I think it extends to a substantial portion of the population that intuitively understands that life has the potential to be far better in the absence of communism, even if it isn't today. I think because of the widening of the gap between aspirations that existed in the early 1990's and the belief in what is truly possible, given Russia's realities, there will be a deepening of cynicism on the part of the Russians about their ability to integrate themselves into the value system and the economic organizations and to adhere to the terms and behavior patterns that are required of members of the OECD and other international agencies.

I believe very strongly that the dual burdens of an unmanageable external debt and an unaddressed problem of capital flight will render the reform agenda largely irrelevant unless they are tackled differently from the way they have been tackled over the last 6 or 7 years.

Mr. TIMMERMAN. Simply put, Mr. Chairman, I think we should do what America does best; we should hold high the light of democracy and engage directly with the Russian people. This Administration has been engaging with the Russian elite and a corrupt Russian elite. Our policy should be crafted at doing things like encouraging private property. There is still not private landownership in Russia after all these years, 10 years after the Wall has gone down. We should be crafting policies that promote the rule of law and the accountability of public officials. Instead, we have just rewarded a corrupt elite.

Mr. WALLER. I think, if current trends continue, we are going to find ourselves engaged in finding a Russia that is very nationalistic, not in the good sense, but in the very bad sense. Scapegoating, worsening problems in the United States, blaming the United States, suspecting us for every type of subversive intent and then rearming not only places like China, but rearming strategic nuclear forces on their own.

The Chairman of the Duma's international relations Committee, Vladimir Luken, who is a voice for moderation there, came out the other day and said we are just going to crank out more and more of these Topol-M nuclear missiles, and we are going to put multiple warheads on them. When you get people of that stature and that degree of moderation saying things that only the Communists were saying only a few years ago, you know we are headed in the wrong direction.

Mr. COOKSEY. Thank you. We appreciate your testimony and your participation in this hearing today. It has been very informative. Your thoughts and comments I can assure you will contribute to this Committee's understanding of the problem. Hopefully, the Administration and maybe the House will review its policy toward Russia and, in the long run, do what is best for the Rus-

sian people, for the American taxpayers and for everyone that is influenced by these two nations.

Thank you very much. The meeting is adjourned.

[Whereupon, at 1:25 p.m., the Committee was adjourned.]

A P P E N D I X

October 6, 1999

NEWS International Relations Committee

U.S. House of Representatives * Benjamin A. Gilman, Chairman * 2170 RHOB * Washington, D.C. 20515

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RUSSIA POLICY "APPROACHING A DEAD END," SAYS GILMAN

WASHINGTON (October 6) – U.S. Rep. Benjamin A. Gilman (20th-NY), Chairman of the House International Relations Committee, said today that Clinton Administration policy toward Russia is "approaching a dead end."

His remarks came at a committee hearing on "U.S. policy toward Russia: warnings and dissent." His full remarks follow:

"It is clear that the path that the Clinton Administration has followed over the last few years with regard to Russia is dangerously approaching a dead-end.

"The pattern is clear: top American officials have repeatedly described Russian President Boris Yeltsin as advancing the objectives of democracy and economic reform in Russia. Yet, for years now, his commitment to those objectives has been questionable at best.

"In fact, some of Yeltsin's actions have been inconsistent with those objectives and his personal engagement in the day-to-day governance of Russia seems to consist largely of his now routine hirings and firings of prime ministers.

"Over the last few years, top administration officials have pressed the International Monetary Fund to provide bigger and bigger loans to the Russian government – but witnesses before this Committee, public commentators, and events in Russia itself have shown that providing more loans will only lead to the need to provide more loans later.

"Huge amounts of money has flooded out of Russia and been laundered in non-Russian banks, including American ones, and yet nothing truly meaningful has been done to halt the flood. If they weren't themselves stolen, IMF monies have only replaced – in part – the monies that have been stolen from Russian industry and government.

"Meanwhile, the Russian economy sinks deeper into a morass while out top officials call for patience and point to a few successes. It is hard to ignore the characteristics of life in Russia today: life-threatening poverty; contagious diseases; a rising mortality rate; the theft of government pensions and salaries; a renewed

anti-Semitism and possible fascism on the horizon.

"It is hard to see how Russia will gain the stability we want for it if these circumstances continue to prevail. In foreign policy, Russian officials tell us one thing and do the other, whether it involves: the new Russian military operation in the region of Chechnya; Russia's recent "surprise" deployment of peacekeeping troops in Kosovo; or what appears to be continued Russian proliferation of weapons technology to Iran.

"The Committee on International Relations will begin a new review of that policy and how it has been implemented over the last few years. Today, we will review warnings that may have been ignored or disregarded over the last few years – warnings that have come from within Executive Branch agencies as well as from outside.

"Today's hearing will be followed by a hearing tomorrow morning, during which the Committee will gauge the extent of corruption within the Yeltsin government. That hearing will be followed by a closed hearing of the Committee next week with the Director of Central Intelligence to discuss the intelligence community's record of analysis and reporting on corruption in Russia.

"The Committee has also extended an invitation – almost three weeks ago – to Secretary of State Madeleine Albright or Deputy Secretary Strobe Talbott to appear before the Committee on the issues of our policy toward Russia and corruption in Russia. We expect to receive a positive response to that invitation in the next few days.

"Finally, there have been a number of troubling stories regarding the administration's willingness to disregard Russian malfeasance.

"There are questions about the State Department's handling of an alleged assault on a United States Naval officer who believed that he was blinded by a laser device while observing a Russian cargo ship near our shores.

"In 1996, American businessman Paul Tatum was murdered in Russia. His family members have expressed their concern that a proper investigation of that murder may never have been carried out due to the possible impact on US-Russian relations.

"There are stories going back to 1995 alleging that an intelligence program was closed down after it questioned the extent of Russia's control over its nuclear materials.

"And finally, there are questions about the removal of an aid officials who openly questioned events in Russia and the character of President Yeltsin."

NOT FOR PUBLICATION
UNTIL RELEASED BY THE
HOUSE INTERNATIONAL
RELATIONS COMMITTEE

STATEMENT OF

JACK DALY

LIEUTENANT, UNITED STATES NAVY

BEFORE THE

HOUSE INTERNATIONAL RELATIONS COMMITTEE

ON THE

UNITED STATES POLICY TOWARD RUSSIA

PART I

WARNINGS AND DISSENT

OCTOBER 6TH, 1999

NOT FOR PUBLICATION UNTIL
RELEASED BY THE
HOUSE INTERNATIONAL
RELATIONS COMMITTEE

INTORDUCTION

This statement is submitted for inclusion in the Congressional Record of the 106th Congress of the United States of America. The opinions expressed in this testimony are not those of the United States Navy. The purpose of this statement is to provide evidence that key Clinton Administration personnel were involved in a conspiracy to cover-up a hostile act, in United States territorial waters, in which a U.S. Naval Officer and an Allied pilot were attacked and permanently wounded. As a result of this cover-up the National Security of the United States has been jeopardized.

My name is Lieutenant Jack Daly. I am an active duty regular U.S. Naval Intelligence Officer who, along with a Canadian Air Force pilot, Captain Patrick Barnes, was wounded aboard a Canadian CH-124 helicopter when we were lazed (shot/targeted with a laser) while on an Office of Naval Intelligence tasked surveillance mission. This surveillance mission was tasked against the Russian merchant ship KAPITAN MAN, which was located five nautical miles north of Port Angeles, Washington, in the Strait of Juan de Fuca.

The intelligence community has evidence that the KAPITAN MAN and other vessels owned and operated by the Far East Shipping Company (FESCO) of Vladivostok, Russia are associated with the Russian military, intelligence services and organized crime entities.

As a result of this lasing, both Captain Barnes and I have suffered irreparable eye damage resulting in permanent retinal damage. Captain Barnes and I continue to suffer agonizing chronic pain 24 hours a day from this incident and our vision continues to deteriorate. The possibility that one, if not both of us, will lose some degree of our vision, or become totally blind does exist.

ILLEGAL RUSSIAN ACTIVITY IN THE UNITED STATES

By way of background, the Russian flagged ship, KAPITAN MAN, and others like her sailing under the flags of China, Cyprus and Panama, et al, transit the Puget Sound on a regular basis. These ships are suspected by the intelligence community to be conducting surveillance against our Ballistic Missile Submarines (SSBN's) and the Carrier Battle Groups operating out of Bangor and Bremerton/Everett, WA. Evidence exists in the intelligence community to indicate that the FESCO vessels still actively support the Russian military. Recent press reports from Russia indicate that FESCO's Chief Executive Officer (CEO) is the Russian Deputy Minister of the Interior, a known branch of the former Soviet, and now Russian, intelligence apparatus.

Since the end of the "Cold War" era, these vessels now freely transit our waters and enter our ports under the guise of merchant shipping and commercial fishing, and engage in a variety of criminal activities in addition to their intelligence collection role. These activities include, but are not limited to, former KGB involvement; Russian Mafia/organized crime activity including extortion, murder and prostitution, as well as alien, drug and weapons smuggling.

HOSTILE ACT IN U.S. WATERS

In essence, this incident left Capt. Barnes and I as victims of what could be argued was a hostile act in an undeclared war, an act of terrorism and, at minimum a federal crime.

The suspected laser incident during the surveillance of the KAPITAN MAN on April 4th, 1997 was not reported by us to higher authority until there was enough credible evidence to substantiate the claim of such an event. Over the course of the 48 hours immediately following the flight, the combination of medical and photographic evidence proved to be impetus enough to say that a hostile act had indeed occurred. On Sunday, April 6th, 1997,in accordance with established procedures, both Canadian and U.S. military chains-of-command and National Command Authorities in Ottawa and Washington, DC, were notified of the suspicion that a hostile act had occurred in U.S. territorial waters.

EVIDENCE OF A COVER-UP

The May, 1999 release of the book BETRAYAL; How the Clinton Administration Undermined American Security, by Bill Gertz of the Washington Times, contains evidence of what amounts to an effort by White House, State Department, National Security Council and Defense Department officials to deny this incident had occurred. Reprints of internal State Department emails list the names of key Clinton Administration appointees who were involved in this effort. They include (but are not limited too): Strobe Talbott, Deputy Secretary of State; Robert G. Bell, Special Advisor to the President for National Security Affairs; James Steinberg, National Security Council Executive Director; James Collins, Ambassador (at that time designate) to Russia; and Jan Lodal, Deputy Undersecretary of Defense for Policy.

Documented results transpiring from high level consultations reveal that a decision was made to notify the Russian Embassy in Washington DC, of the suspicion of a lasing event, within hours of our notification to Canadian and U.S. National Command Authorities. Further warning was also provided of the U.S. Coast Guard's intention to board and search the KAPITAN MAN the following day in an effort to locate the laser device. Documents that I had viewed indicated that Ambassador Collins had personally provided the tip-off to the Russian Embassy. I was subsequently informed that Secretary

of State, Madeline Albright, had "insisted that the Russians be given advance warning of the impending search." As a result, the Russian embassy notified their consulate office in Seattle, which, in turn notified the master of the vessel, providing almost 24 hours advance warning of the impending boarding and search. Additional reports indicate that initially the NSC and State Department wanted to allow the KAPITAN MAN to leave Tacoma, WA without being searched at all, but insistence by the Pentagon delayed the departure and forced a search. According to the evidence in Gertz's book, at 5:00AM prior to the search of the ship, this group, along with U.S. Coast Guard and Navy personnel, decided that, "If the Capt. Mann (sic) crew is uncooperative, a second SVTS (Secure Tele-video Teleconference System) will be convened April 7 to decide on a further course of action."

Further complicating matters was the fact that the State Dept. directed Vice Admiral J. David Spade, Commander, Coast Guard District Thirteen, Seattle, WA to have the combined U.S. Coast Guard and U.S. Naval intelligence team limit the actual time of the search to no more than two hours. A thorough search would have taken days. The search was further restricted to the "common areas" only of the KAPITAN MAN. No coordination or request for assistance was made to the local office of the U.S. Customs Service or the I.N.S., that such a boarding and search was to be conducted. This also hamstring'd the search by minimizing the jurisdictional benefits of these two law enforcement organizations.

The crew of the Kapitan Man did not cooperate and denied the existence or use of any laser device.

According to a subsequent State Department email, "At the 4/7 2300 SVTS, the conferees could not agree on a course of action. State and the NSC opted to let the Capt. Mann (sic) leave Tacoma. DOD (except for the Coast Guard) want to detain the vessel until tests are completed on the helo crew. NSC initiated a secure telcon (telephone conference) at 0015 4/8 with Lodal, Steinberg, Talbott, and Collins to decide the issue." In essence the cover-up was formulated and put into action.

What followed from this point forward was a coordinated effort conducted by select individuals to disprove that this incident had ever actually occurred. Hard evidence was altered, ignored, omitted and refuted. The subsequent so-called investigations and reports that followed served only to support the original intentions of a cover-up. Senior military officers dodged responsibility and proclaimed ignorance isolating me as a renegade who lacked judgement and had violated orders. Official statements were released to the press by the Department of Defense, that were contrived without investigating the facts or interviewing key witnesses.

Additionally, I was informed On Monday morning April 7th, 1997 and on numerous occasions over the next week that President Clinton was being briefed daily on my (our) status (medical condition). Considering the magnitude of this incident and the potential political ramifications I must assume the President was briefed by Strobe Talbott and/or others on the decision(s) that were made on how to handle this issue. Suffice it to say as Commander in Chief he either, acknowledged and approved the decision or reached his

own conclusions. On Thursday, April 10th, the President and the Canadian Prime Minister held a pre-scheduled meeting; it would only be logical to assume that this incident was discussed during that meeting.

CONCLUSIONS

Strobe Talbott and the others contrived a scheme to cover-up a hostile act in U.S. waters by this country's once most feared foe. By providing advance notice of the impending boarding and search to look for a laser, then interfering with the conduct of said boarding and search, this act of aggression went virtually unchecked. However, what it did accomplish, was to give the White House, State Department, Department of Defense and, more so the Russians, the benefit of plausible deniability.

As a result, I would be betrayed; my career, health and family's well being jeopardized and my loyalty questioned. Captain Barnes would find himself in the same situation.

Even more dangerous was the message that was sent. You can commit a hostile act or crime within U.S. borders, injure U.S. service men and women, however, because of potential political sensitivities, not only will you get away with it, you will be assisted by the very government you have attacked. This demonstrates a sign of weakness that could eventually be exploited.

I am convinced that the political slight of hand of the laser incident was an effort to minimize any detrimental impact that might result in jeopardizing relations with Moscow. Also documented in Bill Gertz's book is a copy of "notes" issued by Strobe Talbott from a meeting that took place between President Clinton and Russian President Boris Yeltsin on March 13th, 1996. In these notes it cites that President Clinton "promised not to allow any events to embarrass Boris Yeltsin." This incident was one of those embarrassments.

Considering the ideology espoused by Strobe Talbott of a "single global authority" in the world, anything that might upset the achievement of that power, in his mind, could not be acknowledged as well.

Justice has been denied and our civil rights ignored. No one, regardless of his/her degree of culpability, has been questioned, nor does it look like anyone will be held accountable for the crimes they have committed.

There will be those who will claim that the decision to downplay the laser incident was made "for National Security" reasons. However, it is our National Security that has been jeopardized and our nation that has been weakened by the very men who took an oath to protect our freedom and liberty.

Considering the increasing instability around the world, particularly in Russia with it's numerous nuclear weapons and internal strife, our National Security depends on increased vigilance and not complete appeasement to garner political favor.

