

**Irina Sinitsina**



**Experience  
in implementing social benefits  
monetization reform  
in Russia**

**Prepared for the project:  
Preparation of the strategy for  
social benefits monetization reform in Ukraine**



The Project is co-financed by the Polish aid programme 2008 of the Ministry of Foreign Affairs of the Republic of Poland.



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The publication expresses exclusively the views  
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# **1. Aims and motives of monetization reforms in Russia**

## **1.1 Benefit system in Russia: unclear functions and reform urgency**

By the end of 2004, the system of in-kind benefits in Russia developed into a vast and complicated heterogeneous scheme that encompassed an almost unchanged legacy of the Soviet system social sector as well as numerous new benefits assigned in the course of transition. The latter were the result of extraordinary and mostly non-systematic legislation activities of different levels of public administration aimed at maintaining the living standards of the majority of households against the background of falling real wages and pensions. Throughout the 1990s, decisions to introduce new privileges were often taken at the federal level but the budgets of regions or localities were required to fund them. Both federal and regional authorities have passed a multitude of legislative acts that envisaged various benefits/privileges for several categories of citizens with regard to supply of medicines, transportation, housing, public utilities and other services.

The system of in-kind assistance had evolved to provide benefits to three distinct classes of beneficiaries: (a) the 'deserving disadvantaged', that is, those who mostly, through no fault of their own, would suffer impoverishment in the absence of assistance (e.g. orphans, the disabled and the elderly without pensions); (b) those who had rendered special service to their country (e.g. labor heroes, veterans of the Second World War and other conflicts, and those who worked in particularly hazardous professions or demanding locations, such as first responders at Chernobyl); and (c) those providing current services to the state, where benefits provided a hidden salary supplement (e.g. members of the military, the security services and judges). The system entailed dozens of benefits and dozens of groups with an extremely large set of combinations of privileges and beneficiary categories.<sup>1</sup>

Federal legislation has established over 150 kinds of social privileges, allowances, benefits and subsidies that encompassed over 230 various categories of citizens. In fact, however, the majority of these turned into Federal government claims addressed to regional/municipal authorities, but not supported by adequate financing ('non-financed Federal expenditure mandates'). Local budget means were scarce, a substantial part of privileges was not financed at all, with the resulting growth of the budget system's creditor indebtedness to enterprises. Three Federal laws – 'On veterans', 'On the social protection of disabled in the Russian Federation', and 'On social services rendered to elderly and disabled persons' – accounted for the most part of regional budgets' expenses on financing the Federal social laws mandates.<sup>2</sup>

In the beginning of the 2000s, the Federal center has eventually acknowledged that the budget simply does not have the means to finance all the benefits guaranteed by the federal legislation. According to the estimates made by the Ministry of labor and by independent experts, in order to implement all social support provisions the consolidated budget of the Russian Federation in 2001 would have to be increased twice.<sup>3</sup>

Thus, there emerged an urgent issue of readjusting the system of existing privileges and benefits, of reducing their number, eliminating non-financed expenditure mandates, clarifying social obligations of the state (both at federal and regional levels). The necessity of resolving these problems gave a major impetus to the beginning of reforms.

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<sup>1</sup> Alexandrova A., Struyk R. Reform of in-kind benefits in Russia: high cost for small gain. - Journal of European Social Policy, 2007, Vol. 17. No. 2, pp. 153-166, [http://www.urbanecomics.ru/publications.php?folder\\_id=132&mat\\_id=864](http://www.urbanecomics.ru/publications.php?folder_id=132&mat_id=864).

<sup>2</sup> Голованова Н., Курляндская Г. Еще раз о льготах. - Spero, 2005, № 3. (<http://spero.socpol.ru>)

<sup>3</sup> Ibid.

## 1.2 *The scale of the problem*

To assess the scale of the problem of reforming a manifold system of privileges and a multitude of non-financed government obligations, it was vitally important to organize a system of privileged persons' registration. Still, despite the magnitude of the benefits system in Russia, a unified system for recordkeeping of persons entitled to benefits was lacking. The system of monitoring the programs of in-kind social assistance was based on departmental statistics kept by organizations and agencies that provided services within the framework of the social benefits system. The authorities started to urgently construct registers of persons eligible to privileges and benefits only in the course of preparing the monetization reform, but these registers are still lacking in many regions, which causes many problems (particularly with municipal and suburban transport benefits). This factor became one of the major bottlenecks in preparation of the reform and prevented a detailed analysis of its social, financial and other consequences.

To cite one example, during the parliamentary hearings on social aspects of the already adopted FZ-122 Federal Law held on November 11, 2004 (less than two months before this law came into force!), much had been said about the inconsistency of data concerning the number of future beneficiaries as well as about inadequate financing envisaged for monetization of various kinds of benefits. It was demonstrated that registering activities (performed by the Pension Fund) were in fact only half completed. In fact, lacking were the exact figures even on beneficiaries assigned to direct federal responsibilities: official estimates of the number of persons entitled to privileges ranged from 12 to 19 mln people (8 to 13 percent of the total population)<sup>4</sup>. The number of households with beneficiaries was estimated at 40 percent of the total, whereas experts assessments far exceeded that estimation.<sup>5</sup> Later, at the end of 2006, the Pension Fund register revealed that the number of beneficiaries (receiving cash benefits) amounted to 16.8 mln ('federal') and 11.1 mln ('regional'), i.e. 12 and 8 per cent of the population respectively<sup>6</sup>.

To make up for the shortage of information on the number of persons eligible to benefits, as well as on the coverage of specific benefits, the 2003 National Survey of Household Welfare and Program Participation (NOBUS) could be of value.<sup>7</sup> According to the estimates based on NOBUS data, 27.2 percent of respondents have claimed their rights to various privileges. The most numerous group of persons with rights to privileges was the one of "labor veterans" accounting for 15 percent of the whole population, or 34 percent of persons aged 40 and over.<sup>8</sup> The use of NOBUS data also allowed to estimate the amount of non-financed mandates for specific population categories (i.e. when the right for a privilege existed, but it was not possible to obtain this benefit in a given locality). It turned out, for example, that almost a third of labor veterans have not made use of such privileges (applied to them in accordance with legislation) to a full extent, while in large cities this figure amounted to 40 percent. Similarly, a limited access to benefits was also characteristic for such population categories as disabled persons (invalids of 1<sup>st</sup> and 2<sup>nd</sup>

<sup>4</sup> Готова ли страна к монетизации льгот? - РФ Сегодня, N 23, 2004 ([http://www.russia-today.ru/2004/no\\_23/23\\_Duma\\_2.htm](http://www.russia-today.ru/2004/no_23/23_Duma_2.htm))

<sup>5</sup> Овчарова Л.Н. «Реформы в секторе социальной поддержки населения», в: Обзор социальной политики в России. Начало 2000-х годов. - М., НИСП, 2007, с. 334.

<sup>6</sup> ИСП, <http://atlas.socpol.ru/overviews/household/index.shtml>.

<sup>7</sup> The 2003 National Survey of Household Welfare and Program Participation (NOBUS) [Национальное обследование благосостояния и участия населения в социальных программах, НОБУС] was conducted by Rosstat in 2003 with the financial support of the World Bank; the Survey data were subsequently actualized to the 2007 incomes. The sample coverage included 44 529 households (117209 respondents) from 79 regions of Russia which ensured representative assessments at national, regional and local levels. According to the estimates of Independent Institute of Social Policy (NISIP), 43 regions had a sample size over 800 households which allowed to obtain representative indicators of demographic and social poverty profiles. The Russian expert community widely used the results of this survey for forecasting the results of the monetization reform, as well as for the assessment of the social processes in the country in general (<http://go.worldbank.org/VWPUL3S9F0>).

<sup>8</sup> Овчарова Л., Пишняк А. Социальные льготы: что получилось в результате монетизации? – Spero, 2005, № 3 (<http://spero.socpol.ru>).

groups), persons affected by radiation as well as for those having rights to ‘professional’ privileges.<sup>9</sup>

Still, a more complete understanding of the scale of social benefits prevalence could be obtained by measuring the number of households that include members enjoying rights to privileges. According to NOBUS data, 50.7 percent of households include members that are entitled to various privileges, while almost a third of the latter group belongs simultaneously to two or more categories of beneficiaries. The benefits encompassed payments for medicines and health services, transportation, housing, utilities and communal services, education, health resort vouchers, as well as for food, housing purchase and repair, etc. Of all these, the most prevalent were housing, utilities and communal services benefits (over 40 percent of households that included members entitled to privileges, benefits, and social services), transportation benefits (over 38 percent of households), and benefits for health services and medicines (about 20 percent).

### **1.3 Financial burden: non-financed mandates**

The first necessary steps of the reform of in-kind privileges had to be focused on the volume and transparency of public expenditures. Given the problems with beneficiaries’ registration, the system of in-kind privileges apportionment has not allowed to estimate more or less accurately the required amount of financing. Moreover, a widespread coverage by various types of benefits could not but cause a permanent scarcity of available finance. Although the exact figures of budget appropriations for benefits financing were not available, it is obvious that the existing (at the time) system of benefits was seriously flawed in the sense of its substantial under-financing. According to the information supplied by the Russian Parliamentarism Development Fund, the federal law “On Veterans” was under-financed by 88.6 percent in its federal part, and by 62.5 percent in its regional component. In 2003, the budget appropriations for financing obligations under this law amounted to RUR 55 bn, but this sum did not cover even a half of the necessary expenses, while the required volume of financing was estimated at RUR 189 bn. According to other rough estimates, the total (potential) cost of benefits amounted in reality to over RUR 500 bn.<sup>10</sup> The World Bank estimated the overall burden of privileges at 4.2 percent of GDP in 2002 compared to targeted social assistance programmes that accounted for 0.4 percent, and an estimated 70 percent of the population, *de jure*, enjoyed one or more of these.<sup>11</sup> As a result, a large proportion of citizens were deprived of access to benefits to which they were entitled by law.

### **1.4 Social rationales for reform**

A serious deficiency of the benefits system that prompted experts to speak of the necessity of the reform was low social effectiveness of budget expenditures on social privileges and benefits both at federal and regional levels. This low effectiveness was primarily a result of a very *poor targeting* of benefits and a high level of inter-regional disparities in budget financing. This, combined with a relatively high poverty level in Russia and extreme inequalities in incomes and consumption, has drawn a widespread public attention<sup>12</sup>. The major reason for poor targeting was the fact

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<sup>9</sup> Овчарова Л., Пишняк А. Ibid. 2005 .

<sup>10</sup> Н. Волчкова, Е. Горшкова, С. Лобанов, А. Макрушин, Н. Турдыева, Ю. Халеева. «Оценка последствий реформирования системы социальных гарантий: монетизация льгот и реформа ЖКХ». Серия «Аналитические Разработки и отчеты», № 25. М.:Центр экономических и финансовых исследований и разработок (ЦЭФИР), 2006 г. <http://www.cefir.ru/download.php?id=469>

<sup>11</sup> Alexandrova A. & Struyk R., 2007, op. cit.

<sup>12</sup> With household incomes increasing steadily, a noticeable reduction of poverty level in Russia has been observed since 2000. The proportion of people with monetary incomes below subsistence level decreased down to 21.5 mln in 2007 (15.2% of the total population) as compared to 25.2 mln people (17.7%) in 2005 and 42.3 mln (29.0%) in 2000. The poverty level and the level of income-measured inequality in Russia are significantly higher than in the

that in-kind privileges were, as a rule, distributed according to categorical principle, without regard to real needs of a beneficiary and his/her family and without means testing. Among non-poor families, persons eligible to benefits are represented broader than among poor ones. Hence, from the viewpoint of participation, the poor did not constitute a priority group for the state social programs of subsidies and in-kind privileges.<sup>13</sup>

As highlighted in the World Bank Poverty Assessment of 2005, the current social assistance system in Russia is highly regressive compared to most other middle income countries in that the actual poor receive a small share of social benefits by international standards. A primary reason for this is the fact that 90% of social assistance spending in Russia is not targeted directly at the poor, but at various groups of the population regardless of income level (pensioners, war veterans, invalids, etc.). Only 8% of this spending reaches the poorest 20% of the population. At the same time, Russia has been developing targeted (income-tested) social assistance in three areas: child allowances, housing and utility allowances, and regional programs for the poor.<sup>14</sup> According to Independent Institute for Social Policy (hereinafter - IISP)<sup>15</sup> experts' estimates based on NOBUS data, households with an income per family member below a subsistence minimum accounted for only 25.3 percent of the total amount of social benefits, subsidies and privileges; for households with an income between one and two subsistence minima per family member the corresponding figure was 26.7 percent, while more well-off households, with per capita income exceeding two subsistence minima, accounted for 48 percent of the total state social support expenditures.

**Table 1. Prevalence of benefits among poor and non-poor families, percent of poor and non-poor households**

<b>Types of benefits</b>	<b>Poor households</b>	<b>Non-poor households</b>
Benefits for housing, communal services and utilities	28, 2	49,5
Benefits for health services and medicines	11,7	21,3
Benefits for transportation	24,2	47,5

Source: Ovcharova & Pishnyak (2005) based on NOBUS data (2003)

Inadequate targeting of the privileges system towards the poor was in fact rooted in the system design. For instance, under the free provision of energy benefits, the more appliances a household possesses and the more lights it runs, the greater the benefits coming from greater electricity consumption. Similarly, better-off households have greater benefit from housing privileges. Transport benefits are regressive in a different manner, since by default they exclude the people who are not able to use transport because they either live in rural areas not served by public transport, or have physical (health) constraints which prevent them from traveling. The poor suffer disproportionately from the low quality of services, because, unlike wealthier groups of the population, they often cannot afford private services, while public services are of low quality. As for in-kind privileges, clients did not have a choice either from the provider or from the goods and services themselves.<sup>16</sup>

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developed economies and the Central European countries. Household budget surveys held by Rosstat showed that the year of 2007 saw an acceleration of growth in the income inequality: income concentration index (measured through Gini coefficient) soared up to 0.422 vs. 0.409 reported in 2002–06 (Russian Economy in 2007. In: Trends and Outlooks, No. 29. M.: IET, 2007).

<sup>13</sup> Овчарова Л., Пишняк А. *op. cit.*, 2005.

<sup>14</sup> The World Bank in Russia: Economic Review. Russian Economic Report #14, June 2007. <http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/ECAEXT/RUSSIANFEDERATIONEXTN/0,,contntMDK:20888536~menuPK:2445695~pagePK:1497618~piPK:217854~theSitePK:305600,00.html#14>

<sup>15</sup> Independent Institute for Social Policy - Независимый институт социальной политики (НИСП), an independent research agency in Moscow, <http://www.socpol.ru/>.

<sup>16</sup> Alexandrova A. & Struyk R., 2007, *op. cit.*

Thus, the two major social rationales of the pending reform of in-kind privileges were: to improve targeting of the poor, and to achieve a wider freedom of consumer choice through more assistance from payments made in cash rather than in kind.

