Russian Economic Inequality in Comparative Perspective

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How High Is Inequality in Russia?

The worldwide trend toward rising income inequality has attracted increasing attention from scholars, policy-makers, and publics:[1] economists debate the causes while political scientists examine the effects of rising inequality on political life. A number of studies that focus on inequality in Russia claim that inequality in Russia is declining.[2] In particular, studies using the RLMS find a sharp decline in income inequality from the mid-2000s. For example, a 2015 World Bank report, using Russia Longitudinal Monitoring Survey data, finds that wage and income inequality fell markedly in the decade between 2002 and 2012.[3] However, these results are flawed for several reasons. First, the RLMS sample seriously underrepresents the most highly-compensated, in part due to under-sampling and in part due to under-reporting. (Liliia Ovcharova estimates that household surveys fail to capture income gains among the top 3–5 percent of the population.[4]) Second, the authors of the 2015 World Bank study drop the top and bottom .25 percent of the RLMS sample. Finally, and most problematically, they drop all respondents who did not hold full-time jobs. These problems seriously distort the representativeness of the sample given the high level of informal or mixed formal-and-informal employment.[5] The World Bank authors find that real wages increased, poverty fell, and the dispersion of real wages fell during the 2000s. However, the top-censoring of the data and omission of non-full-time workers means that the results grossly understate the actual difference between the ninetieth and tenth percentiles, since the greatest growth in wages and incomes occurred in the highest percentiles of the distribution. As Frederick Solt observes, the RLMS figures are at odds with every other source and should be used with caution.[6]

Certainly Russian average real wages rose in the 2000s, but they rose much faster for the highest earners than for the median and lower earners. A number of other measures, therefore, suggest a secular trend of rising inequality since the early 1990s, interrupted only by periods of recession. Periods of growth have almost always driven inequality upward; meanwhile, during recessions, inequality levels off or declines slightly. This trend is masked if household surveys do not correct for the underrepresentation of the highest income earners and their tendency to underreport incomes.

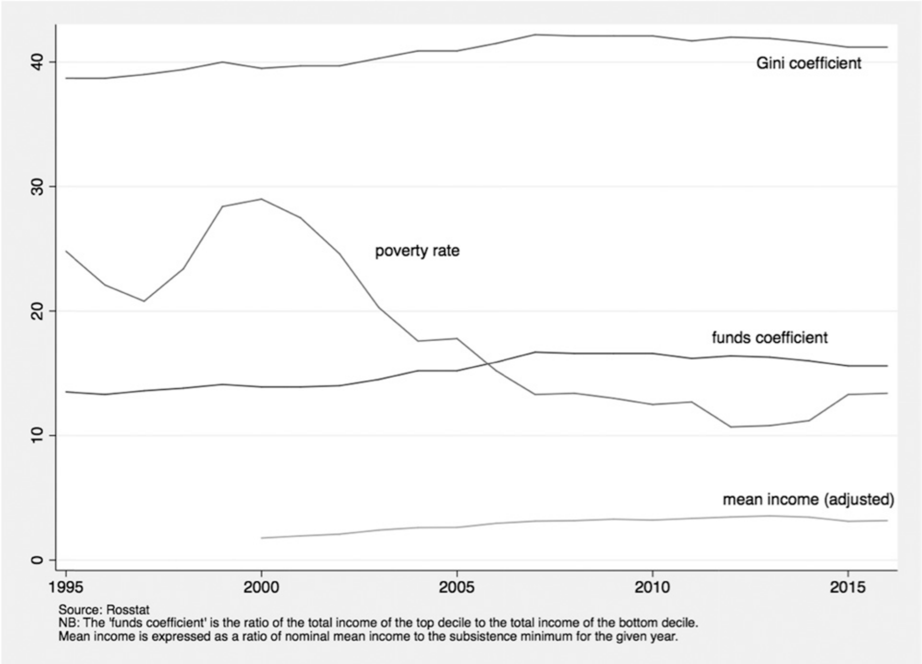
Russia's statistical service confirms these trends. Rosstat reports two measures of aggregate inequality, the Gini index and the "funds coefficient" (*fondovyi koeffitsient*). The funds coefficient represents the ratio of the average income of those income earners in the ninetieth income percentile to the average of those in the tenth.[7] Note that within the highest 10 percent, there is also widening inequality: the top percentiles are realizing higher income gains than those in the ninetieth through ninety-fifth percentile bracket. Because income gains are concentrated among the highest-income strata, the funds coefficient captures the widening gap between the richest and poorest deciles more accurately than does the Gini index, which tends to underrepresent income differences at the extremes. The crucial point is that in Russia, inequality rises as mean incomes rise; when mean incomes fall, so does inequality. On the other hand, poverty tends to fall when mean incomes rise. Thus, the annual growth of inequality and poverty show a very strong inverse correlation, whereas mean income is strongly and positively correlated with inequality and negatively with poverty (Table 1):
These relationships are also evident graphically. Figure 1 shows Rosstat's estimates of the trend in the decile ratio, Gini index, poverty rate, and mean (price-adjusted) income graphically (Figure 1):

We can document the tendency for the highest income strata to receive the largest shares of income growth when the economy recovers from a recession. Between September 2014 and October 2016, real incomes fell by more than 8 percent and real wages by over 7 percent, but inequality as measured by the Gini index and the decile ratio rose only slightly.[8] When wages at the upper end of the distribution begin to rise, inequality rises as well. One way to observe this is to compare the flow of contributions to the Pension Fund with measures of growth in real wages. Real wages began rising again in summer 2016 after falling sharply over the previous two years. However, the wages rose most in the financial and mineral extraction sectors, where the largest increases went to the most highly-paid employees. This is probably due to the resumption of the practice of paying large annual bonuses, which many companies had cut in 2015. (Annual bonuses for senior executives are often the equivalent of 80 to 100 percent of their annual salary.) Therefore, the increases in real wages in these sectors and income brackets are not accompanied by rising contributions to the Pension Fund, since the contribution rate for wages above a certain threshold (currently 798,000 rubles

Table 1 Correlation Matrix of Income, Poverty, and Inequality (Aggregate Annual Change)

	Mean income (adjusted)	poverty	gini	decile ratio
mean income (adjusted)	1			
Poverty	−0.9802	1		
Gini	0.9145	−0.8661	1	
decile ratio	0.9376	−0.8981	0.9921	1

Figure 1 Trends in Income, Inequality, And Poverty, 1995–2016



per month) is only 10 percent.[9] This confirms that when mean wages grow, the largest share of growth goes to the highest-income strata, deepening inequality.