The American public's reaction to the limited media reports of this incident have all demanded answers as to why the lasing incident and it's cover-up were allowed to go unchecked. Based on their words it is obvious they have lost faith in our government and it's ability to protect their freedoms. Many in uniform have privately acknowledged that they too have lost faith not only in the political leadership but also in the military leadership as well in this country. I for one will publicly state that my faith in both has been shaken to it's core and on rely solely now on my faith in God that better days lie ahead, and that truth, liberty, and justice for all will eventually prevail.

This misguided decision, and the acceptance of it, by the Clinton Administration must not be allowed to go unchecked. In our nation's history few acts conducted by our own government have carried the degree of danger, and the potential for graver, more disastrous consequences to our National Security than this.

ARMITAGE ASSOCIATES L.C.

From: Richard L. Armitage
Subject: Thoughts on Russia
Date: September 29, 1999

In December 1991 Deputy Secretary of State Larry Eagleburger asked me to take control of the disparate, chaotic and ineffective efforts of the US Government to provide emergency humanitarian assistance to the 13 states (including Russia) emerging from the collapsed Soviet Union. In April 1992 technical assistance was added to my portfolio. I served as coordinator for US humanitarian and technical assistance until May 1993, when the Clinton Administration found a replacement.

During my tenure I communicated directly, often and in great detail with the appropriate Committees of Congress. I wanted very much to have the advice of key Members and staff and share with the Congress my sense of just how daunting the task of undoing the effects of 70 years of communism would be. We reached, I think, a bi-partisan consensus that we Americans could best serve the cause of reform in Russia by focusing on humanitarian aid and on institution-building at the grassroots level, well-removed from Moscow and its dysfunctional Kremlin. With just $482 million to work with, no one was thinking in terms of a "Marshall Plan."

I was convinced (and I communicated this view repeatedly to Congress) that Russia was facing a *transition period* to democracy and free markets *of approximately the same length of time it took communism to lay waste materially and morally to much of the Eurasian landmass*. I had no confidence that Boris Yeltsin, himself an apt student and high achiever in a system featuring corruption and criminality, could accelerate this transition. It is in fact yesterday's communists — not reformers or revolutionaries — who are today looting Russia, albeit in a less systematic and less ideological manner than they did when they proudly proclaimed themselves disciples of Marx and Lenin.

In March 1993 I gave a speech at Vanderbilt University in which I said, in essence, that after he had dissolved the Soviet Union the usefulness of Boris Yeltsin to the coming transition was, in fact, ended. For "committing truth" I was "*fired*," although I had already resigned effective January 20, 1993. Nevertheless I was asked again to stay on for yet a few more months in order for the Clinton administration to complete its own transition. It seemed to me that the new team was on the verge of making two key mistakes. First, it was consciously and deliberately linking the *person* of Boris Yeltsin to reform, democracy and "partnership" with the US. Second, it was consigning technical assistance to the tender mercies of the Agency for International Development, an organization whose failures around the world hardly qualified it to take command of a unique effort with unprecedented challenges in Russia.

The current situation in Russia is disheartening, but not surprising. Although I do not believe that the President and his lieutenants have conducted Russia policy in a professionally satisfactory manner, I would say now exactly what I said when George Bush was President: Russia is not ours to lose. We need to maintain a correct relationship with a great nation, one inhabited by peoples whose accomplishments in the arts and sciences under the most predatory of rulers have been, at times, inspirational for all of humanity. We need not trivialize, minimize or even jeopardize this relationship by personalizing it, and we need not forget that the journey on which the peoples of the Russian Federation are embarked is just beginning.

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UNITED STATES POLICY TOWARD THE RUSSIAN FEDERATION: TREATMENT OF CRITICISMS, DISSENT, OR WARNINGS

Statement by Mr. David H. Swartz
Retired Senior Foreign Service Officer

House Committee on International Relations

October 6, 1999

I am grateful, Mr. Chairman, for having been invited to testify today on the important subject of United States policies toward the Russian Federation in the initial months and years following the collapse of the Soviet Union. My brief analysis will perforce also address the impact and relevance of those policies on subsequent developments in Russia itself and in its relations with the other successor states of the former USSR.

At the outset, I believe it is important to recall the atmosphere in the late 1980s and early 90s, a setting perhaps now largely forgotten by many given the events that have taken place since. The two key elements to bear in mind, I think, are, first, the ascendancy of CPSU General Secretary Mikhail Gorbachev and the substance of his leadership. Then, secondly but equally important was the wisdom of the West, specifically Presidents Reagan and Bush and Prime Minister Thatcher, in recognizing Gorbachev for what he was: a pragmatic practioner of reality-driven reform and principled communist, and for seizing the opportunity afforded by Gorbachev's flexible realpolitik to advance the seminal changes both within the Soviet Union and in its dealings with the West that now, a generation later, seem all too susceptible to being taken for granted.

Gorbachev's Glasnost and New Thinking concepts and all they entailed, especially in the economic arena, were of course not altruistic. He understood the hard realities of the USSR's inability to compete with the West any longer either economically or militarily and of the absolute moral corruption of communist ideology. His goal was not the dissolution of the USSR or of communism as the vanguard of the proletariat, but rather communism's internal transformation into a value system worthy of popular support. His intellectual vigor and principled convictions in the worth of communist ideology led to a massive, and in the end futile, effort to reform the system and obtain genuine popular support. Gorbachev, in short, was a unique communist leader, i.e. a true believer, and in that he was rivaled possibly only by General Jaruzelski in Poland.

Gorbachev's mortal enemy, Boris Yeltsin—today's seeming leader of Russia—could hardly have been more different in temperament, conviction, and Weltanschauung. A long-standing communist apparatchik and opportunist with a penchant for heavy drinking, erratic personal behavior, and brutal in-fighting abilities, Yeltsin too saw the hand-writing on the wall in the late 1980s and drew from that the conclusion that the Soviet Union's woes presented an unusual opportunity for personal self-advancement. He too cloaked himself in the mantle of reform, eventually becoming the champion of dissolving the USSR in response to events unraveling around him and his countrymen.

The events that enveloped these two political enemies and the rest of the Soviet Union's citizenry need not be recalled again here. What is important is how the U.S. reacted, particularly so since the one—Yeltsin—has been in charge of post-Soviet Russia from Day One until Day Today.

Our topic is U.S. policy toward the Russian Federation, which means the policies of both the Bush and Clinton administrations. If we are to assert—and I feel we clearly have both the right and obligation to do so—that the policies during the two Clinton terms toward Russia are largely failed policies, objectivity demands also a look at the last year of the Bush administration. It of course coincided with the first post-Soviet year, 1992.

I personally became re-involved in U.S. foreign policy toward the region during that year of 1992 when I was sent to Minsk, Belarus in March as charge d'affaires at the newly opened embassy, then was nominated by President Bush as the first U.S. ambassador to Belarus later that spring. (My earlier tours of duty at U.S. diplomatic and consular missions in Moscow; Kiev, then-Ukrainian SSR; and Warsaw, Poland, added up to nearly nine years of physical presence serving in the former Soviet empire.) I was kept on in Minsk by the incoming Clinton team, and so have had ample opportunity to observe and compare both administrations' approaches to Russia, Belarus, Ukraine, the Baltics and other countries of the region.

In fairness, I must say at the outset that it is quite possible that a second Bush administration would have been just as guilty of gross misunderstandings and shortsightedness with regard to Russia as proved to be the case in the first Clinton one. We just don't know. Certainly in many respects all of us were dealing with terra incognita in the unprecedented setting that evolved following the climatic events of December, 1991. But I think the record suggests the approach and hence outcome would have been different.

President Bush's visit to the USSR in July,1991—the "Chicken Kiev" speech notwithstanding or perhaps an unfortunate exception—demonstrated his sensitivity to the evolving centrifugal forces at play in the independence-minded republics. More importantly, he appears to have sized up Yeltsin quite accurately, realizing that this was no Gorbachev, intellectually or morally.

A very important indicator of the Bush administration's understanding and operational acumen occurred during and after the waning days of the USSR's existence in December,

1991. The president opened new embassies in all the now-independent republics—almost instantly. By February, 1992—i.e. a scant six weeks after the death of the Soviet Union—the United States had embassies established and operating in all the capitals. This was a truly remarkable logistical feat, but it was even more important politically.

In sum, it would appear that the Bush administration intended a) to treat Yeltsin very cautiously, correctly understanding his multifaceted problems, including intellectual shallowness, opportunism, and the characteristic communist lack of principles or values; b) treat the non-Russian successor states as equally sovereign and important in their own rights in terms of American interests (the overriding one of which, of course, was to assure that the former USSR stayed permanently fragmented); c) give Russia the due its geographic size and still formidable military, especially nuclear, might demanded; d) press ahead vigorously on all arms control fronts towards centralization and then reduction of the Soviet nuclear arsenal; and e) articulate and implement a gradated assistance policy designed to deal with immediate humanitarian needs and then longer term issues of societal transformation. (This became the Freedom Support Act, legislation that was quite bipartisan and rather policy neutral as regards the two parties, although the Bradley Amendment did provide important clues—later confirmed in specific policy decisions in the first Clinton term—of the naivete of the Democratic approach to assistance to Russia and the other successor states.)

This was quite a policy agenda indeed and one characterized by an overarching caution, indeed wariness, of the new Kremlin leadership in post-Gorbachev Russia. I am quite sure there was little or no naivete, false hopes, or rose-colored glasses among policymakers in the Bush State Department and NSC in 1992.

The arrival of President Clinton and his team in January of 1993 set in motion quite a different approach to Russia and the other successor states, one characterized—in my opinion—by the following features: 1) the seeming oxymoron of the highest level self-proclaimed U.S. administration Russia expert since Zbigniew Brzezinski in the the figure of Strobe Talbott juxtaposed against incredibly naïve specific actions; 2) pronounced russocentrism with consequences discussed below; 3) ignorance of and, worse, indifference toward the other successor states, notably Ukraine (which found ways of getting attention such as threatening to keep the Soviet nuclear weapons on its territory); and 4) misunderstanding completely the political dimension to assistance and, equally, the incompetence of U.S. government organizations to deliver it effectively. I will comment on each of these points briefly.

In the person of then-Ambassador-at-Large and now Deputy Secretary of State Strobe Talbott the Clinton administration found what it thought was a true Russia guru. With the possible exception of Brzezinski in the Carter administration, Talbott is the highest level administration official I met in some 29 years in the Foreign Service (over 10 of them in the former Soviet empire) to claim Soviet specialization. Now nearly seven years in place in this administration's pantheon of foreign policy wizards, Talbott for good or ill would certainly be correct in boasting that all Russian and NIS policy begins and ends with himself. In my experience, Talbott always knew best (he let us know), refuting, rebutting, rejecting, or

simply ignoring advise from his ambassadors in the field and other assistants. In one specific disastrous case involving the President's visit to Belarus in January, 1994, Talbott ignored my advice and that of the President's host, the Belarus chief of state, regarding a centerpiece event near Minsk. The latter told me, prophetically, that "your President will be here six hours, but it is I who will have to pay the price after he is gone." Within days he had been ousted in a quasi-putsch. Shortly thereafter a neo-stalinist became president of Belarus and developments there, and in U.S.-Belarus relations, have been on a downward spiral ever since. These developments bear directly on Russia and on U.S.-Russia relations.

It would appear that Mr. Talbott's Soviet/Russian expertise is limited to the intellectual salons of Moscow and Leningrad, now St. Petersburg, the milieu in which he circulated so brilliantly as a journalist but where political insight, not to mention knowledge of economic matters, is shakier. Mr. Talbott, in particular, seems to have been, and still be, the driving force behind this country's unstinting support for President Yeltsin and his shifting coterie of "reformers," many if not most of whom now turn out to be somewhat less white-hatted than earlier thought. This seems to me to be a function of Mr. Talbott's less than thoroughgoing understanding of the nature of Soviet and early post-Soviet political culture. Self-promotion and opportunism are the absolute norm of this culture and can always be counted on to take precedence over the proclaimed "value du jour," in this case political and economic reform. Mr. Yeltsin is not Mr. Gorbachev and we need finally to understand that.

This Administration seemed not to understand the potency the communist legacy left in the hearts and minds of the masses. Accustomed to the welfare state from cradle to grave, ordinary Russians, Ukrainians, and others lived daily lives of what I call "satisfied deprivation." If they could count on a loaf of bread and some hoary slab of fatty meat at the market each day, they could grumble and survive. The immediate uncertainties and deprivations of the early post-Soviet period left them in no mood to listen to well-heeled Americans assuring them that a great new world of plenty had arrived. It hadn't. It hasn't. Mr. Talbott seems not to understand that. And connected to it is the incredibly naïve notion that circulated then that somehow all the communists had disappeared as if by magic so you could start kicking them around. It turned out they still had some fight left; they still do.

Another feature of the Talbott-driven policy toward Russia and the other successor states, especially in those early months of 1993 and 1994, was a deep, thorough-going russocentrism. By russocentrism I do not mean paying the appropriately high degree of attention to Russia that its size, resources, and—especially—nuclear weapons warrant. Rather, I mean Talbott's policy of looking at regional matters through Russia's prism, as though the Union still existed; of ignoring the other new states; of conveying unmistakable signals to Moscow that the United States recognized its hegemonic "rights" in what Moscow calls its "near abroad." Secretary Christopher, whom I greatly respect but who certainly was no Russia expert, for example, on Talbott's recommendation indicated, through his staffers, in Kiev in March, 1996, that "voluntary reassociation" of the new countries with Moscow would be acceptable to the United States. Only when howls of protest went up from independence-minded reformers in the new countries and U.S. ambassadors alike did the State Department back down—but then only slightly.

I repeatedly warned in cables and policy analyses from Minsk of the dangers of a russocentrist approach. It was my view then and continues to be that fundamental U.S. interests lie in a permanent fragmentation of the former Soviet empire. I was ignored by Talbott but the Ukrainians managed to get Washington's attention when they threatened to delay or even stop the shipment back to Russia of Soviet nuclear weapons on their territory in 1993. Thereafter, Washington's russocentrism became less overtly evident.

Another way Mr. Talbott's russocentrism found its way into early Clinton policy was with regard to the Commonwealth of Independent States and, specifically, the collective security pact that Moscow tried to foist on its "junior partners" beginning already in late 1992 but intensifying in 1993. For whatever reason, Washington seemed satisfied that this pact did not smack of reintegration; indeed, it seemed to have some merit as for example in the various Caucasus insurgencies flaring up from time to time, such as in Georgia. The more independent minded of the successor states strenuously resisted; in Belarus, where I have personal knowledge, there was a sharp internal debate over the pact. This expressed itself graphically in an exchange within the Belarus delegation itself in a White House meeting with President Clinton in July, 1993. The U.S. position as expressed that day hardly supported the reformist Belarus chief of state in his opposition to the pact.

The subject of technical and economic "assistance" to Russia is a large, complex, and highly controversial one. My own view boils down to these two points: 1) it hasn't worked because those giving it didn't know what they were doing either in conception or execution; and 2) there was a major disconnect between the political policy levels (Mr. Talbott) and the assistance operations. Perhaps the greatest single problem stemmed from the fact that the early Clinton years (and perhaps even now) were characterized by the most naïve belief that democracy and market economics would happen almost magically with the wave of a wand. As we now know, neither is yet in place. The veneer of democracy is not supported by a rule of law society. The superficial layer of the marketplace scarcely hides the bulging coffers of the oligarchs, who have supplanted the communist masters of the past while the ordinary people live as bad or worse than during the Soviet period.

