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[1990]: 8/9/90, (11 a.m.), Interagency Meeting of IMF led study, Soviet Union (Chaired by Mr. Boskin)

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Technical Cooperation Proposals for USSR

Issue for Consideration: Should the U.S. focus its technical assistance efforts for the USSR on a limited set of high priority problem areas?

- The purpose would be to focus U.S. and Soviet attention on high payoff projects while providing visible signs of U.S. support for Soviet economic reform.

The following project criteria could be used to identify priority areas:

- a high USSR economic priority, with high visibility benefits for the U.S. if success can be attained;
- an area in which the United States is a world leader;
- a sector/project in which we could generate strong private sector interest and involvement and face minimal USG budgetary outlay.

A list of possibilities, with benefits and drawbacks to each sector noted, is presented below. It should be realized, however, that the success of a number of these efforts depends critically on continued Soviet economic reforms, including movement toward decentralized free markets and convertibility of the ruble.

1. Food Processing/Product Distribution

- This is probably the Soviet's most pressing need. (Of course market pricing is needed to induce farmers to provide goods to market and not hold or sell on black market.)
- U.S. excels at food processing and product distribution over a large land area. U.S. has excellent transportation system needed to move products to consumers, which though not transferrable to the Soviet Union, could offer important lessons. Our private sector also demonstrates good inventory control.
  - U.S. private sector knows how to run railroad and trucking lines.
  - As Soviets scale back military production, truck production becomes an attractive and badly needed alternative output.

- This is a sector in which it would be relatively easier to combine our efforts with those of the American private sector.

Drawbacks:

- U.S. technical assistance in this area would reveal all the infrastructure problems of the USSR. This would immediately make clear the need for massive inflows of foreign investment, and cash, to build or repair roads, railroads, harbors, and storage facilities. Some of these projects are less amenable to private foreign investment, so the Soviets will be looking for foreign official financing, which we are not ready to provide.

2. Financial Sector

- This is one of the highest Soviet priorities. Without a functioning banking system, it will be virtually impossible for the productive sectors to recover and the economy to function.
- U.S. has high degree of expertise in financial markets - stocks, bonds, money markets. This is one area in which we could provide Soviets the most market-oriented technical advice -- how to set up a banking system, stock and bond markets, various savings instruments.
  - We could probably generate substantial private sector interest in this area, helping to minimize USG budgetary costs. Some large U.S. banks may be interested in eventually setting up commercial banking in the Soviet Union, even if they are not prepared to lend on a large scale to the Soviet government.
  - U.S. has an effectively functioning central banking system based on regional federal reserve banks plus central board of governors. This could be the most appropriate structure for USSR as well.
    - Technical assistance in this area could be coordinated by the Federal Reserve out of its ordinary budget. Regional Federal Reserve Banks would also probably be quite interested.

Drawbacks:

- This is a somewhat amorphous project in that a physical entity such as a highway or port will not result. Thus it may not generate a highly visible link to U.S. assistance effort.

- Soviet Republics are involved in efforts to set up their own banking systems, which is leading to considerable chaos, and it may be difficult to create a functioning and coherent program.

### 3. Energy

- Highly visible sector for which Soviets are seeking foreign expertise. Soviets need to increase oil and gas output for domestic needs and for export of hard currency.
- There is substantial scope for improved energy efficiency throughout Soviet economy; U.S. companies are world leaders in improved energy use. High payback for relatively low investment.
- Technical assistance on nuclear safety would help Soviet nuclear industry.
- This is easy sector in which to generate private sector interest, with output sold on world markets, easier to do profit sharing.
- U.S. oil companies have worked around the world, are experienced and desirous of working in Soviet Union to keep up with their competitors (French, Germans).

#### Drawbacks:

- Soviets have used oil trade as economic weapon against Lithuania. Extensive U.S. involvement in this sector might generate adverse publicity should the situation in the Baltics deteriorate.

### 4. Economic Training/Statistics/Management

- U.S. technical assistance in this area could provide rapid results in terms of teaching Soviets how to gather information about their economy, training future economic analysts, and educating the Soviets on how to macro-manage the economy. Budgetary/tax help would be particularly useful.
  - We could do this through extensive technical assistance projects including experts from CEA, Commerce - BEA, Federal Reserve, Treasury, OMB, CBO etc. - this could be funded out of existing budgets.
  - Publication of statistics, ability to produce economic forecasts could be very visible outcomes.
- We have already begun a few projects in this area.

