

Assessment and recommendations

Towards a more efficient labour market and a fairer society

The financial crisis hit the Russian economy hard...

The global financial crisis had a significant impact on the Russian economy and its labour market. The cumulative output loss during the recession was almost 11% in the Russian Federation, considerably larger than the equivalent output loss of almost 5% for the OECD as a whole. The impact of the crisis is even larger taking into account the high growth rates in the Russian Federation prior to the crisis. Indeed, the *cumulative growth loss* – comparing the loss in output with the growth in output that would have occurred in the absence of the crisis – is estimated to be 19% in the Russian Federation versus 8% in the OECD area. An economic recovery has been underway since the third quarter of 2009, with declining unemployment and a positive real wage growth. The latest OECD projections expect growth to be around 4 to 5% in 2010 and 2011.

...and interrupted a protracted period of strong economic growth and poverty reduction...

The crisis halted a protracted period of strong economic growth that resulted in significant improvements in the Russian labour market and substantial reductions in the official absolute poverty rate. Measured against a federally-set minimum subsistence level (MSL), *absolute* poverty more than halved since the turn of the millennium, declining from 29% in 2000 to 13% in 2009. Absolute poverty remained rather stable during the economic crisis of 2008-09, largely because labour market adjustments involved large reductions in working time instead of layoffs and the significant adjustment in real wages was counterbalanced at the lower end of the distribution by a very large increase in the minimum wage in 2009 together with significant increases in transfer payments to pensioners.

... while income inequalities remain large

However, despite the large decline in absolute poverty, *relative* poverty – measured against the standard OECD benchmark of 50% of median household income (adjusted for household size) stood at 17% in 2008. Income inequalities remain very high in international comparison: official Rosstat data suggest the Gini coefficient on income disparities was 0.43 in 2009 compared with an OECD average of 0.31.

Prior to the global economic crisis, employment performance improved significantly...

Thanks to an increased labour demand driven by strong economic growth labour utilisation rose in the decade to 2008. The employment rate for the population aged 15-64 grew from its historical low of 62% in 1999 to 69% in 2008, more than 2 percentage points above the OECD average. High labour utilisation is attributable to high female participation, a feature inherited from the Soviet era. However, due to significant labour hoarding in the 1990s, employment grew much less than output in the decade to 2008. Real wages, on the other hand, experienced high and protracted growth during the economic boom after a very strong drop in the 1990s.

The impact of the crisis on employment and unemployment was surprisingly mild

As in a number of European countries and Japan, the impact on employment and unemployment was surprisingly mild relative to the large fall in output and much of the labour adjustment took place through reduced working hours and, in particular, wages. Unemployment (on an ILO basis, for the population aged 15-64) rose from 6.4% in 2008 to 8.5% in 2009, comparable with the OECD average of 8.3%. As in most OECD countries, youth and males were the groups most affected by the crisis, while the shock did not reverse the trend towards increased older worker employment. Instead, a significant part of the labour adjustment during the crisis took the form of cuts in working hours, reaching 3.7% in 2009 in the Russian Federation, similar to the OECD average of 4%.

Real wages remain the main adjustment mechanism in the labour market

Real wages adjusted significantly during the crisis, similar to what was observed during the first years of transition to a market economy in the 1990s. Real monthly wage growth remained high initially (+10% in 2008), but became negative in 2009 (-1.6%). When expressed relative to its pre-crisis

trend, the cyclical drop in real wages was ten times that of the OECD area. Given that often up to half of the wage of Russian employees is linked to the performance of their firm, wages could even have decreased in nominal terms for some workers. However, the significant increase in the minimum wage introduced in January 2009 has probably cushioned this effect.

