Poverty in Russia
An Assessment

June 13, 1995

Human Resources Division
Europe and Central Asia Country Department III
List of Acronyms

CPI  Consumer Price Index
EF   Employment Fund
FBS  Family Budget Survey
FES  Federal Employment Service
GDP  Gross Domestic Product
LITC Low Income Tax Credit
MCB  Minimum Consumption Basket
MOL  Ministry of Labor
MSP  Ministry of Social Protection
PF   Pension Fund
RLMS Russian Longitudinal Monitoring Survey
SIF  Social Insurance Fund
TES  Temporary Employment Schemes
TSEK Center for Economic Analysis and Forecasting
VCIOM Center for Public Opinion Research
ACKNOWLEDGEMENTS

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The report is based on a series of commissioned background papers presented in Volume II. Jeanine Braithwaite, Mark Foley and Kalpana Mehra were responsible for the poverty profile; Simon Commander and Ruslan Yemtsov for the labor markets analysis; Donald Cox, Zekeriya Eser and Emmanuel Jimenez for the analysis of inter-household transfers; and Elena Sedik, and Venanzio Vella for health analysis. Natalia Rimashevskaya contributed an analysis of poverty trends, and Larissa Zubova and Natalia Kovaleva analyzed public opinion about social problems.

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# POVERTY IN RUSSIA
## AN ASSESSMENT

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The Old and New Poor in Russia: Trends in Poverty, Jeanine Braithwaite

Poverty in Russia: Static and Dynamic Analyses using the RLMS, Mark Foley

Russian unemployment: its magnitude, characteristics and regional dimensions, Simon Commander and Ruslan Yemtsov

Characteristics of Russian Unemployment, Simon Commander and Ruslan Yemtsov

The RLMS Data Set: Analysis of Rounds 1 and 3, Braithwaite, Foley and Kalpana Mehra


Anthropometric Analysis of Round 1 of the RLMS, Venanzio Vella

Family Safety Nets During Economic Transition: A Study of Inter-household Transfers in Russia, Donald Cox, Zekeriya Eser and Emmanuel Jimenez

Incidence of Public Transfers in Russia, Mark Foley

An Analysis of the Nature of Poverty in Russia -- with particular emphasis on categorical indicators to assist in targeting, Bob Dapre

From second economy to informal sector: the Russian labor market in transition Jeanine Braithwaite

Public opinion about social problems, Larissa Zubova and Natalia Kovaleva

Family Allowances in Russia: Progressivity and Equivalence Scale Implications, Mark Foley

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1/ The background papers which have been prepared for the poverty assessment are available on request. These papers are being submitted for publication by the World Bank in the form of a book.
EXECUTIVE SUMMARY

1. Russia's transition to a market economy has been accompanied by a sharp increase in the incidence and severity of poverty. Poverty in Russia is not a new phenomenon, as the country entered transition with extensive hidden unemployment, and one tenth of the population below the then minimum consumption basket. Since that time, however, the number of poor households has risen, and by 1993 some 32 percent of the population was living below the revised official poverty line. Over the same period, there has been a 44 percent increase in the severity of poverty (i.e., the distribution of poverty weighted to reflect the lower welfare of the poorest). Developments during 1994 and early 1995 have not changed this picture. This report analyzes these trends and discusses how government policies could best provide opportunities for the poor to improve their standard of living.

Economic and Labor Market Developments

2. Since 1991, Russia has experienced a significant decline in real money incomes and output of the order of 40 percent, and a gradual widening in the distribution of income among population groups and between regions. High monthly rates of inflation through most of the transition have adversely affected the poor, especially those on administered incomes such as minimum pensions and unemployment benefits. Labor market adjustments have been extensive in the wake of price and wage liberalization. Real earnings have fallen and increasing numbers of people have been subject to layoffs and hours adjustment in the face of inherited overstaffing and falling labor demand. During 1993 and 1994, only 40 percent of the workforce were being paid fully and on time. Real wages rose rapidly in 1991, peaking in December, then fell sharply upon extensive price liberalization in January 1992, and have remained at a level somewhat lower than the 1987 level.

3. The outlook for employment, incomes and poverty, is unlikely to improve in the short to medium term, even under a possible scenario of early economic turnaround. Sustained financial stabilization and related public expenditure cuts could have wide social repercussions. The decline in output has not yet translated into high rates of open unemployment, as enterprises have been reluctant to shed labor. Once this begins to happen, unemployment will increase substantially. Rising income opportunities in the private sector will not easily meet the gaps, given low labor mobility, skills mismatching and undeveloped employment services. Already, these factors are making themselves felt in growing regional imbalances between unemployment and available jobs.

4. At the same time, trends in the distribution of income are towards growing inequality. The liberalization of wages and prices has brought about differentiation in income-earning opportunities, which increasingly reflect skills and regional differences. Already, measures of income inequality have reached levels that are comparable to those in countries with strongly unequal income distributions, such as Argentina and the Philippines, and are much higher than levels in western Europe. Significant regional differences in income inherited from the Soviet period have increased further during transition. Especially hard hit have been industrial oblasts with high concentrations of military firms and/or light industry, especially in central Russia and the North Caucasus, whereas low-unemployment areas are primarily the resource-rich regions in the East or major cities.
Who are the poor?

5. The poor in Russia are primarily families with children, the unemployed, the elderly receiving a single, low pension and women. The homeless and previously institutionalized people form a small, but critical group of the poor. As in other European countries in transition, the working poor predominate. Some 66 percent of the poor live in households where the head of household is employed. The largest sub-group is composed of households with children, including in particular single-parent and young households. Generally, the younger and more numerous the children, the more likely that the family is poor. Nearly 85 percent of families with three or more children under six years of age are poor. In Russia, as elsewhere, family size and composition is a strong predictor of a household’s poverty status.

6. Unemployment is strongly linked with poverty, and an estimated 63 percent of households headed by an unemployed person were poor in 1993. Access to unemployment benefits and informal sector jobs may mitigate hardship among the unemployed, but often incomes from these sources are insufficient to raise recipient households above the poverty level. Unemployment is still mainly short term (averaging less than 6 months), but duration is gradually increasing.

7. Traditionally, pensioners, who represent a large (36 million) and growing share of the population, have been considered amongst the worst off in Russia. While this certainly is true for those drawing minimum pensions that have frequently fallen below subsistence due to the effects of rapid inflation and erratic indexing, average pensions have been maintained in real terms. In addition, a large share (over 20 percent) of pensioners hold jobs in addition to receiving pensions. Still, about one-quarter of the elderly live alone, which lessens the likelihood of support from wage income of other family members, as well as presenting challenges for the purchase of basic goods and access to services.

8. Women in Russia are particularly susceptible to poverty. Despite higher education levels and high labor force participation rates, women have traditionally been concentrated in low wage occupational groups, and paid less than men. They also figure disproportionately among the unemployed, having borne the brunt of job losses in the early stages of transition as firms preferred laying off clerical and auxiliary workers first, the vast majority of whom are women. Over 90 percent of single-parent households are headed by a woman, and such households are much more likely to be poor than other types of households with children. Among pensioners, elderly females are much more likely to be poor than elderly males. One possible consequence of the disadvantaged economic situation of women is the recent increase in maternal and infant mortality, which can be interpreted as an early warning sign of the particularly difficult situation that women are finding themselves in during the transition.

Policy implications for the social support system

9. Sustainable reductions in poverty can be achieved only through policies that promote stabilization and economic growth, which is a longer term undertaking. In the meantime, Russia has to find ways to mitigate the adverse effects of high and rising levels of unemployment and poverty in an environment of constrained public resources at central as well as local levels. This can be done through income support schemes that are both cost-effective and affordable, provided certain reforms and innovations are undertaken.

10. Successful stabilization and resumption of economic growth are necessary underpinnings for managing and reducing poverty. Stabilization, which requires monetary and fiscal restraint, creates the
environment necessary for a market economy to flourish and economic growth to resume. Economic growth, in turn, is necessary to expand income-earning opportunities (jobs), raise living standards and create opportunities for sustainable reductions in poverty over the medium and long term. Whether poverty is in fact reduced, in turn becomes a function of how income is distributed in society, and the opportunities that are offered to the poor to improve their income earning possibilities (through access to productive employment and assets, and through better remuneration) and income earning potential (through access to appropriate health, education and training).

11. In Russia, the medium-term growth prospects for the economy could improve significantly, so long as the Government continues to pursue policies and regulatory reforms that enhance conditions for private sector growth. At the same time, continued adverse effects of transition and the need for further economic restructuring suggest that large numbers of people will continue to be unable to generate incomes above the poverty line for some time to come. Various kinds of income support schemes then become the main tool for bridging this poverty gap and mitigating potential political backlash against reform. The recommendations in this report focus upon improving the system of social protection and health services that are the subject of government programs, rather than the broader problems associated with increasing labor productivity and real wages, and increasing economic growth.

12. **Improving the system of social protection.** Social insurance (pensions, unemployment benefits) and social assistance programs (including family allowances) provide a formal system of social protection in cash and kind. Local authorities provide education and health services, and subsidize housing and domestic utilities. In addition, social benefits provided by enterprises are extensive, encompassing housing, health care and child care. Private, informal transfers remain an important component of the safety net in Russia, as more fortunate people help relatives and friends. Finally, the NGO sector has recently emerged and is rapidly becoming an important part of the social safety net, even in the face of a constraining regulatory and fiscal framework.

13. While needs have increased, public expenditures on social protection, excluding utilities and housing, nevertheless have so far remained fairly stable. The main categories of expenditures -- pensions, employment programs, social assistance -- amounted to 9.0 percent of GDP in 1994, and without reform are projected to rise to some 11 percent of GDP by 1997 (see Table 1).

14. The existing system of social protection is not well-designed to cope with rising demands on it, especially in an environment of severe fiscal constraint:

(a) Benefits are low and often insufficient to lift poor families over the poverty threshold: unemployment benefits average only some 15 percent of the subsistence minimum, and family allowances between 1 and 8 percent of the average wage; the minimum pension has been allowed to fall far below the level of minimum subsistence for the elderly; and social assistance is widely regarded as inadequate in scope and amount;

(b) A large number of poor households do not receive benefits at all (almost three out of ten households classified as very poor, and one of five classified as poor), yet almost four out of five non-poor families receive public transfers;

(c) Existing financing mechanisms are inadequate and badly designed: there is no systematic federal support for the poverty alleviation programs delivered and
financed by local authorities; budget constraints have already resulted in cutbacks in subsidies and transfer payments; regional employment funds (that provide unemployment benefits) are increasingly unable to finance benefits, partly because a significant share of Employment Fund resources are spent on "job creation" activities; and local fiscal burdens will increase as state enterprises divest responsibility for social assets -- in 1992, enterprise social spending was equivalent to about 20 percent of total regional budget expenditures.

Table 1: Costing The Options: Expenditure on Social Protection (% GDP)

<table>
<thead>
<tr>
<th>Type of Expenditure</th>
<th>1994</th>
<th>Projected 1997</th>
<th></th>
<th></th>
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<tr>
<td></td>
<td></td>
<td>Without Reform</td>
<td>With Reform</td>
<td></td>
</tr>
<tr>
<td><strong>Pensions, of which:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increase Minimum Pension</td>
<td>6.0</td>
<td>6.9</td>
<td>6.3</td>
<td></td>
</tr>
<tr>
<td>Flat rate pensions</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Social Assistance, of which:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Poverty benefit</td>
<td>1.2</td>
<td>1.2</td>
<td>1.4</td>
<td></td>
</tr>
<tr>
<td>Family allowances</td>
<td>0.7</td>
<td>0.7</td>
<td>0.6</td>
<td></td>
</tr>
<tr>
<td><strong>Social Insurance Fund, of which:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Impose waiting period for sick pay</td>
<td></td>
<td></td>
<td>-0.1</td>
<td></td>
</tr>
<tr>
<td><strong>Employment program, including:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Flat rate UB to 60% of min-sub level</td>
<td>0.4</td>
<td>1.5</td>
<td>1.9</td>
<td></td>
</tr>
<tr>
<td>Enterprise support</td>
<td>0.7</td>
<td>0.7</td>
<td>1.5</td>
<td></td>
</tr>
<tr>
<td>Public works</td>
<td>0.1</td>
<td>0.4</td>
<td>0.4</td>
<td></td>
</tr>
<tr>
<td><strong>Sub Total</strong></td>
<td>9.0</td>
<td>11.0</td>
<td>10.9</td>
<td></td>
</tr>
<tr>
<td><strong>Rent and Utility Subsidies</strong></td>
<td>3.5</td>
<td>5.0</td>
<td>2.5</td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>12.5</td>
<td>16.0</td>
<td>13.4</td>
<td></td>
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</tbody>
</table>

Notes:
1. 1994 figures are based on six month actuals reported by Goskomstat.
2. Registered unemployment is assumed to peak at 10% in 1997 (i.e. FES measure).
3. Pension projections are based on staff estimates of population growth.

15. The report proposes a series of key changes that would make the system more cost effective and affordable, and help reduce poverty in the immediate future. These changes are possible within tight fiscal constraints. Underlying the various policy responses is the need for federal financial support--conditional, transparent and targeted, in particular to underpin a more comprehensive approach to social assistance, based on a poverty benefit. Common to the various reform proposals are one or more of the following considerations:

- *Adverse incentive effects should be minimized.* Social assistance and unemployment schemes need to be designed to avoid welfare dependency, i.e. benefits should be set at
levels that make work attractive; therefore, existing schemes need to be reviewed with regard to the relative levels of benefits and earnings, and their effects on work incentives.

- **Targeting.** Only the poor should receive poverty relief. In Russia, the only significant distinction between the poor and non-poor for targeting purposes is income. While poverty status is related to certain readily observable attributes as indicated in paragraphs 5-7 above, the correlation is not significant enough to support a comprehensive approach to poverty reduction. For example, only 8 percent of very poor households are female-headed, and only 9 percent have three or more children. However, further institutional strengthening and federal guidance are needed for effective means-testing on an expanded scale. Means-testing should be gradually strengthened, in line with available resources, while complementary approaches targeted toward categories or groups of the population also are applied.

- **Addressing regional disparities.** While a basic requirement for effective provision of poverty relief is proximity to the beneficiary in the day-to-day operational decision-making, the central government should play an important role in providing guidelines for targeting strategic planning and general oversight of service provision and program outcomes. In addition, in Russia, given the magnitude of economic restructuring required in some oblasts and the associated local fiscal shocks, federal support for social expenditures is needed. Transparency and predictability in federal transfers are necessary to allow for consistent operations at the oblast level. Allocative decisions should be based on such information as oblast per capita income and estimates of oblast poverty gap. Moreover, grants should be conditional upon local policy being in line with the central government’s strategy, and preferably matched by local financing. The matching rate should vary across oblasts, depending on local fiscal capacity.

16. The following reform priorities are central for improving individual programs:

(a) **Federal financing mechanisms** should allow: (i) greater transparency and predictability in federal transfers, (ii) better regional equalization based on formula that reflect levels and needs of social and economic development, and (ii) to make certain transfers conditional on local financing of priority social programs and adherence to minimum standards;

(b) **Needs-based social assistance** should be developed and implemented at the local level, underpinned by federal financial support, and targeted at very poor households that are not currently receiving any public transfers. A new federal law along these lines is being drafted. In finalizing it, particular attention should be paid to (i) possible adverse work incentives, and (ii) the affordability of the program. The report recommends a **poverty benefit** targeted to the very poor (those below 50 percent of the poverty line), set at a level below the revised minimum pension and unemployment benefits (see below). Estimates suggest that the costs of such a program, including administration, would amount to about 0.7 percent of GDP. Alongside the poverty benefit, the report analyzes the scope for a system of **tax credits** for the working poor, which would target tax relief to poor people. Attention should also be given to improving the targeting and administration of existing local social assistance measures;
Minimum unemployment benefits should be increased toward oblast minimum subsistence levels (from the present 20 percent to about 60 percent), the rules governing receipt of benefits should be tightened to exclude those with wage earnings, and link benefits to training and job search support; and targeted temporary employment schemes could also be introduced, possibly with federal support for high-unemployment regions;

The minimum pension should be set at about the minimum subsistence level for the elderly; pension inflation adjustments could be shifted to flat rate indexation to gradually compress the structure of pension benefits; and pension eligibility tightened with respect to working pensioners; and

Cost recovery in municipal housing and utilities should be expanded in line with existing legislation to reduce the burden imposed by current subsidies on subnational budgets following enterprise divestiture, while ensuring that vulnerable groups are protected through expanded and strengthened means-tested housing allowances.

17. To the extent that recommended reforms are implemented, offsetting cost cutting measures would be implemented to finance significantly increased levels of targeted social assistance. Major savings could be made through pension reforms, and continued reduction of general subsidies for housing and utilities. The net cost of the proposed reform package (13.4 percent of GDP) is significantly below what public spending on social protection is projected to be in 1997 in the absence of reforms (16.0 percent of GDP), even while increasing expenditure on poverty alleviation.

18. Better poverty relief mechanisms and poverty alleviation can only be introduced in a context of fiscal responsibility. The fiscal impact of the proposed reforms is indicated in Table 1. Current levels of targeted social protection expenditure would increase. However, the costs of programs targeted to the very poor are not large -- of the order of 0.7 percent of GDP including administrative costs and leakage to the non-poor. Additional targeted spending is on employment schemes (about 0.4 percent of GDP), plus some modest costs associated with raising the low level of unemployment benefits and minimum pensions.

19. The fiscal costs of social protection would be reduced significantly if reforms to utility and rent prices are implemented giving projected savings of the order of 2.5 percent of GDP by 1997. This would alleviate subnational budgets of a significant and otherwise increasing fiscal burden, thereby creating greater scope for local financing of targeted social assistance. Beyond reduced housing and utility subsidies, the main savings would accrue through cuts to pension spending. The increase in poverty reduction efforts is affordable provided that the cost savings measures recommended elsewhere in the social protection budget are implemented as well.
CHAPTER 1

DEVELOPMENTS IN THE ECONOMY AND LABOR MARKET

1.1 Trends in poverty and well-being in Russia must be evaluated against a background of enormous economic change. This report investigates the relative impact of such shifts on different population groups as well as on absolute poverty. Chapter 1 sets out, in brief, the major economic trends that have characterized the Russian Federation since independence, focusing on inflation, output and enterprise restructuring, then fiscal policy and regional disparities. We then explore labor market trends in detail.

1.2 Russia inherited a command economy whose weaknesses had become manifest in the 1980s. In 1991, as the old political regime crumbled, inflation surged and output fell precipitously, together with the collapse of internal and external trade and a rapid rise in the fiscal deficit. Figure 1.1 presents some of the broad trends in the macro-economy.

1.3 Monthly inflation averaged just under 10 percent in 1994, well below the 23 percent that prevailed in 1993, but still exceeding government targets. The average cost of the minimum subsistence basket surged from R. 635 in January 1992 to R. 121,494 in November 1994. Real average money incomes fell by 43 percent between 1991 and 1993, then recovered somewhat in 1994, according to Goskomstat. However, changes in prices and money income may not reflect fully individual or household welfare. Price liberalization has largely eliminated the need to search and queue for goods, while trade liberalization has increased the volume and quality of goods available. The Soviet economy reflected a combination of several different allocation mechanisms of goods and services including queues and rationing with black markets (e.g. for consumer durables).

1.4 The break-up of the central planning system, of the former Soviet Union, and of COMECON all contributed to a collapse of output. Recorded GDP has fallen by more than 40 percent since 1991, although the structure of the decline, as well as the failure to account for most informal sector activity leading to an under-statement of post-1991 output, have to be taken into account in assessing the impact on living standards. The overall drop in output partly reflects necessary industrial restructuring, for example in machine building. According to Goskomstat data, light industrial production was hardest hit. The fall in raw material production has been more modest and services, particularly commerce, have shown positive growth. Services expanded from 31 to over 50 percent of GDP between 1989 and 1994. Recent World Bank analysis suggests that unofficial economic activity of both new private firms and privatized enterprises has been expanding at a robust pace, and could add another 10-15 percent to the GDP registered officially by Goskomstat. During the second half of 1994, industrial output was broadly stable on a monthly basis suggesting that the worst of the output decline could have passed. Further significant industrial restructuring will be necessary, however, as Russia moves toward a modern industrial market economy (see paragraph 1.31 below).

1.5 The tighter monetary and fiscal policy in 1994 has led to a deceleration in inflation, and interest rates have generally been positive in real terms since late 1993. However, financing of the government deficit and the extension of credit to agriculture and the Northern territories fuelled monetary

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2/ Moreover, the overestimation of actual pre-reform output levels when enterprise managers had strong incentives to falsify production figures makes the size of the apparent drop over the transition misleading. See E. Gavrilenko and V. Koen, How Large Was the Output Collapse in Russia? Alternative Estimates and Welfare Implications, 1994, IMF Working Paper, No. 154.

3/ Although part of the "growth" is attributable to changes to traditional Goskomstat classification, as well as changing relative prices.
expansion. This contributed to a resurgence of inflation in late 1994. The Government has committed to stabilize the economy at monthly rates of inflation averaging 1 percent in the second half of 1995.

![Image of a graph showing Russia: Quarterly Output, Employment, Prices, Consumption, 1991-94]

**Figure 1.1**

1.6 Progress on structural reforms has been uneven. There has been significant progress in the liberalization of prices and the elimination of quantitative trade restrictions. A major part of the economy has been privatized, although there are regional variations. By mid-1994 over 60 percent of the industrial workforce was employed in privatized enterprises. Participation of the private sector varies across sectors - 85 percent of transport is still state-dominated, whereas in trade the split is 50:50. In October 1994, at the completion of the voucher program, over two-thirds of large and medium enterprises, and over 80 percent of small enterprises, had been privatized, or a majority interest auctioned for vouchers. Nevertheless, in most cases, transfer of title has been made to existing staff and management, without any discernable impact on enterprise behavior.

1.7 The newly emerging private sector has expanded quite rapidly since liberalization began, to contribute an estimated 23 percent to GDP in the first half of 1994. Private employment ranges across activities with very low levels of remuneration (e.g. piece work) to lucrative practices (e.g. private medical services or foreign language translation in a major metropolitan area).

1.8 During 1993 there was a clear shift from direct to indirect forms of price control on raw materials, energy products, and foodstuffs whose prices had not previously been liberalized. Federal authorities reduced the scope of direct price controls, most notably on coal, oil and grain. Major steps to remove export quotas were taken in July and December 1994. However many regional governments have kept domestic utility prices at low levels, directly control a number of prices of basic foodstuffs and restrict trade across internal boundaries.
Fiscal Policy and Adjustment

1.9 Fiscal imbalances have imposed enormous pressure on the Russian economy during the transition. These can be traced largely to the substantial pressures on the Government to provide support to enterprises and poor tax collection. The enlarged cash deficit was reduced from 30 percent of GDP in 1992 to around 11.5 percent in 1994. The deficit needs to be further reduced while balancing tradeoffs among key expenditure groups, and in particular, maintaining priority social expenditures. The report's policy recommendations are put forward in a fiscal framework that costs the specific options.

1.10 The Russian tax system is based on value-added tax (VAT), enterprise profit, payroll, personal income and excise taxes. In theory, the combined tax burden levied by the federal and local budgets and extrabudgetary funds is higher than most industrial economies. However, tax collection has fallen well below expectations, partly due to non-compliance but also to widespread exemptions. Consolidated revenues in 1994 amounted to about 28 percent of GDP, compared to the 31 percent that had been budgeted.

1.11 Federal government transfers to the enterprise sector have been a major source of fiscal imbalance during the last three years. Total transfers, including budget subsidies, directed credits and unbudgeted import subsidies, stood at an estimated 8 percent of GDP in 1994, down from about 32 percent in 1992. Still, despite the overall reduction, the system of government support to enterprises remains complex and badly targeted, and there are also implicit transfers through sectoral extra-budgetary funds, differing tax rates and ad hoc tax exemptions and arrears. Transfers have been increasingly concentrated on a relatively small number of large enterprises.

1.12 Public expenditure on social protection -- pensions, unemployment benefits, family and maternity allowances and local social assistance -- amounted to an estimated 9 percent of GDP in 1994. Most spending is financed out of extrabudgetary funds -- the Pension Fund being the most significant -- and local budgets. The evidence suggests that social spending in aggregate has not been disproportionately affected by any fiscal adjustment to date (although this does not mean that there is not a need to restructure existing spending patterns). Decentralization of responsibility has characterized recent trends. Between 1992 and 1994, local social expenditure rose, from about 5.4 percent to 7 percent of GDP, while federal social spending fell from about 2.3 to 1.9 percent of GDP over the same period. Since 1994, federal budget cash benefit expenditure has been further curtailed, and is now limited to bread allowance to selected groups. It is likely that upward pressure on social spending will be generated by rising unemployment and, especially in the absence of reform, pensions.

1.13 In aggregate, health and education expenditures in Russia have been broadly maintained as a share of GDP, although falling GDP implies a large decrease in real aggregate and per capita expenditures. The real level of health finance per capita in 1993 was about 8 percent lower than the 1990 level. The reduction of social spending by enterprises -- by an estimated 30 percent in 1993 -- is compounding the problem for some services, especially child care. At the same time, as total investment has fallen drastically, it appears that the share of investment in the social sectors has been relatively

4/ The structure and financing of the system of social protection is detailed in Chapter 3.

5/ This is explored further in Chapter 4.
stable. Since 1989, investment in health actually increased slightly as a share of total investment to 2.5 percent in 1993 while investment in education remained at about 2.5 percent. Restructuring is needed to improve economic efficiency in all such sectors, but this will be a long-term process.

Decentralization and Regional Disparities

1.14 Decentralization is one of the most important systemic changes that has taken place in the Russian Federation since 1991. In contrast to the overcentralization that prevailed during most of the Soviet period, the regions have become responsible for planning, delivering and financing most public services. Yet the rapid and often chaotic decentralization of fiscal responsibilities has resulted in a system of intergovernmental relations that is fraught with inconsistencies, uncertainties and problems. Increasing regional disparities play a central role in explaining trends in economic and social indicators, and deserve detailed consideration at the outset.

1.15 There are significant regional variations in economic performance across the country, with corresponding implications for living standards. By 1994, the scale of industrial output decline relative to 1991 (base of 100) ranged from 36.9 in Ivanova and 40.4 in Altai, to less than 76 in Yakutia. This partly reflects the decline in defense-oriented production, metallurgy, and light industry. There have been significant shifts following the increase in terms of trade benefitting, in particular, oil and energy producing regions. Raw material producing and more diversified regions have fared better. Informal sector activities are typically urban (except for private plots) and concentrated in European Russia (where the major cities are located) and in the North Caucus (e.g., Dagestan). There is significant regional dispersion in unemployment (see below).

1.16 The increasing regional disparities in poverty explored in the next chapter can be attributed partly to the differential impact of restructuring upon oblasts with different economic bases, but also to local responsibility for financing social assistance, which means that poorer oblasts are correspondingly less able to assist poor people within their jurisdiction. Under the new constitution, local-central revenue sharing remains in force. The structure and implications of this are addressed in Chapters 3 and 4.

Wages and Employment

1.17 Since the late 1980s, it appears that workers have accepted limited adjustment to wages and employment. There was a significant increase in the average wage following the 1987 Enterprise Law; particularly just prior to, and in anticipation of, the price liberalization in January 1992 (see figure 1.2). In the face of large output declines, real wages received have been reduced by wage arrears, and

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7/ World Bank sector reports on education and health explore in detail systemic and structural issues related to these sectors. See Russia: Reform of the Health System (forthcoming) and Russia: Education in the Transition (April 1, 1995).

8/ There are 19 ethnic republics, 2 "Soviet socialist" republics, 50 oblasts (provinces), 6 krais (native lands), 10 autonomous okrugs (areas), and 2 metropolitan cities (Moscow and St. Petersburg). These 89 regions are grouped into 11 economic/geographic zones plus Moscow, for which separate information was occasionally made available. Formerly, differential pricing and wage coefficients for fixed prices and wages were applied across the economic zones.

9/ More detailed labor market analysis is presented in Volume II, Commander and Yemtsov. The survey results are based on nationally representative samples of 2935 individuals in March, and October, 1994 (referred to as the VCIOM survey).
involuntary leave and short-time. While rates of registered unemployment, at 2.5 percent by the end of 1994, are deceptive, results emerging from household surveys of up to 8% are still low relative to the scale of decline of production and productivity. There is a high number of quits and rehires, largely concentrated on production workers, suggesting some buoyancy in labor demand. Overall, however, the present employment situation is unsustainable. The likelihood of further labor market adjustment--in terms of employment and/or wages--needs to be addressed.


