EMPLOYMENT, ECONOMIC DEVELOPMENT AND LOCAL GOVERNANCE IN NORTH WEST RUSSIA

St. Petersburg, Russia 21 September 2005

The governance of employment and economic development in North West Russia

by

Irina Denisova, Senior Economist,
Centre for Economic and Financial Research (CEFIR)

Marcus Svedberg, Chief Analyst
Stockholm Institute of Transition Economics (SITE)

Preliminary background report
1. Introduction

This paper will discuss the importance of labor market institutions for the economic and employment development in North Western Russia. The paper rests on two established notions; that labor markets are imperfect and that some kind of institutional intervention therefore is needed, and that there is a positive link between economic growth and institutions in general and labor market institutions in particular.

As a way of introduction, we will give an overview of the economic and labor market situation as well as the overall institutional setting in North Western Russia, which will illustrate the diversity of the district and its special situation in Russia as well as in a wider regional perspective. Even though some of the recommendations, such as an increased focus on small business development, are similar to other regions around the Baltic Sea and elsewhere, the underlying challenges are different. Most notably, the main labor market challenge in Russia in general and the North West in particular is not related to high unemployment figures or overly strict labor regulations. The main problem seems to be a lack of mobility in the Russian labor market, across regions and sectors, which stems from institutional imperfections of a more structural nature.

In an assessment of labor markets in transition countries in Europe, the EBRD arrived at three broad messages that can be used as a point of reference for this paper.¹ The first message was that “informal activities . . . have played a crucial role in providing employment and earnings for many people” and that in the more advanced countries “the motives tend to be market-related, including tax evasion and the avoidance of bureaucratic delays and impediments”. The second message dealt with the labor market winners and losers during the transition period and EBRD concluded that “the most obvious beneficiaries being owners of firms and the self-employed.” The third message was that “labor market performance could be enhanced substantially by institutional reforms”.

We will discuss the relevance of these messages for Russia today. By looking at the level of institutional development in Russia, the environment for small businesses and entrepreneurial development, and the impact of the tax and administrative reforms in Russia we will go through the messages in the reverse order.

The key point is that Russia suffers from an inadequate institutional framework, limiting the development of the labor market and economy in the North West and elsewhere in Russia. The weaknesses are evident in the segmentation and the barriers to mobility on the labor market as well as in significant barriers to small business development.

2. Economic and employment context of the region

2.1 Economic indicators

The North West federal district is generally regarded as one of the more dynamic parts of Russia. Although it is true that the North West is ranked first among the seven federal districts in

terms of real gross regional product (GRP) growth, it is important to note that there exist substantial differences within the district. Leningrad oblast and St Petersburg are ranked first and second of all regions in Russia in terms of GRP growth whereas Komi Republic and Murmansk are ranked at the bottom (69 and 71). Kaliningrad oblast (13) and Archangelsk (17) are ranked in the top quartile and Pskov (27), Novgorod (30), Vologda (36), and Karelia (43) are ranked in the middle. The ranking measures growth between 1999 and 2002 and the North West as a whole grew by almost 50 percent during that period.

A similar picture emerges when looking at industrial production growth, which grew twice as fast in the North West (13.4 percent) compared to Russia as a whole (6.1 percent) in 2004. For the past three years, it is Kaliningrad, St Petersburg and Leningrad that has grown the most, between 10 and 35 percent annually, whereas the regions in the North like Murmansk and Karelia have shown modest or even negative growth of industrial production.

The Russian economy is to a large extent dependent on natural resources in general and oil and gas in particular. The oil and gas rich regions are therefore very large in an economic sense. Together with Moscow, which is the dominant commercial, economic and financial centre, these oil and gas regions make up a significant share of the Russian gross domestic product. As a result, the North West is only the fifth largest district in Russia in terms of nominal GRP. In 2002, it made up about ten percent of the Russian GDP. The Central district, dominated by Moscow, is the largest region followed by Volga, Urals and Siberia. Although only one of the 20 largest regions (from an economic perspective) is from the North West, a majority is from the European parts of Russia. The western gravity can, to a great extent, be explained by large cities like Moscow, St Petersburg, Samara, Yekaterinerburg, Kazan, Nizhny Novgorod and Perm.

From a standard of living perspective, GRP per capita may, however, be a more interesting indicator. The most immediate and striking factor is that the spread in Russia is enormous. The most prosperous region in Russia was 35 times wealthier than the poorest one. The differences are less extreme in the North West, but Komi (USD 3000 in GRP per capita) is still three times wealthier than Pskov (1000). It is only Murmansk and St Petersburg, apart from Komi, that are wealthier than the Russian average of about USD 2000. It is interesting to note that the economically smallest and slowest growing regions (Komi and Murmansk) in the district are still the wealthiest in terms of GRP per capita. One possible explanation is small populations but figures on per capita income supports the GRP per capita differences. In fact, Komi is reported to be the fourth richest region in Russia in terms of income per capita. Also Murmansk and St Petersburg are among the top ten regions and above the Russian average. Karelia, Archangelsk and Vologda are close to the average whereas the other regions in the North West are poorer in terms of income.

2.2 Regional employment and wage structure

The restructuring of the Russian industry has been slower than in many other transition countries, but parts of the economy is starting to resemble that of a more modern market economy. Today, the service sector makes up more than half of the economy whereas industry is contributing less than 40 percent and agriculture about five percent. It is also the service sector

---

2 The figures below are taken from Westin, Peter (2004) “A guide to Russia’s regions”, www.aton.ru
that is most competitive and productive. Agriculture still employs about a quarter of the population and is thus rather unproductive. Total employment in Russia decreased almost 14 percent between 1989 and 2003. Relative employment in industry decreased 38 percent during the same period. Almost all new jobs are created in service sector.