Drawbacks:

- Its effects are more long-term rather than contributing to immediate improvements in production and distribution.

5. Health

- Antiquated Soviet health system needs modernization and improvement of technical skills.
  - U.S. has ability to provide such assistance. Private voluntary organizations (PVOs) could be expected to have a high interest in participating in this -- especially arranging exchange and other educational programs.
  - These PVOs have a good track record of providing excellent instruction and services to Third World countries which have many of the problems found in Soviet health care.

Drawbacks:

- While private sector interest in some aspects would emerge, private sector as a foreign investor would look for profit, which is less likely in this area.
- Once again, needs for foreign capital would become evident and we would be unable to provide financing needed to pay for hospital modernization and new equipment.
- PVOs would seek U.S. funding to cover additional programs.

Secondary Priority Areas

The following areas should also be considered, and, in fact, Secretary Baker included some in his list presented to Shevardnadze. However, they do not appear to have the potential for success/visibility as do those listed above.

6. Privatization

- This has been a successful U.S. effort in Poland, which could be applied to USSR and give U.S. firms a leg up on foreign investment in the USSR. Would help absorb ruble overhang.
  - Could play well into link with development of stock market.
  - Would not necessarily entail emergence of foreign official financing need.

Drawbacks:

- Capital market non-existent in USSR and foreign investment may be slow to materialize. Thus, process could be quite lengthy and could generate massive unemployment which could then be blamed on adoption of U.S. capitalistic system. (Soviets never have had much experience with private markets.)

7. Housing

- Strong sector in U.S., with heavy emphasis on smaller scale business, a locally based industry.
- Thus U.S. expertise in this area could help Soviets in learning how to decentralize. Housing would be easiest sector in which to do this.
- Gorbachev has identified this as a priority area and is interested in foreign help.

Drawbacks:

- Private sector interest in this idea may be hard to generate, since private companies helping Soviets build houses would look for profit in foreign exchange. Housing production would not generate foreign exchange.

MEETING August 9, 1990 at 11:00 a.m.

Subject: Interagency Coordination meeting of IMF-Led Study of  
the Soviet Union and other issues.

Invitees: Bob Zoellick, State Dept.  
Condi Rice, NSC  
Charles Dallara, Treasury  
Thomas Dawson, IMF  
Tim Deal NSC

8/90

TERMS OF REFERENCE  
summary

1. Macroeconomic Stability
  - o money supply and ruble overhang
  - o government finance (budget, revenues, deficit)
  - o balance of payments
  - o inflation
2. Development of Competitive Enterprises
  - o planning system
  - o supply system
  - o monopolies and monopsonies
  - o enterprises
  - o bankruptcy (and issue of subsidies)
  - o agriculture
3. Property and Contract Rights
  - o property rights and legal guarantees
  - o privatization
  - o contract rights
4. Social Safety Net
  - o direct social benefits
  - o indirect social benefits
  - o delinking social welfare from enterprises
5. Financial Intervention
  - o banking system (central bank and other banks)
  - o financial markets
  - o commodities exchanges
6. Convertibility
  - o defining convertibility
  - o defining ruble value
  - o foreign exchange allocation
  - o positioning convertibility in the reform process
7. Effective Price Decontrol
  - o existing price system
  - o moving to market prices
  - o assessing the impact
8. Sequencing

## TERMS OF REFERENCE

### 1. Macroeconomic Stability

#### o Money Supply

- Assess the role of money; the money supply, how is it measured, its components, its rate of change, who controls it (and the printing of money) and by what means. How does Soviet interest rate policy relate to the money supply?
- Assess the "ruble overhang" problem? What are the short and longer-term options for addressing it and making the ruble sounder (e.g., currency changeover, parallel currency, sales of public assets, savings bonds, etc.)
- Assess the implications of republic efforts to develop separate currencies.
- What would be the negative effects of improving money supply policy and/or addressing the "ruble overhang" and how can these effects be ameliorated?

