

# **CORRUPTION IN RUSSIA**

---

---

**HEARINGS**  
BEFORE THE  
**COMMITTEE ON FOREIGN RELATIONS**  
**UNITED STATES SENATE**  
**ONE HUNDRED SIXTH CONGRESS**  
FIRST SESSION

—————  
SEPTEMBER 23 AND 30, 1999  
—————

Printed for the use of the Committee on Foreign Relations



Available via the World Wide Web: <http://www.access.gpo.gov/congress/senate>

U.S. GOVERNMENT PRINTING OFFICE

61-362 CC

WASHINGTON : 2000

COMMITTEE ON FOREIGN RELATIONS

JESSE HELMS, North Carolina, *Chairman*

RICHARD G. LUGAR, Indiana  
PAUL COVERDELL, Georgia  
CHUCK HAGEL, Nebraska  
GORDON H. SMITH, Oregon  
ROD GRAMS, Minnesota  
SAM BROWNBACK, Kansas  
CRAIG THOMAS, Wyoming  
JOHN ASHCROFT, Missouri  
BILL FRIST, Tennessee

JOSEPH R. BIDEN, JR., Delaware  
PAUL S. SARBANES, Maryland  
CHRISTOPHER J. DODD, Connecticut  
JOHN F. KERRY, Massachusetts  
RUSSELL D. FEINGOLD, Wisconsin  
PAUL D. WELLSTONE, Minnesota  
BARBARA BOXER, California  
ROBERT G. TORRICELLI, New Jersey

STEPHEN E. BIEGUN, *Staff Director*  
EDWIN K. HALL, *Minority Staff Director*

# CONTENTS

## SEPTEMBER 23, 1999 CORRUPTION IN RUSSIA AND RECENT U.S. POLICY

	Page
Biden, Senator Joseph R., Jr., prepared statement .....	11
Ermarth, Fritz W., former CIA and NSC official .....	24
Prepared statement of .....	26
Legvold, Dr. Robert, professor of political science, Columbia University .....	40
Merry, E. Wayne, former State Department official; and director, Program on European Societies in Transition, Atlantic Council of the United States ..	35
Prepared statement of .....	38
Moody, Jim E., former Deputy Assistant Director, Criminal Investigation Division, Federal Bureau of Investigation; and founder of Jim Moody and Associates, L.L.C. ....	28
Prepared statement of .....	30
Talbott, Hon. Strobe, Deputy Secretary of State, Department of State .....	3
Prepared statement of .....	5
Response to additional question for the record from Senator Helms ...	15
Response to additional question for the record from Senator Hagel ....	16

## SEPTEMBER 30, 1999 CORRUPTION IN RUSSIA AND FUTURE U.S. POLICY

Finckenauer, Dr. James O., professor of criminal justice, Rutgers University (currently on leave) Washington, DC .....	76
Prepared statement of .....	82
Graham, Dr. Thomas E., Jr., senior associate, Carnegie Endowment for Inter- national Peace, Washington, DC .....	66
Prepared statement of .....	70
Reddaway, Dr. Peter, professor of political science and international affairs, George Washington University, Washington, DC .....	57
Prepared statement of .....	61
Smith, Senator Gordon H., prepared statement .....	56

## **CORRUPTION IN RUSSIA AND RECENT U.S. POLICY**

---

**THURSDAY, SEPTEMBER 23, 1999**

U.S. SENATE,  
COMMITTEE ON FOREIGN RELATIONS,  
*Washington, DC.*

The committee met, pursuant to notice, at 3:36 p.m., in room SD-419, Dirksen Senate Office Building, the Hon. Jesse Helms (chairman of the committee) presiding.

Present: Senators Helms, Hagel, Smith, Biden, Kerry and Wellstone.

The CHAIRMAN. The meeting will come to order.

I have been instructed by the distinguished Senator from Delaware, Mr. Biden, the ranking Democrat on the committee, to proceed. He is on his way. Like all the rest of us, he has a busy schedule.

The subject of today's hearing, as is well known, and I am glad to see so many people here today, is corruption in Russia and recent revelations about the diversion of billions of U.S. taxpayers' dollars into the pockets of corrupt Russian officials.

Now, the committee's purpose is to examine if the Clinton-Gore administration contributed to this problem, and if so, how so, and also whether the administration was aware of this corruption, but chose to ignore it.

We are pleased to have Deputy Secretary of State Strobe Talbott with us to discuss the administration's position, following which we will hear from a distinguished group of former officials of the State Department, CIA, and FBI, as well as a noted scholar.

Now, let me stress at the outset, our purpose today is not to debate the wisdom of supporting or engaging Russia. We are here to discuss how the administration managed or mismanaged the United States' relationship with the Russian Government, and specifically what happened to the \$5.2 billion in grants and \$12.8 billion in loans that were entrusted to the U.S. Government by the American taxpayers to support our Russian policies.

Now, the administration's defenders have argued that, yes, the United States' aid was stolen, but they say that was a small price to pay for the nuclear stability our assistance had bought. Now, these defenders and their logic, it seems to me, lean on a weak reed, to say the least.

A program for deconstructing and preventing the proliferation of Russian nuclear weapons accounts for a mere eight percent of the U.S. assistance to Russia. Now, our purpose today is to try to de-

termine what happened to the rest of that money, which was supposed to facilitate Russian reform.

I confess deep concern that the policies pursued by the President and Mr. Gore, through the so-called Gore-Chernomyrdin Commission, may have abetted corruption in Russia.

It has been widely reported that in 1995 the CIA sent a memorandum to the Vice President discussing corruption in the Russian Government, and warning that foreign aid funds were being diverted into the pockets of Russian officials, and the Vice President is said to have sent the memo back with a scatological epithet scrawled across it. Emblematic of the administration's policy, apparently he did not want to know.

Just last week the Washington Post reported that the First Lady's two brothers were involved in a nut-growing venture with a crooked Georgian warlord, whose goal is to overthrow our friend and ally, President Eduard Shevardnadze.

Worse still, the Rodham brothers' partner in this venture was a man named Gregory Loutchansky, and we'll hear about him later today, a known organized crime figure, involved in the smuggling of nuclear materials.

Now, the question is inevitable, why would the Rodhams do business with a thug like Loutchansky? The better question, I guess, is: Why wouldn't they? After all, Loutchansky was invited to attend a 1995 fund-raiser, you know where, and he had his picture taken with the President in 1993, and I guess that's the one over there.

Loutchansky was invited to that fund-raiser the same year the President went to Moscow and called for, quote, "an all-out battle to create a market based on law, not lawlessness." Uttering that worthy phrase, while simultaneously consorting with a corrupt figure like Loutchansky, surely sends the wrong signal to President Yeltsin and Russian leaders of today. How can the United States ask Russian Government officials not to consort with such criminals at home when our own President and Vice President appear to have done so?

I hope our witnesses today will address why the administration has failed to make a priority out of ending the theft of U.S. aid, and of excising corruption from the highest levels of the Russian Government.

The administration's defense has been a declaration that the alternative to looking the other way was to abandon our policy of engagement with Russia. I contend that the opposite is true. By not pressuring Russia's leaders to expunge corruption, the United States has led the Russian people to lose faith in market economics and democracy.

It is patently dishonest to suggest that the only policy choice is between forsaking engagement and giving Russian kleptocrats a carte blanche to pick the American taxpayers' wallets.

It is my hope that this hearing, and one next week, will provide new thinking about ways the United States can help the Russian people get rid of irresponsible leaders who are stealing from us and them.

I would like to welcome in the audience today a delegation from the Russian Parliament, led by Alexander Kulikov, conducting their own investigation on the corruption in Russia.

Gentlemen, I want you to know wherever you are seated that I look forward to cooperating with you to get to the heart of this matter.

I will tell you what I am going to do, Mr. Talbott. We will give Joe Biden the alternatives of making his opening statement when he gets here or after you have completed, if that is all right.

Secretary TALBOTT. As you wish, Mr. Chairman.

The CHAIRMAN. I wish you would let me recognize your lovely wife, if she would just wave at us.

Thank you very much.

You may proceed, sir.

**STATEMENT OF HON. STROBE TALBOTT, DEPUTY SECRETARY OF STATE, DEPARTMENT OF STATE**

Secretary TALBOTT. Thank you, Mr. Chairman. If it is all right, Mr. Chairman, in order to leave maximum time for our discussion, I will submit the full statement for the record, and offer some compressed opening remarks here.

The CHAIRMAN. Very well.

Secretary TALBOTT. I welcome the opportunity to discuss with the committee not only developments in Russia, but U.S. policy toward Russia. Mr. Chairman, I think you have chosen a very good time for this hearing.

Russia is much on our minds these days, and rightly so. Secretary Albright has spent this week up at the United Nations, and she has heard repeatedly from our friends and allies around the world that Russia is much on their minds, too.

You referred in your opening remarks to President Shevardnadze of Georgia. I left a meeting at the White House between President Shevardnadze and President Clinton, and I can assure you that the general subject that we are discussing today is much on President Shevardnadze's mind.

All of our friends, and allies, and partners around the world are counting on us, very much including the executive and legislative branches of the U.S. Government working together, to manage this relationship with skill, foresight, and clarity of purpose.

Now, Mr. Chairman, not for the first time, and not for the last, the Russian people are undergoing what many of them call the time of troubles. Those troubles pose a complex set of challenges to American, foreign, and national security policy.

Now, as you point out, the trouble that has received the most attention of late is a state of allegations and revelations about large-scale financial malfeasance, including charges of money laundering through American banks.

The challenge to us is three-fold. First, to ensure that we are enforcing our own laws and protecting Americans from international organized crime; second, to ensure that we are doing everything we can to protect the integrity and effectiveness of our bilateral and international assistance programs; and third, to intensify our supportive and cooperative work with those Russians who realize, as Foreign Minister Ivanov stressed in New York when he met with Secretary Albright on Monday, and with President Clinton yesterday, that their country and their people are suffering from rampant crime and corruption, and that we must continue to work with

those in Russia who are committed to fighting back against that scourge.

Now, Russia has other troubles, too, continued fighting, which has intensified today, we understand, between insurgents and Russian troops in the North Caucasus, claiming hundreds of lives. Terrorist bombings in Moscow and two other cities in Russia have exceeded the death toll of Oklahoma City and the World Trade Center combined.

Like crime and corruption, terrorism is not just a Russian problem, it is a global one, and like crime and corruption, it will not prove susceptible to just a Russian solution. On both issues, the Government of Russia has sought help from us and from others.

One of the several issues that we and the executive branch are discussing in our current consultations with the Congress, including, I hope, in this hearing today, is the terms of our ability to provide that help and the strategic goals that our support for Russian reform is meant to serve.

Let me, before going to your questions, and those of your colleagues, suggest an overall context for that discussion. First and foremost, our policy must advance the national security of the United States, both in the short term and the long term.

The test that we must apply day in and day out, year in and year out, from one administration to the next, is whether the American people are safer as a result of our policy. This administration's Russian policy needs that test. When we came into office, there were roughly 10,000 intercontinental nuclear weapons in four states of the former Soviet Union; most were aimed at the United States. Today, there are about half that many, some 5,000. They're only in Russia, and none are targeted against us.

We are discussing significant further reductions in overall numbers, and further steps to diminish the nuclear threat in all of its aspects.

Mr. Chairman, would you like me to pause so that Senator Biden can deliver his opening statement, or shall I continue?

Senator BIDEN. No. Please continue, Mr. Secretary.

Thank you, Mr. Chairman.

Secretary TALBOTT. The issue of controlling nuclear weapons and reducing the threat to the United States is one of several issues of vital importance to the U.S. that Secretary Albright and Minister Ivanov grappled with this week, along, by the way, with the subjects of peace in the Middle East, in the Balkans, and in the Caucasus.

My point, Mr. Chairman, is simply this: Corruption is an important issue that we are taking very seriously, but as we probe its cause, and as we refine our response, we must keep in mind that it is part of a much larger process under way in a vast and complex country, a country whose nature is a state and whose role in the world will have a lot to do with what sort of twenty-first century awaits us.

For a decade now, Russia has been undergoing an extraordinary transformation. In fact, it has been undergoing three transformations in one, from a dictatorship to an open society, from a command economy to a market, and from a totalitarian empire and ideological rival toward becoming what many Russians call, and as-

pire to as, a normal, modern state, integrated into the international community of which we are a part.

We have been helping to keep that process going. Just as one example, the FREEDOM Support Act, another program supported by the Congress, has helped Russia make dramatic improvements in the protection of human rights and religious freedoms.

All of us are realistic about the difficulties. Russia's transformation has encountered plenty of obstacles, none greater and more challenging than the crucial need to create the laws and institutions that are necessary for fighting crime and corruption in an open society and a market economy. Still, the transformation continues, and so must our commitment to stay engaged.

I am gratified, Mr. Chairman, to hear you say that there is really no debate about whether to stay engaged, the question is how, to what end, and with what rules and standards.

While there are no easy answers, and no quick answers to what ails the Russia body politic today, there is one overarching principle that is fundamental to creating the forces for change that will drive the scourge of corruption out of Russian society, and that is democracy. I think it is particularly appropriate, Mr. Chairman, that our proceedings today should include the participation of a delegation of parliamentarians from Russia.

When I was in Moscow two weeks ago, I was struck yet again, as I so often am, by the preoccupation of virtually everyone I met with the upcoming parliamentary and Presidential elections. For the first time in their history, Russian citizens are now voters. They can register their grievances, express their aspirations through the ballot box, or for that matter, on a soap box.

Their grievances prominently include disgust with corruption. Their aspirations prominently include good governance, honest governance. If they and the leaders they choose can stay on the course of constitutional rule and electoral democracy, not only will Russia's own people be better off, but so will we.

That is the hard-headed essence of why we must continue to support them in coping with the difficulties they face, notably including those that are in the headlines today. That is also why Russia's current problems with crime and corruption are different from the corruption that was so entrenched under Soviet communism.

Indeed, one way to look at today's troubles in Russia is part of a legacy of an evil past, and as a result of the incomplete, but ongoing transition to a better future. The solution to those troubles is for them to keep moving forward and for us to support them as they do.

For our policy of engagement with Russia to be effective, they must have the backing of the American people and, of course, of this body, and it is very much in that spirit that I look forward to our discussion today. Thank you.

[The prepared statement of Secretary Talbott follows:]

PREPARED STATEMENT OF HON. STROBE TALBOTT

RUSSIA: ITS CURRENT TROUBLES AND ITS ON-GOING TRANSFORMATION

Thank you, Mr. Chairman. I welcome the opportunity to discuss with the Committee developments in Russia and U.S. policy toward that country. You have chosen a good time for this hearing. Russia is much on our minds these days, and right-



ly so. Secretary Albright is at the United Nations this week, and she has heard repeatedly from our friends and allies around the world that Russia is much on their minds too. They are counting on us to manage U.S.-Russian relations with skill, foresight and clarity of purpose.

Not for the first time and not for the last, Russia is undergoing a time of troubles. Those troubles pose a complex set of challenges to American foreign and national security policy.

The trouble that has received the most attention of late is a spate of allegations and revelations about large-scale financial malfeasance, including charges of money-laundering through American banks. The challenge to us is threefold: first, to ensure that we are enforcing our own laws and protecting Americans from international organized crime; second, to ensure that we are doing everything we can to protect the integrity and effectiveness of our bilateral and international assistance programs; third, to intensify our work supportively and cooperatively with those Russians who realize—as Foreign Minister Ivanov stressed in New York when he met with Secretary Albright on Monday—that their country and their people are suffering from rampant crime and corruption, and who are therefore committed to fighting back against that scourge.

Russia has other troubles too. Continued fighting between insurgents and Russian troops in the North Caucasus is claiming hundreds of lives. Terrorist bombings in Moscow and two other cities have exceeded the death toll of Oklahoma City and the World Trade Center combined.

Like crime-and-corruption, terrorism is not just a Russian problem—it's a global one; and like crime-and-corruption, it won't prove susceptible to just a Russian solution. On both issues, the Government of Russia has sought help from us and from others. One of the several issues we in the Executive Branch are discussing in our current consultations with the Congress—including this hearing today, Mr. Chairman—is the terms of our ability to provide that help and the strategic goals that our support for Russian reform is meant to serve.

Let me, before going to your questions, suggest an overall context for that discussion:

First and foremost, our policy must advance the national-security interest of the United States—both in the short-term and the long-term. The test we must apply—day in and day out, year in and year out, from one Administration to the next—is whether the American people are safer as a result of our policy. This Administration's Russia policy meets that test. When we came into office, there were roughly 10,000 intercontinental nuclear weapons in four states of the former Soviet Union; most were aimed at the United States. Today, there are about half as many—some 5,000; they're only in Russia; none are targeted at us; and we're discussing significant further reductions in overall numbers and further steps to diminish the nuclear threat in all its aspects. That's one of several issues of vital importance to the U.S. that Secretary Albright and Minister Ivanov grappled with earlier this week, along with peace in the Middle East, in the Balkans, in the Gulf—and in the Caucasus.

My point, Mr. Chairman, is simply this: corruption is an important issue that we are taking very seriously, but as we probe its cause and as we refine our response, we must keep in mind that it is part of much larger process under way in a vast and complex country—a country whose nature as a state and whose role in the world will have a lot to do with what sort of 21st century awaits us.

For a decade now, Russia has been undergoing an unprecedented transformation. In fact, it is undergoing three transformations in one: from a dictatorship to an open society; from a command economy to a market; and from an totalitarian empire and ideological rival toward becoming what many Russians call—and aspire to as—a “normal, modern state,” integrated into the international community of which we are a part.

We've been helping keep that process going. Just as one example, the FREEDOM Support Act and other programs have helped Russia make dramatic improvements in the protection of human rights and religious freedoms.

All of us are realistic about the difficulties. Russia's transformation has encountered plenty of obstacles, none greater and more challenging than the crucial need to create the laws and institutions that are integral to fighting crime-and-corruption in an open society and market economy. Still, the transformation continues, and so does our commitment to stay engaged. And while there are no easy answers and no quick answers to what ails the Russian body politic today, there is one overarching principle that is fundamental to creating the forces for change that will drive the scourge of corruption out of Russian society, and that is democracy. When I was in Moscow two weeks ago, I was struck, yet again, by the preoccupation of virtually everyone I met with the upcoming parliamentary and presidential elections. For the first time in their history, Russian citizens are now voters; they can

register their grievances and express their aspirations through the ballot box—or, for that matter, on a soap box. Their grievances prominently include disgust with corruption; their aspirations prominently include good governance.

If they and the leaders they choose can stay on the course of constitutional rule and electoral democracy, not only will Russia's own people be better off, but so will our own. That's the hard-headed essence of why we must continue to support them in coping with the difficulties they face, notably including those that are in the headlines today. That's also why Russia's current problems with crime and corruption are different from the corruption so entrenched in Soviet communism. Indeed, today's problems are a result of an incomplete transition to democracy and market reform. The solution to today's problem is to keep moving forward to realize the full promise of the transformation Russia has begun.

Since the Cold War ended, the United States has, as Secretary Albright pointed out in her speech last week in her speech before the Carnegie Endowment for International Peace, pursued two basic goals in our relations with Russia. The first is to increase our security by reducing Cold War arsenals, stopping proliferation and encouraging stability and integration in Europe. The second is to support Russia's effort to transform its political, economic and social institutions. Both of these goals are very much works in progress.

In the years since Russia helped bring the Soviet system to an end, our work with that nation has helped secure some breakthroughs that are clearly in the national interest. First, the Soviet Union dissolved in a largely peaceful fashion with its nuclear weapons in secure hands, an outcome that was not foreordained. Imagine the chaos the world would face if the Soviet Union, and its nuclear arsenal, had come apart in the same way Yugoslavia has. First the Bush Administration and then the Clinton Administration worked assiduously to ensure that such a nightmare did not come to pass.

Second, Russia helped dismantle the apparatus of the Soviet system and has rejected the forcible reformation of the Soviet Union or the creation of a new totalitarian super-state. It has no practical option to turn back the clock.

Third, the people of Russia, and their leaders, have embraced democracy and have held a series of free and fair elections at the national and local levels, followed by a stable transition of offices and power, and more broadly, are assembling the building blocks of a civil society based on public participation.

Fourth, Russia has made important strides in replacing central planning with the infrastructure and institutions of a market economy.

Fifth, and equally important, Russia remains committed to working as constructively as possible with the U.S. and other nations of the international community.

International support is an essential part of helping Russia take difficult internal steps to restructure itself.

The President, the Vice President, Secretary Albright and the rest of us have always understood that in transforming itself, Russia has been tearing down dysfunctional Soviet structures, but it has only begun to put in place the mechanisms of a modern state.

This is an enormous and time-consuming task. Russia, after a millennium of autocracy and more than 70 years of communism, had little or no historical memory of civil society, of a market economy or the rule of law. The Soviet system itself was in many ways institutionalized criminality. I first heard the phrase "kleptocracy" used to describe the Soviet state. There are no "good old days" of real law and order or legitimate private enterprise to which Russia can return.

In short, crime and corruption are part of the grim legacy of the Soviet Communist experience. The rampancy of that problem has impeded Russia's own progress and impeded our ability to help Russia move forward. Moreover, as Russia dismantled communism and sought to create a new market economy, the weaknesses inherent in its new economic institutions created vulnerabilities to corruption. That is why, in his 1995 visit to Moscow, President Clinton called for "a market based on law, not lawlessness."

Yet, just as we cited these dangers, we were also engaged in finding solutions. U.S. assistance, as well as that of multilateral bodies such as the International Monetary Fund, have focused on building the broader structures that will allow the democratic citizens of Russia—who have the most to lose from corruption—to bring transparency and accountability to both government and business dealings.

We have consistently emphasized the need for transparency and accountability in our dealings with Russia, and in the dealings of the international financial institutions working with Russia. When problems have arisen, we have insisted on full and complete investigations and will continue to do so. In instances where there have been concerns about Russian practices, the Fund has tightened controls, preformed audits and reduced lending levels.

The IMF has conditioned further tranches on effective safeguards that lending will not be misappropriated, a satisfactory accounting of relevant Central Bank activities, and genuine broad-based implementation of reforms that go beyond simple commitments. Both multilateral and bilateral support for Russia will be shaped by this kind of realism. A Russian interagency law enforcement team headed by Federal Security Service Deputy Director Viktor Ivanov was in Washington last week to meet with Justice, FBI, Treasury and State officials. By the way, while this visit was primarily to deal with the Bank of New York case, the Russian team also met with FBI Director Freeh and State Department counter-terrorism officials to discuss the recent bombings in Russia.

I have referred several times to the sheer size of Russia. In that connection, I would like to emphasize that three-quarters of FREEDOM Support Act assistance is spent on programs that do not involve the Russian government, as part of our effort to help build grassroots support for change. The U.S. government has worked to build relationships with Russian law enforcement and judicial entities and helping them increase their capabilities to operate in a professional and ethical manner. We have also promoted the rule of law at the grassroots level by working with non-governmental organizations, human rights advocates, and independent media watchdogs, and by promoting ethical business practices.

For example, USAID's Rule of Law Project, which was developed in response to a presidential initiative that arose out of the 1993 Vancouver Summit, works with core Russian legal institutions on judicial and prosecutorial training, legal education reform and strengthening legal non-governmental organizations. The project has assisted the legislative drafting and the training of hundreds of judges from the commercial courts.

In addition, several U.S. law enforcement agencies have representatives based in Moscow who are working directly with their Russian counterparts on issues of mutual concern. There are three FBI attaches in Moscow working on ongoing criminal investigations and prosecutions. The U.S. Customs Service, DEA, U.S. Secret Service, DOJ and INS also have representatives in Moscow.

Law enforcement agreements with Russia allow us to share information on cases and cooperate on investigation, prosecution and prevention of crime. The current Mutual Legal Assistance Agreement between the United States and Russia allows each side to request information, interviews and other background material to support investigations. In June 1999, the U.S. and Russia signed a Mutual Legal Assistance Treaty which, when ratified and brought into force, will replace the Agreement. The Treaty will expand and strengthen the scope of cooperation, facilitating investigation and prosecution of transnational criminals.

In addition, in the recognition of the transnational dangers posed by the increased crime in the NIS and Central Europe, the U.S. government established the Anti-Crime Training and Technical Assistance Program. An interagency effort administered by the State Department, this effort is designed to help law enforcement officials develop new techniques and systems to cope with crime while simultaneously strengthening the rule of law and respect for individual rights. A major goal of this program is to develop partnerships between American and New Independent States law enforcement agencies that will enable them to combat organized crime and prevent organized crime in the New Independent States from spreading in the U.S.

In conclusion, Mr. Chairman, Secretary Albright has asked me to use this occasion to reiterate the case that she has made to you and your colleagues for the resources we need in order to defend and advance American interests. Congress is currently proposing a cut of between 25 and 30 percent from the President's FREEDOM Support Act budget request for programs in Russia and elsewhere in the New Independent States. The Secretary believes such cuts would be dangerously shortsighted, because the purposes of this assistance—from building an independent media to promoting small businesses—are fundamentally in our interests. She hopes that engagement with Russia should be something Republicans and Democrats can agree on. Engagement is a bipartisan foreign goal because it serves the long-term interests of the American people.

The CHAIRMAN. Senator Biden.

Senator BIDEN. Mr. Chairman, I would like to ask unanimous consent that my entire opening statement be placed in the record.

My staff handed me a copy of your opening statement, in which the last paragraph said, "It is patently dishonest to suggest that the only policy choice between forsaking engagement and giving Russia kleptocrats a carte blanche to pick the American taxpayers'

wallet.” I agree with that, and I am delighted that you have made clear the need to have engagement. The question is in how to engage.

One of the things I hope we will not do, not you and I, but the Congress and the country, is engage in an argument of “Who lost Russia.” Russia is not ours to lose. Russia is the Russians’ to lose, and Russia is the Russians’ to find, but I do think that it is important that during this hearing we begin to get some perspective on some of the assertions that have been made in the press, and either may be true, are true, and if are true, may or may not have the impact that they’re asserted to have.

We hear that Russian corruption has put American taxpayers at risk, and those allegations. One troubling charge has been that the Russian Central Bank that received the money from IMF loan programs sent some of that money to an offshore bank, I think the acronym is pronounced—how do you pronounce it—“FIMACO.”

Did Russians cheat when they moved some of their central bank funds to this offshore bank? Yes, they did, in my view. Were IMF funds stolen or diverted for criminal purposes? I don’t know.

At the insistence of the IMF, PricewaterhouseCoopers, an independent accounting firm, undertook a review of those IMF funds, and the deal that I mentioned, and found no evidence that IMF funds were ultimately misappropriated. At the end of the day, those funds were returned to the Central Bank.

Still, this kind of behavior is outrageous and unacceptable, and if Russians want to become part of the international community, like other normal nations, they have to be made to understand that.

As I understand, the IMF is doing just that now. They’re beginning to change the way in which they’ll deal with loans. Have there been consequences because of this deal and other outcomes? The IMF will not deposit funds now in the most recent loan to Russia. This time, the IMF retains full control, using funds to pay off Russian ongoing obligations without any participation by the Russians themselves.

It is something that does not ordinarily—you do not have to baby-sit most countries when you give IMF funds, but obviously, they have demonstrated they need a babysitter. That is on top of new additional commitments and conditions imposed by the IMF to clean up their public finances.

I personally think it is time for us to consider further steps to restore some confidence in our ability to target and to track international financial assistance to Russia, and I hope the administration has something to say about that today as well. Perhaps, the most recent sensational news is the discovery that billions of dollars have been illegally filtered, quote, “laundered” through several U.S. banks. While we must ultimately demand to know the source of these funds, right now there is no evidence that they came from international assistance programs.

Sadly enough, there is, on its face, sufficient private tax evasion, corruption, and racketeering in Russia to account for those funds.

Finally, there is another possibility. The bilateral U.S. assistance to Russia has been among the sources of the mass of capital flows that have plagued the Russian economy, but the fact is that most

of our aid is in the form of expertise, exchanges, and closely targeted projects, with a low risk for diversion, because there is not a high percentage of them being in hard dollars.

Despite the lack of hard evidence that any American taxpayers' money has been drawn into the web of Russian corruption, the very nature of the black market economy and protection rackets that account for so much of Russia's economy these days means that neither blanket accusations nor blanket denials seem to hold any water.

So let us grant the critics the worst of the claims, and for the sake of argument, concede that all the worst-case assumptions are true, but let us also look at the other side of the ledger. Look at the plus side of the balance sheet, and you'll see what the average American has received in exchange for these alleged wastefully diverted funds. I say alleged.

In 8 years since the United States opened its relationship with Russia, this is what we have accomplished. Russia has reduced the number of nuclear missiles from 9,500 to 6,000.

Over 1,500 Russian nuclear warheads have been deactivated. Some 300 Russian missile launchers have been destroyed. Russian troops have withdrawn from Central Europe, the Baltic States, and more importantly, Russia has made no serious effort to reconstitute the Soviet Union under its denomination.

Russia was a participant in the Gulf war, and has joined us in peacekeeping operations in Bosnia and in Kosovo. Russia now holds free elections at all levels around the country. Russian society is open to an unprecedented degree. Russia has opened its doors to the outside world, so foreigners now visit formerly closed cities, and Russians come here by the thousands.

The Russian press, once represented by a dreary Communist Party-controlled *Pravda*, is now free and even raucous in its criticism of the government, and the Russian welfare state that the Communists were so proud of, has, albeit, painfully, begun to feel the effects of a global economy.

So there is another point that needs to be stressed. U.S. assistance to Russia has been targeted in bringing about structure reforms that would be both deep and long-lasting. Importantly, this assistance has included components of fighting both crime and corruption.

The administration, in its semi-annual meetings with various prime ministers, has worked to promote the rule of law in Russia, with not as much success as we would like, but we are trying.

Topics of these meetings include a bilateral law enforcement cooperation, law enforcement assistance, anti-corruption assistance at a grassroots level, ethics training, and dozens more programs. So I would suggest it is simply wrong for people, and I read it in the press, to suggest that these problems have been ignored.