There is no such thing as a common industrial or employment structure in the North West. Industry makes up somewhere between 20-40 percent of the gross regional production. Archangelsk and Karelia are typical forest, timber and pulp and paper regions whereas Leningrad, St Petersburg and Pskov have strong food and beverage production. Fuel is the largest industry in Komi, ferrous metals in Vologda and Murmansk, and chemicals in Novgorod. The service sector is increasing both in terms of value added and employment. A break-down of employment in different kinds of enterprises shows that there are 927 000 small and medium sized enterprises in the North West (of which 298 000 are medium-sized, 17 000 farm enterprises, 476 000 individual entrepreneurs and 136 000 small enterprises). These firms make up 93.4 percent of the economic activity in the North West (compared to 94.3 nationally), exactly half the employment (48.8 percent nationally), and 48.5 of sales revenues (46.9 percent nationally).

It is widely known that regional disparities on the Russian labor market are significant. In particular, there are substantial variations in terms of average wages and unemployment rates across Russian regions. Moreover, there are large variations of wages within regions. Unemployment, both ILO-defined and registered, is of a moderate level in Russia. The all-Russia average level was 8% for general and 1.8% for registered unemployment in 2002. There is substantial variation across regions, however. Regional variation in ILO unemployment rates was as high as 0.42 (0.39 excluding the North Caucasus) in 1999 – to be compare with 0.27 across US states in the early 1980s. The economic and non-economic barriers to mobility are the main reasons for the variation to persist over years.

Unemployment rate in North Western regions are less than the Russia’s average: ILO-defined unemployment rate was 7% on average in the region as compared to 8.6% all-Russia’s average in 2003. The relevant figures for registered unemployment were 1.7% in the North-western region and 2.3% in Russia. There is significant variation in unemployment rate across the regions in the area: ILO unemployment in 2003 was 11.9% in Komi Republic and 10% in Murmansk, while it was only 4.1% in St.Petersburg, 4.8% in Vologodskaya oblast and 5% in Novgorodskaya oblast.

---

It is noteworthy that regions differ with respect to labor force participation rate\(^4\): from 55.2% in Ingushetia to 77.5% in Chukotka in 2002. This implies that regions are non-homogeneous with respect to household behavior in the labor market patterns. The latter has implications for social policy, including the one to stimulate employment so that to alleviate poverty.

The North-Western regions of Russia are characterized by higher than Russia-average level of labor force participation: 67.7% in 2003 as compared to 65% national average, with 73% participation rate for males and 63% for females. The regional variation within the area is also significant. The labor force participation rate is as high as 72% in Murmansk region and as low as 63% in Pskov region.

There is also significant variation in terms of wages. Real average wages being higher in more developed regions with higher GRP. Median wages in 2003 NOBUS database varied from

\(^4\) Labor force participation rate shows the ratio of people having a job (employed) or looking for a job (unemployed) to economically active population.
2.2 subsistence levels in St. Petersburg and 1.71 in Moscow to 1.01 in Mordovia. The variation in wages is not only found across regions but there is also substantial variation in real wages within regions. The magnitude of regional variation implies that restructuring should include significant regional reallocation of resources, including labor migration.

2.3 Regional labor market structure

There are large regional differences with respect to labor market structure: some local labor markets are known to be rather competitive while others are monopsonistic. As a result bargaining power of employers vs. employees varies significantly. This is reported to affect employment outcome in regions. Researchers report that severance pay and wage back stipulated in the Labor Code resulted in labor shedding in the form of ‘forced voluntary’ separations stimulated by wage arrears or through voluntary quits in regions with high bargaining power of employers, while employers were demanded to formally lay workers off in regions with less employer’s bargaining power.

The North Western regions are known for moderate concentration rates (CR4 in 2003 was in the range of 17-30%) with the exception of Komi Republic, Vologda region and Murmansk region which have pretty high concentration ratios. In 2003, the share of the four largest enterprises in employment was 53% in Murmansk, 39% in Komi, and 38% in Vologda region. Ideally, increased mobility together with the development of small business would reduce monopsonistic power and stimulate competition on regional labor markets. In the middle term some regulation to reduce employers’ bargaining power seems welfare improving, however.

The Russian labor market is believed to suffer from segmentation. The danger of labor market segmentation is the creation of primary and secondary labor markets, with more secure high paying jobs concentrated in the former and very restricted if any mobility from the latter to the former. Formal vs. informal labor market, as well as labor markets of metropolitan regions vs.

---

5 Pinto et.al. (2001) “Dismantling Russia’s Nonpayments System: Creating the Conditions for Growth”
the rest are believed to be dimensions of segmentation in Russia: unavailability and inaccessibility of well-paying jobs are reported to be a problem for certain groups and in certain regions.

BOX 1

Akhmedov et.al. (2005) study variation in adjustment costs across regions that may arise from regional differences in industrial structure, including the degree of industry concentration, and/or differences in elasticity of final demand for products. The estimation of labor demand elasticities show that they vary not only across industries, but also across regions. Overall, the authors find higher labor demand elasticities in the northeastern parts of Russia. The differences seem to arise from differences in industrial structure, including degree of industry concentration, on the one hand, and from differences in elasticity of final demand for products, on the other hand. Let us consider for example, two regions: the Northern and the North-Western regions. The estimates clearly show that the Northern region has higher elasticities as compared to the North-Western region: 0.34 as opposed to 0.22 for output labor demand elasticity, and –0.55 as compared to –0.18 for wage responsiveness. It is believed that the difference is driven by a significantly larger share of industries exposed to trade shocks, and hence, those with more volatile employment industries in the Northern region: the share of metallurgy, petrochemical and timber industries in the region amounted to 58% in 1999, with another 16% being fuel industry, while the respective shares in the North-western region were 19.4% and 6.2% respectively.

2.4 Labor Market Regulations and Sustainable Development

The Russian Labor Code remains restrictive as compared to OECD countries even after the new code is introduced. It puts rather strong restrictions on the employers’ adjustment to technological changes and economic shocks through labor shedding or wage reduction by imposing pretty high turnover costs. If formal rules are respected, then the response to high separation and hiring costs would be a decrease in demand for labor, and a decline in turnover.

The Russian labor market, formally rather restrictive, is effectively rather flexible. Many rather restrictive norms of the Labor Code, including the new one, are not enforced allowing labor market participants to overcome the restrictions. Informal employment without contracts’ specification and forced voluntary quits are among the most often cited ways to overcome high turnover costs stipulated in the Labor Code. Moreover, formal contracts are often violated with no penalty.

