INCE the collapse of the Soviet Union the West has been asking how best to use aid to encourage Russia to be democratic and market oriented. At the Tokyo G7 summit meeting in July 1993 an impressive aid package of $43.5bn was promised (see Table).

Thus far, however, the amount of aid actually delivered has been limited and that which has been granted has had onerous conditions attached.

The issue of whether western financial aid to Russia should be extended significantly has posed a dilemma.

Political instability and the uncertainty about attitudes towards market reforms act to discourage large-scale Western involvement, but small-scale involvement undermines the prospects of reforms ever succeeding. The new government headed by Mr. Viktor Chernomyrdin, which has displaced the radical reformers, heightened anxieties as it was widely perceived that it would halt the reform programme and that inflation would get considerably worse.

This has yet to happen and rather surprisingly Mr. Chernomyrdin has succeeded where the radical reformers failed. He has unlocked the second tranche ($1.5bn) of the systemic transformation facility following the recent visit to Moscow by the chief of the IMF, Michael Camdessus.

The release of the new aid by the IMF signals a change in attitude towards funding reform in Russia. In 1992 and 1993 the emphasis was on presenting aid only as a reward for success in implementing reforms.

BELOW the high-minded rhetoric about aid to Russia, the actual Western aid effort in the former Soviet Union (FSU) has been dismal. Economic and political reforms are at risk, or are collapsing, in most of the countries. Western governments act like passive observers, concerned about the drift towards hardline foreign policy in Russia and the general economic collapse, but apparently believing that not much can be done about it.

During 1993, most of the former republics experienced hyperinflation (defined as inflation of more than 50% per month in at least one month during the year). Communists have made political advances in almost all of the countries. Much of the public apparently is nostalgic for the Communist era of steady long-term decay, as opposed to the current tumult of high inflation, growing lawlessness, and unpredictability. The three Baltic states stand out as the only cases of sustained progress in economic stabilisation and reform.

The issue of Western assistance receives all of the due incantations from the G7 leadership. The Clinton Administration repeatedly declares that Russian democratisation is the highest foreign policy priority of the United States. Heaven forbid that we should actually need a foreign policy.

In Fiscal Year 1995, the United States has proposed an aid budget for the FSU that totals $900 million, or 0.18% of US GNP. This compares with the Marshall Plan support during the first 15 months (April 1948-June 1949) of 2.1% of US GNP.

All countries, including the US, have looked for cheap and especially offshore ways to give support, even if that support is poorly conceived and mostly unhelpful.

The favoured form of aid has been export credits, generally at market interest rates and with short-term maturities. In 1992 and 1993, the WestERN governments extended export credits of around $18 billion. These credits were not tied to any reforms. They encouraged the importation of many goods that Russia did not need, but that the Western governments wanted to sell. The imports were then distributed inside Russia on a subsidised and often corrupt basis. In this way, the export credits added $18 billion to Russia's foreign debt, much of which is already coming due in 1994, while providing no real support to the market reforms or to Russia's political stability.

The aid effort of the international financial institutions has been equally adrift. In 1992, the G7 had called for the IMF, the World Bank, and the European Bank for Reconstruction and Development to lend $10.5 billion. The actual outcome was $1 billion.

In 1993, the G7 called for these institutions to lend $18 billion, the actual outcome was $2.6 billion. For several months at the end of 1993, the IMF withheld a $1.5 billion loan from the Russian government when the leading reformers were still in the government. In March 1994, the IMF extended the same loan under vastly worse budgetary conditions, and to a much less reformist government.

There are two interacting problems with the Western aid effort. The first is the absence of a conceptual framework. The IMF has simply failed to set out a reasonable framework for linking Russian reform and Western assistance. The IMF advice has been dismal on most important tactical questions, such as:

- The introduction of Russian national currency (the IMF argued for the preservation of the Soviet rouble, despite the enormous inflationary consequences of the old system).
- The question of stabilising the rouble exchange rate (the IMF has argued for a floating exchange rate, even...

It is time to take some financial risks, not only for Russia's future, but for our own.

Buying Time For Democracy

Professor Jeffrey Sachs
Harvard University

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However, political unrest associated with the measures implemented by the radical reformers seems to have tempering the IMF and the West and a discretionary approach has superseded the previous inflexible approach.

The following articles discuss the role of aid in the restructuring of the Russian economy, with particular regard to the disbursement of aid.

Jeffrey Sachs, a former advisor to the Russian government, argues that the IMF has not acted in a way that is conducive to supporting the establishment of a democratic market economy. He advocates that a dramatic increase in the scale of the aid programme is urgently needed.

By contrast, Padma Desai argues that the restrained approach thus far exhibited by the G7 is sensible and pragmatic.

Paul Hare highlights the limitations that the West faces in its attempts to encourage a radical market reform path in Russia and endorses the cautious approach towards disbursement of aid.

