

RUSSIA'S SOCIAL SAFETY NET: STANDING AT THE CROSS-ROADS

Rostislav Kapeliouchnikov

Institute of World Economy and International Relations, Moscow, Russia

In his illuminating contribution Dr. Héthy identifies the challenges to the social safety net under systemic transformation and the main institutional changes brought about by the post-communist governments to meet them. Although Russia's experience in social protection is close to that of other countries of East-Central Europe (ECE), in many crucial respects it remains quite different.

As Dr. Héthy indicates, social reforms often confront states with more serious problems than economic reforms. However, the nature of these problems is in some sense paradoxical. With the start of market transition, the scale of welfare programmes and proportions of GDP devoted to them sharply increased in the majority of post-communist countries. There were two main factors behind this phenomenon well described by the term "the premature welfare states" coined by J.Kornai.¹ First, the communist rulers laid stress on the so-called "social consumption funds" directly controlled by the state to the detriment of individual consumption where state control was much less effective. Second, by further increasing the number of social transfers and loosening eligibility requirements, new democratic governments tried to mitigate hardships of the transition process and circumvent political opposition to market reforms.

Nevertheless, it soon became evident that such policies might impose a heavy financial burden on the economy and produce adverse incentive effects, particularly in the labour market. Nowadays, the main task to be solved by ECE countries is to adjust the scale and set up of "the premature welfare states" (along with public perceptions and expectations, as Dr. Héthy notes) to the capacities of transition economies.

Trends in Russia's social policies have much in common with those characteristic to ECE countries. The start of market transition was marked by growth (in relative terms) of social spending: in 1992, 27% of total state expenditures were devoted to social purposes whereas nearly 40% were in 1995-97. Alongside, Russia made attempts to compensate for the lack of systemic institutional reforms by increasing the number and coverage of social programmes.

Nevertheless, at first glance the burden of social obligations in Russia looks less heavy and expensive against those of ECE countries:²

- total state spending as % of GDP: 50-60% in ECE, nearly 40% in Russia;

- social spending as % of GDP (excluding expenditures on education and culture): 21-32% in ECE, 12-13% in Russia;
- payroll taxes: 48-61% in ECE, around 40% in Russia;
- ratio of minimum to average wage: 0.60-0.75 in ECE against less than 0.1 in Russia;
- in Russia registered unemployment is still under 3% - much lower than in the most East and Central European countries except the Czech Republic (but it is worth mentioning that the overall unemployment rate exceeds 11%);
- ratio of average unemployment benefits to average wage: 0.25-0.35 in ECE against 0.25 in Russia;
- ratio of average retirement pension to average wage: 0.60-0.71 in ECE against 0.45 in Russia;
- ratio of average disability pension to average wage: 0.44-0.51 in ECE against 0.35 in Russia.

In short, Russia yields to East-Central European countries in breadth and generosity of social benefits, though it is ahead of quite a number of middle-income countries from other parts of the world (Latin America or South-East Asia). From this one might conclude that Russia would face fewer problems in funding social programmes and that their adverse effects on incentives and economic growth would also be weaker.

But in actual fact this is not the case. In contrast with ECE countries, economic recovery in Russia is still barely noticeable. The budget deficit (largely due to massive government social obligations) continues to be high: around 7.5% of GDP in 1997. Inadequate funding of social programmes has become chronic (for instance, arrears on child allowances amount now to R16.5bn [US\$2.7bn]), and most extra-budgetary social funds experience persistent deficits.

Therefore, the fact that Russia's social programmes are less generous cannot be interpreted as a manifestation of political wisdom and farsightedness. In fact it results from harder resource constraints under which the Russian government has to perform. First of all, economic recession proved to be deeper in Russia than in ECE countries: approximately 40% against 20-30%. No less important is the fact that Russia is characterised by extremely poor tax collection conditioned by wide-spread tax evasion, proliferation of barter transactions, expansion of shadow economy and pervasive corruption of state bureaucracy (total tax arrears now equal monthly GDP). The funding of social programmes has been badly affected by the shrinkage of the base for payroll taxes: the share of wages in total incomes fell almost twofold, from 70% to 40%. Wage arrears now exceed R60bn (US\$10bn), further aggravating the situation. In other words, even a more modest burden of social obligations appears to be too heavy for the Russian economy.

