



# **Social Benefits Monetization Reform in Russia**

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Preparation of the Strategy for Social  
Benefits Monetization Reform in Ukraine**

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## **Work structure**

- 1. AIMS AND MOTIVES OF MONETIZATION REFORMS IN RUSSIA**
- 2. EXPECTED OUTCOMES OF THE REFORM**
- 3. DESCRIPTION OF THE IMPLEMENTATION PROCESS**
- 4. CHANGES OF THE ROLES OF VARIOUS ACTORS AND AGENCIES**
- 5. COMPENSATION OF HOUSING AND COMMUNAL SERVICES EXPENSES IN THE COURSE OF HCS AND MONETIZATION REFORMS**
- 6. MAIN GAINS AND FAILURES**
- 7. LESSONS THAT COULD BE DERIVED FROM THE RUSSIAN MONETIZATION EXPERIENCE**



## Changing functions of social privileges in USSR/Russia

- **1920s – 1940s: privilege as a form of acknowledgment of and a social reward for rendering special services to their country**
- **1950s – 1980s: privilege as an instrument of regulating differential access of various household categories to social benefits, given an egalitarian function of wages and salaries**
- **1990s: privilege as an instrument of supporting living standards and the quality of life for disadvantaged and socially vulnerable population groups, given declining real incomes of households**

# System of privileges in Russia

- By 2005, Federal legislation has established 156 kinds of social privileges, allowances, benefits and subsidies that encompassed 236 categories of citizens (veterans, disabled, children, students, etc.)
  - An elaborate system of in-kind benefits has emerged. It included privileges for:
    - ✓ HCS
    - ✓ Health services and medicines
    - ✓ Municipal and inter-city transportation, etc.
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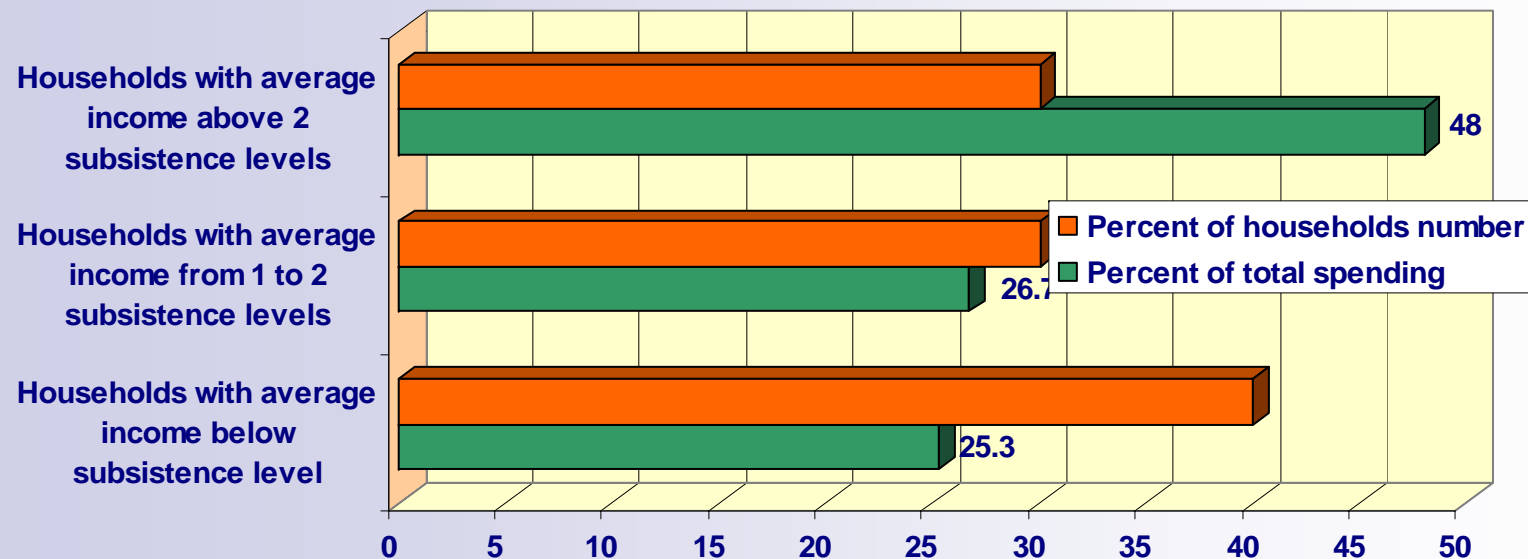
## Major system deficiencies:

- Lack of adequate financing ('non-financed Federal expenditure mandates')
  - ✓ In 2001, in order to implement all social support provisions, the RF consolidated budget would have to be increased twice
  - ✓ The federal law 'On Veterans' was under-financed by 89 percent in its federal part, and by 63 percent in its regional component
- Non-transparent spending and lack of adequate control
- Unequal access to in-kind benefits
- Poor targeting of benefits

➔ Cashing out benefits – a possible way out

# Targeting of benefits and privileges

Distribution of total spending on social benefits, subsidies and privileges between income groups, %



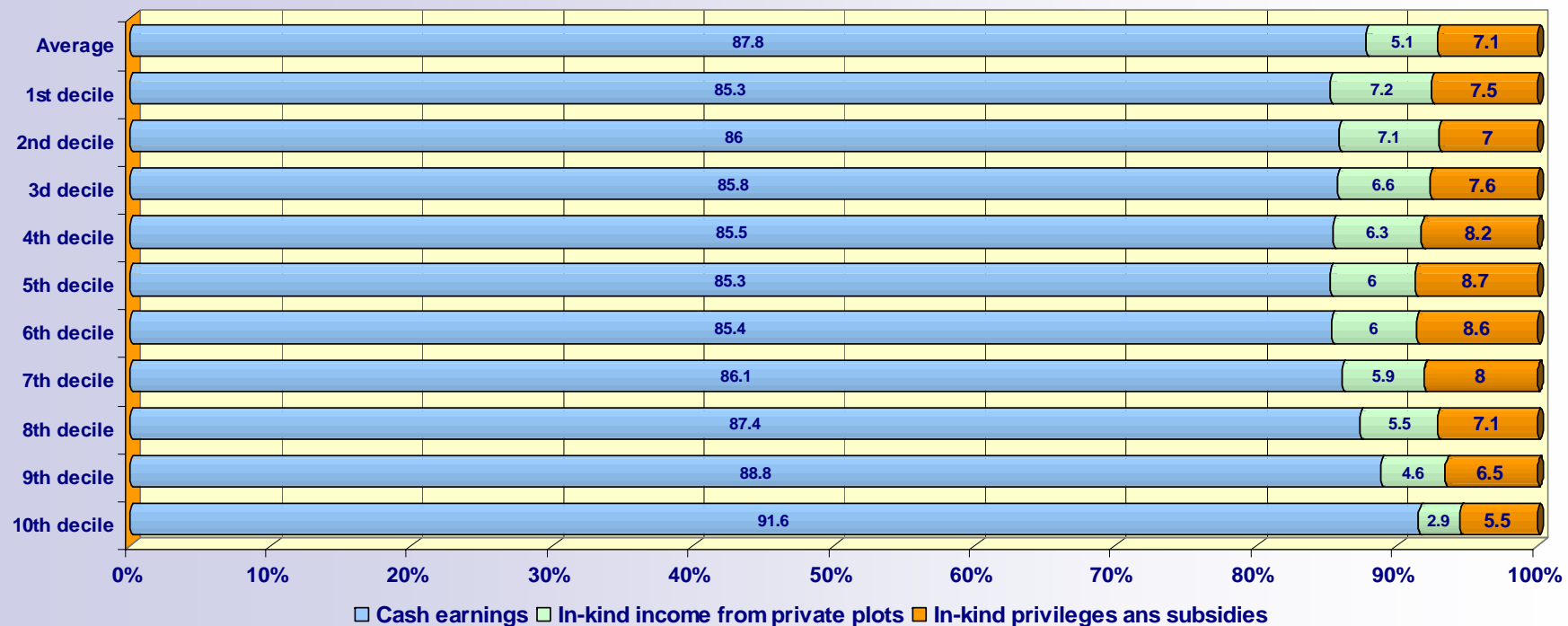
Source: IISP, 2005

- Virtually all types of social benefits, privileges and subsidies in Russia were based on categorical principle
- 90% of social assistance spending in Russia was not targeted directly at the poor, but at various groups of the population regardless of income level (pensioners, veterans, invalids, etc.)
- Only 8% of this spending reached the poorest 20% of the population
- Only three types of social assistance envisaged income-testing: child allowances, HCS allowances, and regional programs for the poor. Aggregate spending on these targeted programs amounted to roughly 0.3% of GDP (RUR 80 bln)

World Bank, 2005

# Who made use of in-kind benefits?

## Structure of per capita disposable income of households receiving in-kind privileges and subsidies



Source: IISP based on NOBUS (2003)

- The poor did not constitute a priority group for the state social programs of subsidies and in-kind privileges

# 2004 Monetization Reform: Design and Outcomes

The primary problems to be solved were :

- Elimination of non-financed social mandates;
- Transparency of interrelations between the federal/regional budgets and service providers;
