

# **“They Pretend to Pay Us. . . .”**

## **The Wage Arrears Crises in the Post-Soviet States**

DANIEL ROSENBLUM

**A**fter the first round of the Russian presidential election last summer, exit polling was conducted in which Russian voters were asked, among other things, what was the most important issue in their vote decision. Their answer might surprise those of us whose primary source of news about Russia is the Western media. For most Russian voters, it was not Boris Yeltsin’s health, or the war in Chechnya, or the growth of “mafia” influence that determined their choice for president. The single most important issue for a plurality of voters surveyed was something closer to home: the timely payment of their wages and pensions.<sup>1</sup> These Russian voters, like people anywhere in the world, were responding to a simple truth: nothing else matters much if you aren’t getting paid what you are owed.

When Leonid Brezhnev ruled the Soviet Union, there was a popular saying that captured the cynicism engendered by the socialist economy: “They pretend to pay us, and we pretend to work!” Today, this old saying has taken on a new and literal meaning. Non-payment of wages (usually referred to as “wage arrears”) is endemic throughout Russia and the rest of the former Soviet Union and has been for the past several years. Although the length of payment delays varies from country to country and from workplace to workplace, it is fair to say that waiting to be paid overdue wages is a common experience for a majority of people in the region. The average Russian, Ukrainian, or Kazak worker is owed at least one month back pay, but some employers have not paid wages in half a year or more.

Wage arrears have become such an established fact of life in these countries that it takes a dramatic event to draw attention to it. Last June, for example, less than a week before the Russian election, 5,000 nuclear industry workers in the formerly closed Urals city of Snezhnisk held a demonstration to protest the fact that they had not been paid since January and were owed 35 billion rubles (\$7 million). Participants warned that if their demands to be paid were not met, the joint U.S.-Russian program to destroy nuclear weapons could be placed in jeopardy.

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Until April 1997, Daniel Rosenblum was senior program coordinator for the former Soviet Union at the Free Trade Union Institute, AFL-CIO.

This protest by scientists and construction workers in Snezhinsk made the international wire services. So did the Ukrainian coal miners who blocked roads and railway lines in early July to protest four months without wages, and the Russian coal miners and power plant workers in the Far East who conducted hunger strikes in late July and again in September to demand their pay. These and other high-profile protests have had similar outcomes: the government promises to eliminate the wage debt and to sack those responsible for it; a portion of the arrears is paid off immediately; solemn pledges are signed to pay off the remainder by a certain date. And a few months later, the cycle repeats itself.

When the non-payment of wages first appeared in the aftermath of the break-up of the Soviet Union, it was widely assumed to be a transitional phenomenon caused by the freeing of prices and wages and the resulting shortage of cash. When enough money was printed and inflation was brought under control, it was reasoned, wage non-payment would no longer be a serious problem. But five years later, the problem, if anything, seems to be getting worse.

Writing about the former Soviet bloc countries as a whole, one Western analyst has identified wage arrears as “a litmus test of the extent to which positive market forces are taking root in those societies.”<sup>2</sup> This argument is supported by the fact that in those central European countries generally considered to have carried out the most successful economic reforms—such as Poland, Hungary, and the Czech Republic—wage arrears are practically nonexistent, while in slower reforming countries like Bulgaria and Romania, they are more common, although not widespread. But it is in the states of the former Soviet Union where wage arrears have reached tidal wave proportions.

Despite a relative lack of international attention and a domestic reaction that has so far not resulted in massive unrest, the governments running these states are beginning to realize that they must resolve the problem soon or risk a social explosion. To do so, they must first accept that persistent wage arrears are a symptom of serious underlying illnesses in the economies of the ex-Soviet states and that it is not enough simply to borrow more money from international lenders to pay wages—the systemic problems have to be addressed. At the same time, the Western governments and financial institutions supporting these countries must be sensitive to the political volatility of the wage arrears problem and help post-Soviet governments to deal with it as a separate and high-priority issue.

