

Russia - The Great Debate on Fiscal Reform

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RUSSIA afforded a unique challenge to both the theory and practise of rent in the late 20th century. Generally speaking, it is widely known that public wealth grows from revenues received from invested capital, human labour and the “labour” of nature. An axiom of economic theory says that taxation, where the main burden is on natural resource rents, is optimal both for sustainable economic growth and the conservation of nature.

The principle of a fair, rational and effective distribution of common wealth, which determines the character of society, always was an issue of prime importance for politicians and economists. Justice is usually connected with the opportunity to eliminate poverty as well as the opportunity to provide everybody with living standards acceptable to civilized society.

The principles of rationality and efficiency are connected with the existence of public finances that provide national security, state guarantees of constitutional rights of citizens and opportunities for private entrepreneurship, and the sustainable growth of aggregate wealth.

A state may choose between the main sources of revenues – taxation of profits, wages or land rent – but the maturity of society is registered when the best tax system is achieved by shifting the revenue base onto the rent of land and natural resources.

THE FIRST STEPS of Russia’s reforms were in the correct direction: among the first laws were “About payments for land” and “About bowels of the earth”, the laws which confirmed public rights to the natural resources of the country. But the reforms which followed, the so-called “Gaidar reforms”, were of pure neo-liberal character. In the sphere of taxation they aimed to copy the conventional tax systems of the West, which were regarded by the reformers as the best. The Tax Code prepared by Gaidar’s successors in the middle of the 1990s reflected that intention to emulate the West’s system of raising public revenue.

The results were so poor that at all levels of society the necessity for tax reform, a need to reduce the tax burden, became obvious. If we follow the declaration about intentions of Russian authorities (at least during the last five years) the necessity for a tax shift onto rental payments in use of natural resources became self evident for them.

For example, in the Programme of Russian Government “Reforms and the development of Russian Economy in 1995-1997” (which was approved by the Government, No.439 from April, 28, 1995), the need to

“reduce the tax burden and simplify the tax system” was a priority objective (Clause 3.2), as well as “the gradual shift onto a system with increased role of taxes related to payments for a use of natural resources potential (cl. 7.9). The Government pledged to “increase the role of rental payments in the process of fair allocation of economic results in the use of nature between budgets of different levels” (cl.8.3). It was explained in the Programme that the objective was among priorities because “taxable potential is allocated extremely unevenly”, a fact that resulted in “objective complications in implementation of uniform normative estimated methods of regulation of relations between different levels of Russian budget system” (cl.8.2.). All those statements could be regarded as attempts to deal with the budget potential of Russia's regions and republics and norms of social expenditures using more objective criteria (natural resources potential, climatic conditions, etc.).

The proposal to substantially increase the role of rental payments for natural resources in public finance was supported in the course of discussions in the State Duma.* For example, in October, 24, 2000 a round table discussion “Rental payments in the use of nature” took place. All participants confirmed the important role of rent in public finances and supported the proposal that reform of Russia's tax system should be based on a gradual and consistent shift onto “resource taxes” on the use of under-surface resources and nature in general.

The public position of President Vladimir Putin about the role and importance of rent in public finance is very similar to the one of the Russian Government and the State Duma. He confirmed this in an article entitled “Mineral Resources in a Strategy of Development of Russian Economy”. President Putin emphasized that “reduction of a number of taxes and a shift onto mainly rental payments” were among the priorities in state policy. Furthermore, he was sure that the state had the right to regulate the process of using resources in the interests of the whole society regardless of the prevailing system of property rights.¹

The revenue raised from rental payments for the use of natural resources in the budgets of different tiers of government were substantial during the last eight years. The payments did not contribute to abolition of the burden of other taxes, which are destructive from the

* See recommendations of the Parliamentary Hearings “Land Relations and Assessment of Natural resources of Russia” (19.01.99) and conclusions of the “round table” discussion “Natural Resources in the system of Public Finance of Russia” (4.11.99) in the State Duma.

point of view of incentives for investment in the production of goods and services. The Russian state officially acknowledged the tremendous scale of the black economy in the market of raw materials. In other words, the system of rental taxation was not an obstacle to those who stole national wealth, which confirms that the implementation of rental payments during the 1990s was not executed to fulfil people's expectations. We may ask why this happened, if the opinions of scholars of authority converged with the reasonable intentions of the Government.

There are many reasons, but they may all be subdivided into three main groups: conceptual, organizational and informational and analytical. At the same time there was one more serious obstacle in the transition towards rent-orientated taxation which overshadows these three reasons: the existence of a powerful lobby of resource speculators and money makers from the black economy who made their fortunes out of privatized rent.

CONCEPTUAL difficulties result from the methodological and terminological complexity of the problem, which have penetrated the laws.

