

# RUSSIA'S LABOUR MARKET: ADJUSTMENT WITHOUT RESTRUCTURING

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Persistent differences between labour market models evolving in Russia and other countries of Central and Eastern Europe (CEE) are one of the most intriguing puzzles challenging students of transition economies. These differences became evident almost as soon as market reforms started in Russia and revealed a unique “Russian” way of labour restructuring.<sup>1</sup>

At the start of systemic transition, both government experts and independent analysts provided gloomy predictions of an explosive rise of unemployment to a level comparable with that in the US during the Great Depression. However, these forecasts were wrong and no catastrophe occurred in the Russian labour market. Instead, unlike the labour markets of most CEE countries, it exhibited a surprisingly high degree of mobility and flexibility. Gradually, it became evident that the Russian labour market is conducive to the proliferation of various “non-standard” behavioural patterns that either do not exist in other economies or play a minor role. Such spontaneously developed adjustment mechanisms as administrative leave, involuntary work on shortened hours, widespread multiple job-holding, massive wage arrears, and “shadow” labour compensation proved to be a real surprise for those who expected that the Russian labour market would respond in a “standard” way to the shocks of systemic transition. Indeed, for an outside observer it may look like a “collection of paradoxes”.

In this brief comment, I'd like to provide some descriptive statistics on developments in the Russian labour market, highlight its most salient features and sketch a general framework which may help the reader to understand a number of its peculiarities.

Let us first consider basic statistical data on the Russian labour market under transition. In Russia, employment reaction to the shock of transition was visibly weaker than in CEE. While GDP shrunk by 39% from 1991 to 1998, employment fell by less than 14%. In other words, each percentage point of output contraction was accompanied by approximately 0.35% of employment reduction. In CEE countries, employment dynamics followed output dynamics more closely, in that a 25-30% fall in GDP caused a 10-30% fall in employment. Therefore,

although in Russia the crisis was deeper and more protracted, job losses were approximately the same or even less than in CEE.

Unemployment was changing in Russia in a rather atypical way. In CEE, the start of market reforms triggered a sharp increase in open unemployment. Almost everywhere it immediately exceeded 10% and in some countries even 15-20%. However, unemployment in Russia has been increasing slowly and gradually. Only by the seventh year of market reforms did the rate of general unemployment pass the 10% level and approach the level attained by CEE countries after their economies started to recover. At present the general unemployment rate in Russia is about 12% whilst registered unemployment still remains unbelievably low at less than 2%.

From this it follows that in Russia **general** unemployment as defined by ILO/OECD has been 3.5 to 5.5 times higher than **registered** unemployment. Such a disparity has never been observed in CEE countries. Moreover, in most of them the ratio was inverse: registered unemployment was 10-70% higher than surveyed or general unemployment. The huge gap between registered and general unemployment rates in Russia signals that the majority of jobless believe that the benefits of official registration do not outweigh the costs. Ergo, they prefer autonomous job seeking.

The proportion of long-term unemployed also remained rather moderate in Russia. The share of this group among surveyed unemployed amounted to 41% in 1998 and among registered unemployed, just 19%. In most transition economies, 40-60% of all unemployed have been seeking jobs for longer than one year.

One of the most prominent features of the Russian labour market is the relatively modest role of layoffs in forming the pool of unemployed. Almost throughout the 1990s, the number of unemployed who quit their previous jobs exceeded the numbers of those who were dismissed. Only in 1997 was the share of the first group among surveyed unemployed slightly lower than the share of the second (15% against 34%). However, among registered unemployed, quitters still outnumbered those laid-off (in 1998, 1 to 0.73). This pattern is quite unusual. For example, at the initial stage of market reforms in Poland, the ratio between “voluntary” and “involuntary” unemployed was 1:7, and in Romania, as high as 1:60.<sup>2</sup> The high share of quitters is a sign that many workers were quite optimistic about their prospects of finding new jobs.

The Russian labour market was distinguished by an extremely high labour turnover. The gross worker reallocation rate defined as the sum of the accession rate and the separation rate reached 40-45% in the economy on the whole and 45-50% in the industrial sector. By the intensity of labour turnover, Russia was visibly ahead of CEE countries. This high mobility of Russian workers is confirmed by data on transition probabilities between various states in the labour market, i.e. employment, unemployment and inactivity. This data suggests that, compared to employees in CEE countries, Russians were less attached to their jobs and each year a larger part of them became unemployed. Thereafter, they

more easily and quickly found new jobs, thereby moving quite rapidly from the labour force to inactivity and vice versa.

