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Income Inequality and Food Insecurity in Russia

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Abstract

The transition in Russia to a partially market-driven economy has failed to produce sustained and broad-based economic growth. The gains of economic growth are concentrated at the top of the income distribution, leaving a sizable part of the population trapped in conditions of low incomes. While abject poverty has largely been eliminated, around 40% of the population struggle to purchase more than basic consumer necessities. Spending on food occupies nearly half of household budgets for the lowest income decile. State social spending, which constitutes an increasing share of total income, is relatively non-progressive. Most is not means-based, but preserves the categorical benefits structure of the Soviet era. A combination of the bureaucratic-authoritarian institutional framework for decision-making and the strongly rent-based relationship between economic and political elites, severely limits policy options.

Keywords

Russia – transition – inequality – poverty – social policy – food insecurity – economic rents

1 Introduction

Under the Soviet socialist planned system, chronic shortages of food and other consumer necessities were offset to some degree by administrative allocation

through the workplace.¹ Today, food prices are not subsidized but persistent near-poverty makes it difficult for a large proportion of the population—as much as 40%—to be able to afford more than food, clothing, and medicine. Policymakers face competing pressures to make social welfare policy more redistributive and at the same time to increase incentives for business investment. The slowdown of the economy in the past several years, (see Figure 1, in the Introduction) coupled with falling real incomes, have placed further strain on households. President Putin has responded by demanding that the government halve the poverty rate by 2024, but has been reluctant to shift social policy in a more redistributive direction. At the same time, the regime faces substantial constraints. It must preserve the stream of rent incomes that maintain the state budget, as well as serve the more immediate political interests of officials. This dilemma deters the Putin regime from enacting more substantial institutional reforms that would stimulate broad based growth oriented around higher value-added production.

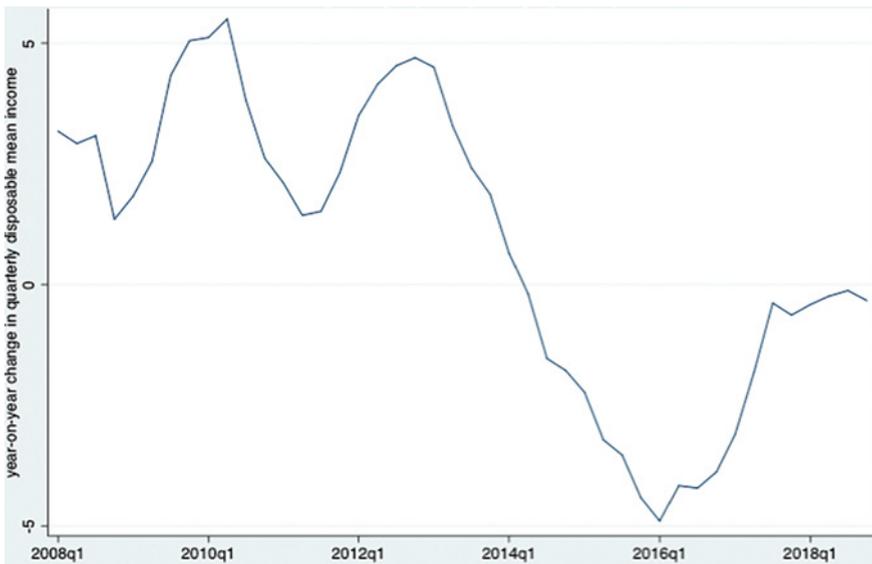


FIGURE 1 Russian real average disposable income change, 2008–2018 moving average, quarterly change, year on year

SOURCE: ROSSTAT

1 The research for this article was conducted with the support of the Basic Research Program of the Higher School of Economics and within the framework of a subsidy by the Russian Academic Excellence Project “5–100.”

This straitjacket is best explained by considering the institutional environment of bureaucratic and economic interests in which the regime operates. The stability of this environment helps explain the inconclusive and contradictory nature of many policy decisions, their frequent reversals, and the continuing overhang of Soviet-era institutions. Political contestation is limited almost totally to bargaining among competing bureaucratic agencies with differing policy priorities; larger aggregates of social interests are largely bystanders to serious debates over economic and social policy. The authorities fear the consequences of a sharp departure from the status quo that might provoke popular unrest, tacit resistance by subordinates in the administrative hierarchy, or defections by oligarchic supporters of the regime. These constraints limit policy options and contribute to policy drift. The comparison to China is instructive. While China also operates within a bureaucratic-authoritarian policymaking regime, its higher degree of regional decentralization enables greater policy experimentation and diversity than in Russia.²

Russia's high level of income inequality ensures that issues such as social protection, social insurance, and taxation pose latent redistributive conflict. Not only do high-income groups oppose a more progressive tax system, but lower-income groups fear the loss of categorical social benefits. The combined influence of these diffuse but important interests tends to reinforce intra-bureaucratic policy deadlock. As I will argue below, powerful administrative restraints on competition both in the market and political arenas facilitate the sharing of rents between economic and political elites. Rent-sharing inhibits economic growth but fosters political stability, while contributing to policy stasis.

Over the last twenty years, periods of economic growth have tended to exacerbate income and wealth inequality because income gains from growth flow disproportionately to higher income groups.³ Periods of slow or negative growth reduce inequality by lowering income gains more at the top than at the bottom. The strong resource dependence of the economy has limited income growth in the middle of the distribution and contributed to the high disparities in growth across regions. At the same time, a large proportion of the labor force has been unable to move into higher-paying jobs. However, inefficient systems

2 Cf Thomas F. Remington, "Institutional Change in Authoritarian Regimes, Pension Reform in Russia and China," *Problems of Post-Communism* (published online 6 April 2018), 1–13.

3 Thomas F. Remington, "Russian Economic Inequality in Comparative Perspective," *Comparative Politics* 50, no. 3 (April 2018), 395–416.

