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THE IMPACT OF RUSSIA'S WTO ACCESSION ON ITS LABOUR MARKET

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Introduction and Executive Summary

1. This paper analyses the implications of Russia's accession to the WTO on its labour market. The country's WTO accession is the subject of heated political debate among industrialists, businessmen, the media and the general public, partly also because of its possible negative impact on the country's labour market and social environment.

2. Section 1 discusses the specific features of Russia's labour market in the transition period. Section 2 provides a brief outline of the current trade regime in Russia. Section 3 looks at trade liberalisation and its impact on employment and uses empirical evidence from countries that have implemented large–scale trade liberalisation. Section 4 analyses possible implications of Russia's WTO accession on its labour market. Section 5 examines the likely impact of Russia's accession to the WTO on its regions. Section 6 discusses the impact of Russia's greater integration into the world economy on the skilled structure of its workforce. And finally, section 7 offers some concluding remarks and sets forth policy implications for Russia's membership to the WTO.

3. The paper distinguishes between two distinct stages in the development of Russia's labour market. During the first stage (1991–1998), the market was adapting to the deep and protracted recession which substantially reduced employment, increased open unemployment, shortened working hours, and seriously decreased real wages. From 1999 to 2003, the Russian economy entered the post–transformation recovery phase when key labour market indicators began to improve rapidly. The paper shows that employment restructuring in Russia differed significantly from that of Central and Eastern European countries. During the transition process, the Russian labour market was characterised by relatively stable employment and moderate unemployment, flexible working time and earnings, intensive labour turnover and the high prevalence of "non–standard" forms of labour relations. In consequence, the country seemed to be well–adapted to absorb the numerous negative shocks. The paper argues that it is highly probable that the labour market will adjust in similar ways to changes caused by Russia's WTO accession.

4. Although the Russian Federation has made considerable progress in liberalising its trade regime over the last decade, the WTO accession implies further adjustments currently under negotiations, in particular foreign producers' access to financial, banking and telecommunication services; the scope of government support for agricultural production; and domestic prices of energy resources. The scope of commitments to be taken by a country acceding to the WTO means that trade liberalisation will have more channels of influence on the country's labour market than the trade reform that was undertaken in Russia in the 1990s.

5. Based on different studies examining the experience of other countries as well as an overview of available analyses dealing with the case of Russia, the paper considers that the change in employment at the macroeconomic level resulting in the country's accession to the WTO will be insignificant not only in the short– but also in the medium–term. Russia's labour market has shown its capacity to adjust through sectoral shifts (especially by growing services employment) and the increased competitiveness of some export–oriented industries. However, the effects and adjustment costs of further market opening on the employment on sectoral and regional levels might be in some cases not negligible, especially in some less developed regions with high concentration of import–competing industries and in "one–company towns"

(some 800 in Russia) where a single company accounts for at least 50% of total production and employs 25% of the economically active population.

6. To facilitate the necessary adjustments and maximise the benefits of market opening, Russia will need to pursue its structural policy reforms. As foreign direct investment could be an important source for technology transfer and job creation, the government will need to create a more attractive investment environment. Another important issue is establishing a favourable environment for the development of small– and medium–sized enterprises which could also be an essential source of job creation. As the negative social consequences of trade liberalisation will be concentrated in some regions and towns, special importance should be attached to regional policy, focussing on an adequate social safety net and training. To increase the capacity of the labour market to adjust to external shocks and changing economic environment, labour–related legislation and policies should seek to reduce existing rigidities and encourage labour mobility and flexibility.

1. Specific Features of Russia's Labour Market in the Transition Period

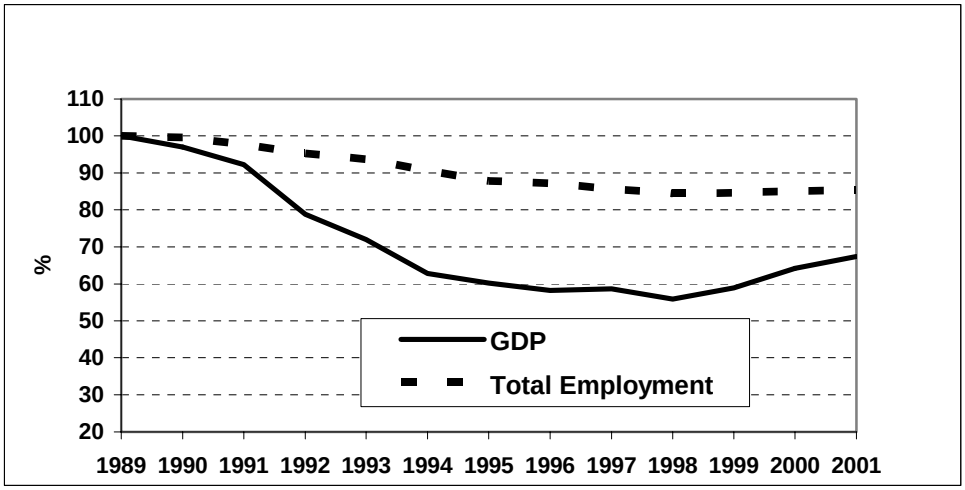
7. When analysing the economic and social implications of Russia's WTO accession, it is important to consider the institutional and functional peculiarities of its labour market. The development of Russia's labour market in the reform period can be divided into two distinct stages. During the first stage from 1991–1998, the market was adapting to the deep and protracted transformation recession which substantially reduced employment, increased open unemployment, shortened working hours, and seriously decreased real wages. From 1999 to 2003, the Russian economy entered the post–transformation recovery phase when the key labour market indicators began to improve rapidly.

8. Employment restructuring in Russia differed in many respects from the same process in the Central and Eastern European countries (CEEs) that had launched market reforms earlier than Russia [Layard and Richter (1995); Commander and Tolstopyatenko (1997); Boeri and Terrell (2002)]. The specific nature of Russia's labour market manifested itself almost immediately after the start of market reforms. In 1992 the response to the Gaidar government's price liberalisation reforms was essentially different than it had been predicted by most observers. The labour markets' subsequent behaviour was also rather peculiar.

9. During the first stage of reform in the Russian Federation, the economically active population rate in Russia decreased from 70.3% in 1992 to 61.1%in 1998. This figure rose to 66% in 2002–2003. The cumulative decline of this indicator in the reform period was less than 5%. In contrast to the CEEs (*e.g.* Hungary) and despite its deep economic recession, Russia managed to avoid a large–scale outflow of the workforce. It is also important to note that the relatively low labour force figures in Russia are due to how the State Statistics Committee of Russia (*Goskomstat*) measures the working population. *Goskomstat* measures the age range from 15 to 72 years. When recalculated for the more standard age range of 15–64, the rate of economic activity in Russia rises to 70%, which is one of the highest rates among the transition economies.

10. Chart 1 shows that employment in the Russian economy proved to be somewhat stable and not too sensitive to the shocks of the transition period. Throughout the reform period, the employment figures declined approximated 15% which was disproportionate to the reduction in GDP. According to official assessments, GDP dropped over 40% at the worse point of the 1998 financial crisis. Several microeconomic studies [Konings and Lehmann, (2002)] confirm the insufficient labour demand elasticity. The low employment elasticity is the reason why continued trade liberalisation would not lead to any substantial reduction in Russian employment.

Chart 1 Russia: GDP and Total Employment

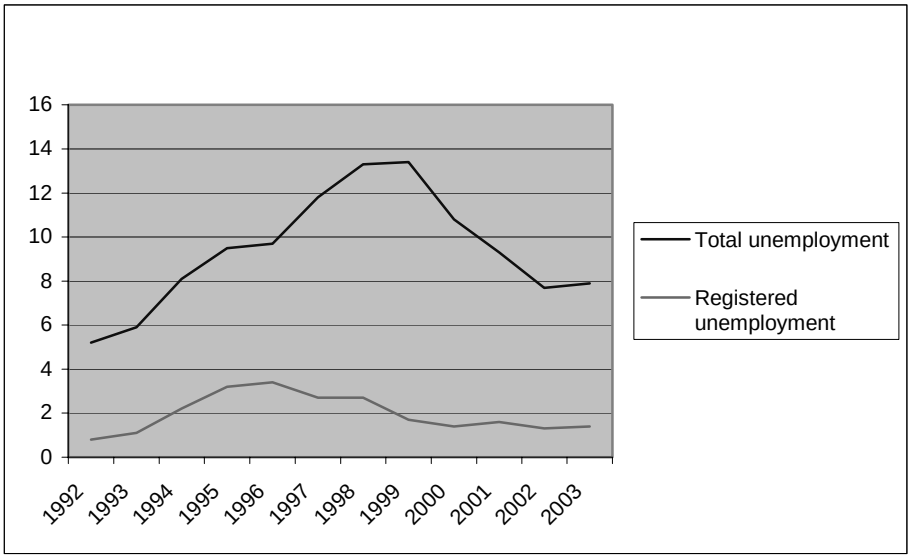


11. Inter–country comparisons show that although its transition crisis was much deeper and longer, employment in Russia did not decrease as rapidly as it did in most CEE countries. According to official assessments, the employment/population ratio in the Russian Federation is currently approaching 60%. When recalculated for the population of the 15–64 age range, the ratio rises to 65%. Also in contrast to the CEEs, the marked divergence of the GDP and employment curves testifies to a sharp drop in productivity in Russia. This was avoided by many CEE countries.

