The Politics of Inequality in Russia

This book investigates the relationship between the character of political regimes in Russia's subnational regions and the structure of earnings and income. Based on extensive data from Russian official sources and surveys conducted by the World Bank, the book shows that income inequality is higher in more pluralistic regions. It argues that the relationship between firms and government differs between more democratic and more authoritarian regional regimes. In more democratic regions, business firms and government have more cooperative relations, restraining the power of government over business and encouraging business to invest more, pay more, and report more of their wages. In more democratic regions, average wages are higher and poverty is lower, but wage and income inequality is also higher. The book argues that the rising inequality in postcommunist Russia reflects the inability of a weak state to carry out a redistributive social policy.

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"Tom Remington's fine new book begins with an unexpected finding: At the subnational level in post-transition Russia, more democratic regional regimes tend to have higher income inequality than more authoritarian ones. More democratic regions do perform better in most respects: Earnings and tax receipts are higher, poverty lower, government more consultative with business and less predatory; whereas authoritarian regional regimes have lower wages and tax receipts, higher poverty, and governments that are exclusionary and predatory toward business, but still more equal income distributions. In a deeply researched and methodologically creative study, Remington identifies the political factors contributing to this conundrum, focusing on government-business-labor relations, communist welfare state legacies, and the inability of Russia's weak state to implement effective redistributive policies, and considers the implications for Russia's future politics, stability, and place in the international system."

– Linda J. Cook, Brown University

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Preface

This study began out of a nagging curiosity about the nature of income inequality in Russia. Why did it rise so sharply after the transition from communism, and why has it stayed so high? Is income inequality in Russia driven by similar forces to those that have been deepening inequality in the United States for the last three decades? What are the effects of democratization on inequality? My initial assumption was that, generally speaking, where democratic political institutions were more effective, inequality would be lower, although whether this was a result of redistribution after market forces had yielded an initial differentiation of earnings, or affected the very structure of earnings, seemed an open question.

I also wanted to understand the three-way interaction among inequality, democracy, and that diffuse, intangible quality of public life that is often termed "governance." Governance is a multifaceted concept, arguably too diffuse to be treated as a single concept at all. As Daniel Kaufmann and his associates at the World Bank Institute treat it, it is a way of characterizing "the set of traditions and institutions by which authority in a country is exercised."[1] This is reasonably broad, but the multiple studies of governance carried out by the World Bank Institute team have demonstrated that assessments of the quality of six sets of institutions by which governance is defined tend to be well correlated, and in fact help predict countries' economic performance. A number of studies have suggested that high inequality subverts governance, thus in turn harming the long-term prospects of economic development. My simplistic notion starting this study was therefore roughly as follows: Early democratization and market reform in Russia, as in other postcommunist countries, had brought about an initial explosion of inequality as wages were decompressed, but with time, more democracy would gradually bring down inequality through the provision of public goods (such as education and public health care) that would equalize conditions for the population, as

[1] Daniel Kaufmann, Aart Kraay, and Massimo Mastruzzi, *Governance Matters 2006: Worldwide Governance Indicators* (Washington, DC: World Bank Institute, 2006).

well as through redistributive mechanisms such as effective pension coverage, unemployment assistance, and poverty relief programs. If at the national and subnational regional levels, more democratic regimes undertook policies that succeeded in reducing inequality, in turn, governance would improve, and with it the country's ability to take advantage of economic opportunities. Where governments failed to reduce inequality, on the other hand (perhaps because they fell captive to powerful "early winners" that sought to lock in the rents from the initial liberalization and privatization efforts), persistent inequality would subvert governance and injure the country's prospects for economic development. My reasoning was similar to the argument that Eric Uslaner makes about the effect of inequality on corruption. Even though inequality itself has a relatively weak relationship with corruption, he finds, it acts to undermine basic trust, the ability to trust people other than family and close friends, and thus to undermine faith in the rule of law. This syndrome of generalized mistrust then increases corruption, which then feeds back onto inequality by perpetuating the gap between haves and have-nots.[2]

Similarly, my basic expectation about Russia was that democratization would lower inequality (at least over time), and that lower inequality would improve governance. Improved governance would produce both higher growth and a more equal distribution of its benefits, reinforcing democracy. I decided to test this argument by taking advantage of the diversity of regional regimes within Russia itself, which have been extensively studied by both Russians and outsiders. In particular, the degree to which the regional regimes reflect democratic characteristics has been measured systematically by a team of experts based in Moscow, who, through their network of contacts in the regions, were able to code each region's regime by scoring each of ten attributes on a five-point scale. I discuss this rating system in more detail in Chapter 1. Suffice it to say here that their scores are widely used and generally trusted. I proceeded to collect a substantial body of data on incomes, income inequality, wages, and a host of social and economic conditions for each region from the early 1990s through the present. Much of this data comes from Russian official sources, as well as from World Bank–sponsored studies of incomes and of government-business relations. In some cases, I have employed regional-level data collected and shared by other scholars, including the measure of the level of democracy in each region.

