Russia's economic reforms are falling prey to confusion, communist counterattack, and neglect from the west.

The reformers, led by the acting prime minister, Mr Yegor Gaidar, have achieved great successes in launching a radical privatisation programme, freeing prices, opening the economy and undertaking fundamental legal reforms. But these achievements are on the verge of being swept aside by hyperinflation. Although data are sketchy, inflation now looks to be around 30 per cent a month and rising. Still worse, the policy responses to this threat have been mostly confused or harmful.

The urgent need is to staunch the haemorrhaging of rouble credits from the Russian Central Bank to enterprises and the budget. But aside from the small number of reformers in the cabinet, few Russian political leaders understand or acknowledge the monetary aspects of the explosive inflation. Many hold that further credits will stimulate production and thereby reduce prices, the same fantasy that once gripped Latin America.

Many politicians and bureaucrats believe that a return to price controls, artificial exchange rates and state orders are the real solution to inflation.

The deep economic problem is the same as it has been for many years. Russia and many of the other new eastern European and former Soviet states are still bankrupting themselves by directing resources - now, via cheap credits - to the oversized military-industrial complex and associated civilian heavy industries. It is mind-boggling, for example, that steel production in the Soviet Union was 80 per cent higher than in the US, even though its economy was less than one-eighth the size. Of course, there is no conceivable reason to produce so much steel but it is viewed as a calamity when the steel factories reduce their output in the face of limited demand.

Much of the political elite in Russia remains mesmerised by heavy industrial capacity, and this clouds understanding of Russia's predicament. Almost no one speaks the simple truth that Russia's capacity in heavy industry was built by starving the society of shops, medical facilities, consumer industries, housing construction and banks. Preserving the old structures not only risks financial catastrophe, but promotes continuing neglect of Russia's real and urgent needs elsewhere in the economy.

Poland's reforms provide some lessons for Russia. With the start of market reforms in 1990, the Polish government maintained macroeconomic discipline in the face of a 35 per cent decline in industrial production (much more than has occurred in Russia). Workers and resources that had been in heavy industry helped build other sectors of the economy, especially services and consumer industries.

As a result, Poland's private sector has grown by 710,000 small businesses and 50,000 corporations since the end of 1989. More than 2m people (about 15 per cent of non-agricultural employment) have joined the private sector, which now accounts for more than half of GDP and which continues to grow rapidly.

Contrary to the fears that were expressed in Poland in 1990, and that paralyse Russia today, Poland's consumers have benefited enormously by the changes. Shortages, queues and hyperinflation are gone. Ownership of consumer goods such as television sets, videos and cars has soared. Economic life is becoming normal.

In Russia, the military-industrial complex has bitterly resisted the decline in production. After a fall in production of around 15 per cent at the start of this year, the military and industrialists demanded, and received, large flows of cheap credits to pay workers and buy inputs to try to maintain production.
widely accepted that the 'industrial recession' must end.

The money supply has approximately doubled since July 1, when the floodgates of credit were opened. The credits allowed the enterprises to produce, but did not generate customers for the output. Inventories have swelled and enterprises have continued to cut their output. More and more, the credits find their way directly into higher wages and into the foreign exchange market, where the value of the rouble has been collapsing.

It is hard to judge how much is power politics and how much is confusion in Russia's disastrous monetary policies. Surely, the lobbying pressures of the industrialists play a role. The main 'centrist' leader, Mr Arkady Volsky, headed industry under former Soviet President Mikhail Gorbachev, and his goal is to preserve the old industrial structures. Many other politicians, such as Mr Anatoly Sobchak, mayor of St Petersburg, defend the military-industrial complex because their constituencies depend heavily on military production. In Ukraine, the head of the largest nuclear missile plant became prime minister this week.

But the role of confusion should not be underestimated.

President Yeltsin stands to lose all by hyperinflation, and yet he is promoting Gorbachev-style 'compromises' with the military-industrial complex which will bring financial disaster. The swirl of advice around Yeltsin is thick with old dogmas: that industrial decline is destroying Russia; that unemployment is too high a social cost (despite an unemployment rate that is less than 1 per cent); and that inflationary subsidies to industry reduce social burdens.

The situation is desperate, but not hopeless. The Russian people generally support the reforms, though their support has been squandered by irresponsible macroeconomic policies. Yeltsin can still reverse his drift back to the hardliners, by recognising the peril of his present course. The west, too, could awaken from its reckless disregard of events in Russia, and weigh in on the side of macroeconomic stabilisation.

At the start of this year, when the reformers had momentum, the west was nowhere to be found. US President George Bush virtually abandoned the international scene altogether, in pursuit of re-election. Japan's role has been even more irresponsible, as it put the return of four tiny islands from Russia above other considerations. And while western Europe did more, its commitment has still been shockingly slight, given the risks of disaster on its own borders.

The International Monetary Fund, sent by the west to co-ordinate its assistance, has had not a single monetary expert in residence in Moscow, and the sporadic IMF visits have just scratched the surface. The Dollars 24bn aid package promised by the west has remained undefined and unfulfilled.

The limited flows coming to Russia, mostly from export credit agencies, have been one or two-year loans that are not linked to reform. Even the debt has not been rescheduled.

There can be no illusions: Russia's transformation to a democratic market-based society will require years of change, including constitutional reforms, new elections, privatisation, and so on. There will be deep frustrations as well as achievements. But the process could soon turn from orderly change to dangerous chaos if there is hyperinflation.

Yeltsin and his reform government still have the chance to steer their country away from the brink of disaster. The west can help them at this pivotal moment. The need for greater financial support, technical assistance and debt relief is clear. The world's leaders, especially the next US president and Russia's neighbours must recognise the urgency of the task.

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