#### o Government Finance

- Assess the all-union government budget (revenues and spending), including how it is measured, developed and approved; how money is expended; the control mechanisms on expenditures by all-union, republic and local government agencies, enterprises and state-supported social organizations; the subsidies bill (and how it is measured) and the extent of hidden subsidies (and how they are measured).
- Assess enterprise payments to (confiscations by) ministries, turnover taxes, payroll taxes, other sources of revenue. Assess tax reform legislation adopted and under consideration and its likely impact on the behavior of governments, enterprises (state, cooperative, other) and individuals.
- Assess the deficit, its components, how it is measured and how it is financed.
- What is relationship between all-union, republic and local taxing and spending authorities? By what means do tax revenues and funds for spending flow from level to level?
- Develop options and recommendations for reform of tax/revenue collection policy, spending policy and deficit financing.

o Balance of Payments

- Assess the balance of payments; how it is measured (especially ruble/transferrable ruble and clearing account "payments" versus convertible currency payments); the size of convertible and non-convertible currency debt; and what is owed to the USSR in convertible and non-convertible currencies.
- What are Soviet gold reserves? What is Soviet gold production?
- What mechanisms exist for central government control of payments abroad and to control borrowing by government entities and enterprises (state, cooperative, other)?
- Assess the balance of trade with convertible currency and non-convertible currency trading partners, plans to develop a modern tariff system, and the likely impact of such a system on the balance of trade and payments.
- What will happen on January 1 when CMEA trade should convert to world prices and convertible currency payments? What kinds of clearing account and negotiated price/exchange rate arrangements will continue and for how long?
- Assess options for increasing convertible currency export earnings, obtaining import financing (especially for consumer goods), and transforming non-convertible debt owed to the USSR into assets.
- Develop and recommend policy options to improve the balance of payments and trade, to reform/modernize payments and hard currency policy and practice, and to ease the transition of CMEA trade to world prices and convertible currency payments.

o Inflation

- Assess open and repressed inflation, its measurement and rate of change.
- Assess the size, role and importance of the black market and the reasons for its recent growth.
- Develop policies that could address the causes of inflation, dampen its effects and/or keep it from accelerating as the economy restructures.

o Assistance

Identify terms and criteria of Western involvement in helping to stabilize, modernize and improve Soviet macroeconomic policy.

## 2. Development of Competitive Enterprises

### o Planning

- Assess the annual and five-year planning process at the enterprise level; the characteristics of enterprise plans, especially regarding output, production processes and supplies; the role of state orders in determining production, allocating supplies and directing internal enterprise behavior, and the rewards/penalties for their fulfillment or non-fulfillment; and the role of other planning norms and guidelines issued by central government agencies.
- Develop options for dismantling the planning system and identify priorities. How can the state ameliorate the disruptive effects of abandoning planning?

### o Supply

- Assess the state supply allocation system, both technically and in actual practice; the non-market limits enterprises face in obtaining and using supplies; and the operations at the all-union, republic and local levels of the State Committee for Material-Technical Supply (Gossnab). What role do Gossnab wholesale trading houses play?
- What is the role of real, market wholesale trade? How does it work (e.g., by what mechanisms do enterprises trade directly among themselves and effect payment)? What factors interfere with market wholesale trade and its spread?
- Develop options and recommendations for expanding free market wholesale trade. What will be the negative short-term effects of abandoning/diminishing the central supply allocation system and how can they be ameliorated?

### o Monopolies

- Assess the problem of monopolistic and monopsonistic behavior/conditions. What role do branch ministries, single-industry trusts and multi-industry amalgamations play in the monopoly/monopsony structure?
- Assess draft anti-trust legislation, its goals and likely effectiveness, and its implications for state and enterprise monopsonies.