Related to the concentration of wage gains at the highest end of the distribution is the stagnation of wages at the lower end. Research by Vladimir Gimpel'son at the Higher School of Economics and by Sberbank has shown that the share of labor in the informal sector has risen over the last decade. Estimates of the informal labor share range from around a fifth to a third, and observers agree that it has steadily increased.[10] Wages in the informal sector are considerably lower than in the formal sector, averaging roughly 55 percent of formal sector wages. Since informal workers pay less than (or none of) the full share of their required contributions to the social insurance funds, the shortfall is considerable: if informal workers were to pay their full share, the Pension Fund would receive another 700 billion rubles per year.[11] Informal workers are therefore doubly disadvantaged: they are paid lower wages and also have lower pension entitlements upon retiring.

The most distinctive feature of the rise of economic inequality in Russia is the growing concentration of wealth. Wealth in all societies is more unequally distributed than incomes. Wealth refers to assets that can be converted into income, whether stock shares, real estate, or something else. Credit Suisse produces an annual report on the distribution of wealth globally and within countries, based on an exhaustive examination of public records. Credit Suisse compared Russia with the rest of the world and concluded that "inequality in Russia is so far above the others that it deserves to be placed in a separate category."[12] Tables 2a and 2b indicate how Russia compares with the US and China in the concentration of wealth in 2016.[13]

The Credit Suisse analysts also sought to estimate the wealth holdings among the middle class, where middle class was defined by wealth holding. Noting the melting away of the assets of those in the middle after the 2008 world financial crisis, the report concluded that, "After trebling in size by 2007, Russia has lost more middle-class members since 2008 than any other country. As with Greece and Turkey, the middle class in Russia is only a little smaller now than in 2000."[14] Yet in the same period, those at the top of the pyramid increased their concentration of wealth.

There are several ways to judge whether these levels of income inequality are high in relative terms. We can compare Russia with other post-communist countries, or middle-income countries, or other large and heterogeneous countries. Russia's level of income inequality is higher than all or almost all other post-communist states, but it is similar to the United States and to China. However, both the United States and China have higher levels of inequality than comparable states (wealthy industrial democracies and East Asian countries, respectively). Compared with the rest of the post-communist world, Russia has the highest level of income inequality (Figure 2).

By comparison with China or the United States, Russia is at a similar level of inequality, although the U.S. and China are also outliers among their peers.

Inequality Is Not Poverty

Inequality is not poverty; it is a related but separate phenomenon. As the above data show, inequality and poverty can move in opposite directions. Inequality is significant

Table 2a Shares of Wealth Owned by Top Strata of Households, 2016

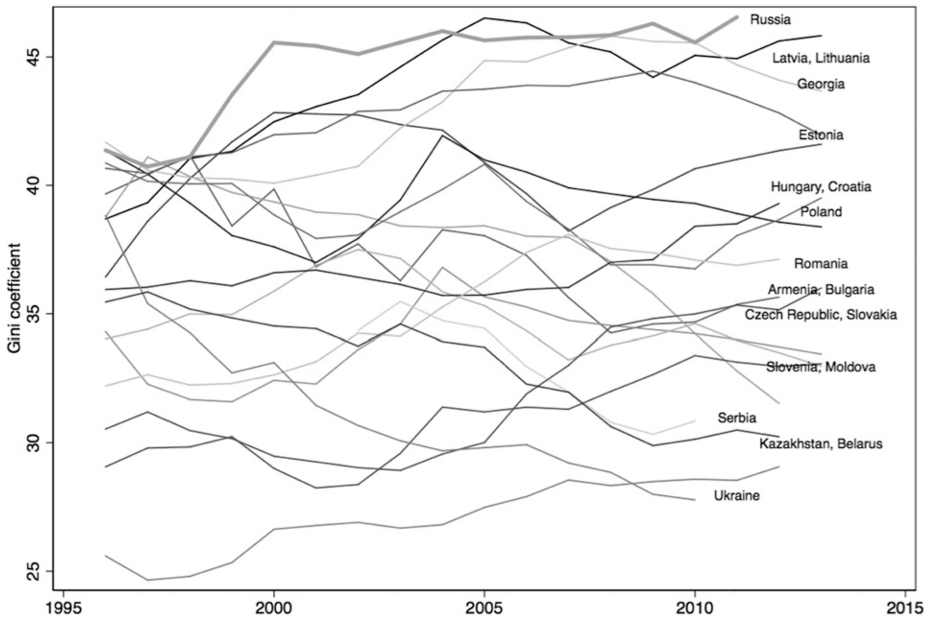
	Top decile	Top 5%	Top 1%
Russia	89	84.8	74.5
China	73.2	63.2	43.8
US	77.6	66.5	42.1

Table 2b Top Decile's Share of National Wealth

	2000	2007	2014	2015	2016
Russia	77.1	75.4	84.8	87	89
China	48.6	56.1	64	66	73.2
US	75.6	74.8	74.6	76	77.6

Source: Credit Suisse Global Wealth Databook, 2016; Credit Suisse Global Wealth Report, 2016.

