Book Review

The fraud of 'democratic reforms': the case of U.S. aid to E. Europe

by Edward Spannaus

Collision and Collusion: The Strange Case of Western Aid to Eastern Europe 1989-98
by Janine R. Wedel
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It is a brutal fact, that the most devastating collapse of the Russian economy and living standards of its population occurred, not under Communism, but during the period of "democratic," "free-market" reforms after the collapse of the Soviet system. A similar phenomenon has taken place in Ukraine.

The same sort of "market reform" and "democracy" programs, which devastated the economies of eastern Europe and the former Soviet Union, are now at the heart of the "Stability Pact" for southeastern Europe being launched at the July 30 summit in Sarajevo.

It is therefore extremely timely to reexamine the so-called "democratic reforms" which were carried out under the auspices of U.S. and western European aid programs during the 1989-98 period.[1]

Collision and Collusion provides a fascinating series of case studies of the operations of Western aid programs to central and eastern Europe during that period. Janine R. Wedel, who is now Associate Research Professor in Sociology/Anthropology at George Washington University in Washington, D.C., particularly focusses on analyzing the relationships between Western aid-givers (or donors), and the Eastern recipients of Western aid programs. Her approach yields often humorous insights into the mentality of aid officials in the U.S. government who were charged with distributing funds allocated by Congress to the East, and the mentality of the various groups chosen by Western agencies to receive grants—who were usually selected because of their ability to speak the language of "democracy" and "reform" while often pursuing their own career or business interests. But, at the same time, she points out the devastating effects on the economies of the recipient countries, and on their attitudes toward the "West."

One of the most useful features of Wedel's book is her highlighting of the paradoxical—truly hypocritical—use of "promoting democracy" programs to assist in forcing through extremely *unpopular* economic measures over the opposition of elected parliaments and responsible government officials in the effected countries.

'A Marshall Plan of advice'

During 1989-91—the period from the fall of the Berlin Wall to the collapse of the Soviet Union—there were many calls for a new "Marshall Plan" to reconstruct central and eastern Europe. But instead, the countries of the former Soviet bloc got only what Wedel calls "a Marshall Plan of advice"—an army of Western consultants and advisers who, in most cases, left their victim countries in worse shape than they found them.

Wedel points out that few if any policymakers advocated a serious commitment to the billions of dollars in capital assistance implied in the notion of a new "Marshall Plan" for the former Communist bloc. She notes that, by mid-1990, Bush administration officials, such as Deputy Secretary of State Lawrence Eagleburger and Commerce Secretary Robert Mossbacher, had explicitly ruled out a modern-day Marshall Plan.

And already, in November 1989, the U.S. Congress passed the SEED (Support for East European Democracy) legislation "to promote political democracy and economic pluralism in Poland and Hungary."

So, instead of capital assistance, the focus became what is called "technical assistance"—which was advice and training on how to create a "market economy" through dismantling of

1. An interview with author Janine Wedel in the June 4, 1999 issue of *EIR* drew out some of the lessons of Russian aid programs for Balkan reconstruction.

state structures, privatization, creation of financial markets, and, of course, training in "democracy"—the biggest fraud of all.

Poland coined the term the "Marriott Brigade" for the short-term, "fly-in, fly-out" consultants (often from the Big Six accounting firms), who descended on Poland after the fall of Communism. Wedel also describes the "econolobbyists"—of whom Harvard's Jeffrey Sachs is her primary case-in-point. If Sachs didn't invent the idea of "shock therapy"—i.e., International Monetary Fund (IMF)-style austerity measures accompanied by abrupt elimination of government subsidies and price controls and the tightening of credit—he was its most prominent proponent.

The lie which Sachs and his ilk peddled to central and eastern European countries was that, if they jumped into the "market economy" and carried out quick and dramatic reforms, Western credits and investment would quickly follow. Sachs told the Poles in 1989 that their standard of living would begin to rise within six months if they followed his dictates. What happened in reality, was exactly the opposite.

The second pillar of "market reforms," after shock therapy, was privatization—the selling off of state enterprises. Wedel notes that the Big Six accounting firms were designated by U.S. and European aid agencies as "the chief agents of privatization and recipients of privatization aid." Wedel also notes, but does not elaborate: "The British, given their experience with privatization under Margaret Thatcher in the 1980s, were seen as having special expertise in privatization and took a lead as consultants on the issue."

