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**CASES FROM ASIA  
AND TRANSITIONAL ECONOMIES**



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## Outcomes of the Russian Model

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To date, little research has been conducted on the effects of privatization on Russia's employment and income distribution. What has been achieved considers the problem from a regional or branch level, or through case studies of particularly affected groups. However, this research always works within a narrow privatization framework predominant in Russia, which implies simple transfer of existing state assets to private possession. Existing studies tend to exaggerate or underplay privatization's role in the making of Russia's emerging social structure. Assessing the distributional effects of privatization requires at least a cursory analysis of the Russian privatization model as it has shaped current property structure. I argue that privatization has substantially affected income distribution throughout the Russian workforce and society.

This chapter broadly defines *privatization* as the process of creating an environment for the emergence of private capital and for extending the private-sector share in aggregate assets and the national product of the country by all possible means, official or unofficial. My concept of privatization encompasses:

- transfer of existing state-run enterprises to private ownership (privatization in its narrow sense),
- relocation of financial flows from the state to the private sector (deliberate de-capitalization of the state sector), and

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- establishment of private enterprises (sometimes called “greenfield” investments).

This chapter provides an overview of this broader privatization process and analyzes the outcomes of mass privatization; resulting ownership and income structure; effects on the labor market, including the emergence of oligarchs and growing shadow employment; and the distributional model that emerged after the 1998 financial crisis.

## **Privatization Process and Outcomes of Mass Privatization**

The final days of the former Soviet Union witnessed unofficial “spontaneous privatization,” as well as leasing and cooperative arrangements. The first official, purely Russian phase of privatization, which occurred during 1992–94, was mass privatization. During this phase, all Russian citizens above the age of 18 received, for a minimal charge, property certificates with a 10,000 ruble nominal value. Citizens were granted the right to exchange their vouchers for shares of enterprises and use them to buy property within the framework of small-size privatization or invest in newly created, privatization investment funds.

The launch of mass privatization coincided with the Russian people’s exposure to the consequences of price-shock liberalization and spreading hyperinflation, which had led to the loss of virtually all savings. About 34 percent of all Russian voucher holders, finding themselves in serious economic difficulty, sold their vouchers without hesitation. According to the time and place of sale, the voucher price fluctuated in the range of \$5 to \$20. For this amount, one could buy a toy car<sup>1</sup> or a couple of bottles of vodka. Even less fortunate were the 25 percent of Russians who invested their property certificates in unregulated privatization or voucher investment funds, which sprang up spontaneously. Nearly all such investors lost everything within a short time. Many voucher investment funds failed after only several weeks. Those that managed to survive on the market usually offered poor dividends.

A surprisingly high percentage (11 percent) of the population gave away their vouchers as presents; about 5 percent of vouchers were held beyond their expiration date and never invested (suggesting that a sizeable segment of the population neither understood nor believed in the process). Some people may have lost their vouchers, while others may have decided to hold them until better times returned, perhaps not realizing that, after a certain date, vouchers would be worthless.

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1. In 2002, Anatoly Chubais (2002), an architect of Russian privatization, claimed: “Reasonably used, the voucher’s initial value (10,000 rubles) may have been increased 100 and even 1,000 times, which would have been more than enough to buy two Russian-made cars.”

Surveys show that only 15 percent of citizens invested their vouchers directly in enterprises, thereby becoming minority shareholders. A few such investors were lucky, choosing one of those few enterprises that, under the new economic conditions, eventually became profitable. Buying stocks of solid companies was not easy, even in the rare cases where information was available, because directors of high-potential firms were reluctant to admit outsiders as shareholders. As a result, most citizens, after holding onto their vouchers for a period of time and then getting little or nothing for them, ended up feeling betrayed.

The official starting and end dates of the voucher phase of Russian privatization were December 1992 and June 1994, respectively. During this relatively short period, shares of more than 12,000 enterprises, with an overall charter capital of more than 800 billion rubles (balance sheet value as of July 1, 1992), and with more than 13 million workers (nearly 50 percent of employees of Russian industry overall), were slated for voucher auctions. For each enterprise, 35 to 70 percent of the stock was placed on sale for vouchers (no more than 80 percent was allowed by law). This included the amount reserved on “closed subscription”—i.e., for members of the work collective (Deryabina 1996, 35).

About 41 percent of all medium and large state firms were privatized during this mass-privatization stage. A parallel program for small-sized privatization succeeded in divesting more than 50 percent of available assets of this type. Combined with leased enterprises bought out, small-privatized enterprises, by the end of 1994, amounted to nearly 80 percent of the total stock of such small business units (Deryabina 1996, 36).

## Workers and Managers

Workers and managers, who became known as insiders in enterprises selected for mass privatization, could choose between several variants of privatization:

- **Variant 1** stipulated that 25 percent of shares of “A” (nonvoting) category would be distributed free of charge among employees; 10 percent of ordinary shares, the “B” (voting) category, would be sold to workers at a 30 percent discount. Five percent of ordinary shares would be sold to management at face value, and 60 percent for cash to other investors.
- **Variant 2** envisaged the sale of 51 percent of stock against privatization vouchers or for cash, under a subscription limited to workers and management. The remaining 49 percent would be offered for sale at auctions (usually not all at once), both against privatization vouchers and for cash to other investors.
- **Variant 3** applied only to medium-sized enterprises. The idea was to form a management group of enterprise employees who would take

responsibility for devising and implementing a privatization plan and preventing the enterprise from going bankrupt.

All employees in the work collective would approve the privatization plan. The management group would then sign a contract with the local division of the state Committee for Property Management (the privatization authority), accepting material responsibility secured on its personal property (by way of mortgage). The group would post a deposit of not less than the amount of 200 minimum wages. The contract would be signed to cover a one-year period. Once the contract expired and its conditions had been met, the management group would have the option to buy 20 percent of ordinary shares of the enterprise at face value, with a two-year payment deferral. If the group failed to meet the conditions stipulated by the contract, it would forfeit the option.

In addition, all employees of a given enterprise (including members of the controlling management group) were entitled to buy 20 percent of ordinary shares representing its own capital, provided that the total sum did not exceed \$30 per employee, after taking the 30 percent deduction from the face value. Payment for shares could be made over three years, with the first installment not exceeding 20 percent of the face value of the shares.

Of the three privatization variants, variant 2 proved by far the most popular. The government's failure to re-value assets to account for the high rate of inflation made this option attractive to insiders. Variant 1 was applied in a few larger firms where insiders could not afford the purchase price. Variant 3, which was hopelessly complex, was hardly applied.

Under variant 2, the bulk of property transferred to private ownership went to the workers and management—the insiders—of the enterprise concerned. In up to 80 percent of firms privatized by vouchers, the work collectives held a controlling amount of stock. Voucher privatization thus produced a typical capital structure of 60 to 65 percent of shares in insiders' possession. Outside investors succeeded in obtaining 18 to 22 percent, and the state retained an average of 17 percent of stock of privatized enterprises. Until the August 1998 crisis, the portion of inside shareholders tended to decrease; however, insiders' property was still dominant. Moreover, from 1999 on, a reinforced insider position emerged.

By the end of 1994, 40 million Russian citizens had formally become shareholders through voucher exchanges and share purchases. In theory, privatization had transformed millions of ordinary Russians into shareholding capitalists overnight. However, as this chapter will show, voucher distribution minimally affected incomes and employment of the broader population. In short, the Russian voucher variant, unprecedented in world practice, was applied behind the smoke screen of allowing popular privatization in the shortest time possible to expropriate a significant portion of common property to benefit a small group (Nekipelov 1996, 281).