- Restoration of fairness towards those beneficiaries that did not make use of the subsidized services;
- Reduction of poverty levels in rural areas;
- Expansion of “rights and freedoms” of beneficiaries to make use of social assistance measures.

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The FZ-122 Federal Law of August 22, 2004 initiated the following changes:

- Delineated federal and regional budgets' powers for financing social protection mandates;
- Re-distributed responsibilities between federal and regional budgets regarding types of beneficiaries rather than types of privileges;
- Eliminated non-financed social protection mandates;
- Reduced expenditure obligations laid out in federal legislation;
- Transferred ('cashed-out') in-kind privileges into cash payments for federal social protection mandates;
- Introduced the so-called Monthly Cash Payment (500 to 2,000 rubles) + 'Social Package' (450 rubles) for 'federal beneficiaries';
- Placed the responsibility for cashing-out regional social protection mandates and for balancing revenue opportunities with new expenditure powers on regional and local authorities.
- Monetization of 'regional' benefits, including in-kind HCS privileges, was carried over to the period after 2008

## Cash payments to 'Federal' beneficiaries

Categories of Beneficiaries	Compensation amount, RU/month
Disabled persons (except war invalids)	
III Group	800
II Group	1000
I Group	1400
Disabled WWII veterans and invalids of other combat actions (war invalids)	2000
WWII participants and other categories of citizens having privileges related to WWII	1500
Other combat veterans	1100
Family members of the deceased WWII invalids, WWII participants and other deceased combat veterans	600
Persons affected by radiation	1700

