

Social Protection During Russia's Economic Transformation

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RUSSIA'S social safety net has to be strengthened if economic reform is to be politically palatable. Contrary to some views, however, adequate social protection in Russia is attainable by improving the existing system.

The transition to a market economy in Russia has reduced most people's real incomes, especially the incomes of the poor. The sharp decline in output and the manifold increases in prices during the last three years have taken their heaviest toll on the more vulnerable segments of the population—the elderly or disabled, unemployed workers, workers receiving delayed or partial wages, and families with many children (Table 1). Cash income for many of these groups is below the estimated subsistence level.

As a result, poverty in Russia is increasing. In 1991, some 17 million persons, or 11.7 percent of the population, had incomes below the subsistence level; by 1992 that number had increased to 44 million, or about 30 percent of the population. Recent studies by Russia's statistical agency suggest that the gap between the highest and lowest income brackets has widened significantly in the past two years, while social indicators (e.g., health and education) have declined markedly.

Despite indications that poverty may have declined slightly in 1994, only broadly based, sustained growth can permanently reduce poverty in Russia over the longer term. In the meantime, the key

issues are how to shield the vulnerable from the impact of price liberalization and reduced employment opportunities, and how to strengthen existing social protection schemes to protect their living standards. In fact, the IMF-supported economic program being pursued in Russia includes measures aimed at strengthening the existing system of social protection.

Table 1
Coming through the transition
Economic and social indicators

	1992	1993 estimate
Real GDP (percentage change)	-19.0	-13.0
Consumer price index (percentage change)	1,353.0	932.0
Employment and wages		
Average employment (in millions of persons)	72.3	71.5
Registered unemployment (in millions of persons)	0.6	0.7
Average nominal wage (thousands of rubles per month)	6.0	58.5
Average real wage (percentage change)	-38.0	1.0
Minimum wage/average wage (in percent)	11.9	11.3
Major cash benefits		
Average benefit/average wage (in percent)		
Pensions	31.3	36.3
Unemployment benefits	18.0	11.6
Child allowances	5.3	4.3
Number of beneficiaries/number of employed (in percent)		
Pensions	47.2	49.4
Unemployment benefits	0.2	1.0
Child allowances	62.2	62.6
Sources: Ministry of Finance of Russia, Pension Fund, Employment Fund, and Social Insurance Fund.		

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The safety net

Russia has an elaborate system of primary social protection, which includes subsidies on some food and other consumption items (e.g., public transportation), pensions, newly established unemployment benefits, sickness and maternity benefits, child allowances, and social assistance programs (see box). Pensions and unemployment insurance are permanent social security instruments and can play important social protection roles during the transition period. Secondary instruments of social protection are social assistance programs that assist individuals who receive insufficient or no benefits from the primary programs.

These social protection schemes are financed and administered by a variety of extrabudgetary funds, as well as directly by the central and local governments (Table 2). In 1993, Russia spent some 8 percent of GDP on social protection, excluding outlays on education and health. Roughly two thirds of spending on social protection was for pensions, while most of the remainder was for the other social programs (see chart).

Inadequacies of the system

Russia's current system of social protection suffers from a number of shortcomings. The challenge is to make the existing system cost-effective while ensuring adequate protection for those who need it most. Some of the major shortcomings of the system include:

Unequal and low benefits. During Russia's economic transformation, only the real incomes of those considered to be most at risk can be shielded, and, within this group, the burden of adjustment has to be borne equitably. During recent years, pensioners have on average fared somewhat better than the unemployed. The low level of unemployment benefits is due partly to the fact that unemployment compensation is determined with a declining statutory replacement rate—which measures the relationship between unemployment benefits and a worker's last wage—and no price indexation. This factor, together with the social stigma attached to being unemployed, results in many unemployed not registering for benefits. Moreover, the cost of becoming unemployed is especially high because of the extensive provi-

sion of social benefits within enterprises. Because unattractive unemployment benefits create incentives for state-owned companies to hoard labor, the system clashes with reforms designed to promote economic restructuring and to improve economic efficiency.

About 30 percent of pensioners receive a minimum pension below the estimated minimum subsistence income. Hence, many of these pensioners (16 percent) try to make ends meet by continuing to work. However, a large

proportion of pensioners with higher benefits also work. In many cases, these pensioners continue to work at the same job after reaching the statutory retirement age. In a tight fiscal situation, this practice has introduced an inequity in the social protection system—between those receiving below subsistence pensions and those with above minimum subsistence pensions and, in addition, earned income. Paradoxically, while some vulnerable groups receive inadequate protection, others may receive relatively

Social protection in Russia

Pensions. One out of every four Russians is a pensioner (35 million people). For many, pensions are the primary, and in many cases the sole, source of cash income. The ratio of the average pension to the average wage—the so-called replacement ratio—was 36 percent in 1993, an improvement over the mid-1992 ratio of about 31 percent. There are, however, roughly 10 million pensioners who receive a minimum or very low pension that is less than the estimated minimum subsistence income for pensioners.

