# Poverty in Russia during the Transition: An Overview

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*It is no surprise that the breakup of the Soviet Union and the overall demise of the planned economy has had a profound effect on the welfare of the Russian people. But the absence of reliable survey data has constrained our understanding of the impact that transition has had on the distribution of income. This article draws upon several rounds of a nationally representative household survey to document the sharp increases in the incidence and severity of poverty that have occurred during the transition. We investigate the routes by which macroeconomic and structural developments have been transmitted through the labor market and examine the performance of an increasingly overburdened, unfocused, and inadequate system of social protection. There is no evidence to suggest that the poor have shared in Russia's emerging economic recovery, and the emergence of a core group of long-term poor appears to be a distinct possibility.*

The social and economic changes that swept across the former Soviet Union in the early 1990s were unprecedented in scale, scope, and speed. The collapse of an empire that spanned eleven time zones and encompassed more than 250 million people and a multitude of ethnic groups has had far-reaching consequences, both domestically and internationally.

The Russian Federation, which covers a vast expanse of Europe and Asia and includes a wide variety of social and cultural groups, naturally looms large in perceptions about the transition from a centrally planned to a market-oriented economic system. For many Russians that transition has been marked by the polarization of a previously egalitarian society and a dramatic increase in the scale of poverty and deprivation. The people who have been most adversely affected by structural changes in the economy were not necessarily so badly off under the old system, suggesting that some conventional assumptions about the structure of poverty need to be adjusted.

Underlying the sharp increases in the incidence and composition of poverty have been the overall decline in national income and the simultaneous increase in in-

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equality. Aggregate shocks to output and productivity have been unevenly distributed among different groups in the economy. We trace the underlying mechanisms that reflect a shift from a system with controlled wages and incentives to maximize employment to a far less constrained environment, albeit at temporarily much lower overall levels of output and productivity. Adjustment in the labor market has affected overall earnings and wage disparities at the same time that the number of employed has declined along with total number of hours worked. Although the government social protection system has yet to adapt to the new economic conditions, the fiscal constraints have hindered its ability to offset the increase in poverty. Growing regional disparities associated with economic liberalization have similarly strained the fiscal capacities of local authorities to effect redistribution.

As the economy stabilizes and clear signs of economic recovery emerge, the situation of the poor could be expected to stabilize and improve. Recent evidence suggests that the worst may be over, although the number of households and individuals below the poverty line continued to rise somewhat in 1995 and 1996. Beyond the direct recessional repercussions of the transition in Russia, the shift toward a market economy will have long-term implications for the poor. Changes in relative prices mean that certain groups (characterized, for example, by skill or location) are likely to be relatively better or worse off than they were before the transition. Inequality is also likely to remain higher than it was in the Soviet period, although the precise pattern of distribution will clearly depend on the government's tax and transfer policies.

This article first looks at the macroeconomic trends relevant to household welfare that have characterized Russia's transition. It then reviews the data sources and methodology—a critical dimension given the paucity of reliable data—and presents the major findings that have emerged from a recent analysis of poverty. After examining developments in the labor market and the limited effectiveness of public income transfers in alleviating poverty, we present some conclusions about social protection policy and its effect on poverty in Russia.

## The Economic Backdrop

Russia inherited a command economy whose weaknesses had become manifest in the 1980s (Easterly and Fischer 1995). The economic story since 1991 is by now familiar to most readers. As the old political regime crumbled, inflation surged and output fell precipitously, leading to the collapse of internal and external trade and a rapid rise in the fiscal deficit. High inflation, which continued to 1995, severely depressed economic activity throughout much of the economy, and real earnings declined. Rapid consumer price inflation followed market liberalization in early 1992 and had adverse effects both generally, in accentuating the depth and duration of the output recession (Popov 1996), and specifically, among those groups whose wages and transfer payments began to lag behind prices.

With the collapse of output, gross domestic product (GDP) fell more than 40 percent during 1991–96 (EBRD 1997). That decline places Russia among the worst of the formerly planned economies; estimated GDP decline ranged from 11 percent in Poland to 57 percent in Lithuania (de Melo, Denizer, and Gelb 1995). These estimates for Russia are problematic, however, because the structure of the decline in output and other measurement problems, as well as the failure to account for output from most informal sector activity, understate post-1991 output. Consistent with the pattern in other transition economies, there has been a relative expansion of the service sector's share of GDP (from 31 to more than 50 percent during 1989–94), especially trade and financial services, and a reduction in the share of investment and military production; part of this 'growth' in services, however, is attributable to changes in classification as well as in relative prices. Unofficial economic activity of both new private firms and privatized state enterprises has been expanding at a robust pace (Gavrilenko and Koen 1994). Industrial restructuring has been associated with a marked shift from secondary manufacturing into raw materials industries. The share of resource industries (energy, steel, and nonferrous metals) in industrial output doubled to 48 percent during 1991–95, while that of secondary manufacturing—particularly machinery, equipment, and light industries—declined.

These shifts have been associated with significant changes in the regional and interpersonal distribution of earnings and incomes. The regional concentration of production under central planning magnifies these subsequent distributive effects. Evidence suggests that the regional variation in nominal wages and incomes fell steadily during the two decades preceding the transition in Russia, but that regional disparities have increased sharply since 1991. The trend is even sharper when measured in real terms that account for significant geographical price variation (Stewart 1996). Indeed by 1994 income disparities among the oblasts (a political subdivision) of Russia were far greater than those among the states of the United States. The coefficients of variation for income among Russian oblasts and American states were 0.519 and 0.148, respectively. (The coefficient of variation shows the standard deviation divided by the mean. Values closer to one are less equal than values closer to zero.)

