by FRED HARRISON

NOVGOROD PLAN CHALLENGE TO YELTSIN

BORIS YELTSIN finally got his way; or rather, the International Monetary Fund did, as he gave the order to shell his erstwhile colleagues in Parliament.

The West had made its money conditional on "financial austerity". President Yeltsin was in no position to argue: the IMF, and the rich nations that wanted to send aid, held back the cash until the Kremlin implemented a programme to their liking. Yeltsin, with $80bn owed to the West, could not argue.

The reactionary extremists among the Deputies were in the minority. Opposition was not based on a refusal to accept the need for a market economy. Ruslan Khasbulatov, who stood shoulder-to-shoulder with Yeltsin in defence of Parliament when the Communists tried their coup in August 1991, is, if anything, even more pro-market than the President.*

Most of the Deputies knew that, though change must come, it needed to be implemented humanely. Unlike the President, however, they were not going to be manipulated by the West. So the seeds were sown for a political tussle over power that ended with Boris Yeltsin's decision to flout the law and call in the tanks.

What now?

THE WEST is impatient, and wants the Yeltsin administration to forge ahead with the prescribed "shock therapy".

By closing opposition newspapers and terminating the Constitutional Court, Yeltsin has not created the conditions for honest exploration of alternative strategies. Much now depends on the elected councilmen in the cities, who were largely opposed to Yeltsin's unconstitutional action.

Most of them are not "hardliners" opposed to reform. On the contrary, they are enthusiastically searching for solutions to the problems of balancing their budgets and maintaining employment. They have learnt that the Yeltsin strategy could create unemployment of 20% in some regions.

They believe, however, that a reform strategy is available that does not rely on the blunt financial instruments of the IMF.

The administrative cities of Russia are investigating a new model of public finance which would accelerate reindustrialisation. At the heart of that strategy is a new approach to public finance.

While accepting the need for privatisation of capital, this new plan emphasises that the rent of land should be the backbone of public revenue. As revenue was raised from rent, so taxes could be abolished. But how is that new system to be put into place?

The Union of Russian Cities had established a committee in Parliament that was drafting legislation. That approach collapsed with the shells from Yeltsin's tanks. But some cities had already decided not to rely on initiatives from Moscow. They decided that, even within the existing law, they could begin to implement the revenue-raising switch. Leading that strategy is the city of Novgorod.

NOVGOROD (population: 240,000) was the first capital of Russia. Its political and religious traditions extend back a thousand years. President Yeltsin, in a TV broadcast earlier this year, referred to the democratic traditions symbolised by the city.

Both the council and administration want to cut taxes and make up the shortfall in revenue from land-rents. They invited the London-based Centre for Incentive Taxation to assist in preparing the groundwork.

Novgorod's leaders knew that, under the law, they could cut taxes by the amount of revenue that was spent locally, and raise the lost revenue by other means. The whole of the revenue from income tax is retained by the city: so the council could abolish that tax completely!

Just 5% of the profits tax is spent by the council: this would not make a large impact on investment. However, 45% of revenue from the profits tax is spent by the oblast (region): so Novgorod hopes that, if the region will participate, they could slash the profits tax in half.

In September, two of CIT's consultants from South Africa - land economist Godfrey Dunkley and property assessor Peter Meakin - flew to Novgorod. Their reports emphasise the importance of helping industry as the first step in the graduated introduction of the new fiscal system.

TO IMPLEMENT the Novgorod plan, a free market in land must be created; that market, however, need not slavishly emulate the western model.

But Yeltsin's Western advisers believe that the imperative step is to establish a market based on western principles of property rights. Refinements to the western system, they presumably believe, can follow once the communist regime has been destroyed. This attitude ignores history, which tells us that once a system has been put in place, it is very hard to change.

But instead of initiating a radical debate, the West has favoured an orthodox approach to property rights - arguing, for example, that land has to be privately "owned" so that deeds

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* Ruslan Khasbulatov, *The Struggle for Russia: Power & Change in the Democratic Revolution,* London: Routledge, 1993.

