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# U.S. Assistance for Market Reforms

## *Foreign Aid Failures in Russia and the Former Soviet Bloc*

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**W**hen the communist Eastern bloc collapsed in 1989 and the Soviet Union itself ceased to exist in 1991, it seemed that the West (particularly the United States) finally had what it had always wanted—the opportunity to introduce quick, all-encompassing political and economic reform. International lending institutions and the foreign aid community, often working in concert with reform-oriented Central and Eastern European leaders, pressed governments to build market economies by introducing economic reforms and privatizing state-owned resources. The United States made aid in support of market reform in the formerly communist countries its chief priority, obligating more dollars to economic restructuring, including privatization and development of the private sector, than to any other single effort.<sup>1</sup>

The plans seemed promising, but their premise and implementation have been less than exemplary. Many U.S. aid efforts have not helped to support market reform, and some have even backfired. Those efforts have not necessarily achieved long-term development or security goals by helping to build enduring, nonaligned institutions or fostering friendly relations. Russia, once considered the poster child of reform, is now heading toward meltdown despite billions of dollars in “help”

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from Western governments. As the United States considers what further course of action to take in Russia, as well as in Ukraine<sup>2</sup> (and also continues to assist some Central and Eastern European countries), it is critical to take the experience of the past decade into account.

Critics of foreign aid often point to cases in which development assistance to the Third World appears to have retarded, rather than stimulated, economic progress. The record of aid to much of the Second World will likely confirm the critics' skepticism. But even advocates of aid must recognize widespread failures of aid to the region. Indeed, in any circumstances, transplanting development assistance (including ideas, know-how, and grants) from one context into another is an inherently troublesome process. The personal and institutional means by which donors connect with recipients, the circumstances in which both are operating, and the goals of each side critically shape the assistance recipients get, how they respond to it, and the impact of the aid. Yet those factors are typically overlooked: little attention is generally paid to how aid is implemented and how it actually works.

In the case of U.S. assistance to Central and Eastern Europe and the former Soviet Union, discussion among policy makers has typically centered on amounts and categories of aid (privatization, private sector, democracy promotion, or humanitarian) and sometimes the kind of aid (technical assistance, training, grants, or loans). But rarely has Washington given careful consideration to the agents of the aid on both donor and recipient sides, the relationships formed between those agents, and the implications of those factors for the outcomes of assistance efforts. Relationships, both between Easterners and Westerners and between fellow Easterners, have shaped the results of nearly all aid strategies that the major donors have employed, including technical assistance through person-to-person contacts, grants to Central and Eastern European political-economic groups and nongovernmental organizations, and loans to businesses. Although those mechanisms differ, each has played a pivotal role in aid outcomes.

## **An Army of Advisers**

The major way that Western donors assisted the former communist countries in their "transition" to a market economy was through "technical assistance" in the form of

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1. During the primary push of U.S. aid to Central and Eastern Europe, nearly three-quarters of all U.S. assistance obligations to the region were for economic restructuring. Of that amount, 18.2 percent went for privatization and assistance to enterprises in the region, and Poland, Hungary, and the Czech Republic received the lion's share (U.S. Department of State 1996b). About one-fourth of U.S. obligations to the former Soviet Union were for private-sector development, economic restructuring and finance, and market reform (U.S. GAO 1995a, 48). As of the end of 1996, the European Union had committed about one-fourth of its PHARE aid program to economic restructuring and private-sector development, including privatization, enterprise support, and aid to the financial and agricultural sectors (European Commission 1997, table A.7, p. 66).

2. The U.S. Department of State reported \$3.5 billion in cumulative obligations to Russia and \$868 million in obligations to Ukraine as of March 31, 1996 (U.S. Department of State 1996a). By 1997 Ukraine was the third-largest recipient of U.S. assistance anywhere in the world.

consultants sent to the region.<sup>3</sup> Although the consultants were initially welcomed by their hosts, within a short time after their arrival, the Poles had coined a derisive term for them—the “Marriott Brigade,” after their penchant for staying in Warsaw’s Marriott and other luxury hotels (see, for example, Kalabinski 1991a and 1991b). Whether in Poland or farther south or east, within a year or so of its arrival the Marriott Brigade had alienated many of the people it was trying to help. Polish aid official Marek Kozak even suggested that the main benefit derived from the Marriott Brigade was not the expertise they provided but the hard currency they contributed to the local economy (cited in Wedel 1992, 133). In 1993, then Czech prime minister Václav Klaus added, “What we really need—instead of aid—is exchange. . . . We do not need one-way transfers because they tend to be misused, misdirected, or misplaced. They are usually not taken seriously by either side. I have in mind financial aid, gifts, technical assistance, and consulting” (Klaus 1997, 143).

One problem was that the majority of those consultants were “fly-in, fly-out” advisers who visited the region for a short time, developed weak links with recipients, and knew little of the countries they were trying to help. The U.S. General Accounting Office (GAO) confirmed Polish officials’ reports that “early technical assistance in the banking sector resulted in many consultants coming to Warsaw for one- or two-week stays, interviewing officials, and producing reports that merely repeated what they had been told” (U.S. GAO 1995b, 8). As a result, the consultants’ ostensible clients—the recipients—often considered the consultants redundant and even meddling. As a Slovak aid official put it, “The Western consultants collect information, get the picture, then they go home. . . . We are solving the West’s unemployment in this way. . . . We get calls from ministries that receive consultants from all over asking if aid can be reduced” (Hrbackova 1994).

What went wrong?

### *Ad Hoc Privatization Aid*

U.S. privatization aid to Central Europe, which was to be directed to “private” entities, often circumvented the host government bodies responsible for privatization.

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3. For example, technical assistance in such areas as privatization and economic restructuring accounted for more than two-thirds of U.S. Agency for International Development expenditures in Russia as of March 31, 1996. Much of that money supported Western consultants. Technical assistance in such areas as privatization and economic restructuring was the main type of aid sent to Ukraine and accounted for more than three-fourths of U.S. AID expenditures in that country as of March 31, 1996. Calculated from figures published in U.S. Department of State 1996a, with input by Deputy Coordinator of New Independent States Assistance William B. Taylor (1996) as to which categories consist largely of technical assistance.

In addition to published and unpublished works, as cited, this section is based on interviews with consultants; officials in aid coordinating and auditing agencies; officials in the ministries of privatization, industry, and finance that received consultants, funds, or both; and representatives of state-owned enterprises. Information and materials also were provided by representatives of U.S. AID and the U.S. Department of State.

Privatization aid was set up to be ad hoc, and it was largely structured to work around, rather than in coordination with, the privatization processes it was supposed to help.

