DIRECTORATE FOR EDUCATION, EMPLOYMENT, LABOUR AND SOCIAL AFFAIRS
EMPLOYMENT, LABOUR AND SOCIAL AFFAIRS COMMITTEE

REVIEW REPORT OF LABOUR MARKET AND SOCIAL POLICIES IN
THE RUSSIAN FEDERATION
Introduction

The scale of the economic and social problems in Russia is without precedent in the OECD area, and is more severe than those encountered in other transition economies. Existing social programmes in Russia appear to be particularly inadequate to the scope of the problems faced. This study analyses the nature of these social and labour market problems and outlines proposals for reform.

The vulnerability of the Russian economy and the unfinished reform agenda limit feasible approaches to social policy reform. The study argues that a balance is required that gives adequate attention to short-term policies and crisis management. The formulation of long-term objectives nevertheless is essential, both as a guide to coherent policies in the shorter term, and as a means of obtaining public participation and agreement in the reform process. Effective and efficient social programmes also require institutions that can administer and deliver promised benefits, enforce compliance with the rules, and monitor the outcomes.

Improvement in labour market performance is a pre-requisite for social policy reform. The solution to low wages and its consequence in Russia, pervasive poverty, must be achieved through implementation of the reforms needed to eliminate distortions in the labour market that are a barrier to higher productivity, higher wages, and non-inflationary economic growth. Higher wages that are sustainable and affordable must be a result of processes that reflect market forces: neither the legislative process nor an administrative fiat can make working pay in the longer term.

Bearing in mind the wide range of issues covered by the study, the report commences with a summary of the main conclusions of the analysis and the recommendations for policy reform. Chapter I discusses the social policy context in Russia over the last decade. Chapter II looks in detail at poverty. Chapter III assesses labour market developments, including trends in employment and wages in the formal labour market, and active and passive labour market policies. Chapter IV outlines trends in health indicators, and discusses the health care system, including the question why recent health-care reforms do not seem to have been successful. Chapter V discusses alternative paths to social policy reform, encompassing cash and non-cash benefits, with specific discussion of pension reform and approaches to assisting the very poor. The report concludes with a summary of the main findings and policy recommendations.
# TABLE OF CONTENTS

Introduction .................................................................................................................................................................................. 2

SUMMARY AND POLICY CONCLUSIONS ........................................................................................................................................ 4

CHAPTER I. THE STANDARD OF LIVING AND POLICY CONTEXT IN RUSSIA ................................................................................. 9
  1. Introduction ................................................................................................................................................................................. 9
  2. Overview of the social protection system ................................................................................................................................. 10
  3. Informal social protection mechanisms .................................................................................................................................. 13
  4. Social spending and financing ......................................................................................................................................................... 14
  5. Inter-governmental fiscal relations ............................................................................................................................................... 16

CHAPTER II. POVERTY IN THE RUSSIAN FEDERATION .................................................................................................................. 19
  1. Introduction ................................................................................................................................................................................. 19
  2. Who are the poor? .......................................................................................................................................................................... 23
  3. The “new poor” .............................................................................................................................................................................. 24
  4. How poor are the poor? ................................................................................................................................................................. 25
  5. Why the poor are poor: the policy implications ........................................................................................................................... 26

CHAPTER III LABOUR MARKET DEVELOPMENTS ................................................................................................................... 28
  1. Introduction ................................................................................................................................................................................. 28
  2. Legacy of the command economy: a stylised description ............................................................................................................ 28
  3. Privatisation and enterprise restructuring .................................................................................................................................... 29
  4. Emerging labour markets ............................................................................................................................................................... 30
  5. Labour force participation, employment, and unemployment .................................................................................................. 32
  6. Active and passive labour market policies ................................................................................................................................. 37
  7. Passive labour market policies ......................................................................................................................................................... 41

CHAPTER IV. HEALTH STATUS AND HEALTH CARE .................................................................................................................. 45
  1. Introduction ................................................................................................................................................................................. 45
  2. The health care system ................................................................................................................................................................. 46
  3. Health care reform after 1991 ......................................................................................................................................................... 49
  4. Assessment of health care reforms .............................................................................................................................................. 53

CHAPTER V. PATHS TO SOCIAL POLICY REFORM .................................................................................................................... 55
  1. Introduction ................................................................................................................................................................................. 55
  2. The political economy of social policy reform .......................................................................................................................... 56
  3. Current programmes ................................................................................................................................................................. 57
  4. Pension Reform ............................................................................................................................................................................ 61
  4. Targeting benefits: approaches to helping the poor .................................................................................................................. 69

BIBLIOGRAPHY ................................................................................................................................................................................. 73
SUMMARY AND POLICY CONCLUSIONS

Russia's reforms have been slow and inconsistent...

The transition to a market economy in Russia has been more difficult and painful than in Central European countries or China. Real GDP declined by about 45% between 1990 and 1998 according to official data, although unofficial estimates have been somewhat less dramatic. A modest recovery that began in 1997 was interrupted during 1998, after which it resumed in the Autumn of 1999 and has continued into 2000. But Russia still has a long way to go before its real GDP returns to the pre-transition level, which already was far below the country's undeniable economic potential.

...leading to more poverty and a growing informal economy.

The downward slide of the economy has resulted in widespread poverty, with a peak at over one-third of the population in early 1999 (see Chapter II). Poverty worsened after the 1998 financial crisis and it now affects all household types, including pensioners and working persons with and without children. To compensate for falling real wages and unreliable wage payments, Russians increasingly have recourse to alternative forms of survival, such as unrecorded secondary jobs, cultivation of private gardens and a variety of other activities which are not always compatible with the national interest.

Public policies must facilitate restructuring to raise labour productivity...

A period of sustained growth in the formal economy would evidently be the best remedy to many problems. Government policies should aim at creating a healthy and competitive market climate, consistent with a rapid growth of new enterprises and a necessary restructuring or bankruptcy of loss-making firms. Labour market and social policies need to support the restructuring process, for example by assisting those who lose jobs so that employers can concentrate on improving labour productivity. At the same time, it is crucial to contain public spending and limit the burden of taxes and social security contributions, which discourage job creation in the formal economy.

...and give consistent priority to alleviating poverty.

Spending on large social programmes such as pensions and public health care should be reoriented towards preventing households from falling into poverty. Too much of this spending currently benefits households with above-average incomes, a bias that has been accentuated by benefit arrears, which disproportionately hurt lower-income households, and by other recent policy developments. Russia cannot afford to help the poor effectively unless it is prepared to accept major spending cuts with respect to other policy objectives. Some social benefits should be eliminated, and for others a better targeting to disadvantaged households is desirable. This report seeks to identify the most urgent tasks with respect to poverty relief, and discusses how they could be realistically fulfilled in the short term.

Other reforms are possible only in the long...

Other possible reforms, such as creating second and third tiers in the pension system, should only be discussed in a long-term perspective. Reforms of this
nature do not only require a more predictable and buoyant macroeconomic environment. Russia also needs time to develop the institutions required to pursue the relevant objectives, and more generally to establish the confidence in government and the rule of law that underpins a democratic society and promotes public participation in the process of change.

Chapter I offers an overview of existing social programmes, highlighting the principal shortcomings that need to be addressed. The social protection system inherited from the Soviet Union is still largely in place. It is not surprising that it has been very ineffective in softening the hardships of the transition period because it was not designed to cope with such a crisis.

The system also has limited impact on the income distribution. Pensions achieve a marginal redistribution of income in favour of the less well-off, but most other programmes actually favour households with above-average incomes. There are many “privileges” for specific groups, but Russia has almost no tradition of paying cash transfers selectively based on individual needs.

Real spending on social programmes (excluding education) has fallen at least in line with the real GDP decline. It remained around 16% of GDP from 1995 until 1998, while preliminary estimates for 1999 suggest a decline to about 13% of GDP. However, some increase in the share of social spending in GDP is expected in 2000 along with higher tax receipts. The real value of all benefits has fallen over most of the past decade. Many promises have not been funded and payment arrears have been common. Pensions were constantly in arrears until the end of 1999, child allowances and unemployment benefits have frequently not been paid and are sometimes replaced by in-kind transfers of questionable value.

Russia’s problems of "fiscal federalism" (i.e. unclear financial relations between Federal, regional and local governments; see OECD Economic Surveys: Russian Federation 1999/2000) must be forcefully addressed, because they prevent effective policy-making in the social area. Federal laws that seek to oblige regional and local governments to implement specific policies are illusory when their resources are insufficient and when local priorities are different. There is a need for fund transfers to poorer regions for relevant purposes.

Chapter III looks at the labour market, which is distorted by unfair competition between employers who are playing by different rules. Some of them face hard-budget limits, others are allowed to accumulate losses; some pay utility bills while others do not; some pay taxes and social security contributions in cash, others in-kind or not at all. Numerous employers accumulate wage arrears and safety standards are sometimes low. In order to encourage the creation of sound jobs in economically viable enterprises, the government needs first of all to ensure fair competition and equitable institutional conditions for business.
To achieve this objective, the government should endeavour to break a traditional administrative bias towards preserving the status quo in employment. Enterprise owners and managers must be held responsible for improving their firms; when this is not possible, the closure of non-viable lines of business should as a rule be accepted.

Existing programmes for unemployment compensation have questionable value in their present form. With an unemployment rate of about 13% according to labour force surveys, only 0.3% of GDP was spent on labour market programmes in 1998, of which about 60% went on unemployment benefits and about 20% on running employment offices. Unemployment benefits are usually quite low, but they include an array of possible supplements that require complex administration and distort the purpose of the benefits. A flat-rate benefit that can be easily administered combined with more resources devoted to counselling and job-search assistance would be more appropriate.

Chapter IV reviews the experience of repeated attempts to reform the public health-care system from the late 1980s and onwards. They were largely unsuccessful under the prevailing adverse conditions. But some of the experience gained is potentially useful and should be taken into account in future policy making.

Health indicators showed a steep deterioration in the early transition years, but some improvement has been recorded since 1994. Life expectancy for men, for example, declined from 65 years in 1988 to 58 years in 1994 before recovering to 61 years by 1997. The changes for women were similar but less dramatic. The re-emergence of diseases that now rarely appear in developed countries is particularly alarming while suicides, alcoholism and accidents cause many premature deaths. All in all, the Russian health system is performing very poorly.

The sharp decline in public spending on health care, although an obvious problem, is not the sole explanation for the very poor performance of the health care system. Total spending – public and private relative to GDP – is roughly comparable to the OECD average, but private sources provide nearly two-thirds of total funding compared with an OECD average of one-fourth. The system also suffers from the inherited rigidities of central planning and a wasteful misallocation of resources, and access to care is increasingly determined by ability-to-pay rather than health needs.

The health care reforms implemented in 1993 and subsequently were not effective. They were too preoccupied with financing mechanisms and devolving control of health-care revenues. The available public funds now come predominantly from regions and municipalities. A trend of decentralisation was perhaps unavoidable, but the report finds that it has gone too far. The reforms placed most of the available public funds in the hands of regional Compulsory Medical Insurance (CMI) bodies whose task is to contract insurers, who, in turn, purchase health care. This "competitive contracting" model should in theory promote efficiency; but it is too complex and requires numerous institutions that are not well developed in Russia, such as health care insurers and many independent providers in each health
care market. In practice, promoting competition has not always been the prime concern of the regional authorities behind CMIs, which are not sufficiently transparent and accountable. Most notably, they have not overcome an inherited bias towards in-patient care in hospitals.

**Essential health care must be guaranteed with limited resources.**

A key challenge facing the Federal government is to ensure that essential health-care provisions are accessible to all, even if it cannot ensure more than a modest part of the necessary funding. The present legislation that promises free and comprehensive health care to all is not credible. The authorities should determine the content of a realistic package of essential health services and establish the necessary procedures and responsibilities for providing it. As an option, it may be relevant to revisit experiments in some regions between 1988 and 1991, which entrusted a fund-holding and contracting function to polyclinics.

**Targeting the most disadvantaged should be the rule…**

Chapter V returns to a question of strategic importance for the future reform path: how best to target social policies. In the face of strong pressures to preserve the status quo in various respects, it is difficult for policy makers to act consistently unless they can agree on a principle of targeting the most disadvantaged.

**…taking account of administrative difficulties.**

Direct targeting of social programmes on households with incomes below a certain limit (means-testing) is a common approach in many OECD countries. But the creation of the informational and administrative infrastructure necessary for an effective targeting of social benefits will take some time in Russia, especially in view of the prevalence of unrecorded incomes. Conceivable alternatives include the targeting of specific groups or geographic areas – but these can only have limited effect at present because, as Chapter II shows, poverty is relatively common in most household types and regions.

**A crisis-management approach is needed for the very poor.**

A third possibility for targeting is to design in-kind services that are most helpful to very poor individuals, e.g. meals in community facilities. Catering for basic nutritional requirements is an immediate concern that justifies a “crisis management” approach. Existing facilities of this type could be expanded temporarily.

**The largest programmes should ensure basic standards...**

The magnitude of Russia's poverty problem is itself a strong reason to avoid administratively complex solutions. As far as possible, poverty should be alleviated within the framework of existing general programmes. There is a case for making the minimum pension amount more adequate to prevent pensioners from falling into extreme poverty. In view of financial and administrative implications, this may be best achieved by a flat or near-flat pension for all current pensioners and those who will become pensioners in the near term. It is desirable to eliminate most of the myriad of special benefits that exist in the present system. In addition, as noted above, a strong policy commitment to provide universal access to basic health care is urgently needed.

**…while expensive pension reform proposals**

Recent Russian plans for pension reform include steps in the opposite direction from what is suggested here, making pensions more and not less differentiated. This would have alarming cost implications and make it even
ought to be abandoned. more difficult to afford helping the poor. But other elements of the planned reform, such as a phased increase of the standard retirement age, are potentially important. Moreover, this should not exclude that reforms of long-term importance are discussed and that early steps may be taken without public spending implications, e.g. to establish better institutional conditions for voluntary pension saving.

Main policy conclusions

In sum, a strong commitment to the following economy-wide objectives – previously underlined in *OECD Economic Surveys: Russian Federation 1999/2000* – is a prerequisite for meaningful policy making in the labour market and social area:

- Economic restructuring based on competition and hard-budget limits.
- Developing public institutions that inspire confidence in the rule of law.
- Collect taxes efficiently and clarify the responsibilities of different levels of government.

On this basis, the report identifies three social policy priorities as most urgent in the short term:

- The lowest pensions need to be increased.
- Access to a basic package of health-care benefits should be guaranteed.
- Arrangements should be made to ensure that the poor do not suffer from hunger and nutritional deficiencies.

To release resources for these three priorities, Russia should rationalise the present too wide range of benefits, subsidies and special privileges. Other possible reforms under discussion that would involve more spending in the short term but not primarily benefit the poor, such as additional tiers in the pension system, should be considered only as options in the longer term.
CHAPTER I.
THE STANDARD OF LIVING AND POLICY CONTEXT IN RUSSIA

1. Introduction

1. The Russian Federation has experienced severe difficulties during the course of the transition years (see Table 1.1) By the beginning of 1994, after the shocks experienced in earlier years, Russia was still struggling with high inflation and continued recession. In 1996, Russia entered a brief period of relative financial stability when it appeared that a corner had been turned. Declines in real GDP moderated in 1996, and real growth in GDP of nearly 1% occurred during 1997. This recovery did not last, however, and 1998 proved to be another turning point. The economic situation became worse at the beginning of the year and culminated in a major financial crisis in August. Inflation re-ignited and real GDP declined by nearly 5% by the end of 1998 relative to 1997. But the seeds of another recovery bore fruit during 1999. By the end of 1999, real GDP had grown by more than 3% relative to the previous year, and continued to grow in the early months of 2000.

2. The dramatic changes over the period had a significant effect on the standard of living of the Russian population. According to Goskomstat, the State Statistical Committee, real per capita income declined by more than 28% between 1994 and 1998, with large reductions after the beginning of 1998 that offset the small gains that had been made in 1996 and 1997. With the recovery in 1999, per capita income has started to grow again. It is still, however, substantially below the 1997 level.

3. The fall in real wages was even larger. By January 1999, the average wage was worth about 40% less than in January 1998 and continued to fall until the final months of the year. Some of the loss was recouped in the early months of 2000: by April real wages showed an increase of almost 25% relative to the same period in 1999, but nevertheless remained below the pre-crisis level.

4. Unemployment based on the ILO definition reached the unprecedented level of more than 14% in February 1999 before declining to about 12% by mid-year. It has remained at that level through early 2000.

5. Income inequality again increased, and the proportion of the Russian population in poverty grew to new heights. Official statistics reported a poverty rate of about 38% by the beginning of 1999 that declined to slightly over 26% by the end of the year as the recovery proceeded.

Table 1.1: Selected economic and social indicators, 1994-1999

1 Earlier estimates of a fall in unemployment based on the ILO definition to 11.7% by early 2000 were revised upward.

2 A revision in late 1999 in the composition of the market basket on which estimates of the subsistence minimum (the poverty line in Russia) is based resulted in an upward revision of the poverty estimate of 38% in early 1999 to about 43%. For consistency, the estimates used in this and subsequent chapters are based on unrevised poverty estimates since official revisions for all years are not available.
6. The system of social protection has been unable to soften the impact of increasing hardship effectively, in part because the very modest funding available is insufficient to provide help to the large numbers of the Russian people in distress. Resource limitations, however, are not the only factor that prevents the system from working well. Some difficulties are embedded within the structure of the system; others relate to the disarray in intergovernmental relations, particularly with respect to policy roles, and revenue and expenditure assignments. Yet other difficulties relate to the enormous size and diversity of the Russian Federation and its political economy. But distortions in product and labour markets that impede higher productivity and higher wages also are a critical problem – a re-occurring theme in this report.

7. The next section of this chapter provides an overview of the system of social protection in Russia and the factors that operate to limit its effectiveness in responding to the growth in poverty. Following sections examine social spending and financing, and the allocation of responsibility for policy-making and the financing of social programmes across levels of government.

2. Overview of the social protection system

Structure of the system

8. The model of social protection in place was created during the Soviet era. It mirrors the promises made and the institutions and programmes created under the former regime when poverty was not publicly acknowledged. With the emergence of open unemployment at the beginning of the transition and the demise of job guarantees, additional programmes and policies were created. The system of social protection now covers most of the contingencies that are familiar in OECD countries, as well as some benefits that are not included in systems elsewhere. There are pensions for the aged and disabled; maternity, child-birth and child-rearing benefits; benefits for work-related injury, sickness, and unemployment; active labour market measures; health care; publicly provided education; scholarships for students; and an array of social services. Less customary benefits include direct and indirect housing subsidies and subsidies for other goods and services, and myriad other categorical benefits – or “privileges” as they usually are called in Russia. There were over 1 000 types of “privileges” by 1997: social privileges that determine ease of access to many benefits, favourable adjustments to pension entitlements, periodic cash benefits and other compensation. Over 250 categories of people, equal to two-thirds of the Russian population, are eligible. However, there is no systematic provision of cash allowances to individuals and households based on need except, at the discretion of regions and municipalities, for limited periods in emergency circumstances – if funding permits. Emergency relief in the form of free meals, the distribution of food, second-hand clothes, and shelter for the homeless also is provided on a limited basis from local funds.

9. Although the various benefits remain statutory entitlements, none have been systematically adjusted for inflation. Despite ad hoc indexation, the declines in real benefit levels have been substantial, to the point of virtual disintegration of some programmes, for example, universal child allowances. Benefit levels for many programmes are determined relative to the minimum wage. Table 1.2 shows that the

---

3 Although poverty was not acknowledged in the Soviet era, it did exist and was the topic of papers with severely restricted distribution as early as the 1960s. (See Ovtcharova et al., 1999)


5 Information provided by the Ministry of Labour and Social Development

6 A new pension formula, adopted in February 1998, provided for quarterly indexation of pension amounts in line with changes in the average wage, but proved to be too expensive. The legal requirement to index unemployment benefits also generally has not been honoured.
minimum wage, which has remained at the same nominal value since 1997, declined by almost 60% in real terms since that year. The absence of an increase in the minimum wage after 1997 may not be surprising. Raising it has potentially serious financial consequences, given the link between it and the level of some benefit amounts.

Table 1.2 Real wage and benefit levels, 1994-2000

**The distribution of social benefits**

10. The large majority of benefits favour households with above-average resources. An analysis of data from the Russia Longitudinal Monitoring Survey (RLMS) by Missikhina (1999) found that households in the upper three deciles of household expenditure received 48% of benefits, while the four lowest deciles received only 25%. It is not surprising, therefore, that most of the households that received these benefits were reported to have incomes above the subsistence level (Table 1.3). Klugman (1997) also found that about 30% of very poor households did not have access to cash transfers and subsidies in 1994, while fewer less disadvantaged households experienced this problem. At the same time, some households receive multiple transfers and subsidies without any limitations.

Table 1.3 Benefit shares received by households above and below the subsistence minimum, 1996

11. The distribution of individual benefit types does vary, however. Missikhina estimated that 41% of child allowances were received by households below the fifth expenditure decile in 1996. These lower deciles only receive about 25% of most of the major cash and in-kind benefits, and therefore, she concludes that the distribution of child allowances may be less regressive than that of a number of other benefits. Child allowances, however, have been subject to serious delays in payment, or have been paid in-kind – if they are paid at all. In 1996, 60% of eligible households did not receive the benefit, and in 1998, 83% of them did not receive it according to RLMS data. Therefore, in the aftermath of the 1998 crisis, despite the decline in its real value, the payment of child allowances deteriorated further and, de-facto, it no longer existed as a universal entitlement in the vast majority of Russian regions.

12. The housing allowance, although putatively means-tested by criteria that vary by region, also was found to favour households in the upper expenditure deciles. About 21% of spending on this benefit were received by the four bottom deciles; the three upper deciles received nearly 43%. Similarly, fuel and transport subsidies heavily favour households in the upper deciles.

13. Access to medical treatment and education by households with limited resources deteriorated in recent years, and the distribution of these services became quite regressive. Informal markets expanded with the growing shortage of public funds and few households could gain access to health and education services without paying formal or informal charges. A survey by Boston University in early 1998 found

---

7 The draft budget for the year 2000 included a provision to increase the minimum wage to 132 rubles a month. (Ekho Moskvy radio, Moscow, 19 October 1999) Very few workers actually earn the minimum wage, but earnings are sometimes recorded at the minimum level in order to evade higher taxes.

8 Included were child allowances, unemployment and sickness benefits, subsidies for pharmaceuticals, fuel, and subsidies for housing and transportation for certain population groups.

9 Data on the prevalence of multiple benefits in households is available only at the local level.

10 A description of the eligibility criteria is found in Chapter V.

11 Some regions, for example, Kaluzhskaya and Karelia, have adopted legislation which formalises patient charges.
that household spending on health care in 1997 was equivalent to public spending, that is, about 3.5% of GDP\textsuperscript{12}. Formal and informal spending by parents on education for their children was estimated to be about 20% of total spending (public and private)\textsuperscript{13}. Since the ability to pay for such services is strongly related to household income, households in the highest income quintile spent more than triple the amount spent in the lowest income quintile on health care\textsuperscript{14}, and about four times more on primary and secondary education\textsuperscript{15}. As a result, the upper quintile also received a higher share of the public subsidies attached to these services. Households in the lower quintiles also abstained from getting medical treatment much more often than better-off ones, presumably because of income constraints (see Table 1.4).

\begin{center}
\textit{Table 1.4 Abstinence from medical treatment, by household income, 1997}
\end{center}

14. In apparent contradiction to the evidence that most benefits are regressively distributed, the effect of all social transfers is a modest equalising effect on household consumption, as shown by Gini coefficients calculated before and after the inclusion of social transfers (Table 1.5). The seeming contradiction – the regressive distribution of several major transfers and the slightly equalising effect of all transfers taken together is explained by the distribution of pensions and their importance in household income relative to most other transfers (see Table 1.6). Nearly all of the difference between the \textit{ex-ante} and \textit{ex-post} Gini coefficients in 1998 was attributable to the effect of pensions.

\begin{center}
\textit{Table 1.5 Gini coefficients before and after the inclusion of social transfers, 1994-1998}
\end{center}

\begin{center}
\textit{Table 1.6 Composition of household income, by quintile, 1994-1998}
\end{center}

15. In sum, total social transfers had a slight equalising effect on household resources over the period examined, attributable for the most part to the distribution of pensions. The effects of other transfers were negligible or regressive. Yet households with above-average resources generally receive higher absolute amounts of transfers compared with other households. But even in light of the regressive or, at best, proportional distribution of the large majority of social transfers, they are more important to lower income households than to those at the top of the distribution simply because they represent a larger share of household income (Table 1.6).

