

**UNITED STATES ASSISTANCE
AND
ECONOMIC COOPERATION STRATEGY
FOR
RUSSIA**

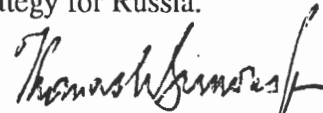
**Approved
by the
Coordinator of U.S. Assistance to the New Independent States
May 19, 1994**

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The Freedom Support Act in Section 102 provides that the Coordinator of U. S. Assistance to the New Independent States shall be "responsible for designing an overall assistance and economic cooperation strategy for the independent states of the former Soviet Union".

The imperative to move quickly in this vitally important region necessitated prompt action on the basis of best judgment and an interim strategy. At the same time, there remained the need for a carefully considered strategic vision as the basis for validating, refining, streamlining, and more tightly focusing ongoing assistance and economic cooperation activities. The first step was approval last January of the Assistance and Economic Cooperation Strategy for the New Independent States as a whole. The next is to put in place more detailed strategies crafted to fit each of the New Independent States, with Russia being the first of this series. This process is part of the ongoing effort by our whole government to respond effectively to this historic opportunity, and the strategies are developed through extensive consultation with agencies and departments involved in providing assistance and promoting economic cooperation.

I approve this Assistance and Economic Cooperation Strategy for Russia.

A handwritten signature in dark ink, appearing to read "Thomas W. Simons, Jr.", with a stylized flourish at the end.

Thomas W. Simons, Jr.
Coordinator of U. S. Assistance
to the New Independent States

INTRODUCTION AND OVERVIEW

Russia is seeking to rejoin the company of the world's most advanced nations. For many Russians, that means a new revolution, a transition from a command economy and centralized political control to a market economy and democracy. These reforms are difficult in every country of what was once the Soviet sphere; they are especially difficult in Russia, which gave birth to the Soviet system itself. Much progress has been made. But the transition, even if fully successful, will be a long one. The United States has an important national stake in its success, as do Russia's neighbors, other countries embarked on their own versions of the same transition, and all of Russia's potential partners in a more open, more secure, more prosperous world community.

Our overall goal is clear: we wish to achieve enduring, normal, and productive bilateral relations with Russia, and to encourage such relations between Russia, the other New Independent States, and the rest of the world. This ultimately requires stability and prosperity within Russia, and international relationships based on mutual recognition of sovereignty, reasonable security interests, normal economic relations, and free movement of people, goods, and ideas.

Over time, stability and prosperity in Russia will require progress in its economic and political reform process, and we hope that progress will be steady. Realistically, however, the process is likely to be much less even. Important national interests, national pride, and enormous dislocations as reforms proceed, all will complicate the course of events. Our strategy needs to account for the full range of these possibilities pragmatically, while consistently seeking to strengthen the chances of favorable results, in the longer term if not immediately.

American assistance is aimed at helping reformers in Russia achieve the following objectives:

- A competitive, efficient, market-oriented economy in which the majority of economic resources are privately owned and managed, so that economic decisions are based primarily on individual choice.
- Transparent and accountable governance, and the empowerment of citizens, working through their civic and economic organizations and democratic political processes that ensure broad-based participation in political and economic life, and respect for human rights and fundamental freedoms.
- Redefined public and private sector roles in the management of humanitarian, health and related social services fundamental to a successful transition to stable democracy and a market-based economy.

The need for responsible environmental practices and responsible management of natural resources cuts across these objectives. Efficient and environmentally responsible use of energy and other natural resources is an essential aspect of Russia's transition to a productive and modern economy capable of competing in the world marketplace, and hence is the only kind of development which is sustainable. Similarly, environmental practices and resource policy have direct impact on the daily lives of citizens. Higher productivity through waste minimization can catalyze and expand market development, while current energy and environmental practices in sectors like nuclear power, fuel use, and raw material extraction undermine both economic progress and public support for the system which permits them.

United States assistance to Russia is guided by four basic principles. These principles recognize the uncertainties facing Russia, its size, its diversity, and its enormous potential to become a major economic and political partner in the international community. They maximize the effective use of

scarce U.S. resources while taking advantage of U.S. comparative advantage in terms of expertise, experience, and priority interest. This strategy covers all United States Government assistance except for Department of Defense programs targeted at various U.S. security and related objectives, and may provide useful guidance for such programs as well.

