



United States
General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

September 25, 1997

Mr. Mark Gage
Staff Member
Committee on International Relations
House of Representatives

Dear Mark:

In response to your request, we are providing you a copy of the staff proposed draft on the Harvard Institute for International Development work in Russia, which was submitted for internal review on August 23, 1996. This draft was the audits teams initial attempt to layout in an organized way the issues we thought that were emerging from all of the data we collected during the review. The draft had not been reviewed by GAO management above my level and had not been referenced to source documents. Accordingly, it contains some factual errors and in some cases less than fully developed interpretation of the data. If you have any questions, please do not hesitate to call me.

Sincerely yours,

A handwritten signature in cursive script, reading 'Louis H. Zanardi'.

Louis H. Zanardi
Assistant Director
International Relations and
Trade Issues



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PURPOSE

*First draft
prepared for
message agreement
conference.*

The U.S. Agency for International Development (USAID) was tasked as the lead U.S. Government agency to provide development assistance to Russia after the December 1991 collapse of the Soviet Union. At the time, changes within Russia touched all political, economic, military and social institutions. USAID alone did not have the organization, contacts, and expertise to accomplish the unprecedented task of assisting Russia's transition to a market oriented economy, and turned to U.S. private contractors to provide economic, business, and financial advice. USAID increasingly relied on one contractor, the Harvard Institute for International Development (HIID), because of its pre-existing relationships with Russian reformers, to provide direct program work and oversight of other U.S. contractors in USAID's Russian Privatization Program. From an initial amount of \$2.1 million, USAID provided HIID with over \$40 million in assistance on a non-competitive basis and another \$17.4 million on a competitive basis. In 1995, USAID decided to expand HIID activities to Ukraine, and again, gave HIID a \$1.5 million award on a non-competitive basis.

Due to the non- competitive nature of much of the HIID cooperative agreements, the Chairman of the House Committee on International Relations Committee requested GAO to review the history of HIID funding, the use of noncompetitive procedures, and the overall effectiveness of the work conducted by HIID in meeting project objectives. Specifically, GAO agreed to evaluate

- USAID's selection process (competitive and non-competitive) for HIID cooperative agreements,
- USAID management of HIID and the effectiveness of its activities; and
- USAID, HIID, and its supported activities' financial controls.

*First
draft
prepared*

BACKGROUND

Profound changes swept the newly independent states of the former Soviet Union in 1991. For sheer scale they were unparalleled in recent history. USAID budgeted \$1.5 billion in support of Russian reforms. About one-third of these funds were allocated to privatization and market reform activities and USAID delegated responsibility for designing, implementing and managing this work to HIID.

The U.S. assistance strategy sought to promote Russia's progress through three key objectives:

- development of a competitive, efficient market oriented economy,
- promotion of transparent and accountable governance, and
- management of the human dimensions of transition.

In its effort to support economic reform in Russia, USAID has developed unique relationship with HIID. HIID was working with the top echelon of Yeltsin's economic reformers in 1992 before the USAID program began. HIID's ongoing work in Russia offered USAID an extraordinary opportunity to support the economic reform work underway, and the assistance gave them unprecedented access to reformers within the Yeltsin government.

From 1992 to the present, USAID has continued to support the reformer's reform agenda. USAID, through HIID, funded the reformers efforts in post privatization, developing the Russian securities and exchange commission, initiated development of a capital market, and initiated the legal reform program. In each instance, HIID helped establish indigenous institutions to sustain the reforms, such as the Russian Privatization Center (RPC), which implemented enterprise restructuring and land reform. In each instance, one

of the early reformers went on to head or heavily influence, the institutes created by HIID for them.

RESULTS IN BRIEF

Because of its contacts with Russian reformers, USAID favored HIID by approving non-competitive awards for work in capital markets and legal reform. USAID eventually decided to compete HIID's work due to political pressure for more competition. USAID then engaged in a series of questionable actions surrounding the competition that resulted in the selection of the wrong proposal and undermined the competitive process. The Russian reformers rejected this contractor, saying that they would not work with them. In Ukraine, USAID and other key U.S. government agencies supported HIID's proposal in spite of concerns raised by the mission and the fact that other contractors were doing some similar work.

USAID practiced a "laissez-faire" management approach with HIID. It turned over responsibility for the management and direction of U.S. assistance in capital market development and legal reform. USAID did not directly link its overall program goals with its agreements with HIID, placed minimal demands on HIID for reporting, and Washington program managers were restricted from making field visits. Although USAID has also provided over \$45 million to the RPC, USAID has not been able to get RPC to submit a work plan or quarterly reports for much of its activities, thus making it impossible for USAID to effectively manage and evaluate RPC performance. HIID demonstrated poor management practices in providing oversight of U.S. contractors. It did not develop strategic plans, prepared evaluations of contractor performance, or submit a workplan to USAID.

HIID effectively assisted in the establishment of an independent SEC. However, HIID was ineffective in creating all the key institutions required for capital markets. USAID's

legal reform project failed to create the legal basis for a market economy. HIID helped draft legislation, however, most has not passed into law. HIID further supported the reform effort by drafting Presidential decrees and regulations that were approved and issued. USAID failed to create a sustainable institution (i.e., the Russian Privatization Center) to carry out commercial based enterprise restructuring activities. Although HIID was generally effective in providing project managers to RPC, it was ineffective at developing key Russian administrative capability to ensure RPC's sustainability.

USAID's financial oversight was weak and some compliance violations persist. GAO found that HIID and RPC expenditures were generally allowable and properly accounted for.

PRINCIPLE FINDINGS

Questionable Contracting Practices

In December 1992, USAID awarded HIID a \$2.1 million non-competitive cooperative agreement based on:

- HIID's existing working relationship with the Russian State Property Committee,
- key Russian reformers' trust of HIID, and
- the limited capacity for competing the cooperative agreement due to time constraints.

Between April 1993 and September 1995, through a series of amendments, USAID increased the scope of work of HIID's cooperative agreement by \$38.3 million for expanded work in capital markets and legal reform and support to the RPC on a non-competitive basis. In each case, USAID justified these amendments on the relationship of HIID with the Russian reformers, HIID's unique capabilities, and the urgency to provide

the assistance. GAO noted that in the case of the legal reform project another USAID-funded university had a pre-existing relationship with other Russian reformers and demonstrated the ability to work with Russian reformers in the development of the Russian civil code. However, the legal advisor to the Russian President and the mission favored HIID over this university and, therefore, USAID continued to support HIID's legal reform program.

Because its guidelines encourage competition, USAID was subject to increasing pressure to compete this work. In this regard, USAID's decisions during the 1995 competition favored HIID in competing for the Russian SEC follow-up and follow-on work for the RPC. For example, the State Department Coordinator for Former Soviet Union Assistance and the USAID Deputy Administrator invited the Russian SEC and RPC to place representatives on the selection panel. This had the appearance of favoring HIID because the SEC Director had voiced a strong preference toward HIID. Regarding RPC, the HIID project manager was a member of its board of directors.

USAID selected the wrong contractor for the SEC work when USAID's procurement officer incorrectly tabulated panel member scores. The panel process was also flawed in several other respects. For example, one panel member was added after the initial evaluation occurred, believed HIID could not be selected for both the SEC and RPC work, and employed a different scoring methodology.

In July 1995, the Executive Director of SEC informed USAID that based on his experience, HIID was the only organization capable of doing the work. In September, the Russian SEC rejected the announced winner of the competition, thus USAID made no award. Before Stanford was notified, USAID provided HIID \$1.7 million by amending HIID's Cooperative Agreement for the SEC in September 1995, allowing HIID to continue supporting the SEC through December 1996. This time-period over-lapped with the time period covered by the competition, and thus, reduced pressure on the Director of the SEC to accept the announced winner.

USAID's questionable practices in Ukraine also favored HIID. In March 1995, USAID began a competition for work in Ukraine modeled after HIID's work in Russia. In May, USAID canceled the competition because the mission reported that the Ukrainian government was uninterested in this form of assistance. In July 1995, HIID submitted an unsolicited proposal that partly duplicated the work solicited under the withdrawn proposal. The work also duplicated activities undertaken by others. GAO found that limited knowledge existed within the Ukrainian government with regard to the proposal. However, HIID, supported by the State Department Coordinator, U.S. Treasury and the National Security Council, was awarded a non-competitive cooperative agreement based on U.S. national security interests.

HIID Had Mixed Success in Developing Capital Markets

After the successful voucher privatization project, USAID and the reformers turned their attention to the development of the Russian capital market. USAID focused on support for an independent regulatory body; independent share registers; clearance and settlement organizations; and self regulatory broker dealer organizations to protect shareholder rights. USAID's goal was to have these efforts substantially in place by the end of 1996 by which time the necessary laws and regulations were expected to be substantially in place.

These were lofty goals given the publication of conflicting regulations coming from various government ministries unaccustomed to dealing with capital markets and the lack of sophistication among individual shareholders and market participants. To implement the strategy, USAID turned to HIID and its connections, developed during the voucher privatization effort, with the Deputy Prime Minister and the Director of the Russian SEC. Specifically, HIID was responsible for project management of U.S contractors providing technical assistance for the development of the capital market infrastructure.

HIID's strategy was to create a Russian SEC Secretariat consisting of Russian lawyers and expatriates. HIID supported efforts to empower an independent SEC to regulate the securities market in the face of continuing power struggles with other Russian ministries and institutions.

With a lack of institutional capability to challenge HIID, USAID gave HIID wide latitude. HIID reporting provided USAID limited information on progress, implementation problems, and strategies for accomplishing USAID goals. HIID saw its client as the Russian SEC and was not inclined to share information with USAID. Furthermore, with the support of the USAID mission director, HIID successfully prevented field visits from the USAID Washington program office.

HIID's General Manager in Russia had limited project management experience and operated in a crisis management mode most of the time. For example, HIID did not prepare a comprehensive strategy but instead often relied on U.S. contractors to make proposals, performed no evaluations of contractor performance, and did not ensure that contractors coordinated their activities with each other. When contractors surfaced problems, the Director of the Russian SEC considered them not to be team players and in one case employees were fired.

By July 1996, HIID and the Russian supporters had achieved only a portion of USAID's goals. With considerable support from the HIID financed Secretariat, Russian reformers were able to pass legislation creating an independent Russian SEC and advance its development. However, efforts to develop the capital market infrastructure were disappointing. For example, after \$14 million and nearly 3 years of effort, there is no institutional clearing or settling of stock trades. Similarly, registrar practices have undergone minimal reform and demonstration projects promoting new share issuance have not demonstrated how this will be done without continued subsidies.

USAID, HIID, and market participants cited a number of reasons for the disappointing outcome of infrastructure projects including political power struggles, market conditions, and taxes. While there is some basis for each of these factors, HIID's ineffective project management also bears some of the responsibility. For example, in the clearing and settlement project, because of the Russian SEC resistance in permitting the Russian Banks to participate, HIID did not include them in the initial strategy for development of the clearing and settlement organization. Moreover, HIID did not ensure that other market participants had a direct role in designing the clearing and settlement organization that would meet their needs.

Legal Reforms Remain Incomplete

Since 1992, Russia has privatized 40,000 state-owned enterprises and allowed private ventures. However, its economic and commercial legislation have not kept pace with the privatization or the emergence of new private enterprises. Basic principles of contract law and property remain poorly developed or retain outdated approaches that often impede commercial activity. Russia lacked a modern system of corporate law to govern the rights and duties of its directors, managers, and shareholders. The restructuring of Russian industry was hindered by the lack of effective bankruptcy laws and the ability to carry them out. And the many types of financing needed to improve businesses was not available due to legal and institutional limitations. Without corporate law or a securities law to protect equity investors, or a bankruptcy law to provide secured lending to protect creditors, it was extremely difficult for Russian businesses to attract needed capital. However, the legislative environment was not conducive for reform legislation. Many parliamentarians were unfamiliar with the legal basis for a market economy and the mix of the parliament favored communist and other non-reform minded elements. USAID stated that passage of specific laws by late 1996 would be the benchmark of their success.

USAID signed an agreement with HIID in June 1994 to implement this strategy. USAID had received separate requests around January 1994 from both the parliament and the

Office of the Presidency asking for assistance in drafting of commercial laws.

USAID/Moscow wanted to support only the request from the Office of the Presidency, which was headed by a Russian reformer with long-ties to HIID. This reformer headed the GPU, the Russian office responsible for writing decrees. However, the U.S. Ambassador stated that assistance should be provided only if both the parliament and the Presidency could form a coordinating committee (CC). The CC was formed in May 1994, with the reformer as its chairman.

USAID viewed this collaboration to be of major significance, and viewed it as a way to accelerate the passage of badly needed legislation, and more importantly, foster a new pattern of executive-legislative cooperation needed to agree on and adopt the laws. The CC identified 19 pieces of priority critical commercial legislation supported by both groups. USAID then approved \$20 million for HIID funding to support this effort for 2 years, as this was seen as the minimum timeframe needed to implement such significant legal reform.

US Goals Partially Met

USAID was notified by another contractor in May 1994, before it signed an agreement with HIID, that USAID's strategy was problematic. The Research Center for Private Law, another office within the Office of the Presidency, had been decreed by the President to draft the civil code (which contains the basis for commercial laws) and subsequent commercial legislation. GPU was neither experienced, nor tasked with drafting commercial legislation. It recommended USAID discuss the issue with senior Russian officials, for this would determine that GPU was not the agency chosen by the Russian government to carry out commercial reform. At the time, the Prime Minister and others have indicated that GPU would not play a coordinating role on commercial law.

The U.S. strategy did not result in the passage of many laws. Of the 19 listed by the CC, only 6 have been enacted. Of the 6 laws that passed, HIID was the principle drafter of

only 3, the others it served either as co-drafter or provided some comments. These laws are significant accomplishments, and include laws on securities, joint stock companies, monopolies. However, the majority of laws USAID hoped the Russians would pass within a two year period have not been enacted. Of the remaining 13 laws, none have been forwarded to from the CC to the parliament for consideration, indicating the lack of political consensus both in the CC and the parliament necessary for enactment. Because of the inability to pass legislation, while it continued to work with the CC, HIID began to work with the reformers to pass decrees and bypass the legislative process.

By 1996, GPU has installed itself as the head of commercial reform through a Presidential decree, and members of the Research Center agreed to work with the CC. HIID's supported reformers in the executive branch, the SEC and RPC, as well as the parliament by evaluating and drafting laws, decrees and regulations. HIID has drafted literally hundreds of decrees in the commercial area. Its work laid the legal basis for the creation of the Russian SEC and much of the capital markets. It also created an institute for Russian lawyers that may be sustainable after USAID funding is completed in early 1997, and was instrumental in helping the Executive Branch obtain a \$58 million loan for continued legal reform from the World Bank.

USAID Management

USAID did not have control over the legal reform program. For example, even before USAID signed the contract with HIID to support legal reform, HIID had begun an effort, at the GPU reformer's request, to develop a civil code needed to frame commercial law. USAID had already paid another contractor to assist the Research Center to do this work, yet HIID spent \$500,000 on this unauthorized effort, which was rejected by the Executive Branch. In another example, when USAID/Moscow raised concerns about HIID's plan to develop an indigenous institution for legal reform, HIID and the reformer bypassed the mission by flying directly to Washington for support. The mission did not learn of the visit

until after the USAID managers in Washington were briefed on the proposal. Moreover, GAO found that HIID officially chartered the institute before it was sanctioned by USAID.

USAID's legal reform agreement was written so broadly that it was difficult for USAID to determine whether HIID met its objectives. Although USAID hoped the assistance would result in numerous laws being passed, their agreement HIID contained no measures to assess their effectiveness. HIID was only required to assist the CC, and therefore does not believe that it should be judged by the number of laws that were passed. In fact, USAID seemed to consistently avoid using any performance indicators, even those provided by HIID including the number of laws passed. When a new project manager took over the project, he found no way to determine exactly what HIID had accomplished, and HIID resisted providing basic programmatic information, such as its employee names and salaries, and the number of laws it had drafted and passed. The project officer finally had to request the Mission Director's assistance to resolve the matter.

USAID Had Limited Control Over the Development of the RPC

As a result of Russia's privatization program, nearly 40,000 state owned Russian enterprises were transferred to private ownership. These newly privatized enterprises, however, lacked the capital and the expertise needed to become economically viable companies. USAID sought to support the RPC in helping 23 privatized firms restructure. In addition to restructuring the targeted enterprises, USAID's goal was to train a core of Russian RPC consultants who could carry out enterprise restructuring after USAID assistance ended.

USAID's addressed these needs through a strategy of:

- paying the majority of the RPC's operating costs for 2 years,
- paying the cost for expatriates to fill key management positions recruited and paid through HIID,

- funding U.S. contractors to implement enterprise restructuring and land reform through pilot projects, and
- training Russians to continue this work after USAID assistance ended.

USAID has not been able to meet all of its goals. For example, although U.S. contractors successfully completed enterprise restructuring, these companies are not making a significant profit and have not attracted adequate foreign investment. In addition, these pilot projects did not train RPC staff to provide consulting services. Instead, materials developed by these pilots were provided to the RPC to continue the assistance, but U.S. contractors questioned whether RPC could implement such assistance without support from private expatriates and independent Russian consultants. If USAID terminates its support for the RPC in 1997 as planned, without significant changes, it is doubtful that RPC will be sustainable.

USAID has not successfully managed RPC's development. For example, USAID has been unable to obtain RPC workplans and progress reports, making it virtually impossible for USAID to effectively manage and evaluate RPC performance. In addition, RPC executives generally circumvented USAID managers in Russia and reported directly and inaccurately to senior USAID and State Department officials in Washington, D. C., which further exacerbated communications.

USAID and others, including the World Bank, have raised questions about RPC's management capabilities. GAO noted that HIID has not successfully fulfilled its responsibilities to develop Russian procurement and financial management expertise in the RPC. Furthermore, RPC financial and procurement management weaknesses persist. As a result, the RPC may not be able to manage a 200 enterprise restructuring project under consideration by the World Bank.

In the absence of a federal land code in Russia, many reformers believed that progress in the area of land reform was dependent on the passage of local legislation providing for

experimentation with model programs. It has been very difficult to get consensus in Russia about land privatization and land reform initiatives. The uncertain political environment in Russia prior to the June 1996 presidential election caused some government officials to take a wait and see position in the face of possible reversals. Since spring 1994, HIID and the RPC played a role in the initiation and development of USAID land-reform assistance. This assistance focused on the development of models that could later be implemented elsewhere.

The role of HIID and RPC changed over time. At the start of land-reform projects, the RPC had undertaken the role of monitoring the work of the contractors and was very active in initiating the work. Later, after the Mission had increased its capability to monitor field work, RPC's role changed to one of providing guidance and implementation assistance.

The RPC lacked a focus in its land-reform initiatives. It has not filled the director of land reform position since December 1995 and has said it has not decided what should be the role of a director. While HIID was tasked with providing support for a director of land-reform at the RPC, this position was only intermittently filled.

While some of the projects appear to be achieving the project goals, the real estate information and titling systems, the largest model project, encountered difficulties in meeting its targets. USAID had hoped to install the system in up to 19 cities, but only 4 cities had operational systems at the time of our review.

HIID and RPC Expenditures
Were Proper, But USAID Financial
Oversight was Weak

Numerous audits by others and our review of \$41 million of HIID and RPC expenditures from inception through May 31, 1996 found these costs to be generally allowable and

EXECUTIVE SUMMARY

PURPOSE

The U.S. Agency for International Development (USAID) was tasked as the lead U.S. Government agency to provide development assistance to Russia after the December 1991 collapse of the Soviet Union. At the time, changes within Russia touched all political, economic, military and social institutions.

USAID alone did not have the organization, contacts, and expertise to accomplish the unprecedented task of assisting Russia's transition to a market oriented economy, and turned to U.S. private organizations to provide economic, business, and financial advice to Russian reformers. USAID increasingly relied on one organization, the Harvard Institute for International Development (HIID), because of its pre-existing relationships with Russian reformers, to provide direct program work and oversight of U.S. contractors in USAID's Russian Privatization Program.

Chairman of the House Committee on International Relations Committee requested GAO to review the history of HIID funding, the use of noncompetitive procedures, and the overall effectiveness of the work conducted by HIID in meeting project objectives. The Committee was interested in whether other universities or institutions could provide similar assistance, and whether the Ukraine project duplicated a previously competed but withdrawn proposal and other assistance being provided by USAID and other donors.

Specifically, GAO agreed to evaluate whether (1) USAID's selection process (competitive and non-competitive) for HIID cooperative agreements favored HIID, and (2) HIID had achieved USAID and State Department goals for capital market development, legal reform, and post privatization.

BACKGROUND

Profound changes swept the newly independent states of the former Soviet Union in 1991. For sheer scale they were unparalleled in recent history. USAID budgeted \$1.5 billion in support of Russian reforms covering such areas as democracy , energy, housing, health, and environment., About one-third of these funds were allocated to privatization, legal reform, capital market development and post privatization., areas that HIID would assume significant responsibility for providing impartial oversight

From an initial amount of \$2.1 million, USAID provided HIID with over \$40 million under a cooperative agreement awarded in 1992 on a non-competitive basis and another \$17.4 million under a cooperative agreement awarded in 1995 on a competitive basis. In 1996, USAID awarded HIID a cooperative agreement for \$1.5 million award for work in Ukraine based on an unsolicited proposal.

In its effort to support economic reform in Russia, USAID had developed unique relationship with HIID. HIID was working with the top echelon of Yeltsin's economic reformers in 1992 before the USAID program began. HIID's ongoing work in Russia offered USAID an opportunity to support the economic reform work underway, and the assistance gave them access to reformers within the Yeltsin government.

From 1992 to the present, USAID has continued to support the reformers' reform agenda. USAID, through HIID, funded the reformers efforts in post-privatization, developing the Russian securities and exchange commission, initiated development of a capital market, and initiated the legal reform program. In each instance, HIID helped establish Russian institutions to sustain the reforms, such as the Russian Privatization Center (RPC), which implemented enterprise restructuring and land reform. In each

instance, one of the early reformers went on to head, or heavily influence, the institutes created by HIID for them

RESULTS IN BRIEF

From the beginning of USAID's program in Russia, the agency relied heavily on HIID, in large part because of HIID's pre-existing relationship with key Russian reformers. Until recently, USAID funded most of HIID's assistance activities in privatization, capital markets, and legal reform under non-competitively awarded cooperative agreements. In response to increasing pressure from a number of sources, USAID decided in 1995 to hold a competition for additional assistance for "Impartial Oversight and Strategic Guidance for Privatization and Market Reform." USAID planned to award four separate cooperative agreements, two for assistance in Russia, one for Central Asia, and one for Ukraine. In our review of the selection process, we found a number actions surrounding the evaluation of proposals that, although not illegal, may have affected the overall fairness of the process. In addition, errors made in tabulation of the evaluation panel members' scores may have resulted in selection of a winning proposal based on an erroneous final score. The Russian reformers who would have received assistance under the proposal rejected the winning proposal. As a result, the award was not made.

In Ukraine, a few months after the competition was cancelled, USAID awarded HIID a cooperative agreement non-competitively based on an unsolicited proposal. USAID made the award despite knowledge that the HIID proposal duplicated areas covered in the cancelled competition and concerned by some USAID officials and other donors that it might be counter productive to U. S. assistance objectives because it duplicated other on-going assistance efforts.

With the assistance of HIID and other U.S. contractors, Russian Reformers have made significant progress in establishing an independent regulatory body, a Russian trading organization, and a self regulatory dealer broker organization. The major disappointment has been the failure to establish clearing and settlement organizations throughout Russia. In this case, HIID did not develop an effective strategy to overcome the many political and structural obstacles confronting the development of capital market infrastructure.

Under the Legal Reform Project, HIID has drafted, or assisted in drafting, key pieces of legislation that have become law. However, the USAID/HIID strategy of relying on Executive Branch and Duma¹ working groups had not overcome a political environment hostile to legal reform. As a result, much of the legislation drafted by HIID has not been enacted or even submitted for consideration by the Duma. However, the project created significant controversy within USAID, when HIID opposed the work of another USAID supported university working on Russia's civil code, began to rely more on decrees in the face of legislative resistance, and when its client, President's Legal Office (GPU), denied country clearance to USAID officials, who were to participate as members of a World Bank team assessing the potential legal reform loan.

Despite USAID's \$40 million investment to create and support the RPC, it is unclear whether the RPC can continue to provide assistance without further U.S. or other donor funding. USAID is concerned that its significant investment in the RPC may be lost, particularly if other donors do not continue to support their activities through the RPC network. Also, USAID funded post privatization projects have produced mixed results and the RPC's

¹The Duma is the lower house of the Russian Parliament; the Federation Council is the upper house.

performance assisting these projects was also mixed.

PRINCIPLE FINDINGS

HISTORY OF USAID FUNDING OF HIID ACTIVITIES

In December 1992, USAID awarded HIID a \$2.1 million non-competitive cooperative agreement to support privatization, legal reform and capital market development based on:

- HIID's existing working relationship with the Russian State Property Committee,
- key Russian reformers' trust of HIID and
- the limited capacity for competing the cooperative agreement due to time constraints.

Between April 1993 and September 1995, through a series of amendments, USAID increased funding under the cooperative agreement by \$38.3 million or expanded work in capital markets and legal reform and support to the RPC on a non-competitive basis. GAO noted that in the case of the legal reform project another university that also receives funds from USAID *for legal reform*, had a pre-existing relationship with other Russian reformers and demonstrated the ability to work with Russian reformers in the development of the Russian civil code. However, the legal advisor to the Russian President and the mission favored HIID over this university and, therefore, USAID continued to support HIID's legal reform program.

Because HIID had been awarded a substantial amount of work in Russia non-competitively and because U.S. law, and USAID guidelines encourage competition in the award of grants and cooperative

agreements, USAID was subject to increasing pressure to award additional work competitively. However, a number of USAID decisions involving the subsequent 1995 competition appeared to favor HIID. For example, the State Department Coordinator for Former Soviet Union Assistance and the USAID Deputy Administrator invited the Russian SEC and RPC to nominate representatives for the selection panel. This had the appearance of favoring HIID because the SEC Director had voiced a strong preference toward HIID. Regarding RPC, the HIID project manager was a member of its board of directors.

Because USAID's procurement officer incorrectly tabulated panel members scores, USAID may have selected the winning proposal for the SEC portion of the work based on an erroneous final evaluation score. The panel process was also unusual at least one other respect. The evaluation panel was reopened after its initial members had already completed and submitted their evaluations so that the SEC nominee could be added. The SEC nominee told us that she believed HIID could not be selected for both the SEC and RPC work and that based on USAID instructions she had employed a different scoring methodology than the other panelists.

In July 1995, the Executive Director of SEC informed USAID that based on his experience, HIID was the only organization capable of doing the work. In September, the Russian SEC rejected the announced winner of the competition, thus USAID made no award. In September of 1995, before the winner was formally notified that it would not receive the award, USAID provided HIID an additional \$1.7 million under its Cooperative Agreement to finance salaries for SEC employees, allowing HIID to continue supporting the SEC through December 1996.

USAID's practices in Ukraine also appeared to favored HIID. In March 1995, USAID began a competition for work in Ukraine modeled

after HIID's work in Russia. In May, USAID canceled the competition because the mission reported that the Ukrainian government was uninterested in this form of assistance. In July, 1995, HIID submitted an unsolicited proposal to provide assistance that partly duplicated the work included in the withdrawn request for proposals. The work under HIID's unsolicited proposal also duplicates some current activities being undertaken by others. GAO found that limited knowledge existed within the Ukrainian government with regard to the proposal. However, HIID, supported by the State Department Coordinator, U.S. Treasury and the National Security Council, was awarded a non-competitive cooperative agreement based on U.S. foreign policy considerations.

HIID HAD MIXED RESULTS IN DEVELOPING CAPITAL MARKET

After the successful voucher privatization project, USAID and the reformers turned their attention to the development of the Russian capital market. USAID focused on support for an independent regulatory body; independent share registers; clearance and settlement organizations; and self regulatory dealer broker organizations to protect shareholder rights. USAID's goal was to have these efforts substantially in place by the end of 1996 by which time the necessary laws and regulations were expected to be substantially in place.

Through its support of the Russian Secretariat, HIID provided policy advice to the RFCSCM and oversight, management, and coordination of the technical assistance delivered by contractors through task orders. HIID supported the development of the Resource Secretariat that helped define a strategy for capital markets and provided impartial oversight over U.S contractors working on the capital market infrastructure. In addition to supporting the Secretariat, HIID through the legal reform project provided technical assistance to support reformers' efforts to

establish an independent Security Exchange Commission.

During the summer of 1994, in anticipation of the creation of a Russian SEC, USAID began to fund a "Resource Secretariat". The idea was to consolidate all technical assistance to the Russian capital markets under a single managerial and coordination structure led by experienced professionals. The Resource Secretariat constituted the "think tank" for the Russian SEC and the market that it oversees. On April 22, 1996, President Yeltsin signed a comprehensive Law "On the Security Market" that established a structure for market regulation by the Security Commission. The concepts of the law and the vision of the capital market regulation contained in the law are a direct result of HIID's support of the Secretariat and RFCSCM

GAO's assessment of the progress of the capital market infrastructure shows that progress has been uneven in developing the needed infrastructure. The work pertaining directly to dealers and brokers including development of a Russian trading system is considered a success along with the development of self regulatory organization for market participants. These areas were rather straight forward efforts that had fewer potential political pitfalls than some of the other infrastructure projects. The Clearing and Settlement Organizational(CSO) project was the centerpiece of the infrastructure effort because it potentially impacted on registrars, dealers and brokers, the central bank, foreign and domestic banks, the tax police and others. But it has not developed into a working clearing and settlement operation.

In mid 1993, Barents and Deloitte began projects to create five CSO's. By late 1994, Deloitte completed the organization of CSO's in Moscow, Ekaterinburg, and Novosibirsk, and Barents had done the

same in St.Petersburg and Vladivostok.² Each CSO evolved from an existing stock exchange and was owned and controlled by the exchange and the market participant. However, as of mid 1996, only the Vladivostok stock exchange was active but trading was limited to 30 transactions a day and the Moscow Depository Clearing Corporation (DCC) was disintegrating. The price tag for this effort was \$14 million. The unsuccessful development of CSO's occurred despite the general belief by market participants for a need for a central depository.

USAID, HIID, U.S. contractors, and market participants cited a number of reasons for the disappointing outcome of the CSOs including political power struggles, market conditions, and tax laws. While there is some basis for each of these factors, HIID also bears some of the responsibility for not developing an effective strategy to overcome these problems.

HIID APPROACH TO LEGAL REFORM RESULTS IN CONTROVERSY

Since 1992, Russia has privatized 40,000 state-owned enterprises and allowed private ventures. However, its economic and commercial legislation have not kept pace with the privatization or the emergence of new private enterprises. Basic principles of contract law and property remain poorly developed or retain outdated approaches that often impede commercial activity. Russia lacked a modern system of corporate law to govern the rights and duties of its directors, managers, and shareholders. The restructuring of Russian industry was hindered by the lack of effective bankruptcy laws and the ability to carry them out. And the many types of financing needed to improve businesses was not available due to

² The Vladivostok CSO was already operational before HIID began implementation of the project.

legal and institutional limitations. Without corporate law or a securities law to protect equity investors, or a bankruptcy law to provide secured lending to protect creditors, it was extremely difficult for Russian businesses to attract needed capital.

On November 8, 1994, 3 months after the legal reform project was authorized, HIID submitted a work plan for the next six months. HIID complied with the terms of the work plan by

- providing commentary, expert advice, and drafting assistance on legislation,

- establishing a core group of long-term resident advisors and short-term Western experts who would be available to assist the working groups preparing draft legislation,

- assisting in the creation of a Russian Institution, the Institute for Law Based Economy (ILBE), to carry out the legal reform project before and after USAID ends its assistance, and

- promoting closer coordination between the Executive Branch and the Duma.

The U.S. strategy did not result in the passage of many laws. Of the 19 listed by the Executive Branch and the Duma Coordinating Committee, only 6 have been enacted. Of the 6 laws that passed, HIID was the principle drafter of 3, the others it served either as co-drafter or provided some comments. These laws are significant accomplishments, and include laws on securities, joint stock companies, monopolies. However, the majority of laws USAID hoped that the Parliament had passed within a two year period have not been enacted. Of the remaining 13 laws, none have been forwarded to the parliament for consideration, indicating the lack of political consensus necessary for enactment. Confronted with the

possibility that none of the remaining legislation would be enacted, HIID began instead to work with the Executive Branch to get decrees promulgated.

HIID support to the Presidents legal advisor and the use of decrees conflicted with the position taken by USAID/ENI's Office of Democracy and Governance. In April 1995, the Democracy group raised the following concerns about HIID's approach. (1) It was very centralized and top-down. (2) Their success was dependent upon working with Legal Advisor to the President on the basis that it was the legal reform czar, (3) HIID's notion that Russian legal reformers were not able to grasp repeated "advice"--even after several discussions--ran counter to the democracy group's experience and (4) HIID's strategy premised on supporting "like-minded reformers" and cutting out "non-believers" from the drafting process failed to accept the political reality that the process for making policy and laws had to be more democratic and inclusive.

SUSTAINABILTY OF THE RPC IS UNCERTAIN

As a result of Russia's privatization program, nearly 40,000 state owned Russian enterprises were transferred to private ownership. These newly privatized enterprises, however, lacked the capital and the expertise needed to become economically viable companies. USAID sought to support the Russian Privatization Center (RPC) in helping 23 privatized firms restructure. In addition to restructuring the targeted enterprises, USAID's stated goal was to train a core of Russian RPC consultants who could carry out enterprise restructuring after USAID assistance ended. USAID has not been able to meet all of its goals.

The RPC network coordinates and implements nearly \$200 million of

donor assisted projects but it depends almost exclusively on USAID for its operational assistance. Its ability to acquire outside funding to support its operations has produced to date mixed results. Although a mixture of donor resources has been either promised or committed they are inadequate to meet fully the RPC network's operational needs after USAID assistance ends in 1997. RPC management has frequently requested additional USAID operational grant funds and as of August USAID Washington has not decided on RPC's latest request or \$6.6 million. The World Bank remains the RPC's best, yet uncertain prospect for future funding.

Although U.S. contractors successfully completed enterprise restructuring, these companies are not making a profit and have not attracted foreign investment. In addition, these pilot projects did not train RPC staff to provide consulting services. Instead, materials developed by these pilots were provided to the RPC to continue the assistance, but U.S. contractors questioned whether RPC could implement such assistance without support from private expatriates and independent.

The RPC lacked a focus in its land-reform initiatives. It had not filled the director of land reform position since December 1995 and had not decided what should be the role of a director. While HIID was charged with the task of providing support for a director of land-reform at the RPC, this position was only intermittently filled. While some of the land projects appear to be achieving the project goals, the real estate information and titling systems, the largest model project, encountered difficulties in meeting its targets. USAID had hoped to install the system in up to 19 cities, but only 4 cities had operational systems at the time of our review.

USAID has not successfully managed RPC's development. For example, USAID has been unable to obtain RPC workplans and progress reports,

making it virtually impossible for USAID to effectively manage and evaluate RPC performance. USAID and others, including the World Bank, have raised questions about RPC's management capabilities. GAO noted that HIID has not successfully fulfilled its responsibilities to develop Russian procurement and financial management expertise in the RPC.

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INTRODUCTION

Since the collapse of the Soviet Union in 1991, Russia has been in the process of transforming itself from an authoritarian state and a centrally planned economy to a more open, democratic society and market-based economic system. The United States began providing limited assistance to the Soviet Union in December 1990 to support the reform effort and then increased the assistance after the Soviet Union dissolved. In October 1992, the Freedom for Russia and the Emerging Eurasian Democracies and Open Market Support Act of 1992 (P.L. 102-511), commonly known as the Freedom Support Act, was enacted. The act set forth the broad policy outline for helping the former Soviet Union countries implement both political and economic reforms. It authorized a bilateral assistance program that is being implemented primarily by United States Agency for International Development (USAID). In January 1994, the State Department Coordinator for assistance to the former Soviet Union approved a regional strategy, and in May 1994, the Coordinator approved a strategy specifically for Russia. The Strategy has three core objectives (1) help the transition to a market economy, (2) support the transition to a democratic political system, and (3) ease the human cost associated with the transition. As of December 1995, USAID has obligated \$___ billion and spent \$ ___ billion for programs and projects in Russia since fiscal year 1990.

The United States strategy recognized that while only Russian reformers could make Russia's transition a success, the United States should support the effort.

The outcome of the reform debate within Russia would have far-reaching consequences for the United States. A democratic, market-oriented, stable Russia could serve as a constructive partner on

a wide range of global issues. The benefits to the United States include reduced defense requirements and expanded opportunities to market U.S. goods and services to a country of 150 million people. Conversely, a Russia in political and economic turmoil would have the potential to destabilize the region and adversely affect a variety of U.S. interests.

USAID was tasked as the lead U.S. Government agency to provide development assistance to Russia. USAID alone did not have the organization, contacts, and expertise to accomplish the unprecedented task of assisting Russia's transition to a market oriented economy, and turned to U.S. private contractors to provide economic, business, and financial advice.

USAID FUNDS THE HARVARD INSTITUTE FOR INTERNATIONAL DEVELOPMENT
THROUGH A COOPERATIVE AGREEMENT TO SUPPORT ECONOMIC REFORM

The Harvard Institute for International Development (HIID) was working with some of Yeltsin's key economic reformers in 1992 before the USAID program began. HIID's ongoing work in Russia offered USAID an opportunity to support the economic reform work underway, and to have access to reformers within the Yeltsin government.

Through a cooperative agreement,³ USAID funded HIID to support of reformers efforts to, develop the Russian securities and exchange commission and initiated development of a capital market infrastructure and a legal reform program. In each instance, HIID helped establish Russian institutions to participate in the reform

³ A cooperative agreement is awarded to an institution when USAID expects to be substantially involved in the planning and implementation of the program covered by the agreement but its involvement is expected to be less than under a contract. The awardee may be expected to develop work plans requiring USAID approval and require periodic reporting.

process, such as the Russian Privatization Center (RPC), which managed enterprise restructuring and land reform projects implemented by other U.S. contractors. In each instance, one of the early reformers went on to head, or heavily influence, the institutes supported by HIID.

Amendments to HIID Cooperative Agreement

There have been nine modifications to the first cooperative agreement with HIID and the completion date has also been extended from August 1995 to August 1997. Five out of the nine amendments have added funds to the agreement. Through these nine amendments, HIID's initial program has expanded gradually from providing strategic policy oversight, primarily to the State Committee of the Russian Federation for the Management of the State Property (GKI), to establishing the Russian Privatization Center (RPC), assisting the drafting of commercial laws channeled through the Presidents Legal Advisor (GPU), and providing support to the Russian Federation Commission on Securities and Capital Markets. As shown in table 1:1, the total amount awarded through the first Cooperative Agreement on a sole source basis had grown from \$2.1 million in December 1992, to \$40.4 million in September 1995.

Table 1:1 Chronology of HIID Cooperative Agreements In Russia

NONCOMPETATIVE

Date	Purpose	Dollar Amount
Dec 1992	Unsolicited proposal awarded for privatization, capital markets, and legal and tax reform	\$2,139,462
April 1993	Amendment 1 increase scope of work to include support for the establishment of the RPC.	3,430,600
Sept. 1993	Amendment 2 expand the scope of work	10,103,912
June 1994	Amendment 3 expand scope of work to large legal reform project	20,000,000
Aug. 1994	Amendment 4 obligate legal reform funds. (no new funds)	-
March 1995	Amendment 5 transfer management responsibility ^{TO} Moscow ^{USAID} (no new funds)	-
March 1995	Amendment 6 bridge funding to increase funding for for RPC and Russian Security Commission because of delay in Request for Application Process.	3,000,000
Jun. 1995	Amendment 7 (a) to update administration information. (no new funds)	-
Sept 1995	Amendment 7 (b) increase funding ^{Business}	3,000,000
Sept. 1995	Amendment 8 funding for Security Commission ^{FUNDOS} ^{USAIN} ^{RETURN}	1,700,000
Sept. 1995	Amendment 9 obligate legal reform funds. (no new funds)	-
	Total cooperative agreement	40,373,994 - ^{STET}

In addition to the cooperative agreement to HIID, USAID approved a

direct grant of \$14.3 million to support and cover the administrative costs of the RPC's operations after the first year.