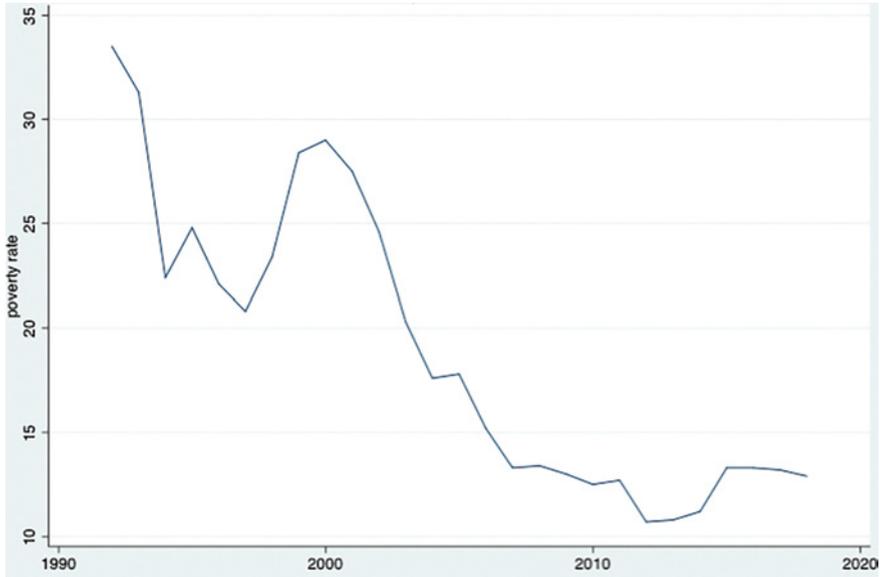


FIGURE 2 Poverty rate, 1992–2018
SOURCE: ROSSTAT

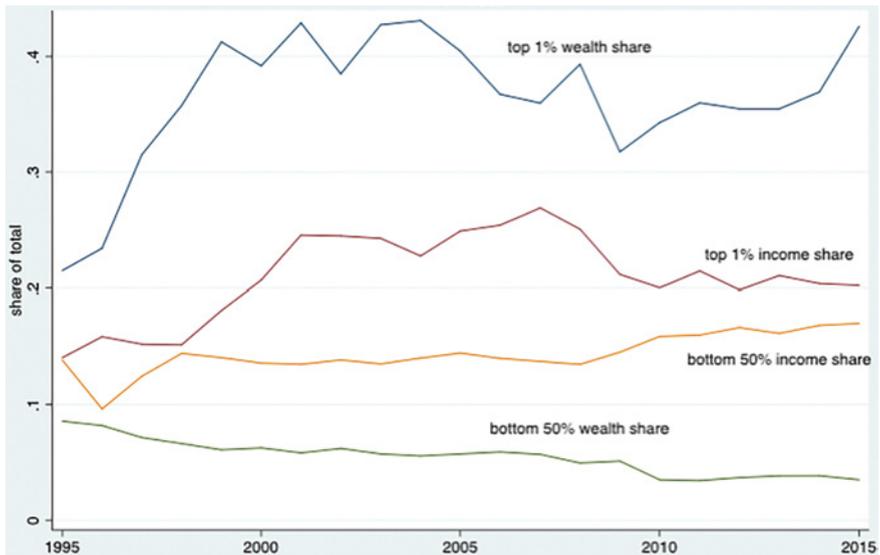


FIGURE 3 Russia: top 1% and bottom 50% shares of wealth and income 1995–2015
SOURCE: WID WORLD

of tax and social insurance contribution collection (due in part to high rates of informal employment) limit the state's ability to target social assistance to those most in need. These factors have rendered Russian social policy relatively non-redistributive. Therefore, even though extreme poverty has largely been eliminated, around 40% of Russian households face a situation where the family budget cannot afford to purchase both food and clothing; 10% say they cannot afford food for their families.⁴ Food prices are not subsidized, and families living just above the poverty line are not provided with cash income supplements for food and medicine unless they qualify for assistance due to invalidity or other special needs. Consequently, food insecurity is the lot of a considerable segment of the population. Moreover, food insecurity has worsened in the last four years as real incomes have fallen, inequality of wealth has risen, inequality of income has abated slightly (at least, according to household surveys), and poverty has once again risen.

As of 2019, nearly 20 million people live below the poverty line of 11,000 rubles per month. In his May 2019 ukaz, issued the day he took office for his fourth term, President Putin demanded that the government act to halve the poverty rate from 13.2% to 6.6% by 2024.⁵ This will be impossible in the absence of a significantly more effective, needs-targeted system of social assistance as well as broad-based income growth. Given the severe budgetary and political constraints hemming in the Russian government, however, it is highly unlikely that this goal will be met.

2 Trends in Wages and Prices

Russia's transition from a state socialist to a mixed economy has replaced a social welfare system structured around administrative allocation of basic goods and services to one where the play of demand and supply sets most prices. Some formerly state-provided goods and services, such as housing, have been largely privatized. Others, such as pensions and health care, have been reorganized as state-run social insurance schemes. Others, such as education, combine state, private, and quasi-private provision. Most price and wage controls have been lifted. The elimination of price controls in an economy characterized by a chronic shortage of basic consumer goods and services resulted in an explosion of price inflation that lasted through much of the 1990s and has

4 Mariia Zheleznova, "Bednost' optimistov," *Vedomosti*, June 29, 2017.

5 <http://kremlin.ru/events/president/news/57425>.

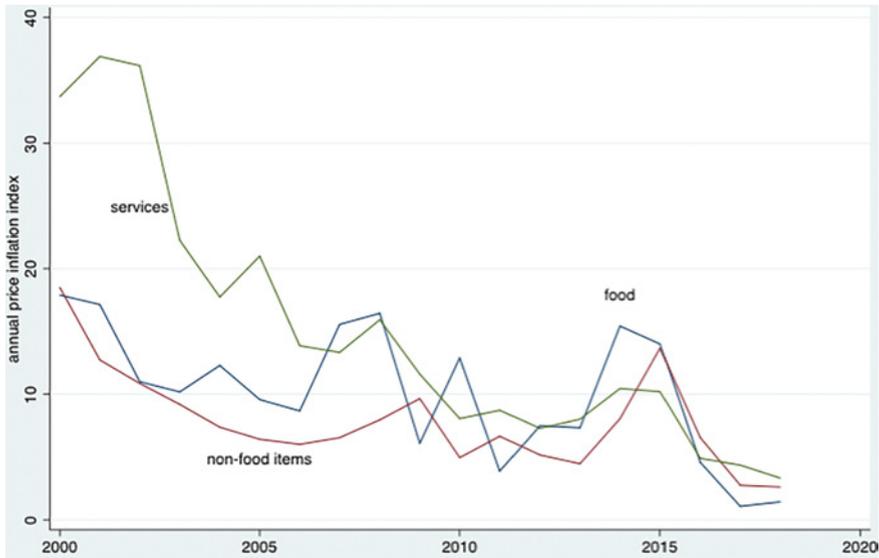


FIGURE 4 Annual Consumer Price Index Change, by category 2000–2018
SOURCE: ROSSTAT

only recently subsided: Russia's path to "growing out of the plan" has been far slower and more painful than was China's. Only in the last year has the annual consumer price inflation rate fallen below 4%

But even as price inflation has been defeated, real incomes have fallen almost continuously for the last four years, as Figure 1 showed. As a result, many families living in poverty and near-poverty must often make difficult choices between food and medicine or food and clothing. Below I will detail patterns of family income and consumption.

Administrative controls continue to regulate the allocation of some scarce goods and services, such as access to privileged recreational and medical facilities. A simplified table illustrates the change:

The table illustrates the point that before 1991, the great majority of valued goods and services were either distributed at plan prices in state stores—resulting in widespread shortages, hoarding, and black markets—or through the workplace. Rationing continued in many localities for many goods through the end of the Soviet era—ration coupons and enterprise orders (the "zakaz" system) for staple goods were still being used in Moscow in the early months of 1991.⁶

6 Personal observation. Under the *zakaz* (order) system, individuals placed orders through their workplaces for consumer goods that were otherwise in short supply.

TABLE 1 Plan vs. market allocation of goods and services, Soviet era and today

		Principle of allocation	
		Market	Administrative
Soviet era:			
Medium of transaction	Cash	Some consumer goods, e.g. at bazaars (<i>rynki</i>)	Wages; pension payments; some <i>lgoty</i>
	In-kind	Black markets in goods and services; informal barter	Education; health care; subsidized food, housing, utilities, other consumer goods, recreation; scarce consumer goods; some <i>lgoty</i>
Post-Soviet era:			
Medium of transaction	Cash	Most food, basic consumer goods; wages; some elements education and health care; subsidized food, housing, utilities, other consumer goods, recreation	Public sector wages; social benefits, social insurance (including pensions), social assistance; monetized <i>lgoty</i>
	In-kind	Corrupt access to services	Privileged access to services; some <i>lgoty</i>

In the Soviet period, and still today, many scarce goods were distributed through the benefits system, referred to as *lgoty*. *Lgoty* entitle the beneficiary to obtain free or discounted goods and services, as well as benefits such as tax exemptions and privileged access to scarce goods and services. The *lgoty* system continues to be a very important part of social welfare today. Then, and now, people are granted such benefits by virtue of belonging to a particular status category, many of which have been carried over from the Soviet era into the present. The benefits system was considerably expanded in the 1990s, as the government created new categories of entitlements—but usually without funding them. The benefits system is categorical rather than need-based. Most benefits, in fact, are not intended to relieve poverty. Only a small number of the categorical benefits are intended to benefit the poor. Taking only

state spending on social assistance, i.e. excluding pension and other social insurance programs, only about a quarter of total spending goes to reducing need.⁷ The existence of a large number of unfunded categorical benefits has led to pressure from budget authorities to replace them with cash benefits instead. But because of the outburst of nationwide protest at a botched effort in 2004–05 to replace administrative entitlements with cash subsidies, the federal government has been reluctant to make any further efforts to monetize in-kind benefits.⁸

