

# STUDYING TRANSITION

## THE RUSSIAN MODEL OF LABOR MARKET: WHAT IS AHEAD? (Article Two)

**R. Kapelyushnikov**

In the first article [1] we drew a picture of *actual* functioning of the Russian labor market, which was described in terms of relatively small job losses and moderate unemployment, flexible working time and ultra-flexible wages, high labor turnover and proliferation of various "non-standard" adjustment mechanisms, and finally, low strike activity. As a result, this market proved to be well suited for absorbing a great number of negative shocks, which happened on the way of systemic transformation. These shocks were mitigated mostly through changes in wages and work hours, and only to a very limited extent, at the expense of cuts in employment. Some time ago, this gave Richard Layard reason to describe the Russian model of labor market as "labour market, which is every neoclassical economist's dream" [2].

### **"Portrait Number Two" - the Official One**

However, the official portrait of the Russian labor market differs radically from the actual one. Let us perform a small mental experiment. Imagine that within a hundred years, a future economic historian will have to write a study "The Russian Labor Market in the End of the 20<sup>th</sup> Century". Assume that for some reason, neither statistical data nor academic publications are left from the period of his concern. All information at his disposal is limited to the "old" Code of Labor Laws (in force till the early 2002) and other pieces of legislation, like Law on trade unions, Law on collective bargaining, etc. And relying on no more than available "official" documents, he has to reconstruct how the Russian labor market was functioning under transition. Most probably his

reconstruction would have little in common with the picture that we have drawn above.

Judging by whatever he could learn from the labor legislation that existed at that time, he would come to a conclusion that the Russian labor market was over-regulated, poorly adaptive and sclerotic:

a) In the first place, our imaginary historian would suggest that the Russian economy suffered from high and persistent unemployment. Indeed, from a formal point of view the unemployment benefit system that had been established in Russia was in general no less and in some respect more generous than similar systems set up in CEE countries. Let us dwell on its key features in greater detail.

By magnitude of officially authorized replacement rates Russia was by no means inferior to other post-socialist countries: ratio of unemployment benefits to previous earnings of a jobless person was about 60%. As for duration of benefit payments, until recently it was the same for all groups of unemployed and amounted to 12 months (only in 2000, duration was cut to 6 months for specific groups).

In CEE countries, maximum duration of benefit payments was usually shorter and in addition, greatly differentiated between various categories of job seekers. In general, such groups of unemployed as quitters, dismissed for disciplinary reasons, entrants and reentrants to the labor market are not eligible for benefits or receive them after some suspension period. To qualify for unemployment benefits, the unemployed person should have been employed in insured employment for a specific period, and benefit payments start after a waiting period. However, in Russia such restrictions are almost unknown: status of registered unemployed with entitlement for benefits is granted virtually to anyone who applies to the public employment service, if he or she is out of job (except retirees and students). In the presence of such strong incentives for official registration, large-scale open unemployment would be assumed to be inevitable, especially under conditions of a deep recession;

b) The future researcher would have nothing else but to conclude that in the Russian economy, a strong inertia was present in dynamics of both nominal and real wages. Russia has a complicated, multi-stage system of overlapped collective agreements. Bargaining proceeds not only at individual enterprises, but also at industrial and regional levels. On the top of this construction there is the General Tariff Agreement, which is negotiated and adopted within a framework of Tripartite Commission. Collective agreements might seriously constrain enterprises' wage and employment policies. Moreover, legislation grants trade unions such a wide range of privileges that they seemed to be in full power to dictate their own will to employers and successfully exert pressure for constant escalation of wages. In such a situation, wages hardly could be believed to demonstrate any flexibility;

c) Russian laws grant a great number of benefits and guarantees to various categories of employees, making employers responsible for their financing. These are partly a legacy of the former economic regime and partly a result of populist lawmaking of the first half of the 1990s. (In most countries small businesses enjoy simplified regulations in the labor market and are free of many employment protection obligations, while Russia has practically no special exemptions for small businesses until recently). In other words, the Russian legislation provides a very high degree of protection for groups with weak competitive positions in the labor market. Accordingly, our historian could make a natural suggestion that the transitional economy of Russia had strong "solidaristic" attitudes, that inequality in earnings was low and that probably there was excessive squeezing of differentiation in the structure of relative wages;

