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Adaptation of labor markets to recession: The case of Russia

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ADAPTATION OF LABOR MARKETS TO RECESSION: THE CASE OF RUSSIA

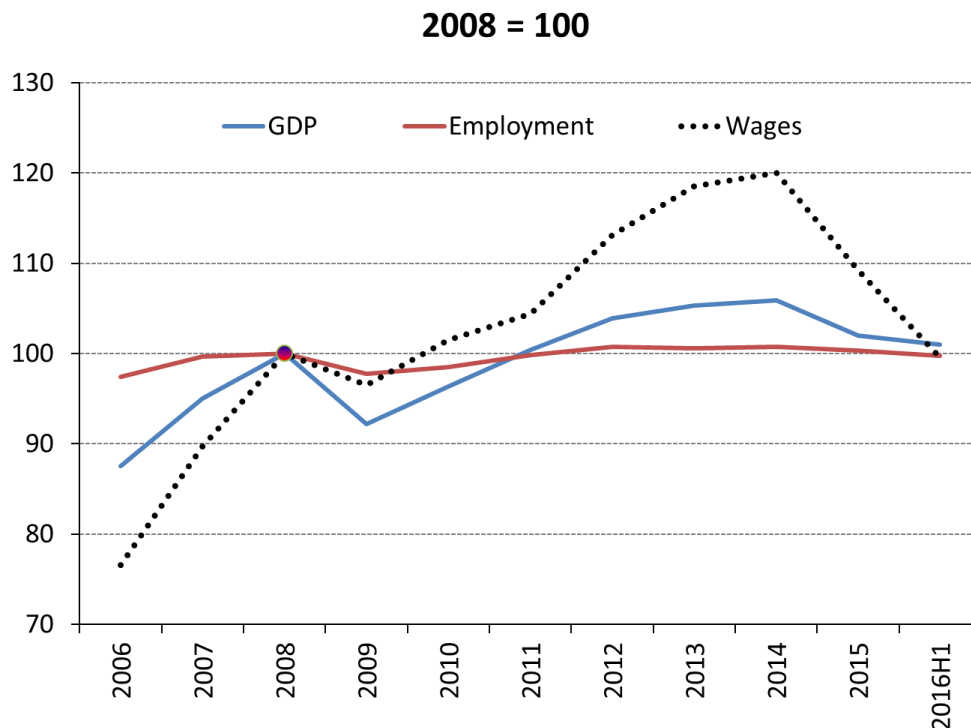
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MAIN ISSUES

1. Recent labor market developments
2. Closer look on changes in employment
3. Evolution of earnings
4. Institutional foundations of the adjustment model
5. Conclusions

HEALING FROM THE 2008-2009 CRISIS WAS INTERRUPTED BY A NEW RECESSION



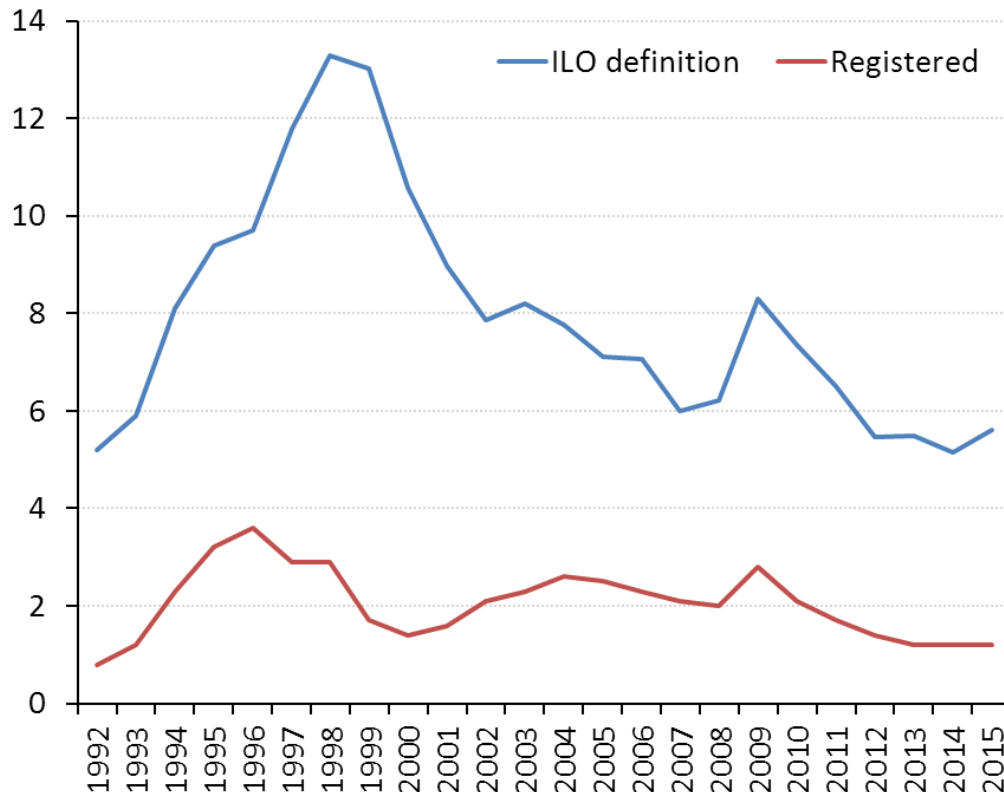
The sharp fall in global oil prices + sanctions regime imposed in July 2014 has resulted in a prolonged recession:

- Q3/Q4 2014 – recession started
- 2015 – contraction accelerated to -3.7%
- 2016 - growth is projected to stay negative; recovery is expected to start in Q3/Q4.

The gains from recovery of 2010-2014 have been lost.

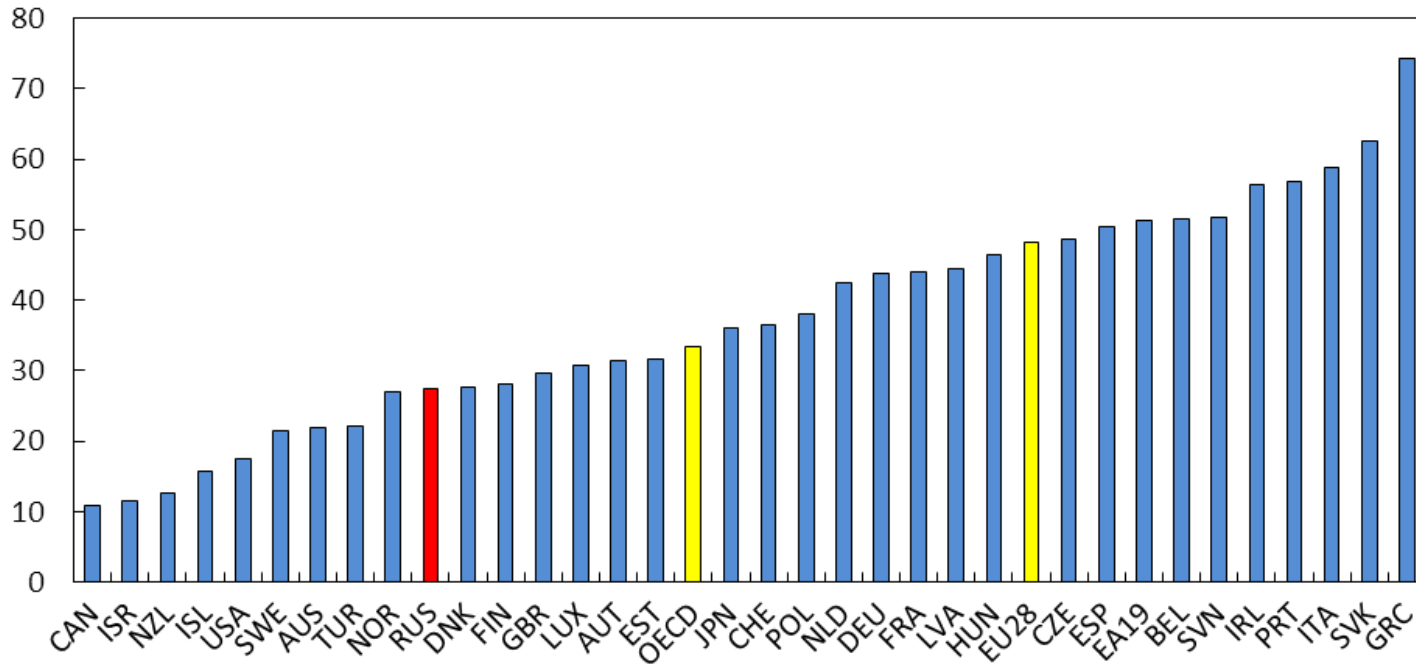
Total GDP loss $\approx 5\%$;
 wage loss $> 10\%$
 employment loss $< 0.5\%$

THE UNEMPLOYMENT RATE IS BELOW THE PRE-CRISIS LEVEL

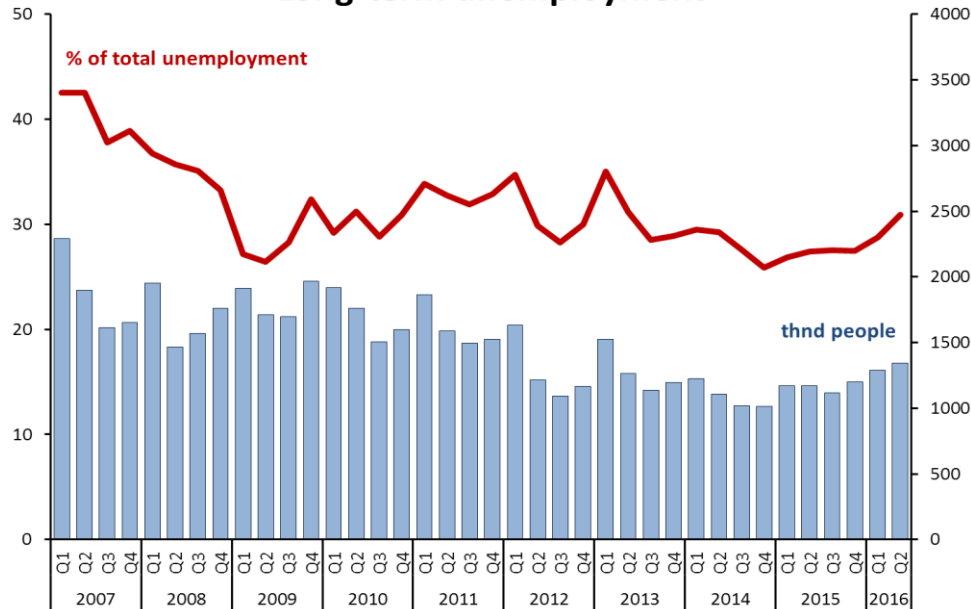


- The unemployment rate increased sharply to 8.3% (6.3 mln) in 2009. but declined quite rapidly.
- 2014: the unemployment rate reached the low from 1992 - 5.2% (3.9 mln)
- 2015: 5.6% (4.3 mln)
- 2016: roughly no changes
- Registered unemployment – no reaction in 2015-2016