\subsection*{Wage and benefit arrears}

16. The sharp declines in the welfare of the population have been aggravated by the increasingly serious problem of wage and benefit arrears. Available evidence indicates that such arrears remain substantial and vary considerably across regions and localities. During 1996 and the first half of 1997, wage arrears in industry grew in real terms by 43\%\textsuperscript{16}. Wage arrears continued to increase in 1998, although the sharp increases in the consumer price index caused a decline in the real value of total arrears. The value of wage arrears again declined in 1999 and the early months of 2000, but this also was largely attributable to increases in the consumer price index\textsuperscript{17}.

\begin{footnotesize}
\begin{itemize}
\item[13] Information from the Ministry of General and Professional Education
\item[16] \textit{Russian Economic Survey}, 4\textsuperscript{th} Quarter, 1997.
\item[17] There is no legal obligation to adjust wage payments for the effects of intervening inflation when wage arrears are paid.
\end{itemize}
\end{footnotesize}
17. Pension arrears also appear to have become a quasi-permanent feature of the Russian pension system. By early 1997, pension arrears exceeded 10% of the annual expenditures of the Pension Fund, but were eliminated in mid-1997 by a massive transfer of funds from the federal budget. A second wave of arrears was triggered by the introduction of a new and more costly pension formula in February 1998, reinforced by a sharp decline in pension fund revenues. According to IMF estimates, pension arrears exceeded 17% of pension expenditures by the end of 1998. By mid-Spring of 1999, pension arrears were reduced from nearly 29 billion roubles to 16 billion roubles, mainly because of the lack of indexation and a precipitous fall in the value of pension benefits. A transfusion from the federal budget of about 1.5 billion roubles again was needed to reduce pension arrears in September of 1999. By the end of 1999, pension arrears had been virtually eliminated.

18. Unemployment benefit arrears have also increased: they had reached 2 billion roubles in 1997 and continued to climb. Those regions that were most affected by recession and unemployment also accumulated the largest arrears. The low proportion of Employment Fund collections that were transferred to the federal level, and other factors that are discussed below, made it impossible to effect meaningful equalisation of resources across regions. Soft eligibility criteria for unemployment benefits also contributed to this crisis. Nevertheless, incentives for the unemployed to register were weak in many regions because of mounting payment arrears. This is a major reason why registered unemployment declined while unemployment, as measured by the ILO definition, climbed to its highest level in 1999 since the beginning of the transition period (see Table 1.1).

19. Arrears in wages and benefits have not only had a direct effect on the economic situation of individuals and households, but they have helped to make the payment of entitlements in goods and services instead of cash a common practice.

3. Informal social protection mechanisms

20. In light of relatively low wages and declining job opportunities, frequent non-payment of wages and social benefits, reduced access to health care and other merit goods and the inefficiency of social transfers, as well as the rising price of consumer goods – how do the Russian people survive? As might be expected, informal mechanisms for self-help and for help from other people are quite important.

21. Among the most important forms of self-help is growing food, for household consumption or for barter, on a small plot owned or rented by the household. Official estimates suggest that this activity nearly doubled as a share of average household income between 1994 and 1998, although estimates based on RLMS data (shown in Table 1.6) indicate a decline in the activity across all quintiles after 1996. The activity generated the majority of in-kind income received by almost all households, and was particularly important in the budgets of those in lower income categories (Table 1.6). Lack of access to a plot that can provide or supplement the food available to a household can result in serious hardship. More than 80% of households among the new poor in 1998 had less recourse to home-grown food than the average for all

---

18 Information from the Ministry of Labour and Social Development.
19 idem.
20 Reliable data on this phenomenon are not available.
21 No explanation for this puzzling result is available.
22 Although land plots are more prevalent in rural areas, urban households often have access to a plot because ownership of a country house (dacha) is a widespread Russian tradition.
23 The “new poor” are defined as those who were not poor in the 7th round of the RLMS (1996), but who were poor in the 8th round (1998). They accounted for about 40% of all poor individuals in 1998.
poor and non-poor households that could grow some of their own food; almost one-third of the new poor had no access whatsoever (see Figure 1.1)

*Figure 1.1 Distribution of new poor households in 1998, by the relative monetary value of home-grown food*

22. Transfers from relatives, friends, and others generally accounted for a small but not insignificant share of household budgets – from about 5 to 10%, and were much more uniformly distributed as a share of household income compared with the value of food grown for consumption at home (see “private transfers” in Table 1.6.). They became increasingly important in the budgets of lower income households between 1994 and 1998, however. The low incidence of private transfers among the new poor in 1998 suggests that private transfers may make a critical difference for households at the margin of poverty: nearly 80% of households that entered poverty in 1998 received no such help (Figure 1.2).

*Figure 1.2 Distribution of new poor households in 1998, by the amount of private transfers received relative to the average*

23. In comparison with the shares represented by the value of home-grown food and private transfers in household budgets, Table 1.6 shows that social transfers, on average, contributed a larger share of income in almost all quintiles – nearly as large as the share attributable to earnings for some households. Nevertheless, their importance to an individual household does not depend on what occurs on average, but instead, on what is actually received by it. Unfortunately, nearly 43% of households that became poor in 1998 were recorded as not having received any of the major transfers. Moreover, among poor households that did receive some cash benefits or subsidies, nearly two-thirds of them received below-average amounts (Figure 1.3).

*Figure 1.3 Distribution of new poor households in 1998, by the relative amount of social transfers received*

24. The possibilities that exist to supplement household resources from unrecorded activities in the formal or the informal sectors of the economy also provide vital survival mechanisms for households. Goskomstat estimates suggest that the size of the shadow economy was about 25% of GDP in the mid-1990s, rising to about 30% by 1998. Higher estimates also exist. The Russian National Academy of Sciences, for example, estimated its size to be around 45% of GDP. A popular belief is that the bulk of such unrecorded activity for cash or barter consists of relatively small-scale transactions. Examples include street kiosks for the sale of goods (legally or illegally obtained); food vendors in outdoor markets; trade in goods that are transported to other jurisdictions and sold for hard currency (commonly called “the shuttle trade”); and other entrepreneurial activities which usually escape the tax authorities, as well as official statistics. Despite the obvious problems that unrecorded activities create for the national economy, they also represent a means of survival for many people in difficult times. This is not intended to condone such activities: it merely attests to failures in the formal economy in Russia.

4. Social spending and financing

25. Social spending at all levels of government reached nearly 18% of GDP in 1994 – its highest level during the transition period²⁴. Despite the increased hardship that subsequently emerged, social

²⁴ Expenditure on housing and transportation subsidies is excluded from the total. Housing subsidies are *producer* subsidies, and the extent to which they accrue to households is not clear. Data on direct transportation subsidies to households were not available to the Secretariat. Also excluded are social
spending declined and never returned to the 1994 level. A drop of about 25% in social spending was forecast for 1999 relative to 1998, which represents a fall in social spending of about 30% since 1994, with reductions across all areas. The largest reductions have affected spending on education and health care: spending on each fell by nearly 2% of GDP – a real spending decline of roughly 40% on each since the beginning of the transition. The relatively high level of spending on pensions as a per cent of GDP in 1998 only reflected GDP declines: real spending on pensions declined by about 10%. Real spending on other cash transfers, including child allowances, sickness, and unemployment benefits declined by approximately 20 to 30% (Table 1.7.) In that the value of per capita income declined by more than one-fourth, cash transfers clearly could not offset the decline in living standards for the large numbers of households affected.

Table 1.7. Public social expenditure as a per cent of GDP, 1994-1999

26. If social spending by former state enterprises had been taken into account, the reductions in actual spending over the five-year period may have been deeper than reported above. Expenditure on social benefits by enterprises amounted to 3.5% of GDP in 199425. As firm ownership changed and social assets were divested, albeit slowly and, as yet, incompletely, responsibility for them was transferred to municipal authorities. But the transfer of social assets to municipalities was not accompanied by commensurate funding to maintain them. Some social assets were kept on the books of enterprises provisionally, and some were not transferred to municipalities26. Given the growth in loss-making enterprises and the fiscal constraints of local governments, it is likely that some social assets were eliminated or spending on them was reduced27.

27. Social programmes, in principle, are financed in ways that are traditional in most OECD countries. A significant share of financing is based on earmarked contributions to extra-budgetary Funds for specific functions: pensions; health care for the working-age population; short-term benefits28; and unemployment compensation and active labour market programmes. The four extra-budgetary Funds29 - the Pension Fund, the Compulsory Health Insurance Fund, the Social Insurance Fund, and the Employment Fund receive total contributions of 39.5% of wages, with specific contribution rates assigned to each, presented in Table 1.8. Also shown are changes in contribution rates that will take place as part of major reforms in the Tax Code (see Box 1.1) These Funds financed expenditures on assigned functions of nearly 8% of GDP in 1998 and somewhat less in 1999. Regional and local governments had the largest role, and spent over two-thirds of the consolidated sub-national budget – nearly 10% of GDP in 1998 – to finance social benefits. The federal budget played a residual role: federal expenditure on social protection represented only about 2% of GDP (Table 1.7) However, problems that result from the unclear allocation of responsibilities to different levels of government and shortfalls in tax collections complicate the financing of social programmes.

Table 1.8: Contribution rates to extra-budgetary Funds, 1991-1999

25  Kuddo, 1998
26  A reliable accounting of the social assets transferred to municipalities and those that remain within the domain of enterprises does not exist, nor is there a full accounting of the financial consequences of the process. (TACIS, December 1998).
27  Survey evidence suggests that the magnitude of such changes may be limited. (See Tacis, 1998.)
28  Included are sickness, maternity, and parental leave benefits; child-birth allowances, funeral benefits, sanatoriums and resorts for workers, and summer camps for children.
29  A fifth extra-budgetary Fund is devoted to financing roads.
5. **Inter-governmental fiscal relations**

28. In the former USSR, both revenue raising and expenditure decisions were highly centralised; sub-national entities played a passive role. During the early years of the transition, substantial decentralisation of state finances occurred and brought with it chaotic bilateral bargaining over the division of derivation-based revenues, federal transfers, and fiscal authority. Although progress has been achieved in imposing relatively stable and uniform rules for tax assignments and the division of revenues, much less attention has been paid to rationalising the *ad hoc* expenditure assignments that have occurred.

29. Responsibility for delivering and financing the vast majority of social protection measures and several other public activities, such as price subsidies, was shifted in 1992 from the federal level of government to sub-national levels of government. Wallich (1994) argues that this was done in order to offload the federal budget deficit. Little consideration was given to the capacity of the Subjects of the Federation or of lower levels of government to pay for these new obligations. Nor was significant flexibility in raising revenues granted to them: the federal government retained control of the definition of the tax base, maximum tax rates, and tax-sharing rules for the major sources of revenue. Only 13% of regional and 8% of municipal revenue came from taxes considered to be discretionary in 1998, and even such taxes were subject to numerous federal regulations.

30. The delegation of expenditure responsibility by federal to sub-national governments without commensurate funding was prohibited by law in 1993. Subsequently, a Presidential Decree declared that all federal mandates that increase the expenditure burden on lower levels of government were obligatory only if there were explicit sources of financing in the respective budgets; otherwise, they were “recommended” rather than obligatory. Despite the lack of clarity in expenditure assignments and the reality of resource limitations, most sub-national authorities nevertheless continue to treat the federal mandates as obligatory, largely because of popular pressure and the interpretation of the courts in some jurisdictions. As a result, the unfunded federal mandates have put unreasonable strain on sub-national budgets, and it has not been feasible to fulfil them. Moreover, the budgetary pressures, rigidities in the formal revenue structure, and the high degree of direct and indirect centralised fiscal authority over revenue and expenditure at lower levels of government, have led to the creation of ways of serving sub-national interests through circumvention of the formal budget process. The reduced transparency and accountability of government officials, and the rent-seeking behaviour it invites, are barriers to formal rationalisation of the relative responsibilities of different levels of government.

31. There also are large disparities in the income and wealth of regions. The ratio of income per capita between regions with the highest and lowest incomes was 10.5 in 1993; more than 14 in 1996; and

---

30 The discussion of fiscal federalism is based in large part on OECD (2000), Chapter 3.


32 The 1997 *Law on the Rights of Local Self-Governments* also prohibits passing on expenditure mandates to lower levels of government without adequate funding.

33 The effects of federal authority on sub-national budgets include not only direct expenditure mandates, but also federal control over the minimum wage, wages in the budgetary sector, the cost of federal responsibilities carried out by local government that are not fully compensated by transfers from the centre, and federal control over revenue-sharing rates, among others.

34 For example, “voluntary” contributions extracted from enterprises by sub-national government authorities permit the creation of extra-budgetary Funds that do not show up in the formal budget. The accumulation of wage arrears acts as interest-free loans. The acceptance of money surrogates, usually with inflated-assigned values, to satisfy tax obligations also bypasses budgetary accountability. See OECD (2000), Chapter 3.
13.5 in 1998. Goskomstat data show that the incidence of poverty in the 4th quarter of 1998 varied from about 14% (Moscow) to almost 60% (Magadan Oblast; Republic of Tuva).

32. Regional needs are not adequately addressed by the system of federal transfers or by rules that impose uniformity on the proportion of revenues raised from a local tax base that must be shared with the federal level of government. The application of uniform revenue-sharing rules to revenue collected at a local level, without regard to taxable capacity or expenditure obligations, exacerbates regional differentials, although some regions cannot or do not abide by those rules. Federal transfers to regions, as well, have been ineffective in reducing regional income differentials, in part because of the low and declining share of funds allocated to them, and in part because allocation of the limited resources is too widely spread. An amount equal to about 3.8% of GDP was allocated to transfers from the federal to regional governments in 1994; it declined to 1.8% of GDP in 1995 and 1998. The low rate of centralisation of extra-budgetary funds also provided meagre resources for inter-regional redistribution from 1995 to 1998. Funds available for re-distribution were less than 10% of total spending from the Pension Fund; less than 6% of spending from the Compulsory Health Insurance Fund; and, according to some estimates, less than 4% of spending by the Employment Fund. The result was that the poorest regions accumulated the largest stocks of wage and benefit arrears.

33. At the height of the Pension Fund crisis, pension arrears varied from zero in regions with a favourable ratio of payroll size to pension liabilities, to more than three months in regions where this ratio was particularly unfavourable. Regions with positive monthly budget balances were forwarding resources to the central account of the Pension Fund; regions with a cash deficit spent all collections locally. The ability of the Pension Fund to equalise the capacity of regions to pay benefits was therefore reduced at a time when it was most urgent to increase it. Transfers within regions also were problematic. Regional authorities often favoured large cities at the expense of the rural population that was less vocal politically, and, on average, poorer.

34. Imbalances in the Employment Fund triggered even deeper problems in some regions. Even surplus collections at the regional level generally were not centralised. The official share of collections required by federal law to be transferred to the centre is relatively modest – only 20%, and Employment Fund officials were not able to enforce even this modest requirement. As a result, arrears in unemployment benefits varied from zero in, for example, Moscow and St. Petersburg, but exceeded 12 months in the majority of distressed territories.

35. The Compulsory Health Insurance Fund had similar problems. Of the total contribution rate of 3.6% of payroll, only 0.2% is centralised and used for inter-regional equalisation and other purposes. The poorer the region, the fewer the resources it had at its disposal; low equalisation transfers could not alter the situation. The previous conclusion that access to health care favours households with above-average resources therefore is reinforced by unrelieved regional disparities.

36. The problems were exacerbated by shortfalls in potential revenue collections, which varied not only geographically, but also by Fund. The Compulsory Health Insurance Fund has shown the highest average collection rate, possibly because of the regional interest in collecting revenues controlled by the region, while the shortfalls in the Pension and Employment Fund collections have been relatively larger. The differences reflect the divided responsibility for the collection of contributions, and the ability and

36  Ministry of Finance
37  Data from the Pension Fund, the Federal Compulsory Health Insurance Fund, and the Ministry of Labour and Social Development. Data for the Employment Fund are for 1997.
38  Informal discussions with former Russian Pension Fund authorities.
willingness of different bodies to enforce payment. Federal representatives at the regional level are responsible for collections for the Pension Fund; local labour offices collect contributions for the Employment Fund; the Social Insurance Fund has its own collection mechanism; and regional authorities are responsible for the collections for the Compulsory Health Insurance Fund. The potential for equalisation across the Funds is lost, accountability is diminished, and duplicative administrative structures lower the resources available for the specified functions. For all of the reasons cited, the recent Tax Code legislation that drastically changes the process represents a step in the right direction (see Box 1.1)

Concluding comments

37. An obvious result of the disarray in the state of intergovernmental fiscal relations is the mismatch between expenditure responsibilities and available resources. There is no single remedy for the larger problem; a comprehensive approach will be necessary\(^{39}\). The absence of explicit expenditure priorities at the federal and sub-national levels of government clearly contributes to it. But clarity in the definition of national social policy objectives and those areas in which local discretion and responsibility is warranted must precede decisions about which level of government should finance social programmes.

<table>
<thead>
<tr>
<th>Box 1.1 The Unified Social Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>The intention of the federal government to lower payroll taxes has taken shape in the context of the major reforms of the Tax Code. A unified social tax that will be included in the state budget will replace all separate contributions to the Pension Fund, the Social Insurance Fund, and the Medical Insurance Fund. The maximum rate proposed is 35.6% – 3.9 percentage points less than the current combined rates for the four Funds. Part of the reduction in the payroll tax rate is attributable to the elimination of the 1% levy on employees currently required for the Pension Fund and elimination of the 1.5% levy on payrolls for the Employment Fund. Unemployment benefits are to be financed directly from the federal budget. (The responsibility for financing the other functions of the Employment Fund is not clear.) As Table 1.8 shows, the Pension Fund will receive revenues equivalent to a 28% contribution rate, the Social Insurance Fund will experience a reduction, and there is no change in the tax rate determining revenues for the Compulsory Medical Insurance Fund.</td>
</tr>
</tbody>
</table>

Changes in the tax base also are included among the proposals. The maximum tax rate of 35.6% applies to salaries of less than 100,000 roubles and decrease in steps to a low of 2% on salary payments in excess of 600,000 roubles. The application of the regressive rate structure is limited for employers that had a low average taxable base per employee (as defined in the law) in the previous tax period. A pre-specified proportion of employees earning the maximum salaries paid by the firm, depending upon firm size, is excluded from the calculation of the average taxable base per employee. Coupled with these and other changes in the Tax Code are measures to improve tax collections. It is therefore not immediately obvious what effect these changes will have on overall revenues to the Funds, except that there is an explicit intention to reduce revenues to the Social Insurance Fund.

This chapter of the draft legislation on the reform of the Tax Code was adopted by the Duma in mid-July, and was acted upon favourably by the upper chamber, the Federation Council, on 26 July 2000.

---

\(^{39}\) For a full discussion of the issues and the current Russian programme for the reform of intergovernmental relations, see OECD (2000).
CHAPTER II.
POVERTY IN THE RUSSIAN FEDERATION

1. Introduction

38. The official poverty rate in Russia reached a historic high of almost 38% at the beginning of 1999. This represented a jump of more than 15 percentage points from January of the previous year, and a sharp increase from the official annual poverty rate of about 21% in 1997 – the lowest one recorded during the transition period. It moderated by the end of 1999 to slightly more than 26%, but this drop still left more than 40 million people in poverty. Although some experts find that official poverty rates are overstated, other unofficial estimates indicate that the poverty rate may be even higher than official estimates suggest. According to RLMS data, more than one-half of the population was poor by the end of 1998 (see Figure 2.1.) Despite the disparity in poverty estimates that use different data sources or methods, the size of the Russian population in poverty is indeed very large (see Box 2.2 and Box 2.3.)

Figure 2.1: Poverty trends in the Russian Federation, 1991-1999

39. Poverty not only grew between 1994 and 1998; it also became deeper and more severe. As Table 2.1 shows, the poverty deficit – the minimum amount required as a per cent of GDP to eradicate poverty – was larger in 1998 than it had been in earlier years, as was the average shortfall and the severity of poverty. There was more extreme hardship and larger concentrations of very poor individuals in each successive period.

Table 2.1: The poverty gap and the severity of poverty, 1994-1998

Box 2.1: Glossary of poverty terms

A poverty line or poverty threshold specifies the standard of consumption below which a person or household is deemed to be “poor”. The construction of a poverty line may rely upon both objective and subjective criteria

An absolute measure of poverty does not vary with changes in overall living standards and is based on the cost of a specified market basket. The basis for the determination of the contents of the market basket may vary, however. (The poverty line in Russia is an absolute measure, described in Box 2.2.)

40 See definitions of poverty terms used in this report, Box 2.1
41 See Chapter I, footnote 2
42 The earlier estimate of more than 34% was revised downward.
43 See Ovtcharova et al., 1999
44 The RLMS, which began in 1992, was conducted during the fourth quarter of each of the years examined in this chapter -- 1994, 1996, and 1998. Therefore, references in this chapter to RLMS data in a given year refer to the 4th quarter of that year.
A relative measure of poverty is related to living standards and the distribution of income or consumption in a country and varies with changes in them. For example, a relative poverty line may be specified as that income level which is a certain percentage below the mean of an income distribution.

The poverty rate or poverty headcount is a measure of the prevalence of poverty.

The incidence or “risk” of poverty is defined as its rate of occurrence in a population group. It is measured as the proportion of a specified group that is poor.

The terms “poverty gap” or “poverty depth” are used interchangeably and have two distinct components:

The poverty deficit is an aggregate measure of the depth of poverty. It is equal to the sum of the monetary distance below the poverty line of the resources available to each person. It measures the depth of poverty and represents the minimum cost of eliminating poverty, that is, the cost of eliminating poverty if transfers to the poor are perfectly targeted.

The average shortfall is a per capita measure of the depth of poverty. It is equal to the poverty deficit divided by the number of persons below the poverty line.

The index of poverty severity is a composite measure of the poverty gap and income inequality. The severity index is quite sensitive to the gains or losses of the very poorest of the poor – a quality that is not inherent in the measures discussed above. It is used in comparisons over time, or between groups, or in comparing the results of alternative policies. A higher rank order of the severity index, rather than the precise number obtained, indicates that poverty is more severe in one case compared with others.

The indices used in this report for poverty depth and severity are the Foster-Greer-Thorbecke measures:

\[ P_q = \frac{1}{n} \sum_{i=1}^{n} \frac{z - y_i}{z} \]

where,

- \( z \) = poverty line;
- \( y_i \) = consumption of the \( i \)th individual;
- \( q = 0 \) (poverty headcount), or \( q = 1 \) (poverty gap),
- or \( q = 2 \) (poverty severity).

40. A substantial amount of analysis has been done to identify the poor in Russia. Appropriate and affordable policies to alleviate poverty require information about the characteristics of the poor and the reasons why they are poor. Simply giving money to all of them would be prohibitively costly, even if the money could be perfectly targeted (Table 2.1). Nor would such a policy be a suitable solution for everyone who is poor if it fails to address the underlying causes of income inadequacy.

41. Several studies have analysed poverty in Russia prior to the crisis in mid-1998 and have emphasised the high risk of poverty faced by households with children, particularly those with numerous and relatively young children and lone-parent families. Moreover, it was found that pensioners were less likely to be poor than working-age families. The unemployed and workers earning low wages were also identified as new vulnerable groups in the 1990s. Gender, however, was not a significant indicator of the risk of poverty, except among older age groups. Examination of the geographic dimension of poverty indicated that poverty in rural areas was less severe than urban poverty in the early transition years, and
that regional variations in poverty were dramatic. In sum, the factors that have been prominent in identifying potentially poor households and individuals in Russia are broadly similar to those in most OECD countries – household composition and size, labour force and employment status, wage rates, and geographic location.

42. Although many of the above observations remained valid, modifications of the conventional wisdom in Russia emerged by the end of 1998. Subsequent sections of this chapter examine the poverty profile of the poor based on RLMS data, and the changes that occurred over a five-year period, particularly those that became visible in the immediate aftermath of the August crisis. The final section summarises the broad policy implications of the changes in the profile of the poor in Russia.