Despite recent improvements, the Russian labour market remains highly segmented

- *Employment growth has been mostly in lower quality jobs:* net employment creation has taken place exclusively in the non-corporate sector. Until 2010, employees of such businesses were not entitled to the regular unemployment benefit, but only to the minimum benefit which is extremely low. Besides, labour laws tend to be weakly enforced in the non-corporate sector, which is more difficult and costly to control.
- *Atypical contracts have increased significantly, but informal employment is limited.* The share of non-standard contracts was rising steadily until 2008, mostly temporary contracts, but also civil contracts for which employers have to pay no social contributions and are not subject to the hiring and firing regulations, and oral contracts, which are very difficult to monitor. As in OECD countries, workers on these atypical contracts were the first to lose their job in the recent downturn. On the other hand, informal employment seems to be rather limited in the Russian Federation: about 4% of employees have no contract, compared to nearly 20% in Chile and 27% in Mexico.
- *Wide disparities persist within the group of large and medium-sized enterprises.* Some businesses have managed to achieve strong productivity performance, enabling them to provide good wages and working conditions to their employees, as well as training. Many others, however, are surviving only thanks to entry barriers and the limiting effects of geographical isolation: they offer low wages and poor working conditions, while often complaining about the lack of skilled labour.
- *Despite some progress, disparities among regions remain large.* The major cities and the regions rich in natural resources perform best, with unemployment rates below 5% in 2009, while regions of the North Caucasus and Southern Siberia experienced unemployment rates above 20% (up to a maximum of 53%). In the poorly performing regions, local and regional governments have been the key driver of job creation, notably through the hiring of support staff in the education and health sectors. Despite recent increases in public sector wages, their level

remains low compared with private sector wages and this contributes to explain the wide earnings disparities across regions. Moreover, geographical disparities in earnings are persistent: labour mobility across regions remains very low, notably due to poverty traps.

- *Although declining, wage inequality remains high.* The Gini coefficient of average monthly earnings declined from 0.48 in 2000 to 0.42 in 2009, remaining higher than in any OECD country (for which data is available). The regional variation in earnings, related to large geographical differences in living costs and the wage premium in the Far Northern regions, seems to be the most important driver behind the wage disparity. Wages also differ substantially according to the nature of the ownership of the firm, with the highest wages being paid in foreign companies or Russian-foreign joint-ventures and the lowest wages being paid in the municipal sector.

Worker turnover is very high, largely driven by voluntary quits of workers looking for better jobs

While worker turnover has always been high in the Russian Federation, worker flows further increased during the prolonged recovery period preceding the recent financial crisis. In 2007, almost one out of four employees in the large and medium-sized enterprises quit voluntarily. However, this average figure hides significant disparities across sectors and groups of workers. While many of the most skilled workers in the public sector quit for the private sector in the 1990s, less productive workers in the public sector stayed in their jobs despite deteriorating employment conditions. By contrast, turnover is very high and increasing among the low-qualified blue-collar workers. Many of them are still involved in very arduous jobs offering poor wages and working conditions and often quit voluntarily to look for better deals. While firms almost freely determine wages, workers often choose to quit if wages are too low. Even during the recent crisis period, more than one fifth of the employees quit their job voluntarily.

The OECD Reassessed Jobs Strategy provides a good framework to promote more and better jobs in the Russian Federation

The 2006 OECD *Reassessed Jobs Strategy*¹ provides a comprehensive policy framework for boosting jobs and income in OECD countries. The Strategy identifies a number of common principles that are also relevant to the Russian Federation: beyond ensuring stable macroeconomic conditions, the *Reassessed Jobs Strategy* stresses the need to establish a simple,

transparent and not overly cumbersome regulatory environment in which firms can find the right incentives to invest, hire and train more workers – and ultimately promote productivity and output growth – while workers have incentives to search for jobs that match their capabilities and to invest in improving their skills and competences.

Strike a better balance between labour market flexibility and workers' protection

Many of the problems discussed above would benefit from policy reforms outside the labour market, to promote competition in the product market, the respect for the rule of law and better business climate conditions, as such reforms would be conducive to the creation and development of more productive and viable private activities (see OECD, 2009a). But much remains to be done also to develop and improve labour market policies and institutions to favour the adjustment towards more and better jobs in the Russian Federation. For example, there is an urgent need to improve the balance between labour market flexibility and income security. Wage flexibility is extremely high in the Russian Federation, but it may not always promote attachment to the job or appropriate investment in the workers' human capital and improve labour productivity. In this context, there is ample room to further develop the collective bargaining framework and improve the representation of different actors in the labour market, redress the uneven bargaining power between workers and employers, and promote greater coordination in wage settings and policy guidance. At the same time, significant progress is needed to provide more effective support to the unemployed within an activation framework. This should involve raising the level of unemployment benefits – which remains low despite the significant increase during the recent crisis – combined with greater investment in cost-effective active labour market policies and public employment services to provide effective re-employment support to jobseekers.

Employment protection regulation is not overly strict except for workers with short tenure...