The continuing use of categorical rather than targeted social welfare benefits renders post-Soviet social policy ineffectual at alleviating poverty and near-poverty. Low economic growth and falling incomes have exacerbated the effects, making it difficult for most Russian citizens to stretch their budgets beyond meeting basic needs. In fact, the complaints of most citizens in 2018 about living standards are remarkably similar to those made at the beginning of the transition era. In 1991, high prices and the shortage of goods were people's main complaints, according to public opinion surveys, but in 1994 and 2016, although the shortage of goods had disappeared, the main complaints remained low incomes and high prices.⁹ To be sure, the current system of social benefits has reduced extreme poverty and, most particularly, has lifted the great majority of pensioners out of poverty, but has left a majority of the population in a condition of near-poverty. Families with two or more children are especially at risk: over 60% of those in poverty are families with children.¹⁰ Half of all families with children receive family incomes below the threshold of 50% above the poverty line.¹¹ Only 30% of families have enough to do more than get by; that is, to satisfy basic needs—food, clothing, and mandatory payments.¹²

7 Ol'ga Kuvshinova, "Sistema sotspodderzhki ne podderzhivaet bednykh—issledovanie," *Vedomosti*, November 28, 2016.

8 On the 2004–05 episode, see Thomas F. Remington, *The Politics of Inequality* (New York: Cambridge University Press: 2011); Susanne Wengle and Michael Rasell, "The Monetisation of *L'goty*: Changing Politics of Welfare Politics and Provision in Russia," *Europe-Asia Studies* 60, no 5 (2008), 739–756.

9 Marina Krasil'nikova (interview), "Mechty ne sbyvaiutsia," Levada Center, March 2, 2017, <http://www.levada.ru/2017/03/02/mechty-ne-sbyvayutsya/>

10 Anastasiia Bashkatova, "Detskaia bednost' – novaia sistemnaia problema strany," *Nezavisimaia gazeta*, August 1, 2018.

11 Liliia Ovcharova, cited in n.a., "L'gotnaia stavka NDS mozhет byt' otmenena dlia chasti tovarov," *Vedomosti*, April 18, 2018.

12 Ol'ga Kuvshinova, "Dolia semei, imeiuschchikh sredstva dlia razvitiia, snizilas' na chertvert' do 30%," *Vedomosti*, April 14, 2017.

They lack the resources to invest in any opportunities for longer-term improvement of their lives, such as education, better housing, and cultural enrichment.

Economic growth in Russia does little to increase the numbers or incomes of those in middle income groups, even if we define the middle class mechanically as the share of the population whose incomes fall between two thirds (or three quarters) and twice the median income. About 30% of the population receives incomes under three-quarters of the median of their region; another 52% are in the middle-income group, receiving between three-quarters and twice the regional median. Among individuals older than 60, about 52% receive less than the regional median.¹³ The share of Russian households in the middle income group is lower even than in the United States, where the middle income group (defined in this case as those with incomes between 2/3 and twice the median) fell to 59% in 2010, and it is far lower than in other developed industrial economies.¹⁴ Likewise, Russia has an even larger share of the population in the low-income group than does the United States, and over twice the share of such countries as Denmark and the Netherlands.

Studies of the labor market reveal that, as in the United States, many Russians are trapped in low-wage jobs. According to Vladimir Gimpel'son and Rostislav Kapeliushnikov, over a quarter of employees of large and medium-size enterprises receive less than two-thirds of the median wage. The Russian Longitudinal Monitoring Study—the principal panel survey of the Russian population—shows that over the period from 2003 to 2016 more than 60% of the employed population were in low-wage employment for at least two years, and 41% for at least five years.¹⁵ The vice-premier for social policy, Olga Golodets, estimated that close to five million people (about 6.5% of the workforce) are “working poor,” that is, employed but living below the poverty threshold.¹⁶ Lillia Ovcharova estimates that if the poverty line is adjusted to account for the cost of raising at least one child, around a quarter of the working population

13 Aleksei Shapovalov, Zhizn' 'ot zarplaty do zarplaty' okazalas' statusnoi, *Kommersant* August 28, 2018.

14 In Germany, France and Finland, 72–75% of households are in the middle – income group. In Denmark, Norway and the Netherlands, the figure is as high as 80%. Rakesh Kochhar, “Middle Class Fortunes in Western Europe,” Pew Research Center, May 25, 2017.

15 V.E. Gimpel'son, R.I. Kapeliushnikov, A.V. Sharunina, “Nizkooplachivaemye rabochie mesta na rossiiskom rynke truda: est' li vykhod i kuda on vedet?” HSE Preprint WP3/2018/05 (Moscow, Higher School of Economics, 2018), 28.

16 Olga Kuvshinova, “Rabota bez zarabotka: za chertoi bednosti – kazhdyi chetvertyi rabotnik v Rossii,” *Vedomosti*, March 15, 2017.

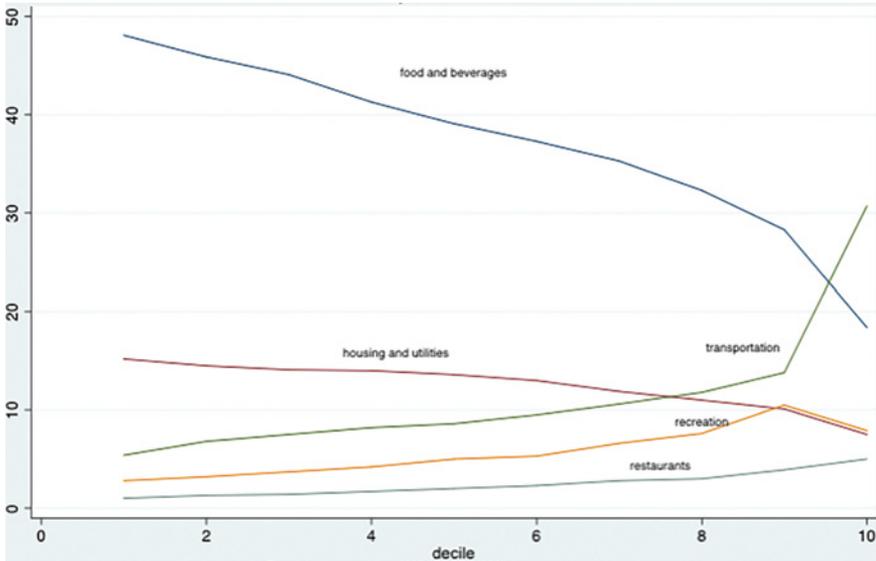


FIGURE 5 Russia, Structure of household consumption by income decile, 2017
SOURCE: ROSSTAT

live below the poverty line.¹⁷ Since many of those whose wages are at the subsistence minimum level supplement their earnings with off-book cash earnings, actual incomes are somewhat higher. But the problem remains that the state loses tax revenues and social insurance contributions when incomes are from informal labor.

Food prices therefore significantly affect poor and near-poor families. Food occupies a very significant share of household budgets at the low-income end. One recent survey finds that over 30% of families spend over half their income on food, and another 21% spend 40–50%¹⁸ According to another survey, food takes up 48% of the incomes for the bottom decile, but only 18% of the incomes in the top decile. The median household spends close to 40% of the family budget on food. In the United States, households in the bottom quintile have seen a decline in the share of spending going to food from about 43% in 1990 to about 35% in 2014 (although, as is often observed, much of the food consumed

¹⁷ Ibid.

