



## **Social Protection Imperatives in Post-Socialist Russia**

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**DRAFT, SEPTEMBER 2002. NOT TO BE QUOTED  
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## 1. Introduction

The abandonment of the central planning in Russia 10 years ago and transition to market-oriented economic system entailed drastic societal shifts and led to profound changes in the national welfare organization. The transition placed new and heavy demands on the welfare system inherited from the socialist era and conceived under entirely different circumstances. The cornerstone of social protection Soviet-style, namely, a highly centralized and rigid system of guaranteed employment has ceased to exist. As a result the long-running system of social security from “a cradle to a grave,” at a modest but quite predictable level, disappeared. Gradually coming into shape through the past decade, it has been replaced by a hybrid system of social protection which is substantially smaller in coverage, even though it carries a strong imprint of the previous welfare organization, co-existing together with some elements which came into being only recently in reaction to emerging market realities. It is fair to say that this system, clumsy and full of contradictions, satisfies no one - neither politicians of neo-liberal persuasion who see social commitments of the State as unnecessary burden undermining efficiency and competitiveness of the economy, nor politicians with a paternalistic bent who are convinced that ultimate responsibility for social protection should stay with the State and only with the State. Worst of all, this existing system may be ill suited to the real needs of the population facing the stress of present conditions when new sources of risks and vulnerabilities changed the prevalent paradigm while the level of living plummeted for the majority of the country’s inhabitants. Among the most difficult challenges is the emergence of income poverty at very high levels, which has an unfortunate potential to become mass poverty, entailing all too familiar features of alienation, exclusion and eventual loss of human potential for millions of people. Trying to highlight some salient features in the picture, which Russia is facing, the author is making an attempt to come up with some specific policy recommendations regarding the welfare reform.

Social protection could be defined as a collective response of the society to sustain the well-being of citizens, including protection against various

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contingencies in order to offset the absence or reduction of income from work; provide assistance to families with children; and provide people with health care and housing. In a broader sense the social protection agenda includes policies to increase human capabilities to manage risks, to participate fully in the society and live with dignity. At least three important functions of social protection help to better understand its essence:

- § a defensive function aimed at protecting people against various risks and contingencies and guaranteeing satisfaction of their basic needs;
- § a developmental function aimed at capability enhancement and capacity building; and
- § a social justice function aimed at promoting social integration and cohesion.

A close connection and interaction of the functions co-exists with some inevitable overlapping of the instruments used in their accomplishment. For instance, such instruments as social assistance, social services or social work can be used to fulfil various functions.<sup>1</sup>

In the final count, the availability of social protection boils down to two crucial elements: *provision* of security to the population (income security, services in kind, subsidies) and *financing* of social protection systems (State, community or the private sector). In this paper I will try to have a look at both dimensions and their evolution in post-socialist Russia.

## **2. Provision of social protection: Soviet legacy and challenges of transition**

Under state socialism most social protection was provided to the population directly by the State through budget transfers or indirectly through State-owned

<sup>1</sup> See, for instance, UN/DESA. Report on the World Social Situation 2001, Chapter XIY “Enhancing social protection”, UN, NY, 2001

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enterprises as a workplace benefits. The role played by the State in the Soviet-style socialist economy was enormous and has been well described in literature. This role is an important point of departure in any attempt to describe the systemic change, which occurred after the demise of central planning and the beginning of the market-oriented transformation, not least because in the past ten years numerous attempts were made to change and reduce that role in all spheres of economy.

In Soviet times, the State engaged in multiple roles as owner of the means of production, employer and provider of social protection. Price interventions were deliberately used as an instrument of income redistribution in order to compensate, at least partially, for low wages and pensions through direct and indirect subsidies covering basic needs, such as food, energy, housing and public transport. Free education and health care provided an important pillar in the overall system of social protection. The economic and social objectives of the State were closely linked, making specific social policy measures and interventions (unlike in any market economy country) a matter of secondary importance, if not outright unnecessary. State benefits, first of all a wide range of subsidies, focused on the population at large rather than on specific disadvantaged groups. The explicit promises made by the State regarding social or welfare commitments (such as extensive package of various benefits or retirement income, for instance) were matched by the ability of the State to collect taxes from the enterprises of the public sector, also using other sources of revenue such as, for example, proceeds from foreign trade based on State monopoly or other funds-generating economic activity. The socio-economic organization of that type was rigid by definition and gave little room for individual choice in social services provision as well as providing woefully inadequate labour incentives. It was extensive, however, in maintaining a basis for equity and certain social cohesion in society, and had the State as an ultimate guarantor of income security in cash and in kind. The package was quite comprehensive and covered not only vulnerable groups but the population at large; its existence reflected the political and social goals of state socialism; incomes were generally low and wages compressed, but arrangements were predictable.

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Ten years of transition brought enormous changes to the system of social protection, which was designed under completely different circumstances and reflected different political and socio-economic priorities. The deep transitional depression resulted not only in the contraction of the registered output by 50 per cent, but also in persistent unemployment, wage arrears, emergence of a low pay on a wide scale and growing “shadow” economy and informality. Contrary to the expectations of “first wave” reformers, in post-socialist Russia a clear deterioration in ability of the society to protect its citizens against contingencies and risks has occurred. The coping mechanism of the transition period reflected a shift from the support of the State to a prime reliance on individual ability to absorb shocks or the family (by default) as a provider of social protection. The sea change in political priorities and policies of the State occurred so rapidly that it could not but inflict a tremendous strain on society. Apart from the shock of liberalized prices and faded out food subsidies, the population has to cope with falling real income which could not keep up with rising prices. Savings of the population kept at the banks were decimated by inflation and lost value. In the context of transformation and in the name of financial responsibility the State drastically decreased budget financing of schools, kindergartens, clinics, public transportation and numerous other establishments of the social sector. Many State enterprises were forced to stop providing work-place social benefits, shifting responsibility to local governments (which were often lacking means to provide any protection). “The premature welfare State”<sup>2</sup> gave a way to an impoverished State.

As a result, there has occurred an enormous increase in the poverty zone in Russia whereas above one third of the population now lives below the poverty line. By itself this unprecedented (for peace time) deterioration of living conditions for millions of people is a human tragedy of a vast scale, which has and will have far-reaching consequences. Without any attempt to diminish the severity and acuteness of other social problems which the country faces, from high

<sup>2</sup> This term was coined by Hungarian economist Janos Kornai. See: Janos Kornai, “Reforming the welfare state in post-socialist societies,” *World Development*, vol. 25, no. 8 (1997).