Unemployment benefits. The number of registered unemployed in Russia since the beginning of the reform process has been relatively modest. There were some 1.2 million registered unemployed in May 1994—a registered unemployment rate of about 1.6 percent. Of these, only 1 million drew unemployment benefits, however, and another 3 million unemployed had either exhausted their unemployment benefits or had chosen not to register. Close to an estimated 8 million individuals were on short working days or partially paid or unpaid leave in the first quarter of 1994. Consequently, only about 9 percent of the total unemployed and underemployed received cash unemployment benefits. The average unemployment benefit in relation to the average wage was meager at about 12 percent in 1993—about one third of the average benefit received by pensioners—and substantially lower than the minimum subsistence income for a working person.

Other social-insurance type benefits. These include birth, maternity, and sickness benefits to meet various contingencies of short-term income loss of those who are employed.

Child allowances. A traditional means of providing financial assistance in Russia, as elsewhere in the former Soviet Union, is through

child allowances. There are some 39 million children in Russia below the age of 18. Until end-1993, there were 14 types of child allowances, but these were consolidated into three allowances in 1994. Child allowance is linked to the minimum wage and varies with the age of the child. The amount of the average child allowance has been rather small—about 4 percent of the average wage in 1993. Federal and local budgets, together with the social insurance fund, share the cost of child allowances. Faced with the need to contain the fiscal deficit, and lacking a well-defined cost-sharing mechanism, state and local governments have tended to underfinance child allowances.

Social assistance programs. A number of social assistance programs, run by the Ministry of Social Protection in collaboration with local authorities, target the disadvantaged, including especially disabled persons. An extrabudgetary fund—Fund for Social Protection of the Population (FSPP)—is also engaged, among other things, in selling humanitarian aid received from abroad. Because of a lack of regular sources of revenue, however, the FSPP engages extensively in income-producing activities, ostensibly helpful to the poor, such as investment in the production of goods consumed heavily by the poor.

Food subsidies. In Russia, three food items—bread, milk, and meat—are subsidized, mostly at the local level. Local governments can regulate the prices of these commodities, and what they spend on subsidies depends in part on their financial position, and in part on the transfers they receive from the federal budget. As a result, the data most probably do not fully capture the amount spent on food subsidies, and do not include any implicit subsidies borne by producers because of price regulation.

generous benefits. For instance, the social insurance fund provides sickness benefits that are generous by international standards, and subsidizes workers' stays in health spas and resorts by covering their operational costs and providing discounted vouchers.

The average amount of child allowance is also too low to have an appreciable impact on the well-being of a poor family. There is evidence that many children are in fact not receiving the payment because of fiscal difficulties at both local and federal levels. If, as a result of tight fiscal conditions, the average benefit is set too low, inequities result, as less needy families continue to receive payments.

Fragmented benefit administration.

The average benefit level has also been affected adversely by the fragmentation of administration between the local and federal governments. For instance, the central Employment Fund receives 10 percent of payroll tax receipts, and the other 90 percent is retained at the local level. The center's share is hardly sufficient to meet the needs of localities whose level of unemployment increases and, hence, whose revenue base contracts. At present, there are no intergovernmental mechanisms for equalizing funding among different local governments.

Poor coverage. Currently, those unemployed who are not registered receive hardly any income support, as reflected in exceedingly low participation rates of retraining and public works programs. Thus, a large number of unemployed are not covered by the existing system of social protection, although some of them work in the informal sector and earn enough for a minimum standard of living.

At the local level, various programs are geared to serving the disabled, and these need to be sustained during the difficult period of

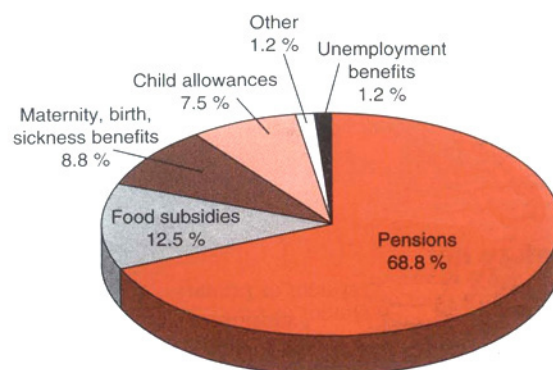
transition. However, few mechanisms, if any, exist at the local level to reduce the gap between family income and the minimum necessary to attain an adequate standard of living. Such mechanisms are necessary to track the working poor and those individuals who do not receive enough from the primary social protection network.

Weak financial base.