That problem was compounded by the way in which the U.S. Agency for International Development's Indefinite Quantity Contracts (IQC) program structured aid to the region. Three consulting consortia led by Big Six accounting firms (Coopers & Lybrand, KPMG Peat Marwick, and Deloitte & Touche) formed the cornerstone of the U.S. privatization assistance to Central and Eastern Europe.<sup>4</sup>

The IQC program worked especially poorly when consultants worked directly with an enterprise, because they functioned largely independently of the ministries responsible for privatization. Although each government in the region had set up an office to plan and manage privatization, U.S. AID did not require or necessarily even encourage U.S. contractors to work with those offices. Instead, consultants saw themselves as working for the donor agencies that paid them—rather than on behalf of the recipient enterprises and ministries that ostensibly needed their services. Recipient officials found they had little authority to assess the work of consultants paid by U.S. AID, to determine their schedules, or to terminate a contract for nonperformance or poor performance. Some consultants' reports even were addressed to U.S. AID in Washington, not to the local officials who supposedly were the beneficiaries. Polish Ministry of Industry official Marek Krawczuk compared such consultants to “a surgeon who comes, does his work without talking with the patient, and leaves without checking to see whether the operation was successful” (Krawczuk 1994).

Another major problem with U.S. privatization aid to Central Europe was that it appeared to be an end in itself and often did not lead to competition among firms or other crucial market activity. According to donors, a major advantage of hiring consultants from the Big Six accounting firms was that they had contacts with potential Western investors. Yet the link between technical assistance and investment was often missing; there was a disconnect between consultants' activities at the enterprise level and activities that might have led to investment. Central and Eastern European officials frequently complained that little concrete investment activity followed from consultants' reports. The Slovak Privatization Ministry hoped that one report, produced by Deloitte & Touche and funded by U.S. AID, would provide “very concrete and tangible results” and help prepare the Slovak Republic for meeting World Bank requirements. Instead, the report turned out to be merely a “general description about the current state of privatization and some general targets” (Palacka 1994). As one privatization official lamented, “No enterprise wants to receive technical assistance

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4. Those consortia won IQCs for multiple projects in privatization and related activities throughout the region that extended over a five-year period, July 1991 to July 1996, and amounted to some \$60 million per consortium. Information provided by U.S. AID procurement officer Steve Dean, November 7, 1996. Consultants under the IQC contracts mainly worked directly with the enterprise or sector; later in the aid effort, some consultants also worked inside ministries.

without investment. . . . There were many studies without useful results because there were no investments [that resulted from them].”<sup>5</sup>

### *Centrally Planned Aid*

U.S. policy makers looked to the privatization of large state-owned enterprises in Central and Eastern Europe, Russia, and Ukraine as a way to measure the progress of “transition.” The number of firms privatized was seen as an indicator of a nation’s will to reform; future aid was often conditioned on the donors’ perception of that will. The donor community pressed for speedy privatization, in part through its consultants in Central and Eastern Europe, who were initially engaged to work with individual companies. Under the auspices of U.S. assistance, teams of resident consultants, supplemented by experts who came in for short times to perform specific tasks, were placed both in Poland’s Ministry of Privatization and in Hungary’s State Property Agency to accelerate privatization efforts. According to U.S. AID official Mark Karns (1994), the teams were charged with helping the ministries to carry out mass privatization. But politics thwarted their work. After the change of governments in Poland in 1993, for example, alternative projects had to be sought for the advisers who were just coming on board.

Tension between the visions and demands of donors, on the one hand, and the political constraints faced by local officials, on the other, appeared to be built in to the Central and Eastern European aid effort. Yuriy Yakusha, economic affairs counselor at the Washington Embassy of Ukraine, cited a “discrepancy in understanding” between donors and Ukrainian authorities as to what could be accomplished in a short period of time. “They [the donors] were expecting a little unrealistic rate for privatization”: eight hundred enterprises each month. “Technically perhaps it was possible,” Yakusha explained, but there was “real political opposition,” and a property registration system was not in place. There is “definitely” a lot of pressure to deliver quick privatization, said Yakusha, “no matter [at what] expense and what outcome. It’s a kind of socialist planning” (Yakusha 1996).

In short, the Western donor was perceived as replacing the Communist Party in the role of enlightened planner, albeit a capitalist one. Just as communist central planners set targets for production, officially mandating that firms meet fixed production quotas, so the donors specified quotas regarding the number of firms to be privatized within a given time frame. The problem is that Eastern Europeans have seen this play enacted on other stages; decades of “planned change” and socialist reform programs have conditioned them to a cynicism that seems well justified in light of what anthropologist John Bennett calls the “myth of planning” in development assistance (Bennett 1988, 16).

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5. Interview with Jiri Hodik, coordinator of the PHARE privatization program in the Czech Ministry of the Economy, cited in Wedel 1992, 136.

As a result, Eastern Europeans dealt with the West as they would deal with a typical socialist bureaucracy. Officials who had engaged in certain “fictions,” ranging from subtle readjusting of figures to outright falsification, to meet the targets of central planning employed the same kinds of fictions to please Western donors. Today, *ochkovtiratel'stvo*, a Russian phrase meaning “to kick dust into someone’s eyes” (or to pull the wool over someone’s eyes) is used in reference to the international financial institutions and donor organizations that have established “conditionalities” for funding. The economist James Millar argues that much current reporting of success in reform is “eyewash” and that *ochkovtiratel'stvo* impedes reform because “it offers a way to evade the reality of economic constraints that true development must overcome” (Millar 1996, 13). Using foreign aid to push hard is likely to delay reforms even further, because it can lead to a backlash effect that can solidify opposition.

### *Conflicts and Company Towns*

The top priority on the donors’ early privatization lists was large enterprises, or “company towns,” with their socialist amenities such as health and day care, as well as employee retreat centers. By transforming those “white elephants,” Western governments were to drive a silver stake through the heart of socialism and bury it forever. In Poland, for example, U.S. AID supported highly visible projects, including the privatization of huge Polish enterprises employing thousands of people such as the Huta Warszawa steel mill and the Sandomierz glass company, and of national icons such as LOT, the Polish national airline. U.S. AID judged, according to the GAO, “that privatizing a few large enterprises in the airline, steel, glass, and furniture industries would have a ripple effect on the economy” (U.S. GAO 1995b, 57).

But those large enterprises would prove especially difficult to divest of state ownership. The GAO reported that the U.S. AID–Poland mission

concluded that firm-specific and sectoral assistance was too time-consuming and costly. For example, the \$3.7 million in U.S. AID funding for the glass sector led to only four state-owned enterprise privatizations, at a cost of more than \$900,000 per enterprise privatized. In addition, as of May 1994, only four of eight targeted enterprises had been privatized under the almost completed furniture sector project. (U.S. GAO 1995b, 57–58).

