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Response to Popov

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There could not be a better time than now to share some thoughts about globalization, or the thing called the global economy. The second biggest economy in the world, Japan's, is in recession. The emerging markets of Asia have been in crisis for more than a year. The economy of Russia is collapsing. The Asian "flu" may spread to China. The stock markets of Latin America have tumbled because investors are afraid that the depreciation of Southeast Asian currencies will hit the exports of South American countries. It seems that even the big and powerful United States is not immune to this disease: the Dow Jones Industrial Average, the heartbeat of the American economy, goes up and down like a rollercoaster. What in the world is happening on planet Earth? It's the global economy, stupid!

As we all know, the globalization process is by no means new. During this decade, the concept has appeared in many positive contexts, maybe because international trade has increased and many regions have enjoyed economic growth. Recently, however, we have seen the dark side of the moon and there are plenty of pessimists who now talk about the possibility of global recession, if not depression.

I met one of those pessimists, the Nobel Prize-winning economist Paul A. Samuelson, a professor emeritus at the Massachusetts Institute of Technology. He said that the situation is like in the Swiss Alps, where the snow has accumulated, and any pistol shot can cause an avalanche.[1] He insisted that a possible global crisis would not be the aftermath of the chaos in Russia, but that Russia's meltdown could be the pistol shot. Although the world stock markets reacted strongly to the Russian crisis, we must keep in mind that Russia's economy is about the size of that of the Netherlands. Compared with the economic superpowers — the United States, Japan, and the European Monetary Union (due to start in 1999)—Russia's economy is tiny, a fact Professor Samuelson emphasized by saying, "The only Russian product I have consumed in years is caviar." The *New York Times* made an apt comparison on 29 August 1998, when it noted that, in one week, the value of Japanese stocks on the Tokyo Stock Exchange had dropped by a sum that exceeded the size of the Russian economy.[2]

But these observations don't make the Russian turmoil insignificant. And for us Finns, Russian troubles are our worries. Vladimir Popov gives an interesting overview of the serious problems that preceded the latest crisis and that partly caused it.[3]

Dr. Popov's essay helped me understand why the latest crisis in Russia occurred, and his main points make a lot of sense. For example, he argues that the speed of the Russian reforms did not matter a great deal. Instead, he thinks the Russian government mishandled the internationalization process in three ways: by sustaining the overvalued exchange rate of the ruble; by sticking to import-substitution policy and failing to stimulate exports; and by failing, or not even trying, to attract straight foreign investment.

But there were other reasons for the failure that the government could not do much about. Those were the initial conditions inherited from the era of central planning. This heritage was far worse than in most other transition economies, and there are still distortions of industrial structure and trade patterns. With a comparative analysis, Popov concludes that the legacy of central planning in former Soviet Union republics was much worse than in East European countries.

Popov demands the devaluation of the ruble because there could be no economic growth without it. I agree, because my country faced a severe depression in the beginning of the 1990s, and most economists now say that one reason for it was the policy of the strong mark (our currency).

But I am skeptical about Dr. Popov's argument that promoting export-oriented growth would require massive and rapid industrial restructuring, which would favor resource-based industries and some competitive sectors like the aerospace industry. That would mean more unemployment, and I am not sure if Russia should assume that burden right now. It would also mean that Russia would move backwards, to be only an exporter of resources, oil, and gas, which does not require the educated, skilled workforce that the country still has.

I would like to propose other ways to deal with the noncompetitive industries, maybe because my country still feels the wounds of unemployment, which caused personal tragedies for many. For example, I don't think Russia should stop subsidizing noncompetitive industries all at once; instead, it should attempt to transform those companies into productive ones. I don't exactly know how that would happen, but perhaps the government should force the owners of bad companies to sell their stakes to foreign companies or global conglomerates. After all, most of the noncompetitive companies are still there because of the government's subsidies. And the foreign companies could try to change nonprofitable plants and businesses. I would even suggest that bad companies should be given to foreigners for free, if the alternative would be bankruptcy. Exports must grow, but unemployment must not!