Ian Davis and Paul Dunne focus on the military industrial complex and they argue that the West has not provided enough targeted aid to help conversion towards civilian production. And John Channon examines reform in agriculture and is critical of the vest for privatisation, arguing that aid should be focused on assisting the development of competitive markets.

The lack of consensus brings the difficulties confronting policymakers in the West.

By supporting the Russian government, the West would reduce the risk of a collapse of central authority in Russia.

Though almost all successful stabilisations have relied on a fixed exchange rate as a 'nominal anchor' to stabilisation: and

- The question of aid itself: the IMF has failed to note the importance of Western support for Russia's budgetary expenditures as a precondition for Russian monetary stabilisation.

The second problem, of course, has been the lack of Western will. Many people suppose that any aid will be money down the drain - that reform is hopeless, or that aid cannot provide any pressure or encouragement. These are the same sentiments, ironically, that were prevalent in the United States in 1947, before President Truman led the effort for the Marshall Plan aid.

One leading chronicle of the Marshall Plan period put it this way:

To an ordinary Congressman, determined to cut budgets, spending billions and billions to rebuild a war-ravaged foreign continent was political madness. Most of their constituents had barely recovered from sacrificing their sons to save Europe; foreign aid was widely viewed as "Operation Rat-Hole". (From The War Men, by Hanson and Thomas 1989).

Negative sentiments of this sort are exacerbated by the failure of the IMF to put forward a conceptual case for foreign aid. It is no wonder that inward-looking politicians have cause to run away from proposals for large-scale aid.

The proper role of aid should be apparent from the history of the 20th century. Governments in deep financial crisis face the risk of an utter collapse of their authority. Such crises in China after 1912, Russia after 1917, and Germany after 1938 have led to political upheavals with devastating consequences for the entire world.

The case for aid is to bolster reform governments long enough for democracy and economic change to take hold, and thereby to ameliorate the financial crisis. This is exactly what the Marshall Plan money did. Similar aid has been successful in supporting financial stabilisation in Israel, Mexico, Bolivia, Poland, and many other cases in the past decade. By supporting an insolvent government, aid also stabilises the political situation long enough for more basic reforms to be implemented.

Seen in this light, the main goal of Western aid should be to provide financial backing to Russia's fragile democratic government, so that core fundamental market reforms can begin to operate. By supporting the government, the West would reduce the risk of a collapse of central authority in Russia.

**The G7 Aid Package**

<table>
<thead>
<tr>
<th>Type of Aid</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bilateral Governments</td>
<td>$15bn</td>
</tr>
<tr>
<td>Export credits and guarantees</td>
<td>$10bn</td>
</tr>
<tr>
<td>IMF: Systemic transformation facility</td>
<td>$3bn</td>
</tr>
<tr>
<td>Standby loan</td>
<td>$4.1bn</td>
</tr>
<tr>
<td>Currency stabilisation fund</td>
<td>$6 bn</td>
</tr>
<tr>
<td>World Bank</td>
<td></td>
</tr>
<tr>
<td>World bank loan commitments</td>
<td>$3.4bn</td>
</tr>
<tr>
<td>Import rehabilitation loans</td>
<td>$1.1bn</td>
</tr>
<tr>
<td>Oil sector loan</td>
<td>$0.5bn</td>
</tr>
<tr>
<td>EBRD European Bank for Reconstruction and Development Small/medium enterprise fund</td>
<td>$0.3bn</td>
</tr>
</tbody>
</table>

**Aid stabilises the situation long enough for more basic reforms to be implemented**

Such a collapse could turn into hyperinflation, a military coup, a turn to political extremism, or even civil disorder if areas were to attempt to separate from Russia in the midst of growing economic chaos.

The risk of collapse is real, though fortunately not certain. For the past four years, government tax revenues as a percent of GDP have plummeted, as characteristic of post-socialist countries emerging from authoritarian rule to proto-democratic institutions.

In 1990, the Soviet Union took 47.2% of GDP in revenues. By 1992, Russian government revenues as a percent of GDP had declined to 33.6%, and in 1993, to just 25.8%. In the first two months of 1994, government revenues have plummeted further, to just 18.5% of GDP. The Russian state, with its 2.5 million-man army, and its intense social needs, almost surely cannot be managed in a stable way on just 15.5% of GDP in revenues.

At the same time that tax revenues are plummeting, other signs of social disorder are growing. There is a sense of rising lawlessness, tax evasion, and even open defiance of central government rule by several regions. At least five regions are reportedly withholding part or all of the taxes that they should be remitting to the central government. This is the kind of behaviour that contributed to the collapse of the Yugoslav Federal Government in 1990, which was, in turn, the prelude to the onset of civil war.

The IMF addresses the fiscal crisis almost entirely by urging sharp budget cuts and tax increases. For a very weak state, with new democratic institutions, this advice is akin to urging a heart attack victim to get back in shape by running a marathon. The Russian Government must be weaned back to health by deep economic reforms and by significant external financial assistance that gives the Russian government time to gain legitimacy and improved administrative capacity.

