

**The Middle Class in Four Russian Regions:
Government Policies and Behavioral Strategies¹**

Paper prepared for annual meeting of Association for Slavic, East European, and Eurasian
Studies
Los Angeles, CA
November 18 - 21, 2010

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DRAFT: Not for citation without permission of author

¹ We are grateful for the support of the National Council for Eurasian and East European Research, which underwrote much of the research reported here.

Introduction

This paper represents an initial report on findings for a study aimed at analyzing several key aspects of middle class development in the Russian regions (subjects of Federation – oblasts, krais, autonomous republics), namely:

- Federal and regional government programs to stimulate the growth of the middle class (content, tools of implementation, effectiveness);
- Behavioral strategies and economic behavior (consumption patterns, propensity to save, investment) of different sections of Russian middle class;
- Middle class value orientation and political preferences (including preferences for democracy).

Financial and time constraints made it impossible to conduct a fully representative survey of the population. Therefore we limited our study to four particular regions that could provide us with a rough qualitative picture of the problems the Russian middle class faces. We cannot claim that the patterns we uncovered in these regions are identical to those in all other regions, but we are reasonably confident that the same issues we identified also exist in other regions. The assessments reported here represent, for the most part, consensus judgments on the part of our respondents. Where there were differences in perceptions among groups of respondents and among regions, these are noted below.

The selection of regions for our study was made after consultations with the leading Russian experts on regional problems: Irina Busygina, Leonid Smirniagin, Nikolai Petrov, and Rostislav Turovsky. Their expertise and readiness to help us significantly aided us in choosing our case studies. The criteria we used in selecting regions were the following:

- A relatively high level of urban development (this excludes backward regions);
- Variation in the level of socio-economic development: region-donor versus region-recipient of federal financial assistance;

- Political orientation of the regional government: democratic versus authoritarian.²

Four regions were chosen on the basis of these criteria:

- Krasnoyarsk kray, Perm kray (two democratically oriented donor regions);
- Kirov oblast (a democratically oriented recipient region)
- Voronezh oblast (an authoritarian recipient region)

² For measuring the level of democracy / authoritarianism of this or that region's political style we used the appropriate rating of the Carnegie Foundation which we were kindly provided with by N. Petrov, head of the program "Society and Regional Policy" at the Moscow Carnegie Centre.

None of the authoritarian donor regions was included in the set of our study due to their “atypical” ethno-cultural or economic profiles: such regions are represented either by Muslim republics (Tatarstan and Bashkortostan) or by “oil-field” regions (e.g. Tyumenskaya oblast) where the problems of middle class formation are too specific to be analyzed in a project as limited as ours.

Collecting primary data was carried out with the help of expert interviews conducted in two waves. From 05 to 12 July 2010, we conducted field research in Kirov oblast and Perm' krai. From 23 to 29 August 2010, respondents were interviewed in Krasnoyarsk krai. From 27 September to 01 October 2010 respondents were interviewed in Voronezh oblast.

The four regions differ significantly in their social-economic characteristics: social inequality, level of democracy, economic structure, quantity of foreign-owned enterprises etc.

The economic structure of two regions – Krasnoyarsky and Permsky krai – is more “liberal.” They have glaring levels of social inequality (see ratio of earnings of top to bottom decline in the table below) and – at the same time - a high level of democracy. The regions possess large raw and mineral assets that account for a large share of their GRP.

In contrast, Voronezh and Kirov oblasts face the problem of a fast aging population and have to provide social support for their pensioners. The governments are burdened with heavy social responsibilities and a lack of natural resources. This explains the relatively high level of social income as a share of total income.

Table 1 provides an overview of the basic economic and social characteristics of the four selected regions.