- **Partnership:** The program is one of partnership with Russian reformers. They must give the lead and direction, and set the pace of change, taking into account the country's political and economic possibilities. We are supplying technical and financial resources to help them analyze, choose and implement options, including options from U.S. experience relevant to Russia. Without partners committed to reform, U.S. technical assistance will not be effective.
- **Flexibility:** The program seeks to take advantage of opportunities, take account of real constraints, respond to sectoral shifts in the pace of change and recognize our limited ability to predict the result. In general, allocation of U.S. resources will reflect the pace of reform as well as Russian and U.S. reform priorities.
- **Linkage:** Russia's transformation has attracted interest and support from a wide range of U.S. agencies, non-governmental organizations, private companies and individuals. Linkages, matching U.S. and Russian partners and emphasizing people-to-people and institution-to-institution contacts, multiply the effectiveness of program resources. Assistance programs will seek to establish and/or strengthen these partnerships.
- **Focus:** It is essential that U.S. programs and diplomatic efforts work together to support reform during this initial period of reorientation. Assistance will therefore be focused on sectors and regions where the reform impulse and reform potential are greatest, and in ways that result in demonstrable impact from our programs.

Resources are limited, and will be even more severely limited in the future. New commitments of economic transition funds for Russia will be significantly lower in Fiscal Year 1995 and end by Fiscal Year 1998. Russia is not underdeveloped in terms of physical and human resources and infrastructure, which it possesses in abundance. Rather, it is misdeveloped in terms of democracy and the market. U.S. technical assistance is intended and designed to encourage and assist reformers who wish to reorient Russian resources and structures toward those goals. If this cannot be accomplished by the turn of the century, the reason will be lack of political will and capacity, rather than lack of resources.

BACKGROUND

Russia is the largest, most populous, and richest of the New Independent States. Its centrality to Eurasian political and economic development both before and during the Soviet period means that changes that begin in Russia have often had resonance far beyond its borders. For these reasons, as well as its military and geopolitical significance, Russia has had and deserves to have the special attention of the United States Government.

Both chronologically and conceptually, Russia has been in the vanguard of the reform process throughout the region. The legacy of political dictatorship and command economies in its Soviet Communist form presents common challenges to all twelve New Independent States, and democratic and market reform is an option for them all in responding to it. Russia has so far been a leader in choosing and implementing such reform. Nonetheless, the problems left by seven decades of Communism have combined with the strains of the transition period to produce significant resentment against various aspects of "reform". Major political debate concerning the appropriate policy responses continues, and consensus is far from achieved. Our assistance must

be crafted with that debate -- and its potential outcomes -- in mind. Our programs should help sustain the reform impulse in practice; they should not become political ammunition for those who wish to stifle it.

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The Russian historical experience is a paradoxical combination of vast resources and centralized management. From early on, the Russian empire was based on political authoritarianism at the center and firm control by the local aristocracy over the direct agricultural producers in the localities. National-level experience with democracy was brief, intermittent, and shallow; many Russians tend to associate popular rule with "anarchy" or "chaos". Economically, the incentive structures for both landlords and serfs discouraged high productivity, economic efficiency, and investment. These features reinforced each other: the aristocratic state played a large role in national economic life by drawing large resources from the country to perpetuate itself and for a limited number of priority national tasks, usually in or connected to defense and expansion of the realm. These Russian patterns survived the end of serfdom in 1861, and gave a peculiar character to 19th century industrialization. Since domestic markets were weak and domestic sources of capital and labor were inadequate in either quantity or quality, the result was a relatively small industrial sector precariously perched on a vast, impoverished mass of largely self-sufficient rural peasants. There were few economic intermediaries between them, just as there were few mechanisms for evolutionary change within the political system. The result was impressive but fragile state power which broke down under the strain of prolonged effort and repeated defeat in World War I.

The Bolsheviks proved the most effective political force within the shambles of familiar institutions of 1917; they seized power in the major cities and hung onto it during an exhausting three-year civil war. Ruling a prostrate, mainly peasant country in a hostile world, within a decade they fashioned a new version of the old recipe of autocratic dominance of politics, society, and the economy, but a version more pervasive and ruthless than any Russia had known before. Josef Stalin imposed political totalitarianism backed by terror, unleashed a virtual civil war to force the peasants into state-managed agricultural production, and sponsored a state-centered industrialization drive that emphasized gigantic factories producing capital goods under near-monopoly conditions. The Stalinist command economy was efficient in its decades in its own terms: it perpetuated Communist power and produced the discipline and many of the goods to survive a ferocious Nazi onslaught and then create and maintain a powerful empire. But in terms of the global economy emerging in the 1970's and 1980's, it was rife with productive and allocative inefficiencies, and politicized, non-productive incentive structures for both labor and managers. It was becoming increasingly inefficient in terms of the global power competition for which it was geared.

Tentatively after Stalin's death in 1953, and much more comprehensively in the early 1980's, some members of the Soviet political elite began to realize the inherent problems with the system they had inherited. It was not until Mikhail Gorbachev came to power in 1985, however, that any real attempt was made to transform both the political and economic aspects of the system to make it a more efficient competitor in the evolving global power context. Gorbachev's rhetoric and objectives were reformist, but he and his leadership colleagues set in train processes of political and economic change that proved increasingly difficult to harmonize and manage within the Soviet structures they were intended to preserve in modernized form. After six years of uncertainty over future directions, caused by both external resistance and internal ambivalences and inconsistencies, the Soviet Union disintegrated into its component republics. Boris Yeltsin, once a Gorbachev ally, and now a more consistent voice for radical change, assumed power in the Soviet Union's Russian successor state.

