

RUSSIA: after the cold war - how to win the peace!

From the ashes of communism could spring the first rent-as-public-revenue society. But the Russians don't yet realise what a potent tool is about to fall into their hands, writes FRED HARRISON

THE PEOPLE appear stunned, traumatised by the loss of faith, still needing someone to give them commands, the few live-wires trying to wheel-and-deal in a commercial vacuum.

In just 70 years, the Russian people have suffered a civil war (Stalinised by their own leaders), a world war (terrorised by the Nazis) and the Cold War (materially drained by the fight against a spectre).

For 70 years there was no fun, no Carnaby Street colour, no period of joyful abandon, no relief from heavy-handed pressure, so now the trauma will be protracted; and then there will be the post-traumatic stress, before they recover composure and creativity.

For 70 years, social relationships were ruptured and remoulded into the vision of a Brave New World that offended biology and psychology, a vision doomed to fail when they could take no more.

A collective therapy is needed, and I perceive it in the Russian love of their land. They are relearning how to characterise land in the most loving terms, and relating that love to the need to restore human relationships.

"Land is feminine, soil ploughing is an act of love; tilling the land is love," wrote Georgi Gachev. "How to plough and cultivate the Russian land, how to treat it and live with it is tantamount to how a Russian man should love a Russian woman, how he should treat her and live with her."

THEY WERE NOT tender with

the land, these last 70 years. Taught to believe that nature had no value - that all value came from labour - the Politburo gang-banged the land to death. Today, the rivers are chemical sewers, almost a sixth of the country is unfit for human habitation, only 15% of the air that city dwellers breathe is pollution-free, over 20% of drinking water does not achieve Russia's (lax) standards.²

And yet, awakening in the people is an awareness that, if Russia is to recover, something special needs to be done about the land. President Yeltsin's decree that land should be privatised has caused offence; the bureaucratic inertia to his law is tantamount to civil disobedience which, in normal times, would be treated as a declaration of war on the federal government.

It is as if the administrators and politicians in the cities of Russia are grasping at an idea, barely expressed, that western nostrums about land rights just won't meet their needs.

How Russia finally resolves her relationship with the land will define the wholesomeness of her society. But what should she do? Are there any historical models to guide her decisions? The devastation in Russia is equal to the scale of damage in defeated Germany and Japan, whose economies were rebuilt in 10 years. But today there is no Marshall Plan, no General MacArthur, to wrench Russia out of the depths. She will have to rely almost entirely on her own inner strengths. But there is hope, if we compare Russia today with Japan in 1870.

by Fred Harrison



WHEN Commodore Perry's American gunboat dropped anchor and threatened a feudal society, the Japanese knew they had no choice but to industrialise. If they were to retain their independence, and not be pushed into the depths of what we today call Third World status, they had to transform their agrarian economy. And they had to do so without foreign aid. How that miracle was performed, between 1870 and 1890, ought to inspire the Russians.

The emperor Meiji and his advisers chose land-rent as the revenue to finance the public expenditures to support the transformation of their society. At one point, over 70% of public expenditure was financed out of land-rents. Taxes on wages and profits were so insignificant, they did not distort the creative efforts of labour and capital.

Alas, the landlords captured the Diet (parliament) in 1890, with the proclaimed aim of shifting the tax burden offrent. That's when the slide began, but the land-value tax had done its job: the institutions and industrial relations that were to transform Japan into a world economic power were established in 20 short formative years.

Russia, although she may not know it, is on the verge of repeating that success today.

SERGEI SAY is deputy head of the land reform committee in St. Petersburg. His committee is a federal agency; there are 600 of them, scattered around Russia, all of them struggling to make sense of how to

use land in a free society.

When he took up his job, he sought to formulate an approach on the basis of what he called "a Russian mechanism". But before Russia can define that mechanism, her technocrats need to understand what they are dealing with. The process of registering people's claims to land has barely begun, but of one thing Mr Say was sure: today, in Russia, no person or organisation has legal title to land. All they can claim is the right to occupy the land. The land, in fact, belongs to the State.