Dr. Popov points out that Russia has failed to attract foreign investment. And direct foreign investments are what globalization — or "internationalization," as Dr. Popov calls it — is all about. Russia's refusal to allow foreigners to get rich on Russian resources may be a case of unnecessary nationalism, or perhaps it indicates that many Russian politicians do not understand what a global market economy means and requires. I contend that Russian workers won't mind who owns their companies as long as they are paid well. There are other, fundamental, reasons why foreign investors are not building production facilities in Russia. Yeltsin's reforms failed, Popov writes, because the institutions needed to enforce law and order and carry out a manageable transition collapsed. Capitalism needs strong, efficient institutions for taxing, financing businesses, and insuring that people involved in the free market play by the rules. Because relevant legislation in Russia is weak and incomplete, conduct occurs there that in other countries would be considered illegal. The weakness of Russian institutions is the secret behind the failure to partake of the global economy.

In their book *Fixing Russia's Banks: A Proposal for Growth*, Michael S. Bernstam and Alvin Rabushka claim that an economic boom in Russia has not yet occurred because Russia has failed to develop a financial system independent of the government.[4] More specifically, it has failed to create a real commercial banking system, which is an essential component of the market economy. Russian banks do not engage in the normal banking practices of accepting deposits and making loans. Since they do not facilitate normal investment, they do not contribute to growth. In fact, Bernstam and Rabushka argue that Russian banks are not really banks at all. Yet they seem to be at the center of the country's phony capitalism. It might be fair to say that Russia is an oligarchy: a lot of power is in the hands of greedy men who don't care much about the well-being of the citizens. Those men dominate the banks. Russian economist Grigory Yavlinsky wrote recently that the current Russian economy shows signs of evolving toward Western-style capitalism on the one hand and consolidating corporatist, criminal-style capitalism on the other. Yavlinsky sees that one trend of the corporatist and corrupt market is the rise of Russian oligarchs, who have created a form of robber-baron capitalism: “Far from creating an open market, Russia has consolidated a semi-criminal oligarchy that was already largely in place under the old Soviet system. After communism’s collapse, it merely changed its appearance, just as a snake sheds its skin.”[5]

Yavlinsky, a leader of a democratic, reformist party, points out that the new ruling elite is neither democratic nor communistic, neither conservative nor liberal — merely rapaciously greedy. He thinks that its market of insider deals and political connections stands in the way of an open economy that would benefit all Russian citizens. (Seven bankers were behind Boris Yeltsin’s reelection in 1996, when the Russian media were unfairly supportive of the sitting president. These bankers control a great deal of Russian media.)

The rise of the robber barons is one sign of Russia’s inability to create trust, which is essential if Russia wants to rise from its slump. One rule of the global economy — in fact, of any economy — is that no trust means no investors and few friends. The weakness of institutions or the total lack of them has led to corruption (and vice versa). In fact, many observers consider Russia one of the most corrupt countries in the world. As Popov points out, crime rates are up, and the portion of the shadow economy is exceptionally high.

Maybe most alarming of all, Russia has suffered, and will continue to suffer from what I would call moral damage, at least in the eyes of the Western world. Without suggesting that Finnish or American people are role models, I believe something seems to be wrong with the moral order of Russia. Maybe it is a heritage of the Soviet Union, where religion played a minor role and the Communist Party failed to build a sound ethical framework. After all, introducing values is not something governments can do with five-year plans. In the global economy, moral damage is economic damage. The ultimate question is: How do you make a moral reform? And what kinds of conditions would the IMF set for such a reform?

Perhaps more than any other country, Finland suffers from Russia’s problems. When I walk through the famous, old, and traditional Finnish department store, Stockmann, I hear more people speaking Russian than Swedish, which is the second official language of Finland. I often wonder why these Russians come there since there is a branch of Stockmann in Moscow. I have talked with many Finnish business leaders who all say that they would be very interested in investing in Russian markets if it were not so risky. Something has changed since the Soviet era, when companies could trust they would get their payments on time. Today, Finland's exports to Russia represent 7 percent of all Finnish exports and account for around 3 percent of GDP. That is still far less than the bilateral trade between Finland and the Soviet Union, which was around 20 percent of all foreign trade.[6]

But I believe Finland can survive the crisis in Russia, thanks to a national readiness for the global economy. We Finns realize that the global forces are bigger than we are and that we must adjust and compete in order to succeed. But that wisdom has come at a huge cost—the depression that began in the early 1990s and that has created mass unemployment.