Thus, notwithstanding the unprecedented deepness and longevity of the transition crisis, Russia experienced neither a sharp employment reduction, nor an explosive increase in open unemployment. Its general unemployment rate has not reached a level characteristic of the peak of transition crisis in CEE countries. The registered unemployment rate has fluctuated around the 2-3% mark; the average unemployment duration has remained rather moderate; dismissals have not become widespread; and enterprises have been actively hiring new employees.

How did and indeed does Russia maintain relatively stable employment and high labour mobility within an overall economic situation of deep crisis? To answer this question, let us turn to the specific adjustment mechanisms, which can be considered a “visit card” for the Russian labour market:

- Involuntary part-time employment has become widespread. During the period under examination, 3-7% of employees worked on shortened hours and 1-3% more were on involuntary administrative leave.
- Simultaneously, secondary employment has been gaining ground: multiple jobholders amounted to not less than 5-7% of all employees.
- Delays in wage payment have been used as a unique adjustment strategy. This phenomenon is almost unknown in other market economies both mature and in transition. On average in 1996-1997, the previous month's wages of 50% of all employees had not been paid on time. After the August 1998 financial crash, the proportion of employees with delayed wages for the previous month grew to an enormous 71%. By the end of 1998, total wage arrears had reached about 77bn roubles (then worth US\$4bn), equal to 11% of the total annual wage bill.
- Another no less specific adjustment option could be viewed as “shadow” compensation. This does not refer to non-registered income from small businesses or illegal activities, a phenomenon well known to many economies in the world. Russia's specifics consist in the fact that large and medium-size enterprises in the legal sector account for the major part of “shadow” compensation. They either disguised wages under other forms of remuneration (interest on bank deposits, insurance payments etc.<sup>3</sup>), or paid them in cash on the basis of informal agreements with employees. Whereas in 1993, “shadow” wages amounted to 20% of the “shown” wages, in 1996-1998, this proportion had increased to 45-46%. Therefore, one-third of total compensation was carried out in “shadow” forms.

All these adjustment mechanisms have one important feature in common - they are informal or semi-formal. It is therefore natural to enquire as to what extent they promoted structural change.

At first, the adaptive potential of the “Russian way” was assessed in the positive, on the assumption that it offered opportunities to directly reallocate labour from stagnating sectors to expanding ones without generating high open

unemployment. Moreover, the adjustment costs are distributed over a wide group of people: the jobless, the partially employed, and the partially paid. As a result, the hazards of such problems as youth or long-term unemployment are mitigated and the economy is relieved of a significant part of the costs involved in supporting unemployment. At the same time, delays in wage payments enable enterprises to maintain a higher demand for labour and shadow compensation leads to the same result by relieving employers of indirect labour costs. Finally, low wages in the traditional sectors facilitate labour reallocation in favour of the new private sector, whilst the costs of recruiting workers from enterprises in the traditional sectors appear to be smaller. All this was supposed to speed up restructuring and diminish related costs.

It would be interesting to see how correct this assessment proved to be and what was the pace of labour restructuring in Russia and CEE countries:

- A structural shift of high importance is the growth of a new private sector. According to the findings of various surveys, Russia's new private sector accounts for 20-25% of all employment. This means that it is less developed than in CEE where the corresponding figure is 35-60%.
- The portion of self-employed grew in Russia from 4.3% in 1991 to 10.5% in 1996. In this respect, Russia fell behind most CEE countries where self-employment reached 13-49%.
- Correcting the sectoral composition of employment inherited from the centrally planned system is one of the cornerstones of systemic transition. The intensity of sectoral labour reallocation can be estimated by standard deviation of annual rates of change of employment across sectors. In CEE, it varied from 9% in Hungary to 20.9% in the Czech Republic throughout 1989-1996. By way of comparison, in Russia it amounted to 6.4%.
- Job creation and job destruction rates are further important characteristics of the restructuring process. During the transition period, 12-16% of jobs were destroyed and 1.5-6% were created annually within the industrial sectors of CEE countries. In Russia, the similar indicators amounted to 11.5% and 1.2% respectively. At the same time, as already revealed, Russia led in labour turnover. A comparison of these findings reveals that while in CEE labour reallocation was conditioned mostly by job movements, in Russia it took the form of "churning". Whereas in CEE countries the share of "churning" in the gross worker reallocation equalled 20-60%, in Russia it reached 70%.