The main drawback of Russia's social safety net is more its poor design, lack of targeting and ineffectiveness than its excessive generosity. So it is hardly justifiable to interpret it in terms of the premature welfare state. Critically-

minded observers often characterise transition societies (especially of the former Soviet Union) as “the wild capitalism”. I do not intend to discuss how appropriate such an assessment is. However, it seems reasonable to describe by analogy the type of social safety net which has evolved in Russia as “the wild welfare state”. Its most salient features are:

- A permanently increasing number of benefits and guarantees to a growing number of claimants. Over 150 types of social protection which cover 236 various categories of population are effective in Russia just at the federal level. In total, two-thirds of the 148 million population are entitled to welfare benefits. Numerous federal social programmes are supplemented by even more numerous ones at the regional and local levels. (For example, in Moscow, 70 categories of population accounting for 60% of the city’s inhabitants have the right to use municipal transport free of charge or with substantial discounts.) One of the main reasons behind the multiplication of social transfers was that under conditions of high inflation (monthly rates reached 10-20%) the authorities preferred not to index monetary benefits but invent new kinds of non-monetary assistance.
- Massive and persistent delays in payments of pensions, unemployment benefits, child allowances, etc.
- Chaotic procedures for indexing social transfers.
- The universal character of the majority of social assistance programmes results in their being non-targeted. The most notorious example is child allowances paid for all children under 16 irrespective of their parents’ income. As a result the average allowance is so negligible (its monthly level amounts to 70% of the minimum wage, around US\$10), that it cannot secure adequate support for poor families. Only two kinds of assistance - poverty benefits and housing subsidies - are provided based upon means-testing. However, these programmes are entirely the responsibility of regional authorities and so far have been introduced only in a minority of regions.
- Although at first glance the social safety net under communist rule had much in common with the western-style welfare state, actually it was based on a totally different philosophy and organisational principles. The Soviet society was a status society. Assistance to “the weak” was combined with favours for “the strong” in the framework of a unified institutional set-up. Personal well-being depended rather on non-monetary privileges associated with an individual’s status than on monetary earnings. Many elements of the old status system were not abolished when market reforms started and are still effective. Indeed, the number of state officials (judges, policemen, MPs, etc.) who have appreciable discounts on rents, telephone services, municipal transport and so on is still excessive. The 1997 government’s proposals to cut these privileges at least partially was rejected by the Duma: only one out of 15 draft social laws submitted to it was passed.

- A lack of effective control over providing social benefits. Indeed, surveys show that a significant part of registered unemployed work either full or part-time. Notorious is the case of Volgograd where additional benefits for diabetics were introduced after which their number doubled.
- Using the social security system as an incentive device to promote employment in selective regions, sectors or professions. For example, the list of professions and territories granting the right for early retirement is as long as in Soviet times. In today's Russia every seventh pension is an early one.³
- Involvement of enterprises as state agents in providing social benefits. Up to 1998, child allowances were paid to parents at the place of their employment, which often resulted in the doubling of payment when both parents received it. In 1997, some regions started to pay child allowance at the place of parents' residence thus diminishing the number of recipients by 20-30%.
- The negligible role of the private sector in providing social protection, i.e. private insurance companies, private pension funds, private charities.
- The extensive use of benefits in-kind instead of cash payments. In some regions up to 70% of social assistance is provided in-kind. Largely this is the result of the general non-payment crisis which plagued the Russian economy. For instance, many employment agencies - confronted by a shortage of funds to pay unemployment benefits - substitute monetary payments for distribution of manufacturing products to be sold by the unemployed in order to convert them into cash.
- Non-transparency of financial relationships between central, regional and local budgets. Decisions on introducing new benefits are often taken at the federal level, while regional or local authorities are commissioned with their execution. On the other hand, central government has no effective levers to control how regional authorities use social transfers from the federal budget. A number of cases became known when regional authorities channelled resources allocated for child allowances to more important in their opinion purposes: housing refurbishment, fuel, commercial projects, etc. Many decisions - at all tiers of government - do not take into account financial constraints and are mere promises that cannot be fulfilled.

