

The Lure of State Capitalism: A CRCE Colloquium

Pros and Cons of State Capitalism: with the examples of Asia, Russia, South America & Europe

Chairman: Phil Hanson

Discussion leaders: Roger Sandilands - *Housing Policies and Urban Land Values under State Capitalism: Lessons for China from Latin America and Singapore*

Silvana Malle - *State corporatism in Russia: an outline of main features and problems*

Rok Spruk: Comment on Slovenia

Phil Hanson: I do not think at this stage any of us need further introduction, but I should stress Roger's remarkable range of work in the past – particularly in the area of development economics, but also in a number of other fields, including the history of economic thought. He has also spent considerable time in Singapore and Colombia.

Roger Sandilands: This speech is a condensed version of a much more detailed paper that I can make available to anyone who wants it. It focuses on the vital role of housing in economic development and its impact on urban land values. I refer particularly to potential lessons for China from the experiences of Colombia and Singapore.

Since abandoning the madness of Maoism, China has achieved unprecedentedly rapid economic growth. Her per capita income now exceeds \$6,000 in terms of purchasing power. What is notable about China is the much lower proportion of her population living and working in urban areas than in other countries with similar levels of income.

China's well-known "hukou" licencing system is largely to blame. It severely restricts migration of impoverished rural families seeking a better life. Thus explains why the gap between rural and urban incomes is unusually large and getting worse. Within the rural and urban areas inequality is also high and widening.

Land is at the heart of these trends. The World Bank recently produced a major assessment of prospects for China over the next 25 years. It estimates that in real terms land values overall are doubling every 12 years. In the major cities they are rising even more rapidly, albeit with big ups and downs.

Unfortunately the World Bank draws odd conclusions from this. To quote: "*Land along with investment* has fuelled China's extraordinary levels of infrastructure development, urban

development and industrial growth; *and has contributed to maintaining social stability*". (Unquote.)

First, this statement glosses over the widespread *instability* and violent protests connected with the corrupt requisitioning of rural land in China. Second, land does not produce wealth. Rather it is a passive recipient of wealth produced by the active factors of labour and capital. Be a country ever so rich in natural resources, without labour, capital, and knowledge, nothing is produced. If land is fixed, production can only increase through more labour, capital or technology.

In 1897 Henry George distinguished "value from production" and "value from obligation". Neo-classical economists ignore this distinction and take all incomes as equal measures of productive contributions. Thus they justify private appropriation of monopoly rent. Worse, by conflating land with capital, as they do, there is no rent – only profits from "enterprise". In this way the neoclassical economist avoids the ethical issue altogether. Naturally, this theory neither explains progress nor why progress marches hand-in-hand with poverty.

- **Let me now briefly explain the main economic forces that drive urbanisation**

The shift in countries' economic centre of gravity is conventionally explained by the "push" and the "pull" forces of supply and demand. However, the distinction is not clear-cut because these supply and demand forces *interact*. One sector's supply is ultimately its demand for other sectors' supply of goods and services in exchange.

Nevertheless, consider first the side of demand. In early stages of development people must spend most of their income on food and basic clothing and shelter. Agriculture then dominates. Being land-intensive, this forces people to live in scattered rural communities with relatively little specialisation and market-based exchange.

As incomes grow, more is spent on food but less as a proportion of income. The proportion rises for other things. Supply responds to demand and labour and capital are pulled toward production of urban-based manufacturing and services.

Next consider the supply side. The Green Revolution, with its miracle seed varieties and improved capital, gives rise to huge *potential* productivity gains.

Why, then, have *actual* productivity increases often been disappointing? A superficial answer is that there has been under-investment in agriculture. A deeper answer is that "markets clear *at the short end*". If productivity and potential *supply* increase faster than effective *demand*, prices fall until actual supply matches the slower increase in demand.

The conclusion is that we must not identify increases in *productivity* with a corresponding increase in overall *production*.

When productivity outstrips sales, it is because the innovators' lower costs have driven non-innovators out of the market. They are then forced either into subsistence farming or to migrate in search of alternative work. The increased output on the modernising farms is partly offset by the non-innovators' loss of market share.

This explains the "push" or labour-displacing effects on migration.

However, there are simultaneous “pull” effects for increased agricultural productivity increases urban employment opportunities. Lower food and raw material costs benefit consumers and lower costs for urban employers. With increased real incomes there is increased demand for primary products. Farmers can then invest more to increase productivity, though this will further displace farm labour.

The question then is whether the “pull” effect on urban jobs from rising agricultural productivity dominates its “push” effects. When we see that in China the rural-urban wage gap has not narrowed, this suggests that push has dominated pull. This *net* push effect keeps rural wages low, which in turn depresses the wages of marginal urban workers - mostly the recent immigrants – despite the rising wealth of the cities.

However, unlike in agriculture, there is no inherent conflict in the cities between rising productivity and jobs. This is because the urban-sector demand elasticities are sufficiently high to offset rising productivity. Also, many urban services are inherently labour-intensive. This explains why the income share of services increases as the economy grows.

Nevertheless, continued existence of a huge pool of effectively redundant rural labour that is desperate to share in the relative prosperity of their city counterparts, indicates that the cities need to do even more than they have done to ensure that the pull of city jobs can dominate the push of labour-displacing innovations in agriculture instead of the other way round.

So I turn now to potential lessons from Colombia and Singapore.

First, the Colombian experience

The growth of resource-abundant Colombia falls greatly below her potential. But her population has grown rapidly, from around 10 million in 1950 to 45 million today.

In 1950 her urban population was 33% of the total. By 1960 this was 45%, a similar percentage to China’s today. But in the absence of adequate housing in central locations, a large proportion of the migrants settled on the peripheries of cities, notably around the capital, Bogota, in unlicensed squatter settlements or ‘barrios de invasión’. Many of these settlements would later be legalised and provided with paved roads and vital utilities. But being distant from the major employment centres, workers had to suffer long and arduous commuting.

Industry and commerce clearly needed a better housed work force. They also needed more factories, offices, shops and social infrastructure.

All these building projects have two things in common: they are long-lasting and they are very costly. Housing is a very large item relative to household income; factories are large relative to business incomes; infrastructure is costly relative to annual state revenues.

Private investments almost always necessitates outside funding repayable over a long period during which the buildings provide their services. Without long-term finance on affordable terms for households and businesses these homes and factories will not be built. Monthly debt servicing costs must be less than rents for comparable existing properties.

This was the background to the 1972 national plan known as “The Plan of the Four Strategies”. Its author was Lauchlin Currie. Currie was Franklin Roosevelt’s personal White House economic adviser from 1939-45. In 1949 he headed a World Bank mission to Colombia and stayed as a top government adviser until his death in 1993. He wrote the main background paper for the 1976 UN Habitat conference in Vancouver, and drafted its Action Plan on “Recapturing Plus Value” (in Spanish, “plusvalia”). This he defined as “the unearned increment from the rise in land values resulting from change in use of land, from public investment or decision, or due to the general growth of community”.

As Currie expressed the problem:

It is a striking example of our economic illiteracy that we have quietly acquiesced in the private appropriation of socially created gains, letting fortunate owners and their heirs levy tribute on the national income to which they have contributed nothing... Generally, the case for capture of a large portion of the pure monopoly gain of rising urban land has been impaired by failure to distinguish between land and capital, between land and building, and between the rise reflecting inflation and that traceable to pure scarcity.

Currie’s 1972 plan was designed to accelerate Colombia’s development by boosting urban employment. In brief, the four interrelated strategies were:

- (i) a new housing finance system together with a more compact type of urban design;
- (ii) a boost to non-traditional exports by ensuring the exchange rate would no longer be chronically over-valued;
- (iii) increased agricultural productivity, partly through greater investment expected to result from higher demand associated with accelerated growth of incomes, together with consolidation of farms as marginal farmers left for the cities; and
- (iv) improved income distribution related to the first three strategies but complemented by more progressive taxation, notably by capture of rising land values via a “valorisation tax”.

The first priority was to ensure that urban families could enjoy far better housing. Hitherto, there had been three main types of housing and housing finance:

- (i) Unlicensed sprawling settlements with shelters built with poor quality materials. Financing was generally from households’ personal savings plus their own work. These “barrios de invasión” or squatter settlements were usually on low-cost, poorly-located land that lacked basic services. But sometimes these barrios were on vacant but valuable central-city sites. Some were vacant for speculative reasons. But this land was scheduled for intensive development with higher standard and higher-rise buildings of a kind that could not be built by unskilled amateurs.
- (ii) *Licensed* housing for the poor, heavily subsidised by a state-owned Territorial (ICT) with inadequate funds. These units were superior to those in squatter settlements but still low quality and on poorly located low-value land.
- (iii) Higher quality middle-income housing financed and built by the monopolistic Banco Central Hipotecario (BCH) – or Central Mortgage Bank – that also enjoyed state subsidies.

Subsidies strain the national budget. Both the ICT and BCH raised finance via tax-exempt bearer bonds that favoured higher-rate taxpayers. During the 1960s inflation averaged 11%, but fluctuated between 5% and 25%. Meanwhile, the interest on ICT and BCH bonds was

fixed at low rates that deterred savers. So the government forced them on pension funds and other institutions.

The government needed to subsidise the ICT because of large losses associated with a high delinquency rate among its low-income renters.

This compared with negligible delinquency at the BCH. With its higher-income customers, the BCH could usually cover its costs. However, its average mortgage rate was 16% and its maximum repayment period was only 10 years. These conditions greatly repressed mortgage demand. But sluggish demand matched the slow growth of funds, and the BCH's monopoly status insulated it from competitive pressures to grow.

All of this meant that growth of both commercial and social housing was falling chronically short of the growth of new family units, so the housing deficit steadily grew.

The solution required long-term loans on affordable terms such that the growth of decent dwellings each year would exceed the growing need. On the one hand saving had to be made much more attractive. On the other hand demand had to match a greatly increased potential supply. As Currie stated the problem:

As rates of inflation rose it became less and less possible, without a heavy subsidy, to provide an adequate volume of long-term loans at low interest rates. As there were many competing demands for public expenditure, public low-cost housing was starved and the economy as a whole was deprived of the large but latent outlet for savings and the impulse for the generation of employment that building could provide.

To convert housing into a leading sector required, on the supply side, mortgage institutions that would give savers safety, liquidity and a competitive return. On the demand side, borrowers needed mortgages on more affordable terms. The conundrum was resolved by focusing on the problem of inflation.

The ideal would be to eliminate inflation. Then, savers could get an attractive interest rate of, say, 4% in both real and nominal terms, with borrowers then charged, say, 6%. That would enable many more families to buy a home compared to when inflation was 15% and the interest rate 21% (to keep the real rate at 6%). A nominal rate of 21% would give rise to a severe cash-flow, or "front-end loading" problem for borrowers, severely stifling demand.

Unfortunately, Colombia has a poor record on inflation, though not as bad as in some other Latin American countries. The problem is not merely that inflation has been high on average, but that high inflation is almost always coupled with greater volatility.

This plays additional havoc with the schedule of real repayments for borrowers if lenders insist on variable rate mortgages. And if mortgage rates are fixed, long-term lenders have difficulty competing with the more flexible short-term markets.

3:1 Colombia's index-linked mortgage finance system

Faced with this difficulty, Brazil and Chile had earlier introduced index-linked housing finance. In 1972 Colombia went further than Brazil or Chile – to make housing (and related infrastructure investment) a motor of accelerated development while simultaneously maintaining the competitiveness of exports – as the second motor of growth.

Of interest for China is that in Colombia (and also in Singapore, as we shall see), these two motors of growth were inherently complementary. For without adequate housing for its workers the export sector would face higher costs.

Likewise, a more dynamic export sector increases the incomes that can finance a bigger housing programme.

The important thing is that all this can be achieved without excessive recourse to the central bank's printing press.

3.1.2 The distinction between real and monetary demand and its significance for housing finance

Here I digress briefly on the importance of the distinction between non-inflationary finance that arises from savings out of real income, versus inflationary finance that comes ultimately from the central bank without the support of real production. If the *money supply* is allowed to increase faster than national output there will certainly be inflation. By contrast, even if the supply of saving deposits grows considerably faster than income this is not itself inflationary because savings only transfer purchasing power to borrowers.

Unfortunately, in Colombia the monetary authorities have often failed to understand this distinction and have allowed money to grow too fast. The ideal is to foster rapid growth of savings while applying strict brakes on growth of the money supply defined to exclude savings or time deposits.

The distinction between demand and time deposits is critical. I have no time to elaborate, but suffice to say that in Singapore – in contrast to Colombia – there has been much clearer understanding. There the authorities have kept tight control over money while encouraging an incredibly fast growth of saving. Her savings rate increased from 10% in 1965 to nearly 50% today. This has financed one of the world's fastest growing economies with the world's lowest rate of inflation.

If Colombia could likewise eliminate high inflation there would be little need to index-link its housing finance. Without going into details, the key point is that the new system did liberate the repressed demand for housing. Builders responded to the greater demand and the whole economy was pulled along behind.

But the new system had its critics. Existing banks hated the new competition and the central bank tried to blame it for continuing inflation rather than admit their own failure to control the money supply. They argued instead that inflation was caused by increased savings and the building it financed.

Others said that housing was unproductive without seeing the irony in their view that investment is “productive” when it is for making bricks, cement, glass, kitchen and bathroom fittings and high-speed lifts.

In fact house-building was spurred to grow at well over 20% a year. This confirmed the hypothesis that savers and borrowers would respond positively to incentives, and that private

builders would likewise respond positively to increased profits from increased demand for the finished product. Urban unemployment fell, and GDP growth doubled to 7%.

Overall GDP growth was partly due to the simultaneous increase in non-traditional exports which also responded to the incentive of a new “crawling-peg” exchange rate adjusted in line with inflation to avoid overvaluation.

Unfortunately continuing inflation and the power of vested interests tended to dilute the system’s dynamism through time. A variety of modifications made it less attractive to save and eventually index-linking was abandoned, forcing borrowers to cope with high and variable nominal interest rates once again.

There is a growing housing deficit. So, for whom should housing be built?

The result of this mixed history is that although the number of good-quality middle-class housing has greatly increased, and has transformed Colombia’s cities, this type of housing has not kept pace with the even more rapid growth of new family formations.

A growing housing deficit has pressured the government to rely increasingly on direct approaches to the crisis. That is to say, on direct subsidies for poor families. Subsidies strain the national budget and put pressure on the central bank to monetise fiscal deficits. This means the housing stock does not expand via *real effective* demand from savings but instead via monetary inflation.

