
RUSSIA'S ROAD TO CORRUPTION

How the Clinton Administration Exported
Government Instead of Free Enterprise
and Failed the Russian People



SPEAKER'S ADVISORY GROUP ON RUSSIA
CHRISTOPHER COX, CHAIRMAN

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Members of the Speaker's Advisory Group on Russia



United States House of Representatives
106th Congress

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U.S. House of Representatives
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Introduction

In March 2000, as Russia prepared for the presidential election that would formally establish the successor to the Yeltsin administration, the Speaker of the House tasked the leadership of six committees of the House of Representatives to assess the results of U.S. policy toward Russia during the Yeltsin years. This report is the result of that effort.

The Speaker's Advisory Group on Russia comprises the Chairmen of the Committees on Armed Services, Appropriations, Banking, Intelligence, and International Relations, as well as the House Vice Chairman of the Joint Economic Committee, and additional members of the House leadership and the committees of jurisdiction. The Advisory Group and its professional staff met several times each week over the past five months with key Clinton administration policy makers, leaders of Russia's executive and legislative branches, and leading academic and private sector experts on Russia and U.S.-Russian relations from both countries. The Advisory Group reviewed the voluminous committee work and official reports produced by each of the relevant committees of Congress, as well as a wide range of primary and secondary sources. In addition, the Chairman, and members of the Advisory Group, and its professional staff have traveled to Russia on several occasions since March 2000.

The persons with whom the Advisory Group and its staff met in the course of preparation of this report include Treasury Secretary Lawrence Summers; Ambassador Thomas Pickering, Under Secretary of State for Political Affairs; U.S. Ambassador to Russia James Collins; Ambassador Stephen R. Sestanovich, Special Advisor for the Newly Independent States; Thomas Dine, Director of Radio Free Europe/Radio Liberty; Prime Minister Mikhail Kasyanov; Foreign Minister Igor Ivanov; former Secretary of the Security Council Andrei Kokoshin; First Deputy Minister of Defense Nikolay Mikhailov; State Duma Member Igor A. Annensky, Deputy Chairman of the Banking Committee; State Duma Member Alexei Arbatov, Deputy Chairman of the Defense Committee; State Duma Member Boris Gryzlov, leader of the Unity party in the Duma; State Duma Member Konstantin Kosachev, Deputy Chairman of the International Affairs Committee; State Duma Member Viktor S. Pleskachevsky, Chairman of the Subcommittee on the Funds Market; State Duma Member Vladislav Reznik, Deputy Chairman of the Committee on Budget and Taxes; State Duma Member Dimitri O. Rogozin, Chairman of the International Affairs Committee; State Duma Member Vladimir Ryzhkov; State Duma Member Alexander Shabanov, Deputy Chairman of the International Affairs Committee; State Duma Member Alexander N. Shokhin, Chairman of the Credit Organizations and Financial Markets Committee; State Duma Member Grigory Yavlinsky, leader of the *Yabloko* party; Andrei Babitsky, journalist, Radio Free Europe/Radio Liberty; Scott Blacklin, President, American Chamber of Commerce, Moscow; Dr. James Billington, Librarian of Congress; Paula Dobriansky, Vice President, Council on Foreign Relations; Pavel Felgengauer, military analyst and author; former Russian Finance Minister Boris Fyodorov; Dr. Thomas Graham, Senior Associate, the Carnegie Endowment for International Peace; Sergei Karaganov, Chairman, Council on Foreign and Defense

Policy; Igor Malashenko, Media MOST; Arkady Murashev, Chairman of the Center for Liberal-Conservative Policy and former Duma Member; Ruslan Pukhov, Director, Center for Analysis of Strategy and Technology; Peter W. Rodman, Director of National Security Programs at The Nixon Center; Ivan Safranchuk, Project Director, Center for Policy Studies in Russia; Dimitri Simes, President of The Nixon Center; and Dimitri Trenin, Deputy Director, Carnegie Endowment for International Peace (Moscow Center).

This report begins with a summary of the historic events that led to the collapse of the Soviet Union in December 1991 and a description of the conditions in Russia during the last year of the Bush administration and at the commencement of the Clinton administration. It assesses the task ahead for Russia in moving from a century of state control to a free enterprise democracy, and compares that agenda with the actual policies pursued by the Clinton administration from 1993 to the present. The manifold failures of both Russian and U.S. government policy are surveyed: the early corruption of the non-market “privatization” to insiders; the spread of organized crime; the eventual complete collapse of the Russian economy in 1998; the rise of weapons proliferation as a means of generating hard currency; and the increasing estrangement of Russia from the United States, essentially reversing the trends that existed in 1992.

Finally, the report addresses itself to the opportunities for U.S.-Russian relations that still remain, despite years of failure. Recommendations of the Advisory Group for future policy appear at the conclusion of the report.

September 2000

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The Fall of the Soviet Union and the Rise of Russia

The collapse of the Soviet Union brought to an end one of the cruelest, most violent, least humane, and most viciously ideological regimes in the history of the world. The Soviet Union—more aptly, the Soviet Empire—collapsed of its own weight, crushed by the material and spiritual burdens of its collectivist ideology.

In the final days of the Soviet Union, President Gorbachev desperately sought billions in foreign loans, and many in the West endorsed a policy of providing enormous amounts of aid in an attempt to save the collapsing Soviet economy. President Bush believed this would not work. “A shortage of foreign capital is not what plunged your economy into crisis, nor can your economic ills be cured by an infusion of cash,” he told the Moscow State Institute for International Relations in a speech on July 31, 1991, five months before the Soviet Union ended.