USAID COMPETES STRATEGIC POLICY WORK UNDER SECOND COOPERATIVE AGREEMENT

To foster competition in Russia for the role of Strategic policy oversight, USAID on March 17, 1995, issued a Request for Application (RFA) for Impartial Oversight and Strategic Guidance For Privatization and Market Reform Programs in the Newly Independent States (NIS) countries. USAID's original intention was to make four awards under the RFA- one for Western NIS countries including Ukraine; one for the Central Asian Republics; and possible two for Russia, one to assist the RPC and the other to assist the RFCSCM. The University of Wisconsin won the award for Central Asia. HIID won one of the Russian awards for \$17.4 million to assist the RPC with privatization activities, tax reform and anti-monopoly policy, as well as to assist in the overall coordination, management, and monitoring of different contractors and initiatives. Stanford Research Institute won the Russian competition for the RFCSCM but the Commission rejected the Institute and no award was made.

USAID AWARDS HIID AN UNSOLICITED PROPOSAL FOR UKRAINE

On May 23, 1995, after the RFA was issued, the Ukraine mission, which is a regional mission for the Western NIS, withdrew from the competition. Consequently, proposals submitted for the Western NIS were not considered. Several of the applicants interested in this region, requested clarification. In June 1995, USAID sent letters to Freedom House and Hudson Institute explaining that a Cooperative Agreement for Western NIS, including Ukraine, would not be awarded due to budgetary issues and the need to reexamine priorities. In addition, the letter specified that " it is not anticipated that

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there will be a separate cooperative agreement for the West NIS or any amount of activity in that region under the RFA"

In July 1995, HIID submitted to the State Department's office of the Coordinator an unsolicited proposal for a strategic policy project to provide macroeconomic advice to the Government of Ukraine, focussing on fiscal, monetary, and privatization issues. On May 24, 1996, USAID entered into a Cooperative Agreement with HIID to provide policy coordination, and monetary, tax, and pension reform advice to the Government of Ukraine. The agreement also had the approval of the State Department Coordinator, the Treasury Department and the National Security Council.

HIID RELATIONSHIP WITH OTHER U.S. CONTRACTORS.

To fully understand the importance of the HIID involvement in the Russian reform effort, it is important to understand the relationship between HIID and other USAID contractors. As indicated in table 1:2, the total USAID obligations for 1992-1996 for the Russian privatization program as of May 10, 1996 amounted to about \$325 million including approximately \$40 million for HIID. For privatization, land reform, capital markets and post privatization most of the funding went to other USAID contractors to implement projects. HIID and the RPC responsibilities to varying degrees included monitoring the performance of these contractors.

Table 1:2 Summary of USAID Russian Privatization Program Obligations 1992- 1996 as of May 10, 1996.

<u>Program</u>	<u>Obligations</u>
Mass Privatization	\$58,324,607
Land Privatization	62,626,116
Capital Markets	77,189,912
Post Privatization	71,559,346
Policy ,Legal and Regulatory Reform	39, 103,676
Other	<u>16,436,643</u>
Total	\$325,240,300

This is critical because it expands HIID's role and importance

HIID'S ROLE IN ESTABLISHING CAPITAL MARKETS

Most of this information appears deleted from work.

In the voucher privatization and capital markets, HIID's responsibilities were to provide impartial oversight and strategic guidance for privatization and capital market reform. This included working with reformers in the GKI and the Russian Security Exchange Commission to develop and implement a strategy for the voucher privatization program, and an independent Federal Securities Exchange Commission (RSEC) along with the necessary capital market infrastructure including self regulatory organizations, independent stock registers, and clearing and settlement organizations. USAID also used omnibus contracts to retain the services of U.S. contractors that had the ability to mobilize the resources and expertise needed to identify and implement privatization and restructuring activities. Although the description of work was general, the contracts were used to establish an obligation under which USAID could reimburse contractors for cost incurred up to a specific amount of the contract.

These contracts required the subsequent approval of task orders and work plans for the purpose of further defining the role the contractor was to perform. HIID (working with Russian reformers, contractors, and USAID) helped write these task orders. GKI and HIID long-term advisors and short term specialists also were responsible for assisting with monitoring contractor performance. During voucher privatization, HIID interfaced mostly with GKI.

After voucher privatization, HIID helped the RSEC create the SEC Resource Secretariat that provided much of the intellectual capital to support the development of the capital market infrastructure. HIID recruited and paid for expatriates to work for the secretariat that worked on task orders and drafting of legislation and regulations. With the approval of the RSEC director, it also

assisted in the recruitment and training of Russian lawyers. Under the omnibus contract, Price Waterhouse was allocated about \$9 million to cover the operational and start-up costs for the Secretariat including the salaries of Russian lawyers. In September 1995, USAID approved a \$1.7 million amendment to HIID's cooperative agreement that allowed HIID to pay the salaries of the Russian Lawyers directly.

HIID's ROLE UNDER THE LEGAL REFORM PROJECT

Under the legal reform project, HIID was responsible for drafting laws, responding to the request of reformers legal review of draft laws, decrees, and regulations. HIID strategy assisted in the establishment of the Institute for a Law Base Economy, (ILBE) and brought in Western experts to write and comment on draft laws. It also paid the salaries of Russian Lawyers that worked for ILBE. Unlike mass privatization and capital markets, the omnibus contractors played only a minor role under the legal reform project. The Rural Development Institute, HIID's subcontractor, played an important role when it came to legislative and decrees related to privatization of land.

HIID's ROLE IN POST PRIVATIZATION

Following the completion of the mass privatization program, U.S. assistance shifted to helping the RPC and 10 Local Privatization Centers (LPCs) work with newly privatized firms on the difficult process of restructuring. In the initial stages, HIID was responsible for setting-up the RPC and oversaw the work of omnibus contractors that were responsible for development of an accounting systems, finding office space, and recruiting personnel. During the first year, HIID was also responsible for overseeing the development and management of the LPC network. After September 1994, the responsibility for RPC oversight shifted from HIID to

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the USAID mission. HIID remained engaged by recruiting and paying the salaries of expatriates who held important positions including the chief financial officer, procurement officer, press secretary and a number of project associates. Finally, HIID provided policy advice through the director of the RPC to the Deputy Prime Minister on such topics as macroeconomics, post privatization, and tax policy.

In post privatization, the RPC selected enterprises for restructuring and managed U.S. contractors involved in enterprise restructuring. The LPC's assisted U.S. omnibus contractors in contacting Russian enterprise managers interested in restructuring. In 1996, the RPC became responsible for management of the LPC network.

In land reform, HIID engaged in strategic development of the U.S. assistance effort and paid for a land director at the RPC. The RPC was responsible for monitoring contractor performance in such projects as land certification and registration, land privatization, enterprise land sales, and real estate information systems that were implemented by omnibus contractors. For some of these contracts, the USAID mission subsequently assume contractor monitoring responsibility from the RPC.

SCOPE AND METHODOLOGY

Due to the non-competitive nature of much of the HIID cooperative agreements, the Chairman of the House Committee on International Relations Committee requested GAO to review the history of HIID funding, the use of noncompetitive procedures, and the overall effectiveness of the work conducted by HIID in meeting project objectives.

Specifically, we reviewed the USAID's basis for making

noncompetitive award determinations in awarding the first cooperative agreement, the \$20 million legal reform amendment, and the unsolicited award for work in Ukraine to HIID after the withdrawal of the West NIS portion of the RFA . We focused on the legal reform amendments to the cooperative agreement because it required a foreign policy exception as did the waiver for Ukraine. For the legal reform amendment, we evaluated whether other contractors could have provided legal drafting and their experience in Russia. For the Ukraine proposal, we evaluated whether the HIID proposal duplicated work of another assistance providers, the support and knowledge of Ukrainian officials about the project, and whether the proposal duplicated work covered by the withdrawn RFA. We analyzed USAID regulations and contract files, interviewed USAID, Department of State, Department of Treasury, National Security Council, U.S. contractor, HIID, Government of Russia, Government of Ukraine and International Financial Institution officials.

In reviewing the RFA competition, we analyzed the competition files and interviewed members of the evaluation panel, the procurement office, other USAID officials and Government of Russian officials responsible for rejection of the RSEC portion of the RFA.

In analyzing HIID's overall effectiveness, we focused on its efforts after the mass privatization including capital markets, RPC development and post privatization efforts, and legal and land reforms. We interviewed officials from HIID, USAID, RPC, ILBE, RSEC. GPU, Russian Parliament, omnibus contractors, capital market participants, international institutions including the World Bank, and beneficiaries of the assistance. We made field visits to projects relating to enterprise restructuring, land reform, and capital market infrastructure and reviewed USAID, HIID, AND contractor files including task orders and work plans.

We conducted our work from March 1996 to October 1996 in accordance with generally accepted accounting and auditing standards.

USAID AWARD OF COOPERATIVE AGREEMENTS

From the beginning of USAID's program in Russia, the agency relied heavily on HIID, in large part because of HIID's pre-existing relationship with key Russian reformers. Until recently, USAID funded most of HIID's assistance activities in privatization, capital markets, and legal reform under non-competitively awarded cooperative agreements. In response to increasing pressure from a number of sources, USAID decided in 1995 to hold a competition for additional assistance for "Impartial Oversight and Strategic Guidance for Privatization and Market Reform." USAID planned to award four separate cooperative agreements, two for assistance in Russia, one for Central Asia, and one for Ukraine. In our review of the selection process, we found a number of actions surrounding the evaluation of proposals that, although not illegal, may have affected the overall fairness of the process. In addition, errors made in tabulation of the evaluation panel members' scores may have resulted in selection of a winning proposal based on an erroneous final score. The Russian reformers who would have received assistance under the proposal rejected the winning proposal. As a result, the award was not made.

In Ukraine, a few months after the competition was cancelled, USAID awarded HIID a cooperative agreement non-competitively based on an unsolicited proposal. USAID made the award despite knowledge that the HIID proposal duplicated areas covered in the cancelled competition and concern by some USAID officials and other donors that it might be counterproductive to U. S. assistance objectives because it duplicated other on-going assistance efforts.

AWARD OF COOPERATIVE AGREEMENTS WITHOUT COMPETITION ALLOWED UNDER
USAID GUIDELINES

The United States began providing limited assistance to the Soviet Union in December 1990 to support the reform effort and then to increase assistance after the Soviet Union dissolved in December 1991. The first cooperative agreement with HIID was an unsolicited proposal awarded on a sole-source basis for \$2.1 million. The purpose of the cooperative agreement was for HIID to provide assistance related to privatization, post-privatization, capital markets and legal and tax reform. Prior to the award, HIID had already worked with the State Property Committee, known as GKI, in the development of the voucher privatization program. Between April 1993 to August 1995, USAID modified the agreement a number of times to add funding and to expand the scope of work in capital markets and legal reform. Total funding under the agreement eventually grew to about \$40 million.

A cooperative agreement, the instrument generally used by USAID to fund HIID activities in Russia, is identical to a grant except that the agency is "substantially involved" in the program's implementation. The federal government uses cooperative agreements when the purpose is to transfer money, property or anything of value to accomplish a public purpose. Such an agreement must be managed in accordance with the Federal Grant and Cooperative Agreement Act of 1977, 31 U.S.C. ____, related Office of Management and Budget (OMB) circulars, and USAID guidelines. Neither the act, the circulars, nor USAID guidelines provide extensive guidance on how cooperative agreements should be awarded because they are viewed as conditional "gifts" to the organization.

However, the Federal Grant and Cooperative Agreement Act of 1977 does require agencies to encourage competition in the award of cooperative agreements. Accordingly, USAID guidelines require

competition "to the maximum extent practicable" but include a number of broad exceptions. For example, competition is not required for certain unsolicited proposals, if the recipient has exclusive capabilities based on an existing relationship with the cooperative country or beneficiary, or for "circumstances as are determined to be critical to the objectives of the foreign assistance program."⁴

In December 1992, USAID awarded HIID a \$2.1 million cooperative agreement non-competitively. The award was based on an unsolicited proposal by HIID for work involving privatization, capital markets, and legal reform. USAID justified making the award without competition because of HIID's existing relationship with Russian reformers and the immediate need to support Russian efforts to design and implement a privatization strategy. The 1992 decision to award HIID a non-competitive cooperative agreement based on its unsolicited proposal appears reasonable because HIID was already working with the State Property Committee, had gained the trust of key reformers, and time constraints limited the capacity for competing the cooperative agreement.

Because of HIID's assistance under the voucher privatization project, USAID made a determination that HIID had the unique capacity to provide technical assistance in the rule of law project. HIID made its case for noncompetitive amendments to the cooperative contract based on close relationships that developed between several important Russian reformers that had worked for GKI during the Russian voucher privatization program. The officials included Mr. Anatoly Chubias, who would become the Deputy Prime Minister and the Presidents Chief of Staff after the July 1996 Presidential elections; Maxim Boycko, who would become the

⁴USAID Handbook 13, Chapter 2 -Selection of Assistance Recipients, paragraph 2B.

Executive Director of the RPC; Albert Sokin, who would become the Executive Director of ILBE; and Dimtry Vasilyve, who would become Executive Director of the RSEC. In addition, HIID had developed a working relationship with Ruslan Orekhov, the Legal Advisor to President Yeltsin.

In 1994, USAID amended the cooperative agreement to significantly expand HIID's responsibility for the rule of law project and provide it with \$20 million in additional funding. Although another U.S. institution, the Center for Institutional Reform of the Informal Sector (IRIS), was also doing rule of law work in Russia at the time, USAID decided to award the work non-competitively to HIID under its existing cooperative agreement based in large part on HIID's relationship with GPU.

The action memorandum provided the justification and arguments for USAID's noncompetitive amendment to HIID's cooperative agreement. In late December 1993, USAID received a request from the State Legal Administration of the Office of the President of the Russian Federation (GPU) for assistance in the implementation of a critical and ambitious program of legal reform. This request, according to the memorandum, was the outgrowth from HIID's ongoing program of assistance in the area of privatization and HIID's solid working relationship with GKI and the GPU. The memorandum went on to explain that a new pattern for executive-legislative cooperation in advancing reform legislation could emerge, around which the consensus necessary for building new laws could be built. USAID noted that both the executive and the Duma had ambitious drafting agendas and that the urgency for providing support under these circumstances does not permit what could be an extended competitive process to select an implementing agency. The memorandum further stated that HIID had a unique advantage to carry out legal reform assistance based upon the deep relationship of trust it had developed with Russian reformers that will be involved in this

project.

USAID Moscow Mission noted that the breadth of the proposal had caused concern both in the mission and in Washington. Many of the activities were in areas in which other USAID financed law reform contractors were already providing assistance or had concrete plans to provide such assistance and the probability of overlap, duplication and conflicts was very high. There was also concern that recognition and support for the GPU as the sole Coordinator for all law reform assistance activities might inhibit the ability of USAID and its other law reform contractors to provide assistance to certain groups and in certain areas. The Mission made it clear that assistance activities to be on law drafting and were not prepared to finance HIID activities in the areas of regulatory agency development, judicial institution strengthening and broad base training for public and private lawyers. These activities were already being addressed by other contractors.

The University of Maryland's Center for Institutional Reform the Informal Sector (IRIS) , another organization that had received USAID funding, was also doing rule of law work in Russia. IRIS was working with the Research Center for Private Law (RCPL) an institute attached to the President of the Russian Federation and chosen by the President to do Parts I and II of the civil code. In May 1994, IRIS challenged USAID's assumption that GPU was the president's chief legal advisor and the coordinator of Russian legal reform. According to IRIS, President Yeltsin sought advise from a broad group of advisors including other members of the Presidential Council , the Ministry of Justice, and the Chairman of the RCPL as well as from the GPU.

In making its case, IRIS highlighted the activities of the GPU and the Research Center in the development of Part I of the Civil Code. To accomplish this task, the Research Center formed a team

representing the entire spectrum of the Russian Government, including the President's Administration, the Government under the Prime Minister, the Ministry of Justice, the Judiciary, the Parliament as well as academic figures. The GKI and the GPU opposed the draft code prepared by the Research Center. HIID continued to pursue the development of a competing Part 1 of the civil code. Eventually, Mr. Orekhov and the GPU were forced to sign off on the Research Center's draft code because virtually everyone else in the government with an interest in the code supported it. Also, the concept of establishing working groups on commercial law, as proposed in the HIID draft was not a new approach. Sergei Glaziev, Chairman of the Economic Policy Committee in the Duma, had been chairing the working group established to coordinate commercial law legislation since early 1994.

Although IRIS had a proven record of providing assistance for legal reform and time constraints appeared to be less critical, the memorandum is accurate when it stated that "HIID had a unique advantage to carry out legal reform assistance based upon the deep relationship of trust it had developed with certain Russian reformers that will be involved in this project." As indicated above, IRIS had an adversarial relationship with both HIID and the GPU. Moreover, given the broad nature of the exceptions to competition provided under USAID guidelines, USAID's determination not to compete the award was permitted under the Foreign Policy exception rule.

ERRORS MADE IN AWARD OF COOPERATIVE AGREEMENT FOR ASSISTANCE TO RUSSIAN SEC

Because other U.S. organizations had established relationships in Russia and its guidelines require competition to the maximum extent practicable, USAID decided to award follow-on work to start in

Fiscal Year 1996 competitively. USAID issued a request for proposals for "Impartial Oversight and Strategic Guidance for Privatization and Market Reform." Organizations could submit proposals for four separate cooperative agreements. USAID planned to award two cooperative agreements in Russia, one for assistance to the RPC and one for the SEC, as well as one agreement for Central Asia, and one for Ukraine. In our review of the selection process, we found a number of actions surrounding the evaluation of proposals that, although not illegal, made us question the overall fairness of the process.

Russian Recipient Organizations Invited to Nominate Representatives to the Selection Panel

Invitations by Ambassador Morningstar and Tom Dine to allow the SEC and RPC to place their representatives on the selection panel favored HIID in the competition. In late June 1995, the Assistant Administrator for Europe and the Newly Independent States (ENI), and the FSU State Coordinator in a meeting with the Russian SEC Executive Director proposed that he send someone from the SEC to take part in HIID successor RFA review. A similar invitation was made by the panel chairman to the Executive director of the RPC. According to USAID officials, it is not uncommon to invite prospective government recipient agencies to participate in the selection process. This makes it more likely that the recipient will accept the results of the selection committee. However, RPC and the SEC were not traditional USAID recipients. HIID had provided personnel for key managerial positions to each of these institutions and both have strongly supported HIID's work. The HIID project manager also sits on the RPC Board of Directors and the RPC was a non-profit private organization.

The Executive Director of the Federal Commission (SEC) wrote to the USAID Assistant Administrator on July 2, 1995, stating

" I am concerned that the Federal Commission for Securities and the Capital Markets continue to have the benefit of the independent policy advice from the Harvard Institute. The Harvard Institute has been deeply involved in the establishment and development of the Federal Commission. My experience suggest that it will not be possible for another organization to carry out the necessary tasks.

I would like to sincerely request that you do all that is in your power to ensure that the Harvard Institute continues to fulfill its current roles long as possible. Any change in firms is likely to have a seriously detrimental impact on the effort to build Russia's capital markets.

At the very least, I request that my representative, -----, be allowed to participate in the upcoming discussions in Washington related to the future policy advice to the Federal Commission."

The USAID procurement officer rejected the nominated individual because he was employed by Price Waterhouse which was subject to HIID oversight. Subsequently, the Federal Commission nominated an individual employed by the Capital Markets Department of the International Finance Corporation. This person had worked very closely with the Federal Commission and had also worked closely with HIID in preparing task orders for USAID contractors. The individual nominated by the RPC worked for the RPC as the Deputy Director and was being paid by the World Bank through funds provided by the Japanese. In both cases, USAID allowed these individuals to participate in the panel because they did not have a direct financial interest in the outcome of the competition, had no other perceived conflicts of interest, indicated that they could be objective, and had expertise in providing technical assistance in transition economies.

*See letter
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USAID Reopens Evaluation for Russian SEC Representative

USAID reopened the evaluation panel after its initial members had already completed and submitted their evaluations. The initial panel members convened and began their evaluations of the proposals on June 15, 1995. According to the panel members, they received

instructions from the procurement officer on the technical issues for scoring the proposals. The initial panel completed its work on July 15, before the SEC Executive Director had received the offer to nominate a representative to the panel. The SEC nominee began examination of the proposals on August 8, 1995 and completed her review on August 22, 1995. The Chairman of the panel told us that opening the panel after other members had completed their work was very irregular. According to panel members, there was no group analysis of the scoring after each member completed their evaluation. and the evaluators simply placed their evaluations in an envelope addressed to the panel chairman. The procurement officer stated that he did not attempt to calculate the scores until the SEC nominated member completed her scoring. On August 24, the contracting officer sent a fax to the project officer in Moscow stating that the SEC nominee had completed her evaluation and " you can imagine what her scoring indicates." He also suggested that USAID would have to go with one applicant for the two Russian portions of the RFA.

Errors in Tabulation of Scores Results in Erroneous Final Score

The SEC nominee used a different scoring system than the other panel members. The panel members were instructed to evaluate each proposal in three different categories. The three categories were assigned the following relative values; institutional qualifications and experience, 20 percent; case studies, 30 percent; and qualification and experience of personnel, 50 percent. Six of the evaluators scored each of the competing institutions as instructed. The panel member nominated by the SEC however simply ranked the applicants in descending order, with 8 being the highest rank and 1 the lowest. To reconcile her score to the other panel members, the procurement office multiplied the ranking by the weighted value of the category. For example, the procurement officer the top ranked proposal an "80" (8 x 100%). Because the

panel members had departed Washington with some members no longer in the country, he made no effort to reconvene the panel for group analysis or to have the SEC nominated panelist correct her scores.

The panelists submitted their recommendations and the official results prepared by the procurement officer showed SRI the SEC winner with an average score of 76.7 percent over HIID with an average score of 76.4 percent or .03 percent difference. However, our discussions with panelists and review of their evaluation sheets disclosed three discrepancies between the panel members' work sheets and the scores recorded by the procurement officer. The three discrepancies all went against HIID. The corrected score resulted a score of 77.1 for HIID and 76.08 percent for SRI. The procurement officer said that he could not explained these errors and that based on the actual scores HIID should had been awarded the cooperative contract.

USAID provides additional funding to HIID for SEC activities.

In September 1995, after the selection panel for the follow on work had completed its evaluation, USAID Moscow amended HIID's cooperative agreement to provide \$1.7 million to HIID to finance 20 Russian professionals for the Resource Secretariat. The amendment allowed HIID to fund these SEC Resource Secretariat personnel from December 1995 to December 1996. The Russian Resource Secretariat had received significant HIID support prior to the amendment and was expected to obtain future funding through RFA competition. Because the time-period of the amendment over-lapped with the time period covered by the competition, the Director of the SEC may have felt less pressure to accept a winner of the competition other than HIID. The Chairman of the evaluation panel told us that prior to the amendment, the mission had indicated that it could only award one of the agreements before the end of the fiscal year. The mission chose to award the follow-on to the RPC to HIID. However,

using Fiscal Year 1995 funds, the mission also extended HIID's funding life with the SEC. Even if the mission expected delays in funding the SEC, it had sufficient funds to support the Russian Resource Secretariat through December 1995, an adequate time to award the SEC portion of the contract.

After the procurement officer informed the USAID mission results of the competition, the mission director informed SEC Director that SRI had won the competition. The SEC Director was opposed to SRI. He said that some of the expatriates on the SRI team were "communists" and that he did not have to work with communists. The Mission Director stated that he tried to convince Mr. Vasilyve that he would have enough control over the personnel and workplans to control the contractor. This did not persuade him to accept SRI. In June 1996, Mr. Vasilyve stated to us that there was a continuing need to support the Resource Secretariat. He explained that the Secretariat needed to continue to coordinate all assistance, especially assistance from the World Bank.⁵ However, the official January 30, 1996 response to SRI stated that "USAID counterparts have explained that there is no longer a need for this type of assistance. Additionally, the USAID program in the Russian Federation has been severely reduced this fiscal year, consequently, we will not be funding these interventions in the future.

Additionally, Mr. Vasilyve met with the State Department FSU coordinator in March 1996 and requested additional funding from Omnibus II contracts for new projects. Ambassador Morningstar agreed to provide support for \$15 million of the \$40 million requested. The Mission Director stated that none of these projects were covered under the rejected RFA proposal.

⁵ The World Bank \$89 million Capital Market loan will include funding for the Resource Secretariat.

ACCEPTANCE OF UNSOLICITED PROPOSAL FOR UKRAINE AFTER SIMILAR RFA
HAD BEEN CANCELLED

The March 1995 RFA included a request for follow-on work in the Western Newly Independent States, including Ukraine, Moldova, and Belarus. The RFA was for a university, institute, foundation or other nonprofit organization to provide impartial oversight and strategic advice for privatization, and market reform programs in Russia, Western NIS, and Central Asia. On May 24, 1995, USAID withdrew the Ukraine portion of the RFA. According to USAID, the Ukraine USAID Mission Directors stated that there were limited funds and the Ukrainians were no longer interested in oversight assistance.

HIID had not submitted a proposal for the RFA. At the time, HIID was in the process of leadership change; the current Director had not been appointed yet. However, by July 24, 1995, HIID's new director showed interest in Ukraine and submitted an unsolicited proposal to do work in that country. HIID's Director told us that unsolicited Ukrainian proposal was quite different from the RFA invitation and that the State Department FSU Coordinator had requested HIID services.

In awarding the cooperative agreement noncompetitively, USAID relied, as it had for most of the non-competitive awards to HIID, on the exception to competition for foreign policy considerations in its guidelines. Other than for foreign policy consideration as determined by USAID, we found little basis for awarding HIID the cooperative agreement without competition. The scope of HIID's unsolicited proposal was broad enough to be viewed as duplicating some provisions of the previously withdrawn RFA. HIID also proposed assistance that was already being provided by the U.S. Treasury, USAID funded organizations, and international donors. At best, a more limited cooperative agreement could have been awarded

on a noncompetitive basis to improve coordination of the Ukrainian Government, the one unique aspect of the Ukrainian proposal. Nevertheless, because USAID justified the noncompetitive award under the broad "foreign policy consideration exception", award of the cooperative agreement non-competitively was allowed by USAID guidelines despite the fact that much of the proposal duplicated the 1995 RFA.

Genesis

According to Dr. Sachs, Dr. Aslund, who managed a small team of advisors in the Ukraine on macroeconomic issues, encouraged him to become involved in Ukraine in early July 1995. Dr. Sachs heard from Dr. Aslund that the Deputy Prime Minister Roman Shpek and the governor of the Central Bank and others had wanted his input. On July 24, 1995, USAID received an unsolicited proposal for a project to be jointly led by Dr. Aslund, the Carnegie Endowment, and Dr. Sachs. HIID would administer the project. At that time, it does not appear that Dr. Sachs had made any exploratory visits to the Ukraine to prepare the proposal but instead relied on input from Dr. Aslund as to the receptivity of Ukrainian officials to the proposal.

The proposal was to provide assistance in several detailed streams of policy implementation by providing world class advisors in interrelated areas of structural and macroeconomic reform. The areas identified included tax reform and administration, privatization, banking reform, social policy, external economic relations, macroeconomic policy, public administration, energy policy, and corporate law. The proposal also identified the principal Ukrainian counterparts including Deputy Prime Minister

Shpek, Deputy Prime Minister Viktor Pynzenyk⁶, the Governor of the Central Bank, and the Prime Minister Yevhen Marchuk.

While HIID was submitting its proposal, David Lipton, the Deputy Secretary of the Treasury, and Carlos Pascual, National Security Council advisor for Ukraine, visited the Ukraine between July 24 and 29, 199~~5~~⁶, to discuss broad economic issues with key officials within the Ukrainian government. According to Ukrainian officials from the Central Bank, Mr. Lipton was well respected because of his early support provided to them in assisting in promoting an economic stabilization program for Ukraine. During these discussions, the Central Bank Governor expressed concern that there was a conflict between ~~three~~ foreign exchange, internal debt, and capital markets blocs within the Bank. Mr. Lipton suggested that he knew of an advisor that might be able to provide some assistance in unifying the Bank's policy apparatus. Bank officials, apparently unaware of the July 1995 HIID proposal, told us that they thought that these discussions had led to the HIID proposal.

*Became
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At a dinner meeting with Prime Minister Shpek, Mr. Pascual asked him if he would like a technical assistance team to help on economic issues. According to Mr. Lipton, he discussed the eternal problems within the NBU and the need for the Ukrainian Government to build policy consensus.. The Prime Minister said that he had tried to contact Dr. Sachs on his own but a proposed meeting with Dr. Sachs in Paris did not take place. Mr. Pascual stated that he was not aware of the HIID proposal until he returned on August 4, 199~~5~~⁶.

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⁶ At the time there were 10 Deputy Prime Ministers in the Ukrainian Government. In July 1996, the Rada passed a new constitution that provided for only one Deputy Prime Minister. It also announced the appointment of Mr Shpek to a new position within the government.

On August 10, 1995, at the invitation of George Soros, Dr. Sachs, Dr. Aslund, Mr. Pascual, Mr. Lipton, and representatives from the World Bank and the IMF met to discuss Ukrainian reforms. According to Mr. Lipton, Mr Soros was interested in launching an effort to assist Ukraine. The discussion included a wide range of issues including the need to help the Ukrainians to develop a coordinated and consensus building policy apparatus.

After returning to the United States, Mr. Lipton provided the name of Dr. Jaramillo to the Governor of the National Bank of Ukraine and information on how to contact him.. Between August 21 and 24, 1995, Dr. Jaramillo, accompanied by Dr. Sachs, met with the Governor. At the meeting, the Governor made it clear that the Central Bank fully supported existing USAID programs and that additional assistance could not be provided at the expense of existing U.S. assistance. Also, he told them that Harvard should have a very limited program that addressed the unification of policies within the Bank. During the visit, Sachs also meet with Deputy Prime Minister Shpek gaining his expressed support for Harvard's advising Ukraine on macroeconomic issues.

On October 2, 1995, the State Department Coordinator held a working group meeting to discuss Ukrainian reforms as well as tax reform in Russia, issues covered in HIID Ukraine proposal and HIID's September 1995 cooperative agreement. By this time., Mr. Lipton told us that he participated in the discussion on the Russian tax proposal but left the meeting before the discussion on Ukraine. He said that because of his previous professional relationship with Dr. Sachs he chose not to participate in the Ukraine discussion. He considered his involvement in the discussions on the Russian tax project to be different because Dr.Sachs, although the Director of HIID, was not directly involved in the implementation of the project. Subsequently, he sent his deputy, Mr. Sobel, to attend when the working group planned to discuss HIID's Ukrainian

need to get the info into report

This info is unus because Sachs ignore it and then claims support by UK Govt to get approval

proposal.

Limited Support within the Ukraine Government

Prime Minister Shpek clearly endorsed HIID's enrollment in assisting the Ukraine. On at least two occasions, he expressed to the State Department support for the project. For example, in an April 26, 1996, to the State Department Coordinator, he stated that:

"More than half a year ago, on behalf of the Government of Ukraine, I asked Professor Jeffrey Sachs, the newly appointed director of the Harvard Institute for International Development, to engage HIID in long-term strategic advisory work on the economic and institutional reform in Ukraine. In view of HIID's unique world-wide experience and institutional capabilities, I made a special request for the institute's staff and consultants' advice in the areas of monetary reform, tax policy, and administration, and the fiscal aspects of social reform."

However, we found that knowledge of the project from other levels within the Ukrainian Government was either limited or non-existing. Most ministries did not hear of the project until after its approval in May 1996 and some had not heard of the project until we met with them in July 1996. However, the ministries generally believed that the final proposal held some promise.

As indicated above, Ukrainian officials did not have specific knowledge of the HIID July 1996 proposal. It was during Dr. Sachs August 1995 visit that he discussed economic issues with the Deputy Prime Minister and the Governor of the Central Bank. Revised proposals submitted to USAID on August 30, 1995 and October 30, 1996 remained ambitious and clearly did not correspond to the Central Bank's concerns raised in the meeting with Dr.

Sachs. For example on August 30, 1995 and October 30, 1996, HIID submitted a revised proposals that provided a more detail description for a two year project in the Ukraine. The October proposal described HIID's strategy for each area and estimated a two year cost of \$6 million. According to a National Bank of Ukraine official, he had an opportunity to review the October proposal and believed that the proposal was duplicative of on-going activities and would work with USAID to stop the project. In March 1996, this official told a HIID project official that he would accept only one advisor to work on the previous mentioned policy concerns.

The Deputy Minister for Economy received a letter dated May 22, 1996 stating that the Council of Ministers had received the HIID project proposal. He told us that he had just recently become aware of the project but supported the general direction of the project. The chairman of the State Property Fund had also become aware of the project in May 1996, but voiced support for the project content. He expected that after about 6 months the project should be reviewed to see what is working and to determine what organizational changes may be necessary. The Minister of Finance and the Head of the General State Tax Inspection, two important players in implementing the HIID proposal, were not aware of the specific HIID project as of July 1996.

Do not need to put this evidence in the report

~~Duplication with the withdrawn RFA~~

On March 1996, the ENI/ Procurement concluded that two of the components of the Ukrainian-HIID unsolicited proposal " may" duplicate in some respects the regional RFA for which the Ukraine mission withdrew from competition and concluded that the proposed activity should be competed. She added that if the waiver invokes a foreign policy consideration, it becomes a political decision, which is outside the scope of her jurisdiction. On March 26,

1996, Tom Dine, the Assistant Administrator for ENI approved a noncompetitive waiver based on foreign policy considerations. Other U.S. Government officials also initialed the waver including a representative from the office of State Department's Coordinator for Assistance to Former Soviet Union, a representative from the Treasury Department, and a representative from the National Security Council.

The RFA stated that the recipient would provide policy, management, and legal assistance to facilitate the ongoing privatization process. The main areas identified included mass privatization, capital market development, legal and regulatory reform, land privatization, post privatization assistance and public education. Under the legal reform, the RFA stated that given the importance of tax law for commercial viability of business, the structure of the tax law and its system of incentives and disincentives must be addressed in the developing policy objectives for many of the fields of law covered in the RFA. Moreover, the RFA required applications to prepare three case studies including one for Enterprise Restructuring. Under this case study one of seven topics to be covered including the spinoff of social assets

The three components of the HIID April 9, 1995 proposal were macroeconomic and monetary policies, tax and budget assistance, and fiscal reform of the pension program. There is no doubt that the tax proposal duplicated the RFA. For example, a large component of the HIID Russian work plan for its impartial oversight contract awarded under the RFA competitive process was for a tax project similar to the one proposed for Ukraine. Also, the HIID Russian work plan contained a section on policy advice including a specific reference to macroeconomics. The RFA appeared broad enough that almost any area of strategic advice could be provided within the framework of the RFA.

Redundancy with Existing Work

According to Dr. Sachs, Ambassador Morningstar suggested to him upon his return that he put together a proposal covering macroeconomic stabilization, tax reform and social policy reform. On April 9, 1996, HIID submitted a scaled down \$ 1.9 million proposal that covered these areas. This proposal contained areas relating to the basis to provide specific policy advice by long term advisors who are highly qualified and recognized experts in their field. The proposal also contained proposed work that would largely duplicate and or contradict work carried out by other donors. Interestingly, HIID was aware of most of this work but chose to ignore these facts in its proposal. The USAID Mission analysis sent to Washington pointed out the potential duplication. The signed cooperative agreement did not alter the general content of the proposal. The contract instead called for close coordination with other USAID contractors, the U.S. Treasury advisor on tax issues, the IMF and other foreign donors, all identified in the mission analysis as providing assistance that overlapped HIID's proposal.

Conclusion

As part of its proposal, HIID proposed the establishment of a Macroeconomics Group of senior Cabinet level ministers and deputy ministers and the Chairman on key staff of the Central Bank to meet regularly to assess macroeconomic data. The Group would be supported a Technical Macroeconomics Team of Ukrainian policy advisors and Ministry specialists. The Missions analysis concluded that this could be a valuable and much needed to the U.S. Government program and should be the foundation of the whole project. Officials from the Ministries of Economy, the Central Bank, and the State Property Fund stated that increased coordination between the Ministries and consensus building would improve the reform process and initial reaction to the HIID proposal was positive. We believe that a cooperative agreement

focused on this aspect could be justified as unique and not covered in the RFA on duplicative of other assistance.

The mission concluded that the four tax components of the HIID proposal would largely duplicate and quite possibly delay the work on tax law and codification already being done by the U.S. Treasury advisor, with assistance from the KPMG/Barents fiscal economist.⁷ The U.S. Treasury advisor stated that he met with the HIID tax advisor between March 4 and 8, 1996 and discussed what the Ukrainian Government with U.S. assistance was doing in the way of tax proposals. In addition, he stated that the approach was first discussed at Harvard in August 1995 during a seminar that included representatives from the State Parliament (Rada), the State Tax Inspectorate, and U.S. tax experts.

This is important for Belarus and ties to custom concerns

He explained that the Treasury approach included establishing a joint working group consisting of Rada and State Tax Inspectorate. It was decided that the best chance of success was to address tax issues in phases and five areas were identified- administration provisions and inspections, value added tax amendments, enterprise profit tax, personnel tax, and excise tax. These are the same areas addressed in the HIID tax proposal. The bases of the Treasury approach was to use a well-recognized international model tax code.

need to know what would be content

He said that the issue of cash versus accrual payments for the value added tax, which is discussed in detail in the HIID proposal, was addressed in current proposals that was awaiting the third reading in the Parliament. He said that if HIID could convince the

⁷The HIID proposal stated that at the end of the first eight months HIID will have fully developed tax reform proposals and will have identified the measures that have the greatest potential to be implemented during the early stages of reform. The proposal identified the value -added taxation, payroll and personnel income tax, corporate and business profits taxation and excise tax as areas of interest.

Prime Minister and others key players in the government to move on taxes it would be very useful. However, if HIID chose to develop an independent tax initiative, using the value added tax as an example, it could be counter productive and might delay enactment of tax reform. On July 29, 1996 the HIID Kiev advisor told us that there was no disagreement with the Treasury approach on taxes in taking a phased in approach. With regard to the value added tax, the HIID official stated that it will look at what is in the law and what else could be done to improve it.

Under budget system reform, HIID proposed, in part, to work with the Ministry of Finance staff to develop the economic models, processes and procedures necessary to formulate effective fiscal policy. The Mission analysis of the proposal noted that the macroeconomic forecasting work was already being done by the KPMG fiscal economist working within the Minister of Finance that had close ties to the Ministry of Economy, the National Bank of Ukraine, and other donor groups active in this area including the Soros -Asland Group and the German Technical Assistance Team. Our discussions with KPMG/ Barents, and officials from the Ministry of Finance confirmed that these groups were working on models to project tax revenue.

The April 9, 1996, proposal also addressed the concern of the Governor of the National Bank of Ukraine over the conflict that arises between the foreign exchange and the credit policies of the National Bank of Ukraine. According to HIID, a main focus of HIID assistance will be to develop institutional mechanisms to foster regular and timely coordination between foreign exchange and credit policies. USAID mission noted that the IMF and in particular the Monetary and Exchange Department at the Fund has the lead for all activities connected with the central banks in the region.