An additional serious disproportion that was socially significant and pushed towards the reform was the deepening of inter-regional differentials in the scope of social protection and the amounts of benefits provided. Poorer areas were, as a rule, the least able to meet public liabilities with their budget resources.

### **1.5 *Economic rationales of the reform***

A powerful impetus to the reform was provided by an extreme inefficiency of enterprises and whole sectors of the economy that rendered in-kind services to population. The existence of various kinds of privileges that encompassed virtually a half of the country population significantly distorted financial balances of several economic sectors – transportation, housing and utilities, etc. This fact hindered the reforms and further development both of these sectors and, to some extent, the economy as a whole.

Unfunded mandates were still delivered by service providers, such as housing, transport companies and clinics. Several programs were not financed at all, while for several others the proportion of financed services did not exceed 50 percent (transport services and medicines). As a result, several subsidized goods and services were in short supply (e.g. medicines or health resort vouchers), while for those benefits that were characterized by a gap between consumption and payment schemes (transport privileges, housing and utilities benefits), regional/local budgets' arrears to service providers started to accumulate. Consequently, many persons entitled to privileges were prevented from using them, and inequality in access to benefits has increased. In turn, the urban infrastructure sector became under-financed, and its crisis aggravated. Besides, under this system it was impossible to calculate the prime cost of subsidized services rendered by service providers. The fiscal gap translated into lost revenue for these providers, creating additional burdens for regional and local economies, thereby preventing effective enterprises from restructuring.

Apart from money shortages to finance an overstated volume of in-kind services, the non-transparency of a mechanism for remuneration of the providers' expenses by the state became an important obstacle for service providers; quite often, the providers were induced to recur to corruption schemes. The enterprises that provided in-kind services (namely, utilities and transport companies) issued invoices to local/regional authorities in order to cover a loss. These invoices, however, were frequently paid by budgets of various levels only on condition of payoffs to specific bureaucrats that made decisions concerning payments. Quite often these invoices were not paid at all, especially when budgets faced credit indebtedness. A transition to cash settlements between consumers and service providers became a vital necessity.

Thus, the driving force behind the reform of privileges was the excess burden of unaffordable social mandates which were non-transparent, and a failure to target public resources to the poor. Transformation of in-kind privileges into cash benefits ('monetization') was supposed to increase transparency of the expenditures, to give beneficiaries freedom of choice, and to simplify administration. As for affordability, to achieve this goal, monetization needs to be complemented by a stronger targeting of the benefits to the low-income population, and a corresponding reduction of those in beneficiary categories. Not all these goals were achieved, as will be described.



## **2. Expected outcomes of the reform**

### **2.1 What kind of a social protection reform was required?**

In the early 2000s, the Russian expert community was well aware of the urgent need to reform the social protection system, particularly along the lines of enhancing its effectiveness and targeting towards the poor. Generally speaking, the introduction of new social instruments was supposed to contribute to:

- increasing the transparency of government social expenditures and eliminating quasi-governmental expenditures;
- eliminating non-financed social mandates and bringing the remaining state social obligations in accordance with the factual budget capacities;
- well-defined delimitation of authority between budgets of various levels;
- elimination (or at least drastic reduction) of the amount of regressive (non-targeted) privileges by conducting their monetization (transformation of in-kind privileges into cash benefits) that would not fully compensate for the losses from benefits abolition for non-poor;
- development and introduction of a new system of benefits for the really needy, the majority of whom were not covered by in-kind privileges;
- intensification of market reforms in the social infrastructure sectors – housing and utilities, municipal transport, health services and medicine supply, etc.;
- linkage between the social assistance system reform and the reform of the pension system, so that social compensations would cease to play a role of formal extra payments to the initially low pensions;
- elimination of economically and socially unfounded limitations on the freedom of consumer choice.

The monetization of the benefits system was supposed to become the first stage of a comprehensive reform of the system of social support in Russia. The priority goals of the current stage of reform that reflected its general concept were the following:

- 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.

### **2.2 What were de facto main reform initiatives?**

The reform notionally started on 22 August, 2004, when President Putin signed the law No. 122-FZ, uniformly referred to as 'The Law on Monetization'<sup>17</sup>. According to this law, the new system

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<sup>17</sup> Federal law No. 122-FZ of August 22, 2004, “On amendments to legislative acts of the Russian Federation and invalidation of certain legislative acts of the Russian Federation in relation to the adoption of federal laws ‘On amendments to the federal law ‘On the general principles of organization of legislative (representative) and executive authorities of RF subjects’ and ‘On the general principles of organization of local government in the Russian Federation’”.

of privileges had to be defined and come into force by 1 January 2005. In brief, the law initiated the following changes:<sup>18</sup>:

- Delineated federal and regional budgets' powers for financing social protection mandates;
- 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;
- Placed the responsibility for cashing-out regional social protection mandates and for balancing revenue opportunities with new expenditure powers on regional and local authorities.

The above list of issues regulated by this law amply demonstrates the limitations of its sphere of action. The law in fact does not address monetization *per se*; rather it focuses on delineating a large set of financial responsibilities (not only in the social protection area) between the federal government and the regions (see Annex 1). According to this delineation, measures of social support for the beneficiaries of several large groups of in-kind privileges, such as labor veterans or former victims of political repressions, must be re-determined and subsequently financed entirely by the regions. Responsibilities for certain groups of privilege beneficiaries (e.g. people with disabilities or Second World War veterans) are determined by the law to be federal responsibilities (see Annex 2). The law details the changes for them, such as the introduction of cash payments (the so called "monthly cash payment"; MCP), the removal of certain privileges, and the introduction of the so-called social package, which hardly differs from in-kind privileges.<sup>19</sup>

The social package complements MCP and includes:

- additional free of charge health services (medicines provision, health resort vouchers);
- free travel by suburban rail transport, as well by intercity transport to "the place of medical treatment".

A cash value of the social package was RUR 450, of which RUR 400 were meant for health services and RUR 50 were supposed to cover transportation to "the place of medical treatment". In 2005, this sum was subtracted from the total of MCP and privileges were offered to all beneficiaries in kind form only. From 2006, 'federal' beneficiaries were free to choose whether to get them in monetized form or to stay in in-kind service sector.

Thus, the majority of the categories remained untouched, and in addition these categories are now split by sources of funding into 'federal' and 'regional' subgroups. The number of beneficiaries has not reduced significantly. Only some narrow categories were excluded. For instance, prior to 2005, housing privileges covered not only the categories defined by legislation, but in some cases their family members as well, although local authorities were free to define specific groups of families covered by these benefits. After 2004 many groups of beneficiaries were deprived of the "extension" of their in-kind benefit on members of their households and the housing privilege was now provided only to the beneficiary (within the limits of the local social standards). Students studying in the regions of the far North lost their annual right to one-off free transport to 'the place of medical treatment'. Free transport was abolished for policemen.<sup>20</sup>

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<sup>18</sup> Выступление генерального директора Центра фискальной политики Г.В. Курляндской на Третьей ежегодной научной конференции Независимого института социальной политики (февраль 2005 г.), <http://www.socpol.ru/news/conf2005.shtml>.

<sup>19</sup> Alexandrova A. & Struyk R., 2007, op. cit.

<sup>20</sup> Alexandrova A. & Struyk R., 2007, op. cit.

Neither the authors of the draft law nor the Ministry of health and social development produced reasonable arguments in support of splitting all beneficiaries into ‘federal’ and ‘regional’ categories; this made it possible for experts to appraise the concept of the law as a non-transparent and controversial one. For example, at the end of 2004 social protection experts across many Russian regions extensively discussed the thesis that the most numerous (and renewable) category of beneficiaries – veterans of labor – were transferred to a regional responsibility sphere because financing all the social obligations towards this category became an excessive burden for the federal budget. Besides, regional authorities felt very uncomfortable since World War II veterans, combat veterans and veterans of labor (all covered by the same federal law “On veterans”) fell under different categories and were now in unequal positions; hence, veterans of labor would be put at a disadvantage and would demand from the regional authorities the same terms of transforming in-kind benefits into MCP as were provided to WWII veterans.<sup>21</sup>

For the majority of regions, such an approach has meant a mismatch between the obligations and capabilities of regional budgets for several reasons, one of them being the fact that regions significantly differ in the proportions of regional beneficiaries. According to IISP<sup>22</sup>, in several regions – Bashkortostan, Kaluga, Vladimir, Samara and other oblasts – almost all pensioners acquired the status of labor veterans. On the other hand, in several subjects of the Federation – primarily in national republics and in less developed autonomous districts with a younger age structure – the proportion of ‘regional’ beneficiaries does not exceed 4 – 6 percent of the total population.<sup>23</sup>

At the same time, the law FZ-122 contained an important provision on non-deterioration of material conditions in conducting monetization (art. 153, para. 2), according to which “when altering, after December 31, 2004, the order of execution of benefits and payments provided prior to this date to specific categories of citizens in in-kind form, *the aggregate volume of financing of corresponding benefits and payments cannot be reduced, and the terms of their provision cannot be worsened*”. In practice, this provision nullified a possible re-distributional effect of cashing-out in-kind benefits.

As in practice the law contained provisions on monetization of ‘federal’ benefits only (and even that in a curtailed form – with an obligatory non-monetized federal social package) and did not demand similar actions from the regions, its impact upon upgrading the efficiency of budgetary expenditures was limited. As for provisions on monetization of ‘regional’ benefits, including housing and utility in-kind privileges, the implementation of these was carried over to the period after 2008.<sup>24</sup>

The ambiguity of the federal legislation with regard to the regional authorities’ rights to use the targeted approach creates negative stimuli for them in the course of monetization; that, in turn, increases the burden on the local self-government level which by default is the closest to the public. Quite often municipalities are forced to react promptly to the negative effects of the reform and to dig up resources for their mitigation within their extremely limited budgets.<sup>25</sup>

The economic effect from the introduction of the FZ-122 law could have been achieved only if the resources released as a result of privileges’ elimination would be redistributed towards the poor and for raising the size of pensions. In that case both economic and social effects would

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<sup>21</sup> Пресс-конференция группы социологов о проблемах монетизации. - Federal News Service - Kremlin Package, 2005, January 20, [www.socpol.ru/publications/pdf/InterFax.doc](http://www.socpol.ru/publications/pdf/InterFax.doc).

<sup>22</sup> Голованова Н., Курляндская Г., *op. cit.*

<sup>23</sup> <http://www.socpol.ru/atlas/overviews/household/index.shtml>

<sup>24</sup> Александрова А.Л. Применение законодательства о монетизации льгот. - Радио России, 7 апреля 2005 г., [http://www.urbaneeconomics.ru/publications.php?folder\\_id=105&mat\\_id=582](http://www.urbaneeconomics.ru/publications.php?folder_id=105&mat_id=582).

<sup>25</sup> Чагин К. Новые технологии управления в сфере социальной помощи и социального обслуживания населения. - Журнал исследований социальной политики, 20 декабря 2005 г., [http://www.urbaneeconomics.ru/publications.php?folder\\_id=103&mat\\_id=736](http://www.urbaneeconomics.ru/publications.php?folder_id=103&mat_id=736).

have manifested themselves to a full extent. Service providers would have started to function more efficiently, thus, on the one hand, providing an impetus to some local economic growth, and, on the other hand, mitigating social consequences of cashing-out by re-distributing resources to lower income households. Still, as the FZ-122 law does not provide neither for better targeting nor for a significant reduction of benefits, its economic effects were barely visible<sup>26</sup>.

According to expert assessments, the major systemic inconsistencies of the law on benefits monetization could be described as follows:

- 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);
- The factor of strongest 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.

The absolute majority of experts are unanimous in their opinion that the law on monetization of benefits, strictly speaking, has nothing to do with social policy. By preserving virtually untouched the categorical principle of benefits allocation, the law did not establish a framework for a future social policy blueprint – since it did not address neither the targeting of social assistance nor the redistribution of budget expenditures towards the poor<sup>27</sup>.

### **3. Description of the implementation process**

#### **3.1 Preparation of legislation, budget estimates, organizational issues**

##### **3.1.1 A chronicle of the legislation adoption**

Preparation and adoption of the regulatory framework for cashing-out benefits in Russia were carried out at accelerated pace. That refers not only to the FZ-122 law, but to legislation that prepared a reform of delimitation of authority between various levels of government and preceded the monetization of in-kind privileges as well. In July 2003, amendments were introduced into the law “On general principles of organization of legislative (representative) and executive bodies of government in the subjects of the Russian Federation”; in October 2003, a new law “On general principles of organization of local self-government in the Russian Federation” was adopted; finally, in August 2004 the State Duma adopted a legislative act (FZ-122, the “benefits monetization” law) that brought multiple federal laws in accordance with the two laws mentioned above.

Experts observed that in the course of the law preparation no sizable professional discussion of methods and forms of the pending reform took place; a socio-economic appraisal of the reform options and its consequences was also absent. Such a hasty preparation has resulted in a multitude of inconsistencies in the text of the law.

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<sup>26</sup> Александрова А.Л., *op. cit.*

<sup>27</sup> Александрова А.Л., *op. cit.*

### Box 1. A chronicle of the FZ-122 law adoption

The law that significantly modified the Russian social protection system and directly affected millions of people was adopted by the State Duma within less than three months:

- **May 13, 2004:** the Government introduced its intention to conduct a reform of social privileges in the Federation Council;
- **May 31:** the Government introduced the draft law into the State Duma;
- **June 1:** State Council meeting on fiscal support of social obligations;
- **July 2:** the State Duma adopted a draft law on the replacement of social privileges by cash transfers in first reading; simultaneously, action of protest against the planned reform took place in several cities;
- **August 3:** draft law adopted in second reading;
- **August 5:** the Duma adopted the law in third reading;
- **August 8:** the law approved by the Federation Council;
- **August 22:** the law signed by the President of the Russian Federation;
- **August 31:** the text of the law published in “Rossiskaya Gazeta”;
- **January 1, 2005:** the law entered into force.

Source: <http://www.hrights.ru/laws/law76.htm> и [http://bd.fom.ru/report/cat/journ\\_socrea/number1\\_05/gur050202](http://bd.fom.ru/report/cat/journ_socrea/number1_05/gur050202)

Because of hastiness with which the federal law was prepared, the legislative basis on the regional level was not developed either – at least by the time of FZ-122 entry into force. Lacking were not just the regulations concerning ‘regional’ beneficiaries, but the mechanisms for the support of ‘federal’ recipients that lived in regions as well. Regions had virtually no time to estimate the costs associated with various reform implementation options and to choose the most acceptable ones. This was the major reason explaining a widespread inaction at regional levels concerning decision-making on monetization issues.

#### 3.1.2 Regional budget deficits

By adopting the FZ-122 law, the federal authorities shunned the responsibility not just for financing ‘regional’ privileges beneficiaries, but for raising the salaries of regional employees paid from the state budget as well. The state budget adopted for 2005 proceeded from the fact that the center does not bear any similar responsibilities towards the subjects of the Federation. At the same time, as was pointed out at parliamentary hearings preceding the FZ-122 entry into force, 60 Federation subjects out of the total of 89 (at the time) had budget deficits amounting to about RUR 70 bn (by the results of the 2003 budget execution). If this figure is supplemented with a substantial amount of accumulated overdue credit debts – RUR 85 bn, as well as significant public debts of regional budgets, it becomes apparent that most regions had no budget funds for conducting benefits monetization offhand<sup>28</sup>.

