

# New Sources of Vulnerability and Risk in Post-Socialist Russia: Toward Social Protection

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*Russia's transition to a market economy dramatically changed the country's socio-economic landscape. The article discusses new demands on the welfare system that was inherited from the socialist era as well as new sources of risk and vulnerability that have emerged. The author argues that in the face of significant social costs and mounting social demands, the country needs a coherent and forward-looking system of social protection that can adapt to market realities.*

**Keywords:** *Russia, welfare system reform, social risks and vulnerabilities, social protection*

The abandonment of central planning in Russia more than 10 years ago and the transition to a market-oriented economic system entailed drastic societal shifts with profound changes in the national welfare organization. The transition placed new and heavy demands on the welfare system inherited from the socialist era. A highly centralized and rigid system of guaranteed employment ceased to exist. As a result, the long-running system of social security, "from cradle to grave," disappeared. The old organization has been replaced by a hybrid system of social protection, which is substantially smaller in coverage even though it carries a strong imprint of the previous era.

The system coexists with new elements that came into being in reaction to emerging market realities. For instance, unemployment insurance had to be

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developed anew while the system of benefits—often provided in-kind—for veterans, people with disabilities, and families with several children remained. The existing system did not satisfy politicians of a neo-liberal persuasion who saw social commitments by the state as an unnecessary burden undermining the efficiency and competitiveness of the economy, or politicians with a paternalistic bent who were convinced that ultimate responsibility for social protection should remain with the state and only the state. New sources of risks and vulnerabilities seriously affected the standard of living for the majority of the country's inhabitants and exposed how ill-suited the system was to meet the needs of the population. Among the most difficult challenges is the emergence of high levels of income poverty that has the potential to turn into mass poverty, entailing the all-too-familiar features of alienation, exclusion, and eventual loss of human potential for millions of people.

The overhaul of the current welfare system was initiated by the Russian government in May 2004 when a new bill was introduced to replace Soviet-era entitlements with cash benefits. It was approved by the Parliament (Duma) and signed into law in August 2004. The program to convert most in-kind benefits into cash affected millions of people and turned out to be highly controversial. Veterans, pensioners, people with disabilities as well as servicemen and police lost their entitlements to valuable benefits such as free transportation and subsidized medicine. Instead they received cash payments that were deemed by most to be inadequate and much lower compared to the previous package. When the implementation phase of the reform started in January 2005, it spearheaded widespread protests of pensioners and other beneficiaries across Russia. In the face of increased social tension, the government was forced to intervene to ease the impact of the reform by promising to return some of the benefits and to increase the amount of compensation. The government also blamed regional authorities for failing to implement the new law properly (Yablokova, 2005).

The benefits-reform unrest revealed glaring inadequacies in the existing social protection regime as well as difficulties in further advancement toward market-oriented welfare reform. The federal government was unable to coordinate reform implementation with regional authorities and suffered a substantial dent in popularity as a result.

Social protection systems vary from country to country. Different traditions, cultures, and organizational and political structures affect national definitions of social protection. Social protection may be defined as the collective response of a society to sustain the well-being of its citizens, including providing protection against various risks and contingencies in order to offset the absence or reduction of income from work; providing assistance to families with children; and providing health care and housing (United Nations, 2001). In a broader sense, a social protection agenda includes policies to increase human capabilities to manage risks, participate fully in society, and live with dignity. Three important functions of social protection that help to better understand its essence are a) a defensive function aimed at protecting people against various risks and

contingencies, and guaranteeing satisfaction of their basic needs; b) a developmental function aimed at capability enhancement and capacity-building; and c) a social justice function aimed at promoting social integration and cohesion.

In the final analysis, the availability of social protection is reduced to two crucial elements: provision of security to the population (income security, in-kind services, subsidies) and financing of social protection systems (state, community, or the private sector). This article looks at both dimensions of social protection and their evolution in post-socialist Russia. The challenges are discussed in light of the current economic and social situation in Russia, and the author makes specific policy recommendations regarding welfare reform.

### **Soviet Legacy**

Under socialism, most social protection was provided to the population directly by the state through budget transfers or indirectly through state-owned enterprises as workplace benefits. The role played by the state in the Soviet-style socialist economy was enormous and has been well described elsewhere (Kornai, 1992; Kapstein & Mandelbaum, 1997). This role is an important point of departure in any attempt to describe the systemic change that occurred after the demise of central planning and the beginning of the market-oriented transformation.

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 income redistribution instrument 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 were important pillars in the overall system of social protection. The economic and social objectives of the state were institutionalized and closely linked, making specific social policy measures and interventions unimportant, if not outright unnecessary. State support, provided in the form of a wide range of general subsidies and in-kind services, focused on the population at large rather than on specific disadvantaged groups. When benefits (usually in-kind) were provided to some categories of people such as war veterans and invalids, these benefits were part of the reward system established by the state for past services rendered rather than a welfare support provided to the disadvantaged based on principles of solidarity (Alexandrova, Ovcharova, & Shishkin, 2003). The welfare commitments undertaken by the state were matched by the state's ability to collect taxes from the public sector and availability of other sources of revenue such as proceeds from foreign trade based on state monopoly or excise taxes on alcohol.

The socioeconomic organization of that type of welfare system was rigid by definition. The organization gave little room for individual choice in social services provision, largely disregarded efficiency, and provided woefully inadequate labor incentives. The former system was extensive, however, in maintaining a basis

for equity and social cohesion in society and had the state as an ultimate guarantor of income security. The system reflected the political and social goals of state socialism; incomes were generally low and wages compressed, but the “social contract” arrangements were predictable.

### **Challenges of Transition**

More than 10 years of transition have brought enormous changes to the social protection system that was designed under completely different circumstances and that reflected different political and socioeconomic priorities. The deep transitional depression resulted not only in the contraction of registered output by 40 percent per capita in real terms between 1991 and 1998, but also in persistent unemployment, wage arrears, emergence of wide-scale low wages, and a growing “shadow” economy (Goskomstat of Russia, 2003). There has been a clear deterioration in society’s ability to protect its citizens from adverse contingencies and risks in post-socialist Russia.