The period since 1991 has seen a firmer, if still hesitant, commitment to reform. Western countries, including the United States, have also increased their efforts to encourage and assist the process. But the process itself, while impressive in its achievements, has been dispersed and intermittent, as is natural given the scale and novelty of the challenge, the extent of disruption, and the weight of the past. Political struggles over the nature and pace of reform within the executive, between the executive and legislative branches, and between central and local governments have slowed economic reform. The struggling economy, marked by high inflation, growing government and inter-enterprise debt and the recession in industry and agriculture is typical of the initial stage of transition from command to market economic structures: all have contributed to political problems. The movement towards a democracy has confronted a number of obstacles: inexperience with democratic principles, confusion over personal and institutional roles and responsibilities in a free society, and a bureaucracy familiar only with command. There are reformers everywhere, in central institutions and in the regions. But the institutions and habits of civil society are relatively underdeveloped. Reform can not be produced by outsiders; it is -- like non-reform and anti-reform -- a natural Russian response to the historic challenges the country faces.

At the same time, Russia has tremendous human and natural resources, and centuries of achievement, and hence the confidence that further achievement is possible. There is great resistance to change, but a Russian pioneer spirit, a willingness to try and strive, is also alive and well. Russia has a highly literate population and education and research systems with a history of remarkable accomplishment in areas such as mathematics, science and technology, the arts, literature and languages. Its ethnically diverse population shares large common elements of culture and language, and it has repeatedly demonstrated an impressive capacity to endure hardships, and to succeed.

These characteristics are apparent in the remarkable progress already made in some areas. The State Property Commission, for example, by the end of 1993 had privatized some 70,000 small businesses and retail services, and 5,000 medium and large companies. Large company privatizations are taking place at 900 or more a month. More than six million apartments across Russia have been privatized, with one million privatized in Moscow alone.

But the real challenges are ahead, as privatized companies and farms are forced to rationalize, unemployment increases, enterprises begin to shift responsibility for social services to government at various levels, and individuals become responsible for many things which had previously been provided by employers, unions, and government. Implementation of economic reforms will impose real hardships, and democracy will translate them into political pressures. Events after September 1993 demonstrated the dangers of those pressures.

CONTEXT: OTHER DONORS AND THE LONG RUN

Assistance to Russian reform is a broad-based international effort. Just as no outside agency, institution, or country can substitute for or replace Russian reformers themselves, so no one country or agency by itself can shoulder the task of encouraging Russian reform at the margin. The partially complete July 1993 OECD Register of donor programs identifies 986 technical assistance projects authorized, budgeted at \$949 million; most of these were targeted on state enterprise restructuring and privatization; the development of reform plans for various sectors; nuclear safety, energy and the environment; and food production, transport and distribution. Known donor plans suggest that new assistance will continue in these same sectors, with somewhat more emphasis on social sector restructuring, defense conversion and agriculture. Humanitarian assistance has fallen back markedly, because the widespread food and humanitarian crises many anticipated in the aftermath of Soviet dissolution never materialized.

The scale of the transformation underway and the scale of the country itself provide ample scope for a multiplicity of technical assistance efforts; the danger of wasteful or damaging duplication should not be exaggerated. Indeed, in some situations, American assistance will parallel (duplicate, even) that of another donor to ensure that American standards are among those considered. Nonetheless, improved consultation and coordination among donors and by the donors with the Russian government would clearly be useful, and is under way. The United States should ensure that its assistance complements and adds value to the efforts of others, and should consider phasing out programs that are simply duplicative. In addition to bilateral contacts and the OECD Register, the World Bank's consultative group process and now the G-7 Support Implementation Group established in Moscow (which is authorized to deal with bilateral assistance issues at the request of the donor country involved) can be useful vehicles for pursuing improved focus and avoiding program redundancy.

This strategy is based on the pace of change to date, and reflects an assumption that present trends will continue. Should the pace of reform change, then the volume and nature of assistance will also change. Nonetheless, as in other countries in the NIS, there are useful, long term programs mutually beneficial to the United States and the people of Russia which should be relatively immune to fluctuations in the pace of governmental reforms. These include training and exchange programs which increase exposure to and knowledge of democracy and market economies among those who will be involved in future years, direct assistance to independent media or democratic political institutions, help for the emerging private sector, people-to-people and institution-to-institution programs, activities which directly benefit people outside government and technical assistance for putting in place the laws, regulations, and institutions a modern market economy requires. Programs which directly work with government are effective only to the extent that they are capable of producing the desired results; accordingly, care must be constantly exercised to ensure that the existence and level of these programs support reform in concrete ways.