Societal transformations, in short, will take a very long time in all these countries. The case can credibly be argued that that our assistance is lengthening the process rather than shortening the misery index. I repeatedly and forcefully argued against providing commodity assistance a) because it was not needed and b) because it would undermine our own policies of reforming the collective farm agricultural system. Now again we appear on the verge of providing many more millions of tons of grain and other commodities to Russia. This should stop. Rather, we should be plowing our scarce assistance dollars much more into such areas as private higher education, where the true battle for societal transformation is and will be fought. But back in 1993, my repeated efforts to get Mr. Talbott's attention focused on these and related issues were rebuffed. Until and unless much better political oversight is applied to those doling out our so-called assistance, taxpayer dollars will be wasted.

What does all this add up to? It adds up to a Russia with corrupt officials, a society devoid of rule of law, an economy dominated by a handful of unbelievably wealthy oligarchs

and supported by the same miserable hoi polloi that the end of communism was supposed to liberate. It is too much to say the United States singlehandedly caused all these problems, just as it would be wrong to assert that we will be the instrument of progress and reform for Russia in the future. Our role was and is marginal. But it could have been important; that it wasn't points, I think, to specific failures of the Clinton Administration as I have outlined above. Since Mr. Talbott sought for himself the mantle as our Russia guru, it seems not only inevitable but also appropriate that he should be held accountable for the consequences of his policy dictums.

Again, thank you very much, Mr. Chairman, for the opportunity of appearing today and presenting this statement.

Statement of Representative Ed Royce
U.S. Policy Toward Russia, Part I: Warnings and Dissent
October 6, 1999

Thank you Mr. Chairman for holding these important hearings. The relationship between the U.S. and Russia remains critical. I'm looking forward to hearing from today's witness' views of where we've been, and where we're going.

3 1/2 years ago this Committee held hearings on Russian organized crime. Unfortunately, we were ahead of the curve. At that time, I said that our aid to Russia should be conditioned on assurances from the Russian Government, and our government, that all is being done that can be done to monitor and counter the growing threat of Russian crime syndicates before they choked off the infant democratic experiment in the former Soviet Union. My concern was about countering a real threat to the chances for a successful political and economic transition in the former Soviet Union, and about stopping an international crime wave before it crested on our own shores.

Well here we are, five years and billions of dollars later, and these concerns may have risen to a level of a scandal. American taxpayers deserve better. Our important relationship with Russia deserves better. As does the integrity of the American financial system.

Over the last several weeks the Administration has been telling us that our relationship with Russia has been moving in the right direction. It is standing behind the International Monetary Fund's yet again reform effort. Well, many of these problems were quite evident five years ago. Some of us on this Committee raised these issues; some of toady's witnesses were raising these concerns. But things were allowed to slide.

Today's hearing is about better understanding where we've been so that we can better understand where we're going, both with the international financial institutions and with the overall U.S.-Russian relationship. It is my hope that this Committee and the Congress will redouble its oversight efforts to help see that something positive comes out of the serious shortcomings in the management of our relations with Russia that are now so evident to all.

Thank you Mr. Chairman.

Russian Food Aid
"Teach Russia to Fish and She Will Have Food for a Lifetime"

Hearing before the House International Relations Committee
2170 Rayburn Building
October 6, 1999

Testimony of
Congresswoman Marcy Kaptur
Ranking Member, House Agriculture Appropriations Subcommittee

Good morning Chairman Gilman, Ranking Member Gejdenson and members of the International Relations Committee. Thank you for arranging this morning's schedule to allow me the opportunity to testify before your Committee on the important issue of Russian food assistance.

The farm crisis that is sweeping across rural America requires immediate congressional action. I would like to share with you this morning some ideas regarding how expanded humanitarian and other export related assistance can help clear our markets and direct delivery of commodities to where it is most needed.

As Ranking Member of the House Agriculture Appropriations Subcommittee I have been working hard to move U.S. commodities abroad. The USDA this year has set an historic high mark by quintupling its sales abroad. There are several proposals that I was prepared to offer during the recent conference consideration of the Agriculture Appropriations bill and I stand ready to work with you and your Committee on my proposals regarding the P.L. 480 programs, Section 416 and a Sense of the Congress Resolution outlining the key role increased food shipments can play in assisting both our market here at home as well as several overseas. I look forward to working with you on these proposals.

In addition, I wish to submit for the record the proposal in which I suggested President Clinton launch a "Millennium Goodwill Initiative" to build on the power of agricultural humanitarian assistance and concessional sales. Targeted U.S. shipments can help guide developing countries down the path of self-sufficiency as we enter the 21st century, while giving a real helping hand to rural America when she needs it. In fact, I believe the Commodity Credit Corporation to be the most innovating global development instrument in our tool kit for democracy building. These developing countries and regions include Kosovo and the Balkans,

the Middle East, Newly Independent States, Sub-Saharan Africa, South East Asia and Turkey.

This year's food shipments to Russia have been helpful in addressing the immediate food gap and lack of resources, but failed to address long-term developmental needs of that country where caloric intake has been decreasing and no reserves exist this year. Particularly in agriculture which undergirds the economic system of the former Soviet Union, our food aid has done nothing to transition the rural countryside toward market reform.

COMPARISON OF U.S.-RUSSIAN-EUROPEAN NUTRITION PER CAPITA ANNUAL CONSUMPTION IN KILOGRAMS				
	ACTUAL RUSSIAN 1990	ACTUAL RUSSIAN 1998	EUROPEAN NORM	U.S. NORM
Wheat/meat (not poultry)	75	49	78	80
Milk/Dairy	386	228	390	261
Veg. Oil	10.2	7.4	13	11.8
Vegetable/ Melons	89	79	139	149.7
Potatoes	125	130	124.2	38.6
Fruits/Berries	35	27	80	128.4
Bread/Bakery	120	118	120	89.8
Sugar	40	32	20.7	30
Fish	19	9.5	--	67
Recently Calculated Norms and Survival Minimums Developed by Russian nutrionists/government				

OFFICIAL SURVIVAL MINIMUMS							
	U.S. Recom-mended	Russian Working Men	Russian Working Women	Russian Pen-sioners	Russian Children (0-6)	Russian Children (7-15)	U.S. Per Capital Con-sumption
Protein (grams	91	88	68	64	49	73	491
Fats	111	69	58	54	51	74	110
Carbo-hydrates	398	437	326	314	228	329	410
Food Energy (kgrams)	N.A.	2,730	2,110	2,000	1,580	2,360	3,800

Of $800 million in commodities, I believe only $2.2 million in proceeds was directed to agriculture development - $1 million to cryogenic storage of seeds at the Vavilov Institute in Pushkin and $1 million to replenish the ACDI/VOCA micro-credit facility for agriculture lending in Russia. That facility had been bankrupt at $20 million when the ruble collapsed last August. It was the only initiative targeted to equip small land-owners with the resources and technical assistance to endure a market transition.

With all food programs, including the $1.1 billion Russian agreement, I am committed to ensuring that our valuable food assistance reaches the people who need it the most. After all, commodities are cash and cash is a precious resource in modern Russia. The economy faces a 70 percent inflation rate. We must have in place proper safeguards to prevent the diversion of our assistance into the wrong hands.

I wish to submit for the record a letter from Citizens Network, one of America's most respected and experienced private voluntary organizations working in Russia in which its President John Costello writes:

> *"Last year's Food Aid Package was well organized and carefully monitored by USDA and achieved positive results, particularly in reviving Russia's feed grain sector. However, the sale and distribution of commodities was done entirely through largely State or quasi-State distribution channels. Russia's emerging private distribution and processing sectors received little benefit and in many cases were put to a disadvantage. The net result is that we unintentionally strengthened the State structures at the expense of the emerging private sector."*

We must use the monetization of U.S. commodities in an applied way to energize and strengthen the sector that undergirds social peace in Russia. But how will that be done?

While I have not seen a report prepared by the Interagency Assessment team, there are questions regarding an unmonitored Russian government and her ability of providing guarantees that food assistance goes to the people who really need it. That is why I have requested the General Accounting Office to report on the package.

The December 1998 U.S. aid agreements had two components. Under the first agreement, the USDA's Commodity Credit Corporation provided long-term, low-interest-rate loans for the Russian government to purchase **1.5 million tons** of various U.S. commodities. Under the second agreement, the U.S. donated **1.5 million metric tons** of surplus wheat to Russia. The total combined cost of this food aid commitment including commodity, transportation, and freight cost is $1.1 billion. As of today, 95% of the commodities included in this package has been purchased and approximately 75% has been shipped to Russia. Due to the efforts of Ambassador Collins and FAS's Gus Schumacher and Robert Walker, diversion of U.S. products appears to have been averted. In fact, the Europeans have copied our inter-agency working group.

In 1992, the U.S. Congress voted to send half a billion dollars to aid the economic transition in post-Soviet Russia. Against the objections of several members of Congress, almost no checks and balances were established to follow the cash. A series of GAO reports on this issue highlighted problems including: agreements on monetization and use of monetized proceeds were not followed; there were commodity accountability inadequacies; limited staffing; unclear delegation of authority; reports to Congress were not filed; and there was a lack of supervisory field visits.

Today, U.S. federal agencies including the Departments of Treasury and Justice are conducting investigations of alleged money laundering schemes resulting in the misdirection of billions of dollars. It is our obligation to American taxpayers to investigate what, if any, connection these alleged abuses have on the current food aid agreement or on any additional packages. The International Relations Committee is holding a hearing today to further examine these allegations. As you know, our government has recently received an official request from the Russian government for more food aid.

I remain concerned however that this Congress and the Administration lacks a clear mission when it comes to helping rural Russia. We must do more to help bolster the private sector in Russia and better assist her in land and agriculture reform. We have the tools readily available and the minds to accomplish this task. But we need to employ a design that creates a partnership in agriculture development with a major portion of the proceeds going to a credit guarantee facility that reduces risk and encourages US companies to sell agricultural equipment inputs, seeds and commodities to Russian buyers.

We should set aside a portion of the funds to support agricultural universities and other agricultural higher education institutes to help Russia move into the 21st Century.

This current shipment of hundreds of millions of dollars worth of goods dwarfs other forms of foreign aid to that nation. These commodities arrive at ports we do not control for delivery across a land so vast it covers 11 time zones. Once, the instrumentalities of the Russian government sold the commodities and deposited the capital into the Russian General Pension Fund. What is this General Pension Fund, who controls it, who has received benefits from it, and how can we be certain that the resources supported by our food are being used for the right purposes?

Any USDA initiative must meet Russia's long-term interests. I argue that an investment today will save us hundreds of times over in the future. I believe that Russian farmers and private plot holders, equipped with the necessary seeds, fertilizers and technical knowledge will achieve effective production, leading Russia to greater self-sufficiency.

While we must help our neighbor in need, teaching the Russian Federation to prepare for its self-sufficiency is in the world's best interest. Currently, private households produce 91 percent of the potatoes and 80 percent of the vegetables that feed 150 million Russians. Even the Russian Orthodox Church is interested in growing food at its 400 monasteries for the needy.

America should also insist that up to one-third of the proceeds of monetized commodity sales be placed in a special account to advance private agriculture for these smallholders' futures. U.S. aid should not result in the strengthening of the old, Soviet system of parastatals that mill wheat or process beef. Rather, America's aid should result in strengthening agriculture microenterprise that can grow into the private sector of the future.

It is the increasing productivity of small farmers that will form the foundation of a Russian agricultural system that can feed all of its citizens, buy U.S. seeds, and ensure that next winter will not yield the same bitter harvest.

Let 1999 be the year we learn from a mistake. Let us use our food aid as a weapon to curb graft in Russia, to feed her hungry people, and invest in her people's self-sufficiency. By doing so, we will anchor the base for political stability in that fragile republic.

TESTIMONY OF FRITZ W. ERMARTH
ON
RUSSIAN CORRUPTION AND RECENT U.S. FOREIGN POLICY
BEFORE
THE HOUSE INTERNATIONAL RELATIONS COMMITTEE
6 OCTOBER 1999

Mr. Chairman, I deeply appreciate the opportunity to testify before this committee on Russian corruption and the challenge it poses to US foreign policy.

I would like to focus my testimony on the larger context of Russian developments that have spawned this challenge. This is because we must keep the most important issue in the forefront, namely, the fate of the political and economic reforms within Russia upon which more than anything else rest our security interests with respect to Russia

We must consider how our country's future security and well-being will be threatened if, once again, Russia fails in the historic task of finding her way to authentic, stable democracy and a just, prosperous society with a market economy.

My bottom line is this: Russia is not lost. Russia is stuck in a swamp between the Soviet past and several alternative future possibilities, some invitingly bright, some ominously dark. The larger purpose of these hearings, in this and other committees, and of the debate now, finally, taking place in our political arena about Russia, is to understand her condition and prospects better and to inform better American policies for encouraging the brighter prospects of democracy and capitalism.

The threat from Russian crime and corruption springs from two fundamental and interrelated realities: first, the grave weakness of the rule of law in Russia, and second, the perversions of what we have called economic reform.

The Soviet communist system was itself a kind of structured lawlessness. To be sure, the Soviet Union had myriad laws. But they were not rules for regulating relations among the members of a self-governing society. Rather they were tools for maintaining power, to be used, abused or ignored by those who held power. They afforded ample space for official and unofficial criminality. In the later Soviet period, the manifestations of this -- ranging from petty thievery, to organized crime, to enrichment of the partocracy -- expanded as the structures of Soviet power decayed. The collapse of communist rule gave free rein to these phenomena in a new setting.

The new setting is something for which I have not found a good definition. It has important features of democracy and capitalism, but it is not authentic democracy and capitalism. Focusing on the economic side, I would use the term crony capitalism without much capitalism. It lacks firm property rights and good corporate governance. It is about the distribution and especially concentration of wealth, but far less about investment and the creation of wealth. And, above all, it is about the extraction and expatriation of wealth.

This came about in large measure because of the manner in which the reformers

of the post communist regime tried to create capitalism amidst the wreckage of the Soviet order. As one analyst I've read put it, they proceeded in good communist fashion to create a new capitalist class by basically appointing them. Relying largely on privileged, insider relationships, vast resources and enterprises were placed into private hands, often old communist hands, at less than fire-sale prices. Enterprises were sold off at less than cash value of annual revenues in some cases. Export and import privileges were handed out to cronies.

Thus, the process of privatization was from the outset a rip-off at the expense of the state and society. This, along with the destruction of people's savings through gratuitous inflation in the early 1990s, deeply blighted the public's view of capitalism from the outset. The reformers took a course certain to alienate society; and they deliberately ignored the task of building public understanding and support.

It still might have worked out had the new owners proceeded to manage their new wealth as real capitalist entrepreneurs by investing, building, and creating. Far too often, however, they did not. Lacking confidence that their new wealth could be profitably invested in Russia or even that they could hold on to it, they all too often extracted it, stripped it, plundered it out of Russia and sent it abroad where it could be safe and profitable for them. In this manner a country rich in natural resources and productive potential saw its state and society impoverished. The society and domestic economy reacted with various coping strategies, from barter trade to moonlighting work. The state reacted with measures that went beyond very creative financing, like simply not paying its bills. Among other things, it created what appeared to be a no-lose casino in short term debt by which Russian and then foreign speculators essentially were allowed to plunder the state budget until it collapsed in August 1998.

