



# How and why transition made income inequality increase in urban Russia: A local study

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**Gustafsson, Björn, and Nivorozhkina, Ludmila**—How and why transition made income inequality increase in urban Russia: A local study

Using sample surveys from the city of Taganrog in 1989 and 2000, we investigate household income, its composition, and its distribution in urban Russia. Income inequality increased greatly as real income at the lowest part of the distribution decreased considerably. Earnings are more concentrated in the upper part of the income distribution in 2000 than in 1989. For many households, public transfers, allowances, private transfers, or subsidiary earned income prevented income from falling further. However, Russia did not inherit from its Soviet past an efficient progressive tax system or programs to protect jobless workers and households facing severe drops in income. *Journal of Comparative Economics* 33 (4) (2005) 772–787. Department of Social Work, Göteborg University, PO Box 720, SE 405 30 Göteborg, Sweden; Rostov State Economic University, B. Sadovaya Street 69, 344007 Rostov-na-Donu, Russia.

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## 1. Introduction

The transition from a planned to a market economy in Russia was accompanied by a rapid decline in production that caused real wages to decrease substantially during most of the 1990s.

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Workers were laid off and employed people were not paid on time. In the later part of the 1990s, unemployment developed and became a social problem. For many Russian households, transformation has meant increased difficulty in supporting themselves by earning wages and salaries. To counteract these conditions, households have diversified their income sources. Some workers have been able to get a secondary job; self-employment has increased and time spent in production for private consumption and for earning subsidiary income has increased.

Transition also means change from a rigid economic environment, in which the rules of the game were well known to most actors and the outcomes of decisions were relatively easy to predict, to a new environment of constant flux. The first period of transition was a disequilibrium environment characterized by unclear rules for market transactions and more volatile factor rewards. Disorganization meant that the income-generating process became less transparent. Economic success in such an environment is often serendipitous and enjoyed by those able to take advantage of the new possibilities. Therefore, we expect young adults to be able to adjust to the new environment better than older workers. Similarly, people with more education should be able to access and process information more easily and benefit more from new opportunities.

An important component of household income in Russia is the social insurance payments. The social insurance system of Soviet Russia consisted of relatively meager pensions for elderly people. Support for families with children was rudimentary and, in a regime that proclaimed full employment officially, unemployment compensation did not exist. Rapidly decreasing production led to an eroding tax base that made it difficult to develop income support programs during the transition. However, a substantial proportion of the voters in Russia are pensioners or other people with low incomes. For a political economy reason, the Russian pension system has been reformed rather than dismantled and local governments and enterprises are under pressure to introduce new systems of income support. In contrast and despite the increased need, a comprehensive, easy to access, and generous system of unemployment benefits has not been introduced and only limited support is provided to families with children.

The burden of Russia's transition has not been shared equally. Although the fall in real wages and loss of income is widespread, members in some households have found new economic opportunities and achieved a higher living standard. As a consequence, the distribution of income in Russia is now considerably more unequal than during the Soviet period as [Milanovic \(1998\)](#), [Commander et al. \(1999\)](#) and [World Bank \(2000\)](#) attest. To analyze the changes using circumstances during the Soviet period as a base line, we compare the situation in 2000 to that of 1989.<sup>1</sup> In this paper, we use two similar household surveys for the Russian city of Taganrog. The benefit of using a local study is our ability to paint a more detailed and reliable picture of change. The disadvantage with this approach is that we cannot determine to what extent changed spatial differences contribute to the rise in income inequality in Russia, as [Fedorov \(2002\)](#) investigates.

To begin, we assess the magnitude of the changes in income inequality and real income at the household level. To analyze the forces causing income inequality to increase, we decompose the change in the Gini coefficient by income components.<sup>2</sup> To assess changes in the relation between

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<sup>1</sup> [Atkinson and Micklewright \(1992\)](#) provide a discussion of the limitations of the official statistics during the Soviet era. [Yemetsov \(2005\)](#) reports the changes during transition. During the 1990s, several new data sources have been developed, including the well-known Russian Longitudinal Monitoring Survey (RLMS). However, the first wave of RLMS occurred in the second half of 1992, which means that it cannot be used to investigate the earliest phases of transition.

<sup>2</sup> [Milanovic \(1998\)](#) reports results for Russia during the period from 1989 to 1994 using official data and the RLMS, while [Commander et al. \(1999\)](#) study the period from 1992 to 1996 using the RLMS. Our dataset contains records having more components of income than the RLMS.

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