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Finding success in Russia's tea leaves

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Despite gloomy press coverage and Vladimir Zhirinovsky, reform in Russia is on track and almost certainly irreversible. Erratic progress should be viewed in the historical sense.

If in early 1988 you were told that as early as 1994 most of the Soviet Union and Eastern Europe would be free, noncommunist democratic countries rapidly privatizing their economies, and that this transition would have occurred for the most part peacefully and with less loss of life than we have annually from crime in the United States - you would probably have rejected the assertion as a highly improbable fantasy. Yet, despite the miraculous, positive events of the last six years, from the time of the Russian elections in December, the international press has been filled with never-ending doomsday articles concerning Russia.

Disaster is always possible, and it is easy to build scenarios about the many things that could go wrong. But it appears that the worst is clearly over for most of the countries of Eastern Europe and the former Soviet Union, including Russia. (Ukraine at the moment is the exception, but one can hope that after their elections two days ago, they too will begin serious economic reform.) The reason is quite simple: The government sectors of these economies, correctly measured, are rapidly shrinking as a percentage of national product. The evidence from around the world is overwhelming that when the relative size of government declines, the economy begins to expand rapidly. In 1994, Poland, as it did in 1993, plus the Czech Republic and Hungary are all likely to have growing economies for this very reason.

The real story of what is happening in Russia has largely been ignored: The world's most rapid and complete, albeit imperfect, privatization program is continuing at full speed. The chief architect of the privatization program, Anatoly Chubais, remains as privatization minister. By July, at the current rate of privatization, as much as 70 percent of the real Russian economy could be at least nominally private. Already, more than 50 percent of the working population is employed by private firms or cooperatives. The irony of this is that the Russians could end up with a smaller state sector as a percentage of their gross domestic product than most of the developed nations, including the United States.

Public opinion polls as well as much economic evidence indicate that the economic decline probably bottomed out in Russia last summer and that economic growth has begun. The official statistics will show decline in output for some months to come, but they largely ignore the new private sector because they have yet to develop a full set of economic measuring tools. In fact, much of the decline in the state sector is a net plus because many of the industries in most rapid decline were value-subtractors rather than value-adders. The problem with the declining industries is not so much a loss of needed output, but a loss of jobs for people without adequate alternative economic safety nets. It is the fear of the loss of the safety net that explains much of the vote for Mr. Zhirinovsky and other hard-liners, more than a desire on the part of the Russian people for a return to communism or for military adventures.

There is no doubt that the economic transition has caused extreme hardship for large numbers of people. The hardship is largely a result of pensions and wages of many state workers not keeping up with inflation. However, a side benefit of the new inflation tax has been to drive the young and the most productive workers into the new private sector, with its higher and growing real wages, at a more rapid rate than would have occurred with less inflation.

The failure of American and the European nations to deliver much of the financial aid they promised, while providing so many government experts with bad advice, did undermine the more radical reformers like Yegor Gaidar and Boris Fedorov. It wasn't that the foreign aid would have done the Russians so much good, but unkept promises always hurt. The result has been for Russians to begin to pursue a bit more nationalistic course, while at the same time becoming more aware that their economic salvation depends largely on themselves. This in turn is encouraging them to seek more private joint ventures and capital rather than government aid, which is all the better.

Even more damaging than the lack of aid has been the hypocrisy of the Western politicians, particularly the Europeans, in denying the Russians and Eastern Europeans reasonable access to Western markets. All this has played into the hands of Mr. Zhirinovsky. Fortunately, many Russians are well-educated, intelligent and increasingly well-informed about the world. Thus, it is unlikely that Mr. Zhirinovsky's star will rise much higher, unless the West through ill-considered policies fuels the resentment of the Russian nationalists, or if President Boris Yeltsin allows reform, and thus economic progress, to be derailed.

There has been much speculation that inflation will accelerate again, given the departure of Deputy Prime Minister Gaidar and Finance Minister Fedorov. Some of the important economic reformers in Russia have the view that the big wage increase given to state workers just before the election will shortly cause inflation to accelerate, and thus the departure of Messrs. Gaidar and Fedorov was a shrewd move to make Central Bank governor Viktor Gerashchenko the scapegoat. Whatever the truth, it i s unlikely that Russia will allow itself to follow Ukraine into near-hyperinflation. The Russian banks can now hold gold and issue gold and other real-asset-denominated securities, which will enable them to offer money-like instruments to replace a hyperinflating ruble if that should occur.

Those of us who have the opportunity to watch the reform process both at the policy level and on the streets are amazed at the rapidity of the transition. Moscow and other Russian cities are increasingly looking like cities in the rest of the world. There are shops that now sell everthing, there is advertising, and you no longer need to go to McDonald's to find helpful, smiling salespeople. An orientation toward meeting the wants, needs and desires of consumers is far from complete, but the month-to-month progress is both significant and noticeable. Even Aeroflot seems to be responding to the competition of the new private Russian airlines. Traveling to Novo-sibirisk from Moscow last month on Aeroflot, we had reasonably on-time flights, cl ean aircraft and helpful attendants, and even seatbelts that work (on a number of my Aeroflot flights last year, the airline seemed intent on proving that you won't die if you lack a seatbelt or have a broken seat).

Those who wait to enter the Russian market until all is peaceful and easy will have waited past a lot of profit.

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