Substantiating this assertion requires an analysis of property relations emerging in enterprises privatized to insiders. One objective of such privatization is to motivate firms to improve performance. To date, Russian research suggests the absence of any positive effect of privatization on enterprise workers' motivation and behavior. The greatest interest in privatization among the workers interviewed was expected dividends. However, even this interest faded rapidly since, in many Russian enterprises, opportunities for shareholders to obtain any cash dividend or benefit were limited.<sup>2</sup>

New shareholder interest in participating in an enterprise development strategy and decision making proved far weaker than initially presumed. Blasi and Shleifer (1996) concluded that rank-and-file workers were not represented on the advisory boards of privatized companies and behaved passively at shareholder meetings, even though they had the legal right to participate. This was often the outcome of management manipulation on the eve of such meetings and Russian workers' traditional apathy and distrust in their ability to influence events. Their assessment was realistic, as members of work collectives had insubstantial control of their managers' activities. Gurkov and Maital (1995) stated that more than 40 percent of workers in privatized Russian enterprises claimed a marked contraction of their chances to influence the decision-making process after becoming shareholders (38 percent of those polled held that privatization brought about no changes in this respect). Moreover, they reported that 46 percent of ordinary shareholders perceived that their access to information about company performance diminished after privatization. It is often claimed that, when workers displayed the slightest initiative about ownership rights, management launched all conceivable mechanisms to block it; even active workers rarely succeeded in passing any decisions that contradicted those proposed by management. Alliances between rank-and-file workers and outside investors aimed at supporting ordinary shareholders—enterprise workers—in their opposition to established management occurred in only 12 to 13 percent of firms (Bim 1996, 12). Similar conclusions can be reached based on press reports.

In conflicts between management and potential outsider investors, workers—convinced that their own management would be less radical and more likely to guarantee employment than any external investor—frequently sided with enterprise management. The idea of concentrating stock in the hands of managers, although unpopular among workers, was, nevertheless, more acceptable than having outsiders—who might lay off workers—assume a controlling stake.

Therefore, it is not surprising that privatization did not immediately motivate enterprise workers (Bim 1996, 13). Of the enterprise directors polled, 100 percent claimed that only in exceptional cases were ordinary

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2. Economic results of 1994 showed that only one-third of privatized enterprises declared their intention to pay dividends.

workers interested in practicing their ownership rights. In 1993–94, from 10 or 12 percent to 15 or 18 percent of rank-and-file workers had no interest in owning stock and were willing to immediately sell their shares on financial markets or to enterprise management (Bim 1996, 12). The remainder was unsure of what to do with their shares and saw no opportunities to influence enterprise development strategy. Thus, in many cases, one byproduct of privatization was that enterprise control became increasingly concentrated in the hands of only a few managers.

Bim (1996, 5–8) showed that 82 percent (in 1993) and 80 percent (in 1994) of enterprises privatized according to variant 2 fell under management control—that is, as time passed, managers took effective steps to concentrate their control of share ownership. For example, in 1993, management held 3 to 5 percent of the stocks of 20.8 percent of privatized firms, 5 to 10 percent of another 20.8 percent, 10 to 20 percent of 12.5 percent, and 20 to 30 percent of 8.3 percent. Nonetheless, in most enterprises controlled by insiders, managers were dissatisfied with their controlling power and generally initiated measures to obtain even larger portions of equity. Indeed, by early 2001, top management's block of shares approached that of workers (21.0 percent and 27.2 percent, respectively). Russian Economic Barometer respondents predicted that managers, on average, tended to become owners of the largest package of group shares within two years of privatization (Kapelyushnikov 2002).

To concentrate property, managers of many privatized Russian enterprises pressured workers into selling management their shares at par or a discounted price. Managers offered workers the chance to either exchange their shares for consumer goods upon retirement or dismissal or sell management shares in lieu of disciplinary action. Heads of enterprises managed to impose self-serving conditions for closed subscription shares in the second issue, which further secured their privileged position. They also concentrated property by buying shares at the first money auctions, at which events (following the voucher auctions) residual state holdings were sold for cash.

Success in the money auctions required access to both vouchers and money with which to buy them. The task was easily accomplished by top enterprise managers through voucher funds, set up under their control using personal savings or other monies accumulated during 1988–91, the initial and highly fluid stages of liberalizing the Soviet economy. Ownership accumulation also occurred through spontaneous (*nomenklatura*) privatization, whereby managers became asset owners through lease and cooperative arrangements. In this way, and without any state regulation or supervision, a large amount of assets formally held by the state was transferred to managerial ownership. Even more dubious methods aimed at property concentration were widely used to (1) create private affiliated structures—private subsidiary firms or investment funds—aimed at concentrating shares in the hands of top managers; and (2) allow private persons, formally not

associated with the given enterprise but in collusion with management, to purchase shares at auctions or on the secondary market and to turn them over to the control of managers.

It is not possible to cite reliable quantitative data on the scale of these processes. Informative data might be gathered if registers of shareholders could be analyzed. An indication of Russia's deficient state of corporate governance in Russia is that share registers, as a rule, are usually inaccessible for both independent researchers and shareholders. Exceptionally, Bim managed to gain access to a set of registers of Russian joint-stock companies; he found that, in 67 percent of cases, 10 to 12 percent of outside shareholders of the company have the same postal address as the headquarters of the relevant enterprise (Bim 1996, 13). This finding indicates that these shareholders were "satellite" or "affiliated" structures under control of enterprise leadership.<sup>3</sup> In 58 percent of enterprises, the number of outside shareholders whose family names were the same as those of the top leaders was as high as 19 percent (Bim 1996, 18).

## **Emergence of the Russian Oligarchs**

Russian research literature uses the term *money privatization* to refer to the period following initial formation of private property, first allocation in voucher auctions, and subsequent redistribution and concentration in the hands of enterprises' bank directorates and favored private investors. However, the term is not justified for several reasons. First, the price of a privatization transaction was rarely the main factor determining a sale. Far more decisive was the political component of the privatization process—that is, the degree of influence enterprise managers had with high-ranking political authorities. This component was often decided by blatantly corrupt means. The term applies not only to the main privatization transactions of the federal government, but also to many—if not most—transactions at the regional and municipal levels. In short, the voucher privatization stage (1992–94) was followed by a quasi money or market stage of privatization, with two substages: 1995–98 and 1999–present.

During these years, typical forms of property redistribution or acquisitions involved

- lobbying by privileged participants to obtain, from desired firms, substantial blocks of shares remaining in the hands of federal and regional authorities;
- voluntary or administratively forced absorption of firms into holdings or financial-industrial groups, often with unclear ownership;

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3. In 1993, 25 percent to 33 percent of all Russian enterprises had satellite companies (Dolgopyatova and Yevseeva [Boeva] 1994, 28).

- loans-for-shares schemes; and
- legalized dilution of state-owned shares through conversion of debt into equity, sale of receivables, trust schemes, buying up of promissory notes, manipulation of dividends on privileged shares, and unannounced capital increases.

All of this was in addition to managers' aggressive, but legal, purchase of shares on the secondary market from workers, investment institutions, brokers, individuals, and banks. The largest, high-potential Russian companies in which one could verify and locate the government's holding were the main objectives of this privatization phase.

The loans-for-shares scheme that followed largely affected wealth distribution in Russia. Under this scheme, a private Russian bank would lend a sum to the state budget against a collateral pledge of federally retained blocks of shares in a valuable company, usually a firm in the natural-resources sectors. In theory, a transparent tender, open to all lenders—both domestic and foreign—was held on the pledged shares. The winner was chosen according to the size of the loan pledged.