The coping mechanism of the transition period reflected a shift from state support to a prime reliance on individual ability to absorb shocks, or the family (by default) as a provider of social protection. The immense change in the 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 phased-out food subsidies, the population had to cope with falling real incomes that could not keep up with rising prices. Savings were decimated by inflation and lost value. Some Russian scholars, such as Nikolai Shmelev, called the failure of the state to protect the savings of the population “the first and the most serious mistake (or even a crime) of the reformers” (Shmelev, 1996, p. 65). The state drastically decreased budget financing of schools, kindergartens, clinics, public transportation, and numerous other social sector establishments in the name of stabilization and financial responsibility. Many state enterprises were forced to stop providing work-place social benefits, shifting responsibility to local governments that often lacked both the financial and administrative means to provide needed protection. “The premature welfare state” (Kornai, 1997, p.1184) gave way to a suddenly impoverished state left, on top of everything else, without a clear-cut social strategy.

### **Poverty**

The combined effect of several adverse factors has resulted in an enormous increase in poverty in Russia. The number of people living in poverty varied between 30 and 35 percent of the entire population for the most part of the last decade (Goskomstat of Russia, 2003). Even today, 5 years after the resumption of economic growth, which is partially fueled by favorable external factors such as high oil prices and relative stabilization of the economy, more than one fifth of the population lives below the poverty line (Bobkov, 2004). The country faces

acute social problems such as a profound demographic crisis including a fall in life expectancy and a decrease in population, deep-rooted problems of public health and health care including the emergence and relentless spread of HIV/AIDS, and environmental degradation in many areas of the country. One can say that poverty has become the major political, economic, and social challenge in Russia.

The State Committee of the Russian Federation on Statistics (Goskomstat of Russia) calculates the poverty rate based on the so-called “subsistence minimum” that is linked to the purchasing power of a certain set of goods. The poverty rate is calculated annually as the percentage of population living below the officially established subsistence level, which in turn is assessed separately for population subgroups such as working-age persons, pensioners, and children. The poverty rate is then computed as the weighted group average. In mid-2004, the subsistence minimum was established at 1808 rubles per month (about US\$61). It is difficult to assess the levels of poverty in the years before the transition as the existence of poverty was not recognized officially in Soviet times. The income poverty rate was estimated to be 16 percent in the 1980s (Alexandrova et al., 2003).

The annual rate of poverty in Russia jumped from that estimated 16 percent in the 1980s to 33.5 percent of the population in 1992. In August 2004, the total number of people living below the subsistence minimum was about 30 million or 20.8 percent of the total population (“Nearly 30 million,” 2004). An analysis of population groups with the highest risk of poverty revealed that families with several children are the most vulnerable. About 60 to 80 percent of families with several children are among the poor (International Labor Organization [ILO], 2002). This group is followed by single mothers and pensioners living alone. The rise in poverty has also seen the emergence of child labor in the last decade despite national laws prohibiting it. Deterioration of living conditions affects the health of children, who then suffer from malnutrition and lack of proper medical attention. Orphaned and abandoned children have become another visible sign of the family as an institution facing a crisis under present circumstances (UNICEF, 2001; Mackinnon, 2002).

The “feminization” of poorly paid jobs has become a trend in the last 10 years, and the social vulnerability of women has increased. Women constitute about 70 percent of the unemployed in Russia (Goskomstat of Russia, 2003). They are also predominant among “the new poor” (or the “working poor”) and among the employees who have been forced by management to cut their working hours and receive reduced wages (Rimashevskaya, 2003). Women become single parents after a divorce, the birth of a child out of wedlock, or the loss of able-bodied male breadwinners due to premature deaths caused by excessive consumption of alcohol and resulting accidents, health deterioration, or homicides (Bennet, Bloom, & Ivanov, 1998). In 2002, there were 853,600 divorces in Russia per 1,019,760 registered marriages, and about 30 percent of children were born out of wedlock (Vishnevskiy, 2004). These changes in the

family structure lead to a substantial deterioration of family income streams, making single-parent families highly vulnerable to poverty.

Inflation and widespread pension arrears eroded the value of pensions affecting the economic well-being of retirees. In 1990, an average pension (typical for two thirds of pensioners) exceeded the cost of the minimal "consumption basket" by a factor of 2.4. This factor dropped significantly and varied in the range of 0.7 to 0.9 of the subsistence minimum between 1999 and 2001, stabilizing at a minimum level of 1.00 in 2002 (Goskomstat of Russia, 2003). The inability of the formal system to protect the elderly has been plainly revealed. The stop-gap solution employed soon after the liberalization of prices was to abolish the Soviet epoch regulations restricting employment of retirees; pensioners were allowed to work and collect pensions at the same time. Given that the retirement age in Russia is still 55 years for women and 60 for men, many retirees used new opportunities and found jobs in either the formal or informal sector, earning additional income. In 1996–1997 about 27 percent of all pensioners in Russia continued to work, but by the year 2000, this share dropped to 16 percent (Ovcharova, 2003). Enhancement of the well-being of some elderly groups through supplemental work incomes may explain an apparently paradoxical situation concerning inter-household transfers in many Russian families: in many cases, transfers from the elderly to their adult children subsidize both adults living at home and adult children who leave home to start their own families. In other words, Russia's familial transfer system tends to reproduce the public goal of income redistribution within the private context of the family (Kuhn & Stillman, 2004).

For pensioners who are unable to work, life may be truly bleak, especially if they are living alone. It is not surprising that this group is among the poorest segments of society, and particularly so if they are also disabled (Ovcharova, 2003). 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 the fall in guaranteed retirement incomes for pensioners. Many pensioners are also dependent on neighbors, friends, or charities for financial support.