Figure 2 Former Soviet Union and Eastern Europe: Income Inequality Trends



Source: Frederick Solt, 2014. 'The Standardized World Income Inequality Database' Working Paper. SWIID V. 5.0, October 2014

in its own right, despite the view by some economists that studying inequality is misleading or irrelevant.[15] It used to be thought, for example, that the growth of inequality in Russia and other transition countries reflected the adjustment of the economies to the market system: wage differentials were decompressed, allowing an appropriate wage return to skill and effort; the composition of industrial employment was transformed as labor shifted into higher-productivity branches; much underground economic activity was brought out of the shadows; and, above all, growth was raising all incomes. Some also argued that there was substantial wage mobility, so that over a lifetime some might fall into poverty only to rise again. Daniel Treisman argues that, both over individual lifetimes and cross-sectionally for society, "both poverty and relative wealth tended to be short-term phenomena, with strong reversion to the mean."[16] Although transition-related factors certainly contributed to the sharp increase in inequality seen in the 1990s and early 2000s, transition-based arguments are less and less compelling as time passes. As has become clear, inequality in Russia was not only a phenomenon of the transition; it has deeper roots in the political economy. For example, whereas in other transition economies, inequality fell in the late 1990s and 2000s, it continued to rise in Russia, as Figure 2 showed. In Russia, with the exception of a few high-profile individuals who ran afoul of the authorities, those who got rich early stayed rich and got richer, in part by locking in the rents they captured in the early days of the transition.[17] Most of those who fell into poverty escaped it, but as mean incomes rose, so did inequality both of income and opportunity. Empirical studies have shown declining upward mobility since the transition and rising downward mobility. This suggests that inequality in social and economic resources is being reproduced across generations.[18] As in the United States, cross-sectional inequality reduces cross-generational social mobility.[19]

Aggregate measures of inequality trends can reflect shifts in incomes at all points of distribution. If low-end incomes fall but incomes in the middle and upper percentiles do not, inequality will rise. Likewise, if top-end incomes rise, while lower- and mid-range incomes stay constant or fall, inequality will also rise. Therefore, inequality reflects several different kinds of movement in income distribution: increases in poverty, stagnation of middle-range incomes, and the concentration of income gains at the top end. In the United States and in Russia, rising inequality is much less a matter of declining low-end incomes than it is stagnation of mid-range and lower incomes and increasing concentration of incomes at the upper end. Poverty and inequality, while related, are distinct phenomena and can move in different directions.

Therefore, the growth of mean incomes does not automatically raise the median income. The ratio of mean to median individual income in Russia is approximately 2.15 (about 30,000 to 14,000 rubles per month) as compared with a ratio of just under 1.5 in the US (44,500 USD to 30,200 USD per year).[20] Rising inequality matters because a widening of the gap between the highest-earning individuals and the poor and middle-income groups drives a wedge into the social cohesion required for sound government, let alone democracy. Inequality in the distribution of wealth and income undermines society's ability to demand that government provide conditions for ensuring equality of opportunity. The critical conditions identified by John Rawls for the principle of justice as fairness are that social and economic inequalities are "(a) reasonably expected to be to everyone's advantage, and (b) attached to positions and offices open to all."[21] To the extent that the institutional arrangements giving rise to higher inequality do not bring benefit to all, for example by capturing private benefits from public goods, locking in cumulative advantage across generations, or withholding public goods, inequality corrodes governance and democracy even when poverty is constant or falling.[22] In the United States, it is strongly linked to the rise of political polarization.[23]

Theories of Inequality

Technological Change and Globalization The standard economic explanation for rising inequality is the theory of "skill-biased technological change." Technological change increases the wage premium to skill and education, widening income differentials between those at different educational levels. In the account by Claudia Goldin and Lawrence Katz, the United States benefited from a rising supply of high-school, and later college-educated, graduates that could gain from the rising technological complexity of industry in the twentieth century. A national commitment to universal high school and later college education enabled the income gains from the increasing productivity of skilled labor to be spread widely through society. However, the slower rate of growth of college graduates in recent decades compared with the demand for skill has deepened the gap in the wage premium to education between those with college and post-college educations and those without. This is what Goldin and Katz call "the race between education and technology."[24]

This theory has some applicability to post-communist economies such as Russia's. The wage return on education and skill in the Soviet economy was very low. The recession of the 1990s and accompanying shocks to market demand and technology caused a massive reallocation of human capital. As many as 40 percent of employed persons in Russia changed occupations between 1991 and 1998, and two-thirds of this aggregate shift occurred between 1991 and 1995.[25] Wage compression, which had distorted the relationship between skill, productivity, and pay, gave way to a precipitous rise in wage inequality. This in turn led to a large-scale inflow of students into universities, reflecting the rapid increase in the individual return to an academic degree.[26] Research by Belskaya et al. and Carnoy et al. indicates that after a rapid increase in the wage returns to skill and education in the 1990s, returns leveled off in the 2000s and even began declining.[27] Therefore, as in other, non-transition, countries, much of the recent rise in income inequality cannot be explained by theories of skill-biased technological change.[28]

However, the theory has limitations, whether applied to the U.S. or to Russia. It certainly cannot explain the marked rise in incomes among the very highest brackets.[29] It does not explain variation in the capital and labor shares of income, because if technological change is biased in favor of capital, then a deepening of capital will raise the capital share of income faster than the labor share.[30] Certainly it is the case that in recent decades, top incomes are mainly derived from employment rather than inherited wealth. According to Emmanual Saez, in 2007 in the United States, the share of total wages and salaries going to top 1 percent was 12.4 percent. It had been only 5.1 percent in 1970, indicating an enormous increase in the levels of compensation going to individuals at the top end of the distribution.[31]