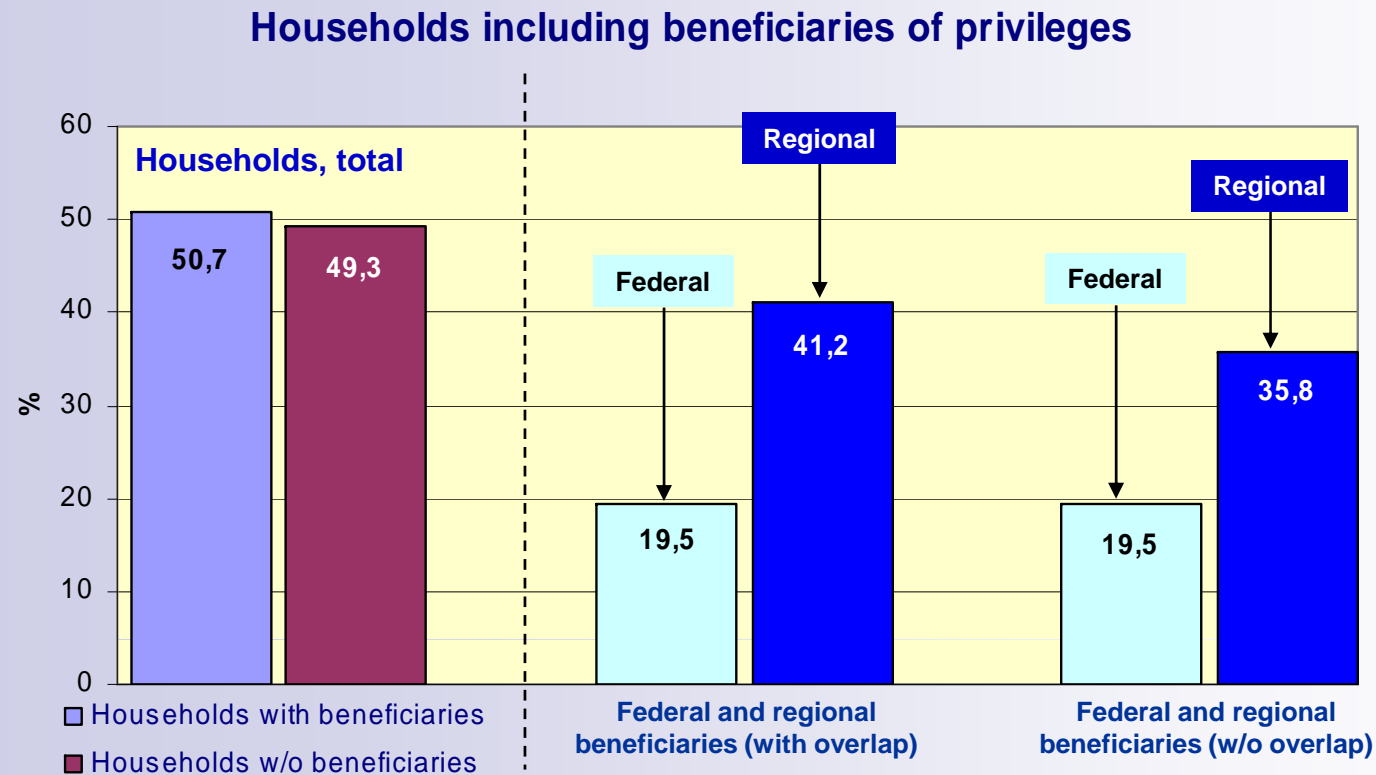


## “Technology” of the reform

1. Early 2004: MinFin suggested to split the total of allocated 170 bn rubles between all beneficiaries, estimated at ~ 35 mln people. → 400 rubles per person monthly (or, say, 200 rubles for labor veterans and 1,000 rubles for war veterans) → 📢
2. March 2004: MinFin proposed to carry over the HCS monetization to a later stage → Payments were still regarded as insufficient → 📢
3. May 2004: MinFin suggested to carry out monetization for most numerous categories – labor veterans (~ 9 mln) + Home-front workers during WWII (~ 9 mln) + Victims of political repressions (~ 1 mln) – at the expense of the regions. → 📢
4. July 2004: At the initiative of State Duma supported by Minister Zurabov, cash payments supplemented by Monthly Social Package → 📢
5. August 2004: 170 bn rubles from the federal budget were divided between ~ 17 mln disabled persons, WWII and other combat veterans + 30 bn rubles from federal budget were reserved for rendering assistance to regions = 200 bn rubles (expected cost of monetization)
6. January 2005: Widespread public dissatisfaction and public protest actions all over the country 💣
7. Public protests were extinguished only by an ahead-of-schedule raising pensions (107 bn rubles) and money allowances to servicemen (46 bn rubles) → **Cost to MinFin increased 77%**

*E. Gontmaher, Otechestvennye Zapiski, No. 3 (23), 2005*

# How many households does monetization affect?



Source: IISP based on NOBUS (2003)

- The majority of households in RF include members involved in privileges programs
- There are twice as many 'regional' beneficiaries compared to 'federal' ones

