

FINANCIAL IMPLICATIONS OF SOVIET ECONOMIC REFORM

HEARING

BEFORE THE

SUBCOMMITTEE ON ECONOMIC GOALS AND INTERNATIONAL POLICY

OF THE

JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES

ONE HUNDRED SECOND CONGRESS

FIRST SESSION

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WEDNESDAY, OCTOBER 30, 1991

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON ECONOMIC GOALS AND INTERNATIONAL POLICY,
JOINT ECONOMIC COMMITTEE,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:35 a.m., in room 2172, Rayburn House Office Building, Honorable Lee H. Hamilton (chairman of the Subcommittee) presiding.

Present: Representatives Hamilton, Johnston, Solarz, Meyers, and Gilman.

Also present: Richard F Kaufman, General Counsel.

OPENING STATEMENT OF REPRESENTATIVE HAMILTON, CHAIRMAN

REPRESENTATIVE HAMILTON. The meeting of the Joint Economic Committee's Subcommittee on Economic Goals and International Policy and the House Foreign Affairs Subcommittee on Europe and the Middle East will come to order.

This morning, we begin a series of hearings on "The Financial Implications of Soviet Economic Reform." They will be jointly conducted under the auspices of the House Foreign Affairs Committee and the Joint Economic Committee.

The purpose of the hearings is to inquire into the likely consequences of financial conditions in the Soviet Union for the international economy. We will concentrate on the economic reforms and how they and the current negotiations between Moscow and the republics are influencing domestic economic performance, interrepublic and foreign trade, and management of the Soviet foreign debt. We will also examine the role of Western economic assistance and how it should be conducted and coordinated.

We are fortunate to have as our witnesses three well-known, distinguished experts on Soviet financial affairs. Donald W. Green is a co-founder of PlanEcon, Inc., where he presently serves as a director and consultant. Previously, he was Executive Vice President and Director of the Mercator Corporation, and before that he worked at the Chase Man-

hattan Bank as a specialist on the centrally planned economies and Deputy Director of International Forecasting. He has held faculty appointments at Columbia University, the University of Pennsylvania, and Princeton University.

Robert D. Hormats is Vice Chairman of Goldman Sachs International. He served as Assistant Secretary of State for Economic and Business Affairs during 1981 and 1982, and as Deputy United States Trade Representative during 1979-1981. He was a member of the National Security Council staff from 1974 to 1977.

Horst Schulmann has been the managing director of the Institute of International Finance since 1987. The members of the Institute are primarily international commercial banks. Previously, Dr. Schulmann served in various official capacities in the German government and the European Community, including undersecretary in the German Ministry of Finance, and director in the Commission of the European Communities. He has also been an officer of the World Bank.

We're very pleased indeed to welcome each of you here. We ask you, as I think you have been informed, to summarize your written statements in approximately ten minutes, and then at the conclusion of that, we'll turn to questions.

Mr. Green, I'll begin with you and move across the table. You'll be followed by Mr. Schulmann, and then Mr. Hormats.

Before you begin, without objection, I will enter into the Subcommittee's record the testimony of Ukraine 2000, a statement before this Subcommittee prepared for the hearing today.

That will be entered into the record, without objection.

[The statement of Ukraine 2000 in full follows:]



UKRAINE 2000

THE WASHINGTON COMMITTEE IN SUPPORT OF UKRAINE

STATEMENT OF

UKRAINE 2000: THE WASHINGTON COMMITTEE IN SUPPORT OF UKRAINE
 BEFORE THE
 SUBCOMMITTEE ON EUROPE AND THE MIDDLE EAST
 OF THE
 HOUSE COMMITTEE ON FOREIGN AFFAIRS
 AND THE
 JOINT ECONOMIC COMMITTEE

October 30, 1991

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

We appreciate this opportunity to submit our views on the general topic of economic reform in the former Soviet Union.

First, we address a number of issues relevant to economic reform in Ukraine. We address whether there are advantages in the possible continuation of central political and economic structures in the former Soviet Union; we consider the idea of international relationships with the republics; the role of international institutions; "Soviet" debt; and Ukraine's rejection of the latest economic agreement between some of the republics and the center. We warn of what may be United States encouragement of force and violence by the center, and we urge that this committee and the Congress actively follow events in the former Soviet Union. We urge that you encourage the Administration to support democratic reform, not thinly disguised imperialism.

**ADVANTAGES AND DISADVANTAGES OF DECENTRALIZED
AND ECONOMIC STRUCTURES**

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

Ukraine as a colony

Perhaps a few comparative charts will show the plight of Ukraine under Moscow's central control. Leonid Savchenko, Rukh's economist, was published in a 1989 issue of the newspaper What Needs To Be Done. In his article "How to Come out of the Crisis?" he included the following:

Quality of Life

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

Economic Potential

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

Intellectual Potential

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

From: "A Study of the Soviet Economy"

IMF, World Bank, OECD, EBRD

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

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

Monthly Salaries, 1989 (% of USSR average)

RSFSR	108
Ukraine	91

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

HOW WE WORK: Per capita annual production of basic products

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

WE PRODUCE AT THE LEVEL OF A EUROPEAN COUNTRY

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

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

WHAT WE HAVE

Median Monthly Salary and Buying Power

	Ukraine	Germany	France	Italy
Monthly Salary: in rubles:	210r	4200m 1400r	6000f 670r	15mil 1 750r
Purchasing Power				
Meat	40kg	180kg	100kg	110kg
Suits	1	8	6	7
Boots (pair)	1.5	10	7	12
Socks	40	800	900	1700
Color TV	.25	3	2	2
Refrigerators	.7	2	1.5	2
To Buy One Auto Must Work:	4yrs	10mts	10mts	9mts

Ukraine is poor because it is not free.

Mr. Chairman, in September, 1991, Mykhailo Horyn, one of the founders of Rukh, a former political prisoner, an elected Deputy to the Supreme Rada of Ukraine (parliament), visited Washington for the first time. In a meeting on Capitol Hill he related a perspective of Ukraine's history that is important to remember. It is a perspective that is on Ukraine's mind, a perspective the United States should understand. Horyn relayed that in 1654 the Ukrainian Cossack Nation signed a mutual defense agreement with Moscow. He said that under the agreement Ukraine was to conduct its own foreign policy and was to have its own army, but after four years some of its autonomy was lost, and after 120 years Ukraine was a colony of Russia. Horyn went on to say that an independent Ukraine again signed a confederation agreement with Russia in 1922. This time it only took 7 years for Ukraine to be forced

into a Russian colony. He said that Ukraine would not put itself in the position of the village farmer who steps on a rake a third time.

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

Abuse by the center

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

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

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

Under the center's command economy Ukraine became a site for major industrial centers - industrial centers where motivation was destroyed and human beings were reduced to mere

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

Chernobyl - the Kremlin's downfall

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

I have asked the founders of Rukh and I have asked people on the streets of Ukrainian cities what led to Ukraine's drive for independence. Nationalism? Economic woes? The answers I have found include elements of these things but much more. Uniformly there is an undertone of emotion, anger, resentment and common strength in the significance of Chernobyl. We in the United States have not appreciated the political significance of that terrible event, Moscow never will.

The explosion of 1986 and its handling by the central government symbolize for all of Ukraine what was wrong with the empire. It was careless with human life, it was secretive, it was corrupt. What a forced famine, purges, wars and prisons could not do, Chernobyl threatens - the destruction of a people. Not just Ukrainians but all of the people of Ukraine: Ukrainians, Russians, Jews, Poles. They all breathe the same contaminated air, they all drink the same contaminated water, they all eat the same food. They all view Chernobyl's invisible poison, its silent death, as the product of the

center. I cannot express within the confines of our language the rage, terror, and commitment one hears and sees in the people of Ukraine when the raw nerve of Chernobyl is exposed. You do not see people debating the quality of life, you experience the emotion of a struggle for survival.

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

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

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

INTERNATIONAL RELATIONSHIPS WITH THE REPUBLICS

If there should be no central structure what type of relations the United States and international institutions should have toward republics like Ukraine that have declared their independence? Our belief is that the United States should have direct and formal relationships with independent nations, and the United States - in its own interests - should encourage peaceful, democratic reform like that underway in Ukraine. Unfortunately, with fleeting exceptions, that is not what we (the United States) are doing. In fact the United States is supporting the center's efforts to rise from its ashes. The propenderance of our country's efforts are supportive of Gorbachev and the center. In fact, as more evidence comes in I fear just how far this Administration may be willing to go or, perhaps more appropriately, how far it is willing to let the center go to hold Ukraine.

The United States supports the Center

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

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

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

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

In fact, The Washington Post this last Sunday (October 27, 1991) reported that in Madrid Mr. Gorbachev would urge the United States to do more, to use its leverage to keep the republics in line.

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

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

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

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

Since World War II and the establishment of the Iron Curtain we have focused almost exclusively on Moscow. Even when the curtain began to come apart revealing a vastly different world than we had understood, we were slow to respond. Our government's institutional ability to deal with national languages, to understand history and critical relationships has been, at best, wanting. Our media rushed to come up with maps and graphics to educate itself and its audience to a forgotten world. Gradually American reporters are finding their way around "the circuits" of the former Soviet Union. An American legacy of neglect must be overcome rapidly. The Congress can help.

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

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

An Ambassador to Moscow, the center or the Russian republic, is not an Ambassador to Ukraine. After Ukraine's referendum of December 1, the United States should recognize Ukraine and officially welcome her into the family of nations.

The United States should provide direct technical assistance to Ukraine; programs ranging from economic, monetary and banking advise and counsel, to environmental advice, legal assistance in addressing the overwhelming complexities of privatization, to how to institutionalize civilian control over the military. In Ukraine we have a nation of 52,000,000 people with a land mass equal to that of France engaged in nation building. United States interests rest in having an early and close relationship with this emerging nation.

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

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

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

Ukraine is very interested in membership in international financial institutions such as the IMF and the World Bank. It would be in the interests of Ukraine and the international financial community for there to be direct relations with Ukraine. We do not believe that Ukraine is seeking direct financial grants, but it does need assistance in adjusting and revamping its economy. Part of the legacy of the empire is that 70% or 80% of Ukraine's manufacturing sector is oriented toward military production. Ukraine seeks to change that orientation. Ukraine will institute its own currency, it seeks to privatize, it will seek private investments to reorient the military focus of its manufacturing sector. But it needs technical help and guidance.

The United States should support and encourage Ukraine's interest in the IMF and the World Bank. The international stumbling and fumbling over the "Soviet Union's" membership is a needless distraction and it is counterproductive to real reform. The center can not bind the republics to any obligations. Neither Gorbachev, Yeltsin or

Yavlinsky speak for Ukraine. They are not representatives of Ukraine nor agents for it. The world situation has changed. International institutions negotiate with the center and its agents at their peril. Their efforts are wasted, their time is wasted; neither Gorbachev or Yavlinsky offer collateral for assistance. They can not commit Ukraine.

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

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

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

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

ROLE OF INTERNATIONAL INSTITUTIONS

Part of the legacy of the Soviet Union is the isolation and limitations its Iron Curtain placed around the

perspectives and scope of the people. Cut off from the world of ideas engaged, theories debated, living in the Union in many respects was like living on the intellectual "dark side." The emergence of the people of the former Soviet Union into the light of options and risks is exhilarating and promising, but the reality is that they need help.

The West should provide technical assistance not direct aid

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

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

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

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

Not only do we urge technical assistance for the republics, we feel that judgment needs to be used in the

providing of assistance to the republics. We will focus on Ukraine.

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

Changes cannot take place or succeed overnight. But we should do everything possible to be as effective and constructively supportive as we can. Our interests and the interests of the post Cold War world will be served by an independent, democratic and productive Ukraine.

FINANCIAL EXPOSURE TO "SOVIET" DEBT

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

Recent news from Moscow indicates that the republics of the former Soviet Union have agreed generally to accept responsibility for the debt.

For my part the overall debt situation is not clearly defined. However, a few observations might be in order:

1. As institutions grapple seriously with a repayment of "Soviet" debt, we think weight should be given the salvo of breast-beating statements by officials of the Russian Republic that Russia is the heir and decedent of the Union. If Russia is to inherit the "wealth" of the union let it inherit

the debt. The republics did not take this debt upon themselves - certainly not voluntarily. Ukraine did not benefit from it. To the extent Russia claims the "assets" of the empire this should be reflected in its portion of the debt.

2. Per capita distribution of the "Soviet" debt is unsupportable.

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

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

UKRAINE REJECTS ECONOMIC PACT

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

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

I knew when I heard the Gorbachev-Komplektov comments that Ukraine should not sign onto the center's ploy. Moscow does not seem capable of understanding that Ukraine is not Russia, that their Russification program did not destroy Ukraine. The Kremlin has been blind for too long, it simply can not see. Ukraine will no longer allow its views and future to be dictated by the center; Gorbachev or Yeltsin. This does not mean that Ukraine intends to sever all ties to the former republics of the Union. Ukraine has great interest in keeping and building upon its economic relations with Russia and the other former republics. As Mykhailo Horyn told any number of Members of Congress in September of 1990 Mr. Chairman, Ukraine wanted and was negotiating trade agreements between its

longtime trading partners, "horizontal agreements" to affirm and maintain economic relationships once the vertical control of the center collapsed. Ukraine proceeded with those negotiations, it signed agreements, it pursued economic interrelationships. Ukraine does not reject its trading partners, it rejects central control and colonization.

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

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

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

What is most troubling about the reaction to Ukraine's rejection of the treaty is that many analysts seem to cast Ukraine as the villain; the "spoiler" of the center's grand efforts. History and current reality belie this victim being made into a villain, certainly not by the likes of Moscow's center.

IS THE UNITED STATES ENCOURAGING VIOLENCE?

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

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

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

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

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

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

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

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

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

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

To date there have been no interfronts in Ukraine. There have been no non-Ukrainian, nationality-based counter independence movements like those that were seen in other former republics. One of the greatest successes of Rukh, if

not its greatest achievement, has been its truly democratic nature. Everything that the movement has stood for has been explicitly democratic. Its platform, the Declaration of Sovereignty it authored in 1990, other new laws and the Declaration of Independence are for all of the people of Ukraine.

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

In discussing this situation with Ukrainian officials last month, there was unanimity between members of Rukh and officials from the former Communist structures in the government. In relation to Ukraine, they believe that there is no difference between the "center" of Gorbachev and Yeltsin. Ukrainian officials believe that both will use every means at their disposal to control Ukraine and see that it is a part of the new union that both want centered and controlled in Moscow.

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

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

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

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

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

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

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

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

Conflict between Ukraine and the center does not need to continue if Gorbachev and Yeltsin are more respectful of Ukraine's right to independence. The center needs encouragement toward this goal and not encouragement toward possessive chauvinism.

CONCLUSION

Mr. Chairman, generally we have offered a view of the political environment within which the economic issues are being addressed. We do not believe that the economic issues and challenges faced by Ukraine and being studied by the world community can be faced effectively without an appreciation of Ukraine's perspective. Ukraine's reality did not begin this morning, or August 24, 1991, when it declared its independence.

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

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

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

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

Mr. Chairman, Ukraine does not intend to step on the rake again, twice was enough. Ukraine wants to control its destiny. Rukh was born out of a passion for individual rights

and the protection of human dignity. It has scrupulously adhered to its fundamental democratic goals. Its original core headed by Ivan Drach, a man of vision and quite strength, and Mykhailo Horyn, a man of conscience and insight, is still in place. And as events move on and new leaders pick up their places, the conscience of democratic reform - Rukh - bears witness to the birth of a new democratic nation in Eastern Europe.

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

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

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

Mr. Green, you may proceed with your statement.

**STATEMENT OF DONALD W. GREEN, MEMBER OF THE BOARD,
PlanEcon, INC.**

MR. GREEN. Thank you, sir.

I'd like to make observations in three general areas: One, having to do with the economy and the outlook; second, with regard to the economic agreement among the republics; and third, with regard to the workout or restructuring of Soviet external debt, which will occupy, I expect, many of us for a while.

First, with regard to the state of the economy. The important thing about the economy is not how much it's declined, but that there is a great dichotomy here. Much as we have observed elsewhere among planned economic systems, what we have seen has been the severe downward spiral of the planned sector—the sector of heavy industry, construction, and transportation—those elements that were the commanding heights of the former economy.

There are a lot of causes for that. Part of it has to do with a breakdown in authority at the center. Part of it with regard to bottlenecks in particular commodities, internally produced and also those that are imported.

At the same time, there is an incredible dynamism present in the land in terms of the vitality of private-sector initiative, of state enterprises operating outside the plan, of cooperatives, of commercial banks, of commodity exchanges.

All of this is remarkable and it gives hope to those that believe eventually we will have market economies in this region.

I don't mean to romanticize at all what is going on here. A lot of what is being done is speculation in the Soviet sense, as well as in the Western sense. A lot of it is closely related to practices which are illegal or semi-legal.

There is a growing differentiation of income inside the society. Now, if you are to be well off in Russia, you need to have connections to cooperatives. You need to have connections to those who are active and wheeling and dealing daily inside the society. Whereas, before, to be well off, you either had to hold distinguished rank, which allowed you to have everything delivered to you, or you needed to be related to someone who had a distinguished rank in the system.

Inequality is taking a new form, and there will be growing social tensions there.

The barrier to the successful growth of the free sector—the free-market sector—is really going to be the withdrawal of the barriers to resource redeployment, and it's going to be the major enterprises which are very hesitant to let go. And their friends in the distribution and transportation systems are uneasy about letting go, or allowing more and more activity at the enterprise level to move into the market sector. They are finding it

much more convenient to rely on the political system to hold onto the resources that they've inherited, and that's in fact what we see in Poland and in many countries in Eastern Europe. The real barrier to change is the large state enterprises today.

This is not a developing country. I think you will hear that again and again. There is a great deal of talent. There is a great deal of resourcefulness. Anyone who has lived day to day in these economies has developed remarkable resourcefulness over time.

There are societal pressures and restraints upon the emergence of the new market economy. But I still believe the major resistance will be from the large state enterprises, which in many cases are noneconomic. They cannot really be sold, no matter how they're repackaged and developed.

With regard to the balance of payments, we have had a very significant phenomenon last year, which is the collapse in CMEA trade. It's hard to know exactly what to make of it. There is a sense in which a lot of that trade was irrational. It was done for political reasons, historical reasons. It was done at the wrong prices. But as that trade has come down sharply in a very abrupt period of time, there have been losses all around. There have been severe losses in Eastern Europe and losses on the other side with respect to the republics inside the Soviet Union.

On the other hand, with regard to the Western current account—the hard currency balance of payments—the most significant thing has been the denial from the capital markets, the denial of Soviet access to capital. This has now been underway for two years. We have had a steady decline in the exposure of commercial banks on their own account. What has happened is that there has been a partial replacement from official sources, but the central story of Soviet external debt has been the successful withdrawal by commercial banks over two years' time.