They have been identified as problems, they have been devoted time, funds, and personnel to deal with, and they have to be dealt with again, and we have to try new ways to try to deal with them.

You might say that we have not committed sufficient resources to these programs, but it is not true that corruption has been ignored. So what are the lessons to be drawn from our experience?

It seems to be that, obviously, there are problems. They are problems that we know about and cannot pretend they do not exist.

That our assistance to Russia has caused problems? No reading of Russian history, which is full of examples of serious corruption, can support the claim that there has not always been corruption. But there has been and continues to be tangible progress, and it may be two steps forward and one back, but there is progress.

So I agree with the Chairman, it should not be a debate about whether or not we engage or disengage, it is about the degrees to which we can engage more rationally and more effectively.

I would conclude by saying, Mr. Chairman, that I can remember when we sat here and I was with the staff members, now an ambassador, a guy named John Ritch, drafting the SEED Act, which became the FREEDOM Support Act, and some iteration of the FREEDOM Support Act, or of the SEED Act, and we all said then, which we should remind everybody now, it has been 8 years, and 800 years of history we are trying to turn around.

The idea that Russia is going to get it right, get it straight, have no corruption, have a market economy that works like ours, have elections that are like ours, and have a system that is remotely like ours, or other Western European countries, in the near term, and have it all done neatly is beyond anyone's capacity, except the Lord Almighty himself, but the Russian people have to do a heck lot more, and Russian institutions do so.

I am anxious to hear how we are going to strengthen our oversight, if you will, on our dealings with Russia, but I sincerely hope that everybody heeds your admonition that this is not about whether or not we engage or do not engage, it is about how to engage.

I thank you for your time, Mr. Chairman, and I thank the Secretary for allowing me to follow him with my opening statement. It should have preceded it.

[The prepared statement of Senator Biden follows:]

PREPARED STATEMENT OF SENATOR JOSEPH R. BIDEN, JR.

There is a lot of clamoring right now—most of it driven by U.S. election hysteria—about “Who lost Russia.” This is absurd. Russia is not lost—it is right there where it has always been.

- In any case, it was not ours to lose. It still belongs to the Russians. They control Russia's destiny—no one else.
- No one—not the IMF, not the United States, not the G-7 countries—was ever going to influence Russia's policy except at the margins.

What has been “lost” however, is a rational perspective on the pace and ease of the current transformation of Russia. No one said that change from a Communist system to a free market, democratic society would be easy.

Change will take generations; we have always known that.

This country, first under George Bush, now under Bill Clinton, has done the right thing in trying to ease Russia's transition from Communist bully to responsible member of the world community.

And the successes are remarkable. We must remember that the Soviet Union came apart less than eight short years ago. In that brief time, Russia has reduced its nuclear arsenal and slashed its military spending. It has held democratic elections and resisted a return to Communism.

It has opened its doors to the outside world so that foreigners now visit formerly closed cities, and Russians by the thousands come here. The Russian press—once represented by the dreary, Communist party-controlled *Pravda*, is now free and even raucous in its criticism of the government. And the welfare state that the Communists were so proud of, has—albeit painfully—begun to feel the effects of the global economy.

Obviously, there have been, and will continue to be, frustrations and missteps. Corruption is one of the most visible ones.

The current hysteria on this topic misses the main point—that corruption, while unpleasant for those of us in other countries to contemplate—harms the ordinary, decent Russian more than it does us.

- Russia has the biggest stake in getting its house in order.

I must admit to some puzzlement about this focus on corruption in Russia right now. Corruption is always deplorable, anywhere that it occurs. But it is an ugly fact of life in many countries that we do business with every day.

U.S. assistance to Russia has been carefully targeted at bringing about structural reforms that would be both deep and long-term. This assistance has included components on fighting both crime and corruption:

- Vice President Gore, in his semi-annual meetings with the various Russian prime ministers, has worked vigorously to promote rule of law in Russia.
- Topics of these meetings included: bilateral law enforcement cooperation, law enforcement assistance, rule of law assistance, anti-corruption assistance at the grassroots level, ethics training, and dozens more programs.

It is patently ridiculous, therefore, to say that this Administration has ignored these problems. On the contrary, this Administration has not only identified the problems, but has devoted time, funds, and personnel toward addressing them.

So, what are the lessons to be drawn from our experiences in Russia?

- That there are problems? Of course there are problems. We knew there would be.
- But there is tangible progress. It may be two steps forward and one step backward. But there is progress.

Should we disengage because of these problems?

- Certainly not. The world needs a stable, prosperous, democratic Russia. There is simply no alternative to that.
- We, the other G-7 members, and other industrialized nations must continue with our assistance programs, IMF loans and other measures to cushion Russia's transition to democracy and free-market capitalism.

Does this mean that we should not be careful of how we spend our assistance money there?

No, of course not. If more controls are needed on U.S. assistance and IMF money, then let's put those controls into place.

But under no circumstances can the West abandon Russia. Russia truly will be "lost" if we do that.

The CHAIRMAN. Very good.

Now, before we proceed, I want to call attention to the second panel, and I want them to be accorded adequate time to testify and to be questioned, but I am going to set the time for the first round, and maybe the only round of questioning, at 5 minutes.

The second panel is Fritz Ermarth, the former CIA and NSC official, Jim Moody, the former Deputy Assistant Director of the Criminal Investigative Division of the FBI, and founder of Jim Moody and Associates, Mr. E. Wayne Merry, former State Department official and director of programs on the European Societies in Transition of the Atlantic Council of the United States, and Dr. Robert Legvold, professor of political science at Columbia University, New York.

Now, bear in mind that, Mr. Talbott, at the last minute after the red light has come on, if you are asked a question, I want you to have time to answer it, but I do not want to run very far over 5 minutes per Senator.

Now, my first question is: Was information known to the United States that former Prime Minister Viktor Chernomyrdin was involved in corruption or failed to use his power to stop corruption by Russian officials?

Now, without divulging any classified material, I wonder if you can confirm whether the CIA did produce a memorandum on corruption by the Prime Minister of Russia, and did Vice President Gore, in fact, read and dismiss that CIA report?

Secretary TALBOTT. Mr. Chairman, let me start—

The CHAIRMAN. That is a mouthful, I know.

Secretary TALBOTT. Sir?

The CHAIRMAN. I said that is a mouthful of a question, but you may proceed.

Secretary TALBOTT. Let me start by respectfully declining to comment on anything whatsoever to do with intelligence matters or the product of the intelligence community. I hope you will permit me that.

In appropriate closed sessions we can, of course, go much further than we can in open session, and nothing whatsoever should be inferred about the specifics of the question that you raised from my inability to say anything about intelligence matters.

Let me say that the issue of corruption has been very much on the agenda of U.S.-Russian relationships at all levels, including at the level of President Clinton and President Yeltsin, and certainly including at the level of Vice President Gore and former Prime Minister Chernomyrdin for quite a number of years.

In fact, one of the many offshoots of the Gore-Chernomyrdin Commission, to which you referred in your opening comments, was a sub-group to deal with the problem of organized crime and corruption.

We have been pursuing that issue directly with the Russians for quite a number of years. If and when either our intelligence community or our law enforcement community comes into possession of information with regard to specific individuals or specific cases, we make sure that the process is in place for those investigations to go forward, and we deal with the facts as they emerge, but the short answer is that with all Russian leaders we have been pushing the issue of corruption, and incidentally, a number of Russians have been quite eloquent themselves, including the Foreign Minister this week, on the harm that corruption has done to Russia.

The CHAIRMAN. Sir, you agree with your colleague, Ambassador-at-Large Stephen Sestanovich, who testified on May 20, 1998 before this committee regarding the IMF bail-out funds flowing into Russia, and we have that on the poster there somewhere.

He said, "What people did with those dollars, I do not know. I would not be a bit surprised if some of them went into Swiss banks, but it is what tends to happen when you have a run on the currency. People get their money out of Russian banks."

Now then, the IMF, as I understand it, puts its funds into the Russian central bank, is that correct?

Secretary TALBOTT. Yes. That has been true in the past.

The CHAIRMAN. If a Russian Government official subsequently steals money from the bank, is that a theft of IMF funds, in your judgment?

Secretary TALBOTT. There are two issues here, of course. One is Russian law and the other is American law, and for that matter, laws governing the other contributing countries of the IMF. If there is a credible allegation that laws are broken, then the issue be-



comes a law enforcement matter, and we pursue it vigorously as such.

With your permission, could I comment on two points that you just touched on—

The CHAIRMAN. OK.

Secretary TALBOTT [continuing]. And what you said? First of all, the IMF, with the, of course, vigorous participation of the Department of Treasury, has taken very seriously over the past year, well before these recent allegations hit the press, any suggestions, whatsoever, that there was misappropriation of IMF funds. For nearly a year after the August, 1998, financial crisis in Russia, IMF lending was suspended to Russia.

In July, there was a new program, but the money for that program, which goes to partial financing of past IMF loans, does not go to Russia at all, it does not go to banks in Russia. It remains here, and simply moves within the IMF to cover that refinancing.

Could I comment on the quoted statement of my friend and colleague—

The CHAIRMAN. Sure.

Secretary TALBOTT [continuing]. Steve Sestanovich here? I think it is—

The CHAIRMAN. Go ahead.

Senator BIDEN. Mr. Chairman, with your permission, I yield you my 5 minutes, and you continue, because I will get plenty of chances to ask him questions later.

Secretary TALBOTT. Mr. Chairman, I thank you for providing the only setting in Washington where I can crash a red light. I appreciate that very much, and I will try to be brief.

We have to distinguish between different forms of the problem here. What I think Steve was talking about was the issue of capital flight, that is, money getting out of Russia. That might be money that Russians have earned, and they may have earned it legitimately. It may also be money that foreign investors had put into Russia.

One of the problems that Russia has coped with over the last—well, actually, inadequately coped with, is failing to develop a banking system, a set of tax laws, and an investment climate that will allow capital to remain in Russia. Not all of the capital that has left Russia, whether for Swiss bank accounts, or New York bank accounts, or real estate in the Riviera is necessarily laundered money, or ill-gotten gains.

Part of our goal in our continuing engagement with Russia on these issues will be to get them to, for their own sake, improve the climate for investment in Russia, so that the money will stay there. So we should not assume that all of the money that we are talking about over here is necessarily symptomatic of corruption.

The CHAIRMAN. Do you agree or disagree that IMF money has been subject to massive capital flight? Yes or no?

Secretary TALBOTT. Well, first of all, money is fungible. There is no question that Russia has suffered generally from the problem of capital flight, being able to keep money of any kind in the country.

An awful lot of it goes into mattresses, literally, in Russia, because Russians do not trust banks, and a lot of it has fled the coun-

try. As for the IMF money, the indications so far are that there is no evidence that IMF money, per se, has been misappropriated.

The CHAIRMAN. There has been no flight of IMF funds, is that your answer?

Secretary TALBOTT. Well, again, when money leaves, it hurts Russia.

The CHAIRMAN. It is all right for you to say you do not know, but do not give me a convoluted answer to it.

Secretary TALBOTT. Well, it is an attempt at just recognizing an economic reality, which is the fungibility of the money.

The CHAIRMAN. What do you know about the assertion by the fired Russian Prosecutor General Yuriy Skuratov, reported in the press that \$3.9 billion of the \$4.8 billion IMF bail-out for Russia in 1998 never entered Russia? Do you deny that?

Secretary TALBOTT. I certainly cannot vouch for that. Both the IMF external auditors, PricewaterhouseCoopers, in particular, the U.S. Government, are all seeking to establish the facts, and we will rely on the facts as our own agencies establish.

The CHAIRMAN. You do not know. You say you do not know.

Secretary TALBOTT. I say that I certainly cannot vouch for his assertions.

The CHAIRMAN. Do you not believe that it was sent by the Russian Central Bank directly to commercial banks, bypassing the currency market, is that not a matter of fact?

Secretary TALBOTT. I would really prefer to confine myself to what our own authorities have been able to establish.

The CHAIRMAN. Well, is that the official answer of the administration? Is that all you know about it?

Secretary TALBOTT. Well, let me—I think probably the best way to both do justice to your question and make use of our time is the following. You have put before me a specific allegation, and I will provide you promptly for the record our analysis of and reaction to his allegation.

The CHAIRMAN. Very well. Senator.

[The following response was received subsequent to the hearing:]

RESPONSE OF DEPUTY SECRETARY STROBE TALBOTT TO THE QUESTION OF SENATOR HELMS

*Question.* What do you know about the assertions of the fired Russian prosecutor general, Yuri Skuratov, reported in the press, that \$3.9 billion of the \$4.8 billion IMF bailout for Russia in 1998 never entered Russia? Do you deny that?

*Answer.* IMF funds were handled in a manner reflecting standard operating procedures for U.S. dollar clearing operations—whether from Russia or any other country. When the Central Bank of Russia sells dollars in the Russian foreign exchange market, the actual transfer of dollars from seller to buyer takes place in U.S. dollar clearing accounts—all of which are located in the United States.

The report by PricewaterhouseCoopers regarding the July 1998 IMF disbursement to Russia summarized the process which took place as follows:

The Government of Russia informed the IMF on July 23 that it would like the IMF payment to be made in dollars and deposited in the Russian Central Bank's account at the New York Federal Reserve Bank. Some of the money was then invested in U.S. T-bills, while the remainder was transferred to the Central Bank's U.S. dollar clearing account at the Republic Bank of New York.

Over the course of July and August, the Central Bank made trades in the Russian foreign exchange market. Most of these trades were directly with 30 or so large Russian banks, with the remainder conducted through domestic currency exchanges such as the Moscow Interbank Currency Exchange (MICEX). At the end of each trading day buying and selling transactions were netted out, and dollars were trans-

ferred between the Central Bank's dollar clearing account at Republic Bank of New York to the dollar clearing accounts of the Russian Banks that bought the dollars. True, the dollars never left the United States. This is normal financial practice.

Senator HAGEL. Mr. Chairman, thank you. Mr. Secretary, welcome. A little off the mark here, but I noted in your testimony the progress that we have made regarding nuclear weapons with the Russians. It may be ironic, but one of the most significant tangible measurements of the relationship we have with the Russians over the last 10 years after the implosion of the Soviet Union has actually been the military relationship.

You note in here, Mr. Secretary, that now we are dealing with about 5,000 Russian nuclear weapons, and you say they are only in Russia now, and you further say none are targeted at us. Who are they targeted at?

Secretary TALBOTT. Let me give you my best attempt at an answer on that, with the proviso that I would like to check with our technical experts to followup. I believe, in effect, they are simply not targeted. Whether that would be true of all of them, I do not know. Russia has other countries that it thinks about in terms of deterrence.

Re-targeting a weapon takes a relatively short period of time. I believe that they are currently simply not targeted, and await re-targeting in a crisis of some kind, but I have some friends at the Pentagon I would like to check with on that.

[The following response was received subsequent to the hearing:]

RESPONSE OF DEPUTY SECRETARY STROBE TALBOTT TO THE QUESTION OF SENATOR HAGEL

*Question.* The Administration has stated that no Russian nuclear weapons are targeted at the U.S. What are these weapons targeted at? How long would it take to re-target them against us?

*Answer.* The detargeting initiative was a confidence-building measure that symbolizes the improved relationship between the U.S. and Russia. In this regard, it is one of a series of such measures adopted in the aftermath of the Cold War, including discontinuing strategic bomber ground alert and continuous airborne command post operations, and withdrawing and eliminating certain tactical nuclear weapons.

For Russian ICBMs, detargeting means that the launch control system has been set with a zero or null set. Targeting data, however, could be reloaded in a missile's on-board computer if so ordered. Russian press reports have stated that Russian systems remain on alert and that in a matter of 15 minutes, at most, Russian ICBMs can be re-targeted to their main targets.

If a missile without targeting data loaded into its guidance system were to somehow be launched, it would almost immediately go into an uncontrolled flight and crash back to earth.

Senator HAGEL. If that is the case, is that not a little misleading to say that they are not targeted at us, when in a matter of seconds, they are re-targeted, as you suggested.

Secretary TALBOTT. I understand your point, but by the way, I am not sure if it is a matter of seconds, but it is not a matter—

Senator HAGEL. It is pretty fast, is it not?

Secretary TALBOTT [continuing]. Of days.

Senator HAGEL. I think we give maybe the wrong impression, I have heard the President say this, too, like this is kind of a benign threat. They may have 5,000 nuclear warheads, they are not targeted at us, so, therefore, life is good. I think that does not accurately reflect the situation.

Secretary TALBOTT. Well, let me, with respect, suggest another way of looking at it, while taking your point that the pure military significance of de-targeting may be at the margins.

First, if you couple it with the other statistics that you referred to and that Senator Biden referred to in his opening statement, namely the overall reduction in levels of Russian strategic weaponry, it requires more significance. But the main point here is political, and that is that the United States and Russia do not now regard each other as enemies in the way that they did during the cold war.

So I think if you look at it in that context, it has significance, but I would not—I take your point, we should not overstate the military significance of de-targeting.

Senator HAGEL. Thank you. Now, on to the subject at hand. In light of the present revelations concerning corruption and other problems, this is an imperfect world, but obviously, reality dominates here. This being the last year of the Clinton administration, you look at the FREEDOM Support Act, and other programs that the United States has with the Russian Government, Russian people, in light of these revelations. What changes is the administration intending to make, anticipating to make, or will make, or are making, to try and focus this assistance, paid for by the American taxpayer, in areas where we have some more reasonable assurance that this money is doing what we intended it to do?

Secretary TALBOTT. Well, let me, if I could, divide the question into two parts. First, as I hope I have already indicated, and want to reiterate, we learn from experience as we go along.

We have certainly learned from the experience of the past year, since August 1998, and every time we either see ourselves an opportunity to tighten up the controls, the stringencies, the protections, particularly when it comes to international financial institutions, and what they do, we do that. We institute those changes.

Secretary Summers, in testifying on the House side earlier this week, detailed some of those measures that the Treasury and the IMF are undertaking.

With regard to our bilateral assistance, as I think Senator Biden alluded to, our bilateral assistance, by and large, does not put money into Russian pockets or into the Russian treasury or banks. Most of our bilateral assistance is much more in the area of technical assistance, know-how, and that kind of thing, but the program you referred to, the FREEDOM Support Act, gives us numerous ways to help the Russians deal with the problems of crime and corruption through our grassroots organizations, better banking laws.

Since my time is out, I will just sort of point over my shoulder to our colleagues from the Russian Parliament as the bearers to the ultimate answer to your question.

The real answer to Russian crime and corruption is for the Russian people to elect legislatures who will pass laws and establish enforcement mechanisms that will get a grip on the problem.

Senator HAGEL. Mr. Chairman, thank you.

Mr. Secretary, thank you.

The CHAIRMAN. Senator Kerry.

Senator KERRY. Thank you, Mr. Chairman.

Mr. Secretary, welcome. We are glad to have you here today.

Secretary TALBOTT. Thank you, Senator.

Senator KERRY. Mr. Chairman, on the subject of money laundering and international crime, thanks to this committee and to your indulgence Mr. Chairman, and at other times with Senator Lugar and Senator Pell, I have had a chance to really be involved in this issue for a long time, and I know it is always very dangerous to use one's self as a reference, but notwithstanding, I wrote a book 2 years ago called "The New War," in which I dedicated a chapter to the subject of Russia, and I called it "The Hijacking of the Russian Bear."

I just want to read one thing to you, to share with you sort of a sense of what already was happening 2 years ago, and then I want to ask the Secretary, because I do not think there is a better expert on Russia in our country than the Secretary to perhaps comment on it.

I wrote 2 years ago that "What is happening in Russia today is more than simple frontier-style robbery," referring to what George Soros had talked about as a period of robber-baron, capitalist transition.

"It is the hijacking of the nation's entire economy by increasingly organized criminal groups through systematic racketeering, murder, fraud, auto theft, assault, drug distribution, trafficking, and weapons, and radioactive material, prostitution, smuggling, extortion, embezzlement, and the infiltration and purchase of Russian banks.

"Russia's criminal class has evolved from the black marketeers, minor thugs, and fixers that existed at the fringe of the old Soviet state, into the sophisticated power brokers and money men who are pushing the one vast and powerful empire into wholesale criminality and corruption. Russians describe the current period as a 'smuta,' or time of troubles, a chaotic interregnum like that of the early 17th and 20th centuries, when anarchy ended only with the establishment of yet another autocracy. Russia is going through a revolution, a depression, and a gold rush simultaneously. Everything is up for grabs, and might makes right."

I might add to that, Mr. Chairman, that at the time, I quoted Mr. Yeltsin, who acknowledged publicly that the Mafia is the single greatest threat to the survival of Russian democracy, at a statement that was underscored by the 1994 Mafia contract killing of Dmitri Kolodoff, the investigative reporter, who was looking at what was happening in Moscow at the time.

But then I also said, and I want the Secretary to comment on this, I said, "A brief glance into Russia's past shows the current criminal chaos was a long-time in the making."

The fact is that when all of the barriers fell down with the fall of the Berlin Wall and the transition, there was this enormous rush into capitalism, a free market system, with no controls, no capacity, and no understanding, no regulation at all, and it was only in 1994 that we got an FBI office finally into Moscow.

I would ask the Secretary, given his superior knowledge of the transitional processes of life under the first 70 years of communism, but even prior to that, under the czar, whether or not we are not going through a process of evolution. Do you believe that

the debate about losing Russia is entirely inappropriate, the debate about how we get at the illicit transfer of our tax money, or how we further regulate and cooperate, and put in place their capacity to survive as a democracy, is the real debate, and is that where we ought to be focusing our attention?

I wonder, Mr. Secretary, would you comment on the historical background, realities, life in Russia, how we ought to be looking at it from our national interests.

Secretary TALBOTT. Senator, I had, before coming up here, hoped very much that nobody would use the phrase, "we lost Russia," and I certainly vowed not to use it myself, and I am now—you and Senator Biden have both used the phrase, and I read the book. I read the book.

Senator KERRY. In a very different context.

Secretary TALBOTT. The following is the best line I have heard, which I hope I can just get onto the record quickly, and then respond to one or two other things that Senator Kerry said.

Jim Collins, our very fine Ambassador in Moscow, likes to say, "Who lost Russia? The Communists lost Russia."

Now, what he means by that is the Communist Party of the Soviet Union. They lost the Soviet Union, and the process that the Russian people have put in place, including the one represented by the parliamentarians here, is really a matter about the Russian people getting their country back.

Now, the essence of what the Senator said is that it is a very messy process, even dangerous, and sometimes bloody, but the only quarrel I have with your overall depiction in the passage that you read is that it is very bleak.

It does not take account that amidst all of those clouds there is some sunlight, including the sunlight that is the best disinfectant for the problem of corruption. You referred to investigative reporters. The Russian press is very lively, and vigorous, and aggressive now.

The Russian Parliament, anybody can get up and say anything, including shaking his fist at the President of the country. The election process is ongoing. That is where the hope is.

The CHAIRMAN. Thank you, sir.

Senator Smith.

Senator SMITH. Thank you, Mr. Chairman.

Mr. Secretary, we welcome you to this committee.

I think it was Senator Biden, who said Russia is not ours to lose, and I agree with that. But U.S. tax dollars are ours to lose, and I suspect that we are losing them. And what I most want to know is when we are going to stop losing them. And I do not know that you have a date certain where you can tell us that.

But I—I am an author, along with Senator Sarbanes, of a letter to President Clinton asking him to be tough with the Congress in negotiations on the budget to try to increase the 150 account.

It is not a politically popular position to take in this body to be for foreign aid spending, but I know that the State Department, frankly, very much cares about our succeeding in increasing that budget beyond what the appropriators have allocated.

But I have to say if a further distribution goes out, I believe it is the end of September from the IMF to Russia—and the public

generally does not get the distinctions of these various columns of accounts.

And I believe that the State Department is playing with its own future when we see stories where money never gets to Russia, but just simply is funneled off in some corrupting scheme.

So I do not know whether—what Senator Sarbanes and I have done is wise or not, but I do want to say on the record that I think that the—the State Department's ability to get more out of this Congress depends on what happens in Russia.

I wonder if you have a comment on that.

Secretary TALBOTT. I do indeed. And my first comment is on behalf of Secretary Albright, very personally, I would like to thank you and Senator Sarbanes for your support for increasing the foreign affairs account of the budget.

And I think it is a very sound position indeed and one that can be argued from the standpoint of the national interest, which she has done on numerous occasions.

I also totally agree, Senator, with the proposition that we who bear responsibility, both for the formulation and the implementation of policy owe it to you and, through you, to the American people to provide accountability for the funds.

As we have discussed earlier in this hearing, with regard to the funds that have been used for macroeconomic stabilization, support of Russia in the past, there is no new money going to Russia under the current IMF program.

It is—the phrase that the Treasury uses is that it is involved in a lockup, which means that it is here in Washington to help with this refinancing.

Larry Summers, earlier this week, detailed additional protections that will be put in place to govern any future programs, with regard to what is actually under the—part of the function 150 account, and that is the FREEDOM Support Act.

I think that we can come up here and meet with you and your colleagues at any time and argue two points very convincingly: No. 1, that we have maintained the highest degree of accountability and protection for the money itself. And second, a lot of those programs are helping the Russians to deal with this problem.

Senator SMITH. Well, I just—I would say in an open mike to everybody at the State Department, I wish you could come with me to any town hall that I hold in Oregon, and you would find invariably that somebody mentions foreign aid as a waste of money.

I try to describe it as waging peace, not waging war, but I do say it is in the interest of the State Department, the 150 account to—to shepherd this money in a way that does not end up in the headlines we see in newspapers right now.

Let me—looking backward with the remaining time—perhaps one more question. I have a question about a Pavel Lazarenko, and wonder if before he was detained at—at the Kennedy Airport, he had met with President Clinton prior to that. He was detained for corruption. What did the administration know of his corruption?

I have a question about Anthony—Anatoliy Chubais. Did the—was he—is he corrupt? What has happened with him? What does the administration know of his dealings?

And finally what does the administration know about payoffs benefiting Boris Yeltsin and his family? I am specifically referring to credit card accounts provided to Yeltsin and his two daughters by a Swiss construction company, and I also wonder about a Yeltsin son-in-law, Leonid D'Yachenks and a—and an apparent money laundering scheme involving the Bank of New York, which has been documented recently in the Washington Post.

What does the administration know of these things and have we been complicit in any way in these things? I think the public really needs to know.

The CHAIRMAN. Right. The Chair is going to let the witness answer the question, but I warn at the outset not to start a question at—when the yellow light is on.

But go ahead and answer the question, because it is a good question.

Secretary TALBOTT. Thank you, Mr. Chairman. I hope you and Senator Smith will understand that I am really constrained from commenting on specific allegations, particularly about individuals, especially when their—the integrity and confidentiality of our own investigative processes are involved.

And for the second time in this hearing, I would ask that nobody infer from that any comment whatsoever on the individuals that you have mentioned.

Now, if—if I am—if I understood you correctly, the first gentleman you mentioned, Mr. Lazarenko, is a former prime minister—

Senator SMITH. Correct.

Secretary TALBOTT [continuing]. Of Ukraine.

Senator SMITH. Correct.

Secretary TALBOTT. Mr. Chubais has held various positions in the Russian Government.

Senator SMITH. Correct.

Secretary TALBOTT. A number of us, including the President in some cases, have had dealings with these gentlemen. I certainly met with Chubais numerous times in recent years in their official capacities.

And I can put it this way succinctly, we have been doing the Nation's business with them, which is to say developing U.S./Russian relations in a way that would serve the American—the American people. That goes for all of the ones that you mentioned.

That said, our investigative agencies and other agencies that are in the business of establishing facts, particularly where criminal law is concerned, do their work; and when their work produces something that either merits public attention or bears on the foreign policy of the United States, they tell us at the State Department. We react accordingly.

The CHAIRMAN. Good. Thank you.

Senator Wellstone.

Senator WELLSTONE. Thank you, Mr. Chairman.

First of all, Mr. Secretary, I am glad you are here. Welcome.

Second of all, on a personal note, I have said it to you before, you know, my father grew up in czarist Russia. His—he fled the Communists, never could go back. I think probably Stalin murdered his family.



And I think for personal reasons and, more importantly, for reasons having to do with our country, I think what happens in Russia will crucially affect the quality of our lives and our children and our grandchildren's lives, so I am in complete agreement with your focus on engagement and I think it is very short-sighted to be cutting the FREEDOM Support Act budget. I think it would be a big mistake.

I have two pointed—rather, two pointed questions for you. One of them, the New York Times—I do not think we have gone over this—just reading from the New York Times, September 8, first paragraph, “The Clinton Administration learned of the Federal investigation into allegations of Russian money laundering at the Bank of New York 5 months earlier than it previously acknowledged, senior Administration officials said today.”

Then they go on and say, “Then Treasury Secretary Robert Rubin”—this is not in the spirit of bashing. I just want to try to get an answer to the question—“and Deputy Treasury Secretary Larry Summers both knew about the investigation before our Government approved a \$640 million installment of loans to Russia in July.”

And my question is: Are—are you concerned that—that the administration may have concealed what it knew about the investigation? Could this have been—

Secretary TALBOTT. May I—I'm sorry. Just—

Senator WELLSTONE. Are you concerned that the administration may have concealed what it knew about the investigation? Could this have been done to avoid having to answer questions about approving the loan without considering money laundering as an issue? And should not money laundering at least have been a consideration in deciding whether or not to approve the loan?

Secretary TALBOTT. I understand your question.

I believe, on the basis of some knowledge of the facts here, that the administration—and that means both the State Department and the Treasury Department—handled this very delicate matter absolutely appropriately.

Senator WELLSTONE. Yes.

Secretary TALBOTT. As so often is the case in government, one has to strike a balance between various considerations, and objectives and principles.

There is a very important principle operating in our Government, which is the sanctity of the grand jury process. And whenever information is at play, as it were, in an ongoing judicial process of that kind, all officials who know about it are very constrained in what they can do about it.

