Inequality: the Russian experience

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Given Russia's size and extreme geographical diversity, it should come as no surprise that it has relatively high income inequality. At least as important as the level of inequality, however, is its type. Unlike in most Western countries, where a family's economic position tends to be quite stable even across generations, the income distribution in Russia has been not just unequal but extremely fluid. During the 20 years since the end of communism, almost all of the population has fallen into poverty at least once or twice, but relatively few have stayed there.

Russia's pattern of income inequality does not determine political outcomes in any simple way. But it shapes the context in which politicians—whether democratic or authoritarian—have attempted to govern. All face the challenge posed by the country's huge interregional disparities. All must manage a population composed of individuals still traumatized by their recent zigzags across the income distribution. The dubious origins of the fortunes of today's billionaires have not yet been forgotten, which offers opportunities for populist attacks, but also creates risks of economic destabilization if such attacks are taken too far.

For 12 years, Vladimir Putin has exploited Russians' fears of economic turbulence and their indignation at a distribution of wealth deemed unjust. Yet the economic growth that boosted Putin's popularity during these years has reduced Russians' sense of vulnerability and modernized society, eroding the effectiveness of such strategies. An old-style politics of mobilizing resentment and redistributing cash cannot by itself provide what Russians increasingly desire—effective provision of public services such as education, healthcare, and personal security. Reforming the state—rather than evening out income differences—is currently the demand at the top of the agenda.

Characterizing Russian economic inequality

How great is economic inequality in Russia, and how does it compare to that in other countries? Set aside for a moment the super-wealthy. Billionaires rarely answer surveys, and so their contribution to income inequality—although often the most salient and controversial aspect—is not captured properly in any country's statistics. The same is true for the truly indigent. As a result, commonly used measures accruately capture just the central part of the distribution, with the extreme tails cut off.

In the late Soviet era, what data we have suggest the range of incomes was limited, as might be expected given the ruling party's egalitarian rhetoric. In fact, economic and social inequality re-emerged on other planes. Access to luxury—and even many quite basic—goods and services was monopolized by the nomenklatura, the class of trusted servants of the communist regime.
Life chances were concentrated in personal networks that bound the elite together and separated it from the masses.

Still, differences in per capita income were relatively small. A common measure of inequality is the Gini index, which ranges from 0—meaning perfect equality (i.e., equal shares for all)—to 1—indicating perfect inequality (i.e., all income received by one person). In 1985, according to the economists John Flemming and John Micklewright, the Gini for per capita income in Russia was .24, compared to .22 for Finland, .28 for Germany, .32 for the UK, and .37 for the USA. Gini indexes for developing countries are sometimes much higher, reaching .49 for disposable household income in Brazil in 2006 and .59 in South Africa in 2008.

In the chaotic early 1990s, no household surveys were conducted in Russia. Official statistics for this period of hyperinflation are unusually sketchy. So determining what happened next is tricky. Still, experts agree that inequality rose sharply. When the relatively authoritative Russian Longitudinal Monitoring Survey (RLMS) began tracking a panel of Russian households in 1994, it revealed an inflation-adjusted Gini for disposable income of .46.

The Gini leapt still higher after the 1998 financial crisis and default, reaching .50 by 2000. Then, as rapid growth returned, inequality began to fall, especially after 2003. By 2007, the Gini was back around .38. Although it bounced up again during the global crisis of 2008, it retreated to .35 in 2009, according to RLMS data analyzed by the economist Irina Denisova.

These trends in income dispersion mirror the phases of Russia's transitional macroeconomic crisis. As output crashed in 1990 to 1994, inequality was driven up by a sharp rise in poverty, from 12 pecent of the population in December 1991 to 34 percent in 1994, according to the RLMS. The income distribution, as it had formed by this time, was strongly skewed, with a heavy concentration around the poverty line. The 1998 financial crisis almost doubled the poverty rate, which approached 60 percent as devaluation cut into the purchasing power of wages.

