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Foreword

The global financial crisis interrupted a protracted period of strong economic growth in the Russian Federation. Despite a large decline in output, job losses and hikes in unemployment remained rather modest, and much of the labour market adjustment took place through reduced working hours and, in particular, real wages. Notwithstanding the recent recovery, the Russian labour market remains characterised by significant structural imbalances resulting in widespread segmentation and large earnings inequalities. To improve the balance between labour market flexibility and the protection of workers, the Russian Federation needs to reinforce its labour market institutions. This can be done by strengthening labour law enforcement, promoting workers representation and collective bargaining, the labour inspectorate, enhancing the effectiveness of active labour market programmes and by removing the possibility to use civil contracts for employment purposes as these provide little or no employment protection.

Poverty and income inequalities are well above the OECD average. Family policy is focused on increasing birth-rates, but ineffective in reducing poverty as working adults and children make up 60% of the poor. Instead, social policy is focused on the elderly and disabled, and in recent years there have been significant increases in transfer payments to pensioners. Recent reform is likely to "eradicate" poverty among pensioners, as measured by official benchmarks, but raises questions on the long-term financial sustainability of the private pensions system. Rapid population ageing further contributes to the need to address the low standard pensionable ages (at which pensions become payable, and which often differ from actual retirement ages) in the Russian Federation and limit access to early pensions. The challenge for the Russian Federation will be to rebalance its social policy towards more effective support for parents to combine work and family life.

This report highlights some of the key labour market and social policy challenges facing the Russian Federation and was prepared as part of the

accession review by the OECD Employment Labour and Social Affairs Committee (ELSAC).

The OECD Council decided to open accession discussions with the Russian Federation on 16 May 2007 and an Accession Roadmap, setting out the terms, conditions and process for accession, was adopted on 30 November 2007. In the Roadmap, the OECD Council requested a number of OECD Committees to provide it with a formal opinion. ELSAC was requested to review the Russian Federation's labour market and social policies in order to provide a formal opinion on the degree of coherence of the Russian Federation's policies with those of OECD member countries. In light of the formal opinions received from OECD Committees and other relevant information, the OECD Council will decide whether to invite the Russian Federation to become a member of the Organisation.

Accession discussions with the Russian Federation are currently ongoing. The formal opinion of ELSAC mentioned above will be sent separately to the OECD Council and the findings set out in the present report are without prejudice to the subsequent discussions and decision of the Council concerning the accession of the Russian Federation to the Organisation.

The review was prepared by Willem Adema, Veerle Miranda and Ann Vourc'h assisted by Tatiana Gordine, Lucy Hulett and Marlène Mohier, under the overall supervision of Stefano Scarpetta. This report also benefitted from extensive comments by John P. Martin, Monika Queisser and Ed Whitehouse. Preparations for this report started in the second part of 2008 and continued until early 2011 (and the most recent data concern that period). The report was discussed by ELSAC on 22 October 2010.

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Acronyms and abbreviations

ALMP	Active labour market programme
AVTOVAZ	Largest automobile company in the Russian Federation
CIS	Commonwealth of Independent States
DC	Defined contribution
DB	Defined benefit
DBPR	Defined benefit pension rate
EP	Employment protection
FES	Federal employment service
FNPR	Federation of Independent Trade Unions of Russia
FPLP	Funded part of the labour pension
GDP	Gross domestic product
GRP	Gross regional product
HBS	Household budget survey
ICS	Russia Competitiveness and Investment Climate Survey
LFS	Labour force statistics
LME	Large and medium-sized enterprise
MSL	Minimum subsistence level
NDC	Notional defined contribution
NEET	Neither in education nor in employment or training
NOBUS	National survey of welfare and social programmes participation
NPF	Non-state private pension fund
PAYG	Pay-as-you-go

PES	Public employment service
PFRF	Pension Fund of the Russian Federation
PISA	Programme of International Student Assessment
PPP	Purchasing power parity
RJS	Reassessed OECD Jobs Strategy
RLMS	Russian Longitudinal Monitoring Survey
Rosstat	Russian Federation Federal State Statistics Service
Rostrud	Federal Service for Labour and Employment
RUB	Russian rouble
TFR	Total fertility rate
TWA	Temporary-work agency
UST	Unified Social Tax
UTS	Unified tariff scale
VEB	Russian Development Bank (*Vnechococombank*)

Assessment and recommendations

Towards a more efficient labour market and a fairer society

The financial crisis hit the Russian economy hard...

The global financial crisis had a significant impact on the Russian economy and its labour market. The cumulative output loss during the recession was almost 11% in the Russian Federation, considerably larger than the equivalent output loss of almost 5% for the OECD as a whole. The impact of the crisis is even larger taking into account the high growth rates in the Russian Federation prior to the crisis. Indeed, the *cumulative growth loss* – comparing the loss in output with the growth in output that would have occurred in the absence of the crisis – is estimated to be 19% in the Russian Federation versus 8% in the OECD area. An economic recovery has been underway since the third quarter of 2009, with declining unemployment and a positive real wage growth. The latest OECD projections expect growth to be around 4 to 5% in 2010 and 2011.

...and interrupted a protracted period of strong economic growth and poverty reduction...

The crisis halted a protracted period of strong economic growth that resulted in significant improvements in the Russian labour market and substantial reductions in the official absolute poverty rate. Measured against a federally-set minimum subsistence level (MSL), *absolute* poverty more than halved since the turn of the millennium, declining from 29% in 2000 to 13% in 2009. Absolute poverty remained rather stable during the economic crisis of 2008-09, largely because labour market adjustments involved large reductions in working time instead of layoffs and the significant adjustment in real wages was counterbalanced at the lower end of the distribution by a very large increase in the minimum wage in 2009 together with significant increases in transfer payments to pensioners.

... while income inequalities remain large

However, despite the large decline in absolute poverty, *relative* poverty – measured against the standard OECD benchmark of 50% of median household income (adjusted for household size) stood at 17% in 2008. Income inequalities remain very high in international comparison: official Rosstat data suggest the Gini coefficient on income disparities was 0.43 in 2009 compared with an OECD average of 0.31.

Prior to the global economic crisis, employment performance improved significantly…

Thanks to an increased labour demand driven by strong economic growth labour utilisation rose in the decade to 2008. The employment rate for the population aged 15-64 grew from its historical low of 62% in 1999 to 69% in 2008, more than 2 percentage points above the OECD average. High labour utilisation is attributable to high female participation, a feature inherited from the Soviet era. However, due to significant labour hoarding in the 1990s, employment grew much less than output in the decade to 2008. Real wages, on the other hand, experienced high and protracted growth during the economic boom after a very strong drop in the 1990s.

The impact of the crisis on employment and unemployment was surprisingly mild

As in a number of European countries and Japan, the impact on employment and unemployment was surprisingly mild relative to the large fall in output and much of the labour adjustment took place through reduced working hours and, in particular, wages. Unemployment (on an ILO basis, for the population aged 15-64) rose from 6.4% in 2008 to 8.5% in 2009, comparable with the OECD average of 8.3%. As in most OECD countries, youth and males were the groups most affected by the crisis, while the shock did not reverse the trend towards increased older worker employment. Instead, a significant part of the labour adjustment during the crisis took the form of cuts in working hours, reaching 3.7% in 2009 in the Russian Federation, similar to the OECD average of 4%.

Real wages remain the main adjustment mechanism in the labour market

Real wages adjusted significantly during the crisis, similar to what was observed during the first years of transition to a market economy in the 1990s. Real monthly wage growth remained high initially (+10% in 2008), but became negative in 2009 (-1.6%). When expressed relative to its pre-crisis

trend, the cyclical drop in real wages was ten times that of the OECD area. Given that often up to half of the wage of Russian employees is linked to the performance of their firm, wages could even have decreased in nominal terms for some workers. However, the significant increase in the minimum wage introduced in January 2009 has probably cushioned this effect.

Despite recent improvements, the Russian labour market remains highly segmented

- *Employment growth has been mostly in lower quality jobs:* net employment creation has taken place exclusively in the non-corporate sector. Until 2010, employees of such businesses were not entitled to the regular unemployment benefit, but only to the minimum benefit which is extremely low. Besides, labour laws tend to be weakly enforced in the non-corporate sector, which is more difficult and costly to control.

- *Atypical contracts have increased significantly, but informal employment is limited.* The share of non-standard contracts was rising steadily until 2008, mostly temporary contracts, but also civil contracts for which employers have to pay no social contributions and are not subject to the hiring and firing regulations, and oral contracts, which are very difficult to monitor. As in OECD countries, workers on these atypical contracts were the first to lose their job in the recent downturn. On the other hand, informal employment seems to be rather limited in the Russian Federation: about 4% of employees have no contract, compared to nearly 20% in Chile and 27% in Mexico.

- *Wide disparities persist within the group of large and medium-sized enterprises.* Some businesses have managed to achieve strong productivity performance, enabling them to provide good wages and working conditions to their employees, as well as training. Many others, however, are surviving only thanks to entry barriers and the limiting effects of geographical isolation: they offer low wages and poor working conditions, while often complaining about the lack of skilled labour.

- *Despite some progress, disparities among regions remain large.* The major cities and the regions rich in natural resources perform best, with unemployment rates below 5% in 2009, while regions of the North Caucasus and Southern Siberia experienced unemployment rates above 20% (up to a maximum of 53%). In the poorly performing regions, local and regional governments have been the key driver of job creation, notably through the hiring of support staff in the education and health sectors. Despite recent increases in public sector wages, their level

remains low compared with private sector wages and this contributes to explain the wide earnings disparities across regions. Moreover, geographical disparities in earnings are persistent: labour mobility across regions remains very low, notably due to poverty traps.

- *Although declining, wage inequality remains high.* The Gini coefficient of average monthly earnings declined from 0.48 in 2000 to 0.42 in 2009, remaining higher than in any OECD country (for which data is available). The regional variation in earnings, related to large geographical differences in living costs and the wage premium in the Far Northern regions, seems to be the most important driver behind the wage disparity. Wages also differ substantially according to the nature of the ownership of the firm, with the highest wages being paid in foreign companies or Russian-foreign joint-ventures and the lowest wages being paid in the municipal sector.

Worker turnover is very high, largely driven by voluntary quits of workers looking for better jobs

While worker turnover has always been high in the Russian Federation, worker flows further increased during the prolonged recovery period preceding the recent financial crisis. In 2007, almost one out of four employees in the large and medium-sized enterprises quit voluntarily. However, this average figure hides significant disparities across sectors and groups of workers. While many of the most skilled workers in the public sector quit for the private sector in the 1990s, less productive workers in the public sector stayed in their jobs despite deteriorating employment conditions. By contrast, turnover is very high and increasing among the low-qualified blue-collar workers. Many of them are still involved in very arduous jobs offering poor wages and working conditions and often quit voluntarily to look for better deals. While firms almost freely determine wages, workers often choose to quit if wages are too low. Even during the recent crisis period, more than one fifth of the employees quit their job voluntary.

The *OECD Reassessed Jobs Strategy* provides a good framework to promote more and better jobs in the Russian Federation

The *2006 OECD Reassessed Jobs Strategy*[1] provides a comprehensive policy framework for boosting jobs and income in OECD countries. The Strategy identifies a number of common principles that are also relevant to the Russian Federation: beyond ensuring stable macroeconomic conditions, the *Reassessed Jobs Strategy* stresses the need to establish a simple,

transparent and not overly cumbersome regulatory environment in which firms can find the right incentives to invest, hire and train more workers – and ultimately promote productivity and output growth – while workers have incentives to search for jobs that match their capabilities and to invest in improving their skills and competences.

Strike a better balance between labour market flexibility and workers' protection

Many of the problems discussed above would benefit from policy reforms outside the labour market, to promote competition in the product market, the respect for the rule of law and better business climate conditions, as such reforms would be conducive to the creation and development of more productive and viable private activities (see OECD, 2009a). But much remains to be done also to develop and improve labour market policies and institutions to favour the adjustment towards more and better jobs in the Russian Federation. For example, there is an urgent need to improve the balance between labour market flexibility and income security. Wage flexibility is extremely high in the Russian Federation, but it may not always promote attachment to the job or appropriate investment in the workers' human capital and improve labour productivity. In this context, there is ample room to further develop the collective bargaining framework and improve the representation of different actors in the labour market, redress the uneven bargaining power between workers and employers, and promote greater coordination in wage settings and policy guidance. At the same time, significant progress is needed to provide more effective support to the unemployed within an activation framework. This should involve raising the level of unemployment benefits – which remains low despite the significant increase during the recent crisis – combined with greater investment in cost-effective active labour market policies and public employment services to provide effective re-employment support to jobseekers.

Employment protection regulation is not overly strict except for workers with short tenure…

The Russian Federation's employment protection (EP) regulation for *regular* contracts is relatively strict for workers with short tenure, since notice periods and severance payments are not related to tenure. In case of workers with short tenure, such as youth, firing costs are thus rather high. For workers with medium or long tenures, on the other hand, the employment protection is not overly strict. This is also the case for collective dismissals, which are basically treated as individual ones. The EP

for temporary contracts is relatively lax. The extension since 2000 of the range of workers and situations for which it is possible to use temporary contracts is a desirable move. However, the possibility for employers to use civil contracts with limited or no employment protection instead of labour contracts, as well as the absence of regulation of sub-contracting or temporary work agencies are detrimental to workers and likely to increase dualism.

Amendments made in 2006 to the labour code have considerably expanded its coverage. However, since the mid-1990s, employers are also increasingly resorting to civil or oral contracts which exempt them from observing labour laws, notably regarding the payment of social contributions, the delivery of non-wage benefits and the observance of hiring and firing regulations. More than 6% of the salaried workers were under such contracts in 2008, and were thus not covered by labour laws. This is contributing to the segmentation of the labour market, and the possibility for employers to use such contracts should be removed.

…but labour law is unequally enforced

In addition, there is evidence that labour laws are unequally enforced. As noted above, rates of voluntary separations have been exceptionally high in the Russian Federation and layoff rates very low. This is the case even in times of crisis; in 2009, the rate of dismissal was only 2% against 22% for voluntary quits. This suggests that part of these separations are probably "forced voluntary quits". One simple way for employers to induce an employee to quit is to reduce the variable part of his/her wage. But employers can also resort to administrative leaves and deteriorating working conditions to force quits. Evidence on the wage distribution also suggests that the minimum wage is not always enforced in poor regions, including in the regional and local government sectors. Managers do not seem to perceive labour regulations as a major constraint, and report the cost of labour law violation as being low. However, there seems to be significant differences of labour law enforcement across firms, which may contribute to the overall uncertainty surrounding the business climate in the Russian Federation. The close ties between the government (at all levels) and the major private firms (OECD, 2009a) are likely to reduce in some cases the pressures exerted on employers to enforce labour laws, but may at the same time allow governments to exert pressures on employers to avoid layoffs in areas with few employment alternatives.

Labour inspection should be reinforced

The number of labour inspectors per employed person is close to the ILO recommendations for transition countries, but much lower than in OECD eastern European countries. Also, Russian labour inspectors have no support staff to assist them and the density of inspectors varies greatly across regions. With the actual available resources, the Russian authorities estimate that each enterprise would be controlled on average once every 20 years. Small businesses, in particular, where labour law infringement is more frequent, are very rarely inspected. Yet, there is some evidence that poorly-paid labour inspectors often tried to extract undue pecuniary advantages from their inspections, instead of properly checking for law infringements and poor working conditions. As part of a larger set of measures introduced in the early 2000s to reduce the costs of doing business in the Russian Federation, the number of labour inspectors has been reduced by 15% since the early 2000s and a limit was put to the number of inspections in each enterprise. However, downsizing the labour inspectorate is not the appropriate answer. Instead, in addition to general anti-corruption measures, the wages of labour inspectors should be increased to attract better-qualified staff and reduce the incentive to extract undue pecuniary advantages, as they are currently much lower than those which people with similar education earn in other sectors. Besides, the level of fines for enterprises and individual entrepreneurs infringing labour laws should be increased significantly so as to strengthen their deterrence role.

Collective bargaining is underdeveloped and wages are fixed by employers…

Despite the relatively high trade union membership and the provision in Russian law for collective bargaining rights at the national, sectoral, regional, and enterprise level, the extent of collective bargaining is *de facto* very limited, and its impact on wages and working conditions is modest. At the national level, general agreements set general objectives, not directly enforceable, and minimum standards which are low and thus not binding. Regional agreements suffer from the significant lack of employers' representation and the effective content of these agreements in terms of wages and working conditions is also limited, so that they provide a low constraint on enterprises. About 42% of employees are covered by collective agreements at the workplace level, and they mostly belong either to the public sector or to enterprises with some public participation. Moreover, agreements at the workplace level often set only general objectives for employers and unions, and at maximum they fix rules for the *fixed part of the wage* that accounts typically for only slightly more than 50% of the total

wage. Employers thus have a large freedom in setting wages, often based on negotiation with individual employees or small groups of employees. The *variable part of wages* is generally set on the basis of the performance of the enterprise, although this is more or less formalised in many firms. Also in the public sector, establishments have significant flexibility in setting wages since the introduction of the new wage-setting framework in December 2008.

... reflecting the weak bargaining power of trade unions

Union membership rates remain relatively high, at about 50%, despite a decrease in the rate of unionisation since the beginning of transition. Nine out of ten trade union members belong to traditional trade unions often dating back from the Soviet era, grouped under the Federation of Independent Trade Unions of Russia. Traditional unions have often not departed from their role during Soviet times, and behave more as mediators between the employers and the workers than as representatives of workers. Alternative trade unions face difficulties in organising and making their voices count in negotiations with employers. In part, this is linked to rather restrictive legal provisions on the right to strike, which result in a very low strike incidence in the Russian Federation compared with most OECD countries. The provisions in the labour code on workers representation also limit the possibility for independent unions to emerge and participate to the collective bargaining process. Finally, the provisions guaranteeing workers representation at the firm level are not always strongly enforced.

The minimum wage is relatively low

Despite an increase by almost 90% in 2009, at 24% of the average wage, the federal minimum wage remains relatively low in the Russian Federation (at the lower end of the OECD distribution), and even below the official poverty threshold, which is at 28% of the average wage. About two-thirds of the regions have also introduced a regional minimum above the federal level. Data on wage distributions show that minimum wages were hardly binding in 2007 (before the recent increase), except in the poorest regions, although non-compliance is also observed there. The large 2009 increase may lead to some "disemployment" effects in the poorest regions, where the minimum wage now represent a significant share of the average wage, or alternatively create stronger incentives for non-declaration or under-declaration of wages. To avoid pricing out the least skilled employees from the formal labour market, the increase in the federal minimum wage should be contained, and regional minimum wages should only be increased in regions where it is compatible with the economic context.

Public spending on labour market policies remains very low in spite of a strong increase during the crisis

In the context of the sizeable stimulus package introduced during the crisis, the Russian government tripled the budget for labour market programmes and similar funding was also kept for 2010. However, at about 0.3% of GDP in 2009 after the increase, expenditure on labour market policies remains well below that in almost all OECD countries. The anti-crisis policy measures included a rise in the maximum unemployment benefit level, and various active labour market programmes amounting to almost 0.1% of GDP in 2009, which is above the amounts that many OECD countries planned to spend over the 2008-10 period (OECD, 2009b). The main active labour market measures were wage subsidies, public works and training that were provided to workers at risk of being dismissed or to the long-term unemployed. These measures are likely to have preserved some jobs and cushioned the income shock on the unemployed, although it is difficult to gauge their impact with any precision. Given their low levels, the authorities should plan to at least maintain labour market expenditure at this level in future years, even when the job crisis unwinds. At the same time, a re-orientation of expenditure needs to occur from short-time work schemes towards cost-effective programmes or uses that facilitate transitions from unemployment to work and shorten the unemployment spells. The Russian authorities can learn from international experience and should invest in rigorous programme evaluation.

Assistance provided to the unemployed could be improved

There is a very large gap in the Russian Federation between the count of unemployment measured according the labour force statistics (LFS) and that based on registration at the labour offices. In 2009, the registered unemployment rate stood at 2.8% against an LFS rate of 8.5%. This gap is largely the result of the relatively weak assistance provided to registered unemployed, which discourages registration of many unemployed, especially the most employable ones. First, while available to many compared with OECD countries, the level of unemployment benefit is low. Second, the assistance provided to jobseekers by public employment services is relatively small. Despite a tripling in 2009, at 0.15% of GDP, the resources available to the PES for active labour market policies are very limited. Personal assistance provided to jobseekers is scant and most time is spent on administrative procedures. All in all, the Russian PES functions more as a social assistance service dealing with the weakest segments of the population rather than an effective intermediary between employers seeking

to fill job vacancies and jobseekers. Reintroducing a well-designed unemployment insurance system would allow for more effective support to the unemployed, and provide incentives to register as unemployed also to the more skilled workers. This would in turn motivate firms to register more vacancies with the PES. As the new system may involve greater spending, at least in the short run, it is important that unemployment insurance is combined with an effective activation strategy. To avoid the problems experienced in the 1990s, the collection of unemployment insurance funds should be centralised and social partners involved in their management.

A federal training policy needs to be developed

Russian industrial firms often complain about the lack of qualified technical workers in the labour market. While overall training incidence is relatively high in the Russian Federation, training is provided to a very small subset of employees and for a rather short period. The majority of on-the-job training is financed by firms, especially in the manufacturing sector where it is almost exclusively financed by firms. A federal policy to encourage on-the-job training and lifelong learning is currently lacking. The authorities should consider investing in training policy, through various possible ways, including the creation of a transparent and credible skill certification system and/or the provision financial incentives to training to enterprises through a levy/grant system or profit tax deductions.

Public social spending is increasing but could be better targeted at the working-age population

Public social expenditure (without housing) amounted to 12% of GDP in 2007, which is low compared with an OECD average of just over 19%. However, with increased social pension payments and revalorisation of labour pensions (see below) public social spending increased to almost 15% of GDP in 2009. At about 6.5% of GDP in 2009, public spending on old-age pensions (see below) in the Russian Federation – not a country with a particularly high old-age dependency rate at present – was the most important spending item and just above the OECD average. Otherwise, public spending on health and smaller items such as unemployment benefits and family allowances is much lower than in OECD countries. On the whole, there appears to be room to refocus social spending from pensioners to the working-age population and children: the two groups who face the highest poverty risks in the Russian Federation today.

Monetisation reform has increased transparency and choice…

One important remnant from the Soviet era concerns "categorical benefits" or "privileges (*l'goty*)" for specified groups, which are paid by either federal (*e.g.* the disabled, war veterans and victims of the Chernobyl disaster) or regional authorities (*e.g.* labour veterans or those with a long employment tenure). In 2005, some social support to different groups enjoying privileges was "monetised". Eligible individuals receive a basic cash payment with which they can choose to (subject to regional variation) monetise certain items of support which is known as the "social package" (additional medical care, free medicine, sanatorium and spa treatments, widely used in the Russian Federation, and transportation supports). Public expenditure on such benefits has increased to almost 1% of GDP in 2009. Nevertheless, much of the housing and utility support is still provided in-kind – on which public spending amounts to around 2-3% of GDP per annum – and only benefits those who happen to have access to low-priced housing and utilities. Although some of the groups, in particular the disabled, face a high poverty-risk, some others, pensioners and older workers with long employment records, do not: categorical benefits are not directly targeted at low-income households.

…but better information flows are required to get support to those who need it most

There is nothing intrinsically wrong with the principles of monetisation and targeting of social supports. However, for it to work efficiently and in a financially sustainable manner, there needs to be a better flow of information amongst public agencies and across society more generally. For example, without transparency on budget rules and awards of federal funds, regional governments will be hesitant to introduce comprehensive local social policy initiatives, as they fear federal funding may dry up leaving them with unfunded mandates. With more information, citizens will have a better view of the benefits to which they are entitled, and make an informed choice on whether they should monetise their social package or not, while both regional and federal governments need to have better data on the income actually earned by individuals and households. Better information systems to which all relevant authorities have automatic access (rather than cumbersome procedural processes) are also needed to make eligibility verification work effectively, and deliver social support to those who really need it. Effectiveness of income-testing and targeting of social support could

be improved by ensuring that regional authorities have easy access to information held by tax and social insurance agencies.

Income supports to the able-bodied working-age population are small

Federal and local policy makers are often loath to make cash support available to those who can work, although the crisis may have changed their attitude, at least temporarily. Payment rates for unemployment benefits are low: at maximum 26% of the average wage for 12 months, but the majority of unemployed benefit claimants receive the minimum payment which equals about 4.5% of the average wage. Social assistance cash transfers by regional authorities to vulnerable clients/families without sufficient incomes and no entitlements to other benefits are similarly low and variable across regions. In 2008, in Kazan such payments could be up to RUB 1 000-5 000 per annum (about USD 45 to 225 at the time), while authorities in Samara paid no such support. Similarly, income-tested child allowances are extremely low (USD 8 per month at present): about two-thirds of all households with children receive them, despite the administrative hurdles in income-testing.

Rebalancing benefits to support the working population and their children

So far, the Russian authorities have shied away from reforming "privileges" in such a manner to re-direct supports from, for example, pensioners and groups with a long employment history to more needy (and possibly younger) groups. However, with working adults and children accounting for about 60% of the poor population stronger, support to them is warranted. In theory, an in-work benefit payment with a supplement for children seems to be the most appropriate approach. In practice, however, a child allowance would be much easier to administer, and increasing the existing income-tested child allowance, as administered by regional authorities, would therefore be a more feasible option.

Fertility concerns drive family policy development

Family policy focuses on spending around birth and keeping mothers at home to care for children…

Very low fertility rates is one of the most serious concerns in family policy in the Russian Federation, much more than issues related to child development, child poverty and, least of all, gender equity. The total fertility

rate (TFR) has been low for decades and was 1.3 in 2006. In response, the government introduced a "family capital" payment of significant value (about USD 11 000) for the birth (or adoption) of a second child (and higher order children) in a family. This amount is deposited in the capitalised part of the Pension Fund of the Russian Federation, and most beneficiaries use the amount to improve their housing conditions (*e.g.* mortgage support), while also claiming a one-off lump-sum payment, worth about USD 400 in 2009. Moreover, in 2010, public policy increased childcare allowances at the beginning of a child's life (paid to parents, essentially mothers, not in work caring for their children until these are 18 months old). The maximum payments for those who are not entitled to an earnings-related parental-leave payment are now higher than the average old-age pension payments. Although parental policies are open to use by fathers, they do not generally use the entitlement, which contributes to employers being reluctant to hire mothers with young children. Altogether, the financial incentives for mothers not to be in work for 18 months upon childbirth are very strong.

...while policies should focus on helping parents to combine work and family life

The introduction of family capital may have contributed to the recent increase in the TFR to just over 1.5 in 2009, while the subsequently introduced lump-sum payment and increased income supports for parents with a child aged under 18 months may well sustain this increase at least in the short-run. However, the experience in OECD countries is that such an effect is likely to be *temporary*. Providing generous support at one point in childhood is one thing, but for modern family policy to be effective on a consistent basis in terms of sustaining fertility rates, what is needed is to give parents the confidence that throughout early childhood, they will be able to combine work and family commitments (OECD, 2011). This suggests that cash spending on children should not be restricted to the first 18 months but rather be smoothed over the early life-course, which would also help fight in-work poverty among Russian families. Furthermore, policy needs to reverse the decline in pre-school places, and reduce the cost of day-care fees for working parents with children aged from 18 months to primary-school age. Finally, improving housing policies is a major objective, if only because it would help young Russians establish a family of their own. All in all, policy measures need not just to support mothers to care for their children in the first 18 months, they need to promote a better work/life balance to help parents combine work and family commitments throughout childhood.

The dynamics of ageing populations will have profound effects on Russian society and pension policy

The working-age population in the Russian Federation will shrink by about one-third in the first half of this century…

The projected increase in the old-age dependency ratio (the number of people over 65 as a proportion of the population 20-64) in the Russian Federation is similar to the OECD average: from about just over 20% in 2000 to around 45% in 2050. However, the underlying drivers are very different. Across the OECD, population ageing occurs because of growth in the number of elderly people; in the Russian Federation it is predominantly because of a declining working-age population. This is because of the persistently low birth rates (see above) and the relatively low life expectancy which curtails growth of the elderly Russian population. In 2008, the average life expectancy of men was 62 years and for women it was 74 years; 14.6 and 7.8 years below the OECD average for men and women, respectively. Unless policies (including price-setting policies and indirect tax levies on spirits and tobacco) become more effective in improving health outcomes, demographic projections suggest that the working-age population could decline by one-third over the next 45 years.

…and achieving pension policy objectives will become increasingly challenging

Pension policy aims to generate a replacement rate of about 40% of earnings on retirement. To achieve this, policy reform over recent years has led to the development of a three-pillar pension system involving: a defined basic benefit pension; a notionally defined contribution insurance scheme; and a funded pension component. Payment and saving rates have been outpaced by rapid wage growth in recent years; notional pension saving is not linked to life expectancy, and the rate of return of the funded pension component of the system has been negative since the start in 2002. Recent reform has increased the scope for investment by asset managers, but it is too early to say whether this will generate positive returns on a long-term basis. To help potential savers overcome their lack of confidence in the system, a co-financing scheme was introduced which involves matching cash payments to the pension fund for each rouble of voluntary pension saving up to a maximum of about USD 500 per year for a duration of ten years.

Recent reform is likely to "eradicate" poverty among pensioners, as measured by official benchmarks...

As measured against the official benchmark, the pensioner poverty rate was 8% in 2008 compared with 13% for the general population. Notwithstanding this low relative poverty rate and the already relatively high proportion of public spending focused on pensioners, policy reforms in 2009 and particularly in 2010 increased pension payment rates (and increased the value of notional pension savings). Over the 2009-10 period, insurance pension payment rates increased by over 50% in nominal terms. Official poverty data are not yet available for 2011, but it is likely that they will show that there are not many pensioners with incomes below the minimum subsistence level poverty line. However, it is likely that wage growth will soon start to erode the real value of pensions again, as it did from the mid-1990s to 2008. The 2010 reform introduced an automatic adjustment of pension payment rates if inflation exceeds 6% since the last benchmark, as well as an automatic adjustment in case wage growth exceeds a certain threshold-level (as determined by price indexation in a given year).

...but achieving adequacy objectives in this manner comes at a price

In 2009, public pension spending amounted to about 6.5% of GDP, about 1 percentage point of GDP more than in 2008. Budget transfers to the Russian pension fund (financed out of the sale of natural resources and general taxation) amounted to 2.8 % of GDP in 2007 and increased to almost 5% of GDP in 2009. By contrast, revenue out of pension contributions only amounted to 2.5% of GDP in 2009. For the future pension system to reach a financial equilibrium, a mix of measures will be needed including, increasing standard pensionable ages, raising coverage of pension contributions, and limiting pension take-up among the working-age population. Unfortunately, the 2010 reform did not address these latter issues, and the Russian Federation's key pension policy challenge is to redress the balance between the limited contribution base and the high number of pensioners in order to ensure long-run financial sustainability in its pension system.

Reform will have to address the low standard pensionable ages in the Russian Federation...

One reason for the low contribution base is the low standard pensionable ages in the Russian Federation: 60 for men and 55 for women. Most OECD countries have now the same pensionable ages for men and women, usually 65. Indeed, in view of life expectancies, perpetuating the current system of gender inequity in standard pensionable ages is difficult to rationalise. So at the very least, the standard retirement ages need to be gradually equalised among the sexes. If, in addition, the male and female standard pensionable ages were to be increased to 62 years of age, the number of pensioners in 2025 would be around 30 million and not 36 million as with the current set-up. The relatively short life expectancy (especially among men) has been used as an argument against increasing the pensionable age, but already in 2008, if men reached 65, they had on average an expected 11.7 years of retirement. Further improvement in life styles and life expectancy could lead to a closer alignment of pensionable ages in the Russian Federation and OECD countries.

...and limit access to early pensions

Reform should also limit access to drawing a full pension before the already low standard pensionable ages. Often service records of 20/25 years grant entitlement to early pensions, which employees often take while also continuing to work in the same job. In many cases, the working conditions in certain sectors no longer warrant the award of the early pensions. But, even if it is difficult to reform established rights to early pensions for teachers, bus drivers or airline staff, at least a start should be made with limiting the maximum period of early retirement to only a few years, with further phasing out of these early pensions at a later stage. Moreover, costs should not be borne by the Pension Fund of the Russian Federation as at present; they should be borne by the employer in the sector. The internalisation of early pension costs would increase transparency on the costs of these early-pension schemes to all involved. In fact, more generally, employees should be made responsible for paying part of the social security contributions: this would increase their awareness of costs and understanding of the need for reform.

The social security contribution base should be widened...

Early retirement further reduces the already low contribution base among the working-age population. Overall contribution revenue is also reduced as in many economic sectors employers are allowed to pay less than the standard social security contribution rate of 26% of the payroll. For example, in agriculture and in new technology-based industries *de facto* social security contributions can be as low as around 10 to 15% (in order to attract investment). Finally, while pension coverage is not considered a significant issue, underreporting of income is widespread. Different public agencies should be granted direct access to each others' databases, not only to improve targeting supports at those who need them most (see above), but also to increase the effectiveness of collection procedures.

... not by increasing standard contribution rates, but by applying them equally across sectors and ensuring that the strongest shoulders bear their fair share of the cost

The Russian Federation should be commended for abolishing its complicated and regressive social contribution rate system in 2010: the Unified Social Tax. Flat-rate social security contributions have been introduced at 26% of the payroll, of which 20 percentage points are pension contributions. At 1 January 2011, the overall flat-rate standard contribution rates were increased from 26 to 34% (of which 26 percentage points consist of pension contributions). This significantly raised labour costs and is likely to reduce formal labour demand as well as investment in labour. Policy should move towards a general application of the existing contribution rates across *all* economic sectors. Furthermore, as of 1 January 2010, maximum earnings thresholds over which social security contributions were due were reduced from RUB 600 000 to RUB 415 000 (just below 1.5 times the average wage), which was increased to RUB 463 000 by 1 January 2011. Apart from regular indexation with average wage growth, policy could consider increasing this maximum threshold (for example, to twice the average wage or above) to raise contribution revenue. Apart from the existing standard tax deduction for very low income households, the Russian Federation's income tax is flat rate at 13%. To further improve the redistributive power of the tax/benefit system, consideration should be given to strengthening progressivity to the personal income tax scheme.

Box 0.1. Labour market and social policy recommendations for the Russian Federation

In the context of its policies to enhance job opportunities for all, the Russian government is invited to consider the following items as part of its strategy to improve the balance between employment security and flexibility, generate trust between the social partners, and the development of an inclusive and active social policy:

Labour market policy

- Rebalance employment protection across different labour contracts. In particular, link notice period and severance payments for permanent workers to job tenure; remove the possibility for employers to use civil contracts with limited or no employment protection; and introduce sub-contracting regulations.
- Strengthen labour law enforcement by increasing the number of labour inspectors and their wages, as well as the level of fines in cases of labour law infringement.
- Promote workers representation and collective bargaining, and encourage trade union pluralism at all negotiation levels. In particular, ease conditions for more than one trade union to participate in the collective bargaining process at the firm level; better enforce the provisions guaranteeing workers representation; and relax the very strict provisions on the right to strike.
- Monitor future increases in the federal minimum wage so as to balance the need to provide an adequate pay floor with the need to preserve the employability of low-skilled workers in poor regions.
- Promote a greater adequacy and effectiveness of labour market programmes for the unemployed. In particular, consider introducing a well-designed unemployment insurance scheme and improve the functioning of the public employment centres and the quality of the employment services they deliver.
- Maintain or even increase further the level of resources for labour market programmes during the recovery but shift public funds towards the most effective programmes such as job-search assistance and counselling, training, and direct job creation for the most difficult-to-place unemployed.
- Reinforce the information system of labour intermediation and encourage a greater involvement of employers in the provision of on-the-job training and efforts towards lifelong learning.

Social policy

- Increase resources for social policy programmes to provide more adequate support to needy households.
- Improve the redistributive power of the tax/benefit system. In addition to regular indexation with average wage growth, the upper income-threshold for social contributions to close to twice the average wage. To further improve the redistributive power of the tax/benefit system, progressivity in the personal income tax scheme should be strengthened.
- Apply equal social security contribution rates to all sectors of the economy and uniform across jobs/occupations.
- Continue the shifting of the monetised in-kind benefits that are linked to employment history into income-tested supports, as for example income-tested housing benefits, which are also accessible to the working-age population and their children.
- Improve systemic targeting of social support, as well as the collection procedures for social contributions, through better information sharing across different public agencies: they should be granted direct access to each others' databases.
- Strengthen policies that help parents reconcile work and family commitments by increasing support for the kindergarten system, both in terms of capacity as well as fee reductions. Give families with young children priority access to affordable housing.
- Increase child allowances to reduce the poverty risk among working families with children.
- Enhance financial sustainability of the pension system by increasing the low ratio of contributors to benefit recipients, through a mix of measures including: gradual increase of female pensionable ages to male levels (at present 60 years of age); consider increasing pensionable age in line with gains in life expectancy; and, limit access to early pension schemes. To increase awareness of the costs of early retirement and change behaviour for employers and workers accordingly, internalise the cost of early pension schemes to employers rather than finance these out of the general pension fund. Employees should also contribute to social security.

Note

1. The *OECD Jobs Strategy* was originally formulated in 1994 with the aim of reducing high and persistent unemployment. While the key recommendations have been found to be useful in this respect, the policy focus has broadened and the *2006 Reassessed OECD Jobs Strategy* (RJS) puts more weight to the objective of promoting labour market participation and employment, and taking into account concerns about low incomes of certain groups. The RJS has four main pillars: *i)* set appropriate macroeconomic policy; *ii)* remove impediments to labour market participation as well as job search; *iii)* tackle labour- and product-market obstacles to labour demand; and *iv)* facilitate the development of labour force skills and competencies. Policy makers need to ensure that each of the four pillars is solid, but individual countries can use different policy combinations to achieve successful outcomes, taking into account policy interactions and country circumstances and objectives.

Chapter 1

A Dynamic but Segmented Labour Market

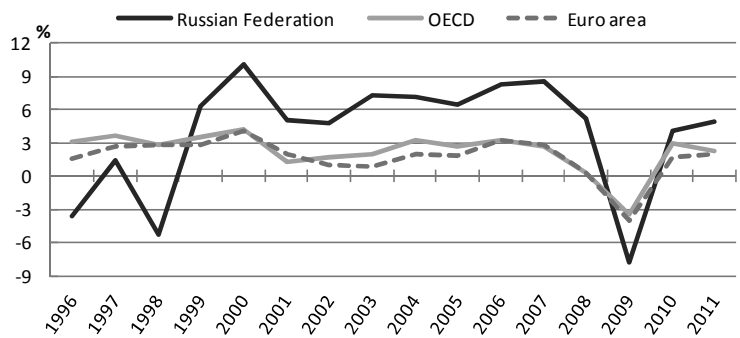
The global financial crisis interrupted a protracted period of strong economic growth and poverty reduction in the Russian Federation. Despite a large decline in output, job losses and hikes in unemployment have remained rather modest, and much of the labour market adjustment has taken the form of cuts in working hours and, in particular, earnings. While a recovery is now underway, the Russian labour market remains characterised by significant structural imbalances resulting in widespread segmentation and large earnings inequalities. High worker turnover points to a dynamic labour market, but employment growth has been mostly in lower quality jobs and atypical contracts have increased. Also, regional disparities remain large as poverty traps hinder workers moving across regions in search of available jobs.

1. The global crisis ended a decade of strong growth, but recovery is underway

Between the Russian financial crisis in 1998 and the global crisis that hit the country in mid-2008, the Russian Federation experienced a decade of sustained and strong economic growth (Figure 1.1, Panel A). Real GDP grew at an annual average rate of 7% and nearly doubled over ten years. Given the gradual decline in the Russian population (*cf.* Chapter 3), per capita growth of GDP was even faster. Nevertheless, with GDP per capita at 45% of the OECD average in 2009 (Figure 1.1, Panel B), living standards in the Russian Federation remain below those in most OECD countries.

Figure 1.1. GDP and GDP per capita in the Russian Federation and OECD, 1996-2011

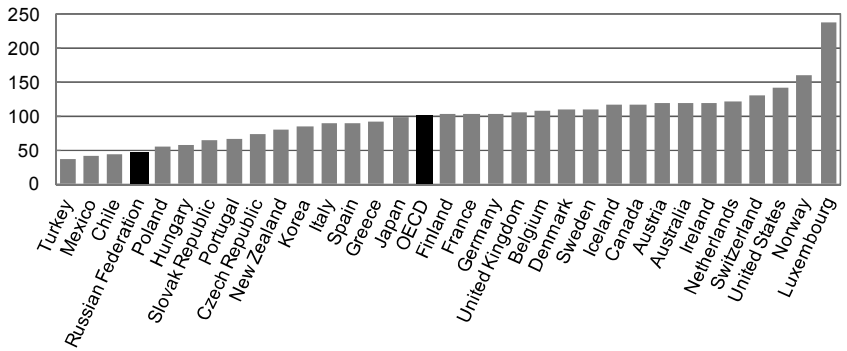
Panel A. Real GDP annual growth[1]



1. Figures for 2011 are projections.

Source: OECD *Economic Outlook Database*.

Panel B. GDP per capita in purchasing power parities, OECD = 100, 2009



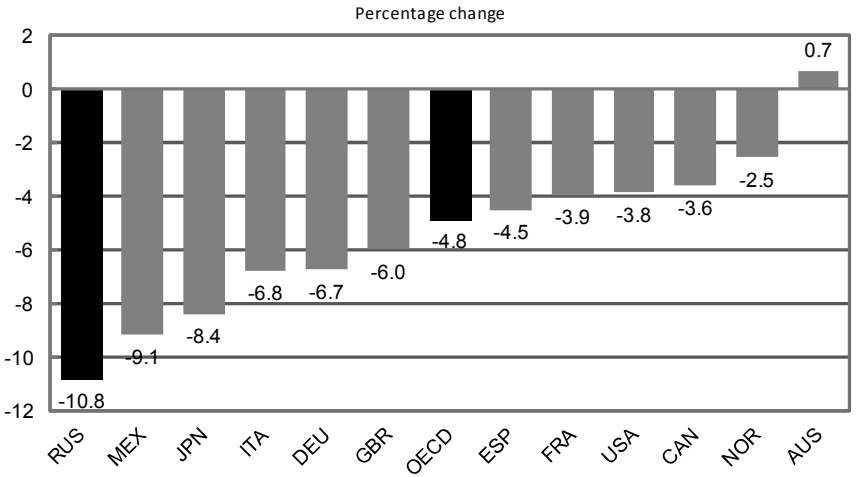
Source: IMF, *World Economic Outlook Database*.

The Russian Federation's strong economic performance prior to the global crisis was fuelled by a number of benign but transitory factors, albeit supported by sound macroeconomic policies (OECD, 2006). Initially driven by catch-up after the transition period and a rebound from the financial crisis in 1998, growth benefited strongly from the developments in the oil industry between 2003 and mid-2008. The surge in commodity prices, and in particular the price of oil, dramatically improved the terms of trade and sparked a boom in domestic demand. By 2007, the Russian economy was showing clear signs of overheating with rising inflation (12% by the end of that year), emerging labour shortages and a real-estate bubble in Moscow and St. Petersburg (OECD, 2009a). The historically low world interest rates and the nominal appreciation of the rouble against the US dollar also created an unhealthy strong increase in foreign-currency borrowing by Russian banks and enterprises.