12. The entry of the Russian economy into the revival phase stimulated a rapid recovery of employment. According to various estimates, the number of newly created jobs varied from 3 to 5 million. The main provider of new jobs was the service sector. Thus, Russia did not experience the so–called "jobless growth", which was typical of many CEE countries. GDP grew much faster than employment which resulted in rapid improvements in productivity figures. At present productivity in the Russian economy has practically reached its pre–reform level.

13. Since the transformation recession in Russia was deeper than in the CEE countries, it would have been reasonable to assume that unemployment would be very high. The growth of unemployment was not very marked or “explosive”, as it extended over a rather long period (see Chart 2). Indeed, it was only after five years of market reforms that the rate of unemployment exceeded 10%. The maximum point of 14.6% was reached at the very beginning of 1999. But as soon as the Russian economy began to recover, the unemployment figures went down rapidly falling to 7.9% in late 2003.

Chart 2 Russia: Total and Registered Unemployment, %



14. As Chart 2 demonstrates, the Russian labour market's performance was rather atypical. Firstly, its curve was comparatively smooth and without any steep rises caused by the influx of large numbers of unemployed into the labour market. Secondly, the unemployment rate never reached the peak figures typical of a great number of other post–socialist countries. Thirdly, when the economy did begin to recover from the transformation crisis, unemployment in the country started to decrease faster than in the other transition economies. Finally, if one evaluates the current state of the labour market on the basis of the higher of the two figures of either the total unemployment or the registered unemployment rate, one finds that Russia has an 8% rate of total unemployment. When compared to the CEEs, this 8% figure shows that Russia is now one of the most successful transition economies. In Poland, Slovakia and Bulgaria unemployment is nearing 20%. In Russia the registered unemployment has always been surprisingly low. It currently is a little more than 2%.

15. About one–third of the Russian unemployed have been jobless for 12 or more months. The figure is much smaller than in the majority of CEE countries, where the long–time job seekers account for 50–60% of the unemployed. Consequently, Russia now boasts one of the lowest rates of long–term unemployment among all the transition economies 2.7%.

16. Another specific feature of the Russian experience was its large reduction in working hours in the reform period. In the first half of the 1990s, the average number of working days in industry dwindled by nearly a month. In contrast, the working time figures in the CEE countries were stable and did not change much as compared with the pre–reform period. Since the mid–1990s, the average working hours in the Russian economy have somewhat increased (by 4%), but still they are shorter than before the start of the reforms.

17. During the first stage of transition, real wages in Russia were flexible. According to official data, real wages in Russia decreased approximately three times between 1991 and 1999. There were a number of factors ensuring their flexibility. First, in the absence of mandatory wage indexation and in periods of high inflation, real wages were easily reduced by either keeping down nominal wages or increasing them in a smaller proportion to price increases. (Major wage "falls" typically occurred during severe macroeconomic shocks and galloping inflation, when the rates of price increases were far higher than the rates of wage increases.) Second, enterprise managers gave a considerable proportion of remuneration (about 15–20%) through bonuses and other incentives. They also had the discretion to deprive certain groups of employees

of such supplements, fully or partially. Third, one extreme method of reducing actual earnings was systematic delays in wage payment (usually this mechanism was widely used in periods of lower inflation). Last, a very high degree of “plasticity” was characteristic of concealed remuneration, which was typically the first to react to any changes in the economic situation.

18. The reduction of real wages was rather uneven and was, in fact, done in three "leaps". They all were associated with the severe negative macroeconomic shocks: the liberalisation of prices in January 1992, the financial crisis of October 1994 and the financial crisis of August 1998. In the first instance real wages were reduced by one–third, in the second case they were reduced by approximately one–fourth, and in the third instance by more than 30%. The revival of the Russian economy stimulated the reverse process. Real wages began to increase quickly. In 2000–2003 their annual growth rates reached 10 to 20%. As a result, during the recovery period real earnings nearly doubled.

19. In all the former socialist countries, the change of the economic regime entailed a greater disparity in distribution of earned incomes. However, in the Russian Federation, this increase of income differentiation was exceptionally sharp. Whereas in 1991 the Gini coefficient was 0.32, at the beginning of the next decade it became 0.45–0.50. Today this coefficient in Russia is 50 or 100% higher than in the CEE countries. Thus, as the above figures show, not only average wages but also the structure of relative wage rates in the Russian economy was rather mobile and flexible.

20. Throughout the transition period, the Russian economy had an intensive turnover of workforce. Labour turnover, defined as the total sum of the hiring and separation rates, reached 43 to 55% for the entire economy and 45 to 60% for the industrial sector. The workforce turnover rates in Russia were noticeably higher than in the majority of the CEE countries. Remarkably, this was due not only to a more active dismissal process, but to a more active hiring rate. Even in the most critical years, the hiring rate in Russia was steadily high, which is one of the most paradoxical characteristics of Russia’s labour market. This means that when hiring new workers, enterprises were quite confident that, if need be, they would be able to get rid of them.

21. One more, no less paradoxical feature is the prevalence of voluntary quits. Involuntary separations were never noticeably frequent in the Russian labour market. Administrative dismissals accounted for not more than 1 to 2.5% of enterprises’ workforce, or 4 to 10% of the total number of persons separated. Voluntary quits prevailed, reaching 16 to 20% of the numbers employed, or 65 to 74% of the total number of persons separated. Even if we admit that a certain proportion of discharges were disguised as voluntary, it is hard to doubt that the overwhelming majority of employees who quit their jobs did it on their own accord. As regards one more very important characteristic feature of labour mobility – the velocity of worker movement between employment, unemployment and economic inactivity, the Russian labour market appeared to be very flexible and mobile in this respect too.

22. The high inter–sectoral and inter–occupational mobility is an important element of the adjustment mechanism typical of the Russian labour market. The process of inter–sectoral workforce redistribution involved about 40% of the working population [Employment Outlook of Russia (2002)]. According to Sabiryanova (1999), 42% of the respondents changed their occupation between 1991 and 1998, and two–thirds of them did so at the initial stage of the reform period in 1991–1995. Afterwards there was a substantial slowdown in mobility. Thus, the changes in the sectoral and occupational structure support the thesis that Russia’s labour market is extraordinary flexible.

23. The distinctive feature of Russia’s labour market was a great variety of "non–standard" methods of adjustment, such as part–time work and forced administrative leaves, secondary employment and employment in the informal sector, pay delays and shadow remuneration, wages in kind and household production of goods and services. These adaptive mechanisms were spontaneously developed by market

agents themselves in order to be able to quickly respond to sudden changes in the economic and institutional environment. As a rule, those market agents were the first to take the blow and cushion it, while adaptation in more settled forms took place later and was therefore smoother. In this case, the "non–standard"character does not mean that such adaptive mechanisms should be considered absolutely unique. Of course, they occurred in different modifications and combinations in other transition economies as well. But nowhere were these mechanisms so large–scaled and diverse, so highly–concentrated and deep–rooted as in Russia.

24. Starting from a certain moment, such methods of adaptation were perceived as generally accepted practices and labour standards. According to assessments by *Goskomstat* (2002), in some years nearly 25% of the personnel of Russian large– and medium–scale enterprises worked shorter hours or were on administrative leave. According to different sources, 10 to 15% of the employees had additional jobs to earn extra money. Unofficial earnings reached nearly 50% of official remuneration. One worker in seven was engaged in informal activities (outside enterprises and organisations). In the worst years, pay delays affected three–quarters of the country's working population. A unique feature of the Russian labour market has long been part–time farming, which at the height of the agricultural season involves nearly 40% of the country's adult population. Though various "non–standard" forms of adjustment have been used less actively since the beginning of the recovery (for example, the rate of involuntary part–time employment has gone down below 1%), they still embrace an enormous part of Russia's labour force.

25. All these "non–standard" mechanisms have one important feature in common: they are informal or semiformal in character. They are typically used to bypass the laws and other formal restrictions or act against them. Delayed and hidden wages and salaries and part–time and secondary employment led to personalisation of employer–employee relationships, which resulted in a substitution of informal relations for formal labour contracts.

26. In summary, the Russian labour market was characterised by relatively stable employment and moderate unemployment, flexible working time and super flexible earnings, intensive labour turnover and high prevalence of "non–standard" forms of labour relations. In consequence, it proved to be well–adapted to absorb the numerous negative shocks that accompanied the system transformation process. The labour market adapted to the shocks primarily through changes in the price of labour and working hours, while changes in employment levels were rather limited. It is highly probable that the labour market's adjustment to changes caused by Russia's WTO accession may take similar forms.