OBJECTIVES OF US TECHNICAL ASSISTANCE

Objective 1: Foster the emergence of a competitive, efficient, market-oriented economy in which the majority of economic resources are privately owned and managed, so that economic decisions are based primarily on individual choice.

Macroeconomic stability is essential for this objective to be fully achieved, even though significant change is possible in specific sectors without it. The task of developing and maintaining sound macroeconomic policies while also making the enormous changes required to transform the economy presents profound difficulties. As is evident, however, loose fiscal and monetary policies and excessive credit supply to state enterprises clearly lead to a large budget deficit and high inflation, without solving any long term problems. United States assistance will support international efforts to assist the Russian Government's macro-economic policy reform by strengthening the capacity of its institutions to evaluate and manage their economic reform process. Upon the request of Russian policy makers, the U.S. Government may help them, on a limited scale, initiate and develop policy strategies for Russia. However, the main emphasis will be to work in coordination with other multilateral and bilateral donors to respond quickly to a broad range of technical assistance requests in policy formulation and implementation. The focus in this strategy, therefore, is on structural features which are susceptible to bilateral technical assistance efforts and which are necessary for a market economy. These are not totally separate, of course, since a growing market economy also tends to create a need and demand for sound macroeconomic policies.

Key Constraints:

- Inadequacy of policy, legal and regulatory environments, key institutions, and systems critical to an active market economy (commercial law, financial markets, adequate regulatory structures, management training institutions, and business support services).
- Inefficient, monopoly-dominated state sectors--in industry, energy, and agriculture--with overly large enterprises, obsolete capital stock, and predetermined market linkages. Problems are especially acute in the large defense industry, in which firms go from a traditionally favored position to the reality of needing to make even bigger adjustments than others.
- Weak market incentives, inadequate knowledge of the basic principles of market economics, and limited experience in market operations. For example, bureaucrats continue to try to reimpose the command system over the economy: old habits die hard.
- Continuing massive inefficiencies in production, allocation, and distribution of goods and services. These are particularly problematic in terms of energy and natural resources; previous government policies (including subsidies and price controls) discouraged efficiency in production and conservation in consumption, and ignored negative environmental impacts.
- Public concern about increased unemployment and loss of social services resulting from restructuring; opposition from managers and government officials facing loss of power and access to resources.
- Crime and corruption thriving in the transition between old and new systems, which retards the development of new enterprises and endangers public support for change.

Strategic Approach:

The strategy aims at helping Russians change their economic behavior so that their country can take its place in the global company of market democracies. It seeks to support Russian efforts to end state controls and subsidies, break up monopolies, and increase competition and responsiveness to market incentives. Ultimately, a functioning market economy will end the productive and allocative inefficiencies of the Soviet system, thereby securing the broad democratic political support required to sustain it. Privatization is a necessary (though not sufficient) step in breaking up the monopoly control inherent in the Soviet system of large state enterprises. In Russia this is a vital pre-condition to new enterprise activity, and the large numbers of new jobs which new enterprises will create.

To date, therefore, much of the program has been centered on supporting a national shift in ownership of productive resources from state to private hands. A major part of this shift--ownership of industrial enterprises and commercial services--is well underway; transfers have also taken place in agriculture, and the pace of change there could accelerate. A short term priority is to substantially complete the transfer of state enterprises, land and real estate to private ownership. This is a necessary (though not sufficient) step that enables managers to restructure (if tentatively at first) without having to first obtain Ministry approval, a process that is already under way. A longer term priority is to support the development of institutions and systems supportive of an independent private sector, including financial institutions, capital markets, commodity markets, and land markets that can serve new private businesses, and a modern international trade regime. Successful completion of the transformation to a market economy will require the restructuring of existing enterprises, and redeployment of existing assets, a long and difficult process in which outside assistance can provide only limited help.

Clearly, foreign assistance alone cannot achieve these goals. Our aid has to be directed at helping reformers establish the proper environment to stimulate both domestic and foreign investment. While technical assistance can help reform and reformers only at the margin, in circumstances of transition that help can be critical. US-Russian activities can catalyze, demonstrate and spotlight the kinds of changes that need to be made in key sectors of the economy to permit it to attract the new investment required for self-sustaining growth. The program will support privatized enterprises through new commercial links and sources of technology, market information, and finance.

The correlation between enterprise inefficiency and environmental degradation provides great opportunities to reap double benefits from economic transformation. Market signals rewarding efficiency in energy practices and natural resources management use can simultaneously decrease waste and lower costs. There would be increased productivity and profitability, as well as significant amelioration of environmental problems. The importance of energy as a domestic and export resource is such that this sector's performance affects the whole transition; the keystone of energy reform is market pricing, without which technical assistance is of only future value. The high economic and environmental payoff of reform in this sector warrants technical assistance to the extent resources permit and utilization warrants.