Despite its downside, globalization opens up free trade. In an environment where all countries have to compete for jobs and investments, small and developed countries have to choose a different strategy for globalization. Finland cannot attract straight foreign investments from labor-intensive industries because of our small size and high wages. We have to rely on education, information-related jobs, services, and, of course, our naturally strong industries, forestry and metal. And we have to rely on information technology to boost productivity.

Globalization is a rough business. Workers must be prepared to change, and job security is — well, there is no such thing. The only thing that is permanent is change: these wise words are the slogan of Nokia, Finland's most successful company and our nation's symbol of globalization. A leading manufacturer of cellular phones and systems, Nokia has emerged from the ashes in just a few years to become a leading player in the telecommunications industry. Its success proves that a company doesn't have to be from the United States or some other economic superpower in order to become influential. Innovation, superior education, and, of course, good luck all play a key role.

But is Nokia truly a Finnish company? We think it still is, although in August 1998, 80 percent of Nokia was owned by foreign investors. Nonetheless, the headquarters are in Finland, as well as most of the knowledge-based jobs; Nokia has factories all over the world in low-wage countries, but the most important assets — engineers and other experts—are mostly based in Finland.

Foreign ownership has been a big issue in my country in the last few years, because many Finnish decision-makers have been suspicious about foreign, mainly American, investors, who own approximately 50 percent of the companies listed on the Helsinki Stock Exchange. So far, these foreign investors have been quiet owners, and few of the funds have even registered their stocks so they could vote in the annual meetings. But what happens when the next recession comes? Will they be aggressive, or will they just dump the shares?

At the newspaper where I work, I am responsible for covering information technology and telecommunication industries. As a result, I am keenly aware of the importance and the problems of the Internet in the globalization process. A year ago, I was covering the OECD conference called "*Dismantling Barriers of Global Electronic Commerce*" where there was a strong consensus that the growth of electronic commerce should be controlled by the private sector, although this poses many problems for governments around the world. One difficult problem is taxation. Should governments tax electronic transactions? Are they even capable of doing so? The Clinton administration says they shouldn't. To many, this may sound unbelievable: governments don't want to tax e-commerce, which is supposed to be a $100 billion business! The reason is that they don't want to slow the development of electronic commerce, and also because they don't really have the means to do so.

On the Internet or other networks, money and information can change countries in milliseconds. What about customs and tariffs on goods and services that are ordered from other countries? It seems that the Internet will be the first truly global marketplace of so-called laissez-faire capitalism. But like Russia, the Internet also needs trust in order to succeed. If you want to make a purchase and you send the number of your credit card through the Internet, you want to be sure that the merchant is honest and that nobody steals the information. Internet commerce also raises serious concerns about money laundering and the security of transactions. Like other aspects of globalization, the Internet, too, needs some self-controlling institutions, although in this case, most of the problems can be solved with technology.

Notes

1. Conversation with Paul A. Samuelson, 1 September 1998, Cambridge, Mass.

2. Nicholas D. Kristof and Sheryl WuDunn, "A Lot of Talk about Russia, but the Numbers Shout Japan," *The New York Times* (29 August 1998): A1 and B2.

3. Vladimir Popov, "Internationalization of the Russian Economy: What Went Wrong?" Essay prepared for the Macalester International Roundtable, October 1998.

4. Michael S. Bernstam and Alvin Rabushka, *Fixing Russia's Banks—A Proposal for Growth* (Stanford, Ca.: Hoover Institution Press, 1998).

5. Grigory Yavlinsky, "Russia's Phony Capitalism," *Foreign Affairs* 77, no. 3 (May/June 1998).

6. Unto Hamalainen, "Impact of the Crisis in Russia," article on the website Finnish Politics (September 1998, http://virtual.finland.fi/english/topical/).