

## The response to the crisis in the Russian Federation

The Russian Federation is, like other countries in Eastern Europe, severely hit by the current economic crisis. The major modes of transmission through which the crisis gained influence on the Russian economy are a) its dependency on commodity exports for which global demand and prices have been falling sharply, b) the limited access to foreign capital and c) a slump in demand for Russian export products in the developed economies.

As a response to the crisis, the Russian government tied a major fiscal stimulus package, which should be worth at least 3% of the GDP expected for 2009. Part of the stimulus package is also spending on social security benefits such as pensions. In this field the government essentially promised to keep earlier made promises despite the negative economic data.

## *Impact of the crisis*

The impact of the crisis on the economy of the Russian Federation is severe. While the GDP growth rates were on average 6.5% between 2001 and 2008, the IMF predicts a contraction of -6% for this year.<sup>1</sup> On a year-to-year basis, in January 2009 investment expenditure fell by 15.5%, industrial output by 16% (including a 24% decline in manufacturing) and real wages dropped by 9.1%.<sup>2</sup> Since the last quarter of 2008 unemployment has been on the rise, exports are declining and imports sagged too, due to the devaluation of the rouble.<sup>3</sup>

Three to four major modes of transmission can be held accountable for the impact of the crisis on the Russian Federation a) the dependency on commodity exports for which global demand and prices have been falling sharply, b) limited access to foreign capital and c) a slump in demand in the developed economies and d) the lack of competitiveness in other sectors than commodity extraction, and an inadequate development of domestic banks and financial services.<sup>4</sup> Following the government's assessment, the high growth rates of the past years could largely be attributed to external factors such as high oil prices and cheap loans of foreign banks for Russian enterprises. A priority of the government's crisis response is thus to support the sustainable development of domestic sources of growth.

## *Impact on /challenges to social security systems*

The core features of the Russian social security system are labour pensions, unemployment compensation, family allowances, sickness and maternity benefits and housing allowances. Additionally, numerous categorical benefits and privileges in cash and in kind exist. It should be kept in mind that the benefit level of the schemes often is below the subsistence level in the various regions. Furthermore, the benefits are not necessarily targeted at the poor, but tend to be categorical. As a consequence, some of the most vulnerable might not get, or only get insufficient state support.

Among the social security schemes, the unemployment insurance is hardest hit. No figures on the affiliated members to the scheme are available hence, we do not have information on whether the number of contributing members is declining. On the beneficiaries side there is a steep rise in unemployed persons and in beneficiaries, the latter is at a 10 year high.<sup>5</sup>

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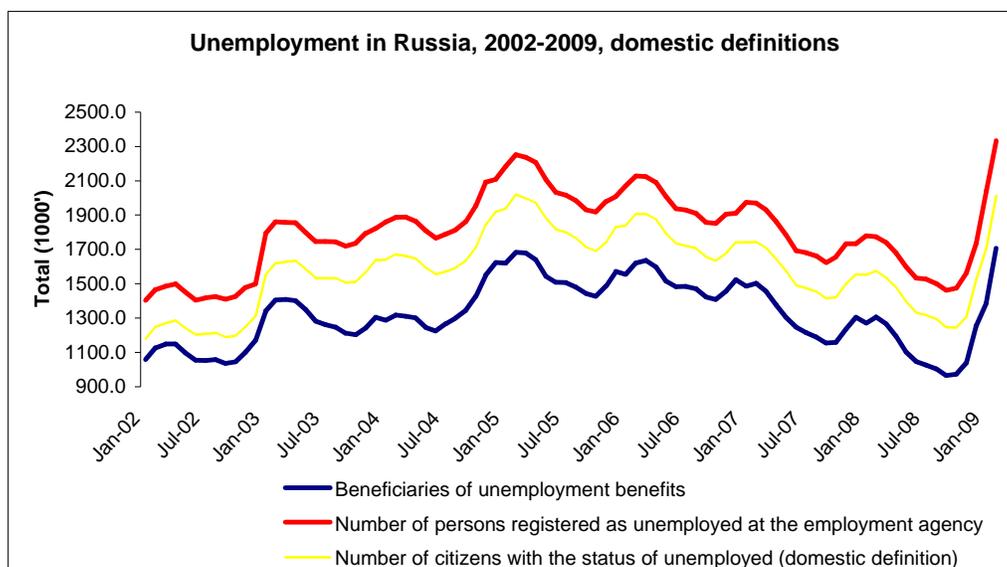
<sup>1</sup> IMF World Economic Outlook April 2009, available at <http://www.imf.org/external/pubs/ft/weo/2009/01/index.htm>