In part due to these structural domestic vulnerabilities, the Russian Federation was hit particularly hard by the global financial and economic crisis. The collapse of the international capital markets and world trade was further aggravated by a rapid decline in oil prices. The cumulative output loss during the recession amounted to 10.8% in the Russian Federation, considerably larger than the output loss of 4.8% for the OECD as a whole (Figure 1.2). Taking into account the high growth rates in the Russian Federation prior to the crisis, the *cumulative* growth loss – which compares the loss in output with the growth in output that would have occurred in the absence of the crisis – is estimated to be around 19% in the Russian Federation versus 8% in the OECD area (OECD, 2010a).

The Russian economy started to recover in the second half of 2009, and the latest OECD projections expect growth to be around 4 to 5% in 2010 and 2011 (Figure 1.1, Panel A). The economy benefited strongly from a rebound in global trade, a gradual recovery of international capital flows and a large rise in oil prices. At the same time, large fiscal savings accumulated over the past decade allowed the authorities to stimulate demand *via* a sizeable fiscal stimulus package. However, there is a risk that over-reliance on oil revenues to sustain growth could create a new boom-and-bust cycle along the lines of the pre-crisis period.

Figure 1.2. Percentage change in real GDP from peak to trough[1]



1. Peaks and troughs are determined using real GDP series in levels. Australia did not have a recession in the 2008-09 period but is shown for comparison purposes over the period 2008 Q3 to 2009 Q2. Canada: 2007 Q4 to 2009 Q2; France: 2008 Q1 to 2009 Q1; Germany: 2008 Q1 to 2009 Q1; Italy: 2008 Q1 to 2009 Q2; Japan: 2008 Q1 to 2009 Q1; Mexico: 2008 Q1 to 2009 Q1; Norway: 2008 Q2 to 2009 Q2; OECD area: 2008 Q1 to 2009 Q1; the Russian Federation: 2008 Q2 to 2009 Q2; Spain: 2008 Q1 to 2009 Q3; the United Kingdom: 2008 Q1 to 2009 Q2; and the United States: 2008 Q2 to 2009 Q2.

Source: OECD *Economic Outlook Database* and OECD *Main Economic Indicators Database* (Russian Federation and OECD area).

2. Real wages remain the main adjustment variable in the labour market

Labour force participation is high despite the economic downturn

Despite the economic slowdown, the Russian Federation enjoys relatively high labour force participation and employment rates, thanks to high employment rates of women. Sustained economic growth prior to the crisis, combined with a decreasing working-age population, led to significant improvements in the labour market. The unemployment rate declined from a historical high of 13.2% in 1999 to 6.2% in 2007 and the share of long-term unemployment (more than one year) in total unemployment was reduced from 47 to 40% over the same period. In several regions, labour shortages started to appear and the demand for migrant workers increased (see Box 1.1). By 2007, 72.8% of the population aged 15-64 was active in the labour market and 68.3% was employed, compared with respectively 70.6 and 66.5% on average in the OECD

(Table 1.1). Women and older workers benefited particularly from the strong labour demand. Only the participation rates for youth (aged 15-24) remained below the OECD average – 40% in 2007 compared with 49% in the OECD – largely due to the high enrolment in education.[1]

Table 1.1. Labour force status of the Russian population, 1992-2009

Age	Total				Men				Women			
	1992	1999	2008	2009	1992	1999	2008	2009	1992	1999	2008	2009
Labour force/Population												
15-24	54.7	45.2	43.1	42.7	58.3	49.5	47.5	46.4	50.9	40.7	38.5	38.8
25-54	91.7	88.1	89.0	88.8	94.7	91.0	92.2	92.0	88.8	85.2	85.9	85.8
55-64	40.2	38.5	52.9	51.6	57.1	51.5	66.1	64.1	27.3	28.8	43.0	42.3
15-64	75.7	70.9	73.5	73.2	81.5	76.0	78.2	77.8	70.3	66.2	69.2	69.0
OECD	69.6	70.0	70.8	70.7	82.0	81.2	80.4	80.2	57.4	58.9	61.4	61.3
Employed/Population												
15-24	47.6	34.4	37.0	34.7	50.7	38.4	41.1	37.9	44.3	30.2	32.7	31.4
25-54	88.2	77.9	84.2	82.4	91.1	80.2	87.1	84.9	85.5	75.6	81.6	80.1
55-64	38.4	34.8	50.7	48.7	55.0	46.5	63.0	60.0	25.8	26.0	41.5	40.3
15-64	71.8	61.6	68.8	67.0	77.3	65.9	73.0	70.7	66.7	57.5	64.9	63.6
OECD	64.3	65.1	66.5	64.8	76.2	76.0	75.6	73.2	52.7	54.4	57.6	56.5
Unemployed/Labour force												
15-24	13.0	24.0	14.1	18.6	13.0	22.5	13.3	18.3	13.0	25.8	15.0	19.0
25-54	3.8	11.6	5.3	7.2	3.8	11.9	5.6	7.8	3.8	11.2	5.1	6.6
55-64	4.5	9.7	4.1	5.6	3.8	9.7	4.7	6.3	5.6	9.7	3.4	4.7
15-64	5.2	13.2	6.4	8.5	5.2	13.3	6.6	9.1	5.2	13.0	6.1	7.9
OECD	7.6	6.9	6.1	8.3	7.1	6.4	6.0	8.7	8.2	7.7	6.2	7.8

Source: Rosstat Labour Force Survey and OECD *Labour Force Statistics Database* for OECD averages.

Box 1.1. International migration could alleviate demographic pressure

Migration could play an important role in slowing down the population decline in the Russian Federation, but full compensation of the decline in the natural rate of growth of the population would require a net immigration of 1-1.5 million per year (United Nations, 2008). Nevertheless, the Russian Federation did not have a migration policy until 2007 and, in the light of the current crisis, the Russian government halved the quota for foreign employees in 2010.

There are no consistent and regular statistics available to accurately document migration flows, but a comparison between the 1989 and 2002 Census suggests that 11 million people had immigrated to the Russian Federation during this period, equal to 15% of the Russian workforce (Andrienko and Guriev, 2005). Initially, these were mainly ethnic Russians who were repatriated from other Commonwealth of Independent States (CIS), but by the mid-1990s labour migrants with temporary residence became the largest group. Official statistics capture, however, only a negligible share of temporary labour migrants. Estimations by the Federal Migration Service show that the majority (more than 95%) of the immigrants do not go through official channels (Andrienko and Guriev, 2005). The number of undocumented immigrants is estimated at around 3-5 million, equivalent to 2 to 3.5% of the total population (Neterebsky, 2002; and Mukomel, 2006).

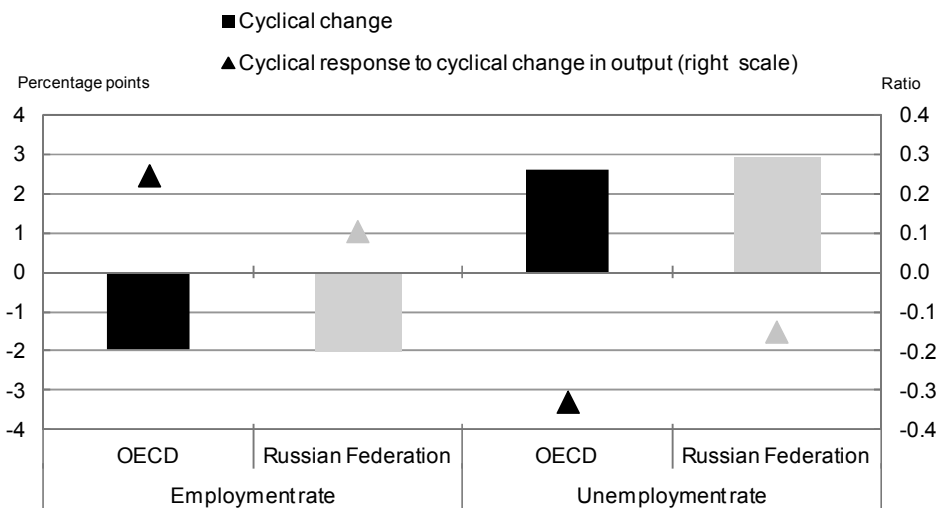
There are no visa requirements for CIS citizens, but all foreigners with temporary residence in the Russian Federation need a work permit. The number of work permits was, however, very limited until 2006 and only granted for a three-month period (migrants are required to leave and re-enter the country to obtain a renewal). Although the Russian Federation's migration policy was significantly liberalised in 2007 to accommodate the high demand for workers in the Russian labour market, the government has again restricted the number of working permits in the light of the current economic crisis (Marat, 2009).

The unregistered nature of the bulk of Russian labour migration makes migrant workers particularly vulnerable to exploitation. They are concentrated in the less regulated labour markets and are willing to accept difficult and low-paid jobs in construction, wholesale and retail trade, agriculture, and public transportation (United Nations, 2008). A small survey carried out by the International Labour Office in 2003 revealed that only 20% of the interviewed migrants had a written contract, and many suffered from various forms of exploitation, including underpayment or wage arrears (39% of the migrants), lack of payment all together (24% of the migrants), and lack of social benefits (90% of the migrants) (Tyuryukanova, 2006).

The impact of the current crisis on employment and unemployment was surprisingly mild relative to the decline in output, although a similar pattern has been observed in a number of OECD countries such as Germany, Japan and Mexico. Figure 1.3 shows the cyclical changes in the employment and unemployment rates during the economic downturn, both in absolute terms and relative to the cyclical change in output.[2] The cyclical decline in the employment rate in the Russian Federation was about the same magnitude

as in the OECD area (nearly 2 percentage points), but the impact was much smaller relative to the size of the output shock. As a result, the employment rate in the Russian Federation (67% in 2009) remains slightly above the OECD average of 65% (Table 1.1). Similarly, the cyclical response of the unemployment rate relative to the size of the shock was less than half as strong as for the OECD, even though the absolute rise was slightly larger. In 2009, the unemployment rate reached 8.5% in the Russian Federation compared with 8.3% in the OECD (Table 1.1). The average figures for the OECD area hide, however, significant dispersion among member countries (OECD, 2010a). For instance, in countries where a boom-bust pattern in the housing market was a major driver of the recession – such as Ireland, Spain and the United States – job losses have been unusually large. Countries where, similar to the Russian Federation, a sharp decline in exports played an important role in driving the recession – such as Germany, Japan and Mexico – experienced a mild employment response.

Figure 1.3. Cyclical change in the employment and unemployment rates in the Russian Federation and the OECD[1]



1. Cyclical changes are calculated as deviations from the pre-crisis trend (covering 2005 Q1 to 2008 Q1) over period during which output growth declined (2008 Q1 to 2009 Q3 for the Russian Federation and 2008 Q1 to 2009 Q2 for the OECD). Data are seasonally adjusted and harmonised unemployment rates are used. See Annex 2.A2 in OECD (2010b) for further details about the calculation.

Source: OECD calculations based on *OECD Main Economic Indicators Database*.

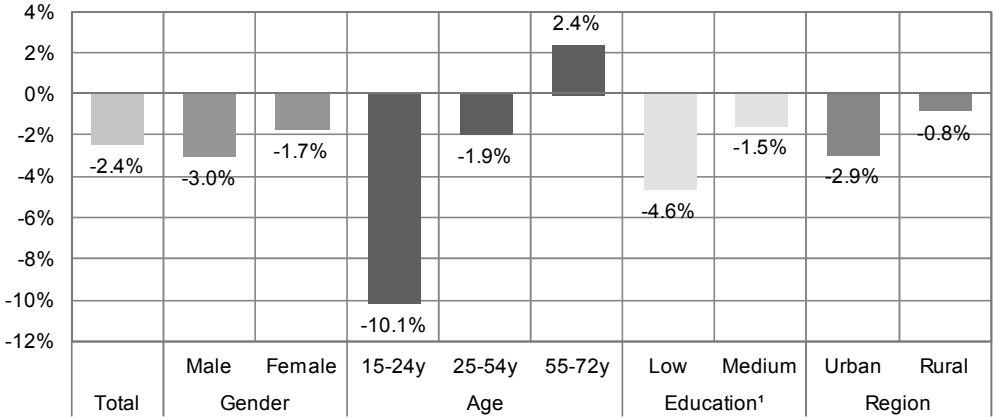
Job losses have been disproportionally large among young workers, while employment continued to grow among older workers. Similar to their counterparts in many OECD countries, youth have always been at a disadvantage in the Russian labour market – their unemployment rate remained in double-digit throughout the 2000s – and their situation has worsened since the start of the economic downturn. Between 2008 and 2009, employment among those aged 15-24 dropped by 10% (Figure 1.4) and their unemployment rate rose to 18.6% (Table 1.1). Employment growth among older workers (+2.4% between 2008 and 2009) is a clear break with the past, even though there are no direct changes in the Russian pension system.[3]

Partly as a result of the sectoral composition of the crisis, men and urban workers have been hit hardest by the crisis (Figure 1.4). As in OECD countries, employment losses have been particularly large in sectors where men are traditionally over-represented, such as the manufacturing and construction sectors, where employment declined by respectively 9.9% and 9.4% between 2008 and 2009. On the other hand, the sector with a high share of female workers, public health and services, saw an increase in employment by 4.5% over the same period. Employment losses were also much higher for low-skilled workers than for medium-skilled workers.

The economic crisis drove the unemployment rates up in nearly all Russian regions in 2009, but the impact varies significantly across the country. The largest increases in unemployment were observed in regions with major industrial and commercial activities, such as the Central Federal District (where the unemployment rate rose from 3.6% in 2008 to 5.8% in 2009) and the Ural Federal District (from 5.5% in 2008 to 8.1% in 2009). However, the highest *levels* of unemployment are still found in the Southern and Siberian Federal Districts (see Section 4).

Figure 1.4. Young men (aged 15-24) and urban workers have been hit especially hard by the crisis

Change in employment by workforce groups for the population aged 15-72, 2008 to 2009



1. Employment data for people with higher education are not comparable between 2008 and 2009 due to a break in the series.

Source: Rosstat Labour Force Survey.

Working hours declined during the crisis

The labour market adjustment during the economic slowdown went beyond changes in employment and unemployment. Similar to a large number of OECD countries where a sharp decline in exports was a major driver of the economic downturn, a significant part of the labour adjustment has taken place through *intensive margins*, such as reduced working hours and wages (OECD, 2010a). As the fall in export demand was probably viewed as a transitory phenomenon rather than as a structural imbalance in the domestic economy, employers, facing labour shortages prior to the crisis, have been reluctant to shed workers and, instead, reduced hours and wages in response to lower product demand.

Comparing changes in employment and weekly working hours suggests that the latter accounted for a larger share of the total labour input adjustment in the Russian Federation. While employment declined by 2.4% in 2009, estimates based on the Russian labour force survey show a reduction in weekly working hours by 3.7% in 2009 or about 1.5 hours of working time less per week (Figure 1.5, Panel A). The fall in weekly hours was especially large in secondary jobs (-15% in 2009; *Source:* Rosstat). For

comparison, total weekly hours actually worked for persons remaining employed in the OECD area fell by a comparable 4% on average in 2009.

Data on large and medium-sized enterprises (LMEs – accounting for 54% of total employment in 2009) show the opposite adjustment pattern, with stronger labour input adjustment through employment rather than through working hours. In 2009, employment in LMEs fell by 4.4%, while annual working hours were cut by only 2.3% (Figure 1.5, Panel B).[4] Also in OECD countries labour hoarding seems to be more common in small and medium-sized enterprises than in larger firms (OECD, 2010a). As argued by Moscarini and Postel-Vinay (2009), larger firms tend to be more productive and offer higher wages, and thus may find it easier to recruit new workers during the recovery. Nonetheless, the comparatively stronger reaction of employment in LMEs to the economic shock has put in the perspective of the structural decline in LMEs employment. Over the period 2000-07, despite the strong economic growth in the country, the number of employees in these firms fell on average by 1% annually. This negative trend points to a lack of competitiveness, even before the onset of the economic crisis, and many LMEs were probably unable to retain their employees when production declined rapidly.

Figure 1.5. Relative importance of the extensive and intensive margins of labour adjustment in the Russian Federation

Annual percentage changes in employment and working hours, 2009[1]

1. The figures on working hours in the total economy are based on the labour force survey, while the working hours in large and medium-sized enterprises are based on employer reports.

Source: Based on Rosstat.

Despite the greater adjustment on the extensive margin, working-time reductions increased significantly in LMEs: between 2007 and 2009, the total number of LME workers affected by involuntary part-time working schemes and unpaid leave multiplied by five and, by 2009, almost one out of ten employees in LMEs were underemployed (Table 1.2). Of those, about 1.9 million people were working reduced hours on the firm's initiative, with each affected employee working three hours less per week on average. Another 1.3 million workers were on administrative leave for 34 days per year on average.

Table 1.2. Underemployment in large and medium-sized enterprises

Workers affected in 2009

	Thousands	As % of LME employment	Change with respect to 2007
Involuntary part-time work	1 894	5.3%	833%
Administrative leave	1 293	3.5%	226%

Source: Rosstat, *Socio-economic Situation in Russia.*

Labour productivity and real earnings dropped sharply with respect to their pre-crisis trend

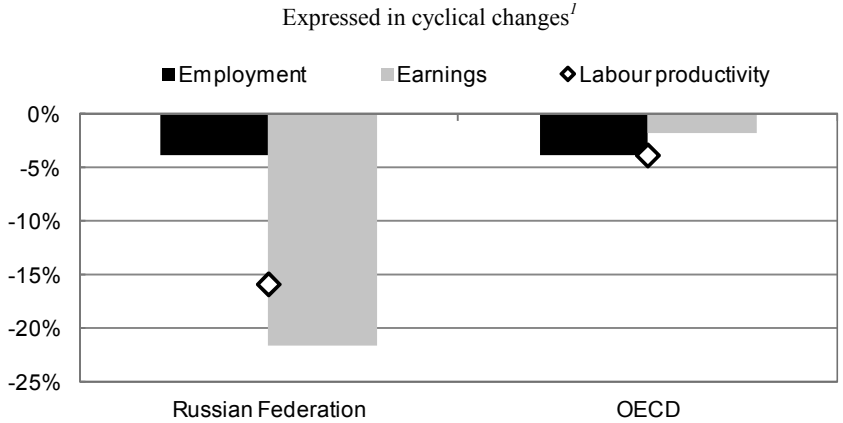
The weak response of employment to the fall in output translated into a sharp decline in labour productivity in the Russian Federation. Measured on a per employee basis, the drop in labour productivity during the economic downturn with respect to its pre-crisis trend was four times that observed in the OECD area as a whole (Figure 1.6). On the other hand, the reduction in hours discussed above suggests that the decline in labour productivity has probably been less severe on a per hour basis than on an employee basis.

The costs resulting from the productivity decline are, however, largely borne by employees through a cut in earnings. Real monthly wage growth remained high initially (+10% in 2008), but became negative in 2009 (-1.6%). When expressed relative to its pre-crisis trend, the cyclical drop in wages surpassed the cyclical decline in labour productivity in 2009 (Figure 1.6).

High inflation rates – 13% in 2008 and 9% in 2009 – gave Russian employers the possibility to save on the wage bill without reducing nominal wages. In 2009, nominal wages grew by 10% against 31% annually on average over the period 2000-08. In addition, the flexible wage-setting system, with 40-50% of the wage depending on the performance of the firm,

allows for an automatic adjustment of wages in times of low production (see Chapter 2). In fact, due to the strong reduction in output, nominal wage growth could even have been expected to become negative in 2009. However, the almost 90% increase in the minimum-wage level in 2009 (see Chapter 2) helped prevent this cut in nominal wages.

Figure 1.6. Cyclical changes in employment, earnings and labour productivity in the Russian Federation and the OECD, 2009



1. Cyclical changes are calculated as deviations from the pre-crisis trend (covering 2005 Q1 to 2008 Q1) over period during which output growth declined (2008 Q1 to 2009 Q3 for the Russian Federation and 2008 Q1 to 2009 Q2 for the OECD). Data are seasonally adjusted. See Annex 2.A2 in OECD (2010b) for further details about the calculation.

Source: OECD calculations based on *OECD Main Economic Indicators Database*.

Wage arrears have played a much more limited role during the recent crisis than during previous crises. Data from the Russian Longitudinal Monitoring Survey (RLMS), a household survey on income and expenditure, suggest that about 6% of the employees were affected by wages arrears, with the majority of them having unpaid wages for less than one month (Denisova and Dorofeeva, 2010). While this is a slight increase from 2008, the scale of unpaid wages is marginal in comparison with previous crises. For instance, in 1998, 64% of the work force had outstanding wages, with the majority of them not being fully paid for more than three months. In 2009, most wage arrears (about 76%) were concentrated in the sectors hardest hit by the crisis, *i.e.* manufacturing, construction and transport (*Source:* Rosstat).

The impact of the recent crisis on the labour market diverges to a certain extent from the adjustment pattern that was observed during the transition period in the 1990s, even though wages bore the brunt of the fall in output during both downturns (see Box 1.2). This time, the underlying drivers seem to be quite similar to those observed in some OECD countries. First, given that the drop in output was largely driven by a steep fall in export demand, the recent downturn has probably been seen by employers as a transitory shock rather than as a structural imbalance. Under such circumstances, it is common to find labour hoarding by firms (OECD, 2009b). Second, unlike during the transition period, the Russian government played an active role in encouraging labour hoarding through the introduction of short-time working schemes (see Chapter 2). About half of the workers on involuntary part-time or unpaid leave have benefited from temporary working schemes organised to compensate for their loss in income, albeit at very low pay. Finally, the relatively weak reaction of employment and unemployment to the fall in aggregate demand is also found in other countries with limited support to the unemployed (OECD, 2010a). As unemployment benefits are very low in the Russian Federation (see Chapter 2), workers had strong incentives to stay in employment, even if this was only possible at reduced earnings.

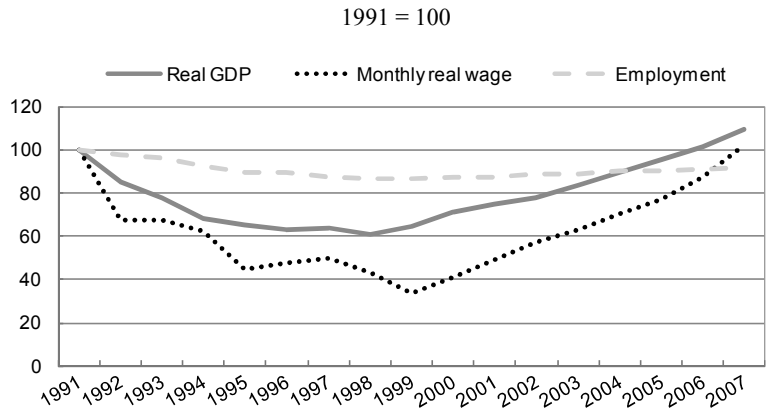
Box 1.2. The central role of wages in labour market adjustment during the transition period

The transition from a command to a market economy in the 1990s brought a deeper and longer recession in the Russian Federation than in most central and eastern European countries. However, while the output loss was accompanied in most countries by large decreases in employment and corresponding increases in unemployment (*i.e.* quantity adjustment), most of the adjustment to the output shock in the Russian Federation occurred through an extreme downward wage flexibility and a reduction in the number of working hours per employee. The decline in employment played only a secondary role. Between 1991 and 1998, output fell by 40%, while employment and monthly real wages decreased by 15 and 66%, respectively (see figure below).

Gimpelson and Lippoldt (2001) showed that significant labour market flexibility was achieved through a combination of mainly three key mechanisms. Depending on their individual circumstances, enterprises resorted to these devices in various combinations:

- A sharp reduction in the number of working hours per worker; the average reduction was equivalent to more than a month per year between 1992 and 1996;
- Flexibility in the overall level of wages, in their structure and their relative levels within the enterprise (*cf.* Chapter 2), and the lack of compensation for high inflation levels;
- Starting from 1993/94, employers who could not pay increasingly resorted to withholding of wage payment.

Labour market adjustment patterns



Note: Average monthly wage deflated by consumption price index.

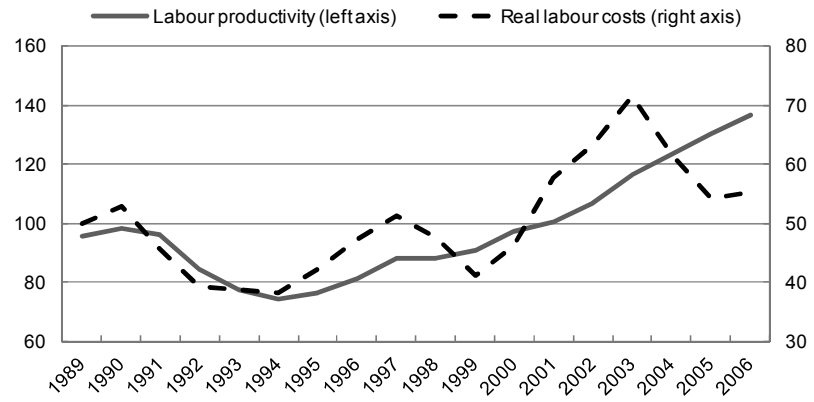
Source: Rosstat, and Gimpelson and Kapelyushnikov (2007).

Such an adjustment was made possible by a strong fear of unemployment among the Russian population, previously used to life-long employment. This contributed to the acceptance of a trade-off between a decrease in real wage and wage arrears on the one hand, and employment on the other. But institutional weaknesses also played a role. Macroeconomic reforms enjoyed priority over institution building – in line with the so-called "Washington consensus" – leaving the country with a set of unreformed or semi-reformed institutions (Gimpelson and Lippoldt, 2001). Institutional loopholes created opportunities for corruption and poor enforcement of laws and contracts. This made wage arrears possible, and more generally damaged incentives for enterprise restructuring and job creation. In this setting, the government not only failed to fulfil its role of arbitrator and guarantor of established rules and regulations, but very often also actively transgressed these rules (failing to pay wages to public servants, paying unemployment benefits with delay, etc.) (Kapelyushnikov, 2003).

Compared with other transition countries, the economic restructuring thus proceeded more slowly. When growth recovered starting from 1999, employment did not follow, as labour hoarding had left many unused reserves. Hence, price adjustment also dominated in the recovery period, with employment increasing by less than 7% between 1998 and 2007, and monthly real wages rose 200%, when real GDP increased by 80% (see figure above). Increased working hours per worker also explain part of the evolution of real monthly wages, but they played less of a role than during the recession. Overall, at least in the manufacturing sector, real labour costs have evolved relatively in line with labour productivity, but with stronger reactions to the cycle (figure below). Their sharp decline in 2004 is due to large reductions in social contribution rates and in the producer price index.

Hourly labour productivity and hourly labour costs in industry, 1989-2006

Roubles per man-hour at 2002 constant prices



Source: Gimpelson and Kapelyushnikov (2007).

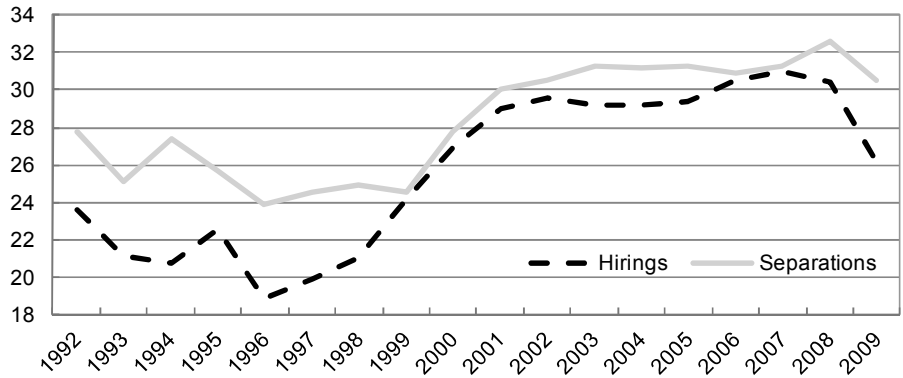
3. The labour market is highly dynamic but strongly segmented

High worker turnover points to structural adjustment

Worker turnover rates are relatively high in the Russian Federation, although comparable to some OECD countries with above-average worker flows. Data on large and medium-sized enterprises in the Russian Federation show that hiring and separation rates hovered around 30% of a firm's average employment in a given year between 2001 and 2008 (Figure 1.7). Given that labour turnover tends to be inversely related to the size of the establishment (Haltiwanger *et al.*, 2008), hiring and separation rates are probably higher in the rest of the economy. Although these data are difficult to compare internationally due to the scarcity of enterprise data on worker flows and differences in coverage, available evidence suggests that worker turnover rates in the Russian Federation are similar to those in France and the United States, two countries with above-average worker flows (OECD, 2009b).[5] In line with the decreasing share of LMEs in total employment (from 82% in 1992 to 54% in 2009), separation rates have surpassed hiring rates in LMEs since the early 1990s.

Figure 1.7. Worker turnover in Russian large and medium-sized enterprises, 1992-2009

Percentage of average employment[1]



1. The hiring and separation ratios are calculated as the total number of workers who joined/left the firm in a given year divided by the firm's average employment over that same year.

Source: Rosstat.

The strong increase in worker turnover rates after the growth rebound is related to structural changes along various lines in the Russian economy:

- *Change in the ownership mix resulting from the economic restructuring.* The transition towards a more market-oriented economy was accompanied by a sharp decline in employment in state-owned companies – which used to have lower turnover rates. Their share in total employment decreased from 70% in 1992 to 32% in 2007, while private domestic and foreign companies saw their share increase to 56 and 4% in 2007, respectively (*Source:* Rosstat).

- *Sectoral reallocation away from the manufacturing sector towards services sectors.* Worker turnover rates are highest in the trade and repair sector, hotels and restaurants, as well as in the construction sector; they are about average in the manufacturing sector and lowest in public sectors (Table 1.3). The sectors with high turnover rates are also those sectors with the most dynamic employment growth, in particular trade and hotels and restaurants, and the financial sector, where employment grew by more than 30% over the period 1998-2007. By contrast, employment decreased in agriculture, mining and quarrying, and manufacturing.

- *Rise in fixed-term employment.* The use of fixed-term contracts was relatively strictly regulated until 2002, but the New Labour Code significantly liberalised their use (see Chapter 2). The share of fixed-term labour contracts in total salaried employment rose from 3.8% in 1999 to 7.6% in 2008 (Figure 1.8). When civil contracts and oral agreements, which consist mainly of short-term contracts,[6] are included, the share of temporary work in total salaried employment reached 14% in 2008. This figure is comparable to many OECD countries and higher than the OECD average (12% in 2008).[7] As employment losses during the recent economic downturn have been well above average for workers with temporary contracts, their share in total dependent employment dropped accordingly in 2009.

Table 1.3. Employment by main economic sector in the Russian Federation[1]

	2007			Employment growth 1998-2007
	Hiring rates	Separation rates	Share in total employment	
Wholesale and retail trade; repair of motor vehicles	68%	58%	17%	39%
Hotels and restaurants	60%	58%	2%	32%
Construction	55%	53%	8%	19%
Fishing	53%	63%	0%	3%
Real estate, renting and business activities	37%	38%	7%	9%
Agriculture, hunting and forestry	36%	47%	10%	-24%
Financial intermediation	36%	26%	2%	62%
Other community, social and personal service activities	35%	34%	4%	22%
Transport, storage and communications	33%	35%	8%	10%
Manufacturing	32%	34%	17%	-5%
Electricity, gas and water supply	30%	32%	3%	5%
Mining and quarrying	30%	30%	2%	-11%
Health and social work	20%	20%	7%	6%
Education	17%	18%	9%	0%
Public administration and defence; compulsory social security	17%	14%	5%	23%
Total	**31%**	**31%**	**100%**	**7%**

1. Sectors are sorted by decreasing employment growth over the past decade. The sectoral classification is based on the OKVED classification, which is compatible with ISIC-NACE.

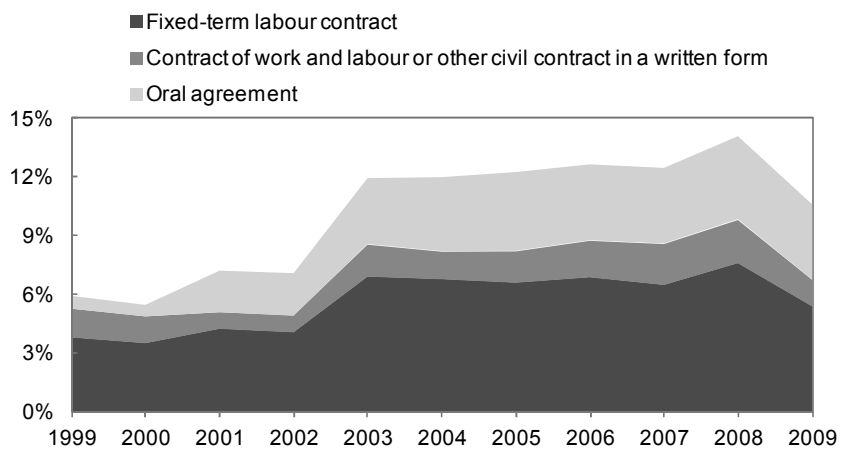
Source: Based on Rosstat.

Overall, employment growth has been mostly in lower quality jobs. Since the early 1990s, net employment creation has taken place only in the non-corporate sector – *i.e.* those enterprises owned by individual entrepreneurs, such as own-account workers and individual entrepreneurs and their employees. Corporate employment – *i.e.* in enterprises registered as legal entities – on the other hand, saw a more than 20% decrease between 1990 and 1998, remaining stable at around 46% of total non-farm employment during the economic recovery in the 2000s (Figure 1.9).

Although it is difficult to know precisely to what extent, workers in the non-corporate sector are much less likely to be covered by labour regulations and social security than those in the corporate sector (*cf.* Chapter 2). For instance, until 2010, employees of non-corporate businesses were not entitled to the regular unemployment benefit, but only to the minimum benefit. In addition, laws tend to be less enforced in this sector, which is more difficult and costly to supervise (*cf.* Chapter 2).

Figure 1.8. Use of temporary contracts in the Russian Federation, 1999-2009

Percentage of total salaried employment[1]



1. The remaining part of total salaried employment is permanent written labour contracts.

Source: Rosstat Labour Force Survey and Federal Employment Service.

Figure 1.9. Evolution of non-farm employment by legal sector, 1990-2006

1. Non-farm employment in the non-corporate sector is calculated as the difference between non-agricultural employment and non-agricultural employment in the corporate sector.

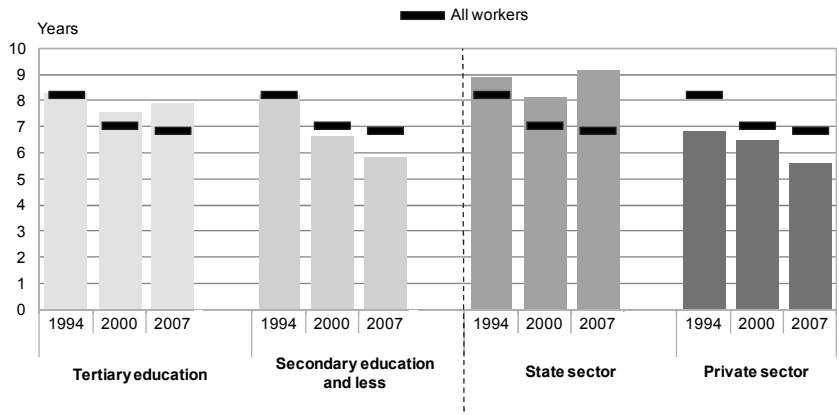
Source: Administrative reporting of large and medium-sized enterprises, Rosstat.

The labour market is segmented and the majority of separations are voluntary

Available quantitative and qualitative analyses suggest that certain groups of workers show high mobility in the labour market, while other groups remain in the same job despite poor working conditions, reflecting the segmentation of the labour market both on the labour supply and on the labour demand side. Gimpelson and Lippoldt (2001) found that both separation and hiring rates were higher for smaller, less profitable and less productive firms, which pay lower wages. The growth recovery after 1998 does not seem to have changed the situation significantly. A large share of Russian enterprises seems to be able to survive only by containing wage and non-wage labour costs and providing poor working conditions to their employees. Golikova *et al.* (2008) – based on a survey of the manufacturing sector in 49 regions of the Russian Federation undertaken in 2005-06 – find that dispersion in average labour productivity *within* sectors is considerably larger than among sectors. Inefficient enterprises are most often relatively small in size, located in small and medium-sized towns in underdeveloped regions, and mainly focused on the local market. They owe their continued existence to low wages and the use of existing fixed production assets, even though they are worn out and outdated. High entry and exit barriers explain the prolonged life of these ineffective businesses (see also OECD, 2009a).

Turnover has been very high among the low-qualified blue-collar workers (Gimpelson and Lippoldt, 2001). Figure 1.10 shows that average tenure has decreased significantly for workers with relatively low educational attainment, while that of high-skilled workers actually increased after 2000. Schwartz (2003) argues that the high hiring rates have often reflected the need to hire low-skilled workers for the same particular types of jobs, in general under arduous conditions, involving few skills, paying low wages and offering few non-wage benefits. At the same time, these bad working conditions imply that the workers often do not stay long in the firm, hereby nurturing the high separation/high hiring loop.

Figure 1.10. Average tenure by educational attainment and sector, 1994, 2000 and 2007



Source: OECD calculations based on the Russian Longitudinal Monitoring Survey.

Most of the time it is the worker's *own* decision to leave the firm, as illustrated by the fact that the vast majority of separations are registered as voluntary. The share of voluntary separations or quits in total separations reached more than 70% since 1998 (Table 1.4); by comparison, this figure was around 55% in the United States in the 2000s outside crisis times and less than 20% in France in the early 2000s. While some of these "voluntary" separations may not be such in practice given the limited options facing workers (see Chapter 2), the fact that their share has risen after the financial crisis of 1998 and remained high even during the recent economic crisis indicates that there is a strong voluntary element.

Table 1.4. Voluntary and forced separations, 1992-2009

Percentage of total separations[1]

	1992-1998	1999-2006	2007-2009
Voluntary quits	66%	76%	77%
Forced separations	8%	5%	5%
Other separations	26%	20%	18%

1. For large and medium-sized enterprises only.

Source: Administrative reporting of large and medium-sized enterprises, Rosstat.

At the same time, a sizeable group of low-skilled workers, with poor labour market prospects, stay in their jobs despite deteriorating employment conditions. As an example, Lukyanova (2006) shows that the gap between public and private sector wages rose between 1994 and 2003, with state workers experiencing slower growth of real wages in all percentiles. Yet, average job tenure is almost four years longer in the state sector than in the private sector (see Figure 1.10 above). Workers staying in the state/public sector are more likely to be in their late 40s or 50s and to be women (Schwartz, 2003). Denisova *et al.* (2007), studying worker transition patterns over 1994-2006, find that the outflow of females from the public/state sector was lower than that of males – consistent with the fact that many families in the Russian Federation diversify risks across sectors, with males typically working in the private sector and females in the state/public sector.

International comparison is difficult, but *informal employment* seems to be rather limited in the Russian Federation. The share of non-salaried workers in total employment – a very rough indication of informality, but easily comparable across countries – was 7% in 2007, compared with more than 25% in the OECD member countries Chile and Mexico (OECD, 2010a). Rosstat's labour force surveys allow for a more accurate description of informal employment by looking at the number of employees without a contract, unregistered self-employed and people engaged in agricultural activities for sale. These estimates suggest a similar prevalence of informal employment, around 8% of total employment (Table 1.5). The highest prevalence of informality is found among employees working for households and individual entrepreneurs (34% of them have no contract), self-employed (29% of them are not registered) and people engaged in household production for sale. On the other hand, less than 1% of the employees working in firms or institutions have no contract.

Table 1.5. Informal employment in the Russian Federation, 2007[1]

	Thousand of workers	Share in total employment of the respective group
Employees without contract	2 506	3.8%
Working for firms, establishments, farms	*298*	*1%*
Working for households and individual entrepreneurs	*2 207*	*34%*
Non-salaried workers	3 027	58%
Unregistered self-employed	*895*	*29%*
Household production for sale	*2 132*	*100%*
Total	5 533	8%

1. The statistics presented in the table cover only main jobs; informal employment in secondary jobs is not taken into account.

Source: Rosstat, *Economic Activity of the Population, 2008.*

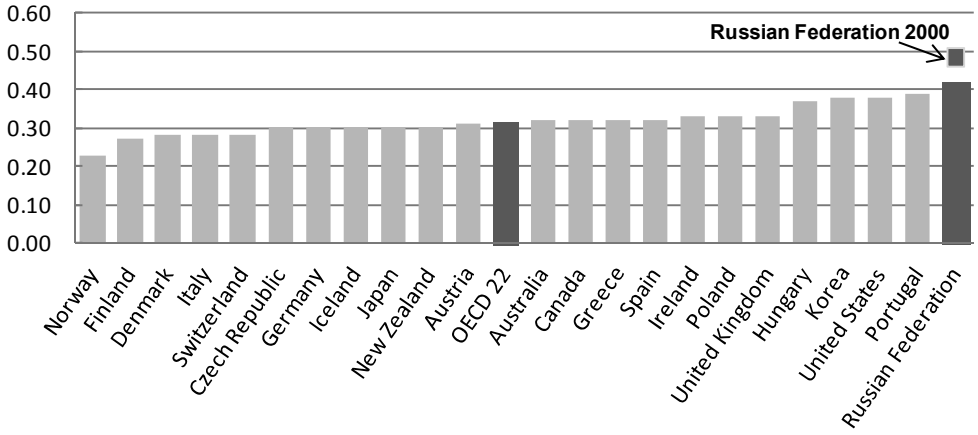
Large wage inequality is related to regional variation

Despite a decline in wage disparity since the turn of the century, wage inequality in the Russian Federation remains larger than in any OECD country (for which data is available). According to Rosstat's estimations, the Gini coefficient of average monthly earnings reached 0.42 in 2009, far above the OECD average of 0.32 (Figure 1.11). Since 2000, the Gini coefficient of wages has been steadily declining, mainly driven by a more rapid wage growth for workers in the bottom half of the earnings distribution (Rosstat, 2009). Reasons behind this trend can be found in the strong labour demand in low-skill industries, such as mining and construction, but also in the improved compensation in the public sector and the strong increases in the minimum wage in 2007 and 2009 (Gorodnichenko *et al.*, 2010).

The most important driver of the Russian Federation's wage inequality is the regional variation in earnings (even after controlling for workers' characteristics and industry structure). Regional wage disparities are in the first place the result of the large geographical differences in the cost of living. For instance, the ratio of the cost of fixed consumer goods between the most expensive region and the least expensive region was 2.4 at the beginning of 2010 (*Source*: Rosstat). Regional wage dispersion can also be associated with the significant wage premium in the Far Northern regions as compensation for precarious job and living conditions (Lukyanova, 2006).

Figure 1.11. Wage inequality in the Russian Federation, 2000 and 2009 and selected OECD countries, 2008

Gini coefficients[1]



1. Small differences in the calculation of the Gini coefficients across countries may lead to under- or over-estimation of the wage inequality. For instance, the inclusion of part-time salaries in the calculation of the Russian Gini coefficients may slightly overestimate inequality.

