

Plundering Russia's Natural Wealth

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RUSSIA IS at the crossroads, with a future that could lead to abundant prosperity for all its citizens or to abject poverty for the majority if its political leaders choose to follow the wrong signposts.

There is a tragic irony about the present situation, because Russia's policy-makers are being pushed to continue with a counterproductive economic paradigm just at the point where it has come under severe challenge from eminent economists in the West. We therefore believe that Russia's own economists should be encouraged to take a hard look at the options which are realistically available to the country before the next President and the new Duma decide whether to further commit Russia to the present unfortunate path.

The record of the past 10 years is now clear to everyone. The production of new wealth by industry has collapsed by 50%. There has been almost no worthwhile investment in the capital infrastructure in either the private or public sectors. The large majority of people are forced to cling by their fingertips to a bare existence, and federal and regional government budgets have sunk to shamefully low levels that would not be tolerated by the most conservative politicians in Europe or North America who preach the gospel of lower taxes.

This has come about because the Yeltsin government and its Western advisors did not have a coherent strategy to implement in 1992. Market economists who are puzzled at the failure of the policies that they recommended for adoption in a post-Soviet society have barely begun their inquest into that turning point in Russia's destiny.

The tragedy that befell Russia stemmed from the rush to construct market relations to replace the command economy. The market was presented as an icon that would enable the people of Russia to raise their material welfare to levels enjoyed in the West. But this was not a well-developed strategy for transforming Russia. The economy is one segment only of society, and you cannot isolate it from the other parts and alter it without affecting the rest of society.

The simplistic policies of privatization and eliminating governmental controls that were spoon fed to the "young reformers" from St. Petersburg did not take into account the full range of social and spiritual needs of the population. The reformers ought to have carefully examined their proposals in the context of Russian history and social psychology. Had they done so, they would have realized that many aspects of the old regime that economists label

“inefficient” served to guarantee people that their basic emotional and material needs will be met, and that any plan that would truly serve the people who were supposed to benefit from Western advice would incorporate ways of addressing these needs.

Instead, recommendations were based on the presumption that the Western model of a secular, capitalist society would fulfil all their needs. The collapse in moral life, to which Vladimir Putin has drawn attention, is one index of the failure to offer people a prospect of a decent life that would elevate everyone’s living standards. And the collapse in the health and life expectancy of the population, especially men reaching the age when they should be looking forward to the enjoyment of some years in retirement, is a deadly warning that the time has come to abandon the crude ideas that devastated Russia’s economy in the 1990s.

FOREIGN CONSULTANTS have no right to push people to adopt social models that neglect their needs. It is fair to say that the European and US “experts” who were busy in Moscow during the formative years of what has become an economy driven by kleptocracy were arrogant in their belief in the superiority of their theories.

At the same time, however, a nation that wishes to reject a former way of life has an obligation to identify the kind of society it wishes to become. But the Russian people were denied the time and opportunity to discover for themselves what kind of future they wanted. The main responsibility for this has to be placed on the shoulders of the leaders who held power at the time.

The people were left with one simple choice: to try to stuff their culture into a Western model. Was this what Russians really wanted? This is a difficult question, which will preoccupy historians for many years. In the meantime life must go on, and some decisions must be made. In our view, it is important to limit those decisions to ones that will not deny the population the freedom to exercise their choices once they have had the opportunity to make up their own minds.

The priority is to listen to the wishes of the people themselves. But this does not mean that Russia should ignore the expert testimony of well-informed experts from the West. The problem is to decide which advice to take. We suggest that one reliable source of information would be Joseph Stiglitz, who resigned from the World Bank last November after publishing a series of critiques against the set of monetarist policies known as “the Washington Consensus”. Dr. Stiglitz was criticised for speaking frankly about the errors in the policies that were being urged on Russia.

Stiglitz became unpopular because he had the courage to examine the consequences of those policies, and to draw the rational conclusions. He published the view that the time had come to change the direction of reforms in Russia. For example, in a major article published in *The Economic Journal* (November 1999), one of the most prestigious academic publications in the world, he compared the reform programmes of China and Russia. He noted: “the contrast between the experiences of China and Russia has raised

questions about the reform strategy emphasising privatisation over competition: China focused on competition, and saw its per capita GDP increase almost eight-fold in two decades; Russia ignored competition policy, and, even after privatizations and other reforms that were supposed to improve efficiency, saw its output decline markedly”.