2. The Role of Trade in the Russian Economy

27. Throughout the transition period, trade played a prominent role in the Russian economy. During the first few years of the reform, food supply largely depended on imports. A drop in domestic demand resulting from the transformation crisis stimulated the export of commodities. Commodities such as minerals, metals and timber could easily compete in the world markets. Exports also had a significant impact on the formation of Russia's key macroeconomic indices after the 1998 financial crisis. While GDP rose by 6.1% in 2000–2002, exports increased by 14.3% over the same period. This contributed substantially to the acceleration of economic growth. The proportion of exported goods and services in the country's GDP increased from 3.5% in 1995 to 10.6% in 2002.

28. Despite these favourable figures, however, the pattern and principal qualitative parameters of Russian exports are increasingly deviating from the general trend in world trade, which consists of an increasing share of processed products. Over the last few years, the share of processed products in Russian export supplies is decreasing, having never exceeded one–third of supplies. Russia's external trade is oriented towards raw materials, making the country dependent on the unstable world prices of primary products. The decrease of Russia's foreign trade turnover in 1997–1998 caused by a substantial fall in

world oil prices was one of the determinants of the 1998 financial crisis. Predominant in Russia's import mix are finished goods with a high proportion of value added. According to the data of *Goskomstat* (2002), machines, equipment and transportation facilities accounted for 39% of the overall import supplies in 2002, foodstuffs for 24%, and chemical products for 18%.

29. In 1991 the Russian Federation began liberalising its trade regime. It abolished the state monopoly on trade and all legally registered entities were given the right to carry out export and import transactions. Concurrently, the government began to liberalise the foreign exchange regime to a considerable extent. During the last decade import tariffs were repeatedly reduced. As of 1 January 2001, the ceiling of *ad valorem* tariffs for 883 items out of 888 was reduced from 30% to 20%. The number of commodity groups subject to 25% duties decreased more than six times from 624 to 104. Simultaneously, import tariffs on homogeneous commodity groups were unified. Those measures helped bring down the weighted average import tariff to 10.6% in 2002. In April 2003, after the new Customs Code was adopted and import tariffs were further reduced, the figure decreased to 9.8%. Importantly, though receipts from foreign trade account for one–third of federal budget revenues, import tariffs produce a mere 8 to 9%. Therefore, even a drop in revenues from import duties in case of their reduction will not be able to deteriorate the state of public finances.

30. As the figures demonstrate, the Russian Federation has made tremendous progress in liberalising its trade regime over the last decade. During this time, the country has also made substantial progress in its negotiations with the WTO in the Working Party framework. However, a large number of issues are yet to be agreed upon. Several important areas remain, including foreign producers' access to financial, banking and telecommunication services; the scope of government support for agricultural production; and domestic prices of energy resources. Accession to the WTO implies not only reduced import rates but also commitments under agreements on services, intellectual property rights, quality standards etc. The scope of commitments to be taken by a country acceding to the WTO means that trade liberalisation will have more channels of influence on the country's labour market than the trade reform that was undertaken in Russia in the 1990s.

3. Trade Liberalisation and the Labour Market: International Experience

31. As a consequence of trade liberalisation, increased imports have a stronger negative impact on the labour market if a country uses a fixed exchange rate, while its wage setting system is not flexible. That is the reason why standard economic theory emphasises the importance of flexible wages as one of the principal method of preventing mass unemployment.

32. In the long term, it is not tariff regulation that determines employment and unemployment movement, but such macroeconomic and institutional factors as the demographic pattern of the labour force, the degree of wage flexibility, competition between commodity groups or commodity markets, "generosity" of the social security system, and the labour market's institutional structure. What makes the study of trade liberalisation's effect on the labour market difficult to determine is that along with removing trade barriers, countries, as a rule, simultaneously carry out stabilisation, currency, tax and other reforms. There are certain methodological difficulties of differentiating effects of trade from those of technological progress.

33. Many countries have had to radically reduce their customs barriers as a condition of their WTO accession. Russia can draw on several lessons learned from the experience of the countries that have liberalised their trade regimes.

34. First, transition countries that have liberalised their trade regimes have not experienced any marked reduction in GDP or industrial output. The effect of liberalisation on employment has been rather

weak; the overwhelming majority of the countries have not had any marked reduction of jobs. Even the negative effect experienced by some of the countries was short–lived [Matusz and Tar (1999)]. According to the study by Harrison and Revenga, (1995), a reduction in employment occurred in the Czech Republic, Poland and Romania after their WTO accession but changes in employment in these countries were largely caused by the transformation crisis. Significantly, the reduction of jobs in these three countries was slower than in other post–communist countries that did not undertake trade liberalisation.

35. Second, trade liberalisation does not imply deindustrialisation of the economy. Of course, there is a global trend towards an increasing service sector and a corresponding reduction of industrial employment. However, the expansion of the service sector is stimulated by growing per capita incomes and also by lower productivity in industry [Schettkat and Yocarini (2003)]. Country studies have shown that trade liberalisation has a weak negative impact on changes in the numbers employed in manufacturing industry. According to a World Bank study [Papageorgiou *et al.* (1990)], in eight out of nine countries (including large countries such as Brazil, Argentina, the Philippines and Turkey), the number of workers employed in manufacturing industries a year after large–scale liberalisation was carried out exceeded the pre–reform level. The one except is Chile. A study by Edwards (1986) showed a considerable reduction in employment but this was due to the impact of institutional factors rather than from trade liberalisation. According to Ravenga (1995), who studied changes in industrial employment in Mexico on the basis of micro data, job reduction in this sector was 2 or 3% between 1985 and 1990.

36. Opponents of trade liberalisation argue that the international division of labour condemns less developed countries to produce raw materials. However, studies show that there has been a substantial increase in the share of processed products in the value of goods exported by these countries. In the first three post–WWII decades – 1950s, 1960s and 1970s – this share varied between 30 and 40% of total exports. From the start of the 1980s, the share of industrial exports in these countries steadily grew to reach 84% by 1996 [OECD Open Markets Matter (1998)]. Accordingly, the structure of employment underwent considerable changes during this time frame.

37. Of course, insignificant changes in overall employment may hide considerable movements of labour force between different sectors of the economy. The study by Levinsohn (1999) demonstrates that though employment in Chile's manufacturing industry shrank by 8% in the period of liberalisation, about a quarter of the working population changed their jobs. A more efficient distribution of resources as a result of economic openness entails a flow of workforce from low–competition industries to rapidly expanding sectors and may even lead to a growth in unemployment. In an open economy, the first "victims" are those industries that employ plenty of workers with low levels of skills.

38. Third, the labour market's response to trade liberalisation is largely determined by its institutional structure. In countries with liberalised labour markets, employment's short–term reaction may be stronger (like it was, for example, in Canada after the Canada–US FTA was signed), but the gain in production efficiency is very substantial. One important result of the Canada–US Free Trade Agreement was intensified workforce inflows to high technology industries, with an accelerated growth of production in the entire economy. Employees, too, benefited from that. According to Trefler (2001), wage rises in the industries that had their import tariffs reduced were much bigger than the average figures.

39. In developing countries the informal labour market is the shock–absorber that alleviates occurring shocks. By pursuing macroeconomic structural policies, attracting foreign investment and providing a social safety net, a government can considerably diminish some of the negative effects of liberalisation on the labour market.

40. The experience of China that acceded to the WTO in 2001 after a long period of negotiation may be of particular interest to Russia. The available studies [Wang and Schuh, (2002)], [Diao, Fan, and Zhang

(2003)] assess the influence of China's accession to the WTO on aggregate demand at the national level as positive. At the same time it is already quite clear that advantages associated with the liberalisation of trade for the Chinese economy are distributed among various regions of the country unevenly. The poorest regions with the overwhelming agrarian population specialising in low value–added crops may even suffer from the increase of agricultural import.

41. However, the China comparison is not as relevant for Russia. The structure of the economy and the labour force is considerably different in the two countries. The Chinese labour force has a high proportion of workers engaged in the agricultural sector. The labour force is also much less educated – only 3.8% of Chinese employees have higher education [Monthly Labour Review (2002), August. p.29]. As will be discussed later in the paper, the Russian economy is increasingly turning to the service economy and its share of qualified staff is growing among those employed.

4. Possible Consequences of Russia's Accession to the WTO for the Labour Market

4.1. Overview of Existing Studies

42. Reaction of the labour market to trade liberalisation depends on various factors: competitive position of the national economy, specialisation of the country in the world division of labour, a country's skill structure and the mobility of labour force. The existing mechanism of labour market adjustment to macroeconomic shocks, including institutional structure, is also of considerable importance.