Table 1: Descriptive statistics for the four selected regions:

	Voronezh	Kirov	Perm'	Krasnoyarsk
2006 population	2295	1427	2731	2894
urbanization 2005	0.627	0.716	0.749	0.756
ratio of earnings of top to bottom decile	8.83	10.97	10.97	14.36
Dependency ratio (number of persons employed in the economy for each pensioner, average for year)	1.45	1.71	1.82	1.9
pensioners per 1000 population, 2006	320.3	287.3	270.2	260.9
real wage 2006 (nominal wage as multiple of regional subsistence minimum)	2.399	2.27	2.66	3.356
unemployment rate, 2008	5.3	7.3	8.5	6.5
Petrov democracy score, 2000-2004	29	28	41	41
Petrov democracy score, 2005-2009	33	31	43	42
Petrov corruption index, 2005-2009	3	3	4	4

share of employment in state enterprises, 2006	18.4	17.5	16.1	21
share of employment in private enterprises, 2006	60.1	58.3	54.1	51.1
share of employment in forieign-owned enterprises, 2006	2.7	2.5	4.6	5.8
agriculture share in output 2005	10.4	17.4	3.9	5.1
mineral extraction share in output 2005	0.4	0.2	15.2	3.9
processing industry share of output 2005	21.5	21.3	28.2	47.1
human devel index 2004	0.755	0.737	0.76	0.779
decile ratio 2008	15.2	11.4	18	18.2
entrepreneurship as share of total income 2006	10.9	10.6	14.3	10.5
labor as share of total income 2006	35.1	45.3	31.6	52.6
social income as share of total income 2006	17.4	20	10.5	13
infant mortality per 1000 born alive 2009	7.8	6.6	8.5	10.3

Factors affecting the development of the middle class

Overview

The respondents' assessments of the conditions and tempo of middle class development did not differ much across regions despite the significant disparities in social, economic and political characteristics of the regions included in our research study. In other words, in this aspect our four regions are much more similar than different – at least at first glance.

This gives us an opportunity (once again as a rough approximation) to describe the current status of the middle class without needing to differentiate significantly across regions. Several general observations stand out.

First, there was no common agreement about the current condition of the middle class among any group of respondents. There were three primary categories of interviewees: representatives of regional governments; experts; and representatives of business associations.

The assessments of the regional authorities vary from positive (when they talk about decisions they made) to negative (when they talk about the actual size of the middle class).

The representatives of the business associations were much more unanimous in their view: the middle class exists but the conditions of its life are extremely complicated.

The variation in the assessments of the expert community is moderate. Most experts judge the current situation with respect to the state of the middle class as satisfactory (3 points out of 5), some of them as non-satisfactory and no one - as perfect.

The respondents often emphasize the low quality of government policies regarding middle class support. They explain this on the basis of the limited authority possessed by regional authorities vis-a-vis the federal government.

Second, the factors influencing the development of the middle class can be divided into two groups:

1. initiatives taken by the regional and federal governments aimed at developing the middle class;
2. the environment in which these initiatives operate.

The initiatives of the federal and regional governments

Policies aimed at development of small and medium-sized business [henceforth SMB]

A) Lawmaking

Legislative measures supporting SMB activity have been enacted by the federal government since the early 2000s. There are three principal sets of such measures:

1. Simplification of the taxation regime and system of accounting and reporting

In most cases these programs are far from being realized. (a) The rules of accounting and reporting change quite often and tend to become more complicated. (b) Civil servants have gained greater opportunity to extort money from SMB. (c) The situation is aggravated by the tax pressure from the federal government³.

The majority of the respondents say that the federal government policies are destroying SMB, creating a dilemma: either to go into the shadows, or to incur regular losses. The regional government lacks the power to offset the negative effects of federal pressure on SMB. One of the most important reasons to avoid reducing tax levels is that such a reform could undermine existing social support programs and thus to increase the social tension and provoke a social explosion. Moreover, among some representatives of the regional government there exists another viewpoint: that it is not necessary to help SMB, and moreover that it is even necessary to reduce the volume of the current support. They justify this position by the claim that today because of the growing concentration of production, the SMB sector is losing its economic and social importance.

³ This includes not only the direct taxation but the indirect taxes on the fuel, municipal rent rates and customs duties.