The nature of the firms and size of the equity involved might lead one to think that competition to offer loans would be great and the sums pledged would be large. In reality, all foreign banks and many domestic ones were excluded from tender. A few private Russian banks, politically well-positioned, colluded to determine which one would make the sole offer and receive collateral shares. Thus, the blocks of shares were pledged for low sums. For example, a near-controlling equity stake in the giant Norilsk Nickel company was provided as collateral for a loan of \$179 million, compared to an expert's evaluation of \$2 billion. Moreover, the government never made any effort to repay any of the money. These tenders and loans were, in effect, indirect sales at a low price to a buyer known in advance, without any bidding or competition. In this way, ownership stakes in the best natural-resources firms fell to Russian oligarchs at low prices. In sum, a vast amount of highest-potential equity was transferred to only a few people, while the state and the Russian people received little.

Another example of wrongdoing in the loans-for-shares scheme was the Menatep St. Petersburg Bank (SPB) acquisition of shares in Yukos oil company. In this case, collusion among the participating banks broke down. Heads of three other Russian banks—Rossiyskiy Kredit, Alfa-bank, and Inkombank—later charged the State Committee for Property Management (Russian Federation Privatization Ministry, headed by Anatoly Chubais) and Menatep SPB with mercenary collusion during preparations for auction of Yukos shares, arguing that Menatep designed and organized the auction. Losing bankers alleged that the government funds officials of the State Committee for Property Management had deposited in Menatep were used to make a loan to the government (in effect, to buy Yukos). Before the auc-

tion, a leading Menatep official reportedly claimed: "Two opinions are impossible; Yukos will be ours" (Pelekhova 2000).

A similar rigged scheme was applied in the loans-for-shares arrangement for 51 percent of shares of Sibneft oil company (founded in mid-1995) by means that bypassed government-approved sales procedures. On December 28, 1995, the commission overseeing the sales tender announced that SBS joint-stock bank and Oil Financial Company closed joint-stock company had won the competition for Sibneft. An investigation carried out by the Russian Federation (RF) Audit Chamber alleged that, before the tender, the RF Ministry of Finance deposited \$137.1 million with SBS joint-stock bank; the bank then "lent" the government these funds following its winning of the tender.<sup>4</sup> This made a mockery of the notion that the scheme was imposed on a cash-short government, and lent weight to the allegation that, from the outset, the idea had been to transfer ownership of valuable property to a well-connected few.

Before the 1998 financial crisis, the key conflict in property redistribution was the clash of interests: old-line natural monopolies—with a new corporate façade—and major industrial and mining structures led by still-powerful Soviet-era managers versus younger entrepreneurs in new financial-industrial groupings. The expansionist and acquisitive interests of these two groups clashed over distribution of former state property. To reiterate, behind the largest transactions of 1995–98, including those in the loans-for-shares schemes, property redistribution outcomes were determined, not by economic factors or fair distribution of assets, but by the political power and interests of enterprise managers, emerging oligarchs in the banking sector, and representatives of state authorities.

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4. The agreement (paragraph 3.1) stipulated that the loan would be extended until one of two dates expired: 1) January 1, 1996, when the borrower (Ministry of Finance) would pay the date liabilities using 1995 federal budget funds; or 2) the date determined by adding five calendar days to the date when revenues from selling shares transferred as security of the loan (stipulated by paragraph 2 of the agreement) were deposited.

In signing the loan agreement, paragraph 6 of "Mandatory Conditions of a Loan Agreement" (approved by Decree No. 889, August 31, 1995, by the RF President) was bypassed, which absolutely ruled out the right of the borrower (Ministry of Finance) to redeem liabilities on the account of the federal budget, since the 1995–96 budgets did not provide for assigning funds to redeem the loan. The Ministry of Finance was given only one working day (December 29, 1995) to locate resources with which to pay off the loan. According to the report of the Audit Chamber, on December 29, 1995, the SBS joint-stock bank transferred \$97.3 million of the loan value (\$100.3 million offered as loan, minus \$3 million as security) to the currency account of the RF Ministry of Finance, No. 704000011420, with Menatep SPB; however, the federal budget did not receive the monies until a month later because they were continuously transferred from one account to another until January 31, 1996. Menatep SPB, the second auction bidder, was virtually granted a month loan of \$97.3 million. In this way, it was rewarded for participating in the auction.

The 1998 financial crisis and the changeover in political leadership a year later had little effect on the privatization process; however, it led to substantial regrouping of the main players on the privatization stage, reevaluation of their role in economic management, and an occasional shift in their political power.

By 2002, redistribution of property to benefit outside investors—which began to emerge in the 1995–98 period—came to a virtual standstill. A second surge of rapid growth of managers' equity share and stagnation in the increase of outside investors' property are correlated with the 1998 financial crisis and subsequent economic recovery. The August 1998 shock undermined the positions of many financial institutions owned by oligarchs, thereby limiting—at least temporarily—their opportunities for expanding further into the real sector of the economy. General economic revival of many enterprises in 1999–2002 allowed enterprise managers to sharply promote the process of obtaining additional shares, mainly from workers.

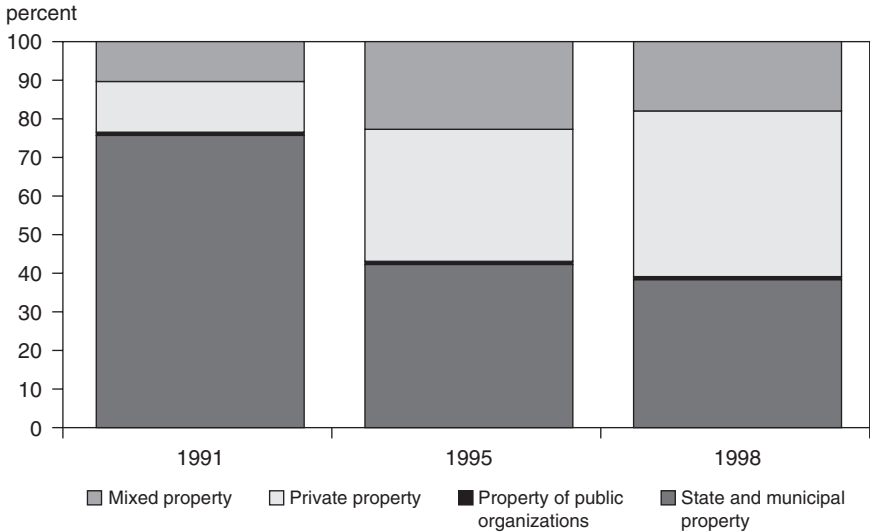
Today, the battle for control continues; in 1996, it was estimated that not more than 30 percent of enterprises had been completely privatized (Radygin 1996). Surprisingly, despite a decade of giveaways and sales, property valued at roughly \$90 billion (equal to nearly 30 percent of GDP) remains in state hands. In the gas industry alone, assets still available for privatization equal about 8 percent of GDP. Privatization reform in the railway industry might also yield 8 percent of GDP (already one can witness oligarchs seeking to “occupy the lower floor” of the industry by buying depots and repairing facilities and other assets). An increasing number of large-capital owners have shifted their focus to the agro-industrial sector (7.5 percent of GDP). The financial-services market, representing 4 percent of GDP, is another new field of activity since the Russian government aims to eventually end Sberbank's exclusive right in offering deposit insurance. Forthcoming pension reform will allow private financial structures to accept and manage pension monies. Both investors and oligarchs await the persistently rumored privatization of the electricity sector (2.5 percent of GDP).