### **The Scope of the Problem**

The extent of the wage arrears crisis was first brought home to me during a visit to Kazakstan in December 1994. As a representative of the AFL-CIO’s Free Trade Union Institute, this author attended a meeting of miners’ union leaders held in Kentau, a town in southern Kazakstan not far from the border with Uzbekistan. Kentau had been built in the 1950s to mine large deposits of nonferrous metals, such as lead and barite. With the collapse of the Soviet Union, former customers in the military-industrial complex had disappeared, old supply links with Russia and Ukraine were broken, and production had practically stopped. As a result, miners had not been paid their salaries for nine months. In the previous two years,

40 percent of the town's population had emigrated; those remaining faced power blackouts four or five hours each day. People were cutting down trees in the public parks for firewood. It was a grim situation. But was Kentau typical?

I became convinced that Kentau was not an aberration when I began talking to workers from other mining centers around Kazakhstan who described similarly horrific conditions in their hometowns. The delegate from the northern iron ore mining city of Rudny, however, told me that she considered herself "lucky" in comparison with her colleagues from Kentau. She maintained that life was much better in the northern regions of Kazakhstan. "After all," she exclaimed, "in Rudny, we're only two months late in receiving our wages!"

Wage arrears have become such an established fact of life in Russia that the State Committee for Statistics (*Goskomstat*) has started keeping two sets of data: one for wages formally allotted and one for wages actually paid.<sup>3</sup> In Russia and elsewhere in the former Soviet Union, the statistics bear out the extent of this crisis. A survey carried out in November 1996 found that 62 percent of Russian workers had not been paid their October wages<sup>4</sup> Similarly, a poll conducted in Ukraine in March 1996 found that 48 percent of respondents had not been paid for two months or more; 5 percent had not been paid for more than six months.<sup>5</sup>

Even as governments declare their intention to eliminate wage arrears, the situation seems to be worsening. By the end of 1996, Goskomstat was reporting that the total wage debt in Russia had reached 47 trillion rubles, or about \$8.3 billion at current exchange rates. This represents a doubling of unpaid wages since mid-February, when President Yeltsin, officially announcing his intention to run for a second term, boldly stated, "From March there will be no problem with wage arrears. I am not only promising; this has been fully worked out." In Ukraine, the wage debt in late November 1996 stood at 3.6 billion hryvnias or about \$2 billion—again nearly double what it had been at the beginning of the year. Similarly, in Kazakhstan, total wage arrears went from \$638 million in August 1996 to \$685 million by the end of the year. Although such statistics are not available for every FSU country, anecdotal evidence strongly suggests that the problem exists throughout the region and, in many cases, is growing in scope.

### **What Causes Wage Arrears?**

The origins of wage arrears go back to early 1992 when the first serious dismantling of the centrally planned and controlled Soviet economy began. First in Russia and later in other ex-Soviet states, prices were deregulated, resulting in a period of very high inflation, which in turn greatly increased the need for cash. The existing capacity to print bank notes, as well as the system for their distribution, proved inadequate when confronted by a sudden increase in demand. Because wages could be paid only in cash,<sup>6</sup> employers' ability to pay wages was severely restricted by the general cash shortage.

In 1992, it was widely assumed that wage arrears were a transitional problem that would go away when the government printing presses caught up with demand. But in fact, the problem has persisted and grown in scope and frequency. What explains this phenomenon?

Today, when employers in the former Soviet Union do not pay their employees a variety of explanations are offered. In privately owned or newly “privatized” companies, management says that it does not have the money because the company has not been paid by its customers or because it cannot find any customers at all. State-owned or -subsidized firms (such as coal-mining or power generation enterprises) invariably blame the government for failing to deliver promised subsidies or credits. The government, in turn, points to low tax collection rates and the resulting budget deficit as the reason it cannot pay its own employees or provide the full subsidies expected by industry.

These commonly heard explanations are accurate as far as they go, but they do not go far enough. First, they do not provide enough perspective on how the various causes of wage arrears connect with and reinforce one another. In fact, these causes are intimately linked as part of a massive, economywide non-payments problem, which makes untangling the wage arrears mess all the more difficult. Second, these explanations skirt the question of accountability: Wage arrears are always laid to “circumstances beyond our control.” Each employer has someone else to blame for his lack of cash to pay salaries. Yet there is considerable evidence that a portion of wage non-payment is, in fact, due to mismanagement or intentional (and illegal) diversion of wage funds for personal profit.