# Systemic inconsistencies of the Monetization Law

- A lack of a clearly formulated goal of privileges' reform (in practice, the goal of in-kind privileges reform was replaced by the goal of delimitation of budget authorities);
- A delimitation of authority on social protection of citizens was substituted by splitting the beneficiaries into categories;
- The decentralization of social protection institutes was not supported by the establishment of a mechanism to implement benefits cashing-out at regional levels;
- Regions could renounce their right to conduct monetization (with regard to 'regional' recipients); on the other hand, regions are free to increase the number of 'privileged' categories;
- A factor of very strong economic and social differentiation between the regions was totally ignored;
- A lack of a program for consistent implementation of social benefits reform;
- The size of cash payment was inadequate to tariff value of subsidized services.
- A populist provision on 'non-deterioration of material conditions' left room for ambiguity, made the Law unworkable and blocked further targeting of social assistance at the regional level.

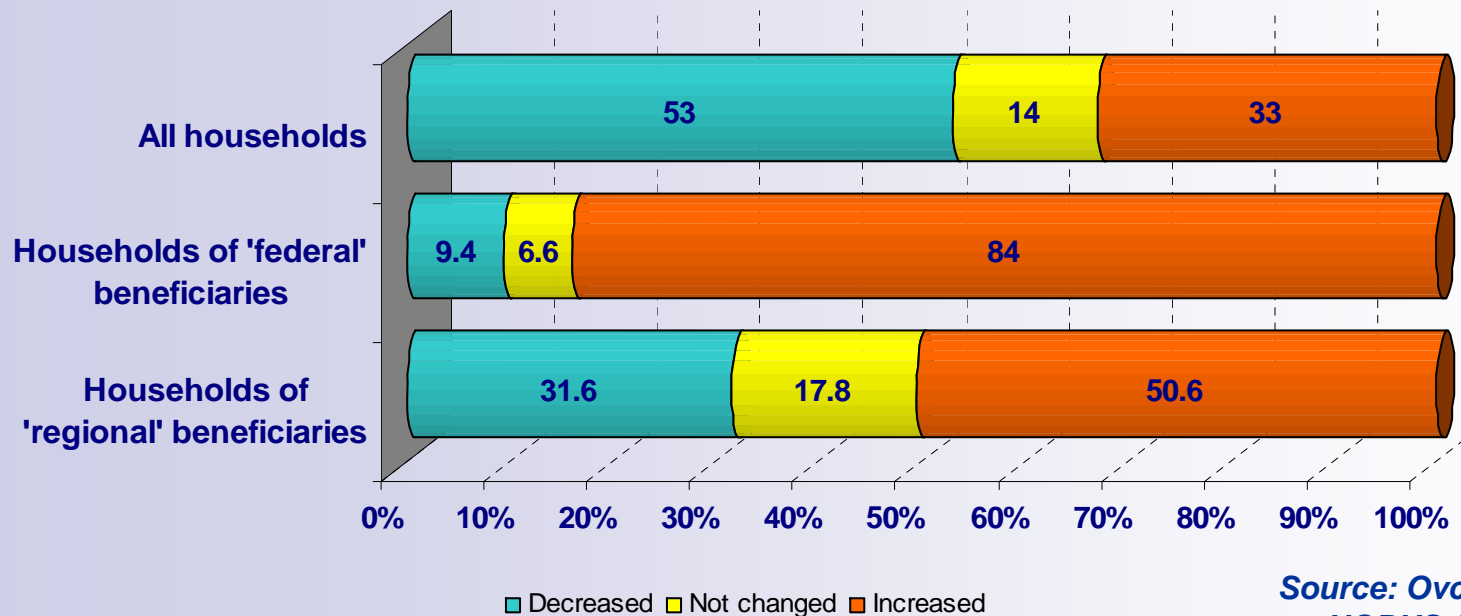
➔ Negative stimuli for regions and maximal burden for municipalities