When the Soviet Union’s Vice President, Prime Minister, Defense Minister, KGB Chairman, and other hard-line Communists launched a coup against Gorbachev on August 19, 1991, the Russian President, Boris Yeltsin, denounced it as unconstitutional. The following day, on the only functioning phone line, Yeltsin spoke to President Bush, who firmly pledged that the United States would not recognize the coup government. Bush’s action in support of Yeltsin and the Russian people proved decisive.

The rapid failure of the coup demonstrated the weakness of hard-line Soviet Communist Party elements. Within a month after the coup, 11 of the Soviet Union’s 15 republics had declared their independence.

Following the coup, U.S. Secretary of State James A. Baker III and Gen. Vladimir Lobov, Chief of the Soviet General Staff, signed an agreement to dramatically reduce the number of short-range nuclear weapons in the U.S. and Soviet arsenals. By the end of the year, the United States had committed \$400 million to help dismantle Soviet nuclear weapons.

When Mikhail Gorbachev resigned as the last leader of the Soviet Union on December 25, 1991, America’s relations with the largest of the captive nations newly freed from the Soviet Empire were auspicious.

Conditions in Russia at the Outset of the Yeltsin and Clinton Administrations

The West’s victory in the Cold War presented America with its greatest foreign policy opportunity since the end of World War II. Just as America’s defeated enemies, Nazi Germany and Imperial Japan, had become free enterprise democracies and close U.S. allies, so too might the new Russian Federation.

The U.S.-Russian relationship that President Clinton inherited could only have been dreamed of by his predecessors from Truman to Reagan. American values, including free enterprise and democracy, enjoyed an astonishing level of prestige and popularity among the Russian people. Building a relationship with the United States was the highest priority for the Russian government. Prior to 1993, Moscow worked harmoniously with Washington across virtually the entire spectrum of international issues—including Operation Desert Storm, waged against the Soviet Union’s client state Iraq; arms control, culminating in a START II treaty that slashed U.S. and Russian nuclear arsenals by 66%; and ballistic missile defense, on which President Bush and President Yeltsin launched negotiations that were aimed at the changes in the ABM Treaty of 1972 necessary to take account of the spread of ballistic missiles and weapons of mass destruction.

The Task Ahead: Creation of a Free Enterprise System After a Century of State Control

The collapse of Communism in Russia ended not only the Soviet police state but the Soviet-era centrally-planned economy. In January 1992, there was for the first time in the experience of most living Russians a genuine opportunity to build the foundation of a free enterprise system.





The necessary bricks for that foundation were clear enough. The question was not whether, but where—and how—to begin. To move from the Soviet Union's state-controlled economy to a free enterprise system based on private property, markets, and individual choice called for change on a breathtakingly large scale.

- Soviet-era laws and regulations governing commerce would have to be repealed.
- New legal protections for private property and private contracts would have to be enacted, and the courts would have to build public confidence that private contracts would be enforceable.
- Private banks that paid for deposits at market rates, evaluated credit risks according to market criteria, and served as genuine intermediaries between sources of capital and start-up private enterprises would have to be legalized.
- The Soviet-era network of 200,000 inefficient state-owned enterprises would have to be forced into competition.
- Over 1.5 trillion acres of arable land owned by the Soviet government would have to be transferred to private ownership to provide a source of wealth to the Russian people, collateral for commercial and agricultural lending, and the basis for home ownership and mortgage finance.
- The existing stock of Soviet-era state-owned housing would have to be converted to private ownership, and the private construction of more and better housing legalized.
- A workable bankruptcy procedure creating the “freedom to fail” would have to be established, in order to end wasteful subsidies and subject commercial enterprises to market discipline.
- A lower tax rate and simpler tax code would have to be enacted to demonstrate that the new Russian government was not bent on redistributing income but rather sought to promote a market economy.
- A commercial code—a basic set of rules that could be relied upon by any Russian citizen or foreigner who wished to buy or sell something—would have to be enacted.
- Soviet-era barriers to foreign investment in Russia would have to be eliminated.

The opportunities that awaited Russia in 1992 were exhilarating, but dismantling the Soviet system of government controls, and erecting in its place a free market economy based on private decision making and risk taking, was a task of monumental proportions. It required significant new legislation from Russia's parliament. Yet the ultimate objective was abundantly clear: the new Russian government's job was to get itself out of the economy and facilitate private actors through clear commercial rules for enforcement of private property rights and private contracts.

The Fundamental Flaws of the Clinton Administration's Russia Policy

During his 1992 campaign and the first several years of his administration, President Clinton made clear his unwillingness to involve himself in foreign policy generally, and the critical issue of U.S. policy toward Russia specifically. The virtual absence of any non-ceremonial presidential involvement in the greatest foreign policy opportunity for the United States since World War II was to prove crippling to the development and execution of United States policy toward Russia.

Lacking presidential attention, decision making on Russia policy eventually devolved to a troika of subordinate officials: Vice President Gore (assisted by his foreign policy mentor Leon Fuerth), Strobe Talbott at the State Department, and Lawrence Summers at the Treasury Department. Creation of the Gore-Talbott-Summers troika vested authority for the development and execution of Russia policy in an elite and uniquely insular policy-making group without accountability to the normal checks and balances within the executive branch.