![Graph showing monthly wage trends in Russia from 1991 to 1994.](image)

From a poverty perspective, trends in the average real wage are not very useful. First, apparent trends in average real wages depend critically on the period of comparison, given the inflation dynamics of the past several years. During the late 1980s, average nominal wages increased substantially, but the system of controlled prices then in force meant that inflation was not openly expressed. Instead, a large monetary overhang developed and waiting time in queues greatly increased. Real wages rose rapidly in 1991, peaking at year end. The subsequent price liberalization of January 1992 resulted in a dramatic decline in the real average wage, which then recovered slightly in the first half of 1992, and remained stable but on a slightly downward trend throughout 1993 and 1994 so that by December 1994, the real average wage was significantly below its level in 1987 and only half the 1991 (Q4) peak (see figure 1.2). Second, the wage distribution has widened significantly during the transition. Distributional trends are detailed in the next chapter (see paragraph 2.59). The widening of the wage distribution is illustrated by the trend of the real minimum wage (Table 2.3). Even in 1991, it had fallen below its 1987 level, and has eroded dramatically since then. Since the minimum wage serves to scale many of the cash transfers provided by the government, its pronounced erosion has been difficult for those dependent on such transfers. Third, reported wages often exceed actual wages, because of wage

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10/ These cash transfers include the social pension (paid to those who have never worked), minimum unemployment benefits, some kinds of disability pensions and family allowances. Old age pensions (and some disability pensions) are based on past average wages, and as a result, do not follow the real minimum wage trend.
arrears, particularly in 1994, when arrears totalled over 10 percent of the wage bill. Throughout 1993 and 1994, VCIOM surveys found that only about 40% of workers were being paid fully and on time. This is reportedly a source of labor unrest.

1.19 Given high inflation through most of the past two years, real incomes have been critically affected by the frequency and timing of adjustments in wage and benefit payments. Wage setting has been fairly decentralized since the passage of the Enterprise Law in 1987-- in the privatized (mixed) and newly emerging private sector in 1993, microeconomic evidence suggested that wages were adjusted about every two months. In the state sector -- budget sphere and state-owned enterprises -- wage movements tend to be governed by changes in the minimum wage. As table 2.3 below shows, the minimum wage has been adjusted about every three to four months during the transition. Sometimes the lag was longer -- for example the nominal minimum wage remained the same between December 1993 and July 1994. Shifts in the minimum wage also determine the level of certain benefits, such as family allowances and the floor for unemployment benefits.

Unemployment

1.20 There has been a huge asymmetry between adjustments to GDP, industrial output and employment since 1990 (see Figure 1.1). There was a fall in net employment of around 4 percent or 3 million jobs between 1991 and 1993. Contrary to conventional wisdom, labor force surveys suggest that Russia inherited a significant stock of open unemployment from the Soviet period, probably about 4 percent of the labor force. Registered unemployment climbed sharply in 1992, but the rate of increase declined through most of 1993 resulting in a pause in the overall rising trend. A further surge resulted in about 1.7 million registered unemployed by December 1994, with 1.4 million people in receipt of unemployment benefits. Table 1.1 presents various measures of unemployment in Russia over the period 1992-1994.

1.21 In Russia, in contrast to Eastern Europe, employment losses from the state sector have not been large nor rapid. The employment contraction that has occurred has been concentrated in industry (accounting for 36 percent of the drop). Other sectors where formal employment has shrunk include kolkhoz, science and construction -- although in some cases, for example construction, informal sector activity is increasingly important. The gradual adjustment of employment to falls in output may be partly attributed to continuing government subsidies whose size is implicitly related to employment. The share of total separations due to mass layoffs and enterprise closure was only about 7-8 percent at the end of 1994. Layoffs have been relatively infrequent; indeed many state firms have continued to recruit at relatively high rates. Since 1992, some parts of the economy have expanded their workforces, including trade and catering (14 percent), individual economic activity (865%) and self employment (162.6%). Joint ventures have more than doubled their work forces. The newly emerging private sector is reported by Goskomstat to account for 16 percent of total employment in early 1994. More surprisingly, public administration (civil service) and agriculture have also expanded employment over the same period, by 28.5 percent and 12.7 percent respectively.

1.22 While the bulk of reported recruitment is still being undertaken by state and mixed (privatized) firms, informal sector jobs and self-employment are becoming increasingly important.

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11/ The share of registered FES jobseekers who were laid-off is higher, and rising -- from about 25 percent in the first quarter of 1993 to more than one-third in October 1994--since those who are laid off are more likely to become unemployed.
Informal sector employment -- defined as where someone is hired without record in her formal work history (trudovaya knizhka) -- is a significant source of income in general, and in particular for the "unemployed" (see below). It covers a wide range of activities and levels of remuneration. Also, women engaged in individual labor activity tend to live in very poor or poor households much more frequently than men (see paragraph 2.70). Use of part-time and temporary workers appears to be widespread in the private sector, perhaps due to firms' uncertainty about longer term prospects.

1.23 The number of people exiting from the pool of unemployed has been large and fairly stable since 1992. Although average duration of unemployment has risen over time, it remains quite low relative to Eastern Europe and many industrial countries -- below 6 months in late 1994. By the end of 1994 less than 10 percent of the current stock had been unemployed for longer than one year. While this is partly due to expiration of benefits and withdrawal from the labor force, even outflows to jobs have been large, relative to most of Eastern Europe, averaging 5.3 percent per month in through 1994 for the registered unemployed (with large variations across regions and time).

1.24 Statistics do not satisfactorily discriminate between unemployment and non-participation in the labor market. There have been large movements out of the labor force during the transition, particularly of married women, as would be expected given the high rates of labor force participation inherited from the Soviet period. Official FES data report a monthly outflow in the range of 10-15 percent for 1993 and 1994 (of which 40 percent were to jobs). In most oblasts negative changes to employment have far exceeded changes to unemployment. A one percentage point rise in unemployment rate is associated with a 2.5 percent fall in employment.

1.25 Goskomstat estimates of open unemployment (based on ILO methodology) stood at about 7.4 percent in first quarter 1995, and involuntary leave and short time work was estimated at about 5-6 percent. This reflects evidence from surveys that more people are actually unemployed than the number registered with the Federal Employment Service (FES). There are varying estimates of how many more (see table 1.1). Best estimates of the World Bank indicate that the true rate was about 4.5-5 percent in 1994.12

1.26 Hours adjustment, as a response by firms to adverse shocks, is widespread and growing. There are two basic forms of hours adjustment, short time and involuntary leave, the evolution of which is given in Table 1.2. In mid 1994, over 6 percent of employees were on short time and over 8 percent on involuntary leave. Involuntary leave has dominated with average leave lengthening to about one month by the first quarter of 1994. The type and extent of hours adjustment varies across sectors.

1.27 Short time is usually associated with limited hours adjustment and high likelihood of re-employment full time. In most cases, hours adjustment for those on short time is temporary. The March 1994 survey suggested that nearly half of those waiting were in full time work by the following month (April 1994). Those on involuntary leave have generally been subject to far larger hours contraction that those on short time work.

12/ Although the number would be larger if all workers on short work time were included, this is not appropriate since the contraction in working time is often quite small and limited in duration.
Table 1.1: Unemployment in Russia: Various Measures 1992-1994 (percent of labor force)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Labor Force Survey</td>
<td>4.8</td>
<td>5.6</td>
<td>5.9</td>
<td>6.5</td>
</tr>
<tr>
<td>VCIOM Survey</td>
<td></td>
<td>6.2</td>
<td>6.7</td>
<td>8.0</td>
</tr>
<tr>
<td>RLMS</td>
<td>5.5</td>
<td>6.9</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Registered Unemployed</td>
<td>1.1</td>
<td>1.4</td>
<td>2.1</td>
<td>2.3</td>
</tr>
</tbody>
</table>

Notes: 1992 and 1993 figures are mid-year (RLMS figures relate to August 1992 and July 1993) VCIOM surveys relate to June 1993, April 1994, and October 1994. Labor force survey is conducted by Goskomstat now using ILO methodology, and concept of active "actively seeking work".

1.28 Involuntary leave is a more complex phenomenon. About one-third are unemployed, with zero work hours, and actively looking for employment. One third are just waiting to be re-employed. The remaining third find alternative employment, generally of a secondary or informal nature. According the March 1994 survey, half the cases of reported secondary work involved self-employment, almost exclusively in trade and services. The other significant source of such work was in private firms. Another part is probably related to primary state employment, done "after hours".

1.29 Skill mismatch is a problem. In Moscow, for example, most posted vacancies have been for manual and primarily male jobs whereas a significant share of the unemployed were, up until late 1993, women. An increase in posted vacancies appears to be associated with a fall in the outflow to jobs. Similar trends are revealed in other major industrial regions -- including Nizhegorod, Krasnoiarskii Krai and Samara oblast -- with a negative association between vacancies and outflows. This can be traced to the way that Russian industry has initially tended to shed clerical and professional staff, while most of the hiring has been of manual and production workers.

1.30 In terms of labor shedding, much more restructuring will be needed in the short to medium term in most of the non-service sectors, but especially in coal, metallurgy, chemicals, machine-building and agriculture. This follows the inherited levels of overstaffing, the failure of many sectors to adjust employment to output declines, and the need for further structural change. There are clear signs that unemployment is rising and set to rise further. Registered vacancies have fallen almost continuously since September 1993, although there have been limited recoveries at various times. The ratio of vacancies to unemployment has fallen since mid-1993. The incidence of unemployment is shifting from the initial preponderance of women and becoming more widespread across different population groups. Regional dispersion is increasing, with some adversely affected regions suffering rates of registered unemployment exceeding 10 percent by early 1994.

13/ The survey was actually undertaken in April, asking about activity in the previous month (March).
Table 1.2: Employment in Russia: Hours Adjustment and Regional Range, 1993-1994

<table>
<thead>
<tr>
<th>Category</th>
<th>1993 Q1</th>
<th>1993 Q2</th>
<th>1993 Q3</th>
<th>1993 Q4</th>
<th>1994 Q1</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Short Time (Share of employed)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Russia</td>
<td>1.7%</td>
<td>1.6%</td>
<td>1.9%</td>
<td>2.8%</td>
<td>5.9%</td>
</tr>
<tr>
<td>max</td>
<td>10.1</td>
<td>8.0</td>
<td>8.2</td>
<td>9.0</td>
<td>13.5</td>
</tr>
<tr>
<td>min</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.2</td>
</tr>
<tr>
<td><strong>Involuntary Leave (Share of employed)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Russia</td>
<td>3.4</td>
<td>4.9</td>
<td>6.5</td>
<td>8.6</td>
<td>8.3</td>
</tr>
<tr>
<td>max</td>
<td>13.0</td>
<td>15.4</td>
<td>16.8</td>
<td>20.4</td>
<td>16.0</td>
</tr>
<tr>
<td>min</td>
<td>0.3</td>
<td>0.6</td>
<td>0.3</td>
<td>1.2</td>
<td>1.0</td>
</tr>
<tr>
<td><strong>Average Duration of Involuntary Leave (days)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Russia</td>
<td>18</td>
<td>18</td>
<td>24</td>
<td>29</td>
<td>19</td>
</tr>
<tr>
<td>max</td>
<td>49</td>
<td>47</td>
<td>63</td>
<td>64</td>
<td>45</td>
</tr>
<tr>
<td>min</td>
<td>5</td>
<td>9</td>
<td>10</td>
<td>15</td>
<td>4</td>
</tr>
</tbody>
</table>

Note: Only covers firms with ≥ 200 employees
Maximum and minimum refer to the regional range.

Regional Trends in the Labor Market

1.31 Emerging regional differences are an important part of the Russian transition in the labor market, as elsewhere in the economy. This is not surprising, since different regions have faced shocks of varying magnitude and equalizing mechanisms -- particularly of a fiscal nature -- are lacking (see paragraphs 1.14-1.16 above). There is a growing mismatch between regional vacancy and unemployment rates, ranging from 14 registered unemployed for every vacancy in Volga-Vyatika in early 1995, to 6.5 in the Central region. Lack of labor mobility could be expected to accentuate such differences. In Eastern Europe regional mismatch between unemployment and vacancies has increased over time. The same trend is found in the Russian Federation.

1.32 The regional dispersion in unemployment rates is large and rising, once we include involuntary leave. At mid-1992 the coefficient of variation in the unemployment rate was 0.4; by 1994 it had jumped to 0.7. Figure 1.3 shows trends in unemployment, by oblast. High unemployment regions are primarily industrial, predominated by military firms and/or light industry; both branches subject to the largest negative shocks. Inversely, low unemployment oblasts are primarily resource rich regions in the East, or the major cities, and in most cases, unemployment actually fell in the year to October 1994. Flows out of the labor force have not been a major factor driving the growth in regional dispersion, since the labor force participation rates have remained quite stable across oblasts with low variation.

1.33 Labor mobility is limited in Russia. Almost two-thirds of the unemployed in the March and October 1994 surveys stated that under no conditions would they be induced to move. Higher wages or

14/ These regions also report extensive use of involuntary leave and other forms of hours adjustment.
housing were cited by only 25% of respondents as preconditions for moving. People who were older, city residents and higher skilled all had a lower propensity to move. Thus despite evident wage flexibility and an emerging conventional association at the regional level between changes to wages and unemployment, described below, it seems likely that regional variation in unemployment rates will persist. This is partly because of the large spatial mismatch in the distribution of unemployed and jobs. Housing shortages will be a major constraint to mobility in the short to medium term.

Regional Unemployment Rates
Initial Levels and Changes over 1993-94

![Regional Unemployment Rates Graph](image)

Figure 1.3

Is the Labor Market Adjusting?

1.34 An effectively functioning labor market will play a critical role in raising living standards in Russia. Do recent movements in real wages reflect a labor market that is adjusting to the shocks associated with the transition? On a regional basis, changes in average real wages could be systematically related to changes in employment or unemployment. A regression based on regional observations charts the emergence of the expected link between regional wages and unemployment, so that by the first quarter of 1994 there is a clear inverse association between changes in wages and unemployment (see figure 1.4). This relationship did not exist at the beginning of the transition.

1.35 It follows that regional wage setting has begun to be more responsive to regional labor demand and unemployment. The implications of downward wage flexibility at the individual and household level and regional disparities in income earning opportunities are traced in the next chapter.
1.36 From a poverty perspective, the most salient features of recent macroeconomic developments can be summarized as follows. First, there has been a significant fall in overall national income and output. This is true even if current and past output estimates were, respectively, under and over-reported. Alongside the decline in income and output, there has been a widening in the distribution of income, across regions and also across the population. Fiscal stringency has meant that equalizing mechanisms among regions, as well as social assistance to the poor, have been limited. Third, the high inflation through most of the transition has had adverse effects on those least able to protect themselves against rising prices. Fourth, there has been some adjustment in the labor market that has reduced real earnings - falling labor demand has shown up in declines in total employment and increasing numbers of people on short time work and involuntary leave. And real wages of the poor have been eroded, as wage arrears have grown and the wage distribution has widened. All of these factors would be expected to lead to an increase in the incidence and severity of poverty. This is explored in the next chapter.
CHAPTER 2

POVERTY PROFILE

2.1 An important objective of this report is to provide a profile of poverty for the Russian Federation -- such a profile sheds light on who is poor, why they are poor, and will help frame recommendations to reduce poverty. The analysis is based on traditional Goskomstat statistics as well as more recent representative surveys.

2.2 Although this report focuses on recent trends, poverty was not created by the transition. Poverty existed in the Soviet Union, although it was not openly acknowledged. Nonetheless the extent of poverty increased during the transition period. In particular, very high inflation has widened the scope of poverty to encompass much larger numbers of working poor, and the open expression of previously hidden underemployment meant that unemployment has become a causal factor for poverty. Recent developments suggest that poverty did not recede in 1994.

2.3 This chapter draws a poverty profile of the poor during 1992-93. First, poverty is defined. Second, the composition of the poor is detailed. Briefly, the poor primarily consist of families with children (including single-headed households and other working poor), the unemployed, families with a disabled family member, the elderly depending on a single income, and the homeless. Third, factors causing poverty are explored. The erosion of real benefits, increasing income inequality and the decline in real income levels not only contributed to a significant reduction of average living standards in Russia but also pushed many households into poverty. Causal correlates of poverty are considered, including gender, location, education, and occupation. Fourth, the growth in disparities is considered. Wage and income differentiation clearly increased during the transition, while regional differences became more pronounced.

2.4 Poverty is a multi-dimensional phenomenon. Money indicators of wellbeing are the main focus of this report. However, poverty extends beyond lack of money, to inadequate access to other aspects of wellbeing such as nutrition and health. An important dimension of poverty and poverty alleviation is access to social services. The severe health crisis in Russia today reduces the standard of living of both the rich and poor, but the poor lack the income necessary to, for example, purchase pharmaceuticals at market prices. Evidence of worsening health outcomes are serious cause for concern. In 1993, there was a 20% increase in the crude death rate over the previous year, infant mortality increased and life expectancy has continued to decline. Demographic and health trends are recounted in the final section.

What is poverty?

2.5 In order to determine who is poor, one must decide how to define poverty. Conceptually, few would dispute the contention that poverty is the inability to sustain some minimal level of existence. Yet defining that "minimal" level, especially when money income does not give a good measure of real

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16/ See the forthcoming World Bank report Russia: Reform of the Health System.
consumption, is problematic. The standard approach to defining an absolute level of poverty is to price a basket of essential goods and compare income to the cost of these necessities. Leaving aside the considerable difficulties in determining even essential food consumption (let alone non-food needs), an absolute poverty line can be used to gauge poverty only to the extent that money income reflects real consumption. It is important to bear in mind that poverty lines and measurement can never be entirely objective and value-free. Where the poverty line is drawn is partly a question of policy. When the line is moved up or down, even slightly, significant numbers of Russians appear to be included or excluded from being classified as poor. Additionally, high inflation makes the precise measurement and comparison of any nominal aggregates much more difficult.

2.6 Analysis of available Russian data revealed some correlation between money indicators such as income, and non-monetary indicators such as life expectancy and infant mortality. Spearman correlation coefficients calculated for life expectancy in 1992 and 1993 and for mortality in 1993 were statistically significant at the 5 percent level. Mortality was negatively correlated with real per capita income; areas with high real per capita income have low mortality rates, and areas with low per capita income have high mortality rates. However, some areas with low real per capita income have high levels of life expectancy. This surprising finding underscores the difficulty of using per capita income to reflect well-being, although the influence of special ethno-demographic factors is also evident. Correlation coefficients for infant mortality were not statistically significant, but there is some weak inverse association between infant mortality and real per capita income. Areas such as Dagestan and Checheniya have high levels of infant mortality and low levels of real per capita income.

2.7 This report utilizes the official poverty line of the Russian government to measure poverty (for reasons explained in Box 2.1). Wherever possible, total household income or expenditures were compared to a household-specific poverty line (reflecting the differing official minimum subsistence estimates for children, elderly, and able-bodied people). The household-specific poverty lines do not vary regionally. At the time of writing, such a comparison was possible for the first and third rounds of the Russian Longitudinal Monitoring Survey (RLMS), conducted during the summers of 1992 and 1993. For other points in time, we relied on the official per capita poverty line as compared to published per capita income and expenditure figures as well as a variety of independent studies and surveys. Other data

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18/ The Spearman correlation coefficients were -0.362, -0.244 and -0.254 for life expectancy in 1992, in 1993 and mortality in 1993, respectively.

19/ The Caucasus region is renowned for the number of "long-lived" elderly, for reasons that have not yet been established, although intensively studied by Soviet and Western scientists. For example, the areas in 1993 with the highest life expectancies included (in descending order): Dagestan, Karachayevo-Cherkesskaya, and Karbardina-Balkarskaya, all located in the Northern Caucasus.

20/ The analysis is based on official infant mortality statistics, which understate actual infant mortality. If infant mortality statistics were available on an oblast basis, a statistically significant correlation might be obtained.

21/ Given the large variations in the oblast minimum subsistence level, we investigated the extent of poverty using regionally differentiated poverty lines. The national poverty line was found to be a good proxy for assessing regional poverty because the headcount results were quite similar.

22/ A joint initiative of Goskomstat Rossi and the World Bank, the RLMS is a nationally representative sample survey of approximately 17,000 individuals in 6,500 households. The RLMS is a stratified random sample drawn from voting lists, and has a panel dimension. Details about the RLMS and other information of Goskomstat Rossi are provided in Volume II of this report: Braithwaite (1994a) and Foley (1994a, 1994b).
on income and expenditure tend to confirm the portrait of poverty which emerges from the RLMS, although trends in some official data in 1994 are unreliable (see paragraphs 2.49-2.50).

2.8 Since the goal of poverty analysis is to consider the real consumption of people, expenditure can be a better measure than income. In the RLMS, reported household expenditures exceed reported income. Beyond the saving and dissaving of households attempting to smooth their consumption over time, participants also may seek to conceal income because of taxation and other concerns. In the former Soviet Union, most informal activities were illegal, and some residual stigma may also induce households to underreport such income. Moreover there are theoretical advantages to using household expenditure for measuring poverty, because it better reflects permanent income. The definition of expenditure used in the analysis is more akin to consumption, since it includes the imputed value of in-kind goods and services produced in the home, and received (e.g. from employers). Here we use household expenditures in the RLMS analysis, but Goskomstat data (based on income) are also considered.

2.9 Another way to characterize the poor is to examine the share of expenditures spent on food by various groups. In Russia, the share of total expenditures spent on food is higher than in many other middle- and high-income countries largely because utility prices and rents are still very low. In the summer of 1992, for the very poor (those with expenditures less than 50 percent of the poverty line), the food share was 68.5 percent. By the following summer the food share of the very poor had increased to 77 percent.

2.10 Based upon the RLMS data for the period July 1992 to September 1993, poverty headcounts had increased markedly, from approximately 25 percent of households in summer 1992 to nearly 32 percent by summer 1993. Goskomstat data also demonstrate the trend of increasing poverty in 1993, although to a lesser extent than that measured by the RLMS (due to problems with the Goskomstat sample). The latest round of the RLMS indicates a decline in poverty in the second half of 1993 and very beginning of 1994, consistent with the pattern evident from Goskomstat's estimates. (For comparison with income-based and individual measures, see Table 2.1.)

2.11 A limitation of headcount measures of poverty is that the depth or severity of poverty is not indicated. Clearly, a person with zero income is much worse off than someone with income 99 percent of the poverty line, but a typical headcount assigns equal weight to both, simply noting that each falls below the poverty line. The Foster-Greer-Thorbecke P1 measure of poverty distinguishes among the poor according to how far below the poverty line their income or expenditure falls (the "poverty shortfall"), and can be therefore be considered a measure of the depth of poverty. Table 2.1 indicates that the depth of poverty increased significantly from 1992 to 1993. However, this measure of the depth of poverty may not adequately capture differences in the distribution of consumption among the poor. The Foster-Greer-Thorbecke P2 measure of the severity of poverty therefore weights the poverty shortfalls of households by the specific poverty shortfall so that the poverty shortfalls of those households...
far below the poverty line receive greater weight in the aggregate measure of the severity of poverty. The P2 measure is more useful than simple headcounts for comparing changes across time, and for assessing the impact of policies. Using the expenditure-based poverty comparison, the severity of poverty rose significantly from 5.44 in summer 1992 to 8.01 in summer 1993, or an increase of approximately 47 percent. During this same period, the headcount increased only 26 percent. In other words, poverty became much more severe during 1993. Although the poverty measures for end-1993 had improved slightly from their mid-1993 levels, they still remained significantly above the measures for summer 1992.

Box 2.1: Development of the minimum subsistence basket in Russia

In the late Soviet period, a minimum consumption basket (MCB) was developed that was intended to provide a measure of what would be minimally acceptable consumption under a socialist system. The social minimum was introduced in 1975 at R 50 per month, then raised to R 70 in 1984 -- which happened to equal half the average per capita income.

The minimum consumption basket was not supposed to be a measure of poverty during the Soviet period (since, after all, poverty did not officially exist). However it was to some extent used as such. After the 1992 price liberalization and transition from a command system began, such a large proportion of the population fell below the minimum consumption level that the concept became irrelevant for policymakers. Local MCB estimates were often not published for fear of unduly raising expectations about social benefit levels.

During 1992, technical assistance was provided to the Russian government to refine the food portion of the basket (Popkin, Mozchina and Baturin, 1992). A revised food basket corresponding to World Health Organization nutritional guidelines was subsequently adopted by the Ministry of Labor (MOL). Under the MOL methodology, the poverty level is assumed to equal a percentage of the food basket, and reflects the different cost requirements of different age groups. However, the food share, set at an average of 68.3 percent, will need to be adjusted downwards as the relative cost of non food goods and services (such as utilities) rises, and households need to replace durable goods.

The MOL approach to calculating the poverty line, known as the subsistence minimum income, is now widely used throughout Russia. Although some oblasts, for example Moscow, have departed from this recommended methodology and adopted standards that are twice as high, most oblasts do follow a uniform methodology. There are further alternative approaches, including those published by another government agency, the Center for Economic Analysis and Forecasting (TsEKh) and VCIOM (see Box 2.3). The former includes a "physiological minimum" which could represent a lower bound for poverty, while the latter, subjective, approach results in up to 90 percent of the population being classed as poor.

The subsistence minimum income, as defined by the Ministry of Labor, is the poverty threshold used in this report. It is preferred because it now has wide acceptance and usage among government agencies. The revised MOL methodology is consistent with earlier World Bank recommendations. This poverty line is not an absolute physiological minimum, however, in that significant numbers of Russians are living below 50% of the level. Moreover future revisions will be necessitated by changing relative prices and conditions.

2.12 Different poverty headcounts in Russia emerge from different institutes and agencies. The official poverty line used in this report, based on Ministry of Labor methodology, is consistent with the approach developed under World Bank financed technical assistance in 1992 (see Box 2.1). Some surveys are designed to take into account the subjective nature of poverty by including a question on how much income the recipient thinks is necessary to provide for a minimum existence. Such subjective (sometimes called "Leiden school") poverty measures tend to be an increasing function of the respondent's income, but serve to illustrate the arbitrary nature of setting the poverty line in Russia and in other countries. Sensitivity analysis plays a useful role in poverty assessments, revealing how sensitive or robust our conclusions are, relative to where the poverty line is drawn. Box 2.2 describes the results of recent sensitivity analysis.
Who are the poor?

2.13 The poor in Russia are primarily comprised of families with children (including single-headed households and other "working poor"), the unemployed, families with a disabled family member, and the elderly depending on a single income. The largest group is comprised of families with children, particularly single-parent households and young households. Of poor households, nearly 60 percent had one or more children in summer 1992, and 57 percent of poor households had one or more children in summer 1993. The contribution to poverty in summer 1993 by occupational status of household head is shown in figure 2.2. It indicates that a majority of poor households have a head who is working, so that social benefits directed to the traditionally vulnerable groups, such as the disabled, would miss these "working poor" households.

Children

2.14 The younger and more numerous the children, the more likely the household is to be poor or very poor. Households with children under the age of six were much more likely to be poor than households with children in general or households without children. During summer 1992, approximately 35 percent of households with a child under the age of six were poor, while nearly 46 percent of households with two children under six were poor. Most surveyed households with three or more children under six were poor—nearly 85 percent. These patterns were essentially the same in summer 1993: approximately 47, 59, and 82 percent of households with one, two, and three children under six respectively were poor.

2.15 In Russia, as in many other countries, family size is a strong predictor of a household's poverty status. Smaller households are less likely to be poor than larger households, which have more non-wage earning dependents to support. Census data reveals that average family size in Russia is not large (3.2 in 1989) although there is a significant minority (2.3 million families) which has three or more children. In the summer of 1993, approximately 58 percent of poor families had one or more children, compared to 46 percent for the sample as a whole. Only 40 percent of non-poor families had one or more children.

2.16 During 1993, non-poor families averaged 2.6 members, while poor families had 3.2 members on average, and very poor families slightly larger. Figure 2.1 indicates the risk of poverty among selected groups. Poverty increases with the number of children: among RLMS households, for

<table>
<thead>
<tr>
<th>Table 2.1 Russia: Poverty Measures (percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>RLMS: expenditure-based</td>
</tr>
<tr>
<td>Headcount for Households</td>
</tr>
<tr>
<td>Very Poor</td>
</tr>
<tr>
<td>Depth (P1)</td>
</tr>
<tr>
<td>Severity (P2)</td>
</tr>
<tr>
<td>Headcount for Individuals</td>
</tr>
<tr>
<td>RLMS: income-based</td>
</tr>
<tr>
<td>Headcount for Households</td>
</tr>
<tr>
<td>Headcount for Individuals</td>
</tr>
<tr>
<td>Goskomstat: Income-based headcount*</td>
</tr>
</tbody>
</table>


* Figure in first column is based on Goskomstat data and adjusted for population income. See Volume II: Braithwaite 1994a. Technical Appendix Data are for June not July for both 1992 and 1993. The latter two Goskomstat figures are from the monthly statistical bulletins and correspond to June 1993 and December 1993, respectively.
the period October 1993 to February 1994, approximately 28 percent of those with one child were poor, 36 percent of those with two children, and 52 percent of those with three or more children.

