

EXECUTIVE SUMMARY

Labor Market in Russia: Moving from Crisis to Recovery

I. Introduction

i. One of the main challenges confronting Russia today is increasing real wage and productive employment in order to improve the standard of living of its population. The main focus of this report are *labor market policy options* that are important for achieving this outcome. The most critical impact on employment and wage outcomes come from macro-economic policies that promote competitive product markets, raise aggregate demand for labor and increase labor productivity. However, labor market policies and institutions can also affect the functioning of the labor market and impact the level of employment and wages.

ii. The study is forward looking, in that it suggest measures that would help Russia develop a formal competitive labor market over the medium term. The study addresses four major questions: How well has Russia been able to re-dress the misallocation of labor inherited from its socialist past? Do wages increasingly reflect market forces? Are labor market institutions consistent with those required in a market economy? How well has Russia been able to reduce explicit protection offered by firms and create an effective safety net? Each question is addressed in a separate chapter of the report that also highlights key issues and policy options in each area.

iii. Attempting a evaluation of labor market in Russia, given its vastness, complexity and diversity, is a daunting task. This report attempts to remedy these problems in part, by providing a more comprehensive picture on labor markets. However, we rely heavily on work by both Russian and international scholars in informing this report. We have also incorporated the salient points from the considerable discussions and debate on labor market policy issues that took place in Russia during the course of preparation of this study. We have attempted to overcome data issues by using both nationally representative surveys and smaller regional surveys of enterprises, workers, and the unemployed; and by cross checking their results with each other.¹ No data set is perfect. Therefore, the strengths and weaknesses of each is discussed in relevant sections of the report.

kindergartens, etc.) have also sharply declined, though they have not completely disappeared. The unemployment rate has declined sharply—more so than in CEE (Central and Eastern European countries) over a similar growth period. Consistent with this trend, job creation rates have significantly increased and job destruction rates have decreased—at least in the manufacturing sector which has benefited from the recent devaluation of the ruble.

vi. The report cautions that a large outstanding agenda in creating a well functioning labor market still confronts the Government, employers, unions and workers. Years of slow restructuring, limited economic reforms, and lack of job opportunities have led to the decline in formal labor market activity and a shift of many employed towards subsistence self-employment, primarily in agriculture. Despite recent declines, the level and duration of unemployment are not low by OECD standards. The employment share of the private sector remains small and genuine entrepreneurship is limited. Moreover, despite progress in market determination of wages, non-market forces (e.g. wage arrears, inappropriate fringe benefits and in kind substitutes) remain important. Wage inequality already high by regional standards, has increased since 1998, and the incidence of poverty remains very high.

vii. Further, labor market regulatory institutions have not evolved significantly since the socialist era, and are very ineffective. Despite recent changes, the new labor code is still quite restrictive relative to OECD standards. Employers are limited in their ability to adjust their workforce in response economic and technological change; workers and employer do not have adequate opportunity to voice their concerns; contract enforcement is weak; and mechanisms for resolving workplace disputes and addressing health and safety concerns are limited. Even though the Government created a modern safety net in the early 1990s, limiting financing of this program has made the system largely ineffective, contributing to high rates of poverty among the unemployed (relative to national levels).

viii. The lack of strong labor market regulation means that the excessively restrictive labor code has not greatly constrained labor adjustment in Russia. Poor incentives and reputational risks for employers in laying off workers have likely played a more important role in Russia's gradual restructuring. While limited regulation of the labor market is beneficial for labor market outcomes, the virtual absence of labor regulation has imposed large welfare and productivity

direction, but more needs to be done. Further reforms along these lines would help both improve labor productivity as well as promote worker welfare.

The main findings and conclusions of the report are presented in greater detail below.

II. Recent Developments

x. The Russian labor market has been gradually restructuring over the past decade, mainly as a result of market liberalization, a non regulated labor market, and growth of the private sector.

- *The level and duration of unemployment has gradually increased over the 1990s, from 5.2 percent in 1992 to nearly 15 percent in 1998, declining recently to 9 percent in 2001. Most of the unemployed have previous work experience, confirming that the exit of workers was the main reason for unemployment growth. Increasing job destruction rates and low rates of job creation are consistent with this trend.*
- *Among those remaining officially employed, there has been a substantial reallocation of workers. This movement reflects large shift of workers across industries and occupations and sectors consistent with those found in a market economy. Russia now ranks at the median level for reduction in the employment share of industry and growth in the share of services, in the latter case ahead of Bulgaria, Poland, Romania, and Slovenia. This can also be seen in the decline in the output share of agriculture and industry and the increased share of services in GDP over the last decade. These transitions can be explained in part by the decline in state employment and employment growth in mixed, domestic private, and foreign firms.*
- *Labor Mobility across occupations also increased post 1991 and became more complex. The number of people who moved to another industry, firm, or occupation was considerably higher during the first four years of reforms (1991-1995) than during the preceding six years (1985-1991). Mobility also became more “complex,” more frequently involving simultaneous changes in occupation, firm and industry. Another indicator of*

xii. The post 1998-2000 period of 11 percent cumulative growth led to major response from the labor market.