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mortality rates, family crises or environmental degradation to list just a few, one can say that poverty has become the major social challenge in Russia. It is a political as well as social and economic challenge. It cries out for a well-thought out and comprehensive policy response based on coherent and consistent policy measures, combining both short-term and long-term considerations.

The methodology used by the Russian Government for establishing the poverty rate as done by the State Statistical Committee (*Goskomstat*) is based on the calculation of the so-called “subsistence minimum” of the population linked to purchasing a certain set basket of goods.<sup>3</sup> The poverty rate is calculated annually as a percentage of the population living below an officially established subsistence level.

Table 1 shows the annual rate of poverty in Russia jumped to 33.5 per cent of the population in 1992, declined somewhat prior to the financial crisis in 1998 and increased again after the crisis staying at the same high level at the very end of the nineties. In the year 2002 the total number of people living beyond the subsistence minimum was 42.2 million or 28.7 per cent of the total population.<sup>4</sup>

Analysis of the population groups with the highest risk of poverty reveals that families with several children are the most vulnerable in this regard, followed by single mothers and pensioners living alone. In particular, one-parent families and families with several children face the most material hardship. The poverty rate tends to increase with the number of children in the family since increase in the household size means a proportionate fall of income per family member. About 60-80 per cent of those families are among the poor. Largely due to those negative trends such phenomenon, as child labour has emerged in Russia in the last decade despite existence of national laws prohibiting employment of children. Also deterioration of living conditions affects the health of children who are forced to cope with malnutrition and lack of proper medical attention. Parentless and

<sup>3</sup> In 2002 the official subsistence level was established at 1,303 roubles or about 45 dollars per month.

<sup>4</sup> *Izvestia*, 30 August 2002.

abandoned children is another gruesome phenomenon, a visible sign of a crisis of family as an institution.

Table I. Population with income below the poverty line

	Millions of people				As percentage of total number of the poor				As percentage of total population of respective age/gender group			
	1992	1997	1998	1999	1992	1997	1998	1999	1992	1997	1998	1999
Population with income below poverty line ("subsistence minimum")	49.7	30.7	34.3	43.8	100	100	100	100	33.5	20.8	23.4	29.9
<i>Including:</i>												
Children up to 6 years old	4.9	2.5	2.6	2.8	9.8	8.2	7.4	6.4	31.6	22.9	25.1	29.2
Children age 7-15	9.2	6.7	7.0	8.1	18.5	21.9	20.4	18.6	45.9	31.3	32.9	39.3
Youth age 16-30	8.8	6.0	6.9	9.0	17.7	19.4	20.1	20.5	28.6	19.5	22.3	28.4
Women age 31-54	8.6	6.7	7.2	9.5	17.4	21.9	20.9	21.6	34.4	26.6	28.1	36.2
Men age 31-59	8.3	5.8	6.3	8.1	16.8	18.7	18.5	18.4	30.6	20.4	22.5	28.9
Women over 55	7.6	2.4	3.3	4.7	15.2	7.9	9.6	10.8	36.8	10.9	15.1	22.2
Men over 60	2.3	0.6	1.0	1.6	4.6	2.0	3.1	3.7	29.0	7.1	12.0	18.0

Source: Goskomstat. *Sotsialnoe polozhenie i uroven' zhizni naselenia Rossii, Moskva, 2000*, p. 183 ( State Statistical Committee: Social situation and level of living of population in Russia, Moscow, 2000).

As employment of women declined more quickly than employment of men, while the "feminization" of poorly paid jobs has become a clear trend in the last ten years, social vulnerability of women as a group has increased. Women constitute about 80 per cent of the unemployed in Russia; they are also predominant among "the new poor" (or the "working poor") as well as among those employees who have been forced, on the initiative of companies' management, to cut their working hours and receive reduced wages.<sup>5</sup> Apart from the families with many children, one-parent families (predominately headed by a woman) belong to the poorest segment because of the lower income of women. Such families come into being either after a divorce or due to a birth of a child out of the wedlock (currently, about 27 per cent of children born in Russia belong to

<sup>5</sup> M.Toksanbaeva. "O sotdial'noi uizvimosti zhenshtin", *Voprosy Ekonomiki*, 2000, no.3, p.138-140 (in Russian) (M. Toksanbaeva. Regarding Social Vulnerability of Women).

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that category). After a divorce women often experience difficulties with receiving alimony payments. Another Russia - specific problem is a loss of an able-bodied male breadwinner at a relatively young age due to unnatural causes of his death. Both of these changes in family structure lead a substantial deterioration of family income stream, making single parent families highly vulnerable to poverty.

Another vulnerable large group of people in poverty are pensioners, particularly those in poor health and/or living alone. The erosion in the value of old-age pensions due to inflation and widespread pension arrears directly affected the economic well-being of retirees. In 1990, an average pension (typical in the case of two-thirds of pensioners) exceeded cost of the minimal “consumption basket” by a factor of 2.4, while in the mid-nineties that factor has fallen to only 1.06.<sup>6</sup> The inability of the formal system to protect the elderly has been revealed in a glaring fashion. Although the informal family system of caring for the elderly has always played a substantial role in social protection in the former USSR, the need for family support has dramatically increased as a result of reduced stream of guaranteed income owed to pensioners. As a result, many pensioners, particularly single persons or those with low pensions, have been able to sustain themselves only with the help of family members, neighbours, friends or charities.

Since unemployment and low level of wages are at the root of poverty in contemporary Russia, it may be of a particular importance to consider them in the context of addressing these ills and finding social protection solutions. Both challenges are awesome and difficult to solve. However, analysis of policy failures in this field may be of particular relevance in finding solutions.

## **2.1 Unemployment**

As it is well known a drastic decline in the demand for labour proved to be a common feature in the transition from centrally planned to market-oriented economies, and Russia is no exception to this rule. Since labour hoarding was an integral part of the economic organization of state socialism, some contraction of

<sup>6</sup> Goskomstat. *Sotsialnoe polozhenie i uroven zhizni naselenia Rossii v 1995* (Moskva, 1996).