¹⁸ Cited in Anastasiia Bashkatova, “Rossiiane—eto prezhde vsego bednye liudi,” *Nezavisimaia gazeta*, November 21, 2018.

by poor households is of low nutritional value), and the average household spends around 13% on food.¹⁹ If the problem for the United States is that food is too cheap, in that large-scale industrial production of highly processed foods strips nutrients from food, the problem in Russia is the large transportation and storage costs for food. As a result, the Russian family budget devotes a much larger share of its income to food than is the case in the United States: whereas families in the highest quintile in the United States spend between 6 and 7% of their budget on food, the top decile in Russia spends almost 20%. Even if we consider the United States a poor point of comparison, we might note that in Canada, the share of the family budget spent on food hardly differs across income groups: the poorest quintile devotes 15.3% of all spending on goods and services to food, whereas the top quintile spends barely less, 13.1%.²⁰

As the labor economist Vladimir Gimpel'son has noted, Russia's labor market is distinctive in that it responds to downturns not by layoffs but by reducing wages.²¹ This tends to prevent large-scale unemployment, but it means that many workers receive relatively low wages. For many workers, half or more of labor income is paid under the table or in variable forms such as bonuses. When times are hard, as has been the case since 2013, enterprises often cut the variable portion of pay. This phenomenon helps explain the paradoxical finding that real wages rose in 2017 and 2018 even as real incomes were falling.²²

A large share of the labor force is employed in inefficient enterprises, but formal sector employment remains the key for many to the system of social benefits well into the post-Soviet period. As a result, when workers' hours are cut, many find informal employment to supplement their incomes. If we define informal employment as employment outside the sector of medium – and large-scale enterprises, formal employment has been shrinking as a share of total employment.²³ Moreover, the practice of paying unreported wages

19 US BLS, <https://www.bls.gov/news.release/cesan.nro.htm>; US Department of Agriculture, <https://www.ers.usda.gov/amber-waves/2016/september/percent-of-income-spent-on-food-falls-as-income-rises/>.

20 <https://www150.statcan.gc.ca/n1/daily-quotidien/171213/too2b-eng.htm>.

21 Vladimir Gimpel'son and Rostislav Kapeliushnikov, "Labor Market Adjustment: Is Russia Different?" Discussion paper series // Forschungsinstitut zur Zukunft der Arbeit, No. 5588, 2011. Institute for the Study of Labor (IZA), Bonn <http://nbn-resolving.de/urn:nbn:de:1011-201104134105>.

22 "N1U VshE: Real'nye dokhody rossiian upali n 20% s 2014 goda," *Vedomosti*, August 1, 2017.

23 V. Gimpel'son, R. Kapeliushnikov, "Zhit' 'v teni' ili umeret' 'na svetu': neformal'nost' na rossiiskom rynke truda," *Voprosy ekonomiki*, no. 11 (November 2013), 65–88.

(“in the envelope” pay) is widespread.²⁴ Consequently, payments into the social insurance funds are insufficient to ensure adequate replacement rates. At present, the average old-age pension is equivalent only to just under 34% of the average wage. Low wages and low pensions drive many, therefore, into working second jobs or continuing to work after they have begun drawing their pensions. Wages in the informal sector tend to be lower than in the formal sector by 20% or more, and are subject to much more volatility and insecurity. The high share of informal income means that many families have more income than they report, but undermines state efforts to alleviate poverty and ensure adequate financing for pension and other types of social insurance.²⁵

In Russia, periods of economic growth raise incomes, but they raise incomes most in the upper brackets of the distribution. Periods of economic stagnation increase poverty but reduce inequality as incomes at the top level off. Therefore, rising income inequality is built into the structure of the distribution of income gains from growth.

The large share of households with low incomes also means that relatively few Russians have savings: about two thirds report none. (Table 2). Only in the top quintile do more than half of Russians have savings; among the bottom quintile, fewer than a quarter do. As of early 2019, the share of income going to savings had fallen to a twenty-year low.²⁶ Meantime consumption was being sustained by borrowing; consumer debt has rose 20% in 2018 over 2017.²⁷ This is further evidence that to an increasing degree, as real incomes are falling, more and more Russians are living from payday to payday.

Moreover, prices for food and other goods needed by the poor tend to rise more quickly than the overall consumer price index.²⁸ When prices rise, therefore, poor households make painful choices, more often reducing spending on medicine than on food.²⁹ As economists note, elasticity of demand to price increases is lower for food than for discretionary expenses.

24 Friedrich Schneider, Andreas Buehn, Claudio E. Montenegro, “Shadow Economies All over the World: New Estimates for 162 Countries from 1999 to 2007,” World Bank Policy Research Working Paper, #5356, July 2010; Apurva Sanghi, Samuel-Freije-Rodriguez, Aleksandra Posarac, “Stemming Russia’s Inequality: Unearthing Causes and Developing Solutions, World Bank Group, May 2019.

25 Pavel Aptekar, “Razgovor ne v pol’zu bednykh,” *Vedomosti*, June 18, 2019.

26 Vasilii Robak, “Nechego kopit,” *Polit.ru*. May 16, 2019.

27 Anastasiia Bashkatova, “Udarnaia rossiiskaia piatiletka obnishchaniia,” *Nezavisimaia gazeta*, January 27, 2019.

28 Liliia Ovcharova (interview), *Noye izvestiia*, March 17, 2016.

29 *Vedomosti*, March 23, 2018.

TABLE 2 Share of households with savings by income group (%)

Mean for sample	35
1st quintile (0 – 20K rubles)	23
2nd quintile (20 – 30K)	31
3rd quintile (30 – 40K)	33
4th quintile (40 – 55K)	31
Top quintile (>55K)	53

SOURCE: LEVADA CENTER, [HTTPS://WWW.LEVADA.RU/2019/05/16/SBERZHENIYA-ROSSIYAN/](https://www.levada.ru/2019/05/16/sberzheniya-rossiyan/)

3 Inequality and the Rent-Seeking Equilibrium

The problem of widespread food insecurity arises from what Joel Hellman many years ago referred to as a “partial reform equilibrium.”³⁰ This refers to a condition in which those corporate interests that were successful in capturing rents from transition early in the post-communist period of economic liberalization formed mutually advantageous alliances with political leaders that enabled both sides to suppress challenges to their dominance. Market-dominating corporate actors benefited by using their political influence to prevent a further opening of product markets to competition. These corporate actors raised barriers to entry for rivals, while political leaders called on the material and in-kind resources of rent-capturing tycoons to provide them political support and allow them to suppress political challenges to their power. Through time, the Russian regime has come increasingly to rely on rents from natural resources and from administrative controls over market activity to generate sufficient tax revenues to finance government operations, including modest redistributive spending for the poor.³¹ At the same time, rent-extracting corporate actors supply policymakers with resources for their personal and political interests, such as purchasing seats in federal and regional legislatures,

30 Joel Hellman, “Winners Take All: The Politics of Partial Reform in Postcommunist Transitions,” *World Politics* 50, no. 2 (January 1998), 203–234.

31 Clifford G. Gaddy and Barry W. Ickes, “Resource Rents and the Russian Economy,” *Eurasian Geography and Economics* 46, no. 8 (2005), 559–583; Clifford G. Gaddy and Barry W. Ickes, “Russia’s Dependence on Resources,” in Michael Alexeev and Shlomo Weber, eds., *The Oxford Handbook of the Russian Economy* (New York: Oxford University Press, 2013), 1–34.

spending on high-visibility construction projects, and providing political leaders with lavish country retreats.³²

In this equilibrium, no outside combination of interests – whether from the left or the right—has sufficient power to force open political and economic markets. Hellman's insight was contrary to predictions that social unrest by those made worse off by liberal reforms, such as industrial workers and urban consumers, would be the major source of opposition to the completion of the liberalization. Hellman argued that, instead, the “early winners” of reform were liberalization's most powerful enemies. As time passed, this alliance of oligarchic interests and policymakers came to define the political economy of the regime and set the constraints to its policymaking autonomy.