Globalization is also often cited as a causal factor for inequality. Globalization should be understood as complementary to technological change in hollowing out the wage distribution in higher-wage countries—that is, limiting the growth of wages in the middle of the distribution.[32] If technological change (such as the spread of digital communications technologies) allows mid-skill jobs, such as routine clerical tasks, to be performed more cheaply overseas, then the wage premium to the skill needed to perform such labor in the high labor cost country will drop, but rise in the lower-wage country. High-end manufacturing skill may bring a wage premium to labor in the high-wage country, but mid-level manufacturing skill may be cheaper to hire in a low-wage country, thus capital goods can be produced more cheaply in low-wage countries. Employment in service-sector jobs in high-wage countries is rising, but service jobs show a wide dispersion between high-wage jobs and low-wage jobs. Therefore, the labor force in high-wage countries has fewer and fewer jobs earning middle-level incomes. This is the phenomenon of "wage polarization" of the labor force observed in developed countries in recent years.[33] This is taking place to some extent in Russia as well, where there has been a moderate shift of employment out of manufacturing and into services. Employment in industry (including mineral extraction, energy production, and manufacturing) has dropped from over 25 percent of total employment in 1995 to less than 20 percent in 2015, whereas employment in wholesale and retail commerce has almost doubled from 10 to 19 percent over the same twenty-year period. Wages in some manufacturing and services occupations are extremely low, well below the subsistence minimum. In February 2017, the vice-premier for social policy, Olga Golodets, noted that 4.9 million people are employed but earning wages below the subsistence minimum.[34] The subsistence threshold for a working-age person is about 10,500 rubles per month, but the minimum wage is only 7,800 rubles. There has been a great deal of discussion about raising the minimum wage to the subsistence level, but the cost would be prohibitive. Many workers in industry and services earn less than or little more than the subsistence minimum. Meantime, since 2014 the labor share of national income has begun falling and the capital share rising.[35]

Piketty's r > g The theory developed by Thomas Piketty in his book *Capital in the Twenty-First Century* offers a simple and powerful explanation for the long-term trends in income inequality in Western countries over the last two centuries.[36] He holds that national income can be broadly divided into capital and labor shares and that the capital share of income will rise if the ratio of the capital stock to the flow of national income (which he designates as β) increases. The share of capital income (α) in total national income equals the rate of return on capital (designated as r) times the ratio of capital stock to income. If economic and population growth rates fall, income and wealth inequality will grow over the long run as wealth grows more concentrated. Piketty acknowledges that it appears anomalous that the return on capital can continue for a long time (decades at least) to be higher than the rate of growth of national income ($r > g$), but he demonstrates that this has indeed been the case over long periods in the past—such as the nineteenth century in a number of European countries—and appears to be occurring again after the anomalies of the twentieth century. The twentieth century was anomalous, in Piketty's theory, because of the immense destruction of capital stock brought about by the two world wars. They, and the radical democratization of labor relations that accompanied them during "the great compression," should be treated not as the normal trend, but as a historically exceptional period. Piketty attacked the "Kuznets curve" theory that held that inequality would first rise, then fall, as societies undergo industrialization. Kuznets had hypothesized that wage premiums to capital and skilled labor tended initially to rise as labor shifted out of the low-wage, low-productivity agrarian sector to the capital-intensive, high-productivity industrial sector, until wage levels tended to equalize as skilled labor became less scarce and the labor share of national income rose again. Kuznets erred, Piketty argues, by failing to recognize that the conditions under which this phenomenon was observed were historically exceptional. Economists debate sharply whether Piketty's theory is right.[37]

Piketty and his associates are developing comprehensive and consistent estimates of the ratio of aggregate national wealth to national income for non-Western countries, including China (the World Wealth and Income Database).[38] To do so, they combine data from household surveys, tax returns, and national accounts to calculate the distribution and composition of income over time. To interpolate income shares for the very highest income strata—where data from income tax declarations may be sparse or absent—they use Pareto-parameter estimation methods.[39] Recently, Piketty's team produced calculations for Russia that estimated the concentration of income among the top 1% as about 20-25%, approximately the same level as in the US and far higher than reported in official statistics. The share of income of the bottom 50% fell to 18%, while the total amount of wealth held in offshore accounts was roughly equal to the amount held in accounts in Russia. The concentration of income and wealth at the top, they find, rose faster than in either the US or China. They attribute the rise in inequality to the privatization of public wealth, but do not consider the similarly dramatic increase in the inequality of labor income.[40]

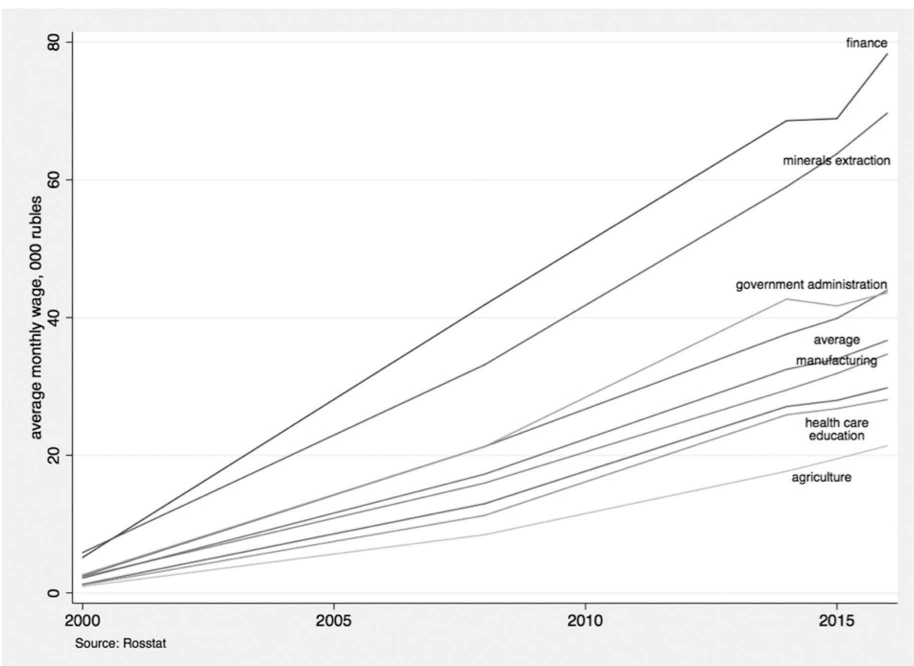
In reality, however, Piketty's explanation of income inequality as a function of rising capital share in national income fits the Russian case rather poorly. The OECD finds that the labor share of income rose in Russia—alone among the major emerging market economies (the BRICS plus Turkey, Saudi Arabia, and Mexico)—over the period from 1995 to 2012.[41] This may be due to the tendency for real wages to rise significantly under Putin, faster than the rate of accumulation of capital stock. Therefore, we cannot attribute the growth of inequality to a tendency for the return on capital to exceed the rate of growth of the economy as the ratio of the capital stock increases relative to national income.

