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Dial a scandal

It seems quite likely that the contract between Delhi International Airport Ltd (DIAL) and the ministry of civil aviation will end up in the courts, now that both parties have sought legal opinion on how various clauses in the contract are to be interpreted. DIAL had won the bid for modernising and running the capital's airport on the basis of a 45 per cent revenue share, but the ministry of civil aviation now alleges that the way it is structuring subcontracts for developing the airport and associated facilities could see the promised 45 per cent share fall to a paltry 6 per cent. For instance, DIAL called in bidders for developing 45 acres of land within the airport boundaries but asked for a huge security deposit which would lower rentals; the result is that the amount to be shared with the government falls dramatically. Similarly, as a news report in this newspaper points out, DIAL plans to farm out other development work at the airport to subsidiaries that will be out of the purview of the original contract between DIAL and the ministry. While a court battle could delay the modernisation of the airport, scheduled to be completed in time for the Commonwealth Games, the larger danger is that this dispute could place the very concept of public-private partnership under a cloud — especially since a number of other PPP projects too have been shown up as being poorly conceived from the government's point of view.

It is possible that the GMR group bid an impossibly high revenue share in its eagerness to win the contract, and is now taking advantage of various technicalities and loopholes to reduce what it has to give the government. But this is not the first time that revenue-share agreements are being interpreted creatively, and the government should have got wise to things and used proper legal advice to draft an agreement that took care of such eventualities. For instance, when the telecom industry moved to a revenue-share system for licence fees in 1999, companies started coming up with various offers in which a substantial part of the sums paid by subscribers on pre-paid cards was treated as processing charges or something else — handsets were bundled together with airtime, and while handset costs were inflated, airtime tariffs (on which the revenue share was to be done) were lowered. It is surprising that none of this taught the government anything. Surely, contracts should have been designed to ensure that no related parties could take over any functions in Delhi airport, that all transactions would have to be at arm's length, that all revenues relating to or accruing from the airport project would be shared with the government, and so on.

While all this points to the imperfect manner in which the contracts were drawn up and vetted, there is also the matter of a conceptual flaw in such bidding — seen also in the various port privatisations that have taken place. If a company has to part with 45 per cent of its revenues, and is still expected to make handsome profits, the only conclusion must be that tariffs in a local monopoly situation will be fixed much too high, since the firm will have to make good the revenues being shared. If the tariffs are then fixed at reasonable levels, or on the basis of competitive bench-marking, then the company which wins the bid will either go bust, cheat or renegotiate the project — there is no fourth option. One way out, in a situation where bids are invited on the basis of revenue shares, is to fix tariff principles before asking companies to bid, so that the end result is not what is known as the winner's curse. The important point is to frame model contracts and concession agreements, which can then be used in different situations — and quite a lot of work has been done on this in the Planning Commission. If, on the other hand, the wheel were to be reinvented every time, the only certainty is that the very idea of PPP will get discredited.

No room for complacency

A Russian economic miracle?

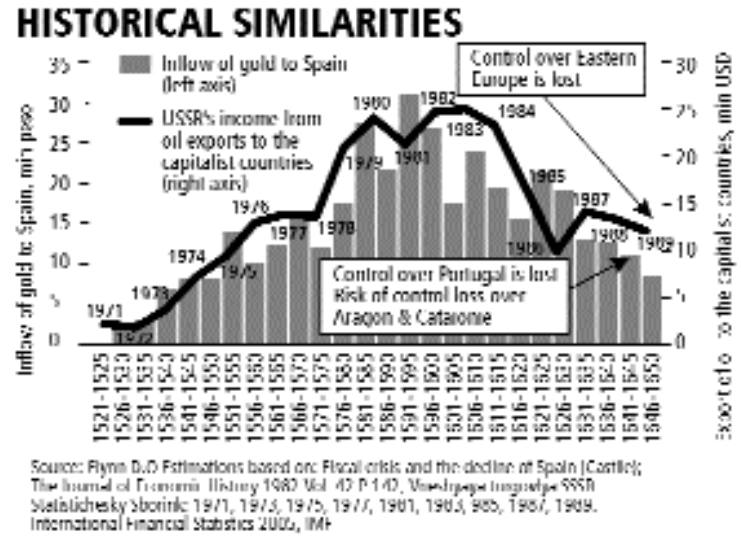
AUTHORITARIAN CAPITALISM - I / DEEPAK LAL

My wife and I were in Moscow last month for the launch of the Russian edition of my book *Unintended Consequences*. This took place in what was purportedly Stalin's dacha, where he died. It was also the venue where the foreign advisors to Yegor Gaidar's government devised the programme of shock therapy to turn Russia into a market economy. So, the cross-cultural theme of my book that, modernisation does not require westernisation, had considerable resonance with the audience there and at a seminar in the new Moscow Higher School of Economics. The major question most of the participants were concerned with was whether Russia could be a democracy, or was the creeping authoritarianism under Putin inevitable. No one thought that Russia would revert to a planned economy by eschewing its growing integration into the global market economy. In line with the thesis of my book, I argued that Russia would probably maintain its Tsarist authoritarian traditions, but this would not prevent it from continuing on its recent path of capitalist development.

A recent fascinating paper by Boris Yeltsin's first Prime Minister, Yegor Gaidar (on "Post Revolution Stabilization and its Discontents," available on www.iet.ru/files/persona/gaidar/un_en.htm), has since given me cause to pause. Though an equally impressive recent study by Dmitri V Trenin (*Getting Russia Right*, Carnegie Endowment) seems to be more in line with the argument of my book, that Russia, because of its cosmological beliefs, is likely to continue to be ruled by a Tsar — the only question being whether he turns out to be a good or bad Tsar. But that the change in Russian material beliefs with the embrace of capitalism is likely to be irreversible, because of the undeniable prosperity it has already brought and the increases in popular opulence it promises.