Long-term unemployed (more than one year) as a percentage of total unemployed, Q4 2015



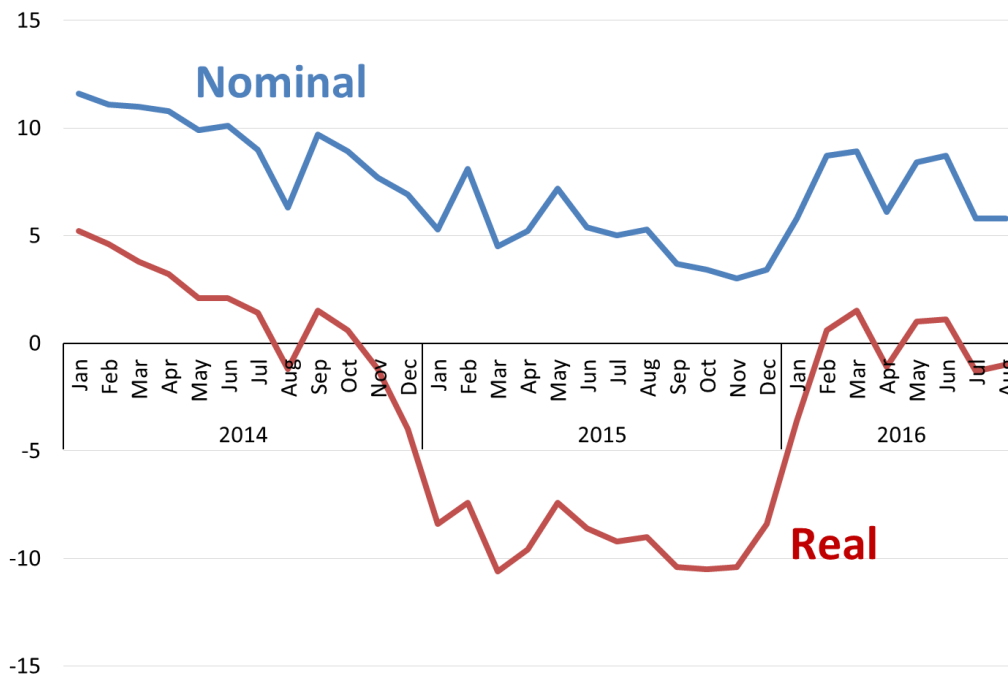
Long-term unemployment



- Despite a rise in long-term unemployment, it remains close to historical lows and lower than the OECD average

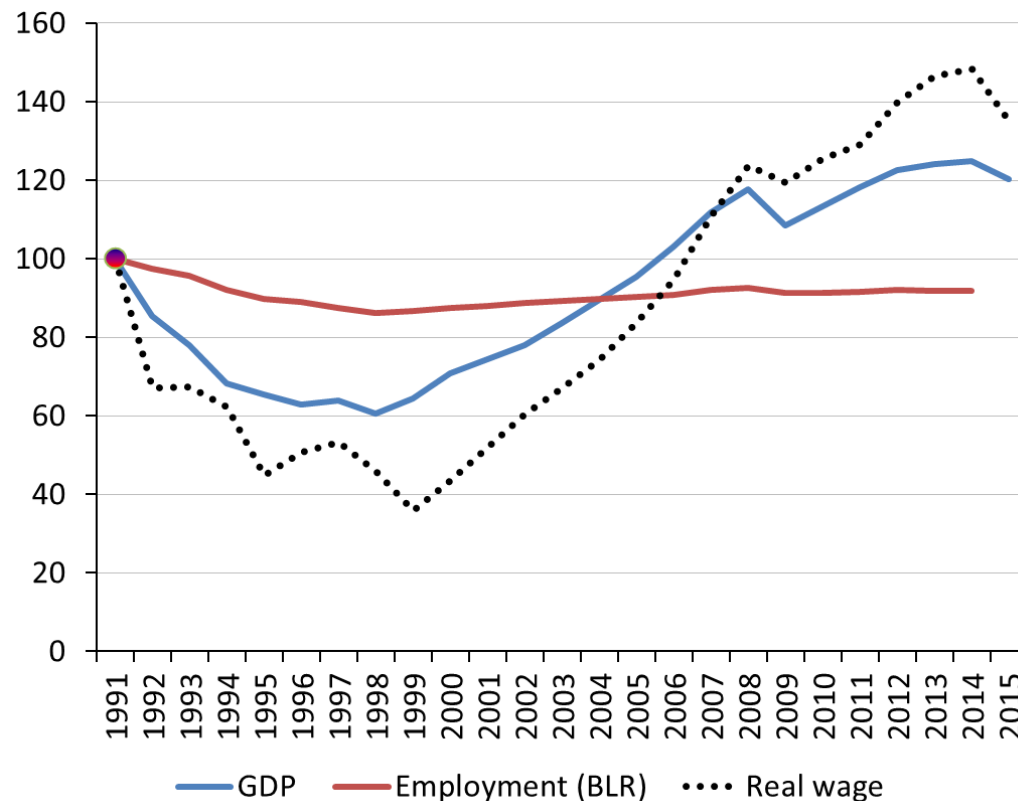
BURDEN OF ADJUSTMENT IS PLACED ON THE WORKERS

Earnings growth, y-o-y percentage change



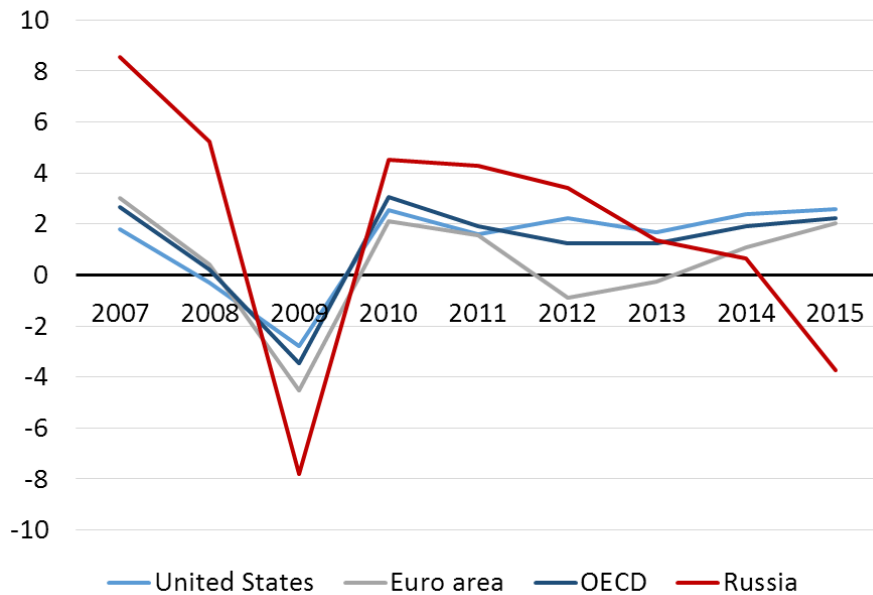
- Rapid wage growth just prior to the recession. Growth was fueled by increase in oil prices.
- Slower nominal wage growth: 2015 – 5.1%. 2016H2 – 7.8%
- Sharp drop in real wages
- Growth of real wages bounced back in 2016. but remains fragile
- With sluggish GDP growth, real wages are expected to stagnate in near future

ADJUSTMENT THROUGH WAGES IS TYPICAL OF THE “RUSSIAN” MODEL OF LABOR MARKET

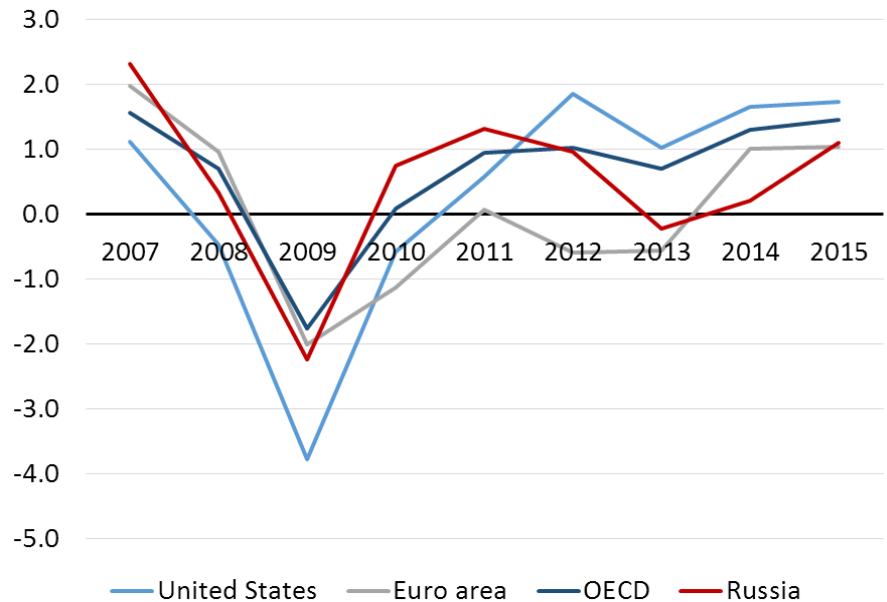


“Russian” model of the labor market =
Flexible wages & relatively stable employment

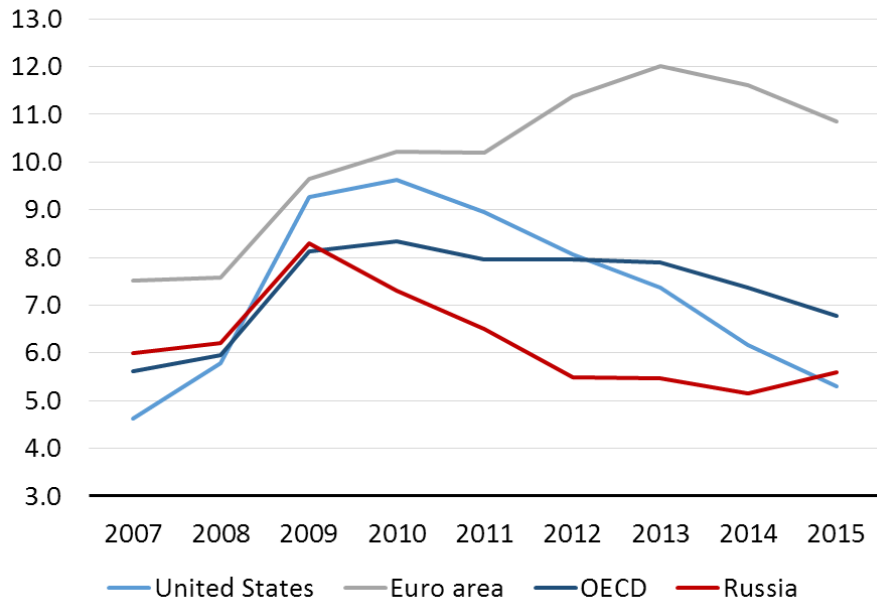
Real GDP growth, y-o-y percentage change