What the U.S. and British aid agencies did in eastern Europe with respect to privatization is exactly what those same agencies today denounce as "cronyism" in Asia and elsewhere. The same accounting firms that were designing privatization programs and providing ridiculously low valuations for state enterprises, were then advising their other clients how to come in and buy up the assets cheap.

In 1991, the Polish government's auditing agency found that government officials had often been paid off by the private companies involved in privatization; the agency also concluded that accepting the recommendations of Western consulting firms with respect to asset valuation, had resulted in significant losses for some Polish enterprises and losses to the national treasury.

'Democracy building'

Central to Western aid efforts is the notion of "civil society" and "democracy-building"—the creation of organizations independent of the government, which are to serve as a mediation between the citizen and the government. Such "civil society" institutions are supposed to offer an antidote to Communist systems in which everything was controlled by the state. But, in fact, the new "democratic" institutions of civil society were anything but "democratic"—they were largely non-governmental organizations (NGOs), funded by foreign governments or foreign institutions (such as George Soros's Open Society Institute), which selectively supported individuals or groups which were politically compatible with the funding agencies. This generally meant that the NGOs selected for funding were advocates of radical free-market ideology, friendly to "Western" ideas, and generally hostile to the state.

Other recipients were members of the old elite, the *nomenklatura,* who learned to manipulate Western donors and institutions for their own benefit, mastering the jargon of "democracy" with such catch-phrases as "transparency" and "empowerment." Wedel's book contains often-hilarious examples of how aspiring operators in Poland, for example, quickly learned how to propitiate Western aid-givers by repeating the proper words, setting up foundations, and so on, in order to get access to Western money, office equipment, and contacts.

As Wedel describes it, Western donors gave money to groups in central and eastern Europe "that were associated with people who the West identified with programs of market reform (such as that of Finance Minister Leszek Balcerowicz in Poland, where the most vocal alternatives to the Balcerowicz program were post-communist or nationalist populist programs). . . . Economic agendas appear to have been the decisive factor in many aid decisions said to be about democracy, pluralism or civil society."

For example, the SEED legislation passed by the U.S Congress in 1989 authorized millions of dollars to "promote the private sector" and "democratic pluralism." Nearly all of these funds were distributed through the U.S. National Endowment for Democracy. This meant that, often, U.S. funds—government or foundations—went directly to subsidizing political groups or political parties in eastern Europe and Russia. Not only was this an intervention, an interference, in the internal political life of these countries, but it often represented a direct undermining of the institutions of government of those countries.

As one Bush administration official put it in 1992: "We do not have government-to-government agreements. . . . Our task is to promote the growth of the private sector rather than to encourage the growth of new bureaucracies."

This practice continues to this day. Testifying before the House International Relations Committee on June 9, 1999, the coordinator of U.S. assistance to the Newly Independent States, William Taylor, stressed that U.S. aid is premised on a "bottom-up" approach, what he called supporting "constituencies for reform." In Ukraine and Russia, Taylor testified, "our programs have focussed on mobilizing popular support for change and working with reformist regions." Taylor boasted that U.S. "NGO support programs" involving grants and training, have resulted in a dramatic growth of NGOs, so that there are now more than 65,000 NGOs registered in Russia.

Taylor was asked by one Congressman: "But Mr. Taylor, did I understand you correctly that at this point our financial assistance to Russia is bypassing the Russian government, the central government, and is going to the private sector and to states, or something under the national government of Russia? Is that correct, or did I misunderstand?"

Taylor answered: "No, you understood me correctly, sir. We are moving in that direction increasingly."

The case of Harvard and Russia

The most extreme case of such internal interference and playing of favorites was that of U.S. aid to Russia, where, as Wedel puts it, the United States "placed its economic reform portfolio—set up to engineer the enormous shift from a command economy to free markets—into the hands of a single group of self-styled Russian 'reformers.' " This is the group she calls the "Chubais Clan" or the "St. Petersburg Clan," which received much of its funding steered through the Harvard Institution for International Development (HIID) from 1992 to 1997. The Chubais clan controlled hundreds of millions of dollars in aid from the United States, the G-7, and the international financial institutions (IFIs). Two clan members alone became gatekeepers for about one-third of a billion dollars in aid money and millions more from the IFIs.