Rent-Seeking The theory of inequality developed by Joseph Stiglitz for the United States may provide greater explanatory leverage for Russia. Stiglitz criticizes Piketty on the grounds that rising inequality in the U.S. is not well explained by the accumulation of productive capital in the economy. Rather, Stiglitz observes that much of the increase in wealth in the U.S. is due to the growth in the value of fixed assets, such as real estate. The financial sector is able to generate new forms of credit, often secured by real estate, pushing up both the apparent value of real estate and the return to the financial industry. The result is the growth of the financial sector's share in the total corporate profits (the financial industry now takes in around a quarter of total corporate profits in the U.S.).[42] Other sources of fixed assets include drug pricing and intellectual property. Stiglitz observes that where there are significant opportunities to extract rents from such assets, their capitalized value yields wealth but not productive wealth.[43] Institutional rules that protect monopoly rents—as when certain large banks or corporations are "too large to fail" or are state champions—increase the rent-generating value of assets. This pushes up income and wealth inequality without increasing the capital stock, capital share, or productivity of the economy.

In the case of Russia, it is clear that such rent-generating opportunities are prevalent as well, especially in the financial and natural resource sectors and in state administration. The existing literature has recognized the importance of Russia's dependence on oil and gas extraction for inequality within regions and redistribution across regions.[44] What has not been sufficiently appreciated is the fact that, as in the United States and other countries with rising inequality, the financial sector is also a substantial source of income rents. The ability of the resource, financial, and state administration sectors to capitalize rents is apparent in the over-time data on the growth of wages in these sectors compared to other sectors. Figure 3 shows this trend graphically.

Wages in the financial sector have risen hand-in-hand with those in oil and gas since 2000. Wages in state administration have risen faster than the average wage in the economy except in the most recent years, when the government allowed state sector wages to stagnate relative to inflation. State administration wages have risen to levels above machine-building and metallurgy; driven by the very rapid growth of wages in the resource and financial sectors, the average wage in the economy is higher than machine-building and metallurgy. One reason that financial sector and resource extraction sector wages have risen in parallel is that both have acquired power vis-a-vis manufacturing sectors, thanks in part to monopoly positions, and have captured rents in

Figure 3 Average Wage by Branch, 2000–2016



the form of higher compensation. These rents are then often capitalized through real estate and other acquisitions abroad rather than being reinvested in productive capacity in Russia. Note that as we saw above, once real wages began rising again in 2016, they rose most in finance and natural resource extraction (whereas public sector wages continued to lag).

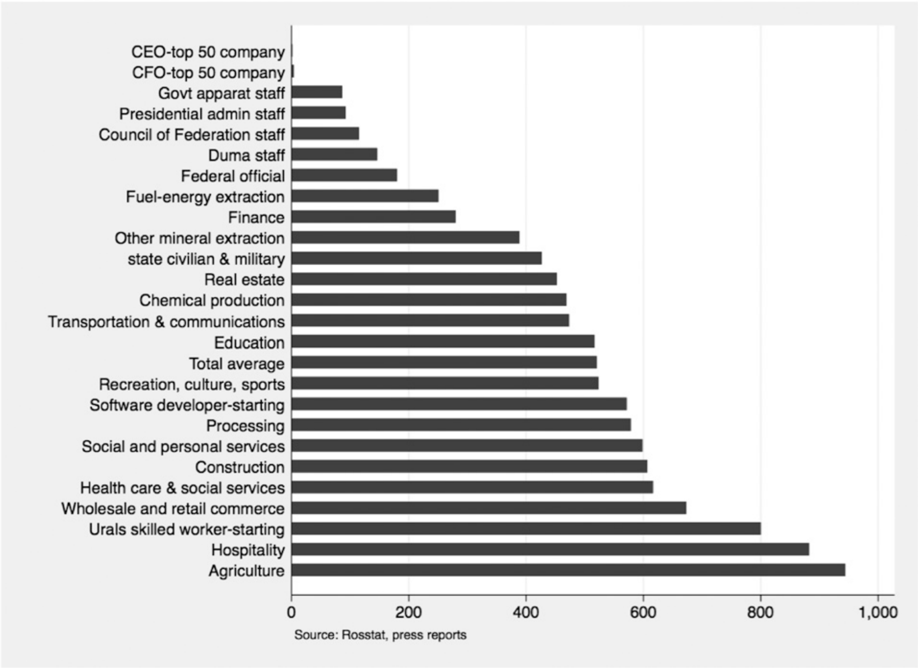
Within the resource and financial sectors there is also a substantial dispersion of wages, with the largest increases in compensation going to those at the very top. Data on the compensation of CEOs in Russia show that, when comparing companies of similar capital asset value, Russian CEOs are paid better even than their American and British counterparts. A recent study by the firm Spencer Stuart found that the general directors in Russia's fifty largest private-sector firms received an average of 233 million rubles per year, or more than 3 million USD. This included base pay as well as bonuses and other forms of incentive pay, which can equal 100 percent or more of base salary. The range of total annual compensation for the CEOs was wide, from 3 million rubles to over 50 million. The compensation of the CEO of two companies with equal capitalization could vary by as much as three hundred percent. The study found that when Russian firms were compared with U.S. firms of similar capital value, the American CEOs were paid 47 percent less, while British CEOs at comparable firms were paid 41 percent less.[45]