Finally, U.S. AID spent more than \$1 million restructuring LOT in preparation for privatization (U.S. GAO 1995b, 58). As of this writing, LOT is still in state hands. Thus, the GAO concluded that “the pace of privatization for larger state-owned enterprises has been slower than expected, and significant portions of Polish productive capacity and employment remain in the hands of the government” (U.S. GAO 1995b, 6). That result was typical. According to a report commissioned by U.S. AID to evaluate its Central European privatization projects, of the five large firms assisted

by U.S. AID-paid consultants, only one was privatized, and that one not as a result of U.S. AID help. The evaluation determined that “assistance to large individual enterprises has not generally been successful in bringing about privatization promptly and cost-effectively. . . . In most cases, privatizations of large enterprises are almost invariably slow in being consummated. Invariably, these enterprise-specific situations and the problems that surround them are new and complex” (Development Economics Group 1993, 31–33). Likewise, an evaluation commissioned by the European Union delicately concluded that “the impact of the [EU-paid] consultants was less satisfactory in highly politicized cases” (Bogdanowicz-Bindert 1993, 1).

The problems with consultants’ recommendations were more than a case of some Central and Eastern Europeans reacting in a knee-jerk fashion to foreigners’ advice. Rather, they represented a real fear that the consultants would say something that many of the players in the privatization process might not want to hear: that workers’ jobs and their pensions were no longer secure and that the bedrock of their existence had turned to quicksand. Many workers have expressed concern through the ballot box. Both Poland and Hungary have elected reformed socialist-leftist governments, as did some nations farther south and east.

Privatization aid often failed to have the effects donors intended, and consultants’ involvement in planning and implementation often left behind an undesirable legacy. Instead of encouraging privatization, in some cases aid may actually have discouraged it. Charges of industrial espionage were common across the region. Officials, managers, and workers sometimes suspected advisers of unscrupulous intentions and even intimated that their “advice” could be designed to sabotage the recipient nation’s future competitiveness. The deputy director of NIK (the Supreme Control Board, which is the Polish government’s chief auditing agency and roughly equivalent to the GAO in the United States) reported in 1994 that “[a] few years ago the [consulting] firms had an industrial espionage quality to them. They came and got all [the] valuable information about the enterprises—the state of the firm, the amount and cost of production, and so on—and after this they disappeared” (Kownacki 1994).

The point is not whether allegations of impropriety are valid in a given case but rather that the involvement of aid-paid consultants may feed the perception among some groups that “foreigners have come to loot.” In some cases consultants’ involvement appears to have encouraged anti-capitalist, anti-Western, and anti-privatization sentiments among radical populist groups (with elements of radical nationalism) who charged that local elites involved in privatization had been corrupted by the West. For example, the unionists at Ursus, a large Polish tractor enterprise, decorated the main entrance to the factory as follows: “A Foreign Elite Steals from Us While the Polish People Are at the Bottom” and “Polish Property for All Poles.”

An analyst who observed efforts by Poland’s Privatization Ministry to answer objections to its mass privatization plan in 1992 holds that those efforts “indicate the ways in which it, the MoP [Ministry of Privatization] and the foreign consultant presence all

were politically sensitive and may have contributed to declining support for privatization” (Meaney 1993, 30). Aid aimed at quick privatization may have helped to produce some of the same results as the ideology it purported to replace—in short, it served to replicate the type of suspicion and planning that existed under communism.

### A Few Good Reformers

When Western governments promised economic aid to Russia following the collapse of the Soviet Union, they wanted to see new faces and remain untainted by association with the erstwhile Communist regime.<sup>6</sup> And so a cadre of self-styled Russian “reformers” stepped into that role. From 1992, when aid first appeared, until mid-1997, U.S. economic aid to Russia essentially was entrusted to those men, who were dominated by a decade-old clique from St. Petersburg that Russians called a “clan” (here referred to as the “St. Petersburg clan” or the “Chubais clan,” after its leader, Anatoly Chubais).<sup>7</sup>

Working closely with Harvard University’s Institute for International Development (HIID), also known as the “Harvard Project,” the St. Petersburg clan controlled, directly and indirectly, millions of dollars in aid through a variety of institutions and organizations set up to perform privatization, economic restructuring, and related activities. Between 1992 and 1997 HIID received \$40.4 million from U.S. AID in noncompetitive grants for work in Russia and was slated to receive another \$17.4 million until U.S. AID suspended its funding in May 1997.<sup>8</sup> In addition to receiving millions in direct funding, HIID helped steer and coordinate U.S. AID’s \$300 million reform portfolio, which encompassed privatization, legal reform, capital markets, and the development of a Russian securities and exchange commission (U.S. GAO 1996, 4, 18).

Further, U.S. support bolstered the St. Petersburg clan’s standing as Russia’s chief brokers with the West and the international financial institutions. Chubais and the clan were favorites of the IMF, and the clan managed some World Bank loans to Russia.

But was economic reform the driving agenda of the St. Petersburg clan? And what made it deserve the status of partner with the West more than other Russian reform-oriented groups and individuals? More important, did the strategy of focusing largely on one group further the aid community’s stated goal of establishing the transparent, accountable institutions so critical to the development of democracy and a

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6. In addition to published and unpublished works as cited, this section is based on interviews with American and Russian consultants, observers, and analysts. Information and materials also were provided by U.S. AID and U.S. Department of State representatives.

7. Some other members of the St. Petersburg clan are Maxim Boycko, Dmitry Vasiliev, Alfred Kohk, and Sergei Shishkin. For details, see Wedel 1998a, appendix 4, pp. 221–25.

8. Between 1992 and June 1996 HIID received \$40,373,994 in noncompetitive grants under the First Cooperative Agreement. Another \$17,423,090 was designated for HIID under the Second Cooperative Agreement (a three-year agreement that began on September 30, 1995), of which \$4.5 million was obligated. Clifford 1996 and U.S. AID documents.



stable economy for this world power in transition? What were the long-term implications of supporting one group of “reformers” at the expense of others? From the very beginning, Russian observers took note of the activities and motivations of the St. Petersburg clan. But it would not be until 1997—and the eruption of a scandal that could hardly be ignored—that some Western observers would begin to consider the implications of U.S. and Western policy and what it had wrought.

### *The Consummate Clan*

In a 1996 article, Thomas E. Graham, a senior political officer at the U.S. embassy in Moscow, opined that Russia was run by rival “clans” with largely unchecked influence (Graham 1996, 26). Amid unstable political, legal, and administrative structures, there were myriad opportunities for clans to penetrate public institutions, bypass other influences, and lay claim to resources. No member of the St. Petersburg clan appeared to be more shrewd than the chief figure in the group, Anatoly Chubais. Before going to Moscow to work in the national government in 1991, Chubais and other members of the clan were influential with the mayor of St. Petersburg, Anatoly Sobchak, and worked in that city’s administration. Several members of the clan, including Chubais, served as first deputy mayor under Sobchak.

Chubais was a useful figure for Russian president Boris Yeltsin: first as head of Russia’s new privatization agency, the State Property Committee, beginning in November 1991, then, in addition, as first deputy prime minister in 1994, and later as the lightning rod for complaints about economic policies after the Communists won the Russian parliamentary (Duma) election in December 1995. Chubais made a comeback in 1996 as head of Yeltsin’s successful reelection campaign and was named chief of staff for the president. In March 1997 Western support and political maneuvering catapulted him to first deputy prime minister and minister of finance. Although fired by Yeltsin in March 1998, Chubais was reappointed in June 1998 to be Yeltsin’s special envoy in charge of Russia’s relations with international lending institutions.