However, rapid growth after 2000 raised tens of millions out of poverty, filling out the middle of the distribution, which by 2008 had become remarkably symmetrical. By that year, fewer than 15 percent of Russians were poor, and the proportion apparently stayed low through the global financial crisis. As the economist Tatyana Bogomolova has shown, the share of Russians with incomes 1.5 to 7 times the poverty line increased from 40 percent in 1994 to 64 percent in 2008.

In some ways, Russians' experience of inequality in the last two decades has been quite unlike that in most Western countries. For one thing, it has been combined with an unusually high rate of income mobility. Most people do not stay poor or middle class; they drop into poverty under the shock of a macroeconomic crisis such as those in 1998 and 2008, and then recover in subsequent years. And they exchange places in the distribution at very high rates. Normal economic life, for many Russians, has turned into a gut-wrenching roller-coaster ride.

One sees this in the experience of those respondents who participated in all annual rounds of the RLMS from 1994 to 2008. Fewer than 10 percent of these respondent never fell below the poverty line during this period, and 60 percent had been poor in more than one year. But only one percent remained poor throughout. Of those in the bottom 10 percent in 2000, only 30 percent remained there six years later, and only about 30 percent of those who started in the top 10 percent had not fallen out of it after six years, according to the economists Anna Lukiyanova and Aleksey Oshchepkov. Both poverty and relative wealth tended to be short-term phenomena, with strong reversion to the mean.

Given these rapid leaps and dives across the income spectrum, inequality turns out to be much lower if one averages across several years. Just combining two years reduces the inequality measure by 8 to 25 percent. Another consequence is that individuals whose incomes qualify them as poor in a given year sometimes look much more like members of the middle class. Somewhat paradoxically, as poverty and inequality surged in the early 1990s, ownership of consumer durables was also spreading through the population. The proportion of Russians with color televisions rose from 55 percent in 1992 to 68 percent in 1996 and 74 percent in 1998—the year that 60 percent fell beneath the poverty line. The proportion of housing with hot water rose from 51 to 58 percent between 1993 and 1998, and the share with central heating increased from 64 to 72 percent.

What explains the jump in inequality in the early 1990s, and the variation since then? Not the privatization of large enterprises, which only got underway after inequality had already surged in 1992-3. For most Russians, income from capital represented a tiny percentage of income. The main driver was decompression of wages, which had been kept relatively uniform under communism. The Gini index for wages rose exactly in parallel to that for incomes. In part, wage decompression reflected growing divergence across economic sectors. In 1990, the average wage in the highest-earning sector, geology and exploration, was 2.3 times that in the lowest-earning, culture and art. By 1994, the ratio—now between finance and agriculture—had grown to more than four times.

But much of the decompression represented increases in regional variation. The ratio of the average wage in the richest of Russia's then-89 regions to that in the poorest started out around four times in 1990. It shot up to more than ten times in 1994, before settling back to around seven times in the early 2000s. For comparison, the ratio for US states is about two times.

Thus, the early shakeout reflected the adjustment of wages from an ideologically-motivated, artificial schedule which required major subsidies (to both sectors and regions) to a set of prices determined mostly in increasingly free labor markets. Why did workers in some regions suddenly start earning far more than similar workers elsewhere? In part, wages simply tracked differences in the cost of living. Still, as of 2010 prices in the most expensive region, Kamchatka, were only about three times those in the cheapest region, Tambov. As Vladimir Gimpelson and colleagues have shown, much of the remaining difference consists simply of premia necessary to lure workers, no longer forcibly assigned to enterprises, to settle in unattractive locations. The real wage is significantly higher in regions where life expectancy is lower, medical services are less extensive, the climate is colder, and the environment is more polluted.

The ups and downs in Russian inequality since 1994 are well explained by the macroeconomic shocks already noted. The fall in the country's Gini from .50 in 2000 to.35 in 2009 can be credited largely to the return of stable growth. The global crisis of 2008-10 had a much smaller impact than that in 1998, perhaps because it was not accompanied by devaluation and inflation, perhaps also because of an energetic government policy of raising pensions and pressuring businesses to forego layoffs and sharp wage cuts.