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The structure of the policy-making troika left the rest of the government either unwilling or unable to critically assess the direction of the Clinton administration policy. The policy decisions that emerged were marked with the personal biases and predispositions of these three individuals. Their small circle soon became an echo chamber, reinforcing their own views and excluding independent information, analyses, and recommendations from the national security, foreign policy, and intelligence professionals throughout the U.S. government.

The troika also excluded Congress from the development of the Clinton administration's Russia policy, thereby further isolating it from outside review, and failing to develop the broader institutional and popular support that it would need to succeed in America and abroad. As a result, the Clinton administration's policy has repeatedly been repudiated by bipartisan majorities in Congress.

The unorthodox “troika” institutional arrangement produced the following fundamental flaws in U.S. policy toward Russia from 1993 forward:

- A strong preference for strengthening Russia's central government, rather than deconstructing the Soviet state and building from scratch a system of free enterprise
- A close personal association with a few Russian officials, even after they became corrupt, instead of a consistent and principled approach to policy that transcended personalities
- A narrow focus on the Russian executive branch to the near exclusion of the Russian legislature, regional governments, and private organizations
- An arrogance toward Russia's nascent democratic constituencies that led to attempts at democratic ends through decidedly non-democratic means
- An unwillingness to let facts guide policy, or even to make mid-course corrections in light of increasing corruption and mounting evidence of the failure of their policies

By focusing on strengthening the finances of the Russian government and on transforming state-owned monopolies into private monopolies, instead of building the fundamentals of a free enterprise system, the Clinton administration ensured that billions in Western economic assistance to Russia would amount to mere temporizing. The Gore-Talbott-Summers focus—on macromanagement of the Russian economy instead of the legal fundamentals that would permit individuals to start businesses, grow a competitive market economy, and create a tax base—doomed their “privatization” efforts to failure.

Worse, by using massive lending and aid to plug the gap in the Russian central government's operating budget, the Clinton administration exposed these funds to theft and fraud.

For its part, the Russian government lacked the facility to turn these massive aid flows into real economic reform. Instead, the aid had the opposite effect: it made possible the subsidies to the Soviet enterprise network that allowed it to continue operating. Effectively unconditional large-scale international assistance simply contributed to Russia's problems by killing incentives to reform and propping up a government whose policies were bankrupting the Russian people.

The flood of loans also added to Russia's growing foreign debt, which continues to burden the central government's operating budget and weigh down the nation's economic prospects.

The Clinton administration was unwilling to recognize the costs to Russian democracy—and to Russian perceptions of America—of its unquestioning support for its Russian partners despite their corrupt conduct. The Clinton administration's enormous political stake in its Russian partners gave it an overwhelming incentive to ignore and suppress evidence of wrongdoing and failure by officials including Viktor Chernomyrdin and Anatoly Chubais, who had come to personify the administration's Russia policy. The Clinton administration's closeness to a few Russian individuals impaired its ability to confront genuine differences between U.S. and Russian interests—as, for example, in the case of Chechnya, where President Clinton compared Yeltsin to Abraham Lincoln.





The Clinton administration's exceptionally close personal relationship with its few official Russian partners was a sharp contrast with its merely *pro forma* engagement with Russia's legislature, its opposition parties, and its regional governments.

The Clinton administration encouraged disregard for the legislative branch by the Yeltsin administration, and thus played a part in undermining the growth of pluralistic, democratic government in Russia. This has aptly been called a "bolshevik" approach to accomplishing "reform"—authoritarian measures in both the political and economic spheres, typified by Yeltsin's propensity to rule by decree. It virtually guaranteed that the legal reforms needed to establish a genuine free enterprise system would not be enacted in the Duma or in the regional legislatures.

The Gore-Chernomyrdin Commission

In April 1993, during his first meeting with President Yeltsin, President Clinton effectively delegated the management of U.S.-Russian relations to Vice President Gore. The charter of the U.S.-Russia Commission on Economic and Technical Cooperation, co-chaired by Gore and Russian Prime Minister Viktor Chernomyrdin, was eventually expanded to include the full range of U.S.-Russia relations.

Clinton's abdication to Gore of authority over the most important foreign policy opportunity for America since World War II—the rebuilding of Russia after the collapse of the Soviet Union—had fateful consequences. By assigning this portfolio of overarching importance to his second-in-command—whose priorities were "reinventing government," environmental issues, and technology policy—Clinton guaranteed that Russia policy would receive only desultory attention.

The Gore-Chernomyrdin Commission's function and structure offered a perfect blueprint for the eventual failure of the entire Clinton administration policy toward Russia. By superseding normal policy making and well established intra- and inter-governmental channels of communication, the Gore-Chernomyrdin Commission would come to impede the information flow to decision makers in Washington. The Gore-Chernomyrdin Commission likewise distracted Russian government officials from what should have been their main focus: constructing the essential elements of a free enterprise economy.

The meager accomplishments of the Commission could hardly mask its fundamental failures. Russia even today lacks the most basic elements of a free market economy; the costs and delays from U.S.-Russian space cooperation (the initial project of the Commission) continued to escalate; the "privatization" of Russia's energy sector (another Commission priority) was becoming criminally corrupt; and Russia was accelerating its proliferation of dangerous technology. The Commission worked to divert attention from this string of major policy failures, and issued frequent proclamations of minor successes.