How did this come about? Wedel describes how in the late summer and fall of 1991, as the Soviet state was collapsing, Harvard Professor Jeffrey Sachs, Anders Åslund, and other Western economists held a series of meetings at a dacha outside Moscow with a group of young Russian "reformers." Sachs and Åslund offered the "reformers"—including Chubais and Gaidar—their services and access to Western money. Through Sachs, Chubais met Andrei Shleifer, a Russian-born emigré who had become a tenured professor of economics at Harvard while in his early 30s, and who came to head HIID's Russia project.

Sachs used Gaidar (who was Minister of Finance and Economy from November 1991 to April 1992, then deputy Prime Minister, and then acting Prime Minister until December 1992) to implement Sachs's "shock therapy"—the rapid elimination of price controls and state subsidies. The result, among other things, was an at least 2,500% hyperinflation, and the evaporation of much of the savings of ordinary Russians.

By late 1992, Gaidar was under political attack for his failed policies, and Sachs cynically turned on Gaidar, and offered his services to the parliamentary opposition—who wisely turned him down.

Chubais then took over where Gaidar left off. Wedel describes Chubais as being "on intimate terms" with certain Western officials, including high officials of the IMF, the World Bank, and the U.S. government—particularly then-deputy Treasury Secretary Lawrence Summers. Chubais's power was based on these Western contacts and on his consequent control over money flows to Russia from the West.

Harvard's HIID got its first award for work in Russia from the U.S. Agency for International Development (USAID) in 1992, during the Bush administration. Over the next four years, HIID got almost $58 million—most of it without competitive bidding, as is usually required. The waiver for HIID non-competitive grants was signed by various U.S. government officials, including then-USAID Deputy Assistant Administrator Carlos Pasqual.[2]

HIID not only got direct grants, but it became the key agency for recommending and overseeing other aid contractors, such as the Big Six accounting firms. A U.S. General Accounting Office study determined that HIID had "substantial control" of the U.S. assistance program for Russia. As Wedel puts it, "This meant that, in practice, the United States, under cover of economic aid, delegated foreign policy in a crucial area . . . to Harvard University—a private entity."

The 'great grab'

After the abject failure of "shock therapy," the keystone of "reforms" in Russia became privatization—which had been Chubais's portfolio since 1991 when he was appointed to head the State Property Committee, the GKI.

Following a plan drawn up by the Harvard-Chubais team, the "mass-voucher privatization" program was launched in November 1992; under that program, citizens were given shares, or "vouchers," in state-owned enterprises. This was a fraud from the start. Wedel cites a study which shows that Chubais and his clique "were telling the public one thing while pursuing an entirely different goal." While Chubais was telling parliament that the purpose was " 'to let everyone take part in people-oriented privatization,' the plan that the GKI had secretly developed was designed to have the opposite effect." What Chubais actually intended was that the population should have the "freedom to cash in" their vouchers—meaning that the vouchers were bought up cheap, and quickly become concentrated in a few hands—often those of organized crime.

Privatization was decidely unpopular. Russians called it the "great grab" or "grabitization." In 1997, the State Duma (lower House of Parliament) denounced the privatization program by a vote of 288-6. The reform measures being pushed by the Harvard-Chubais gang were so unpopular that Chubais had to circumvent the elected parliament and other institutions of government, and carry out his program through a series of Presidential decrees. Many of these decrees were actually drafted at Harvard University! This dictatorial process was assisted by the network of NGOs set up through Western aid programs. As Wedel puts it:

"USAID set up a network of 'private' organizations that

2. Pasqual continued to support HIID. Today, Pasqual is the National Security Council's Senior Director for Russia, Ukraine, and Eurasia; on July 23, Pasqual appeared with Al Gore's National Security Advisor Leon Fuerth for a press briefing on the July 27 meetings of what is now called the "Gore-Stepashin Commission."

would help reformers to circumvent channels of government decision making, such as the Duma, and to bypass legitimate bodies of government, such as ministries and branch ministries, that might otherwise be relevant to the activities being performed. Thus, U.S. assistance policies in Russia, like some of those in Central Europe, concentrated on supporting specific reform measures at the expense of democratic processes and institutions."