Measuring the social impact of the transition from a command economy is difficult, not least because the official economic data are unreliable (Koen 1996). Traditional sources of information on production, incomes, and prices, never totally reliable, have grown weaker, partly because many enterprises now fall outside the reporting network; official GDP figures were revised significantly every year between 1991 and 1994. Even more worrying has been the apparent divergence of time-series data that would normally be positively correlated (such as average money income and GDP). Thus the macroeconomic statistics cited here should be regarded with caution, and the revealed trends regarded as indicative. Official poverty and income distribution measurements raise their own set of data problems.

## Measuring Poverty in Russia: Conceptual and Empirical Issues

Assessments of household welfare confront a range of methodological and practical problems, from devising an appropriate definition of poverty to determining the appropriate measure of household welfare (using income, expenditure, or some non-monetary indicator).

### *What Is Poverty?*

Conceptually, few would dispute that poverty is the inability to sustain some minimal level of existence. The standard approach to defining an absolute level of poverty is to price a basket of essential goods and compare an individual's income to the cost of these necessities. But both in the definition of nutritional and other basic needs and in the calculation of corresponding cost, the experts or politicians who decide on a certain method must make value judgments (Hagendaars 1986).

Moreover, money income may not be a good measure of real consumption. During the Soviet period, most informal sector activities were illegal, and some residual stigma may induce households to under-report such income. Because the goal of poverty analysis is to consider people's real well-being, expenditure can be a better measure than income (Deaton and Muellbauer 1980). The definition of expenditure used in the Russian Longitudinal Monitoring Survey results reported below is more akin to consumption than to income, because it includes the imputed value of in-kind goods and services produced in the home, and received (for example, from employers).

Whether based on income or expenditures, monetary indicators of welfare can also cause problems for analysts trying to make comparisons across economic regimes. High inflation creates additional difficulties in measuring and comparing nominal aggregates. Another complication arises from the shift from a regime that relied on several different allocation mechanisms for goods and services, including queues and rationing with black markets. Searching and queuing imposed significant costs—although they were not evenly distributed. But price liberalization has largely eliminated scarcities and trade reform has increased the volume and quality of goods available. Consumer surveys reveal that shortages have gradually diminished over the transition, first in the metropolitan areas, and then in provincial and rural parts of the country. It has been argued that the net welfare gains now that queuing is no longer required have been significant, even where real incomes and consumption fell (Roberts 1995). This observation, however, does not take into account distributional effects, which are obviously important in measuring poverty. Consumers on low incomes may actually prefer queuing at low prices because their opportunity costs of waiting are low. Even while money has become a much more meaningful indicator of welfare in Russia, comparisons over time are bound to be approximate. On balance the best approach is to base our assessments on household expenditure, mindful of the qualifications noted above. The next question is where to draw the poverty line against which to compare expenditures.

### *Drawing the Poverty Line*

Drawing the official poverty line is in part a question of judgment and in part a matter of policy and politics. Thus it is important to bear in mind that the extent of measured poverty in the analyses here is sensitive to where the poverty line is drawn.[1]

Under Khruschev, a "minimum consumption budget" was developed (Sarkisyan and Kuznetsova 1967; see also Atkinson and Micklewright 1992), although official estimates of its ruble value as a poverty line were not published.[2] By January 1992, when extensive price liberalization was undertaken, the minimum consumption budget was manifestly unusable, because virtually the entire population had incomes below this standard (Mozhina 1992). A revised basket corresponding to World Health Organization guidelines was subsequently adopted, and the assumed high share spent on food (68.3 percent) was consistent with the structure of low-income household expenditures in the early years of transition, although future adjustment will be necessary to take account of changing relative prices—especially for services, which de Masi and Koen (1995) find extremely cheap relative to market economy standards. Table 1 compares the nominal value of the official poverty line to the average wages during the 1990s. The poverty line (per capita) has typically been only about half the average wage, suggesting that the threshold is quite austere. It is this poverty line, as calculated by the Ministry of Labor in Moscow, that we use in the analysis below.

### *Data Sources and Problems*

Official censorship of poverty issues does not mean that information about incomes and expenditures did not exist in the USSR. The Family Budget Survey (FBS), instituted in 1922 (Dmitrichev 1992), is still the most widely cited source of information about poverty in Russia and other former Soviet republics. About 60,000 families made up the survey pool in 1970–85, which widened to 90,000 in 1988–90. In 1995 the Russian sample was approximately 50,000 families. At least through 1996, the survey was completed every quarter.

Although the FBS represents a rich potential source of data, the survey's methodology has been subject to extensive criticism, both internally and externally (Rimashevskaya

Table 1. *Official Poverty Lines and the Average Wage, 1980–96*
(rubles)

| Year | Minimum consumption basket | Official poverty line | Average wage |
|---|---|---|---|
| 1980 | 64.6 | — | — |
| 1990 | 93.3 | — | — |
| 1991 | 190.0 | — | 770 |
| 1992 | — | 4,282 | 16,071 |
| 1993 | — | 42,800 | 141,000 |
| 1994 | — | 145,400 | 354,000 |
| 1995 | | 321,000 | 735,000 |
| 1996 | — | 379,000 | 944,000 |

— Not available.