Employment growth, y-o-y percentage change



Unemployment rate

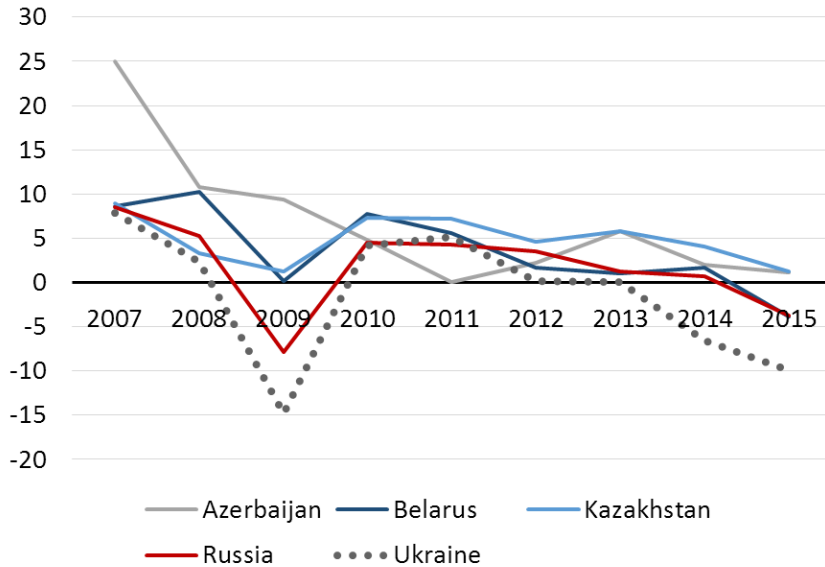


RUSSIA VS ADVANCED ECONOMIES

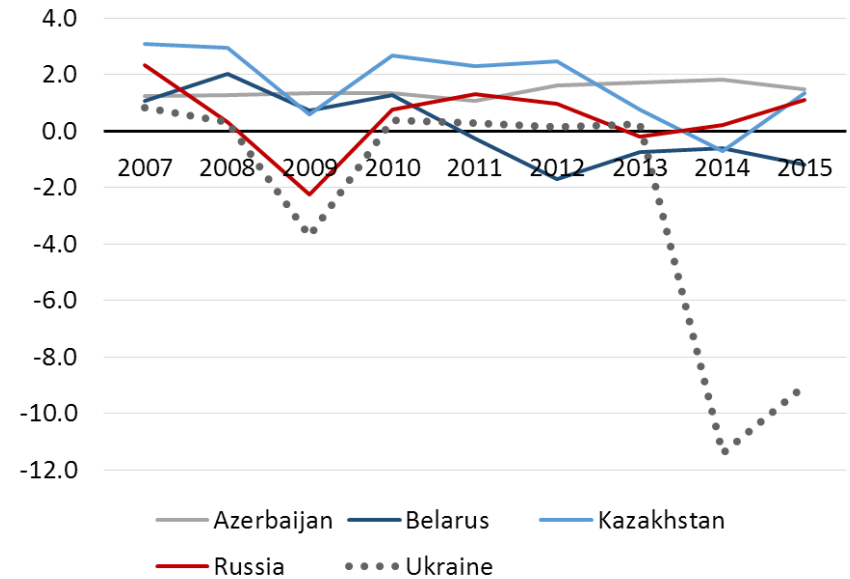
- The 2008-2009 recession Russia was deeper in Russia than in advanced countries with less effect on employment
- The unemployment rate was falling particularly rapidly

RUSSIA VS LARGEST CIS ECONOMIES

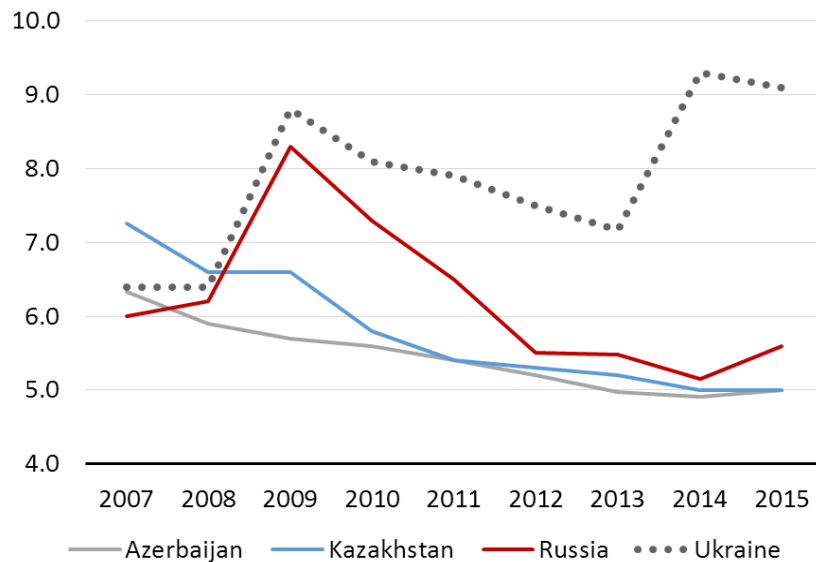
Real GDP growth, y-o-y percentage change



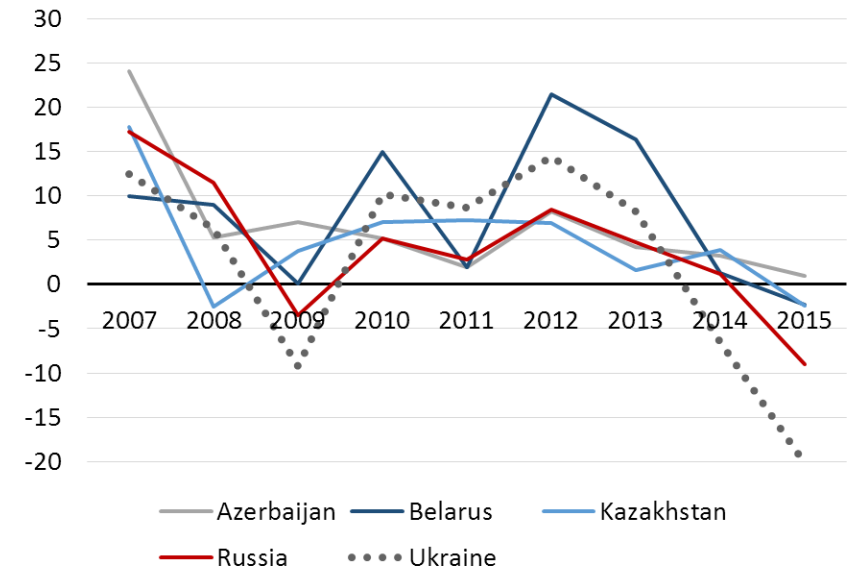
Employment growth, y-o-y percentage change



Unemployment rate



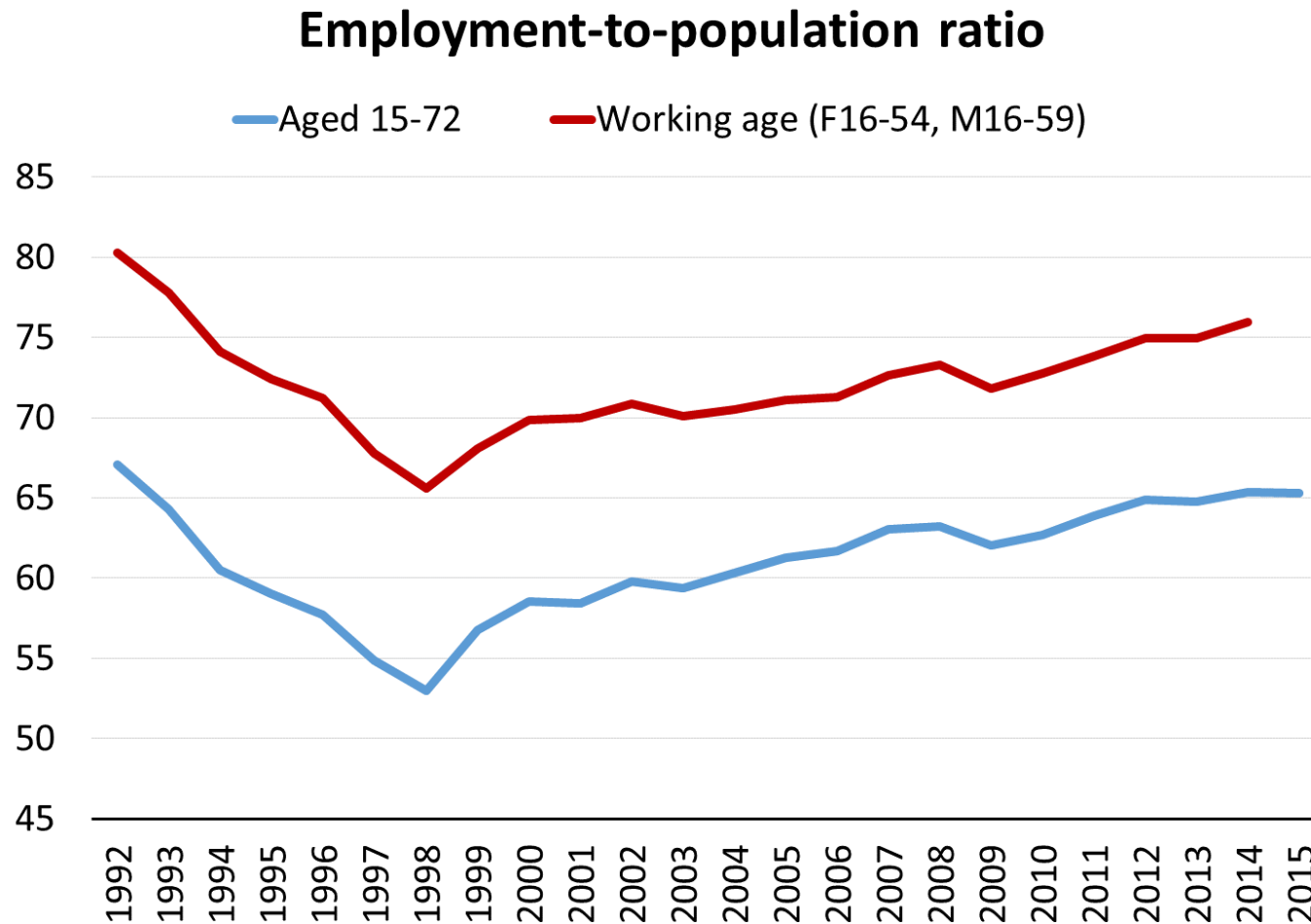
Real wage growth, y-o-y percentage change