With regard to the economic agreement, there's a lot said about common economic space, about the advantages of maintaining a unitary monetary system, trading relations, regulations, and so on. I applaud those arguments, but I just think they're beside the point.

There is no way today of creating an effective economic agreement, even of the type drafted and signed by eight republics recently. This agreement is a weak agreement. It has the seeds of its own destruction. What I expect to happen is that in Russia, there will be a growing sense that, in effect, that economic agreement is not in Russia's interest in the long term and that it's better off to get on with its reorganization and its reform effort generally, without spending a great deal of time trying to negotiate multi-republic agreements and mechanisms.

They simply will not work going forward over the next several years. I think you've heard that in the new statements by President Yeltsin. You certainly ought to read carefully the statements of the Ukraine. The Ukraine has been, I think, most forceful and specific about what aspects of the Union they're willing to retain. And they're very small, those aspects.

I do not regard this sort of breakdown of central unified structures as necessarily a bad thing at all. I think it simply will hasten the process of restoration and recovery. In particular, I've looked at the monetary circumstances in the USSR, and I don't expect the central bank to continue in the sense of a unified currency within a multirepublic sense.

I think there are people inside Russia who still say that that's an objective. But I think as they think harder and harder about Russian national interest, they're going to see that spending a great deal of time trying to sustain interrepublican mechanisms will in fact not pay off. It will delay the transformation.

Let me just talk briefly about external debt.

We've just had an announcement of an "historic" agreement of 12 republics that they are jointly and severally to be responsible for existing Soviet external debt. That was an agreement forced through by G-7 influence. I don't think it will work. I think if you simply take the circumstances 6 months from now, 12 months from now, when a republic cannot meet its obligations to V-Bank, the central agent for this kind of centralized external debt, what will happen? Will the Ukraine and Russia step up and cover those obligations which are not paid by Kyrgyzstan? No, they will not.

And so, I think we're wasting a great deal of time and effort, and I really have great difficulty understanding the position of the U.S. Government on this, which is to try and seek a joint and several[??] obligation from new nations which are prepared in most cases to live up to their external obligations, however, so those are divided within the Union.

I think we are going to probably waste a great deal of their effort and our own in trying to maintain a situation of centralized debt servicing that will not last. And in fact, to what purpose does it last? It lasts only to continue debt servicing for months, a few months more, and it, in effect, doesn't provide the rewards for republics, which, in fact, work out an arrangement for meeting their obligations over time. It's the republics that will be borrowing, and it will be enterprises from successful republics that will be coming to the capital markets.

The success of V-Bank, through some kind of centrally coerced collection of debt service, is not going to rebound to the benefit of enterprises coming to the market from Kazakhstan three or four years from now. And so, I think we are wasting a great deal of our own energy in this regard.

That's all I'll choose to say for now until the discussion period.

REPRESENTATIVE HAMILTON. Thank you, Mr. Green.

[The prepared statement of Mr. Green follows:]

PREPARED STATEMENT OF DONALD W. GREEN

I am appearing before you today as a private citizen and as a specialist on the Soviet economy, the international capital market and the Soviet financial system. In those areas of expertise, I have been employed as an academic, a consultant for business and governments, an economist at the Chase Manhattan Bank, and most recently at the Morator Corporation. The views expressed are my own and are not necessarily those of my clients or employers.

1. The Present State of the Soviet Economy

There was an acceleration in the rate of decline in aggregate output or GDP in the USSR during the last quarter of 1990 and the first three quarters of 1991. This contraction has primarily taken place in the large-scale planned sectors of the national economy, energy, heavy industry, construction and transportation. The principal causes of this downward spiral have included key product bottlenecks, regional autarchy, and a sharp decline in critical imports from Eastern Europe and the West.

The sharp decline in the formerly planned sectors has been partially offset by vigor in new market activity—private firms, cooperatives, state enterprises acting outside the plan, commercial banks, and commodity exchanges. It was always difficult for the analyst to appropriately value the activity which was recorded in official Soviet statistics and to estimate the scale of unrecorded activity in the black and grey markets. In the turbulence of today, those assessments have become even more difficult.

The USSR economy has clearly declined significantly from previous peak levels in 1988-89, by perhaps 15 percent or more. However, the decline in Soviet average consumption levels is certainly less than the decline of GDP and also less than the decline in Polish average consumption levels during the early 1980s. One should remain skeptical of those with apocalyptic views about Soviet economic collapse, starvation and mass migration.

With regard to Soviet external accounts, the most significant developments in 1990-91 have been the collapse of Soviet trade with the former members of CMEA and the virtual denial of Soviet access to the world capital markets. The unavailability of commercial credit, only partially offset by continuing loans from Western governments, has driven the Soviet current account into surplus during 1991. The measured surplus for the year may reach \$3.5 billion, but the actual surplus may have been much greater given a broad capital flight not adequately measured in the official export statistics.

2. Prospects for an Economic Agreement among the Republics

The recent economic agreement signed in Moscow among eight Republics and the Center is a very weak document, and it will probably weaken still further as the details are negotiated. Even within Russia, there exists strong opposition to such a proposed economic commonwealth from those who expect continuing demands for subsidization by the poorer Republics in Central Asia. In other Republics, most importantly in Ukraine, there is a broad rejection of any continuing central authority over monetary policy, fiscal policy, or international trade.

Yavlinsky and his economic advisers from the West have strong theoretical arguments for preserving the "common economic space" for currency, trade, capital flows, and regulation. Their position can be challenged, however, on both theoretical and practical grounds. The Soviet economy is so distorted by past investment decisions and regulations that no expert can now predict what relative prices will eventually arise under market conditions and how competitive various regions would be within a common economic space. A unified monetary policy with a single external exchange rate, even if attainable, would probably have devastating consequences for certain Republic and for certain regions within Republics. We must remember the disruption caused by monetary unification in

Germany at the "wrong" exchange rate, a rate which made most human and physical capital uncompetitive.

The crucial flaw in Yavlinsky's position, however, is on the practical level of politics. The only basis for a general economic recovery is through the establishment of fiscal legality and monetary confidence, and that will require political legitimacy. This basis has emerged rather quickly in the Baltics and Armenia, seems likely to appear in Ukraine within the next year, might yet arise with considerably more difficulty in Russia and other Republics, but cannot reasonably be expected in a broader Union for many years, if ever. Trade among the Republics has already declined sharply and will continue to fall for some period, but can begin to recover through bilateral agreements and perhaps in a multilateral framework under some clearing mechanism supported by Western reserves.

The fundamental flaws of an economic confederation can be illustrated in the monetary sphere. Ruble liabilities—in the form of currency and bank money—are the responsibility of the old USSR and its monetary instrumentalities, the Gosbank and the Ministry of Finance. Traditional administrative methods which kept currency circulation separate from bank money have broken down in recent years. Bank assets, primarily loans to firms and government entities by State-owned banks, have exploded without any relationship to productive tangible assets or cashflow. Those bank assets have been funded ultimately by citizen deposits of currency or by Gosbank credit. Under present conditions, measures of bank capital or reserves have become virtually meaningless. Only accelerating inflation and the printing press keep many enterprises and banks solvent.

Why should Republics—newly independent and sovereign—honor the domestic liabilities of the USSR and Gosbank? Many of those liabilities arose from the mismanagement of the Union government under Gorbachev, Ryshkov and Pavlov. No objective observer would accept that present ruble balances held by firms and individuals reflect past productivity or skills. The Republics are unlikely to repudiate the external debt of the USSR since they wish to eventually join the IMF and borrow from the global capital market themselves. However, politically legitimate governments in the Republics will see no benefit or justice in honoring a debased USSR ruble and may seek to reach a "new monetary deal" with their citizens.

3. Foreign Debt, Western Assistance and Private Foreign Direct Investment

It is my judgment that Western efforts to sustain President Gorbachev, the central structures of the Soviet economy, and a more general political/economic union will eventually fail and that additional delays in political/economic recovery may result. Western interests may have to insist on unity among the large Republics in some key areas—military matters, foreign policy and external debt. But Western government should recognize that even where this is successful, such unity is probably only a transitional phenomenon which may or may not be followed by voluntary arrangements among the Republics.

The external debt of the USSR needs to be sorted out rather quickly as part of the initial program of the IMF. The Fund should regard such an agreement as fundamental for membership by Republics, along with the establishment of the clear status of the USSR balance sheet and the balance of payments. The IMF should not seek to make the Republics jointly liable for the existing debt, but should acknowledge the need to separate both liabilities and assets of the various Republics.

It will be a mess to negotiate this separation and the appropriate distribution of Republic debt to official and private creditors, but one should not be deluded by any hope that this difficult task can somehow be avoided through skilled diplomacy. It may be that a new institution under IMF regulation will need to administer the external debt of the smaller and poorer Republics, but it should be an objective to clearly define at least the Russian and Ukrainian debt (which would together amount to 90 percent of USSR debt).

The total package will probably include this separation of USSR debt into Republican debt, the restructuring of both official and commercial debt, and some debt reduction for the poorer Republics.

Western assistance, where appropriate, should be provided to the Republics and not to the Center. The IMF and GATT should continue, however, to deal with the Republics collectively in certain respects, including policy coordination and multilateral clearing of current and capital transactions. The World Bank and the new European bank, however, should concentrate their resources on Republican programs or on projects which may involve more than one Republic.

The role of private foreign direct investment on the territory of the USSR has been small to date and is unlikely to become significant until and unless there is clarification of the political/economic framework and the external accounts have been determined. Significant Western investments in the petroleum sector and some other export industries would arise quickly if the present political and legal uncertainty were reduced to tolerable levels, but investments in the domestic markets of the Republics will probably wait for the establishment of fiscal and monetary policies with political legitimacy.

REPRESENTATIVE HAMILTON. Mr. Schulmann, please proceed.

**STATEMENT OF HORST SCHULMANN, MANAGING DIRECTOR,
THE INSTITUTE OF INTERNATIONAL FINANCE, INC.**

MR. SCHULMANN. Thank you very much, Mr. Chairman.

I'd like to summarize my statement in eight points. Before I do so, I want to make it clear that, on the basis of what we know about trade and credit flows, we believe that the Soviet Union and its republics have the means to meet its hard currency obligations certainly in 1991, but also beyond 1991.

In any case, the Soviet Union is not a highly indebted country. And if there is a problem, it is a political problem in the sense that the center does not appear to be receiving its share of foreign exchange earnings, and has lost its monopoly on the country's reserve assets.

But I guess it's also fair to say that nobody knows how severe this problem really is.

On the economy, the first point I would like to make, Mr. Chairman, is that the Soviet Union still does not provide meaningful and comprehensive statistical information on its economy, in general, and on the balance of payments, in particular. And that means talking about the Soviet Union is tantamount to making more guesses than one normally makes when discussing a country.

What is clear, however, is that the economy is shrinking at the same time the money in circulation is growing very rapidly. These are the elements that will make for hyper-inflation sooner or later. This process is driven by the budget deficits of the Union and the republics, which in total represent 25 percent of Soviet national income; that is, five times as much as the U.S. deficit.

On the economic community treaty, I think I tend to agree with MR. GREEN. It's broad in scope, short in specifics. There are many contentious issues that will have to be sorted out in 26 special agreements and that have yet to be negotiated. The chances that these agreements will actually be reached appear to be pretty slim.

The third point I'd like to make is that Soviet debt is really not all that big. Our estimate is that the hard currency debt of the Soviet Union presently stands at \$55 billion. That's less than the number one usually sees in the papers.

One of the reasons here is that a large share of this debt is in nondollar currencies. And so, the dollar equivalent of the debt rises and falls with the dollar. And since the dollar has appreciated in 1991, the dollar equivalent of the Soviet debt is down. More importantly, of the \$55 billion, \$34 billion are either held or guaranteed by Western governments. That's 60 percent. Western governments have twice as much exposure in the Soviet Union as commercial banks, whose unguaranteed claims total about \$17 billion.

The Soviet Union should have no difficulty in servicing this debt. We consider a \$5 to \$6 billion hard currency trade surplus possible this year. And the current account should be in surplus to the tune of \$2.5 to \$3.5 billion.

As I said, if there is an Achilles heel, it is the ability of Vneshekonombank to gain control of a sufficient share of a country's hard currency export earnings.

Nevertheless—this is my fourth point—even if it should turn out that there is an immediate debt servicing problem—and I emphasize that I'm not ready to accept this proposition—then it would be a mistake to re-schedule the Soviet debt. A rescheduling of the Soviet debt would be highly undesirable and would be extremely costly for the Soviet Union and its republics. This goes for a deferral of principal payments as well.

My conclusion, therefore, is that it is in the interest of the West to maintain whatever is left of the credit-worthiness of the Soviet Union. Here are the reasons that I would like to advance in support of this proposition. First, looking ahead, what will be the sources of Soviet capital imports?

Given the budgetary situation in the leading industrial countries, I guess most of these governments will be looking to their private sector for capital flows to the Soviet Union. I always like to remind people that after the Bolsheviks repudiated the Czarist debt in 1917, it took the Soviet Union more than 70 years to launch a bond issue in Zurich.

Second, as I already explained, it's Western governments, not their banks, that are the most important creditor group of the Soviet Union. And if the Soviet Union were to default, this would have a negative budgetary impact on the leading industrial countries.

Third, and most importantly, I think that there could be substantial damage to the international financial system in case the Soviet Union defaults. I certainly believe that crisis prevention is vastly preferable and superior to crisis management.

The fourth point is that—and I use exactly the same words as Mr. Green used—the Soviet Union is not a developing country. Moreover, the Soviet Union is not a poor country. In terms of its endowment with natural resources, it is richer than any other industrial country in the world. The Soviet Union has considerable human and natural resources, and its hard currency debt is small by comparison with the debt of Latin American countries.

The fifth point is that it may indeed be possible that the Soviet Union has drifted into a liquidity problem. If so, this is the result of the political turmoil in the country, not the result of insufficient debt-servicing capacity.

There are a number of important reasons why the center may not be receiving as much foreign exchange as it should be receiving. One is that the republics may be hoarding foreign exchange. More importantly, probably, the enterprises are hoarding foreign exchange because the commercial exchange rate at which they have to tender the foreign exchange is

absolutely unrealistic. The commercial exchange rate is 1.8 rubles per dollar, whereas, the black market rate yesterday was over 70 rubles, following Mr. Yeltsin's speech.

That means also that the ruble is rapidly losing its function as a store of value and as a means of payment. It also means that individuals are increasingly hoarding foreign exchange in the Soviet Union.

So, as a result, it's possible that Vneshekonombank's ability to meet its debt-servicing obligations may be impaired, and therefore, the West should continue what it has been doing successfully on Sunday and Monday; namely, to press the republics to ensure that the center retains the means to meet Vneshekonombank's foreign exchange obligations.

Very quickly, what can the West do?

I think that the West should buy some insurance just in case the Soviet Union incurs a serious liquidity problem. I think that the best way in which this insurance can be bought is to set up a standby facility, perhaps under the auspices of the Bank for International Settlements, which would be backed by Soviet collateral, including gold and oil receivables and mining rights. I think it's important to have that kind of insurance, because the international repercussions of a Soviet liquidity problem are quite unpredictable.

As to humanitarian assistance, I guess humanitarian assistance is necessary under the present circumstances. The problem I have with the pledges made by the West so far is that most of this assistance appears to be made available on commercial terms. That is, in the form of loans rather than grants. And, of course, that increases the hard-currency debt of the Soviet Union, and makes it more difficult for the Soviet Union to restore in due course its full creditworthiness.

On the question of general or specific purpose financing, I think that there is not a very strong case, if any, for balance of payments assistance to the Soviet Union under present circumstances, with runaway inflation and ballooning budget deficits. I think that there is a strong case, however, for project financing, particularly in areas where the Soviet Union could either increase its foreign exchange earnings or reduce unnecessary foreign exchange expenditures. And the three areas are energy, transportation, and communications, and third, food production, processing and distribution.

The final point that I would like to make is that what the G-7 deputies accomplished in Moscow on Sunday and Monday is certainly a step in the right direction. But it's only a memorandum of understanding. It has yet to be implemented. It will take difficult negotiations among the republics to actually agree on a mechanism that will ensure that Vneshekonombank does receive the foreign exchange necessary to service the debt of the Soviet Union. I think that there is no serious alternative. I don't agree with my friend, Bob Hormats, that a deferral of principal payments would be a convenient way to gain time until the republics have sorted out how they want to divvy up the assets and liabilities of the Soviet Union. This would be a very costly way to buy time, and it would seri-

ously delay the transition of the Soviet economy from a command economy to a market economy. Thank you, Mr. Chairman.

REPRESENTATIVE HAMILTON. Thank you, Mr. Schulmann.

[The prepared statement of Mr. Schulmann follows:]

PREPARED STATEMENT OF HORST SCHULMANN**Introduction**

My name is Horst Schulmann. I am Managing Director of the Institute of International Finance. The Institute has 183 members, primarily commercial banks, in 37 countries. We are engaged both in tracking economic and financial developments in some 50 middle-income countries and in serving as a forum and catalyst for our membership on cross-border banking issues.

Summary and Conclusions

On the basis of what we know about trade and credit flows, the Institute believes that the Soviet Union and its republics have the means for Vneshekonombank to meet its hard currency obligations in 1991. Also, the Soviet Union is not a highly indebted country.

If there is a problem, it is political in the sense that the center appears not to be receiving its share of the foreign exchange earnings and has lost its monopoly on the country's reserve assets. We do not know for sure, however, how severe the problem is.

Nevertheless, even if there should be a liquidity problem at the center, a deferral of principal payments and, *a fortiori*, a rescheduling are not the answer. To varying degrees, they would destroy the creditworthiness of the Soviet Union and its republics for an unknown period of time, delaying the day when the Soviet command economy is transformed into a market-based economy.

Therefore the West should press the republics to ensure that the center retains the means to meet Vneshekonombank's foreign exchange obligations. Since this may take time, the West should insure against the risk of a Soviet liquidity crisis. This is in the interest of the West because the international repercussions of a Soviet liquidity problem are quite unpredictable. This insurance could take the form of a stand-by facility under the auspices of the Bank for International Settlements, preferably backed by Soviet gold, oil receivables or mining rights.

The case for general purpose financing appears to be weak at present. Project finance should focus on sectors which either increase Soviet foreign exchange earnings or reduce unnecessary foreign exchange expenditures, i.e.,

energy; transportation and communications; and food production, processing and distribution.

Full membership of the Soviet Union in international institutions would make these institutions truly universal and help the Soviet Union and its republics become a full member of the international economic and financial system in due course.