## Implementation flaws

- **Shortage of time and lack of skilled personnel**
- **Insufficient information for political decisions making → Multiple mistakes in resource transfers**
  - ✓ Lack of a database on the number of beneficiaries (especially beneficiaries falling under more than one category)
  - ✓ Underestimation of social and political significance of social and political weight of various categories of beneficiaries
  - ✓ Underestimation of inter-regional disparities
  - ✓ Inadequate budget transfers to regional level
- **Lack of public information and feedback from population**
- **'Invalidization' phenomenon — a public response to situation of uncertainty**
- **Administrative problems due to transfer of functions to allocate and issue MCP to the Pension Fund**
- **Lack of methodological assistance from the Ministry of Labor**
- **Wrong timing for introduction of the reform (simultaneously with raising HCS and transport tariffs)**

# Simulation of monetization impact

Changes in the amount of disposable income after benefits' monetization (including raised transport and HCS tariffs)

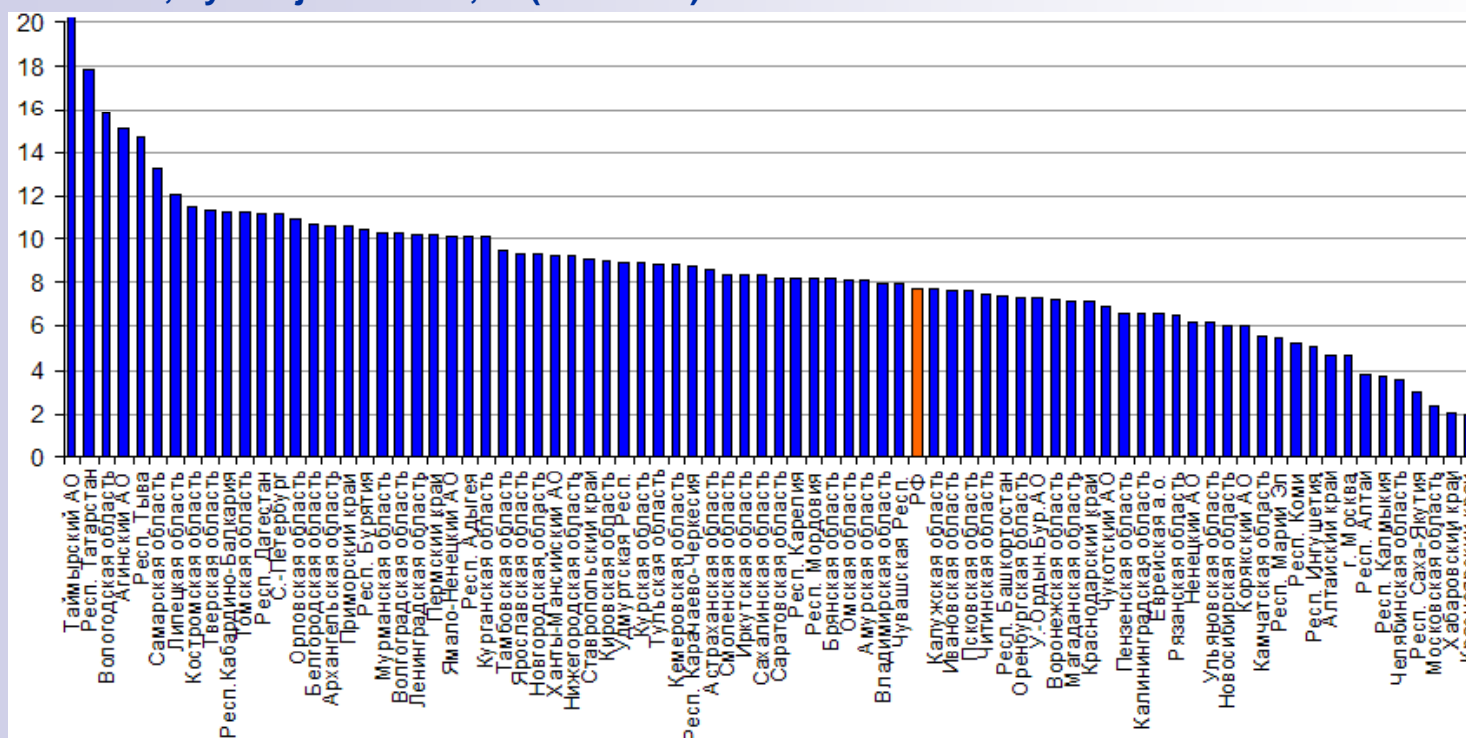


Source: Ovcharova (2005) based on NOBUS (2003)