While specific qualitative indicators related to the transition process can be questioned or interpreted in different ways, it is clear that the transition to a market economy had profound social and human costs in Russia. Significant segments of the population saw their real incomes plummet. In addition, the entire way of life once taken for granted—with its familiar mainstays, such as accessible medical services and a reliable social security system—crumbled around them (UNDP, 1995; United Nations, 1996). As a result of profound psychological shocks experienced by the majority of the population, concepts such as "democracy" and "the market" lost a lot of luster or were outright discredited in Russia in the 1990s (Protsenko, 2005).

## Unemployment and Peculiarities of Adjustment

One of the most visible features of this profound and painful change was the end of guaranteed employment. A drastic decline in the demand for labor has proven to be a common feature in the transition from centrally planned to market-oriented economies, and Russia is no exception to this rule (Nesporova, 1999). Since labor hoarding was an integral part of the economic organization of state socialism, some contraction of employment was anticipated at the onset of transition as part of the restructuring of the economy. However, both the scale of joblessness and the duration of unemployment turned out to be much worse than anticipated by the policy makers, 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 established after the launch of reforms.

The transition process reshaped the composition of employment by sector and branch; the industrial sector experienced the most serious job losses (Nesporova, 1999). The levels of unemployment vary across the country but remain higher in the provinces. In particular, unemployment soared in many small towns that had spread around industrial enterprises created by central planners during the Soviet epoch. The population in these towns became highly dependent on the ability of such enterprises to stay in business in the new market environment. The collapse in demand, accompanied by a difficult period of uncertainty and economic adjustment, forced many such firms to rationalize operations in order to compete with domestic rivals or imported goods, or close down entirely. Rationalization and restructuring were often accompanied by shedding unproductive labor. This resulted in open unemployment in some areas of the country that was made worse by low labor mobility (Standing, 1996).

The adjustment process chosen and implemented in Russia in this area, however, has been different compared with many other transition economies, particularly Central European countries (Boeri & Terrell, 2002). Even in the face of low or declining output and falling demand, many companies in Russia did not lay off workers but cut working hours, introduced forced “administrative vacations,” or started withholding salaries. The share of part-time jobs also increased. As a result, the level of employment in state and privatized firms has remained relatively high. Often managers used unconventional ways such as in-kind payments rather than monetary payments to compensate workers. To a certain extent, this policy reflected the structure of internal control within the company.

The state implemented voucher privatization by issuing special certificates or vouchers to all citizens to facilitate the redistribution of state-owned assets to private owners. Apart from directors and senior managers who became owners and benefited most from privatization, voucher privatization sometimes allowed workers to become formal co-owners of companies and participate in the economic decisions of the firm, including lay-offs. A substantial number of shares

were often retained in the hands of workers of the enterprise, and managements, at least initially, were hesitant to antagonize this voting block by opting for the solutions mentioned above over outright lay-offs (Blasi, Kroumova, & Kruse, 1997; Desai, 2005).

Retaining excess workers on the payroll can, however, also be traced to government pressure on firms to limit the number of workers to be laid off. Such policies signified the continuation of “soft budget constraints” at the enterprise level and the failure of the state to enforce financial discipline. Labor demand elasticity with respect to output and wages was less pronounced in Russia compared to the more market-oriented pretransition economies of Central Europe, where it rose rapidly after transition was launched (Svejnar, 2002). In relative terms, the wage decline in Russia was more substantial compared to Central and Eastern Europe at the onset of transition and was followed by stagnation of wages during the transition period. In a certain sense, a policy of half-measures and “bad” compromises was chosen, and an artificial sustaining of employment levels became a safety valve in order to preserve social peace.

### Wage Crisis

The introduction of radical economic reforms 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 in the socialist period was a result of ideology-driven efforts to prevent social stratification and avoid wide income inequalities by often disregarding education, qualifications, special talents, or other skills of the labor force. With the advent of market-oriented changes, the wage structure based on the predetermined tariff system geared at standardizing wages became a thing of the past when wage ceilings were lifted. Profound and rapid changes in the organization of labor markets produced not only greater wage flexibility, but also weakened existing legal and administrative levers in this area. As a result, the flexibility of the wage-setting system surpassed all reasonable expectations (Standing, 1996). However, at the beginning of the transition and in line with the logic of economic reforms, the government introduced a tax-based income policy geared at controlling wage increases above a specified level through a punitive tax. This policy existed until January 1996 (Nesporova, 1999). The subsequent erosion of real wages that was due partly to the wage tax contributed to the rapid growth of the informal sector.

Wages remain the most important source of income for the Russian population despite the appearance of previously nonexistent income from property or entrepreneurial activities in the last 10 years. Adverse changes in industrial output accompanied by high inflation resulted in a substantial decrease in real wages that in turn augmented the growth of poverty. In 2002, the real average monthly wages in Russia were only slightly above half of the level in 1990 (Goskomstat of Russia, 2003). Very soon after the transition, in 1992–1993, the average wage in Russia started its downward trend, coming close to the min-

imum wage level. At the same time, the minimum wage dropped to lower than the subsistence minimum level. In 2000, minimum wage was only 8 percent of the subsistence minimum level, and more than 60 percent of people employed in agriculture, health, education, and recreation fields received wages lower than the subsistence minimum. Minimum wages fell from 23 percent in 1990 to 9 percent in 2003 in relation to average wages (Goskomstat of Russia, 2003). The 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 and social protection. Minimum wages were de facto not used as a policy tool because the weakness of bargaining institutions and the lack of an efficient network of labor inspectors made minimum wages, to a large extent, unenforceable. Minimum wages may have, thus, played only an indirect role as a basis for calculating social benefits such as welfare, unemployment, and health benefits (Boeri & Terrell, 2002).