---

**Box 2.2: The Subsistence Minimum**

The subsistence minimum, based on the concept of absolute poverty, was introduced in early 1992, and is used as the official poverty line in the Russian Federation. It was determined by the cost of a market basket, valued at average prices in each region, that provides the minimum required caloric intake as recommended by Russian research institutions and the World Health Organisation. The share of food, goods and services and any obligatory payments such as taxes that are contained in the total market basket corresponded to their proportions in a low-income family budget until a change in the method of determining the non-food items in the market basket was made in November 1999. The consumption of items is differentiated by the age of each household member. Under the former methodology, the share of food represented slightly more than 68% of the cost of the average basket. The food share was 82.9% for a pensioner; 61.6% for a working-age adult; 74.5% for a child six years of age and under; and 73.4% for a child from seven to 15 years of age. A consumption equivalence scale adjusts for differences in the age-composition of households: the subsistence minimum amount for children is calculated as 0.9% of the standard for a working-age adult, and for the individuals of pensionable age, 0.63%. No distinction is made by sex. Adjustments for household size are made on a per capita basis. The average per capita subsistence minimum was 936 roubles per month in August 1999 and, based on the new methodology, increased to 1138 roubles early in 2000.

There was no consensus that the unrevised subsistence minimum level was an appropriate poverty threshold. Mikhailov (1996) argued that the official subsistence minimum was an inadequate measure of poverty in Russia. Designed as a temporary measure under conditions of acute economic crisis, he claims that it traditionally understated needs for non-food consumption items and durables – items which have risen considerably in price. Ovtcharova et al. (1999) held a similar view. In contrast, officials at the Ministry of Labour and Social Development stated that the (unrevised) subsistence minimum might have been unrealistically high: if the measure of poverty had been accurate, the manifestations of poverty would have been more apparent. Other officials supported the view that the poverty threshold was too high. One reason given was that the use of average prices in retail establishments did not reflect the actual shopping habits of Russians and, therefore, exaggerated the cost of the subsistence market basket. Officials in Astrakhan, however, considered the level of the subsistence minimum reasonable, while officials in Tula considered it too low.

---

45  For example, Braithwaite, (1999); Grootaert and Braithwaite, (1998); Milanovic, (1998); Ovtcharova et al. (1999); Mozhina and Ovtcharova, (1998).

46  Discussions with officials in Moscow, Astrakhan, and Tula in June 1999.
Box 2.3 Caveats on the assessment of poverty in Russia

Despite the strong evidence that hardship in Russia has increased, it is nevertheless difficult to interpret accurately the severe picture of poverty that is described above. The propensity to under-report income, other measurement problems, and the distortions introduced by a large underground economy cloud any analysis of poverty in Russia. These factors also make it difficult to target benefits on the poor through means-tested programmes with reasonable accuracy.\(^{47}\)

First, the choice of the basis for poverty calculations is a critical factor. Although under-reporting of income is not uncommon in household surveys, particularly in the upper and lower tails of the income distribution, the degree of under-reporting of income in Russia appears to be substantial in all quintiles.\(^{48}\) As Table 2.2 shows, the difference between poverty estimates based on income versus those based on expenditure using RLMS data vary considerably: household expenditure data generally result in a lower poverty estimate by a significant margin.

Table 2.2 also documents the large disparities between official poverty estimates based on the Household Budget Survey (HBS) data and those based on RLMS data. The discrepancies may be due, in part, to changes in the methodology used by Goskomstat. In 1994, a controversial upward adjustment was made to the raw income distributions from the HBS to attempt to compensate for income under-reporting. In 1997, a second adjustment was made and an estimate of “disposable household resources” replaced reported income as the primary criterion.\(^{49}\) As a result, there are discontinuities in the data series based on the HBS. Poverty rates estimated by RLMS data have been 10 to more than 20 percentage points higher than official estimates since 1994, and do not show a decline in poverty at any time during the transition period, whereas the direction of change of official poverty statistics has cycled.

The choice of a poverty line and the equivalence scale used for adjustments to family size also are critical in the estimation of poverty, and there is disagreement about them in Russia. (See Box 2.2 for a discussion of the poverty line.) Official poverty estimates adjust for family size on a per capita basis – as does this study in order to maintain comparability with official methodology. This assumes that there are no significant economies of scale experienced as family size increases. Ovtcharova et al. (1999), based on household consumption data from the Volgograd region, has estimated an equivalence scale that declines slightly with household size, although less steeply than frequently used alternatives.\(^{50}\) The relatively low share of housing costs in the Russian household budget is one reason for the modest gradient of the estimated equivalence scale which ranges from 1 to 3.6 for households of one to five and more members. This adjustment for household size results in poverty rates that are more than 10 percentage points lower than official estimates. If this approach is correct, the use of per capita income in adjusting for differences in household size also undercounts smaller households and over-counts larger households among the poor.

---

Table 2.2: Poverty Headcount by income and expenditure measures, 1994-1998

---

47 Experiments using a proxy means test were sponsored by the World Bank and the Russian authorities in three regions. Preliminary evaluations suggest that there have been significant errors of exclusion and inclusion in these experiments, but final evaluations have not yet been completed. (See Braithwaite, 1999; Ovtcharova et al., 1999.

48 See, for example, Braithwaite (1996), Annex One, Table A-1.

49 Ovtcharova et al. (1999)

50 Korchagine et al. qualify their results by the observation that, to some (unmeasurable) extent, the savings that accrue to marginal additions to family size might be attributable to reductions in the quality of consumption rather than to economies of scale.
2. Who are the poor?

43. The view that the problem of poverty in Russia is particularly acute for households with children and less so for pensioner households was no longer as obvious by the end of 1998 as it may have been earlier. Nor were households that included only working-age adults more likely to be more immune to poverty than were others – a contrast with the experience of OECD countries. Virtually every household type was at risk of economic hardship as it became more widespread. The prevalence of different types of households among the poverty population in each year examined, however, varied considerably.

**Poverty population shares**

44. Households composed of one or more adults and children contributed the largest share to the poverty population in each year examined – more than one-third according to RLMS data, but less than 10% of them had only one adult present. Households that included one or more pensioners, nearly one-half of which also included a working-age adult, represented more than one-quarter of poor households over the period. Those composed of only working-age adults were almost one-fifth of poor households in 1998, which was somewhat more than in previous years. Although there were slight to moderate changes in the prevalence of various groups, the same rankings of household types prevailed over the period from 1994 to 1998 (see Table 2.3.)

45. These rankings should not be surprising. The contribution of each household type to the poverty population was closely related to its prevalence among all households. What may be more surprising is that the presence of children in the household was no longer a distinguishing factor among poor households by late 1998: households with and without children were almost equally numerous.

**Table 2.3: Composition of poor and new poor households, 1994-1998**

46. The incidence or risk of poverty among different types of households varied somewhat, but was quite high for all categories in 1998 (see Table 2.4.) The highest incidence was found in households that included children and pensioners. Nearly 60% of these households were poor in 1998, but they represented only a modest share of all poor households. The lowest incidence occurred among households that included one or more pensioners: under 40% of these households were poor, but they accounted for as many poor individuals as did the households with the highest incidence of poverty. Households comprised of one or more adults and children also had a very high risk of poverty – about 55%, and, as mentioned above, were the largest group among the poor. In fact, differences in the prevalence of household types among the poor were far greater than differences in the risk of poverty associated with each of them. The risk of poverty among different household types had moved towards convergence in the post-crisis period, in contrast to the significant variations in previous years.\(^{51}\)

**Table 2.4 The incidence and prevalence of poverty in 1998, by household type**

\(^{51}\) Results based on RLMS panel data for 1994 and 1996 show that the risk of poverty for households with children, with and without pensioners, was almost twice as high as the risk experienced by those without children. (Braithwaite, 1999, Annex 3, p. 18.) However, the RLMS panel data used in the referenced study is not strictly comparable with the RLMS cross-sectional data used in this report.
3. The “new poor”

47. The changes in the composition of the poverty population and the risks faced by different household types were due to the characteristics of the “new poor” – defined as those households that were poor in the RLMS survey in the post-crisis period that had not been among the poor at the time of the 1996 survey. These new entrants accounted for more than 40% of all poor households in late 1998. The clear majority of them were households without children. While the nuclear family remained the most visible group, it was less visible among the new poor than it was among all poor households in 1998. The observation that households with children were no longer a large majority of the poor in late 1998 does not necessarily mean that their situation improved, but it does suggest that the situation of households without children became relatively worse. The economic situation of pensioners, in particular, disintegrated and they flooded the ranks of the “new poor”. Households that included only pensioner households outnumbered households with adults and children among the new entrants to poverty – a reversal of the traditional hierarchy.

48. The rank order of household types most at risk of poverty also changed among the “new poor” in 1998. The incidence of poverty among pensioner-only households was higher than it was for households with children and adults, while the opposite ranking was found among all the poor. Households with both children and pensioners, however, remained the group most at risk (see Table 2.4).

49. The major factor affecting the growth in the number of pensioners among the poor by late 1998 was the sharp decline in the real value of pensions. The average monthly pension was 90% of the subsistence minimum for a pensioner in the 4th quarter of 1998. By December 1998 it dropped to slightly below 80%. By January 1999 it fell to 72%, and by March it had fallen to 65% of the subsistence minimum. The minimum pension amount was only 50% of the subsistence minimum by the 4th quarter of 1998, and was estimated by Goskomstat to have dropped to 40% by March 1999. The increase in poverty among pensioners points to the desirability of pension reforms that elevate pension levels for current pensioners, particularly at the lower end of the pension distribution.

Household size

50. Household size generally is a good predictor of poverty, but the concentration of poverty in large households diminished somewhat over the period. The average size of poor households was estimated, based on RLMS data, to be just over three persons in 1994, with slight declines observed in subsequent years. The average size of all households was estimated to be about 2.8 in 1994, and also declined thereafter. More than one-half of all individuals in poverty in each year examined lived in households with four or more members – a size that is larger than average for poor households and much larger than the average for all households (Table 2.5).

Table 2.5: The composition of poor and new poor households by household size, 1994-1998

51. The profile of household size among the poor changed along with changes in the composition of the poverty population. The distribution by size of poor households, as shown in Figure 2.2a, indicates that they were most frequent around the mean household size of about three persons in 1998. The highest concentration in 1994 had been at a household size of four persons. A large part of this change undoubtedly is explained by the influx of pensioner households, which contain fewer individuals than average. In fact, the distribution of households by size among the “new poor” showed the highest concentration at a household size of two persons (Figure 2.2b). The average household size among the

52 Declines in the fertility rate and other demographic factors also influenced changes in the average size of households.
poor was clearly moving toward convergence with the average for all households. The largest households, however, still accounted for the majority of poor individuals in 1998, although only one-third of all individuals lived in households of four or more persons among the new entrants to poverty in that year.

52. As might be expected in large households, those with dependent children were dominant. More than 85% of all large households that were poor contained one or more children, but numerous children were not always the only reason for the large size of a household. More than one-quarter of large households included pensioners. Among the new poor in 1998, nearly 40% of large households included one or more pensioners. (See Table 2.6.)

Table 2.6: Composition of households with four and more members, 1994-1998

Figure 2.2: Frequency distribution of the poor and the new poor by household size, 1994-1998

4. How poor are the poor?

53. The question, “who are the poor?” was raised above. The answer, in brief, was that identification of the poor by categorical indicators such as age or household composition no longer appeared to be a reliable approach. Virtually all types of households and all age groups had a high risk of being poor. Each, moreover, was represented in the poverty population more or less in accord with its prevalence in the population at large, with the nuclear family as the largest group. But households with children were not the majority among the new entrants to poverty in late 1998: pensioner households were the dominant household group. The shift in the composition of the poor and in the risk faced by different household types, albeit significant, does not itself reveal who are the poorest among the poor. This is examined below.

The poverty gap and the severity of poverty

54. Two critical dimensions of poverty are its depth and its severity. The aggregate economic distance from the poverty line of all the poor is a measure of the depth of poverty. When the depth of poverty is comparable in two groups, however, the extreme poverty that may exist in one group but is absent in the other is not captured by this measure. The index of severity is a measure that ranks groups according to a composite measure of the depth of deprivation and the income extremes that may exist (see Box 2.1). The profile of the poor and sub-groups of the poor in 1998 is presented in Table 2.7, and includes measures of the contribution to the poverty population, the prevalence of poverty (the poverty headcount), and the depth and severity of poverty among individuals who belong to various household types.

Table 2.7 Poverty profile of poor, very poor, and new poor individuals in 1998

55. Among all poor individuals in late 1998, the variations in the depth and the severity of poverty experienced among different types of households were not very large. Those living with children (but without pensioners) were slightly worse off than other households by most criteria. Individuals who were part of households that included both children and pensioners had the highest incidence of poverty, but it was neither quite as deep nor as severe as it was in households with only adults and children. The situation of pensioners appeared to be slightly better, on average, than that of other individuals by every measure. Most surprising, perhaps, was the position of working-age adults in households without children or pensioners. The extent of their economic distress was about as great as that of individuals in households with children.

56. The picture alters somewhat when the analysis is applied to the very poor – the individuals with consumption below 50% of the subsistence minimum who comprised nearly one-half of the population in poverty in 1998. The resources available to them permitted consumption, on average, of less than one-third
of the subsistence minimum market basket. The poorest among the very poor were pensioners and working-age adults without children.

57. The economic situation of individuals who were the most recent entrants to poverty in 1998 (the so-called “new poor”) appeared to be slightly less difficult, on average, than that of other poor people. Although the new poor contributed heavily to the poverty headcount, they did not contribute to the growth in the depth or severity of poverty in 1998. Both the poverty gap and the severity of poverty for this group were less than the average for all of the poor. Many probably had been in fragile economic circumstances earlier, and were pushed over the edge of poverty by the effects of the financial crisis in mid-1998, but remained relatively close to the poverty threshold. This, in turn, indicates that the growth in the depth and severity of poverty between the 4th quarter of 1996 and the 4th quarter of 1998 was due to further reductions in the circumstances of individuals who had been poor for a longer time. The most unfavourable circumstances within this group also were those of working-age adults without children.

5. Why the poor are poor: the policy implications

58. The decline in the standard of living in Russia between 1994 and 1999 followed the path of macroeconomic declines. It could be said that the sustained macroeconomic difficulties over the course of the transition years were a major cause of burgeoning poverty, and the major engine required to alleviate hardship is rapid economic growth. Although undoubtedly correct, this generalisation does not help to clarify the reasons why the fall in the standard of living was not equally distributed among all individuals and households. The increase in inequality and, particularly, the increase in the poverty gap and the severity of poverty, indicate that some fared worse than others over the period. And, indeed, there were factors at work that had selective effects.

59. The reason for the poor situation of pensioners is the simplest to explain. The large reductions in the real value of pensions over several years were the primary but not necessarily the only cause of the difficulties experienced by this group. Although full adjustments for inflation on a systematic basis have not been the norm for any category of benefits, the lack of pension adjustments was particularly serious because pensions are a large share of the average household budget, and are the dominant source of income in pensioner-only households. As concluded previously, policies that lift the low end of the pension benefit distribution for current as well as future pensioners merit consideration – not only to ameliorate poverty among pensioners, but also to help the non-aged poor who often live with them. Pensioner households and households with pensioners and other family members accounted for nearly 40% of all the poor and more than one-third of the very poor in 1998 (see Chapter V).

60. Many of the factors that contributed to the economic distress experienced by working-age individuals and their families are related to labour market problems. Although it has been stressed repeatedly that households with children have a high risk of poverty and are the most prevalent group among the poor, it is not the presence of children that is the cause of economic difficulties. This is amply demonstrated by the severe hardship among households with working-age adults without children. It is the circumstances that present a barrier to earning an adequate income that are the cause of poverty. Some may be specific to the characteristics of the individual – low educational attainment, inadequate or obsolete skills, or physical or mental impairment, among others. Some, however, relate to characteristics of the labour market that distort the way it functions and stand in the way of implementing the reforms needed to obtain higher productivity and higher wages (see Chapter III.).

53 Note, however, the caveat in Box 2.3 with respect to the use of a per capita measure as the adjustment for household size, and the possible bias this may introduce.
61. Although unemployment has increased, it is not the main reason why so many households and individuals are poor. According to RLMS data, only about 15% of all poor households in 1998 reported at least one unemployed household member. Nevertheless, the distribution of unemployment between the “new” and the “old” poor does appear to link longer-term poverty and unemployment in Russia. Slightly more than 9% of newly poor households contained an unemployed person, while more than 20% of households that had been poor longer reported at least one unemployed member.

62. The relatively low number of poor households affected by unemployment suggests that there are more people who work and are nevertheless poor, than there are people who are poor because they don’t have a job. The poor, and particularly the very poor, are far more dependant on wages as a source of income than are households that are not poor. But employment is not a guarantee of income adequacy if underemployment is commonplace and wages are low. Wage inadequacies have also been aggravated by delays in wage payments in the public and in the private sectors of the economy. Poor households, particularly very poor ones, have borne this burden disproportionately, as shown by RLMS data (Table 2.8).

*Table 2.8 Wages and wage arrears as a per cent of the household expenditure of non-poor and poor households, 1998*

63. The factors that affect income adequacy are not restricted to the labour market. Wages also were low in the Soviet era, but there was little to spend them on. Money was not the primary means of accessing goods and services, even at highly subsidised prices; privilege was the key element. In the course of adaptation to a new economic environment, money has supplanted privilege as the key to a better life – at least in part. The reconstruction of policies and institutions, however, has not kept pace with the changes taking place and the need to assure that access to merit goods, such as health care and education, is not lost in the process. The claims on the money income of households for such goods and services have grown enormously, and have further diminished the adequacy of earnings and income from all sources (see Chapters I and IV.).

**Concluding comments**

64. A major policy implication that emerges from the profile of the poor is that no single categorical group can be distinguished as the obvious policy priority above all others. But it also indicates that no particular group among the poor can be ignored. The amelioration of poverty, however, entails more than just finding a way to target cash benefits on the very poorest among the poor, or, at the other extreme, waiting until economic growth lifts the average standard of living to a higher level. Policies that improve the situation of large numbers of the population, within existing budget constraints and based on the present institutional capacity of the Russian Federation are the most desirable. A large majority of the poor could be helped by improvements in the adequacy of pensions; equitable access to a more cost-effective health care system; and timely payment of wages and benefits; as well perseverance in restructuring the economic institutions that hamper the creation of good jobs at good wages. Means-tested cash benefits should be treated as a residual approach to help those individuals who cannot be reached by other policies – if they can be accurately identified. If not, there are relatively simple ways of helping the poorest of the poor – at least to help them avoid daily hunger. These and other policy options in the labour market, the health care sector, and in the social sphere are developed in subsequent chapters.

---

54 Nothing definitive can be said about the duration of unemployment among the “old” poor from the cross-section data used in the analysis.
CHAPTER III
LABOUR MARKET DEVELOPMENTS

1. Introduction

65. The Russian labour market does not yet exhibit all the main characteristics of a competitive market. It has evolved in ways that distinguish it from labour markets in the OECD area and in many other countries in transition. The enormous size of the territory, the heterogeneity of the population, and the decentralised government structure help to explain why there are many regional and local labour markets that are virtually autonomous. However, these are not the primary factors that underlie major differences. The slow pace of economic reform, the way in which reforms have been implemented, and continuing reliance on the traditions and priorities of the past have had a strong influence on the distinct development of labour markets in Russia.

2. Legacy of the command economy: a stylised description

66. In the former command economy, the allocation of resources was determined by the production priorities of central authorities. Since the structure of a labour market and its performance is inextricably related to the structure of product markets and producer incentives, inefficiencies in production were mirrored by inefficiencies in the labour market. Enterprises, owned and controlled by the State, did not have freedom of entry and exit from the marketplace, nor did hard-budget constraints and profit maximisation guide the decisions of the firm. Labour, beholden to the dictates of a single employer, did not have unfettered geographic or occupational mobility—although such limitations eased in the post-Stalinist era. Remuneration was based in part on low cash wages—also centrally determined, and in part on access to a range of benefits and privileges provided by the workplace. Moreover, a job was guaranteed to everyone of working age. The security provided by job guarantees was counter-balanced by underemployment, low average labour productivity, and low wages.

67. Labour mobility faced certain geographic limitations. First, an official permit was required to live in an area, and inter-regional mobility therefore was less common than changes within a locality. Labour mobility also was constrained because housing was in short supply and access to housing, as well as other social benefits, was linked to the workplace.

68. Occupational choice and mobility also was subject to certain limitations. After completion of approved academic or vocational training, new entrants to the labour force were placed in their first job by administrative decision, usually for a period of at least three to five years. In sum, the element of voluntary decision-making to meet the interests of the firm or the individual worker, characteristic of competitive markets, was quite limited.

69. At the onset of the transition process, labour legislation was enacted to facilitate and respond to the changes induced by the reform process. A law that defined the employment rights and obligations of
citizens as workers and employers and the role of the State was enacted in 1991\textsuperscript{55}; a labour code was legislated in 1992\textsuperscript{56}. A Federal Employment Service (FES) was put in place to implement many of the provisions of the new laws: provide labour market information, facilitate job search, administer active labour market policies and the payment of unemployment benefits; and to provide other material assistance to the unemployed. The spirit of the legislation enacted and the institutions created closely resembled practices in the OECD area. The transition to a more competitive and productive labour market, however, also depends upon other reforms, particularly enterprise restructuring.

3. Privatisation and enterprise restructuring

70. Efforts to privatise and re-structure national enterprises proceeded rapidly, but in a somewhat disorganised manner. The initial phase of privatisation relied on the distribution of vouchers to all citizens and resulted in widely dispersed ownership. Employee-buyouts with control of acquired enterprises retained by the existing management were frequent, often with special conditions attached to protect jobs. Consequently, re-structuring was not a primary objective, and inherited job guarantees were maintained when they coincided with the interests of employers. This posture was facilitated by provisions of the Employment Law that permitted suspension of mass layoffs for six months or the phasing of layoffs over the course of a year upon the request of Subjects of the Federation, local authorities, employment offices, trade unions, or other worker representatives\textsuperscript{57}. The result was that mass layoffs were the exception rather than the rule, and declines in total employment were substantially below the steep declines in GDP – a phenomenon that was unparalleled in most other transition economies (see Figure 3.1) Between 1990 and 1998, GDP fell by about 45\%\textsuperscript{58}, while aggregate employment declined by about 16\%. Unemployment was hidden by means of underemployment and low wages, unpaid administrative leave, and accumulating wage arrears. Restructuring therefore proceeded at a snail’s pace.

\textbf{Figure 3.1 Changes in GDP and in total employment in selected transition economies, 1990-1998}

71. The second phase, from approximately mid-1994 to 1997, was a period of privatisation for cash payments, motivated primarily by the need to generate revenue for the federal budget\textsuperscript{59}. Valuable shares of large national enterprises were sold at low prices, and fierce competition for the potential windfall benefits took place among the dominant financial-industrial groups\textsuperscript{60}. The second phase of privatisation resulted in concentrated ownership and was characterised by rent-seeking, rather than by entrepreneurial behaviour and enterprise restructuring.

72. The sale of shares of major enterprises continued after 1997, but the process was disrupted because of factors arising out of the financial crisis in 1998. The devaluation of the rouble caused the collapse of price guidelines for the sale of assets and effectively halted or caused the modification of many planned sales\textsuperscript{61}. Coupled with a weak legal basis for contract enforcement, the lack of secure property

\begin{itemize}
  \item \textsuperscript{57} Law of the RF on the Employment..., Chapter I, Article 7.4; Chapter IV, Article 21.2.
  \item \textsuperscript{58} Critics of official GDP estimates indicate that reported declines are seriously overstated. See, for example, Gavrilenkov and Koen, 1994; Koen, 1996.
  \item \textsuperscript{59} See Institute for the Economy in Transition, 1999, Chapter 4.
  \item \textsuperscript{60} The Economist Intelligence Unit Country Report, Russia: 1999-2000.
  \item \textsuperscript{61} Institute for the Economy in Transition, \textit{ibid.}
\end{itemize}
rights and rent-seeking behaviour, the privatisation process did not result in significant restructuring of large enterprises.

4. **Emerging labour markets**

73. The chaotic path of reform did not prove to be a direct route to a functioning market economy in Russia. This is reflected in the uneven progress towards the development of competitive labour markets. Generally, in sectors of the economy and in regions where reform and restructuring have been slow, the labour market practices of the former regime remain dominant. Labour markets appear to be somewhat closer to a competitive model in areas where reforms are at a more advanced stage, labour market institutions are better developed, and the economic base is relatively diversified.