General Economic Situation

Mr. Chairman, the Soviet Union is one of the countries which we follow regularly. Unlike other countries, however, the Soviet Union still does not provide comprehensive and meaningful statistical information on its economy in general and the balance of payments in particular. Lack of such information can easily have the same effect as negative information and lead to decisions which might not be warranted if clear, reliable and timely data, for example on the country's external reserve assets, were made available. The current economic and political turmoil has magnified these shortcomings. What meager statistical information does exist can be summarized as follows.

According to official statistics, national income (NMP) in the first nine months of this year declined 13 percent compared with the same period a year ago. GNP fell by a reported 12 percent while industrial production declined 6 percent. Oil output declined by 10 percent. The decline in production and the rapid growth of money in circulation have raised concerns that the country may be moving toward hyperinflation. Retail prices in September are reported to have been 96 percent higher than at the beginning of the year. Unofficial estimates now have prices increasing at more than 3 percent a week. This represents an annual rate of over 350 percent. With money printing presses reportedly operating 24 hours a day and with the supply of goods dwindling, monetary overhang has mushroomed. As a result, the ruble is rapidly losing its basic monetary functions.

This runaway growth in money supply is the direct consequence of ballooning budget deficits. Budget revenues of the Union have certainly suffered from the contraction in the economy. Even more damaging has been the growing unwillingness of republican authorities to remit revenues to the center, however. At the same time, government expenditures at all levels have increased significantly. As a result, Soviet officials estimate that the deficit of the Union budget in 1991 will amount to more than 200 billion rubles with the inclusion of off-budget items. The aggregate deficit of the republican budgets is projected to be 120 billion rubles. In total these deficits would represent more than 25 percent of national income this year.

With forecasts for the harvest growing more pessimistic and with grain procurement by the state running far below plans, the Soviets are calling for large-scale humanitarian assistance. In mid-September, the deputy head of the national economic committee informed EC officials that the Soviet Union would need \$14.7 billion in grants and guaranteed credits to cover its food import bill for the coming year. President Gorbachev in early October scaled down the Soviet request for assistance to \$10.2 billion. U.S. Secretary of Agriculture Madigan, following a recent trip to the Soviet Union, indicated a need for assistance of the same magnitude.

In recent weeks, Soviet officials have steadily lowered their forecast of this year's grain harvest. Some officials now expect the 1991 harvest to fall in the range of 160-170 million metric tons (mmt), following last year's harvest of 237 mmt. The October forecast of the U.S. Department of Agriculture was 185 mmt, down 5 mmt from the previous month's forecast. According to Soviet officials, 156.3 mmt of grain were harvested by October 21, down 28 percent from the same time last year. The grain available directly to the central authorities has lagged along with the harvest. As of mid-October, state procurement of grain had reached 38.5 mmt compared with 64.8 mmt for the same period in 1990.

Economic Community Treaty

A new economic community treaty has been signed by eight of the twelve republics. The treaty appears broad in scope but short on specifics. Details are to be worked out over the next three months. The most contentious issue will be the conduct of financial policy, including the establishment of a central banking structure, and the role of the ruble as a common currency. It also remains to be seen whether the stipulation of no taxation at the community level will hold up. Rules to limit the budget deficits of the republics will have to be developed. The servicing of external debt also will have to be addressed.

With the union treaty calling for 26 special agreements to be negotiated (covering everything from labor markets to price regulations) these will not be the only contentious issues. Although some of the drafters have expressed a good deal of pessimism about the workability of this economic community, there also exists a belief that some form of inter-republic cooperation will be necessary to prevent a collapse of domestic trade. Also, western governments have urged the Soviets to maintain some type of economic union as a precondition for large-scale assistance.

External Debt and Assets

The external debt of the Soviet Union and its ability to meet payments have recently become the subject of a good deal of self-inflicted speculation. For example, on September 23, the Russian Information Agency reported that the Soviet Union owed \$60 billion to the West. The agency was quoting a discussion paper circulated at an inter-republic meeting on foreign economic relations. Officials at Vneshekonombank would neither confirm nor deny the figure of \$60 billion. Two days later, the chairman of Gosbank, Victor Gerashchenko, stated that the Soviet Union's external debt amounted to \$68 billion. While these figures are not necessarily inconsistent, they contribute to the uncertainties which surround the Soviet debt situation.

The debt situation has been made even more confusing by contradictory Soviet statements about the country's ability to meet debt servicing obligations. A few weeks before the meeting of the G-7 and Soviet officials in Bangkok, Mr. Gerashchenko was quoted as saying the country could handle up to \$15 billion more debt at prevailing interest rates. On the day before Gerashchenko's statement, Tass reported that Vneshekonombank had no hard currency to repay foreign debt or ensure urgent payments for imports. A

Vneshekonombank official on the same day stated that his bank continues to meet all its obligations on time and that this will not change for the time being.

The Institute estimates that the hard currency debt of the Soviet Union presently stands at about \$55 billion. Since a large share of this debt is in non-dollar currencies, its dollar equivalent rises and falls with the dollar. At current exchange rates the debt is therefore lower in dollar terms than it would have been on December 31, 1990. The bulk of Soviet debt was contracted or guaranteed by Vneshekonombank, acting on behalf of the Soviet Union. About \$34 billion of the debt is either held or guaranteed by western governments. These governments therefore account for more than 60 percent of the exposure. Unguaranteed claims of commercial banks total about \$17 billion, half of the exposure of western governments. Interest payments on the entire hard currency debt total about \$5 billion in 1991, less than 12 percent of estimated hard currency earnings. As of today, Vneshekonombank is current on all debt service payments.

Our analyses also lead us to believe that the Soviet Union and its republics have the economic means for Vneshekonombank to meet the remaining 1991 debt service obligations. Of course, our analysis, like those of others, is based on sketchy and often conflicting information as well as on less than adequate statistical data. With that proviso, we conclude that hard currency receipts and credits flowing to the Soviet Union are sufficient to meet current and capital account at least during the remainder of 1991.

We consider a \$5-6 billion hard currency trade surplus possible this year. The substantial increase in this year's trade surplus stems from a sharp compression of imports and higher hard currency oil export revenues. Oil production is likely to decline by 10 percent this year which would reduce the volume of total oil exports by 25 percent. However, with the Soviet Union now selling a large portion of its oil to former CMEA member countries for convertible currency, the total volume of oil sold on this basis is likely to rise by one third to 1.9 million barrels per day. At an average price in 1991 of \$20 per barrel, hard currency oil export revenues would increase \$1 billion from last year's level to more than \$13 billion. As a result of the sharp improvement in the trade surplus, we anticipate the current account to swing into a surplus of \$2.5-\$3.5 billion following a deficit of \$3.5 billion in 1990.

The Achilles' heel of the Soviet Union's external payments position at this time would seem to be the ability of Vneshekonombank to gain control of a sufficient share of the country's hard currency export earnings. Reportedly, official Soviet foreign exchange reserves were down to \$4.4 billion at the end of September, and most of these reserves may be tied up in Soviet-owned banks in western Europe. Soviet gold reserves are also reported to be sharply lower. Against this backdrop, the news of a so-called hump in debt service payments in the final quarter of this year is disturbing.

The reported foreign exchange position still awaits confirmation and clarification by the Soviet authorities. The gold reserve position has been subject to an assault by Soviet officials and Western analysts claiming to

know the true level of such assets. The outcome so far has been to create a barrier of confusion to augment the barrier of state secrecy which has surrounded this issue for more than 50 years. As to the hump in debt service payments due in the fourth quarter of 1991, we estimate that payments to all creditors could total more than \$19 billion in all of 1991. (This figure includes interest due, amortization on medium- and long-term debt and repayments of short-term loans.) With such payments in the final quarter likely to be on the order of \$5 billion, this profile would not be at variance with what we believe payments to have been in the first nine months of the year.

Rescheduling Counterproductive

Mr. Chairman, you have invited me to discuss the desirability of rescheduling the Soviet debt. On the basis of what I have said so far a first answer to your question is that it is not at all clear that the Soviet Union needs a rescheduling at this time. Even if it should turn out that there are indeed immediate debt-servicing problems (a proposition which I am not ready to accept), I would stress that a rescheduling of the Soviet debt is highly undesirable and would be extremely costly.

The important point is the longer-term damage a rescheduling would inflict on the Soviet Union and its republics. The difference between recent performance in Poland, Hungary and the Czechoslovakia is instructive in this regard.

As is well known, Poland's relations with its external creditors have been fairly stormy in the past ten years. Poland has totally lost market access. There is no near-term prospect for growth whatsoever. The IMF program is up in the air. Foreign direct investment is minimal.

The contrast with Hungary is striking. The recession in Hungary is much more shallow, growth is now in prospect, foreign direct investment abounds, and the current account position is promising. Of course, Hungary has painstakingly serviced its external debt and maintained market access both before and after the revolution of 1989.

Czechoslovakia is another success story. During the third quarter of this year, the inflation rate was zero, and there were budget and current account surpluses. It is no coincidence that Czechoslovakia will make a bond issue in Frankfurt this week -- the first since the end of World War II.

It would be counterproductive if, at the beginning of the Soviet Union's long march into capitalism, there would be a deferral of principal payments. *A fortiori*, rescheduling of existing external obligations would be totally counterproductive since it would destroy the Soviet Union's creditworthiness for many years, if not decades, to come. This includes the creditworthiness of the republics.

Maintaining what is left of the creditworthiness of the Soviet Union and bringing it back to the global capital market as soon as possible should be the key objective of western governments for several reasons.

First, looking ahead, we must all ask ourselves what can be the potential sources of Soviet capital imports. Since the budgetary situation of many industrial countries is rather bleak, it is in the creditor governments' interest to mobilize other sources of funds for the Soviet Union. Thus, our governments will be looking to the international financial institutions and the private sector to lend to the Soviet Union and its republics. Coming on top of the major losses banks incurred in the 1980s, a Soviet default would entail a very high price in terms of future access to private sources of capital. Private capital is not only shy, it also has a very long memory. After the Bolsheviks repudiated the Czarist debt in 1917, the Soviet Union was unable to launch a bond issue in the international capital market for more than 70 years.

Second, contrary to popular belief, western governments, not their banks, are the most important creditor group of the Soviet Union, as mentioned earlier.

Third, the damage to the international financial system could be substantial. The system is still recovering from the aftermath of the two oil price explosions of the 1970s. A Soviet default would not only set a dangerous precedent, it could also lead to a reevaluation of the creditworthiness of other sovereign borrowers, inside and outside the OECD area. Nobody predicted the full repercussions of the Mexican payments crisis in August 1982, just as nobody foresaw the longer-term consequences of currency floating in March 1973. A system that is so highly interdependent as international banking and finance, has a built-in tendency to overshoot when it experiences a shock. Because of this, crisis prevention is vastly preferable and superior to crisis management.

Soviet Debt Not Large

It is useful to put the current difficulties into perspective. The Soviet Union is clearly not a developing country. Illiteracy is below 1 percent. Over 80 percent of the appropriate age group is receiving secondary education. Although qualifications may be overstated in published Soviet occupational statistics, the Soviet Union is ahead of the United States, Japan, or Germany in terms of numbers of engineers per million of population. The degree of urbanization is high (66 percent). The Soviet Union has orbited over 1000 earth satellites and undertaken more manned space flights than any other nation.

The Soviet Union is also not a poor country. In terms of its endowment with natural resources it is richer than any of the industrial countries. It accounts for more than 10 percent of the world production of virtually all minerals, including gold, silver and platinum. Its share of world coal production is 15 percent, 19 percent of oil production and 40 percent of natural gas production.

In other words, the Soviet Union has considerable human and natural resources. Its hard currency debt is small by comparison with the Latin American countries, most of which have experienced severe payments problems in the 1980s. The Soviet GNP is probably around \$750 billion, putting the debt/GNP ratio at 7 percent. This compares with almost 40 percent in Latin America. The debt equals 130 percent of hard currency exports, far below

the 270 percent average for Latin America. Likewise, current interest payments on the hard currency debt are about 12 percent of hard currency exports, compared with almost 40 percent in Latin America in 1982.

Risk of Liquidity Problem

It is unwarranted to argue that the Soviet Union has a structural debt problem and therefore is comparable to a country like Nigeria. At worst, it is conceivable that the Soviet Union has drifted into a liquidity problem. This would be a result of the current political turmoil in the country, not the result of insufficient debt servicing capacity.

In the present climate, not all of the stipulated 40 percent of the foreign exchange earned by Soviet exporters is remitted to the center. There are clearly tensions between the republics and the center, and the republics may be hoarding foreign exchange for the day when they sever their relations with the center. Also, given the uncertainties that exist, enterprises have a strong incentive to hoard foreign exchange in case inter-republican trade is interrupted and supplies are only available at world market prices and against hard currency. This tendency is further reinforced by the totally unrealistic exchange rate at which enterprises are expected to tender the foreign exchange earned, i.e., R 1.8 per dollar, when the black market rate is around R 60 per dollar. Since the ruble is rapidly losing its function as a store of value, individuals are likely to hoard foreign exchange, too. The dollar and the DM are used increasingly also as a means of payment. If, say, every citizen of the Soviet Union were to hold just ten dollars, \$2.9 billion of the country's foreign exchange would be tied up and therefore not available for official debt service.

For all these reasons, it cannot be ruled out that Vneshekonombank's ability to meet its debt servicing obligations could be impaired. It is therefore in the interest of the West to press the republics to ensure that the center retains the means to meet Vneshekonombank's foreign exchange obligations.

Western Financial Assistance

Mr. Chairman, you have asked me to comment on the appropriate role and level of western assistance. I would like to distinguish between the immediate future, say the next 3 - 6 months, and the slightly longer run. I have interpreted "western assistance" to mean financial assistance extended by western governments.

In the wake of the growing unease among western governments over the deteriorating situation in the Soviet Union, additional commitments of financial assistance have been forthcoming in the past several weeks. At the time of the G-7 summit in July, commitments of various forms of assistance by western governments and others amounted to more than \$56 billion, according to information compiled by the European Community. The U.S. share in this total is approximately 5 percent. During October, an additional \$5.3 billion in assistance has been committed. Japan has offered a package worth \$2.5 billion which includes \$1.8 billion in trade insurance to guarantee Japanese exports and \$0.5 billion for food and medical aid. The European Community has put forth \$1.8 billion in new credit guarantees

for food and medicine. In addition, Saudi Arabia offered \$1 billion in emergency humanitarian aid.

Looking at the immediate future, it would appear useful to have a credit mechanism in place in case Vneshekonombank should incur a temporary liquidity problem. Since the Soviet Union is not yet a full member of the IMF, a stand-by facility might be organized on an ad hoc-basis, possibly under the auspices of the Bank for International Settlements. It would help if this facility were at least partly backed by Soviet collateral, e.g., gold, oil receivables or mining rights. This facility would represent insurance against the risk of a Soviet liquidity crisis. It is in the interest of the Soviet Union as well as the West that such a facility exists because the international repercussions of a Soviet liquidity problem are quite unpredictable.

As mentioned earlier, the Soviet Union has several banks in Western Europe, including Moscow Narodny Bank, Banque Commerciale de l'Europe du Nord and Ost-West Handelsbank. These banks play an important role in the Soviet Union's finance and trade relations with the West. During the days of the August putsch, these banks were the subject of a good deal of speculation. It is likely that Vneshekonombank had to inject substantial funds into these institutions in order to ensure their liquidity. In the event, a liquidity problem was averted. It is not certain, however, that such a problem could not arise in the future since these institutions have an umbilical relationship with Vneshekonombank. In this sense, a safety net for the Soviet Union is also a safety net for these banks, and vice versa. From the vantage point of the international financial system it is important to maintain the liquidity of both.

A different matter is humanitarian assistance. Although the main food supply problem may well be a food distribution problem, rather than a production problem, it seems to be real and growing as a result of the political tensions between the republics which have already led to the erection of export barriers. Therefore such assistance will probably be needed. I do have difficulties, however, with the idea that this type of assistance would be made available on commercial terms, i.e., in the form of loans rather than as grants. This implies an increase in the hard currency debt of the Soviet Union which, in turn, will make it more difficult for the Soviet Union to restore, in due course, its full creditworthiness.

Looking slightly further ahead, it is clear that it will take some time before private investors -- be they multinational corporations, commercial banks, institutional investors or private bondholders -- will have sufficient confidence to invest in the Soviet Union and its republics without some form of third party guarantee or insurance. For all practical purposes, such guarantees can only be provided by western official entities since the Soviet Union is presently not insurable on commercial terms. Specifically, bank lending will, for the time being, depend wholly on the degree of support the export credit agencies of industrial countries provide.

The limited creditworthiness became evident when it turned out to be impossible to find U.S. banks willing to make CCC-supported loans at standard terms. Only when CCC agreed to guarantee 100 percent of principal

and raise the interest guarantee to the average rate on one-year Treasury bills, did some banks respond. It is equally telling that in the publication Euromoney, the country risk rating of the Soviet Union this September dropped to 11th place. In 1988 the USSR was ranked 17. By comparison, the United States is in 7th place.

General or Specific Purpose Financing?

A key question for all lenders, official or private, is whether to provide general purpose or specific purpose financing. The case for general purpose financing appears to be weak at present. Until such time as macroeconomic equilibrium has been restored in the Soviet Union, i.e., budget deficits have been curtailed and the money supply is under control, this type of finance does not appear to serve a useful purpose. It is also unlikely that commercial lenders would be interested in providing such finance.

The case for financing specific projects is much stronger, however. There is an urgent need to help the Soviet Union and its republics to remove bottlenecks in the economy. Economists all over the world were caught flat-footed by the events of 1989. There is no theory for transforming a command economy into a market economy. It is unlikely that the Soviet Union and its republics will adopt any of the existing capitalist models. In any case, it will take the Soviets a considerable amount of time to sort out their preferences. Important as macroeconomic stabilization is, the real revolution will have to occur at the microeconomic level. One allocation system will have to be exchanged for another. This points to the need of financing for large-scale technical assistance specific projects.

In principle, that need is unlimited. Since Soviet enterprises never had to operate under conditions prevailing in the international market, it is almost certain that few of them are competitive by our standards. But some investments clearly have a higher priority than others. I would argue that western assistance, for the time being, should focus on projects that make the Soviet Union and its republics a going concern. That means making them able to attract private investment by giving priority to projects which either increase Soviet foreign exchange earnings or reduce unnecessary foreign exchange expenditures. In other words, we should focus on three sectors: energy; transportation and communications; and food production, processing and distribution.

Reforms are clearly needed on the supply side. Soviet oil production is declining, and some experts fear that the Soviet Union may become a net oil importer as early as 1993. This increases the risk that the world will become more dependent on non-Soviet oil. I understand that it is not all that difficult to increase Soviet oil production and exports, but it will take more than technical assistance. It will require pumps and compressors, too. In turn, these will have to be imported, and these imports will have to be financed. If we help the Soviet Union and its republics increase energy production, this is also in our interest, because it reduces our dependence on other oil-producing countries.