#### 3.1.3 Insufficiency of staffing and methodical ware

In the course of FZ-122 law implementation at the regional level, one of the most severe issues was the *insufficiency of staffing and methodical ware*. Experts are certain that the shortage of professionals in the social protection system is still widespread, while up-to-date innovational social techniques are available from a limited number of sources only and are not adequately used within the system. In the course of preparing the monetization reform, neither regional nor local social protection bodies have received any methodical assistance from the Ministry of health and social development with regard to interpretation of complex and ambiguous provisions of the law, the ways of most effective information dissemination among beneficiaries, the methods of dealing with marginal categories of recipients (e.g. disabled, handicapped or aged persons, or, conversely, the most socially active and organized groups of beneficiaries), the or-

<sup>28</sup> Готова ли страна к монетизации льгот? – РФ Сегодня, N 23, 2004, [http://www.russia-today.ru/2004/no\\_23/23\\_Duma\\_2.htm](http://www.russia-today.ru/2004/no_23/23_Duma_2.htm).

ganization of recipients' recurring registration, the assessment of social and fiscal consequences of the legislation adopted, etc.<sup>29</sup>

### 3.1.4 Administrative difficulties

The implementation of the new law was significantly hampered by *administrative difficulties* as well. These were mainly related to the transfer of functions of allocating and issuing MCP to 'federal' recipients from social protection bodies to the Pension Fund<sup>30</sup> that had stronger resources compared to social protection authorities. Within very limited time, between August 2004 and 1 January 2005, social protection authorities had to focus their very limited capacities on composing and verifying databases on privileged categories. Moreover, databases for 'federal' categories had to be transferred to the Pension Fund, local data had to be integrated with those of the regions, so that administration of social assistance provision to 'regional' groups could be made uniform within each region. At the same time, no resources were made available for training personnel, organizing methodical support, or putting in order social assistance or Pension Fund offices so that they would be prepared to deal with large inflows of clients after January 1, 2005.<sup>31</sup>

### 3.1.5 Lack of information for political decisions making

A reverse side of the above problem was the *lack of information for political decisions making*. Only in a few cases, like e.g. in Perm oblast, surveys of beneficiaries in order to estimate actual needs in benefits and to forecast their total scope, to assess possible social risks, to identify public attitude towards in-kind vs. cash benefits and to evaluate the associated problems, were made prior to developing social support measures for 'regional' recipients. In most cases the decisions on cashing out benefits (or on preservation of in-kind privileges) were made on the basis of very loose and inaccurate information being at the disposal of the social protection bodies, without any modeling of financial or social effects of monetization.<sup>32</sup>

### 3.1.6 Lack of public information and feedback from population

In many cases, subjects of the Federation simply have no information intended for public dissemination. Public opinion surveys made in late 2004 demonstrated that due to the lack of adopted regional legislation 'regional' beneficiaries possessed totally inadequate information on the measures planned as compared to 'federal' recipients for whom social support measures were defined since the moment of the law signature.<sup>33</sup>

At the same time, certain public expectations were associated with the fact that at the stage of the reform discussion, in 2004, the forthcoming changes were frequently described as a "replacement of in-kind benefits by cash transfers", and the issue of benefits curtailment or of their incomplete compensation was not emphasized specifically. A similar problem for public perception (in terms of mismatch between the state obligations under the law and actual budget capacities) was shaped by the law provision on non-deterioration of recipients' material status.

Meanwhile, opinion polls conducted by Levada-Center in January 2005 witnessed a rather poor public informational awareness regarding the FZ-122 law: 44 percent of the respondents had no idea of the compensation accrued to them; 58 percent thought that the reform would bring about the deterioration of the material status of the poorest; 31 percent believed that the reform would worsen the respondent's family well-being. Responding to the question on the reform's goals, 53

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<sup>29</sup> Александрова А., Коваленко Е., Кузнецова П. Реформирование натуральных льгот на региональном уровне: Высокая цена скромных достижений. – *Spero*, 2005, N 3 (<http://spero.socpol.ru>).

<sup>30</sup> Pension Fund of the Russian Federation provides pensions to 38.2 mln Russian pensioners and operates 2192 territorial branches in every *raion* of the country.

<sup>31</sup> Александрова А., Коваленко Е., Кузнецова П., *op. cit.*

<sup>32</sup> Александрова А., Коваленко Е., Кузнецова П., *op. cit.*

<sup>33</sup> Александрова А., Коваленко Е., Кузнецова П., *op. cit.*

percent said that the reform was meant to save budget funds at the expense of the least well-off, and just 13 percent responded that reform was oriented at improving the status of the poor. 74 percent believed that monetary compensation did not correspond to the amount of privileges it was meant to replace; 57 percent spoke against substitution of the existing benefits for pensioners (on housing and utilities, telephone, medicines, municipal transport) by additional payments to complement pensions.<sup>34</sup>

An illustration of the public response to the situation of uncertainty was the phenomenon of mass 'invalidization' which was observed in many regions across Russia in the autumn of 2004. It was a period when the FZ-122 law had already defined the benefits, including the MCP size, for people with disabilities (federal category 'invalids'), but many subjects of Federation were only starting to define social protection measures for the groups assigned to them ('regional' beneficiaries). In this situation, citizens that could, because of their age and state of health, claim to be classified as 'disabled persons', fell under the category of 'regional' recipients (e.g. labor veterans), on the one hand, but received a clear-cut incentive to obtain a 'federal' status of 'invalid' and thus to gain some sort of certainty, on the other hand. Besides, as one could assume, by no means all the regions could offer to their 'regional' beneficiaries MCPs comparable in size to 'federal' ones, and thus the above incentive was rather strong. For regional authorities, the mass 'invalidization' was also advantageous, since it meant the reduction of their own expenditures. Moreover, as at the end of 2004 the disability assessment commissions were subordinate to regional authorities, the latter privately encouraged physicians to grant an 'invalid' status to all comers, thus saving on regional budget funds. As a result, elderly people flooded the disability assessment commissions, and the at the beginning of 2005 the number of 'federal' beneficiaries well exceeded the budget projections.<sup>35</sup>

### **3.1.7 Choice of timing for the reform**

The social situation in Russia at the first stage of monetization was aggravated by co-occurrence of the two processes – cashing out benefits and a rise of tariffs for services that were *inter alia* provided on a privileged basis. Average tariffs for housing and utilities were raised by 28 percent, and transport tariffs were increased by 13 percent. That provoked an acute public reaction. Raising tariffs for utilities and transport was not related to the implementation of the FZ-122 law and was carried out by totally different governmental bodies; however, the fact of a simultaneous start for raising tariffs and the introduction of cash compensation instead of privileges has bound these processes in a single knot. Despite the fact that the two events had different socio-economic nature, at micro level the tariffs hike was perceived as a consequence of the monetization.

## **3.2 Experience of the first months of reform implementation**

### **3.2.1 Winners and losers**

The geographical and categorical structure of persons that strongly negatively responded to the introduction of monetization was closely related to a lack of provisional evaluation of the social effects of the reform. In fact, most of the research studies concerning evaluation of reform social consequences were performed after the reform came into force. The main points of the reform social impact are the following:

(1) According to IISP estimates based on NOBUS data, it is the 'regional' category of beneficiaries (with a total number twice the amount of 'federal' recipients) that appeared to lose most as

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<sup>34</sup> Хахулина Л.А. Социальные реформы глазами российского населения. – Левада-Центр, февраль 2005, [www.socpol.ru/news/conf2005/khakhulina.ppt](http://www.socpol.ru/news/conf2005/khakhulina.ppt).

<sup>35</sup> Alexandrova A. & Struyk R., 2007, op. cit.

a result of monetization. Within this category, the proportion of losers was three times as high as that among 'federal' beneficiaries.<sup>36</sup>

(2) 'Federal' beneficiaries were also dissatisfied, as the size of their benefit (MCP) was uniform across the country regardless of a recipient's place of residence. Still, tariffs for services varied a great deal across regions; hence the size of MCP that could be adequate for compensation in the European part of Russia could turn out insufficient at the Far North or in the Far East. Besides, starting from January 1, 2005 'federal' beneficiaries lost their right to free transportation.

(3) Beneficiaries living in large cities suffered most compared to other categories; it was proved by their behavior in early January 2005, when large cities became the focal points of social protest.<sup>37</sup>

(4) The monetization law contained no provisions on compensations to pensioners, since all privileges to this category were granted exclusively by regional authorities and were not regulated by federal legislation. Thus, the federal center has in fact kept back from dealing with the pensioners' problem, and its solution was assigned solely to regions' responsibility. As pensioners as a category were not technically beneficiaries of any privileges, neither federal nor regional budgets provided any compensations for this group. Not surprising that it was the 'abandoned' pensioners who became the major driving force of social protests.

### **3.2.2 Budget consequences.**

Due to widespread public dissatisfaction with the reform implementation, the Ministry of finance already in January 2005 was forced to acknowledge the fact that the funds initially allocated for MCP financing were insufficient and to increase them urgently. The implementation of the FZ-122 law provisions necessitated an increase in total expenditures on social protection 2.77 times in 2005 as compared to 2004, while the federal budget expenditures had to increase 4.6 times. In 2004, the federal budget appropriations for social protection have amounted to RUR 45.4 bn (0.27% GDP), and those of regional budgets – to RUR 63 bn (0.37% GDP); in 2005, these figures have increased to RUR 208.6 bn (0.96% GDP) and RUR 92.6 bn (0.43% GDP) accordingly (even taken the modest scope of regional monetization)<sup>38</sup>. Eventually, due largely to new financial influxes, the social tension has subsided and the public assumed a neutral stance towards the implemented social reforms.

### **3.2.3 Implementation at federal level**

As was mentioned above, at the first stage of the reform (in 2005), federal beneficiaries were entitled, along with cash compensation, to an 'in-kind' federal social package that included additional free health services and medicines, health resort vouchers and free travel to "the place of medical treatment". Since 2006, this group of recipients was entitled to a right (remaining unchanged till present moment) to get the federal package in the cash form. That obviously increases the cost of the package, as persons that do not use the privileges would choose cash compensation, but for those who would prefer to get the package in the 'in-kind' form its value may substantially exceed the sum of the compensation provided.

According to IISP experts, the majority of 'federal' beneficiaries benefited from the monetization process – if additional resources allocated for these purposes after the January 2005 wave of protests are accounted for. In particular, the right for a free use of municipal transport by 'federal' recipients (initially revoked) was restored in some cases at a later stage. Several well-off regions that preserved in-kind transport privileges for their 'own' recipients, decided to extend similar privileges on 'federal' beneficiaries as well; that, however, came into conflict with the reform concept on delimitation of expenditure obligations between levels of authority. These deci-

<sup>36</sup> Spero, 2005, № 3 (<http://spero.socpol.ru>).

<sup>37</sup> Spero, 2005, № 3 (<http://spero.socpol.ru>).

<sup>38</sup> Информационное агентство «Финмаркет», 2005, 28 апреля.



sions placed 'federal' recipients from such territories in a more advantageous position compared to similar recipients living in other regions.

On the other hand, as subsequent analysis demonstrated, the goals of social protection in the case of 'federal' recipients were not achieved either. Since most 'federal' beneficiaries belong to middle-income category, just 18 percent of the resources allocated for cash compensations reach poor families.

### **3.2.4 Implementation at regional level.**

Notionally, the FZ-122 law gave regional authorities full freedom to define social protection measures for labor veterans, families with children, victims of political oppression and home-front workers. As regions differ widely in economic and social parameters, the status of 'regional' beneficiaries also varies a great deal across regions.

Regions have acted very cautiously in cashing-out benefits. A review of regional legislation, finally adopted by spring 2005<sup>39</sup>, shows that:

- An absolute majority of the regions kept housing and utility 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.

Three regions (Tatarstan, Tver' and Tyumen oblasts) demonstrated a high level of monetization, an intermediate level of monetization was observed in 30 regions, a relatively low one – in 27 regions, and 19 regions displayed a low level of monetization.

A rapid cashing-out of all kind of benefits occurred in Tyumen oblast; this was due to massive financial influxes in 2005 (RUR 20 bn, which almost equaled the regional budget) in the form of transfers from the two autonomous districts that recently were incorporated into the oblast structure. In Tatarstan, a very detailed system of compensatory payments was developed; besides, the budget of the republic is one of the most prosperous due to large federal assistance.

Most common factors explaining the low rates of monetization were usually a lack of its mechanism at regional levels and inadequate own capacities of the regions to finance monetary compensations. Another factor was an irregular 'load' of regional beneficiaries that varied greatly across regions. In Ingushetia, for example, victims of political repressions and their family members accounted for 45 percent of the total population; in many regions (Bashkortostan, Kaluga, Vladimir and Samara oblasts, etc.) almost all pensioners obtained the status of labor veterans in order to be entitled to benefits.

In regions, the choice between carrying out monetization and rejecting it only partially depended upon resource endowment, because since the abolishment of direct governors' elections the authorities' behavior was strongly affected by the political cycle and by their ability to come to terms with the federal center; at the same time, a direct dependence of the authorities on public opinion has dropped significantly<sup>40</sup>.

The Ministry of Finance recommended to regions to establish the compensation amount at a meager size of RUR 300 for home-front workers and at RUR 200 for veterans of labor. Not surprisingly that almost a fifth of regions (including most wealthy and relatively well-off ones) refused from monetization for 'own' beneficiaries, and almost all of them preserved a free use of

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<sup>39</sup> For details, see Александрова А., Коваленко Е., Кузнецова П., *op. cit.*

<sup>40</sup> Александрова А., Коваленко Е., Кузнецова П., *op. cit.*

municipal transport even for ‘federal’ recipients (that received a cash compensation), while some of the regions extended these benefits to all pensioners.

In the regions where benefits were cashed-out, both the amounts of compensation and the sets of ‘monetized’ privileges differ widely. E.g. compensation levels varied from RUR 1,500 in Nenets autonomous district and RUR 500 in Vologda oblast to RUR 100 – 120 in Bashkortostan. In the poorer regions compensation usually did not exceed RUR 200 which was not sufficient even for purchasing a monthly ticket pass.

Cashing-out benefits for urban transport services became one of the most urgent issues. After mass protests of city pensioners the federal center allocated additional funds to regions and worked out a mechanism of partially subsidizing the costs of ‘privilege’ monthly tickets from the federal budget. Eventually, in the regions that carried out monetization it was the rural and small towns’ citizens that gained most from cashing-out transport benefits, while the majority of urban dwellers, where transport benefits had much larger importance, have come off losers.