Thus, we are now witnessing a notable phenomenon in the former Second World of the major countries of "really existing socialism", the development of what may be termed authoritarian capitalism. In this and the next column I want to explore the implications of this fairly general phenomenon (which currently encompasses not only Russia but also the fast-growing economies of China and Vietnam) for both the global economy and its political systems. I begin in this column with the recent Russian economic miracle.

I had first visited Russia in December 1997 at Yegor Gaidar's invitation to present a paper on the political economy of reform in Latin America at a conference his Institute for the Economy in Transition had organised on the political blockages to Economic Reform. Reading his recent paper I can now see the reason for his invitation. For, the central argument Gaidar makes is that the economic history of the Soviet Union in the 20th century can only be understood by the interplay between domestic grain supplies and their prices and those of natural resource intensive exports.



Source: Flynn D.O Estimations based on: Fiscal crisis and the decline of Spain (Castile); The Journal of Economic History 1980 Vol. 40 P.140, Vuedrapes Imprudpe 9959; Statisticheskiy Sbornik 1971, 1973, 1975, 1977, 1981, 1983, 985, 1987, 1989. International Financial Statistics 2006, IMF

He argues that Russia in 1928-29 (at the time of its famous "scissors" debate) was comparable to 1979 China. Bukharin and Rykov argued for what became Deng Tsiao Ping's strategy for China: preserving peasant farms, financial stability and market mechanisms under the political control of the Communist party. Stalin instead chose the path of coercing the kulaks to disgorge grain for the towns, which, whilst working in the short run, condemned Soviet agriculture to stagnation for decades. The output of grain of 65 million tons remained unchanged for the next 25 years. Whilst the heavy industry-based forced industrialisation financed by Stalin's collectivisation of agriculture did not produce the manufactured exports, which could have financed the imports of grain that were needed, once the demand for grain with the growing population outstripped stagnant supply. By the late 1960s the Soviet Union had become the world's largest importer of grain and agricultural products.

Fortunately, by 1970, Western Siberia became a large oil producer, and its oil revenues enabled the Soviets to provide an adequate food supply to their cities. The subsequent economic and political history of the Soviet Union depended on the price of oil. With the oil price rises of the early 1970s and 1980s the value of the Soviets oil revenues burgeoned. This allowed them to feed their population and invest in arms, and undertake their military adventure in Afghanistan. But, just as in 17th century Spain, argues Gaidar, the unstable profits from natural resources meant that when these revenues declined, the imperial power had to cede control over its "colonies" even though it had not suffered any military defeat (see Fig). Gaidar cites official Soviet memoranda which show that, by 1990 it was clear that with no means to pay for the grain imports needed to maintain the domestic food supply, the only alternative was to seek loans from the West. These it became apparent were only available if force was not used to maintain the "evil empire". With mounting arrears on its imports, Western companies had stopped their shipments, and the Soviet leadership was faced by the threat of food riots. In 1990 when Lithuania declared independence, and the Soviets threatened military force to regain control, the West sent "an unambiguous signal: 'Do what you will. Please do not bother asking for hundred billion [dollars] of politically motivated loans'" (Gaidar, *op. cit.*). This began the disintegration of the Soviet empire.

On assuming power, Yeltsin was faced with the same problem of feeding the towns that faced the Tsarist regime in late 1917, the Provisional Government and the Bolsheviks. But, unlike his predecessors he realised that grain from the peasantry could not be taken by force, whilst with the deterioration of the oil industry there was not enough foreign exchange for imports. He opted for price liberalisation enabling farmers to sell their produce at a price acceptable to them. This unpopular measure and the others taken to deal with the revolutionary situation Yeltsin inherited with the collapse of the Soviet state and empire, meant that his popularity slumped. The ensuing "post revolutionary democratic" chaos led to popular demands for order, which Putin fulfilled, leading to his continuing soaring popularity.

The rise in oil prices in the late 1990s led to solid economic gains, and the order that Putins's turn towards authoritarianism has created has put demands for political freedom on the back burner. But Gaidar believes that with its level of GDP and education these will arise in the future, as has happened to the authoritarian Kuomintang regime in Taiwan. I think there is something in this, though along with Trenin I think that it is highly improbable. The economic prosperity based on exporting natural resources remains hostage as in the past to volatile commodity prices. But their de facto nationalisation under Putin does not augur well for their efficient current or future deployment. Moreover, this reliance on foreign exchange windfalls exacerbates the "Dutch Disease", with non-natural resource based exports being discouraged and non-traded goods (like real estate) booming, by the real exchange appreciation that is entailed. Finally, there is the demographic problem facing Russia. At present not only is its population declining, but also its health status with an unimaginable fall in male life expectancy. Hence my doubts about the sustainability of the Russian economic miracle.

Finally, there is an atavistic impulse — the Russian hankering for empire — reflected in some of President Putin's recent foreign policy pronouncements. With the decline of the Russian population, and with most of the natural resources fuelling its current economic boom concentrated in Siberia, where few Russians want to live, it is difficult to see how effective territorial control over this natural resource rich area can be maintained in the future. There is reportedly large legal and illegal Chinese migration already into the region. One solution to Russia's eternal dilemma of its divided "soul" — being both European and Asian — would be a variant on the "Alaska solution": to lease Siberia to the Chinese, in return for a share in the rents that the Chinese would extract from the region's natural resources. This would allow Russia to finally escape from its unviable imperial dream which has entailed authoritarianism, by becoming a natural European state — perhaps even a liberal democracy — which makes a living by its wits and not the precious bane of natural resources. But there were no takers for this line in my recent seminars in Moscow!

Indirect effects: a more realistic policy