According to Boeri and Terrell (2002), the role of the so-called nonemployment benefits in social protection should be reevaluated upward as they affected wage setting in transition economies. Nonemployment benefits (such as unemployment benefits, active labor market policies, welfare assistance, disability, and sickness benefits) can function as a de facto minimum wage compressing the wage distribution from below, particularly in countries with weak unions, low and unenforced minimum wages, and falling unemployment benefits.

Apart from the outright decrease in real wages or shift to in-kind wages, many companies used wage arrears as a convenient method of adjustment (Maleva, 2001; Desai & Idson, 2001). Wage arrears became the preferred method of retaining workers under the conditions of instability and uncertainty, particularly at the initial stage of the reform process. Efforts to increase minimum wages were made several times by the legislature, but were not particularly successful since prices were rising faster than wages in general. The efforts lacked consistency and were largely short-lived. At the same time uncertainty in the labor market created by privatization and restructuring also proved to be a wage-depressing factor. However, the decline in real wages reflected, in part, a much larger problem of rising poverty and income inequality. In early 2000, wage arrears equaled some US\$13 billion at the official exchange rate (Zhukov, 2000).

Though trade unions in Russia nominally retained their representation in several industries, their role weakened substantially. Adverse economic conditions constrained their rise as equal counterparts to management in wage-setting matters. The absence of strong trade union pressures and limited opportunities for collective bargaining led to an increased dependence on employers. This lack of autonomy on the part of trade unions along with inadequate information on the functioning of enterprises and the inability to make independent judgments regarding the good, mediocre, or outright harmful performance of an enterprise's management often has negative consequences for workers

(Nesporova, 1999). The weakened role of the state was also visible in its difficulty in enforcing existing wage contracts and its overburdened courts.

Not all labor market developments were negative. The evolution of the wage structure has been reflecting increased returns to education for wage earners with skills that are in greater demand. Many of those employed in the rapidly growing service sector were able to find high-paying jobs. The new Labor Code, signed into law in January 2002, obliged employers to accept collective bargaining while easing the restrictions on employers wanting to dismiss staff. The code also introduced substantive penalties for employers who failed to pay wages on time (Jack, 2002).

Many analysts (L'vov, 2004; Ovcharova, 2003; Tarasova, 2004) agree that the exceptionally low wage levels compared to international standards and the sharp differences among industries in relation to wage levels are some of the crucial challenges in Russia. Rural households are particularly vulnerable, having the largest income deficit per capita; average wages in agriculture are the lowest in the country, and in 2001 the average wage constituted only 40 percent of the average national wage level (Ovcharova, 2003). On the other hand, wages and salaries in the oil and gas sectors of the economy often exceeded national averages by a factor of 10 (Protsenko, 2005). The "new poor" in Russia are, first and foremost, working poor whose wages are not sufficient for meeting everyday needs. Many of these poor people work in the public sector or in the education, health care, utilities, and housing fields where salaries have traditionally been extremely low. Their families often find themselves left behind in existing social protection schemes due to the inadequate level of state support provided. Even two working parents are unable to make ends meet (Ovcharova, 2003).

The low average wage level not only has a detrimental effect on the standard of living of the population, but also creates poverty for some groups, making it a chronic phenomenon. Low wage levels therefore became a political issue, and many scholars believe that the fact of low wages itself represents a hindrance for further economic and social development (L'vov, 2004; Rimashevskaya, 2003). Comparing the picture in Russia with some advanced market economy countries based on country-specific studies (e.g., Canada), and simultaneously taking into account variables such as average productivity of labor and wage levels, reveals that Russia lags behind Canada in terms of average labor productivity by a factor of about 3.7, and by a factor of 8.6 in terms of average wages. These figures demonstrate that in terms of relative productivity of labor per unit of pay, Russia actually exceeds Canada by a factor of 2.3 (Tarasova, 2004). While the price levels of consumer goods in Russia are roughly comparable with the world levels, the level of average wages falls far behind countries with similar levels of education. At the same time, large earnings gaps were not matched by coherent state policy aimed at preventing wider differences in household incomes, giving rise to growing inequalities and the parallel existence of a handful of super-affluent households and numerous poor households.

## Health Care Crisis

Access to affordable health care is an integral part of a well-established social protection system. The transition dealt a severe blow to the health system inherited from the Soviet times, depriving many people, particularly the “new poor,” of health care services and often forcing them to do without modern medicine. Economic decline triggered a visible reversal in both health and health care in the country and included a fall in life expectancy, a decline in pediatric health, and the large-scale return of some communicable diseases such as tuberculosis. Adult male mortality rates increased sharply with dire demographic consequences (Bennet et al., 1998). The risk of premature death among men increased by 70 percent in the period 1987–1994 (World Health Organization [WHO], 2002). Also, the cumulative number of people living with HIV/AIDS in the Russian Federation has doubled every year since 1995. Currently the number of infected persons is estimated to be between 800,000–900,000, exceeding by at least three times the official figure of 300,000; the majority of those infected are young people in the age group 15 to 29 years (Konygina, 2004; Feshbach & Galvin, 2005).

Despite these major challenges associated with transition, public health spending has plummeted. In the late 1990s, public spending was three times less than during the pretransition period; public health care funding as a percentage of GDP decreased from 3.7 percent in 1993 to 2.8 percent in 2001 (Shishkin, 2003). Currently, per capita government expenditure on health is on average five to seven times less than in advanced market economies such as Germany or France, three times less than transition economies such as the Czech Republic and Slovenia, and twice as less as per capita spending in such transition economies as Hungary (WHO, 2002).