#### **Non-payment in Action: Primorsky Krai**

The crisis that unfolded in the Russian Far East last summer is a good illustration of how wage arrears are linked to a larger, economywide debt problem. It is also a useful case study in how post-Soviet governments have so far reacted to the disorder caused by this massive debt. In early July, severe cutbacks in power supplies began leaving homes in Vladivostok and other parts of Primorskii Krai (the enormous and resource-rich Pacific Coast region) without electricity for up to sixteen hours a day. By 16 July, ITAR-TASS was reporting that the area’s largest electrical power station was producing only 30 megawatts of power, compared with its usual output of 1,400 megawatts. Factories were idled, and public transport stopped running; even municipal hospitals were being cut off for several hours each day. Rumors spread (later denied) that the alarm system on the Russian-Chinese border had also been switched off because of the power shortage.

The situation went from bad to worse in late July, when coal miners working for the region’s main coal company, Primorskugol, began striking to demand payment of \$22 million in back wages. They had not been paid for four months. Within days they were joined by power plant workers in Vladivostok, who were owed \$23 million in unpaid salaries. By the end of July, up to 12,000 miners and several thousand power plant workers had stopped working. Three hundred of the power plant workers staged a hunger strike to dramatize their plight.

The proximate cause of the Far Eastern energy crisis was a decision by the Primorskugol coal company to halt supplies to consumers who had not paid their bills. The company’s board of directors ordered its mines, beginning on 1 July, to stop delivering coal to delinquent customers. It happens that the main consumer of Primorskugol’s coal—and by far its biggest debtor—is the Dalenergo elec-

tricity company, which by the end of June owed 400 billion rubles (about \$80 million dollars). When Primorskugol halted shipments of coal to Dalenergo, the consequences were predictable and immediate: Dalenergo could no longer produce enough energy to supply its customers. But the story by no means ends there.

Dalenergo, in turn, was owed nearly 1 trillion rubles: 400 billion rubles by its own customers and 600 billion rubles by the Russian government, which provides state subsidies to cover the difference between the cost of producing energy and the prices charged to consumers. The company claimed it could not settle its debt with the coal company or pay its employees until it collected at least a portion of its own overdue payments. For its part, the Russian government, while admitting its failure to provide Dalenergo with the

full subsidy to which it was entitled, faulted an inefficient energy system and a mushrooming state budget deficit, brought about largely by the failure of large industrial enterprises—including Dalenergo! —to pay their taxes.

Not until a series of high-level Moscow officials—including the fuel and energy minister and first deputy prime minister—visited the region, bearing promises of cash to pay at least a portion of the overdue wages, did the strikes subside. Other government officials spoke about the need to restructure the energy industry, and Primorskugol was urged to avoid precipitous cutoffs of coal supplies in the future. The ineffectiveness of these half-measures became clear two months later when the Far Eastern crisis was replayed, almost headline for headline.

Such crises have become almost routine. Nearly every week a similar scenario plays itself out somewhere in the former Soviet Union.

### **The Roots of the Debt Crunch**

The experience of Primorsky krai shows the interconnectedness of wage debts with other debts throughout the economy. Understanding how this broader debt problem originated is crucial to addressing wage arrears.

In the economic Wonderland that was the socialist economy, financial discipline was unnecessary because the state simply wrote off all debts. Under central planning, the financial transactions accompanying exchanges of goods among enterprises were simply bookkeeping entries based on fictitious prices and the guidelines of the Five-Year Plan. Enterprise managers worried first about meeting the plan's production quotas; the books could always be adjusted later to fit the realities of production. The behaviors and attitudes engendered by this system persist today in what one observer has called a "culture of non-payment."<sup>7</sup> Many post-Soviet enterprises continue to produce and ship goods *in spite of* the fact that there is no one to pay for them. Their working assumption is that somebody will bail them out.

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Governments tend to reinforce the bad habits of these Soviet-style managers by serving as the financier of last resort. Afraid of the potential consequences, they are reluctant to allow enterprises to go bankrupt. Because they refuse to enforce what economists call a “hard budget constraint,” these governments have in effect facilitated the enormous growth in interenterprise debt.