Returning now to the extremely rich, one can get some sense of the changing contours of wealth at the top by examining the Russian members of *Forbes'* annual lists of the world's billionaires, which the magazine has compiled since 1996. These show that the explosion of wealth in Russia is a phenomenon not of the 1990s, when the term “oligarch” was coined to denigrate the victors of privatization, but of the 2000s, when Putin claimed to be bringing big business to heel. According to *Forbes*, the 10 richest Russians in 1997 had a total net worth equal to less than 3.5 percent of the country’s GDP (for the previous year, converted at the market exchange rate). This increased to somewhere under 5.5 percent in 2001, 8.5 percent in 2003, and 15.2 percent in 2008, by which point GDP was itself more than three times larger in dollar terms than it had been in 1997. With the market crash of 2009, the wealth of the top 10 fell to 8.6 percent of GDP in 2010.

In short, the wealth—and associated incomes—of the super-rich are pro-cyclical like those of the population. The robust growth in the 2000s that pushed tens of millions of Russians out of poverty also multiplied the value of businessmen’s stocks and other investments. As improving conditions evened out the distribution lower down, soaring fortunes at the top probably stretched it out in a way that is not captured by available statistics.

Why inequality was bound to rise after communism

For at least three reasons, Russia was almost certain to have higher income inequality than most other countries. Some factors relate to the particular challenges of transition from communism. Others are essential characteristics of Russia and Russians that are unlikely to change.

First, although geography has already been mentioned, its role runs deeper than just explaining the decompression of wages after 1991. By far the largest country on the planet, stretching from Arctic permafrost to southern desert, Russia might be expected to exhibit economic diversity to match its natural variety. While some regions are conveniently located next to navigable seas or on the edge of Europe, others are hidden thousands of miles inside the Eurasian heartland or next to remote parts of China and Mongolia. While a province bordering Finland might be expected to converge with

Scandinavia, one next to rural Kazakhstan is less likely to be pulled up by trade with the neighbors.

Another aspect of geographic diversity concerns the country's main export. Russia's incredible natural resources are concentrated in a few areas. If the country pursues its comparative advantage in extracting these raw materials, some regions will inevitably be far more profitable than others. Indeed, in 2010, enterprises in 10 regions, containing 32 percent of the population, earned 75 percent of the country's total net profits.

Considering the country's geographic range, it is actually surprising that Russia's income inequality is not greater than it is. Ginis for the income distribution *within* individual regions ranged from .33 in the Republic of Ingushetia to .52 in Moscow City in 2009. Then, as already noted, there is a seven-fold difference between average incomes in the richest and poorest provinces. Given this, one might have anticipated a Gini for the country as a whole higher than .35.

A second, related reason for economic inequality has to do with the legacy of Soviet planning. Industrial plants and cities were developed across Russian landmass in a pattern that bore no relation to economic logic. In fact, industrial centers were deliberately built in remote parts of the country to make them less vulnerable to a European invasion. Of course, settlements to extract natural resources have to be sited where the resources are. But industrial centers in isolated outposts face enormous costs associated with transporting goods to market and combatting the Siberian climate. One former head of the national electricity company admitted in the 1990s that it would have been more cost-effective to close down many cities in Siberia and the Far East and resettle their residents than to repair and update their energy systems.

Enterprises located far from the dreaded onslaught of NATO troops faced the double challenge in the 1990s of restructuring to produce goods for which there was demand in a free market *and* competing with companies with far lower infrastructure and transportation costs. Many of them died gradually over the course of the two decades, scraping by for years on a small helping of state orders and subsidies. Their employees swelled the ranks of the working poor.

The third reason to expect high inequality in Russia concerns the particular political economy that evolved there. Countries differ in how they respond to recessions. Some—such as the US and Latvia—adjust to the drop in demand mostly by laying off workers, temporarily increasing unemployment. Wages change little for those who remain in work. Other countries—primarily Russia and some other former Soviet states—adapt by reducing wages, thus avoiding having to fire workers. Unemployment rises much less, but the cost is far greater volatility in earnings—and consequently in income inequality.