<sup>2</sup> Economist Intelligence Unit (EIU), Country Report Russia, April 2009 available at [http://www.eiu.com/report\\_dl.asp?issue\\_id=84449193&mode=pdf](http://www.eiu.com/report_dl.asp?issue_id=84449193&mode=pdf), Figures are based on IMF data unless stated otherwise.

<sup>3</sup> The rouble lost 23 % against USD and € between early November 2008 and the end of January 2009 (EIU as above).

<sup>4</sup> All information on the analysis of and the response to the crisis of the government of the Russian Federation is based on the following source unless indicated otherwise: <http://www.government.ru/content/governmentactivity/antikrizismeriprf/5431178.htm>. The share of commodities (oil, fuel, gas) was as high as 64% of all principle exports in 2006 (EIU as above).

<sup>5</sup> Russian State Institute for Statistics, Rostat, available at [http://www.gks.ru/wps/portal/lut/p.cmd/cs.ce/7\\_0\\_A/.s/7\\_0\\_32U/\\_th/J\\_0\\_CH/\\_s.7\\_0\\_A/7\\_0\\_FL/\\_s.7\\_0\\_A/7\\_0\\_32U](http://www.gks.ru/wps/portal/lut/p.cmd/cs.ce/7_0_A/.s/7_0_32U/_th/J_0_CH/_s.7_0_A/7_0_FL/_s.7_0_A/7_0_32U)



Source: Russian National Institute of Statistics

The figures of the national institute for statistics clearly show the steep rise in unemployed persons and unemployment benefit beneficiaries. According to president Medvedev, by March the number of registered unemployed had already reached the level, which the government expected for the end of 2009.<sup>6</sup> Based on ILO methodology the number of unemployed is much higher and was estimated to be 7.1 million in March 2009, which is equal to an increase of 1.8 million on a year-to-year basis. Next to the high unemployment figures, nearly another million of workers are said to involuntarily work shortened hours.<sup>7</sup>

Also, the pension scheme has severely come under pressure due to the crisis. Unfortunately, no figures on revenues, expenditure, assets, or beneficiaries are available for the pension scheme. The constraints, which the system is currently facing, can at least partly be attributed to promises about rising benefit levels that have been made earlier. As a reaction to the crisis, these promises have been extended. The consequence of raising the benefit levels is a gap in the revenues of the pension scheme in 2009, which will have to be covered from other sources than contributions. The expansion of benefits is not temporary but a permanent change, which might threaten the pension fund's future fiscal sustainability in the long run.

### *Responses in general to the crisis*

As a reaction to the crisis, the government of the Russian Federation has passed two action plans, a first one in the late 2008 and a second one in April 2009. The government points out that the reactions to the crisis taken now, are understood as part of an overall strategic modernization process of the Russian Federation. According to the government, the crisis response packages serve the following objectives:

- Support citizens and families that have been hardest hit by the crisis;

<sup>6</sup> BBC Monitoring Former Soviet Union: English translation of an interview with the Russian President Dmitry Medvedev, broadcast on Gazprom-owned NTV's "Itogovaya programma" on 19 April (also published in Russian at kremlin.ru)

<sup>7</sup> EIU quotes Rostat data from February 2009 (EIU s.a.).