To my surprise, I found that it was the regional regimes scoring highest on the democracy scale that have the highest income inequality – even after controlling for other factors that are related to income inequality (such as natural resource wealth). Generally, regions with higher incomes have higher income inequality. But even after accounting for the effects of income, more democracy is positively associated with higher inequality. Trying to understand the causal pathway for this effect led me to study the political forces that shape the structure

[2] Eric M. Uslaner, *Corruption, Inequality, and the Rule of Law* (Cambridge: Cambridge University Press, 2008).

of employment, wages, incomes, and welfare region by region. My conclusions remain tentative, necessarily, because not all links in the chain of reasoning are amenable to measurement and empirical verification. The evidence, however, is reasonably strong, and the pieces of the argument fit together.

Briefly, I conclude that:

1. The effect of democracy on income inequality runs through earnings, not post-tax or post-transfer policy. Where wage differentiation is greater, that dispersion translates directly into income inequality.
2. More democratic regimes are those where the political authorities have institutionalized greater participation in decision making by economic and social elites and maintain more consultative relations with local firms. They have accepted some constraints on their power to confiscate the gains of business, including greater media freedom and electoral competition. Less democratic regimes not only block competition and consultation in the political arena, but they are also more predatory toward local enterprises.
3. Regions with more cooperative relations between government and regional firms encourage managers to pay higher average earnings. Earnings are higher at both the lower and the higher ends of the spectrum, and there is greater dispersion between the lower and upper ends of the distribution than in lower-wage, lower-democracy regions. Thus this decompression of earnings appears to improve wages for both lower-paid and higher-paid employees, but at the cost of greater inequality. Poverty and social dependency are higher in less democratic regions. Small-business development and other indications of secure property rights are stronger in more democratic regions.
4. Some portion of the higher inequality of earned incomes in the more democratic regions is a function of their greater openness. In other words, it may be that income inequality in less democratic regions is also high, but that much less of earned income is reported to the authorities, taxed, and returned to the public in the form of collective goods and redistributive transfers. But because the practice of under-the-table earnings is not amenable to systematic study, only to anecdotal reports, I have no direct evidence of this. However, it is worth noting that the current economic crisis in Russia is driving more and more earned income back into the shadows, which will certainly increase inequality.
5. Finally, even though the more democratic regional regimes seem to have done a better job of adapting the regional economies to the conditions of market competition, they did so at the expense of allowing some of Russia's inefficient giant industrial firms to survive, often because the life of an entire city or region depends on it. This left Russia's economy susceptible to the devastating effects of the global 2008–2009 crash.

This book addresses the political determinants of income inequality in Russia rather than its short-term or long-term consequences. It is certainly contrary to my initial expectations to find that it is the more democratic regions where inequality is greatest. However, because this effect runs through the organization of the labor market, which is deeply embedded in the institutional matrix of state-business relations in each region, the implications are not straightforward. On the evidence I have examined, the prospect for a reduction in income inequality over time in Russia rests on three factors: how wages are distributed in the labor market, how much redistribution there is through government taxes and transfers, and how open versus how informal wage payment is. I agree with Vladimir Putin and Dmitrii Medvedev that the level of income inequality in Russia at present is much higher than is good for Russia's long-term economic and social performance, and that it would be in Russia's interest for a middle class to expand at the expense of the poor and the rich. However, achieving a reduction in income inequality will require changes in the structure of power in the labor market (in particular, greater collective-bargaining capacity on the part of employees across enterprises), more effective representative institutions so that the producers of wealth have some assurance that their taxes are going to benefit the larger public good rather than lining the pockets of corrupt officials, and a public commitment to open and honest reporting of incomes. If the current economic crisis works to bring these changes about, its effect will be salutary.

In writing this book, I have incurred more than the usual number of debts. It is a pleasure to acknowledge my gratitude to Daniel Berkowitz, Linda Cook, Lev Freinkman, Tim Frye, Jennifer Gandhi, Vladimir Gel'man, Henry Hale, Tomasz Inglot, Jana Kunicova, Edmund Malesky, Stanislav Markus, Nikolai Petrov, Mikhail Pryadil'nikov, Alexander Remington, Elina Treyger, and Xin Zhang, as well as two anonymous reviewers, for comments on some portions or all of the manuscript; for research assistance by Dimitry Doohovskoy, Alexander Remington, and John Reuter; for statistical advice by Marcus Alexander, Nealia Khan, and Adam Okulicz-Kozaryn; for data shared by Rudiger Ahrend, Daniel Berkowitz, Scott Gehlbach, Nikolai Petrov, Elina Treyger, and Ekaterina Zhuravskaia; and for a Senior Fellowship from the Davis Center at Harvard University, which made possible much of the research on which this book is based and provided a wonderfully stimulating and collegial atmosphere in which to write it.

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