MAIN ISSUES

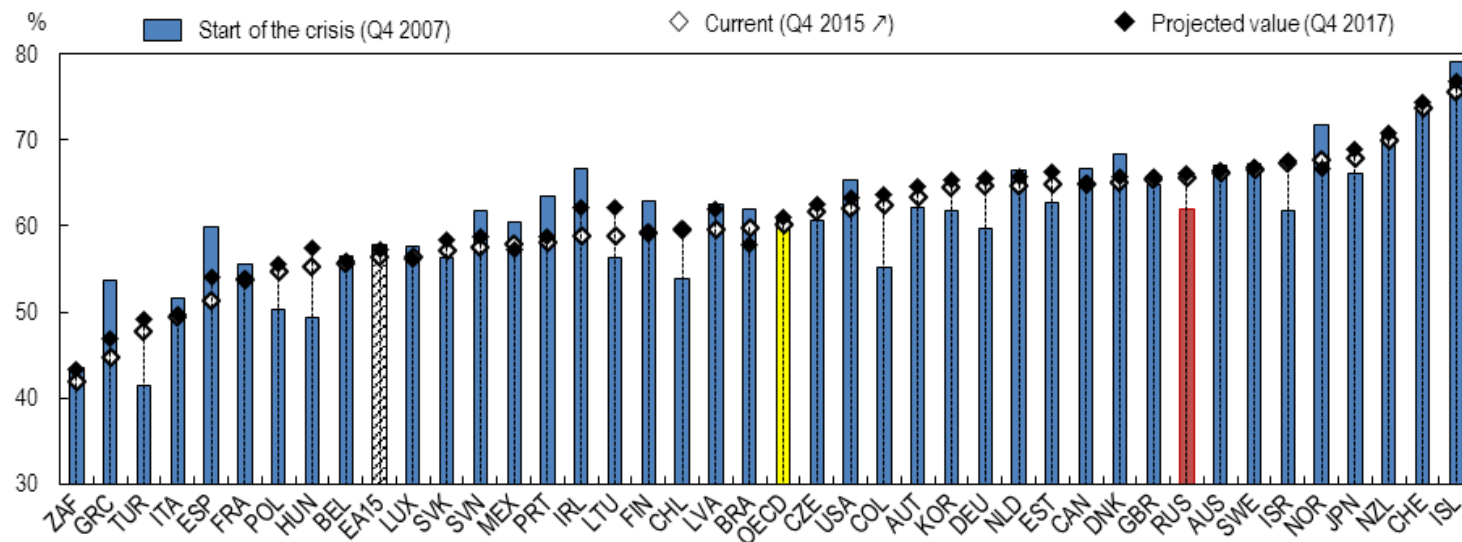
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THE RECESSION OF 2014-2016 HAD NO EFFECT ON OVERALL EMPLOYMENT RATES



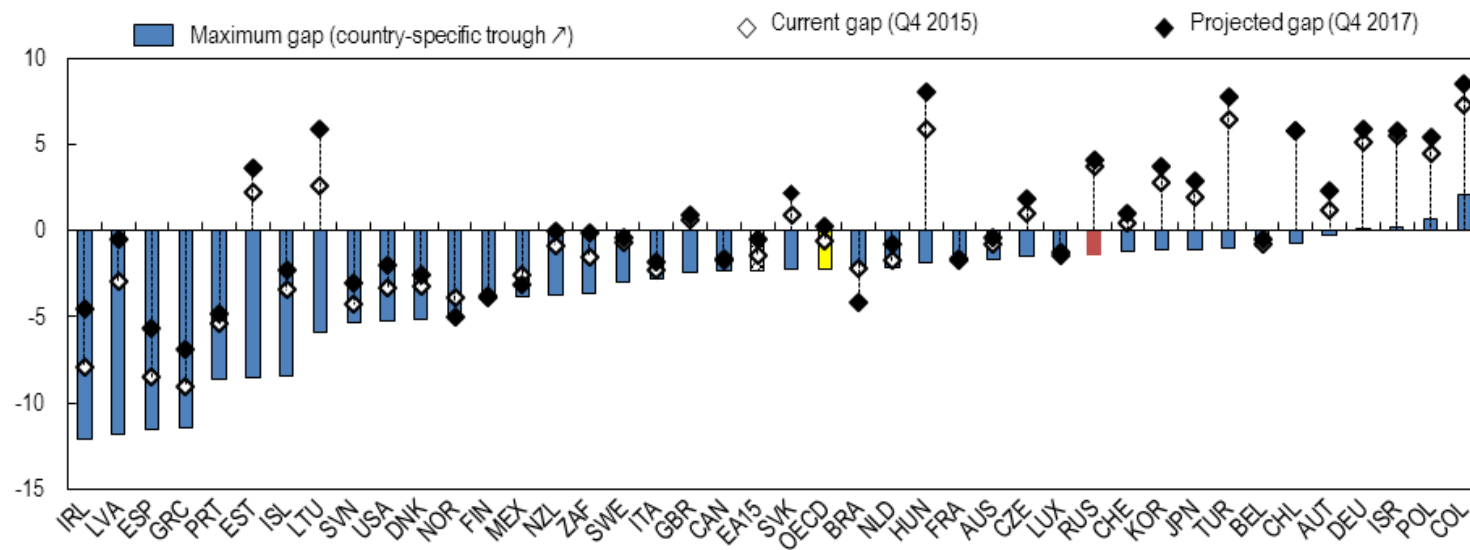
Evolution of the employment-to-population ratio

Percentage of the population aged 15-74



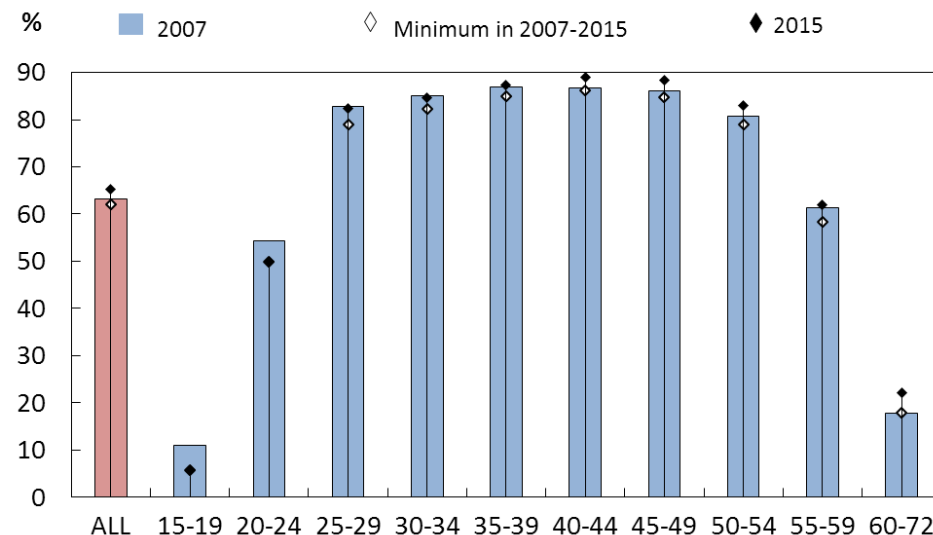
Employment gap

Percentage-points change in the employment rate since the onset of the crisis (Q4 2007)

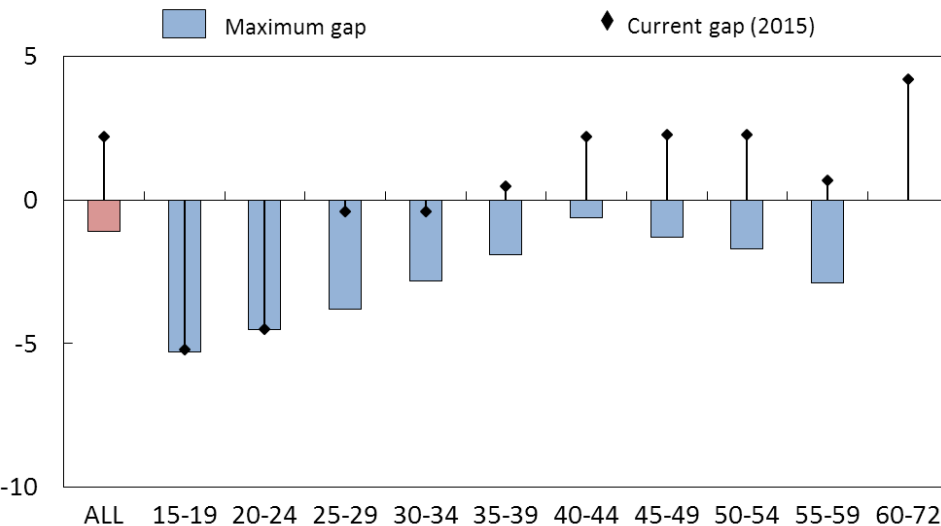


GROWING LABOR FORCE PARTICIPATION AND EMPLOYMENT IN ELDER AGES

Evolution of the employment-to-population ratio
Percentage of the population aged 15-72



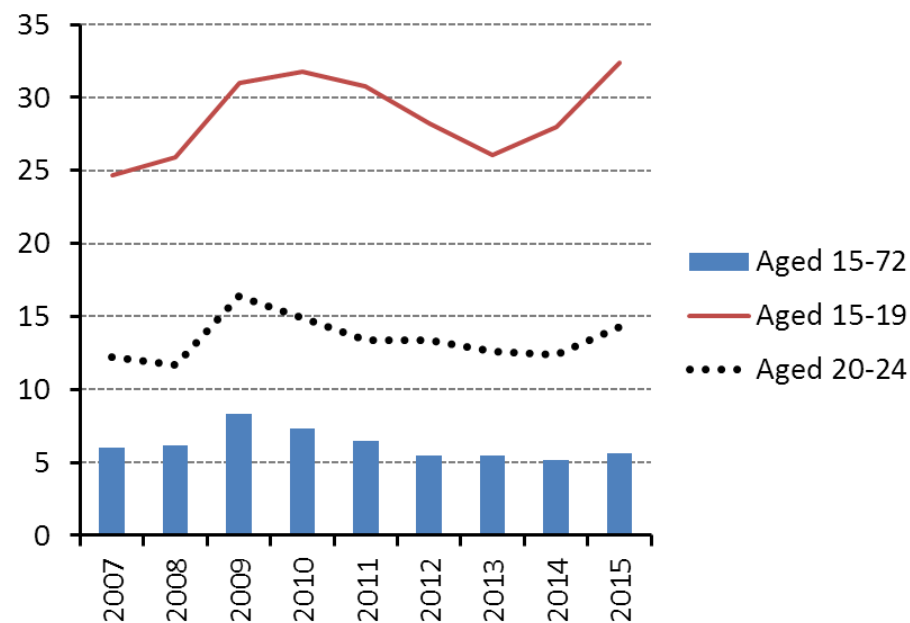
Employment gap
Percentage-points change in the employment rate since 2007