President Yeltsin created a challenging problem when he signed a decree ordering that people should pay a tax on land. The municipalities had no idea what land was worth, so the land reform committees prepared crude zoning maps based on the existing use of land, and distributed the tax accordingly.

"Everybody used land in an inefficient way, because it was 'free,'" said Mr Say.

"That's why many industrial enterprises don't use it properly, and there was a lot of wasteland. There's a lot of vacant land, used badly, according to satellite photographs. Enterprises had the majority of the land, and don't pay for it, and were not interested in rational land use."

"That's why the first step is to identify everyone who has land plots. The land-tax also has to be collected, for this one year, to show them that land is valuable and they have to pay."

Yeltsin's land-tax applies for just one year. Thereafter, as far as the cities are concerned, the users of land have to pay a rent to the owners of that land - the federal and the municipal governments. Existing users will not necessarily be dispossessed of their sites; but they have to enter into leasing agreements, under which they would pay rent for the land.

Right now, no-one knows what

the land is worth; which is not surprising, because rent was never measured before, and today there is barely a wealth-producing economy capable of generating surplus income (rent). But that is going to change: the economy will take off. And if Russia's Parliament refuses to alienate the freehold rights to land to existing holders, the nation will find itself enriched beyond imagination by the flow of rent into the public coffers.

The federal government currently relies on traditional western forms of wealth-destroying taxes (see

those two ingredients that Russia needs most: private enterprise and capital formation. Premier Yegor Gaidar has already had to give assurances on tax reforms to the managers of the big state-owned enterprises. At an emergency meeting with their "centrist" parliamentarians, last month, he announced concessions which move him in the correct direction. From January, profits ploughed back into capital investment will be free from tax.

But such concessions will not be enough if Gaidar's administration is to survive. People are beginning to

support some unholy alliances as an expression of their frustration. One of these is a coalition of the extreme right and left: a meeting of nationalists and communists on October 25 was held beneath the crossed banners of the Soviet Union and the Tsarist government!

There has been a catastrophic collapse of production, hyper-inflation and a drop in living standards for 80%

RUSSIAN FEDERATION BUDGET REVENUES

1st quarter 1992

	Billion	%
	roubles	
VAT	140.8	28.2
Profit tax	67.0	13.4
Excise duties	19.3	3.9
Income tax	19.2	3.8
Taxes on natural resources	0.8	0.2
Revenue earned from activities abroad	228.0	45.6
Other income	24.3	4.9
	499.4	100.0

Source: G. Kipermann and A. Belyalov, *Taxation of Companies and Citizens in the Russian Federation*, Moscow, 1992.

table) - such as a 28% VAT. It would be easy to condemn that tax structure, but we have to realise that the transformation of the command economy has to be financed. In the transitional void, the expenses of government have to be covered. There is no land market; no payment of rent for holding land. So where else does the government raise its revenue? See the table.

But force of circumstances is leading, even now, to the creation of a land market. State enterprises are sub-letting property and pocketing the money - in other words, they are privately appropriating land-rent which is not only a socially-created income, but also happens to be the legal income of the state! However, as the system settles down there will be no excuse for this to continue.

And nor will there be any excuse to continue to levy taxes that suppress

of the population. Discontent is easy to ferment, so Yeltsin's federal government will have to bolster the market reforms with the announcement of a rational, easily-understood programme of reinforcing measures. There is one solution only at his disposal. He will have to banish the deterrent taxes, but in favour of what? Well - if land is retained in public ownership - it will discover that there will be no need for ANY taxes, for rental revenue will smoothly offset the reduction of VAT, excise duties and the rest of the plunder on private incomes which is inflicted on wealth-producers and consumers everywhere else.

Supplemented by user charges, federal and local governments will wake up one day to discover that the simple act of recovering rental income is sufficient to meet all public expenses!