By 2008, when most regions cashed-out most of “small” in-kind benefits, monetization of urban transport privileges still remains a hot issue and causes mass public tension (e.g. public protests in Chelyabinsk in April 2008). The reason is that the size of compensation offered is usually much smaller than actual expenses on municipal transport. This problem is usually solved by offering monthly tickets at preferential prices to those categories of recipients that actively use municipal transport. The administration of this method, however, is cumbersome and involves additional costs. It would have been more logical and convenient to sell the tickets via conductors upon presentation of a respective certificate, but that would violate the federal law whereby only social protection bodies are authorized to verify personal data. At the same time, municipalities lack the potential to calculate the costs associated with transport privileges monetization, as well as to select the most appropriate form of such a monetization.

Serious complications of transport benefits monetization are related to the fact that a large number of beneficiaries make no use of their privilege to a free use of municipal transport: e.g. in Chelyabinsk oblast some 70 percent of rural recipients and 60 percent of the urban ones fall into this group. At the same time, for solving the problems of the remaining active users additional funding, not provided for in local/municipal budgets, is required.

In some cases, regions use their rights to autonomous decision-making on social protection issues and introduce their own, additional benefits. For example, the city of Zlatoust (Chelyabinsk oblast) has abolished, starting from May 1, 2008, municipal transport fare for pensioners not entitled to federal or regional benefits, as well as for students and schoolchildren.<sup>41</sup>

On the whole, cashing out of municipal transportation service privileges provides a clear example of under-financing in respect of regional beneficiaries. Providing beneficiaries with “single transportation tickets” was in fact an *ad hoc* way out in monetization implementation at the regional level: sums envisaged in exchange for the right to free services (which differed a lot between the regions and municipal entities) were nowhere enough to cover the total amount of real requirements of those beneficiaries who regularly use transport services. On average, these sums ranged from 20 to 40 trips a month (which is far from enough, for example, for a working beneficiary who has to get to his/her workplace every working day). Besides, not to raise social tension, many regions were bound to provide similar tickets to “federal” beneficiaries (who by default already got this compensation in a form of a “federal” MCP).

Chelyabinsk oblast provides a recent example of a more or less consistent monetization of transport service privileges demonstrating that real costs of such a monetization are far beyond the potential of poor regions. To implement monetization in 2008, the regional budget had to increase sums appropriated for cashing out transport privileges of ‘regional’ beneficiaries 2.4 times

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<sup>41</sup> Российская Газета - Южный Урал, 25.04.2008, N 46-48, <http://www.rg.ru/gazeta/rg-ygural/2008/04/25.html>.

(up to RUR 1,3 bn) as compared to RUR 545.7 mln in 2007.<sup>42</sup> Each regional beneficiary will get an advanced monthly payment (RUR 200) from the regional budget as a compensation of transport expenditures. This sum is equivalent to 20 tram and trolleybus trips or 15 bus trips in Chelyabinsk. In other cities of the region, where the costs of transport are lower, this compensation can cover a larger number of trips, e.g. 28 trips in Zlatoust and Miass. This initiative concerns almost 592 thousand of regional beneficiaries who live in Chelyabinsk region.

At the same time, federal beneficiaries (about 140 thousand) who were previously provided with subsidized single tickets from May 1<sup>st</sup> 2008, lost their right to obtain compensation financed from the regional budget and will have to pay for communal transport from their pockets unless regional authorities receive respective financing from the federal budget.

In other regions, overall sums of compensations for transport privileges look comparable or even larger: in Tyumen region regional beneficiaries in rural settlements receive RUR 75 a month as a transport compensation, while residents of Tyumen city receive RUR 130 and the beneficiaries in Bashkortostan get RUR 200. In Perm and Saratov, the compensation is higher but in these regions it includes three types of in-kind benefits – costs of post-office services, municipal transport and dentoprosthetic rehabilitation.

The specifics of two other major areas of monetization, namely of housing and communal services (HCS) and of supplementary provision of pharmaceuticals to privileged categories are dealt with in Section 5 and in Annex 4 respectively.

## **4. Changes of the roles of various actors and agencies**

### **4.1 *Defining zones of responsibilities between the respective levels of authority***

The FZ-122 Law has determined the expenditure obligations of the federal budget and budgets of subjects of RF, as well as defined zones of responsibilities between the respective levels of authority. Issues of methodical and coordination character were assigned to the federal authorities. Subjects of RF were to bear responsibility for federal legislation implementation, for working out, financing and implementing social service programs, for establishing, managing and ensuring the activities of social services, etc.

Sources of benefits' financing have also changed: mandates of direct financing from the federal budget were cut down. According to new law provisions, financing of social services for the population has become one of the expenditure obligations of the budgets of the RF subjects. These budgets have become the main sources of financing for obligations towards 'regional' beneficiaries; in addition, non-budgetary financing sources could be used as a supplementary channel – bank credits, income from securities, and others.

New financial obligations came into a certain conflict with the ongoing process of budgetary centralization at the federal level. In practice, by the beginning of monetization reform the financial status of many regions remained unsustainable since they had very limited ability to supplement their budgetary revenues with increasing tax returns, and thus their capacity to finance the growing social obligations was quite narrow. Their situation deteriorated further in 2004 when in the course of revenue sources centralization one of the few regional taxes – sales tax – was abandoned, and in 2005 corporate profit tax was centralized.<sup>43</sup>

To comply with the growing financial obligations, regional budgets required a substantial amount of co-financing. According to the Budgetary Code, the subjects of RF could supplement

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<sup>42</sup> [http://uralpress.ru/delivery\\_full\\_1207559016.htm](http://uralpress.ru/delivery_full_1207559016.htm).

<sup>43</sup> Голованова Н., Курляндская Г., *op. cit.*

their financial resources through the Fund of Co-financing of Social Expenditures (FCSE) and the Fund for Compensations (FC).

Consequently, in 2005 the size of the FCSE was sharply (3.6 times) increased as compared to its 2004 level and reached RUR 23 bn. In the framework of the 2005 federal budget, the fund has envisaged significant financial resources (55 percent of the total) for the support of regions in order to meet their commitments vis-à-vis the recipients of social benefits. A sharp increase in the FCSE size resulted in its growth from 0.04% of GDP in 2004 to 0.12% of GDP in 2005, while in 2006-2007 the volume of transfers of this type has been gradually declining. In 2007, the FCSE share decreased by 0.01 p.p. (just as in 2006) and amounted to 0.1% of GDP.<sup>44</sup>

The principal goal of the Fund for Compensations was to finance federal mandates. Since 2005, the Fund has been integrating resources allocated for financing all the federal expenditure mandates stipulated by the federal law, including the financing of 'federal' beneficiaries under the FZ-122 law. The 2007 law on federal budget provided for a considerable (2.08 times) increase in the volume of FC up to RUR 153.1 bn. In 2007, 53 percent of the Fund volume (1.4 times more than in 2006) were allocated for subventions to regional budgets on payments for housing and public utilities services delivered to 'federal' recipients.<sup>45</sup>

A support for financing social benefits for regional beneficiaries from FCSE was envisaged for those regions which were to initiate monetization. Co-financing was envisaged for four main categories of beneficiaries: rehabilitated individuals and those recognized as victims of political repressions, home-front workers during WWII, labor veterans, and families with many children. FCSE also included resources to provide subsidies to the regional budgets on partial reimbursement of regional and municipal level expenditures on targeted HCS subsidies.

In 2005, the Working group for improvement of inter-budgetary relations in RF has developed a methodology of distribution of subsidies from the FCSE between the RF subjects. According to this methodology, the amount of subsidies to the RF subjects with regard to the first two categories of citizens rests upon two indicators – the number of citizens falling under the respective category and residing in the territory of a given Subject of RF, and the size of the cash allowance set by the federal center per one recipient (for 2006, RUR 227.9 a month for victims of political repressions and RUR 206.7 a month for laborers of the Home Front). As concerns the other two categories, the amount of subsidies is computed according to a more sophisticated formula, with account to the differentiation of the price scale and the level of budgetary sufficiency of the region (on which the level of co-financing depends).<sup>46</sup>

Subventions from the FC on payments for housing and communal services to privileged categories of citizens are allocated between the RF subjects in accordance with a methodology annually approved by the government. The calculation of these subsidies rests upon three indicators: 1) the number of citizens eligible for benefits with respect to payments for HCS in a given subject of RF; 2) the federal social housing standard employed for calculation of intra-budgetary transfers of 18 square meters per person; 3) the federal standard of the costs of HCS provision per 1 square meter of the overall living area per month set by the Resolution of the RF Government for every subject of RF (this indicator takes into account the interregional price differentiation with regard to HCS costs).

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<sup>44</sup> Russian economy in 2007 (Issue 29): Trends and outlooks / Inst. for the Economy in Transition; [Y. Gaidar and others]. – M. : IET, 2008 (<http://www.iet.ru/files/text/trends/2007-eng/2007-eng.pdf>).

<sup>45</sup> Russian economy in 2005, 2006, (Issue 27, 28): Trends and outlooks / Inst. for the Economy in Transition; [Y. Gaidar and others]. – M. : IET, 2006, 2007 ([http://www.iet.ru/files/text/trends/2006\\_en/2006\\_en.pdf](http://www.iet.ru/files/text/trends/2006_en/2006_en.pdf); [http://www.iet.ru/files/text/trends/2005\\_en/2005.pdf](http://www.iet.ru/files/text/trends/2005_en/2005.pdf)).

<sup>46</sup> Russian economy in 2005 (Issue 27: Trends and outlooks / Inst. for the Economy in Transition; [Y. Gaidar and others]. – M. : IET, 2006.

In 2005, within the framework of the ongoing process of delimitation of expenditure obligations between different levels of public authority, changes in structural composition and tasks were also introduced into other federal budgetary funds – the Federal Fund for Financial Support of the Subjects of RF, the Fund for Regional Development, and the Fund for Reforming Regional and Municipal Finances. Initially, they were designed to achieve other goals - to strengthen regional and local finance and to level off their budgetary potential, to assist regional and local budgets in debt repayment and debt servicing, as well as to develop social infrastructure and finance other social needs.

From the year 2004 onward, attempts have been made to increase the transparency of inter-budgetary relations. At present, the resources of the Federal Fund for Financial Support of the Regions, the Compensation Fund, the Fund for Reforming Regional Finances, and the Fund for the Development of the Regions have been distributed in accordance with the methodology approved by the RF Government resolution. The formation and use of the FCSE has also been carried out on a formalized basis. Nevertheless, a substantial part of federal financial aid to the regions is still being distributed without any methodological, financial, or economic justification. The share of inter-budgetary transfers distributed on a formalized basis in 2007 accounted for approximately 59 percent of the total sum of resources transferred from the federal center to RF regions.<sup>47</sup>

To sum up, the changing roles of budgets of different levels in the course of monetization resulted in the growth of shares of federal transfers aimed at financing ‘regional’ categories of beneficiaries in the expenditures of different RF subjects. This actually means that the federal authorities have shuffled off the burden of non-financed (or scarcely financed) social commitments at the regional level and then proceeded with a partial financial support of new regional legislation initiatives on the basis of often non-transparent criteria.

#### **4.2 *Changing roles of regional and local administrative bodies***

Under the new system of distribution of social support responsibilities and their radical shift to the regional and local (municipal) level, administration bodies (self-government authorities) have to gain new functions. The main role of local bodies in the context of the ongoing reform is connected with the use of a comparative advantage of this level of public administration – flexibility and ability to consider the local needs and specific features of the population. These bodies remain the only authorities of public administration which retain capabilities to initiate and implement targeted assistance to the poor and to perform some kind of adjustment of targeting to the ongoing monetization reform. By their nature, these bodies are capable to concentrate the administrative and financial potential on the support of the poor, contributing at the same time to a more efficient functioning of the social support system. These local actors are also known to be more effective in organizing the monitoring of the ongoing reform results, the assessment of its social consequences and the need to initiate local initiatives to support the most needy categories of the population.

Another important task of local administrative bodies and their social support units which proved to be very important in the course of monetization reform is a comprehensive interaction with local population. This includes provision of adequate and important information, communication with civil society organizations including the informal ones, as well as identification of those socially inactive persons and families who are in need of additional psychological support, etc.

Should these functions be successfully realized or not is dependent on what scheme of transmission of governmental social responsibilities is used in the region. A special study provided by the

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<sup>47</sup> Russian economy in 2007, p. 144.

Institute for Urban Economics <sup>48</sup> revealed that in most cases regional authorities suggest local bodies to choose one of the two possible schemes of behavior:

- (1) to retain special bodies for social protection management within the structure of municipal administration and to delegate them public (state) authorities;
- (2) to incorporate municipal bodies for social protection management into the unified public administration system and to assign them a status of a territorial unit of the regional department.

The first scheme provides local administration with more flexibility by allowing it to introduce new innovative social protection schemes, to optimize social protection management, and to organize work with the local vulnerable population on an individual basis. The second scheme is considerably less flexible both for local administration and the public, since it limits the municipalities' potential to provide independent social support programs irrespective of the availability of resources.

In practice, in the course of monetization reform when the main body of social mandates became concentrated on the regional level, local municipal bodies tended to avoid initiating their own social programs and would rather stick to the set of their purely municipal tasks and duties. Thus, as it was reported by The Institute for Urban economics, in the course of 2005-2006 the first scheme has been implemented only in ¼ of the regions while the majority of regions preferred centralization.<sup>49</sup>

### **4.3 New obligations of Pension Fund**

Monetization reform has added new functions to the Pension fund and limited functions of social protection agencies. The government decided that for 'federal' categories of beneficiaries, cash benefits (MCP) would be paid through the Pension fund since almost all the beneficiaries were pensioners anyway. According to experts' opinion, the decision to transfer cash payments to the Pension Fund was probably an optimal one in terms of administration – a quick arrangement to administer universal flat benefits across the country. This decision can also be regarded as an optimal one from the viewpoint of economy of scale since the Pension fund maintains a comparatively effective operational system on a country-wide scale. The fact that the data on federal beneficiaries were transferred to the Pension fund has contributed to their unification and improvement.

On the other hand, regional social protection bodies were thus turned into agencies alternative to the Pension fund, oriented at providing cash transfers to regional beneficiaries. Moreover, such a solution created a considerable systemic problem for a prospective benefits distribution reform, since the Pension Fund system is not designed to work with means testing, so that targeting of benefits in the future can become problematic from an administrative viewpoint.

Furthermore, this solution created disincentives for social protection agencies to establish a comprehensive approach to assisting households and initiating and providing a monitoring process. This is because they have given away a large part of the essential data on assistance sources and because the person-based, not the household-based principle of assistance is now well fixed throughout the system. To use the Pension Fund data in future, a social office will need to make them compatible with its own data, train personnel, and invest in data exchange systems.<sup>50</sup>

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<sup>48</sup> Сиваев С. Промежуточные итоги реформы жилищно-коммунального комплекса. – „ЖКХ - журнал руководителя и главного бухгалтера”, март 2006 (<http://www.urbanecomomics.ru>); Роль местного самоуправления в обеспечении эффективной социальной поддержки населения в условиях трансформации системы льгот ([http://www.urbanecomomics.ru/download.php?dl\\_id=1425](http://www.urbanecomomics.ru/download.php?dl_id=1425)).