Now, the facts here were the following: It is true that—that what I would call the upper middle levels of the State Department, somebody did find out about the fact that there was a judicial inquiry or a criminal inquiry elsewhere in the United States having to do with the Bank of New York.

That individual and the State Department did exactly what the book requires. They made sure that the Justice Department was aware of this.

And the procedure here is that the Justice Department will then brief the State Department at an appropriate level when the facts

and the case are developed to the point where they are felt to have some kind of foreign policy relevance. And that happened in August, and I was part of that briefing.

So the—we originally—we, the Department, originally found out about the Bank of New York case in the spring. It was briefed to me, Ambassador Sestanovich and some others, a few weeks ago in August.

Now, how would this have affected our posture with regard to money laundering? First of all, we were already pushing, as we felt effective and appropriate, our Russian partners and colleagues to put in place a money laundering law.

In fact, that is one of the themes that Vice President Gore had been developing in his work with Prime Minister Chernomyrdin. And, in fact, the Duma did pass a money laundering law, and the Yeltsin administration vetoed it. We were critical of that decision.

Senator WELLSTONE. Mr. Secretary, what I was really asking was how it—how it affected our posture vis-a-vis the granting of the loan, knowing about this. Should it not have been more of a consideration?

Secretary TALBOTT. The loan you referred to—the loan that would have been in the timeframe here would have been the loan in July, the IMF loan in July, which is covered by this—this lock-out provision that I referred to earlier—lockup, excuse me. Lockout is something else. That is, protecting the money so that it remains in a closed circuit within the IMF.

So I—you would have to ask Treasury. Secretary Summers did address this case in some detail earlier in the week, but my impression is that it would not have had any effect on that.

Senator WELLSTONE. OK. Thank you.

Secretary TALBOTT. But what it does underscore is the need for us to keep pressing, and I hope the issue will come up when you meet later with the Russian Parliamentarians, the importance of Russia having a money laundering law.

Senator WELLSTONE. Yes, absolutely.

The CHAIRMAN. Mr. Secretary, it was nice of you to come up, and you are an old hand at this. I think you kind of enjoy sparring with Senators.

Bear in mind that a lot of Senators are absent today who would be here if they were not tied up on appropriations conference reports and that sort of thing.

But we thank you for being here, but I hope it is not too much to ask that I allow Senators who are not here, and Senators who are here, to file additional written questions with you, and you would expedite your answers to us. Would you do that?

Secretary TALBOTT. I will.

A question—could I say, Mr. Chairman, in addition to thanking you for the chance to be up here that I know several of the individuals on the next panel.

I have profited from my association with them. In Bob Legvold's case, as a long-time mentor of mine; and in the others, as—as colleagues. And I will study very closely the proceedings that are about to follow.

The CHAIRMAN. Very good. I do not like for the second panel to be postscripts. And these are, as you say, very talented, interesting individuals.

Thank you, sir, for coming. And thank you for bringing Mrs. Talbott with you.

Secretary TALBOTT. Thank you, Mr. Chairman.

The CHAIRMAN. The second panel will assume their positions.

Let me say at the outset that the committee thanks you so sincerely for being here this afternoon.

As I said, I am trying to get away from this thing where distinguished witnesses, like yourselves, amount to postscripts and I want the media to hear you, too.

So that is the reason I was sort of expediting and if I might suggest we are going to print in the record your entire remarks. And to the extent that you feel inclined to do so, let us move it along so we could have some back and forth with the members of the committee.

Mr. Ermarth, you may begin.

**STATEMENT OF FRITZ W. ERMARTH, FORMER CIA AND NSC OFFICIAL**

Mr. ERMARTH. Thank you, Mr. Chairman. I am deeply grateful to you, sir, and to the committee for this opportunity to speak on an agenda so important to our Nation and to—to Russia.

You have my written testimony. I will confine my remarks to a handful of short but, I think, very important points—

The CHAIRMAN. Very well.

Mr. ERMARTH [continuing]. Which I think represent a foundation of the critique of people like me and others who have been critical of our administration.

It is true, first, the roots of Russian crime and corruption go way back in—in Soviet—in the Soviet past. This applies especially to the lack of the rule of law. It is particularly important to understand that the plundering and capital flight we have been talking about, characteristic of today's Russian economy, were really initiated by the Communist leadership and the KGB back in the late eighties. That is where the short gentleman standing with Mr. Clinton—with President Clinton got his start.

That is not, however, an excuse for wrong-headed policies on the part of Russia subsequent to the collapse of communism or on our part.

Second, what we have called economic reform in Russia has not created market economy or capitalism as most hoped. Rather, it—it created what I would call crony capitalism, without capitalism.

Insider privatization in alliance with corrupt officialdom has produced a system dominated by a very few powerful individuals and entities who strip wealth out of the country, and send it abroad, rather than investing to create wealth and prosperity at home.

The result has been impoverishment and profound instability. And now a battle royale is going on among the stakeholders in this system for the control of the Kremlin and the Presidential succession.

So what we are talking about is more authorized crime than organized crime—official crime than organized crime.

But organized crime is there. And it interacts with this plundering system as both a beneficiary and as a facilitator, through such activities as protection racketeering and money laundering.

Now, these realities have been completely visible from the start, although the administration has not been saying so until in the last few weeks. They have been amply reported by a host of Russian and Western observers.

No failings of American intelligence can be blamed for any failure to see these realities. There were some failings, and they need to be corrected.

The historic failing of American policy, however, in this period was that it gave support too uncritically for too long to this phony crony capitalism in Russia. It did so rhetorically, politically and financially, chiefly through the IMF.

The result has been that prospects for true economic reform in Russia have been made in many ways more difficult than they were initially. And worst of all, we have lost much respect and admiration among the Russian people, as have the very ideas of democracy and capitalism.

This in no way ignores what has been achieved under the Nunn-Lugar program, for example. But I believe Secretary Talbott misrepresented that balance sheet somewhat. And I would be happy to respond to questions on that, if you wish.

The problem with the IMF has been more perversion of funds—perversion of funds than diversion of funds. Rather than encouraging the stabilization and growth of the Russian economy, it has served to legitimize the extraction of wealth, the plundering.

But there does seem to have been something that sure looks like diversion to me in the summer of 1998. And that is what Prosecutor General Skuratov was talking about.

Now, why the administration pursued the policies it did for so long in the face of these realities is still not entirely clear, because its belated explanations I do not find terribly persuasive.

There were alternative strategies and tactics for reform available to the Russian regime, which we could have supported more honestly and effectively.

That our national security objectives required us to support the— the Yeltsin regime and its policies so uncritically is hardly persuasive, because our security interests in Russia are arguably in worse shape now and face a more problematic future than the very positive and very optimistic atmosphere that existed in 1992 and 1993.

The influx of vast sums of Russian money into our economy during this period, probably amounting to hundreds of billions of dollars, poses serious questions for law enforcement, for banking regulation and so forth.

Now, whether that money was stolen by crime or just by corrupt businesses, laundered or just deposited, it inevitably created American stakeholders in the process that brought it—brought it here.

Whether such American stakeholding in this phony crony capitalism and the capital flight it produced exerted an influence on U.S. policies that helps explain the otherwise not easily explainable, and thereby abetted the process, is a valid question for this committee.

Finally, Russia is not lost. It is stuck. It is stuck in a swamp between a Soviet past and alternative future possibilities, which range from the bright and friendly to the dismal and threatening, from our point of view and from their point of view.

Our task here is to assay the past, reassess our policies, and get ready for the possibility that a window of real reform in Russia will reopen if and after they get through their impending elections.

At the very least, we must quit repeating past errors. There are better paths available to the Russians and for our policy.

If this committee can illuminate them, I—as I understand it intends to do in future hearings, Russia and America will both be grateful to you.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, sir.

[The prepared statement of Mr. Ermarth follows:]

PREPARED STATEMENT OF FRITZ W. ERMARTH<sup>1</sup>

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

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

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

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

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

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

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

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

<sup>1</sup>This prepared testimony is a significantly amended version of that provided by the author to the hearing of the House Committee on Banking and Financial Services on 21 September.

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

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

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

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

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

One of the sad consequences of US policy, so persistent in the face of reality that one has to suspect intent, was that IMF lending, while ostensibly aiming to stabilize the economy and encourage investment, actually lubricated and legitimized this process of stripping and expatriation of wealth. It was more perversion than diversion of IMF money. This perversion of the IMF into a cover for Russian kleptocracy was hugely injurious to Russia and to our interests. It raises questions as to whether the IMF should be the central institution for financial aid to the transition economies in Russia and the rest of the former Soviet Union.

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

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

Why have American policymakers bought into this plundering system so uncritically? Perhaps we shall have to await their departure from office for candid answers to this question. To date, their explanations have been most unsatisfactory. They claim to have known about Russian crime and corruption all along. This is true; but then why the persistent support for and misrepresentation of this system?

They claim that they have always known the development of Russian democracy and capitalism would take a long time. This is also true; but then why support a system that in many ways makes successful development of Russian democracy and capitalism even more difficult than it was at the beginning? They claim they had no better alternatives. This is NOT true; they had the alternative of honesty about what was happening. And the Russia regime had alternatives to what they did—among others, the democratic opposition was offering them—and they were open to Western recommendations because they needed Western money. Finally, the defenders of American policy claim that we had to give the Yeltsin regime the support we did because your security interests on such matters as arms control, proliferation, and the Balkans demanded the support of that regime. Yet our security relations with Russia are in worse shape today than they were at the beginning of the current administration. And worst of all, we have lost the respect and admiration of much of the Russian people.

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

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

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

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

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

The CHAIRMAN. Mr. Moody.

**STATEMENT OF JIM E. MOODY, FORMER DEPUTY ASSISTANT DIRECTOR, CRIMINAL INVESTIGATIVE DIVISION, FEDERAL BUREAU OF INVESTIGATION; AND FOUNDER OF JIM MOODY AND ASSOCIATES, L.L.C.**

Mr. MOODY. Thank you very much, Mr. Chairman. I would like to thank you and the committee for having me here.

The CHAIRMAN. It is our pleasure. Thank you.

Mr. MOODY. As for my statement, I will be pleased that you will accept that. I will even cut down the one I have just to make sure that everybody gets a lot more time.

I am not a Russian scholar. I am a law enforcement practitioner, retired. But I started dealing with the Russians in October 1990; and from day one I found out that corruption was one of the major problems that they were facing, corruption and organized crime.

I will give you an example. During one of my trips, in the early morning hours—and it must have been 3 or 4 o'clock in the morning—a high ranking Russian official brought seven officers in to meet me, so we could talk a little bit, and he wanted me to meet people in Russia that were not corrupt.

On another trip, I met a high-ranking officer and he estimated that 90 percent of his officers were corrupt, which is a monumental problem to address.

But almost always when they talk about corruption over there, they say the court system is worse, and based upon—

The CHAIRMAN. Pull the mike a little closer.

Mr. MOODY. OK. And based upon their system, it is very possible that the court system is worse, because their system is similar to Napoleonic code where you only have to bribe, threaten, or intimidate one individual and it will stop a case.

When—whenever you start looking at this and start establishing a relationship with them, I think there is a number of steps that has been taken that have been very positive.

One is the PDD42, addressing international organized crime. Another one is the FBI office in Moscow, which is the point for coordinating of investigations.

A third one was the relationship that the G-8 countries have gotten together and started addressing law enforcement issues, the fact that law enforcement issues are now an agenda item on diplomatic meetings, the fact that the financial action task force is taking a lead on addressing money laundering internationally, and the money that has been allocated by Congress for training, including FBI training, other agencies' training in the former Soviet Union and the establishment of the International Law Enforcement Academy in Budapest.

I also believe that the fact that Congress amended some of the legislation that—that allows the intelligence communities to produce assistance to United States law enforcement agencies is very important.

Now, there were—when you start looking at the problem as you sit now, Senator Kerry aptly described what happened a few years ago, but I would say today that has been raised to a little bit higher plane, in that you have not just strictly the former black marketeers involved. You have high-level party and government officials that are literally plundering the country.

So what is the long-term effect to us here in the United States? You—you—you always worry about Russia reverting back to what it was. I do not think that will ever occur.

But what we will see in the United States—we will continue to see significant criminal activity carried out by individuals, both



here in the United States and ordering illegal activity in the United States from without the United States.

And these will all be addressed. Items like the Bank of New York is on—is—is in the press today. And probably what we will find out about that is the vast majority of that money will never be proven to be money laundering.

That is a very visible thing that you can see that is a threat. But to me, that is not the biggest threat facing us today.

The biggest threat facing us today in the United States is the literal billions of dollars that these people have generated that they are going to start investing.

And the best place in the world to invest right now is the United States, so they are going to be purchasing companies. They are going to be establishing companies, or they are going to be investing in our stock market to have a tremendous economic effect upon us.

Now, I am an experienced organized crime investigator, and I have never found anybody who was a criminal who gained his money as a criminal that did not run a business illegally once they get control of it.

The long-term effect of what we are facing is monumental, and I do not know how bad it is going to be. Now, that to me is—is the biggest problem that we are facing.

There is going to be a tremendous appearance of legitimacy and a tremendous amount of back-door illegal activity that is going to be very, very, very difficult to root out.

I do believe, though, that we should continue to build the infrastructure with the Russian authorities. I think that is very, very important for us for the long-term future to address this problem.

And I—again, I would like to thank you very much for inviting me.

The CHAIRMAN. Well, we certainly thank you, sir. And you can expect some questions and discussion—but I agree with you.

[The prepared statement of Mr. Moody follows:]

PREPARED STATEMENT OF JIM E. MOODY

I would like to thank the Chairman and the United States Senate's Committee on Foreign Relations for inviting me to appear before you on the issue of "Russian Corruption and Recent U.S. Policy."

As background, I am not a scholar on the Soviet Union, Communism or foreign intelligence operations. I am a law enforcement practitioner with extensive knowledge of organized criminal activities, methods, modus operandi, strengths, weaknesses and the development of criminal intelligence. With regard to the former Soviet Union, other than training to do battle with their military forces and preparing defense plans during the Vietnam era, my first association with the Russians occurred in October 1990.

FIRST MEETING WITH RUSSIAN AUTHORITIES

As an explanation, I managed the FBI's Organized Crime Program from September 1988 until I retired in June 1996. The investigation of both local and worldwide organized crime groups, including those involved in drug trafficking, was my responsibility. In October 1990 I attended a United Nations sponsored conference in Russia hosted by the Ministry of the Interior or MVD. At this conference I met and discussed organized crime issues with law enforcement officers, practitioners and scholars from around the world. I also met with the Interior Ministers or their Deputies from all the Soviet Republics. In addition, I had sidebar meetings with Russia's Komitet Gosudarstvennoi Bezopasnosti (KGB) and others interested in organized crime.

As a result of these meetings I brought back to the United States a belief that great changes were occurring in the Soviet Union. Also, I became aware of the fact that the Russian authorities had an organized crime problem that was a threat to their national security. They also had significant corruption problems along with inadequate laws, which were generally accepted and supported by civil society. Their lack of understanding and/or knowledge regarding how to address the organized crime problem was another great concern.

#### PREPARING TO MEET THE CHALLENGE

Based upon the worry that we were not adequately prepared and with the concurrence of the FBI Director, I ordered a survey of the approximately 63,000 ongoing FBI criminal investigations. The goal of the survey was to learn what criminal cases we had involving Russia or Russians. I believe we found 68 investigations at that time that met those criteria. However, what struck me about these cases was not only the fact that they crossed all the FBI's criminal program lines, but that they were complex investigations with significant violence and money involved.

Based upon this survey, in June 1991 the FBI established Russian Organized Crime as a subprogram of our overall Organized Crime Program. Identifying Russian Organized Crime in this manner allowed FBI offices, for the first time, to investigate these criminal groups. Subsequently, in October 1991, based upon my presentation, the Attorney General and her Organized Crime Council established Russian Organized Crime as an investigative/prosecutive priority for Federal Law Enforcement.

Due to manpower restrictions, the FBI prioritized the criminal groups and criminals on which we can focus our investigations based upon their threat to America or United States citizens. Our priorities after designating Russian Organized Crime a subprogram, not in priority order, were as follows:

- American La Cosa Nostra
- Italian Organized Crime—(Sicilian Mafia, Comorra, N'drangheta, Sacred Crown)
- Colombian and South American Organizations
- Mexican Drug Trafficking Organizations
- Asian Criminal Enterprises—(Major groups include Japanese Boryokudan, Chinese Triads and Chinese Drug Trafficking Organizations, Korean, Vietnamese and Filipino Criminal Enterprises)
- Criminal Syndicates—(Major criminal groups, primarily involved in drug trafficking, such as the Jamaican Drug Trafficking Organizations and the Nigerian Criminal Enterprises)
- European/Eastern European Organized Crime—(Commonly called Russian Organized Crime)
- Gangs—(Examples would be the Crips and Bloods Street Gangs, Black Gangster Disciples, Outlaw Motorcycle Gangs, and others who may be regionally or locally prominent or extremely violent)

It should be noted that six of the eight above listed groups are headquartered outside of the United States. These groups supply the two indigenous groups. It is because of these threats to the United States that the FBI is attempting to place itself in a better position to address the problem by expanding its offices in our Embassies overseas.

#### WE HAVE THE TOOLS AND KNOWLEDGE

Being an Organized Crime specialist I fully support the FBI's definition of the organized crime phenomenon. The FBI defines Organized Crime as a "continuing criminal conspiracy having an organizational structure, fed by fear and corruption, and motivated by greed." The purpose of Organized Crime is to generate profits. Profits provide power. Corruption is a vital tool of Organized Crime. I believe you cannot have Organized Crime without corruption. This corruption can take many forms and can range from a telephone repairman installing call forwarding services for a small apartment with ten telephone lines, knowing he is supporting an illegal gambling operation to Government officials using their positions to support illegal activities.

Once you have organized criminal activity entrenched in a society, it is very difficult to eradicate. I do not believe it is possible to destroy organized crime using autocratic methods. Benito Mussolini tried to do that in Italy. He failed.

I do believe that you can destroy organized crime structures using the "rule of law" and gaining the support of society. Fortunately, the United States has anti-organized crime legislation that will support this. However, technology is overtaking the basis of some of these laws, requiring some modifications.

Even with the legislation, there are a number of problems and obstacles that must be overcome before addressing organized crime or major conspiracies. One of the major problems is identifying the problem. As explanation, a friend of mine liked to describe the problem of detecting who or what is Organized Crime by using the analogy he took from a Sherlock Holmes mystery. To paraphrase, Dr. Watson once asked Sherlock Holmes, "Who is the most dangerous criminal in England?" Holmes responded, "Dr. Morarity." Dr. Watson's replied, "Dr. Morarity? I never heard of him." To which Holmes replied, "That's why he is the most dangerous." "Who" is very important for successful Organized Crime investigations.

With regard to Russian Organized Crime and Russian crime in general, the "Who" continues to be a pressing problem for US law enforcement. I learned from my first interaction with Russian authorities that they had an endemic corruption problem. In fact, you could easily observe corruption, though on a small scale, when I was first there. I also met Russians that wanted to do something about the problems facing their society.

#### RUSSIA'S LAW ENFORCEMENT SHORTCOMINGS

However, events often overtook good intentions. As the former Soviet Union dissolved, Russia and the Newly Independent States did not have an infrastructure of regulatory agencies such as the United States' version of the Federal Deposit Insurance Corporation or the Securities and Exchange Commission to regulate newly emerging capitalistic industries. In addition, many internationally recognized criminal laws were nonexistent or sorely lacking. I would describe their criminal code shown to me as consisting of a 6" x 9" pamphlet approximately 1/8" thick.

Then as now, the recognized law enforcement authorities were lacking in training and equipment. In addition, the police were underpaid, underprivileged, understaffed, overly bureaucratic and were not supported by government mechanisms for ensuring democratic law enforcement. Also, like most other governmental agencies in the former Soviet Union, the police had a significant corruption problem, as did the judicial system. One ranking officer confided to me that he believed that over 90% of his officers were corrupt.

Because of the rapid collapse of the Soviet system, the lack of regulatory institutions, corruption of authorities and institutions, and virtually no criminal legislation, organized criminal groups suddenly became the only functional organizations providing goods and services. They controlled the black market. The black market became the Russian version of free enterprise and it fed and clothed Russia. This led to big problems. The black market was run by criminals who were positioned to gain vast amounts of wealth and influence, expand their operations, recruit new members—including government officials—further corrupt the system and even challenge the emerging democratic institutions and governments as well as entrepreneurial capitalistic efforts. These groups became an even more important element of Russia and became entrenched in their society just as the Cosa Nostra did in the United States.

In the last few years, organized criminal activities increasingly have had a debilitating effect on Russia's move towards a capitalist society. The lack of adequate criminal laws, a fair and impartial civil court and tax system and corruption have also harmed Russia's budding entrepreneurs. Most small to mid-sized Russian companies have been required to operate in a system unlike any other. Security is one of the biggest non-income producing items in many Russian company's budget. They often pay up to 30% of their budget for security, most often to an Organized Crime Group. Due to corruption, another equally high expense is lobbying. A peculiar feature of doing business in today's Russia is that the two expenses are almost always interconnected and interdependent. This is a lot of overhead to pay in order to be allowed to operate a company securely.

#### POLITICAL CORRUPTION THE MAJOR PROBLEM

However, organized criminal groups preying on Russia and its businesses are but one problem facing the country. A larger problem is the government and former party officials that have also used the opportunities available to them to enrich themselves and their associates. Corruption has flourished; promises of a rapid transition to a democratic society based upon capitalism have been sidetracked. Full privatization of government-owned industries and land has not occurred. When industries were privatized, only insiders have benefited.

Once again, the FBI's definition of Organized Crime is a "continuing criminal conspiracy having an organizational structure, fed by fear and corruption, and motivated by greed."

## EFFECT UPON THE UNITED STATES

At the same time, the easing of travel restrictions has enabled many Russians to come to the United States. The number of United States visitors' visas issued for Russians had at one time increased by more than forty times. Successful criminals are greedy; they want to increase their profits, safely. Since the United States is the richest country in the world and their assets are safe here, we have hosted many organized crime members and corrupt officials. We have also received their money. We still do. *However, we have to recognize that the money we receive, though probably generated using methods deemed illegal in the United States, is not necessarily illegally generated in Russia.*

Organized crime groups attempt to legitimize their affairs and profits by influencing or controlling businesses. Violence, intimidation and use of illegally generated money are their tools for taking over businesses. Once established in legitimate businesses, however, criminal organizations are not content to play by the rules as their legitimate business competitors do; they will illegally manipulate the affairs of the legitimate businesses they control in an attempt to monopolize the industry or business in question. Legitimate businesses are a prime target for exploitation or infiltration by organized crime. You can rest assured that US-based businesses are being established or being purchased using money from Russia. The long-term effects of these investments remain to be seen.

I do not believe that there is a society free of corruption. Law enforcement must work within the confines of the "rule of law" to address corruption, one of the foundations of organized crime. We must use the "rule of law" as a weapon. Fortunately, the FBI has been successful in doing this in the past. I believe they will continue to be successful in the future.

## PREVIOUS FBI SUCCESS USING THE "RULE OF LAW"

In the early 1980s we learned how successful international organized crime investigations could be using the "rule of law" while investigating Italian Criminal Enterprises.

Sicilian Mafia members were operating in the United States and internationally but were headquartered in Sicily. At that time we knew that there was a significant amount of corruption in Italy.

We were able to identify Italian law enforcement officers and prosecutors who we believed we could trust and cooperate with to jointly address the crime problem in our countries. At that time, however, Italy's laws were based upon the Napoleonic Code. These laws did not allow undercover operations, court-ordered electronic surveillances or adequate plea-bargaining. They had no Witness Security Program and criminal conspiracies could not be adequately surveilled to develop evidence against those directing others to commit crimes. These authorities are absolutely necessary to successfully address organized crime. Despite these obstacles, we were successful with developing sufficient evidence to support the Pizza Connection prosecution in the United States and the Maxi-trial in Italy.

Based upon this success, we established the Italian-American Working Group. Although organized crime members have murdered some of the original Italian members of this Working Group, the Working Group continues to function today.

Through our cooperation, Italian law enforcement officials were able to observe how the FBI conducted Criminal Enterprise Investigations, within the "rule of law." Based upon these successes and lobbying by Italian law enforcement, Italy changed its laws to somewhat mirror United States' anti-organized crime legislation. Actually, their laws now give more legal authority to law enforcement agencies than ours do.

The FBI uses lessons learned jointly with Italian authorities as the "Italian Model" to follow in their efforts internationally. This genuine give and take, finding ways to support each other and working within the applicable "rule of law" is the "Italian Model" being used as an outreach program to other law enforcement agencies internationally and with Russian authorities. Successes have been achieved. Much remains to be done.

## FBI RELATIONSHIP WITH THE MVD

After overcoming some significant administrative and bureaucratic obstacles within the FBI, I was able to establish a working relationship with the Russian MVD beginning in February 1993. At that time, Mikhail Yegorov, Russia's First Deputy Minister of Interior newly designated to head their anti-organized crime effort, and I met for one week at FBI Headquarters.

At the end of our meeting, the FBI and MVD agreed to cooperate on organized crime issues. From that moment, the MVD helped the FBI identify the "who" described above as being so important in organized crime cases. They saved us untold investigative man-hours. In addition, the MVD was instrumental in returning FBI fugitives to the United States for prosecution. They assisted us in this manner even though we had no Mutual Legal Assistance Treaty or Extradition Treaty.

We established a Working Group consisting of the MVD, the German Bundeskriminalamt (BKA) and the FBI. The BKA's involvement was vital because Germany experiences organized criminal problems coming from Eastern Europe a short time before we do in the United States. In addition, the criminals often operate in all three countries. This Working Group continues to meet regularly to share criminal intelligence and coordinate investigations.

Investigations coming from this Working Group have been successful. Some of the investigations have targeted high-level Russian government officials requiring the MVD officers to conduct their portion of the investigation while under death threats. Some of these officers have indeed been physically harmed. The group of officers we worked with in Russia has been described by one new magazine as the "Untouchables."

Due to new Russian legislation and Presidential Decrees, the KGB was reorganized and split into different sections and given new responsibilities. At this time, the FBI is also working jointly with the Federal'naya Sluzhba Bezopasnosti or, translated, the Federal Security Service (FSB). This organization is the descendant of the former 2nd Directorate of the KGB and has been given law enforcement responsibilities.

Also, after some effort, we were allowed to post an FBI Legal Attache's office in our Embassy in Moscow. This office allows our Agents to build relationships with Russian law enforcement and is the focal point for coordination of criminal investigations conducted jointly.

#### US GOVERNMENT RESPONSE TO INTERNATIONAL ORGANIZED CRIME

I believe that the United States Government has taken some significant steps to address international crime including organized crime. Because of these steps, the United States is in a much better position to address the criminal problems we see today. In addition, the future may bring even more success.

I will name a few of these positive steps that I believe have been helpful and will be to future successes. In October 1995, President Clinton signed a Presidential Decision Directive (PDD) regarding international organized crime. He also made a speech before the United Nations identifying the problem and requesting that organization and its member states to address the problem. Additionally, the PDD caused a better coordination of efforts by all government agencies.

Through the Great 8 conferences, international crime and specifically international organized crime has been an agenda item resulting in the Great 8 countries agreeing to encourage other countries to act forcefully to address the problem. They also agreed to enact legislation and set up procedures themselves that will have a significant, long-term, positive impact on the crime problem. Also, the Financial Action Task Force, which is composed of several countries, has supported initiatives that have been and will continue to be of assistance in the law enforcement effort. Our Treasury Department is the lead United State agency in this effort.

Also, Congress has authorized funding for FBI training of Eastern European law enforcement as well as the establishment of the International Law Enforcement Academy in Budapest managed by the FBI jointly with Hungarian authorities. In this manner, the FBI has trained hundreds of Eastern European officers. Some of this training has been specialized. For instance, I know that the FBI held specialized corruption training for Russian investigators and prosecutors at their Academy in Quantico. It is my understanding that other Academies modeled after the FBI Academy are planned.

In short, these initiatives are attempting to work with countries and law enforcement agencies throughout the world to enact laws and address international crime and organized crime in a coordinated manner. These efforts are the first steps in a long-term process. Corruption is but one of the targets of these efforts. However, it should be remembered that it is not illegal in many leading countries to pay foreign government officials. Also, some countries allow their businesses to deduct bribe payments as a business expense, just as other countries expect to pay bribes to conduct business.

I believe that Russia must enact adequate criminal laws. Several times proposed legislation have been processed through the Russian Duma and Federation Council and forwarded for President Yeltsin's signature. Each time the legislation has been returned, unsigned.

If President Yeltsin or his successor eventually approves the proposed legislation that I last reviewed as requested by the Federation Council, Russia will have one of the strongest anti-organized crime legal authorities in the world. As I set forth above, I believe it is vital to have the necessary legal authority to address organized criminal activity within the "rule of law."

Concurrently, the Russian Courts must be strengthened and corrupt officials removed. The same is true for the law enforcement agencies. If there is adequate legal authority and the courts and law enforcement authorities can get corruption within their ranks under control and they do not acquiesce to self-serving and possibly illegal political pressures, I believe that we will see a sea change in Russia. Russian citizens will be able to trust their government institutions, depend upon justice being applied equally and the forces of democracy and business will greatly improve their standard of living.

There are Russian authorities that want to improve their system. They want to root out corruption and lawlessness. They want to develop a democratic society based upon capitalism with a Russian tilt. We should be prepared to support their efforts, while understanding that they will not totally follow the American example. However, we can provide them our expertise and experience while they make the transition through these difficult times.

I would like to thank Chairman Helms and the Senate Committee on Foreign Relations for inviting me today. I would be pleased to provide any additional insight that I may have.

The CHAIRMAN. Mr. Merry.

**STATEMENT OF E. WAYNE MERRY, FORMER STATE DEPARTMENT OFFICIAL; AND DIRECTOR, PROGRAM ON EUROPEAN SOCIETIES IN TRANSITION, ATLANTIC COUNCIL OF THE UNITED STATES**

Mr. MERRY. Thank you, sir.