The Russian Federation's employment protection (EP) regulation for *regular* contracts is relatively strict for workers with short tenure, since notice periods and severance payments are not related to tenure. In case of workers with short tenure, such as youth, firing costs are thus rather high. For workers with medium or long tenures, on the other hand, the employment protection is not overly strict. This is also the case for collective dismissals, which are basically treated as individual ones. The EP

for temporary contracts is relatively lax. The extension since 2000 of the range of workers and situations for which it is possible to use temporary contracts is a desirable move. However, the possibility for employers to use civil contracts with limited or no employment protection instead of labour contracts, as well as the absence of regulation of sub-contracting or temporary work agencies are detrimental to workers and likely to increase dualism.

Amendments made in 2006 to the labour code have considerably expanded its coverage. However, since the mid-1990s, employers are also increasingly resorting to civil or oral contracts which exempt them from observing labour laws, notably regarding the payment of social contributions, the delivery of non-wage benefits and the observance of hiring and firing regulations. More than 6% of the salaried workers were under such contracts in 2008, and were thus not covered by labour laws. This is contributing to the segmentation of the labour market, and the possibility for employers to use such contracts should be removed.

...but labour law is unequally enforced

In addition, there is evidence that labour laws are unequally enforced. As noted above, rates of voluntary separations have been exceptionally high in the Russian Federation and layoff rates very low. This is the case even in times of crisis; in 2009, the rate of dismissal was only 2% against 22% for voluntary quits. This suggests that part of these separations are probably “forced voluntary quits”. One simple way for employers to induce an employee to quit is to reduce the variable part of his/her wage. But employers can also resort to administrative leaves and deteriorating working conditions to force quits. Evidence on the wage distribution also suggests that the minimum wage is not always enforced in poor regions, including in the regional and local government sectors. Managers do not seem to perceive labour regulations as a major constraint, and report the cost of labour law violation as being low. However, there seems to be significant differences of labour law enforcement across firms, which may contribute to the overall uncertainty surrounding the business climate in the Russian Federation. The close ties between the government (at all levels) and the major private firms (OECD, 2009a) are likely to reduce in some cases the pressures exerted on employers to enforce labour laws, but may at the same time allow governments to exert pressures on employers to avoid layoffs in areas with few employment alternatives.

Labour inspection should be reinforced

The number of labour inspectors per employed person is close to the ILO recommendations for transition countries, but much lower than in OECD eastern European countries. Also, Russian labour inspectors have no support staff to assist them and the density of inspectors varies greatly across regions. With the actual available resources, the Russian authorities estimate that each enterprise would be controlled on average once every 20 years. Small businesses, in particular, where labour law infringement is more frequent, are very rarely inspected. Yet, there is some evidence that poorly-paid labour inspectors often tried to extract undue pecuniary advantages from their inspections, instead of properly checking for law infringements and poor working conditions. As part of a larger set of measures introduced in the early 2000s to reduce the costs of doing business in the Russian Federation, the number of labour inspectors has been reduced by 15% since the early 2000s and a limit was put to the number of inspections in each enterprise. However, downsizing the labour inspectorate is not the appropriate answer. Instead, in addition to general anti-corruption measures, the wages of labour inspectors should be increased to attract better-qualified staff and reduce the incentive to extract undue pecuniary advantages, as they are currently much lower than those which people with similar education earn in other sectors. Besides, the level of fines for enterprises and individual entrepreneurs infringing labour laws should be increased significantly so as to strengthen their deterrence role.

Collective bargaining is underdeveloped and wages are fixed by employers...

Despite the relatively high trade union membership and the provision in Russian law for collective bargaining rights at the national, sectoral, regional, and enterprise level, the extent of collective bargaining is *de facto* very limited, and its impact on wages and working conditions is modest. At the national level, general agreements set general objectives, not directly enforceable, and minimum standards which are low and thus not binding. Regional agreements suffer from the significant lack of employers' representation and the effective content of these agreements in terms of wages and working conditions is also limited, so that they provide a low constraint on enterprises. About 42% of employees are covered by collective agreements at the workplace level, and they mostly belong either to the public sector or to enterprises with some public participation. Moreover, agreements at the workplace level often set only general objectives for employers and unions, and at maximum they fix rules for the *fixed part of the wage* that accounts typically for only slightly more than 50% of the total

wage. Employers thus have a large freedom in setting wages, often based on negotiation with individual employees or small groups of employees. The *variable part of wages* is generally set on the basis of the performance of the enterprise, although this is more or less formalised in many firms. Also in the public sector, establishments have significant flexibility in setting wages since the introduction of the new wage-setting framework in December 2008.