Rent capture is a characteristic feature of many transition economies as insiders convert previously state-owned resources to private or corporatized profit-generating assets—converting power to money, as a common phrase in Eastern Europe and China put it. Individuals with privileged access to the policymakers in charge of privatization and commercialization are able either to acquire a controlling ownership stake outright, or to acquire managerial control over their commercialization. These included a wide range of potential sources of rents, such as natural resource deposits, supplies of scrap metal or other industrial inputs, favorably situated commercial hubs such as ports and harbors, infrastructure assets such as airports, highways and railroads, financial institutions, industrial enterprises, electric power generating companies, arable land and marine fishing zones. Among the early winners therefore were managers who acquired ownership rights to state-owned monopoly enterprises and then worked to shut out potential competitors from their markets. Others were state officials who collected informal payments to grant licenses to importers and exporters or permits for doing business. Still others were bankers who took out cheap state-subsidized loans from the Central Bank and then lent out money to entrepreneurs at exorbitant rates. Many enterprise directors set up profitable sideline businesses, while using the state enterprise as a cheap source of production equipment, raw materials, and labor; the state enterprise then recorded losses, while the private sideline business made the director and his friends a tidy profit. All these newly advantaged groups cultivated ties with policy makers who protected them from both a rollback of the reforms and their advancement to the next stage.

The liberalizers assumed that following the initial distribution of property, however flawed in design and execution, there would gradually come about

32 The vacation compound provided to Premier Dmitrii Medvedev and documented by Aleksei Naval'nyi is a notorious example. See, <https://dimon.navalny.com/>.

an exchange of rights to ownership and control that would both increase the efficiency of assets and raise aggregate social welfare. This is consistent with Coase's theorem, which holds that if bargaining costs in a market are relatively low, agents who initially acquire title over assets through some privatization mechanism will subsequently enter into contractual bargaining with other agents over the rights to own and use the assets. Eventually they will reach agreements that result in assets being used to their highest and fullest value, thus maximizing both private return and social efficiency. In practice, however, insiders' ability to exploit their privileged access to rents in many postcommunist countries invalidated the premises of the theorem. Inherited asymmetries in political and social status, personal networks, location, and information instead locked in initial inequalities in the distribution of title to state properties and therefore allowed assets to be used in a way that was suboptimal from the standpoint of social welfare, but that produced rents for their owners and managers.³³

Russia's "loans-for-shares" programs represents a good example of the ability of insiders to thwart the objectives of liberalization by locking in oligarchic market power. The case of Norilsk Nickel offers a vivid case in point. Norilsk Nickel, a giant metallurgical firm in Russia's North, is the world's largest producer of nickel. An inefficient, debt-ridden giant of a company, Norilsk Nickel was also potentially one of Russia's most valuable assets. In 1995, with presidential elections approaching and the government desperate for cash, a well-connected entrepreneur named Vladimir Potanin proposed an arrangement to the government. His bank would bid on the right to manage a block of 51% of the shares of Norilsk Nickel in return for granting a loan to the government. If after a year's time the government failed to repay the loan, the bank would have the right to purchase the shares outright. He proposed conducting similar auctions for several other companies of strategic importance as well. Yeltsin and the government approved the plan despite the fact that it was clearly designed to turn over ownership of some of Russia's crown jewels to a small coterie of tycoons. Potanin's bank organized the auctions and his banks were the sole bidders for Norilsk Nickel. Not surprisingly, his bid won. A year later, when the government failed to repay the loan, Potanin proceeded to acquire majority ownership in Norilsk Nickel. This was an astonishing bargain: for \$170

33 For this reason, the theoretical reasoning underpinning the privatization programs in Russia and other post-communist countries was fundamentally flawed. It assumed away the legacies of inequalities in political power into the postreform era. See, for example, Maxim Boycko, Andrei Shleifer, and Robert Vishny, *Privatizing Russia* (Cambridge, MA: MIT Press, 1995).

million, Potanin bought a company whose output now accounts for close to 2% of Russia's GDP.³⁴

The case of Norilsk Nickel was only one example of the "loans for shares" scheme. Other oligarchs acquired controlling stakes in several of Russia's largest oil companies, also at bargain-basement prices. The entire "loans for shares" program stands as a vivid example of the close alliance between Russia's oligarchs and the Yeltsin regime under which powerful corporate interests acquired extremely high levels of ownership concentration in Russia. As of 2003, the top 10 families in Russia owned approximately 60% of the value of the stock market.³⁵ For Yeltsin, the loans-for-shares scheme was a means to ensure the support of the oligarchs in his reelection run in 1996, but for the oligarchs as a class, it cemented their ability to extract a continuing stream of rent incomes by restricting economic competition and political regulation.³⁶

China's transition generated rents in like manner. Chinese economists estimated that rents in 1992 constituted over 30% of national income.³⁷ Intermediaries who were able to acquire natural resource and industrial inputs at low state-controlled prices and resell them at market prices captured enormous rents, some in the form of bribes paid in order to acquire such privileges. Continuing market dominance by monopolies and oligopolies, most of them SOEs, also generates rents because of the absence of competition.³⁸

In the absence of countervailing power, higher shares of rent incomes in an economy deepen economic inequality. This is because those with the power to extract rents also have the ability to determine their own incomes if they are

34 <http://www.nornik.ru/page.jsp?pageId=about>.

35 Daniel Treisman has argued that the loans for shares scheme, while unsavory, was actually a catalyst for the recovery in the 2000s. He shows that the firms run by the oligarchs performed better in the 2000s than firms that remained under state ownership. Daniel Treisman, "Loans for Shares" Revisited," *Post-Soviet Affairs* 26, no. 3 (2010): 207–227. For a reconsideration of the role played by the oligarchs more generally, see Sergei Guriev and Andrei Rachinsky, "The Role of Oligarchs in Russian Capitalism," *Journal of Economic Perspectives* 19, no. 1 (2005): 131–150.

36 Note that individual oligarchs ran afoul of the authorities when Putin came to power in 2000. Three of the most prominent oligarchs were exiled or arrested. However, the oligarchs as a group continued to profit from their alliance with the Putin regime.

37 Wan Anpei, "Zujin guimo de dong tai kaocha," (Inquiry into the trends in the scale of rents), *Jingji yanjiu* 2 (February 1995), 80. Wan found that the total rent income had risen from the late 80s to the early 90s, Cf Wang Xiaolu. "Grey Income and Income Inequality," Credit Suisse. Analysing Chinese Grey Income, August 6, 2010.

38 Wu Jinglian and Ma Guochan, *Whither China? Restarting the Reform Agenda*, trans. Xiaofeng Hua and Nancy Hearst (NY: Oxford University Press, 2016), 279.

not checked by opposing forces such as organized labor or government regulation.³⁹ The tendency for rent-extraction to exacerbate inequality is therefore a characteristic of any economy where organized labor and government regulation are weak.⁴⁰ Where large firms enjoy concentrated market power, they are able to extract rents in the form of higher profits, while reducing their labor costs and tax bills.⁴¹ These rents are then paid in the form of higher compensation to top executives,

In Russia and China, and to some degree in the United States, a portion of the rent income received by high-end individuals goes unreported. For China, Xiaolu Wang estimates that 63% of unreported income goes to the top decile there.⁴² The high share of unreported incomes at the top end is the reason that household surveys do an increasingly poor job of measuring actual inequality in income distribution and that top shares must be calculated through a combination of methods, including tax returns, national accounts, and estimates of the relationship between consumption and income.⁴³

Serguey Braguinsky et al. made an ingenious effort (2014) to calculate the actual incomes of automobile-owners in Moscow.⁴⁴ They matched

39 In some older models of labor markets, owners, managers, and workers were said to share rents. Cf Milanovic blog, <https://glineq.blogspot.com/2015/05/bob-solow-on-rents-and-decoupling-of.html>) However, in an economy with weakened labor power and government power, rents do not need to be shared with workers or the general public, only with the politicians that ensure the continuing flow of rent incomes.