We have disposed of the "Who lost Russia" question here today as meaningless, which it is. But the "Who robbed Russia" question is very real, and it is going to stay with us.

There is also the question what impact there has been on our own national interest from the failure of economic reform in Russia.

The robbing of Russia has been pretty much a global activity, with lots of non-Russian hands. This is how Baltic states became exporters of commodities they did not produce; how Switzerland, Singapore and Caribbean countries became centers of Russian finance. It is how Russians have transformed the real estate market of Southern Europe. And it is why thousands of automatic teller machines in posh parts of Manhattan are all programmed in the Russian language.

I suspect much of the money is already in non-Russian hands. Past lootings of other countries like Nigeria, Zaire, the Philippines, and so forth, all enriched the West. And I see no reason why Russia is going to be any different.

We Americans have certainly played our part and quite knowingly provided a warm welcome for many tens of billions of dollars that were strip-mined from Russian public properties. And I think we should be very cynical when we hear bankers claim to be "shocked, shocked" that money laundering was going on.

But we are also complicit through our Government's role in determining what economic path Russia was going to take. Russia is certainly responsible for itself for good or ill, and Russians pretty much are always their own worst enemies.

But the Russia that emerged from the collapsing Soviet Union was very dependent on the United States, both financially and psychologically. It received a very great deal of money and advice from this country. And I think our authorities are responsible not just for the dollars, but for the policies as well.

Our Government—and this applies to both the previous and the current administrations—made our assistance conditional on the adoption of what is sometimes called the “Washington consensus” of monetarist mechanisms known as shock therapy. In Russia, these policies were catastrophically wrong. Russia was very much like a very sick middle-aged man seeking medical advice after decades of chronic bad habits. Unfortunately, he consulted a team of surgeons at the U.S. Treasury and at the IMF, who prescribed radical surgery, because that is all they knew how to prescribe. Unfortunately, the Pennsylvania Avenue surgical team never bothered to take this patient's medical history nor to evaluate his capacity to survive surgery. When the Russian patient's vital signs began to fail on the operating table, the surgeons just resorted to more and deeper surgery, until his family members finally called a halt.

The very worst feature of this monetarist-malpractice case is that alternative therapies were never even considered, nor were suggestions that this patient would be better served by less radical, less intrusive or longer-term care. The patient was less important than the doctrine. We forgot the maxim, “First do no harm.”

Most Russians of the reformist stripe did not favor our economic prescription. They felt that shock therapy was just wrong for their country, that it was too much of a challenge and was insufficiently concerned with vulnerable members of the society. They were interested in other models and looking for a right mixture for their own needs, their own traditions, and their own national limitations.

But the United States absolutely insisted on radical market reform and used our dominance of the international financial institutions to force-feed it on Russia. In the process we allied ourselves with some of the most ruthless, undemocratic and rapacious people in the country, people who are so shameless they actually refer to themselves as “The Oligarchs.”

Now, these robber-barons and their political allies care very little for the well-being of average Russian people. And their attitude toward electoral democracy is one of undisguised contempt. These people have made the name of free enterprise stink in Russia as decades of Soviet propaganda never could.

However, I think the most egregious of American policy errors and one that is almost incomprehensible, given our own national history, is the confident assumption of the Washington consensus that a viable legal system would appear in Russia automatically and as a matter of course after the application of market shock therapy.

This is certainly a case of putting the cart before the horse. Our policy quite literally gave precedence in our Russia policy to the concept that “greed is good” over the concept of “due process of

law.” In the process, we created incentives for the very public theft and capital flight that we now deplore.

Unfortunately, legal reform was the single field where we as a country could have made the best and most enduring contribution to the Russian transition. A few years ago, I can tell you, most Russians saw America as the best model for a successful constitutional system and law-based state. Unfortunately, our Government’s priorities were elsewhere. A number of Americans, mostly in private institutions, have worked with Russian counterparts on legal reform and I salute them. But they never received much more than lip service from their own Government. You only have to look at the tangible record of the programs and at the low priority given to rule of law at summit meetings and other high-level meetings. It is very easy in Washington to identify who in our Government is responsible for cooperation with Russia in energy, space flight, privatization, Bosnia, and other things. But who in our Government has Russian rule of law as a top priority? I put it to you: No one.

American businessmen in Russia are constantly pointing to the need for legal reform, because they know that law and not money is the true basis of market capitalism. Russia can choose any kind of different economic model, but any one is going to require a bedrock of law in order to succeed. I believe the old Soviet system ultimately failed because it was based on arbitrary and unaccountable power, rather than on law. And the crony capitalism which we helped to create and rationalize as a mere blemish on the road to the Promised Land, has failed because it is lawless. Now, the rule of law did not develop automatically or by accident in this country, and it is not going to in Russia.

It has been asked recently “What did our policymakers know about corruption in Russia, and when did they know it?” I can only say that anyone involved with Russia, whether in the Government or on the street, knew about it all along. It was never any secret. Even if the U.S. Embassy and the CIA had never written a word on the subject, the Western press covered the story; and the Russian media has reported on corruption constantly. Indeed, an entire series of reporters have been killed for their efforts in this area. Anyone who wanted to know knew. The real questions are: What did our policymakers care about this issue, and what did they do about it? I put to you that the record of neglect on legal reform in our policy will give you the answer.

Mr. Chairman, we have been told by our authorities that there was really no alternative to the shock therapy policy and to support for the crony capitalists, that these policies were vital to shore up pro-Western forces in Russia, to forestall a Communist return to power, to assure responsible behavior by a nuclear armed country and to protect American influence and interest.

I ask you not to believe it. The Russian oligarchs are not pro-Western. They are pro-self. Most true Westernizers in Russia today are alienated from their own government and its policies; and they are alienated from the United States.

Eight years ago, our reputation and prestige as a society in Russia were supreme. Today, even the young in Russia see America as unprincipled and cynical. Russian democrats condemned their gov-



ernment's war against the people of Chechnya. Our authorities condoned it.

Russia's Communists are a fading political force, and the strength they retain comes from an understandable popular anger at the enrichment of an odious handful and the impoverishment of working people. If such policies were carried out in this country, you might see red banners on our streets.

The Russian military maintains the stewardship of its nuclear arsenal for their country's benefit and not for any convenience of ours. Our cooperation in reducing nuclear arsenals, and not just theirs, but both of our nuclear arsenals in tandem, in parallel, is a mutual interest. And if anything, this process has been slowed down, delayed by shock therapy and the consequent collapse of the military industrial sector in Russia.

And to imply, finally, that we must accommodate systemic corruption in order to maintain influence is the eternal rationale of short-term expediency. We were given the same rationale in other places, from Iran under the Shah, Zaire under Mobuto, to Indonesia under Suharto. And we have seen the price of such short-term expediency.

Mr. Chairman, I certainly do not equate Russia and Boris Yeltsin with the cases I just cited. Unfortunately, I think that our Government, for practical policy purposes, does. And I think this is unworthy of both of our countries. Russia is certainly one of the great countries of the world and it will be important for our interests in the century ahead.

Russia is also a very resilient society, but we should not expect its people to show endless patience with failed policies. They have a right to organize their national household as they see fit, even if it does not equate with current American fashion and doctrine.

Disengagement from Russia is certainly not an option. I would hope that learning from our mistakes could be.

Mr. Chairman, it is an honor to appear before your committee, sir.

The CHAIRMAN. Thank you, sir.

[The prepared statement of Mr. Merry follows:]

PREPARED STATEMENT OF E. WAYNE MERRY

Mr. Chairman, I appreciate the opportunity to appear before this famous Committee.

The question "Who Lost Russia?" is meaningless and misleading. In contrast, the question "Who Robbed Russia?" is very pertinent. We should also inquire into the damage done to American national interests from the failure of economic reform in that country and our role in that failure.

Robbing Russia is a global activity, with lots of foreign participants. How else could Baltic states become major exporters of commodities they do not produce; how else did Switzerland, Singapore and Caribbean islands become centers of Russian finance; how else could Russians transform the real estate market in southern Europe; and why else are automatic teller machines in posh sections of Manhattan programmed in Russian? I suspect much of the loot is already in non-Russian hands. The looting of Nigeria, Zaire, Mexico, the Philippines, and Indonesia all enriched the West. Why should Russia be different? Americans have played their part and provided a warm welcome for many billions of dollars strip-mined from Russian public properties. We should be very cynical when bankers profess to be "shocked, shocked" to learn that money-laundering has been going on.

We are also complicit through our government's role in determining Russia's economic path. Yes, Russia is ultimately what Russians themselves have made it, for good and ill, and Russia is always its own worst enemy. But the Russia emerging

from the Soviet collapse was both financially and psychologically very dependent on the United States. It received a great deal of both money and policy guidance from Washington. I believe our authorities are accountable for the dollars and for the policies as well.

Our government—both the current and previous Administrations—made assistance conditional on adoption of the so-called “Washington consensus” of monetarist mechanisms called “shock therapy.” In Russia, these policies were disastrously wrong. Russia was like a sick middle-aged man seeking medical advice after decades of chronic bad habits. Unfortunately, he consulted surgeons (at the U.S. Treasury and the IMF) who prescribed radical surgery as their standard response to any ailment. The Pennsylvania Avenue surgical team did not bother to take the patient’s medical history nor to evaluate his ability to survive surgery. When the Russian patient’s vital signs began to fail on the operating table, the surgeons resorted to more and deeper surgery, until his family finally called a halt. The very worst feature of this monetarist-malpractice case is that alternative therapies were never even considered, nor were suggestions the patient would be better served by less radical, less intrusive, and longer-term care. The patient was less important than the doctrine; we forgot the principle, “first do no harm.”

Mr. Chairman, most Russians reformers did not favor our economic prescription; they felt shock therapy was wrong for their country, was too great a challenge, and insufficiently concerned with vulnerable elements of society. They discussed other models, ranging from Scandinavian and French to Korean and Chilean alternatives, looking for the right mix for their own needs, traditions, and limitations. The United States absolutely insisted on radical market reform and employed our dominance of international financial institutions to force-feed it on Russia. In the process we allied ourselves with some of the most ruthless, undemocratic, and rapacious people in the country, people so shameless they refer to themselves as “The Oligarchs.” These robber barons and their political allies care little for the well-being of the Russian people, while their attitude toward electoral democracy is undisguised contempt. These people have made the name of free enterprise stink in Russia, as decades of Soviet propaganda never could.

However, the most egregious of American errors—and one made almost incomprehensible by our own history—is the confident assumption of the “Washington consensus” that a viable legal system would appear in Russia automatically and as a matter of course after the application of market shock therapy. The mildest metaphor I can apply to this view is that it put the cart before the horse. Our policy gave precedence in the Russian transformation to the concept that “greed is good” over “due process of law.” We thereby created incentives for the public theft and capital flight we now deplore.

Ironically, legal reform was the field where we could have made the best and most enduring contribution to the Russian transition. A few years ago most Russians saw America was the best model of a successful constitutional system and law-based state. Sadly, our government’s priorities lay elsewhere. I salute those American institutions and citizens, mostly private, who have worked with Russian counterparts on legal reform, but their efforts never received much official appreciation or support. Lip service, yes, but look at the tangible record: at the meager programs and funding and at the low status given to rule of law at summits and other high-level meetings. It is easy to identify the Washington officials responsible for cooperation in such fields as energy, space flight, Bosnia, or privatization. Who in our government has Russian rule of law as a top priority?

American businessmen in Russia constantly point to this problem, because they know that law, not money, is the true foundation of market capitalism, but Washington still does not get it. Russia can choose a different economic model, but any approach requires legal bedrock to succeed. I believe the old Soviet system ultimately failed because it was based on arbitrary and unaccountable power rather than on law. The “crony capitalism” we helped create (and then rationalized as a mere blemish on the road to the Promised Land) has failed because it is lawless. The rule of law did not develop automatically or by accident in America; it will not in Russia.

It is now asked, “What did our policymakers know about corruption in Russia and when did they know it?” I can only say that anyone involved with Russia—in government or on the street—knew about it all along. There was no secret. Even if the Embassy and CIA had not written a word, the Western press covered the story fairly well, while the Russian media reported on corruption constantly; indeed, a series of reporters were killed for their efforts. Anyone who wanted to know, knew. The real questions are, “Did our policymakers care and what did they do about it?” The record of neglect on legal reform will give you the answer.

Mr. Chairman, we have been told there was no real alternative to shock therapy and to support for the “crony capitalists,” that these policies were vital to shore up pro-Western forces in Russia, to forestall a Communist return to power, to ensure responsible behavior by a nuclear-armed country, and to protect American influence and interests. Please don’t believe it.

- The Russian oligarchs are not pro-Western, they are pro-self. Most Westernizers in Russia today are alienated from their own government, its policies, and from the United States. Eight years ago our reputation and prestige in Russia were supreme; now even the young see America as unprincipled and cynical. Russian democrats condemned their government’s war against the people of Chechnya; our government condoned it.
- Russia’s Communists are a fading political force, and the strength they retain comes from understandable popular anger at the enrichment of an odious handful and the impoverishment of working people. If such policies were carried out in this country, you might see red banners in the streets.
- The Russian military maintains stewardship of its nuclear arsenal for their country’s benefit, not for any convenience of ours. Our cooperation in reducing nuclear arsenals is a mutual interest and has, if anything, been delayed by shock therapy and the collapse of the military-industrial sector.
- To imply we must accommodate systemic corruption in order to maintain influence is the eternal rationale of short-term expediency. We were given the very same rationale about Haiti under Duvalier, about Iran under the Shah, Zaire under Mobutu, Indonesia under Suharto, and elsewhere. The long-term price of such short-term expediency should be clear.

Mr. Chairman, I absolutely do not equate Russia and Boris Yeltsin with the cases I just cited. Unfortunately, I think our government, for practical policy purposes, does. This is unworthy of both countries. Russia is one of the great nations of the world and will certainly be important for our interests in the century ahead. Russia is also a resilient society, but we should not expect its people to show endless patience with failed policies. They have the right to organize their national household as they see fit, even if it does not equate with current American fashion and doctrine. Disengagement from Russia is not an option, but learning from our mistakes should be.

Mr. Chairman, it is an honor to appear before your Committee. Thank you.

The CHAIRMAN. Mr. Legvold.

**STATEMENT OF DR. ROBERT LEGVOLD, PROFESSOR OF  
POLITICAL SCIENCE, COLUMBIA UNIVERSITY**

Dr. LEGVOLD. Mr. Chairman and other committee members, for me, too, it is very much an honor to be before you today.

My concern is rather different from the colleagues who have appeared before you today, including that of Strobe Talbott at the outset.

I am fearful that in this sudden renewed focus on Russia, we are framing ways—we are framing issues in ways that are likely, in the long run, to jeopardize our national interest.

There is much in U.S. policy toward Russia since the fall of communism that has been wrong, or at least arguably so, and Mr. Merry has just very vigorously argued so.

There, however, is also much that is wrong in our current national discourse about Russia. And I have been taught since I was a small boy that two wrongs do not make a right.

As long as I am tossing around this word “wrong,” let me add two other relevant wrongs. In Russia, since independence, things have gone wrong, in some respects very wrong, but that is only half the story, for as others have said, there is some important things that have gone right considering the circumstances.

In U.S./Russian relations, things are going wrong now. In some important respects, very wrong. But, again, that is only half the

story. There are other extraordinarily important things to preserve and to pursue within that relationship.

None of this is to say that the topic of your hearing—of these—of this session today and subsequent one, and the issue that now seems to have re-centered Russia in our mind's eye is illegitimate. Far from it. This question of corruption and money laundering and collateral issues are very important for several reasons.

And it is important that we unravel the issue, and that we address it effectively, first, in order to protect the integrity of our banking system; second, in order to protect the integrity of our foreign aid programs; third, in order to protect this country from the international effects of organized crime; and finally, in order to appreciate an important dimension of what indeed is going wrong in Russia.

That is the way in which the conversation has been focused up to this point and very much in the panel this afternoon.

And in the process, in terms of what has gone wrong, something that is threatening a key interest of ours, a national interest of ours, which is namely Russia's successful passage to an open, vibrant market-oriented society.

In reviewing the last 9 years of U.S. policy toward Russia, one could argue that the Bush administration failed to push hard enough for critical elements of economic reform essential at the very outset of the process, and that the international financial institutions failed to provide their fair—their fair share of the where-withal in order to make it occur.

One could argue that the Clinton administration was mistaken in the degree of unconditional support given to Yeltsin, particularly in the first 2 years of the administration—and Fritz Ermarth has made that argument—that it did not raise a sufficient ruckus soon enough over not merely the rise of corruption within Russia, but what I would call the criminalized state, which is a very different problem.

And it is the one that Jim Moody began to focus on, which is the heart of the matter, not just corruption or organized crime, or syndicates or many of the elements that were in Senator Kerry's paragraph from the book, but a criminalized state. And that is not what we have been talking about up to this point, how you address it.

One could argue that the administration can be criticized because it did not stop, that it merely dissented from a malignant step like the 1995 loans-for-share deal, which contributed so much to the growth of this fundamental problem; or one could even argue in a different vein that the administration should have, but failed to encourage devaluation of the ruble in the fall of 1997 and, therefore, contributed to the August crisis of 1998 and everything that has followed from it.

I would be inclined to make most of these arguments. But I also believe that honest people could disagree over each of—each of these points.

But more important are two other considerations. First of all, even if these charges have merit, I have no way of assuring you that had we followed another course implied by this, that the outcome would have been materially different on any large scale. And that is worth thinking about.

And second, and more important from my point of view, they are not the central point. The core problem today is not that we have misengaged Russia, though that is very important and for the reasons that you have already been given on this panel and that you already know based on the comments that you have made.

It is that we are disengaging from Russia. I have heard everyone around this panel and this table say that we do not disagree over remaining engaged. The truth of the matter is that this country is in the process of disengaging from the Russian challenge.

Let me be more concrete. I will finish that first thought. When I say, "We are disengaging from Russia," the administration is a part of the "we." But it is by no means the worst part of the "we" in this instance.

Let me be more concrete. A month ago, the last week in August at the Ashuluk test range in the Astrakhan region of Russia, Russia, Belarus, Armenia, and Kazakhstan ran their Commonwealth 1999 military exercises.

The scenario was to thwart and to destroy imitative massive attacks by aviation and cruise missiles, with no attempt to disguise the fact that this was inspired by what Serbia had encountered several months before.

This, in turn, is against a background in which opinion among a majority of the foreign policy elite, I say a majority of the foreign policy elite in Moscow, including some of the most pro-reform liberal elements, believe that NATO would permit itself unilaterally to do in or around Russia exactly the same thing. And they do not see that as a element of protection. They see that as a threat.

It is accompanied by a tendency these days in Russia to consider solving the problem of Russia's immense weakness in conventional arms by introducing low yield tactical nuclear weapons in order to strengthen conventional defense.

And in terms of addressing the issue of deterrents with NATO expansion, continental deterrents with NATO expansion, there are those voices now who say the answer should be intermediate nuclear forces, INF, and if to—if to do so, you have to scrap the INF agreement of 1987, so be it.

This in turn is part of a broader context in which Russian policymakers and politicians stress increasingly an emerging strategic rivalry with the United States and the West within the post-Soviet space.

And everything from the way we exercise partnership for peace to our support for multiple oil pipelines to the bilateral relations that we build in Central Asia and the Caucasus, together with the actions of NATO, are put together in order to demonstrate what I think is a very distorted notion of what is happening, but one to which they are responding.

And this is only a capsule version, this list that I have given you, of what is a much more complex and large dynamic in the relations between the United States and Russia at this point.

This awkward chain of suspicions on the part of the Russians, from my point of view, is distorted and wrong. But it is also the malign product of enormous Russian weakness.

Who in this town—who in this town is arguing that this represents a crucial danger over the long run to our national interest,

and a problem with which we should be profoundly seized and engaged rather than disengaged?

Who in this town recognizes that this is one road to a genuinely lost Russia, a Russia that is alienated from the West and combative; a Russia that is set against the United States, either alone or in league with, should it arise, an alienated and combative China?

Nearly all—second point, nearly all of the major candidates for the Presidency the next time around on both sides of the aisle, Republican and Democrat, recognize that it is crucial to our national interest over the long run that the Russians succeed with the transformation that they undertook in the late Gorbachev years and under independence, to a modernized political and economic system.

But who in this town is ready to grapple with the ways we and our allies might engage the Russians—that is, with material support and appropriate conditionality—after we have satisfied ourselves on the issues that are before you now in this hearing, that would induce the political leadership, both parliamentarians and the executive to attack the underlying structural obstacles to reform, including the criminalized state, which all of us agree is one of the major structural obstacles to reform?

Rather than wrestle with these profound and difficult versions of the Russian challenge, we have retreated to a few marginally useful programs, not to be dismissed as they are described, but being cut back increasingly under the pressure of legislative decision in this country, and to relief in facing the debt overhang, which is what the IMF business is all about.

But when the IMF repays the IMF on behalf of the Russians, which is a useful thing to do because we prevent the Russians from going over the cliff, we are not doing anything to lead the Russians or encourage the Russians to address the underlying structural obstacles to reform that are leading to contraction of the economy and all the rest of it.

That is, we are not doing nothing to attack, to briefly conclude now, the criminalized state, ineffective commercial banking, the liquidation of value destroying industry, and the creation and protection of real property within that—within that system.

If the economic failure continues—of the last 8 years, continues and deepens within Russia, that leads to the possibility of another kind of lost Russia.

That other lost Russia—and I do not say the possibility—I do not say the inevitability. I say the possibility of another lost Russia, is a failed state, Russia in ruins, Russia as a vortex of instability, of violence and of deadly contaminants beyond our wildest imagination.

I think we got to this point—I say all of us, this body, my kind of people in the outside world as analysts, the media, our leadership within this country—through inattention, except for moments of spasms of interest as we are going through right now.

And I think that this spasm of interest has been caused and sustained by what would appear to be a widespread sense that the stakes for us are not all that high, where we can afford to disengage from the Russian challenge.

The words of our public figures say otherwise, but the actions, including much of the way in which we are shaping this current debate, I think, move in the other direction.

They suggest that in the Congress you have a bipartisan, veto-proof majority in favor of walking away from the Russian problem in its hard form.

Thank you.

The CHAIRMAN. Thank you.

And my question is to Mr. Ermarth. Do you have any explanation satisfactory to yourself, sir, about the President and the Vice President having met with figures associated with corruption and organized crime in the former Soviet Union? I am talking about Vadim Rabinovich, or figures like that.

The President and Vice President met him in 1995 at a fundraiser in Miami, and there is a photograph somewhere of that. It was a 1995 fundraiser in Miami and that photograph just being posted right now, was taken at that fundraiser.

Do you have any opinion about that?

Mr. ERMARTH. Well, I have an opinion. I think it is rather careless. I am sure that had the—the true business profiles of these gentlemen been known to the planners of those occasions, things would have been done differently.

I think the point that—to be taken from these episodes is the one I was making very briefly in my remarks, namely that these guys by influence, you know, insinuating their money and their—and their influence into our political processes comes naturally to them.

We should not make it natural to receive it. As to the particular instances you are querying me about, Mr. Chairman, I—I cannot illuminate it further. I do know about what Mr. Loutchansky was up to.

The CHAIRMAN. Very well. I have a followup question. Do you believe that IMF money was diverted improperly into private foreign bank accounts?

Mr. ERMARTH. The diversion of IMF money?

The CHAIRMAN. Yes, sir.

Mr. ERMARTH. I believe Mr. Skuratov is telling the truth and providing additional detail about something that was widely known in Russia in August—August, September 1998 and even got some coverage in the Western press.

The IMF lent Russia about—about \$4.5 billion in a tranche of a larger package of \$20 billion to support the currency and stabilize the financial markets during the crisis of summer 1998.

It bought—it used those—the—the Russian central bank used those dollars to buy rubles. That is what you do when you stabilize a currency, but rather than going through the Central Interbank Currency Exchange with about \$3 billion of those dollars, it bought them directly from—it bought the rubles directly from the commercial banks and the commercial banks ended up with the dollars. The dollars ended up in New York, just like that.

Now, maybe the IMF is telling us that unless they ended up in the private pockets of certain individuals, it is not diversion. But the banks are in the private pockets of certain individuals. I defy you to sell the IMF version of this to any of your constituents.

The CHAIRMAN. I think you are right.

Mr. Merry.

Mr. MERRY. Yes, sir.

The CHAIRMAN. You were stationed at the American Embassy at Moscow, is that right?

Mr. MERRY. Yes, sir.

The CHAIRMAN. Could you elaborate on the suppression of information, given that experience? Was information about the corruption of senior Russian Government officials suppressed and—let me ask the whole question; then you can answer it in one lump—was such information about a Viktor Chernomyrdin, was that suppressed, and was such information available to anybody in the administration, e.g., the Vice President?

Mr. MERRY. The questions of corruption almost all took place after my years in Moscow. I left in the summer of 1994. The case you referred to took place after that time. I have no information about that.

What I would say is that what took place was not suppression of information, so much as there were, I think, very sharply conflicting views within the embassy about the appropriateness of the market reform policies that we were forcing on the Russians, and the degree of success they were experiencing.

And I think there was certainly a considerable problem, in my view, that people who were institutionally responsible to the Gore-Chernomyrdin commission mechanism were also responsible for overseeing the evaluation of the success of the policies, and this constituted a conflict of interest.

I can only say that in my own section of the embassy, what was called the Internal Political Section that dealt with internal Russian affairs, I received nothing but the fullest support from both of my Ambassadors and their deputies in sending out messages which frequently made our readership in Washington extremely unhappy, telling Washington things it did not want to hear.

I have to tell you that I think that in other parts of the embassy, there were a lot of very energetic, mostly junior reporting officers who were trying to get out the message, as they saw it, the information that they gained from their travels around the country. And their message traffic never went out.

The CHAIRMAN. Thank you very much. My time is up.

Senator Biden.

Senator BIDEN. Thank you very much. Mr. Chairman, with regard to that picture, it reminds me—I remember in, I think it was, 1976—I am not positive; I think it was 1976—seeing a picture using the campaign of Jimmy Carter with John Wayne Gacy, you know, the guy who chopped up and ate those folks, you know, buried them under his—I am serious. You all—are you reporters old enough to remember that?

And I remember the same implication being drawn from that, that Jimmy Carter really wanted to have the support of a guy who molested, killed and ate children, just as Vice President Gore wanted to have the oligarchs support him.

I mean, that is the thing that every living politician, because of the corrupt political system we have here and not having public financing of elections—every one of us lives in fear of.



We live in fear. Seriously, we live in fear, and we do not have the FBI sitting next to us and tell us everybody who comes in. I would like you to vouch for every contributor you have. I sure in hell am not going to vouch every one that I have.

But at any rate, it is—it is kind of amusing, but—to me, anyway.

Mr. Merry, the irony I find—and I do not disagree with much of what you said. The irony I find in what you said is I remember Jeffrey Sachs, who—who shocked Poland through its renewal. There was a great debate. Conservatives in this town and on this committee were saying Russia should go the Sachs route, Russia should go the Sachs route, shock treatment.

The irony is: you are being critical of this administration for its shock treatment, when they were getting beat up now—the very people who are beating them up now are the very people that said the reason they are in trouble is they did not have the shock treatment.

You do remember that debate, do you not?

Mr. MERRY. Yes, sir.

Senator BIDEN. Yes. So I—I find this incredibly ironic, the very people who are talking about the failure here of the way we—we engaged Russia economically are saying we failed for the very reason that—totally different reason than you are saying we failed.

I happen to agree with you, because I was on the side saying, “Hey, you cannot expect these folks—they do not have anything remotely approaching Poland’s circumstance, and it will not work. It will not work in Russia.”

And I—the irony is that the bulk of the criticism that you are getting—that we are getting from—not from within the Congress, but outside the Congress and from your colleagues, Mr. Legvold, who are being critical, is that, you know, they were the very guys back then who were saying, “Shock, shock, shock. Sit—sit him in that chair and turn up the pressure, because that is the only way it is going to happen.”

I just put—I will put that down as a historical footnote here, because I was here for that debate.

Mr. Legvold, one of the things that I find absolutely compelling about what you said is: I just got back from a trip to Kosovo and the region, and I recently have been in other parts of Europe and the Middle East.

And I was astounded, as you seem not to be, by the reaction of our allies as well as our adversaries, if we can call it that, by what went on in Kosovo.

Our allies walked away thinking, Oh, my God. What an incredible display of power by the United States, military power. And guess what? We’re not even close technologically to the capacity they displayed.

It has caused political eruptions in France. It is causing difficulty within NATO. The NATO alliance is in a position now where after having observed what we have been telling them all along, that you should be spending more money to increase your technological capability to keep up with us, now are having this—mark my words. I am not an expert like you, but I have been doing this for 27 years.

Mark my words. You are going to see an increased move within western Europe to disengage with NATO, because there has got to be a different way to do it because the only way to stay in it without us totally dominating it is to spend money they are not willing to spend and take the years it takes to catch up.

So the irony, I found, was here you have our very allies going, Oh, my God. Look what those Americans can do, even though they allegedly knew it.

Every other part of the region I went to whether it was the Middle East or Russia, it was, My God. If they can do that here for a violation of human rights, they can do it anywhere.

And we actually had people in China, in Russia, in Beijing, in Syria, in small and large countries being chastened in a way that leads them, I think, to the proliferation of cheaper means by which to be able to deal with what they believe to be an inclination of ours and a capacity we demonstrated to do them great harm.

Chemical weapons, biological weapons, theater nuclear weapons, intermediate range nuclear weapons, in the case of—of—the Russians.

What is your suggestion? Step out of what you academics love to do. Give us a concrete suggestion as to what we should be doing now.

The CHAIRMAN. In 30 seconds.

Dr. LEGVOLD. Mr. Chairman—

Senator BIDEN. Submit it in writing, because I am really interested in what you have to say.

