

Submitted 3/94

PREVENTING AMERICA FROM TRANSFORMING RUSSIA INTO A THIRD WORLD NATION

The image America presents to the world is not the reality. Many people believe American business has made nearly everyone in America rich, has created a distribution of property that most Americans regard as fair, and has provided equal opportunity to all to make a million dollars -- all of these perceptions are false.

America is not the country many Russians think it is, and I doubt it is the type of country many Russians would want their country to become.

With the talent, education and sense of justice of most Russian people and their land's resources, Russia can do much better than America. It certainly can avoid becoming just another third world, underdeveloped, banana republic.

The Impact of American Business Practices

What is wrong with America is that it is grossly unfair. America's motto should be, "From each according to his fragilities, to each according to his greed." A few facts about America will illustrate its inequities:

- 1% of America's families own about 35% of all the wealth in America (over \$5 trillion) and nearly 45% of all the financial wealth;
- A family in the top 5% makes around 20 times more than a family in the bottom 20%;
- The average net worth of a family in the top .5% is \$9 million, while the average net worth of a family in the bottom 40% is essentially zero;
- Between 1977 and 1989, incomes for Americans increased by approximately \$600 billion. Of that increase, the top 1% of families received 77%, or \$462 billion;
- In 1989, the average income for the top 1% of families was \$560,000, and for the bottom 20%, it was \$8,400 -- a 66 to 1 discrepancy;

- Taxes for a middle class family have doubled since 1980;
- When inflation is taken into account, average weekly wages for non-agricultural workers are now less than they were in the early 1960's;
- Since 1979, the group of people earning below poverty wages grew from 12% to 18% of the work force;
- 25 million Americans, 1 in 10, are now on food stamps and over 30 million live in poverty;
- America ranks 56th among all the world's nations in immunizations and ranks behind Cuba in infant mortality;
- 40 people every working day die from occupational injuries;
- There are an estimated 45,000 sites in America that are polluted with radioactivity, 20,000 are controlled by the Federal Government; and
- About 11%, or 13 million, workers are unemployed in America.

These facts show that much of America's wealth goes to a few rich families and much of the misery to the rest of American families.

The historical flaw in America differs only in degree with the flaw in Russia before August 1991 and the potential danger for Russia since -- so many have too little because so few have too much. America has its group of families who through their wealth exercise a disproportionate amount of influence over the political, economic and social life of the republic; the Soviet Union had the Communist Party which did the same through political power. Now, however, for Russia, there is a transition: economic reformers and bureaucrats strive for the influence and privilege of the former nomenclatura by becoming rich. In other words, some people in Russia seek to create through a so-called free market a small group of wealthy families that will rule Russia as a shadow government, just as a relatively small number of wealthy families run America.

To a large extent in America, the wealthy families control through stock ownership and corporate offices a relatively small

number of corporations that account for nearly one half of America's economic activity.

Economic dominance by giant corporations in America results in the power to monopolize markets, to collude with one another, to keep prices high, to break unions, to pollute the environment without paying adequate compensation, and unduly influence much of the life of most Americans. America's history has shown that corporations possessing vast economic power do not voluntarily agree to meet even the minimal standards of pollution control, worker safety, product safety, liveable wages, or taxes for the betterment of the community where they are located.

Self-interest ranks as the primary concern of America's wealthy corporate elite, and self-interest in America is best protected with money -- profit is the creed of the rich and the corporations they control. As a result, America's corporate elite opposes or dilutes most regulation that may lessen profits regardless of the benefit to the general public. Corporate opposition to business regulations has existed since the late 19th century, has been largely successful, and has resulted in a social order closer to economic Darwinism than to a fair market.

Every so often effective regulations do become law, but since all business regulations in America have been enacted in an environment in which a small number of families controlled vast amounts of wealth, these families have been able to delay for decades regulations preventing corporate activities which harm the general public. Furthermore, when it becomes expedient for propaganda purposes to enact a regulation, usually because of public outrage over some abhorrent business conduct, the regulation is either too weak to deter the harmful conduct or it is not vigorously enforced.