*Source*: Estimates of the Soviet minimum consumption basket are for the whole year, based on press reports (see Braithwaite 1997). The official poverty line is the prozhiochniyy minimum, as calculated by the Ministry of Labor in Moscow. The yearly data are for December.

and others 1979; Shenfield 1983; Braithwaite and Heleniak 1989; and Atkinson and Micklewright 1992). A major concern is the sampling frame, which does not encompass the entire population but remains based on the so-called branch principle. Workers are drawn from enterprise rolls, with large and urban enterprises overrepresented, and workers with seniority much more likely to be included given the material incentives to participate. The more workers in a family, the greater the likelihood that the family will be selected. A separate sample was set up for pensioners, but again, those retired from large enterprises are more likely to be included. The net result is that the lower part of the income distribution is not adequately represented. And the exclusion of certain occupational groups, such as senior bureaucrats, KGB officials, and military officers, raises some concerns about the upper end of the distribution (although this is a perennial problem in market economies as well). Nor does the design allow the calculation of sampling errors or confidence intervals, statistical techniques that allow an assessment of the reliability of results obtained from the survey.

Further, the interviewing and recording practices are questionable; the interviewer leaves a diary with the household and returns frequently to assist them in filling it out. This practice suggests the possibility of the interviewer simply creating and recording the data. The household is responsible for keeping both expenditure and income data. Before the transition there were severe penalties, including imprisonment, for illegally earned income from informal sources and from private capital or enterprise, and there was thus a very high degree of correspondence between stated household income and expenditures. For example, during the anti-alcohol campaign of the 1980s, households under-reported alcohol purchases to such an extent that the alcohol beverages weight in the consumer price index had to be imputed, using data from retail sales.

There are also serious problems associated with the analytical methodology currently used by the Goskomstat Rossii, the government statistical agency, particularly the calculations of monthly indicators of income and distribution.[3] As the figures reported in table 2 suggest, the official monthly estimates of poverty and distribution are not very plausible. Goskomstat's reported poverty head counts fluctuated markedly from month to month in 1993 and 1994. Nonetheless, the FBS was the basis for reports and analysis of poverty and distribution published by the Goskomstat.

Table 2. *Official Trends in Poverty and Distribution of Income in Russia, 1980–96*
(percent)

| *Year* | *Head count* | *Poverty gap* | *Severity* | *Gini coefficient* |
|---|---|---|---|---|
| 1980 | 11.3 | 2.34 | 0.70 | 27.60 |
| 1985 | 13.4 | 2.96 | 0.94 | 27.56 |
| 1989 | 11.0 | 2.24 | 0.65 | 26.49 |
| 1990 | 10.1 | 2.12 | 0.63 | 28.45 |
| 1991 | 11.4 | 2.03 | 0.56 | 26.54 |
| 1992 | | | | |
| January | 30.2 | 7.25 | 2.45 | 23.93 |
| June | 23.1 | 6.59 | 2.68 | 28.70 |
| Dec. | 15.7 | 4.11 | 1.49 | 34.98 |
| 1993 | | | | |
| March | 34.7 | 10.48 | 4.45 | 29.38 |
| June | 24.7 | 7.00 | 2.75 | 34.67 |
| 1994 | | | | |
| January | 34.9 | — | — | 40.9 (annual) |
| May | 16.4 | — | — | — |
| Sept. | 20.5 | — | — | — |
| 1995 | | | | |
| January | 33.0 | — | — | 38.1 (annual) |
| July | 26.0 | — | — | — |
| Dec. | 20.0 | — | — | — |
| 1996 | | | | |
| January | 25.0 | — | — | 37.5 (annual) |
| July | 21.0 | — | — | — |
| Dec. | 18.0 | — | — | — |

— Not available.

*Note*: For 1980–91 the minimum consumption basket was used as the poverty line; for the period since, the subsistence minimum. The head count index shows the percentage of individuals in the population falling below the poverty line. The poverty gap index sums all the poverty gaps in the population, that is, the amount of money needed to bring all the poor up to the poverty line, as a share of GDP. The severity index gives greater weight to those individuals (households) furthest from the poverty line (see Ravallion 1992 for further details). The Gini coefficient is closer to zero when incomes (expenditures) are more equally distributed.

*Source*: Authors' estimates based on published Goskomstat sources.

In July 1992 Goskomstat Rossii implemented a new household survey, the Russian Longitudinal Monitoring Survey (RLMS), with technical and financial assistance from the World Bank and the U.S. Agency for International Development, that ran in parallel to FBS. The first round of the RLMS was nationally representative and involved 6,500 households. It was designed to meet scientific standards for a true probability sample (see Klugman and Braithwaite 1997 for details on the sampling method). The availability of this data has made it possible to undertake detailed analyses of poverty during the transition (World Bank 1995b; Klugman 1997; Glinskaya and Braithwaite forthcoming).

The demographics of the original RLMS sample compared favorably with the Soviet census that was carried out four years earlier (Foley 1997). The initial rounds achieved a high response rate (about 90 percent), although participation declined in later rounds. The original panel of households was replaced with a new panel after the fourth round. The household questionnaire collects data on expenditures, income, housing conditions, and ownership of land and assets. The individual questionnaire covers employment, use of time, migration, and anthropometry of young children.