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employment was anticipated at the onset of transition as part of the restructuring of the economy. However, both the scale of joblessness, as well as the duration of unemployment, turned out to be much worse than anticipated, creating a new pool of people who needed social protection. Prior to transition, the unemployment insurance system in Russia did not exist and had to be created from scratch.

While the levels of unemployment varied across the country (it was always much lower in big cities) in the provinces it stayed at high levels, in particular in those cities which were built or became highly dependent on “city-forming” enterprises. The collapse in demand, accompanied by a difficult period of economic adjustment, forced many firms either to start a rationalization of operation in order to compete with domestic rivals or imported goods, or to close down entirely. Rationalization and restructuring were often accompanied by shedding some unproductive labour. These trends resulted in open unemployment in some areas of the country, made worse by low labour mobility. Often the spread of joblessness was accompanied by hidden unemployment as well as various forms of negative labour market adjustment.

The adjustment process chosen and implemented in Russia has been different compared to many other economies in transition, particularly countries of Central Europe.<sup>7</sup> Even in the face of low or declining output and falling demand, many companies in Russia neither did nor lay off workers but either cut working hours, introduced forced “administrative vacations” or started withholding their salaries. As a result the level of employment in State and privatized firms has remained relatively high. Apart from the above many managers used to the full extent new opportunities to pay compensation to workers in various unconventional ways, not necessarily in monetary form but often including in kind payments. Many analysts agree that cutting working hours and wages, instead of laying off workers, being a Russian specific form of adjustment, was not necessarily the best option, at least after the reform gained some steam and some labour shedding already occurred. To a certain extent, this policy reflected the structure of internal control within the

<sup>7</sup> See Tito Boeri and Katherine Terrell, Institutional Determinants of Labour Reallocation in Transition, *The Journal of Economic Perspectives*, vol. 16, No. 1, Winter 2002.

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company,<sup>8</sup> but it can also be traced to government pressure on firms to limit the number of workers to be laid off. Most of all, however, such situations were connected to the continuation of “soft budget constraint” at the enterprise level and failure of the State to enforce financial discipline and hard budget constraint. In any case in Russia labour demand elasticity with respect to output and wages was less pronounced compared to the more market-oriented pre-transition economies of Central Europe, where it was rising rapidly after transition was launched.<sup>9</sup> The flip side of this pattern has been a trade-off between lower employment and reduced wages. In relative terms the wage decline in Russia was more substantial compared to central and Eastern Europe and was followed by stagnation of wages thereafter. In a certain sense, a policy of half-measures and “bad” compromises was chosen, when artificial sustaining of employment levels became a safety valve, preserving social peace.

## 2.2 Crisis of wages

The introduction of radical economic reform in 1992 started with liberalization of prices and wages and signified a drastic departure from a system of centrally - determined pay. The rigidity of the wage system of the socialist period was a result of determined ideology-driven effort to prevent social stratification and avoid wide inequality of income, often disregarding education, qualifications, special talents or other skills of the labour force and leading to compression of wages. With the advent of market-oriented changes the wage structure based on the pre-determined tariff system geared at standardizing wages quickly became a thing of the past when ceilings on wages were lifted. However, profound and rapid changes in the organization of labour markets produced not only greater flexibility of the wage system but resulted in loosening any strings in

<sup>8</sup> After voucher privatization many workers became formal co-owners of their companies and had a say in the economic decisions of the firm, including lay offs. A substantial number of shares often were retained in the hands of workers of the enterprise and management was hesitant to antagonize this voting block.

<sup>9</sup> Jan Sveinar, “Transition Economies: Performance and Challenges”, *The Journal of Economic Perspectives*, Vo.16. number 1, Winter 2002, p.16.

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this field. As a result flexibility of the wage setting system became extraordinary, clearly surpassing any reasonable expectations. At the same time in Russia large gaps in earnings were not matched by coherent State policy aimed at preventing extra wide differences in household incomes, giving rise to ever-growing inequality and parallel existence of handful of super affluent households together with numerous poor.

Despite the changing balance in the sources of income in the last ten years, wages remain the most important source of income for the Russian population. Adverse changes in industrial output, accompanied by high inflation, resulted in substantial decrease in real wages, giving in its turn a boost to growth of poverty. The decade of transition saw gradual erosion of income from work; as a result in 2000 the real wages in Russia were less than one-third of the level of 1990.<sup>10</sup> The minimum wage dropped at the same time much lower than the “subsistence minimum”: in 2000, it was only 8 per cent of that level.<sup>11</sup> In 2000, more than 60 per cent employed in agriculture, health, education and culture-received wages lower than “subsistence minimum”. One particularly disturbing fact was a large drop in minimum wages in relation to average wages. It fell in Russia from 23 per cent in 1990 to 5 per cent in 1999.<sup>12</sup> This profound decline signified a direct blow upon the level of living; low pay became a single most important factor in rising poverty. Inability of the State to reverse the decline in minimum wages or at least to cushion it was one of the first obvious failures of the new Government in the field of social policy in general and in the area of social protection, in particular. The reasons why minimum wages were *de facto* not used as a policy tool is that they were to a large extent unenforceable, due to the weakness of bargaining institutions and lack of an efficient network of labour inspectors in these countries. In this context minimum wage may have played *only indirect* roles as a

<sup>10</sup> Goskomstat. Sotsialnoe polozhenie i uroven zhizni naselenia Rossii (Moskva, 2000).

<sup>11</sup> Ibid.

<sup>12</sup> Ibid.

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basis for calculating most social benefits like welfare, unemployment and health benefits.<sup>13</sup>

The erosion of the statutory minimum wage, which was kept at the subsistence level before the transition, and was based on a tariff system, resulted in a situation when statutory minimum wage lost its main protective purpose and became an indicator completely unrelated to real life, dropping to such low levels when it could not be binding for the overwhelming majority of workers. As result, the tariff system of wage setting itself lost touch with actual wages and could no longer perform its intended societal functions. Very soon after the start of the transition in 1992-1993 average wage in Russia started its downward move, coming close to the level of minimum wage while minimum wage was dropping beyond subsistence minimum.

### **2.3 Inequality**

High post-liberalization inflation was the most significant factor that eroded the values of wages. Plummeting wages as well as decimated savings of the population in the State savings banks created an unjust redistribute wave when people who worked and contributed to output started to face continuous decline in the standards of living.