- Develop a demonopolization strategy. In what sectors, industries and enterprises should priority be given to the break-up of monopolies/monopsonies; by what mechanisms and according to what schedule; what will the negative effects be; and how, especially during the transition period, can they be ameliorated? What are options for the breakup of multi-industry amalgamations to facilitate competition?
- Develop options for regulating monopolies where they persist temporarily or permanently.

o Enterprises

- Assess the characteristics of Soviet enterprises, management's internal control over factories and production lines, firms' legal and real status vis-a-vis branch and functional ministries, prospects for enterprises existing outside of the branch ministry structure and the role of amalgamations.
- Assess the 1987 Law on State Enterprises and planned amendments/changes to that legislation.
- What are the characteristics of state and party interference in enterprise management? What are the tools for state interference in enterprise management decisions (taxes, prices, supply allocations, confiscation of excess profits, annual plans, etc.) and how are they manipulated in practice? What will be the characteristics of republic and local authorities' control over enterprise behavior in connection with decentralization of power and authority to the republic level?
- What are the incentives for enterprise managers, factory foremen and workers? How can they be improved?
- Assess legislation on and the actual operations of joint ventures, joint-stock enterprises, cooperatives, leased firms, share owning arrangements and private enterprise where it exists. Assess their potential as vehicles for enterprise reform.
- Assess the prospects for privatization, including republic-level plans for privatization, likely public reaction and sources of finance.
- Develop options and recommendations for reform of the existing enterprise system, especially including privatization; identify priorities; and assess the negative effects of such changes and how can they be ameliorated.

o Bankruptcy

- Assess the laws and regulations governing bankruptcy and how they are applied in practice; the criteria for determining bankruptcy; the actions taken towards creditors, management and workers (including liability questions) and other characteristics of bankruptcies which have taken place.
  - What are the laws, regulations and practice regarding bankruptcy of joint ventures, joint stock enterprises, share-owned firms, cooperatives, leased enterprises, private farms and other private economic activity?
  - How many firms are losing money? What criteria are used to determine losses and what is the extent of the enterprise subsidy problem? Assess hidden subsidies to enterprises and their implications.
  - How do parent enterprises, branch ministries or other government entities assist ailing firms?
  - Evaluate how the transition to market conditions and world prices will affect the subsidies question and enterprise losses. Assess the impact for subsidies of the
    - o transition of CMEA trade to world market prices and convertible currencies; and
    - o the development of market-based wholesale trade and the abandonment of centrally-directed planning and supply allocation.
  - Identify options and recommendations for the development of modern bankruptcy law and practice, including how the negative effects can be ameliorated.
- o Agriculture
- Assess the state of agriculture; the extent and characteristics of the monopsony problem in agriculture (e.g., the characteristics of wholesale trade in food, the role of the State Commission for Food and Food Procurements and that of state agents at the republic, oblast and rayon levels); and the private plot system and its viability as a model for expansion as a free farming sector.
  - Assess the successes, failures and problems of lease arrangements and of private farming where they exist.
  - Identify the agricultural sector's short and long-term bottlenecks (transport, supply, labor, etc.) and assess their importance.
  - Identify options, recommendations, priorities and a timetable for:

- o the development of incentives and farmers' independence, including private family farming, more developed leasing arrangements, and genuine farmers' cooperatives;
  - o changing the state's role in agriculture; and
  - o addressing infrastructure and other technical issues (transport and supply bottlenecks, insufficient and inappropriate equipment, labor shortages, etc.).
- Evaluate the problems of decollectivizing agriculture and how they can be addressed.
  - Develop options for reform/decontrol of farm purchase prices and retail food prices so as to promote economic efficiency and competition.
  - What is the relationship of agricultural reform to the broader development of competition and economic reform generally?
- o Assistance
- Identify terms and criteria of Western involvement in helping to foster competition, ending monopoly and monopsony domination of the economy, modernizing arrangements for bankruptcy and addressing the underlying ills of Soviet agriculture.
- 3. Property and Contract Rights
- o Property Rights and Legal Guarantees
- Assess property rights as they currently exist for individuals, organizations and enterprises (including the extent to which arbitrary confiscation of enterprise property and profits by the state continues). Assess new elements introduced by recent laws on land, leasing and property and their implementation (especially regarding the effective transfer of the means of production to new ownership, transfer of the land, control over financial assets, control over profits, etc.) Do the new laws resolve definitional questions of private, state and collective property? How are decisions regarding the sale, lease or long-term use of land and other assets made?
  - What is the status of republic implementing legislation regarding property rights? How is property divided between all-union, republic and local authorities' control?
  - Assess the mechanisms for enforcing property rights.