## Trends during the Transition

Since 1991, the number of poor households in Russia has risen sharply, and according to the RLMS, a record 35 percent of the population was living below the official poverty line by the end of 1995 (table 3). The share of individuals in poverty is higher (41 percent in 1995) than the share of households because poor households tend to be larger than average. Beyond the head-count measure, however, indicators suggest that the worst poverty occurred in 1993, when both the share of the popula-

Table 3. *The Incidence, Depth, and Severity of Poverty among Households, 1992–95*
(percent)

| *Unit* | *1992* | *1993* | *1994* | *1995* |
|---|---|---|---|---|
| Poor households[a] | 25.2 | 31.9 | 26.8 | 35.0 |
| Very poor households[b] | 8.4 | 12.0 | 10.4 | 10.9 |
| Depth | 9.8 | 13.6 | 11.7 | 13.2 |
| Severity | 5.4 | 8.0 | 7.2 | 6.9 |
| Head count for individuals | 26.8 | 36.9 | 30.9 | 41.1 |

*Note*: Percentage of households (unless noted). Expenditure-based.
a. Percent of households with expenditure below the poverty line.
b. Percent of households with expenditures less than half the poverty line.
*Source:* Rounds 1-6 of the RLMS; Foley (1997); Kolev (1996).

tion classified as very poor (households whose expenditures were less than half of the household-specific poverty line) and the severity of poverty peaked. By late 1995 about 11 percent of households in Russia were very poor, significantly higher than in 1992 although below the peak of 1993. Despite some abatement during 1994, the poverty head count at the end of 1995 was some 10 percentage points higher than it had been in mid-1992, and the depth and severity measures were also markedly higher.

These overall trends in poverty result from rapid declines in national income and changes in the distribution of income during the transition. Based on the early years (Milanovic 1995) estimated that an additional 1 percent decline in Russia's national income would lead to only 0.5 percent increment in the poverty head count. Decomposition of more recent trends in poverty suggests that the continued lack of significant real growth in 1995–97 accounts for most of the increase in poverty, and that household inequality has been fairly constant during the past two years. There are indications that a group of long-term poor may have emerged (Glinskaya and Braithwaite forthcoming).[4]

Who are the poor in contemporary Russia? About two-thirds of those living in poverty are in households where the head of the household is employed. They are primarily families with children, the unemployed, and single elderly people living alone. Nearly 85 percent of families with three or more children under 6 years of age were poor in 1994. Poverty, always associated with family size, has become increasingly concentrated in families with children as well as in households with an unemployed person. Thus while the overall head-count index increased by about 8 percentage points between 1994 and late 1995, in the same period poverty in families with one child rose by 14 points, and by more than 19 points in families with children under six years of age. Cross-tabulations show that in late 1995, consistent with the pattern that had emerged earlier in the transition, the incidence of poverty was almost 52 percent among children under 18, and an even higher 57.6 percent among children under six, compared with 41 percent for working-age adults and 26.7 percent for the elderly. Controlling for other observed factors, the presence of one unemployed person in a household increased the poverty risk of the household by more than 15 percentage points above the national average.

## Causes of Increased Poverty

Dynamic aspects of poverty were investigated between 1992 and 1994 through the RLMS panel. There were significant flows into and out of both poverty and severe poverty, even while the overall incidence of poverty was rising.

Table 4. *Changes in the Gini Coefficient for Money Income, Selected Countries, 1989 and 1994*

| *Country* | *Gini coefficient* 1989 | 1994 |
|---|---|---|
| Bulgaria | 25.0[a] | 35.3 |
| Estonia | 27.2 | 38.6 |
| Lithuania | 27.5 | 37.0 |
| Moldova | 26.7 | 40.0 |
| Poland | 26.9 | 30.4 |
| Romania | 26.9 | 28.4 |
| Russia | 25.7 | 40.9 |

a. 1990.

*Source*: UNICEF TRANSMONEE, based on data reported by national statistical offices; UNICEF, International Child Development Centre, Florence, Italy.

A key element of trends in poverty has been rising inequality. The disruption of the old system with its controlled wages and prices has clearly led to greater differentiation in income-earning opportunities. Unlike the output shocks associated with the transition, the disparity in income associated with changes in relative prices is likely to persist. Table 4 suggests that the rise in Russia's Gini coefficient (a widely used measure of income inequality, with higher values indicating less equal distribution) is somewhat greater than that of most Eastern European countries, yet of a similar order of magnitude to several former Soviet countries (including Estonia, Lithuania, and Moldova).

Measurements based on Goskomstat (1995) data suggest that the ratio between the highest and lowest income deciles widened dramatically, from 4.5 in 1991 to 15.1 in 1994, then moderated slightly to 13.5 in 1995. Goskomstat's calculated measures of inequality are significantly below other estimates, mainly for reasons related to sampling. RLMS calculations, not surprisingly, reveal higher levels of inequality both at the outset and through the transition. Given the weaknesses of the FBS in measuring income distribution, this finding seems more plausible than a very sharp rise in inequality within the space of a few months. The RLMS-based Gini coefficient stood at 49.2 by mid-1993, then declined slightly to 48.4 by the end of 1995. Trends in the decile distribution based on the RLMS reveal that the top decile's share of total expenditure rose from about 33 to more than 37 percent between 1992 and 1995. The relative share of each of the bottom five deciles also increased, albeit slightly from very low levels, over the same period. Hence in relative terms the consumption of the former middle class appears to have been squeezed most. This is consistent with Milanovic's (1995) observation that the income of the former middle class (which includes clerical staff, production workers, teachers, administrators, and doctors) had declined significantly. The changes in relative wages analyzed above help to explain these shifts.

## The Underlying Mechanisms

What mechanisms underlie these developments? In this section we attempt to link the risk factors associated with poverty in contemporary Russia to changes in the labor market and in the extent and direction of public transfers.

### *Adjustments in the Labor Market*

According to Goskomstat data, wages, salaries, and entrepreneurial income amounted to almost 80 percent of total personal income in 1995 (public and private transfers accounted for the remaining 20 percent). Changes in the level as well as in the relative share and distribution of these components significantly affect household welfare. Labor market adjustments have been extensive in the wake of the price and wage liberalization involved in the move to a market system (Commander and Yemtsov 1997). Aggregate declines in the demand for labor as a result of the drop in output have led to rising unemployment, albeit at a slower rate and to a lesser extent than originally expected by external observers, including the World Bank. This is partly because significant cuts in real wages have accompanied the decline in demand. Average real earnings during 1992–95 were about half the level of the 1980s (table 5).