2.17 Since households vary in size and composition, a typical approach is to normalize the household to a standard adult male, which results in a scale that assigns an equivalence of less than one to an adult female, and an even lower equivalence to a child as they tend to consume less goods than adult males. An example of an equivalence scale used in the OECD normalizes the first adult to 1, assigns a weight of 0.7 to additional adults, and a weight of 0.5 to children under age 14. The Ministry of Labor methodology for the official poverty line incorporates differences in nutritional requirements for different ages. However the MOL approach does not capture household economies of scale that may occur as the per capita costs of reaching a certain level of consumption fall, as household size increases. This may be a significant gap, but preliminary results from the RLMS indicate that economies of scale in consumption were not particularly great. Factors underlying this result include the high food share in household expenditure. As housing and utility prices are liberalized (see paragraphs 3.30-3.35), household economies of scale will likely become more significant. At present, however, household per capita income is an acceptable approximation.

2.18 Regression analysis reveals that household size and composition are very significant in determining whether a household was poor. When household composition variables were added to the regression, household size was still significant and positively correlated with poverty. Even controlling for household composition, increasing a household’s size by one person increased its probability of being poor by more than 7 percent in summer 1992, with the marginal probability increasing to nearly 9 percent in summer 1993.

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27/ Foley 1993, p. 30 Volume II.
Children living in single-parent households were more at risk of poverty than children living in nuclear households, with an estimated 5 percent increased chance of poverty. Almost 63 percent of households headed by a woman on maternity leave or involved in full-time child care were poor in summer 1992. It is interesting to note that 44 percent of female respondents in the VCIOM survey described themselves as principal breadwinners in the family.

Box 2.2 The Importance of Where Poverty Line is Drawn

While income dispersion has increased during the transition, households seem to be fairly evenly distributed around the poverty line. In other words, although the distribution has become much more unequal, households in the lower income brackets were not particularly concentrated around the poverty line in summer 1992 or summer 1993. In summer 1993, decreasing the poverty line by 20 percent would reduce the expenditure-based headcount from nearly 32 percent to approximately 24 percent of the population—which is a 24 percent reduction. Decreasing the poverty line by 10 percent would cause the headcount to decrease to 28 percent, a 12 percent decline. Increasing the poverty line by 10 percent and 20 percent would cause the headcount to increase by 13 percent and 24 percent respectively. Such proportionate increases, and decreases, suggest that the distribution is not especially “bunched” around the poverty line in 1993. There does appear to be a slight increase in the concentration of households just above the poverty line over time, as evidenced by an increasing percentage change in the headcount for the 10% and 20% higher poverty lines.

Sensitivity Analysis of Poverty Measures

<table>
<thead>
<tr>
<th>Poverty Measure</th>
<th>Official Poverty Line</th>
<th>10% Higher</th>
<th>20% Higher</th>
</tr>
</thead>
<tbody>
<tr>
<td>Headcount mid-1992</td>
<td>25.2</td>
<td>28.3</td>
<td>31.6</td>
</tr>
<tr>
<td>Headcount mid-1993</td>
<td>31.9</td>
<td>36.1</td>
<td>39.6</td>
</tr>
<tr>
<td>Headcount end-1993</td>
<td>26.8</td>
<td>30.6</td>
<td>34.5</td>
</tr>
<tr>
<td>Headcount mid-1992</td>
<td></td>
<td>10% Lower</td>
<td>20% Lower</td>
</tr>
<tr>
<td>Headcount mid-1993</td>
<td></td>
<td>21.4</td>
<td>17.9</td>
</tr>
<tr>
<td>Headcount end-1993</td>
<td></td>
<td>23.5</td>
<td>20.0</td>
</tr>
</tbody>
</table>

A subjective evaluation of the minimum income needed to keep an individual or family out of poverty leads to very different results about the extent of poverty. The Russian Center for Public Opinion Research (VCIOM) includes a block of questions on this topic as a part of its monthly public opinion surveys. VCIOM conducts the only nationally representative surveys available for Russia (other independent surveys are localized, e.g. in the city of Taganrog). Typically, the VCIOM survey includes at least these two queries: What minimum income does a person need to live normally? What income is necessary to provide for a minimum existence? The level of income estimated by respondents as necessary for a “minimum existence” significantly exceeds the official poverty line. In June 1994, the official per capita poverty line was rub 92,000 while the VCIOM subjective poverty line was rub 194,000. The share of the population under this subjective line leaps to 88 percent.

The subjective poverty measure is not the only measure of poverty presented in the Russian press which exceeds the official poverty line; there are actually several purported “poverty lines” which exceed the official poverty line, due to poor construction (see Volume II: Braithwaite 1994). For example, some so-called “poverty lines” include allowance for

2.20 Young families are at greater risk of poverty than older families. This pattern has also characterized other European economies in transition. Almost two out of five families headed by a student were poor in summer 1992, and nearly 31 percent were poor in summer 1993. Households with heads aged 60 or older comprised nearly 30 percent of non-poor households, but only 23 percent of poor households. Non-poor families had more elderly family members (0.61 on average) than poor households (0.47) or very poor households (0.30).

28/ Milanovic 1995 op cit.
2.21 Although poverty disproportionately affects children, evidence is mixed as to whether children in poor families are at serious risk of malnutrition in Russia.\textsuperscript{29} CARE estimated that the proportion of children with protein-energy malnutrition ranged from 0.3 to 1.3 percent in a sample drawn from three cities (Moscow, St. Petersburg, and Yekaterinburg), and 0.7 to 2.3 percent in the outlying parts of these cities. A major finding of the RLMS in 1993 was a relatively high prevalence of stunting (21 percent in the first year of life), that declined with age (to 8 percent by the fifth year). The prevalence of underweight and wasting was only slightly higher than in a normally nourished population.\textsuperscript{30} The prevalence of malnutrition was higher among children from poor households.

The Unemployed\textsuperscript{31}

2.22 In Russia, as elsewhere in the world, unemployment is commonly associated with poverty. As Chapter I has shown, open unemployment has risen slowly in Russia, relative to the scale of output decline. Still by the end of 1994 there were an estimated three million unemployed, of whom 1.6 million were officially registered as unemployed. About 1.4 million were receiving benefits (see paragraph 1.25). It seems that incentives to register are reduced by low benefit levels and stigma associated with joblessness, as well as the fact that only about one third of vacancies are reported to the FES.\textsuperscript{32} Lack of information and access may also play a role. Large numbers of workers have been subject to hours adjustment since the transition began.

2.23 Not surprisingly, unemployment was strongly linked to poverty in the RLMS. Households headed by an unemployed person were more than twice as likely to be poor—63 percent of households

\textsuperscript{29/} This discussion is based on data on weight for age, which does not differentiate between acute and chronic malnutrition. Height for age measurements can indicate long-term malnutrition (stunting), while weight for height can indicate the impact of an acute interruption in food supply (wasting).

\textsuperscript{30/} Despite technical limitations (such as rounding of the final digits in measurements) and small sample size, the results seem to be fairly robust. See Vella, Volume II.

\textsuperscript{31/} Commander and Yemstov, \textit{Characteristics of Russian Unemployment}, The World Bank, 1995 (see Volume II).

headed by an unemployed person were poor in summer 1993 and as table 2.2 indicates, over 40 percent of households with an unemployed member were poor and almost half of these were very poor. Regression analysis revealed that the number of unemployed persons in a family was significantly and positively correlated with poverty status with an additional unemployed family member increasing the household's probability of being poor by 18.4 percent during summer 1992 and by about 7 percent in summer 1993. For those unemployed who were in receipt of benefits, 50-60 percent had incomes below the poverty line as measured in the 1994 VCIOM surveys, and for the "truly unemployed", 75 and 65 percent respectively in the March and October surveys had incomes below the poverty line.

2.24 Some of the unemployed receive unemployment benefits, which are set as a share of previous earnings which declines over the twelve month period of entitlement. However, in early 1995, 60 percent of unemployment benefit recipients received only the minimum benefit (equivalent to the minimum wage). This is partly due to the fact that benefit levels are based on earnings actually received, not earnings a worker is entitled to receive, thus reducing benefits for those who had been subject to hours adjustment. Many unemployed people join the informal sector. The March 1994 VCIOM survey showed that 18 percent of the registered unemployed were engaged in informal sector activity although men were much more likely to do so than women. Education is positively correlated with holding a secondary job, often in the informal sector. In the same survey, 60 percent of the unemployed who found jobs made the transition to an informal sector job.

2.25 The impact of unemployment on the welfare of affected individuals and households depends on its duration. In many industrial countries, long term unemployment is a serious social and economic problem. To date, the average duration of unemployment has been short in Russia (less than six months). In early 1994, over three-quarters of current unemployment spells were less than 12 months. Over time, however, the average duration of unemployment has increased, suggesting a rising number of long-term unemployed.

2.26 The composition of unemployment has shifted since 1991. Job losses have been concentrated on early retirees and women. During the early stages of the transition, the vast majority of the unemployed were women -- over 80 percent in some oblasts. This was attributed to firms' desire to retain 'core' production workers, as well as a preference for laying off clerical and auxiliary workers first, the vast majority of whom are women. By mid-1993, the share of women among total registered

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**Table 2.2 Risk of Poverty in Households with Selected Characteristics, End of 1993**

<table>
<thead>
<tr>
<th>Type of Household</th>
<th>Poor (Percent)</th>
<th>Very Poor* (Percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>≥ 1 child under 6</td>
<td>40.5</td>
<td>15.8</td>
</tr>
<tr>
<td>≥ 3 children</td>
<td>52.3</td>
<td>23.4</td>
</tr>
<tr>
<td>2 children</td>
<td>36.6</td>
<td>13.6</td>
</tr>
<tr>
<td>Pensioner households</td>
<td>15.9</td>
<td>6.1</td>
</tr>
<tr>
<td>Has unemployed member</td>
<td>40.4</td>
<td>16.4</td>
</tr>
<tr>
<td>Has disabled member</td>
<td>35.5</td>
<td>14.0</td>
</tr>
<tr>
<td>Head works in:**</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Forestry</td>
<td>51.8</td>
<td>26.8</td>
</tr>
<tr>
<td>Agriculture</td>
<td>46.5</td>
<td>18.5</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>32.6</td>
<td>10.2</td>
</tr>
<tr>
<td>Construction</td>
<td>32.0</td>
<td>9.9</td>
</tr>
<tr>
<td>Trade</td>
<td>21.6</td>
<td>6.5</td>
</tr>
<tr>
<td>National Average</td>
<td>26.8</td>
<td>10.4</td>
</tr>
</tbody>
</table>

* Very poor households are those with expenditures less than 50% of the poverty line

** These figures pertain to June-September 1993.

Source: RLMS, Round 4, October 1993 - February 1994
unemployed had dropped to about half. In the VCIOM/World Bank surveys, the likelihood of being
unemployed was strongly associated with education level (negatively), occupation (e.g. clerical workers),
and location (people in medium sized towns and oblast centers had a slightly higher risk of being
unemployed).

2.27 In both rounds of the VCIOM/World Bank survey, layoffs were the major factor causing
unemployment. Movements out of the labor force (and thus out of registered unemployment) appear to
have been large during 1993-94. Approximately 10 percent of unemployed persons surveyed decided to
withdraw from the labor force. Many women and older workers have thus become 'discouraged'.

Disabled

2.28 Households with a disabled head are more likely to be poor. The presence of a handicapped
family member also significantly increased the chance that the family would be poor or very poor. In
1993, the incidence of poverty was 35 percent in households with one or more disabled members (see
table 2.2). Nearly 15 percent of households with a disabled member are very poor. The presence of an
additional disabled family member increased the probability that the household was poor by 10.4 percent
in summer 1992, with this marginal probability increasing to 12.2 percent a year later.

Pensioners

2.29 In 1994 there were 36 million pensioners in Russia; about 5 percent more than in 1991. It
is difficult to generalize about the situation of pensioners during the transition. Obviously, those living
on administered incomes suffer during periods of high inflation, especially when indexation is ad hoc and
infrequent. In particular, Russians on disability and social pensions typically depend on very low benefits
(below the minimum old-age pension). And at times (for example, June to October 1992, and the second
half of 1994), the minimum pension has eroded in real terms more rapidly than average wages. Average
pensions have tended to be better protected (see figure 2.4 and table 2.3) on average. The position of
pensioners has tended to improve, relative to wage-earners (see table 2.3). Further factors which have
mitigated the relative impact of the transition on some pensioners include the earnings of those pensioners
who maintain employment, as well as the wage income of other family members. In early 1994, about
22 percent of all pensioners were earning a wage income, and up to 40 percent of pensioners who retired
early worked.

2.30 A low rate of measured poverty for pensioners emerged from the RLMS in the summer of
1992. Regression analysis also suggests mixed results for RLMS pensioner households. Age of the head
of household is inversely correlated with poverty, meaning that households with older heads are
significantly less likely to be poor. For example, 16 percent of elderly males lived in poor households,
compared to 26 percent of prime-aged (18-59 years) males. Similarly, an analysis of private transfers
showed that age of the household head was positively correlated with the likelihood that the household
was a net donor. This is despite the fact that the summer of 1992 was a period during which pensions
were eroding more rapidly in real terms than average wages.

2.31 There is a clear gender distinction among the elderly, though. In the summer 1992 RLMS,
the poverty rate for prime-aged females and males (18-54) were similar but for elderly females (aged 55
and over) the poverty rate was 44 percent higher than the corresponding rate for elderly males—22.5
percent. At that time, households comprised of two pensioners were less likely to be poor than
households comprised of two incomes and one child.
2.32 Goskomstat data also show that poverty is not as acute a problem for the elderly as for prime-age families. In October 1993, women and men of retirement age had poverty rates of 29.5 and 23.4 percent respectively, and the latter was well below the average reported headcount of 30.6 percent.

2.33 Anecdotal evidence suggests that the plight of pensioners who live alone (approximately one-quarter of the elderly) is likely to be acute. Physical separation also lessens the likelihood of support from the income of other family members, as well as presenting challenges for mobility and the procurement of food and other necessary items. In 1992 surveys of the elderly (aged 70 or more) in Ekaterinburg and Moscow, approximately 40 and 60 percent respectively of respondents reported that their weight had fluctuated by more than 5 kilograms in the preceding three months.33 Rural pensioners who have access to a private plot could bolster their real consumption, but may not be physically able to farm the plot. They are also located farther from medical facilities and other social infrastructure.

Homeless and De-institutionalized Population

2.34 The smallest group in numerical terms could be the worst off in Russia—the homeless and recently institutionalized population. This is not a new phenomenon. Although the Soviet Union in principle provided a universal job guarantee, the de-institutionalized population was at a significant employment (and therefore housing) disadvantage, as all stays in prisons or mental hospitals were recorded in their labor book.

2.35 The housing shortage not only meant a preponderance of intergenerational families and non-related families sharing communal apartments, but also homelessness. In spite of the labor book requirement, it was possible for people to move through informal employment in labor-scarce regions such as the far North, given the shortage of skilled labor there. Anecdotal evidence suggests that off-the-books workers were typically paid less than the normal wage, and had to resort to illegal boarding houses (which evaded the *propiska*). They were not covered by the social welfare system.

2.36 There is anecdotal evidence that homelessness has increased during the transition, as Russian and Western press reports identified the emergency of homeless people and beggars congregating in large cities, particularly around railroad stations. This appears to be connected with changes in laws and law enforcement, although some concerns have also been raised about the impact of housing privatization, since waiting lists have traditionally been very long for public housing. Returning flows of military personnel from abroad will also put pressure on housing waiting lists.

Table 2.3 Average and Minimum Wages and Pensions, and the Subsistence Minimum 1987-95
(as of first of the month)

<table>
<thead>
<tr>
<th>Year</th>
<th>Average Wage</th>
<th>Minimum Wage</th>
<th>Average Pension</th>
<th>Minimum Pension</th>
<th>Avg Minimum Subsistence</th>
<th>Year</th>
<th>Average Wage</th>
<th>Minimum Wage</th>
<th>Average Pension</th>
<th>Minimum Pension</th>
<th>Avg Minimum Subsistence</th>
</tr>
</thead>
<tbody>
<tr>
<td>1987</td>
<td>216</td>
<td>80</td>
<td>80</td>
<td>50</td>
<td>...</td>
<td>1991 Q1</td>
<td>318</td>
<td>80</td>
<td>113</td>
<td>80</td>
<td>...</td>
</tr>
<tr>
<td>1988</td>
<td>235</td>
<td>80</td>
<td>83</td>
<td>50</td>
<td>...</td>
<td>1991 Q2</td>
<td>426</td>
<td>130</td>
<td>...</td>
<td>...</td>
<td>...</td>
</tr>
<tr>
<td>1989</td>
<td>259</td>
<td>80</td>
<td>85</td>
<td>50</td>
<td>...</td>
<td>1991 Q3</td>
<td>554</td>
<td>130</td>
<td>...</td>
<td>...</td>
<td>...</td>
</tr>
<tr>
<td>1990</td>
<td>297</td>
<td>80</td>
<td>92</td>
<td>50</td>
<td>...</td>
<td>1991 Q4</td>
<td>613</td>
<td>180</td>
<td>255</td>
<td>180</td>
<td>520</td>
</tr>
<tr>
<td>1991 Q1</td>
<td>318</td>
<td>80</td>
<td>113</td>
<td>80</td>
<td>...</td>
<td>1992 Jan</td>
<td>1,438</td>
<td>342</td>
<td>419</td>
<td>342</td>
<td>635</td>
</tr>
<tr>
<td>1992 Feb</td>
<td>2,004</td>
<td>342</td>
<td>...</td>
<td>342</td>
<td>774</td>
<td>1992 Mar</td>
<td>2,726</td>
<td>342</td>
<td>...</td>
<td>342</td>
<td>1,031</td>
</tr>
<tr>
<td>1992 Apr</td>
<td>3,052</td>
<td>342</td>
<td>436</td>
<td>342</td>
<td>1,226</td>
<td>1992 May</td>
<td>3,673</td>
<td>900</td>
<td>...</td>
<td>900</td>
<td>1,405</td>
</tr>
<tr>
<td>1992 Jun</td>
<td>5,067</td>
<td>900</td>
<td>...</td>
<td>900</td>
<td>1,639</td>
<td>1992 July</td>
<td>5,452</td>
<td>900</td>
<td>1,303</td>
<td>900</td>
<td>1,779</td>
</tr>
<tr>
<td>1992 Aug</td>
<td>5,876</td>
<td>900</td>
<td>...</td>
<td>900</td>
<td>1,939</td>
<td>1992 Sep</td>
<td>7,270</td>
<td>900</td>
<td>...</td>
<td>900</td>
<td>2,163</td>
</tr>
<tr>
<td>1992 Dec</td>
<td>16,071</td>
<td>900</td>
<td>...</td>
<td>2,250</td>
<td>4,282</td>
<td>1993 Jan</td>
<td>15,341</td>
<td>2,250</td>
<td>3,468</td>
<td>2,250</td>
<td>5,567</td>
</tr>
<tr>
<td>1993 Feb</td>
<td>19,069</td>
<td>2,250</td>
<td>...</td>
<td>4,275</td>
<td>6,753</td>
<td>1993 Mar</td>
<td>23,559</td>
<td>2,250</td>
<td>...</td>
<td>4,275</td>
<td>8,069</td>
</tr>
<tr>
<td>1993 Apr</td>
<td>30,562</td>
<td>4,275</td>
<td>7,387</td>
<td>8,122</td>
<td>9,873</td>
<td>1993 May</td>
<td>37,505</td>
<td>4,275</td>
<td>...</td>
<td>8,122</td>
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</tr>
<tr>
<td>1993 Jun</td>
<td>47,371</td>
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<td>...</td>
<td>8,122</td>
<td>16,527</td>
<td>1993 July</td>
<td>55,995</td>
<td>7,740</td>
<td>14,737</td>
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</tr>
<tr>
<td>1993 Aug</td>
<td>65,408</td>
<td>7,740</td>
<td>...</td>
<td>14,620</td>
<td>24,764</td>
<td>1993 Sep</td>
<td>80,900</td>
<td>7,740</td>
<td>27,701</td>
<td>14,620</td>
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<td>1993 Oct</td>
<td>93,900</td>
<td>7,740</td>
<td>27,701</td>
<td>14,620</td>
<td>37,908</td>
<td>1993 Nov</td>
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<td>...</td>
<td>26,320</td>
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<tr>
<td>1993 Dec</td>
<td>141,218</td>
<td>14,620</td>
<td>...</td>
<td>26,320</td>
<td>42,300</td>
<td>1994 Jan</td>
<td>136,000</td>
<td>14,620</td>
<td>41,800</td>
<td>26,320</td>
<td>51,360</td>
</tr>
<tr>
<td>1994 Feb</td>
<td>144,700</td>
<td>14,620</td>
<td>...</td>
<td>34,320</td>
<td>54,759</td>
<td>1994 Mar</td>
<td>164,833</td>
<td>14,620</td>
<td>...</td>
<td>34,320</td>
<td>60,388</td>
</tr>
<tr>
<td>1994 Apr</td>
<td>171,450</td>
<td>14,620</td>
<td>...</td>
<td>34,320</td>
<td>66,536</td>
<td>1994 May</td>
<td>183,500</td>
<td>14,620</td>
<td>...</td>
<td>38,700</td>
<td>77,800</td>
</tr>
<tr>
<td>1994 Jun</td>
<td>207,400</td>
<td>14,620</td>
<td>...</td>
<td>38,700</td>
<td>84,100</td>
<td>1994 July</td>
<td>221,000</td>
<td>20,500</td>
<td>75,700</td>
<td>38,700</td>
<td>91,800</td>
</tr>
<tr>
<td>1994 Aug</td>
<td>232,800</td>
<td>20,500</td>
<td>...</td>
<td>41,600</td>
<td>90,000</td>
<td>1994 Sep</td>
<td>253,200</td>
<td>20,500</td>
<td>...</td>
<td>41,600</td>
<td>92,300</td>
</tr>
<tr>
<td>1994 Oct</td>
<td>265,000</td>
<td>20,500</td>
<td>90,000</td>
<td>41,600</td>
<td>105,300</td>
<td>1994 Nov</td>
<td>281,600</td>
<td>20,500</td>
<td>113,200</td>
<td>41,600</td>
<td>121,500</td>
</tr>
<tr>
<td>1994 Dec</td>
<td>355,000</td>
<td>20,500</td>
<td>113,200</td>
<td>41,600</td>
<td>145,400</td>
<td>1995 Jan</td>
<td>320,000</td>
<td>20,500</td>
<td>...</td>
<td>...</td>
<td>...</td>
</tr>
</tbody>
</table>

Sources: Ministry of Labor, Goskomstat bulletins, and IMF, Russian Federation Economic Reviews, No.8, 1993, p.91

**"** Deflated using retail price index for 1987-1991, urban consumer price index for 1992, and expanded CPI for 1993 average annual retail price inflation in 1987-1989 was proxied by data from retail prices in state trade which includes state trade in rural area "cooperative" trade, but excludes collective farm markets. Average annual inflation in 1990 assumed to equal 10 percent.

**v** Excludes extra compensation made to all pensioners in some months of 1992.

**v** Average subsistence minimum, in rubles per month per capita, is based on Ministry of Labor methodology which distinguishes among working age adults, pensioners, and children.

**w** For average pension, the figures for year as a whole are reported in Q1 line. Q4 nominal value is an estimate.

**x** Applicable to all sectors only from July 1, 1992

**y** As of April 15, 1993
Refugees and Migrants

2.37 The disintegration of the former Soviet Union and armed conflicts in several regions have increased migration of people with Russian citizenship. Perhaps as many as 3 million people have returned to Russia. This inflow has burdened local authorities and exacerbated housing shortages, especially in the larger cities of European Russia. The situation of refugees and migrants is often difficult, although little can be gleaned from household surveys. Not all migrants flee armed conflicts; there is clearly some portion of migrants who are drawn by better job opportunities in Russia than in their countries of origin (see Box 2.3). There is a pronounced trend of internal migration towards European Russia, away from the Far East and other areas with difficult climatic and living conditions.

Box 2.3: Migration During the Transition

During the transition, Russia faces the additional problem of absorbing millions of ethnic Russian migrants from other former Soviet republics. The causes of migration vary, from escaping armed conflict to perceived discrimination by some of the newly independent governments. This challenge has implications not only for the individual migrants, but also for political and social stability in Russia itself and the republics of origin.

There are no reliable accounts of the number of Russian migrants -- according to the Federal Migration Service, only about 10 percent register. Best estimates suggest that, by mid-1994, there were up to two million Russian returnees, plus about 500,000 non-Russian refugees from conflict zones in the FSU, and 600,000 refugees from the far abroad. Projections for the rest of the decade are about half to one million annually.

Russian returnees seem to be concentrated in southern and central Russia. In some southern oblasts, registered returnees amount to 3 percent of the population. These individuals and their families have immediate needs -- for assistance and housing, for example -- which impose additional burdens on local authorities. Despite commonality of language and religion, Russian migrants reportedly have problems integrating into local communities.

Overall, however, it appears that migrants are quite well-placed to cope with the transition. They tend to be better educated than the local population, typically younger, and thus more dynamic.

Why are people poor?

2.38 During the Soviet period, poverty was not unknown. Although, up until the late 1980s, data was scarce and discussion discouraged, it was clear that certain groups of people did not fare well under the old system. Hidden poverty under the old system makes comparisons to the more open poverty of the transition difficult, but it is important to emphasize that the transition did not "create" poverty in Russia. Nonetheless the command economy did administer a system of wages and benefits, full employment and prices for goods and services that ensured a minimum standard of living for most Russian citizens.

2.39 In the 1980s, more than one-tenth of the Russian population had per capita income below a poverty line based on the minimum consumption basket. This "minimum consumption basket" (MCB) was not a useful absolute measure of poverty, but provided for overly generous consumption of food and non-food items. At the same time, it provided a standard that can be used to qualitatively characterize
the disadvantaged groups in Soviet society. It is also the reference standard for available official information from that period.\(^{34}\)

2.40 Families with children comprised at least half of the poor in Soviet Russia. At particular risk were families with more than three children, children of single parents (particularly of single mothers in poorly-paid occupations), and children in dual-parent families where one parent was temporarily not working (often on maternity leave). Soviet wage policy meant that a family typically required two income-earners to be able to meet the per capita MCB standards for socially acceptable consumption.

2.41 Pensioners living alone or lacking another source of income comprised the second-largest group of the poor, although being a pensioner per se did not mean that the individual or family was poor.\(^{35}\) Mozhina (1992) estimated that pensioners comprised about one-fifth of the poor, but this may be due to their under-representation in the FBS. In Taganrog, a medium sized industrial city in European Russia, pensioners were the bulk (46 percent) of the poor in 1978. A third type of poor family was comprised of wage-earners in poorly-paid professions (overwhelmingly women in feminized branches of the economy).\(^{36}\) In the Soviet Union, female labor force participation, high in 1960, grew over the next two decades but the ratio of male to female earnings remained constant, at around 70 percent.\(^{37}\) Finally, a numerically small group--the homeless and the recently released institutionalized population--probably comprised the core of the ultra-poor under the Soviet system.

2.42 Education is a traditional avenue for escaping from poverty, since completion of higher education typically results in higher-paying jobs. In summer 1992, graduation from college or university was found to reduce the likelihood of being poor by 9.2 percent. In summer 1993, relative to those with university education, households whose head had secondary or vocational education were 12 to 15 percent more likely to be poor, while those with unfinished secondary or primary education were 20 to 22 percent more likely to be poor. In Russia, literacy is virtually universal, and to some extent, college education correlated with higher-paying jobs. During the Soviet period, however, wage policy was directed towards raising the income of blue-collar workers in priority industrial sectors and reducing earnings differentials. Certain branches of the economy typically required higher education, but salaries were low--notably in primary education and health care.

2.43 The transition has been associated with a dramatic decline in living standards for some Russians, while others have evidently been able to take advantage of the changes and improve their situation. The increasing incidence and severity of poverty is associated with the significant fall in real money income and output since the transition began, alongside a significant widening in the distribution of income. In contemporary Russia, we find the existence of both "old" and "new" poor. Adjustment in the labor market has shown up in declines in total employment and increasing numbers of people on

\(^{34}\) However poverty headcounts from the Soviet period cannot be directly compared to current estimates--indeed up to three-quarters of the population may now fall below the MCB standard.