In a February 27, 1996 letter to the Mission, the Assistant Director

for Monetary and Exchange Department noted that the IMF had maintain a post of General Advisor to the National Bank of the Ukraine but unfortunately the post had been vacant for several months pending the approval of the National Bank of Ukraine President of the new candidate. He also noted that

" there is always the danger that with many sources of technical advice, the Banks management will search for the advice until it finds one that it is looking for. Indeed, we must also be cognizant of the possibilities of contradictory advice when many sources are involved and little coordination taken place. It is with these elements in mind that I would caution providing additional advisors to the NBU at this time and would think that the proposed advisor from Jeffrey Sachs' think tank could be repetitive of assistance already provided and could be counterproductive."

On July 3, 1996, the resident IMF representative stated that it had in fact filled the advisory position to the President of the National Bank of Ukraine and that the HIID advisor would duplicate the role of the IMF advisor.

HIID proposed to provide technical assistance on pension reform, including developing a proposal to change the financing for pensions, and preparing actuarial estimates of the pension liabilities, developing a proposal to use part of the assets of the enterprises currently being privatized to finance long-term pension liabilities and analyzing the impact of various pension reforms on the budget and on private savings. The Mission analysis concluded that the work being proposed would largely duplicate and in part contradict work being carried out by other donors.

For example, the Mission noted that the reform of the state pension fund is on the agenda of Ukraine's President and Parliament. It is

one of the packages of reforms and introduction of the social insurance funds, development of which is being coordinated by the Minister of Labor under the aegis of Victor Pynzenyk, the Deputy Prime Minister for Economic Reform. The European Union under its technical Assistance to the Commonwealth of Independent States had recently begun a project, with a long term resident advisor and substantial short-term technical assistance to work intensively with the Labor Ministry and the group it coordinates within the overall development of social policy, including social insurance reform.

Within the overall framework of the development of social insurance, the Mission noted that the Ministry of Social Protection has been in charge with the development of a reform pension system. The mission stated that the German government has been providing technical assistance in the development of a reformed pension system for over two years and had won the trust of the Government of Ukraine. The Mission analysis noted some deficiencies in German program but concluded that it would be counter productive to begin a new project from ground zero.

Efforts to Coordinate With On-Going Activities

The May 24, 1996 , cooperative agreement with HIID recognized the potential duplication with ongoing programs and made reference to the need for coordination between HIID and other technical assistance providers. Specifically, it stated that:

- Early-on in the project concerted effort will take place to ensure integration of the work of the HIID advisor with the IMF Bundesbank advisor.
- Coordination of on-going policy decisions in tax and budget

system reform is particularly important to ensure that sound policy work is continued.

- Because the issue of pension reform affects a number of Government of Ukrainian ministries, coordination will be critical in this area.

In early July 1996, the HIID project advisor told us that he was in the process of calling upon other donors including the U.S. Treasury advisor, Barents, Soros and the IMF. He planned to review their activities to determine how HIID could compliment the assistance already being provided.

CAPITAL MARKETS

With the assistance of HIID and other U.S. contractors, Russian reformers have made significant progress in establishing an independent regulatory body, a Russian trading organization, and a self regulatory dealer broker organization. The major disappointment has been the failure to establish clearing and settlement organizations throughout Russia. HIID provided the executive management for the Resource Secretariat, a professional staff that provided the intellectual capital for Russian Federal Securities Commission; acted as the liaison between the Russian Federation Commission on Securities and the Capital Markets (RFCSCM) and U.S. contractors; planned, coordinated and directed projects of the U.S. contractors, and provided financial oversight for the projects in connection with USAID.

CHALLENGES IN THE DEVELOPMENT OF THE RUSSIAN CAPITAL MARKETS

Before discussing the results of the \$77 million capital market effort, it is important to understand the conditions that existed when USAID decided to support the effort. Russian securities markets were created with the mass privatization of thousands of State Owned Enterprises. These markets suffered from many of the same ills typically associated with new and emerging markets.

The lack of an organized, controlled environment for trading securities presented a huge obstacle to the development of a secondary market in Russia. For example, because of the way share ownership was handled in Russia, brokers had to physically travel to a company's registrar in order to ensure that the change in ownership of shares were entered in the books correctly. Brokers then had the option of carrying suitcases full of cash to close the

deal, or transfer money through the banking system, which could take weeks or even months, all the while exposing the broker to additional risk. One such risk was that in the interim, the price of the shares purchased could have fallen. Or, in the case of a price increase, the risk that the seller decided to back out of the deal in order to retain the gain for himself.

The capital markets in Russia were highly fragmented and opaque. There were no mandatory listings of shares. Trading occurred principally through informal arrangements among brokers and was almost entirely in the over-the-counter markets. Brokers rely on their own connections with enterprises to find shares and then set their own prices which could differ by a huge margin from another seller. Most often, information on transactions and prices was not disclosed and when it was disclosed, it was not trustworthy. In most cases, stock certificates were not used and instead ownership was recorded in company ledgers which were not necessarily independent of the actual company they served. These factors encouraged trading activities that were non-standardized, fragmented, costly, time consuming and from an investor's perspective, unreliable.

In many cases, there was a flurry of trading activity following privatization of a company however, to a large extent, this trading represented control block trading where management was trying to retain control and consolidate their ownership position. Secondary trading tended to decline after positions were consolidated.

The absence of organized trading markets had also meant that enterprises had few avenues for raising capital through the issuance of shares. Broker syndicates, as a method of placing shares, were only just begun to emerge. Moreover, a number of logistical and practical difficulties impeded the sale of shares, particularly on an interregional basis. Given the inadequate

placement power by brokers, enterprises had to devise their own method of attracting buyers interested in the shares. This had given rise to the practice of aggressive television commercials and advertisements in the mass media that 'promise' exorbitant returns to investors rather than the quality and prospects of the enterprise. Similarly, in the absence of organized capital markets, Russian enterprises had generally found it unnecessary to engage in practices designed to ensure investor confidence. Enterprises did not disclose detailed financial information on a regular basis. Their boards rarely included truly independent directors. Some enterprises tried to deliberately thwart the rights of outside investors.

According to HIID, the threats to the Capital market development have been real and serious. Capital markets take economic power away from Soviet style bureaucrats and bad managers and therefore have lots of enemies. HIID resident project manager stated that over the last two years, many parties have been interested in an aggressive bureaucratic intervention to prevent market mechanisms from functioning normally. He provided the following examples

- ~~deleted~~ - Bureaucrats in various ministries, such as the National Bank of Ukraine control of banks participating in the securities market, have been strongly interested in rules that increase their control of capital market allocation through regulation or indirectly through control of the market participants.
- Burdensome tax rules that put capital markets under the Thumb of local tax authorities
- managers that have turned to bureaucrats in various ministries to enforce inefficient rules that discourage share trading.
- and some parts of popular opinion that are offended and

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frightened by the large number of scandals have supported aggressive and heavy handed bureaucratic interventions designed to "protect" them.

HIID PLAYS IMPORTANT ROLE IN THE DEVELOPMENT OF AN INDEPENDENT FEDERAL COMMISSION

Through its support of the Russian Secretariat, HIID providing policy advice to the RFCSCM and oversight, management, and coordination of the technical assistance delivered by contractors through task orders. HIID supported the development of the Resource Secretariat that helped define a strategy for capital markets and provided impartial oversight over U.S contractors working on the capital market infrastructure. In addition to supporting the Secretariat, HIID through the legal reform project provided technical assistance to support reformers efforts to establish an independent Security Exchange Commission.

HIID Working through the Resource Secretariat assisted in the Establishment of an Independent Federal Commission

During the summer of 1994, in anticipation of the creation of a Russian SEC, USAID began to fund a "Resource Secretariat". The idea was to consolidate all technical assistance to the Russian capital markets under a single managerial and coordination structure led by experienced professionals.

The Resource Secretariat constituted the "think tank" for the Russian SEC and the market that it oversees. Thus, Resource Secretariat objectives and the Russian SEC were to:

- To develop the institutions and infrastructure of the Russian securities market,
- To foster self-regulation by market participants, and

-- To create regulatory oversight of the market and its "self-regulatory organizations (SROs)

The Resource Secretariat is a product of HIID and USAID contractors. Specifically, the Harvard Institute for International Development ("HIID") recruited and paid for the salaries of the executive management positions of the secretariat. HIID also coordinated the work of other U.S. contractors, Arthur Anderson, the Barents group of KPMG, Booz-Allen, Deloitte & Touche and Price Waterhouse, and of their subcontractors that created the administrative and organizational component of the Secretariat and implemented various infrastructure projects. USAID funded the Federal Commission and the Resource Secretariat by providing U.S. contractors more than \$15.6 million. Of this amount, USAID official records showed that as of May 1996, HIID has received \$1.7 million.⁸

The Resource Secretariat and its consortium of technical assistance contractors supported the Federal Commission in setting policy, establishing the regulatory and enforcement framework, developing the relationship between government regulation, and the regulatory responsibilities of private industry. The original USAID-funded expatriate Secretariat managers are currently being replaced by Russians, including the appointment of a Russian national to succeed the Executive Director of the Secretariat. However, HIID will continue to fund the Russian employees through December 1996.

In addition to the work performed by the Resource Secretariat, HIID

⁸The \$1.7 million was approved in September 1995 to pay the cost of Russian working for the Resource Secretariat. The amount is understated because it does not include the funding for the executive management positions funded through the HIID's cooperative agreement that ~~the~~ were categorized as policy advice.

assisted the Russian Securities Commission through their Legal Reform Project. Among other efforts, the Legal Reform Project worked on a draft securities law and provided amendments and refinements to the draft. On April 22, 1996, President Yeltsin signed a comprehensive Law "On the Security Market" that established a structure for market regulation by the Security Commission. The concepts of the law and the vision of the capital market regulation contained in the law are a direct result of HIID's support of the Secretariat and RFCSCM. According to HIID, it's work as of June 20, 1996 has resulted in 6 laws and decrees and 19 regulations promulgated in the capital markets area. These included _ laws, __decrees and __regulations were the legal reform project was the principal drafter.

Permanency of Resource Secretariat Uncertain

After December 1996, it is unclear whether the Federal Commission will be able to keep the Secretariat operational. The need for the Secretariat was to have a vehicle to pay market salaries to Russian employees. Under Russian law, salaries to federal employees are capped at levels that are not competitive with the private sector. The Russian National Bank of Ukraine has a waiver from the cap and can pay higher salaries. However, the Commission has been unsuccessful in obtaining a similar waiver. The Executive Director stated that the Resource Secretariat will be needed to coordinate the activities funded by the World Bank loan for \$89 million. As of August 1996, the World Bank had approved the loan but the Russian Ambassador's signature was pending. According to a World Bank official, funding for the Resource Secretariat is included as part of the loan.

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HIID PROJECT MANAGEMENT AND USAID OVERSIGHT

Under the HIID cooperative agreement, HIID had the responsibility

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P. 23

to work with the Commission for its regulatory and infrastructure projects by teaching basic concepts with respect to the regulatory requirements and infrastructure needs, and then participating in project design and implementation by helping to (1) design and execute information gathering task, (2) analyze existing needs, (3) define key concepts for the project, (3) articulate the vision for the projects, and define and execute the projects.

In 1994, HIID with the assistance of a representative of a senior investment office from the International Finance Corporation prepared a memorandum on the Russian capital market. The memorandum presented some of the choices about the structure of the capital market and made recommendations as to the course of action. For example, it recommended that the capital market should be centralized through a combination of self regulatory and a centralized bureaucracy. It also recommended that the market participants should be left to chose the trading system that best meets there needs. The memorandum also discussed shared holding and settlement, shared deposits, and custodial services but did not make any recommendations in these areas.

According to former contractor employees, HIID and the Secretariat did not develop a strategic plan as to how it would overcome the many political and structural obstacles in developing a capital market. As discussed under infrastructure, in some cases the omnibus contractors would generate the concept of a project and seek support from either USAID or HIID before presenting it to the Russian Federal Commission. Moreover, we found no evidence of systematic contractor evaluations and progress reports that discussed problems being encountered and strategies for overcoming them.

In designing projects, it was not clear as to the role of market participants. In the more complicated projects such as the

This deals with the trading plan

clearing and settlement projects, former contractor employees noted that not all stake holders were part of the design process due in part to the competing agendas of other ministries and conflict with the National Bank of ~~Ukraine~~ ^{Russia}.

According to one contractor, neither HIID nor the Director of the Russian Federal Commission had much tolerance for objective criticism. In one case, a contractor expressed concern that it was being asked to perform work outside of the scope of the task order. This contractor had also met with the State Department Coordinator to discussed concerns he had over the capital markets project. According to the former executive director of the Resource Secretariat his actions were interpreted as disloyalty to the Commission. Subsequently, the contractor at the request of the Federal Commission Director, removed the employee and his assistant from the project. The former executive director told the contractor that these employees had performed admirably and indicated to us that the Russians that employees had worked with spoke highly of their assistance.

The relationship between the USAID mission and Washington deteriorated throughout the course of the project. According to the Director of ENI/Privatization and Economic Restructuring, (PER) repeated efforts to visit Russia to monitor and coordinate the Economic Restructuring project were stopped by the mission. Also, in October 1995, she had recommended that her assistant visit Russian as part of the World Bank team. This effort also proved to be unsuccessful. Eventually, the Director of ENI/PER requested that she no longer be held accountable for privatization and economic restructuring work done in Russia.

HIID ACHIEVED MIXED RESULTS IN DEVELOPMENT OF THE RUSSIAN CAPITAL MARKET

USAID described their goals and objectives in a strategic plan entitled United States Assistance and Economic Cooperation Strategy for Russia. This plan was approved by the Coordinator of U.S. Assistance to the New Independent States on February 3, 1995. The text relevant to the capital markets efforts reads as follows:

"Recognizing the vital importance of efficient capital markets for investment, the U.S. will continue to give a high priority to helping Russia build the legal and institutional infrastructure needed to permit stock trading and new stock offerings. U.S. technical assistance is focused on support for an independent regulatory body; independent share registries; clearance and settlement organizations; recognized accounting, reporting, and auditing standards; and ethical codes for corporate officers and dealer/brokers to protect shareholder rights. Most of these efforts will end in late 1996 by which time the necessary laws and institutions will be substantially in place."

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Our assessment of the progress of the capital market infrastructure shows that progress has been uneven in the areas covered in the State Department strategy document. The work pertaining directly to dealers and brokers including development of a Russian trading system is considered a success along with the development of self regulatory organization for market participants. These were rather straight forward efforts that had fewer potential political pitfall than some of the other infrastructure projects. The Clearing and Settlement Organizational(CSO) project was the centerpiece of the infrastructure effort potentially impacted on registrars, dealers and brokers, the central bank, foreign and domestic banks, the tax

police and others has not developed into a working Clearing in Settlement operation. These projects are discussed below and the results should be considered within the context of the previously discussed conditions existing in 1994 as well as the management issues discussed above.

We recognize that a cooperative agreement provided broad and general goals for HIID under the capital market program with the expectation that HIID would provide long term advisors and short term consultants that deal with the formation of the Capital Market/Securities Commission. As discussed above HIID, successfully completed this requirement. In addition, HIID was responsible for impartial oversight of U.S. contractors including the design and vision of projects. The issue is not one of compliance but how effective the use of HIID as an impartial oversight contractor was in achieving USAID goals.

The Trading System Adopted by Dealers

In early 1994, Barents recognized that the market had evolved into a market of dealers (not brokers) buying and selling vouchers. These dealers were beginning to trade shares among themselves by telephone and e-mail. Barents proposed to USAID in December 1993 and the Western staff (Resource Secretariat) of the Security Commission in February 1994 that the market's evolution might best be advanced by organizing dealers in an NSADQ Self Regulatory Organization as an evolutionary step from their chosen current activities in an informal Over The Counter (OTC) market. In mid 1994, Barents, the Federal Commission (Resource Secretariat) and USAID began to create a national electronic OTC market largely patterned on the U.S. market. The task orders for implementing the Russian Trading System (RTC) amounted to approximately \$14 million.

The project covered the operational costs to "jump-start" the trading system. For example, the contract covered the salaries of expatriate advisors that provided technical assistance to self Regulatory Organizations, covered the operational cost of these organizations, provided computers and software along with the training to establish a telecommunications network that connected Moscow brokers and regional brokers to the trading network.

Most importantly, the software introduced by U.S. contractors was modified to address Russian needs using both Western and Russian programmers. The RTS was built on the foundation of the PORTAL system. The PORTAL system was originally developed under the auspices of NASDAQ, not as a trading system, but as an information system designed to track and disseminate information on primarily inactive corporate issues in the U.S. As such, the RTS's primary success (corroborated by the brokers) is in increasing the quality of pricing information.

Currently, over 130 brokers use the system and roughly 40 percent of the over the counter trading in Moscow flows through the RTS. The RTS connects several cities throughout the Russian Federation and there are plans to add more cities in the near future. In early 1996, there were over 100 issues listed on the RTS with 60 issues boasting firm quotes and nearly 40 issues boasting two-sided quotes. Approximately one dozen of these issues are generally viewed as liquid.

The future of the RTC appears favorable. It no longer receives assistance and is operated by the market participants on a self financing basis. The Russian brokers noted one unresolved issue concerning the RTS; ownership of the RTS. They would like to market the system but the issue of ownership needs to be resolved. NASDAQ, USAID, and Russian dealers each can make an ownership claim. Since the system is based on NASDAQ technology, NASDAQ can claim that it

still has rights to the modified system, USAID also can claim ownership because it funded the initial modifications and the Russians can also claim ownership because they funded additional modifications. As of June 1995, USAID has indicated ~~that~~ its willingness to transfer ownership to the Russians as soon as conditions are right.

Development of a Self Regulatory Dealer/Broker Organization.

The success of the RTS initiative served as a springboard for the effort to promote professional associations and self-regulatory organizations for brokers and dealers. According to a Barent's official, Barents based on his experience with the RTC, presented to the State Department Coordinator a proposal to assist in organizing A self regulatory dealer/broker organization. He believed that there was a need for uniform practices and codes of ethical conduct in the Russian market is significant. Without organized discipline, liquidity and costs suffer, and market activity is impeded.

He was successful in obtaining the Coordinators support and then presented his ideas to HIID. According to the contractor, HIID was not very enthusiastic about the proposal but agreed to pass it on to the Director of the Russian Federal Commission. When the Commission supported the project, it was approved for implementation. The contractor met with many dealers and brokers explaining to them the benefits for a self regulatory organizations. The assistance introduced and promoted ethical and modern practices for Russian firms engaging in securities activities.

PAUFOR is the name for the Professional Association of Market Participants. There are currently two organizations bearing the same name, a Moscow-based organization, and the national

organization which is essentially an umbrella organization for the four largest professional associations in Russia. The associations are self-regulatory organizations of market participants that develop governance, fair practice rules, trading rules, and compliance and enforcement procedures to help promote fair and trustworthy markets that earn the confidence of investors in Russia and overseas. The organization has been active for approximately one year.

Market participants, both Russian and foreign, stated that PAUFOR, while still in its infancy, has had a positive effect on market practices and was helping to improve the conditions in Russian capital markets. While the organization is not yet as strong or effective as many would like to see it, market participants were generally quite impressed with the progress to date. PAUFOR is gaining members on a fairly steady basis, and as more and more market participants adhere to the association's codes and practices, it will become increasingly difficult for 'rogue' traders or firms to conduct business in the Russian market.

The future of PAUFOR seems generally favorable. The organization is operating at close to a break-even level and is increasing in membership at a promising rate. Compliance with financial and disclosure requirements is improving and disciplinary measures are being taken against transgressing firms. An area of concern is the viability of the brokers and dealers in the region. Due the concentrated nature of trading activity in Moscow, the brokers and dealers based in the regions are not very active and have difficulty in paying the membership dues that already been lowered to alleviate but may not be enough to continue there participation. PAUFOR is taking measures to assist the regional broker-dealers but the initiatives are not yet mature enough to be assessed. **What are they?**

The strategy memorandum recognized that the performance of shared registrars was one of the most important factors decreasing the liquidity of trading and increased the risk of scandals that would harm investor confidence. The memorandum noted that at the time, GKI had done little to fulfill its obligations to regulate and ensure the performance of the registrars. It noted that shared registrars must be one of the highest priority areas for activity by the Federal Commission.

On _____, USAID approved a task order for Deloitte and Touche to assist in the development of a large issuer registrars. The task order noted that for large insurers (defined as those companies having in excess of 100,000 shareholders) the challenge of obtaining quality services from an independent registrar is considerably greater than for smaller companies.

Large issuers presented particular problems in the areas of shareholders communications, exercise of voting rights, dividend payments, rights offerings, and other shareholder entitlement. Furthermore, large issuers will often have their shares broadly distributed across a number of regions, with transfers occurring in more than one principal location, introducing significant organizational, processing and even legal and regulatory questions to resolve such as the role of sub-registrars and multiple transfer agents.

The specific goal of the task order was (1) to play a catalytic role in stimulating the creation of one or more third-parity registrars capable of providing quality services, on an interregional basis to large issuers, and (2) provide guidance to the registrar industry to provide legal, regulatory and operational issues concerning such areas as shareholders entitlement and

distributed share transfer processing.

The contractor successfully met the terms of the task order by providing technical services to The National Registry Company (NRC), a large-issue shareholders' registry designed to conform to international standards for registry activities. The NRC is a closed joint stock company that was initially capitalized at \$10 million. The Bank of New York International Stock Registry Corporation, Nikoill Investment Company, Uneximbank, the International Finance Corporation, and the European Bank for Reconstruction and Development each provided \$2 million in capital.

The concept behind the NRC was that Russian companies seeking foreign capital would be compelled to use NRC or a similar registrar. A centerpiece of the proposal, was the participation of very large and visible Russian companies such as Lukoil, that would serve as examples of significant companies willing to place their registrars in the new company. This would have induced other companies to move their registries to the new, or similar registrars.

The NRC effort can not yet be called a success. The centerpiece of the initial project, Lukoil, backed out of the arrangement at the last minute asking that the move of their registry be postponed until certain matters had been concluded. This, among other factors, has led to a certain amount of skepticism on the part of market participants concerning the viability of the exemplar share of the concept. While they do not doubt that the registrar itself will be a responsible and good organization, market participants do not believe that other registrars will voluntarily adopt more stringent measures and modern practices. The fact that Lukoil backed out of the arrangement also lowered hopes in the broker community and gave the appearance, at least to some participants, that the project did not have the momentum necessary to succeed.

While certain decrees and regulations have been passed in an attempt to improve industry-wide registrar practices, many companies such as Lukoil have gotten around these measures by setting up "pocket" registrars, i.e. registrars that they control. This has proven to be a major impediment to secondary trading. Management is often able to use its relationship with the "pocket" registrars to get them to refuse to record changes in ownership of shares to lessen outsider participation in the firm.

Efforts to Develop CSO's Are Disappointing.

In mid 1993, Barents and Deloitte began projects to create five CSO's. By late 1994, Deloitte completed the organization of CSO's in Moscow, Ekaterinburg, and Novosibirsk, and Barents had done the same in St. Petersburg and Vladivostok.⁹ Each CSO evolved from an existing stock exchange and was owned and controlled by the exchange and the market participant. However, as of mid 1996, only the Vladivostok stock exchange was active but trading was limited to 30 transactions a day and the Moscow Depository Clearing Corporation (DCC) was disintegrating. The price tag for this effort was \$14 million. The unsuccessful development of CSO's occurred despite the general belief by market participants for a need for a central Depository. Our work focused on analyzing development of the Moscow DCC.

USAID, HIID, U.S. contractors, and market participants cited a number of reasons for the disappointing outcome of the CSOs including political power struggles, market conditions, and tax laws. While there is some basis for each of these factors, HIID also bears some of the responsibility for not developing an effective strategy to overcome these problems.

⁹ The Vladivostok CSO was already operational before HIID began implementation of the project.

HIID, through its support of the Resource Secretariat, took an active role in the design and implementation of the DCC. The Resource Secretariat's executive manager, an HIID employee, devoted considerable time towards the implementation of the DCC. Moreover, HIID paid the salary of DCC's ~~first~~ ^{supervising} President, an American that had successfully worked on the voucher privatization program. U.S contractors identified potential institutions in which it would work with to develop CSOs, determined the level of assistance required and developed a work plan, provided financial support to these institutions to cover operating expenses, provided policy and organizational advice, and trained staff to perform the activities required of a self regulatory organization.

Operating Without CSO's

The lack of an organized, controlled environment for trading has been a huge obstacle to the development of a secondary market in Russia. For example, because of the way share ownership is handled in Russia, brokers must often physically travel to a company's registrar in order to ensure that the change in ownership of shares is entered in the books correctly.

Brokers then have the option of carrying suitcases full of cash to close the deal, or transferring money through the banking system, which could take weeks or even months, all the while exposing the broker to additional risk. Such as the risk that in the interim, the price of the shares he bought have fallen or in the case of a price increase, that the seller decides to back out of the deal.

A functioning clearing and settlement organization (CSO) avoids these problems by establishing an efficient and reliable system for book-entry settlement of securities trades. The CSO reduces the time and expense of trading by avoiding the necessity of making contact and arrangements with every party to every trade agreed to

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by a broker and dealer. The CSO also provides a controlled environment (which can be directly monitored by market participants) within which these transactions are consummated thereby reducing the risk to both the buyer and the seller.

The original concept was to establish an organization to provide reliable and efficient depository, clearing, and settlement services. As a depository DCC would hold the shares in either nominee name or in the name of the owner.¹⁰ As a CSO, ~~the DCC~~ the DCC would settle transactions ~~on~~ either a delivery versus payment basis or a free delivery basis.¹¹

The establishment of clearance and settlement organizations was a high priority of the RFCSCM. Among other the considerations were geographic diversity demographic pragmatism, and a desire to promote projects at the local level to garner the strongest support possible.

Market Conditions Reduced the Demand for CSO's

According to HIID, DCC had not fulfilled its promise because the market was not ready for such organizations. In 1994, the dealers in Moscow and to a lesser extent in St. Petersburg were buying and selling shares mainly to accumulate share packages for large buyers. The dominant force in the 1994 market was foreign buyers purchasing through Credit Suisse First Boston (CSFB). The Moscow dealers were feeding CSFB shares they brought from small regional

¹⁰ If securities are held in nominee name DCC is the owner of record on the Company registrar and DCC maintains the records of individual ownership

¹¹ A delivery versus payment basis is when there is a simultaneous transfer of book-entry securities and cash occurs between the accounts of the buyer and the seller. A free delivery basis is when the book-~~entry~~ securities are transferred between the accounts of the buyer and seller without the movement of cash.

dealers.

By Mid 1995, foreign interest in Russian shares declined and market activity centered around the consolidation process for domestic buyers. In these cases, dealers were buying from small customers and selling to larger customers, usually Russian enterprises, banks, and voucher funds. These activities did not create a settlement between dealers. Moreover, high inflation and political uncertainty continued to reduced the demand for shares to a few dozen large well known companies, mainly traded by 20 or 30 Moscow dealers. Because the Federal Commission goal to keep the five CSO's alive as part of the needed infrastructure, USAID continued to funnel funds to the CSO's through U.S. contractors.

Taxes and Registrar fees

Discourage Foreign Investors Use of CSO's

Foreign Banks and other market participants stated that even if the DCC had the capacity to settle trades, it would not be in there interest to trade using domestic organizations because of the current tax structure. Russian law makes no distinctions between beneficial (the investor) and nominee (generally the custodian) holders in offshore custody arrangements. This creates uncertainty as to whether the investor or the nominee will be required to pay taxes.

According to a former contractor official, the Russian tax inspectorate had a legitimate concern about the resolution of nominee tax issue but was never consulted by HIID. The tax inspectorate opposed the nominee concept. With regard to the issue of nominee, one contractor noted that in late 1993 the long awaited decree on nominee ownership was published but without elaboration and specificity that might have created confidence among investors and market participants.

The amount of taxes on domestic transaction also works against the goal of getting foreign companies to trade through domestic CSO's. If a foreign company sells property in Russia, (for example, shares) it is liable for a 20 percent withholding tax on the profits. (Capital gains are taxed as ordinary income in Russia, at a rate of 35-38 percent.) Market participants stated they had not paid taxes on Russian trades going through offshore trading companies.

International Bankers also stated that to transfer their current holdings to the DCC was currently not in their clients interest. Although they are DCC board members, they explained that to move the shares that are currently ~~have~~ under their custodial care would require that the shares to be registered in the nominee ownership of the DCC. This would incur a significant registration fee. The president of the DCC stated that the Banks were making money on acting as depositories and were therefore not interested in using the DCC as a depository.

Politics Results in the Loss of Investor
Confidence in the DCC

According to HIID, U.S. contractors, and market participants politics has been a driving force in the history of clearing and settlement and has contributed to the disintegration of the DCC. The early history of the project was affected by the political struggle between the National Bank of ~~Ukraine~~ ^{Russia} and the Federal Commission and triggered the decision to set-up independent regional CSO's.

In 1994, the task order directed the contractors to attempt to obtain some level of commitment and input from the National Bank ~~of Ukraine~~ of Russia on the general concept and legal, regulatory, and operational analysis. The task order recognized that a key step in

the intra and inter-regional funds movement was to obtain the cooperation of the National Bank of ~~Ukraine~~^{Russia}.

Unfortunately, the National Bank of ~~Ukraine~~^{Russia} and the Federal Commission did not have a good relationship until early 1996. At one point the National Bank of Ukraine called for the resignation of the Director of the Federal Commission after it had published a report critical of the Bank's management of the government bond market. This political fight became public as accusations were made by the National Bank of ~~Ukraine~~^{Russia} in the Russian Press.

This dispute directly effected the development of the DCC. For example, Dcc could not obtain a general banking license from the National Bank of ~~Ukraine~~^{Russia}, and for a long time did not secure a bank or other financial institution with such a license. At one point, HIID brought a high priced consultant that came up with a scheme to do settlement off shore for the DCC. This scheme went nowhere. By June 1996, relationships between the National Bank of ~~Ukraine~~^{Russia} and the Commission had improved but not to the point where the Bank fully supported the DCC.

A direct threat to the future of the DCC has been the election of its second President of the DCC in October 1995. The first president, who was being paid from HIID funds, resigned when the fact that she was an American became an issue. The new president was put forth by the head of the GPU, the organization that supported HIID's legal reform program. The President's legal advisor told us that he was concerned with the direction of the DCC and opposed all forms of monopolistic practices. Interestingly, The DCC concept is one of a natural monopoly as it becomes more efficient as a larger share of the equity market is held in nominee ownership. Also, he had heard that DCC had some related tax problems.

According to the DCC president, complicated legal problems have brought into question the survivability of DCC. An audit report concluded that the DCC is liable for significant taxes and penalties because of erroneous treatment of capital infusion it received when the Banks became shareholders. He blamed the past administration for these errors. The director was attempting to form a new organization to replace DCC. However, this would require new capital contributions and it was doubtful that USAID would allow the new organization to use ~~equipment~~

According to one contractor the installation of the government bureaucrat as the president of what they thought was there own organization had substantially diminished their support for the DCC. As of June 1996, DCC was not operating as either a depository or a clearing and settlement organization but was generating revenue by providing registration services.

CHAPTER 4

THE COMMERCIAL LAW PROJECT HAS PARTIALLY MET ITS GOALS

Under the Legal Reform Project, HIID has drafted, or assisted in drafting, key pieces of legislation that have become law. However, the USAID/HIID strategy of relying on Executive Branch and Duma¹² working groups has not overcome a political environment hostile to legal reform. As a result, much of the legislation drafted by HIID has not been enacted or even submitted for consideration by the Duma. In the face of strong opposition, HIID, working with the President's Legal Office (GPU), bypassed the Duma by issuing the legislation as decrees. In the process, HIID also helped the GPU become the legal reform czar in Russia. HIID also assisted the Director of the Russian Securities and Exchange Commission develop an independent regulatory body, the Federal Commission, by drafting enabling decrees, legislation, and regulations. HIID also played a critical role in the creation of a Russian Institution, the Institute for Law Based Economy (ILBE), to carry out the legal reform project after USAID ends its assistance. Lastly, HIID helped the Government of Russia obtain a major legal reform loan from the World Bank.

HIID's approach to legal reform generated controversy within USAID. Officials from the rule of law project noted that most of HIID's work has been accomplished through decrees, which undermined the democratic processes envisioned by the project. They pointed out that HIID's success was dependent upon GPU and its ability to bypass the legislative process through decrees. They disagreed with HIID's strategy premised on supporting only "like minded"

¹²The Duma is the lower house of the Russian Parliament; the Federation Council is the upper house.

reformers, and cutting non-believers out of the legal reform process.

USAID management did not incorporate the goal to pass reform legislation into HIID's agreement or work plan, placed minimal demands on HIID reporting, and Washington program managers were restricted from making field visits. HIID did not meet all its reporting requirements, and it was difficult to determine HIID accomplishments from their progress reports. USAID avoided incorporating performance measurements into the project, and did not to submit include HIID information into the USAID monitoring system used to assess project effectiveness. ~~Most USAID officials could not provide specific examples of HIID's accomplishments.~~

STATE DEPARTMENT AND USAID GOALS FOR LEGAL REFORM PROJECT IS TO PASS LEGISLATION

The Department of State's 1995 Strategic Plan stated that

"Legal and regulatory reform will continue to receive a high U.S. priority in U.S. assistance programs because of its importance for creating a hospitable environment for successful market development. Legal advisors will continue to provide technical assistance and training to counterparts in the Office of the President, the Parliament, and the Center for Private Law Reform to support the drafting of specific laws and enforcement mechanisms, based on the recently enacted civil code. Activities will focus on areas essential for the development of a strong private economy such as demonopolization, real estate sales, securities market regulation and banking supervision. Passage of specific laws in these areas by late 1996 will be the benchmark of success."

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the legal reform project's justification emphasized the need to

pass critical reform legislation and to improve coordination between the Executive Branch and the Duma. In December 1993, USAID/Moscow received a request from the State Legal Administration (GPU) of the Russian Office of President for assistance in the implementation of a critical and ambitious program of legal reform. This request was a direct outgrowth of HIID's ongoing program of assistance in the area of privatization and HIID's solid working relationship with the Russian Privatization Ministry (GKI) and GPU. The GPU was the primary legal counsel to the President. GPU was thus instrumental both in advancing the President's legal agenda and influencing the President's judgement on whether or not to accept laws passed by the Duma.

Shortly after the receipt of the GPU proposal, the Embassy and USAID/Moscow received a request from Sergei Glaziev, chairman of the Duma Economic Policy Committee for a major program of technical assistance to the Duma on the drafting of legislation. USAID/Moscow expressed two concerns: (1) the U.S. Government could become entangled in domestic political issues if the legal assistance effort appeared to favor either the Duma or the GPU; and (2) the implementation of the assistance activity would be hindered if the Duma and the GPU endorsed contradictory approaches to law drafting in the same areas. It was also strongly believed that the U.S. should provide support, if at all possible, to both the legislative and executive branches to the Russian Government. USAID and the State Department strongly believed that U.S. Government support in the drafting of legislation should be provided only in areas in which the two branches agreed to a collaborative approach, using either joint drafting teams or under agreement between the Duma and GPU that one or the other body would take the lead in certain areas.

do we need to raise concerns ahead of time

The conditions under which USAID was prepared to provide support

were discussed with the GPU head and key Duma committee chairmen in separate meetings in Moscow in April, 1994. USAID was informed on May 7, 1994 that GPU and the Duma had reached agreement to establish a coordinating committee for law drafting, chaired by the head of the GPU, Ruslan Orekhov, and composed of representatives from the GPU, the Duma and the Federation Council (the upper house of the Parliament). The Mission later received a letter signed by Ivan Ruybkin, Speaker of the Duma, and GPU's Orekhov, confirming the establishment of the coordinating committee and requesting U.S. assistance in the form of expert advice, foreign legal literature, translation services, and training in support of the committee.

The above information was contained in USAID's June 3, 1994 action memorandum providing the justification for a non-competitive award to HIID. The memorandum further stated that

"It is critical that we respond quickly in support of these extremely positive developments. Should these collaborative efforts prove unworkable, the introduction of badly needed new legislation could be greatly accelerated and, more importantly, a new pattern for executive-legislative cooperation in advancing reform legislation could emerge, around which the consensus necessary to adopt and implement the new laws could be built. Both the Duma and the Yeltsin Administration have an extremely ambitious law drafting agenda: the Duma with a list of close to 120 priority pieces of legislation. Both bodies see a critical need to move forward immediately. Should this cooperative effort not succeed, the result could be the parties polarizing into opposing camps, with no real progress on law reform until after the 1996 elections, if then. The urgency of providing the support in these circumstances does not permit what could be an extended competitive process to select an implementing agency."

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"The program is being funded for a period of two years since this is the minimum timeframe required to implement such complex and significant legal reforms. As mentioned above, the Duma and Yeltsin Administration together have some 174 priority pieces of new legislation. It is critical that USAID show strong support for this program through a long term commitment. We anticipate that any additional work beyond the extended completion date will be competed..."

HIID ACHIEVES THE REQUIREMENTS OF THE WORK PLAN

On November 8, 1994, 3 months after the legal reform project was authorized, HIID submitted a work plan for the next six months. Based on the work plan HIID would:

- provide commentary, expert advice, and drafting assistance on 19 pieces of legislation (see appendix I for status of these laws)
- establish a core group of long-term resident advisors and short-term Western experts who would be available to assist the working groups preparing draft legislation,
- develop an institutional structure for continued legal reform work after USAID funding ended and
- promote closer coordination between the Executive Branch and the Duma.

HIID Provided Advice On Legislation.

As of June 1996, the Legal Reform Project identified the passage of five laws related to the 19 areas of legislation identified by the Coordinating Committee in 1994. These laws were the (1) Law on

*See finding note
p. 44
9 pieces of
legislation*

Joint Stock Companies, (2) the Law on Securities, (3) Law on Advertisements (4) the Law on Holding Companies and Financial Industrial Groups, and, (5) the Federal Law on Non-Commercial Organizations.

HIID had begun work on the first two laws one year before the start of the Legal Reform Project, and was not the principle drafter on the last three laws. USAID funded work on the first two laws in April 1993 as part of HIID's Russian privatization effort. These two laws were enacted in December 1995 and April 1996 respectively. HIID was the principle drafter of these laws, co-drafted the third law, and participated in the drafting of the last two laws. The USAID/Moscow Mission Director, ILBE Director, HIID/Moscow's General Manager, the former Project Director, the GPU Director, and members of the 1994 Coordinating Committee, all approved of HIID's performance, and offered several explanations as to why more laws were not passed.

According to HIID, the legal reform project worked in the following way. Typically, ILBE developed or assisted in the development of concept papers that outlined the relevant issues to be addressed in a particular subject of legislation and how the legislation should be dealt with in the Duma. This required lengthy consultations with foreign experts and extensive meetings within the relevant government ministries, Duma Committees, working groups and the private sector. Once a consensus had developed, the legislation would be introduced to the Duma and the legislative process would begin. The first hurdle was to get the Duma to approve the first reading of the draft law. The draft legislation would then go through a process described as a "black hole", where it would be revised and amended through two more readings. If passed by the Duma, it would be sent to the Federation Council (the upper house of the parliament), and if passed, would be sent to the President's Office for consideration. There is no official record or formal reporting on this legislative process.