Transportation and communications are important because they have become an important bottleneck in the Soviet economy. This is an area where

the conversion of military plants to civilian use should go a long way to meet the requirements of a modern industrial society. But again, it will not be sufficient to provide know-how; some cash will be needed.

Food production, processing and distribution is perhaps the single most important potential foreign exchange saver for the Soviet Union and its republics. I have yet to find a fellow economist who maintains that the Soviet Union and its republics represent the standard case for a net food importer. I will be happy to argue that the People's Republic of China should become a net food importer because it has a comparative advantage in manufacturing. But the Soviet Union is a totally different proposition. If the incentives are right, Soviet suppliers should be able to meet the demand for food. There might even be some left for export. If the necessary reforms are to be politically acceptable in the Soviet Union and its republics, they will have to start on the supply side.

Soviet Membership in International Organizations

Thus, I believe there is a strong case for project assistance, a job the World Bank is good at. This assumes, however, that the Soviet Union will soon become a member of the World Bank Group. The case for full Soviet membership in the IMF as well as the World Bank is very strong indeed.

The Bretton Woods institutions and the GATT were conceived as universal institutions. They came closer to this point when the People's Republic of China was admitted to the IMF and the World Bank Group in 1981. Admission of the Soviet Union and its republics would more or less complete this process, which started with China and Soviet participation in 1944. I do not believe that Soviet membership in the IMF and the World Bank poses insurmountable hurdles. Clearly, some difficult decisions will be needed but if the G-10 countries are serious about Soviet membership it can be realized in less than a year. Membership in the GATT may be a different matter as long as the Soviet economy remains so distorted as it is at present.

Full membership in the Bretton Woods institutions would also relieve the major industrial countries of the necessity to impose jointly or severally economic policy conditions on the Soviet Union and its republics. Such conditionality is usually more effective and politically less troublesome if imposed by multilateral organizations. Also, multilateral lending helps save bilateral budget outlays.

Impact on Developing Countries

Mr. Chairman, a final question you have asked me to address today is the effect of resource flows to the Soviet Union and Eastern Europe on the availability of capital for developing countries. Underlying this question seems to be the concern that if you take from Peter and give to Paul, there is less for Peter. The world economy is not a zero-sum game, however.

First, a higher level of investment and production in these countries will also create additional savings both at home and abroad. In any case, I would expect that most of the investment in these countries will be financed out of domestic savings. Second, in the short run the bottleneck may not be

so much the availability of foreign exchange but the absorptive capacity of these countries. This is certainly true for private investment. At present, there are simply not enough opportunities for profitable private investment in these countries, particularly in the Soviet Union where the most elementary steps to create private property rights have yet to be taken.

To repeat, however: A debt rescheduling would increase the need for official funds from the West since private lenders and investors would shy away from the Soviet Union and its republics. By the same token, a rescheduling would prolong the necessary transformation of the Soviet command economy.

Concluding Remarks

Maintaining its creditworthiness is first and foremost in the interest of the Soviet Union. Following the meeting with a Soviet delegation in Bangkok, the finance ministers and central bank governors of the Group of Seven issued a communiqué which listed key conditions the Soviet Union and its republics must follow in this regard.

Since then it has been reported that a decree issued by President Gorbachev on October 19 and approved by 10 republican leaders, recognizes Vneshekonombank as the sole agent responsible for servicing the country's debt. The decree also calls for Vneshekonombank to handle new credits and manage convertible currency resources in the interests of the Soviet Union and its republics.

Although this is helpful, it falls short of what is required. Given the present uncertainties, creditors need additional assurances that the Soviet Union and its republics will live up to their international financial obligations, including the obligations that would arise from the dismemberment of the Soviet Union.

In practical terms, the problem boils down to getting four of the remaining twelve republics to reach an agreement on how to share the existing external obligations of the Soviet Union. These four republics -- Byelorussia, Kazakhstan, Russia and the Ukraine -- account for 80 to 90 percent of the total, depending on the criterion applied (e.g., population, GNP, exports). The remaining eight republics can probably be expected to follow suit once the four largest republics have reached an agreement among themselves.

In this context, it would appear to be vastly preferable to continue to have one single agency in charge on the Soviet side to deal with the existing obligations. In principle, this would also apply to future obligations although it is likely that individual republics will wish to test their own creditworthiness. These republics will need to bear in mind, however, that for many years to come creditors will judge them by the payments performance of the former Soviet Union. If the latter defaults, the creditworthiness of the republics will be severely impaired as well.

Therefore I would also like to challenge the view that a deferral of principal payments is a convenient way to gain time while the republics of the Soviet Union are sorting out what their share of the external liabilities is. The fact is that the Soviet Union has incurred certain financial obligations and is liable for them. Therefore the republics have every interest to meet these obligations on schedule. If they do not, their own creditworthiness will be affected as well. As a minimum, it will take them considerably longer to establish credit once the credit of the Soviet Union is destroyed.

REPRESENTATIVE HAMILTON. Mr. Hormats, please proceed.

**STATEMENT OF ROBERT HORMATS, VICE CHAIRMAN,
GOLDMAN SACHS INTERNATIONAL**

MR. HORMATS. Thank you, Mr. Chairman.

I would like to focus on some of the internal changes in the former USSR that are probably going to be necessary to address the broader issues that have been talked about, with respect to getting the Soviet financial arrangements back in order.

There are really two revolutions taking place in the former Soviet Union. One is against communism and the other, in several republics, at least, is against centuries of Russian imperialisms.

In some republics—for instance, the Ukraine—the anti-Russian revolution is at least as powerful as the anticommunist revolution. And in some republics, communist leaders still retain power. They've used their anti-Russian zeal to divert popular attention from their communist past. I think that's important in that it says two things: One, it's going to be very difficult to establish a centralized institution to run monetary policy, or anything else, because of fear in the other republics that it will be dominated by Russians. Second, that one has to look republic-by-republic at what one does and how one operates in the former Soviet Union, because some are reformers and some are not. And while it might be desirable from a strictly economic point of view to try to look at the republics as a whole and deal with the center, there really is no center when it comes to economics. The sooner we recognize that, the better. That means dealing with the republics, particularly, as I'll point out a bit later, the three major republics.

There are 12 republics. Many of them are really very small and don't have much impact. If the Russian republic, in particular, does well, it will serve by example and its prosperity to benefit other republics. If it does poorly, the best of policies in some of these small republics in the trans-Caucuses or Central Asia are going to find it very difficult to survive and prosper.

The second broad point, the United States needs to find better ways—indeed, the West itself needs to find better ways—of coordinating assistance at all stages and at all levels. It has not done very well in this area.

If food is going to be a major assistance program, then I think we're going to have to look at a way of making sure the food gets where it's supposed to go.

Now, Horst Schulmann is absolutely right. So far, the food program has not really been a relief program in the sense that it was in Europe after World War II. It's been financed essentially by export credits that add—as he's correctly pointed out—to the Soviet debt.

Now, we have to figure out, if, in fact, the Soviet debt is unmanageable. If one makes that judgment—and I'm not making it at this point—

then it hardly makes sense to pile more debt on top of old, particularly making them finance the import of a consumable item—food.

If the debt problem is serious, then we ought to look at some other type of device for getting the food to the various needy groups. Here, again, distinctions need to be made among the republics. Some need food, some don't.

The real problems is in the cities. That's where the food need is going to be greatest, in part because there's a lot of hoarding of food in the rural areas. They don't want to sell it for rubles. It's on the black market. It's just not getting to where it's supposed to go.

Therefore, in searching for precedents, the two that come to mind are the American Relief Administration headed by Herbert Hoover after World War I, and the U.N. Relief and Rehabilitation Administration, UNRRA, after World War II, headed by former New York governor, Lehman.

It seems to me that if there really is a food crisis—and there's a food crisis in the cities—then something along those lines, which I've described in greater detail in my written testimony, might be desirable. Not just an American operation, as it was in Western Europe after World War II, but a multilateral operation, chaired by a strong individual.

Names that come to mind are Paul Volcker or John Whitehead or Karl-Otto Pohl, someone of that character and international stature.

But coordination is critical. Otherwise, we won't be able to utilize our resources well. Moreover, our influence over the reform process will be diminished to the extent that we can't coordinate.

Third, the question of harmonious ties among the republics on monetary and financial issues.

It strikes me that we ought to insist, as a minimum, that these countries not declare trade wars on one another, which is exactly what they're doing now. Curiously enough, protectionism in the Soviet Union is not protection by one republic against another, with respect to imports. Republics don't want to export goods to other republics for rubles.

Why? Because the other republics pay in rubles. Rubles are, as Horst pointed out, next to worthless today. So, what republics do is, if they have real goods, they'll hoard the goods and barter them for some real goods produced by another republic all across the board. That makes sense when you have a currency which is essentially debased, worthless.

Now, that brings me to the point about what to do on the currency front. We've had a lot of experience in the world in figuring out how to develop credible currencies. The problem is, the ruble is not credible. It strikes me that no currency developed today by any of the republics is going to be credible, unless it is linked to something that is credible—either the dollar, the ECU, or gold or commodities.

Now, there are various ways that you can do these linkages, but the basic point is that there would be a set ratio between the amount of money a republic created and the amount of—in the case of gold or commodities—those gold and commodities it held in the central bank, or

the amount of dollars or ECUs that it held in the central bank. And it would link its currency somehow to a harder currency.

They can't do what we have done in the West. The Bundesbank or the U.S. Fed have money supply objectives. Those are generally credible. The market looks at them and says, they're right or they're wrong.

The problem is that if the republics are [p. 24] those became uncomfortable for the political leaders in various republics; they wouldn't have any credibility. It wouldn't give the currency credibility. Unless there's currency credibility, open trade among the republics is going to be awfully hard to achieve.

Now, one way of substituting bad rubles for good rubles, essentially, was done in the German monetary reform of 1948, where they simply closed all of the deposits, and for a hundred Reichmarks, you got 10 new Deutschmarks. That was done in a relatively short period of time, and it gave credibility to the currency, not just because it was done, but because it was backed up by a lot of other reform programs that were instituted primarily by Ludwig Erhard; these were very market-oriented and involved eliminating price restrictions on the system. Which brings me to my next point.

The Soviet system now is in a financial no-man's-land. Some prices are decontrolled. Some are controlled. It's an incredible morass of distortions. And the problem is that because they partially decontrol prices, hoarders wait until the next step in the decontrol, and that invites hoarding.

I think the way the Germans did it—obviously, I'm not comparing Germany to the Soviet Union; there are a lot of major differences—but it seems to me that the Soviets have to decontrol prices almost entirely; the half-way house is not a particularly good idea.

Moving on, the other element of the monetary question would be developing a Soviet payments union similar to the European Payments Union after World War II.

Again, the objective was to make sure that there is trade among the various entities in the Soviet Union. This is a difficult thing to do in the Soviet Union. It worked well in Europe. But they had reasonable people working on it. Nationalism in the Soviet Union might make it very difficult to do this. In particular, if the Russian republic sells oil to the other republics, it might build up such large and chronic imbalances in this payments union that the union would simply run out of money over a short period of time. So, it's not a panacea, but it's a concept, I believe, worth exploring.

Demopolization of the economy it seems to me is very critical. The Soviet economy really is a lot of monopolies. The Soviet economy is not an economy like anything any of us have really experienced.

There was a survey done of 6,000 products. Three-quarters of them were produced in the Soviet Union by one single factory. So, what happens when you decontrol prices is that monopolist get what we call in

the economics world "monopoly rent." They could raise the price to whatever level they want because there's no competition.

So, demonopolizing the system is extremely important. If you have price decontrol without that, you have a very difficult time of it.

One point that Horst raised that I wanted to comment on is that which relates to financing. I have no way of knowing whether the Soviets need rescheduling or don't need rescheduling. I agree with Horst, however. It will ruin their creditworthiness if they do it, particularly if they do it in the irresponsible way that has sort of been brooded about.

The point I was making was not to advocate building up arrearages. I was simply saying that if, in fact, the Treasury believes that permitting the Soviets to build up arrearages is better, as opposed to easier, that should be reexamined. It's easier in the sense that you don't have to have a negotiation to do it. But if they believe that it is a better answer, they should consider the undesirability of that as a precedent. My point is, it's an undesirable precedent. It sets a very bad precedent for building up arrearages.

So, I don't think we disagree on that. I wasn't making the point that it was a good idea. I was just saying that we ought to consider it, if you do it there; it is not a precedent for other areas.

Now, the IMF. Membership in the IMF. This is one of, I think, the most poorly understood issues involved here, vis-a-vis, the Soviet Union.

The Soviets want to join the IMF. They cannot get money from the IMF simply by joining the IMF. Indeed, they have to pay money in. Joining the IMF is stage one. Then they have to come up with a stabilization plan, the way the Brazilians and the Argentines and the Mexicans and others have done.

Question—who's going to do it? Who's going to join the fund? Is it the Soviet Union?

Today, because the Soviet Union has no economic power, the power is in the hands of the republics. Is it the Ukrainian republic, the Russian republic, the Kazakhstan republic? Is it all 12 of the republics? And then each of them, if that's the case, has to negotiate a stabilization fund—a stabilization arrangement similar to Mexico.

Even with the Mexican government used to doing this—even the British in the 1970s negotiated one of these things—it took a long time. Horst and I worked on this together, I don't know how long ago. It was months, agonizing months. The government of Great Britain also took a ??? [p. 29]. Think of the complexities of negotiating this with the government in the Ukraine or any other place in that part of the world.

Just a final point. I think there is a lot to be said for an American engagement in the process of Soviet reform. We can't influence the process in a decisive way, but there is a lot we can do through technical assistance, through emergency assistance, and through constant urging to conduct their policies in a rational way.

But I think the great danger now is that we will not consider the precedence of what we do—debt rescheduling—all these things that are sort of

looked at, because we really don't know the numbers. And before we leap into these things and establish bad precedents, we have to think more carefully about it.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Hormats follows.]

PREPARED STATEMENT OF ROBERT D. HORMATS

I appreciate the opportunity to testify this morning on US policy toward what has come to be known as the former Soviet Union.

Before the world lies the tragic prospect of prolonged economic turmoil in the former Soviet Union coupled with political volatility and ethnic strife. The ongoing collapse of the Soviet economy -- which will be measurable in years rather than months -- will bring economic misery to many millions of people in that long-suffering land.

Collapse of the Soviet economy also will prove enormously harmful to the new democracies of Eastern and Central Europe -- which, I feel compelled to plea at the outset of this testimony, we must not forget or neglect just because the focus of public attention has now shifted to the Soviet Union. What a sad example it would be to potential reformers in the Soviet Republics and elsewhere in the world if we in the West let down those in Eastern Europe who have had the political courage to undertake bold democratic and economic reforms.

Despite its good intentions the West can do little in the near term to avert the economic collapse of the Soviet Union. But it can and should help to alleviate some of the attendant misery in that country and engage reform-minded citizens in the Republics -- whose leaders now hold economic power as opposed to those at the center -- in a wide range of programs aimed at creating the basis for the a market-oriented economy. That will be necessary if the peoples of this region are to have any chance at achieving greater prosperity by the end of the decade.

In deciding how to help the newly sovereign republics, the West needs to bear in mind the fundamental political fact there are two revolutions now taking place in the former Soviet Union -- one is against communism and the other, in several republics, against Russian imperialism. In some republics, e.g. the Ukraine, the anti-Russian revolution is at least as powerful as the anti-Communist revolution. In some republics, communist leaders still remain in power; many have used their anti-Russian zeal to divert popular attention from their communist past. Many republics will reject outright the establishment in Moscow of a strong centralized economic authority in a new "Soviet Economic Community" or "Common Market" not because it doesn't make economic sense but because they fear that authority would be dominated by Russia. Some republics refuse to embrace democracy or free market principles; instead, their leaders want to use authoritarian measures and state economic controls to retain power. The west must bear these realities in mind as it shapes its approach to providing support for economic reforms in the former Soviet Union.

Understandably the west is eager to support a relatively strong center because it wants a single interlocutor from whom it can obtain debt repayments, suspects that there is too little economic expertise in the country that it can be spread among 15 or 12 successor states and wants to preserve a single market. This is also consistent with its desire to maintain Gorbachev's power and capability of preventing an outright political collapse and the possibility of wars breaking out among nuclear-armed republics. But in light of political pressures for greater autonomy and fear of a Russian-dominated center the best possible outcome might be a common market with something less than a monetary union with a single currency.

The argument for a decentralized system of separate republican currencies (which will be discussed below) is that as budget authority is already devolved to the republics, fiscal discipline can now only be achieved if republic leaders are faced directly with the monetary consequences of their own budgetary irresponsibility and if prudent republic leaders are protected by adjustable exchange rates from the monetary spill over of irresponsibility in other republics. Under the present system the existence of a single central bank has not prevented inflation from rising to an annual rate of over 300% in September.

In response to the questions raised in your letter of invitation I will outline three basic elements of a western approach to the former USSR:

1. The West must distinguish between short, medium and long-term assistance.

Short-term help should be of a humanitarian nature to ease the misery of people during what could be a very hard winter. There is general agreement on this but no comprehensive plan; I shall suggest a possible approach below.

Medium-term help should consist primarily of technical assistance to establish the basis for the market economy and train individuals in the various skills that are required to make a market work. The Soviet republics should also be assisted to create an internal payments union and be accorded increased trade opportunities with the West. They should be invited into various international groups and institutions where appropriate to their level of development and commitment.

Longer term, broader, financial support should await progress in building the basis for a market economy; but the key to the success of reform will depend most on whether it enables the republics to attract private investment -- which is key to their ability to attain sustained prosperity.

2. The West must find better ways to coordinate its assistance to the former USSR.

Most urgently required is a method of ensuring that the Soviet republics which need assistance will receive it while avoiding a diversion of such funds to the black market. The Soviet Union experienced food shortages last winter after an unusually large

harvest. This winter it is likely to suffer an extremely poor harvest and will have to transport agricultural produce with a collapsing infrastructure. Food deficit republics may well need to import 40-50 million tons of grain in coming months.

In the first winter after such dramatic moves toward democratic reform in Russia and other republics, the West must not turn its back on the hardships of the Soviet people. It needs to develop a program to finance large scale food and medical aid and -- recognizing the deficiencies of the existing Soviet system -- create a new mechanism for distributing it, especially to large metropolitan areas such as Moscow and St. Petersburg. The Baltic nations will also need help. We should not, however, confuse the Soviet Union with Ethiopia; it is far better off than that unfortunate nation, and massive starvation is unlikely. But the political stakes are high and the West's response should bear that in mind.

