

29 of 45 DOCUMENTS

The Boston Globe

May 25, 1997, Sunday, City Edition

## Probe of Russian work shocks Harvard adviser; David Filipov reported from Moscow, David L. Marcus from Washington.

**BYLINE:** By David Filipov and David L. Marcus, Globe Staff

**SECTION:** NATIONAL/FOREIGN; Pg. A1

**LENGTH:** 1925 words

**DATELINE:** MOSCOW

The notebooks on Jonathan Hay's shelves contain an economic history of the new Russia: legislation on tax reform, privatization, and capital markets that he helped draft as head of a Harvard University project mapping Russia's transformation from Communism to capitalism.

For five years, Hay has been one of the most influential foreign advisers behind Russia's determined but imperfect embrace of a market economy. But it wasn't until last week that he made front-page news here, under the headline: "American Professors Couldn't Resist Russian Corruption."

Allegations by US officials that Hay and a Harvard colleague used their positions for private gain, resulting in the suspension of a \$ 14 million grant to Harvard, caused shock waves here and in the United States. The outcome of a US investigation is likely to affect a dispute here over control of Russia's rapidly growing capital markets, and debate in Washington over whom the United States should be supporting in Russia, and how.

For Hay, the case is a nightmare. In an interview Friday in his office in a high-rise rented by Russia's Federal Securities Commission, he expressed disbelief at the allegations.

"I feel totally devastated," Hay said. "In many ways it's very painful to have been doing all this work and then find the reaction isn't what I thought it would be. I feel good about what I've done here."

US officials say the case has nothing to do with the Harvard team's approach to the Russian economy. Investigators from the US Agency for International Development, or USAID, which has funded the Harvard project, say that Hay and Harvard economics professor Andrei Shleifer abused their positions to profit from investments on the Russian securities markets and pursue private business interests.

Among the allegations are that Hay directed AID-funded staff to assist Shleifer's wife, Nancy Zimmerman, with investments in Russia for a fund she owns. They say that Hay engaged in a conflict of interest by investing in Russian government bonds while working as a government adviser on capital markets. USAID also investigated whether Hay used his influence to assist his companion, Elizabeth Hebert, in setting up a mutual fund in Russia.

In a telephone interview in the United States last week, Shleifer denied the allegations, which were outlined in a letter to Harvard from a USAID official. An attorney in Washington for Shleifer and Hay called the letter "wrong in its conclusions, wrong in its assumptions, and inaccurate in its facts and foolish in its rhetoric."

Probe of Russian work shocks Harvard adviser; David Filipov reported from Moscow, David L. Marcus from Washington. The Boston Globe May 25, 1997, Sunday, City Edition

Despite the personal nature of the allegations, critics and supporters of market reforms in Russia see in the case lessons beyond the scope of the USAID investigation, and are seizing the opportunity to assess Russia's progress toward an open society and the contribution of groups like the Harvard Institute for International Development, or HIID.

"This is like a metaphor for the end of the Cold War: Americans are running around trying to turn these countries into little capitalist Americas, to recreate our economy, and they're not setting a very good example," said a Clinton administration official who spoke on condition of anonymity. "These guys went over and helped invent the Russian banking and market system, then they are accused of trying to make money off it. It's farcical."

Hay came to Russia in 1992 after studying at Harvard Law School. The collapse of the Soviet Union had provided a dream opportunity for economists and others who wanted to create a market economy almost from scratch. USAID, eager to help with the transition, did not have enough experts and Russian speakers for the job. Starting in 1992, the agency hired HIID, which had contacts and experience in Russia. The first contract was for \$ 2.1 million in a noncompetitive bid. In five years, the total grew to \$ 57 million.

The Harvard team founded the Russian Privatization Center and guided the government as it sold off 35,000 state-owned businesses. It advised officials drawing up laws governing the activities of private enterprises, and helped form capital markets and the Russian Federal Securities Commission to oversee them. The Harvard advisers helped design financing of environmental projects and planned legal reform and even wrote drafts of legislation.

US officials gave the Harvard team unusual freedom because of its expertise. In some cases, HIID also managed other groups that received grants from USAID. The team was so respected that the privatization center also received loans from the World Bank and the European Bank for Reconstruction and Development.

Last year, a General Accounting Office audit criticized USAID oversight of HIID as "lax," an allegation disputed by Donald L. Pressley, an agency deputy assistant administrator.

"We don't think we were too lax in our oversight of Harvard before," he said. "We're doing what we believe is the appropriate level of management. We believe that Harvard has done excellent work for us and for the government of Russia. On the other hand, when a situation like this comes up, we have to respond to it and respond quickly."

Because of its influence in Russia, the Harvard project attracted political enemies here. HIID worked closely with Anatoly B. Chubais, who between 1992 and 1994 was the chief Russian official in charge of privatization. A master administrator and a fervent believer in a market economy, Chubais has gradually become one of Russia's most powerful politicians. But he is also reviled by most Russians, who blame him for the inequities of the country's reforms.