The CEOs at the top state firms receive at least as much. A study in 2014 found that managers who served on the board of directors at Gazprom received, on average, 249 million rubles per year. Most of this compensation comes from sitting on the boards of the firm's daughter companies.[46] Other major resource firms, such as Rosneft', award similarly high compensation packages to their board members and top managers. RBK estimates that Igor Sechin's total compensation in 2015 was somewhere between 459 and 612 million rubles, of which only 180 to 240 million was his base pay while the rest comprised various bonuses. Likewise, the ten members of the Rosneft's board received 370 million rubles on average in 2015, of which 70 million was base pay and the rest consisted of bonuses and other payments. At a shareholder meeting in June 2016, Sechin defended this level of compensation on the grounds that "the scale of income of our top-managers corresponds to the level of large Russian companies and must be comparable to the level of world companies, otherwise we will face an outflow of qualified cadres."[47]

The phenomenon of extremely high pay packages for Russian CEOs is consistent with the trend toward the rise of "super-managers" in the U.S. and elsewhere. Although the "Hollywood" or "winner-take-all" phenomenon is evident in sectors such as entertainment, sports, and NGOs, the extremely high compensation packages for private sector "super-managers"—whose total pay is often three hundred or more times greater than the average pay of their employees—is the largest factor in the growth of income among the very highest percentiles of income distribution.[48] Moreover, the ratio of CEO pay to average worker pay is extremely high, as Figure 4 indicates.[49]

As Piketty acknowledges, the trend toward "super-managers" is not readily explained by the r $>$ g theory, just as it cannot be explained by the notion of a "race

Figure 4 Ratio of Top Management Pay to Average Wage by Occupation, 2016



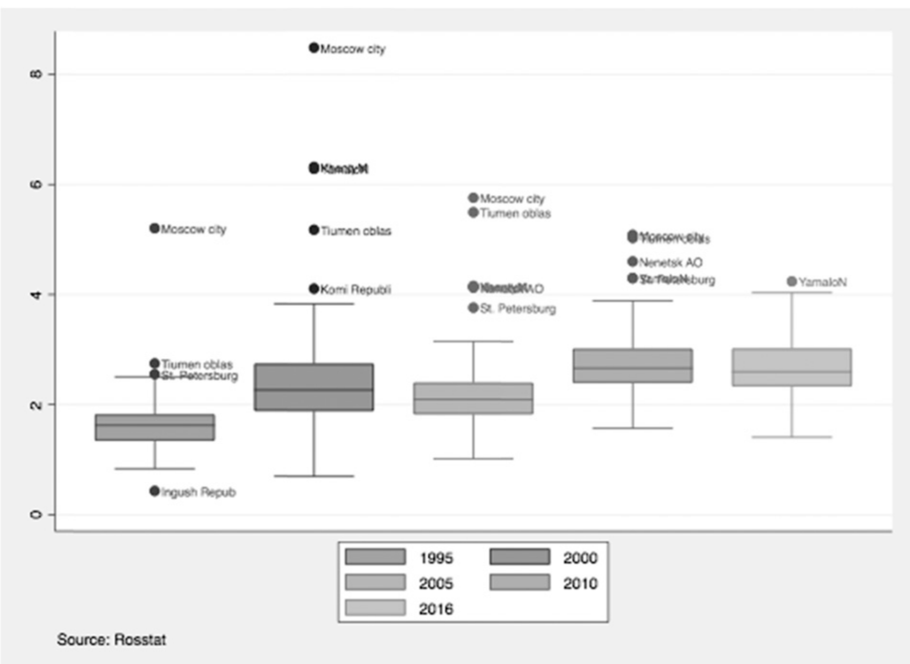
between education and technology" or globalization. Like Stiglitz, Levy and Temin, and others, Piketty suggests that the reason for the rise of "super-managers" is a shift in the balance of bargaining power between top managers and boards in favor of the former. Public policy, the decline in the bargaining power of organized labor, and changing social norms help explain this phenomenon.[50] This explanation is consistent with the observation that by far the largest factor in the growth of income inequality in the U.S. is the rising inequality in earnings. And the largest piece of the rise in earnings inequality is the far greater increase in earnings in the highest brackets of the income distribution.

Thus, the "Hollywood effect" of super-high compensation for top managers has diffused to Russia, as to other countries. A large state-owned oil firm extracts resource rents, enabling it to raise wages throughout the firm, but distributes them unequally. Just as the oil and gas industry pays wages far above the national average, so senior managers within those firms receive disproportionately high shares of the income. The same is true of financial institutions. These rent-based income streams are then capitalized in the form of real estate and other assets, often held overseas and sheltered from taxation.

Cross-Regional Inequality The concentration of wage income growth in the natural resource sector (and within firms in that sector) in turn contributes to a widening of income disparities across Russian regions. The boxplot in Figure 5 (below) depicts the widening gap between richer and poorer regions over time among the middle half of regions, the inter-quartile range. Even after discounting for the differences in prices across the regions, the richer regions have generally seen faster income growth than the poorer regions. The richest six regions (Moscow, Tiumen, St. Petersburg, Sverdovsk, Nenetsk autonomous oblast, and Tatarstan) benefit from being administrative, commercial, or natural resource centers. The fact that gains accrue disproportionately to those regions that can capitalize administrative, financial, and resource rents helps explain the fact that cross-regional inequality in Russia shows no tendency toward decline.[51] Average wages in resource-rich regions are as much as four times higher than in poor regions. On average, incomes in regions where at least half of the economic output comes from extractive industries such as oil and gas are a third higher than in other regions.[52]

Neo-classical economic theory holds that over long periods of time, cross-regional inequality tends to decline. This is said to occur for several reasons. One, if there are

Figure 5 Spread of Average Inflation-Adjusted Incomes across Regions (Expressed as Multiples of Regional Subsistence Minimum)



national markets for capital and labor, a rising gap in production costs between high-cost and low-cost regions eventually prompts investors to move into regions with lower costs for land and labor. Technological change can also equalize production costs across regions. Finally, national governments may respond to pressure, actual or anticipated, for cross-regional redistribution. The national government may increase redistributive spending across regions or invest disproportionately in poorer regions' infrastructure. With time, if these conditions hold, growth rates in the poorer regions should outpace those in richer regions, bringing about a convergence in incomes.[53]

Convergence theories assume that there is a sufficiently robust set of national institutions, however, to overcome obstacles to factor mobility. If local labor markets are distorted by historical legacies, convergence may not occur or occur only over very long periods as institutions are reformed. In China, labor mobility is substantially restricted by the household registration system (*hukou*). In Russia, high costs of transportation and housing make it difficult for labor to move freely across regions, and capital mobility is restricted by high interest rates, corruption, the immobility of many productive assets in the resource sector, and political controls by local elites over investment. Under these conditions, only strong pressure from the central government for policies targeting redistribution of investment capital might be able to set the country on a path toward convergence of incomes across regions. So far, however, state policy is not sufficiently redistributive to overcome institutional obstacles to capital and labor mobility.