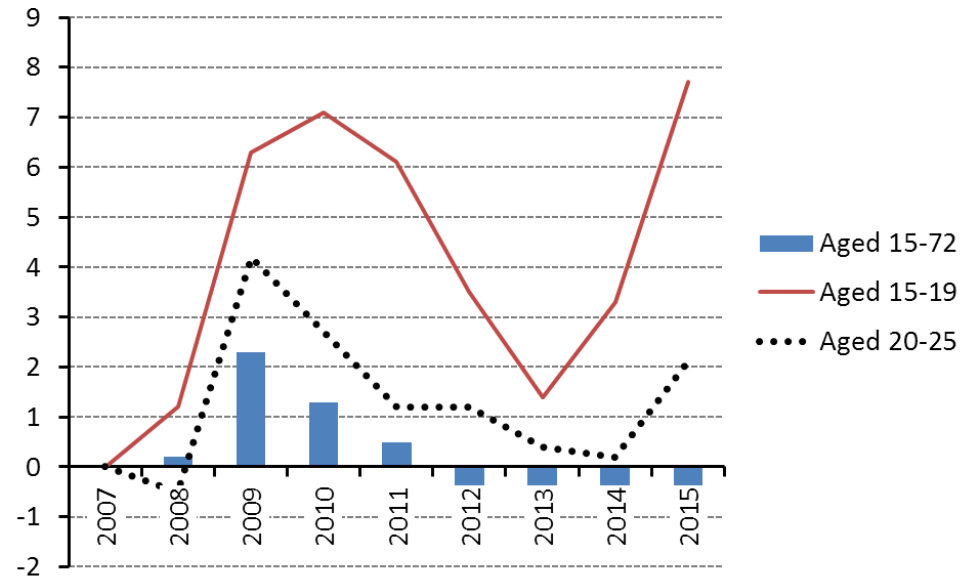
- All age groups were hit by the crisis in 2009. Employment losses were larger for younger workers. Employment rates for 15-24's have not recovered since 2009.
- Employment rates have been growing for elder workers (40+)

YOUTH UNEMPLOYMENT RATES ARE HIGHLY RESPONSIVE TO THE NEGATIVE SHOCKS

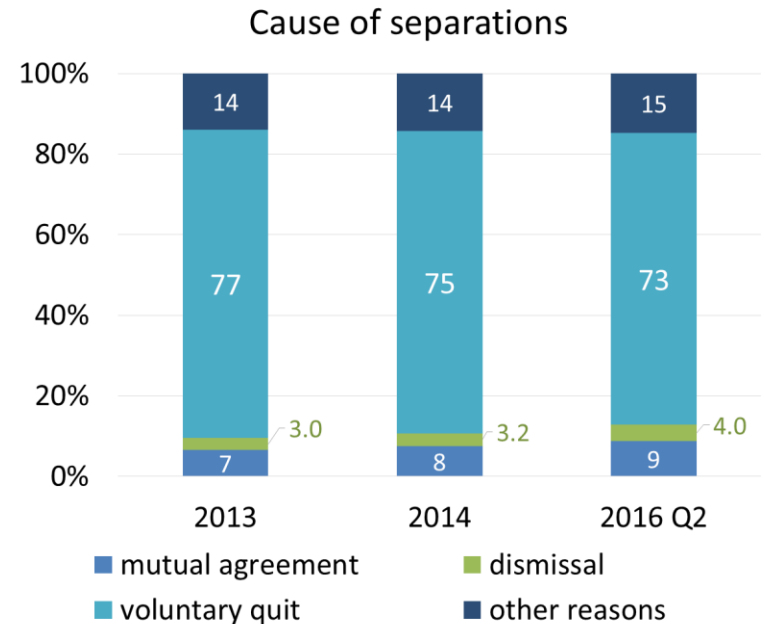
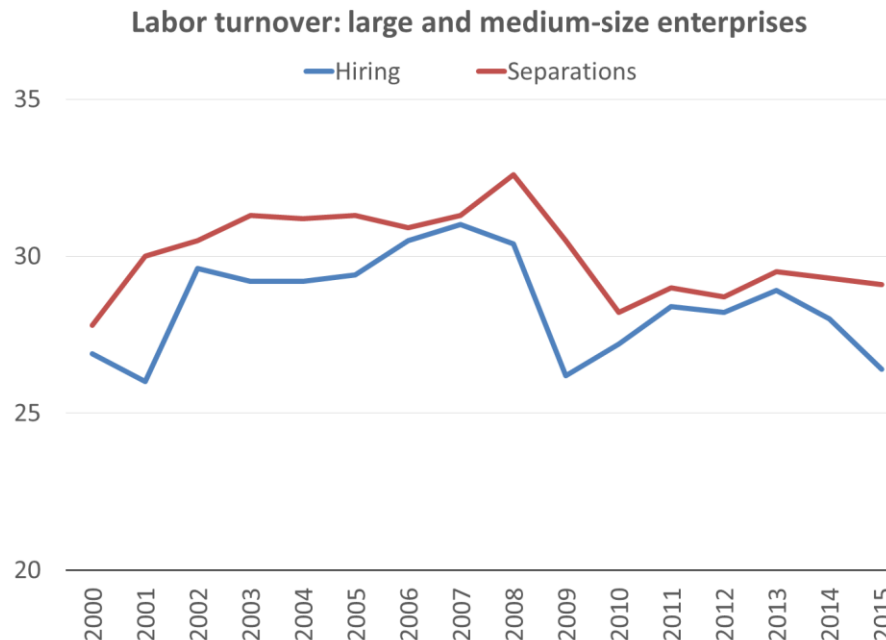
Youth unemployment rates, percent