Dr. LEGVOLD. OK. I will submit it in writing, because I cannot do justice to the question in 30 seconds—

Senator BIDEN. I understand.

Dr. LEGVOLD [continuing]. And it is fundamental to the overall structure of the problem that I was laying out.

Senator BIDEN. That will be my question for you to respond.

The CHAIRMAN. All right.

The CHAIRMAN. Senator Hagel.

Senator HAGEL. Mr. Chairman, thank you.

Gentlemen, thank you, each of you. We are grateful for your insight and your time.

As a matter of fact, I—I do want to really attach myself to what Senator Biden was asking.

But I would like to ask each of you the general question—we heard some very insightful thoughts from each of you, coming from different perspectives, different experience basis.

And my question following along Senator Biden's question really is from each of you: What do we do now? Where do we go from here? What is the policy we should—we should follow with this administration just a year out?

You heard me ask the question of the Secretary of "What changes do you plan or intend to make based on a year, only 1 year before a new administration takes over?"

So I would like to hear from each of you. Thank you.

Mr. Ermarth.

Mr. ERMARTH. Well, sir, I believe we have to start in going from here with a thorough audit of our policy of a sort that a few hearings cannot accomplish.

I mean, we have got a—we have got to tally what happened to the nuclear weapons on the front end of those missiles that were dismantled, and what happened to the dollars that were expended in achieving that. How much went to U.S. contractors? How much went actually into Russia? A thorough audit of our policy on practical matters, to preserve and identify the good as well as things that we did not want to see.

Then I believe we can craft a more constructive policy for dealing with the next Russian administration, and what will probably be the next American administration as well.

And it is going to have to be more therapy than shock. It is going to have to be a—a policy that puts much more emphasis on the legal, institutional, even cultural foundations of capitalism.

The principles expressed in what this—the chief economist of the World Bank said, “Capitalism will not work, if everything is for sale, including the state.”

Now, some of that is going to involve some policies that are not very popular, particularly on the Republican side, state controls of various things, controls on the movement of capital in some respects, a kind of industrial policy.

But remember, we are dealing with a very disheveled, in some ways very primitive economic scene there, and different policies than are orthodox here are required there.

Now, we cannot impose them, but we need them as a checklist for “What are you doing right in our eyes? What can we support with our taxpayer money, and with our applause,” so that we do not repeat the mistakes we have committed in the past.

Senator HAGEL. Thank you.

Mr. Moody.

Mr. MOODY. If I may, I am a businessman by background. And I believe that you have to set up a plan, and the whole time I was in government I never knew or never saw a U.S. Government-Russia policy.

And I believe that you have to establish a plan. You have to identify the issues as Fritz just set out. Then you are going to have to articulate the policy on each—each issue; for instance, supporting the proposed legislation they have today.

Then you need to make sure that everybody in government understands what the policy is within the entire organization so everybody is marching along the same way. And I think that way we can be successful.

Senator HAGEL. Thank you.

Mr. Merry.

Mr. MERRY. In my view, the most important U.S. national interest with Russia during the remainder of the current American administration is that the upcoming Russian Parliamentary and Presidential elections actually take place, that they are legitimate and that the results of the elections are respected, and that we have a constitutional transfer of both legislative and executive power in that country.

I can think of nothing that would better set the stage for whoever is in power in the United States after our next election than to have a government in Russia which enjoys electoral legitimacy.

And I think this time, our administration should really communicate in ways that are available to it that we expect no less. We went along with unconstitutional actions in 1993. That may have been necessary. That is a long debate. We went along with the war in Chechnya. I happen to think that was totally unjustifiable.

In 1996, Boris Yeltsin through his own immense energy actually did win the election, but it is pretty clear our administration would have settled for an outcome which was not constitutionally legitimate.

I think this time we have to put constitutional legitimacy and the rule of law at the absolute top of our platform. Whatever government emerges will obviously want to demonstrate its nationalist credentials. It will want to demonstrate a break with the past. It will want to demonstrate that it is not the vassal of the United States. That is going to lead to some fairly difficult rhetoric, perhaps on both sides. And I think it is going to lead to the Russians being more inclined to rely on their own internal resources and their own capabilities rather than assistance from the West. And I think that is going to be a good thing.

Senator HAGEL. Thank you.

The CHAIRMAN. Mr. Legvold, please proceed for 2 or 3 minutes.

Senator HAGEL. Thank you, Mr. Chairman.

Dr. LEGVOLD. Thank you.

Well, first of all, I want to begin by—by re-emphasizing what Mr. Merry started with. I think it is absolutely crucial that not merely the U.S. administration executive branch, but that you in your dealings with the parliamentarians, stress the importance of going ahead with no confusion, obsfucation or circumvention of the elections, both sets of elections in December and in—in—in July, the Presidential elections.

Second, I agree with what Fritz had said about doing the audit.

Third, I think clarifying all of the issues that are before you around the current matter of corruption, malfeasance, money laundering, so on, is very important for the reasons that you mentioned, Senator Hagel.

I think we cannot mobilize political support for engaging the Russians materially, unless we can demonstrate that it is not simply down a black hole or that we are being taken for a ride on it.

But then I come back to the agenda that I laid out, that we are missing, that we are failing to engage. The sad part about this story—implications of Senator Biden's point about Kosovo and the way others other than our allies are responding, the Russian reaction that I began to describe in only bits and pieces, is how warped and distorted and inappropriate it is for the Russians in terms of their security agenda.

The same week that they did that Commonwealth 1999 exercise that I referred to, a month ago in August, Shamil Basiath was bringing 2000 or more Chechens across the border into Dagestan, seizing villages and the Russians were then tasked with this military contest, a series of terrorist bombings that many people associated with that.

The Russians have a very different security agenda from addressing a kind of threat, so-called Serbian threat, within their own territory.

And yet by not wrestling with these problems together and the way we are seeing one another's behavior, whether it is in how we go about building ballistic missile defense in the context of preserving the ABM agreement, the degree to which we do that by imposing it unilaterally or the extent to which we are or are not engaged in a serious discussion with the Russians about our respective positions in Central Asia—we are not doing that now—or in the Caucasus, or the extent to which we are utterly insensitive to the way our politically motivated approach to multiple pipelines in the Caucasus comes across, we simply—we simply reinforce this warping of the way in which they do their security agenda.

And we create this prospect of the lost Russia I was referring to in the long run, a genuinely alienated Russia, because for all their frustration and anger, if you look at their behavior in the last several years, the Russians in the end have remained constrained.

And in the end they have not turned over the furniture. In the end, they have not turned out to be spoilers for all international enterprises among the great powers in the United Nations.

And then we get to the fundamental question of the degree to which we are prepared to engage them on that most crucial issue that the administration is right to focus on from the beginning, and that is a successful domestic transformation to democracy and economic reform, and a series of things that we need to think about, not merely as the U.S., because we cannot do it as the U.S. effectively unless we are leaders of the G-7, the industrialized democracy. But that would take more time than I should.

The CHAIRMAN. Thank you, sir.

Senator HAGEL. Thank you.

The CHAIRMAN. Senator Kerry.

Senator KERRY. Mr. Chairman, thank you.

I think there has been a great deal of wisdom from this panel. And I want to thank all of you for your comments here today. I think there has been more wisdom from you as a panel than there has been from the Congress in its recent politicization of some aspects of this issue.

Now, gentlemen, you, Mr. Ermarth, Mr. Moody, and Mr. Merry have focused more on the criminal transition that has taken place.

And I think you have appropriately placed some blame on a combination of naivete and what Professor Legvold has called inattention which, candidly, has combined to minimize the kind of impact that we might have had that might have implemented some of what the professor just talked about.

And you are correct, I think, in the picture you draw. I certainly agree with you.

I—just to amplify, Mr. Moody—also did write about the KGB plundering that began with the vision of the demise that was coming, and the great plundering that has taken place since, which is why a place like Estonia can boast about being the greatest metal producer in the world, yet there is not a metal factory in the country. It has all come from Russia. It is all smuggled. And it has all gone elsewhere. There has been a plundering of Russian assets.

And indeed the Apparatchki were able to transition themselves from Communist Apparatchki into the oligarchy and into the criminal authorized group that you talk about.

But—and here is the “but”—there are good things that have happened. And the professor has referred to them. There have been acts of responsibility. Yeltsin himself has tried to walk a line in a dangerous atmosphere.

And so the question is really not “How can we in the Congress find ways to make this a political football,” and chew each other up over who did or did not do something.

I would agree with the criticisms that someone must have known there was a level of criminality that was such that these transfers of money and other things we were trying to achieve were threatened without other safeguard in place.

The issue for all of us now is: What should those safeguards be? How do we proceed? How do we undo this combination of criminality and all of the other forces that are loose in this country? The perception of America and American capitalism is considerably less than we would like it to be today because of what has happened.

So a lot hangs in the balance. And I think that—I thought the professor’s summary of it was really superb, when he talked about the combination of these challenges, the criminality, the lack of structure, the laws and the inattention that may have led us here and the spasms of focus that we have on this.

I think it is essential that we not let this become political because our national interest is so entwined in it, and that may be a useless plea in a city that is increasingly more partisan and politicized.

But, professor, maybe you want to lead off, and each of you might share with us. You say do not disengage. Clearly, some moneys have been essential to the de minimis stability levels that we want to continue to maintain, and even to some of the connections and good faith exchanges that people rely on that do not empower the more radical nationalistic forces that would clearly take us down a very different and more dangerous road.

So how do we manage that now in your judgment? I mean, what is the order of priority as to how we can establish the law and order, the legal structure, the system that inspires the confidence that helps build the other things we want to do, without giving in to the lowest common denominator here that threatens everybody?

Do you want to begin that, professor?

Dr. LEGVOLD. Well, I—I—again, in a brief compass, I cannot—or in a short time, I cannot do justice to the question, Senator Kerry, but I would say the following, and maybe especially since I am the one that has strayed farthest from your—the—the core issue of these hearings, that on the issue of corruption and malfeasance, the way I would bring it together is the following:

First to underscore a point, Mr. Chairman, in particular, given your interest and concern about this point I have made of the criminalized state: It is implicit in the way Fritz Ermarth phrase the issue and it was explicit in what Jim Moody had said. There is a fundamental difference between countries that have corruption and even at times corruption in government.

This country has corruption, organized crime. It has even had corruption at local and state and Federal levels.

Italy has corruption and often corruption that penetrates in the government.

That is very different from a criminalized state. That means that when you sit down with Chernomyrdin or when you sit down with Putin these days, or when you sit down with parliamentarians and you talk to them about fighting corruption and you are willing to join forces with them and you beg the question that they are themselves the problem, who really are missing the boat.

That means that the issue of—of fighting corruption in this case, the criminalized state, is very tough. It is very difficult.

And I think it is probably wrong to assume that it is emerged largely because of our neglect or the things that we did or what international financial institutions did.

I would, however—to come back to your question, Senator Kerry—say that in the future if we were really going to try to influence the structural obstacles to reform—and we agree that one of the major ones is the criminalized state, not just corruption, but the criminalized state—then the degree to which we enter into the bargain with material commitments and the conditionality will be the degree to which national leaders and parliamentarians attack the criminalized state, not just corruption.

And if we have to give a percentage point or two on stabilization packages in order to maintain budgets in the way in which we give money, I would argue that we should, in order to get at that underlying structural problem.

I do not know whether it will work. I do have the impression, perhaps mistaken, that when—when Primakov was prime minister, that he was somebody who might have been willing to attack the problem of state corruption or the criminalized state.

The CHAIRMAN. Thank you so much.

Senator KERRY. Can the others comment, Mr. Chairman?

The CHAIRMAN. Well, I tried to warn against asking a question that ended on the caution light, but, yes, we will hear from the others.

Senator KERRY. Thank you, Mr. Chairman.

Mr. MERRY. In my own view, as we look ahead we should really be concentrating on things where we do not judge the value of our programs by the number of dollars we spend.

I think the greatest positive accomplishments in Russia in my lifetime have been in the area of civil liberties. I lived in Russia under Brezhnev. And I think the state of civil liberties in Russia today exceed anything I ever would have dreamed I could live to see.

I think encouraging things like that do not necessarily cost a lot of money. Some of the kinds of exchange programs the Librarian of Congress James Billington has put forward, are not going to cost a vast amount of taxpayer money. And we are going to get immense returns for them.

I think also we should greatly increase our support for some of the private American programs in rule of law and legal reform, particularly in commercial law.

I think, beyond that, we should get out of the habit of regarding Russia as a welfare case. It is still eminently a very rich country. It has lots of resources. And the best way for it to learn to use its own resources is by not providing opportunities for those resources to be strip-mined by a bunch of robber-barons. And there is nothing

that encourages people to look to their own resources than knowing they are not going to get bailed out from abroad.

I do think, however, that in the next few years, the West—and I do not mean just the United States, because other countries actually have more interest in this than we do—the Soviet era debt is almost certainly going to have to be disposed of. I just cannot imagine that money is ever going to really be repaid.

Beyond that, I think it is very important and I would commend this administration for its efforts in this regard, to keep Russia engaged in many areas of the world, even when they do not have much of a contribution to make, even when they are sort of a pain in the neck to have around, but just to give them the sense that we treat them as a great power.

Now, this is an empire that has failed. It is not the only empire that has failed in our lifetime. I know a lot of French people who still have not gotten over the loss of Algeria. I know English people who still get very upset when people talk about Gibraltar reverting to Spain. The Russians—

Senator KERRY. I thought you were going to say Delaware, North Carolina and Massachusetts.

Mr. MERRY. That, I would not touch, sir.

The Russians are going through what is a deep psychological problem. Keeping them engaged in many areas even when their objective strength does not justify it is its own reward.

The CHAIRMAN. Very well.

Mr. Moody.

Mr. MOODY. I—I think that the first issue I would address right at the moment is the fact that the oligarchs are purchasing the news media. They are purchasing the televisions. They are purchasing the magazines. They are purchasing the newspapers to have effect on the next election. Now, we ought to at least speak up about that.

The second thing I would do is—it does not work with my children, so I do not believe it should work in other ways. I do not believe in giving money away. It is never appreciated. And it is never spent like you want.

But anyway, especially when the Russian Government auditors at the same time, even prior to this, were saying, “Do not give us anymore money. It is just going to be stolen anyway.”

The third thing I would say is the United States has an enormous wealth of expertise and information out there that is not being used today, and by that a lot of retirees.

And I think it would be very good for, maybe a kind of a Peace Corps type operation to go on in the former Soviet Union using a lot of these retirees to go over, show them how to set up businesses on a real grass root level, work with them on—on legislation and things like this.

American retirees should love to do that, because it is a great country to go see. It is—you know, it is magnificent to be there and to understand the—the people over there. And I think in the long-term it is a nice cheap way to build things from the grass roots up.

The CHAIRMAN. Mr. Ermarth.



Mr. ERMARTH. Senator Kerry, let me answer your question by sketching very briefly a rosy scenario. It may be smelly, but at least rosy. And we ought to support it.

They get through the elections. Whoever wins—and we should not be calling favorites on this. Whoever wins is going to—I mean, is going to have some prospect, some stability, some creditability.

And then I suspect there will be an opportunity for that winner, in alliance with possibly the leftovers of the Yeltsin official family and the power ministries, to turn to the oligarchs, to the opposition, to the regions and say, “OK, guys. Let us have a deal here. Let us start out by fixing the Constitution so the President is accountable, the—the Duma is responsible and the government is responsible to the Duma. Then let us start the long agenda of tamping some law and order into place.”

Big complicated problem, but it means like going back and passing that money laundering bill that Yeltsin vetoed and getting it passed.

Then comes the hard part, the money, working out how much you give back and how much you got to—you get to keep. It is not going to be clean and neat. But it is the least worst scenario.

I posed this scenario to General Kulakoff, the former chief of the—of their national police force. He says, “Yes. That is it. That has got to be something like that.”

Now, if they go on that course, we have to be in a position to know what is real, what is phony, what we can support and what we—what we cannot.

The CHAIRMAN. Gentlemen, I thank you very much. We have kept you here longer than I had anticipated, but you have made such a difference in this hearing and I appreciate it personally, and I know my colleagues do.

Now, if I may ask you to submit to written questions from members of the committee who were here and committee members who were not here, because they will have an interest in it too.

And I thank you again.

Senator BIDEN. Mr. Chairman.

The CHAIRMAN. Yes.

Senator BIDEN. Before you close, 30 seconds. I want to tell Mr. Moody, you and I and others of this committee have supported a thing called the International Executive Service Corps of Retired Executives.

Thousands of them have participated. They are ready to do it. They are not—they come away disillusioned sometimes, but also come away with some contributions.

So that—that is well under way. I do not know how to make it better. If you have any ideas, we would like to hear them.

Thank you.

The CHAIRMAN. Thank you. If there be no further business to come before the committee, we stand in recess. Thank you again.

[Whereupon, at 5:47 p.m., the committee adjourned, to reconvene at 10:30 a.m., September 30, 1999.]

## **CORRUPTION IN RUSSIA AND FUTURE U.S. POLICY**

---

**THURSDAY, SEPTEMBER 30, 1999**

U.S. SENATE,  
COMMITTEE ON FOREIGN RELATIONS,  
*Washington, DC.*

The committee met at 10:42 a.m., in room SD-419, Dirksen Senate Office Building, Hon. Gordon H. Smith presiding.

Present: Senators Smith and Biden.

Senator SMITH. Good morning, ladies and gentlemen. We will convene this hearing of the Foreign Relations Committee. Senator Biden will join us shortly, but he is literally speaking on the floor right now, and so his staff has suggested we go ahead in the interest of time and out of respect for our witnesses today on this very important topic.

This is the second of two hearings this committee has held devoted to the subject of corruption in Russia. These hearings could not be more timely, given that 80 percent of an IMF bailout in 1998 did not even reach Russia, that enormous sums of money have been laundered through the Bank of New York, and that President Yeltsin may—and I emphasize “may”—have received kickbacks from a Swiss construction company.

In our first hearing on the subject a week ago, this committee learned first about a pattern of organized crime and officially-sponsored crime in Russia and, second, about administration policy in light of that pervasive pattern.

Unfortunately, at that hearing the administration was not able to give us details regarding what the administration knew about specific corrupt figures in the Russian elite. We were able to have somewhat of a dialog about the need for engagement as a policy with the Russian Federation. It's a policy I agree with. We must engage Russia.

But it's impossible to perceive United States policy as containing only two paths to our relationship with Russia: isolationism on the one hand or blind engagement on the other. I reject the isolationist tendency too prevalent in politics today and firmly believe that we need to help consolidate market economies and democratic governance in today's Russia. We do this by sharing American values, by democracy building, by teaching how a court system works, and by the rule of law.

In turning to the question of future U.S. policy regarding corruption in Russia, we have in today's hearing an opportunity to explore precisely in what fashion the United States should further pursue engagement.

As I pointed out in our hearing a week ago, I'm a strong supporter of funding for international affairs. We do some good things in Russia, in particular, work in the area of the Nunn-Lugar program assisting Russia with the safe and secure transportation, storage, and elimination of nuclear weapons. I am, however, concerned that American taxpayers underwriting other, perhaps not as well-known, assistance to Russia have a right to ask how those other funds are being used.

For example, they need to know whether the Russian officials with whom we are dealing are trustworthy. They have a right to know that the administration will insist on the accountability and commitment to the rule of law of those officials when we offer our assistance to Russia, consisting to date of over \$5 billion obligated in grants and almost \$13 billion in loans from the United States.

In today's hearing on corruption, we will examine, one, the prospect for change and reform in Russia; two, the relative impact U.S. policy is likely to have on Russian reform; and three, what policies the United States should pursue given the experience of what has worked and what has not during the Clinton administration.

I hope, in particular, that we will focus on what needs to be done on the ground in Russia and what the United States can do to facilitate it.

Among our witnesses today, we have Peter Reddaway, professor of political science and international affairs at George Washington University. He is the co-author with Dimitri Glinski of a book to be published in January entitled "The Tragedy of Russia's Reforms: Market Bolshevism Against Democracy." The very title of the book shows how appropriate a witness Dr. Reddaway is for today's hearing. And we welcome you, sir.

Dr. REDDAWAY. Thank you.

Senator SMITH. We also have as a witness Thomas Graham, senior associate at the Carnegie Endowment for International Peace. As a Foreign Service officer, Dr. Graham served in several capacities at our embassy in Moscow, including political counselor and head of the Political/Internal Section of the embassy staff. And we welcome you, Dr. Graham.

Dr. GRAHAM. Thank you.

Senator SMITH. Our third witness is Dr. James Finckenauer, a professor of criminal justice on leave from Rutgers University. He has a special expertise in the area of organized crime and that includes organized crime in Russia. Our welcome to you, sir, and to all of you.

#### PREPARED STATEMENT OF SENATOR GORDON H. SMITH

This is the second of two hearings this committee has held devoted to the subject of corruption in Russia. They could not be more timely, given allegations that 80 percent of an IMF bailout in 1998 did not even reach Russia, that enormous sums of money have been laundered through the Bank of New York, and that President Yeltsin may have received kickbacks from a Swiss construction company.

In our first hearing on the subject a week ago, this committee learned, first, about the pattern of organized crime and officially-sponsored crime in Russia and, second, about the Clinton-Gore Administration policy in light of that persuasive pattern.

Unfortunately, at that hearing the Administration was not able to give us details regarding what the Administration knew about specific corrupt figures in the Russian elite. We were only somewhat able to have a dialogue about the need for engagement as a policy with the Russian Federation.

But it's impossible to perceive United States policy as containing only two paths to our relationship with Russia—isolationism or blind engagement. I reject the isolationist tendency too prevalent in some politics today and firmly believe that we need to help consolidate market economies and democratic governance in today's Russia. We do this by sharing American values, by democracy building, by teaching how a court system works and by rule of law.

In turning to the question of future U.S. policy regarding corruption in Russia, we have in today's hearing an opportunity to explore precisely in what fashion the United States should further pursue engagement.

As I pointed out in our hearing a week ago, I am a strong supporter of funding for international affairs.

We do some good things in Russia, in particular, work in the area of the Nunn-Lugar program assisting Russia with the safe and secure transportation, storage, and elimination of nuclear weapons. This is largely Defense Department funding. I am, however, concerned that American taxpayers underwriting of other, perhaps not as well-known, assistance to Russia have a right to ask how those funds are being used.

For example, they need to know whether the Russian officials with whom we are dealing are trustworthy. And they need to know that the Administration will insist on the accountability and commitment to rule of law of those officials when we offer our assistance to Russia—consisting to date of over \$5 billion obligated in grants and almost \$13 billion in loans from the United States.

In today's hearing on corruption, we will examine (1) the prospects for change and reform in Russia, (2) the relative impact U.S. policy is likely to have on Russian reform, and (3) what policies the United States should pursue given the experience of what has worked and what has not during the Clinton Administration.

I hope, in particular, that we will focus on what needs to be done on the ground in Russia and what the United States can do to facilitate it.

Among our witnesses today, we have Peter Reddaway, professor of political science and international affairs at George Washington University. He is the co-author with Dimitri Glinski of a book to be published in January entitled "The Tragedy of Russia's Reforms: Market Bolshevism Against Democracy." The very title of that book shows how appropriate a witness Dr. Reddaway is for today's hearing.

We also have as a witness Thomas Graham, senior associate at the Carnegie Endowment for International Peace. As a Foreign Service officer, Dr. Graham served in several capacities at our embassy in Moscow, including political counselor and head of the Political/Internal section of the embassy staff.

Our third witness is James Finckenauer, a professor of criminal justice on leave from Rutgers University. He has special expertise in the area of organized crime, including Russia.

Senator SMITH. We will hear from Senator Biden when he arrives from the floor. Without further delay, we will turn to Dr. Reddaway and invite your testimony.

**STATEMENT OF DR. PETER REDDAWAY, PROFESSOR OF POLITICAL SCIENCE AND INTERNATIONAL AFFAIRS, GEORGE WASHINGTON UNIVERSITY, WASHINGTON, DC**

Dr. REDDAWAY. Thank you very much, Mr. Chairman.

With your permission, I would like to offer my statement for inclusion in the record.

Senator SMITH. We will receive that and do so without objection.

Dr. REDDAWAY. Thank you, and I will present a brief summary of that statement with a little bit of elaboration in one or two places.

I would like to start with a list, that I hope is in a logical sequence, of points which I think the U.S. Congress, the executive branch, and also the American people need to recognize even though most of these facts are uncomfortable and not very welcome. I would like to start with four that relate principally to the past and the present and then go on to another four that relate to the future.

The first one—and I cannot state this strongly enough—is we have to recognize that the whole Russian system, political and economic, is in a very profound crisis of legitimacy. I think the word “legitimacy” sums it up best. And it is uncertain whether the Russians are going to come through and develop better legitimacy in the future.

The second point is that the Russian Government is the major player that bears responsibility for this most unfortunate development through its ineptness, its corruption, Mr. Yeltsin’s obsession with holding onto power at any cost to his own country. But we in the West also bear a considerable responsibility for what has gone wrong in Russia, in my opinion, especially since 1991 when we became particularly closely engaged.

My third point is that—and this is particularly uncomfortable—the United States is today viewed by most Russians with at best indifference, more often by suspicion, resentment, or even with outright hostility. And the hostility side applies particularly to the political, economic, and social elite in Russia which is on the whole more alienated from us than the mass of ordinary Russians.

My fourth point, which is also very uncomfortable, is that those Russian politicians with whom we are particularly closely associated and have been over the last 7 or 8 years, President Yeltsin, Mr. Chubais, Mr. Gaidar, Mr. Nemtsov, these are the politicians who are at the moment most distrusted and often hated out of all the politicians in Russia.

Looking to the future, my four points are as follows, and they derive from what I have just said about the past. We should, in my opinion, as a country and a Government, stop doing what we have been doing for the last 14 years and especially since 1991, which is advising Russia in a rather insistent way on how to run their internal affairs. Most of our advice over these last 14 years, and especially the last 8 years, turns out to have been inappropriate or even downright wrong. Most of the outcomes in my opinion have been unfortunate or even tragic. At first, of course, in the early 1990’s, the Russian Government very much sought our advice, wanted our advice. That situation has changed in the last 2 or 3 years. They show less and less interest in our advice and increasing interest in opposing us in various regards.

My second main point about the future is that, rather than go on giving advice and lectures to them, which has been the hallmark of our policy over the last 8 years, we should, rather than doing that, open our minds and listen. The key word is “listen” carefully to the internal debates that the Russians are now deeply into and will be into for the foreseeable future over why their system has entered into this acute crisis of legitimacy and how they, the Russians themselves, think that they may be able to come through and get out of that crisis.

My third point is that, after doing a lot of listening, we ourselves listening to the Russians should extend our current and long-delayed debate about what has been wrong with our Russian policy and turn it into a debate about how, in light of the Russian debate and of our own national interests, of course, we should radically reshape our policy toward Russia. The final stage of that debate should involve frequent consultations with the Russians.

At the present stage, I might mention in passing that the Carnegie Corporation of New York is just launching a major Russia initiative which should come to fruition about a year from now, and we will be sharing the results of that project with the Congress through a variety of channels. Mr. Graham and myself are some of the leaders of that Russia initiative.

My fourth point is that for a limited time, perhaps a year or so, we need, in fact, to a certain extent to disengage from Russia. At the same time, we need to explain carefully to the Russians why we are partially disengaging and make it clear that we plan to re-engage on a more full scale as soon as we have listened to their debate and carried out our own debate and entered into consultations with them as to what the future pattern of our relations can most fruitfully be.

Those are my broad points. Let me say why I think this is an especially critical turning point in U.S.-Russian relations. Some of the reasons should be clear from what I have said, but let me add an extra dimension.

The danger does exist, in my opinion, that if we are not extremely careful, Russia could conceivably at some point in the next few years again turn into a rogue state. Russia was a rogue state for 70 years under communism. We did not use the term at that time, but that is in fact what it was.

Now, in my view history is not very often a linear process, and especially that is true when it comes to Russia. In the period from 1860 until 1917, Russia was steadily integrating itself into the Western world, economically, politically, socially, culturally, and so on. Then when we thought that Russia was more or less part of the Western world, suddenly in 1917, what did it do? It pivoted through 180 degrees and shot off in a totally unexpected direction, which was the exact opposite. Instead of embracing democracy, it embraced totalitarian dictatorship. Instead of becoming part of the world capitalist system, it became a closed state socialist system.

Well, by the late 1980's, the Russians had tired of totalitarianism and state socialism, and they were interested again in democracy and free markets. In 1991, they threw off communism and they embraced what is often called shock therapy as a strategy for economic reform, or the Washington consensus. Again, the goal to integrate themselves into the world community, into the world economy, the world political system, international organizations, and so on.

However, that strategy of shock therapy and the Washington consensus has turned out to be—and some of us warned that this would happen from the start—not suitable for Russia and it explains why Russia has landed in the present unfortunate situation with perverted and criminalized forms of economy and political system.

As a result, most Russians are alienated today from the Russian state and to a considerable extent from capitalism and even to some extent from democracy because of the perverted forms that those important institutions have taken in Russia. Today Russia is divided socially into a very small layer of political and economic haves who lead lives of conspicuous consumption, a small layer of middle class, and the great majority of the population who are

have-nots economically, 40 percent live in poverty, even by the Russians' low standards of what poverty is, and they have no effective political or labor union representation.

In these circumstances, it is not impossible that Russia might make another 180 degree pivot as it did in 1917, and instead of continuing to engage itself and integrate itself in the world community, it might shoot off in some other direction. That is the ultimate danger that our Russia policy is called upon to face.

When we rethink our Russia policy, we need to face unpleasant facts, as I mentioned before. Anti-Americanism is now a big feature of the Russian scene. The politicians we are closely associated with—Mr. Gaidar in the latest poll has the trust of 2 percent of Russians and the distrust of 81 percent of Russians. Mr. Chubais has the trust of 3 percent of Russians and the distrust of 85 percent of Russians. Mr. Yeltsin has the trust of 2 percent of Russians and the distrust of 90 percent of Russians. These are the politicians that we are associated with in the minds of ordinary Russians.

