CONFERENCES

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Poverty and Shared Prosperity in Russia: Income Dynamics and Social Inequality

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Abstract

The session *Poverty and Shared Prosperity in Russia* was held on April 8, 2015 at the XVI April International Academic Conference on Economic and Social Development organized by the National Research University Higher School of Economics with support of the World Bank in Moscow. Situated within the broader field of social policy, the session explored the impact of various factors such as non-market income, taxation, institutional context, geographic position, educational level and composition of the labor market on inequality and poverty in Russia. The presented reports were based on the *Poverty and Shared Prosperity in Russia* project undertaken by the World Bank in partnership with the Higher School of Economics (Russia) and Tulane University (USA) in order to assess how different micro and macro factors can explain the capacity of the bottom 40 percent of the population to contribute to economic growth in the country. The research was conducted using the Commitment to Equity (CEQ) methodological tool developed by Nora Lustig and her team at Tulane University.

The session focused on three aspects of the bottom 40 percent income in Russia which are (1) the role of non-market income and the incidence of the fiscal system; (2) income inequality and the decomposition of the distribution of wages; (3) productivity and sustainability of wage dynamics.

The keynote speakers of the session were Vladimir Gimpelson (HSE), Luis F. López-Calva (World Bank) and Daria Popova (HSE). Irina Denisova (World Bank) and Carolina Sanchez-Paramo (World Bank) acted as lead moderators. The session attracted a wide audience, including Russian and foreign researchers from various academic fields.

Keywords: poverty; inequality; shared prosperity; market and non market income; bottom 40 percent; composition of economic growth; labor market dynamics; fiscal system.

During the XVI April International Academic Conference HSE held a joint session on *Poverty and Shared Prosperity in Russia* together with the World Bank. During this session, a leading research fellow from the Institute for Social Development Studies at HSE Daria Popova, economist and regional poverty advisor at the World BankLuis F. López-Calva and director of the Center of Labour Market

Studies at HSE Vladimir Gimpelson gave the keynote lectures and participated in round-table discussions on various problems associated with the issues of poverty, inequality and shared prosperity. The session was chaired by a lead economist in Center for Economic and Financial Research in Moscow Irina Denisova and senior economist in the Poverty Reduction and Equity Group at the World Bank Carolina Sanchez-Paramo.

Non-Market Income and the Incidence of the Fiscal System

Daria Popova (HSE) opened the session by presenting the main findings of the first part of the *Poverty and Shared Prosperity in Russia* project which was focused on non-market income and fiscal interventions. The study was conducted by the international research team consisting of Luis F. López-Calva (World Bank), Nora Lustig (Tulane University), Mikhail Matytsin (World Bank) and Popova. Using the Commitment to Equity (CEQ) framework[1] — a standardized method of tax and benefit incidence analysis — the research explored the impact of taxation and public spending on inequality and poverty, the incidence of direct and indirect taxes and benefits, and the equity of access to services (in particular, education, health and urban infrastructure) in Russia [Lustig, Higgins 2013]. Data from the Russia Longitudinal Monitoring Survey (RLMS-HSE)[2] with a cross-sectional sample (2010), revenue and spending data from national accounts along with the set of policy rules implemented in 2010 constituted the empirical basis of this study.

The speaker first drew the attention of the audience to the mathematical understanding of the post-fiscal income (income after taxes and transfers) which is equivalent to the sum of transfers received and a household's raw income (pre-fiscal income) excluding the sum of taxes paid. According to the CEQ, the fiscal incidence method is an accounting approach which does not include behavioral effects, general equilibrium effects nor intertemporal effects, but does incorporate assumptions to obtain economic incidence such as tax evasion. Based on the described methodological approach the market income was estimated for each household and then compared with net market income, disposable income, post fiscal income and final income. In such a way, it is possible to estimate a variety of poverty and inequality indicators with and without fiscal redistribution.

Popova briefly presented a list of social benefits and taxes which were emphasized by the research due to its unequal redistribution (in case of benefits) or imposition (in case of taxes) among certain categories of population. The former includes social security pensions, direct transfers and indirect subsidies while the latter includes direct taxes on income and property and indirect taxes on value added. In addition, Popova pointed out the main assumptions of the study among which she distinguished the fact that the tax burden depends on the recipient income while the value added taxes are shifted forward to consumers. Besides, this assumes that both labor supply and consumer demand are perfectly inelastic, which makes the described approximations reasonable and, therefore, is an assumption commonly used in academic and practice-oriented research.