The reforms undertaken in the early 1990s were largely inspired by the “European model” with strong emphasis on employer-provided funding for medical care. A two-pronged system was created; in addition to “traditional” health care allocations from federal and local budgets, the so-called Mandatory Medical Insurance (MMI) was established that was geared at collecting funds from insurance premiums paid by employers. In 2001, the MMI contribution (about US\$3.2 billion) was about 50 percent of the total health budget. Introduction of the MMI system, however, did not solve the main challenge—a perennial shortage of funding for health care. On one hand, employer contributions in Russia have been only 3.6 percent of employee salaries compared to 8 to 12 percent of employee salaries in Western Europe (Bogatova et al., 2002). On the other hand, many administrators at the regional levels used funds earmarked for health for completely different purposes because of numerous conflicting demands and budgeting priorities. As a result, health care providers were left without urgently needed additional funding.

The discrepancy between obligations undertaken by the state and actual ability to guarantee provision has become a very noticeable feature in Russia,

and health care is no exception. Formally, under existing laws, hospitals have to dispense medicine at no cost or with a heavy discount to people who are chronically ill, people with disabilities, infants under the age of 1, and pensioners. In practice, many hospitals have been unable to do so and are forced to ask patients to pay for the required medicine because of the shortage of funds. Since many medicines are expensive (very often they are imported), the inability of the state to cover the costs and the dire financial circumstances of the population result in the exclusion of many people from health services. The situation is compounded by the low income of doctors (the nominal equivalent of the basic salary may be between US\$100–150 per month), which forces them to work extra shifts or look for supplementary incomes (Shishkin, 2003). As a result, many hospitals and clinics are becoming more and more understaffed as doctors leave for better-paying jobs. As recurrent public health budgets remain scarce, the burden of payments for health services is shifting towards the country's population and employers. According to some estimates, the share of health care funding from nongovernmental and/or private sources increased from 14 percent in 1994 to 36.5 percent in 1999 (Shishkin, 2003).

The World Health Organization (WHO) (2002) sees a clear relationship between life expectancy and gross domestic product per capita, and rampant poverty has been identified as the main cause for the worsening of health. Children are particularly affected (Jensen & Richter, 2001), and the picture remains truly worrisome since, according to some estimates based on household surveys, more than 70 percent of Russian children lived in households where needs exceeded income during the 1990s (Lokshin & Popkin, 1999). Apart from individual biological factors, household characteristics such as mother's education, father's employment status, and per capita household expenditures are found to have especially large effect on children's health (Fedorov & Sahn, 2005). The decline in life expectancy in Russia (and in most other former Soviet republics) has reached a magnitude without precedent in peacetimes (WHO, 2002). In 2002, life expectancy at birth for both sexes was 64.8 years (Vishnevskiy, 2004), compared with 71.1 years in China and 77.3 years in the United States (WHO, 2004). The discrepancies in life expectancies between the poor and the rich are among the highest in Europe. The gap in life expectancies between the highest and lowest income groups has been estimated to be 15 years (WHO, 2002).

### Inequality

In terms of equality, the transition and privatization, in particular, have dealt a blow to the relatively egalitarian society that existed in Russia. Wide-scale privatization of the economy brought new social realities to the country and resulted in the creation of a completely new paradigm of development with a very different institutional, economic, and social set-up. Privatization was implemented at breakneck speed within 2 years, creating a tangible private sector. By 1996, 63.4 percent of all enterprises in Russia were privately owned, signifying

an unprecedented redistribution of property from the state to private owners. By 2003, 76.9 percent of all enterprises in Russia were in private hands. However, asset grabbing, insider deals, and political connections provided almost overnight riches to some individuals, contributing enormously to the rise in inequality. The Gini ratio in Russia grew from 0.27 in 1989 to 0.40 in 2002 (Goskomstat of Russia, 2003).

Shleifer and Treisman (2005) agree that inequality has increased sharply after the introduction of radical reforms. However, they refer to Milanovic (1998) and argue that it was the growing dispersions of wage incomes that created inequality in Russia and not privatization as such. Others (Shmelev, 1996, Rimashevskaya, 2003) indicate that the entire privatization process was flawed and inequitable. Currently, the buying and selling of large enterprises leads to a very high concentration of ownership and the strengthening of a small group of super-rich and influential individuals called "oligarchs." The property rights of these oligarchs are deemed illegitimate by the majority of the Russian population (Guriev and Rachinsky, 2005).

Privatization was, first and foremost, a politically motivated process aimed at a speedy transfer of large sections of the economy to private owners. The goal was not to increase the economic efficiency or performance of state-owned enterprises, at least in the short or medium term. Though the circumstances of many, if not most, cases of privatization of state enterprises were dubious and far from transparent, the private sector now became a significant player, and market-oriented development was firmly entrenched. But many people ended up receiving very little for the vouchers they were given by the state. Moreover, information provided to owners of vouchers about the real worth of factories put up for sale was incomplete, and people were not able to make informed choices (Desai, 2005). The political actors of the liberal persuasion ignored the injustice that pervaded privatization; in fact, a demonstrated disdain for social equality in the early years of the reforms marked ". . . a historical break from Russia's cultural traditions" (Shlapentokh, 1999, p.1167).

By the end of the transition decade in Russia, the visible retreat of the state from the economic sphere was accompanied by a similar retreat from the social sphere. It resulted in substantial decreases in public spending, which in turn was connected to the state's decreased ability to collect taxes and perform redistribution functions for the poorer segments of the population. It is not surprising, therefore, that the Russian people consider the socioeconomic results of the transition quite disappointing and controversial. According to aggregate data based on several polls, less than 10 percent of the Russian population directly gained from the neo-liberal reforms. Thirty percent believe that their material well-being did not change significantly or even improve. Forty percent consider themselves worse off compared to Soviet times, but are still somewhat optimistic about possibilities of welfare improvement, and 20 percent became "contemporary destitutes" without any hope that things will get better for themselves or their children (Neshchadin & Maliutin, 2002).