40 Therefore, the same point applies to the United States. Since the early 1980s, both the capital share of national income and the labor share have declined. The share of income going to profits, in the form of markups, has risen more than six-fold. (See Simcha Barkai, "Declining Labor and Capital Shares," Chicago Booth Stigler Center for the Study of the Economy and the State, November 2016, New Working Paper Series, No. 2, pp. 9–10.)

41 Gustavo Grullon, Yelena Larkin, Roni Michaely, "Are U.S. Industries Becoming More Concentrated?," https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2612047 August 2017; Jan De Loecker and Jan Eeckhout, "The Rise of Market Power and the Macroeconomic Implications," NBER Working Paper Series, No. 23687 (August 2017).

42 Wang Xiaolu. "Grey Income and Income Inequality," Credit Suisse. Analysing Chinese Grey Income, August 6, 2010. Remarkably, IRS experts similarly estimate that the top decile in the US receives about 63% of unreported income. Andrew Johns and Joel Slemrod, "The Distribution of Income Tax Noncompliance," *National Tax Journal*, 63, no. 3 (September 2010), 405–6.

43 Cf Facundo Alvaredo et al., "Global Inequality Dynamics: New Findings from WID World," NBER Working Paper 23119 (February 2017).

44 Serguey Braguinsky, Sergey Mityakov, Andrey Liscovich, "Direct Estimation of Hidden Earnings: Evidence from Russian Administrative Data," *Journal of Law and Economics* 57 (May 2014), pp. 281–319.

administrative data from Moscow on car ownership to the records of the car owners' employer-reported earnings, for 1999–2003. They found that for a majority of Moscow's car owners (and excluding the top and bottom earners), actual earnings exceeded reported earnings by a factor of three and more. In smaller private-sector firms, particularly in banking, retail trade, and services, as much as 80–90% of earnings were hidden from the authorities. They calculated that total earnings were on the order of 50% higher than those officially reported. Consequently, the size of the shadow economy in Russia, they concluded, was probably higher than the 45.6% figure proposed by Alexeev and Pyle for 1995.⁴⁵

The fact that economies with larger shares of rent incomes have higher inequality also has two other major implications. One is that the flow of rents maintains the alliance of policy makers and large corporate interests as rents are shared. The other is that it deprives the fiscal and social insurance systems of revenues as policymakers work to reduce the progressivity of taxation, spending on public goods and services, the collective power of organized labor, and the pooling of social risk. Because both policymakers and corporate interests prize stability, they keep opponents from the left (those who would advocate for more redistributive policies) and the right (those that would reduce barriers to competition in the marketplace) from allying. Depending on the context, they ally with the right against threats of higher taxes, regulation, and labor power, or with the left against more open markets. (For example, populist movements against “globalism” and “crony capitalism” are often backed by oligarchic interests.⁴⁶)

Rent-seeking represents a net drain of resources from the economy. Rent-seeking means that resources are being diverted to those who control rents rather than being invested in productive activity.⁴⁷ The pursuit of rents is

45 Michael Alexeev and William Pyle, “A Note on Measuring the Unofficial Economy in the former Soviet Republics,” *Economics of Transition* 11, no. 1 (2003), 153–175.

46 The Tea Party movement in the United States is an example. Cf Vanessa Williamson, Theda Skocpol, and John Coggin, “The Tea Party and the Remaking of Republican Conservatism,” *Perspectives on Politics* 9, no. 1 (March 2011), 25–43. Williamson et al. show that while the Tea Party movement was not created or controlled by powerful corporate interests such as the Koch Brothers network, those organizations provided it with substantial funding.

47 Joseph E. Stiglitz, *The Price of Inequality: How Today's Divided Society Endangers our Future* (New York: Norton, 2013); Joseph E. Stiglitz, *People, Power, and Profits: Progressive Capitalism for an Age of Discontent* (New York: Penguin Books, 2019); Joseph E. Stiglitz, *Rewriting the Rules of the American Economy: An Agenda for Growth and Shared Prosperity* (New

costly to society, therefore, while yielding higher private returns than in a fully competitive market environment.

What Hellman referred to as the partial reform equilibrium can be generalized, therefore, well beyond the transition environment. Such an equilibrium results from the capture of rents from liberalization of an economy with few checks on the alliance of corporate interests with policymakers, followed by the sharing of rents between corporate and political interests acquired by limiting competition in the political and economic arenas. As an equilibrium, it is therefore difficult to upset. At the same time, such an equilibrium results in suboptimal economic performance. Growth yields gains in incomes that are greater at higher strata of the distribution, even as incomes at the bottom may be raised.

The rent-seeking equilibrium in Russia stifles broad-based economic growth. The sectors best positioned to extract rents are natural resources, finance, and government. As Figures 6 and 7 show, the natural resource and financial sectors contribute the highest shares of value-added to the economy, and they have the highest average wages. Gaddy and Ickes estimate that over the 1999–2001 period, resource rents were equivalent to one-third of GDP.⁴⁸ These rents return income to the government not only in the form of taxes, but also in indirect forms, such as subsidies to Russian consumers for energy, bribes to officials, and projects that enhance the political stature of leaders.⁴⁹ Some examples illustrate the scale of the transactions involved. In 2007, the going price of a secure seat on a party's list—one high enough to ensure that the individual would be elected—was \$7 million (US); \$2–3 million ensured a spot on the list but not one guaranteeing election. The Kremlin instructs corporate interests how and to whom to contribute to political parties and their associated foundations. The oil firm Lukoil and the aluminum firm Rusal are said to have provided \$150 million to the Just Russia party, and more to United Russia. Such donations give firms access to the key committees as bills affecting their interests are considered in parliament.⁵⁰ There are also prices for acquiring the credentials of a staff assistant to a member of parliament, introducing an amendment to a bill, or making a formal parliamentary inquiry.⁵¹ Corporations

York: Roosevelt Institute, 2015); Anne O. Krueger, "The Political Economy of the Rent-Seeking Society," *American Economic Review* 64, 3 (1974), 291–303.

48 Gaddy and Ickes, "Russia's Dependence on Resources," 7.

49 Ibid., 11–13.

50 Maksim Stepenin, "Skol'ko stoit deputatskoe kreslo," *Novoe vremia*, No. 18, June 15, 2007.

51 David Szakonyi, "Renting Higher Office: Firm-Level Returns from Connections to Elected Politicians," Academy of Management Annual Meeting (2015).