\(^{35}\) A peculiarity of the Soviet pension system, and the 1990 Russian law, was that both old-age and disability pensioners were able to draw a salary without a reduction of pension benefits.

\(^{36}\) Families with children and low-income families comprise the "working poor"--those with limited income earning opportunities.

short-time work and involuntary leave. And real wages of the poor have been eroded, as wage arrears have grown significantly and the wage distribution has widened.

2.44 Wage adjustment has not been uniform across sectors or regions. Some sectors have been particularly hard-hit by real wage declines, in particular the science and budget spheres, while other sectors have been relatively less affected. Regional data reflect a positive correlation between profit and wage changes in 1992-1993. The wage distribution is evidently less equal in firms whose size and sectoral characteristics—primarily small trade firms—more closely correspond to semi-private and private sectors. This is consistent with Eastern European experience and suggests that the wage distribution is likely to widen further as privatization and restructuring proceeds. Nonetheless, major departures from the pre-transition structure of wage relativities have been limited to date. It appears that institutional features in wage setting have tended to dominate the redistributive effects of high inflation and decentralization of wage decisions. Relative wages disaggregated by skill have also been fairly stable. The RLMS clearly demonstrates the legacy of Soviet wage differentials, with certain occupational classes strongly correlated with a higher or lower likelihood of poverty (see figure 2.3). Household heads working in forestry or agriculture, for example, had poverty headcounts markedly above average. Budget sphere workers, whose wages are based upon multiples of the minimum wage, have tended to experience declines in relative wages. In early 1995, an estimated 15 million budget sphere workers were receiving less than the subsistence minimum.

2.45 A job in Russia during the transition has been no guarantee that wages would actually be received. Wage arrears have increased significantly, particularly in 1994. According to VCIOM surveys, only about 40 percent of workers were being paid fully and on time in 1993 and 1994. Delays in wage payment are particularly onerous for "near poor" households, and can mean that working households fall into poverty.

2.46 Price liberalization and inflation have been especially difficult for those living on

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administered incomes, since the 1991 law specifying "automatic" quarterly indexation was not implemented. Instead, pensions were increased on an ad hoc basis. Real average pensions declined relatively more than average wages and minimum pensions in the first quarter of 1992, and fluctuated until mid-1993 around half the December 1992 level. Real average pensions recovered somewhat through the third quarter of 1994, then fell sharply again at the end of the year (see figure 2.4). Again, however, as with the story on wages, trends in the average level may not provide much insight into the lower end of the distribution. Indeed minimum pensions have not recovered as much as the average (Figure 2.4).

Flows into and out of Poverty

2.47 The RLMS panel of households allows the dynamic nature of poverty to be investigated. Table 2.4 summarizes the flows into and out of poverty. The poor do not appear to be comprised of a stagnant pool of households. Rather, a significant percentage of households exit as well as enter poverty. In fact, nearly half of the very poor households in summer 1992 are not considered poor one year later while one-quarter of non-poor households become poor during the period. As shown in table 2.4, between the middle and end of 1993, over one-third of very poor and one-half of poor households exited poverty, while 15 percent of non-poor households became poor.

2.48 Moreover, it is significant that only 7.3% of households in the RLMS panel remained poor between summer 1992 and the end of 1993, with only 1.0% considered very poor throughout the period. About 49% of households did not have a spell of poverty at any time during the survey. In other words, over half of all households were in poverty at one time during the period July 1992 through February 1994 with a small pocket of chronically poor.

2.49 Given that the sensitivity analysis does not show a disproportionate concentration of households around the poverty line, the large flows into and out of poverty imply that most households which change poverty status have experienced a significant shock, positive or negative, greatly impacting their welfare. For example, layoffs, involuntary leave, and wage arrears all contribute to households becoming poor. On the other hand, successful marketing of home production, profitable entrepreneurial ventures, and finding a well-paid job contribute to households exiting poverty.

39/ Administered incomes are those set by bureaucratic decision, such as minimum pensions and unemployment benefits, and the minimum wage.

40/ These figures are not shown in table 2.4. They were calculated for the poverty transitions over the year long period between summer 1992 and summer 1993 interviews.

41/ Multivariate analysis will be conducted to more precisely identify the determinants of transitions into and out of poverty.
**Table 2.4 Transition Probabilities for Changes in Poverty Status**

<table>
<thead>
<tr>
<th>1993 Poverty Status</th>
<th>1994</th>
<th>Non-Poor</th>
<th>Poor, but not Very Poor</th>
<th>Very Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Non-Poor</td>
<td>0.848</td>
<td>0.110</td>
<td>0.042</td>
<td></td>
</tr>
<tr>
<td>2 Poor, but not Very Poor</td>
<td>0.581</td>
<td>0.283</td>
<td>0.136</td>
<td></td>
</tr>
<tr>
<td>3 Very Poor</td>
<td>0.368</td>
<td>0.286</td>
<td>0.345</td>
<td></td>
</tr>
</tbody>
</table>

Original Stocks: \( N_1 = 3,848 \); \( N_2 = 1,110 \); \( N_3 = 660 \)

* The transition probabilities refer to the period between round 3 (June-September 1993) and round 4 (October 1993-February 1994) interviews.

**Recent Trends in Poverty**

2.50 Unfortunately, the most recent representative household data available to the World Bank date to February 1994. What has happened to poverty in Russia since then? To answer this question, we must use official information carefully. There are two measures of living standards that are commonly considered: real GDP growth and real wages. At the same time, averages may be meaningless if one is interested in poverty, hence the relevance of trends in income distribution. According to official information, real GDP declined by 15 percent in 1994 over 1993 and the real average wage declined by 17 percent in the year to December 1994. On the other hand, however, real disposable income was reported to increase by 16 percent in 1994. Worsening trends in income distribution are analyzed below (paragraphs 2.56-2.59).

2.51 The story of a continuing decline in real GDP and real wages is consistent with other official information. For example, using official nominal wages and the official CPI, indices of real average and minimum wages pensions were calculated in Table 2.3. In July 1993, the index number for real average wages (based on fourth quarter 1991) was 59, and deteriorated further to 51 in December 1994 (a decline of approximately 13 percent). For the same period, the real minimum wage index declined precipitously from 41 to 15; the real minimum pension declined from 43 to 30, but real average pensions increased slightly from 55 to 58. The recent trend for real average wages in early 1995 shows a distinct decline of the order of 25 percent from a year earlier.

2.52 Since pensioners on average are not at special risk for poverty and the poor are primarily working poor with children, the declining trends in real GDP, real average wage, real minimum wage, and unemployment benefit levels suggest that poverty could not have improved much in 1994 over its level in late 1993/early 1994. At that time, 27 percent of households were below the poverty line.

2.53 It is important also to take into account a growing group of new poor: the unemployed. Rates of unemployment have continued to rise steadily, if slower than expected, during the transition. By the end of 1994, an estimated 5 percent of the labor force were unemployed. The RLMS revealed that the incidence of poverty among the unemployed and marginally employed is very high -- rising to about 56 percent for households affected by open unemployment.
2.54 Official data have not been able to capture the growing significance of informal sector activity. Bank staff estimates suggests that such activity could add another 10-15 percentage points to GDP. According to the VCIOM surveys, up to 20 percent of the working age population has a second job, for example. However, as would be expected, the informal sector covers a wide range of activities and levels of remuneration. Recent evidence confirms that there is a strong positive link between such activity and education as well as location in Moscow or St Petersburg. Moreover, it is clear that such activity is unlikely to lift poor households above the threshold. For only 7 percent of secondary jobs in the VCIOM survey did this source of income represent more than half of household income. Among unemployed benefit recipients who are working informally, this largely comprised of poorly remunerated jobs, mostly located in services, so that the majority were still receiving incomes below the poverty line.\textsuperscript{42}

\textbf{Are Disparities Growing?}

2.55 For many Russians, the transition to a market economy is associated with growing disparities. This is not to say that inequality did not exist in the Soviet Union. However existing disparities have become overt and likely increased since 1991. This section explores three major dimensions of disparities -- income, region, and gender.

\textbf{Income Distribution}

2.56 The disruption of the old system with its controlled wages and prices has clearly led to greater differentiation in income-earning opportunities. All measures of income dispersion in Russia suggest that the distribution of money income has become more unequal during the transition. Yet differentiation in well being had always existed in Russia, partly because money was not a good measure of welfare throughout most of the Soviet period. By giving money meaning (that is, a command over goods and services), the market system has made more transparent the welfare distinctions between people and social groups which characterized the Soviet period.

\textsuperscript{42} Commander and Yemtsov, \textit{Characteristics of the Unemployed}, 1995, volume II.
2.57 The second economy, perquisites, and pervasive shortages during the Soviet period render the use of money income to characterize and compare social welfare before the transition somewhat problematic. For example, certain low-paid occupations had considerable scope for illegal side earnings, such as the store clerk who could set aside choice merchandise, or the fel’dsher (a type of medical attendant) who accepted a tip to change bed linen in a hospital. These occupational groups were under-represented in official data because they worked in occupations which were less likely to be selected for inclusion in the FBS sample, and even if selected, they often refused to participate. The top end of the money income distribution was distorted by the system of perquisites for the elite, including the network of special stores and supplemental payments of hard-currency coupons. They also had access to higher quality education, medical care and recreational facilities. The size of the elite is difficult to quantify; estimates ranged from 0.3 to 1.5 percent of the Soviet urban population.

2.58 In any case, information about income distribution during the Russian transition is difficult to interpret. Measurements are typically based either directly or indirectly on Goskomstat data, which have some well-known drawbacks. In particular, the exclusion of both the upper and lower income groups from the FBS sample means that the inequality in the underlying population distribution of money income is understated. Unfortunately, some alternative estimates not drawn from Goskomstat data (such as reported by trade unions) may exaggerate the extent of inequality, based on samples which are too small for accurate inference. Another complicating factor follows the shift from a regime characterized by shortages. Searching and queuing created deadweight utility losses—although such losses were not evenly distributed. Consumers on low incomes may prefer some sort of rationing in that their opportunity costs of waiting are low.

2.59 Most sources reflect increased inequality since 1992, though to differing extents. The degree of measured income inequality in the RLMS is higher than Goskomstat data, with a Gini coefficient of 0.43 during summer 1992, rising to 0.48 by summer 1993 and 0.49 by the end of 1993. Gini coefficients calculated from Goskomstat data were 0.35 in December 1992 and 0.40 in October 1993. However, Gini coefficients calculated from representative samples conducted by VCIOM corroborated the RLMS result. In the VCIOM sample, the Gini coefficient for per capita income was 0.43 in April 1993 and increased to 0.46 in March 1994. Since all these measures are based on different income data strict comparability is limited, but they serve to illustrate the trend of increasing inequality. Countries with Gini coefficients in the same range as contemporary Russia include Argentina (0.46), The Philippines (0.46), and Turkey (about 0.44).
Regional Disparities

2.60 During the Soviet period there were significant differentials in income distribution and poverty across the constituent republics. Although some of these newly independent countries are small and relatively homogenous, Russia is not. There are large differences across Russia’s 89 oblasts in terms of prices, incomes, and poverty rates (see maps in Annex 1).

2.61 For virtually every macroeconomic or demographic indicator, there is a high level of regional differentiation that has increased during the transition period. Regional price information allows a comparison of real per capita income by oblast in Russia in 1992-94. Nominal per capita income by oblast (published by TsEK) was deflated for 11 areas (plus Moscow city), and the resulting real per capita incomes were ranked. The Tyumen’ area of West Siberia had the highest real per capita income in March 1992, and second highest after Magadan, in September 1994, reflecting the very rapid wage increases for oil-sector workers. The dual impact of liberalized prices and enterprise autonomy in wage setting resulted in a dispersion of the oblasts in Siberia and the Far East across the ranking of real per capita income, which previously had been clustered towards the top of the nominal per capita distribution. The Northern Caucasus areas comprise the absolute poorest regions in Russia, with the erosion of reported real income in the Republic of Dagestan and Kabardino-Balkarskaya reaching alarming proportions.

2.62 There was a dramatic increase in regional differentiation of welfare indicators in 1992-94. The ratio of real per capita income between the top and bottom increased from 8.36 to 42. By September 1994, the central regions of Russia (with the exception of Moscow city, Yaroslavl, and Tul’skaya) and the North Caucasus comprised the bottom third of the real per capita income rankings (along with the Omsk region in West Siberia, Novosibirskaya, Saratovskaya and Mordovskaya). These were among the poorer regions in March 1992 as well.

2.63 Regional disparities in life expectancy, mortality, and infant mortality have increased in 1991-93. The coefficient of variation for life expectancy increased from 2.71 in 1992 to 3.88 in 1993, while the coefficient of variation for infant mortality increased from 18.37 in 1991 to 20.42 in 1993. While infant mortality rates worsened significantly overall, in several regions there was some improvement in the period 1990-93 (e.g., Northwest) whereas there was serious deterioration elsewhere (e.g., the Urals).

Rural-Urban Differentials

2.64 Approximately three in four Russians live in urban areas. The relative incidence of poverty in rural and urban areas appeared to change between 1992 and 1993. At the later date, 39 percent of rural households reported expenditures below the poverty line compared to 29 percent of urban households. Other European economies in transition appear to have witnessed a similar trend: that city residents have done better than rural residents. In ten countries studies in Milanovic (1995) the relative position of farmers worsened (in eight) or remained unchanged (in two). This is associated with the shift in labor demand toward white collar skills, and the dislocation associated with farm restructuring.

2.65 Assessing urban-rural differentiation in Russia requires weighing the relative importance of access to a private plot of land versus the more limited access to infrastructure and services in rural areas. The expenditure-based measure of poverty does include the reported value of home production although this may be undervalued. Access to a private plot was found to be strongly correlated with a reduced


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risk of poverty in the RLMS (by 7.3 percent), and private plots traditionally provided the bulk of food consumption for rural families. Therefore, the reported headcounts by type of residence should be treated with caution.

2.66 The apparent rising incidence of poverty in rural areas is a cause for concern. While the causes underlying this trend are not clear, the scaling down of heavy subsidies to agriculture and the fact that soviet style collective and state farms were expected to fulfill both productive and local government functions appear to be contributing factors. Figure 2.3 reveals that the incidence of poverty among households whose head works in agriculture or forestry is significantly higher than average, at about 52 and 46 percent respectively. At the same time, there is significant hidden unemployment on the farms: a survey in Orel oblast found that 10-15 percent of people listed as employed did not in fact work, nor did they receive wages. Another hypothesis is that price liberalization has eliminated the rents that used to accrue to farm households which sold their produce on the black market; in other words, the terms of trade have turned in favor of urban residents. Finally, data from case study research shows that access to social services has declined significantly for farm employees and even more substantially for private farmers. There are reports of a widespread collapse of social services in rural areas. The issue of rural poverty requires further investigation and analysis.

2.67 Due to technical limitations, data from the RLMS tend to over-estimate malnutrition, stunting, and wasting. However, even within these limitations, there is a marked disparity between urban and rural areas regarding indicators of chronic versus acute malnutrition. Urban children are more likely to experience wasting (low weight for age) than rural children, perhaps indicating that during 1992-93, rural children had relatively better access to food. However, the rate of stunting (low height for age) was much higher among rural children than urban children. The relatively higher rate of stunting in rural children could indicate the long-term effects of lower access to medical care, poorer infrastructure, especially water quality and sanitation, and chronic problems stemming from inadequate nutrition over a longer period.

Gender

2.68 Gender was traditionally correlated with poverty and this has not changed dramatically during transition. Some women are especially vulnerable to poverty because of limited access to transfer payments, wages and informal sector earnings. Women comprise about two-thirds of pensioners, largely because of the legacy of World War II on those male cohorts, and higher male mortality rates. On the other hand, women also become entitled to pensions at a younger age than men. Pensioners living alone, nearly all of whom are women, are especially vulnerable to poverty. Until early 1994 the vast bulk of the registered unemployed were women (up to 70 percent in 1992), although as aggregate unemployment has increased the share of women has fallen to about half. Among the pool of unemployed, women are more likely than men to be highly skilled. Women comprised about the same share of the poor in summer 1993 as their overall share in the sample. Single-parent female-headed households were significantly more likely to be poor than other types of households with children. Regression analysis demonstrated that female-headed households were significantly more likely to be poor. A probit analysis of the RLMS data suggested that having a female head of household increased the probability of poverty by 5.4 percent.


Women’s work has traditionally been associated with low pay, in Russia as elsewhere in the world. The RLMS suggests that in the summer of 1992, women earned approximately 71 percent of the hourly wage that men did, and this is quite close to the historical trend. This is partially offset by earlier pension eligibility. Approximately half of the gender wage gap is due to the segregation of men and women into different occupational groups, and gender segregation within occupational groups. Occupational segregation by gender is more severe in Russia than in Western countries, with men heavily concentrated in more senior white collar and skilled blue collar occupations. Skilled blue collar jobs still command a large wage premium which benefits men. On the other hand, women may benefit from the expansion of services during the transition, a traditionally "feminized" sector of the economy, that is associated with the shift to a market economy. Box 4.1 suggests ways in which policy makers can help enable women to take advantage of emerging opportunities.

One reason for the earnings differential between men and women in Russia is that women have less time available to devote to career advancement or working over-time, due to the unequal division of labor in the home. Among the RLMS sample population with children under 14 years, women in very poor households reported spending 37 and 33 hours in the previous week caring for children and doing housework respectively. They worked in a paid job for 13 hours on average. The comparable figures for men in very poor households were 14, 6 and 25 hours, respectively. Regardless of poverty status, women spent about 33 hours a week doing housework (more than four times as much as men), and about twice as much time caring for children. Women in Russia face a double burden -- they are expected both to seek paid work and to be solely responsible for home upkeep and child-care.

Box 2.4: Russian Women and Agrarian Reform

Farm restructuring and land reform have affected millions of rural residents in the Russian Federation. Recent evidence suggests that women may have been more adversely affected by these changes.

Under the Soviet system, rural women were largely concentrated in a handful of occupations, including livestock, manual field labor, bookkeeping and social services. Although these jobs were typically relatively poorly paid, the livestock sector as well as farm social services were traditionally heavily subsidized by the state. Second, women, to a greater extent than men, depend on the delivery of services at the farm enterprise level, in particular, child care. Third, women comprise the vast majority of elderly in rural areas.

The impact of the transition on women has recently been evaluated by the World Bank using case studies in Orel oblast, a black soil region about 300 km south of Moscow. Most farms there had been reformed in the sense that everybody who lived and worked on the farm was given a land share; women comprised the majority -- 53 percent of landshare holders in Russia. The individual could effectively either establish joint ownership rights in the farm enterprise (e.g., joint stock company form), or claim a specific piece of land. The former option was generally preferred. The capital assets of the farm were distributed using a formula based on the individual's wage rate and years of employment, thereby tending to give men a larger share. The vast majority of private farms in Orel are registered in males' names, though in most cases their spouse worked the farm.

There is extensive hidden unemployment on the restructured farms. In Orel, 10-15 percent of listed employees were on long term unpaid leave, of whom 70 percent were women. Yet women appear more likely to remain on the farm, even unpaid, for several reasons, including their dependence on farm social services; their predominance in the (now) unprofitable dairy sector and less valuable property shares; and their higher preference for a regular rather than self-employment.

Access to social services has declined significantly for farm employees, and even more so for private farmers. Women with young children, and pensioners who had depended on income supplements from their former employer, have been especially adversely affected. In some cases, farm kindergartens have closed down, in others, the farm has sought to transfer the facilities to the local authorities.

Greater clarity on farm restructuring is important, for men and women, in order to establish the legal rights of property shareholders and managers. This would include, for example, policies that clarify and uphold land shareholders' rights as owners.


Demographic and Health Trends

2.71 Recent demographic developments in Russia have no parallels anywhere else in the world. The fertility decline has been extraordinarily rapid, and has resulted in very low fertility rates. Recent changes in mortality rates have also been striking, especially for men. Male life expectancy at birth has dropped from 63.8 years in 1990 to 58.9 in 1993 -- the biggest increases in mortality occurring in 1993. While the figures for females are less dramatic, there has still been a significant worsening. Many age-specific death rates rose by 50 percent between 1990 and 1993.

2.72 Infant mortality, always a significant problem in the Soviet Union, increased during the transition from an official level of 17.4 per 1000 in 1990 to 19.9 in 1994. However, due to methodological differences, official infant mortality statistics have tended to understate actual infant mortality as measured by the World Health Organization due to the Soviet definition of a "live birth".52

2.73 There are serious concerns surrounding health status in Russia -- although in general these appear to be attributable to systemic problems, falling incomes and aggravated risk factors such as stress,

52/ Although the official definition has been revised, not all local authorities have consistently adopted the new definition. See Kingkade W. Ward, Soviet Infant Mortality in International Perspective, US Bureau of the Census, mimeo, April 1989.
rather than the deterioration of health services. Life expectancy has been stagnant for over twenty years - and the differences between Russia and Europe are due to coronary heart disease and "external" causes, such as stroke and trauma. Between the 1960s and early 1980s age-specific death rates increased, particularly for men. For men in the late 1970s and for women in the early 1980s, average life expectancy declined. These declines appeared to have been associated with lifestyle factors such as alcohol consumption, diet and smoking.

2.74 The reasons underlying recent rises in mortality reflect that circulatory diseases (heart diseases and strokes), are the most significant cause of death, and of rising mortality, and are very high by international standards -- twice the level in the US and three times that in Japan. At the same time, the largest proportionate rise was trauma (accidents, homicide, etc.) that are now four times Western levels. In general, rural residents experience worse mortality levels, including higher levels of heart disease and trauma.

2.75 Links between poverty and health status were explored using the RLMS. Poor individuals had a lower level of hypertension and obesity than was present in the overall sample. When asked to evaluate their health, poor people reported more frequently that their health was satisfactory and poor people visited medical institutions less frequently. However, the poor were more frequently hospitalized and they stayed in hospitals longer than the non-poor, suggesting that the poor might report health problems less frequently than the non-poor (perhaps due to more pressing problems, e.g. financial stress). Certainly, lack of recognition of health problems may mean that where the poor finally do seek care, their situation is more severe than the non-poor (as reflected in longer hospital stays). The poor spent more time traveling to reach health institutions, and received fewer medical tests and procedures, than did the non-poor.

2.76 Undernutrition does not appear to be a problem for the adult population in Russia. The prevalence of undernutrition was around 2 percent for the 18-59 year old age group, although significantly higher (6 percent) for people under 29 years. Obesity, however, is high overall at around 16 percent, and represents a risk factor for cardiovascular diseases. Obesity was found to be more frequent among women and in rural areas, and less common among the poor.53 The RLMS allowed study of the risk factors underlying certain health problems. Of the group who had normal body mass index in 1992, about 2 percent became undernourished, 92 remained normally nourished and 6 percent became obese in 1993. The likelihood of becoming undernourished was higher among the very poor (2.4 percent) relative to the non-poor (1.2 percent). At the same time, however, even the very poor were more likely to become obese, than undernourished, over the period.

53 Body mass index (weight/height squared) was used to assess nutritional status: below 18.5 indicated undernutrition, 18.5-30 normal nutrition, and 30 and above for obesity.
CHAPTER 3

THE SYSTEM OF SOCIAL SUPPORT

3.1 Income from work is the primary form of support for the vast majority of people in Russia. However, the system of social support, both formal and informal, does play a critical role. The formal system comprises several social insurance and assistance programs which are directed to certain population groups. Informal support ranges from private plots that allow people to engage in home production to the help that people receive from friends and relatives outside the household.

3.2 This chapter explores the various types of social support, and their interaction. We look at the major cash benefit programs—pensions, unemployment benefits, family allowances and social assistance—as well as household subsidies for housing and utilities, and health care. Analysis reveals the extent of leakages of income transfers to the non-poor, and gaps in the current net. About three in ten very poor households do not currently receive any public transfers. There is an evident need to rethink social assistance programs. Ways to improve the effectiveness of social assistance for the poor, old-age and disability pensions, and unemployment benefits are suggested in the final chapter.

Overview of Programs and Expenditures

3.3 There have been significant changes to social programs and expenditures since Russia embarked upon the transition from a command economy, including increased decentralization of responsibility for services and programs and the introduction of unemployment benefits. Perhaps the most striking feature of the current system of social protection is the fragmentation of funding sources and responsibilities. Four federal extrabudgetary funds, several ministries and lower levels of government each play some role. In 1994 social protection expenditures represented roughly 9% of GDP. Table 3.1 highlights the main programs, source of financing, and basis for benefit calculation.

3.4 Some cash benefits have hovered around very low levels. Unemployment benefits averaged about 15 percent of the average wage throughout 1994 and family allowances varied from 1 to 8 percent of the average wage. For many individuals and households in poverty and on minimum benefits, support has not been sufficient to lift their household incomes over the level of minimum subsistence.

3.5 Local authorities have received responsibility for the delivery and financing for most public services. In 1994, the share of total public expenditure on education and health from subnational sources amounted to 78 and 89 percent respectively. Most social assistance is locally financed. Considerable variation in economic and fiscal bases across the country lead to large differences in per capita social expenditures. Prior to the breakup of the Soviet Union, social spending in some oblasts

54/ Further detail on financial, policy and administrative responsibilities can be found in a recent World Bank Report, Social Protection During Transition and Beyond (11748-RUS, Feb. 1994), Chapter 3.

55/ This figure excludes significant subnational budget expenditure on housing and utilities of the order of 3.5 percent of GDP in 1993, as well as social services (health and education) and enterprise social spending.

was as much as four times more per person than in other oblasts. Such differentials have widened, because the adjustment process has a much greater impact on incomes and taxable capacity in some regions than others, and because existing mechanisms to redistribute revenues from better-off to relatively poor regions in Russia are limited. A few regions have become fiscally far wealthier while the majority have experienced a real revenue decline. In 1993, the coefficient of variation of per capita fiscal expenditure was 0.71 overall, though somewhat less for education and health (0.66 and 0.55 respectively). The situation will be exacerbated as enterprise restructuring and privatization proceeds.

3.6 Under the present system, it will be extremely difficult for many localities to cope with sharply rising unemployment and falling revenue. The challenge is to maintain minimum levels of social services and assistance to the poor, and to finance unemployment benefits and employment services in those parts of the country hardest hit by enterprise closures and restructuring.

Social Insurance Programs

3.7 The Pension Fund (PF) is a significant source of support for Russia’s 36 million pensioners. Average pensions have been maintained at reasonable levels, although the minimum pension has frequently fallen significantly below the level of the subsistence minimum, and about 3 percent of pensioners receive a social pension, as low as two-thirds of the minimum pension. At the same time some pensions remain relatively generous according to certain privileges and special benefits. Moreover, about 22 percent of all pensioners (and 40 percent of early retirees) also earn wage income.

3.8 Overall, in 1992-3 the average position of pensioners was actually better than for working-age households, as Chapter II revealed. Yet there is a clear need to reallocate pension expenditures toward those receiving the minimum benefit, because current projected expenditures are not affordable, and equitable ways to cut spending are needed. Based on current eligibility and real levels of average benefit, pension spending is projected to increase from 6 percent of GDP in 1994 to about 7 percent of GDP by 1999. This is projected to lead, by 1997, to a significant PF revenue shortfall, amounting to one percent of GDP. The flat rate indexation mechanism that was adopted in late 1993 and suspended six months later is a useful way to re-allocate pension expenditure towards pensioners at the bottom of the distribution.

3.9 Unemployment benefits are paid out of the Employment Fund (EF). The level of benefit is a share of the individual’s previous average wage and it declines over time. The average unemployment benefit is low, and the minimum unemployment benefit falls to the minimum wage (see table 2.3 for trends). Many unemployed do not actually receive or take-up benefits. As the incidence analysis below reveals, in 1992 only about 2.9 percent of households headed by unemployed individuals received transfers.

57/ The majority of social insurance cash benefits are financed out of extra-budgetary funds (EBFs). Prior to 1993 there were budget transfers to the EBFs to pay for certain other benefits (such as child allowances). The financial position of the EBFs has been reasonably buoyant—mainly because nominal wages (the revenue base) have tended to increase more rapidly than benefit levels. However revenue compliance declined during 1993 for all EBFs—for PF, from 95 to 80 percent over the year; while the compliance rates for the EF and SIF are around 67 and 63 percent respectively.
3.10 Registered unemployment remains low, about 2.5% by the end of 1994. Still the EF is increasingly unable to finance benefits. Chapter 1 highlighted emerging regional disparities in unemployment that are likely to persist. Most (68 out of 88) oblast EFs ran into deficit in 1994. The structure of the EF does not allow surplus revenues from better-off oblasts to be reallocated to those with high unemployment and correspondingly less revenue.