## Evolution of Employment Patterns

Under privatization, a new employment pattern rapidly emerged. The labor market influenced distributive relations in modern Russia, which resulted in

- narrowing of the scale and impact of the state-owned sector,
- major employment shift from the production to the services sector, and
- change in the social structure of employment and worker status.

**Figure 9.1 Employment in enterprises by property types, selected years (percent of end result)**

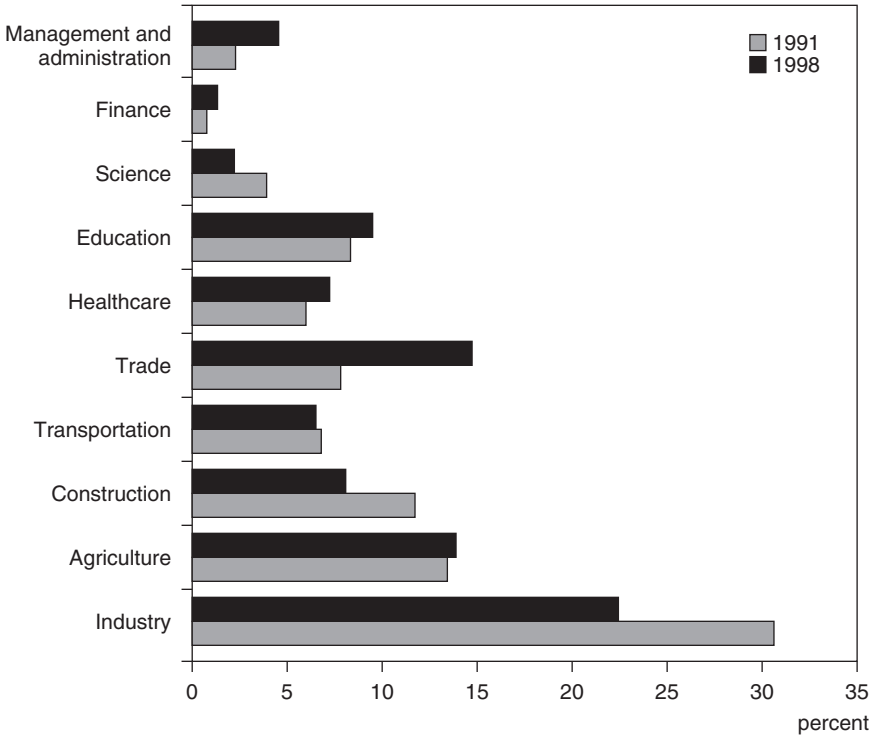


Source: RF State Statistical Committee.

As figure 9.1 demonstrates, the public sector has lost the principal-employer status. Figure 9.2 illustrates, employment declined most sharply in the leading branches of the real economy (industry, construction, and—to a lesser degree—transportation) and in science. Trading and middleman activities and financial, administrative, and social spheres (e.g., education and healthcare) have attracted labor resources. Moreover, as table 9.1 shows, a clear-cut differentiation between hired and nonhired workers has occurred.

However, the data do not allow one to assess the absolute numbers of hired and nonhired workers. Until 1996, official statistics stated with certitude the ever-increasing proportion of nonsalaried workers (6 percent in 1992 and 11.2 percent in 1996). Surprisingly, this category then decreased sharply (from 12.5 percent in 1994 to 4.8 percent in 1997 and 4.6 percent in 1998) (Civil Society European Academy 1998). In 1997, employment surveys showed that the criteria for identifying nonhired labor had changed, resulting in lower figures for the share of self-employed. With this in mind, evolution of the ratio of hired to nonhired labor in the late 1990s appears less volatile (table 9.1). Moreover, Moskovskaya and Moskovskaya (1999) correctly state that numerous divisions of large- and medium-sized enterprises began converting rapidly into independent economic agents during the first stage of reforms. However, numerous enterprises—many of which

**Figure 9.2 Employment in individual branches, 1991 and 1998**



Source: Civil Society European Academy (1998).

started as production cooperatives<sup>5</sup>—could not compete and folded, resulting in fewer nonhired workers. In addition, the share of nonhired workers fell gradually as a result of property concentration—that is, large enterprises’ acquisition of small businesses.

The category of salaried workers is heterogeneous in composition, including both managers of large enterprises and nonskilled workers. Among

5. Cooperatives were the first and, for a period of time, the only officially allowed form of private entrepreneurship in prereform Russia. Each member of the cooperative (consisting of at least three people) was responsible for contributing materially to set up and develop production, working on the enterprise they founded, and voting in decision making, irrespective of the amount of material contribution, which ultimately determined the income share obtained. Inevitably, this organizational pattern suffered from permanent, sharp conflicts among cooperative members. As soon as an opportunity emerged, most cooperatives changed their legal status and chose one of the two possible variants: limited partnership or open/closed joint-stock company, where relations among business partners are based on the amount of the founding contribution shares (in financial terms) or the stock acquired.

**Table 9.1 Russia: Worker differentiation by employment status, for selected years**

| Worker type                        | 1994  | 1995  | 1997  |
|------------------------------------|-------|-------|-------|
| Hired                              | 85.60 | 86.00 | 95.20 |
| Nonhired                           | 14.40 | 14.00 | 4.80  |
| Employer                           | 0.35  | .37   | 1.30  |
| Self-employed                      | 1.40  | 1.80  | 2.90  |
| Member of production cooperative   | 12.50 | 11.60 | .60   |
| Unpaid worker of family enterprise | 0.10  | .15   | .10   |

Source: Moskovskaya and Moskovskaya (1999).

those who ventured to start their own businesses, most were self-employed and only 25 percent became employers.

### Unemployment: The New Russian Phenomenon

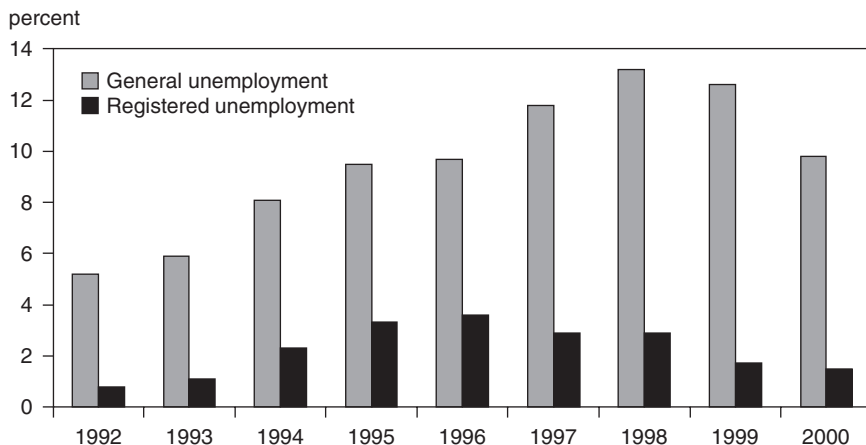
Over the last decade, Russia has faced previously unheard of phenomena: unemployment and underemployment. While these came about slowly, and on a considerably lesser scale than reformers anticipated, they were accompanied by large and troubling wage arrears—one of the principal methods the Russian labor market used to adjust to the shocks of transition. Enterprises of all sizes, branches, and property forms have used the arrears mechanism. Because of workers' difficulty in seeking other employment, most tolerated wage arrears or partial payments at first. The overwhelming majority passively waited for the situation to improve. The typical reaction to wage delays was declining labor discipline and productivity. Low labor productivity, rooted in Soviet times, persisted throughout the transition.