2. Preferential procedure for payment of rent for use of municipally-owned facilities by SMB

These measures are being implemented partially because some of them are in the competence of regional government. This allows businesses to lobby for their interests, including an appropriate level of municipal property rent.

3. Simplification of procedures for SMB participation in government procurement ⁴

Our respondents saw no positive dynamics in this area because of the predominance of corrupt and informal practices.

4. Legal and financial support to SMB and establishment of a supporting infrastructure (agencies encouraging new business activity).

This bloc of supporting measures appears to be the most effective one. The infrastructure is represented by the government owned organizations (municipal centers of business support, job centers, business associations etc.) and includes the following types of support:

- Small subsidies and microloans for enterprise reconstruction.
- Assistance in dealing with regulatory agencies.
- Free-of-charge consultations.

Obstacles to the effectiveness of such measures include the lack of high quality staff and latent resistance on the part of bureaucrats.

B) Banking regulation

This problem is one of the most serious for SMB according to the respondents. On the federal level there are no special banks for small business and no federal regulation of the preferential credit-granting activity. Some civil servants suggest that this problem could be solved by government subsidies of loan rates. But other respondents say that such measures would not significantly influence the situation.

C) Large-scale investment projects in the region

The respondents noted that federal government tries to support SMB with large-scale investment projects aimed at improving the regional economic situation, upgrading regional infrastructure and thus broadening the sphere of small business activity.

However according to our respondents, such projects can not solve the problem because big business typically gain control of these projects and use them for their own interests in opposition to the interests of SMB.

⁴ Under the Federal Law of July 21, 2005 № 94-FZ "About placing orders for goods, works and services for state and municipal needs"

Regional authorities versus SMB: reciprocal grievances

A) Business grievances

- Regional government's support of SMB is incomplete and inefficient.
- Regional government often distorts business' initiatives and make them senseless.
- Good decisions made at the top of bureaucratic hierarchy are often distorted by lower echelons.

- Regional government does not guarantee equality before the law in the field of taxation.

- Incompetence of regional civil servants.

- Low level of institutionalization of interaction between government and business makes "the personal factor" the chief precondition of success in programs of support of small and medium business.

- Regional government is dependent on the federal center and therefore cannot solve many of the most important problems: realizing programs of development of territories, counteracting the rise in prices for electric power and fuel, and so on;

- Regional authorities do not explain (or do so poorly) to SMB what their place is in the economic strategy of the region;

- Regional and municipal authorities often without justification raise the rent for facilities used by small and medium business.

B) Grievances on the part of the authorities towards business

- Representatives of government often spoke about the a priori mistrust towards government on the part of business, about the widespread conviction that "direct financial support goes to a very narrow circle of entrepreneurs," that "it is complicated for us to acquire support, that only a certain list of recipients get it."

- According to government representatives, this mistrust is one of the main reasons for the unwillingness of many entrepreneurs (especially in villages) to turn to the state for help.

- Another grievance is the injustice of complaints by entrepreneurs at the excessively complicated nature of the documents that are demanded in order to receive state aid, and the absence of information about the forms of state aid to business.

- The representatives of the authorities tend to explain these complaints by the low level of education of entrepreneurs (particularly of legal education).

- Finally, among the obstacles to cooperation between the authorities and business the representatives of the authorities noted the excessive--as they see it--secretiveness of the entrepreneurs.

Measures to develop the "new" middle class (ie white-collar employees in the budget sector)

Neither the federal government nor regional authorities at present have special strategies, nor are they developing any, aimed specifically at building the new middle class. However, several aspects of social policy of the federal and regional governments towards employees of the budget sector could be considered indirect measures to stimulate its development. Among these measures our respondents noted the following initiatives:

Auctions held in several regions to obtain budget subsidies by state educational institutions, preparing employees of high-technology production. Here the subsidies are going predominantly toward the most advanced higher educational establishments and colleges.