- *Employment increased cumulatively by 2 percent and unemployment and non-participation fell.*³ As in advanced CEE reformers, the employment response was much smaller than that of output. Employers re-allocated existing labor more productively as opposed to increasing employment, and labor productivity increased (7 percent in 2000). The average annual growth in employment and labor productivity are similar to those found in CEE countries after the first two years of economic recovery, but the decline in unemployment was far greater in Russia than realized in CEE countries over this period.
- *Labor market transitions between 1998-2000 are much higher than in the 1994-96 and 1996-98 period.* The transition out of unemployment into employment increased significantly and the transition to nonparticipation declined in response to positive economic activity. The probability of remaining employed increased, as did new entry to the labor market and re-entry into employment from out of the labor force. Economic growth in post-crisis Russia was not only strong enough to increase the probability that workers would remain employed, but it also brought the unemployed back to employment more quickly than before, and it even pulled in labor force non-participants. Consistent with this trend, job creation rates in the manufacturing increased, and job destruction rates declined—though the latter continued to dominate job flows.
- *Real wages lagged employment and output growth between 1998 and 2000; and wage arrears declined by half.* The average annual increase in real wages between 1998-2000 was negative, as wage growth lagged behind employment and output growth. However, this was also the case in both Poland and Hungary in their first two year growth period. The decrease in wage arrears may be a result of several factors, including a decree by the Government criminalizing this practice, positive macroeconomic trends, the devaluation of the stock due to the burst of inflation at the end of 1998, and the larger trend toward reduction of barter in the economy in the past few years.

xiii. However, the Russian labor market is still far from the formal private sector based labor markets typical of OECD countries. Despite recent economic recovery, much remains to be done.

- *Formal employment is low and a significant share of workers are self-employed in subsistence agriculture.* Despite recent increases, the decline in employment was significant in absolute terms (but less relative to output). The formal employment to population ratio remains low by OECD standards, indicating that the productive capacity of the country is not fully utilized. What happened to individuals who left employment? Some joined the ranks of the unemployed, but the majority left the labor force, and a considerable share took up self employment, primarily in subsistence agriculture. This shift has helped individuals cope with poverty, but it represents forces of decline in the Russian economy.
- *The state remains an important employer.* Government policies that have constrained downsizing of firms, through soft budget constraints and local government pressure on enterprises to maintain jobs and services, have led to excess jobs in the state sector. While the extent of over-manning declined over the past decade, and estimates about its size are under debate, its existence is confirmed by the small response of employment to output. Despite recent increased, the private sector share of employment remains lower than in advanced CEE countries⁴; and the share of self employment and genuine entrepreneurship is low as well.⁵
- *Labor productivity is low.* Though employment fell sharply, output declined even more, leading to cumulative labor productivity losses of approximately 30 percent over the 1990s—much higher than in lead CEE countries. The decline in labor productivity reflects limited restructuring over the transition. The main employment adjustment was quantity of workers. Hard evidence suggests that the role of secondary employment and adjustment in hours of work are much lower than commonly believed.⁶
- *Unemployment: skills and regional mismatch* Despite recent declines, Russia can no

regions, concentrated in Eastern and Western Siberia and the North Caucasus have lower expenditure per capita, high poverty rates, high birth rates and a high industrial share of output. High unemployment rates in high industrial share regions indicating that these might be exacerbated (in the short run) by economic restructuring, and require social policy focus. The evidence on the extent of regional mobility is mixed, though there is some evidence that lack of affordable housing may limit worker flows.