Many other postsocialist European countries, including Poland and Hungary, more rapidly restricted subsidies and soft budgets to enterprises, which inevitably accelerated growth in open unemployment.

According to the official definition of the RF State Statistical Committee, the unemployment rate of a certain age category is the proportion (in percent) of jobless to the economically active population of the same age category. The State Employment Service considers an individual jobless if he or she is an able-bodied RF resident, is without a job or earnings from labor, is registered by employment agencies, is seeking a job, and is willing to start work.

During 1992–2000, both general and registered unemployment grew moderately (figure 9.3). General unemployment increased from 5.2 percent in 1992 to 13.2 percent in 1998, then fell to 9.8 percent in 2000. Registered unemployment rose from 0.8 percent in 1992, peaking at 3.6 percent in 1996, and falling to 1.8 percent in 2000. Only in the sixth year of market reforms did general unemployment pass the 10 percent level, reaching a level more typical of most transition countries. Kapelyushnikov (2001) points to the atypical behavior of the Russian labor market in the 1990s: a

**Figure 9.3** General and registered unemployment rates, 1992–2000



Note: The RF Ministry of Labor and Social Development reports registered unemployment at the end of each year.

Source: *Russian Statistical Yearbook 2001*.

much weaker, less explosive unemployment crisis than what occurred in other countries of Eastern and Central Europe.

Contrary to the declared shock-therapy policy aimed at the instantaneous development of genuine market relations, unemployment resulting from privatization was mitigated by artificially maintaining surplus employment in many privatized enterprises. To illustrate: In 1992–97, GDP fell by 36 percent, while, remarkably, the number of hired workers fell by only 17 percent, less than half. In the mid-1990s, 60 percent of surveyed industrial enterprises—both state and privatized—had a worker surplus, which, in certain cases, amounted to 50 percent of the total number of employed (according to the Russian Economic Barometer). The Institute of Employment Problems at the Russian Academy of Sciences concluded that 50 percent of the enterprises surveyed had a surplus work force. According to this study, in half of the excess labor at firms, the surplus was not more than 10 percent of the total number of employed; in 42 percent of such enterprises, the surplus ranged from 10 to 30 percent; and in 5.6 percent, it was 30 to 50 percent (Federation of Independent Trade Unions of Russia 2002).

Surplus employment is found in enterprises of various property forms (table 9.2); however, in privatized enterprises, one can detect specific features of the problem, which vary according to the privatization method used. For example, excess labor is less typical of enterprises privatized according to nonstandard schemes (e.g., leased and bought out). As expected, privatization that transfers a controlling share of stock to the work collective is associated with preservation of surplus labor. These variants are most frequently chosen by enterprises in which the initial workforce overhang

**Table 9.2 Russia: Share of enterprises with surplus work force, 1995–99 (percent)**

| Status or variant   | 1995 | 1996 | 1997 | 1998 | 1999 | Special poll,<br>1997 |
|---|------|------|------|------|------|-----------------------|
| <b>Enterprise group status<sup>a</sup></b>                                      |      |      |      |      |      |                       |
| State-run   | 61   | 68   | 62   | 65   | 46   | 53                    |
| Nonstate-run  | 58   | 61   | 60   | 61   | 48   | 55                    |
| Intermediate  | 63   | 60   | 61   | 62   | 50   | 65                    |
| <b>Variants of benefits offered to the work collective during privatization</b> |      |      |      |      |      |                       |
| First   | 55   | 66   | 58   | 75   | 65   | 54                    |
| Second  | 73   | 68   | 65   | 58   | 52   | 69                    |
| Third   | 100  | 100  | 50   | 60   | 23   | 100                   |
| Nonstandard schemes   | 42   | 59   | 62   | 64   | 40   | 38                    |

a. As reported by enterprise managers.

Source: Kapelyushnikov (2001).

is large, while more dynamic, better performing enterprises tend to select nonstandard ways.

According to Kapelyushnikov (2001, 111, 222), the causes of surplus-labor retention involve the high costs of laying off surplus workers as well as Russian management's expectations and inherited paternalistic orientation. He demonstrates that the costs of severance payments to enterprises are 5 to 10 times that of maintaining the same quantity of surplus workers over the same period. However, while a policy of maintaining as much employment as possible may have been positive in distributional terms, it was highly inefficient and costly over the long run, delaying needed enterprise restructuring. Since one observes the same policy applied in state and private firms, it cannot be said that privatization was a serious obstacle to gradually eliminating surplus labor; over time, it may have helped.

The high costs mentioned above consist of severance payments and paying off wage arrears, which, under widespread nonpayment conditions, are difficult to tackle. Apart from purely financial costs, enterprises must also consider transaction costs linked to a range of legal and administrative procedures, which must be completed before dismissal is allowed. Moreover, at the outset of property-relations reform, there were many legislative barriers to job reduction. For example, national-privatization legislation guaranteed workers' rights and jobs: The State Privatization Program of State-Owned and Municipal Enterprises in the Russian Federation (Article 20, paragraph 12) prohibited layoffs of more than 10 percent in an enterprise wholly owned by the state or municipalities in the six months before the date of its transformation into an open joint-stock company and until the time of its official registration by state bodies.<sup>6</sup> Difficult conditions were

6. State Privatization Program of State-Owned and Municipal Enterprises in the RF approved by the Decree of the RF President no. 2284, December 24, 1993.

imposed on enterprises sold through a tender that employed half or more of a locality's population: retaining the jobs of not less than 70 percent of those employed in the enterprise at the time of sale and professionally re-training any dismissed workers or placing them in new jobs (Law on Insolvency [Bankruptcy],<sup>7</sup> Article 137).

Thus, large-scale reductions in workforce of privatized enterprises began only in mid-1994, after mass privatization ended.<sup>8</sup> By the end of 1995, official unemployment increased almost five times compared to 1992, according to the RF State Statistical Committee. From 1995 until 1998, when the financial crisis broke, observed employment trends included relatively high employment, with strong dynamics toward reduction; relatively low, open unemployment that tended to become chronic; and large-scale latent or hidden unemployment or underemployment, which was chronic for certain categories of workers. Hidden unemployment grew as ever-increasing numbers of employees failed to receive wages. In 1992, the average period of back-wages payments was 1.6 months; by 1997, the period had increased to 5.7 months, with massive growth in informal and secondary employment for all groups.

### **Coping with the New Reality**

By the end of 2001, officials estimated the unemployment rate at 18 to 20 percent of the economically active population. (This estimate included part-time workers in the informal sector, workers with long-standing wage arrears, and those receiving wages significantly below the minimum subsistence level.) An even larger percentage of the economically active population was classed in a marginal situation—neither employed nor officially recognized as unemployed. Thus, from 1992 to 1998, employment in the overall economy decreased from 71 million to 58 million workers; registered jobless grew from 0.6 million in 1992 to 2.5 million in 1996, falling to 0.6 million by late 1998. The distributional effect of such enormous increases in unemployment and underemployment was negative; however, the question was whether privatization or the general process of economic transformation was to blame for increased inequality.

As the transition deepened, informal-sector activity became an important survival mechanism for many Russian people. For a period of time, incomes from second jobs or sources amounted to half or more of major work-place earnings. Popularity of secondary employment peaked in 1994 and then faded until the crisis year of 1998 (table 9.3).

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7. Federal Law on Insolvency (Bankruptcy) No. 6-FZ, January 8, 1998.

8. Massive layoffs before completing privatization might have caused problems for managers, who needed the work collective's support to achieve a controlling portion of equity.