The Estonian real estate newspaper used by speculators to promote their properties

Already, 40% of federal revenue is rental income: the "revenue earned from activities abroad" is mainly the extraction of rent from the export of natural resources such as petroleum and diamonds. All that Russia's economic policy-makers need to understand is that - like Japan (1870-90) - financing public expenditure out of rent leads to the swiftest reconstruction of the economy.

But that strategy also has another major implication. Unearned income would not fall into private hands - an income which, when capitalised, is traded in the western economies, and becomes the primary source of instability (ask financiers why so many banks have gone bust, or are technically bankrupt. Answer: rotten loans to land speculators!). By treating rent as its principal source of public revenue, Russia would be creating a truly "Russian mechanism": a moral market economy, the likes of which we have not seen in modern history.

PRIVATISATION is now under way. In St. Petersburg, Anatoli Peibo - reassuringly impressive in beard and herringbone suit - presides over the process in St. Petersburg, where he

is Deputy General Director of the city council's Fund of Property. His job is to identify enterprises ripe for hiving off, and prepare the legal documentation for the Property Foundation which stages the auctions. Thus are enterprises placed in the hands of citizens. The new entrepreneurs bid sums for leases to the land (lease periods are not more than 50 years), and they also agree to pay an annual rent for occupying the sites, which can be revised every five years. This provision is even superior to the arrangements in Hong Kong, where all land is leased from the Crown.

What did Mr. Peibo think of the President's decree on land ownership? He offered me the St. Petersburg interpretation: "Though they declare the opportunity to sell land in the federal law, we think it is not effective and sensible to sell land in St. Petersburg. In St. Petersburg, the sale of land is not allowed yet."

The Russians are still trying to define the legal status of land, a process that will take some time. As Mr Peibo pointed out: "It took western countries many years to work out their legal base, and we are just starting it."

RUSSIAN RENT

IN SEPTEMBER, President Yeltsin signed a decree that gave a small town an hour's drive from Moscow the right to sell the freehold of its land. This was passed off as an experiment, but political observers treated the decree as a provocative act aimed at challenging parliament to pass a law on land ownership.

That law, which will seal Russia's fate, will be passed next year. There is, then, the great prospect that Russia will retain land in public ownership, and lease it to users. This lease/rent approach reflects the practice in Hong Kong, that most successful of capitalist economies where not one acre of land is held freehold.

In other words, Russia retains the option of adopting the fiscal strategy recommended by the Physiocrats and Henry George - defraying the costs of the community out of the rent of land. That option, unfortunately, is no longer possible for the East European and Baltic countries: they have rushed to restore the right of free-hold ownership of land, thereby denying future generations an equal share in the value of the resources of nature.

In Estonia, December 31 is the government's deadline for the assessment of the value of the whole country. The assessment process has already begun, helped to an extent by the black market in land values (which are being traded, even though the law does not yet permit the private ownership of land).

Henn Helmut, head of the land management department at the Estonian Agricultural University, reports that the tax on land values will be very low, but there are provisions to try and deter people from speculating in land.

But as we all know, once there is private appropriation of land-rent, laws do not deter (they merely aggravate) the business of speculation; in doing so, however, they further distort an already destabilised economy.

Real estate agencies have sprung up all over Estonia, to help the owners of buildings cash-in on the new property market. Technically, they cannot

sell the land, but property owners are not mugs. As Mr. Helmut noted: "Selling land is banned, and you can only sell buildings. But if we sell the building the price includes the price of the land!"

He cited the example of the sale of two identical buildings: the inner city building achieved a price three times as great as the similar one on the city's fringe! That is the lesson that Russia has to learn: ultimately, the letter of the law does not matter one iota, if the community fails to recover the full market rent for land for the public's benefit.

Initially, rents will be underestimated. Such mistakes won't matter, if Russia retains the legal right to correct them at an early opportunity. An immediate task is to get the land and buildings into the hands of users, to kick-start the economy, while reserving the legal right of the community to revise the rent charges in line with economic growth.