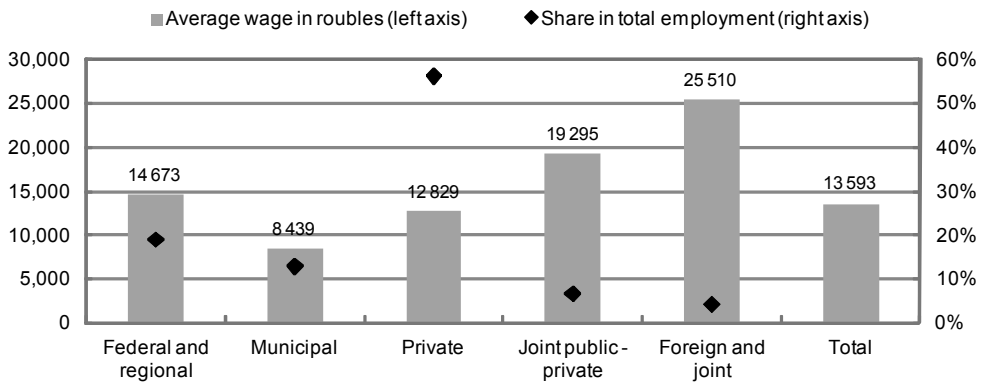
Source: OECD calculations based on the *OECD Earnings Distribution Database*; Rosstat, *Work and Employment Yearbook 2009*.

Wages also differ substantially across ownership. The lowest wages can be found in the municipal sector, at 62% of the average wage level in 2007 (Figure 1.12). The highest wages, on the other hand, are paid in foreign companies or in Russian-foreign joint-ventures, reaching 188% of the average monthly wage. The vast majority (56%) of the employees are, however, employed in private Russian companies, earning on average RUB 12 830 per month (or about USD 430).

A significant proportion of the population living in a household with at least one worker are poor, the so-called "working poor". In 2008, nearly 15% of individuals living in one-earner households in the Russian Federation had an income below the minimum subsistence level (RUB 4 593 in 2008, or 40% of the median income), while 7% of individuals living in two-earner families were poor. Although data on OECD countries are not directly comparable since a poverty threshold of 50% of median income is used (instead of the 40% threshold used in the Russian Federation), on average 14% of individuals living in households with one earner are poor in the OECD area.

To cope with low wages, Russian workers have resorted to secondary activities to supplement their income. Multiple job-holding has developed particularly after the 1998 crisis, jumping from about 1.2% of the employed population in 1998 to 6% in 1999. Since 2001, it has remained at around 4% of the employed population, close to the EU average of 3.7% (OECD, 2008b). The majority of these second jobs are in the agricultural sector (2.8% of the employed population had a second job in marketed agricultural activities in 2007) and in the informal sector. Also, a significant share of the employed population – almost 16% in 2007 (*Source*: Rosstat) – engages in subsistence farming, although it has tended to decrease over the past years (from 24 million persons in 2002 to 19 million in 2007).

Figure 1.12. Average monthly wage and share in total employment by type of ownership, 2007



Source: Rosstat, *Work and Employment Yearbook 2009*.

4. Regional disparities are large but declining

The overall labour market situation described in Section 2 masks strong differences across Russian regions. The best-performing regions include the major cities (Moscow and St. Petersburg) and surroundings, and regions rich in natural resources. Until 2008, unemployment was nearly non-existent in the Central and North-Western Federal Districts, with an unemployment rate of 0.9% in Moscow and 2.0% in St. Petersburg (Rosstat Labour Force Survey). Employment rates reached 70% or more in those regions, as well as in some northern regions rich in natural resources (Yamalo-Nenets and Chukot) (Rosstat Labour Force Survey). The majority of the Russian Federation's inactive and unemployed people reside far away from these

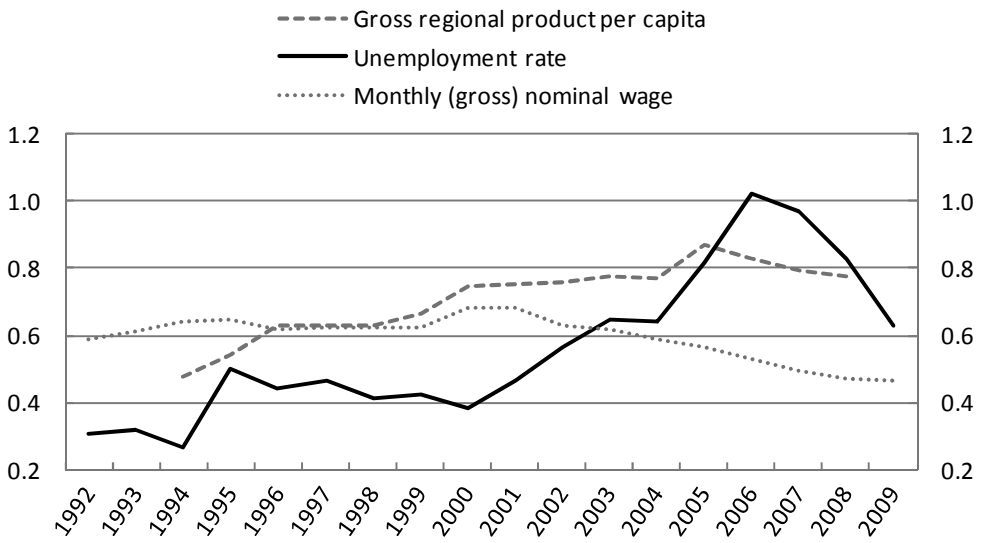
major industrial and commercial centres. In 2008, the highest unemployment rates (for the population aged 15-72) were recorded in the populous regions of North Caucasus, reaching 19% in Tuva, 36% in Chechnya and even 55% in Ingushetia. Also several regions in southern East-Siberia and the Republic of Komi in the North West registered unemployment rates above 10%.

The coefficient of variation for regional unemployment rates nearly quadrupled between 1994 and 2006, but declined strongly in the subsequent two years (Figure 1.13). The initial rise in regional variation reflected both a strong increase in the maximum regional unemployment rate (up from 15% in 1992 in Dagestan to 67% in 2006 in Chechnya) and a strong decline, especially since 2000, in the minimum regional unemployment rate (down in Moscow city from 5.8% in 1999 to 0.8% in 2007). The decline in cross-regional variation since 2007 was initially the result of a drop in unemployment rates in a couple of regions with exceptionally high unemployed rates, while in 2008, unemployment started rising as a result of the economic crisis in many industrial and commercial regions with typically low initial unemployment rates. Nevertheless, the ratio of the maximum to minimum unemployment rate still reached 20 in 2009. As a comparison, the max/min ratio ranged from 2 to 7 in the OECD area in 2003, with the exception of two outliers, Iceland and Italy, which recorded a ratio of respectively 10 and 21 (OECD, 2007b).

Regional variations in labour market outcomes are related to unequal regional growth and a strong concentration of jobs in the most prosperous regions. The highest levels of gross regional product (GRP) per capita are found in the main cities, Moscow and St. Petersburg, and in regions rich in natural resources and energy endowments. These are also the regions attracting the highest share of foreign direct investment (Svedberg *et al.*, 2006). The rapid rise in the price of oil and other natural resources over the past decade further contributed to the increasing GRP per capita differentials. By 2008, GRP per capita in the richest region (Tyumen Oblast) was 24 times that of the poorest region (Republic of Ingushetia) and the coefficient of variation almost doubled since 1994 (Figure 1.13).

Figure 1.13. Regional disparities in the Russian Federation, 1992-2009

Coefficients of variation for selected variables[1]



1. The coefficient of variation is defined as the ratio of the standard deviation to the mean.

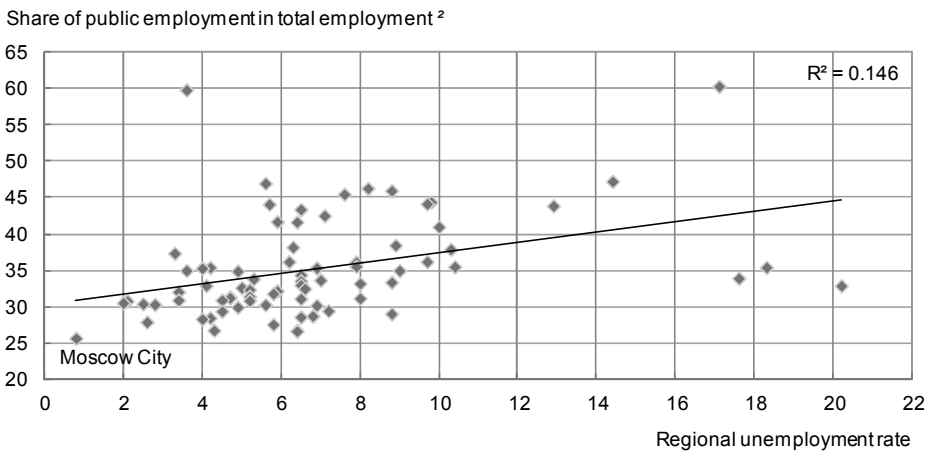
Source: Rosstat Labour Force Survey and OECD calculations.

The divergence in economic growth is, to some extent, related to geographical preconditions (such as the availability of natural resources or strategically attractive location) and the concentrated industrial structure inherited from the Soviet planned economy, with many towns and even entire regions still depending on the performance of a single industry or a single enterprise (one-company towns). There are, however, also a number of institutional and political factors driving the difference in performance of Russian regions, such as the ability and willingness of the local governments to implement (and enforce) economic reforms, and the relationship between the authorities and local enterprises. During the transition to a market economy, the combination of a weak federal government and the lack of a consistent legal framework allowed the new corporate powers (the so-called "oligarchs") to exert strong pressure on local politics and to influence the pace and direction of economic reforms according to their own interests (state capture) (Svedberg *et al.*, 2006). These politically powerful firms continue to create obstacles for the emergence and development of (often more productive) small businesses. Regions with a lower degree of state

capture tend to have higher growth rates and a higher share of small business activity (Mosina, 2006).

The regional divide is also visible in the relative importance of *public employment*. In regions such as Chechnya and Ingushetia, more than 50% of the working population is employed in the public sector or in establishments owned by federal, regional or municipal governments. Overall, there tends to be a positive, albeit weak, relationship between a region's unemployment rate and its share of public employment in total employment (Figure 1.14). In areas with limited private sector demand, local and regional governments tend to use public employment as a kind of social insurance, notably through hiring in public administration.

Figure 1.14. Regional unemployment and the importance of public employment, 2007[1]



1. Two extreme outliers were excluded to improve the readability of the graph. These two regions are Chechnya and Ingushetia with an unemployment rate of respectively 53% and 47%, and a share of public employment in total employment of respectively 55% and 52%.

2. Public employment covers all employees working in firms and establishments owned by federal, regional or municipal governments. This definition includes the public service sector (such as health and education sector and public administration), but also employees working in state-owned enterprises.

Source: Rosstat, *Central Statistical Database* and *Regional Yearbooks*.

Poverty traps hinder internal migration

With high and increasing inter-regional dispersion in economic development and unemployment rates, one would expect people to migrate from poor to wealthier and more dynamic regions. Although statistical information is limited, evidence suggests that internal migration is very low

and has been decreasing over time. According to the official statistics reported by Rosstat, the number of Russian citizens changing their place of residence declined from 4.7 million in 1989 to 1.9 million (or 1.3% of the population) in 2005 (United Nations, 2008). However, as not all migrants register in their new place of residence, the flow of internal migration is probably much larger in reality.

The main obstacles to internal migration are the underdevelopment of financial and housing markets. As people have major difficulties to borrow to pay the migration costs, only those with relatively high incomes are able to afford migration (Andrienko and Guriev, 2004). According to Andrienko and Guriev's estimations, one third of the Russian population is locked in such poverty traps. In addition, an underdeveloped housing market and the lack of access to mortgages keep the rents high in the cities and make them unaffordable to village people.[8]

The low number of officially registered internal migrants is also related in part to administrative barriers. In order to get access to official jobs and local services such as social benefits, kindergartens, school and healthcare, migrants are required to register at the police department of the city of arrival. Even though registration should be granted to all applicants by law, some local authorities (*e.g.* in Moscow and Krasnodar Krai in the South West) tend to abuse the system and request bribes and deny registration (Light, 2007).

5. Educational attainment of the workforce is high, but average quality is rather low

The workforce is highly educated, with mainly technical qualifications

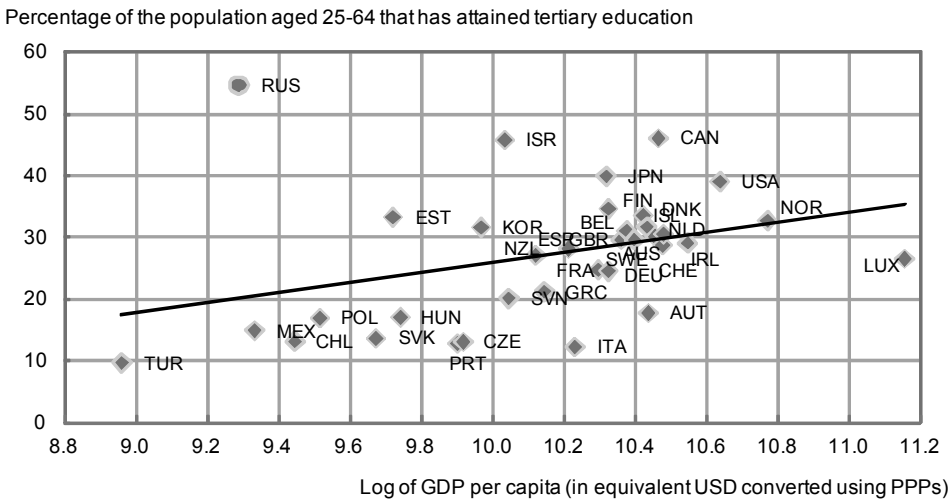
The Russian Federation has one of the most educated workforces in the world and the demand for higher education continues to increase. In 2005, 55% of the Russian population aged 25-64 had attained tertiary education, a level higher than any OECD country. The high educational attainment is even more striking when comparing the Russian Federation with OECD countries with a similar level of GDP per capita (Figure 1.15). Over the period 1990-2005, the number of students enrolled in tertiary institutions rose 1.9 times, illustrating that the high educational attainment of the Russian workforce is not merely a heritage from the communist period, but continues to improve (Kapelyushnikov, 2008).

High educational attainment in the Russian Federation comes from the large proportion of the population (34% in 2003) with a tertiary education type B qualification (OECD, 2007a). These programmes are typically

shorter than those of tertiary type A institutions and focus on practical, technical or occupational skills. A peculiar feature of the Russian educational system is that students can enter tertiary type B institutions after having completed only lower secondary school and can thus not be classified as tertiary students in the strict sense (Kapelyushnikov, 2008). If we consider only educational attainment of tertiary type A attainment, the Russian Federation still scores better than the OECD average, but ranks only eleventh among OECD countries (OECD, 2007a).

On the other hand, according to the new data set on educational attainment of Barro and Lee (2010), the Russian Federation ranks only 25th compared with the OECD countries in terms of average years of education. In 2010, the average number of years of schooling for the population aged over 25 years was 9.8 years in the Russian Federation compared with 10.6 years on average in the 31 OECD countries.

Figure 1.15. Educational attainment in the Russian Federation and the OECD, 2005[1]



1. 2003 for the Russian Federation; and 2004 for Chile.

Source: Based on OECD (2007a), Table A.1.3a.

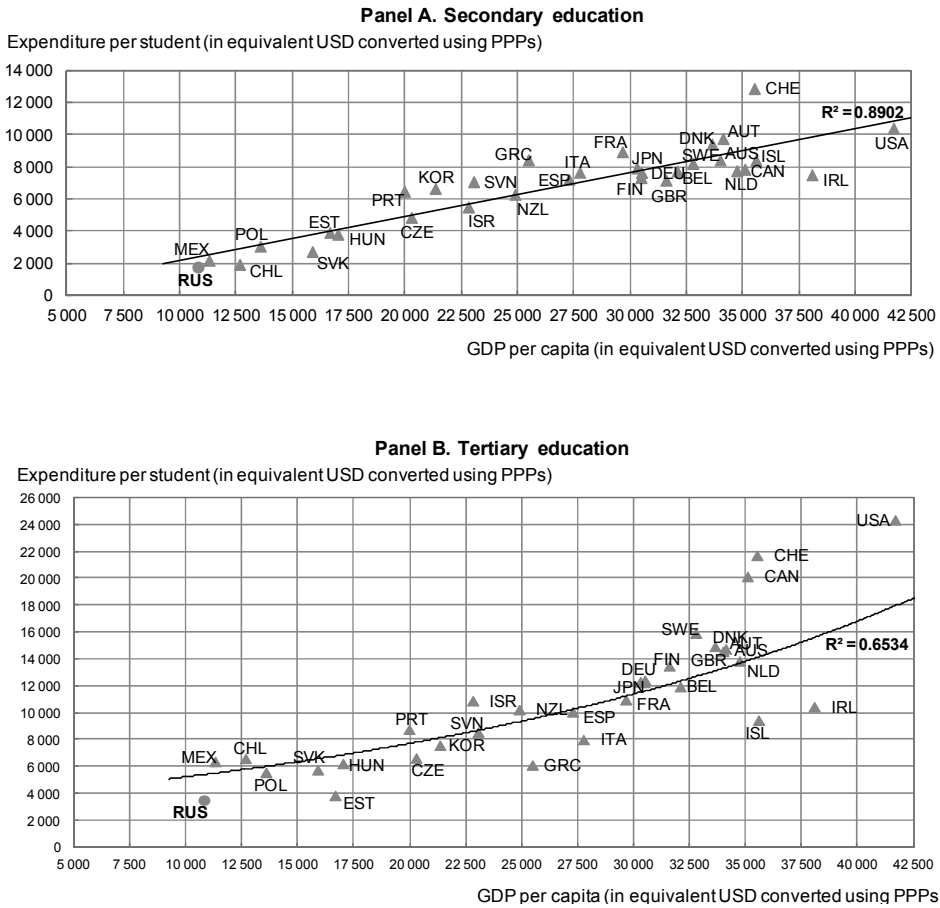
Low spending affects the quality of education

Despite the country's educational achievements, the Russian Federation fares less well in terms of *quality* of education, as perceived by its scores in the OECD Programme of International Student Assessment (PISA). The Russian Federation ranks only 26th compared with the OECD countries in

the performance of 15-year-olds in science, just before Italy and Portugal (OECD, 2008a). The low scores on the PISA test in part relate to the greater emphasis in Russian schools on the acquisition of encyclopaedic knowledge as opposed to problem-solving, innovative thinking and creativity (Fretwell and Wheeler, 2001).

Figure 1.16. Annual expenditure on educational institutions per student relative to GDP per capita, 2005

In equivalent USD converted using PPPs, by level of education



Source: OECD (2008a), Chart B1.6.

Limited spending on education is likely to affect the quality of education as well. In 2005, the Russian Federation spent around 3.8% of GDP on education, while education expenditure within the OECD area ranged from 4.2% of GDP in Greece to 7.4% of GDP in Denmark (OECD, 2008a). For secondary education, the annual expenditures per student are more or less in line with those OECD countries with a similar GDP per capita (Figure 1.16, Panel A), but total expenditures per student in tertiary education lag behind (Figure 1.16, Panel B). The latter is related to the high enrolment rates in tertiary education and the very low wage levels for teachers and professors (65% of the average wage in 2008, *cf.* Rosstat).

Notes

1. The share of young people who are neither in education nor in employment or training (NEET) is low in Russia relative to the OECD average (7.8% versus 13.1% in 2007, *cf.* OECD, 2008b).

2. Cyclical changes in employment and unemployment rates are calculated as deviations from their respective pre-crisis trends over the period during which output growth declined. See Annex 2.A2 in OECD (2010b) for further details about the calculation.

3. One reason could be that older workers (aged 55 and over) are relatively cheap employees, with average wages at around 85% of the average wage level of prime-age workers (25-54 years) (*Source:* 2009 October Wage Survey Rosstat). Many pensioners continue working while drawing pension benefits and are thus willing to accept lower wages. See Chapter 4 for more information regarding the Russian pension system.

4. In part, the opposite adjustment pattern might relate to differences in the data sources. The figures on working hours in the total economy (Panel A) are based on responses of adults who were interviewed as part of the Russian labour force survey and may be subject to considerable reporting error. The figures for large and medium-sized enterprises (Panel B), on the other hand, are based on employer reports.

5. LMEs in Russia are defined as enterprises or organisations (including non-market-oriented state institutions) with more than 100 employees (in industry, transport and construction) or more than 50 employees (in other sectors). In France, the hiring and separation rates in enterprises with more than 50 employees were around 37% over the period 2001-07 (*Source*: Déclaration de Mouvements de Main-d'Oeuvre, DARES). In the United States, hiring and separation rates for establishments of the same size averaged around 50% over that same period.

6. We cannot be sure, however, whether these two types of contracts solely consist of temporary contracts. According to the Labour Code, all labour contracts should be settled in a written form, and oral agreements are thus illegal by principle. There are, however, some workers with very long tenure dating back from Soviet times when contracts often did not exist, who have not signed a contract. Yet,

most of the workers with oral agreement contracts are seasonal and casual workers, household workers, etc. "Contract of work and labour or other civil contract in a written form" are mainly used for workers executing temporary, irregular or specific jobs or providing certain services. However, in some cases this type of contract is used to restrain workers' rights (see Chapter 2) and hence masks permanent labour relations.

7. As the activities of subcontracting agencies are not regulated by law, there is little or no information available on the number of subcontracted workers.

8. For example, if all costs associated with migrating to Moscow from a town situated at 200 km away from the capital are taken into account (*i.e.* the cost of moving, registration (*propiska*) and job searching, and the difference in rent), a painter would start making profit only one and a half years after his arrival in the city (Svedberg *et al.*, 2006).

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Chapter 2

Reinforcing Labour Market Institutions

The Russian Federation needs to reinforce its labour market institutions to improve the balance between labour market flexibility and the protection of workers. Employment protection regulation is relatively strict for workers on permanent contracts with short tenure, but relatively flexible for those on other types of contracts. But labour laws, in general, do not seem to impose major constraints on employers owing to the lax and unequal enforcement. The State Labour Inspection is relatively understaffed and sanctions for labour law violations are too low to act as a deterrent. The collective bargaining framework is fairly developed but has a very limited effect on wages and working conditions given the weak bargaining power of the trade unions. Employers almost entirely set wages on their own, which helps explain wage flexibility. Employment services and unemployment benefits have been scaled up in response to the recent economic downturn, but major restructuring of the system is necessary to provide adequate assistance to all unemployed people and to improve the cost-effectiveness of existing programmes.

1. Introduction

Sustained economic growth prior to the crisis led to significant improvements in labour market participation, especially among women and older workers. The recent economic downturn put an end to these improvements, although the impact on employment and unemployment has been relatively moderate compared with the fall in output. Instead, wages and working hours have borne the brunt of the shock. At the same time, structural weaknesses continue to cause large segmentation in the labour market along various axes.

The overall institutional framework greatly influences the way labour markets function and react to cyclical changes. Institutions are instrumental in stimulating supply and demand of labour and enhancing equal employment opportunities. This chapter reviews the Russian Federation's main labour market institutions and policies, using the framework provided by the *Reassessed OECD Jobs Strategy* (OECD, 2006). The first two sections analyse the employment regulations and their enforcement. The subsequent section discusses the industrial relations and wage setting. The final two sections review the labour market services and professional training in the Russian Federation. The chapter concludes with a summary of the key observations and policy suggestions.

2. Employment protection is not a strong constraint on employers

Regulations are strict for workers with short tenure, but flexible for others

Overall, employment protection – the rules governing the firing of workers and the use of temporary contracts – is not very restrictive in the Russian Federation compared with most OECD member countries. The *overall* index of the strictness of employment protection was 1.9 in 2008 against 2.2 on average in the OECD (Figure 2.1). This is due to low indexes on collective dismissals and on temporary contracts.

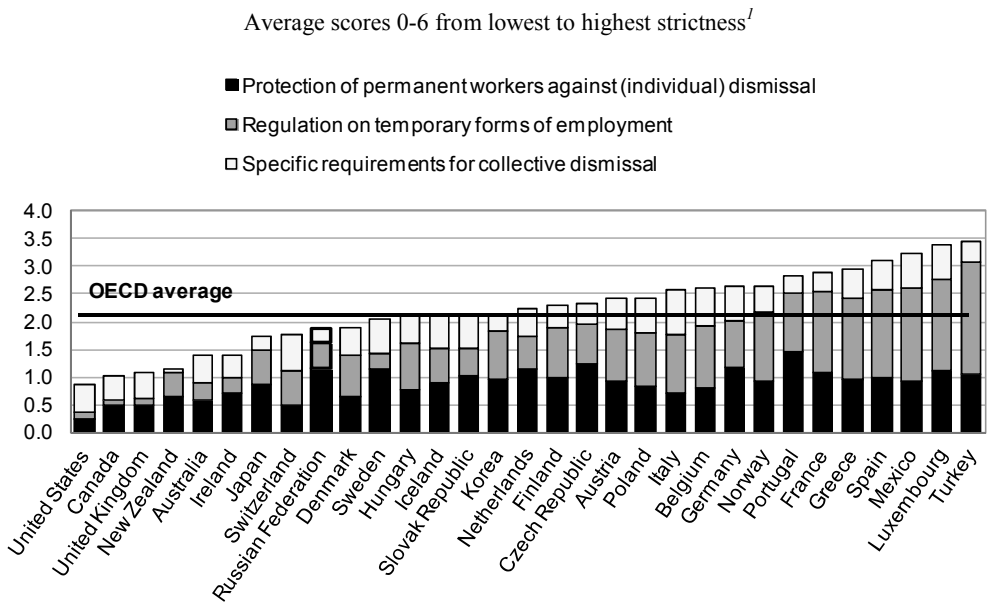
Hiring and firing rules are costly for permanent workers with short tenure

The employment protection index for *permanent contracts* is rather high, reaching 2.8 against 2.1 on average in the OECD – Portugal is the only OECD country with a higher index. However, this is mostly due to the fact that notice periods and severance payments are not related with tenure. The Russian Labour Code stipulates that the employer must give an employee two months' notice, irrespective of his/her tenure (Annex 2.A1). In addition,

the dismissed employee is paid a severance allowance equal to his/her average wage for the period between dismissal and taking up a new job, with a maximum of two months. In exceptional cases, the severance payment can be extended with a third month by decision of a public employment service agency, provided that the employee had applied to that agency within a two-week period after the dismissal and had not been placed in a job in the meantime.[1] For a worker with average tenure, these regulations are not particularly strict by OECD standards (OECD, 2009b), but in the case of short-tenure employees, in particular young workers, these rules become rather costly.

As there are almost no additional regulations on *collective dismissals* in the Russian legislation, collective dismissals are treated as individual ones.[2] The employment protection index on collective dismissals is thus very low, at 1.5 compared with an OECD average of 3.0.

Figure 2.1. Strictness of employment protection in the Russian Federation and OECD, 2008



1. Scores for France, Portugal and the Russian Federation refer to 2009.

Source: OECD Employment Protection Database (*www.oecd.org/employment/protection*). See Annex 2.A1 for a discussion of the OECD employment protection indicator.

Regulations are flexible for temporary contracts

The estimated employment protection index for *temporary contracts* is 1.1 for the Russian Federation against 2.1 on average in the OECD, due to a low index on the use of fixed-term contracts and temporary agency work. The new Labour Code, introduced in 2002, and subsequent amendments in 2006, have liberalised the use of fixed-term contracts, as reflected in their increasing number (see Chapter 1). The previous legislation limited the use of fixed-term contract arrangements by the nature of work, but the new labour code extends the use of such contracts to a wider range of workers and situations, which are precisely documented. One of the most important changes is that small business (up to 20 or 35 employees, depending on the nature of the business) can now hire fixed-term workers without limitation; pensioners or students can also be hired on a fixed-term contract without conditions. The maximum cumulated duration of fixed-term contracts is five years, although in many cases the labour legislation states that such contracts cannot exceed three years.

Subcontracting or temporary-work agency (TWA)[3] is allowed by law (on the condition that the work is temporary in nature) and the same conditions apply as for fixed-term contracts. There are, however, no provisions regulating the activities of TWAs and there is little or no information available on the number of TWAs and subcontracted workers in the country.

Employment protection is not overly strict

Many workers remain de facto uncovered by the labour code

The 2006 amendments to the labour code considerably expanded the description of the status of a private individual operating as an employer and thus expanded the coverage of the labour code to a wider range of economic activities. On the other hand, an increasing share of employers are resorting to civil contracts – such as work contracts, contracts of delegation, or contracts of services provided on the basis of remuneration, instead of employment contracts (Gorbacheva, 2006). Such contracts allow the employer to escape labour regulations, notably to avoid paying social contributions and respect the hiring and firing rules stated in the labour code. Workers under these contracts are not entitled to the guarantees and benefits stipulated in the labour legislation, such as rights to annual paid leave, sickness and unemployment benefits, compensation for work injuries, regular and timely payment of wages, etc. In 2007, about 2% of all salaried employees had civil contracts (see Chapter 1). Another 4% of the salaried workers only had oral contracts, which are very difficult to enforce. Besides, even for those holding a written labour contract, non-conformity of contracts

with the legislation is relatively frequent, implying that labour rights cannot be properly enforced (World Bank, 2003).

Employment regulations are not a binding constraint on employers

Rates of voluntary quits have been exceptionally high in the Russian Federation and layoff rates very low, even during the recent crisis (Chapter 1), suggesting *de facto* that employers find ways to escape employment regulations. Voluntary quits concerned between 64 and 80% of total separations since the early 1990s, while only between 3 and 9% of the separations were forced. For comparison, voluntary quits accounted for about 17% of total separations in France in 2005. As discussed in Chapter 1, a large proportion of the voluntary quits is truly voluntary, but the very low layoff rates, even in times of large economic restructuring, can be partially explained by "forced voluntary" separations. As wages are linked to the financial performance of a firm, they automatically adjust when firms face significant economic difficulties. Employees unwilling to accept large losses in salary take the initiative to voluntarily leave the company and this, in turn, diminishes the need for the company to fire people. Employers can also induce such separations through various forms of deteriorating working conditions, including prolonged administrative leaves, the non-payment of wages, reduced working hours or threat of disciplinary proceedings. In new private enterprises, especially those with no trade union representation, Clarke (2007a) reports that, whatever the terms of the contract, the employer can dismiss an employee without any difficulty.

Overall, managers' perceptions seem to confirm the weak enforcement of employment regulations, but uncertainty about enforcement may also be problematic. In a recent survey covering small, medium and large businesses, less than 5% of the firms ranked labour regulations as a major or severe business constraint (Tan *et al.*, 2007). The cost of labour law violation is also reported as being low. However, 60% of the surveyed managers admit that there are significant differences across firms in the labour law compliance. Employment regulations tend to be more strictly enforced in large firms with stronger labour unions, while rules are hardly binding in small firms. This may contribute to the uncertain climate surrounding business, due to the inconsistent application of laws and regulations on a non-transparent basis. In that same survey, 40% of the large and medium enterprises and 50% of the small firms (with less than 100 employees) report that they are constrained by state regulation uncertainty.[4]

The climate of uncertainty relates to the very specific relationship prevailing between state institutions and businesses in the Russian Federation. Many business owners are more or less directly linked with state

affairs, and important bureaucrats are deeply involved in business or represent their interests (OECD, 2009a). The Russian Federation is also known as one of the more corrupt countries in the world (Business Anti-Corruption Portal, 2008). As a result, politically connected companies are often able to manipulate state institutions for their own interests, and regional and local courts are often subject to political pressures in their interpretation and application of the laws.[5]

3. Enforcement of labour regulation is weak

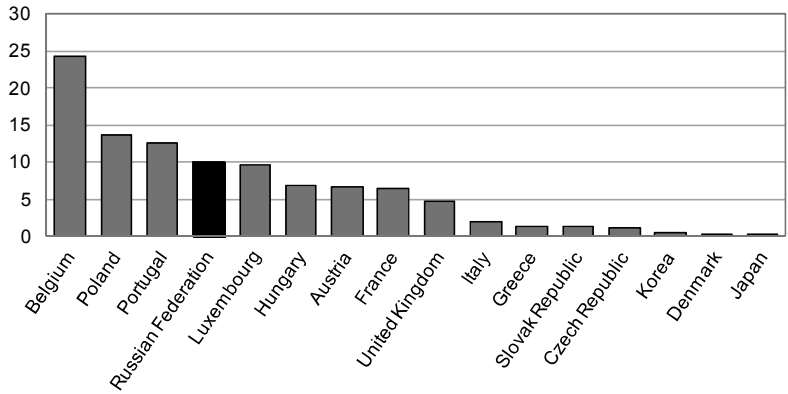
There are no specialised labour courts

As specialised labour courts do not exist in the Russian Federation, claims related to labour rights such as unfair dismissal, non-payment of wages, must be brought by workers to civil courts.[6] To minimise costs and the time needed to solve conflicts, labour disputes can be solved at the enterprise level through individual disputes procedures. While this is a positive aspect in principle, the reconciliation process seems to be rather cumbersome and the time frame is too tight. If the dispute has not been considered within ten calendar days from the worker's application, the case has to be proceeded with in court. Ashwin and Clarke (2003) note that appeal to the courts is often sufficient to persuade the employer to settle, without the need for a hearing.

The number of labour law cases brought to court is relatively high compared with OECD countries (Figure 2.2), but employment cases represent only 5% of the total number of cases, which are mainly concerning (the non-payment of) wages. Evidence on the length of labour cases in the Russian Federation is not available.

Even though employees are relieved by law from paying the court expenses, they are often unable to afford legal representation for financial reasons. Trade unions do not have the right to participate in individual disputes (only in collective labour disputes), but try to offer some legal services instead. Yet, even if the worker wins the case, court decisions are often not enforced and appellants tend to be victimised by the employer (World Bank, 2003). The lack of judges specialised in labour laws also affects the quality of the decisions on labour disputes (Tchetvernina *et al.*, 2001).

Figure 2.2. Number of labour cases per 1 000 of the labour force[1]



1. Data refer to 2005 for the Russian Federation and the latest available year (2002 to 2007) for the other countries.

Source: OECD (2009b) and the Supreme Court of the Russian Federation.

Labour inspection is under-staffed and sanctions are low

The monitoring of labour legislation and occupational safety is carried out by state labour inspectors, but also to some extent by the trade unions.

The State Labour Inspection is a federal service under the jurisdiction of the Ministry of Health and Social Development, but labour inspectors are located in regional offices. Those offices are divided in two branches: *i)* safety and health, in charge of controlling working conditions and accident prevention; and *ii)* labour legislation, responsible for monitoring and analysing claims of labour legislation violations and for undertaking actions to enforce the legislation. In 2007, there were about 3 300 labour inspectors in the country (Federal State Labour Inspection, 2008), which represents one labour inspector per 21 300 employed persons, a ratio in line with the ILO recommendation of one inspector per 20 000 employed persons for transition countries (OECD, 2008). However, unlike in many OECD countries, labour inspectors in the Russian Federation have no support staff to assist them in their activities and the density of inspectors varies greatly across regions (Gimpelson *et al.,* 2009b). Overall, in terms of total staff, Russian labour inspection compares poorly with OECD eastern European countries.[7] While the number of labour inspectors per worker has tended to increase since 2000 in OECD eastern European countries, the number of labour inspectors has been reduced by 15% in the Russian Federation since 2001.

One problem was that inspectors tended to extract undue pecuniary advantages from businessmen rather than officially reporting violations. In addition, inspections were viewed as an excessive regulatory burden on enterprise development (Yakovlev and Zhuravskaya, 2008). Hence, the reduction in the number of labour inspectors was part of a larger set of measures introduced in the early 2000s to reduce the costs of doing business in the Russian Federation. This was done by simplifying procedures and reducing the red tape associated with the entry regulation (registration and licensing) and with the regulation of existing business (all types of inspections). The government also limited the number of planned inspections in each particular business to a maximum of one every two years. Only when a violation occurs can the inspectors revisit a firm in this time frame to check whether workplace practice has changed in compliance with the law.

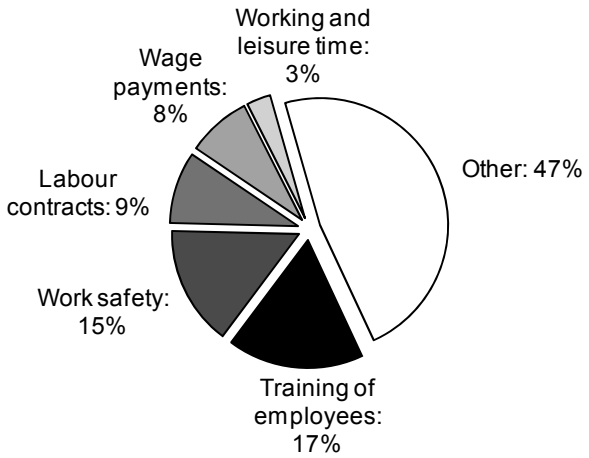
Simply downsizing the inspectorate does not solve the corruption problem, however. The underpayment of labour inspectors remains a major problem. The required level of education for the job is tertiary education, but for example labour inspectors in the Republic of Tatarstan and in Samara Oblast earn respectively 55% and 76% of what people with a similar education earn in other sectors. As a result of the uncompetitive wage, enterprises can easily exert pressure on the inspectors and poaching is actually frequent.

With the current resources and number of state inspectors, the Ministry of Health and Social Development estimated that every enterprise would be checked on average once every 20 years. Given their limited means, inspections mostly take place as a result of complaints or follow up of previous cases. In 2007, only one third of the total number of control missions were planned missions, the rest were targeted inspections following worker complaints or requests by other authorities. The main complaints concern training of employees, followed by work safety, the absence of labour contracts (mostly in SMEs), and wage payments (Figure 2.3). Small businesses are very rarely inspected,[8] and in fact, during their first three years of existence, non-corporate businesses are exempt from planned inspections. If still existing after three years, many of these businesses are simply not in the labour inspectorate database.

In addition to the federal labour inspection, trade unions also have their own voluntary labour inspectors, a practice that remains from the Soviet times when trade unions were the main body responsible for health and safety inspection (Ashwin and Clarke, 2003).[9] However, trade union representatives mainly have a monitoring function and they have to appeal to the State Labour Inspection for enforcement when violations are detected. In 2008, there were about 1 500 legal and technical inspectors from the

Federation of Independent Trade Unions of Russia, the most important trade union organisation. They operate on their own or sometimes jointly with the labour inspectorate (10% of their inspections).

Figure 2.3. Type of registered violations of the labour law, 2008



Source: Federal State Labour Inspection (2009).

Due to their relatively low level, sanctions probably play little role in preventing labour law violations. Fixing the right level of fines requires striking a balance between the objective of acting as a deterrent and the desire to preserve the ongoing viability of the business and to protect workers' jobs (OECD, 2008). In the Russian Federation, fines for enterprises range from RUB 30 000 to RUB 50 000, equalling 18-30% of the average annual wage (Federal State Labour Inspection, 2008).[10] By comparison, in OECD eastern European countries, fines are set between one and nine times the average annual wage (OECD, 2008). For individual entrepreneurs in the Russian Federation, the actual penalty is only 10% of the fine for enterprises, *i.e.* RUB 1 000 to RUB 5 000.

4. Collective bargaining has a limited impact on wages and working conditions

The collective bargaining framework is quite developed but delivers little

Despite relatively high trade union membership and legal provisions for full collective bargaining rights at the federal, sectoral, regional and

enterprise levels, bargaining on wages and working conditions is quite limited in practice. Trade union density has been decreasing since the early 1990s, but it is still at around 50%. This is a relatively high figure compared with many OECD countries, close to that in Belgium and Norway.[11] More than 90% of trade union members are affiliated to trade unions belonging to the Federation of Independent Trade Unions of Russia (FNPR), which groups many trade unions dating back from the Soviet era and some that have emerged after the transition. Although there are a number of other trade union associations, the FNPR is the only trade union taking part in negotiations at the federal level.

Apart from decisions concerning the minimum wage, federal, sectoral and regional agreements provide mostly general recommendations. The general agreement is negotiated at the federal level by the tripartite commission, the most recent one covering the period 2008-10. General agreements consist mainly of: *i*) recommendations on labour and social policies; *ii*) recommended minimum standards generally set at a very low level;[12] *iii*) indexation rules for the wages in the public sector; and *iv*) targeted limits for unemployment rates across the country (Denisova and Svedberg, 2005).

At the sectoral level, collective agreements seem to provide a point of reference for agreements at the workplace level rather than a binding commitment on employers. Employers' representation in these agreements, which used to be very weak, has progressed recently, but about a fourth of the sectoral agreements remain not signed by any employer organisation.[13] In negotiating sectoral agreements, trade unions represent not so much the workers in opposition to the employer, as the interest of the sector in relation to the government (Ashwin and Clarke, 2003). In any case, the effective content of the agreement in terms of wages and labour conditions is limited. Information available for the early 2000s indicates that the section on wages usually only established a minimum wage for the branch and sometimes included an obligation on employers to give priority to the payment of wages over other outlays. Very few agreements made reference to pay scales and even fewer to wage levels, although some provide for indexation to inflation (Ashwin and Clarke, 2003).[14] In their survey of industrial enterprises, Gimpelson and Kapelyushnikov (2007) found that in 25% of the cases, the industrial/regional agreements were considered as providing a low constraint on the independence of industrial businesses surveyed to determine their wages and no constraint in all other cases.

Regional agreements are generally tripartite, but the representative status of employers' organisation is very limited, implying that they are also mainly agreements between the trade unions and regional governments (Clarke, 2007b). For example, in Samara, the organisation of employers

signing the regional agreement (the Union of employers of Samara Oblast) had only 150 members in 2005 (*Source*: *www.warwick.ac.uk/fac/soc/complabstuds/russia/ngpa/SamaraEng.doc*). They embrace issues which do not apparently have any direct relevance to the regulation of labour relations but concern the well-being of the population as a whole. For example, they include general provisions on supporting regional growth and creating employment.[15] Measures to smooth the functioning of the labour market are also included, but most of them are already contained in the federal or regional legislation. A recommendation to work towards raising the wages of full-time workers towards the subsistence minimum level and increasing wages of public employees is often provided, but it is of limited enforceability.

At the workplace level, collective agreement coverage varies significantly across sectors and agreements rarely provide for binding commitments regarding wage increases. According to the Federal Labour and Employment Service, officially registered collective agreements in 2009 covered about 29 million employees or 42% of the total number of employees.[16] A majority of agreements were concluded in public enterprises/entities (education, municipal housing and health). Collective agreements are less prevalent where economic restructuring has occurred more rapidly, since they are rare in smaller enterprise and in the *de novo* private sector. In terms of content, Denisova and Svedberg (2005) note that they often reflect a poor understanding of what collective bargaining really is: it is common that they define the main employers' goal as business growth and the main trade union task as setting labour discipline and favourable working climate.

Trade unions have weak bargaining power

The limited effective content of collective agreements largely reflects the weakness of trade unions. The primary functions of the dominant traditional trade unions at the workplace level have not changed much from those of the soviet times, which were to maintain labour discipline, encourage productivity increase and administer a broad range of social services (Clarke, 2007b). In this context, trade unions tend to still play a mediation role between workers and managers (who can be members of the union) in order to solve a problem before it escalates into a conflict. However, traditional trade unions almost never oppose senior managers in the names of workers and their close ties with management often imply that they limit their activities in the enterprise to the areas the employers are ready to share with them (Tchetvernina, 2009).[17]

Alternative trade unions have been created on the occasion of conflicts in some enterprises. But their development has been strongly limited by a

combination of: *i*) legal provisions on the right to strike and collective representation: *ii*) resistance from the traditional unions; and *iii*) resistance by employers.