Anointed “the czar of economic reform in Russia,” in the words of a U.S. AID-sponsored report (Bernard 1995, 1), Chubais acquired a broad portfolio, ranging from privatization and the restructuring of enterprises to legal reform and the development of capital markets and of a Russian securities and exchange commission. The creation of the Commission on Economic Reform in 1995 was further confirmation, as the Russian newspaper *Kommersant-Daily* declared, that “a new center of economic power is being created around First Deputy Prime Minister Anatoly Chubais” (Borodulin 1995, 23). Chubais also secured sweeping political powers: a 1996 presidential directive dictated that only Chubais (at the time Yeltsin’s chief of staff) had the authority to decide whether presidential decrees were ready to be signed—a directive that could be circumvented only upon receipt of direct instructions from the president.<sup>9</sup>

Through all this, Chubais enlisted the help of his energetic associates—the “St. Petersburg mafia”—to “infiltrate the power structure in Moscow,” as a report paid for by U.S. AID expressed it (Bernard 1995, 1). Members of the St. Petersburg clan quickly discovered that their Western contacts could help them leverage support that would serve as a critical launching pad and a political and economic resource at home and abroad. Indeed, U.S. support helped to propel members of the clan into top positions in the Russian government and to make them formidable players in local politics and economics.

### *Reform by Decree*

The preferred method of governance continued to be presidential decree, now orchestrated by Chubais. This applied not only to political moves but also to market reform. The Communist Russian Federation’s Supreme Soviet had passed a series of initiatives mandating privatization in 1991, followed by a privatization program in 1992 that was structured to prevent corruption (for details, see Nelson and Kuzes 1994 and 1995). However, the program that Chubais implemented led to the accumulation of property in a few hands and opened the door to widespread corruption. Chubais’s program was so controversial that he ultimately had to rely largely on presidential decrees for its implementation. Members of the St. Petersburg clan noted that, after the privatization program passed the Duma, “every subsequent major regulation of privatization was introduced by Presidential decree rather than parliamentary action” (Boycko, Shleifer, and Vishny 1995, 5).

Some U.S. AID officials explicitly promoted market reform through presidential decree and circumvented parliamentary authority. As Walter Coles, a key American official in the privatization and economic restructuring program in Russia, explained, “If we needed a decree, Chubais didn’t have to go through the bureaucracy.” Acknowledging the lack of political support for many reform measures, Coles said, “There was no way that reformers could go to the Duma for large amounts of money to move along reform” (Coles 1996). Unfortunately, without wide support, reforms were likely to be subverted in the process of implementation.

U.S. AID’s showcase efforts to reform Russia’s tax system and to set up clearing and settlement organizations (CSOs)—an essential ingredient in a sophisticated financial system—failed largely because they were put solely into the hands of one group, which declined to work with other market participants. In Moscow, for example, despite millions of U.S. AID dollars, many of the Russian brokers were excluded from the process and declined to use the Moscow CSO. (For details of this case, see Wedel 1996.) One market participant, Viktor Agroskin of the brokerage

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9. Information about the presidential directive was published in *Rossiiskie Vesti* on August 15, 1996. Cited in “Chubais Controls Presidential Decree Process,” *OMRI Daily Digest* 148 (August 15, 1996).

Rinacoplus, remarked that the Moscow CSO was “incorporated and nothing else” (Agroskin 1995). Thus, since 1994, when consultants working under U.S. AID contracts totaling \$13.9 million<sup>10</sup> set out to design and implement CSOs in five Russian cities, very little evidence of progress has emerged. After a 1996 investigation of HIID activities in Russia, the GAO issued a report calling the CSO effort “disappointing” (U.S. GAO 1996, 8).

In addition to hindering particular market reforms, governance by decree stifled democracy and the building of transparent, nonaligned institutions so critical to its development and that of a stable economy. Some voices within U.S. AID concur: U.S. AID’s Washington Office of Democracy for Russia opposed using decrees “because it believed decrees did not support the democratic processes envisioned by the project” (U.S. GAO 1996, 50).

### *Clique-Run Organizations*

The reformers also set up a network of aid-funded “private” organizations controlled by the St. Petersburg clan and HIID. Those organizations enabled reformers to bypass established bodies of government, such as ministries and branch ministries, and to circumvent the Duma, thus fomenting political opposition and creating the perception that the reform was not legitimate.<sup>11</sup>

The donors’ flagship organization was the Russian Privatization Center, a private, allegedly nonprofit organization set up in Moscow. The RPC was closely tied to Harvard and epitomized the operations of the aid-sustained Harvard–St. Petersburg coterie. The center received money and loans from all major, and some minor, Western donors: the United States, the World Bank, the IMF, the European Bank for Reconstruction and Development, the European Union, the United Kingdom, Germany, and Japan. The center’s CEO, a Russian from the St. Petersburg clan, has written that he managed some \$4 billion, all from the West, according to Veniamin Sokolov (1998a), head of the Chamber of Accounts, Russia’s rough equivalent of the GAO. For example, the RPC received more than \$41 million from U.S. AID (Clifford 1996) and millions of dollars more in grants from G-7 countries.<sup>12</sup> It also implemented loans both from the World Bank (\$59 million) (Lieberman 1996) and from the European Bank for Reconstruction and Development (\$43 million) to be repaid by the Russian government.<sup>13</sup>

Formally and legally, the RPC is a nonprofit organization. But the “private” RPC was established by Russian presidential decree and received foreign aid funds because it was run by the St. Petersburg “reformers,” who played key roles in the

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10. Based on figures provided by Clifford 1996.

11. For case studies illustrating this point, see Wedel 1996, 583–89.

12. As of June 1996, Japan was the largest contributor of the G-7, according to Montag Girmes 1996.

Russian government. Lending credence to its appearance as a “government” organization, the RPC’s tasks have included helping to formulate macroeconomic policy, as well as negotiating loans with international financial institutions (Coles 1996; Montag Girmes 1996). In practice, the RPC and other aid-created organizations were situated somewhere in the twilight zone between state and private, between the Russian government and Western donors, and between Western government and Russian government allegiance and orientation. Whatever their predilection at any given moment, those organizations were run by the St. Petersburg reformers (with support from U.S. AID through HIID and U.S. contractors) and were used to politically allocate resources in the communist tradition, through patronage networks like those that virtually ran the Soviet Union.