3.11 To date the Federal Employment Service (FES) has had a strong emphasis on "job creation", expenditure on which has been running about twice as high as that on unemployment benefits. It has tended to comprise loans to enterprises rather than public works. In 1994, the FES directed about 24 percent of total expenditures toward "job creation", of which, however, very little went to temporary employment schemes (public works). This included compensation to an estimated one million recipients in selected one company towns or "emergency" regions where workers are part-time or on forced leave.

3.12 Sickness and maternity benefits are paid out of the Social Insurance Fund (SIF), which at present is under government authority and formally independent from the Independent Federation of Trade Unions. However the current system of management and control appears to vary across the country. Most of the SIF contribution is retained at the enterprise level. About half of SIF expenditure goes to sick pay and one-fifth to sanatoria.

Box 3.1: Non-governmental support mechanisms

An assessment of social support in the Russian Federation would be incomplete if the role and efforts of the private, non-governmental sector were ignored. Numerous initiatives have emerged since the transition began, representing both collective response to the liberalization of political and legal constraints that had inhibited independent activities, and the growing hardships suffered by vulnerable groups.

The NGO sector has emerged throughout the country, from Moscow to the Far East, largely as a response to the growing unmet social assistance needs of the disadvantaged. Religious organizations, for example, are playing an increasingly active role in alleviating hardship at the grass-roots level. Some observers have argued that NGOs are fast becoming a necessary adjunct to the national social service delivery system. Some of these NGOs are currently receiving government subsidies -- in the form of staff salaries, office space and tax relief. Most NGOs are pursuing revenue raising, through membership dues and, more importantly, business activities.

NGOs working with the disabled have tended to form either around specific disability concerns (e.g., for the blind), or around such issues as employment or raising awareness. Typically, disabled people or their families register, pay membership fees, and thereby become entitled to use the services of the organization. The types of services include vocational training and employment opportunities, for example cottage industries where individuals work at home.

Women's groups have also been particularly active. For example, in Khabarovsk, there is a Women's Council that meets fortnightly to discuss job possibilities, training courses and small business creation. The Federal Employment Service has been cooperating with, and contracting out service delivery to, women's NGOs.

Yet non-governmental activity faces serious constraints. Difficult economic conditions are exacerbated by the existing regulatory environment for NGOs (such as registration requirements) and the taxable status of income-generating activities. Nor are charitable contributions tax deductible for individuals. Nonetheless, recent evidence from, for example the Far East, suggests that the lack of a specific legal basis for NGOs does not seem to be hindering their establishment or operation.

58/ Chapter 1 analyzed labor market trends in detail.
59/ Proposals to consolidate EF resources into regional budgets in the second quarter of 1994 were suspended due to the worsening financial situation of most local EFs.
Family Allowances

3.13 The inherited Soviet system of family allowances was extensive and complex. There are various maternal and birth allowances designed to replace foregone wages. Child allowances have a broader objective than poverty relief, to support all families with children. Benefit amounts were not differentiated according to household income and at most totalled about one-quarter of the subsistence minimum. Since actual program costs have fallen below projections, either take-up is low or benefits are not being delivered.

3.14 In early 1994, the system was simplified into a single child benefit, plus three further allowances for mothers with young children. Financing responsibility was assigned to the oblasts. The level of benefit has been increased, and minimum and maximum benefits introduced. The level is related to the minimum wage (see Table 3.1). Still, family allowances are available to all families regardless of need. Program costs rose as a share of GDP in 1994, to 0.7 percent, compared to 0.6 percent in 1993. Enterprises administer, but do not actually finance, most budget and SIF-financed family allowances. Although the MSP is formally responsible for delivery, it does not control or monitor payments.

<table>
<thead>
<tr>
<th>Type of Benefit</th>
<th>Source of Financing</th>
<th>Base</th>
</tr>
</thead>
<tbody>
<tr>
<td>Labor Pension</td>
<td>Pension Fund</td>
<td>Formula based on work history and past earnings. Minimum pension is the floor.</td>
</tr>
<tr>
<td>Unemployment Benefit</td>
<td>Employment Fund</td>
<td>Formula based on past earnings and duration of unemployment. Minimum wage is the floor.</td>
</tr>
<tr>
<td>Family Allowances</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Birth grant</td>
<td>Social Insurance Fund</td>
<td>500% of minimum wage</td>
</tr>
<tr>
<td>Unified monthly benefit bonus</td>
<td>Regional Budget</td>
<td>60-70% of minimum wage</td>
</tr>
<tr>
<td>For child care under 18 months (working mothers)</td>
<td>Social Insurance Fund</td>
<td>50% of the amount of benefits</td>
</tr>
<tr>
<td>For child care under 3 years old</td>
<td>Enterprises</td>
<td>Not related to minimum wage</td>
</tr>
<tr>
<td>Sick Pay</td>
<td>Social Insurance Fund</td>
<td>Current earnings. No waiting period</td>
</tr>
<tr>
<td>Local Social Assistance</td>
<td>Local Budget</td>
<td>Assessment of need and available resources</td>
</tr>
<tr>
<td>Housing Allowance</td>
<td>Local Budget</td>
<td>Formula based on gap between actual expenditure on rent and utilities, and 10% of income</td>
</tr>
</tbody>
</table>

Note: Levels of average and minimum pension, relative to wages and minimum subsistence, are given in Table 2.3.
Social assistance in a Federal System

3.15 In the absence of new federal legislation governing social assistance, the Russian government has relied primarily on Soviet practices and regulations. The elderly and disabled living alone who have no other means of support were traditionally the main vulnerable groups for whom basic social services are provided. Based on local experience, the federal Ministry of Social Protection has developed, and in 1994 adopted, the Standard Regional Program for Social Protection, with the foremost objective of mitigating the impact of the transition on the most vulnerable. The first priority for assistance are those people living below the regional subsistence minimum. Since late 1991 local assistance to the poor has greatly expanded to meet rapidly rising demands. In the first half of 1994 alone, for example, one raion in Vladimir reported that the number of applicants had tripled. While there are no aggregate data to assess the impact of local social assistance nationwide, these local programs appear to be extensive, and have the potential to play an important role in alleviating poverty.

3.16 Local programs comprise extensive in-kind benefits and services, traditionally tailored to the individual client depending on assessed needs and the availability of resources. Typically, subnational social assistance programs have three things in common: (i) introducing an income test to identify the poorest. To meet rapidly growing demands for assistance, many subnational governments are using a combination of criteria—based on both category (for example, single pensioners) and income (for example, minimum pension or less)—to target the needy people and thus effectively utilize limited resources; (ii) expanding in-kind transfers rather than cash benefits; and (iii) financing assistance through local resources, with some central government support.

3.17 Present social assistance arrangements are administratively demanding. The emphasis is on individual interviews and home visits to verify details relating to needs as well as income and expenditure. The approach is highly personalized. A family seeking assistance may first be urged (or required) to apply for a private plot rather than receive cash assistance. However commendable, this proactive approach toward identifying people in need adds to the administrative burden. And because typically assistance is not awarded on an ongoing basis but is determined on each application, social workers have to deal with the same case on numerous occasions. There is also a risk of subjectiveness and arbitrariness inherent in the current individual-based approach.

3.18 Survey evidence suggests that current social assistance efforts are regarded by the population as inadequate in scope and amount. The number of recipients in many oblasts is significantly less than the estimated number in need. In Serpukhov raion in Moscow oblast, for example, a household survey found that local social assistance addressed only one percent of the population in 1993, compared to an estimated poverty rate of 28 percent. The most urgent need cited by 300 poor people surveyed by VCIOM in June 1994 was for additional cash. In particular, low income households and single parents seem prefer to cash to other forms of assistance, contrary to current practice. Moreover, most respondents described the efforts of government authorities and public organizations in their neighborhood as insufficiently active (41 percent) or virtually inactive (37 percent). The opinion of government assistance was especially low among low income households and the elderly. This is consistent with the findings of the incidence analysis below.

3.19 The draft federal law, On the Subsistence Minimum in the Russian Federation passed through the third reading in the Duma in May 1995. It provides for the introduction of a poverty benefit for individuals and households whose per capita income falls below the oblast subsistence minimum. This would be a significant step forward and is broadly consistent with previous World Bank
recommendations. However further clarification and certain amendments are recommended in order to avoid adverse work incentives and refine the targeting mechanism. These are outlined in Chapter IV below.

3.20 **Financing.** Overall budget financing of cash social assistance amounted to about 1.1% of GDP in 1992 and 1993, increasing to about 1.3 percent of GDP in 1994. The bread allowance introduced in August 1993 for certain disadvantaged groups costs about 0.18 percent of GDP. There are also several extrabudgetary funds earmarked as such: the Supreme Soviet Fund for Social Protection, the Ministry of Social Protection’s Fund for Social Support, and various oblast and raion funds for social protection. The Fund for Social Support supplements a variety of local social assistance programs, though on a limited scale.

3.21 Federal resolutions on social assistance that are not directly supported by any financial allocation lead to significant divergence between central decisions and actual implementation at the local level. Under the new constitution, the system of local-central revenue sharing based on projected social expenditures remains in force. The concept of a "federally guaranteed social minimum" has been introduced, comprising pensions, unemployment benefits and family allowances, but the mechanisms for financing social assistance (family allowances and the proposed poverty benefit) are not yet clear.

3.22 Under the 1994 federal budget, provision is made for greater transparency in financial assistance to poorer oblasts. The transfers involved are potentially significant, projected to be 1.5 percent of GDP in 1994 (although tax collection has been falling significantly behind estimates). They are block grants which are not tied to any particular expenditure on revenue effort on the part of the recipient oblasts. The mechanics of the fund are described in Box 3.2. It is not yet clear whether the new objective formulae would replace the prevailing *ad hoc* arrangements.

**In-Kind support**

3.23 In-kind support for households, from enterprises and local authorities, are pervasive and important in Russia. Local authorities have often traditionally provided assistance in kind rather than in cash. More significant are enterprise benefits, that range from housing, to cheap food and meals, to sanatoria.

3.24 During the Soviet period, non-wage employee benefits were an important part of household’s real consumption. A significant proportion of the labor force continues to have access to some non-wage social entitlements through the workplace. Available evidence suggests that the adjustment in non-wage benefits to date has been less sharp than the fall in real money wages since the transition began. At the same time, loss of non-wage benefits exacerbates the income loss to individuals who are laid off.

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Box 3.2: Federal Transfers to the Regions: Recent Developments

The 1994 budget attempted to establish a transparent system of redistribution. The Fund for the Support of the Regions was formed by allocating 22% of the VAT revenue, which amounts to about 1.5% of GDP. The Fund is designed to carry out transfers in two categories, first to oblasts 'requiring support', where the per capita total tax revenue is below the national average, and second, oblasts 'requiring special support', where the projected revenue falls short of the projected expenditure needs. Both kinds of transfers are block grants not earmarked for any particular type of expenditure and not bound by any other conditionality.

Currently 66 out of 89 subjects of the federation are getting at least one transfer from the Fund. The first category has a strong equalization character and accounts for over three quarters of the Fund's resources (76.3%). The second category is more opaque because the mechanism determining "projected expenditure needs" is unclear. Receiving the first transfer by an oblast is neither a prerequisite nor a deterrent for it to be considered for the second grant. In fact, in 1994 about two-thirds of the regions eligible for the second transfer are also receiving the first, and the other seven include, most notably, coal mining Kemerovo (47% of the second category) and oil producing Tumen. These examples suggest that the second grant has a political aspect, and is poorly designed if the objective is to support the poorest oblasts.

The Fund, while an improvement upon the previous negotiated system, suffers several drawbacks. The formula excludes relevant demographic and geographic criteria and reinforces existing disparities in service provision. There is no conditionality with respect to use of the transfers. Moreover several oblasts apparently retained VAT revenues in 1994, in lieu of transfers from the Fund.

A mechanism to transfer federal resources to support the maintenance costs of divested social assets was introduced in 1993. Municipal authorities make direct requests for support following the transfer of social assets (kindergartens, health care facilities and housing). The Ministry of Finance determines how much to allocate to each oblast on a Mutual Settlements Account, although the underlying formula is unclear. Oblast authorities then reallocate among the municipalities and raions, at their own discretion. The bulk of budget allocations to date have gone to support housing maintenance (mainly heating), and amounted to R 5 trillion or 0.7 percent of GDP in 1994. The budgeted amount was only 45 percent of centrally estimated needs.

The above funds are not the only channels used to transfer federal resources to the oblasts. There is a whole range of sectoral programs that continue to be used to transfer public resources to the oblast level like, for example, support for the agriculture and coal industries, the Children of Russia program, and so on. It does not appear that the amount of money received by any particular locality through these programs affects its eligibility for a transfer from the Regional Fund.

3.25 It is difficult to actually quantify the value of the enterprise non-wage benefits to individual households in the absence of realistic parallel prices. Nonetheless it is clear that these enterprise expenditures have been significant -- amounting to about 21 percent of regional budget expenditure in 1992 -- and mostly directed to housing.

3.26 Table 3.2 shows the share of people reporting access to various social services from the enterprise in 1993. Incidence analysis below suggests that enterprises benefits tend to flow to the better off, being received by almost 19 percent of non-poor households compared to only 9 percent of the poor, and 4 percent of the very poor (see table 3.3). At the same time, enterprise social expenditures vary widely across regions and compound budget disparities. With a coefficient of variation of 1.3, regional per capita enterprise social expenditures have varied more widely than the major categories of budget expenditure. The regions with the highest per capita enterprise social expenditure are also among those with highest per capita budget revenues. The coefficient of variation of regional social -- budget plus enterprise -- expenditures amounted to 0.82 in 1992.

3.27 Enterprise surveys suggest that there is a positive association between enterprise size, as measured by employment, and the range of benefits. Industrial workers tend to be relatively privileged, although temporary workers rarely have access to such benefits.

3.28 It is likely that, in the course of enterprise restructuring and rationalization, enterprises will limit the provision of discretionary social benefits. Some may withdraw entirely. Clearly this will have a significant impact on the workers and their families who will be forced to purchase at least some of the services at market prices; as well as on local government authorities who undertake the financing and provision of services that are of a public good nature. This transition will imply, on the one hand, the need for upward adjustment of real wages so that the services can be individually purchased, and on the other hand, improvement in local fiscal bases and management. Divestiture will bring fiscal gains to local budgets, in that the enterprise tax credit and exemptions associated with service provision should cease. On the other hand, local budget expenditure on housing will likely increase, at least in the short term. Ways to alleviate the fiscal impact of the latter effect while protecting poor households are discussed in the next section.

### Price Subsidies for Housing and Utilities

3.29 Since the transition began, there has been a significant reduction in consumer price subsidies. The prices of basic foods have been largely freed. To a large extent, however, subsidies remaining on housing and utilities are a significant burden on subnational budgets. In 1993, about one-quarter of consolidated regional (oblast plus municipal) expenditure was on housing, equivalent to about 3.5 percent of GDP. Given increasing heat and water costs, the subsidy probably rose in real terms in 1994. Energy costs (mainly heat and hot water) account for the bulk of budget expenditure.

3.30 Energy prices, domestic and industrial, remain centrally set and controlled. Since the transition began, the prices for industrial users (who comprise the bulk of customers for most distribution companies) have been adjusted more often than those for consumers. Given very irregular adjustments of utility prices by central authorities, the relative cost of utilities likely declined significantly over certain periods. Domestic gas prices, for example, remained constant in nominal terms between July 1993 and March 1995. Below cost utility prices could lead to excessive usage. However it is important to bear in mind the structure of heat supply to Russian households -- individual units are unable to adjust district heat usage. This, in turn, may lead to inefficient use of other energy sources, such as gas.

3.31 Average expenditure on domestic utilities, that is water, electricity, gas, wood/coal and central heating amounted, on average for households using such services, to about 3 percent of total

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62 There is reportedly a signed Presidential decree that would devolve price setting authority to the oblasts.
household expenditure in 1992. As expected the expenditure shares are much greater for poor households, with an even sharper distinction for very poor households. In 1992, for very poor households which reported utility expenditure, on average over 13 percent of total household expenditure went toward utilities. Disaggregating this by utility reveals that the source of this large disparity is expenditure on wood and coal, as well as water. In general, residents in less comfortable housing (lacking centralized heat, for example) face higher housing costs.

3.32 Housing was traditionally provided to Soviet citizens virtually free of charge, either through their employer, or the local authority. As late as 1991, the Soviet Union may have had the most regulated housing market in the world. The gains associated with a shift in the sector to market principles could be enormous: on the one hand, housing investment accounted for about 25 percent of the total, and on the other, many Russian families have queued for years to live in a small apartment with undependable utility services in a badly maintained building. Housing privatization has transferred a significant share of the housing stock to its occupants -- about 31 percent by the end of 1994 and rental reform has begun. The development of a housing finance market is also evident.

3.33 Private expenditure on housing has traditionally been low, although the quality of housing is also low and access to utilities limited. The RLMS indicated that, in the summer of 1992, households spent an average of less than 0.5 percent of their total expenditure on housing. There is significant variation by poverty status, although the poorest do not spend as much on housing as might be expected: non-poor households spent only 0.2 percent, whereas poor households spent an average of 0.89 percent. For very poor households, the share rises sharply, to 2.1 percent of household expenditure. Liberalization of the housing market is likely to increase private housing expenditures significantly. The question addressed in Chapter IV is how the impact on poor households might be alleviated.

3.34 There are low rates of access to many basic utilities. In the RLMS sample, only 40 percent had access to hot water, 48 percent to gas, 61 percent to centralized heating and 39 percent to telephones. Thus significant numbers of households would not be affected by utility price liberalization. The foregoing analysis reveals that the current structure of housing subsidies excludes many households, mainly in rural areas and small towns and on average with lower incomes. Such families will not be adversely affected by increased cost recovery for subsidized housing utilities. On the one hand, increased cost recovery is needed, although reforms of utility and housing pricing still need to take into account the potential adverse impact on vulnerable groups, particularly in a country with Russia’s harsh climatic conditions.

Access to Health Care

3.35 Under the health care financing and delivery system developed during the Soviet period, Russians were entitled to free, comprehensive medical care. Health infrastructure and personnel were extensive (far in excess of most industrial countries), and access was virtually universal. Yet the system

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63/ Unfortunately, reliable data on household expenditure by different income groups are available only for mid-1992, and mid-1993 (pending further analysis). Only 11 percent of households reported no expenditures on any utilities.

was inefficient, resulting in health outcomes that were poor relative to the provision of personnel and infrastructure.

3.36 Since 1992 there have been significant changes in the financing and delivery of health care. The most striking shift has been the decentralization of responsibility to oblast and raion authorities. This would be expected to lead to large disparities in health spending, which has occurred, even though the coefficient of variation of health expenditure is somewhat less than that for total local expenditure. Oblasts appear to have protected health and social spending to a considerable extent, even though there are some reports of payroll taxes collected for health care being used for other expenses, for example, agricultural subsidies.

3.37 The recent Health Insurance Law continues to guarantee a basic package of care for every citizen, while moving to separate the provision and financing of services. Compulsory payroll levies are managed by health funds at the regional (3.4 percent of the payroll) and federal (0.2 percent) levels. In 1993, payroll contributions represented 21 percent of local budgets, on average. Implementation of the legislative reforms have begun, but will be a long and difficult process.

3.38 It is important to bear in mind that much of the decline in health status suffered by the Russian population over the past several years is not due to the deterioration of health services or seriously worsening financial constraints. Rather, declining health status can be largely traced to damaging behavioral and social factors. At the same time, the ability of the Russian health system to respond to aggravated risk factors has declined in the face of decreasing real levels of financing associated with general shocks to the economy.

3.39 Overall Russia appears to have increased health expenditures, at least as a share of GDP, during the transition, although aggregate and per capita spending has fallen in real terms (by an estimated 8 percent between 1990 and 1993). The number of physicians per 10,000 population increased between 1991 and 1993, as did the number of visits per 10,000 population. By way of contrast, in the Kyrgyz Republic, for example, health spending has declined much more dramatically since 1990, as a share of GDP and in real per capita terms. It appears that the introduction of fees for a range of services, including primary care, has led to falling utilization among the poor and very poor Kyrgyz who cannot afford to spend the same amounts as the better off.

3.40 Analysis of the RLMS revealed that the poor, in 1993, had less access to health services than the non-poor. The poor spent a similar share of household expenditure (about 0.5 percent) on health, though fewer rubles per capita. The proportion of health expenditure directed to drugs was 80, 94 and 100 percent for the non-poor, poor and very poor respectively. In other words, the poorest could not afford to purchase much more than drugs to meet their health needs. The likelihood of use of preventive services declines with the severity of household poverty. The next chapter explores the implications of these findings for health sector reform.

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65/ Outpatient drugs are not generally provided free of charge. There are subsidies for certain groups of the population, for example, children.

45
The Impact of Existing Social Protection Expenditures

3.41 Increasing poverty is being experienced by some Russians alongside severe fiscal constraints that restrict the scale of government social programs. In this context it is necessary to re-examine existing expenditures in order to determine who receives social benefits, their significance in overall household income and, in particular, how well targeted they are. The public transfers that are examined here are pensions, unemployment benefits, family allowances, local social assistance and scholarships. Other types of social expenditures that have important distributional implications -- obvious examples include health care and education--require further investigation.

Who Does and Does Not Receive Public Transfers

3.42 Most households do receive some type of transfer from the government -- equally however, a significant proportion of the very poor (almost three out of ten), and of the poor (one of five) do not receive any such benefits. And almost four out of five households that are not poor do receive public transfers. For policymakers it is important to ascertain the characteristics of the poor households who do not receive any assistance. Do they have more children, for example, but do not take-up family allowances? The reason for their not receiving assistance is a key factor in the design of new social assistance programs. Non-receipt due to ineligibility, for example, should be treated differently than non-receipt due to lack of information or high opportunity costs of obtaining the benefit.

3.43 The RLMS suggests that households not receiving transfers are more likely to be very poor, but less likely to be poor. This vulnerable group is thus of particular importance in formulating assistance strategies. Households not receiving transfers are smaller, on average, than those which do receive transfers, and they have significantly fewer elderly members, significantly fewer children, but more working age adults. As expected, the distribution of household types for those not receiving transfers is concentrated in childless dual income and single income households. However, surprising finding is that many non-recipients are entitled to some assistance - for example, six out of ten very poor families not receiving any transfers have children. Those that do receive transfers are most likely to have zero wage income with no children or two wage incomes and one or two children (these households are more likely to receive subsidies from local authorities).

3.44 Households not receiving transfers are much less likely to have access to a private plot. This is of particular concern since access to a private plot has proven to be a strong factor in alleviating poverty. As expected, most households whose head is retired or disabled receive public transfers. The distribution of occupations for households not receiving transfers is concentrated in crafts and related trades as well as plant and machine operators and assemblers.

3.45 Heads of households not receiving transfers are, on average, better educated. They have more years of high school education, and a greater percentage have completed eighth grade. Also a greater percentage of heads from households not receiving transfers, versus those from households which do, have graduated from institutions of higher learning, such as technical school or university.

3.46 Finally, with respect to regional concentration, the distribution of households not receiving transfers is fairly even across oblasts in the RLMS sample. Nonetheless a larger share of households are not receiving assistance in Moscow City, Saratov Oblast (Krasnoarmeisk), and Kabardino-Balkarskaya (Nal’tchik), whereas in Riazan Oblast (Riazhskiy and Saraevskiy Raions) and Tatarstan (Kazan) rates of non-receipt among the poor were lower.

46
The Significance of Public Transfers in Household Income

3.47 Public transfers comprised 32% of household income on average in mid-1993, according to the RLMS. Here we focus on recipient households (i.e. 73% of total) for whom transfers represented 44% of income on average in the RLMS sample. However, non-poor households are more likely to receive transfers than poor and very poor households. (See table 3.3.)

3.48 Among the different types of transfers, pensions are most frequently received, and comprise the largest part of income. For recipient households, 75% of income in very poor households, 67% in poor households, and 58% in non-poor households comes from pensions; declining pattern indicates that pensions are most critical for households below the poverty line. 66 However, pensions are more frequently received by non-poor, and less often by poor and very poor households (48 percent versus about 40 percent).

3.49 The percentage of poor households receiving family allowances is slightly above the percentage of non-poor households. However family allowances constitute only 5.9% of income in non-poor households, with the share rising sharply to 14.5% for poor households and over 23% for very poor households. Clearly, poorer households are more dependent on family allowances. This is consistent with the finding that poor households, on average, have more children. However, it is striking that the vast majority of the very poor (71%) do not receive any family allowances.

3.50 Local social assistance is limited overall, and does not appear to be well targeted. Indeed the share of non-poor receiving such assistance is almost fifty percent greater than that of the very poor. Local social assistance comprises nearly 10% of poor as well as very poor recipients' income, with the share for non-poor recipients only slightly smaller. There is a strong need for federal guidance in targeting poor households. By way of comparison, for non-poor and poor households, non-wage subsidies from enterprises represent a greater percentage of income than local social assistance; however, the prevalence of enterprise subsidies for very poor households falls below local social assistance, indicating that such transfers do not accrue to the poorest groups.

How Well-Targeted Are Public Transfers?67

3.51 How well-targeted public transfers are depends on whether or not transfers accrue to the poor. Here we look at ex post targeting, that is households which are classified as poor or non-poor after the receipt of transfers.

3.52 Family allowances are relatively evenly distributed--neither concentrated on the lower income deciles, nor the upper income deciles (see figure 3.1). Although poor households in the RLMS sample have 0.44 more children on average than non-poor households, and this is large relative to the average number of children in households (0.58 non-poor, 1.02 poor households), it is not enough to make family

66/ The typical demographic composition of very poor households (that they tend to be young) means that they are less likely to receive pension.

67/ The concentration coefficient shows how well-targeted public transfers are. It ranges from -1 when all transfers are received by the poorest household, through 0 when all households receive the same amount of transfer income, to +1 when all transfers are received by the richest household. See Volume II: Foley 1994b for details.
allowances strongly targeted to poorer households. Thus, if the objective is to reach primarily poorer households, then a benefit could be restricted to households with more than two children, for example. This would limit the inclusion of richer households but would come at the expense of excluding poor households with less than 3 children. The balance between these offsetting effects needs to be empirically investigated.

3.53 In contrast to family allowances, the share of total pension expenditure accruing to each income decile shows a distinct increasing pattern as we move from poorer to richer deciles, levelling off at the higher income deciles. In other words, the incidence of pension expenditure is not progressive. This is consistent with the fact that pensions comprise a significant part of non-poor total household income nearly 30% on average for all households, not just recipients—which is in fact the same overall average as for poor as well as very poor households.

3.54 Local social assistance has a concentration coefficient significantly above zero, indicating that they are not evenly distributed across the population. The lower income deciles realize much less assistance while the highest income decile accrues over one-quarter of local government subsidies. Contrary to expectations, then, local social assistance is not progressive in impact.

3.55 Scholarships are focused on the non-poor, accruing primarily to households with greater per capita income. This could be due in part to children of richer households being more likely to receive better quality education than those in less well-off and less well-connected households, and thus receiving more scholarships.
Table 3.3: Significance of Public Transfers in Household Income for Households Receiving the Benefit

<table>
<thead>
<tr>
<th>Transfer</th>
<th>Very Poor</th>
<th></th>
<th>Poor</th>
<th></th>
<th>Not Poor</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>% Receiving the benefit</td>
<td>Avg % of Recipient Household Income</td>
<td>% Receiving the benefit</td>
<td>Avg % of Recipient Household Income</td>
<td>% Receiving the benefit</td>
<td>Avg % of Recipient Household Income</td>
</tr>
<tr>
<td>Family Allowances</td>
<td>28.8</td>
<td>23.6</td>
<td>32.4</td>
<td>14.5</td>
<td>25.7</td>
<td>5.9</td>
</tr>
<tr>
<td>Pensions</td>
<td>40.3</td>
<td>75.0</td>
<td>41.0</td>
<td>66.9</td>
<td>48.7</td>
<td>58.4</td>
</tr>
<tr>
<td>Unemployment Benefit</td>
<td>0.8</td>
<td>21.7</td>
<td>0.4</td>
<td>17.8</td>
<td>0.3</td>
<td>9.8</td>
</tr>
<tr>
<td>Subsidies from Local Authorities</td>
<td>10.4</td>
<td>9.6</td>
<td>10.4</td>
<td>9.6</td>
<td>14.5</td>
<td>8.1</td>
</tr>
<tr>
<td>Subsidies from Enterprises</td>
<td>5.0</td>
<td>9.4</td>
<td>8.7</td>
<td>10.8</td>
<td>17.7</td>
<td>11.7</td>
</tr>
<tr>
<td>Scholarships</td>
<td>5.2</td>
<td>17.8</td>
<td>6.2</td>
<td>18.2</td>
<td>6.7</td>
<td>8.7</td>
</tr>
<tr>
<td>All Transfers*</td>
<td>66.8</td>
<td>58.5</td>
<td>70.9</td>
<td>48.4</td>
<td>74.4</td>
<td>42.6</td>
</tr>
</tbody>
</table>

* All Transfers includes those listed (except subsidies from enterprises, which are included for comparison with subsidies from local authorities) plus welfare (blagotvaritelnaya pomozh).