Statutory payroll tax rates in Russia are relatively high. However, the "effective rates"—the rates actually paid by the working population—are lower than the statutory rates by 20–35 percent, reflecting the nonpayment and/or underpayment of taxes by businesses, legal exemptions, and, more recently, delays in receipt of payments or arrears. Low effective rates also reflect the lower rates applied to some sectors (agriculture) and enterprises (those employing the handicapped), and the self-employed, designed ostensibly to reflect differential risks. Lower than expected revenue collection, in turn, has limited the ability to close the gap between minimum benefits and minimum subsistence levels.

Wasteful expenditures. Two of the extrabudgetary funds—Employment Fund and Fund for Social Protection of the Population—provide wage and other subsidies to enterprises with the principal objective of maintaining employment. There seems little rationale for providing subsidies for employment that are also financed by workers' social

Spending on social protection in Russia, 1993



Sources: Ministry of Finance, Pension Fund, Employment Fund, and Social Insurance Fund.

insurance contributions that are meant to cover unemployment.

Making the system effective

The social safety net in Russia can and should be made more effective, and this can be done within the tight fiscal constraints present during the transition to a market economy. In the short term, the existing social protection instruments can be adapted to establish a more effective social safety net. During the transition, however, Russia faces potential conflicts between short-term and long-term reform agendas. Over time, it is critical that social insurance schemes—especially pensions and unemployment compensation—be made as effective as possible, based on sound economic and actuarial principles.

Some basic principles. In the short term, a number of principles that recognize the financial and institutional constraints in Russia today should underpin more effective safety nets.

- Eligibility requirements should aim to provide effective protection to potentially all members of vulnerable groups; this requires careful targeting.
- Benefits should be set at levels that balance social adequacy with available resources.
- Protection schemes should recognize short-run administrative constraints.
- The design of social benefits should be compatible with fostering the development of the private sector and competition.

One of the critical principles for an effective safety net is that minimum benefits should at least equal the minimum subsistence income, and be fully protected against inflation. The minimum pension remains below the minimum subsistence income for pensioners, and should be raised. The decision in Russia in late 1993 to switch from full price indexation of all pension benefits to a flat, indexed payment

Table 2

Administering social protection in Russia

Program	Agency	Funding source
Pensions	Pension Fund (PF)	Payroll tax of 29 percent for most workers
Food subsidies	Local governments	Local budget, central government transfers
Unemployment benefits	Employment Fund (EF)	Payroll tax of 2 percent for most workers
Child allowances	Local governments, enterprises	Central and local government budgets and SIF
Birth, maternity, sickness benefits	Social Insurance Fund (SIF)	Payroll tax of 5.4 percent for most workers
Social assistance programs	Local and central governments	Local and central government budgets; and an extrabudgetary fund

to all pensioners reflects the need to at least protect the purchasing power of less well-off retirees to a greater extent than their counterparts with more income.

For the system of unemployment insurance to operate as a catalyst for the macroeconomic and structural adjustment that is needed in Russia, however, the average benefit must clearly be increased from levels observed to date. A higher average benefit could induce more unemployed to register and assist the process of industrial restructuring. Beyond unemployment compensation, and especially for those workers who have exhausted allowed benefits, additional resources for retraining and public works are needed to complement other forms of assistance.

Improved targeting of child allowances, if direct identification of larger poor families is not

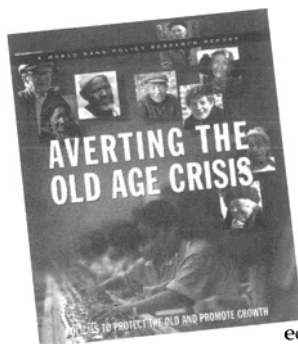
possible, could be achieved by limiting allowances to second and additional children. This will also save resources that could be used to finance other benefits or to increase the value of child allowances. Further improvements in the minimum and, in some cases, average benefits currently provided in the Russian social protection system can be financed without recourse to new forms of financing.

This will require a number of steps to both enhance revenue and make expenditures more cost-effective. About one half of additional resources can be found by rationalizing the benefits structure. For example, pensions for working pensioners receiving more than the minimum pension could be reduced. The retirement age for both women and men—low by international standards at 55 and 60, respectively—could be raised gradually. The

cost of sickness benefits could be borne by employers for the first few days, and subsidies for vouchers for sanatoria could be eliminated. Wasteful practices, such as wage subsidies paid by the Employment Fund to enterprises, could be eliminated.

On the revenue side, compliance with the payroll tax could be strengthened through more widespread and frequent audits and by levying a positive real interest rate on overdue contribution payments. Also, payroll tax exemptions could be reduced or totally eliminated. Both the Pension Fund and the Employment Fund could generate additional resources by putting their surpluses in accounts that pay market interest rates. The resulting strengthened social safety net can be expected to play an extremely catalytic role in accelerating the transition to a market economy. ■

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