What we've seen here is not so much organized crime as authorized crime intertwined with corrupt government and politics at all levels. And it has abetted and been abetted by organized crime with its money laundering skills and protection racketeering.

The fundamental misdemeanor of Western, including American, policy was that it bought into this phony-crony capitalism too uncritically and for too long. So did the mainstream media, and the mainstream foreign policy establishment. The protests of Russian and Western observers who knew what was going on went unheeded.

Let it be noted here that the kleptocratic or plundering nature of Russian so-called reform was obvious from the start. You did not need exotic CIA analysis to see or understand it. It was lavishly reported in the Russian press. Moreover, you did not need to read Russian. There was plenty of English language analysis out of Russia and from Western analysts. And you did not need a lot of time: Anyone who cared about Russia and was willing to take one half hour a day could get the whole story from Johnson's Russia List, an heroic one-man compilation of daily reporting by David Johnson of the Center For Defense Information, a source known to all Russia watchers.

One of the sad consequences of US policy, so persistent in the face of reality that one has to suspect intent, was that IMF lending, while ostensibly aiming to stabilize the economy and encourage investment, actually lubricated and

legitimized this process of stripping and expatriation of wealth. It was more perversion than diversion of IMF money. This perversion of the IMF into a cover for Russian kleptocracy was hugely injurious to Russia and to our interests. It raises questions as to whether the IMF should be the central institution for financial aid to the transition economies in Russia and the rest of the former Soviet Union.

Defenders of current US policy have not even addressed this charge of perversion of the IMF directly. As to the charge of diversion, they are basically saying, "We did no wrong and we are not going to do it again." In other words, they are saying diversion has not been proved, but new IMF lending will not go to the Russian central bank but rather from one IMF account to another to service Russian debt.

Perhaps not proved conclusively, the charge of diversion is very compelling with respect to events of summer 1998. Anatoly Chubais, the leader of Russia's dream team of reformers, has said "we conned" (my kinuli) the IMF into that round of lending to support the ruble and crisis ridden Russian financial markets. The IMF lent the Russian Central Bank some $4B for that purpose. The IMF bought rubles in the Russian market with those dollars, and the dollars immediately escaped to the West, in fact never really left the West. This was widely reported in the Russian press at the time, in some Western reporting as well. And now the embattled former Russian prosecutor, Mr. Skuratov, undoubtedly relying on investigative data fully accessible by him, has described what happened. The Russian Central Bank used at least $3B to buy rubles, not from the Interbank Currency Exchange, but directly from Russia's most active kleptocrats, its so-called commercial banks. They immediately deposited the dollars in Western correspondent accounts. What is diversion if not this?

Why have American policymakers bought into this plundering system so uncritically? Perhaps we shall have to await their departure from office for candid answers to this question. To date, their explanations have been most unsatisfactory. They claim to have known about Russian crime and corruption all along. This is true; but then why the persistent support for and misrepresentation of this system? They claim that they have always known the development of Russian democracy and capitalism would take a long time. This is also true; but then why support a system that in many ways makes successful development of Russian democracy and capitalism even more difficult than it was at the beginning? They claim they had no better alternatives. This is NOT true; they had the alternative of honesty about what was happening. And the Russian regime had alternatives to what they did – among others, the democratic opposition was offering them – and they were open to Western recommendations because they needed Western money. Finally, the defenders of American policy claim that we had to give the Yeltsin regime the support we did because our security interests on such matters as arms control, proliferation, and the Balkans demanded the support of that regime. Yet our security relations with Russia are in worse shape today than they were at the beginning of the current administration. And worst of all, we have lost the respect and admiration of much of the Russian people.

I cannot adequately explain the motives behind the policies we have seen except as a toxic combination of political and economic naivete, a cynical belief that a continual misrepresentation of Russian realities could be sold to most audiences, and a certain amount of selfishness on the part of influential American

stakeholders in the great outflow of Russian wealth.

If one includes the period of the late 1980s, when much of this activity accelerated under the aegis of the KGB and the communist leadership, one might guess that from 200 to 500 billion dollars have left Russia in what is very loosely called capital flight. Some of it is derived from plain crime, like drug traffic, stolen cars and weapons. Some it is entirely legitimate except for tax evasion. I strongly believe that most of it is in the gray zone in between, that is, the product of phony-crony capitalism. Some of it gets laundered because its owners need to disguise its origins to all observers. But a lot of it just gets deposited and invested. And not much of it stays in Cyprus or other tax havens. Much of it, probably most of it, has come into the biggest, safest, most accessible, and profitable investment target in the world, the United States.

Here it undoubtedly goes in several directions. Some stays liquid for future use. Some returns to Russia for business, political, or criminal purposes. Some gets invested in portfolios, real estate, and business. And I am sure that some of it goes to political contributions of various kinds. Why can I permit myself this seemingly inflammatory statement? First, because of the logic of the situation; that's normal behavior for this kind of money. And I am sure it is quite bipartisan, because this kind of money doesn't care about the values, the issues, the candidates or the parties. It cares about influence. Second, because there have been some examples in the press. And, third, because knowledgeable FBI specialists in this area have said so. This is, I believe, a proper subject for the investigations of the Congress.

I would assign greater weight, however, to a more general problem. Money on this scale acquires patrons, protectors, and leverage. How much leverage and with what effects on government policies? I would ask for example: Did those Americans heavily invested in the Russian GKO market, by which vast profits were extracted from the Russian budget and vast losses risked, exert influence on the US Government to encourage more IMF lending last summer? Mr. Soros and others have strongly implied so.

Mr. Chairman, let me state that the picture I have painted so far is unfair. There is real capitalism and real democracy in Russia. There are decent businesses, honest policemen, and clean politicians. Which returns me to my first point. Russia is stuck, not lost. If the Russians can somehow get through the current crisis of terrorism, conduct their elections, and create a somewhat stable and legitimate government, I believe there is a possibility that a window for real reforms will reopen. I hope then we shall be ready to be supportive with policies more perceptive, more honest, and more constructive than they have been in the past. At least we must avoid repetition of past errors. That I see as the most important purpose of our inquiry here. Thank you, Mr. Chairman.

[Supplementing this written testimony, the witness has appended two recent articles on Russia written by him and published respectively in The National Interest and The New York Times.

J. Michael Waller

Vice President, American Foreign Policy Council

October 6, 1999

House Committee on International Relations

United States policy toward Russia has been tailor-made for exploitation by the gangster-bureaucrats, oligarchs, militarists and secret police officials ruling Russia today. Administration suppression of warnings and analysis about deteriorating conditions in Russia shows a calculated policy to prevent decision-makers, Congress, and the public from learning the truth and taking early corrective action.

That policy has rewarded and protected corruption in Russia, discouraged honest crime-fighters in Russia, breathed new life into anti-Western retrograde forces, undermined progressive and pro-Western forces in Russia, and dismissed and even retaliated against constructive critics at home.

Misguided U.S. policy toward Russia has rested on six fundamental points:

1) Unconditionally support the incumbent corrupt Kremlin regime and excuse away all its excesses;
2) Keep billions of dollars in cash flowing into the corrupt central bank with no accounting of how the money is spent;
3) Leverage none of the United States' immense resources to reduce corruption, promote openness and fairness, or to make sure the aid gets to where it is needed in Russia;
4) Place the bulk of bilateral aid resources into the pockets of U.S. companies, not into projects within Russia that brought rapid tangible benefits and hopes to the Russian people;
5) Ignore or suppress opinions and facts indicating that the policy might be failing;
6) Insist that the policy is working.

This is not a partisan issue. Former Senator Bill Bradley warned in a 1995 address to the Kennan Institute that administration policy toward Russia was becoming dangerously counterproductive: "Not only do we fail to influence the course of Russian reform, we actually create an anti-American backlash based on disappointed expectations."

The warning signs were everywhere from the beginning. Congressionally mandated reports by the General Accounting Office (GAO) have carried warnings and policy recommendations since at least 1994. Former diplomatic officials and intelligence officers more recently have testified recently to Congress about politically motivated

suppression of classified diplomatic reporting, intelligence collection and analysis. Even the most casual observer could tell what was happening by reading the newspapers over the past five or six years.

And it was Russians first and foremost -- officials, lawmakers, former officials, and journalists -- who blew the whistle early and often. Some paid with their lives.

Prominent Russians warned the United States from the start, in public and in English, that IMF and other U.S.-led "aid" policies would harm Russian reform. Former Finance Minister Boris Fyodorov warned the U.S. in an April 1, 1994 *New York Times* op-ed that corrupt and retrograde politicians in Moscow were conning the West. Referring to a recently approved $1.5 billion IMF loan to the Russian Central Bank, Fyodorov cautioned:

> "Russian Communists go to the United States . . . and lots of people are enchanted to call them democrats. . . . Is it not clear that the West is being manipulated to bury the remnants of reforms? Is it not clear that anti-Western and nationalist attitudes are becoming more and more prevalent?"
>
> "The sooner the IMF's money is handed over, the sooner we will see a change in policy -- in the wrong direction. . . . The $1.5 billion is immaterial to Russia, given the scale of its problem, and will be eaten up in a matter of minutes. . . ."
>
> "The idea of those in power is to abandon Western-type economic policies with Western approval. . . ."
>
> "Please do not believe Western experts who claim -- just as our nationalists do -- that Russia is so special that nothing in the civilized world applies to it. That is stupid. . . ."
>
> ". . . I think Western taxpayers have a right to know how and to what ends their money is being spent, when they have problems of their own back home. . . ."
>
> "There are too many people in senior positions in the Russian government who think it patriotic to take as many loans as possible, and then quietly plot to obtain debt forgiveness and debt reduction. . . ."
>
> "I do not believe in compensation from abroad for local incompetence and corruption. . . . I am sure that a weakening of Western restrictions on aid will be detrimental to my country."[1]

Fyodorov said in the same piece, more than four years before the August 1998 crash, ". . . now that the IMF has extended this loan, on the ground that it will be

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[1] *New York Times*, April 1, 1994.

politically beneficial to the West, I say: Lock up the advisers who give such counsel and throw away the key."

Few Russians dared be so outspoken. It was clear that the U.S. would not listen to them. Meanwhile, since the creation of the Gore-Chernomyrdin Commission in early 1993, the U.S. Embassy in Moscow was under pressure to portray all the commission's work as a success and to suppress bad economic news, including reports on corruption. E. Wayne Merry, a foreign service officer who headed the internal political section of the embassy from 1991 to 1994, and his successor, Thomas E. Graham, Jr., have commented publicly on this along with other former diplomats and intelligence officers including the CIA's former top Russia officer Fritz Ermarth. Among the diplomats' complaints:[2]

* Gore-Chernomyrdin "because a Soviet-style bureaucracy in which success was mandatory, and any information that would contradict success simply was filed forever." (Merry)

* Gore-Chernomyrdin blocked embassy reporting "about the realities of crime and corruption . . . . failures in the privatization and general bad news." (Merry)

* Senior economics section officials in the U.S. Embassy Moscow in 1993 and 1994 blocked cables to Washington describing the nature and massive scale of corruption, and forbade them to be sent because they contradicted the official line. (Merry)

* A Treasury Department official in Moscow later pressured the political section not to send a cable to Washington about the role Russia's corrupt banks were playing in Russian politics. "The cable was killed." (Graham)

Pressure on aid contractors

At the same time, U.S. aid contractors were under similar pressure. A concrete example, with documentation, illustrates the problem. ARD-Checchi, a major contractor with the U.S. Agency for International Development (USAID) that ran the "Rule of Law" program in Russia,[3] tried to suppress a noted expert in Russian crime and corruption from voicing concerns about the USAID-sponsored privatization program.

That expert, Professor Louise Shelley of the American University and a colleague of mine at *Demokratizatsiya* journal, had early evidence that organized criminal elements had exploited the U.S.-backed privatization program. In June 1994, ARD-Checchi Rule of Law project director David Bronheim sent an e-mail notice to offices in Moscow, Kiev

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[2]Robert Kaiser. "Pumping Up the Problem: Has Investing in the Yeltsin Machine Put America's Relationship with Russia at Risk?" *Washington Post*. August 15. 1999.
[3]By way of disclosure, this writer consulted for the ARD-Checchi Rule of Law program for about one month in 1995.

and elsewhere with a warning about Dr. Shelley that appears to be intended to suppress and discredit her:

> "1 - Prof. Shelley. Please treat this with enormous care. If I had known what Shelley was up to, I would have resisted Henderson's instruction to put her on the consulting contract. She is a bomb with a lit fuse. Her hobby horse is that the AID privatisation program has been exploited by organized crime.
>
> "1.1 The privatisation program is the showpiece, flagship etc of the AID program in Russia. Shelley, without understanding what she is doing, is trying to sink the flagship. Under no circumstances can we be seen as helping that effort. We have no interest whatsoever in damaging the centerpiece of the AID program in Russia."

There you have it: as frank an admission possible that experts concerned with corruption of U.S. assistance programs were simply not welcome. A copy of the e-mail is attached.

I am aware of a few other instances, but because the individuals involved remain involved in federally funded aid, exchange or educational programs, they are still unwilling to come forward for fear of retaliation.

Other evidence suggests something at work far larger than a USAID contractor suppressing warnings of corruption, and it fits the pattern suggested by Merry, Graham, Ermarth and other former officials. One such piece of evidence is a May 3, 1995 memorandum circulated by U.S. Agency for International Development Deputy Administrator Sally Shelton concerning how the executive branch would deal with the now-completed, congressionally-mandated initiative to merge USAID with the State Department. The memorandum does not discuss Russia specifically, but it is important to the Russian aid debate because of its context. The memorandum, which Shelton sent to posts around the world, stated bluntly:

> "The strategy is to 'delay, postpone, obfuscate, derail.'"

The memorandum cited then-National Security Adviser Anthony Lake as saying that as part of the strategy, the administration would "tar" critics, in Lake's words, as "back-door isolationist."[4] So critics, in the administration's view, even constructive critics who shared the policy goals of aiding reform in Russia, were not to be debated on the merits of their views or of the facts, but "tarred."

This was not a rogue operation of an over-zealous contractor or official: It began, at least, with the president's own national security adviser and permeated the bureaucracy.

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[4]Sally Shelton. USAID staff notes to U.S. posts abroad, May 3, 1995, 7:58 a.m., provided by the Senate Foreign Relations Committee.

For this reason, honest critics who depend on federal contracts are fearful to voice their concerns for the record, lest they lose their livelihoods.

