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THE DECENTRALIZATION OF MINIMUM WAGE SETTING IN RUSSIA ECONOMIES

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In this paper, we study the minimum wage reform in Russia, which aimed to decentralize the fixing of the minimum wage and to increase the involvement of social partners in this process. The old system of the minimum wage setting was based on a single nation-wide minimum wage, which was differentiated across regions and occupations via a cumbersome framework of coefficients. The new system is a mixture of a government-legislated minimum wage at the federal level and collective agreements at regional levels. We show that the system of minimum wage setting has become more flexible. The reform succeeded in raising the real value of the minimum wage and increasing earnings of low paid workers without causing considerable negative effects in terms of employment. However, the reform did not lead to greater regional variation of minimum wages. It introduced some new imbalances: an unintended consequence of the reform was the emergence of separate regional wage sub-minima for private and public sector workers in many regions. The major challenge in coming years is to strengthen the institutions of collective bargaining, introduce evidence-based evaluation and boost the capacities of government and non-government monitoring agencies.

JEL codes: J31, J38, D33

Keywords: minimum wage, wage policy, Russia, decentralization

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1. Introduction

As a market economy fails to provide adequate insurance against income risks to which workers are exposed, different forms of labour regulation are an institutional response to those risks [Bertola, 2009]. Minimum wages are a nearly universal policy instrument—being applied in more than 100 countries [ILO, 2008]. At the same time, this institution remains one of the most controversial issues in labour economics and economic policy, reflecting Freeman's 'institutionalist-distortionist' divide [Freeman, 1993]. From an 'institutionalist' point of view, most consistently described in Eyraud and Saget [2008], the main aim of the introduction of the minimum wage is to provide essential guarantees for workers against economic volatility and the strong bargaining power of employers. Adherents of this view consider the wage minimum both within a rights-based framework and as a social policy instrument. Conversely, 'distortionists' emphasize that a minimum wage can have unintended negative consequences. Setting the minimum wage above the market-clearing level can have detrimental effects on employment and increase unemployment, in particular, among the youth and less productive workers [see Neumark and Wascher, 2007; Betcherman, 2013 for an overview of this position]. In economic policy, the setting of a minimum wage involves a trade-off between reducing poverty among the most vulnerable groups of workers and shutting down low productivity jobs.

Empirical studies focus on the effects of the level of the minimum wage or, more often the ratio of the minimum wage to the average/median wage (the Kaitz index), on the unemployment rates of different groups of workers, on poverty and on wage distribution [Betcherman, 2013]. Much less attention has been paid to different types of minimum wage fixing mechanisms and their possible economic consequences. For a long time it has been believed that the system for setting minimum wages, as opposed to the rate of the minimum wage, has no significant independent effects on overall performance of the labour market. In fact, the effects of minimum wages on labour market outcomes depend on the fine-tuning of the minimum wage to the elasticity of labour supply and demand, and the presence of other labour market institutions. In this respect, the minimum wage setting mechanism is very important as it affects not only the rate but the responsiveness of the minimum wage to changes in the economy.

One of the most cited studies, which investigate the link between the mechanism for minimum wage setting and its level, is the paper by Tito Boeri [2012]. Although minimum wages constitute a key labour market policy instrument in developed, developing and emerging economies, there is no international uniformity in the process of setting, adjusting and enforcing minimum wages. Boeri identifies three main regimes of minimum wage setting with regard to the intensity of the state intervention. At one extreme, there is a regime where the minimum wage is set by the government or the parliament ('government legislated minimum'). The least direct regime is a ‘bargaining process’, whereby the minimum wage is determined exclusively by the social partners. Between these two extremes, there is a ‘consultation process’ where the wage floor is the result of formal negotiations between government representatives and social partners. In this case, the wage floor fixed in collective agreements can vary substantially across labour market segments. Government legislated minimum wages are significantly lower than minimum wages set in the context of collective agreements and this result can be interpreted as a causal effect of the fixing regime [Boeri, 2012].

The level of development and the quality of industrial relations can be an important determinant of the minimum wage setting mechanism [Aghion *et al.*, 2008]. In the systems with advanced industrial relations, national employers’ organizations and trade unions are influential, and collective wage bargaining covers the majority of workers and there is little need for government-legislated minima. This is the case in Germany and Denmark where minimum wages are set within the framework of sectoral collective agreements. However, government intervention in the process of establishing the wage floor becomes a necessity when the trade union movement is weak and employers are fragmented. At the same time the situation when social partners rely mostly on the government can lead to a number of negative consequences, in particular, to the emergence of an ‘active government’ which, in turn, can hinder the development of effective industrial relations.

Unfortunately, time-series variation in the minimum wage levels (relative to average wages) and, especially, in fixing regimes is very low in most countries. In this paper, we undertake a case study of the reform of minimum wage setting in Russia. This reform, introduced in 2007, involved the decentralization of minimum wage setting, which gave Russian regions the power to set their own regional minima above the federal floor. It was followed, not accidentally, with extremely large increases in the federal minimum wage—minimum wages doubled twice in next two years. The main objective of this article is to explore the determinants of the changes in Russia’s minimum wage policy, its main features, and the consequences for the labour market.

The rest of the paper is organized as follows. Section 2 describes the institutional background of minimum wage setting in Russia after the collapse of the USSR. Section 3 details the major drawbacks of this system. Section 4 outlines the key feature of the 2007 reform, presents the results of this reform and discusses whether the reform has reached its goals. Section 5 concludes.

2. The institutional framework of minimum wage fixing in Russia and the role of social partners

The minimum wage is not a new phenomenon in Russia as it existed during the Soviet period. The former USSR belonged to the group of countries with government-legislated minima. The rate was set by the central government and approved officially by the USSR parliament. Negotiations with unions on the minimum wage rate took place but were predominantly ceremonial. At the same time the relative value of the minimum wage during the Soviet times was comparable to that observed in many OECD economies. For example, the minimum wage was equal to 70 rubles in 1985 and given the average wage of about 190 Rubles[4] [Goskomstat, 1987], this yields a Kaitz ratio of about 37%. Even in 1991, the year before the start of the economic transition from a command to a market economy, the Kaitz ratio was 25% (Figure 1). However, it should be stressed that wages of Russian workers during the communist period were very low by international standards.

The minimum wage fixing mechanism that emerged after the start of market reforms in Russia inherited many features from the Soviet system. As before, the country had a single federal minimum wage. The mechanism for regional differentiation was quite rigid. During the Soviet era and the early period of transition, minimum wages were differentiated across Russian regions via the so-called regional or Northern coefficients. In a number of Russian regions, mostly North and Far East territories but also in some continental regions with adverse climate conditions, the federal minimum wage was multiplied by regional coefficients. The value of the regional wage coefficient ranges from 1.0 (no extra regional compensation) in central Russia to 2.0 (which tripled the federal minimum base wage) in the Arctic islands[5]. The Northern coefficients were used as a financial instrument to attract and maintain labour in highly industrialized but low-populated areas rich in natural resources. The system was inflexible because the authorities of these regions could not influence either the value of the federal minimum wage, or the size of regional coefficients.

Different countries use a single- or multi-tiered approach to minimum wage fixing. According to ILO estimates [ILO, 2010], more than 65% of countries have a complex set of minimum wages, differentiated by age, industry or even occupation, while only one third of the countries use a single minimum wage. The USSR and transitional Russia belonged to the group with a single minimum. Legally, the federal minimum was applied universally to all groups of workers, regardless of age, occupation or industry. This means that wages of both teenage workers and employees with long tenures were subject to equal minima. However, that was not

[4] Data on Russian median wages are unavailable.
[5] The system of regional compensations in the USSR and Russia is described in some details in Berger *et al*. (2008).

entirely true for occupations as the minimum wage related to gross monthly earnings net of mandatory regional wage supplements, shift pay, other compensations and bonuses. The labour safety legislation specified dozens of special compensating coefficients for work in hazardous or difficult conditions. They were set at the government and industry level and functioned similarly to the regional coefficients. This framework introduced some differentiation of minimum wages across occupations and industries.

Countries differ not only in how the minimum wage is initially set, but also in its subsequent ‘upgrading’ for inflation. In Russia, the legislation does not identify the periodicity of minimum wage adjustments. Since the early 1990s adjustments of the minimum wage have been irregular and varied greatly in size.

Some countries have explicit or implicit anchors for the minimum wage [Euraud and Saget, 2005]. In developing and emerging economies, the minimum wage is often linked to the poverty line. The minimum is set to cover the basic needs of workers and sometimes the needs of their families. In other countries a greater variety of economic factors are taken into consideration: the rates of economic development and productivity, economic cycle, unemployment levels, the issues of earning inequality, among others [Belser and Sobeck, 2012]. In other words, the level of the minimum wage is often determined not only by assumptions about worker needs but also the financial capabilities of employers to pay the increased minimum.

The new Russian Labour Code adopted in 2002 set an explicit target to increase the level of the minimum wage and equalize it with the national subsistence minimum[6]. This provision was a result of harsh negotiations between the government and trade unions. When introduced into the legislation, it did not take into consideration any economic factors. At the same time, as stated in the Labour Code, this legislative provision was to be implemented by a special legal act, which has been constantly delayed. This delay is an indirect way of taking economic conditions into account. Actually, the process of minimum wage fixing is still lacking a binding target.