- 'Regional' beneficiaries (with a total number twice the amount of 'federal' recipients) appeared to lose most as a result of monetization. Within this category, the proportion of losers was three times as high as that among 'federal' beneficiaries.
- The changes in well-being reflect both the effects of benefits monetization and those of raised tariffs for HCS (28%) and public transportation (13%) that coincided in time and hence in mass consciousness.

# Implementation at regional level (1)

Ratio of average monthly payment made to 'regional' beneficiaries to subsistence minimum, by subjects of RF, % (end 2006)



IISS data, <http://www.socpol.ru/atlas/overviews/household/index.shtml>

- An absolute majority of the regions kept HCS privileges in the in-kind form.
- More than two-thirds kept solid fuel provision in kind (e.g. wood for wood-burning stoves in rural areas).
- About half the regions retained in-kind dental services for all categories, and the privileges for medical drugs for the home-front veterans and victims of political repressions.
- A third of the regions did not transform or cancel the free provision of city and suburban transport for all categories of regional beneficiaries.

➔ Generally, size of payment bore no relation neither to the level of region's development, nor to its geographic position, nor to the number of beneficiaries

## Implementation at regional level (2)

- Inequality in household income between 'wealthy' and 'poor' regions increased, as the majority of relatively better off regions could afford to make larger cash payments to beneficiaries.
- Beneficiaries in Northern and Eastern regions faced deterioration of their living standards, as the size of compensation was poorly related to higher living costs.
- Inequality in regions' capacities to implement social policies increased, as 'poorer' regions had to bear excessive social liabilities.
- Instead of unification of social protection system and social benefits financing, a regional fragmentation of these systems emerged with a confused and varying list of payments.
- A diversion of funds from local budgets for regional MCPs severely reduced their abilities to develop targeted social assistance.



## Aims & intermediate results of the reform

Aims	Results
1. Reduction of number of privileges	Absolute majority of privileges retained
2. Streamlining and ensuring transparency of privileges structure	Structure made more complicated due to separation of beneficiaries into federal and regional categories
3. Bringing into correspondence government social liabilities with available economic resources	Aim achieved at federal level only. Imbalances still persist in regional budgets
4. Replacing in-kind privileges by cash compensations	During 2005-2006, the majority of in-kind privileges was retained in most regions
5. Alignment of income inequality between various categories of beneficiaries	Some re-distribution of real disposable resources occurred, inequality reduced somewhat, but is liable to grow over longer term



# HCS benefits and subsidies (1)

## Existing schemes of HCS social assistance

Type of social assistance	Assistance substance	Beneficiaries	Drawbacks
Subventions	Setting tariffs below economically viable levels with compensation of difference from municipal budgets	All households	Does not depend on beneficiary's income. Greater benefit is obtained by those having better housing conditions
Benefits (privileges)	Reduced payments for HCS	Several population categories (34%)	Does not depend on beneficiary's income
Subsidies	Reduced payments for HCS / Cash compensation	Low-income households (13%)	Low households' involvement

## HCS benefits and subsidies (2)

### Federal schemes used to calculate the size of HCS subsidies

1. In case average monthly of a household is equal to or exceeds the respective regional living minimum:

$$S = (R_s * n) - (M_s * I), \text{ where:}$$

$S$  - size of a subsidy, RUR;

$R_s$  - size of a regional HCS standard per capita for the respective household;

$n$  – number of household members;

$M_s$  - a regional standard of a maximum proportion of HCS expenditures in the aggregate income of a household;

$I$  – household average monthly income, RUR.