The federal program beginning as of the end of 2009 for providing credits to employees of the budget sector. The goal of the program is to provide preferential conditions of credit for teachers, doctors, military officers, customs officers, police and other employees of the budget sector.

A change in the mechanism for paying salaries in the budget sector.

Several respondents noted that these measures have led to a sharp differentiation in the incomes of doctors, teachers, and university instructors.

The implementation in several regions of programs of support for families with middle incomes in order to provide them with an opportunity to send their children not to state but to private, high-quality kindergartens or to hire for the child a private care-taker.

These may be regarded as measures to develop human capital.

As to the idea of the federal government to create "intellectual mega-projects," the respondents in our study were skeptical about the ability of such projects to help form a "new middle class."

Environmental factors that affect the content and effects of state initiatives to develop the middle class

Among these factors are the structure of the power elite in the regions, corruption, the structure of the regional economy, the business associations of the traditional middle class, and the political representation of the middle class

A) The structure of the power elite in the regions

With respect to its relations with the "traditional" middle class, the power elite in the regions we studied can be readily divided into two groups with rather clearly opposed interests:

- A group oriented primarily toward support of the existing large natural resource and commercial sector, which, according to our respondents, currently is fully controlled by "Muscovites" and acts, above all, in the interests of the federal elite;
- A group representing the interests of regional small and medium business.

The clash of interests between these groups arises over issues such as the distribution of budget resources at the region's disposal (whether of regional or federal origin); tax policy; the creation in the regional economy of a competitive arena, favorable for the development of small and medium business; corruption; etc.

The group supporting big business

In this group are: leadership of the regional branches of large natural resource and trading companies, which understandably have close ties with the political elite at the federal level; governors (in the cases of Perm' and Krasnoyarsk krajs); several prominent figures in the regional legislative assemblies (in all four regions).

According to the respondents, this group has well-established channels of influence on decision-making at the regional level and is relatively independent from public opinion at the regional level. This circumstance makes it relatively free in using corrupt practices to obtain beneficial political and economic decisions at the regional level.

With respect to conflicts of interest between big business and the traditional middle class (ie small and medium business), the respondents predominantly called attention to the following circumstances that weaken small and medium business: restricted competition and the collusion between big business and the authorities; and the withdrawal of resources of big corporations out of the regions and to Moscow.

As to the influence of big business on the "new" middle class (ie white collar employees), the respondents tended to see that influence as favorable.

The group supporting small and medium business

This group is represented mainly by small and medium business people and by highly-educated specialists holding positions in executive bodies of the regional government or influential in business associations. A distinguishing trait of officials

belonging to this group is their direct responsibility for developing SMB in the region to the federal government.

According to our respondents, the political influence of the group of support of small and medium business in these regions is clearly weaker than that of the group oriented toward big business. The respondents noted that they are free to adopt decisions only in spheres that are not of interest for big business and for large natural resource companies. In all other cases the enforcement of decisions benefiting small and medium business encounters serious difficulties.

However, the influence of this group varies across regions. According to the respondents this is determined above all by the level of dependence of the regional authorities on the federal government, which, in turn, is determined by whether the region is a donor or a recipient of federal resources.

Therefore, all else being equal, this group is weaker in recipient-regions than in donor-regions. However, both groups of elites have some common points of view. One is the desire to reduce the volume of federal and regional powers, and to give the municipalities more resources and rights. Small and medium business supports contacts with both groups of the power elite. Moreover, according to the respondents, entrepreneurs employed in the service sector or production that does not require extensive equipment--ie those whom many of our respondents termed 'torgashi' [peddlers] --are oriented mainly toward the group representing big business.

These representatives of the small and medium business sector do not seek any political influence and prefer to adapt themselves to the high taxes with the aid of shadow practices for paying wages and for corrupt relations with officials (both proposing such arrangements and responding to them).

But entrepreneurs engaged in more complex production, including innovation, and who need to attract rather considerable investment and protection of their rights, they, according to our respondents, face a fundamental choice: to move into the "shadows" and form corrupt relations with representatives of the elite group of big business, or else to operate legally, and depend on various forms of support on the part of the elite group that defends the interests of the middle class. The latter option is considered to be much more difficult, and likely to lead to a number of serious economic and legal problems.