This suggests a rather paradoxical conclusion, namely that, notwithstanding the deeper imbalances inherited from the centrally planned system along with a higher flexibility and dynamism within its labour market, structural shifts were less intensive in the Russian economy than in other economies under transition.

How could such a puzzling combination of high labour mobility and flexibility with slow restructuring emerge? In my opinion, one clue is the de-institutionalised character of the Russian labour market, by which I do not exclusively mean

the lack of powerful groups with special interests, such as trade unions or entrepreneur associations, whose active presence in the Russian economy would probably further hamper transition and paralyse even the adjustment mechanisms which have evolved spontaneously. No, there is a more fundamental reason, namely the lack of clear and effectively enforced “rules of the game” that would otherwise direct interaction between economic agents. This does not imply that the Russian economy operates without any standards or rules, only that informal arrangements and institutions take precedence over formal ones. It seems that in all segments of the Russian economy, implicit rules and unwritten agreement prevail over contract provisions and other formal obligations.

In a certain sense, the prevalence of informal transactions over formal ones was predetermined. In critical situations, any rigidity of laws and other formal rules might often become a hindrance to a society’s survival and may provoke additional social tension. In such cases, informal arrangements and institutions (embodying such concepts as solidarity and reciprocity) come to the fore. That is why one cannot overestimate the role of such informal or semi-formal patterns of economic behaviour (such as barter, administrative leave, shortened hours, secondary employment, and the development of an unofficial sector) in alleviating the social costs of transition, especially in the early stages.

As short-term shock absorbers, informal arrangements have visible advantages. However, although informal institutions secure a “safer fall”, they do not guarantee a “swifter rise”. Unlike short-term adaptation, restructuring cannot be carried out without clearly defined and effectively enforced formal “rules of the game” which make it possible to plan economic activity with a long-term perspective. Moreover, a shift from formal arrangements and institutions to informal ones makes the transactional foundation of the economy more primitive. Russia’s economy seems to have fallen into an institutional trap. On the one hand, the end of informal transactions would paralyse its performance, whilst on the other, their prevalence reduces the chance of ever overcoming the transition crisis.

The de-institutionalised Russian labour market is a part of the de-institutionalised Russian economy. It has proved to have had a significant adaptive capacity and has for some time blocked the emergence of such hard-to-cure problems as long-term unemployment and high youth unemployment, which hit CEE countries as soon as transition began.

However, implicit contracts have a serious drawback, namely, that because they are formulated in vague terms and are not backed by reliable enforcement devices, it is difficult if not impossible to control their implementation. As a result, they provide vast room for abuse and opportunistic behaviour (widespread delays of wage payments may serve as the most striking illustration). It is this absence of transparent general rules and reliable enforcement mechanisms aimed at minimising abuses and opportunistic behaviour that results in the personification

of transactions in the Russian labour market, whilst also creating the conditions that allow ineffective forms of employment to survive.

More than once has the Russian labour market demonstrated its high capacity to mitigate shocks. In this respect, it is indicative that the August 1998 financial crash had a very limited impact on employment. However, the Russian labour market is not conducive to deep economic restructuring. By combining an initially ineffective employment structure with a net of informal relationships, it promoted its conservation rather than renewal. With a little exaggeration, its main operational principle may be defined as “adjustment without restructuring”.

Nevertheless, it is quite plausible that having been helpful in avoiding many serious problems in the short-run, the “Russian way” has created problems for the long run. Although slow restructuring has prevented the growth of open unemployment during the initial stages of market reform, it may contribute to persistently high unemployment in the years to come.

#### *Notes*

- 1 R. Layard and A. Richter. Labour Market Adjustment - the Russian Way. In: A. Aslund, ed., Russian Economic Reform at Risk. London: Penter. 1995.
- 2 Unemployment, Restructuring and the Labour Market in Eastern Europe and Russia. Ed. by S. Commander and F. Coricelli. Washington: World Bank, 1995, pp.80, 264.
- 3 To do this, enterprises opened for their employees fictitious accounts with unreal interest rates in “friendly” banks. In a similar way, they acquired for the employees fictitious policies in the “pocket” insurance companies that guaranteed unreal insurance payments.