Areas of Programmatic Emphasis:

1. Help the Government of Russia complete the transfer of state-owned assets (both land and capital) to the private sector:
 - a. Provide technical assistance and administrative support for national and regional programs for privatization of state enterprises, while working with the World Bank and other donors to accelerate their programs in this area;
 - b. Provide technical assistance and administrative support for national and regional programs to privatize land, housing, and other real property;
 - c. Provide technical assistance for development of de-monopolized, competitive agriculture business systems;
 - d. Provide assistance in developing and disseminating educational programs and materials which promote understanding of market economy, including both short and long term issues.
2. Provide assistance in creating a policy, regulatory, and institutional framework that will support and accelerate domestic and foreign direct investment and trade, as well as the integration of Russia into the global economy.
 - a. Support Russian efforts to develop and implement a body of commercial law through technical assistance on policy, legal and regulatory reform and implementation;
 - b. Provide technical assistance to help develop and implement legal and administrative requirements for private ownership of real estate, including property markets, and institutions required to make those markets work efficiently;
 - c. Provide technical assistance and training to help rationalize central/commercial bank relations including banking supervision, payment clearing systems, and monetary/credit policy instruments;
 - d. Support the modernization of commercial banking, payment instruments, and other

banking services necessary for the efficient operation of private firms, farms and households through specialized banking and financial sector training programs;

e. Provide technical assistance to help the creation and development of financial, securities, exchange and commodities markets, including regulatory institutions, to enhance capital mobilization, privatization and post-privatization activities.

f. Provide technical assistance in development of a tax system appropriate to a market economy.

3. Provide assistance to privatized and new enterprises:

a. Provide assistance on management, ownership, financial or operational restructuring of firms through loan financing and direct equity contributions (through enterprise funds);

b. Establish exchange and other programs to facilitate direct contact with U.S. businesses in order to strengthen market orientation of Russian firms, and encourage trade and investment links between U.S. and Russian enterprises;

c. Leverage enterprise assistance to encourage multilateral and bilateral financing and encourage U.S. private sector participation through investment packages drawing on OPIC, EXIM and TDA facilities;

d. Support technical assistance, internships and training programs for new and privatized businesses in management, financial planning, technical operations and marketing and encourage the development of Russian consulting and training institutions capable of delivering such programs;

e. Promote the development of non-governmental business support and advocacy organizations, associations and institutions.

4. Foster economically rational and sustainable development (including environmental risk, damage and waste reduction) in the energy and natural resource sector:

a. Technical assistance to create an understanding of the need for efficient pricing and a competitive environment in energy and other non-renewable natural resources, and the ability to analyze supply/demand relationships and management/investment decisions;

b. Assist the Government of Russia to clarify and strengthen the relative roles of central and local governments and the private sector in relation to natural resources management;

c. Provide technical assistance, technical exchanges and training, and feasibility studies linked to potential multilateral loans that address: (a) production-level environmental hazards such as oil spills, gas flaring, coal mine safety and fuel combustion emissions; (b) transmission and distribution losses and leakages;

d. Provide technical and commodity support to reduce safety hazards of nuclear power plants, including development of appropriate regulatory mechanisms.;

e. Provide technical and commodity financing for urgently needed equipment and materials to demonstrate technologies that will improve the economic and environmental performance of Russia's energy sector, with a particular emphasis on the creation of conditions permitting the closure of unsafe nuclear power plants.

Objective 2: Transparent and accountable governance, and the empowerment of citizens, working through their civic and economic organizations and democratic political processes that ensure broad-based participation in political and economic life, and respect for human rights and fundamental freedoms.

Key Constraints:

- Limited experience in the rights and responsibilities in a democracy, little tradition of democratic problem solving based on negotiation and compromise, and a tradition of authoritarianism.
- Shortage of trained professionals in key areas and absence of modern curricula in the educational system.
- Fear of the uncertainties inherent in market economies and democratic processes.
- Lack of responsiveness, accountability and transparency in most existing governmental structures and institutions, bureaucratic inefficiencies and resistance to change.
- Ambiguity in the relative responsibilities between branches of government, and between national and local governments.
- Weak civic and legal institutions (independent media, political parties, advocacy groups, civic organizations) to support democracy. As an example, groups affected by environmental problems were isolated from decision-making and there was limited non-governmental capacity to translate public concern and discontent into advocacy for change.
- Crime and corruption thriving in the transition period jeopardizes public tolerance of reform among people conditioned to rely on arbitrary power and order rather than the rule of law.

Strategic Approach:

The New Independent States of the former Soviet Union, including Russia, lack a number of institutional arrangements inherent in functioning, viable democracies, among them:

- a) interactive relationships between the government and the citizen (itself a new role for Russians) as legitimate partners;
- b) working relationships among government bodies at all levels of administration; and
- c) the rule of law as a basis for governing society.