For example, the RPC has presided over a network of some ten Local Privatization Centers outside Moscow (Ciepiela 1996). With Western aid concentrated in Moscow, donors endorsed aid to the provinces. However, far from serving development, the LPCs instead have been used for political purposes, according to representatives of the three aid-paid consulting firms (Price Waterhouse, Arthur Andersen, and Carana) that set them up. Dennis Mitchem, a former partner at Arthur Andersen, notes that LPC leaders were rewarded for blind loyalty, even if that involved doing little or nothing, and even scolded for local reform initiatives. Mitchem says that the LPC directors were concerned mainly with pleasing the RPC; Carana’s Robert Otto concurs that local directors “did what [the RPC] wanted doing. . . . The LPC people slid very easily into that because it was normal for them to get orders from Moscow.”<sup>14</sup>

Sokolov and the Chamber of Accounts have attempted to investigate how some of the \$4 billion the RPC was awarded was spent. According to Sokolov (1998a), a report issued by the chamber in May 1998 showed that the “money was not spent as designated. Donors paid hundreds of thousands of dollars for nothing . . . for something you can’t determine.”

Could the RPC and other St. Petersburg clan-run, U.S. AID-funded organizations spawn self-sustaining institutions? All three contractors who helped set up the LPCs questioned the extent to which they could have a lasting positive impact—as did the GAO, which concluded that “the RPC’s sustainability is in question once U.S. AID assistance ends in 1997” (U.S. GAO 1996, 52). The practice of funding personalities over reform processes appears to collide head-on with the aid program’s broader goal of building sustainable, independent institutions.

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13. The European Bank for Reconstruction and Development has contributed about \$43 million to the RPC, according to the EBRD’s Renae Ng, in a conversation on September 24, 1996.

14. Interviews with a representative of Price Waterhouse, July 18, 1996; Dennis Mitchem of Arthur Andersen, August 18 and 19, 1996; and Robert Otto of Carana, August 27, 1996.

### *The Faces and Interfaces of the St. Petersburg Clan*

Both visibly and behind the scenes, HIID was active in setting up, advising, supporting, staffing, and lobbying for funding on behalf of the St. Petersburg clan and its network. HIID received two Cooperative Agreements, managed by U.S. AID's Moscow mission, to serve as an impartial adviser to U.S. AID on related projects in Russia (Clifford 1996). Those agreements put HIID in the position of recommending U.S. aid policies while being a chief recipient of the aid, as well as overseeing some other aid contractors, some of whom were its competitors. The GAO found that "HIID served in an oversight role for a substantial portion of the Russian assistance program" and that HIID had "substantial control of the U.S. assistance program." The GAO described U.S. AID's management and oversight of HIID as "lax" (U.S. GAO 1996, 17, 3, 43).

One group's near-monopoly on aid in support of top-down reform through communist-style patronage networks and the creation of chameleon-like private organizations used as political machines made it easy for members of the St. Petersburg clan and their supporters to work all sides of the table. If criticized by Russians for public policies or misuse of funds, the clan could claim that donors made the decisions. If they came under fire for funding privatization, which many Russians have dubbed *prikhvatizatsiya*, or the "great grab," donors could disassociate themselves from the state because they were funding "private" organizations, even if those organizations were run by government officials. It was a setup that not only facilitated denial but institutionalized it.

Such an aid system lacked outside accountability and precluded significant oversight by U.S. or Russian authorities not aligned with the chosen group. Thus it is not surprising that, against the backdrop of Russia's Klondike capitalism, key HIID advisers exploited their intimate ties with Chubais and the Russian government and were allegedly able to conduct business activities for their own enrichment. In early 1997 U.S. AID's inspector general received incriminating documents about HIID's activities in Russia and began investigating.<sup>15</sup> In May 1997 the agency canceled most of the \$14 million still earmarked for HIID, citing evidence that its two principal consultants had "abused the trust of the United States Government by using personal relationships . . . for private gain" (U.S. AID 1997a; see also U.S. AID 1997b). In particular, the project's two principals allegedly used their positions and inside knowledge as advisers to profit from investments in the Russian securities markets and other private enterprises. The Harvard men remain under investigation by the U.S. Department of Justice (see, for example, "U.S. Jury Probes Russia Project Run by Harvard University Aides," *Wall Street Journal*, February 5, 1999, p. A13).

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15. Sources close to the U.S. investigation; and Robbins and Liesman 1997. For details see Wedel 1998b.

### *Following in Communism's Footsteps*

It is easy to understand the donors' impulse to support reformers. As U.S. AID's Walter Coles said, "Reformers are the ones that are willing to take the risk. Their necks are on the line" (Coles 1996). Although that explanation sounds good in principle, it is less convincing in practice because it attempts to disguise as a technical matter choices that represent an inherently political approach. As self-styled reformers Maxim Boycko (a St. Petersburg clan member) and Harvard principle Andrei Schleifer acknowledged, "Aid can change the political equilibrium by explicitly helping free-market reformers to defeat their opponents. . . . Aid helps reform not because it directly helps the economy—it is simply too small for that—but because it helps the reformers in their political battles." U.S. privatization aid, those reformers added, "has shown how to . . . effectively . . . alter the balance of power between reformers and their opponents" (Boycko, Shleifer, and Vishny 1995, 142). In a 1997 interview, the U.S. aid coordinator to the former Soviet Union, Ambassador Richard L. Morningstar, stood by this approach: "If we hadn't been there to provide funding to Chubais, could we have won the battle to carry out privatization? Probably not. When you're talking about a few hundred million dollars, you're not going to change the country, but you can provide targeted assistance to help Chubais" (Morningstar 1997). U.S. assistance to Chubais continued even after he was dismissed by Yeltsin as first deputy prime minister in January 1996; Chubais was placed on the HIID payroll.<sup>16</sup>

Several fallacies appear to guide the approach defended by Morningstar and Coles. One is the faith of U.S. policy makers in stated ideological positions. Donors tended to identify the reformer as such not because he was an agent of change (although he might, indeed, have embraced reform). The prototypical "reformer" was Western oriented; was conversant in English as well as in the donor vernacular of "markets," "reform," and "civil society"; had Western contacts; and was a self-declared reformer (at least when talking to Westerners) who associated with other reformers. The most popular Russian reformers in Western political and aid circles were young, energetic, and adept in their dealings with donors. Western government officials took them at face value. As U.S. AID's Thomas A. Dine remarked, "If Maxim Boycko tells me that X, Y, and Z are reformers, I believe him." Dine went on to note that "it's no secret that nationalists and Communists don't like [Chubais] and perhaps that's the best proof of all [of his reform credentials]" (Dine 1996). Yet identifying reformers on the basis of personal attributes and declared ideological positions—as they look in the West—is wrongheaded. As the Russian economist and former presidential candidate Grigory Yavlinsky stated, "The new ruling elite is neither democratic nor communist, neither conservative nor liberal. It is merely greedy and rapacious" (quoted in Hoagland 1997).

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16. This information was confirmed by Taylor and by Thomas A. Dine (1996) of U.S. AID.