Note that the overall average percent of household income can be calculated from the two values reported for each poverty status.


3.56 Overall, then public transfers are weakly focused on non-poor households as the concentration coefficient equals +0.132. This is due both to the levels and coverage of benefit. Even categorical programs, such as family allowances, may not be received by eligible recipients. The fact that the poor do not enjoy significant relative benefits from public cash transfers provides significant motivation for the reform proposals set out in Chapter IV.
Table 3.4. Concentration Coefficients for Public Transfers

<table>
<thead>
<tr>
<th>Transfer</th>
<th>Concentration Coefficient</th>
</tr>
</thead>
<tbody>
<tr>
<td>Family Allowances</td>
<td>-0.029</td>
</tr>
<tr>
<td>Pensions</td>
<td>+0.136</td>
</tr>
<tr>
<td>Subsidies from local authorities</td>
<td>+0.203</td>
</tr>
<tr>
<td>Scholarships</td>
<td>+0.247</td>
</tr>
<tr>
<td>All Transfers</td>
<td>+0.132</td>
</tr>
</tbody>
</table>

The concentration coefficient for Unemploymentbenefits was not calculated due to the small number of individuals who reported an amount received. They were included in the All Transfers coefficient.


Informal Sources of Support

3.57 Only about one in five Russian households rely solely upon their official job and transfers from the formal system of social protection. Most people respond and cope to economic changes in different ways that are outside the formal economy and the system of cash and in-kind benefits provided by enterprises.
3.58 A significant source of informal support for many Russian households lies in access to private plots. Six out of ten households in the RLMS reported such access. Other surveys have estimated even higher participation in private plot activities. In the New Russia Barometer II survey in summer 1993, 72 percent of respondents either grew their own food directly or helped friends and relatives do so, while almost one in three urban residents reported spending several hours a day growing food. 68

3.59 Publicly financed benefits are not the only means of transferring resources from one group to another. Networks of families and friends are an alternative to government as a means of income redistribution. 69 In many countries, the informal, private safety net is a critical aspect of poverty alleviation; Russia is not an exception. In a VCIOM survey in June 1994, only 5 percent of respondents stated that they would rely primarily on government agencies if they were in need—whereas 42 percent, on average, and 50 percent of single parents, would rely primarily on friends and family.

3.60 The RLMS data set allowed us to explore how private networks of support function in Russia. 70 It revealed that private transfers in Russia are large and responsive to the socio-economic characteristics of households. For the sample as a whole, private transfers averaged 4.7 percent of household income; for net recipients the contribution was much higher, averaging 20 percent of total household income. On average, they appear to benefit such vulnerable groups as younger households, female-headed households with many children, and those affected by unemployment.

3.61 Private transfers in Russia are both widespread and significant. In the RLMS sample in 1992, 40 percent of households participated in private transfer networks as recipients, donors, or both. About 37% of respondents to the VCIOM survey reported the free exchange of favors and 27% regularly provided free help to friends and relatives. At the same time, participation in transfer activities varies significantly among regions.

3.62 Involvement in a private transfer network is correlated with lower levels of poverty. Poverty rates among households participating in private transfer networks are over 10 percentage points lower

68/ Rose and Tikhomirov, 1993. The differences revealed by the various surveys may partly reflect people’s willingness to respond more openly to a short and broadly gauged questionnaire of a private agency, compared to a large, official budget survey.


70/ For details, see Volume II of this report: Cox, Eser and Jimenez, 1994.
than those of households not participating in private transfer networks. Whether or not private transfers have an equalizing effect, in favor of assistance to vulnerable households, is unclear. Recipient households are on average headed by younger people, and more frequently headed by women or unemployed persons; they are also on average larger and relatively fewer have access to a plot of land. The probability of receipt increases with the number of children. Age of the household head is a significant factor determining receipt (see figure 3.2). In 1992, nearly half of all reported in-kind support flowed from parents to children in urban households. Yet although transfers tend to go to lower income households, the probability of receiving a transfer declines only slightly as earned income increases.

3.63 Transfer behavior and patterns appeared to persist in Russia during 1992 and 1993, in spite of high inflation, declining real wages, and worsening poverty and inequality. There was no apparent weakening of the private system of support, as was the case during Poland’s economic transition.71

3.64 From a policy perspective, it is important to know how public and private transfers interact. Analysis of the RLMS suggests that the effect of public transfer income on private transfers is positive. Compared to having no such income, the average public transfer income raised the probability of receiving a transfer by almost 4 percentage points. It is also notable that an increase in the regional unemployment rate reduces the probability of receiving a transfer. These results suggest that private and public transfers are complementary. This is discussed further in the next chapter, in the context of incentives (para 4.23-4.24).

CHAPTER 4

IMPLICATIONS FOR POLICY

4.1 The Russian people have experienced dramatic changes in their living standards following the breakup of the Soviet Union. The number of poor people, and the severity of poverty increased in 1992 and 1993, and probably did not improve in 1994. There is still enormous labor hoarding in firms and much higher unemployment is likely to emerge. Certain programs to combat these changes appear to be well targeted, whereas others are clearly in need of reform. There are large gaps in the existing safety net—many very poor households do not receive any public assistance at all. Regional disparities in real income, employment opportunities and access to basic social services are critical.

4.2 The widening of income inequality associated with the transition to a market economy may induce the government to take active redistributive measures, depending, inter alia, on its aversion to inequality. In the short term, there is a conflict between efficiency and equity -- for the economy to expand and produce the fruits expected of a market system, the distribution of money income is likely to widen further. Yet the Government is constrained with respect to redistributive taxes and transfers.

4.3 This chapter addresses the policy implications of the foregoing poverty analysis, and sets out specific options for reform. It builds on a recent World Bank report, Russia: Social Protection During The Transition and Beyond (Report No 11748-RUS). We begin by briefly reviewing the macroeconomic and structural policies that would help to reduce poverty. The principles underlying policy responses to poverty are then set out, before presenting the fiscal implications of possible new responses and ways to increase the effectiveness of existing social programs.

Establishing Economic Conditions Conducive to Poverty Reduction

4.4 Stabilization and the need to facilitate renewed economic growth are critical and necessarily underpin the policy recommendations. This will allow improved access to income-earning opportunities which must be the main guarantee of decent living standards and poverty reduction in the medium term. Sustained reductions in inflation are needed, for without stabilization, it is virtually impossible to provide adequate social protection. Even so, it is still unclear to what extent output and incomes will recover in the short term.

4.5 Severe fiscal constraints have been imposed by the collapse of economic activity and the need to drastically reduce the budget deficit. Current World Bank working assumptions to the end of the decade show that total public expenditure should be cut if domestic non-bank deficit financing is to be kept to reasonable levels; otherwise there is likely to be crowding out and/or renewed inflation pressures. Budget transfers to enterprises, the coal sector and defence should be cut further. However, the recent approach to monetary restraint based on sequestration and arrears is arbitrary in impact and could adversely affect services and activities that help protect the welfare of the poor. Commitments to increase

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benefits have been made without any clear source of financing and gone unpaid. Improved financial budget management is needed for government credibility and financial stability.

4.6 Scope for increasing public revenue is generally limited. The tax shares inherited from the Soviet period are high by market economy standards, and stifle efficiency. Payroll taxes are especially high. Yet the costs of restructuring are also significant. Revenues are falling as the formal tax base is eroded and the economy stabilizes. The diversity of rates and exemptions erode the tax base for social insurance and resulted in an effective tax rate of 22.7 percent in 1993, compared to a nominal rate of 39 percent. Actual tax collections have fallen dramatically. The government should consider broadening the base for social insurance taxation. Rates could be unified across different sectors (e.g. agriculture). It is also necessary to increase compliance. These measures may allow a shift to lower overall rates.

4.7 The transition to a market economy does create wider opportunities to enhance the returns to labor, alongside improvements in efficiency. The Soviet system was capital intensive and oriented toward so-called "productive" activities. An economy that is more responsive to consumer demand, and the expansion of services, could lead to a more labor intensive structure of production. However the distribution of assets and wealth will critically affect the distributive impact of the transition.

4.8 Continuation of reforms could yield significant growth of the Russian economy. The working assumption of the World Bank is that a 4 to 6 percent growth rate may be feasible in the medium term. Such growth would be expected to alleviate poverty, although the link is not automatic. In Poland, for example, the only transition economy whose real GDP has grown for three consecutive years to 1994, the poverty rate had not fallen and inequality had risen. In Russia, even as growth resumes, the severity of poverty and increasing inequality suggest that many people could still remain in need. Much more restructuring in most of the non-service sectors is required, in particular coal, metallurgy, chemicals, machine building and agriculture. This is likely to involve significant labor shedding given inherited levels of overstaffing, the failure to date to adjust employment levels to falling output, and the need for further structural changes. Stabilization of the economy and further restructuring imply that large gross flows into severe poverty evident in 1992 and 1993 could continue for some time.

Facilitating Private Sector Growth

4.9 The emerging private sector is likely, as in other European transition economies, to provide the bulk of new jobs in Russia. In Poland, most of the recovery in industrial output has taken place in the emerging private sector rather than the privatized SOEs. In Russia, individual economic activity and self employment have expanded rapidly from low bases in 1991, almost nine-fold and two-fold respectively. This will be an important source of income for increasing numbers of people, as either their secondary or primary job. Demand for services is likely to prompt growth in the private sector. Surveys in 1994 revealed that most people on involuntary leave had found alternative, typically informal, employment. At the same time, it is clear that the distribution of private sector income is significantly

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74/ According to IMF estimates: see IMF, Russia: Strengthening Social Safety Nets During Transition, March 1994 p.28.
less equal than either wages or social transfers. Hence a rising share of private sector income has been associated with rising overall inequality in Eastern Europe.\textsuperscript{75}

4.10 Macroeconomic stability is needed to foster private sector development and provide a more certain climate for investment decisions.\textsuperscript{76} High inflation and high risk reduce the time horizon over which people are prepared to enter contracts or make financial commitments. The coordination and streamlining of laws and regulations—in particular tax regulation, property rights and business registration—is also necessary. Alongside these reforms, the development of a market for real estate and improvement in banking and finance will be critical.

4.11 Regulatory changes that shift most private businesses out of the grey areas of the system will reduce the high rents associated with early entry, increase ease of entry and create opportunities for larger numbers of people. Many emerging service sector activities are labor-intensive. These changes could have a pro-poor impact. However for some people, individual economic activity is likely to be associated with low income levels—the issue then is how to provide public transfers to assist them without discouraging work effort. This is discussed below.

4.12 Women work longer hours and earn less than men in Russia, because of unpaid domestic work and lower overall pay levels. Due to both vertical and horizontal segmentation of the labor force, men are in the top jobs and high paying sectors. This was rather inefficient in the command economy given women’s higher levels of education, and is even more inefficient in the transition, because women are in those sectors, in particular services, most likely to expand. To draw more fully on the human capital investments already made in women, it is necessary to remove labor market barriers to women’s full participation (such as “protective” legislation excluding women from certain activities) and remove obstacles in the household to women’s full labor force participation. For example, government-sponsored family support (such as child sick leave or maternity leave) could be made available equally to men and women. These steps would likely both promote growth and reduce gender inequality in Russia (see Box 4.1).

**Principles Underlying Policy Responses to Poverty**

4.13 Stabilization and economic recovery will play a critical role in reducing poverty in Russia. However during the transition period some people will be unable to obtain incomes to maintain themselves and their families above the poverty line. And even in a growing market economy there will always be poor people who for some reason need support.

4.14 Income redistribution is difficult under any circumstances. It is even harder because governments lack the relevant information on which to base policy interventions. Such information would include the income earning opportunities that each individual/family faced, and the effort they had to exert to attain any given level of remuneration. This is essentially a problem of knowing individuals’ (potential) wages. The necessary information would also include information about how easily their needs could be satisfied—for example, whether the individual had a particular health problem and so needed a higher monetary income to attain the same level of well-being as an able-bodied person.


\textsuperscript{76} See *Enterprise Reform in Russia: Next Steps*, Report No. 12840-RU.
Box 4.1: Some Gender Dimensions of Policy Responses to Poverty

The promotion of an effectively functioning labor market, irrespective of gender, will play an important role in establishing economic conditions conducive to poverty reduction. As a first step to lessening the occupational segregation that permeated the Soviet labor force, job announcements and classifications by sex should be eliminated. All occupations could be opened up to qualified persons regardless of sex, and the current and proposed labor legislation that prohibits women from certain types of activities should be re-examined, as should the admission rules and practices for vocational training. Instead of restricting access by gender, all employees should be made aware of any physical and other risks associated with their jobs. Although such practices are now well accepted in most Western countries, this may be controversial in Russia. As one World Bank survey of managers found, while employers insist that there is no gender discrimination in the labor force, they do have very definite ideas about what is a woman's job, and what is a man's job.

More generally, in the transition toward a market economy, it will be necessary to revisit the financing and institutional arrangements underlying the extensive leaves and benefits that were used to encourage female labor force participation during the Soviet period. It is important to avoid what could become obstacles to women's employment in profit-oriented firms. In this sense it could be preferable to finance such benefits as birth grants and maternity benefits through the tax system rather than through employer mandates. At the same time, there should be a gradual shift toward equalization of pension eligibility ages between women and men, as the overall pension age is increased also.

Finally, the potentially positive aspects of the transition from a command economy that could enhance women's earnings opportunities should be noted. Foremost perhaps is the expansion of services, alongside the demise of the Soviet priority to heavy industry that was reflected in the wage structure. Given the nature of Russian women's education, training and work experience, they are well placed to take advantage of growing demand for services and professions. The possibility of more flexible working patterns may also be particularly welcomed by women -- a 1990 Goskomstat survey of 100,000 women throughout the USSR revealed a distinct preference among many women for part-time work, for example, although this was not generally available. The expansion of part-time employment has been one of the most marked shifts in Western labor markets over the past two decades. Small business and individual economic activity may also be attractive options for some women, although survey results (e.g. VCIOM) suggest that women prefer security rather than high income in more risky pursuits.


4.15 Governments never have this kind of information available to them. Not only are wages hard to observe in decentralized economies (especially given large informal sectors), the government would have to know the potential wage that someone can earn per unit of effort. As a proxy for this unknowable quantity, the government can use alternative measures, most obviously income. If effort and labor supply are fixed, then this is a good proxy for the potential wage, and efficient redistribution can be based solely on income. However, positive tax rates generally reduce labor supply, with associated economic costs - in particular reduced output. The problem is to design a system which satisfies the social objective of reducing income inequality while maintaining adequate work and production incentives. There are inherent trade-offs -- financing and incentive constraints -- so that it may not be desirable to bring every individual and family up to the poverty line. There are also political economy considerations related to motives for social assistance: if redistribution is motivated partially by altruism, and partially for insurance purposes, there may not be popular support for programs targeted on characteristics (e.g. location) which people do not consider they would ever possess, even if they became poor.

4.16 Three principles should underlie the design of policy responses to poverty—equity, efficiency, and feasibility. The set of feasible policy options is restricted due to fiscal imperatives, which have already resulted in real cutbacks in subsidies and in some cash transfer payments. The challenge facing Russia is how to reform the social protection system to be both affordable and to meet the needs of the most vulnerable. Certain inefficiencies inherited from the Soviet period limit the effectiveness of current programs, while revenue shortfalls have worsened the fiscal crisis. There is a need to increase targeted social expenditure to cushion household consumption as the transition proceeds.
Minimizing Adverse Incentive Effects

4.17 There is a potential conflict between two primary social policy objectives: reducing poverty and encouraging people to look after themselves. Russia, like other industrial countries, is concerned that government benefits could discourage individual efforts to look after themselves and their families, as well as reduce the informal support of family and friends. Those close to the poverty line could face particularly high effective marginal tax rates, and risk falling into the so-called "poverty trap". In mid-1993, about 9 percent of poor households fell within 25 percent of the poverty line. People might reduce their labor supply (and labor earnings) in order to qualify for benefits. In Russia moreover, there is a strong tradition associated with the Soviet system of full employment, that able-bodied people ought to support themselves and their families, and that the focus of public agencies should be the elderly and infirm, the disabled and others facing special needs that affect their ability to work.

4.18 The importance of incentive effects partly depends on the relative levels of wages and benefits. A practical problem confronting policymakers in Russia today is that the real incomes of many working households are close, if not below, the estimated levels of minimum subsistence. Table 2.3 highlighted this problem. Careful consideration therefore needs to be given to the relative levels of benefits and their interaction, especially with respect to payment levels that are administratively determined—e.g. social insurance payments, such as unemployment benefits and the proposed poverty benefit. This is addressed in paragraph 4.49 below.

4.19 If support is given to some Russians to help support themselves and their families, certain principles should minimize adverse work incentives. First, the level of benefits should remain austere, so that paid work remains clearly the most attractive option: this applies to social assistance as well as unemployment benefits. Second, rules governing assistance could allow some private earnings or income, up to certain limits. If the withdrawal of benefit is tapered, the reduction of benefit for each ruble earned is less than one ruble. This would allow, for example, the unemployed to engage in informal activities so that their work skills can be maintained or enhanced. Third, the definition of the income unit should be carefully considered: if the household as a whole is assessed, they face a common marginal tax rate. If the wife's decision to work is more sensitive than that of the husband, and she is lower paid, she may decide to withdraw from paid work. Fourth, rules governing unemployment benefits that exclude voluntary quits as well as people who refuse more than two jobs, should be enforced.

4.20 One route to avoid work disincentives is to make receipt of the benefit conditional upon a minimum level of work. Family Credit in the UK, for example, is only available to families whose head is working at least 24 hours a week. This was intended, in part, to ensure that persons on welfare benefits were not better off than those in substantial work. In Russia already, many unemployed and poor people do some paid work. The Low Income Tax Credit outlined below requires that eligible households have some earned income. However, a general work requirement could be onerous where long term unemployment becomes a more serious problem and no alternative forms of assistance are available, unless the Government was prepared to establish a "workfare" type scheme, guaranteeing a place under the Temporary Employment Schemes discussed below. For such a system to operate, significant planning is required and major costs are involved.

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77/ This concern has a long history, from the seventeenth century Poor Law debates in England, to the USA today.
4.21 Further factors suggest that the risk of adverse work incentives in Russia may not be as serious as first appears. The replacement ratio for the unemployed, for example, (average unemployment benefit/wage) was only 14 percent in September 1994. Attachment to an enterprise still yields significant non-wage benefits for many workers and therefore discourages quitting to become unemployed. Given dual workers in most Russian households, the alternative social assistance benefit may not quickly approach the income of two employees. Labor supply decisions have many dimensions--hours per week, second job, choice of job, early retirement and so on--that are affected by various factors. The provision of income support may allow people to make choices that lead them to become more productive. For example, social assistance to people in low income activities may encourage some people to leave low productivity jobs to become self-employed, with all the attendant risks involved. Already many unemployed people are involved in secondary activity (about 25% of the registered unemployed surveyed in October 1994 were thus engaged).

4.22 Finally, empirical evidence suggests that labor supply may be fairly inelastic in the face of changes in benefit levels, benefit reduction rates, benefit-earnings ratios and unemployment rates. Evidence from Western countries about the disincentive effects on labor supply of welfare payments gives a wide range of estimates, including zero. A generous unemployment benefit system and a macro-economic shock which generates a large number of layoffs can erode social norms about work, but Western evidence suggests that such an erosion can take several years. In the US, there is still considerable uncertainty about the magnitude of any disincentive effects associated with the Aid For Families with Dependent Children program. The most important factor is likely to be the level of benefit relative to net income available from work. Another factor is the duration of benefit -- a program which is explicitly temporary is perhaps less likely to cause an erosion of work incentives.

4.23 Beyond the recipient's responses to a public transfer, another risk is that private interhousehold transfers will be cut back in response to public redistribution. This is sometimes called 'crowding out'. International evidence on the extent of crowding out of informal support is mixed. Analysis of the RLMS from the summer of 1992 showed that the effect of public transfer income on private transfers was positive. Compared to having no such income, receiving the average amount of public transfers raised the probability of receiving a private transfer by four percentage points. Private transfers thus complement public transfers to households, since private transfers in Russia appear to respond to the economic distress caused by unemployment, childbirth and other special household needs and are not deterred by current levels of public assistance.

4.24 Although private transfers might be potentially important for alleviating the effects of job loss for some, their impact in expected value terms is not large, because most households will not receive private support. If, say, a household head loses her job, the probability that the household will receive a private transfer is about one in ten. Further, there are regional effects: if job loss occurs when unemployment is rising in the region generally, there is very little increase in the household's predicted probability of private transfer receipt. This suggests the need for public assistance to the unemployed.


Targeting people in need

4.25 The problem of targeting income transfers to those in need without discouraging work effort can be ameliorated somewhat if individuals and families have certain fixed characteristics which are correlated with need. For example, working single mothers might on average be less well off than the general populace. Targeting those in need does not necessarily have to proceed on the basis of an income test. If possible, it is preferable to rely upon self-targeting, or some other, more easily observable, correlates of poverty, such as family size or assets owned. While a single indicator is unlikely to be definitive, a group of indicators weighted to reflect their relative significance in poverty status could be used to determine whether a household should be entitled to assistance or not. We undertook detailed analysis of the RLMS to identify non-income categorical correlates of poverty that would reduce the administrative burden of targeting social assistance.

4.26 However no clear alternative categorical indicators could be derived for Russia (using the RLMS). Among the very poor, less than 8 percent are single parent households, for example, and only 9 percent have three or more children. So confining assistance to these groups would lead to significant errors of exclusion. For such characteristics as housing conditions and assets owned there was little difference between the poor and non poor--any differences were not sufficient to separate the two groups. Nor were there significant distinctions in these variables with respect to the very poor. This is likely due to the relative egalitarianism of the Soviet system, and the fact that increasing poverty associated with the transition has not yet had much effect on the long-standing asset holdings of the population. A VCIOM survey of 2175 poor Russians in March 1994 found that the volume and composition of their household assets was a result of past rather than present financial capacities. Most durable items had been acquired more than a decade ago.

4.27 Households that have access to land are less likely to be poor. It is not the amount or value of the land that is important, rather the important factors are access per se and whether households produce from the land. However the differences were not significant enough to base entitlement to assistance: while 63 percent of the non-poor had access to land, 52 percent of the poor did too.

4.28 For targeting policy purposes, the only significant distinction between the poor and non-poor in Russia is income. Poverty status is related to certain readily observable attributes, such as the number and age of children, and oblast residence, but the correlation is not significant enough to base a comprehensive approach to poverty reduction. Incomes-testing raises significant problems however, in particular adverse work incentives and poor administrative capacity. It always depends on a high degree of self-declaration and is therefore difficult to administer against a background of informal activity. Means-tested benefits should be regarded as the last option after eliminating as many potential claimants through alternative mechanisms as possible. For example, setting the minimum pension above the social assistance income threshold means that the elderly do not have to resort to social assistance. The same applies to unemployment benefits. The issue then is how to exploit complementary targeting approaches, such as self-targeting, and focus on devastated areas (identified in terms of, say unemployment rates relative to the national average) for example through the Temporary Employment schemes discussed below, in order to minimize reliance upon incomes testing.

81/ See Atkinson op cit.

Geographical targeting could be quite important in Russia, given the widening economic, employment and associated fiscal disparities that have emerged during the transition. "One company towns" dependent on a limited range of industrial output are a common legacy. Support could be directed to selected oblasts or districts that are especially poor, either due to economic devastation associated with the transition, or chronic underdevelopment. It could encompass federal transfers subject to certain criteria as well as temporary employment schemes, discussed below.

Addressing Regional Disparities

Decentralization of public resource mobilization and expenditure has exacerbated existing inter-oblast fiscal disparities in Russia. The coefficient of variation of per capita regional revenue rose from 0.6 in 1991 to 0.7 in 1993, and in expenditure, from 0.5 to 0.7 (although the variation in social expenditure is somewhat less). Underlying this overall trend of increasing budget disparities is the disparity in regional incomes. As set out above, the transition from a command economy has led to increasingly divergent paths of per capita income, prices, unemployment and poverty.

The system of intergovernmental fiscal relations that was introduced in 1992 did not take into account the role of the federal government in equalization among the regions. Since then, however, federal transfers have taken place, of the order of about 3 percent of consolidated budget expenditure in 1994, through short term loans, transfers and "mutual settlements". The latter, which are used to cover pre-determined purposes agreed with the Ministry of Finance where there is an ex post budgetary shortfall (e.g. to finance wage increases), in fact comprise the bulk (80 percent) of total federal transfers. The impact of federal grants on equalization has been restricted, however, largely due to the relatively limited size of federal transfers in Russia. Yet despite the apparently large scope for discretion and negotiation, the distribution of federal grants appears to reflect two distinct patterns, interregional and intertemporal equalization -- so that the regions that benefit from federal grants have per capita expenditures that are below average, and/or that have declined in real terms. The intertemporal equalization aspect explains why the ten regions which received the highest per capita federal grants were also among the regions with the highest per capita income.

The federal government has a potentially powerful redistributive role, in collecting revenue on the basis of ability to pay, and allocating funds on the basis of need. The latter can be done either through a bias towards poorer areas (tackling inter-district inequality), or via specific grants which tend to benefit the less well off (e.g. for needs-tested benefits), thereby enhancing intra-district equity.

As a prerequisite to a better functioning system of intergovernmental relations, the detailed assignment of expenditure and policy responsibilities needs to be clarified and rationalized. At present, the piecemeal process of decentralization has resulted in a number of blurred areas of responsibility. A governmental working group was set up to review expenditure responsibilities in 1994, although progress has been slow.

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83/ Le Houerou (1994) op cit.


85/ Le Houerou (1994) op cit.
4.34 A clearer distinction could be made between decentralization of expenditure responsibility for, and delegation of (that is, where local authorities deliver, but the center finances) public services. Specifically, it is important on equity grounds that the minimum standards and financing of major social transfer programs delivered by local authorities are underpinned by the federal government. In sum, there is a need for federal support for anti-poverty programs, at a minimum level while local authorities should be encouraged to pursue poverty alleviation activities.

4.35 Most national governments regard poverty reduction as too important to be left entirely to local discretion. This need not imply fully centralized financing, but it does suggest that at least some central support and "encouragement" needs to be available to oblasts that have an unusually high incidence of poverty. Moreover, given the significant disparities that already exist, the future magnitude of economic restructuring that is required in Russia and the likelihood that some local authorities will be faced with virtual collapse of their economic bases, the central government will not be able to abdicate responsibility for all social expenditure. Social assistance programs should not be left entirely to the center either, because taxpayer altruism may be somewhat stronger for local residents, and because local authorities are better placed to identify the poor, and might undertake valuable innovations. Similar concerns apply to the financing and delivery of health services.

4.36 Oblasts differ from one another in their capacity to raise their own revenue and in their needs for expenditure. A central equalization mechanism could seek to capture both in one formula. For example, tax capacity might be measured by an indicator of average real income—and need, by some measure of poverty. If the equalization formula was based on some weighted combination of these, would the formula be calculable? Some of the data, such as population, age structure and price indices, are already available by oblast. Reliable data on oblast poverty incidence is not currently available for all oblasts. A measure of the oblast poverty gap would capture both the numbers of people below the local poverty threshold and the seriousness of income shortfalls. Federal transfers to finance social programs could be made according to an explicit formula, based on two components: per capita oblast real income and an agreed upon measure of the oblast poverty gap.

4.37 Even in the absence of thoroughgoing reform, changes could be made to improve the federal arrangements for financing certain social expenditures. If the Government is seeking to directly encourage local poverty alleviation efforts, then conditional matching grants could be implemented, in order to tackle disparate abilities to finance income redistribution programs. Given information problems inherent in social assistance, local authorities are best placed to identify who are the poor, and how much assistance they need. In order to promote local reform efforts the grants could be made conditional upon the withdrawal or scaling down of subsidies to housing and domestic utilities, and/or agriculture. The current ineffectiveness of local social assistance efforts (see para 3.55 above) suggests that federal guidance is important, and that transfers could be made conditional upon better targeting outcomes. These federal grants would match certain types of local expenditures, so that local authorities
have incentives to efficiently undertake poverty alleviation efforts. Matching requirements ensure that local revenue efforts are not discouraged and that local authorities are committed to the program.

4.38 Definitive guidelines are not available to assist the Russian government in setting precise matching rates for particular programs. The matching rate reflects two components: the degree of interest of the central government in the provision of the particular program—i.e. first the externalities accruing outside the jurisdiction that are associated with the expenditure, which would tend to be high for basic social programs; and second, the rate should be related to a measure of need (e.g. poverty incidence or unemployment rate) of the particular locality. Matching rates could vary among oblasts, depending upon the measured level of need. The poorest oblasts could receive, say, 80 rubles for each 20 rubles of local expenditure; the converse could apply to the better-off oblasts.