It also means that rather than expanding middle-class housing ahead of the growth of new family formations we build more and more actual or potential slums. If middle-income families must stay put in their existing homes rather than “trading up”, this means that poorer families are also prevented from trading up.

When building focuses on new-build homes for the poor the average quality of the stock falls and the poor have lower quality housing at a higher price than if the “filtration” or “escalation” process had been promoted instead. Ultimately it is those at the bottom of the income scale who suffer most, including especially the rural poor who lose the opportunity to migrate. Or, if they do migrate, their families must live in a one-room instead of a two-room shack.

3.3. Urbanisation and land values

This brings us to consider not only the efficiency gains from rapid urbanisation, but also the distribution of those gains. On the side of efficiency, we have already stressed the importance of greater mobility of labour and capital.

Mobility increases employment and puts a natural upward pressure on wages as the pool of surplus rural labour is absorbed. At the same time, this process of demographic shift to the cities comes up against a fixed supply of land. The increased pressure on land from increased population, incomes and economic activity inexorably drives up the price.

Normally, a rise in price above the cost of production elicits an increased supply that tends to reverse the price and bring it back in line with costs.

But the land market is different. First, the overall supply cannot be increased when demand increases. The supply can only be transferred from one person or use to another. Second, land *qua* land has no labour costs. It is “the free gift of Nature” in David Ricardo’s famous phrase. Thus, when demand increases its resource cost does not increase.

However, it does have *opportunity costs*, so that one use of the same piece of land displaces other uses. This is one reason why land commands a price. The other reason is that some plots are more desirable than others because of intrinsic differences or locational advantages. Then, for the buyer or renter of land the price is a private cost. For society the price is only a transfer payment. Land has no *social* cost.

Society, however, rather than the individual owner of a particular site, has built and paid for the infrastructure that makes land more valuable. The individual owner pays for buildings and improvements on his land and enjoys their value. However, these improvements have only a trivial effect on the value of the particular site on which they sit.

This brief excursion into classical economics highlights a powerful force acting against what would otherwise be the equalising forces of competition and mobility – to the extent that these are allowed free play. Whereas competition and mobility promote more equal wages for labour and more equal returns on man-made capital, no such forces operate in the land market. Land is both fixed and immobile. Competition does not drive its price down to its zero labour cost of production. Pure scarcity relative to demand determines its price.

The socially efficient use of land requires that it goes to those who can obtain the highest social value from the labour and capital applied to it. Price then performs a socially useful rationing function.

But insofar as the value of land reflects Nature’s bounty or the collectively provided civic amenities and infrastructure and purchasing power of the community, its value is a community value and our common birthright. This is the ethical as well as the economic case for financing government from land values rather than from taxes on work and enterprise.

In Colombia “valorization taxes” have captured some of the increased value of lands surrounding major public works where localised enhancements could be identified and political obstacles overcome. However, even in the case of a big new mass transit system for Bogota it has been hard to disentangle the increases in land values related to this one project from the many contemporaneous influences of new and old economic activity. Thus most of the windfall gains have remained in private hands except insofar as the city authorities already owned some of the land or could acquire it at pre-development values before auctioning it to prospective private developers after granting planning permission for developments stimulated by the new public infrastructure (as is common practice in Singapore).

It is well-known that the granting of permissions to convert land to higher economic uses is open to much abuse. In Colombia, as in China today, permission to convert farmland to urban uses releases huge repressed land value, yielding major gains to owners if left untaxed. Stories abound of the corruption that these windfalls can induce.

However, these dramatic windfall examples should not hide the widespread *secular* rise in the values throughout existing urban space in the face of ever-increasing demand. Regular

reevaluations of properties for local property tax purposes (preferably distinguishing value of buildings from value of land, with higher rates imposed on the latter) would go a long way to redistributing community-created values *to* the community.

3.4. Urban design

The typical pattern of urban growth in Colombia has largely driven and been driven by market-determined land values. However, land values are also influenced by the national and city planners in zoning decisions and the location of infrastructure and public housing.

These latter projects, however, have tended to follow and reinforce rather than consciously modify market-driven land values. Interesting attempts to buck market trends have been made in Colombia through so-called planned “cities-within-the-cities” designed to minimize the use of space while maximizing specialization and agglomeration economies.

Unlike individual piecemeal projects, large-scale public investments like these do generate significant increases in land values. If the land is acquired at pre-development value the cities can be self-financing, and there have been some successful cases.

The idea, influenced by Singapore, Paris and Moscow, was also to try to minimise the dominance of the private car by creating within each metropolitan area, separate distinct centres which would be as self-contained as possible, with an appropriate mix of residences, workplaces and social amenities serving mainly the residents of each centre, and making each centre as walkable, hence as densely occupied as possible

Comparisons with Singapore

A partial precedent for this model is in Singapore. Since self-government in 1959, she has engaged in continuous massive reconstruction and rehousing. An unusually high proportion of national income was assigned to building without harming the overall GDP growth rate. The proportional share of building grew over the years as a leading sector that, along with the complementary export sector, levered up the overall growth rate.

The Housing Development Board

Singapore’s most important statutory body, the Housing Development Board (HDB), was established in 1960 because massive investment in public housing was considered not a liability but a prerequisite to the country’s overall development plan. The HDB was given wide-ranging powers to acquire land and create self-contained new towns housing large numbers in high-rise apartments with related public buildings and services.

Between 1960-90, the HDB completed more than 650,000 units (plus a substantial volume of related facilities), and rehoused more than 85% of its 3 million people. This permitted a considerable amelioration of the overcrowding problem and a progressive improvement in the quality of the stock.

The HDB encouraged people to buy rather than rent. The Central Provident Fund (CPF) played a crucial role in this.

The Role of the Central Provident Fund (CPF) in the Financing of Public Housing

Unlike Colombia, Singapore has not had a serious inflation problem. Hence high nominal interest rates have not been a major block on demand for mortgages. But the supply of funds had been a major constraint on demand, with demand being rationed by large down-payment requirements. This constraint was progressively alleviated through high and rising compulsory contributions into the CPF pension fund by employers and employees. Families have then been allowed to use their accumulated CPF contributions for both down-payments and monthly mortgage repayments on their HDB flats.

CPF contributions reached a remarkable peak of 50% of gross wages in the 1980s and go a long way to explain the remarkable rise in the overall national savings rate. In view of the country's fiscal conservatism, with the public-sector budget normally in surplus, CPF revenues also explain Singapore's very low taxes and why the country could accumulate huge foreign exchange reserves without inflationary consequences.

Housing, land ownership, and the distribution of income

However, as in other developing countries rapid population growth and economic activity increased demand for space. Strong upward pressure on the value of land has permitted great potential and actual fortunes to be made by individuals who have made little or no corresponding contribution to the creation of wealth.

Singapore is fortunate in having inherited large areas of public land from the British in 1959. But the Land Acquisition Act of 1966 has given the government strong powers of compulsory purchase, with compensation reflecting, at best, pre-existing use values only. By 1990, due largely to HDB land purchases (plus substantial land reclamation by public bodies), the state owned around 75% of all of the land of the island.

The Land Acquisition Act greatly reduced the HDB's financial requirements. This is reflected in the relatively low selling prices of HDB flats and has thus spread land value increases to a wider public. Once families have subsidised flats they benefit from future increases in the land value, but they do pay annual property taxes, with property values regularly updated.

Of equal importance for Singapore's poorest groups has been continuous full employment and rising wages. But statistics on *relative* incomes and wealth show increasing inequality. This is due in no small measure to the way that overall economic success has placed some of the spectacularly high land values in private hands. If the government would try to capture even more of these unearned incomes it would reduce speculative holdings of land that have been a significant cause of boom-and-bust.

One final comment regarding the sharing of land values: To minimise land given over to the private car, as well as to reduce traffic congestion that hampers efficiency, the government has introduced draconian restrictions on private car ownership. Licences are auctioned and a car may cost up to four times the world price, generating very large government revenues. These are effectively land value revenues. Much of this is invested in an excellent public transport system for everyone.

Lessons for China

I conclude with a brief list of lessons for China from Colombia and Singapore.

1. Colombia and Singapore both demonstrate the importance of a government-assisted boost to residential housing and related infrastructure and services. This is vital for geographical and occupational mobility so that labour productivity can be maximised and the distribution of income improved.
2. Housing and related infrastructure rely heavily on long-term financing and are more seriously affected by high and variable inflation than other sectors.
3. This distortion calls for special measures to protect savings and loans for housing finance and other construction projects.
4. The more that is done to boost voluntary and forced saving, the less the pressure on inflationary sources of funds. This message is particularly apt today, at a time when inflation has been accelerating in China.
5. In view of the social benefits of a well housed population and the desirability of a good social mix there is a case for subsidies, though budgetary constraints limit the role that subsidies can play as compared to reforms that boost non-inflationary private savings.
6. The provision of housing should be matched to real effective demand. Long-term mortgage repayments can be made more affordable if inflation and nominal interest rates are kept low and stable or if index-linked finance is introduced to overcome the front-end loading problem, and amortisation terms lengthened.
7. China should avoid building new housing *directly* for the very poor because only by building very basic structures on cheap land can the costs be covered by rents that the poor can afford.
8. The *indirect* approach is likely to be more successful. But this requires that China builds each year at least as many good apartments as can keep up with new family formations.
9. Investment in housing is at least as productive as any other investment if the potential effective demand can be actualised through the mobilisation of non-inflationary savings to satisfy that demand. These savings can be supplemented by subsidies to poorer families to the extent affordable out of central and local government budgets.
10. The construction sector complements industrialisation. It can also be used to compensate for any industrial downturn due to global recession or from pressure to revalue the renmimbi. This is especially feasible for China with its huge foreign reserves.
11. Urban design should foster increased density to economise on land. This can be helped by restricting the growth of private car ownership. Revenues raised by taxing car ownership can be used to subsidise public transport.
12. Economic growth goes hand-in-hand with rapidly rising urban land values and these are the main source of increasing inequality. Governments must capture these land values

and not be captured itself by vested interests. Leaders must fight bribery and corruption – and improve their understanding of classical rent theory.

Phil Hanson: I would like to thank Roger for this instructive analysis. I know that we all want to ask questions but first I will invite Silvana to speak and then we shall have the discussion.

Silvana Malle:

Nature of corporatism in Russia

How successful has been - could still be - state corporatism in Russia? In Post-Soviet Affairs (PSA 2012), I discuss the features that - in my opinion - characterise the Russian political regime as a corporatist state. The fundamental basis for corporatism lies in the way the three major economic parties - labour organisations, businesses and the state through its structures - ensure the stability of the political arrangements together with economic and social development. Businesses of any scale are allowed to carry out their projects as long as they do not conflict with government's plans; many times they are also asked to support the latter. Hanson and Teague define Russian entrepreneurs as *doverennyi*; i.e. tacitly and respectfully conforming to government wishes (Hanson and Teague, 2008). The trade unions – an organization whose Soviet features reveal to be extraordinarily persistent – have never managed to become really independent. There are practically no tables/schedules for discussion of workers' claims and no open controversies. Strikes are uncommon. Powerful branch unions like that of metallurgists in Germany or machine building workers in Italy are unknown. The government has a major role in setting any dispute at the factory level. The premier and/or the president are often called to large (system-forming, as they are often defined) factory plants to discuss specific problems. The way to settle them is to, firstly, pinpoint the “guilty” officials and, secondly, instruct line ministers and departments to intervene with measures ad hoc. President and premier are never deemed personally responsible – a situation that may be changing (see below) – in their role of the benevolent “patronage”. There is practically no instance to my knowledge in which either one in their respective capacity/role was politically challenged by the workforce as is often the case in our countries when loud and visible industrial action causes serious political concern. The way such relations work in Russia is through corporatist *do ut des* arrangements between managers, workers and their patrons worked out informally from above. Such agreements are, in part, a legacy from planned economy and, in part an alternative to functional market-based institutions where agreements would be reached between concerned parties at the level of the organization - be that, as in Douglas North (1990), a financial or industrial group, a corporation, a party or a government agency. The alternative is ingenious in so far as the referee's role played by the rulers makes them look indispensable.

These arrangements have worked well during the first two presidential mandates of Putin (2000-2008) and that of Medvedev (2008-2012) despite the obvious social challenges spurred by the 2008-10 financial crisis and the dramatic output fall in 2009 (-7.8% GDP y-o-y).

Stability has been easily maintained during the years of strong growth, i.e. from 2000 until mid-2008, and thereafter, thanks to fiscal stimulus and populist policies – including rises in minimum wages and pension – in spite of ballooning federal budget deficits. These policies have allowed for the re-election of Putin to President of the Russian Federation (RF) in May 2012 (Putin III) pulled by strong social consensus that such policies, and their “operator”, were able to garner.

The question this paper raises is a) whether this power structure will be able to survive long enough –the time of Putin III’s mandate at least - to deliver on its promises and b) whether the formidable glue, stemming from a mix of hope and apprehension in society that keeps corporatist actors mutually supportive, will hold and foster corporatist/holistic arrangements or fray into incompatible segments and demands. Corporatism lasted long in Italy and was interrupted, but not fully overcome, by the IIWW. It lasted longer in Spain and Portugal just to mention some European countries where the demise of the illiberal state structure occurred rather smoothly – certainly more smoothly than in former USSR and Yugoslavia. The case for the dissolution of corporatist relations and their replacement by horizontal interactions among crucial players based on equal rules of the game, when independent interests mature with growth and become able to form their own organisations, is strong, if interference from the state/government abates, but not inevitable. Survival of corporatist relations based on political patronage for a certain, a priori undetermined, period is not impossible either.

Speculations about possible strengthening or demise of corporatism in Russia need to take into account a number of factors: structure of economy and trade, type of linkages between power and society, development strategies and goals, and last but not least ideology or ethos.