The German Government especially attaches urgency to emergency aid to the USSR. It remembers what happened in Germany after the Treaty of Versailles due in part to the absence of economic help from the victorious powers. German leaders do not want to see the USSR or Russia become a slavish Weimar Republic, suffering from hyperinflation and massive unemployment. They recall how these conditions turned their country into an embittered, resentful and militaristic nation. They do not want to see this replicated in Russia. Nor do they want the Soviet republics to collapse into feuding, well armed countries that take out their frustrations on one another. The US must recognize the intense dangers of these threats as well.

There are two precedents for massive, coordinated economic relief in Europe: The American Relief Administration, created after World War I, which was headed by Herbert Hoover, and the United Nations Relief and Rehabilitation Administration (UNRRA), created following World War II, headed by former New York Governor Herbert Lehman. A relief organization of a similar nature is needed today to draw expertise and staff from the major donor nations and institutions including the World Bank, bilateral aid agencies and private organizations such as the Red Cross and Project Hope. The Group of Seven leaders should be the primary oversight body.

The relief organization -- a Soviet Relief and Rehabilitation Administration (SRRA) -- would need a strong executive committee, an administrator of the stature of a Hoover or Lehman (an individual such as Paul Volcker, John Whitehead or Karl-Otto Pohl) and regional field offices in the republics and municipalities. It would determine, in conjunction with republic and local leaders, areas where help was needed and ensure that food and medicine were delivered to them and are not diverted to the black market. Because the major problem is likely to be in the cities the SRRA should work especially with the newly created League of Mayors. The military airlift capabilities of western governments might also need to be mobilized.

This group should also provide funds to Eastern Europe to finance the sale of food and medicine to the USSR. That would give Eastern Europe vitally needed hard currency, increase agricultural

and manufacturing employment there, and enable it to deliver goods quickly overland to needy areas thus avoiding congested Soviet ports. The European Community has provided some funds for this purpose but the west as a whole should do more.

3. The West, while seeking to promote harmonious economic ties among all of the republics, should concentrate its primary efforts on financial and monetary reforms in the major republics, particularly Russia, the Ukraine and Kazakhstan. They are the most powerful players in the Soviet system today. If they succeed, others will benefit from their prosperity and example. If they fail most other republics will suffer no matter how good their domestic policies are. The key to effective reform in these republics will be their ability to 1) establish sound stabilization programs and stable currencies, 2) work with one another to establish a Payments Union similar to that established after World War II in Western Europe, and 3) embark on a quick two track program of price decontrol and demonopolization.

MONETARY AND BUDGET REFORM. A slashing of subsidies to plants and workers, which means, importantly, big cuts in military spending is important to the future stability of all republics. So far budgets have not been brought under control. On the contrary, subsidies to industry have caused them to rise considerably.

Budgetary restraint must be coupled with control over the rate of growth of money creation -- which is now running wild. In the current context, in which the ruble has little value (thus creating a disincentive to work, save and invest) there will need

to be some form of external monetary commitment or linkage to boost domestic confidence in the currency and thus increase incentives to produce, invest and save.

There are strong arguments for maintaining a common currency for all of the republics, but in light of the position taken on this matter by leaders of the Ukraine (which accounts for 18% of the Soviet population, 17% of its electricity output, 24% of its coal production and 26% of its grain production), that appears at the moment to be unlikely. Another alternative would be for the Russian Republic to create a new and credible ruble which other currencies could tie their currencies to -- much as many Western European countries have tied their currencies to the deutschemark. Alternatively the republics could go their separate ways while working together in a loose union to try to stabilize their different currencies.

However the republic's choose to organize currency relations among themselves they will need some outside discipline to remain credible. Linking the ruble, or any other republic's currency, to an external unit such as the dollar or ECU, means making hard exchange rate commitments, limiting the domestic money supply to a level that is directly related to the ECU or dollar holdings of the central bank and backing the currency with those reserves. The process of money creation thus is taken out of the hands of the politicians. They might object, but given the public's recent experience with the collapse of the value of the ruble, internal confidence could not be restored without such a linkage, A second

possible approach would be to back domestic money with gold or some other basket of primary commodities. This too would take the process of money creation out of the hands of politicians, because excess monetary creation would lead to the draining of gold or commodity reserves. Either the link to an external currency or the domestic commodity link would create currency credibility assuming that commitments to this link were clearly observed.

The traditional western approach of announcing annual targets for money supply growth would not be sufficient to restore confidence in light of the recent irresponsible Soviet monetary experience -- which has made Marlboro cigarettes a preferred medium of exchange relative to the ruble. There would be enormous and understandable scepticism about any currency arrangements which leave disgressionary powers in the hands of republics or the Union itself. The concern that announced money supply targets could easily be jettisoned as soon as they started to prove politically inconvenient would reduce their credibility.

Germany's monetary reforms of June, 1948 might prove to be an excellent model for substituting a credible ruble for the presently nearly worthless one. In that reform all banking and savings accounts were frozen. Every 100 of the old Reichmarks were replaced by 10 Deutschemarks when the new accounts were finally freed. While all accounts remained frozen, German Food Offices issued 60 Deutschemarks to each person on two separate occasions to pay for necessities until the operation was completed.

It should be noted, however, that what gives a currency value

in the final analysis is the productive capacity of the economy that issues it. Thus the strong German economy, whose productivity was freed up by the elimination of price controls and other market oriented devices, gave strength to the deutschemark. Simply declaring a new ruble convertible or giving it a link with a foreign currency or even with gold will be of little value unless other steps are taken to make the Soviet economy work more efficiently and productively.

TRADE. The intensely interconnected character of trade relations among the republics would make a breakdown in trade among them a catastrophe and exacerbate the collapse of the region's economy. Each republic obtains over 70% of its imports from the other republics (except for Russia with 50%) and less than 30% from abroad. The country's industrial structure is dominated by plants that are the sole source of a specific good for the entire Soviet Union. One recent Soviet study found that of 6,000 products, three quarters were supplied by just one factory.

This production structure was designed by the Communist Party and Gosplan to prevent any region from going its own way. It also was part of their ideology that competition was bad and production should be concentrated in particular factories. The CIA points out that "the Soviet Union's entire output of potato, corn and cotton harvesting equipment comes from single factories -- all in different republics." Republics simply cannot get along economically without one another. For example, virtually all Soviet locomotives are produced in a single factory in the

Ukraine; it requires 800 parts, which are made by 114 other factories in seven different republics.

Republics would be committing economic suicide if they were to engage in trade wars with one another, yet that is what several appear on the way to doing. Some republics are displaying autarchic tendencies -- restricting the export of products they produce such as coal, timber and food to other republics because of a desire to barter them for goods rather than sell them for rubles.

The US and its western partners should counter such tendencies by encouraging republics to establish a free trade zone among themselves, consistent with the Alma Ata agreement or, if that proves unworkable, to create free trade arrangements bilaterally as have Russia and the Ukraine. The concept of a free trade zone could be reinforced by seeking to have the republics as a group agree to accept the US-Soviet Trade Agreement of June 1, 1991 and to implement it collectively, and by encouraging the republics to work together vis a vis the GATT -- rather than seek to join individually.

The West should also explore with the republics the practicality and possibility of establishing a payments union similar to the highly successful European Payments Union (EPU) established following World War II. The importance of this instrument in permitting trade to increase among Western European countries after the war was seen by Ludwig Erhard (with whom, late in his life, I had the opportunity to discuss this matter and

other post war reforms) and others as a significant boost to the region's recovery.

I suggested such an idea for Eastern Europe in early 1990, but underestimated then the enormous desire of these countries to move as quickly as possible to develop trade links with the European Community and to downplay the importance of continued trade with one another. In the republics of the former Soviet Union opportunities for closer trade links with the EC are more tenuous; and trade binds them together more closely than it did the countries of Eastern Europe.

A Soviet Payments Union need not have a strong center; it would require agreement on a formula for clearing deficits and settling accounts. The West has had considerable experience with such arrangements and can help the Soviet republics to establish one with outside seed money; some of the funds should be put up by the republics themselves.

The chief problem will be with chronic imbalances among the republics, with some building up large surpluses and others large deficits vis a vis others; that would quickly deplete the resources of the SPU. Before creating such an arrangement this issue would have to be resolved. It is to a substantial degree related to price reform, because future imbalances will be difficult to predict with much precision unless there is some concept of the actual price of goods rather than an artificial one. Its practicality would also depend heavily on the price which the Russian Republic charges other republics for oil, because big

oil surpluses by Russia, if unmatched by roughly similar amounts of exports of other types of by other republics to Russia, will mean large and prolonged imbalances that will strain the capacity of the SPU.

DECONTROLLING THE ECONOMY. The last area of stabilization reform in the republics is demonopolization and price decontrol.

The large number of single factory monopolies in the USSR means that price decontrol without greater competition will simply lead to further price rises in an economy already suffering from an inflation rate which by the year's end could reach well over 400% (some estimates envisage 1000%). Demonopolization means, among other things, privatization of, and an elimination of subsidies to, government corporations. One approach would be to establish holding companies, similar to the German Treuhandanstalt, that would be responsible for temporarily running, restructuring and then reselling a cross-section of industrial enterprises. This would inject private sector motivations into the system prior to a massive restructuring of industry. Shares of the holding companies could be traded on newly reconstituted stock exchanges in the major republics. Remarkably even the most reform-minded of leaders in the Soviet republics appear not to have developed well throughout privatization programs. They should be assisted to do so.

Price decontrol will be critical to the success of reforms in all republics. Experience with previous stabilization programs suggests that it is important to decontrol prices and eliminate price subsidies very rapidly. This was the key to the Erhard reforms in Germany. Ludwig Erhard, when he became Director of

Economic Administration of the Bi-zonal Economic Area, assumed responsibility for an economy similar in a few respects to that of the Soviet Union today: it suffered from repressed inflation, massive hoarding, and disincentives to production which all were largely due to extensive price controls. Erhard took the bold move of eliminating such controls. In Erhard's words: "It was strictly laid down by the British and Americans that permission had to be obtained before any definite price changes could be made. The Allies never seemed to have thought it possible that someone could have the idea not to alter price controls but simply to remove them."

This bold action, together with the currency reforms described above, led to a burst of productive activity, the release of hoarded goods and, after a sharp rise in inflation, remarkable price stability. As Erhard stated "it isn't as if we had any choice. What we had to do in this situation was loosen the shackles. We had to be prepared to restore basic moral principles and to start with a purge of the economy of our society."

Partial decontrol of prices, such as was adopted in the Soviet Union under the 500 day program last year is precisely what Erhard understood had to be avoided. It merely invites speculation about future price rises; that in turn encourages the hoarding of goods. Moreover, for the Soviet Union the sooner industrial and farm enterprises learn to set prices the better. A related benefit is that price decontrol would vastly improve the efficiency of resource allocation.

There are of course risks in immediate price decontrol. These include a tendency for monopoly producers, of which there are, as noted, many in the Soviet Union, to take advantage of their freedom to increase prices with the goal of reaping high monopoly prices. This occurred in Eastern Europe earlier and led to large price increases well ahead of the pace of wage increases. Also, there is a risk that higher prices will lead to pressure for higher, rather than lower, price subsidies. This has happened in the USSR this year. But the risk is worth taking given the alternative. Although the Soviet economy is unlikely to respond as well as did the German economy -- given considerable differences in work habits and knowledge of how to make a market function -- price deregulation is a strong step in the right direction.

A final word on financing. Some experts estimate that the Soviet trade surplus this year could reach six billion dollars due to drastic import cuts of more than 40%; that together with sales of 400-500 tons of gold could enable it to meet 1991 debt servicing needs of \$11-12 billion. If this does not prove to be the case, pressures will grow for a rescheduling of debt. I find it difficult to comment on the need for this without having the numbers but I would add that if reports are correct that the US Treasury believes that permitting the Soviets to build up arrearages is a better -- as opposed to an easier -- answer it would do well to consider the desirability of that as a precedent.

In so far as membership in the IMF is concerned, that would not help the Soviets much in the near term as it would take some time to negotiate a stabilization agreement and then the question would be raised as to who the correct counterparty on the Soviet side would be. If the 50% increase in Fund quotas is fully approved by the end of this year, the Administration might be more willing to entertain the idea of full Soviet membership -- but problems of the Soviet quota, contributions etc would still need to be worked out as would questions of representation (Union government, Russian government, Ukraine government or all three and more?). If these issues can be worked out Soviet membership could be appropriate by the end of next year -- but new money should not be provided without a stabilization and reform plan which ensures its effective use.

CONCLUSION. There are strong arguments for the West to become actively engaged in the effort to assist the process of reform in the former Soviet Union. The US should use its influence in the Group of Seven to establish an oversight body of subcabinet officials whose job it would be to ensure that the various agencies and governments involved in assistance efforts coordinate their efforts and, except for humanitarian aid, that assistance is linked to performance-related conditions. Poorly coordinated western aid would dilute the west's influence over the reform process. And it is hard to envisage that large scale funds lent to the former Soviet Union today, or to any republic, could be used effectively. The primary result would be to enlarge that country's debt.

Reform will be a protracted process. Yet an American investment of time, patience, technical expertise and, where appropriate, financial resources can payoff in a more stable group of market oriented and perhaps even genuinely democratic republics to replace the deteriorating Soviet Empire. The West's ability to influence a process so intertwined with ancient feuds and suspicions is limited -- but without some measure of engagement it can have no influence at all.

REPRESENTATIVE HAMILTON. Thank you, Mr. Hormats. Thanks to all of you.

We'll begin now with questions and follow a five-minute rule.

I want to focus first just on the question of U.S. aid to the Soviet Union. You know that's one of the policy questions here in Washington. We've emphasized CCC credits—\$2.5 billion. We have \$300 million in Eximbank credits. We've delivered very small amounts—a few million dollars—in medical supplies, that kind of thing. We have some agreements out here to provide technical assistance in food distribution, in energy, defense conversion, and other areas.

As you look at what we have done thus far, what's right and what's wrong about our policy of assistance to the Soviet Union right now?

If you were structuring an aid program to the Soviet Union from the United States, or if you want to tackle it more broadly from the West, how would you do it?

MR. GREEN. Shall I start?

REPRESENTATIVE HAMILTON. Yes.

MR. GREEN. I think over the past years, the U.S. policy of emphasizing CCC as its major involvement with the Soviet Union has probably been a reasonable policy. It in effect allowed a development of the livestock sector in parts of the Soviet Union that would not have arisen under the planned system. They would have arisen if there had been a market-type reform ten years ago. But as the agricultural system was developed in the USSR, the grain assistance allowed the development of certain sectors which raised the standard of living.

Most of the grain goes into Russia. And within the Soviet system itself, some of those benefits were redistributed to other republics in the form of other goods or investment resources.

Today, that is not the situation. I just want to suggest to you and other members of the Congress, when you provide grain credit today, and particularly, when you are providing it to the areas that are most dependent upon imported grain, you are having a number of consequences that are different than what they were four years ago.

In particular, consider what is likely to happen in early 1992. In early 1992, I expect a number of bilateral agreements to be hammered out on exchanges of commodities between republics. And, in effect, by providing U.S. grain with credit to Russia, which is where most of the dependency on imported grain actually is, you are going to shift the terms of trade in 1992 against Ukraine, which is a grain exporter, for oil; you're going to shift the terms of trade against Kazakhstan. You're going to, in effect, result in Kazakhstan receiving less for its grain sales to Russia than they probably did in the past. And I don't want to get into what the rationality was in the past.

Now, we're dealing with infant trading nations, dependent upon their comparative advantage. And just as food assistance from Europe and the United States into Eastern Europe had devastating effects upon rural incomes and the ability of rural farms and enterprises to finance them-

selves, to improve their capability to expand output locally, we are poised really in a situation where we will, in effect, benefit Russia remarkably in our current posture toward the region.

I'm not saying that that necessarily means we shouldn't provide grain and do so with credit. It means that we now have to really think very seriously about the interests of others—farmers, republics—with comparative advantage in agriculture where we can depress and really stunt the development of the private sector, if we continue indefinitely providing grain under credit.

REPRESENTATIVE HAMILTON. Now, let me make sure I understand you. You're arguing against providing these agricultural credits at this point.

MR. GREEN. No, I said I'm not arguing against them. I'm saying, the idea of a similar—

REPRESENTATIVE HAMILTON. You're not exactly arguing for them.

MR. GREEN. No. A similar magnitude of food credit at the present time has adverse consequences inside the Soviet Union that weren't there necessarily before. And that you want to be very concerned, I believe, about the magnitude of the assistance program. If you're going to assist Russia in grain credits, then you should look very seriously at other means to assist the republics whose interests will not be benefited—in fact, will be depressed—by those circumstances with other types of support.

REPRESENTATIVE HAMILTON. Okay. Let's go on to the other two. The broader question is how do you construct an aid program to the Soviet Union?

MR. HORMATS. Let me talk about a couple of segments of the question.

I think what Don Green was talking about on food aid has another implication as well. And that is, we should look not only at the implications for the other republics but at the implications for Eastern Europe. Because what he said about other republics rings true for Eastern Europe as well.

The Poles, who are traditional grain exporters to the Soviet Union—Russia—are very concerned that by our financing grain to Russia, it reduces their market in Russia. We need to look at that.

One point that I think is worth bearing in mind as we focus on the calamity of the Russian economy is that we should not marginalize the Eastern Europeans. And we should certainly not do things for the Soviet Union which have an adverse impact on Eastern Europeans. There are a lot of elements to this.

In fact, they have not just talked about reform. Most of them have done these reforms, and now their political leaders are suffering, as we see in the Polish elections, for their bold approach to reforms.

That having been said, I think at this point that technical assistance of a much wider and broader sweep is needed. People from the New York Fed went over to the Soviet Union and talked to them about the banking system—the financial system in general.

This is critical. They look to us for advice in this area, as in many others, but in this in particular, because we have a Federal Reserve Board. The Board is in there for a reason. It represents not simply the center, but all parts of the country—the Open Market Committee and the Board as well.

They look at this as a prototype model. The Bundisbank is also a federal central bank and does much the same thing. But they would like us to provide a lot more technical assistance to build up their financial sector, which is virtually nonexistent today. There are some commercial banks, but they're not like ours or others in the West. A lot of assistance is needed in that area, and we can provide it. And that helps them to intermediate the savings rate, which traditionally in the Soviet Union was relatively high, partly because people couldn't spend money on goods, because the goods weren't there, but in general, it's been high. To move the money and savings into the productive sector of the economy, they need some intermediation institutions, and that's the financial system. We could be doing alot more there.