Well, I do not think, as I hope I made clear earlier that it is appropriate for us at this stage to put out even a tentative blueprint of what our new Russia policy should be. Let me conclude with a few very broad principles that should guide us, in my opinion, for the interim period.

We should not continue to meddle in Russia's internal political processes and their top personnel choices as we have done on over the last 8 years.

We should not lecture the Russians.

We should not allow the IMF to send large quantities of cash to Russia because it is too uncertain what would happen with that cash.

We should not collaborate extensively with their law enforcement agencies because those agencies are, unfortunately, too corrupt and unreliable.

We should, on the other hand, maintain low key but large scale cultural and educational programs with Russians, especially young Russians.

We should continue the Nunn-Lugar program as long as it is politically feasible to do so.

We should prepare to help the Russians in the various humanitarian and Chernobyl-type crises that are likely to arise in the coming years.

I hope that the Congress will develop close relations with the new Duma which is set to be elected in December of this year.

We should try to develop trade as far as possible, providing it is on a transparent basis.

And, of course, we should not lose sight of our national interests which means openly—more openly than over the last 7 or 8 years—telling the Russians when their behavior is something that we are not prepared to tolerate. Mr. Weldon in the House has taken a strong lead on this. I very much support him and indeed all his policy suggestions vis-a-vis Russia. I think he has a very well thought out program, and it involves being open and frank and direct with them when they do things that we are not prepared to tolerate.

Thank you, Mr. Chairman.

[The prepared statement of Dr. Reddaway follows:]

PREPARED STATEMENT OF DR. PETER REDDAWAY<sup>1</sup>

My statement aims to advance several main ideas:

1. We must recognize that the Russian political and economic system is in a profound crisis of legitimacy.

2. We need to acknowledge that while the Government of Russia bears the major responsibility for this crisis, the West bears a considerable responsibility too.

3. We must face the fact that the U.S. is now viewed by most Russians with indifference, suspicion, resentment, or even outright hostility.

4. We need to ponder the fact that those Russian politicians with whom we are most closely and intimately identified—Yeltsin, Chubais, Gaidar, Nemtsov—are the politicians who are more deeply distrusted and hated by Russians than any others.

5. We should therefore stop what we have been doing for the last fourteen years, that is, advising the Russians how to run their own affairs. Most of our advice has been inappropriate or wrong, and has turned out badly.

6. We should, rather, listen carefully to the debates the Russians are now conducting among themselves about why they are facing a major crisis of their system, and what they should do about it.

7. When we have opened our minds and done a lot of listening, then we should extend our current U.S. debate about what went wrong with our Russia policy into a debate about how—in light of the Russian debate and of our national interests—to radically reshape that policy. The final stage of the debate should be conducted in frequent consultation with the Russians.

8. For a limited time, then—perhaps a year or so—we should to some extent disengage ourselves from Russia, explaining carefully to the Russians why we are doing so, and making clear that we plan to re-engage in accordance with goals that have been, as far as possible, painstakingly and mutually agreed with them.

While the above prescriptions are more precisely defined than such processes can be in real life, I attach great importance to their essence. U.S.-Russian and U.S.-Western relations are, in my view, at a critical turning-point, and if we are not careful, it is possible that Russia could, at some point in the next 5–10 years, become again a rogue state—as it was for seventy years under communism. History, often, does not proceed in linear ways, and least of all in Russia, which has twice in this century been the victim of false ideologies of economic determinism.

During the last fifty years of the tsarist period Russia integrated itself steadily into the world community—economically, politically, and culturally. Yet suddenly, in 1917, with virtually no warning, it pivoted through 180 degrees and sped away in exactly the opposite direction. It embraced Marxism, which held that if the state suppressed the ruling class and ruthlessly seized all economic assets for itself, a Marxist utopia could be built. Thus, instead of continuing to develop free markets and democracy, Russia's Bolsheviks built a totalitarian dictatorship and an economy completely owned and operated by the state.

In the late 1980s Russia tired of Marxism and began to aspire again to democracy and free markets. In 1991, at our urging, it embraced an ideology known as “shock therapy” or “the Washington consensus.” This ideology held—as applied to Russia by the Kremlin and the IMF—that if market mechanisms were imposed on the Russian economy with an iron political will, and the state's assets were quickly privatized, this economic revolution would cause new democratic institutions and the rule of law to arise almost spontaneously. Russia would steadily be integrated into the world community.

After 1917 and after 1991, the “economic base” would determine everything. After 1917 it would produce a socialist utopia. After 1991 it would produce free markets and democracy.

Today, the mounting disillusion of most Russians with the perverted market and democratic system they see around them could conceivably—at some point in the coming years—lead them to pivot again through 180 degrees and speed off in some new direction as a reborn rogue state.

This is the biggest danger that our radical re-thinking of our Russia policy is called on to avoid.

## WHAT HAS GONE WRONG SINCE 1991?

The first and indispensable step towards fashioning a new policy is to examine carefully and honestly what was wrong about the old one. In highly condensed form, this, in my view, is what happened. The U.S., the G-7, and the IMF pushed Russia

<sup>1</sup>Professor of Political Science and member of the Institute for European, Russian, and Eurasian Studies, George Washington University; formerly Director of the Kennan Institute for Advanced Russian Studies.



in 1991 into accepting an economic reform strategy that was not suitable for it. Its cultural traditions after centuries of tsarism and communism were not appropriate for shock therapy. It did not yet have the necessary political, economic, legal, and financial institutions. President Yeltsin's imposition of shock therapy in unsuitable conditions soon produced widespread political opposition, which, with U.S. agreement, was eventually, in October 1993, suppressed through the armed, violent dissolution of the Parliament.

To compensate for his loss of popular support, Yeltsin bought the support of the beneficiaries of the privatization of the state's assets—the so-called oligarchs—by granting them financial and political favors. Although rhetorically opposing the new “crony capitalism” and the widespread corruption of government officials, in practise he allowed corruption and organized crime to flourish virtually unchecked. The outflow of capital out of Russia exceeded the inflow of capital from trade, foreign aid, and investment by roughly two to one. The oligarchs, the officials, and the politicians, including the Yeltsin family, systematically plundered the Russian state. Democracy was subverted, because the Parliament had few powers and the extremely powerful presidency was, in practise, subject to few serious or consistent checks. The judiciary was neglected, and became, in almost all critical cases, a tool of the executive or of organized crime.

Because the West and the U.S. were so closely linked to Yeltsin and the oligarchs, they became objects of suspicion to most ordinary Russians, 40% of whom, even by the low Russian definition of the subsistence level, now live in poverty. The West's expansion of NATO to the east, and its military campaign against Yugoslavia over Kosovo, both in the face of strenuous Russian objections, deepened Russians' alienation from the West.

Today the U.S. is sufficiently unpopular that, for example, according to a poll of 17–21 September 1999 by VTsIOM, only 27% of Russians think that Russia should cooperate with the U.S. in the fight against international terrorism, while 61% are opposed to such collaboration. According to another poll by the Public Opinion Foundation, which does some of the Kremlin's polling, the politicians most closely linked to the U.S. have these ratings: Boris Nemtsov is trusted by 8% of Russians and distrusted by 66%, Yegor Gaidar is trusted by 2% and distrusted by 81%, Anatoly Chubais is trusted by 3% and distrusted by 85%, and Boris Yeltsin is trusted by 2% and distrusted by no less than 90%.

#### WHAT DOES RUSSIA'S FUTURE HOLD?

At present Russian society is divided between a small layer of economic and political haves, a small and—since the rouble devaluation and government bond default of August 1998—diminished middle class, and a big majority of economic have-nots who are, in reality, without representation by either politicians or labor leaders. The big question is whether the alienation of the latter can be reduced without, eventually, major revolts or even revolution. Almost all the contenders for high office in the Duma and presidential elections are beholden to strong private interests, and will not therefore be in a position to put the national interest above these personal and group interests. The tendency of the ruling class is to try to divert attention from its own failings by blaming foreigners, whether international terrorists, as in the current highly dangerous developments in Chechnya and Dagestan, or the U.S. and the West. The main hope is that present and future crises might bring the ruling class to allow the sort of frank national debate which could end in a new emphasis on the national interest. It is the popular longing for this to happen that accounts for the popularity of Yevgeny Primakov, who is seen as non-corrupt and as a defender of the national interest.

In a sentence, can the Russian system regain a measure of legitimacy?

#### RETHINKING U.S. POLICY

As suggested above, I believe it is inappropriate for the U.S. to build a new Russia policy until much rethinking has been done in both Russia and the U.S. But there are some things we should NOT do, and others that we can and should do in a low-key sort of way.

We should NOT:

- interfere in Russian internal political and economic debates over policy;
- in general, lecture the Russians about political and economic reform;
- allow the IMF or other bodies to send the Kremlin large amounts of cash;
- collaborate extensively with Russian law enforcement bodies, because they are mostly too touched by corruption.

We SHOULD, on the other hand:

- continue low-key, but large-scale cultural and educational programs, especially for young people;
- prepare to help when humanitarian or Chernobyl-type crises arise;
- continue Nunn-Lugar assistance as long as it is politically feasible;
- develop Congressional relations with the new parliament to be elected in December;
- trade with Russia wherever this can be done on a transparent basis, realizing that foreign markets are of the greatest importance to the Russian economy.
- counter openly actions of the Russian government that affect our national interests: the Russians interpret anything else as either weakness or evidence of some cunning plot.

## CONCLUSION

The American key-notes should, in my view, be patience, humility, readiness to admit past mistakes, and understanding that the Russians have entered a major systemic crisis: We need to listen, make clear we do not intend to isolate Russia, while, of course, being alert to possible mischief.

Senator SMITH. Dr. Reddaway, I think you have been very helpful. I think you have just stated, as one of your principles, that we should draw back and we should listen to the Russian people generally and their political debate, to their solution, how they get out of it.

What do we do with IMF money in the meantime? I think you said do not be just handing over cash.

Dr. REDDAWAY. Right. At the moment the IMF does not intend to actually hand over any cash, but it does intend to go forward with the present loan. They just transfer the money from one account into the account through which the Russians are paying back previous loans. That policy itself is open to question in my view, but at the very least, in my opinion, the U.S. Government should put pressure on the IMF not to hand over actual new sums of cash. As I say, this is not on the agenda at the moment, but just to keep that in mind.

Senator SMITH. When Russia shot off in an unexpected direction in 1917, it did so under the guise of a new ideology, obviously, communism. Should they do that again, what do you think that guise will be under? What will the political drapings be? Will it just be a fascist situation?

Dr. REDDAWAY. I do not think it would be any sort of return to communism. I think I would rule that out. I do not think it would be fascism. There has been a lot of very good, thoughtful work done by Russian and Western scholars examining the reasons why fascism as such is not actually very suitable for the Russian political culture. It is to do with the fact that the Russians have always really been a multinational people, a multi-ethnic people, and fascism does not go very well with that.

Senator SMITH. Are the Russian people capable of really turning to the West? Is Russia part of the West? Can it ever be part of the West, or is it a nation caught between two continents?

Dr. REDDAWAY. It has had an ambivalent attitude toward the West for the last 3 centuries, and the debate about Russian national identity has been going on all of those 3 centuries. The tragedy and one of the reasons why my co-author and I have named our book "The Tragedy of Russia's Reforms" is that in 1991 it appeared that there was a very good chance that Russia would at last adopt a decisively Western identity. They were extremely open to us. They were wanting to join our world economy. They were want-

ing to become democratic in the way that the West was democratic. There was a unique opportunity, if we had pursued more wise policies, to actually make a breakthrough in this 3-century ambivalence that the Russians have had about the West, and unfortunately, I think for the time being we have blown that opportunity.

Senator SMITH. Are we to be excused at least by the fact that we were dealing with people who at least called themselves reformers, even though apparently they really were not reformers, they were perhaps looters?

Dr. REDDAWAY. I think the root of the problem was that we decided to go along with the ideology that is called shock therapy, or the Washington consensus. I think that that ideology may be applicable to some countries at certain stages in their development, but it was most emphatically not suitable for Russia in 1991. I myself argued that actually 2 or 3 months before Mr. Yeltsin adopted it. He adopted it very much at the urging of the G-7 and the IMF and certain individuals, Jeffrey Sachs and Anders Aslund, in particular. I think it was a profoundly flawed strategy, and the trouble was that it determined the shape of a lot of other policies outside the economic sphere. So, I am afraid we cannot excuse ourselves because we were very much involved in pressing that strategy on the Russians.

Senator SMITH. I guess in our hearing last week, as we went back and forth with Secretary Talbott in the debate about "Who lost Russia," the contention from the administration is that we are not capable of losing Russia. It is not ours. Their defense was we were dealing with people that were democratically elected. We had to deal with them. We were doing as best we could. But I think you might be saying—

Dr. REDDAWAY. I am saying something different.

Senator SMITH. You are saying something very different, that there is a case to be made that Russia was lost.

Dr. REDDAWAY. Yes. Of course, I am against the formula that we lost Russia because the ultimate responsibility did, indeed, lie with the Russians. They decided to adopt shock therapy. Mr. Yeltsin decided to adopt this strategy which was profoundly anti-democratic in its essence. He turned against the democratic support movement that had brought him to power and he emasculated that democratic mass support, and it all came to a head in October 1993 when he dispersed the Parliament by force. I think those were developments that flowed, to a very considerable extent, from the adoption of the shock therapy strategy. I think we made a great mistake by allowing Mr. Yeltsin—it was not for us to allow him, but by giving him advice which led to him subverting and betraying democracy in the interests of a, to my mind, false ideological economic strategy.

Senator SMITH. There is one final question I have. You talked about our need to stay out of Russia's internal affairs, and yet I wonder, on the question of anti-semitism and religious persecution, if we can afford to be quiet in any country.

Dr. REDDAWAY. I was wanting to put special emphasis on staying out of their, if you like, macroeconomic and political policymaking.

Senator SMITH. So, your comments do not extend to our efforts to try to urge and incentivize religious toleration of Jews and other faiths.

Dr. REDDAWAY. They would not extend to that. I think we should speak up on those issues, again not with an overly domineering and morally superior tone, although that cannot be avoided altogether certainly.

We have this record of involving ourselves not just in economic policymaking in Russia, but also in personnel. It was actually an unwritten condition of the IMF loan in 1995 of \$6.8 billion that Mr. Chubais would be the person in charge of running economic policy. It was not written into any agreement, but it was an unspoken agreement, unrecorded agreement, but it was let out of the bag by certain people. That is the sort of meddling, the sort of attempt to direct Russian policy at the macro level, and supporting Mr. Yeltsin prior to his decision to destroy the Russian Parliament in 1993, we gave our permission to do that. We allowed democracy to be subverted in that way. Those are the sorts of meddling and involvement that I think have been very much against our national interest.

Senator SMITH. Any predictions on what direction these elections will cause Russia to go?

Dr. REDDAWAY. I think the new elections to Parliament in December, 3 months from now, are likely to produce a Duma that is even more hostile to Mr. Yeltsin than the present one. It is hard to know how much the support will be for the alliance of Mr. Luzhkov and Mr. Primakov. It is possible they might get 20 percent of the vote, possibly even a little more. It will be a hostile Parliament to Mr. Yeltsin. It is possible that they might renew their attempts to impeach him, assuming he has not resigned by the time the new Duma assembles next January.

As regards the Presidential elections, I do not know if you were asking about those as well.

Senator SMITH. Those as well.

Dr. REDDAWAY. Those as well in June. Those are in some ways more important than the parliamentary elections. That at the moment I would regard as an extremely open race. The only thing I would say is that if Mr. Primakov runs and if he does not make major mistakes between now and then, as things look at the moment, he would have the best chance of winning, and I do not think that would be bad for Russia.

The reason I say that is that he is almost the only prominent politician in Russia who is believed by most Russians to put the national interest above personal and private interests. Almost all the other politicians, with the exception of Mr. Yavlinsky and one or two others, are regarded as representing private and personal interests, group interests. And frankly, those interests have been concerned and still are to plunder the Russian state for their own personal and group interests. It is very sad to have to say that, but that is my considered judgment.

Senator SMITH. The evidence is there.

Thank you, Dr. Reddaway. Very helpful.

Dr. Graham.

**STATEMENT OF DR. THOMAS E. GRAHAM, JR., SENIOR ASSOCIATE, CARNEGIE ENDOWMENT FOR INTERNATIONAL PEACE, WASHINGTON, DC**

Dr. GRAHAM. Thank you, Mr. Chairman. I want to take a few minutes simply to summarize the statement that I have submitted for the record.

This committee has already spent a day focused on the nature of corruption and organized crime in Russia, and I would like to start with just two points on that issue before turning to the broader issue of U.S. policy.

First, corruption has deep roots in the historical conflation of the public and the private in Russian history. For most of Russian history, the state was either the private property of the csar or what I would call the collective property of the Communist Party of the Soviet Union.

What we have witnessed since the breakup of the Soviet Union and the demise of the Communist Party is the fragmentation of the state. The central bureaucracy is much less coherent and disciplined than it used to be, but the one thing that remains the same is that key parts of the state structure remain in the hands of private individuals. They are privatized parts of the state, and they are used largely for private gain and not for advancing the public good.

It is this fragmentation of a privatized state that has exacerbated the problems of corruption that grew out of the Soviet period. Corruption is pervasive now. It is more chaotic. The holders of state power are greedier. The Russians themselves have a word for it. It is "bespredel." It is a world without limits, without constraints, without rules. This corrupt state has sent much of the wealth of the country abroad and it has watched the GDP decline by nearly 50 percent over the past 8 years, and it has watched the standard of living for the vast majority of the Russians deteriorate quite sharply. Not surprisingly, according to recent polls, most Russians view the Brezhnev period, what we used to call the period of stagnation, as a time when life was better.

The second point I would like to make is that there are no easy solutions to this problem of corruption, and some of the remedies can be worse than the disease. While we understandably want the Russian Government to move quite aggressively against corruption, we need to appreciate the dangers of doing that in an environment where the rule of law has not been institutionalized in an independent, reliable, and non-politicized court system, nor has it been internalized by the citizens as a code of conduct. Under such circumstances, the term "Mafioso" or "corrupt official" could easily become the functional equivalent of "enemy of the people" of Stalinist notoriety, and if this happens, an aggressive anti-corruption campaign could become a witch hunt, and that over time will serve only to destabilize Russian society, erode support for democratic principles, and deepen the lawlessness that we see in Russia today.

Combating corruption is going to take political will, imagination, patience, and money over many years, and even then corruption is only going to be tamed. It is not going to be eradicated. This campaign against corruption has to proceed simultaneously with efforts to rebuild the capacity of the state to govern effectively, to separate

the private from the public sphere, to make the state an autonomous entity that works for the public good, not for private gain, and at the same time we have to instill within the citizenry as a whole respect for the rule of law. This is going to take a great deal of time.

Now, this is not counsel for moving slowly against corruption, nor is it counsel for being lenient toward the Russian Government. It is counsel to proceed with full awareness of the difficulties involved, of what is realistically possible. We need to pay attention to the down sides of an anti-corruption campaign so we can minimize them. At the very least, we can and we should insist that the Russian Government cooperate in the current investigations. But as Peter has already pointed out, need to proceed with caution. As any Russian will tell you, the law enforcement agencies in their country are deeply politicized and corrupt themselves. And as a result, even as we cooperate, we will need to verify repeatedly the information we receive from the Russian side, and we are going to need to reassess the motives of our Russian interlocutors.

So, Mr. Chairman, how do we deal with Russia? What principles should guide U.S. policy? Like you, Mr. Chairman, I would add my voice to those who have warned against disengaging. That is not an option given the importance of Russia, what happens in and around Russia to our own security and well-being and to the security and well-being of our allies and partners around the world.

That said, we also need to appreciate the difficulties of engagement. To put it simply, it takes two to engage, and the Russian Government has increasingly lesser capacity to engage productively because it is fragmented and privatized. So, rather than broad engagement, which we have been practicing over the past several years, I would urge pragmatic engagement, that is, engagement on those issues that are priorities to the two sides. Strategic nuclear stability, for example, is a shared top priority, even if we differ on the solutions. On this matter, engagement is both necessary and natural.

Nonproliferation of weapons of mass destruction is, however, another issue. There is a shared interest but the priorities that we attach to this are quite different. For us it is a top priority, one of the few real threats to our security over the next decade and beyond. For the Russians, however, the immediate security threat arises from socio-economic decline in their own country, not from proliferation. For this reason, Russians tend to be lax on technology export controls because the sale of technology provides desperately needed money for dealing with domestic ills.

So, the challenge to the United States is to develop ways in which we can provide incentives to Moscow to raise the priority of nonproliferation for them, and I think that is going to mean that we are going to have to engage them on issues of high value to them that might be of lesser significance to us, say, something like debt relief. Now, I am not saying that this is the appropriate linkage or the only linkage. All I am saying is that we are going to have to make some serious and tough tradeoffs if we are going to engage Russia to our benefit.

Now, on the more specific issue of dealing with Russia, knowing what we do know now about corruption, I want to make five recommendations.

First, we need to ensure the integrity of our own institutions. I think the steps that the Congress is taking to ensure better oversight of our banking and financial system are steps in the right direction. We need to make them less vulnerable to money laundering operations.

Second, we need to continue our efforts to integrate Russia into the global economy. To succeed globally, Russian businessmen will have to adapt to the values and principles of the world economy where corruption is, or at least can be, punished more harshly than it is within Russia today. Integrating Russia will entail that we continue to provide properly safeguarded IMF funding to the Russian Government, at least to cover debts, and moving it from account to account, not simply handing it over to the Russian Government. I think it is also going to require that we consider some form of debt relief, but then again, only in exchange for a Russian commitment to move forward on micro-economic restructuring.

Third, we need to refocus some of our technical assistance. To date, we have spent relatively little on rule of law programs, preferring to spend the money on economic reforms and business practices. I think we need to remember, as we do this, that our influence, as Peter has already pointed out, is going to be on the margins. The demand for a rule of law society has to originate within Russia itself. The demand has to come from Russians themselves. At best, we can help nurture and channel these desires.

Fourth, we need to do a much better job of selling America and our values in Russia. As Peter has pointed out, over the past 8 years, we have squandered a vast reservoir of goodwill toward the United States by our close identification with an increasingly enfeebled Yeltsin, by our support for the increasingly unpopular so-called radical reformers, and by our unwavering support for shock therapy, or the Washington consensus, for an economic policy that the vast majority of Russians believe led their country to ruin.

There are two ways at least in which we can improve the image of the United States while imparting values to Russians in a non-patronizing fashion and laying the foundation for the development of rule of law over the longer term.

First are exchange programs. We have already done a considerable amount in this area, and many observers have pointed out that these programs are the best payoff in imparting values and winning friends for the United States. As we look toward the future, I would suggest that we focus less on passing technical information and skills through these exchange programs, even in the areas of democracy-building. Rather, what we need to do is give a greater number of Russians the opportunity to enjoy a liberal education in the United States. Longer-term exchanges will allow them to experience firsthand how our society functions. They will become acquainted with the values that are essential to building an effectively functioning rule of law society. This approach has the advantage of allowing Russians to adapt our experience to their society, to Russian conditions, rather than our telling them how they have to be adapted.

Second are our information centers. Now, Peter has said that there is growing anti-Americanism in Russia, and he is certainly right on that score. But I would also point out that there is an abiding curiosity about the United States as a successful and powerful country, and we need to play to this curiosity. One of the unusual successes of the past several years have been information centers that we have set up in major cities across Russia. These centers provide printed material and access to the Internet. As such, they have become valuable sources of information about the United States, both our political system and our legal system.

Senator SMITH. Are they highly utilized?

Dr. GRAHAM. That is the next point I was going to make. They are highly utilized, and more important, what we have noticed over time is increasing numbers of Duma deputies and other officials at both the national and regional level are turning to these centers for information about the United States, particularly about legislation that is under consideration in the Duma. They want to know how we do it, how it is done in a normal and successful country, and then they try to adapt those principles to their own legislation. This, I think, is a way in which legislation within Russia has improved over time. So, I think as we move forward, one of the things we might consider is expanding the collections of these centers and also expanding the network across Russia.

Now, the last point I would like to make is that as we proceed, our senior officials of this administration and any future administration should seek to establish what I would call a respectful distance from their Russian counterparts. The problem was not that this administration over-personalized the relationship with Yeltsin, although that in fact did happen, but rather that a relatively small circle of senior administration officials entered into what I would call a partnership with a similarly small circle of senior Russian Government officials for the purpose of transforming Russian society. Like all partnerships, this one required a high level of interaction and a high degree of trust among the individuals involved. The result was that senior administration officials were tempted to turn more to their Russian partners than to the intelligence community and the Foreign Service for insights as to what was happening in Russia and how to proceed. Moreover, the success of their partners became critical to the success of the enterprise itself, and slowly the political survival of specific individuals, Mr. Chubais in particular, became a symbol of the success of overall reform effort. This close association with Russian senior officials led to a great misreading of the political situation which led to the administration's being caught off guard by the financial collapse of August 1998.

Now, this example that senior administration officials set I think had a pernicious influence down the line. Lesser government officials began to see their Russian counterparts in a similar fashion, as partners and not, first of all, as representatives of a foreign government with its own motives and its own agenda. As a result, over time we as a Government tended to see Russia through the eyes of our official Russian partners who had a vested interest in persuading us that they alone knew what was happening and what needed to be done.



To guard against this tunnel vision, I think we as a Government need to engage a broader range of Russian contacts in serious discussion. There are, of course, limited possibilities for senior officials. There is the press of time, time constraints. But what we need to do is utilize to the maximum the opportunities afforded to embassy and consulate officials and official Washington visitors to engage Russians, not only to argue our point of view to represent our interests, but as Peter has said, to listen attentively to what they are saying about their own country, about where it is headed, and what needs to be done. This is a task that we have not taken seriously enough to date, but it is critical to the success of our policy and I think we need to begin to do a much better job in this regard.

Thank you, Mr. Chairman.

[The prepared statement of Dr. Graham follows:]

PREPARED STATEMENT OF DR. THOMAS E. GRAHAM, JR.

Mr. Chairman, I deeply appreciate the opportunity to speak before this committee on the issue of corruption in Russia and U.S. policy responses.

This committee has already spent a day focused on the nature of corruption and organized crime in Russia. I only want to stress two points on this matter, before turning to the question of U.S. policy.

First, corruption has deep roots in the historical conflation of the private and the public in Russia. For most of Russian history, the state was for all practical purposes the property of the Tsar. There was no formal distinction between sovereignty and ownership, between the public sphere and the private sphere. Almost by definition, public positions were exploited for private gain. This situation was beginning to change in the nineteenth century, but the Bolshevik coup d'etat put an end to this positive evolution in 1917. The Communists reverted to the old tsarist tradition, with one distinction: The state became the collective property of the rigidly hierarchical Communist Party of the Soviet Union, not the sole property of a single ruler.

What we have witnessed since the breakup of the Soviet Union and the demise of the Communist Party of the Soviet Union is the fragmentation of the state. Much power has flowed out of Moscow into the regions. The central governmental bureaucracy has become less coherent and disciplined. But the important point is that various key pieces of the state remain the private preserves of specific individuals, managed primarily for private gain rather than for the public good. Moreover, unlike the Soviet period, when "property owners" derived profit from the state's strength and control of society, today's proprietors find it more advantageous for the state to be weak and incapable of mobilizing resources for its own projects at home or abroad. They enrich themselves by preying on the weakness of the state, by stripping assets from property that once belonged to the state as a whole.

This fragmentation of the state has exacerbated the problems of corruption that grew out of the Soviet period. Corruption has become pervasive, more chaotic; the holders of state power greedier. The Russians have a word to describe the situation: *bespredel*, or a world without limits, constraints, or rules. The corrupt Soviet state was in some ways better for the population as a whole. It may have squandered resources on excessive military production, but it did keep wealth within the country and slowly raised living standards. The new Russian, fragmented state has overseen the collapse of production—GDP has plummeted by nearly a half since 1991—and sent much of the country's wealth abroad, while the standard of living of most Russians has sharply deteriorated. Over 37 percent of the population now lives below the official poverty line; five years ago, the corresponding figure was just over 20 percent. Should it be surprising that, according to recent polls, Russians look back to the Brezhnev period, once known as the "time of stagnation," as a time when life was better?

Second, there are no easy solutions to the problem of corruption in Russia, and some remedies can be worse than the disease. While we understandably would like the Russian government to move aggressively against corruption, we need to appreciate the dangers of doing so in a country where the rule of law has not been institutionalized in a reliable, independent, and non-politicized court system or internalized by most citizens as a code of conduct. Under such circumstances, "Mafioso" or

“corrupt official” could easily become the functional equivalent of “enemy of the people” of Stalinist notoriety. The only difference would be that whereas most of the charges against “enemies of the people” were absurd, those against “mafiosi” or “corrupt officials” would have a certain ring of credibility. An aggressive anti-corruption campaign could easily turn into a witch-hunt, which in the long run would only serve to destabilize Russian society, erode support for democratic principles, and deepen lawlessness.

Combating corruption will demand political will, imagination, judiciousness, patience, and money applied over many years, and even then corruption will not be eradicated but only reduced to manageable proportions. The campaign against corruption has to proceed simultaneously with efforts to rebuild the capacity of the state to govern effectively; to separate the public from the private sphere and make the state an autonomous entity for the promotion of the public good; to construct an independent and reliable court system; and to instill respect for law within the political class and more generally across society. Both Russian and Western leaders must pay close attention to ensure that there are no excesses, no dangerous encroachments on human rights.

This is not counsel for slow movement on corruption or leniency toward the Russian government. It is counsel to proceed with full awareness of what is realistically possible and the potential downsides, so that we can take steps to minimize them. At the very least, we can—and should—insist that the Russian law enforcement agencies cooperate with us in the investigation of cases such as that involving the Bank of New York. But even here, we must proceed with caution. Any Russian can tell you that his country’s law enforcement agencies are themselves corrupt and highly politicized. Much of the mud-slinging, or *kompromat* wars, now escalating as Russia enters an electoral cycle, has at its origins information obtained from these agencies. As a result, even as we cooperate, we will need to verify repeatedly the information we receive and reassess the motives of our Russian interlocutors.