Various factors appear to determine labor market rewards. Education and skill levels appear to be factors in determining whether someone is poor. The results of the econometric analysis of the RLMS data indicate that higher educational attainments are associated with a somewhat lower risk of poverty: for example, the risk is reduced by 9 percent for households headed by university graduates. Households

Table 5. *Trends in Real Benefits and Wages, 1989–96*

| *Year* | *Average pension* | *Minimum pension* | *Family allowance*[a] | *Minimum wage* | *Average wage* |
|---|---|---|---|---|---|
| 1989 | 82 | 68 | — | 109 | 70 |
| 1991 | 73 | 85 | — | 85 | 67 |
| 1992 | 38 | 43 | — | 43 | 36 |
| 1993 | 43 | 37 | — | 37 | 50 |
| 1994 | 55 | 49 | 27 | 27 | 49 |
| 1995 | 49 | 32 | 12 | 12 | 35 |
| 1996 | 48 | 33 | 20 | 18 | 37 |

— Not available.

*Note*: Fourth quarter 1991 equals 100. For the years 1992–96 inclusive, the reference month is January, for 1991 first quarter, and for 1989, annual.

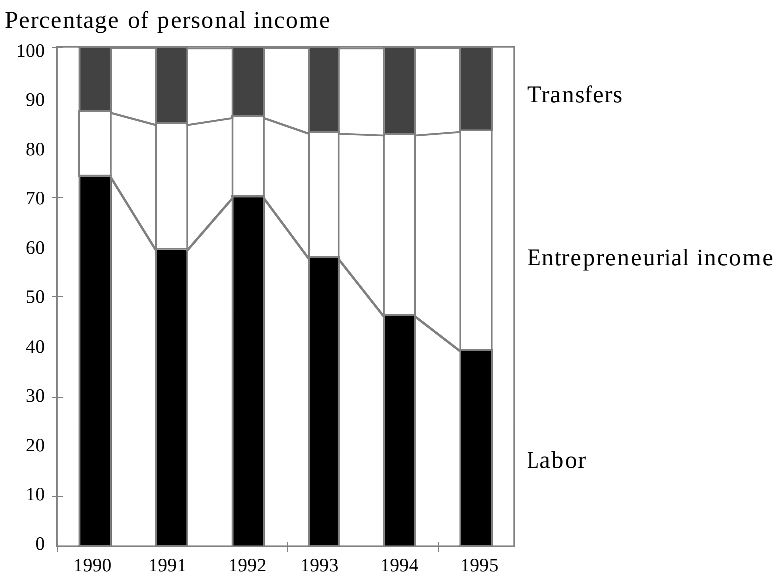
a. It is not possible to give a single figure for the period before 1994 because of the variety of benefits (see text). The base was calculated using an estimate based on the minimum wage (to which a number of benefits were linked).

*Source*: Braithwaite (1997), table 2.1; Ministry of Labor, Moscow.

that are headed by the unskilled, by clerks, and agricultural workers are at higher risk of poverty. Finally, and perhaps less expected, the number of individuals in a household engaged in primary employment (that is, a main job) does not significantly affect the risk of poverty. Participation in secondary employment (often in the informal sector) does reduce the expected probability of poverty, however, by about 11 percent.

The liberalization of wage decisions was expected to affect the distribution of income significantly. Before the transition the share of wages in total personal income was almost 75 percent, which is high by international standards. For example, in 1989 wages accounted for only 59 percent of total personal income in the United States (U.S. Department of Commerce 1991). Increasing inequality in the distribution of total income in Russia has been largely driven by the decline in the share of wages in total personal income and the corresponding rise in the contribution of entrepreneurial and capital income (figure 1). The drop in the wage share is quite plausible in the context of the previous regime's ban on virtually all types of entrepreneurial earnings and private capital investments. In 1990 wages and entrepreneurial income (including capital) contributed 74.1 and 12.9 percent respectively to total monetary income. By 1995 the combined share of entrepreneurial (38.6) and capital (5.2 percent) income outstripped the 39.5 percent share contributed by wage

**Figure 1.** *Structure of Personal Income, 1990–95*




*Note*: Entrepreneurial income includes capital income, which amounted to 5.2 percent in 1995.
*Source*: Goskomstat (1996)

Table 6. *Selected Wage Indices Relative to National Average Wage,1990–95*

| *Sector* | *1990* | *1991* | *1992* | *1993* | *1994* | *1995* |
|---|---|---|---|---|---|---|
| Industry | 103 | 111 | 118 | 108 | 104 | 111 |
| Agriculture | 95 | 84 | 66 | 61 | 50 | 43 |
| Construction | 124 | 127 | 134 | 133 | 129 | 131 |
| Transport | 115 | 120 | 146 | 151 | 150 | 152 |
| Commerce | 85 | 91 | 91 | 107 | 123 | 117 |
| Science/R&D | 113 | 90 | 64 | 68 | 78 | 78 |
| Finance | 135 | 180 | 204 | 243 | 208 | — |

*Note*: National average is 100.
*Source*: Goskomstat (1996).

income. These changes reflect the dramatic erosion in the average real wage as productivity of employed labor has fallen over the period. As in other transition countries, such as Bulgaria (Milanovic 1995), the growing share of entrepreneurial and capital income has driven the overall shift to a less equal distribution of income.