This explains what HIID did why they did it

*We don't
need this
to make our point?*

The USAID/Moscow Director said that, at the onset of the program, he expected that more laws listed in the work plan would be passed by the end of 1996. USAID did not anticipate the Communist would win the December 1995 Duma elections, or that work on legal reform would slow during the build-up to the June 1996 Presidential elections. According to the ILBE Director, the 19 laws contained in the work plan were viewed as the most elementary laws needed for the first stage of a market economy. In addition to the five enacted laws, a number of others have been introduced into the Duma for consideration. These included laws on taxes, land, mortgages, and bankruptcy. (See appendix 11 for a listing of law and decrees that HIID has worked on)

The HIID General Manager in Moscow said that the Duma has been a very difficult place to work, and that it was amazing that anything got done. He said that had the Duma been more productive, Russia would have a firmer legal basis for a market economy, and that it would be based on laws rather than decrees. But he said that in regard to getting the market to work, the Russians had done a good job getting the needed things in place either by law or decree. He said the Duma has been opposed to market reform in general, and many member didn't understand the need for a market-based approach.

According to the former HIID Project Manager in Moscow, HIID was too optimistic about the number of laws that could be passed within two years. She said that they now know it takes about 2 years to pass a law in Russia. She said the number of laws listed in the work plan indicates how overly optimistic the project was, and that they were wrong to think they could pass this number of laws. Despite the time it takes to pass laws in Russia, she said that HIID's input resulted in more reform-oriented laws than if there had been rapid implementation of many laws. She also said that factors within the Duma slowed legal reform. The Duma was new, did not know how to work as a legislative machine, had to develop an agenda to follow, spent

most of the year trying to pass a budget, was distracted by the Chechnya crisis, and lacked such basic systems as a data base for members to identify what bills had been introduced, their status, or their location within various committees.

The GPU Director said the pace of legal reform was as good as it could be. He said his employees work overtime and weekends on drafting laws, and that his foreign advisors, such as HIID, could collapse due to the work's pace. He said that HIID, ILBE, and others, developed many draft laws that could not be adopted due to disagreements with the Duma. He said that some drafts were "waiting for their time", and while concerned with the pace of legislation, he said the country shouldn't hurry unnecessarily. For example, he said it took almost 5 years of effort to pass the Law on Securities. He said it took the GPU and others one year to convince the Duma and the Office of the Presidency that the securities market needed a regulatory agency, and three more years to convince them it needed real power to regulate the market. He said that now everyone considers the RSEC a normal part of the market. He said that many in the Office of the Presidency, the Government, the Parliament, and the public, often don't understand the need for specific laws at first, and that, as a result, the politics for passing a good law was always bad.

The Coordinating Committee members had varying recollections of HIID's input to the legislative process. One member, now the head of the law department for the Duma, remembered the presence of HIID lawyers during drafting of the Joint Stock Company Law and the Civil Code. However, he was unable to remember which of the thousands of amendments offered from many participants came from HIID staff. Another member, now the Chairman of the Committee for Property, Privatization and Economic Activity in the Duma, was actively involved in the passage of the Joint Stock Company Law. At that time, there were 3 versions of the law and none were acceptable to

the Duma. He said that HIID was able, over the course of several months, to craft a draft acceptable to the Duma. He said that HIID lawyers had great expertise, and were highly qualified and skilled, and that HIID provided the organizational and financial support needed. He said HIID worked with the Coordinating Committee in the finalization of the draft, which was signed into law by the President in December 1995. He said HIID was also an active participant in other draft laws, such as the laws on public utilities, bankruptcy, and administration and management of federal properties. (see appendix 11 for further details on HIID law and decree participation)

we need to give HIID credit

HIID Assisted the Coordinating Committee and Initiated ILBE

HIID set-up the Legal Reform Project and hired a team of about 40 Russian lawyers to initiate support of the Coordinating Committee. According to the HIID/Moscow's General Manager, these specialists included Russian lawyers, economists, and accountants experienced in Western commercial law. HIID also brought in Western experts to assist on short-term assignments to assist on specific laws. The long-term Russians hires were assigned to 9 working groups that covered various subjects, such as Financial Instruments, Legal Entities, Taxation and Accounting, and Land and Real Estate. These working groups corresponded to the working groups set up by the Coordinating Committee in the Duma. In addition, HIID hired an additional 42 consultants that worked directly for the Coordinating Committee's working groups in the Duma. While HIID paid these consultants, they were selected by the Coordinating Committee. For the first year of the program, HIID did not collect resumes from these consultants, but has begun recently to collect evidence of their qualifications.

Because it was not politically acceptable for HIID or other foreign organizations to be directly involved with the Russian legislative

process, Russian officials and HIID proposed the establishment of ILBE. ILBE provided the legislative drafting a way to "Russify" the project: a Russian organizational structure, staffed with Russian specialists, interacted with Russians involved in the legislative process. Russian specialists on commercial law development, who had been working on privatization and the Legal Reform Project, staffed ILBE. Thus ILBE, not HIID, did most of the substantive work for the Legal Reform Project.

In April 1995, HIID formally chartered the Institute for Law Based Economy (ILBE) as a non-profit organization. ILBE is made up of the roughly 40 Russian lawyers employed by ILBE that are mostly paid through its cooperative agreement with USAID. Its charter and operations reflect HIID's methods of using resident experts supplemented by short term experts to assist in the development of commercial laws. Though currently 80 percent dependent on USAID funding, HIID and USAID representatives are optimistic about ILBE's long-term sustainability as USAID assistance is completed in early 1997.

According to HIID's General Manager, ILBE has established itself as the leading Russian group with expertise in commercial law development and has a very high reputation with the range of Russian interests. This was supported by a wide range of people involved in legal reform. For example, the World Bank representative who has worked with ILBE staff, another USAID contractor who worked with ILBE drafting land reform legislation, and a private Russian lawyer who worked with ILBE lawyers, all endorsed the competence of the ILBE staff.

The World Bank is likely to play a critical role in determining the sustainability of ILBE. The World Bank plans to provide ILBE funding in the securities area from its capital markets loan. For the World Bank's legal reform loan, ILBE will be able to compete for work on

specific laws the Bank and the Russian Government have agreed to work on. Bank officials believe that ILBE should be competitive for these laws because of ILBE's unique blend of Russian nationals with expertise in Western commercial law.

Closer Executive/Duma Cooperation

The establishment of Coordinating Committee was a major achievement in terms of improving the cooperation between both branches and in rationalizing the legislative process. Before the project, Duma committees had no staff or resources to help develop, evaluate, or consolidate various legislative drafts. Officials we spoke with on the Committee praised the input of HIID's work for the Coordinating Committee and the usefulness of the working groups. However, some USAID officials and the Head of The Duma Legal Department voiced concern over the Executives Branch use of decrees to by-pass the legislative process.

A World Bank representative said that the Coordinating Committee created an unprecedented mechanism to coordinate and help create consensus on legal drafting between the Office of the President, the Duma, and the Russian Government Ministries. She said that this contrasted with the Bank's experience of working in Russia, which faced great difficulty in that its advice was rarely reflected in laws or decrees. For example, she said that if the Bank talked to one ministry about the need for a law on oil production sharing, the ministry would never agree on the need to get action on the legal framework or the regulatory structure. She also said that there was no coordination between ministries with overlapping jurisdiction. She said that the Coordinating Committee helped bring the ministries together.

A member of the first Coordinating Committee, now the Chairman of the Committee for Property, Privatization and Economic Activity in the

This is one of weak laws of federal level. Can we eliminate decrees?

Duma, said that the creation of the Coordinating Committee was an important achievement. In January 1994, before the advent of the Coordinating Committee, the Duma had no council with any expertise in commercial laws. The Duma needed the most qualified people who could put on paper commercial laws. He said that the Coordinating Committee gave them this solution. He said that, in the beginning, there was great pessimism about the outcome of the Coordinating Committee, but after 2 years of existence, the results far exceeded their expectations. He said however, that the Communist victory in the December 1995 elections, has slowed passage of commercial laws. The Head of the Duma Legal Department stated that the Executive's branches use of decrees continues to be a negative pattern by-passing the legislative process (see page___ for ILBE's increased dependency on decrees)

The sustainability of the Coordinating Committee and its working groups is doubtful. The Coordinating Committee was developed as a condition of USAID funding and the Coordinating Committee has not been institutionalized. While the World Bank has indicated to the President's Administration that it supports the continued existence of the Coordinating Committee, the World Bank cannot financially support the Coordinating Committee because of its charter restrictions against funding parliamentary activities. This restriction will also prevent the World Bank from funding the working groups that now support the Coordinating Committee and the Duma.

HIID CONTRACTED WITH RDI TO DEVELOP LAND-REFORM LEGISLATION

Russia's lack of a clear legislative and regulatory framework for the ownership, registration, and use of land has constrained economic growth, inhibited domestic and foreign investment, and slowed the transition to a market-oriented system. To help address these concerns, in October 1993, HIID subcontracted the Rural Development

Institute¹³ (RDI) to work on land-reform legislation issues in Russia. The political environment for land reform in Russia has not been conducive to major reform and RDI's major accomplishment has been to support the reversal of a Presidential decree that was counter producter to farm reorganization.

RDI's work in Russia had actually started in the fall of 1990 when it was invited by the government to look at the issues related to decollectivization of farms. Between 1990 and 1993, RDI's influence was in establishing contacts and educating people on the issues regarding land ownership and buyer/seller transactions. After becoming affiliated with HIID, RDI continued to provide policy and legal advice on land privatization and land-market development to Russian policymakers. RDI, has cooperated with ILBE in drafting and reviewing drafts of legislation that clarified land-related functions such as registration, mortgages, and zoning and in acting as advocates for adoption of land-reform legislation.

RDI Contributed to Both Federal and Local Statutes

RDI preferred to work on the federal level when possible, but also worked with local jurisdictions when there was an opportunity for creation of models for land privatization and land market creation. Russian law recognizes joint authority for legislation, and if there is no federal statute, oblasts can adopt their own measures. RDI said that in some instances it prepared draft legislation to have ready to promote when the time was right. While private ownership of land was allowed under the 1993 constitution, it had not been widely implemented due to an absence of implementing legislation. RDI's

¹³RDI is loosely affiliated with the University of Washington Law School and has been in existence for 29 years. It has worked in 26 countries overall, 10 of which had been centrally planned. RDI's subcontracts with HIID have totaled about \$3 million.

work included regulations that specified land-transaction documents and forms, to assist in developing the implementing mechanisms.

RDI characterized its most significant accomplishments as its contributions to two presidential land-reform decrees. One in 1993 that laid the groundwork for transformation of rural and urban land ownership and agricultural reform and a 1996 decree that provided individuals who rented small plots could obtain full ownership rights to this land. The draft provided for private ownership of land plots, but missed some features including some regarding mortgages, which RDI added.

In 1994, ILBE lawyers worked on a Duma working group to help draft a federal land code that would be a comprehensive codification of land-reform statutes. RDI participated in the effort by reviewing drafts of this legislation. But this effort has not produced a workable document. The version of the land code that was adopted by the State DUMA in May 1996 was so regressive after being transformed by other reviewers that RDI and ILBE no longer supported it. This unacceptable land code could be a severe constrain on private land rights in both urban and rural sectors. President Yeltsin had indicated that he would veto the present land code if it is submitted for his signature. After trying to work with the present Duma, RDI has predicted that the President will have to continue to exercise decree powers in order to pass land-reform measures.

In 1995, RDI was instrumental in calling attention through newspaper articles and meeting with USG officials to a section of a presidential decree prepared by another donor organization that RDI assessed could have sabotaged land reform in Russia and was counter to the sum of land reforms passed prior to this. About one year later, according to RDI, this decree was rescinded through its efforts. RDI said that in addition to commenting and adding to draft land reform legislation, it also plays a role in reviewing ideas of

GOR officials on land reform and helping identify unworkable ideas before they gain much support.

RDI's workplan with HIID for 1996 identified 9 potential areas for development of federal land-reform legislation. RDI said 1 piece of legislation on which it had worked was being considered by the Duma, in 3 areas it had reviewed drafts of laws, 4 areas were not likely to be addressed in 1996, and 1 area relating to real estate taxation would be considered by the HIID tax group. The workplan recognized that often regional and local government leadership was more progressive than at the federal level, and set expectations for RDI to work on development of laws and other initiatives to develop regional or municipal legislation that reflect laws it is promoting on the federal level. The RDI workplan lists two areas for its regional focus, and RDI reported that it worked on regional measures promoting land privatization but that it did not work on legislation for privatization of urban commercial land this year due to unanticipated work on other legislation. The staffmember based in Moscow said he thought that there might still be an opportunity to do this work later in the year. The workplan also lists two expectations in the area of farm restructuring and RDI reported that its work on several decrees helped address both expectations by defining expanded rights for holders of agricultural land shares. RDI reported that it worked on drafts of legislation for several oblasts that enabled land transactions and prescribed forms.

HIID EFFORTS SUPPORT THE WORLD BANK LEGAL REFORM LOAN

Although not part of the HIID work plan, HIID played a critical role in assisting the GPU to secure a \$56 million World Bank legal reform loan. The loan could have long-term ramifications and may possibly help fund ILBE activities after USAID funding ends.

At the request of the Coordinating Committee, 3 people from the Legal

Reform Project worked with the Committee, the President's Office, and senior officials in the Russian Government to develop proposals for the design and financing of a large scale legal reform project financed by the World Bank. This group developed concept papers, developed and obtained the adoption of a Presidential Edict that authorized the government to borrow from international organizations to support legal reform, and drafted a Presidential Regulation that called for almost 40 different organizational measures necessary to adopt large scale legal reform.

According to HIID records, the idea of promoting a "loan for legal reform" was conceived by the staff of the Legal Reform Project. It prepared background papers for Russian Government officials whose approval was a prerequisite for the borrowing of funds, and the Legal Reform Project carried out many discussions and negotiations to build support for the loan in the Duma, the executive branch, judiciary, and other organizations. It worked closely with the GPU Director to design the legal reform loan, to identify the highest priority components for loan financing, and advised the executive branch on its negotiations with the World Bank.

A World Bank official told us that HIID played a significant role in the Bank's decision to go forward with a legislative drafting component to the loan. She said that HIID's work in legal drafting gave the World Bank confidence to include legislative drafting in their program. She cited HIID's work on the Law on Joint Stock Companies, and its Capital Markets legislation and regulations. She said that HIID demonstrated that assistance in legal drafting, if done at the right time, could significantly improve the quality of legislation. She said passage of the Law on Joint Stock Companies, which was very progressive, reform-oriented legislation, was "amazing" given the number of anti-reformers in the Duma.

HIID's STRATEGY GENERATES CONTROVERSY WITHIN USAID

HIID approach was to support the Presidents legal advisor and to respond to his request for his assistance including the use of decrees. The HIID strategy conflicted with the position taken by USAID/ENI's Office of Democracy and Governance. The controversy concerned the HIID's close relationship with the GPU, it's willingness to increasingly rely on decrees rather than laws, and efforts to keep democracy office officials from making field visits and participating in discussions with the World Bank.

Most of USAID's legal reform work in Russia was managed by USAID/ENI's Office of Democracy and Governance in Washington, D.C. The democracy office was responsible for rule-of-law reform efforts, including legal drafting, jury-trial, judicial reform, commercial law reform (through another contractor), law school programs, reform of the criminal justice system, and parliamentary development. The mission and the democracy office each funded different offices with the Russian Office of the Presidency involved with drafting commercial legislation. The democracy group began providing assistance to the Research Center for Private Law, and the mission began funding the GPU effort.

The democracy office began the commercial law drafting program in August 1993 to support the Research Center's efforts to develop the civil code. The civil code was considered the next critical step, after the Constitution, to move Russia toward economic reform because it forms the basis for all subsequent commercial legislation. President Yeltsin had decreed that the Research Center would be the office responsible for drafting the code.

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¹⁴ USAID provided \$890,000 to the University of Maryland's Center for Institutional Reform and the Informal Sector (IRIS) to support the Research Center's efforts. The Russian Duma passed Part I of the Civil Code in December 1994, and Part II of the landmark legislation was signed by the President in January 1995.

HIID and the GPU opposed portions of Part I of the Civil Code (see chapter two for additional information on the Research Center), believing that officials within the Research Center were not adequately reform-oriented. At GPU's request, and before USAID approved HIID's Legal Reform Project, HIID began an effort to develop a competing version of Part I of the Civil Code. USAID had not approved funding for the development of a competing draft, which was later rejected by the Office of the President.¹⁵

In April 1995, the Democracy group raised the following concerns about HIID's approach. (1) It was very centralized and top-down. (2) Their success was dependent upon working with GPU on the basis that it was the legal reform czar, (3) HIID's notion that Russian legal reformers were not able to grasp repeated "advice"--even after several discussions--ran counter to the democracy group's experience and was inconsistent with the Russian's professional reputation and the legal and economic training. Rather, it would appear that the better explanation for the Russians to refuse to amend a proposed law was that there was not enough political will to do so at that time, or that they just disagreed with HIID's position. (4) HIID's strategy premised on supporting "like-minded reformers" and cutting out "non-believers" from the drafting process failed to accept the political reality that the process for making policy and laws was much more democratic and complex than during the privatization "decree spree".

Legal Reform Project Relied Increasingly On Decrees

While USAID's action memorandum and HIID's first year work plans do

¹⁵ Eventually, HIID used \$500,000 from the Legal Reform Project to cover the cost of foreign experts and Russian lawyers involved in this failed effort. By contrast, IRIS's efforts, which made significant contributions to Part I, cost \$559,000.

not discuss the issuance of decrees, much of HIID's work has resulted in decrees as opposed to laws. According to HIID, anti-reformers in the Duma or Ministries could stall or kill reform legislation through outright objection, proposing anti-reform amendments, or using delaying tactics. HIID believed that this had been the case with many pieces of reform legislation. They identified (1) banking and payments legislation, where the National Bank of ~~Ukraine~~ ^{Russia} had been an impediment; (2) bankruptcy legislation, where the Federal Bankruptcy Agency had not wanted any such legislation passed and the many state-owned enterprises that were technically bankrupt opposed the legislation; and, (3) tax legislation, where the Ministry of Finance and the Tax Police, for a variety of reasons, opposed serious tax reform. Although the Legal Reform Project had prepared draft legislation in these and other areas, it increasingly relied on Presidential Decrees because of the political opposition to reform legislation.

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Presidential decrees bypass the Duma but are legally binding unless they contradict pre-existing laws. The use of decrees is opposed by some USAID offices because they subvert the democratic processes called for in the action memorandum. In effect, the decree process by-passes the Coordinating Committee and the Duma, does not engender the democratic traditions of compromise and consensus, and is reflective of the Communist legacy, which used decrees rather than laws to govern.

HIID's General Manager in Moscow stated the Chairman of the Coordinating Committee has turned increasingly to decrees as it became clear the Duma lacked the consensus to pass reform-oriented laws. While acknowledging that decrees were not part of the work plan, he stated that he cannot control the GPU's decision to turn to decrees. However, he noted that decrees have had many beneficial effects because they put pressure on the Duma to pass a law, and it helps build a consensus for a law if the market participants accept

HIID
side

the decree. For example, some recently passed laws, such as the Law on Joint Stock Companies and the Law on Securities, were originally decrees. He said that once these were seen as meeting needs of market participants, the consensus developed on the need for laws.

HIID and GPU Prevent USAID/Washington Visits to Russia

HIID strategy resulted in elevating the GPU as the office responsible for legal reform in Russia. Moreover, GPU exercised considerable control over the USAID assistance program to the point that it prevented USAID participation in a follow-up legal reform project with the World Bank and blocked visits of USAID officials.

In considering the legal reform project, the mission noted that support for the GPU as the sole coordinator for all legal assistance might inhibit the ability of USAID from assisting groups not supported by GPU. As previously discussed, the GPU and HIID had been in a political fight with the Research Center for Private Law, another office within the Office of the President that was supported by USAID/Washington Office of Democracy. This would develop into a difficult political decision for USAID in its support of a follow-on legal reform project with the World Bank. In end, GPU would dictate to USAID who could participate on the World Bank team assessing legal reforms needs in Russia.

In June 1995, the World Bank began to consider a major legal reform proposal developed by GPU with HIID assistance. The World Bank project manager began working with the USAID democracy group official responsible for most of legal reform work on-going in Russia, with the exception of HIID's work. Because the World Bank was planning on building on the legal reform work begun by USAID, it was decided that the democracy official would accompany the World Bank on a pre-loan assessment mission. However, the GPU representative told the World Bank and USAID/Washington to stop this activity. He managed to get

the World Bank manager removed from the project and effectively cut-out the USAID official from involvement in the loan. When the democracy official requested country clearance for the assessment mission, the USAID/Moscow Director said he tried to reach a compromise with the GPU official, but he could not get his permission, and the USAID representative was denied country clearance.

These issues are described in detail in an October 12, 1995 correspondence from the USAID/Moscow Director to the Assistant Administrator of ENI, "As you probably know, Ruslan Orekhov [the GPU Director] is in Washington for discussions relating to the proposed new World Bank law reform project. (We did not know this till yesterday.)...He also was told by the Bank that Keith Henderson, (the USAID democracy official) would be USAID's liaison person for our involvement in supporting the project development. Orechov called Jonathan Hay [HIID/Russia's General Manager]...and told Jonathan that Keith was unacceptable to him. He also said that the World Bank has decided to replace Ian (the World Bank officer who was the lead person for their project design activities) as the lead person...Orekhov...sees much of the project design planning work that he takes violent exception to as flowing from the close relationship between...Keith and Ian Newport. Orekhov requested Jonathan call Paul Rosenberg [of the U.S. Coordinator's Office] (sigh) and propose to him that I be the AID liaison person (sigh)...The most important thing is the Orechov has the lead for the GOR...It is his agenda, not ours...I think it would now be extremely difficult for Keith to play a productive role on the design team. Frankly, I was a bit concerned, in any event, that the apparent AID jockeying for involvement in designing the Bank project looked like an effort to fight our turf wars and philosophical differences in a new context..." On October 13, 1994, the ENI Deputy Assistant Administrator stated that the USAID/Moscow Director would be "the primary person to interface with the GOR. The ENI/Democracy official

was removed as the USAID liaison for the World Bank loan.

On October 12, 1995, the ENI/Assistant Administrator's Office noted the philosophical differences between the mission and headquarter's approach to reform issues. It stated that..."There are at least toward problematic phenomena in evidence here. First, the tendency of Moscow to re-centralize everything, including reform and assistance efforts under the guise of 'coordination"... Secondly, we see a classic "divide and conquer" strategy on the part of the Russians, in this case aimed at the donor community. The fact that Russia is borrowing the money (for the World Bank loan) is no excuse for the donor community to allow Russia to dictate matters that may affect the very integrity of the legal reform agenda. (The USAID/Moscow Director's) capitulation on these points, while understandable in the political context he finds himself working in, is not good strategy..."

This was in response to correspondence sent earlier that day from the ENI/democracy office, which stated that this raised the political issue as to whether USAID wanted the GPU Director to exclusively set the agenda and whether USAID wanted to set him up as the one and only legal reform czar in Russia. Some USAID officials continued to have serious reservations about working exclusively through the GPU without more political analysis being done. The ENI/Democracy official stated that "the USG should not allow any foreign government to dictate to us how we do our business -- particularly with other donors".

HIID REPORTING ISSUES

Although USAID and HIID agreed that USAID would be substantially involved in the planning and implementation of the HIID program, placed minimal demands on HIID reporting, and did not incorporate

measurable goal into its workplan. The involvement of USAID management in the legal reform project is particularly important because, unlike HIID's work in capital markets, where HIID provides oversight of the work of other U.S. contractors, HIID is the implementor of the legal reform project.

HIID Did Not Meet All Of Its Reporting Requirements

According to the Cooperative Agreement, HIID was required to provide semi-annual work plans which detailed program objectives and the main anticipated results or targets, and monthly progress reports. The progress reports were to include such information as an evaluation of the effectiveness of the assistance, proposals by the Russian counterpart for improving the delivery of assistance under the program, an outline of any decisions that must be undertaken by Russian counterparts, and a description of upcoming activities for the next month.

USAID/Moscow accepted HIID's first two work plans with no formal approval as called for by the cooperative agreement. HIID provided quarterly progress reports, from July 1994 until January 1995, instead of monthly progress reports as called for in the agreement. In addition, these reports only highlight inputs and not the results. Moreover, the progress reports did not include Russian proposals to improve project operations.

USAID/Washington raised several problems concerning the lack of information in the progress reports. For example, according to a USAID/Washington analysis in late 1995, they noted that (1) HIID never explained why new projects started or how they tied-in with the overall work, (2) accomplishments were not easy to discern, (3) each progress report should explain the purpose of the project, (3) the section on conferences did not state what was learned from the conference, and (4) a section should be added on the projects that

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have been completed. On October 2, 1995, AID/ENI/Economic Restructuring sent the USAID/Moscow project officer these suggestions. According to the project officer, these suggestions were discussed at the Mission and it was decided they were unnecessary.

HIID Resisted Providing Information to USAID

On June 5, 1995, the USAID/Moscow project officer requested basic programmatic information from HIID, including information (1) a list of legal memorandum, commentary, draft laws, and other material produced by HIID, (2) a list of all Russian and expatriate staff, salary levels and job descriptions, (3) a list of the committees or working groups which HIID is assisting, with a description of the work underway in each, and (4) a list of all laws drafted under the direction of the Coordinating Committee, those under development, and those which have passed. He noted that USAID had requested this information for several months to no avail, and noted that other rule of law contractors had provided this type of information.

On June 5, 1995, the project officer also sent correspondence to, among others, the USAID/Moscow Director, stating that "we have not had much luck yet encouraging HIID to share this kind of basic information...Have we reached an impasse?" On June 8, 1995, HIID responded that it had provided some information, but would not provide other information. For example, HIID agreed to provide the names and position of expatriate staff, but that if preferred not to give out salary information. HIID also stated that for the Russian staff, "we are extremely concerned about their security", and will provide job descriptions but not their names. It stated that the request to have a list of all legal memorandum "goes beyond the reporting requirements of our cooperative agreement. No such list exists", and noted the burdens associated with getting the documents. In its place, HIID provided a one page list of laws it supported.

On June 9, 1995, the project officer noted in correspondence to the USAID/Moscow Director that "although some progress has been made, HIID still will not produce to us the names of the Russian employees...and does not want to produce an outline or details reflecting their work products, which several of our other contractors working on law reform, such as IRIS and RDI¹⁶, have produced in one form or another...I appreciate the concerns about employee identity...there is however, some value in getting information about work product to help us coordinate work, avoid duplication...and to share resources between contractors working on related projects." That same day, a USAID representative with the Director's Office responded to the project officer, and stated that "it is essential that the project manager understand what is being worked on in order to understand whether key progress indicators are being reasonable met...and be able to report to Washington...about what is taking place... Thus, too complete a rejection (by HIID) of our requests for information would then lead to forcing us to call in a program audit."

By January 1996, the USAID/Moscow project officer believed that monitoring problems had been settled. In a January 25, 1996 correspondence to the AID/ENI/democracy office, he stated that "we continue to be in almost daily contact (with HIID), have been receiving written and verbal reports from them, are attending lectures and seminars (conducted by HIID), and have been visiting their offices weekly." When we visited Moscow in June 1996, the project officer provided us with general information on HIID accomplishments and said that the previous monitoring problems had been overcome.

USAID Has Not Incorporated Measurable Goals

¹⁶See Appendix XX for a detailed discussion of RDI's land reform efforts with HIID.

USAID never incorporated measurable goals in HIID's work plan. In fact, USAID/Moscow appears to have avoided every opportunity to incorporate measurable goals and assess HIID's progress toward meeting those goals. For example, USAID/Russia has not submitted any reports on the commercial law program into the ENI monitoring system. This system requires that each project identify specific goals and measure progress towards meeting those goals. While the mission has made 33 submissions for other activities, the mission has made no submissions for HIID's work.

Interestingly, HIID had not resisted the establishment of program goals. For example, on September 23, 1994, HIID's project manager sent USAID/Moscow a document entitled "Indicators of Success & Measurements of Results" for the first 6 month work plan. These suggested measurements of success included the

- increased number of laws adopted by the Duma (by the end of X years, the Duma will have adopted 15 laws with the HIID drafted, proposed amendments to, etc.)
- implementation of a legislative regulatory regime to replace the current system of ad hoc development of law by inconsistent and conflicting edicts and governmental pronouncements (measured by the number of laws adopted by the Duma which previously were governed by presidential decree);
- increased level of investment through removal of risk (indicated by level of guarantee investors feel as to the certainty of their legal rights), and
- enhancement of commercial viability of newly privatized enterprises through development of enforcement mechanisms and laws on contracts, employment law, and intellectual property law.

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However, these suggestions were not incorporated into the work plan.

Washington/Moscow Management Issues

This is not important

USAID has not determined what level of oversight it should provide political sensitive programs in the field, such as HIID commercial law drafting activities. ENI had not articulated a policy on the relationship between headquarters and the field until July 1995, when it issued Bureau Operating Procedure 102. That procedure describes the role and responsibilities of various project participants. It stated that USAID policy is to maximize utilization of personnel and technical resources in the field throughout project design, implementation, and management.

The procedure emphasizes the roles and responsibilities between Headquarters and the field when the project manager is located in Washington, but does not give detailed instructions about this relationship when the project manager is in the region, as it is the HIID program. However, the procedure is clear on the importance of a close, cooperative working relationship between Washington and the field. The guidance also requires that the project officer monitor the accomplishments of the agreed upon milestones and outcomes. USAID/Washington is required to coordinate and integrate these inputs into the broader goals for the region. Monitoring is supposed to be carried out through in-country visits from headquarters and by the in-country staff. Project Officers play a major role in ensuring that the USAID Monitoring and Reporting System is maintained with accurate and complete data.

Its clear that the bureau and the mission were not meeting the procedures in the case of HIID activities. On at least three occasions, the mission denied bureau officials country clearance. Both the directors of the bureau's democracy group and economic

restructuring group said they had given up trying to coordinate the programs because of the lack of mission cooperation. The director of the economic restructuring group had not been able to get into country for 18 months, and asked to be relieved of the Russian portfolio. ~~The bureau was not sent progress reports and did not have copies of HIFD work plans until late 1995.~~

*no later discovered
progress reports had been
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CHAPTER V

USAID ACHIEVED MIXED RESULTS WITH ITS ASSISTANCE TO THE RUSSIAN PRIVATIZATION CENTER (RPC)

Despite USAID's \$40 million investment to create and support the RPC, it is unclear whether the RPC can continue to provide assistance without further U.S. funding.¹⁷ USAID is concerned that its significant investment in the RPC may be lost, particularly if other donors do not continue to support their activities through the RPC network. Also, USAID funded post privatization projects have produced mixed results and the RPC's performance assisting these projects was also mixed. Since USAID began funding the RPC in April 1993, it has had limited control over the management and development of the Center.

THE U.S. GOVERNMENT'S INVESTMENT IN THE RPC HAS BEEN SUBSTANTIAL

USAID developed the following strategy to create the RPC and its network of LPCs that included:

- channeling RPC start-up funds through HIID,
- providing direct operating assistance to the RPC for 2 years,
- providing funds to create and manage the LPC network, and
- providing funding to HIID to recruit highly qualified staff to perform RPC's mission

Between 1993 and 1996, USAID assistance to the RPC network accounted

¹⁷The RPC, a Russian voluntary nonprofit organization, was founded by presidential decree in November 1992. The RPC was expected by USAID, the Russian government and the international donor community to support enterprise restructuring and land reform. Specifically, the RPC was intended to help borrowers avoid political and legal impediments when using World Bank and other multilateral loans.

for nearly 100 percent of its start-up and operational expenses. Through a \$1.3 million amendment to a existing cooperative agreement with HIID, USAID created the RPC in Moscow. HIID administered and managed these funds until September 1994 when USAID relieved it of administrative responsibilities. This was made possible by a USAID direct grant to RPC for \$11.9 million to support its operations for two years. The USAID mission managed this grant directly from Moscow.

Prior to this grant, USAID completed task orders in May and June 1994 with three U.S. management consulting companies to create and provide management support to eight LPCs located throughout the Russian Federation. This investment totaled \$16 million and, by the end of 1994, USAID had committed nearly \$30 million to the RPC and LPC network. In September 1995, USAID's direct grant was amended to (1) increase the grant amount by \$4.5 million to transfer the management of the LPC's from the U.S. consultants to the RPC and (2) extend the duration of the grant from September 1996 through December 1996. This amendment was aimed at reducing overhead costs associated with LPC management and providing the RPC more flexibility to use its existing grant funds.

After the September 1994 direct grant, the role of HIID changed significantly but continued at RPC. The cooperative agreement was amended twice during 1995 providing HIID with \$8.1 million to recruit and retain highly-skilled technical advisors at the RPC. This role was expected to increasingly diminish but continue through 1998. USAID committed an additional \$3 million in a new cooperative

agreement with HIID in March 1995.

SUSTAINABILITY OF RPC NETWORK IS UNCERTAIN

The RPC network coordinates and implements nearly \$200 million of donor assisted projects but it depended almost exclusively on USAID for its operational assistance.¹⁸ The administrative costs of the RPC network and operating expenses of the RPC in Moscow are estimated at \$7 million and \$6.5 million respectively for 1996. Its ability to acquire outside funding to support its operations has produced to date mixed results. Although a mixture of donor resources has been either promised or committed they are inadequate to meet fully the RPC network's operational needs after USAID assistance ends in 1997. RPC management has frequently requested additional USAID operational grant funds and as of August USAID Washington has not decided on PRC's latest request of \$6.6 million. The World Bank remains the RPC's best, yet uncertain prospect for future funding.

Throughout the last 12 months, RPC representatives have consulted with U.S. officials in Moscow and Washington, D.C. to request more time and money for the RPC to secure other resources for its operations. USAID/Russia does not support additional RPC requests for operational support because (1) the existing pipeline will provide RPC operating funds for about 6 months beyond the original grant completion date and (2) the RPC has been unable to clearly identify its objectives for the proposed extension period in a well-thought-out business plan and budget. This latter point is consistent with USAID Russia's experience with the RPC with the operational grant whereby the RPC failed to submit workplans or progress reports. Unlike USAID Russia, USAID Washington and State

¹⁸The RPC successfully solicited funds from the German government, the United Kingdom's Know-How Fund, and the Japanese government (through its grant to the World Bank) to pay the RPC's rent of about \$xx thousand over the next year.

Department officials have not ruled out the possibility for additional support but they have yet to make a decision on the latest RPC request.

In June, RPC representatives visited with officials from USAID's ENI office and the Coordinator's Office for Assistance to NIS to request a \$6.6 million cost extension to the exiting USAID operational grant. According to a senior USAID Washington, D.C. official, USAID is considering RPC's \$6.6 million request but it is unlikely that such funds are actually available and, therefore, would have to be reprogrammed from other funded projects. USAID was unable to tell us officially when they plan to make a decision on the funding request but unofficially said that the decision will most likely be made after we issue this report.

World Bank Provides Increased Support to RPC

The RPC recently concluded negotiations with the World Bank in which the Bank agreed to cover some of the administrative overhead costs associated with management and disbursement of its \$90 million enterprise restructuring loan to be managed by the RPC. This agreement will become effective in January 1997.

This loan is expected to support enterprise restructuring activities for about 200 newly privatized enterprises throughout Russia. According to Bank officials, the loan will allow a management fund to be established and it is considering the RPC network to manage this large restructuring effort. However, this loan will not cover all of the RPC networks operational costs. If the RPC is unable to obtain other resources to make up the deficit it will be forced to down size and streamline its operations accordingly.

USAID RUSSIA HAD LIMITED CONTROL OVER THE DEVELOPMENT OF THE RPC

Despite USAID's substantial investment in the RPC network, it had limited success in leveraging the RPC to effectively manage its direct grant funds. The RPC did not comply with reporting requirements of the grant agreement and USAID never had a clear understanding as to RPC's long term goals and business plan. In land reform, RPC responsibilities changed as USAID assumed greater responsibilities for the program.

USAID Russia Unable to Effectively Manage and Evaluate RPC Performance

The lack of adequate RPC progress reporting to USAID managers made it very difficult to effectively manage and evaluate RPC's performance. Since the September 1994 grant, the RPC has never submitted a work plan or presented an adequate financial plan showing its strategy for spending the grant monies and exiting from full dependence upon USAID for its operational support. Furthermore, the RPC never submitted quarterly program progress reports on its donor supported activities, which were also required under the direct grant. As a result, USAID has been unable to identify a well-thought-out post privatization role for the RPC. Moreover, USAID had limited leverage to remove managers it believed ineffective.

Due to the flexible nature of a cooperative agreement, USAID's authority over HIID staffing at the RPC was limited to either approving or disapproving staff being hired for the first time. USAID had limited control over HIID technical advisors at the RPC once those advisors were placed. In addition, the RPC had significant influence over the hiring and retention of HIID supported technical advisors. Consequently, despite USAID Russia concerns about the performance of certain HIID technical advisors, it was unable to

remove them. The procurement officer is the most recent and illustrative example of USAID's limited control over HIID technical assistance.

The HIID supported procurement officer was responsible for developing the overall capacity of the RPC to eventually manage procurement functions independently. Since this position was filled in April 1995, USAID has been concerned that HIID's technical assistance to the RPC was ineffective because RPC procurement staff were (1) unaware of certain procurement requirements as evidenced by frequent fundamental procurement mistakes and (2) frequently contacted USAID for guidance on basic procurement actions. USAID is concerned that the RPC procurement department still requires technical assistance and that the department may not be able to handle large-scale donor assistance.

According to the 1996 HIID Work Plan, the chief procurement officer position was full-time but did not require the officer to be resident in Russia. In this regard, the officer was three-quarter time United States based and one-quarter time Russia based. An arrangement that both USAID and HIID agreed was unusual but acceptable provided the officer supported USAID's objectives. However, the procurement officer was not working full time on RPC matters but was also supporting other components of HIID's activities in Russia including the capital markets and legal reform programs

According to HIID and RPC, the part-time and non-resident arrangement of the procurement officer was both acceptable and effective. USAID, however, disagreed and tried unsuccessfully to change the position so that a full-time procurement advisor would be available to ensure that the RPC procurement department was adequately trained and staffed. Because HIID and the RPC was satisfied with the existing arrangement and because the cooperative agreement limits USAID's leverage, the position remains unchanged as of August 1996.

USAID-FUNDED POST PRIVATIZATION ASSISTANCE PROJECTS IMPLEMENTED
THROUGH THE RPC NETWORK PRODUCED MIXED RESULTS¹⁹

During privatization, the RPC worked with the GKI to successfully implement the large-scale voucher auction program. The RPC also effectively served as a channel for HIID to provide macroeconomic policy advice to the Deputy Prime Minister. Although RPC successfully facilitated the efforts of U.S. contractors to implement USAID's post privatization programs, RPC's made questionable decisions concerning the selection of participating enterprises and RPC staff did not acquire the skills to provide consultant services to other enterprises as envisioned in the USAID strategy.

RPC Accomplishments During Voucher Privatization Most Notable

During the Voucher Privatization process, the RPC's main task dealt the organization and supervision of Russia's voucher auction privatization program. As a result of the mass privatization effort, nearly 40,000 state-owned enterprises were transferred to private ownership. From January 1993 to June 1994, ownership in Russia moved from the ministries of the Soviet state to million of Russian citizens. The RPC helped the GKI to establish the all Russian Auction system. The RPC also participated in the creation of the central Voucher Auction Support Group, which coordinated the work of regional auction support groups, trained auction specialists and maintained voucher auction data bases in the regions.

¹⁹Our review of RPC assisted projects was limited to USAID's Financial Management Assistance (FMA) program, Program for Intensive Enterprise Support (PIES), and the Real Estate Information System (REIS) and Enterprise Land Sales (ELS) projects because 1) these activities combined represent the largest share of U.S. government assistance that was implemented through the RPC and LPC network and 2) these activities were designed to impart skills and abilities to RPC and LPC staff to continue such activities after USAID assistance ended.

RPC's Policy Advice Difficult to Measure But Apparently Influential

The RPC provides on-going policy advice to government agencies, including assistance in drafting laws on natural monopolies, competition, antitrust policies and tax reform. During 1995, RPC's Chief Executive Officer and the HIID General Director worked with senior reformers in the Russian government to negotiate and receive a stabilization credit from the International Monetary Fund. According to the HIID General Director, this policy dialogue will continue while HIID remains engaged in Russia.