74. Moreover, the public sector, as a major employer, has retained a strong influence on employment practices, particularly in areas where large enterprises that existed prior to 1991 remain intact. As Table 3.1 shows, more than 40% of employment remained in state and municipal enterprises in the late 1990s. The majority of the workforce in these traditional industries is middle-aged or older, qualified in outdated occupations, and is imbued with the expectations of earlier years.

Table 3.1 Distribution of employment by sector, 1990-1999

75. Labour market institutions that are traditional in OECD countries, such as trade unions, collective bargaining, and the FES do not have a significant influence on Russian labour markets. Practices that are not typical in the OECD area, however, often play an important role in the operation of Russian labour markets.

**The institutional labour market**

76. Russian labour markets, at one extreme, are biased towards maintenance of the status quo. The policy of job preservation is common, and underemployment is pervasive, as are low wages, and administrative leave and wage arrears instead of layoffs. These practices are most apparent in the budgetary sector and in large enterprises, typically in primary industries, processing, transportation, communications, and utilities.

77. The status quo objective reflects economic pressures to maintain output and employment in industries that are not competitive, given that the short-term risks associated with competition often are more apparent than the potential benefits. It also reflects resistance to the establishment of new and transparent rules by economic actors who can realise personal gain or privileged status in the absence of competition in product markets. A political interest in avoiding major economic disruptions and public protest also plays a role. The high priority given to job preservation, despite severe budget limitations, also reflects the legacy of paternalism – the expectation of soft-budget constraints and bailouts, and of jobs as personal entitlements.

78. Enterprises can circumvent hard-budget constraints in several ways. Government subsidies and soft loans are the most direct means, and according to the EBRD (1999) amounted to 6.5% of GDP in 1998. Loans from the banking sector that are not repaid are another avenue. The most pervasive means,

---

62 The stylised description is based upon direct observation and discussions with local officials in several regions and municipalities in the Russian Federation visited by the OECD survey team.

63 See Åslund, 1999.
however, is deferring the payment of utility bills, taxes, social contributions, and wages\textsuperscript{64}. No financial penalty is imposed on public sector enterprises that defer such obligations, and both public and private sector firms benefit from the effect of inflation on delayed payment of debts specified in nominal roubles. Enterprise subsidies also result from the payment of taxes and wages in-kind at inflated valuations – a practice explicitly sanctioned by the acceptance of over-valued goods instead of cash by the tax authorities and by some workers. In effect, enterprises with soft-budget constraints are subsidised by government budgets and by workers who are not paid on time.

79. The cost of severance payments to workers affected by a mass layoff, paid by the employer, also strengthens the employer bias – not only towards job preservation, but also towards strategies that reduce wage costs without job losses. A total of 4.7 million workers economy-wide were given unpaid administrative leave in 1998, and 4.3 million workers were temporarily restricted to shorter hours of work – a total of at least 14\% of the employed population\textsuperscript{65}.

80. The cost of severance payments are usually financed by employers in those OECD and transition countries that offer them, but this practice in Russia appears to act as a barrier to enterprise restructuring and labour shedding. The potential cost burden is shifted to employees in the form of effective wage reductions and delays in wage payments. Nevertheless, it may not be desirable to eliminate this practice completely. It does serve the purpose of easing worker acceptance of a mass layoff and can speed up labour adjustments when state enterprises are selected for restructuring or liquidation. In such cases, it would be appropriate to have the cost of severance payments borne by the federal budget. Financing from the Employment Fund, which is financed by local employers, would effectively shift the major costs of labour adjustments to enterprises in the areas most directly affected by them, and should be avoided for this reason. Enterprises that release workers in the ordinary course of business should remain responsible for financing severance payments agreed to in a labour contract.

81. Experience in other countries suggests that certain elements are desirable in the design of special severance payments that are intended to facilitate enterprise re-structuring or liquidation. They should be relatively generous, as they now are in Russia, in order to have the desired effect on labour-market behaviour. Sequential eligibility for severance payments and unemployment benefits, as in current law, should be maintained. Simultaneous benefits would be overly generous and too costly, while sequential benefits will be more helpful to workers who remain unemployed a longer time.

82. A temporary programme that provides severance payments for workers affected by planned restructuring or liquidation of state enterprises is more likely to provide an incentive for rapid re-structuring than is one in which no termination date is announced. The eligibility of workers affected by a mass lay-off should be linked to a process that systematically identifies those state enterprises that must undergo major labour shedding within a defined period of time. If payments are held hostage to resource constraints, the programme could be counter-productive: employers and workers may delay necessary changes if they believe that more public funds will be available in a subsequent period. Therefore, the promise of severance payments must be based on realistic criteria, and benefit administration must be rapid, predictable, and reliable.

\textit{The unregulated private sector}

83. At the other extreme, and in contrast to the strong bias in the budgetary sector and in many large enterprises towards the \textit{status quo} and job preservation, the emerging private sector in the formal economy

\textsuperscript{64} For example, more than one-third of enterprises, most of them large, reported tax arrears in 1998. See EBRD, 1999.

\textsuperscript{65} Cited in Nesporova and Ghellab, 1999
is characterised by relatively precarious employment. A formal labour contract often is limited to a fixed-term, or is informal and based on oral agreement. Although labour is generally used to enhance the competitive position of firms, the competitive margin gained often is at the expense of worker protection and unpaid or hidden liabilities to suppliers and to the tax authorities and the Social Funds. If social contributions are paid, they sometimes are based on the minimum rather than the actual wage. If wages are not recorded and social contributions are not paid, there is no social protection. Nor are established labour standards strictly observed in this labour market.

84. Recent studies\(^66\) have found that about 5% of workers are employed in full-time jobs that provide their main source of earnings without a formal labour contract, while a formal labour contract was absent in more than one-half of the jobs that provided supplemental earnings. One fifth of workers were found to receive earnings from two or more jobs on a regular basis, while one-half received sporadic income from secondary jobs.

85. This type of labour market is typical in areas with declining industries, and a relatively large share of small and medium-sized enterprises (SMEs)\(^67\) that are predominantly new start-ups. The poor job prospects in traditional industries and enterprises force workers to find alternative employment or, if employed, alternative ways of supplementing meagre wages. Workers in the unregulated private labour market are generally younger than average, new entrants, and migrants and, to a lesser extent, workers released from large state enterprises. Relatively high labour turnover related to seasonal factors or cyclical fluctuations and a high risk of unemployment are common.

5. Labour force participation, employment, and unemployment

86. The labour force participation of both men and women of working age (age 15 to age 60/55 for men and women, respectively) has traditionally been very high, but declined somewhat during the transition years. Reductions in the labour supply occurred primarily in the age groups under 20 years and over 50 years of age, with slight increases recorded among the population of prime working-age\(^68\). Participation nevertheless remains high relative to participation rates in OECD countries. As Table 3.2 shows, more than three-fourths of the working-age population in Russia were economically active in the late 1990s, with a rate of female participation that is comparable to that of males. The average activity rate across the OECD area was slightly under 70% in 1998, with a substantially lower average rate for females than for males.

Table 3.2 Labour force participation by age and sex, 1992-1999

87. Employment remains concentrated in the industrial sector of the Russian economy: this sector accounted for nearly one-quarter of all employment in the late 1990s. A dramatic contraction of industrial output of over 40% occurred between 1990 and 1998, but a comparable downsizing of the workforce did not take place – employment declined by only about 16% (see Figure 3.2.). This, in turn, implies that a drastic reduction in average labour productivity occurred\(^69\). (The difference between the decline in

---

\(^66\) See Kapelushnikov (1999) and Cherneyko (1999).

\(^67\) Roughly defined as less than 200 full-time employees. According to the EBRD (1999), more than one-half of SMEs in countries in transition are micro-enterprises with up to nine employees.

\(^68\) The total population also was declining, with increases in mortality rates that affected the working-age population, particularly males. (See Chapter IV.) Therefore, increases/decreases in activity rates by age and sex may be somewhat overstated/understated because of the decrease in the working-age population base.

\(^69\) A study by the McKinsey Global Institute calculated that average labour productivity in Russia is one-fifth of the world’s best practice, with the worst performers at or below 10% of the labour productivity of the world’s best. (Cited in the EIU Country Report on Russia, 4th quarter 1999.)
industrial output and employment in large part accounts for the disparity between GDP and aggregate employment changes mentioned above.) Agricultural employment, which also declined during the transition period, had been falling in earlier decades as well, and its drop after 1991 may not be attributable solely to the transition process. As Table 3.3 shows, the major shift in employment after 1990 was away from industry and towards the service sector, especially to the retail and catering trades.

Table 3.3 Employment change by sector, 1990 – 1997

Figure 3.2 Industrial output and employment, 1990 – 1998

88. Consistent with the moderate decline in the level of employment relative to the steep fall in GDP, open unemployment levels also have been relatively moderate. According to the Goskomstat, unemployment based on the labour force survey (LFS) increased steadily and reached a peak of slightly over 14% by early 1999, and declined slightly in subsequent months. In contrast, registered unemployment was substantially lower throughout the period and the direction of change fluctuated. From a low of less than 1% at the beginning of the period, it peaked at 3.4% at the end of 1996, and oscillated around rates between 2 to 3% thereafter (see Figure 3.3.).

89. The average length of an on-going spell of unemployment increased steadily in each year according to both administrative and LFS-based data, but remained lower than in most transition economies throughout the transition period. It was under seven months among the registered unemployed and about nine months by the LFS measure in 1998, compared with an average LFS-based duration of about 18 months in, for example, Romania 70. Approximately 40% of the LFS-unemployed in Russia were out of work for more than one year; only 20% of the registered group were among the long-term unemployed in 1998.

Figure 3.3 Labour force survey and registered unemployment rates in Russia, 1992-2000

90. The large difference between the two unemployment rates and the surprisingly low rates of registered unemployment in Russia are explained in large part by the apparent resistance or indifference on the part of the unemployed to registration at employment offices. Unemployment benefits often are low and irregularly paid; jobs on offer through the services of the FES are limited and often are unattractive; access to training programmes also is limited because of resource constraints; and the labour office may be remote and transportation, expensive or unavailable 71. However, the strategies used by workers in response to unemployment and to other disruptions to earnings also help to explain why registered unemployment rates are so low.

Labour mobility

91. According to FES data on the reasons why workers left jobs, voluntary quits were recorded as the main source of flows into registered unemployment throughout the transition period (Table 3.4). However, the conclusion that these workers left a current job because they were optimistic about finding a better one in the formal sector is arguable. The pattern of labour mobility in Russia appears to be more complex than the path suggested simply by recorded flows between the three traditional states of employed, unemployed, and inactive.

70 OECD, 2000a
71 The employment office authorities in the Sverdlovsk region indicated that only one-fifth of the unemployed were registered in 1999, giving the size of the territory and the poor transportation facilities available as the main reasons.
Table 3.4 Composition of the registered unemployed, by reason for job loss, 1992-1998

92. Pressured by declining real wages, wage arrears, unpaid administrative leave, and shortened hours of work, many workers with a full-time job in the formal economy have been forced to find alternative strategies in order to maintain themselves and their families. The options include working at multiple jobs in the formal economy, becoming self-employed, engaging in activities in the informal sector, growing produce for home consumption or for sale or barter, or some combination of them. Under similar economic pressures because of real income declines, individuals who move into unemployment or inactivity have many of the same options available, even if they cannot find employment – or do not choose to be employed – in the formal sector.

93. A study by Najman and Pailhé (1999), based on RLMS data from 1994 to 1996, used the expanded framework of movement between the traditional labour force states and the above activities or combinations of them to examine labour mobility between the 4th quarters of 1994 and 1996. The flows, perhaps not surprisingly, were found to be considerably higher than suggested by official statistics.72

94. Over the two-year period, the total outflow from unemployment was found to be more than 80% when activities in the informal sector and/or work on plots were included as gainful activities. The major destination of the outflow was into these activities, as well as into paid employment in the formal sector. About 38% of the inactive group left that state, with the overwhelming majority moving into some type of gainful activity, but not only formal employment. Less than 10% of individuals working in the formal sector or in unrecorded gainful activities flowed out of the labour force or into unemployment.

95. Among working-age individuals, it was found that about 45% changed activities over the period, presumably in large part as a labour supply response to wage arrears and the diminution of income and earnings for other reasons. The relative importance of a job in the formal sector as a unique economic activity declined, and workers with multiple jobs increased by more than 50%. The likelihood of being without any gainful activities if unemployed or out of the labour force also declined. Work on plots increased substantially across all labour market states. Although activities in the informal sector also increased among the unemployed, the combination of a formal job and informal activities declined somewhat.

96. The probability of a worker remaining in a primary job in the formal sector was high despite wage arrears. Workers probably stay at jobs because they expect to be paid eventually, and/or they are reluctant to lose social benefits by leaving formal employment, or they cannot find alternative employment opportunities. The availability of other gainful activities helps to explain how some people can afford to stay in jobs with substantial delays in wage payments. It also offers a partial explanation for low registered unemployment rates: it decreases the urgency of registering as unemployed and applying for benefits, particularly if the time required to report at an employment office interferes with time that might otherwise be spent working in unrecorded activities.

Real wage trends

97. The complex paths to survival, described above, are not motivated only by disruptions to earnings imposed by an employer. The value of a job and the wage it commands declined precipitously for the average worker as the economy declined. As Figure 3.4 shows, the average real wage fell by nearly 60% from 1991 to 1998 – more than the percentage decline in per capita income during the same period.

---

72 Data from the FES show annual outflows from registered unemployment that varied from about 10 to 13% between 1993 and 1998. Less than one-half of the outflow each year flowed into employment. (cited in Kapelushnikov, 1999)
Slight real wage growth had emerged during the brief economic upturn around 1996/1997, but disappeared at the onset of the financial crisis in August 1998. By the first quarter of 1999, seasonally adjusted real wages had fallen to about 40% below January 1998 levels. A modest recovery began in the third quarter of 1999 that continued through the first quarter of 2000, but real wages still remained substantially below their pre-crisis level.

Figure 3.4 Trends in real wages and per capita income in the Russian Federation, 1991-1999

98. In addition, as real wages declined, the economic distance between workers with the lowest wages and those paid the most kept increasing. Flemming and Micklewright (1999) report findings, based on enterprise surveys, that show an “extraordinary” increase in the dispersion of monthly earnings for full-time workers in Russia, particularly after 1992 (the first year of price liberalisation). The increase in inequality was driven by roughly similar changes at both ends of the distribution: earnings in the bottom decile dropped by one-half relative to the median over the period 1989 to 1997, while earnings in the top decile rose by 60%. The ratio of earnings between the top and the bottom of the distribution in Russia was reported to have increased from about 3.4 in the 1980s to more than 10 by 1997 – well in excess of equivalent ratios found in OECD countries, but less than shown by Goskomstat data. The results for the mid-1990s found by Flemming and Micklewright were corroborated by findings based on RLMS data, but the authors indicate that the results from both the enterprise survey data and the RLMS data probably have a significant upward bias. On balance, the evidence is consistent in showing a very substantial increase in earnings inequality, but the exact magnitude of the change is uncertain.

99. Average wages in private firms outpaced average wages in state-owned enterprises by about 75%, according to Goskomstat data. Nonetheless, significant wage differentials were recorded in both: on average, the differential was more than 5 to 1 in private enterprises, while in state-owned firms, it was more than 4 to 1 despite low productivity and, often, a critical dependency upon soft-budget constraints.

100. The difference in average wages across sectors of activity, however, was lower than within-sector differentials. Relative to the national average wage, Goskomstat data indicate that it was less than 3 to 1 in 1997. The highest average wage was reported to be in the banking and financial sector and in primary industries; the lowest, in agriculture and public sector services such as education, and medical and social services.

101. These differences, in turn, were reflected in growing regional wage disparities. Where economic activity is concentrated in primary industry (Siberian territories) or in banking and finance (Moscow and Saint Petersburg) wages are well above the national average. Average wages in many rural regions and territories and those with a concentration of low-paid industries were about one-half of the national average or less.

102. Although movement away from the administratively compressed wage distribution of the Soviet era was to be expected, the wage differentials that have emerged have not been simply the result of competitive forces. While wages in the budgetary sector have been constrained as part of macroeconomic

---

73 EUI Country Report, 4th quarter 1999
74 Russian Economic Trends, April 2000
75 Data from Goskomstat show that the average wage of the top 10% of wage earners was about 25 times higher than the average wages of the bottom 10% by 1997. (Cited in UNDP, 1999.)
76 Flemming and Micklewright cite numerous data and measurement problems, including uncertainty about the coverage of the employer survey, the questionable meaning of “full-time” employment in Russia, and the inadequate treatment in surveys of temporary reductions in hours of work, income under-reporting, and wage arrears.
stabilisation policies, soft-budget constraints, cronyism, and corruption have permitted the salaries and wages of a privileged group to soar.

Real wage levels

103. Despite large and growing wage inequality and the windfall wages that some enterprise managers receive, the average real wage in Russia is low in absolute and relative terms. As noted in Chapter II, this has resulted in significant poverty among the employed. In contrast with the general experience in OECD countries, wages represent a far higher share of the budgets of poor households in Russia, particularly very poor households, than they do in non-poor households (see Chapter II, Table 2.8.)

104. As Figure 3.5 shows, the average wage in Russia is very low compared with average wages in transition economies that pursued reforms (e.g. Poland); it is even lower than in some that did resist reforms for a number of years (e.g. Romania). Compared with a range of OECD countries, the value of the average wage (in PPPs) in Russia represents only a small fraction of the purchasing power of those wages elsewhere – as little as 3% of the average production worker’s wage in Germany in 1997.

Figure 3.5 Average monthly wages in Russia compared with average wages in selected countries in $US, circa 1999

105. Simply raising the minimum wage is not an adequate remedy to the problem of low wages and poverty. The minimum wage is not an effective anti-poverty measure, since many workers who receive it are not members of low-income households. In addition, the links between the minimum wage and salary schedules in the budgetary sector and many benefits would make the change a very costly one for the public purse despite its limited efficiency.

106. The solution to low wages and pervasive poverty in Russia must be achieved through implementation of the reforms needed to eliminate distortions in labour and product markets that are a barrier to higher productivity, higher wages, and non-inflationary economic growth. Higher wages that are sustainable and affordable must be a result of processes that reflect market forces: neither the legislative process nor an administrative fiat can make working pay in the longer term.

Wage arrears

107. Chronic wage arrears were officially estimated to be at the level of 55 billion roubles as of the beginning of October 1999, down from 88 billion roubles one year earlier. The decline in wage arrears was in part attributable to the decline in real wages that made it easier for employers to pay workers, although

---

77 Although the “working poor” exist in a few OECD countries, this phenomenon is the exception rather than the rule. See Förster, 2000.

78 It was not possible to make adjustments to account for wage under-reporting, wage arrears, and wages paid in-kind in Russia, or to account for relevant differences in average hours of work across countries. Moreover, the average production-worker wage is slightly higher than the average wage in most countries, but is comparable across OECD countries and was used for that reason. The comparative purchasing power of the Russian average wage therefore is likely to be biased downward in Figure 3.5.

79 It was found that the majority of minimum-wage workers in OECD countries are not members of low-income households. (See Gregg, 2000; OECD, 1998*).

80 Legislation that breaks the link between the minimum wage and various benefits was adopted but has not been implemented.
declines in arrears continued through the last three months of 1999 even as real wages began to recover. The accumulated wage debt in the budgetary sector was reduced by nearly one-half to about 10 billion roubles by the end of the year, although other estimates differ somewhat81. The general picture of declining wage arrears nevertheless is supported by survey evidence (VTsIOM) that found non-payment or late payment of wages dropped by one-third between February and September of 199982.

6. Active and passive labour market policies

Expenditure

108. Labour market policies in Russia have the formal characteristics of a very ambitious programme. The scope and diversity of the measures, described below, meet and even exceed those found in many OECD countries. The level of public expenditure on such measures, however, is quite low – about 0.3% of GDP in 1998, with the bulk of this spending (75%) going on passive income support. (See Table 3.5.) Moreover, expenditure on the unemployed has not risen significantly over time even as open unemployment rose sharply. This, in turn, indicates that labour market policies suffer from severe resource constraints, are thinly spread, and are not responsive to overall changes in need.

109. As Table 3.5 shows, the shares of expenditure on active and passive measures were broadly similar in 1994, but as resource constraints increased with continuing declines in GDP, expenditure on passive measures increased relative to the share devoted to active measures. Both, however, declined in real terms. Particularly notable has been the large share of resources generally devoted to administrative costs in all years – almost 20% in 199883.

Table 3.5 Revenue and expenditure of the Employment Fund, 1994-1998

Financing

110. Benefits for the unemployed are financed through the extra-budgetary Employment Fund based on a contribution rate of 1.5% of gross wages, paid by the employer. (Henceforth, these obligations will be borne by the federal budget. See Chapter I, Box 1.1.) According to the Law on Employment of the Population, 80% of the contributions collected remain at the disposal of the regions, while 20% must be transferred to the federal level for re-allocation to under-funded regions and for other purposes. In practice, the transfer of the required proportion to the federal Employment Fund frequently does not take place. The average proportion of collections actually centralised was estimated by to be about 11% in 1997 by officials from the Ministry of Labour and Social Development, but other estimates from the same source were as low as 4%.

81 According to a statement by a high-level government official, reported by ITAR-TASS news agency, the reduction in the stock of wage arrears in the budgetary sector was from 13 billion roubles in January of 1999 to 5 billion roubles by December. The duration of wage arrears was reported by the same source to be less than one month in 24 regions, but from two to four months in 17 territories by the end of 1999.

82 EIU Country Report, op. cit.

83 The high average administrative cost is explained in part by the large bureaucracy created to administer relatively small programmes. The FES consists of a national centre in the Ministry of Labour and Social Development, a network of 89 regional offices, 2,444 district and municipal employment offices, and about 300 subsidiary offices. The staff numbered about 35,000 workers in June 1999.
111. Moreover, employers do not or cannot always comply with collection requirements. The average compliance rate was reported to be 84% in 1998 by the Ministry of Labour and Social Development, with regional variations on the order of 65% to 87%. Such variations in compliance, coupled with the low centralisation ratio, result in the least ample programmes for the unemployed in territories that are most disadvantaged and have the highest unemployment rates.

112. The continuous shortfall in collections and the modest rate of contributions resulted in persistent deficits. Despite transfers from federal and regional budgets, the Employment Fund deficit accumulated to 13 billion roubles between 1994 and 1998, and arrears in unemployment benefits amounted to nearly 4 billion roubles.

113. The Ministry of Labour and Social Development intervened to resolve the problem of persistent deficits in the Employment Fund by rescheduling employer debt, limiting active measures, and reducing administrative costs. However, regions were not uniformly supportive of central intervention. Donor regions strongly preferred to preserve a high degree of financial autonomy, while regions that are the recipients of transfers generally supported greater financial centralisation and the distribution of resources commensurate with the needs of distressed regions.

114. The apparent weak fiscal discipline of employment offices at regional and municipal levels of government stems in large part from the responsibility allocated to them to collect contributions and to make expenditures – including the transfer of the federal share to the central Fund. The potential for full accountability is limited when such transactions are not carried out at arms-length from each other. Without appropriate accountability, the authority to collect contributions invites untoward influence over local employers with respect to conditions attached to collections – as well as potentially undesirable influences in the reverse direction. Moreover, it offers virtually no protection against regional and local pressure to make expenditures that are not within the legal mandate of employment offices. The accountability of employment offices does not appear to have been increased by organisational changes that imposed greater centralisation in supervision and reporting requirements after 1996.

115. Equity and accountability is also undermined by the collection of contributions for each of the Funds by different agents (see Chapter I). Centralised collections by a single institution of the total contribution required for all Funds would facilitate equalisation across Funds and across regions, avoid the duplication of administrative mechanisms and administrative costs, and increase accountability – if the rule

---

84 The deficits cited, based on data from the Ministry of Labour and Social Development, cannot be reconciled with the accounting published by Goskomstat and presented in Table 3.5, although deficits generally do show up at the regional level. According to Russian experts, problems exist in Fund accounting and the Fund has continuously resisted an audit of revenues and expenditures.