The Gore-Chernomyrdin Commission contributed to a deliberately uninformed U.S. policy toward Russia. It refused to acknowledge failure, and, even worse, celebrated failure as if it were success. The Clinton administration's dependence on the Gore-Chernomyrdin Commission, coupled with the Commission's refusal to listen to independent information, meant that administration Russia policy was both procedurally and substantively unsound.

'Bull****': Gore and Other Administration Policy Makers Systematically Ignore Evidence of Corruption of Their 'Partners'

In 1995, CIA officials dispatched to the White House a secret report based upon the agency's large dossier documenting the corrupt practices of then-Russian Prime Minister Viktor Chernomyrdin. Chernomyrdin's private assets accumulated in his official position, according to Russian security sources, ran into the billions of dollars. When the secret report on Chernomyrdin reached Vice President Gore, he refused to accept it. Instead, according to several CIA sources, he sent it back to the agency with the word "BULL****" scrawled across it.



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It is difficult to imagine a more dangerously intemperate reaction to official corruption in Russia. Yet this was hardly an isolated incident. The administration had ignored repeated earlier warnings of corruption by Chernomyrdin and other senior Russian officials. Several Clinton administration senior officials have stated publicly that, by 1995, they had received a number of reports from the CIA alleging corruption by Chernomyrdin, and that the CIA had submitted many other reports alleging corruption among other senior Russian leaders, including Clinton administration favorite Anatoly Chubais.

Gore's close personal relationship to Viktor Chernomyrdin—and not any superior intelligence that he possessed as Vice President—was obviously decisive in his emotional dismissal of the CIA intelligence report of Chernomyrdin's corruption. (While Gore has publicly denied the “bull****” incident, he has also re-stated his harsh criticism of CIA reporting on Chernomyrdin's corruption.) This reflexive dismissal of corruption allegations against Viktor Chernomyrdin was all the more remarkable given contemporaneous Russian and U.S. media reports about Chernomyrdin's alleged corruption and continuing links to the Russian gas conglomerate Gazprom after his entry into government.

At precisely the same time that Gore was receiving reports of Chernomyrdin's corruption, the vice president was effusive in his public comments about Chernomyrdin, stating in June 1995 in Moscow: “Friends have a right to be proud of friends.”

In this way, the Clinton administration—and Gore personally—contributed not only to the spread of corruption, but to Russia's failure to overcome it. Since Chernomyrdin served as prime minister for five years, it is clear that this embrace of corruption fundamentally compromised Russia's efforts at economic reform.

Vice President Gore has hedged his denial of the “bull****” incident, saying “I don't think” that I “ever wrote a message of that kind.” Moreover, while denying writing the word “bull****,” Gore plainly referred to a *specific* CIA report, saying “whoever sent *that* over there [could not have] expected the White House to be impressed with *it* ... *it* was a very sloppy piece of work.”

Other administration officials, defending Gore's position, dismissed the CIA reports of Chernomyrdin's corruption as lacking “conclusive proof.” But agency reporting is necessarily based on intelligence sources, often covert. By conveniently demanding a “smoking gun” whenever they sought to suppress uncomfortable facts, Gore and other top Clinton administration officials established a rigged system that rejected “inconvenient” intelligence whenever it suited the preferences of the White House.

CIA officials have described the intelligence information concerning Chernomyrdin that was provided to Gore as “more detailed and conclusive than allegations of bribery and insider dealing that have been made in the Russian media and elsewhere.” Yet when asked—as recently as July 2000—whether Chernomyrdin is corrupt, Gore replied: “I have no idea.”

The Rise of Organized Crime

The Clinton administration's failed economic strategy for Russia and its tight embrace of corrupt officials including Viktor Chernomyrdin had serious negative consequences for Russia's battle against organized crime.

The Clinton administration's failure to focus its full attention on replacing Communism with the basic legal elements of the free enterprise system helped create the conditions in which organized crime has flourished. Without such essentials as legislated protections for private property, a modern commercial code, and honest, efficient, and speedy courts to enforce property rights, the “privatization” of government entities in Russia predictably resulted in chaos.

Organized crime came to be responsible not only for grisly mayhem and violence, but also for functions as diverse as enforcing contracts and court judgments, providing personal security, and even allocating scarce resources (through bribes to corrupt officials). The ability of some Russian organized crime groups to draw upon





the specialized expertise and contacts of former Soviet security personnel further increased their ability to compete with such legitimate law enforcement as existed, both in technological sophistication (in areas such as cyber-crime) and geographic reach.

The oligarchic economy, created with the advice and assistance of the Clinton administration, also tightened the stranglehold of official corruption over the Russian government and the large sector of the ostensibly “privatized” economy that it influenced. This official corruption both obstructed law enforcement and created a symbiotic relationship between corrupt government officials and organized crime, assisting them in laundering money and in the commission of other crimes.

The Clinton administration’s decision to base U.S.-Russian relations on Vice President Gore’s relationship with Viktor Chernomyrdin and a handful of other high officials sent a strong public signal that the United States would not only tolerate but embrace figures clearly identified in the Russian media and public consciousness with corruption—further undercutting law enforcement, and demoralizing not only the out-manned and underpaid Russian foes of organized crime, but also the Russian people.

Russia’s rampant capital flight, estimated at as much as \$500 billion since Russian independence, is another serious consequence of corruption and organized crime. Even the most conservative estimates of capital flight demonstrate that the amount of money leaving Russia has far outstripped the money coming in from all sources—including foreign direct investment in Russia, Russia’s soaring foreign debt, and direct Western aid to Russia.