The flagship of USAID-funded "private" organizations was the Russian Privatization Center (RPC), established by Presidential decree in November 1992 under the direction of Chubais, who was chairman of the RPC while at the same time heading the State Property Committee. According to some accounts, the "private" RPC had more control over the privatization process than did the GKI.

The RPC, run by the Chubais-Harvard clique, received $45 million from USAID, millions more from the British and other governments, plus more than $100 million in loans from the World Bank and the European Bank for Reconstruction and Development—which loans had to be paid back by the Russian government! But there are indications that much more money was involved—some $4 billion, according to an RPC official.

In the autumn of 1994, HIID set up several other aid-funded "private" organizations. One was the Russian Federal Commission on Securities and the Capital Market, roughly equivalent to the U.S. Securities and Exchange Commission. Again, it was run by the Chubais clique, with Chubais himself the chairman of the board.

Another was the Institute for a Law-Based Economy (ILBE), funded by the World Bank and USAID, which was set up to develop a legal and regulatory framework for markets, and which drafted decrees to be issued by the Russian government.

That these programs were intended as a *political* intervention in support of "free-market reforms" is explicitly acknowledged in a 1995 HIID book, *Privatizing Russia*—a book which, Wedel points out, is found on the desks of many USAID officials: "Aid can change the political equilibrium by explicitly helping free-market reformers to defeat their opponents. . . . Aid can help reformers by paying for the design and implementation of their projects, which gives them a greater capacity for action than their opponents have. Aid helps reform not because it directly helps the economy—it is simply too small for that—but because it helps the reformers in their political battles."

This approach was affirmed by the State Department's top aid official, Richard Morningstar, in an interview with Wedel in 1997, who said: "If we hadn't been there to provide funding to Chubais, could we have won the battle to carry out privatization? Probably not. When you're talking about a few hundred million dollars, you're not going to change the country, but you can provide targetted assistance to help Chubais."

It was a nice deal while it lasted. For Chubais, it continued after he was sacked from the Russian government in January 1996; he was then put on the HIID payroll.

Looting for fun and profit

In 1997, USAID was forced to cancel most of its funding for HIID, after investigations showed that top HIID officials Shleifer and Hay had used their positions and insider information to profit from investments in the Russian securities markets. Among other things, ILBE was used to assist Shleifer's wife, who operated a hedge fund which speculated in Russian bonds!

In other words, from Wedel's description it is obvious that the Harvard-Chubais gang was not just ransacking the Russian economy for ideological and political reasons; they were looting it for personal profit as well. At one point, the Russian directors of the ILBE were caught removing $500,000 of U.S. office equipment from the ILBE offices.

Not surprisingly, the Gore-Chernomyrdin Commission was involved as well, particularly through its Capital Markets Forum; HIID's Shleifer was the special coordinator for all four of the Forum's working groups. In the fall of 1997, Congress asked the GAO to look into Shleifer's role in the Gore-Chernomyrdin Commission. (There are reliable reports that there is a current Federal grand jury investigation in Boston involving the HIID program, and *EIR* has learned that some sources expect that indictments may be issued in the near future.)

Mega-speculator George Soros also worked closely with the Harvard-Chubais clique, and he was given special privileges under the "loans-for-shares" privatization program lauched under Chubais in 1995, whereby banks got shares in state enterprises in exchange for loans to the state treasury.

The effect of all this, Wedel shows, was to convince Russians that the West, and especially the United States, was to blame—was out to loot and destroy the Russian economy. As one Russian quoted by Wedel put it: "Western policy was designed to break us up and make sure we never, ever come up again."

Wedel does not address the question of whether this was deliberate. In truth, as *EIR* has shown, it *was* intentional, and it originated in Britain. Gaidar, Chubais, and former Finance Minister Boris Fyordorov had been picked up already in the mid-1980s by that center of Mont Pelerin Society feudalist, anti-capitalist ideology in London, the Institute of Economic Affairs (IEA). Gaidar's Institute for the Economy in Transition was sponsored by the London IEA; it almost shut down in 1991, because most of its members then entered the Yeltsin government to carry out the British free-market assault.[3]

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3. See, Roman Bessonov, "IRI's Friends in Russia," *EIR,* Sept. 6, 1996; Rachel Douglas, "The Systematic Destruction of Russia," *EIR,* April 16, 1999.