Russia's ultra-reformers (now the new nomenclatura) have already deterred effective business regulation and amassed fortunes by allying themselves with American businesses, in part, to export vast amounts of raw materials at prices below the world market. Exporting has made some of the new nomenclatura very wealthy and

grateful to American businesses. In return, America has acquired necessary resources cheaply (which it needs since America with 6% of the world's population consumes 30% of the world's natural resources extracted each year). America has also acquired profits from the manufactured goods and agriculture products that were purchased by Russia with the hard currency gained from its raw material exports. America, through various agencies, even provided hard currency credit for the purchase of additional American goods and services for which Russia lacks the hard currency. Of course, the Russian government, which means Russian citizens, are the ultimate guarantor and therefore liable for the credits.

The continued export of raw materials will not raise enough hard currency to repay American credits and purchase more American goods and the lack of a modern industrial basis for creating wealth (which is prevented from modernizing due to the tightening of the money supply under the International Monetary Fund's plan) will leave Russia deeply in debt and stripped of its natural wealth. Russia already owes nearly \$80 billion to the West. The end result will be very similar to Latin America, which functions as a cheap source of raw materials and labor for America, a key export market for American goods and services, and a continent whose economies are predominantly influenced by American banks because of the large indebtedness of the countries. (The 125 largest banks in America control worldwide 2.3 trillion dollars in assets.)

In the end, Russia will have a small band of families who owe their wealth to their dealings with American businesses and government. These wealthy families will control the government, and by then it will be too late to establish laws that ensure a fair, rather than free, market.

The time to act then is now before even greater amounts of wealth, and therefore, power, become concentrated in the hands of a relatively few families. Russia does not yet have an organized, cohesive class of wealthy families wielding extraordinary economic and political power that can block regulations that ensure a more equitable distribution of wealth and protect the public from

unchecked avarice. At the same time, such regulations need not destroy incentive, innovation, the ambition to achieve material well-being or deter productive foreign investment.

Regulations for Ensuring a Fair Market

The importance of establishing a market economy is that history has shown it to be the most effective means of creating wealth, but a successful economic system does not depend on a handful of families owning much of the wealth the system creates. Regulations, such as the following, can assure both economic success and fairness.

An upper limit in the form of a tax imposed on the net worth of all families would avoid high concentrations of wealth and distribute Russia's wealth more equitably; however, it would not destroy incentive as does an economic system which guarantees equal pay for unequal work. A net worth limit of perhaps one million U.S. dollars or less per family should provide more than enough incentive for persons (now owning very little) to take risks, use their ingenuity and work long hours for the material rewards of success. Once a successful businessman, professional or other worker reaches the net worth limit, a 100% tax would be imposed on any increases in net worth. The individual may retire with his wealth or continue working without material reward but still earning all the psychological benefits that come from exercising his talents and knowledge. The limit on net worth would make it possible for many more persons to participate in and contribute to the creation of wealth in Russia, avoid the growth of a monied ruling class, and still offer material incentives to inventors, innovators and hard workers.

Another tax, which would prevent over-exploitation by America, is a windfall profits tax on American corporations that do business in Russia. If an American corporation is in a joint venture with a Russian business, then a windfall profits tax can apply only to the American corporation's share of the joint venture profits. A windfall profits tax would tax profits over a certain amount at a

much higher rate than the normal tax on profits. For example, if the normal tax on profits is around 34%, a windfall tax might be 70% or more on profits over a certain amount. A windfall profits tax help prevent the excessive greed that drives a corporation to maximize profits at the expense of the consumer, laborer, or the environment. For example, monopolies and oligarchies using their market power to charge high prices not reasonably related to their expenses.

A corporation may also reap windfall profits when its expenses to produce a product does not reflect the true cost of the product. The cost of cleaning up pollution or compensating workers injured in the production of a product should be born by the corporation. If such costs are not part of a company's expenses, then it is reaping windfall profits. Besides fairness, a key reason for the price of a product to reflect its true cost is to allocate resources efficiently. A consumer's decision to purchase a product or service depends on whether the consumer believes the money he pays is worth what he receives in return. If the consumer is unaware of the total amount of money he will have to pay for the product or service, then he cannot decide whether his purchase is wise or foolish. The consumer's ignorance would result in an inefficient allocation of resources because resources would be allocated to products and services that the consumer bought only because he was unaware of their true cost.