Formally, the value of the mandatory minimum wage is set by a law passed by the Russian Parliament based on a proposal by the federal government. However, first of all consensus about the level of minimum wage must be achieved within the tripartite commission consisting of representatives of peak employer associations, trade unions and the federal

[6] The subsistence minimum is the amount of income that is considered necessary to cover the most basic needs of a person living in the country or in a given region. In Russia the value of the subsistence minimum is used as an official poverty line. The consumer basket for the national value of subsistence minimum is fixed by the law. The consumer basket has to be redefined every five years, that is why the time-series for subsistence minimum are not entirely consistent over time. Regions are allowed adapting this consumer basket to local cultural and climate specifics. The federal and regional values of the subsistence minima are indexed at the quarterly basis.

government. All three sides sign a tripartite agreement on the principles for establishing the minimum wage. The tripartite commission sits on a permanent basis, but it is especially active during the preparations and signing of a three-year general agreement, which serves as an ideological symbol of the operative partnership in the Russia. According to the classification of Boeri, [2012], the Russian system of minimum wage determination may be characterized as a ‘consultation process’ where the new minimum wage is the result of negotiations between the state and the social partners.

In comparison with the planned economy, the role of the social partners is no longer formal. At the same time, Russian trade unions and employer organizations have not yet become equal partners to the government. The government still plays the leading role in the tripartite commission in deciding the level of the wage floor. The prominence of the federal government can be partly justified the fact that the state remains a large employer. Though the share of state employment dramatically declined over the transition period, 29% of all employees worked in the state and municipal sector of the economy, and an extra 6% worked in mixed (state-private) enterprises in 2012 [Rosstat, 2013]. The state was not especially good at balancing the interests of capital and labour. As shown in the next section, the early transition period when the state tried to support employers allowing the minimum wage to fall to a negligible level was followed by abrupt jumps of the wage floor during the 2000s.

From a formal point of view, Russian unions may be proud of high density rates. The majority of Russian unionized workers are members of the Federation of Independent Trade Unions of Russia (FITUR) which is the successor to the traditional communist unions. The FITUR suffered from a severe membership decline from almost 100% in the communist period to 33% of total employment in 2013[7]. Nonetheless, the federation remains the most powerful trade union organization in modern Russia. Other independent trade unions established over the transition period are small and cover only 5% of the total union membership and do not play any visible role in public life [Chetvernina, 2009]. Nominally, the FITUR represents all Russian workers in the central tripartite Commission.

Along with traditional reasons for the decline in union membership (globalization, the disappearance of the blue-collar industrial jobs, the growth of the service economy), there are some explanations that are specifically relevant to Russia and other post-communist countries. They witnessed declining union density because of the transformation from obligatory to voluntary union membership. The trade union movement as a whole is increasingly confined to the residues of the old state industrial sectors of the economy. Most of the FITUR membership

[7] See, www.fnpr.ru. Note that data on unionization rates are not based on administrative sources (the Russian Statistical Office has stopped collecting data on trade unions membership) but on files reported by the union federation. Estimates from household surveys generally confirm this information (Lehmann and Muravyev, 2009).

come from large companies in manufacturing and mining. In these sectors, density rates approaches 70% of all employees. The FITUR has made little effort to recruit new members in the emerging private sector, especially in the expanding segment of the service economy and small- and medium-size enterprises.

Traditional unions were especially sensitive to the collapse of the Soviet system where they used to be an integral part of the party-state apparatus at all levels. While the FITUR generally manages to keep hold of a considerable part of its property, it lost some of the rights enjoyed during the socialist period, among them the right of legislative initiative and control over social insurance funds. The most significant changes occurred in 2007, when trade unions lost control over dismissals at the enterprise level. In addition, high unemployment and falling living standards during the first decade of the transition also contributed to the decline in union membership. Even so the Russian unionization rate remains high by international standards.

The current situation with collective bargaining agreements in Russia is characterized by the weak regulatory impact of unions on wage policy, and working conditions at the enterprise level. Industry-level trade unions do not control wage determination in companies either. The system of wage setting in Russia can be called ‘managerial’ as managers determine wages in Russian enterprises [Kapelyushnikov, 2007]. Russian trade unions are not effectively able to determine the wages and working conditions of their members at the grass-root level and adhere to a strategy of negotiating these issues with the government, rather than directly with the employers. Many of the FITUR leaders share the hope that legislation and government regulation will grant what unions are unable to achieve themselves. Traditional unions have interpreted the principles of social partnership as collaboration with the state. This collaboration provides them with some guarantee of retaining their former privileged status. Moreover, close relationships with the state enable FITUR to fend off the challenges from independent trade unions. The weakness of Russian trade unions is impressively illustrated by the inability of Russian unions to secure decent minimum wages during the initial period of the market reform.

The fragmentation of employer organizations is another barrier to the development of social partnership in Russia. They are unable to serve as an effective union counterpart in negotiations. Unlike trade unions, which existed in the Soviet times, employer organizations were established only after the start of the transition period. Naturally, the first employer organizations represented the largest state and former state enterprises. The main purpose of these organizations was not to present the enterprises as employers but to provide them with a channel for lobbying the federal and regional authorities for tax credits and other privileges, and to establish personal connections with government officials. In subsequent years, several hundred employer organizations have been set up at the national, regional and industry level.

They represent the interests of employers in different industries, mainly related to the goods market. As a result, the employers' side has a more fragmented organizational structure than the workers' side.

Over the transition period, Russian employers experienced enormous difficulties in establishing umbrella organizations. Several cross-sectoral peak employer organizations with different degrees of political weight emerged and have survived until now. The Russian Union of Industrialists and Entrepreneurs (RUIE) is the leading employer organization. It acts on behalf of large and some medium-sized enterprises. The RUIE, as the most powerful organization, is the main social partner in the central tripartite commission. Small and medium-sized enterprises are united in a number of separate organizations that also participate in the work of this commission. However, they do not possess any real power either politically or in industrial relations.

In summary Russia entered a market economy with a rigid government-dominated mechanism for setting the minimum wage based on a single minimum, but complicated with hundreds of coefficients to adjust for regional diversity and differences in working conditions. The limited membership of the employer organizations and the lack of 'fighting spirit' among Russian trade unions have led to a situation when both social partners look to the state rather than to their immediate counterparts to undertake the obligations of social partnership, including the setting of the minimum wage.

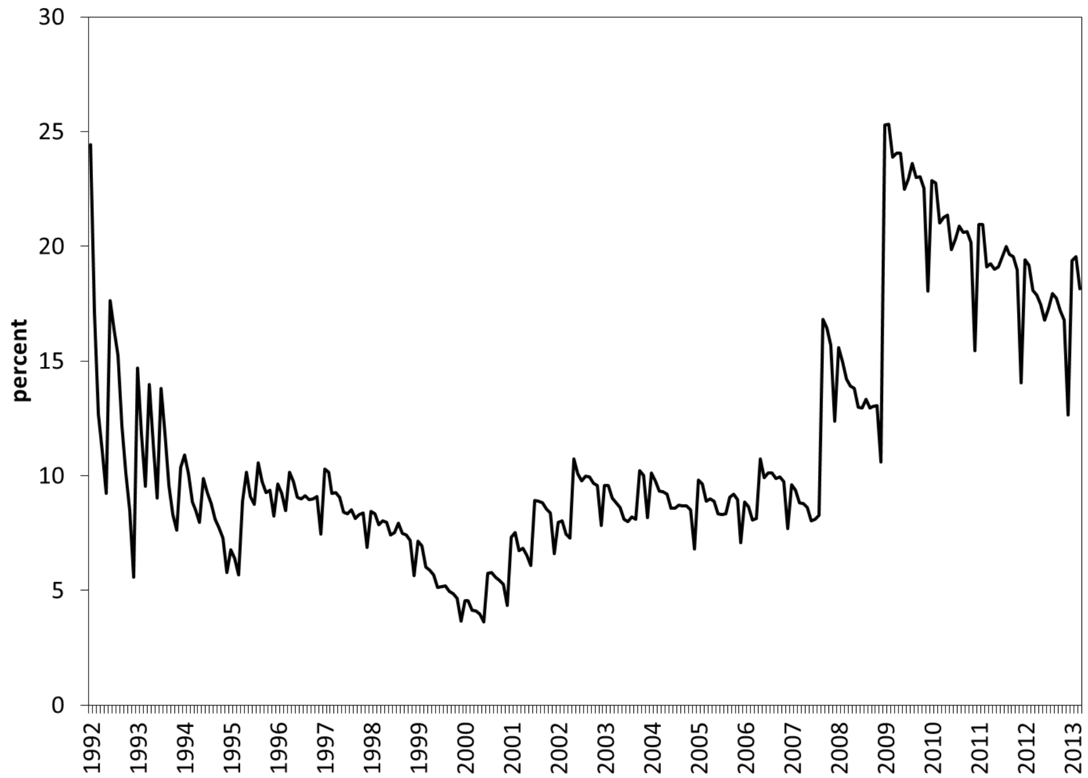
3. Why the reform of the minimum wage fixing became an urgent problem in Russia?