The overall rise in real incomes observed in Russia in the last 5 years has been unable to close the mounting gap between the rich and the poor. For instance, according to a Goskomstat appraisal of population income growth in 2004, which is considered a relatively “favorable” year, the average income in the poorest group of Russian society rose by only 6 percent to the level of 1,360 rubles a month (about US\$50), while the average income of the affluent rose by 10 percent to the level of 18,778 rubles (about US\$680), representing a 14-fold difference in average income levels (Protsenko, 2005). When benefits of market-oriented development are available only to the wealthier population groups, the situation can only be called socially explosive and detrimental for the future development of the country. According to some Russian scholars, the deep polarization of society represented by existing huge gaps between the upper and lower levels, between the super-rich and extremely poor, leads to visible antagonism in these groups, thus representing the main socioeconomic challenge in contemporary Russia (Zaslavskaya, 2003).

Lack of proper attention to social development and the preeminence of macroeconomic considerations, particularly in the early transition years, had substantial social costs. The reformers “were largely indifferent to their program’s acceptance by the public and its distributional impact on the losers. . . . [T]he urgency of minimizing costs for the most vulnerable groups was not even articulated in the design of policies, much less in their implementation” (Desai, 2005, p. 90). Combined with sluggish institutional improvement and lack of coherent strategic direction, this myopic policy contributed to the increased vulnerability of many segments of the population. Heightened uncertainty and insecurity severely weakened the resilience of households in the face of profound and rapid changes.

### **Coping Strategies**

The financial crisis of August 1998 that received much world attention highlighted the mounting disequilibria between ongoing 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.

The crisis dealt a very heavy blow to living standards, putting the “new poor” in further distress. The restoration of the external balance came through an 80-percent devaluation of the ruble. Many households were able to make ends meet only through intra-family transfers and work in the informal sector. The pain was confronted collectively, but the state was hardly a part of the equation. The crisis underscored a visible trend in public policy to avoid new commitments and assume only minimal obligations under basic legislative guarantees (Rzhanitsyna, 1999).

Based on information from the Russian Longitudinal Monitoring Survey, a nationally representative sample of households in the Russian Federation, the method of coping with hardships most widely used by families with children was spending less on basic necessities such as food and clothing. Switching to cheaper foods often meant less nutritious food, creating additional health risks in the long run. Health-related characteristics such as low weight among children under 5 years of age and lower than average height have been found to be connected to poverty levels and were particularly prevalent among the poorest population groups (Ovcharova, 2003).

Rapid growth of employment in the informal sector (agriculture, forestry, wholesale and retail trade) reflected another dimension of coping strategies. In the absence of support from the state, people were forced to develop their own ways to deal with poverty, often turning to the “shadow” economy. The State Committee of the Russian Federation on Statistics estimates that in 2001 about 10 million people (or 15.4 percent of those employed) worked in the informal sector in Russia. Informal employment in rural areas exceeded the national average by a factor of 2 and was 29 percent of formal employment compared to 11 percent among city dwellers. Work in the informal sector was the only source of income for 8 million people who, in many ways, lacked social protection because of the specific nature of their jobs. Russia’s shadow economy was estimated to be worth US\$90–110 billion (Sazonov, 2002).

In the face of falling revenues, the government had de facto abandoned hopes of meaningful and wide-ranging social protection by 1993 and reverted to stop-gap measures. Introduction of budget restrictions led to a substantial decrease in all kinds of outlays and a drastic reduction in the state’s abilities to finance social programs from the federal budget. Attempts to introduce more targeted social assistance, even on a limited scale, however, proved to be far from a panacea. For example, in the mid-1990s, three pilot projects sponsored by the Russian government (in the Komi Republic, in Voronezh, and in Volgograd oblast’) to reach the poorest of the poor in Russian regions demonstrated that only a very narrow circle of recipients (just 2 to 6 percent of the 20 to 25 percent of the people in poverty) was able to claim and receive targeted assistance. This was primarily because of difficulties in establishing the real needs of vulnerable groups and partly because establishing eligibility was a complicated process. The administrative costs of targeting turned out to be quite high (Rzhanitsyna, 1999).

As a rule, government response to social challenges was of an ad hoc nature. Attempts to regulate the minimum income levels of wage earners, pensioners, or recipients of welfare benefits were sporadic and lacked consistency. The introduction of the so-called minimum subsistence income, established in March 1992, became the key policy instrument aimed at decreasing the growing gap between minimum wages and the cost of the existing minimum “food basket.” Supplementary employment, which acted as a compensatory mechanism for

falling incomes, was encouraged by the government and helped many people to survive. This type of employment, however, has its natural limits and may not be feasible on a wide scale in the long-term. The subsistence minimum indicator, which is still used for determining the poverty line, has not become a real and tangible social floor either for the state or for the nascent private sector.

Recognizing the inevitable financial challenges of a rapidly aging population, a new multi-pillar system aimed at increasing the role of private pension funds was introduced by the government in January 2004. Currently Russia has roughly three workers for every two pensioners, but according to the World Bank estimates, by 2020, this ratio may drop to 1:1. While the average pension-to-average-wage ratio was 33 percent in 2002, it will be 24.4–27.8 percent by 2030 (Protsenko, 2005). According to the new pension scheme, half of the payroll tax collected is to be saved by the state to provide a basic pension; the other half is split between a pay-as-you go pension scheme and a funded pension to be invested by the state in assets such as government treasury bills. The system turned out to be quite complicated. Workers also got an option to choose private pension funds for managing a part of their pensions. According to press reports, of the 38 million citizens, only 700,000 have opted for private pension funds (Belton, 2004). Pension reform clearly remains one of the most pressing priorities in a search for better social protection for the elderly.

### **“Benefits-to-cash” Controversy**

The government move to replace a range of in-kind social benefits with cash payments (Law 122) in January 2005 turned out to be exceptionally unpopular with the public and was met with outrage by many recipients of benefits across the country. In numerous public pronouncements and press interviews, the government ministers were forced to defend this unpopular reform, explaining its logic and “liberal” philosophy (Netreba, 2005; Zyat’kov, 2005). The complaints of the population were numerous, but can be summarized in three main points: the original level of compensation was in many cases not sufficient; regional authorities—key players in the whole scheme—were not well prepared for the forthcoming reform; and the law itself needed much additional work and amendments (Voloshin, 2005; Kazakov, 2005; Burdakova, 2005).