85 The commentary is based on discussions by the OECD survey team with regional and local officials.

86 “Voluntary contributions”, although a negligible item among revenue sources, illustrates one way in which such influence might be exerted. It is conceivable that such contributions might be based on favoured treatment of employers by the Employment Office with respect to the collection of contributions. Influence also may be exerted in the other direction, e.g. according to officials in local employment offices, employers sometimes request expenditure on specific active measures in return for the payment of required contributions.

87 For example, a St. Petersburg Ordinance in June of 1998 recommended that the cost of travel to summer recreation locations for children of the unemployed be paid by local Employment Offices.

88 Territorial branches of the Federal Employment Office were supervised by employment offices at a higher level and by regional authorities until 1996. After 1996, the FES was subsumed under the Ministry of Labour and Social Development, and employment offices reported directly to the Ministry. They must nevertheless co-ordinate their activities with regional and local authorities.
of law is strictly observed. Uniform governance of the total collection process would limit the potential for inappropriate expenditure or undesirable shifts in expenditure responsibilities across Funds, increase the potential for standardised application of procedures, and improve collections. (Recent legislation has addressed the above difficulties by the creation of a Unified Social Tax, collected under the authority of the federal government. See Chapter I, Box. 1.1.)

**Active labour market programmes**

116. Measures to help the unemployed find jobs include virtually all of the ones typical in OECD countries: counselling; training and re-training; the design of employment programmes in collaboration with local authorities, employers, and trade unions; public works employment; promotion of entrepreneurial activities; subsidies for re-location. Nevertheless, the fact that similar measures are found elsewhere does not necessarily make all of them appropriate choices for the Russian Federation, given the problems discussed above. The severe resource constraints alone suggest that, in the near-term, assistance also should be focused primarily on those measures that are most efficient and effective, rather than spread thinly across many types of assistance.

117. Martin (2000), who reviewed the evaluation literature on what works among active labour market policies in OECD countries, found that various forms of job-search assistance showed consistently positive outcomes on re-employment probabilities and appeared to be helpful for most of the unemployed. These programmes also tended to be the least costly option. Efforts to improve the information available on job vacancies in Russia and to solicit more attractive ones would be helpful. Upgrading the skill level of staff who offer such services, combined with increased monitoring of the unemployed and enforcement of work tests, is essential.

118. The evidence on public training programmes in OECD countries suggested a very mixed track record. Some programme evaluations showed low or even negative rates of return for participants when the estimated programme effects on earnings or employment are compared with the cost of achieving those effects. The group that appeared to benefit most consistently from training was adult women. The findings were less optimistic with regard to adult men, and almost no training programme was found to work well for youths.

119. Although the share of Employment Fund expenditure on employment subsidies in Russia has been declining (Table 3.5), the relative emphasis on this form of assistance that remains is questionable if it is subsidising underemployment in enterprises that are not viable, or entrepreneurial start-ups that have little chance of success. Evaluations of subsidies for small business start-ups in OECD countries suggest that this is a useful policy only for a small group among the unemployed, primarily males between the ages of 30 and 40 years with a relatively high level of educational attainment. In addition, public sector employment for the unemployed has had a dismal record in helping them to get permanent jobs in the open labour market in OECD countries, although policy debate about the utility of this intervention is still active.

**Education, training, and re-training**

120. The potential contribution of the education system, however, is far more important than the role of active labour market policies in matching the demand for and the supply of skills needed in an evolving labour market. Active measures, in principle, are called upon to increase the employability of the unemployed and to help them find jobs. The education system is responsible for the investment in human resource development that helps to avoid unemployment - the skills and competencies that facilitate flexibility and adaptability as the structure and content of jobs change. Unfortunately, there is a disjunction between education and training in Russia and labour market needs.
121. The OECD Review of National Policies for Education in the Russian Federation (OECD, 1998) found that vocational education and training (VOTEC) in Russia has not yet overcome the rigid rules of the Soviet era that pushed it towards training for narrowly defined occupations in large state-owned enterprises. Decades of under-funding and training for obsolete industrial jobs have left the system in a poor position to respond to changing needs. Systemic reforms are required, as discussed in Box 3.1.

122. A subsequent OECD Review of Tertiary Education and Research (OECD, 1999) found that higher education is subject to similar inherited rigidities, and suffers from serious and growing disparities in equitable access to the system - a problem that has become increasingly prevalent at all levels of education (see Chapter I).

123. It is the education establishment that potentially holds the key to the provision of the skills that will enable the Russian economy to restructure and narrow the productivity gap relative to the level of productivity in OECD countries. Primary attention to the reforms required in the education system is recommended, rather than an expansion in the near-term of active labour market policies that too often have dubious results.

### Box 3.1 Education and the labour market: summary conclusions of OECD Reviews of National Policies for Education in the Russian Federation

Vocational education and training (VOTEC)

*Modernisation* is required to bring the vocational education and training content, delivery systems and facilities up to international levels. Many changes are now in process, but budgetary constraints and the absence of significant signals and support from a crisis-ridden industrial sector imperil further progress.

*Structural change* is required to reshape the internal structure and decision-making mechanisms of the education system. This particularly concerns the forms of qualifications, types of schools, streams and flows of students, relations between types and levels of education, possibilities of transferring from one type of education to another and financing. It also concerns mechanisms for decision-making within the educational system. Although many changes have been initiated since the early 1990s, the present situation appears to reflect an initial phase of uncoordinated initiatives taken at various levels; the reform process needs more systematic organisation and management.

*Systemic reform* is required to adapt the relationship between training and employment to the requirements of the new market conditions. Where in the past vocational education was based on guaranteed and stable employment, today it must be able to cope with less secure and variable employment mediated by labour markets. Efficient communication between the institutions of education and employment is particularly important, as are fundamental changes in expectations, attitudes and behaviour.

Introducing such changes in the VOTEC system is a formidable task further complicated by its history in Russia. Unlike the educational and employment modernisation of the 1960s in western market economies, Russia did not experience a wave of post-war modernisation. Despite pockets of high technology within the military-industrial complex, its industrial infrastructure is dated; there has been little external pressure for the VOTEC system to change. Although VOTEC has become more attractive for students since it has been combined with general education, the content has remained largely unchanged and access to higher education has remained restricted.

Inadequate funding for VOTEC constitutes another fundamental obstacle to change. In practice, the education budget only provides funds for payments of so-called “protected items” such as teacher salaries and student meals and stipends. Basic utilities, such as heating, lighting and sanitation, have become highly problematic for some.

---

89 OECD, 1998; OECD, 1999
vocational schools. Low wages create a high turnover of qualified teaching staff in initial vocational institutions; about 11% leave every year while about one-third of industrial training teachers have “a qualifying category equal to or even below the required level of qualification for the trade they teach.” There is a real dearth of suitable textbooks and teaching materials and much of the equipment in vocational training institutions was obsolete and inappropriate for the needs of modern industry.

An education system disconnected from employers

In contrast to the integral relationship between vocational schools and state enterprises in the Soviet era, colleges appear to have only limited arms-length relationships with employers. Ironically, the closest relationships appeared to be those that involved the very same state enterprises to which colleges were linked in former times. Beyond these links, there are few examples of the kinds of employer involvement one would expect in OECD countries. These usually include participating on advisory bodies for curriculum, teaching courses, offering apprenticeship and other on-site work experiences, providing state-of-the-art equipment and learning materials, providing upgrading and retraining of staff on the latest advances in the field. The lack of this employer involvement strongly suggests that employers in the emerging economy do not see these colleges either as a source of rapid-response training or as a major long-term source of highly skilled, trained employees.

The earlier planning instruments used to forecast production and hence, the allocation of labour, are no longer effective in guiding educational content. Ideally, both educational and labour market systems should respond to one another’s signals to produce a good match between the applicant and the position. For this to occur, schools must give students skills that are valued in the workplace and employers must give weight to educational credentials in hiring decisions. Educational institutions, and vocational schools in particular, need to have information about the labour market and employer needs. This calls for greater employer involvement in developing curricula, providing on-site training to both teachers and students, giving career advice, and even directing students to jobs. Financial incentives may be one of the only available inducements available to foster synergies between education and the workplace – for their mutual benefit. They can be in the form of tax breaks for employers, educational vouchers or academic credit for participating employees, reimbursement for training, co-ordination and supervision, and direct grants to pay for equipment.

Since a large proportion of new businesses fail, it is important that schools link up with those businesses with the greatest chances for success. Administrators at the New Economic School in Moscow, for example, successfully targeted bankers at the leading financial institutions and persuaded them to make modest contributions based on the assumption that many of the School’s graduates will be recruited by these banks. If employers believe that they are investing in their future employees, they will be much more willing to establish a dialogue with educators.

7. Passive labour market policies

124. The array of cash benefits available to the unemployed is large, access to benefits is relatively easy, but frequent changes have been made and the rules have become increasingly complex. The cash assistance available to the unemployed includes periodic unemployment benefits; early pensions; stipends for individuals undergoing training and retraining offered by employment offices; and material assistance. (The benefits and the most important rules and recent changes are described in Box 3.2.)

125. The calculation of unemployment benefit amounts is complicated by the variety of possible supplements and exceptions to the basic rules, with the result that benefits can vary from very low to quite generous. In principle, a three-tiered declining replacement rate for the basic benefit limits the duration of relative generosity. In practice, supplements for dependants that are not subject to the same declining schedule damp this effect. Moreover, such supplements duplicate and are more generous than benefits from the child allowance programme, particularly when both parents are unemployed and both are eligible for identical supplements. In fact, supplements can exceed the amount of the basic benefit, despite the ceiling on their amount, even if only one worker receives them. However, data provided by the FES
indicate that average benefit replacement rates are low, largely because nearly one-half of basic benefits are paid at the minimum level (see Table 3.6.)

Table 3.6 Unemployment benefits: coverage and levels, 1994-1998

126. The provision of material assistance for up to six months after the expiration of the unemployment benefit, paid for from the Employment Fund and provided at the discretion of the local employment office, duplicates responsibilities assigned to municipalities to provide similar forms of assistance to broader population categories (see Chapter V.) Such assistance, in addition to the extended duration of benefits and early pensions for some older workers, results in inequitable disparities in the actual duration and level of benefits among the unemployed based upon age, family status, and on regional and local differences in willingness and capacity to pay.

127. In sum, the unemployment benefit system is complicated, duplicative, and inequitable. It is difficult and costly to administer, particularly with continuing changes in the rules. Given limited vacancies in the formal sector and the prevalence of unrecorded activities that the unemployed can engage in, it also is difficult to enforce the basic eligibility criteria and to encourage formal job search. Simplification of the structure would increase transparency and accountability, reduce administrative costs, and permit more attention to be devoted to enforcing compliance with eligibility and job search requirements. Consideration might be given to a flat-rate system at an affordable level. The provision of family allowances and early retirement pensions should not remain an appendage to the unemployment benefit programme. (Elimination of these expenditure items are discussed in the larger context of social policy reforms in Chapter V.)

Concluding comments

BOX 3.2 Passive labour market policies

Basic unemployment benefits

The level of unemployment benefits depends upon the cause of unemployment, previous work experience, and previous wages earned. All persons with at least 26 weeks of paid work within the past 12 months who lose a job are eligible for unemployment benefits related to their previous wage. During the first three months of the benefit period, they receive 75% of their average wage over the last three months; the benefit declines to 60% for the following four months; it is reduced to 45% in subsequent months. The basic level of the unemployment benefit cannot exceed the regional average wage, nor fall below the national minimum wage.

Those who do not meet the length of service requirement receive a benefit equal to the minimum wage, but a change in this rule was adopted by the State Duma in June 1999. The change redefined the benefit base for certain individuals without previous or continuous work experience to the subsistence minimum, and benefits were raised slightly to 20% of the new base.

A worker with dependants and individuals working in severe climatic conditions or hazardous areas are eligible for supplements equal to one-half of the minimum wage per dependant, up to a maximum of 1.5 times the minimum wage. If both parents are unemployed, both are entitled to such supplements. (The June 1999 amendments to the Law on Employment reduced dependants’ supplements slightly, but raised supplements for unemployed workers in the Far North. Part of the increase in costs for workers in the Far North is to be financed from the federal budget.)

Benefits are paid for a maximum of 12 months, but renewed eligibility for benefits at the minimum wage is possible 6 months after expiration of the maximum unemployment benefit period if no suitable job offer has been made during the entire 18-month period. However, this rule also was modified in 1999 for certain workers. The duration of benefit eligibility was reduced to six months in the previous 12 months for benefit applicants without previous work experience, fired for cause, or who have repeated voluntary quits in a year, or who have refused employment in a
public works project. These workers also are no longer permitted to renew eligibility after the expiration of their benefit period.

A job is considered “suitable”\textsuperscript{90} if:

- It corresponds to the skills of a worker;
- The duties are appropriate, given the worker’s health status;
- The journey to the workplace is deemed reasonable by local authorities.

A job is not considered “suitable” if:

- It entails an involuntary change of residence;
- Wages are less than a worker’s previous average wage over the last three months of employment (except in cases where previous earnings were higher than the national average or the average in high-wage areas such as Moscow or St. Petersburg);
- Working conditions do not meet the standards of the labour code.

The duration of unemployment benefits for older workers can be extended if they meet the required length of service for an old-age pension, including those granted on privileged terms, but are below retirement age. An additional two weeks duration per year of service above that required for pension eligibility is added to the duration of unemployment benefits. The total duration cannot exceed 24 out of the past 36 calendar months.

The unemployed who receive cash benefits are required to appear at the employment office at least twice monthly, or benefits can be decreased or payment stopped for up to three months.

According to law\textsuperscript{91}, benefits that are actually paid must be indexed, but delayed benefits are not similarly adjusted.

\textsuperscript{90} Territories with difficult labour market circumstances, as federally defined, were given increased authority to change the criteria for “suitable” employment, as well as authority to modify conditions and procedures for the payment of various benefits.

\textsuperscript{91} Article 28.3 of the Law on Employment….
**Severance payments**

Workers who become unemployed because of enterprise restructuring or liquidation are eligible for a severance payment of three months wages, paid by the employer. They become eligible for unemployment benefits when employment ends and the period covered by severance pay has expired.

**Early pensions**

Workers who are redundant because of the liquidation of the enterprise and cannot find suitable employment are eligible for an early, unreduced pension benefit if, as above, they meet the required length of service for an old-age pension and are within two years of the age of eligibility. (It is not clear if the claimant must be within two years of the age requirement at the onset of unemployment, or if the claimant can reach the age requirement for an early pension by an extension of the duration of unemployment benefits.) The outlays for early pensions are advanced by the Pension Fund, with subsequent compensation by the Employment Fund.

**Training stipends**

The stipend for the unemployed during a training period organised by the employment office is set, at the discretion of the Subjects of the Russian Federation, at level within 20% of the regional subsistence minimum, but not lower than the federal minimum wage. Workers who are being re-trained because they cannot do their usual and customary work due to a work accident or an occupational disease are paid 100% of previous wages. Supplements can be granted, similar to those available with standard unemployment benefits.

**Material assistance**

A wide variety of assistance may be provided to the unemployed and their dependants after the expiration of unemployment benefits, at the discretion of the employment office. The types of assistance include, but are not limited to, subsidies for kindergartens; housing; municipal services such as utilities; public transport; health care; and catering services.
CHAPTER IV.
HEALTH STATUS AND HEALTH CARE

1. Introduction

128. Health indicators in Russia paint a troubling picture. Although the underlying trends have been evident for a long time, they deteriorated rapidly during the early years of the transition period\(^92\). Life expectancy, moreover, was lower in Russia than in many other countries in transition, and markedly lower than the average for OECD countries in 1997 (see Figure 4.1.)

129. There had been no significant improvement in life expectancy for several decades prior to 1990\(^93\). Life expectancy at birth dropped to 64 years by 1994 (less than 58 years for men and about 71 years for women) – a fall of more than seven years for males, and more than three years for females over a relatively short period of seven years. More than 75% of the decline between 1990 and 1994 was due to increased mortality rates of individuals between the ages of 25 to 64 years. More than one half the of the rapid decline was attributable to increases in cardiovascular disease and injuries caused, for example, by motor vehicle accidents, suicide, and homicide\(^94\). Between 1994 and 1998, gains in life expectancy, largely by men, of slightly over three years occurred\(^95\). Life expectancy in 1998 at all ages and for both sexes nevertheless remained below the levels recorded in the first two years of the transition period (Table 4.1).

Figure 4.1: Life expectancy at birth in selected countries

Table 4.1: Age-specific life expectancy in Russia

130. The sharp increase in the mortality rate in Russia between 1990 and 1994 lies outside the peacetime experience of industrialised countries in the 20\(^{th}\) century. The annual number of deaths rose by almost 650,000 – an increase of almost 40% (see Table 4.2) Both sexes and all age groups were affected, but the largest increases in mortality occurred between the ages of 35 and 44 years. Although the dramatic

\(^92\) Caution is advisable in comparing health status over the longer-term and during the transition period in the Russian Federation. Some experts suggest that measured deterioration in health status indicators is largely attributable to better data collection over time rather than to significant changes in health status. At the same time, it is reasonable to expect that Russian health status indicators would have shown a dramatic improvement with the loss of entities in Central Asia after the break-up of the Soviet Union since life expectancy and mortality and morbidity rates in Central Asia were among the lowest in the Soviet Union. On balance, improved reporting alone does not appear to be the major explanation for declining health status in Russia during the transition years.

\(^93\) There was a significant but short-lived improvement for both men and women between 1985 and 1987, with sharp declines occurring subsequently. It is tempting to speculate that the temporary improvement in life expectancy – if not a measurement error, might have been related to a reduction in alcohol consumption due to the anti-alcohol campaign started in 1985 by then President Gorbachev.

\(^94\) See Notzon et al., 1998

\(^95\) No explanation for the upturn in life expectancy is available from the data in Table 4.3.
changes in mortality are difficult to explain, experts have found that the phenomenon was not simply an
artifice of data or reporting inaccuracies. Mortality rates began to decrease by 1995, but remained high
relative to experience elsewhere. For example, the maternal mortality rate was five times higher in Russia
in 1997 compared with the OECD average.

Table 4.2: Births, Deaths and Natural Increase in Russia, 1985-1997

There also have been significant increases in the incidence of most major illnesses since the early
1990s, as is shown in Table 4.3. Increases in the incidence of cancer, diseases of the nervous system, and
sexually transmitted disease ranged from more than 25% to about 60% over the period. The increase in
infectious and parasitic disorders is disturbing: it points to a breakdown in sanitation and hygienic
conditions. The re-emergence of diseases that now rarely appear in developed countries is particularly
alarming. The reported incidence of tuberculosis has reached epidemic proportions – largely among the
prison population; diphtheria has re-emerged as a significant health problem; and cases of polio are re-
appearing.

Table 4.3: Incidence of major illnesses in Russia, 1990-1998

An increase in addictive behaviour, self-inflicted injury, and suicide also was recorded during the
transition period, although Russia was not unique among transition countries in this respect. Alcohol
consumption and drug addiction rose, and the number of suicides and self-inflicted injuries in Russia
increased from 27 to 37 per 100 000 of the population between 1990 and 1997 – more than three times
higher than the average across OECD countries. These social pathologies are more prevalent among men
than women, and have resulted in an abnormally low male/female ratio in the total Russian population. A
study by the UNDP (1994) estimated that there were nearly six million “missing men” in Russia in 1994,
that is, a shortfall in the number of men one would expect if the male/female ratio was comparable, for
example, to that of the United Kingdom or Japan. The causes of self-destructive behaviour are complex,
but the tumultuous course of the transition years in Russia and the uncertainty and economic insecurity that
emerged undoubtedly played a role.

2. The health care system

The deterioration in the health status of the Russian people was influenced by many factors
including unfavourable life-style changes, environmental factors, such as the effects of the Chernobyl
disaster, laxity in sanitation and hygiene, increased poverty and insecurity, and declines in the performance
of the health care system. During the 1990s, when demographic indicators of the health of the Russian

---

96 See Walberg et al., 1997. Reporting problems work in both directions. Among those that tend to understate
rather than overstate the mortality rate, the Soviet-era definition of infant mortality excludes pre-term
births with death occurring within seven days. The official definition was modified in 1993 to conform
with WHO standards, but traditional reporting practices remain essentially unchanged. As a result, Notzon
et al. estimate that infant mortality is under-reported by about 25%.

97 The maternal mortality rate in Russia in 1997 was 50 deaths per 100 000 births compared with an OECD
average of about 10 deaths per 100 000 births. The high maternal death rate has been attributed largely to
the high rate of abortions, many of which occur outside of the health care system. (Serbanescu, 1998)

98 Changes in infant and child mortality rates, for example, are more closely related to the effectiveness of the
health care system than many other health outcome indicators, and this measure increased in the mid-
1990s. Despite a slight improvement by 1997, the rate remained high compared with that of many other
people were deteriorating, real public expenditure on health care fell by more than 30% (Table 4.4). Public satisfaction with health care provisions also deteriorated. The Russian public ranked health care as the social issue with the highest priority in a survey conducted in November 1997. The large majority of respondents with serious health problems saw it as the most pressing issue, but a substantial proportion of those without health problems also considered it a high priority.

The belief that resources limitations are the most serious problem affecting the health care system appears to be widespread among Russian authorities. The deterioration in the health care system in Russia, however, did take not take place only because of the sharp reduction in financing. The inability to discard the least attractive features of the Soviet-era health care system has proved to be extremely difficult (see Box 4.1.).

Table 4.4: Public expenditure on health care, 1991-1998

Box 4.1: Health care in the Soviet era

A major achievement of central planning in the Soviet era was the creation of a health care system that guaranteed equitable access to health care on the basis of citizenship – the Semashko model. The elements of the system included universal coverage, general revenue financing, centralised policy decisions and strong central controls, and regional planning. Low salaries for doctors and other health care workers were a key element of cost control. Mihály (2000) argues that...

the original Semashko model was a coherent, cost-effective system to cope with the medical necessities of its own time and for a period where (sic) health care systems were less technology-intensive and less diversified. (Mihály, op. cit., p.11.)

The Semashko system did not persist in its original form throughout the Soviet era. Modifications from the 1930s onwards, linked to industrialisation efforts, resulted in the emergence of parallel systems that favoured industrial workers and other privileged groups, and major cities and industrial centres at the expense of territorial equity. Increasingly, the official system of referrals was circumvented by use of under-the-table payments in order to access better quality health care. Although the changes reflected the priorities of the times, they also reduced the efficiency of the system.

The rigidities of central planning did persist throughout the Soviet era. Resources were allocated on the basis of success in meeting centrally planned supply-driven targets, for example, occupied hospital beds, the number of procedures performed, the capacity of polyclinics, and staff size. Treatment norms were centrally imposed and the length of a hospital stay was specified for each category and type of illness or procedure. There was a heavy reliance on secondary and tertiary care at the expense of primary care and public health services, and medical education stressed the development of narrow skills rather than the training of generalists. A strict scale of low salaries for physicians existed, which varied slightly with years of service and level of training.

This is not to suggest that spending declines were a major cause of declines in health status indicators. The evidence is somewhat mixed on the association between health status and the level of health care expenditure in advanced industrial economies. However, there does appear to be a strong link when there is a change in the composition of spending, and the public share falls while private spending increases. As an illustration of the importance of public spending that is responsive to need rather than ability-to-pay, Cuba at a low level of development has achieved health status indicators that compare favourably with those of advanced economies.

The survey, sponsored by TACIS, covered respondents from Novgorod, Rybinsk and Volgograd.

The model is attributed to Dr. N. A. Semashko, who was the first Commissar of the Peoples’ Commissariat of Health of the Russian Republic in 1918.
The competition for resources among health care providers, given the rigid rules and the implicit penalties for use of least-cost options, led to a serious misallocation of resources. Faced with funding shortages and systemic problems, an experimental reform of the health care system began in late 1980s.

The *New Economic Mechanism* (NEM) was implemented between 1988 and 1991 in the city of Leningrad (now St. Petersburg) and the Kemerovo and Kubyshev (Samara) oblasts. The objective was to encourage greater efficiency and higher quality medical care. Polyclinics acted as fund-holders, and were provided resources from the state budget on a weighted capitation basis\(^{103}\). The polyclinic provided most primary care, and had the right to select a sub-contracting hospital, along with the obligation to pay for in-patient care. Hospital fees were set according to diagnostic related groups (DRGs), with reimbursement based on the standard or average rate for a given procedure. The incentives in place clearly favoured outpatient treatment, reduced length of hospital stays, and higher quality performance.