So, Mr. Chairman, how do we deal with Russia? What principles should guide U.S. foreign policy? I would add my voice to those who have warned against disengaging. That is not an option, given the importance of what happens in and around Russia for the security and well-being of the United States, as well as of our allies and partners the world over. Moreover, we cannot reliably isolate or contain the problems arising from the breakdown of governance and the rise of corruption in Russia. We need to deal with the problems at their origins.

That said, we also need to appreciate the difficulties of engagement. It takes two to engage. And Russia in its current state has an increasingly lesser capacity to engage productively. We need to take care not to overburden the circuits or impose engagement on the Russians where they are not ready for it. Rather than broad engagement, we need pragmatic, engagement on those issues that are priorities to the two sides. Strategic nuclear stability, for example, is a shared top priority issue for both sides, even if we differ on the solutions. On this matter, engagement is both necessary and natural.

Non-proliferation of weapons of mass destruction is another matter, however. There is a shared interest, but the priority each side attaches to it is different. It is a top priority for us, one of the few real threats to our security. For the Russians, the immediate security threats arise more from socio-economic decline than proliferation. Russians are more lax in their technology export controls in part because the sale of technology brings into the country desperately needed resources for dealing with urgent domestic problems. The challenge for the United States is to create incentives for Moscow to give non-proliferation greater attention, and that will only occur if we begin to address issues of great value to them that might be of lesser priority to us, say, debt relief, restrictions on imports of Russian steel, or repeal of the Jackson-Vanik amendment. This is not to say these are the right or only possible linkages, but rather that we will have to be prepared to make tough trade-offs if we are to engage Russia to our benefit.

On the more specific issue of engaging Russia, knowing what we now do about corruption, I would offer the following five recommendations.

First, we need to ensure the integrity of our own institutions. The Congress is to be commended for introducing legislation that will tighten the supervision of our own banking and financial system to make it less vulnerable to money laundering operations. At the same time, we need to press ahead with the investigation of the current charges, taking care to distinguish criminal actions from capital flight, not accepting allegations against specific individuals as fact, and refraining from generalizing from this case to all Russian businessmen and officials. There are thousands of honest and decent Russians engaged in business or trying to make government work for the welfare of the people.

Second, we need to continue our efforts to integrate Russia—and Russian business—into the global economy. To succeed globally, Russian businessmen will have to adapt to the values and principles of the world economy, where corruption is—or at least can be—punished more harshly than it is within Russia. Integrating Russia entails that we continue to provide properly safeguarded IMF funding to the Russian government (at least to cover past debt to the IMF) and that we consider debt relief, but only in exchange for Russian movement on a genuine program of micro-economic restructuring. Finally, this means we have to take a tough look at our own practices to determine whether we can open our own markets up further to competitive Russian products.

Third, we need to refocus some of our technical assistance. As others have noted, the United States has spent relatively little on programs designed to advance the rule of law and other democratic practices, choosing to concentrate instead on economic reforms and business practices. These programs can range from developing programs to train judges to assisting in the development of civic education courses for schools and universities. Our goal should not be to impose our system on Russian society, but to help Russia develop one that fits its own conditions, while meeting international standards.

At the same time, we need to remember that, like the rest of our assistance programs, our influence will be only at the margins. The demand for a rule of law society must emerge from within Russian society. At best, we can help nurture and channel it. This is true of democracy-building more generally. In the ongoing debate on where Russia is headed, the Administration and others have pointed to regular elections, a vigorous media, and respect for basic democratic freedoms as signs of progress and the success of Administration policy. It is important to remember, however, that the origins of the great democratic opening of Russian society occurred under Soviet leader Gorbachev when there were few credible promises of Western assistance. It happened because the Russian elites and society more broadly saw these developments as critical to restoring the country's vitality and turning it into a "normal country."

Fourth, we need to do a better job of selling America and our values in Russia. Over the past eight years, we have squandered the vast reservoir of goodwill Russians had for the United States through our close identification with an increasingly enfeebled Yeltsin, strong backing of profoundly unpopular "radical reformers," and unwavering support for economic policies, which Russians believe led their country to ruin. Preaching to the Russians about the evils of corruption now will do nothing to restore that reservoir. There are two ways, however, in which we can restore some of this goodwill, while imparting values to Russians in a non-patronizing fashion and laying the foundation for the development of rule of law over the longer term.

- Exchange programs. We have already done a considerable amount in this area, and many observers have pointed to these programs as the best payoff in imparting values and winning friends for the United States. As we look toward the future, there is less of a need to impart specific technical skills in democracy-building, NGO-building, and so on. Rather, we need to give a greater number of Russians the opportunity to enjoy a liberal education in the United States. Longer-term exchanges will allow them to experience first-hand how our society functions, as well as to become acquainted with values that are essential to the building of a rule of law society. This approach has the added advantage of letting the Russians themselves adapt our experience to Russian realities.
- Dissemination of information and information centers. There remains a critical need for information about the United States and the West in general in Russia. One of the unsung successes of the past several years has been the information centers we have set up in several cities across Russia (Moscow, Vladivostok, St. Petersburg, Rostov-on-Don, Tomsk, Nizhniy Novgorod, and Yekaterinburg). These centers play to the natural curiosity Russians still have about the United States as a prosperous and successful power. They provide not only books and other printed material but also access to the Internet. As such, they are a source of valuable information on the United States, including our political and legal systems. Over the years, Duma deputies and local officials from across the political spectrum have routinely requested information on U.S. legislation from these centers on a range of issues that were under consideration in the Duma and other legislative bodies. This information has improved the overall quality of Russian legislation. For these reasons, we should consider building up the collections of these centers and expanding them into other cities.

Last, senior officials of this and future Administrations need to establish and maintain a respectful distance from their Russian counterparts. The problem was

not that this Administration overpersonalized the relationship with Yeltsin—although that did happen—but rather that a relatively small group of senior Administration officials entered into a “partnership” with a similarly small group of senior Russian officials to push forward an agenda focused primarily on the domestic transformation of Russia. Like all partnerships, this one required constant interaction and a high level of trust to function effectively. The result was that senior Administration officials were tempted to turn more to their Russian partners than to the Intelligence Community and the Foreign Service for insights as to what was happening in Russia and how to proceed. Moreover, the success of their partners became critical to the success of the enterprise as a whole, and slowly the political survival of someone like privatization czar Chubais became a symbol of the success of reform as a whole. This ultimately led to a grave misreading of the political situation, which resulted in the Administration’s being caught off guard by the financial collapse of August 1998.

The example senior Administration officials set had a pernicious influence down the line, as lesser officials began to see their counterparts in the Russian governments in a similar fashion, as partners, rather than as first of all representatives of a foreign government with its own agenda. The goal was to push forward the domestic transformation of Russia, not to provide critical assessments of the policies themselves. These official contacts became the primary sources of information about what was happening in Russian society, in part because dealing with policy issues left little time for nurturing contacts elsewhere in Russian society. As a result, we developed as a government a tendency to see Russia through the prism of our Russian partners, who had a vested interest in persuading us that they alone knew what was really happening and what needed to be done.

To guard against such tunnel vision, we need as a government to engage a broader range of Russian contacts in serious discussion. There are, of course, limited possibilities for doing this at the highest levels; the time constraints and press of other business leave little time for serious grooming of contacts. But we need to utilize to the maximum the opportunities afforded to Embassy and Consulate officials and official Washington visitors to engage Russians, not only to argue our policies and represent our interests, but to listen attentively to what they are saying about their own country. This task we have not taken seriously enough to date.

Thank you, Mr. Chairman.

Senator SMITH. Thank you. You have been very helpful.

I wonder if you can speak to some specifics. You had some great suggestions, but in our hearing last week, we were trying to draw out what has gone on really in all of this. The former Deputy Assistant Director of the FBI in charge of criminal investigations, Jim Moody, testified before this committee that a Russian law enforcement official he spoke to estimated that 90 percent of his officers were corrupt. How can the United States collaborate with Russian law enforcement and security services if large numbers of them are just simply corrupt?

I love your idea about more and more engagement, but it seems to me the Clinton administration has tried to engage. And I am saying this as a Republican, trying to be fair. They have tried to engage but they have met with folks whose motives are not to the benefit of the Russian nation.

Dr. GRAHAM. Yes. The point that I would make on that is that if 80 percent are corrupt, then there is a 20 percent that is not corrupt. The real challenge for us, as we try to engage Russia, is to find those 20 percent—I would suggest that it is somewhat more—who do have an interest in dealing with corruption in an equitable fashion in Russia today.

Senator SMITH. We would have to be careful because it seems to me that it may allow sensitive information to get to criminal hands.

Dr. GRAHAM. Obviously. So, this is why I urged that we have to treat these relationships with extreme caution. We have to know

whom we are dealing with. But simply not to engage because of the possibility of the leakage of information I think is the wrong approach. What we need to do is to check as carefully as we can who we are dealing with, proceed cautiously as we develop the level of trust that we need in order to engage productively across a range of issues, particularly in criminal investigations.

Senator SMITH. I think that is right.

It is alleged that the intelligence community and our diplomats in Russia were discouraged from fully airing information about systematic corruption in Russia. You spent some time there. You can tell us whether that is the case or not. They were discouraged from giving information about the lack of transparency in the Gore-Chernomyrdin Commission. Is that fair? Is that accurate?

Dr. GRAHAM. I would argue that that is not an accurate picture of what the embassy did at least. I cannot speak to the intelligence community, but you have had people who could address that issue.

My experience in over 3 years of supervising all reporting on domestic political matters in Russia is that there was no systematic attempt to prevent us from sending back what we thought needed to be sent back no matter what official it concerned, no matter what the charges were, whether it be corruption or something else.

That said, you have to remember that as Government officials and embassy officers, we had a responsibility I think to be quite careful and cautious in the way we treated specific allegations against specific individuals. We, as Foreign Service officers, did not have the ability, I would say, to investigate these charges fully. They were rumors. What we tended to do was to present these as rumors back to Washington in the hopes that there was someone else in our Government, whether it be in the intelligence community, the FBI, or elsewhere, who would find this a useful piece in a puzzle that they were trying to put together. But we were always very careful to give some assessment of the source and what we thought might be the possible validity of the information.

The second point I would like to make is that for most of the time that I was in Moscow, I had the authority to sign cables out of the embassy. I did not have to give them to the Ambassador for prior review. I can tell you that we sent out what we thought needed to be sent out, and at no point did the Ambassador come back and say, stop sending that information back to Washington, they do not want to hear it. We were encouraged to do that.

The point I would like to make on the Gore-Chernomyrdin Commission is that I think this falls into a somewhat different category. The problem with the commission was not so much its original design. I think it served a useful purpose in bringing together government officials on both sides to discuss a range of issues that were of interest to both governments. There were some, I think, productive and useful exercises, particularly in working on some business exchanges within that commission.

The commission, however, came to meet too frequently, and anybody who has served at an embassy knows that when you are bringing over hundreds of senior U.S. officials, eight or nine cabinet officers, all demanding the attention of a senior administration official, this is a tremendous burden on an embassy. We would have to close the embassy down for other business, by and large,

3 to 4 weeks before these delegations arrived. Obviously, that puts a limit on what we can do in our real job, which is interacting with Russian society. It puts a limit on what we can do in reporting on Russian society. So, I think the frequency and also the nature of high level meetings like this, that is, to look for success stories, ultimately had a pernicious influence on the reporting out of the embassy. That is not to say we should not have done it. I think we should have done it, but we should have stretched out the time between sessions and had them not so much on a regular basis but ad hoc when there was real business to be discussed and business to be concluded.

Senator SMITH. Can you speak to the IMF managing director who told the Washington Post in February 1996 that in a real sense the IMF was financing Russia's military efforts in Chechnya? Do you think that is accurate?

Dr. GRAHAM. I think you have already had a discussion over whether money is fungible or not, and I think that is the point that I would make. Obviously, the Russian Government chose what to do with the money. You will never be able to demonstrate that there were bills that were printed and received from the IMF that were spent on the Chechnya effort.

Clearly I think we should have been much harsher in our judgments against the Russian Government at that time. It was a time when it was probably wise for, again, political reasons to withhold the tranche of an IMF agreement precisely because we knew that money was fungible and that any money that we would put in at that time would allow the Russians to use other sources to conduct the war against Chechnya.

Senator SMITH. What should our policy be with respect to Russia and Chechnya, and Russia and Kosovo, in providing financial resources?

Dr. GRAHAM. The Russians have a tremendous problem in the north Caucasus now. It is not only Chechnya, but it is Dagestan, it is elsewhere. I think, unfortunately, they are going down the wrong track in seeking a military solution to what is largely a socio-economic problem. Of course, the problem is that Russians do not have the resources in order to engage in a broad political and socio-economic program aimed at pacifying the region by giving the people of that region a reason to stay within the Russian Federation.

I also think that you have to see this crisis within the context of the broader Caucasus. It is not only instability in Russian regions, but there is instability in Georgia, Armenia, and Azerbaijan. I would submit that there is no solution to Chechnya outside of a broader solution to the whole Caucasus situation.

What is probably called for at this point is something along the lines of an international conference on the Caucasus where we bring together the leaders and the political actors, both Russian from the Trans-Caucasian region, Chechen leaders, Dagestani leaders, and so forth, and look to see whether it is possible to make broad tradeoffs that will satisfy both sides.

Clearly for this to succeed, it is going to require financial resources, and that is where the West comes in. We are the only people who have the resources that could be used for a solution of this

kind. Now, I do not know what the details are of it, but as I said, I would submit that solving this problem simply between Russia and Chechnya is impossible at this point. Our national security does, I think, call for stabilizing the region, and I think it is at least worthwhile pursuing this option at this point to see what can be done.

Senator SMITH. Thank you very much, Doctor. I appreciate so much your testimony.

Dr. Finckenaue, we appreciate your being here and look forward to hearing your views on how we deal with corruption.

**STATEMENT OF DR. JAMES O. FINCKENAUER, PROFESSOR OF CRIMINAL JUSTICE, RUTGERS UNIVERSITY (CURRENTLY ON LEAVE), WASHINGTON, DC**

Dr. FINCKENAUER. Thank you very much, Mr. Chairman, and thank you for giving me the opportunity to speak with you today. I certainly agree with your comment at the outset, that this is a very important and timely topic.

I would like to divide my presentation roughly into three areas, and some of what I will say will echo what my two colleagues have already spoken about. I think it is important to have a little bit of a historical overview to give us some context for understanding what is going on today. I will talk a little bit about the current state of affairs and then also offer just a few recommendations for some future strategies and policies.

With regard to this history, I think it is important to understand that what we see called today crony capitalism and patrimonialism not only in Russia, but also in other of the former Soviet Republics, are not new phenomena. I think it would be wrong and remiss to assume that this sort of symbiotic relationship among crime and the government and the economy all began after the collapse of the Soviet Union in 1991. As I think Professor Reddaway alluded to, corruption and corrupt bureaucrats in Russia go back to the time of the csars. What is particularly important to understand about the historical period is that so too does a very blase attitude about the legality of stealing from the state as being accepted as normal behavior. I think it is important to understand that that very much shapes the kind of mentality that exists in Russia today, given the economic situation and the corruption situation.

Senator SMITH. Doctor, Secretary Talbott was here and he said last week—and I quote—“Russia’s current problems with crime and corruption are different from the corruption so entrenched in Soviet communism. Indeed, today’s problems are a result of an incomplete transition to democracy and market reform.” I think you are saying that is not the case.

Dr. FINCKENAUER. I think they are different in the sense of the differences in the economy that exist today and the opportunities for corruption that exist today. I do not think they are different in the sense of a mentality about taking advantage of opportunities and, in a sense, having a sort of historical perspective to this.

I think other elements of the history are the role of organized crime that began very early in the Soviet Union, the linkages, the growth out of the Gulag system of organized crime. We had the Communist Party that took on the trappings and characteristics of

a sophisticated criminal organization, and then we had, as was also mentioned, the Brezhnev period in particular in the Soviet Union that was a period in which corruption sort of rose to its zenith. So, we see certain historical legs that provide the foundation for what has happened in Russia since 1991.

I think a critical characteristic of that Soviet period is what the Russians call "blat." It means use of informal personal networks to obtain goods and services that are in short supply. As we will remember, lots of things were in short supply in the Soviet Union. If we draw a contrast with the United States—and my area of specialty in criminal justice is organized crime, and I have spent a lot of time studying organized crime in the United States—we see that organized crime arises principally to provide goods and services that are in demand, but that are either illegal or in short supply because they are being regulated. What we saw in the Soviet Union was that the response to the shortage of goods and services was a black market, a shadow economy, and this system of blat, the system of informal social networks and connections.

Senator SMITH. How do you spell that word?

Dr. FINCKENAUER. B-l-a-t.

Senator SMITH. Blat.

Dr. FINCKENAUER. Blat.

I think that is the foundation which has evolved into what we see as today's more formal or more, say, sophisticated, higher level kind of corruption. Things like insider trading, preferential licenses, rigged auctions, illegal banking of state funds are all new examples of the same phenomenon, this phenomenon of blat.

I just recently read a book called "Collision and Collusion" by Janine Wedel in which she talks about how the informal networks in Russia and Ukraine and also in Eastern Europe diverted and subverted massive amounts of the Western aid that has come into Russia and Ukraine in the 1990's. Subverted because it got linked into this personal network system that people were accustomed to. This is the way they did business. This is the way things operated in the Soviet Union.

In the work I am now doing in Ukraine, I see some of the same practice, but I think it is what we would call cronyism. The people that I deal with in Ukraine see nothing wrong with this. They do not understand that we are looking to develop, for example, a merit-based system to award grants to researchers or to award Internet contracts. They want to deal with the people they know because they trust them because they have some track record with them. It is not hard to see how this can get elevated to a much larger scale and bring in many, many more people who do not essentially see this as wrong. This is the way we do business, and this is the way a sort of interpersonal trust operates in this area.

I think that, as other people have said better than I, we need to understand this history. We need to look at the impact of that history on what we have done and also need to draw lessons for what we do in the future and learn from that experience.

As my colleagues have also said today, in Russia we see a very feeble commitment to the rule of law. And maybe feeble is overstating the commitment. In part it flows from the kind of background that I have just sketched out. Whereas, in most of the coun-



tries of the world, crime is something that is outside the state and the society and sort of in opposition to them, in Russia crime is inside the state and the society. It is insidious. It is pervasive, but it is also mainstream in a way that we in the West do not quite understand. The kind of centrality, if you will, of official crime and its relationship to what is taken to be normal political activity is a carryover of this blat system that I described.

As a result of this, we see in Russia state institutions that are very protective of their own vested interests, but are very negligent and deficient when it comes to defending the interests of ordinary Russian citizens. One of the results of this is to breed disrespect and distrust of legal and political institutions among the Russian people, and it also opens the door to opportunities for Russian organized crime because what happens is when the state falls down on its job of providing protection and employment and social services, other mechanisms begin to move in to fill that gap. Russian organized crime is one of those mechanisms.

To give you another Russian word, there is a word "krysha" which in Russian means roof. Practically every business operating in Russia today has to have a krysha, or roof. This is a form of protection, a form of insurance, if you will, to protect businesses from extortion. Now, why is there this role for the krysha? It is because the state and state institutions do not have either the will or the capacity to protect businesses. So, for example, if somebody wrongs you in a business deal, who do you go to in order to get redress of your grievance? There is no mechanism to go to. There is no mechanism that is trusted by Russian people and by Russian businesses, so they turn to organized crime to resolve that. What that does is simply continue to promulgate and strengthen the role of organized crime in Russia.

Senator SMITH. Doctor, can that explain perhaps why an American businessman named Paul Tatum was slain over a dispute over a hotel? We may never find out who did that. Is that what you are telling me?

Dr. FINCKENAUER. That is correct. Let me put on my social scientist hat and say I think that is a plausible hypothesis. Given that we know that these kinds of activities go on and given that we know organized crime is in fact being paid to protect the interests of businesses, it is not hard to make the next step and say, well, that killing was a step in protecting somebody's business interest. Certainly, as I say, a plausible hypothesis.

One other thing about these so-called kryshas, often they are made up of police types who may be active duty police officers who are working in protection rackets—and I will call them rackets—on the side as a way of making extra income. They may be ex-KGB agents who have skills in the areas, or they simply may be traditional organized crime types. But it is a pervasive operation that permits business and facilitates business practices to continue.

Senator SMITH. But you are not describing a system that is going to attract a lot of U.S. or European capital.

Dr. FINCKENAUER. No, I do not think so. I think that early on there was a naivete and an ignorance about the way business was done in Moscow and elsewhere in Russia, and I think American businesses, as they are oft to do, looking for opportunities—they

are entrepreneurs. They were looking for opportunities. But I think there have been some hard-learned lessons out of the last 10 years of trying to bring business practices into the Soviet Union.

Senator SMITH. But if it is as pervasive as you suggest, maybe I should be more pessimistic about it. I have tried to remain optimistic. I am not sure I should be if there is the system of blat and what was the other word?

Dr. FINCKENAUER. Krysha.

Senator SMITH. Krysha. If that is the way it is done, there are other places to invest.

Dr. FINCKENAUER. But if I jump ahead to propose an alternative, I think that the krysha system, the roof system, the protection racket system is related to the weak role of the state. So, therefore, one needs to think about how do you begin to build—and my colleagues have already mentioned it—a rule of law? How do you build a viable judicial system and legal system that would provide the avenues for businesses to turn to if they have grievances or they have other problems that they want to be worked out? That is obviously the way we do it in the United States. We do not turn to organized crime—or at least most of the time we do not—to resolve those kinds of disputes. So, one is related to the other.

I think that the development of the legal system and the judicial system is very much intertwined with the attempt to develop a viable economic system, and among the aspects of that development is trying to do away with this krysha system, do away with the need for that kind of a system.

Senator SMITH. Is it fair to say, though, that this existed even with a dominant, heavy state under the Soviet Union with central planning? This existed anyway because that state—even though to the outside world it was a powerful, centrally planned super power—was really a very weak state when it came to protecting its citizens. Therefore, this kind of thing predated the collapse of Soviet communism.

Dr. FINCKENAUER. But I do not think you had this kind of krysha system in the economic role. You had a black market and you had a shadow economy, but by and large, those were permitted by the state because the state well knew that the state economy was unable to meet the needs of the Russian people.

Senator SMITH. And it has just grown.

Dr. FINCKENAUER. So, they sort of allowed, if you will—not only allowed, but in part benefited from allowing—the black markets to exist.

But now we see this explosion of other kinds of economic enterprises that did not exist before. You have pizza joints, for example. I have a colleague. We were standing on a corner in Moscow and just looking around, and she said to me every one of these businesses, including this local little pizza place, is paying a krysha in order for them to operate.

I had another colleague describe to me how an individual that he knew set up a small kiosk, literally on a sidewalk, in Moscow selling rugs that he was bringing in from Central Asia. He very quickly was approached by some individuals who said to him, this is our territory. We will, in effect, allow you to operate on this corner or in this area in return for 10 percent of your profits. When this

same friend of mine talked again to his colleague who is still in the rug selling business, this percentage had grown to 80 percent. So, the challenge to the business person is how much is that 20 percent worth to me? Is this still a viable business that I will pay the other 80 percent simply to be allowed to operate?

But the point is that the individual has nobody to go to. There is no recourse. Who does he go to to complain about this, who is actually going to come in and take some action? No one.

So, we see, I think, a system that has bred distrust and disrespect of legal and political institutions in Russia.

We do, by the way, have an analogous situation that I think we could learn lessons from, and that is in Sicily where the Sicilian Mafia, also in the instance of there being a weak state, came in and essentially ran an extortion racket and a protection racket. But we now see strong measures being taken to combat the Sicilian Mafia, often driven by grassroots efforts to support that. And I think that perhaps we could look to that as a model or as an example of where we could apply some of those lessons in the Russian situation.

The nature of organized crime in Russia is quite different than it is in the United States. It is much more, I would say, professional, much more adept at what we call white collar crimes as opposed to the traditional crimes of prostitution and gambling and drugs and so on, not that they are not engaged in those, but they are also involved at much higher level, more sophisticated kinds of crimes, electronic crimes, defrauding banks and other financial institutions, money laundering.

They are also engaged in supporting political candidates. There were questions about what is going to happen with the elections. I would be interested in where the money is coming from to support candidates in the elections and how much of that is dirty money perhaps coming out of organized crime.

They are buying mass media. They make charitable donations to very considerable degrees.

They are also a global phenomenon, and I think it is very important that since we are sitting here in Washington, DC, we not lose sight of the fact that we have other reasons to try to engage in what is going on in Russia and to help bring about reform that go beyond the altruistic and philosophical reasons of, for example, supporting democratic governance. Beyond Bank of New York type problems, we see threats of trafficking of arms, drugs, women and children, cybercrime, counterfeiting, economic espionage, et cetera, all of which are threatening to the United States, in the United States. It is not just what are the United States' interests in Russia per se. My point is we have other reasons to want to be engaged and stay on top of this in an attempt to encourage and bring about reform.

Let me quickly turn to the future and premise this by saying, given this sort of dark and gloomy scenario, what can be done about any of this? Again, I think first of all, we have to recognize what our limitations are. There is only so much the United States is going to be able to do. The major solutions—I agree with my colleagues—rest with the Russians themselves.

But I would take a little bit different tack on that, and I would say the Russian people have got to become disgusted—disgusted—with the system that they see. Unless and until that occurs, those who are benefiting from this will continue to operate business as usual.

Senator SMITH. But I think we have heard it is not disgusting yet. It is normal.

Dr. FINCKENAUER. That is correct. Lest we think that this notion is naive, I would again offer the example of Sicily and Palermo and particularly Mayor Orlando Leoluca in Palermo who started out as sort of a one-man band in taking on the Sicilian Mafia, not a small task in Sicily. But what we now see is grassroots efforts of teachers and mothers in a variety of strategies to begin to combat the Sicilian Mafia and essentially shame the government and shame the political system into moving against that Mafia.

I think the thing is how could something like that begin to be done in Russia. We know that the Russian people do not like this. I talk to lots of Russians. They do not like it, but they see themselves as being sort of powerless in making any efforts in this regard. And I think there are things that we can do to encourage them to show that they are not powerless, to provide them with examples. I would echo the notion of exchanges. I would echo the notion of how do we get more supportive information out to the Russian people.

In particular, I would mention a small, tiny, little program called Developing a Culture of Lawfulness. This includes a curriculum that has been developed, and presently being pilot tested in southern California and in Mexico. The goal of this curriculum is to create a hostile environment for bribery and corruption among school children. The idea is if we could begin to turn around these young people's minds that they would see the harm, they would see the pervasiveness and the insidiousness of corruption and crime and they would become our allies, they would become our ambassadors, first of all, within their own families, within their own classrooms, with their own teachers, and out of this little, tiny pebble in a puddle, if you will, that could radiate out, we could begin to see the foundation of support for the notion of building a rule of law society. They are doing this in Sicily. They have done it in Hong Kong. If this notion can work in southern California where they have got all kinds of kids being drawn into street gangs, et cetera who then get into drugs and then link up with adult criminal activities, this is not unlike what we see going on in Moscow and St. Petersburg and other places. This is an idea I think that is like an egg. We should warm it. We should protect it. We should let it hatch. We should watch it grow and see how it develops. And if it works, we should move that egg to Moscow and to other places and see if we cannot do it there.

I would also say that we need to think about providing additional equipment and training and technical assistance for law enforcement. I was taken with your point about Jim Moody's comment on the degree of corruption among Russian law enforcement, an enormous problem. But I would draw a contrast, and I hope you will not view this as splitting hairs, but I would like to differentiate

among different types of corruption. There is a kind of venal corruption and then there is something called situational corruption.

We have Russian police officers who are making money that puts them below the poverty line, lots of them. They are in this situation at the same time where they have the authority and the power of being a police officer. Do those police officers all like the fact that they have viewed themselves as having to take money or take bribes, be involved in corruption? I suspect they do not, but what is their alternative? How could we, for example, sort of weed out the venally corrupt ones, who we could write off and forget about? If we could provide the right opportunities, increase their salaries, increase their professionalism, increase their training, give them equipment to do the kind of jobs they want to do, would they still be corrupt? I suspect a lot of them would not.

So, I think we need to think about those kinds of strategies, not simply say, well, we cannot deal with them because they are all corrupt. We should not be naive. And we should understand that if we share information, we had better be very careful with the kind of law enforcement information we are sharing because we do not know what might be done with it. But I think there are avenues there that we could pursue.

Finally, I would say that for the whole system of administration of justice, we have got to look to build an independent and incorruptible legal and judicial system because that is now the weakest link in the Russian governmental system. It is being overpowered by the legislature and particularly by the executive. There is no avenue, as I have mentioned, for citizens to turn to for redress of grievances. A prominent judiciary would undercut the role of organized crime in these krysha respects that I have talked about.

I think projects like the ABA/CEELI program need our encouragement, they need our support. We need more of that to be done.

Finally, I think all of this presents enormous challenges, but also opportunities for the United States, but what we must understand is that this is not a sprint. This is a marathon, and we are only going to be ultimately successful if we are willing to stay the course. I think that is probably the most important lesson that we can learn out of all of this.

Thank you, Mr. Chairman.

[The prepared statement of Dr. Finckenaueer follows:]

PREPARED STATEMENT OF DR. JAMES O. FINCKENAUEER

Thank you very much for giving me this opportunity to speak with you today. The topic of our discussion is not only important but also timely. I would like to make clear at the outset that I am speaking here, not as a representative of the Department of Justice nor of the National Institute of Justice, but rather as a Professor of Criminal Justice at the Rutgers University School of Criminal Justice in New Jersey. It is in that role that my research, which provides the basis for my statement, was conducted.