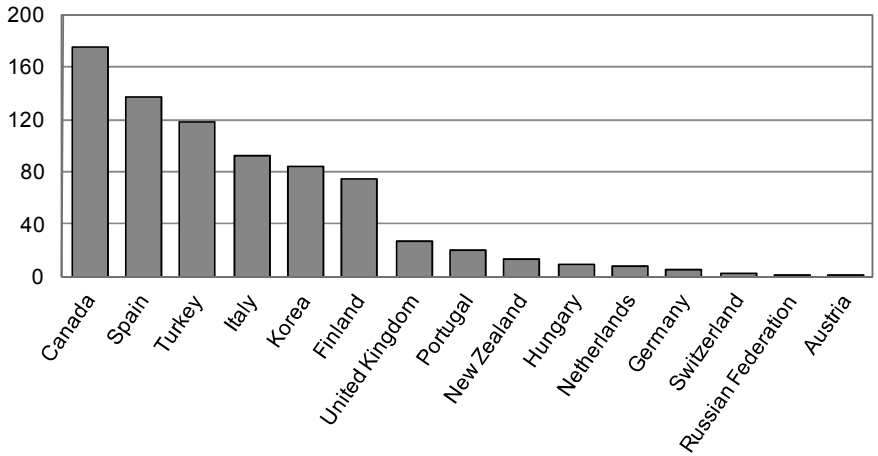
While the law provides for the right to strike, it also makes it difficult to exercise this right. First, the Labour Code limits the possibility to conduct a strike (or any collective action) only on those issues which are included in the workplace collective agreement. Hence, a strike cannot be called, for example, on grounds of delays in the payment of wages or for the failure to pay the legally prescribed rates for overtime, if these issues are not included in the collective agreement.[18] Second, the procedures governing collective disputes are exceedingly complex, implying that most strikes are considered technically illegal and that workers can then be punished by disciplinary sanctions (ICFTU, 2006). Third, a strike may be called only with the consent of a majority of the workers in every establishment affected by the strike decision. Fourth, courts can order the confiscation of union property to settle the damage incurred by the employer. Finally, a minimum level of "essential services" must be maintained during a strike in the public sector. The definition of these services, much broader than ILO standards, deprives most public sector employees of the right to strike (ICFTU, 2006). Even when a strike is authorised, employers are not forbidden to hire substitute labour during the dispute. Perhaps not surprisingly, the recorded incidence of strikes is very low in the Russian Federation compared with most OECD countries (Figure 2.4).

The provisions of the labour code on workers representation are also very restrictive. Only unions belonging to an organisation with a branch representation can negotiate collective agreements with the employer, thus excluding smaller, new independent unions. When the union represents less than half of the workers, the employer can negotiate with "another representative". Also, when there is more than one union in an enterprise, if the various unions do not manage to find an agreement among each other, the majority union will represent the workers. In practice, the traditional union in place may simply not convene the smaller trade union for negotiations.[19]

Finally, private employers have tended to resist the creation and functioning of alternative trade unions. Unions are still largely absent from the *de novo* private sector and remain confined mostly to the public sector and former state enterprises (Clarke, 2007b). When a union is established, employers sometimes ignore union requests to negotiate collective agreements (ICFTU, 2006).[20] Finally, registration rules give law enforcement bodies control over the creation of trade unions, sometimes implying delays or denial (ITUC, 2009).

Figure 2.4. Number of days on strike per thousand employees

Average over the 2000s[1]



1. 2000-06 for Austria, Finland, the Netherlands and Portugal; 2000-07 for the other countries.

Source: Laborsta, ILO and Rosstat.

Wages are fixed by managers

Given that little real bargaining occurs, wage setting is not only very decentralised, but almost completely in the hands of the management. 84% of the industrial enterprises surveyed in Gimpelson and Kapelyushnikov (2007) considered that they were (completely or mostly) free in conducting their wage policy. Unlike in most OECD countries, they even feel freer to set their wages than their output prices. In general, it is the enterprise director or a senior manager who initiates wage increases, most often triggered by an improvement in the financial position of the firm or by labour productivity growth. Local labour market conditions, as well as inflation or the subsistence minimum, also play a role. The whole process is often rather informal, based on negotiation with individual employees or small groups of employees.

The specificity of the Russian wage-setting system lies in the importance of the variable part of the wage compared with the *fixed* part. The former represents around 40-50% of the total wage and is generally based on the result of the enterprise, although this is more or less formalised depending on the type of enterprises (Gimpelson and Kapelyushnikov, 2007). The more sophisticated enterprises among the traditional ones are moving towards a bonus system based on separate indicators for each

workshop (Clarke, 2007a).[21] *De novo* private enterprises have more flexible, simpler, and less transparent systems than traditional enterprises. It is common for them to pay a low official salary, on which taxes and social contributions are paid, and to provide an additional cash payment which is undeclared (Gimpelson and Kapelyushnikov, 2007). Bonuses are not used as an individual incentive mechanism, but cutting bonuses can be used by management as a sanction tool or as a way of prompting the employee to quit voluntarily instead of dismissing him/her (Section 2).

The minimum wage is set at the federal level but regions are allowed to increase it

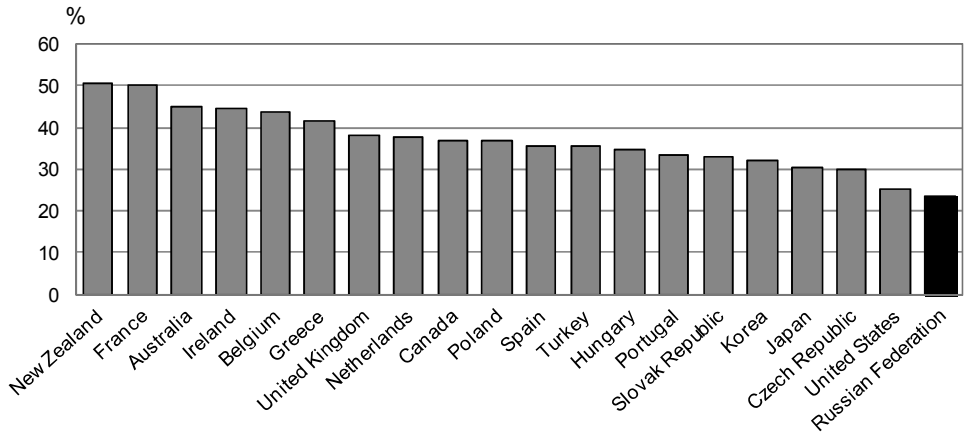
The federal minimum wage is set by legislation, after discussion in the tripartite commission. There is, however, no indexation rule, nor any precise provisions for its setting, and it is very much left to the government decision. In January 2009, the minimum wage was raised from RUB 2 300 to RUB 4 330 (or about USD 140), reaching 24% of the average wage, a low level compared with OECD countries (Figure 2.5, Panel A). Despite several increases over the past three years (the ratio of the minimum wage to the average wage was less than 10% until 2006, see Figure 2.5, Panel B), the minimum wage remains well below the official Russian minimum subsistence level (RUB 5 144 in the fourth quarter of 2009).

Since November 2007, regions have the right to set their own minimum wages above the federal level, provided that the government, employers and trade unions all agree. By 1 October 2008, 59 out of the 91 Russian regions had set their own minimum wages. In 22 regions, the regional minimum wage was set at a level at least equal to the regional subsistence minimum for the working-age population.

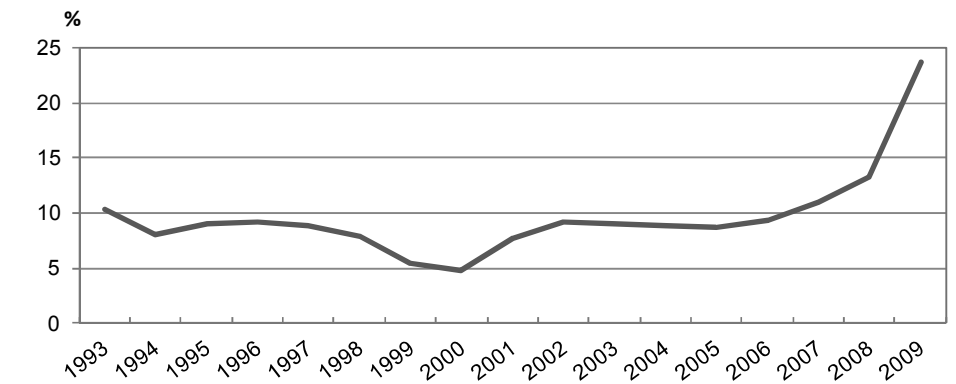
In 21 regions, the regional minimum wage was above the new federal minimum wage of RUB 4 330. In some regions, minimum wages are set only for non-budget sectors of economy, while establishments financed from regional and municipal budgets are exempted from these agreements. The Labour Code gives employers a right to deny joining a regional agreement on the minimum wage, if done in a written form within 30 days after the publication of the relevant regional law.[22]

Figure 2.5. Ratio of minimum wage to average wage, level and evolution

Panel A. Level in the Russian Federation (2009) and selected OECD countries (2008)[1]



Panel B. Evolution in the Russian Federation[2]



1. The denominator is the average wage of full-time workers (over 30 hours of work per week).

2. Minimum wage at the end of the year over the average wage of all workers.

Source: Based on *OECD Minimum Wage Database* and Rosstat.

Overall in 2007, the minimum wage was hardly effective, largely because of its low level, but also because of poor enforcement. In regions with high or medium average wage levels (*i.e.* rich or intermediate regions), very few full-time employees were earning less than the

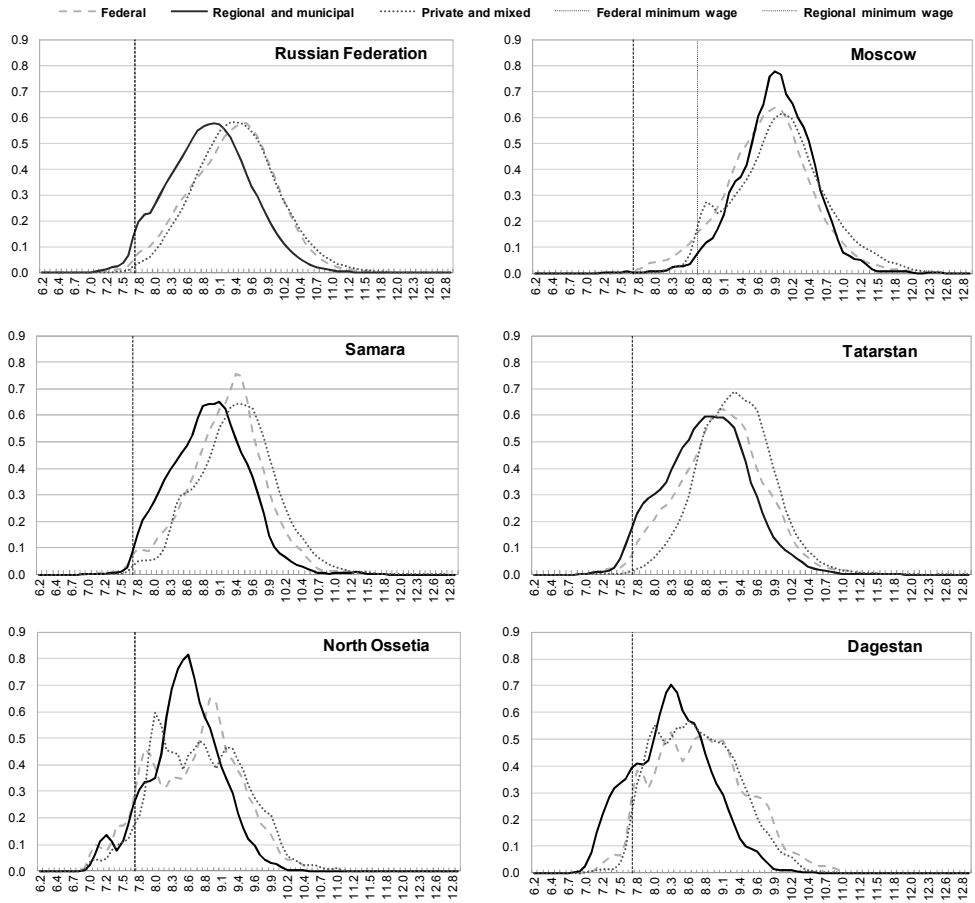
minimum wage (Figure 2.6). This was the case in Moscow, where the regional minimum wage was slightly more than twice the federal minimum wage, but also in Tatarstan and Samara.

In poor regions, however, such as Dagestan and North Ossetia, a non-negligible share of employees received the minimum wage or less, especially in the regional and municipal public sector, but also in the private and mixed (public-private) ownership sectors, and in the federal administration.[23] Except for the regional and municipal public sectors in all five regions shown in Figure 2.6 but Moscow and for the mixed ownership sector in Moscow, no spike could be observed in the earning distributions at the level of the minimum wage in 2007. This reflects the fact that, apart from these sectors, given the very low level of the minimum wage, most workers were paid above the minimum wage.

Given that it took place in the midst of the global crisis, the relatively large increase in the minimum wage in January 2009 did not boost wage inflation. In addition, the minimum wage level remains relatively low, so that the overall effect of its increase on employment is probably limited. Regional and municipal administrations, where wages are lowest, will be most affected by the increase.

In the absence of significant improvements in enforcement policies, the minimum-wage hike is also likely to have raised incentives for non-declaration or under-declaration of wages. Although evidence is not available, in the poorest regions, such as Dagestan, the private sector might also have been affected, at least those enterprises complying with the legislation. In Dagestan, for example, the new minimum wage represented 56% of the September 2008 average wage and this ratio was above 40% in ten other regions. The agricultural sector might be particularly concerned, as the minimum wage represented more than 50% of the average wage in the sector in 41 out of the 91 regions, reaching a ratio of close to 130% in Dagestan.

Figure 2.6. Earnings distribution of full-time employees by sector, 2007[1]



1. The horizontal axis represents log earnings. The vertical axis represents the scaled density (so that the area under each curve is equal to one). The sample includes full-time employees who worked more than 30 hours per week in the reference month.

Source: Based on 2007 October Wage Survey.

More flexible wage setting for public employees

Wage setting in the government sector has undergone major changes in recent years. Until 2008, employees of all government levels (federal, regional and municipal) had the same pay system, based on the unified tariff scale (UTS) defined by the federal government with a link to the federal minimum wage. Two teachers in the same region with the same grade in the

tariff scale thus earned the same wage, even though heads of establishments had some room for manoeuvre through providing supplementary payments for extra-curriculum tasks, overtime and other types of bonuses.

Since December 2008, the wage system for federal employees has been completely reformed towards a much more flexible system. Wages are no longer based on the UTS, but determined by collective agreements, local and other regulatory legal acts in accordance with the Russian Labour Code that establish the base salary, a multiplication ratio and compensation payments. The base salary is determined by the minimum salary, the job position and the required qualification level, but establishments can apply (general or individual) multiplication ratios to allow for more flexibility. In addition, workers receive compensation payments – *i.e.* individual bonuses for high performance and work quality, and seniority and work experience payments. These payments are stipulated by law and should be at least 30% of the wage,[24] but the heads of establishments have significant flexibility in increasing the amounts subject to justification. The new system thus provides a lot of flexibility, even though there is a restriction that the total wage bill of the top manager should not be more than five times the average wage within an institution. Overall, wage inequality has significantly decreased in the public sector between 2007 and 2009, but this seems to be more related to the strong increase in the minimum wage than to the new wage system.[25]

5. Expenditure on labour market policy is very low

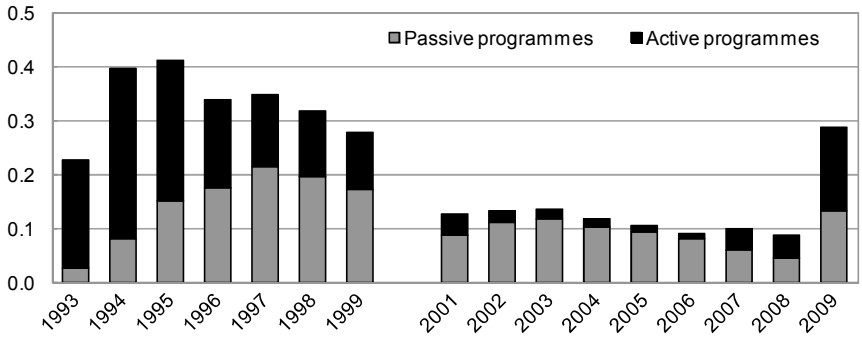
Employment promotion and unemployment protection programmes are financed through the Federal Compensation Fund (see Box 2.1) and are the responsibility of the Federal Employment Service (FES). The latter is a department of the Federal Labour and Employment Service (Rostrud), which is part of the Federal Ministry of Health and Social Development since 2004. As part of a more general process of decentralisation of responsibilities towards the regions, the regional public employment services (PES) have been subordinated to regional authorities since January 2007. They have become part of the regional ministries responsible for labour issues, although their staff is still paid by the federal government. The FES retained the power to control and to supervise the activities of the regional public employment services, whereas the latter received increased responsibility in the implementation and financing of active labour market programmes (ALMPs).

Box 2.1. Funding of labour market programmes

Before 2001, labour market programmes depended on the Employment Fund, which was financed by an employer social contribution of 2% of the wage bill until end 1995 and 1.5% subsequently. The system suffered from a number of problems, however. First, starting from 1995, the functioning of the employment fund was undermined by sizeable arrears due by employers – a problem similar to other parts of the budget (Gimpelson and Lippoldt, 2001). Second, the collection of social security contributions was decentralised and the regional Employment Funds often stopped transferring the 20% share of their collection to the federal branch of the employment services, as required by federal rules. This severely limited the redistribution of funds between surplus and deficit regions.[a] Third, federal control over regional expenditures was limited and the lack of a legislative framework resulted in inefficient use of the resources for unauthorised purposes (Tchetvernina *et al.*, 2001). Lack of transparency in operations allowed regional government officials to put pressure on the PES to use the funds for political ends, *e.g.* to support a local company with political connections. While most of the resources of the employment fund were initially devoted to ALMPs, the growth in unemployment benefit claims and the decline in the overall budget resources led to a progressive reduction of the ALMP share in total labour market policy spending in the second half of the 1990s (see figure below).

Labour market expenditure in the Russian Federation, 1993-2009

In percentage of GDP



Source: Gimpelson and Lippoldt (2001) for 1993-99; Rosstat and Federal Service for Labour and Employment for 2001-09.

The introduction of the Unified Social Tax (UST) in 2001 – collected by federal tax authorities – put an end to the decentralisation of the collection of social security contributions and the Employment Fund was abolished.[b] Since then, labour market policies have been financed through the Federal Compensation Fund in the form of transfers to regions. Each year, the regions make a projection of the number of registered unemployed for the following year and estimate their expenditures. Depending on the federal budget and the priorities set by the Ministry of Health and Social Development, funds are allocated

between regions in proportion to the projected number of registered unemployed. There is, however, little information available on the exact allocation procedures and, according to Zubarevich (2007), the distribution system is subject to severe manipulation. Local governments are allowed to use their own financial means to co-fund active measures, but regional expenditures remain minor. For instance, in the Republic of Tatarstan, the regional budget accounted for only 8.7% of the total ALMP budget in 2006 (Urban Institute, 2007).

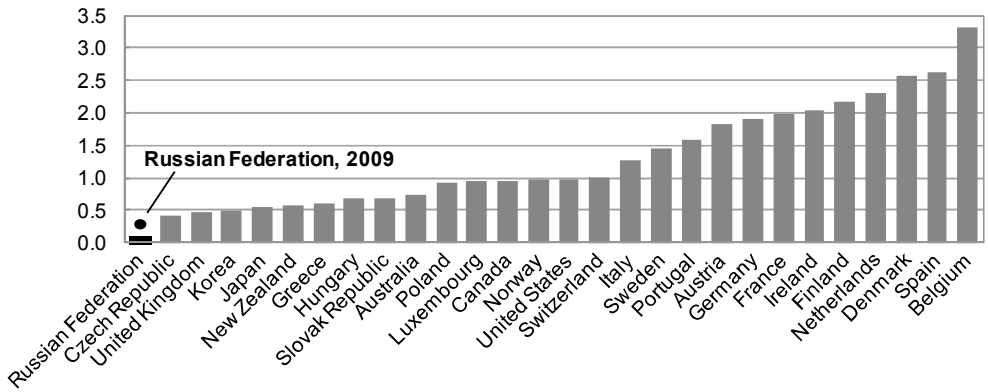
a. In 2000, only 11 out of 89 of the regions were able to fully pay their contributions to the Employment Fund (Tchetvernina *et al.*, 2001).

b. For a description of the UST, see Chapter 3 and Kuznetsov and Goncharenko (2008).

Despite a doubling of the budget in 2009 to deal with the economic crisis, the Russian Federation's labour market policy expenditures are far below those of OECD countries. The strong increase in unemployment due to the crisis pushed the government to raise the initially very low level of the maximum unemployment benefit and to expand active labour market policies (see below). As a result, expenditure on labour market policies tripled from 0.09% of GDP in 2008 to 0.29% of GDP in 2009, remaining nevertheless at around one-fifth of the average OECD spending (Figure 2.7).

Figure 2.7. Expenditures on labour market policy in the Russian Federation and OECD countries

In percentage of GDP, 2008[1]



1. Data for the United Kingdom, New Zealand and Norway are for 2007. Data for Greece exclude expenditures on PES and administration.

Source: OECD Labour Market Programmes Database and Federal Service for Labour and Employment (Rostrud).

Unemployment benefits are available to most registered unemployed but are very low

There are two types of unemployment benefit available:

- *An earnings-related benefit* is available to those who worked at least 26 calendar weeks (or the equivalent for part-time employment) during the last 12 months. The benefit is equal to 75% of the previous wage during the first three months of unemployment, 60% for the next four months, and 45% thereafter. Despite a 60% increase in January 2009, the cap on the unemployment benefit remains at a rather low level: RUB 4 900 in 2009, representing 26% of the average wage in the same year.[26] There is also a floor for the benefit, set at RUB 850 in 2009, *i.e.* 4.5% of the average wage, augmented with a regional coefficient. The total duration of the earnings-related benefit is 12 months;

- A *flat-rate unemployment assistance benefit* is available for all individuals who do not qualify for the first type of unemployment benefit or have exhausted their 12-months earnings-related benefit. The unemployment assistance benefit equals the minimum unemployment benefit (RUB 850 in 2009 plus regional coefficient) and is also limited to 12 months.

The pool of eligible recipients of the Russian unemployment benefit system is large compared with other countries. Every registered unemployed is eligible for unemployment compensation, including individuals without previous work experience, individuals dismissed for disciplinary problems, re-entrants to the labour market, dropouts from training programmes, and long-term unemployed. The system thus works as a quasi-social assistance programme. At the end of 2009, 87% of the registered unemployed were receiving an unemployment benefit, the majority of whom received the low unemployment assistance benefit, either because they had no work experience or were trying to resume working after a break, or because they were long-term unemployed.[27]

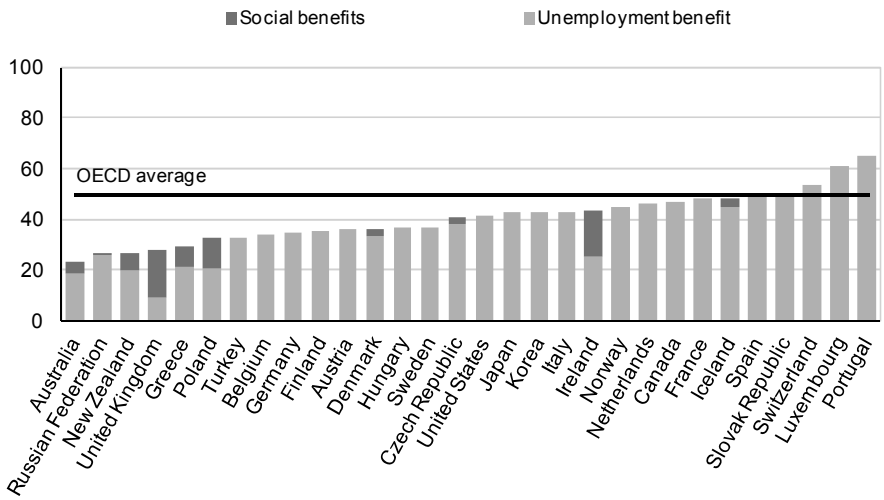
Despite the strong increase in the maximum benefit in 2009, the *net* (after tax) replacement rate associated with the unemployment benefit is very low in the Russian Federation compared with most OECD countries. At the initial stage of unemployment, the estimated net income replacement rate for a single person previously earning the average wage was 26% in 2009, compared with 50% in the OECD on average in 2008 (Figure 2.8, Panel A). For long-term (over 12 months) unemployed people in the Russian Federation, the replacement rate drops to 5% of the previous wage.

In some cases, additional benefits significantly increase the net replacement rate. Besides unemployment benefits, registered unemployed have access to various subsidies and preferences, including supplements, reduced fees for community services, and discounts on medicines (Denisova, 2003). In addition, like other Russian citizens, unemployed people are eligible for housing and utility allowances if their expenditures on housing and communal services exceed the threshold set by the regional government.[28] These two allowances are the most important items in the "social benefits" component of the net replacement rate shown in Figure 2.8. In the case of one-earner couples with two children, these benefits bring the total net replacement rate more in line with the lower end of OECD countries, at around 47% of the previous wage (Figure 2.8, Panel B).

In practice, however, the replacement rate is likely to be lower than indicated above, because few people seem to actually take up the housing and utilities allowance. According to World Bank (2005), only one-fourth of eligible persons applied for the housing subsidy in 2002.

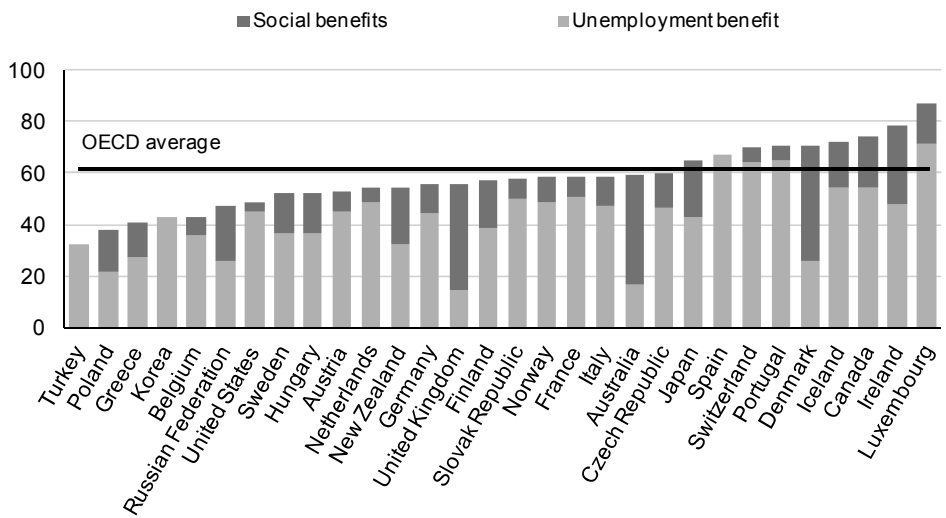
Figure 2.8. Net income replacement rates at the beginning of the unemployment spell for persons previously earning the average wage, 2008[1]

Panel A. Income replacement rates for single persons without children



1. Data for the Russian Federation are for 2009. The replacement rates take into account unemployment benefits as well as other cash benefits (such as social assistance, family benefits, housing benefits, and child-raising allowance).

Panel B. Income replacement rates for one-earner-couples with two children[2]



2. The spouse of the unemployed person is assumed to be "inactive" in the sense that she/he is not working and does not have a recent employment history. However, where receipt of unemployment benefit/ social assistance is subject to activity tests (such as active job-search or being available for work), these requirements are assumed to be met. Children are aged 4 and 6 and neither childcare benefits nor childcare costs are considered.

Source: *OECD Benefits and Wages Database*.

The ALMP budget is insufficient and evaluation is scarce

Besides administrating unemployment benefits, regional public employment centres are also responsible for the implementation of ALMPs. However, the ALMP budget tends to be limited – 0.04% of GDP in 2008 or RUB 12 per registered unemployed person per year – which restricts the PES' ability to properly assist people in their search for a new job. Local governments are allowed to use their own financial means to co-fund active measures, but so far regional expenditures remain minor (see Box 2.1 above). As PES staff have little time for each jobseeker, personal assistance provided to the registered unemployed is limited, and most time is spent on basic administrative procedures.[29] No doubt, despite the significant increase in resources during the crisis, the increase in registered unemployed people due to the economic crisis is likely to have worsened the caseload situation.

To limit the social costs of the economic downturn, the Russian authorities introduced an anti-crisis package in early 2009, accounting for about 0.1% of GDP, which raised the total ALMP budget in that year to 0.15% of GDP. The programme is centrally funded with regional execution and covers a range of policy measures, with a strong focus on public and temporary works schemes both for unemployed people and for people in work but at risk of dismissals (*cf.* Box 2.2). A package of a similar size and content is foreseen for 2010.

As in many OECD countries, the anti-crisis package has played a role in preserving jobs in the short run and providing income support to underemployed workers, *i.e.* workers who are temporarily on unpaid leave or reduced working time, although it is difficult to assess to what extent. According to Rostrud, 130 000 enterprises and 2.8 million people, corresponding to 4% of the labour force, participated in the different programmes in 2009 and about half of the underemployed workers benefited from public and temporary work schemes.

The downside of short-time and public work schemes is that they tend to generate large deadweight losses and hinder structural changes if kept for too long (OECD, 2009b). It is very difficult to assess *ex ante* whether a firm's economic difficulties are indeed temporary and the protected jobs will be viable once the subsidy is terminated. At the same time, some subsidised jobs would probably have been preserved even in the absence of the government subsidy.

So far, there has been little or no evaluation of the ALMPs in the Russian Federation. The FES estimates the efficiency of ALMPs by comparing the ratio of those who found a job after participating in a training programme over all registered unemployed and find good results. However, this is partly by construction since the PES often only provides training under the condition that there is a contract with an enterprise at the end of the programme. Evaluating the same ALMP in two different Russian regions – *i.e.* Voronezh province and Chelyabinsk city – Akhmedov *et al.* (2003) found that in the region where the PES was seen more as a social support institution than as a labour market institution, Voronezh, the programme tended to lengthen the unemployment spell whereas it had the opposite effect in Chelyabinsk city.

Box 2.2. Policy measures to address the crisis

The predominant ALMP measure in the anti-crisis package is "public and temporary works", accounting for 72% of the total labour market anti-crisis resources and 87% of all participants (see Table). In fact, the name of the programme is slightly misleading as it actually consists of *i*) wage subsidies for employees at risk of layoff (63% of the participants); and *ii*) direct job creation (37% of the participants).

- The first component is a type of short-time work or partial unemployment scheme similar to those introduced in many OECD countries (OECD, 2010a) and seeks to preserve jobs and provide income support to workers who are on unpaid leave or on reduced working time. But unlike in OECD countries, participants to the scheme are meant to provide some kind of public work for the enterprise (*e.g.* cleaning the premises) or for the local community. The PES compensates for the wage reduction due to a cut in working hours up to the minimum wage (RUB 4 330) plus regional supplements and payroll taxes. There are no rules with regards to the maximum duration, but the average period of engagement was two months in 2009. Although, since there was no personal registration of programme participants in most regions, a worker could participate several times in the same programme.

- The second component consists of public works targeted at harder-to-place unemployed people who receive no benefits or who have been unemployed for more than six months. These public works are organised both in the private and public sector, and participants receive the minimum wage, plus regional supplements and possible additional compensation paid by the enterprise, depending on the type of work. They may also retain their unemployment benefits if they are entitled to it.

For workers at risk of dismissal, enterprises can also apply for subsidies from the employment centres to organise training, either in-house or externally. However, the PES can use the federal funds only to finance the cost of the training – *i.e.* teachers' salaries, office lease, procurement of training material, etc. – but not the participants' salaries. The latter should be paid by the company according to the regulations provided in the Labour Code, collective agreements or individual labour contract.

Other measures include:

i) self-employment assistance in the form of business start-up subsidies – equalling 12 months of the maximum unemployment benefit (*i.e.* RUB 58 800);

ii) mobility grants for unemployed people who are willing to move to a region with better job opportunities (aimed at city dwellers who are willing to move to rural areas, not the other way around); and

iii) assistance to the largest automobile company in the Russian Federation, AVTOVAZ, in the form of wage subsidies for workers on unpaid leave or part-time working schemes.

Anti-crisis labour market programme in 2009

Panel A. Participants

	Participants		Labour force status of the participants (%)			
	Number	In % of total	Unemployed <6 months	Unemployed >6 months	Other non-employed	Workers at risk of dissmissal
Public and temporary works	2 434 473	87	11	4	22	63
Trainining programmes	216 017	8	-	-	-	100
Mobility grants	11 033	0.4	22	6	64	8
Self-employment assistance	127 609	5	82	17	1	-
Assistance to AVTOVAZ[1]	14 651	0.5	-	-	-	100
Total	**2 803 783**	**100**	**14**	**4**	**19**	**63**

Panel B. Expenditures

	Total expenditures		Average duration of the programme (days)
	Roubles ('000)	In % of total	
Public and temporary works	25 570	72	57
Trainining programmes	1 354	4	32
Mobility grants	387	1	80
Self-employment assistance	7 523	21	-
Assistance to AVTOVAZ[1]	750	2	43
Total	**35 584**	**100**	**-**

1. AVTOVAZ is the largest automobile company in the Russian Federation (about 100 000 workers), situated in Togliatti, the largest one-company town in the Russian Federation near Samara. The company experienced a major fall in sales due to the economic crisis and was close to bankruptcy. To prevent social unrest, the government assigned a special programme to support the AVTOVAZ workers, although it is basically the same as the "public and temporary works" measure.

Source: Federal Service for Labour and Employment (Rostrud).

The assistance system for the unemployed functions poorly

In the Russian Federation, there is a substantial difference between the unemployment rate based on labour force survey data (ILO definition) and registered unemployment (derived from the administrative data of the Federal Employment Service). In 2009, the registered unemployment rate stood at 2.8%, while the ILO-based unemployment rate was 8.5%. By comparison, registered unemployment in the 18 OECD countries for which data are available was on average 8.2%, compared with an ILO-based unemployment rate of 8.3%.[30]

This difference is largely the result of the weak assistance provided by the PES that discourages registration of the most employable unemployed.

This is related to a combination of factors including: *i*) low levels of unemployment benefit; *ii*) administrative costs associated with the registration procedures; *iii*) lack of interesting vacancies; *iv*) very limited resources for active labour market programmes; and *v*) a popular belief that the PES cannot really help. Only those workers without (or with least employable) qualifications seek assistance from the PES, whereas others rely on informal contacts, the media, vacancy fairs or private agencies to find a new job. As a result, the PES *de facto* functions more as social assistance services than as employment services and enterprises tend to report vacancies to the PES mostly if they cannot find a candidate on the market because the offered conditions are too poor.[31] According to the Statistical Report of the Federal Employment Service, almost half of the reported vacancies at the PES in 2009 offered wages below the regional subsistence minimum level, while 60% of the vacancies concerned a job for a period of less than three months.

Companies largely rely on the media and internet to fill their vacancies, and, for those vacancies with specific technical skills more difficult to fill, on private or foreign employment agencies, which are more costly. These agencies operate through a head-hunter system and have a relatively large and up-to-date database, and they charge a fee usually comprised between one or two months of salary. Private employment agencies are growing in number and importance, and are especially common in financial, trade and computer industries, and international business (Denisova and Svedberg, 2005). However, for the time being, these private agencies are not considered to be playing an important role in reducing unemployment.

Both employers and trade unions are aware of the deficiencies of the system and attribute them to the lack of resources available for labour market policies. In this context, they consider desirable the re-introduction of an unemployment insurance system, based on specific contributions (*cf.* Box 2.1.).

6. A policy for professional training is lacking

Notwithstanding the large proportion of the population with technical education (*cf.* Chapter 1), many Russian industrial firms complain about the lack of qualified technical workers in the labour market. According to the Russia Competitiveness and Investment Climate Survey (ICS) of the World Bank, the proportion of manufacturing firms reporting understaffing started to increase in 1999 and by 2005 one in four firms reported that the existing personnel was insufficient to meet the expected demand (Gimpelson *et al.*, 2009a).[32] Especially the shortage of skilled manual workers seems problematic, with more than half of the surveyed manufacturing enterprises

reporting shortages in this skill group. To a large extent, however, this skill shortage is likely to be related to the poor working conditions offered by these enterprises to the workers (*cf.* Chapter 1). While the more efficient firms manage to attract workers with the required skills by paying an adequate wage premium, less efficient firms – kept afloat by persistently weak competitive pressure in product markets – are unable to offer competitive wages but at the same time do little to attract or retain workers (Gimpelson *et al.*, 2009a).

While the incidence of training is relatively high in the Russian Federation, companies provide training to very few of their employees and for a rather short period. Evidence from the Russian Investment Climate Survey suggests that about 70% of large and medium-sized enterprises (LMEs) in the Russian manufacturing sector provide in-service training to their employees (Tan *et al.*, 2007). While this is relatively low compared with West European countries such as the United Kingdom, the Netherlands and Sweden – where more than 90% of LMEs provide training to their employees – the Russian Federation's training incidence is higher than in Portugal, Hungary and Poland (OECD, 2005).[33]

Nevertheless, in those manufacturing LMEs that provide in-service training, only 8% of the skilled workers and 1% of the unskilled workers receive formal training (Tan *et al.*, 2007). These figures are confirmed by household data from the Russian Longitudinal Monitoring Survey (RLMS), covering both the public and private economy, where 7% of the employees said that they received training in 2003 (Lazareva, 2006).[34] These percentages are extremely low in comparison with OECD countries where the average adult population participation rate in learning activities is around 40% (OECD, 2005).

The average duration of training reported in the RLMS household dataset was 47 days in 2003 (Lazareva, 2006) versus 2-3 weeks in manufacturing LMEs according to the Russian ICS survey (Gimpelson *et al.*, 2009a). The majority of on-the-job training is financed by firms (68% in 2003 based on RLMS), especially in the manufacturing sector where training is almost solely financed by the firm.

With the collapse of the Soviet system, the (nearly) mandatory training system in Russian enterprises, as well as their close relationship with educational institutions, was largely destroyed (except in the health and education sector) and today there exists no (federal) policy to encourage on-the-job training or lifelong learning. There are no financial incentives for enterprises to invest in training and the lack of a transparent and credible certification system and borrowing constraints for individuals discourage workers from investing in their skills upgrading.

7. Conclusions

The characteristics of the Russian labour market discussed in Chapter 1, in particular the strong reaction of wages and working-time to cyclical changes, and segmentation along various axes, are in part the result of the weakness of existing labour market policies or institutions. While many of the problems would also require actions in areas outside the labour market, such as competition policy and tax policy, developing and improving labour market policies and institutions would promote a more equitable and efficient economic system.

Employment protection regulations are not overly strict – except for permanent workers with short tenure – but there is widespread evidence that labour regulations are poorly enforced in the Russian Federation. Even so, enforcement does not seem to rank high on the government priorities: the State Labour Inspection is relatively understaffed and underpaid. Higher penalties for employers found in breach of labour regulations could probably act as a first deterrent and provide a more effective incentive for employers to comply. Labour law enforcement could be further strengthened through an increase in the number of labour inspectors, combined with an increase in their wages to reduce corruption. The lack of enforcement is more entrenched, however, and is the result of the very specific relationship prevailing between state institutions and businesses in the Russian Federation, whereby business owners are often linked with state affairs and bureaucrats are involved in business. Pressures are exerted in both directions, leading to pervasive corruption.

The existing collective bargaining framework has little real impact on wages and working conditions. Due to the limited bargaining power of trade unions, wage determination is not only decentralised but almost entirely in the hands of employers. Official trade unions are often still in a position close to that occupied during the soviet times, *i.e.* as a mediator between employers and workers, while the emergence of more representative trade unions is still limited by some provisions in the labour law and the weak enforcement of others. In order to reduce the imbalance in bargaining power the following reforms could be envisaged:

- The right to strike should be strengthened by *i*) extending possible strike triggers beyond issues pertaining to collective agreements; *ii*) simplifying the procedures governing collective disputes; and *iii*) easing quorum requirements;

- The labour law provisions regarding workers representation should be revised to allow trade unions without branch representation to

participate in collective agreements and minority trade unions should be given effective access to collective negotiations;

- The freedom of association should be better enforced.

The economic crisis and the upsurge in unemployment put the social safety nets and employment services under pressure to provide adequate assistance to job losers and other affected workers. The government acted promptly and introduced a package of policy measures soon after the first symptoms of the labour market slack became visible in early 2009. The increase in the maximum unemployment benefit and the introduction of short-time and public works schemes limited to a certain extend the social costs, but the employment services system has deep-rooted functional problems that have to be tackled for the system to become effective.

The public employment centres currently function more as social assistance centres than as public employment services. Despite the increase in 2009, unemployment benefits are too low to lift unemployed people out of poverty and the limited ALMP budgets do not facilitate employment centres to provide effective services. As a result, they do not reach the target group of unemployed with immediate previous work history and spend most of their resources on assistance payments to socially vulnerable groups.

In order to improve the Russian employment services system, major restructuring is necessary. Introducing a well-designed unemployment insurance system could allow for more effective income support to job seekers and give workers greater incentives to register as unemployed, including high-skilled workers. This would in turn motivate firms to register their vacancies with the employment centres and participate more actively in the decision-making process for the design of active labour market programmes. A better functioning employment services system would also help make the labour market more transparent and encourage the formalisation of informal jobs. To avoid the problems experienced in the 1990s, the collection of funds should be centralised (at the federal level) and clear and transparent rules should be established for the reallocation of funds.

The tripling of the budget for labour market programmes to tackle the job crisis is a step in the right direction, but it is important that these additional resources are maintained after the recovery. The Russian government should then reorient the active labour market programmes towards addressing structural unemployment. The emphasis on short-time work schemes, while useful for temporary shortfalls in production, becomes increasingly problematic in the longer run and can create significant distortions in the labour market. It is thus vital to shift the focus towards

cost-effective programmes that facilitate transitions from unemployment to work and shorten the unemployment spell, such as job-search assistance and counselling, training and education, and direct job creation. The Russian authorities can learn from international experience in good practices and should invest in rigorous programme evaluation.

To encourage in-service training, the Russian government could develop a federal training policy. Based on OECD experience, there are various ways, *e.g. i*) creating a transparent and credible certification system; *ii*) providing financial incentives for enterprises, such as profit tax deductions or levy/grant schemes; *iii*) introducing individual learning accounts or training subsidies; and/or *iv*) promoting coordination between the education system and social partners.

Notes

1. There is no empirical evidence on the extent to which this provision is used by public employment services in practice.

2. According to a small survey conducted in 2002, 23% of the collective agreements contained provisions regulating mandatory dismissal procedures (Gimpelson and Kapelyushnikov, 2007). However, these provisions do not seem to have a significant impact as there is no difference in the intensity of dismissals in firms with such provisions in their collective agreements compared with firms without restrictions.

3. Employees of temporary work agencies are included in the staff of the agency but work in other companies in need of their specific skills, for periods ranging from a few hours to several years.

4. The Business Anti-Corruption Portal (2008) reports that many SMEs choose to operate in the shadow economy because they prefer the instability of the informal economy over the instability related to running a legitimate business.

5. On the other hand, in regions with few employment alternatives (*e.g.* in "one-company towns"), employers will avoid laying-off workers to maintain good relationship with the government authorities, which is often essential for them to survive (World Bank, 2010b).