Political Institutions The theory of "geographic asymmetry" outlined by Pablo Beramendi helps shed light on the relationship between cross-sectional and cross-regional inequality.[54] Even though the theory was intended to apply to democratic political systems, its implications also apply to non-democratic, but large and heterogeneous states such as Russia. Beramendi argues that inequality is likely to be highest in states where policies on redistribution are set locally and where cross-regional redistribution is low.[55] This is the case in Russia to a large degree because policy at the central level is scarcely redistributive at all. Many forms of social policy are in fact regressive in effect; only pension policy tends to be slightly progressive. For instance, the increases in pension benefits under Putin have alleviated poverty among the elderly (Table 3).

Thus, while pensioners are underrepresented among the highest-income groups, they are not overrepresented among the lowest 20 percent. Indeed, less than 2 percent of

Table 3 Distribution of Pensioners and Labor Pensions by Income Group (%), 2009

	Lowest quintile	2nd	3rd	4th	Top quintile	Top 50%
All pensioners	19.4	31.1	22.4	16.3	10.8	36.5

Source: Gurvich, E., and Iu. Sonina, "Mikroanaliz Rossiiskoi Pensionnoi Sistemy," *Voprosy ekonomiki*, No. 2, 2012, Tables 14–15, pp. 41–43. Based on RLMS.

the population receives incomes below 25 percent of the median, while another 10 percent or so receives between 25 and 50 percent of the median.[56] On the other hand, Russia's median is very low (about 14,000 rubles per month), only about 40 percent higher than the subsistence minimum. We can infer that while pensions protect a large share of the population from destitution, the fact that about a third of the population gets by on less than 75 percent of the median income implies a high level of economic insecurity.

Moreover, other social policies fail to be redistributive. Because most social benefits programs are categorical and not need-targeted, half the poor receive no means-tested benefits at all.[57] The cumulative effect is to compound advantages for those well-off enough to benefit from access to better services. As in liberal market economies such as the United States, the entrenchment of privilege also increases the ability of the rich and powerful to block moves toward more redistributive taxation and spending or toward broader pooling of risks and benefits.

Yet, although Russian social spending is only weakly redistributive, the share of state transfers in overall income is rising and the share of wages, entrepreneurship, and property as sources of income is falling. Currently nearly 20 percent of total income comes from state transfers, including pensions. The state budget accounts for about half of total income, and for the lower income brackets, state transfers make up 60 percent and more of total income. The lowest six deciles of the population are net beneficiaries of state spending, if spending on health and education are included.[58] The fact that the state share of total income is rising at the expense of income from wages, entrepreneurship, and property suggests that state fiscal policy is aimed at averting extreme poverty without producing either strongly redistributive or productivity-enhancing human capital investment.

From the standpoint of the relationship between cross-sectional and cross-regional inequality, therefore, it appears that while the poorer strata in poor regions might benefit from central-level policies that advance redistribution, both elites and lower-income strata in richer regions are likely to prefer greater fiscal autonomy at the regional level. Certainly, they are likely to accept the political desirability of some redistribution from richer to poorer regions as an alternative to more robust central-level mechanisms for inter-personal redistribution nationally. Subsidizing poorer regions tends to leave them in a better position than allowing a highly redistributive central policy. It also leaves them greater autonomy to set migration and social policy. This mechanism would be consistent with the fact that a small number of donor regions in Russia contribute to a growing share of the central government's revenues: the richer regions still retain enough economic surplus to allow them faster income growth than the populations of poor regions. In particular, the absence of a strongly redistributive fiscal policy at the center means that the richest strata in the richest regions can gain a disproportionate share of the income growth of the region. This, as we have seen, is precisely the case for regions where the powerful rent-extracting industries are concentrated.

However, at the same time, federal policy discourages regions from building their own revenue base through self-generated economic development. In recent years a number of regions that were formerly net donors to the federal budget have become net recipients of subsidies. While part of this is due to the shrinking economy, another part is due to federal policies that increase the required contributions by regions to jointly financed federal programs and to the mandates laid out in Putin's 2012 decrees that require regions to raise public sector pay.[59] Zero or negative economic growth rates mean that the more the federal government attempts to redistribute across regions, the greater the strain on the declining number of regions that record budget surpluses. Thus, federal policy has a relatively modest effect on cross-regional redistribution, but undercuts regional incentives to induce economic development.

Periodically there are proposals for restoring a progressive income tax in Russia (Putin enacted a flat 13 percent income tax beginning in 2001 as part of a broad set of pro-business economic reforms). The Ministry of Labor floated the proposal again recently. However, the government and its United Russia allies in the State Duma always block it. The revenues from the income tax, at present, go to regional budgets, rather than the federal budget. Therefore, only a few wealthy regions are likely to see net revenue gains from a progressive scale, and other regions likely fear that they would lose federal transfer payments if they were made more dependent on income tax revenues. A progressive income tax is administratively demanding, which critics also cite as another reason to reject it.[60] They also argue that there would be more evasion of a progressive scale of taxation. Therefore, support for a progressive income tax system is insufficient to overcome the strong latent resistance from the wealthy.[61] The resulting policy deadlock means that efforts to raise taxes and social insurance contributions on employers and employees drives more wages and employment into the informal sector while preventing fiscal and social policy from reducing inequality.