In Russia the main owner of natural resources remains the state. It, obviously, has the right to charge for the use of common resources according to market rates. Doing so would not interfere with the profits of enterprises.

Competing opinions may exist in scientific discussions, but it is not good when conceptual-methodological and terminological complexity penetrates the laws. Here is a recent example.

In September 2000 Russia's regions were sent a draft of the Federal law "About Rental Payments in Use of Nature", which was proposed by the legislators of Irkutsk. This is a law which had been long expected. The need to develop the draft was recommended on at least two occasions during Parliamentary Hearings in the State Duma. The original draft was not supported by regional governments, but it is very important to pay special attention to it because it expressed the terminological complexity of the problem and it retained old fashioned views on rent.

The most important mischief of the draft law was that the authors proposed to collect rent out of the profits of enterprises. But rent is not correlated with profits. It is a surplus representing the difference between market price and the cost of production.

In addition, the draft proposed that rental payments were to be

introduced and collected in addition to other taxes, e.g. VAT, profits tax, taxes on labour, etc. But we know that when rent is charged instead of taxes on labour and capital, incentives emerge for new investment in production, and leads to the creation of jobs. The taxation of profits, presented as the collection of rent, would deny Russia all the benefits it could receive as a state rich in natural resources and in cheap labour. In other words, the draft law is a way to create a twisted economy in which taxes would not fall on natural resources. Russia will never manage to stabilize her economy if such distortions are preserved.

The draft law, similar to many other natural resource laws currently in force, proposes to assign to the regions rigid proportions of revenue to be collected from resources. For example, 40:60, or 10:30:60. But such an approach contradicts the essence of rent. We should remember that under the planned economy, rent in the primary industries was extracted with the help of purchasing prices for raw materials. These were differentiated according to the regions, seasons and objects of mining as well as with the help of direct financial channels which differentiated charges for values of realized raw materials. For example, there were 18 price zones for grain, 25 regional price lists for fresh water fishing, etc. This confirms the high differentiation of collected rental charges. The proposed draft laws in the post-Soviet era turn out to be hybrids based on Marxist and market theories and personal points of view.

Organizational difficulties arise from the low qualifications of civil servants in financial and economic government departments. They are supposed to implement the rental idea. A draft of the Tax Code confirms that statement. As for the Ministry of Natural Resources, which traditionally understands the problem of payments for natural resources better than others, problems have arisen because of changes in its responsibilities and the reassignment of personnel.

The ideology of rental taxation needs to incorporate territorial principles. By territorial, I mean the need to take into account the natural resource potential and revenues per head of population. Gross rental revenue from the use of natural resources needs to be a basic indicator for constructing inter-budget relations and financial transfers. The lack of a clear mechanism for equalizing this revenue across the regions, according to their natural resource base, fosters the social tensions that could lead to the destruction of Russia as a single economic and legal space. Ideas of separatism are nourished, in the wake of competing claims between resource "poor" and "rich" regions, which provokes budget conflicts between them. One result is the creation of the absolute

power of “natural monopolies”, the growth of speculation and corruption in the economy.

Informational gaps and poor enforcement of laws are due to the fact that the existing informational data bases, which were essential to develop starting rates of payments for the use of natural resources, were destroyed in the course of the reforms. The situation, of course, favoured the rent-seekers. Some of them (e.g. oil extracting companies) declare that there is no such thing as oil rents. It is very difficult to persuade the population that land could make a serious contribution to the budgets of their cities, because tax collection is extremely inefficient. And that is not surprising, because in many cities tax exemptions are granted for the majority of land users.

THE SITUATION is not as hopeless as the foregoing analysis suggests. Among the signs that offer some hope is the fact that more and more people are becoming aware of the rent thesis, and they are beginning to understand the importance of providing the state budget in general with a sound source of public revenue. The intention of Vladimir Putin to analyze the laws that have been enacted since the beginning of reforms, and his repeated intention to make changes in taxation in the direction of a shift onto taxation of natural resources, should be regarded as very positive.

The laws that passed during the first years of Putin’s presidency were intended to reduce the tax burden on labour (there has been a considerable reduction of income tax on people since 2001, and a slight reduction of payroll taxation since 2002). There has been a similar reduction of the burden on capital (with a reduction of profits tax rates by almost 10% since 2002). These are definitely positive steps, but their impact on the economy would be more significant if they were phased in with a simultaneous increase of rent-based charges.

Tax reformers now need to emphasise the need to implement a process of mass appraisal of land and other natural resources (including urban and rural lands, forests, etc.). The education role is also vital. To elevate rent-based taxation into a dominant theme of political discourse requires a clear understanding of the issues as they relate to public finance. Fortunately, it appears the President has this depth of understanding. I believe this fiscal reform would be supported by the people of Russia, a support that would permit the country to overcome the strong resistance from those who became very rich by securing for themselves the private access to the flow of rental income.