Low level of the minimum wage

The level of minimum wages relative to average wages varies widely across the countries, but there is a relatively high frequency at around 40% [ILO, 2008]. In post-reform Russia, it has never reached this level. Figure 1 shows that, for most of the transition and post-reform period, the minimum wage in Russia was so small that it can be defined as a 'mini minimum wage' [Saget, 2008, p. 27]. During the first decade of the economic transition, the Kaitz index demonstrated a downward trend with short-lived upsurges at the points of minimum wage hikes. The low of 4% was reached in 2000.

In the economic literature, low minima are usually found to be unintended consequences of the link between minimum wages and social benefits including old-age pensions, maternity and unemployment benefits [Saget, 2008]. Indeed, over the 1990s the wage minima in Russia were used as a reference value for several welfare provisions (child allowances, unemployment benefits), tax exemptions and some fees (for example, traffic fines). The linkage of the minimum wage with social benefits increased potential budgetary costs of the minimum wage increases. In

2000, the government decoupled the minimum wage setting mechanism from the social security and tax systems introducing two types of 'minimum wages'. The first type is the traditional minimum wage used as a floor in wage setting. The second type functions as the basic tariff for taxes, penalties and other administrative payments [Bolsheva, 2012]. Both types of minimum wages are still called the 'minimum wages' causing certain confusion in the legislation. Throughout this paper, we are talking exclusively about the first type.

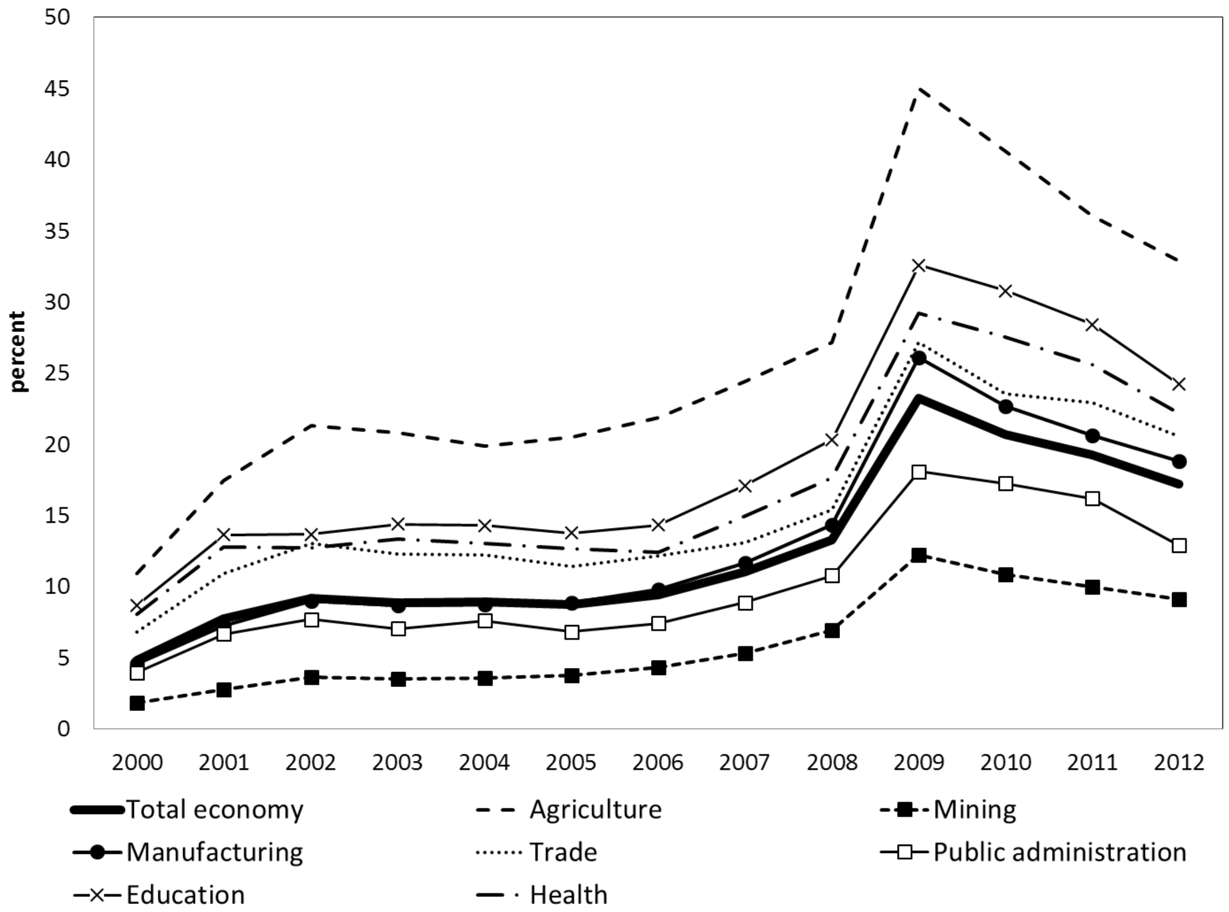


Source: Authors' calculations based on the Rosstat data.

Note: Minimum wages are not adjusted for regional coefficients.

Figure 1. The federal minimum wage as percentage of the average wage, 1992-2013

Given the low level of the minimum wage, it is not surprising that a small share of the workforce had wages at or below minimum wage (the federal minimum wage is set for monthly wages of full-time workers, thus, part-time contracts are the major exclusion from the regulation). According to the Rosstat, minimum wage earners represented 1.6–2.4% of all workers in 1996–2005 [Vishnevskaya, 2007, p.171]. In 2006, this percentage increased to 2.9% [Rosstat, 2007. Table 5.4]. The incidence of the minimum wage varies substantially across industries. In 2006, the proportion of workers with wages at or below the minimum ranged from 0.2% in mining to 15.6% in agriculture. The share of minimum wage recipients was higher than the average in education (4.3%) and trade (3.6%) [Rosstat, 2007. Table 5.6]. Figure 2 plots the evolution of Kaitz ratio for selected industries. It shows that the 'bindingness' of the minimum wage used to be higher for the public sector (largely, for education and health) and small firms which are dominant in agriculture and trade.



Source: Authors' calculations from the Rosstat data.

Note: Minimum wages are not adjusted for regional coefficients.

Figure 2. The federal minimum wage as percentage of the average wage by industry

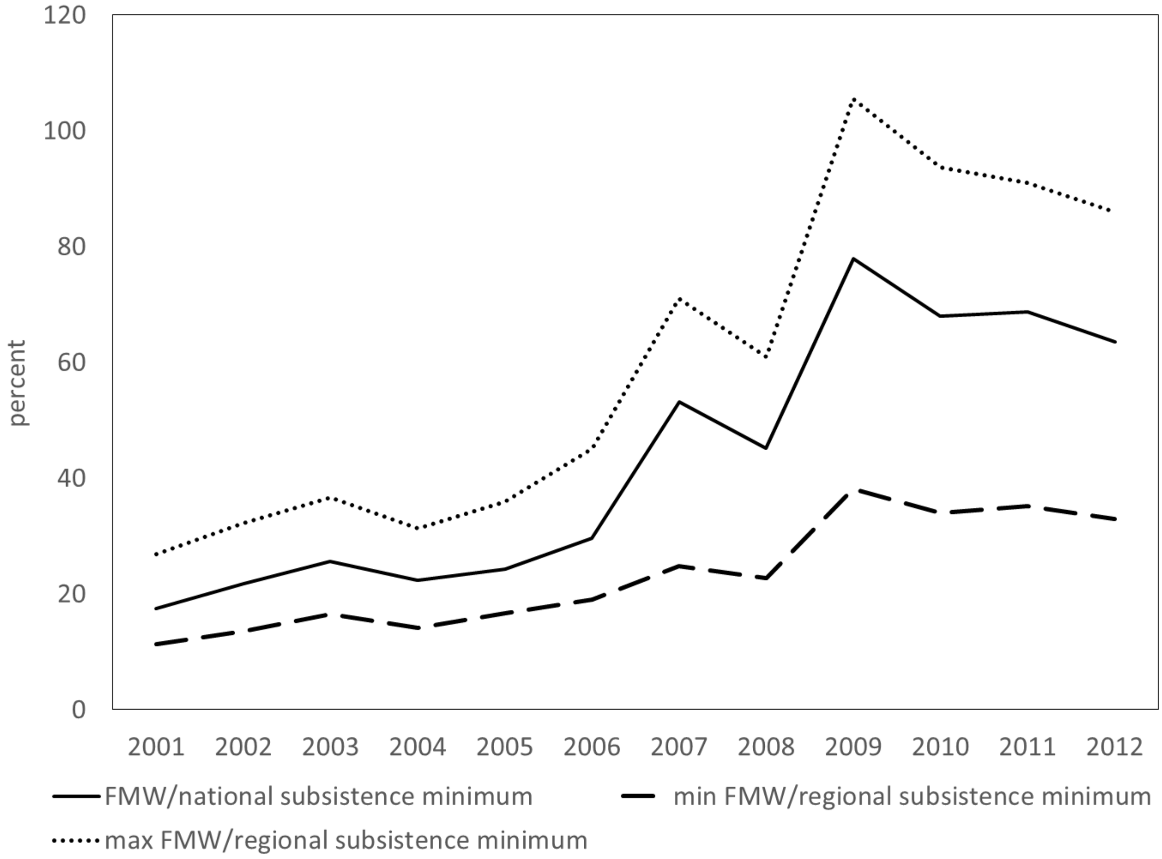
The majority of low-paid workers are concentrated in the public sector of the Russian economy [Lukiyanova, 2011] and public sector organizations bear the financial burden of minimum wage increases. For a long time the federal minimum wage was equal to the lowest grade of the Unified Tariff Scale (UTS). The UTS was the basis of the payment system for employees of all government levels (federal, regional and municipal). Base salaries of all budgetary sector workers and civil servants were defined as the product of the minimum wage and the grade coefficient fixed in the UTS for each occupation and qualification level. Therefore, any increase in the federal minimum wage triggered, through the UTS coefficients, an increase in the all tariff wages in the budgetary sector. The UTS coefficients gave rise to significant spillover effects on the entire wage distribution, including the top deciles [Gimpelson and Lukiyanova, 2009].