... reflecting the weak bargaining power of trade unions

Union membership rates remain relatively high, at about 50%, despite a decrease in the rate of unionisation since the beginning of transition. Nine out of ten trade union members belong to traditional trade unions often dating back from the Soviet era, grouped under the Federation of Independent Trade Unions of Russia. Traditional unions have often not departed from their role during Soviet times, and behave more as mediators between the employers and the workers than as representatives of workers. Alternative trade unions face difficulties in organising and making their voices count in negotiations with employers. In part, this is linked to rather restrictive legal provisions on the right to strike, which result in a very low strike incidence in the Russian Federation compared with most OECD countries. The provisions in the labour code on workers representation also limit the possibility for independent unions to emerge and participate to the collective bargaining process. Finally, the provisions guaranteeing workers representation at the firm level are not always strongly enforced.

The minimum wage is relatively low

Despite an increase by almost 90% in 2009, at 24% of the average wage, the federal minimum wage remains relatively low in the Russian Federation (at the lower end of the OECD distribution), and even below the official poverty threshold, which is at 28% of the average wage. About two-thirds of the regions have also introduced a regional minimum above the federal level. Data on wage distributions show that minimum wages were hardly binding in 2007 (before the recent increase), except in the poorest regions, although non-compliance is also observed there. The large 2009 increase may lead to some “disemployment” effects in the poorest regions, where the minimum wage now represent a significant share of the average wage, or alternatively create stronger incentives for non-declaration or under-declaration of wages. To avoid pricing out the least skilled employees from the formal labour market, the increase in the federal minimum wage should be contained, and regional minimum wages should only be increased in regions where it is compatible with the economic context.

Public spending on labour market policies remains very low in spite of a strong increase during the crisis

In the context of the sizeable stimulus package introduced during the crisis, the Russian government tripled the budget for labour market programmes and similar funding was also kept for 2010. However, at about 0.3% of GDP in 2009 after the increase, expenditure on labour market policies remains well below that in almost all OECD countries. The anti-crisis policy measures included a rise in the maximum unemployment benefit level, and various active labour market programmes amounting to almost 0.1% of GDP in 2009, which is above the amounts that many OECD countries planned to spend over the 2008-10 period (OECD, 2009b). The main active labour market measures were wage subsidies, public works and training that were provided to workers at risk of being dismissed or to the long-term unemployed. These measures are likely to have preserved some jobs and cushioned the income shock on the unemployed, although it is difficult to gauge their impact with any precision. Given their low levels, the authorities should plan to at least maintain labour market expenditure at this level in future years, even when the job crisis unwinds. At the same time, a re-orientation of expenditure needs to occur from short-time work schemes towards cost-effective programmes or uses that facilitate transitions from unemployment to work and shorten the unemployment spells. The Russian authorities can learn from international experience and should invest in rigorous programme evaluation.

Assistance provided to the unemployed could be improved

There is a very large gap in the Russian Federation between the count of unemployment measured according to the labour force statistics (LFS) and that based on registration at the labour offices. In 2009, the registered unemployment rate stood at 2.8% against an LFS rate of 8.5%. This gap is largely the result of the relatively weak assistance provided to registered unemployed, which discourages registration of many unemployed, especially the most employable ones. First, while available to many compared with OECD countries, the level of unemployment benefit is low. Second, the assistance provided to jobseekers by public employment services is relatively small. Despite a tripling in 2009, at 0.15% of GDP, the resources available to the PES for active labour market policies are very limited. Personal assistance provided to jobseekers is scant and most time is spent on administrative procedures. All in all, the Russian PES functions more as a social assistance service dealing with the weakest segments of the population rather than an effective intermediary between employers seeking

to fill job vacancies and jobseekers. Reintroducing a well-designed unemployment insurance system would allow for more effective support to the unemployed, and provide incentives to register as unemployed also to the more skilled workers. This would in turn motivate firms to register more vacancies with the PES. As the new system may involve greater spending, at least in the short run, it is important that unemployment insurance is combined with an effective activation strategy. To avoid the problems experienced in the 1990s, the collection of unemployment insurance funds should be centralised and social partners involved in their management.