Russia needs to develop for itself arrangements which are appropriate for local conditions and traditions. These include new sets of institutions (both governmental and non-governmental), new models of public participation, and new attitudes and modes of political behavior. This means involving citizens in various forms of empowering activities: electoral activity, policy discussions, interest-group advocacy, and legal action. This also means reworking and reconceptualizing the governing institutions (elected executive, civil service, legislative, and judicial) to make them more effective and responsive to citizen input (thus creating a feedback loop which convinces citizens of the meaningfulness of politics), and a system worthy of their support and participation. The approach involves work both from the bottom up, through the growth of civic organizations, and from the top down, through reform of government systems and institutions.

American programs will provide help to institutions, organizations, and individuals involved in these areas in order to increase their understanding of successful approaches to similar issues. This will include direct assistance to emerging organizations when appropriate. People-to-people and institution-to-institution type activities, along with exchange programs, will be heavily utilized to

increase the exposure of present and future opinion leaders to American experience. In addition, assistance will be designed to provide encouragement and support to individuals and organizations which are demonstrating initiative and leadership in the long process of developing enduring democratic institutions. We must accept and be constantly mindful that these developments are already underway, and depend far more for success on indigenous initiatives than on our efforts.

Areas of Programmatic Emphasis:

1. Encourage creation of legal and judicial framework required for rule of law, increased government accountability and protection of individual rights:

- a. Support judicial reform and development of an independent judiciary through training programs for judges in all fields of law, support for development of a judicial training institute in Moscow, and assistance in the re-introduction of the jury trial system.
- b. Provide technical assistance to those engaged in drafting, passage, implementation, and public acceptance of laws providing a solid foundation for private commercial activity (with appropriate regulatory mechanisms), and protection of individual rights and property.
- c. Support the strengthening of the legal profession through the retraining of lawyers, establishment of professional associations, and curriculum reform of law faculties and legal institutes.
- d. Promote public awareness of the rule of law in a democratic society by providing support for publications and documentaries on democratic institutions and democratic values.

2. Support an effective Russian system of governance with separate and balanced powers, including efforts among federal, regional and local governments to develop systems for fiscal management and services delivery compatible with a market economy:

- a. Provide training and exchange programs that focus on fundamental issues of parliamentary process, market economics, roles of government institutions, the use of negotiation for problem solving and conflict resolution, responsibilities to constituencies and to other branches of government, and respect for and adherence to established law and procedures.
- b. Through focused visits to the United States, familiarize local, regional and national leaders with American Federalism in practice, and provide relevant in-country training at national, regional and local levels for both executive and legislative branches, including new members of legislative bodies. For example, technical assistance may be provided to strengthen institutional capacity to integrate environmental considerations into key policy decisions, and to help authorities develop a framework defining governmental jurisdictions on environmental issues.
- c. Provide technical assistance to develop a general national framework for revenue and expenditure responsibilities among federal, regional and local governments. In parallel, provide technical assistance and training to selected oblast and municipal governments to apply the national framework to specific regional circumstances, reconstruct tax and revenue collection strategies, establish management and accounting systems, and define regional priorities for public expenditures. (NOTE: It may be useful to coordinate this effort with the World Bank program to provide US \$500 million in support to oblasts where there are significant numbers of privatized enterprises.)

d. Provide technical assistance and training to a limited number of oblasts for pilot programs for effective and accountable provision of key government services.

3. Strengthen public participation in political processes at all levels:

a. Promote participation in free and fair elections by providing technical assistance to appropriate governmental bodies in electoral administration as well as to political parties regarding effective party organizations and campaigning; by assisting NGOs train local election monitors; by assisting Russian entities to inform the public about the need for citizen participation in elections; and by providing support to media outlets to cover election campaigns in a fair and objective manner.

b. Help develop a democratic political culture through exchanges, information sharing, and curriculum development; during 1994-95, at least 15,000 Russians (from high school students to entrepreneurs) will be brought to the United States for short and long term educational or training programs.

c. Provide technical assistance to develop public information messages promoting understanding that people can be both advocates for change and instruments of accountability, to be disseminated through Russia's independent media and emerging NGOs and PVOs;

d. Provide expert assistance to emerging Russian PVOs and NGOs to help them develop the capability to organize around and act on themes key to Russian life. As an example, support effective public awareness and participation in decision making on key environmental issues, through non-governmental environmental advocacy organizations to build broad-based, public involvement in environmental decision-making and natural resource management issues.

e. Provide policy assistance to Russian PVOs, NGOs, and the Russian government to assist the development of a policy, legal and regulatory environment supportive of the non-governmental sector,

4. Support independence of the media as a source to unbiased information and increased governmental accountability:

a. Encourage independence by providing business management advice on reducing costs and increasing market revenues, in order to reduce the media's financial reliance on the state. Support private media programming, provide training and technical assistance on roles and responsibilities for independent media and on media management in a market economy;

b. Help Russian journalism better define its role in a democracy through training, seminars, internships in the United States and media partnerships. Promote linkages between American journalism educational institutions and Russian journalists and managers;

c. Encourage a culture of independence of the media through consultations and information to familiarize legislators and policy makers with models for insulating media, including state media, from political interference.