More generally, the main reason for the low wage floor in Russia is related to the specific adjustment model of the Russian transition. The combination of flexible wages and inelastic employment was the key feature of the Russian model of the labour market [Gimpelson and Kapelyushnikov, 2011]. In this model, minimum wages were subject to irregular and partial indexation. The Russian government avoided frequent indexations of the wage floor, fearing that increases in the wage threshold would further raise wage arrears, accelerate inflation and generally worsen the economic conditions for businesses. Russian trade unions were too weak to insist on minimum wage increases. When they occurred, they were motivated by political factors. We observe clear correlation between the increases of the wage minimum and the electoral cycle. The level of minimum wage was raised 11 times between 1992 and 1997 - 7 revisions occurred during pre-election periods.

High earnings inequality and the high incidence of working poverty

The introduction of market reforms led to an immediate increase in wage inequality. The sharp growth of wage dispersion was observed in the early stage of transition, but later it slowed down. The Gini coefficient for wages rose from 0.22 at the beginning of transition period to 0.5 in 1996, and the 90/10 decile ratio increased from 3.3 in the late 1980s to 10 in 1995 [Flemming and Micklewright, 1999]. The peak of inequality was recorded in 2001, a few years after the 1998 financial crisis occurred and economic recovery began. In the period before the recovery, the bottom half of the distribution narrowed more than the upper half. Less skilled workers lost substantially both in real terms and relative to skilled workers. The large increase in inequality in the bottom part of the distribution is likely to be a reflection of the erosion of the minimum wage during the reform period [Brainerd, 1998]. The decline in the value of the minimum wage had a larger effect on inequality for female workers since they tend to be paid less than male workers.

The minimum wage does not cover the basic needs of workers as it has always been below the poverty line (Figure 3). In 2006, the federal minimum wage was less than 30% of the national subsistence minimum, which is used as a poverty line in Russia. For the whole period between 2001 and 2008, it failed to reach the poverty line even in poor regions. The share of workers with a wage below the subsistence level was 24.4% in 2005 and 22.2% in 2006 suggesting that one out of every four or five workers received below-subsistence wages in 2005-2006. The wages of another 30% of workers were in the range of one to two subsistence levels implying a high risk of absolute poverty for their families. Of course, the link between low pay and poverty is not straightforward, and low paid workers are often supplementary earners in multiple-earner households or trainees who work to gain job experience. Nonetheless, the incidence of poverty among the low-paid (with a wage of less than two-thirds of the regional median wage) is almost 30% higher than the average, and they constitute a quarter of those in poverty [Denisova, 2012].



Source: Authors' calculations from the Rosstat data.

Note: Minimum wages are adjusted for regional coefficients in 2001-2006 (as required by the law), for later years – without adjustment. Based on data for the 4th quarter of each year.

Figure 3. The federal minimum wage (FMW) as percentage of the subsistence minimum of the working age population

Inadequate regional differentiation

The overall dynamics of the minimum wage mask strong differences across Russian regions. There is a group of high-wage regions including the major cities (Moscow and St-Petersburg) and surroundings, and regions rich in natural resources. The lowest average wages are paid in the regions of North Caucasus, South Siberia and some parts of Central Russia. Most of regional disparities (in wages, life expectancy, etc.) peaked in the 2000s and began to decline later reflecting the changes in the budgetary policy to redistribute huge oil revenues [Zubarevich, 2011].

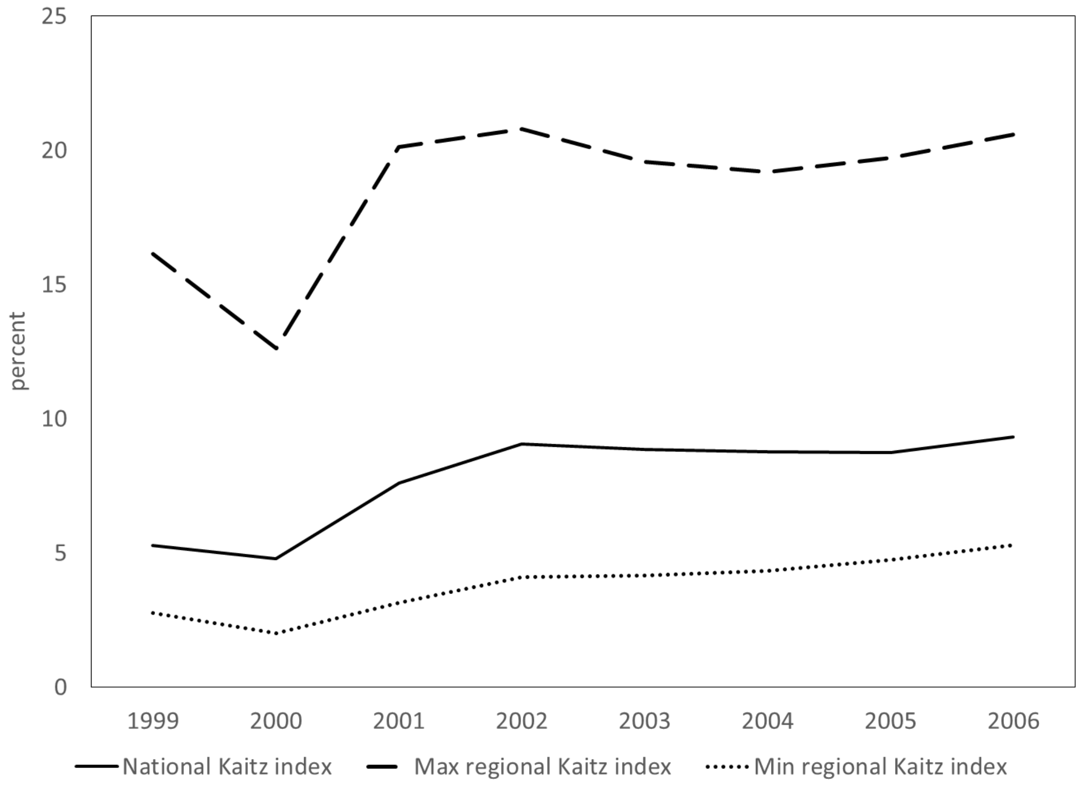
The divergence of regions in terms of economic performance is to a large extent related to geographical position and the concentrated industrial structure inherited from a command economy. Many small towns and even entire regions still depend on a single enterprise or single industry and therefore are very sensitive to various negative economic shocks. Several political and institutional factors contributed to the widening of regional disparities. During the early period of the economic transition, the weak federal government and the lack of legislation allowed large companies governed by oligarchs to 'capture the state' and influence the pace and direction of economic reforms according to their interests. Over time, with the growing power of the state, the situation evolved into a form of elite exchange in which large companies receive favourable treatment in return for providing benefits to state agents, including direct corruption [Frye, 2002]. The power of large companies is strongest at the regional level. These politically and economically powerful firms hamper the creation of new jobs in small businesses and suppress economic growth. Moreover, a system of dysfunctional incentives created by the interaction of electoral pressures with the system of fiscal federalism led to the excessive growth of public employment in depressed regions [Gimpelson and Triesman, 2002]. As a result, budgetary organizations are often overstaffed, ineffective, and low-paid.

Figure 4 shows that the national Kaitz ratio can be misleading in assessing the regulatory pressure of the minimum wage. In the richest regions, the Kaitz ratio[8] was well below 5% for the entire period before 2007 while it exceeded 20% in poor regions. This finding suggests that the federal minimum wage created very diverse institutional settings at the regional level with regions with the lowest wages facing the most unfavourable regulatory environment.

The purchasing power of the federal minimum wage varied dramatically across regions (Figure 3). The generosity of the minimum wage tends to be lower in the rich regions while in poor regions it provides higher (albeit, still extremely low) living standards. In Q4 2006, the federal minimum wage (adjusted for regional coefficients) covered 19% of the regional subsistence minimum in Moscow and about 45% of the regional subsistence minimum in Kemerovo region. Adjustment for mandatory regional coefficients had limited equalizing effect: the unadjusted ratios of the minimum wage to the regional subsistence minimum varied from 13% in Chukotka to 42% in Dagestan. The reason is that regional coefficients were designed for the needs of a command economy with full control over prices and large fringe benefits. They reflected climate differences and disregarded the contributions of other location amenities and

[8] Federal minimum wages were adjusted for mandatory regional coefficients. In some regions different coefficients are applied to different areas with the region. To account for differences in regional coefficients within the regions we weighted regional coefficients by the share of population in areas with different coefficients.

differences in the level of economic development and cost of living. Under a market economy, regional coefficients could partially reflect the changing balance between various regional factors.