Youth unemployment rates: p.p. change, 2007 = 100

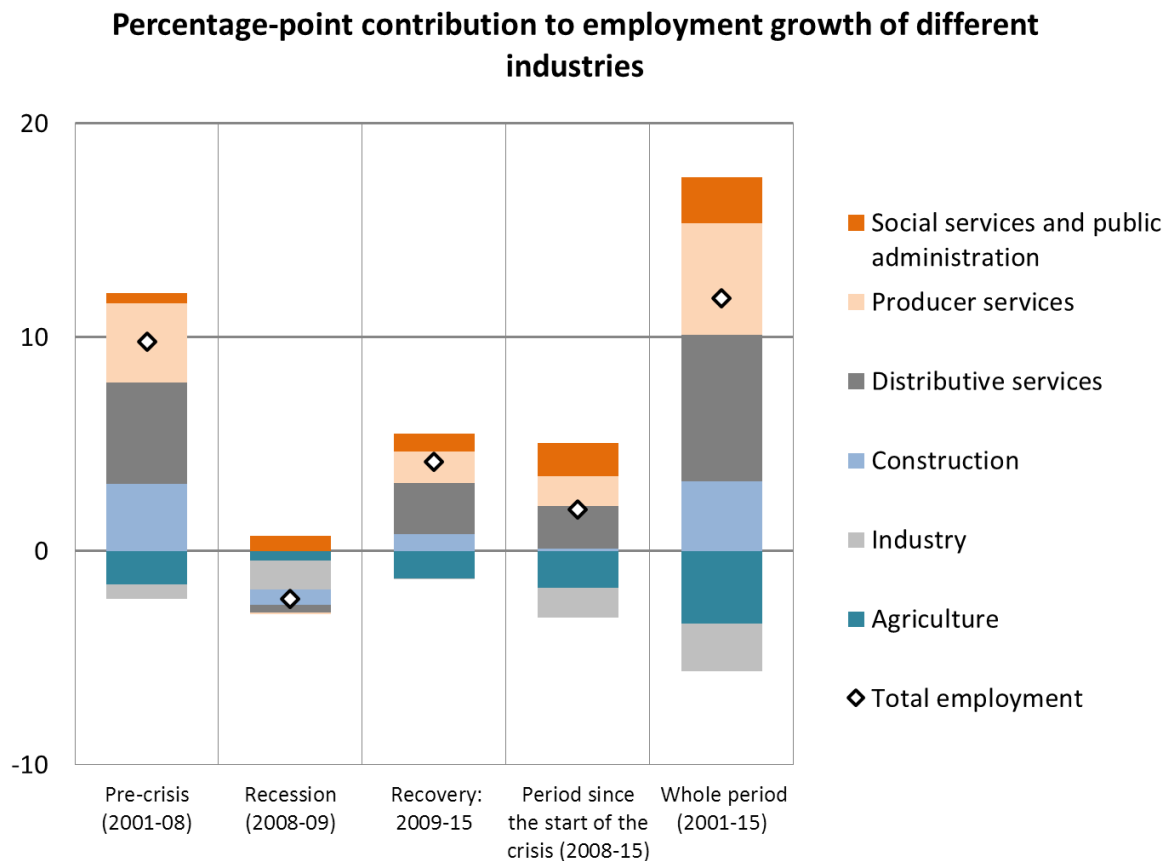


WORKER TURNOVER REMAINS HIGH. MAJORITY OF SEPARATIONS ARE VOLUNTARY



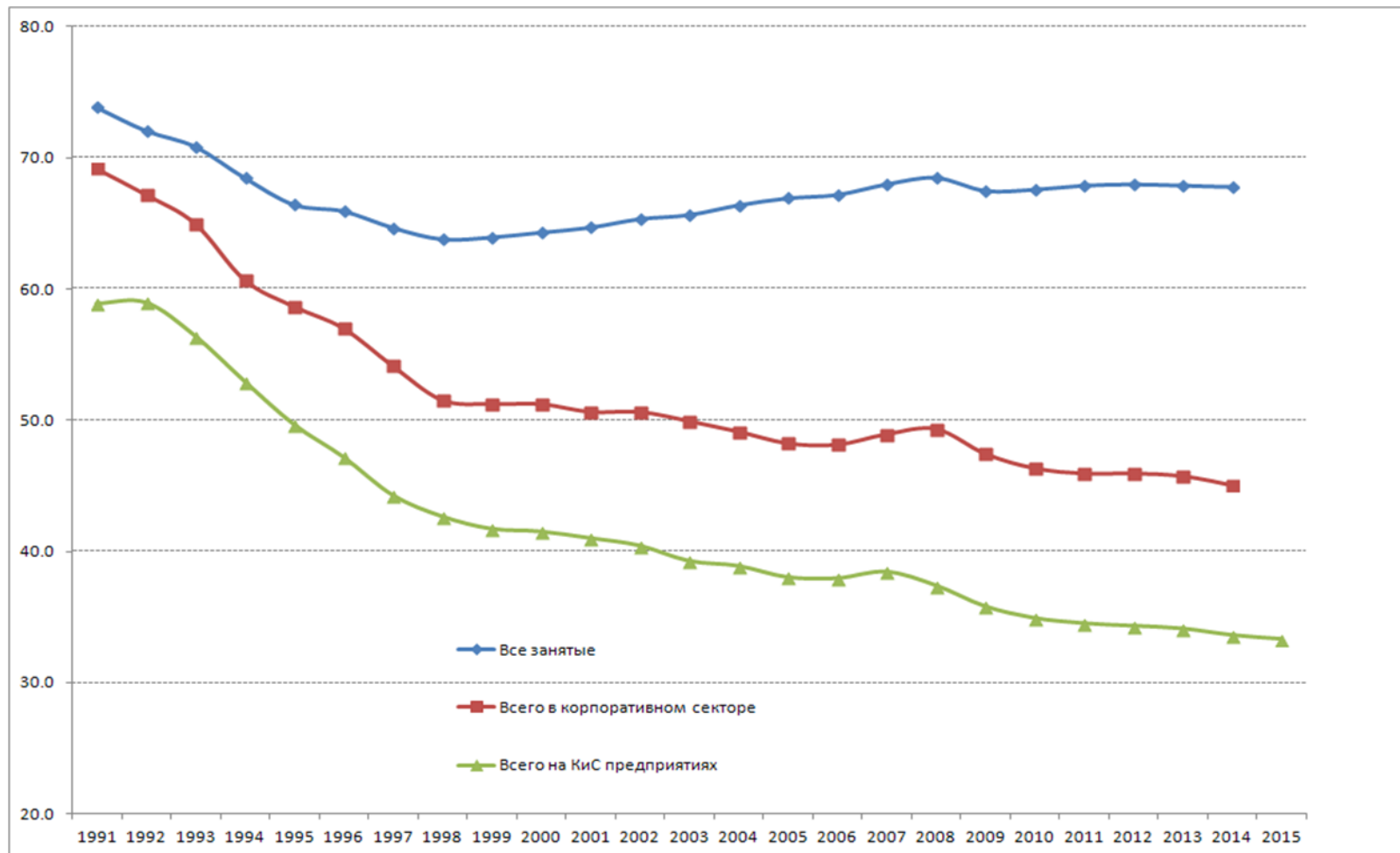
- Wage determination is firm-specific: workers leave because of wage cuts
- Most job changes are job-to-job transitions without unemployment spells
- High wage flexibility sustains backward employers. encourages churning and removes incentives to improve productivity

JOB LOSSES WERE HIGHLY CONCENTRATED IN THE GOODS-PRODUCING INDUSTRIES



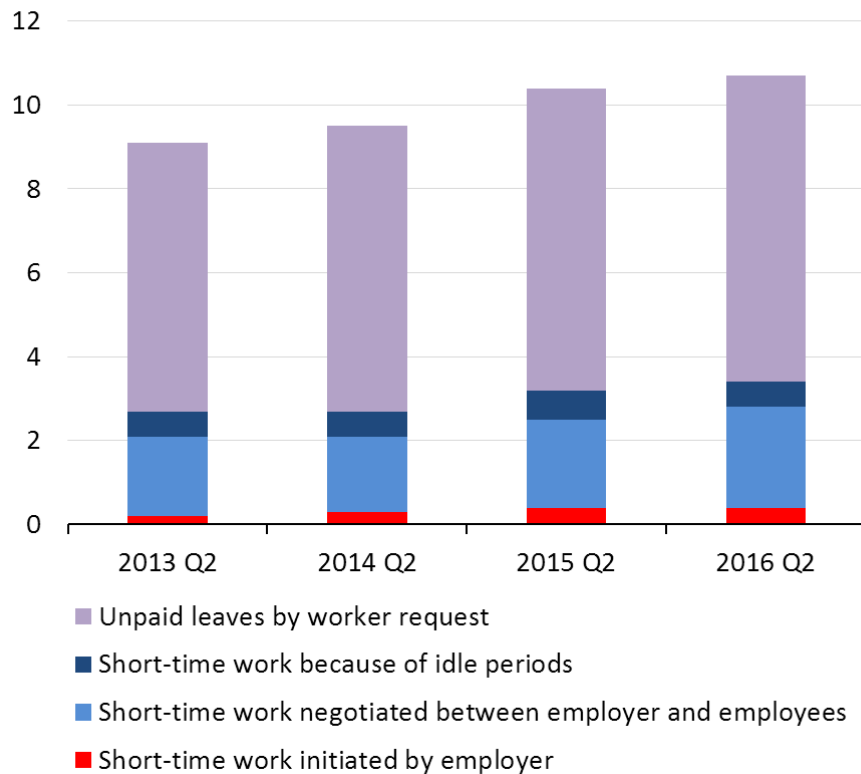
- The service sector accounted for all of the jobs added during the recovery
- The public sector expanded both in recession and during recovery
- The net shift of employment away from the goods-producing sector towards the service sector represents the continuation of a secular trend

EMPLOYMENT HAS BEEN GROWING OUTSIDE THE FORMAL SECTOR

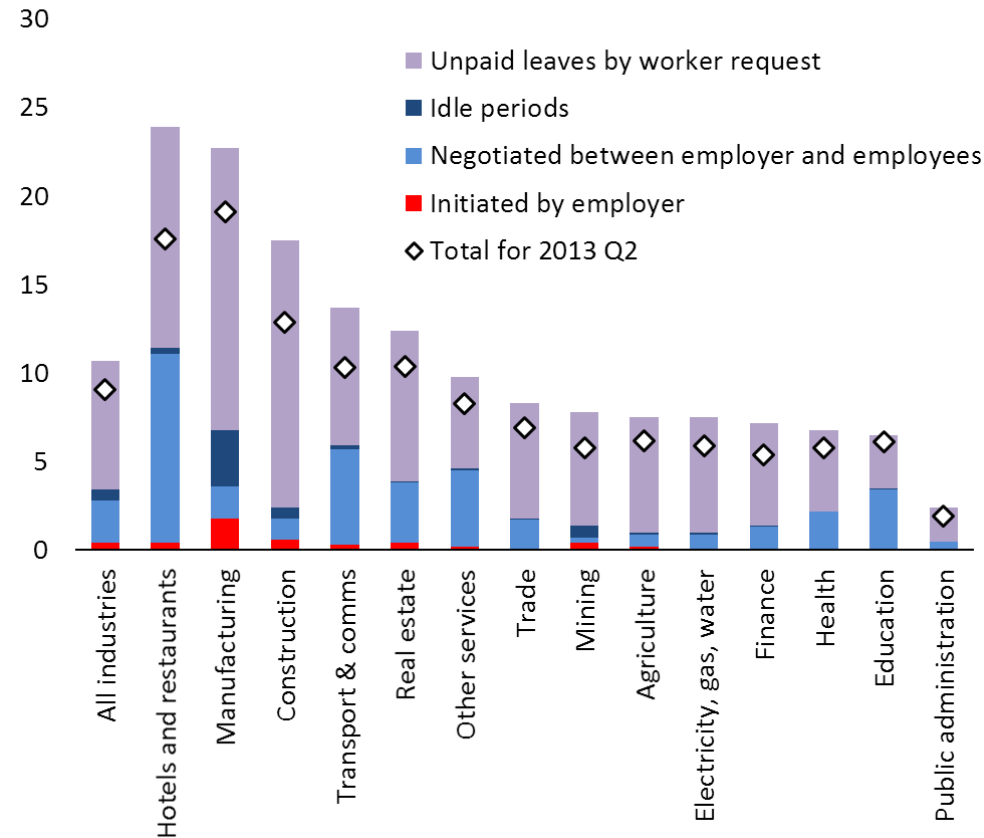


SHORT-TIME WORK TAKE-UP RATES INCREASED SOMEWHAT BUT DO NOT EXCEED 3.5%

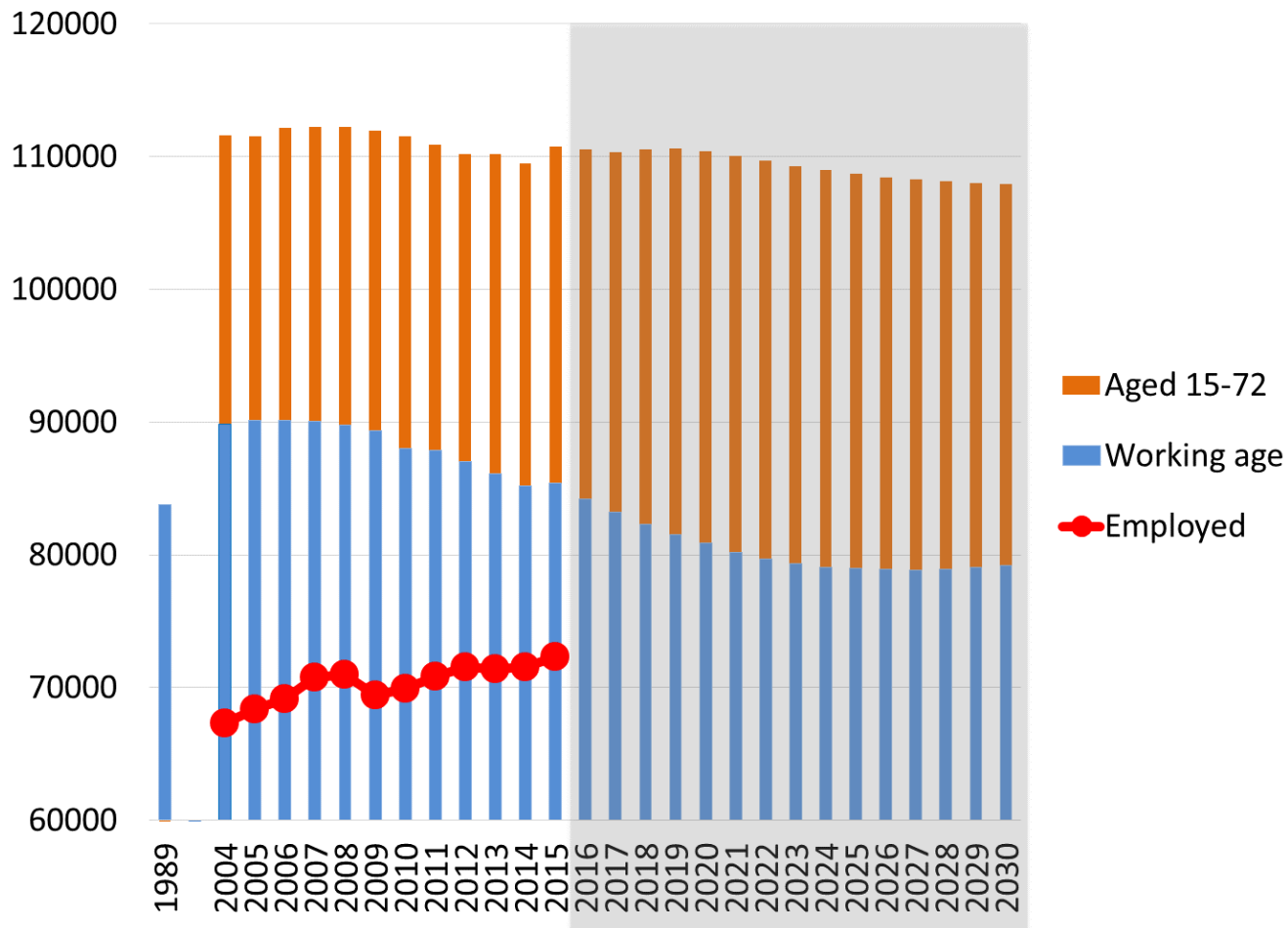
Short-time work take-up rates, % of listed staff