- Develop recommendations for strengthening property rights, including private property rights.

- o Privatization

- What new forms of ownership are foreseen? Assess draft legislation on property, joint stock enterprises and foreign investment. What limitations exist on foreign and joint stock ownership? Assess their tax treatment and its implications.

- What are the prospects for fully private ownership of the means of production -- both small scale and large scale? What limitations exist on private businesses? Assess the tax regime private businesses face.

- Develop options, recommendations, priorities and a timetable for privatizing, including proposals on who should be allowed to sell and to buy state assets, what criteria should be applied, and to whose budget privatization proceeds should go (e.g., all-union, republic, local coffers, etc.) Develop guidelines and a methodology to inventory state assets.

- o Which privatization option best fits with other economic objectives such as absorbing the ruble overhang, financing the budget deficit, creating competition, breaking up monopolies, etc.?

- o Contract Rights

- Assess the rights and responsibilities of individuals and firms under existing contract laws; the penalties which result for producing and consuming ministries, enterprises and individuals from the non-fulfillment of contracts; and the liabilities which state organs bear when their actions result in the non-fulfillment of a contract by a firm.

- Develop guidelines to strengthen contract law.

- o Assistance

Identify the terms and criteria of Western involvement to support diversified forms of ownership, including especially private property, and the development of modern property and contract law.

- 4. Social Safety Net

- Assess current retirement, pension, unemployment and other direct welfare benefits, their cost and their role in the economy. Assess indirect social benefits (e.g., retail price subsidies, free health care and education, transportation subsidies, etc.) and their cost, role in the economy and importance to the public.

- What agencies distribute direct benefits? What criteria do they use to determine who are recipients and how much should be provided? Assess mechanisms for distributing indirect benefits and their effectiveness in reaching the needy. Detail the extent to which direct and indirect social benefits are channeled through enterprises and official trade unions, and assess the costs this imposes on enterprises in terms of effectiveness and efficiency.
- Are workers in cooperatives, leaseholders and private farmers covered by different social welfare guarantees and, if so, how do these arrangements differ? How would they be expanded as the non-state sector grows?
- Assess social welfare legislation recently passed (e.g., pension law, law on employment and unemployment, law on paid vacations, etc.) and its implications at the macro level and for the public.
- What will be the employment, consumption and other effects of stabilization and other reforms (from factory closings, price increases, etc.)? Assess government plans to address these effects and their budgetary implications.
- Develop options in each area of social security (employment, consumption, health care, education, etc.) to continue providing support to those who need it and to support those adversely effected by reforms, including the viability of compensation and indexing schemes. Indicate priorities, assess costs and benefits of options, and evaluate different mechanisms for financing.
- Develop options and mechanisms for delinking social welfare from the enterprise/trade union system.

o Assistance

Identify terms and criteria of Western involvement in helping to develop an appropriate, modern social safety net which can help to diminish social tensions resulting from the reform program and to improve both economic efficiency and effectiveness.

5. Financial Intervention

o Banking System

- Assess the banking system and its main problems; the role of Gosbank, the influence it exercises over the money supply, and the legal and real controls or influence it has over sector, republic, commercial and cooperative banks; the variety, role and economic significance of the other banks in the Soviet system; and the role banks plan in the allocation of credit, especially vis-a-vis central planners and other governmental/political entities.
- How are interest rates set and what role do they play?
- What control does the official banking system (e.g., Gosbank and the Bank for Foreign Economic Relations) have over convertible currency transactions? Assess the role, independence and viability of Soviet offshore banks.
- Assess banking reform legislation and its ability to foster market competition and sound financial management.
- Assess the implications of republic economic autonomy and/or autarky on the banking system (e.g., the development of republic central banks and currencies, the setting of interest rate and credit policies at the republic level, etc.).
- Develop options, priorities and recommendations for banking reform, including the consolidation of central bank functions, the development of independent banks, consumer banking and control over foreign exchange.

o Financial Markets

- Assess the arrangements for sales and marketing of government deficit financing bonds, warrants, public savings bonds and shares.
- What plans exist to allow free trading in these and/or other financial instruments? On what legal basis will such trading take place? How will investors assess the creditworthiness of specific borrowers and/or backers of bond and share issues? What hurdles must be overcome before a bond and stock exchange is feasible?
- Develop options for opening modern financial markets and identify the steps that should be taken toward that end.

o Commodities Exchanges

- What plans exist for developing commodities exchanges? What property and liability rights will traders have?
- Identify how a commodities exchange could support Soviet economic, and especially agricultural, reform and development. Develop options and recommendations for a commodities exchange and identify steps carrying them out.