Enterprise Restructuring Projects Generally Met Goals, But Systemic Impact Questionable

The Financial Management Assistance (FMA) program focused on financial management accounting, managerial accounting, cash management and operational improvements. The Program for Intensive Enterprise Support (PIES) focused on improve management and overall performance of the enterprises, as well a identifying potential investment opportunities. In May 1995, USAID reduce the number of targeted PIES's enterprises to be restructured from 18 to 15 and reallocated the savings for the development and field testing of enterprise restructuring "Tool Kits".²⁰

Role of the RPC in Post Privatization

To implement both FMA, PIES and the Tool Kit programs, USAID used U.S. management consulting companies, and the RPC and LPC network to assist in program delivery. Specifically, the RPC was required to:

²⁰The Tool Kit is a series of support materials addressing typical issues that are facing every restructuring enterprise in Russia. These issues included how to establish an effective finance and marketing department, manage product portfolio, conduct industry and competitor analysis, and manage cost.

- publicize the projects at the federal level through the RPC and the local level through the LPCs,
- make available to potential consultants and enterprises participant application forms,
- propose candidates that they believed were suitable for the programs,
- review submitted applications and establish a short-list of candidates,
- select and approve with USAID and contractors, candidates to participate in the projects, and
- monitor Contractor progress

In addition to assisting with program implementation, USAID's strategy to involve the RPC and LPC network was also directed at developing LPC staff capabilities. When USAID created the LPC network, it envisioned that LPCs would act as facilitator and coordinators for technical assistance. However, by the time that USAID assistance to the RPC ended, USAID expected the LPC network to be able to independently provide certain technical assistance services to local enterprises. In addition, USAID expected that the dissemination of Tool Kits through selected LPCs would create a consulting product for the network to provide on a commercial basis to the local enterprises.

Enterprises Restructured But Systemic Impact Uncertain

According to project reports from the consultants, and USAID and RPC officials, the program objectives of the FMA and PIES activities were largely achieved. For example, 32 consultants were trained, 2 of which are currently working for the LPC network, to continue to provide financial management advice to enterprises and a total of 23 enterprises received substantial technical assistance. In addition, the enterprise restructuring Tool Kits were prepared and the results

of the field testing indicated that demand for this product exists and that enterprises could afford to pay nominal fees to attend Tool Kit seminars. As a result of these USAID-funded programs, participating enterprises have changed their operations by downsizing labor forces, improving accounting and financial management, prioritizing investment planning, revising procurement procedures, and developing new products and marketing strategies.

However, most of the companies that participated in the programs have not received foreign investment. According to some enterprise directors, and USAID and LPC officials, newly privatized enterprises lack the foreign investment needed to take full advantage of the changes made to their operations. Capital short falls and lagging foreign investment concern enterprise managers. One enterprise official stated that even after downsizing his company in response to recommendations made by the contractor, it was unable to pay its remaining employees on a regular basis because of insufficient capital. He said that his employees had not been paid in 3 months.

When asked whether they would be able to afford similar but unsubsidized technical assistance, enterprise officials responded that they did not have the resources to pay what these projects cost. The FMA project cost about \$200 thousand per enterprise while the PIES project cost about \$1 million per enterprise. The willingness exists, but the ability to pay does not. One RPC official explained that enterprises will have to take out loans or attract investors through the local capital markets to raise the capital to pay for such services in the future. The World Bank is developing a lending scheme to enable enterprises to borrow money to pay for these services.

Questionable RPC Enterprise Selections

Generally, the contractors implementing these programs worked well

with the RPC and LPC network and found their efforts to publicize the programs and coordinate the application process very useful. Enterprises also commended the RPC and LPC network on these accomplishments. Reaching enterprises and consulting candidates was an important component of the programs because contractors implementing the programs were unfamiliar with the potential clients. The LPC staff knew the clients in their locations and made the necessary contacts. In at least one instance, the LPC staff played an instrumental role in defusing a potential conflict between one of the contractors and the general director of one of the enterprises participating in the program. However, we noted several questionable decisions as to what enterprises would participate in the PIES program.

Although methodological and relatively transparent for Russian standards, the selection of certain enterprises raised questions about potential bias in the selection process. For example, an enterprise selected for one of the two USAID programs had already received technical assistance through one of the other donor funded enterprise restructuring programs. The selection criteria prohibited a company from participation if it already received technical assistance from one of the other donor funded programs. The RPC made an exception in this case because the prior technical assistance did not address the same issues as the USAID program. USAID concurred.

Another enterprise selected was one of Russia's premier defense industries. The selection criteria strictly prohibited defense industries from participation. The RPC determined and USAID concurred that this enterprise was no longer producing military products and, therefore, was not excluded by the selection Criteria. When asked whether this enterprise could be producing military equipment, USAID responded that it would have been made aware of this if in fact it were true. However, other non-defense industry enterprises were competitive applicants for the program but were not

selected.

According to some of the contractors, a few of the RPC's selections appeared to be politically motivated (i.e., political or personal ties between senior level RPC and LPC staff and the heads of selected enterprises), but they could not provide proof to this effect. Also, the World Bank officials expressed their concerns about some apparent political motives affecting the RPC's selection of enterprises.

Future RPC Role In Enterprise Restructuring Is Unclear

Contractors also raised questions about the RPC's role in future projects and whether it would be able to sustain its operations in a competitive market. Some contractors stated that what the LPC did most successfully will become increasingly less valuable for the programs. For example, now that many Western consulting companies have been working throughout Russia, they have established contacts and personal relationships with many potential clients precluding the need for the LPC network to provide this service.

Also, some contractors said that the RPC and LPC network does not possess the consulting expertise on a scale required to compete these services in a market economy. According to two contractors, the RPC simply cannot compete with the ever developing consulting base in Russia and, therefore, should not try to duplicate what others can do more effectively. Commercially, however, these contractors might use the LPC network on a case-by-case basis depending on whether their services would be needed in more remote locations.

Both USAID and contractors agree that there was potential for the RPC to market the tool kits. For example, the field testing of the enterprise restructuring Tool Kits concluded that the kits can be commercialized because enterprises value their utility and

overwhelming reported that they could afford to pay nominal fees for the assistance. According to USAID, this undisclosed fee would adequately recover the LPC costs of maintaining and delivering Tool Kit seminars. However, the development of LPC staff skills has been uneven and it is not clear which LPCs could successfully offer the Tool Kits.

LAND REFORM INITIATIVES FOCUS ON DEMONSTRATION PROJECTS

In land reform, the RPC and the LPC network had a much more limited role than in post-privatization especially after USAID Moscow assumed greater responsibilities for these projects. Over the two-year duration of the USAID land-reform initiatives, the nature of RPC's role changed as the administrative oversight authority for the projects was transferred from Washington to the Mission; the directors of land reform took different approaches toward their jobs and the RPC land reform positions were left unfilled for a long period; and RPC had a greater role in urban land reform while the GKI took the lead on the privatization of agricultural land. The urban land reform project was less successful than the other projects in meeting project goals. We also noted that there was considerable friction between the USAID staff and HIID over a land decree that was required for USAID to implement a pilot real estate tax project.

RPC's Responsibilities Changed as Land Reform Initiatives Evolved

From the inception of bilateral assistance program to Russia in 1992, through mid-1995, State and USAID decided to keep the missions in the former Soviet Union small and manage the program from Washington. Therefore, in 1994 when the land-reform projects were initiated, since the USAID management responsibility for the projects was still in Washington, and there was only one Mission project officer assigned to land-reform issues, the RPC land director performed a larger role than was envisioned by the task orders and

managed project implementation. The RPC land director's participation in the projects at this time was very close and detail oriented while the USAID project officer was responsible for more general monitoring.

However, once the contracting officer technical representative (COTR) authority was transferred to the Mission in mid-1995, and additional project officers were assigned to the program, the management and monitoring of the projects was done by USAID project officers. According to the USAID land program director, decisions on personnel, budget, and scope of work were never delegated to the RPC. When suggestions are made by the RPC personnel, USAID has to ^{buy off} ~~buy off~~ on it.

There have been two individuals who have held the RPC director of land reform position and each one had dealt differently with the job. The first director participated in developing and implementing the USAID projects at a time when the RPC was helping to initiate the projects. By the time the second director of land reform was appointed in May 1995, there was no longer a need for the same hands-on involvement with the USAID program as before, and he initiated coordinating meetings of all technical assistance providers in land reform for sharing information and experiences and worked on developing new proposals for land projects. However, in mid-1995 land ownership was not a priority in the existing political climate and second director found that his proposals did not get the attention of the RPC director nor were submitted for consideration by Government of Russia officials. After his departure in December 1995, the RPC position of land director has not been filled. Additionally, a HIID-funded position of land project manager, described in the 1996 HIID workplan has never been filled.

At the time of our review, USAID and the RPC said they were considering whether the role of the RPC director of land reform

should be changed, in the light of the political situation in Russia that had become more conservative leading up to the June 1996 presidential elections. An RPC deputy director said that he thought there was still a need for an expatriate director of land reform with real estate experience to back up the Russian staff, and generate new ideas for projects such as business park development. USAID said it was no longer encouraging RPC to fill the director of land reform position by someone who functioned primarily as a manager but was supporting the hiring of an individual at RPC who would act as a promoter of land-reform initiatives.

USAID Had Modest Goals for Land Reform Effort

Since 1994, USAID has implemented land-reform projects to help develop land privatization initiatives in Russia. The projects, totalling about \$58 million, were to assist in the introduction of market-oriented mechanisms in Russia and were expected to promote the overall goal of helping create a market-oriented economy where a majority of economic resources are privately owned and managed. However, the specific goals in land-reform initiatives were moderated by the recognition that, while land privatization was of great importance, it was also so controversial, that the role for foreign assistance was limited. On this sensitive political issue, the limited role that was planned sought to work with principally local officials who were receptive to experimentation and change. The strategy that was developed focused on model-building activities that would have a potential for a demonstration effect and would provide the Russians with a range of options as they grappled with land reform.

Three model projects constituted about two-thirds of USAID's land-reform initiatives.

-- The Real Estate Information Systems (REIS) was to design and

implement integrated land and real estate information systems for local jurisdictions that would serve as a basis for later land registration and titling.

--The Enterprise Land Sales (ELS) project was designed to assist enterprises to acquire municipal land they were presently using and start to manage it as an asset. Some of the subsequent enterprise activities that could have an impact on economic growth would be the sale of surplus portions of land and the possible use of land holdings as collateral for financing of its commercial activities.

--The Farm Reorganization project that was to assist local administrations to privatize collective farms by helping the present collective farm share owners to break up the present organizational structures into potentially more efficient units

Although RPC's had a planning role as consultant and reviewer of USAID land-reform projects, in practice, the RPC has had a close working relationship with only the REIS project. The RPC had limited involvement in the implementation of USAID's enterprise land sales project, and nearly no role in farm reorganization.

REIS Project Does Not Met Expectations.

The real estate information and titling systems, the largest model project, encountered difficulties in meeting its targets. In the REIS projects, with funding of about \$21 million, USAID had hoped to install the system in up to 19 cities, but the projects were implemented in only 9 cities of which 6 are still not functioning for land registration. In 4 cities, the municipal officials rejected the systems offered by the contractors and were working on their own versions. In one city, the officials implemented their own system after observing the implementation of a titling system by contractors in a neighboring city.

A major hurdle that the REIS contractors faced was getting the various municipal agencies to agree on how the information that each agency was collecting would be made available to all of the other municipal agency users of the new system. Reasons cited by contractors as contributing to the limited results include:

- the project was oversold by USAID, and the cities did not know what they would get;
- USAID pushed to get the projects started quickly and the project design was not complete when work began;
- the legislative basis for the work was not in place in all but one of the cities when the projects were started;
- the cities were not required to pay for the services of the REIS contractors and so in some cases did not value their work; and
- USAID's approach involved two different systems which were designed by the two contractors, which was confusing for the recipients and raised doubts that some cities slated to receive the simpler system they were not being provided the best system possible.

The RPC helped select the cities included in the project. The RPC and LPCs negotiated with the municipal authorities; helped prepare drafts of sample documents used in the project; prepared drafts of local legislation, although the passage of which was the responsibility of the local authorities; and were involved on the federal level in working on a draft law on registration to codify land registration nationwide.

In St. Petersburg, the contractor had a volatile relationship with some of the directors of city agencies with which they had to interact. The U.S. contractor said that the difficulties with his computer subcontractor were exacerbated because the subcontractor was not selected in an open and transparent manner but was forced on the contractor by the city. In St Petersburg, the RPC land-reform manager

was assigned to help coordinate and mediate the final implementation of the project, but after one year of disagreement all of the issues were still not resolved.

The St Petersburg agency director said she asked that 10 contractor staff members be removed due to their inability to do the project. A manager sent by the contractor to troubleshoot was given high marks in assigning staff who were more acceptable to the city. However, the agency director said that at the end of the contract period, the contractor did not complete installing all of the equipment and work continued on it. Final agreements on data sharing between city agencies were also holding up the completion of the system. She complained that the contract for computer subcontractor wasn't signed until the end of 1995, shortly before the end of the contract period. The subcontractor who had worked without a contract wasn't paid for all of his work. Nonetheless, she was confident that once the contractors completed their work the city would obtain a system that it wanted.

The contractors involved in REIS are preparing a manual that could be used to help spread information about the techniques of land titling, but it isn't clear how the manual will be disseminated. The RPC said it will not take on the responsibility for doing this because it lacked funds for this activity. An upcoming USAID project will have the task of identifying mechanisms for spreading the land reform training materials.

ELS Project successfully implemented

The \$8 million ELS project, successfully established and implemented a legal and procedural process for the sale of land first by the municipal administrations to the new owners of the privatized former state enterprises and later to new buyers. At first, enterprises in Russia were privatized without obtaining title to the land on which

they were located or used in the course of doing business. This project is now being rolled out in about 43 cities appears to be meeting its targets in St. Petersburg where we observed the program.

Although the project also has goals for secondary sales, which is subsequent sales to new buyers from the privatized owners, the contractor said this goal will be difficult to meet. Some people fear that if the political situation is changed, the sales to secondary buyers could be considered criminal. The challenge for the contractor was to work within the present legal environment where there is no federal land code that addresses the purchase of urban land. The contractor made recommendations to city administrators and managers of enterprises and provided training on how to organize land privatization. The contractor also prepared legal documents and suggesting strategies for enterprises on how to begin to purchase land from the state. Furthermore, sales of commercial property that are being undertaken under the project are already being copied by others without the contractor's help giving some positive indication that if the political and legal environment continues to be conducive, private citizens will be able to buy and sell land without the intervention of further technical assistance.

The ELS contractor told us that while RPC and LPC staff were helpful in making the initial contacts for the project, since they had an established presence in the cities in which the ELS projects were implemented, they were not real estate professionals and were not particularly useful to the subsequent development of the project. The ELS contractor trained some LPC staff, along with others, in commercial real estate appraisal as part of the project, and these skills could be useful once a commercial real estate market develops. At present, it is unclear to what extent those who received this training will be able to sell their services as brokers and appraisers or if the LPCs will be able to collect fees for these

services.

The Farm Reorganization Project Appears to be Meeting Objectives

Farm reorganization, in total an \$8 million project, is to complete reorganization on 225 farms in 15 oblasts with at least 50 having achieved formal distribution of land and property shares. Many of the farms undergoing reorganization are now bankrupt. As with all of the land reform projects, training is a large component in preparing the participants for undertaking this stage of land privatization. The redistribution of land that occurred in 1992, when the farms were organized into joint stock organizations and some subsidies were cut, did not in most cases change the management of the farms nor eliminate the unproductive workers, as the present reorganizations attempt to do.

The post-1994 farm reorganizations seek to change the production structures and intra-farm relations on the farms. A number of organizational forms were considered by the shareholders on the farms. Several variants include the breakup of the original farm into individual farms entirely so that the original farm ceased to exist or some farms split away, while some shareholders opt to stay with the original enterprise. Another possible organizational structure is the transformation of the collective farm into cooperative farms consisting of profit centers that function as independent farms. This last variant is seen as an intermediate step before further reorganization may be pursued. The farm reorganization models chosen most frequently provide the new farm entities with a tax break and relief from the debt incurred by the previous farm. The most recent presidential decree on land has had the effect of promoting splitaways, and the contractor expected over half of the farms reorganized in 1996 will choose the splitaway forms.

In the reorganization process, consensus building is overseen by a working group made up of local officials, including a GKI representative, with the contractor acting as an advisor, new legal farming entities are created that hopefully will be managed better. The participants in the process complained about the length of time they are being given to undergo the reorganization. If all goes well, a reorganization can be done in two months, but if there are delays, having the reorganization overlap with the agricultural season lengthens the process because people do not show up at meetings.

In the raion we visited the goal was for 15 farms to be reorganized and nearing the end of the project about 11 were completed, though the contractor said that several other farms were near completion. A contractor estimated that USAID, other donor farm reorganizations, and spontaneous reorganization efforts have resulted in about 2 percent of all Russian farms having been reorganized.

A two-week training program for the working groups developed by the USAID farm reorganization project was conducted at the Ministry of Agriculture training institutes and has been incorporated into the Ministry's regular training program. The Ministry said it was looking for additional funding of contractors to act as advisors. They said that they believed that in the oblasts where some farms have already been reorganized, it will be fairly easy for other farmers to understand the necessity and benefits of reorganization. However, in oblasts where reorganization has yet to be started, the Ministry's director of training said it would be helpful to have a foreign advisor available to troubleshoot and give credibility to the process. One contractor predicted that unassisted, the process of farm reorganization would take longer. If efforts to secure further outside support of farm reorganization activities are not successful, the GKI said it would again try to introduce a line item in the budget for farm reorganization. However, the last time the GKI tried

to do this, the Ministry did not support it, but GKI hoped that this might change.

Problems in Obtaining Draft Decrees From HIID and ILBE Identified by Contractor

A contractor working on a pilot of a property tax system for Russia reported to USAID that its work in obtaining passage of a decree draft that would allow its pilot to go forward was hampered by HIID's position on which decree it would help promote. In the early stages of planning the work, USAID wanted to coordinate this project with HIID and GOR officials that was to be implemented first in 2 cities, and was expected to be extended to other cities later. An interministerial and intercontractor working group was created to coordinate the development of the property tax pilot and the decree that was needed to allow for the work to be done. Included in this group were representatives from the Ministry of Construction, the Ministry of Finance, ILBE, the Russian Land Committee, GKI, RPC, CFED, USAID, as well as, HIID.

The committee reviewed USAID's property tax work proposal along with the contractor's plan to try to obtain a limited presidential decree that would allow for the pilot to be done in two regions. While HIID said it supported a broader nation-wide decree, HIID appeared to go along with the working group's consensus to first try for the limited decree because its passage was likely going to be easier to obtain. The USAID property tax contractor paid ILBE to write the limited decree because the communities in which these experimental tax systems were to be tried had to be exempted from the current tax law and a new tax law was required.

When the project was going to start working in the regions, the Mission director talked to HIID and the Chairman of the RPC and found out they thought that the first decree allowing for local property

taxes was too narrow to be suitable for tax policy work.

HIID unilaterally took the position that only a nation-wide decree was acceptable and pushed for this. The project officer asked the Mission director to talk to HIID about this interference with the implementation of an USAID project and HIID took the position that the nature of the decree was a policy issue and within its mandate. The project officer also said he thought that HIID might have wanted to been the contractor for the property tax project. He said that with declining budgets he has observed an increase in HIID's aggressive behavior which he characterized as getting more competitive and going after work. He said HIID appears to be trying to get into implementation. At the time of our review the issue was not resolved, but the contractor said that it likely going to be more difficult to obtain the broad decree and that the HIID and ILBE intervention would delay its work.

STATUS OF 19 LAWS IN HIID'S FIRST WORKPLAN²¹

	Laws	Status	Comments
1.	Tax Code	Not Passed	HIID was not the principle drafter but has participated in the drafting process after the first reading in the Duma.
2.	Contact Law	Not Passed	No mention of work in the area.
3.	Law on Insurance	Not Passed	HIID worked on framework in early 1995
4.	Law on Holding Companies and Financial Industrial Groups	Passed November 30, 1995	HIID was not the principle drafter but participated during the drafting process.
5.	Law on Fundamentals of Pricing Policy	Not Passed	HIID actively discouraged work in area to keep State away from pricing decisions.
6.	Law on Non-Commercial Organizations	Passed January 12, 1996.	HIID was a co-drafter of this legislation.

²¹ Source: HIID documents prepared for the GAO review.

7.	Law on Advertisement	Passed July 18, 1995	HIID was not the principle drafter but participated in its drafting.
8.	Law on Delivery of Products for State Needs	Not Passed	
9.	Law on Non-State Pensions Funds	Not Passed	HIID rewrote a draft developed by a Russian Ministry in early 1996 and it was submitted to the Duma in May 1996.
10.	Law on Bankruptcy	Not Passed.	HIID was not the principal drafter but participated in rewriting the draft with the Federal BAnkrptcy Agency in June 1996.
11.	Law on Pledge	Not Passed	No information
12.	Law on Foreign Economic Activity and Investment	Not Passed	No information in HIID progress reports or provided by HIID.
13.	Law on Management of State Property	Not Passed	
14.	Law on Joint Stock Companies	Passed December 26, 1996	HIID was the principle drafter of this legislation.
15.	Law on Movement of Capital	Not Passed	Not discussed in HIID progress reports.

16.	Law on Securities	Passed April 22, 1996	HIID was the principle drafter of this legislation.
17.	Law on Intellectual Property	Not Passed	Not discussed in HIID Progress Reports.
18.	Law on Concession Contracts and Agreements on Division of Production	Not Passed	
19.	Law on Competition and Restrictions of Monopolistic Activities in Commodities Market	Not Passed	HIID participated in the drafting process. It was submitted to Government Ministries for review in June 1996.

HIID'S LEGAL DRAFTING ACTIVITIES

The following tables lists the laws and decrees HIID has worked on during the Legal Reform Project. The tables are broken down by

- laws
- decrees
- draft laws, and
- draft decrees.

Within each category, the tables are further broken-down by whether HIID was

- the principle drafter,
- a co-drafter, or
- a participant in the drafting process²².

HIID/Moscow's General Director compiled this list for GAO's investigation in June 1996. Those in italics were on the 1994 list of laws USAID hoped to pass by late 1996; decrees that may cover areas the 19 legislative areas are not included. In addition, HIID's work on regulations drafted for the RSEC and others have not been included. Much of the information provided on the status and HIID's level of involvement has not been independently verified.

LAWS**Laws Principally Drafted by HIID**

²² HIID did not define its level of participation in each law.

Law	Process of Adoption
<i>The Federal Law on Joint Stock Societies</i>	President signed on December 26, 1995.
Federal Law on Taxation of Small Business	President signed on December 29, 1995.
<i>Federal Law on Securities Market</i>	President signed on April 22, 1996.

Laws Codrafted by HIID

Law	Process of Adoption
<i>Federal Law on Non-Commercial Organizations</i>	Signed by the President January 12, 1996.

Laws with HIID Participation

Laws	Process of Adoption
<i>Federal Law on Financial Industrial Groups</i>	Signed on November 30, 1995.
Federal Law on Introducing Amendment and Changes to the Law on Education	Signed on January 13, 1996.
Federal Law on Condominiums	Signed by the President on June 15, 1996.

Laws	Process of Adoption
<i>Federal Law on Financial Industrial Groups</i>	Signed on November 30, 1995.
<i>Federal Law on Advertising</i>	Signed by the President July 18, 1995.
4 <i>Federal Law on Banks and Banking Activity</i>	Signed by the President February 3, 1996.
5 <i>Federal Law on the Central Bank</i>	Signed by the President April 26, 1995.
6 <i>Federal Law on Agricultural Cooperatives</i>	Signed by the President November 19, 1995.
7 <i>Federal Law on Introducing Amendments and Changes to the Law of the Russian Federation "On Protection of Consumer Rights" and the RSFSR Code of Administrative Violations"</i>	Signed by the President January 9, 1996.

DECREES

Decrees Principally Drafted by HIID

Decrees	Process of Adoption
Decree #746 On Priority Measures For Improving the Tax System	Signed by the President July 21, 1995.
8 Presidential Decree #685 on Main Directions of Tax Reform Measures and Measures to Strengthen Tax and Solvency Discipline	Signed by the President May 8, 1996.
9 Voronezh Oblast Law on Regulation of Land Relations	Adopted May 25, 1995.
Decree of the President of the Russian Federation #765 "On Measures to Raise the Effectiveness of Investment Policy in the Russian Federation"	July 26, 1995.

Decrees Codrafted by HIID

Decree	Date Effective/Signed
Presidential Decree #293 "On Additional Measures to Promote Mortgage Lending	Signed by the President February 28, 1996.
Decree of the President #1157 "On Some Measures for Investors and Shareholders Protection"	Signed 18, 1995.
Decree of President #408 "On Approving Complex Program for Securing Investors and Shareholders Rights"	March 21, 1996.

Decree	Date Effective/Signed
Decree of the President #416 "On Measures to Protect Investors and Shareholders Interest and Bringing Commercial Activity, Carried Out on Financial and Capital Markets Without Corresponding Licenses, into Compliance with the Russian Federation Legislation"	April 26, 1965.

Decrees With HIID Participated

Decree	Date Effective/Signed
Presidential Decree #2130 "On State Land Cadastre and Reality Right Documents Registration"	December 11, 1993.
Presidential Decree #337 "On Realization of Citizens Constitutional Rights to Land"	March 7, 1996..
Draft Presidential Decree on Some Issues of Implementation of Decree #1767 date October 27, 1993, "On Regulation of Land Relations and Development of Agrarian Reform in Russia"	Fundamental provisions of draft decree incorporated in Presidential Decree 337 of March 1996.

DRAFT LAWS**Draft Laws Principally Drafted by HIID**

Draft Law	Status
<i>Federal Law on Non-State Pension Funds</i>	Submitted to Duma May 1996
Federal Law on Property Relations Reform and on Organizational Forms in Health Care System	First draft submitted to the Duma Spring 1995.
Federal Law on Functional Zoning	Further elaboration required for adoption at the regional level. Submitted to the Duma Spring 1996.
Federal Law on Real Estate Valuation	The draft was adopted in the first reading April 15, 1996. The draft is being prepared for the second reading in June 1996.
Federal Law on the Basis of Federal Policy in the Area of Land Use and Protection	Submitted to the Duma Committee on Legislation Spring 1996.
Federal Law on Funds Transfer	First draft completed May 1995. Amended draft was reintroduced to the Duma Subcommittee in March 1996.

Draft Law	Status
Federal Law on Introducing Amendments and Changes to the Code of Civil Procedure of the Russian Federation (Class Actions)	Draft submitted to the Government Spring 1996.
Federal Law on Private Arbitration Courts	First draft completed and is being finalized for the Duma

Draft Law	Status
Draft Laws Principally Drafted by HIID (Continued from preceding page)	Status
Federal Law on Tax Amnesty	Submitted to GPU June 1996.
Federal Law on the Basis of Federal Policy in Regulation of Relations Regarding Use and Conservation of Lands in the Russian Federation	Draft submitted to GPU and GKI.
Law on Specifications of Realizing Citizens' Constitutional Right to Land	Draft of April 1996 submitted to GKI for review.
Law on Conducting Real Estate Tax Reform in Novgorod and Tver	Draft submitted to the Ministry of Finance April 1996.
Federal Law on Investment Funds	Draft submitted to the Government for further consideration in June 1996.
Federal Law on Cessation of Shares, Reserved in the Federal Property and Contributing Objects in Federal Property to Charter Capitals of Partnerships and Societies	Adopted by the Duma after extensive amendments were added in October 1995. The President vetoed the legislation. HIID has redrafted the law, combining it with the draft below before its introduction in the Duma.
Draft Law on the Order of Disposition of Shares Fixed in the Federal Property	Adopted by the Duma October 1995 extensive amendment; vetoed by the President; redrafted.

Draft Law	Status
Federal Law on Taxation of Unit Investment Funds	Draft submitted to the RSEC for review April 1996.
Federal Law on Amending the Criminal Code and the Code of Administrative Violations (amendments related to violations of the securities market.	Introduced to the Duma in June 1996.
Federal Law on Appraisal Activity	First reading began May 15, 1996; various amendments were made.

Draft Laws Codrafted by HIID

Draft Decrees	Status
Federal Law on State Registration of Legal Entities	This draft was vetoed by the President after it was adopted by the Duma with significant amendments; the second draft was finalized in June 1996 but had not been forwarded to the Duma.

Federal Law on State Registration of Real Estate	The Duma adopted the draft on the first reading in July 1995; the second reading, scheduled for December 1995, was rejected, and was rescheduled for June 1996.
Federal Law on Trust Management	The November 1995 draft passed its first reading in the Duma; changes were required before the second reading to conform with the Civil Code.
Federal Law on State and Municipal Enterprises	Second reading scheduled for July 1996.
Federal Law on Development of Competition in the Financial Services Market	Introduced to the Duma May 1996.

Draft Laws in Which HIID Participated

Draft Laws	Status
<i>Tax Code</i>	First reading occurred in Duma; HIID working with principle drafters in joint working groups
Federal Land Code	Draft adopted by the Duma in the third reading in May 1996. Draft was being considered by the Federation Council. HIID contributed to the original draft, which was significantly altered by the Communist Party legislators. A presidential veto is expected and desired by HIID.
<i>Federal Law on Bankruptcy</i>	Work with Duma continued in 1996. Working on extensive comments and rewrites with the Federal Bankruptcy Agency as of June 1996.
<i>Federal Law on Amending the Law "On Competition and Limitation of Monopolistic Activity in the Commodities Market"</i>	Submitted to the Government June 1996.
Federal Law on Education Finance	Concept Paper Drafted Spring 1996.

Author: B Patrick Hickey <hickeyb.nsiad@gao.gov> at INTERNET
Date: 9/9/96 10:08 AM
Priority: Normal
TO: Jose M Pena III at GAO-NSD2
Subject: Strategic Forum 77

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[Institute for National Strategic Studies ~ Strategic Forum]

Number 77, June 1996

Sustaining Success in Haiti...

by Robert Oakley and Michael Dziedzic

Conclusions

- * The objectives sought in UN Security Council (UNSC) Resolution 940 have been achieved--but are not irreversible. The next several months are critical.
- * Sustaining the success of Operation Uphold Democracy requires Haiti--and the international community--to confront, simultaneously, crucial transitions in political leadership, law and order, economic assistance, and the international military presence.
- * Freezing humanitarian aid and long-term financial support to force reforms is counterproductive. Such international pressure weakens the Haitian government's ability to improve living conditions--undermining domestic support for democracy, increasing the risk of lawlessness--which decrease the likelihood of reform and increase the likelihood of yet another boatlift.
- * Due to delays in recruitment and training, Haitian police forces lack most of the supervisors and much of the experience needed to successfully maintain order if the last UN forces leave as scheduled by July 1996. A follow-on international force will likely be needed while the Haitian National Police (HNP) become capable of autonomous action.

Background

The next several months will be crucial as Haiti confronts four fundamental transitions:

- * Political Leadership: Relations between the business class and the new political elite; between the executive and an increasingly independent Parliament; and between Jean Bertrand Aristide and his successor, President Rene Preval, all remain in flux.
- * Law and Order: Responsibility for public security has shifted from an Interim Public Security Force with 900 UN civilian police (Civ-Pol) monitors working closely with a highly visible Multinational Force (MNF) and United Nations Mission in Haiti (UNMIH) military forces to the inexperienced HNP with few trained supervisors, only 300 Civ-Pol, and no visible UNMIH military liaison.
- * Economic Assistance: Instead of readily available humanitarian aid and balance of payments support, much assistance is frozen pending enactment of several controversial reforms. Without external funding, the Government of Haiti (GOH) will be unable to function beyond

other macro-economic problems persist after years of exploitation by the country's despotic leadership and the devastating impact of the embargo.

- * International Military Presence: UNMIH has been reduced from a 6,500-member, U.S.-dominated, highly mobile force to a much smaller, less mobile contingent with no U.S. participation; unless there is an extension to the mandate, UN presence will end July 1, 1996.

Will Success Endure?

The last U.S. soldier serving as part of the UNMIH departed Port-au-Prince April 17, 1996. The remaining force of 1,900 Canadian, Pakistani, and Bangladeshi troops is led by a Canadian general. The U.S. military "exit strategy" has been executed as planned, in a three-phased transition that began with the replacement of the U.S.-led 22,000 member MNF by a contingent of 6,000 UNMIH troops in March 1995.

The objectives established in UNSC Resolution 940 have been achieved. The credible threat of U.S. military action, combined with the 11th-hour diplomacy of the Carter-Nunn-Powell mission, peacefully dislodged the Cedras regime where all else had failed. A secure and stable environment was established, allowing open and orderly elections to be held for local and national level officials. This was followed by an even more historic event: Haiti's first peaceful transfer of power from one democratically-elected president to another. Remarkably, the entire process of controlling and ultimately dissolving the Haitian Armed Forces was accomplished with only one U.S. service member killed in action. An entirely new police force of 5,200 was recruited, given four months training, and deployed by February 1996. Large-scale relief efforts and temporary work projects helped alleviate the misery of the masses. Progress was made in restoring basic infrastructure such as electricity, roads, and water, and a few private sector enterprises also resumed operations. A crucial factor undergirding these achievements was the exceptional cooperation among key players: the Special Representative of the UN Secretary General Lakhdar Brahimi, the U.S. and UN force commander Maj. Gen. Joseph Kinzer, the U.S. Ambassador William Lacey Swing, and Haitian authorities.

In the process, U.S. interests in Haiti--stopping atrocities, securing our borders against illegal immigration, promoting democracy in the hemisphere, upholding our international commitments, and restoring national credibility tarnished by the abortive deployment of the USS Harlan County--were also furthered.

Although the MNF and the UNMIH successfully accomplished their assigned tasks, some of these achievements are fragile and subject to reversal. Much remains to be done by the extended UNMIH mission, by the United States, the international community, and principally by the Haitian people themselves. If success is to be sustained in Haiti, each of these actors will need to take appropriate measures.

Political Leadership: Haiti's democratic roots are shallow, and the ability of the government to respond to citizen needs is severely constrained. A genuine commitment to resolve future political disputes through peaceful, democratic means has yet to be forged. The conduct of the French-speaking oligarchy and of hard-core Aristide supporters within the Lavalas movement will be particularly crucial. The possibility also exists that essential economic reforms could be thwarted by opposition from within Lavalas. If political gridlock immobilizes the Preval government, eroding its legitimacy and prolonging economic stagnation, domestic stability could give way to serious disorder, with all the attendant consequences.

Also vital to the consolidation of democracy is governmental performance. Given that Haitian government has traditionally been little more than a mechanism of self-enrichment, a major role reversal is obviously required if it is to respond effectively to the basic needs of the people. Dire shortages of both material resources and administrative-technical expertise at all levels immensely compound this challenge.

Law and Order: In spite of Herculean efforts to create a police force de novo, serious voids remain:

- * Recruitment and training of a full cadre of supervisors for Haiti's rookie police force. When Preval took office, only 35 of 257 supervisory billets had been filled. (This deficiency is being

Federal Law on Mortgage	Second reading scheduled for July 1996.
Tula Oblast Law on Land	(No information provided)
Federal Law on Exchange and Promissory Notes	Submitted for the first reading in Duma April 1996.

DRAFT DECREES**Draft Decrees Principally Drafted by HIID**

<u>Draft Decrees</u>	<u>Status</u>
Presidential Decree of the President "On State Support of Real Estate Market Development in the Russian Federation"	Submitted to the Government for consideration (no date provided).
Presidential Decree "On the Basic Principles of the Federal Policy Concerning Regulation of Land Use and Land Conservation Relations in the Russian Federation"	Draft of May 1996 submitted to the Government.

Appendix II**Appendix II**

Decree "On Granting Additional Authorities to the Federal Commission on Securities Market under the Russian Federation"	Submitted to the RSEC May 1996.
Decree "On Amending and Amplifying Decree of the President N1186 "On Measures for Regulations of Securities Market During the Privatization of State and Municipal Enterprises, dated October 7, 1992"	Submitted to the Government April 1996.
Decree of the President "On Investment (Financial) Broker"	Submitted to the Government July 1995.
Decree of the President "On Self-Regulatory Organizations in Securities Market Area"	Submitted to the Government July 1995.

Draft Decrees Principally Drafted by HIID (Continued from preceding page.)	Status
Decree "On Organizations of Payments for Securities Market Operations and Certification of Organizations, Including Banks Carrying Out Payments in the Securities Market"	(No information provided.)
Decree "On Securities Issued by the State Authorities of the Subjects of the Russian Federation and Local Self-government Bodies"	Submitted to RSEC Fall 1995-1996.
Decree "On introduction of Amendments and Amplifications to the draft Decree of the President "On Securities Issued by the State Authorities of the Subjects of the Russian Federation and Local Self-government Bodies"	Submitted to RSEC Fall 1995-1996

Draft Decrees HIID Participated in Drafting

Draft Decrees	Status
Decree on the Development of a Real Estate Market	December 1995 (no other information provided).

EXECUTIVE SUMMARY

PURPOSE

The U.S. Agency for International Development (USAID) was tasked as the lead U.S. Government agency to provide development assistance to Russia after the December 1991 collapse of the Soviet Union. At the time, changes within Russia touched all political, economic, military and social institutions.

USAID alone did not have the organization, contacts, and expertise to accomplish the unprecedented task of assisting Russia's transition to a market oriented economy, and turned to U.S. private organizations to provide economic, business, and financial advice to Russian reformers. USAID increasingly relied on one organization, the Harvard Institute for International Development (HIID), because of its pre-existing relationships with Russian reformers, to provide direct program work and oversight of U.S. contractors in USAID's Russian Privatization Program.

Chairman of the House Committee on International Relations Committee requested GAO to review the history of HIID funding, the use of noncompetitive procedures, and the overall effectiveness of the work conducted by HIID in meeting project objectives. The Committee was interested in whether other universities or institutions could provide similar assistance, and whether the Ukraine project duplicated a previously competed but withdrawn proposal and other assistance being provided by USAID and other donors.

Specifically, GAO agreed to evaluate whether (1) USAID's selection process (competitive and non-competitive) for HIID cooperative agreements favored HIID, and (2) HIID had achieved USAID and State Department goals for capital market development, legal reform, and post privatization.

BACKGROUND

Profound changes swept the newly independent states of the former Soviet Union in 1991. For sheer scale they were unparalleled in recent history. USAID budgeted \$1.5 billion in support of Russian reforms covering such areas as democracy , energy, housing, health, and environment., About one-third of these funds were allocated to privatization, legal reform, capital market development and post privatization., areas that HIID would assume significant responsibility for providing impartial oversight

From an initial amount of \$2.1 million, USAID provided HIID with over \$40 million under a cooperative agreement awarded in 1992 on a non-competitive basis and another \$17.4 million under a cooperative agreement awarded in 1995 on a competitive basis. In 1996, USAID awarded HIID a cooperative agreement for \$1.5 million award for work in Ukraine based on an unsolicited proposal.

In its effort to support economic reform in Russia, USAID had developed unique relationship with HIID. HIID was working with the top echelon of Yeltsin's economic reformers in 1992 before the USAID program began. HIID's ongoing work in Russia offered USAID an opportunity to support the economic reform work underway, and the assistance gave them access to reformers within the Yeltsin government.