One need to note that, contrary to traditional corporatist states Russia is an open economy. Corporatism in general benefited from a high degree of autarchy and state control of both the domestic economy and its international exposure. That is not the case of Russia that – taking into account all possible caveats - is an open market economy and, as manifested by the financial crisis, largely exposed to the world economy and price shocks. This is an obvious weakness from a corporatist point of view. After accession to the World Trade Organisation (WTO, on 22 August 2012) open market transactions and competition are likely to increase albeit along an altogether comfortable transition schedule (Connolly and Hanson, 2012). That has already provoked the formation of anti/WTO lobbies and protectionist pressures on the part of producers - not only from the laggard agricultural sector but also from well-established and influential branches and companies, be those state or privately owned. After accession to the WTO Russia should become a member of the Organisation for Economic Cooperation and Development (OECD) - an organisation that - despite having no conditionality attached to membership requirements (apart from a couple of conventions to be signed by future members) - exerts moral influence. Evidence of this is that “name and shame” on mutually agreed best practices have become the rule and the ranking attached to any member country is increasingly exploited by economic analysts, as well as by peer countries and their business organisations. Putin’s promise to bring Russia’s shameful 120th

ranking on “doing business” down to 20th during his mandate is an example of such “soft” pressures.

Interestingly, the issue as to whether the OECD may exert pressures for changes of the political construct that would be conducive to more democratic practice has also been raised. Though the Secretary General of the OECD reminded member countries that Spain and Portugal had been invited to join the organization – and became members - while still under (more) authoritarian regimes, it is not to be ruled out that the approach may change vis-à-vis Russia and other countries in the future.

The first point this paper wants to raise is that corporatist arrangements, unlike authoritarian or totalitarian systems, need large and stable political consensus that the leader in charge cannot command unless supported by parties or movements that act as mediators with different groups and organisations. Corporatist systems have no greed for violence. They need legitimation through as large as possible consensus. Such systems can survive only if they can deliver on populist promises. While this entails a high degree of state control on resources and their distribution that is not without cost. Mediation is also costly in so far as assuring loyalty to policy-makers has a price. In relation to Russia, the paper examines the nature and extend of support to Putin III’s leadership provided by the party Edinaia Rossia and the movement called All Russian National Front.

The second point wishes to raise is that corporatist arrangements - and support from below – need an ethos, a sentiment of identity and pride that is difficult to emerge unless society is urged to achieve far-reaching national goals or frightened by exogenous threats. In this regard, the paper examines the developments surrounding the concept of a Eurasian Customs Union (already in place) and a Eurasian Union (still in fieri) that unfolded rapidly (from the initial concept of a Single Economic Space-SES) precisely when Russia was coming close to WTO membership. While the Eurasian Union for the time being is rather an issue for discussion than a deed, other structures have been put in place to prepare for this development, such as the tripartite customs union of the RF with Belarus and Kazakhstan and the establishment of a supranational court in charge of trade disputes that were largely unexpected. More are on the way. Whether such developments point to Russia’s effort to rebuild the Former Soviet Union (FSU), or are part of a corporatist drive, as maintained in this paper is briefly discussed below.

The fundamental aim of this paper is to highlight among the current developments in both areas –internal and foreign policy – those hinting to efforts on the part of Putin III and its *doverennyi* elite to reinforce internal stability while also trying to control outward-looking pressures. The paper also discusses whether such developments have a defensive or aggressive nature. In other words actions are taken to try to withstand accelerated liberalization in all areas including the political system stemming from a higher degree of international integration and interaction required not only by the WTO and the OECD, but also by independent businesses’ exchanges; or aimed at boosting the role of Russia in the region and beyond.

During the years of the crisis, 2008-09 a modest but visible drive towards liberalisation, competition and innovation was stimulated by the failure of the Russian model of growth to resist its worst effects. This drive may continue to make its way through the intricate network of old and newly established institutions, organisations, innovation and privatization programmers put together by Medvedev together with the intellectual debated it helped stimulate (Malle 2012). If so, corporatist structures may be endangered.

But it is also possible that efforts to fight foreign political and economic pressure, more than a rather weak internal opposition, in trying to amend fissures in the structure of power will increase paving the way for a nationalist turnaround. In trying to understand these developments the paper focuses on the changing nature of the political organisations designed to gather/maintain social consensus rather than on personalities and their respective individual allies.

The paper concentrates, firstly, on developments regarding the party Edinaia Rossiia, the movement designed as the All Russian National Front and the creation of expert councils under the new open government approach by the government and the presidential administration. Concerning the Eurasian project that is gradually unfolding, the paper discusses only those developments and goals that better help understand which strategy underscore the roadmap to the Eurasian Union pursued Putin III.

Edinaia Rossiia (ER): the party of power is losing power

This party, created by Putin during his first mandate, grew fast over the years: in some ten years ER managed to open its own branches in all the regions (Malle 2012) and conquered considerable majority in the parliament. Putin never became a member of the Party although being its indisputable leader. ER remains the majority party after December 4 2011 elections with 49.3% of the votes representing 32,348,000 voters. The second and third party from these elections were the Communist Party and Just Russia, respectively with 19,2% (12,5 millions) and 13.2% (8,7 millions) of the votes. The number of voters fell three per centage points compared to 2007 elections, but remained 5% higher than in 2003 when ER emerged as the party of power. The threshold for representation remained at 7% of total voting established in 2003.

Table 1. Results of December 2011 elections. Number of voters: 60,2 per cent of total having right

Edinaia Rossia	49,3
KPRF (coomunist party)	19,2
Just Rossia	13,2
LDPR (Zhrinovskii's Liberal-Democrat	11,7
Iabloko	3,4

Patrioti Rossii	1,0
Pravoe Delo	0,6

Source: RIANOVOSTI, 2001.

ER lost millions of supporter in 2011 compared with 2007 when it got 64% of the voting. Ironically, ER was even hoping to achieve qualified majority at 2011 election. That outcome is, perhaps, more revealing than the concomitant claim of electoral frauds whose impact could have been important in a few cases/localities, but overall numerically insignificant. After a well-gearred campaign of alleged wrongdoing and theft against its members carried out by part of the opposition. ER – from a Putin’s asset in earlier elections –evolved into a burden even if Putin was able to maintain a high rating despite the effects of the crisis on the economy and social welfare. In May 2012 Putin was elected with 64% of voting. There have been a number of critical comments on the way the selection of candidates for Presidency and both Duma and Presidential elections had been run this paper does not wish to comment.

What matters politically is that the elections revealed that social support for Putin is much higher than support for ER: not only his charisma did not suffer from his diminished role as premier during 2009-2012 but possibly increased vis-à-vis the obviously weaker personality of Medvedev.

Table 2. Survey: Do you approve the slogan “ Russia without Putin”, “Putin must go”

	Dec.11	Jan.12	April.12	June12	Sept.12
Definitely approve	6	6	5	7	5
Rather approve	15	15	14	15	14
Rather disapprove	26	29	35	30	30
Definitely disapprove	35	32	31	32	31
Difficult to answer	19	17	16	16	19

Levada Centre 8 October 2012 from <http://www.levada.ru/08-10-2012/protestnye-nastroeniya-rossiyan>

Putin III’s charisma, much alike that of former leaders of corporatist states in Europe last century, is crucial to the stability of the legally weak political arrangements that support corporatist structures. A corporatist state is unlikely to survive its “recognized and/or respected” leader. In other words, deprived of a charismatic leader the whole system is likely

to collapse. This is probably the principal reason an agreement was quietly reached in September 2011 to propose Putin for President rather than Medvedev. Sergei Elkin's cartoons¹ are probably more telling than any profound analysis circa how the two personalities are perceived in society. An additional observation is that the collapse of corporatism does not entail *per se* sweeping democracy and – especially in Russia today - may even lead to much worse political developments.

The analysis of ER's evolving fate may give some clues about the chances Russian corporatism has to develop peacefully into a more democratic system. The fact that Medvedev was pushed to assume the leadership of ER before 2011 Duma elections and decided thereafter – contrary to Putin to become a member – should not go unnoticed. It could be interpreted as a democratic development along the lines of western politics: therefore a fissure in the corporate construct of power. Being a member of a party implies taking responsibility for its achievements and errors. Medvedev made this clear accepting membership. More time is needed to see whether *de facto* this will occur and help streamline the party along a more liberal vision, or, instead, Medvedev and/or ER will distance one from the other.

Recent developments suggest that the party is not at ease with Medvedev's leadership and personality. Preparing for regional elections and propaganda Sergei Neverov, the Secretary of the General Council of the ER and deputy speaker of the Duma, hesitated on whether to display posters featuring Medvedev in some regions (such as defence-related Krasnoyarsk). In the end the decision was not to feature the party's leader anywhere. On the other hand, Medvedev himself has tried more than once to distance himself from the party's poor image primarily in major urban areas.

Finally, a major development is the post-electoral clear lack of purpose/vision among ER members. Curiously ER has been spending a long time going through a soul-searching exercise in which its members have been exchanging views on whether the party should move left or right without even reaching a preliminary conclusion on the eve of regional elections (Malle, forthcoming 2013). While ER seems incapable of forwarding a clear message to its electorate, according to a recent survey² for the first time up to 45% of Russians express their belief that the ER is corrupt and unreliable.

All in all, ER is losing power, self-esteem and political impact at both the federal and regional level. It could even break into factions. Does this mean that Russian corporatist state is about to collapse? Looking at concomitant developments (discussed below) - at least until the end of Putin III's mandate, this is not to happen. Political stability until at least 2018 is very likely owing to a number of factors. Firstly, Putin remains the crucial anchor of the existing and, by and large, accepted Russian political construct; secondly, nobody in the political scene has offered a credible alternative and, thirdly, this order is necessary to carry out nation-binding and enhancing projects. A nationalist drive seems to be developing that practically nobody in Russia dares to challenge. Finally, Putin's from mid-2011 has been

¹ See Elkin daily cartoons in www.polit.ru

² Levada Centre 27 August 2012 from <http://www.levada.ru/issledovaniya>

strengthening the corporate pillars and alliances, in terms of state-businesses cozy relations - he managed to build over his quasi-four presidential terms.

The possible fortunes of the parliamentary and extra-parliamentary opposition are minimal. Andrew Monaghan (2012) concludes that post-electoral developments rather show the end of the opposition era. It is worth noting that the best possibly challengers to the existing order, billionaire Mikhail Prokhorov, on the one side, and respected former Minister of Finance Alexei Kudrin, on the other, both ruled out to be part of the “opposition” : For Prokhorov, the (liberal) opposition made shame of itself over the years; for Kudrin, the problem is to work out meaningful alternatives and frame them into a convincing political programme. Both hesitate to form and run alternative parties (Malle forthcoming 2013).

The All Russian National Front (ARNF): a suitable pillar for Russian corporatism?

While ER is losing grounds, the ARNF, another Putin’s creature, is on the rise. The ARNF can be compared – with due caveats - the Gran Consiglio del Fascismo (GCF- Great Council of Fascism) created by Mussolini in the early 1920s and increasingly used thereafter to bend and constrain the fascist party’s power after several instances of wrongdoing and harassment of citizens by its bullies. Mussolini’s resentment against the party came to the utmost when ebullient Farinacci became the Secretary of the Party in 1925 and was unable or unwilling to rein local episodes of violence contrary to Mussolini’s will and instructions. In the political order of fascism the Party Secretary was second only to the supreme authority, that of the Duce (*Dux in Latin =Leader*), i.e. Mussolini. The GCF was, finally, turned into a constitutional body on December 9, 1928 and endowed of extraordinary powers such as to respond to the Duce (and premier of the government) alone. Before carrying on with some insightful parallels between fascism and Russian corporatism – one need to highlight a major institutional difference. In Italy Monarchy continued to exist until the end of the IIWW, though *de facto* the king was more a nuisance than an obstacle to the plans of fascism. In Russia, developments after the 2008-2012 Medvedev’s interregnum and weak leadership and subsequent changing roles provide a clear perspective on where the effective levers of power were consistently located from 2000 onwards.

Some similarities between the Italian and Russian corporatism could be telling about future developments in Russia. Notably, Mussolini chose to be the Duce, a leader above the party rather than its official head. Putin also refused identification with ER despite being seen as its leader. This is not accidental. It is, on the contrary, necessary to ensure the stability of the constitutional order regardless of who is the party secretary. In corporatism, to preserve legitimacy, the leader must be beyond any suspicion- while allowing for, or even directly exposing, party officials to public anger/disrespect. *De facto* such leaders are quasi-monarchs: they command respect as such.

As mentioned above, however, they remain political leaders that must deliver on their political promise. This is something monarchs by lineage would not be expected to do. Mussolini’s corporatist state helped minimize the pains of the economic crisis in the thirties. State intervention was large and hardly efficient, but (discriminatory) useful labour laws

helped to curb rising unemployment. Corruption and criminal gangs were fought with some success in certain regions. As major scholars on fascism, such as Renzo De Felice (1966 and 1968) and Emilio Gentile (2005) have shown, populist policies and nationalism mattered a lot for people's support to the Duce in the thirties.³

Interestingly, in this context one may wonder whether Russia that is now on the edge of a new crisis will be capable of delivering on Putin's populist agenda. Many in the Ministry of Finance are worried. It is worth noting that, at last, Putin's personal responsibility as a policy-maker is being questioned, if not challenged. For the first time in mid-2012 more than 50% of the population was found to consider that Putin bears responsibility for the problems of the country.⁴ This is an interesting development that makes us wonder what could be the response from above.

Another parallel with Italy of the 1920s can be found between the GCF and the ARNF. Much alike Mussolini's personal interest in creating and later empowering the GCF, Putin formed the ARNF in May 2011 to capture social consensus despite the crisis' follow-up in the expectation that Duma elections six months later could turn against ER in favour of even more populist parties, such as the communists and Zhirinovsky's so-called Liberal-Democrats. It was Putin, in fact, that ordered ER to open its list to independent candidates, some of whom were chosen under his personal instructions, and make room for the elected ones to sit in the Duma as de facto ARNF representatives.

With Putin III and in expectation of regional elections in 2012, the ARNF, under the direction of Vyacheslav Lysakov, try to form its own branches in the regions – ideally separate from ER's own cells – in a search for autonomy and showing disdain for ER: a development that is still causing strains between the two organizations and ER in particular that is trying to achieve 50-50% of the voting versus 49% a year earlier.⁵ The issue of granting the ARNF legal political status came to the fore in mid-2012 together with the empowerment of its (political) monitoring structures through the establishment of special bodies. Interestingly, while Putin refrained from taking political responsibility for ER – i.e. official leadership - he was tempted to take over the leadership of the ARNF but finally renounced while keep strict control of its developments, much alike Mussolini's policy visa-vis the GCF. It is too early to see whether the ARNF will manage to achieve a legal/constitutional status as the GCF did in Italy. It took 5 years to this body to finally be approved as a constitutional organ. It may take shorter for the ARNF to reach a legal status in Russia. This is likely to happen if ER does not recover support in the regional elections. Putin is clearly unhappy about the situation and needs to compromise as it happened in Riazan where the ARNF's better placed candidate had to withdraw in favour of the ER's former governor after Putin III's instruction.