The Clinton administration, prone to “spinning” bad news and ignoring its implications, has addressed both organized crime and capital flight superficially. The administration’s efforts against organized crime have focused on modest technical assistance to Russian law enforcement and the creation of an FBI presence in Russia, in every case channeling that assistance through their Russian “partners” who were central to the corruption of the Russian government. By its own admission, the administration gave insufficient priority to Russian money laundering—as revealed by the Bank of New York scandal, involving the laundering of as much as \$10 billion.

The Clinton troika inferred from these phenomena no lessons about the consequences of its failure to promote the basic elements of a free enterprise economy to replace Communism.

1998: Years of Bad Advice Culminate in Russia’s Total Economic Collapse

The culmination of the Clinton administration’s fatally-flawed macroeconomic policy for Russia occurred in August 1998, when Russia’s default on its debts and devaluation of the ruble led to the nation’s total economic collapse. By all measurements, the disaster was worse than America’s Crash of 1929.

The disaster that began on August 17, 1998, spread immediately throughout Russia. Millions of ordinary men and women who had deposited their money in Russian banks lost everything. ATM and debit cards ceased to work. Dozens of banks became insolvent and disappeared. Angry depositors besieged Russian banks, only to learn they had been wiped out.

Millions of senior citizens, whose meager pension income had been suspended for months, were cut off completely. When the dust finally settled in March 1999, the ruble—and with it, every Russian’s life savings—had lost fully 75% of its value.

The devastation of Russia’s economy was worse than what America experienced in the Great Depression. By 1932, the U.S. gross national product had been cut by almost one-third. But within just six months of the 1998 crash, Russia’s economy, measured in dollars, had fallen by more than two-thirds. From \$422 billion in 1997, Russia’s gross domestic product fell to only \$132 billion by the end of 1998.

At the end of 1929, following America’s disastrous stock market crash, unemployment in the United States



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reached 1.5 million, representing 1.2% of the total population. The 1998 collapse of the Russian economy was far worse: 11.3 million Russians were jobless at the end of 1998—7.7% of the nation’s total population.

In the Crash of 1929, stock prices fell 17% by year end—and 90% by the depth of the Great Depression four years later. By contrast, the Russian stock market lost 90% of its value in 1998 alone.

“Most fundamentally,” said Sergei Markov, an analyst at the Institute of Political Studies, “it is a crisis of the real economy—Russia doesn’t work.”

Foreign investment in Russia plummeted from \$4 billion in 1997 to \$1.7 billion in 1998. The collapse of international trade not only curtailed the supply of foreign goods, but also created scarcities and high prices for Russian-made goods with foreign components. Drugs and medicines, always in short supply, became even more difficult to come by. Shortages of meat and cooking oil were so severe that humanitarian food aid from the West, which had not been necessary since the collapse of Communism, was resumed on emergency basis.

The lack of a reliable currency reduced much of Russia to a barter economy.

The 1998 economic collapse also accelerated Russia’s deepening social pathologies. Russia’s population, which has fallen every year since 1992, shrunk at an accelerated pace as deaths outnumbered births by 784,000 in 1999, the year following the crash. The economic hardship of raising a child further inflated Russia’s sky-high abortion rates: for every birth in Russia, there are now two abortions. Drug use and addiction in Russia have skyrocketed, fueled by the growth in organized crime and widespread economic depression.

Alcoholism, a chronic problem in Russia, has grown worse as economic conditions have worsened: according to a January 2000 report, the number of deaths resulting from alcohol poisoning is over 100 times that in the United States.

The jump in drug use has also led to an increase in HIV infections. Drug addicts account for 90% of all HIV-infected people in Russia. The collapse of the Russian economy in 1998 coincided with a massive increase in the number of people living with HIV. Russia’s HIV population literally doubled between 1997 and 1999—the fastest growth rate in the world.

The road to this crisis had been littered with warning signs that the Clinton administration ignored for years. The U.S. encouragement of increasingly massive loans to the Russian central government from the IMF continued despite the lack of basic free market legislation in place to justify it. With no market in banking services, no reliable protection for private property rights, no mortgage lending, and no commercial dispute resolution, capital flight—fueled by IMF hard currency—approached 10% of Russia’s gross domestic product.

Russia’s heavy reliance on borrowing to finance its annual operations caused investors to demand exorbitant premiums to hold Russian debt. The government offered ever-higher interest rates—at times approaching 250%. The process was unsustainable. In a full-blown Ponzi scheme, new higher-interest Russian bonds were issued to pay interest on old bonds. By mid-1998 some 30% of Russia’s budgetary outlays were devoted to debt service.

As they had for five years, the Clinton administration and its tight policy clique miscalculated the effects of their policies and closed their eyes to the consequences. On July 28, 1998, Treasury Secretary Robert Rubin wrote to then-House Speaker Newt Gingrich that the Russian government could now be expected to “finally take the myriad steps needed to put its finances on a sustainable path.” The same day, Stanley Fischer, the IMF’s Deputy Managing Director, insisted: “The pressure is off the ruble.”

In early August 1998, President Clinton was concerned about his scheduled September 1998 summit with Yeltsin. The White House dispatched a Treasury Department official to Moscow “to ensure that the show stays on the road for the next three weeks at least.”