6. In 2003, labour law cases were estimated at 12.8% of all civil law cases (Gorbacheva, 2006).

7. According to a survey done for Chapter 2 of the *OECD Employment Outlook 2008*, the number of workers per labour inspector was about 14 200 in the Czech Republic, 6 700 in Hungary, 9 800 in Poland and 9 300 in the Slovak Republic. Also, in the Czech Republic, Poland and Slovak Republic, labour inspectors represented only between 50 and 60% of the total staff of labour inspectorates.

8. According to the World Bank Enterprise Surveys, less than 15% of enterprises with two to ten employees had been subject to a labour or social security inspection in 2005.

9. Until 1996, labour inspection was performed only by trade unions and financed out of the social security funds.

10. In 2010, the Ministry of Health and Social Development submitted a draft proposal to the federal government to raise the level of penalties that can be imposed by the labour inspectorate to RUB 500 000.

11. In practice, however, the relevance of the membership ratio is limited by the fact that many trade union members are not aware that they belong to a union.

12. Borgnäs (2006) notes that the recommended minimum standards are often of little or no practical use to the unions at a lower level.

13. In 2009, 13 out of the 58 sectoral agreements were signed by the federal government and trade union representatives only. More than 50% of the 61 sectoral agreements in force at the end of 2007 were not signed by any employer organisation, while in 2005 only five out of 57 sectoral agreements were signed by employers.

14. Even in sectors dealing with public employees, such as health and education, the Finance ministry is not represented in the negotiations, so that the agreement cannot include any commitment with budgetary implications.

15. Clarke (2007b) indicates that this reflects the fact that the regional agreements do not represent a contract between the unions and employers but between the government and the people, with the unions serving as the government-appointed representatives of the people.

16. According to the Russian authorities, the coverage of the collective agreements at the workplace level has slightly improved since then. In 2009, 230 000 collective agreements were registered, covering about 29 million employees or 42% of the total number of employees.

17. For example, according to the Samara University survey monitoring the labour and social sphere of businesses in the region, only 15% of the workers believed that the trade union had any power in the enterprise in 2006. Results of the survey are analysed in *Проблемы труда, трудовых отношений и качества жизни*, Самара 2007.

18. Conflicts over the terms and conditions of employment not included in the collective agreement are defined as individual labour dispute between each employee and the employer, and should be resolved in the Labour Disputes Commission.

19. For example, in the largest car factory in Russia, Avtovaz (105 000 employees), the traditional union never invited the independent trade union to form a joint negotiating commission.

20. The International Trade Union Confederation also reports some evidence of anti-union discrimination practices, including intimidation, mistreatment, harassment, dismissal and in some cases physical attacks (ITUC, 2009). In January 2010, two cases were submitted to the ILO Committee on the Freedom of association by independent trade unions and endorsed by the FNPR. These cases involve a series of violations of trade union rights, including by state authorities. They have not been settled yet.

21. A formerly state-owned aluminium enterprise visited by the Secretariat had a rather elaborate system in place, with four different indicators set at the workshop or department level, such as fulfilling job duties, respecting safety rules, and fulfilling the time schedule.

22. According to the Federal Service for Labour and Employment, employers refused to accept the regional agreement in ten out of the 18 regions which had introduced a regional minimum wage in the first half of 2008.

23. Moscow is a rich region, with an average wage two times higher than the national average wage. Samara and Tatarstan are intermediate regions, with average wages representing 100% and 80% of the national average wage, respectively. North Ossetia and Dagestan are among the poorest regions with an average wage equal to half the national average wage (*Source*: October Wage Survey 2007).

24. In 2009, the average federal wage consisted of a fixed part of 43%, 16% for compensation and 41% for incentives.

25. According to Rosstat, the ratio of the 10% highest average wages over the 10% lowest average wages in the public administration declined from 13.8 in 2007 to 9.8 in 2009, due to a much lower increase in the top decile of wages (+26%) than in the bottom decile (+78%).

26. In fact, the cap is set at a level even lower than the minimum subsistence level, which was RUB 5 144 in the fourth quarter of 2009. In 2008, the cap on the unemployment benefit represented 18% of the average wage.

27. *Source*: *Federal State Statistical Report* on the provision of state services in the field of employment promotion and Federal Service for Labour and Employment.

28. In Moscow, for example, the threshold of housing expenditure in total household income is 3% if per capita income in the household is between RUB 800 and

RUB 2 000; 6% for the range RUB 2 000 to 2 500; 10% if higher than RUB 2 500. Above these thresholds, households receive housing subsidies to cover their housing expenditures. Yet, the subsidies are restricted to a living space within the "social norm". For instance, for a single-living person the social norm is 33m2. If his living space is larger, the rest of the costs will not be covered.

29. For example, in the Republic of Tatarstan, each staff member has 100-200 clients and sees about 30 persons a day, each interview lasting around 15 minutes. In Samara, staff members are called "inspectors" and the job seeker stands in front of a counter behind a window when talking to them.

30. *Source*: OECD Main Economic Indicators and Labour Force Survey.

31. According to the Public Employment Service in Samara, around 35% of all vacancies in Samara Oblast are reported to the center.

32. Gimpelson *et al.* (2009) use the Russia Competitiveness and Investment Climate Survey (ICS), which was conducted in 2005 by the World Bank and the Higher School of Economics and contains a representative sample of around 1 000 large and medium-sized firms (with 100 employees or more) in the manufacturing sector.

33. Training incidence is not directly comparable, however, as the OECD study reports figures for enterprises with more than 250 employees and enterprises with 50-249 employees, while the ICS survey covers enterprises with 100 employees or more.

34. Lazareva (2006) uses the Russian Longitudinal Monitoring Survey (RLMS), which is a nationally representative survey of around 5000 households and has 16 rounds of repeated cross-section sampling over the period 1992-2007.

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Annex 2.A1
Employment Protection in the Russian Federation

To compare the rigidity of employment protection regulation across countries and over time, the OECD developed a method for calculating employment protection strictness for 21 basic items on a scale from 0 to 6, with 0 representing total flexibility and 6 the highest possible rigidity (Venn, 2009). Each score is weighted in order to obtain aggregate indices for three main areas: *1)* employment protection for regular workers against individual dismissal; *2)* regulation of temporary forms of employment; and *3)* additional requirements for collective dismissals. Based on these three indices, an overall score can be calculated representing the rigidity of a country's employment protection as a whole. The following table contains a description of the employment protection scores for the Russian Federation based on the Russian Federation's Labour Code as applicable in 2009.

Table 2.A1.1. The Russian Federation's employment protection scores, 2009

Component	Sub-component		Legislation	Score	EPL index
Procedural inconveniences	1. Notification procedures		Trade union must be notified for trade-union members	3	Regular contracts = 2.8/6
	2. Delay to start notice period		11 days for union members / 1 day for non-members	1	
Notice and severance pay for no-fault individual dismissals	3. Notice period after	9 months	2 months	6	
		4 years	2 months	4	
		20 years	2 months	1	
	4. Severance pay after	9 months	2 months	4	
		4 years	2 months	3	
		20 years	2 months	1	
Difficulty of dismissal	5. Definition of unfair dismissal		A transfer and/or retraining to adapt the worker to	4	
	6. Trial period		3 months	4	
	7. Compensation		6 months	1	
	8. Reinstatement		It is always made available	6	
	9. Maximum time for claim		1 month	1	
Fixed-term contracts	10. Valid cases for use of fixed-term contracts		Exemptions exist on both the employer and the employee	2	Temporary contracts = 1.1/6
	11. Maximum number of successive contracts		No limit	0	
	12. Maximum cumulated duration		60 months	1	
Temporary work agency (TWA) employment	13. Types of work for which TWA is legal		Same conditions as for fixed-term contracts, but no	1.5	
	14. Restrictions on number of renewals		No limit	2	
	15. Maximum cumulated duration		60 months	1	
	16. Authorisation and reporting for TWA		No requirements	0	
	17. Equal wages and conditions for TWA		No requirement for equal treatment	0	
Collective dismissals	18. Definition of collective dismissal		Additional regulations apply from 50 dismissals upward	1.5	Collective dismissals = 1.5/6
	19. Additional notification requirements		Trade union must be notified for trade-union members	1.5	
	20. Additional delays involved		30 days	3	
	21. Other special costs to employers		No additional requirements	0	

Source: The Russian Federation's Labour Code as applicable in March 2009.

Chapter 3

Supporting the Working-age Population More Effectively and More Fairly

Strong economic growth until 2008 led to a reduction in official absolute poverty rates since the beginning of the new millennium. The financial crisis has interrupted the downward trend but it has not led to a poverty rebound. However, large income inequalities remain in the Russian Federation. Poverty risks are highest among children. The social support system in the Russian Federation is not geared towards the working-age population who, if not physically or mentally impaired, are widely held to be undeserving of social support. In addition, the redistributive power of the social protection system is limited. Social benefits are badly targeted and social security contributions are paid on income up to about 1.5 times average earnings in 2010.

In 2005, reform introduced the cashing out of in-kind benefits. This process has improved transparency in spending. But inefficient and badly targeted social outlays limit the ability to address poverty among the working-age population. The deepening demographic imbalance also requires more investment in measures such as pre-school supports which would help parents find a better balance of work and family responsibilities.

This chapter reviews trends and current outcomes in income distribution and poverty, including indicators on relative poverty to facilitate comparison with OECD countries. It identifies the population groups most at risk of poverty and their chances of moving in and out of poverty. The chapter reviews existing social policies, and recent attempts to find better ways of allocating public resources for those most in need, in particular families with children. It concludes with a summary of the main challenges and suggests reform avenues to develop a social protection system which would support the working-age population more effectively.

1. Introduction

Strong economic growth until the end of 2008 contributed to a reduction of poverty in the Russian Federation as measured by *absolute poverty* benchmarks. The subsequent sharp economic slowdown in 2009 did not generate a significant increase in overall poverty rates as labour market adjustments involved reduced working hours rather than lay-offs (Chapter 1), and because pension payments increased almost by 50% since 2007 (Chapter 4).[1] However, growth in economic prosperity has had only a limited effect on *relative poverty*. Since the start of the new millennium, the poor have made some gains in the Russian Federation, but others gained at least as much and there has not been a significant change in the large income disparities in the Russian Federation.

The redistributive power of the current tax/benefit system in the Russian Federation is limited. The social support system includes an important remnant of the Soviet era via a system of "privileges" (*e.g.* housing and utility subsidies), whose award is related to physical and mental impairments, but also for those with special service records and/or occupational benefits (who are not necessarily the poorest in society). There is also a fairly comprehensive pension system (Chapter 4), some insurance-based programmes for the working-age population and in terms of overall expenditure some relatively small income-tested programmes for low-income families. Finally, the financing of social support involves considerable distribution of natural-resource generated wealth across the country, but is otherwise regressive with a flat-rate personal income tax scheme and a social security contribution scheme levied on earnings up to about 1.5 times the average wage.

Reform is under way and some progress has been made towards increasing transparency, reducing inefficiencies and improving targeting with the cashing out of in-kind benefits that started in 2005. Compared with overall social spending, this "monetisation reform" was limited in magnitude, and the categorical nature of the benefit system has not yet changed fundamentally; whether paid out in cash or in-kind, benefits still mainly go towards deserving categories of recipients rather than being income-dependent (except in a few cases, *e.g.* child benefits).

The poverty risk is highest among children and the working-age population without access to seniority and/or occupational-related privileges. Indeed, the social protection system is not geared towards the working-age population, and this is likely to have contributed to both the elevated poverty risk of families and the choice by young people to postpone parenthood and/or have fewer children. Notwithstanding the recent increase in birth rates,

demographic trends add to the need for effective reform of the existing social protection system.

This chapter does not pretend to be in any way complete in terms of the coverage of the wide range of social policy challenges that the Russian Federation faces. In particular, housing benefits and housing policy reform warrant a much more detailed account than is possible to give here. The chapter begins by reviewing trends in income distribution and poverty. It discusses some of the strengths and weaknesses of the available datasets, and presents information on the characteristics of those most at risk of poverty, the depth of poverty, regional disparities and conditional probabilities to move and out of poverty. Then it discusses social expenditure, its financing and ongoing reform to improve the efficiency and targeting of the social protection system. The fourth section of the chapter casts an eye over work and family outcomes and recent policy reform to help parents have as many children as they want at the time of their choice (OECD, 2011a) and address the issue of persistently low birth rates.

2. Income disparities and poverty

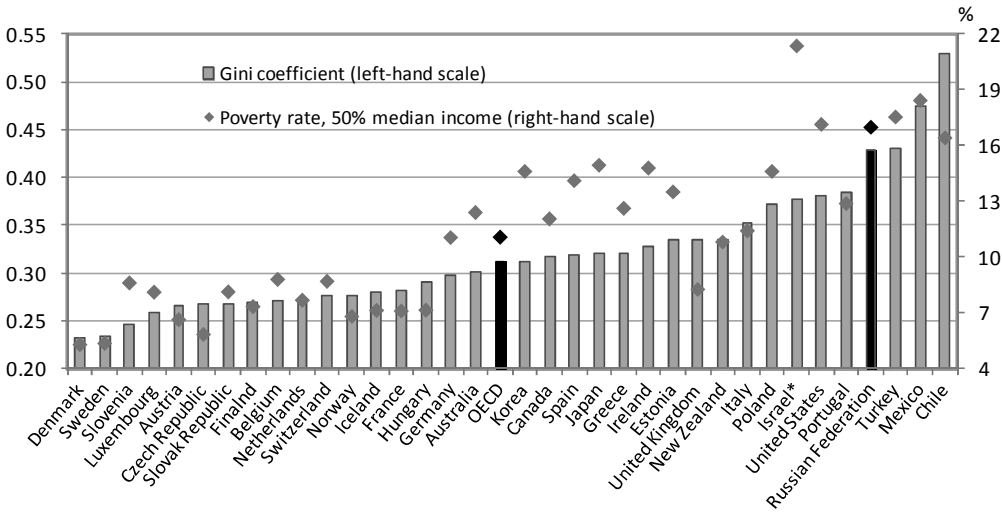
Income inequality

Income inequalities are substantial in the Russian Federation, and in international comparison, income inequalities are wider than in all OECD countries, except Chile and Mexico. Poverty rates also rank among the highest across the OECD area (Figure 3.1). The relative poverty rate, as measured against 50% of equivalised median household income, was around 17% in 2008; this is comparable with relative poverty rates in Chile, Mexico, Turkey and the Unites States, but not as high as in Israel (OECD, 2008a and 2010a).

In view of the large earnings differences in the Russian Federation (Chapter 2), it is no surprise that at almost 43% the Gini coefficient on income inequality is well above the OECD average of 31%. Available income data based on a small panel-data set suggest a Gini coefficient that is about 5 percentage points higher (Figure 3.2) than the Rosstat statistics on income distribution and poverty (Box 3.1). Other sources suggest that in reality income dispersion is much wider than this: because of shortcomings of the RLMS-sample and the methodology underlying the official statistics which both affect the measurement of high incomes, the "real" Gini coefficient on income inequality could be as high as around 60% (Yemtsov, 2008).

Figure 3.1. The Russian Federation has high poverty rates and a wide income distribution compared to most OECD countries

Income inequality (Gini coefficients) and relative poverty



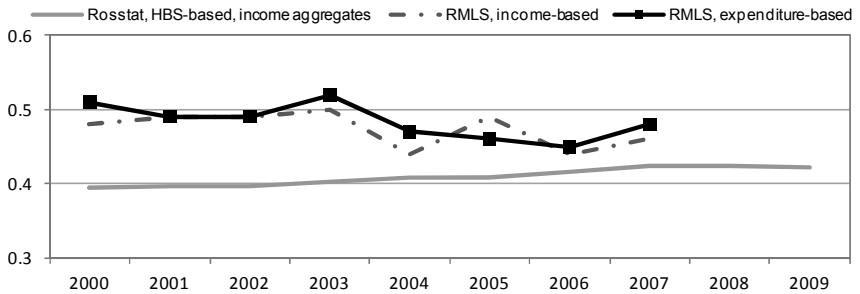
Note: Countries are ranked in increasing order of the Gini coefficient of income inequality. Data refer to the distribution of household disposable income in cash across people, with each person being attributed the income of the household where they live adjusted for household size.

* Information on data for Israel: *http://dx.doi.org/10.1787/888932315602*.

Source: OECD (2008a; 2009a; 2009b; 2010a and 2010b), and data provided by Rosstat.

Figure 3.2. Income disparities appear to have changed little in the new millennium

Gini coefficients of inequality based on different sources (Rosstat, RLMS) and concepts (income and expenditure)



HBS: Household Budget Survey; RLMS: Russian Longitudinal Monitoring Survey.

Source: Based on Denisova (2011) and Rosstat (2010a).

Box 3.1. Data sources for measuring poverty and income inequality in the Russian Federation

Since 1997, Rosstat's quarterly Household Budget Survey (HBS) of about 50 000 households is the basis for aggregate expenditure statistics, and official data on poverty and income inequality. The data contains detailed information on expenditures and transfers (based on diaries), and data are adjusted in a complicated and non-transparent manner to account for sampling and non-response biases. The only source of data on aggregate incomes of Russian households is the balance of monetary incomes (and expenditures) of Russian households; Rosstat compiles this dataset on the basis of all available sources of information (including wage surveys) for both national and regional levels. These two sources are then "combined" to estimate an income distribution on the basis of the HBS data assuming that average household income is equal to that estimated on the basis of the balance of monetary incomes. Inevitably, this process involves more or less arbitrary choices, which raises questions on the quality of the data (World Bank, 2005; and Yemtsov, 2008). Subject to availability of the necessary funds, Rosstat hopes to address the lack of detailed income data by introducing a household income survey covering 160 000 households in future.

In April/May 2003, Rosstat surveyed 45 000 households in its national survey of welfare and social programmes participation (NOBUS). The household and individual questionnaires included detailed questions on household composition, the consumption and income patterns, and other issues including the various benefits and discounts received by households, and the labour market status of adult household members. Although slightly dated by now, given its size and the geographical distribution of respondents, the NOBUS is considered to be particularly useful for regional analysis of the 46 regions that were covered (Denisova and Kartseva, 2005; and Denisova, 2011).

Another data source on income and expenditure is the Russian Longitudinal Monitoring Survey (RLMS): a household survey jointly operated by the Population Centre of the University of North Carolina and the Institute of Sociology of the Russian Academy of Sciences. The RLMS is a panel with 16 waves covering 1992-2007; there were three data collection rounds in 1993, but there are no data for 1997 and 1999. Since 2000, data are collected annually (Artomonova *et al.*, 2007). However, the sample is small at around 4 000 households or about 10 000 persons, and it is biased toward the low-income populations (the sample does not cover those who change residential area and new buildings which are often occupied by richer households). The RLMS does not seem to be representative at regional level, not least because of the low response rate and high attrition in major cities. Then again, the questionnaire is quite comprehensive on the income side in terms of wage and non-wage incomes of adults (with a special section on small-scale farming) and on expenditure patterns including detailed questions on food consumption in the last seven days and non-food consumption over the last three months.

In terms of sample size, the HBS and the NOBUS are preferable over the RLMS, certainly when it comes to regional analysis, but NOBUS data only refer to 2003. Hence, where possible the HBS data are used in this report. The RLMS data facilitate panel analysis and its income data have been used for the calculation of relative poverty measures in line with the prevailing OECD methodology (Denisova, 2011; and OECD, 2008a).

Rosstat (2010a) suggests that in 2008, the top 20% of earners in the Russian Federation claimed almost half of the national income, while the income quintile below had just over 20% of income. The remaining 60% of the population claimed just 30% of all income, with the bottom quintile having just 5% (Annex 3.A1, Table 3.A1.1).

Regardless of the source and income data being used, all indicators suggest that large income disparities have persisted since 2000 (Figure 3.2). Rosstat data suggest the Gini increased markedly in the early 1990s and has been relatively stable since 1993 (Annex 3.A1, Table 3.A1.1). The income share of the top quintile increased from 33% in 1989 to 47% in 1995 and it remains at this level; the income share of the bottom quintile dropped from almost 10% in 1989 to 5-6 % in 1993/94 and has been around that level ever since (Annex 3.A1, Table 3.A1.1).

Relative and absolute poverty

Comparison of poverty indicators across OECD countries is based on a *relative income* measure, with the standard OECD measure of relative poverty being the "equivalised" (accounting for different numbers of people in a household) household incomes below 50% of the median (OECD, 2008a). The relative poverty series presented in Figure 3.3 is based on data from the Russian Longitudinal Monitoring Survey (Box 3.1 and Denisova, 2011).

The relative poverty rate (based on RLMS data) has edged up from just over 20% in 2000 to just below 25% in 2004, but since then has fallen to below 20% (Figure 3.3), and there is little difference between expenditure and income-based measures (Annex 3.A1, Table 3.A1.2). Notwithstanding the recent decline in poverty at 16.5%, the relative poverty rate in the Russian Federation (as based on RLMS data) is high compared with the OECD average of 10.6% in 2005 (OECD, 2008a).

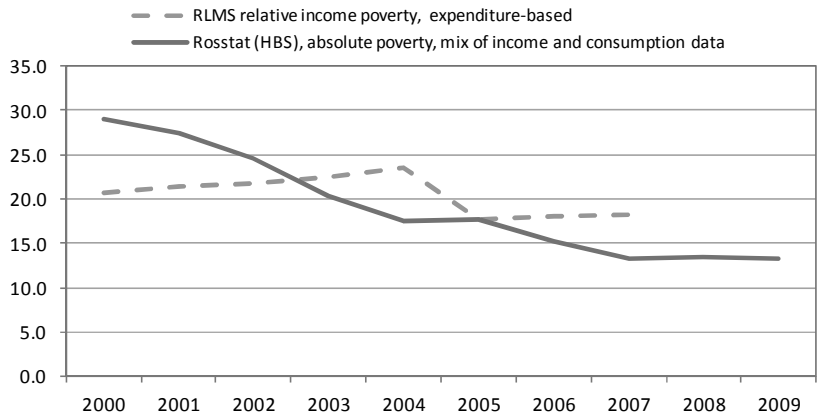
Over the 2000-05 period incomes more or less increased at similar rates across different income groups, and it was only in 2005 that lower income groups started to make relatively large income gains leading to a reduction in the relative poverty rate. For the years 2006 and 2007, Denisova (2011) showed that incomes in the bottom 5% of income earners grew by around 20 percentage points annually, while incomes of people in the higher income groups grew on average by around 12.5% per annum.

In view of the wide income distribution and the large group of people with very low incomes, a minimum subsistence standard is useful to measure poverty in absolute terms (Box 3.2). Figure 3.3 shows that, while relative poverty slowly edged upwards until 2005, absolute poverty as measured

against a minimum basket of goods and services (the minimum subsistence standard discussed below) has been declining from 29% in 2000 to 13.4% in 2009. Income-based data from the RLMS confirm this strong downward trend over this period.

Figure 3.3. Absolute poverty has fallen since the beginning of the new millennium, but relative income gains for the poor have been limited

Relative and absolute poverty measures based on HBS and RLMS datasets



HBS: Household Budget Survey; RLMS: Russian Longitudinal Monitoring Survey.

Source: Based on Denisova, 2011, forthcoming, Denisova and Dorofeeva (2010), Rosstat (2011a).

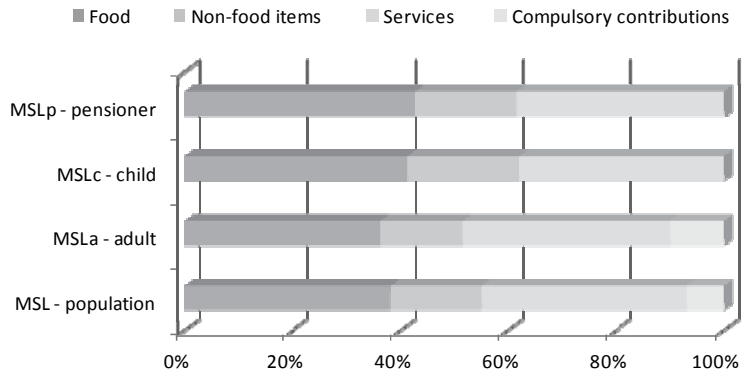
Public policies have been able to contain poverty increases in the context of the economic crisis. Since 2007, Rosstat's absolute poverty rate has been stable at around 13%. BOFIT (2010) suggests that without the sharp increase in pension payments (Chapter 4) the *absolute* poverty rate would have increased to 17%. The World Bank (2010) projects absolute poverty rates to fall further to about 10% in 2011.

Box 3.2. The minimum subsistence level

The minimum subsistence level (MSL) plays a key role in the Russian Federation, both in the assessment of poverty and through linkages with benefit entitlements in the development of policy. This official poverty line was established in 1992 and revised most recently in 2005 under the supervision of the Ministry of Health and Social Development. The value of the MSL is updated each quarter to reflect price and cost-of-living developments.

The MSL is based on three minimum consumption baskets including a detailed listing of items (main items between brackets): *i)* food (cereals, potatoes, vegetables, meat, fish, dairy products, eggs, etc.); *ii)* non-food products (clothing and footwear, stationary, and detailed specifications of sanitary, medical and domestic products); and *iii)* services (the cost of housing, utilities, water, transport, culture, and a set amount of 15% of all spending on services). In addition, for the working-age population account is taken of the costs of compulsory contributions. The official food and non-food baskets are determined by experts rather than household behaviour (see World Bank, 2005 for a detailed discussion). Overall, food items account for close to 45% of the MSL, while the cost of services constitutes about 35%.

Minimum subsistence level structure, fourth quarter 2009



Source: Rosstat (2010b).

The MSL is established for a working-age adult (MSLa), a pensioner (MSLp) and children (MSLc). In addition, the MSL varies by region with each of the 83 regions setting its own MSL within the federal guidelines. In general, the MSL for pensioners is about 70% of the MSLa, with the MSL for children being just below 90% of the MSLa. However, this varies across regions (see table below). For example, in both Samara and Tatarstan (regions visited by an OECD team in 2008), the MSLc is about 87% of the MSLa, while this is 83% in Moscow. However, in Samara the MSLp equals about 74% of the MSLa while this is only 65% in Tatarstan and Moscow. Since the MSL is sometimes linked to benefit entitlement (*e.g.* child benefit), this causes some variation in benefit payments across the country.

Minimum subsistence levels for population groups by region, 4th quarter 2009

	Population	Working age population	Children	Pensioners
	MSL	*MSLa*	*MSLc*	*MSLp*
Russian Federation	5144	5562	4922	4091
Moscow region	5850	6557	5452	4256
Samara	5408	5943	5215	4373
Tatarstan	4101	4522	3911	2965

MSL: Minimum subsistence level: for a working-age adult (MSLa), for a pensioner (MSLp) and for children (MSLc).

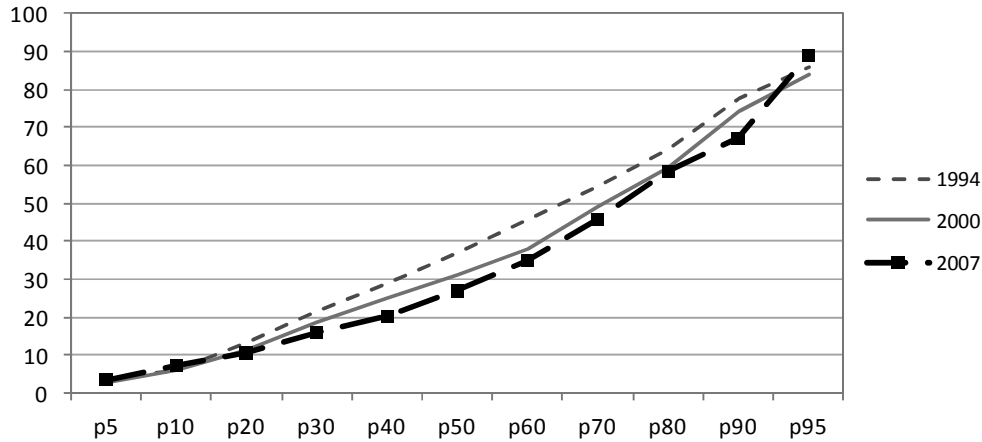
Source: Rosstat (2010b).

Poverty gaps

Compared with the mid-1990s, in 2007 there were less people living in poverty in the Russian Federation and incomes of the poor in 2007 were closer to the poverty line than in preceding years. Figure 3.4 shows the poverty gap relative to the absolute poverty (accounting for regional prices) threshold for the years 1994, 2000 and 2007. In 2007, the median poverty gap, as measured at the 50th percentile of individuals in absolute poverty, was 27% of the poverty threshold compared with gaps of 31% in 2000 and 37% in 1994 (the median poverty gap was largest in 1996, Denisova, 2011). Thus, not only has the incidence of absolute poverty declined, it also has become less pronounced. In 2007, about 20% of the poor needed to increase their incomes by up to 10% of the MLS to reach the absolute poverty threshold (MLS) and about 75% of the poor needed less than 50% of the MLS to do so. However, the 5% poorest needed 90% of the MLS in income terms to reach this absolute poverty threshold.[2]

Figure 3.4. Poverty gaps have been declining for most of the poor population since 1994

Poverty gaps, absolute poverty, by income percentile, 1994, 2000, and 2007



Source: Based on Denisova (2011).

Who are the poor?

Table 3.1 shows that in absolute terms poverty has trended down since 2000 for all population groups (Rosstat, 2008a). In 2008, 13.4% of the population had incomes below the MSL. Children below the age of 16 are most at risk of poverty: 18.3% of them had (allocated family) incomes below the MSLc (Box 3.2 above). For young people (age group 16-30) and prime-age persons, poverty levels closely reflect the pattern for the population at large. On the whole, pensioners are better off than the population at large: in 2008, 8.4% of the people above the standard pensionable age had incomes below the MSLp, and this proportion is expected to fall significant with the increase in pension payments in 2009.

This general picture is confirmed by a more detailed analysis of the factors that determine the incidence of poverty. Table 3.2 shows that employment participation, the presence of pensioners in households, engagement in subsistence farming and living in urban areas were all factors that significantly reduced the poverty risk. Having an unemployed adult in the household increases the poverty risk, but whether or not a household member worked in the relatively lowly paid public sector does not have a statistically significant effect on the absolute poverty incidence.

Table 3.1. Children and young people are most at risk of poverty in the Russian Federation

Population with incomes below the minimum subsistence level as percentage of the population group[1]

	2000	2001	2002	2003	2004	2005	2006	2007	2008
General population	29.0	27.5	24.6	20.3	17.6	17.7	15.2	13.3	13.1
Children (<16)	33,7	32,7	28,7	24,2	21,0	22,1	19,0	17,4	18.3
Young people (16-30)	28,9	27,6	25,3	20,7	18,1	18,0	15,3	13,3	13.2
Prime age persons (Men 30-60; Women 30-55)	30,5	28,9	25,7	21,2	18,2	18,3	15,7	13.7	13.2
Pensioners (Men over 60; Women over 55)	20.9	19.2	17.2	14.4	12.4	11.9	10.4	9.2	8.4

1. In terms of number of people, this meant that in 2007, for example, 18.9 million people in the Russian Federation had incomes below the minimum subsistence level. In the same year, 4 million children, 4.7 million young people, 7.5 million prime-age persons and 2.7 million pensioners also had incomes below the minimum subsistence level.

Source: Rosstat (2009a and 2010a).

Over the years, employment participation and having a pensioner in the household had the largest poverty-reducing effects. The effect of subsistence farming has remained statistically significant throughout, but it has become smaller since 1994 (families from all income deciles engage in farming of small plots, but it mostly concerns low-income families). Having a university degree also reduces the poverty risk, but its effect has become smaller over time and its statistical significance also seems to have weakened.[3] This may point to the importance of rapid and recent wage growth in the informal sector in urban areas, where employment is less dependent on academic accomplishments (in contrast to public sector where wage growth has been relatively limited).

The larger the household, the smaller is the poverty risk (Table 3.2). This finding is related to the inclusion of working adults or pensioners in the household. The presence of children, on the other hand, significantly increases the poverty incidence, although its effect is noticeably smaller than the poverty-reducing effect of having a pensioner in the household. Households whose head is a female or male pensioner (living alone or with spouse) are less likely to be poor than households headed by male working-age adults, though this effect is small. Whether the adult head of a household of working age is male or female made no statistically significant difference to the poverty incidence. The presence in a household of an adult in bad health also does not seem to have a strong statistically significant effect on the absolute poverty incidence (Annex 3.A2 summarises evidence on conditional probabilities of moving into and out of poverty).

Table 3.2. Living in larger households, in urban areas, being in work, having a pensioner in the household and engaging in subsistence farming significantly reduce the risk of being poor

Probit regression to identify determinants of absolute poverty incidence; marginal effects of relevant characteristics[1]

Year *(N = sample size[2])*	**1994** *(N = 10676)*	**2000** *(N = 9885)*	**2007** *(N = 11847)*
Household size, number of people in household	-0.021 *[0.007]****	-0.025 *[0.011]***	-0.01 *[0.003]****
Number of kids less than 7	0.06 *[0.015]****	-0.01 *[0.019]*	0.015 *[0.007]***
Number of kids 7-18	0.038 *[0.012]****	0.01 *[0.016]*	0.019 *[0.006]****
Household head is an adult female[3]	0.033 *[0.031]*	0.026 *[0.027]*	0.008 *[0.006]*
Household head is a retired male[3]	-0.122 *[0.014]****	0.008 *[0.028]*	-0.015 *[0.007]***
Household head is a retired female[3]	-0.11 *[0.014]****	-0.005 *[0.029]*	-0.017 *[0.005]****
Share of adults in the labour force	-0.169 *[0.037]****	-0.051 *[0.023]***	-0.081 *[0.012]****
Share of adults unemployed as to ILO definition	0.301 *[0.040]****	0.295 *[0.049]****	0.083 *[0.021]****
Share of adults with bad health	0.098 *[0.029]****	0.05 *[0.031]*	0 *[0.013]*
Share of pensioners	-0.179 *[0.038]****	-0.285 *[0.029]****	-0.087 *[0.014]****
Share of adults in public sector	0.038 *[0.018]***	0.051 *[0.022]***	0 *[0.007]*
Share of adults with university degree	-0.131 *[0.027]****	-0.204 *[0.039]****	-0.021 *[0.010]**
Share of adults with secondary school only	0.033 *[0.028]*	0.131 *[0.026]****	0.017 *[0.009]**
Household involved in subsistence farming	-0.099 *[0.014]****	-0.09 *[0.028]****	-0.025 *[0.005]****
Living in urban area	-0.061 *[0.025]****	-0.046 *[0.029]*	-0.034 *[0.013]****

1. Standard errors in brackets; * significant at 10%; ** significant at 5%; *** significant at 1%.

2. The average household size in the sample is 2.75 persons. Almost one third of the households have children in the 7-18 age group (23% have one child, another 8% have two children, and only 1% have three or more children); about 20% of households include children not yet 7 years old (18% have one child of the age group, and 2% two children of the age group). About 60% of the households have a male adult head, while this is 12, 13 and 14% for retired males, retired females and adult females, respectively. Two-thirds of the household in the sample live in urban areas. Almost two-thirds of the adults in the sample are in the labour force: 60% have a job and less than 5% is unemployed when measured according to the ILO definition. The average share of adults in a household working in the public sector is 26%, and on average, 14% of households are involved in subsistence farming. On average, the ratio of those receiving pensions to adults in a household is about 40%. The average share of adults in bad health is 18%. The average share of adults having completed secondary school only is 11%, with 15% in poor families. The share of adults with university degree is 16% on average.

3. Reference categories for household types: household head is an adult male.

Source: Denisova (2011).

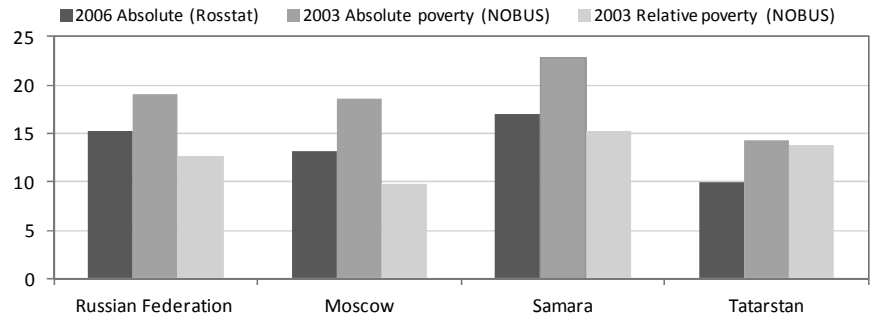
Regional disparities

Income inequality seems to be most prevalent in the regions where, until recently, the pace of economic growth was highest. Rosstat (2007a) suggests that income inequalities were largest in Moscow, indicated by a Gini coefficient of .56 in 2006, while in other regions the Gini varied from .46 to .32. In Samara (.43) and Tatarstan (0.4), the Gini was close to the Russian average (.41), whereas in about 20 regions (the economically least advanced regions) the Gini is .35 or less.

Absolute poverty rates also vary considerably around the Russian Federation (Rosstat, 2007). In 2007, the absolute poverty rate, as measured by Rosstat, was 15.3% for the Russian Federation as a whole; it was highest in Ingushetia at 57% (data for neighbouring Chechnya are not available) and lowest in St. Petersburg at 9.7%. Tatarstan had the second lowest poverty rate in the Russian Federation, while the poverty rate in Moscow was also below average; the poverty rate in Samara was 2 percentage points above the national average (Figure 3.5).

Figure 3.5. Poverty rates in Moscow are below the Russian average

Absolute and relative poverty rates for the Russian Federation, Moscow, Samara and Tatarstan



Note: In 2003, Rosstat absolute poverty rates were: 20.3 for the Russian Federation; 18.6 for Moscow; 21.1% for Samara; and 19.2% for Tatarstan.

Source: Denisova (2011) and Rosstat (2008a).

The NOBUS dataset facilitates considering regional variation in relative poverty rates. Compared with absolute poverty rates, relative poverty rates vary far less across the Russian Federation from 18% at maximum to 8% at minimum (Denisova, 2011). In 2003, Tatarstan and Samara had slightly above-average levels of relative poverty (15% and 14% respectively), while this was just below 10% in Moscow. In Moscow, Samara and for the Russian Federation as a whole, relative poverty rates are about 7 percentage points

below than absolute poverty, as also measured by the NOBUS survey. By contrast, the absolute and relative poverty rates in Tatarstan as measured by the NOBUS survey, are relatively close. This suggests that the poverty thresholds (50% of the median regional income and the regional MSL) are relatively close in Tatarstan, whereas in Moscow and Samara the regional MSL is much higher than 50% of average median income. This is in line with the Table in Box 3.2 which showed that compared with Moscow and Samara, the MSL in Tatarstan is set at a low level.

3. Social policy in the Russian Federation

The social protection system of the Russian Federation consists of several cash transfer schemes: a pension-insurance system (Chapter 4); some insurance-based programmes for the working-age population (*e.g.* unemployment insurance and other employment supports (Chapter 2); mandatory social insurance for temporary disability and maternity; and mandatory accident and occupational injury and disease insurance); and, some income-tested programmes for low-income families (child allowances and housing subsidies). There is a range of social services for the elderly and disabled but also family services and services for youth, and the state also provides food subsidies for children in full-time education and financial support towards children in kindergartens (see below). Box 3.3 reviews some financing issues related to public social spending.

Box 3.3. Financing social supports, the Unified Social Tax and the new schedule of social security contributions

Public social spending is financed through general revenue with health, pension and social insurance systems also being financed out of personal income tax, which is paid at a flat rate of 13% (there is a tax deduction of RUB 400 (USD 13) per month for household with very low incomes (less than RUB 40 000), and social security contributions paid by employers. General revenue plays a key role in financing public social spending. For example, in 2009, just over half (at 4% of GDP) of the revenue of the Pension Fund of Russia was financed out of general federal budgetary transfers (Chapter 4).

Until 2010 the Russian Federation had a regressive generalised social contribution system: the Unified Social Tax system. For employees with annual earnings up to RUB 280 000 (about USD 11 265 in 2008), employers paid UST contributions at a rate of 26%, 2% over earnings in excess of RUB 600 000, and 10% over intermediate earnings (see table below). Contribution rates for the self-employed are lower than for employees in general (see table below). Rates also vary by sector of economic activity, and, in fact, employers in many sectors pay considerably lower contribution rates, as for example in agriculture and "new industries" to stimulate their development.

Key parameters of the Unified Social Tax, in force throughout 2008/09

Annual earnings[1]	Employer (no employee contribution)	Self-employed
0 < Earnings < RUB 280 001	26% of earnings	10% of earnings[2]
RUB 280 001 < Earnings < RUB 600 000	RUB 72 800 (= 26% * 280 000) + 10 % of additional earnings	RUB 280 000 + 3.6% of additional earnings
RUB 600 000 < Earnings	RUB 104 800 + 2% of earnings in excess of RUB 600 000	RUB 39 250 + 2% of earnings in excess of RUB 600 000

1. Valued at the average exchange rate for 2008, RUB 280 000 was USD 11 265 and RUB 600 000 was USD 24 139.

2. Contributions to the pension fund should be at least RUB 150 per month.

Source: Information provided by the Russian authorities, see also Council of Europe (2009), Mutual Information System on Social Protection of the Council of Europe (MISSCEO).

The UST was allocated among pension, social insurance and health funds as follows: from the 26% tax base 20 percentage points towards the Pension Fund of Russia; 2.9 percentage points to the Federal Social Insurance Fund; 2.9 percentage points to the Federal Compulsory Medical Insurance Fund; and 1.1 percentage points to Local Compulsory Medical Insurance Funds. Furthermore, for different rates different allocation keys applied: for example, from the 10% of contributions paid by the self-employed: 7.3 percentage points was transferred to the pension fund, etc. Overall, the scheme was unnecessarily complicated involving a large number of different rates across different sectors.

In 2010, the system was simplified into a flat-rate social security contribution system. The total rate was 26% of earnings and contributions were allocated among the four insurance funds as before. However, exemptions for certain industries still apply, so in agriculture and "new industries" contributions rates are considerably lower.

Furthermore, the maximum ceiling was reduced from RUB 600 000 (over 2.5 times the average wage) to RUB 415 000 (below 1.5 times the average wage). This increased to RUB 463 000 in 2011, and will be regularly indexed to average wage growth in future. From 1 January 2011, the overall rate of social insurance contributions was raised up to 34% of the payroll. Pensions contributions amount to 26% of the pay-roll percentage, whereas contributions to the Social Insurance Fund amount to 2.9% and contributions to federal and local medical insurance funds amount to 5.1%.

Income disparities in the Russian Federation are very high and the redistributive power of the Russian tax/benefit system is limited. First, it would make more sense to ensure that the single-rate contribution system is applied equally across all economic sectors. Moreover, to improve the redistributive nature of the system, it seems appropriate to increase the earnings limit over which social insurance contributions are due over and above what is prescribed by indexation rules. To further strengthen redistribution, the flat-rate personal income tax system could be reformed into one which involves a mild form of progressivity over a few income bands to ensure that the overall system is not too cumbersome to administer. Finally, as employees do not directly pay contributions themselves, they have limited awareness of relevant costs: it seems appropriate to consider requiring employees to pay part of the social insurance contributions, as in so many OECD countries (OECD, 2009c).

In addition, and this is an important remnant of the Soviet era, until 2005 there was a system of "privileges", *i.e.* benefits, for specific categories of citizens including the disabled, special merit categories (veterans) but also a large group of workers and retirees with a long employment record. Reform introduced 1 January 2005 aimed to transform ("monetise") these specified in-kind supports into cash transfers while also delineating social policy responsibilities between federal and regional authorities. Together with the "demographic programme" introduced in 2006, with its focus on increasing birth-rates and improving health status of the working-age population (Chapter 4 and OECD, 2011b), these reforms constitute the most important social policy re-orientations in recent years, and are discussed in more detail below.