For example, assume a motorist has a choice between one liter of gasoline and one liter of methanol (assuming both are equal in performance), the gasoline costs 100 rubles and the methanol 200 rubles. The motorist will buy the gasoline. If the motorist knew, however, that he would later receive a bill for 150 rubles in the form of higher taxes to pay for cleaning up the pollution caused by producing one liter of gasoline, then the motorist would have purchased the methanol, and resources would be directed towards methanol production and not gasoline production; that is, resources would be allocated efficiently.

American businessmen and their allies in the American

government will bluff and bluster against a windfall profits tax and net worth limit tax. They will call the measures undemocratic and socialistic but windfall profits taxes are not unknown in America; they applied to oil companies during the 1970's Arab oil embargo, and not too long ago, America had a progressive tax system that taxed the richest American's incomes at 90%, which clearly limited the growth of their net worth.

American businessmen will also threaten not to invest if a windfall profits taxes exist, but they will be lying. An American corporation generally makes a profit before income taxes of 8% to 10% in a good year. If windfall taxes were enacted in Russia that started at 15%, American corporations could still make an additional 5% to 7% over their normal profits before income taxes before the windfall tax applied. The 5% to 7% extra profits before income taxes will be enough to attract American investments providing it compensates for the additional risk of investing in Russia.

For Russian companies and Russian partners in joint ventures, a windfall profit reinvestment rule rather than a tax may be more useful. The rule would require a Russian company to reinvest into its business profits over a certain amount rather than paying those profits out to the owners. By limiting the rule to large companies, small to medium sized family businesses, which usually provide the sole source of income for their owners, would not be interfered with.

Inflation can be attacked with effective and enforceable anti-trust laws that break up monopolies and oligarchies which, because of a lack of competition, charge inflated prices. By breaking up monopolies and oligarchies, competition will increase because there will be more corporations producing a product or providing a service. Efficiency and lower prices will also occur because one or more corporations will try to increase business by cutting their prices, and in order to cut prices, they will have to increase efficiency.

One of the chief reasons why the IMF and ultra-reformers'

tightening of the money supply caused price inflation was because Russia's industries were and still are mainly monopolistic. The IMF and reformers knew the tightening of credit in a monopoly capital system would simply cause monopolies to raise prices and produce fewer products or services. In a competitive system, corporations try to reduce costs and prices through efficiency so they can continue to sell their products or services, make a profit and use those profits, instead of credits at high interest rates, to finance their businesses. Competing corporations cannot raise their prices because their more efficient competitors lower prices will attract their customers.

Before Russia can create wealth from its industrial base and provide its people with needed goods and services, the monopolies that now exist will have to be broken up into competing enterprises. Otherwise, production and services will continue to decline and prices to rise because monopolies will continue to try to make a profit by providing fewer goods and services at higher prices. At some point, the prices will be too high for the people to pay, no matter how desperately in need they are, production will drop even more drastically (Russia's manufacturing output declined by 15% in 1993 alone), stagnation will set in, and Russia will be financially dependent on America and willing to sell the remainder of its natural resources and what is left of its industrial base to American investors at rock bottom prices.

By using anti-trust laws to break up large monopolies into competing private enterprises, some enterprises to survive will have to cut costs by laying off employees and some enterprises will go bankrupt no matter how many employees they lay off. The result will be high unemployment and social unrest because privatized competitors will no longer be receiving subsidies from the central government or negative interest rate credits from other enterprises to keep people working at unproductive jobs. Factor in that many towns are dominated by one large enterprise which uses part of the subsidies to fund the town's social services and the elimination of these subsidies could lead to violent uprisings.

A possible solution, however, does exist. Use the subsidies now paid to unproductive monopolies for a public works program. People laid off by a privatized enterprises can be employed in a government program that puts them to work in jobs building Russia's infrastructure: railroads, ports, airports, industrial parks, communication systems, etc. All of the modern facilities that an industrialized country needs. The program can also provide retraining so that laid off workers can find employment in the new economic market. President Franklin Roosevelt set up such a program in 1933, which helped lift America out of its worst depression.

Roy Den Hollander is an American lawyer.