The disillusionment of those who were not young or glib or “Western” enough to be chosen was expressed by Aleksandr Lebed’s spokesman:

We [are] disappointed by the way you Americans find friends in Russia. . . . Criminal and corrupted men can use all new opportunities with success, but men of work and honor cannot advertise themselves. . . . If you did not want crisis in Russia, if you want [a] free, wealthy, democratic Russia, try to find friends that really can work on market reforms. (Titov 1996)

### *Conflicting Agendas*

Another fallacy is the expectation that any group—even a group of talented, visionary reformers—will ignore its own agenda, especially when it is designated the sole beneficiary of so much aid. For example, in apparent pursuit of their own agenda, key St. Petersburg players have been known to actually obstruct reform when reform initiatives have originated outside the group. When a U.S. AID-funded organization run by St. Petersburg players did not receive the additional funds it had expected from U.S. AID, those players interfered with legal reform initiatives in title registration and mortgages that had been launched by other U.S. AID-funded contractors and their local partners.

Whereas in the West consistent support for the same policy group might signal effectiveness, many Russians regarded the clan as a communist-style group that created and shared profits. The fact that the chosen St. Petersburg “reformers” were visibly involved in politics and creating opportunities for themselves reinforced such suspicion. By siding with a particular group in a highly politicized environment, U.S. assistance undermined the importance of its own ostensible objectives and may have inadvertently encouraged skepticism about capitalism, reform, privatization, and the West. How Russians perceive the efficacy of aid programs and the motives of donors should be a source of concern, especially because many Russians have questioned American intentions. According to one public opinion survey carried out by Igor Kliamkin in the spring of 1995, two-thirds of the Russian people believed that the United States had a calculated anti-Russian foreign policy (Kliamkin 1995, 16–17). As long as suspicion of Western motives remains pervasive, anti-Western, anti-reform politicians can manipulate the Russian self-image of a wounded superpower and proclaim that Russia is, as always, being exploited by the West. Members of the Duma, after an investigation, issued a report decrying the “dozens if not hundreds of American organizations operating in Russia within the framework of various assistance and cooperation programs.” The report concluded that “intelligence and other operations are performed by such organizations, including the Peace Corps, which has nothing to do with the goals proclaimed by these organizations” (“Popular Rule Group” 1997).

Thus, while professing simply to support reform, U.S. policies have afforded one group a comparative advantage and allowed much aid to be used as the tool of that group. They have created an environment that feels familiar to Russians raised with the communist practice of political control over economic decisions—the quintessence of the discredited communist system. Ironically, far from helping to separate the political and economic spheres, U.S. economic aid has instead served to reinforce the interdependency of those spheres.

### *The IMF Bailout: Making a Bad Situation Worse*

The latest IMF bailout of Russia represents not only a continuation but an escalation of that policy. The \$22.6 billion aid package crafted by the IMF in July 1998 was supposed to put an end to Russia's financial crisis. Yet certain political-economic players—and by no means the population at large (such as the “employed” masses who have gone without wages for months)—stand to reap any benefits. Sokolov and his auditors investigated the destination of some previous monies from international lending institutions and aid organizations. In a visit to Washington in May–June 1998, before the IMF's July bailout, Sokolov spoke against further loans (Sokolov 1998a, 1998b). He reported that “all loans made to Russia go to speculative financial markets and have no effect whatsoever on the national economy” (Williamson 1998). Yet those loans are the obligation of the Russian people to repay. Sokolov's appearances were summed up by Anne Williamson, a journalist specializing in Russian and Soviet affairs who interviewed him, as follows:

Russia's fiscal watchdog blew the whistle on how Western loans are squandered on speculation and siphoned off by American profiteers, how Russia's cash-flush “oligarchical” economy masks runaway inflation in its cash-starved national economy, and how the corruption of the Yeltsin government is killing the hopes of ordinary Russians in a country where jet planes are bartered for butter. (Williamson 1998)

The very call for an IMF bailout is a commentary on the failure of previous economic aid to Russia: If aid had been effective, why were billions in IMF loans needed to prevent the country from falling into crisis? Further, the extent of the bailout's failure surprised even its critics. The IMF loan and accompanying hype were intended to revive confidence in Russia's plummeting markets and give the government time to get its financial markets under control. However, just weeks after the IMF deal was approved, investor confidence hit a new low and the Russian government was forced to devalue the ruble.

Not only did the IMF bailout fail to restore confidence, but the business of international aid has been fundamentally ill-conceived. Sokolov concluded:

Giving more loans to the Yeltsin government is comparable to giving a drug addict a fresh supply of narcotics. Any new loans will only go to the realm of



financial speculation and to prop up support for Boris Yeltsin. Russia does not need any further such lending. Russia needs loans only for the purchase of new equipment or the restructuring of enterprises, and such funds can be obtained from the private sector. (Williamson 1998)

Thus, any further aid will go to the same corrupt groups, and that is likely to make the situation worse, not better (Sokolov 1998a, 1998b).

### *A Repeat Performance in Ukraine?*

As Ukraine, also strategically important, began to enjoy more Western press and political attention in 1994 and 1995 following President Leonid Kuchma's attempted economic reforms, that nation became the target of much assistance, partially as a reward for its perceived advances. Aid to Ukraine also was seen as an alternative to aid to Russia, which was threatened with cutbacks following that country's assault on Chechnya and its suspected sales of nuclear technology to Iran. By 1996 Ukraine, which faced and still faces severe financial crisis, was the third-largest recipient of U.S. assistance (after Israel and Egypt).

U.S. policy makers were inclined to emulate the Russian aid model in Ukraine, that is, to look for "reformers." As U.S. AID's assistant administrator Dine expressed it:

The reformers are the performers. USAID supports the activities of key economic reform leaders. . . . For example, USAID staff work closely with Russia's first deputy prime minister, Anatolii Chubais . . . Chubais and his proteges are the Adam Smiths of Russian reform economics. USAID is also working with Ukrainian economy minister Roman Shpek, whom President Kuchma tapped to help lead an independent Ukraine out of three years of decline. (Dine 1995, 29)

HIID was also active in Ukraine. Thus, while certain HIID consultants were lobbying for aid dollars in Russia, their colleague Jeffrey Sachs, head of HIID since the summer of 1995, turned his attention to Ukraine. Sachs's prescriptions had rendered him anathema in Russia and he was not to be left out of Ukraine—the new economic reform frontier. Sachs and his associates built on methods that HIID had perfected for securing U.S. AID funding for HIID operations in Russia: the backing of their Harvard colleagues now in official Washington and the claim that HIID's work in the former Soviet Union was essential to U.S. foreign policy. As in Russia, HIID (this time composed of different players) lobbied for, and was awarded, a contract to provide macro- and microeconomic advice and to work with high officials, notably the Ukrainian minister of economics, Roman Shpek.