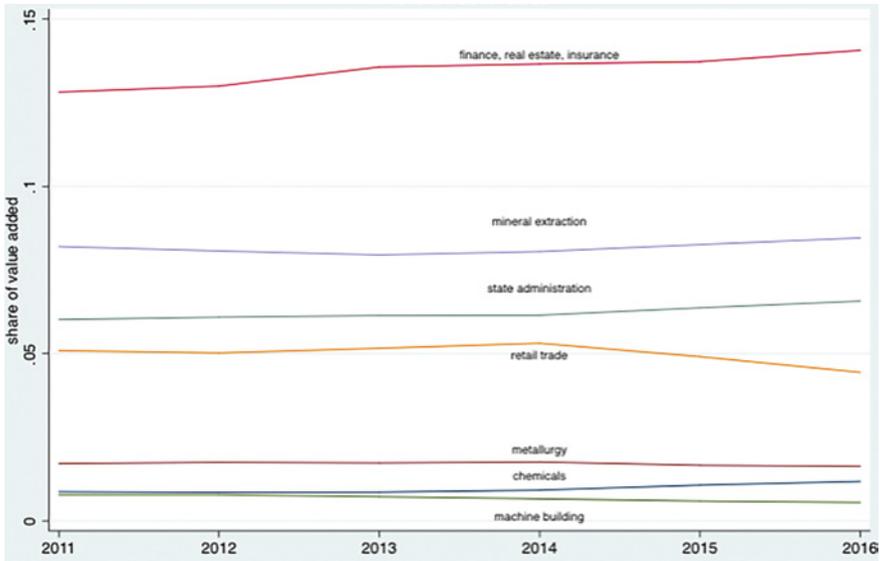


FIGURE 6 Russia: value-added by branch, 2011–2016 in constant 2011 rubles
SOURCE: ROSSTAT

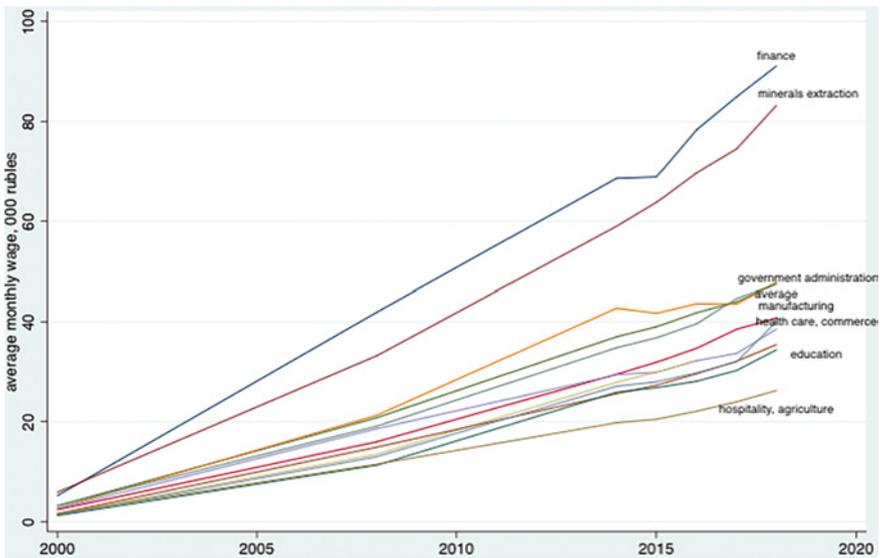


FIGURE 7 Russia: average wage growth by branch 2000–2018
SOURCE: ROSSTAT

finance these expensive services in the expectation that policymakers will ensure a continuing stream of rent incomes; politicians benefit from avoiding the need to compete with opposition parties for their seats. However, mutually beneficial the alliance of oligarchs and officials may be to one another, this system of shared rents comes at a high cost to the society by blocking competition both in the economic and political arenas. The result is the perpetuation of a system of slow growth and policy stasis.

The regime's rising dependence on revenues from the rent-producing sectors, particularly natural resources and finance, undercuts any incentive to shift to a system of taxation that would reward investment in knowledge-based industry. Fearful that any increase in corporate or personal income taxes would push business further into the shadows, the Putin regime has kept fiscal taxation low and non-progressive and tolerated enormous evasion of social insurance taxes by employers and employees. Rising spending on defense, law enforcement, and policing has imposed a substantial constraint on the government's ability to increase spending on productivity-enhancing items such as education, training, and health care. As Gaddy and Ickes put it, "the extreme inequity in the distribution of wealth creates fundamental risk for the rent producers of any change in control over rents."⁵² That risk applies equally to the policymakers who share in the rent streams.

Although the economy grew overall at a rapid rate during the first decade of Putin's presidency, this growth was based on recovery and rising world oil prices rather than modernization and diversification of productive capacity. Since then, the combined effect of the global recession of 2008–09 (the economy shrank by almost 9% in 2008) and the exhaustion of recovery-based growth have led to the renewal of economic stagnation. The stagnation reflects the fact that Russia's economy has become *more*, rather than *less*, dependent on revenues from the oil and gas sector as opposed to knowledge-intensive production. And, as in the United States, the share of the financial industry's contribution to GDP has risen even as machine-building's share has declined. Russia's dependence on revenues from oil and gas extraction and processing also means that the state budget depends heavily on this sector. In 2013–15, oil and gas revenues made up a little over half of state revenues. When world oil and gas prices fall, therefore, the budget faces a strain. State spending (on large-scale infrastructure projects, face projects, and defense) is the main stimulus that the government can deploy to increase growth rates, but these do not lead to sustained growth and tend rather to increase the deadweight burden of state spending on the economy.

⁵² Gaddy and Ickes, "Russia's Dependence on Resources," p. 23.

4 Obstacles to Needs-Based Social Policy

Several inherited institutional arrangements of the old regime, among them the non-progressive tax system, inefficient social insurance mechanisms, and use of categorical social benefits, leave social policy relatively non-redistributive. Despite continuous calls by senior government officials, such as vice-premier Tat'iana Golikova (who oversees social policy) to target social assistance more effectively towards the poor, only about 4.2 million people out of 19 million living in poverty receive social assistance.⁵³ Over the past several years the government has considered a number of proposals to alleviate food insecurity. Responding to President Putin's 2019 ukaz demanding that the government cut poverty in half, the Ministry of Labor has initiated a new effort to gather comprehensive data on the situation of the poor, beginning with pilot projects in eight regions. The goal is to introduce a kind of "conditional cash assistance" program, such as those widely used in Latin America. The goal is to establish a unified system for identifying and targeting poor households and providing them with appropriate forms of help, including job training. However, this effort is barely in its beginning stages.⁵⁴

Another idea is to eliminate the lower rate of the value-added tax on food and other consumer necessities and to use the additional revenues to subsidize the incomes of the poor. Currently the VAT rate is 18% on most items, but it is 10% for food, children's goods, books, textbooks, and medicine. Because this lower rate affects all consumers, rather than low-income groups, it is not redistributive. The lower rate costs the treasury an estimated 360 billion rubles each year for food alone, and another 100 billion for medicines. The finance ministry first proposed this idea in 2016 and it continues to be debated. However, the recent experience with the reform of the pension system – raising the pension eligibility age for men and women in exchange for the promise of higher pension benefits—demonstrates how sensitive the public is to any perceived loss of traditional social entitlements. Consequently, it is likely that this proposal, like other proposals that replace categorical benefits with targeted cash assistance, will face strong latent political resistance. Consistent with the bureaucratic-authoritarian politics model, Russian efforts to reform social policy tend to be subject to frequent reversals due to fear of social unrest and

53 (n.a.), "Lish' kazhdyi piaty bednyi rossiiainin poluchaet sotspodderzhku ot gosudarstva," *Nezavisimaa gazeta*, February 15, 2019.

54 Anastasiia Manuilova, "Sotsial'naia pomoshch' razyshchet adresa," *Kommersant*, December 3, 2018.

constant shifts in the balance of power between the social and liberal wings of the government.⁵⁵

Another initiative that has been debated for several years is a system of “food cards” that would enable low-income families to purchase subsistence goods at discount prices. Initially floated by the Ministry of Industry and Commerce in 2015, the concept is supported by the liberal wing of the government, but so far it has not taken shape as a legislative proposal.⁵⁶ The Ministry of Industry and Trade declared in 2017 that the system would take effect in 2018. In 2018 it expressed hope that the system would be introduced in 2019.⁵⁷ In its current form, the plan would be to transfer 830 rubles (about \$12) in value to special cards each month to poor individuals (those living below the regional subsistence minimum). Any unused balance at the end of the month would be erased. The program would cost about 300 billion rubles to start up (about half in administrative costs). The cost of the program and haggling over the details of which food products would be eligible and the like account for the continuing delay in the program’s rollout.