The absence of countervailing political mechanisms in the form of corporatist bargaining or competitive elections of course reinforces the deadlock. Tripartite bargaining is largely pro forma, and business representation is much more influential than organized labor.[62] Likewise, in the absence of competitive parties, electoral contests do not address redistributive issues. At most, it can be said that intra-bureaucratic bargaining between "liberal" and "social" blocs of the bureaucracy proxies for the latent cleavage between capital and labor, or the dependent population and those that prefer a laissez-faire policy.[63] In Russia, these sectors are represented by neither corporatist interest groups nor political parties.

So far, although the public is aware of the large differentials between rich and poor, the regime has been able to deflect responsibility and resentment away from itself. In 2015, the percentage of people believing that the gap between rich and poor has risen compared with the Yeltsin period rose to 69 percent (it was 48 percent in March 2009, but had been 65 percent in 2007).[64] Likewise, the number of people believing that the current distribution of incomes is "fundamentally unjust" has risen to 56 percent from 43 percent in 1990. 70 percent of the population believes that it is impossible to earn millions of rubles in today's Russia by honest means.[65] At the same time, like Americans, Russians tend to underestimate actual levels of inequality.[66]

Occasionally inequality has surfaced as an issue in Russian politics. Before the 2011–2012 election cycle, Vladimir Putin and the leaders of the United Russia party frequently expressed concern over the high level of income inequality. "The differentiation of incomes," Vladimir Putin wrote in *Komsomol'skaia Pravda* in February 2012, "is unacceptable, outrageously high. [. . .] Therefore the most important task is to reduce material inequality."[67] Putin used to state that the solution to the problem of inequality, as well as of excessive economic dependence on resource rents, was to expand the middle class. Until the large-scale protests of 2011–2012, Russian leaders regarded the middle class as a basis of stability and potential support for the regime rather than as a source of demands for democratization. Since then, however, there has been very little interest on the part of the top leadership in building up the middle class. References to the problem of inequality have largely disappeared from official statements.

Inequality Trends over the Long Run

Branko Milanovic argues that while the Kuznets curve theory has been largely discredited by the evident fact of rising inequality as high-end incomes rise in the developed world, there may exist a phenomenon of "Kuznets waves."[68] That is, inequality may initially rise, then fall, then rise again over the process of social development. The combined forces of technological change and globalization, together with the reduced bargaining power of labor and the greater political ability of the wealthy to lock in rent streams from real estate, finance, pharmaceuticals, oil and gas extraction, state administration, and intellectual property, bring about rising inequality within societies. Over time, industrialization tended to reduce intra-society inequality and increase cross-national inequality, but now the trend is beginning to reverse itself as members of a global elite benefit from the ability to capitalize rent streams. The extremely high concentration of wealth in Russia and the capitalization of rent streams from gas and oil, finance, and state administration is widening inequality of incomes, opportunities, and regions. Much of the wealth generated by rent-extraction flows is capitalized overseas, benefiting the financial and real estate sectors in more secure countries and contributing to the deepening of inequality there. Russia's wealth of course also flows to offshore tax havens rather than into productive investment. The absolute number of people employed as individual entrepreneurs fell from 8.3 million in 2008 to 5.6 million in 2014. The number of small enterprises has shrunk by 28 percent since 2011. The recessions of 2010–2011 and the present have slowed economic growth (to a negative rate in 2015), increased poverty, reduced real incomes, and slightly reduced inequality. Neither growth nor recession has spurred entrepreneurship.

The close link between growth and inequality in Russia creates a dilemma for the regime. Redistribution across regions has neither stemmed rising cross-regional inequality nor stimulated higher rates of economic growth in poorer regions. When inequality has fallen, it is because of recession, and recessions reduce the government's policy leverage over inequality. Fear of capital flight and tax evasion inhibits the government from adopting more redistributive tax and social policies. The longer-run solution would be to stimulate forms of economic growth that would expand the middle class, as occurred in some East European countries where an entrepreneurial private sector arose alongside the state sector.[69] In Russia, by contrast, those regions with the greatest extent of privatization saw a weakened regulatory environment and less small business development, and those regions with higher inequality have the most developed small business sector.[70] Small business development, therefore, does not mitigate the growth in income inequality. Thus, the reform of political and legal institutions would decouple growth from inequality, both by encouraging entrepreneurship and a progressive social policy. So far, however, the regime has not seriously pursued such reforms.

Conclusion

This review of the evidence bearing on income inequality in Russia confirms some conventional propositions. Russia's dependence on natural resource exports turns resource rents into income streams that are unequally distributed within the resource sector and across sectors and regions. It undermines incentives for more administratively-demanding income and corporate profits taxes, in turn undermining demands for representation. It reduces the urgency for the government to invest in productive assets outside the resource sector or to reform institutions in such a way as to induce innovation and entrepreneurship. Russia's inequality is also strongly affected by cross-regional differences, particularly the location of natural resource assets and administrative power. Technological change and the decompression of wages have also permitted a widening of wage differentials as the returns to skill and education have risen.

At the same time, the Russian case bears some surprising similarities to that of the United States. The problem of inequality in Russia is more than a story of the resource curse. In both Russia and the United States, the top income strata today, unlike their predecessors in the eighteenth or nineteenth centuries, receive most of their income from the labor market, not from capital income. When incomes rise, the lion's share of the income growth flows to those at the highest end of the income distribution. As in the U.S., this reflects the ability of the wealthy to convert their social and economic resources into political influence so as to control durable rent streams. Their political influence enables them to protect the sources of their livelihoods—whether extractive industries, banks, or administrative agencies—from competitive or regulatory pressures for reform and accountability. In this regard, today's rich in Russia are similar to their American peers. Like them, by protecting their livelihoods from competitive pressure or effective regulation, their high incomes reflect rent-seeking more than wealth creation. State fiscal and social policy is sufficiently redistributive to prevent large-scale abject poverty, but not enough to redirect resources in either a clearly redistributive or growth-stimulating direction. As in the United States, the institutional arrangements of the Russian political system, rather than raw economic forces, are the main reason for this outcome.

NOTES

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