Objective 3: Redefined public and private sector roles in the management of humanitarian, health and related social services fundamental to a successful transition to stable democracy and a market-based economy.

Key Constraints:

- High and unsustainable expectations for the role of the state created by historical guarantees of full employment and comprehensive social services through government and state enterprises. The public sector is simply unable to fund pensions, health and social services at traditionally promised levels out of tax and other revenues. Because the system had not yet collapsed when the Soviet Union dissolved, the general public is still unaware of the extent to which the Soviet Union had financed social services and the military by decapitalizing industry and infrastructure, and so tends to blame market and democratic reforms for this situation.
- Jurisdictional ambiguities among central, regional, and municipal governments over responsibilities for social services, and inadequate fiscal systems to permit appropriate financing of social services or administrative systems to deliver them.
- Fear of loss of social services as privatization and restructuring of generally overstuffed and non-competitive state enterprises force them to retrench, cutting off workers not only from income but from their access to housing, health care, and education. Russian families face real vulnerabilities and risks, and the need to assume major new responsibilities, without seeing new delivery or financing systems in place.
- Transition-induced financial weakness in systems for monitoring and control of important health problems are causing increased numbers of disease outbreaks, and rising health vulnerability, especially for women and children.

Strategic Approach:

The strategy in this area must be both long-term and short-term. In the long term, Russia needs to develop sustainable systems of social support, including pensions, health care, unemployment insurance and targeted social support, appropriate to a market-oriented economy. This means uncoupling social service functions not only from retail trade, as has largely been accomplished, but also from production. In the short-term, the threat of extensive unemployment, loss of access to social services, and the state's fiscal difficulties, creates a need for addressing the economic distress associated with the transition.

Only Russian political leaders can determine the politically sustainable pace of change, but the experience of many other countries, including other post-Communist countries, strongly suggests that growing deficits, loose monetary policy, and high inflation will only raise the economic and political pain and cost of the transition. Only a restructured economy, built on productive enterprises producing for a free market will create the wealth that can finance social benefits. Slowing transition will not reduce social costs, but only delay the start of economic recovery. Therefore, American assistance is primarily directed at the economic transition.

Technical assistance will be provided to help the Russian government delineate the responsibilities, services, and functions—including revenue, expenditure and management—which should remain within the state domain and define which governments—federal, regional or local— should administer them. Priority will be on expert advice in helping develop appropriate systems to utilize limited funds for targeted social services to those in greatest need and for programs for which public sector financing and/or management is most clearly necessary. Assistance will also be provided to help demonstrate approaches based on private sector production or delivery in those

areas in which the government will have a reduced role. Assistance in fiscal policy reform (provided through programs described under the democracy objective) will help local governments develop the financial base required for essential social services and to mitigate the social burden and political risk of transitional unemployment. Throughout this sector, particular effort will be made to target the limited American assistance on policy issues necessary to utilize World Bank and other resources, which will be the primary source of finance for necessary reforms.

Areas of Programmatic Emphasis:

1. Support fiscal reforms that shift general price subsidies to targeted subsidies focused on the unemployed and the working poor:

a. Technical assistance to help the Ministry of Finance examine current expenditures for price subsidies, coordinate plans with relevant sectoral ministries and authorities to plan phase out of subsidies, and develop a strategy to target subsidies to ease transitional employment;

b. Coordinate with World Bank efforts to assist the government to develop training programs and unemployment offices which will help record and track the unemployed.

2. Assist the government of Russia find ways to rationalize government and private roles in the economy:

a. Identify the key areas in which realignment of public and private sector responsibilities present opportunities for rationalizing financing and reducing inefficiencies. Initially the areas in which the United States will provide technical assistance will be:

-- Health: delineate health care services which will be financed and/or provided by the state, and which by non-governmental means; promote a secure supply of vaccines, pharmaceuticals, and medical equipment through sustainable local production, imports where necessary and rationalized use and distribution; health financing and service delivery reform to improve efficiency and quality by creating market-driven delivery systems; improved health monitoring and surveillance to develop accurate information on, and focus attention on, critical public health concerns. Pilot projects focused on specific local problems will also help reduce environmental health effects from air pollution, water contamination, and hazardous waste, including nuclear waste. U.S. assistance will not finance remediation of environmental hazards, but will seek to demonstrate technologies and management tools that will enable Russians to address such problems themselves;

-- Housing: provide technical assistance to help various levels of government phase out rent subsidies and target allowances to vulnerable groups that cannot afford price increases; and shift responsibility for financing housing construction from the state to private sector including housing finance through the commercial banking sector. Technical assistance will be concentrated at a municipal level, with some federal support on overarching policy, legal and regulatory issues;

-- Municipal Services: technical assistance to help municipal governments rationalize their financial administration and privatize selected services such as housing maintenance. To the extent possible, technical support and training will be concentrated in the same oblasts and municipalities receiving technical assistance on fiscal reforms.