At the same time, there is evidence of the influence of institutional restrictions on participants of formal labor market. Gimpelson argues that the observed decrease in employment at large and medium size enterprises in recent years are due to high turnover costs of enterprises in the formal sector. It is informal sector which increases employment.

The social tax, which even though being reduced is believed to be rather high, is blamed for the widespread use of grey wage payment schemes. It is also likely to reduce labor demand and hence employment.


7 Russian Regions (2000), Table 13.3, p.372-373, Goskomstat

8 Гимпельсон, Владимир (2003) «Дефицит квалификации и навыков на рынке труда: недостаток предложения, ограничения спроса или ложные сигналы работодателей?» - mimeo
Low job security combined with bad unemployment insurance is likely to affect labor mobility. It is suggested that the perceived job security and fringe benefits may be important in transition behavior of workers.\(^9\)

Bad jobs holding are believed to be a result of the lack of enforcement of bankruptcy regulations and effectively lower than survival levels of unemployment benefit.\(^10\) Those are viewed as the main determinants of the Russian pattern of employment adjustment which is mainly through job-to-job movement without entering unemployment. It is a question whether the pattern is better or worse than the Eastern European, especially if potential social conflicts are taken into account. There is little doubt, though, that it has prolonged the adjustment period and exposure to poverty.

The new Labor Code introduced some changes aimed at lowering turnover costs. In particular, trade unions do not any longer have veto right in separation decisions. The financial costs of separation are left high, however. Fixed-term contracts which are expected to substitute infinite contracts and to reduce labor turnover costs are specified in the new Code. A list of reasons for the type of contract is specified as well, however. The code preserves significant obligations of employer with respect to tenured employees, i.e. those with infinite contract.

The new Code is believed to favor large trade unions at the expense of small but independent trade unions and to emphasize firm-level resolution of labor disputes.\(^11\) This is expected to redistribute formal bargaining power to employers, while informally employers are already very strong on the Russian labor market. The latter comes from the mixture of decentralized bargaining and poor law enforcement.

Collective bargaining institutions are still weak: trade unions do not reflect interests of employees, and employers’ organizations lack support from employers. At the same time a better representation of workers in the bargaining process could not only increase labor share in profits, and but could also help to increase the amount of on the job training and to improve working conditions.

Researchers studying the reaction of enterprises to the new Labor Code by interviewing managers of about 300 enterprises found that only 26% of managers believe that the new Code introduces more flexible labor relations, while 36% believe that it rather introduces additional problems for managers, and the rest do not see any changes.\(^12\) The new Labor Code is regarded as more flexible mainly by new small private enterprises in good financial position located in small towns. As far as enforcement is concerned, only 24% of managers expect the Code to stimulate better compliance, while about 70% do not expect any changes, and 5% expect even worse compliance.

---


\(^12\) Гимпельсон, В., Р.Капельшников и Л.Хахуллина (2003) «Новый трудовой кодекс: принес ли он перемены?» - Мониторинг общественного мнения, N2 (64), стр.41-50I
There are some positive shifts mentioned: almost one third of managers indicate that it is easier to use fixed-term contracts now, and more than 18% find it easier to fire employees. More than half of respondents do not recognize any improvements though. The bargaining power of employers is estimated to shift upwards at the expense of employees, but by much lower extent than was expected.

Wage regulation in Russia is done mainly by setting minimum wage level and minimum wage tariff for public sector employees. The minimum wage is not binding, though, and neither the level nor the tariff provide protection from poverty. The ratio of minimum wage to average wage fell from 23% in 1990 to 5% in 1999. At the same time, both minimum wage and minimum tariff showed to increase in real terms during the recent period of economic growth. The tariff wage system in the public sector is known to be very compressed thus lowering labor motivation. The recent attempts to reform the system by introducing sectoral tariff systems did not work out yet.

The wage regulation instruments mentioned do play some role in the economy-wide wage-setting, however. Kapeljushnikov reports that more than a half of enterprises in their sample use minimum wage, or minimum tariff or regional subsistence level when setting lowest wages at an enterprise. A large share of enterprises use either old Soviet or current Russia’s tariff system as a basis for creating compensation schemes for both blue-collars (45% of respondents) and white-collars (34% of respondents). Both facts reflect the role of the state as a large employer in the economy.

3. Institutional aspects of labor market policy

3.1 Different levels of government

In 1996 the Ministry of Labor and Social Development (Ministerstvo truda i sosialnogo razvitiya) was established as the principal agency of the federal government responsible for labor and employment policies. Aiming at better co-ordination, the Government unified the former Ministry of Labor, Ministry of Social Protection (Minsotszashity) and the Federal Employment Service (FES) in a single body. In 2004 yet another reorganization and centralization took place: the Ministry of Labor and Social development became the Federal Labor and Employment Service (Federalnaya Sluzhba po Trudu i Zanyatosti) under the Ministry of Health Protection and Social Development of the RF (Ministerstvo zdravookhraneniya i socialnogo razvitiya).

The Federal Labor and Employment Service operates through its central body (with 7 departments on the main activities), 89 territorial bodies on employment (regional Departments of Federal Employment Service), 89 territorial bodies on labor protection (regional inspectorates), and 9 territorial bodies on settlement of collective disputes. The Federal Labor and Employment Service is financed through the federal budget.

The organisation of regional labor market institutions follows the federal structure of Russia. Each of 89 Russia’s regions (oblast’, respublika or okrug) has its own elected or appointed
governor and his/her administration (government). Within the administration there is a single labor department dealing with labor issues in the region.

The formerly independent Federal Employment Service now reports to the Department for Employment Policy in the Federal Labor and Employment Service. The FES registers the unemployed and directs them to job vacancies offered by employers. The number of vacancies relative to the number of unemployed fluctuates around 2 unemployed per vacancy. According to Rosstat, the ratio decreased from 6.6 in 1998 to 1.6 in 2000, and increased slightly to 2.3 in 2003. There is significant variation in the ratio across regions. For instance, the ratio is as high as 10.3 in Neneckii AO and 5.3 in Murmansk region, and is as low as 0.8 in Leningrad oblast and 0.9 in St.Petersburg.