³In English see authoritative Renzo De Felice, *Fascism: An Informal Introduction to Its Theory and Practice* (ISBN 0878551905 (0-87855-190-5), Transaction Pub 1976

⁴ Levada Centre, 27 August 2012 <http://www.levada.ru/issledovaniya>

⁵ *Vedomosti*, 9 September 2012

Putin may have more difficulty than Mussolini in his own time to master a rather loose and dis-homogeneous coalition of industrial and other groupings while also having to fight the rising chances of parliamentary and other opposition after the thresholds for party registration and representation have been both lowered (Malle 2012). The disparate founders of the ARNF and ISEPI – a recently revived foundation of the Institute of Socioeconomic and Political Studies – are the Union of Transport Workers, the Russian Women’s Union, the Freedom of Choice union of Russian drivers, the Union of Veterans of the Armed Forces, the AKKOR association of private farms and agricultural cooperatives, the Russian Pensioners Union, Business Russia and FITUR (Federation of Independent Trade Unions of Russia).

Contrary to the Russian framework where Soviet-type associations are mixed with professional societies, the Italian corporations (*corporazioni*) had a definite professional character and a major claim: that to limit access to each profession. Market segmentation turned to be costly to consumers but, all in all, profitable to producers: an acceptable outcome perhaps in time of depression, but unfortunately a long-lasting one that even democratic or technocratic governments seem unable to fight.

The disparate Russian landscape of the ARNF and the often incompatible goals of each member association may be the reason why Putin – almost in parallel with Medvedev’s Open Government Initiative – set up a number of commissions, councils and bodies at the Presidential level aimed to interpret current developments and offer ad hoc solution based on a broader country vision. Just to mention some, Putin set up a Commission to monitor economic socio-developments in the country on 16 July 2012, an Economic Council of experts on 20 July 2012 inviting eminent people to join and appointing MIT Ph.D. Xenia Yudaeva as a Secretary (and his current Sherpa), as well as an ombudsman for businesses appointing to the job respected Boris Titov of *Delovaia Rossiia*.⁶ Many among the liberal-minded Russian intelligentsia have not rejected Putin’s offer to provide own advice on reforms. Through ARNF’s pulled aggregation from below and co-optation from above corporatist structures should consolidate in principle. What is still missing is a supra-nationalist ideology as evoked by the group formed around the Izborskii Club: an ethos capable of welding different groups around a cause rather than a personality.⁷

While some in the opposition are understandably critical of co-optation, others are diffident of the opposition’s nihilism and, in some cases, opportunism (Belkovskii, Milov, Ryshkov, Kudrin, etc.). Cooptation, one of the most powerful pillars of corporatism, succeeded in attracting support for Mussolini from some eminent liberals including the philosopher Benedetto Croce. But the Duce did not have to struggle against the left-wing that had been politically crushed from the starting of the corporatist regime in Italy.

Putin III has a double task: to fight growing populism from the left – be that represented or not in the parliament, and to drive the country to modernization within the narrow rails of an

⁶ See <http://news.kremlin.ru/news/15996/> and <http://en.rian.ru/business/20120621/174168935.html>

⁷ On this Club and expectations/proposals from its members, see: <http://www.zavtra.ru/content/view/izborskij-klub-2/> accessed on 8 October 2012

evolutionary model of development easier to proclaim than implement. Nationalism anchored to a state emboldened by far-reaching national strategies rather than ethnicity would better suit Putin III's goal. Recently, in an interview Putin pointed to the korennoi rossiiskii (instead of ruskii)⁸ narod as his base for consensus.⁹ Interestingly, according to a Levada Survey, about 44% of Russian citizens would spontaneously take arms to defend their country if under threat.¹⁰ The threat could be either immediate or highly probable. In either case the survey signals that the nation would move to fend or prevent aggression.

A Eurasian vision to provide a nationalist ethos for corporatism

Clear prospects on potential enmity coming from either aggressive economic competition or other threats of different nature (illegal immigration, drug trafficking, terrorism, perceived hostility on the part of other powers) provide good grounds for lasting corporatism. In this context, the paper draws attention to Eurasian Union project enunciated by Putin as a priority soon after his candidacy to President was announced,¹¹ and reiterated after taking office for the Third Presidential Mandate. Lip service to the reconstruction of a Eurasian space was spent far back in the mid-90s after which nothing relevant happened. Some action was taken by Putin starting his presidential mandate in 2000. Under the first two mandates of Putin a series of steps led to the concept, first, and creation later of the tri-partite Customs Union (CU: Russia, Belarus and Kazakhstan). The Duma ratified the agreements on the CU on 12 December 2010. The mastermind of this project had been Sergei Glaziev – a visionary technocrat and Secretary of the CU until V. Khristenko took over in 2011. Note that Glaziev is currently a member of Putin's Economic Council and his advisor on Eurasia.

The life of the CU has been punctuated by a number of disagreements, conflicts and lengthy/often inconclusive negotiations as well by many carrot and stick attempts on the part of Russia to convince Ukraine to join. There were disagreements also among the Russian authorities. Whilst Putin did not hesitate threatening the G8 to withdraw from WTO time-consuming negotiations and resort to post-soviet free trade area agreements, not everyone in Russia agreed. Ex-post, Medvedev recognized that he had not given more than 10% chance to the creation/viability of the tri-partite CU that, to his surprise – as he also admitted - helped increase intra-union trade by 36% in one year (125bnUSD: almost twice the trade with China). According to Khristenko, intra-CU trade increased more rapidly than trade with other foreign countries having also a positive impact on the structure of trade.¹² While compared to

⁸ See the different meaning – with ruskii being related to ethnicity and rossiiskii to state symbols -, in http://www.gramota.ru/spravka/trudnosti/36_186

⁹ See Aleksandra Samarina, "Novoe bol'shinstvo Vldimira Putina, 9 October 2012 from <http://www.ng.ru/printed/274195>

¹⁰ Survey published on 22 June 2012, see <http://www.levada.ru/22-06-2012/44-rossiyan-poshli-na-front-v-sluchae-voennoi-ugrozy-strane>

¹¹ See *Izvestiia*, 3 October 2011

¹² See <http://news.kremlin.ru/news/16050/>

trade with Europe the intra-CU trade is a small fraction, it would be wrong to neglect the strategy underlying such developments.

The vision of a Russia-controlled post-soviet free trade area has strengthened over time. Whether this was in part due to excessive requirements imposed on Russia for the entry into WTO, as she claimed, or that belongs to Russia's post-imperial anxieties and revanchist sentiments is a matter for discussion. One point is clear. Eurasian economic institutions are being gradually put in place. A law on ratification of agreements to form a free trade area (FTA) within the CIS countries was signed by Yanukovich on 9 August 2012 despite Ukraine's resistance to join the existing tripartite CU.¹³ Such agreements have been signed by almost all CIS countries. By themselves those agreements in some countries could be simply a smokescreen to please big brother Russia, but a situation is developing where pro-CU feelings, as reported in Ukraine, may be increasing in tandem with the deterioration of economic prospects in Europe and intra-EU on-going squabbling.

On 1st July 2012 the Eurasian Economic Commission came officially into force with the aim to help not only developing a free trade area that would compete with the European Union, but also working out common economic policy.¹⁴ Its council is composed of the deputy premier of each CU country. The Commission has the status of supra-national government concerning the CU and the single economic space in so far as it will have the power to appoint its own representatives within the union and abroad and sign international agreements when the Higher Eurasian Economic Council will start working. This structure - still in fieri - has been modeled largely on the EU. The Eurasian Union, as such, is expected to enter in force starting 2015.

There are problems on the road to further Eurasian integration already evidenced by the multifarious conflicts on import duties and true origin of intra-union tradables. Foreign countries are ready to exploit the loopholes of the existing CU to penetrate the larger Russian market. China in particular can more easily benefit by transiting its products to Russia and the West through Kazakhstan depriving Russia of transit fees.

There are important questions regarding these developments this paper does not discuss, but wish only to address. How consistent is the Eurasian Economic Union project with Russian foreign policy as such? Is it a manifestation of antagonism against less than good relations with the West (reset, ABM strategy or other) or, on the contrary, a possible vehicle to improve foreign relations with some East-situated but West-orientated OECD countries? Is the Eurasian project an alternative to further integration with the European Union? Are long-term benefits of building a market-friendly Eurasian space high enough for Russia to be ready to bear the short-term costs of such far-reaching project? Do the other two CU countries have the same interests as Russia regarding the Eurasian project? Could the Eurasian Project help provide a new vision of nationalism centered not anymore on Russia only, but definitely on a broader all-embracing concept of Eurasia's uniqueness?

¹³ See <http://en.rian.ru/world/20120809/175100605.html>

¹⁴ *Rossiskaya Gazeta*, 2 December 2012

To answer these questions one would need strong evidence in support of either one alternative. Unfortunately there more speculation than evidence so far although a number of issues are openly debated in Russia. Interestingly a large number of experts appear to be convinced that the Eurasian project will materialize. But it is not clear which priorities will be tackled first. Prospects of integration in the Pacific Region may be more interesting for OECD and EMEs in the region than what we were used to believe years ago. As declared by Putin III in Vladivostok at the 2012 APEC meeting (Russia joined APEC in 1998 and has been a regular participant member), New Zealand and Vietnam have shown interest to possibly become associate members of the CIS' FTA.¹⁵

Russian experts and government agencies are actively engaging in trying to assess/simulate costs and benefits under different constraints where foreign policy and possible alliances as such play a major role. One such study has been worked out for Ukraine. According to one simulation (Development Centre on request from the Ministry of Economic Development) Ukraine would better get out of current problems by joining the CU and improving trade with Russia than turning for help to the EU. The Higher School of Economics is currently working on a project on the Eurasian economic space together with some Hong Kong and Mainland China scientific institutions.

Russian experts have different views on the pros and cons of the Eurasian Project, but all in all seem to be favourable, though for diverse reasons and from different perspectives regarding the world order. In trying to build consensus for her Eurasian project Russia cannot – and does not - ignore security issues although there seems to be confusion on potential enmity. The most challenging points raised by Russian experts on the Eurasian Project and its implications are discussed in (Malle, forthcoming 2013). They regard security issues, economic benefits and costs, investment in transport and infrastructure, prioritizing development in some regions, finding workable arrangements with less developed CIS countries and watching implementation, setting up special institutional frameworks for the development of Russian regions more exposed to competition from abroad

Concerns for the North-Eastern borders with expansionary China are expressed by (Ivanshentsov 2012; Inozemtsev 2012). On a similar vein, there are security concerns for the porous borders between some CIS countries and their bordering problematic states that Russia can hardly handle on her own (Ivashov L. July 2012). Focus on the accelerated development of Siberia and the Far East is the main concern of both presidential administration and government. There is no alternative for Russia to the accelerated development of better transport infrastructure in Siberia and the Far East: Russia is paying too much for imports from the Pacific region through longer routes (Baltic ports for instance) and waiving transit fees on exports from the East to European countries that could be raised if

¹⁵ See <http://news.kremlin.ru/news/16410/print>

they would be carried through her own territory.¹⁶ Such development will need a special institutional framework, economic incentives and state investment, but also better relations with the more industrialised and advanced countries of the Pacific compared to China (Inozemtsev 2012; Ivashentsov 2012). They may also need the establishment of another capital –or at least special government agencies - in the East to facilitate businesses, but also a sense of drive in the long neglected region (Karaganov and Barabanov 2012). Counter-arguments based on perverse demographic trends, waste of money and diversion from more urgent problems and hopeless nostalgia for the past are also put forward (Lukyanov 2012, Aslund 2012).

The debate is going on and no doubt other important issues, pros and cons will keep coming out. One will need to follow closely these developments because they may also impinge on the relations between Russia and the West. These relations may improve if the modernization drive carries on together with openness to foreign investment and trade, but they could also worsen if Russian strategies are perceived as hostile and backward looking. In the first case, corporatism may evolve smoothly towards a more liberal order; in the other case it may consolidate with the help of nationalist sentiments artificially provoked or spontaneously originated in society.

A quasi-conclusion

The viability of corporatism in Russia will depend on the capacity of the leadership to garner and keep social consensus and its ability to propose goals that would help rise and maintain a strong nationalist ethos. Corporatism needs a vision and more solid pillars than what ER – or the opposition - offered so far. The ARNF may develop into a more solid organization in support of government projects in the region but needs time. A Eurasian Union focused on the development of the Asian part of Russia may offer new prospects- and vision - to people and businesses so far neglected by the government. A Eurasian Economic Space in the sense of coordination of economic/trade policy is a feasible – though time-consuming project, as the European Union (EU) shows. Compared to the EU member countries, a common language and to a certain extent heritage/mindsets should facilitate both negotiation processes and the reading between the lines that those entail. The accelerated development of Siberia and the Far East is to be seen as a historical, but not unique, break-through that will need time to deliver. Similar policies have been put in place in the through the institution of “concessions” where private companies were assigned “state” powers in certain regions or the ruling authorities were offered privileges consistent with the maintenance of a favourable status-quo. Maddison (2007) provides examples of the pros and cons of those ventures in colonized countries. Perhaps that model is outdated today, but its main pillars – a different legal framework than in the more advanced countries- may still teach something. A flexible institutional framework for business in the central-eastern regions of Russia in preparing for further integration should not be ruled out. Contrary to colonization practices, a special framework for development in Russia’s Far East could adapt to – take advantage of - local

¹⁶ See Igor’ Shuvalov, “Russia's trade with APEC to exceed that of Europe in 5-10 years” and the 7 September 2012 from: <http://www.kazinform.kz/eng/article/2492660>).

informal institutions along Steve Pejovich's theory and insights on pathfinders (Pejovich 2008).