A federal training policy needs to be developed

Russian industrial firms often complain about the lack of qualified technical workers in the labour market. While overall training incidence is relatively high in the Russian Federation, training is provided to a very small subset of employees and for a rather short period. The majority of on-the-job training is financed by firms, especially in the manufacturing sector where it is almost exclusively financed by firms. A federal policy to encourage on-the-job training and lifelong learning is currently lacking. The authorities should consider investing in training policy, through various possible ways, including the creation of a transparent and credible skill certification system and/or the provision financial incentives to training to enterprises through a levy/grant system or profit tax deductions.

Public social spending is increasing but could be better targeted at the working-age population

Public social expenditure (without housing) amounted to 12% of GDP in 2007, which is low compared with an OECD average of just over 19%. However, with increased social pension payments and revalorisation of labour pensions (see below) public social spending increased to almost 15% of GDP in 2009. At about 6.5% of GDP in 2009, public spending on old-age pensions (see below) in the Russian Federation – not a country with a particularly high old-age dependency rate at present – was the most important spending item and just above the OECD average. Otherwise, public spending on health and smaller items such as unemployment benefits and family allowances is much lower than in OECD countries. On the whole, there appears to be room to refocus social spending from pensioners to the working-age population and children: the two groups who face the highest poverty risks in the Russian Federation today.

Monetisation reform has increased transparency and choice...

One important remnant from the Soviet era concerns “categorical benefits” or “privileges (*l’goty*)” for specified groups, which are paid by either federal (e.g. the disabled, war veterans and victims of the Chernobyl disaster) or regional authorities (e.g. labour veterans or those with a long employment tenure). In 2005, some social support to different groups enjoying privileges was “monetised”. Eligible individuals receive a basic cash payment with which they can choose to (subject to regional variation) monetise certain items of support which is known as the “social package” (additional medical care, free medicine, sanatorium and spa treatments, widely used in the Russian Federation, and transportation supports). Public expenditure on such benefits has increased to almost 1% of GDP in 2009. Nevertheless, much of the housing and utility support is still provided in-kind – on which public spending amounts to around 2-3% of GDP per annum – and only benefits those who happen to have access to low-priced housing and utilities. Although some of the groups, in particular the disabled, face a high poverty-risk, some others, pensioners and older workers with long employment records, do not: categorical benefits are not directly targeted at low-income households.

...but better information flows are required to get support to those who need it most

There is nothing intrinsically wrong with the principles of monetisation and targeting of social supports. However, for it to work efficiently and in a financially sustainable manner, there needs to be a better flow of information amongst public agencies and across society more generally. For example, without transparency on budget rules and awards of federal funds, regional governments will be hesitant to introduce comprehensive local social policy initiatives, as they fear federal funding may dry up leaving them with unfunded mandates. With more information, citizens will have a better view of the benefits to which they are entitled, and make an informed choice on whether they should monetise their social package or not, while both regional and federal governments need to have better data on the income actually earned by individuals and households. Better information systems to which all relevant authorities have automatic access (rather than cumbersome procedural processes) are also needed to make eligibility verification work effectively, and deliver social support to those who really need it. Effectiveness of income-testing and targeting of social support could

be improved by ensuring that regional authorities have easy access to information held by tax and social insurance agencies.

Income supports to the able-bodied working-age population are small

Federal and local policy makers are often loath to make cash support available to those who can work, although the crisis may have changed their attitude, at least temporarily. Payment rates for unemployment benefits are low: at maximum 26% of the average wage for 12 months, but the majority of unemployed benefit claimants receive the minimum payment which equals about 4.5% of the average wage. Social assistance cash transfers by regional authorities to vulnerable clients/families without sufficient incomes and no entitlements to other benefits are similarly low and variable across regions. In 2008, in Kazan such payments could be up to RUB 1 000-5 000 per annum (about USD 45 to 225 at the time), while authorities in Samara paid no such support. Similarly, income-tested child allowances are extremely low (USD 8 per month at present): about two-thirds of all households with children receive them, despite the administrative hurdles in income-testing.

Rebalancing benefits to support the working population and their children

So far, the Russian authorities have shied away from reforming “privileges” in such a manner to re-direct supports from, for example, pensioners and groups with a long employment history to more needy (and possibly younger) groups. However, with working adults and children accounting for about 60% of the poor population stronger, support to them is warranted. In theory, an in-work benefit payment with a supplement for children seems to be the most appropriate approach. In practice, however, a child allowance would be much easier to administer, and increasing the existing income-tested child allowance, as administered by regional authorities, would therefore be a more feasible option.