Higher overall wage inequality has been accompanied by sectoral shifts in the economy and changing sectoral wage relativities. Table 6 suggests that workers in the industrial, construction, transport, commerce, and especially, financial, sectors have done relatively better than average. The most marked deterioration occurred in agriculture, in science, and in research and development. The decline in agricultural wages reflects the withdrawal of state subsidies combined with declines in output and only limited adjustment in employment. Additionally, Russia's delay in undertaking comprehensive land privatization likely hurt agricultural laborers. In Armenia, by contrast, swift privatization was associated with rates of rural poverty that were significantly less severe than in urban areas (Braithwaite 1995). The official wage figures support the findings of the RLMS that the incidence of poverty among households headed by skilled agricultural workers in late 1995 was the highest among all reported job occupations, at 64.7 percent, even higher than unskilled workers (47.1 percent) and far higher than the national rate of about 35 percent.

In the face of inherited overstaffing and falling demand for labor, employers have laid off increasing numbers of workers or reduced their hours of work. By mid-1996 registered unemployment stood at about 4 percent of the labor force, although International Labour Organization methodology, which includes all unemployed individuals whether or not they are formally registered with the Federal Employment Service, puts it at about 9 percent. Blue-collar workers have borne the brunt of the decline in labor demand. Hours were cut for about 5 million workers in 1994, and another 7.4 million were placed on involuntary leave. During 1993 and 1994 only 40 percent of the work force was paid in full and on time. If wages are paid late and consequently are eroded by inflation or are not received at all, earnings figures can be quite misleading. Multivariate analysis of the RLMS suggests that households reporting wage arrears are 11 percent more likely to be poor. Overall, however, firms appear to prefer to retain workers, a preference that can be traced to insider influence at the firm level, as well as to the limited social safety net for displaced workers.

The incidence of poverty among the unemployed is high; in late-1995 about half of households with an unemployed member were poor. An additional unemployed person in the household raised the probability of a family being in poverty by about 9 percentage points. The Federal Employment Service, which is responsible for income support and labor market programs for the unemployed, reaches only a segment of its target group. Commander and Yemtsov (1997) found that the majority of the unemployed do in fact have some marginal employment and that, as expected, there was a strong positive link between marginal employment and education, quitting a previous job (as opposed to being laid off), and residence in Moscow or St. Petersburg.

Increasing regional disparities—apparently caused by changing relative prices along with reductions in the subsidies to the producer—are a critical dimension of recent labor market trends. Industrial areas in central Russia and the North Caucasus have been especially hard-hit, while regions with abundant natural resources, such as Yakutia, and commercial centers such as Moscow and St. Petersburg have suffered less. Trade liberalization has had differential impacts because of the sectoral concentration of economic activity. The changing structure of demand has also had an uneven effect across regions, for the same reason. The most obvious example is the impact on areas that were previously dependent on military production.

Indeed, there is an inverse relation between industrial output and registered unemployment, with oblasts that did not suffer from high unemployment or wage arrears tending to have experienced either substantial real wage cuts or relatively less industrial decline. Theory and the empirical evidence suggest that regional disparities in unemployment are likely to persist, despite signs of wage flexibility and an emerging inverse association at the regional level between changes to wages and unemployment. Commander and Yemtsov (1997) have identified a geographic mismatch in the distribution of the unemployed and the availability of jobs that is associated with severe constraints to labor mobility (particularly lack of housing).

The average duration of unemployment is increasing but is still relatively short. At the end of 1994 labor force surveys suggested that about 60 percent of the unemployed found a primary job within six months, while 23 percent were out of work for longer than a year. These relatively short episodes indicate that gross flows in Russia's labor market were large, especially compared with most European transition economies where unemployment was generally higher, while hiring is increasingly concentrated in the more flexible nonstate and informal sectors (Commander and Yemtsov 1997).

## *Systems of Social Support*

The government's social policy response appears to have failed to stem the rise in poverty. The formal system of social protection has become increasingly inadequate for many vulnerable population groups, with the important exception of those who receive old-age pensions. We have examined the impact of public transfers by analyzing the incidence of various benefits at different dates using the RLMS as well as movements in the real official level of benefits.

During the Soviet period, the system of social support was based upon low administered prices for food, rent, household utilities, and other basic goods and services, along with a guaranteed job. This inherited system of support for households was not easily adapted to the introduction of market principles. Nor was the structure of social protection adequate to deal with the type and scale of needs created by the transition, even though this protection included both social insurance (pensions and unemployment benefits) and social assistance programs (including family allowances). Sources of financing have been squeezed because social insurance is largely financed through payroll taxes, which have fallen, whereas social assistance is largely the responsibility of local authorities whose economic fortunes have varied enormously.[5]

The government allocated about 4.5 percent of total budget expenditures for social transfers in 1995, most of which was provided by regional budgets. The real value of transfers has been seriously eroded, however, as GDP has declined (see table 5). The average pension, which has hovered at about half the level of late 1991, has nevertheless been relatively better protected than both the average wage and other benefits. The minimum pension was also badly affected during the same period, falling to nearly one-third of its level in 1991.

During the Soviet period, family allowances were paid to single mothers and to large families. A new system of universal child allowances evolved in the wake of the price liberalization; a complicated system with some 18 different benefits for families with children. Because most of these were set as some proportion of the minimum wage, however, lagged indexation significantly eroded their value (World Bank 1994). In 1994 the system was simplified with the introduction of a unified benefit. But the real value remained very low, at only about one-fifth of the pretransition levels.