The vicious circle of low productivity and heavy but inefficient and non-progressive state social policy leads to perennial underfunding of both social assistance and social insurance instruments. Yet the Putin government has refused to make the income tax progressive. Each time the idea is broached it is rejected. President Putin explicitly addressed this issue in his “open line” broadcast in June 2018. An audience member asked the president why Russia could not increase state revenues by raising taxes. The president’s response is worth quoting in full:

“V. Putin: ‘One of the sources [of additional revenue] would require a certain tuning up of the tax system. The measures you named, such as the personal income tax, that is the tax on the incomes of physical persons, or a tax on sales, have been discussed among the government and at the expert level. As we know, many are proposing to change the personal income tax, including political parties that are in the opposition but are represented in parliament. We have thought about this a long time. At first glance, a differentiated scale for taxing personal incomes appears to

55 Thomas F. Remington, “Institutional Change in Authoritarian Regimes: Pension Reform in Russia and China,” *Problems of Post-Communism*, online publication, 6 April 2018.

56 N.a., “Dlia maloimushchikh vvedut produktovye kartochki,” *Parlamentskaia gazeta*, May 11, 2017.

57 Oleg Adamovich, “V Rossii vernut produktovye kartochki,” *Komsomol’skaia pravda*, February 16, 2018.

be more just, that is, those who receive higher incomes should pay more. But practice is more complicated than these theoretical formulas. What does practice tell us about the differentiated personal income tax in past years?

“A. Kondrashov, [the moderator]: ‘People hid their incomes.’

“V. Putin: ‘Exactly right. As soon as it is introduced, a part of the citizens, those who receive higher incomes, begin to use various means to hide their incomes. Immediately people start receiving their pay in envelopes [i.e. in unreported cash] and so on and so on. That is, the fiscal effect is nearly zero, but there is a lot of noise, and overall a worsening of the investment climate. So, this has been deemed inexpedient.’”⁵⁸

His explicit admission that latent and overt resistance to higher personal income taxes from those who are well-off would stifle any benefit from a more progressive system confirms that low administrative capacity, and lower political will, make it politically difficult for the fiscal system to serve redistributive purposes.

As is the case with most proposals to make social policy more redistributive, the government has been unable to define a coherent set of objectives or policy instruments. The reason for this is the difficulty of reaching a final compromise across the multiple competing policy interests that are at stake. The principal reason that the industry and commerce ministry proposed food cards was to provide a stimulus to the domestic food industry at a time when Russia had imposed counter-sanctions on the European Union that restricted food imports from Europe. By stimulating demand for domestic food products, the ministry hoped to use the subsidized food cards to increase sales. The objective of improving the food security of the poor, however consistent with that goal, posed a number of questions. For example, what products would the cards be eligible to purchase: staples or perishables? One idea was that only purchases of perishables would have the effect of boosting demand for domestic food products, since staples are by definition long-lasting goods and purchased at longer intervals. Against this was the view that for much of the population staple goods such as macaroni and flour are vital necessities. Another question concerned stores’ ability to accept cards: would all stores be equipped to process transactions using them, or only specially adapted stores? What about farmers’ markets? Still another concerned eligibility requirements. The system for determining eligibility would be cumbersome and designed to ensure that

⁵⁸ Priamaia liniia, June 7, 2018. <https://www.1tv.ru/shows/vystupleniya-prezidenta-rossii/pryamaya-liniya-2018/pryamaya-liniya-s-vladimirom-putinym-2018-polnaya-versiya>.

the undeserving poor (*"tuneiadtsy"*) who are too lazy to work be ineligible. But enforcing any such restrictions would be administratively burdensome.⁵⁹ And setting up a system for electronic processing to distribute the cards, add value to them, renew them, and calculate their balances would strain the federal government's limited administrative resources. Because the participants in the decision-making process are departments of government, not political parties or corporatist associations, the government lacks a means to build social consensus around a policy that balanced incentives for investors with social protection for the poor. Characteristically, neither President Putin nor Prime Minister Medvedev has chosen to close the debate with a decision, preferring to allow the inter-agency bargaining process to proceed slowly until all ministries have signed off on it. Evidently the issue is not of sufficient salience for either to impose a solution.

5 Conclusion

I have argued that food insecurity in Russia is the product of multiple factors. Most broadly, it is the outcome of a configuration of political and economic power in which powerful corporate interests share rents with policy makers in order to preserve political dominance in the economic and political arenas. Rents generated from the natural resource and financial sectors, reinforced by the intrusive power of administrative controls over virtually every branch of the economy, keep the regime stable—but also make it unable to shift policy significantly either to a growth-oriented, competitive market system or a system of full state socialism. This system produces high incomes for the top strata, ensures the continuing power of the Putin regime, and allows a certain amount of redistributive spending targeted to the poor. But it keeps labor incomes low for a majority of the population and inhibits the potential of market competition to raise economic productivity and diversify the country's economy. Likewise, this system deprives the country of the potential benefits of open political contestation among organizations aggregating and representing the interests of broad social interests, consumers and producers, poor and rich, countryside and city, young and old. The confinement of decision making on difficult fiscal and social issues to the narrow circles of the state bureaucracy severely restricts linkage between policymakers and society but at the same time raises anxiety among those in power that any major shift of policy could lead either to widespread social unrest, as broke out in the 2004–05 monetization

⁵⁹ Ibid.

of benefits episode, or to a quiet, large-scale, tacit resistance by businesses and oligarchs to paying higher taxes—what President Putin delicately referred to in his June remarks as “a lot of noise” (*mnogo shuma*).

The partial reform equilibrium that set into Russia’s economy two decades ago has had severe consequences for social policy. The “winner-take-all” nature of the distribution of economic power has fueled a rent-extracting pattern of income distribution, where economic growth yields income gains at the top but limits the expansion of incomes in the middle of the distribution. In response, informal employment has expanded at the expense of employment in medium and large-scale firms. The result is to deprive the state of tax and social insurance revenues that could be used to reduce deprivation among the poor and near-poor, to expand the provision of public goods such as infrastructure, education and health care, and to increase tax incentives for productive investment.

Thus, paradoxically, even as more and more Russians have come to depend on state transfers for their incomes, the state finds it increasingly difficult to meet the social needs of an aging population. Social transfers now account for 20% of total incomes of the population. 60% of Russians now are net beneficiaries of state spending, once health and education are included in public spending. Government spending has become the main driver of income growth, above all through public employment and pensions. For the bottom two quintiles of the population, state pensions are the main source of income. Even in the top decile by income, government spending accounts for half of total income.⁶⁰ Over the past twenty years, income from entrepreneurship has fallen in half, to under 8%. The state has succumbed to a vicious cycle of low growth, high inequality, and growing dependence on state spending for incomes and for growth. The consequence is that while abject poverty has largely been eliminated, a growing share of the population is trapped in a condition of low incomes and material insecurity.

Therefore, it is unlikely that in the absence of a very substantial change in the rent-based character of the regime, the government will be able to achieve Putin’s declared goal of halving poverty by 2014 or relieving the population of the food insecurity it now faces.

60 World Bank Group. *Russia Economic Report*, no. 36 (November 2016) “The Russian Economy Inches Forward: Will that Suffice to turn the Tide?” <<http://www.worldbank.org/en/country/russia/publication/rer>>.