On Monday, August 17, the Russian government formally declared its insolvency, and the horrific economic consequences rapidly followed. The Clinton troika strategy of massive lending to the central govern-





ment as a substitute for the construction of a free enterprise system in Russia had proved an error of historic proportions.

The administration had, in effect, hijacked the IMF to implement its economic strategy, and the IMF debt, far from solving Russia's problems, had exacerbated its difficulties. But despite having engineered the entire series of loans that contributed to Russia's complete economic collapse, the Clinton administration immediately attempted to distance itself from the fiasco. "It was the Russians' choice," said one Clinton administration official.

Few in Russia accepted this version of events. Many Russians, not surprisingly, blamed the West, the IMF, and the United States for intentionally leading Russia down the path of ruin. The heavy-handed and wrong-headed involvement of Clinton administration officials in Russian government economic policy made America an easy scapegoat for disgruntled Russians. Since the beginning of the Clinton administration, U.S. officials had urged a steady diet of borrowing to mask the Russian economy's fundamental weaknesses—prolonging and deepening the eventual collapse.

Russia's economic collapse in August 1998, after six years of American advice and scores of billions in Western aid, shattered the last illusions in both Russia and the West that a free market and prosperity were making slow but steady progress in Russia. It marked the final bankruptcy of the Clinton administration's economic strategy of macroeconomic "stabilization" and massive aid inflows, and contributed to the discrediting of American advice and institutions within Russia.

The effects of the complete collapse of the Russian economy in August 1998 were profound. They are still being felt today.

Weapons Proliferation Feeds a Corrupt and Cash-Starved System

The failure of the Clinton administration's economic strategy for Russia has had profound implications for Russia's policy on proliferation of weapons and technology, and therefore for America's national security interests.

Between 1992 and 1999, the Russian economy contracted 25%. Currently, 13.3% of the labor force is officially unemployed, compared with only 4.8% in 1992. The complete collapse of Russia's economy in 1998 saw industrial and agricultural output drop sharply. Investment in Russia suffered as capital flight crippled the private sector. These increasingly severe financial pressures, coupled with a paucity of alternate sources of much-needed hard currency, tempted the Russian government to both legal and illegal weapons sales as a way out.

Russia's failure to create a working free enterprise system likewise stalled conversion of the military sector of the economy. In Soviet days, the one industry in which Russia enjoyed a true comparative advantage in global markets was its military hardware, weaponry, and related technologies. When the Soviet Union collapsed in 1991, Russia inherited a massive infrastructure devoted to the development and production of weapons. Despite the 1992 beginnings of downsizing in the former Soviet military-industrial complex, much of that infrastructure remains in Russia.

The decline in Russian military spending and the general failure of Russia's economy during the Clinton-Yeltsin years meant that this immense military-industrial complex faced urgent incentives to sell as much as possible as quickly as possible, often irrespective of the long-term implications for Russia's own security.

At some former research facilities, fully half of the scientific personnel had been laid off by the fall of 1995, but the Russian economy could not absorb them. As a result, individual officers, bureaucrats, and scientists, whole research facilities, design bureaus, ministries and even the central government had economic incentives to sell extraordinarily-sensitive weapons and technology to any nation or groups that would buy them.

To many in the Russian government, exporting such hugely valuable contraband seemed to solve several problems. It would generate hard currency; it would utilize existing Russian assets; and it would put possibly hun-



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dreds of thousands of unemployed Russians back to work. For the many Russians increasingly involved in organized crime, there was yet another benefit: the opportunity for significant personal wealth.

Official Russian policy was eventually brought into line with these expedients. Under the rubric of “strengthening multipolarity,” the avowed purpose of the new Russian consensus on foreign policy and national security is to increase the strength of global forces arrayed against the United States. This consensus helps allay any concerns that Russian officials, scientists, and businessmen might have about transferring weapons or military technology to such countries as Iran, Iraq, North Korea, Libya, and the PRC.

President Putin recently amended Yeltsin’s 1992 decree limiting Russian nuclear assistance to countries whose nuclear programs are not fully monitored by the International Atomic Energy Agency, including Iran and North Korea. When Russia’s national interest is understood to be strengthened by weakening the United States, the Russian military-industrial complex can do well by doing good.

The Clinton administration’s culpability for this proliferation extends considerably beyond helping to create the economic prerequisites for it. The administration has consistently de-emphasized proliferation in its discussions with Russia—ignoring credible American and Israeli evidence of proliferation, accepting Russian assurances that were patently not credible, and strongly opposing bipartisan Congressional efforts to take a stronger stand against proliferation.

This has been particularly true of Vice President Gore’s stewardship of the issue of Russian proliferation to Iran. In fact, Congress’ efforts to combat Russian proliferation to Iran have drawn far more vocal opposition from the administration than the dangerous spread of weapons that Congress seeks to address. The administration has been compromised from the outset by an unwillingness to admit that its anointed Russian “partners” might have been dishonest in their assurances, or unwilling to live up to their commitments, that weapons proliferation would stop.

From Friendship to Cold Peace: The Decline of U.S.-Russia Relations During the 1990s

Eight years ago, when President Clinton took office, the stated objective of the Russian government was a formal alliance with the United States. Russia pursued a strongly pro-American foreign policy, and the United States enjoyed unprecedented affection and admiration among ordinary Russians. Today, the United States’ relationship with Russia has been shattered.