- *The incidence of wage arrears has declined but the average amount of wage arrears for those who continue to receive them did not change (between 1998-2000).* Wage arrears remain persistent across particular individuals (less educated, with longer job tenure), regions (rural), occupations (military) and sectors (agriculture). It is important to note that wage arrears are not synonymous with contract re-negotiation (or wage flexibility) but with contract violations. They tilt the earnings-tenure profile, which together with the lack of contract enforcement, the market power of many employers, limited regional mobility all serve to moderate workers' quit behavior and to increase the incentives of firms to use wage arrears.
- *Wage remuneration in the form of inappropriate fringe benefits still remain prevalent,* particularly for employees of large firms. It is therefore not surprising that unlike CEE countries, market forces (such as education) are not the main factors explaining differences in wages. Rather non-economic factors, and/or regional differences are likely the main reasons for wage differences in Russia. There is also considerable under-reporting of wages (which make wages measurement difficult), perhaps to avoid high payroll taxes. Recent studies find that over one-third of private-sector employees earn more than their registered wage and, in 10% of the cases, actual payments are at least 6 times the official level.
- *Poverty among the labor force increased* over the transition (both according to Goskomstat and RLMS data) and remains high despite recent declines. High rates of poverty reflect the still low level of wages and other income (self-employment) in Russia and very high level of wage and income inequality.⁷ The highest poverty rates among the labor force are among the unemployed and workers with wage arrears.

III. Labor Market Regulation

xiv. Labor market regulation is restrictive in law but not in practice Over the transition, labor market regulation in Russia was unrealistically strong and inappropriate for market economy. Moreover, in practice for many firms and workers, it was completely bypassed, so that the labor market was virtually unregulated. Recently, after considerable public discussion and debate, a new labor law has been adopted. Given the diversity of views about labor law reform, passage of a new Code is a significant political accomplishment. However, the law marks only a modest move towards a framework for labor relations that is appropriate for employment, productivity growth, and worker protection in a market economy. The legislation has been and still remains quite restrictive, particularly in the following areas:

- *Excessive restrictions on flexible forms of contracting* The legal framework in Russia has been geared heavily towards formal permanent, open-ended contracts. There are numerous restrictions on the use of fixed-term contracts. These restrictions induce employers to engage in contracting practices which are in violation of the labor law. According to OECD data, excessive restrictions can also hurt vulnerable groups, such as women and youth. The new labor code makes some promising steps to introduce more flexible contracting practices. However, the Code does not make any marked improvements in either the deployment of labor or in terms of the protections of certain categories of workers, including women. Future reforms will be necessary to provide employers with the similar scope to deploy workers that their western counterparts have.
- *Statutory employer obligations towards permanent employees have been substantial specifically regarding termination rights*, although this may change somewhat with the new Labor Code. Where obligations are large, the international experience indicates that the result is more informalization, and potential reductions in the productive efficiency of enterprises. In OECD countries, employers often overcome high protection accorded permanent employees in the labor law through the use of fixed term and temporary contracts. In Russia, as discussed above, these options have been restricted. As a result, employers have resorted to wage arrears, administrative leave, voluntary quits rather than layoffs, and negotiation in the informal sector. These practices, particularly wage arrears

However, there is a long way to go particularly in terms of developing the institutions that underpin effective industrial relations. Unions or the bargaining structure do not adequately reflect the voices of employers or workers. International research has demonstrated that worker voice, embodied in the true representation of workers and employers in the bargaining process can improve training and health and safety in the work place, thereby contributing to productivity gains and improvements in worker welfare. In the new Code, provisions remain for collective bargaining at all levels. The Code does change procedures for determining bargaining representatives for employees. These new rules specifically pertain to what is considered a “local union” as well as how a bargaining representative is selected where multiple trade unions exist. These may have the effect of limiting the opportunity for small and independent unions to represent workers

- *The failure of enforcement and dispute resolution pose major challenges for Russian policy-makers, employers, and labor.* The consequences of the weak institutional framework for industrial justice are exacerbated in a slack labor market, and while disputes and contract violations dissipate in when economic activity increases labor demand, workers remain vulnerable to their re-emergence in times of economic slack. The new Code does not appear to make major changes in this area. A positive aspect of the approach is that most conflicts are intended to be resolved at the enterprise level which should minimize costs and time requirements. However, it appears to create a cumbersome practice of reconciliation of differences at enterprise level. The time table for hearing and resolution of labor disputes is very tight. While labor inspectors and inspectorates significant privileges and rights to monitor the execution of labor legislation, their role as mediators, conciliators and arbitrators of labor disputes is diminished if non-existent.
- *What is the impact of labor market institutions on the labor market in Russia?* The weak enforcement of the restrictive labor law has likely allowed more adjustment in wages and employment than if this law were enforced. Reputational risks of employers and other poor incentives to managers for laying off workers may primarily be at work in reducing the pace of layoffs in the past decade. However, the absence of labor regulation has had