Since in no way could the Russian federal budget finance in the short term the infrastructure that is necessary for the takeoff of the Eurasia Union project, public-private partnership projects will need to be pursued if necessary with sufficient state guarantees. Choosing the right partners – possibly large multinationals that cannot be bullied by the locals- would help saving time and boosting efficiency. Western countries should not take side against this project as a matter of principle. The EU that has little to offer nowadays should quietly monitor such developments while trying to take advantage from them. Western companies should decide what is good for them and bear responsibility. Let Russians learn from business ventures rather than from governments. The Eurasian project should not be seen as the project of a single Presidential mandate, but as a generational visionary turning point aimed at pulling together capital and human resources to fight backwardness and spur growth. Much will depend on the ethos of mobilization strategies. Whether this occurs along the vision of Russia helping to bridge West and East or, more likely, under pressure to withstand aggressive competition from the East and prepare to stem possible conflicts in the region may not matter to the average Russian. It may however change the vision of motherland among many: a point that relates to a nationalist approach that seems to be already developing in some government circles. Like cholesterol, nationalism can be either bad or good. It will be up to the leadership to be wise and choose what is good.

Phil Hanson: I think Silvana has given us much food for thought and I look forward to a lively discussion on both papers. And first of all, Silvana!

Silvana Malle: Roger, you assert that with productivity growth and potential supply growth, demand will ultimately be less than supply. But are you only referring here to domestic demand? Because this could also be an issue – you could export your food and so on. You could have rising international demand. Your presentation seems to exclude international demand. You are talking only about closed economies.

Secondly, when demand is below supply, prices should go down. This did not happen in China recently. In fact one strong component of inflation in China has been the food prices. Not always – they have gone up and down over time - but the situation is different now, that is something which would not run the way you present it. And turning to the Provident Fund in Singapore – in Italy we also inherited from fascism some sort of Provident Fund which provided housing for poor people. But only under fascism was it used for this purpose. Mussolini built housing for poor people, but this did not continue after the war. People's money was still put into the Provident Fund, but it was used for other purposes in post-WWII “democracy”. It is not enough to have a fund, but one must also see how the fund is used and managed. Here we go back to politics, and we know what the politics of Singapore are as these are serious people. Italian politics is not serious – simply put. Another scheme is France. In France there is social engineering for poor people. I witnessed this when I lived in

one of the most prestigious quarters of Paris when I was with the OECD, which was based in that quarter. I saw that, by law, each quarter had to provide housing for the poor. So each quarter, including the most expensive one, had to provide a certain number of houses for poor people. What happened? They gave the flats to poor people and the poor people sold it at market prices to wealthy people!

Phil Hanson: One question that we might want to come back to is the legacy of the Singaporean government, and in what sense they were serious people. But, Peter.

Peter Mihalyi: Thank you. Roger, you gave a fascinating, thought-provoking and informative lecture. I have a quick comment and then a question. The quick comment goes along the lines of Silvana's comment – that indeed from a macroeconomic perspective, mandatory savings are much better than income taxation as long as you have a serious government. Let me illustrate this. In Hungary, we had a pension system along these lines between 1998 and 2010. Then a new government came and took away all the money accumulated in the so-called II Pillar. When the mandatory private pension system was introduced, there was a big debate; and one of the system's opponents was an old socialist fellow, who did not like the private system. He stated publicly that it is very fine to have a private pension system, but soon there will be a government which will steal the whole thing away. A socialist said that. And he was right!

So that is the comment, and now my question. In your paper you have a section entitled "Lessons for China," and under Point 8 you recommend that China builds many "good" apartments. So the question is what is a "good" apartment? The story that you described of the link between agricultural productivity and migration into towns has happened everywhere during the socialist period. From the Soviet Union to Eastern Europe, everything basically happened the same way, and the solution in most of these countries was that the government started to build high-rise buildings. You are all familiar with this type of housing estates. These buildings were and are good quality in a certain sense. They have hot water, district heating, a kitchen, etc. They also have a supply of social institutions: shops, kindergartens, and other services. So in a way we could call them "good apartments," and they were perceived in that way when people moved into them. However, as incomes started to grow throughout the Soviet Union and Eastern Europe, people found these apartments miserable, because they were too small, and did not provide any opportunity for some activities. So people started to have second houses or *datchas*, as they were called in Russian. After the collapse of communism, there were two alternatives. There was the East German approach, which was to bulldoze practically all of these houses because they were considered to be valueless. Now from a development perspective that is a waste. You build 100,000 dwellings for a hundred years and then you simply knock them down. The other approach is the Hungarian one. There we have something like 600,000 apartments like this, which simply cannot be pulled down. We are now modernising them – insulating, improving heating systems, double glazing, and so forth. This is extremely expensive, and the market value of these apartments is still extremely low. What would you recommend to China? What type of houses should they build? You went into detail about the financial technique, which is of

course important, but my question is this: Do you recommend more stand-alone houses or rather multi-storey high rise buildings?

Krassen Stanchev: I am missing something, and that is the central bank policy. As far as I remember, the central bank of China determines both rates on credit and rates on saving. And as far as I remember, the rates on saving are kept artificially low, in order to force exports and investment. So how does this enter the picture?

And on a similar point to Peter's, this forced saving was well-known in Bulgaria, as it was in other countries. So the government, under the Bulgarian housing board, was building blocks of flats and immediately selling them to the public. This was a conduit to collect money from the public, and to finance different government priorities. To financing Nicaragua and Angola, to doing other stuff, such as paying the COMECON credits. So over time the experience was that in the Sixties the housing was reasonable. It still had a high value, people loved to live in those houses in the early Sixties. But with the second default of the Communists in the early Seventies, the quality of housing deteriorated tremendously. And with the third default in the eighties, the housing quality deteriorated even further. So the system kept the finance of the state-saving bank – which is equivalent to the housing policy of the institution in Colombia – to channel money from the state-saving bank to other purposes. So does that happen in China at all? Or are they perhaps very reasonable? Your last point is that government must capture these land values, which cannot be captured alone by vested interests. As far as I can remember, what is private in China is the user's right, not so much the full ownership or the possession right. So I thought there was something missing here. My information about Chinese property rights is probably not correct, but I do not understand this part.

Phil Hanson: Does anybody understand property rights in China? If there are no more questions right now, I would turn to Roger.

Rok Spruk: Thank you for a remarkable presentation. First of all I have a comment, and then I have a question for you.

One question regarding China: what particularly amazes me about China is that for a middle-income country with a GDP per capita of 6000 dollars (adjusted for purchasing power), the country is aging rapidly, and it is aging too rapidly for a middle-income country. For instance I will offer some of the demographic data that is striking. The fertility rate in China is below one, and below the replacement fertility rate in the rest of the world. The fertility rate in Tibet, for example, is a little above two. So in this respect, there is no surprise that the rural/urban gap is not declining in China, because of the urban mismatch of fertility distribution. And the second factor that can explain urban disparities in China is that 95% of the economic output is produced in the coastal region, which accounts for only 8% of the geographic area of the entire country. The third factor is that one of the great advantages for economics is that more and more data is becoming available, and once the data is grasped from China's statistical bureau which is incredibly difficult to distinguish, one can easily

notice that income inequality in China is one of the most rapidly rising in the world since the 1970s. What we have learnt is that the Chinese government has prepared reports showing that income inequality is declining, whereas in fact it is rising rapidly – more so than in any other country. My question to Roger is regarding the rural/urban income gap in China. Do you think that this gap can be reduced with or without inclusive economic institutions, which allow mine workers and rock breakers to participate equally in the economic opportunities?

The second point which may have already come up, regarding the long-term viability of government to provide sustainable mortgage finance, I think that we should also emphasise credit or income equality in Colombia. Of course it is not a result of only all these other bad types of inequality emerging from rent grabbing or rent seeking. A point which was recently emphasised by Daron Acemoglu and James Robinson is that Colombia has been plagued by paramilitary rule – 57% of the country has been ruled by paramilitaries since the 1960s, as far as the recent satellite images have shown. Thirdly Colombia has an extremely poor track record of macroeconomic stability, so when I hear Dani Rodrik speaking of Latin American countries adopting Washington-Consensus type policies – well this is simply not true. At least Colombia is among the countries that have really been plagued by poor macroeconomic policy, as Roger mentioned; with high inflation and a dire state of public finance.

Lastly I would like to make a small point about Singapore, especially the Central Provident Fund. Taking a closer look at the governance and investment structure of the Central Provident Fund, it is arguably demonstrated that it achieved the highest rate of return on the portfolio of its investments in the world of all government-managed pension funds. And when we realise who these experts are, highly intelligent people, most of them mathematicians, the striking aspect is that the political structure does not interfere with Central Provident Funds. This also, as Roger mentioned, allows Singapore to maintain low taxes and to robust real savings rate.

Those are my comments, and the question that I have for Roger is whether, in your opinion, the urban/rural income gap can be declined with or without inclusive economic institutions?

Lastly I would like to make a small point about Singapore – especially the Central Provident Fund. If you take a look at the governance and investment structure of the Central Provident Fund, you will see that it achieved the highest rate of return on the portfolio of its investments in the world of all government-managed pension funds. And when you realise who these experts are, highly intelligent people, most of them mathematicians, the striking aspect is that the political structure does not interfere with Central Provident Funds. This also, as Roger mentioned, allows Singapore to maintain low taxes and to time-manage the real savings rate.

Those are my comments, and the question that I have for Roger is whether, in your opinion, the urban/rural income gap can be declined with or without inclusive economic institutions?

Roger Sandilands: Okay, I will try to take those points in order.

Regarding whether the export of primary products is an escape route for the conflict between rapid productivity growth and demand, one should note that Colombia does export primaries. It is the second biggest exporter of coffee, and a major exporter of cotton, tobacco and sugar. But the growth of world demand for coffee and primaries like cotton has also grown very slowly, and Colombia is in competition with Brazil, Peru, Africa and Asia in the provision of food crops and raw materials like cotton, and one could also talk about coal. Essentially, at least as far as agricultural commodities is concerned, the green revolution proceeds apace. The number of *campesinos* in Colombia today still greatly exceeds those who are needed. There are still huge amounts of disguised unemployment in rural Colombia. And these people are champing at the bit to leave agriculture, and to enjoy the higher wages available in urban areas, together with better education, health and entertainment facilities in the towns and cities. But all of this is hinged upon there being adequate housing. So long as this is a constraint it restricts the migration process, and this maintains the rural/urban income gap. In Colombia this gap is now narrowing. So, income inequality between rural and urban is narrowing, even if within rural and urban areas the income disparities are growing. Within the urban areas, the worst disparities in particular are very markedly associated with the way in which massive infrastructure programmes like the TransMilenio rapid bus service – and metro systems – have given rise to huge windfall gains for those who happen to be living and working close to these stations. This is a continuing source of resentment and inequality that could be addressed if more were done, for example, through the *valorizacion* programmes that try to capture these windfall gains.

I hope that I have answered that part of your question, Silvana. The other part of your question, which relates to what Peter was asking – namely how far governments can be trusted to use savings that have been captured compulsorily into pension funds for productive use, rather than squandering them on unproductive military spending and so on – is of course a political question. In Colombia the story is very patchy: at times revenue has been used well and at other times not. But in Colombia the pension fund system does exist and it has been growing. It has been used to build what they call “cities within cities,” trying to intensify urban development in order to minimise the use of space for cars and roads, rather than for housing and businesses. But that has not always been the case. Someone here mentioned Colombia as a militarised country – yes and no. It was a military dictatorship in the 1950s under President Rojas Panilla, but since then there has been the drug problem and a lot of money has been poured into the police and the army to get to grips with that. They are getting to grips with it. I cannot see how else they could get to grips with it without pouring money into the military. It has been a problem that has not bothered Singapore so much. Although actually they have a lot of resources poured into the military in Singapore and they still have conscription. But Singapore has been so dynamic, that the proportion of the government budget devoted to the armed forces has been manageable, and it has been manageable through tax revenues, low though income taxes are in Singapore. Singapore chronically runs budget surpluses, which is why it preserves the foreign exchange accumulating substantially.

It has substantial foreign exchange reserves – at one point it had more than India had. With just three million people it had more foreign exchange reserves than India with its seven or eight hundred million people, or whatever it was in those days.

So with budget surpluses the need to rely on the Central Bank to finance budget deficits has been minimal. And what Singapore succeeded in doing – which in my mind is an ideal situation – is that their policy over decades has been characterised by monetary austerity, together with a tightening of monetary conditions: so that the monetary supply grows only in line with the growth of the economy; so that the supply of money grows in line with the demand for money. This means that if the velocity of circulation is stable, and to the extent that the supply of money only keeps pace with the demand for money which is related to the growth of the real economy. It is not inflationary and it is a source of seigniorage, which is a useful and desirable source of state revenue.

At the same time they have done all they could to maximise savings: genuine savings, as opposed to reliance on the printing press. This means that people who have earned their income do not spend a portion of it and instead lend it to other people to buy other things. So instead of buying a car, I am forced to put money into the CPF, and the CPF then goes into housing or infrastructure development. So the allocation of resources and the direction of expenditure differ substantially because of that. You have got tight money and a very dynamic expansion of savings. That is a beautiful combination which I think explains much of Singapore's dynamism – and non-inflationary dynamism – unlike in much of Latin America. So Singapore is a technocracy, relatively incorrupt. The propaganda is probably misleading to some degree, but compared to other countries corruption is much less. Those who are caught with their hands in the honey pot are dealt with very severely, and this includes presenting them with a silken cord to do the appropriate thing with, namely hang themselves.

How do I define “good” housing? Well, your description of apartment buildings with running water, sewage systems that work, electricity, surrounded by clinics and schools and nurseries and playing fields and jobs nearby, to my mind is vastly superior to the kind of settlements that characterised Colombia. They still do in fact, because I do not want to give the impression that everything was transformed overnight and from then on everything has been goodness and light – it has not been. There has been a very patchy record. But that is what one should aspire to. For a country that is very poor, typical housing conditions are dire, really dire. Typically the majority of the population in Latin America in the fifties and sixties and seventies were trying to make a subsistence living out of agriculture. Housing conditions in the countryside were actually worse. If you look at statistics of the number of people per room in the countryside compared to urban areas, it is worse. This is partly because the fertility rate in rural areas is much higher, on account of incomes being much lower and so on. As incomes generally grow, fertility rates fall, which is a good thing too: demographics are very important. So we have been trying to address the problem of overall rapid population growth.

Peter Mihalyi: So in this case the alternative is clear, that shanty housing is not a good solution, and nobody would recommend building that. But the alternative is what is happening in South Africa for example, where family houses are being built with government resources. I do not know a lot about it; my impression is that it is a kind of small America and everybody has a house built by the state. Is that the recommendation, which would force expansion into larger territories, or is it this type of high-rise building which I would call just for the sake of comparison the East-European model or the Soviet model.

Roger Sandilands: Well that is a typical model. In Singapore, 80-90% of the population live in high-rise apartments.