Russia's unusually high wage flexibility is supported by several distinctive institutional elements. First, the minimum wage has traditionally been extremely low—around 10 percent of the average wage, compared to about 40 percent in Central and Eastern Europe—which increases competition at low wage levels. (Unemployment benefits are also far from generous.) Second, Russians often receive a significant portion of their salary in the form of discretionary bonuses, which managers can reduce as required. And third, for long periods in the 1990s unprofitable enterprises simply did not pay their workers for months or even years at a time. This avoided the need to formally fire them, cutting them off from access to company housing and other benefits, and helped essentially defunct enterprises to delay a final bankruptcy. Economists estimate that in the mid-1990s such wage arrears accounted for a sizeable part of the growth in income inequality.

Political ramifications

As economic disparities in the West have surged in recent decades, scholars have debated how the income distribution influences a country's politics. Of course, since government policies themselves shape the income distribution—both before and after taxes—it is hard to disentangle the two.

One common argument is that too great a concentration of wealth and income allows the rich to corrupt the political process, buying officials and manipulating elections. Another argument supposes that the extent of inequality determines how willing elites are to tolerate democracy. The more skewed the distribution, the greater will be the temptation for a democratic government to redistribute wealth from rich to poor. Anticipating this, the rich will fight harder to prevent democracy. In both these views, inequality corrodes free politics.

Yet other arguments suggest that the political consequences will depend upon what type of income-bearing assets are at stake. If the wealth of the elite is vulnerable to expropriation—for instance, agricultural land, or mines—they may struggle more to prevent a popular regime coming to power, or to corrupt it if it does. Some evidence suggests that countries with greater land-holding inequality in the 19^{th} Century were slower to democratize. More recently, believers in the so-called "resource curse" have shown evidence that oil deposits reduce the odds of accountable government.

By contrast, if the capital of the super-rich is in forms that can be easily protected, they have less to fear from a democratic government. Inventors or entrepreneurs rich in human capital can emigrate to where their talents are most welcome. Those with financial capital can park it in banks in countries with low tax rates and greater security of property rights. In recent decades, the successful consolidation of democracies in Latin America, along with the survival of democracy in the US, have demonstrated that democracy is possible in countries with relatively high income inequality. At the same time, the assumption that the rich will be safer from expropriation in authoritarian states is questionable. In fact, dictators also seize their citizens' wealth, and they too often feel pressures to redistribute in order to prevent unrest.

Although it might be tempting to attribute Russia's troubled maneuvering between democracy and autocracy in the first twenty years of its independence to the country's increased inequality, it is hard to see any simple, direct relationship. The initial surge in inequality occurred during the most democratic phase of the country's evolution. Under

Putin, who gradually reduced accountability, restricted the national media, and undermined the integrity of elections, inequality fell to its lowest level since the Soviet collapse. During his increasingly authoritarian rule, the business elite became more—not less—anxious about state expropriation.

Even if Russia's political dynamic does not track neatly with trends in the Gini index in the ways some theories would predict, inequality does constitute an important aspect of the political context. As elsewhere, what matters is not just the absolute level of inequality, but how it is perceived and interpreted by the public. To the extent that citizens view income disparities as the result of different levels of effort, risk-taking, and talent, in a competion that is fair and open to all, they are more likely to tolerate or even embrace them. In the US, the belief that there is considerable equality of opportunity reconciles many to the gross divergences of outcomes.

That is not the case in Russia. From the turmoil of recent decades, Russians have inherited both a belief that the existing income distribution is arbitrary and unjust and a fear of the kind of catastrophic economic shocks that drove many into temporary poverty in the past. Cynicism about the current situation runs deep.

Almost two thirds of Russians believe that those rich today amassed their fortunes through criminal activities, and 47 percent attribute their wealth to political connections, according to Denisova and colleagues, analyzing data from the 2006 RLMS. Only 20 percent think that the affluent owe their success to effort and talent. Similarly, less than one third of respondents believe the poor are poor because of bad luck, laziness, or lack of will power. Almost all the rest blame social injustice, unfavorable initial conditions, or an inability to adapt to new conditions. As in all other East European and former Soviet countries, a large majority says it favors reviewing the results of 1990s privatizations.