**Table 9.3 Russia: Share of employed with secondary job, selected years (percent)**

| Share of employed            | 1994 | 1995 | 1996 | 1998 |
|------------------------------|------|------|------|------|
| Without secondary job        | 87.8 | 89.7 | 89.8 | 90.5 |
| With secondary job           | 12.2 | 10.3 | 10.2 | 9.5  |
| With permanent secondary job | 4.7  | 4.5  | 4.4  | 4.5  |
| With extra earnings          | 8.2  | 6.3  | 6.2  | 5.7  |

*Source:* Razumova and Roshin (2001).

In 1994–95, 11 to 13 percent of the working population held at least two jobs,<sup>9</sup> mainly ones in the same firm or agency (34 to 44 percent of additional employment). Repair, construction, and tailoring services accounted for 19 to 23 percent of additional employment. The main source of secondary work has been the new private sector. In most cases, the labor force has been hired informally, a profitable situation for both employers and workers. For employers, workers constitute cheap, readily available labor. Workers, in turn, can earn additional income without having to learn specialized professional skills; secondary employment has been a vital source of financial support for many families during the period of radical market transformation.

It is estimated that the informal labor market employed 7.5 million Russian citizens (11.6 percent of overall employment).<sup>10</sup> More than half (56.6 percent) provided services in construction, maintenance repair, and tailoring; 11.8 percent were engaged in street trade, while another 8.4 percent owned private enterprises (shops, cafés, and stalls). Many of the informally employed held several part-time jobs. By the mid-1990s, informally arranged work was widespread, involving about 20 percent of private-sector workers (though not more than 1 percent of public-sector workers).

Labor intensity is higher in the sphere of unregistered employment. The average work week for those informally employed is an estimated 50 hours, or 8 hours more than that of the officially employed, and 60 percent of the informally employed work more than 40 hours a week. Despite the informally employed work week often exceeding the legally established norm, only 4 percent of workers reported that they were remunerated for overtime. In the informal sector, piecework payment affects more than 50 percent of employees, 30 percent more than in the formal sector. Labor rights of those employed in the informal sector are not protected. Nearly two-thirds of

9. According to the Russian Monitoring of the Population's Economic Situation and Health (RMES).

10. Federal Target Program of Providing Employment of the RF Population 1998–2000 approved by the RF Government Resolution, July 24, 1998.

those with unregistered employment state that they can be fired without legitimate cause; half claim to have been unjustifiably punished materially. Registered employees make such statements more seldom (23 to 25 percent of cases). In short, workers in the informal employment sector are vulnerable.

Although one cannot directly link the above trends with privatization, I believe that privatization affected the move toward additional secondary and informal employment. In most state-run enterprises, in contrast to private ones, the mentality of workers and managers still approximates the socialist game rules. However, labor and social guarantees stipulated by the Labor Code are reportedly often ignored, even in legal private business. Private-sector workers may accept less security of tenure and rights (than in state-run firms) as a form of payment for their substantially higher remuneration.

### **Higher Private-Sector Wages**

By 2000, public-sector wages averaged only 60 percent of those in the private sector. The share of income wages for a family with all its members engaged in the public sector accounted for only 24.5 percent, compared with 41 percent for families engaged in the private sector.

If one considers hidden wages from informal and secondary employment, the difference between these proportions is even more striking. In 2000, wages averaged 61.3 percent in total per capita income of the population. If one assumes that the hidden wage is derived largely from the private sector, then the wage proportion (hidden wages included) of a family's monetary income—with all members engaged in the private sector—amounts to 74 percent. For example, in October 1999, the average wage in the public healthcare system was only 66 percent of the average wage in nonstate, healthcare institutions (not including hidden wages). Proportions in other branches of the social sphere were: 51 percent (education), 76 percent (science), and 24 percent (culture and art). Workers in state-run sectors of economy, including healthcare, education (mostly high-school level), and culture and art did their best to find professional jobs in the nonstate sector (table 9.4).<sup>11</sup>

Table 9.4 shows that the share of enterprises admitting breaches of labor legislation is significantly higher in the private, than public, sector of the economy. Though private-sector workers have fewer legal rights, they are, indisputably, in a privileged financial position, compared to state-sector workers—an important factor in modern Russia's income, property, and social differentiation. The transition period, with its not yet fully established game rules, has largely justified the situation.

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11. See Main Directions and Priorities of State Social Policy in Improving Incomes and the Living Standard of the Population, [www.nasledie.ru](http://www.nasledie.ru).

**Table 9.4 Russia: Guarantees to labor stipulated by legislation and labor contracts in enterprises of various property forms**  
(percent of workers who answered positively)

| Share of workers  | State-owned enterprises | Privatized enterprises | Private enterprises |
|---|-------------------------|------------------------|---------------------|
| <b>Regularly paid wage</b>  |                         |                        |                     |
| Twice monthly   | 51.7                    | 61.6                   | 65.6                |
| <b>Regular leave</b>  | 1.6                     | 2.3                    | 22.6                |
| Unpaid or paid lower than what legislation stipulates, including workers whose pay is additionally guaranteed by contract | 1.1                     | 1.4                    | 8.4                 |
| <b>Temporary disablement</b>  | 8.0                     | 8.8                    | 37.8                |
| Unpaid or paid lower than what legislation stipulates, including workers whose pay is additionally guaranteed by contract | 5.9                     | 6.5                    | 16.1                |
| <b>Overtime</b>   | 29.6                    | 47.3                   | 50.1                |
| Unpaid or paid lower than what legislation stipulates, including workers whose pay is additionally guaranteed by contract | 6.6                     | 10.1                   | 6.1                 |
| <b>Total number polled</b>  | 558.0                   | 771.0                  | 884.0               |

Source: Chetvernina and Lomonosova (2001).

To sum up, the main findings are that privatization results in a decline in employment; however, those fortunate enough to be retained generally earn higher salaries, with less likelihood of suffering arrears. Even so, the terms of service and rights of private-sector workers are more vulnerable.

## Privatization, Income, and Property Differentiation

Privatization has contributed significantly to the new economic pattern, characterized by considerable differentiation in income and property. Indeed, by the end of 2001, the degree of inequality (as measured by the Gini coefficient) reached 40.9 percent, a dramatic increase from the estimated 1990 figure of 25 percent (table 9.5).

### Privatization and Societal Inequality

To what extent did privatization contribute to increased income inequality in society, especially with regard to the large decline in shares of the two

**Table 9.5 Russia: Overall income distribution, by population quintile, 1991–2001 (percent)**

| Factor           | 1991 | 1992  | 1993  | 1994  | 1995  | 1996  | 1997  | 1998  | 1999  | 2000  | 2001               |
|------------------|------|-------|-------|-------|-------|-------|-------|-------|-------|-------|--------------------|
| Quintile         |      |       |       |       |       |       |       |       |       |       |                    |
| 1 (poorest)      | 11.9 | 6.0   | 5.8   | 5.3   | 5.5   | 6.2   | 6.0   | 6.1   | 6.1   | 6.1   | 5.9                |
| 2                | 15.8 | 11.6  | 11.1  | 10.2  | 10.2  | 10.7  | 10.2  | 10.4  | 10.5  | 10.6  | 10.4               |
| 3                | 18.8 | 17.6  | 16.7  | 15.2  | 15.0  | 15.2  | 14.8  | 14.8  | 14.8  | 14.9  | 15.0               |
| 4                | 22.8 | 26.5  | 24.8  | 23.0  | 22.4  | 21.5  | 21.6  | 21.1  | 20.8  | 21.2  | 21.7               |
| 5 (wealthiest)   | 30.7 | 38.3  | 41.6  | 46.3  | 46.9  | 46.4  | 47.4  | 47.6  | 47.8  | 47.2  | 47.0               |
| Gini coefficient | 0.26 | 0.289 | 0.398 | 0.409 | 0.381 | 0.375 | 0.381 | 0.398 | 0.399 | 0.394 | 0.396 <sup>a</sup> |

a. The 2001 Gini coefficient, provided by the RF Ministry of Labor and Social Development, differs from that in the text, provided by the RF State Statistical Committee.