Speaking about the main preliminary results of the research, Popova emphasized the fact that if pensions are treated as market income, the incidence of taxes and transfers will have a low redistributive impact. Since the overall tax system was found to be regressive, the tax payers from the sixth decile onward are net payers, and the final income of the bottom decile is 13 times as high if contributory pensions are treated as public transfers. Nevertheless, the categorical targeting leaves some poor populations which seem to be the victim of the fiscal

[1] The methodology and diagnostic framework were developed as part of the Commitment to Equity (CEQ) project —a joint initiative of the Inter-American Dialogue and Tulane University — used to assess the taxation and public spending systems of twelve countries in Latin America, and currently being expanded to other regions of the world. The standardized methodology allows one not only to assess the equity, efficiency, and effectiveness of revenue collection and public spending patterns in a particular country, but also to compare the performance of various countries. For more information see the link: www.commitmentoequity.org (accessed 28 April 2014).

[2] The Russia Longitudinal Monitoring Survey (RLMS) is a series of nationally representative surveys designed to monitor the effects of Russian reforms on the health and economic welfare of households and individuals in the Russian Federation. For more information see the link: http://www.cpc.unc.edu/projects/rlms-hse (accessed 28 April 2014).

system with few social protections. Among other important conclusions, Popova also noticed that the growth in social services spending in 2000s was driven mainly by the growth in spending on pensions.

In such a way, the continuation of this study will help to answer more precisely the question of who bears the burden of taxation and who receives the benefits of public spending, and how these burdens and benefits are distributed across socioeconomic groups, with emphasis on the bottom 40 percent of the population by income.

Understanding the Sources of Changes in Wage Inequality

Luis F. López-Calva (World Bank)was the next speaker of the session. He presented the main findings of the research devoted to the exploration of the origins of changes in earnings inequality that Russia witnessed in the context of transition to market economy in the post-Soviet period. Based on the recently developed two-stage procedure of decomposition of the distribution of wages [Firpo, Fortin, Lemieux 2009] the study provides a long-term view of inequality. The research was conducted by the World Bank together with the Higher School of Economics with the participation of Andrea Atencio (World Bank), Vladimir Gimpelson (Higher School of Economics), Josefina Posadas (World Bank) and the speaker himself. The empirical basis of this study is the data from the Russia Longitudinal Monitoring Survey (RLMS-HSE) with the cross sectional sample of full-time employed wage workers from 1995 to 2012 (the present analysis draws on the period from 2002 to 2012).

Luis F. López-Calva began by pointing out the fact that, due to the transition to a market economy, in the post-Soviet period Russia experienced a sharp rise in inequality, with a significant peak during the three years following the 1998 financial crisis. Referring to the Gini index (World Bank estimate) skyrocketing from 0.29 in 1992 to 0.5 in 1993, the speaker outlined growing inequalities, which were partly a consequence of differences between regions and industries [Lukiyanova 2006]. In addition, he emphasized that low employment and flexible real wages during the crisis were unexpectedly accompanied by high inflation rates [Gimpelson, Lukiyanova 2009; Dohmen, Lehmann, Schaffer 2009]. As for more recent years, wage inequality drastically decreased, and Gini index fell by 19% from 2002 to 2012, while Russia saw the compression of wage distribution. According to López-Calva, this shift was mostly due to a large increase in real wages, even with accumulated inflation.

The speaker drew the attention of the audience to the methodological part of the study based on a non-parametric evaluation by briefly describing the main significant variables included in a series of regression models. In order to improve the quality of the regression analysis, the dummies for educational level were affiliated to the occupation and industry. López-Calva especially emphasized the composition of the institutional variables which included business ownership, firm size and minimum wage level. This methodological approach allows identifying the contribution of each factor within the composition and wage structure effects, however it does not resolve the omitted category problem.

Considering the major preliminary results of the research, Luis F. López-Calva highlighted the most relevant factors that might explain changes in the wage distribution in post-Soviet Russia which are (1) institutional component, (2) education and (3) geographic location. Institutional factors which include firm ownership, size of the firm based on the number of employees and minimum wage level in real terms have a significant influence on the declining earnings inequality. Besides, the composition of the labor force with the change in the educational attainment and the specificities of geographic location (urban or rural), contributed greatly to the reduction of inequality. Among other important conclusions the speaker also noticed that the changes in the returns to labor market skills were considered to have affected Russian inequality, while wage structure effects are more important than composition effects.

As López-Calva noted, the research went beyond income and wage inequality and could be very helpful for understanding the patterns linked to the structure of economic growth, especially in case of labour income. Further research in this sphere could shed light upon the process of affecting the composition of the labor market and the economy by demand and supply factors.