Short-time work take-up rates by industry



THE MAJOR RISK COMES FROM DEMOGRAPHY: IT WILL BE DIFFICULT TO MAINTAIN CURRENT EMPLOYMENT NUMBERS IN THE LONG RUN



MAIN ISSUES

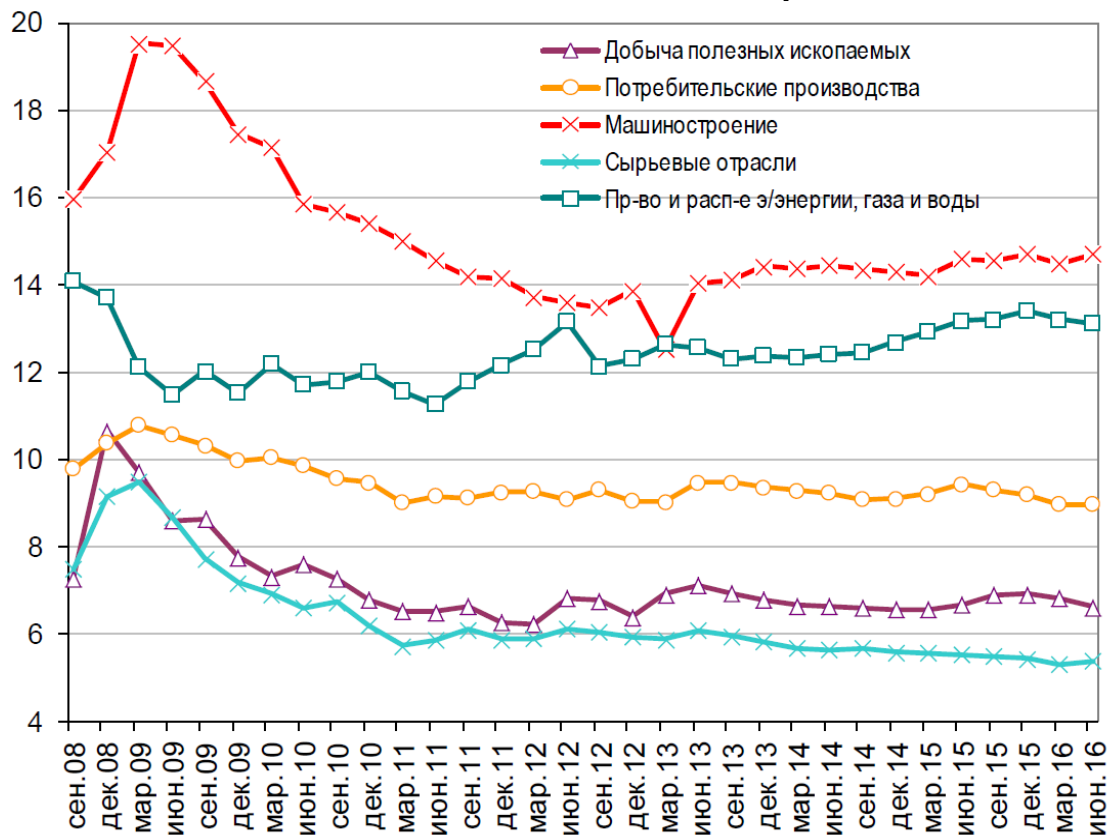
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REAL WAGES DROPPED IN ALL LARGE CIS COUNTRIES IN 2015



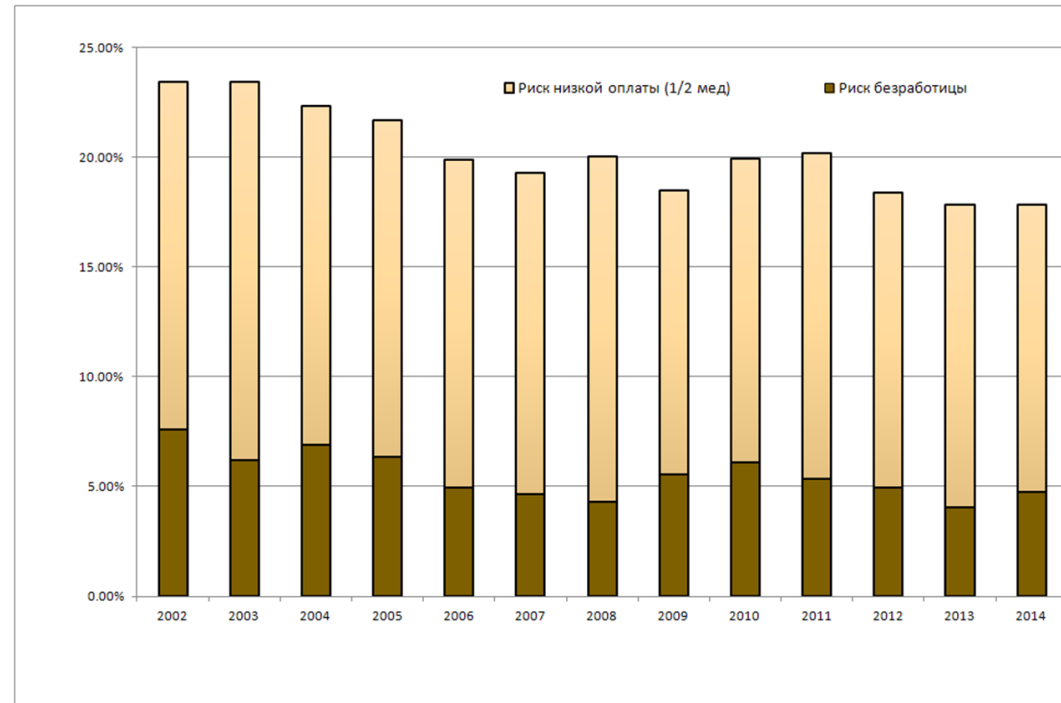
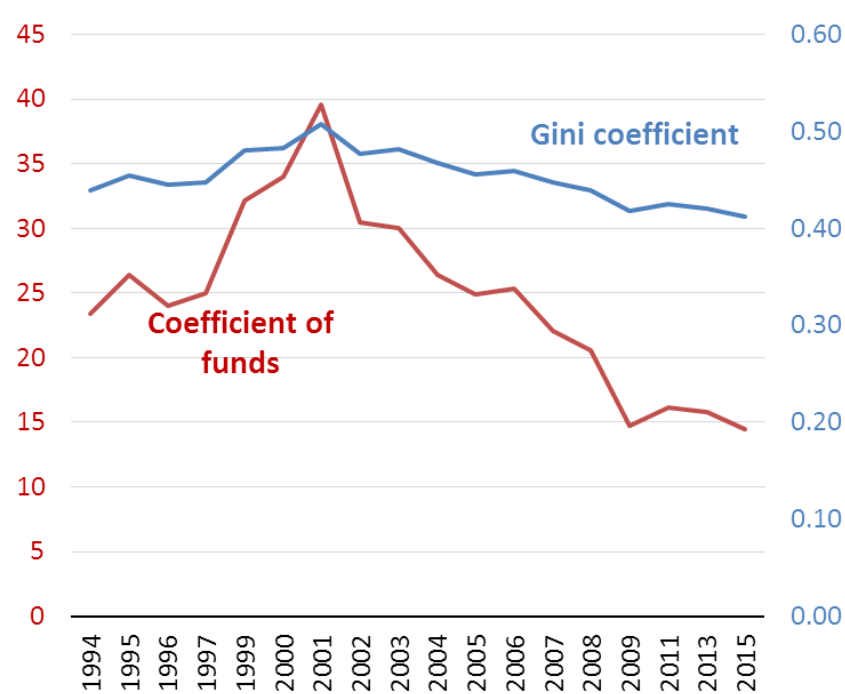
LABOR COSTS

The share of labor costs in the output, %



- The crisis of 2009 had significant impact on unit labor costs.
- In 2014-2016 there is hardly any impact
- The share of labor costs in major industries remained unchanged

EARNINGS INEQUALITY REMAINS HIGH. THE SHARE OF LOW PAY IS PERSISTENTLY HIGH IMPLYING HIGH LABOR MARKET RISK



WAGE ARREARS NO LONGER USED AS A TOOL FOR ADAPTATION



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HOW DOES IT WORK?