Wide-scale privatization of the economy brought to bear new social realities in Russia and resulted in the creation of a completely new paradigm of development with very different institutional, economic and social set-up. Voucher privatization was implemented with a break-neck speed within two years, creating tangible private sector. First and foremost privatization was a politically motivated process, aimed at speedy transfer of large sections of the economy to private owners, initiating an irreversible process that would be legally, economically and politically unassailable. It never had a goal of increasing economic efficiency or performance of state-owned enterprises, at least in the short- or medium-term. While the circumstances of many, if not most, cases

<sup>13</sup> Tito Boeri and Katherine Torrell, op.cit.

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of privatization of State enterprises were dubious, to say the least and clearly far from transparent it had an intended result in making the private sector a significant player,<sup>14</sup> and making market-oriented development firmly entrenched. The unprecedented redistribution of property from the State to private owners did occur.

In terms of equity, the transition in general and privatization in particular has dealt a direct blow to the relatively egalitarian society created in Soviet times. Notorious for asset-grabbing and insider deals, privatization provided almost overnight enrichment to individuals with political connections, contributing enormously to the rise in inequality. The Gini ratio in Russia has increased from 0.27 in 1989 to 0.47 ten years later; in a different measure of inequality the ratio of a rich person's income to a poor person's income in Russia grew from 3.1 to 8.8.<sup>15</sup> There has also been a sharp rise in earnings differentials; the number of employees whose earnings are below two-thirds of national median (OECD definition for low pay) has widened and reached about a third of all employees.

Apart from the outright decrease in real wages, or payment wages in kind, many companies used wage arrears as a convenient method of adjustment. These highly inequitable and unjust methods became preferred methods of retaining workers in Russia under the conditions of instability and uncertainty, particularly at the initial stage of the reform process. However, efforts to adjust minimum wages upwards, which were undertaken in Russia several times by the legislature, were not particularly successful, since in general prices were rising quicker than wages. These efforts lacked consistency and were largely short-lived. At the same time uncertainty in the labour market, created by privatization and restructuring, also proved to be a wage--depressing factor.

<sup>14</sup> At present time eight major Russian Industrial holdings created through voucher privatization account for more than 50 per cent of gross domestic product (Moscow Times, August 15, 2002).

<sup>15</sup> A decade of Transition. The Monee Project CEE/CIS/Baltics. Regional monitoring report. No.8-2201,p.26-27.



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While trade unions in Russia nominally retained their representation in several industries, in real life their role weakened substantially. Also adverse economic conditions constrained their rise as counterparts equal to management in wage setting matters. The absence of strong trade union pressures and limited opportunities for collective bargaining led to increased dependence of workers from employers. At the same time enforcement of existing wage contracts became a problem reflecting clear a weakness of the state, including its overburdened courts. In Russia almost half of the labour disputes have not been concluded within the deadlines stipulated by law.

Not all developments on the labour market were negative. In Russia as in other economies in transition, the evolution of the wage structure has been reflecting increased return to education for those wage earners whose skills turned out to be in greater demand. Many of those employed in rapidly growing service sector were able to find highly paying jobs.

According to some analysts, the role in social protection of the so called non-employment benefits should be re-evaluated upward as they affected wage setting in transition economies. Non-employment benefits (such as unemployment benefits, active labour market policies, welfare assistance, disability and sickness benefits) can function as *de facto* minimum wage, compressing the wage distribution from below, particularly in countries with weak unions, low and unenforced minimum wages and low and falling unemployment benefits. The higher level of non-employment benefits implied floors to wage distributions and prevented further declines of wages. The wage floor imposed by non-employment benefits in the countries of central and eastern Europe meant that old and inefficient firms were forced to shed their least productive labour rather than being allowed to adjust wages downwards or even accumulate wage arrears, as occurred in Russia. Non-employment benefits also imposed a wage floor in the private sector, which made jobs in the new, gap-filling retail sector more attractive. Non-employment benefits also operated as subsidies to job creation in the new sector. Compared with countries of central and eastern Europe, in Russia, these type of benefits do not redistribute nearly as much in favour of lower-wage earners; leading to increases in the inequality of earnings. At the same time while

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a higher level of non-employment benefits helped to encourage structural change and to reduce income inequality, they also generated more unemployment.<sup>16</sup>

In Russia, the visible retreat of the State from the economic sphere was accompanied by similar retreat from the social sphere. It resulted in substantial decreases in public spending which in its turn was connected to a decreased ability to collect taxes by the State and perform redistribute functions for the poor segments of the population. As seen by Russian people in socio-economic terms the results of 10 years of transition are quite disappointing and controversial. According to aggregate data based on several polls, less than 10 percent of the population of Russia directly gained from the liberal reforms (some sources put this strata even at 5 percent),<sup>17</sup> 30 per cent believe that their material well-being did not change significantly or even a bit improved, 40 per cent consider themselves worse-off compared to Soviet times but still are somewhat optimistic about possibilities of their welfare improvement, and 20 per cent became modern dispossessed without any particular hope for the better for themselves or their children.<sup>18</sup>

### **3. Coping strategies**

The social and economic shock associated with transition interrupted the reliance of the population on formal systems for social protection. The support from central and local governments to the population to alleviate the hardships caused by transition has been provided but its scope has been substantially reduced while effectiveness has been substantially less compared to private sources, first of all family and friends. Moreover, the economic costs of the transition have fallen disproportionately on more vulnerable groups of the population as the income gap between rich and poor has significantly increased

<sup>16</sup> Tito Boeri and Katherine Torrell, *op.cit.*

<sup>17</sup> See Natalia Rymashevskaya interview in VEK, no.30, 6 September 2002.

<sup>18</sup> A. Neschadyn, M. Maliutin. The Russia's way to modernize. "Obschestvo i ekonomika" (in Russian), n.5, 2002.

during the transition decade. Another aspect of the challenge was highly skewed geographical distribution of wealth in the country, with large cities absorbing most generated wealth while provincial cities, unless they were not producers of major export commodities, had to face much smaller "piece of the pie".