Official rejection of bad news about Russia spans the federal government, including the following instances:

* **"Barnyard epithet" incident.** A 1995 incident in which a CIA report discussing corruption among Vice President Gore's Russian interlocutors was rejected and angrily returned to the CIA with a "barnyard epithet" scribbled across the cover. "CIA analysts say they are now censoring themselves," according to the *New York Times*.[5]

* **NASA corruption coverup.** A 1995 incident in which former NASA rocket scientist James Oberg revealed that Russian officials diverted NASA space cooperation money to build large houses for themselves in Star City. One "space mansion" owner was General Yuri Glazkov, whom a Houston TV reporter confronted at the Johnson Space Center. Instead of leaning on Moscow, NASA squeezed American journalists. Writes Oberg: "NASA's reaction was telling: It immediately clamped down on the U.S. news media" issuing "highly restrictive" new procedures to journalists "to make sure no visiting Russian space official had to go through such an ordeal again." A NASA spokeswoman commented, "What Russia does with their own money [sic] is none of our business." The White House refused to help the House Science Committee to find out what happened to the money.[6]

* **Coverup of laser incident and reprisal against injured officer.** A 1997 incident in which U.S. Navy intelligence photographed a laser emanating from the bridge of the Kapitan Man, a Russian spy ship in American waters off Washington state. The U.S. Navy officer, Lt. Jack Daly, and his Canadian helicopter pilot, Capt. Patrick Barnes, suffered laser burns to their eyes. Yet the Clinton administration -- led by Deputy Secretary of State Strobe Talbott, current U.S. Ambassador to Moscow Thomas Collins and others -- not only covered up the incident, but directed a policy that ultimately ruined the careers and damaged the family lives of the two officers.[7] A Navy Inspector General investigation substantiated Lt. Daly's allegations of "reprisal for reporting of the Kapitan Man laser incident."[8]

* **FBI retreat from organized crime report.** A 1997 case in which FBI Director Louis J. Freeh suddenly backed away from his embrace of a Center for Strategic and International Studies (CSIS) study of Russian organized crime, despite the FBI's

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[5] *New York Times*, November 23, 1997.
[6] James Oberg, "NASA's Russian Payload," *American Spectator*, August 1998.
[7] For accounts of the incident, see J. Michael Waller, "Shot by a Laser," *Reader's Digest*, October 1999, pp. 125-131; and Bill Gertz, *Betrayal: How the Clinton Administration Undermined American Security* (Washington: Regnery, 1999), pp. 7-32.
[8] Capt. R. L. Zeller USN, Deputy Chief of Legislative Affairs, Department of the Navy, "Memorandum for Interested Members of Congress/Subj: Lieutenant Jack Daly Personnel Records," September 8, 1999.

participation in the study and the credibility lent to it by the project chairman, former FBI and CIA Director William H. Webster.[9]

Kozyrev to Washington: Tell the truth.

Our government's dishonesty has not been lost on the Russians, some of whom credibly accuse Washington of dealing duplicitously with the Russian people themselves. Former Russian Foreign Minister Andrei Kozyrev is one of them. In a 1997 *Newsweek* essay, Kozyrev pleaded with the U.S. to be truthful with Russia about the deteriorating state of the bilateral relationship: "The Russian people must be told the truth." And by telling the truth, the U.S. must "resist capitulation to the old guard. . . . An entirely new generation of leaders in our country is waiting for this policy shift."[10]

The shift never came. Last May, Kozyrev pleaded in the *Wall Street Journal Europe* for the U.S. to deal with Russia honestly, to stop pretending, and to tell the truth: "the relations should be honest and robust." In an epitaph for assistance programs, he wrote, "Western aid, however well intended, boils down to a payoff to the hard-liners." Washington's policy had undermined hope: "The made-for-TV hugs between the highest American officials and their Russian counterparts, be they reformers or not, concealed till recently" a relationship that smashed reform: "When the Russian government tried bold reforms, billions of dollars of aid were promised, but much less came." Furthermore, "When that aid opened the gates to corruption, and an oligarchic capitalism supplanted a liberal one, the West paid little attention."[11]

Recommendations

1. Establish a "dissent channel" and whistleblower-type protections for private aid contractors and consultants to enable them to report problem areas without fear of retaliation.

2. With the new public diplomacy apparatus with the merger of the U.S. Information Agency into the State Department, the U.S. should mount a frank and honest public diplomacy effort in the former Soviet Union. The Russian people deserve it and so do the American taxpayers.

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[9]Gerard P. Burke and Frank J. Cilluffo, eds. *Russian Organized Crime: CSIS Task Force Report* (Washington: Center for Strategic and International Studies Global Organized Crime Project, 1997). Project director Arnaud de Borchgrave recently testified to this effect before the House Banking Committee.
[10]*Newsweek*, February 10, 1997.
[11]*Wall Street Journal Europe*, May 6, 1999.

FROM: David Bronheim, 73744,2306
TO: Moscow office (murphy), INTERNET:ard@ard1.law.msk.su
Dennis Whelan (1), INTERNET:whelan@whelan.law.msk.su
CC: Michael Goldstein (1), INTERNET:mg%ruleoflaw.kiev.ua@relay.ussr.eu.net
gregory goss, 73744,2323
Richard Hart (ARD), 73252,2335
Peter Maggs, 73744,2317
Hope Payne, 73203,373
DATE: 6/17/94 11:22 AM

Re: 94(2)db/13

94(2)db/M13

1- Prof. Shelley. Please treat this with enormous care. If I had known what Shelley was up to, I would have resisted Henderson's instruction to put her on consulting contract. She is a bomb with a lit fuse. Her hobby horse is that the AID privatisation program has been exploited by organised crime.
1.1. The privatisation program is the showpiece, flagship etc of the AID program in Russia. Shelley, without understanding what she is doing, is trying to sink the flagship. Under no circumstances can we be seen as helping that effort. We have no interest whatsoever in damaging the centerpiece of the AID program in Russia.
1.2. Reed must understand our position, and must realize we have a very nervous stomach about this. You will discover that this will make his stomach hurt as well. He will not want to be seen in USAID as someone involved with a program that might discredit AID. Please discuss this with him frankly.
1.3. Henderson will be in Moscow in ten days. Please encourage Reed to have the 3 of you talk this over.

2- Repeat of earlier question: How are you paying Watts for time after June 2 ???

3- ref yr dw_dc.c june 10, para 1.b. It raises no problems at all to come back to USAID with more tech assist and less toys. We are only following their advice and adding more tech assistance. They will love it. (Have you in fact submitted to USAID a Work Plan and a draft MoU? Newton is away today, but I have seen niether. The only thing I am aware we submitted to AID was a design document. John says he left with you draft work plan and MoU documents, but nobody here has any awareness of a submission to USAID).
3.1. Again, the fact that we follow USAID's inclinations and develop our project along more satisfactory lines is something to be pleased about. We should be very upfront about this. We are making more headway than we anticipated.
3.2. Scholarships is a very difficult concept to administer. We can't do it directly, and to do it through the academy will be an adminstrative tangle - since they told us that it is the sending jurisdiction that pays for the student. It would be easier to pay lump sum to academy to cover the cost of a certain number of students if they tell us how students are selected, what the attendance is and what the courses are.

The Russian missiles we could have stopped

Testimony before the House International Relations Committee

Hearing on U.S. Policy toward Russia: Warnings and Dissent

Washington, DC

October 6, 1999

by Kenneth R. Timmerman

President, Middle East Data Project, Inc.

EMBARGOED BEFORE 0930 10/6/99

The Middle East Data Project is an independent consulting group that specializes in analyzing strategic trade. It publishes a monthly investigative newsletter, The Iran Brief.

Some of the source materials referred to in the attached testimony can be viewed on the Internet at www.iran.org

Kenneth R. Timmerman was the editor of Middle East Defense New(MEDNEWS) in Paris from 1987-1993, before returning to the United States to join the professional staff of the House International Relations Committee. After leaving the House, he worked as an investigative reporter for Time magazine, the American Spectator, and Reader's Digest, and writes regular columns for the Wall Street Journal and other publications. He also serves as the Executive Director of the Foundation for Democracy in Iran, a nonprofit group that monitors human rights conditions in Iran that was established with seed money from the National Endowment for Democracy (NED) in 1996.

The Russian missiles we could have stopped

Testimony by Kenneth R. Timmerman
before the House International Relations Committee
Washington, DC
October 6, 1999

Thank-you Mr. Chairman. It is a pleasure and an honor to testify before this committee, where I had the opportunity to serve six years ago as a professional staff member working on nonproliferation issues and export controls.

I believe that issues of such monumental import for our national security should be bi-partisan in nature. And the unanimous support for the Iran Nonproliferation Act of 1999, which you championed, is eloquent testimony to that.

But that has not been the case over most of the past 6 years. In fact, partisanship has been the rule, and cooperation the exception. I hope we can begin to redress that as we look at Russia's role in the proliferation of weapons of mass destruction, and at the stunning accumulation of opportunities we missed to prevent that from ever occurring. So I want to commend you and the ranking member for holding this very timely hearing.

In 1992, after I had completed a study on the missile, nuclear, and chemical weapons programs of three Middle Eastern "rogue" states - Iran, Libya, and Syria - for the Simon Wiesenthal Center in Los Angeles, I was invited to present the conclusions of my study at a conference in Paris. In his inimitable Viennese accent, Simon Wiesenthal - who was already well over 80 years old at the time - paid me the greatest compliment I have ever received. "I have spent my life tracking down the murderers of yesterday," he told the audience. "Mr. Timmerman is tracking down the murderers of tomorrow."

That is why we are here today, Mr. Chairman: to track down the murderers of tomorrow. For the unchecked flow of Russian technology into Iran's missile and nuclear weapons programs, could very well lead to the deaths of many of our fellow citizens tomorrow, as well as thousands, if not millions, of innocent people in the Middle East.

Strobe Talbott and Russia

As members of this committee know well, the architect of this administration's policy toward Russia, Strobe Talbott, was a journalist as I am

Mr. Talbott jump-started his career after a brief stay in Moscow in the summer of 1969, where he had gone with his Oxford roommate Bill Clinton, and met up with a well-known KGB asset named Victor Louis.

Victor Louis's job for the KGB was to serve as a talent scout and what we would call today a spin doctor. He planted stories in the Western press that were favorable to the Soviet leadership and to the KGB, and many reporters got to know him. In 1969, Soviet leader Leonid Breznev was intent on debunking Stalin and opening a new era of détente with the United States, to further the Soviet Union's strategic aims. Key to this was planting a carefully-edited version of his predecessor's diaries with a mainstream Western media organization.

By all accounts, it would appear that Victor Louis leaked the Khruschev diaries deliberately to a young man whose sole journalist experience until then was working as a summer intern at the Time magazine bureau in Moscow, Strobe Talbott. It was a great way to start a career.

Assuming that Mr. Talbott's lifelong association with Victor Louis was totally innocent, it illustrates how a journalist can be used unwittingly by a foreign intelligence service which is smart enough to give him real information for purposes that go beyond a journalist's ability to know.

In preparing a profile of Mr. Talbott two years ago, which I would ask the Chair's permission to include in the record of this hearing, I examined Strobe Talbott's public positions toward the Soviet Union, Israel, and disarmament issues during the Cold War. Mr. Talbott was a great champion of détente, an enemy of President Reagan's initiative to deploy Pershing II and cruise missiles in Europe in the early 1980s, urged the U.S. to end its support for Israel, and wrote an entire book portending imminent doom because Mr. Reagan had walked out on a Soviet arms proposal in Geneva. It is my opinion that Strobe Talbott consistently misread America's interests during the Cold War, and he continues to do so today. And like so many others in this town, he continues to get rewarded for being consistently wrong.

I dwell on Mr. Talbott's record because this administration's policy toward Russia, its unwavering and uncritical support for Boris Yeltsin in the face of mounting evidence of criminal corruption and anti-American policies, has been largely shaped and controlled on a day-to-day basis by Strobe Talbott.

Strobe Talbott and the Shahab missile

I have testified in various committees on Iran's Shahab and Kosar missile programs, which would not exist without direct assistance from the government of Russia. The Shahab-3 missile in particular, which is now deployed in southwestern Iran and is capable of targeting Israel with nuclear, chemical, or biological warheads, should in my view have Strobe Talbott's name written all over it.

Mr. Talbott's consistent refusal to confront the Russians over their missile technology transfers toIran illustrates once again a series of opportunities we missed to prevent post-Cold War Russia from going down the dark paths where we encounter her today.

The warnings were visible early on, and they were ignored. Initial information on Russian assistance to the Shahab missile programs in Iran came

from Israeli agents in Russia in 1995 and 1996. The Israelis felt confident enough of their information to present a detailed briefing to Mr. Talbott in Washington in September or October of 1996. According to one of the Israelis who took part in the briefing, whom I interviewed in Tel Aviv the following year, Mr. Talbott told them not to worry: he had the situation with Russia "under control."

The Israelis expected something to happen; shipments from Russia to Iran to be blocked, or some other form of U.S. intercession with the Russian government. There was none of this. Mr. Talbott took the Israeli information, and promptly relegated it to his "inactive" file.

Three months later, by January 1997, the Israelis were getting anxious. Their sources in Russia were detailing new contracts between Russian entities and Iranian missile development centers, and estimated that the missile would be deployed within two years if the Russian transfers and technical assistance was not stopped. So the Israelis dispatched the head of the Research Department of Military Intelligence, Brigadier General Amos Gilad, to meet with Leon Fuerth, Vice President Al Gore's national security advisor, in late January 1997. Mr. Fuerth was alarmed by the exceptional quality of the Israeli intelligence, and brought it to the attention of the Vice President, who was reportedly "stunned" by the information.

He shouldn't have been. The U.S. intelligence community had been reporting for years on Russia's growing military ties with Iran, something which I was able to report on as a journalist as early as 1989, when I first interviewed official Soviet arms merchants who boasted of selling Iran more than 100 MiG-29 fighters at a Middle Eastern arms show. In fact, it was this burgeoning arms trade with Iran that initially prompted the administration to establish the Gore-Chernomyrdin Commission in 1994, to handle disputes over Russian arms sales to rogue states.

Gore turned to the CIA and was informed that the U.S. was aware of Russia's assistance to the Iranian missile programs, but did not share Israel's concern over the urgency of the problem. (Indeed, acting CIA Director George Tenet testified to Congress on Feb. 6, 1997 - the same day Gore met with Chernomyrdin - that the Iranian effort to acquire long-range missiles would "probably" succeed "in less than 10 years" but not earlier). As for Chernomyrdin, he told the Vice President it was "impossible" that Russian state-owned firms were involved in Iran's missile projects, and demanded that Gore supply him with specific information so he could investigate the matter back in Moscow.

Mr. Gore turned over to the Russians what the Israelis had given him through his advisor, Leon Fuerth. Soon thereafter, as several top Israeli officials told me when I was investigating the matter one year later, Israel's sources in Russia "began to dry up." In other words, the U.S. through its desire to bend over backwards to meet Russian demands actually helped the Russians identify human agents working for Israel on the ground. We don't know what actually happened to them, Mr. Chairman, except that Israel no longer received their information.

Despite this, the Israelis continued to bring fresh information to Washington, where they met with Deputy Secretary of State Strobe Talbott, who rebuffed them at every step of the way. "We understood the that the

Americans had a larger agenda with Russia," the secretary general of Israel's Defense Ministry, General David Ivry told me in Tel Aviv. "Until NATO expansion was completed, they sought to put off all other issues."

So with Russia, our policy was one crisis at a time, one issue at a time. Don't pressure Moscow over missile sales to Iran until the Russians bought on to NATO expansion - something I believe we should have done in 1993 as a unilateral gesture, when the Russians were in no position to pose obstacles to our setting a term to the Cold War. Instead, largely at Mr. Talbott's urging, we put off that part of our national security agenda until the Russians were in a better position to exact concessions from us.

By April 1997, when U.S. spy satellites detected the plume of the Iranian rocket booster test at Kuh-e Bagh-e Melli outside of Tehran, the U.S. intelligence community came around to the Israeli view. By May, the CIA had confirmed not only the general outlines of the Israeli thesis, but had identified other Russian entities that were cooperating with the Iranians to design and build the new missiles. They also identified Yuri Koptev, the head of the Russian Space Agency, as one of the officials who was directly involved in the Iranian projects.