HIID's proposal was unusual in a number of respects, beginning with its point of origin, which was not U.S. AID. The unsolicited Sachs proposal did not prove to be

an easy sell; the prospect of HIID's working in Ukraine met with resistance from U.S. AID officials both in Washington and in Kiev, as well as from the IMF and from Ukrainian officials, including some in the Central Bank; all opposed the HIID project as redundant. The HIID-Ukraine project "has not been without controversy"—the need for it was questioned by both the U.S. AID mission in Kiev and by players within the Ukrainian government, including the National Bank, according to deputy aid coordinator William B. Taylor (1996). Further, a letter to U.S. AID from the government of Ukraine stated that Ukraine did not need more macroeconomic advisers. U.S. AID's Dine acknowledged that "they [the IMF] thought it would be duplicating their work" (Dine 1996).

However, the considerable objections to HIID work in Ukraine were overruled by the U.S. executive branch. A high-level interagency steering committee, some of whose members had personal and professional ties to HIID people, favored Harvard and promoted the HIID-Ukraine award. Representatives of the steering committee (or their deputies) signed the "foreign policy" exemptions that directed U.S. AID to bypass the usual competition and enabled HIID to secure funding for its Ukraine operations (U.S. GAO 1996, 6).

With high-level U.S. officials solidly behind the Harvard coterie and the policy prescriptions it promotes, some of the damage wrought by the United States in Russia may be duplicated in Ukraine. The GAO did investigate HIID's Russian and Ukrainian projects in 1996, but the findings were largely suppressed by the agency's timid management. The audit team concluded, for example, that the U.S. government exercised "favoritism" toward Harvard, but that conclusion and the supporting documentation were removed from the final report.<sup>17</sup>

## A Few Good Financiers

Western governments deemed supporting new businesses an important goal in helping to develop the private sectors of the former communist nations.<sup>18</sup> Following the collapse of communism in Central and Eastern Europe in 1989, the region experienced an explosion of what the Poles call *biznes*—mainly mom-and-pop enterprises that featured traders hawking everything from bananas to computers. The Western aid community viewed a stronger, more highly developed business sector as a prerequisite to a market economy and democracy. Consuming a substantial portion of the overall U.S. aid package, the U.S. Enterprise Funds were intended to encourage private enterprise, mainly through loans and direct investments rather than through

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17. This statement is based on conversations with Louis H. Zanardi of the GAO audit team.

18. This section is based on interviews with observers of recipient country financial conditions; beneficiaries of Enterprise Fund loans; Enterprise Fund principals in the United States, Poland, Hungary, the Czech Republic, the Slovak Republic, and Russia (and printed materials provided by the funds); as well as representatives of similar programs such as the EU's Struder program and Caresbac.

more traditional foreign aid grants. The first to be undertaken were the Polish-American and the Hungarian-American Enterprise Funds, designed to promote the development of the region's private sectors, including small business, agriculture, and joint ventures with American companies. Each fund was to function as a private, nonprofit corporation with a board headed by a prominent financier or venture capitalist and members such as AFL-CIO president Lane Kirkland and former national security adviser Zbigniew Brzezinski, all of whom donated their time.

Operating in more than twenty countries by 1996, the Enterprise Funds were often cited as aid "success stories" and held up by the U.S. Congress and many critics of traditional aid programs as a template for future foreign aid. The U.S. Enterprise Funds employed a combination of the aid approaches thus far described: sending Western consultants (in this case, loan officers) and funding indigenous groups (in this case, businesses composed of partners of previous acquaintance). The Enterprise Funds exhibited some of the problems of both of those approaches. As in other cases cited, the means through which donors interacted with recipients, the agents of assistance on both recipient and donor sides, and the constraints under which they operated all shaped the effectiveness of the funds.

### *The Mission of the Funds*

The major challenge facing the Enterprise Funds is an inherent conflict between "aid" and "business" orientations—an identity crisis typical of development banks: Are funds in the aid business or are they in business, period? Do they support risky business activities that can produce big results or less risky activities that will demonstrate "success," especially in the eyes of the U.S. Congress? And is their mission to give aid liberally or to make sound business decisions using stringent loan criteria?

The funds have generally taken a conservative approach to lending money, the idea being to foster self-sufficiency. Therefore, the funds have not dispensed money easily or quickly and have required loan applicants to produce many of the same kinds of financial documents that are typically required for loans in the United States. At least initially, that was nearly impossible for most business people in the former communist countries because they lacked a paper trail and credit track record (audited financial statements and tax returns were unavailable) and were unaccustomed to Western loan application procedures.

The funds have generally concentrated on bigger businesses, in some cases joint ventures, which were listed as an option in the Support for East European Democracy legislation that authorized the funds.<sup>19</sup> Joint ventures were easy to create, were lucrative, yielded incentive funds for the partners, and looked good to Congress—even

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19. U.S. Public Law 101-179, *Support for East European Democracy (SEED) Act of 1989*, November 28, 1989, sec. 201(a).

though smaller indigenous businesses were the ostensible targets of the funds' attentions. To bypass the \$150,000-a-year salary ceiling for fund officers set by Congress, some fund officers devised enterprising ways to augment their salaries. In Poland, fund managers created an Enterprise Fund "clone," the Polish Private Equity Fund, which is funded partly by foreign private investments and partly by the original Enterprise Fund. A share of the profits of the private fund goes to the managers. Similarly, the Hungarian-American Enterprise Fund set up and invested \$4 million in an independent merchant bank, earning some of its partners twice the fund's salary ceiling. In addition to raising questions about the salaries of fund partners and staff members, the GAO found that there were potential conflicts of interest with regard to the Polish and Hungarian funds (see U.S. GAO 1994, 60–62).

All this has led to criticism that the funds, being too risk-averse, fail to fulfill their primary mission of supporting small- and medium-sized indigenous businesses. When the Hungarian Fund directed 12 percent of its capital investment to companies that had access to other sources of capital, the GAO questioned "whether such investments were consistent with the Fund's mandate to develop small- and medium-size businesses." Hungarian Fund officials countered by asserting that those investments in publicly traded companies "leveraged additional investment capital by (1) encouraging other investors to invest and (2) helping to stabilize the stock market, which was not very efficient in pricing stock offerings." Fund officials added that the investments helped to balance the portfolio and enabled the fund to invest in other, riskier businesses (U.S. GAO 1994, 20–21). But Brzezinski, a member of the board of the Polish Fund, seconded the judgment of the GAO when he said, "The Funds should promote native private enterprises. They were not set up to establish foreign private investment" (Brzezinski 1994).

### *Regional and Fluctuating Need*

The funds have tended to focus on the most developed areas of the recipient countries where investment already is concentrated. In underdeveloped areas there has still been little investment. For example, in Poland, high unemployment, a virtual stalemate in privatization and the development of business infrastructure, and a nearly complete lack of foreign investment are concentrated in certain regions, whereas very low unemployment and a high degree of private-sector development, privatization, and investment characterize others. In March 1993 the Warsaw province accounted for about 41 percent of all foreign capital invested in Poland and for about 33 percent of the total number of joint-venture companies, according to Jacek Szlachta, deputy director of Poland's Central Office of Planning, Regional Policy Department (Szlachta 1994, 1993). The pattern of regional disparities (of weak and strong regions) was much the same five years later (Szlachta 1998; see also Glowny Urząd Statystyczny 1997).