Table 2 provides some date on coping strategies adopted by Russian households in the face of hardships caused by economic contraction and reduced streams of family income. Based on information from the household's survey, the data shows that the method of coping with hardships mostly widely used by families was spending less on the necessities, including cutting down expenditure on meals and on clothes. Cutting back on consumption, obviously, has its limits. For instance, switching to cheaper foods for poor families often meant worse nutritional content, creating additional health risks in the long run.

Table 2. Selected coping strategies used by Russian households (1998) (percent)

	All households	Poor households with children
<i>Spent less</i>		
Cut down on meals	62	65
Cut expenditure on clothes and shoes	70	74
Spent less on holidays	42	46
<i>Generated more income</i>		
Found supplementary employment	7	7
Cultivated more on agricultural plots	20	20
Rested out apartments	2	1
<i>Sold assets</i>		
Sold possessions	6	6
<i>Sought help from others</i>		
From relatives	21	31
From friends	9	13
From government	7	7

Source: Russia Longitudinal Survey Microdata, 1998

Rapid growth of informal sector employment in Russia reflected another dimension of coping strategies. According to the *Goskomstat* estimate in 2002 about 10 million people (or 15.4 per cent of the total employment) worked in the

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informal sector in Russia.<sup>19</sup> In rural areas informal employment exceeds the national average by a factor of two and comes to 29 per cent as compared to 11 per cent among the city-dwellers. The work in the informal sector (agriculture, forestry, wholesale and retail trade, etc) was the only source of income for eight million people who, in many ways, were lacking social protection.<sup>20</sup>

Despite the obvious need for the State action in the face of growing poverty and destitution, a coherent and predictable social policy has been missing in Russia. From the very beginning of transition economic objectives were declared as pre-eminent while social spending was cut back, in effect making social policy a hostage to macroeconomic considerations. The agenda of the first years of the reform was dominated by short-term financial considerations rather than social concerns. Partly it reflected “theoretical” obsession of the policy makers with issues of “macroeconomic stability” and adequate financial reserves; it also reflected substantial behind the scenes influence of the paragons of the “Washington Consensus”, both homegrown and foreign.<sup>21</sup> The irony of the situation is that is “theoretical “ preoccupation with a stabilization agenda did not prevent major policy failures such loose monetary and fiscal policies at the onset of transition. The post-liberalization collapse of economic growth and contraction of GDP<sup>22</sup> was accompanied by the emergence of very high poverty rates and resulted in further deterioration of social fabric.

Already in 1993 facing the collapse of revenue the Government de facto abandoned hopes of the meaningful and wide-ranging social protection. The failure to sustain the average level of income of population at the pre-transition levels forced the Government to introduce more targeted assistance. The principle of regular indexation of fixed income was considered but abandoned in practice.

<sup>19</sup> Izvestia, 30 August 2002.

<sup>20</sup> Ibid.

<sup>21</sup> See Alexander Nekipelov, “The Washington Consensus and Russian economic policy”; and Jacque Sapir, “The Washington Consensus and transition in Russia: history of a failure”. *International Social Science Journal*, Blackwell Publishers/UNESCO (December 2000).

<sup>22</sup> By the year 2000, Russia still was unable to restore the level of registered GDP achieved before the transition (it was at 60 per cent of the 1989 level).

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One result was the rapidly diminishing ability of the State to compensate budget sector workers for decreasing value of their salaries. Introduction of budget restrictions led to substantial decrease in all kind of outlays and drastic reduction of possibilities for the State to finance programmes from the federal budget. Up to 1994 the Government considered the funds allocated for consumption as a sorts of wasteful spending, seeing those funds as a reserve fund, which could be easily slashed in the fight against inflation; only in 1995-1997 did the situation change.

As a rule Government response to social challenges was of an *ad hoc* nature. Attempts to regulate the minimum level of incomes of various groups of people - whether of wage earners, pensioners or recipients of welfare benefits were of a sporadic nature. The introduction of the so-called minimum consumer budget, established in March 1992, became the key policy instrument. The hope was that by itself this measure would be able to decrease the growing gap between minimum wages and the existing subsistence minimum. However, these hopes did not materialize. The only positive adjustment measure which was encouraged by Government and used by some segments of the economically active population was supplementary employment, which provided some sorts of compensatory mechanism for falling incomes. Social protection of the non- economically active part of the vulnerable population groups such as people with disabilities or pensioners was clearly falling far short of real and pressing needs. The subsistence minimum indicator which was still used for determining the poverty line, also serving as a criteria for putting one or another group into the category of those who needed social protection of the state, *has not* become a real and tangible social floor either for the State or for the nascent private sector. In 1995 for the first time the average pension dropped below the subsistence minimum, without provoking any emergency response or remedial action on the part of the State.

Contrary to the professed desire of the “first wave” reformers to judge the success of the reform effort by the increased income of the middle class population, the number of people with higher incomes grew incomparably less compared to vast increase of the lower-income strata. The people who were negatively affected included not only individuals with few skills or lower motivation, predominately this segment involved millions of highly-motivated

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workers who were unable to change jobs quickly or adjust to changing conditions in another ways.

Despite numerous declarations regarding “creation of socially-oriented economy” as a major policy goal of the Government in the context of transition, social priorities were never identified as important benchmarks of the reform. The question why the government could ignore the social sphere without paying high price at the polls during the elections is very logical in this context. Russian research literature on the subject provides several major explanations.<sup>23</sup> First of all, at the onset of the reform there was a relatively small differentiation of incomes and wealth of the population, and the feeling was that most people equally shared the burden of reforms. Second, since Soviet times the population had some accumulated material and financial assets, which were created under the conditions of perennial shortages in the economy, but they existed and were the population before the reforms. Third, many social services taken by the population for granted could still be provided for some time even without additional financial injections simply because there was some reserves created in the previous system. Fourth, the expectations in the society on the onset of transition were very high.<sup>24</sup> Even the loss of saving accumulated in the Soviet times to the post-liberalization inflation (the loss, by the way, very painful for millions who saw their life savings decimated, allowing at the same time the Government “to solve” instantly the problem of “money overhang” in the economy), a step clearly detrimental to the well-being of citizens and implemented largely at the expense of the population, did not prevent the Government from carrying out numerous unpopular measures nor created some social havoc.