Peter Mihalyi: Yes but it is an island, a small island, there is no alternative there. My question is what is your recommendation for China, where 90% of the territory is actually active?

Roger Sandilands: Well I should like to go back to the point that Rok made – that 8% of the population live in coastal areas, and these coastal cities are producing 80% of GDP. So what? This is the typical naive geographer's approach to development: just fill the empty spaces. One should also question where business and people ought to be located in order to maximise wealth creation, and to maximise their social and welfare desires. Living in high-rise apartment blocks in Shanghai... If you have been to Shanghai, Beijing, Hong Kong – it is like Singapore! There are vast open spaces, but from an economic point of view it would be stupid to extend the periphery of Shanghai, or to build up small towns fifty miles away from each other. This would mean sacrificing the agglomeration economies that dense urban metropolises can provide. If you look at the per capita incomes of cities in Colombia and worldwide, there is a close positive correlation between size of city and per capita income. This is because of agglomeration economies.

In the sixties when the new towns were being built, and massive efforts were being put into rehousing, conditions in the area around the Singapore river – where all the entrepôt trade was being brought in and where the godowns were and so on – overcrowding was really quite scandalous. The British were being blamed for this, although I do not know if this is right. A few years ago Milton Freidman presented a very interesting series of programmes called "Free to Choose." I remember him standing dockside in Hong Kong and looking at these houseboats, where conditions were quite bad, and saying "This is a poverty to which half the world aspires." I think that he was right. The early apartments in Singapore and Hong Kong were quite small and the households were quite large, because the birth rate was quite high. They tackled the birth rate problem quite controversially. So anyway the birth rate has come down, incomes have gone up, and they have approached the change by knocking two small apartments into one. So instead of having eighty units in a twenty storey apartment block, you now have forty units.

Phil Hanson: "They" being the provincial government?

Roger Sandilands: This is the Housing Development Board in Singapore.

So the retrofitting programme has continued apace. And in my paper I give a lot of space to the question for whom housing should be built. Namely whether housing should be built *directly* for the poor, or *indirectly* by initially building middle-income apartments – as is the case in Singapore – and at a pace that matches the growth of new family formations. It may be that by building middle-income housing which is generally of a better quality, you are improving the average quality of the housing stock and facilitating an escalation process. So ultimately the very poorest have two bedrooms rather than one. The end result may be that the annual improvement in the standard of housing for the very poorest improves more rapidly than if you build directly for the poor. I would like to use an analogy for this. In Britain today I could buy a very nice car for £1000. It would be impossible to imagine building a new car that could get you around for £1000 – even £5000. But plenty of very poor people in Britain drive cars. They do not drive new cars; they drive cars that are ten years old. Why can that same principle not apply in the housing market? That is what I would recommend for China.

One point in my paper relates to China's vast accumulation of foreign exchange reserves, which they are having difficulty sterilising and consequently inflationary pressures are building up. As a result, major questions are being asked about the appropriate allocation of credit, and the distortion of the pricing structure for credit in China. This may produce big problems for them. I would say that the world economy needs China to move towards an inward-oriented development strategy, to a greater degree than they have in the past. In the past they have depended more on an export-oriented development path, to a degree that is destabilising the world economy. The counterpart of three trillion dollars of Chinese official foreign exchange reserves are massive deficits in America and Europe. This global disequilibrium is causing grave damage to our economies, and I think if China were to reorientate their spending programme towards domestic consumption – to a greater degree than they already have done through their residential building programmes – this would be beneficial for both the Chinese people as a whole, and for the world economy. I am not sure if that answers your question exactly, but that is how I have interpreted it.

I have partly answered Rok's question about the aging population and so on, and your views on Colombia's politics and history. But one quick comment I would make – yes, Colombia's macroeconomic performance has not been brilliant, but it has not been the worst by any means within Latin America. If you take a longer sweep, say the last 50 years, I think that Colombia's average inflation rate has been between 10 or 15%. But if you look at Brazil or Chile or Peru or Venezuela's, it is much worse. That is not to say that one ought to be complacent about it. But as long as China does not get to grips with its inflation problem, I think that the question of adequate compensation to savers – in terms of giving them a real return on their savings – will be problematic. It is also problematic for the demand for housing, where this front-end loading problem arises, when nominal interest rates are high because of the inflation.

Phil Hanson: Now at the moment I have got Tomasz Mickiewicz, Krassen Stanchev, John Moore and Bob Reilly.

I would also just like to put in my penny's worth. It would be interesting, Roger, to hear also whether the Singaporean experience could be replicated other than with the very special nature of the Singaporean state; namely recruitment to state positions, selection, career patterns, pay relative to the private sector. As I understand it, the Singaporean public administration is exceptional in all sorts of ways. So I wonder whether you could tell us about its exceptionality or otherwise; and how transferable the Singaporean experience is in the absence of that particular instrument for it; but first of all, Tomasz.

Tomasz Mickiewicz: It is perhaps a similar point. There were a few comments around this theme, starting with yours, Phil. Perhaps the simplest way to say this is to say that things are easier in small countries. The reason why they may be easier in small countries is that these countries are more homogenous. Since they are more homogenous, there is less advantage in and more difficult to realise some political rents at the cost of somebody else. In contrast, if you are in a country where there is some clear division along easily identifiable lines, it is easier to use politics to expropriate one group at the cost of another.

Colombia, from what I know about the country, has actually been doing relatively well recently. So in that sense we are talking more about history than the present, because I think that the situation has improved considerably over the past few years. But it was a country that was driven by internal conflict for a very long time. That conflict was also subsidised from outside, and I think the situation in Colombia improved when Cuba and the Soviet Union came close to bankruptcy, and there was basically no money to sponsor FARC. But again, it is these institutional implications that interest me, and the question of credibility that Peter mentioned. You may have a very nice scheme, but if the government is not credible then the people will not believe it and so on. So there are two levels always: the level of regulation, which is of course crucial and the level of fundamental credibility of those who implement those regulations; because if they are not credible, then nobody will believe them.

There is another story from Colombia, which I have read about but cannot verify. This is that if you think about production in the countryside, there are some products that are easy to steal and others not. It is very easy to steal cattle; this was a problem in Texas before they invented barbed wire and all this. The story I read was that the insecurity in the countryside destroyed small-holding agriculture, because the product that is the least easy to steal is sugar cane. Sugar cane is not easy to steal because unlike cattle you need to spend a lot of time cutting it and so on. So that was one of the factors driving a sort of concentration of production in the countryside, which in itself led to income inequality. What I really wanted to say is that nobody likes poverty. All of us can agree that there is no question about it. But there is an interesting rule between poverty and insecure property rights, and that was one of the factors. If you have no property rights, then you have no opportunity for poor people to accumulate wealth, because it is basically being stolen from them. And that was probably one of the factors driving this move towards the cities.

Krassen Stanchev: Roger, I would like to make a point that although it is interesting, the analysis so much resembles the central command in these issues that I cannot help but remember what has happened in our countries. There you had the government providing housing, forced regulation, and so on. You had some elements that were retained from previous property rights, but it was still easy for the government – as is now the case in China – to take property away. Ultimately I cannot see how under this system, a person who does not want to be told by the government where to live would be able to buy his or her own house. How would they do it in China? Is it at all possible?

John Moore: Very much related to the question I wanted to raise, but Tomasz mentioned the connection between poverty and property rights. What strikes me here is that there has been a lot of talk about how to provide housing in a way that will increase productivity and output. What has been almost totally excluded is anything about what people actually might want in housing, and how that gets translated into this. From the urban planners point of view of course, it is good to have fifty-storey buildings. These have not worked very well in the United States however. But for a miner, sure, maybe it is better than what they come from – but not necessarily. It is not necessarily what they would want. When the discussion is put in terms of productivity improvements and GDP growth, it sounds like people are being treated as factors of production. You would then work out how to treat these factors in the best way possible, like cattle or raw materials, but they are not. They are people with preferences, and they want something. That is what I find really missing in this discussion.

Bob Reilly: A friend of mine once described Singapore as Disneyland with the death penalty. Roger, my question is a little off-subject, but since you probably know the answer I cannot resist asking it. It is that Singapore purportedly has a high-quality health system, yet they spend as a percentage of their GDP a good deal less than half the percentage that the US spends on its health care. What is the secret there, how do they do that?

Roger Sandilands: Well I will just address that one very quickly first. The accumulated CPF balances, that have been so substantial and so rapidly rising over the years, were initially designed simply to finance retirement – so you could not touch it until you were 55, which was then the retirement age. But then you were allowed to use it, as a down payment and to service a mortgage – if you buy the apartment of whatever it is that you have been renting. But as time went by, the government extended the uses for which you were allowed to access your CPF savings, and they introduced three things. First, you could invest in the Singapore Bus Corporation to promote better public transport which seemed to be for the public good. Second, Edusave, which meant that you could use the money to buy private educational services, to pay school fees in the private sector. Third, Medisave, and if you had x thousand dollars in your account and your child had appendicitis, you were obliged to withdraw your Medisave element – I think that 12% of your balance was set aside as Medisave. If you did not withdraw it, it was yours when you retired as credit to be spent as you wished. Thereafter your child would still have their appendix operation, but it would be paid for by the state. In

effect the private sector is therefore funding the brilliant health service in Singapore. But I think the statistics you are referring to refer to the cost of state healthcare.

Bob Reilly: No I think that it is overall expense on healthcare.

Roger Sandilands: Well it might simply be that it is so well organised again, I am afraid.

Peter Mihalyi: And also the doctors in Singapore earn much less than in the United States. The American healthcare system is so expensive because the doctors earn a lot of money; and the reason why the doctors earn a lot of money is because they have to pay back their tuition fees.

Bob Reilly: Well it could also be that they do not subsidise the demand for healthcare; or maybe that the insurance costs of the doctors is not catastrophically high because of the ever present threats of litigation.

Tomasz Mickiewicz: Access to the medical profession is also very strict in America, and that creates rents.

Roger Sandilands: But that issue maybe brings me to an attempt to answer Phil's initial question about the salary structure in Singapore; and in particular he talked about the civil service. Well the health service is a state sector, and doctors are actually paid very well in Singapore, as are teachers and university professors. Although they may not match what MIT pay to their top professors, their salaries are still very attractive; and they do attract high-ranking people. There is a big joint programme between NUS – where I worked for six years – and Stanford, for example. They are prepared to pay top dollar for that, and top dollar for world class, Nobel-Prize-winning class medical people.

But the bureaucracy is highly technocratic. The educational system from primary through to university is heavily funded, and then they are extremely selective – it is highly meritocratic. They do pay well, but they get something in return and if people do not deliver, they are sacked.

Silvana Malle: Well that is a good example for all our European countries!

Phil Hanson: But if I were a twenty-one year old graduate deciding which path to follow in Singapore, would I find the immediate conditions and salary and so on as attractive or almost as attractive as being a lawyer in a private practice, say?

Roger Sandilands: Well this is very much an individual decision, as it is everywhere. There are costs and benefits, and there are psychological benefits from various professions as much as there are monetary ones. Individuals differ as to how they perceive the value of a psychological benefit as opposed to a monetary benefit, and people will allocate themselves accordingly – whether in the public or private sector, by occupation and so on. By and large

in Singapore people are free to choose where they move. One interesting sideline is that if you are a brilliant student at high school and you have got top grades, there is a great propensity for top students to want to become doctors, and the government rations this. They tell the top students, almost by lottery, how many of them can become doctors. There are others who are told they have to go into Physics or Engineering or so on. So there is that degree of control and paternalism that characterises Singapore, and restricts free choice. But by and large it is not some directed, tyrannical, totalitarian system.

Steve Pejovich: Can they trade off? I want to be a doctor but I am told I have to be an engineer, and he wants to be an engineer but he wants to be a doctor. Can we exchange?!

Roger Sandilands: I do not know about that! But you have reminded me of something that I really wanted to say. That is, in respect of land values, it is incredible how if you want to buy a car in Singapore, you must buy a certificate of entitlement. This is auctioned, and each month they auction a specific number. You cannot buy a new car without a certificate of entitlement, and they auction these according to what they regard as “road capacity.” If the road capacity improves by 1% a year, then there will be an annual growth of 1% in certificates of entitlement. Now with rapidly growing incomes, there is a huge potential demand for cars in Singapore. There is not a 1% growth in voluntary demand for cars; it would be more like 10% a year, with income elasticities of demand under market conditions. But the government has taken a view that traffic congestion is bad for the economy. Also, with the escalating growth of private demand in places like China, Beijing – the situation in Beijing is dire in respect to growth. The amount of land space, road space required to accommodate the escalating car population is something that is also driving land values up. In Singapore if you want to own a car, you have to buy one of these certificates. That means that a 1.3 Ford Escort that might cost £10,000 in Britain, would cost you about £50,000 or £60,000 in Singapore, five times the world price. And if you buy a car abroad you are subject to the additional tax as well.

This is effectively a taxation of road space for the rich people that want to acquire a car. And they amass huge revenues from this which they use to subsidise public transport – excellent for those who do not have cars! You do not really need a car in Singapore; many people would love to have a car, but they are constrained. You might say that is paternalistic, it is immoral, and you may be right. But that is the way they look at that. So I hope that has dealt with the paternalism question.

Steve Pejovich: It is like a central planning state!

Tomasz Mickiewicz: But there are rules, and they follow the rules.

Phil Hanson: Yes, they are top of the ease-of-doing business ranking.

Roger Sandilands: Well coming back to John’s point about whether people are treated like factors of production rather than as people, I would say that people are voting with their feet

voluntarily. Now it is not all together voluntary, and this goes back to Tomasz's point about displacement because of insecure property rights. A lot of that is related to the guerrilla problem, the FARC and so on, and all that is related to drugs. There is this unholy alliance between the drug barons and the semi-ideological, Cuban-sponsored, Venezuelan-sponsored guerrillas. The last few administrators have really been cracking down on this now, because they have seen that negotiating with the guerrillas is pointless. They come to an agreement; the government sticks to what it said it would do – normally backing off – and sees that the guerrillas do not stick to their side of the bargain. They just extend their power. There has been huge violence in the countryside, so there is a strong push factor, if we come back to these push and pull influence on migration. I think the biggest push factor has been the green revolution, as I explained, but there is also this violence and insecurity of property rights that has been causing people to flee in their thousands to the towns and cities.