Interenterprise debt is exacerbated by the overall decline in demand that accompanied the collapse of the Soviet Union. Defense-related enterprises were hit especially hard as the government orders they once relied on vanished. But substantial portions of the civilian industrial base of the Soviet Union also suffered in the process. Before 1992, many Soviet factories were producing huge quantities of shoddy goods that nobody—except the State Planning Committee—wanted. Now, these enterprises are unable to sell their goods, revenues fall, and there is simply not enough money in the company’s bank account to pay suppliers or employees.

Meanwhile, post-Soviet governments themselves have run up large debts. Under pressure from international financial institutions to cut spending and to cease the inflationary practice of borrowing from the central bank, most governments in the region have been startlingly successful at maintaining fiscal discipline, slashing the average budget deficit from 13 percent of GDP in 1992 to below 5 percent in 1995. But this has occurred simultaneously with a huge drop in revenues caused by the deep economic recession, tax exemptions granted to politically powerful firms, and widespread tax evasion practiced by people at all levels of society. As a result, the governments cannot fully fund basic social services, let alone pay the full subsidies they have promised to companies like Primorskugol and Dalenergo. And they often cannot pay wages to the so-called budget workers—the tens of millions directly employed by the state, such as teachers, medical workers, and military personnel.<sup>8</sup>

The various debts outlined above reinforce one another. When enterprise X is late paying enterprise Y, enterprise Y cannot pay its own suppliers, its employees, or the taxes it owes to the national and local governments. Non-payment of taxes causes government budget shortfalls and delays in paying state subsidies. Without subsidies, enterprises fall further into debt, and so on. A vicious circle of non-payment has been created, a debt whirlpool that generates its own momentum and prevents the economy from functioning normally.

### **The Blame Game**

Whenever non-payment of wages reaches crisis proportions in a particular sector of the economy, many are quick to blame incompetent enterprise managers or corrupt government officials. This raises the question of to what extent wage arrears are caused by the actions (or inaction) of identifiable individuals. Intentional withholding or diversion of salary funds is difficult to trace or quantify because it is obviously in the interests of guilty parties to hide what they are doing. But enough well-documented cases exist to conclude that at least a portion of the wage arrears problem is due to what Russian Deputy Prime Minister Anatoly Chubais described as “elementary laxity or just plain stealing.”<sup>9</sup>

The most common situation involves enterprise directors who claim that they do not have funds to pay salaries when, in fact, they are investing the money elsewhere for profit.<sup>10</sup> For example, a Russian government commission set up to investigate the debt crisis in the coal industry in 1994 found widespread misuse of wage money. One regional branch of the Russian state coal company, Rosugol, was found to have used 17 billion rubles earmarked for miners' wages to fund various commercial ventures. In 1995, an Austrian company that had taken over management of a complex of lead and barite mines in southern Kazakhstan conducted its own investigation of the financial practices of the previous enterprise managers. They found that although employees had not been paid, in some cases, for up to fifteen months, top management had received six months' salary in advance, while investing enterprise funds in horse-breeding farms and other potentially lucrative activities. In another especially egregious incident, the Russian gas giant Gazprom, one of the country's most profitable companies, announced plans to purchase several Hungarian banks, despite the fact that many of Gazprom's employees had not been paid for two or three months.<sup>11</sup>

Another theory, more difficult to prove, is that enterprise managers deliberately delay wage payments to encourage workers to quit their jobs, hoping to reduce the labor force without formally dismissing people.<sup>12</sup> Because the socialist economy ensured full employment by giving enterprises strong incentives to "hoard" labor, almost all post-Soviet enterprises now find themselves tremendously overstaffed. As they try to adjust to the new system, enterprise managers desperately need to reduce their work forces. But laying off workers can be expensive. Under the labor codes in effect in most of the post-Soviet states, enterprises are required to provide two or three months of severance pay to each laid-off employee, and in some cases national law or collective bargaining agreements provide for a series of other benefits. Naturally, if the employee leaves "voluntarily," none of these benefits need be paid. Hence the presumption that enterprise management is withholding wages to drive workers away.

No hard evidence has been presented to support this allegation. Yet the charge continues to be made, perhaps because the alleged behavior is consistent with a broader pattern of behavior exhibited by the managers of post-Soviet enterprises that are trying to survive in the unfamiliar terrain of a quasi-market economy.