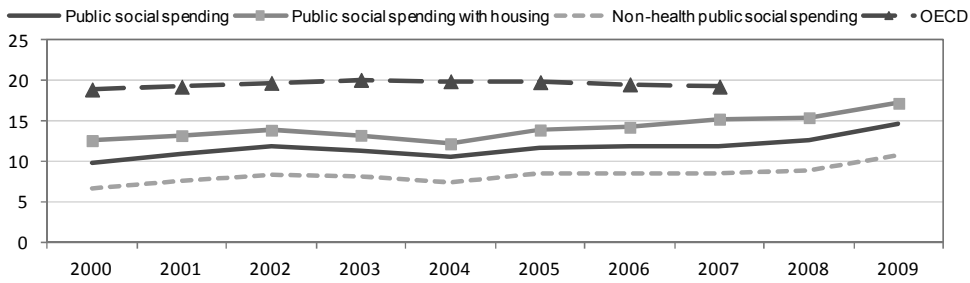
An overview of public social effort

There is no comprehensive official time-series on social expenditure, and the Russian authorities (Rosstat) have not submitted data on social expenditure in line with the requirements of the *OECD Social Expenditure Database* (SOCX). However, the Secretariat has estimated a series from the mid-1990s onwards on the basis of historical information in World Bank (2005), Rosstat (2010a) and public expenditure on health (WHO, 2008).[4]

OECD (2001) showed that in 1994 and 1997 the public social expenditure (including health and housing services) to GDP ratio for the Russian Federation was quite close to the OECD average of just below 20% of GDP. However, economic growth has been relatively strong since then and throughout the 2000s, public social spending including housing and health, has been just below 15% of GDP (Figure 3.6). Since the mid-2000s, the spending to GDP ratio increased to 15% of GDP because over the 2005-08 period: *i)* the "monetisation" reform increased cash transfers by about 1 percentage point of GDP; *ii)* there was an increase of about 1% of GDP in public housing support in 2007; and *iii)* public expenditure on health grew by half a percentage point of GDP from 2005 to 2008 (Box 3.4). Pension reform (Chapter 4) contributed to a rise in this public social spending-to-GDP-ratio to around 17% in 2009.

Figure 3.6. Public social spending in the Russian Federation is increasing since the mid-2000s

Public social expenditure (including health) as a percentage of GDP



Source: OECD (2010c) and Secretariat estimates for the Russian Federation.

Box 3.4. Housing reform: a major challenge

Housing reform is arguably one of the most pressing and daunting social policy challenges in the Russian Federation. In the soviet era, the State was responsible for the provision and maintenance of housing stock and free housing for eligible categories. There was rent control, low running costs, but also a low quality of maintenance, long waiting lists (10-20 years) and no housing market. Since 1990, there has been cost-free privatisation of the housing stock from rental accommodation into owner-occupation, by allowing individual tenants to claim ownership of the dwelling they lived in. In 1990, about 33% of the total housing stock was privately owned, whereas this proportion had increased to 75% by 2006 (Shomina, 2007). The new housing code introduced in 2005 defines rights and responsibilities of owners, tenants, and institutes home-owners associations facilitating a possible role as management companies of, for example, condominiums.

About 60% of the housing stock was built before 1960 and 20% of the housing stock has no running water or sewage system. Because of lack of maintenance, about 150 000 flats per annum become unfit for occupation. Almost 4.5 million households are on the waiting list to improve their living conditions and at the going rate it will take 20 years before their current needs (let alone future needs) are addressed. With privatisation, maintenance obligations of apartments and condominiums were often ill-defined, which contributed to the lack of overall maintenance of housing stock by owners.

Policy reform in the new millennium aims to increase the housing stock, reform the housing allowance system, and develop mortgage facilities (MOF, 2008). The income-tested housing allowance is available for families depending on income and regionally-set standards for living space and the costs of communal services. In general, the federal standard prescribes that housing costs should not be more than 22% of total family income, but this is 10% for Moscow and 15-20% for most of the regions.

The federal "Housing Project Affordable and Comfortable Housing for Citizens" which superseded the Housing for 2002-10 initiative, aims to upgrade housing and utilities and double the construction of housing from 40m2 in 2004 to 80m2 in 2010. This includes the construction of housing for low-income families, but identification of appropriate clients is a major issue. The initiative also facilitates mortgage lending at 8% and generally intends to reduce the waiting list for state housing from 20 to seven years. In 2007, the "affordable housing project" was budgeted for RUB 175 billion (about 5% of GDP), of which RUB 138 was for different housing construction and upgrading projects and RUB 38 billion for mortgage and loan support (MOF, 2008). From 2007 to 2008 public investment in housing and utilities increased by 1 percentage point to 3.3% of GDP, but by 2008, this had fallen back to 2.4% of GDP (Rosstat, 2010a).

However, methodological issues hamper the collection of internationally comparable information on public spending on housing, and, therefore housing expenditure data in SOCX only includes spending on rent subsidies across OECD countries (Adema and Ladaique, 2009), and income-tested housing and utility cash payments for the Russian Federation (Table 3.3). Comparing the Russian Federation with OECD countries, public social spending in the Russian Federation in 2007 was 12.6% of GDP, and almost 15% in 2009: about 4.5 percentage points below the OECD average (Figure 3.7).

Table 3.3. Non-pension-related social cash transfers (not including health and housing services)

Millions of roubles (per cent of GDP in italics)

	1995	2000	2001	2002	2003	2004	2005	2006	2007	2008
Total	*1.54*	*1.07*	*1.10*	*1.19*	*1.07*	*0.83*	*1.46*	*1.74*	*1.92*	*2.00*
	22 028	78 510	98 612	128 703	141 319	141 013	314 912	467 523	639 498	829 995
of which:										
- Temporary incapacity benefit	*0.51*	*0.46*	*0.54*	*0.58*	*0.53*	*0.41*	*0.30*	*0.30*	*0.32*	*0.32*
	7 215	33 245	48 511	62 699	70 335	69 204	65 072	81 296	106 391	134 413
of which occupational accidents and diseases	107	487	719	918	1 010	1 090	1 256	1 510	1 893	2 393
- Family and maternity benefits	*0.84*	*0.37*	*0.39*	*0.40*	*0.35*	*0.26*	*0.22*	*0.21*	*0.36*	*0.40*
	11 982	27 042	34 576	43 721	46 143	45 024	46 736	57 811	120 828	167 113
of which:										
Pregnancy and birth	920	3 675	5 550	8 604	10 724	12 079	14 403	19 109	29 410	44 222
Child's birthday	343	1 533	1 821	5 732	6 513	6 490	8 192	11 047	12 246	14 158
Childcare leave up to 1.5 years	579	1 757	1 966	5 176	5 656	5 641	5 632	7 607	54 306	75 210
Leave for disabled child	16	141	198	267	307	345	374	424	776	912
Monthly child benefit	10 124	19 936	25 041	23 942	22 943	20 469	18 135	19 624	24 090	32 611
Liability for monthly child benefit (at year end)[1]	..	20 615	14 980	9 462	5 152	2 400	1 304	345	156	42
- Assistance and material help to the unemployed	*0.16*	*0.09*	*0.08*	*0.10*	*0.10*	*0.08*	*0.08*	*0.07*	*0.05*	*0.04*
	2 231	6 322	7 216	10 598	13 002	13 937	16 452	19 530	15 733	15 954
- Social assistance to victims of accidents in nuclear power plants and other accidents	*0.01*	*0.05*	*0.06*	*0.05*	*0.04*	*0.04*	*0.02*	*0.02*	*0.04*	*0.02*
	165	3 997	5 058	5 368	5 736	6 257	5 312	5 749	14 680	6 857
- Other types of benefits and social assistance, including income-tested housing and utility subsidies, cash payments, burial costs[2]	*0.03*	*0.11*	*0.04*	*0.06*	*0.05*	*0.04*	*0.84*	*1.13*	*1.15*	*1.22*
	435	7 904	3 251	6 317	6 103	6 591	181 340	303 137	381 866	505 658

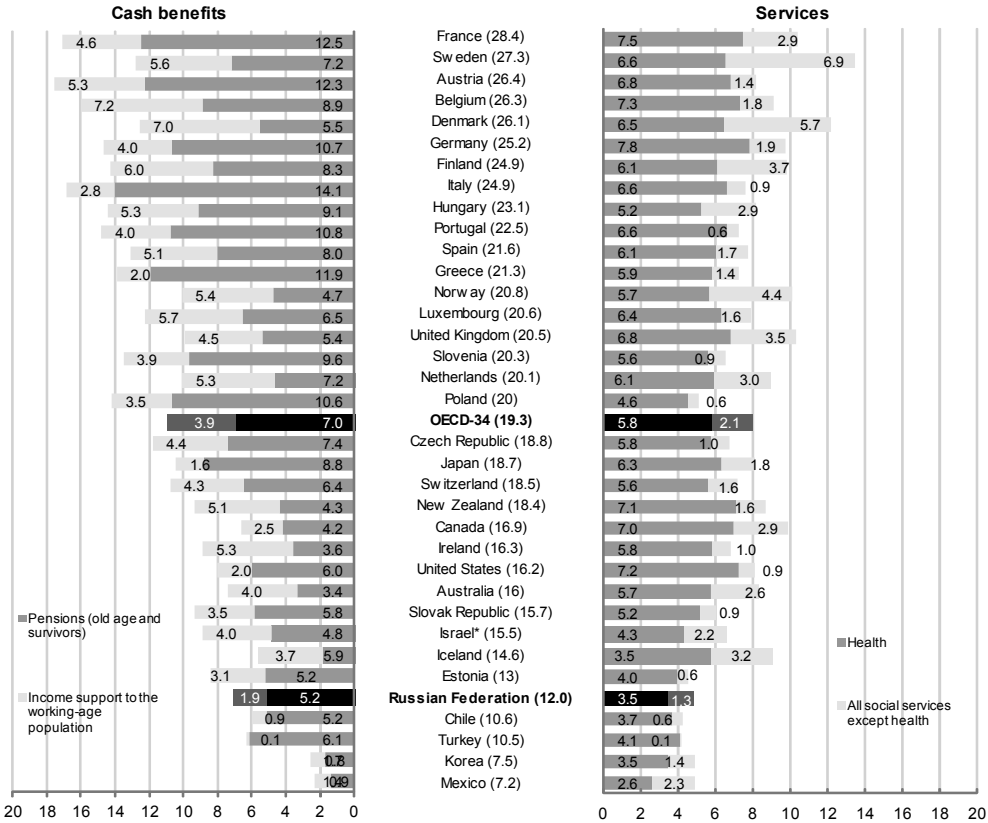
1. Not included in the annual totals.

2. Other types of benefits supports to victims of political repression, assistance for Chernobyl radiation victims and other accidents, assistance to supports to refugees and migrants.

Source: Rosstat (2011b), (*www.gks.ru/free_doc/2009/B09_13/06-15.htm*), downloaded January 2011.

Figure 3.7. Public social spending in the Russian Federation is lower than in most OECD countries, especially in terms of income support for the working-age population and public spending on health

Public social expenditure by broad social policy area, in percentage of GDP, in 2007[1, 2]



1. Countries are ranked by decreasing order of public social expenditure as a percentage of GDP. Spending on Active Labour Market Programmes (ALMPs) cannot be disaggregated in financial transfers and services; they are, however, included in the total public spending (shown in brackets); 2005 data for Australia, Mexico, Turkey and the United States. Data do not include public spending on housing and utility services, except for income-tested housing cash payments as included in the totals in Table 3.3.

2. Spending on income support to the working-age population concerns non-pension related income support payments, see Table 3.3.

* Information on data for Israel: *http://dx.doi.org/10.1787/888932315602*.

Source: OECD (2010c), *Social Expenditure Database, 1980-2007* (www.oecd.org/els/social/expenditure); for the Russian Federation, OECD Secretariat estimates, for recent years on basis of Minfin website (*www.minfin.ru)*, and Rosstat for pensions *(www.gsk.ru)*.

The relative importance of different broad social policy areas is shown in Figure 3.7. The pension system will be discussed in detail in the next chapter, but the system is fairly comprehensive with public spending at around 5.2% of GDP in 2007 (it was 6.6% in 2009, Chapter 4), about 2 percentage points of GDP below the OECD average. The amount spent on cash transfers to the working-age population and their children is much smaller: just below 2% of GDP. Public expenditure on health amounted to 3.5% of GDP in 2007 (OECD, 2011b), well below the OECD average of around 6% of GDP. Public spending on other social services amounted to almost 1.5% of GDP in 2007, of which about 40% concerned public spending on childcare and kindergartens (Sinjavskaya, 2010).

In 2009, there were about 4 000 institutions (including shelters and social service centres), providing services to about 15 million elderly citizens and people with disabilities. Also, there were about 3 200 institutions (including family centres and social centres for youth) serving about 4.4 million families and 5.9 million children. The fee charged for these services is income-dependent. Those with incomes below the MSL do not have to pay, and reduced fees (up to a pre-set maximum) are charged to those with incomes up to 2.5 times the MSL. Above that level, standard fees apply.

The monetisation reform in 2005 increased overall spending on non-pension-related cash transfers to about 2% of GDP in 2008 (Table 3.3). This increase coincided with the lowest income groups making income gains that led to a reduction in relative poverty (Figure 3.3).

Prior to 2005, temporary disability benefits and family and maternity payments made up the bulk of non-pension-related social cash transfers, but by 2008 spending on these two groups of payments accounted for about 0.7% of GDP (see also Annex 3.A1, Table 3.A1.1). Spending on income-tested housing and utility supports to families with incomes below subsistence level amounted to only 0.2% of GDP (a fraction of all spending on housing supports, see above), while spending on support to the unemployed was even lower in 2008, although such support went up in 2009 (Chapter 2). The limited spending on family benefits and the poor working-age population more generally is reflected in relatively higher poverty rates among children and young people (Social pensions and social pension supplements that can also be paid to, for example, the disabled are discussed in Chapter 4).

As discussed in Chapter 2, payment rates for unemployment benefit are low: at maximum 26% of the average wage for 12 months, but the majority of unemployed benefit claimants receive the minimum payment which equals about 4.5% of the average wage. Comprehensive data on other social assistance supports to the working-age population across the regions are not available, but available evidence suggests that such spending is not high either. For example,

Kazan, the capital of the republic of Tatarstan, introduced a means-tested payment to low-income families in 2005, which was paid to about 20 000 households and conditional on the signature of a social adaptation contract by the recipient (World Bank *et al.*, 2007). The average payment rate was RUB 3 575 in 2005 (just over USD 100 at the time), and in 2008 social office staff confirmed that they would award about RUB 5 000 at maximum (either as a lump-sum or in three different payments) to beneficiaries. Authorities in Samara make cash payment to able-bodied persons of the working age (who were willing to work) on an exceptional basis (there are homeless shelters and other in-kind supports), but in general across the Russian Federation, income support for the working-age population is very small.[5]

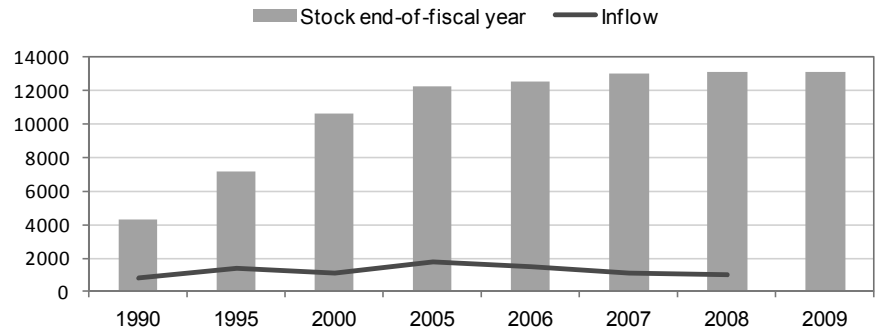
The prevalence of disability

Temporary disability and maternity benefits are important social insurance benefits; by comparison spending on benefits for occupational injuries and accident insurance is relatively small (Table 3.3). Temporary disability benefits are paid for a range of reasons including illness, and the need to care for a sick family member, with generous entitlements for parents (used by mothers rather than fathers) having to take time off to care for sick children.[6] Claimants with a contributory record of over eight years receive the full wage, with lower payment rates for those with shorter contributory records.[7] There is no maximum duration of temporary incapacity benefit, but after four months of sickness, a claimant is referred to a commission which decides on the granting of a disability pension of a fixed or indeterminate duration, classified in three groups depending on the severity of the impairment (type I is the most severe; type II the most common).

The number of registered disabled increased rapidly during the 1990s, with the inflow of new claimants tailing off in recent years (Figure 3.8). By the end of 2008, there were 12.6 million people registered as disabled with the Pension fund of the Russian Federation (including about half a million children). This means that 8-9% of the population is classified as (at least partially) disabled.[8] It is difficult to compare this figure with other countries as the number includes people in receipt of old-age and survivor pensions. However, in Austria, another country where people do not change their disability pension for an old-age pension on reaching the standard pensionable age, the Secretariat estimates the ratio of recipients of disability benefits to the overall population to be around 5.5%.

Figure 3.8. Disability benefit receipt increased sharply during the 1990s, but inflows have declined in recent years and the stock of beneficiaries has stabilised

Number of disabled persons in the Russian Federation



Source: Rosstat (2010c).

To some extent the high incidence of disability is related to risky health behaviours (OECD, 2011b) which contribute to Russians' relatively low life expectancy in international comparison (Chapter 4). However, there is ample evidence that in many countries take-up of disability benefit is also related to labour market and early-retirement-related reasons (OECD, 2006, 2007b, 2008b and 2010d). The rapid increase in disability receipt of the 1990s cannot be linked to a similarly swift deterioration of the health status of Russians. The NOBUS survey suggests that the average age of receiving a disability pension is about 44 (Sinjavskaya, 2004), while Merkuryeva (2004) suggests that 50% of the individuals receiving disability benefits do not have worse health conditions than the rest of the population. In financial terms, the disability benefits are also attractive. A single disability pensioner would receive about a quarter of the average wage in benefit income (Chapter 4), and that does not include the value of social housing and utility support to which the disabled are entitled. In OECD countries, benefit income of recipients of disability benefits generally ranges from 25 to 40% of average earnings (OECD, 2010d).

Monetisation of in-kind supports

One remnant of the Soviet era was a complex system of privileges (*l'goty*) or supports to special categories of citizens in the Russian Federation (OECD, 2001).Broadly speaking, these benefits were available to three different groups of citizens: *i)* groups of "vulnerable" citizens (*e.g.*, the disabled; war victims; those affected by radiation, but also former political

prisoners); *ii)* citizens who have access on "special merit" as they provided exceptional service to the State (*e.g.* "Heroes of the Russian Federation" or war veterans); and *iii)* those with a long employment record and other holders of occupational benefits (*e.g.* servicemen, judges, etc.). The benefits in question include the in-kind provision of housing (including maintenance) and utilities (energy) support, but also free transport, and medical care. This system was a very important part of the social fabric in the Russian Federation as their estimated value amounted to about 4.2% in 2003 (World Bank, 2005) compared with only 0.4% of GDP on social-assistance-type transfers (including, income-tested housing allowances and child benefits, see Table 3.3 above). Out of a population of about 140 million people, 35 to 40 million persons were direct beneficiaries of privileges and, if other household members are also included this concerned about 65 million persons or around 45% of the population (Rimashevskaya, 2006; Sinitsina, 2008; and World Bank, 2005). The system of privileges raised different inter-related issues, including targeting of households and "regressivity" in support (richer households get more support) and efficiency concerns.[9]

Some of the privileged groups, in particular the disabled, face a high poverty-risk. Otherwise, these benefits are not targeted at low-income households and not intended to support the most vulnerable. Of the about 35 million claimants in 2004/05, about 20 million claimants were "labour veterans" (people with a long employment record and/or other occupational benefits), with an average age of 62. Most beneficiaries thus do not belong to the younger part of the population, which is most at risk of poverty (see above).

Monetisation reform (or cashing out) of in-kind benefits served a multitude of goals, including: improved transparency; reduced (bureaucratic) inefficiencies; elimination of unfunded mandates; and more choice for citizens. Reform had to attract hitherto "unserved" clients but with more transparency, and as targeting could be improved, at least in theory, spending outlays do not have to increase markedly.

Monetisation reform in 2005 involved various different practical aspects including:[10]

- A demarcation of federal and regional responsibilities for privileged groups;
- A monthly cash payment;
- A "social package", which includes health services and transport to the place of treatment;

- Ability for regional authorities to monetise in-kind privileges of their choice.

Financial responsibilities for specific groups of beneficiaries was delineated among federal and regional authorities: the 12 million disabled are the largest group for which the federal authorities are responsible, while regional authorities are responsible for supports to citizens with long service records and occupational benefits: about 15% of the population, and one-third of the population aged 40 and over (Rimashevskaya, 2006; and Sinitsina, 2008).[11] It is not clear why this particular allocation to regional and federal authorities was chosen, but it has caused some resentment among "labour veterans" who used to be treated similarly to the war veterans and the disabled, but now face regionally-set payment rates.

The federal authorities have established a "registry" of citizens eligible for federal support and by the end of 2007, this number amounted to 16.9 million people (about 13% of the population), of which about 48% continued to receive assistance in-kind. By 2010 only one quarter of eligible recipients received assistance in-kind: Russians are increasingly cashing out their "social package". Public spending on monetised payments was 0.9% of GDP in 2008; 70% of those registered were disability pensioners, 6% veterans, and 3% are disabled children (Rosstat, 2010e).

"Monetisation reform" introduced the following payment scheme for eligible disabled citizens for whom the federal authorities are responsible. For example, in 2008 the largest group of disability pensioners (type II disability pensioners) received a monthly cash payment of RUB 550 (USD 22). If they decide to cash out their social package entitlement (which covers health services and transportation to the place of medical treatment), then they receive an additional RUB 450 (USD 40). Payment rates vary per beneficiary category (see below): disabled WWII veterans can receive up to RUB 2 000 per month (USD 80) if they cashed out their social package, while survivors of disabled WWII veterans would get far less (Table 3.4).

In 2009/10, there were substantial increases in monetisation payments. In nominal terms, payments more than doubled, and together with the substantial increase in pension payments (Chapter 4), this contributed to the eradication of poverty among pensioners, at least when the latter is measured in absolute terms against the prevailing minimum subsistence level.

Table 3.4. Monetisation of federal privileges and the associated payment rates to disabled citizens[1]

Disability pensioner	Monthly cash payment (RUB)		Social package (RUB)		Cash payment when "monetising" social package (RUB)	
	1 April 2008	1 April 2010	1 April 2008	1 April 2010	1 April 2008	1 April 2010
Disability Type I	950	2 378	450	705	1 400	3 083
Disability Type II and disabled children	550	1 698	450	705	1 000	2 403
Disability Type III	350	1 360	450	705	800	2 065
Disabled WWII veteran	1 550	3 397	450	705	2 000	4 102

1. On average in 2008, USD 1 was around RUB 25, so a disabled pension type II (the most common disability pensioner) or disabled children would receive about USD 40 per month in additional payment to their pension if they were to monetise their social package; in June 2010 USD 1 was about RUB 31 and a disability type II pensioner would receive USD 78 per month.

Source: PFRF (2010a).

For the eligible citizen, the decision to monetise or not is not always straightforward. In general, beneficiaries who are in need of intensive medical care, or frequently use public transport, are probably better off not to monetise (Sinitsina, 2008). On the other hand, for rural clients without any access to public transport, monetisation is a clear gain. In any case, the authorities emphasise the principle of free choice. Thus, if a beneficiary with health problems chooses to monetise the health benefits, and opts to spend it on alcohol instead of relevant pharmaceutical products that is regarded as his/her free choice. That public resources expressly allocated towards health purposes are used in this manner does not seem to cause major concern.

Table 3.3 showed that with monetisation spending on cash transfer increased rapidly prior to 2008 (thus before the increase in payments in 2009/10 as shown in Table 3.4). However, it is as yet unclear to what extent this reflects an increase in transparency of costs that were thus far hidden, or whether citizens who were entitled to in-kind benefits but who had hitherto never been able to validate their right to access (because of capacity-constraints in service provisions, shortages in subsidised housing, lack of public transport in rural areas, etc.) are now able to do so.

Regional aspects

In principle, regions are free to choose which of the privileges for which they are financially responsible they would like to monetise. However, thus far regional enthusiasm for monetisation has been limited (*e.g.* Alexandrova and Struyck, 2007; Rasell and Wangle 2008). Sinitsina (2008) reported that:

- The majority of regions did not monetise housing and/or utility supports.
- One third did not change in-kind provision of transport privileges.
- Half of the regions monetised dental services.

With about two-thirds of the regions facing budget deficits, many regions face strong financial incentives not to monetise too much and keep spending growth in check. In principle, federal government functions can only be transferred to other tiers of government if relevant financial resources are provided. In addition, since the federal government sets the standards of quality of service (which are not allowed to diminish over time), regions do not have full discretion and unfunded mandates persist.

The federal government ensures that regions are uncertain about the amount of money they receive from Moscow, which gives them considerable sway over regional (social) policy development (Kurlyandskaya, 2006; Sinitsina, 2008). For example, there is a system of fiscal equalisation across regions which, on the basis of federally-set formula using economic indicators, determines a region's tax capacity. The difference between the regions' tax capacity and the national average determines the size of the equalisation transfer. However, the Ministry of Finance introduces changes to the formula each year so that the size of the annual transfer remains unpredictable, except for the 20% or so wealthy regions (that do not receive equalisation transfers), which in 2008 included Samara and Tatarstan (MOF, 2008).

In addition, the federal authorities make use of a wide range of transfer mechanisms to regions masking the overall transfers to any particular region (for a detailed overview of budgeting mechanisms in the Russian Federation, see Kraan *et al.*, 2008). Since 2004, regional budgets for social benefits are supported with funding from the Fund for Co-financing Social Expenditures and the Fund for Compensation. Additional funding can be forthcoming from the Federal Fund for Financial Support of the Regions, the Fund for Reforming Regional Finances, and the Fund for the Development of Regions. However, use may also be made of, for example, matching grants for federal welfare policy, transfers for public infrastructure projects, etc. As a result, federal co-financing for regional government and regional social benefits differs from one region to another, and from year to year. For example, in 2005 the co-financing of housing and utility subsidies in both Tatarstan and the region of Tomsk amounted to just over 30% of all such regional outlays; however, in 2006, this proportion increased to 50% for Tatarstan and dropped to 9% for Tomsk (Zubarevich, 2007). In all, about 40 to 50% of the federal transfers to regions are made on the basis of less transparent criteria, leaving

ample room for federal policy influence. The economic crisis also led to an ad-hoc increase in federal grants to regional budgets, but there was no clear link between the amount of money transferred and the intensity with which the crisis affected particular regions, leading to inefficient increases in public administration costs in many regions in 2009, and problems for local policymakers when federal grants were subsequently cut in 2010 (Zubarevich, 2010).

4. Family policy

The Russian population is ageing and declining and low fertility rates are one of the reasons. The extent to which (potential) parents perceive they can combine work and family life has been shown to be an important factor in determining fertility trends (OECD, 2007a); in the Russian Federation combining work and family life appears to be difficult (Table 3.5). The female employment rate is well above average. But with many women being in low-wage employment (Chapter 1), the gender pay gap is large at almost 40% at median earnings (comparable with the situation in Korea). Low wages and limited access to employment-related "privileges" contribute to the high relative poverty rate among children (Table 3.1). People in their 20s and 30s need to work to avoid poverty, they generally defer childbirth and have few children, if any: fertility rates have been persistently low, but have increased somewhat in recent years (see below).

Russian policy encourages mothers to take care of very young children at home, and participation in *formal* childcare by children under 18 months is limited. For those with a sufficient employment record (at least 12 months with the same employer), parental-leave payments are linked to earnings (Table 3.3 provides information on other cash benefits to families). For those who are not entitled, there is, since 2007, a general "childcare payment" for those with children under 18 months. For the years 2007-09, the general childcare allowance payment (for the second child) amounted to about 20% of the average wage, whereas the maximum earnings-related payment during the 18 months maternity leave was 40% of the average wage. Since 1 January 2011, the maximum payment for those with earnings-related entitlements is RUB 13 833 (close to 70% of the average wage), and maximum general childcare allowance payment to those without sufficient employment records is RUB 8 240 per month (about USD 266).[12] This is more than the average old-age pension (Chapter 4), equivalent to three times the minimum wage, and thus a substantial benefit for Russian low-income families.

Table 3.5. Combining work and family life is difficult in the Russian Federation[1]

	Total fertility rate	Female employment population ratio (working age population)[2]	Childcare enrolment, ages 0, 1 and 2	Poverty among families with children	Gender pay gap (at median earnings)
Year	2008	2008	2008	2007	2008
OECD average	1.7	57.5	30.4	10.6	16.0
Russian Federation	1.5	64.9	33.0	24.0	39.3

1. Childcare enrolment data concern 2006 for the OECD, while data on poverty among households in OECD countries concerns 2005. Gender wage gap data for the Russian Federation concerns 2007.

2. The employed population is defined and measured with respect to the working-age population (16-64 age group)

Source: OECD (2008a), *Growing Unequal?*; OECD (2010e), *Employment Outlook*; and OECD (2010f), *OECD Family Database.* For the Russian Federation*:* Rosstat for data on fertility rates, female employment and gender pay gaps; Denisova (2011) for relative poverty among families with children; and, Sinjavskaya and Gladnikova (2007) for estimates on formal childcare participation.

Fathers generally do not use parental-leave entitlements which contributes to a large gender pay gap as employers are hesitant to hire and invest in young female workers. This also contributes to self-selection of female workers in the low-paid public sector rather than the better paid part of the informal sector (Chapter 1).

Historically, the Russian Federation has had a well-developed childcare/pre-school system. Federal Law stipulates that parents should not pay more than 20% of the cost of childcare (this is 10% for parents with at least three children, and care is free for handicapped children), and sets rules on compensation towards parental fees (20% for the first child, 50% for the second and 70% for the third). Many regions aim to provide free childcare to low-income families. However, the system is under some pressure as regions which are responsible for its financing are struggling to meet the cost, including for parental fee support. The number of kindergartens and places has declined considerably since 1990 (Sinjavskaya, 2010; and Sinjavskaya and Gladnikova, 2007). Regional data suggest that about 33% of children under 18 months and 40% of children aged 18 to 36 months are enrolled in care, and three-quarter of the 3-5 year-olds, survey-based indicators suggest enrolment is somewhat lower: almost 20% of the children aged 0 to 2 participate in childcare about 70% of children aged 3 to 6 attended in pre-school facilities (Sinjavskaya, 2010; and Sinjavskaya and Gladnikova, 2007). Both indicators suggest that in terms of childcare and pre-school enrolment the Russian Federation is close to the OECD average of 33% for under 3s and 76% for 34 and 5-year-olds (OECD, 2011a). The pre-schools

frequently provide full-day-care, from about 9am to 5pm, with grandparents and neighbours frequently covering the time immediately before and after to help parents hold down a full-time job.

On the whole, leave and childcare policies are comparable with the OECD average, and, while they could be improved upon, constraints in these policy supports do not appear to be key drivers of the very low fertility rates. Nevertheless, fertility and labour supply concerns have also rekindled interest in childcare issues in the Russian Federation: potentially, labour supply gains could be made among older (55+) female workers, if many of these were not involved in providing childcare on an informal basis.

The high employment rates among men and women have not prevented a high poverty risk for families with children. This means that policy needs to address the adequacy of benefit supports to supplement earnings from work (Whiteford and Adema, 2007). Until 1999, child benefits were universal and financed from the federal budget; since then benefits are income-tested with eligibility depending on per capita household income being less than the regional subsistence level. Public spending on child benefits has declined between 2000 and 2006 (Table 3.3), and the share of households with children receiving child benefits decreased from 88% in 1999 to 66% in 2004 because of a decline in poverty among households with children during that period.

Since 2006, there has been a revaluation of families in policy development. Spending on child and parental benefits doubled from 2006 to 2008, with the introduction of "family capital payments" (see below) further underlining the increased importance of families on the Russian policy agenda.

Child allowance payment rates are low, and equivalent to around 5% of household income of poor households (income at RLMS level). In 2008, the federally prescribed minimum payment rate was RUB 85 (USD 3.5) per child to couple families and RUB 170 to sole-parent families, which by June 2010 had increased to RUB 255 (about USD 8) and RUB 510, respectively. Payment rates vary across the country. In June 2010, in Samara child allowance payments were RUB 130 (USD 4) per child per month in couple families and RUB 266 in sole-parent families, and in Tatarstan, these payment rates were RUB 198 and RUB 528 respectively. In Moscow child allowances in June 2010 were RUB 750 per child to couple families and RUB 1 500 (USD 48) per child per month for children in sole-parent families.

The efficiency of targeting by regional authorities is debatable (*e.g.* World Bank *et al.*, 2007; and Rasell and Wengle, 2008). If information on beneficiaries is collected, it is often not shared with other agencies. For

example, regional authorities do not have direct access to tax records which would facilitate improved income-testing procedures. However, Gassman and Notten (2008) suggest that the targeting of child benefits, at least, has improved since 1999: in 2004, 73.4% of children in low-income households (up to 150% of the RLMS) were covered, up from 31.3% in 2000. Also, 45% of children in the richest quintile of households still receive child benefits. In view of the low payment rates, targeting procedures cannot be cost-effective. If child payment rates were to be increased significantly to fight poverty amongst families with children effectively, this would also provide authorities with financial incentives to improve their targeting techniques. Such a scheme does not need to cost much. Gassman and Notten (2008) suggest that a means-tested child benefit worth about 30% of the single adult MLS would reduce poverty by one-third and the poverty gap by 36%, at a cost of around 0.06% of GDP.

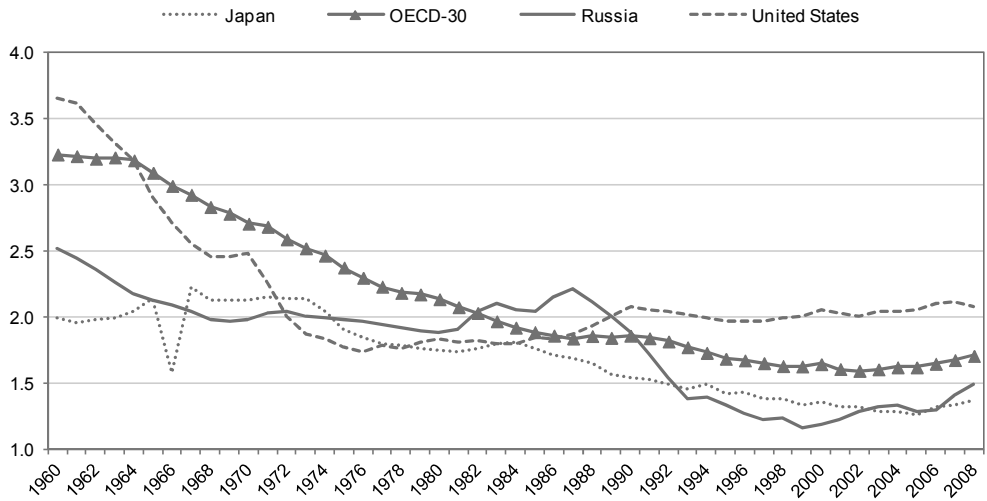
Policies to redress the demographic imbalance

In 1960, the TFR was already comparatively low in international context at 2.5 children per woman; it oscillated around two during the 1970s and most of the 1980s (Figure 3.9). The most recent decline in fertility started at the end of the 1980s, when there was growing uncertainty about the outcomes of political reform. Around the turn of the millennium, fertility rates fell to their lowest levels of about 1.2-1.3 children per women, but they have increased, particularly since 2006, to 1.5 in 2008 (Rosstat, 2010d).

In the beginning of 2007, the authorities introduced the "Demographic Programme" which aims to achieve population stability in 2015 at around 142-143 million people (and 145 million people in 2025) and increase life expectancy to 70 years (and 75 years in 2025), and raise the fertility rate to the level desired by parents which is deemed to be at around 1.65 to 1.7 children per women. From 2007 onwards, child allowances for children under 18 months of age were increased to RUB 1 500 (about USD 60) and RUB 3 000 for two children or more; pre-school, increase financial supports to foster parents,[13] and, most importantly in terms of spending (at about RUB 55 billion per annum), the introduction of "family capital".

Figure 3.9. Fertility rates in the Russian Federation have fallen considerably since the late 1980s

Total fertility rates, 1960-2008



Note: The total fertility rate (TFR) in a specific year is the number of children that would be born to each woman if she were to live to the end of her childbearing years and if the likelihood of her giving birth to children at each age was the currently prevailing age-specific fertility rates. A TFR of 2.1 children per woman is defined to be the replacement level, as this level ensures broad stability of the population, assuming no migration flows and unchanged mortality rates.

Source: OECD (2011c), *Society at a Glance*, and Rosstat (2010d).

"Family capital" is payable to parents who gave birth to (and/or adopted) a second and or more children after 1 January 2007 (and before 31 December 2016); in May 2008 the number of holders of family capital certificates amounted to 208 600 people). On the account of the certificate holders, the state has deposited "family capital" worth on 1 January 2010 RUB 343 279 per eligible family (about USD 11 867) in the capitalised part of the Pension Fund of the Russian Federation (PFRF, 2010b). Withdrawals, which in theory can be partial, can be made by parents of three-year old children conditional on these being used towards: *i)* improvement of housing conditions (in this case this, family capital can also be withdrawn before the child turns 3); *ii)* education of children (<25 years); *iii)* the funded pension entitlements of mothers; and iv) a lump-sum payment towards the daily needs of families worth RUB 12 000 in 2009 (about USD 400). Apart for the lump-sum payment, the vast majority of parents choose to use the entitlement to improve their housing conditions.

In April 2009, the first millionth family capital certificate was awarded, while the 2 million benchmark was reached in March 2010 (and awarded on 28 June 2010, Moscow Evening Post, 2010). The increased frequency points to parents choosing to have their second child now rather than later or not at all. It seems that the introduction of family capital in 1 January 2007 has contributed to the recent increase in fertility rates, but it is unclear whether this effect is permanent or temporary: the experience in OECD countries is that such measures are most likely to have a temporary effect (*e.g.* OECD, 2005, for the experience in the province of Quebec in Canada).

Housing issues play a significant role in fertility outcomes in the Russian Federation (Box 3.4). In the early 1990s, the housing stock was privatised with dwellings offered to the then tenants (most of whom have now taken up ownership). Newly formed families have to enter either the market or have to wait for social housing to become available, and this may take up to 20 years. Regional policy makers in Moscow aim to reduce the waiting period for young families with children to 3-5 years by 2015 (*The Demoscope Weekly*, 2008). The lack of adequate housing, combined with high prices and long waiting lists for social housing, means that, as in southern European and Asian OECD countries, young people in the Russian Federation face great difficulties moving out of the parental home, and establishing a family of their own.

Population dynamics also point to increasing demands for formal long-term care services. At present, much of such care is often provided by relatives and neighbours. Among the elderly and disabled in need of care, 80% received social (non-medical) care, of which 25% received care by public organisations, and almost 70% received informal social care by non-professionals (*e.g.* relatives and neighbours). In 60% of the cases, care is provided at home, and in almost all cases, additional support is provided by others in the community. 30% of those who need care get it from non-relatives. In about a quarter of the cases, such informal care is paid for, and all such care concerns elderly pensioners without relatives (Maleva and Sinjavskaya, 2007). By 2050, 3 to 4% of the Russian Federation's population are likely to require long-term care support. Much of such care will be provided by relatives and neighbours, but formal care demand could amount to as much as 4% of GDP in 2050 (World Bank, 2007).

5. Conclusions

Between 2000 and 2009, strong economic growth led to a reduction of poverty in *absolute* terms to 13%, which was halted by the economic downturn that took place in 2008/09. Nevertheless, at 17%, the *relative*

poverty rate is high compared with OECD countries and the poverty risk is most elevated for children and people in their thirties who have had no time to gain access to seniority and/or occupational-related benefits. Furthermore, compared with other income groups the poor have made little progress. The large income inequalities in Russian society have not noticeably diminished and to a considerable degree, this reflects the limited redistributive power of the Russian tax/benefit system, except for those in receipt of pensions.

The financing of social spending should become more equitable. In addition to indexation of the upper income-threshold for social security contributions, this threshold could be set at a higher level, for example, twice average earnings. To further improve the redistributive power of the tax/benefit system, consideration should be given to strengthening progressivity in the personal income tax scheme.

In the longer term, oil and gas wealth cannot be relied upon to finance the increasing ageing-related demand for social protection. Overall, social insurance rates have increased from 26% to 34% of the payroll, nut many exemptions remain. It would be less administratively demanding, and more transparent and fair, to apply contribution rates equally across workers. In fact, to increase worker' awareness of costs, social insurance contributions could be levied on both workers and employers, as in many OECD countries.

Social spending should be better focussed on those who need it most. The role of *targeting* within the current system is limited and authorities have difficulty identifying the relevant client groups. The award of privileges, in-kind benefit support, is not just related to those classified as disabled, but also goes to those with special state service records and 20 million or so "labour veterans" with the necessary occupational requirements. This system is not intended to, and does not serve the most vulnerable in society.

The monetisation reform introduced in 2005 started to cash out some in-kind privileges. This has introduced a monthly cash payment to eligible citizens, and provides them with some choice over how to receive some items of support. Regions can also choose to monetise support, but on the whole they been cautious with implementation. In general, small spending items were monetised first. Reform in this area costs money. This restricts coverage to those who are most in need of social support. The monetisation of the substantial in-kind housing and utility support has so far been largely left untouched by regional authorities who cannot easily resolve the issue of waiting lists for affordable social housing, and do not have sufficient funds for *in lieu* cash payments to all eligible citizens. In all, monetisation has improved transparency in social support, but otherwise gains have been limited. It has not changed the fundamental nature of the system and regions

have not fully replaced the privileges (whether paid in cash or in kind) with income-tested support for the most vulnerable on a grand scale.

Some targeted programmes have been introduced, but in terms of public spending they remain small. The income-tested housing allowances, for example, have not grown dramatically in importance and spending remains at about 0.2% of GDP; a fraction of the estimated value of in-kind housing support. Moreover, targeting seems difficult to implement with recipients almost evenly spread across lower and middle income groups. Child benefits are also income-tested and, here too, targeting is not optimal. Nevertheless, given the high poverty risks among families with children, and the low wage payments to many female workers, increasing child benefit payment rates seems an effective tool in the fight against poverty, which need not be overly expensive, in part because the target-group is relatively easy to identify.

There is nothing intrinsically wrong with the principles of monetisation and targeting of social supports. However, for it to work efficiently and in a financially sustainable manner, there needs to be a better flow of information amongst public agencies. For example, without transparency on budget rules and awards of federal funds, regional governments will be hesitant to carry out social reform, as they fear federal funding may dry up leaving them with unfunded mandates. With more information, citizens will have a better view of the benefits to which they are entitled, while both regional and federal governments need to have better information on the income actually earned by individuals and households. Progress is being made with improving the exchange of information between different public agencies. However, better information systems to which all relevant authorities have direct access are needed to make eligibility verification work, and deliver social support to those who really need it.

Furthermore, existing information systems do not allow for a comprehensive evaluation of policy measures. The NOBUS survey provided a wealth of information on the effects of policy, but it was held in 2003 and has not been followed up. The introduction of a similar initiative on a regular basis would help policymakers to choose more effective policies and the actions from this would more than justify the cost of the survey.

Finally, family policy is not as much affected by issues as child development, child poverty and, least of all, gender equity, as it is by concerns about the low fertility rate. Public policy has increased earnings-related maternity allowances at the beginning of a child's life (the first 18 months), so that they are now as high as average pension payments. Also, policy has introduced a "family capital" payment of significant value (about USD 11 000). However, in addition to strengthening financial supports to families, the considerable problems with combining work and family life

after the first 18 months after a child's birth also need addressing. In particular, the decline of pre-school places must be reversed, and childcare fee supports (including direct investment in facilities or vouchers for parents) could be further strengthened. Improving housing policies is a major challenge too, if only because it needs to help young Russians establish a family of their own. If Russian family policy wants to become effective in a sustainable manner, it would be best to spread spending over the childhood period rather than frontload it during the first 18 months, and build a continuum of supports that allows parents to combine work and family life (*e.g.* through investing more in pre-schools, increase child allowances at the expense of childcare allowances), rather than having to choose between children and work.

Notes

1. BOFIT (2010) suggests that without recent public policy interventions poverty rates would have increased from 13 to 17%.

2. Except for the poorest 5%, Denisova (2011) shows that *poverty gaps* measured in relative income terms are slightly larger than when measured in absolute poverty terms. For example, the median poverty gap in 2007 was 38% when measured against relative poverty compared with 27% when based on absolute poverty.

3. Denisova (2011) shows that, when measured against *relative poverty,* having a university education has a strong poverty-reducing effect throughout the sample period.

4. This series includes data on spending by pension and social insurance funds (including the old employment insurance fund) and estimates on the value of past in-kind housing and utility supports, and recent information on such spending (also by regional governments), as in Rosstat (2010a). The "monetisation reform" has improved the reporting of social spending (for example, see Table 3.3). Nevertheless, experience with OECD countries that have a federal constitutional set-up suggests there is likely to be under-reporting of social spending by lower tiers of government (Adema and Ladaique, 2009).

5. By contrast, in those OECD countries where authorities pay the most attention to concerns regarding baskets of goods and services on the provision of a decent minimum standard of living, including Belgium, the Czech Republic, Germany, Switzerland and Sweden, payment rates are relatively high which raises concerns about benefit traps for families on such income support (Adema, 2006).

6. Eligible working parents can take up to 60 days of leave per calendar to care for sick children aged under 7, for children aged 7-15 this is 45 calendar days. In the case of disabled children up to 15 years, this is 120 calendar days.

7. Workers with a contributory record of less than five years receive 60% of their average wage over the reference period, and those with a contributory record of five to eight years are paid at 80%.

8. There are many different benefits for disabled people in Russia. For example, there are benefits for war veterans and disabled children, while the pension fund of Russia also pays old-age, survivor or disability pensions based on employment records to people who are categorised as disabled. The disabled also have access to "privileges" as financed by federal authorities (see below).

9. For a more detailed discussion of the shortcomings of the system, of privileges (*l'goty*), see, for example, Alexandrova and Struyk (2008); OECD (2001); Rimashevskaya (2006); Sinitsina (2008); and, World Bank (2005).

10. Sinitsina (2008) describes the various mishaps with the administrative implementation of reform in 2005.

11. Federal authorities are financially responsible for the privileges to: the disabled; WWII and other combat veterans; disabled veterans, and survivors of WWII veterans; radiation victims (Chernobyl); and, disabled children. Regional authorities are responsible for "Labour veterans" or civilians with a long employment record (*e.g.* 25 or 30 years of employment, or in given region/sector) and others entitled to occupational benefits; civil WWII veterans ("home-front workers"), victims of political repression, "Heroes of the Soviet Union", and some other categories.

12. The Federal childcare allowance for children up to 18 months is RUB 2 060 (USD 66) for the first child and RUB 4 120 for the second and higher order children.

13. The demographic programme also involves increased payments to foster parents. For example, to foster child development, the authorities in Samara prioritised placing orphans/children in need in a family environment rather than institutional care.

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Annex 3.A1
Selected Background Statistics

Rosstat's quarterly Household Budget Survey (HBS) of about 50 000 households serves as the official source for data on poverty and income inequality in the Russian Federation. The HBS contains detailed information on expenditures and transfers, which is mapped (in a convoluted process) with data on aggregate incomes of Russian households (the balance of monetary incomes to estimate an income distribution. The data on income distribution by income quintile is presented in Table 3.A1.1.

Table 3.A1.1. Summary of income distribution statistics, official data for 1989-2007

Shares of quintiles in per capita money incomes, and the gini coefficient

Quintiles of per capita incomes	1989	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
First quintile	9.8	9.4	6	5.8	5.3	5.5	6.2	6	6.1	6.1	6.1	5.7	5.7	5.5	5.4	5.4	5.3	5.1	5.1	5.1
Second quintile	14.9	14	11.6	11.1	10.2	10.2	10.7	10.2	10.4	10.5	10.6	10.4	10.4	10.3	10.1	10.1	9.9	9.7	9.7	9.8
Third quintile	18.8	17.9	17.6	16.7	15.2	15	15.2	14.8	14.8	14.8	14.9	15.4	15.4	15.3	15.1	15.1	14.9	14.8	14.8	14.8
Fourth quintile	23.8	22.8	26.5	24.8	23	22.4	21.5	21.6	21.1	20.8	21.2	22.8	22.7	22.7	22.7	22.7	22.6	22.5	22.5	22.5
Fifth quintile	32.7	35.9	38.3	41.6	46.3	46.9	46.4	47.4	47.6	47.8	47.2	45.7	45.8	46.2	46.7	46.7	47.3	47.9	47.9	47.8
Gini coefficient	**0.227**	**0.256**	**0.289**	**0.398**	**0.409**	**0.381**	**0.375**	**0.381**	**0.398**	**0.399**	**0.394**	**0.397**	**0.397**	**0.403**	**0.409**	**0.409**	**0.416**	**0.423**	0.423	**0.422**

Source: Rosstat (2010a and previous years) and Yemtsov (2008).

Amongst other things (World Bank, 2005), it could be argued that consumption and household expenditure date are better sources for the measurement of inequality and poverty when large parts of incomes are under-reported to tax authorities, which is considered to have been a widespread phenomenon, particularly in the early days of the transition period. However, data on relative poverty in the Russian Longitudinal Monitoring Survey (RLMS) measures on basis of expenditure and reported income show that the differences between the two data series are limited, throughout the measurement period (Table 3.A1.2).

Table 3.A1.2. Relative poverty measured on basis of income and expenditure data, 1994-2007

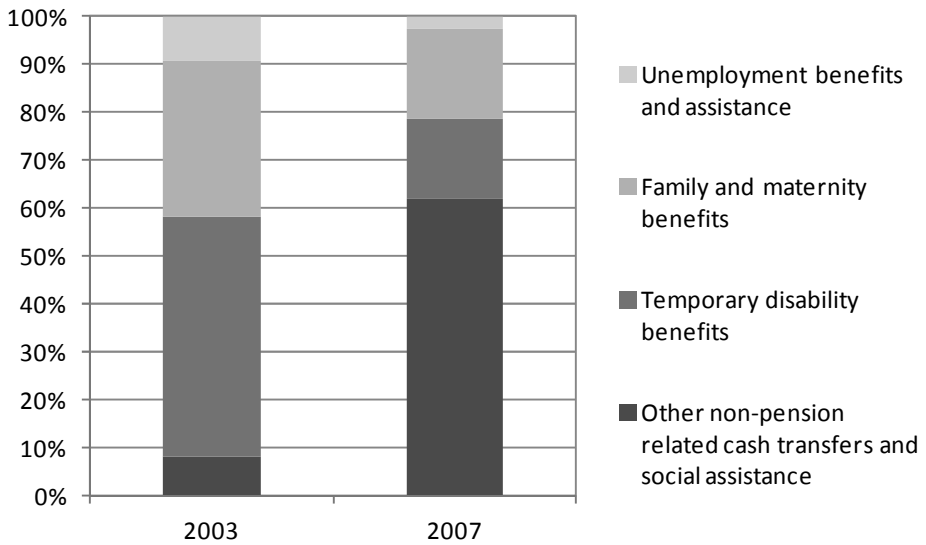
Poverty as measured against 50% of median income, persons

	1994	1995	1996	1998	2000	2001	2002	2003	2004	2005	2006	2007
Relative poverty, income-based	0.17	0.20	0.24	0.20	0.22	0.21	0.24	0.23	0.23	0.16	0.15	0.17
Relative poverty expenditure-based	0.18	0.18	0.19	0.20	0.21	0.21	0.22	0.22	0.24	0.18	0.18	0.18

Source: Denisova (2011).

Monetisation reform introduced 1 January 2005 cashed out some in-kind services (see below). In 2003, temporary disability benefits and family and maternity payments made up more than 80% of all spending on non-pension related social cash transfers. In 2007, this was about one/third. By then, other non-pension related cash transfers (including the cashed out service payments) accounted for over 60% of spending (Figure 3.A1.1).

Figure 3.A1.1. The structure of spending on non-pension related social cash transfers before and after monetisation reform



Note: Non-pension related cash transfers and social assistance includes funeral grants and supports to radiation victims.

Source: Rosstat (2008a and previous years).

Annex 3.A2
Moving Into and Out of Poverty

Panel data can be used to study entry into and exit from poverty. The RLMS is a panel data set for the 1994-2009 period and can be used for this purpose provided estimation techniques address the high attrition rates (Box 3.1). This can be done by estimating proportional hazard rates by using the Kaplan-Meier estimator which estimates the survival function (the probability that someone will "survive in a specified status" beyond a certain time, even when the sample is censored and biased, Denisova, 2011). However, these are not unconditional probabilities that can be used to depict the general chances of moving in and out of poverty; these are conditional hazard rates indicating, for example, what the chances are of someone exiting poverty, if he/she has been in poverty for, say, two years, given a set of specified characteristics (*e.g.* household characteristics, labour market status of adults, eligibility to public transfers, human capital characteristics, but also region and time). These conditional probability functions can be estimated both regarding relative and absolute poverty lines.

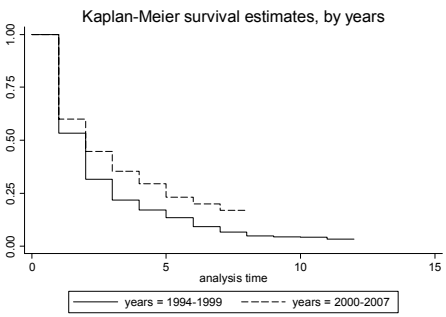
On the basis of detailed information available for 2007, Denisova (2011) shows that after one year in poverty about 40% of households leave poverty, and that, after five years of being in poverty, the probability of exiting poverty is about 80% (the results are similar when measured against relative and absolute poverty thresholds). After one year out of poverty, the chance of moving into poverty is about 10%, whereas after five years, this is about 30%.

Figure 3.A2.1 shows the survival rate of staying in poverty and out of poverty for two different economic periods: 1994-98 around the financial crisis; and 2000-07, when economic growth was strong. It shows that, during the period of strong economic growth, the conditional probability of becoming poor is lower (the chance of staying out of poverty is higher, see Panel B). However, the conditional probability of staying in poverty is also higher (Panel A). This may appear counterintuitive, but, again, these are conditional probabilities. During a period of economic growth the chances of becoming poor are smaller. So, the finding that it becomes more difficult

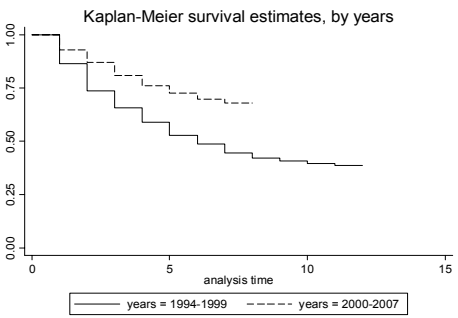
to leave poverty in times of growth suggests that those in poverty at the time are problem cases whose characteristics make leaving poverty unlikely.

Figure 3.A2.1. Conditional probabilities of remaining in poverty and staying out of poverty (relative poverty)

Panel A. Survival function of remaining in poverty



Panel B. Survival function of staying out of poverty



Source: Denisova (2011).

Not surprisingly, the factors that increase the risk of falling into poverty are quite similar to the factors that determine the incidence of poverty (see Table 3.2 and Denisova, 2011). In terms of the conditional probability of leaving poverty, larger families have a relatively high chance, but the presence of children does not seem to affect the probability. Families in urban areas tend to have a relatively high chance of leaving poverty (especially in Moscow and St. Petersburg); those from metropolitan areas also have shorter poverty spells.

The higher the share of pensioners in a household, the lower is the probability to escape poverty. This implies that once pensioners have slipped into poverty, they are more likely to face long-term poverty (Corroborating findings by Kalugina *et al.*, 2004). In a similar vein, households with a relatively high share of adults in employment who are in poverty have a low chance of leaving poverty compared with households with an unemployed adult. This implies that it is relatively difficult to increase earnings for adults in low-paid employment to lift household income above the poverty line. Beuran and Kalugina (2006) show that informal employment is negatively associated with poverty persistence: a finding which seems in line with the suggestion that informal employment is often higher paid than formal employment.

In all, the results seem to suggest that economic growth reduces the conditional probability of leaving poverty. This means that households that were in poverty when economic growth started or who slipped into poverty during the economic upturn (*e.g.* low-wage workers with limited opportunities to increase earnings and pensioners whose income has fallen in relative terms) have a relatively low chance to leave poverty, and face relatively long poverty spells.

Chapter 4

Ensuring Adequate and Financially Sustainable Pensions in the Russian Federation

The Russian pension system has undergone various reforms over the past decade. Since 2002, the general public pension system comprises a basic benefit, an earnings-related scheme based on notional accounts and a funded component. In 2008, the government started to financially promote voluntary pension saving by matching individual contributions up to a maximum, and it sharply increased the basic public pension in 2009-10 to fight old-age poverty.

However, there is a need for further pension reform in the Russian Federation. Some remnants from the past remain, such as relatively generous early pension benefits and low pension eligibility ages (55 for women and 60 for men). Furthermore, many workers start to draw a pension before these low standard pensionable ages, the cost of which is borne by the Pension Fund of the Russian Federation (PFRF) and not by employers and/or the workers involved. The notional accounts scheme does not follow actuarial principles (unlike similar schemes in Italy, Poland and Sweden): benefits are not adjusted as life expectancy changes. Finally, the real rates of return on funded plans have been negative since they were introduced in the early 2000s. All of these factors challenge the financial sustainability of the Russian pension system.

This chapter begins by presenting evidence on the extent of old-age poverty. It then traces the demographic environment over the next 40 years or so. It goes on to analyse the key features of the pension system in the Russian Federation and recent changes. It concludes with a discussion of further changes that would help achieve both adequacy of pension benefits and financial sustainability.

1. Introduction

Poverty among Russian pensioners, using the official poverty line, is less widespread than among the population as a whole. Nevertheless, policy changes in 2009-10 substantially increased public pension payments with the avowed objective of eliminating poverty among pensioners.

Older people already constitute around a quarter of the Russian population, and, as in OECD countries, this proportion is expected to grow rapidly in future. However, in contrast to most OECD countries, the increase in the old-age dependency ratio in the Russian Federation will be driven less by an increase in the number of retirees and more by a decline in the working-age population. This, in turn, is the result of persistently low fertility rates (see Chapter 3). Compared with OECD countries, life expectancy is short, particularly for men. Risky health behaviours (for example, consumption of large quantities of alcohol) contribute to Russian men at birth having on average a life expectancy of only just over 60 years. This is 15 years shorter than the average for men in OECD countries.

The standard pensionable ages are low: 55 for women and 60 for men. Many people start drawing a (full) pension even before these ages.[1] Employment in certain occupations and geographical regions brings with it eligibility for early pension schemes. Many people draw these early pensions and continue working, for at least a few years. This reduces the incidence of pensioner poverty, but the continuing practice of early pension take-up is detrimental to the financial sustainability of the pension system.

Pension reforms undertaken in the 1990s and the early 2000s culminated in the establishment of a general "labour pension" system which has three components: a basic pension; an earnings-related pension benefit based on notional accounts; and mandatory contributions to funded pension schemes. The design of the system is similar to those in Poland and Sweden, which also have a combination of notional defined contribution schemes and funded plans. However, not all of the principles of notional accounts have been implemented in the Russian version: unlike the other countries, there is no adjustment to the value of entitlements with changes in life expectancy.

The financial sustainability of the pensions system is of immediate concern. Recent policy has increased pension entitlements rapidly, with the aim of achieving a pension replacement rate of 40% of individual

earnings after 30 years' contributions. This is not high by international standards: the average replacement rate of an average earner in OECD countries is 59% and is less than 40% in just six of them. But the low ages at which people start to draw pensions in the Russian Federation already results in a considerable annual shortfall in pension contributions relative to benefits and this deficit is likely to widen in the future as the population ages.

2. Poverty among pensioners

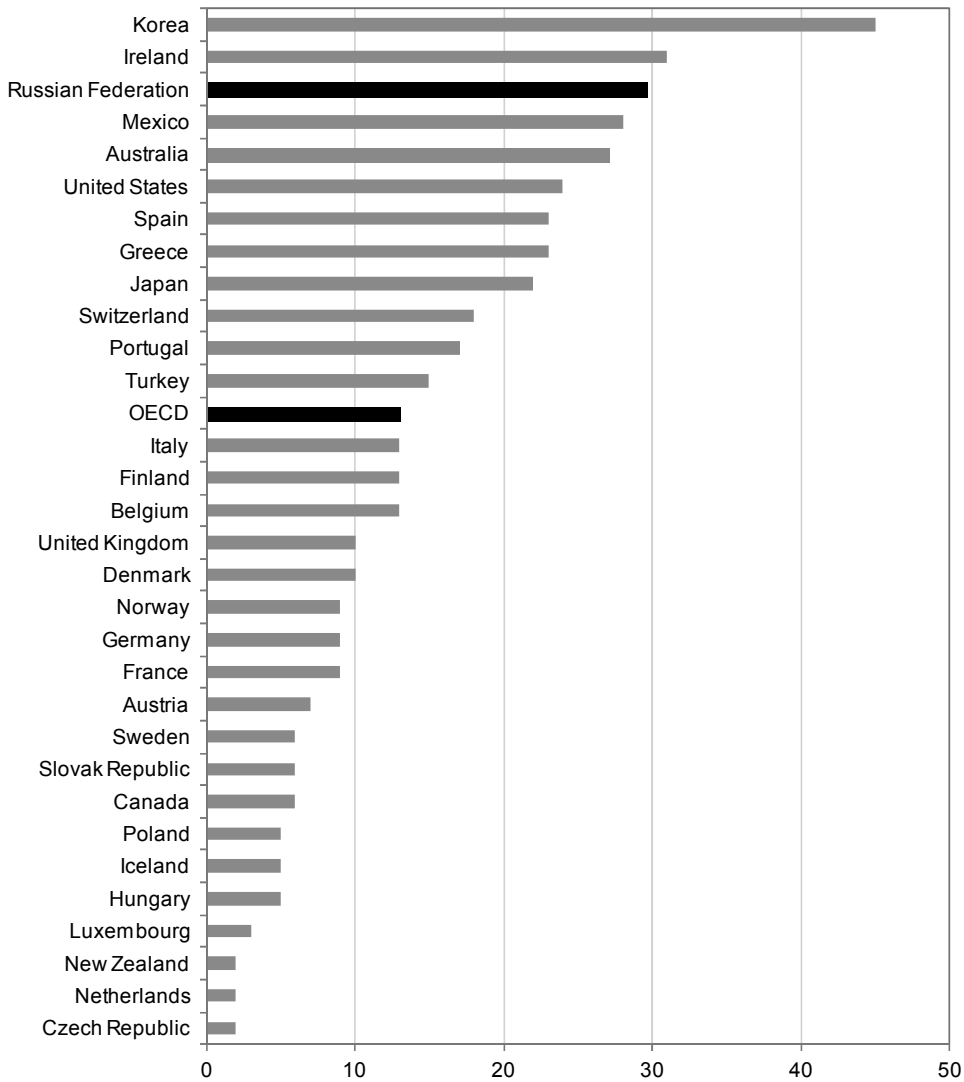
The OECD uses a different poverty line than the official Russian statistics. To allow for different income levels prevailing in different countries, the OECD poverty line is set at half the national median household income, with the latter adjusted to reflect differences in household sizes. Considering this relative poverty line in international comparison, it appears that in 2008 poverty among those aged 65 and over in the Russian Federation was twice as high as the OECD average, but considerably less than in Korea (Figure 4.1).

Trends based on official statistics show that the proportion of people living in poverty has more than halved over the period 2000-08 (Chapter 3, Table 3.1), among both pensioners and the population as a whole. By 2008, 8.4% of the pensioner population lived in absolute poverty compare to 13.1% across the general population.[2]

With substantial increases in benefit payments in 2009 and 2010, the average social pension payment increased to a level just above the social minimum (Table 4.1). Average pension payments of all different types at the beginning of 2008 were worth just over 20% of average earnings, but by the beginning of 2010, the average pension had almost doubled to just under 40% of average earnings. As a result of these changes, official poverty data for 2010 will probably show that pensioner poverty has been virtually eradicated.

Figure 4.1. Poverty among those aged 65 and over in the Russian Federation is twice as high as across the OECD on average

Poverty rates by age: percentage of individuals aged 65 and over with incomes of less than half the national household median income



Note: Adjustment of incomes for household size uses an equivalence scale elasticity of 0.5.

Source: OECD (2008), *Growing Unequal?* and data provided by Rosstat on the OECD questionnaire on income distribution and poverty.

Table 4.1. Pension payments have increased sharply since 2008; on average, social pensions have increased to the minimum subsistence level

Average pension payments at 1 January 2008 and 1 January 2010[1] as related to minimum subsistence levels and average wages[2]

	Payment in RUB p/m		Average pension payment Ratio of average pension payment to:			
			Minimum subsistence level		Average wage	
	2008	2010	2008	2010	2008	2010
Pensioners total	3 682	7 119	115	174	21	38
Labour pensions	3 737	7 334	117	179	22	39
Social pensions	2 724	4 238	85	104	16	22

1. Price inflation was 14.1% in 2008 and 11.7% in 2009 (Chapter 1).

2. The minimum subsistence level for pensioners was RUB 3 191 per month at 1 January 2008 and RUB 4 091 at the end of December 2009; on the same dates the average wages were RUB 17 290 and RUB 18 938, respectively.

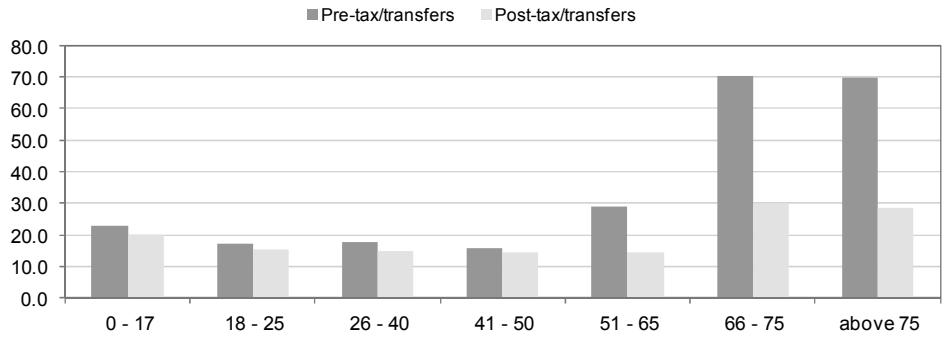
Source: Data provided by the Ministry of Health and Social Development of the Russian federation.

Figure 4.2 illustrates the strong poverty-reducing effect of the pension and tax systems: poverty rates *after* taxes and transfers (mostly public pensions, of course) for over 65s are only about 40% of the rate before taxes and transfers are taken into account. Because of the additional income support for pensioners aged over 80, poverty rates are slightly lower for the age group 75 and over than for 66-74 year-olds.

Because of earnings, poverty rates before taxes and transfers are generally lowest among the working-age population. However, Figure 4.2 also shows that poverty rates after taxes and transfers are as low for the 51-65 age group as for the working-age population. Because of the low standard pensionable ages (60 for men and 55 for women), this age group includes many pensioners and the combined effect of earning and drawing a pension leads to low poverty rates compared to other age groups. Pensions in payment are not subject to personal income tax or social contributions: pensioners in work only pay social security contributions and income tax on their earnings.

Figure 4.2. About a quarter of people aged over 65 are poor

Poverty rates by age: percentage of individuals with incomes of less than half the national household median income



Note: Adjustment of incomes for household size uses an equivalence scale elasticity of 0.5.

Source: Data provided by Rosstat on the OECD questionnaire on income distribution and poverty.

In the Russian Federation, qualifying for, and receipt of, an old-age pension does not always mean that people have withdrawn from the labour force. Table 4.2 shows that almost one-third of the 36 million old-age pensioners in receipt of a "labour pension" are in employment, and this proportion is probably much higher for those who started to draw a pension in the past five years.

Table 4.2. About one-third of the Russian Federation's old-age pensioners are in work

Number and percentage of pensioners as of 1 January 2010

	Pensioners		
	Number (in thousands)	Category of pensioner in percent of the total	Ratio of working pensioners
Pensioners total	**39215**	***100.0***	***29.9***
State pensions	**3040**	***7.8***	***6.5***
- social pensions	2661	*6.8*	*2.9*
Labour pensions	**36176**	***92.3***	***31.9***
- old-age	31758	*81.0*	*34.3*
- disability	2903	*7.4*	*24.4*
- survivor	1515	*3.9*	*0.6*

Source: Data provided by the Ministry of Health and Social Development of the Russian Federation.

Employment rates among pensioners are highest for those covered by special early retirement provisions for long service and specific occupations and geographical regions (Sinjavskaya, 2004). Most people combining work and pension receipt are in the public sector in relatively low-paid jobs. Usually, working pensioners remain in their previous job; only a quarter of them changed employment when they started drawing their pension (Sinjavskaya, 2004). Hence, it is no surprise that those who have just reached pensionable age are often relatively well off, and that poverty among "new" or young pensioners compares well with other age groups. Implicitly, this practice also means that the pension system subsidises low-paid jobs in the public sector (recent reform of pay and working conditions in the public sector is discussed in Chapter 2).

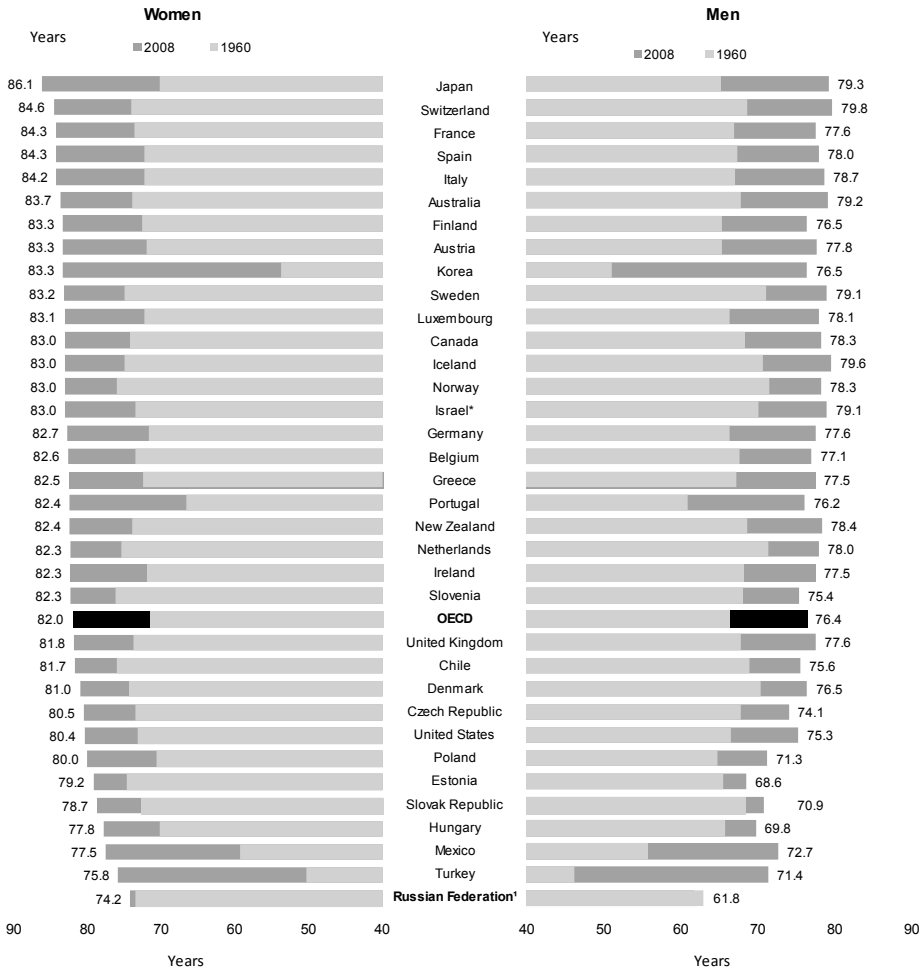
3. Demographic change will have a profound effect on Russian society

Life expectancy at birth is relatively low in the Russian Federation (Figure 4.3a). For women, the Russian Federation's life expectancy at birth is 74.2 years compared with an average of 82 years in OECD countries. The difference for men is even starker: 14.6 years lower life expectancy in the Russian Federation than the average for OECD countries. Life expectancy at birth for men is just 62. However, when men make it to 65, the standard retirement age in many OECD countries, they have on average another 11.7 years to live. For women aged 65, the average life expectancy is 16.1 years, but this is still low when considered in an international perspective (Figure 4.3b).

Life expectancy trends are also very different. Over the period from 1960 to 2006, life expectancy at birth increased rapidly across the OECD: by an average of just over ten years. In the Russian Federation, life expectancy generally changed little during the 1970s and 1980s. It declined from 70 years of age at its peak in 1987 to 64 years of age in 1994 for both sexes. The decline in life expectancy was most pronounced for men: falling from 64.9 years in 1987 to 57.6 in 1994. Since 2003, life expectancy has increased by three years to 67.9 in 2008 (Rosstat, 2010a). The reasons for the reduction in life expectancy include: stress associated with rapid privatisation in 1992-94 affecting mortality among working-age men (Stuckler *et al.*, 2009), stress associated with frequent labour turnover, and unhealthy behaviour as drinking and smoking (Denisova, 2009). Treisman (2008) relates the reduction in life expectancy to price liberalisation in January 1992. This reform meant that less dangerous forms of alcohol, such as beer and wine, became relatively more costly, while the real price of vodka fell significantly, contributing to the increase in vodka consumption during the 1990s. Recent health policy initiatives are aimed to encourage more people taking up a healthy lifestyle (OECD, 2011b).

Figure 4.3a. Life expectancy is low in the Russian Federation and has not increased over the past 40 years

Life expectancy at birth, in years, men and women, in 1960 and 2008[1,2]



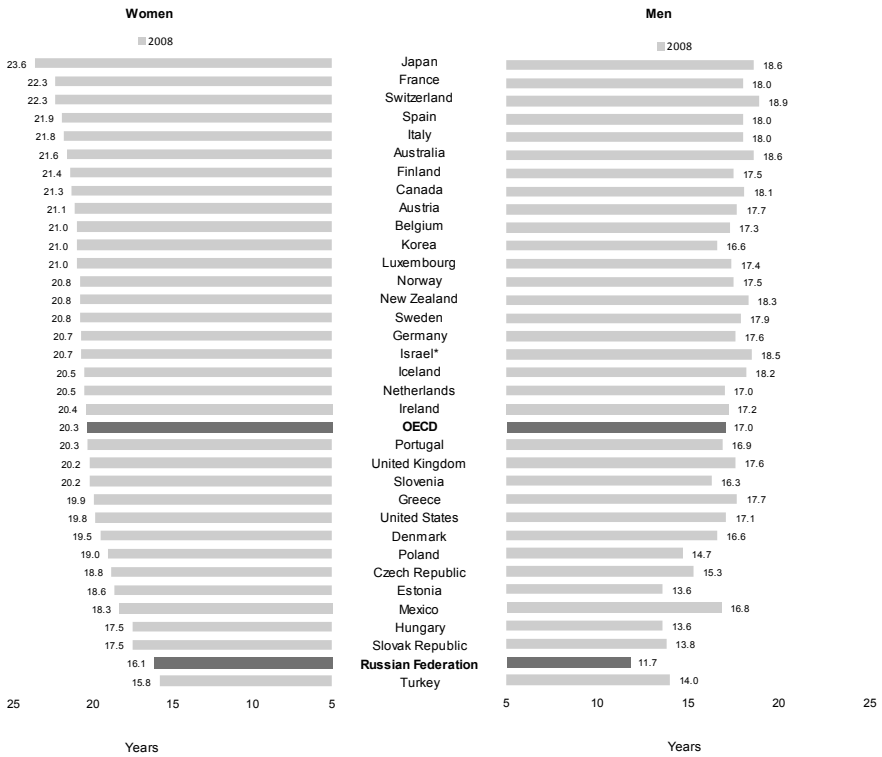
1. 2005 for Canada, United Kingdom and United States; 2004 for Italy; 1970 and 2008 for the Russian Federation.

2. Life expectancy for men in the Russian Federation in 1970 (at 63 years) was higher than in 2008.

* Information on data for Israel: *http://dx.doi.org/10.1787/888932315602*.

Source: OECD (2011a), *Society at a Glance*; for the Russian Federation: Rosstat (2010a).

Figure 4.3b. Life expectancy at age 65 by sex, 2007 or latest year available (2008 for the Russian Federation[1])



1. 2005 for Canada, United Kingdom and United States; 2004 for Italy; and, 2008 for the Russian Federation.

* Information on data for Israel: *http://dx.doi.org/10.1787/888932315602*.

Source: OECD (2011a), *Society at a Glance*; for the Russian Federation: Rosstat (2010a).

As a result of falls in life expectancy and low birth rates (Chapter 3), demographic projections show a marked reduction of the Russian population over the next 45 years (Table 4.3). The old-age dependency ratio (the number of people over 65 relative to the population 20-64) in the Russian Federation is projected to increase from just over 20% in 2000 to around 45% in 2050. This change is of similar magnitude to that in OECD countries. But the driving forces are very different: across the OECD ageing occurs because of growth in the number of older people while the working-age population remains relatively constant. In the Russian Federation, the higher dependency ratio largely results from a decline in the working-age population of around 40 million between 2005 and 2050, while the number of pensioners increases only slowly.

Table 4.3. The Russian Federation's population is projected to decrease and get older

Population by sex and age group, 2005 and 2050, millions of people

	Russian Federation		OECD	
	2005	2050	2005	2050
Total population	144	107.8	1129.6	1334
- Men	66.8	49.2	554.5	652
- Women	77.1	58.6	575.1	681.9
- Age 0-15	21.7	16.2	231.7	211.5
- Age 16-65	102.4	66	750.5	785.8
- Age 65+	19.8	25.7	147.5	336.7
Old-age dependency ratio[1]	22%	42%	22%	47%

1. Old-age dependency ratio (number of people age 65+/number of people 20-64) in 2000: 22%; in 2050: 47%.

Source: OECD (2007), *Society at a Glance*: and UN (2005).

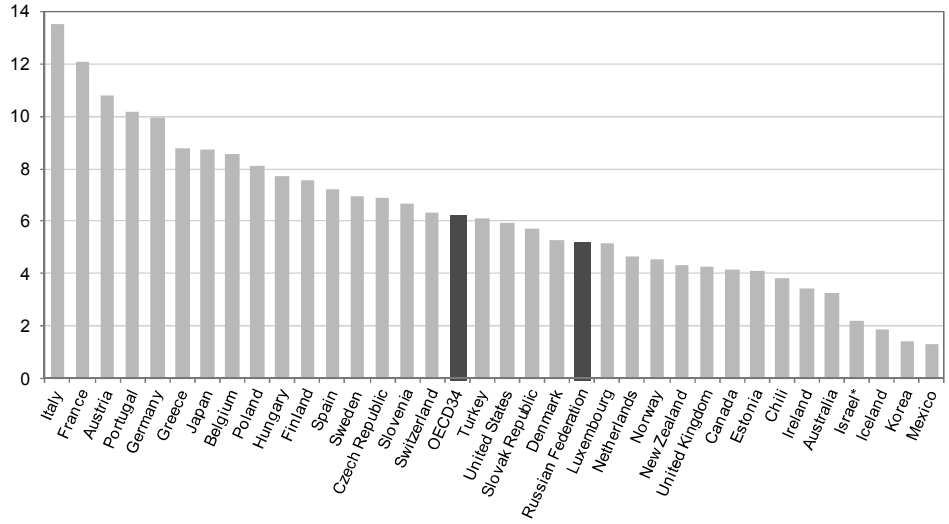
4. Pension policy developments over the past 20 years

Public spending on pensions in the Russian Federation was 5.2% of GDP in 2007, about the same as in Denmark and Luxembourg and some 2 percentage points below the OECD average (Figure 4.4, Panel A). The pattern in public pension spending over time is very different between the Russian Federation and the OECD (Figure 4.4, Panel B). The more volatile time series in the Russian Federation reflects major changes in pension policy during the period. But it is also a consequence of a much more variable pattern of growth in GDP. In the Russian Federation, the ratio of pension spending to GDP rose sharply in the mid-1990s, when the economy slowed down (which both reduced GDP and put pressure on the government budget). During the subsequent recovery, spending declined relative to GDP. GDP growth was especially strong during most of the first decade of the new millennium. As a result, pension spending accounted for a smaller proportion of GDP in 2007 than it did in 2002. The reverse pattern can be seen in 2009, when the economy contracted and pension payments were increased.

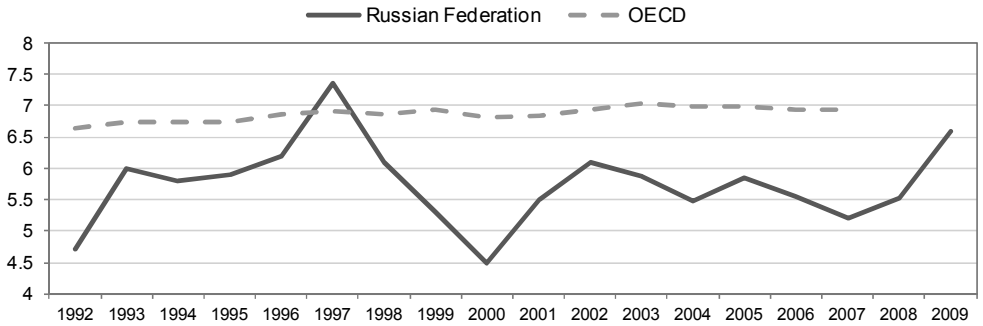
In most of the OECD countries, the social-security system developed relatively slowly through incremental growth in the areas and people covered by social protection. By contrast, within a relatively short period the Russian Federation had simultaneously to develop a market-based economy, put government finances on a healthy footing and try to find a way of coping with existing entitlements to pensions and other social benefits.

Figure 4.4. Public spending on pensions in the Russian Federation is below the OECD average but underlying trends are very different

Panel A. Public expenditure on pensions as a percentage of GDP, Russian Federation and OECD countries, 2007



Panel B. Public expenditure on pensions as a percentage of GDP, 1992 onwards



Note: For OECD countries, the data include spending on old-age and survivors' benefits only. Data on public spending in the Russian Federation includes these two components plus disability pensions: disability benefits account for around 5% of all spending on labour pensions by the Pension Fund of the Russian Federation.

* Information on data for Israel: *http://dx.doi.org/10.1787/888932315602*.

Source: OECD (2010), *Social Expenditure Database* and Ministry of Health and Social Development for the Russian Federation.

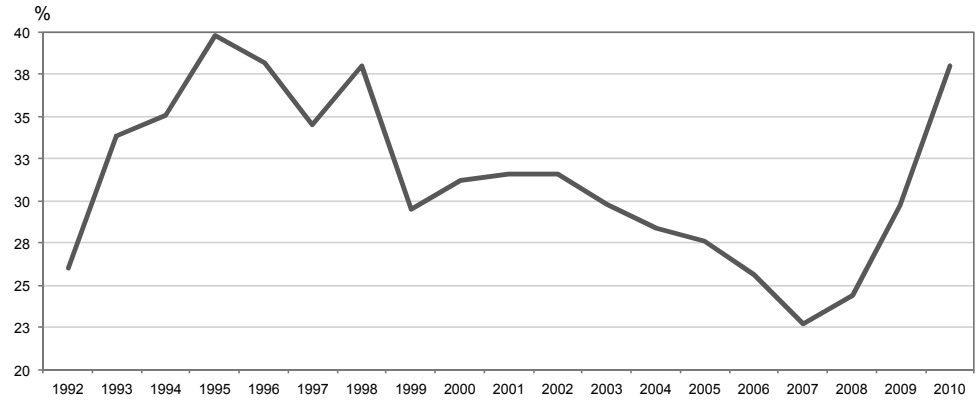
Until the series of pension reforms in the 1990s, the pension system was of the defined benefit (DB) type, under which the value of the pension depends on a measure of individual earnings and employment history. It was financed on pay-as-you-go (PAYG) principles, meaning that current contribution revenues and state subsidies were used to pay current benefits (there was no accumulation of assets in a pension reserve). The system comprised of a main scheme plus separate schemes for party and state workers (who received relatively high payments) and collective farmers, whose benefits were relatively low. Nevertheless, in an economic system with little (official) income inequality and low incomes more generally, provisions for retirement incomes were not regarded as particularly poor and pensioners had access to free health and social services (Sinjavskaya, 2008). The standard pensionable ages were also low at 60 for men and 55 for women. Furthermore, the wide array of special rules for different occupations and regions often permitted retirement well before these already low standard pensionable ages (see below).

The current pension system has evolved through a series of reforms in the 1990s, and major changes in 2002 that established the system as it is today. Economic downturns, a reduction of the tax base through considerable underreporting of earnings and widespread early retirement have all undermined the finances of the pension system. Although the authorities have consistently ensured personal entitlements to a pension *per se* and systemic coverage, the value of benefits has been subject to considerable change and, during the 1990s, there were sometimes problems with the timeliness of payments.

Figure 4.5 shows the volatility over time in the *gross replacement rate* of the Russian pension system. The replacement rate is here defined as the ratio of average pensions paid by the Russian pension fund to average gross earnings. Immediately after the establishment of the Russian Federation, budgetary shortfalls led to a rapid decline in the value of pension payments in the early 1990s: the ratio of average pension to average earnings dropped to just over a quarter by 1992. In response, reform introduced in 1991 increased the ratio of average pensions to earnings to a peak of 40% in 1995. An important change in 1995 was the introduction of pension contributions: employees had to contribute 1% of their wage, while the employer contribution rate was set at 28%.

Figure 4.5. Pensions in payment are volatile relative to wages in the Russian Federation

Ratio of value of average pension to average earnings, 1992-2010



Source: Rosstat (2010b).

During the mid-1990s the fiscal situation was so dire that pensions were paid late and significant pension arrears materialised, imposing considerable hardship on pensioners. Improved economic conditions in the late 1990s allowed the government to increase the real value of pensions. However, growth in average earnings outpaced increases in the average pension in payment between 2002 and 2007. This downward trend was reversed in 2008, with the slowdown of wage growth and the increase in pensions in 2009/10.

The major changes to the pension system are outlined below. The net result of these reforms has been a systemic change to the pension system, away from the "defined benefits" (DB) and "pay-as-you-go" (PAYG) principles. Many of these systemic reforms were inspired by policy developments elsewhere in OECD countries (as set out below):

- 1995/96: a law allowing the establishment of voluntary occupational pension schemes (Canada, Ireland, the United Kingdom, and the United States) was put in place and individual records in the public pension system were introduced (OECD, 2006);
- 1997: proposals to introduce mandatory private pension saving were developed (OECD, 2009) and much of Latin America, central and eastern Europe). These private plans would be defined contribution (DC), where benefits depend on the amount contributed and the investment returns earned. As well as the contrast with the

DB model used previously, this involved a shift from PAYG to prefunding of pensions. Means-tested benefits for those without insurance coverage were introduced.

- 1998: the public pension system was transformed from a DB regime into notional accounts (Italy, Poland, and Sweden). These schemes are often called notional defined contribution (NDC) because they mimic some features of a DC scheme. However, unlike true DC schemes, they are still financed on a PAYG basis.
- 2001/02: the legal basis of the current pension system was finalised in the Russian Federation. The process of centralisation of the administration of the pension system by the Pension Fund of the Russian Federation (PFRF) was completed.
- 2005: the funded, DC component of the mandatory labour pensions in the Russian Federation was restricted to individuals born after 1967.
- 2009: introduction of match of individual contributions to voluntary private pension plans in the Russian Federation on a rouble-for-rouble basis up to a ceiling to expand coverage of these schemes.
- 2009-10: increasing the value of: social pensions and other state pensions; income supplements which depend on social pension payment rates; and, labour pensions by means of revalorisation of pension entitlements (as based on previous pension contributions). The average pension payment (in nominal terms) increased by over 50%. The PFRF becomes responsible for collecting pension contributions. The ceiling on pensionable earnings is reduced from RUB 615 000 to 415 000 (USD 13 540).
- 2011: pension contributions increased from 20 to 26% of the pay-roll; the ceiling on earnings over which contributions are due was increased to RUB 463 000.

This whirlwind of reforms means that the Russian pension system has moved from one based on PAYG and DB principles to a mixed or "multi-pillar" arrangement. The various components or pillars of the new system include a mix of mandatory and voluntary provision; a mix of PAYG and pre-funding to finance benefits; and a mix of DB, DC and notional accounts principles. Nevertheless, retirement-income provision continues to rely heavily on the public budget, and there is no reason to believe that this will change dramatically in the foreseeable future.

5. The 2010 pension system: reform to strengthen adequacy of pension payments

The structure of the Russian pension system does not fit easily with the OECD's taxonomy of pension systems (OECD, 2011c). Moreover, there is much scope for confusion as the Russian literature has its own terminology. For example, what are commonly described as "state pensions" in the Russian Federation comprise the pensions of civil servants, social pensions paid to those who were unable to earn sufficient pension income in their own right and pensions to some other groups of citizens (see below). The "labour pension" system operated by the PFRF, which serves most workers and pensioners, includes a basic benefit (the first-tier of the OECD's pension typology), as well as second-tier pension saving, based on compulsory contributions. Since 1 January 2009, the labour pension system also allows for voluntary private pension contributions, introducing a third-tier saving element in the labour pension system. Finally, there is a system of private, occupational pensions that are mainly offered by large enterprises (Table 4.4).

Table 4.4. Taxonomy of the Russian pension system

<table>
<tr><th>National definitions</th><th colspan="2">Pension programme</th><th>OECD definitions</th></tr>
<tr><td rowspan="2">State pensions</td><td colspan="2">Pensions to civil servants, law-enforcement personnel and the military, participants of the great patriotic war, citizens injured as a result of nuclear or other catastrophes</td><td></td></tr>
<tr><td colspan="2">Social pensions, subsistence-level support for the disabled; financed through the federal budget</td><td rowspan="2">First-tier pensions</td></tr>
<tr><td rowspan="4">Labour pension</td><td rowspan="2">Insurance part of the labour pension (IPLP)</td><td>Defined benefit pension rate (DBPR): flat-rate benefit (payment rate varies with categorisation (e.g. age, household status) of pensioners)</td></tr>
<tr><td>Notional pension rate (NPR), based on notional accounts principles; benefits depend on contributions and notional interest rate set by government</td><td rowspan="2">Second- tier pensions</td></tr>
<tr><td rowspan="2">Funded part of labour pension (FPLP)</td><td>Benefits accruing from mandatory contributions to funded pensions (for those born in 1967 and onwards)</td></tr>
<tr><td>Benefits accruing from voluntary contributions to funded pensions, which are matched by state contributions up to a ceiling</td><td rowspan="2">Third-tier pensions</td></tr>
<tr><td>Private pensions</td><td colspan="2">Voluntary (often occupational) private pensions through private pension funds</td></tr>
</table>

State pensions

The term "state pensions" in the Russian Federation is applied to two different programmes: schemes for government workers and social pensions. This grouping is used because both kinds of scheme are non-contributory. More than four out of every five state pensions are social

pensions, paid to individuals who are unable to work or have been unable to work in the past and earn a pension in their own right. These people include the disabled; children younger than 18 who have lost one or both parents; individuals belonging to a small number of ethnic groups in North Russia; and other individuals who have reached the age of 65 and 60 (men and women, respectively) but are not entitled to a "labour pension" (see below). The value of state pensions varies between different categories of claimants. By 1 January 2010, the average social pension payment of RUB 4 238 (USD 140) exceeded the official minimum subsistence level (MSL) for pensioners (Table 4.1, and Chapter 3 for a discussion of the MSL).[3]

By law, citizens of pension age should have incomes equal to at least the minimum subsistence level. Social pension supplements, consisting of a federal and/or regional supplement, have been introduced on 1 January 2010 to ensure that pensioners have incomes that at least equal the relevant federal or regional minimum subsistence level (Chapter 3). On 1 January 2011 there were 5.1 million recipients of social supplements: 2.7 million people received federal social pension supplements, and 2.4 million people received the regional supplements. The total payments of the federal social pension supplements ranged from RUB 704 (Tambov Region) to RUB 1 597 (Ingush Republic). In January 2011 the amount of regional social supplements varied from RUB 1 238 (Samara Region) to RUB 3 862 (Moscow).

Labour pensions

The category of labour pensions covers a range of contributory retirement benefits. They are generally paid from age 60 for men and age 55 for women. However, pension receipt is not contingent on withdrawal from the formal labour market. Also, full labour pensions can be awarded earlier than the standard ages to people in specific occupations or regions of the country. There are survivors' benefits under labour pension schemes and disability benefits in case of loss of earnings capacity. Pensioners can also have access to one or more additional benefits or "privileges" (Chapter 3).

Between 1994 and 2007, pension payments fell compared with wages (Figure 4.5). Although *average* pension payments were above the minimum subsistence income level for pensioners (MSLp), many pensioners – in particular recipients of survivor and disability benefits – received less than the MSLp (Table 4.1). This motivated the pension reform of 2008, which set a goal of increasing the social pension to the level of the MSLp by 2010 (Ministry of Finance, 2008). This reform was implemented, despite the financial and economic crisis of 2008-09 (Chapter 1).

Insurance part of the labour pension

Since the 2010 reform, the primary component of the old-age labour pension is the "insured part of the labour pension" (IPLP), which consists of a flat "defined benefit pension rate" (DBPR) and a notional pension rate (NPR) based on contributions into notional accounts. Finally, there is the funded part of the labour pension (FPLP) for people born in 1967 and onwards. Benefits under this component will depend on mandatory contributions and state-subsidised voluntary contributions plus the investment returns earned by the pension fund.

With reform in 2010, specific contributions to the basic pension were integrated in the overall level of contributions to the insurance part of the pension, while the maximum earnings threshold was reduced (Chapter 3). An increase in pension contribution rates to 26% is planned for 2011 (see below). Table 4.5 summarises the information on mandatory contribution rates.

Table 4.5. Mandatory contribution rates for individuals born after 1967[1]

Year	Earnings range (RUB)	Basic part	Insurance part	Funded part	Overall
2009	0 to 280 000	6%	8%	6%	20
	280 001 to 600 000	6%	RUB 22 400 + 3.1% of amount over RUB 280 000 (*i.e.* RUB 31 080 at maximum)	RUB 16 800 + 2.4% of amount over RUB 280 000 (*i.e.* RUB 23 520 at maximum)	
	Above 600 000	6%	RUB 32 320	RUB 24 480	
2010	Below RUB 415 000	Integrated in insurance part	14%	6%	20
2011	Below RUB 463 000[2]	Integrated in insurance part			26

1. Individuals born before 1967 have the same overall contribution rate, but they do not contribute to the funded part of the pensions system.

2. The threshold amount is subject to annual indexation in line with growth of average earnings.

Source: Information provided by the Russian authorities.

A flat defined benefit pension rate

As part of the overall drive to improve the adequacy of pensions, the value of flat-rate benefits has increased. Until the 2010 reform, the Russian pension system included a flat-rate "basic part of the labour pension". Between 1994 and 2000, the value of the benefit was set equal to the minimum wage, which itself is relatively low compared with average wages (Chapter 2). Between 2002 and 2008, the basic pension was indexed to consumer prices, which meant that pension payments fell relative to wages.

Between 2008 and 2010, the policy of increasing benefits to the MSLp level was implemented. The rate of the DBPR (for a single pensioner under 80 with no dependants) increased from RUB 1 794 in August 2008 to RUB 2 562 in December 2009, an increase of 42% in nominal terms. With inflation at almost 12% over the period, this amounts to an increase of about 30% in real terms.

Currently, the main qualifying condition for the basic component of the pension is the individual's age. However, from 2015 onwards, the DBPR of the labour pension will depend on the contributory period and will increase by 6% for each year beyond 25 years for women, and 30 years for men).

Notional accounts pensions

The other component of the insured part of the labour pension is based on notional accounts principles. The calculation of benefits is complicated because of rules that deal with the transition from the old defined benefit scheme to the new rules. The new rules apply in full to pension rights earned from 2002 onwards. In 2010, the contribution rate was 20% of earnings for individuals born before 1967. For individuals born after 1967, 6 percentage points of the contribution were diverted to the funded component (see below). Since the contributions to notional accounts pensions are not invested, the interest rate on them is set by the government. The notional interest rate is the growth of the contribution revenues of the insurance part of the labour pension (*i.e.,* excluding contributions to the funded part) divided by the number of pension recipients.[4] Because the number of people of working age is falling fairly rapidly while the number of people of pension age is increasing (see Section 3 above), the notional interest rate is likely to be well below the rate of growth of average earnings. Pensions are indexed to price inflation[5]. Between 2002 and 2007, the growth in contribution revenues per pensioner was above price inflation but below growth in average earnings. Hauner (2008) estimates that benefits were reduced by 7 percentage points relative to growth in wages over the 2002-07 period as a result. Recent reform stipulates that if the annual growth rate of average monthly earnings exceeds a certain threshold (as depending on price indexation in that year), then from April the following year there will be an additional increase to the payment rate.

For pension rights earned before 2002, the situation is slightly more complex. The calculation recognised the value of existing pensions rights: a "replacement rate" of 55% for men with 25 years of contributions and women with 20 years of contributions, with 1% additional "replacement rate" for each year of contributions above these thresholds. For individuals with less than 25/20 years of contributions, the "replacement rate" figure was prorated directly: for example, 15 / 25 x 55% = 33% for a man with

15 years of contributions up to the year 2002. The resulting individual "replacement rates" were then applied to individual earnings averaged over the two years 2000-01 (or to any consecutive period in work of 60 months before 2002). To allow for wage and price inflation in those two years, earnings in the early period were re-valued in line with average earnings growth to average earnings in the period of July-September 2001 (RUB 1 671 per month). The resulting pension entitlement was then multiplied by a factor representing the expected number of years over which the pension would be paid. This notional capital is then added to the individual's account. This last operation is simply the reverse of the calculation of benefits from notional capital set out below.

In recognition of the relatively low pensions generated for years before 2002, notional capital derived from these earlier years was further increased in the 2010 reform by 10% for all employed before 2002. Moreover, the notional capital is increased by an extra 1% for each full year of employment before 1991. This measure was applied both to workers who were continuing to earn pension rights and to people who were already drawing their pensions. It is this change that drove the increase in the average labour pension of around 90% in nominal terms between 1 January 2008 and 1 January 2010. After accounting for the increase in basic payments and price inflation, the notional accounts component increased by around a third in real terms.

At the time of retirement, the accumulated notional capital is converted into a stream of pension payments (an "annuity") by dividing by a factor that reflects the expected duration of pension payment. This was set at 12 years from 2002, 16 years from 2010 and will increase to 19 years from 2013. The figures for 2010 and 2013 are slightly above life expectancy for men at the normal pension age of 60. But they are significantly below the life expectancy of women at their normal pension age of 55 (Table 4.6). Once increased to 19 years, this is close to the average life expectancy of men and women at their respective pension ages.

The coefficient applied to notional capital to convert it into a stream of pension payments is therefore rather less than life expectancy at normal pension ages currently, and much less for women. Nor does the coefficient vary with the age at which the individual draws the pension.

Table 4.6. Life expectancy at normal pension ages by sex, 2000-50

Year	Men (at age 60)	Women (at age 55)	Average
2000	13.2	22.5	19.6
2010	14.3	23.9	21.2
2020	16.4	25.9	23
2030	18.6	27	24.9
2040	19.3	28.6	25.5
2050	20	29.2	25.8

Source: Actuarial forecast by the Pension Fund of the Russian Federation developed in accordance with the targets used in the Concept for Demographic Policy of the Russian Federation until 2025.

The notional accounts schemes of Italy, Poland and Sweden base benefits on the life expectancy of each cohort of individuals at the time of retirement. Thus, benefits automatically fall as life expectancy increases.[6] Over ranges of early and (Italy apart) late retirement, differences in the expected duration of pension payment are reflected in the calculations. The Russian pension system has not adopted these key components of notional accounts principles.

Funded part of the labour pension

Participation in the funded part of the pension system has been *mandatory* for people born in 1967 or later since 2004.[7] Contributions to the funded part are generally 6% of earnings (see below for more details). At the time of retirement, the accumulated capital from contributions and investment returns is converted into a stream of pension payments using exactly the same life-expectancy factor as the notional accounts scheme; that is, 19 years from 2013 onwards. Given current pensionable ages for men and women, the first old-age pension benefits based on a full record of contributions to the FPLP will be made in 2022. However, just exactly how benefit payments will be related to contributions and investment returns is unclear. The authorities have not yet set minimum and maximum payment rates, although they plan to do so in the future. To a degree, this delay does not matter because people with significant funded pensions will not retire in large numbers for some time (although survivor and disability pension entitlements will be paid rather sooner). But this administrative delay means there is significant uncertainty about the value of funded-pension entitlements. This provides incentives to under-report earnings, reducing the value of contributions paid in.

Since 1 January 2009, the Russian authorities have opened up the FPLP to *voluntary* pension saving. There are financial incentives to make voluntary contributions to top up entitlements under the mandatory schemes. The federal authorities will match individual contributions rouble-for-rouble for savings ranging from RUB 2 000 (USD 68) to RUB 12 000 (USD 408) annually. In addition, if an individual continues to make these contributions until retirement (and/or defers pension payments), the maximum annual state contribution increases to RUB 48 000 (USD 1 633). This level of state support for pension saving is not expected to be permanent. Most probably it will run for individuals beginning to contribute for the next five years, with matched contributions withdrawn from existing savers after ten years. However, the effect of this policy on voluntary retirement saving is probably limited by the lack of transparency in the eventual benefits discussed above. Clarity and transparency about future benefits are essential to the success of programmes to encourage voluntary retirement savings.

Social contributions were collected by the tax authorities until 2010, when this responsibility was passed to the PFRF for mandatory pension payments to PFRF and for mandatory medical insurance payment to respective Medical Insurance Funds.[8] When tax authorities collected the contributions, it took about 15 months before these were placed into individual pension accounts. It is expected this period will be reduced to six months, during which the PFRF is allowed to earn interest on these contributions.

Participants in the funded pension component in the Russian Federation have a choice of pension providers. First, they can choose who administers the individual account: the PFRF or a non-state private pension fund (NPF). Secondly, they can choose who manages the assets: the state asset-management company, the Russian Development Bank ("Vnechococombank", VEB) or a private asset-management company sub-contracted by the PFRF. However, individuals do *not* have a choice as to how the portfolio is allocated between different asset classes: each provider has a "one-size-fits-all" portfolio. While most countries adopting mandatory funded pensions initially started with single portfolios, many – such as Australia, Chile, Hungary, Mexico, Poland and the Slovak Republic – have now moved to offer a choice of portfolios with each provider. These portfolios are designed to offer different degrees of risk and potential investment returns.

Employees can choose the pension administrator and asset manager once a year. The idea is to stimulate individuals to take an active interest in the accumulation of their future pensions while limiting the degree of costly switching between providers that has plagued many of the funded pension systems in Latin America. However, private-pension companies are not

allowed to compete actively (through advertisements, for example) with each other or with the government agencies for a share of the market. The authorities have made resources available for financial education and to increase awareness of the different options among pension savers. However, in view of the overall complexity of the pension system, it is unclear how pension savers could make an informed choice about who is best placed to manage their savings.

If pension savers do not express a choice, the default is that pension assets are held by the PFRF and managed by the VEB. By the third quarter of 2009, aggregate assets in mandatory pension fund amounted to RUB 538 billion or about 0.8% of GDP. Of the total assets of the mandatory fund, 82% is managed by the VEB. Until October 2009, the VEB had to invest funds in government securities or state-certified corporate bonds, which have consistently generated a rate of return below price inflation. In 2008 and 2009, the annual real rate of return on investment by the VEB was almost –9%. Until 2008, the investment portfolios of private asset-management companies were more diverse (Renaissance Capital, 2008). Investment returns by funds managed by private companies were generally positive (but not in 2007; see Hauner, 2008), which has contributed to the authorities widening the VEB investment portfolio to include international bonds, regional bonds, mortgage bonds, and Russian bank deposits.

The Russian private pension market has evolved since 1992. Non-state private pension funds can also hold pension accounts of the labour pension system. They offer a variety of pension products for individual savers and corporate clients, typically for large firms such as Gazprom. These occupational schemes account for some 90% of all private pension savings in the Russian Federation (Renaissance Capital, 2008). At January 2009, these non-state private pension funds paid benefits to over 1.1 million people, and there were about 3.6 million people with mandatory pension savings in individual accounts; there were over 6.7 million participants in the private pension system. Because of more stringent capital requirements introduced in 2009, there has been some consolidation in the pension industry: the number of non-state private pension funds declined from 243 in October 2008 to 164 in March 2009. At 1 January 2010, assets held in voluntary asset reserves were about RUB 518 billion (0.8% of GDP). This is in addition to the mandatory pension assets which also amounted to 0.8% of GDP in 2009. This is very small compared with most OECD countries, where private pension funds' assets are worth 33% of GDP on average.

One peculiar feature of the FPLP is that while accumulated assets in pension plans are owned by pension savers in OECD countries, this is not the case in the Russian Federation. The law provides for an explicit guarantee of the mandatory contributions made to the FPLP if these are held by the PFRF. However, the law is unclear as whether this also applies to assets held by non-state private funds. And these guarantees do not apply to voluntary pension contributions. In the absence of individual ownership and benefit guarantees, it is hardly surprising that voluntary individual pension saving has not yet taken off in the Russian Federation.

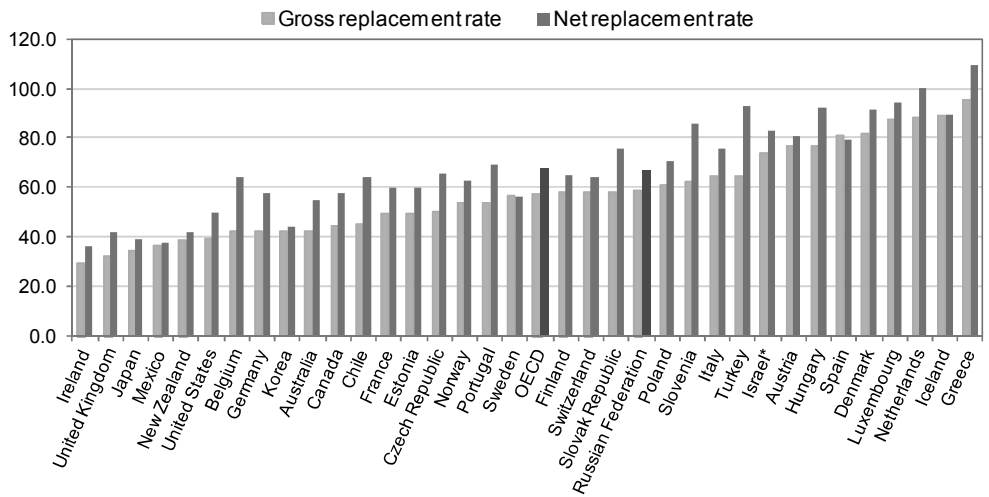
Future pension entitlements accruing from the current system

Current pension system parameters can be modelled to generate a picture of the entitlements which current pension plan participants will receive. The OECD's *Pensions at a Glance* provides a framework for cross-national comparisons of pension systems and future pension entitlements. By standardising long-term economic and financial assumptions (price inflation, wage growth, investment returns, etc.), it focuses on differences in the parameters and rules of pension systems rather than on the variance in national economic trajectories. Under the current system in the Russian Federation, a man with average earnings working from age 20 to the normal pensionable age of 60 would receive a gross replacement rate (pension relative to individual earnings) of about 58%. The *net* (after-tax) replacement rate is somewhat higher at 67%.[9] From this international perspective, the replacement rate generated by the Russian system is around the OECD average, as shown in Figure 4.6.

Table 4.7 looks in more detail at the different components of the Russian pension system and provides a sensitivity analysis of some of the assumptions involved in modelling future pension entitlements. Column 1 applies the standard OECD assumptions used in *Pensions at a Glance*, which include a full career and annual real earnings growth of 2% annually (OECD, 2011c).

The OECD pension models consider life expectancy beyond the standard pensionable age as the expected period of pension payment. However, in the Russian Federation this period is set at 19 years from 2013 onwards, which has a negative effect on replacement rates compared with the baseline OECD scenario (Table 4.7, Column 2).

Figure 4.6. Replacement rates for mandatory pensions in the Russian Federation are around the OECD average



Note: Gross and net (after-tax) replacement rates for mandatory pension programmes, men, percentage of average wages.

* Information on data for Israel: *http://dx.doi.org/10.1787/888932315602*.

Source: OECD pension models.

The rest of Table 4.7 shows further analyses:

- Column 3 shows the effect on the replacement rate if men achieve only 30 years of contributions at the time of drawing the pension, rather than the full career of 40 years (over age 20-60). The Russian government's objective for the pension system is to generate replacement rates of 40% of gross earnings after 30 years' contributions. Here, the shorter career is modelled by assuming entry into the pension system at age 30 with a full record thereafter. If it were instead assumed that the gaps in the contribution record were later on, then replacement rates for 30 years' contributions would be higher than those shown.
- Column 4 presents entitlements under the insured (public) part of the Russian pension system, consisting of the flat-rate payment and notional accounts. Replacement rates (for full-career workers) are expected to be around 35% gross and 40% net; and
- Column 5 illustrates what would happen to replacement rates if the real return on investments were 1% over the long term instead of the 3.5%

baseline assumption. (Since their introduction, real returns on funded pensions have been negative.)

- Column 6 shows how much lower replacement rates would be if the contribution rate for pension in the long term were reduced from 26% of gross earnings to 20%.

Table 4.7. Pension replacement rates for a man with average earnings: sensitivity analysis

		Expected period of pension payment T = 19				
	OECD *Pensions at a Glance* (1)	(2)	30 year employment (3)	Insured part only (4)	Rate of return on capital is 1% (5)	Contribution rate at 20% (6)
Gross replacement rate	58.4	52.3	38.2	35.0	45.4	41.8
Net replacement rate	67.1	60.1	43.9	40.2	52.2	48.0

Source: OECD pension models.

Finally, these results look at the value of the pension at the time of retirement. In the Russian Federation, policies for the indexation of pensions in payment have varied. Moreover, both price inflation and real earnings growth have been very volatile. The policy for indexation of pensions in payment is therefore especially critical in the Russian Federation: a sustained period of rapid growth in nominal earnings could, as it has done in the past, risk leaving pensioners' incomes behind.[10]

6. Financial sustainability

Recent changes to the Russian Federation's pensions have addressed the immediate issue of the adequacy of current pension payments. However, the ageing of the population – which will see the proportion of the population aged 65 and over double over the coming 40 years – provides a major challenge to the finances of the pension system.

Current financial position

Table 4.8 shows the financial flows related to the pension system for 2009. Revenue amounted to 8.25% of GDP. Revenue from social security contributions amount to 2.5% of GDP while interbudgetary transfers for the federal budget amounted to 5% of GDP, *i.e.* more than 75% of expenditures. In 2009, expenditure on labour pensions amounted to 6.1% of GDP in 2009 and on State pensions 0.4% of GDP (spending on monthly cash payments – see Chapter 3, administrative costs and other outlays amounted to almost 1% of GDP).

Table 4.8. Pension revenues and expenditures, 2009

Income	Billion RUB	% of GDP	Expenditure	Billion RUB	% of GDP
Total	**3223**	**8.25**	**Total**	**3009**	**7.70**
Including:			*Including*		
Social security contributions	991	2.54	Labour pensions	2374	6.08
Interbudgetary transfers from the Federal budget	1944	4.98	- Basic part of the labour pension	979	2.51
Including transfers for payment of :			- Insured part of the labour pension	1395	3.57
Basic part of the labour pension	984	2.52			
State pensions	182	0.47	State pensions	173	0.44

Memorandum item: Total accrued savings of the PFRF as of 1 January 2010 amounted to RUB 976 billion or 2.5% of GDP.

Source: Information provided by the Russian authorities.

Projecting future pension spending accurately is difficult, and individual projections differ because of different assumptions on a range of factors, as for example, GDP growth, wage growth, interest rates, life expectancy and the inclusion of different types of pension schemes. Nevertheless, broad trends can be revealed. OECD (2011c) projects public pension outlays to edge up to almost 9% in 2020 and decline slowly from then onwards to 7.5% in 2050. The PFRF expects spending to decline earlier: from almost 8% in 2010, to 7.35% in 2020, 6.5% in 2030 and remain around 6% of GDP in 2040 and 2050. The PFRF (2009) projects revenue from social security contributions to amount to 4% of GDP over the 2010-50 period and federal budgetary transfers to decline from 7% of GDP in 2010 to 4% in 2020 and 2% in 2050. This seems optimistic, as contribution revenue is only 2.5% of GDP at present, and even with a contribution rate increase from 20 to 26% (see below) revenue is likely to be closer to 3% of GDP. Federal budgetary transfers are likely to continue to play an important role in the financing of pensions in the Russian Federation for years to come.

Early pensions

The standard pensionable ages of 55 for women and 60 for men are relatively low by international standards, although for men, this is perhaps justified by their relatively low life expectancy. The main financial pressure on the pension system comes from the fact that about 35% of people draw their pensions *before* the standard retirement age.[11] Many pension recipients continue to work.

Starting with women, at age 50, 30% have taken a pension, half of whom have fully retired. At age 55, nearly all women have begun to draw a

pension, but only 40% of them have retired. However, by age 60, 80% of female pensioners are no longer working. Men tend to work a little longer and claim their pensions a little later on average than women. About 20% of men aged 50 are claiming a pension, of whom half have retired. By age 55, 40% of men are pensioners; again, half of them have retired. Almost all men have taken a pension by age 60, yet 40% are still in employment (Sinjavskaya, 2004).

The large extent of early pension receipt is a result of a complex series of institutions and policies: disability benefits and the plethora of schemes that grant full pension entitlements to specified categories of workers.[12] Early pensions are awarded to workers because of their presumed deterioration of work-capacity in view of unfavourable conditions, including: *i)* hazardous and arduous work conditions (Lists 1 and 2 – the so-called "short lists" include a list of specified professions/occupations *e.g.* logging or mining); *ii)* demanding work-environments (certain categories of medical and pedagogical workers); and *iii)* socio-economic factors (mothers with many children or with disabled children) and regional living conditions (*e.g.* working in the Arctic and similar regions).

The "short lists" of jobs apply to positions and professions across the Russian Federation, regardless of firm-ownership. If a worker is employed in an industry or at a manufacturing facility that is included in the lists or his/her profession or job description corresponds to the positions or professions designated in the list they are eligible for early pensions. In general, the type of profession/job, total length of insured employment, and length of services under specific conditions, determine the number of years at which workers can retire before reaching the standard pensionable age. For example, the most numerous group of early pension recipients are those with a certain length of service in hazardous and harmful labour conditions, and ten years of the work in such conditions for men and 7.5 years for women with insurance periods of 20 and 15 years, respectively, entitle men to retirement on a full labour pensions at age 50 (rather than 60) and women at age 45 (and not 55).

For workers in the extreme North, standard pensionable ages are generally 55 for men and 50 for women, subject to a work history of 15-20 years. The average age of pension claim for workers in these regions is just below 50 for women and 53 for men. Retirement "privileges" are also offered to workers in occupations such as transport (railways, docks, trucks, buses, airlines, etc.), loggers and medical staff (OECD, 2001). Workers in these industries typically draw their pensions two years before the national average (Sinjavskaya, 2004).

For many of these privileged occupations, or work in designated geographical areas, the fact is that modern technology has facilitated great progress in living and working conditions in most sectors, compared to the time when these early-pension privileges were first awarded. Thus, many of these privileges cannot be justified any longer. Change is strongly resisted, and some argue that the current list of jobs/occupations which involve "harmful working conditions" is more related to the power of lobby groups than based on a realistic assessment of working conditions (Sinjavskaya, 2004). However, reform is being considered, which involves certification of work conditions in terms of risks, and compensatory payments to employers in view of their increasing social security contributions (see below).

Changing established pension rights is difficult at the best of times, but this is all the more difficult when *both* employers and employees stand to lose. Employees would be averse to losing their early pension and the opportunity to keep on earning in their job as many of them currently do. Employers would be opposed to having to internalise their staff-costs, which are currently, and inappropriately, borne by a pension system financed out of general taxation. The public system should not pay for early pensions, and any financial compensation towards employers for the reform of the current early pension system should be phased out as soon as possible.

Pension contributions

The pension contributions in 2010 amounted to 20% of wages, of which 6 percentage points goes towards the funded part of the pension system (if the worker is born in 1967 or later), and the other 14 percentage points go toward the insurance part of the Labour pension (20 percentage points if the worker is born before 1967).

Figure 4.7 compares this contribution rate with the 21 OECD countries that levy separate pension contributions.[13] In 2010, the Russian Federation's contribution rate was just below the average for OECD countries of 22%.

A major difference with OECD countries is that contributions are paid by employers only in the Russian Federation. In OECD countries, employees pay 36% of pension contributions, with employers and the self-employed paying the remainder (OECD, 2011c).

The fact that contribution revenues pay for only a minority of pension benefits is an indication of the size of the challenge of financial sustainability for the Russian pension system. While the Russian Federation raises 2.5% of GDP in pension contribution revenues with a contribution rate of 20% of earnings, OECD countries raise an average of double that figure – 5% of GDP – with an average contribution rate just above that of the Russian Federation (OECD, 2011c).

There are three factors that limit the aggregate value of pension contribution revenues:

- *Coverage and labour-force participation.* It is estimated that pension contributions are made on behalf of almost three-quarters of the labour force in the Russian Federation. Some 87% of the labour force is covered on average in OECD countries.[14]

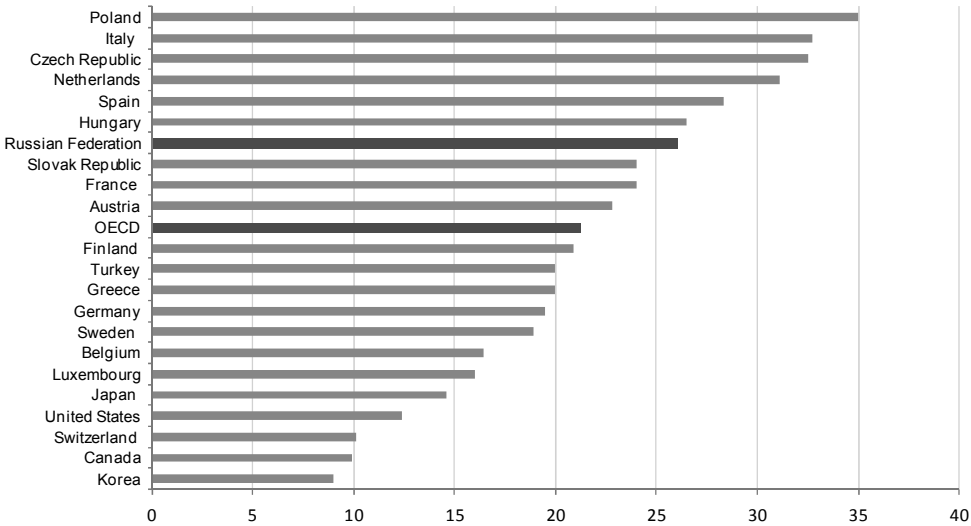
- *Under-reporting of earnings*. It is widely acknowledged that employers under-report the earnings of their employees. Estimates of the extent of this practice are naturally subject to a high degree of uncertainty, but this could be as high as 35-40% of aggregate earnings (or about 11-12% of GDP). This seriously compromises contribution revenues. To avoid overburdening employers, the PFRF will hold joint inspections with other relevant public agencies (such as the tax authorities or the social-insurance fund). However, the PFRF lacks instant access to the databases of these and other public authorities, and *vice versa*. Hence, it is unrealistic to expect a significant increase in compliance with contribution rules in the Russian Federation in the near future, unless policy moves to address these access issues.

- *Exemptions from standard contribution rates.* Employers in specified industrial sectors – such as agriculture and emerging technologies – are charged contribution rates well below the norm. In these sectors, contribution rates average around 10% of earnings, or half of the standard rate. Mandatory contributions by the self-employed are also very small. Despite reform in 2010, many sectors will continue to benefit from exemptions to the standard contribution rate, and there is clearly a risk that employer lobbies will maintain these exemptions.

From 1 January 2011 onwards, the standard pension contribution rate increased from 20% to 26% of earnings (there have been proposals for a further increase to 30%). The increase in contribution rates should increase revenues, at least in the short-term. However, this will feed through to higher benefit payments because of the link between contribution revenues per pensioner and increases in pensions in payment (and also with the notional interest rate in the notional accounts scheme). In the longer term, the higher contribution rate may aggravate the problem of under-reporting of earnings. Nevertheless, contributions were 30% of earnings in the 1990s and the decline in contribution rates in the early 2000s had no discernible effect on reported earnings. Clearly, the authorities are not put off by the negative effects that increased contribution rates may have on labour demand (both informal and formal).

Figure 4.7. Pension contribution rates in the Russian Federation are well above the OECD average

Pension contribution as a percentage of gross earnings, 2007 (2011 for the Russian Federation)



Source: OECD (2011), *Pensions at a Glance.*

7. Conclusions

Financed through the Russian Federation's considerable natural resources, recent policy reform has moved to improve the adequacy of pension benefits. Between 2008 and 2010, through the increase of social pension supplements, incomes of minimum pension payment were raised to at least the minimum subsistence level, At the same time, labour pensions have been improved to generate incomes closer to 40% of the average wage, the avowed long-term objective in terms of replacement income. The overall structure of the pension system is generally sound: redistributive components, such as the basic pension and social pensions, to combat poverty and a balance between pay-as-you-go financing and pre-funding of income-replacement benefits. However, the system is complex and lacks transparency. Furthermore, frequent *ad-hoc* changes in the parameters and rules of the different components have led to a great deal of uncertainty about retirement incomes for both pensioners and workers. The current pension system combines fairly meagre benefits with a high fiscal cost, primarily a result of the early age at which people draw pensions.

The issue of adequacy of benefits is discussed next, then early pensions and fiscal sustainability. The analysis ends with a discussion of some of the design features of the current system that could be improved.

Adequacy of benefits

In the short-term, it is likely that earnings growth will erode the purchasing power of pensions, as it did from the mid-1990s to 2008. Pensions are indexed to price inflation. . If the annual growth rate of the average monthly earnings exceeds the year's cumulative pension indexation coefficient, then from April the following year there will be an additional increase in the payment rate. Demographic trends and the diversion of contributions to the funded part of the pension system mean that revenue growth is likely to be well below growth in average earnings. As a result, the value of pensions in payment will fall behind the growth of incomes of workers in the future.

The notional interest rate applied to the notional accounts pensions is also linked to the rate of growth of contribution revenues per pensioner. Since this is likely to fall behind growth in average earnings, the value of benefits relative to earnings will decline for each successive cohort of new retirees, over the longer term.

The performance of the funded component has been disappointing so far. Real rates of return on investments have been consistently negative since 2002. If this continues, then benefits under this part of the system will also be low. Reform is needed to ensure that these accounts deliver positive real rates of return over the long term. There has been some liberalisation of the types of assets open to managers. However, there is no competition between pension funds or asset managers; it is unclear how fund managers can attract clientele to their funds or how individuals can make an informed choice concerning pension investment. There is also a need for greater awareness of this part of the pension system, which could be helped by information campaigns. Shifting contributions to this component from employers to employees would also make people more aware of this pension scheme.

Early pensions

There were about 20 million people in the Russian Federation aged over 65 (the typical standard pension age in OECD countries) in 2005. But because of the low ages at which people draw pensions, there were about 37 million pensioners, of which about six million were covered by disability and survivors' benefits.

The standard pension ages of 55 for women and 60 for men are low by international standards. Yet increases in pension age have played little part

in the pension-reform debate in the Russian Federation. The relatively short life expectancy (especially among men) has been used as an argument against increasing the pensionable age. However, men who reach age 60 are likely to live an additional 14 years. Women aged 55 have 23 years of additional life expectancy. As a first step, women's pension age should be increased gradually (say over a ten-year period) to equalise it with men's. All bar two OECD countries either have equalised or will equalise pension ages for men and women.

Further increases in pension age beyond 60 would also be desirable, if the recent increases in life expectancy continue. The effects would be considerable. For example, if standard pensionable ages could be increased to 62 years, the number of pensioners in 2025 would be around 30 million, rather than 36 million on current policies. This would also increase the number of workers contributing to the system. Both developments would improve the scheme's finances which, through the link between benefits and the growth in revenues per contributor, would also enhance the value of pensions.

The issue of take-up of pensions before the already low standard pensionable age also needs to be addressed. Service records of just 20-25 years often generate entitlement to early pensions. Many people who draw these early pensions continue working, often in the same job. Working conditions in some sectors no longer warrant the award of early pensions. But, even if there is a case to be made for awarding early pensions to, say, bus drivers or airline staff, then the maximum period of early retirement should be limited. A maximum of five years would be reasonable. The costs of this early retirement should be borne by the employer. The current arrangements effectively cross-subsidise these sectors from others by financing pensions from general taxation and pension contributions. The internalisation of such costs would provide transparency of the costs of these early-pension schemes to all involved, and further increase understanding of the need for reform. The costs of early pensions should be borne by the employer in question: any financial compensation towards employers for the reform of the current early pension system should be phased out as soon as possible.

Financial sustainability

The pension system already requires a huge subsidy from general government revenues: pension contributions pay for only about 40% of current benefits. This financial situation will deteriorate further in the future under the weight of demographic pressure. The population as a whole is projected to decline by a quarter between 2005 and 2050. During this period, the number of people aged 16-64 will fall by 35% while the number aged 65 and over will increase by 30%. From a position of having over five people aged 16-64 for each one aged 65 and over, this ratio will decline to 2.5.

Dealing with the cost of paying benefits from early ages is a necessary part of moving towards financial sustainability. But it will not be sufficient. Action is needed on the revenue as well as the expenditure side of the accounts. First, contribution-collection procedures need to be strengthened as a matter of priority to deal with the pervasive problem of under-reporting of earnings. Better co-ordination between different public agencies, particularly mutual, direct access to databases, would help. Complex control procedures should be simplified. Secondly, reduced contribution rates for particular economic sectors should be removed and a *single contribution rate* and *schedule* applied to *all* employers and employees.

The increase in contribution rates introduced in 2011 is one way of raising revenues However, at 26%, the new rate will be above the average in OECD countries. This is effectively a tax on employment and is likely to reduce demand for labour. Moreover, the design of the Russian pension system means that part of the revenues will be diverted into paying higher benefits at that point and in the future because of the link between indexation of pensions in payment and the notional interest rate with the contribution revenues of the system. To generate more revenue, it may be better to increase the upper earnings threshold over which contributions are due to at least two times the average wage or more.

Design features

The overall architecture of the system, with different components playing different roles, is a good one. But, in some features, it falls short of best practice. First, indexation of pensions in payment to prices would protect the real value of benefits more effectively than the complex mix of price inflation, earnings growth and growth in contribution revenues per pensioner. Secondly, both the notional accounts and funded components of the system divide accumulated capital at the time of retirement by an arbitrary figure of 12, 16 and 19 at different points in time. Instead, as with notional accounts and defined contribution schemes in other countries, this figure should be linked to projected life expectancy at the time the individual draws the pension. Finally, this calculation of life expectancy should also take into account the age of individuals when they draw their pension. This would mean that benefit levels reflect the length of duration over which the pension is to be paid.

Notes

1. In the Russian context, the phrase "standard pensionable age" is much more appropriate that "standard retirement age", as many Russian pensioners continue to be in employment after they take up their pension.

2. There are different reasons for the absolute level of poverty among pensioners being so much lower than relative income poverty. First, the absolute poverty line in Official Statistics is about 80% of the relative poverty line used here. In addition, the poverty line for pensioners is set at about 80% of that applying to the general population (Chapter 3, Box 3.2), which further reduces the probability of older people being counted as "poor".

3. Other state pensions include those for victims of radiation or similar catastrophes; disability pensions paid to the military; veterans of the Second Wold War; and survivors' benefits for families of people in the previous categories. The families of other categories of pensioner may be eligible for survivors' labour pensions and disabled civil servants are also covered by labour pensions.

4. The interest rates applied in OECD countries are the growth in GDP in Italy, average earnings in Sweden and the higher of price inflation or growth of the wage bill in Poland.

5. The 2010 reform also introduced an automatic adjustment of pensions-in-payment rates if inflation exceeds 6% since the last adjustment of benefits.

6. See Whitehouse (2007) for a discussion of automatic links between pensions and life expectancy in these and other OECD countries.

7. During the first three years of the funded pension regime (2002-04), some men born between 1953 and 1966 and women born between 1958 and 1966 were covered by the funded pension scheme.

8. On 1 January 2010, the Unified Social Tax was replaced by contributions to the pension fund and the social insurance fund of the Russian Federation and local medical insurance funds. The PFRF is once again responsible for the collection of contributions and all its operational aspects, including increasing awareness on

contributory rules, identification and registration of contributors and workers on whose behalf contributions are made in a database which registers individual entitlements, reimbursement of excess payments and the imposition of fines where appropriate.

9. As pension payments do not vary across the country, while wages do (Chapter 1), in net financial terms, pensions have a somewhat greater value in Samara and Tatarstan than on average for Russia as a whole or for those living in Moscow.

10. For a detailed discussion of indexation issues, policies and practices, see Whitehouse (2009).

11. The numbers are approximately the same whether one looks at the stock of current pensioners or new pension recipients in a given year.

12. Many of these schemes were established prior to 1990, but during the 1990s access to early pensions was extended. For example, the number of long-service pensioners increased eightfold in the decade following 1991. Long-service pensions were offered to teachers and medical staff in rural areas in 1996, and these workers can retire at any age with 25 years of relevant experience. (Sinjavskaya, 2004).

13. The other nine countries do not separately identify "pension" from other social security contributions or do not levy contributions at all.

14. *Source*: *World Bank Pensions Database*.

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