Fluctuating business conditions in the recipient countries also meant that needs for dollar-denominated loans would change. The need for Enterprise Funds in the host countries had to be periodically reconsidered because of changing financial conditions. Whereas, for example, in the early 1990s there was demand for loans from the Polish Enterprise Fund, demand later diminished because the fund's dollar-denominated loans lost attractiveness to borrowers as the Polish inflation rate went down and bank interest rates in zloty declined accordingly. Businesses generally preferred to take credit in local currency. In addition, the Polish banks became increasingly reluctant to refer credit-worthy borrowers to the fund's program as the banks became more experienced in credit analysis and risk assessment. By 1994 the Polish banks had begun extending loans to those borrowers themselves.

The president of the Hungarian-American Fund, Charles Huebner, reported that the Hungarian Fund experienced the same problem as the Polish Fund, with most investments concentrated in certain regions (Huebner 1994). A U.S. AID-commissioned evaluation concluded that the "funds must establish an investment philosophy based on a clear understanding of the host country's business, legal, and policy environments and not simply mirror the approach of other funds."<sup>20</sup>

## Conclusion

The record of U.S. aid to Central and Eastern Europe, Russia, and Ukraine points to the difficulties of conceptualizing and implementing effective aid in support of market reform—aid that is by definition political. Central and Eastern Europeans' appreciation of the political factors behind past reform efforts and the disappointing results fueled cynicism regarding aid. Rather than help to dissipate the legacies of communism, U.S. economic aid has in some cases instead reinforced the legacies of suspicion, central planning, and political control over economic decisions.

Donors face a dilemma. What happened in many Central and Eastern European enterprises drives home the point that in most places privatization aid has yielded few favorable results. As the Russian case shows, aid projects that were "successful" in donors' eyes appeared to replicate the closed systems of personal relationships upon which the functioning of communist societies depended. The "successful" aid projects relied on small cliques to circumvent, override, or otherwise reorganize political and economic institutions and authorities in the service not only of the donor's goals but also of those of the clique. The dilemma for aid providers is that, to be successful in a situation dominated by personal connections, they must work through such relationships. To do so, however, lends resources and legitimacy to communist-style social organizations, thereby both undermining the donors' celebrated attempts

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20. Development Alternatives 1995, ix. For additional information and analysis of the Enterprise Funds, see Bandow 1996.

to build “independent institutions” and fomenting resentment against the elite cliques that benefit.

Should aid money have been used to pay for privatization efforts in Central and Eastern Europe? Little of the privatization that actually took place could be linked to foreign aid. By concentrating aid on large, state-owned enterprises and by delivering aid primarily outside local privatization bodies, the United States missed much of the action. Other developments, such as the sale or liquidation of smaller state-owned enterprises at the local level and the considerable growth of private sectors, tended to be the chief engines of restructuring processes.<sup>21</sup> It also is revealing that some Central and Eastern European companies committed to privatization and to finding joint-venture partners chose to bypass foreign aid and Western consultants entirely. When outside help was deemed necessary, the companies selected and paid their own consultants, who answered directly to the companies. Likewise, when Central and Eastern European governments deemed the privatization of a company to be a priority, they, too, employed their own resources and those of potential joint-venture partners to get the process under way.

Despite donors’ good intentions, in a highly politicized arena characterized by disincentives to quick privatization, the conversion of state-owned enterprises can hardly be accelerated simply by bringing in outside consultants to promote privatization. Giving aid under those circumstances is politically risky, especially without an understanding of the relevant political nuances. No consultant or aid agency can reasonably be blamed for not predicting the twists and turns of Central and Eastern European politics. But the politics and changing nature of privatization policies, combined with the time it takes to get contracts signed and consultants into the field, make providing effective aid difficult.<sup>22</sup>

Foreign aid–financed consultants and technical assistance in Central and Eastern Europe have frequently produced unimpressive results, not only because the agenda is often driven by Western governments and because the funds are used for political purposes, but also because the aid appears to have become an end in itself and has in many cases been used for self-enrichment. Aid has generated some cushy jobs for Western consultants but, in terms of development, has added little to what private, voluntary exchange could provide on its own. Official funds appear to have been used for private gain by some advisers of Enterprise Funds and of HIID, the latter of which was in the position of both recommending aid policies and receiving aid money. The United States and other Western nations should learn from their experiences in Russia and many of the former Soviet bloc countries to avoid repeating their mistakes as the countries of the region continue to develop.

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21. In Poland, for example, much privatization was accomplished through liquidation; the major players were company insiders and the Ministry of Industry (Meaney 1993, 29).

22. Development Economics Group/Louis Berger International, Inc., and Checci and Company Consulting, Inc. (1995, 16–17), arrived at the same conclusion.

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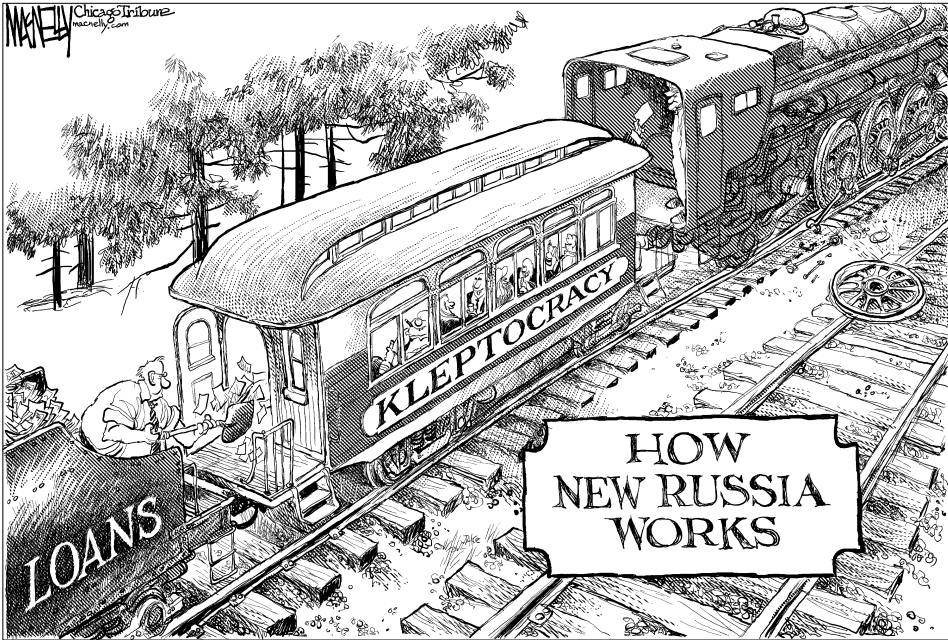
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