By early June, the U.S. intelligence was cut and dried, but U.S. diplomacy was unsuccessful in convincing the Russians to back off. In testimony before a Senate Governmental Affairs Subcommittee on June 5, deputy assistant secretary of state for nonproliferation Robert Einhorn displayed an unusual moment of pique. "We have pressed the Russian leadership at the highest levels and we have been told that it is not Russia's policy to assist Iran's long-range missile program," he said. "But the problem is this: There's a disconnect between those reassurances, which we welcome, and what we believe is actually occurring."

Because of Talbott's concerns over NATO expansion and his desire not to anger the Russians, it was not until July that the White House decided to kick the issue into high gear, naming veteran diplomat Frank Wisner as special envoy to Moscow. Wisner was to conduct a joint investigation with the Russians into the U.S. and Israeli allegations. The man the Russians appointed to be his counterpart was none other than Yuri Koptev, the head of the Russian Space Agency - the same man the CIA had identified as being one of the driving forces behind the cooperation with Iran. "He was a good choice for the Russians," an Israeli official quipped, "since he knows where all the bodies are buried. He knows what secrets to really protect."

Two months later, Wisner and Koptev presented a joint report to Gore and Chernomyrdin, who were holding their bi-annual meeting at a resort outside of Moscow. Speaking to reporters, Gore called the investigation "extremely thorough," and that "new information has been brought to light."

But while the Russians and the Americans kept talking, Russian technicians continued to travel to Iran, the Iranians continued to work in Russian weapons labs, and shipments of vital missile components continued to reach Iran.

By late summer 1997, the Israelis had concluded that it was a Russian government policy to assist Iran in these projects. It may also have been the intention of Strobe Talbott to see Iran armed with long-range missiles that

would finally keep pesky Israel under control. I think you should ask Mr. Talbott that question.

In late September 1997, the Israeli Foreign Ministry's top arms control official, Shimon Shtein, provided new information to Talbott during a visit to Washington on Russia's assistance to Iran. According to an Israeli press account of the meeting, Talbott warned Shtein that if Israel didn't stop feeding information to the U.S. Congress and the media about the missile programs, it would "seriously undermine" U.S.-Israeli relations. Using four letter expletives, Talbott said he would see to it that U.S. aid to Israel was reduced if the Israelis continued to go behind his back to Congress.

I spoke with Shimon Shtein in Tel Aviv shortly after this encounter. He confirmed the meeting with Talbott, but would not comment on what had occurred. Talbott's angry and threatening words were read to me from a cable by a top advisor to Israeli Prime Minister Benjamin Netanyahu. "It's very simple," this official said, trying to minimize the import of Talbott's refusal to tackle the issue head on: "We are on the receiving end of these missiles, whereas Talbott views it in the broader context of U.S.-Russian relations." In my view, that was a very charitable way of putting it.

The crux of the matter is very simple: for nearly a year, despite having detailed intelligence on Russia's involvement with the Iranian missile programs, the U.S. government failed to press the Russians in any meaningful or effective way. And the official who played the greatest role in this disaster was Deputy Secretary of State Strobe Talbott. If we had intervened with the Russians when the Israelis first came to us in late 1996, the Shahab missile would never have been tested successfully two years later, and would probably still be on the drawing board. Instead, not only have the Iranians deployed the Shahab-3, they have also begun work on a 4,500 kilometer-range missile known as "Kosar," which is being disguised as a satellite launch vehicle. As with the Shahab-3 and Shahab-4, Kosar will be powered by a Russian-designed booster rocket - again, thanks to Strobe Talbott and his steadfast refusal to pressure the Russians over these transfers or to put Russians non-proliferation behavior at the center of our relationship with Moscow.

Getting back on track

Ultimately, Russia has far more to gain by engaging the United States and winning commercial space launch contracts and development deals with U.S. defense contractors, than it does with Iran. But this administration's policy of turning a blind eye to Russian misdeeds, has allowed the Russian Space Agency and its hundreds of subsidiaries to believe it can have it both ways.

The bipartisan approach of this committee, that led to the unanimous passage of the Iran Nonproliferation Act on September 14, is a first step, and a major one, to putting our relationship with Russia back on track.

During the Reagan administration, we repeatedly took some of our best allies to task for shipping advanced defense production technology to the Soviet Union. Some of you will remember the Toshiba machine-tool case. But there were many, many more such cases, involving French, German, even British companies. Did a vigorous exchange between the U.S. and our allies inalterably

damage those relationships? It did not. Friends and allies can speak frankly to one another behind closed doors. That's what diplomacy is for.

It's time to stop turning a blind eye to Russia's misdeeds, Mr. Chairman. Because if we don't, the Russians are going to continue building up WMD capabilities in countries like Iran and Iraq, because they see this to be in their strategic interest. We have powerful tools and pressure we can bring to bear. It's time to start using them.

Congressional action

I would also offer a few concrete proposals for Congressional action.

1) Congress should establish a blue ribbon panel to include a cross section of Russia experts, policy analysts, and nonproliferation experts, to take a fresh look at how we might engage Russia while holding her responsible for her misdeeds. The "B-team" initiative of the Potomac Foundation could serve as a model here, with its successful efforts to identify and engage interlocutors on the Russian side who are not tainted by the widespread corruption, such as nuclear scientist Dr. Evgeny Velikhov.

2) Similarly, I strongly encourage you to pursue the efforts spearheaded by Mr. Weldon and other members to establish direct parliamentary ties with the Russian Duma. It is clear that significant segments of the Russian political establishment reject the kleptocracy established by President Yeltsin and his top advisors, and supported by Mr. Talbott. We need to reach out to these Russian patriots, engage them, and support them where our interests coincide.

3) The administration is proposing to spend an additional $600 million to fund Russian nuclear scientists, the so-called "Nuclear Cities Initiative." The Government Account Office found earlier this year that much of the money spent so far on similar programs has been diverted, and may have actually helped the Russians to develop better nuclear weapons, missiles, and biological weapons. I would urge you to immediately freeze all funding to Department of Energy and Department of State nonproliferation programs in Russia until a thorough GAO review has been conducted and alternate proposals have been examined. Most of the former project directors engaged in the DoE and State programs in Russia I interviewed earlier this year believe we can do much better by starting from scratch and focusing our aid on creating viable commercial ventures that get the scientists out of the nuclear cities, instead of keeping them there, as the administration's plan does. (I would ask that my article, entitled "Russo-American Nuclear Cities," from the July 1999 issue of the American Spectator, be submitted for the record to provide members with background on this issue).

4) You have passed excellent legislation with the Iran Nonproliferation Act of 1999. But now, Mr. Chairman, you need to begin rigorously monitoring it and holding the administration's feet to the fire. I would recommend that you hold regular oversight hearings, and if the administration continues to temporize, that you waste no time in making that bill's sanctions mandatory and binding.

5) Although I have not discussed this in my presentation, it is clear that Russia has diverted huge sums from the more than $20 billion in IMF financing they have received over the past few years. It is not enough for the IMF to claim that none of this money has been diverted. Russia's state prosecutor, Yuri

Skuratov, who was fired earlier this year because he was investigating state corruption, concluded more than a year ago that at least one $4.8 billion tranche of IMF funds, transferred in August 1998, made its way around the world in just three days, ending up in private bank accounts. Treasury Secretary Treasury Secretary Robert Rubin confirmed this in Congressional testimony on March 18, 1999 when he noted that most of that $4.8 billion payment "may have been siphoned off improperly."[1] I would urge that you immediately suspend U.S. payments to the IMF until the IMF supplies a thorough accounting for the money paid out to Russia. Along with this immediate step, I would strongly support the Russian Economic Restoration and Justice Act, introduced yesterday by Mr. Weldon, which conditions U.S. assistance and IMF payments to the achievement of real economic reforms in Russia.

I am not very hopeful that this administration, with Mr. Talbott at the helm of our Russia policy, is going to suddenly see the light in its waning days. Therefore, I believe Congress has a significant role to play, and should step up to the plate.

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[1]Wire reports, 3/18; also, NYTimes 3/19/99

Testimony
Committee on International Relations
U.S. House of Representatives
October 6, 1999

U.S. Policy Toward Russia

By
Martin Cannon
Managing Director, CIS Operations
A.T. Kearney, Inc.
On behalf of
The U.S.-Russia Business Council

Chairman Gilman, Ranking Member Gejdenson and Members of the International Relations Committee, it is an honor to be asked to testify here today on this important subject. My name is Martin Cannon and I am the Managing Director of CIS Operations for A.T. Kearney, Inc. I am testifying today in my capacity as a member of the Board of Directors of the U.S.-Russia Business Council.

The U.S.-Russia Business Council is the leading U.S.-based trade group representing private-sector interests in Russia. It is a nonprofit membership organization launched in 1993 with the mission of enhancing trade and investment between Russia and the United States. The Council's 250 firms range from small entrepreneurs to the most prominent Fortune 500 corporations, and they represent every industry sector – energy, aerospace, agribusiness, telecommunications, financial services, manufacturing, and high-tech, to name a few.

A T Kearney is the management consulting division of the EDS Corporation. It has had a presence in the Russian market since the late 1980s, which was substantially augmented in 1996 by the acquisition of my firm, Cannon Associates, in 1996. We have executed hundreds of projects for scores of major Western corporations seeking to participate in virtually every sector of the post - Communist Russian business economy.

I want to focus my comments today on U.S. policy toward Russia over the past decade through the eyes of American business.

Over the past 2-3 months, Washington has witnessed a burgeoning discussion of whether Russia is "lost" and if so by whom. Much of the discussion is political, but not much about policy. Not many in the business community believe Russia is lost. What has, or should have been lost is any lingering illusion concerning the magnitude of the devastation wrought by 70 years of Communism, and that effective remedies will require anything less than a sustained, rigorous, exhausting, generation-long effort by those who have a part to play.

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There was no prediction of the suddenness and totality of Soviet collapse. No blueprint existed to guide U.S. policy through this extraordinary, unprecedented event. And it would have been a staggering and unparalleled feat of policy design had we had got it all right first time and had now no reason to discuss what worked and what didn't. Equally we would be derelict at this juncture if we did not take the opportunity presented by nearly a decade of hard experience and the impending, near simultaneous change in Presidential administrations to appraise the record in search of more effective future policy.

We therefore believe the assignment of blame is a damaging distraction from the required constructive debate in which we wish to participate that seeks changes that build on the best of our programs and approaches and discards those that have not met rigorous standards of effectiveness.

The members of the U.S.- Russia Business Council recognize that in dealing with Russia, security issues are and must remain the priority. We recognize too that effective support for the creation of democratic institutions in Russia is and must be a guiding principle of policy. Efforts to promote a productive business environment cannot be in conflict with these aims. We are not charitable institutions. We want to succeed in Russia for obvious reasons. But we believe strongly that our success will advance these other goals.

Embedded in the "Who Lost Russia" sloganeering is the view that U.S. policy has failed in several areas. Programs directed at supporting Russia's transition to a market-based democracy are ineffective and wasteful. Pressure allegedly has been exerted on the IMF and World Bank to allocate resources unwisely. An attitude of Yeltsin "right or wrong" caused us to sanction, at least implicitly, people, policies and values opposed to democracy and free markets.

We can all allocate resources efficiently after the fact, but the business community on balance believes that U.S. assistance programs throughout the 1990s have mostly met, and in some cases exceeded, their practical, limited objectives on numerous fronts.

First, the majority of assistance dollars allocated to Russia (and the NIS) over the years quite rightly have focussed on our national security, in the form of nuclear safety initiatives and programs to reduce the threat posed by weapons of mass destruction.

But a significant amount has been directed at the nuts and bolts of building a market economy from the rubble and decay of the Soviet system. We believe that our efforts overall have been practical, forward-looking, and in many cases directly helpful to the success of American firms engaged in this risky market. These programs represent a positive force in a contentious arena of debate in Russia.

Allow me to cite just a few examples:

- tax reform
- securities market infrastructure
- lending to small and medium-sized business
- business-skills training

- conversion of accounting standards
- environmental clean-up and protection
- judicial training
- development of civil society institutions
- health care
- land reform and agriculture development
- business codes of conduct and dispute settlement mechanisms
- exchange programs (outside the specific business-related assistance but vital as part of a long-term plan).

That they have not alone overcome all the embedded obstacles to Russia's transformation is hardly definitive proof of lack of value. Equally, our accumulating experience does raise useful issues. Have we got the balance right between investments in policy prescription versus investments in enabling infrastructure? Are all these programs individually or collectively at or below a critical mass of scale and intensity sufficient to bring about lasting change? Are we sufficiently willing to discontinue, initiate, or modify programs in light of experience?

The majority of these programs have been conducted not with the Russian federal government but with nongovernmental organizations that are increasingly outside Moscow. A large number of these programs, from health care to micro-lending, have been exemplary models of public-private partnerships in action.

The criticism of uncritical support for Yeltsin is easy to level. Russia has and will continue to pose tough, unpalatable choices to our government. The council would urge those attracted to the view to remember that for the majority of his term in office, the principal threat to the Yeltsin Administration has come from those seeking restoration of the Soviet Union under either Communist or militant nationalist leadership. The option of an electable and irreproachable ally of democratic modernization has yet to be made available. Until it is, we will not criticize any administration for engaging constructively with the best option available. Furthermore, we have observed our government, at both the working level and at the highest levels, meeting routinely with leaders from every political faction, including opposition groups. And, "regional outreach," both in country and here in the U.S. with visiting delegations, is reducing our former, excessive preoccupation with the center.

The American business community has worked closely with U.S. government officials to keep trade and investment-related issues on the table while exhorting the Russian government agencies with which they routinely meet to move forward on key elements of reform. U.S. business will continue to work with our government to fashion policy and to get the message across to the Russians. We will continue to encourage or criticize as the occasion demands, bluntly when necessary, and our focus will be on results not headlines.

From its inception, the Council and its members have supported and participated in the bilateral commission structure under Vice President Gore's leadership. It is not a perfect structure, and like all bureaucratic organizations it has become somewhat unwieldy in the effort to include a multitude of issues. Nonetheless, we would not have wanted to "go it alone" without the ongoing communication link it has provided over the past seven years. Several of its committees

not only involve a business component, but pursue their policy agendas and problem-solving checklists via meaningful public-private partnerships that encompass input and analysis prior to commission meetings, dissection of the issues during the semi-annual sessions themselves, and as an ongoing information channel all 12 months of the year. Our goal now is that the appropriate pieces of the joint commission structure become increasingly a business-to-business dialogue that would ultimately either replace or more concretely complement the government-to-government arrangement.

Russia in October 1999 – Economic and Political Indicators

Even with all the difficulties, the first post -Communist decade provides reason for optimism. On the economic front, despite dire predictions to the contrary, parts of the Russian economy are rebounding from the devastating financial collapse last year. On the political front, in December Russians will freely elect their third parliament since 1992, and next July go to the polls to select the second president of the Russian Federation in the first constitutionally based transition of power in the history of the country.

This is not to say that there isn't plenty of bad news about which to be concerned: appalling healthcare statistics, rock-bottom poverty levels, serious wage and pension arrears, and an only partially completed restructuring of Russia's industrial base. Much work remains to be done, and anything beyond a pseudo-debate should elucidate, not obscure, the opportunities and challenges that lie ahead.

And we should take note of the encouraging signs. Russia has bounced back strongly since its financial collapse last year and continues to move toward a market economy. How did this happen? Russia's recovery is the result of a sharply devalued ruble, higher oil prices and what appears to be an emerging consensus on the Government's economic direction in the country's political class.