Source: RF Ministry of Labor and Social Development (2002).

poorest quintiles and the equally large increase in the share of the wealthiest quintile (table 9.5)? I believe that privatization contributed to increased inequality; the single most important factor was concentration of business income and property revenue with a limited cadre—a phenomenon heavily influenced by the Russian privatization model. A second factor, stemming partly from privatization, was the rapid differentiation in wages, the major income source for most people.

At the end of 1991, the government abolished wage limits.<sup>12</sup> The new, more flexible Labor Code contributed to the sharp differentiation in people's incomes. Reduced state regulation of citizens' incomes (e.g., outside the public sector, this role is reduced to fixing a minimum wage) led to large differences in pay between those deriving their incomes from labor and those engaged in business activity. Large income differences appeared between regions and sectors of activity, and between enterprises of differing property forms.

Pay-scale differentiation between the highest and lowest income deciles reached 34 points in 2000.<sup>13</sup> Obviously, income and property differentiation is not unfair; what is inequitable in Russia is its rapid increase and large scale compared to other transition countries. For example, in 1997–99, the average Gini coefficient for Central and Eastern Europe was 0.30, compared to 0.40 for Russia. Also noteworthy is that, in 1999, the decile coefficients (ratio of rich to poor income) for Hungary and Poland were 3.0 and 4.0, respectively, compared to 8.8 for Russia (RF Ministry of Labor and Social Development, 2002). This finding suggests that, in post-transition Russia, sensible regulatory or taxation limits to preserve social cohesion were exceeded. Ever-increasing numbers of marginalized citizens on the one hand and the super-rich—even by world standards—on the other pulled the social pyramid in opposing directions, threatening those in the middle.

The current situation is fraught with increasing social tension. Inter-branch differentiation in pay is high, amounting to 8.5 times in 2000.<sup>14</sup> The highest wages are concentrated in the country's fuel and energy complex, nonferrous metallurgy, and financial sectors, while the lowest are in agriculture and forestry, light industry, and remaining public-sector branches of the economy.

Enormous regional differences in pay do not compensate sufficiently for the labor conditions of climatically harsh areas, which results in labor-force migration to the western and southern regions of the country (table 9.6).

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12. RSFSR Government Resolution No. 195 (On the Abolition of Wage Limits), December 26, 1991.

13. See Main Directions and Priorities of State Social Policy in Improving Incomes and the Living Standard of the Population, [www.nasledie.ru/fin/6\\_7-1/1.html](http://www.nasledie.ru/fin/6_7-1/1.html).

14. See Main Directions and Priorities of State Social Policy in Improving Incomes and the Living Standard of the Population, [www.nasledie.ru](http://www.nasledie.ru).

**Table 9.6 Russia: Monthly professional wages, by region, 2002 (in US dollars)**

| Region          | Department chief, mid-size bank | Department chief, Gazprom or Mezhtregion-gaz structure | Department chief, regional energy system | Worker, private fuel station | Taxi driver | Therapist, state-run hospital | Therapist, private medical institution | Programmer, provider firm | Regional administration department chief |
|-----------------|---------------------------------|--|--|------------------------------|-------------|-------------------------------|--|---------------------------|--|
|                 | Chelyabinsk                     | .25-.30  | .50-.60                                  | .45-.55                      | .12-.17     | .20-.25                       | .07-.12                                | .20-.25                   | .30-.50                                  |
| Kaliningrad     | .60-.70                         | .75  | .70                                      | .20-.30                      | .18-.20     | .07-.09                       | .12-.20                                | .25-.35                   | .40-.45                                  |
| Kemerovo        | .50                             | .40-.50  | .25-.50                                  | .07-.15                      | .12-.20     | .07-.12                       | .13-.20                                | .20-.30                   | .60                                      |
| Kirov           | .35-.50                         | .40-.70  | .30-.60                                  | .15-.20                      | .20-.24     | .05-.10                       | .13-.15                                | .18-.20                   | .25-.40                                  |
| Krasnoyarsk     | 2.00-2.50                       | 1.00   | 1.00                                     | .13-.16                      | .70-1.00    | .07-.10                       | .16-.18                                | .33-.70                   | .27-.40                                  |
| Kursk           | .50-.80                         | .40-.60  | .40-.50                                  | .20                          | .30-.50     | .025-.050                     | .20-.25                                | .15-.40                   | .30-.40                                  |
| Nizhni Novgorod | 2.00-3.00                       | 2.00-3.00  | 2.00-3.00                                | .10-.20                      | .15-.20     | .05-.10                       | .15-.20                                | .15-.50                   | .15-.20                                  |
| Novosibirsk     | .60-.80                         | n.a.   | n.a.                                     | .10-.20                      | n.a.        | .05-.10                       | .10-.30                                | .10-.30                   | .20-.50                                  |
| Orenburg        | 1.50                            | 2.00   | 3.00-4.50                                | .05-.80                      | .09-.13     | .10                           | .15-.20                                | .115-.270                 | .40                                      |
| Perm            | .26-.40                         | .40-.50  | .40-.50                                  | .16-.20                      | .15-.20     | .05                           | .10                                    | .15-.20                   | .10-.20                                  |
| Rostov          | 1.00                            | 1.00-1.50  | 1.00-1.50                                | .10                          | .30-.45     | .10                           | .30                                    | .30-.50                   | .50-.70                                  |
| Samara          | .50-.70                         | .30-.50  | .25-.50                                  | .15-.20                      | .15-.30     | .05-.10                       | .20-.25                                | .15-.35                   | .30                                      |
| St. Petersburg  | 2.00-2.50                       | n.a.   | n.a.                                     | .12-.15                      | .10-.12     | .080-.105                     | .20-.25                                | .40-.50                   | .15-.30                                  |
| Stavropol       | .50-.70                         | 2.50-2.80  | 2.30-2.50                                | .20                          | .20-.40     | .10                           | n.a.                                   | .20-.50                   | .30                                      |
| Tomsk           | .50                             | 2.00   | 1.00                                     | .065                         | .160-.225   | .08-.10                       | .16-.30                                | .10-.30                   | .13-.65                                  |
| Tula            | .50-.80                         | .40-.50 <sup>a</sup>                                   | .40-.60 <sup>b</sup>                     | .12-.17                      | .30-.40     | .05-.17                       | .20-.25                                | .15-.20                   | .20-.35                                  |
| Ulyanovsk       | .50-.70                         | .30-.40  | .32-.35                                  | .065-.100                    | .12-.14     | .042-.068                     | .08-.09                                | .16-.19                   | .20-.25                                  |
| Yekaterinburg   | 1.00-1.30                       | 2.50-2.80  | 3.20-3.50                                | .30                          | .20-.30     | .03-.05                       | .20-.30                                | .20-.30                   | .18-.30                                  |

n.a. = not available

a. Data are for Tula-region-gaz.

b. Data are for Tui-energo.

Source: Mikeli (2001).