43. A number of studies on Russia have been carried out recently that estimate the possible influence of trade liberalisation on major macroeconomic indicators, including employment. Considering that the final terms of Russia's admission to the WTO have not yet been stated, the studies below analysed possible developments in production and employment under various scenarios of import tax reduction (including their complete abolition) in comparison with the existing *status–quo*. Though a number of different economic approaches were used, significantly the studies all gave similar results.

44. The National Investment Council and the Russian Academy of Sciences (2002) has analysed the consequences of Russia acceding to the WTO both at the macroeconomic level and from the branch and regional points of view. According to the calculations made, expected changes in import duties will only exert insignificant negative influence on the macroeconomic development – not exceeding 1 percentage point of GDP. The branch analysis made it possible to identify the most vulnerable branches. They are food, furniture, metallurgical, pharmaceutical, chemical, automobile and aviation industries.

45. The International Labour Organisation (2003b) using the Partial Equilibrium Model considered two possible scenarios of import tax rates alteration and its impact on different industries. The first scenario envisages gradual import tariffs changing during the five–year period starting in 2003 up to their final binding. Quantitative estimates show that this will only result in the industrial production decrease in 2007 by 0.27%. The greatest decrease can be envisaged for light industry – 3.39% and the food industry – 0.94%. The average annual reduction of employment in the industry as a whole may only reach 0.04%. According to the second scenario, in 2003 import tax rates are increased up to the original level of their binding and during the following four years they will be gradually reduced to the final binding level. Under this scenario a 2.1% increase in employment can be expected during the first year with the following annual reduction of 0.6%.

46. Akhmedov *et al.* (2003) studied the effect of Russia's accession to the WTO on the labour market based on the Computable General Equilibrium model. The authors came to the conclusion that the production decrease will not exceed 1% and, taking into account low elasticity of Russian employment, the number of jobs will be cut by 0.2%, which does not exceed a statistical error. However, the level of

employment may not reduce at all if the real wage adjustment mechanism is taken into account. Similar results on the level of employment were received by another group of researchers [Alekseyev *et al.* (2003)].

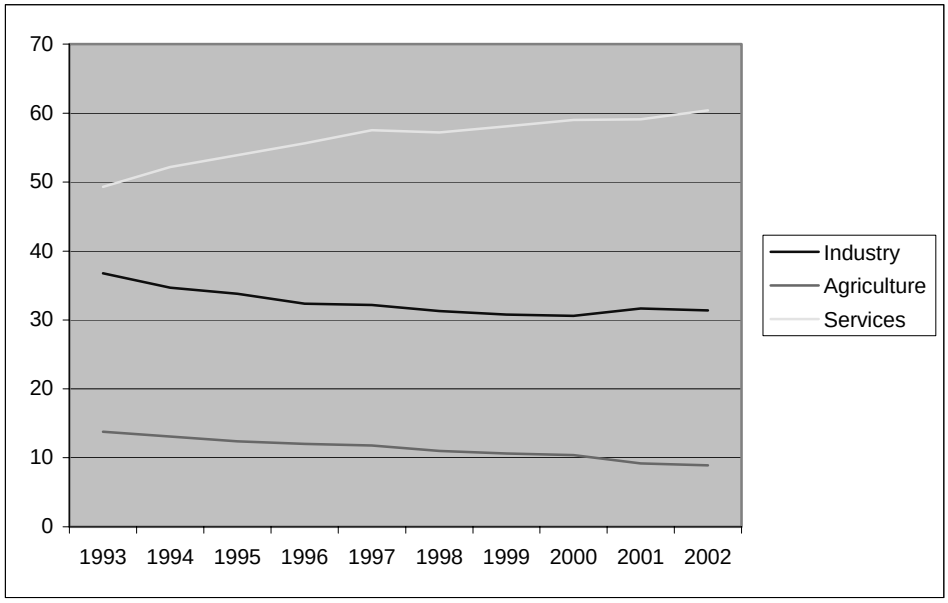
47. Therefore, it is possible to conclude that the change in employment at the macroeconomic level will be insignificant not only in the medium– but also in the short–term. It is also important to note that Russia's increase in the economic growth rates since 1999 has also contributed to the absorption of the labour force made redundant as a result of more severe competition with foreign manufacturers.

4.2 Tradable and Non–Tradable Branches

48. The response of employment to the opening of the economy largely depends on the correlation of export–oriented and import–competing branches. Though in the context of on–going globalisation ever greater numbers of economic branches becomes involved in the international economic system, the level of such involvement for various branches of economy still differs considerably. According to the degree of their sensitivity to trade, all the branches of the economy can be divided into three main categories: i) export–oriented, ii) import–competing and iii) virtually non–tradable.

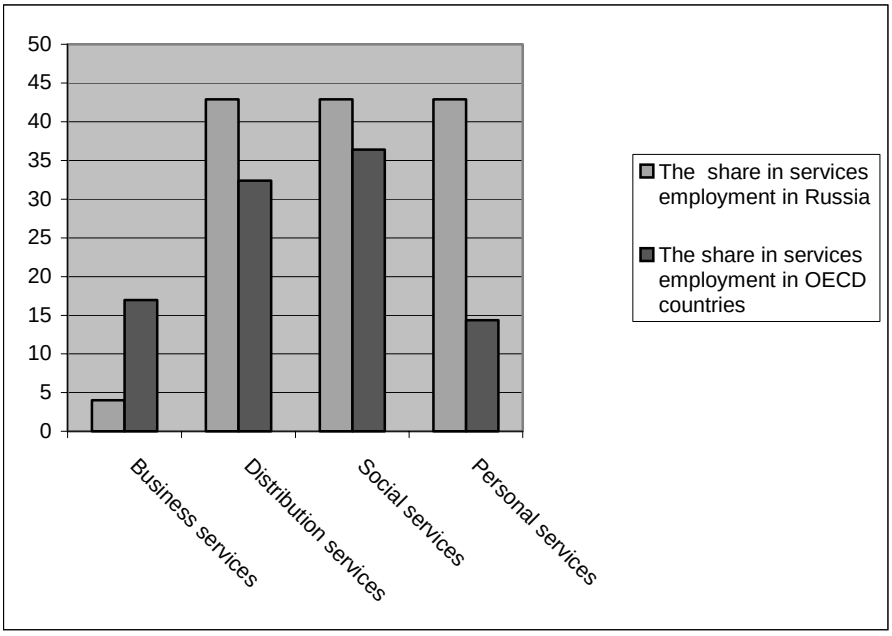
49. As was discussed earlier, during the transition period the structure of the Russian economy and, consequently, that of employment, has changed. As a result, the weight of non–tradable branches has increased. According to a labour force survey carried out by the State Committee for Statistics (*Goskomstat* [2002]) 59% of the Russian labour force is at present employed in the service industry (see Chart 3). Significantly, this is the same percentage as in Hungary and higher than in other transition economies of Eastern Europe[1].

Chart 3. Russia: Employment by sector, %



1 Employment in service industry amounts to 55% in the Czech Republic, 54% in Croatia, 51% in the Slovenia, and 50% in Poland (see "Key Indicators of the Labour Market", 3rd edition", ILO, Geneva 2003).

Chart 4. Employment Structure in Services, Russia and OECD Countries, %



50. If one divides the employment in the Russian service industry into four sectors — business, distributional, social and personal — and analyses it sector by sector, one can conclude that only insignificant proportion of services are tradable. Chart 4 shows that in Russia the proportion of social services is extremely high and accounts for over 40% of the total employment in the service sector. State government, defence, education, health care and social services practically take no part in the international division of labour. Employment trends in this sphere are chiefly determined by internal factors, including politics. Municipal, social and personal services, accounting at present for about 10% of the total employment in services, do not participate in the international division of labour either.

51. The highest growth rate of employment among all non–productive branches of the economy is registered in trade and public catering (3.4% on the average for the whole period, including 5.3% in the period of 1997–2002). This branch of the economy is in the current decade the major service and the second biggest branch (after the industry) in the economy as a whole in terms of the number of employees. At present it accounts for one fifth of the total employment. It should be emphasised that the development of the most important subdivision of this branch – wholesale and retail trade – is directly and positively connected with the trade liberalisation implemented in Russia in the 1990s. Dramatic inflow of imported consumer goods contributed to the development of trade that had been in a rudimentary stage under the socialist economic system.

52. The proportion of employment in business services, which are ever more actively involved in the worldwide economic system, is still insignificantly small in Russia. Although it should be mentioned that it is quickly developing. The employment in the finance and credit sector has been increasing at the average rate of 8% a year since the reforms were implemented, and in real estate operations at the rate of 26.9% (the latter figure refers for the period between 1997 and 2002, when this branch started to be reported separately by statistics). Still in 2002 this sub–sector only provided employment for 4% of people employed in services in comparison with the 17% in the OECD countries [*Goskomstat* (2002) and OECD Employment Outlook (2000)].