I would urge a large-scale aid program along the following lines.

First, the Russian budget deficit would remain on the order of 9% of GDP, rather than trying and failing to bring...
Russian GDP is around $300 billion; therefore, financing on the order of 5% of GDP would be around $15 billion for 1994. Similar amounts would probably be needed in 1995 and 1996, and could be tapered off substantially in later years.

In addition to the Western bond purchases, the Russian government would be assisted in selling government bonds to the Russian population on attractive terms (such as indexing to the ECU or dollar, and at favourable interest rates), so that another 2-3% of GDP of budget deficits would be financed by the markets rather than the Central Bank. This would leave only 2% of GDP to be financed by the Russian Central Bank.

Therefore, the combination of foreign and domestic bond financing would eliminate the immediate monetary pressures, and provide the underpinning for currency stabilisation.

The Western governments would also make available a $6 billion rouble stabilisation fund, using the resources of the General Agreement to Borrow, now under the management of the IMF.

As in Poland in 1990 and many, many other cases in history, this stabilisation fund would act as a buffer for the Russian rouble, to give credibility to a commitment to peg the value of the rouble for the coming months. By committing to a pegged rouble, the government and the Central Bank could rebuild some confidence in the domestic currency, and thereby help to halt the high level of capital flight in the past two years.

To complete the short-term financial reconstruction of the Russian state, Russia's creditors — including the official creditors in the Paris Club, and the commercial bank creditors in the London Club — would offer a comprehensive rescheduling (i.e. postponement) of all debt servicing obligations during the period 1994-96. Each year's rescheduling would be predicated on the continuation of the overall macroeconomic programme negotiated between Russia and the Western governments.

These measures would not solve Russia's fundamental problems, but they would give time for those problems to be addressed. During the period of breathing space, it would be urgent for Russia to continue on its programme of privatisation, on the construction of an adequate social safety net for those who are displaced by the chaotic conditions in Russia, on the integration of Russia into the world economy through a negotiated accession to the GATT; and on the closure and restructuring of significant parts of the heavy industrial sector, based in part on private and official capital flows to the enterprises (above and beyond the flows directly to the Russian budget).

So far, proposals for large-scale assistance have been defeated by combined response of three camps — in short by those who believe one or more of the following:

The situation is hopeless; this camp is content to spend hundreds of billions of dollars per year for Nato, but not to

Jeffrey D. Sachs is Galen L. Stone Professor of International Trade at Harvard University. He has been economic adviser to more than a dozen countries in recent years, including Estonia, Poland, Slovenia, and Russia.

Massive aid inflows to cushion jobs and living standards should be ruled out

No Megabucks
And No Miracles

THE results of the December 1993 elections have created new worries and prompted a fresh debate on aid to Russia.

Yegor Gaidar's reformist party Russia's Choice received 15% of the popular vote signalling Russian voters' rejection of radical reform. If the vote for the other mildly reformist parties were to be added, the total pro-reform vote added to 34%. By contrast, Vladimir Zhirinovsky's Liberal Democratic Party pulled in the highest vote at 28%. The total vote for the three hardline parties was 43%.

The attitude of these hardline parties on the issues of free markets and democracy and the role of foreign aid range from lukewarm support to outright hostility. This is bad enough. To make matters worse, larger issues have also surfaced.

The 'What-if' challenges, befitting a Metternich, are back in the arena of formulating a Russian policy. The fundamental question of defining a Russian role in the 'near abroad' of the former Soviet Union, in Europe and with respect to the United States has bounced back. It influences, even overshadow, the immediate and rather mundane decisions risk some tens of billions of dollars to try to win the peace;

We are already doing all we can. The complacency of the IMF, the World Bank, and the G7 on this score has been remarkable; and finally

Reform is its own reward, and that all Russia needs to do is to get on with reforms and all will be right. Such an attitude begs the question: will the government ever have the stability to introduce the needed changes?

All of these views, in my opinion, gamble recklessly with our future. If we want a world of peace, and a Europe united in democratic institutions and economic freedom, we will have to work harder for that goal. It is time to take some financial risks, not only for Russia's future, but for our own.

Professor Padma Desai
University of Columbia, New York

with respect to the size, timing and type of aid to Russia.

Inevitably, therefore, there are divisions over the complex, long-run issue of defining Russia as a state. In one view the election results destroyed the misplaced illusion that with the demise of communism, Russia had undergone transformation and overcome its authoritarian tendencies.

Accordingly, the Clinton Administration must resolve the issues of the lim of Russian nationalism harshly rather than generously. Russian aspiration are unlikely to be limited to its ethno-geopolitical interests in its near abroad and will spill beyond.

More specifically, Russia should be allowed to step militarily into a form republic for 'peacekeeping' purposes. From this perspective, the quest for Russian acceptance of restraint peacekeeping poses the question of giving further aid to Russia.

The pragmatic and more realist view characterises Russia a la Ge