Instances of corruption or callousness among enterprise management play a significant role in terms of shaping public perceptions of the wage arrears issue. An already cynical population grows more jaded daily, assuming that unpaid wages are lining the pockets of managers and state officials.

Still, the available evidence suggests that the majority of employers—private and public—who fail to pay their employees on time have fallen victim to larger forces outside their immediate control: economic depression and interenterprise debt.<sup>13</sup> Granted, individual government officials and enterprise managers bear responsibility for this state of affairs—after all, it is they who have perpetuated the "culture of non-payment." But the point here is that there are negative processes at work in the post-Soviet economies that will not be reversed by identifying and punishing individual culprits.

### Why Don't They Quit? Why Don't They Protest?

What is hardest for many people to understand is not why wage arrears occur but why they have not resulted in a massive social explosion. Foreign observers cannot fathom how someone would endure four or six or eight months of no pay without quitting or going on strike.

Perhaps the single most important reason that more workers do not leave their jobs when wages are not paid is that they have nowhere else to go. New job opportunities are not plentiful in the depressed economies of the former Soviet states, and many of the openings available require special skills (such as foreign languages or knowledge of business) that few workers possess. Alternative employment is especially scarce outside the capital cities or major urban centers like Moscow, St. Petersburg, or Kyiv. A severe housing shortage and the persistence of the *propiska*, or residence permit system—both holdovers from the Soviet period—also constrain labor mobility. Without a place to live or the legal right to resettle, workers cannot simply move around in search of employment.

It is also the case that many workers have links to their enterprise that go well beyond receiving a monthly pay envelope. Enterprises in the Soviet Union customarily provided an array of social benefits not available anywhere else, such as child care, medical care, housing, hard to obtain consumer goods, and subsidized vacations. While such services have declined in the post-Soviet era, they still exist and provide a strong incentive for an employee to stay on the company's books, even if he or she is not being paid.

Another reason more workers have not left their jobs—and also an explanation for the relative lack of protest against wage arrears—is the persistence of a paternalistic employer-employee relationship in post-Soviet enterprises. Particularly in the many post-Soviet “company towns,” which are dominated by one or two huge, crumbling industrial enterprises, enterprise directors maintain an almost feudal relationship with their workers. The directors are easily the most powerful figures in these company towns, providing their employees with cradle-to-grave security and demanding loyalty in return. Although these industrial fiefdoms have begun to fall apart in the post-Soviet chaos, the attitudes and habits they engendered have remained.

Lingering paternalism can clearly be seen in the results of privatization. When Russia carried out its “mass privatization” of state-owned enterprises in 1992–94, it was widely assumed that this would bring an influx of outside investors who would gain a controlling interest in many firms and thereby break the paternalistic pattern. Instead, more than 70 percent of firms opted for the so-called Option Two, under which employees were allowed to buy a controlling packet of shares at discounted price. Today, there are still relatively few cases where outsiders have succeeded in gaining control of industrial enterprises.<sup>14</sup> Most privatized firms are majority-owned by their own workers, with effective control still in the hands of their managers. To the extent that other ex-Soviet countries have privatized their industry, they have experienced very similar results.

Enterprise managers today wield, if anything, more power vis-à-vis their employees than in the old days. The combination of fear of unemployment and

dependency on social benefits linked to the enterprise has cowed many workers into silence. There are, of course, exceptions—coal miners, energy workers, and teachers being among the most notable—and it is those exceptions that make the newspapers. What does not make the newspapers is the huge number of unpaid workers who do not protest.

### **Where Are the Trade Unions?**

The relative passivity of post-Soviet workers is intensified by the inability of trade unions to serve as an effective voice for their members' interests. By and large, organized labor has failed to mount a serious response to the wage arrears crisis in any of the ex-Soviet states.

Most people in these countries still formally belong to trade unions that are the successors to the old, Soviet organizations that functioned primarily—to use Stalin's own memorable phrase—as “transmission belts” for Communist party policy. Traditionally, their role was to maintain labor discipline, to help management ensure that Five-Year Plan targets were met, and to distribute an array of benefits and scarce goods at the workplace. Trade union leaders at all levels were selected and appointed through the same nomenklatura system as party officials, factory managers, KGB officers, and so on. In addition, the entire management structure, including enterprise directors, also belonged to the union, further confusing the union's role in the management-worker relationship. In short, trade unions did not *represent* employees' interests in the sense that this term is used in the West.