53. The financial sector is still underdeveloped in Russia, which restrains the economic development rate. One study emphasises that "Russian banks ten years into the period of transformation of state socialism to capitalism lack the capacity significantly to create mobile money to facilitate the growth of wealth" [edited by D. Lane, p. 23]. The General Agreement on Trade and Services (GATS) envisages that on Russia's entry into the WTO the conditions will be created for foreign banks and insurance companies to operate in the Russian market. In turn this will encourage the development of the financial sector of the economy. In order to survive under the conditions of increasingly severe competition, Russian banks and insurance companies will be forced to use modern technologies, to raise the level of customer services and to reduce its cost, which undoubtedly is in the interests of bank clients. The companies that prove unable to implement restructuring and thus to raise their competitive advantage will be forced out of the market. Liberalisation of the banking and insurance market is potentially dangerous for certain Russian owners but not for the branch as a whole. As seen from the experience of foreign banks, Russian citizens make up a considerable part of their personnel. Thus the "opening of economic frontiers" may primarily manifest itself in new and higher requirements for professional qualifications of personnel, rather than in overall tendencies of labour demand in business services.

54. Public opinion is first and foremost worried about the impact of trade liberalisation on employment in industry that is much deeper involved in the international labour division. Inter–state competition can significantly influence the development in this sector of the economy. According to *Goskomstat* (2002) at present industry provides jobs for 14.5 million people, that is, 22.2% of total employment, whereas in 1991 industry provided jobs for 31% of the working population. During the reform period the total loss of jobs in industry amounted to 8 million. Declining employment in this branch at the time was brought about by such "internal" causes as decreased demand in the context of the transformational crisis, obsolescent production base and hence poor quality of many Russian goods, lack of long–term investments and insufficient flexibility in production restructuring. The soft budget constrains in the first stage of the reforms failed to give an impetus to industrial development. Strengthening competition on the part of foreign manufacturers played a subordinate role and could noticeably influence only a limited number of branches (though it should be mentioned that this influence was not always negative).

55. The fall in industrial employment during the crisis (the reduction of jobs in Russia continued until the end of 1999) could have been much larger if not for the specific features of the Russian labour market. These features caused the reduced labour demand to be realised in the form of shorter working hours and non–payment of wages rather than in the form of dismissals. This practice, though somehow tempering the social consequences of economic transformations, brought about the situation where enterprises had "surplus" labour[2], which they were unable to use rationally in the production processes.

56. Excess employment, in turn, became one of the reasons for the slow rise in industrial employment during the years of economical growth. In the period of 1999–2002 the industrial output increased nearly by a quarter, whereas industrial employment over the same period went up by mere 2.6%, including 2001 when industrial growth was achieved in the context of falling employment. Low elasticity of industrial employment shows that the growing output in industry during the post–crisis years was achieved chiefly by higher labour productivity.

[2] According to the polls of enterprise leaders — carried out by the Center of Economic Situation under the Government of the Russian federation — excess labour in the enterprises in the period of 1996–1997 exceeded 25 per cent of total number or people engaged in industry ("*Modernisation of Economy in Russia: Results and Prospects"*, 2003, vol. 1, State University – Higher School of Economics, p. 120).

57. During the transition period employment in the processing industry has undergone considerable "internal" structural changes which, on the one hand, were the result of irregularity of recession, and, on the other hand, reflected labour adjustment to the changing configuration of demand. One of the most significant changes was the strengthening of some export–oriented industries whose products are competitive on the world market and which are deeply involved in the international economic system. These are fuel and energy industries, and they recruited considerable labour force during the last decade. During the period of 1992–2002 the number of jobs in power engineering went up by 70%, in oil production by 142%, and in the gas industry by 160%. At the beginning of the current decade the power engineering and fuel industries (including coal) accounted for over 13.2% of the total labour in industry, whereas in 1990 it was only 6.4 %.

58. Foreign markets have helped quite a few industries to sustain the level of production and employment in the context of declining domestic demand. Among such industries are iron industries, non–ferrous metallurgy, some branches of chemical industry, particularly the production of mineral fertilisers. Thus we can draw a conclusion that nearly one third of the Russian industrial labour force is engaged in the industries having sufficiently strong position on the world market. Russia's accession to the WTO will allow the country to establish an institutional system in order to protect their trade rights on foreign markets, and in particular, a mechanism for antidumping investigations.

59. A characteristic feature of Russian industry is that import–competing industries include both those with a high proportion of unqualified labour (light industry, including textile and shoe industries) and engineering where the unit weight of qualified labour is higher than the average in industry. Two thirds of demand for machinery and equipment in the country are satisfied by import supplies. The reduction of engineering output can be attributed first of all to internal causes: deterioration of capital facilities because of, among other reasons, low investment levels, cuts in the government defence orders and the difficulties of conversion, as well as drastic fall in domestic demand at the initial stage of reforms brought about by the transformation crisis. Employment in this industry was cut by half, and its share in the total employment in industry went down from 46% in 1990 to 35% in 2002. At the same time engineering remains the biggest processing industry as to the labour engaged.

60. Lower import duties in connection with Russia's accession to the WTO will not have any disastrous consequences for this industry, as the policy aimed at Russian industry modernisation resulted in the introduction of rather low import tax rates for engineering products. During the post–crisis years this industry has shown relatively high growth rate, which is connected, among other reasons, with orders placed by oil–producing companies. The competitive ability of Russian engineering is also supported by lower prices comparing with import analogues.

61. The major branch of engineering is the automobile industry accounting for approximately a quarter of labour engaged in engineering as a whole. Import of second–hand foreign cars, accounting at present for about 25% of the market, can really go up considerably, provided the customs duties are brought down. And this, in turn, will restrain the output in this industry. This is a straightforward political trade–off, and the Russian government could best decide to retain some protection against second hand imports in return for the Russian car industry accepting the ultimate best solution for the consumer and production worker – foreign design, technology, investment capital and ownership. The reduction of imports tariffs on component parts and semi–assembled cars would assist renewal of the Russian car market through local manufacture and/or assembly, thus helping to achieve quality, productivity and prosperity, as well as maintain the level of employment in the industry.

62. Light industry, especially textile, clothing and shoe industries, is the very industry where considerable decline was mainly brought about by the increase in imported goods. The total loss of jobs in light industry was much greater that in any other industry. In the period of 1990–2002 the industry lost

nearly two thirds of its labour, thus bringing down its share in total industrial employment from 11 to 6 %. The competitive position of light industry was undermined by imports of consumer goods from a number of near–by countries, first and foremost from Turkey and China (though undoubtedly the decline in consumer demand during the crisis period has also played its negative role). Very often the goods were imported by passing the existing customs regulations, as they were mainly brought into the country by "shuttle traders", which resulted in extraordinary low price of the delivered goods making it impossible for the formally registered enterprises to compete on the market.

63. The project funded by the Ministry of Economic Development and Trade and carried out by a group of experts [Daniltsev, Vishnevskaya, Guimpelson and Salnikov (2002)], considers three scenarios of industrial employment development up to 2010 in 20 consolidated and 52 subdivided industries[3]. The forecast made on the basis of the macroeconomic and inter–sectoral balance models of the Centre of Macroeconomic Analysis and Short–Term Forecasting has shown that trade liberalisation, whatever the scenario chosen for accession to the WTO, will not produce a considerable impact at the level of industrial employment. All the three scenarios of economic development show very close rates of employment growth: 1.71% for a ten–year period, provided the country does not join the WTO, and 1.55% for scenarios 1 and 2 respectively. There are no significant deviations in the scenarios for specific industries. For instance, in the food industry, where employment is most sensitive to tariff protection, the difference between the two scenarios was just 1% of the total labour.

64. In any case, there are good reasons to believe that the net impact of bringing down the customs barriers at the level of employment will be inconsiderable. Possible employment decline brought about by greater competition on the part of foreign manufacturers can be made up for by the opportunities that will open up for Russian companies as a result of their participation in the international division of labour.

65. When employment development is considered in the 52 sub–industries, the fact that the numerous industries which are going "to lose" part of their jobs (pharmaceutical, engineering for light and food industries, agricultural machinery manufacturing, as well as the manufacturing of medical equipment), are practically the same in all the three scenarios. This testifies to the fact that their development will be mostly determined by "local" reasons, rather than by external factors. These are for the most part "not numerous" industries with the joint employment not exceeding 3% of the total industrial employment. A possible employment reduction over a ten–year period may amount to 3 000 or 4 000 people.

4.3 Russian Agriculture and the WTO

66. The agricultural sector in Russia at the present time accounts for 11.8% of total employment, which is much higher than in most industrially, developed countries and many other European transition economies. Because of a considerable lag behind in the agricultural sector, Russia is a net–importer of agricultural products. At the same time the inflow of capital in this branch of the economy, registered over the recent years, has encouraged the development of agricultural production. The drastic devaluation of the ruble in 1998 made import products less attractive for consumers. According to *Goskomstat* (2002) in the period of 1999–2002 the share of foodstuffs in Russian import went down from 28 to 23%.