HYPOCRICY

and World Trade

by Peter Poole

THE WEST has been mean towards Russia over financial aid, but even more serious has been the reluctance to open up the markets to Russian goods. Free trade for Russia would do far more to facilitate the switch to a market economy than the infusion of dollars that add to inflation.

But there's the rub: Europe, in particular, is keen not to underwrite reindustrialisation of Russia at the expense of her own industries. Which is why the EEC is dragging its heels over President Boris Yeltsin's demand for greater access to Europe's consumers.

This contradiction in global policyreflects a general hypocricy towards free trade.

Bringing down the trade barriers would make the world richer. The World Bank estimates that the loss of income due to existing protectionist measures is mind-boggling - about $477 bn. by the year 2,002, which is the additional value that would be generated if all distortions associated with protectionism (subsidies and tariffs) were removed.

So the prize of truly free trade is a great one. Yet the world's trading nations may still not be able to conclude a General Agreement on Tariffs and Trade deal by Dec.15.

A new study by the World Bank and OECD calculates the benefits if there was just a 30% removal of tariffs and subsidies. In agriculture alone, the gains for OECD countries would be $120 bn; for the developing and former Soviet countries, the gains would be $70 bn. For manufactured goods, the total gains would be $23 bn.

These numbers reflect the enormous constraint on the freedom of people around the world to produce as much wealth as they would like. The World Bank has not produced an estimate of the millions of jobs that would be available, if people were free to trade as they will.

THE POORER countries of the Third World would have the most to lose from free trade. Yet they have made constructive contributions to the Uruguay Round of talks, even though their farmers would be at a further disadvantage, when confronted by the power of the food exporting economies of Europe and North America.

France in particular is not satisfied. She threatens to block the GATT agreement unless her subsidised farm goods are offered even greater protection. The US government has refused to be intimidated, and so the future of GATT hangs in the balance.

If the GATT deal is not struck, it would not be "business as usual". The global implications are alarming.

• According to the world's three most powerful monetary officials - the heads of the IMF, the World Bank and GATT - the failure would fuel a "rising wave of protectionism". One result, they warn, would be to jeopardise the efforts of East European countries to shift towards democracy.

• Political unity of the EEC is also likely to be jeopardised. France threatened that if she did not secure a better deal for her rent-seeking farmers, she would exercise a veto to block future European activity. Britain retaliated by warning that she would do exactly the same if France succeeds!

• The world financial system would also be at risk, for the Third World debt continues to pose serious problems. How are debtor countries supposed to pay, if they cannot expand their exports on the world markets?

If France proves that it pays to be bloody minded, the United States is likely to fall prey to the protectionists.

The winner would be billionaire Ross Perot, the would-be president who is twisting statistics to argue against freer trade between the US/Mexico/Canada. The US economy already suffers from severe distortions to trade:

• Since Bill Clinton took office, the US has imposed new textile import quotas on more than 15 nations;

• This year, US taxpayers will hand over $2 bn as federal subsidises to wheat producers this year.

A GATT failure would lead to mutual trade recriminations in which everyone loses. Except, of course, the owners of French farmland.

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can be handed over to banks by entrepreneurs who want to borrow money. This betrays a serious misunderstanding of the fundamental influence exercised by the tax system on people's lives. It is too important to be treated as an afterthought. For sensible answers cannot be given to these kinds of issues, until the system of public revenue has first been defined:

• In which localities should the entrepreneur invest? And in what kinds of enterprises? How should the most valuable sites in a town be used? Incentives that encourage risk-taking and innovation cannot be designed without first identifying the principles on which the revenue-raising system is to be founded.

• The economics ministry in Moscow says that Russia needs $30-50bn a year in foreign investment until the end of the century, to help revive the economy: will the tax system encourage foreigners to take risks in Russia?

• Should Russians work for wages, or does taxation encourage entrepreneurial activity? Should people create wealth, or would they make more money as speculators?

• How can a society redefine its relationship with its natural habitat (as Russia needs to do) without first taking taxation into account?

Boris Fyodorov, the deputy prime minister of finance, is now working on a tax plan to devolve taxation powers to the regions and republics. President Yeltsin hopes to use the public revenue route to satisfy the need for local autonomy. The cities now have their own plan to put to the president. The political realities might yet save the day for Russia.