All attempts at financial stabilization implemented by the Government in 1992-1997 always meant less money for social sphere. As the social area, unlike

<sup>23</sup> See for example: V.Kosmarskyi and T.Maleva, “Sotsial’naiya politika v Rossii v kontekste makroekonomicheskoi reformy”, *Voprosy Ekonomiki*, (Moskva) 1995, no.9. (In Russian) (Social Policy in Russia in the context of macroeconomic reform”).

<sup>24</sup> *Ibid*, p. 4-5.

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macroeconomic considerations, was not a priority, people were asked not to wait for any more help from the State. According to some assessments, the only time when the Government took the social dimensions into consideration was the issue of the bankruptcy of unprofitable businesses and redundant labour. In the context of the pace of the structural reforms, the choice was made not to insist on the bankruptcy of unprofitable businesses, i.e. not to enforce “hard budget constraint”. The fear of potential electorate backlash resulted in dubious decisions to leave such enterprises afloat, choosing a policy of artificially sustaining of relatively high levels of employment and low growth of unemployment. A conscious choice was made which resulted in “forced vacations”, wage and pension arrears and led eventually to a vast decrease in real incomes. However, from the standpoint of macroeconomic considerations it was preferable to have many workers beyond the system of formal protection rather than to pay unemployment insurance.<sup>25</sup>

Many policy choices at the beginning of transition were clearly inspired by a neo-liberal thinking and personified by several leading proponents of the market-driven reform, both Russian economists and foreign advisors coming from international financial institutions and research centres, who were deeply convinced that social commitments of the State should be sacrificed in the name of potential gains of increased economic efficiency. Almost all-existing State programmes in the social sphere were branded as paternalistic and were criticized as grossly inefficient. Actually, the social component of the reform was never a particular concern of the first wave of reformers in power, who believed that “economic order” issues were much more important than concern about the dispossessed and the needy. This shortsightedness has cost Russia dearly as the standard of living of the average person has declined considerably over the decade. Broadly based deterioration in living conditions, growth of mass poverty, unemployment and reduction of incomes are troubling signs of a systemic policy failure and woeful inadequate social protection measures. The depth of economic and social decline which Russia currently faces may require years, if not decades,

<sup>25</sup> Ibid, p.6.

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of high growth rates coupled with sensible social protection policy in order to regain what was lost by the people.

#### **4. Financing of social protection**

In Russia, as in any other country, adequate funding remains the basic pillar and core of a meaningful social protection system. Inevitably the drastic fall in real GDP (by about 50 percent since 1989) resulted in decreasing opportunities for sufficient funding of most welfare programmes as well as social services. Actually, lack of sufficient resources to finance the current obligations in social protection domain remains the most pressing challenge for the authorities implementing budgets at all levels, be it central, regional or local. An obvious gap between commitments taken by the State in the area of social protection and actual disbursements in these areas adds to instability and undermines confidence of the population in the State.

One of the peculiarities of the existing situation remains a very broad range of individuals who used to be entitled to various social protection benefits in Soviet times when the State created a complex interlocking system of social welfare aimed at rewarding specific categories of citizens through various social benefits. Despite many changes, this particular aspect of social welfare remained intact; there are many people in Russia who still enjoy numerous benefits “bestowed” to them by the State, even when these benefits may be financially insignificant for the individuals in question. Only at the federal level in Russia there exists about 150 types of entitlements (social benefits, subsidies, payments of various kind and other welfare commitments), which are provided to more than 200 categories of recipients among the population. As a result about 70 per cent of the population in Russia remain entitled to social payments and benefits. The peculiarity of such a seemingly complex system is that *the need* of the recipients clearly is not a decisive factor in the provision of benefits; the benefits (as it was prevalent in Soviet times) are still provided to people who belong to various *categories* such as veterans, children, people with disabilities. On the federal level only three categories of social payments in Russia are provided on a means- tested



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basis and go to families with income beyond the subsistence level: monthly child subsidy, housing subsidy and so-called state social assistance.

Of course, many individuals belonging to those categories find themselves in really dire circumstances; they should have got social protection and material support of society even if it would be a means tested method of provision. However, an estimated 60-65 per cent of those payments go to individuals whose income is above the subsistence minimum while truly needy get either a meagre amount of assistance or no assistance at all.

Despite the formal availability of a wide range of social protection payments, their effectiveness in protecting against risks and vulnerabilities has been very low and has the tendency to decrease. One example will suffice: while in 1993 a subsidy paid to a child age 16 or younger was 19 per cent of the subsistence minimum, in 1997 it declined to 14 per cent, while in 1999 it was only 6.1 per cent of the substance minimum.<sup>26</sup> It is obvious that this level of social protection cannot be considered adequate under any circumstances. Dispersion of funds proved to be an obstacle to achieving goals of meaningful protection.

Taxes remained the main source of funding: federal budget outlays amounted to 16.2 per cent of the GDP, regional and local budgets-15.1 per cent and the four major insurance funds (the Pension fund, Social Insurance Fund, and Medical Insurance and State Employment Funds) amounted to 10.8 per cent. State authorities consumed about 42 per cent in revenues. Attempts to balance the federal budget often resulted in delegating responsibilities for social programmes to the regional and local levels. Not at all this delegation of authority was always accompanied by adequate local financing, which put many local administration into a very difficult situation in meeting commitments. The difficulty and main challenge is that even when federal budget outlays are added to regional and local budgets the cumulative total is not sufficient to fund all social obligations of the State. The existing gap diminishes the value of commitments and increases

<sup>26</sup> Goskomstat. Rossiiski Sataisticheski Ezhegodnik, Moscow, 1998-2000; Sochialnoe polozhenie i uroven' zhizni naselenia Rossii, Moscow, 1998-2000.

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mistrust in the Government's promises regarding sustaining the well-being of the populations.

In 1999 the federal budget covered about 53 per cent of all expenditure on social protection; the other part was provided through regional and local budgets as well as through social insurance funds. The share of social protection expenditure was 2.0 of GDP. To cover all social commitments it would be required to provide *10 times more* funds compared to present level. However, 1999 was the first year when the contraction of the output stopped and a partial recovery emerged. It was preceded by several years of constant decline.

