

Wages in Russia: Evolution and Differentiation

The growth in wage inequality and the wage race will most probably continue in the medium term

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An analysis of the Russian wage formation shows that its key distinguishing feature is a high degree of flexibility. Reaction to economic shocks is manifested above all in the change of the price of labor while the level of employment is little affected. In periods of economic decline a minority do not lose their jobs, but all workers see their wages drop. The benefits of growth, in turn, translate themselves not so much into the creation of new jobs as into overall growth of wages. Whatever jobs are created are mainly in the informal sector of the economy. Thereby, economic growth increases segmentation in the labor market.

This model "saved" low-productivity jobs in the Russian economy in the most difficult periods of the 1990s thus helping to keep unemployment at a relatively low level. However, the stability of such a model in the future is far from guaranteed.

A Unique Wage Structure

The high degree of wage flexibility stems directly from the unusual structure of the wages themselves. In Russia the share of the fixed (guaranteed) part of pay has been and remains very low by international standards, at about 50-60%. Accordingly, much of the remuneration is variable and is made up of bonuses, benefits, lump-sum payments, etc. At the same time the share of the "non-wage" component in the structure of labor costs is no longer disproportionately large and is approximately at the same level as in most developed or post-socialist countries.

In terms of overall wage inequality, Russia is among the most unequal countries in the world. Russian wages are not only flexible, they are closely related to:

- the region, which is the key differentiating factor because of the high cost of migration and low level of labor mobility;
- the sector of industry to which the enterprise belongs;
- the professional status of the worker;
- the financial and economic performance of the enterprise.

When setting wages Russian employers proceed from the economic situation at their enterprises rather than the national wage scale or the situation in the local labor market. Such factors as gender, age, employment history, and education contribute only little or not at all to wage inequality.

A comparison of the wages of more experienced and less experienced workers makes paradoxical reading (see Graph). In Russia the upward trend of the individual's wage curve ends by the age of 35 and workers at the most productive age earn only 30-40% more than young people. This can be compared with a 2-2.5 times difference in the US where relative wages may also

continue to grow until the age of 55. Obviously, the Russian mechanism of wage-setting is greatly distorted. A large proportion of the knowledge and skills acquired by the older generations in the planned economy have been dramatically devalued and these losses of human capital are unlikely to ever be made up.

Minimal Importance of Minimum Wage

For most of the transition period in Russia the minimum wage has been so low that its impact on the labor market has been barely noticeable. Nor were low-productivity workers pushed out of the labor market as normally happens in developed countries and post-socialist countries. These workers kept their jobs, but had to accept a very low pay — often much lower than the official poverty line. The fact that a huge mass of unproductive (and low-paid) workers stayed in the labor market was an important factor behind the dramatic drop in labor productivity and, on the other hand, a significant growth in wage inequality. It cannot be ruled out, however, that the attempts to raise the minimum wage that have been stepped up in recent years may result in low-productivity workers being pushed out of the labor market.

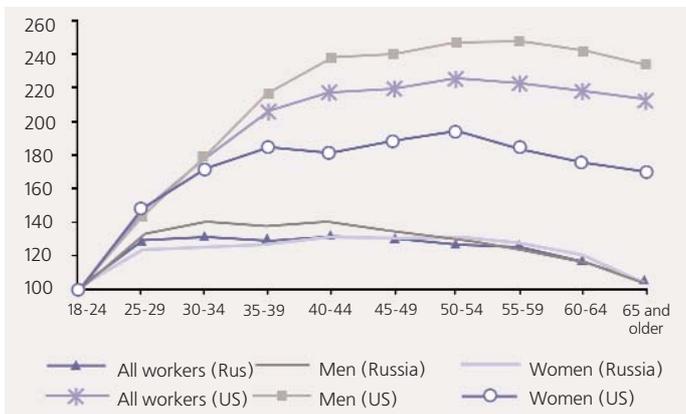
Possible Future Scenarios

The persisting gap in wages is currently accompanied by another important trend: a faster growth of real wages compared to labor productivity.

Russia has yet to work out institutional mechanisms for curbing wage inflation. In the countries of continental Western Europe such a mechanism is provided by the coordination of the wage policy between employers and the trade unions aimed above all at protecting the interests (and maintaining the competitiveness) of the most competitive sectors.