EMPHASIS ON REFORMING REGIONS

Like the United States, Russia is a large, diverse country. As it moves from the centralized command economy and autocratic politics of the past, both in government and in the economy, the role of the regions becomes stronger. Though this ultimately makes the Russian nation stronger, the implicit changes are profound. American assistance should not be directed only at Moscow and a few easy-to-reach cities, but rather should be provided on a national basis (including the Far East). Russia's diversity is reflected in the fact that reform is uneven among regions: some have changed profoundly, while in others reforms have barely begun. Therefore, U.S. assistance will concentrate as many activities as feasible in a relatively limited number of regions which generally have shown the most reform progress, and in those regions make extra efforts to coordinate and cooperate with regional reform leaders. Given Russia's size, our assistance risks being spread so thin that its impact is obscured; focusing it on specific regions should result in greater concentration, synergy, visibility, and, hopefully, enhanced support for those regions which are making the greatest reform efforts. The benefits of reform will also hopefully be accelerated, as well. A collateral benefit will be to accelerate the process of American firms developing normal contacts with counterpart firms wherever they are located, rather than to conduct transactions only through Moscow.

ACTIVITIES OUTSIDE THE STRATEGY

The U.S. government will continue to initiate specific activities to address immediate concerns not clearly within the strategy. To the extent possible such activities will be used to further our strategic objectives. For example, the Officer Resettlement Program, being carried out as agreed at the Vancouver Summit, is to provide 5,000 housing units and retraining for demobilized military officers and their families returning from the Baltics and elsewhere. Aspects of this project can contribute to other housing reform efforts.

The United States provided direct food and medical humanitarian assistance to Russia in the initial phases of its economic and political transition process. This support helped address localized transition problems, but Russia has the resources to provide for basic human needs on a national scale. The aim therefore, must be to strengthen self-sufficiency and to target modest amounts of urgent humanitarian medical assistance to genuinely vulnerable populations on a transitional basis. In the region as a whole, humanitarian donations of food and drugs will accordingly be focused on areas of civil unrest, refugees, displaced persons and economically disadvantaged regions, and this approach will also guide our efforts with respect to Russia, should such conditions emerge there.

MEASURING RESULTS

Assistance can only support and help reformers to make necessary changes. Only if the reforms themselves succeed can we really call our efforts successful. A clear distinction is needed between indicators of a country's progress and indicators of success for our assistance activities. Both must be tracked, but with the distinction between them clear. Appropriate indicators which reflect progress by Russia in successfully moving to a market economy and democracy include the following:

Market economic systems:

- Macroeconomic policies providing a stable monetary and fiscal environment.

Indicators include:

- rate of inflation
- real interest rates
- budgetary deficit as percentage of GDP

- prices set by markets
- currency convertibility
- The extent to which the economy is privately owned and operating free of arbitrary interference by government and/or politicians. Indicators include:
 - the portion of the population which is employed in the private or non-governmental sector
 - the portion of economic output which comes from the private or non-governmental sector
 - the extent of government subsidization of the productive sector
 - the extent of monopoly production of goods and services
- Progress in establishing clear laws and regulations regulating economic activity, so that individuals have a realistic opportunity to start new ventures, and existing ventures can operate efficiently. Indicators include:
 - levels of private investment, both domestic and foreign
 - improved efficiency, reflected in reduced waste discharged into the environment, and improved profitability of enterprises
 - measures of adequacy of banking system, such as efficiency and cost of transactions, and availability of private credit
 - qualitative measure of commercial, bankruptcy, tax, tangible and intellectual property, communications, banking, contracts, and other laws regulating economic activity
 - the rate of new enterprise creation

Enduring governmental systems based on democratic politics:

- Free elections taking place at local and national levels
- Some form of separation of powers at the national level
- News media free of censorship, with diversified ownership, and individuals able to establish new media outlets
- An independent judiciary ensuring impartial arbitration of disputes within society
- Institutional or legal protection of civil rights and liberties
- Effective state institutions capable of performing limited but essential functions of regulation, rule-enforcement, and social support

Easing of the human costs associated with the transition:

- Establishment of social support mechanisms appropriate to market-based democracies
- Stable or declining levels of absolute economic and social distress

At the same time, specific assistance activities need to have their own criteria by which to track their progress. These indicators (not detailed here) measure specific results which are achieved by the projects themselves, though always directly contributing to realization of larger objectives.

Of course, while tracking specific indicators, it is necessary to constantly validate them against the ultimate indicators of successful transition: a growing economy, increased employment, and higher levels of domestic and international trade. It is not necessary for a country to perform equally well in each area to do reasonably well overall; nor is it possible for American assistance to be directed at all or even most areas that these indicators suggest are important. But overall, they should fairly indicate progress toward the objectives of economic and democratic reform.