The controversy related to Law 122 highlighted again the problems of social protection inherited from the socialist past, primarily on the financial side. Adequate funding is the basic pillar of a meaningful social protection system in any country. Lack of sufficient resources to finance current social protection obligations remains the most pressing challenge at central, regional, and local levels. An obvious gap between commitments of the state in the area of social protection and actual disbursements became a factor of instability, undermining the confidence of the population. It was one of the apparent reasons why a major overhaul of the social welfare system was initiated in the first place. The change was aimed at ending the practice of unfunded mandates and replacing the many

benefits “on the books” (i.e., benefits people were entitled to, but were not receiving) with cash compensations. Some of these benefits survived from Soviet times, while others were introduced in the 1990s after the government was forced to introduce in-kind benefits to compensate for delays in payments of wages and pensions (Ovcharova, 2003).

The “cash-for-benefits” bill generated heated debates in Russia and created a feeling of discontent simply because the lives of millions of people were affected. Many population groups in the country enjoyed various benefits bestowed on them by the state. There were about 150 types of entitlements (social benefits, subsidies, payments of various kinds, and other welfare commitments) at the federal level, which were provided to more than 200 categories of recipients in the population. As a result, about 70 percent of the population was entitled to social payments and benefits; in some cities pensioners alone make up a third of the population (ILO, 2002). However, as many analysts observe, despite the formal availability of a wide range of social protection payments (mostly in-kind), their effectiveness in protecting against risks and vulnerabilities has been very low and decreasing (Ovcharova, 2003; Alexandrova et al., 2003). For example, in 1993 a child age 16 or younger received a subsidy that was 19 percent of the subsistence minimum; in 1997, it declined to 14 percent, and in 1999, it was only 6.1 percent of the substance minimum (ILO, 2002). It is clear that this level of social protection cannot be considered adequate under any circumstances. At the federal level, only three categories of social payments have been provided on a means-tested basis and were reserved for families with incomes below the subsistence level. These included the monthly child subsidy, housing subsidy, and the so-called state social assistance that was a lump sum amount given to poor households (ILO, 2002).

The peculiarity and inner contradiction of such a complex system was that the needs of recipients had not been a decisive factor in the provision of benefits (Alexandrova et al., 2003; Ovcharova, 2003). An estimated 60 to 65 percent of the benefit payments went to individuals whose incomes were above the subsistence minimum, while the truly needy got either a meager amount of assistance or no assistance at all (ILO, 2002). According to some estimates, in 2002, 10 percent of the poorest households received 2.6 percent of in-kind benefits, while 10 percent of the wealthiest received about 31.8 percent of in-kind benefits (Alexandrova et al., 2003).

The new “benefits-to-cash” law provided an opportunity to simplify the existing outmoded system and offered greater transparency, a needs-based approach, and equal treatment of beneficiaries in the cities and rural areas. However, two main concerns were expressed by opponents of the government-sponsored changes almost immediately after the law was introduced. First, many of the benefits provided to the population were in-kind, retaining their value even in inflationary environments. The non-indexed cash benefits would lose their value if prices continued to rise quickly. Second, much of the funding under the new scheme has to be provided by regional authorities who will need

to match federal budget transfers with locally generated funds. Any local difficulty in generating funds could deprive beneficiaries of the promised cash (Yablokova, 2004). There were also complaints that the law was rushed through the legislature, that the population at large was not well informed about all aspects of the new law, and that nationwide discussion was limited (Felgenhauer, 2004; Mereu, 2004).

Many concerns expressed by the critics of the reform turned out to be correct, and these particular concerns sparked street protests from pensioners in January 2005. Had the government listened to the warnings more attentively, it could have avoided an apparent debacle with “monetization” of benefits, including the urgent need to find 200 billion rubles (US\$ 7.2 billion) as a stop-gap measure to increase pensions and cash transfers (Netreba, 2005). The practical experiences with the implementation of the reform package, particularly the lack of flexibility and efficiency in delivery, also demonstrated that even a sound idea could be discredited if implemented in a clumsy and incoherent way (Guseva, 2005).

Taxes in Russia remained the main source of funding: Federal budget outlays amounted to 16.2 percent of the GDP, regional and local budgets to 15.1 percent, and the four major insurance funds (the Pension fund, Social Insurance Fund, Medical Insurance, and State Employment Funds) amounted to 10.8 percent. State authorities consumed about 42 percent in revenues (Goskomstat of Russia, 2003). In financially lean years (until the late 1990s), numerous attempts to balance the federal budget (before it achieved a surplus 4 years ago) often resulted in delegating responsibilities for social programs to the regional and local levels. This delegation of authority was not always accompanied by adequate local financing, which made it difficult for local administrations to meet commitments. The main challenge was that even when federal budget outlays were added to regional and local budgets, the cumulative total was not sufficient to fund all the social obligations of the state. While the current Law 122 is based on the assumption that the situation can be decisively changed in this regard and funding can be made transparent, only time will tell if the new law will help to bridge that gap.

In a certain sense, the mishaps with introduction of the benefits-to-cash reform reflected a much deeper problem of Russian socioeconomic policy—perennial “second class” status of the social sphere among the state priorities. There is a lack of understanding that social protection is not a luxury but a necessity for a civilized society that cares about its citizens and thinks about the long-term well-being of its population, rather than simply paying lip service to social concerns.