Another factor responsible for increased inequality was, paradoxically, preservation of the system of social transfers to the population. Attempting to maintain the existing system with considerably reduced financial means produced a dispersion of transfers and weakened their connection with real need. According to the RF Ministry of Labor and Social Development, the country currently has some 1,000 social benefits, allowances, subsidies, and compensation payments; these are introduced for more than 200 categories of citizens: veterans, invalids, children, the unemployed, and students. Nearly 100 million people or about 70 percent of the Russian population receive various types of payments or benefits, while those in real need represent less than 30 percent. Consequently, as of the late 1990s, about 70 percent of property revenue, 62 percent of other incomes (including business incomes), 38 percent of the aggregate wages fund, and a disproportionate 27 percent of social transfers accrued to the fifth population quintile (those in the top 20 percent of Russia's citizenry, who received 47 percent of all income) (Ovcharova 2001). Only in 2004 did the Putin administration start addressing these issues.

### **Population Patterns: Adapting to the New Environment**

Increasing property and income differentiation also involves the ways in which people choose to adapt to new living conditions. One can observe two major adaptation strategies:

- **Active.** Workers interrelate with the changing labor-market environment, thereby ensuring an acceptable income level through self-employment, entrepreneurship, work in a high-wage sector, or secondary employment.
- **Passive.** Workers aim to preserve an acceptable level of income; adaptation occurs by providing the family foodstuffs from one's plot of land,<sup>15</sup> leasing one's property, and obtaining social assistance.

Within the framework of the passive adaptation strategy, intra-family redistribution of income—getting help from other family members'

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15. During the transition, a barter economy—exchanging self-made production without cash—emerged. In 1991–95, 1.5 to 2 times more potatoes, vegetables, meat, and milk were produced on personal plots of land than during the 1980–90 decade. In 1992, the ratio of consumed foodstuffs that were bartered versus purchased was about 7 percent; by 1995–97, it had grown to 15 to 16 percent. As a rule, the share of self-made foodstuffs delivered outside (for sale or further processing) was insignificant, but revenues from sales were a marked addition to rural residents' monetary incomes (by the end of the period, they represented more than 10 percent of rural cash incomes). On balance, production of foodstuffs (i.e., meat, milk, potatoes, eggs, and vegetables) on personal plots of land helped preserve the consumption level and, thus, in many ways, compensated for failing cash incomes.

incomes—is widespread. One can see a relationship between the unemployment level in a particular region and business-income shares in aggregate incomes. For example, in the Evenk Autonomous Region, where unemployment was 3.2 percent in 2000, the business-income share accounted for only 1.2 percent; however, in the North Ossetian-Alaniya Republic, the unemployment rate in 2000 was 28.5 percent and the business-income share was 34.8 percent of citizens' overall income. One may observe a similar regularity when analyzing corresponding overall statistical data by region (Goskomstat Rossii 2001). Real unemployment drives people to start a private business, which helps them provide an adequate living standard for their families. Thus, during market transition, privatization and private business development play key roles in an alternative survival strategy for the most flexible, enterprising segment of the population, which is more willing to run economic risk.<sup>16</sup>

Sociological surveys show a relationship between successful adaptation to the new conditions and employment type; probability of the former is higher among workers engaged in the private sector and business managers and owners—that is, groups that emerged as a result of privatization.

Under influence of the above factors, a deep stratification of Russian society occurred (table 9.7).<sup>17</sup> Experts from the Institute for Social-Economic Problems of Population in the Russian Academy of Sciences find that 8 to 12 percent of Russian citizens occupy the well-off category, according to Russian standards. The lower-income margin of this category is about \$5,000 per month, while the upper tier is \$10,000 per month. Those above \$10,000 are considered the rich and super rich.

Two-thirds of the wealthy polled hold that they necessarily need strong patrons in state administrative bodies, which reflects precisely the shift in

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16. Undoubtedly, such factors as local authorities' policy toward small- and medium-sized businesses may disrupt this relationship. In regions where favorable administrative, legal, credit, and financial conditions have been created to harness the population's business potential and effective demand exists for goods and services produced by this economic sector, the proportion of business income is high, irrespective of the unemployment rate. Typical cases include the city of Moscow and the regions of Belgorod, Nizhny Novgorod, Novgorod, Ulyanovsk, and Chelyabinsk, where the unemployment rate is 3 to 6 percentage points lower than the average for Russia (10.5 percent in 2000), and the proportion of business income equals or is 1 to 4 percentage points higher than the country average (15.9 percent in 2000). At the same time, several regions have an extremely unfavorable relationship of the above indicators. For example, the unemployment rate is high in Kalmyk Republic (20.1 percent), Tyva Republic (22.9 percent), and Buryat Autonomous Region (15.6 percent) and is not compensated by developing business activities. In fact, business income is 1 to 5 percentage points lower than the average Russian indicator.

17. Stratification is considerably less equitable in Russia than in such transition countries as Slovakia, Czech Republic, or Hungary. In Russia, 6.2 percent and 47.4 percent of incomes go to the poorest and wealthiest quintiles, respectively. The respective figures are 12 and 31 percent in Slovakia; 10 and 37 percent in the Czech Republic; and 9 and 37 percent in Hungary. See Savchenko, Fedorova, and Shelkova (2000).

**Table 9.7 Russia: Distribution of employed, by income characteristic, 1998 (percent)**

| <b>Employed classification</b> | <b>Incomes exceeding twice subsistence minimum</b> | <b>Incomes below twice subsistence minimum</b> |
|--------------------------------|--|--|
| Private enterprise             | 24.6   | 75.4   |
| State-owned enterprise         | 13.2   | 86.8   |
| Activity type                  |  |  |
| Manager                        | 30.6   | 69.4   |
| Worker                         | 14.1   | 85.9   |
| Additionally employed          |  |  |
| Yes                            | 26.8   | 73.2   |
| No                             | 17.2   | 82.8   |
| Business-owner status          |  |  |
| Yes                            | 40.5   | 59.5   |
| No                             | 15.6   | 84.4   |
| Work-day duration              |  |  |
| Eight hours or less            | 15.2   | 84.8   |
| More than eight hours          | 23.1   | 76.9   |

Note: Selection value is 4,249 persons.

Source: Popova (2002).

perception and ethos in postprivatization Russia. Half of those polled think that connections with the criminal world are extremely important, and 84 percent of those polled believe that the largest fortunes in Russia have been and are being built by criminal or illegal means.<sup>18</sup>

## Conclusions

Privatization's effect on the overall Russian economy—and on distribution in particular—is multifaceted (figure 9.4).

Income distribution in Russia is the outcome of various interconnected factors associated with radical systemic transformations of the economy and society, of which privatization is one factor. Nonetheless, the Russian privatization model has helped to evolve an ownership structure similar to that of countries in developing regions (e.g., Latin America). Such countries are typified by high concentration of property within oligarchic structures, low levels of transparency in important transactions, nonexistence of a broad class of petty owners, and failure to protect minority shareholders. Small business is not integrated into the national economic network—rather, in most cases, it is driven into the shadow economy and represents the sphere of survival for the majority of its agents.

18. See *Argumenty i fakty*, December 13, 2000.

**Figure 9.4 Privatization’s effect on Russian economy and distribution**



In Russia, the scale of capital flight is unprecedented, even in the post-socialist world. Much of the wealth placed offshore has grown out of privatization processes. Only recently has privatization begun to exert great influence on the labor market. Dismissal of inefficient or redundant workers has proceeded slowly because of the high price to employers and because managers and owners have discovered mechanisms—mainly wage non-payments—whereby they can avoid overt unemployment. Low wages and low minimum wage help to keep workers in line.

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