

Russia Has Its Own Tea Party

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On Dec. 16, 1773, a group of people disguised as Mohawk Indians boarded ships belonging to the East India Company and threw chests with tea into Boston Harbor. The incident, known as the Boston Tea Party, signaled the beginning of the U.S. Revolution against the British Empire, which led to the formation of the United States.

One of many lessons from this event is that there is a link between taxation and democracy. To be more specific, there is a link between direct taxes — such as taxes on income, property or King George III's unfortunate stamp levy — and democracy. In Russia, where the bulk of the state's revenue comes from exportation of raw resources, value-added tax and other indirect taxes, the government — it may seem — can do whatever it wants.

But reality is more complex than that. Russians quietly but fiercely resist taxes when they consider them excessive and unfair. It would seem that Russia has its own covert “tea party” as well.

Like most pension systems in other countries, Russia's pension system is funded by its

current workers. This works as long as the population is growing. But Russia is shrinking at an accelerating pace. In 1992, the country's population decreased by about 220,000. In the past few years, it decreased by 700,000 to 800,000 per year. As a result, there are about 1.6 working people for one retiree, which is four times less than in the 1970s. What's more, according to the United Nations Population Division, in 2050 Russia's population will fall by a quarter from its current 140 million to 108 million.

This means that the State Pension Fund, already facing a deficit of nearly \$40 billion, will inevitably go bankrupt. This is a serious problem.

Effective Jan. 1, the payroll tax — which is comprised of obligatory payments to the pension, social security and compulsory medical insurance funds — increased from 26 percent to 34 percent.

In countries with a high compliance of paying taxes, higher taxes mean higher net revenues for the state. But in Russia, tax collection has fallen. The drop is so substantial that it cannot be explained by the economic crisis. Interestingly enough, in 2005, after tax rates were cut, tax revenues soared. Russians simply don't pay more taxes than they think are fair.

According to the Moscow think tank Center for Strategic Studies, from 2009 to 2010 payroll costs rose 25 percent compared with 2008. On top of that, the government has added higher taxes on salaries, making payroll costs even more expensive. It is not surprising, then, that business considered this unfair and quietly moved payroll expenses into the shadows.

In theory, the taxes we pay deliver dividends in the form of good health service when we get ill, reasonable state pension when we get old and quality education for our children. If the dividends are small in relation to our investment, we feel deceived.

Amazingly, many Russians do not rely on the government at all. Since state health care is low quality and sparse, many buy private medical insurance. Since the state pension is miserly, many invest in real estate to supplement their income.

Expenditures on health care as a percentage of gross domestic product are less than in any country belonging to the Organization for Economic Cooperation and Development except Turkey and half as much as the OECD average. Moreover, Russia spends only 3.8 percent of its GDP on education, less than Zimbabwe, Ethiopia or Ivory Coast.

The middle class is no longer an active consumer of state services, and it refuses to finance what it perceives as inefficient social programs. Since Russians do not believe government assurances, they realize that they are the only ones who can provide for their social needs.

The Soviet Union was a highly paternalistic state, providing its citizens with free education and health services and comparatively high state pensions. Those days are gone. Now, paradoxically, Russia is much more laissez faire than the West. By all indications, this will remain the case for the long term. The authorities tried to raise taxes and failed because Russians simply ignored the increases.

In the end, taxes will remain low for one simple reason: The government realizes that it is useless to even try raising them.

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