Like the paternalistic culture of the Soviet enterprise, trade unions in these countries have been slow to change. Some of the old trade unions have “reformed” by electing new leaders who see their role first and foremost as defending the rights and interests of their members. But the majority of the old unions still function essentially as appendages of enterprise management, handing out social insurance benefits such as vacation passes and sick leave pay.

Meanwhile, alternative unions have emerged in some sectors, particularly energy and transport. These new unions often started out as “strike committees,” formed spontaneously to lead a specific worker protest (in response to non-payment of wages or another grievance) when the old union was either passive or obstructionist. The strike committees later evolved into more structured and permanent organizations, with democratically elected leaders and an activist approach to representing their members. However, these new unions have grown little since they first appeared in 1991, and they still represent a tiny fraction of the overall work force in the ex-Soviet states (between 1 percent and 5 percent in most cases). Not coincidentally, those sectors where the new unions have made the furthest inroads have also been among the most likely to see strikes over non-payment of wages.

### **Survival Tactics**

A final reason that workers in the ex-Soviet states have not been more restive to date may be their highly developed coping mechanisms. The first response of most citizens of these post-Soviet societies to the adversity caused by wage non-payment is not to seek redress or organize protest—it is to find creative ways to survive.

In Soviet times, the central planning system worked poorly and was tremendously inefficient, so people at all levels of society developed elaborate ways of working over, under, and around the system to get the most out of it. At industrial enterprises, managers would hire special employees whose job was to obtain scarce inputs through barter or trade with other enterprises. None of this activity would show up in “official” reports to the government. Ordinary people would use networks of friends and relatives and systems of mutual favors to obtain access to scarce goods and services. People would grow extra food at their dachas and use it to supplement their diets. Despite the state’s efforts to control all economic activity, there was a tremendously large “shadow” economy, without

which the whole system probably would have collapsed much sooner than it did.

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Today, the state is no longer trying to micromanage the economy, so many of these “shadow” activities are no longer illegal. But the fact that they are legal does not make them any less necessary. Because of wage non-payment, many workers are able

to continue feeding their families only because they—or their relatives and friends—grow food in private garden plots. Surveys of urban families in Russia have shown that more than 90 percent rely on home production as an important source of food and that produce from private plots represents nearly 70 percent of a family’s winter food supply.<sup>15</sup> Many people sell personal items to bring in extra income or trade goods to obtain something they otherwise could not afford to buy. Those who are fortunate enough to have marketable skills or access to the new private sector take on second or third jobs to make ends meet. While remaining technically employed by their state-owned or newly privatized enterprise, they spend most of their time “moonlighting.”

The exact extent of such “informal” economic activity is extremely difficult to calculate, but it is clearly huge and seems to be increasing. An economic research institute recently estimated that 60 percent of Ukraine’s GDP was produced in the shadow economy in the first half of 1996, compared with 40 percent during the same period in 1994 and 50 percent in 1995.<sup>16</sup> Most observers concur that similar processes are taking place in the other ex-Soviet states. Just as in Soviet times, when the parallel economy helped to keep an extremely inefficient system functioning, today informal economic activity is acting as a safety valve that may be preventing a social explosion.

### **The Response of Governments**

Governments in the former Soviet states have either been unable or unwilling to address the wage arrears problem effectively. A typical response has been to issue

Soviet-style administrative decrees “ordering” that the problem be resolved. Belarusian President Alyaksandr Lukashenka, for example, issued a decree in early September instructing managers of companies and government bodies to pay all wage arrears no later than 20 October. A somewhat more targeted approach has been to hold enterprise directors personally accountable when workers are not paid. This has resulted in fines and other legal sanctions being imposed on some enterprise managers: In Russia, for example, in the first half of 1996 some 4,000 managers were brought to court and punished for failure to pay wages on time.<sup>17</sup>

The implicit assumption behind such solutions, of course, is that wage arrears are due primarily to the intentional actions of enterprise managers or government officials, that the money to pay wages is being illegally diverted for other purposes. In fact, as we have seen, although corruption and incompetence surely account for some portion of wage arrears, the bulk of the problem is connected with broader systemic problems in these transitional economies.