Before August 1998, when the ruble collapsed, there was much fear that a sudden devaluation would reignite inflation. But, as it turned out, the devaluation was a powerful tonic. Russia had become addicted to imported food and consumer goods, and the low ruble drove up the price of imports, chasing many off the shelves; sales of imported goods declined more than 50 percent in the last year. Russian entrepreneurs are taking advantage of the low ruble and increasing production in textiles, food, clothing, and automobiles.

The result: in 1999, economists have become more bullish. They estimate the economy will grow by nearly 2 percent this year. This would represent only the second year of growth since the collapse of the Soviet Union in 1991.

As the private sector behaves more as a private sector should, Russian government policies have been surprisingly sound, despite the rapid turnover of Prime Ministers. When Yevgeny Primakov took office last year, many thought he would roll back reforms and print money to finance a state-led revival of manufacturing, a move that would have led to hyperinflation.

But Mr. Primakov did nothing of the sort. Instead, he and his two successors have pursued more or less the same low-ruble, low-inflation, market-oriented policies. Such broad agreement,

shared by politicians and entrepreneurs, certainly did not exist at the beginning of the 1990s: it is the product of a decade of painful learning.

Rising oil prices are also stimulating the economy. The collapse of oil prices in 1998 helped bring about Russia's financial crisis. But now, oil dollars are flooding back. Energy exports account for about half of Russia's export earnings and taxes on oil alone make up nearly a quarter of the Government's revenues.

The situation is still unstable. Economic growth could still stall. Or, as the stakes rise in the battle to succeed President Yeltsin, economic policy could go awry. And the country needs long-term investment. Throughout the 1990s, foreign investors shied away from Russia. Out of $430 billion invested worldwide in 1998 (of which more than 40 percent still flowed to emerging markets, despite the East Asian crisis and its worldwide repercussions), Russia attracted only $1 billion. Over the decade, cumulative foreign direct investment in Russia has been a paltry $9.2 billion, compared to $16.9 billion in Hungary and $8.5 billion in the Czech Republic.

A big part of the reason is crime and corruption, but the main culprit is the tax system. Tax rates can run over 100 percent, the rules are contradictory and constantly changing, and enforcement is arbitrary. The system turns entrepreneurs into criminals and distracts them from running their businesses. Indeed, a substantial part of what is now called "money laundering" is more likely to be capital flight that results directly from the unreformed tax system.

Crime and Corruption in Russia and the U.S. Response

American business in Russia has been dealing with the effects of organized crime and systemic corruption for many years. While many of these issues have come to a head in the past weeks since the money-laundering stories appeared in the media, it is not really new or shocking to those who have been operating in Russia throughout this decade. Organized crime is a fact of life around the world and American business must protect itself from its tentacles whether in Russia, China, Colombia, or the United States. We applaud the steps that Congress is taking to strengthen money-laundering laws in the United States. But I would also refer you, Mr. Chairman, to an impressive record of collaboration between our FBI and the Russian MVD in solving several complex criminal schemes – the ones that don't necessarily grab headlines, but that in many cases protect U.S. firms as computer-based and other crimes are thwarted.

Corruption – either public or private – is a different problem requiring different solutions. American business is protected by the Foreign Corrupt Practices Act. The U.S. government has a multitude of programs from 1992 on that are intended to help the Russians help themselves in this area. The OECD initiative has a huge role to play in this process.

Was there something that could have been done differently? Would an earlier diagnosis have helped? Would the majority of our scarce assistance dollars have been better spent on rule of law programs rather than business support activities? These are the real questions that should guide the debate.

U.S. Business in Russia

Our survey of members conducted last fall immediately following the financial collapse, and now being updated at the one-year mark, has yielded several common themes expressed by members irrespective of industry-sector affiliation. The banking crisis and the continued lack of any real restructuring to date make conducting everyday business more difficult in the short term. The devaluation of the ruble has decreased demand for imported consumer and manufactured goods. Distributors continue to have difficulty paying suppliers, one aspect of the widespread nonpayment issue that is far from being resolved.

Over half of the company responses indicated last year and this year that the top two concerns for most members are market conditions (sales demand, customs, and distribution) and banking and financing problems. Compared to these specific economic concerns, the uncertain political atmosphere ranks a distant third for most members, although there is general consensus that very little is expected to change before a new president is elected and installed in office.

With respect to layoffs and downsizing, some consumer-products firms scaled back quickly and dramatically, with layoffs ranging from 30 percent to half the local workforce, even as high as 70 percent in some cases. It is important to note here that the success of member company investment in human capital had been a source of pride and a bright spot in an otherwise difficult business environment. Having to let these employees go, even temporarily, has been one of the most disappointing aspects of the August economic crisis.

When we asked in September 1998 how long it would take Russia to return to spring 1998 business conditions, roughly 22 percent of survey respondents predicted that it would take up to a year. Another 35 percent of survey respondents predicted 6 to 18 months, while over 40 percent forecasted an 18-36 month window. About 15 percent, the fewest responses, believed it would take 3 years or more.

Since our members made these predictions, it is interesting to note that an increasing number of policy experts inside and outside Russia are coming to the same conclusion as the majority of our members. It now seems that the two to three years is an accurate timeline for signs of real progress in a number of areas that will impact economic growth. Most member companies who took a pessimistic view 12 months ago have revised their estimates to shorten the recovery time.

When asked how they would gauge the change in their company's plans for the Russian market, one-third of the companies reported no change—thus the largest category of respondents were staying the course and pursuing their long-term commitment—while the remaining respondents stated they were at that point reviewing their plans before making any strategic decisions or taking any drastic measures. In the ensuing months, companies have revised their attitude from "no change" to a "more cautious approach." The difference seems to be very difficult 3rd and 4th quarters of 1998, with slow recovery over the first nine months of 1999. Retrenchment has led to an overall strategic decision that while they remain committed to the Russian market in the long-term, there will be no major business activity until after the June 2000 elections.

The U.S.-Russia Business Council continues to advocate a series of reforms that are needed to accomplish a favorable investment climate for all business activities in Russia. We continue to

promote changes in a number of areas, all directly related to creating a structure of laws and regulations that are both investor friendly and that can be implemented with some degree of success.

Unfortunately, this is much the same list of concerns we have presented to the Russian government over the past six years. Every government has promised but has never been able to take the necessary steps to deliver on the investment agenda. Each government since 1992 has employed much the same well-intentioned rhetoric, but without the political will that translates words into deeds.

And, although the Council's main concern is its members, it should be noted that there is a legitimate, albeit struggling, Russian business community that needs this legal framework in which to operate as much as foreign companies. While much of the focus over the past years has been on the "oligarchs," during this same period, there have been many legitimate Russian businesses trying to operate under these incredibly chaotic, "anti-business" conditions. A combination of factors, outlined below, have made it almost impossible for a fledgling Russian private sector to survive, much less succeed.

A number of commercial issues have already been addressed by Russian law (in large measure), but clarity and transparency, implementation and enforcement are lacking, and thus continue to hinder business activity and economic progress. The problem areas described below can be addressed through the direct involvement of various branches of the Russian government. With the election cycle now underway, immediate and concerted government action is more imperative than ever if the business climate is to improve in the near term.

1. Tax Reform

The current system of taxation is a primary obstacle to foreign investment (and domestic investment) in Russia. American businesses cite four main problem areas to be addressed: the complexity of the tax system, inadequacies in tax regulations, the severity of tax penalties for unintended mistakes, and deficiencies in tax administration. Though revenue has improved in 1999, tax collection remains a problem. But beyond the use of tax legislation to improve and increase budget revenues, the American business community is hampered by a system in which foreign companies bear the main burden.

2. Energy Sector Issues

The adoption of both the Production Sharing Agreement Amendments and the Enabling Legislation gave us a sense of guarded optimism about the investment framework that will allow companies to make rational economic calculations about whether to move forward on possible ventures in the energy sector. Nonetheless, what was once thought would be the investment engine has not materialized, with Western firms having little to show for the time and capital they have put toward this vital sector.

The environment for investments in Russia's energy sector continues to be compromised by legal, fiscal and regulatory infrastructure that is essentially "investor unfriendly." For the near and medium term, it is unfortunate that Russia will likely not be able to attract substantial

amounts of foreign direct investment in any part of the energy sector, despite the pressing need for large capital investments.

The Russian government can assist in this process by continuing to follow through on its efforts to develop normative acts that clarify and fully implement the contractual terms of PSAs. In addition, future legislation, including the Tax Code, will need to recognize and consistently affirm the enacted PSA-related legislation.

While any structural changes will prove useful in attempts to understand the full cost structure of the gas industry in Russia, we urge the Russian government to foster wholesale competition in the Russian gas industry and commit to making open-access pipelines a reality.

The Ministry of Fuel and Energy's tentative proposal for consolidating UES and Gazprom into a "super ministry" would have represented a huge step backward and damaged investor confidence even outside the energy sector, and we are encouraged that this initial idea is not likely to become Russian policy.

Finally, American investors are supportive of Transneft proposals to move to a competitive bidding scheme for export allocations, provided the bidding processes are conducted in a fair and transparent manner.

3. Restructuring and Resuscitation of the Commercial Banking System

In the early days of the transition from the Soviet Union, the banking sector was the scene of explosive growth, but the default on the domestically held government debt of last August brought much of the banking industry to collapse. The larger, Moscow-based banks, which had been most aggressive, were hit hard, while more than a few of the regional banks weathered the storm because they had not been in the highly speculative GKO market. A slow process has ensued in which there was finally created in the last six months a government restructuring entity called "ARKO," for Agency for Restructuring of Credit Organizations. But with limited capital, the organization has prioritized its efforts to shore up some of the regional banks, since it lacks even enough money to manage the proper liquidation of any one of the major Moscow banks although even this effort is difficult.

The fact remains that until the legal framework can be created for the proper supervision of a private banking sector, the Russians are being denied a crucial leg of the development process. However, the influence of a true private banking sector would be strongly positive on Russian industry, and the lack of a swifter move in that direction is a major drag on the evolution of the Russian economy.

4. Commercial Infrastructure Issues

There are numerous specifics requiring attention under this category.

Shareholder Rights

Issues of corporate governance and greater protection of shareholder rights are closely correlated to investor confidence, as one measure of how the rule of law is applied in the Russian market. Of particular concern to the private sector are the issues of dilution, interested transactions and

major transactions, the creation of an information disclosure system to facilitate greater transparency of entities, ongoing education of issuers and shareholders as to all parties' rights and obligations, and greater focus on the role of independent directors. The Federal Securities Commission requires additional resources and an improved legislative basis to ensure that shareholder rights are enforced.

Closely related to the problem of shareholder rights is the need for greater disclosure of information from Russian entities. The regulations issued last year by the Federal Securities Commission are a promising step. We urge rapid implementation of the REDGAR system.

Bankruptcy and Arbitration
Unfortunately, there are numerous examples, particularly in the banking sector, of obstructionism in getting at the truth of a company's actual financial condition. Additionally, there are at least two examples of business disputes involving American companies that have gone to international arbitration and won, but the execution of the arbitration order has been subverted by asset stripping or court obfuscation.

International Accounting Standards
Recent progress toward adoption of international accounting standards as the lingua franca of Russian business has stalled primarily due to bureaucratic considerations. In order to move forward, the following steps should be taken:

- Announce the adoption of the internationally accepted IAS as the standard for Russia (without significant internal modification);
- Stop the drafting process of different versions of definition and implementation being put forward by various entities in the Russian executive branch; and,
- Create an independent Accounting Standards Association to monitor and, as needed, enforce the long-term conversion process.

Standards and Certification
We are pleased to note that reforms leading toward clear and precise rules governing standards and certification are ongoing, and Gosstandart has achieved considerable success. The glaring exception to this progress has been Goskomsviaz, which continues to operate as a separate fiefdom that charges rapacious fees for type approval from foreign telecommunications companies. This issue is now tied to Russia's WTO aspirations. We would like to see Goskomsviaz adhere to the same international standards and certification guidelines, as does Gosstandart.

Intellectual Property Rights
Intellectual property rights (IPR) protection is an issue of great importance to both the international and Russian business communities, and the Russian government has demonstrated its serious commitment to developing a legally sound and enforceable IPR regime. Rospatent has played a critical role in developing Russia's intellectual property rights protection system, in advocating Russia's full compliance with international norms, and in protecting Russia's national interests. We strongly believe that the elimination of Rospatent would entail severe

consequences, including the loss of a uniquely talented and professional staff, the disruption of IPR policy making, and the possible erosion of the existing IPR regime.

5. Sector-Specific Issues
In addition to the above-mentioned energy legislation, other sectors of the Russian economy in which foreign investment can make a significant contribution are being targeted by legislation that will have the effect of discouraging new investment and even reducing the present levels of economic activity. For example, draft laws now in the Duma will negatively impact foreign investment in the tourism, aviation, and insurance industries.

Next Steps for Russia and the U.S.
Russia is in the midst of a generational transition process, so we should keep in mind that we are roughly one-third of the way through an unparalleled societal shift. For Russia, the next steps in the next decade of reform seem clear. Hold fair and free elections in December and July. Transfer power peacefully, and engage in a constitutional assembly if publicly supported. Address the issues of crime and corruption head on, with clear laws and a political will that will stay the course. Welcome investors as the best means to economic growth through reforming the tax laws, investment regime, property rights, and so forth. Not only will this bring in the much-needed foreign direct investment, it will go a long way toward bringing back flight capital to be invested in Russia, by Russians. And, while encouraging the development of emerging Russian business especially as those prospering over the past year, do not use this as an excuse to protect domestic industry at the expense of foreign investors. Take the steps to move rapidly to membership in the World Trade Organization.

For the U.S. government, we would strongly urge the continuation of assistance programs under the Freedom Support Act that will address the specific needs of building a democratic, civil society and a true market economy. The work of the Duma-Congress Study Group should be given a greater priority as a means of increasing legislator to legislator contact.

As the past decade has shown, real progress will come with time and with the movement of generations of younger Russians into positions of decision making. As such, our exchange programs should be expanded as the best means of reaching the younger generation.

Closing
I would end this testimony with several questions that must be answered in any honest debate about the future of U.S. policy toward Russia. We don't have the answers, but we do have opinions on what next steps should be taken and are willing to participate in such a forward-looking exercise.

Do we understand the challenges that are facing us in Russia?

Have we valued our technical assistance in all areas of support at the appropriate price to get the job done?

Are we ready to deal with the unresolved issue of Russia's debt with our G-7 partners and international financial institution partners?

Ultimately, what we in the United States do about Russia is only a small part of the solution. Our programs have been diverse, focusing on security concerns, civil society development, and trade and investment technical assistance. The question has never been what element of our assistance should come first, but rather how to accomplish all of these priorities in tandem with one another.

U.S. policy has not been a one-size-fits-all box, but a flexible array of approaches to meet the challenges of this enormous undertaking. In 1993, our willingness to help the Russian people help themselves set a policy in motion that has evolved to meet the needs of the moment. There was no crystal ball to predict the future (much less the present). Congressional oversight has been an important component of the process and an honest debate about our Russian policy is a useful exercise to focus our efforts.

In the end, everyone wants the same outcome—a free, prosperous and stable Russia that can take its place among the global community of democratic, market-based countries. The American business community is ready to engage in a constructive debate on the next steps in U.S. policy to help achieve this objective.

MARCY KAPTUR
MEMBER
9TH DISTRICT, OHIO

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July 21, 1999

The Honorable William J. Clinton
President
United States of America
The White House
Washington, DC 20500

Dear Mr. President:

Please let me draw your attention to the unique and vital circumstances affecting current U.S. farm prices and bumper crops. These circumstances present special opportunities to expand humanitarian commodity shipments abroad. Today, our farmers and ranchers, in virtually all sectors of our agricultural economy, including wheat, soybean, corn, cotton, rice and livestock have faced unprecedented low prices and critical worldwide market conditions.