Fertility concerns drive family policy development

Family policy focuses on spending around birth and keeping mothers at home to care for children...

Very low fertility rates is one of the most serious concerns in family policy in the Russian Federation, much more than issues related to child development, child poverty and, least of all, gender equity. The total fertility

rate (TFR) has been low for decades and was 1.3 in 2006. In response, the government introduced a “family capital” payment of significant value (about USD 11 000) for the birth (or adoption) of a second child (and higher order children) in a family. This amount is deposited in the capitalised part of the Pension Fund of the Russian Federation, and most beneficiaries use the amount to improve their housing conditions (e.g. mortgage support), while also claiming a one-off lump-sum payment, worth about USD 400 in 2009. Moreover, in 2010, public policy increased childcare allowances at the beginning of a child’s life (paid to parents, essentially mothers, not in work caring for their children until these are 18 months old). The maximum payments for those who are not entitled to an earnings-related parental-leave payment are now higher than the average old-age pension payments. Although parental policies are open to use by fathers, they do not generally use the entitlement, which contributes to employers being reluctant to hire mothers with young children. Altogether, the financial incentives for mothers not to be in work for 18 months upon childbirth are very strong.

...while policies should focus on helping parents to combine work and family life

The introduction of family capital may have contributed to the recent increase in the TFR to just over 1.5 in 2009, while the subsequently introduced lump-sum payment and increased income supports for parents with a child aged under 18 months may well sustain this increase at least in the short-run. However, the experience in OECD countries is that such an effect is likely to be *temporary*. Providing generous support at one point in childhood is one thing, but for modern family policy to be effective on a consistent basis in terms of sustaining fertility rates, what is needed is to give parents the confidence that throughout early childhood, they will be able to combine work and family commitments (OECD, 2011). This suggests that cash spending on children should not be restricted to the first 18 months but rather be smoothed over the early life-course, which would also help fight in-work poverty among Russian families. Furthermore, policy needs to reverse the decline in pre-school places, and reduce the cost of day-care fees for working parents with children aged from 18 months to primary-school age. Finally, improving housing policies is a major objective, if only because it would help young Russians establish a family of their own. All in all, policy measures need not just to support mothers to care for their children in the first 18 months, they need to promote a better work/life balance to help parents combine work and family commitments throughout childhood.

The dynamics of ageing populations will have profound effects on Russian society and pension policy

The working-age population in the Russian Federation will shrink by about one-third in the first half of this century...

The projected increase in the old-age dependency ratio (the number of people over 65 as a proportion of the population 20-64) in the Russian Federation is similar to the OECD average: from about just over 20% in 2000 to around 45% in 2050. However, the underlying drivers are very different. Across the OECD, population ageing occurs because of growth in the number of elderly people; in the Russian Federation it is predominantly because of a declining working-age population. This is because of the persistently low birth rates (see above) and the relatively low life expectancy which curtails growth of the elderly Russian population. In 2008, the average life expectancy of men was 62 years and for women it was 74 years; 14.6 and 7.8 years below the OECD average for men and women, respectively. Unless policies (including price-setting policies and indirect tax levies on spirits and tobacco) become more effective in improving health outcomes, demographic projections suggest that the working-age population could decline by one-third over the next 45 years.

...and achieving pension policy objectives will become increasingly challenging

Pension policy aims to generate a replacement rate of about 40% of earnings on retirement. To achieve this, policy reform over recent years has led to the development of a three-pillar pension system involving: a defined basic benefit pension; a notionally defined contribution insurance scheme; and a funded pension component. Payment and saving rates have been outpaced by rapid wage growth in recent years; notional pension saving is not linked to life expectancy, and the rate of return of the funded pension component of the system has been negative since the start in 2002. Recent reform has increased the scope for investment by asset managers, but it is too early to say whether this will generate positive returns on a long-term basis. To help potential savers overcome their lack of confidence in the system, a co-financing scheme was introduced which involves matching cash payments to the pension fund for each rouble of voluntary pension saving up to a maximum of about USD 500 per year for a duration of ten years.

Recent reform is likely to “eradicate” poverty among pensioners, as measured by official benchmarks...