Increasing regional disparities in poverty rates can be attributed in part to the effects of restructuring in regions with different economic bases, but also to the devolution of responsibility for financing social assistance to local authorities. Disparities in resources and incomes have constrained local authorities, who also have responsibility for financing and delivering the bulk of education and health services as well as subsidizing housing and domestic utilities. Thus decentralization has contributed to the trend toward regional inequality. Analysis of federal fiscal transfers shows that the impact is not progressive (World Bank 1995a). The introduction of a new federal transfer mechanism in 1994 was indeed perversely disequalizing, apparently because the transfer was based on the oblast's own assessment of need derived from the current level of service, which tended to be higher in wealthier areas. Evidence suggests that health and education expenditures have been relatively protected against budget cuts but that social assistance has been cut disproportionately. Stewart (1996) found that no correlation between a locality's official poverty head count in 1994 and the amount it spent on social assistance, meaning that areas with greater relative need spend less on social assistance.

Because pension payments are closely related to previous employment and levels of income, these transfers are regressive (World Bank 1995b). Pensions appear to be an effective means of intergenerational transfer in that reported poverty among the elderly has been kept consistently below the national average since 1992. This pattern mirrors that of an increasing number of western industrialized countries in which public pension systems have signifcantly reduced, and in some countries virtually eliminated, old-age poverty (Scherer 1997). Among pensioners who are not poor (table 7), pensions represent more than half their income. For the elderly living in very poor households, pensions contribute an even larger share of their income.

Table 7. *Coverage and Significance of Public Transfers, 1994 and 1995*
(percent)

| | *Very poor* | | *Poor* | | *Non-poor* | |
|---|---|---|---|---|---|---|
| *Type of transfer* | *Receiving the benefit* | *Share of recipient household income* | *Receiving the benefit* | *Share of recipient household income* | *Receiving the benefit* | *Share of recipient household income* |
| Family allowance | | | | | | |
| 1994 | 28.8 | 23.6 | 32.4 | 14.5 | 25.7 | 5.9 |
| 1995 | 29.3 | 16.3 | 32.3 | 13.1 | 17.2 | 7.1 |
| Pension | | | | | | |
| 1994 | 40.3 | 75.0 | 41.0 | 66.9 | 48.7 | 58.4 |
| 1995 | 36.8 | 61.5 | 39.7 | 54.7 | 54.0 | 52.5 |
| Unemployment benefit | | | | | | |
| 1994 | 0.8 | 21.7 | 0.4 | 17.8 | 0.3 | 9.8 |
| 1995 | 2.1 | 37.6 | 2.6 | 19.6 | 0.9 | 14.1 |
| Local social assistance[a] | 10.4 | 9.6 | 10.4 | 9.6 | 14.5 | 8.1 |
| Housing subsidy[b] | 3.3 | 7.5 | 3.6 | 7.5 | 6.4 | 5.2 |
| Scholarship | 5.2 | 17.8 | 6.2 | 18.2 | 6.7 | 5.2 |
| All transfers | | | | | | |
| 1994 | 66.8 | 58.5 | 70.9 | 48.4 | 74.4 | 42.6 |
| 1995 | 61.6 | 43.3 | 67.7 | 40.3 | 70.0 | 43.3 |

a. Data all for 1994, first quarter.
b. Information is for December 1995 and January 1996.
*Source*: Foley and Klugman (1997); Kolev (1996).

As suggested above, the Federal Employment Service has been largely ineffective in providing social protection for the unemployed. Indeed, table 7 reveals that in late 1995, when about 13 percent of poor households had an unemployed member, less than 3 percent of the poor received unemployment benefits. Moreover, given its minimal level (see table 5), the contribution to income is only significant for the very poor.

According to the RLMS, from 1992 to late 1995, public transfers accounted for almost 30 percent of total household income; the average contribution to the income of *recipient* households was higher—an estimated 42 percent in late 1995. Important trends during this period can be observed regarding the relative importance of different transfers (see table 7). Pensions remain the most widely received benefit. Unemployment benefits, although still very limited in their coverage, are going to an increasing number of the poor and accounting for a growing share of their income. Coverage of family allowances was steady for the poor, but dropped for the nonpoor, probably because families that are not needy may not bother to apply. Such benefits also declined as a share of income for poor and very poor households, given the erosion of their real value and the delays in payment.

Although the coverage of public transfers across the population is fairly extensive, there are some perhaps unintended results. For example, most of the poor and very poor are eligible for transfers, and yet they do not receive benefits (table 8). Nearly four out of ten very poor households and one out of three poor households did not receive any transfers. Yet the majority of nonpoor families *did* receive public transfers. Most poor households not revceiving benefits are in fact eligible for them. These errors of exclusion appear to be administrative problems, fiscal ones (that is, local authorities do not have sufficient funds to pay benefits), or both. Inadequate information about eligibility and lack of access to local offices may contribute to low take-up rates. The number of those receiving benefits to which they are not entitled (er-

Table 8. *Errors in Targeting of Public Transfers, 1995*
(percent)

| *Category* | *Very poor* | *Poor* | *Non-poor* |
|---|---|---|---|
| Did not receive benefits | 39.8 | 33.0 | 30.9 |
| Did not receive benefits although eligible | 36.4 | 29.7 | 22.8 |
| Not eligible to receive benefits | 6.2 | 6.1 | 13.5 |
| Received benefits although ineligible | 0.8 | 1.5 | 3.9 |

*Note*: Public transfers considered here are limited to pensions, unemployment benefits, scholarships, and family allowances; based on the RLMS.
*Source*: Kolev (1996).

rors of inclusion) appears to be relatively limited. These overall patterns have persisted throughout the transition.