- Develop industrial and technological potential for future growth;
- Increase domestic demand in the short- and long-term (as part of domestically driven growth strategy);
- Modernization of industries, services, infrastructure, and investment in human capital;
- Lowering administrative pressure on business;
- Development of the domestic banking and financial sector;
- Long-term macroeconomic stability.

Outside the field of social security, the major actions taken are

- Financial support to the financial sector;
- Financial support for certain sectors and individual enterprises;
- Measures that aim at boosting domestic demand; and
- Introduction of tax exemptions and cuts in taxation.

The total additional expenditure foreseen for 2009 for these measures amount to nearly rb2.25 billion,<sup>8</sup> or more than 3% of GDP. At the same time, the considerably lowered taxes (e.g. corporate tax decreased from 24% to 20% and for small enterprises from 15% to 5%) together with declining revenues from commodity sales, will reduce the overall state revenues in 2009 considerably. Tax revenue declined by 20% in January 2009 on a year-to-year basis. For the full year 2009, the government expects state revenues to fall by 25% compared to the previous year. Concomitantly, the level of expenditure is planned to remain at the same level or to be increased. Therefore, the government expects a budget deficit of 8% of GDP for 2009.

To cover this gap in government expenditure, Russia as opposed to other states, will not have to rely heavily on more foreign lending. In times of high oil prices the Russian Federation had established a Federal Reserve Fund, which now covers most of the additional expenditure on crisis response. The total additional expenditure foreseen for 2009 equals rb2.7 billion.

### *Social security responses*

The government calls the protection of those hit hardest by the crisis the foremost objective of the stimulus package. Emphasis is placed on the fact, all obligations made earlier in the field of social security will be met. Thus, the pension levels will rise as agreed before, and will rise even steeper to meet the hardship caused by the crisis. Similarly the planned construction and purchase of social housing will be enlarged. Most of the additional costs foreseen in the stimulus package for 2009 are allocated to existing social security schemes, or are preponed measures that had been planned earlier. While the first measures taken in 2008 were aimed at limited groups within the population,<sup>9</sup> this year's programme is more extensive, but focus should be given to those citizens with the lowest incomes, says the government.

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<sup>8</sup> Please see the annexed table with the budget for stimulus measures in 2009 for details.

<sup>9</sup> E.g. in the crisis response in the field of social security of last year one focus was on invalids and parents of invalid children. For them three specific programmes each at rb100mn were to be implemented: (1) provide support to the families with invalid children for social integration; (2) provide vocational training and employment opportunities to the parents of invalid children and (3) provide rehabilitation to prevent physical invalidity to children. In general families are target groups, but no information on how they are targeted in the programmes was available.

In detail, the following measures have been adopted:

- Benefits such as child benefits and maternity benefits will be indexed to the latest inflation forecasts. An additional rb12.7bn will be available for this purpose.
- Categorical benefits such as the social pensions for Chernobyl survivors, and war veterans will also be raised and rb11.5bn have been allocated for this purpose.
- An earlier decision to raise the average social pension to the subsistence minimum will be implemented in 2009. A transfer of rb315.6bn from the federal budget to the pension scheme is foreseen for this year.
- Labour pensions will rise more steeply than announced earlier. The costs are estimated at rb12.5bn, which will be transferred to the pension scheme from the state budget.
- It is planned that pensions will be increased three times: in March, basic part of pension by 8.7%; in April, insurance part of pension for 15.6% and in December, again basic part by 26.5%. By the end of year the average size of social (minimal) pension is expected to reach to the level of subsistence minimum of rb4245. In April 2009, actually, insurance part of pension has been increased by 17.5%. As a part of anti-crisis measures, labour pension in general is expected to increase by 35% and social pension is expected to increase by 42.8%.
- The maximum unemployment benefit has been increased by 50% by January 1<sup>st</sup> 2009. Rb33.9bn will be made available.
- The state government financially supports the provision of vocational training to workers that have been laid off. For this purpose rb43.7bn are available to the regional administrations, which will carry out the training.
- Additionally, rb33.9bn will be provided for not specified active labour market policies.
- The efforts to improve the national health system (e.g. cancer and TB treatment, maternal health programmes, blood donations, improve the supply of pharmaceuticals) will be continued. Although there is quite some talk on health care provision no additional funds have been allocated as part of the stimulus package.