But by and large people vote with their feet, and what should happen – to a much greater degree than in other parts of the world – is that the pull mechanism should be given more prominence. The provision of decent housing, and the supply of non-inflationary savings that go into financing that, should be expanded such that people are not forced off the land. They are then neither displaced by technology nor by the guerrillas but rather because they are happy to move. They should see that as bettering their own position and the position of the children, because of the much greater wealth-creating potential that cities represent. As incomes grow, a bigger fraction of those incomes gets spent on things that are more efficiently produced in urban areas, rather than in scattered rural communities.

On the homogeneity point – Singapore is actually in many ways heterogeneous. There is something like 75% ethnic Chinese, 10% Indian, 15% Malay, 1% European – something like that. In the past that was a big problem – there were big riots and Lee Kuan Yew cracked down quite ruthlessly on those. But he dealt with that and again, it was probably quite paternalistic through the allocation of housing in the new towns.

Laszlo Csaba: Could I just briefly insert something here? This is leading me to recall my former Professor Ivan Berend, who in 2008 or 2009 published a book with Cambridge University Press entitled 'The Economic History of Europe in the Twentieth Century.' In this book he goes to great lengths to explain that everything we try to associate with Soviet initiatives, Soviet planning and so on, by and large directly originates from colonial practice of the 1920s and 1930s. Starting with people caring about what others do in their leisure time, to cultivating physical culture and the beauty of the body and so on. I think that what Ivan had to say about this – and he made a good argument and brought up points that I had not previously thought about – was very instructive.

Just for the sake of intellectual exchange I would try to formulate some counter propositions, because if I understood correctly the big question that Silvana did not answer, but implied should be answered, is whether Putinism – this type of corporatism – is to survive until 2018 or perhaps even longer. In the EU, we have the deadline 2020, so why don't we take 2020. And my idea is that perhaps the system is more viable, more able to reproduce itself, than one

might think, because we do not consider a number of factors that are specific to Russia. I would be very surprised to see oil prices going down anytime soon, and everyone knows that the discontinuation of insufficiently high prices will direly and unfavourably affect the Russian macro economy. We saw this in 2009, oil prices went down and the Russian economy contracted; prices went up and the Russian economy recovered. As soon as oil prices are high enough, the budget is okay; and as soon as the budget is okay, the government can spend or can court a variety of interest groups. Therefore it might be more sustainable than it looks. Also, I think that it is important in this corporatist arrangement that there are neither checks nor balances. This is important, and Putin has been quite successful at getting rid of all checks and balances. It is oftentimes bordering on the absurd to see that you have thirty demonstrators taken away by three hundred policemen in the middle of Moscow. This type of overreaction is clearly indicative that he is very aware that he does not really need checks and balances. I would doubt if Edinaia Rossia were to do well in the elections whether we should draw wide-ranging conclusions, as long as the opposition is not represented. We do know that what is represented in the Duma is licenced oppositions. It is toothless opposition as the British would say. Then it is fine, then you can have it for five years and it is very democratic; and there are certain surveys in the United States and Europe that say Russia is a very normal, democratic country.

What is more important I think is still this overreliance on the resource sector, and then we have the resource curse. This is something widely studied in academic literature. It basically proposes that once you have weak institutions whilst the resource curse is still relevant, then you have this vicious circle of rents reinforcing the weak institutions that allow for rent-seeking and the further weakening of institutions. It is not inevitable – but it is an old idea, a new edition of the state idea from the 1920s – but it works under conditions which exist in Russia and that can be self-perpetuating. Otherwise you have to question what might stop the ball rolling, although I think that is unlikely in Russia. If you compare Russia to other former communist countries, there are at least two factors which would stop this. One is a large endogenous middle class that is independent of the state, rather the opposite to the Singaporean model that we have seen. The second, of course, is foreign investment and foreign ownership. If you consider nationalisation and globalisation, it is extremely obvious in the cases of Poland, Hungary and the Czech Republic that you have banks and new corporations and much of the media in foreigners' hands. When you have internet, and infiltration by foreigners, then there is simply no room for this type of nationalistic rule. In Russia this is not the case, and I would just emphasise that openness in Russia has not increased. This is especially so if you correct for oil prices, most sectors of the Russian economy are as closed or nearly as closed as they used to be. It is a very closed system, particularly in those parts that would be important for undermining the coherence of a system based on rents and state power.

Once you have it then I agree that this Eurasian Project may be good. I do not know whether this nationalism will change any time soon. I happened to watch the celebrations of this Victory Day and it was like, what, thirty years ago! It started with a minister calling to the guards, and that was for me the biggest surprise: a call I had not heard for ages! And on and

on and on. What does this mean? This is the final point, an on-going question, which way Russia should go? The Russian eagle has two heads; one looking West and the other looking East! These are not split: the two constitute one. The Eurasian Project and the WTO Project, and the special relationship with the European Union is a long story, but you probably know it better than I do. If you just think about all the energy projects, Russia would never give up this leverage it has, and it is likely to increase it over the European Union countries – in exchange for, say, exerting more leverage over Tajikistan or whatever the logic here is not clear; “less leverage”?.

Phil Hanson: To allow us some time for discussion of Slovenia, we will be running over 12.30 if everybody is okay with that.

Silvana Malle: Of course! If you command....

Phil Hanson: That is the right answer! So if the people with questions could try as far as possible to condense them... Stefan.

Stefan Hedlund: With regard to what Silvana said and the Eurasian Union business; we can debate about whether it is a good idea or whether it will work, but I think the core question is if anybody wants to join. They have three now – because Belarus has nowhere else to go, Kazakhstan because it was Nazarbayev’s idea to begin with – Nazarbayev wants to be in it, but we should not underestimate that he does not want to be an equal partner. I do not think that Putin is used to being told that! So there is friction even within the hardcore of the Eurasian Union. Now Kyrgyzstan and Tajikistan may join, at least that is the idea; ignore that. I saw an interview with Tigran Sargsyan a while ago saying that Armenia is very hesitant to join the Customs Union. Georgia obviously would not join, nor would Azerbaijan, nor the Baltic republics. I am convinced that Turkmenistan will not either because it has such good relations with China now, and that is the real hardcore energy asset in Central Asia. Uzbekistan will probably not join either, because this is a Nazarbayev project and Karimov does not like Nazarbayev very much. Karimov views Eurasianism as a form of Russian Imperialism, so he is very hesitant. All other attempts that Russians have made to build organisations are floundering on these issues.

But of course the big prize is Ukraine. Does anybody believe that Ukraine is going to join the Customs Union? The last time Putin had a discussion with Yanukovich, who has become a great disappointment to Moscow, they just agreed that the Eurasian Union is not going to pressure anybody to join. So Ukraine is not going to be in it. So you can have Belarus, Kazakhstan and Russia. It is obviously a very big deal for Putin personally. Why, I am not really sure, but I do not think that this bird is going to fly.

That is the first part. The other part is that the Russians are very insensitive, in the sense that when they started the Secretariat for the Common Economic Space at the start of this year, they should have placed it in Astana, obviously. But they placed it in Moscow, and made Khristenko the head of it. Now they are paying for it, and unnecessarily.

With respect to the WTO and the OECD, again we can debate on economic grounds whether this is good for Russia or not. I find it very hard to believe that any of these organisations are going to discipline Russia; in the sense that if you join this club, you are going to have to transform your institutions. We have a very long track record of that.

My third point, which is really the core point here, is whether Putinism will survive for a long period. I think the core here is that what Putin has succeeded in doing is completely to personalise power. And this is why he could easily leave the Kremlin to Medvedev. Whether they agreed that he was going to return or not, or whether they agreed just to share this, is neither here nor there. I think what Putin has succeeded in doing is completely draining all forms of institutions of all real content. So all this is just a facade; it does not really matter what [...] the government and all that – it is all very personal. The problem with extremely personalised power is that the guy in charge has to be grozny: he has to be respected and feared at the same time. As all know, the definition of grozny means both respected and feared simultaneously; awesome. And Putin is no longer awesome – he is being made fun of left right and centre by important elites in Moscow. So the thing is beginning to work. And I think the real problem here is that if Putin's cronies see a risk that he is going to go down, they will go down with him, and that will not be allowed to happen. So if there is a sense that Putin may be on his way out then something have to be done. And what may trigger this is obviously a fall in the price of oil, which generates terrible problems, because the party is held ransom to the oil price, and then there will have to be severe security measures which will then create all kinds of dissatisfaction in the provinces. And now Putin will be blamed for that. I saw the first opinion poll recently where more than 50% blamed Russia's situation on Putin. Now that is very new, and it is very rare in fact for Putin personally.

So if Putin has to leave, there will be a very ugly scramble for asset redistribution, and there may be some sort of negotiated solution with LDPR. And what may trigger a fall in the price of oil is that when the Euro collapses, it will take the oil price down with it; and then there will be very severe repercussions in Russia, with the Putin regime probably going down at the same time. So many forces are at play at the present, but it is very hard to gauge which way the game might go. There is not one opposition, but many kinds, and there are all kinds of opposition also within the regime. I am sure that there are many close to Putin with a great deal of sympathy for the Snow Revolution. We saw a lot of people who are close to the regime actually taking to the streets. So it is fissures and fractures all over the place. Which way they will go will be played out over the coming months, and it will have a lot to do with the Euro crisis and the price of oil.

Karl-Peter Schwarz: Recently a Romanian friend tried to explain the difference between the foreign policy of the United States and the West in general and Russia. She said that the Americans and the Western countries decide their foreign policy in terms of years or decades, whereas the Russians do it in centuries.

Everywhere there are vested interests, and they are vested under different regimes with other purposes; but the substance is the same. The very concept of the regime Eurasian Project goes

back to the geopolitical discussions in Russia in the nineteenth century. We cannot forget this. And we should also not forget that since the nineteenth century and after the revolution – Russia and its people ruled the countries in between – between Russia and Germany – a landlocked Pan-Asian. As to the effects of this generation of the Eurasian Project, I do not think that it is so important whether it happens over the coming years or not, but just to have this project once. It is a very important step by Putin, and it immediately affects not only the more obvious countries of Central Asia and China, but also the more marginal countries of the European Union. These countries are heavily shaken by prices within the European Union, where you have competitive forces reorganising themselves which are always connected with Russia. I think we also need to consider this aspect of it.

Richard Connolly: First I wonder whether this idea of the corporate state is really saying something about the effectiveness of the pastiche of the Russian State. The picture you present suggests to me that the State is at the top telling business, or business donors, what to do; and business must do what it is told and then lay passive at the bottom. But it seems to me that Russia – not just in the last two decades but over hundreds of years – has had problems with getting its orders implemented down on the ground. That compromises the whole notion of an effective corporatist state in Russia. I am not sure how it played out in Spain or Italy, whether the State there was more powerful, more able to get its orders implemented down on the ground. We could look at Russian politics over a number of areas, but very often what the State says it wants to do, has a rhetorical value but does not get implemented. It is ineffective. It is verging on useless.

So that is my first point. I also think – and this is related to the first point – that if you talk about the erosion of the transfer mechanisms of Edinaia Rossia and elsewhere, that the regions have a role to play in this, in subverting or implementing the will of the centre. I think that to exclude them from the analysis is to miss an important element of determining whether or not a policy becomes a reality in Russia.

What is causing the erosion of these transmission mechanisms at different levels? Whether or not it is a good thing, or whether what we are seeing is in some way a slow playing out of the economic modernisation hypothesis, people are getting richer now so we are seeing more economic competition. We are seeing more durable constituencies for reform, and they are complaining, as Stefan said, within and outside the regime. Some are pro-liberal, some are more nationalist – a whole variety of them, but they seem to have a greater voice. So I wonder, whether that is a structural phenomenon, whether it is because people are becoming richer. Perhaps people are becoming more ‘modern,’ funnily enough, given that the Russian government talks so much about the need for modernisation. Is what we are seeing actually a demand for the rule of law coming from below? I wonder if that is what is causing the erosion. If so, that suggests that we are going to have a pretty rocky ride for some time to come.

This brings me to a point about the regime’s survival. The point has been made about the price of oil – that is important. Another structural fact that I think militates against the

durability of Putinism is the demographic factor. The shrinking of the labour force is going to impose costs on the government that it will have to pay. If this is combined with a reduction in the price of oil, it is looking really bad. The government is then going to have to make some pretty radical changes to get the fiscal position in order, whilst responding to all these demands, these very vocal pressures from below. So it does not look good. You could question whether this regime, as you have described, will be there in six years time. Who knows, but I think over time the probability is decreasing.

On the Eurasian economic system, I agree with Stefan. You make a point that I wanted to make. Phil and I have written about the WTO and our main conclusion is that it is a bit of a non-event. Well, the Eurasian Economic Union seems to be an even bigger non-event! If Ukraine were there, then that is really important. That is a point that Brzezinski has always made about the Russian Empire – that without Ukraine it isn't one. It also seems to apply to the Eurasian Economic Union here. If it is just Russia, a couple of 'stans and Belarus, then I fail to see that it will be of much significance at all. I mean most important unions across the world have more than one large country. It is a strange union where it is dominated by one behemoth compared to its partners.

Olga Kuznetsova: Silvana mentioned at the beginning that nobody mentioned state corporatism, I really wanted to come back to this, because who knows more about this topic than her? You mentioned that corporatism needed poverty. This morning we had a conversation inspired by Roger's paper, and I mentioned the visible presence of religion in Russian politics. Religion here is very strong and I was questioning why that is, and nobody seemed to be very surprised. Religious leaders are given every opportunity to be present, and they are invited to express their opinion. I think now in light of what you said that's they are looking for an additional allies, and of course survival is on the agenda. If they can invite other groups it would be useful. But I have another question: what is going to happen to the middle class? Because you would expect the middle class to be on the opposite side; you would expect them to be veering away from Putin's policies and from supporting him. But implementing reforms would mean giving opportunities for the middle class to develop, so it appears against the agenda. So what is your take on the future of the middle class?

Peter Mihalyi: When we have meetings like this – where we analyse papers – we always work by analogies and models. Truthfully I am a bit worried by your analogy where you call it a corporatist system. Because as you say yourself, there are no trade unions there, no real parties there. But when you started to explain another analogy with Italian Fascism I was cheered up, because that is convincing. But then why do we not call it a Fascist system? Similar to Italy, not so much the Hitler era let us say. And if you think about the Eurasian Project – well of course the Italian system had this worldwide project, Hitler more so. The Japanese also had their own worldwide vision and sold it with their own Chinese branch in Manchuria: that everyone will be happy to work together. So a typical Fascist project is that everyone will be our friend under our conditions. The one-man dictatorship is also very similar to that, as Stefan explained very convincingly. So forget about corporatism, and let us agree on this being a kind of Fascist system. The fact that it cannot be sustained is very

reassuring, but whilst they are expanding towards Asia we will not be able to sleep well for a while!