It is not therefore surprising that the effectiveness of Russia's social safety net is extremely low. By estimates of the International Labour Organisation, the effectiveness of social programmes in Russia calculated as the share of resources accrued to the poor in total social transfers equals a mere 19%.⁴ At the same time, by official data, 22% of Russia's population live below the poverty line and income inequality measured by the Gini Coefficient reaches 0.37 against 0.23-0.31 in ECE countries.

Of course, the Russian government realises these shortcomings of the existing social safety net (partially inherited from the communist regime and partially shaped during the first years of market reforms) and makes attempts to modernise and rationalise "the wild welfare state". A whole package of laws intended to

launch reforms in pension security, social insurance and social assistance are being elaborated. Changes to be introduced largely coincide with those described by Dr. Héthy in his analysis of the situation in Hungary:

- *pensions*: gradual replacement of the pay-as-you-go, tax funded system with a new, three-tier system comprising state minimum pensions, obligatory and voluntary pension insurance;
- *labour legislation*: introducing a new Labour Code, cutting severance pay and shortening the notification period;
- *unemployment insurance*: restricting unemployment benefits to the subsistence minimum and imposing stricter eligibility requirements;
- *social insurance*: reducing sick payments and tightening conditions for their provision;
- *social assistance*: proper targeting of social transfers and cutting their total number, replacing benefits in-kind with cash payments, transition from universal programmes to ones focused on the poor with obligatory means-testing.

However, prospects for promoting and implementing these reforms appear to be rather bleak. Virtually all governmental proposals are fiercely opposed by the Duma where communists dominate. A majority of political parties in Russia are proponents of further increasing social expenditures and the extension of social programmes. Another important point is that principal changes should be made in 1998 because no serious cuts in social spending will be politically feasible in the next two years when parliamentary and presidential elections take place. In other words, social reforms will be inevitably partial, conflictory and slow.

Moreover, steps in the opposite direction are often made with the adoption of further social obligations beyond the economy's funding capacity. The most vivid example is the Law on Subsistence Minimum adopted in 1997. This envisages a new methodology for calculating the subsistence minimum which increases its level by about 30%. As a result almost one-third of the country's population will fall below the new poverty line (defined in Russia by the subsistence minimum) with an additional potential cost of about US\$17bn (equal to Russia's monthly GDP).

That is why a pessimistic forecast assuming the conservation of the main elements of the existing costly and ineffective social safety net seems to be the most plausible one. But an attempt to construct "the premature welfare state" to which a major part of Russian political opinion and forces are oriented might result in much more serious problems in Russia than in ECE countries, thus dashing hopes for sustainable economic growth.

Notes

1. *Kornai, J.* The Socialist System: the Political Economy of Communism. Oxford: Oxford University Press, 1992.
2. The comparisons are made with three ECE countries: the Czech Republic, Hungary and Poland. **Sources:** *Dmitriev, M.* Budgetary Policy in the Contemporary Russia. Moscow: Carnegie Endowment for International Peace, 1997 (in Russian); *Kramer, M.* Social Protection Policies and Safety Net in East-Central Europe: Dilemmas of Postcommunist Transformation. In: The Social Safety Net in Postcommunist Europe, ed. by *Kapstein, E.B., and Mandelbaum, M.* New York: Council of Foreign Relations, 1997, pp.46-123.; *Social Conditions and Living Standards of Population in Russia.* Moscow: Goskomstat, 1997 (in Russian); Transition Report, 1996. London: EBRD, 1996.
3. In contrast with ECE countries early retirement pensions for unemployed are not widely practised in Russia. The number of such pensioners currently account for around 1% of the total number of pensioners.
4. *Dmitriev, M.* Op. cit., p.24.