The experience of the NEM was largely positive. The three regions reported improvements in efficiency and in the quality of care\(^{104}\). The total number of hospital beds declined, average length of stay and waiting lists were reduced, and there were fewer patient complaints. However, there also were problems because of the low salaries of physicians and difficulties in maintaining lists of registered patients. Monitoring quality standards also became an important task for health authorities, particularly to avoid inappropriate denials of hospital referral by polyclinics.

In 1991 the NEM expanded to about a dozen regions. Unfortunately, the timing coincided with the beginning of the transition period, declines in GDP, and an upsurge of inflation. Polyclinics, as fund-holders with fixed capitation payments, could not accommodate the increasing payment demands made by hospitals, and the experiment with the NEM came to an end.

3. **Health care reform after 1991**

The demise of the Soviet regime brought with it a new direction in health care reform. Prior to the implementation of health care reforms in 1993, responsibility for delivering and financing social protection measures had been shifted from the federal government to local government, as discussed in Chapter I. The health care system was carried along in the tidal wave of decentralisation. The primary goal of health care reforms, in that the mandate passed on to lower levels of government was unfunded, was to create a mechanism to finance health care and, it was hoped, to solve the persistent problem of insufficient funding that had been inherited from the previous regime\(^{105}\). The re-organisation of financial management and health care delivery also were major objectives of legislation adopted in 1991 and amended in 1993\(^{106}\).

**Decentralisation of Financing**

A radical departure from tax-based financing was implemented and fundamental changes in the structure of the health care system commenced. Regional Compulsory Medical Insurance (CMI) Funds were established as financial managers. The CMI Fund is financed in large part from payroll-based mandatory contributions of 3.6% paid by employers, of which 3.4% remains at the regional level and 0.2%

---

103 Capitation payments per registered client were regionally adjusted by age and gender, morbidity and mortality rates, working and living conditions of the population served, and/or the quality of medical facilities in the region. See Twigg, 1998.


105 Under the centralised procedures of the Soviet era, health care had been financed according to a “residual principle”. It and other relatively low-priority activities received what was left after key sectors, such as defence and space, had been allocated resources.

106 The law *On Health Insurance of Citizens of the Russian Federation*. 

49
is transferred to the federal CMI Fund. The federal share is intended to cover the costs of training and research, medical care considered to be of national importance, such as care for tuberculosis and sexually transmitted diseases, and to provide territorial equalisation grants. The contribution levied on employers is applied, in principle, to cover the health care costs of the working-age population, but regional authorities have total control over the regional CMI Fund and, in practice, exercise independent discretion over how the payroll contributions are spent. The regional CMI Fund is supplemented by funds from regional and local budgets and, to a lesser extent, from the federal budget to cover the cost of care for the non-working population. The majority of funds from the regional budget allocated to health care are spent to operate health care facilities owned by regions. The required local funding is calculated on a flat per capita basis, with the amount decided through negotiations between regional and local authorities, but must be at least equal to the average per capita contribution made by employers in the region. Expenses for medical facilities owned by various levels of government are financed entirely by them.

Health insurance organisations (HIOs)

The regional CMI Fund and its territorial branches contract with insurers who broker the purchase of medical services from independent providers. New entities were created to act as insurers – health insurance organisations (HIOs), and are paid on a weighted capitation basis for an enrolled population. The objective of the purchaser/provider split was to encourage competition among insurers and providers of medical services in order to improve the efficiency and the quality of the health care system. In practice, the distribution of HIOs is uneven, and many regional CMI Funds and their territorial branches continue to pay health care providers directly – a privilege they were granted on a temporary basis immediately after the introduction of the law. According to Sheiman (1997), the major reason that the new strategy does not function as intended is because health authorities are reluctant to lose control of the money and therefore tend to allocate financial resources on a non-contractual basis.

Nor do HIOs necessarily enter the health marketplace under competitive conditions: they are licensed at the discretion of regional health authorities. Competition among insurers is generally based on improving their market share, and they appear to have had negligible influence on provider behaviour. If a municipality is the sole owner of health facilities in an area – a not infrequent occurrence, there is a de facto provider monopoly and a barrier to competition. The development of competing private health care facilities and services, as originally envisaged, failed to materialise, except to a limited extent in major urban areas such as Moscow. Moreover, although individuals are free to choose among insurance

---

107  The 1999 budgetary law, for example, stipulated that 84% of the federal CMI Fund was to be used for equalisation grants in that year. The proportion of the federal CMI Fund to be used for equalisation is not specified in the law On Health Insurance....

108  Nearly 70% of regional funds were spent on health care institutions owned by the region in 1997. (Yudaeva and Gorban, 1999.)

109  This requirement has contributed to the incomplete divestiture of health facilities from formerly state-owned enterprises, since local authorities are reluctant to accept responsibility for them without a transfer of resources to operate and maintain them.

110  The law permits integration of the purchaser and provider functions through “managed care” arrangements, such as health maintenance organisations (HMOs) that provide comprehensive care for a pre-defined per capita amount covering a specified period, usually a year.

111  According to Sheiman (1997), a substantial private market for health care failed to emerge in large part because of the lack of a specified package of guaranteed medical benefits under public auspices, with the residual as the clear domain for private provision of medical care.
companies and providers when such choice is possible, they generally are assigned to medical facilities according to their home address\(^{112}\).

139. Although HIOs have not proven to be instrumental in improving the efficiency of the health care delivery system, they have increased administrative costs. Some regional authorities have reduced or eliminated the role of HIOs as a result. As of 1997, only 42 of the 89 regions still permitted insurance companies to act as brokers in the transfer of regional CMI funds to health providers, although some continue to use them in a limited administrative capacity\(^{113}\). A draft law, adopted on first reading in June 1999, annuls the requirement that regional CMI Funds operate through insurance companies.

**Provider payments**

140. There is a mixed system of payments to providers: capitation, fee-for-service, or on the basis of diagnostic-related groups (DRGs). The gains that might be achieved from explicit controls over the use of the mixed payment options have not been realised for at least two reasons. First, an important distinction between those services that are to be encouraged by means of open-ended fee-for-service payments and those that should be subject to a budget constraint might be lost when there are no explicit rules or guidelines as to how the options are to be applied. Second, the inappropriate use of open-ended funding via fee-for-service payments when there are no hard-budget constraints results in the misallocation of resources through supplier-induced demand, particularly when there is an excess supply of doctors. The decisions are made through negotiations with regional authorities, but the basis on which choices are made is not transparent. Polyclinics are paid by either capitation, or for each episode of care, or on a fee-for-service basis, or some combination of them. Hospitals are paid on a complicated fee-for-service basis that takes into account the ICD diagnoses, sex and age of the patient, and a consumption coefficient, or according to the average rate by speciality (a flat rate)\(^{114}\). In reality, the traditional budgeting norms inherited from the previous regime are dominant: the cost and the average supply of services generally determine budget allocations. Nevertheless, even this payment system rarely works in practice because the CMI Fund and regional and local funds often are inadequate to pay for services at the contracted prices. Accumulation of arrears is the result. In January 1999, the widespread payment arrears amounted to nearly three billion roubles, or 0.1% of GDP\(^{115}\).

141. The practice of informal patient payments (“gratitude money” in the Soviet era) or formal patient charges, particularly by medical institutions, expanded to help meet the shortfall. It also was a vehicle through which patients gained access to medical care. People who could pay, received care; those who could not, waited – or did not receive care. A survey by Boston University found that, between 1997 and 1998, private expenditure on health care increased substantially while reductions in public expenditure on health care occurred at all levels of government. Total health care spending – public and private – was about equal to the OECD average, although the composition of spending on health care was markedly different (see Table 4.5) The ratio of public to private financing of health care in Russia was almost 1:2 as of December of 1998, while the OECD average has been about 3:1\(^{116}\). A system of health care based on ability-to-pay rather than on need became dominant in Russia, and the crowning achievement of the health care system in the early days of the Soviet era – universal access to health care – was disregarded.

---

\(^{112}\) See Yudaeva and Gorban, 1999.

\(^{113}\) *idem.*

\(^{114}\) Rate setting does not include the cost of utilities and certain other fixed costs that are paid directly by local governments.

\(^{115}\) Yudaeva and Gorban, 1999.

\(^{116}\) The OECD average ratio refers to 1994. See Schieber *et al.* (1997)
142. The Boston University survey also found that households in Moscow and St. Petersburg and other population centres have a higher absolute level of spending on health care than households in rural areas, although it is a smaller proportion of household budgets in urban areas (Table 4.6). This is a result of both relatively higher incomes and the greater availability of medical services in urban areas. Discussion with health authorities confirmed that the distribution of medical facilities favours urban areas, while rural areas remain under-served, as was the case in the pre-transition period.

Table 4.5: Public and private health care expenditure, 1997-1998

Table 4.6: Private household expenditure on health care in urban and rural areas, 1997-1998

Medical facilities and services

143. When the 1992 law *On Health Insurance of Citizens of the Russian Federation* was adopted, access to free and comprehensive medical services was guaranteed – as it had been in the Soviet era. Although this legal guarantee has never been rescinded, it was not possible to meet this promise after 1991, nor had it been possible to do so before then. In actuality, resource constraints, rigid budgetary norms, the supply of medical facilities, available services and their distribution, traditional patterns of practice, and under-the table payments determine what benefits are provided and who receives them. Rules that determine budget allocations continue to be based on inputs and prescribed standards of care, and are strongly biased in favour of the *status quo* and an emphasis on in-patient care – a legacy of the former regime. About 70% of available resources are spent on hospital care. Relative to the average in OECD countries, the supply of health care facilities and physicians in Russia is high, as is the average length of stay in a hospital. (Table 4.7). Despite disproportionate allocations to in-patient facilities relative to practices in OECD countries, hospital facilities often are in poor condition. A study by the World Bank in the early 1990s found that one-quarter of hospital facilities had no running water, and nearly one-third did not have a sewage system.

Table 4.7: Health care facilities, medical personnel, and length-of-stay in hospitals, 1985-1998

144. Russian doctors and other health care professionals are not in short supply, as shown in Table 4.7, but they are seriously hampered in applying their skills to maintaining the health of the population because of deteriorating facilities, obsolete equipment, shortages of drugs and other means of providing appropriate treatment. According to health system administrators, who generally are physicians, state-of-the-art diagnostic equipment is lacking almost everywhere, except perhaps in Moscow. Domestic production of pharmaceuticals is insufficient to meet domestic needs, and those produced outside of Russia usually are unaffordable.

145. In addition, the traditionally low salaries of health care professionals were lower in 1998 relative to the average wage than they had been earlier. Average salaries in the health care sector had been about three-fourths of the average wage in 1993; by 1998, they were about two-thirds of the average wage.

---

117 Resolution of the Government of the Russian Federation No. 1096, September 11, 1998; Order of the Russian Government No. 1063-r, July 3, 1996. Incomplete reflection of actual costs also reinforces the *status quo*. Most utilities still are centrally provided in the community, and are paid for by local budgets rather than by the health facility that uses the services.


119 Discussions held with authorities in Moscow, Tula, Astrakhan, Ekatarinburg, Sverdlovskaya and Leningradskaya Oblasts, and St. Petersburg.

120 Goskomstat.
This results in pressures for informal payments from patients, reductions of time spent on official activities by medical personnel, and other practices that potentially damage the performance and integrity of the system.

4. Assessment of health care reforms

146. The departure from traditional lines of responsibility for the financing and delivery of health care in Russia was drastic, although major changes in health care systems are not unprecedented in previously centrally planned economies. The main objectives of the reforms at the time of implementation were to raise additional revenues for the health care system; eliminate the rigidities of central planning and improve the efficiency of the system; improve the quality of care; and increase equity and consumer choice. None of these objectives were satisfactorily met, and the health care system continued to deteriorate. Improvements in efficiency should have received a very high priority. The system continues to suffer from an excess supply of medical facilities and doctors and a misallocation of resources. It is less costly to achieve higher quality care and increased equity if a health care delivery system operates efficiently or is becoming more efficient. The means by which health care is financed is far less important. Yet the reforms in Russia showed a preoccupation with financing mechanisms.

147. The unfunded mandate from the federal government to regional and local governments forced decisions to be made about alternative sources of financing. The attractiveness of financing that removes the health care sector from competition with other functions for scarce resources in the budget is understandable, but the widely held view at the time that contributions based on payrolls would infuse new and more adequate revenues into the system was unfounded. The payroll base was not immune to the shocks experienced throughout the economy, nor was it immune to generally poor performance with respect to tax collections. Therefore, it could not solve problems related to resource inadequacy, particularly in those regions with an unfavourable wage base. Moreover, regional control over the overwhelming majority of revenues from contributions or any other revenue source used to finance health care is not helpful in equalising the disparities across sub-national jurisdictions. The decentralisation of financing may have gone too far.

148. The choice of an extremely complicated model that rests on institutional features that are not well developed in Russia is surprising and, perhaps, unfortunate. Experience with the competitive contracting model is relatively recent in a limited number of OECD countries, and its full effects have not yet been fully evaluated. Moreover, only countries that already have competing insurers usually adopt this approach, possibly because existing insurers must be given a role in any reformed system for political reasons.

149. The attempt to introduce elements of competition into the health care market by means of competing insurers appears to have had little success in effecting notable improvements in the delivery system. The basic objective of organised systems of competing insurers is to reward those providers that

---

121 Anecdotal evidence suggests that the growth in the number of physicians was an accounting artifice in order to permit doctors to receive the salaries of fictitious colleagues in addition to their own wages. See Yudaeva and Gorban, 1999.

122 The model of competing insurers emerged as an option for a national health care system in the United States in the late 1970s; various reforms based on a similar concept were proposed in subsequent years, but none were ever adopted. The model of competitive contracting and "managed care" does exist on a sub-national scale in the United States and, based on that experience, has been adopted as a partial or experimental feature of national health insurance schemes in several other OECD countries such as New Zealand, Sweden, and Turkey.

123 See discussion in OECD, 1994
offer high quality, cost-effective care. But insurers in Russia are in competition with the dominance of traditional budgeting norms for health care facilities and the low salaries of health care providers that discourage efficient patterns of practice and productivity improvements. The purpose of the separation of purchaser and provider with “money following the patient” is to secure higher quality care at lower cost by encouraging competition between providers. This assumes that there are a relatively large number of independent providers in a given health market – a condition that often is not met in Russia. In sum, the reform path chosen may not be the most direct route to major reforms in the efficiency and effectiveness of the delivery system in Russia. A more realistic alternative might be the use of the widespread system of polyclinics in Russia as “fund-holders” – a locus for primary care and gatekeepers to other levels of medical care – as in the NEM experiment (see Box 4.1.).

Concluding comments

150. Improvement of the health care system and adequate and equitable health care financing merit a high policy priority by the federal government. As a corollary, the federal level of government must assume a significant role in the oversight and financing of the health care system, while permitting an appropriate margin for local discretion. The national interest in maintaining and improving the health status of the population transcends the boundaries of sub-national governments. It is generally agreed that setting overall objectives and priorities for the health care system, and ensuring that they are met, is the province of central government. (It should be noted, however, that this role does not require a return to a command-and-control model of health care.) These responsibilities, in turn, require effective monitoring, regulation, and financing controls to ensure that mandated priorities are honoured, including an appropriate emphasis on public health measures, preventive care, and equitable access to a clearly-defined basic package of health care benefits. The repudiation of a strong federal role and the severe reduction in public financing was a catastrophe at a time when health indicators were unfavourable and becoming worse.

151. Clear lines of responsibility and accountability at all levels of government are essential. The general lack of clarity in the respective roles of federal, regional and local government is damaging to the health care system, in the same way that a moving car without a driver is potentially life threatening. Subject only to certain budgetary norms and standards traditionally imposed at the federal level, regions have virtually full discretion over the collection of contributions and local transfers to the regional CMI Fund, and full discretion over how monies are spent. Regional authorities have little or no accountability with respect to the outcomes related to spending decisions, and inadequate incentives to maintain transparency. The lack of transparency is compounded by the complexity of the system.

152. The changes in the health care system and the variations implemented across localities nevertheless have provided information that can be helpful. Sheiman (1997) reports several approaches that have been used: for example, in Kemerovo Oblast, the rates of payment are regulated to avoid inappropriate admissions and to strengthen primary care. Utilisation management procedures also were put in place with an emphasis on reducing the use of hospital resources. In Samara Oblast, the polyclinic became the “fundholder” and the gatekeeper to the health care system. Other regions also have been experimenting with various types of “managed care”. These efforts are reminiscent of the health care system experiment in Russia between 1989 and 1991 that showed promise, but was aborted because of the difficulties experienced at the onset of the transition period (see Box 4.1.) It may be judicious to revisit that experience and to transfer what was learned to current reform efforts.
CHAPTER V.
PATHS TO SOCIAL POLICY REFORM

1. Introduction

153. The prolonged recession has resulted in the severe erosion of standards of living in the Russian Federation. As documented in previous chapters, marked declines were reported in real income and earnings, wage and benefit arrears accumulated, open unemployment grew, and inequality increased. Thus, the social costs of the transition have been quite high, particularly in fundamental respects such as the rapid deterioration of health status indicators described in Chapter IV.

154. Some individuals and families clearly fared much worse than others. A survey of public opinion by the National Centre for the Study of Public Opinion (VTsIOM) found that 60% of Russians considered their situation as poor or very poor; only 4% considered themselves to be in good circumstances. The widening income gap between those who prospered and those who lost ground (see Figure 5.1) also exacerbated social discontent, particularly in light of the popular view that many who prospered did so by unfair or illegal means.

Figure 5.1 Distribution of household income, 1991-1998

155. As the economic circumstances deteriorated, no clear strategy for reforms in the social sphere emerged to help cushion the impact. In practice, the implicit social policy objective was to keep a tenacious hold on the institutions, traditions, and practices of the past, although this was no longer a viable option. Nor were resource constraints the only problem.

156. Social protection in the Soviet era was based on the notion that the state had full responsibility for everyone’s social welfare. A job was guaranteed, albeit at a low wage, supplemented by the social benefits administered by state-owned enterprises. Universal access existed to benefits provided by the state, such as free health care, free education, and an array of pensions. Finally, the administered prices of necessities, such as food, housing, utilities, and transportation, were kept at a low and affordable level. The expectations inherited from the Soviet era could not be easily or quickly changed. Resource constraints nevertheless resulted in a number of unintended changes: promises were broken and confidence in government diminished.

157. Pressure to maintain the traditional social protection provided by the state, despite inadequate resources, is not unique to the Russian Federation. This tendency has been apparent in virtually all transition economies, as well as in mature market economies at certain points in time. However, in contrast to the situation in Russia, rarely has a potential imbalance persisted for an extended period in OECD countries without resolution nor have benefits ever been delayed or not paid.

158. Social protection systems must adapt to changing circumstances and priorities in all countries. In the OECD area, solutions often entailed marginal changes to existing systems; radical changes have been less frequent. Some transition economies, such as Poland and Hungary (now included in the OECD group), did realise radical changes in their Soviet-style social protection systems with relative success, but the main engine that supported such changes was a commitment to structural reform and the achievement of
stable economic growth. Other transition economies, such as Bulgaria and Romania, experienced the increased costs of hesitation in introducing structural reforms. Economic crisis precipitated many of the major economic and social policy reforms in these countries. The scale of the problem in Russia, however, is without precedent in the OECD area, and is more formidable than those encountered in transition economies that moved quickly to make necessary reforms, as well as in many that delayed acting.

159. Social policies in Russia, as in every country, must reflect the social, political and economic climate. That a policy works well in one country is not a guarantee that it will do so in another country. A blueprint for social policy reforms in Russia based on a model in place elsewhere therefore might be inappropriate, but the experience of other countries nonetheless can enrich the policy dialogue in Russia. In this spirit, subsequent sections examine feasible paths to social policy reform that focus on ameliorating immediate problems in ways that are consistent with the achievement of longer-term objectives. The first two sections discuss the political economy of reforms in the social sphere, and why both the approach to, and the speed of, reforms in Russia may face some limitations; the importance of setting priorities is stressed. The next sections examine the wide array of social programmes in place and pension reforms in Russia, and discuss the concept of “targeting” and the various ways in which this can be interpreted and implemented to help the poor.

2. The political economy of social policy reform

160. The hallmark of social protection in advanced market economies is the creation of conditions that enable individuals to help themselves. Of course, not all are capable of helping themselves by working, such as the old and infirm or individuals with severe disabilities. Nor are the results of unfettered market forces always the most efficient or the most socially desirable outcomes. The provision of health care, for example, is one of several areas where government intervention may be needed to correct “market failure”. The role of government in providing social protection in market economies therefore is quite broad: it is not limited to targeting transfers on designated population groups such as the poor. The primary emphasis is on the prevention of poverty. This objective is easier to achieve in a robust and stable economy with strong institutions that help to make policies work well. It also requires strong incentives for individual effort provided by adequate rewards to working, both psychic and monetary, in order to make work more attractive than dependency on government transfers. The low returns to work experienced by many workers in Russia is a key problem (see Chapters II and III.) The distortions in product markets and other factors that cause distortions in labour markets cannot be remedied by social policies alone.

161. Reforms in the social sphere are often contentious. Some people lose rights acquired earlier, and it is difficult to make new rules that benefit the majority of the population when the fiscal constraints are severe. The potential gains and losses and public acceptance of them largely depend upon how reform priorities are structured. Meeting overall budgetary limitations is an obvious priority. However, if all social benefits were reduced to meet a global resource constraint without selectivity, the self-interest of all beneficiary groups would be adversely affected without compensation in the form of increased efficiency and effectiveness in any programme area. No group is likely to be satisfied and public dissension is likely to be magnified. Alternatively, bowing to pressures from the largest interest groups or those with the most political leverage could disadvantage the weakest members of society and impede more desirable strategies for change.

162. The changes in social programmes that have taken place in Russia have indeed magnified the potential for dissension and social unrest. Most have occurred haphazardly because of an inability to finance existing social programmes and maintain the real value of benefits, rather than because of explicit policy priorities. While vestiges of all social programmes inherited from the former regime have been retained, the result has been that most beneficiaries – the large majority of the Russian population, have been losers.
Approaches to social policy reform: obstacles and limitations

163. Social programmes have been affected in different ways across the territories of the Russian Federation because of substantial variations in need and resource availability. These geographic disparities have been amplified by the mismatch in the allocation of expenditure responsibilities and the capacity to pay, as well as by other shortcomings in intergovernmental fiscal relations discussed in Chapter I. The problems in this area, if unresolved, will continue to impede efforts to implement changes in social policies.

164. The vulnerability of the Russian economy and the unfinished reform agenda also limit the approaches to social policy reforms that are feasible. Despite the recent rebound in GDP, the Russian economy has not yet reached an equilibrium state. Reforms implemented in the near-term that are designed to meet objectives for the more distant future implicitly assume otherwise. (The need to abort the implementation of pension reforms adopted in May 1998, discussed below, illustrates this point.) Moreover, plans for the long term may not be responsive to more immediate problems. A balance is required that gives adequate attention to short-term policies and crisis management. The formulation of long-term objectives nevertheless is essential, both as a guide to coherent policies in the shorter term, and as a means of obtaining public participation and agreement in the reform process.

165. Effective and efficient social programmes also require institutions that can administer and deliver promised benefits, enforce compliance with the rules, and monitor the outcomes. Relatively uncomplicated approaches to helping people may be most appropriate at a stage when all of the necessary mechanisms and institutions are not yet in place. Ambitious and complex programmes that are premature in this respect could be excessively costly and might not achieve their intended objectives. For example, the ways of “targeting” social benefits customarily employed in many mature market economies may be too demanding to be suitable in the Russian context at this stage. This point is developed below.

166. In sum, changes in social policy that are feasible must be designed with due consideration of the obstacles that might hinder their success, and adjusted accordingly. Impediments include not only the incomplete restructuring of many sectors, institutions that are not yet in place, but also types of behaviour that are not compatible with the rule of law and good governance. Policies and practices with rules that can be administered and enforced, and the willingness to enforce those rules are paramount. In the interim, until such obstacles can be ameliorated or eliminated, the timing and the approach to social change must be in accord with the current reality. This implies that effective programmes must be simple to administer and monitor, and resource limitations must be respected so that promises made can be relied upon.