Source: Authors' calculations from the Rosstat data.

Note: Minimum wages are adjusted for regional coefficients.

Figure 4. The federal minimum wage as percentage of average regional wage

4. Reform of the minimum wage setting mechanism and its consequences

Description of the reform

In 2007, the Russian government, with the support of social partners, initiated a reform of the minimum wage setting mechanism. The reform had several objectives but one of the main aims was to increase living standards and differentiate the real minimum wages across Russian regions with regard to differences in wages, prices, costs of living, and financial capabilities of businesses. The reform also intended to shift the financial burden of raising the minimum wage from federal to regional budgets. The shift in minimum wage policy was the result of changes in political 'milestones' which occurred after 2000 and the trend towards greater state intervention in the economy. The low level of the minimum wage became unacceptable for political reasons during a period of economic growth. Additionally, Russian trade unions and employer organizations gradually became more influential, especially at the regional level.

Finally, high oil prices and budget surpluses made it possible to increase the wages of public sector workers who constitute the majority of minimum wage recipients in Russia. The increase of the minimum wage was eased by the reform of wage setting in the budgetary sector. The pilot reforms were implemented in a few regions in 2005–2007, while large-scale reform started in 2008. The unified tariff scale was abandoned in December 2008 and replaced with a more flexible system decoupled from the minimum wage. In the new system, wages are determined by collective agreements, local and other legal acts that establish the base salary, payments for qualification levels, compensations and bonuses. Above that establishments can develop and apply their own remuneration systems within the limits of the given total wage bill. Managers of budgetary organizations received much more flexibility in determining wages and employment numbers [OECD, 2011].

Until 2007 the Russian model of the minimum wage setting was highly centralized as regions were completely deprived of the opportunity to influence its level. Following the 2007 reform, all Russian regions were empowered to define their own regional minimum wages with the only condition being that the regional minima should be set above the federal floor. This development was in line with international experience showing that the centralized model does not take into account the specifics of regional economies. Large countries with vast territories very often use a decentralized mechanism of minimum wage determination and consequently have multiple wage minima (for example, the United States, Canada and Brazil).

The implementation of reforms needs active cooperation between local authorities and social partners at the regional level as the rate of the regional wage floor is now established with the consent of all parties: regional employer associations, trade unions and local authorities. A very important aspect of the process is agreement among the parties on the wage floor which is acceptable for the majority of local employers. It means that one of the expected consequences of the reform is the strengthening of social partnerships at the regional level. Regional minimum wages are more flexible than the federal minimum for several reasons. First, the regional social partners are empowered not only to establish a new minimum, but also to 'freeze' the regional minimum wage in worsening economic conditions. Second, employers in a difficult financial situation may postpone the introduction of a new wage floor sending a notice to a regional tripartite commission. Nevertheless, it should be stressed, local authorities very often use 'administrative resources' to avoid opportunistic behaviour by employers.

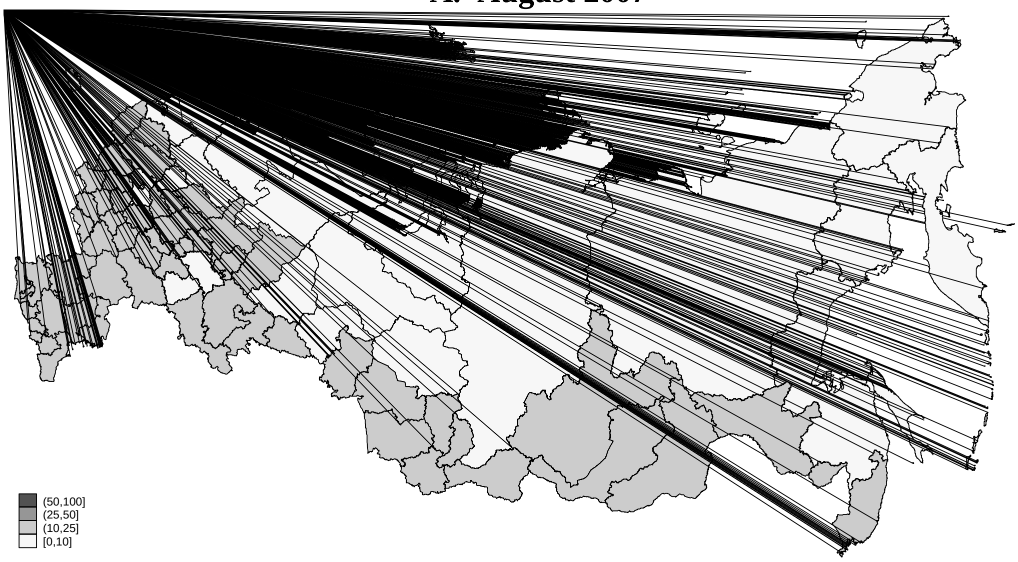
Simultaneously with the introduction of regional sub-minima, the procedure for calculating the minimum wage was modified. It was made to neutralize the possible negative impact of the rapid increases in minimum wages. Until 2007, it was the basic tariff rate that could not be less than the minima and all compensations and bonuses were paid over and above the wage floor. The introduction of a new approach to the calculation of the minima can be explained by the peculiarities of wage formation in Russia. In many other countries, various bonus systems are used fairly frequently as part of the tendency to decentralize the wage setting in recent years. For example, in Finland, payments by results were quite common, especially in the private sector where in the first half of 2000s 43% per cent of firms or workplaces used some form of payment by result and around 95% of those who were covered by a bonus system actually received a bonus [Johansson, 2006]. In Russia, the use of a variable wage component is much more frequent and the share of bonuses in wages is much higher than in other countries. According to Rosstat, the share of tariff wages was 43% in 2005. The analysis of industry collective bargaining agreements also shows that the share of non-tariff wages was 40–50% [Vishnevskaya, Kulikov, 2009]. Thus, if the use of regional minima led to the increase in the minimum wage rate (at least in many parts of the country), the changes in the definition of the wage floor were aimed to suppress its growth.

The implementation of the reform and its consequences

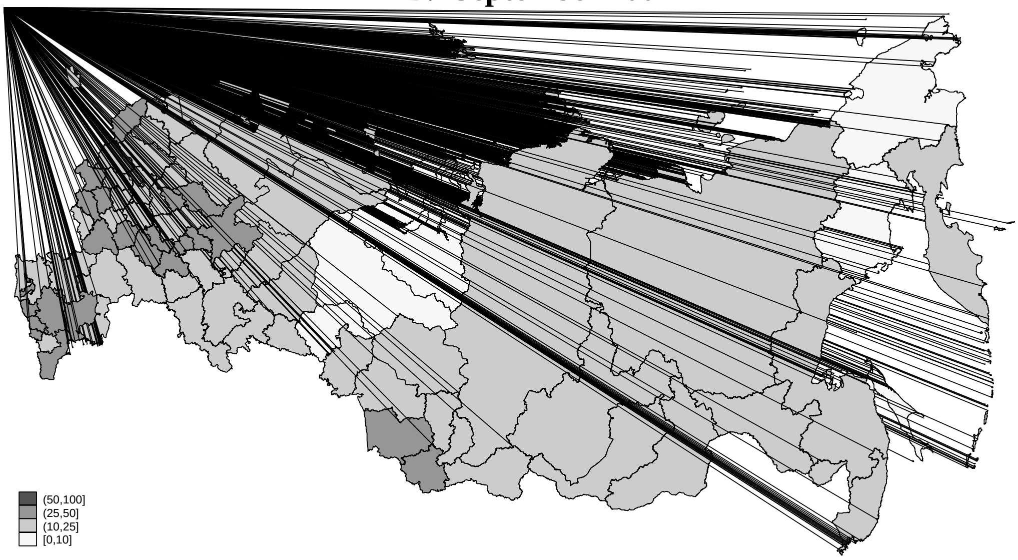
The rapid rise of the real minimum wage was the most apparent consequence of the reform. The minimum wage was increased four times after September 2007, when the reform provisions came into legal force. Two increases were particularly large. The nominal minimum wage was raised by 109% in September 2007 and 88% in January 2009. Later increases were much smaller in magnitude (6.5% in June 2011 and 12.9% in January 2013). In total, the federal minimum rose by a factor of 4.7 in nominal terms and by a factor of 2.9 in real terms between January 2007 and January 2013. The Kaitz index, which was equal to 8–9% in the year preceding the start of the reform, rocketed to 25% at the beginning of 2009. The global economic crisis and tightened budget constraints had a negative impact on the dynamics of the Kaitz index, but the ratio of the minimum wage to the average wages has not drop below 15% since 2009 (Figure 1).

The 2007 reform of the minimum wage setting removed the link between the minimum wage and the regional coefficients. This change generated additional variation in the minimum wage increases across regions. In particular, most regions experienced an increase in the nominal minimum wage by 109% from 1,100 Rubles to 2,300 Rubles in September 2007. Some Northern territories like Chukotka had a small increase of 5% because the previous value of the minimum wage was equal to 2,200 Rubles, that is the federal minimum of 1,100 Rubles times the regional coefficient of 2 [Muravyev and Oshchepkov, 2013].