As measured against the official benchmark, the pensioner poverty rate was 8% in 2008 compared with 13% for the general population. Notwithstanding this low relative poverty rate and the already relatively high proportion of public spending focused on pensioners, policy reforms in 2009 and particularly in 2010 increased pension payment rates (and increased the value of notional pension savings). Over the 2009-10 period, insurance pension payment rates increased by over 50% in nominal terms. Official poverty data are not yet available for 2011, but it is likely that they will show that there are not many pensioners with incomes below the minimum subsistence level poverty line. However, it is likely that wage growth will soon start to erode the real value of pensions again, as it did from the mid-1990s to 2008. The 2010 reform introduced an automatic adjustment of pension payment rates if inflation exceeds 6% since the last benchmark, as well as an automatic adjustment in case wage growth exceeds a certain threshold-level (as determined by price indexation in a given year).

...but achieving adequacy objectives in this manner comes at a price

In 2009, public pension spending amounted to about 6.5% of GDP, about 1 percentage point of GDP more than in 2008. Budget transfers to the Russian pension fund (financed out of the sale of natural resources and general taxation) amounted to 2.8 % of GDP in 2007 and increased to almost 5% of GDP in 2009. By contrast, revenue out of pension contributions only amounted to 2.5% of GDP in 2009. For the future pension system to reach a financial equilibrium, a mix of measures will be needed including, increasing standard pensionable ages, raising coverage of pension contributions, and limiting pension take-up among the working-age population. Unfortunately, the 2010 reform did not address these latter issues, and the Russian Federation’s key pension policy challenge is to redress the balance between the limited contribution base and the high number of pensioners in order to ensure long-run financial sustainability in its pension system.

Reform will have to address the low standard pensionable ages in the Russian Federation...

One reason for the low contribution base is the low standard pensionable ages in the Russian Federation: 60 for men and 55 for women. Most OECD countries have now the same pensionable ages for men and women, usually 65. Indeed, in view of life expectancies, perpetuating the current system of gender inequity in standard pensionable ages is difficult to rationalise. So at the very least, the standard retirement ages need to be gradually equalised among the sexes. If, in addition, the male and female standard pensionable ages were to be increased to 62 years of age, the number of pensioners in 2025 would be around 30 million and not 36 million as with the current set-up. The relatively short life expectancy (especially among men) has been used as an argument against increasing the pensionable age, but already in 2008, if men reached 65, they had on average an expected 11.7 years of retirement. Further improvement in life styles and life expectancy could lead to a closer alignment of pensionable ages in the Russian Federation and OECD countries.

...and limit access to early pensions

Reform should also limit access to drawing a full pension before the already low standard pensionable ages. Often service records of 20/25 years grant entitlement to early pensions, which employees often take while also continuing to work in the same job. In many cases, the working conditions in certain sectors no longer warrant the award of the early pensions. But, even if it is difficult to reform established rights to early pensions for teachers, bus drivers or airline staff, at least a start should be made with limiting the maximum period of early retirement to only a few years, with further phasing out of these early pensions at a later stage. Moreover, costs should not be borne by the Pension Fund of the Russian Federation as at present; they should be borne by the employer in the sector. The internalisation of early pension costs would increase transparency on the costs of these early-pension schemes to all involved. In fact, more generally, employees should be made responsible for paying part of the social security contributions: this would increase their awareness of costs and understanding of the need for reform.

The social security contribution base should be widened...

Early retirement further reduces the already low contribution base among the working-age population. Overall contribution revenue is also reduced as in many economic sectors employers are allowed to pay less than the standard social security contribution rate of 26% of the payroll. For example, in agriculture and in new technology-based industries *de facto* social security contributions can be as low as around 10 to 15% (in order to attract investment). Finally, while pension coverage is not considered a significant issue, underreporting of income is widespread. Different public agencies should be granted direct access to each others' databases, not only to improve targeting supports at those who need them most (see above), but also to increase the effectiveness of collection procedures.

... not by increasing standard contribution rates, but by applying them equally across sectors and ensuring that the strongest shoulders bear their fair share of the cost

The Russian Federation should be commended for abolishing its complicated and regressive social contribution rate system in 2010: the Unified Social Tax. Flat-rate social security contributions have been introduced at 26% of the payroll, of which 20 percentage points are pension contributions. At 1 January 2011, the overall flat-rate standard contribution rates were increased from 26 to 34% (of which 26 percentage points consist of pension contributions). This significantly raised labour costs and is likely to reduce formal labour demand as well as investment in labour. Policy should move towards a general application of the existing contribution rates across *all* economic sectors. Furthermore, as of 1 January 2010, maximum earnings thresholds over which social security contributions were due were reduced from RUB 600 000 to RUB 415 000 (just below 1.5 times the average wage), which was increased to RUB 463 000 by 1 January 2011. Apart from regular indexation with average wage growth, policy could consider increasing this maximum threshold (for example, to twice the average wage or above) to raise contribution revenue. Apart from the existing standard tax deduction for very low income households, the Russian Federation's income tax is flat rate at 13%. To further improve the redistributive power of the tax/benefit system, consideration should be given to strengthening progressivity to the personal income tax scheme.