<sup>49</sup> Ibid.

<sup>50</sup> Александрова А., Коваленко Е., Кузнецова П., *op. cit.*

#### 4.4 *The changing role of social services providers*

Monetization reform was to contribute to the improvement of financial sustainability of HCS, transport and other providers (local, regional or state unitary enterprises). As was already mentioned, in-kind service provision was compensated to the respective providers in the form of budget subsidies which were, as a rule, inadequate for covering these enterprises' losses. Thus, according to the Urban Economics Institute, the amount of federal and regional budgets underpayments to these enterprises for services delivered to in-kind beneficiaries was estimated at 30 percent of the services' cost in 2004<sup>51</sup>. Subsidies practice was also known to be non-transparent, often involving corruption techniques. Monetization was believed to initiate a shift from budgetary subsidizing of these services to financing of their provision by the population itself and to introduce market-based economic relations between providers and consumers.

It was also believed that monetization could bring transparency into budgetary expenditures on HCS and to contribute to marketization of communal services, since about 21.5 mln people (15 percent of the population) were paying for HCS at a fare reduced by 50 percent (according to the Urban Economics Institute data). In practice only a few regions started HCS privileges monetization from the very beginning of reform, and only 14 regions initiated benefit monetization for 'regional' beneficiaries through personal accounts.

In the majority of regions, monetization of HCS benefits was intensified only in the middle of 2008 (see Section 5). Until recently, an overall progress in this sector was very limited: actual costs of HCS providers are not compensated due to the intense growth of population indebtedness for communal services (RUR 300 bn), cross-subsidization and scarce benefit monetization<sup>52</sup>. Besides, communal infrastructure stays predominantly in public (municipal) ownership; there exists a number of obstacles for private capital involvement in the management of and investing into HCS sphere.

Taken together, these facts lead to an overall conclusion that ongoing HCS reform has not brought necessary changes into financial situation of service providers, and has not initiated a growth of private capital inflow into the sector.

In the sector of public transport, the impact of monetization on service providers was also limited. The absolute majority of regions have monetized their transport benefits (82 out of 85 subjects of RF by mid-2007). Most of them (72 regions) used the quasi-monetization form of unified social monthly tickets the costs of which were subsidized on the basis of an average number of trips in respective locality. According to RF government estimates<sup>53</sup>, monetization made the transport enterprises' finances more transparent and contributed to overall growth of their incomes from carrying 'reimbursable' passengers. The process of compensation for shortfalls in incomes resulting from carrying in-kind beneficiaries became more transparent and fair. Besides, transport enterprises are now more limited in their capabilities to misrepresent their revenues from non-provided services.

Yet total revenues of transport service providers from passenger fare taken together with budget subsidies still do not compensate for their total costs. Enterprises involved in the social sector of passenger transport remain highly dependent on budgetary subsidies which are not sufficient even for reproduction on a simple scale; the sector remains unattractive for private investors. The

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<sup>51</sup> Institute for Urban Economics data, <http://www.fss.ru/digest/2005/obzor11042005.doc>.

<sup>52</sup> Press-conference by Sergei Kruglik, RF Deputy minister for regional development, March 13, 2008 (Information service DAILYSTROY, [www.dailystroy.ru](http://www.dailystroy.ru)).

<sup>53</sup> A teleconference of Igor Levitin, RF Minister of transport, at the RF House of Government, April 24, 2007 ([www.mintrans.ru/prensa/Novosty\\_070424\\_2.htm](http://www.mintrans.ru/prensa/Novosty_070424_2.htm)).

situation looks similar in other sectors providing services to the population, e.g. in health resort sector, etc.<sup>54</sup>

## **5. Compensation of housing and communal services expenses in the course of HCS and monetization reforms**

### **5.1 Forms of HCS benefits**

In Russia, there are two main, rather different by their nature, types of instruments aimed at partial compensation of housing and communal services (HCS) expenses of a household (individual). These are: (1) subsidies for poor households on dwelling and communal services payments, and (2) benefits assigned to specific categories (which are an integral component of a monetization reform).

#### **5.1.1 Subsidies on HCS payments for poor households**

The system of subsidies on HCS payments for poor households (initially established in 1993<sup>55</sup>) was not a subject of monetization reform in Russia since the latter was designed to cover specific population categories regardless of their level of material well-being. In the course of the 1990s and in the beginning of 2000s the schemes for provision of subsidies were subject to numerous changes.<sup>56</sup> Currently, subsidies on dwelling and communal services payments for poor households are provided on the basis of art. 159 of the Housing Code of the Russian Federation and the Rules set by the Government Resolution No. 761 of December 14, 2005.<sup>57</sup> According to these documents, rules and procedures of these subsidies' provision are established by federal legislative bodies, while regional authorities are free to develop regional standards of HCS costs which are to be used by local authorities to provide subsidies to the population.

The major difference between the previous and the current systems of subsidies provision lies in the methods of their acquisition. If formerly subsidies were transferred directly to service providers, currently they are transferred to recipients via the existing or newly opened private bank accounts or (in the distant regions) delivered through post-office departments. Thus, one can conclude that these subsidies have now acquired in a sense a monetized form.<sup>58</sup>

According to the newly established rules the size of subsidies is calculated on a monthly basis according to a uniform scheme and methodology. At present, their amount is determined by: (1) the size of a regional HCS standard per capita of the respective household, (2) regional standards

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<sup>54</sup> Александрова А.Л. Применение законодательства о монетизации льгот. - Радио России, 7 апреля 2005 г. [http://www.urbaneeconomics.ru/publications.php?folder\\_id=105&mat\\_id=582](http://www.urbaneeconomics.ru/publications.php?folder_id=105&mat_id=582).

<sup>55</sup> Resolution of the Government of RF No. 935, September 22, 1993 "On transfer to a new system of payments for dwellings and communal services, and on the order of provision of compensations (subsidies) to citizens on payments for dwellings and communal services.

<sup>56</sup> RF Government Resolution No. 707 (June 18, 1996) "On improving the system of payments for dwellings and communal services" introduced a new mechanism of provision of HCS subsidies that in fact violated the principles of social justice and thus resulted in a number of critical problems within the system. It was replaced by Government Resolution No. 887 (August 02, 1999) "On improving the system of payments for dwellings and communal services and measures for social protection of population". The system of subsidies provision was further detailed in the RF Government Resolution No. 444 (August 30, 2004) "On the provision of subsidies on payments for dwellings and communal services".

<sup>57</sup> Government Resolution No. 761 of December 14, 2005 «On the provision of subsidies on payments for dwellings and communal services».

<sup>58</sup> Another type of housing subsidies – a non-repayable subsidy on the construction or purchase of housing – was established on the basis of the RF Government Resolution of August 03, 1996. It is provided exclusively in a non-cash form and in practice represents a non-repayable sum of money that supplements the savings accumulated by a potential housing purchaser. Such a subsidy can be provided to a person who is registered in a municipal waiting list as a potential renter of a municipal (free of charge) housing. The longer the record of the registration, the larger is the non-repayable sum of money that a person can get.



of dwelling space per family member for various categories of households, and (3) a regional standard of a maximum proportion of HCS expenditures in the aggregate income of a household (its federal maximum was set at the level of 22%). If the average income of a household is equal to or higher than the size of the regional living minimum, the amount of subsidy is defined as the difference between (1) regional standard of HCS costs multiplied by the number of household members and (2) the regional standard of a maximum proportion of HCS expenditures in the aggregate income of a household multiplied by the average income of the household. If the average income of a household is lower than the size of the regional living minimum, the amount of subsidy is defined as the difference between (1) regional standard of HCS costs multiplied by the number of household members and (2) the regional standard of a maximum proportion of HCS expenditures in the aggregate income of a household multiplied by the average household income and by a correcting coefficient. The latter is defined as a proportion of the average household income in the size of a living minimum for the respective household. (the living minima are defined for different socio-demographic groups).

Thus, these new rules ensure that the size of a subsidy does not take into account the volume of the de facto consumed HCS, i.e. the sum of money actually paid for HCS by the household. Instead, this component in the formula is substituted by a fixed sum (for the specific region) calculated for a given type of a family.

Major responsibilities for allocation of these subsidies lie with a regional (municipal) level of authority. Regions are free to set their own HCS standards, as well as standard of a maximum proportion of HCS expenditures in the aggregate income of a household: in fact, many regions set its value at a lower level compared to recommended federal standard (22%). The main reason for this reduction was a commitment to provide a more substantial help for poorer families. In practice, regional/local legislative rules vary a great deal. For example: in Nizhni Novgorod, the 18% level is set as a maximum standard of HCS expenditures in the total household income; in Chelyabinsk this share is reduced from 22% to 11% for households with income exceeding the regional cost of living not more than by 20%, as well as for pensioners living alone, families of pensioners, families with many children, single mothers with junior children, etc.; in Murmansk region, the regional standards for a maximum share of HCS expenditures in the total household income were set at the end of 2007 at the level of 22% and 15%. The latter referred to families of pensioners, disabled persons and families with many children; in Rostov region, administration declared plans to reduce the maximum share from 18% (operational from 01.11.2007) to 16% from 01.01.2009, and to 15% from 01.01.2010; in Irkutsk region, maximum share varies greatly across households with different incomes, and ranges from 7 to 22% for families of pensioners, and from 13 to 22% for households of working members. For families with incomes lower than a minimal regional cost of living the respective shares (7 and 13%) are additionally reduced in proportion to the ratio of the household income to a minimal regional cost of living.

It is clear that the above mentioned regional initiatives combined with changing the formulae of the subsidy calculation tend to push forward the number of newly assigned subsidies as well as contribute to an increase of their average size.

On the whole, registration of families entitled to such subsidies is quite complicated and bothersome both for beneficiaries as well as for administrative bodies. Not surprisingly, quite a few people fail or give up the registration; at the same time, social services do not have enough resources to check the accuracy of income records of the applicant families. According to experts' estimates, the available statistics on the number of recipients of these subsidies do not adequately reflect the number of households in need.

HCS subsidies are financed from local budgets that receive subventions from the budgets of subjects of Federation. To cover these expenditures, the latter receive financial resources from the Federal budget. Federal financing is provided in the amounts calculated according to federal standards set by the Government (22%). Although regions and local authorities are free to set

their own standards (of a household dwelling space, costs of HCS and the maximum share of HCS expenditures in the household income), they have to find additional financing in their own budgets in order to finance these additional expense items.

### **5.1.2 Categorical HCS benefits**

Categorical benefits is another widely used form of a partial or full compensation of HCS expenses to a household (individual) These benefits, as was shown above, became the subject of monetization reform, although initially the time schedule for monetization of these benefits was not envisaged. The eligibility of HCS benefits as well as their relative size are presented in Annex 3. Prior to FZ-122 law entry into force, the average size of the benefit amounted to 50% of the respective service or housing payment. Prior to 2005, housing privileges covered not only the categories currently defined by legislation, but their family members as well; for many groups of beneficiaries, such as teachers, the HCS benefit is now provided only to the beneficiary. In the course of the reform some of the benefits were abandoned, e. g. benefits for telephone subscription fee for most of beneficiary groups (except Heroes of the Soviet Union and equated categories for whom a 100 percent benefit was retained). All kinds of benefits on housing, communal and telephone services were canceled for victims of political repressions and their close relatives and some others categories.

As can be seen from Annex 3, the FZ-122 law authorized regional authorities to provide all kinds of social support in the sphere of HCS payments both for 'federal' and 'regional' beneficiaries.<sup>59</sup> Regional authorities were free at their own expense to establish any additional social support provisions, including HCS benefits, for 'federal' beneficiaries. These can include benefits in the form of a discount of the total payment, a formerly used in-kind privilege, as well as cash payments in the form of subsidies (before the date due) or compensations (after the payment was made by the beneficiary); HCS payments could as well be compensated irrespective of time limitations of payments.

## **5.2 *Problems of categorical HCS benefits monetization***

The FZ-122 law did not specifically determine the timing of monetization of HCS benefits. It was only mentioned that the program of cashing-out benefits in this sphere had to start in 2006. At the same time, according to FZ-122 law, regional authorities gained the right to cash-out HCS benefits without waiting for the permission from the federal center, from the very beginning of the reform, i.e. from 2005. In practice, serious steps to make these norms obligatory were made only in 2008.

The primary incentive for regional authorities to cash-out HCS benefits was to intensify market reforms in this sector. Besides, cashing out these benefits was a lot more easier than, for example, transport benefits, because (1) the former were equal for most groups of beneficiaries, and (2) the number of beneficiaries was more or less known and they were easier to register. Thus three regions – Tatarstan, Tver and Tyumen oblasts – monetized these benefits almost at once. In other regions, the progress was not that obvious. Until recently, only some 25 regions and municipal entities implemented HCS monetization programs (including some pilot projects). Since 2008, however, regional authorities became quite limited in their choice to cash out HCS benefits or not<sup>60</sup>, since a completion of these benefits' monetization was made one of the conditions for obtaining resources from the State Corporation - Fund for Assistance to HCS Reform.<sup>61</sup>

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<sup>59</sup> According to FZ-122 Law, HCS benefits for persons awarded with a badge "Honorary Blood Donor of Russia" were monetized and a yearly compensation in an annual sum of 6,000 RUR was envisaged for them that absorbed HCS benefits.

<sup>60</sup> An Order of the President of the Russian Federation, February 23, 2007.

<sup>61</sup> Federal Law No. 185-FZ of July 21, 2007 "On the Fund for Assistance to Housing and Communal Services Reform".

Monetization of HCS benefits which is being pushed up in many regions nowadays is often referred to as a second stage of monetization reform.<sup>62</sup>

The process of HCS benefits monetization was considerably hindered by significant regional differences in per capita costs of HCS, which were estimated at 8.7 times. This fact entailed grave consequences in terms of differences in regional budgetary burdens; it also indicated that uniform compensation schemes for ‘federal’ beneficiaries were not applicable to all regions alike, since that could contribute to a considerable differentiation of the social results of the reform and would lead to a clear-cut division of recipients into winners and losers<sup>63</sup>.

Another important obstacle in the course of HCS benefit monetization was related to extremely high disproportions in distribution of the overall amount of benefits between beneficiaries from different income groups: the total sum of HCS benefits that reach the I decile income group is 31 times less than that in the most wealthy families (X decile). As estimated by IISP experts, only 18,7 percent of families from the I income decile are entitled to these benefits, while among the middle income families (IV-VI decile groups) the proportion of such households is considerably higher and exceeds 44 percent. The proportion of the most well-off households (X decile group) receiving these benefits is larger than that among the poorest families. Thus the use of fixed sums for compensation of in-kind transfers aimed at [at] minimization of losses for individual families should only increase income inequality instead of alleviating it.<sup>64</sup>

For both ‘federal’ and ‘regional’ beneficiaries, monetization of HCS benefits is provided simultaneously and on the basis of the same methodology; responsibilities of respective budgets in financing Monthly cash compensation (MCC) for beneficiaries are retained.