Where 70% of Russians held a favorable view of the United States when President Clinton took office, 37% hold such views today. More than 80% of Russians polled by the U.S. government in February 2000 thought that the United States was seeking to weaken Russia, while 85% believed that the United States sought world domination.

The quality of the economic advice that the Clinton administration has offered to Russia has been so bad, and its results so dismal, that 81% of Russians believe it was purposely designed to make Russia a second-rate power. President Clinton himself has become one of the most unpopular international figures in Russia, second only to Saddam Hussein in some polling.

These negative views of America have grown steadily worse throughout the course of the Clinton administration, and are shared by all levels of Russian society and by all age groups. As a result, ordinary Russians today are now working up hostility toward the United States, a phenomenon decades of Soviet propaganda had been unable to achieve during the Cold War.

The collapse of American prestige in Russia has been largely caused by the failure of what Russians perceive as the “American model” of economic and political reform—that is, the policy advice proffered by the Clinton administration. Russians find evidence of this failure all around them. Russia today is more corrupt, more law-





less, less democratic, poorer, and more unstable than it was when President Clinton and Vice President Gore took office—a society some Russian and American observers chillingly describe as “Weimar Russia.”

The political and policy vacuum created by this failure has empowered some of the most retrograde, anti-American elements of the Russian foreign policy and military establishments. Many of their views have lately entered the mainstream of official Russian thinking. As a result, the Russian government today works against American foreign and defense policy around the world, often at the expense of Russia's own long-term interests. In concert with a rogue's gallery of rivals and enemies of the United States, Russia is today maintaining its intelligence relationship with Castro and its listening post at Lourdes, Cuba; working with Beijing to renew both political and military ties with the pariah regimes in Iraq, North Korea, and Libya; and cultivating the Milosevic dictatorship in Belgrade.

Eight years after Russia announced its pursuit of a formal alliance with the United States, Russian foreign policy has retrogressed toward that of the pre-*perestroika* Cold War period. Whereas Presidents Yeltsin and Bush had agreed to pursue amending the ABM Treaty to take into account the proliferation of ballistic missiles, the Russian government has recently stated that U.S. failure to observe the treaty as the linchpin of our mutual security will cause Russia to renew the nuclear threat to Europe. Moscow has also threatened to deploy multiple warheads on its Topol intercontinental ballistic missiles (in violation of the Bush-Yeltsin START II agreement) as part of its “asymmetrical” response to the U.S. position that the ABM Treaty is outdated.

Russia is simultaneously continuing the very proliferant activities that have made a U.S. missile defense essential. As recently as June 2000, just weeks before President Putin's visit to North Korea, missile component companies in Russia and Uzbekistan were reportedly collaborating to sell North Korea a special aluminum alloy for missile manufacture, laser gyroscopes used in missile guidance, and connectors and relays used in missile electronics.

The Russian government has intensified its opposition to NATO enlargement, and zealously seeks to weaken ties between the United States and NATO Europe. Recent Russian policy has revived Soviet-era proposals to substitute a pan-European collective security structure for the current alliance-based security system.

A more troubling contrast to the atmosphere of the early 1990s could hardly be imagined. Yet, confronted with the consequences of its policies, the Clinton administration has applauded itself for having avoided an even worse scenario such as a Soviet Communist restoration, a military dictatorship, or nuclear war. That is a remarkably inadequate vision of what could have been made of the most significant opportunity in this century for Russia, and the greatest foreign policy opportunity for the United States since World War II.

‘The Enemy of My Enemy Is My Friend’: Russia Emerges as a Strategic Partner of the People's Republic of China

Although the Clinton administration has long boasted of its “strategic partnership” with Russia, the Russian government unmistakably disavowed any such relationship in its authoritative *Foreign Policy Concept*, approved by President Putin in June 2000. The *Foreign Policy Concept* flatly states that “certain plans relating to establishing new, equitable, and mutually advantageous partnership relations of Russia with the rest of the world”—plans embodied in the 1993 version of the *Concept* approved as President Clinton was taking office—“have not been justified.”

Instead, the June 2000 *Concept* lists first among the threats to Russia “a growing trend towards the establishment of a unipolar structure of the world with the economic and power domination of the United States.” To challenge America's dominance, Russia today cultivates its strategic partnership with the People's Republic of China—a partnership explicitly targeting American policies and interests around the globe, and founded on increasing both the PRC's and Russia's military capabilities against the United States. This is in stark contrast to Russia's explicitly seeking an alliance and missile defense cooperation with Washington in 1992.

Russia and the PRC have rapidly increased the level of their cooperation in opposing American plans for



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national and theater missile defense, NATO enlargement, U.S. security cooperation with Taiwan, and U.S. opposition to the North Korean missile program.

Even more troubling is the dramatically increasing scale and sophistication of Russian arms and technology transfers to the PRC: *Sovremenny*-class destroyers equipped with Moskit surface-to-surface missiles, state-of-the-art weapons systems specifically designed to destroy U.S. aircraft carriers; ultra-quiet *Kilo*-class diesel submarines; Su-30 long-range attack aircraft and MiG-31 long-range fighter-interceptors; AWACS radar systems; T-80U tanks; state-of-the-art Russian surface-to-air missiles; and rocket engines, as well as many other weapons systems and technologies. Negotiations are reportedly underway for still more sophisticated weapons systems and technology. There are also reports of far-reaching Russian military commitments to the PRC in the event of hostilities over Taiwan.