## **Discussion and Conclusion**

Judging by the thrust of the reform efforts so far, the social component of reforms was never a preeminent concern of the “radical” reformers in power who

over-emphasized the trickle-down effect of economic growth; they believed that macroeconomic priorities were much more important than social concerns. The economic reform was “devoid of an offsetting component to buy out the losers” (Desai, 2005, p. 97). All attempts at financial stabilization implemented by the government in the period 1992–1997 meant less money in real terms for the social sphere. This was partly a result of the decline in revenues, but it also reflected the deep-seated skepticism prevalent among many influential economists and politicians who considered public social spending to be grossly inefficient (Dmitriev, 1998). Research (Kosmarskyi & Maleva, 1995; Rimashevskaya, 2003) offers several major explanations as to how the government could ignore the social sphere without paying a high price at the polls. First, there were relatively small differences in incomes and wealth in Soviet times, and the feeling was that most people shared the burden of reforms equally at the onset of transition. Second, the population had accumulated material and financial assets during the Socialist period that could be used by the population at least at the onset of the reforms. Third, many social services that were taken for granted by the population could still be provided for some time without additional financial injections by using reserves created in the previous system. Fourth, expectations at the onset of transition were very high.

The advent of radical economic reform and the transition to a market economy dramatically changed the country’s socioeconomic landscape, creating new sources of instability and new social needs. The social protection system of the previous epoch is unsustainable in the present situation; it cannot and should not be restored. At the same time, the response of the state to the challenges that emerged has been passive at best, tackling most of the pressing needs in an ad hoc manner. A well-thought-out and coherent social strategy was sorely missing. It could be explained in part by the magnitude of the tasks and sheer scale of the challenges, in part by difficulties in finding appropriate answers under difficult circumstances, and in part by the inherited institutional rigidities, including a huge and inflexible bureaucracy. One of the main flaws of the implemented policies is the obvious under-appreciation of the role of social protection in society. Social protection should not be seen simply as a residual policy function of welfare for the poorest, but as the foundation to promote social justice and develop human capabilities for society (United Nations, 2001).

The creation of a comprehensive and consistent national social strategy that uses market instruments and is geared at protecting people under new realities is clearly on the agenda. The renewed commitment to full employment in the context of a market economy could send an important political signal, signifying, without doubt, a major move towards a new social protection paradigm.

Economic reform should not be implemented for the sake of reform; the well-being of the population should be the ultimate goal of any reform effort. Creation and adoption of a national social strategy must include a social protection system as a vital component. Social protection makes economic sense, particularly if one considers the very high opportunity cost of not providing it for

society. The system will require a supportive environment and the long-term involvement of all stakeholders, including the legislature, government, business sector, and civil society organizations. No strategy can succeed in the long run without active public support.

Reform of the welfare system, including conversion of benefits into cash, is a sound idea in principle, but it was implemented in such a poor way that it created social tensions and aggravated relations between the federal and regional authorities. The population learned the hard way that much depends on how changes are implemented, and whether concerns about well-being and living standards are given the same importance as financial considerations in the eyes of authorities.

A higher guaranteed income, at least at a subsistence level, would be an important factor in poverty reduction. One of the obvious, but difficult to achieve, solutions is an increase in minimum wages. The pitiful state of the minimum wage indicator requires the close attention of policy makers (Ovcharova, 2003). Loss of the protective function of the minimum wage should be a matter of concern. So far, there is no legal provision mandating that the legal minimum wage equal the subsistence level. It is an obvious retreat from the Soviet times when this ratio was fixed at a much higher level, namely 150 percent (Alexandrova et al., 2003). An increase in minimum wages to the subsistence minimum, starting with the public sector, and subsequent 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 the government to make and implement fair decisions.

Any major changes should entail a nationwide discussion of the pertinent issues, bringing on board not only legislative and executive branches, but also civil society organizations and trade unions. 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, child welfare, retirement income, and social protection in general. It is the responsibility of the government to put on the agenda various options regarding social services provision and closely collaborate with the private sector in solving pressing social needs. A lack of public response to acute social problems could have immeasurable harm on individuals and the society at large.

Broad-based and sustainable economic growth remains the only true foundation for reestablishing 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 for sustainable economic growth regionally and nationally. Achieving sustainable economic growth and continuing institutional reforms may create a platform for gradually reducing poverty and increasing the standards of living and quality of life of the population. The macroeconomic policy of the government should stimulate investments in the economy and in human capital.

The problem of wage arrears should become one of the short-term priorities

of the social protection agenda; in the long-term this problem must be solved through the collective action of public and private sectors. The level of the unemployment benefit system should be increased to make it meaningful for the recipients while eligibility rules should aim at promoting active job seeking.

Further steps in the tax reform are also required. The wealthiest segment of the population (5 to 10 percent who gained enormously from privatization) should pay higher rates of income tax than the current flat rate of 13 percent. Increased levies on natural resources exports may provide another important source of budget revenue (L'vov, 2004).

When millions fall into the poverty trap, targeting is difficult, if not entirely useless. The retreat of universalism resulted in the residual role assigned to social concerns, and substantial deterioration of human development indicators. According to estimates provided in the Human Development Report of 1991 and of 2002, Russia's ranking in the world in the years of the reform in terms of Human Development Index deteriorated substantially: In 1990 Russia ranked 31<sup>st</sup> in the world while in 2000 it ranked 60<sup>th</sup> (UNDP, 1991, 2002). The relentless spread of poverty in Russia must be contained; fighting poverty, which at last has been recognized as a crucial national task, still does not have its own road map with clearly identified benchmarks. The government must recognize that the existence of mass poverty is detrimental for economic growth, since poverty is a pervasive social phenomenon closely linked to the de-motivation of the labor force, ill health of the population, and overall deterioration of human capital.

Apart from preventing a further increase in poverty, providing appropriate conditions to enable the active part of the population to earn enough income for the family should be an overarching priority of the social protection system. The government, recognizing the defensive function of social protection, must develop an effective system of social support for those who are most vulnerable (single mothers, elderly living alone and unable to work, people with disabilities, families with many dependants). All the above components of social protection should be considered as a system rather than as separate components.

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