Although federal legislation does not necessarily require limiting the amount of provided HCS benefits by regional standards of HCS consumption as a basic point in defining the size of MCC, many (if not most) regions use this already tested approach since it allows them to take into consideration many characteristics – e.g. types of settlement, size of a household, type of a dwelling, the time of the year (heating period), etc. In some regions, in cases when MCC does not cover 50% of a beneficiary’s expenditures on HCS, a possibility to use an individual multiplying ratio is envisaged.

Beneficiaries will be receiving MCC in advance (before regular monthly payments for HCS should be made); they are free choose whether to transfer it to their personal bank account, or to receive it at the post office together with pension payment.

In case the regional standard is chosen as a standpoint for MCC, the whole process of HCS benefits monetization in most regions is reduced to a simple re-direction of cash flows: the responsibility for payment of the compensation is shifting from a Managing company (HCS provider) to a respective local social protection body. A beneficiary will then provide a 100% payment for HCS in accordance with a monthly bill.

### **5.3 HCS benefits at the regional level**

The ambiguous norms of federal legislation on HCS benefits monetization in addition to granting extensive decision-making rights to regional authorities concerning the course of monetization reform have resulted in a controversial and differentiated situation across regions in 2005-2008. In fact, throughout 2005-2006, the absolute majority of regions have preserved the old in-kind mechanism for both “federal” and “regional” beneficiaries unchanged. Since at that time no uni-

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<sup>62</sup> Respective federal legislative acts that serve as a background for pushing forward this process are the above mentioned Federal Law №185-FZ and a Protocol Order by the President of the Russian Federation (19.01.2007).

<sup>63</sup> Овчарова Л., Пишняк А. op. cit.

<sup>64</sup> Овчарова Л., Пишняк А. op. cit.

form country-wide standards and general principles were established, regional authorities were bound to invent their own home-made approaches and schemes of benefits calculation. Thus one could observe a wide variety of local legislation initiatives<sup>65</sup>, as well as of the amounts paid to recipients, since consumption standards, social norms of a housing space per person (that serve as a basis for estimation of a compensation), costs of maintenance and repair, communal services' prices and tariffs were defined at the local level (e.g. by municipal government bodies and the authorities of cities with a federal status – Moscow and St. Petersburg).

The second half of 2008 was marked by intensive legislation preparation work at the regional level. In some regions the above mentioned legislative work appeared to be more difficult and thus the timetable for implementation of new regulations was extended. For example, in Chelyabinsk region plans for HCS benefits monetization implementation were shifted to the second half of 2009, which was above all due to the desire of regional authorities to reduce the burden of high tariffs imposed by natural monopolies, and thus to attempt to maximally reduce regional standard of HCS costs. In Novosibirsk region, monetization mechanism is planned to be implemented since the beginning of 2010, meanwhile a series of a pilot projects at the local level are initiated. At present, it is hard to predict what will be the final result of these actions both from the viewpoint of budgetary consequences and overall costs, as well as from the point of view of distributional impact.

Besides, up to the present moment in some regions it is not clear enough what basic schemes will be implemented, and regions, as well as municipal authorities, use their rights to assign additional benefits for beneficiaries in their locality. Thus, for example in Vladivostok the local legislative body has assigned an additional 50% discount on HCS payments for six additional categories of beneficiaries.

Samara region provides another example of such kind. Since August, 10, 2008 all in-kind HCS benefits for “federal” and “regional” beneficiaries in Samara region are being transformed into monthly cash compensation payment (MCC).<sup>66</sup> The amount of this MCC is calculated as a percentage of the regional standard for HCS costs. According to press reports (since the text of the law is not available), the new local law sets MCC at a 50 percent level of the regional standard for disabled WWII veterans and WWII participants, disabled combatants, former under-age prisoners of fascism, victims of Leningrad siege, labor veterans, victims of political repressions and their close relatives and some others. At the same time, for persons affected by radiation, those employed in special risk units and some others it is set at the level of 47 percent of the regional standard. The MCC for mothers with many children is set at the level of 23 percent of the standard. Family members of WWII participants and fascism prisoners, as well as some other categories are to receive MCC equivalent to 12 percent of the standard. For those beneficiaries whose entitlement to benefits is applied to members of the family as well, a total sum of a monthly cash compensation is increased as a percentage proportion to a regional standard<sup>67</sup>.

Regional authorities are well aware that HCS benefits monetization is bound to expand the number of households that would claim an HCS subsidy, with a possible increase in the size of an individual subsidy as well. This is due to the fact that currently (as was mentioned in para 5.1.1), according to the existing rules, regional standard of HCS costs is reduced in case there is a beneficiary in a household. The “preferential” coefficient applied e.g. for a single invalid is set at the level of 0.5 and halves the size of an HCS costs standard in the above mentioned formula. If the benefit is provided in a monetized form, the coefficient is not applied and the sum of a compensation is added to the total household income. The size of a subsidy is thus enlarged, and those who were not previously entitled can now claim for it.

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<sup>65</sup> Гонтмахер Е.Ш. Анализ законодательной базы в области социальной защиты на региональном уровне. - SPERO, 2005, № 3 (<http://spero.socpol.ru>).

<sup>66</sup> The law adopted by the regional Duma on 10.07.2008.

<sup>67</sup> Новости Самары, 16.07.2008 (<http://www.samru.ru/society/samaranews/39664.html>).

Still it is important to stress that, as it was in 2004, the implementation of new cashing-out instruments at the regional level is not based on the assessment of possible outcomes, and little is known about what income groups would finally win or lose. In some regions the authorities declare that the cashed-out sums would be set very close to the monetary equivalent of the previously received services, and in case the MCC appears to be lower than the amount of in-kind support the beneficiary used to receive on an annual basis, he/she would be able apply for an additional benefit to local social protection services. This suggests that no targeting instruments are still incorporated into the new schemes introduced.

Another characteristic feature of the ongoing process of HCS monetization in the regions that could be drawn from the local and regional press available on Internet, is connected with the “2005 syndrome”: the ongoing discussions reveal rather negative expectations of the population regarding possible social consequences of the second stage of monetization.

#### 5.4 Compensation of expenses on HCS

Available Rosstat data allow to get an insight into the changes in the quantity of beneficiaries entitled to a reimbursement of HCS payments in the form of subsidies vis-à-vis the number of recipients of categorical benefits during the first half of the 2000s (see Table 2). As could be seen, while the ratio of households payments in the overall costs borne by HCS providers increased substantially (over 30 percentage points), the number of beneficiaries receiving categorical HCS benefits has decreased by 8.5 mln. people, and the share of families - recipients of HCS subsidies has risen by almost 4 percentage points.

According to experts assessments, the total burden on the budget related to these forms of social assistance in 2000-2005 decreased. That was due to the contraction in the number of recipients from those categories that were not being replenished by new members, to the cancellation of benefits for some occupational categories (police, military officers, etc.), and straightening up the system of registration of beneficiaries. After the majority of regions adopted a new federal standard of a 22 percent ratio of HCS expenditures to overall family income, the number of recipients of HCS subsidies also decreased.<sup>68</sup>

**Table 2.**  
**Beneficiaries entitled to reimbursement of HCS payments in the form of subsidies and categorical benefits**

	2000	2001	2002	2003	2004	2005
Families - recipients of HCS subsidies (percent of the total)	7.7	9.1	11.4	15.2	13.7	11.6
Number of beneficiaries receiving categorical HCS benefits (mln. people)	46.0	48.8	49.8	44.0	43.9	37.5
Ratio of households payments in the overall HCS costs, percent	53	59	69	73	78	84

Source: Овчарова Л.Н. Доступность жилья: возможности и ограничения. В кн.: Обзор социальной политики в России. Начало 2000-х. М., НИСП, 2007, с. 319 (calculated based on Rosstat data).

Still, budgetary expenditures on subsidies and benefits remain considerable, and the share of these expenditures in the total payments for HCS has not changed radically. Available data for 2003 (before the start of monetization reform) provide an insight into the structure and proportions of budgetary aid to households: financing of the subsidies program through budget funds accounted for 6.2 percent of the total HCS sector financial receipts (households' payments plus budgetary financing). Category-related benefits accounted for a slightly higher share of this total, i.e. 10.4 percent; compensations of the difference between the economically feasible prices and

<sup>68</sup> Обзор социальной политики в России. Начало 2000-х годов. - М., НИСП, 2007, с. 319.

actual household tariffs (paid from the budget directly to service providers) accounted for a much larger figure, 21.1 percent.<sup>69</sup>

### **5.5 Simulation exercises: analysis of the consequences of social benefits monetization in Russia**

As was mentioned above, one of the most serious drawbacks of the monetization reform was the lack of a preparatory social expert assessment; that, in fact, deprived federal and regional authorities of the opportunity to evaluate possible social consequences of the reform as well as to control the process of its implementation. Only after the FZ-122 law came into force and the government faced mass manifestations of social discontent, experts in Russia have initiated several independent studies of the reform effects, including its consequences for households. An assessment of the reforms consequences was undertaken using the micro-simulation modeling technique. A micro-simulation model of the Russian population was built based on NOBUS data.

As concerns a simulation of a complete monetization of HCS benefits, an exercise of such kind for all categories of beneficiaries was carried out by CEFIR researchers<sup>70</sup>. The authors took into consideration only limitations on social norms of housing, since no information on consumption norms (cold and hot water supply, electric power, etc.) was available. These data were used to estimate values of in-kind privileges for each of the beneficiaries' categories. It was assumed that each beneficiary receives a sum of money equivalent to an average cost of benefit within his/her category. If a benefit is provided to the whole of household then the family receives a money equivalent of an average sum for the category to which the beneficiary belongs times the number of family members. It was also assumed that households would compensate full costs of HCS in conformity with the proportion set in the respective region (in 2003-2004, this proportion actually did not differ much across regions, and it was assumed that an average households' share amounted to 77 percent). It was also assumed that the whole sum of compensation is spent exclusively on payments for HCS.

The simulation by CEFIR demonstrated that some 22 percent of households, mostly urban and of old aged, would lose out. Until HCS benefits are monetized, the overall distributional effect simulated appears quite positive. This is because the majority of 'losers' are the non-poor, while the poorest families, single pensioners apart, tend to gain from monetization.

Simulations of housing privileges showed that the ongoing reform will affect poor households and pensioners severely and the government will need to allocate large subsidies to mitigate the potential negative effects. The main trend was as follows: the smaller was the share of HCS payments by the households in the respective settlement before the monetization, the larger were the losses of the households. Thus the simulation revealed that inhabitants of large cities, where the share of households payments used to be lower (71,22 percent), would lose most. This situation would consequently require an intensive growth of housing subsidies which, as simulations showed, are to grow considerably in most of the regions. As a result, in order to cover the additional financing of HCS subsidies and monetized benefits the respective budgets will need to increase the overall financing by dozens of percent.<sup>71</sup>

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<sup>69</sup> Овчарова Л.Н. Доступность жилья: возможности и ограничения. В кн.: Обзор социальной политики в России. Начало 2000-х. М., НИСП, 2007, с. 306.

<sup>70</sup> Н. Волчкова, Е. Горшкова, С. Лобанов, А. Макрушин, Н. Турдыева, Ю. Халеева. «Оценка последствий реформирования системы социальных гарантий: монетизация льгот и реформа ЖКХ». Серия «Аналитические разработки и отчеты», № 25. М.: Центр экономических и финансовых исследований и разработок (ЦЭФИР), 2006, <http://www.cefir.ru/download.php?id=469>.

<sup>71</sup> Another study (Independent Institute for Social Policy, 2006), using NOBUS, also concludes that monetization might reduce cash poverty; but this effect will be wiped out by increased prices for housing utilities and medical

Thus, to minimize the negative effects it would be necessary to change the procedures of subsidies' allocation and to enhance their targeting. It appears that the housing subsidies program offers a ready vehicle for a targeted distribution of these benefits. Another important conclusion from a simulation of HCS monetization reform is that special attention should be paid to pensioners living alone, and that this category of the population, though not specially referred to during monetization reform, needs a special subsidy program.

## **6. Main gains and failures**

### **6.1 Major gains**

As can be seen from the above, the goals set by the FZ-122 law, were in general achieved. The major gains of the reform could be specifically described as follows:

- several non-financed mandates were eliminated;
- responsibilities between federal and regional zones of budgetary were delimited;
- the zone of federal responsibility as concerns social expenditures was substantially reduced and brought into balance with available financial and economic resources;
- the main body of non-financed or inadequately financed mandates was transferred to the sphere of responsibility of regional and local authorities;
- regional and local authorities were placed in charge of balancing revenue availability with the new expenditure mandates;
- the financial position of service providers has in general improved;
- compensation payments (MCP) were introduced for the 'federal' beneficiaries, and the financial situation for most of them improved;
- personal registration of 'federal' beneficiaries was carried out;
- the division of privileged categories into two groups created positive incentives for the establishment of transparent accounting and information systems.

Thus, major gains were primarily related to the creation of budgetary and organizational prerequisites for a comprehensive reform of the benefits system.

### **6.2 High costs and controversial implementation path**

A serious and to some extent unexpected failure of the reform was its high cost that resulted in a slow and controversial implementation path. That, in turn, was a result of numerous failures in the course of reform preparation and the evaluation of its expected results (e.g. at the initial implementation stage extra financing was required urgently to calm down mass manifestations of social discontent), on the one hand, and of the endogenous controversies of the reform concept (e. g. a categorical principal of monetization, or provisions of the FZ-122 law on non-deterioration of material conditions), on the other hand. Benefits monetization and payments of cash benefits (corresponding to an average market cost of services) to all the beneficiaries in a specific category required a considerable increase of budgetary expenditures. As a result, in the course of division of expenditure powers between federal and regional budgets and a re-allocation of specific revenue sources between them, the size of expenditure mandates and the needs for financial resources from regional and local budgets were underestimated.<sup>72</sup>

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services, previously provided as privileges. It was estimated that the overall growth of expenditures needed to monetize HCS benefits could exceed 40%. Овчарова Л., Пишняк А. *op. cit.*

<sup>72</sup> Голованова Н., Курляндская Г., 2005, *op. cit.*

### **6.3 Negative impact on pension indexation schemes**

Monetization produced a strong negative impact on pension indexation schemes. The process started from the urgent reaction of the central authorities on mass social protests against the monetization of benefits; these materialized in the indexation of the basic part of pensions far above the previously planned schedule.<sup>73</sup> Apart from the fact that it caused a dangerous precedent of pension legislation violation, economic consequences of these actions resulted in a growth of the pension system deficit. Furthermore, a rapid increase of the basic part of pension undermined the balance between the insured and basic parts of pension and thus prevented an introduction of insurance principles into the overall pension scheme.<sup>74</sup>

### **6.4 Failure in gaining transparency**

The priority goal of the reform – a radical decrease of the number of benefits, streamlining their structure and making it more transparent – was not achieved. The main cause was the choice of a categorical mode of monetization. The absolute majority of benefits have been retained and their structure was additionally complicated by the division of beneficiaries by sources of funding into 'federal' and 'regional' subgroups.