Although some post-Soviet government officials undoubtedly recognize the real reasons behind wage arrears, none have adopted the sort of comprehensive approach that would be necessary to address the problem. This could be explained in several ways. Assuming they are well-intentioned, these governments could be afraid of the social consequences of imposing real financial discipline on firms. If, for example, post-Soviet governments would firmly and finally cut off most, if not all, subsidies and soft credits and enforce bankruptcy laws so that firms that fail to pay their bills face real consequences, this might eliminate interenterprise arrears, but it would also lead to high levels of unemployment and enormous dislocations.

It is also possible that those with real decisionmaking power are unable to escape the Soviet mindset. Government officials who grew up under the socialist system may be assuming that a painless solution is just around the corner. A good illustration of this is a speech given by former Ukrainian Prime Minister Marchuk in May 1996, in which he proposed to “solve” the wage arrears crisis by pressuring the National Bank of Ukraine to ease its tight monetary policy and by diverting a recently granted credit of \$150 million from Japan’s Export-Import Bank to pay off wages.

Perhaps the simplest explanation for the governments’ failure to address this problem is also nearest to the truth: Wage non-payment is a tricky problem fraught with political risk. Human beings will avoid a tricky problem unless someone else forces them to deal with it. And at the moment, the leaders of the post-Soviet states evidently are not feeling sufficient pressure to force a resolution of the issue, either from their own unpaid citizens or from the IMF, World Bank, and other international donors who are providing the financial means to pursue economic reforms.

### **The Fall-Out**

While governments fail to address the root causes of wage arrears, the very fact that people are not getting their salaries is having its own negative consequences,

which threaten to derail further progress toward democracy and reform. Wage arrears are causing the post-Soviet economies to take a dangerous detour along the road from socialist central planning to the free market. A large segment of the population in these former Soviet states is essentially being forced to retreat into a sort of economic “Stone Age.”

As noted above, wage non-payment is compelling more and more people in the former Soviet Union to resort to the shadow economy in order to feed themselves and their families. To the extent that “informal” economic activity means earning extra income by providing a needed service or starting a new small business outside of one’s “formal” job, such activities are contributing to the development of a normal market economy. Unfortunately, most of the informal activity seems to consist of subsistence farming on small private plots, buying and selling of personal goods, and barter. Such activities—which also took place on a more limited scale during Soviet times—represent a dead end as far as building a modern economy is concerned.

The behavior of enterprise managers often exacerbates the trend toward “barterization” of the economy. Unable to pay their workers in cash, many enterprise managers use in-kind transfers as a substitute. Instances abound of workers being paid with sausage, clothing, or even television sets. A newspaper in Kazakhstan recently reported on a tire factory in the city of Shymkent that “paid” two tires to each employee to make up for several months of salary arrears. Accompanying the story was a poignant photo showing the workers rolling their “wages” home.

At the same time, wage arrears add to the general contempt for the rule of law found in post-Soviet society. Failure to pay salaries on time is a clear violation of labor laws and collective bargaining agreements in most of these countries. Yet, with the exception of a relatively few fines brought against enterprise directors and a handful of court cases brought by unpaid workers, no one has been held accountable, least of all the national and local governments who are among the worst offenders. In these circumstances, the goal of developing a law-based system is being undermined on a daily basis. Widespread wage arrears merely confirm what the vast majority already believe: that there are two sets of rules—one for the “power” and one for everyone else.

Finally, wage non-payment and the inability of current governments to do anything about it carry serious political risks. To the extent that market reforms are responsible in the popular mind for wage arrears, political support for further reform is undermined. For many citizens in these ex-Soviet states, the bottom line is that while under the old system they may have had shoddy goods, long queues, and no freedom, at least they got paid every month! This does not necessarily mean that they want to return to “the way things used to be.” It does mean that they are profoundly dissatisfied with the status quo and are at the same time cynical about the need for more “reforms.” Furthermore, any politicians promising quick and painless solutions to this problem, no matter how irresponsible they may be, are likely to win support.

