

## RUSSIA'S LAND RENT: the strategic weapon that threatens western markets

*Mikhail Gorbachev wanted to merge the market with industrial bureaucracy. Boris Yeltsin condemned that as a "marriage between a hedgehog and a snake" - and won. Almost. The bosses of Russia's state enterprises are obstructing the president's reforms.*

**P**RESIDENT YELTSIN appealed to the Congress of People's Deputies. He offered to trade his Prime Minister, Yegor Gaidar, for the heads of four other government ministers. Congress, meeting last month, snubbed the president, rejected Gaidar, and declared war on his plans to transform the Russian economy on the basis of market principles.

That was a serious mistake, for there is no going back to the Soviet command system: people have tasted liberty, and the logic of the global economy will dictate a transition to production based on profit-and-loss.

But the transformation could be long and painful, unless the 100,000 Directors of state enterprises realise that it is in their interests to deal with Yeltsin on the basis of a rational plan that can smooth the way into the future. Such a plan, alas, does not exist. No wonder the Legislature is at loggerheads with the Executive.

The losers, as ever, will be the people, as I found when I investigated the case of the Pigment factory in St. Petersburg.

PIGMENT is a state-owned enterprise. Its Division No.4 employs 60 people in ramshackle buildings on a site near the Ladozhskaya Metro station. The factory occupies (but does not fully use) 2.2 hectares, surrounded by trees and wasteland, slap bang in the middle of a 15-hectare vacant site.

When she scanned that slice of land on the map, a gleam lit up the eyes of Olga Paryeva. As Chairman of the district's Committee for Urban

Development, she realised that she could use that location to everyone's advantage. Mrs. Paryeva's years as a town planner had taught her the value of land, even if - as under the Soviet Union's system - that value was not explicitly accounted for monetarily.

Her task now is to attract investment, a process that has to begin with the efficient allocation of land. Unfortunately, Mrs Paryeva found herself trapped behind a barrier every bit as lonely as the wrong side of Checkpoint Charlie. She is caught in the No-man's Land between the old and new economic systems.

PIGMENT makes the lacquer that is needed to coat food tins. As the sole producer, its fate during the period of perestroika is crucial to the economy's ability to distribute processed food around Russia. So the word came from Moscow that the factory had to maintain its output: 8,000 tons of lacquer a year.

For the residents who live in the apartment blocks overlooking the site, the leaking lacquer factory is an eyesore, its pollution a menace to children who play in the nearby river. For Mrs. Paryeva, the implications of the factory go much deeper. It is an obstacle to the redevelopment of the area around the Metro station.

According to the Master Plan, the intention is to build an international railway station to take traffic from the old Moscow and Finland stations. And the station would be connected by underground road to a free trade zone. The 15 hectares, therefore, have an enormous com-

mercial future: boutiques, restaurants, offices, recreational facilities - all the amenities of a modern shopping centre.

German and US investors want to develop the commercial centre, but everything depends on moving the factory. Fortunately, one of the foreign investors has a lacquer-making subsidiary company that is willing to affiliate with Division No.4. Together, they could establish a new factory on another of Pigment's sites on the embankment down the Neva River. Last May the persuasive Mrs Paryeva approached Pigment. Niet! They were not interested.

The managers could not understand why the land they occupied was now of immense value. Forty years ago, when the factory was opened, there had been the remnants of a village nearby; but it was to be many years before the Metro was built, so the rental value of the site was, indeed, very low. Today, with thousands of commuters pouring in and out of the station every day, the adjoining sites are worth a fortune!

Division No.4 finally set its terms. It would move to another site, providing someone else first paid for the new factory to be fitted out with the latest technology. Pigment was not willing to incur any costs. Negotiations came to a full stop: Mrs Paryeva was determined to make the changes on the basis of correct economic criteria. Why, she asks, should Pigment get a factory for nothing, just to persuade them to vacate land that belongs to the community?