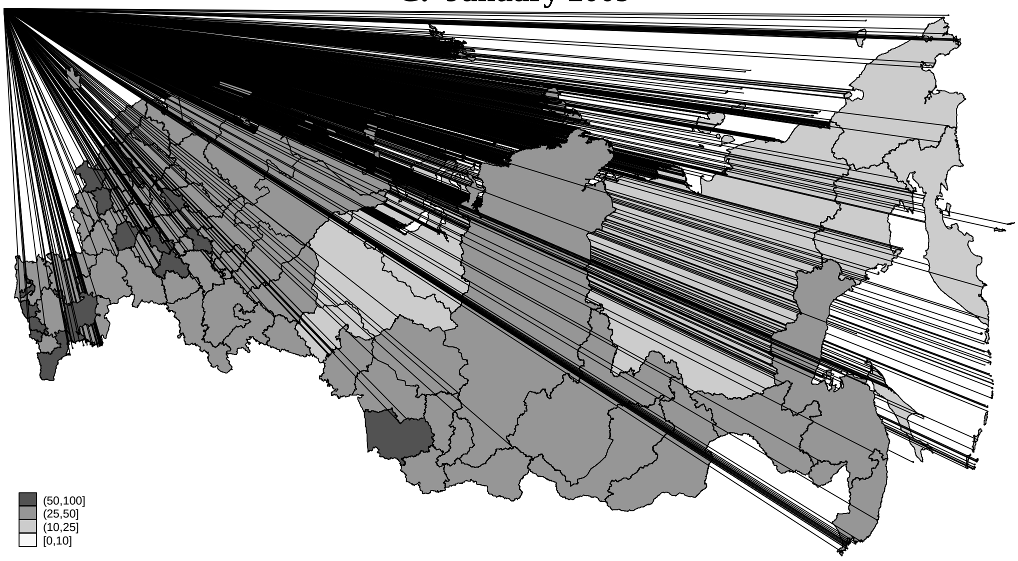
A. August 2007



B. September 2007



C. January 2009



Authors' calculations from the Rosstat data.
Note: Minimum wages are adjusted for the regional coefficients for August 2007, no adjustment is made for other periods.

Figure 5. The federal minimum wage as percentage of average regional wages

Figure 5 maps the ratios of the federal minimum wage to average regional wages in August 2007, September 2007 and January 2009. The decentralization reform increased the variation in the regional Kaitz indices based on federal minimum wages. Before the reform the Kaitz ratio varied from 4–5% in oil-rich Tyumen' region to 15–20% in the Caucuses and South Siberia with a substantial clustering of regions in the 8–10% range. The doubling of the federal minimum wage and the elimination of the regional coefficients led to a considerable increase in the regulatory burden. The pressure hardly changed in Northern areas, where the Kaitz ratios increased to 6–7%, and doubled in the depressed regions where the Kaitz ratios reached 30–40%. The next increase in January 2009 further increased the variation in the 'bite' of the federal minimum wage. In Russia's highest-wage regions, the minimum wage was equivalent to 12–15% of the average wage. By contrast, in 15 of the lowest-wage regions the figure exceeded 50%. This means that at least in some regions the minimum had become binding at sufficiently high percentiles of the earnings distribution. Additionally, some regions had ample room for increases at the regional level without fears of causing unemployment while other regions had to cope with a shock change in the regulatory pressure. However, for most regions the Kaitz index was between 25% and 30% with an unweighted average of 28%, which is not high compared to other countries. In 2010–2013, increases in the federal minimum wage were gradual and lagged behind the growth of the average wage leading to a substantial decline in the Kaitz ratio in the most affected regions. By January 2013, the maximum of regional Kaitz ratios declined to 36% and the unweighted average to 24%.

The degree of toughness of the minimum wage is measured by the proportion of workers paid at or below the minimum. The average proportion of affected workers is very small. According to the Rosstat biennial survey of large and medium size firms, it peaked in 2009 at 3% of all workers and declined to 1.8% in 2011 and 1.2% in 2013[9]. The adjustment of employers was fairly quick. The minimum wage incidence is significantly lower than in many developed and emerging economies, where this share often exceeds 5–15% [OECD, 2009].

Generally, regions with higher Kaitz ratios also have larger shares of minimum wage earners. However, regional variation is great (Figure 6). For example, in 2009 11.3% of workers had wages at or below the minimum in Dagestan (the darkest region on the map) compared to 0.1% in the Northern regions. Although hard evidence is not available, in the poorest regions like Dagestan, the minimum wage may increase incentives for non-declaration or under-declaration of wages. The agricultural sector should be particularly concerned as, in Dagestan, the minimum wage exceeded 130% of actual average wages in agriculture before its increase in 2009 [OECD,

[9] See http://www.gks.ru/free_doc/new_site/population/trud/obsled/trud2013.htm.

2011]. Studying the impact of regional variations within Russia, therefore, gives a good sense of what would happen if the federal minimum wage were to be raised to a much higher level.

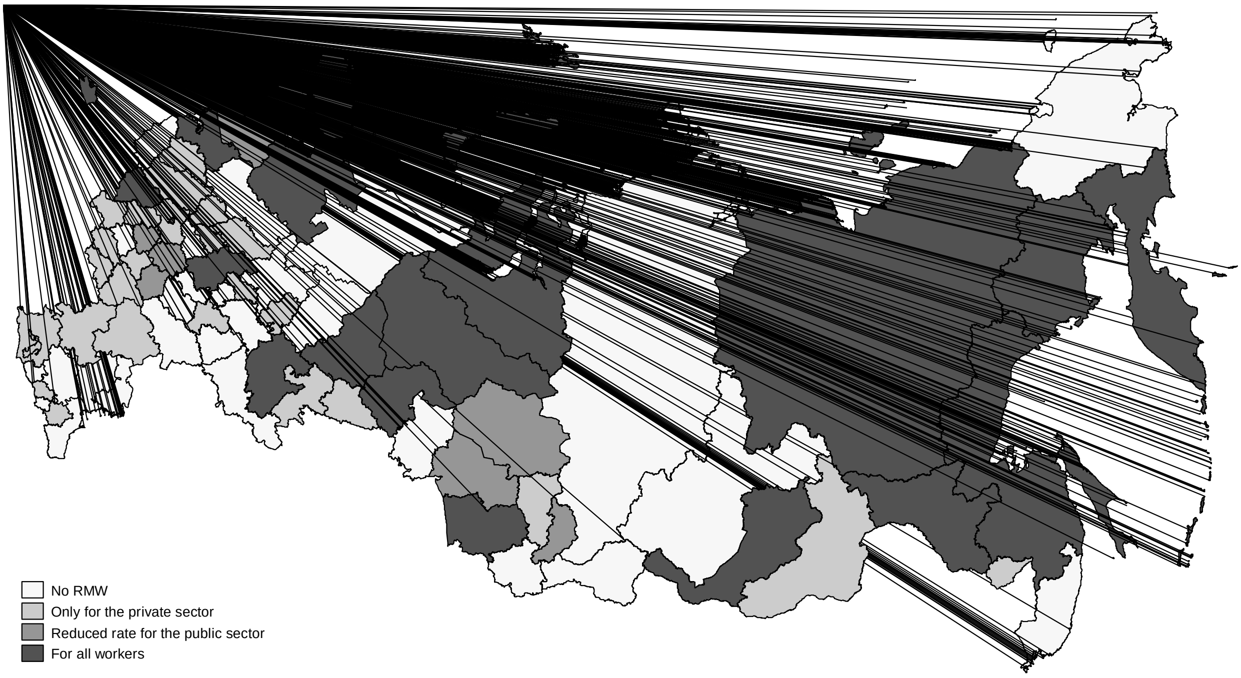
Source: Rosstat, results of the April Survey of earning distribution, 2011.

Figure 6. The share of full-time workers at or below the federal minimum wage

The minimum wage increases introduced in 2007 and 2009 led to a substantial increase in the purchasing power of minimum wages. In Q1 2009, the federal minimum wage increased to 80% of the national subsistence minimum of the working age population (Figure 3). The improvement of pay standards was impressive in poor regions where the regional subsistence minimum is below the national level. In the poorest regions with relatively low prices, the minimum wage stayed above the regional poverty line for 2009 and for part of 2010. The regions with higher prices did not gain much from the increases. First, many of these regions are located in northern areas and the Far East and, therefore, they experienced only a modest increase in the minimum wage after the elimination of the regional coefficients. Second, the implicit intention of the policy makers was to trigger the introduction of regional minimum wages set through collective bargaining at the regional level.

The Russian regions actively took advantage of the right to set their own sub-minima. Regional tripartite agreements, setting the wage floor, take into account the economic and social situation in the particular region and the phase of the economic cycle as well. In 2005, only one region—Moscow City—had the regional sub-minimum that exceeded the federal minimum wage (its legal status was uncertain as the Labour Code had no provisions for regional sub-minima at that time). According to the monitoring by the FITUR, by the end of 2007, 27% of all

Russian regions introduced regional sub-minima which were higher than the federal wage floor. This group included the most developed regions. By the end of 2008, the share of regions with their own minimum reached 49%. Regional minimum wages were very sensitive to economic cycles, and in some regions, the regional sub-minima were surpassed by the federal minimum after its increase in January 2009. As a result, the share of regions with regional sub-minima declined to 32% at the beginning of 2009. Later on, with the improvement of the economic situation in Russia, the regions returned to the practice of setting their own minima. In 2013, the regional sub-minima existed in 62% of all Russian regions.