- *The unemployment benefit program is quite generous according to law.* The formal target replacement rate of benefit is quite high (75 percent for first three months; 60 percent for the next four, etc); and the duration of benefit is quite long (12 months; with re-entry guarantees) relative to CEE norms. The main eligible groups are laid off workers and voluntary quits¹⁰. However, more so than other countries, many other workers are also eligible, but for a significantly lower benefit, e.g., individuals who have never worked, been fired for disciplinary reasons, have re-entered the work force). Some groups receive special (higher) benefits (Chernobyl veterans and Northern workers).
- *However, the program is not generous according to practice. The coverage of the program is very low—only 14 percent of surveyed unemployed were registered with employment offices in 2000, much lower than the coverage rates for CEE or OECD countries. The main reason for low coverage is low and uncertain level of benefit. Effective, or actual, benefit replacement rates (25 percent of average wage) are much lower than rates specified by law, and are subject to uncertainty (a result of benefit arrears—also evident in 2000). Over time, inflation has resulted in a largely flat distribution of benefit, with about 50 percent of the beneficiaries receiving the minimum benefit.*
- *Financing Issues?* The main reason for low and uncertain benefit is inadequate financing of the program. Program funding is very low—0.16 percent of GDP in 2000—much lower than financing norms for advanced CEE countries (0.68 percent of GDP¹¹)—but consistent with Russia's level of GDP. This is not necessarily the result of limited public resources in Russia, but of their mis-allocation to non-targeted programs. The difficulty of administering an unemployment program with benefits linked to individual wages in an environment where wages are under-reported also complicates program implementation.
- *The net impact of ALMP program in Russia is not well known.* There has been no rigorous evaluation of ALMPs in Russia. Existing administrative data on ALMPs raises some concerns. There are four main areas of concern. (i) Russia spends more on

restructuring and layoffs. Finally, (v) on a positive note, survey evidence (though not based on rigorous evaluations) from the restructuring of the coal sector suggests that the active and passive programming and Employment Services may be effective in allaying the social and political cost of restructuring in strategic sectors.

- *The Government is considering a net impact evaluation of ALMP programs in the country.* This is an important exercise for understanding which programs work best in Russia. Contrary to popular belief, international evidence indicates that active labor market programs only have a modest impact on reducing long term unemployment. They work best if targeted to specific groups, and even then are very expensive. The most cost effective programs are job counseling and job information services. However, ALMPS can play a part in facilitating restructuring (see below)

V. Policy Options

xvi. Sustained economic growth that involves increases in employment and labor productivity will be the key for improving the living standard of Russian workers. This will involve completing the re-structuring process and promoting private sector development and investing in education. However, creating efficient labor market institutions and an effective safety net will also be important for achieving this objective.

A. Creating an Enabling Environment for Growth

xvii. *Growth in labor productivity will require the creation of a strong private sector.* Sustaining current economic growth and closing the gap in labor productivity between Russia and CEE and OECD countries, will require stronger private sector led growth (and ensuing investment in modern technologies and physical capital). Policies to enhance economic growth are extensive and discussed elsewhere in the Government's reform program and other Bank reports. These include developing greater product competitiveness, development of property rights, strengthening of financial markets, reducing administrative barriers to the growth of small and medium enterprises, lowering tax rates and creating the rule of law. The Government reform

B. Creating Modern Labor Market Institutions

xx. Moving to market based regulatory practices mean reducing the excessive protection to workers offered by the legislative framework within the firm, and at the same time, beginning to strengthen the role of institutions in allowing workers voice to ensure that basic rights are protected. These changes need to be complemented by a strong enforcement regime (dispute resolution, labor inspectorates). Social protection for workers, beyond the basic rights offered through labor legislation and more effective industrial relations, could be achieved through active and passive labor market programming. Reform strategies in this area must therefore be made in concert with those in the social protection area.

xxi. *What should the priorities be?* Considering the existing laws, institutions, and actual practices, and in light of the international experience, priorities could include the following:

- *Reducing Excessive Rigidity in the Labor Code.* Amending the Labor Code to formalize flexibility in hiring (especially the use of fixed-term contracts) and in dismissing redundant workers is a priority. The union veto over economic redundancies is an inappropriate feature for a market economy. The new Labor Code appears to make important progress in this area by removing this veto and implementing advance notice and effective appeals procedures. Some progress has also been made in providing for more flexible hiring arrangements, especially with respect to fixed-term contracting. More could still be done. Increasing flexibility in hiring and dismissals should bring more employment “out of the shadows” and international experience tells us that it should most help vulnerable segments of the workforce (e.g., women and youth). It is true that these amendments will reduce ‘formal’ job security and, as noted above, it is important that they be coupled with improvements in the social protection system for workers (see next chapter).
- *Continuing the increase minimum wages.* The current level plays little role in determining wage floors. Higher minimum wages (given the low base) are unlikely to

would help improve work conditions (ii) consider decentralized bargaining approaches in collective bargaining, if centralized approach is not yielding efficient bargaining outcomes; (iii) increase the resources available to the Federal Labor Inspectorate and build its capacity to provide technical assistance and advisory services to enterprises; (iv) establish alternative dispute resolution mechanisms based on professional third-party mediation, conciliation, and arbitration services outside the court system.