The financial crisis of August 1998 in Russia, which received much world attention, highlighted the mounting disequilibria between on-going government expenditures and available revenues. The crisis was a result of some gross policy miscalculations on the part of the Government, including premature introduction of a "currency corridor" based on fixed exchange rates while existing fiscal deficits required perennial infusions of borrowed funds. It was also spearheaded by an unfortunate combination of negative domestic and external factors such as the contagious effect of the Asian crisis and growing disappointment of foreign investors in emerging markets in general and Russia, in particular. In the years before the crisis in 1996-1997 the reported deficits of the country's budget (comprising the balance on the federal, regional and local government budgets) was estimated to be 5 to 7 per cent of the GDP. The dependence on domestic and foreign borrowing to finance the deficits coupled with inconsistencies in policies contributed to the atmosphere of instability and uncertainty which led to the currency, debt and banking crises of August 1998. It had some implications for mobilization of the resources for social development: collapse of the domestic debt market deprived the federal and regional governments of sources of income. In the wake of this calamity, personal consumption dropped 4 per cent while unemployment increased sharply as well. The restoration of the external balance came through an 80 per cent devaluation of the rouble and was paid by Russian households. Crisis dealt a blow to living standards, put the new poor in increasing distress and once again demonstrated inadequacy in the system of social protection. GDP per capita declined by 40 per cent while unemployment topped

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12 per cent. As in previous times, many households were able to make ends meet only thanks to intra-family transfers. The pain was confronted collectively, but the State was hardly a part of the equation.

While the consequences of the crisis were felt by society at large, in one-way crisis facilitated a departure from the “virtual economy” with its severe cash shortages as the use of monetary surrogates such as barter, promissory notes and mutual offsets declined. Another important development in the aftermath of the crisis was the reduction in wage arrears. In 1999-2000 wage arrears shrunk 77 per cent in real terms, as public sector wage arrears fell by 80 per cent.

As discussed above, in the context of growing poverty the problem of the wage arrears still remain one of the most painful. Wage arrears clearly became a new factor of risk in contemporary Russia, increasing income instability. In many ways this is far more than a financial dilemma facing the enterprise. It also is a unique feature of the Russian labour market, adding qualitatively new dimensions to the overall grim picture. Its roots are found in the specific response of Russian enterprises to the radical change in socio-economic conditions. In many ways it is a logical continuation of such dubious practices as retaining surplus manpower at enterprises at reduced hours, the practice of forced leave without pay and a widespread phenomenon of part-time employment. All of these factors, including the wage arrears, are different facets of an attempt of enterprises to adapt to the market economy environment *at the expense of workers* while avoiding a supply-side response in the form of enterprise restructuring and bankruptcies.<sup>27</sup>

One disturbing aspect of this phenomenon is a constant re-appearance of wage arrears on a national scale. How can this persistence be explained? There are clearly two sides in this equation: the State (and budget-financed workers) on the one hand and the private sector employers on the other hand. In mid-2001 the private sector arrears exceeded the public sector arrears by approximately eight

<sup>27</sup> See Tatiana Maleva et al., *Zarplata y rasplata*, Carneie Endowment, Moscow (in Russian), 2001. Padma Desai and Todd Idson. *Work without wages. Russia's non-payments crisis*, MIT Press, Cambridge (Mass/London), 2001.

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times (31 billion roubles versus 4 billion roubles).<sup>28</sup> However, the behaviour of the State should not be underestimated as it sets some standards in this field: The inability or unwillingness of the State sector to pay wages gives a very wrong signal to all employers, even when employers of the private sector could pay wages on time. A contagious effect is really vividly pronounced when replication of wage arrears occurs on a constant basis. According to some authors who wrote on this phenomenon, a situation of stable equilibrium has developed in the Russian economy whereby wage arrears or underpayment are taken for granted.<sup>29</sup> On the other hand, geographical factors, namely location of the region, seems to matter more in the spread of wage arrears compared to the economic structure of the region. The epicentre of the non-payment crisis is clearly not in the large metropolises but rather in the provinces where the opportunities to find jobs for workers are incomparably low compared to major urban centres.

The crisis of non-payments in Russia is clearly of a systemic nature rather than an unfortunate episode, reflecting an adverse combination of accumulated problems and deformations of a political, institutional and economic nature. By itself even if resumption of growth occurs and becomes sustainable, it would not be able to clear up the situation, in particular regarding the accumulated arrears. The government's attempts to deal with the non-payment problem so far have been largely ad hoc and clearly unsuccessful. On the one hand the weakness of the State was visible in the perennial failure to collect taxes and fulfil its own obligations on time; on the other hand policy stopgap solutions to deal with this issue such debt-write-offs and tax-offset schemes did not have the desired effect. It would have been more promising albeit difficult to enforce proper behaviour of employers through restructuring of enterprises. As a result there is evidence that the non-payment of wages drove many households into poverty.<sup>30</sup>

The financial and fiscal crash of 1998 dealt a heavy blow upon the well-being of the population. However, it had a modicum of a silver lining, providing a

<sup>28</sup> Pravda.ru, 14 August, 2002.

<sup>29</sup> Zarplata I Rasplata, op.cit.

<sup>30</sup> P.Desai, I.Todson, op.cit.

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powerful impetus to take budget commitments seriously. The budgets of 1999-2001 were austere but realistic, enabling the Government to fund in full most commitments.

One of the difficult dilemmas facing the Government is substantial outlays (about 4 per cent of the GDP) still provided by the State (locally and federally) to subsidize housing maintenance and utilities. New investment in equipment is necessary, but the majority of households in Russia can hardly afford a major change in the current system, which would require additional spending on municipal services and utilities by 150 per cent. The average monthly wage in 2000 was only 2,268 roubles (\$78), which is less than the official subsistence minimum for an adult and child.

One of the solutions (which would be also beneficial for solving municipal payments and housing maintenance crisis) is a *minimum wages increase*. It is very much relevant for a discussion on basic income, but has Russian specifics. Larger guaranteed income, at least at the level of subsistence, would obviously enable workers to pay for increased bills for utilities. It would also increase income streams and help to reduce poverty.