67. The misgivings that Russia has regarding its WTO accession is connected with the anticipated sharp increase of foodstuffs deliveries from abroad. Such concerns could well be grounded if the domestic

[3] Scenario 0: inertial variant of development without joining the WTO. In this case the index of tariff protection does not change and remains at the level of 2002. Scenario 1: imports tariffs are raised in the initial stage to a maximum level for certain goods, and later they are gradually brought down. Scenario 2: imports tariffs are gradually reduced.

market of agricultural products were well protected. However at present Russia has one of the most liberal procedures regulating the import of agricultural products. In 2002 the weighted average import tariffs for foodstuffs amounted to less than 15% *ad valorem*. There are only a few countries, including Estonia, New Zealand and Australia, who have trade protectionism at a lower level. In this situation making import barriers still lower would not radically influence the position of domestic producers.

68. Russia has already started exporting a number of foodstuffs and thus it is extremely interested in being able to export such items to foreign markets. The share of foodstuffs and agricultural raw materials in the total exports increased from 1.1% in 1999 to 2.4% in 2002. In 2002 alone Russian export of agricultural products exceeded the level of the previous year by 40%. According to the Customs Statistics of Foreign Trade [Transition Economy (2003)], in the period of 1996–2001 the deliveries in the four major export–oriented groups jumped considerable: frozen fish export increased from 89 to 864 thousand tons, wheat from 360 to 1 710 thousand tons, barley from 195 to 1 595 thousand tons, and sunflower–seed oil from 43 to 117 thousand tons. Russia has become a noticeable grain exporter to the world market.

69. The studies from the Institute of Transition Economy (2004) have demonstrated that the growth of internal demand will be rather limited in the medium term. This means that considerable output growth in the agricultural sector can only be induced by exports. Therefore it is very important that Russia should gain access to the markets of other countries. Greater output in this sector of economy will make it possible to enhance labour efficiency, to prevent unemployment rising and growing social tension. At present agricultural producers suffer more inconveniences from Russian internal hindrances rather than from import restrictions existing in other countries. Some of these hindrances are of a legal nature. In particular, the development of agriculture is impeded by the lack of consistent policy regulating the sale and leasing of agricultural lands. Accession to the WTO also presupposes harmonising of many aspects of the legal system, for instance, standards, and this is the very thing that could significantly facilitate access to foreign markets for Russian exporters.

70. A specific feature of subsidising agriculture in Russia is the fact that, unlike other countries, export subsidies are not used here; neither are price transfers or actual taxation of consumers. Support to agriculture comes almost exclusively from the budget, and mainly (nearly 70%) at the regional level, whereas the use of such measures is essentially restricted in the WTO. Therefore the necessity to work out a protective policy in keeping with the WTO agreements is a pressing issue.

5. Regional Analysis of Possible Consequences of Russia's Accession to the WTO

71. All of the 89 Russian regions (or *Oblasts*) greatly differ in the level of economic development, economic specialisation and the condition of its labour market. This means that at the regional, and particularly at the local level, the consequences of Russia acceding to the WTO can differ significantly. In the regions, where most import–competing industries are concentrated, production decrease brought about by intensified competition may have adverse social consequences: rise of unemployment, reduced income of the population, contraction of tax revenues and related increase in local budget deficit.

72. Russia is characterised by significant differentiation of regions according to their economic development, with a considerable range between the most and the least economically developed regions. The first category of regions includes Moscow, St. Petersburg and oil–and gas–producing regions. Among the second category there are North Caucasian regions, as well as the remote regions of South Siberia. In 2002 the difference between the five most developed and the five least developed subjects of the Russian Federation compared by per–capita gross regional product (GRP) adjusted for the regional cost of living

amounted to five times. However, most parts of the Russian regions form a rather compact group, with similar close GRP indicators and levels of industrial production[4].

73. As regards local labour markets, considerable differences are also registered between the most successful capital region, with the level of unemployment amounting to mere 1.4% of the population, and the North Caucasian Republic of Ingushetia, where 46% of economically active population are unemployed. Despite the fact that after the 1998 financial crisis the number of the unemployed was considerably cut down, the regional differentiation became even greater, because the situation in the regions with surplus labour was improving more slowly than in the economically developed regions. Whereas in 1998 the difference between the ten regions with the best and the worst indicators was 2.9 times, in the comfortable year 2002 it increased to 4.4 times. At the same time the level of unemployment in the majority of Russian regions does not differ much and is close to the national average of 8% of the economically active population.

74. It is quite clear that, assuming Russia accedes to the WTO and competition increases, the adaptation costs will be higher for the regions with the most specialised economies than for those with greater concentration of export–oriented industries. As was demonstrated by the transition period experience, the best developed regions with the most diversified economic structures found themselves in a relatively better economic situation during the economic recession and were the first to overcome the economic difficulties. An open economy is beneficial for the regions with greater concentration of export–oriented industries, and primarily those developing mineral resources. High incomes received by gas– and oil–producing companies contributed to rapid growth of various service industries in these regions, besides the development of their main production.

75. The regions with one–branch import–competing economic structure, primarily engineering and light industry, having low competitive ability may find themselves in the most difficult situation. Some of the "most vulnerable" industries are located in a few regions, where they play major roles determining the region's specialisation. For example 80% of Russian cars are produced in two regions of the Russian Federation. In the textile industry, three regions account for 65% of output. However we cannot disregard quite a few factors, levelling off, to a certain extent, adverse impact of narrow specialisation. Growing employment in small businesses can be an alternative to a possible reduction of employment in the basic industries. Other factors could be inflows of foreign capital and the appearance of joint ventures. Easy access to imported materials and component parts can give a new impetus to the development in import–competing industries.

76. Based on such criteria as the level of economic development, concentration of import–competing industries, proportion of one–company towns and the conditions for small business development, 13 regions were identified as the most vulnerable. Half of these regions are situated in the Privolzhsky Federal Okrug, with the rest located in the so–called old industrial regions in the Central Okrug: Bryansk, Vladimir, Ivanovo and Kaluga *Oblasts*.

77. Provided Russia accedes to the WTO, the adaptation expenses in the context of intensifying competition with foreign manufacturers could be much higher for "one–company towns". A town or a populated area is regarded as "one–company" if a single company accounts at least for 50% of the total production and employs 25% of economically active population or more. According to the calculations made by the authors of the project [One Company Towns edited by I. Lipsits (2000)] approximately 800 Russian towns can be referred to this category, two thirds of which have a population of fewer than 50,000 people.

[4] http://www.socpol.ru

78. One–company towns are rather unequally located on the territory of Russia. If we consider the allocation of one–company towns with regard to their population, we will see that the greatest concentration of such populated areas can be found in the Urals, in Central Russia and in Western Siberia. In the ten areas with the maximum proportion of population living in one–company towns this proportion equals 45–55% of the total population. It is obvious that closing down of the enterprise on which the economy of the whole town relies heavily or its serious restructuring will have grave social consequences. The problem of small towns is still aggravated by the fact that, because of their geographical position, there is no alternative labour markets for "swing" migration and the mobility of population is extremely low due to the underdeveloped housing markets. The industrial growth of recent years has made the situation in most depressed one–company towns less acute; however they will be the first to feel any deterioration in economical situation and to suffer from adverse social consequences.

79. The structure of employment in one–company towns makes them more vulnerable to the deterioration of the economic situation or stronger competition. On average, the proportion of population engaged in industry in one–company towns is approximately one forth higher than for all towns taken together. Small businesses are considerably less developed in such towns. Local budget deficit leads to the situation when the proportion of the population engaged in social services, such as education, health care and state government, is lower than in the areas with more diversified structure of production.

80. Although all industries have their own one–company towns, over 1.7 million people or 80% of one company town personnel are engaged in four industries: fuel industry (mainly coal mining), engineering, non–ferrous metallurgy and the chemical industry. Of course, all one–company towns cannot be regarded as depressed. The coal mines of Kuzbass are undergoing active restructuring of their production, mainly thanks to the loans of the World Bank. There are quite a few successful enterprises in non–ferrous metallurgy. The risk group should first and foremost include one–company towns with engineering, timber and textile enterprises. Using two criteria – the number of one–company towns and their industrial specialisation – three Russian regions can be considered the most problematic: Sverdlovskaya and Nizhegorodskaya *Oblasts* (engineering) and Ivanovskaya *Oblast* (textile industry). In such populated areas any industrial restructuring must be accompanied by a whole set of government measures aimed at developing alternative enterprises, encouraging small businesses, re–training personnel, and, in some instances, setting up public works.