d) He would also conclude that length of working hours in Russia was strictly unified. According to the Russian law, a standard working week cannot be longer than 40 hours, and overtime work is permitted only to specific categories of workers. But even they are prohibited to work more than 120 additional hours a year. There exist also strict legal constraints on using fixed-term contracts;

e) He would have no doubt that the transitional economy of Russia was characterized by low labor turnover, because hiring and firing costs were extremely high. For example, in case of a layoff the employer is obliged to pay severance payment equal to 2-3 month earnings. For those working in the Far North and on territories with the same status (about 10% of total employed), severance payments reach six-month earnings. Non-pecuniary costs that accompany dismissals are also quite heavy. Employer is obliged to notify the worker of a pending dismissal no later than two months in advance. Furthermore, he has to give the public employment service a notice of a pending dismissal no later than two months in advance, and if it is going to be a mass lay-off, he has to notify the trade union no later than three months in advance. However, the main point is that until recently no dismissal could be done unless it was agreed upon with trade unions. The former Labor Code actually granted them a veto power: they could nullify employer's decision without giving the reasons and without any time limit (in the new version of Labor Code, this requirement was alleviated);

f) And finally, taking into account the great variety of rights and privileges that were given to trade unions by the law, the future historian would be totally sure that the Russian economy had a fairly high level of strike activity.

As a result, having analyzed all available evidence, he would come to a conclusion that the Russian labor market was little different from labor markets in other post-socialist economies, if only it was still more sluggish and inertial.

A comparison of the two portraits, the official and the actual one, leads to a fairly obvious conclusion: stance of the Russian legislation on industrial and labor relations was not in correspondence with flexible functioning of the labor market but in striking contrast to it. Delays in wage payments were perhaps the most spectacular example. The phenomenon of wage arrears illustrates that the plasticity, which was characteristic of the Russian labor market, was ensured not by the

content of labor regulations (which, in fact, were and still are rigid and extremely onerous) but by poor law and contract enforcement.

From the institutional viewpoint, peculiar features of the Russian labor market (and in a broader sense, of the transitional economy of Russia as a whole) are associated with ineffectiveness of available enforcement mechanisms. There is an array of devices to enforce laws and contracts in the labor market. Apart from judicial system, there are special agencies within the executive branch of power (such as the Russian Labor Inspection); trade unions that negotiate over collective agreements and monitor their execution; protest activities (both organized and non-organized); various reputation mechanisms (when the employers whose reputation is "poor" have troubles in hiring new workers). Mass media may also play an important role, since they can help to establish negative public attitude towards illicit labor practices. Finally, there is one more means "of last resort" the workers can rely upon - this is the so-called "voting by their own feet" when they leave an enterprise in response to systematic infringement of laws and contracts by employer.

However, in the post-reform Russia all these mechanisms were surprisingly inept. Legal regulations and contractual liabilities were successfully evaded or even openly ignored without any fear of serious sanctions. The point was not only that the government failed to fulfill its role of arbiter and guarantor of established rules and regulations. Very often it was an active transgressor of these rules (failed to pay wages to public servants, delayed payments of unemployment benefits, etc.). This distorted radically the incentives that directed the behavior of economic agents in the labor market.

Let us try to look at this state of affairs through the prism of relative costs and benefits. In the Russian labor market, their balance is strongly biased towards acting beyond formal "rules of the game": a) costs of abiding by laws and contracts are extremely high (in some cases, prohibitively high); b) costs of breaking laws and contracts are quite low. No surprise that with this configuration of costs and benefits, the vast

majority of labor market participants preferred to deal with each other in an informal way. As a result, the actual institutional foundation of the Russian labor market turned to consist of a variety of informal ("shadow") relationships and practices rather than of formal laws and contracts.

## **References**

1. Kapelyushnikov R. The Russian Model of Labor Market: what is ahead? (Article One), REB, vol. XI, 4, 2002, p. 11-19.
2. Layard, R., and A. Richter. Labour Market Adjustment - the Russian Way, 1994 (draft).