The FES pays unemployment benefits to the unemployed, provides consultancy and arranges public works and professional re-training. The FES used to be financed through the Federal Employment Fund, which received mandatory payments from employers, and is financed directly from the budget since 2001.

There exist a number of newly-created recruitment/employment agencies and many foreign private ones, that provide recruitment services for a certain fee (usually a proportion of salary, e.g., two months salary etc.). These are especially common in financial, trade and computer industries, and international business. Private employment agencies are growing in number and importance, but they operate with respect to a limited number of occupations: e.g. professionals, interpreters, secretaries, etc. (Institute for Employment Research, 1997). For the time being they are not considered to be playing an important role in combating unemployment.

The Federal Migration Service (Federalnaia Migracionnaya Sluzba, FMS) was founded in 1992. In 1999 the FMS joined the Ministry on National Affairs and became the Ministry on Federal Affairs, National and Migration Policy (Ministerstvo po delam Federacji, Nacionalnoi i Migracionnoi Politike). After a reorganization in 2002 the Federal Migration Service became a part of the Ministry of Internal Affairs of the RF. It comprises of the central body and the network of regional departments on migration and regional departments on visas and registration. The FMS is to regulate immigration, including labor immigration. Regulation and facilitating internal labor migration is not a part of FMS mandate now. Some facilitation is attempted by the regional departments of FES instead. The programs of financial support to the migrants are of tiny size.

**BOX 2**

Benus et.al. (2004)\(^{14}\) provide a comparative analysis of re-training programs provided by public employment offices in Russia and Romania from micro perspectives. Net impacts of the programs are estimated using a rigorous quasi-experimental evaluation technique. The study is based on follow-up surveys in two Russian and one Romanian regions. Propensity score approach is utilized to estimate overall and group treatment effects.

The analysis reveals substantial differences between the two countries. It turns out that the impact of re-training programs in the Russian regions is statistically not significant for all the four outcome measures. To put it differently, there is no positive overall effect found for the programs, which is in contradiction with the perception of the employment officers that this particular program is ‘100% efficient’. There is no overall negative effect as well, which is against the view of some experts that all the public programs in the area are harmful.

In contrast, the program impact in Romania is statistically significant and positive for the three out of the four outcomes. Such a substantial difference between the two countries, being a surprise given the institutional underdevelopment in both, is likely to be attributed to the differences in existing institutional rules and selection procedures. The latter could be affected by the existence of external anchor in terms of potential EU membership for Romania and its absence for Russia: in expectation to become a member of EU at certain point of time Romania is closer in its unemployment benefit provision regulations and practices to EU standards than Russia is.

3.2 Centralization and decentralization

The wage and employment bargaining is highly decentralised in Russia. Formally, there are collective bargaining institutions. They are underdeveloped, however, and in the majority of cases leave employee alone to bargain job terms and conditions with his/her employer. The situation is obviously much worse in the shadow sector.

Large enterprises are also still involved in provision of social services, which tend to restrict mobility in the labor market. In the planned economy, industrial firms were made responsible for supplying a great variety of social benefits, such as housing, medical services and day care. Despite the opportunity to divest social assets run by firms to municipalities in the mid 1990s, many Russian firms still actively provide such benefits. The data from a survey of 404 middle-sized and large manufacturing firms from 40 Russian regions carried out in April-June 2003 reveal that a great majority of firms still provide at least some form of social services. Some firms continue to keep social assets although on a much lesser scale, while others have switched from keeping assets to other forms of support, such as subsidies to the employees to acquire services. In particular, 56% of the firms have their own housing or provide financial assistance in obtaining housing, 91% provide medical care, 26% provide or subsidize daycare services and 73% of the firms have recreation facilities or support employee’s recreation activities. 36% of firms spend on social service provision between 1% and 5% of their payroll, another 31% spend between 5% and 20% of payroll, 4% spend more than 20% of payroll.

The motives behind provision may differ considerably across firms and regions. To some extent social service provision is affected by firms’ relationships with local authorities, as shown by the difficulty of divesting the assets to the municipalities, and by the fact that some firms still provide financial support to the already transferred assets. Juurikkala and Lazareva (2005) explain provision of social benefits to employees as a strategic choice of firms in an imperfect labor market. They find strong evidence that Russian industrial firms use social services to reduce the costs of labor turnover in face of tight labor markets. At the same time, the share of non-monetary compensation decreases with improved access to regional social infrastructure.

3.3 Social partners and tripartism

At present time, there are more than 150 trade unions in Russia. The total number of unionised workers exceeds 50 million, i.e. 69 per cent of the labor force or 76 per cent of the national workforce.

---


16 T. Juurikkala and O. Lazareva (2005): Non-wage benefits, costs of turnover and labor attachment in Russian firms. mimeo

17 As of October, 1997 156 all-Russian trade unions were registered (The Ministry of Justice data).
employed. The trade unions are consolidated into trade union centres, the largest being the FNPR (Federation of Independent Trade Unions of Russia). The FNPR includes many trade unions which used to be part of the old system as well as some trade unions which have emerged in recent years. The FNPR consists of 43 nationwide trade unions uniting workers of particular industries and 78 regional trade union organisations (Institute for Employment Research, 1997). There are also eight associated members. The FNPR inherited the network of branches from the old system. Besides membership fees, returns from the stock of real estate are a significant source of finance for the FNPR.

Trade unions at the level of enterprise are quite independent from the FNPR. There is some evidence of co-operation between trade unions and employers at enterprises\(^{18}\). It could have several possible explanations: in some cases trade unions co-operate with employers pursuing their strategic goals of protecting employees or they are simply forced to by employers. Besides the FNPR, there are also a few trade union centres, which in total include 30 member trade unions.