Wage Dynamics: Productivity and Sustainability

While the previously discussed research underlined the fact that in recent years the wage inequality decrease in Russia has occurred larger at the bottom of distribution due to wage structure effects along with firm-related factors, the third study presented by Vladimir Gimpelson (HSE) focused more on industrial foundations of changing inequality. Since the transition to a market economy, wages in Russia have been much more reactive to both growth and shocks than employment levels; in recent years the wage premium has been declining. The research explored whether this scenario is mainly demand or supply driven, and tried to answer the question of what changes occur in relation to assets, particularly human capital. Gimpelson conducted this study in partnership with researchers from the World Bank Andrea Atencio, Luis F. López-Calva, and Josefina Posadas. Due to the shortage of wage statistics, various sources of empirical data were brought into analysis including Russia Longitudinal Monitoring Survey (RLMS-HSE), ROSSTAT aggregate employment and wage data series[3], Russia KLEMS[4] and some others. In order to identify industry-related factors, the researchers used macro and industry level data, in particular job creation dynamics, cross-industry reallocation and productivity statistics.

First of all, Gimpleson brought attention to the context of the research underlining the fact that the transition to market economy in Russia was accompanied by contradictory changes in the labor market. These changes included a significant reallocation of labour across industries towards higher paid jobs, absolute and relative decline in employment in low pay industries, employment growth in medium pay industries and expansion of informality. As the speaker noted, all these radical and rather paradoxical changes eventually implied the significant fall of wage inequality.

The speaker described the main aspects of the reallocation of employment and wages, and noted that the relative pay advantage of high wage industry decreased, while the relative wage of low pay industries, on the contrary, increased. At the same time the fractions of high wage industries remain stable in the total employment, thus, the inequality is expected to be suppressed.

Gimpelson also focused on the important factor of job creation and destruction, emphasizing the fact that the Russian net change appeared to be negative, due to the contraction in the corporate sector. Job destruction is the most sensitive to shocks, but meanwhile job creation in the private sector goes much faster than in the state one. Gimpelson also noticed that agriculture and manufacturing industries are losing employment, while trade and finance are expanding industries. Thus, the increasingly high pay industries rapidly develop but still remain a rather small fraction, while low and medium pay industries continuously expand, and largely impact inequality situation.

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3 Russian Federal State Statistics Service (also known as Rosstat) is the governmental statistics agency in Russia which provides official statistic data. For more information see the link: http://www.gks.ru/wps/wcm/connect/rosstat_main/rosstat/en/main/ (accessed 28 April 2014).

4 The World KLEMS (capital (K), labour (L), energy (E), materials (M), and services (S)) initiative has been set up to promote and facilitate the analysis of growth and productivity patterns around the world, based on a growth accounting framework. The Russia KLEMS project has been implemented in Russia by the HSE with the support of the Ministry of Economic Development and the Federal State Statistics Service. For more information see the link: http://www.hse.ru/en/org/hse/expert/lipier/ruklems (accessed 28 April 2014).

The speaker briefly outlined the main conclusions of his research. While total employment seems to be almost stable, an expanding non-corporate sector, informal trade and construction increasingly replace formal agriculture and manufacturing. Among the main findings of the study he noted as well employment restructuring, the growth of medium pay and fall of low pay businesses which might lead to falling inequality. Nevertheless, as Vladimir Gimpelson noted, if reallocation boosts productivity, informality will offsets this growth. In addition, the speaker explained that the effect of reallocation on productivity and earnings is found to be generally positive but is partially off-set by growing informality. In such a way, informality appears to influence inequality in a great extent if it keeps rising at the same rate.

As the speaker noted, this research is particularly important due to the fact that it enhances the general understanding of the falling wage premium and links it to the structure and composition of economic growth. The study proposes policy lessons by linking its findings to sectoral growth dynamics, job creation and destruction patterns by sector and, thereby, emphases the productivity and sustainability implications of the changes observed. Vladimir Gimpelson concluded by saying that the continuation of the presented research could provide various explanations of market dynamics, and, therefore, results in different policy responses.

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The session "Poverty and Shared Prosperity in Russia" organized by the National Research University Higher School of Economics in association with the World Bank during the XVI April International Academic Conference on Economic and Social Development explored the highly relevant issues related to the impact of non-market income, taxation, institutional context, geographic position, educational level and composition of the labor market on social inequality and poverty in Russia. Each of the reports was accompanied by active discussions concerning methodological problems and practical implications within the studied field. The specificities of the application of various income and transfer measurements aroused considerable interest in the audience.

As the conference chair Irina Denisova noted, the "Poverty and Shared Prosperity in Russia" project recently has received much attention from the part of Russian academic community and could be regarded as an incentive for further research in this field. The results of the study may allow policymakers and stakeholders to learn about whether the current fiscal structure reinforces or offsets the patterns determined in the market. This kind of information along with a future thorough analysis of the labor income dynamics will allow us to establish lessons and potential areas of balanced intervention.

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