Through the measures listed above, the federal government aims at

- Training 173,000 employment opportunities,
- Create 982,000 temporary and public works jobs,
- Grant financial aid to 55,800 entrepreneurs, and
- Provide relocation grants to 15,000 internal migrants.<sup>10</sup>

The total additional costs budgeted for social security amount to roughly rb460 billion. The share of social security measures as part of all federal government expenditure on stimulus in 2009 is about 17%.

## Conclusion

As the Russian Federation belongs to those countries hit hardest by the economic and financial crisis, a clear social security response, which shields its population from the worst effects, is needed. The government's crisis response is largely limited to keep earlier made promises, and to the adjustment of pensions and other benefits to either inflation or subsistence levels. Given the soaring unemployment rates and the pre-existing poverty in the Russian Federation, this reaction was due if not overdue. A

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<sup>10</sup> At the same time the quotas for foreign workers have been cut by half.

problem that has not been solved as part of the crisis response relates to the high number of categorical benefits that neither target nor reach the poor, while the poor are receiving inadequate or no benefits.

## Budget for the stimulus package 2009

bn roubles

Active labour market policies/unemployment benefits	
Support to the regions for active employment policies	43.70
Increased costs for unemployment benefits	33.90
Additional funding for active labour market policies	33.90
Subtotal active labour market policies/ unemployment benefits	111.50
Pensions	
Transfer to the pension scheme the additional costs from the extra-ordinary raise in basic pensions in 2009	315.60
Transfer to the pension scheme to cover the additional costs increase labour pensions	12.50
Additional costs increased targeted social pensions for war veterans, Chernobyl survivors and under-aged prisoners	11.50
Subtotal Pensions	339.60
Social assistance - Indexation of social assistance to inflation rate	12.70
Education - support of student loans	0.03
Subtotal additional spending on social security measures	463.83
Financial sector support	
Obligations to the Bank of Russia	8.80
Transfers to the Bank of Russia to reimburse grants for agricultural industries	10.00
Loans to private banks	555.00
Additional loans distributed through the bank of Russia	500.00
Additional state guarantees for banks	300.00
Subtotal financial sector support	1,373.80
Export subsidies	6.00
Direct state support for various sectors and individual enterprises	
Agriculture	7.00
Fisheries	1.10
Automotive	2.50
Railways	60.30
Military industrial complexes	27.00
To individual companies	50.00
State airline	12.00
Lumber industry	0.33
Support to small business	6.20
Loans to SME	30.00
Subtotal direct state support for various sectors and individual enterprises	196.43
Domestic demand boost	
Credit ease for the purchase of domestic cars	3.00
Credit to agricultural industries to support the purchase of new machinery	70.00
Purchase of domestically produced cars for the federal and public services	32.50
Support to organizations to prevent them from bankruptcy	3.00
Construction of housing for war veterans	35.00
Construction of social housing	26.30
Deductibility of certain construction costs	0.30
Subtotal boost of domestic demand	170.10
Coverage and repayment of household mortgages	85.70
Subtotal additional spending other measures	1,832.03
Subtotal additional expenditure	2,295.85
Loss in revenues through tax exemptions	
Change in depreciation especially for the oil and mineral industries	34.00
Lowered profit tax and additional payments to the regions from the federal budget	330.90
Change in depreciation rules for durable and non-durable goods (total revenue losses of rb50,4bn of which the biggest part is borne by the regions)	5.60
Lowered tax on the purchase of real estate	43.00
Subtotal lost revenues	413.50
Total value stimulus package for the federal budget	2,709.35
Share of additional social security spending in percent	17.12