Energy. Energy strikes me as an area where the problem is not technical assistance. The problem is that the Soviets—Kazakhstan and some of the other republics—have put up enormous bureaucratic and other barriers to some of the big American companies going in and making investments. The companies can do that. The companies want to do that. Given the right environment, you will see Chevron, Amoco, and probably three or four others investing in energy in the Soviet Union, particularly in Kazakhstan. The Tengese field is an enormous field. It's of North Slope proportions.

In agriculture, they need help, in particular, because the storage and transportation systems have deteriorated. They lose a third of their crop—

REPRESENTATIVE HAMILTON. If I may interrupt, you were talking about an expansion of technical assistance.

MR. HORMATS. Yes.

REPRESENTATIVE HAMILTON. The President has spoken in terms of \$15 to \$20 million in technical assistance. What are you talking about?

MR. HORMATS. Multiples of that. \$15 or \$20 million—that's the sort of technical assistance you give Des Moines to improve its transportation system. [Laughter.]

I didn't use Indianapolis, you note.

[Laughter.]

That amount is nothing.

REPRESENTATIVE HAMILTON. Fortunately, for you.

[Laughter.]

MR. HORMATS. That's nothing. We're talking about an economy of 290 million people. It's not Ethiopia, as I pointed out in my testimony. It's not a developing country, but it is an underdeveloped country in the sense

that the human resources, the material resources, are underdeveloped. They've had 70 years of communist neglect and need technical assistance.

The sums are absurdly low. If we're going to do it, we need to do it right, and \$20 million doesn't really cut the mustard. And it needs to be broad, across the board. The other Western countries need to do it.

The Japanese——

REPRESENTATIVE HAMILTON. Provided principally to the center or to the republics?

MR. HORMATS. Only to the republics.

REPRESENTATIVE HAMILTON. Only to the republics?

MR. HORMATS. With two potential, possible exceptions. One is to help the center to organize the free-trade area and the payments union that I had described. And the other is, if they're going to try, as they seem to be willing to do, to create some central financial authority— this is the thing Yeltsin talked about. They're going to need help to do that. That would probably be centered in the Russian republic.

REPRESENTATIVE HAMILTON. Okay. Mr. Schulmann, you respond to this question, and then we'll go to Mrs. Meyers.

MR. SCHULMANN. Well, very briefly, Mr. Chairman, of course the IMF and the World Bank are starting to provide some technical assistance. But, again, I would fully agree with Bob Hormats. The problem is so large that multiples of what people are talking about at this stage will be required.

I'd like to bring to the Subcommittee's attention that the European Community earlier this month approved food and medical assistance totalling \$1.8 billion. A portion of that—I think one-third—will be used in a triangular operation. The Soviet Union will use some of that money to buy wheat in Poland.

So, there is a round-about way to address the problem that Mr. Hormats has mentioned.

I'd like to come back to energy. Fifty percent of the hard currency exports of the Soviet Union are oil and gas. Soviet oil production has now declined for, what, three years in a row. And there are people who argue that the Soviet Union might become a net oil importer as early as 1992. I find that very worrisome. I think that it's in our interest in the West to prevent this from happening, because it would increase our dependence on other oil producers.

Now, basically, this is a job for the private sector. However, at this stage, the problem is that the property rights just are not sufficiently well defined for the private sector to get involved without some form of contingency guarantee.

So, we have to think about ways the governments in the West can encourage the private sector to help the Soviets increase their oil production, which is not only a matter of exploring new fields. It's also a problem of getting new pumps and compressors in place so that they can increase the outtake.

Thank you.

REPRESENTATIVE HAMILTON. Let me just ask about oil, if I may.

In 1990, the Soviet oil exports were \$12 billion, and then they had about \$4 billion in gas sales. That's out of total hard currency exports of about \$36 billion. What is the impact on the world economy if you get a major decline in Soviet oil exports? And that's anticipated, isn't it, that we're going to have a sharp decline?

MR. GREEN. I don't think it's altogether necessary at all. There's a great many small, as well as large, project potentials in the next several years to sustain levels of oil production in the territory of the USSR, and eventually boost production within—in many of these cases, a couple of years.

It's a property rights issue.

REPRESENTATIVE HAMILTON. You don't see a sharp decline coming?

MR. GREEN. No.

REPRESENTATIVE HAMILTON. And it's going to be in our interest, as well as the Soviet interest, to keep these exports up. Right?

MR. GREEN. That's right. Most of the cuts in exports were in exports to Eastern Europe, which, in effect, pushed East Europeans more abruptly into sourcing oil elsewhere. And there have been a lot of adjustment costs faced there. But that is something that is going to happen in the non-Russian republics in the Soviet Union as well. They're going to find that the bargains that they reach in 1992, it's not just Lithuania that's going to be dissatisfied with its arrangements, but Armenia and many other republics are going to find themselves forced to conserve energy rapidly, to pay a larger proportion of their domestic product in order to purchase energy sources.

All of that will mean that consumption of energy in the territory of the USSR is declining almost as rapidly as production.

The Soviets were incredible wasters of energy, have always been. They've built up structures of production and output and projects that are energy-intensive. Those are the elements of the planned system which are contracting most rapidly today.

So, you have both sides of the equation moving today. In fact, Eastern Europe bore most of the immediate adjustment. But it was the decline of domestic demand for energy, along with the downward movement of the planned system, which accommodated and left the world market of oil not really that much affected in 1991.

REPRESENTATIVE HAMILTON. Mrs. Meyers?

MRS. MEYERS. Thank you, Mr. Chairman.

You said that what is really needed is technical assistance of a much broader scope. I agree with that. You've also said that there are tremendous bureaucratic and legal barriers to working with the republics. And I would agree with that, also.

It seems to me that maybe this technical assistance shouldn't be so much a government-to-government kind of technical assistance, as the kind of

technical assistance that companies could provide, if they could go in and get past the legal barriers and have some way of getting their money back out.

The big needs in the Soviet Union right now are in the energy field, in food transportation and processing. How can the government assist in giving that kind of technical assistance? What can we do as a government to help them?

It seems to me that it's going to have to be from the private sector.

MR. GREEN. I think there's been a beginning. I think the Europeans have been quicker to recognize this. And with the experience in Eastern Europe, the government funds to meet the cost of Western training of Western support, of Western involvement in reform, those kinds of payments can flow to financial and legal advisors, accounting firms, and a variety of specialized consulting groups that might deal with a variety of what you're talking about—which is the most important—which is the institution building at the private level—the small sector level—in the sectoral level, in the sense of agricultural credit, for example.

It's not only a finance component that would sustain an agrarian credit function inside Russia, but it necessarily involves specialists who have dealt with agrarian credit from multilateral institutions, from government and private institutions. You don't have to have government do all of this. You're quite right.

MRS. MEYERS. I guess I thought that the best technical assistance we could give them is, if there could be some kind of a joint venture, for instance, with some of our transportation systems and our food processing people who would go over there and establish plants and set up systems, and not only show them how to do it, but actually do it. Otherwise, I think it's going to take an incredibly long time.

MR. GREEN. Let me just point out, as someone who has been struggling to negotiate joint ventures in the Soviet Union for three years, a joint venture is an overused vehicle. It's a terrible vehicle to actually get things done in these kinds of environments, because you have this dilemma that the ones that you can get going are the ones that are very small, with very little capital, so that a private sector entity can bear the risk. And so, you have a lot of entrepreneurial things. But you would need so many of them across the map to get anywhere.

If you have to spend time determining the organizational form, the sharing of the revenues and profits, and all the rest of it that's going to go thereafter, your property law basis is very murky to operate within. You're going to spend more time negotiating the structures than you are doing the job. And what's needed this coming year and probably for some time to go is to get on with doing the job, and there's going to be the need for some funds to pay for expertise to work on the ground.

Companies may price and bid for those rights to carry out those at less than what they might charge elsewhere, because they anticipate an ability to enter that market with the expertise that they gain.

So, you may be able to reach a public/private bargain with institutions that want to go there, but have difficulty, when looking at their own bottom line, justifying bearing the risk today.

So, I think there's considerable scope for developing what you're talking about.

MRS. MEYERS. One other question, Mr. Chairman.

I've been reading recently that not only are there tremendous problems among the various republics, but the Russian republic itself is beginning to fragment tremendously.

Is that going to happen? Are they going to split into various republics? And if so, you've all spoken about the Russian republic as being kind of the center linchpin of this thing. If it fragments, then what kind of problems do we have? Infinitely worse, of course, but—

MR. HORMATS. Well, that's the point. It is a federation. The Russian republic in itself is a federation of other republics. Some of them have their own strong views on particular issues.

I don't know that it will necessarily fragment, because there are a lot of reasons why these little republics are not viable entities. But, for instance, the saga of the diamonds. There's one republic where most of the diamonds come from in the Russian republic. They said, well, the diamonds are on our territory, we should get the money, not the Russian republic. So, you may get a lot of internacine economic warfare. That's another risk, because the Russian republic is so enormous. You get deals now in Sakhalin Island where the Japanese are making deals, in fact, investing a lot of money there.

Now, the question is, is the benefit from that investment going to go to the Russian republic, Yeltsin, or to the people who are running Sakhalin Island. It's a very difficult economic problem.

REPRESENTATIVE HAMILTON. Mr. Johnston?

MR. JOHNSTON. Thank you, Mr. Chairman. Let me just give you a personal observation, and you correct it if I'm very wrong.

We have spoken to Jeffrey Sachs. He appeared before us and some of the people who authored the Harvard Plan. We spoke to the State Department. They went through a litany of things that we are doing for the USSR republics or the center. And yet, we can't get down to any specificity when it comes to that. Mr. Green, I quoted you—getting on with doing the job.

I literally see us, and maybe the European community, too, Mr. Schulmann, sitting around watching the patient bleed to death while we're looking for his Blue Cross/Blue Shield policy.

It's November at the end of this week. We're into the Russian winter. You're hearing some very bleak stories. You're hearing also the fact that if we don't shore them up we're looking for another coup. And the best thing that we could do is come in and help them with technical assistance—fiber optics, getting their telephone and banking system to work. But nobody's doing anything. And particularly, the United States.

Am I dead wrong in that observation? Starting with Mr. Green.

MR. GREEN. I think you're wrong. I think it's a question of scale. I have a colleague just back from the province in the middle of Siberia. He said that every Western oil field supply company that's operating a few facilities has a niche expertise, and is out talking to the production associations, doing small transactions. The Texans are the largest minority in Tyumen province right now.

MR. JOHNSTON. Let me interrupt you. How are they getting paid?

MR. GREEN. They're getting paid in oil. They're getting paid because, in effect, the local production association and Tyumen province have worked out somewhat of a revenue-sharing arrangement locally. They have received the tolerance from the Russian federation to use more of their export receipts for their own needs than are legal.

The legal status under Pavlov's Decree—which, as you know, has been done away with, but nothing else has really replaced it—would say that most of that oil revenue would accrue to the center, would go directly into the center's accounts.

Part of the reason why there's a shortfall in currency is that many of these local entities which produce the stuff are, in fact, taking command of the export proceeds. And they're paying for the assistance.

I'm not concerned so much about Tyumen province finding its way once the tolerance from the center—the sort of central, coercive nature of the Soviet Union—is broken down enough that these people can deal. They will find the right people to deal with, and people will lose some money, and others will make quite a bit. There will be a lot of activity.

We need more of that type of active, market-type activity in other segments in other provinces. People are there because it's clear—if you have the oil, you can move it on and get paid.

But if you're going to go in and work to improve the storage system in the Krasnodar, in the southern Russian federation, you're going to get paid in grain. There's a surplus of grain in the world. You're going to get paid in rubles.

Who's going to pay you to come and do the hard work that has to be done before the next harvest is wasted, by getting the facilities in place and training local personnel to run those storage facilities?

That's what needs to be done now. We're into the winter. There's some limitation of exactly what will be done. I have commented in the testimony—I don't think we're going to have apocalypse this winter, just as we did not have it last winter.

I expect that there will be needy people. There will be people in the cities, as Mr. Hormats suggests, that will find themselves unable to afford food, even though it's available in the market place. They will find themselves unable to pay for it, and there will be a need for some central assistance.

MRS. MEYERS. Will the gentleman yield for a minute?

MR. JOHNSTON. Certainly.

MRS. MEYERS. The arrangement that you just described, where the oil companies are going in and have made an agreement and are taking their profits in oil. I presume that they are also taking some of their own equipment in because the equipment is in such bad shape in the Soviet Union.

Now, that's what I am calling a joint venture. I want to know what you call it, because you said joint ventures don't work. But that's what I call a joint venture.

MR. GREEN. There's a lot of mythology in these realms. And a lot of these transactions are very simple, contractual, production-sharing transactions. But there's a legal system and a popular ideology which says there's something good that comes about if we call it a joint venture. So, what we do is hire some good talent and draft an agreement which meets Russian law. But neither of the parties believes in that agreement. They don't believe that that contractual form has, in perpetuity, division of the profits. They know they're going to be negotiating again and again, as each new venture takes place in the actual production-sharing arrangement.

These are not complicated contracts. You can set them up and get going. And the equipment is being parked. It's around different places. It's the same equipment being moved back into the Middle East, into Kuwait. It's available.

MRS. MEYERS. There would be a great deal more of that going on if there were some liquidity. In other words, if they could take the profits out in other ways than in oil and vodka and whatever.

MR. GREEN. Yes. Mr. Schulmann's quite right, the problem of the exchange rate is critical, to take your rubles, if you do a small venture and want to eventually pay yourself back, you're really left with either this official rate, which no one will choose, or you are involved with a very managed, narrow interbank market. And the reason that's very narrow is that there's no commitment by a political entity to push more of the available currency through that market.

And now we're waiting for the Russian federation, in effect, as part of its new program, will expand this capacity of using the market rate to deal with convertability issues very aggressively by the spring.

MR. JOHNSTON. Let me go on. Mr. Schulmann, my original question, are we doing enough?

MR. SCHULMANN. I would like to point out that if you add up the commitments made by Western governments and others to the Soviet Union for one kind of assistance or other, these commitments total by now over \$60 billion. Our estimate is that perhaps, at best, \$15 billion of the \$60 billion have been disbursed.

Now, one of the reasons why there is not more of a take is that the Soviet economy is in such bad shape. But I must say that I am encouraged by the speech that President Yeltsin made on Monday. I think the essence of that speech is quite clear, that Russia must get on with the

task, that it's not the West that is going to save Russia, but only Russia can save itself. And I'm also encouraged by the fact that at least there is one politician now in the Soviet Union who is willing to bet his political career on the success of the economic reforms that he has announced on Monday.

MR. JOHNSTON. Mr. Hormats?

MR. HORMATS. I think the numbers are large. It's a question of how they're utilized. There has been a lot of money lent to the Soviet Union. The big numbers really come from Germany. Probably half that \$60 billion would be German, I would guess.

MR. SCHULMANN. More than that.

MR. HORMATS. More than that. And part of that was connected, and for good reason, with the removal of the Red Army from German soil and housing and a whole lot of other things. It was really partly a payment to the then-Soviet government to allow a unified Germany to go into NATO in a fairly expeditious way.

The problem is that, to the extent money has actually been provided, it doesn't comport with any plan. It's just done for political reasons. There's no particular organized method to the whole thing.

What troubles me now with the new debate over money, as opposed to technical assistance, which you can pinpoint, as opposed to the whole question of big balance of payments loans that people are talking about, I'm incredulous when I hear this notion of giving them large sums of money, because to date there's no operative plan.

Therefore, I think that the amounts are big that Horst referred to. Technical assistance is what we ought to be focusing on now and not additional large sums of balance of payments money or other sums of that nature.

MR. JOHNSTON. One last question, Mr. Chairman. We always talk about convertibility, setting up a fund like we did in Poland and things of that nature. But now you're talking about, they have no federal reserve bank.

MR. HORMATS. No.

MR. JOHNSTON. How do you convert six or seven different republics within the next five years with separate currencies, separate stabilization funds?

MR. HORMATS. This is one of the problems. There are various ways one can look at this. There can be a credible, convertible Russian ruble with a Russian central bank, and others link their currencies to this, as the Europeans did with Germany. But that's because Germany had a credible currency and a credible central bank and a credible economy, none of which apply today in Russia. Another is to have a common currency for 8 or 10 or 11 or 12 republics, however, many decide to have that. That requires a federal reserve bank or a Deutsche Bundesbank—something like that—with each of them having a vote, and making sure that it's not dominated by Russia. That's possible. You could do that, too.

The other is that there are 8 or 9 or 10 different currencies. There you have a problem, what do you link them to? Do you link them to a credible ruble or do you link them to the ECU or the dollar or gold? If you do that, you have to have a central bank for each one, or you can have a currency board. The currency board could work a little differently. You could have a currency board, which is essentially an automatic institution.

If they have a billion dollars' worth of gold, they are permitted to create ten billion dollars' worth of currency. But the currency can only be created in some ratio to that gold. That has to be fixed.

Now, if the currency gets out of line, then people are going to convert that into gold, and you'll lose all your gold supply. So, you have to figure out some way of handling this. It's going to be very difficult.

And the other problem is that the republics have no experience at running these things—none of them—because they've never really run a central bank in the sense that the Germans and the Americans and the French run central banks.

That's why I emphasize financial technical assistance as one of the priority areas.

MR. JOHNSTON. Thank you very much.

REPRESENTATIVE HAMILTON. I'm having some scheduling problems up here. I'm going to turn to Mr. Gilman for some questions in just a minute. I am anxious to get your views on the prospects for the Soviet economy.

I am interested in some of your comments. I guess what interested me was that you seem more positive and optimistic about the future for the Soviet economy than most of the information that seems to be in the press.

Debt is not all that big, you said Mr. Schulmann. Mr. Green, you talked about the incredible vitality of the private sector, or words to that effect. You emphasized the talent and resourcefulness of the country.

Well, what do you think as you look at the Soviet economy? Is the Soviet economy a disaster? Is it a calamity? Are we going to have hyper-inflation? We hear a lot about that. We hear a lot about imminent collapse and that it's not worth giving them any assistance of any kind.

You seem to be a lot more optimistic than some of these statements. Straighten me out. What are the prospects for the Soviet economy? As you look at it right now, given the fact of U.S. and economic community aid and all the rest of it, what are the prospects for that economy?

MR. SCHULMANN. I think you have to discuss this question, first, under unchanged policies, and then the answer is fairly simple. Under unchanged policies, there will indeed be a disaster.

REPRESENTATIVE HAMILTON. If we hold the present course.

MR. SCHULMANN. That's right.

REPRESENTATIVE HAMILTON. Given the EC assistance you referred to earlier, U.S. assistance?

MR. SCHULMANN. No, I'm not talking so much, Mr. Chairman, about Western assistance.

REPRESENTATIVE HAMILTON. Okay.

MR. SCHULMANN. I'm talking about unchanged policies in the Soviet Union. That will be a disaster.

REPRESENTATIVE HAMILTON. Okay.