### **6.5 Regional budget imbalance**

Another important goal of the reform, to balance the amount of state social obligations with financial and economic resources available was attained only partially – at the federal level. The regional budgets still suffer from a misbalance that resulted in slow monetization progress at the regional level and a wide use of a quasi-monetized forms of in-kind benefits. Regions also suffer from the lack of implementation instruments to push forward monetization.

### **6.6 Invisible progress in reforming social safety net**

The ongoing monetization reform in Russia did not (and could not, due to its concept) provide an impetus to a vital reform of social protection system. Indeed, very little was made to adjust the ongoing replacement of in-kind benefits by cash payments to the needs of a radical reform of a very expensive and outdated system of benefits and its channeling to meeting the needs of the most needy and low-income population groups. These issues were not on the agenda neither during discussion period prior to the reform implementation, nor were they reflected in the law provisions. Russian reform followed the categorical principle which was the easiest way of action for administrators at all levels, and thus only limited targeting via categories was possible. Thus the reform failed to produce a considerable impact and to become a sizable event in the social and economic life of the country. Somewhat improved accounting, modest results in transition towards cash benefits and zero progress in introduction of targeting do not appear worth the implementation difficulties and political price paid to calm public protests.

### **6.7 Low impact on redistribution**

The controversy of the reform concept in fact prevented it from leveling out the existing income disparities between beneficiaries from different categories. In fact, according to several experts estimates<sup>75</sup>, some progress in redistribution of real disposable incomes took place and inequality

<sup>73</sup> Обзор социальной политики в России. Начало 2000-х годов. М., 2007, с. 211.

<sup>74</sup> См. Малеева Т.Ю., Синявская О. Пенсионная реформа в России: история, результаты, перспективы. М., 2005.

<sup>75</sup> Volchkova et al., 2006, op. cit.



was slightly reduced. This was due to the fact that the majority of 'losers' were the non-poor, while the poorest families (with the exception of single pensioners) tend to gain from monetization. Yet, this positive effect is likely to evaporate as soon as the housing privileges are monetized and it will affect poor households severely. The fact that some 22 percent of households, mostly urban and of older age, would lose-out will force the government to allocate large subsidies to mitigate the potential negative effects.

### **6.8 Unclear impact on poverty reduction**

The monetization reform came in conflict with the declared national priority goal of poverty reduction. As was estimated, the existing system of benefits excludes almost 80 percent of single-parent families and more than 60 percent of the families with many children which have the maximum risks of poverty<sup>76</sup>. According to the specified priorities of social policy, these families are to become the key group for social protection programs. Today, the fact is that not a single regional government has introduced targeting of categorical social assistance to low-income people or households, at least within the defined categories. Social protection authorities acknowledge that unclear rules of the game cause them to avoid targeting, so that they are not charged later by the Prosecutor General's office for worsening the conditions of the non-poor, who would lose as a result of targeting the poor. This is a visible anomaly of the reform rules that reduces its potential value.

Social protection experts' estimates demonstrate that to implement the two social programs simultaneously – to run for poverty reduction by expanding respective social programs, on the one hand, and to preserve almost unchanged a system of benefits, on the other one – is an unsolvable task. It is clear that its resolution would require to supplement monetization programs by additional complicated and expensive managerial decisions that should exclude non-poor population groups from social programs.<sup>77</sup>

### **6.9 Consequences at the regional level**

At the regional level, monetization reform caused serious negative consequences<sup>78</sup>:

- monetization has stimulated the growth of inter-regional differentiation in the material status of 'federal' beneficiaries, since compensations from the federal budget (paid to 40 percent of beneficiaries' total number) do not take into account the differences in the costs of living across regions, whereas per capita compensations paid to 'regional' beneficiaries differ to a considerable extent among the regions;
- monetization contributed to the growth of differentiation of incomes between the population of "rich" and "poor" regions, since in the majority of regions with higher budgetary sufficiency the size of per capita compensations is larger;
- the material standing of beneficiaries in Northern and Eastern regions of the country, where costs of living are higher, have deteriorated, since the size of compensations is poorly adjusted to the increased costs of living;
- the inequality of regions in their capacities to implement social programs has increased, as "poor" regions were forced to bear social responsibilities that were beyond their capabilities;

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<sup>76</sup> IISP estimates based on NOBUS data.

<sup>77</sup> Овчарова Л., Пишняк А., 2005. *op. cit.*

<sup>78</sup> Зубаревич Н.В. Трансформация механизмов социальной политики: Как адаптируются регионы? (Леонтьевские чтения - 2007), <http://www.journal.leontief.net/rus/2007/papers/zubarev.rar>; Доходы и социальные услуги: неравенство, уязвимость, бедность. М., НИСП, 2005 (<http://www.socpol.ru/publications/book1.shtml>).

- instead of unification of the systems of social protection and social benefits financing, arrangements in various regions were subject to fragmentation with alternating and confused lists of cash benefits provided;
- The vector of the benefit monetization reform has the opposite direction to the one of declared policy of budgetary adjustment.

On the whole, the reform of in-kind privileges in Russia can be assessed as making very limited progress, compared to what it could have achieved and what other CIS countries have accomplished. Russia represents perhaps the most outstanding case of social policies and practices to be avoided by countries building an efficient social safety net that can function sustainably in a market economy.<sup>79</sup>

## ***7. Lessons that could be derived from the Russian monetization experience***

Poor results of Russian monetization experience suggest that a similar reform, in order to be successful, should address the following essential issues at various stages of the process:

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

- The monetization of in-kind benefits should be to a maximum possible extent integrated into the overall concept of social safety net reform and be subordinated (at least partially) to its main principles, providing cohesion and preventing social exclusion.
- To avoid, whenever possible, a categorical principle of benefit assignment and rather concentrate on the real needs and bottlenecks of beneficiary groups based on the information collected in the General register of beneficiaries. 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. Information from General register (in case it contains data on real needs or income and family status of a beneficiary), as well as simulations of different options could be of great help here.
- To avoid an interregional differentiation of a real value of cash benefits, it is essential to introduce a set of regularly revised coefficients reflecting the proportions in living costs between different regions of the country. The size of an individual compensation should be justified at the regional level.
- The concept of HCS monetization should be closely connected with the system of targeted housing subsidies.
- Transparency of financial obligations of the budgets of different administrative levels is absolutely necessary, as well as clearly defined “zones” of responsibilities of executive bodies at different levels.
- Experience of many countries demonstrates that decentralization of social protection responsibilities coupled with the allocation of essential funds proved to be effective in gaining the maximum results with limited resources. Thus, a decentralization in decision-taking rights (regarding assignment of payments, their size, etc.) is essential since local self-governance level provides the best opportunities for targeting social assistance and, as a result, the most simple and effective way to eradicate poverty and social exclusion.

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<sup>79</sup> Alexandrova A. & Struyk R., 2007, op. cit.

- As concerns structure of beneficiaries characteristic for FSU countries, it seems that in all these countries it is important to maintain (or maybe marginally modify) the privileges established earlier for categories of elderly beneficiaries (war veterans and homefront workers, victims of political repressions, etc.), the number of which is dwindling each year. It is equally important not to enlarge this category through extending their privileges on other population groups.
- As regards those categories of beneficiaries that are more numerous and growing in number, the realistic way out here should be based on a maximum personalization of cash benefit, the size of which should be determined (apart from age) by: (i) beneficiary's real income, (ii) his/her housing conditions; (iii) state of health, (iv) number of dependents and (v) adjusted for a regional cost of living. A formal assignment of an equal cash benefit on the basis of belonging to a certain category only does not make much sense. An institute of "category of a beneficiary" should be transformed into a specific (or unified) cash benefit. Thus no moratorium on assigning new benefits will become necessary at the local level.

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

- The experience of monetization reform in Russia demonstrated the importance of close coordination of interests of different state ministries and agencies. This primarily relates to the ministries of the social block, responsible for the ideology of the reform, and financial and economic block ministries. A close coordination between the reform design and the provisional schemes of budgetary and tax adaptation reform would be of great value. Lack of such coordination in Russia caused delays in reform implementation, made the reform more expensive and brought about quite controversial results. Monetization reform by itself is not exclusively a financial balancing and budgetary delimitation exercise, but rather a structural element of a future social safety net adjusted to the needs of a market economy.
- 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. Such expertise must answer the question what share of the total budget expenditures on the whole of monetization reform would be targeted directly to the poor families.
- Various reform options should be checked on resource availability. A deep analysis of budgetary obligations and potential should be provided.

*(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.

## Annexes

### Annex 1

#### *Division of groups of beneficiaries according to financial responsibilities of federal and regional budgets*

##### 1.1 Groups of beneficiaries assigned to the federal budget

Disabled persons (I, II, III groups)
Disabled WWII veterans
WWII participants, combat veterans (a total of 8 subcategories within this group)
Family members of the deceased WWII invalids
Persons affected by radiation
Handicapped children

##### 1.2 Groups of beneficiaries assigned to regional budgets

Home-front workers during WWII
Labor veterans
Victims of political repressions
Heroes of the Soviet Union
Employed in special risk units
Beneficiaries entitled to benefits according to professional affiliation
Employed on hard types of work
Other categories

##### 1.3 Changes resulting from the monetization reform of 2004 for selected programs by responsible level of government

<i>Bene- ficiaries</i>	<i>Benefits before 'monetization'</i>	<i>In-kind bene- fits remaining in 2005</i>	<i>Cash benefits introduced since 2005</i>
<b>RESPONSIBILITY OF THE FEDERAL BUDGET STARTING FROM 2005</b>			
WWII partici- pants and combat veterans (total of 8 subcate- gories within this group)	<ol style="list-style-type: none"> <li>50% discount on housing and utility services.</li> <li>50% discount on guard services for single-living persons or couples.</li> <li>Free provision of medicines.</li> <li>Free denture services.</li> <li>Free provision of prosthetic devices.</li> <li>Free urban and suburban transportation.</li> <li>Railroad and water transport commuter services.</li> <li>Once every two years (or 50% discount once a year) free return ticket on rail, water, air or bus services.</li> </ol>	50% discount on housing and utility services. Free provision of prosthetic devices.	RUR 2,000 (to WWII in- valids), RUR 1,500 (WWII participants), RUR 1,100 or 600 (others) (came into force from Jan. 1, 2006).
Disabled persons	<ol style="list-style-type: none"> <li>Free provision and repair of rehabilitation equip- ment or compensation for equipment purchased.</li> <li>Free provision of a motor car or compensation for transport services.</li> <li>Free provision of medical and domestic services (if needed).</li> <li>50% discount on telephone and wired-radio ser- vices.</li> <li>For those not working – free provision of sanato- rium-resort therapy.</li> <li>For those working – subsidized provision of sanato- rium-resort therapy.</li> </ol>	Free provision and repair of rehabilitation equipment or compensation for equipment purchased. Free parking for special cars.	<ol style="list-style-type: none"> <li>RUR 1,400, 1,000, 800 or 500 , depending on the degree of disability, as defined by state ex- perts (came into force from 1 January 2006).</li> <li>Payment for transport to prosthetic-orthopedic organization (depending on transport cost).</li> <li>Payment for accommo-</li> </ol>

	<p>7. For disabled and their attendants - urban, suburban and intercity transportation.</p> <p>8. For disabled or for a disabled person (I group) and his/her attendant - 50% discount on railroad, water or air commuter services in the period from 1 October till 15 May or free return ticket once a year on railroad, water, air, or bus services at other periods.</p> <p>9. For a disabled person (I or II group) and for disabled child - once a year free return ticket to the place of treatment</p>		<p>ation when traveling to prosthetic-orthopedic organization (depending on number of days' stay).</p>
<b>RESPONSIBILITY OF THE REGIONAL BUDGETS STARTING FROM 2005</b>			
Labor veterans	<p>1. Denture services equal to those of old-age pensioners.</p> <p>2. Free urban and suburban transportation.</p> <p>3. 50% discount on railroad and water commuter services.</p> <p>4. 50% discount on housing and utility services.</p> <p>5. 50% discount on solid fuel provision.</p> <p>6. 50% discount on telephone, wired-radio and TV antenna services.</p>	To be defined by regions of the Russian Federation	To be defined by regions of the Russian Federation
Victims of political repressions	<p>1. For rehabilitated - compensation = RUR 75 times # months of imprisonment, but not more than RUR 10,000 .</p> <p>2. For rehabilitated - refund of seized property or compensation for it (not exceeding RUR 400 for property without dwelling and RUR 10,000 for property with dwelling).</p> <p>3. For rehabilitated pensioners and disabled - 50% discount on provision of medicines.</p> <p>4. For rehabilitated pensioners and disabled - free urban and suburban transportation.</p> <p>5. For rehabilitated pensioners and disabled - rail and water commuter services.</p> <p>6. For rehabilitated pensioners and disabled - once a year railway return ticket or 50% discount on return ticket on water or air services.</p> <p>7. For rehabilitated pensioners and disabled - 50% discount on housing and utility services.</p> <p>8. For rehabilitated pensioners and disabled - 50% discount on solid fuel provision.</p> <p>9. For rehabilitated pensioners and disabled - free telephone installation.</p> <p>10. For rehabilitated pensioners and disabled - denture services.</p> <p>11. In case of a rehabilitee's death – funeral at the expense of the state</p>	To be defined by regions of the Russian Federation	<p>1. For rehabilitated - compensation = RUR 75 times # months of imprisonment, but not more than RUR 10,000.</p> <p>2. For rehabilitated — seized property refund or compensations for it (but not more than RUR 400 for property without dwelling and RUR 10,000 for property with dwelling).</p> <p>3. Others to be defined by regions of the Russian Federation</p>
Home-front workers during WWII	<p>1. Zero interest credits for building.</p> <p>2. 50% discount on provision of medicines.</p> <p>3. Free denture services.</p> <p>4. Free provision of prosthetic devices.</p> <p>5. Free urban and suburban transportation.</p> <p>6. 50% discount on railroad and water commuter services.</p>	To be defined by regions of the Russian Federation	To be defined by regions of the Russian Federation

Source: A. Alexandrova, R. Struyk, Reform of in-kind benefits in Russia: high cost for a small gain. Journal of European Social Policy, 2007, Vol. 17(2): 153-166.

## *Annex 2*

### *Payments to 'federal' beneficiaries (without "Social federal package")*

<b>Beneficiary category</b>	<b>Compensation, RUR</b>
Disabled, I group	950
Disabled, II group	550
Disabled, III group	350
Disabled WWII veterans	1550
WWII participants	1050
Combat veterans	650
Family members of the deceased WWII invalids	150
Persons affected by radiation	1000
Handicapped children	550

Source: Обзор социальной политики в России. Начало 2000-х годов. М.: НИСП, 2007.

