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Do-Gooders Undone?

David Ignatius

Watching the once-bright promise of Russian economic reform become entangled in U.S. criminal investigations, you can't help remembering the old saw about how the road to hell is paved with good intentions.

The investigative spotlight so far has focused mostly on a probe by the U.S. Attorney in Manhattan of alleged money laundering through the Bank of New York. That still-murky scandal was at the center of last week's congressional hearings into Russian corruption.

The reform-to-ruin process also is highlighted by a largely unnoticed investigation under way by the U.S. attorney's office in Boston into consulting work with Russian reformers done during the mid-1990s by Harvard University's Institute for International Development.

The "Harvard Project," as it was known, became a prominent symbol of America's efforts to help Russia create a modern capitalist economy. The fact that it's now caught up in a criminal investigation underlines America's broader failure in Russia: While meaning to do good, we helped foster a class of criminal oligarchs. And some of the contamination may have rubbed off in a small way on our own institutions -- perhaps including our greatest university.

The Wall Street Journal reported last February that prosecutors in Boston are investigating whether Harvard economics professor Andrei Shleifer and legal expert Jonathan Hay may have invested in Russian junk bonds for personal gain -- even as they were helping supervise reform efforts there under a \$ 57 million contract from the U.S. Agency for International Development.

Shleifer's attorney, Earl Nemser, denied that his client has done anything wrong. "I believe that after this matter is fully investigated," Nemser said, the U.S. attorney will agree with Shleifer's contention that because he was a consultant to AID rather than an employee, "he wasn't restricted in terms of investment activities."

Hay also has denied wrongdoing. When the allegation that he invested in Russian bonds first surfaced in 1997, he responded that his investments weren't covered by AID's conflict of interest rules. His attorney, David Zornow, said Friday: "We are confident that at the conclusion of the investigation, the government will find that Jonathan Hay did nothing wrong."

The Harvard Project embodied U.S. hopes that we could create a kind of "instant capitalism" in Russia through privatization and what came to be known as "shock therapy." Among the early advocates of this approach was Harvard economist Jeffrey Sachs, who had used similar methods with some success in Poland.

The Harvard Institute for International Development spearheaded the effort, with an initial \$ 40 million grant from AID. Shleifer, a Russian-born economist, became director of the Russia project. Hay, a recent graduate of Harvard Law School, was the project's general director in Moscow. The project was scheduled to receive another \$ 17 million in 1997 when AID abruptly suspended funding because of auditors' concerns about improprieties.

The Harvard team's key ally in Moscow was Anatoly Chubais, a leading proponent of privatization. Many U.S. and Russian analysts now fault Chubais for pushing a 1995 scheme known as "loans for shares," which allowed Russia's new oligarchs to obtain control of the most valuable assets in the Russian economy -- its mining and natural resource companies -- in exchange for cheap loans to the government.

Chubais's plan fatally corrupted the reform effort, many analysts contend, by allowing capitalism to be equated with thievery. He and his American advisers made a devil's bargain.

The Boston criminal investigation involves questions about Shleifer's and Hay's investments while they were helping run the Harvard Project. A companion civil investigation is exploring whether Harvard supervised their activities closely enough. A summary of some of the issues in the case is contained in Janine R. Wedel's recent book, "Collision and Collusion."

Wedel writes that AID investigators gathered evidence in 1997 that Hay had invested in Russian junk bonds, known as "GKOs," while he was advising the government on financial matters. AID rules ban employees from investing in project nations. In the case of Shleifer, investigators examined whether he was involved directly or indirectly in investments made by his future wife, who ran a hedge fund in Boston that traded in GKOs.

What makes the Boston investigation so sad is that the Harvard Project seemed to illustrate America at its best. We were helping a country that was emerging from a 70-year Communist nightmare. But those reform efforts were tarnished -- first by the Chubais team's embrace of the corrupt privatization scheme and later by U.S. endorsement of the shaky GKO junk-bond scheme to finance the ever-growing Russian debt.

It's bad enough that our do-gooders may have quietly invested in the GKO market, which exploded in a spectacular default on Aug. 17, 1998. What adds to the embarrassment is that Harvard apparently failed to monitor their activities adequately.

No wonder people around the world roll their eyes when America offers its beneficent assistance. We're sometimes as prone to make mistakes as the people we're trying to help.