From 1992 to the present, USAID has continued to support the reformers' reform agenda. USAID, through HIID, funded the reformers efforts in post-privatization, developing the Russian securities and exchange commission, initiated development of a capital market, and initiated the legal reform program. In each instance, HIID helped establish Russian institutions to sustain the reforms, such as the Russian Privatization Center (RPC), which implemented enterprise restructuring and land reform. In each

instance, one of the early reformers went on to head, or heavily influence, the institutes created by HIID for them

RESULTS IN BRIEF

From the beginning of USAID's program in Russia, the agency relied heavily on HIID, in large part because of HIID's pre-existing relationship with key Russian reformers. Until recently, USAID funded most of HIID's assistance activities in privatization, capital markets, and legal reform under non-competitively awarded cooperative agreements. In response to increasing pressure from a number of sources, USAID decided in 1995 to hold a competition for additional assistance for "Impartial Oversight and Strategic Guidance for Privatization and Market Reform." USAID planned to award four separate cooperative agreements, two for assistance in Russia, one for Central Asia, and one for Ukraine. In our review of the selection process, we found a number actions surrounding the evaluation of proposals that, although not illegal, may have affected the overall fairness of the process. In addition, errors made in tabulation of the evaluation panel members' scores may have resulted in selection of a winning proposal based on an erroneous final score. The Russian reformers who would have received assistance under the proposal rejected the winning proposal. As a result, the award was not made.

In Ukraine, a few months after the competition was cancelled, USAID awarded HIID a cooperative agreement non-competitively based on an unsolicited proposal. USAID made the award despite knowledge that the HIID proposal duplicated areas covered in the cancelled competition and concerned by some USAID officials and other donors that it might be counter productive to U. S. assistance objectives because it duplicated other on-going assistance efforts.

With the assistance of HIID and other U.S. contractors, Russian Reformers have made significant progress in establishing an independent regulatory body, a Russian trading organization, and a self regulatory dealer broker organization. The major disappointment has been the failure to establish clearing and settlement organizations throughout Russia. In this case, HIID did not develop an effective strategy to overcome the many political and structural obstacles confronting the development of capital market infrastructure.

Under the Legal Reform Project, HIID has drafted, or assisted in drafting, key pieces of legislation that have become law. However, the USAID/HIID strategy of relying on Executive Branch and Duma¹ working groups had not overcome a political environment hostile to legal reform. As a result, much of the legislation drafted by HIID has not been enacted or even submitted for consideration by the Duma. However, the project created significant controversy within USAID, when HIID opposed the work of another USAID supported university working on Russia's civil code, began to rely more on decrees in the face of legislative resistance, and when its client, President's Legal Office (GPU), denied country clearance to USAID officials, who were to participate as members of a World Bank team assessing the potential legal reform loan.

Despite USAID's \$40 million investment to create and support the RPC, it is unclear whether the RPC can continue to provide assistance without further U.S. or other donor funding. USAID is concerned that its significant investment in the RPC may be lost, particularly if other donors do not continue to support their activities through the RPC network. Also, USAID funded post privatization projects have produced mixed results and the RPC's

¹The Duma is the lower house of the Russian Parliament; the Federation Council is the upper house.

performance assisting these projects was also mixed.

PRINCIPLE FINDINGS

HISTORY OF USAID FUNDING OF HIID ACTIVITIES

In December 1992, USAID awarded HIID a \$2.1 million non-competitive cooperative agreement to support privatization, legal reform and capital market development based on:

- HIID's existing working relationship with the Russian State Property Committee,
- key Russian reformers' trust of HIID and
- the limited capacity for competing the cooperative agreement due to time constraints.

Between April 1993 and September 1995, through a series of amendments, USAID increased funding under the cooperative agreement by \$38.3 million or expanded work in capital markets and legal reform and support to the RPC on a non-competitive basis. GAO noted that in the case of the legal reform project another university that also receives funds from USAID *for legal reform*, had a pre-existing relationship with other Russian reformers and demonstrated the ability to work with Russian reformers in the development of the Russian civil code. However, the legal advisor to the Russian President and the mission favored HIID over this university and, therefore, USAID continued to support HIID's legal reform program.

Because HIID had been awarded a substantial amount of work in Russia non-competitively and because U.S. law, and USAID guidelines encourage competition in the award of grants and cooperative

agreements, USAID was subject to increasing pressure to award additional work competitively. However, a number of USAID decisions involving the subsequent 1995 competition appeared to favor HIID. For example, the State Department Coordinator for Former Soviet Union Assistance and the USAID Deputy Administrator invited the Russian SEC and RPC to nominate representatives for the selection panel. This had the appearance of favoring HIID because the SEC Director had voiced a strong preference toward HIID. Regarding RPC, the HIID project manager was a member of its board of directors.

Because USAID's procurement officer incorrectly tabulated panel members scores, USAID may have selected the winning proposal for the SEC portion of the work based on an erroneous final evaluation score. The panel process was also unusual at least one other respect. The evaluation panel was reopened after its initial members had already completed and submitted their evaluations so that the SEC nominee could be added. The SEC nominee told us that she believed HIID could not be selected for both the SEC and RPC work and that based on USAID instructions she had employed a different scoring methodology than the other panelists.

In July 1995, the Executive Director of SEC informed USAID that based on his experience, HIID was the only organization capable of doing the work. In September, the Russian SEC rejected the announced winner of the competition, thus USAID made no award. In September of 1995, before the winner was formally notified that it would not receive the award, USAID provided HIID an additional \$1.7 million under its Cooperative Agreement to finance salaries for SEC employees, allowing HIID to continue supporting the SEC through December 1996.

USAID's practices in Ukraine also appeared to favored HIID. In March 1995, USAID began a competition for work in Ukraine modeled

after HIID's work in Russia. In May, USAID canceled the competition because the mission reported that the Ukrainian government was uninterested in this form of assistance. In July, 1995, HIID submitted an unsolicited proposal to provide assistance that partly duplicated the work included in the withdrawn request for proposals. The work under HIID's unsolicited proposal also duplicates some current activities being undertaken by others. GAO found that limited knowledge existed within the Ukrainian government with regard to the proposal. However, HIID, supported by the State Department Coordinator, U.S. Treasury and the National Security Council, was awarded a non-competitive cooperative agreement based on U.S. foreign policy considerations.

HIID HAD MIXED RESULTS IN DEVELOPING CAPITAL MARKET

After the successful voucher privatization project, USAID and the reformers turned their attention to the development of the Russian capital market. USAID focused on support for an independent regulatory body; independent share registers; clearance and settlement organizations; and self regulatory dealer broker organizations to protect shareholder rights. USAID's goal was to have these efforts substantially in place by the end of 1996 by which time the necessary laws and regulations were expected to be substantially in place.

Through its support of the Russian Secretariat, HIID provided policy advice to the RFCSCM and oversight, management, and coordination of the technical assistance delivered by contractors through task orders. HIID supported the development of the Resource Secretariat that helped define a strategy for capital markets and provided impartial oversight over U.S contractors working on the capital market infrastructure. In addition to supporting the Secretariat, HIID through the legal reform project provided technical assistance to support reformers' efforts to

establish an independent Security Exchange Commission.

During the summer of 1994, in anticipation of the creation of a Russian SEC, USAID began to fund a "Resource Secretariat". The idea was to consolidate all technical assistance to the Russian capital markets under a single managerial and coordination structure led by experienced professionals. The Resource Secretariat constituted the "think tank" for the Russian SEC and the market that it oversees. On April 22, 1996, President Yeltsin signed a comprehensive Law "On the Security Market" that established a structure for market regulation by the Security Commission. The concepts of the law and the vision of the capital market regulation contained in the law are a direct result of HIID's support of the Secretariat and RFCSCM

GAO's assessment of the progress of the capital market infrastructure shows that progress has been uneven in developing the needed infrastructure. The work pertaining directly to dealers and brokers including development of a Russian trading system is considered a success along with the development of self regulatory organization for market participants. These areas were rather straight forward efforts that had fewer potential political pitfalls than some of the other infrastructure projects. The Clearing and Settlement Organizational(CSO) project was the centerpiece of the infrastructure effort because it potentially impacted on registrars, dealers and brokers, the central bank, foreign and domestic banks, the tax police and others. But it has not developed into a working clearing and settlement operation.

In mid 1993, Barents and Deloitte began projects to create five CSO's. By late 1994, Deloitte completed the organization of CSO's in Moscow, Ekaterinburg, and Novosibirsk, and Barents had done the

same in St.Petersburg and Vladivostok.² Each CSO evolved from an existing stock exchange and was owned and controlled by the exchange and the market participant. However, as of mid 1996, only the Vladivostok stock exchange was active but trading was limited to 30 transactions a day and the Moscow Depository Clearing Corporation (DCC) was disintegrating. The price tag for this effort was \$14 million. The unsuccessful development of CSO's occurred despite the general belief by market participants for a need for a central depository.

USAID, HIID, U.S. contractors, and market participants cited a number of reasons for the disappointing outcome of the CSOs including political power struggles, market conditions, and tax laws. While there is some basis for each of these factors, HIID also bears some of the responsibility for not developing an effective strategy to overcome these problems.

HIID APPROACH TO LEGAL REFORM RESULTS IN CONTROVERSY

Since 1992, Russia has privatized 40,000 state-owned enterprises and allowed private ventures. However, its economic and commercial legislation have not kept pace with the privatization or the emergence of new private enterprises. Basic principles of contract law and property remain poorly developed or retain outdated approaches that often impede commercial activity. Russia lacked a modern system of corporate law to govern the rights and duties of its directors, managers, and shareholders. The restructuring of Russian industry was hindered by the lack of effective bankruptcy laws and the ability to carry them out. And the many types of financing needed to improve businesses was not available due to

² The Vladivostok CSO was already operational before HIID began implementation of the project.

legal and institutional limitations. Without corporate law or a securities law to protect equity investors, or a bankruptcy law to provide secured lending to protect creditors, it was extremely difficult for Russian businesses to attract needed capital.

On November 8, 1994, 3 months after the legal reform project was authorized, HIID submitted a work plan for the next six months. HIID complied with the terms of the work plan by

- providing commentary, expert advice, and drafting assistance on legislation,
- establishing a core group of long-term resident advisors and short-term Western experts who would be available to assist the working groups preparing draft legislation,
- assisting in the creation of a Russian Institution, the Institute for Law Based Economy (ILBE), to carry out the legal reform project before and after USAID ends its assistance, and
- promoting closer coordination between the Executive Branch and the Duma.

The U.S. strategy did not result in the passage of many laws. Of the 19 listed by the Executive Branch and the Duma Coordinating Committee, only 6 have been enacted. Of the 6 laws that passed, HIID was the principle drafter of 3, the others it served either as co-drafter or provided some comments. These laws are significant accomplishments, and include laws on securities, joint stock companies, monopolies. However, the majority of laws USAID hoped that the Parliament had passed within a two year period have not been enacted. Of the remaining 13 laws, none have been forwarded to the parliament for consideration, indicating the lack of political consensus necessary for enactment. Confronted with the

possibility that none of the remaining legislation would be enacted, HIID began instead to work with the Executive Branch to get decrees promulgated.

HIID support to the Presidents legal advisor and the use of decrees conflicted with the position taken by USAID/ENI's Office of Democracy and Governance. In April 1995, the Democracy group raised the following concerns about HIID's approach. (1) It was very centralized and top-down. (2) Their success was dependent upon working with Legal Advisor to the President on the basis that it was the legal reform czar, (3) HIID's notion that Russian legal reformers were not able to grasp repeated "advice"--even after several discussions--ran counter to the democracy group's experience and (4) HIID's strategy premised on supporting "like-minded reformers" and cutting out "non-believers" from the drafting process failed to accept the political reality that the process for making policy and laws had to be more democratic and inclusive.

SUSTAINABILTY OF THE RPC IS UNCERTAIN

As a result of Russia's privatization program, nearly 40,000 state owned Russian enterprises were transferred to private ownership. These newly privatized enterprises, however, lacked the capital and the expertise needed to become economically viable companies. USAID sought to support the Russian Privatization Center (RPC) in helping 23 privatized firms restructure. In addition to restructuring the targeted enterprises, USAID's stated goal was to train a core of Russian RPC consultants who could carry out enterprise restructuring after USAID assistance ended. USAID has not been able to meet all of its goals.

The RPC network coordinates and implements nearly \$200 million of

donor assisted projects but it depends almost exclusively on USAID for its operational assistance. Its ability to acquire outside funding to support its operations has produced to date mixed results. Although a mixture of donor resources has been either promised or committed they are inadequate to meet fully the RPC network's operational needs after USAID assistance ends in 1997. RPC management has frequently requested additional USAID operational grant funds and as of August USAID Washington has not decided on RPC's latest request of \$6.6 million. The World Bank remains the RPC's best, yet uncertain prospect for future funding.

Although U.S. contractors successfully completed enterprise restructuring, these companies are not making a profit and have not attracted foreign investment. In addition, these pilot projects did not train RPC staff to provide consulting services. Instead, materials developed by these pilots were provided to the RPC to continue the assistance, but U.S. contractors questioned whether RPC could implement such assistance without support from private expatriates and independent.

The RPC lacked a focus in its land-reform initiatives. It had not filled the director of land reform position since December 1995 and had not decided what should be the role of a director. While HIID was charged with the task of providing support for a director of land-reform at the RPC, this position was only intermittently filled. While some of the land projects appear to be achieving the project goals, the real estate information and titling systems, the largest model project, encountered difficulties in meeting its targets. USAID had hoped to install the system in up to 19 cities, but only 4 cities had operational systems at the time of our review.

USAID has not successfully managed RPC's development. For example, USAID has been unable to obtain RPC workplans and progress reports,

making it virtually impossible for USAID to effectively manage and evaluate RPC performance. USAID and others, including the World Bank, have raised questions about RPC's management capabilities. GAO noted that HIID has not successfully fulfilled its responsibilities to develop Russian procurement and financial management expertise in the RPC.

October 10, 1996

*Editor's
version
of draft.*

EXECUTIVE SUMMARY

PURPOSE

After the December 1991 collapse of the Soviet Union, the U.S. Agency for International Development (USAID) was designated the lead U.S. government agency to provide transition assistance to Russia. At the time, changes in Russia touched all political, military, economic, and social institutions. USAID faced an unprecedented task of assisting Russia in making the transition to a market economy. These reforms would have far-reaching consequences for the United States. However, USAID alone did not have the organization, contacts, and expertise to accomplish the unprecedented task of assisting Russia's transition to a market-oriented economy. Therefore, it turned to U.S. private organizations, in particular the Harvard Institute for International Development (HIID), to provide direct program work and oversight of U.S. contractors in USAID's Russian privatization project. HIID had pre-existing relationships with Russian officials and helped establish Russian institutions to sustain reforms. These institutions included the Russian Privatization Center (RPC), which assisted with the restructuring of business enterprises and facilitated land reform.

The Chairman of the House Committee on International Relations asked GAO to provide information on (1) how USAID awarded

assistance agreements to HIID to carry out work in Russia and Ukraine and (2) HIID's role and accomplishments in implementing assistance agreements to (a) develop a Russian capital market¹ and (b) devise a legal reform program. In connection with evaluating HIID's role, GAO also assessed the effectiveness of the RPC in implementing USAID post-privatization and land reform projects.

BACKGROUND

In December 1992, USAID initially provided HIID with \$2.1 million under a cooperative agreement² awarded without competition to initiate activities covering privatization, capital markets, legal reform, and other related areas; with amendments to the original agreement, this amount escalated to \$40.4 million by September 1995. In that year, USAID awarded HIID on a competitive basis another \$17.4 million to continue its work in Russia. HIID's responsibilities included providing project monitoring and oversight of other U.S. contractors. USAID had approved these contractors, including HIID, to give a total of \$325 million in technical assistance to various Russian institutions and private companies.

¹Footnote will explain "capital market."

²A cooperative agreement is identical to a grant except that the government agency that signs the agreement is to be "substantially involved" in the program's implementation.

The federal government uses cooperative agreements when the goal is to transfer money, property, or anything of value to accomplish a public purpose. Such an agreement must be managed in accordance with the Federal Grant and Cooperative Agreement Act of 1977, 31 U.S.C.*_?____; related Office of Management and Budget circulars; and USAID guidelines. Neither the act, the circulars, nor USAID guidelines provide extensive guidance on how cooperative agreements should be awarded.

However, the act does require agencies to encourage competition in awarding cooperative agreements. Accordingly, USAID guidelines specify competition "to the maximum extent practicable" but include a number of broad exceptions. For example, competition is not required for certain unsolicited proposals if the recipient has exclusive capabilities based on an existing relationship with the cooperative country or beneficiary. In addition, competition can be waived for "circumstances as are determined to be critical to the objectives of the foreign assistance program."³

RESULTS IN BRIEF

Because USAID believed HIID's efforts regarding establishment of capital markets, reform of the legal system, and privatization of Russian enterprises were critical to the U.S. foreign assistance

³Update reference.

program, USAID awarded noncompetitive agreements to HIID to work in Russia beginning in 1992 and Ukraine beginning in 1996. USAID's belief was based on HIID's ties to Russian reformers and that time was of the essence in accomplishing reforms. Subsequently, another U.S. organization began legal reform activities in Russia. Nevertheless, USAID amended its noncompetitive agreement with HIID to expand its legal work.

In 1995, USAID opened a competition for four further cooperative agreements to foster economic reforms throughout the region. HIID won one award for work in Russia and no award was made for other Russian work. In addition, the cooperative agreement for work in Ukraine was cancelled, and a U.S. organization won the award for Central Asia. However, problems developed during the process of selecting the winners. These problems involved the composition of the selection panel, the tabulation of the panel members' scores for choosing award winners, and a Russian official's refusal to accept one of the winners. USAID had no specific guidelines for running the competition. Further, although the cooperative agreement for Ukraine--for which HIID did not bid--was dropped, HIID later submitted an unsolicited proposal to do similar work. USAID accepted the proposal and awarded HIID a noncompetitive cooperative agreement despite the fact that USAID knew the proposal duplicated some of the work contained in the cancelled competitive proposal and other ongoing assistance efforts. This course of action had high-level interagency support.

HIID successfully accomplished a substantial portion of its noncompetitively awarded cooperative agreement to assist in developing a Russian stock market structure. For example, it provided technical assistance to establish a Russian organization that managed and coordinated the process for establishing a Russian Securities and Exchange Commission (SEC). Some aspects of its work, however, did not meet USAID's expectations, particularly HIID's assistance in trying to develop a clearing and settlement organization to facilitate stock trading operations.

Regarding legal reform efforts in Russia, HIID served as adviser on and drafter of laws for economic and commercial ventures. The Russian parliament has passed 5 of 19 HIID-sponsored laws. HIID also assisted in creating a Russian institute to craft laws during and after USAID funding is terminated. Some USAID officials expressed concern that HIID (1) supported Russian leaders' use of decrees to promulgate laws rather than working through the legislative process and (2) excluded dissenters from its proceedings. The USAID officials considered these practices as not encouraging democratic reforms. Further, HIID's progress reports did not contain information essential to evaluate its success.

Since April 1993, HIID's responsibilities for the RPC and the local privatization center (LPC) network⁴ have been focused mainly on

⁴footnote will explain RPC and LPC

providing macroeconomic policy advice and recruiting program and management specialists as needed. With HIID support, the RPC has assisted with the privatization of state-owned enterprises, restructuring of those enterprises, and promoting land reform. However, the RPC might not be sustainable without further donor assistance because its revenue-raising activities are speculative.

PRINCIPAL FINDINGS

USAID's Award of Cooperative Agreements to HIID

In 1992, USAID noncompetitively awarded a cooperative agreement to HIID because HIID was well situated in Russia to provide immediate support to USAID's efforts. In 1993, another organization, also funded by USAID, began working on legal reform. HIID was able to persuade USAID that its relationship with the advisor to Russian President Boris Yeltsin presented a better chance for meeting legal reform goals.

Although USAID funded HIID's activities through noncompetitively awarded cooperative agreements from December 1992 through September 1995; however, in March 1995 USAID requested competitive bids for four cooperative agreements to do follow-on work in Russia and similar work in other newly independent states (NIS). HIID was awarded an agreement to help develop Russian tax laws, continue land reform, and sustain support for the RPC. However, USAID made

no award for work to continue to develop a Russian capital market and a Russian Securities and Exchange Commission (SEC), which was part of the request for proposals, because the Russian head of the SEC refused to accept the winner. USAID withdrew its request to bid for Ukrainian work, ostensibly because of limited funds and lack of Ukrainian interest. Nevertheless, HIID later submitted an unsolicited proposal for the Ukrainian work and received the award without competition. As for the award to perform oversight of USAID contractors in Central Asia, another university gained the cooperative agreement.⁵

GAO found that individuals representing the Russian government who had ties to HIID participated in the selection panel that determined the winners of the competition for assisting in the areas of tax law and land reform, supporting the RPC, developing a Russian SEC, and working in Central Asia. According to USAID officials, having such representation was an acceptable practice. Nevertheless, GAO noted that one of Russia's representatives joined the panel after the panel had completed considering the applications--a highly irregular event, according to the Chairman of the panel. The scoring system the late-arriving representative used differed from that of the other panel members. Other discrepancies occurred as well, all of which went against HIID and caused it to lose the award for the Russian SEC. These

⁵HIID did not enter the competition for this award.

discrepancies were apparently a result of a USAID official's incorrectly recording the panel's scores. When an organization other than HIID was declared the winner, the Russian reformers who were to receive aid through the cooperative agreement rejected the organization. The Russians strongly preferred HIID because of HIID's deep involvement with the Russian SEC.

With regard to the withdrawn Ukrainian portion of the request for proposals, GAO found that HIID subsequently submitted an unsolicited proposal to USAID to perform very similar work in the areas of macroeconomic and monetary policies, tax and budget assistance, and fiscal reform of the pension program. Although the Ukrainian Deputy Prime Minister endorsed HIID's proposal, GAO found that others within the Ukrainian government knew little about it, contrary to USAID's statements. USAID had asserted that HIID had widespread relationships with government officials. Also, GAO noted that tax reform work was already being done by a U.S. Treasury advisor. HIID's proposal quite possibly could delay this work, the U.S. mission in Ukraine believed. Thus, the stage was set for dissension in Ukraine about HIID's proposed work. In the United States, however, USAID accepted HIID's unsolicited bid based on "foreign policy considerations." USAID's decision was also supported by the State Department's Coordinator for the NIS, the Treasury's Director of the Office for Economies in Transition, and the National Security Council advisor for Ukraine.

HIID's Role in Developing a Russian Capital Market

HIID's implementation of the December 1992 agreement to help Russia develop its capital market assisted the Russians in making progress toward creating a capital market but also encountered some disappointments. Through its support of the Russian Resource Secretariat (the "think tank" for developing a Russian capital market), HIID provided policy advice to the Russian SEC, and oversight, management, and coordination of the technical assistance delivered by other contractors. In addition to supporting the Russian Resource Secretariat, HIID provided technical assistance to support reformers' efforts to establish an independent Russian SEC.

On April 22, 1996, President Yeltsin signed a comprehensive law concerning the securities market that established a structure for market regulation by an independent Russian SEC.⁶ The concepts of the law and the vision of the capital market regulation contained in the law can be attributed directly to HIID's support of the Russian Resource Secretariat and the Russian SEC, according to HIID's Moscow project director. However, in August 1996, President Yeltsin issued a decree placing the Russian SEC under the Finance ministry, thus putting its future independence into doubt--a potential major setback to market participants.

⁶In August 1996, President Yeltsin issued a decree placing the Russian SEC under the Finance ministry, thus putting its future independence into doubt.

HIID's oversight of work on encouraging dealers and brokers to develop a Russian stock market trading system is also considered a success, as is the creation of a self-regulatory organization for overseeing market participants. These developments encountered fewer potential political hindrances than some of the other infrastructure projects. In contrast, work on creating a clearing and settlement organization for facilitating stock trades was more difficult. This effort would likely affect stock registrars, dealers and brokers, the Russian central bank, foreign and domestic banks, the state tax inspector, and others. It has not developed into a viable operation.

USAID, HIID, U.S. contractors, and market participants cited a number of reasons for the disappointing outcome of the clearing and settlement organization. These included political power struggles, unfavorable market conditions, and complicated tax laws. While there is some basis for each of these factors, HIID is also partly responsible for not devising an effective strategy to deal with these difficulties.

HIID's Role Under the Legal Reform Project

Since 1992, Russia has privatized 40,000 state-owned enterprises and allowed private ventures but has lacked economic and commercial laws to underpin these developments. Under a noncompetitively awarded cooperative agreement, HIID

- provided commentary, expert advice, and drafting assistance on legislation;
- established a core group of long-term resident legal advisors and short-term western experts who would be available to assist the Russian working groups that were preparing draft legislation;
- helped create a Russian organization, the Institute for Law-Based Economy (ILBE), to carry out a legal reform project before and after USAID ends its assistance;
- promoted closer coordination between the Russian executive branch and the Russian lower house of parliament (the Duma); and
- helped gain funding from the World Bank for continued legal reform.

Of the 19 laws listed by the executive branch and the Duma coordinating committee established at the behest of the U.S. Ambassador, 5 have been enacted. Of the five laws that were passed, HIID was the principal drafter of two; for the others, it served either as codrafter or provided some comments.⁷ These laws

⁷HIID participated in work on seven additional laws that were passed but were not part of HIID's original work plan.

are significant accomplishments and include rules on securities, joint stock companies, and advertising. However, the majority of laws USAID hoped that the parliament would have passed within a 2-year period have not been enacted. Confronted with the possibility that none of the remaining legislation would come to fruition, HIID began to place more emphasis on working with the executive branch to have decrees promulgated rather than passed legislatively.

HIID's approach raised concerns within USAID. Some USAID officials stated that HIID relied extensively on its ties to the legal advisor to the Russian President and that it attempted to dismiss from the law-drafting process those who disagreed with its approach. Also, HIID did not meet all its reporting requirements, submitting quarterly rather than monthly reviews. In addition, officials at USAID in Washington questioned the completeness of the data in the reports. For example, no information was provided on how specific HIID projects were related to the overall goals of the legal reform program.

HIID's and the RPC's Role in the Russian Privatization Program

HIID's efforts to provide policy advice, create the RPC, and facilitate post-privatization were generally successful; however, USAID's land reform projects were not as successful, and the RPC may not be self-sustaining.

During 1993 and afterwards, HIID gave advice to Russian reformers on lowering inflation and setting the Russian economy on a path to stability. Regarding the RPC, HIID was responsible for initially setting up the RPC and overseeing the work of the contractors who were to develop an accounting system, find office space, and recruit personnel to run the RPC. After September 1994, the responsibility for RPC oversight shifted from HIID to the USAID mission in Moscow. USAID then gave a direct grant to the RPC to cover its operating expenses. Nevertheless, HIID remained engaged by recruiting and paying the salaries of expatriates who held important positions such as the chief financial officer, the procurement officer, the press secretary, and a number of project associates.

Following the completion of Russia's privatization of most state-owned enterprises in November 1994, USAID focused on using the RPC and 10 LPCs to help USAID work with newly privatized firms on the difficult process of restructuring and of devising procedures for land reform. U.S. contractors working with the RPC helped Russian firms successfully complete enterprise restructuring. For example, some of the enterprises reduced labor costs by streamlining operations and lowered other expenditures by revising procurement procedures. With regard to USAID's largest land reform project that was to create a real estate information system in selected municipalities, the RPC was responsible for facilitating negotiations among local agencies to unify into a single data base

the information each was maintaining on land, structures on the land, and housing. However, in a number of cases, because the negotiations became protracted, this project did not meet its objectives.

Although the RPC facilitated enterprise restructuring projects, additional companies have not hired the RPC for consulting services. Thus, they are not providing fees to the RPC for services, as USAID anticipated would need to happen for the RPC to become self-sustaining. Moreover, U.S. contractors also were unsure whether the RPC could implement such assistance without support from private expatriates and independent contractors. Nevertheless, GAO notes that outside support through the World Bank may be provided. However, these funds are not expected to fully meet the RPC network's operating costs.

AGENCY COMMENTS

(TO BE OBTAINED)

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Version

Ants
report

No input by
Louis Stabb

Jim
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OGC mission
- gets work.

CHAPTER 2

USAID's AWARD OF COOPERATIVE AGREEMENTS

USAID used non-competitively as well as competitively awarded cooperative agreements to fund HIID activities in Russia and Ukraine. We looked at a December 1992 non-competitive award for work in Russia, a competition held under a request for applications issued in March 1995, and a May 1996 non-competitive award for work in Ukraine. We found that USAID awarded the agreements in accordance with applicable law and USAID guidelines. However, the 1995 competition was poorly managed in some respects.

MINIMAL REQUIREMENTS FOR AWARD OF COOPERATIVE AGREEMENTS

A cooperative agreement is a funding mechanism used by a federal agency to transfer funds to a public or private organization to support an agency program. Agencies use cooperative agreements when they plan on being substantially involved in management of the project being funded. The agreement defines the agency's relationship with the recipient. Unlike acquisition of goods or services by contract, cooperative agreements are often used to define project goals and determine the best approach for achieving them. Because of the need for flexibility, applicable laws and regulations impose only minimal requirements with respect to the procedures agencies must follow when selecting recipients and awarding cooperative agreements.

The Federal Grant and Cooperative Agreement Act of 1977 (31 U.S.C. 6301) establishes criteria for selecting the appropriate funding instrument—procurement contract, grant,

or cooperative agreement—for a particular activity. The Act requires agencies in awarding cooperative agreements to "encourage competition, where deemed appropriate." Likewise, USAID's guidelines "encourage" competition in the selection process. However, the guidelines describe a number of circumstances where competition is not required. For example, competition is not required for (1) unsolicited proposals; (2) awards where one recipient has exclusive or predominant capability based on an existing relationship with the cooperating country; (3) follow-on awards that continue an existing assistance relationship; or (4) such other circumstances determined to be critical to the objectives of the foreign assistance program (the "foreign policy" exception).

1992 NON-COMPETITIVE AWARD OF FIRST HIID COOPERATIVE AGREEMENT(CNN-0005-A-00-3023)

In October 1992, HIID submitted a proposal to USAID seeking funding to provide technical assistance to Russia. The proposal focused primarily on support for Russia's privatization efforts. At the time, USAID's assistance program in Russia was in its early stages. HIID officials already had experience working with Russian reformers and had provided substantial assistance in establishing Russian institutions designed to sustain economic reforms.

Since in USAID's view there was an urgent need to begin U.S. support for Russia's privatization efforts and to coordinate Western donors and contractors, the agency decided to award HIID a cooperative agreement without competition. Under USAID guidelines, competition is not required when the recipient is considered to have exclusive or predominant capability based on an existing relationship with the cooperating country. Therefore, in our view, the award was consistent with USAID guidelines.

USAID initially provided \$2.1 million in funding for the agreement. The agreement was modified a number of times to increase funding. By September 1995, funding for the agreement totalled \$40.4 million.

The largest single increase in funding was a non-competitive amendment executed in July 1993 that provided \$20 million for a legal reform project. The amendment increased funding for the agreement from \$15.6 million to \$35.6 million and extended the completion date to August 31, 1997. USAID concluded that providing the additional

funds to HIID under its existing agreement was justified in order to take advantage of an opportunity to work with a newly formed Russian coordinating committee for law drafting.

USAID determined that the amendment was critical to the objectives of its foreign assistance program and that HIID had exclusive or predominant capability based on its existing relationship with Russian reformers. The USAID mission director indicated in a memorandum justifying the decision that HIID's continuing work was supported by the State Department NIS Coordinator's Office, the National Security Council, the Department of Treasury, OMB, and the USAID Assistant Administrator for Management. In our view, USAID's decision to amend the agreement for foreign policy considerations was consistent with its guidelines.

1995 COMPETITION UNDER REQUEST FOR APPLICATIONS

On March 17, 1995, USAID issued a request for applications for "Impartial Oversight and Strategic Guidance for Privatization and Market Reform Programs in Russia, West NIS [Ukraine, Moldova, and Belarus], and Central Asia of the Former Soviet Union" (RFA No. OP/ENI/EPE 95-01). USAID planned to award two agreements for assistance to Russia—one for work related to the Russian Privatization Center (RPC) and one for assistance to the Russian SEC (RSEC)—and one agreement each for work in Ukraine and Central Asia. HIID submitted two proposals—one for assistance related to the RPC and one for assistance related to the RSEC.

USAID awarded only two agreements, one to HIID for work with the RPC and one to the University of Wisconsin for work in Central Asia. While proposals were received for the RSEC and Ukraine projects, USAID canceled the portions of the request pertaining to those projects.

We found that, in some respects, the selection process was poorly managed. In particular, USAID used erroneous scores to select the winning proposal for the RSEC project. Ultimately, the RSEC rejected the proposal and USAID did not award a cooperative agreement for the project.

The Ukraine portion of the request was withdrawn after proposals were submitted but before they were evaluated, based on USAID's determination that funds were limited and that Ukrainian officials were not interested in oversight assistance. We found no basis to question USAID's decision to accept an HIID proposal after the Ukraine portion of the request was canceled.

Poor Management of Selection Process

USAID established a committee and developed criteria for evaluation of proposals for the RPC, RSEC, and Central Asia projects. USAID developed the following criteria and weights to be used by the committee for the evaluation of proposals:

Institutional Qualifications and Experience	20%
Case Studies	30%
<u>Qualifications and Experience of Personnel</u>	<u>50%</u>

*Complete
whitehurst*

Total

100%

USAID also specified that it would "look favorably on applications that minimize the number of expatriate person months, maximize the participation of local indigenous staff and provide the best overall value to the Government, cost and other factors considered."

The evaluation committee was composed of five individuals including three USAID officials, an RPC representative, and an RSEC representative. The committee chairman was from the USAID project office. The U.S. Ambassador to Russia and the Department of State's Assistant Administrator for European and NIS Affairs suggested to the Directors of the RPC and the RSEC that they nominate individuals to represent their institutions' views. According to USAID and State Department officials involved in this decision, the Russian institutions were allowed to place representatives on the committee because they would be working closely with the winners of the competition. The officials wanted to ensure that the Russian institutions would have a say in and ultimately accept the selection of the organization with whom they would be working.

The Director of the RPC nominated a high-level RPC employee. The employee was approved by USAID and named to the committee. The RSEC nominated a individual employed by the International Finance Corporation who had extensive experience working in the Russian capital markets. The Executive Director of the RSEC stated that the nominee was very familiar with the content and organization of his programs and plans for the future. USAID approved the nominee. However, because the RSEC had not received the offer to nominate a representative until after the other committee members had completed their evaluations, USAID had to formally reopen the committee

to allow the RSEC to conduct her evaluation.

According to the USAID procurement officer responsible for conducting the competition, the RSEC representative used a scoring method for evaluating proposals that differed from that used by the other panel members and specified in the request for applications. The panel members were instructed to evaluate each proposal by applying a numerical score for each of the three criteria specified in the request for applications (institutional qualifications and experience, 20 percent; case studies, 30 percent; and qualification and experience of personnel, 50 percent).

The RSEC representative did not follow the instructions. Instead, she ranked the eight applicants in descending order, with eight being the highest rating and one the lowest. The procurement officer reconciled her ranking with the other committee members' numerical ratings by multiplying each proposal's ranking by the weighted value of the category. For example, he gave the top-ranked proposal an 80 ($.8 \times 100$ percent). Because most of the panel members had departed Washington, D.C., where the voting had taken place, the USAID procurement officer said he made no effort to reconvene the panel for group analysis or to have the RSEC representative correct her scores.

Mathematical Errors in Calculation of Final Scores

We found several mathematical discrepancies made by the USAID contracting official when calculating the committee's final scores for the RSEC proposals. According to the official, he made the errors when he transferred committee members' individual scores to his final work sheet. Based on these scores, the procurement officer calculated that the committee had scored a proposal submitted by the Stanford Research Institute (SRI)

the highest. He calculated an average score of 76.7 percent for SRI and 76.4 percent for HIID. Our discussions with the panelists and our review of their individual evaluations disclosed several discrepancies between the panel members' ratings and the ratings recorded by the procurement officer. Based on our calculations, the committee actually gave HIID an average rating of 77.1 and SRI an average rating of 76.03. The responsible official said that he could not explain the errors.

The contracting official said that he recommended SRI for award of the RSEC cooperative agreement based on the committee ratings that he now acknowledges were incorrect. According to USAID officials, when USAID informed the Director of the RSEC that SRI had been selected for the cooperative agreement to work with his organization, he refused to accept them. Consequently, USAID chose not to award a cooperative agreement for the RSEC work.

According to the head of the contract division, although they are not required to do so, it is his office's practice to make award to the proposal receiving the highest score. Therefore, if the committee scores had been correctly tabulated, his office would have selected HIID for the RSEC cooperative agreement.

1996 NON-COMPETITIVE AWARD OF COOPERATIVE AGREEMENT FOR UKRAINE

The March 17, 1995 request for applications covered assistance in the western newly independent states of the former Soviet Union, including Ukraine, Moldova, and Belarus. The request was for impartial oversight and strategic advice for privatization and market reform programs. On May 24, 1995, after applicants had submitted proposals, USAID decided not to award a cooperative agreement for assistance to Ukraine and withdrew

that portion of the request. According to the USAID mission Director, the decision to withdraw the request was made because of limited funds and Ukrainian officials had indicated they were not interested in oversight assistance.

In July 1995, HIID submitted a proposal to USAID for a project to provide macroeconomic policy advice to the Government of Ukraine. USAID decided to award without competition a cooperative agreement for \$1.5 million, based on scaled-back version of HIID proposal. The non-competitive award was made under the authority provided in USAID Handbook 13, Chapter 2, Paragraph 2B3e, which states that competition is not required for "circumstances determined to be critical to the objectives of the foreign assistance program by the cognizant [Assistant Administrator]." According to USAID, earlier attempts to provide policy advice to Ukraine through the competitive process had been rejected by the Ukrainian government, which had a generally negative view of foreign advisors. However, Ukrainian officials subsequently specifically requested assistance and macroeconomic advice from HIID. The justification for waiving the requirement for competition, which was approved by the Assistant Administrator, provided:

"It is squarely in the interest of the United States for Ukraine to implement its reform programs successfully, and high-level strategic advice will clearly serve as a critical catalyst at this juncture. Thus, it behooves USAID to be responsive to the [Government of Ukraine] request for HIID's assistance, which will enable strategic policy advisors, who specialize in transition economies, to help shore up the [Government of Ukraine's] political will and provide them with the technical expertise to formulate and implement appropriate policies. Earlier attempts to provide economic policy advice through a competitive Request for Applications

process was specifically rejected by the [Government of Ukraine], because at the time, they did not perceive the need for technical assistance that they now acknowledge."

Because of the Ukrainian Government's specific request for HIID assistance, we have no basis to question USAID's decision that it was critical to the foreign assistance program to award HIID a cooperative agreement without competition.

CONCLUSIONS

(TK)

CHAPTER 2USAID 's AWARD OF COOPERATIVE AGREEMENTS

USAID used non-competitively as well as competitively awarded cooperative agreements to fund HIID activities in Russia and Ukraine. We looked at a December 1992 non-competitive award for work in Russia, a competition held under a request for applications issued in March 1995, and a May 1996 non-competitive award for work in Ukraine. We found that USAID awarded the agreements in accordance with applicable law and USAID guidelines. However, the 1995 competition was poorly managed in some respects.

MINIMAL REQUIREMENTS FOR AWARD OF COOPERATIVE AGREEMENTS

A cooperative agreement is a funding mechanism used by a federal agency to transfer funds to a public or private organization to support an agency program. Agencies use cooperative agreements when they plan on being substantially involved in management of the project being funded. The agreement defines the agency's relationship with the recipient. Unlike acquisition of goods or services by contract, cooperative agreements are often used to define project goals and determine the best approach for achieving them. Because of the need for flexibility, applicable laws and regulations impose only minimal requirements with respect to the procedures agencies must follow when selecting recipients and awarding cooperative agreements.