**Policy Options**

4.39 The Russian government is seriously constrained with respect to feasible policy options to combat rising poverty. We suggest a possible strategy that would directly address the increasing poverty associated with the transition, within these limits. To summarize, the recommended reforms include the introduction of a poverty benefit and strengthening existing local social assistance, wider use of temporary employment schemes, and increasing the minimum levels of benefit for the unemployed and elderly. First, the fiscal implications of the reform options are set out, then the proposed reforms are described in detail. Ways to strengthen social assistance are addressed. Of particular concern are the very poor people not currently receiving any public transfers, who are mainly childless working households. Next, the difficulties surrounding extensive labor hoarding in firms are addressed, through restructured enterprise support and regionally targeted temporary employment schemes. Recommendations to make existing social programs more effective follow. The scope extends beyond income maintenance programs, to ways to enhance access to basic health services.

4.40 Beyond the pervasive fiscal constraints, a determining factor is administrative capacity -- that support for the poor be delivered in the simplest and most cost effective way. A final consideration is political -- in some countries the prospect of assistance to the poor is only realistic if it is restricted to people deemed "deserving" for example, or if attached to some work requirements. It is for Russians to decide whether, and how, this consideration constrains their own choices about approaches to social assistance.

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Table 4.1: Costing The Options: Expenditure on Social Protection
(% GDP)

<table>
<thead>
<tr>
<th>Type of Expenditure</th>
<th>1994 Without Reform</th>
<th>1994 With Reform</th>
<th>Projected 1997 Without Reform</th>
<th>Projected 1997 With Reform</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pensions, of which:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increase Minimum Pension</td>
<td>6.0</td>
<td>6.9</td>
<td>6.3</td>
<td></td>
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<tr>
<td>Flat rate pensions</td>
<td></td>
<td></td>
<td>-1.3</td>
<td></td>
</tr>
<tr>
<td>Social Assistance, of which:</td>
<td>1.2</td>
<td>1.2</td>
<td>1.4</td>
<td></td>
</tr>
<tr>
<td>Poverty benefit</td>
<td></td>
<td></td>
<td>0.7</td>
<td></td>
</tr>
<tr>
<td>Family allowances</td>
<td>0.7</td>
<td>0.7</td>
<td>0.6</td>
<td></td>
</tr>
<tr>
<td>Social Insurance Fund, of which:</td>
<td>1.4</td>
<td>1.4</td>
<td>1.3</td>
<td></td>
</tr>
<tr>
<td>Impose waiting period for sick pay</td>
<td></td>
<td></td>
<td>-0.1</td>
<td></td>
</tr>
<tr>
<td>Employment program, including:</td>
<td>0.4</td>
<td>1.5</td>
<td>1.9</td>
<td></td>
</tr>
<tr>
<td>Flat rate Unemployment Benefit at 60% of</td>
<td></td>
<td></td>
<td>0.7</td>
<td>1.5</td>
</tr>
<tr>
<td>minimum subsistence level</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Enterprise support</td>
<td>0.7</td>
<td>0.7</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Public works</td>
<td>0.1</td>
<td>0.1</td>
<td>0.4</td>
<td></td>
</tr>
<tr>
<td>Sub Total</td>
<td>9.0</td>
<td>11.0</td>
<td>10.9</td>
<td></td>
</tr>
<tr>
<td>Rent and Utility Subsidies</td>
<td>3.5</td>
<td>5.0</td>
<td>2.5</td>
<td></td>
</tr>
<tr>
<td>TOTAL</td>
<td>12.5</td>
<td>16.0</td>
<td>13.4</td>
<td></td>
</tr>
</tbody>
</table>

Notes:
1. 1994 figures are based on six month actuals reported by Goskomstat.
2. Unemployment is assumed to peak at 10% in 1997.
3. Pension projections are based on staff estimates of population growth.

Fiscal Implications of Reform

4.41 This report has stressed throughout the importance of fiscal constraints. It is necessary to show, therefore, that the package of reform options that have been put forward are fiscally responsible. While a broad range of reforms have been examined, only a select few are recommended in the short term. Here we briefly summarize the fiscal impact of the various recommended reforms shown in Table 4.1.

4.42 The net fiscal impact of the entire package could be to reduce current levels of targeted social protection expenditure below the level projected for 1997. More comprehensive social assistance targeted to the very poor would cost about 0.7 percentage points of GDP. The estimated cost of the poverty benefit is based on the size of the "poverty gap" - using a threshold that is 50 percent of the poverty line plus administrative expenses (see paragraph 4.43). Additional targeted spending is on public works (about 0.4 percent of GDP), plus some modest costs associated with raising the low level of unemployment benefits and minimum pensions.
4.43 The projected fiscal costs of social protection would be reduced significantly if reforms to utility and rent prices, are implemented alongside compensation to poor households. Continued reforms to rent and utility prices would alleviate subnational budgets of a significant and otherwise increasing fiscal burden, saving an estimated 2.5 percent of GDP by 1997, and thereby creating greater scope for local financing of targeted social assistance.

4.44 Beyond reduced housing and utility subsidies, the main savings accrue through cuts to pension spending. The impact of further pension reforms--in particular changes to entitlement years--will be felt in later years. The increase in poverty reduction efforts is affordable provided that the cost savings measures elsewhere in the budget are implemented as well. The rest of this chapter sets out the policy options set out above in greater detail.

Strengthening Social Assistance

4.45 Local authorities and the federal government have already taken significant steps toward strengthening social assistance efforts. However further reforms need to be implemented, mindful of the problems associated with incomes-testing and regional disparities, and taking advantage of the potential scope for self targeting. The avoidance of adverse work incentives is also an important consideration. The suggested strategy has two main pillars: first, a targeted poverty benefit, building on a proposal already contained in draft legislation, and second, a scheme of tax credits that could be introduced for the working poor. This would constitute the potential basis for a more comprehensive approach to poverty reduction. Alternatively, Russian authorities could continue to rely upon social assistance measures based on categorical and/or subjective criteria of need. At the same time, the self-targeting potential of temporary employment schemes could be exploited on a wider scale.

4.46 It is useful to briefly reiterate the principles that should underlie the design of social assistance to the poor:

- target those most in need
- provide adequate levels of support throughout the country
- provide work incentives to those who are able to work
- operate within existing fiscal constraints; and
- be as easy to administer and understand as possible.

Tradeoffs must be made to balance these sometimes conflicting objectives: most obviously between adequacy and affordability. Still it is useful to measure any reform proposals against these principles.

Poverty Benefit

4.47 The draft federal law *On the Subsistence Minimum* fares well with respect to the first two objectives--yet is weakened by the likelihood of work disincentives and clouded by the issue of affordability. The proposed benefit aims to close the gap between actual per capita income and the per capita subsistence minimum income in the particular oblast. As the bill stands, the marginal tax rate will be at least 100 percent for households below the threshold, so that an individual or household below the threshold has no incentive to increase work effort, unless they were somehow certain that the incremental income would bring them well over the poverty line. The problem of adverse work incentives is worse for households with children--very quickly the amount of social assistance available to a family with two or three children could rise above the average wage.
4.48 Certain options are available to reduce work disincentives and the likelihood of poverty traps. First, the threshold used to set the maximum benefit could be lower, to mitigate the risk of adverse work incentives. Second, to encourage recipients to increase work effort (and thereby earnings), the level of benefit could be gradually reduced as the income from other sources increases. Either a certain amount of private income could be disregarded (a "free area", e.g. 10% of the subsistence minimum) and/or a taper could be used. For example under a 50% taper, for each two additional rubles earned over the threshold only one ruble of benefit is withdrawn, up until say, 125 percent of the threshold.\footnote{90}{The general practice in a number of countries is to apply a single income test to the combined rate for a married couple. However this means that a married spouse may have very little incentive to seek low-paid work. If each partner is income tested separately, they have a greater incentive to seek even part-time work. The latter arrangement is therefore preferable, though more complicated.}

4.49 As suggested above, careful consideration is needed in setting the level of the poverty benefit, relative to other social benefits, and wages. Otherwise adverse repercussions could follow for work incentives, and the administrative burden could be heavier than necessary. It is recommended, in the light of the foregoing, that the poverty benefit be targeted to the very poor, and set at 50 percent of the oblast level of minimum subsistence. This would be below the recommended levels of social insurance payments in the event of unemployment or old age, and thereby reduce the number of potential applicants for social assistance. Only about 6 percent of the total population would be eligible for such assistance. Even at such an austere level, the poverty benefit would probably still stand above the minimum wage—however, since the latter is used as a scaler for wages and benefits in Russia, and very few people are actually paid only the minimum wage, adverse work incentives are not foreseen.

4.50 The importance of adverse incentive effects is an empirical question: how many households are close to the threshold and what is the elasticity of their labor supply. In Russia, as Chapter 2 revealed, in 1993 poor households were not bunched close to the poverty line. Another option to reduce the risk of adverse work incentives is to give a flat rate benefit, the amount being determined by fiscal constraints and the oblast level of minimum subsistence. The poverty benefit would \textit{not} then seek to bring the particular household up to the poverty line. Poor households could be eligible for benefit amounts based on a certain proportion, say 25 percent, of the oblast level of minimum subsistence. A flat rate benefit would reduce the scope of the poverty trap, but would still not eliminate the disincentive problem for people close to the line. Moreover, such an approach is inequitable in that the poorest households may still be left below the poverty line, while those who were already closer to the line may be pushed much above it. On balance a tapered benefit, related to the individual household's shortfall below the threshold, is recommended.

4.51 Under the draft federal law, the income unit for eligibility is the household, and the per capita requirements of each member (depending on their age and sex) are aggregated, according to the oblast level of minimum subsistence. This raises two points. First, economies of scale in household consumption should be taken into account in determining a household's income requirements. In other words the poverty cutoff for eligibility should be much less than simply aggregating the income requirements of all the household members. In Australia a relativity of 167 percent of the single rate applies for married couples. Further work is needed to determine whether Russia should (for social assistance purposes) take into account economies of scale.\footnote{91}{For treatment of similar question in Hungary see OECD, \textit{The Labor Market and Social Policy Review of Hungary}, May 1994.} Second, since the minimum consumption level varies enormously across oblasts, it is important that an oblast-specific cutoff point for assistance is utilized. It is also necessary that all oblasts use the same methodology, as established by the Ministry
of Labor, to calculate the oblast level of minimum subsistence. Finally, while the methodology should be uniform across the country, individual oblasts could (if they want, and can afford to) supplement local benefits.

4.52 The program could be administered by local departments of social protection. Evidence suggests that current local social assistance efforts are not well targeted (see para. 3.55), so that a significant strengthening of local institutional capacity would be required, in particular staff training. Federal guidelines and support would play a critical role, for example, in the detailed work necessary to develop the means test. Lessons should be drawn from the implementation of the housing allowance scheme. This points to the need to publicize the program's existence, especially among the potentially eligible population. At the same time program administration appears to be quite efficient and client satisfaction is high. The basic outline of a poverty scheme is briefly set out in Box 4.2.

4.53 Any proposed social assistance must not breach existing fiscal constraints. Bank estimates suggest that the program costs (i.e. excluding administration), if perfectly targeted only to those in severe poverty, that is 50% or below the poverty line who are not receiving pension or unemployment benefits, would have amounted to less than 0.4 percent of GDP in the summer of 1993. This could be affordable if there are expenditure cuts elsewhere in the budget (e.g. enterprise subsidies). In March 1995, a survey of selected cities revealed that administrative costs as a share of housing allowance benefits ranged from 10 percent to 50 percent (in Ryazan, where program take-up was only 0.8 percent, and hence the fixed costs associated with administration were relatively high). Based on international experience, the inclusion of administrative costs as well as leakage to the non-poor would increase the cost of the poverty benefit up to about 0.7 percent of GDP.

4.54 Finally, the bill provides that the federal budget shall finance 80 percent of program costs and local authorities would finance the remaining 20 percent and administer the proposed benefit. Central transfers to help finance the benefit should be conditional upon local authorities achieving efficient targeting outcomes in identifying the poor, and possibly upon further reforms such as cutting local subsidies to agriculture. While central transfers will overcome the problem that oblast fiscal capacity is inversely related to need for poverty alleviation efforts, there would be no incentive for local authorities to target as efficiently as possible if all the financing is centrally guaranteed. Variable matching requirements, as described above (paragraphs 4.37-4.38) should be utilized. The federal government could provide specific grants based on estimates of oblast poverty, then an additional matching element could be available. Finally, local authorities could top-up the benefit from local financial resources.

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92/ Contrary to present practice where some oblasts have employed different methods e.g. in Moscow the basket is much more generous.

93/ The scheme proposed here is simpler, than the gap formula used to calculate housing allowances, though it draws heavily upon the work done there. See R Struyk and A. Puzanov (op cit) which describes Russia's experience with the most advanced means-tested scheme to date, housing allowances.

94/ This is for a poverty line equal to 50% of the minimum subsistence level, the precise figure being 0.33 percent of GDP. For a poverty line of 40% of the minimum subsistence level, the cost falls to 0.27 percent of GDP and if it were set at 60% of minimum subsistence, the cost rises to about 0.39 percent of GDP.
Box 4.2 Possible Structure and Delivery of a Poverty Benefit in Russia

Effective delivery of a poverty benefit to targeted households will involve several stages, including:

- **Public information and outreach** about program terms and conditions that would help households assess whether they would be eligible or not.

- **Application interviews** -- conducted in person. First, in group briefings (say for 30 to 60 applicants) program terms and conditions are explained, emphasizing the rights and responsibilities of the program participants and the agency as well as the consequences of misreporting. Second, in individual interviews, applicants provide information on household composition, income and assets, and bring supporting documentation. A preliminary determination of eligibility and the benefit amount is then made contingent upon the accuracy of the information provided.

- **Certification** -- At the end of the interview the head of household is asked to sign the Applicant Data Form and an affidavit certifying that all the information is accurate and that the consequences of misinformation are understood. She/he should also sign a General Release of Information Form to allow the agency to contact relevant third parties and other public agencies in order to verify the accuracy of the information.

**Income eligibility criteria.** Income measured is total income received during the preceding month, net of taxes. The Russian government has already set out guidelines for such calculations (e.g. the Ministry of Labor decree, *On Establishing the Method of the Average Total Household Income Calculation*, January 28, 1994, appendix 1).

The components of total household income should include all wages, bonuses, overtime, and the imputed value of in-kind benefits received from registered or unregistered institutions; and net income from self-employment earned by every member of the household. Income from assets, and transfers received from the government are also included, such as pensions (old age and disability), unemployment benefits, all types of child allowances and maternity benefits. The value of produce from a dacha or vegetable plot should also be counted. Finally, there should be an 'available funds' test, that is any household savings or cash.

Low Income Tax Credits.

4.55 Several industrial countries utilize tax credits for low income individuals and families as a redistributive tool. The basic objectives are clear: to target tax relief (transfers) to poor people and to improve incentives to work. The credit, which should be refundable, operates through the taxation system on the basis of returns filed, to credit workers at certain rates for earned income. This could be a way to target the significant numbers of very poor and poor households who are not receiving any public assistance—the RLMS suggests that they are overwhelmingly working households without children. A significant share of the poor are already in the formal tax system and paying personal income taxes: about 39% were recorded as such in the RLMS in 1992. 95

4.56 The advantages of a Low Income Tax Credit (LITC), are two-fold. First, the benefits create additional work incentives because LITC accrue only to working households, and can be structured to encourage additional work effort. In the US, under the Earned Income Tax Credit (EITC), the credit amount initially increases -- rather than decreases -- for each additional dollar of earnings, remains constant as earnings rise past a certain point, and then decreases with earnings until it is fully phased out. Second, the scheme depends on the capacity of the State Taxation Service (STS) to measure personal incomes, which needs to be strengthened in any case for the system of personal income taxation to function effectively. It does not depend upon the creation of another administrative structure to measure income and the resulting duplication that would entail. However, the tax credit is not the basis for a

95/ This share would have been expected to rise since then—since the real level of the tax free threshold (the minimum wage) has fallen significantly.
comprehensive safety net; there would be a need to implement, alongside the tax credit, various programs for poor people who, for one reason or another, cannot work, or a more general poverty-type benefit.

4.57 In Russia, the operation of a LITC can be illustrated as follows. A LITC could be *tapered* in up to the tax-free threshold, to provide an increasing incentive to work. Between the tax-free threshold and about 25% above that level, there would be a constant lump sum transfer. The LITC could phase out completely at 1.5 times the tax-free threshold. This *possibility* is shown in figure 4.1 for a tax-free threshold equal to the minimum subsistence level. In Russia, the current tax-free threshold is set at the minimum wage, significantly below the subsistence minimum. The scheme would have wider scope if the thresholds were instead linked to the minimum subsistence level. In this example, marginal tax rates are negative for people below the minimum subsistence; and for those close to 1.5 times the minimum subsistence (the phase-out point for the LITC) marginal tax rates are positive but lower than with no LITC. For families with different structures -- e.g. numbers of children -- the cut-off points and rates can be adjusted.

4.58 In practice, introduction of an effective LITC should be based upon higher thresholds (related to, say, the minimum subsistence level as in the example) in order to benefit a significant share of the working poor. However, this, in turn, would require an upward revision of current tax-free thresholds for personal income tax reform, from, the minimum wage to, say the national average level of minimum subsistence. The fiscal cost of a LITC is not predetermined: it would depend upon the tax-free thresholds and tax credit rates selected. Indicative estimates based on the scheme set out in figure 4.1 suggest that the cost would be of the order of 3.5 percent of GDP. 9

4.59 The effect of a LITC would be expected to vary over the income range. First it would likely induce non-workers to enter the labor force by increasing the return to work. For very low income workers who are in the phase-in range of the credit, the LITC would encourage work effort by increasing the return to work. Beyond the phase-in range, the effects on work effort may be less positive--over the flat range, the credit does not increase with earnings but workers would receive a significant lump-sum transfer. The impact of the LITC on poverty depends on the tax credit rates selected: in the foregoing example poverty would be eliminated among the working poor, thereby reducing the incidence of poverty by about two-thirds.

4.60 Policymakers can affect the work incentives for LITC recipients by changing any of three parameters: 97 (i) the income ranges for the phase-in, plateau and phase-out ranges of the credit; (ii) the credit phase-in rates; and (iii) the phase-out rates for the credit. Other policy variables include the eligibility rules, such as whether the individual should be married and/or have dependents.

4.61 Certain preconditions would have to be satisfied in establishing such a scheme. This could take some time, limiting the potential poverty alleviation role of the LITC in the short term. First, the capacity of STS needs to be strengthened. The coverage of the existing personal income tax system is limited. Second, an upward revision of personal income tax-free thresholds would be needed. Third, unlike the US where most claimants prefer an annual lump sum refund following the filing of their tax

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96 This figure overestimates the cost because it is assumed that wage earnings are the only source of income. Also it should be noted that people receiving the LITC would not be eligible for a poverty benefit, thereby reducing the cost of the latter.

return, high inflation necessitates periodic payments and hence an increased administrative burden. This could be achieved by reducing the withholding rates required of employers. Finally, the fiscal costs of increasing the tax free threshold and introducing credits need to be more precisely calculated in order to determine affordability.

Low Income Tax Credit*  

![Low Income Tax Credit Graph](image)

* Illustrated for Minimum Subsistence at 100,000 rubles

Figure 4.1

**Box 4.3 The Earned Income Tax Credit: The US Experience**

A similar system to the Low Income Tax Credit proposed in this report was established in the USA in 1975 and is now the largest cash public assistance scheme in the USA. The participation rate of eligible taxpayers has been estimated at between 80-86 percent, in contrast, say, to food stamps, which are received by only 59 percent of eligible Americans. Approximately 11.2 percent of the American population claimed the EITC in 1992. The corresponding state figures range from as low as 4.8 percent (Connecticut) up to 25.7 percent in Mississippi. Much of this variation can be attributed to state-by-state differences in per capita income.

In 1993, for the 14 million families projected to receive the credit, the average payment was $859 and the program cost was an estimated 0.2 percent of GDP. Effective reductions of the EITC during the 1980s have been criticized as resulting in real levels of assistance that are too low. The Russian government can set eligibility criteria and benefit rates to be consistent with the desired level of poverty alleviation, and fiscal constraints.

4.62 To summarize, social assistance benefits and low income tax credits each have their relative advantages and disadvantages. The proposed poverty benefit is much more thoroughgoing in its scope, whereas the tax credit would only accrue to households with working member(s). However, the poverty benefit would require a significant strengthening of local administration capacity to identify the poor. Under either approach, it would be possible to further target by, for example, varying benefit rates according to the number or age of children in the household.

**Other Forms of Social Assistance**

4.63 There are a range of types of social assistance delivered and financed by local authorities. Examples include one-off cash support, grants of private plots, and the purchase of household items.
However, as Chapter III revealed, these transfers tend to be quite badly targeted and inadequately financed. Few of the poor and very poor currently benefit from local social assistance. Significant steps to improve the operation of local social assistance should be undertaken, with or without the introduction of the poverty benefit and LITC set out in the previous section. The Ministry of Social Protection has already compiled a set of guidelines, based on the experience of local authorities, to help strengthen local targeting efforts.

4.64 Improvements to the system of social assistance, that could be pursued in the absence of a more comprehensive poverty benefit, would involve the following elements. First, a greater degree of federal financial support could be provided, conditional upon better targeting outcomes and matched to a share of local budget financing. Second, the introduction of objective guidelines to determine eligibility would reduce the administrative burden and discretion involved in current approaches. This could be done even in the absence of formal means testing. Third, assistance could be granted on a periodic rather than the present one-off basis which require poor households to re-apply each time assistance is needed—for example, reassessing eligibility each quarter. Fourth, there should be a shift toward cash rather than in-kind assistance, to allow poor households to assess and meet their own needs, provided regular indexation is adopted.

Enterprise reform and employment policy

4.65 Growth in the enterprise sector will help determine the pace and nature of employment growth. In the short term, however, employment and social policy on the one hand, and the need for enterprise reform on the other, present difficult tradeoffs between equity and efficiency objectives. The imposition of hard budget constraints on enterprises has been postponed to some extent, and subsidies have continued, albeit on a curtailed scale. Nor has the most popular approach to privatization, that is transfers to worker-manager control, prompted restructuring. There is still massive labor hoarding in firms. Part of the motivation has been to avoid mass unemployment and social dislocation. This has been at the cost, however, of fuelling inflation, stifling the adjustment process and perpetuating inefficiencies in the economy.

4.66 Aggregate unemployment is expected to rise to levels at least as high (perhaps 10-15 percent), and to be as varied across sectors, as in the countries of Central and Eastern Europe. There are oblasts and towns where the local economy faces collapse and where unemployment rates have risen far above the national average. In early 1994, examples included Ivanovo and Kalmikia oblasts. Differences in regional unemployment rates are already large, and are likely to persist (see Chapter 1).

4.67 Jobs can be created or preserved in the local economy through a variety of means, including temporary employment services, small business promotion, or financial support to loss-making enterprises. The choice between these options will be influenced by financial costs, by the goals for economic restructuring, and by the effects of any scheme on economic efficiency. A reform strategy could seek to alleviate the conflict between equity and efficiency without incurring excessive costs for either objective. First, there may be scope for a regionally targeted temporary employment schemes; and second, enterprise support could be reduced, restructured and directed to support short term employment
objectives. These possibilities are discussed in turn, before making recommendations to improve the effectiveness of income support to the unemployed.

Regionally Targeted Temporary Employment Schemes

4.68 Regional variations in the incidence of poverty, open unemployment and fiscal capacity are large and increasing, alongside significant differences in access to basic infrastructure. In such a context, regionally targeted temporary employment schemes (TES) could play a useful role. Given the significant problems associated with identifying the poor, the self-targeting aspect of TES is particularly attractive.

4.69 Public works programs operate on a very limited scale at present, on a seasonal basis, costing less than 0.4 percent of EF expenditure. The scope of TES is potentially much larger—although limited by fiscal constraints, the implementation capacity of local authorities and private sector capacity. Historical factors are a further constraint. Suggestions in Russia today about temporary employment schemes suffer from the past Soviet association with labor camps. It is therefore important to emphasize that first, participation in the schemes proposed in this report would be entirely voluntary, and second, that the range of activities could focus upon the provision of community services rather than heavy manual labor. Here we sketch out the nature of a possible scheme.

4.70 First it is necessary to determine the types of TES that could be financed. The possibilities range from large infrastructure projects, to the rehabilitation of schools and clinics, to community services. The dramatic decline of public investment expenditure on physical and social infrastructure (see paragraph 1.13) widens the scope for useful activities under TES. It is important to take into account the composition and skills of the unemployed, and in particular, of the long-term unemployed in setting the types of TES. Experience suggests that some earlier versions of mass TES, for example in Bolivia, had a strong bias toward men because of the heavy manual nature of the activities.

4.71 A matrix setting out the types of activities that could be financed under TES, and the population groups that are likely to self-select into different activities, assuming similar remuneration, is shown in table 4.2. Local authorities could determine from a list of possible activities which needs were most urgent, balancing infrastructural and service needs against social assistance objectives given the local profile of poverty and the unemployed. Rehabilitation of facilities that are likely to close down—such as excess hospital capacity—should be avoided. Screening criteria could exclude such types of expenditure. The types of schemes could vary seasonally.

4.72 There is scope for involving likely participants and the private sector in developing the range of activities that could be financed under the TES. While they would have to think within broad guidelines (such as the matrix set out above), prior local participation could help determine such factors as the appropriate length of employment on TES, available skills and the reservation wage. It would help avoid the risk of designing schemes that would face a shortage of labor.

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98/ In principle, workers could be encouraged to move. However, people are generally reluctant to move in times of economic depression, and it is difficult to persuade local communities to accept migrants when many of their own workers are unemployed. Almost two-thirds of a sample of unemployed individuals surveyed in March and October 1994 stated that under no conditions were they prepared to relocate. Likewise proactive programs by the FES (job matching, training, and other measures to encourage labor market flexibility) will help to enhance productivity and reduce unemployment due to structural imbalances in the labor market in the medium term.
Table 4.2 Possible Activities under Temporary Employment Schemes

<table>
<thead>
<tr>
<th>Type of activity</th>
<th>Likely self-selecting target group</th>
<th>Likely private — public participation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Laboring on basic physical infrastructure works/repairs</td>
<td>males under 50</td>
<td>Private construction contractors</td>
</tr>
<tr>
<td>Public cleaning/sanitation activities</td>
<td>both sexes; males for heavier tasks</td>
<td>Typically public</td>
</tr>
<tr>
<td>Social services ancillary services (e.g. feeding, cleaning, laundry)</td>
<td>women</td>
<td>Small businesses</td>
</tr>
<tr>
<td>Home care for the aged</td>
<td>younger unemployed; women</td>
<td>NGOs</td>
</tr>
<tr>
<td>Environmental cleanup</td>
<td>younger unemployed</td>
<td>NGOs</td>
</tr>
<tr>
<td>Childcare outside of formal kindergartens</td>
<td>women</td>
<td>Small businesses</td>
</tr>
<tr>
<td>Rehabilitation work on social facilities</td>
<td>males under 50</td>
<td>Private construction contractors</td>
</tr>
</tbody>
</table>

4.73 Second, the mechanics and institutional arrangements have to be established. Under a demand-driven approach, the local authority would invite bids that fall within the criteria set out above. This approach has worked well in Chile, for example. Government authorities should not directly implement all schemes. Rather, this could be an opportunity to promote private sector development. Private contractors should be encouraged to bid, and public agencies (e.g., the local department of public works) would have to compete with them for projects. Certain activities could be limited to private sector participation.

4.74 Overall responsibility for TES would be largely devolved to the oblast level with close federal monitoring of procurement and execution. The relevant department of the local authority (e.g. roads or social protection) should be involved, as well as the department of finance, and representatives of the employment service. The oblast Department of Finance could be responsible for allocations. This mechanism would also facilitate overall consistency with local budget priorities and management. Bids could be judged on the basis of some weighted combination of cost benefit appraisal, and the likelihood of self-selecting the long-term unemployed or some other target group.

4.75 Third, the TES benefit (wage) has to be set at an appropriate level in order to promote self-selection. This mechanism operates through attaching work to a wage set between the reservation wage of the unemployed and that received by people in work. In this case, given excess labor supply, the risk of increasing the private sector wage is small. Offering firms cheaper labor in a surplus labor market may reduce wages. The level at which the benefit is set depends partly on the main purpose of the scheme. It is recommended that the main objective should be to self-target the poor by attaching work requirements to benefit receipt, so that the TES benefit can be set quite low. However, a workfare scheme is not recommended—in the sense of requiring recipients of public assistance to work. TES should be strengthened alongside the introduction of a poverty benefit for the very poor.