Box 0.1. Labour market and social policy recommendations for the Russian Federation

In the context of its policies to enhance job opportunities for all, the Russian government is invited to consider the following items as part of its strategy to improve the balance between employment security and flexibility, generate trust between the social partners, and the development of an inclusive and active social policy:

Labour market policy

- Rebalance employment protection across different labour contracts. In particular, link notice period and severance payments for permanent workers to job tenure; remove the possibility for employers to use civil contracts with limited or no employment protection; and introduce sub-contracting regulations.
- Strengthen labour law enforcement by increasing the number of labour inspectors and their wages, as well as the level of fines in cases of labour law infringement.
- Promote workers representation and collective bargaining, and encourage trade union pluralism at all negotiation levels. In particular, ease conditions for more than one trade union to participate in the collective bargaining process at the firm level; better enforce the provisions guaranteeing workers representation; and relax the very strict provisions on the right to strike.
- Monitor future increases in the federal minimum wage so as to balance the need to provide an adequate pay floor with the need to preserve the employability of low-skilled workers in poor regions.
- Promote a greater adequacy and effectiveness of labour market programmes for the unemployed. In particular, consider introducing a well-designed unemployment insurance scheme and improve the functioning of the public employment centres and the quality of the employment services they deliver.
- Maintain or even increase further the level of resources for labour market programmes during the recovery but shift public funds towards the most effective programmes such as job-search assistance and counselling, training, and direct job creation for the most difficult-to-place unemployed.
- Reinforce the information system of labour intermediation and encourage a greater involvement of employers in the provision of on-the-job training and efforts towards lifelong learning.

Social policy

- Increase resources for social policy programmes to provide more adequate support to needy households.
- Improve the redistributive power of the tax/benefit system. In addition to regular indexation with average wage growth, the upper income-threshold for social contributions to close to twice the average wage. To further improve the redistributive power of the tax/benefit system, progressivity in the personal income tax scheme should be strengthened.
- Apply equal social security contribution rates to all sectors of the economy and uniform across jobs/occupations.
- Continue the shifting of the monetised in-kind benefits that are linked to employment history into income-tested supports, as for example income-tested housing benefits, which are also accessible to the working-age population and their children.
- Improve systemic targeting of social support, as well as the collection procedures for social contributions, through better information sharing across different public agencies: they should be granted direct access to each others' databases.
- Strengthen policies that help parents reconcile work and family commitments by increasing support for the kindergarten system, both in terms of capacity as well as fee reductions. Give families with young children priority access to affordable housing.
- Increase child allowances to reduce the poverty risk among working families with children.
- Enhance financial sustainability of the pension system by increasing the low ratio of contributors to benefit recipients, through a mix of measures including: gradual increase of female pensionable ages to male levels (at present 60 years of age); consider increasing pensionable age in line with gains in life expectancy; and, limit access to early pension schemes. To increase awareness of the costs of early retirement and change behaviour for employers and workers accordingly, internalise the cost of early pension schemes to employers rather than finance these out of the general pension fund. Employees should also contribute to social security.

Note

1. The *OECD Jobs Strategy* was originally formulated in 1994 with the aim of reducing high and persistent unemployment. While the key recommendations have been found to be useful in this respect, the policy focus has broadened and the *2006 Reassessed OECD Jobs Strategy* (RJS) puts more weight to the objective of promoting labour market participation and employment, and taking into account concerns about low incomes of certain groups. The RJS has four main pillars: *i)* set appropriate macroeconomic policy; *ii)* remove impediments to labour market participation as well as job search; *iii)* tackle labour- and product-market obstacles to labour demand; and *iv)* facilitate the development of labour force skills and competencies. Policy makers need to ensure that each of the four pillars is solid, but individual countries can use different policy combinations to achieve successful outcomes, taking into account policy interactions and country circumstances and objectives.



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