MR. SCHULMANN. Ninety-five percent of the job has to be done in the Soviet Union.

REPRESENTATIVE HAMILTON. And they're headed for disaster, as of today.

Is that right?

MR. SCHULMANN. As of today—well, as I said, I'm optimistic following the speech which President Yeltsin made on Monday, because I interpret that speech as meaning they have to get their act together, and they're not going to wait for the other republics to get it together. They will start to do what is necessary in Russia.

REPRESENTATIVE HAMILTON. Now, Mr. Green, do you react the same way?

MR. GREEN. I do. I think that the essence of the task is internal. I think, as we look at issues of transition, there are a lot of technical things that need to be done. But the fundamentals rest upon politics and political responsibility.

REPRESENTATIVE HAMILTON. And political decisions.

MR. GREEN. That's right.

REPRESENTATIVE HAMILTON. And the speech of Yeltsin gives you encouragement. You think they'll have the capability to carry out the kinds of reforms that Yeltsin spelled out?

MR. GREEN. The problem is that, in some respects, Yeltsin is recapitulating Gorbachevian developments. He has as many economic advisers as Gorbachev had. He moves from one policy position to another every month.

I am not convinced by the speech. I'm not convinced by the present economic advisory team that's in place. I think we are going to have a sequence of further struggles at the political core of Russia.

REPRESENTATIVE HAMILTON. Let me ask you this. As of this morning, as you look at the Soviet Union trying to project 4, 5, or 10 years into the future, what are we confronted with? Are we confronted with just a long, tough, very difficult period for the Soviet Union for 10 years, or are you more optimistic than that?

Mr. Hormats?

MR. HORMATS. I am very pessimistic. I think we're in for a decade or the better part of a decade of enormous economic volatility, chaos, and friction among the republics. They simply don't have the agents of the market to do the sorts of things that they need to do to get their economy in order.

There's talk of a coup in the future. What's going to happen under the Yeltsin plan essentially is that you will see massive unemployment and very large price increases all at once. And he's put his name on the line. I think that's right. He's put his name on the line and his career. But I think the adjustment process to these big price increases and the high unemployment is going to be very difficult.

Germany did it after World War II, but it should be borne in mind that it wasn't a democratic government then. They did it under a military administration. They did it right, and it worked brilliantly, but I'm not sure that the Soviets have the capacity to do that, and I'm not sure their political institutions are strong enough to withstand the enormous economic adjustments that are going to occur.

The point on the coup is that we have to stop thinking about the Soviet Union. Future coups now could be not Soviet coups, but in the various republics. If policy X or policy Y goes wrong, there's a lot of unemployment, a lot of inflation; there's no credible currency; they can't barter adequately; people can't afford food in the big cities. I just don't see any real prospect of an improvement in, at a minimum, two to three years, and at a maximum, much longer.

Poland is an example. Look what happened to Poland, with a government that was very ambitious, with a very bold reform program. Now, they're getting enormous political pressure. And they had a legitimate government that was democratically elected, and they're getting this pressure.

REPRESENTATIVE HAMILTON. I want to get Mr. Schulmann's and Mr. Green's reaction to what Mr. Hormats just said. And if I understand him, he said he's basically quite pessimistic about the future.

How about it? Mr. Schulmann?

MR. SCHULMANN. Well, Mr. Hormats just mentioned Poland. I would like to mention Hungary and Czechoslovakia. These two countries are certainly in better shape than Poland.

I think it's very risky to generalize about the prospects of the Soviet Union. I think one would really have to—

REPRESENTATIVE HAMILTON. I understand all that. I understand that I'm asking you an impossible question. Nonetheless, look, we're talking about the Soviet economy. We have to make judgments up here about the future. I just want to get some sense of how you feel.

MR. SCHULMANN. No, no. I'd be happy to respond.

I was saying earlier on that here we have for the first time a politician in the Soviet Union who is willing to bet his political career on a set of economic reforms. What we have not seen yet is whether the Russian populace is willing to make the sacrifices that will inevitably come along as a result of these economic reforms. There's the risk of a putsch and that risk exists. How big that risk is, I do not know. I also do not know what the answer to the question is of how many nuclear powers there will be on the territory of the present Soviet Union. How many currencies will circulate on that territory.

I do not know, Mr. Chairman. I know, however, that what Mr. Yeltsin is now beginning is just what the doctor ordered. He has a huge macroeconomic stabilization task in front of him and a microeconomic revolution to conduct in Russia, if Russia is to become a market economy.

MR. GREEN. I would say that I'm pessimistic for several years. I really don't believe that we're going to see dramatic improvement, certainly, in the next several years. I don't believe we'll also see catastrophe and many of the things that people worry about—mass migration, and so forth.

I am somewhat optimistic about what will happen five years and beyond. I am impressed by energy and resilience and so on that's observable. The commercial banking sector is one that I've been watching develop in Russia for the last year, and it's phenomenal what has happened. It's an insolvent, wildcat banking sector that is affecting the ability to produce and distribute goods.

There are productive assets coming out—it's not like strip malls across our own country, developed out of regulatory mismanagement.

There is a sense in which the energies are poised to develop this capacity of private-sector activity. They will take advantage of regulatory failure. They will take advantage of inflationary circumstance to bring it about.

I think five years from now, we will probably see a smaller Russian economy than it is today, measured in aggregate terms, but one that delivers a higher standard of living than it does today.

REPRESENTATIVE HAMILTON. Well, I have to go testify before the Rules Committee, so I'm going to have to run. I want to express my appreciation to you, and I'll turn this over to Congressman Gilman.

Without objection, I'm inserting into the record a statement by Senator Connie Mack, and a paper prepared by Leon Abalkan on the economic situation in the Soviet Union.

[The written opening statement of Senator Mack, and a report by Leon Balkina follow:]

WRITTEN OPENING STATEMENT OF SENATOR MACK

The outlook for the people of the Soviet Union in their move to a market economy is dynamically uncertain. We in the West want the fruits of individual initiative through free markets for all the people of Eastern Europe and the Soviet Republics. The Joint Economic Committee has scheduled the hearing this morning on Soviet reform as Boris Yeltsin announces a dramatic initiative for the Russian Republic. On October 15, an historic economic agreement was signed to allow economic cooperation among the Republics of the Soviet Union. We in the United States want economic freedom to take root along with political freedom, and we must do what we can to encourage that.

The current economic and trade outlook for the Soviet Union changes daily and is uncertain, but one thing is clear: currently measured economic indicators are negative. Yearly estimates of trade are down significantly. The value of Soviet exports to Eastern Europe is estimated to be down 39 percent and imports by the Soviets from Eastern Europe down 50 percent according to Planecon, Inc., a group that includes one of this morning's witnesses, Donald W. Green. I appreciate Mr. Hormats, Mr. Green, and Mr. Shulman making themselves available this morning.

On October 18, 1991, 8 of the 12 Soviet Republics signed a treaty of economic union in an attempt to keep intra-USSR trade and commerce intact. The Soviet Republics face the possibility that trade within the Republics will fall as dramatically as the trade with the former satellite nations of the USSR. History is, unfortunately, replete with examples of the expediency of raising tariffs in a revenue crisis. The Yeltsin reform plan for the Russian Republic is pegged as a dramatic move towards a market-based economy, but it clearly has a fiscal dividend of reducing the burden of subsidized prices supported by government, as well as unlocking some supplies of needed goods and services.

The other side of the flow of trade in goods and services is the monetary, banking and international finance system, which facilitates trade. This basic need of the Soviet Republics for a stable currency or currencies, as well as their need for a workable tax and legal system, must be a precondition to reaping the real benefits from entering the mainstream of the world trading system. Rising nationalism threatens such an accomplishment, but it is also a sign of increased freedom that such national pride is shown. These feelings must be balanced with the need to keep daily economic activities in progress. We will assist the Republics in achieving a working economic and monetary system on their way to expanded participation in the world's trading and monetary organizations.

L. ABALKIN
Academician
Director of the Institute of Economics of the
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The Modern Crisis and Perspectives
for the Development of the Soviet Economy

The Soviet economy is experiencing hard times nowadays. Exit from its deep crisis is complicated by political instability and growth of disintegration trends.

These are the very factors which complicate forecasting of its further development and, naturally, impedes the elaboration of anti-crisis programs. This necessitates consideration of different possible scenarios of potential development of events, assessments of their chances and socio-economic consequences of their implementation.

1. Scale and elements of the economic crisis.

Our economic crisis, though sharply aggravated since the beginning of 1991, has not reached its climax yet. At the same time, even today it is possible to estimate its scale and describe its component basic elements. The drop in production has practically spread over all the spheres of the national economy, and as compared with the first half of 1990, constituted in the first six months of 1991 (in comparable prices):

Industrial Production	-6.2%
Agricultural Production	-11%
Retail Trade Turnover	-12%
Paid Services	-15%

The dynamics of GNP for a number of recent years (as compared with the preceding year percentage) is as follows:

	1986	+3.3%
	1987	+2.9%
	1988	+5.5%
	1989	+3%
	1990	-2.0%
(first half)	1991	-10%

Extraction industries, primarily oil and gas, have been in an especially difficult situation. In 1990, oil extraction dropped to the level of 1978, coal to that of the beginning of the 70s. In the first half of 1991, oil extraction decreased by 28 million tons, coal by 41 million tons as compared with the same period in 1990.

In 1991, for the first time in recent years, we witnessed an absolute decrease in consumer goods production by 4.5%, including food by 8.5%.

Livestock has also decreased, cattle by 0.8 million heads, pigs by 5.6 million heads. The same situation is true for sheep and goats. This was accompanied by a drop in livestock productivity--milk production per cow shrunk by 112 kilos during the first half of 1991.

Corn crop is also expected to be less than the year before. The financial crisis is steadily growing and threatens to completely destroy money turnover in the country. According to experts' estimation, gross deficit of the union, republican and

local budgets can reach as much as 300 billion rubles or around 15% of GNP. An ever growing share of this deficit is covered at the expense of emission.

We have practically lost control over the population's money income growth as well as logical natural connection between labor results and remuneration, economic efficiency and money incomes of the population. The rates of increment of labor productivity and money incomes of the population are characterized by the following figures (percentage to the preceding year):

	<u>Social Labor Productivity</u>	<u>Money Incomes of the Population</u>
1986	+2.1	+3.6
1987	+1.6	+3.9
1988	+4.8	+9.2
1989	+2.3	+13.1
1990	-3	+16.9
1991 (first half)	-11	+43.5

Inflation is gaining momentum and can easily turn into hyperinflation.

Hard currency situation of the country has sharply worsened with our paying capacity undermined. In the first half of 1991, the country's exports dropped by 23.4%, imports by 47.7% as

compared with the same period of 1990.

Structural crisis, which has affected the Soviet economy, has deep historic roots. It is manifested in distorted structure of our economy, enormous share of the military-industrial complex, backward state of service sphere and agricultural sector. Basic funds of the majority of industries are highly worn-out and, as a rule, outdated from a technical point of view.

The existing structure of the national economy does not correspond to modern world trends.

The scale of the crisis and its multiform performance demand well elaborated and thought-over, in-depth, distributed hierarchy, envisaging both immediate first-priority actions and long-term measures of strategic character.

There are no easy quick ways out of the crisis.

2. The August putsch, its lessons and impact on the economic situation.

The August events in the USSR the abortive coup d'etat and its suppression have shaken the country and deeply influenced the character and directions of its further development. They have cleared up many things and at the same time brought to life new processes, which are far from being homogeneous or simple.

Evidently, it was these very events that have laid bare so strikingly, clearly and indisputably the depth of the changes, brought to life by perestroika. It has become clear that our people don't want and will never live the old life-style, that

despite possible zig-zags of history, the break from the past is irreversible.

Of no less importance is one more lesson of these events: political and economic reforms, started from "above", have gained powerful mass support. It is equally true both for democratic transformations in political life and for the development of new entrepreneurial structures in our economy.

The following figures prove the scale of this new dynamically developing sector of the Soviet economy (data, valid for the first half of 1991):

	Number of Enterprises (thousands)	Number of Staff Employed (MLNS of people)	Production Volume or Realized Volume of Produce or Services (CLNS rubles)
Industrial Enterprises on Lease	3.7	2.2	70
Enterprises on Lease in trade, catering and services	5	2	73
Cooperatives	255	6.5	42

The first share-holding societies have been created and started functioning; 1.5 thousand non-state (commercial or cooperative) banks have appeared. The number of private farms has reached 70 thousand and increased by 1.7 times during the first half of this year.

A large social group of entrepreneurs, who understand new perspectives and have become a reliable solid basis for economic

renovation, has been sprung to life.

Fairly powerful and influential associations of entrepreneurs are being formed now. They actively support political stability and integrity of general economic space of the country.

At the same time a number of new processes, created as a result of the August events, lead to further deepening of the economic crisis and can produce extremely negative consequences, especially in the short-term perspective. Growing separatist trends and creation of artificial barriers among constituent republics destroy historically created integrity of economic space. Continuing deficit financing of budget expenses, populist flirting with people facilitates and stimulates aggravation of the financial crisis. Appeals to create separate republican currencies may lead to further break-down of the monetary system.

Together with the acquisition of enormous right by the republics under their new status as sovereign states, the leadership of these republics has accepted the responsibility for solving the whole complex of economic and social tasks which previously had been to a great extent the responsibility of the center. Under the circumstances of sharpening crisis, this can push them to the renewal of administrative command system and restriction of democracy on the republican level.

But in a more remote perspective the growth of national ethnic consciousness (provided it would be combined with democratic transformations and support for entrepreneurship)

can become a powerful factor for revival and upsurge. This is proved by world experience, we should take into account not only from a purely economic approach, but also as far as socio-cultural (including ethnic) factors of success of this or that particular country are concerned.

And at last, one should keep in mind that in-depth roots of different extremist actions do not vanish. Continuing production recession, decline in living standards of many layers and stratas of our population, growing inflation and the likelihood of mass unemployment upsurge are fraught with serious social explosion.

Euphoria, connected with quick liquidation of the past, should not lead us to underestimate the complexity of this situation. Danger of new conflicts has not yet passed.

3. Ways Out of the Crisis: Struggle Between Logic and Emotions

The peculiarity and dramatic nature of the existing situation is not just the absence of programs to get out of the crisis or deficit of intellectuals, capable to work them out. The main problem is that emotions are prevailing over and suppressing the voice of reason, and populism is blocking implementation of extremely tough measures which are not popular. Collision of these and other contradictory trends of the same nature will determine immediate steps on the way out of the crisis.

Elaboration and signing of the Treaty on Economic Union (together and simultaneously with the Treaty on Political Union) among sovereign states should be among the most immediate

first-priority steps. Under the existing circumstances it is only joint, well-coordinated actions which can preserve single economic market-oriented space and help to take the country out of the crisis. Other action, however correct in essence and objectively, have no chance and are doomed to failure.

This opinion is shared unanimously by both Soviet leading experts and their most prominent colleagues from the West. The question is whether political leaders of the union and republics would listen to their opinion.

Success will depend not only on reaching a general economic union, but also on its support by a set of more working agreements in the sphere of banking alliance, budgetary system, customs policy, creation of favorable conditions for entrepreneurial institutions, anti-monopoly regulations, etc.

Improvement of financial situations and money circulation is a decisive precondition for getting out of the crisis and for the achievement of economic stabilization. In principle, the program of actions is quite clear: decisively drastic reduction of state budgetary deficit in all the links of the budget system; coordinated determination of interest rates and common reserve policy in relation to commercial banks; introduction of efficient measures to regulate money incomes of the population; consecutive, step-by-step introduction of ruble convertibility, accompanied by money circulation normalization.

It is clear enough, that accomplishment of all these measures is impossible without preservation and strengthening of

single currency within boundaries of common single economic space as well as single efficient banking system. And again, the problem is whether decision-makers will be able to demonstrate wisdom and political will to provide joint exit out of the crisis or otherwise condemn the people to a new level of suffering.

Alongside with large-scale measures, we need to resort to energetic, immediate steps in order to stabilize the situation for the coming autumn and winter. Considering the above, it becomes clear how sharp the problems of food, energy and fuel are now.

What is usually not taken into account, but of great importance, is that today we can't operate with generalized food and energy data for the country as a whole because these resources are distributed around the country extremely unequally and there is no reliable mechanism of their redistribution, neither administrative nor market.

If we fail to come to concerted measures within the shortest period of time, local regional disasters and social explosions, connected with them, are unavoidable. And again, we have to rely our hopes upon reason and common sense to prevail before such calamities would erupt.

We will have to get rid of illusions that somebody from outside would solve our accumulated problems and drag us out of the crisis. The bulk of the job will have to be accomplished by ourselves--Soviet people in general, entrepreneurial and government structures, including establishment of political conditions

and guarantees to attract foreign investments. From a professional point of view, it is quite clear what should be done in order to attain this goal.

The same is true for the elaboration of programs aimed at economic stabilization and transition to market system. No doubt, western experience and consulting are quite useful to us. But it is impossible, in principle, to work out realistic and socially acceptable programs without participation of Soviet specialists in this work. It would also be naive to expect the disappearance of socio-cultural distinctions and differences in conditions and models of economic functioning in sub-regions of the world economy this century or even at the beginning of the next one.

4. Socio-political Factors for Economic Improvement

The complexity of the modern situation is connected with the fact that the deep economic crisis "superimposes" a socio-economic, spiritual and moral crisis which has stricken the Soviet society. Revival and subsequent upsurge can be attained if, and only if, a society would find a great goal and unite around it. Short-term targets and care for daily bread cannot play such a role.

These are the lessons of history and conclusions of the theory of success.

The question is, if there will be such social forces to put forward a program of economic, political and spiritual revival, capable to inspire people, if such forces will be able to organize and unite the society and, if yes, under what banner.

In a more practical aspect, the first priority is the Treaty on the Union of Sovereign States and a set of economic agreements.

For all this, independently from concrete contents of these agreements, creation of a government of public consent, which in the existing situation can be of a coalition nature, is of crucial, decisive significance. The only criteria for forming such a government is that it should enjoy public confidence.

In this connection we should bear in mind that for the next 1.5 year term as a minimum, the economic situation in the country will be worsening and we won't be able to arrest further decrease in the living standard. Under such circumstances, only on the basis of confidence and public trust, support on the part of the people is possible to rule the country and carry out a stabilization policy.

If we fail to achieve such a consent in the nearest future there can be two possible different scenarios of development. Either such a consent will be reached later at the expense of additional sacrifice and social conflicts or, unavoidably, dictatorship will be established. As world experience shows, such dictatorship can be introduced either through coup d'etat or regeneration and degrading of democratically elected power structures. Depending on the scenarios and factors mentioned above, relations among the states within today's USSR will be shaped in definite directions.