The association with Chubais has produced alliances with officials like Dmitry Vasiliev, a Chubais confidant who heads Russia's Federal Securities Commission. Vasiliev credits Hay with doing as much for Russian reforms as any foreign adviser.

But in Russia, being close to Chubais can be a liability. Vasiliev suggested in an interview that the source of the allegations against HIID could have been his political enemies.

Vasiliev has been trying to win powers for his commission that would allow it to have similar powers to the US Securities and Exchange Commission. He is opposed by Russia's powerful banking lobby, which in the past year has become one of the leading forces in Russian politics. The banks want to control the Russian stock and bond markets, using them as a source to raise capital for their industrial holdings.

While Vasiliev acknowledged that the government might be forced to fire him to limit political fallout from the allegations involving Hay and Shleifer, he declined to link the case specifically to his conflict with the banks.

"We are for strict regulation of the market. We want there to be more competition," he said. "Many people don't

Probe of Russian work shocks Harvard adviser; David Filipov reported from Moscow, David L. Marcus from Washington. The Boston Globe May 25, 1997, Sunday, City Edition

like this."

Harvard's connection with Chubais has detractors in the United States as well. Janine R. Wedel, a research professor at George Washington University, wrote in an article in the journal *Demokratizatsiya*, published in Washington, that the HIID project often relied on presidential decrees to advance its agenda while avoiding Russia's Communist-dominated parliament and the bureaucratic maze within ministries. In other words, a group committed to broadening democracy and the rule of law circumvented democratic institutions.

"The Communist concept of a planned economy was simply replaced with a capitalist one, in which the Western donor filled the gap left by the Communist Party," Wedel wrote.

Wedel and others suggested that the impact of American advisers associated with such an approach was bound to contribute to anti-American sentiment in Russia. A recent article in the popular Russian daily *Komsomolskaya Pravda*, for example, alleged that Chubais had robbed Russia of millions of dollars, that Hay was a CIA agent, and that US advisers in general "were effectively collecting economic information about the situation in the Russian economy" that "ends up in the hands of American financial-industrial corporations."

Even some of those who admire the Harvard team disagree with the advice they have given Russian leaders.

"Andre is a friend, and I respect him, and he's done some very respected work moving Russia away from the Communist system . . . he was like a pioneer," said Marshall Goldman, associate director of the Davis Center for Russian Studies at Harvard.

But Goldman has disagreed with many of the choices made as Russia plunged into the brave new world of free markets. He is writing a book titled "Insider Capitalism," in which he argues that Russia failed to develop the institutions needed to check the markets and make them operate honestly and competitively.

Hay staunchly defended both HIID's choice of allies and its approach to reform.

"My role is to try and make technical assistance effective for people who are pushing for reforms. The view is that we've done a pretty good job," Hay said. "I don't think USAID has any program in the world that has had the success that they've had here."

Hay cited as one success his decision to hire and train young Russian professionals, rather than high-paid US consultants.

It was this conviction, he said, that led HIID, with the approval of USAID, to create the Institute for a Law-Based Economy and a subsidiary, ILBE-Consulting, a commercial firm that was intended to give Russian lawyers a laboratory for practical application of their skills. It was ILBE-Consulting, Hay said, that assisted Zimmerman with her Russia investments.

The potential conflict, he said, was whether the staff that assisted Zimmerman billed their hours to USAID or to ILBE. This, Hay said, was a matter USAID should have supervised on its own.

"USAID was informed," he said. "Systems were in place. If people were concerned about it, audit it."

Hay acknowledged that he had invested his own money in Russian treasury bonds while working as an adviser to the government. The investment, made during early 1996, was in the treasury bills market, which is regulated by the Russian Central Bank and the Russian Finance Ministry, agencies Vasiliev said Hay does not work with.

Hay said that he had made less than \$ 3,000 in the investment, and that he was not aware of any USAID ethics rules that prohibited him from investments in markets that were not related to his work.

Probe of Russian work shocks Harvard adviser; David Filipov reported from Moscow, David L. Marcus from Washington. The Boston Globe May 25, 1997, Sunday, City Edition

"I didn't think I was risking my reputation and my career when I did it," he said.

Asked whether he gave advice on helping Hebert set up a mutual fund in Russia, Hay presented a letter he wrote to Vasiliev of the Federal Securities Commission in December, before he began advising the commission. In the letter, a copy of which was sent to the World Bank office in Moscow, Hay made his relationship with Hebert clear and pledged to avoid giving advice about her fund.

"I treat Beth like I would any market participant," Hays said. "I bounce ideas off of her, but it's not like I'm going to give her a draft law in advance."

Even after the decision last week to suspend funding, Hay's office continues to operate. Staff workers type on computers and make photocopies on office equipment marked with USAID stickers. But there is a tense atmosphere. The phone rings constantly. During one call, Hay listened for a moment, then said, "Just calm down," and put down the phone.

However the investigation concludes, Hay said he intends to continue to work in Moscow - whether as an employee of Harvard or the US government. "I don't have a specific need to be paid by the US government," Hay said. "I

**LOAD-DATE:** May 28, 1997

**LANGUAGE:** ENGLISH

Copyright 1997 Globe Newspaper Company