The numerous local strikes, which occurred in recent years have demonstrated the increasing strength of emerging new trade unions (members and non-members of the FNPR). They include relatively few members but are better organised and are quite strong in protecting the interests of particular groups of workers. The most effective of the new trade-unions were formed by coal-miners (the Independent Trade Union of Coal-miners, NPG) and air traffic controllers (FPAD), which have refused membership to managers and have been effective in organising a few strikes in recent years. Before the emergence of these trade unions, workers and managers were members of the same trade unions.

Mostly, however, Russians view the unions as relics from the Soviet period and do not trust them to defend the workers’ interest. Ideologically weak, adhering to the official government policy the FNPR leaders contribute to these views. Unions have significant rights under the legislation. In many enterprises the existence of an efficient union would give leverage to the employees.

Employers associations emerged recently. There exists more than 60 employers’ associations with about 30-35 functioning in practice\(^{19}\). The most comprehensive employers' associations are the Russian Union of Industrial Employers and Entrepreneurs (Rossiskii soyuz promyshlennikov i predprinimatelei), and the Federation of Producers of Goods (Federatsiya tovaroproizvoditelei). To a large extent employers’ associations are still oriented towards lobbying for special interest groups.

The General Agreement (Generalnoe Soglasheniyie) sets general principles regulating labor relations in the Russian Federation. It is signed every year by the Russian Tripartite Commission (Rossiyskaya Tryokhstoronnyaya Kommissiya). The Russian Tripartite Commission includes


\(^{19}\) Ibid.
representatives of the Government, the all-Russian Trade Unions, and the all-Russian Employers Associations.

The most recent General Agreement was signed for the period of 2005-2007. It has a very general form and consists mainly of non-enforceable directives on labor and social policies. It also sets the indexation rules for the wages in the budget sector and sets targeted limits for unemployment rate in the country. A list of disagreements between associations of employers and employees has been attached to the General agreement which is the disagreement on the level of the minimum wage.

At the Federal level the so-called Sectoral Tariff Agreement and the Professional Tariff Agreement may also be signed. They define the labor conditions and social guarantees for specific sectors and professions. Some sectoral agreements also set minimum wages for a particular sector, which can substantially differ from the minimum wage in the country. For instance, the sectoral agreement in textile, light and faience sector for 2003-2004 stipulated that the lowest tariff rate should not be less than the regional subsistence level while there is no such a restriction in the federal agreement.

Sectoral agreements are not binding for employers: if an enterprise does not sign an agreement then it may not follow its rules. However, legislation is biased towards forcing enterprises to participate in agreements. If a sectoral agreement at federal level is adopted then the federal officer in charge of the labor policy has a right to offer employers of other enterprises to join the agreement. If employers or representatives of employees have not declared they would not participate within 30 days, they are considered to be involved in the agreement (The Labor Code, Article 48). Naturally, there were cases when enterprises did not respond in time and as a result joined the agreement under compulsion.

The corresponding regional institutions sign a collective agreement at the regional level following the General Agreement. The regional employers' associations, as well as their regional trade union counterparts, report to their central authorities but are quite independent in stipulating special conditions and adding articles to the agreements, which take into account regional specifics. The centre-region hierarchies are not rigid.

By the end of 2004, there were 57 sectoral agreements at the federal level. In practice, sectoral agreements are often quite formal and only reproduce labor legislation norms. The associations of employers are still rather weak. As a result, one party - representatives of employers - is often lacking in the negotiation process and is replaced by the state ministries and structures. Out of 25 sectoral agreements sent for registration to the Federal Labor and Employment Service, only 5 were signed on behalf of employers by their associations. Another problem with agreements’ enforcement concerns the power of parties. Trade unions are often weak and passive in pursuing their own goals.

20 Data from the Federal Labor and Employment Service (www.rostrud.info)
21 Ibid.
Practically all the Russian regions have general regional agreements, and many enterprises have collective agreements. The content of agreements and degree of their enforcement varies a lot across regions reflecting differences in economic development.

The North Western regions collective agreements have the status of regional laws. There is some variation in the content\(^{22}\) of the general agreements across the regions in the North West. For instance, the agreements on St. Petersburg and Leningrad oblast remind programs from the central planning era: achievement of planned GRP growth rates, together with eleven other indicators, are taken as the criterium of success and effectiveness of the collective agreement, and targeted programs are named as the main mechanism of achieving the set targets. In contrast, the regional agreement in Komi republic is more focused on wage and employment bargaining issues, though it is still too general.

At the level of a particular company the collective agreements are referred to as 'Kollektivnye Dogovory' (unlike ‘Kollektivnye Soglasheniya’). On employees’ side, the decision whether or not to participate in a collective agreement is voluntary. The decision to conclude a collective agreement is to be made by the general meeting of employees or by their representatives. Then the proposal is discussed by a commission, which consists of the representatives of employees and the employer. If the parties do not agree then the procedure of the Collective settlement of disputes comes into force.

Monitoring and control for law enforcement are carried out by state labor inspectorates at regional, local and enterprise level and by trade unions. The first group forms the system of Federal Labor Inspectorate (Rostrudinspektsiya) under the Federal Labor and Employment Service. The functions of the Federal Labor Inspectorate include: to monitor violations of the labor legislation; to screen employees’ claims and take measures towards their solution; to analyse the cases of legislation violations and suggest ways towards its improvement; to develop legislative initiatives and disseminate information about the existing labor legislation.

Labor inspectorates may also be formed within trade unions at sectoral, professional and enterprise level. Labor inspectors and representatives of trade unions may enforce the observance of the legislation, put forward claims to the courts (representatives of trade unions - to the Federal Inspectorate) and take binding decisions to stop enterprise activities when working conditions create danger for life and health of employees. Employers who violate the labor legislation incur administrative, disciplinary and criminal liabilities according to the legislation.

In spite of a large scope of rights given by the legislation, the Labor Inspectorates proved to be inefficient in labor law enforcement. It is caused, to a great extent, by an overall enforcement problem.