### Conclusion

With the breakup of the Soviet Union and the disintegration of the system of state ownership and central planning, hopes were raised that a new kind of economy would arise from the ashes of communism. It would be based on real prices, private ownership, competition, labor market mobility—in short, all the characteristics of a modern market economy. Unfortunately, today's post-Soviet economies are as far from being a "free-market paradise" as the old Soviet Union was from being a "workers' paradise." It turned out that underneath the ashes of communism was a deep swamp, which is providing the foundation for constructing market economies in the former Soviet states. What has emerged as a result of this unstable foundation is a strange mixture of unbridled, nineteenth-century-style capitalism combined with vestiges of twentieth-century Communist bureaucracy and a heavy dose of organized crime.

While they have reformed at different rates and with varying degrees of success, the former Soviet states today by and large possess economies that are dysfunctional, full of distortions, and too weak to generate wealth and provide a decent standard of living for all—or even a majority—of their citizens. The enormous problem of wage arrears is one of the most dramatic side effects of this economic disarray. Post-Soviet governments will have to recognize it as a symptom of the broader problem of interenterprise debt and address it on that level.

But at the same time, these governments need to recognize that when it comes to resolving the economywide debt problem, wage arrears must be singled out and given priority. If they are unable or unwilling to address this issue on their own, it is the responsibility of the IMF, the World Bank, and Western donor governments—who are providing the financing for macroeconomic reform and the technical support for privatization and enterprise restructuring—to give them the incentive and the tools they need. Wage arrears have already caused widespread protest and social discontent and have the potential to create an even bigger antireform backlash. Furthermore, the longer wage non-payment persists—reinforcing cynicism and contempt for the rule of law and encouraging reliance on a primitive informal economy—the less likely it is that the post-Soviet world will ever be able to develop the necessary foundations on which to build healthy, market-based economies.

### NOTES

1. Based on exit polling conducted by Mitofsky International in cooperation with CESSI, Ltd. Results were based on 7,439 questionnaires filled out by voters leaving polling places throughout Russia. Of those polled, 35 percent identified "payment of pensions and salaries" as the "most important issue in your vote decision." Reported in *The New York Times*, 18 June 1996.

2. Peter Rutland, "Firms Trapped Between the Past and the Future," *Transition*, 22 March 1996, 28.

3. Penny Morvant and Peter Rutland, "Russian Worker Face the Market," *Transition*, 28 June 1996, 7.

4. As reported in *Izvestiya*, 26 November 1996.

5. SOCIS-Gallup report, "Ukrainian Political and Economic Index," March 1996, 12.

6. The Soviet system had never developed mechanisms for noncash financial transac-

tions between individuals or between employers and employees. Interenterprise and government-to-enterprise financial transactions, on the other hand, were commonly carried out on a noncash basis. To this day, the use of checks and credit cards is still extremely rare in Russia, and rarer still in Ukraine and other ex-Soviet states.

7. Unclassified cable from U.S. Embassy in Kyiv, “The Problem of Wage Arrears in Ukraine.”

8. The recent spate of news stories about the deterioration of the Red Army—caused in large part by the government’s failure to pay salaries—is a vivid illustration of how these extremely tight fiscal policies, which were undertaken with the best intentions, may have extremely risky, if unintended, consequences.

9. *Izvestiya*, 6 April 1995.

10. See for example OECD, 1995 18, and Volodymyr Zviglyanich, “Ukraine’s Labor Policy: Underemployment,” *Prism*, The Jamestown Foundation, 17 May 1996.

11. In fact, the oil and gas industries in Russia, among the few sectors able to generate foreign currency through export, have also been among the worst offenders in terms of wage arrears. In the spring of this year, fully 86 percent of the companies in the oil sector were late in paying their workers by at least one month.

12. This accusation has been made by, among others, Russian Labor Minister Gennadii Melikyan. ITAR-TASS, 21 March 1996.

13. OECD, 1995, cites a report appearing in the Russian newspaper *Segodnya* that estimated that non-payments accounted for 90 percent of wage arrears as of November 1994, whereas the remaining 10 percent of cases were caused by inadequate revenues because of declining output.

14. Rutland, *Transition*, March 22 1996.

15. Kimberly Diane Cartwright, “Essays on Family Life and Poverty In Russia,” unpublished doctoral dissertation, 1996, 210.

16. *Eastern Economist*, 30 September 1996.

17. *Rossiiskie vesti*, 25 July 1996.