The Federal Grant and Cooperative Agreement Act of 1977 (31 U.S.C. 6301) establishes criteria for selecting the appropriate funding

*Revisions
10/11/96*

*OBC chapter
just contracting to
my attempt some additions
of cells into
chapter*

*Louis
response to
OAC*

instrument--procurement contract, grant, or cooperative agreement--for a particular activity. The Act requires agencies in awarding cooperative agreements to "encourage competition, where deemed appropriate." Likewise, USAID's guidelines "encourage" competition in the selection process. However, the guidelines describe a number of circumstances where competition is not required. For example, competition is not required for (1) unsolicited proposals; (2) awards where one recipient has exclusive or predominant capability based on an existing relationship with the cooperating country; (3) follow-on awards that continue an existing assistance relationship; or (4) such other circumstances determined to be critical to the objectives of the foreign assistance program (the "foreign policy" exception).

1992 NON-COMPETITIVE AWARD OF FIRST HIID COOPERATIVE AGREEMENT

(CNN-0005-A-00-3023)

In October 1992, HIID submitted a proposal to USAID seeking funding to provide technical assistance to Russia. The proposal focused primarily on support for Russia's privatization efforts. At the time, USAID's assistance program in Russia was in its early stages. HIID officials already had experience working with Russian reformers and had provided substantial assistance in establishing Russian institutions designed to sustain economic reforms.

Since in USAID's view there was an urgent need to begin U.S. support for Russia's privatization efforts and to coordinate Western donors and contractors, the agency decided to award HIID a cooperative agreement without competition. Under USAID guidelines, competition is not required when the recipient is

considered to have exclusive or predominant capability based on an existing relationship with the cooperating country. Therefore, in our view, the award was consistent with USAID guidelines.

USAID initially provided \$2.1 million in funding for the agreement. The agreement was modified a number of times to increase funding. By September 1995, funding for the agreement totalled \$40.4 million. The largest single increase in funding was a non-competitive amendment executed in July 1993 that provided \$20 million for a legal reform project. The amendment increased funding for the agreement from \$15.6 million to \$35.6 million and extended the completion date to August 31, 1997.

By September 1993, USAID's legal reform efforts in Russia had expanded and other USAID recipients were providing technical assistance to Russian institutions. For example, the University of Maryland's Center for Institutional Reform the Informal Sector (IRIS), another organization that had received USAID funding, was also doing rule of law work in Russia. IRIS was working with the Research Center for Private Law (RCPL) an institute attached to the President of the Russian Federation and chosen by the President to do Parts I and II of the civil code. In May 1994, IRIS challenged USAID's assumption that GPU was the president's chief legal advisor and the coordinator of Russian legal reform. According to IRIS, President Yeltsin sought advice from a broad group of advisors including other members of the Presidential Council, the Ministry of Justice, and the Chairman of the RCPL as well as from the GPU.

In making its case, IRIS highlighted the activities of the GPU and the Research

Center in the development of Part I of the Civil Code. To accomplish this task, the Research Center formed a team representing the entire spectrum of the Russian Government, including the President's Administration, the Government under the Prime Minister, the Ministry of Justice, the Judiciary, the Parliament as well as academic figures. The GKI and the GPU opposed the draft code prepared by the Research Center. HIID continued to pursue the development of a competing Part 1 of the civil code. Eventually, GPU was forced to sign off on the Research Center's draft code because virtually everyone else in the government with an interest in the code supported it.

USAID considered doing a limited competition but instead chose to increase HIID's existing cooperative agreement. However, USAID concluded that providing the additional funds to HIID under its existing agreement was justified in order to take advantage of an opportunity to work with a newly formed Russian coordinating committee for law drafting. IRIS noted that the concept of establishing working groups on commercial law, as proposed in the HIID draft was not a new approach. The Chairman of the Economic Policy Committee in the Duma, had been chairing the working group established to coordinate commercial law legislation since early 1994.

USAID determined that the amendment was critical to the objectives of its foreign assistance program and that HIID had exclusive or predominant capability based on its existing relationship with Russian reformers. The USAID mission director indicated in a memorandum justifying the decision that HIID's continuing work was supported by the State Department NIS Coordinator's Office, the National Security Council, the Department of Treasury, OMB, and the

USAID Assistant Administrator for Management. In our view, USAID's decision to amend the agreement for foreign policy considerations was consistent with its guidelines.

1995 COMPETITION UNDER REQUEST FOR APPLICATIONS

On March 17, 1995, USAID issued a request for applications for "Impartial Oversight and Strategic Guidance for Privatization and Market Reform Programs in Russia, West NIS (Ukraine, Moldova, and Belarus), and Central Asia of the Former Soviet Union" (RFA No. OP/ENI/EPE 95-01). USAID planned to award two agreements for assistance to Russia--one for work related to the Russian Privatization Center (RPC) and one for assistance to the Russian SEC (RSEC)--and one agreement each for work in Ukraine and Central Asia. HIID submitted two proposals--one for assistance related to the RPC and one for assistance related to the RSEC.

USAID awarded only two agreements, one to HIID for work with the RPC and one to the University of Wisconsin for work in Central Asia. While proposals were received for the RSEC and Ukraine projects, USAID canceled the portions of the request pertaining to those projects.

We found that, in some respects, the selection process was poorly managed. In particular, USAID used erroneous scores to select the winning proposal for the RSEC project. Ultimately, the RSEC rejected the proposal and USAID did not award a cooperative agreement for the project. However, in September 1995, after the selection panel had completed its evaluation and before the

award was withdrawn the USAID/Moscow amended HIID's prior cooperative agreement to provide \$1.7 million to cover work that would have been part of the competed cooperative agreement.

The Ukraine portion of the request was withdrawn after proposals were submitted but before they were evaluated, based on USAID's determination that funds were limited and that Ukrainian officials were not interested in oversight assistance. ~~We found no basis to question~~ We found that HIID's proposal duplicated certain aspects of the withdrawn request and ongoing assistance being provided by other donors. We found no legal basis to question USAID's decision to use the foreign policy exception to accept an HIID proposal after the Ukraine portion of the request was canceled.

ERRORS MADE IN AWARD OF COOPERATIVE AGREEMENT FOR ASSISTANCE TO RUSSIAN SEC

Because U.S. organizations aside from HIID had established relationships in Russia and USAID guidelines require competition to the maximum extent practicable, USAID decided to open up competitive bids for follow-on work to start in fiscal year 1996. On March 17, 1995, USAID issued a request seeking program proposals for four separate cooperative agreements. USAID planned to award two cooperative agreements in Russia—one for assistance to the RPC and one for the Russian SEC—as well as one agreement for Central Asia and one for Ukraine. Actions involving the evaluation of proposals have raised questions about USAID's management practices.

SD said that, based on GAO's description, placing the RSEC and RPC representatives on the panel would be, at the very least, an appearance of conflict of interest, and certainly the appearance is not favorable. SD said that the Office of Procurement was not aware that these were HIID-created institutions, and that HIID was paying key staff positions in these organizations. He said he thought that these were quasi-governmental agencies, not independent institutions.

SD said that if this was a contract, it would violate contracting law against putting people on the panel with real or the appearance of conflict of interest. Though this is not applicable to a CA, USAID practice is to abide by the spirit of this clause in its CA competitions. He said that while USAID is not legally required to follow contract laws and procedures for running CA competitions, it generally uses contracting guidelines to run CA competitions. He said that if he was made aware of the HIID connections, he would have dealt with it. He said the fact that the RPC was a private organizations troubled him but perhaps this by itself would not disqualify it from having an opportunity to nominate a panel participant.

2. USAID reopened the evaluation for the Russian SEC representative.

- On June 15, 1995 the panel convened and paperwork was completed July 15.
- The RSEC rep began her evaluation on August 8, and completed it on Aug. 22.
- The chairman told us reopening a panel was very irregular.
- There was no group analysis of the scoring.
- The negotiator/contract specialist sent a fax to the program officer stating that the RSEC nominee had completed her scoring, and stating that "you can imagine what her scoring indicates."

SD said that under contract and CA procedures, it is allowable to reopen competitions. This was a judgement call, since the RSEC representative was considered preeminent in her field. I asked SD how she could be considered independent, given that the RSEC executive director had written USAID ENI Bureau Administrator that only HIID could carry on the work at the RSEC and the contracting officer sent a fax to the program officer when the RSEC nominee had completed her scoring, stating that "you can imagine what her scoring indicates." SD agreed that this panel member probably was biased for HIID. He noted that this sounded like it was a politically charged case, which doesn't happen often. But, SD thought the important thing is that her scoring didn't affect the final outcome of the panel. (Note: Her scoring changed the outcome if no tabulation errors had occurred.)

According to SD, he often sees some "incestuous relationships" among the individuals who are asked to sit on panels and the organizations submitting proposals. It is impossible to get panelists who are completely impartial and do not know the organizations that are competing, because a level of subject expertise is required in order to be able to judge the merits of a proposal.

SD said that, regarding the lack of group scoring, this was undesirable, and he believed this violated requirements for contract review panels. He said it wasn't possible to reconvene the panel because a number of the original participants had left Washington. This kind of situation does not often occur. SD said that USAID "policy", though probably unwritten, is that the technical panel chairman is supposed to present to the negotiator/contract specialist (Dorsey) a summary of the panel deliberations and is responsible for reflecting any divergences. The fact that there was no group analysis should be reflected in this memo, and SD said he believes that in a contract competition, the technical panel chairman should summarize all proceedings. If the memo was written before the RSEC representative had provided her input, there should have been a second memo. [See C3-2/3 for the Memorandum of Negotiation dated 9/27/95. (Note:

The memo did not provide details on the RSEC negotiations outside the facts on panel milestone dates.))

3. The RSEC nominee used a different scoring system from the other panelists.

- The panelist scored the competitors based on a percentage basis, but the RSEC nominee used a scale of 1 to 8.
- To reconcile her score, the procurement officer multiplied the ranking by 100%.
- The contracting officer did not reconvene the panel, because some members had left the country.

SD said that he had not heard that there were scoring problems or math errors in the competition until I raised them 3 days ago. (Note: Dorsey told us in early July that he would write a memo on these mistakes and 2 days ago said that he had not written the memo, but still planned to.) He said that to avoid use of different scoring methodologies, panel members are given instructions on the proper scoring methodology. Because the RSEC representative was brought in after the panel was completed, its not surprising she didn't follow the same scoring system.

SD said he wasn't sure if the discrepancy in the scoring methodology was a "fatal flaw" in the integrity of the scoring but acknowledged that it makes it difficult but not impossible to use her scores with the panel's. He said there is no rule against using different scores in either contracts or CAs, but its just "common sense" to use the same scoring system. He said that you can't regulate every aspect of the procedures.

SD said a conversion factor could have been used to manipulate the final scores, but when GAO pointed out that the scoring was a ranking rather than the percentage assessment used by the other panelist, SD said this makes it very tough to do a legitimate conversion. SD said he had never been faced with this problem before. He said that one option would have been to throw out the RSEC panelist's scores if there was no clear way to convert them and only use whatever notes she had included in her evaluation on the quality of the proposals and compare these to the other panelists' observations.

4. The Negotiator/contract specialist added the scores incorrectly and announced the wrong winner.

- GAO found 3 math discrepancies that all went against HIID.

- The contracting officer said the errors were caused when he transferred the scores from the panelists' worksheets.

- No one checked the contracting officers math.

SD said that math errors should not have happened, and that Dorsey should not have been involved with the scores. Normally, the technical panel chairman (Warman) would consolidate the panel's scores. SD said he didn't know why Warman did not do this. SD said he would have insisted on it. He said that maybe there was no regulation stipulating this, but the concept is the same as in contracting: the technical panel chairman is responsible for writing the final memo based on the scores. The fact that Dorsey did this was unusual.

SD said there is no written policy that more than one person do the calculations or check

another's math, but it is an unspoken policy. Ultimately, the grant officer is responsible for ensuring the competition was completed in a fair and open way and in accordance with the rule of competition. She should have checked the math to make sure it was right to ensure the award was correct.

5. USAID has not notified the top scorer that it won the competition.

-- Although in a previous interview the negotiator/contract specialist said that the top scorer (HIID) should be notified that it won the competition, this has not occurred as of October 1, 1996.

SD said he had never heard of a case like this before. Normally, USAID would revoke the award, if it had been awarded, but in this case, it was not awarded. I asked SD what would happen if the Mission, HIID, and RSEC said that HIID was the rightful winner, and they now wanted to award the cooperative agreement one year late? SD asked if GAO was absolutely sure that there were math mistakes giving SRI the award incorrectly. I told him we had verified it with Dorsey, who agreed that HIID should have won the award based on the corrected math.

SD said he would not resurrect the cooperative agreement in question and at this late date award the RSEC cooperative agreement to HIID. Since the award was cancelled based on the Mission's position that it was no longer needed, SD wants to take the Mission at its word and considers this case a closed issue. HIID cannot force USAID to give it a cooperative agreement nor is there any basis for a legal proceeding over this. SD said that there was no precedent at all for what USAID should do in a case like this. He said that if the Mission pushed for the award, it would be up to the agency, but that he also hoped if this happened, the Mission itself would issue the award and not involve the Office of Procurement in Washington. This matter is very embarrassing for the

Office of Procurement and USAID.

6. USAID provided HIID additional funds non-competitively after the wrong winner was announced.

- In Sept. 1995, after the evaluation panel had completed its evaluation, USAID amended its non-competitive cooperative agreement with HIID for RSEC-related work.
- Because the time-period of the \$1.7 million amendment overlapped with the time period covered by the competition, the RSEC Director may have felt less pressure to accept a winner besides HIID.

SD said he was unaware of this award, and that ENI must have "disguised" the requirements to make it look different from the RFA requirements. He said that if he had recognized it as funding similar work as the RFA, he would have rejected it. SD said he told the Mission in a memo (later he said an e-mail) not to dare fund the RSEC non-competitively or through an alternative method. The funding increase was through an amendment to the existing cooperative agreement, and thus a new RFA was not issued. We felt this would be unethical and violate the spirit of competition. It would leave Stanford out in the cold and it would make a mockery of the competition. SD said that there were no regulations against this for either CAs or contracts, but that its not fair or right if USAID advertises a competition, and then does not abide by the outcome. We should always award the funds to the winner of the competition.

I told SD that ENI/Assistant Administrator Dine had agreed to provide RSEC \$15 million more, and noted that this, as in the case of the \$1.7 million, contradicts the USAID claim to Stanford

that RSEC no longer needs the assistance. SD said his position is that once the award was withdrawn, that should be the end of it, no more money should be given to RSEC.

7. The Russian RSEC rejected the announced winner, stating it would only work with HIID.

- The RSEC Director rejected Stanford, stating that he would not work with Communists.
- In March 1996, the RSEC Director informed USAID that it needed more assistance to continue operations, and USAID agreed to provide \$15 million in additional support.
- This contradicted the official USAID explanation to Stanford that there was no longer any need for this assistance, and due to a severe reduction in assistance levels, USAID will not be funding this type of assistance.

8. The RFA for Impartial Oversight and Strategic Guidance for Privatization and Market Reform Programs in the West NIS was cancelled and about 2 months later a similar proposal for work in Ukraine was awarded non-competitively to HIID after it was approved by an interagency review.

-- The position of the USAID Office of Procurement is that HIID should not be awarded work non-competitively that was included in the cancelled RFA.

-- The assertion that a non-competitive proposal is unique often is hard to verify, as is the assertion that SD believes was made in this case, that the unique

aspects outweighed the similarities.

- Political considerations were not part of the evaluative criteria of the RFA and the evaluation for the West-NIS work in a competition would have been made on merit. Once a competition is chosen, the Office of Procurement tries to make the competition as transparent as possible. However, a decision to make an award non-competitively may include political aspects that are outside the purview of the Office of Procurement, and the Office tries not to second guess the ENI Assistant Administrator and others who make this kind of call.



Memorandum

FOR CONGRESSIONAL CONTACT FILE

House Committee on International Relations

Date: October 4, 1996

To: Director, OCR

From: Assistant Director, NSIAD - Louis Zanardi

Subject: Report on Harvard's activities in Russia and Ukraine

Mr. Mark Gage of the Committee staff called me today⁴ about the status of our report. He said that the Committee was expecting to get the report this week. I told him that the report was in draft and GAO management has not come to closure on the report message. I told him that a message agreement meeting would be held on Monday.

He expressed disappointment in that status of the report. He reminded me that GAO had committed to getting him a report at the end of September. I told him that once GAO agreed on a message it should not take long to get it to the agency for comment. He could not believe that the report had not yet been sent to the agency. He said that the Committee needed the report by the middle of October and a draft report would not serve the Committees interest because it could not be made public. He suggested that the Agency be given no more than 1 week to comment on the report. He said that the information presented in the GAO briefing was very important and the Committee needed the information now.

cc: ACG, Policy
Director, OPA
ACG, NSIAD
Ben Nelson
Harold Johnson
Lynn Gibson

HIID/RPC FUNDING BY FUNCTIONAL AREA 5-31-96

R. STOLTZ
9-20-96

HIID #3023 (F4.1.33)

<u>Acct</u>		<u>Actual to</u> <u>5-31-96</u>	<u>Budget</u>
674	GKI POLICY PROGRAM	\$ 7,631,897	\$ 7,741,716
676	RPC SUPPORT	7,987,986	8,280,549
777	GKI LEGAL REFORM	14,431,395	20,000,000
778	RESOURCE SECRETARIAT	2,083,265	4,203,923
	UNALLOCATED FUNDS	—	147,806
	TOTAL	<u>32,134,543</u>	<u>40,373,994</u>

HIID #5122 (F4.2.7)

194	RPC SUPPORT	\$ 6,097	4,497,668
755	TAX REFORM PROJECT	239,221	5,096,917
784	POLICY II	371,358	5,489,603
786	LAND REFORM	<u>291,384</u>	<u>2,338,902</u>
		958,060	17,423,090

RPC #4035 (FF5.6)

F300	RPC OPERATIONS	7,098,173	11,990,893
F311+351	LPC OPERATIONS	<u>946,057</u>	<u>4,500,000</u>
		8,044,230	16,490,893

GRAND TOTAL

\$ 41,136,833 \$ 74,287,977



RUSSIA

THE BATTLE FOR RUSSIA'S WEALTH

Can rich new capitalists weather a popular backlash?

Russia's answer to J.P. Morgan could not be less like the eccentric, bulbous-nosed original. Vladimir O. Potanin is a shy, athletic man of 35. Holding court in his rosewood-paneled office on Moscow's Masha Poryvaeva Street, the Oneximbank president quietly gives instructions to two bodyguards at his door. Cool and controlled, Potanin is a standout in a group of dynamic businessmen who have seized huge slices of the economy.

Five years after the fall of Communism, bankers such as Potanin are at the center of a fierce battle for Russia's wealth. Having amassed cash in

the chaotic early years of Russia's economic transformation, they have scooped up formerly state-owned oil, mining, forest products, and real estate assets to create financial-industrial conglomerates that resemble Japan's prewar *zaibatsu*.

About 32 of these giants have taken shape, linking more than 500 factories and 72 banks and employing more than 2.5 million people. Dozens more are being formed. The top six already control Russia's oil, gas, and metals industries (table) and bring in the bulk of the country's hard currency.

These titans of industry and their companies are symbols of the new Rus-

CRUCIBLE: Top nickel producer Norilsk is caught in a power struggle

sian capitalism. Each has political "uncles," or *dyadyas*, in the government. And they use their contacts to win privileges: tax concessions, protectionist measures against foreign competitors, exemptions from duties. Gas monopoly Gazprom, whose patron is Prime Minister Viktor S. Chernomyrdin, has paid hardly any taxes since 1993, for example. Its new headquarters, a \$150 million skyscraper, towers over southwest Moscow.

BITTER REMINDERS. Such jarring symbols of wealth are fueling a backlash against capitalism. Russians who once made fun of Communist leaders now joke about the New Rich, with their vulgar, free-spending ways. But to many Russians, the disparity between rich and poor is no laughing matter. Although stores, unlike before, are full of goods, many people can't afford them. To *babushki* selling vodka on the street to supplement their pensions, every Mercedes zooming by is a bitter reminder of a more stable time.

Opponents of Russian President Boris N. Yeltsin are making the most of the discontent, with Communist Party

The Key Conglomerates Vying for Russia's Riches

GROUP/CEO	INDUSTRIAL HOLDINGS	POLITICAL PATRONS
ONEXIMBANK Vladimir Potanin	Most powerful group with 38% of Norilsk Nickel, 26% of jet-engine maker Perm Motors, 26% of auto maker Zil, plus oil, metallurgy, and real estate interests	Tightly linked to Kremlin
MENATEP Mikhail Khodorkovsky	Most diversified conglomerate, with 78% of oil giant Yukos, plus controlling interests in plastics, metallurgy, textiles, chemicals, and food-processing companies	Close to former Communist apparatchiks
ALFA Mikhail Friedman	Big player in Moscow region, with interests in real estate, securities trading, cement, candy, and chemicals industries	Lacks good connections at national level
ROSSISKAYA METALLURGIA No CEO	Controversial group created by Kremlin decree; links 14 institutes and troubled plants producing steel, alloys, and other metals	Deputy Prime Minister Oleg Soskovets
MOST GROUP Vladimir Gussinsky	Active in Moscow, its interests include banking, real estate, government, construction, independent television network NTV, and the influential daily newspaper <i>Today</i>	Close ties with Moscow Mayor Yuri Luzhkov
GAZPROM Rom Vyukov LUKOIL Yegor Alikperov IMPERIAL BANK Sergei Rodionov	Very powerful but loosely tied together, this group links Russia's gas monopoly, its largest oil company, and their jointly owned bank; it has big export clout, with Gazprom supplying gas to Europe and Lukoil in oil deals in Libya and the Persian Gulf	Prime Minister Viktor Chernomyrdin

chief Gennady Zyuganov leading the way. Yeltsin's main rival in presidential elections in June, the former school-teacher rails about the "mass plunder" of Russia's wealth. He is also targeting the new capitalists. Zyuganov has called for a review of the controversial loans-for-shares privatization scheme, which allowed private banks to snap up lucrative shareholdings at rock-bottom prices in exchange for low-interest loans to the government. Now, some businesspeople fear that a victorious Zyuganov would launch a witch hunt for free-marketeters. "If Zyuganov wins, I am emigrating," claims one leading executive.

The upcoming election could turn out to be a defining moment in Russia's transition to free markets. Zyuganov, who is leading in the polls, has pledged not to turn the clock back to full state ownership of the economy. But he might come under pressure from his party's left wing, which could push him to nationalize property, reintroduce

price controls or take over the banks.

There's no doubt that the stakes are high. Throughout Russian history, the battle for political power has revolved around control of Russia's property. When the Bolsheviks seized power in 1917, they nationalized scores of private enterprises. When communism fell in 1991, Yeltsin's government grabbed Communist offices, dachas, and businesses. As other former Soviet republics declared independence, the party lost an entire empire of assets.

With June's elections, then, the Communists may have their first big chance to settle scores. But during Yeltsin's presidency, one crucial thing has

changed: State ownership of the economy has dropped from close to 100% to about 30%, through one of this century's most sweeping privatization programs.

To be sure, Yeltsin's reformers failed to create the transparent Western-style market economy they envisioned, with a middle class of shareholders that would have wanted to defend capitalism and democracy. Instead, a more concentrated, shadowy, and oligarchic form of capitalism dominated by a small group of powerful shareholders has emerged.

Zyuganov will have a tough time deciding what to do about the conglomerates if he wins the election. For starters, he is probably receiving money from them. Although they won't talk about it, big businesses are helping to finance the campaigns of Yeltsin, Zyuganov, and other candidates. Says one prominent banker: "You can say there's a little bit of diversification of the portfolio going on."

PERESTROIKA START. What's more, Zyuganov would run into former comrades among Russia's capitalist barons. The new elite includes shrewd industrialists who were once members of the old structure. Some were party members and managers who adapted quickly to the new market climate. Others got their start through the Young Communist League, which supported young businesspeople as part of Mikhail Gorbachev's *perestroika* reforms in the late 1980s. Indeed, the powerful Menatep Bank began as a scientific center in a Young Communist branch where Menatep President Mikhail B. Khodorkovsky, then a chemistry graduate student, was active.

Menatep earned its first profits doing research for Moscow-area factories. It then became one of the first groups to get a banking license under another Gorbachev experiment in 1988. The bank was rumored to have helped the Communist Party funnel funds to the West, but Khodorkovsky always denied it. Menatep grew fast as it lent money and traded currency in the era of high inflation and interest rates in 1992-93.

Now, Menatep is Russia's 10th-largest private bank and runs the most diversified conglomerate in the country. Its assets, which totaled \$2.1 billion in 1995, include the 19th century castle that served as Young Communist headquarters in Moscow. Menatep also controls more than 20 companies in

Titans of Industry

Both new-style bankers like Potanin and old-style bosses like Soskovets use their clout to win privileges for their groups



POTANIN



SOSKOVETS

International Business

chemicals, textiles, and food. Its crown jewel is Yukos, Russia's No. 2 oil company, worth some \$700 million. In December, Menatep and its allied banks picked up rights to 78% of Yukos for \$350 million in loans and promised investments.

It's hard to say whether Zyuganov would seize Menatep. Although the party's platform calls for strategic companies, including energy, to be returned to state hands, Zyuganov has also said he won't tamper with private companies that perform well. Should he become president, then, he may pick and choose which companies to target for interference.

There are also economic reasons why curbing the conglomerates might prove difficult. Although controversial, the groups play a key economic role. With foreign investment at just \$1 billion a year, the government in debt, and Russia's capital markets too illiquid to tap, the groups are channeling capital, technology, and new management into enterprises sorely in need of restructuring.

RED DIRECTORS. Many observers see the Russian-style *zaibatsu* as potential engines for spurring an economic revival. Since Yeltsin launched his reforms on Jan. 2, 1992, Russia's gross domestic product has plunged 19%, with industrial production falling 40%. While the decline is still serious in industries such as machine building, many believe the economy has hit bottom and could grow next year.

Much depends on attracting investment to boost production rather than allowing it to be siphoned off by corrupt managers. Indeed, a major debate is heating up about so-called Red Directors, Communist-era managers who bought shares at low prices and thus held onto their jobs when their enterprises were privatized in 1992-93. Some have been bleeding their companies and refusing to pay workers. But as outside shareholders build up controlling stakes, they are pushing to oust the old bosses.

Potinin's Oneximbank is waging a public campaign against the Red Directors. Potinin wants to oust General Director Anatoly Filatov, 60, and other

top managers of giant Norilsk Nickel, which Oneximbank acquired in a loans-for-shares deal in December. Potinin says the managers allowed \$1 billion in debts to accumulate, even as pretax profits doubled, to \$1.16 billion, in 1995.

Potinin, a former Soviet bank official, is no angel himself. In an auction that the bank itself ran, Oneximbank offered a \$170 million loan for a 38% stake in Norilsk. Another bank, Rossiskiy Kredit, complained bitterly that Oneximbank refused to consider its bid

for twice as much because it arrived 20 minutes after the deadline.

Nevertheless, Potinin

gunning of Russian transnational companies," he says.

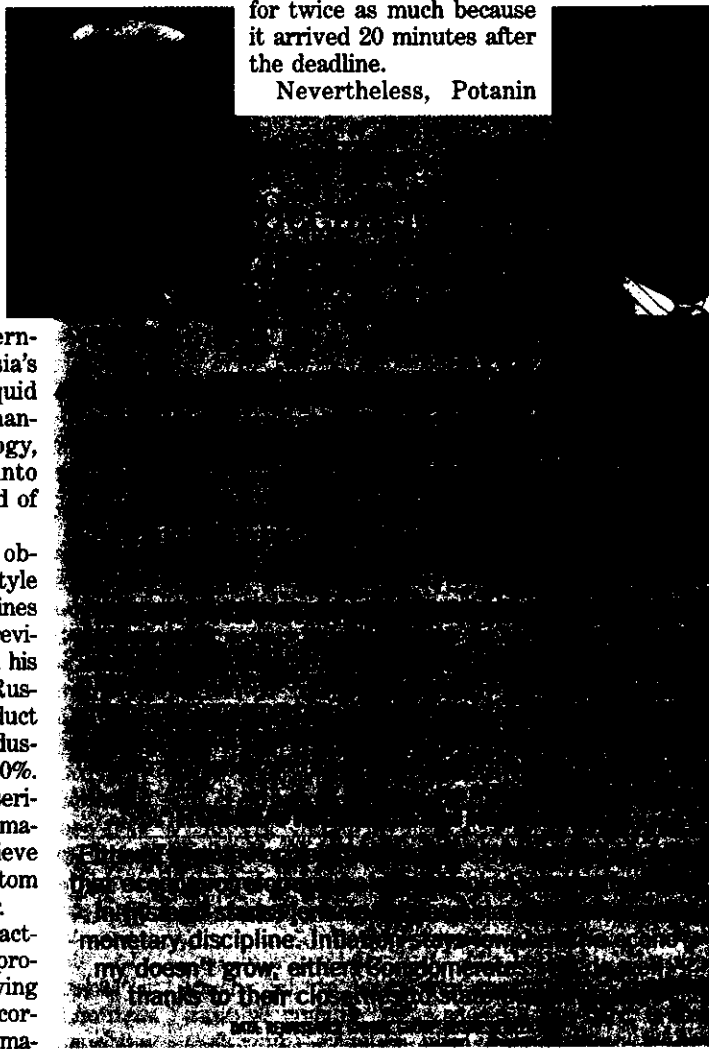
If Potinin wins his fight with Norilsk's management, it will mark a turning point for Russia: The new elite of financiers will have gathered enough strength to curb long-entrenched industrial managers. But the Red Directors aren't giving up easily. In some industries, they have created their own conglomerates, with the backing of key figures in Yeltsin's government. First Deputy Prime Minister Oleg N. Soskovets—Yeltsin's campaign manager—is behind a group linking 14 metals plants and institutes, most of which are losing money. Soskovets wants Yeltsin to boost subsidies and protection for Russian industry.

Russia's economic landscape will thus pose uncomfortable choices for the next president. Russia watchers see both dark and bright possibilities. If Zyuganov is elected and gets pulled to the left, Russia could plunge into chaos. The renationalization of property could lead to civil war, some observers warn. **WESTERN MODELS.** Yet there is also an optimistic view. If Yeltsin wins, he could push for a faster industrial shakeup, open trade, and a better investment climate. That could attract some of the more than \$30 billion Russians have banked overseas. Russia's economy could take off at a 3%-4% clip.

The hope of less sanguine observers is that Russia will continue to muddle through its effort to develop free markets. This could happen if either Yeltsin or Zyuganov wins the presidency and adopts a centrist course. Then Russia would zigzag between reform and re-

trenchment—just as it has since 1992. Russia is developing its own version of capitalism, and conglomerates are, for now, leading the way. Unless a Communist backlash sets in, they will eventually try to model themselves after Western and Japanese groups like Siemens, Mitsubishi, and United Technologies. Potinin's Oneximbank is the beginning. Now, as ever, Russia's future depends on who wins the battle for its wealth and what the victors make of it.

By Peter Galuszka in Moscow and Rose Brady in New York



MEMORANDUM TO THE FILE

DATE: APRIL 12, 1995

SUBJECT: LOANS FOR SHARES

PRESENT:

ANDREI SHLEIFER, PROJECT DIRECTOR
GREGORY POPPE, HARVARD LEGAL COUNSEL
MARIA OLIVER, GAO
L. ZANARDI, GAO
CLAUDE ADRIAN, GAO

During opening conference Dr. Shleifer stated that he had corresponded with Maxim Boycko, RPC, concerning his concern over the loans for stock program. I requested a copy of these memorandum and the following discussion took place.

Mr. Poppe informed me that Dr. Shleifer was concern over the disclosure of these documents to the committee. Dr. Shleifer did not wantt Boycko to know that GAO had reviewed the documents.

I told Poppe that these documents were prepared at government expense and that GAO had a right to them. We provided him with legal references. Poppe said that it was possible that the memos were prepared on Dr Shleifer own time since he worked 4 days a week and 1 day a week on university time. I said the loans for shares program remains part of the HIID project and couldn't accept this line of reason. However, I agreed to a compromise that I would review the documents and take some notes. However, if we needed the documents at a later date, we would expect to get them. I also told Dr. Shleifer that these documents should not be destroyed. Dr. Shleifer stated that he was not stupid.

Extracts from memo # 1

Boycko

Andrei Shleifer

May 16, 1995

1. Semi private banks are ripping off shareholders and stealing everything from managers
2. bank get all the proceeds
- 3.

4. risk/bank ownership. Bank doesn't sell by a certain date it goes to another bank.
concern about Banks a year from now

5. Boycko his idea, banks get proceeds, not control

Extracts from Memo # 2

June 30, 1995

to Maim

Andrei

1.

2. recommends companies \$10 million or more...

3. schedule number of enterprises per month.....

4.

5. competition of block of shares should be a straight auction of individual blocks (never bundle of firms)

6.

7. concern dilution of the government stake by the bank at the times it owns the shares.
... prohibit share issuance for the duration of the agreement

8. Banks demanding too much.... 30% upside, .5% fee

9.

10. What happens if shares value fall- is govt liable

11. Don't be generous in allowing banks to determine mechanism of the eventual sale.
incentive to sell

12. govt will get nothing for this venture up front, and nothing on the back end either.
Tell Chubias (note: Poppe alerted me to this point as one that is particularly sensitive.
It also said that government is getting screwed but I didn't make a specific note of this
because Poppe was looking over my shoulder and I didn't want to look too surprised)

13. What happens if bank becomes insolvent during period of agreement. Shares revert
back to the government that pays 1/2 for them with the bidder agreed to pay up front..

*Chubias knows
well in
advance about
implications of
leaving for shares -
knows about
from Shleibee /
Boycho*

14. negotiations with Belegaeve and Kokloeve

COMMENT

These memos demonstrate that (1) RPC, an AID contractor, HIID, another AID contractor were involved in the loans for share project, (2) Boycko, head of RPC and also a govt employee were on notice that there were significant problems with the proposal, (3) Chubias may have known of the pending problems, (4) HIID understood the potential problems but apparently unable to stop it from happening.

Poor Management of Selection Process

USAID established a committee and developed criteria for evaluation of proposals for the RPC, RSEC, and Central Asia projects. USAID developed the following criteria and weights to be used by the committee for the evaluation of proposals:

Institutional Qualifications and Experience	20%
Case Studies	30%
<u>Qualifications and Experience of Personnel</u>	<u>50%</u>
Total	100%

USAID also specified that it would "look favorably on applications that minimize the number of expatriate person months, maximize the participation of local indigenous staff and provide the best overall value to the Government, cost and other factors considered."

The evaluation committee was composed of five individuals including three USAID officials, an RPC representative, and an RSEC representative. For both of these organizations, HIID had provided personnel for key managerial positions and each organization strongly supported HIID's work. In both cases, USAID allowed these individuals to participate in the panel because they did not have a direct financial interest in the outcome of the competition, had no other perceived conflicts of interest, indicated that they could be objective, and had expertise in providing technical assistance in transition economies. The committee chairman was from the USAID project office. The U.S. Ambassador

to Russia and the Department of State's Assistant Administrator for European and NIS Affairs suggested to the Directors of the RPC and the RSEC that they nominate individuals to represent their institutions' views. According to USAID and State Department officials involved in this decision, the Russian institutions were allowed to place representatives on the committee because they would be working closely with the winners of the competition. The officials wanted to ensure that the Russian institutions would have a say in and ultimately accept the selection of the organization with whom they would be working.

The Director of the RPC nominated a high-level RPC employee. The employee was approved by USAID and named to the committee. The RSEC nominated a individual employed by the International Finance Corporation who had extensive experience working in the Russian capital markets including working with HIID. The Executive Director of the RSEC stated that the nominee was very familiar with the content and organization of his programs and plans for the future. USAID approved the nominee. However, because the RSEC had not ~~received~~ acted on an initial invitation it did not send a representative to the panel until it received a second offer made by the Assistant Administrator for ENI. The nominated ~~the offer to nominate a~~ representative arrived ~~until~~ after the other committee members had completed their evaluations, thus USAID had to formally reopen the committee to allow the RSEC to conduct her evaluation. The Chairman of the evaluation panel told us that opening the panel after other members had completed their work was very irregular. The USAID procurement officer, who received the panel's scores, did not attempt to calculate the scores until the RSEC nominated member had completed her scoring. This panel member stated that she was under the assumption that HIID could win only one of the two proposal for Russia. She told the procurement

officer that she was operating under these assumptions, however, the procurement officer did nothing to correct her.

According to the USAID procurement officer responsible for conducting the competition, the RSEC representative used a scoring method for evaluating proposals that differed from that used by the other panel members and specified in the request for applications. The panel members were instructed to evaluate each proposal by applying a numerical score for each of the three criteria specified in the request for applications (institutional qualifications and experience, 20 percent; case studies, 30 percent; and qualification and experience of personnel, 50 percent).

The RSEC representative did not follow the instructions. Instead, she ranked the eight applicants in descending order, with eight being the highest rating and one the lowest. The procurement officer reconciled her ranking with the other committee members' numerical ratings by multiplying each proposal's ranking by the weighted value of the category. For example, he gave the top-ranked proposal an 80 ($.8 \times 100$ percent). Because most of the panel members had departed Washington, D.C., where the voting had taken place, the USAID procurement officer said he made no effort to reconvene the panel for group analysis or to have the RSEC representative correct her scores.

Mathematical Errors in Calculation of Final Scores

We found several mathematical discrepancies made by the USAID contracting official when calculating the committee's final scores for the RSEC proposals.

According to the official, he made the errors when he transferred committee members' individual scores to his final work sheet. Based on these scores, the procurement officer calculated that the committee had scored a proposal submitted by the Stanford Research Institute (SRI) the highest. He calculated an average score of 76.7 percent for SRI and 76.4 percent for HIID. Our discussions with the panelists and our review of their individual evaluations disclosed several discrepancies between the panel members' ratings and the ratings recorded by the procurement officer. Based on our calculations, the committee actually gave HIID an average rating of 77.1 and SRI an average rating of 76.03. The responsible official said that he could not explain the errors.

The contracting official said that he recommended SRI for award of the RSEC cooperative agreement based on the committee ratings that he now acknowledges were incorrect. According to USAID officials, when USAID informed the Director of the RSEC that SRI had been selected for the cooperative agreement to work with his organization, he refused to accept them. Consequently, USAID chose not to award a cooperative agreement for the RSEC work.

According to the head of the contract division, although they are not required to do so, it is his office's practice to make award to the proposal receiving the highest score. Therefore, if the committee scores had been correctly tabulated, his office would have selected HIID for the RSEC cooperative agreement.

USAID Provided Additional Funding to HIID for Russian SEC Activities

In September 1995, USAID/Moscow amended HIID's prior noncompetitively awarded cooperative agreement to provide \$1.7 million to HIID to finance 20 Russian professionals for the Russian Resource Secretariat (the Resource Secretariat provided professional advice to the new SEC). The amendment allowed HIID to fund these Resource Secretariat personnel from December 1995 to December 1996. The Russian Resource Secretariat had received significant HIID support prior to the amendment of the cooperative agreement and was expected to obtain future funding through the 1995 competition. Because the time period of the amendment overlapped with the time period covered by the competition, the Executive Director of the Russian SEC may have felt less pressure to accept a winner of the competition other than HIID. SRI was told that there no longer was a need for assistance to the Russian SEC and that USAID's funds for work in the FSU had been "severely reduced." The Chief of the ENI Contract Division stated that he was unaware of the amendment and if he had recognized it as funding similar work as the request he would have rejected it. He informed USAID/Moscow that it should not seek alternative financing. Moreover, he felt that this action would be a violation of the spirit of the competition.