- o Assistance

Identify terms and criteria of Western involvement in helping to develop modern financial intermediaries.

- 6. Convertibility

- o Defining Convertibility

- What characteristics of inconvertibility are specific to the Soviet economic system? What role does inconvertibility play as a systemic requirement for a centrally-planned economy? How does it protect the artificial price system and a taut resource allocation system? What are the costs and benefits of ruble inconvertibility?
- How do the Soviets define ruble convertibility, including in its existing forms (partial, "soft," transferable, internal, external, etc.)?

- o Defining Ruble Value

- What is the current exchange rate regime? How many rates exist, how do they change, how are they determined, and how are they administered?
- What laws and regulations govern the setting of exchange rates? Assess the system of currency coefficients and prospects for its change/abandonment.
- Assess the viability of exchange rate unification, devaluation, a parallel currency and currency conversion schemes. What would each of these steps do? What are the obstacles to full convertibility (e.g., the irrationality of Soviet prices, the lack of wholesale trade, etc.)?
- What indicators exist to help determine the ruble's value, including black market rates, hard currency auctions, off-shore foreign exchange markets, new retail trading centers, etc.

- o Foreign Exchange Allocation

- What rules govern access to convertible and non-convertible foreign exchange? How are they administered? What is the practice enterprises face in obtaining and using foreign exchange?
- Examine the trading system, including foreign trade organizations, trade subsidies, taxes, differentiated currency coefficients, tariffs and government direction of trade policy.
- Consider ways to liberalize access to foreign exchange in a pre-convertibility and transitional economy.
- o Positioning Convertibility in the Reform Process
  - Evaluate the priority and importance of ruble convertibility in the context of other reform goals.
  - Identify options and steps for achieving the desirable forms of convertibility and the optimal timing for implementation of a convertibility program in light of overall sequencing and priorities.
- o Assistance

Identify the terms and criteria of Western involvement in supporting steps toward convertibility, including options tied directly to Western interests (e.g., profit repatriation on foreign investments).
- 7. Effective Price Decontrol
- o Existing Price System
  - Assess the current administrative price setting system, the role of enterprises and of the market in influencing price setting and the relationship between retail and wholesale/farm purchase prices.
    - o How irrational are prices in relative domestic terms and compared with world market prices in relative terms (try to avoid exchange rate distortions)?
- o Moving to Market Prices
  - Assess the obstacles to introducing market prices. Where do subsidies play a substantive or policy role and where are they the result of inattention and an overly complex administrative price system?
  - Examine Soviet proposals for price reform. Assess the reasons behind recent failed attempts to reform price policy.

- Develop criteria and guidelines for price decontrol. Identify options (including scenarios) in which prices can achieve market values. Assess the extent to which market factors could produce hyperinflation if prices were freed (e.g., ruble overhang, monopolistic industrial structure, etc.) and recommend measures to ameliorate it. Which key sectors should be targeted for deregulation first?
- Consider structural steps, such as allowing firms to compete for state orders or giving them access to sets of supplies solely on the basis of price.
- o Assessing the impact
  - Assess the impact of price decontrol, especially economic dislocations, bottlenecks, shortages, adjustment at the consumer and retail levels, etc.
- o Assistance

Identify terms and criteria of Western involvement in developing a sound price decontrol policy and toward supporting the implementation of that policy.
- 8. Sequencing
  - What plans do the Soviets currently have for proceeding with macro- and micro-economic reform? Assess those plans and the sequence of anticipated steps.
  - Develop sequenced economic reform policy options, assess their costs and benefits, identify ways to maximize the benefits and reduce costs, and make recommendations.
- o Assistance

Identify terms and criteria of Western involvement in devising, overseeing and enforcing a properly-sequenced and appropriate reform program, and locate points at which Western involvement can be of assistance.