I will divide my presentation into three parts: (1) a brief historical survey to provide a context for current events; (2) a description of the current state of affairs; and (3) some recommendations for future assistance and strategies. I would be happy to try to expand upon any of these should you so desire.

THE PAST

The so-called crony-capitalism and patrimonialism that we see in Russia and other former Soviet Republics today are not new phenomena. We would be both wrong and remiss to assume that the kind of symbiotic relationship among crime,

government, and the economy we are now hearing about all began after the collapse of the USSR in 1991. Corruption and corrupt bureaucrats in Russia date back to the time of the czars; and so too does the blase attitude toward legality that accepted stealing from the state (in that case the czar) as normal behavior.

Crime, and more particularly organized crime, became closely linked with the Soviet government after the October revolution—especially so under Stalin. The 75 years of Communist rule created the prism through which we should view today's developments if we want to understand why things are the way they are today. The foundation for the current problems rests upon several historical legs. Stalin's Gulag prison system spawned a professional criminal class known as the *vory v zakone* or thieves in law; the all-powerful Communist Party took on the trappings and character of a criminal organization; and, the Brezhnev period (1964–1982) that immediately preceded a series of reform efforts was a time when corruption, stagnation, and disillusionment reached their zeniths.

A critical characteristic of this Soviet period was the important role of *blat*—informal personal networks that were used to obtain goods and services that were in short supply. And many things were in short supply. In the United States, organized crime responds to the demands for goods and services that are either illegal or in short supply because of regulation. In the Soviet Union, in contrast, it was the black market, the shadow economy, and *blat* that fulfilled this function. It is this *blat*—this social network system—that has evolved into the more sophisticated forms of corruption we see now. Insider trading, preferential licenses, rigged auctions, and illegal banking of state funds are all examples of the new forms of *blat*. In her new book "Collision and Collusion," Janine Wedel describes how these informal networks diverted and subverted massive amounts of Western aid coming to Russia and Ukraine in the 1990s. In my own work in Ukraine, I see examples of this unusual reliance upon personal relationships—what we in the United States would call cronyism—to award grants and other aid. My point is that this is normal and accepted behavior founded upon a peculiar cultural history. We perhaps had little reason to know this before, but we should know it now, and we should understand what its implications are for our future policies and assistance.

#### THE PRESENT

What we see in Russia today is a very feeble commitment to the rule of law. This flows in part from the background I have just sketched out. Whereas in most countries of the world crime is something that is outside the state and the society, and in direct opposition to them, in Russia crime is very much inside. It is insidious, not only pervasive but mainstream. There is a centrality of official crime and other illegality to what is taken to be "normal" political activity, a carry over of the *blat* system.

Because of this centrality, this linkage, we see State institutions that are very protective of their own vested interests, but very negligent or deficient when it comes to defending the interests of ordinary Russian citizens. This breeds distrust and disrespect of legal and political institutions among the people. It also opens the door for Russian organized crime, in all its varieties, to assume what would otherwise be State roles—for protection, for employment, for social services. This State weakness is one of the reasons behind the growth of the *krysha* system. *Krysha* in Russian means roof. Nearly every Russian business has to have a *krysha* or roof. This is a form of protection or insurance policy against extortion. Because businesses cannot turn to and depend upon the State to protect their interests, they must turn to this alternative form. Roofs are provided by private security firms that may actually employ the police, by former KGB types, or by more traditional organized crime. The result is a pervasive protection racket. This kind of lawless and stateless environment is similar to that of Sicily some years ago; an environment that lead to the growth of the Sicilian Mafia.

Russian organized crime has penetrated business and state enterprises to a degree that is unfathomable to most Westerners. It has also shifted more and more away from such traditional forms as the *voiy v zakone* mentioned earlier, to become more professional and adept at white-collar types of crimes. These include the kind of electronic crimes, the defrauding of banks and other financial institutions, and the money laundering that have recently risen to the fore. In addition to its already intertwined relationship with business and government, organized crime continues to extend its reach by supporting political candidates, by buying mass media, and by making charitable donations.

The transnational crime emanating from the former Soviet Union has also become a global phenomenon. This means that in addition to any altruistic or philosophical reasons (for example, supporting democratic governance) the U.S. may have for

helping Russia engage its problems, there are also pragmatic and self-interested reasons for doing so. Besides the Bank of New York type problems, which are actually quite benign in many respects, there are threats from trafficking in arms, drugs, women and children, from cybercrime, from counterfeiting, and from economic espionage.

#### THE FUTURE

Given this dark and gloomy scenario, what might be done about any of this? First, we should recognize that there are limitations, perhaps severe limitations, on how much the United States can do about it. The major solutions rest with the Russians themselves. The Russian people must become so disgusted with what they now see that they begin, from the grassroots level, to change it. Lest one think this is extremely naive, we can look at the example of Sicily and the city of Palermo in particular. There Mayor Orlando Leoluca has led a counteraction against the Mafia. Mothers and teachers and children have taken up the cause to achieve real successes.

Russia, and other ex-Soviet republics such as Ukraine, lacks an aware and active civil society. There are not traditions of democratic governance, of peaceful resolution of disputes in accordance with accepted rules, and of a rule of law. This is why the U.S. could survive the impeachment of the President by the Congress, and continue to function. In Moscow, a dispute between the president and the parliament ended in armed conflict and the shelling of the Parliament building. Stephen Handelman, in his book "Comrade Criminal," argues that it was a fundamental mistake to attempt to develop free markets in Russia without first having a strong civil society in place. It was that ordering that led to the continued ascendancy of *blat*.

One small approach to building this necessary civil society would be to adopt what has been called the "culture of lawfulness" curriculum for school children. The intent is to create a hostile environment for bribery and corruption. This idea is currently being pilot tested in schools in Mexico and southern California, and builds on practices in Sicily and in Hong Kong. If this approach bears fruit, it could be adapted and extended to Russia.

Also needed are equipment, training, and technical assistance for law enforcement. Each of these is already being provided. We need now to assess the effectiveness of our current efforts in these areas and build upon the successes. Training, for example, might be more efficient and better targeted though the use of distance learning and web-based techniques.

Finally, and perhaps foremost among the areas where we can help is in respect to the administration of justice. Russia sorely needs an independent and incorruptible legal and judicial system. This is now the weakest link in the system of governance. There is no brake on the excesses of the executive and legislative branches. There is also no avenue to which ordinary citizens and businesses can turn for redress of grievances and for dispute resolution. A strong judiciary would undercut the predominant role now being played in this area by organized crime. Projects such as those of ABA/CEELI are critical in helping achieve this goal.

All of this presents enormous challenges as well as opportunities for the United States. We must, however, understand that this will not be a sprint, but a marathon. Ultimate success will be achieved only if we stay the course. I thank you for your attention and for this opportunity to engage the debate. I would be happy to answer any questions you may have.

Senator SMITH. Thank you very much, Dr. Finckenauer. Very, very helpful. Very insightful.

To any of you, in the current environment, do each of you think it is appropriate for the Ex-Im Bank to issue its largest loan guarantees ever to Russia? Is it appropriate, Dr. Reddaway?

Dr. REDDAWAY. To what entities?

Senator SMITH. The Russian Government.

Dr. REDDAWAY. To Russian Government.

Senator SMITH. Yes.

Dr. REDDAWAY. I think that is not appropriate. I think that although different parts of the Russian Government are corrupt in different degrees, the great majority of Russian Government is, to one degree or another, corrupt and making large loans in cash to entities of the Russian Government is a very, very dubious propo-

sition, indeed. I would want the particular cases to be looked at very, very closely indeed.

Senator SMITH. Let me clarify. It is to a U.S. company investing in a Russian enterprise.

Dr. REDDAWAY. That is different. Again, I would say that the exact circumstances and the exact people involved need to be looked at very, very closely. I agree with what both my colleagues have stressed. It is certainly wrong to think that all Russians are corrupt, and I very much agree with Dr. Finckenauer that there are these different types of corruption: outright venal corruption and situational corruption. If the company that the Americans wanted to invest in was a relatively non-corrupt company—

Senator SMITH. It is a highly questionable enterprise.

Dr. REDDAWAY. Oh, if it is highly questionable, then—

Senator SMITH. Dr. Graham, do you know what I am talking about?

Dr. GRAHAM. I do not know about the specific case, but I would argue along the lines that Dr. Reddaway has. You have to take a very close look at the specific enterprise, the activity. What we need to do is due diligence. We need to know whom we are dealing with, what type of activities they have conducted in the past before we issue loan guarantees of this sort.

Senator SMITH. You would argue high caution right now.

Dr. GRAHAM. High caution, particularly at this point.

Dr. REDDAWAY. If I could add, it is also important to look very carefully at the local political leaders, the mayor of the city, the Governor of the region, and see what his record has been over how that individual has handled major investments by U.S. and Western companies in his city or region because some mayors and Governors encourage investment and then when the investment starts to produce some profits, they introduce new taxes, new regulations that make it possible to skim off a lot of the profits for the benefit of the local administration. That is something that is impossible to foresee. The only guard against it is what the track record of that local political leader has been up to now.

Dr. GRAHAM. If I remember correctly, this concerns an oil company—

Senator SMITH. It does.

Dr. GRAHAM [continuing]. That is engaged in trying to purchase an asset from another oil company that is in bankruptcy. There have been accusations that the oil company that is the subject of the deal is in fact engaged in illegal, or at least unethical, practices in its effort to purchase this other oil producing facility.

The problem here is that we have got two American companies involved now. I forget the name of the one who got the loan guarantees, but BP-Amoco is also involved in this as well. It seems to me that it is inappropriate at this time for the Ex-Im Bank to be guaranteeing a loan so that an American can enter into a partnership with a Russian oil firm to take over an oil production facility that is in dispute and when one of the litigants is another American oil company.

Senator SMITH. A final, sort of general, question. If we desire to help and we want to leverage the rule of law to encourage its creation, is that leverage best applied with the incentive of loans and



cash and these kinds of things that the Ex-Im Bank is on the verge of doing?

Dr. GRAHAM. If I could take a first shot at that. No, I do not think so. I think money sent to Russia now, particularly without proper safeguards, is money that will wind up in the West sooner as opposed to later.

The way you help encourage, I think, a rule of law society is, as I said, by trying to encourage activities that integrate Russia into the outside world, but I think also by simply providing an environment in which Russians can learn about how our society functions. I do not think that you can stress too much the extent to which they are curious and envious of how successful our country is, and what they are looking for is ways to repeat that success in their own society.

Senator SMITH. Cash in almost any form, however you dress it up, maybe just reinforces the worst kind of lessons, the wrong kind.

Dr. REDDAWAY. As a general proposition, I think that is true. I do, however, think that we have accumulated some experience in the West about small grassroots organizations which are not corrupt. Small amounts of money sent to small grassroots groups which have a track record to my mind is still feasible and desirable. But large sums of money are another matter, and I think one has to be very careful.

Can I take a couple of minutes to make a few more remarks?

Senator SMITH. Sure.

Dr. REDDAWAY. I think that one of the things that we should be uncompromising about is saying quietly but insistently and repeatedly to the Russians, you want us to come and invest. We would like to come and invest. You are an attractive country ultimately for us to invest in, but we cannot. We simply cannot invest on any scale today because of the political and legal conditions in your country. We should not pull any punches about that. As I say, we should not do it in a lecturing tone in big public forums, but we should insistently give that message through every possible channel we can because that is an argument that every Russian will understand.

The second point is that I very much endorse Dr. Finckenauer's eloquent description of how in the long run the way to develop a rule of law society is from the grassroots up, and if we can persuade members of the young generation partly by bringing them over here, as Dr. Graham said, for prolonged visits so that they can absorb our values and understand them, then we have some hope.

We should not, however, be blind to the difficulties involved. Ultimately, this sort of approach logically leads to promoting revolution in Russia against a corrupt regime. Now, that may be desirable. It may be the only way that you are going to get an improvement in the Russian situation. But obviously it involves very tricky political and diplomatic problems, and we need to look those problems squarely in the face and not flinch from them. Again, there are not easy answers.

And a final point. Tom Graham said we should cooperate with the honest legal enforcement people. In principle, I agree with his argument, but in practice it is very difficult to do. I think Dr. Finckenauer was suggesting the same thing.

Let me give just two interesting examples.

There is an honest—or there was an honest—policeman in Moscow who testified in a court case against an oligarch. Almost immediately after he testified, he got threats against his life, and he and his family are now living in Switzerland and will probably stay there for a long time.

A second example is a U.S. reporter who went to Russia and did extensive research about one of the most prominent Russian oligarchs, Mr. Berezovsky, wrote a big article in the U.S. press, and was very quickly threatened with his life, although he was living in the United States. On the advice of the FBI, he went to live in Europe incognito for about 6 months until the fear that he might be assassinated had diminished. He had got his information from honest police officials in Moscow, and those honest police officials—of course, he kept them anonymous in his story for the U.S. press, but quite possibly those officials are also in a position of great danger.

So, the principle is right. We need to identify and work with the honest minority, even if it is a small minority, but we have to realize there are huge risks involved for those honest Russians. In addition, there are risks involved even for the Americans involved.

Senator SMITH. Gentlemen, you have been terrific and very enlightening. Joe, as I mentioned, has been on the floor doing battle, and we welcome him here. Unfortunately, I have to go and so I am going to leave this committee in his care.

Senator BIDEN [presiding]. Thank you. I will be brief, Mr. Chairman. Thank you very much.

Gentlemen, I apologize. We have been having an ongoing debate about whether or not we should bring up the ABM Treaty. Excuse me. We have been debating that as well, but debating the Comprehensive Test Ban Treaty. There was an offer made by the Republican leader to be able to bring that up on very short notice, which is fine by me, without any hearings. A minor issue. So, we were discussing that on the floor, and that is the only reason I was not here because the three of you are very knowledgeable, and I am told by staff, as well as the chairman, this has been an excellent exchange you have had so far.

I very much wanted to be here because all three of you know better than I do that we had better get this relationship right somewhere along the way here. To state the obvious, not referring to the three of you, but at least on this side of the bench, there can be an awful lot of politics engaged in this issue over this Presidential campaign, and I hope we can sort of get through the din and the fog here of the political rhetoric on both sides we are going to hear to try to come up with a rational policy and understanding of how to get there.

As I understand it—well, let me not characterize what you have said so far. Let me ask my question. If it has been asked already, please just indicate it and I will read it in the record. OK?

Unlike the IMF assistance, U.S. assistance has not passed out big chunks of money. We do not decide to send \$5 billion to a central bank in Moscow. Our programs are basically thus far exchange programs, technical assistance programs, technical expertise, equipment of various kinds, with the exception of the programs we

have had to dismantle nuclear arsenals, which has, I think, been remarkably successful and money very well spent.

But notwithstanding this, the way in which we have gone about it since the Bush administration through the present administration, how sure do you think the U.S. Government can be about where and how its assistance is being used?

I am used to dealing with the criminal justice system here in the United States and used to be chairman of the Judiciary Committee. We had oversight hearings. We could track, not always well as we should have, how the money being sent out for programs is working and make a judgment about whether or not it made sense to continue it or not.

How do we, in light of the way in which our aid has been forthcoming, to the extent it has, gain any confidence or certainty about what is working and what is not working and what makes sense and what does not make sense? We will start, Doctor, with you, however you would like to proceed.

Dr. FINCKENAUER. Well, if I could respond from my experience with Ukraine. The assistance is very similar. The problems are very similar. We are presently engaged in an assessment process to look at the effectiveness of the delivery of law enforcement training by the United States in Ukraine. Obviously, there have been considerable resources devoted to this over the last 10 years, and there is little knowledge at this point about how well all that is working. Who is being trained? Are the right people being trained? Is it having any effect in terms of what they are doing?

So, what we are in the process of doing is developing what we call a template by which we could look at how training needs are being assessed and whether the subjects that are being taught in these training programs are, in fact, the appropriate ones. Are they the ones that are really needed given what the concerns are?

Not surprisingly, there has been a very haphazard process by which these training needs have, in the past, been assessed and been matched up with what we offer. It is very much off-the-shelf items. We have people who can teach about this topic. They must need to know this. So, we go there. We teach on that topic.

I think people more and more have become aware that that is not the way to do this. Let us look at what we are doing and see if we cannot do a better job. I would simply suggest that that same model could be employed in Russia or in any other place where the United States is doing law enforcement training.

Senator BIDEN. Dr. Graham.

Dr. GRAHAM. Look, this is a very difficult question and very difficult to assess.

Senator BIDEN. That is why I asked you. If I knew the answer, we would not call you guys experts. We would not pay any attention to you at all.

Dr. GRAHAM. That is right.

Senator BIDEN. Except how you voted.

Dr. GRAHAM. Right, exactly.

Part of the problem, of course, is that we give assistance to vast numbers of individual Russian entities, and it is physically impossible for us as a Government to evaluate all of them. Some of this we take on faith that the programs are going in the right direction.

The second point I would make is that I think there is a danger in trying to determine whether something has been successful in the short run or not. In many of our programs, what we are looking for is a payoff that is going to come 5 to 10 years down the road in the change in attitudes. So, something that focuses on whether the money spent has given us a return already or not many times is going to miss what is most important for us to do in Russia. I think part of the problem we have as a Government is that we tend to focus on the short term. In order to get additional money for programs, we have to demonstrate short-term success. That is very difficult. I think that is the wrong way to approach it.

The third point I would make is what we really need to do on some of these programs that are aimed at developing rule of law democracy is devising some way of conducting a sociological research that would demonstrate or at least help us determine whether we are seeing changes in political attitudes and social attitudes among the people who participate in our programs. Setting up an efficient program to evaluate that is a major project in itself and will cost some money, but I think that is something that we ought to consider.

Senator BIDEN. Thank you.

Dr. Reddaway.

Dr. REDDAWAY. If I could add. We have had some discussion—and I think the three of us are agreed—that the elite in Russia today has become so corrupt that real change in Russia is probably only going to come from the grassroots of Russian society over a long period of time. That has some direct relevance to your question.

On the one hand, in my opinion we should be extremely cautious and in general not give sums of money to government entities, whether at the Federal or the regional level. We should not give money to big Russian companies.

On the other hand, we can, with much better chance that the money will not be abused, give it to grassroots groups, small sums of money to large numbers of grassroots groups, across Russia and the former Soviet Union. If particular groups abuse the money, then OK, it is lost, but it is just a small sum of money. Other groups will not abuse it and will put it to good use, and you will eventually get a culture of rejection of corruption that Dr. Finckenauer was talking about earlier, a culture of believing that Russia must renew itself from the grassroots upwards, which is I think the only real hope for the long-term future of Russia.

Senator BIDEN. Can I ask any of you to cite for me, if you have any in mind, examples of where we have given large sums of money to individuals, companies, and/or a government that you believe has resulted in inappropriate confiscation of that money or aided and abetted the corruption, et cetera? Are there any? If you had to list just the number of direct grants of dollars that you consider large to the Government of Russia or any entities, because we keep hearing people talk about this. We should not give these large amounts of money, like you said, to the government. What large amounts of money have we given to the government for the record? Can you think of any?

Dr. REDDAWAY. I can give one example, which is not exactly in response to your question, but it is I think relevant. The World Bank has given large sums in order to try to help the Russians restructure their coal industry. I think there have been at least two major grants or loans over the last 3 or 4 years.

Senator BIDEN. That is true.

Dr. REDDAWAY. There has been extensive and growing evidence that a lot of this money has been diverted into private pockets in Russia. I read an article last week by John Helmer in the Journal of Commerce in which he detailed how this money had been embezzled in St. Petersburg. That is one example.

Senator BIDEN. Well, let me be more precise. I think if you go home this evening and ask your next door neighbor, assuming they are not engaged in the same academic pursuits that you are—they are automobile salesmen or own a local company or work for a large outfit or work for the Federal Government—and you ask them what they think all this thing about the waste—the “Who lost Russia” and all the money we are wasting in Russia, they think that, when you use phrases like we should not give large amounts of money, you mean taxpayers’ dollars directly. Now, can you think of any bilateral program where we have given large amounts of money that has been wasted? Anybody.

Dr. GRAHAM. Look, I think the answer to that question is no.

Senator BIDEN. Good.

Dr. GRAHAM. I cannot think of any.

Senator BIDEN. Bingo.

Dr. GRAHAM. The issue has been more the money that has been provided through the IMF.

Senator BIDEN. Good. Now, why do we not say that? I do not mean you, but why do we not all say that? Why do we not stop this malarkey about these large Government programs that we are funding? We are not alone funding any that I am aware of.

And you understand—I need not educate you I am sure, Doctor—how the World Bank works and how the IMF works and how our money is put at risk and how we have not lost any money. Would you not be prepared to acknowledge that?

Dr. GRAHAM. That is a much more difficult question to answer—

Senator BIDEN. Give it a shot. I have patience.

Dr. GRAHAM [continuing]. Because the question is not whether IMF money has been returned or not or not lost at this moment. The question is the impact of that lending on government practices.

Senator BIDEN. That is your question. That is not my question.

Dr. GRAHAM. No.

Senator BIDEN. And I get to ask the questions. OK? You have got to run for office to get to ask the questions.

Dr. GRAHAM. I understand that and perhaps I should.

Senator BIDEN. I think that would be a good idea. It is always a salutary experience.

Dr. GRAHAM. But the point is when you have to make the payment and what form. You may get your taxpayers’ money back on the IMF. We have not lost any money in that regard. No IMF money has been lost. But if what the IMF money has done is facilitate corrupt practices among high ranking government officials and

then we have to spend more money, taxpayers' money, in investigating that and in setting up defenses against that, then I would submit that this is perhaps not—

Senator BIDEN. Good. Now, we are getting somewhere.

Dr. GRAHAM. So, we need to focus on what the real tradeoffs are—

Senator BIDEN. See, all I am trying to do is I think there has been—I think this is a corrupt society in Russia. It has been from my first meeting after Gorbachev's fall. I went over and met with all the major political party leaders, literally every one of them, ranging the whole spectrum. All of those who you would call democrats with a small D said do not give them any money. So, we started defining it. That is why when the seed program was written, that became the FREEDOM, whatever the heck we call it, Act, that is why we did not do it that way with direct, big, bilateral—

Now, what has happened, though, is—we have to cut through, as I said, the fog here a little bit. We have a little bit of honesty in academia, honesty in advertising here. Everything you read, you read the headlines that say—not that any of you have written, but you read the headlines that say, billions in American tax dollars lost. That is what one of the articles said that everybody quotes around here. Billions in taxpayer dollars lost.

Now, people at home are pretty smart. They divide it into two ways. They say, look, if you are pouring my money down a rat hole, like you would if the local corrupt mayor is taking the money and keeping his mistress and four other people, and they are raising my property taxes to do it, then that is one thing.

If you are saying that, although I am not losing any money, I may be, as a consequence of decisions made by my Government participating in them, causing a circumstance where we “may lose Russia,” where we end up generating and perpetuating or invigorating a culture of corruption, where we enable it to happen because of what we are doing, then that is an equally serious problem in my view.

But I think one of the obligations that I have at least as a United States Senator is to articulate as clearly as I can with as much precision as I can what is at stake, what the issue is. I just want somebody, for a change, to say sitting there, experts, what is at stake is a policy we have engaged in in two administrations through the so-called IFF'ies—I love the way the foreign policy guys use that phrase—the international financial institutions that we are talking about, the World Bank and the IMF and others, whether or not our policies relative to those institutions and how we vote in those institutions has created a circumstance that is detrimental and not positive or has not been used with as much efficacy as it should or could have been. That is a legitimate debate I want to engage in, and I want to solve, I want to be part of.

But as long as it is confused with the debate and the assertions that are not true and a perpetuation of the notion that we are taking large, direct grants in foreign aid of U.S. taxpayers' dollars and pouring them down a rat hole so that Yeltsin's daughter can shop at Paris fashion shows, then you know what we do when you guys are not honest enough to put it in the way we should phrase the debate? Then we lose support for all foreign aid. Then we find our-

selves in the position like we have in this foreign aid bill. And I will end my little diatribe here.

We are cutting by \$3 billion—hang on, Doc. You will get a chance. We are cutting by billions of dollars not only aid to Russia, we are not funding the Wye Agreement—we—we, the United States of America—because there is an attitude over in the House that I am not going to vote for foreign aid in this atmosphere, man. I am not going home and explaining to anybody. I am not going to vote for that. That is a killer for me politically.

So, I think if we are going to be responsible adults and inform foreign policy experts, of which I consider myself one, we should be accurate and precise in the way in which we discuss the issue. That is the only point I am trying to make, and that is why I asked the question.

Now, I will conclude my thing and hear what you have to say, Doctor, and not trespass on your time anymore, any of you. I think there is a big problem here, a gigantic problem. I think the culture of corruption in the Soviet Union and Ukraine I might add—forget Belarus. I mean, that is a different deal—is extreme, is something that has existed from csar through commissar, back to what do they call themselves now? The elite. The oligarchs. From csar to commissar to oligarchs, not much has changed except we have a clearer view now—a clearer view. So, we have got to do something about it, and that is what I am here about, trying to figure out what we do.

Doctor, the floor is yours.

Dr. REDDAWAY. I have had time to think up a good response to your question. The U.S. food program—

Senator BIDEN. Food, f-o-o-d?

Dr. REDDAWAY. F-o-o-d program for Russia is in my opinion a major scandal—and I hope that you will find ways to investigate it—partly because it, I think, has directly fed Russian corruption and—

Senator BIDEN. In what way, Doctor? I am not doubting you.

Dr. REDDAWAY. I will explain in a moment. And second, because it seems that it is entirely possible that we will go through a new round of this unneeded, corruption-feeding food aid program in the next year, sometime in the next year. There are people pushing for it on both sides, both in the United States and in Russia.

The program that was launched about a year ago, if I remember rightly, had a price tag of about \$1.3 billion—billion dollars. That food aid went ahead. The program was launched last fall, early winter against the objections of almost all the independent food experts in Russia, against the wishes of important people within the Russian Government. It was pushed by our Government because we wanted to help U.S. farmers and it was pushed by corrupt elements in the Russian Government who wanted to benefit directly from it themselves.

The food was eventually sent late, too late to be of any use, not that there was in fact a shortage of food in Russia. So, the whole thing in that sense was corrupt from the start.

Senator BIDEN. There was no shortage.

Dr. REDDAWAY. There was no serious shortage of food. It was not actually needed. They got through the winter. The first food arrived in the spring.

The terms of the deal were that the Russian Government was supposed to sell this food to the Russian people at, roughly speaking, market cost, and the money was supposed to go into the Russian pension fund, which is dramatically underfunded. Virtually nothing has gone into the Russian pension fund. The money has disappeared into the hands of corrupt Russian officials, in particular, the former Deputy Prime Minister, Mr. Kulik, in charge of food in Russia, no longer I believe now. It has already been documented in the Russian press the corrupt ways that he benefited from this food aid.

And now we are apparently considering another food program despite the fact that it is not needed in Russia and despite the fact that the last time we fed Russian corruption with it.

Senator BIDEN. A very good point.

Dr. REDDAWAY. Now, this is with direct American taxpayers' money.

Senator BIDEN. If you can, in addition to your cogent explanation of the waste of that money and how it impacted on corruption, supply additional detail, it would be very useful because I think you are absolutely right. We should be looking at that. That is a concrete example and it is something that obviously, as you point out, will be back on the agenda again. If you are correct, we should not be going forward with such a program.

Dr. REDDAWAY. I will be happy to supply documentation.

Senator BIDEN. I appreciate it very much.

Well, gentlemen, as I have said, I have gone beyond the time that you expected to have to stay here. I would like to ask your permission to be able to submit two questions to each of you in writing. Again, no urgency in responding. If after the fact you think of anything that you wish you had said or issue that was not brought up or you want to in any way expand on any explanation you have given, with the permission of the chairman, who is not here—but I am sure he would not object—I would invite you to do that for the record. It would be very useful.

I for one believe that this is an area where we should let the chips fall where they may because I believe if we do not do it, if we do not address this problem straight up, honestly, and thoroughly, we are going to not only undermine our engagement with Russia in any prospect for a positive engagement, that is, that has a positive impact, we are going to undermine our engagement with other nations as well. In a political context, this is a very porous issue. People do not make distinctions very clearly between one type of foreign aid and foreign aid and international institutions where there is, in effect, in the minds of people, foreign aid, but it is a policy decision we make to help or not help. And they do not make a distinction in what parts of the world it occurs.

So, I think your testimony—I am told from my staff, as I walked in, the first thing that they said to me was this is the best hearing we have had so far. These guys really know what they are talking about. That was the comment made. I hope you do not view that as being solicitous. It was seriously stated and I look forward to



reading the record. I also look forward to your expanding on anything you have said, as I said before.

And, Doctor, if you could specifically on the food program because I think that is a very good example because I would note for the record as well that this time last year I was given assessments about the state of the agricultural commodities and availability and food that would not be on the shelves in Russia that were fairly bleak. As a consequence of that, I was one of those people who sat down with—if they give me any more notes, I am going to shoot them. I was one of those people who sat with some of the agriculture community and said, now, are you willing to participate in getting food there? How do we get it there and so on and so forth? And the issue we were talking about then was the physical capacity to lift the food there. So, to that extent, I was involved in that because I must tell you I had been convinced that not that there was not the capability of producing all the food they needed, but because of the lack of any infrastructure that they have within the country. More food gets wasted and lost in the fields in Russia than ever gets into the towns and cities, to overstate it slightly. But I had become convinced that this was a serious potential humanitarian problem. I quite frankly thought it would be better to run the risk on losing our food than direct dollars to the Russians. So, it would be very helpful because the point you make is a very, very valid one.

Again, I thank you very much.

I would like to keep the record open until the close of business tomorrow to allow Senators to offer additional questions for the record, if they have them, and again invite you to submit anything you would like, and particularly you, Dr. Reddaway, on this issue of food. Unless anyone has any comment they would like to make, I will adjourn the committee.

Committee adjourned.

[Whereupon, at 12:37 p.m., the committee was adjourned.]