Russians are hardly unique in their dark view. But Russia consistently shows up among a group of countries, many of them former communist states, in which the economic system is seen as inherently unfair. Among respondents from 38 countries included in the

2009 International Social Survey (ISS), Russians came third after Ukrainians and Hungarians in agreeing that in order to get ahead it was important to give bribes (50 percent thought it either “fairly important,” “very important,” or “essential”). Conversely, Russia had the sixth lowest percentage of respondents saying that hard work was important for success. Only in Denmark, Ukraine, Chile, Argentina, and France was their greater doubt about the payoff to effort.

The dominant view may be changing as the macroeconomy becomes more predictable. According to the ISS, the proportion of Russians who considered a good education essential or very important rose from 51 percent in 1992 to 69 percent in 2009. In the same years, the percentage who thought hard work essential or very important rose from 59 to 67 percent. Between 1999 and 2009, the share agreeing that “to get all the way to the top in today’s Russia, you have to be corrupt,” fell from 73 to 59 percent.

The common feeling of personal vulnerability is illustrated by the fact that almost two thirds of RLMS respondents in 2006 believed they fell in the bottom half of the wealth distribution. Russians’ fears of unemployment are out of proportion to the actual risk of getting laid off, and vary little with the unemployment rate. In most years, according to Gimpelson and colleagues, more than 50 percent say they are concerned or very concerned about losing their job, compared to fewer than 10 percent in the US or UK. (In 2010, the unemployment rate was 7.5 percent in Russia, 7.8 percent in the UK, and 9.6 percent in the US.) Insecurity is accompanied by a sense of unfairness. In 2009, 68 percent of Russians thought that they “earned less than they deserved”—more than in any other country except Ukraine, Hungary, and Argentina.

Perhaps predictably, given the macroeconomic buffeting they have endured , Russians express a strong desire for state intervention to insure against economic shocks. Big majorities favor state ownership of large enterprises and price regulation. This is not just a hangover from socialism. In fact, support for state intervention has grown over the years. The World Values Survey regularly asks respondents to place themselves on a 10-point scale between the position that “The government should take more responsibility to ensure that everyone is provided for," and the position that "People should take more responsibility to provide for themselves." The proportion of Russians closer to the "government responsibility" end of the scale rose from 40 percent in 1990 to 79 percent in 2005. Similarly, in the ISS the percentage agreeing that "people with high incomes should pay a larger share of their income in taxes than those with low incomes" rose from 65 percent in 1992 to 81 percent in 2009. (That was still fewer than agreed with this in Germany, France, or Switzerland.)

These attitudes shape the setting in which Russia's complicated political game unfolds. The geographic—and associated economic—inequality discussed earlier mean that any leader, whether democratic or authoritarian, must use the state to redistribute from rich to poor regions at least enough to forestall unrest or even separatist challenges. Given the lingering traumas of the 1990s, leaders also recognize the strong demand for social insurance and responsible macroeconomic policy. Putin has repeatedly invoked the fear of economic instability to boost his support and discredit challengers. He has exploited suspicion and resentment of the oligarchs, imprisoning one of them, Mikhail Khodorkovsy, on a dubious fraud charge.

Yet, with the embourgeoisement of a larger slice of Russian society, this strategy may be reaching its limit. What Russians seem to want is not so much equalization for the sake of equalization but a well-functioning state with a significant welfare component. As documented by a series of focus groups conducted in the spring of 2012 by Mikhail Dmitriev's Center for Strategic Research, many Russians in the provinces are deeply upset about the failure of a visibly corrupt bureaucracy to provide high quality education, healthcare, and legal enforcement. Mere redistribution of money—to regions or even to individuals—will not satisfy the demand for these services. Institutional changes are required.

For the reasons already mentioned, economic inequality in Russia is likely to remain quite high. The political consequences of this will depend on how perceptions of that inequality evolve. If the state becomes more effective at securing broad opportunities for all and providing insurance for those who fail, while avoiding devastating economic turbulence, then Russians are likely to accept the coexistence of multi-billionaires and paupers, as do most of their American counterparts. However, the current combination of crony capitalism with a corrupt and ineffective state does not seem likely to remain stable as the country continues to modernize.