3. Current programmes

Cash benefits

167. There is no longstanding tradition in Russia of providing cash transfers to the poor per se. The large majority of cash transfers is provided by old-age, survivor, and disability pensions financed for the most part through earmarked contributions to the Pension Fund. Social pensions are paid to older people who do not have at least five years of work; these are financed from the federal budget. Other traditional cash support includes short-term benefits financed by earmarked contributions to the Social Insurance Fund, such as birth grants, maternity leave and child-care leave payments, sickness benefits, benefits for work-related injuries, and funeral grants (see Table 5.1.) The primary change that took place with respect to these cash transfers was the shift in the sources of funding early in the transition period from the federal budget to contribution-based funding and the creation of extra-budgetary funds.

Table 5.1 Revenues and Expenditures of the Social Insurance Fund, 1994-1998
168. Several new benefits were added in the 1990s. Family benefits – mainly child allowances – were introduced in 1990 and are financed by regions. Unemployment benefits were introduced in 1991, and are financed by earmarked contributions to the Employment Fund. A housing allowance programme, with eligibility contingent on income, was adopted in 1993 to substitute limited cash compensation for reductions in widespread housing and utility subsidies.

169. The housing allowance programme is particularly notable as the first one in Russia to incorporate an income-test, albeit a crude one. Households with housing costs above 15% of income (or less, at the discretion of regions) whose income does not exceed a defined income threshold, specified according to household size and space utilisation, are eligible to have the gap filled by a reduction in housing costs. Adjustments are made in the income threshold for space utilisation per capita according to “social norms” in an area. Thresholds initially were set at levels that severely limited the amount of the allowance and total costs, with the intention of encouraging growth in programme participation by reducing the income thresholds as utility subsidies diminished. Documentation certifying household income is required, but the way in which the income eligibility threshold is determined is biased in favour of upper household expenditure deciles. As cited in Chapter I, about 21% of spending on this benefit was received by the four bottom deciles in 1996; the three upper deciles received nearly 43%. The allowance is paid from regional budgets for occupants of municipal and private housing, and by enterprises for housing they own.

In-kind benefits

170. There also is a wide array of benefits in-kind that were previously delivered by state-owned enterprises. The responsibility for administering and financing some of these benefits was shifted from enterprises to municipalities as social assets were divested during the privatisation process, albeit incompletely. Social services range from child-care centres and residential day-care and holiday facilities for pensioners, to cultural and rehabilitation institutions, and services such the distribution of free meals, second-hand clothing, and other assistance in emergencies. As new problems were recognised, such as domestic violence and abused or homeless children, new institutions and services appeared. It is the bulk of the in-kind assistance and certain subsidies that are provided by municipalities that is commonly referred to as “social assistance” in Russia.

171. For the most part, the social service institutions inherited from the former regime remain intact, operated out of the same facilities, and often managed by the same staff. As exemplary as many of these efforts may be, all are underfunded. Most social institutions can serve only a small proportion of the categorically eligible populations, and localities have resorted to various methods of restricting access. Despite the shortage of resources, the total number of social service institutions grew during the transition years. A rationalisation of social services appears to be necessary, but little or no effort appears to have been made to provide the tools that might help to do this.

172. The Ministry of Labour and Social Development claims a policy oversight role for social assistance. The ability of the Ministry to monitor services nevertheless is limited by the fact that the Federal Ministry has not set any minimum standards in any programme area, although Ministry officials stated that this has been a longstanding intention. Nor is any information provided by local administrations in a form that enables judgements to be made about the appropriateness of priorities in a given locality, or the quality or quantity of service provided. For both reasons, the picture of social assistance in Russia is incomplete and it is extremely difficult to recommend changes in the absence of such information. At present, the federal role in the area of social services is not clear. It neither funds nor prescribes nor monitors social services, despite the federal bureaucracy in place. Centralised data collection and

systematic monitoring of local social assistance practices would facilitate the ability of the federal government to determine what role, if any, it should play.

**Subsidies**

173. Subsidies to households are varied, and they too reflect patterns of the past. Many households are recipients of some type of subsidy, as shown in Table 5.2. The purpose of some of the subsidies, such as those for leisure activities or “gifts”, is of highly questionable social value. The distribution of the subsidies is equally questionable. While subsidies for transport and housing were received by more households than any other subsidy, the one of highest average value for leisure activities⁸¹ is received by very few. All represent a public expenditure that might be better directed to those most in need.

*Table 5.2 Proportion of all households and pensioner households receiving selected subsidies, by type and average amount per month, 1998*

174. It is noteworthy that, on average, nearly one-fourth of consolidated regional and local budgets was spent on housing and utility subsidies from 1995 to 1999, as shown in Table 5.3. These subsidies are highly regressive. Households with the largest dwellings and the highest utility usage receive the highest subsidies. Moreover, a large proportion of utility subsidies is not captured by this data: some subsidies are financed directly by utility companies because of tolerance of non-payment, payment by barter at inflated valuations, and low or preferential pricing arrangements.

*Table 5.3 Expenditures on housing subsidies in consolidated regional and local budgets, 1995-1999*

**Benefits for families with children**

175. Families with children, particularly when there are numerous children, have traditionally been considered at high risk of poverty. However, not all families with children are poor, nor are the poor among them necessarily worse off than other family types according to the evidence in Chapter II. It is therefore worthwhile to review the complex and duplicative array of provisions for parents (primarily mothers) and their children that exist (see Box 5.1) They are distinguished by the source of financing, and according to employment status – and by their relative generosity.

176. Many came into being because of pro-natalist objectives. (The birth rate has fallen continuously since the late 1980s nonetheless, although it is conceivable that it might have fallen even more in the absence of family benefits.) Those that are linked to the minimum wage are no longer worth much, since the nominal value of the minimum wage to which many benefits are linked has stagnated since 1997. Many have experienced payment arrears or have not been paid at all, or access to them has been limited because of the strained budgets at all levels of government. Universal child allowances, for example, have virtually disappeared (see Chapter I). Some appear to be relatively generous, particularly when eligibility for duplicate benefits is possible⁸⁶. Rationalisation of the array of benefits and allowances might serve both equity and the need to reduce costs.

177. Savings might be achieved in virtually all of the benefits shown in Box 5.1. The maternity leave granted in Russia is unusually long relative to the practices in OECD countries. Birth grants have apparently not achieved their intended objective of encouraging births and could be reduced and, eventually, eliminated. Part of the cost of leave from work to care for a sick child could be shifted to

¹²⁵ “Leisure” includes activities such as subsidised access to resorts and spas.

¹²⁶ No centralised data is available on the prevalence of multiple benefit receipt from all funding sources.
employers. The trend in OECD countries with respect to all sick leave benefits has been towards a partial shift to employers of the cost of at least the first few days. The open-ended leave permitted also is unusual. Small and duplicative benefits, such as cash subsidies for the food or clothing of children could be eliminated without great loss to most families.

178. The (previously) universal child allowances invited heated discussion in Russia that led to legislation to impose an income restriction, albeit a high one that permitted about 70% of families with children to remain eligible. The income restriction was not implemented, largely because it is not restrictive enough to meet budgetary limitations in most jurisdictions and it is difficult to assess household income reliably. Some have proposed that child allowances be eliminated on the grounds that they are not affordable and not worth enough to any family to maintain them. Under recent circumstances in Russia, it is difficult to argue with this proposal. But however meagre the benefits are, they are worth something to families with children that have few resources to sustain them. If other benefits were reduced or eliminated, it might be possible to maintain universal child allowances in some form and at a higher level. Income or means-testing may be a premature approach because of the difficulties in making a reliable determination of income and the costs of administration. Restricting benefits to children below school age, however, would be an administratively simple and effective way of allocating the scarce resources available. The rationale for using an age below the age of entry to school as the eligibility criterion is that this is the period when a child is most likely to present limitations on the ability of the mother to work for pay. If the child allowance programme could be salvaged, that would be reason enough to eliminate supplements to unemployment benefits. If the benefit were to be maintained at a uniform level with universal eligibility, there would be no justification for the benefits to be financed at any but the federal level.

**Box 5.1 Benefits for parents and children**

*Financed by the Social Insurance Fund (employed mothers)*

- Maternity leave of 70 days before and after the birth of a child at a mother’s previous wage (at the level of the minimum wage if unemployed);
- Child-care leave at twice the minimum wage until the child is 1.5 years of age;
- A lump sum at the birth of a child of 15 times the monthly minimum wage;
- A lump sum of one-half of the minimum wage if registered at a medical centre during the first 12 weeks of pregnancy;
- Paid sick leave for care of a sick child for duration of illness: 100% of previous wage if worked at least 8 years; 80% of previous wage if work history of 5 to 8 years; 60% of previous wage if worked less than 5 years (special rules apply to certain privileged groups such as veterans, workers with more than three children, disabled workers, etc.).

*Financed by Employment Fund*

- Benefits are increased by 50% of the minimum wage for up to 3 dependants. If both parents are unemployed, both may receive the benefit supplement.

*Financed by Regions (all eligible parents)*

- Child allowances
• For children aged 16 years or under, or 18 years of age if in school in families with a per capita income of less than twice the subsistence minimum. (Income limit has not been implemented in practice.)

• Amount of benefit: 70% of minimum wage, or 120% if lone parent.

### Financed by localities

- Yearly subsidy for purchase of children’s clothing for those 13 years of age or less: amount depends upon per capita taxable family income;

- Yearly subsidy for baby food for children under 3 years of age;

- Yearly food subsidy for students in school: 3% of minimum wage per child per day.

Memorandum item: The monthly minimum wage has been at the level of about 83 roubles since 1997. (An increase in the minimum wage to 132 roubles per month in 2000 has been proposed.)

### 4. Pension Reform

179. More than 26% of the population of the Russian Federation received old-age, survivor, and disability pensions, at a cost of slightly more than 6% of GDP in 1998 and about 5% of GDP in 1999. (See Tables 5.4 and 5.5.) Although the proportion of pensioners appears to be quite high compared with their share in OECD countries, the expenditure level appears relatively modest. The cost of pensions nevertheless has been a heavy burden in Russia, aggravated by difficulties in collecting pension contributions. There has been a persistent imbalance between revenues from contributions and benefit expenditures of the Pensions Fund that has led to the accumulation of pension arrears and periodic, unplanned transfers from the federal budget.

Table 5.4 Share of pensioners, by type of pension, 1992-1998

Table 5.5 Revenues and expenditures of the Pension Fund, 1994-1998

180. The shortfalls in contributions reflect not only a propensity towards tax avoidance and evasion, but also popular dissatisfaction with the pension system. The Russian pension system has become increasingly complicated and, in light of the frequent legislative changes, is not sufficiently transparent to enable people to fully comprehend what they can expect from it (see Box 5.2 and Box 5.3.). Part of the

---

127 In Denmark, Finland, Norway, Spain, Sweden, and the United States, pensioners account for approximately 15 to 19% of the total population. Of these countries, Sweden has the largest population share of individuals aged 65 and over in OECD Europe. All have standard ages of pension eligibility at age 65 or over. (Difficulties in cumulating the number of beneficiaries across all types of pensions in other countries preclude other country comparisons.)

128 By the end of 1998, pension arrears reached 29 billion roubles, but were almost eliminated by the third quarter of 1999.

129 Table 5.2 shows the official accounting of the Pension Fund revenues and expenditures but masks annual deficits. (See the note to Table 5.2.)

public dissatisfaction also clearly stems from declines in the real value of pension amounts, the unreliable pattern of benefit payments, and the accumulation of pension arrears – all of which are symptoms of the financing difficulties. Figure 5.2 illustrates the steep decline in the real value of average and minimum pension amounts to about 60% and 40%, respectively, of 1991 levels.

Figure 5.2 Real benefit levels in Russia, 1991-1999

181. The narrowing of the distance between the average and the minimum pension amount also is apparent in Figure 5.2. It continued to narrow after 1998\textsuperscript{131}, mainly due to preferential indexing of minimum pensions. The distance between the minimum and maximum pensions also narrowed, in part because of the preferential indexing mentioned above, but largely because of length of service provisions \textsuperscript{132}. These factors have led to a heavy concentration of pension awards at or near the maximum pension, without regard to previous earnings\textsuperscript{133}. It is the effective compression of the benefit distribution that has been the driving force underlying the pension reforms legislated in May 1998 and the subsequent revised reform proposal.

182. From the perspective of workers who will be pensioners in the future, particularly those with above-average earnings, it appears unfair that those who earn more and contribute more to the system do not get much higher pensions than workers with lower earnings and lower contributions. No matter how much an individual contributes to the system, the pension amount will not change much. Therefore, why pay full contributions?

183. The disincentive to pay contributions is the primary concern among government officials. It is believed that a stronger link between benefits and contributions would alleviate this problem. Although a stronger link would help to provide a greater incentive to pay contributions, it would be optimistic to assume that it alone could produce a level of compliance that would pay for the pension benefit improvement for workers with higher earnings\textsuperscript{133}.

The May 1998 pension reforms

184. A major reform of the pension system was adopted in May 1998, but was discarded prior to implementation. The major thrust of the reform was the creation of a notional defined contribution tier (NDC) that was to be implemented almost immediately, but was postponed to 2001 after the effects of the mid-1998 crisis first became apparent, and was abandoned shortly thereafter. It is nevertheless important because it revealed pension reform preferences in Russia as well as the difficulties, financial and political, of achieving them.

185. Benefits under the 1998 legislation were linked to earnings-related contributions, with the aim of achieving decompression of the pension distribution. Pay-as-you-go financing of the new tier was to be effected by a phased but relatively rapid shift of contributions away from the old system to the new tier, starting at 2% of contributions in 2001 up to about 8 to 9.5% within five to ten years. Minimum pensions

\[\text{From a ratio of 1.72 from the second quarter of 1998 through the first quarter of 1999, it decreased to 1.46 by the fourth quarter of 1999, and was further reduced to 1.37 by February 2000.} \] Dmitriev (2000)

\[\text{About 90\% of pensioners received the maximum pension in 1999. (Information supplied to the Secretariat by Mikhail Dmitriev.)} \]

\[\text{Thompson (1998) takes the argument to its logical conclusion. “If a clear and close linkage between contributions and benefits were sufficient by itself to produce near-perfect compliance, there would be no need to have mandated the program in the first place.” In other words, if everyone willingly saved enough for their retirement years, major factors that justify public intervention, such as myopia and the free-rider problem, would be absent.} \]
were to be maintained at not less than 80% of the subsistence minimum of a pensioner, as decreed by President Yeltsin earlier in 1998. Although the minimum pension had fluctuated between 75 and 80% of the subsistence minimum of a pensioner in the pre-crisis period, it had dropped well below this level in the post-crisis period. In principle, no structural change was to be made in the existing system other than the diminution of contributions. The two tiers were to exist in parallel, and each was expected to contribute about one-half to the flow of income in old age, on average, when the system matured.

186. Other significant changes were contained in the legislation:

- The standard age of eligibility was to be increased by five years for both men and women over ten years, starting in 2002. It was also intended (but not stated in the legislation) that equalisation of the standard age of entitlement for men and women would be accomplished during the subsequent ten years.

- The earlier retirement ages for individuals who work in the Extreme North or under similar unfavourable conditions were to be phased out starting in 1999, with the responsibility of paying for pensions during the early retirement years partially shifted to voluntary occupational pension schemes (OPS). The financing of the minimum pension during the early retirement years was guaranteed through the federal budget. The timing was to be synchronised with reductions in the payroll and individual income tax rates in order to limit the burden on employers.

- A funded tier with universal mandatory contributions by employers was to be put in place on the same schedule, and with supplementary contributions of the same order of magnitude as for the NDC tier. (The dearth of reliable instruments in which to invest pension reserves was nevertheless recognised by many experts as a serious obstacle to implementation of this provision.)

187. The financial implications of the legislated reforms were alarming, particularly since there was serious political opposition to some of the elements that might have generated savings or shifted costs off-budget. If the NDC tier had been implemented in 2001, even with implementation of the proposals that reduced or shifted costs, the cost would have been unsustainable. Dimitriev (1998) estimated that the rate of revenue growth would lag behind the increase in pension liabilities of a mature NDC system as pension differentiation increased, resulting in an increasing Pension Fund deficit. It was estimated that even in the case of sustained economic growth at an annual rate of 3.5% after 2003, the system would face financial difficulties for about 20 years.

The May 2000 pension reform proposal

188. The new version of pension reform that emerged in May 2000 represented a political compromise. The main objective of decompressing the pension distribution remained intact, but the NDC tier was abandoned. The proposal modified the existing system to achieve the intended objective by raising the maximum pension to 120% of average earnings, rather than the 90% ceiling that was effective as of February 1998. The change is prospective, and will affect new awards only. Pension indexation, currently based on changes in the national average wage, will be changed to price indexation as soon as possible within the next few years. As proposed in the 1998 legislation, the standard age of eligibility for a pension will be increased by 5 years, phased over ten years starting in 2002. The proposal to shift the cost of certain privileged early retirement to occupational schemes was abandoned because of strong political opposition.

The forecast of an increasing imbalance was calculated without taking into consideration the proposal to reduce the contribution rate and base, subsequently enacted into law in July 2000. (See Dimitriev, 1998)
No changes are proposed at the lower end of the pension distribution, but the new indexing provisions will apply to all pensions. Eventually, a funded tier with universal mandatory contributions by employers will be implemented, based on same rate schedule as in the 1998 legislation: 2% at the time of implementation, gradually raised to 8 to 9.5% over 5 to 10 years.

189. Although full details of the new reform proposal and forecasts of the future cost are not yet available, certain potential results are reasonably clear nonetheless. First, if the pension amounts at higher earnings levels are increased by about 50%\(^\text{135}\), as new entrants to the system increase, benefit costs will increase *ceteris paribus*. It is less clear that contributions to the system will increase in tandem, since the underlying assumption is that an (unspecified) increase in compliance will occur spontaneously. The estimates of the financial consequences of the 1998 legislation send a warning signal in this regard, since an imbalance was forecast even with an increase in the retirement age, a shift of some costs off-budget, and an assumed increase in the required contributions actually paid. The point at which the costs of the benefit improvement might be expected to stabilise would not occur until pensioners subject to the old maximum are completely replaced by pensioners subject to the new maximum – at least 20 years after implementation. It is highly recommended that the expertise of the actuarial sciences be applied to estimating the cost consequences of all pension reform proposals.

190. Second, the change from wage indexing to price indexing invites a high risk. The real wage increase of nearly 25% by the Spring of 2000 relative to its level one year earlier does represent a cost (as well as a benefit) to the pension system. But there is no certainty that prices will not increase faster than wages in future periods as they have over the entire transition period. If inflation does re-ignite, the option that is less expensive today may be too expensive tomorrow. Since movements in wages are related to the way pensions are financed, wage indexing is the more stable option for the system. However, wage indexing is more likely to reflect the capacity of the economy to pay for benefit increases if the *total wage bill*, and not simply average wages, is used as the benchmark. Aggregate wages reflect changes in both wage and employment levels, while average wages confound the two. The safest option is to allow some margin for discretion and use a factor that is slightly less than movements in aggregate wages, with compensating percentage points added to the indexing factor at times when it is clearly affordable to do so.

191. An increase in benefits only for average and above-average earners in a public pension system invites public pressure to raise benefits at the lower end as well. That pressure undoubtedly already exists because of the severe declines in real pension values over the course of a decade. Moreover, a promise already has been made to maintain minimum pensions at no less than 80% of the subsistence minimum of a pensioner by the 1998 Presidential Decree to this effect. Under these circumstances, it is somewhat surprising that a public policy choice for the basic pension system in Russia would favour higher earners rather than lower earners, and future pensioners rather than current pensioners. Resources are extremely limited and the problem of pension adequacy is an immediate one. Given the starting point of a compressed pension distribution with a ratio of maximum to minimum pensions of about 1.3, the most feasible option may be to provide flat-rate increases in all pensions or preferential increases for low pensions in current payment status. This approach could raise the minimum pension closer to the promised level of 80% of the subsistence minimum or some other acceptable and affordable level\(^\text{136}\). The pension

\(^{135}\) The current maximum benefit, although technically 90% of the national average wage, is actually about 80%, on average. This difference is attributable to the fact that the 1998 change affected new awards, and many of the benefits in payment were subject to the lower maximum in previous law of 3 times the minimum wage or 75% of the worker’s average earnings. As new entrants increased as a share of the pensioner population, the average ceiling increased in tandem after February 1998.

\(^{136}\) The subsistence minimum for a pensioner should not be treated as a rigid policy parameter in the pension system, but should be used only as a policy guideline in setting benefit levels in order to avoid establishing expectations that cannot be met. For example, the recent change that increased the level of the subsistence minimum also automatically increases the cost of the promise that links minimum pensions to it.
system would have been effectively transformed into a flat-rate system, and legislation to formalise this structure merits consideration. Pension differentials could be achieved by the proposed mandatory defined contribution scheme under public auspices on a pay-as-you-go basis, or on a funded basis with non-governmental administration, or as mandatory or voluntary occupational schemes offered by employers, or some combination of them. An adequate and affordable flat-rate system would provide a sound base on which to build a second tier at a later time when there is less uncertainty about its sustainability.

192. Although it might be too costly at the present time to provide pension benefits that are proportional to earnings without a significant increase in the earnings-related contribution rate, it is nevertheless possible to link a less-costly flat-rate system to work effort. A flat-amount per month of service, for example, would reward those who work longer rather than those who have higher earnings. This model is in place in Ireland, and although benefits are unrelated to earnings, the system is financed by contributions based on earnings up to a defined maximum level.

193. A flat-rate system with benefit improvements, however, would entail added costs if all or some pensions in payment status were raised and none were reduced. Since the savings attributed to raising the standard age of eligibility would occur only gradually over the longer term, new pension expenditures might be feasible only if some changes were instituted that also reduced or shifted certain costs more quickly. The daunting list of privileges accorded in the pension system is an obvious candidate for cost-reduction strategies (see Box 5.3.) The cost of these pension privileges is not transparent. Nor is there any corresponding increase in the contribution rate for them. They are a charge against the contributions of employers and employees across the economy. Not only do they add considerably to the costs of the pension system and complicate administrative tasks, but some also beg clear interpretation.

194. The strength of the opposition to tampering with acquired privileges was demonstrated by the decision to drop the provision of the 1998 pension reform law that would have shifted certain early retirement privileges to occupational schemes. Therefore, cuts would have to be made in ways that might accommodate political concerns. For example, privileges that are deemed to be desirable could be honoured by provisions paid for outside of the pension system, with the recipient drawing only the pension acquired by the standard rules. Possible examples in this category might be compensation for service to the state, or for carers of the disabled. Certain privileges, such as extra pension rate increases, advantageous computation of years of service, and the right to draw more than one pension might be eliminated prospectively. As a transition device, a parallel mechanism financed by the federal budget could be created to provide partial lump-sum compensation for individual losses for a limited period, after which the privilege would cease to exist. (Eventually, as in other market economies, compensation for difficult and arduous work, hazardous working conditions, or for jobs that are difficult to fill for other reasons should occur by means of higher wages that are determined through market mechanisms and collective bargaining.) Diminution of privileges in payment also might be effected by limitations on benefit indexing. If only the basic pension amount was indexed, and not those calculable amounts derived through privileged treatment, the value of the privileged amounts would diminish rather rapidly. This would be the approximate outcome of, for example, repeated flat-rate compensation payments for inflation for a specified duration.

137 For example, the category of “a women in the textile industry performing highly intensive and arduous works” (Article 12 c) or men and women who have “performed works in severe working conditions” (Article 12 b). Without clear rules sitting behind the law which establish what these mean, they appear to be open to local interpretation.

138 For example, the privileges accorded to fire fighters and rescue workers were added in 1995; those for prison workers were added in 1996.
195. These are not the only options available to reduce costs and increase the fairness of the system. For example, if a link to previous wages is maintained, the averaging period, now only the two last years or any five continuous years of work, could be gradually extended to cover a full work life. This feature would eliminate the possibility of collusion between employers and employees to declare high earnings for pension purposes near the end of a work-life. A long averaging period also is generally considered to provide a better (and a lower) measure of actual average earnings. For these reasons, public pension systems in most OECD countries have a much longer averaging period than two to five years. Particularly relevant for Russia is the potential a longer averaging period holds as an incentive to pay contributions on earnings for all the years included.

196. The years of service required for a full pension, as well as the averaging period, also have been gradually increased in many OECD countries, such as in France, among others. Increases in the years of service required to receive a full pension have an effect that is similar to increasing the age of eligibility for benefits, but this effect also occurs gradually.