Note: The federal list of beneficiaries also includes several categories that received much smaller compensation payments and who were not entitled to the in-kind social federal package. Still, they also could appeal for social services, although the amount of services to be provided to them cannot exceed the size of their monthly cash payment.

**Annex 3**

***Housing and communal service benefits assigned to different categories of beneficiaries***

<b>Groups of beneficiaries</b>	<b>Housing benefit, %</b>	<b>Communal services benefit, %</b>	<b>Telephone service benefit, %</b>	<b>Free installation of a telephone line, %</b>
Heroes of the Soviet Union and equated categories	100 (benefit retained) <b>A</b>	100 (benefit retained) <b>C</b>	100 (benefit retained)	100 (benefit retained)
Disabled WWII veterans, disabled former under-age prisoners of fascism	50 (benefit retained) <b>B</b>	50 (benefit retained) <b>C</b>	50 (benefit retained)	100 (benefit canceled)
WWII veterans, former under-age prisoners of fascism	50 (benefit retained) <b>B</b>	50 (benefit retained) <b>C</b>	50 (benefit canceled)	0
Combat veterans	50 (benefit retained) <b>B</b>	0	0	0
Invalids awarded with the label "Resident of Leningrad during the Siege"	50 (benefit retained) <b>B</b>	50 (benefit retained) <b>C</b>	50 (benefit canceled)	0
Family members of killed (deceased) war invalids and equated categories	50 (benefit retained) <b>B</b>	50 (benefit retained) <b>C</b>	50 (benefit canceled)	0
Labor veterans and equated categories	50 (benefit retained) <b>B</b>	50 (benefit retained) <b>C</b>	50 (benefit canceled)	0
Disabled (I, II, III groups)	50 (benefit retained) <b>C</b>	50 (benefit retained) <b>C</b>	50 (benefit canceled)	0
Handicapped children	50 (benefit retained) <b>A</b>	50 (benefit retained) <b>A</b>	50 (benefit canceled)	0
Persons affected by radiation	50 (benefit retained) <b>B</b>	50 (benefit retained) <b>C</b>	50 (benefit canceled)	0
Victims of political repressions and their close relatives	50 (benefit canceled) <b>B</b>	50 (benefit canceled) <b>B</b>	0	100 (benefit canceled)
Employed in special risk units	50 (benefit retained) <b>B</b>	50 (benefit retained) <b>C</b>	50 (benefit canceled)	0
Persons awarded with the badge "Honorary Blood Donor"	0	50 (benefit canceled) <b>C</b>	50 (benefit canceled)	
Families with many dependent children	0	30 (benefit retained) <b>C</b>		



Notes:

**A** – Discount covers all members of the family.

**B** – Discount for all members of the family, calculated proceeding from social housing standards and social norms of services consumption.

**C** – Discount calculated proceeding from social housing standards and standards of services utilization is provided only to a person entitled to a respective benefit.

Source: Волчкова Н., Е. Горшкова, С. Лобанов, А. Макрушин, Н. Турдыева, Ю. Халева. Оценка последствий реформирования системы социальных гарантий: монетизация льгот и реформа ЖКХ. Москва, Московский общественный научный фонд, Центр экономических и финансовых исследований и разработок (ЦЭФИР), 2006. Приложение А2.

## Annex 4

### **Implementation of the Program for supplementary provision of pharmaceuticals to privileged population categories<sup>80</sup>**

The program for supplementary provision of pharmaceuticals (SPP) to certain population categories receiving state social support from the federal budget was initiated in 2005. It had a very ambitious goal of changing, in qualitative terms, the provision of pharmaceuticals to disabled persons, war veterans, and persons exposed to radiation, by considerably expanding the list of pharmaceuticals to be provided to them free of charge, without imposing any limitations on physicians in prescribing these. In the 2005 federal budget, the allocations to cover the cost of pharmaceuticals issued to privileged population categories amounted to RUR 48 bn, which is 6 times higher than in 2004 (see Table).

#### **Indices of SPP Program implementation**

	2005	2006	2007
Number of citizens included in Federal Register of persons entitled to state social support, mln persons*	14.5	16.3	16.9
Total number of recipients of package of social services, mln persons*	12.6	8.4	7.7
Share of recipients of package of social services in total number of citizens included in Federal Register, %	87.1	51.4	45.6
Value of package of social services per persons per month, RUR	450	477	513*
Including value of pharmaceuticals, RUR	350	424	456
Sum of invoices submitted for payment for pharmaceuticals delivered under program of supplementary provision with pharmaceuticals, bn RUR	44.0	74.9	55.0
Federal budget expenditures on program of supplementary provision with pharmaceuticals, bn RUR		29.1	34.9
Initially established size of allocations	48.3	10.0	22.0**
Supplementary allocations			15.0
<i>Subtotal:</i>	<i>48.3</i>	<i>39.1</i>	<i>71.9</i>
Resources of Federal Compulsory Health Insurance Fund, bn RUR		5.0	8.8**
<i>Subtotal:</i>		<i>5.0</i>	<i>27.1</i>
<b>State expenditures on program – total, bn RUR</b>	<b>44.0</b>	<b>44.1</b>	<b>99.0</b>

\* As for January 01 for each year.

\*\* To final settlements in respect of pharmaceuticals delivered in 2006.

Source: The RF Ministry of Health Care and Social Development ([http://www.mzsrrf.ru/inform\\_fz/](http://www.mzsrrf.ru/inform_fz/)); Federal CHI Fund (<http://www.ffoms.ru/ffoms>).

However, this scheme had serious flaws from the very start. The privileged population categories were granted the right of choice as to whether to remain in that system, or simply to receive a money compensation instead. The sum of compensation and the sum allocated to pharmaceuticals per person remaining in the SPP program were identical. Quite naturally, the decision to remain within the system was made by those whose need for pharmaceuticals was greater. The volumes of pharmaceuticals being prescribed were not subject to any regulation. In such a situation, the system's default was only a matter of time. It should be said that the leadership of the Ministry of Public Health Care and Social Development had been duly warned about these flaws by specialists, but they hoped that the budget allocations would be sufficient for the system to function normally. Indeed, in 2005 there was no shortage of money. The expenditures on pharmaceuticals granted to privileged population categories amounted to RUR 44.0 bln.

In 2006 the SPP program was covering the remaining 8.4 mln out of the 16.3 mln citizens registered as entitled to social support from the federal budget. The rest had preferred money compensation. With due regard for the diminished number of the recipients of the package of social services that included, in addition to pharmaceuticals, also free-of-charge provision of treatment at a sanatorium or a health resort and the payment of the cost of travel to the place of such treatment, the allocations to the SPP program in the 2006 federal budget were initially established in

<sup>80</sup> Russian economy in 2007 (issue 29): Trends and outlooks / Inst. for the Economy in Transition; [Y. Gaidar and others]. – M. : IET, 2008. – 610 p. (<http://www.iet.ru/files/text/trends/2007-eng/2007-eng.pdf>)

the amount of RUR 29.1 bn . However, the level of demand of the privileged population categories for pharmaceuticals quickly began to soar as a result of the efforts of pharmaceutical companies, which created incentives for physicians to prescribe more expensive medications. The average cost of a prescription issued increased from RUR 448 in January 2006 to RUR 687 in December 2006<sup>81</sup> . As early as mid-2006 there already emerged a deficit of resources needed for the payment of invoices drawn by pharmaceutical distributors. The sum of invoices for the pharmaceuticals delivered to privileged population categories reached, by the end of 2006, RUR 67.0 bn, and ultimate total sum of the invoices presented by distributors amounted to RUR 75.9 bn .

To settle the payment, the residuals in the Federal Compulsory Health Insurance Fund (CHI) for the year 2005 in the amount of RUR 5.0 bn were used. In December 2006, RUR 10 bn RUR were allocated from the 2006 federal budget, and another 6.0 bn RUR –from the 2007 budget (Article 8 of the Federal law “On the budget of the Federal Compulsory Medical Insurance Fund for the year 2007”, of 29 December 2006, No. 243-FZ). In the Federal Law “On the introduction of alterations into Federal Law “On the 2007 federal budget”, No. 132-FZ, of 17 July 2007, it was envisaged that another sum of up to RUR10 bn was to be allocated to the final settlements against the pharmaceuticals supplied in 2006. But, quite obviously, this money was not sufficient. The sources of funding to cover the remaining RUR14.8 bn were determined in November 2007 by Federal Law “On the introduction of alterations to Federal Law “On the 2007 federal budget”, No. 269-FZ, of 23 November 2007, and by Federal Law “On the introduction of alterations to Federal Law “On the budget of the Federal Compulsory Medical Insurance Fund for the year 2007”, No. 264-FZ, of 23 November 2007. As a result, in 2007 a total of RUR 22.0 bn was allocated from the federal budget to complete the settlements for the pharmaceuticals delivered under the SPP program in 2006, and it was allowed to use 8.8 bn RUR out of the fixed insurance reserve of the Federal CHI Fund.

It is interesting to note that the Federal CHI Fund carried out an expert’s estimation of the invoices drawn and presented by distributors, in order to check the compatibility between the prescribed and delivered pharmaceutical and a given patient’s diagnosis, the instances of incompatible pharmaceuticals being prescribed to one and the same individual, and the compatibility between a pharmaceutical prescribed and the patient’s age and sex. The expert’s estimation revealed the presence of such incompatibilities amounting to a total of RUR 5.7 bn , or 7.5% of the total volume of pharmaceuticals delivered to privileged population categories. However, despite these results, additional funding was allocated in the amount corresponding to the total sum of invoices drawn.

The financial crisis experienced by the SPP program urged the Ministry of Public Health Care and Social Development to adopt some measures designed to adjust its basic principles. In October 2006 the list of pharmaceuticals to be made available to privileged population categories was shortened. The provision of pharmaceuticals to privileged population categories suffering from severe chronic diseases (7 nosological forms – hemophilia, mucoviscidosis, hypophysial nanism, Gaucher’s disease, myeloleukosis, multiple sclerosis, and immunosuppression associated with organ and (or) tissue transplantation) was separated from the SPP program into a separate program, to be financed from the federal budget. In accordance with Federal Law “On the introduction of alterations to the Federal Law “On the 2007 federal budget” of 24 November 2007, a total of RUR 47.9 bn was allocated to these purposes.

In February 2007, a new procedure for prescribing pharmaceuticals and filling-up the prescription forms was established (Order of the RF Ministry of Public Health Care and Social Development, No. 110, of 12 February 2007), which required that this was to be done in accordance with the approved clinical standards for each specific disease.

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<sup>81</sup> Hereinafter, if not specified otherwise, the data of the Federal Fund for Mandatory Health Insurance are cited (<http://www.ffoms.ru/ffoms/>).

However, these measures proved to be not far-reaching enough to prevent the emergence, in 2007, of the same situation of insufficiency of planned expenditures for the provision of privileged population categories with medications to cover the cost of pharmaceuticals delivered to them. The Ministry of Health Care and Social Development, Roszdravnadzor and the Federal CHI Fund were evidently incapable of ensuring centralized control over the substantiation for the prescription of pharmaceuticals to privileged population categories. This could have been easier to do for regional and local authorities, but they were, from the very start, placed outside of the network of financial flows in the SPP system, and therefore no clearly determined responsibility for the results of its functioning had been delegated to them.

The regions were also displeased with the numerous instances of lack of coordination between the actual needs of their populations and the actual items being supplied by distributors, as well as their volumes. The authorities of RF subjects had no effective instruments for influencing these deliveries, because both the list of pharmaceuticals and the list of suppliers were determined by federal agencies.

In the SPP system, by early 2007, there had remained less than 50% of the citizens belonging to such categories – 7.7 mln. In the 2007 federal budget it was initially envisaged that RUR 34.9 bn should be allocated to their provision with pharmaceuticals. However, the value of the actually delivered pharmaceuticals in 2007 will amount, according to the Federal CHI Fund, to no less than RUR 55 bn. By Federal Law “On the budget of the Federal Compulsory Health Insurance Fund for the year 2008 and the planned period of the years 2009 and 2010”, of 21 July 2007, No. 184-FZ, it was envisaged to allocate RUR 15 bn from the federal budget to the final settlements for the pharmaceuticals actually delivered in 2007; to allocate to the same purpose RUR 8.0 bn from the Federal CHI Fund as part of subsidies to the CHI territorial funds for the implementation of territorial CHI programs, as well as to spend up to RUR 10.3 bn from the fixed insurance reserve of the Federal CHI Fund.

Thus, the total sum of allocated funding will amount to RUR 68.2 bn. Thus, the financial results of the SPP program’s implementation in the past three years are disappointing. In 2006 the sum of invoices drawn by distributors for pharmaceuticals delivered to privileged population categories exceeded the initially planned budget 2.2 times, and in 2007 – 1.6 times. The provision of privileged population categories with pharmaceuticals, indeed, improved by comparison to the situation prior to 2005, but the problems arising from untimely settlements of the invoices presented by suppliers resulted in temporarily diminished deliveries and uncertainties as to how long would be the period of waiting for a prescribed pharmaceutical to be actually delivered. At first, privileged population categories had unreasonable hopes, which then gave way to disappointment and dissatisfaction. And for all this, the State had to pay very dearly – no less than RUR 174 bn in three years, without taking into account the size of money compensations paid to the group of more than a half of the “privileged” population which had left the system. In 2008 the number of those belonging to privileged population categories who remained in the SPP program diminished to 5.5 mln, thus amounting to 33% of the total number of the population granted the right to social support from the federal budget (16.9 mln persons).

The practical experience of implementing the SPP program has made obvious the fact that the exclusion of the authorities of RF subjects from full-fledged participation in it, and the attempt to manage the program exclusively from the federal level was a gross error. As a result, a legislative decision was made to transfer to the bodies of state authority of RF subjects the powers pertaining to the organization of the provision of pharmaceuticals, medical products and specialized dietary foodstuffs for disabled children to the citizens included in the Federal Register of persons entitled to state social support (Article 18 of Federal Law “On the introduction of alterations in individual legislative acts of the Russian Federation in connection with improving the delimitation of powers”). From 1 January 2008, the organization of the placement of orders for the supplies of pharmaceuticals under the SPP program in the form of auctions, the conclusion of government contracts, as well as the organization of the population’s provision with pharmaceuticals

purchased under government contracts has been effectuated by the authorities of RF subjects. The SPP program will be financed within the framework of the basic compulsory medical insurance program as part of the subsidies allocated to that program's implementation, and these expenditures will no more be entered as a separate item into the federal budget and in the budget of the Federal CHI Fund. According to the Federal CHI Fund, the financial backing for the SPP program in 2008, allocated as part of the subventions transferred to territorial CHI funds for the implementation of the basic CHI program, will amount to RUR 27.5 bn. Now, it is, in fact, RF subjects who bear the responsibility for overspending the resources allocated to the SPP program from the federal budget. In addition to the already mentioned expenditures on the SPP program, in the 2008 federal budget it has been envisaged that RUR 18.7 bn should be allocated to centralized purchases of pharmaceuticals needed for the treatment of the 7 severe pathologies listed above.