Development of this or that scenario is not totally

predetermined. While it is not too late, we should do our utmost to direct the development of events along the most democratic and painless road. And all those who are able to one way or another influence the processes under way, have no right to stand aside and dodge their civic and moral duty.

This paper is a personal estimation of the author drawn from the analysis of the situation for mid-September 1991.

REPRESENTATIVE HAMILTON. Thank you very much for your participation. We've had a good discussion. I've really got about 50 questions I'd like to ask you and I can't get to them this morning, but that's part of the routine here.

Congressman Gilman, thank you for helping me out.

REPRESENTATIVE GILMAN. Thank you, Mr. Chairman.

I want to welcome the panelists. Certainly, we have some good expertise here. Welcome Mr. Hormats, particularly. We've worked with you in the past, and the Administration.

If any of these questions were asked before I came in, please don't hesitate to let me know. I have a few questions that I'd like to get into. How serious do you feel is the Soviet economic situation today, and how bad will it get in the next few months? Is it in a freefall state? Does it face imminent collapse? Is hyper-inflation likely? Do you foresee, as the Soviets told us when we were there recently, that there could be widespread hunger and starvation this winter if we don't come forward?

I address that to the entire panel.

MR. HORMATS. I'll take a quick run-through.

REPRESENTATIVE GILMAN. Mr. Hormats?

MR. HORMATS. Hyper-inflation, yes. Increased unemployment, yes, particularly if they close down or stop 70 ministries.

REPRESENTATIVE GILMAN. Do we have any idea of how extensive the unemployment is today?

MR. HORMATS. I don't know. Maybe Don knows. I don't have a number.

MR. GREEN. Most of the unemployed, truly, in an economic sense, are those still employed. They simply aren't doing anything productively.

MR. HORMATS. That's a chronic problem. That's well put.

The economy, I think, is for the moment in a freefall. Any time you lose, say, 15 percent of your GNP—I mean, we're agonizing in this country because our GNP in the recession went down by about 2 percent, give or take. That was the recession.

We're talking about a Soviet decline of 15 percent this year, give or take. It's hard to measure numbers, and the probability of a similar decline, maybe a little more, a little less, next year. That's enormous. The cumulative effect, if it occurs for several years, obviously, it is catastrophic.

I don't think there will be famine. It's not Ethiopia or Sudan. But there will be groups of people who, as Don pointed out earlier, can't afford to buy food. They're largely going to be in the big cities—St. Petersburg, Moscow, and some of the larger cities in the Soviet Union.

But is it going to collapse? I don't know that it will collapse, but it will be a very nasty economic situation for some time to come.

REPRESENTATIVE GILMAN. Mr. Schulmann and Mr. Green, go ahead.

MR. SCHULMANN. Well, I'd like to emphasize once more, are we talking about unchanged policies in the Soviet Union or not?

If the policies do not change in the various republics of the Soviet Union, then indeed the things that Mr. Hormats predicted will happen.

REPRESENTATIVE GILMAN. Do you see some good prospects for early change, or is it going to be a long haul before we get some good economic reforms in the republics?

MR. SCHULMANN. Well, I said earlier that I was encouraged by the speech President Yeltsin made on Monday. And I hope that other republics will follow his example.

REPRESENTATIVE GILMAN. What about the ambitious program that he announced? Are you confident that those programs could be implemented? Are they likely to succeed?

He talked about privatization in medium-sized state farms, industrial enterprises, decontrol of prices, termination of funding to about 70 percent of the government ministries, defense cuts in funding, and to end limitations on private earnings.

He also announced that he was ready to head a new government of national unity. What about some of those proposals? Are they practical? Can they be readily implemented?

MR. SCHULMANN. Well, these are certainly the right elements. And I think we have to make the assumption that this program will be implemented. It cannot be in our interest to assume that it will not be implemented. There is no doubt, however, in my mind, that it will be very difficult in political terms to implement this program.

REPRESENTATIVE GILMAN. And how about the other republics? How will they be affected? How will they respond? Will they go along with the Russian republic?

MR. SCHULMANN. I guess most of the smaller republics have very few alternatives. They will more or less have to do the same. Which course the Ukraine is going to take, that is a different question. But I think basically that the Ukraine will have to move in the same direction, too.

REPRESENTATIVE GILMAN. Mr. Green, did you want to respond?

MR. GREEN. I think there are a couple of points that I might add to that. I think Yeltsin has taken a very courageous step. But it also bears some costs as we think about the prospects for success.

I think in this case, as in reform efforts we've seen elsewhere, there will probably be several rounds of failure before we see generalized success.

In this instance, he has decided to proceed with basically an unreformed parliament, to not go to elections. And he's done so because he thought he could accept the political situation inside the parliament, which he would like, as opposed to dealing with elections in the smaller units of the federation, because the message he was getting from his political supporters around the federation was that if he went to elections, the people who would win on the local level are those opposed to the reforms.

The people who would come in were the ones who would say, we're not going to make you unemployed. We're not going to liberalize prices. That, in fact, at the grassroots level inside the republic, there are not the pre-conditions for the type of radical economic reform that he's going to attempt.

So, he is going to proceed into 1992, and it's simply a matter of months, I believe, before he will retreat. He will retreat when there is enough popular outcry to the price liberalization effects, to increased shortages in certain circumstances.

Certain regions will find themselves very disadvantaged, because they've been left with uneconomic structures that were somebody else's decision long ago. It's not their fault that they cannot compete.

You're going to have pockets of that federation that are just going to be up in arms.

So, what I anticipate that we'll see is retreats by the Russian federation from its radical program. It doesn't have the political strength and hasn't been thought through enough to the ultimate system of politics and economics that it wants to reach. It hasn't been thought through, and it hasn't contested those issues politically yet.

And so I would expect, in effect, not to get there this program. But to the extent that there is a little more liberalization, a little more resources moved out of the state sector, from large enterprise sector into private hands, there can be some sustenance, some bottom left to the economy, and that it need not go down another 15 to 20 percent in the next 12 months.

REPRESENTATIVE GILMAN. Readdressing the food shortage problem that they anticipate during the winter months, is there any emergency plan that's been put in place by either the Russian republics, by the Gorbachev central government, or by any of the republics to forestall this kind of an emergency that they anticipate?

MR. SCHULMANN. Well, the Soviet Union at various times has said that it would need somewhere between \$10 and \$15 billion in food aid during the next month. I think the number is now \$10 billion. Part of that food aid is coming forth now.

REPRESENTATIVE GILMAN. So, you think that that is going to suffice if all of that comes forward, and that should take care of the problem?

MR. SCHULMANN. The major problem is the distribution problem inside the Soviet Union.

REPRESENTATIVE GILMAN. Well, that's what I'm asking about. Is there any emergency plan to make certain that they get over those obstacles?

MR. SCHULMANN. That would really be a logistical challenge for us in the West to help the Soviet Union solve that short-term distribution problem.

REPRESENTATIVE GILMAN. Do we have any people out there trying to work on that kind of a problem?

MR. SCHULMANN. Not to the best of my knowledge.

REPRESENTATIVE GILMAN. I understand that there has been some teams of U.S. experts in the Soviet Union, especially from Harvard and some of our other institutions, who are trying to advise and be of support. Are you familiar with any of those teams and is their advice being heeded? Are they making any progress?

MR. GREEN. I would just say that I think that those were historical artifacts. We were in the development to the G-7 meetings with Gorbachev, and there was a good element in it in terms of bringing very radical expertise out of the Soviet Union to talk with Western experts.

But they didn't talk with Western experts on the Soviet Union. They really didn't. They didn't interact with the community out here that actually has worked and lived and studied Soviet institutions for 20 years. It was almost as if Mr. Sachs ought to be the vehicle to deliver the message of what to do. And unfortunately, neo-classical economics and the essence which comes from our major economic institutions tends, in some of its work, to understand transactional and adjustment costs, but unfortunately, doesn't include them when they do policy prescriptions.

They don't tend to put enough weight upon the institutional inertia, the need to build institutions, the necessity of underlying any kind of economic change with political legitimacy and confidence, and fiscal and monetary integrity. Those things cannot be achieved by just dramatic announcements, radical breaks from the past.

REPRESENTATIVE GILMAN. Well, let me ask you. Do you feel that the multilateral banks are acquiring too much influence and power over the global economy, and what should be done with regard to the Soviet economy?

Bob Hormats, I guess, argues that the balance of payments assistance shouldn't be provided to the Soviet Union, and that was, I guess, a recommendation out of the G-7 and U.S. policy meeting. I think Bob says it will have the effect of inducing government or governments who receive such aid to postpone reforms.

Is there too much reliance on the international banking institutions with regard to solving these problems?

MR. HORMATS. So far, the IMF and the World Bank has gone in with technical assistance. Their technical assistance makes a lot of sense. They're not envisaging at this point, nor is there any possibility that they can provide balance of payments assistance, because the Russians—the Soviets—are not members of the Bank or the fund.

I don't think there's too much reliance. I think they have key roles to play and indeed, it's better in my judgment to have multilateral institutions to do this and to coordinate than to have a whole host of bilateral players playing the game.

Let me just make one point.

REPRESENTATIVE GILMAN. Do you think that's better than government-to-government type of accountability?

MR. HORMATS. Well, it's going to be government-to-government. The question is how do you coordinate it? Under what umbrella do you provide it?

The government-to-government question on the Soviet side, which governments? Is it the Russian government or the Kazakhstan or the Tragesian government?

It's largely at this point going to be government-to-government, the sort of technical assistance we're talking about.

But on Mr. Green's point, I very much agree with him on the grand bargain, and the notion that you can design an economic policy for the United States at some university think tank just boggles the mind. The notion that you can do it in the Soviet Union—one has to just be breathless with incredulity.

The fact is that, as Don correctly pointed out, it's a question of building political institutions that can undertake this massive adjustment, that can create legitimacy, political legitimacy for these policies. Imagine doing a grand bargain with Ryzhkov and Pugoff. These are the people who they originally suggested we do the bargaining with. These people have no semblance of legitimacy.

Yeltsin is going to have great difficulty implementing reforms, and he's been elected. And the politics of adjustment from a catastrophic situation to a better one is going to involve enormous dislocations. You need a political system which can ease that adjustment process.

REPRESENTATIVE GILMAN. How best do we help that process?

MR. HORMATS. I don't know the answer to that. I think it's important that politics in the Soviet Union or the Russian republic, or whatever, understand just how far they can go.

These are political judgments as well as economic ones. If economics reigned, we would have no budget deficit today in this country, if all we did was base our judgments on economics. But we base them on political inputs, and the political inputs say that this country wants more services from the government than it's willing to pay for. That's not very different from anywhere else in the world. I don't think that's something that outsiders can do. I think it depends largely on internal political judgments.

REPRESENTATIVE GILMAN. Mr. Schulmann, do you want to comment on that?

MR. SCHULMANN. On your question whether the international financial institutions are doing too much, they've barely started to do anything. In the first instance, they have to get the most basic information out of the Soviet authorities.

When the deputy finance ministers of the G-7 met with the authorities in Moscow on Sunday and Monday, they came back empty-handed in the sense that they did not receive any additional information on the foreign exchange assets of the Soviet Union, for example.

Like Mr. Hormats, I would argue that full membership of the Soviet Union and probably some of its republics is desirable, because, otherwise, it will put us in the West in a very awkward position to impose policy

conditionality, either severally or jointly, and that is not the best way to go about this business. This business is best left to multilateral institutions.

REPRESENTATIVE GILMAN. Mr. Green, do you want to comment?

MR. GREEN. No.

REPRESENTATIVE GILMAN. Some of you have already commented on the lack of coordination of the various programs.

How serious is that problem, and is there something that should be done about trying to get better coordination of all of the nations and institutions involved in trying to do something? Do you think that there should be a temporary office of Soviet aid coordination established, for example?

MR. GREEN. I think this issue of the coordination is a difficult one. I think that, in effect, we almost have to continue to talk about the urgency and catastrophic conditions in order to get movement out of governments, in terms of providing assistance.

I think the best hope is to utilize the international financial institutions as the first realm. The G-7 initiative of recent months seems to have a cycle in it. It has a cycle that doesn't help continue to deliver. It gets just as far as the next round, and then there's usually a shift to a new assistance area, something else that's become a concern.

So, I would really hope very much that we can assist the republics to become members of the fund as quickly as possible, and help coordinate much more of this assistance through the World Bank, through the fund itself, through OECD, through institutions that aren't on such a political cycle as the G-7 arrangements are.

I'm really very skeptical that the G-7 is going to be of much contribution, other than getting it started. And afterwards, I think we need the continuity of those institutions that's elsewhere.

REPRESENTATIVE GILMAN. So, you don't see any of the need for the creation of any mechanism to coordinate all of this?

MR. GREEN. No, I don't see the need to create anything new.

REPRESENTATIVE GILMAN. Mr. Schulmann, Mr. Hormats, do you want to comment on that?

MR. SCHULMANN. No, I agree with that.

MR. HORMATS. The only thought I had was for emergency assistance that we're talking about. I think we might envisage, as I mention in my written testimony, something similar to UNRRA after World War II, which is to provide relief.

But that's a specific type of effort. But on the broader question, I agree. I think the G-7 has a political responsibility to launch it. I think that's exactly right. But day-to-day, it's not a good idea. G-7 was really never meant to coordinate massive amounts of assistance. And shouldn't do it. It couldn't do it if it wanted to, I don't think.

REPRESENTATIVE GILMAN. Some of the experts have been predicting that the Soviet Union may be forced to sharply curtail the export of oil in 1992 because of declines in production and difficulties in transportation.

What are the effects on the global economy if there's a major decline in Soviet oil exports next year? Are there any steps that we in the West could be taking in view of that prospect?

MR. GREEN. We discussed this a little bit previously, so let me just summarize quickly, and then I want to add something that I hadn't talked about before.

We have had a dramatic adjustment in production. We have seen some spill-over into the world market. There has been some shortfall—perhaps, a million barrels a day—of oil delivered into the world market. It was primarily oil that was sold to Eastern Europe. And so East European recipients have had to move on to the market to substitute for that. We may get a little bit more of a contraction in the net sales from Soviet territory in the year to come. But I'm seeing a great deal of activity at the local level where entities are now maintaining more control of the export earnings, either at the republic level or local government or with the production association, and are being able to get the assistance, and there are lots of companies—private-sector initiative—that will come in in this environment to sustain production levels.

The one other aspect that I wanted to raise is really the issue of what happens in the energy system more generally in the Soviet Union. The energy system is one that has a great deal of connections into Western Europe. There's a great deal of commercial value in what has been developed in the territory of the USSR. I'm thinking of the natural gas pipelines, which have immense market value, not only historical cost value, but immense current market value.

Those pipeline systems, which were built with Western credits and which have been paid off, provide perhaps a basis for doing some more collateralized finance for the republics that, in effect, possess those grids. This applies to the electricity grid. It applies to a variety of infrastructural elements.

What we would hope to happen is with the establishment of property rights, with the establishment of legitimate governments and republics, there will be the possibility of raising funds under the responsibility of republics on the basis of selling interest, of partial privatization of those assets. And that's the way in which capital flows hopefully will be coming forward from the Western market in the next several years. The type of noncollateralized, nonmarketable elements of pure finance coming from the markets is not going to be there. It's not going to be there for sometime.

I don't see—just to come back to this point about enforcement of the collection of Soviet debt—Soviet creditworthiness could not be worse than it is today. It is at the bottom of the ranking. There is no way to restore Soviet creditworthiness. The only creditworthiness that can be established in a period of time is going to be republic creditworthiness.

And that's going to be established only to the extent that republics bear their past obligations, which they negotiate, and they come up with credible property rights programs and policies in order to come to the market as responsible borrowers.

REPRESENTATIVE GILMAN. Just one other question. Some of us have difficulty understanding the position of Germany, France, and Italy on the question of assistance to the Soviet Union. On the one hand, they've been advocating strong financial assistance to the Soviets through the IMF, through opening the window for the Soviet Union at the European Bank for Reconstruction and Development, and through EC and bilateral assistance packages. On the other hand, these governments have blocked progress on the immediate problem that the Soviets face, and that's the external payments crisis.

How do we reconcile those two approaches? Are those governments willing to make grant commitments, except when they have to come up with the financial resources themselves?

What approach do governments on the Continent prefer on the issue of Soviet debt? What problems does the United States have with that approach?

MR. SCHULMANN. I assume that you're addressing the question of rescheduling of the Soviet debt?

REPRESENTATIVE GILMAN. Yes.

MR. SCHULMANN. Or deferral of principal payments.

My understanding is that the European position is what it is because these governments fear that this would destroy whatever is left of the limited creditworthiness of the Soviet Union for many years to come. And I share this view.

We're not only talking about the creditworthiness of the Soviet Union. We are also talking about the creditworthiness of the republics, because the creditworthiness of the republics will, in the first instance, be determined by the experience creditors have with the payments performance of the Soviet Union.

So, if the Soviet Union does not live up to its international obligations, this will also have a negative impact on the future creditworthiness of the republics. And that is at stake.

REPRESENTATIVE GILMAN. Do you want to comment on that, either Mr. Hormats or Mr. Green?

MR. HORMATS. No, I agree.

REPRESENTATIVE GILMAN. And what about Japan's position on the question of assistance to the Soviets? Does Japan's stance remain fundamentally tied to a resolution of the northern territory question?

And if so, why did they decide to provide a \$2.5 billion package for the Soviets, including \$1.8 billion in trade credits and \$500 million for food and medical aid, if they have been reluctant?

MR. HORMATS. Well, they think that there is a thawing beginning to occur on the question of the four islands. And that's part of it.

They've been pressed by the other countries in the G-7 to ante up some money. They were reluctant to do that politically while there was no potential for movement. Now, there are discussions between the Russian republic government and the Japanese on this island question. I think it's a sweetener for that process.

Also, bear in mind, while this island issue is still a political issue, there are a number of Japanese investors who are investing in Sakhalin and the oil area off Sakhalin, in timber, etc. They want to keep some degree of goodwill. But the deal they're going to make essentially in the future is with the Russians.

REPRESENTATIVE GILMAN. Any of the other panelists want to comment?

MR. SCHULMANN. Well, I think the Soviet Union is a clear-cut case for international burden-sharing. Japan, so far, has not put up any money, and it is high time that it did.

REPRESENTATIVE GILMAN. Mr. Green, you agree?

MR. GREEN. I agree.

REPRESENTATIVE GILMAN. And I want to thank the panelists for their very astute comments and analysis in helping our Subcommittee review this issue.

Thank you for being with us.

MR. HORMATS. Thank you, sir.

REPRESENTATIVE GILMAN. The Subcommittee stands adjourned.

[Whereupon, at 12:30 p.m., the Subcommittee adjourned, subject to the call of the Chair.]

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