There are no specialised labor courts in Russia. The cases are ruled in civil courts. In 1995, the Federal Law on Collective Settlement of Disputes (Federalnyi Zakon o poryadke razresheniya trudovykh sporov) was passed and dispute resolution functions were given to the Service for Collective Settlement of Disputes (Sluzhba po uregulirovaniyu kollektvnyh trudovykh sporov). They are currently carried out by the Department of Collective Settlement of Disputes within the

---

\(^{22}\) Some of the agreements are available in Consultant-Regions database.
Federal Labor and Employment Service at the federal level and in the corresponding divisions in regional government. The Law on Collective Settlement of Disputes does not give any privileges to trade unions in the settlement, stating only that employees themselves or their representatives can participate in the settlement.

If a dispute is not resolved by the above procedure or the employer does not fulfill the dispute resolution the employees have the right to organise meetings, demonstrations, pickets, and strikes according to the Article 37 of the Constitution. Participation in such actions is voluntary and there is a punishment for forcing participation or non-participation in strikes. Employers are not allowed to organise or join strikes. Lock-outs are prohibited.

3.4 Assessment of collective bargaining framework

As already mentioned, labor market bargaining is de-facto highly decentralised in Russia though there are (weak) institutions of collective bargaining. In spite of the attempts to reform the labor institutions, there still exists an institutional vacuum with respect to trade unions and employers’ associations. Trade unions are disorganised and employer-captured in many cases. Employers associations are also undeveloped, and do not fulfil their function as a participant in collective agreements.

Reading through collective agreements, one can’t help thinking that the very instrument of collective bargaining is not well understood. In particular, many collective agreements are quite formal and do not aim at bargaining better terms and conditions. For instance, it is common when the main goal of employers in collective agreements is claimed to be business growth, and the main task of trade unions – to set labor discipline and favourable working climate in the collective. As a result, collective agreements fail providing leverage for labor rights protection.

4. Institutional Aspects of Economic Development

That positive relationship between institutions and economic development was mentioned in the introduction. The importance of institutions has been studied extensively and that they are important prerequisites but no guarantee for economic growth has been confirmed by transition and development economists. Institutional reform has accordingly become a central policy objective in the transition process from plan to market. But designing good institutions are not enough as the new or modified institutions will have little impact until implemented. In Russia, as in many other transition countries, implementation has proved to be quite a challenge.

4.1 Assessment of the institutional framework

The overall institutional framework in Russia is not very well developed. Compared with the transition countries in Central Europe that became EU members in 2004, the institutional development in Russia has been rather slow over the last decade. But the institutional framework in Russia is also less developed than the average of countries at the same stage of economic development. The World Bank has developed a series of governance indicators – voice and accountability, political stability, government effectiveness, regulatory quality, rule of law, and

---

[^23]: See IMF World Economic Outlook 2003 for an overview of the discussion about growth and institutions on the one hand (chapter 3) and labor market institutions on the other (chapter 4)
control of corruption – which are being measured every fourth year. The most recent survey shows that Russia is behind the other lower middle income countries in all but one governance indicators (see graphs below).

It is only government effectiveness that scores higher in Russia compared to its economic peers. And it is also government effectiveness that has improved the most in Russia over the last six years. Rule of law and control of corruption have also been improved somewhat since 1998, but voice and accountability has, at the same time, been weakened considerably. Political stability and regulatory quality have basically been unchanged during the same period, which is troubling given the low level of development. Moreover, there are indications that corruption has increased substantially lately.

The governance structure is to a certain extent set by the federal government and it may be difficult to find equally strong regional indicators. The Expert Magazine has, however, been rating the investment attractiveness of Russian regions over several years by developing a set of regional investment components, including legislative, political, economic, financial, social, criminal and ecological risks.24

The regions in the Northwest that stand out for their low risk are Novgrod, St Petersburg and Vologda, which are among the ten least risky regions for investment, according to Expert. Leningrad, Kaliningrad, Archangelsk and Murmansk are also ranked on the top half whereas Pskov, Karelia and Komi are ranked on the bottom half of the Russian regions. It is clear from Expert’s ranking that the regions in the Russian Northwest not only are different between one another but the investment risk also differs a lot within the same region. St Petersburg, for instance, has very low economic, financial and social risks, but the political and legislative risks are among the highest in the country, suggesting poor quality of governance. The Northwest on average scores rather well in economic and financial risks. The criminal, political and ecological risks are also above the average whereas the social and legislative risks are below the average.

24 See http://www.gateway2russia.com/art.php?artid=218314&rubid=#data for details and methodology
It should, however, come as no surprise that Russia has a relatively poorly developed institutional framework and that the Russian regions are diverse. The question is what impact the implemented reforms have had and what the prospects for future reforms are.

4.2 The reform agenda

The current reform process, referred to as the second decade of reform or the Gref program, was adopted in 2001 and is mainly focused on state institutions. It is a very ambitious reform agenda covering some very large and complex issues.

It is not possible to go into detail about all the reforms in this paper, but it may be useful to briefly look at the most important reforms before discussing the potential impact some of these reforms have on small business development and economic growth. The Centre for Strategic Research (CSR) in Moscow has put together an overview of the reforms with an assessment of the growth potential according to a number of factors. It becomes clear that even if reforms are introduced according to declared intentions over the following two years, Russia will still be lagging behind the most advanced transition countries in many areas. A realistic assessment, taking the potential obstacles into account, gives an even more pessimistic outlook except for trade, social and fiscal reforms.

It is becoming increasingly clear that the Russian Government, on the one hand, has acknowledged the importance of the institutional reforms, and, on the other hand, lacks the capacity to implement all the reforms at this point. This will, at best, lead to prioritizing and sequencing of the most urgent reforms. The Centre for Economic and Financial Research (CEFIR) in Moscow has been charged with monitoring the institutional reforms over the next three years and has singled out administrative/deregulation, judiciary, law enforcement, restructuring of public sector, tax administration, healthcare, and education as the most likely reforms.

In the following chapter, we will discuss the importance of some of these areas for small business development and, ultimately, economic growth and prosperity.