This was the last analysis to be published by Dr. Stiglitz before he was forced to leave the World Bank. But he did note in this article that the Bank had changed its views on development strategies, in order to embrace broader objectives for societies that sought its help. These other goals include sustainable development. This is a more sensitive approach to the previous attitude, which was the “belief that solving certain technical problems to achieve a more efficient allocation of resources was the key to successful development”.

Dr. Stiglitz frankly agrees that the so-called market reforms that were favoured in the last few years often failed to establish the institutional framework that is necessary to make markets work. In Russia, unfortunately, the Yeltsin years were characterised by the rush to privatise property rather than developing the institutions that are necessary in competitive markets.

Dr. Stiglitz is not alone in concluding that a major shift in economic thinking is necessary to meet the challenges of the 21st century. In Europe, for example, the most progressive advice of the research institutes employed by the European Commission emphasizes the need to shift the structure of taxation away from penalties on people’s earned incomes from their work and saving. Instead, advisors to the European Union explain why public revenue should be raised from the rental income of land and natural resources. The benefits of this new policy are to create more jobs and a fairer distribution of income, improve economic efficiency and protect the natural environment. This progressive thinking is based on the best scientific evidence on which reforms will be most efficient at fulfilling the needs of European societies.

In the light of these important shifts in thinking, which are likely to shape new government strategies in countries like Britain, we have to ask this difficult question: should Russia’s political leaders continue to champion the policies of the past 10 years just when they are being increasingly discredited in the West?

WE BELIEVE it is fair to say that the people of Russia have been bullied into accepting the policies that have been unsuccessful in the last 10 years. But the deconstruction of the industrial base and civil society was not an unprofitable experience for some people. In the main, these were the few who saw the opportunity to exploit an unstable period by extracting the natural riches and safely depositing the profits overseas.

Economists at the Russian Academy of Sciences have shown that this capital flight was based exclusively on the rental revenue extracted from the land of Russia. That rental revenue ought to have been continuously reinvested in Russia, to renew the fabric of society and buy time for the people to re-

adjust to what could be a rewarding and exciting existence in the market approach to -increasing the nation's wealth. There need be no conflict between competitive markets and the moral society driven by the principles of mutual respect and co-operation.

The economic basis for such a reform was proposed to Mikhail Gorbachev in the last year of his Presidency of the USSR. Two of us signed an open letter that described how the socialisation of rent could be balanced with the privatisation of people's earned incomes to produce a unique economic template. This would have allowed complete freedom for the people of Russia to choose the kind of society that they then wanted to build for themselves. Three of the economists who signed the document giving this advice to Mr. Gorbachev were distinguished winners of Nobel prizes (Franco Modigliani, James Tobin, and Robert Solow). Another one of the economists who supported that recommendation was Dr. William Vickrey, who was awarded the Nobel Prize for his contribution to economics in 1996.

Unfortunately, this advice was 10 years ahead of its time. Mr. Yeltsin did not adopt the advice when he came to power, with the result that a terrible tragedy was inflicted on the people of Russia. Today, however, the wisdom of this advice is beginning to reach Western governments, which are facing budgetary crises of their own. From where can they raise revenue (they spend far more money on public services than does Russia) in the global market when capital and skilled labour are mobile? People move to countries with lower tax regimes, and this is threatening the fiscal security of European countries. The one obvious solution now being canvassed was identified in *The Economist* (January 29), the leading financial weekly newspaper published in London. It concluded: "land taxes, which used to be one of the most important revenue-earners, may regain their former pre-eminence". There are other ways of tapping the rents of natural resources such as pollution taxes and road pricing which the British government, for one, is now preparing to include in its tax code.

The lesson for Russia is that the Duma and the federal government should re-examine the principles on which they base their philosophy of property rights and public finance. It is essential to tailor policies so that they do not inflict damage on people who want to work and save. At the same time, to empower people on difficult issues such as the Land Code, the idea of a referendum is sensible provided that the public is given the full opportunity of access to the media to express their views on what is a complex problem.

There are people in the West who wish Russia well and are willing to offer their advice without wanting to get rich at the expense of the people of Russia. Having said that, we do emphasise that the best solutions are likely to be made if the people themselves formulate their preferences and insist on their democratic right to have those views embodied in the laws of the land.