Only about one in five Russian households rely solely on income from employment and transfers from the formal system of social protection. Private interhousehold transfers have been investigated by Cox, Eser, and Jimenez (1997), who found that private transfers in Russia are large and responsive to the socioeconomic characteristics of the household. Private networks are extensive, with four out of ten Russian households acting as donors, recipients, or both. Longitudinal analysis shows that this behavior has persisted throughout the transition, in contrast to Poland, for example, where private transfers diminished as economic conditions worsened. For the RLMS sample as a whole, private transfers average about 5 percent of household income; for net recipients the contribution was much higher, amounting to about 20 percent of household income.

Overall, private transfers appear to flow to such vulnerable groups as younger families, female-headed households, and households affected by unemployment. Households participating in private transfers tend to be better off than those who do not participate, although whether such transfers have an equalizing effect on the distribution of income is unclear. Although private transfers tend to be directed from better-off to poorer groups, the probability of receiving a transfer declines only slightly as earned income increases. Empirical investigation reveals that the theoretical concern about public transfers crowding out private transfers are not warranted: private and public transfers appear to be complementary.

In light of this evidence, it is perhaps not surprising that overall attitudes toward government-provided social protection are mixed. On the one hand, surveys suggest an increasing degree of self-reliance. The vast majority say they would first rely upon themselves, and then friends and family, for help in time of need. Yet most people still expect the government to make good on the perceived right to employment for every able-bodied person. Moreover, the expressed needs for social support from the government, as measured in nationally representative public opinion surveys, are significant (Zubova and Kovaleva 1997).

## Conclusion

Analysis of household survey data shows that Russia's transition from a command economy has been associated with a significant worsening of household and individual well-being. Although some indicators suggest that the worst may have passed in 1993, the numbers of individuals and households below the poverty line rose again in 1995, despite signs of economic recovery.

Russia is not unique among economies in transition in experiencing worse and more prolonged poverty than many expected at the outset. As elsewhere, aggregate trends in poverty result from changes in output and income distribution. In both respects, however, the Russian experience has been relatively adverse. The lack of general consensus on an appropriate economic and social reform strategy delayed sustained stabilization and prolonged the period of high inflation and recession. The associated collapse of public revenue has severely strained the government's capacity to finance social transfers, as well as essential public goods and services

The publicly financed system of pensions has kept the rate of poverty among the elderly consistently below the national average. Yet for those outside the formal payroll-based system of social insurance, in particular such families with children, social assistance is ad hoc and limited. The same is true for the increasing number of households affected by unemployment, suggesting that the ongoing European debate about the social exclusion of marginalized groups may be relevant to Russia in the longer term. Several factors—low skills, type of employment, regional location, family structure, and benefit rules—appear to be interacting to marginalize some groups in society. At the same time, as elsewhere in transition countries and the West, popular demands for more comprehensive social assistance raise concerns about welfare dependency.

The emerging economic recovery does not yet appear to have begun to turn around poverty, according to the aggregate poverty measures. In this sense the experience of Russia might be analogous to that of Poland, where several years of positive growth occurred before poverty began to decline (World Bank 1995b). The extent of poverty in Russia—in 1995 some 11 percent of the population was very poor—suggests that the resumption of growth could take longer to reduce poverty. Moreover, restructuring is needed in several sectors of the economy, such as coal, metallurgy, chemicals, machine-building, and agriculture. Business reorganizations will likely entail a significant number of layoffs, thereby increasing unemployment and possibly poverty as well.

The interest of the international community in the social impact of Russia's transition lies, at least in part, in its impact on the political sustainability of continued economic and democratic reform. Public opinion surveys are a potentially rich source of information in this regard (Zubova and Kovaleva 1997). In Russia, as elsewhere, subjective poverty standards are much higher than the officially established absolute poverty lines, so a much higher share of the population regards itself as poor. Belief in an egalitarian distribution of income remains persistent and widespread. People tend to attribute poverty to economic and structural causes, such as unemployment and lack of educational opportunities, rather than to individual characteristics. Russian society in general is rather pessimistic about the future, and the assessments of the poor are especially negative. These results suggest that even if poverty rates improve in the short term, widespread dissatisfaction with the process of economic and social policy reform may well persist for some time.

# Notes

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1. The poverty headcounts are not overly sensitive to shifts in the threshold, however. If, in late 1995, the poverty line had been moved up by 10 percent, the poverty incidence rises by about 4 percent; a 10 percent lower threshold reduced the poverty headcount estimate by 5 percent (Kolev 1996).

2. The budget was intended to be an absolute measure of minimally acceptable consumption under a socialist system, rather than an absolute measure of poverty per se (since, after all, poverty did not officially exist). Thus the Soviet standard for protein consumption was twice the level recommended in the United States (Lane, Marston, and Welsh 1987).

3. The published monthly income distribution data are based on the FBS, but are not actually summary totals from that survey. The FBS survey forms are collected and processed quarterly. The monthly income distribution data are synthetically generated by Goskomstat, using a previously tabulated FBS distribution as a historical template for the variance and grossing up the distribution by presumed increases in the mean. Average income is assumed to grow at the rate of such various monthly macroeconomic indicators as average wages or the wage funds of large state-owned enterprises. Generally, such an estimating methodology would be expected to lead to understatements in measures of income dispersion.

4. A decomposition breaks down changes in the poverty headcount among three components: growth, redistribution, and a residual component that is ill-defined (Ravallion and Datt 1991).

5. The Employment Fund, which is responsible for financing income support for the unemployed as well as programs for the employed, faces both problems: the financing base is a 2 percent payroll tax, the bulk of which is retained at the oblast level, limiting scope for any redistribution of funds to finance unemployment benefits in badly hit regions.

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