Source: FITUR monitoring

Figure 7. Coverage by regional wage sub-minima, Q4 2012

The co-existence of the federal minimum wage and regional minimum wages led to new imbalances. Workers employed by federal establishments and enterprises are exempt from the regional minimum wage legislation. In some regions, regional and municipal employees are also excluded from the regional regulation and the regional wage floor applies only to the private sector workers[10]. In 2012, the coverage was limited to the private sector in half of all regions that introduced the regional sub-minimum (in 25 regions out of 53 regions that introduced regional sub-minima). A few other regions set different sub-minima for the private and public sectors. This means that in the same region substantial groups of workers rely on a lower minimum

[10] Additionally, the Budgetary Code forbids increases in the regional minimum wages for the public sector workers if a region receives subsidies from the federal budget to cover its budget deficits.

wage. The lower minimum wage paid to federal employees is not only discriminatory but leads to the adverse selection into the public sector.

Figure 7 maps the incidence of regional minimum wages as at the end of 2012 and the differences in the coverage of different groups of workers in the regions that introduced regional sub-minima. Although most regions have some sort of regional sub-minima, relatively few regions have ones which cover all workers. The majority of regions introduced complex frameworks with differentiated rates for the private and public sectors. Setting reduced rates for the public sector workers is uncommon. Such frameworks seem to be a compromise between the desire of local elites to be popular among the public, and safeguarding regional budgets. At the same time, workers in several Northern and Far East regions are clearly put at a disadvantage because these regions do not have regional sub-minima and are no longer subject to an automatic increase through the Northern coefficients. The regions in this sub-group either are poor or lack organized social partners to negotiate the agreement.

Table 1. Variation of regional minimum wages (RMW), October

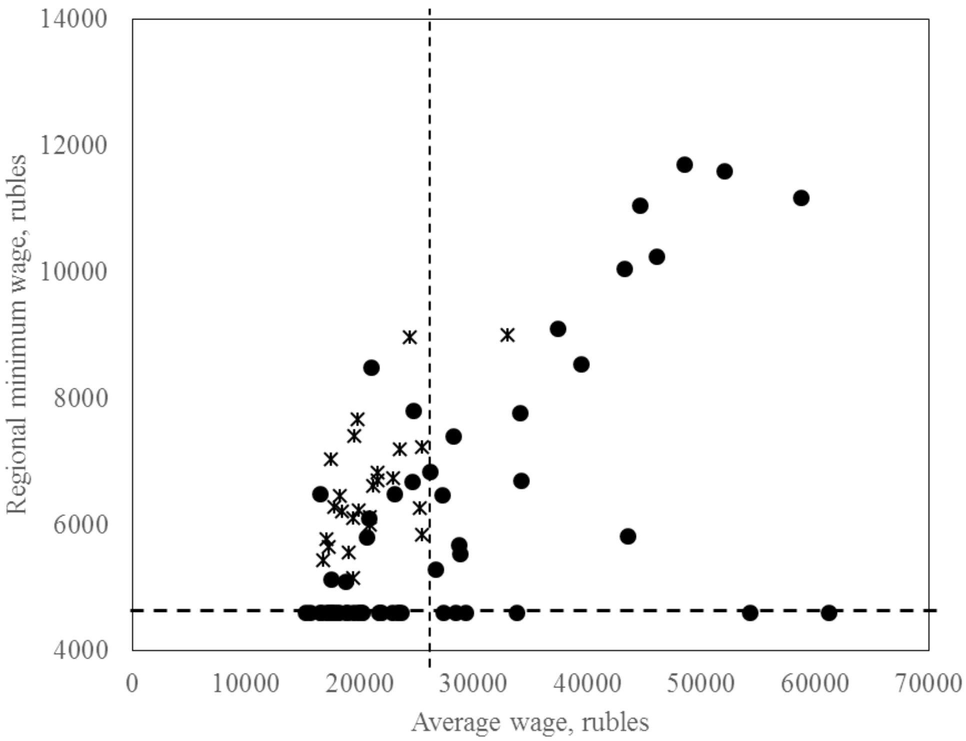
Year	Average RMW by regions, rubles*)	Minimum RMW by regions, rubles	Maximum RMW by regions, rubles	Coefficient of variation
2005	939.2	800	3124.0	0.31
2007	2560.4	2300	5829.1	0.26
2009	4793.9	4330	7956.8	0.18
2011	5514.4	4611	9912.3	0.22

Note: regional minimum wages in each region are corrected for differences in coverage.
*) – unweighted average
Source: Authors' calculations based of the wage data from Rosstat and the data on regional minimum wages from the FITUR monitoring

A detailed examination of the determinants of minimum wages at the regional level is beyond the scope of this paper and deserves a separate study. A first impression, though, is that economic concerns have limited impact. Table 1 shows that the decentralization reform failed to increase regional variation of minimum wages measured by the coefficient of variation[11]. Regional variation in minimum wages dropped abruptly after the elimination of regional coefficients (compare the figures for 2005 and 2007). An extremely generous increase in the federal minimum wage in January 2009 further reduced the variation since it surpassed many of existing regional sub-minima. Regional variation increased moderately in later years following

[11] The coefficient of variation is equal to the standard deviation divided by the mean.

the decline in the real value of the federal minimum wage and the recovery from the 2008–2009 global economic crisis. The rapid fall of regional variation in 2009 suggests that this hike was excessive, and a more gradual approach to increasing the minimum wage should be advocated.

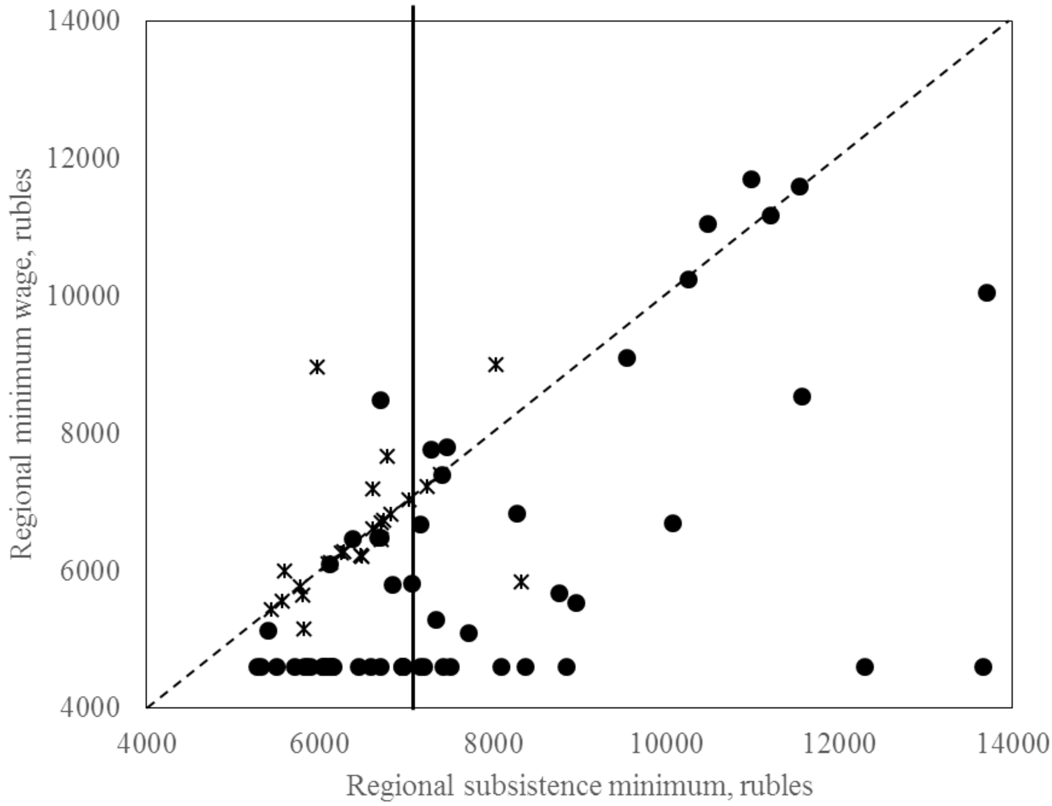


Source: Authors' calculations based of the wage data from Rosstat and the data on regional minimum wages from the FITUR monitoring.
Note: ✳ denotes regions that introduced minimum wages only for the private sector.

Figure 8. The relationship between regional sub-minima and regional average wages, Q4 2012

Figure 8 shows the relationship between regional sub-minima and regional wages in Q4-2012. Dashed vertical and horizontal lines depict the national average wage and the federal minimum wage, respectively. There is a positive correlation between the minimum wage and the average wage at the regional level. High-wage regions are more likely to introduce regional sub-minima that cover all workers. Poor regions have a higher probability of staying with the federal minimum wage or limit the coverage of regional sub-minima to private sector workers. However, the correlation between the two variables is far from being perfect. Several high-wage regions did not introduced a minimum wage. Businesses face a very different regulatory environment in poor regions: the Kaitz ratio can be 1.5–2 times higher in regions with similar average wages. According to our estimates, regional wage sub-minima increase the Kaitz ratio, on average, by 9 percentage points in the regions that have introduced a regional minimum wage.