The high level of wage inequalities, while contributing to a high turnover of

Age-Related Changes of Relative Wages in Russia (2005) and the US (2004) (Wages of 18-24 Age Group = 100%)



manpower also spurs the wage race. Besides, it is a disincentive for employers to invest in personnel training while encouraging them to "poach" workers from their rivals. The result may be further growth of wages not matched by higher labor productivity.

There is a high probability that both trends will continue in the medium term. They will inevitably leave an imprint on all the other aspects in the country's economic development which until recently has seen a growing labor supply. But the situation is changing rapidly and within a few years the Russian economy may face a constantly shrinking workforce.

At the same time, the continued high rate of economic growth in Russia would mean that labor demand will constantly increase. A combination of these opposite trends — steady decline of

labor supply and steady growth of demand for labor — will inevitably send wages upward.

The progressive growth of the cost of labor may undermine the competitiveness of many Russian enterprises on the international and domestic markets. The sectors that produce tradable goods will be particularly vulnerable. In the future the shrinking and highly inelastic labor supply may become the major constraint on the growth of the Russian economy.

Policy Recommendations

The government's actions to bridge wage inequalities could proceed in two main directions:

- Strengthening the mechanisms of market selection would speed up the "sifting off" of inefficient enterprises with low-valued labor. That would stimulate

the reallocation of workers into competitive sectors with a higher price of labor, and would thus bridge the gap in wages.

- A lowering of administrative barriers and the costs of migration would speed up the flow of labor from low-wage to high-wage regions. An increase of wages in sending regions and a decline of wages in receiving regions would eliminate interregional differences and thus reduce the overall wage inequality.

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Russian Labor Market Flows in Transition

The transition from a command to a market economy caused a significant reallocation of resources, especially of labor. Based on micro-level data from 11 rounds of the Russian Longitudinal Monitoring Survey covering the years 1994-2006, we estimate labor market trajectories in Russia with special attention to flows between state and private sector and upward and downward occupational mobility. In particular, we estimate conditional probabilities at each point in time for a person to move between different labor market sectors: work for wages, self-employment/entrepreneurship, unemployment and out-of-the-labor-force. Within work for wages, we identify those working in the public sector or at state enterprises with no private participation versus those working at private or mixed-ownership enterprises. In addition to the private/public division, we introduce a distinction between having a high-qualification job versus a low-qualification job. Our main findings are as follows:

- The public sector was shedding labor throughout the period, with the major flow being to jobs in the private sector. The share of males staying within the public sector declined from almost 80% in 1990 to 27% in 1994. This trend continued in the period 1994-2000 with almost a half of all males leaving the public sector. The share of females staying in the public sector diminished during the early 1990s and then stabilized but at a higher level compared to males. This is consistent with other pieces of evidence that point to the fact that many families in Russia diversify risks across sectors with males working in the private sector and females working in the public sector.

- The private sector strengthened dramatically during the period and substituted for the public sector. The share of both males and females working in the private sector reached about 60% in recent years. The flow from unem-

ployment to work in the private sector increased from 15% to 25% for males and from 10% to 17% for females after 2000. This is another indication of the fact that the private sector overtook the public sector in Russia, and more unemployed found jobs in the private sector compared to the public sector. As transition proceeded, more graduates started their careers in the private sector or in self-employment.

- Self-employment served as a buffer in the period of financial crisis. The stock of self-employed in the economy in 2006 reached 3-4% of the working age population for males and 2-3% for females, which is rather low by international standards. Self-employment and entrepreneurship attracted labor from wage jobs, especially in the public sector. The most intensive changes took place in the early 1990s while after 2000 the in and outflows balanced out. The stability of self-employment also increased dramatically and now, following one year of self-employment, almost 50% of males and 60% of females stay self-employed for a second year in a row.

- The transition-related movements of people with the same qualifications between the public and the private sectors are especially pronounced among those in mid and low qualification jobs. About 20% of males and 15% of females in low position jobs in the public sector moved to the private sector. The reverse movement declined steadily throughout the period and resulted in halving the share of people holding low position jobs in the private sector from almost 20% in 1995 to 10% in 2005.

Source: CEFIR/NES Policy Paper No. 28 "Transition Patterns in the Russian Labor Market: 1994-2006" by Irina Denisova, Marcus Eller, and Ekaterina Zhuravskaya.

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