2. In case average monthly of a household is lower than the respective regional living minimum:

$$S = (R_s * n) - (M_s * I * K), \text{ where:}$$

$K$  – correction coefficient calculated according to the following formula:  $K = I_{AV} / SM$ , where:

$I_{AV}$  - household average monthly income per capita, RUR;

$LM$  – size of subsistence minimum for the beneficiary's family, RUR.

3. In case beneficiary has a right to HCS privileges, a regional HCS standard per capita for the respective household is multiplied by a coefficient calculated according to the following formula:

$$K_L = P_d / P_t, \text{ where:}$$

$K_L$  – coefficient

$P_d$  – amount of payment for HCS after a discount, RUR;

$P_t$  – amount of payment for HCS before a discount, RUR.

*Source: RF Government resolution No. 761 of December 14, 2005 "On the provision of subsidies for housing and communal services payments"*

4. If the benefit is provided in a monetized form, in some regions the coefficient is not applied, and the sum of a compensation is added to the total household income, thus increasing the size of a subsidy.

# Lessons to learn (1)

Russian benefits monetization experience suggests that a similar reform, in order to be successful, should address the following essential issues:

**(1) At the stage of developing the reform concept:**

- maximum possible integration into the overall concept of social safety net reform and adjustment to its main principles, providing cohesion and preventing social exclusion;
- to avoid a categorical principle of benefit assignment and rather concentrate on the most urgent needs of beneficiary groups. Benefits assigned according to professional status should be eliminated;
- to use every possibility to introduce targeting principle while transforming the vast nomenclature of in-kind benefits into the form of one (or a set of) cash benefit(s). Available resources should be to a maximum extent directed to those beneficiaries who are associated with households with maximum poverty risks;
- the size of an individual compensation should take into consideration regional living costs;
- HCS monetization should be closely connected with the system of targeted housing subsidies;
- clearly defined “zones” of responsibilities of different level executive bodies as well as transparency of financial obligations of respective budgets is absolutely necessary;
- decentralization in decision-taking rights is essential since it provides the best opportunities for targeting social assistance and thus a way to eradicate poverty and social exclusion;
- it is preferable to retain (or to modify only slightly) privileges for categories of elderly beneficiaries (war veterans, home front workers, etc.), the number of which is dwindling each year;
- categories of benefits that are more numerous and growing in number should be transformed into specific (or unified) cash benefit (s).

## Lessons to learn (2)

### (2) At the stage of reform design and drafting the appropriate legislation:

- a close coordination between the reform design and the provisional schemes of budgetary and tax adaptation reform would be of great value;
- discussing the reform scheme with regional stakeholders is essential with the aim to adjust the reform concept for capturing regional specifics;
- it is necessary to determine what categories of beneficiaries are really dependent on in-kind services and really need additional assistance, as well as what kind of services provided nowadays in an in-kind form are most important for households with beneficiaries;
- a detailed expertise (both at the country-wide and regional levels) of socio-economic consequences of various reform options is essential. It is important to have the idea what share of the total budget expenditures on the monetization reform would be targeted directly to the poor families;
- various reform options should be checked on resource availability. A thorough analysis of budgetary obligations and potential should be provided.

## Lessons to learn (3)

### (3) At the stage of implementation preparation:

- local authorities and agencies responsible for the reform at the local level should have at their disposal all necessary methodological recommendations, information and legislative acts provided by respective ministries and agencies; local personnel involved in reform implementation should be properly prepared and instructed;
- an appropriate means testing system should be designed and established;
- organization of a wide-scale public discussion and providing full information to population about the future reform and ongoing specific changes; organization of special consultation points in local social services, of hot telephone lines, etc.;
- initiating various forms of social dialog that could provide a feedback from population, civil society institutes, etc.;
- a thorough selection of timing for starting the reform.

### (4) At the implementation stage:

- Implementation monitoring including feedback from households that allow to eliminate the unexpected negative consequences and processes.



**THANK YOU FOR  
YOUR ATTENTION!**