Russia - A Prosperous Country, But When?

Transforming socialist planned economies into capitalist market economies is no easy matter, as German reunification and systemic change in Central and Eastern Europe have already taught us. As the processes now underway there highlight, the only way to master the transition crisis quickly and achieve economic growth is to remain steadfast in implementing reforms. This is how Poland in 1992, Slovenia in 1993 and the Czech Republic and Hungary in 1994 managed to move onto the growth course they have kept to till today, despite the many adjustment problems they still face.

Russia on the other hand is having tremendous trouble with transition from the post-Soviet command economy. Despite many reform attempts.and programmes (Gaydar, Yavlinski and others) as well as massive moral and financial support from the international community, seven years after the demise of the Soviet Union the Russian economy is still in grave crisis: industry has collapsed, GDP is falling, government tax revenue is declining and the expenditure side of the budget is increasingly shaky (e.g. wage and salary arrears). The trend in,exports and direct investments is also pointing downward.

The collapse of the Russian financial markets and banking system in August 1998, which brought the largest country in the world to the brink of economic, social and political disaster, revealed with brutal frankness that the partial successes achieved so far - in combating inflation and stabilizing the rouble, for example - are little more than a soap bubble and that the macroeconomic and social framework for a market economy resemble a gigantic Potemkin village. Shaken by the Asian crisis and falling oil prices, the village, which appeared so splendid to outsiders and which impressed many, including even the IMF on occasion, just fell apart. The consequences: effective devaluation of the rouble, higher prices, production stops in Russian firms, import shortfalls, supply bottlenecks and the return of the already forgotten queues in front of shops. In August/September 1998 Russia seemed to have reverted to the year 1991. Open power struggles threatened the political stability and the integrity of the country.

Why is the transition in Russia so difficult? Are endogenous factors to blame? Or is perhaps the West's universal reform package quite unsuitable for Russia? As in other transition countries, the reform programme agreed with the IMF aimed at creating monetary stability, which, in combination with privatization and the emergence of a legal and institutional framework, was supposed to effect the necessary structural change and lay the foundation for sustained economic growth. The simultaneous liberalization of foreign trade was intended to help achieve these goals in the medium term. The initial phase of an extremely loose monetary policy with high inflation and freely fluctuating exchange rates was followed as of 1995 by a policy of tight money, halving inflation every year. A corridor for the exchange rate was fixed for the first time in 1995. The rouble then gradually depreciated as of 1996 within this corridor and had come to act as another stability anchor along with prices. The Russians gradually regained confidence in their currency. Some 30 thousand million dollars were deposited in bank accounts at the end of July 1998, about 80 per cent of this in roubles.

Monetary stability seemed to be achieved and the way open for further financial aid. What was missing was the transmission of the macroeconomic stability signals to business. This could not take place, however, because it was thwarted by unbridled privatizations, patchwork legislation and inefficient institutions. Russian privatization created a powerful group of *nouveaux riches* who knew how to siphon off their private property from the national economy and put it to use for their own ends. The bulk of the proceeds and earnings were not reinvested, but transferred to foreign countries, circumventing the state. In collusion with regional power centres, the corrupt economic elite undermined monetary stability by shifting to a barter economy, dispensing almost entirely with monetary transactions. Foreign trade liberalization was also exploited ruthlessly.

The desolate tax system was unable to fill government coffers with the amount of tax revenue which had been planned, resulting in months-long delays in the payment of wages, salaries and pensions. The government offset the tax shortfall by issuing high-interest bonds. This issue of treasury bonds deprived the real investment sector of a large part of domestic and foreign private capital. As a consequence a colossal financial pyramid reared up on the one hand and on the other the real economy remained stuck in the valley of tears. The biggest country in the world and the richest in terms of raw materials had to import 70 per cent of its food! In the end all that was needed to plunge the country's entire monetary and financial system into collapse was for a crowd of financial speculators to withdraw their money from Russia.

A brief retrospective of Russian transition over the last years reveals that the causes of the recent collapse are home-made - incoherent reform schemes, inconsistent implementation of reform and some incompetent reformers. The West is also to blame because its financial aid, while appearing to bolster political stability, was tied to the person of Yeltsin and in fact at best postponed economic collapse. On the threshold to the new millennium, the Russian economy still lacks a solid foundation for growth! The greatest harm in all this has been suffered by the Russian people, who have already had to make so many sacrifices and have still not seen any of the prosperity promised. After the latest financial turmoil and its economic and social impact, free-market reforms have been discredited again in the eyes of the population and are associated even more closely ^with speculation, corruption, privation and social ineqality. Even before the crash about 50 to 60 per cent of Russians lived at or below the subsistence level. Over a third of the population were neither rich nor poor by Russian standards and only 3 to 5 per cent were classed as wealthy. The latest crisis is bound to raise the number of poor by a large margin. Not only will those who have so far belonged to the not-so-poor be hard hit due to the loss of some of their modest savings as a result of rouble devaluation, but so will the beneficiaries of transition, employees in private companies and banks who belonged to the middle class and have now lost their jobs.

Russia now needs a concerted economic strategy. Constructive lessons need to be learnt from past experience and reforms need to be implemented consistently. It is doubtful whether the cabinet under Primakov, made up of Communists and moderate reformers, can do this. There are grounds to fear that populist measures will be taken - printing money and subsidizing state-owned enterprises - which will not bring the country any stability in the medium term. Also the new government's declared intention of moving towards a social market economy, when the basis for a market economy is still lacking, shows that it plans to put the cart in front of the horse. The approaching parliamentary elections in 1999 also fuel fears that progress in reforms is not likely in the near future.

In itself, the half-hearted reforms to date are not evidence that a market economy is not right for Russia. What this gigantic country needs are a comprehensive legal framework and solid institutions to set general rules for implementing reform, not to comply with the needs of any particular clientele. All those in power in Moscow and in the regions must solidly support the reforms. Reform will, though, take longer to make itself felt than in'smaller transition countries. This view is also shared by Domingo Cavallo, father of the Argentine economic miracle, who in answer to the question whether Russia would be able to solve its problems said, "I am sure that Russia will be a prosperous country, but I don't know when."

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