5. Institutional development for small business development

It has been repeated many times that Russia, like many other countries, needs to diversify its economy and develop new sources of growth. Small firms need to grow into medium sized enterprises, firms in the grey or black sector need to move into the official economy and entrepreneurs need to turn their ideas into companies. In order for this to happen, the barriers to

25 The reforms, listed in order of importance according to Mikhail Dmitriev at CSR, are (1) administrative reform, (2) judiciary reform, (3) reform of law enforcement, (4) WTO accession, (5) restructuring of public sector, (6) development of civil society, (7) reform of the welfare system and fighting poverty, (8) regulatory reform: natural resources, (9) migration policy, (10) tax administration, (11) reforming natural monopoly in natural gas sector, (12) reforming electricity sector, (13) railroads reform, (14) communal utilities reform, (15) healthcare reform, (16) education reform, (17) military reform, (18) reform of the technical regulation.

26 CSR differs between obstacles at the policy development stage (special interests, insufficient effectiveness of the policy development process, and insufficient political prioritization of certain areas of reforms) and obstacles at the implementation stage (ineffective design and law-implementation by the executive and judiciary system, lack of trust, and limited administrative capacity)
and costs of doing business need to be reduced. The institutional reforms affecting new sources of growth need to be implemented in order to reap the economic benefits.

5.1 Cost of Doing Business

The actual costs associated with doing business (the time and costs associated with starting and closing a business, hiring and firing workers, registering property, getting credit) is being measured by the World Bank and the most recent survey shows that Russia has been making progress in some important areas and are ahead of the CIS average. But that is of little comfort as the CIS is performing so poorly. In spite of the improvement, Russia is losing out to the transition countries in Central Europe.

Interestingly enough, Russia scores relatively low on the labor market regulations index (difficulty in hiring and firing, rigidity of working hours and employment, and firing costs), being second only to Denmark. This suggests that the Russian labor market is more flexible compared to most other markets in the Baltic Sea Region.

<table>
<thead>
<tr>
<th>Country</th>
<th>Year</th>
<th>Difficulty of Hiring Index</th>
<th>Rigidity of Hours Index</th>
<th>Difficulty of Firing Index</th>
<th>Rigidity of Employment Index</th>
<th>Firing costs (weeks of wages)</th>
</tr>
</thead>
<tbody>
<tr>
<td>AVERAGE</td>
<td>2004</td>
<td>26</td>
<td>57</td>
<td>33</td>
<td>39</td>
<td>35</td>
</tr>
<tr>
<td>Denmark</td>
<td>2004</td>
<td>0</td>
<td>40</td>
<td>10</td>
<td>17</td>
<td>39</td>
</tr>
<tr>
<td>Russia</td>
<td>2004</td>
<td>0</td>
<td>60</td>
<td>20</td>
<td>27</td>
<td>17</td>
</tr>
<tr>
<td>Poland</td>
<td>2004</td>
<td>11</td>
<td>60</td>
<td>30</td>
<td>34</td>
<td>25</td>
</tr>
<tr>
<td>Lithuania</td>
<td>2004</td>
<td>33</td>
<td>60</td>
<td>30</td>
<td>41</td>
<td>34</td>
</tr>
<tr>
<td>Sweden</td>
<td>2004</td>
<td>28</td>
<td>60</td>
<td>40</td>
<td>43</td>
<td>24</td>
</tr>
<tr>
<td>Estonia</td>
<td>2004</td>
<td>11</td>
<td>80</td>
<td>40</td>
<td>44</td>
<td>33</td>
</tr>
<tr>
<td>Finland</td>
<td>2004</td>
<td>33</td>
<td>60</td>
<td>40</td>
<td>44</td>
<td>24</td>
</tr>
<tr>
<td>Latvia</td>
<td>2004</td>
<td>78</td>
<td>20</td>
<td>50</td>
<td>49</td>
<td>42</td>
</tr>
<tr>
<td>Germany</td>
<td>2004</td>
<td>44</td>
<td>80</td>
<td>40</td>
<td>55</td>
<td>80</td>
</tr>
</tbody>
</table>


However, as we argued in the introduction, it is not overly strict labor regulation that is the main problem on the Russian labor market. A larger problem is the obstacles for new firms to enter the market that constitutes the main institutional challenge, such as corruption and administrative barriers.

5.2 Corruption and state capture

Corruption, which can be regarded as one of the most painful costs of doing business and effective barrier for small firms’ entry and expansion, is increasing rapidly in Russia. The Indem Foundation’s most recent report shows that bribery has increased 10 times over the last four years in Russia, totaling more than USD 3 billion for citizens and more than USD 300 billion for companies every year. The average bribe has increased by 13 times, from USD 10.200 to USD 135.800.27

The Russian version of market economy is often described as crony capitalism, which is a system characterized by a very close relationship between business and state institutions. Russia is

also known as one of the more corrupt economies in the world. Transparency International ranks Russia 90 out of 145 countries on its corruption perception index. The combination of crony capitalism and corruption often leads to state capture, which is a situation where powerful firms are able to influence the state institutions for their own interests. The politically connected firms have, in other words, captured the bureaucrats and politicians to favor their interests often at the expense of other companies or would-be companies. The magnitude of this problem can be illustrated by the notion that “every single important bureaucrat in Russian government or Russian administration is at the same time deeply involved in business or represents their interests.”

Another illustration is that Russian businesses pay an equivalent of 266 percent of the annual Russian budget revenues in bribes.

It may be difficult to give one single reason to the emergence of state capture in Russia but the weak accountability and frail institutional framework at the time of the establishment of the Russian market economy in combination with the loans-for-share privatization process are probably the most important factors. The effects of state capture are widespread in Russia but are perhaps most significant at the regional level.

One would expect that the level of state capture have been reduced during the Putin administration as a result of the increased centralization and crack-down on big business, exemplified by the attack on Yukos. However, the extent of state capture, in terms of concentration of preferential treatment in a region, has not been reduced during Putin’s first term. The captors has, however, changed from the financial-industrial-groups involved in the loans-for-shares privatization and connected to regional governments to firms connected to the federal government. The nature of state capture also changed as the most common preferential treatment, tax breaks, was made more difficult after the tax reform in 1999. During Putin’s first term in office, subsidies, subsidized budget loans, budget guaranties of credits and subsidized energy prices became the preferential treatments of choice.