6. Trade and Skill Structure of the Russian Labour Force

81. Economic studies continue to discuss the issue of trade as a factor affecting the changes in demand for specific groups of qualified workers. The estimated impact on the rise in skill differentials differs widely across the various studies. At the one extreme the studies of Berman, Bound and Griliches (1994) attribute a small or no role to trade, but an overwhelming role to technological change. On the other extreme, Wood (1994) attributes 70% to trade. Most of empirical studies [Jansen (2000)] estimate the share of trade in the reduced demand for low skilled labour within 10 to 20%. Yet the factor of trade should not be ignored; it should also be taken into account that trade is one of the instruments that promotes technical progress [Acemoglu (1999)].

82. Although, as far as we are aware, no research of this kind has ever been made in Russia there is indirect evidence that scientific progress and related production restructuring play a leading role in the increased demand for more qualified labour. In the course of the reform period the intra–industry changes in the professional structure became a major factor of structural changes in employment [Sabirianova (2003)]. Intra–industry changes have a major impact on the trends in the employment of professionals and skilled workers. This fact may be considered as proof of the accelerating restructuring of the Russian economy.

83. Trade may influence the rates and structure of production technological modernisations through several channels:

- Economic "transparency" results in the increased share of imported investment goods in the total amount of investments. As imported investment goods require more skilled labour the increase of the import share consequently results in the increased demand for skilled workers. [O'Connor and Lunati, (1999)]. Imported equipment will allow upgrading of fixed funds of the Russian industry, which have often become technically obsolete and structurally ill–adapted. According to *Goskomstat* (2002, p. 355), the degree of fixed assets depreciation is about 50% while the upgrade ratio did not exceed 1.5% recently.
- Companies that participate in the foreign economic exchange get adequate signals about the world market conditions which allow them to design more efficient production strategies concentrating their efforts on quality aspects of performance.
- Given the conditions of "inclusion" in the world markets the local companies enjoy an opportunity to make rational decisions in respect to its price component. The use of imported raw materials and components purchased at the best prices allows companies to raise the quality of the output and provide them with a chance to expand markets for their products without huge financial injections. It becomes especially important in the situation characterised by limited financial resources for investments.

84. There has been a growing tendency of qualified labour share increase and a corresponding decreased demand for unqualified labour not only in developed but in many developing countries in the last decades. [Berman, Bound, Machin (1998)] and [Machin and Reenen (1998)]. Countries like China and India even became large exporters of qualified labour.

85. In line with this general trend, Russia has also faced an increased demand for more qualified labour though it should be stated that the rates of current changes are not yet sufficient. Throughout the 1990s there was an increase in the share of non–manual workers, which grew from 46% in 1992 to 52% in 2002. During the crisis phase (1992–1998) the share of "white collar" professions grew due to slower reduction rates for this group as compared with the "blue collar" sectors. It is only with the beginning of economic growth that this group has started to increase in absolute terms. Thus, changes in the number of non–manual, unlike manual workers, showed a weaker dependence on the recession.

86. At the economic growth stage the number of non–manual workers grew at rates far exceeding the relevant indicator for manual workers. As a result the share of professionals had reached 15.7% by 2002, the same proportion shown by technicians and associated professionals. This indicator is comparable with those in developed market economies. At the same time the share of office workers amounts to only 3.3%. The lack of auxiliary workers engaged in information processing make necessary to employ more qualified employees in these jobs, thus using this more qualified workforce irrationally. The white collar professional group of lawyers, senior officials and managers saw their numbers drop during the reform years. The reduction of this group – which fell from 6.4% to 4.3% from 1997– 2002 – is due to the suppression of intermediary managerial links, mass impoverishment and stagnation of small enterprises during the 1998 crisis.

87. Significant changes in the manual professions segment testified to the growing share of the labour force with higher professional characteristics. Employment rates for craftsmen and skilled workers amounted to 2.2% in 1997– 2002, with the number of operators and assemblers growing much slower (1%). At the same time the demand for elementary occupations fell absolutely, diminishing by 2.4% annually.

88. It should be noted that the share of non–manual workers in Russia (52%) is still much lower compared not only with the developed market economies but also with transition economies. In the Czech Republic and Croatia, this indicator is 57– 58%, in Slovenia, Estonia and Hungary 55%. [ILO (2002)] Significant differences are observed in the structure of blue collars workers as well. Over half of the blue collars in the most developed transition economies are craftsmen and skilled workers while in Russia their share does not exceed 40%.

89. Both advocates and opponents of trade liberalisation in Russia admit that the problem of production modernisation and efficiency growth is crucial due to the out–of–date structure of production, high proportion of raw materials industries and depreciation of the technological base. It is generally known that Russia lags behind most developed industrial countries. The situation is complicated by the fact that the underdeveloped banking sector fails to ensure modernisation of the Russian economy given its limited intermediation capacities to channel financial resources to investments.

90. Most Russian policy–makers and businessmen believe that closer integration of the country into the world markets will promote economic adjustment. In turn this will lead to an increased demand for more qualified labour. Yet there are Russian businessmen who insist that a longer transition period after Russia's accession to WTO would be necessary to carry out technological modernisation. They argue only then should foreign producers be allowed into the market.

91. The trade liberalisation experience of many countries shows that the policy of transparency could be used as a leverage to increase economic efficiency. Studies using microeconomic data of companies from India [Krishna and Mitra (1998)], Chile [Pavsnik (1999)], as well as from Japan and the Republic of Korea [Lawrence (1999)] demonstrate that trade liberalisation has a positive effect on the labour productivity developments.

92. In the 1990s, Russia took the first steps to liberalise its trade and raise foreign capital. The opening of the internal market to foreign producers, the related increase in competition and the inflow of direct foreign investment (FDI) had a positive effect on Russian companies. They began to restructure production, introduced new technological schemes, and imported modern methods of production and personnel management. Researchers [McKinsey Global Institute (1999)] came to the conclusion that labour productivity in the Russian economy could be reached with very modest amounts of investment. The rise of the quality level is important to all Russian industries, especially for import–vulnerable industries. Closer foreign economic ties can help these industries overcome their backwardness and enhance their competitiveness.

93. Experience from Russia confirms that enhanced competition with foreign producers may act as an incentive to invigorate their efforts on production restructuring. Russian companies showed higher rates of labour productivity growth in the processing industries where the competition with foreign producers was tougher than in those where there was virtually no foreign capital [Brown and Earle (2000)]. One recent study [Bessonova, Kozlov and Yudaeva (2003)] estimated that growth rates of total factor productivity (TFP) were even higher in the import–competing industries where the share of import exceeded 80%.

94. The so–called "demonstration" effect played an important role in some of the Russian industries. High quality imported goods that appeared on the Russian market began to serve as an example for Russian enterprises. After a period of simple copying the imported goods, many firms started to create similar products that had never before been manufactured in Russia. This method of increasing output quality was especially typical of the food industry. Because of strong competitive pressure from foreign producers the food industry in Russia managed to undergo technical re–equipment and strengthen its

market positions. Reduction of employment in this industry (it reduced only 3.2% for 1990–2002) has been much weaker than in the production as a whole where it fell 36% for the same period.

95. Special attention should be given to the role of FDI on the qualitative structure of the Russian labour force. Just because a country may liberalise its trade regime does not necessary imply that there will be a large FDI inflows. The volume of foreign capital and the resulting introduction of new technologies depend, among others things, on the size of the private sector, the development of the banking system, currency regulation, the state of the legal system and political stability. In the case of the Russian Federation in particular, the lack of legislative enforcement may be a key obstacle to the increase of FDI. Also important are the level of human capital and educational system efficiency.

96. In their paper, Bevin, Estrin and Meyer (2001) review institutional determinants of FDI in a number of transition economies, including Russia. They indicated some non–institutional determinants, such as the size of the internal market and geographical proximity to capital–exporting countries that have a significant impact on the FDI amounts. They also concluded that institutional development also plays a critical role.

97. FDI has started to exert a positive effect on the Russian companies that supply components. This is the case with the Swedish firm IKEA. However, this is an exception rather than the rule. Yet even competition among Russian producers to provide supplies to a large foreign company could be a powerful incentive to modernisation production.

98. During the transition period, FDI flows in the Russian Federation depended on the political and economic situation and consequently there were significant fluctuations in FDI in the 1990s. With the relatively stable political and economic environment over the past several years, FDI flows have been rising. However, it has been only in 2003 that there has occurred a large increase in foreign capital flows resulting from Russia's higher investment rating. In 2003, FDI amounted at USD 6.8 billion (USD 47 per capita) still much lower than in other transition economies.

99. Production facilities involving foreign ownership in transition economies tend to use a more qualified labour force compared with local companies. This is due to the use of advanced technologies and up–to–date forms of labour organisation [EBRD Transition report (2000)]. Those employed by companies with foreign capital must at the same time get used to more strict labour organisation. As a rule, companies with foreign ownership do not face the problem of absenteeism and labour discipline violations.