Here, then, we see what is bad

with the command system, and what is good with the market system. Under the command system, no-one is responsible to society for putting the land to its best use. A ministry in Moscow sets the output target, and that is all that matters. Under the market system, however, prices and profit-and-loss accounting are the signals that alert people to opportunity. They also generate the swiftest pressures for organic change, to ensure the highest levels of productivity and wages.

RUSSIA is at the crossroads. The old system can only function on the basis of hyper-inflation; the new system cannot work because enterprises like Division No.4 are not obliged to pay rent for the sites they occupy.

Had the law forced the factory to pay rent, the managers would have quickly discovered that they were sitting on valuable land. For the announcement of plans for the railway station, linked to the prospect of commercial redevelopment, multiplied the rental value of their site a hundredfold. But the managers did not have to pay rent, so the conversion of the value of the land beneath the rusting sheds went unmonitored.

What are the choices now facing Russia?

Land privatisation. This option, created by Boris Yeltsin with his decree No.631, applies exclusively to the privatisation of enterprises. Had Pigment taken up the option, the workers could have applied for the ownership of the 2.2 hectares. To privatise the land, however, they would have had to present documents that proved their right of occupation.

If they had succeeded, the 60 workers would have become multi-millionaires overnight without producing another drum of lacquer! They could have shut down the factory, gone home, and waited for the foreign investors to offer the appropriate bribe - the monopoly price of the site - for them to release "their" land. Society would have been the worse off for such a strategy, but the former workers of Division No.4

would have been enriched beyond their dreams.

Mrs. Paryeva was determined not to let Division No.4 get away with such a financial coup. So she did not encourage the factory to pay the small land tax for which it was liable under federal legislation. Why? Because payment of the land tax would have included the formal preparation of the documents proving the legal right to occupy the land. And that would have been the first step down the road to ownership of the site!

Rent socialisation. This option offers the perfect solution to the Pigment case. It is based on this formula: any individual or enterprise that occupies a site, must pay the community the rent that measures the benefits received from control over the land. The logic of this rule is twofold.

First, there is the need for a motive power that ensures the smooth, organic adaptation of the community to the changing needs of its citizens. These changing needs are reflected in corresponding changes in the use (and therefore the value) of land. So the obligation to pay rent directs the land to new uses.

Second, the thirst that people have for social justice has to be enshrined in the solution. In this case: land was not created by anybody, and so it belongs to everyone. But if land belongs to us all, how can we all occupy the most valuable sites? The desire to do so is natural, for the best sites provide the most benefits.

But we cannot all have equal access to the best land. Even so, there is a solution to this physical problem that is both practical and fair: the socialisation of rent. We cannot all move our enterprises into the prime properties in Nevsky Prospekt, but we can all share, equally, in the value of the sites beneath those buildings. This is accomplished through the equal enjoyment of the public amenities that would be financed by the rent of land. This is the lesson that Russia now has to learn.

PIGMENT, by its refusal to agree to

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a smooth adjustment to the new economic conditions, has arbitrarily made the decision to impose an enormous economic and social loss on the citizens of St. Petersburg.

The location of new transport and commercial facilities around the Metro would create thousands of jobs and multiply economic wealth and social amenities. Pigment's refusal to relocate on a more appropriate (lower rent) site means that 15 hectares of prime commercial land will remain derelict. And no law exists that obliges Division No.4 to compensate society.

Russia cannot raise her prosperity until legal and economic processes and institutions are developed to deal with the conflict of interest created by all cases similar to Division No.4. That such reforms must be implemented follows from the realisation that what is good for a particular enterprise is not necessarily in the best interests of the community.

Naturally, the managers of state enterprises would not agree. In December 1992, through the Russian Union of Industrialists and Entrepreneurs, they sought an understanding with President Yeltsin in an attempt to secure maximum state protection from the pressures of "the market". But what is this "market" from which they seek protection? It is nothing other than what ought to be the orderly expression of the preferences of the people of Russia in the course of exchanging their goods and services with each other.