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Fourth, targeting criteria, for both regions and individual participants, have to be established. The scheme should be concentrated on a subset of hard hit regions. Regions could be selected based on a composite index that captured the oblast unemployment rate and fiscal revenue (or household income) per capita. Schemes typically work best if there are no additional restrictions placed on eligibility, and rely on self-selection through the wage offered. Nonetheless, if long-term unemployment is an acute problem in the locality, individual participants could be restricted to the registered unemployed—and perhaps only those who have been out of work longer than eight months. TES should not seek to include those who are unable to work (e.g. disabled), nor those whom society does not expect to work (such as women with very young children).

Finally, the financing arrangements have to be determined. TES should be distinguished from those "job creation" activities that have dissipated a significant share of Employment Fund resources which the Government intends to curtail. The federal government could finance the TES out of the recently established Regional Fund. The Ministry of Finance could monitor oblast allocations, say quarterly, focusing on (i) cost-benefit appraisal; (ii) private sector participation; and (iii) the degree of local co-financing. Local co-financing, through matching requirements, could be used to demonstrate local commitment to TES projects and help to ensure that any recurrent costs after completion will be covered locally.

From a financial point of view, TES can be expensive, relative to simply giving poor people a cash benefit. TES typically require expenditure on complementary inputs, while workers may have to be paid above the minimum wage. The output may not generate revenue to defray the costs (although the potential for revenue generation could be part of the decision about which types of TES to initiate). The overhead costs could be significant. A significant advantage of TES, however, lies in the potential for self targeting in a context where identifying the poor is difficult.

Contrary to present practices in Russia, where in 1993 57 percent of public works participants were not even drawn from the unemployed. Only 9 percent were those whose unemployment benefit had expired.
The coal sector in Russia, as in many other countries around the world, is facing a difficult process of restructuring. Despite price liberalization, coal subsidies still consume about 1.2 percent of GDP—second only to agriculture in the burden imposed on the government budget. The subsidies exceed the industry's total wage bill, even though wage arrears are running high. Coal demand has fallen significantly, yet employment in the sector has not adjusted.

Given so many urgent competing demands on the federal budget, the World Bank has recommended that subsidies to coal be phased out over the next 3-5 years and that, from 1996, all subsidies budgeted for the coal industry should be directed to enterprise social services, special lump-sum redundancy payments, and temporary employment schemes.

The goal of restructuring is to adapt to the new market environment, and to reduce the drain on the government budget. It is recommended that subsidies directed to pay wages should cease, and each mining company should be fully responsible for its own wage bill. The overall reduction in employment required in the coal industry has been estimated by the World Bank to be of the order of 30 percent. The impact of restructuring is likely to vary across regions—in Kemerovo and the Komi republic the scale of reductions in coal jobs is very large relative to total employment.

In the hardest hit coal regions, the Government could consider establishing special temporary employment schemes. The types of activities could include environmental restoration and rehabilitation of infrastructure. However, it is important to avoid large infrastructural investments in regions with poor overall economic prospects.

Source: World Bank, Restructuring the Coal Industry, Report No.131187-RU

Restructuring Enterprise Support

4.79 Current transfers to enterprises are non-transparent and excessive in size and may distort prices. They are received by politically powerful and well-connected enterprises, not just by enterprises in difficulty, and sometimes support production of non-saleable output. They are not conditional on firm restructuring. Enterprise subsidies currently tend to merge, and therefore confuse, three separate problems: the present illiquidity of the firm; the individual workers and their employment needs; and the individual's family, that may or may not be poor. And as a result enterprises are given an excuse for demanding more subsidies.

4.80 The current approach to enterprise support to promote social and economic objectives is very inefficient. The incidence analysis above revealed that enterprise benefits tend to flow to better off households, for example, not to the poor, and even less to the very poor (see Table 3.3). However, it is beyond the scope of the present report to deal with the complicated issues of enterprise restructuring. It is nonetheless clear that assistance to the poor generally should be given directly to individuals and families, rather than through enterprises.

4.81 It is nonetheless possible that in certain circumstances, it might be justifiable to postpone enterprise closure and mass layoffs. Such situations might arise in one company towns where very few alternative job opportunities exist. Maintaining workers within firms, rather than outside on unemployment benefits, could be justifiable in terms of the expected duration of unemployment and potential social externalities. If employees stay attached to firms, they retain contact with the labor

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101/ There is an extensive literature documenting the ill-effects of long term unemployment, both for the individual and the economy: for a recent review see OECD Employment Outlook, 1993
market, and there is evidence to suggest that job search while working may be more effective.\textsuperscript{102} Employees may also have access to equipment and facilities that allow informal earnings.

4.82 However in practice, the multiplicity of current support schemes is wasteful, opaque and resistant to monitoring and accountability. A large part of the subsidies given to support enterprises do not accrue to the workers. It may be appropriate to provide temporary subsidies from the budget, as opposed to providing them through bank credits, on a declining basis. Such subsidies should be used to promote restructuring, as in the coal sector, where the World Bank has recommended that all subsidies from 1996 be limited to financing lump-sum redundancy payments, temporary employment schemes and enterprise social services (see Box 4.4).

4.83 From a poverty perspective, TES have distinct advantages of self-selection of the poor and that they can be structured to target people in need -- such as the long-term unemployed, as well as enabling people to preserve or gain new work skills. Recent falls in public investment spending leaves opportunities to create useful social or economic infrastructure. The scope for promoting private sector development are further significant attractions. There are distinct groups of participants that would benefit from TES, namely the long-term unemployed and small businesses. In contrast, enterprise subsidies support existing firms and workers at risk of being laid off. Russian policymakers could consider the design and implementation of both TES and redirected enterprise support, perhaps on a pilot basis, though with increasing emphasis on regionally targeted TES as economic restructuring proceeds and long-term unemployment rises.

**Wage Policy**

4.84 In industrial market economies, the direct role of the Government in wage determination varies.\textsuperscript{103} On the one hand, there are more coordinated approaches such as found in, say, Scandinavia and Australia, and on the other, the decentralized model characterizing the US. Typically, however, wage policy tends to be driven more by concerns about labor costs and inflation than by concern about living standards. Government intervention in wage setting is primarily to set a low "non-accelerating inflation rate of unemployment" (NAIRU).\textsuperscript{104} At the same time, there may be agreements or regulations that seek to protect low paid workers while mindful of the possible adverse repercussions of raising labor costs at the expense of increased unemployment.

4.85 In Russia, during the transition the average real wage has fallen, but given the slow adjustment of employment levels to falling output, unit labor costs have begun to rise, by 7.2 percent in 1993 and 12.1 percent in 1994.\textsuperscript{105} There have been corresponding falls in labor productivity in 1992-1994 -- a cumulative decline of about 50 percent. In such a context, why should the Government be involved in wage setting? Raising the price of labor, in a market economy, will typically lead to reduced

\textsuperscript{102}/ Layard and Richter, 1994 \textit{op cit.}

\textsuperscript{103}/ See World Bank Report Number 11748 \textit{Social Protection During the Transition and Beyond} pp. 155-158 for a more extended discussion of systems of wage determination.

\textsuperscript{104}/ The underlying idea is that such interventions might help overcome information asymmetry and coordination problems that lead to higher inflation and unemployment: see generally Dombush and Fischer \textit{Macroeconomics} McGraw-Hill, 1992.

\textsuperscript{105}/ See Commander, Dhar and Yemtso\v{\i} 1995 \textit{How Firms Make Their Wage and Employment Decisions}. Preliminary Draft World Bank mimeo. Labor costs are still a low share of total costs -- approximately 20 percent of total costs in industry, including social costs.
demand for labor -- if the minimum wage is raised very significantly from its currently low level, then the repercussions would be felt first by low paid workers who would be retrenched and thereby become worse off than before. Beyond the fiscal costs, this is the fundamental dilemma faced by policymakers in setting the level of the minimum wage in Russia and elsewhere.

4.86 Governments in market economies tend to pursue distributional objectives through taxation and transfer mechanisms rather than direct intervention in wage determination. The poverty reduction strategy set out in this report largely relies on the one hand, on stabilization and the resumption of economic growth to create decent income earning opportunities, and on the other, on tax-financed income transfers for poor people who are unable to work, either because they cannot due to old age, or because there are no jobs available. In this context, the most direct vehicle for the Government to affect workers' net incomes is through the system of personal income taxation: a progressive approach can be used to exempt the poor (see the recommendations to increase the tax-free threshold and introduce low income tax credits above) and levy higher marginal rates of taxation on higher paid workers.

4.87 In Russia, the Government does influence wage payments in at least two ways. First, the level of payroll taxes may well reduce take home pay if in Russia, as elsewhere, the burden of the tax is borne by labor. This suggests that levels of payroll taxation should be carefully monitored and not raised unduly. The second potential instrument for influencing labor compensation is the minimum wage, that is established by the Duma. The minimum wage has eroded much more significantly than the average wage during the course of the Russian transition -- by the end of 1994, the minimum wage stood at only 15 percent of the December 1991 level compared to about 51 percent for the average wage. Although very few workers actually receive the minimum wage, it operates as a numeraire setting the level of some social transfers (such as minimum unemployment benefits being received by 60% of recipients in early 1995). Budget sphere money wages are set as a multiple of the minimum wage, although they also receive a range of additional cash and in-kind allowances. The Government has resisted large rises in the minimum wage because of the budgetary implications (although the nominal level was doubled as of May 1995).

4.88 This report recommends delinking of the major social transfer programs from the minimum wage. Under the proposed reforms, the minimum level of unemployment benefits and pensions would be related to the minimum level of subsistence, as are the proposed poverty benefit and tax credits for the poor. The minimum wage is too low to perform the role of a benchmark for major social transfer programs.

4.89 The only sector where the Government cannot escape a direct role in setting wages is the budget sphere. Remuneration in the budget sphere has become a problem, both from a poverty perspective and also because of the "brain drain" of the many talented staff to the private sector, as well as the anecdotal evidence suggesting moonlighting and corruption. Relative wage declines have been especially sharp in the spheres of culture, science and research. Certain wage reforms could help to build a modern professional civil service cadre. On the institutional side, the current wage structure is rigid and the Duma plays a critical role in setting the minimum wage. A new pay and grading structure could


be introduced that would simplify the inherited Soviet system and delink levels of pay from the minimum wage. More regular indexation is needed, within the constraints set by stabilization objectives. A major challenge for the Russian government will be to realign the skill structure of the civil service, possibly reduce the number of staff and increase wages in accordance with skills and productivity.

**Making Existing Social Benefits More Efficient and Fairer**

**Assistance for the Unemployed**

4.90 Many households affected by unemployment are in poverty, as chapter 2 revealed. Not surprisingly, surveys suggest that unemployed individuals regard benefit payment as the most important function of the employment service. Yet the level of average unemployment benefits was very low during 1994, averaging about 15 percent of the average wage. This was due to the effect of high inflation as benefits are related to past earnings. The floor, or minimum benefit, is even lower being set at the minimum wage. It is recommended that the minimum level of unemployment benefit be raised closer to oblast minimum subsistence levels (say 60 percent thereof), and reviewed quarterly. Since the present scheme is complex administratively, and it is not feasible to increase payments so as to create a genuine social insurance system for the unemployed in the short term, the government could adopt a flat rate scheme for the unemployed for the time being. Alternatively, benefit entitlements should be linked to wage entitlements rather than wages received, to increase the level of benefits for people who had been on short-time work, administrative leave or subject to wage arrears.

4.91 The rules governing the receipt of unemployment benefits should be tightened and enforced. The definition of "unemployed" could be clarified so that only people without any wage earnings are included. In October 1994, surveys suggested that around 25 percent of unemployment benefit recipients held secondary jobs, and a further 10 percent actually held primary jobs and were working on nearly a full-time basis. Given severe fiscal constraints and equity objectives, it is preferable not to provide public support to people who can get by themselves. Many countries means test eligibility for unemployment benefits although that additional test is not recommended here. Individuals should only be eligible for benefits if they do not have any wage earnings—the fact of losing a job should not suffice.

4.92 The local employment service office should have clear knowledge about the local labor market so that, for example, people who refuse appropriate job offers are excluded from benefits. The payment transaction can be used to provide accurate and up-to-date advice to jobseekers. This would include information about skills in demand, job possibilities outside the locality as well as about the types of service available, such as retraining and TES. Clearly the quality of such advice will depend critically upon the local FES staff maintaining close relations with local employers. At present, not only are rates of registration among the unemployed low, a widespread perception among the registered unemployment is that there is little or no probability of finding a job through the FES.

4.93 Only a relatively small proportion of the unemployed are registered as such, and an even smaller share receive benefits. How can or should the FES assist people whose working hours and earnings have been drastically reduced but do not come and collect benefits each week? In most European countries, employment services take the route of only serving minimally those people who do

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108/ A VCIOM survey of 1016 registered urban unemployed individuals indicated that for those receiving job offers, roughly half made one or more refusal. See Volume II, Commander and Yemtsov.
not receive benefits. In Russia there is provision for income supplements to be paid out of the EF to people on unpaid leave receiving less than the minimum wage, for up to three months, although this has not been widely utilized. It could be useful for the FES to provide them with job search assistance. A survey of the poor in March 1994 revealed that 14 percent cited help to provide them with job search assistance. A survey of the poor in March 1994 revealed that 14 percent cited help to find a new full-time or secondary job as the kind of aid their family most needed (cited by even more, 18 percent, single parent families).

4.94 In many industrial countries, large and growing numbers of people have become long-term unemployed. Russia has not yet had to face this problem largely because labor hoarding has persisted and labor demand appears to have been relatively buoyant. Average spells of unemployment have remained fairly short—between 60-80 percent of those registered as unemployed left within four months. Long term unemployed (those in a current spell exceeding one year) comprised only 8 percent of the unemployed stock at the end of 1994 (although this had risen sharply from about 2 percent a year earlier). It is nonetheless important to consider policy responses to combat long-term unemployment, since this is likely to become an increasingly serious problem. In Europe, many active labor market programs are aimed at the long-term unemployed, or people thought to be at risk of becoming so, including vocational training, recruitment incentives, direct employment, aid for entrepreneurship, and counselling and guidance. In 1992 the UK spent around 0.5 percent of GDP on such schemes and Portugal around 0.6 percent.

4.95 Several questions arise with respect to the long-term unemployed. Should they be entitled to some form of social assistance once their unemployment benefit is expired, and if so, at what level and under what conditions? Provided that the rules governing receipt of benefit are more strictly enforced—especially about wage earnings and job refusals—there is a case for allowing unemployment benefits to extend beyond twelve months. The case for extending benefit duration is stronger in those regions where the severity of unemployment and local demand conditions are such that longer duration is unlikely to adversely affect work incentives. Shifting people over to social assistance creates administrative difficulties and also reduces individual access to job search assistance. If longer or unlimited benefit duration is thought undesirable, the regionally targeted TES described above could be aimed at the long-term unemployed. It is nonetheless important to appreciate that workfare schemes are more costly than simply giving people money. It is therefore necessary to identify social or economic benefits (such as self selection of the poor or skills preservation) that justify the additional public expenditure.

Family allowances

4.96 Families with children form the largest poverty group in Russia. Yet the case for a universal child allowance is questionable during a fiscal crisis. Most households receiving family allowances are not poor (see paragraph 3.53 above). The recent trend in a number of countries has been to means-test what were traditionally universal payments.

4.97 The simplification and greater transparency of the system of family allowance as well as increased benefit levels, introduced in 1994, are welcomed. However, further reforms are desirable. The new system increased costs, to about 0.7 percent of GDP in 1994.

4.98 Family allowances should be targeted to families that need additional support. Categorical criteria could be used to restrict receipt of the unified monthly benefit to households with three or more children, or to households with children under, say, three or six years of age. Both factors were shown to be significantly correlated to the risk of poverty in Chapter 2. On the same grounds, the additional
publicly-financed benefit for working mothers should be extended to non-working mothers and care-takers as well.

4.99 It is recommended that, whether or not family allowances remain universal, such benefits should be included in the definition of taxable income so that their net value to the household would be reduced as household income increases. Under the means-test for social assistance or tax credits, any entitlement should be reduced by the full amount of any family payments received.

Pensions

4.100 The major category of expenditures in the Russian social safety net is pensions. Pensions also present a serious source of pressure on public spending. The key parameters that determine the financial balance of the Pension Fund is the share of elderly in the population, relative to the formal workforce, and movements in the real wage on the one hand, and indexation rules on the other.

4.101 A striking characteristic of the Russian pension systems is the ability of an elderly person to both draw a pension and to work full-time. Approximately 22 percent of all pensioners worked in early 1993, including 40 percent of both the privileged and early retired groups of pensioners. Very few social pensioners work although their benefits are very low.

4.102 The earnings-related component represents the bulk of pension payments. The average pension replacement rate is high by international standards -- in 1994 average pensions in Russia ranged between 31-42 percent of the average wage. Given fiscal pressures, and evidence that many pensioners are not badly off, a flat-rate benefit is recommended. This benefit could be set at about the minimum subsistence level for elderly people. This is significantly above prevailing levels of the minimum pension which averaged only 60 percent of the subsistence minimum in 1994, so poor pensioners would be much better off. If general flat rate indexation is not thought feasible, each quarterly indexation could alternate between flat rate and proportionate, pension adjustment. The latter measure (increasing all pensions by some fixed rouble amount), which was followed for several months in late 1993 and again 1994, tends to compress the pension structure, eventually resulting in a flat-rate benefit. Less drastic steps include the elimination of double-dipping, to stop people from receiving full pension benefits while working full-time.

4.103 If the foregoing measures are not politically feasible, there still could be more limited steps in the appropriate direction. No new groups eligible for pension privileges should be created. Pensions for working pensioners could be reduced by, say, 25 percent through partial indexation. Instead of flat rate indexation for all, a declining scale of indexation could be introduced—the higher the benefit the lower the rate of its adjustment to inflation. This would reverse the trend apparent in 1994, where the average pension was protected better than the minimum. In any case, the total income of pensioners should be subject to personal income tax, including any earnings and benefits.

Disability Benefits

4.104 The presence of disability is strongly correlated with the risk of a Russian household being in poverty. There are benefits in the event of disability, although the system is unnecessarily complex. At the same time there are people whose disability does not affect their ability to work who are receiving public benefits.
4.105 It is recommended that Group I and II disability pensions be combined into a single category. As in most industrial countries, there should be a recognition that people classified as totally incapacitated may be able to do some work. Hence the retirement condition should be abolished (it is generally not enforced anyway). Group III pensions for the partially disabled could be abolished. The partially incapacitated should receive a modest (non means-tested) disability allowance, and, if they qualify under the normal conditions, social assistance. About 62% of this group worked in any case in 1992.

Sickness Benefits

4.106 Consistent with the practice in most industrial countries there should be a waiting period (say two days) before one becomes eligible for sick pay (due to non work-related conditions). Employers should bear the cost of the following three days. This would reduce SIF expenditure by an estimated 0.1 percent of GDP. Enterprise contribution rates to the SIF should be adjusted to reflect the shift in responsibility.

Raising Housing and Utility Prices and Protecting the Poor

4.107 It was shown above that subsidies to the housing sector (covering housing and domestic utilities) are a large drain on subnational budgets. In the absence of pricing reforms, the fiscal burden is likely to worsen as the relative price of domestic energy is increased. Hence the Government adopted a timetable for gradual subsidy removal over a five year period to 1998. A program of increased cost recovery, alongside housing allowances\(^{109}\) has begun to be implemented in many oblasts across the country. Informal monitoring (by The Urban Institute) suggests that most jurisdictions sought to reach the target of increasing rents to cover 20 percent of full operating costs in 1994.\(^{110}\) At the same time, it is critical that pricing reforms take into account the needs of vulnerable groups.

4.108 The Government is aware of the need to protect or compensate poor families who would be adversely affected by the liberalization of domestic utility and housing prices, before the implementation of significant price reforms. There are several options available, including:

(i) *Lifeline rates.* Introduce Price differentiation for different levels of consumption of utilities could be introduced, e.g., a single block based on a certain minimum consumption could be free.

(ii) *Preferential rates, cash or vouchers for the certified poor.* In some cases, such as Hungary, payments are given to families in a desperate situation, based on social worker evaluation. In Russia, the scheme of housing allowances, operating on a broader means tested basis, is being introduced to assist the poor in meeting increased housing costs.

\(^{109}\) The term "housing allowance" should be construed here in a broad sense: the costs included for calculating the allowance include rent (maintenance and repair), heating, hot water, gas, rubbish removal and water and sewerage.

\(^{110}\) The percent of operating costs to be covered by tenants is to rise to 20-40 percent in 1995, 40-60 percent in 1996, 60-80 percent in 1997, and 100 percent in 1998. The problem is, however, that there is no clear indication of what full cost recovery implies, and therefore the scale of future price increases implied by the announced reforms is unclear.
Increase in minimum cash benefit rates. Increased levels of minimum pension, unemployment benefits, and so on, to reflect increased costs for housing and utilities. This would occur if those benefits were related to the level of minimum subsistence.

In principle, it is probably preferable to avoid the proliferation of different types of assistance to the poor, administered by different agencies, which suggests that the third option is to be preferred. Yet it may well be unrealistic to expect adequate compensation for utility price increases through increases in general social assistance and wages, at least in the short term. Moreover, experience in Croatia and Hungary for example, suggests that indexation of wages and benefits alone will not suffice to protect the poor. These governments introduced emergency assistance to households under threat of, for example, disconnection of electricity.

With respect to the alternative compensation mechanisms, it is important to avoid incentives for households to waste energy, which can happen where the size of the subsidy is determined by actual energy costs. The lifeline rates suggested above would help avoid wastefulness, but if the quality of housing is lower for poor families, they may consume more heat than better off households. Moreover a critical, and likely continuing, obstacle in Russia to this type of approach is the absence of meters for domestic utilities, except electricity. Another possibility, closer to social assistance, would provide the maximum subsidy to the lowest income groups (regardless of actual utility expenditure), then the subsidy would be gradually withdrawn as household income increases. This has been recently adopted in Bulgaria, where with respect to electricity, the population is divided into three income groups, and the subsidy declines as income rises.

In Russia, many local authorities have begun to implement housing allowances to mitigate the impact of increased costs of housing and utilities on poor families. Separate offices have been established to administer the allowance at the municipal level. This is done on a means-tested basis, depending on the share of income spent on rent and utilities relative to certain norms. Income verification procedures are simple, based on stamped documentation of wages, pensions and other forms of income. Most localities require that households must spend 10 percent of income on rent and utilities before receiving the subsidy. There are variants, however. In Nizhny Novgorod, there is a graduated scale beginning at 2.5 percent of income for the poorest households and increasing to 10 percent at moderate income levels. Moscow oblast subtract a minimum wage for each household member in determining eligibility. Household eligibility is re-established every six months. In many jurisdictions, administration of the program is computerized.

Take-up in the housing allowance program among eligible households has been low to date -- from 5 to 10 percent. This is attributed to lack of information about the program and eligibility, as well as still low rents and relatively large household contribution rate. Most monthly subsidy amounts are quite modest -- a few thousand rubles. In six selected cities surveyed in March 1995 the average subsidy ranged up to R13000, and the participation rate varied from 1 percent (Ryazan) to 12 percent in Nizhny-Novgorod. The cost of the housing allowances benefit and administration averaged about 1.5 percent of incremental rent collected. As a result, the evidence suggests that most increased rental revenues actually accrue to the local budget, and seem to be directed to improved maintenance and repair.

111/ See Struyk et al (1993) Implementing Housing Allowances in Russia, and Struyk and Puzanov (1995), Monitoring Russia's Early Experience with Housing Allowances. Urban Institute Report 93-1. The Urban Institute, under a USAID project, has been active in helping to establish the program.
At the same time, the Government has maintained preferential tariffs for selected groups in the population, who typically pay only 50 percent or less of the set price for rent and utilities. Some of these groups may be considered "at risk" (such as families with many children), but others are not (an obvious example is police). There is no need to maintain these conventional privileges once the new housing allowance scheme is implemented. This report has shown that the vast majority of the poor in Russia today do not fall into the traditional categories, and that traditional approaches to assistance miss many poor and very poor households (see paragraphs 3.48 - 3.57).

The reduced burden of utility and housing costs on municipal budgets should create scope for spending on better targeted locally financed social programs. Overall, it seems that the Government has established a clear and workable framework for compensation to poor households against the impact of rent and utility price increases, through the housing allowance program. The demands on the program will grow as the real costs of housing and utilities are increased (for example, the price of gas increased ten-fold on March 1, 1995). More active measures may be needed to promote public awareness about the program, and to encourage take-up among eligible households. In the longer term, consideration could be given to integrating the housing allowance scheme into the system of social protection. This will be especially true if local departments begin to deliver means-tested social assistance to the poor, as this report recommends. Nonetheless, it might still be advisable for local authorities to provide temporary assistance for payment of rent and utility bills in emergency situations.

A final point relates to the possibility of enabling individuals to use their housing assets to increase their current income. Survey data suggests that there is a significant age dimension to the misallocation of housing stock relative to current purchasing power. It seems that elderly households in the lowest income quartile have more housing space than young households in the highest income quartile, on average as much as five square meters per person more. This, of course, is not universally true, and ignores such variables as quality and location. Nonetheless, it seems that some poor pensioners might be able to move out of poverty if their housing wealth could be liquidified. This could be dealt with through a financial program -- such as the experimental Home Equity Program now underway in the U.S. This allows the elderly to stay in their homes and issue a reverse mortgage which pays them an annuity for the rest of their lives, in return for an agreement to transfer the property on death to the payee. A preliminary evaluation of the US program indicates success.\textsuperscript{112}

**Health Sector Reform**

The performance of the health system, its organization and financing are topics outside the scope of the present report.\textsuperscript{113} The discussion here is limited to an overview of the direction of health care reform from a poverty perspective.

Utilization of health care is already lower for poorer groups. The RLMS suggested that few people, and especially among the very poor, use preventive services. This is especially unfortunate in that the epidemiological picture that emerged confirmed that the major causes of death (cardiovascular disease, some types of cancer and violence) could be reduced with preventive interventions. The major

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\textsuperscript{112} The scope for such a scheme in Russia is being explored in ongoing World Bank research: see Buckley and Gurenko (1995), *Housing Demand in Russia: Rationing Revisited*. The World Bank. March.

\textsuperscript{113} A separate World Bank report (*Russia: Reform of the Health System*) traces many of these issues.
risk factors identified include smoking, alcohol consumption, obesity, hypertension, and psychological and social stress. Improvements will in part depend on public education and long-term behavioral changes. There are significant variations in health expenditure among oblasts. Yet simply increasing financing for poorer oblasts would probably not solve the complicated problem of access. Access to services is limited by such factors as vaccine shortages, non-payment of salaries, and poor transportation in rural areas.

4.118 Increasing use of preventive services depends on overcoming a series of biases in the current system. Primary level facilities are the lowest funding priority, and the system is managed by and oriented toward curative care, in particular, hospital-based specialists. In some central Russian oblasts, for example, despite reductions in health funding, inpatient share continues to receive an increasing part of total spending, and inpatient care does not appear to be changing.

4.119 Given the significant disparities in health indicators, and since the vast bulk of health expenditures are locally financed and the proceeds of health insurance payments are locally retained, variations in local health expenditure and service provision should be closely monitored. There may be a need for greater federal support to combat emerging disparities.

4.120 This leads to the following recommendations for consideration in future health reforms:

- Reorientation of care toward health promotion, preventive medicine, primary care, and maternal and child health, including family planning. These types of interventions have proven to be cost-effective and to have the greatest impact on mortality and morbidity.

- Special attention should be given to developing system management and quality assurance regulations and ensuring access, especially in remote rural areas.

- Health financing reforms should take into account possible adverse repercussions for equity stemming from the introduction of health insurance and shifts toward increasing cost recovery. The new legislation does clearly state the government’s obligation to finance services for the "non-employed", but not necessarily for all disadvantaged groups. However it appears that under the new HIL system, those not making payroll contributions (including the unemployed and the elderly) are dependent upon general revenues and household resources to finance their medical needs. This may render them even more vulnerable to economic fluctuations and associated fiscal constraints in the absence of a clearly defined basic package of care.

- Although some co-financing of certain services may lead to improved utilization, most primary services should be free. The household survey suggested that private expenditures on health care are still relatively low (though higher among the poor). Efforts are needed to define a basic package of care, narrower than the scope of services currently provided, for which access should be free.

- There is a need to define transparent guidelines for the allocation of Federal Health Insurance money to the regions in order to meet equalization objectives.
IMAGING

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