After tens of billions of dollars in Western assistance and eight years of mismanagement by the Clinton administration, the U.S.-Russian relationship is in tatters, characterized by deep and growing hostility and divergent perceptions of international realities and intentions. The Sino-Russian relationship, by contrast, has grown steadily stronger, and has steadily assumed a more overtly anti-American aspect.

Because of Russia's current and future importance, the consequences of this failure are difficult to overstate, and almost certainly exceed the consequences of the American defeat in Vietnam and the fall of the pro-American government in Iran. To find a foreign policy failure of comparable scope and significance, it would be necessary to imagine that after eight years of American effort and billions of dollars of Marshall Plan aid, public opinion in Western Europe had become solidly anti-American, and Western European governments were vigorously collaborating in a "strategic partnership" directed against the United States.

Despite Years of Policy Failure, a Bright Russian Future Is Still Possible

The task ahead for Russia in 2000 is essentially the same as it was in 1992. Since so little progress has been made toward putting in place the building blocks of a free enterprise economy, that work must now begin in earnest. But whereas conditions in Russia in 1992 were eminently hospitable to such an undertaking, the ensuing years of policy failure have squandered that advantage. Now, with so many Russians having soured on "reform," the necessary work will be much more difficult.

Despite the dimensions of the task ahead, the outlook for Russia is not entirely bleak. The economic collapse of 1998, while devastating, has given way to a determined effort to dig out from beneath the rubble and start afresh. The hostility engendered by the statist, incoherent, and clumsily-administered Clinton administration foreign policy need not create an enduring cold peace.

The slow economic progress that began in 1999 has gained some momentum in 2000. The Russian government reported in July 2000 that the economy was growing at an annual rate of 7.3% during the first six months, while output from January to June rose 8.6%. Fueled by strong energy exports, Russia's trade surplus reached \$27 billion for the first five months of this year.

Importantly, the Russian government is using the breathing room created by high oil prices to implement much-needed tax simplification and government spending reductions. After President Boris Yeltsin's December 1999 resignation, Russia's Center for Strategic Research was tasked with drafting an economic reform program for the incoming Putin government. The Center released its report in June 2000, which emphasized:

- Reducing government spending
- Balancing the central government's budget
- Eliminating many state subsidies
- Implementing a 13% flat income tax





President Putin signed the flat tax into law on August 7, 2000, calling it “the most important event in the country’s life.”

Amidst these signs of slow economic recovery, foreign investment is tentatively trending toward pre-August 1998 levels. More than \$10 billion in foreign capital has entered Russia during the first five months of 2000—twice as much as during all of 1999.

Russia has other inherent assets that were not wiped out by the economic collapse of 1998, nor erased by decades of Soviet Communism. For example, a silver lining to the Soviet state’s lack of academic freedom was its focus on training scientists and specialists. The high level of education and skills in these areas among much of the Russian workforce is an asset that Russia still possesses intact.

Perhaps most important for Russia’s future is that young Russians are significantly more supportive of democracy and free enterprise than their older countrymen. The younger generation in Russia—less influenced by the legacy of Soviet Communism than its parents—displays an entrepreneurial spirit unknown in Soviet days. Remarkably, three-quarters of 18-29 year olds believe that it is important “to achieve success with a business of their own.” This energy and vigor can transform Russian society and Russia’s economic future, if it is not indefinitely stifled by current government impediments to the market.

Religious faith has sharply increased since the collapse of the Soviet Union. As one sociologist noted, “in a remarkably brief period of time, Russia has become one of the most God-believing countries in Europe.” Interestingly, the revival of faith in Russia is concentrated among the young and the educated.

Despite the Soviet legacy of outlawing private civic organizations, a number of civic groups have been founded in recent years. The number of human rights organizations has grown from 50 in 1996 to over 1,200 in 1999. According to the U.S. Agency for International Development, there are now approximately 65,000 active civic and social groups of all kinds in Russia.

Russia’s rich culture, which ties its people together and is universally admired, also provides a base upon which the nation is building anew today.

The successful elevation of Vladimir Putin to the Russian presidency is widely attributed to the public longing for order after a decade of chaos. But despite the unmistakable public clamor for a crackdown on crime and corruption, public opinion surveys show that a majority of Russians are not prepared to give up their most cherished and hard-won liberties. An August 1999 U.S. Information Agency survey found that 73% of respondents opposed loosening restrictions on police and security forces, 66% opposed banning meetings and demonstrations, 62% opposed canceling elections, and 53% opposed media censorship.

Russia is a great nation, and must eventually determine its own course. If it is to successfully make the transition from nearly a century of Communism to a free enterprise democracy built upon individual decision making and individual rights, it will be because of the determination of Russia’s people to do so. As the world’s leading free enterprise democracy, the United States offers the quintessential model for Russia’s future, if Russia chooses freedom. It was in 1992, and is now, America’s opportunity—if not our duty—to respond.

America and Russia have lost a decade. The growing estrangement of Russia from the United States, the hostility to American interests reflected in Russia’s foreign policy, and the telltale signs of authoritarianism in the post-Yeltsin era provide ample evidence that Russia faces a more formidable task because U.S. foreign policy was weak, and did not lead. But it is not too late for the United States to stop impeding and start assisting the transition from Communism to free markets, from authoritarianism to democracy, and from disorder to order. It simply requires that we begin anew—but this time, with a clear purpose.