The overnight transformation favoured by western advisers is not realistic. But equally unrealistic is the desire to retreat to the command economy. Managers of state enterprises ought to favour a balanced adaptation, by accepting that full employment and the growth of the nation's income is contingent on progressive change.

We are told, for example, by Arkady Volsky, the leader of the Union of Industrialists, that only 16% of enterprises could withstand international competition. Does this mean a retreat behind a new anti-free trade wall? That would be a fatal error. But

Boris Yeltsin, under pressure from the IMF, wants to sell land outright, and he signed a decree allowing the sale of a tract in the village of Kratovo, near Ramenskoye, a textile mill town where officials auctioned nine sites in November, the top price 3m roubles (about \$8,000) for 20,000 square feet of Russian soil.



there is a need for a planned opening up of the economy to western products, within realistic timescales, to minimise the social dislocation.

There are two main elements to such a transformation. One is the need for society to control the direction and pace of change, by charging rent. This would ensure efficiency in the combination of resources (land, labour and capital), in a period of scarcity. The second is the need for competition between producers, to generate the best value-for-money prices for consumers, which the state also has to phase in through its foreign trade policies. How would this combination of policies affect the Pigment case?

Pigment says that, if it had to pay rent, it would simply put up the price of lacquer! It has no doubt that it could pass rent payments on to consumers, because it is the sole producer of lacquer. Those are, indeed, the facts of life in Russia today; but they need to be changed, as quickly as possible, if the economy is to adjust.

In an efficient economy, rent is paid by the user of land, and not by the customers who buy their products or services. Why? Because com-

petition forces down prices to the level of the cost of production. And the rent of land is not, in fact, a cost of production.

A different situation arises, however, when a monopolist has total control over its market. The exercise of that power damages the economy. For it enables producers to survive commercially on the basis of high production costs and poor quality products - the fatal combination that contributed significantly to the bleeding of the Soviet economy.

The inescapable lesson is that Russia urgently needs more factories to manufacture lacquer. The phased introduction of both competition in the lacquer-producing market, and the obligation to pay rent, would eliminate both the inefficiency in production methods and the power of control over prices. That would oblige Divison No.4 to pay rent out of the aggregate revenue it received from a competitively-priced product. Under such conditions, the factory could not remain on the high-rent site near the Metro: it would have to move to a site that it could afford. This would benefit both the enterprise (productivity would increase,

because new technology would be installed in the new factory) and the people of Russia (who would be able to buy the lacquer at cheaper prices).

Our general conclusions, then, are as follows.

Responsibility towards earth cannot be expressed properly until society measures the cash value of land, and requires users to pay the full annual value (rent). But this would not mean the immediate bankruptcy of enterprises. At the beginning, measured rents are extremely low. They rise in line with two main factors. The first one is the growth of the economy: as re-industrialisation progresses, there is a rise in productivity, parts of the benefits of which are reflected in higher rents.

The second influence on the level of rent stems from the decrease in the tax burden. There are two components to this change. One is that existing rents (which are disguised as "profits", for example) would be correctly identified. The other is that relief from taxation accelerates the rate of growth: incentives to production are increased, which multiplies the rate of increase of productivity.

VIEWED in this context, we can place in perspective the powerful conservative desire to preserve the old command economy.

This conservatism assumed major political importance for the survival of Yeltsin's administration in December 1992. I believe that this pressure will wither away, as Russia edges closer to the more powerful system of the market. But this entails a plan for the progressive support of enterprises within the framework of a planned adoption of the pricing system in line with the introduction of rent-for-government-revenue.

Such a micro-economic strategy has a better chance of success than the macro-economic approach suggested by the bankrupt economic theory of Yeltsin's western economic consultants, who ignore the moral and economic role of land in the welfare of citizens.