Lukyanova [2011] estimates that on average the RMWs lead to an additional 3.3 percentage point increase in the share of minimum wage earners in such regions.



Source: Authors' calculation based on Rosstat data on regional subsistence minima and the data on regional minimum wages from the FITUR monitoring

Note: ✳ denotes regions that introduced minimum wages only for the private sector

Figure 9. The relationship between regional sub-minima and regional subsistence minima, Q4 2012

In 2002, the Labour Code set the value of the subsistence minimum as a long-term target for the minimum wage. This provision has not been implemented at the federal level (the introduction of the relevant article was conditioned on the adoption of a special federal law that has not yet been adopted). However, the value of the subsistence minimum seems to be a natural target for the legislation at the local level because regional minimal consumer baskets are cheaper than the national substance minimum. In fact, it is not a common practice to tie the regional sub-minimum to the regional subsistence level. In 2012, only 18 regions had this provision in regional agreements (including those that limit the coverage to the private sector workers). They make up about 30% of all regions that have introduced a minimum wage. Figure 9 shows the relationship between the regional minimum wage (Q4 2012) and the regional subsistence minimum in the previous quarter (Q3 2012). The dashed line depicts the points where the regional sub-minimum is equal to the regional subsistence minimum. The solid vertical line shows the value of the national subsistence minimum in Q3 2012. About half of all regions had wage sub-minima that were equal to or exceeded the regional subsistence minima, at least, for the public sector workers. At the same time, many regions with a high cost of living either have not introduced the regional sub-minimum or have relatively low regional sub-minima.

Table 2 shows that low-wage workers benefited from the minimum wage hikes, especially in poor regions. Minimum wages cover a higher proportion of the living costs. Even in the worst performing region, the minimum wage covers about 39% of basic living costs compared to 20% in 2005. In the most generous region, this proportion increased from 64% to 141%. The most generous regions are found among the regions with relatively low costs of living; they usually limit the coverage to private sector workers. Therefore, such generosity is largely populist because the majority of low-paid employees work in the public sector. More generally, poor regions with low costs of living benefited mainly from increases in the federal minimum. Regions with high costs of living had to increase the regional minimum wage. However, the overall regional variation in this indicator hardly changed between 2005 and 2011.

Table 2. The ratio of regional sub-minima to regional subsistence minima

Year	Average by regions*)	Minimum	Maximum	Coefficient of variation
2005	0.30	0.20	0.64	0.18
2007	0.63	0.24	1.33	0.25
2009	0.86	0.38	1.39	0.17
2011	0.80	0.39	1.41	0.19

Note: regional minimum wages in each region are corrected for differences in coverage.
*) – unweighted average
Source: Authors' calculations based of the wage data from Rosstat and the data on regional minimum wages from the FITUR monitoring

Enforcement of regional sub-minima is difficult for several reasons. First, there is much uncertainty about the meaning of provisions set in many of regional agreements. For example, some regions said that the regional minimum wage is tied the regional subsistence minimum but did not specify the exact procedure of its adjustment to changes in the subsistence minimum. Therefore, it is not clear how often the indexation should be made, what time lag should be taken for the subsistence minimum. Second, issues of minimum wages are not the priority for monitoring agencies. The monitoring of labour legislation, including the minimum wage agreements, is carried out by state inspectors. Labour inspections are under-staffed, small businesses are rarely inspected, sanctions are low and play little role in preventing violations of the law. Third, the coexistence of different minimum wages (for example, for federal employees, private sector workers, and regional and municipal employees) at the regional level reduces the regulatory transparency and complicates enforcement.

What impact did the 2007 reform have on the Russian labour market in terms of employment and wage inequality? Very few studies have investigated these effects empirically. Muravyev and Oshchepkov [2013] found significant negative effects of the recent minimum wage increases expressed in increased youth unemployment and a higher incidence of informality. In contrast, the employment of prime-aged workers was not affected by the minimum wage increases. Lukyanova [2011] reported that earnings distribution has changed shape markedly in response to the increased minimum wage. According to her estimates, about 50% of the compression of lower tail inequality in the overall wage distribution is attributable to the increase in the real value of the minimum wage. The compression effect was stronger for teenage and elderly workers, workers with low education, and public sector employees.

When interpreting the evidence now accumulated on the minimum wage, it should be noted that the strongest evidence on the negative employment effect of the minimum wage hikes comes from the two extremely large increases in 2007 and 2009. The robustness of this evidence is ambiguous because the period of big changes coincided with the global economic crisis, which means that it is very difficult to identify the impact of the minimum wage increase on unemployment and informality from other factors. Nonetheless, the magnitude of the reported negative coefficients is so small that adverse employment effects are offset by the positive effects on the wage distribution and incomes of low-wage workers. It happens because young workers earn a very small fraction of the total wage bill.

With a small, or possibly no, effect on employment, one might be tempted to conclude that the minimum wage can be pushed up at a faster rate than average earnings. The answer is no, a more careful approach is needed because some sub-sections of the Russian labour market have already entered the 'red' zone (for example, low-paid workers in agriculture and the public sector, workers in low-wage regions) where the minimum wage is very high compared to median wages.

5. Conclusion

The economic literature has not paid much attention to the possible impacts of different types of minimum wage fixing mechanisms. Earlier findings suggest that a government legislated minimum wage is consistently lower than a wage floor set through collective bargaining [Boeri, 2012]. In this paper, we study the minimum wage setting reform in Russia which aimed to decentralize the fixing of the minimum wage and to increase the involvement of social partners in this process. What makes the Russian case especially interesting is that fundamental regulatory changes were accompanied with extremely large increases in the magnitude of the minimum wage.

The old system of the minimum wage setting was inherited from the communist era. It was based a single nation-wide minimum wage which was differentiated across regions and occupations via a cumbersome framework of coefficients. The level of the minimum wage was determined by the government with ceremonial roles for parliament and social partners. The reform, which started in 2007, eliminated all coefficients, giving regions the power to set their own minimum wages above the federal minimum through tripartite agreements at the regional level. The reform was not comprehensive in the sense that the procedures for setting the minimum at the federal level remained unchanged. Therefore, the new system is a mixture of the government-legislated minimum wage at the federal level and collective agreements at the regional level. Parallel to the reform of the minimum wage setting, the government reformed pay in the public sector which weakened the link between the minimum wage and wages in the public sector. These changes reduced the financial burden and the risks of the minimum wage increases and triggered a number of generous increases in the minimum wage. Moreover, the low level of the minimum wage became politically unacceptable during the period of economic growth.

The real federal minimum wage doubled over a period of less than two years. However, due to the elimination of the regional coefficients northern regions experienced moderate changes in both nominal and real minimum wages whereas other regions faced a shock change in the regulatory environment. In 2009, the minimum wage reached the level of 40–50% of the average wage in the low-wage region compared to 15–20% before the reform. However, the increase in the share of minimum wage earners was small and short-lived even in the depressed regions suggesting that regions—probably with a few exceptions—are comfortable with the current level of the federal minimum wage. There is scope in richer regions to pay more than the federal minimum wages without negative employment effects.

Many of the regions took advantage of introduction of regional wage sub-minima. At the beginning of 2013, the regional wage sub-minima existed in 62% of all Russian regions, but the coverage was limited to the private sector in half of these regions. Therefore, the generosity of regional sub-minima is largely populist because the majority of low-paid employees work in municipal establishments.

The reform achieved its goals of raising the real value of the minimum wage and increasing earnings of low-paid workers without causing considerable negative effects in terms of employment. The regional minimum wages have better correspondence with the regional cost of living. Additionally, the minimum wage increases led to a substantial compression of the earnings distribution which is notoriously high in Russia.

The assessment of institutional changes is more problematic. The system of minimum wage setting has become more flexible. Regions were excluded from the process of fixing the minimum wage before the reform. Given the lack of a tradition of collective bargaining about the minimum wage at the regional level, it is amazing that there are few regions, which can 'afford' a regional sub-minimum but do not have one. The reform contributed to the strengthening of social partnership at the regional level. However, trade union organizations seem to have little confidence in collective bargaining in the regions and continue to campaign for further substantial increases in the rate of the federal minimum wage.

Surprisingly, the decentralization reform did not cause an increase in the regional variation of minimum wages. In fact, the variation in the regional sub-minima is lower than it used to be before the reform, but is tending to increase. This may reflect the fact that variation induced by the regional coefficients was excessive for the most remote regions. Additionally, time is probably needed for social partners at the regional level to find the balance between the conflicting interests of the parties. This process is subject to trial and error. After initial euphoria and populism, most regions show a preference for gradual changes in the value of minimum wage taking into account macroeconomic conditions and budgetary constraints.

The co-existence of different minimum wages reduces the regulatory transparency and complicates enforcement. The system of minimum wage setting has the advantage of increased flexibility which, however, is associated with greater complexity and higher demands for the capacity of both government and nongovernmental institutions. Complex wage structures are effective in OECD countries because they are based on institutions that allow for appropriate wage setting, proper evaluation and effective enforcement. The design of the 2007 reform completely overlooked these issues. The major challenge in coming years is to strengthen the institutions of collective bargaining, introduce evidence-based evaluation and boost the capacities of government and trade union monitoring agencies.

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