B) Corruption

Corruption was generally the most sensitive theme among those discussed in our interviews. The ineffectiveness of corrupt bodies of the regional authorities, their

economic and managerial weakness, were noted by all representatives of the business associations and all regional experts.

C) The Structure of the regional economy

According to our respondents, those regions with more balanced infrastructure, with a larger number of medium-sized cities and a differentiated economy, that have both extractive and processing industries, and high-technology centers, are more favorable for the development of the small and business sector of the middle class. By contrast, a factor restricting the development of small and medium business is the presence of mono-cities [factory towns] and very large, concentrated enterprises.

D) Business associations of the middle class⁵

Representatives of the regional authorities tended to give us varied evaluations of the activity of business associations, ranging from "very active" to "active, but insufficient." Blame for the relative passivity of the associations was attributed to business. For their part, representatives of the business associations expressed dissatisfaction about the attitude toward them by the authorities. Independent experts tended to see business associations of small and medium business as weak and ineffective. This was explained by the diversity and political passivity of the SMB sector, the lack of financial resources on the part of their organizations, the socially alien nature of their leaderships, and finally, the inability of the regional authorities to conduct a constructive dialogue with business as a result of their dependence on federal structures.

Behavioral strategies of the middle class

There are two main behavioral strategies on the part of the middle class: integration and flight. Integration refers to adaptation to the existing economic, social and political conditions, accepting the 'rules of the game' set by the dominant elite groups. The strategy of flight refers to departure from the given region, either abroad or to Moscow or St. Petersburg first, and then to go abroad.

Integration is more characteristic of representatives of large companies and government bodies, as well as a significant part of the representatives of small and medium business working in the commercial sector.

Flight is more characteristic of those representatives of the SMB sector who are engaged in production as well as highly-skilled specialists who are not working in big companies or government bodies (such as self-employed lawyers, free-lancers, and so on). The problem of emigration has been acute since the early 1990s. But, judging from our

⁵ Currently Russia has about 10 all-Russian business associations and several hundred funds and associations for support of entrepreneurship in the regions.

interviews, currently this problem has become particularly serious. It is taking place not as a response to economic crisis (such as 1989-94 or 1998), but under conditions of relative economic and political stability. The crisis of 2008 almost did not affect the scale of emigration out of the regions of our study. Those who are emigrating are not those who created businesses in the 1990s (people older than 45, with poor knowledge of foreign languages and close ties in the region), but the generation of their children--young people with higher education from well-off families. People are leaving the country not due to political reasons, but because of the impossibility of freely doing business or to realize their professional interests without special connections and *blat*.

The respondents noted that for representatives of the creative professions who are connected to public activity (media work, analysis, journalism), the market is very limited. Salaries are not high and there are considerable political risks. The only region where the squeezing out of the cultural stratum was considered to be less of a problem was Voronezh oblast'. There are probably several reasons for this, but the proximity of the region to Europe may play a particular role.⁶

These behavioral strategies, in the long run, tend to weaken the demand for democracy among the middle class. It is the democratically oriented representatives of the middle class who prefer to emigrate, or at least leave the region for the center. Those middle class groups remaining in the country do not feel a need for a democratic regime. Their social and material situation is much better ensured by stability based on the absence of economic and political competition. Meantime the dissatisfaction among the middle class is expressed above all in the growth of political apathy, rising to the level of a political ideology. The actions of protest that occur from time to time are not of mass character and do not have a political character as much as a social-economic character.

It is difficult to say whether the political orientations we have identified are stable over the long term, or in what direction they are moving or will evolve. We hope to provide a more detailed answer to this question in the next stage of the research.

⁶ Rosstat figures indicate that the bulk of emigration from Russia is to the West. See http://www.gks.ru/wps/portal/OSI_N/DEM#