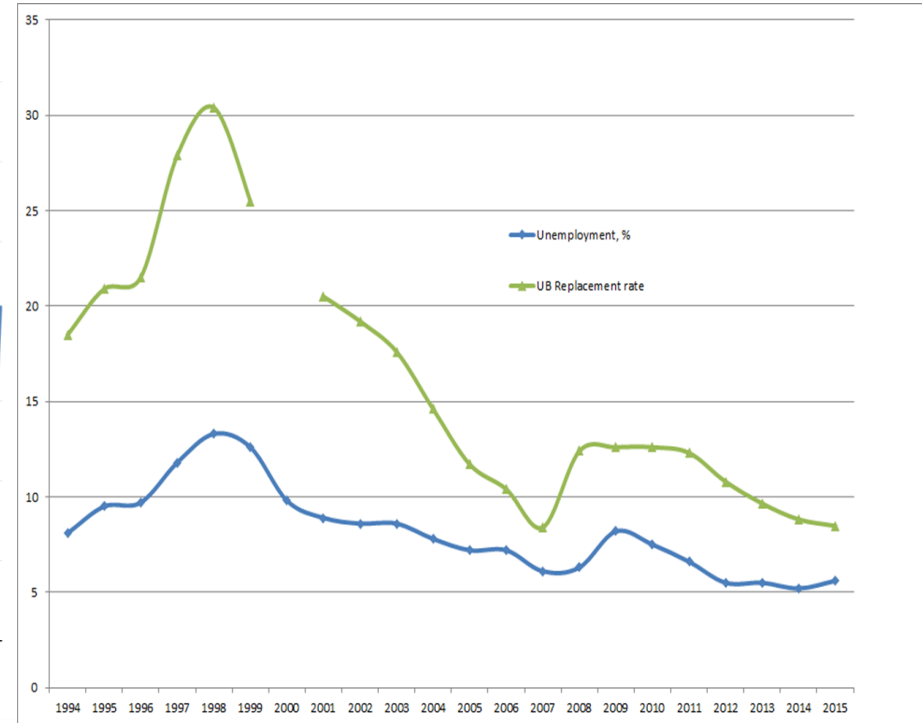
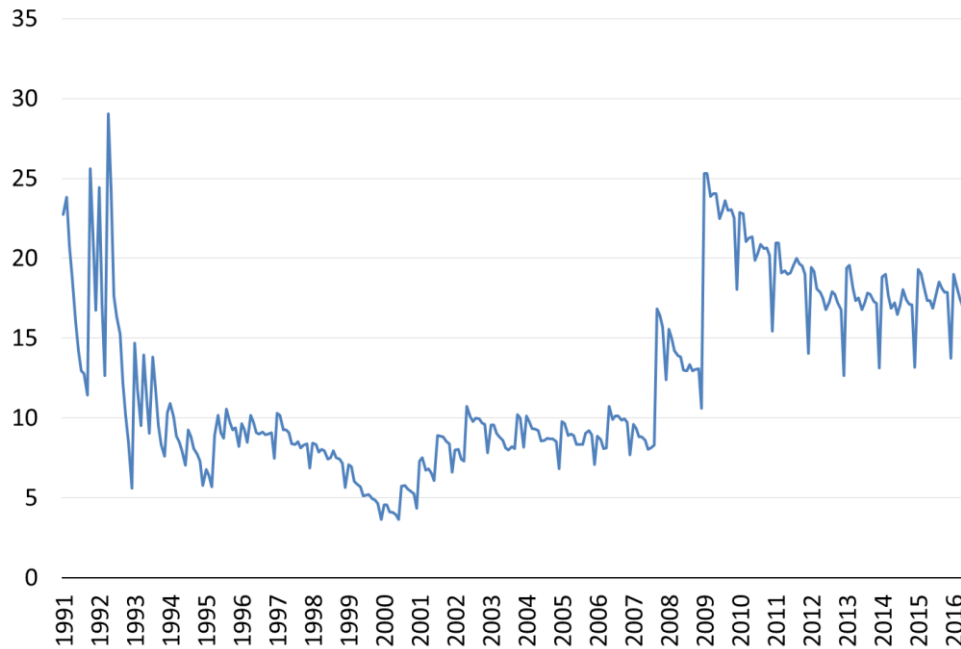
THE INSTITUTIONAL FOUNDATIONS

Blocking employment adjustment + letting wages fluctuate freely

- Wage floor (minimum wage & unemployment benefits)
- Two-tier wage structure
- Employment regulations (EPL)
- Trade unions and wage agreements
- Enforcement efficiency

LOW WAGE FLOOR DOES NOT CONSTRAIN DOWNWARD WAGE ADJUSTMENT

Minimum wage / average wage, percent



LARGE AND PERSISTENT VARIABLE COMPONENT IN THE TWO-TIER WAGE STRUCTURE WORKS AS AN AUTOMATIC RISK-SHARING DEVICE

	Percentage of the total wage bill:			
	Tariff-based part	Regional allowances	Premiums and bonuses	Other payments
1995	53.0	15.8	28.2	3.0
2000	49.2	15.1	32.7	3.0
2005	47.8	14.2	35.1	2.9
2009	52.5	11.4	33.3	2.9
2013	60.1	11.6		28.3

- Wage consists of two tiers:
 1. fixed (tariff-based) and rigidly contracted part,
 2. variable and flexible part.
- Wages are highly dependent on firm performance

TRADE UNIONS AND WAGE BARGAINING INSTITUTIONS ARE WEAK

- Density – high but declining!
- Coverage – high but declining!
- Union voice – weak!
- Mobilization capacity – weak!
- Asymmetry in bargaining power

EMPLOYMENT PROTECTION LEGISLATION AND ITS ENFORCEMENT

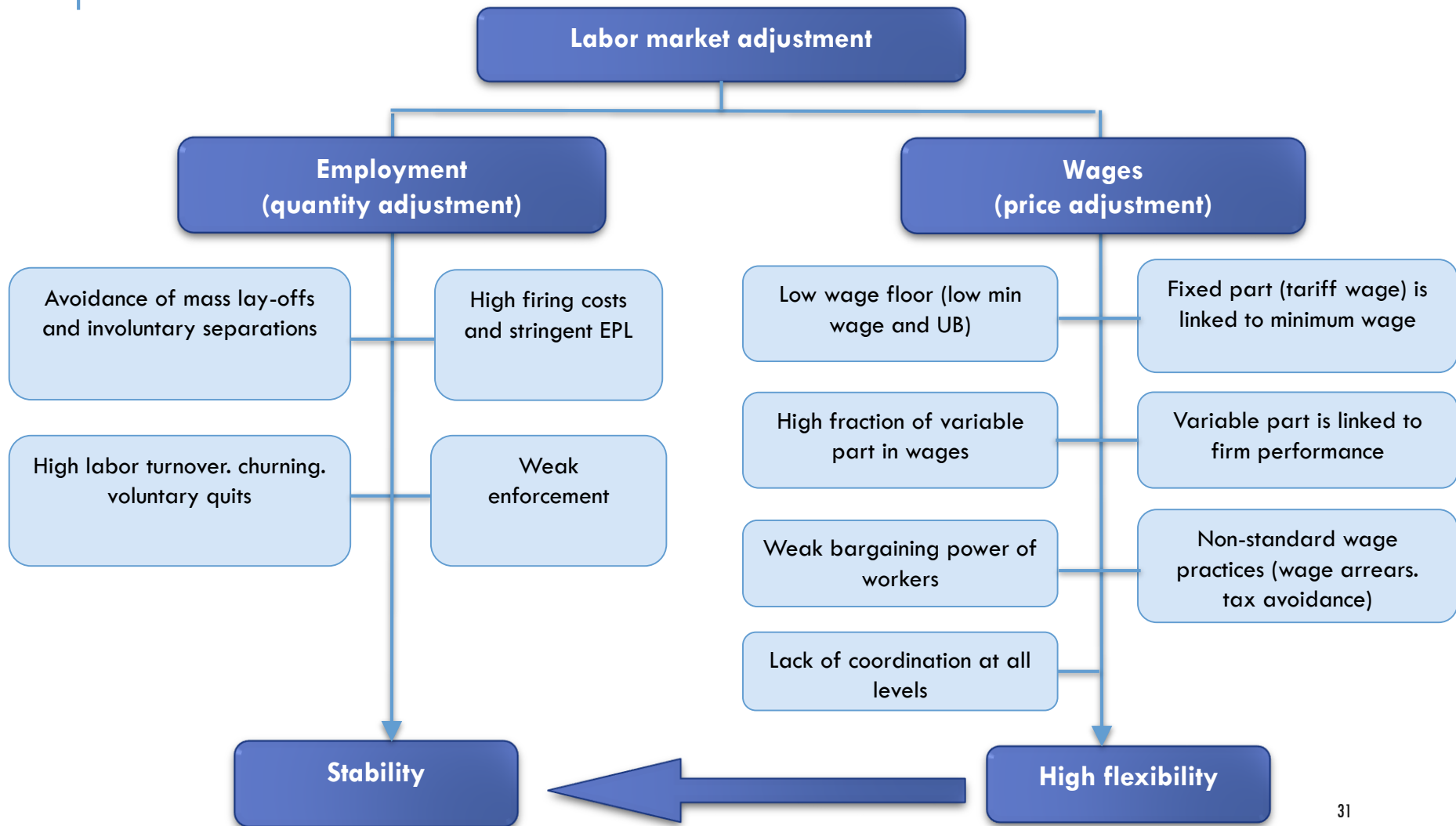
ON PAPER

- The EPL tends to be strict, complicated and costly to apply
- Firing costs are high
- Administrative and selective interventions are possible

IN PRACTICE

- «The stringency of Russian laws is offset by their non-observance» (M. Saltykov-Tchedrin)
- Non-observance of laws and rules is an additional element of the observed flexibility
- Many adjustment mechanisms (wage arrears, involuntary leaves, unofficial wage payments, etc) operated beyond the formal “rules of the game”

RUSSIAN MODEL: STYLIZED PICTURE



ON THE POSITIVE SIDE

- 😊 Good shock absorber, allows to keep unemployment low and employment stable
- 😊 Low expenditures on labor market policies
- 😊 From the social perspective, individuals get time to adjust, avoid joblessness, look for outside options and keep social ties.
- 😊 Large-scale social conflicts associated with displacements are avoided
- 😊 Provides minimum income

ON THE NEGATIVE SIDE

Firms:

- ☹ Does not facilitate enterprise restructuring
- ☹ Weakens incentives to enhance productivity and invest in training
- ☹ Stimulates opportunistic behavior of employers (wage arrears, displacement through quits, etc.)

Workers:

- ☹ High wage inequality and high proportion of low-wage earners
- ☹ Deprives people of formal/institutional social protection
- ☹ Devalues formal contracts, generates low trust behavior, destroys the rule of law

CONCLUSIONS

- Falling wages remain the primary mechanism through which the labor market is adjusting to the recession.
- Adjustment costs are placed on the whole working population (not concentrated in a small group of the unemployed)
- The Russian LM model buffers shocks but is not friendly to restructuring and coping with competitive pressures.

CONCLUSIONS

- Structural reforms to facilitate the reallocation of resources and restructuring:
 - Product markets: competition-enhancing reforms. lowering administrative barriers
 - Pension reform is the highest priority needed to preserve employment numbers. reduce costs and increase pensions
 - Reforms of employment protection legislation: reduction of dismissal costs, wider use of part-time employment
 - Reform of unemployment protection: increase of unemployment benefits. effective activation strategy to support jobseekers
- Structural reforms may induce transitory employment losses but significantly improve productivity growth and employment in the long run