- *The debate over labor market reform in Russia is a contentious one, but may offer a false choice.* The debate divides those who want to see more social protection from those who want to see more labor market flexibility. In a sense this is a false choice: by instituting a more realistic and enforceable flexible formal regulatory regime with a modernized safety net, the equity and efficiency concerns of both groups could be alleviated. Achieving these outcomes will also require the development of a broad consensus regarding the need and direction of labor market reforms.

C. Enhancing Public Protection Through a Formal Safety Net.

xxi. Ensuring that a public safety net exists to protect workers against income loss from job loss is particularly important in Russia, because it would protect workers against poverty, facilitate layoffs, and would help move protection out of firms and into the public domain. The government has introduced general revenue financing of unemployment benefit and ALMP programs. However, the benefit design and ALMP strategy has not been fully defined. The report concludes that the following elements might be considered for the design of the safety net for workers in Russia.

xxii. *Moving From Firm-Based Support to Effective Public Safety Nets* Considerable progress has been made in de-linking the safety net from enterprises. However, the remaining benefits provided by firms should be divested to municipalities, and municipalities adequately prepared to take over this responsibility.

xxiii. *Unemployment Benefit Design: Simple to Administer, with Incentives, and Timely Payment* Policy makers could consider the option of a flat benefit—such as that used in Poland

beneficiaries. Given large regional differentiation in wages, differentiation of regional benefit will be important

- If benefits are to be linked to wage (rather than flat), the report recommends that the assessment period for benefit should be increased, and benefits established at a fixed proportion of an individual's wages might be used (e.g. 30 percent of wage) in order to ease administrative requirements.
- *The duration of benefit* could also be reduced to a maximum of six/nine months as in other CEE countries. As in those countries, long duration of benefit, coupled with more generous unemployment benefit, might induce longer unemployment spells.
- *Benefits could also be better targeted* and more easily administered if they are provided to a fewer category of workers, such as laid off workers and voluntary quits. Over time, as the distinction between voluntary quits and laid off workers is reduced, benefits for voluntary quits should be phased out or the eligibility of voluntary quits should considerably tightened in line with international practice.

xxiv. *ALMP strategy?* The future thrust of ALMP programs in Russia is difficult to determine since programs have not yet been empirically evaluated, though efforts in this area are being initiated by Government, and should be expedited. However, based on administrative data and international experience, the chapter indicates the following direction for ALMP programs:

- The focus of ALMPs on job counseling and job information services should increase, given their cost effectiveness, particularly where resources are limited. The use of *employment quotas* (individuals should have a job before being trained) should be discontinued.
- *Empirical Profiling* of users, currently being considered for introduction, may be useful for assessing what programs work best for particular groups—but its benefits and costs should be evaluated in Russia prior to introduction as it is administratively complex program to implement.
- The focus of *Employment Services* should be to help individuals find jobs themselves rather than helping preserve or create new jobs. Political pressure on Employment agencies to contain unemployment is therefore misplaced

administration of both active and passive programs requires considerable attention to appropriate remuneration and training of staff, and their allocation across regions.

xxvi. Social support restructuring. This form of assistance has proved important in downsizing the coal sector in Russia and is also widely used internationally to facilitate restructuring. It could therefore be used for downsizing in other sectors and regions in Russia e.g. regions with high share of the industrial, over-manned state sectors, or one-company towns. The development of a strategy for identifying priority areas for restructuring and social programs for affected workers would be important first step in this direction.

D. Monitoring and Evaluation: Bringing Information Closer to Policy Makers

xxvii. The study illustrates the importance of availability of data in order to monitor labor market developments and labor market programs in order to inform labor market policy. There are three main sources of labor market information that are important for monitoring the labor market: i) the Labor force Survey and Household Budget Surveys, ii) administrative data and iii) enterprise based surveys. All surveys are key to monitoring labor market developments. It is important that these surveys be strengthened and modernized. It is important that policy units within the Ministry of Labor and Social Development and Ministry of Economic Trade and Development are strengthened to use administrative and survey data to make basic forecasts of the impact of labor market policies. It is equally important that survey data is available to the public so that labor market researchers, a strong and growing community in Russia, can help Government evaluate the labor market situation and inform policies that would ultimately assist in improving the standard of living of the population.