To respond to declining farm prices, I urge the Administration to consider developing a "millennium goodwill initiative," perhaps as a supplemental appropriations measure, or coupled with pending "debt relief" initiatives. I also urge the Administration to utilize the Food for Peace and Food for Progress programs, along with the appropriate titles of Public Law 480 and Section 416, to target humanitarian assistance in regions of the world where food supplies are desperately needed. In addition, I would urge you to structure this program in such a way as to encourage commodity monetization in recipient countries to spur resources for internal sustainable rural development -- including credit, agricultural investments and human development programs.

Particularly in Kosovo and Russia, commodities are needed to compensate for diminished production due to war, market transition and drought. Further, Sub-Saharan Africa needs long-term development assistance to help lift the massive debt that plagues that region. I implore you to include Sub-Sahara Africa in such development initiatives that

build on the power of agricultural humanitarian assistance. Targeted U.S. shipments can help guide developing countries down the path of self-sufficiency as we enter the 21st century, and give a real helping hand to rural America when she needs it. I stand ready to work with you in accomplishing this project of "goodwill for the new millennium."

Sincerely,

Marcy Kaptur
Member of Congress

CC: Vice President Gore
Secretary of State Albright
Secretary of Agriculture Glickman

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G. William Miller
David Rockefeller, Jr.
Donald H. Rumsfeld
George P. Shultz
Cyrus Vance

October 5, 1999

The Honorable Marcy Kaptur
Unites States House of Representatives
2311 Rayburn Building HOB
Washington, D.C. 20515-3509

Dear Representative Kaptur:

I want to thank you on your concern and leadership on the issue of U.S. Food Assistance to Russia.

A stable, democratic and prosperous Russia is of enormous strategic importance to the American people. Also, Russia represents a market of huge potential for America's farmers, input suppliers and farm equipment manufacturers.

The Government of the Russian Federation has requested additional Food Aid Assistance to address shortfalls of production which, if not addressed, will have potentially damaging impact on political and economic stability and which will lead to serious decline in the diets of the average Russian people.

The U.S. should respond positively to this request to avoid serious disruptions this winter. The fact is that this year, the Russians do not have the carry over reserves that sustained them last year (particularly feed grains).

However, our response this time should not be patterned on the U.S. response that was utilized in the program which is just now nearing completion. Our response to last year's request did little to address the root causes of the continued shortfalls of Russian agriculture and did little to strengthen the emergence of a private food and agribusiness sector.

Last year's Food Aid Package was well organized and carefully monitored by USDA and achieved positive results, particularly in reviving Russia's feed grain sector. However, the sale and distribution of commodities was done entirely through largely State or quasi-State distribution channels. Russia's emerging private distribution and processing sectors received little benefit and in many cases were put to a disadvantage. The net result is that we unintentionally strengthened the State structures at the expense of the emerging private sector.

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Also, while it is laudable to address the problems of Russian pensioners, the first tranch did nothing to address the problems of Russian agriculture; particularly the need to build the capacity of Russian farmers to purchase essential crop inputs and farm equipment, and the need to spur increased investment in Russia's woefully inadequate food processing and distribution infrastructure.

This new request presents an opportunity to respond in a way which will meet the critical needs of the Russian people and which will benefit the long term interests of American farmers and farm input manufacturers.

First, to the greatest extent possible, the U.S. should ensure that U.S. Food Aid Assistance should be monitized through Russia's emerging private sector. A significant segment of Russia's private agriculture sector has survived the 1998 financial crisis and is in a position to be greatly strengthened.

Second, the proceeds of these sales should be utilized—under U.S. control and accountability—to strengthen the capacity of Russian farmers and enterprises to purchase essential U.S. commodities, inputs and equipment; and to leverage additional U.S. investment in Russian food and agribusiness infrastructure.

The U.S. has the opportunity to fashion a creative and constructive approach to Russia's request for assistance. We have the opportunity and means to not help Russia in the short term, but to build strong trade and investment linkages for American farmers and business for the future. It will be more difficult but it is the road to take. I strongly urge Congress to ensure that this is the choice we make.

Sincerely,

John H. Costello
President

PROPOSED ADDITION TO THE CONFERENCE REPORT FOR H.R. 1906, AS REPORTED OFFERED BY MS. KAPTUR OF OHIO

Before the short title at the end, insert the following:

1 **SEC. ___. FINDINGS AND SENSE OF CONGRESS.**

2 (a) FINDINGS.—Congress makes the following find-
3 ings:

4 (1) Abundant agricultural production in the
5 United States has resulted in historically low com-
6 modity prices and hardships for farmers whose in-
7 comes have fallen drastically.

8 (2) Less developed countries cannot afford to
9 import adequate supplies of food to meet the basic
10 nutritional needs of their people and face an annual
11 14,000,000 metric ton shortfall in grains.

12 (3) Disasters in developing countries, due to
13 flooding, drought, earthquakes, and civil war have
14 compounded the suffering of the poor and thrust
15 millions of low-income and even middle-income fami-
16 lies into poverty.

17 (4) Food aid donations from the United States
18 can fill the food gap in developing countries and re-
19 gions such as Kosovo, the Middle East, and newly

1 independent states, sub-Saharan Africa, South East
2 Asia, Turkey, and Macedonia, mitigate the effects of
3 disasters, and provide long-term benefits through
4 monetization and targeted economic and social devel-
5 opment programs.
6 (5) Commodities can be purchased under a va-
7 riety of existing authorities to stabilize the United
8 States farm economy and then donated abroad to
9 provide assistance to people in needs and to build
10 United States markets abroad.
11 (b) SENSE OF CONGRESS.—It is the sense of Con-
12 gress that—
13 (1) commodities held in the Bill Emerson Hu-
14 manitarian Trust should be increased to the
15 4,000,000 metric ton maximum level allowed by law
16 to help lift surplus off the backs of American farm-
17 ers and to be prepared for humanitarian assistance
18 efforts in the future when little or no surplus exists;
19 (2) monetization of commodities should be car-
20 ried out in needy countries as an important develop-
21 mental tool;
22 (3) use of the Commodity Credit Corporation
23 and all other existing authorities should be maxi-
24 mized to assure surpluses in the United States are

1 procured and targeted to be shipped and delivered
2 overseas to needy people;
3 (4) USAID and USDA should entertain and
4 evaluate PVO proposals for food assistance in a
5 timely fashion without obstacle;
6 (5) USAID should increase humanitarian non-
7 emergency food aid to the extent possible and give
8 PVO's flexibility to use monetization to address local
9 development needs;
10 (6) the Treasury Department should look more
11 aggressively at Public Law 480—debt forgiveness
12 for highly indebted poor countries to promote fur-
13 ther economic development;
14 (7) sanctions should be removed, consistent
15 with United States foreign policy, to promote United
16 States agriculture exports and humanitarian goals;
17 and
18 (8) the USDA and all other appropriate depart-
19 ments and agencies of the Federal Government
20 should also participate to the maximum extent pos-
21 sible in multilateral food assistance and development
22 programs operated by the United Nations and other
23 multilateral organizations.

PROPOSED ADDITION TO THE CONFERENCE REPORT FOR H.R. 1906 OFFERED BY MS. KAPTUR OF OHIO

At an appropriate place, insert the following:

1 **SEC. ___. FOOD FOR PROGRESS AND SECTION 416.**

2 (a) TRANSPORTATION OF FOOD AID.—Section
3 1010(f)(3) of the Food Security Act of 1985 (7 U.S.C.
4 1736o(f)(3)) is amended by striking "$30,000,000" and
5 inserting "$100,000,000".

6 (b) MAXIMUM COMMODITIES TO BE FURNISHED.—
7 Section 1010(g) of the Food Security Act of 1985 (7
8 U.S.C. 1736o(g)) is amended by striking "500,000" and
9 inserting "1,000,000".

10 (c) DEVELOPMENT OF PRIVATE SECTOR AGRI-
11 CULTURE.—Section 1010(l)(1) of the Food Security Act
12 of 1985 (7 U.S.C. 1736o(l)(1)) is amended by striking
13 "$10,000,000" and inserting "$30,000,000".

14 (d) SECTION 416.—Section 416(b)(5) of the Agricul-
15 tural Act of 1949 (7 U.S.C. 1431(b)(5)) is amended by
16 adding at the end the following:

17 "(C) The Commodity Credit Corporation may pay
18 costs incurred in the development of program proposals
19 and costs associated with the administration, sale, imple-
20 mentation, and monitoring of programs implemented by

1 private voluntary organizations, nonprofit agricultural or-
2 ganizations, cooperatives, intergovernmental organiza-
3 tions, or other private entities.".

Translated from Russian

DEFAULT MEANS SELF ABOVE SERVICE.

Article published by Novaya Gazeta in edition issued

on September 27 - October 4, 1999

We were right. The assumption made (ref. to the article of Bulat Solyarov

"How could 15 billion dollars be stolen" is being confirmed by new facts.

In the 33rd edition we have described the scheme which helped the senior executives of the financial sector to earn billions of dollars on the development and collapse of GKO pyramid. They have done it easily through associated companies which enjoyed access to insiders information about decisions taken by the Cabinet. According to our version, the rubles which were made on GKO trading, were used to buy dollars at the currency exchange market (the fact confirmed by stock exchange players). In order to secure a maximum amount of dollars (and the possibility to take them abroad) exchanged for the minimum amount of rubles, the same bureaucrats urged the IMF to disburse credits for ruble stabilization. As a result, they got an opportunity to buy an unlimited amount of dollars provided by IMF at the exchange rate of one to six.

We continue to examine our version and get convinced that an enormous number of new confirmations prove that we were right. Considering that Russia still does not have a mechanism of personal responsibility for financial decisions taken by the Government and the Central Bank, we can not put the blame on anyone in particular. However, it is common knowledge that decisions regarding GKO trading were taken by a narrow group of persons: Dubinin, Zadornov, Kirienko, Aleksashenko, Chubais and Gaidar. The country always knew its heroes.

First, let us speak about unimportant. It does not surprise us any more that many things are conducted illegally in our country. And still we have to state: firstly, the people who took the decision to default on August 17, violated clauses 310 and 817 of the Civil Code which say that the state does not possess the right to change unilaterally the conditions of the debt issued for circulation including GKO bonds. This action violated Article 35 of the Constitution which says " nobody can be deprived of its property unless such decision is taken by court", and states that creditors' claims towards the Central Bank should be examined at the constitutional level.

These are, so to speak, the victims who were justified by the objective set forward by establishing the financial scam called GKO market.

The objective is clear. We can define with precision the purpose of the domestic debt pyramid which collapsed on August 17, 1998. It didn't have any other objective except enriching the players of the Russian stock market who were always represented by the Central Bank and companies close to the well-known state officials.

We believe that in the last years of its functioning, the GKO system didn't have anything in common with state interests. Firstly, the profitability of state securities was insane and was unwarranted. While the securities in industrialized countries earn the profit of no more that 5% per year, in developing countries 10% annually, and in under developed approx. 15%, in Russia in the best times of economic development it amounted to 30%, and in August 1998 to 200%. Taking into consideration the fact that the Central bank and institutions close to it have always controlled not less that 50% per cent of the stock market, the federal authorities could, if really wished, to lower the profitability of state securities which has made the pyramid grow at the supersonic speed. However, such action was not part of the plans of the companies who earned super profits on the securities market: they needed a high anti- federal speculative rate of profitability. We all remember those companies: companies close to Chubais - Aleksashenko group - MFK Renaissance Capital Group (Jordan), Montes Auri (Kokh), ONEXIM (Potanin), etc. And certainly, the group of Central bank. The market players at that time would explain their confident behavior exclusively by the friendship between their leaders and state officials. They needed the state to guarantee the rate of profitability not of 10-15% per year (which is more or less reasonable), but 30-200%.

The federal authorities had another serious reasoning for maintaining such excessive interest rates for state securities: the Central Bank was looking for profits. For example, in 1997 the net income earned by the CB on GKO trading brought 5.5 billion rubles. In other words, by managing the financial pyramid on the eve of August 17, the CB was leading the country to default. The CB made an interesting use of these profits. According to Yuri Boldyrev, vice-Chairman of the Audit Chamber, the audit in 1997 showed that 7.5 billion rubles had been spent by the Central Bank for administrative purposes. We can add that all the expenditures for state management in Russia were approximately equal to this sum while the magnitude of construction works conducted unceasingly by the CB could be compared to the scale of residential construction in the entire country.

Superprofits gained on GKO market by the government and Central Bank bureaucrats became enormous in the period between January and August of 1998. By that time everything became clear even for the least educated people. Starting from December 1997, the GKO market stopped to be a donor of the stated budget. In order to survive the state had to prolong the life of the pyramid and start to pay off the bonds not by newly attracted assets (increasing internal federal debt) but at the sacrifice of the state budget. In other words, starting from December 1997 the GKO trading lost any budgetary sense. Instead of replenishing the budget, it was draining up to 35% of its revenues. The Ministry of Finance spent 600 billion rubles from the budget to keep the GKO market. The bureaucrats started to fill its own pockets and the pockets of associated oligarchs not at the expense of the loans drawn from the market but at our expense, at the expense of tax payers, miners, teachers, and physicians who started to experience arrears in salaries.

It means that starting from 1997 it was completely senseless to issue new GKO. What is more, this issue was criminally wrong. Such action was producing nothing but further enrichment of the stock market players. The rest of the story is already known.

As soon as it became clear that the federal securities market was about to collapse and the pyramid was getting too heavy for the state to sustain, the government received a number of projects which proposed a civilized way of restructuring the domestic debt. None of this projects has been used. The well - known persons brought the annual profitability rate of federal securities from 30 to 200% and declared default at the moment when there remained nothing to pay off the debt.

We assume that the country didn't need the GKO market in general, because its budgetary

profitability existed for a short period of time and ceased already in 1996. However, if that happened and the guys built the pyramid, at least in the period between 1997 and 1998, it had to be restructured. But the government was motivated not by the state interests. That is why there was no restructuring. It didn't take place because great assets were gained by notorious people exactly due to the market collapse in 1998.

The restructuring could have cushioned the consequences of pyramid building (in relation to its timeliness), but they continued to say that the pyramid was solid and the situation was under control not only in the beginning of 1998 but also in August. They brought the situation to default crisis and as a consequence, we got the following results: defaulted domestic debt of 400 billion rubles, losses suffered by the banking system of 150-200 billion rubles, catastrophic GDP and investments volumes, lowering of the country's credit rating and continuing deterioration of the living standards of the population.

In edition 33 (D) we reported that around three billion dollars our of almost five-billion IMF stabilization credit were bought out by state officials and their friends who made rubles on GKO trading. All in all, according to our experts' opinion, they have bought dozens of billion of dollars in the course of federal securities market functioning. The CB used to sell around 100 million dollars daily and replenished its assets from IMF funds.

In order words, by providing disbursement to stabilize the ruble, in fact the IMF contributed to launder the black rubles earned by notorious people on pyramid building.. Our experts estimate that the participants of the federal securities market bought approximately 70% of all the currency available on the market.

P.S. Since the Constitution does not foresee personal responsibility on behalf of state bureaucrats for their decisions, all the attempts of citizens, State Duma and the Federation Council to institute proceedings through the General Procurator's Office on GKO case will be doomed to failure.