Silvana Malle: Thank you all for your comments, which I found very useful. Some indeed reiterated some points that were covered in my paper, which shows that some people *did not* read my paper – neither that circulated by Lisl nor the one that I put here on the table! Having said this, yes Laszlo I really think that the system is going to stay. This system – if we leave aside oil prices, an issue which is largely exogenous and unpredictable - is not weak. It is, very difficult to predict the how, when, and what of the system. But I think this system, which I will continue to call a corporatist system, is there to stay.

Why do I call it a Corporatist system? I do not like the term Fascist because it has been labelled in a negative sense. And I do not think that Corporatism is necessarily bad. There are many types of Corporatism in the world, and they are not all necessarily negative.

The question has been raised, particularly by Richard, that the system is shaking, and that there have been protests. Regarding this point, my paper puts it very clearly: there is no systemic opposition! On this issue I recommend you all to read an excellent paper by Andrew Monaghan. He has written a paper for Carnegie Europe entitled “The End of Putin’s Era?” (with a provocative question mark). He concludes by saying that, on the contrary, we can observe in Russia the end of the opposition’s era. Andrew was present in almost all of the demonstrations; he saw who was there and who said what. He noticed that speakers who pretended to have large support from the so-called liberals were indeed met by people (most of them from Gennady Zyuganov’s communist party), screaming “who is he? Who is he? Get him out!” The demonstrators were by and large communist agitators and some other ugly nationalists. This makes me even more inclined to think that this system is going to stay, at least until the end of Putin’s presidential mandate. One can see, as I have said, that there is some shakiness of support here and there, but the authorities including Medvedev will try to control the opposition by co-opting some practical minds and the ones who are afraid of social unrest. I did not mention this in my presentation, but it is in my paper, which nobody read.

Phil Hanson: I did!

Silvana Malle: Bravo! Uno!

Silvana Malle: I say in my paper that Putin has gone more or less – again, as is typical in a corporatist state – on a sort of a co-opting exercise. Medvedev had done this earlier; creating his so-called open government and inviting a number of intellectuals and scholars from the Higher School of Economics, as well as many others, to take part in decision-making by participating in policy dialogue. Putin has done the same. He has created his Council of Economic Experts. Who is the Head of this Council? Ksenia Yudaeva, who is one of the best economists in Russia. I have known Ksenia for twenty years or so. She is a really great person, with a PhD from MIT and good economic skills! She is going to be Putin’s Sherpa: a

reform-minded official like Kudrin was for long time in the government. Putin listened to Kudrin's advice and it is likely he will do the same with Yudaeva. There are some other good people too in such extra-government bodies – including our friend Sergey Aleksashenko is in. So even people who are, or could potentially be, critical of Putin take part, one way or the other in policy making. From this we can conclude that the co-opting exercise is working very well, and that is a characteristic in corporatism.

I do not have time to answer all of the other questions. I think there have been very good contributions, critical contributions, on Eurasia. Will other countries join, how many and so on? All of this has been discussed in the Russian press by the same people who put forward the Eurasian Project. So they know what Nazarbayev is like; they know that in order to convince some countries to join, Russia will have to make concessions. All of this is known by the Russians; we do not have to teach them anything. But it is also true that this is a long-term visionary programme. It is a generational turning point. I think that we, scholars in particular, should take into account how Russia is moving. As Peter said, whilst it is moving towards Asia, it is better for us. I think it is better for everyone, because to a large extent this turn in policy shows that Russia is increasingly insecure on her eastern front and trying to avert excessive expansion of China. Interestingly, while the United States is also re-directing its foreign policy out of Europe and towards the Pacific, Russia is also moving the same way. Both countries are concerned with China's impressive dynamism. Even though its growth rate has declined this year, it is still growing very rapidly. This makes it a very significant country, and potentially a dangerous one. Facing China, Russia needs to rapidly develop her Eastern territories, although with great difficulty given the costs of such programmes. But the novelty is to finally prioritise Siberia and the far Eastern regions; to create transport and housing infrastructure; to care for eastern Russians that for centuries have been forgotten. These people are poor. There has been some improvement in the region in preparation of hosting the APEC conference in Vladivostok, but all the same, most people live in appalling conditions.

While this policy re-orientation will be good for many Russians, I also think that moving that way could reinforce that sense of nationalism which indeed worries me. In principle, nationalism should not be a concern: nationalists are not a threat per se. As Kissinger said about Putin, he is not a dictator, he is a patriot! You could put it like that. Putin wants his country to have a role in the world – fine! Maybe he does not choose the best way according to our paradigms, but that is what he is trying to do. One should not rule out increasing support in the country for his strategy. Nationalism is on the rise.

What one should not underestimate is that other (than current governments) forms of nationalism from everywhere in the political spectrum – including from the Communist party, are also on the rise and may turn to be much worse than what we observe today.

Phil Hanson: I think we really ought to call a halt here. I am very, very grateful to Silvana and all the questioners – this is something we could go on discussing for a long time. But for now I would like to thank Silvana.

Stefan Hedlund: We must always remember one thing – “it can always get worse.”

Phil Hanson: We can all agree about that.

Before we end, I would like to invite Rok Spruk to speak. Would you give us an introduction to the problems of the Slovene economy?

Rok Spruk:

Slovenia's Post-Independence Economic Performance: A Retrospective View

During the 2008/2009 economic and financial crisis, Slovenia experienced one of the deepest declines in aggregate output compared with other Eurozone members. In 2009, investment-to-GDP ratio, measuring short-term growth performance, plummeted by almost 10 percentage points whilst annual output declined by 7.84 per cent, placing the depth of recession in Slovenia amongst those of the most vulnerable members of the Eurozone. Industrial production and export - two important drivers of growth in small and open economies - declined by a third which exacerbated an unparalleled macroeconomic outlook not witnessed since the country gained independence in 1991. The really intriguing question behind this is how a society whose virtues in the post-independence period were profound could suffer such a deep recession, which has further restrained its medium-term growth potential. In fact, according to British economist Angus Maddison, between 1991 and 2008, the Slovenian economy expanded at an average 3.72 per cent annual rate, which implies that its overall output would double approximately every 19 years if economic growth continued. However, the 2008/2009 economic crisis fundamentally altered the economic policy landscape beside its macroeconomic implications for stability and growth.

The Price of Wrong-Headed Privatisation

The origins of the current crisis, unsuccessfully tackled by Slovenian policymakers, date back to the early post-independence years when the post-socialist political and economic establishment, with the idea of a gradual transition towards a market economy, dismantled barriers to trade, savings and investment step-by-step. The choice of gradualism as a legitimate economic policy implied gradual privatisation of state-owned enterprises. However, the design of the privatisation strategy did not follow the well-established empirical evidence, that sale of ownership stakes to institutional foreign direct investors delivers the best outcome in terms of large-scale enterprise restructuring. This clears the losses exacerbated by four decades of socialist self-management. Hence, the privatisation of state-owned enterprises did not follow the principles of accountability, transparency and integrity since ownership shares in state-owned enterprises were not sold on transparent and accountable terms. The entire process of privatisation evolved into a piecemeal game of political power, wherein corporate elites from old networks seized the momentum and gained direct ownership control over state-owned firms. This was either via direct informal influence

on policy establishment or via corporate control over special investment funds which controlled ownership stakes in state-owned enterprises. Such a tragic development of the privatisation episode further amplified former socialist elites' power, with profound implications for the nature of economic growth in the post-independence period. The metamorphosis of post-socialist oligarchs into capitalists wearing the emperor's new clothes completely hindered the crucial enterprise restructuring that is emphasised in the EBRD's Transition Report. Here the progress of enterprise restructuring in Slovenia has been shown to be slow compared to other successful post-socialist reformers such as Estonia, Czech Republic, Slovakia and Poland. Throughout the post-independence period, instead of Schumpeterian creative destruction, the absence of large-scale enterprise restructuring increased fierce public resistance to privatisation of poorly-managed state-owned firms. At the same time, the losses of social ownership continued to be felt: high latent unemployment rate; high probability of default due to the miserable credit rating of state-owned firms and an inefficient investment schedule due to political control rather than entrepreneurial self-discovery. The resistance to privatisation, one of the key engines of growth in post-transition economies, was increased further by lavish media propaganda that privatisation would result in significant job losses. Worst of all, large-scale enterprise restructuring was completely absent in the banking and financial sector, which should allocate credit and investment funds, by screening, to boost entrepreneurial self-selection and subsequent credit allocation.

However, the top three banks in the country (Nova Ljubljanska Banka, NKBM, ABanka) remained under state ownership and accounted for more than three quarters of the total assets in the banking sector. In the meantime, the rise of the para-state construction sector, plagued by inefficient and poorly-managed construction firms; combined with the direct influence and control over the banking sector by the government that resulted in a system where loans and credit were allocated to actors with the greatest political influence rather than to private-sector entrepreneurs with the best investment schedule. As a result, the growth rate of the construction sector accelerated, which can be demonstrated by empirical macroeconomic data. For instance, between 1992-2007. Go to the now have an investment-to-GDP ratio climbed from 12.5 per cent in 1992 to 31.9 per cent in 2007, which is the fastest recorded increase among current Eurozone members. Such an unusual pattern readily suggests that by 2007 Slovenia had a similar investment-to-GDP ratio to emerging economies in Southeast Asia, such as China, India and Vietnam. Yet, the historical economic evidence suggests that unprecedented investment booms are followed by prolonged subsequent investment busts, where growth recovery is timid due to the process of deleveraging. This triggers the lower expected investment funds and it takes years to reach pre-bust level of income and welfare. Although business cycles and output volatility are both inherent features of a market economy, slow and timid recovery can lead to profound implications for future growth and macroeconomic stability.

When Growth Comes to a Halt

Current economic forecasts by the International Monetary Fund (World Economic Outlook, April 2012) predict that Slovenia would reach pre-crisis level of PPP-adjusted income per capita in 2014, suggesting that the country experienced six years of zero and even negative

growth. Structural declines in growth beyond short-term momentum imply serious implications for future growth. Even in 2008 when Slovenia's per capita GDP peaked, she was still catching-up EU15 level of per capita income whereas the years of zero growth imply that the country should grow at a disproportionately higher growth rate in the coming years, in order to recover from the crisis era. The empirical evidence readily suggests that both medium-term and long-term growth can be accelerated through sensible policies in high-quality institutions, human capital and higher investment rate.

In 2008-2012, the Pahor government's implementation of state intervention policies to boost growth and recover from the crisis were unsuccessful. In fact, during this time, Slovenia experienced 33.3 per cent increase in debt-to-GDP ratio which remains historically the highest recorded increase in the size of public debt relative to GDP in the Eurozone. This increase in the relative size of public debt followed the issue of 10-year government bonds and a rise in public sector wages and employment against the backdrop of a wage decline in the private sector. Subsequently, the Pahor government failed to implement pension reform and labour market reform aimed at a higher effective retirement age, lower labour tax wedge and fiscal solvency of the public PAYGO pension fund.

By and large, the failure to act and implement structural reforms to reignite productivity growth led to a significant decline in Slovenia's credit rating by Moody's, Standard and Poor's and Fitch. This was to such an extent that government bond markets predicted Slovenia could no longer afford growth with such a rigid labour market and a fiscally-insolvent pension system, despite a relatively low debt-to-GDP ratio which triggered a rapid rise in 10-year government bond yield. Yet, grandiose New Deal-style public intervention failed and zero growth ensued. As Carmen Reinhart and Kenneth Rogoff recently demonstrated, the size of public debt crucially determines the subsequent economic growth.

Their evidence, based on the empirical historical overview of eight centuries of financial crisis, largely suggests that when debt-to-GDP ratio exceeds 90 per cent, economic growth comes to a halt and seldom recovers given a large burden of debt service, impeding investment, hampering job creating and lowering productivity growth which determines standards of living. As Michael Boskin recently remarked in the context of the United States' rapidly-rising debt levels since the end of 2008, "Failing to rapidly begin bending the long-run debt-GDP curve down risks a growth disaster, whose severity could be much worse even than the recent deep recession and tragically anaemic recovery. Left unchecked, it eventually risks a lost generation of growth, a long-run growth depression." Moreover, a recent study of the International Monetary Fund (Kumar & Woo, 2012) identified the effect of public debt on economic growth on a large panel of countries for the period 1970-2007, concluding that each 10 percentage point increase in initial debt-to-GDP ratio, leads to 0.2 percentage point decrease in annual output growth rate. If expansionary debt-boosting fiscal policies are continued, calculations suggest that GDP will be 17.9 per cent lower by 2030. Under the scenario of debt stabilisation and reversion, however, GDP in 2030 would be 10.7 per cent lower compared to the initial year. The overview of public debt dynamics in Slovenia readily suggests that debt-to-GDP ratio increased from 21.9 per cent in 2008 to 46.8 per cent in 2011. By 2016, debt-to-GDP ratio is expected to increase up to 57.4 per cent. If correlation implies

causality, such a magnitude of increase in the relative size of public debt suggests that the burden of debt is likely to be the major impediment to growth and macroeconomic stability in Slovenia in future years.

Contours for the Future

The only key to address the growing burden of debt in the ensuing years is a bold and decisive set of structural reforms to reignite growth and boost macroeconomic stability. The essential policy measure is a transparent and open privatisation of state-owned banking and financial services to both domestic and international institutional owners. Empirical findings and experience from other advanced countries suggest that privatisation is beneficial to both growth and corporate performance. The liberalisation of the labour market towards greater flexibility and a lower tax burden is necessary to ignite productivity growth, and is the only meaningful step towards a higher standard of living in the future. Moreover, since Slovenia possesses the most rapidly aging population in the Eurozone, next to Portugal, net financial liabilities to the present and future generation of retirees are the main culprit behind the rise of implicit public debt. Therefore, the transition from PAYGO to a fully-funded pension system based on the experience of Chile, Australia, New Zealand, Netherlands, Iceland and Switzerland is the necessary measure to boost growth through higher capital formation, and also address large net financial liabilities under a fiscally-insolvent public PAYGO pension fund. Without these measures, Slovenia can expect to face the negative consequences of a growing debt burden, which is the result of two decades of ill-informed policy decisions.