100. Since enterprises with foreign capital have higher labour productivity they can pay their employees higher relative salaries. Employees of enterprises belonging to foreign owners got 2.1 times more than the average salary in 2003 [Labour and Employment (2004). p. 378]. For the labour market that may imply the re–distribution of the most qualified labour force from Russian companies to companies owned by foreigners. As current amounts of FDI are insignificant, it is difficult to assess their impact on the Russian employment (in 2002 only 3.1% of all those employed worked for the enterprises owned by foreign capital). Nevertheless it is important to point out that if in the future educational and vocational training lag behind Russia's current and future production needs and Russian companies are reluctant to raise the level of their employees' salaries, the process of re–distribution of the labour force in favour of foreign producers may bring about a deficit of qualified staff for domestic firms.

101. An increase in the share of the qualified labour segment could also result from recent specific features of the labour force supply in Russia. Russia is characterised by a high level of education compared with the countries that have similar GDP per capita figures. The share of people with higher education grew one and a half times since the beginning of economic reforms in 1992 to 2002 from 16.1% to 23.4% of the total number of employed [Labour and Employment (2004). p.67)]. This indicator is much lower in

other transition economies: 16.5% in Hungary and Slovenia, 12–13% in the Czech Republic and Poland [ILO (2003)a]. The increase is due to the surge of interest in higher education among young people. State and private funded higher educational establishments responded to the increased interest in higher education by increasing their student admissions. At the beginning of the last decade there were 407 students per each 10 000 of the population in Russia – more than in many developed countries.

102. An increased premium for education has become the reason for the growing interest in higher education. A study by Denisova and Karzeva (2004) states that the premium for higher education was not only steadily positive, but showed an upward tendency throughout the transition period. While in 1996 the premium for higher professional education over the general secondary education was 22.4% for men and 64.5 for women, in 2001 these indicators grew to 31.8% and 73.7%, respectively. It reflects the tendency of pulling the premium up to the level of market economies (the yield for education in the socialist times was definitely underestimated).

7. Main Conclusions and Policy Responses

103. The implications of Russia's WTO accession are a hotly debated issue in the country. This paper has examined the possible impact of trade liberalisation on the Russian labour market. The analysis provides evidence that in case of Russia's accession the change in employment at the macroeconomic level will be insignificant not only in the short– but also in the medium– term. The increase in the economic growth rates, registered in Russia since 1999, has also contributed to the absorption of the labour made redundant as a result of more severe competition with foreign manufacturers. Nevertheless, in order to benefit fully from the accession complementary policies are required.

104. Russia will only be able to make full use of the potential benefits from liberalisation if the country continues to implement structural reforms. The Russian government has followed this path for at least the last two years. Rather than advocating a large role for the state in the economy, the Russian government has adopted medium– and long–term programmes, including "de–bureaucratisation" campaign, that emphasise improving the enabling conditions for private business and the investment climate.

105. Foreign direct investments may become an important source of creating new jobs. Political stability, anti–corruption measures, judicial reform, transparency of business and removal of barriers for the access to market will make Russia more attractive to foreign investors. Co–operation with foreign producers will attract new technologies and know–how and raise the technical level of the Russian economy. The country will have an opportunity to change the structure of production in favour of commodities with higher value added.

106. As the negative social consequences of trade liberalisation will be mainly concentrated in specific regions, special importance should be attached to regional policy. The need to nurture an entrepreneurial climate by easing start–up costs, facilitating small business growth (*e.g.* through access to information and advice) and elimination of regulatory impediments will help revive production and, consequently, increase employment. An important role in reducing adaptation costs will be played by the active policy on the labour market pursued by the State Employment Service. Re–training of the unemployed to acquire professions in demand, support of small enterprises set up by the unemployed and, in some cases, organisation of community work will help reduce the level of regional unemployment.

107. Through the social safety net, the government may be able to level out some negative social consequences associated with trade liberalisation. Such a system can help to reduce labour adjustment costs in the event of a job loss. If a less painful transfer of employees from contracting industries to rapidly developing ones is ensured, the general efficiency of the labour market performance will rise. It is also

important that a well–established system of employee's social protection promotes consensus in the society with relation to such an important decision as the country's accession to the WTO.

108. The system of unemployment benefits is an important instrument of labour adjustment. Yet an excessively generous system of unemployment benefits can impede labour adjustment. The most liberal system of assignment of unemployment benefits in Russia is combined with a very low amount of the benefit. In 2003, 80% of all registered unemployed receive benefits. However, the average benefit amounted to only 44% of subsistence level and half of all the benefits were paid at the minimum rate, that is, one third of the subsistence level. A low amount of benefit is one of the reasons for a four–fold gap between the total and registered unemployment.

109. In order to realise the advantages provided by trade liberalisation it would also be important to overcome the rigidities that prevent the labour market from adapting to new conditions. Since some localities, especially one–company towns, may suffer from the intensification of international competition, it would be useful to remove barriers to territorial mobility so that the population could move from the declining zones to more prosperous areas with better employment opportunities. Unlike sectoral and inter–professional mobility, the geographical mobility of the Russian labour force remains rather low. During the first stage of economic reform, major obstacles for the geographic mobility of the population were administrative barriers. After obligatory registration was abolished, the role of this factor diminished. However, local authorities, especially in big cities, continue to limit the inflow of new inhabitants. They justify this by the risk of additional burden on the social infrastructure of the cities. Yet the inflow of active and employable people would increase tax receipts to local budgets.

110. A major obstacle for the increase of geographical mobility in the modern conditions is high cost of housing, lack of mortgage schemes and insufficient municipal housing for people with low income. A large gap in the cost of housing between various regions virtually deprives the family that arrived from a small provincial town where they sold their housing to buy an apartment in a large city. A more efficient mortgage system could, to some extent, help to solve the problem of geographical mobility.

111. Institutional factors are responsible of "sclerosisation" of the labour market and are preventing the workforce adaptating to the changing conditions. Rigid legislation on employment protection does not facilitate the adaptation to external shocks, including trade liberalisation, and hampers movement of labour resources from contracting industries to other rapidly developing sectors. The experience of OECD countries testifies [OECD Employment Outlook (1998). pp. 96–102] that outsiders suffer most from the market rigidity: young people and recent graduates of educational institutions as well as the unemployed and those re–entering the labour market. Excessive regulation of labour relations has a negative effect on the creation of new jobs and level of employment and encourages indirectly the development of unofficial labour relations.

112. The new Labour Code enacted in Russia at the beginning of 2002 has not, as a whole, become an instrument for liberalisation of labour relations despite a number of positive changes complying with the market paradigm. The adaptive capacity of the labour force is especially affected by the regulations regarding recruitment and dismissal. In particular, high costs for the employer in the event of employees' dismissal thwart the business efficiency. This also hampers the hire of personnel in periods of production expansion. Further liberalisation of labour legislation would facilitate adaptation of the labour market to new conditions of competition and remove one of the obstacles to labour force mobility.

113. In light of the increased demand for skilled labour due to technical progress and globalisation, Russia should maintain a supply of skilled labour. The high educational level of the Russian labour force is an important advantage for successful competition in world markets. As indicated in this paper, Russia is ahead of other transition economies with regard to the share of labour force having higher education. But

the first and foremost task is for Russia to raise the quality of education and re–orient curricula towards professions needed in the market. The recognition of Russian diplomas is essential for the successful integration of the labour force in world markets.

114. Maintaining high quality labour force is to treat education as on–going and permanent process and priority. Such approach has been so far applied in large companies or in the State Employment Service. The role of private retraining institutes is still insignificant in Russia today. The development of this system is critical not only for keeping up the quality of the Russian labour force but also to ensure a less painful switch of workforce from contracting industries into expanding ones.

115. An important element of the economic and labour policies is to establish favourable conditions for the development of small– and medium–sized enterprises (SMEs). The SME sector in developed and transition countries is an essential source of new jobs. Moreover, between 10 to 50% of export originate from the SME sector in OECD member countries. [OECD (1998). p. 30]. The SME sector in Russia is underdeveloped despite the government–declared efforts to support small business. Although Russian SMEs show high "tenacity" in a very unfavourable institutional environment, their potential to generate new jobs remains rather limited. According to official data [*Goskomstat* (2002)], the number of small enterprises in Russia increased only by 0.2% in 2000 compared to 1997 (from 841 100 to 843 000 firms) and in the following years, their number even decreased in absolute terms. SMEs are also unevenly distributed throughout Russia – 40% of those employed in this sector are concentrated in only five regions. The SME sector is constituted mainly by small enterprises: the share of enterprises with one to five people was 55.2% of the whole economy while the share of enterprises with 50 to 100 persons amounted to only 2%. It is difficult for small enterprises to grow into larger entities. The development of this important segment of the Russian economy requires the establishment of sound conditions for the activities of SMEs, in particular the limitation of excessive government interference and the introduction of a stable tax regime.

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