In the Northwest, the level of state capture has been decreased in all regions but Karelia and Pskov during the Putin presidency. These two regions also have the highest levels of state capture in the district. Although the levels have been reduced in Komi and Kaliningrad these regions still have relatively high concentration of preferential treatments. The most significant reduction of preferential treatment during the late 1990s (Yeltsin’s second term) and the early 2000s (Putin’s first term) in the North West was seen in Archangelsk and Murmansk. The level has reduced to one fifth of its previous level and is today relatively modest by Russian standards.

5.3 Administrative barriers to small business development

The Centre for Economic and Financial Research (CEFIR) in Moscow has been monitoring the level of regulatory burden on small businesses in order to analyze the actual effects of the deregulation reform on actual administrative barriers to business. The so called

---

31 It was increased in Karelia and maintained in Pskov. There is no data for St Petersburg.
debureaucratization package included new laws on inspection, licensing, certification, registration and tax administration and has been adopted since 2001 (see box 3).

The most important finding in the monitoring survey is that deregulation has had a positive effect on small business development but that two thirds of the surveyed firms still consider at least one problem related to regulation to be very serious. In most regions the fastest growth of small business sector took place in 2002, which was the year when most of the de-bureaucratization laws took effect. However, the survey also found indications of a class ceiling. Companies under a certain size had relatively modest problems with bureaucrats, which changed once the company grew larger. Small business growth is exactly what Russia needs in order to diversify its economy and to achieve the goal of doubling the GDP which is why the improvements are so encouraging and the indications of glass ceilings and other barriers so troubling.

In connection to the administrative reforms, Russia introduced a tax reform aimed at lowering and simplifying taxes, especially for small businesses. A simplified tax system\(^{32}\) for small enterprises was introduced in 2003 and the positive results came immediately in terms of improved tax morale, larger tax revenues and significant improvement for small enterprises. CEFIR has surveyed the simplified tax reform and small businesses both use and appreciate the reform. Almost 60 percent of the surveyed firms already use the simplified tax system. Those firms have seen the number of taxes drop by almost 50 percent (from 9.56 to 5.72) and they regard taxes as less of a problem than do other firms.\(^{33}\) Moreover, companies now regard the tax level as a more serious problem than the tax procedures, which should be regarded as a positive step towards a well-functioning market economy.

**Box 3 Monitoring deregulation of small business development, Round 1-5**

The first monitoring round was carried out in the spring of 2002 and served as a benchmark. The survey has been repeated in the fall of 2002, spring of 2003, spring of 2004, and the fifth round in the spring of 2005. About 2000 small private firms in 20 regions have been surveyed in each round. Before any of the deregulation laws took effect, the practices in the areas of registration, inspections, licensing, and certification were found to be very far from the benchmarks established in the new legislation.

The new laws on inspections (August 2001) and licensing (February 2002) have induced significant positive changes in these areas of regulation. Number of license applications decreased during the surveying period and the frequency of inspections by most actively inspecting agencies decreased. The new law on registration (July 2002) reduced the number of agencies to be visited during registration by one, made registration faster and simpler, but more expensive. The levels of administrative pressure on small firms in these (and other) areas remain high and far from the levels set out in the new laws mostly due to poor enforcement.

Progress of reforms is not geographically uniform: better results were achieved in localities with better fiscal incentives, less concentrated production, and large initial pro-reform small business constituency.

There was a marked improvement in general perceptions of business climate. Competition started to be perceived as a more serious problem than government regulations and tax administration. Fair competition and tax level now share the first place in the subjective perceptions of problems on the way of doing business. The survey also confirmed that simplified tax system indeed simplifies tax administration.

---

\(^{32}\) Instead of VAT, profit, sales, and property taxes, small enterprises can pay one unified tax. NEW LAW (2003): 15% of profit or 6% of revenue, if revenues below 11mln rubles and employment below 100 people. OLD LAW (1995): 10% of profit for federal and <20% for regional budgets; 3.3% of revenue for federal and <6.7% for regional budgets, if revenue below 7.5mln rubles and employment below 20 people

\(^{33}\) “Monitoring Administrative Barriers,” Cefir (2004), www.cefir.ru
6. Conclusions

We set out to discuss the importance of labor market institutions for the economic and employment development in North Western Russia in this paper. Based on the assumption that institutional intervention is necessary for a well-functioning labor market we can conclude that the poor institutional development in Russia is indeed a serious problem. This problem is exacerbated by the findings that the main challenge of Russian labor market is not necessarily lack of work manifested by high unemployment figures but rather institutional imperfections resulting in segmentation and lack of mobility on the labor market.

The poor quality of institutions is evident both in general terms and specifically in labor market institutions. Several international surveys show that although there has been some improvement in Russian institutions and governance structures, it remains much worse than that of its neighbors and economic peers. Similarly, the labor market institutions have been improved with the new labor code but are still underperforming, partly because of poor implementation. Labor regulation is restrictive on paper, which would ultimately result in decrease in demand for labor and a decline in labor turnover if implemented, but is quite flexible in practice. The situation is leading to increased reliance on informal employment, low job security combined with bad unemployment insurance, which in turn is likely to negatively affect labor mobility. And the lack of mobility, across regions and sectors, is already one of the most important problems in the Russian labor market.

We have also seen that informal activities continue to play a crucial role in providing employment and that the reasons are both institutional (poorly implemented labor code and high turnover costs) and market-related (high levels of corruption and administrative barriers). This is likely to affect small businesses and entrepreneurs the most, which are believed to be not only an important source of growth and the most important labor market winners in transition countries, but also an important constituency for further reforms. Russia seems to be stuck in a catch-22 where institutional imperfections are making life hard for would-be entrepreneurs and small businesses, which in turn, would be an important internal anchor for further reforms.

All this is likely to have a negative affect on economic growth. The second assumption of this paper was the positive relationship between economic growth and institutions in general and labor market institutions in particular. The fact that these institutions are in such a poor state and that the prospects for comprehensive reforms in Russia are bleak will certainly have a negative impact on economic growth.