1996 NON-COMPETITIVE AWARD OF COOPERATIVE AGREEMENT FOR UKRAINE

The March 17, 1995 request for applications covered assistance in the western newly independent states of the former Soviet Union, including Ukraine, Moldova, and Belarus. The request was for impartial oversight and strategic advice for privatization and market reform programs. On May 24, 1995, after

applicants had submitted proposals, USAID decided not to award a cooperative agreement for assistance to Ukraine and withdrew that portion of the request. According to the USAID mission Director, the decision to withdraw the request was made because of limited funds and Ukrainian officials had indicated they were not interested in oversight assistance.

Chronology of HIID's Ukraine Proposal

According to HIID's Executive Director, a representative from the Carnegie Endowment, who managed a small team of advisors in the Ukraine on macroeconomic issues, encouraged him to become involved in Ukraine in early July 1995. HIID's Executive Director heard from the Carnegie Endowment that the Deputy Prime Minister and the governor of the Central Bank and others had wanted his input. On July 24, 1995, USAID received an unsolicited proposal for a project to be jointly led by the Carnegie Endowment, and HIID's Executive Director. HIID would administer the project. At that time, it does not appear that HIID's Executive Director had made any exploratory visits to the Ukraine to prepare the proposal but instead relied on input from the Carnegie Endowment as to the receptivity of Ukrainian officials to the proposal.

While HIID was submitting its proposal, the Deputy Secretary of the Treasury, and the National Security Council advisor for Ukraine, visited the Ukraine between July 24 and 29, 1996, to discuss broad economic issues with key officials within the Ukrainian government. During these discussions, the Central Bank Governor expressed concern that there was a conflict within the Bank. The Deputy Secretary suggested that he knew of an advisor that might be able to provide

some assistance in unifying the Bank's policy apparatus. Bank officials, apparently unaware of the July 1995 HIID proposal, told us that they thought that these discussions had led to the HIID proposal.

At a dinner meeting with the Deputy Prime Minister, the National Security Advisor asked him if he would like a technical assistance team to help on economic issues. According to the Deputy Secretary, he discussed the eternal problems within the NB and the need for the Ukrainian Government to build policy consensus. The issues dealing with the problems within the Central Bank and building policy consensus became elements of HIID's proposal. The Deputy Prime Minister said that he had tried to contact HIID's Executive Director on his own but a proposed meeting with the HIID Executive Director in Paris did not take place. The National Security Advisor stated that he was not aware of the HIID proposal until he returned on August 4, 1996.

Between August 21 and 24, 1996, HIID's Executive Director met with the Governor of NB. At the meeting, the Governor made it clear that the Central Bank fully supported existing USAID programs and that additional assistance could not be provided at the expense of existing U.S. assistance. Also, he told them that Harvard should have a very limited program that addressed the unification of policies within the Bank. During the visit, HIID's Executive Director also met with Deputy Prime Minister gaining his expressed support for Harvard's advising Ukraine on macroeconomic issues.

On October 2, 1995, the State Department Coordinator held a working group meeting to discuss Ukrainian reforms as well as tax reform in Russia, issues

covered in HIIID Ukraine proposal and HIIID's September 1995 cooperative agreement. By this time., Deputy Secretary of Treasure told us that he participated in the discussion on the Russian tax proposal but left the meeting before the discussion on Ukraine. He said that because of his previous professional relationship with HIIID's Executive Director he chose not to participate in the Ukraine discussion.

~~In July 1995, HIIID submitted a proposal to USAID for a project to provide macroeconomic policy advice to the Government of Ukraine.~~ In March 1996, USAID decided to award without competition a cooperative agreement for \$1.5 million, based on scaled-back version of HIIID proposal. The non-competitive award was made under the authority provided in USAID Handbook 13, Chapter 2, Paragraph 2B3e, which states that competition is not required for "circumstances determined to be critical to the objectives of the foreign assistance program by the cognizant (Assistant Administrator)."

According to USAID, earlier attempts to provide policy advice to Ukraine through the competitive process had been rejected by the Ukrainian government, which had a generally negative view of foreign advisors. However, Ukrainian officials subsequently specifically requested assistance and macroeconomic advice from HIIID. The justification for waiving the requirement for competition, which was approved by the Assistant Administrator, provided:

"It is squarely in the interest of the United States for Ukraine to implement its reform programs successfully, and high-level strategic advice will clearly serve as a critical catalyst at this juncture. Thus, it behooves USAID to be responsive to the (Government of Ukraine) request for HIIID's

assistance, which will enable strategic policy advisors, who specialize in transition economies, to help shore up the (Government of Ukraine's) political will and provide them with the technical expertise to formulate and implement appropriate policies. Earlier attempts to provide economic policy advice through a competitive Request for Applications process was specifically rejected by the (Government of Ukraine), because at the time, they did not perceive the need for technical assistance that they now acknowledge."

On March 1996, the ENI/ Procurement concluded that two of the components of the Ukrainian-HIID unsolicited proposal " may" duplicate in some respects the regional RFA for which the Ukraine mission withdrew from competition and concluded that the proposed activity should be competed. She added that if the waiver invokes a foreign policy consideration, it becomes a political decision, which is outside the scope of her jurisdiction. On March 26, 1996, the Assistant Administrator for ENI approved a noncompetitive waiver based on foreign policy considerations. Other U.S. Government officials also initialed the waiver including a representative from the office of State Department's Coordinator for Assistance to Former Soviet Union, a representative from the Treasury Department, and a representative from the National Security Council.

Limited Support Within the Ukraine Government

While the Ukrainian Deputy Prime Minister clearly endorsed HIID's role in assisting Ukraine, we found that knowledge of the project from other levels within the

Ukrainian government was either limited or nonexistent contrary to USAID's statements in its justification for the non-competitive award.

As previously indicated, Ukrainian officials did not have specific knowledge of HIID's July 24, 1995 proposal. Further, HIID's revised proposals submitted to USAID on August 30, 1995, and October 30, 1995, remained ambitious and clearly did not correspond to the NB concerns according to an NB official. This official believed that the October proposal was duplicative of ongoing activities. He said he would work with USAID to stop the project. In March 1996, this official told a HIID official that he would accept only one advisor to work on the previously mentioned project. Most other ministries did not hear of HIID's proposal until after it was approved in May 1996; some did not hear about it until we meet with them in July 1996. However, the ministries generally believed that HIID's final proposal held some promise.

Because of the Ukrainian Government's specific request for HIID assistance, we have no basis to question USAID's decision that it was critical to the foreign assistance program to award HIID a cooperative agreement without competition.

Proposal Duplicated Some Aspects of Withdrawn Request for Application

In March 1996, USAID's procurement officer concluded that two of the three components of HIID's unsolicited proposal for Ukraine might duplicate in some respects the original proposal that had been withdrawn from competition. She noted that the proposed activity should be placed into competition. State's

Assistant Administrator for European and NIS Affairs approved a noncompetitive waiver for HIID based on foreign policy considerations.

The three components of HIID's proposal were for macroeconomic and monetary policies, tax and budget assistance, and fiscal reform of the pension program. There is no doubt that the tax proposal duplicated the March 17, 1995 request for proposal. For example, a large component of HIID's Russian work plan for its impartial oversight contract awarded under the competitive process was for a tax project similar to the one proposed for Ukraine. Also, the HIID Russian work plan contained a section on policy advice including a specific reference to macroeconomics.

Redundancy with Existing Work

As part of its proposal, HIID proposed the establishment of a Macroeconomics Group of senior Cabinet level ministers and deputy ministers and the Chairman on key staff of the Central Bank to meet regularly to assess macroeconomic data. The Group would be supported a Technical Macroeconomics Team of Ukrainian policy advisors and Ministry specialists. The Missions analysis concluded that this could be a valuable and much needed to the U.S. Government program and should be the foundation of the whole project. Officials from the Ministries of Economy, the Central Bank, and the State Property Fund stated that increased coordination between the Ministries and consensus building would improve the reform process and initial reaction to the HIID proposal was positive.

The mission concluded that the four tax components of the HIID proposal would

largely duplicate and quite possibly delay the work on tax law and codification already being done by the U.S. Treasury advisor, with assistance from the KPMG/Barents fiscal economist. The U.S. Treasury advisor stated that he met with the HIID tax advisor between March 4 and 8, 1996 and discussed what the Ukrainian Government with U.S. assistance was doing in the way of tax proposals. In addition, he stated that the approach was first discussed at Harvard in August 1995 during a seminar that included representatives from the State Parliament (Rada) , the State Tax Inspectorate, and U.S tax experts.

He explained that the Treasury approach included establishing a joint working group consisting of Rada and State Tax Inspectorate. It was decided that the best chance of success was to address tax issues in phases and five areas were identified- administration provisions and inspections, value added tax amendments, enterprise profit tax, personnel tax, and excise tax. These are the same areas addressed in the HIID tax proposal. The bases of the Treasury approach was to use a well-recognized international model tax code.

He said that the issue of cash versus accrual payments for the value added tax, which is discussed in detail in the HIID proposal, was addressed in current proposals that was awaiting the third reading in the Parliament. He said that if HIID could convince the Prime Minister and others key players in the government to move on taxes it would be very useful. However, if HIID chose to develop an independent tax initiative, using the value added tax as an example, it could be counter productive and might delay enactment of tax reform.

Under budget system reform, HIID proposed, in part, to work with the Ministry of Finance staff to develop the economic models, processes and procedures necessary to formulate effective fiscal policy. The Mission analysis of the proposal noted that the macroeconomic forecasting work was already being done by the KPMG fiscal economist working within the Minister of Finance that had close ties to the Ministry of Economy, the National Bank of Ukraine, and other donor groups active in this area including the Soros -Asland Group and the German Technical Assistance Team. Our discussions with KPMG/ Barents, and officials from the Ministry of Finance confirmed that these groups were working on models to project tax revenue.

The April 9, 1996, proposal also addressed the concern of the Governor of the National Bank of Ukraine over the conflict that arises between the foreign exchange and the credit policies of the National Bank of Ukraine. According to HIID, a main focus of HIID assistance will be to develop institutional mechanisms to foster regular and timely coordination between foreign exchange and credit policies. USAID mission noted that the IMF and in particular the Monetary and Exchange Department at the Fund has the lead for all activities connected with the central banks in the region.

HIID also proposed to provide technical assistance on pension reform, including developing a proposal to change the financing for pensions, and preparing actuarial estimates of the pension liabilities, developing a proposal to use part of the assets of the enterprises currently being privatized to finance long-term pension liabilities and analyzing the impact of various pension reforms on the budget and on private savings. The Mission analysis concluded that the work

being proposed would largely duplicate and in part contradict work being carried out by other donors.

For example, USAID/Kiev noted that the reform of the state pension fund is on the agenda of Ukraine's President and Parliament. It is one of the packages of reforms and introduction of the social insurance funds, development of which is being coordinated by the Minister of Labor under the aegis of the Deputy Prime Minister for Economic Reform. The European Union under its technical Assistance to the Commonwealth of Independent States had recently begun a project, with a long term resident advisor and substantial short-term technical assistance to work intensively with the Labor Ministry and the group it coordinates within the overall development of social policy, including social insurance reform.

Within the overall framework of the development of social insurance, the Mission noted that the Ministry of Social Protection has been in charge with the development of a reform pension system. The mission stated that the German government has been providing technical assistance in the development of a reformed pension system for over two years and had won the trust of the Government of Ukraine. The Mission analysis noted some deficiencies in German program but concluded that it would be counter productive to begin a new project from ground zero.

Efforts to Coordinate With Ongoing Activities

HIID recognized the potential duplication with ongoing programs and made

USAID Russian Privatization Program 1992-1996

SUMMARY

	<u>Obligations</u>	<u>Accrued Expenditure as of 31-Mar-96</u>	<u>Pipeline \$</u>	<u>Accrued Expenditure %</u>
Mass Privatization	58,324,607	57,374,155	950,452	98%
Land Privatization	62,626,116	48,579,132	14,046,984	78%
Capital Markets	77,189,912	60,503,490	16,686,422	78%
Post Privatization	71,559,346	48,810,683	22,748,663	68%
Policy, Legal and Regulatory Reform	39,103,676	28,469,439	10,634,237	73%
Other	16,436,643	11,790,893	4,645,750	72%
TOTAL	<u>325,240,300</u>	<u>255,527,793</u>	<u>69,712,507</u>	<u>79%</u>

Source:
USAID
end of Sept. 1996

USAID Russian Privatization Program 1992-1996

MASS PRIVATIZATION Small, Medium, and Large Enterprises

		Obligations	Accrued Expenditure as of 31-Mar-88	Pipeline \$	Accrued Expenditure %
NON OMNIBUS CONTRACTS					
Bain & Co.	Small Scale/Voucher Auction Mgmt.	4,400,000	4,030,420	368,580	92%
Deloitte & Touche	Voucher Clearing & Depository System	2,754,110	2,754,110	0	100%
Int'l Finance Corp.	Small Scale/Trucking	4,371,559	4,371,559	0	100%
Int'l Finance Corp.	Voucher Auctions	3,250,000	3,220,795	29,205	99%
Price Waterhouse	Regional Voucher Auctions	2,124,226	2,124,226	0	100%
Price Waterhouse	National Auction System	4,063,055	4,063,055	0	100%
Sawyer Miller Robinson Lake	Public Education	7,277,716	7,270,469	7,247	100%
	subtotal	28,240,666	27,834,634	406,032	99%
OMNIBUS I					
Deloitte & Touche	Voucher Clearing & Depository System	1,228,100	1,228,100	0	100%
Deloitte & Touche	Public Education/Sawyer Miller	507,945	507,945	0	100%
Deloitte & Touche**	Public Education/Sawyer Miller	3,703,774	3,703,774	0	100%
IBTCI	Health	2,210,701	1,989,764	220,937	90%
KPMG Peat Marwick***	Bain-Voucher Auction Mgmt.	3,041,339	3,041,339	0	100%
KPMG Peat Marwick	Burson Marsteller - Public Education	1,755,713	1,755,713	0	100%
KPMG Peat Marwick*	Burson Marsteller - Public Education	5,767,654	5,745,498	22,156	100%
Price Waterhouse	Regional & National Auctions	5,078,291	5,014,837	63,454	99%
Waterhouse	National Auction System	6,790,424	6,552,551	237,873	
	subtotal	30,083,941	29,539,521	544,420	
total		58,324,607	57,374,155	950,452	98%

USAID Russian Privatization Program 1992-1996

LAND PRIVATIZATION

		Obligations	Accrued Expenditure as of 31-Mar-96	Pipeline \$	Accrued Expenditure %
<u>NON OMNIBUS CONTRACTS</u>					
Int'l Finance Corp.	Land Privatization - Nizhny	1,822,973	1,822,973	0	100%
	subtotal	1,822,973	1,822,973	0	100%
<u>OMNIBUS I</u>					
Arthur Anderson	Land Certificates and Registration	9,999,585	8,984,010	1,015,575	90%
Arthur Anderson	Farm Reorganization	1,198,760	974,786	223,974	81%
Arthur Anderson	Land Privatization	1,999,313	1,787,966	211,347	89%
Chemonics	Land Privatization	3,995,104	3,940,457	54,647	99%
Chemonics	Agricultural-Economic Review	145,088	145,088	0	100%
Chemonics	Land Certificates and Registration	8,713,406	8,713,406	0	100%
Chemonics	Farm Models	698,346	698,346	0	100%
Chemonics	Communications	5,544,438	5,502,864	41,574	99%
Deloitte & Touche	Sawyer Miller/Pub. Ed. Surveys	1,000,000	1,000,000	0	100%
KPMG Peat Marwick	Burson Marsteller/Pub. Ed.	1,000,000	995,954	4,046	100%
Price Waterhouse	Land Privatization	1,999,999	1,930,212	69,787	97%
	subtotal	36,294,039	34,673,089	1,620,950	96%
<u>OMNIBUS II</u>					
Andersen	Real Estate Information Systems Pilots	1,280,538	0	1,280,538	
A. Andersen	Real Estate Information Systems	708,938	500,000	208,938	
Bancroft Group	Land Use, Zoning and Pricing	2,971,327	929,039	2,042,288	31%
CFED	Property Tax	2,931,837	2,205,175	726,662	75%
Chemonics	Enterprise Land Sales	6,383,454	1,971,311	4,412,143	31%
Chemonics	Public Education	1,994,117	1,228,458	765,659	62%
Chemonics	Farm Reorganization	6,000,000	3,915,804	2,084,196	65%
Chemonics	Real Estate Information Systems	708,938	708,938	0	100%
KPMG Peat Marwick	Land Mortgages & Real Estate Finance	1,379,955	624,345	755,610	45%
	subtotal	24,359,104	12,083,070	12,276,034	50%
<u>Field Allowance</u>					
USAID/Moscow	GDO Land Design	150,000	0	150,000	0%
	total	<u>62,626,116</u>	<u>48,579,132</u>	<u>14,046,984</u>	<u>78%</u>

USAID Russian Privatization Program 1992-1996

CAPITAL MARKETS

<u>NON OMNIBUS CONTRACTS</u>		<u>Obligations</u>	<u>Accrued Expenditure as of 31-Mar-96</u>	<u>Pipeline \$</u>	<u>Accrued Expenditure %</u>
U.S. Securities and Exchange	Inter Agency Agreement	524,375	524,375	0	100%
	subtotal	524,375	524,375	0	100%
 <u>OMNIBUS I</u>					
Arthur Andersen	Rus Fed Commision on Secs & Exchanges	3,685,275	3,203,549	481,726	87%
Arthur Andersen	Broker Dealer Back Office Support	1,833,205	1,758,723	74,482	96%
Arthur Andersen	Securities Market Monitoring Capability	2,329,351	2,073,182	256,169	89%
Booz-Allen Hamilton	Communications & Training	1,741,355	1,282,147	459,208	74%
Deloitte & Touche	Transfer Agency, P2 & 3	2,783,592	2,501,721	281,871	90%
Deloitte & Touche	Clearing & Settlement Organizations (CSO)	9,890,155	9,361,624	528,531	95%
Deloitte & Touche	Telecommunications Systems Support	3,216,912	3,173,379	43,533	99%
Deloitte & Touche	Transfer Agency, Phase 1	155,251	155,251	0	100%
KPMG Peat Marwick	Transfer Agency, Phase 1	165,517	135,308	30,209	82%
KPMG Peat Marwick	Clearing & Settlement	4,008,281	3,977,279	31,002	99%
KPMG Peat Marwick	Trading Institutional Development	9,626,040	9,164,558	461,482	95%
KPMG Peat Marwick	Transfer Agency, P2 & 3	3,289,362	3,253,997	35,365	99%
KPMG Peat Marwick	Burson-Marsteller/Public Education	5,000,000	4,981,043	18,957	100%
Price Waterhouse	RFCSE Resource Secretariat	5,748,143	5,427,486	320,657	94%
Price Waterhouse	New Issues & Securities Distribution	4,221,904	3,996,822	225,082	95%
	subtotal	57,674,343	54,446,069	3,228,274	
 <u>OMNIBUS II</u>					
Arthur Anderson	Broker/Dealer Back Office	1,691,416	0	1,691,416	0%
Booz-Allen Hamilton	RFCSE Resource Secretariat	499,496	358,971	140,525	72%
Burson-Marsteller	Communications and New Issues	2,496,491	1,146,119	1,350,372	46%
Intrados	Collective Investment	2,999,077	436,765	2,562,312	15%
KPMG Peat Marwick	Trading Systems	5,599,785	1,374,630	4,225,155	25%
Price Waterhouse	RFCSE Resource Secretariat	4,004,929	2,120,554	1,884,375	53%
	subtotal	17,291,194	5,437,039	11,854,155	31%
 <u>Field Allowance</u>					
Harvard University	Resource Secretariat/Russian Staff	1,700,000	96,007	1,603,993	6%
	subtotal	1,700,000	96,007	1,603,993	6%
	total	<u>77,189,912</u>	<u>60,503,490</u>	<u>16,686,422</u>	<u>78%</u>

amend # 8

USAID Russian Privatization Program 1992-1996

POST PRIVATIZATION

NON OMNIBUS CONTRACTS		Obligations	Accrued Expenditure as of 31-Mar-96	Pipeline \$	Accrued Expenditure %
ABT Assoc.	4 Vegetable Warehouse Pilot	739,551	739,551	0	100%
ABT Assoc.	4 Vegetable Warehouse Pilot	265,258	230,000	35,258	87%
Harvard University	HIID/RPC Policy Oversight	4,300,000	600,000	3,700,000	14%
IESC	IESC Grant	3,995,960	1,800,000	2,195,960	45%
McKinsey & Company Inc.	Enterprise Restructuring Pilot	1,750,000	1,750,000	0	100%
Russian Privatization Center	RPC Direct Grant	14,370,893	8,017,943	6,352,950	56%
	subtotal	25,421,662	13,137,494	12,284,168	52%
OMNIBUS I					
Arthur Anderson	4-Local Privatization Centers	7,499,933	7,409,671	90,262	99%
Arthur Anderson	Initial Establishment of LPCs	171,179	155,170	16,009	91%
Booz-Allen Hamilton	St. Petersburg Port	1,444,910	1,444,910	0	100%
Burson-Marsteller	Public Education, Cash Auctions, Shrhldr.	4,592,834	4,592,834	0	100%
Carana	Program for Intensive Enterprise Support	4,065,165	1,408,779	2,656,386	35%
Carana	4 Local Privatization Centers	4,638,646	3,816,452	822,194	82%
Deloitte & Touche	Ward Howell	713,070	569,310	143,760	80%
Deloitte & Touche	Program for Intensive Enterprise Support	6,373,276	2,667,392	3,705,884	42%
Deloitte & Touche	Fin'l Mgmt. Assistance to Enterprises (FMA)	2,747,616	2,368,853	378,963	86%
Medos	Training	1,113,132	837,710	275,422	75%
Peat Marwick	Program for Intensive Enterprise Support	4,399,960	3,049,656	1,350,304	
Peat Marwick	Burson-Marsteller/Public Education	1,000,000	995,954	4,046	
Pricewaterhouse	Local Privatization Centers (LPCs)	4,169,514	3,869,512	300,002	
Sibley International	Franchising	1,028,823	994,008	34,815	97%
Sibley International	Franchising	700,000	606,049	93,951	87%
Sibley International	Franchising	79,629	79,629	0	100%
	subtotal	44,737,687	34,865,689	9,871,998	78%
OMNIBUS II					
Carana	MINATOM Industrial Conversion	599,997	132,500	467,497	22%
	subtotal	599,997	132,500	467,497	22%
Field Allowance					
Pepperdine	Training (Defense Conversion)	800,000	675,000	125,000	84%
	subtotal	800,000	675,000	125,000	84%
	total	<u>71,559,346</u>	<u>48,810,683</u>	<u>22,748,663</u>	<u>68%</u>

USAID Russian Privatization Program 1992-1996

POLICY, LEGAL, AND REGULATORY REFORM

		Obligations	Accrued Expenditure as of 31-Mar-96	Pipeline \$	Accrued Expenditure %
<u>NON OMNIBUS CONTRACTS</u>					
DOJ/FTC	Inter-Agency Agreement	592,350	3,450	588,900	1%
Harvard University	GKI/Mass Privatization Policy/Oversight	2,139,482	2,139,482	0	100%
Harvard University	Russian Priv. Ctr & Cap. Mkts Policy	3,000,000	3,000,000	0	100%
Harvard University	Legal Reform	10,000,000	8,050,601	1,949,399	81%
Harvard University	RPC & Policy Advice/Oversight	13,534,512	13,534,512	0	100%
	subtotal	29,266,344	26,728,045	2,538,299	91%
<u>OMNIBUS I</u>					
Booz-Allen Hamilton	Antimonopoly	243,007	182,076	60,931	75%
Price Waterhouse	Legal Reform	1,138,325	1,138,325	0	100%
	subtotal	1,381,332	1,320,401	60,931	96%
<u>OMNIBUS II</u>					
	subtotal	0	0	0	0%
<u>Field Allowances</u>					
SUNY/Morozov	Bankruptcy Training	500,000	0	500,000	0%
IESC	Bankruptcy Reorganization	500,000	0	500,000	0%
University	GPU Duma/Commercial Law Drafting	2,456,000	138,659	2,317,341	
University	GPU Duma/Commercial Law Drafting	5,000,000	282,334	4,717,666	
	subtotal	8,456,000	420,993	8,035,007	
	total	39,103,676	28,469,439	10,634,237	73%

HIID - NED'S MISSION - VALUE!

USAID Russian Privatization Program 1992-1996

OTHER					
NON OMNIBUS CONTRACTS		Obligations	Accrued Expenditure as of 31-Mar-96	Pipeline \$	Accrued Expenditure %
Boston Consulting Group	Demonopolization Pilot - Perm	1,785,820	1,785,820	0	100%
		1,785,820	1,785,820	0	100%
<u>OMNIBUS I</u>					
Booz-Allen Hamilton	Pilot Port Privatization	1,805,624	1,700,592	105,032	94%
IBTCI	Wholesale Vegetable Demonopolization	1,406,636	1,406,636	0	100%
IBTCI	Small Business Development	1,998,108	1,998,108	0	100%
IBTCI	Medical Tech Transfer	2,996,152	2,537,139	459,013	85%
KPMG Peat Marwick	Small Business Development	854,866	854,866	0	100%
	subtotal	9,061,386	8,497,341	564,045	94%
<u>OMNIBUS II</u>					
Chemonics	Trading/CSO; Macroeconomic Pub Ed	3,956,710	607,732	3,348,978	15%
	subtotal	3,956,710	607,732	3,348,978	15%
<u>Field Allowance</u>					
iana St. Univ.	Ports	782,727	50,000	732,727	6%
Proj. Fin. Bank	TA/Training	850,000	850,000	0	1
	subtotal	1,632,727	900,000	732,727	
	total	<u>16,436,643</u>	<u>11,790,893</u>	<u>4,645,750</u>	<u>72%</u>

USAID Russian Privatization Program 1992-1996

Notes: Harvard University, although listed several times throughout this list, is only listed three times in our official reporting system. For future reference, it is as follows:

\$9,156,000	Cap Mkts	\$1,700,000	\$4,300,000	
	Policy/Legal	\$5,000,000	Post Priv	\$2,500,000
		\$2,456,000		\$1,800,000

\$25,673,994	Policy/Legal	\$2,139,482
		\$13,534,512
		\$10,000,000

MASS PRIV

* KPMG/Burson Pub Ed total amount \$12,767,654. Mass Priv=\$5,767,654; Land=\$1.0; CapMkts=\$5.0; Post Priv=\$1.0
Disbursed amounts total \$12,715,226 distributed by percentage.

** Deloitte/Sawyer Miller total amount \$4,703,774. Mass Priv=\$3,707,774; Land=\$1.0. Amount totally disbursed.

*** KPMG/Bain Voucher Auction Management (VAM) - Split funded \$1.6M + \$1,441,339=\$3,041,339. Fully dispersed

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MICHAEL H. VAN DUSEN
Democratic Chief of Staff

One Hundred Fourth Congress
Congress of the United States
Committee on International Relations
House of Representatives
Washington, DC 20515

February 5, 1996

Mr. Charles Bowsher
Comptroller General
U.S. General Accounting Office
441 C Street, N.W.
Washington, D.C. 20548

Dear Mr. Bowsher:


At the request of majority staff of the International Relations Committee, staff of the General Accounting Office have recently inquired with officials of the U.S. Agency for International Development (AID) and the Department of State regarding the grant of AID program funds to the Harvard Institute for International Development (HIID) for work it has conducted in the Russian Federation under the "Economic Restructuring" project for the New Independent States.

To date, GAO staff have pursued their inquiry into the funding of HIID's work and the effectiveness of that work as part of the on-going GAO review of AID's support for "Rule of Law" and law enforcement assistance programs in the New Independent States. Given the non-competitive nature of much of the grants providing funding to HIID for its work, however, I would appreciate an expeditious, thorough review of the history of funding for HIID's work in the NIS and the use of non-competitive procedures for the award of much of that funding. I also request a review by GAO of the overall effectiveness of the work conducted by HIID to date in the New Independent States in meeting project objectives.

Mr. Bowsher, at this time I have placed a "hold" on the proposed, non-competitive grant of \$6 million to HIID for work to be done under the "Economic Restructuring" project in Ukraine. I would therefore appreciate your ensuring that the GAO's review of HIID's work in Russia takes place in a thorough yet expeditious manner. The results of GAO's review will likely have some bearing on my decision as to the disposition of that "hold."

Thank you for your assistance in this matter. Please contact Mr. Mark Gage, Professional Staff Assistant on the International Relations Committee, should you have any questions with regard to this request.

With best wishes,

Sincerely,

BENJAMIN A. GILMAN
Chairman

BAG/mg



United States
General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

The Honorable Benjamin A. Gilman
Chairman, Committee on International Relations
United States House of Representatives

Dear Mr. Chairman:

This letter confirms our commitment to study Harvard Institute of International Development (HIID) contracting and performance issues based on your letter of February 5, 1996 to the Comptroller General. In our statement of intent of April 23, 1996, we outlined our approach to designing the study. Based on that design and discussions with your staff on May 6, 1996, we will provide you a detailed briefing by mid-August and issue a written product to you by the end of September 1996. The enclosure sets forth the understanding reached with your staff on the key aspects of the study.

We look forward to working with you and your staff on this assignment. If you should have questions, you may contact me on (202) 512-4128 or my Assistant Director, Mr. Louis Zanardi, on (202) 512-4367.

Sincerely yours,

Benjamin F. Nelson, Director
International Relations and Trade Issues

Enclosure

Terms of the Work**OBJECTIVES/KEY QUESTIONS**

Based on our May 6, 1996 discussions, we will evaluate (1) U.S. Agency for International Development's (USAID's) selection processes for both competitive and noncompetitive awards to HIID for technical assistance and oversight in Russia and Ukraine, (2) the adequacy of USAID's financial controls and management over activities of HIID and the Russian Privatization Center (RPC), and (3) HIID and RPC effectiveness.

SCOPE

The work will cover HIID's assistance in Russia and Ukraine and USAID's decisions related to the March 1995 Request for Application (RFA) for Russia and Ukraine. Work will be conducted in Washington, Cambridge, New York, Russia, and Ukraine. We will meet with representatives from USAID, State, Treasury, the World Bank, International Finance Corporation, HIID, and other contractors working in related fields, as well as officials from the Russian and Ukrainian governments. As agreed in the May 6 meeting, we will limit Ukraine work to duplication and contracting issues and forgo work on HIID environmental issues due to time and personnel constraints.

METHODOLOGY

To evaluate USAID's contracting awards, we will (1) review appropriate laws, regulations, and waiver justifications for Ukraine; (2) review USAID contract files in Washington, Russia and Ukraine; and, (3) interview key participants, including HIID, USAID, and State officials and Russian and Ukrainian government officials. To assess USAID financial controls, we will review HIID and RPC accounting reports and records, and conduct limited transaction tests to determine compliance with AID requirements and whether documentation supports their financial reports. To assess HIID's effectiveness in meeting contract objectives, we will conduct case studies on major HIID and RPC activities involved in privatization, post-privatization, legal reform, capital markets, and land privatization. Work will be in accordance with Generally Accepted Government Auditing Standards.

PRODUCT TYPE

Assistant Director Mr. Louis Zanardi will provide a detailed briefing to the committee. A blue cover report, signed by Associate Director Mr. Harold Johnson, will also be provided to the Committee.

PRODUCT DELIVERY DATE(S)

The briefing will be provided in mid-August and the report will be provided by late September 1996.

SPECIAL CONDITIONS

None.

REPORTING ON JOB STATUS

We will provide briefings as requested.

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RICHARD J. GARNON
Chief of Staff

One Hundred Fourth Congress
Congress of the United States
Committee on International Relations
House of Representatives
Washington, DC 20515

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EARL HILLARD, Alabama

MICHAEL H. VAN DUSEN
Democratic Chief of Staff

October 4, 1996

Mr. James F. Hinchman
Principal Assistant Comptroller General
and Acting Comptroller General
U.S. General Accounting Office
441 C Street, N.W.
Washington, D.C. 20348

Dear Mr. Hinchman:

In my capacity as Chairman of the House of Representatives International Relations Committee, on February 5th of this year I requested that the U.S. General Accounting Office undertake a review of the history of funding for work performed for the U.S. Agency for International Development by the Harvard Institute for International Development (HIID) in the newly independent states of the former Soviet Union and of the use of non-competitive procedures for the award of much of that funding.

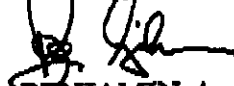
After written and verbal consultations between staff of the International Relations Committee and the General Accounting Office in March, Mr. Benjamin Nelson, Director of International Relations Issues for GAO, committed GAO to the completion of the design phase of this project by May 15th and to issuance to the Committee of a written report by the end of September. (A verbal briefing on the preliminary findings of the review was in fact provided to Mark Gage of the Committee staff on July 26th by the relevant GAO staff.)

I was disappointed to learn today that GAO will not in fact meet its commitment to provide the Committee with a written report by the end of September. I am concerned to learn also that GAO has not yet even begun to circulate the report for comment by the appropriate US Government agencies.

Mr. Hinchman, I am indeed appreciative of the work done to date by GAO staff on this project. I expect, however, that GAO will now move very quickly to provide the full written report to me, no later than October 18th. Your cooperation in ensuring that this date for completion -- a date that provides a three-week extension beyond GAO's committed date of completion -- would be appreciated.

With best wishes,

Sincerely,



BENJAMIN A. GILMAN
Chairman

BAG/mg

cc: Hon. Newt Gingrich
Speaker

REVIEW OF USAID MANAGEMENT OF HIID'S NIS CONTRACTS

Code 711186

Ned George

NSIAD/IRT
October 3, 1996
file:dean.wp5

INTERVIEW: Steve Dean/USAID Contracting**Date:** **October 3, 1996****Location:** **U.S. Agency for International Development (USAID), 1100 Wilson Blvd. Rm. 1400 Arlington, Va.****Participants:****USAID**

- **Steve Dean, Chief, ENI Contract Division, ENI Office of Procurement
(703)875-1040**

U.S. GAO, NSIAD/IRT

- **Ned George, EIC**
- **Maria Oliver, Senior Evaluator**

Purpose: **To follow up on the events that occurred during the competition of the RFA for economic and post-privatization assistance to the RPC and the SEC in Russia in the summer of 1995.****Note:** **The following summarizes the comments of the official(s) noted above.****THE INTERVIEW Overall Comments**

Steve Dean said he is two levels removed from the negotiator or contract specialist (Dennis Dorsey) in the competition in question. A grant or contract officer, Sharon Zavestoski [(703)875-1592], was Dennis Dorsey's direct supervisor and was responsible for signing off that the competition for the cooperative agreement on "Impartial Oversight and Strategic Guidance for Privatization and Market Reform Programs" in Russia and Central Asia, held in the summer of

Steve Dean

1995, was conducted according to policy and procedures of the ENI Bureau and the Office of Procurement. According to Mr. Dean, the grant officer has unlimited authority in dealing with a competition for a cooperative agreement, but if there were any policy issues, these would be reviewed by management. Although there are few regulations governing the awarding of cooperative agreements through competitions, it is the ENI Bureau's practice to follow the same guidelines for cooperative agreement competitions as it has to follow for holding contract competitions.

Mr. Dorsey was conducting his first competition, but Ms. Zavestoski is an experienced grant officer. Any questions about the process that arose, which could not be handled by Mr. Dorsey, should have been addressed by Ms. Zavestoski. The Missions decided there would be 3 components to the RFA, and in the end, awarded two of these.

Panel Scores Always Determine the Outcome

Technical review panels are used to evaluate all proposals by using the selection criteria set in the RFA. It was up to the technical panel chairman (Art Warman in this case) to resolve issues that could arise, such as widely differing scores. The panel members are to strive to score all of the proposals with the same level of review. That is, tough raters should be tough on all of the proposals. When the technical panel chairman reviews the results of the panel's work, consistency in applying the criteria is one of the factors that he is to look for, and if inconsistencies are found, the panel should meet to resolve them. The panel decides if the proposals are technically acceptable. The contract officer reviews the panel scoring and makes a recommendation for making an award.

Once scores are added up, if the review was done in accordance with the selection criteria set in

the RFA announcement, and the contract officer was satisfied with this, it would be very rare to have the Office of Procurement or the technical panel chairman make the award to the second highest scorer or some candidate other than the top scorer. SD said the authority exists to do this, but he couldn't think of an instance where it had happened, and the highest scoring proposal was not selected. The only exceptions would be if the criteria had been applied incorrectly or if there was a breakdown of negotiations with the winner of the competition. The spirit of the process, and the practice followed in the ENI Bureau are to award to the top scorer.

SD Suspicious That the Mission Would Ignore the Competition Results

The Mission's decision to not award one of the winners of the competitions [Stanford for its proposal for the Russian Securities Exchange Commission (RSEC)] was considered, even at the time, to be controversial and unusual. The Mission's delay in notifying the Office of Procurement on its decision to not award the RSEC cooperative agreement indicated that something was amiss and that the Mission was likely not happy with the ranking that put Stanford on top. However, the Mission can make decisions not to award cooperative agreements to projects, and it notified the Office of Procurement there was no longer a need for this work. The Mission said the circumstances in the country had changed and that such a project was not needed. The Mission did not inform the Office of Procurement that the RSEC refused to work with Stanford.

SD said he warned the Mission that the Office of Procurement would not agree to an award later for similar work under a separate competition or amendment, and the Mission said it would not do this. SD especially had this conversation with the Mission contract officer, Orian Yendell, because he was suspicious that the Mission might try to fund HIID through back channels. SD said that generally he would not have been involved in the details of specific competitions unless they were controversial.

GAO asked SD about the \$1.7 million non-competitive amendment to the original cooperative agreement with HIID that was made in 9/95 to cover the salaries of staff at the RSEC. SD said this was just what he had tried to prevent from happening with his warning to Orian Yendell, but he was not aware that this had occurred, and the first he heard of it was in this interview. HIID should not have been given money non-competitively for RSEC work after they lost the competition, as this makes a mockery of the competition. SD said that it was the ENI, Office of Procurement practice that if the mission agreed to a competition, it had to abide by the outcome.

Reaction to Math Error and Appearance of Conflict of Interest

SD said that he was "floored" to learn about the math errors. He said it was highly troublesome that errors in recording and calculating the scores of the panel members were made by the negotiator/contract specialist, and an award for this part of the competition was nearly made.

He concurred there is an appearance of a conflict of interest from the panel participation by the panelists selected by the RSEC and the RPC, and he would not have allowed these representatives on the panel if he had known their relationship with HIID, HIID's responsibility for setting up the organizations, that HIID was paying senior staff on the two organizations, and that the RPC was not quasi-governmental organizations but a private organization. He said he should have stopped the participation of these panelists. (He later said that after thinking about it, perhaps it didn't matter that the RPC was private. If all other factors were acceptable, as a recipient of assistance

they could have been eligible to sit on the panel.) When informed that the RSEC panelist had written notes that indicated she did not believe HIID could win both Russian awards, SD this could have been grounds to disqualify her scores.

Answers to Specific Questions and Comments on Specific Issues

The following lists the questionable practices GAO identified during the 1995 competition for cooperative agreements on -- Impartial Oversight and Strategic Guidance for Privatization and Market Reform Programs in the Newly Independent States.

I asked SD to respond to GAO observations about the chronology and management of the review panel and whether these constituted violations of contract or CA guidelines, or the spirit of USAID's competition policy.

1. The Russian RSEC and RPC were allowed to place their representatives on the selection panel.
 - The RPC and RSEC were not traditional USAID recipients because HIID had provided personnel for key management positions to each of these institutions and both strongly supported HIID's work, the HIID general manager sits on the RPC board of directors, and the RSEC executive director had written USAID ENI Bureau Assistant Administrator that only HIID could carry on the work at the RSEC.
 - RSEC sent a representative from IFC who had worked closely with HIID and had written task orders for USAID contractors.