197. Vesting rights, that is, the minimum years of service required to get any pension at all, are often used to limit pension awards to workers who have worked a relatively long time and to exclude those who have had a casual attachment to employment, thereby reducing costs. Eligibility for a labour pension in Russia requires at least five years of work. Vesting requirements vary considerably across OECD countries and range from a full working life of 40 to 45 years - as in Belgium, to three years or less - as in Canada. Requirements of 10 to 20 years are not uncommon: the United States, for example, has a 10-year vesting requirement, while Ireland requires 20 to 24 years of work. However, the stringency of a vesting requirement depends not only on the number of years of service required, but also on how a year of service is defined. Careful attention must be given to this critical detail in order to avoid unintended penalties for workers with less than full-time year-round continuous service.

198. Early retirement in many OECD countries usually is contained, not only by a higher age of eligibility than is imposed in Russia, but also by actuarial reductions for early retirement and increasing stringency in eligibility for disability pensions. Also important, however, is the frequency of attractive jobs for older workers at attractive wages – a circumstance that is not yet available in Russia.

199. That pensioners may receive a pension while continuing to work does represent a cost to the pension system in Russia. The administrative feasibility of a work test or an earnings test is arguable, however, because of the large informal economy in Russia and the opportunities for unrecorded earnings. Moreover, low pension benefits have provided a strong incentive – if not a necessity, for many older individuals to remain economically active. (Not surprisingly, the greatest incidence of poverty among pensioners is among those who are not working.) It may be feasible to prevent pensioners from retaining employment with their current employer while receiving a pension, but this might push many of them into unrecorded activities. Therefore, although it might be desirable to limit the receipt of pensions by those who continue to work, there does not appear to be any feasible way of doing so that will not have other undesirable results at the present time.

200. There is considerable scope to reduce administrative costs, especially if the complexity of the system could be reduced. However, all administrative costs are not assumed by the Pension Fund. While pensions are a federal responsibility, much of the administration falls to local government, with no funding...

---

139 For example, the requirement in United States of 10 years of work is relatively easy to meet. The technical requirement is 40 quarters of earnings. A worker receives credit for one quarter for a specified (low) amount of annual earnings on which contributions have been paid, up to a maximum of 4 credits per year. (The amount required for one credit was $740 in 1999.) Therefore, persons who have worked part-time or intermittently over the course of a work-life often meet the 40-quarter requirement.

140 Gorban et al., 1999
to do the job. The full cost of administering the pension programme therefore is not at all clear. However, the cost of delivering pensions is clear – and quite high. The pension payment agent is Russia Mail, which charges local authorities from 1.5 to 2% of pension payments for delivery. Such costs would be more transparent and easier to rationalise if the Pension Fund assumed full responsibility for them.

### Box 5.2 Standard pension rules in brief

<table>
<thead>
<tr>
<th>Eligibility</th>
<th>Covered employment</th>
<th>All</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age</td>
<td>60/55 for men/women</td>
<td></td>
</tr>
<tr>
<td>Early pension</td>
<td>For exceptions to standard rules, see Box 5.2</td>
<td></td>
</tr>
<tr>
<td>Premature pension</td>
<td>Certain unemployed who meet service requirements and are two years or less below standard age; administered by employment service; financed by Employment Fund.</td>
<td></td>
</tr>
<tr>
<td>Vesting requirement</td>
<td>5 years</td>
<td></td>
</tr>
<tr>
<td>Required years of service for full pension</td>
<td>25/20 for men/women (See Box 5.2 for exceptions.)</td>
<td></td>
</tr>
</tbody>
</table>

### Benefit determination

<table>
<thead>
<tr>
<th>Covered earnings</th>
<th>Total earnings net of 1% contribution rate (5% for self-employed and independent farmers).</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indexing of past earnings</td>
<td>Effective as of 1 February 1998 for non-working pensioners only. Individual coefficient [ratio of worker’s average wage to national average wage for same period multiplied by ratio of actual years of service to required years of service (but not more than 0.75)] multiplied by average national wage at time of award. Individual coefficient must not exceed 1.2.</td>
</tr>
<tr>
<td>Benefit formula</td>
<td>55% of average wage during previous 24 months or during any 60 continuous months of work, whichever is higher, plus 1% per year in excess of requirements up to a maximum supplement of 20%. Optional formula for non-working pensioners as of February 1998: See indexing of past earnings, above.</td>
</tr>
<tr>
<td>Early pension reduction</td>
<td>None</td>
</tr>
<tr>
<td>Minimum pension</td>
<td>Minimum wage if service requirements are met.</td>
</tr>
<tr>
<td>Maximum pension</td>
<td>Three times the minimum wage if service requirements are met and 75% of worker’s average wage. Alternative maximum using new method (see above) equals 0.90 of national average wage.</td>
</tr>
<tr>
<td>Less than required years of service</td>
<td>In proportion to ratio of actual to required years of service, but not less than the social pension</td>
</tr>
<tr>
<td>Less than five years of service</td>
<td>Social pension equal to two-thirds of minimum pension</td>
</tr>
<tr>
<td>Indexing after award</td>
<td>Old method: indexed to changes in minimum pension as approved by Duma; applicable to working and non-working pensioners. New method: indexed in February, May, August, and November of each year to changes in national average wage; applies to non-working pensioners only. Both methods co-exist.</td>
</tr>
</tbody>
</table>
Other compensation  
*Ad hoc* lump-sum compensation for changes in cost-of-living, by Presidential Decree or by Duma.

<table>
<thead>
<tr>
<th>Contribution base</th>
<th>Tax treatment</th>
</tr>
</thead>
<tbody>
<tr>
<td>No ceiling</td>
<td>Tax-exempt</td>
</tr>
</tbody>
</table>

**Box 5.3 Selected privileges: variations on standard old-age pension rules**

<table>
<thead>
<tr>
<th>Age or years of service</th>
<th>Pension Age</th>
<th>Years of required service</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Men</td>
<td>Women</td>
</tr>
<tr>
<td>Standard</td>
<td>60</td>
<td>55</td>
</tr>
<tr>
<td>Service underground</td>
<td>50</td>
<td>45</td>
</tr>
<tr>
<td>Harmful working conditions/hot shops</td>
<td>50</td>
<td>45</td>
</tr>
<tr>
<td>Workers in severe working conditions</td>
<td>55</td>
<td>50</td>
</tr>
<tr>
<td>Women drivers of tractors, and building and road-building machinery</td>
<td>-</td>
<td>50</td>
</tr>
<tr>
<td>Women in textile industry performing highly intensive and arduous work</td>
<td>-</td>
<td>50</td>
</tr>
<tr>
<td>Rail transport workers and certain types of truck drivers</td>
<td>55</td>
<td>50</td>
</tr>
<tr>
<td>Geological and other expedition workers</td>
<td>55</td>
<td>50</td>
</tr>
<tr>
<td>Logging and timber rafting workers</td>
<td>55</td>
<td>50</td>
</tr>
<tr>
<td>Dockers and mechanics at cargo handling ports</td>
<td>55</td>
<td>50</td>
</tr>
<tr>
<td>Sea, river and fishing vessel crew</td>
<td>55</td>
<td>50</td>
</tr>
<tr>
<td>Regular city bus and trolley car drivers</td>
<td>55</td>
<td>50</td>
</tr>
<tr>
<td>Professional rescue service workers</td>
<td>40</td>
<td>40</td>
</tr>
<tr>
<td>Prison workers</td>
<td>55</td>
<td>50</td>
</tr>
<tr>
<td>Fire fighters</td>
<td>50</td>
<td>50</td>
</tr>
<tr>
<td>Work in the Extreme North</td>
<td>55</td>
<td>50</td>
</tr>
</tbody>
</table>

**Right to draw two types of pensions**

- People disabled as a result of military injury
- Veterans of the Great Patriotic War who have become disabled
- Widows of servicemen who died during the Great Patriotic War

**Pension rate increase (several different methods under various Articles):**

- Article 18 - work underground, work in harmful working conditions and in hot shops
- Article 21 – for carers of disabled pensioners; disabled dependants; veterans of the Great Patriotic War who are not drawing two pensions

---

141 Article 14 deals with those working in the Extreme North and those working in areas equated to the Extreme North. It contains a formula for varying the retirement age for people who worked in these regions for more than 7.6 years.

142 Article 5.

143 Article 18: The maximum rate for the scheme in general is three times the minimum, however for these groups it is 3.5 times the minimum.
• Article 22 - for those deferring receipt of pension while continuing to work\textsuperscript{145}
• Article 110 - Recipients of certain awards (e.g. Heroes of the Soviet Union, Order of Glory), Olympic champions, minor inmates of Nazi concentration camps etc, war veterans, those repressed, those disabled since childhood in the Great Patriotic War\textsuperscript{146}

**Computation of years of service**\textsuperscript{147}:

• Certain groups of seasonal workers have a season deemed to count as a full year
• Periods of work in Leprosariums and anti-plague institutions are doubled.
• Certain military units receive credit for triple the period of service.
• Work period during the Siege of Leningrad is tripled.
• Work period during of the Great Patriotic War is doubled.
• Period of work in the Extreme North and localities equated to the Extreme North multiplied by 1.5.
• Period of military conscription is doubled.
• Period of groundless imprisonment and repression, with subsequent rehabilitation receives triple credit.

### 4. Targeting benefits: approaches to helping the poor

201. The issue of targeted assistance, rather than categorical eligibility for benefits that now predominates, has become a hotly-debated topic in the social policy reform dialogue in Russia. With the array of under-funded programmes and the increased demand as hardship spread, revisiting current programmes with a view to targeting expenditure on those most in need or most at risk was inevitable. However, targeting can be interpreted in several ways.

202. In its narrowest sense and most customary usage, it refers to limiting particular types of assistance only to those individuals and households that fall below some designated threshold of wellbeing. The measures most frequently used are household income or a combination of household income and assets referred to as “means-testing”. As mentioned previously, the housing allowance programme, established in 1993, was the first one in Russia to use an income test to determine eligibility, and legislation was adopted in 1998 to apply this concept to child allowances. In addition, several experiments were conducted to find a relatively simple and effective way to apply it in the provision of cash assistance to the very poorest in Russia\textsuperscript{148}.

203. There also are more general, although sometimes less precise ways of targeting benefits. Benefits that focus on geographic areas where a disproportionate share of the population is economically disadvantaged is one way. Therefore, transfers across and within regions that tend to equalise resources is a method of targeting that improves the ability of local authorities to help disadvantaged individuals and households. If such transfers are earmarked specifically for this purpose, this form of targeting has the

\textsuperscript{144} Article 21 provides for a “mark up” ranging from the rate of a social pension, to twice the minimum old-age pension. That means that some recipients can get triple rate pensions.

\textsuperscript{145} Article 22 provides for an extra 10\% of the pension for each year a pensioner defers application for a maximum of three years.

\textsuperscript{146} Article 110 provides for increases in pensions ranging from 15\% up to 100\% for the specified groups.

\textsuperscript{147} Article 94.

\textsuperscript{148} Experiments in the provision of social assistance to the poor using three different “proxy” means-tests took place in three areas in the Russian Federation: the Republic of Komi, and the Volgograd and Voronezh regions. The Russian government and the World Bank sponsored the experiments. Preliminary evaluations indicated mixed results. (See, for example, Braithwaite, 1999; Bobkov, 1999; Ovtcharova et al., 1999.)
potential of being reasonably effective and efficient. It is not likely that any one set of rules that determine which individuals or households should be the final recipients of assistance will work well in every jurisdiction across the vast and heterogeneous expanse of Russia, but some minimum standards or guidelines are generally considered appropriate. Most large OECD countries allow some degree of local discretion in this regard, but the boundaries of such discretion usually are carefully defined.

Programmes that have wide coverage often have elements of targeting inherent in their design because of the redistribution built into them. Many programmes redistribute income to some extent to help the lowest income strata disproportionately, or provide services to the all or most of the population that are most helpful to the most disadvantaged. The current pension programme in Russia is an example of the first case, in that it tends to redistribute income, as discussed in Chapter I. The proposed reform, discussed above, would severely limit this redistributive element. Health care, if there is universal access to a package of basic services, is an example of the second case. Unfortunately, Chapter IV showed that the health care system in Russia has moved away from the universal access, and no longer serves the poorest people as well as it does those who can afford to pay for services.

Programmes that serve the public-at-large meet several purposes. First, and perhaps most important, they help to prevent poverty. Second, because benefits are spread widely across the population and most people eventually receive some level of benefit, this type of social programme generates greater willingness on the part of taxpayers to pay for it. Programmes that benefit only individuals and households that cannot or do not provide for their own needs often suffer from lack of public support.

It is therefore not surprising that public benefits in OECD countries are concentrated among middle-income households, although not to the complete neglect of other income brackets. Because virtually no one is excluded from some form of social protection in OECD countries, support for most public social programmes generally is high. Social assistance to the poor – targeting in its narrow sense is a residual approach reserved for people who fall between the cracks of larger and more wide-spread programmes that are intended to prevent poverty.

Since social assistance programmes are a residual approach to treating the problem of poverty after it has occurred, rather than preventing its occurrence, they usually are relatively small programmes that affect only a small proportion of the population. In Russia, the potential clients of income or means-tested assistance are quite numerous. This in itself is a problem because targeted social assistance programmes generally are complicated and expensive to administer. The resources devoted to administering a programme are a dead weight loss; no one receives benefits from them. Moreover, because of their intrusiveness into the personal lives of people and the stigma attached to being identified as poor, participation often is below the numbers potentially eligible. This has been found to be the case in virtually all OECD countries.

For all of the above reasons a broader approach to targeting may hold greater potential for success in reaching more disadvantaged people than would a policy approach that only provided means-tested benefits to the very poor, while condoning limitations on redistribution in major programmes such as pensions and health care.

The large shadow economy and the prevalence of unrecorded income mitigate against income or means-testing. In addition, a means-test that relies on penalties for constructive activities such as growing food may be ill-considered. Those that rely on the income-producing potential of assets when there may not be a market in which to realise that potential are unrealistic. The absence of the conditions needed to assure that targeting will work well, namely reliable income-reporting behaviour and mechanisms that

\[149\] Forster, 2000.
permit adequate checks on reported income and assets, means that the effective implementation of such a policy may take some time to achieve in Russia.

210. Moreover, there already are substantial efforts at the regional and local level to ration or target limited programme resources in a variety of ways. They may not be in accord with any single view of how this should be done, but imposing yet another layer of income or means-tested assistance on top of these efforts without the infusion of substantial new resources might not accomplish much more. The minimum amount of money required to bring all of the poor up to the poverty line in 1998 is estimated by the Secretariat to have been nearly 8% of GDP (see Chapter II, Table 2.1.). To put this figure into some context, public expenditure at all levels of government on social protection (excluding housing subsidies) was 16.4% of GDP in the same year (see Chapter I, Table 1.7). If cash assistance was limited both in amount and with respect to the depth of poverty among eligible recipients, the costs could be constrained but would not be trivial. Moreover, it is difficult to justify the provision of cash assistance to a very small proportion of the poverty population when the transfers would be made at the expense of many who may be only marginally better off.

211. The problem is twofold: nothing that holds much promise to help the poor can be done without a substantial investment of public resources; the availability of resources depends in large measure on the political will to rationalise the plethora of programmes with varied purposes that already exist. The effort to devise a targeted cash assistance programme that will achieve intended objectives efficiently also takes time as well as financial resources. Nonetheless, “crisis management” remains an immediate concern.

212. Assistance for the very poor need not simply be left to the discretion of local authorities and their budgets, or depend solely upon the creation of a new targeted programme of cash assistance. Those who are severely deprived know that they need help, and self-selection for assistance may be a reasonable option – perhaps not for cash benefits, but for a basic need such as food. If existing facilities that provide hot meals in the community and home delivery of meals or unprepared basic food items were expanded
d and provided basic nutritional requirements to anyone who asked for help, the chances are that the overwhelming majority of people who asked for help would really need it.

Concluding comments

213. Russia is both blessed and cursed with a wide array of social programmes. Most were inherited from earlier times; some were created during the transition period to respond to new circumstances. All continued to deteriorate while the standard of living plummeted during the years of economic decline. There has been a strong tendency to hold fast to all of the traditional programmes and social institutions, despite the inability to pay for all of the benefit promises they contain.

214. Social policy problems stem not only from resource inadequacies, but also because clear priorities have not emerged. There is a tendency to consider social policy reforms on a programme-by-programme basis, without a clear vision of the objectives for the entire system of social benefits. Wasteful new programmes need not be created when there are old ones that will do the job; wasteful old programmes should not be maintained in the face of new needs and limited resources. Not everything that appears to be appropriate can be accomplished unless the political will exists to re-evaluate and rationalise

---

150 Inter-regional federal grants, earmarked for the purpose of expanding existing catering facilities in communities, might be an appropriate financing mechanism. Structured with a “matching” requirement, inversely related to a measure of local capacity-to-pay or need, the grant would tend to favour poorer communities. Localities should be required to maintain their current level of financial effort and not substitute federal funds for local funds spent for this purpose. Intra-regional distribution by a formula specified in law merits consideration.
the existing plethora of benefits, cash and in-kind, and subsidies and privileges. Promises that can not be funded or are unrealistic in other respects are not solutions to the social problems that face Russia.
BIBLIOGRAPHY

Åslund, A. (1999),

Åslund, A. and M. Dmitriev, (eds.) (1996),
*Social Policy During Transition*, Moscow.

Bobkov, V. (1999),

Boykov, V. and F. Philie, I. Sheiman, S. Shishkin (1998),
“Household Expenditures on Health and Pharmaceuticals”, *Voprosy Economiki* No.10, Moscow.

Braithwaite, J. (1999),

Cherneyko, D.C. (1999),

Dmitriev, M. (2000),
“Key elements of reform in the social sphere”, paper presented at the International Conference on the Investment Climate and Prospects for Economic Growth in Russia, Moscow State University-Higher School of Economics, International Monetary Fund, and World Bank, April 5-6, Moscow.

Dmitriev, M. (1999),
“Patterns of Incomes, Consumption, Poverty, and Social Transfers in Russia During 1994-1998”, draft prepared for the OECD, Paris (processed).

Dmitriev, M. (1999),
“Social Sphere during Financial Crisis; Problems of Adjustment”, *Voprosy Ekonomiki*, No. 2, Moscow.

Dimitriev, M., (1998),
“Financial crisis and the new challenges to pension reform in Russia”, Moscow (processed).

Economist Intelligence Unit (EIU),

Economist Intelligence Unit (EIU), 2000
*Country Report on Romania*, London
Economist Intelligence Unit (EIU), 2000

Economist Intelligence Unit (EIU), 2000
*Country Report on Poland*, London

Economist Intelligence Unit (EIU), 2000
*Country Report on Ukraine*, London

Engberg, B. A. Sjöstedt and P. Tüll (1999),

European Bank for Reconstruction and Development (EBRD) (1999),

Flemming, J. and J. Micklewright (1999),

 Förster, M. (2000),

Gavrilenkov, E. and V. Koen (1994),
“How large was the output collapse in Russia? Alternative estimates and welfare implications.” IMF Working Paper No.154, Washington DC.


Gorban, M., I. Denisova, T. Khohlova, and K. Yudaeva (1999),
“Social Expenditure Programs in Russia”, Moscow (processed).

Goskomstat of Russia,
*Sotsialno-ekonomicheskoe polozhenie v Rosii* (Socio-Economic Situation In Russia, 1998)
Goskomstat, Moscow (various issues).

Goskomstat of Russia, 1999,
Goskomstat, Moscow.

Goskomstat of Russia. 1998;
Grootaert, C. and J. Braithwaite (1998),

Gregg, P. (May 2000),

Institute of the Economy in Transition, (1999),

Institute of the Economy in Transition (IET) (1998),
Ekonomika Perekhodnogo Perioda, (Economics of Transition) IET, Moscow.

Institute of Social Research and Boston University (1998 and 1999),

Interstate Statistical Committee of the Commonwealth of Independent States (1998),
Commonwealth of Independent States in 1997, Moscow

Kapelushnikov, R. (1999),

Klugman, J., ed. (1997),
Poverty in Russia: Public Policy and Private Responses, The World Bank, Washington D.C.

Koen. V. (1996),

Kuddo, A. (1998),
Social Transition: Social and Employment Policies in the Former Soviet Union States, World Bank, Washington DC.

Martin, J. (1998),

Mihály, P. (2000),
“Post-socialist health systems in transition: Czech Republic, Hungary and Poland”, draft prepared for the OECD, Paris. (processed)

The Ministry of Labour and Social Development of the Russian Federation (1998),
Sotsialnie indikatory dokhodov il uravnyu zhizni naseleenia, (Social Indicators Of Income And Standard Of Life Of The Population), • 2(52).

The Ministry of Finance of the Russian Federation (1998),
Sotsialnaya politika v period perekhoda k rinku: problemi i reshenia, (Social Policy During The Transition To The Market: Problems And Solutions), Moscow.
DEELSA/ELSA(2000)8

Mikhalev, V. (1996),

Milanovic B. (1998),
*Income, Inequality, and Poverty during the Transition from Planned to Market Economy*, The World Bank, Washington DC.

Missikhina, S.G. (1999),
*Sotsial'nye Posobiya, L'goty i Vyplaty v Rossiiskoi Federatsi*, (Social Benefits and Subsidies in the Russian Federation), TACIS, Moscow.

*Bednost': Al'ternativenye Podkhody k Opredeleniyu I Izmereniu* (Poverty: Alternative Approaches to Definition and Measurement), Carnegie Centre, Moscow.

Najman, B. and A. Pailhé, (1999),

Nesporova, A. and Y. Ghellab, (1999),
“Labour Market Impacts of the Economic Crisis in the Russian Federation”, paper presented at ILO Conference on Social and Labour Issues, Moscow (processed)


OECD (2000),

OECD (2000),

OECD (1999),

OECD (1998),

OECD (1998),
“Making the most of the minimum: statutory minimum wages, employment and poverty”, *The Employment Outlook*, OECD, Paris.


OECD (1994),

Ovtcharova, L. (1999),
“Policies to alleviate poverty in Russia”, draft prepared for the OECD, Paris. (processed).
Ovtcharova, L., I. Korchagina and E. Turuntsev (1999),

Poitman, M. (1991),
“The market is tempting, the market is frightening”, J. Medicine, (“Rynok manit, rynok pugaet”, Meditsinskaya gazeta), 5 July, Moscow.

Reznikov, L. (ed.), (undated),
History of Russia: IX-XX Centuries, Russian Book Union, Moscow.

Russian Center for Economic Reform (RECEP),
Russian Economic Trends: Monthly Update, Moscow (various issues).

Russian Centre for the Study of Public Opinion (VTsIOM),

Russian Economic Survey,
Obzor Eekonomiki Rossii, (Review of the Russian Economy), Moscow (various issues).

The Russian Longitudinal Monitoring Survey (RLMS) (1999),
The Monitoring of the Economic Situation in the Russia Federation, Moscow.

Schieber, G. and A. Maeda (1997),

Serbanescu, F. (1998),
“Reproductive Health Issues in Eastern Europe and Newly Independent States: Country Cases”, Center for Disease Control and Prevention, Atlanta GA (processed).

Sheiman, I. (1997),

Shiskin, S. (1998),
Household Spending on Health in Russia, Institute of Sociological Studies, Moscow

Stewart, K. (1997),

TACIS (1998)
Social impact of economic restructuring and privatisation in the Russian Federation: Key problems and solutions, TACIS, Moscow.

Thompson, L. H. (1998),
Older and Wiser: The Economics of Public Pensions, Urban Institute, Washington DC.
Twigg, J. L. (1998),
“Balancing the State and the Market: Russia’s Adoption of Obligatory Medical Insurance”, Europe-Asia Studies, Vol. 50, No. 4.

United Nations Development Program (UNDP) (1998 and 1999),

Walberg, P., M. McKee, V. M. Shkolnikov, L. Chenet, and D. A. Leon (1998),

Wallich, C. I. (1996),
“Russia’s dilemma”, Russia and the Challenge of Fiscal Federalism, ed. C. I. Wallich, World Bank, Washington DC.

Yakushev, L. (1998)

Yudaeva, K. and M. Gorban (1999),
“Health and Health Care”, Russian Economic Trends, RECEP, Moscow.