If the Russians handle that challenge correctly, they will develop something that is not available in any other country: a smoothly operating land market. Such a market can exist only if it is free of the rent-appropriators, who are the biggest drag on the wealth-creators in the other market economies. It also guarantees every citizen a direct stake in the riches of nature through the social expenditure of rent.

This is a prospect of what has been characterised as a Single Tax society envisaged by American social reformer Henry George which every trading country in the world should fear. For it would give Russia an enormous price advantage on the export markets (rents, unlike taxes, are not reflected in the prices of goods and services). Having lost the Cold War, Russia would be on the path to winning the peace.

REFERENCES

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- 2 David Hearst, "Portrait revealed of a Russia that is killing itself," *The Guardian*, London, Oct. 8, 1992.
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CARNIVALS OF DESTRUCTION

The Culture of Contentment,
J.K. Galbraith,
New York: Houghton Mifflin.

THIS ESSAY is Professor Galbraith's attempt to jolt the American middle class, and economics profession, out of its complacency. His analysis is particularly, though not peculiarly, about America; similar trends are to be seen in Britain and elsewhere. (Galbraith claims to explain the unanticipated victory of the Conservative party, led by John Major, in the recent general election.)

Galbraith's thesis is simple. America is gripped by a contented electoral majority, who will tend to vote against any major encroachment on the politico-economic system that supports their comfortable way of life. Thus has America reached the position dreaded by political philosophers for centuries (in America by Tocqueville and Thoreau) - the tyranny of the majority. This is not what they hoped for from democracy, but it is perhaps inevitable, as Henry George foresaw, when democracy is grafted on to a politico-economic system that promotes and perpetuates great inequalities of wealth.

This is a society which pleads the social philosophy of utilitarianism in defence of the present politico-economic system. When first advanced by Bentham, and Mill, utilitarianism sought to satisfy the needs and aspirations of the many poor at the expense of the few rich. Now utilitarianism has been turned on its head, and the many who are comparatively rich are further enriched at the expense of the minority who are poor. Moral populism has descended upon us, and we are corrupted into thinking that the test of morality is endorsement by a popular majority. Thus has the contented electoral majority become in its own eyes the moral majority. Such is the bankruptcy, moral, political and now economic, into which America has sunk.

Galbraith's essay is not a philosophical or historical work. It is more of a report "from the front", and a guarded prediction for the future. In less than two hundred pages, it paints a broad panorama of the political economy of America in the aftermath of the 1980s. When the dust has finally settled, it could prove one of the most timely and important books of the 1990s.

This culture of contentment is not opposed to government interference in the economy. Far from it. It endorses big government, seeking subsidies for its members, from agriculture to defence. It seeks tax cuts for the rich, on the basis that more money will encourage them to produce more, while seeking cuts in benefits for the poor, on the basis that more money will only encourage them to live off the state. It seeks greater and more costly regulation of industries, to strengthen their position against potential competitors (domestic or foreign). It has privatised gain and socialised loss, for example through deregulation of the banking and finance industries but with the retention of federal deposit insurance; their speculative activities, therefore, result in profits to them and losses borne by the federal government (i.e. the American tax-paying public). It encourages the government to fund its expenditures not by taxing the rich but by rewarding the rich with interest on a national debt of awesome proportions.

And the consequences? The most immediate and important is the creation of a functional underclass, different from past lower classes in one important respect: there is now little prospect of escape from the ghetto. First generation immigrants may be content with their lot as an improvement on conditions in the societies from which they have escaped; but second and third generations seek a better life and become restive when they see no way of attaining it, other than through crime - from drug dealing to racketeering to simple fraud.

It is a bleak message. Galbraith was heralded as a prophet when the riots in Los Angeles erupted, only weeks after the publication of this seminal essay.

But how much greater was the prophet of San Francisco more than a century ago. Henry George could have had no advance warning of what was to come in the 20th century other than what he could read in the troubles of his own time. In 1879 he foretold of a century of unparalleled bloodshed and social disintegration: