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by

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Introduction[1]

At present, 70% of the Russian population are entitled to a large variety of social benefits. Estimates based on data from service suppliers and government agencies paying social benefits put the number of benefit receivers at about 100 million. The current system of social benefits and benefit payment mechanisms has limited potential for redistributing resources to those who need them most. In addition, Russia does not have an adequate system of accounting for social payments and benefit provision, which creates problems in defining the responsibilities of both benefit providers and recipients.

Trying to push towards greater efficiency of social policy, while cutting overall spending (a goal shared at present by all welfare states, East and West), the Putin administration has so far focused specifically on three objectives:

- Centralization of financial resources allocated for fulfilling social guarantees (e.g., elimination of off-budget social funds);
- Redistribution of the social-support burden between various levels of government on the one hand, and employees and employers on the other hand;
- Provision of social benefits on the basis of targeting (means test).

With the stabilization plan in 1998 measures to achieve these goals have been incorporated into the government's social and economic reform strategy. In July 2000, the government approved the "Strategy of Russia's Development in the years 2000-2010" (the so-called "Gref Plan"), which emphasizes the need to improve the efficiency of the social insurance system. The introduction of the Unified Social Tax, and therefore the reform of the collection and distribution of financial resources allocated for social payments, represents a central part of this strategy.

This paper presents an analysis of the introduction of the Unified Social Tax. We ask what the main changes are in the areas of financing and collecting social security contributions, and how these changes affect social policy reform in the fields of pensions, health, and employment.

In the first section (Social Policy 1999/2000: Starting Point for the Second Wave of Reforms), we will describe the legacy of the Yeltsin era, the starting point for the second wave of reforms in social policy. Section two (The Unified Social Tax: Basis for Funding) gives an overview over the newly introduced Social Tax and the related political debate. This new method of collecting social insurance contributions directly affects three areas of social policy: pensions, health, and employment. In section three (Specific Social Policy Fields), we outline current reforms in each of these three fields. The last section (Findings) sums up the main findings and evaluates the implications of the Unified Social Tax for Russia's current social policy.

Up to now there are no academic studies which describe or analyse the Unified Social Tax and its implications. As a consequence, this article relies heavily on up-to-date information provided by Russian media, statistics, and interviews. Moreover, we would like to point out one particular limitation of this work. This article takes a "state-centralistic" approach. We therefore largely ignore the role and contributions of non-state actors, as well as of Russia's regions and their relations with the federal centre in the provision of social policy.

[1] The authors would like to thank Tat'yana Maleva (Carnegie Foundation, Moscow), Lev Savulkin (Leontief Centre for Economic Research (Tsentr ekonomicheskikh issledovanii Leont'eva)), St. Petersburg), Katharina Mueller (University Viadrina, Frankfurt/Oder) and Andreas Heinrich (Institute for East European Studies, Berlin) for their valuable support and advice.

Social Policy 1999/ 2000: Starting Point for the Second Wave of Reforms *(Susanne Nies)*

Social Policy in Putin's Russia: Bringing the State back in

Reform Incentives

When Putin came to power at the end of 1999, he inherited a system of weak and dispersed government. Intransparency, corruption, shadow economy and barter trade had become dominant features of the post-Soviet economy. Due to a complicated legal system, foreign direct investment remained insignificant. The defeat in the first Chechnya War, the intervention by NATO in Kosovo and the financial crisis of August 1998 reinforced the overall impression of Russian decline.[2]

The rise of raw material prices and a favourable distribution of power in the upper house of the parliament presented a unique opportunity for a re-design of government. This is all the more important as forecasts predict falling oil prices from late 2001 with a consequent negative impact on the budget.[3]

The new administration prioritised the restoration of central government. The creation of seven "super-regions" situated administratively between the centre and the 89 subjects and the redirection of fiscal flows are part of this strategy. Public policy and thus social policy are strongly dependent on the success of this change in terms of trade. Supplementary specific social policy reforms have to address two other major points: the targeting of social spending, and specific reforms in social policy sectors (health, employment, pensions, education etc.).

Government and Federalism

One important consequence of federalism Yeltsin-style was the absence of a clear division of powers and responsibilities between federal, regional and local entities. The huge regional autonomy which existed from 1992 onwards meant in practice liberty without responsibility. New mechanisms of bypassing obligations emerged, such as the creation of extra-budgetary funds – perceived to be a panacea to all budgetary problems. The social situation of Russian citizens became strongly dependent on the capacities and the economic potential of the regions of which they were residents. The best off were and are the citizens of the countries "top dozen regions": Moscow, Moscow Oblast, St. Petersburg (the prime gateway regions); Samara, Nizhny Novgorod, Perm, Sverdlovsk, (industrial regions with good infrastructure); Tatarstan, Bashkortostan (rich in resources, with a good infrastructure), Krasnoyarsk (Norilsk Nikel, the largest non-ferrous metal producer in Russia), Irkutsk, Tyumen (Gazprom, the oil and gas giant).[4]

The "Bottom Ten" are regions such as Marii El, Republic of Adygeya, Republic of Northern Ossetia, Republic of Kalmykia, Chita Oblast, Republic of Dagestan, Jewish Autonomous Oblast, Republic of Ingushetia, and Republic of Tuva. The GDP per capita of Tyumen for 1999 was ten times as large as the GDP per capita of Kalmykia.[5] Better-off regions preferred to sup-

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[2] Cf. Fruchtmann, Jakob / Pleines, Heiko: Das russische Steuersystem. Profil und erste Ergebnisse des Forschungsprojekts "Wirtschaftskulturelle Faktoren in Steuergesetzgebung und Steuerpraxis der Russischen Föderation", Arbeitspapiere und Materialien der Forschungsstelle Osteuropa No. 25, Bremen 2001, p. 8.

[3] Russia economy: Falling oil prices. Economist Intelligence Unit, 4.12.2001, published on the internet at: http://www.securities.co.uk/

[4] Cf. UNDP: Human Development Report 1998-2000, Russia's Prosperity by Regions, Washington, published on the internet at: http://www.undp.org

[5] Smith, Graham: The Post-Soviet States, London 1999, p. 194.

port "their" needy instead of participating in fiscal redistribution between federal entities. Solidarity with the state was everywhere on the wane. For an overview of the main taxes and their distribution between the centre and the regions see Table 1. The distribution of these revenues was sharply criticised by the regions, mostly because the lions' share of the important VAT went to the centre.[6]

Table 1: Division of Tax Revenues between Centre and Region in 1998

Tax	Percentage to the centre	Percentage to the region
Excise (energy and imports)	100	0
VAT	75	25
Excise (domestically produced Alcohol)	50	50
Profit Tax	37	63
Personal income tax	0	100

Source: Nelson, Erick / Breach, Al: Russia: The Federation and its subjects – How much decentralisation, in: Goldmann Sachs, 30.11.1998, p 17.

Nevertheless there is no simple answer concerning the role of the regions during the 90s: Local administrations behaved irresponsibly, some regions were simply overburdened with their social problems, some became laboratories of reform: from communist reforms such as in Ulyanovsk to liberal ones such as in Nizhny Novgorod.

Inefficiency of social spending and the absence of targeting

One hundred million Russians, or seventy percent of the population, are today entitled to benefits.[7] According to official estimates, only one third of allocations go to the really needy –[8] there is as yet no efficient targeting. The old Soviet system of l'goty[9] remained intact. People are often entitled to l'goty because of risks they have undergone in the past: participation in wars etc.

[6] Cf. Nicholson, Martin: Towards a Russia of the Regions, London 1999, p. 33.

[7] Cf. Kosmarsky, Vladimir: Social Policy. First Steps towards reform, in: Russian Economic Trends Monthly, The Centre for Economic Reforms, 9.1.2001, published on the internet at: http://www.securities.co.uk/

[8] Cf. Kosmarsky, Vladimir: Social Policy. First Steps towards reform, in: Russian Economic Trends Monthly, The Centre for Economic Reforms, 9.1.2001, published on the internet at: http://www.securities.co.uk/

[9] Literally „benefits, privileges".

Overview: Social policy allocations in 2000

Total number of persons entitled to social assistance in 2000	100 million citizens = 70 % of the Russian population
Benefits by categories	256 categories of citizens are entitled to social benefits. Entitlements are dependent on • risks from former times (e.g. participation in wars and other risks of the past which entailed a higher than average risk) • kind and conditions of employment, both in the past and in the future • duration of employment (Hero of labour) • health (invalidity) • number of children
Number of different kinds of social transfers	256 kinds of social transfers

Compiled by Susanne Nies, Berlin 2001.

Specific reform requirements in social policy sectors

The introduction of the Unified Social Tax is a response to problems of the funding side. At a lower level, specific social policy problems have to be addressed. The most urgent requirements for reform concern wages in the public sector, the erosion of public health, the pension reform and specific regional problems.

The Unified Social Tax: Basis for Funding (*Gesa Walcher*)

Brief History of Tax Legislation Reforms

For about a decade, Russian tax legislation was based on a basic law of December 1991.[10] It specified a range of federal, regional and local taxes. A set of laws on specific taxes (VAT, profit tax and income for banks and insurance companies, etc) entered into force in 1992. The tax system was structured similarly to that of Western industrial countries, but its drawbacks, including an enormous tax burden on enterprises, became more and more obvious. During the years of transition, numerous amendments to these laws were made, most of them ad hoc and aimed at solving isolated problems, without tackling the whole system - which, as a consequence, became more and more complicated. As a starting point for a complex and comprehensive tax reform, a new Tax Code was submitted to the Duma in early 1996, after three years of preparatory work. Initially, it had been expected that the Code would have passed through the Duma the end of 1996 at the latest, but this did not happen. In June 1997 the general part had been passed in the first reading with a large number of amendments, so that the adoption of the document was postponed. A new version of the Tax Code was submitted to the Duma only in February 1998.[11]

[10] Zakon RF ot 27.12.1991 Nr. 2118-I "Ob osnovakh nalogovoi sistemy v Rossiiskoi Federatsii", in: Vedomosti Soveta narodnykh deputatov RSFSR i Verkhovnogo Soveta RSFSR 11/1992, St. 52.

[11] For an overview of the development of the Russian tax system, see: Himes, Susan / Miliet-Einbinder, Martine: Russia's Tax Reform, OECD Observer 215/1999; Seidel, Bernhard / Schooten, Mechthild: Fiscal Federalism and

The first real steps towards standardisation and reform of the tax system were made in 1999 with the adoption of the first part of the Tax Code, which established basic tax terms and principles of tax administration. The adoption of this document increased standardisation and simplification of the system. However, this first part of the Code brought only limited changes to the application of the new rules in real life. In practice, changes were dependent on the introduction of the operative chapters of the Code.

This process began in summer 2000 when the Duma passed the chapters of Part Two of Tax Code in the second reading, which regulates taxation of individuals. The new legislation is based mainly on the proposals of German Gref's Centre of Strategic Research.[12]

The new taxation rules reduce the level of personal income tax from 30% (top marginal rate) to a flat rate of 13% for residents and introduces a 'penalty rate' of 35% on income derived from insurance-based, loan-bonus and bank deposit arrangements. Non-residents have to pay a rate of 30% on income from Russian sources. Furthermore, the legislation introduces a Unified Social Tax (UST, discussed below), pooling payments to the Social Insurance Fund, the Pension Fund and the mandatory Medical Insurance Fund. The new legislation entered into force on 1 January 2001.

The main aims of the tax reform are: lowering the overall tax burden, increasing equality within the tax system, simplifying the tax system by reducing the number of tax rates, and improving tax administration and tax collection. The overall tax burden is predicted to decrease by around 2% of GDP in 2001 and by more than 5% in the medium term.

The UST: Facts and Figures

The UST, as part of the new tax legislation, is meant to replace many mandatory deductions that employers were formerly required to withhold from the salaries of employees and transfer to the Pension Fund, the Social Insurance Fund and the Medical Fund.[13] This consolidation of several payroll taxes simplifies the tax system and alleviates the tax burden on the payroll fund, which had amounted to 46% of the total. Employers' contributions to the Employment Fund have been abolished and the Fund will thus be financed exclusively via personal income tax revenue (1% of 13% of the personal income tax is allocated to the Employment Fund). Fees required for mandatory social insurance to cover accidents at work and professional diseases are not included in the UST, but will nevertheless be levied in the future according to current legislation on such payments.

Application of the Regressive Scale

The new chapter of the tax code introduces a regressive scale of the UST. The tax base is to be calculated by the employer separately for each employee based on the employee's accumulated income for the year. For individual entrepreneurs, the tax rates will range from a high of 35.6% on income below 100,000 roubles to a low of 2% on income above 600,000 roubles. Employers will generally pay less total tax under the UST than they currently pay to the non-budgetary social funds.

Financial Resources for Regional Development: Co-operative and Competitive Models. The International Experience – an Example for Russia? DIW Discussion Papers No. 220, Berlin 2000.

[12] The Economist Intelligence Unit, 26.1.2001, published on the internet at: http://www.securities.co.uk; Chmelev, Alexander / Astakhov, Evgeny: Part Two of the Russian Federation Tax Code, in: BISNIS, 10.8.2000, published on the internet at: http://www.bisnis.doc.gov/bisnis/COUNTRY/000818rstxcde2.htm

[13] For an overview, see Cochrane, Ian / Gidirim, Vladimir / Carty, Tim / Dobritskaia, Zhanna: The Russian Tax System. Achievements in 2000 and the Possible Agenda for 2001, in: Russian Economic Trends, 3/2000, pp. 17-19; Nezavisimaya Gazeta, 6.10.2000.

Table 2: The Unified Social Tax

Tax rate for the employer (organisations and enterprises)	The income fund (the employee's annual salary)
35.6%	Below 100,000 roubles
20.0%	100,001 to 300,000 roubles
10.0%	300,001 to 600,000 roubles
2.0%*	Above 600,000 roubles

* Until 1 January 2002, the rate was 5.0%.

Table 3: Distribution of the Unified Social Tax rate of 35.6%

Pension Fund	28.0%
Social Insurance Fund	4.0%
Mandatory Health Insurance Fund	3.6%
TOTAL	35.6%

Source for Table 2 and 3: Pricewaterhouse Coopers, Global Tax Bulletin, 10.8.2000, published on the internet at: http://www.taxnews.com/

This regressive scale is designed to encourage companies to accurately report salaries paid to employees. Therefore, it is evident that it will be preferable, at least in terms of raw mathematics, to pay staff compensation as remuneration through the payroll. Many organisations (including foreign companies) have underreported the salaries of employees in order to reduce the payouts into social funds.[14] An additional benefit is the fact that a single monthly remuneration will replace the current system where each of the four funds requires its own calculation and payment. This is widely considered to be a positive step in terms of transparency within the Russian economy as a whole, and specifically in the labour market.

Although this all sounds fairly simple and straightforward, certain transition regulations have been introduced, which employers planning to opt for the new social security regime will have to satisfy. In order to qualify for the new regressive contribution scale, the average level of compensation to all employees of a company or organization must have exceeded 25,000 roubles for the last six months of 2000. The top 30% of employees (in terms of salary) will be ignored in calculating the average. For organizations with more than 30 employees, the remuneration of the top 10% will be ignored. This means that in order to qualify for the regressive scale, an organization will have to prove that it paid an average level of compensation in excess of approximately 160 US$ per month in the second half of 2000. In economic terms many employers would satisfy this test. However, where any of the 'alternative' schemes were used, the level of income paid as remuneration may have been less than this figure. These organizations need to look carefully at their payroll, and need to raise averages by increasing salaries paid to staff.[15]

If regressive rates do not apply, social fund contributions should be paid at 35.6%. These "anti-avoidance" rules might slow down the process of employers declaring salaries in full, as benefits from truthfully declaring salaries in 2001 will, in certain cases, arise only a year later, depending of course on the extent to which salaries are being understated in 2000. However, bear-

[14] Estimation by Pricewaterhouse Coopers: Global Tax Bulletin, 10.8.2000, published on the internet at: http://www.taxnews.com

[15] Kogtev, Iurii: Far-reaching Tax Reform in Russia, in: Russia/Central Europe Executive Guide, 15.1.2001.

ing in mind the relatively small amounts of remuneration this might not become a crucial issue for most companies but could discourage employers with large numbers of employees with relatively low salaries from adopting transparent structures.

It was expected that the introduction of the UST would clarify the applicability of Russian social security to foreigners. However, this remains a rather grey area of the legislation. Apart from the Pension Fund which specifically declared that Russian pensions are not applicable to foreigners (with the exception of those permanently residing in Russia and certain CIS citizens) none of the social security funds have made a clear statement whether or not foreign citizens have the right to use Russian state medical and social insurance.

Public Opinion

The UST was widely discussed in public within the context of the overall debate and the drafting of part two of the new Tax Code, in spring 2000.[16] On the eve of the Duma vote, both the government and the presidential administration believed that the deputies would pass a more conservative form of the bill. However, on the last day, leaders of the budget committee started to persuade the Duma factions that a compromise would deprive the tax reform of any meaning. Tax cuts would not reach a critical level, and enterprises would continue no to report salaries accurately.[17] Deputy Prime Minister Valentina Matvienko, supported by trade union leader Mikhail Shmakov, Head of the Pension Fund Mikhail Zurabov, and Head of the Presidential Administration Alexander Voloshin, insisted on a bill which would allow the Pension Fund to stay independent for the next two years. Deputy Prime Minister Aleksei Kudrin, Finance Ministry officials, and the Minister of Economic Development German Gref wanted the bill to be more radical, but at the same time were afraid of a conflict with the Prime Minister. Prime Minister Mikhail Kasyanov was interested in the most advanced form of the bill, but he had to take the opinion of the Presidential Administration into account.[18]

During the process of the drafting of the new Tax Code and immediately after its publication, Trade Union members all over the country gathered for protests and rallies – for the first time in many years. The main argument of the unions was that there is no guarantee that the state will actually allocate all the sums collected to the social funds. Also, the distribution in their respective proportions would not be not secured. They demanded that the Federal Authorities should stop any changes in the social sphere, which will lead to restrictions and the abolition of already miserable social guarantees.[19] A similar criticism came from international unions, for example the 200-million-members strong World Industrial Union. They claimed that the social tax would lead to insufficient funding of pensions, of benefits in the case of unemployment or temporary incapacity to work, of treatment in sanatoria, and of medical care for children.[20] In their opinion, it seemed unacceptable to put the burden of social expenditure on the shoulders of workers, especially at a time when one third of the Russian population is living below the poverty line. They called on the Russian government to consult properly with the country's unions on the

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[16] Since then, discussions have shifted and now concentrate on policy-making circles, government agencies and research institutions.

[17] "Duma vote on tax reform brings surprises", in: WPS – Russian Political Monitor, 16.6.2000; television interview with Prime Minister Mikhail Kasyanov on Zerkalo RTR, published in CentreInvest – Russian Market Weekly, 13.6.2000.

[18] Vedomosti, 14.6. 2000.

[19] Kovalev, Vladimir: Suspicion greets tax law changes, in: Russian Economic Barometer, 6.10.2000; The Union Messenger, Information Bulletin on the Labour Movement in Russia, July-August 2000; "Russia economy: Tax reforms", The Economist Intelligence Unit, 12.6.2000; "Russian Communists oppose government-proposed tax reforms", BBC Monitoring, source: NTV Moscow, 7.6.2000.

[20] International Federation of Chemical, Energy, Mine and General Workers' Unions (ICEM) at a meeting in Brussels, May 2000. ICEM Update 53/2000.

issue, in order to come up with an equitable social security system that will guarantee the funding of these essential social benefits for workers and their families.

Other arguments against the UST came from pensioners who have been frightened into believing that their meagre pay cheques will no longer arrive once the social security taxes are channelled through the budget rather than specialised funds. The communist party backed this argument. Furthermore, they did not agree to mandatory payments for health and education, and that the only solution to the pension problem is the transition to a fund-based pension-entitlement.[21]

As will be described in the section "Current Discussions and Plans", the fiercest opposition came from the non-budgetary funds, in particular the Pension Fund. In recent years these funds have become powerful, independent institutions, which have been able to block any attempts to meddle with "their" charges. They accepted the new system only after the government promised them that not much would change, apart from the fact that social taxes would from now on be channelled through the federal budget and then passed on to the non-budgetary funds.[22]

Economic analysts and enterprises generally assessed the reform positively.[23] Business representatives liked the idea of an "all in one"-option for making their payments. In the past they had to deal with the bureaucracy of four different administrations, as well as with the Federal Ministries, just to pay their payroll taxes. A number of analysts expected that channelling the social payments through the federal budget would allow the government to keep the non-budgetary funds on a short leash and reduce payments where money was wasted.

It is clear that the reform of social security contributions is primarily intended to bring more transactions into the open, with the further intention of simplifying tax collection and encouraging both employers and employees to be tax compliant. In unifying the social taxes, the government is trying to make the social funds more transparent and less powerful.

The introduction of the UST goes hand in hand with wider reform discussions in the field of social security, and certainly effects decision-making in this important policy field. The social tax is a new way of collecting and distributing social security contributions – nothing more, but also nothing less. The wider implications for social policy implementation will be discussed in the following chapters.

Specific Social Policy Fields

The creation of social funds in Russia dates back to 1991: pensions, medical insurance, unemployment insurance and welfare. They were independent of the general state budget; the state's role was simply to make sure that the enterprises paid. The total enterprise contributions to the various funds were set at 38.6% of the wage bill (pensions – 28%, health insurance – 3.6%, unemployment – 1.6%, welfare – 5.4%). In addition, 1% of income tax was passed to the Pension Fund. Until 1993, these funds were under the supervision of parliament, which, in response to the galloping inflation, voted to index pensions.[24]

The adoption of the new tax code, under which social payments are defined as a tax, is a first step to reintegrating the social funds into the general budget. A new system of individual accounts will be phased in, whereby 2% of a worker's wages will be paid into a personal pension

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[21] Press conference with the Foundation "Politika", in: Federal News Service, 16.6.2000.

[22] Country briefing: Russian economy – Tax reform, in: Economist Intelligence Unit, 12.6.2000.

[23] McChesney, Andrew: Streamlined Social Taxation Gets Approval of Business, in: Economist Intelligence Unit, 27.7.2000.

[24] In the Soviet Union, social spending was part of the state budget, while the unions disbursed the money. For an overview over the Soviet social system see: Connor, Walter: Social Policy under Communism, in: Kapstein, Ethan / Mandelbaum, Michael (eds.): Sustaining the Transition: The Social Safety Net in Postcommunist Europe, New York 1997, pp. 10-45.

account, starting from 2002. New laws on medical and social insurance programmes are being drafted and are to be approved by the cabinet. There will be a transition period of one to two years, and the new programme will start in 2003.

The impact of the new contribution system on social reform in general as well as the wider policy discussions will be examined in more detail on the next pages. We will concentrate on three sectors: pensions, health and employment, as these are the fields which are directly affected by the new method of collection/distribution of social contributions.

Reform of the Pension System *(Gesa Walcher)*

Despite a dramatic decline in life expectancy over the past decade, the proportion of the elderly among Russia's population is increasing rapidly – pensioners make up more than a quarter of the Russian population, and this proportion is growing. Currently, the relation pensioner-worker is 1:1.4. These demographic developments are overwhelming the discussion of the country's current pension system and prompting leading experts to call for its overhaul.[25]

Although the ageing of populations is straining social security systems all over Europe and economic theory on old age pensioning and studies of pension policy are a growing industry, the crisis in Russia seems to be most acute. With 8% of GDP spent on retirement, disability, and widespread occupational privileges,[26] demographic forecasts indicate that without a reform those expenditures will have to increase to about 25% of GDP in 2050.[27] With a sharp decline in the number of economically active citizens as compared with the number of pensioners, the simple distribution of insurance premiums – as is being done today – will cause a reduction in the sum received by each pensioner. However, according to current legislation the average pension is tied to average wages throughout the country. In other words, there will be less money, but the same amount will have to be paid out. In about eight years, the ratio of pensioners to workers will reach that critical value after which the Pension Fund budget will inevitably go into deficit. This will lead to a collapse of the state pension system.

Many experts involved in the reform of the Russian pension system concluded from the Chilean and most other Latin American experiences of the 1980ies[28] that a comprehensive pension re-

[25] According to current projections, one third of the population will reach pensionable age in five to seven years. See interview with Labour Minister Aleksandr Pochinok, "Demographic Decline Almost Irreversible", Intercon Daily Report on Russia, 17.5.2001. For an overview of statistics and impact on the demographic crisis, see: Goskomstat: Quarterly Statistical Reports, published on the internet at: http://www.securities.co.uk, 30.12.1999; Vassin, Sergei A.: The Determinants and Implications of an Ageing Population in Russia, in: DaVanzo, Julie / Farnsworth, Gwendolyn (eds.): Russia's Demographic "Crisis". Conference Report, RAND, CF-124-CRES, Santa Monica 1996, published on the internet at: http://www.rand.org/publications/CF/CF124/CF124.chap6.html; Nivorozhkina, Ludmila: Living Standard of the Russian Pensioners and Pension System, in: Stropnik, Nada (ed.): Social and Economic Aspects of Ageing Societies, Lyjublyana 1997, pp. 195-211.

[26] Around 38 million people in Russia receive pension benefits, however, only half of them (around 20 million) are actually above retirement age. Sinyavskaya, Oksana: Chelovek i gosudarstvo v rossiiskoi pensionnoi sisteme, in: Pro et Contra 6/2001, pp. 46-62, here: p. 58, published on the internet at: http://pubs.carnegie.ru/p&c/Vol6-2001/3/v6n3-03.pdf

[27] Healey, Thomas: Russia's Uniquely Enormous and Complex Problem, in: Pensions International, April 2000, http://www.pensionsinternational.co.uk; Kapstein, Ethan / Milanovic, Branko: Dividing Transition Gains and Losses: Pensions, Privatization, and Reform in Russia, in: Transition, 1/2000, pp. 4-7; Vittas, Dimitri / Michelitsch, Roland: Pension Funds in Central Europe and Russia. Their Prospects and Potential Role in Corporate Governance, Policy Research Working Paper No. 1459, Washington 1995.

[28] Following an invitation by Presidential Advisor Andrei Illarionov to Moscow in April 2001, the chief architect of the Chilean reform, Jose Pinera, started a discussion about the Chilenian reform as a model for Russia – the social security system now in place in Russia is the same Chile had until the 1980s. Pinera is of the opinion that the chief obstacle for implementing a Chilean style reform in Russia is employers' lack of trust of the domestic financial system. He argues that Russia needs to copy Chile's free market economic reforms if it is to emerge from its Communist past – Russia's pay-as-you-go pension system should be replaced with a system of personal retirement accounts

form – as opposed to merely improving the existing system – has to start by replacing the current monopoly of the "pay-as-you-go" system (with pensions paid out of tax revenues) by a combination of a fully funded, mandatory contribution system with voluntary, private funded schemes.[29] As they embark on systemic reform, the key issues to be addressed by Russia are the relative size and functions of the public and private pillars that will evolve from the reform process, and the speed of the transition to the financial pension system.

Main Shortcomings of the Current Pension System

Russia currently operates a "pay-as-you-go" pension system: The younger generation sponsors the elder. Contributions made by those in employment are immediately paid out as benefits to pensioners. This system requires companies to transfer 28% of their wage bill and individual workers 1% of their salary to the Pension Fund. Pension transfers in Russia support 38.5 million pensioners. Due to revenue shortfalls, the centrally managed Pension Fund has been in a deepening fiscal crisis since 1995. Falling output, tax evasion, and tax offsets at the enterprise level have repeatedly forced the Pension Fund to cut or even suspend pension payments. As a result of the fiscal crisis, and despite periodic upward revisions, there has been a steady erosion of pensions vis-à-vis subsistence needs. In late 1998 pension arrears amounted to 30.5 billion roubles (at that time about 1.1 billion US$).[30]

The inadequacies and defects of the current pension system can be summed up as follows:[31]

High contribution rates and weak compliance

Poor collection of contributions has led to arrears in the payment of benefits. The pension system is replenished from the budget if it runs into a deficit. Employees' direct contributions are either zero or minimal. As successful collection depends heavily on the employer's tax burden, this encourages managers to evade tax by under-reporting their payroll. The gap between official and actual contribution rates, coupled with other budgetary problems, explains the current shortfall in pensions

invested in real economic assets like stocks and bonds. Pinera, Jose: A Chilenian Model for Russia, in: Foreign Affairs, 5/2000, pp. 62-73.

[29] Recent studies on the reform of the Russian pension system: Cashu, Ilean: The New Politics of Pension Retrenchment in Russia, New York 2000 (draft); Denisova, Irina / Gorban, Maria / Iudaeva, Ksenia: Social Policy in Russia: Pension Fund and Social Security, in: Russian Economic Trends, 1/1999, pp. 12-23; Cook, Linda: The Impact of Globalization and Liberalization on the Russian Welfare State, Providence 1999 (draft); Vasin, S. / Gontmakher, E. / Dmitriev, M. et al: Pensionnaya Reforma v Rossii: Prichiny, soderzhanie, perspektivy, St. Petersburg 1998; Charlton, Roger / McKinnon, Roddy / Konopielko, Lukasz: Pensions Reform, Privatisation and Restructuring in the Transition: Unfinished Business or Inappropriate Agendas?, in: Europe Asia Studies 8/1998, pp. 1413-1446; Castello Branco, Marta de: Pension Reform in the Baltics, Russia, and other Countries of the Former Soviet Union (BRO), IMF Working Paper WP/98/11, Washington 1998 published on the internet at: http://www.imf.org/external/pubs/ft/wp/wp9811.pdf; Fox, Louise: Pension Reform in the Post-Communist Transition Economies, in: Nelson, Joan / Tilly, Charles / Walker, Lee (eds.): Transforming Post-Communist Political Economies, Washington 1997, pp. 370-384; Udodova, Svetlana: On the Strategy of the Implementation of the Pension System in Russia, in: Stropnik, Nada (ed.): Social and economic aspects of ageing societies: An Important Social Development Issue, Lyublyana 1997, pp. 214-218; Mikhalev, Vladimir: Social Security in Russia under Economic Transformation, in: Europe-Asia Studies 1/1996, pp. 5-25; Vittas, Dimitri / Michelitsch, Roland: Pension Funds in Central Europe and Russia. Their Prospects and Potential Role in Corporate Governance, World Bank Policy Research Working Paper No. 1459, Washington 1995.

[30] Kapstein, Ethan / Milanovich, Branko: „Russia badly needs pension reform", in: Transition Newsletter, The World Bank Group 1/2000.

[31] Spravochnik sotsial'no-ekonomicheskie problemy Rossii: Istoki krizisa pensionnoi sistemy (glava 10), published on the internet at: http://fiper.ru/spr/chapter-10-1.html; Nussberger, Angelika: Eine neue Etappe in der Reform des russischen Rentensystems, in: Deutsche Rentenversicherung 6-7/1999, pp. 406-414.

Missing link between salaries and benefits

There is no direct link between salaries earned, pension payments made and benefits ultimately received. As the amount of contributions does not directly influence the amount of benefit, there is no incentive for employees to work more effectively and receive better salaries. Many Russians see this system as another state tax and feel they have little to benefit from participating in it and little incentive to save for retirement.

Unfavourable demographic trends

The share of pensioners in the overall population is 19% and rising. Between 1959 and 1990, the proportion of the population aged 60 and above doubled. From 2010, Russia is expected to see a dramatic increase in the number of pensioners while the working population will be decreasing. The retirement age is 55 for women and 60 for men, which is extremely low compared to international retirement standards. While specialists recognise that because the population is becoming older the retirement age should be increased, politicians refuse to consider this possibility – one reason for that is the extremely low life expectancy of the Russian population. The average life expectancy fell to 65.5 years in 1999, according to a report presented by the Russian Academy of Medical Science. The rate for men was 59.9 years, while the average life expectancy for women was 72 years.[32]

Reform 2000/2001: The Introduction of a Mandatory Funded System

The government has long been committed to the move from the current "pay-as-you-go" pension system to a funded three-tier system of pension provision including a basic state pension, a state earnings-related pension and a supplementary pension financed by voluntary contributions to private pension funds. At a government meeting in September 2000, which reviewed the financial background to the pension proposals, the economic and financial outlook was judged favourable. The basic proposal for the new system was put forward on 5 October 2000.

The shape of the reforms is based broadly on the document drafted by a previous administration in May 1998. Though the final proposals look likely to be less ambitious than the May 1998 blueprint, some details are becoming clearer. The system will consist of three "pillars":

- The *first pillar* in the form of a publicly financed "pay-as-you-go" system, designed to provide an income floor for all elderly persons (as described above);
- A *second pillar* with mandatory earnings-related programs, which in turn would be fully or at least partly capitalised (as described below);
- A *third pillar* with voluntary earnings-related pension regimes, which, in the long run, should be fully capitalised (as described below).

The second pillar: Earnings-related pensions

Currently, the working assumption is that funds will start to be set aside for the mandatory second pillar in the near future.[33] Who will manage the funds and what securities it will be allowed to invest in remains unclear. One of the suggested options is that they will be kept centrally on one account opened at, for example, the Central Bank of Russia. The Pension Fund will invest these funds through investment companies and the interest accrued will be reflected on each

[32] "Life expectancy falls again", in: The Russia Journal, 28.10.2000. See also: DaVanzo, Julie / Adamson, David: Russia's Demographic Crisis: How real is it?, in: RAND Issue Paper July 1997, published on the internet at: http://www.rand.org/publications/IP/IP162/

[33] Originally, the beginning of 2002 was envisaged, using 100 billion roubles left over by the Pension Fund from 1999. Zubarev, Leonid / McKenna, Cameron: Emerging Legislation for New Russian System, in: Pensions International, February 2001, published on the internet at: http://www.pensionsinternational.co.uk

individual account.[34] The government will have to try to avoid the high costs of the second pillar which were caused. for example, by the implementation of the system in Poland, as a result of the competition of funds leading to an increased administrative burden and marketing costs.

The goal of the reform is to split the current pension contribution of 28%, setting aside one half to pay the minimum pension, and the other half for pension accumulation. Employers will pay 2% of their employees' wages into superannuation accounts. This share will be raised to 9% by 2009. Employee contributions of 1% are due to be abolished. All information regarding an employee, his salary and contributions made by the employer will be kept on an individual notional account – an electronic document that will be a modified version of the already existing personalised data recording system run by the State Pension Fund.[35]

Participation in the second pillar will be mandatory for all new entrants to the labour force and for all male workers born in 1950 or later and female workers born in 1955 or later. For older workers it will be voluntary. As currently planned, young workers would have to transfer some 6% of their salaries, while older workers may only have to contribute 2%. The redistribution system will remain, but its share will decrease. It could possibly become a minimum pension guaranteed by the government.

According to Minister of Labour Aleksandr Pochinok, first payments out of the savings system will be made in 2010. The amount will, of course, depend on the general state of the domestic economy but, according to the best-case scenario, by 2010 the average additional benefit received from the savings system could be equal to 12% of the average pension. By 2025 funded pensions could be equal to or higher than the state "pay-as-you-go" payment.[36] However, the government acknowledges the right to return to the distribution system in case economic conditions worsen establishing the funded pillar will inevitably leave less money to pay for the existing "pay-as-you-go" state scheme. The hope is that economic growth, depending on the world oil price, will expand the surplus of the state fund to the point where most or all of the contributions to the second pillar can be paid out of the surplus.[37]

The third pillar: Voluntary contributions to private pension funds

Safeguards and investment opportunities for private pension funds are one of the critical issues for Russia. Russian institutions have a poor record of managing the population's savings. Moreover, the potential to conservatively invest pension money in growing sectors of the Russian economy is limited.

At present only 260,000 pensioners receive payments from private funds – although more than 2.5 million Russians participate in them.[38] Private funds pay 107 roubles per month on average, or 25% on top of the average 580 roubles state pension. At the same time, the official subsistence minimum for pensioners is set by government decree at 851 roubles (30 US$). Corporate pension funds, which are the strongest element of a private pension system, can afford payments dozens of times higher than the state rate. Major corporate funds, which account for only 15% of the country's private funds, hold 93% of all assets and 65% of its clients. Indeed, during 1999, they tripled their own funds and invested more than 11 billion roubles into the economy. The corporate funds of Lukoil, Surgutneftegaz and Gazprom, which are among the largest, indi-

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[34] "Turf War Hinders Progress", in: Pensions International, April 2001, published on the internet at: http://www.pensionsinternational.co.uk

[35] Zubarev, Leonid / McKenna, Cameron: Emerging Legislation for New Russian System, in: Pensions International, February 2001, published on the internet at: http://www.pensionsinternational.co.uk

[36] Izvestiya, 6.2.2001.

[37] Kommersant", 7.2.2001.

[38] On private pension funds in Russia see: WPS – The Russian Finance Report, 20.4.2001, published on the internet at: http://www.securities.co.uk; Petrosian, Kristine: Pensions Overhaul Shapes Up, in: The Russia Journal, 1.7.2000.

cate that the growth rate is most impressive for the funds related to the most promising sectors of the economy. However, most company pension funds are reinvesting the money into themselves. Surgutneftegaz, for one, has used its pension fund to buy 40% of its own stock, something that would not be allowed in the West. The other big two – Lukoil and Gazprom – are following suit. Between them, these three companies account for about half of the assets in pension funds.[39]

Since the beginning of 2001, 11 new funds were registered; according to Andrei Mudrakov, Head of the Private Pension Funds Revision Committee, several foreign banks and companies have shown interest in organising such funds in Russia.[40]

Current Discussions and Plans

In February 2001, President Vladimir Putin initiated the creation of the National Council for Pension Reform, to be led by Prime Minister Mikhail Kasyanov.[41] The purpose of the Council is to lead a public debate about the pension reform plans and try to achieve a consensus between the various government agencies with differing ideas on the nature and speed of reform. Two of the leading proponents of reform are Mikhail Zurabov, Head of the State Pension Fund and Mikhail Dmitriev, Deputy Minister for Economic Development and Trade and main promoter of the pension reform. A number of working groups have been set up to discuss the details of the reform, such as the legal, budgetary and investment issues. Although the exact membership of the Council has not been published, it is at the highest level and includes the Prime Minister and heads of government departments and the State Pension Fund.[42]

The Turf War between the Pension Fund and Ministry of Economy

As the introduction of the UST has drastically reduced the influence of the State Pension Fund – one of the most powerful financial institutions in Russia – by depriving it of the responsibility for collecting pension contributions, it is now anxious to recover some of its former eminence within the reform debate. The Pension Fund concept proceeds from the traditional Soviet principle of a unified fund, although it makes provisions for organisation of a reserve fund to make a transition to the individual system easier in the future. It wants the transition period to the new three-pillar system to be drawn out over 20 years so as to retain its powerful position as the provider of the first pillar “pay-as-you-go” system for as long as possible. At certain points in the debate it has argued against having any mandatory funded pillar at all and has pressed instead the virtues of a national defined contribution system. Moreover, one version of its proposals argued against the introduction of individual accounts.[43]

Ranged against the Pension Fund is a group of reformers within the government, headed by the Ministry of Economy, which wants to stop the Pension Fund regaining any of its old authority. It argues that the reform should take a more conventional path along the route of international experience. This means individual accounts (payments by each employee to the Pension Fund should be transferred to a personal account, as a result of which these savings will be strictly connected to the owner), individual choice and private sector managers. According to Mikhail

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[39] However, most company pension funds are reinvesting the money into themselves. Surgutneftegaz, for one, has used its pension fund to buy 40% of its own stock, something that would not be allowed in the West. The other big two – Lukoil and Gazprom - are following suit. Between them, these three companies account for about half of the assets in pension funds. Kristine Petrosian: Pension overhaul shapes up, in: The Russia Journal, 1.7.2000.

[40] Petrosian, Kristine: Pensions Overhaul Shapes Up, in: The Russia Journal, 1.7.2000.

[41] “Putin Sets Up National Council for Pension Reform”, in: Pensions International, March 2001, published on the internet at: http://www.pensionsinternational.co.uk

[42] Nezavisimaya Gazeta, 6.3.2001.

[43] “Turf War Hinders Progress”, in: Pensions International, April 2001, published on the internet at: http://www.pensionsinternational.co.uk

Dmitriev, superannuation funds should be invested in the most promising sectors of the Russian economy. If this is done, the government will receive an interest-free loan from its citizens. Dmitriev also speaks about the possible attraction of foreign companies for "international diversification" of the assets of the accumulating element of the Russian Pension Fund.[44]

The Question of Pension Management and Financing

The main problem connected with the creation of a pension fund is where to invest the assets in order to achieve security and a return above the rate of inflation. Various options have been considered but it is generally recognised that at present there is no investment instrument or institution within Russia which would secure the savings of millions of people.

There are similar problems with regard to insurance and the investment of reserves. Being commercial organisations, insurance companies are subject to the usual tax treatment. In addition, according to the recent changes in tax legislation re-insurance premiums on life policies paid by Russian insurance companies to foreign reinsures are not tax deductible as from 1 January 2001. As non-profit organisations, pension funds enjoy a less onerous tax regime. But while there are about 1,400 insurance companies in Russia, the number of pension funds is far smaller and nearly all have been established only to provide pension benefits for employees of a major enterprise or an industry as a whole.[45]

This balance between tax treatment of premiums paid to insurance companies and contributions to pension funds has been in dispute since the first pension fund was established. At present, an employer may attribute to the cost of production (i.e. deduct them from taxes) contributions made to a pension fund or life insurance premiums paid to an insurance company in an amount not exceeding 1% of the gross salary per year. The draft legislation prepared by the government provides that employers will be able to deduct contributions to pension funds in an amount not exceeding 9% of the gross salary per year while life insurance premiums will be deductible if they do not exceed 2,000 roubles per person per year.[46] However, insurance companies are lobbying for the introduction of similar tax treatment for life insurance premiums.

Implementation: Problems and Risks

A number of issues arise which may defer the implementation of the new system. The advantages of the new pension system are evident, but the difficulties connected with applying this system are no less obvious.

Coverage

Unfavourable demographic trends will soon lead to a 1:1 ratio between workers and pensioners: the present pension system will not work in such a situation. At the same time, if the superannuation system starts working, the size of the pension payments will depend on each individual's income – rather than on the present complicated system of coefficients. Indexing pensions to the average wage is an alternative to the planned pension reform; but this would lead to shortfalls in the Pension Fund's budget, which could only be covered by extra state funding. It is clear that citizens with low incomes will not be able to save enough over 20 years to guarantee themselves acceptable living standards after retirement. The architects of the reform hope that those who

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[44] "Government to Permit Export of Pension Fund Money", in: WPS – Russian Business Monitor, 27.10.2000, published on the internet at: http://www.securities.co.uk; Pensions International, "Russian Debate Centres on Asset Management", February 2001, published on the internet at: http://www.pensionsinternational.co.uk

[45] Postanovlenie Gosudarstvennoi Dumy Federal'nogo Sobraniya ot 8.4.1998 GD No. 2353-II "O povtornom rassmotrenii federal'nogo zakona 'O negosudarstvennykh pensionnykh fondakh'", in: Sobranie zakonodatel'stva Rossiiskoi Federatsii 16/1998, St. 1809.

[46] Zubarev, Leonid / McKenna, Cameron: Emerging Legislation for New Russian System, in: Pensions International, February 2001, published on the internet at: http://www.pensionsinternational.co.uk

receive the greater part of their income "off the books" will demand that their employers legalise their wages.

The mandatory system will be effective only if the economy keeps growing steadily. Only economy growth – to be precise: the world oil price – will make it possible for the Pension Fund to maintain pension payments despite cuts in the social tax. These cuts are also complicated: in reducing the social tax by 1% per year, the government will have to obtain the Duma's approval each time.

Participation

While many Russian people realise that the state will not provide adequately for them in retirement, fewer are willing or able to put away additional contributions towards retirement. Historically, the Russian people generally do not trust financial institutions. However, they might trust a well-regarded international bank or insurance company if it were to enter this market and set up an insurance company or a pension fund. As regards private pension funds, there is no competition from major international players at the moment.

Funds and Investment

Monitoring the money of the Pension Fund is another problem. The architects of the reform face a difficult task. They have to find reliable financial tools, which will guarantee an interest rate higher than inflation. Currently the government does not have such tools: neither short-term treasury bills (GKO, Gosudarstvennoe kratkosrochnoe obyazatel'stvo), nor other securities guarantee a high and stable return. In short, there is nothing to invest the funds into. Russian private funds mostly played the speculative stock market, which conflicts with the main principle of private funds – conservatism.

Furthermore, local financial markets would not be able to cope with the inflow of money from a funded system. The alternative of investing some of the money abroad is not viewed positively, according to Elena Zotova of the World Bank's Moscow office, not least because politicians find it difficult to argue that savings should be invested abroad when they are promoting funded pensions partly as a way of channelling capital into the national economy.[47] Mikhail Dmitriev thinks 20-25 % of the Pension Fund's money must be invested in foreign financial assets to achieve reasonable portfolio diversification.[48] This would require new legislation, as Russian law currently does not allow the movement of pension funds abroad. There is no such antipathy to the participation of foreign fund managers in the reformed Russian system – only some doubt as to whether many will want to.

Operation

Another key issue is the monitoring of individual contributions. It is unclear who is going to maintain individual records of career history and earning levels. Administrative costs will necessarily have to increase. So far there are few details of the investment policies which the fund will be expected to pursue. The Federal Securities Committee (FSC)[49] sees the need for a strong regulatory framework to protect assets from fraud and theft. Vladimir Milovidov, an FSC committee member, stated that in other countries depositary fees are calculated on the basis of the assets of a fund, while the committee suggested fees should depend on the return on the fund's assets. The only persons holding claims to the asset would be the account holders, creditors and brokers would have no claims.[50]

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[47] "Turf War Hinders Progress", in: Pensions International, April 2001, published on the internet at: http://www.pensionsinternational.co.uk

[48] Petrosian, Kristine: Pensions Overhaul Shapes Up, in: The Russia Journal, 1.7.2000.

[49] Federal'naya komissiya po tsennym bumagam (FKTsB).

[50] Petrosian, Kristine: Pensions Overhaul Shapes Up, in: The Russia Journal, 1.7.2000.

Evaluation

The development of a new concept for the pension system in Russia is an original one insofar as neither existing pension models of Western industrial countries nor suggestions of World Bank and IMF seem to play a great role in current policy making. Although negative experiences of other countries which apply the multi-pillar approach might seem to get a raw deal in the approach, the overall impression is of an intensive and balanced discussion – the direction and main ideas of the reform seem to have remained rather unchanged for the last years, despite changes in leadership.

At the moment, however, the concept of the pension system in Russia is no more than that – a lot of questions remain to be answered, many concrete problems are unsolved. Whether the government will get political backing for the implementation of the reform plans or not will depend on the overall political and especially the economic developments within the next months and years. As the pension reform is, at the same time, a factor which can heavily determine these developments, and as the majority of today's pensioners (voters) will not benefit from the changes under discussion, it remains to be seen if the trust in the policy makers is high enough to back the changes to come.

Health Reform: No Rouble for a Deficient System (*Susanne Nies*)

Overview: The Russian health system and its Legacies

The Russian health system was established in the late 19th century as a huge network of provincial medical stations and hospitals free of charge. The victorious communists decreed free medical care for the entire population. Thus, Russia set up the first universal, centralized and state-controlled health care system. Soviet medicine was not preventive medicine but patient care. Efficiency was measured only in terms of quantity: the number of beds in hospitals and the bed-day ratio where considered to be the basic indicators.[51] This lead and leads to significant misallocations: 65% of state-expenditures on public health are allocated to hospitals. A more sophisticated system, covering cities and the countryside, providing small- and large-scale services has to be introduced in order to raise efficiency.

The Status Quo

The dramatic decline of public health in the Russian Federation and the CIS countries can hardly be overestimated. Life expectancy has decreased sharply.[52] Indicator diseases such as tuberculosis and diphtheria have re-emerged, and AIDS has spread.[53] Infant mortality at birth is

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[51] Vocatch-Boldyrev, Igor, The promotion and privatisation of medical services in the Russian Federation, Ukraine and Georgia. ILO Working Paper IPPRED-15, 2000, published on the internet at: http://www.ilo.org/public/english/employment/ent/papers/ippred15.htm and Rozenfeld, Boris A.: The Crisis of Russian Health Care and Attempts at Reform, Moscow 2001.

[52] Life-expectancy has been decreasing for decades, but dramatically so since the beginning of the transition period: men live on average only to the age of 60 as a result of alcoholism, industrial accidents and heart diseases. Women's life-expectancy is at 72 years six to eight years below Western levels. According to Labour Minister Pochinok Russia has been facing a steady unprecedented population decline since 1992, the population decreasing by 750.000 people per year.

Interview with Labour Minister Alexander Pochinok in Moskovsky Komsomolets, 17.5.2001. Tat'yana Maleva attributes responsibility to long-term developments for the last thirty years, i.e., since Soviet times. See: Vyshnevsky, Anatoly / Shkol'nikov, Vladimir: Smertnost' v Rossii: glavnye gruppy riska i prioritety deistviya, Nauchnye doklady, Moskovsky tsentr Karnegi Vypusk 19, Moscow 1997, published on the internet at: http://pubs.carnegie.ru/books/1997/11tm/toc.asp and Shkol'nikov, V. / Andreev, E. / Maleva, T. (eds.): Neravenstvo i smertnost' v Rossii: kollektivnaya monografiya, Moscow 2000, published on the internet at: http://pubs.carnegie.ru/books/2000/02tm/

[53] Velkova, A., / Wolleswinkel-Van den Bosch, J. H. / Mackenbach, J. P.: The East-West life expectancy gap: differences in mortality from conditions amenable to medical intervention. International Journal of Epidemiology 1/1997,

extremely high, whereas the birth rate has dropped to 1.1 children per family.[54] The quality of services has been subject to serious deterioration in the countryside and in regions affected by the crisis.[55]

Table 4: Life Expectancy in the USSR, Russia and selected European countries (1960/1990)

Country	Life-Expectancy in years				Infant mortality per 1000 births	
	Men		Women			
	1960	1990	1960	1990	1960	1990
Russia	63.6	63.8	71.8	74.2	36.6	17.6
UK	67.9	72.9	73.7	78.5	22.5	7.9
FRG	66.9	72.9	72.1	79.3	35.0	7.0
Greece	67.3	74.6	72.4	78.5	40.1	9.7
Spain	67.4	73.3	72.2	80.4	43.7	7.6
Italy	72.3	80.1	72.3	80.1	43.9	8.2
Portugal	61.2	70.4	66.8	77.4	77.5	10.9
France	66.9	72.7	73.6	80.9	27.5	7.3
Switzerland	71.2*	74.8	74.9*	80.4	16.6	6.0
Soviet Union	65.3**	64.3	72.7**	73,9	35.3	21.8
EC	67.5	72.8	72.7	79.4	34.5	7.6

*1960-1964, ** 1960-61.

Sources: Vyshnevsky, Anatoly / Shkol'nikov, Vladimir: Smertnost' v Rossii: glavnye gruppy riska i prioritety deistviya, Nauchnye doklady, Moskovsky tsentr Karnegi Vypusk 19, Moscow 1997, p. 11, using data from: Evolution démographique récente en Europe 1996, Conseil de l'Europe, Strasbourg 1996, Eurostat 1996, Naselenie Rossii 1996. This particular table is published on the internet at: http://pubs.carnegie.ru/books/1997/11tm/9711tm-chp01.pdf

The complete publication can be accessed via: http://pubs.carnegie.ru/books/1997/11tm/toc.asp

pp. 75-84. Russia faces a return of indicator diseases as such as tuberculosis and diphtheria, due to insufficient health care and overcrowded and dirty prisons and dormitories in orphanages, barracks etc. Aids became a serious problem with 70,000 officially recognised infected persons in 2000: the WHO estimates the number to be ten times higher. Moskovsky Komsomolets, 17.5.2001.

[54] Moskovsky Komsomolets, 17.5.2001. The reproduction rate is 2.1 children per family.

[55] The propiska system is a handicap for people from the countryside: there is no access to public health care in cities, only via private funding.

Table 5: Life Expectancy in Russia 1987-1996

Year	Men and women	Men	Women
1987	69.94	64.87	74.32
1988	69.76	64.61	74.29
1989	69.62	64.21	74.56
1990	69.25	63.77	74.38
1991	69.02	63.45	74.29
1992	67.89	62.01	73.76
1993	65.16	58.95	71.96
1994	63.88	57.49	71.04
1995	64.61	58.22	71.70
1996	65.88	59.73	72.51

Source: Vyshnevsky, Anatoly / Shkol'nikov, Vladimir: Smertnost' v Rossii: glavnye gruppy riska i prioritety deistviya, Nauchnye doklady, Moskovsky tsentr Karnegi Vypusk 19, Moscow 1997, p. 12, using data from: Evolution démographique récente en Europe 1996, Conseil de l'Europe, Strasbourg 1996, Eurostat 1996, Naselenie Rossii 1996. This particular table is published on the internet at: http://pubs.carnegie.ru/books/1997/11tm/9711tm-chp01.pdf

The complete publication can be accessed via: http://pubs.carnegie.ru/books/1997/11tm/toc.asp

The system suffers from lack of funding. Eastern European investment in public health is low compared to other industrialised countries. In addition, Russian medical staff are affected by the overall problem of unpaid leave. Bribes and poor quality of services are the consequence.[56] The compensatory function of private health care is low, since only 5% of the population are covered.[57]

Table 6: Expenditures on health care in the USSR, the USA and France 1960-1990

Year	Expenditures / per capita			Growth since 1960		
	USSR (Roubles)	USA (Dollars)	France (Francs)	USSR	USA	France
1960	27	143	242	1.0	1.0	1.0
1970	49	346	816	1.8	2.4	3.4
1980	72	1064	3566	2.7	7.4	14.7
1990	124	2601	9521	4.7	18.2	39.3

Source: Vyshnevsky, Anatoly / Shkol'nikov, Vladimir: Smertnost' v Rossii: glavnye gruppy riska i prioritety deistviya, Nauchnye doklady, Moskovsky tsentr Karnegi Vypusk 19, Moscow 1997, p. 14, using data from: Narodnoe khozyaistvo SSSR, Statistical Abstract of the US 1994, Washington 1994, p. 104, Annuaire rétrospectif de la France, Séries longues 1948-88, Paris 1990, p. 190. Annuaire statistique de la France, Paris 1995, p. 241. This particular table is published on the internet at: http://pubs.carnegie.ru/books/1997/11tm/9711tm-chp01.pdf

The complete publication can be accessed via: http://pubs.carnegie.ru/books/1997/11tm/toc.asp

[56] Wage arrears for medical workers: only forty-three of 89 federal entities of the RF have no debts to medical workers. In some parts wages have not been paid for a month. Arrears amounted to 488.9 million roubles in May 2001. BBC Monitoring 16.5.2001, published on the internet at: http://www.securities/

[57] Cf. Annex: Interview with T. Maleva, 2.10.2001.

A third problem of public healthcare in Russia is missing data and thus the absence of central coordination: one outstanding example is the absence of a database for stocks of blood bottles, donors' organs or pharmaceuticals.

Reforms since 1991: Meditsinskaya Sluzhba

In the mainstream of the transition from Beveridge to Bismarck, an extra-budgetary health fund was set up in 1993: the so-called Meditsinskaya Sluzhba (Health-Insurance Fund).[58] Similar to the other social policy funds, the fund consists of a central fund in Moscow and branch offices in the federal entities. Since the introduction of the UST, this fund is financed by 3.6% of the overall total of the social tax.[59] But, as mentioned above, the problem is rather the funding side than the structure. For the latter, a fundamental reform is not yet in sight. The conservative Ministry of Health is more concerned with assessment than with policy-making.

Evaluation: UST and Health care

The most important point on the agenda is the transition to preventive health care. Once this reform is implemented, an essential increase in funding is necessary.[60] The first step has to be an overall assessment, followed by basic and general reforms. Conservative resistance will be difficult to overcome. One possibility to "flood" the conservative system could be the setting-up of competing private health care, a public-private mix, and the redirection of hospital-shares to new institutions.

Employment (*Susanne Nies*)

Overview

The Russian labour market was afflicted in the 1990ies by the following problems:

Low wages and unpaid leave:

The most important problem of the Russian labour market in the 1990ies was not so much unemployment as low wages.[61] Unpaid leave and wage arrears became a nightmare for millions of civil servants, in the army, public health, education and other services. There is a widespread fear that shrinking oil-prices could lead to a renewal of this experience.

Victims of labour-market restructuring:

Specific groups became victims of labour market restructuring in Russia: people related to the huge military-industrial complex, civil servants and refugees. Regional disparities due to the former "division of labour" among the countries of the CMEA or to climate and raw materials have an important impact on regional labour markets.

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[58] The 3.6% from enterprises, employers and employees put together were submitted to regional health-funds (3.4%), and, for fiscal redistribution, to the central Health Insurance Fund (0.2%). For details see: Rinck, Sabine: Lebensstandard und soziale Sicherung, in: Höhmann, Hans-Herrmann / Schröder; Hans-Henning (eds.): Russland unter neuer Führung. Politik, Wirtschaft und Gesellschaft am Beginn des 21. Jahrhunderts, Münster 2001, pp. 159-169, here: p. 167.The non-working population was within the jurisdiction of regional funds. This meant that regions with high unemployment had difficulties facing their social obligations.

[59] See section "The UST: Facts and Figures" of this paper: application of the regressive scale.

[60] Cf. Rozenfeld, Boris A.: The Crisis of Russian Health Care and Attempts at Reform, Moscow 2001.

[61] "Working poor" in the public sector.

Unemployment:

Even if unemployment rates remain relatively low (8% in 1995, 12% 1999 and 8.5% in 2001),[62] the mental acceptance of the phenomenon was difficult for a country which had officially never experienced unemployment.

The unofficial labour-market:

An unofficial labour market emerged as well as alternative forms of revenues: both reveal tax-evasion strategies.

Reforms since 1991: The employment fund and its abolition in 2001

The Employment fund and its abolition

The Employment Funds (Fond zanyatosti) was established in July 1991 as a Department of the Labour Ministry. At the same time, an independent labour-market institute was set up, the tasks of which were research and publications on labour-market developments. Since 1998, both the Fund and the Institute have become a subject of permanent dispute between political fractions. The abolition of the controversial institutions in the context of the introduction of the UST therefore did not come as a surprise.[63] From 1 January 2001 onwards the State-Employment Service and dependent regional employment services are financed directly from the federal budget.

Immediate reactions were mostly sceptical. The Mayor of Moscow, Luzhkov, declared in November 2000 that his city would prefer to pay unemployment benefits itself. According to him, the government's intention of fully re-centralising labour market policy was an "ill-considered mistake".[64] Experts fear that fewer financial resources will be devoted to employment programmes, and that labour-market policy will be limited to unemployment-benefits.

Evaluation

The introduction of the regressive UST has had a positive effect on the downsizing and elimination of the parallel labour market. The regressive scale is an incitement to fully declare and raise revenues. On the other hand, small and medium-sized enterprises can be seriously hurt by the regressive scale, and therefore might engage in tax evasion.

A further step in the direction of regulated labour relations is the adoption of a Labour Code.[65] Many, on the other hand, considered the closing-down of the Unemployment Fund and the Independent Institute for Labour-Market Research to be a mistake. The position of the Ministry was reinforced, and labour market policy limited, at least for the moment, to unemployment-benefits.

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[62] Rinck, Sabine: Lebensstandard und soziale Sicherung, in: Höhmann, Hans-Herrmann / Schröder; Hans-Henning (eds.): Russland unter neuer Führung. Politik, Wirtschaft und Gesellschaft am Beginn des 21. Jahrhunderts, Münster 2001, pp. 159-169, here: p. 165. ITAR-Tass 20.4.2001: 6.85 Mio. Unemployed = 9.6 Percent of the working population. (total working population in March 2001: 71.7 Mio.). The national labour force survey was suspended in 1998, to save money, thus abolishing the only source for the monitoring of unemployment. Kasyanov 30.11.01, published on the internet at: http://www.securities.co.uk/

[63] The Ministry of Labour announced this decision on 13.10.2000.

[64] BBC Worldwide Monitoring, Moscow mayor wants to pay unemployment benefits himself, 24.11.2000, published on the internet at: http://www.monitor.bbc.co.uk/

[65] See: Kudyukin, P. M. / Maleva, T. M. / Misikhina, S. G. / Surkov, S. V.: Skol'ko stoit trudovoi kodeks?, Rabochie materialy Moskovskogo Tsentra Karnegi 3/2001, Moscow 2001, published on the internet at: http://pubs.carnegie.ru/workpapers/2001/wp0301.pdf

Findings

Main changes

A comparison of the Social Insurance System in Russia before and after the introduction of the UST shows the following features:

	Before the introduction of UST (until 31 December 2000)		**Since the introduction of the UST (since 1 January 2001)**	
Type of tax	Progressive		Regressive	
Proportion of taxes allocated to social sector	5-39.5% of the individual income (Sum of contributions to funds)		2-36.5 % of individual income	
Base for taxation	Individual income (per annum)		Individual income (per annum)	
Progression			Below 100,000 roubles	35.6%
			100,000-300,000 roubles	20.0%
			300,001-600,000 roubles	10.0%
			Above 600,000 roubles	2.0%
Number of funds	Four		Three	
Proportions of tax allocated to the various social insurance funds	Pension Fund:	28% employer 1% employee	Pension Fund:	28.0%
	Health insurance Fund:	3.6%	Health insurance Fund:	3.6%
	Employment Fund:	1.5%	-	-
	Social Insurance Fund:	5.4%	Social Insurance Fund:	4.0%
Relationship between the Centre and the Subjects of the Federation	Decentralisation of receipts: 100% of income tax to the federal entities		Re-centralisation of social tax receipts: channelling via the federal budget	

Compiled by Susanne Nies, Berlin 2001.

UST: Pros and Cons

The goal of the UST was to improve the efficiency of the state social insurance system by means of a unified tax. The “pros” of this measure are: it increases tax revenues (this has been proven in 2001) by encouraging companies and individuals to legalise a larger share of incomes currently earned and paid in the shadow economy (regressive scale); the inclusion of all revenue and spending in the federal budget can vastly increase the transparency of the fiscal system; the channelling of social payments through the federal budget allows the government to keep the off-budget funds on a short leash, reduce payments where money is wasted, and prevent corruption; it re-centralises the system in which the regions do not behave responsibly. There are, however, some "cons": the regressive social tax might lead to bad targeting of social policy, which might not address the needy, specific problem groups, children etc.; the re-centralisation via UST could mean a loss of influence and responsibility for the regions; the "Trety Sektor",[66] engaged in social welfare, may be seriously hurt.

Evaluation

The current reform of social security contributions makes transactions more transparent, thereby increasing the accountability of the social funds and reducing their power. The UST replaces many mandatory deductions that employers were formerly required to withhold from wages and that flew into the state pension fund, social insurance, or medical funds. Besides consolidating several payroll taxes and thus heavily simplifying the tax system, the introduction of the UST brings with it also a reduction in total deductions, which had amounted to 46 percent of wages.

During the first five months of 2001, the revenues collected via the UST ran up to 3,948 million roubles. From this sum 3,364 million roubles were transferred to the Pension Fund. This was almost 10% more than the tax collectors had expected. Hence, at least in this respect trade union leaders, who have been predicting a bad future for the UST, appear to be wrong: the new system works, and it is effective.

One argument against the UST that is often heard is that it undermines the development of social insurance institutions by breaking with a key principle of the organisation of social insurance guaranteeing the equivalence of contributions and payments, i.e., the existence of a range of specific insurances. It is argued that contributions to the social funds are compensatory, which distinguishes them from taxes, which are levied as part of the government's fiscal policy. However, this argument does not lead to convincing conclusions. The UST is a different way of collecting social security contributions, but without immediate effect on the output. The UST is only one piece of the puzzle of social security reform, aimed at the simplification of the overall system. The key problem of the social security system, the poor targeting of social benefits, cannot be solved by the introduction of a different method of collecting the contributions. The UST may also lead to the violation of a fundamental principle of current legislation, under which off-budget funds cannot be used to cover household deficits. There is a danger that revenues allocated to the social funds may be used for solving problems other than the financing of social services. This misuse of funds would hurt the poorest groups in society most. However, it still remains to be seen how the mixing of the federal budget and of off-budget revenues will change individual entitlements to benefits and their payout.

[66] The Third Sector, non-commercial and non-state social welfare organisations.

Annex: Interview with Tat'yana Maleva *(Susanne Nies)*

Moscow, 2 October 2001

Tat'yana Maleva is Scholar-in-Residence and Post-Soviet Economies in Transition Program Co-Chairperson, Carnegie Foundation, Moscow, and Director of the newly founded Institute for Social Policy, Nezavisimy institut sotsial'noi politiki, Moscow.

Question: How would you assess, in general terms, the introduction of the UST and its impact on social policy?

TM: There is no simple answer. It is positive that financing of social policy has become more transparent. Tax-income increased significantly. However, tax evasion is still possible. The regressive scale is positive, but it works only with big enterprises. There are still a lot of holes in the application of the UST regulations. I have nevertheless some doubts concerning the transition from an insurance system to a tax-based system. There are a lot of contradictions. NGOs, which are active in the social policy sector, are seriously affected by the new legislation.

How would you evaluate the abolition of the employment fond and the fund system in general, both at the federal and at the regional level?

It is positive that the fond structure was reconceived, and there was and is without any doubt a lot of abuse in the different funds. In my opinion, the abolition of the employment fund was a mistake. The fund was linked to an institute for research on employment, which was abolished as well. We will have no more reliable data on employment in the Federation. The consequences will become obvious only in some years, but they will occur. The employment policy of the government today is limited to unemployment subsidies. At the moment, there is no active employment policy. I think that the abolition of this fond was something like a test case for others. Others might follow, such as the healthcare fond: there could be something like a Russian NHS.[67] The exception will be the pension sector since there are different interests (domestic fund raising etc.).

How would you assess the impact of the introduction of the UST on specific areas such as the pension system, employment, education and health?

The health sector in Russia is completely inefficient and has to be reformed as a whole. The problem is not money or taxes, but the structure. Our health system today was developed in the 1960ies as a response to epidemics and the problems of large groups of the population. The approach was a quantitative one. Today an individual approach has to be introduced. I wouldn’t put even one rouble in [the present] system. People compensate for the absence of state service by asking for supplementary help and paying for it themselves, but only 5 % of the population have the financial means to do so. 95% percent are entirely dependent on the State health-system. A complete restructuring of the health-system is urgent and necessary. Unfortunately, I don’t see the political will to do that. The Ministry of Health is one of the most conservative ministries.

Problems of employment and education are closely linked. We have an education system with high standards, but this doesn’t mean high work efficiency. A specific problem is education in the countryside. This is very expensive, and in fact is nonexistent. Quality is poor outside of the big cities. We have to reform the education system – as it is done now in Western countries – in the sense of life-long learning, permanent education (nepreryvnoe obrazovanie).

What are the aims of your newly founded Institute for Social Policy (Nezavisimy institut sotsial'noi politiki)?

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[67] The National Health Service in the United Kingdom.

My institute came into being yesterday. It was set up with the aid of the Ford Foundation. It will be independent, and it will conduct research, seminars and it will have an archive. Concerning the latter, there is no place where the data from the former Soviet Union and now Russia are collected. Which means that we simply don’t have them at our disposal. My institute will give grants to regional researchers for fieldwork, and also for research on specific areas of policy.

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