As recognized by many observers the pitiful state of the subsistence minimum indicator requires close attention of the policy makers. Loss of the protective function of the minimum wage is also a matter of concern. It is only reasonable that in the context of the debate on the new Labour Code some amendments were introduced in the Duma, mandating that the legal minimum wage equals the subsistence level. The Government took a defensive stand, insisting that the proposed measure would increase the wage bill of Government employees both at the federal and local levels -- to 800 billion roubles (\$26.7 billion) at the level of the Federal budget and almost to 2.500 trillion roubles (or \$83.3 billion) at the regional and local budgets. That expenditure would surpass total outlays of the consolidated budgets of all three levels of government. The consolidated amount of the increased wage bill (about \$110 billion) would substantially exceed the current debt service on the external debt payments (\$ 18.2 billion and \$23.3 billion due in the year 2002 and 2003 respectively). The

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compromised version of the Labour Code included the mandate, but provided that it would go into effect only after a separate authorization bill was enacted.<sup>31</sup>

Despite the seemingly enormous amount of additional funds, in the Russian context the above proposal clearly makes sense from humanitarian, economic, social and strategic standpoints. *At one point in the future it may become feasible financially* under the conditions of sustainable and robust economic growth, and provided that taxation reform is implemented and the wealthiest segment of the population (5-10 per cent who gained enormously from privatization) is asked to pay income tax at a much higher rate than the current 13 per cent flat rate. Increased levies on natural resources exports may provide another important source of budget revenue. Russia's sovereign domestic debt at the end of 2000 stood at only \$20 billion (less than 10 per cent GDP), and in the long run it may also be considered as a potential source of funds for social sphere.

When making difficult financial decisions like this considering increase in financial burden of the State, the crucial point is to identify the well-being of the population as a benchmark and the main goal of any policy efforts. So far it has not been the case in the Russian transition. Social protection clearly makes economic sense, particularly if one considers very high opportunity cost for the society of not providing it.

It is clear that the whole system of State welfare entitlements needs to be restructured and streamlined. An increase in minimum wages to the subsistence minimum and strict enforcement of this mandated increase in the private sector would be a sure way for the State to restore the lost confidence of its citizens in the ability of their Government to take and implement fair decisions. Any major changes should entail a nation-wide discussion of the pertinent issues, bringing on board not only legislature and executive branches, but also civil society organizations, including trade unions.

<sup>31</sup> Vremia MN, June 1, 2001.

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## 5. Conclusions

The advent of radical economic reform and transition to market economy dramatically changed the socio-economic landscape, creating new sources of instability and new social needs. The social protection system of the previous époque is unsustainable in the present situation; it cannot and should not be restored. At the same time the response of the State to the merged challenges has been passive at best, tackling most of the pressing needs as they emerged. Well-thought out and coherent social strategy was sorely missing. This largely *ad hoc* response based on improvization and stopgap measures has inevitably been inconsistent. It could be explained in part by the magnitude of the tasks and sheer scale of the challenge, in part by difficulties in finding appropriate answers under difficult circumstances, and in part by the incompetence of the national bureaucracy.

The creation of a comprehensive and consistent national social strategy is clearly on the agenda. Economic reform should not be implemented for the reform sake; well-being of the population should be the ultimate goal of any reform effort. Creation and adoption of national social strategy, including social protection system as its vital component, requires supportive environment and the long-term involvement of all stakeholders, including the legislature, governments, business sector and civil society organizations. No strategy can succeed in the long run without active public support.

Under no circumstances can the modern State in a democratic country simply abandon its commitments to the citizens, especially in the areas of education, health, social protection, child welfare or retirement income. It is the responsibility of the Government to put on the agenda various options reading alternatives in social services provision and closely collaborate with the private sector in solving pressing social needs. On the other hand, if the Government chooses not to have a public response to acute social problems such as child

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poverty or the health crisis, the consequences of such a choice in terms of harm done to individuals and society at large could be simply innumerable.

Broad-based and sustainable economic growth remains the only true foundation for re-establishing a fair, far-reaching and sustainable system of social protection. Social spending should be recognized as a productive investment. The development of human resources should be seen as the most important factor in sustainable economic growth, both nationally and regionally. Achieving sustainable economic growth and continuing institutional reforms may create a platform for gradual rolling back poverty as well as increasing standards of living and quality of life of the population. The macroeconomic policy of the Government should stimulate investment in the economy as well as investment in human capital. Without reform of education at all levels the enabling functions of social protection system will remain unrealized.

The problem of wage arrears should become one of the priorities on the short-term social protection agenda; in the long term this problem must be solved through collective action of public and private sectors. Special efforts should be undertaken to restore the social protection function of the minimum wage while gradually bringing its level to the subsistence minimum. The level of the unemployment benefit system should be increased while eligibility rules should aim at promoting active job seeking.

When one-third of the population falls into the poverty trap targeting is difficult, if not entirely useless. The relentless spread of poverty in Russia must be contained; fighting poverty should be recognized as a crucial national task and as an important international commitment made by the Russian Government in 1995 at the Copenhagen Summit for Social Development and in 2000 at the Millennium Summit. Russian government should have its own road map in the fight against poverty, with clearly identified benchmarks. As it is well recognized that a meaningful social protection system is an indispensable element in the fight against poverty; enhancing its effectiveness is crucial in this context as well. It should be recognized that actually, the existence of mass poverty is detrimental for economic growth as such since poverty is a pervasive social phenomenon



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closely linked to the demotivation of the labour force, ill health of the population and overall deterioration of human capital.

Apart from containing and preventing a further widening of poverty zone, the creation of appropriate conditions enabling the active part of the population to earn enough money for his or her family is an overarching priority of the social strategy and social protection. The defensive function of social protection should be utilized in full particularly in the context of creating an effective system of social support for those who are most vulnerable (single mothers, elderly, people with disabilities, families with many dependants). All the above components of social protection should be considered in a system rather than in a stand-alone manner.

Specific measures to decrease poverty and low pay should envisage an increase of wages at least for budget-funded workers. This increase in minimum wages at least to the level of officially established subsistence minimum is long overdue. In the final count, this measure is not of a fiscal but rather of a political nature.

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Table 3. Budget social expenditure and insurance funds expenditure (percentage of GDP)

Budget expenditure	1997	1998	1999
Total	10.9	9.1	8.1
<i>Including</i>	4.6	3.7	3.3
Education			
Health care and sports	3.1	2.5	2.3
Social Policy	2.6	2.4	2.0
Expenditure of insurance funds	9.9	8.8	8.3

Source : Vremia MN, June 1, 2001

\* GOSKOMSTAT. Sochialnoe polozhenie i uroven' zhizni naselenia Rossii, Moscow, 2000

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