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Labor Markets in CIS Countries

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Abstract

This work is done as contribution to the Regional Human Development Report 2004 section 3.7 on “Labor Markets”. The paper focuses on discussing peculiarities of the labor market transition in CIS countries, features of unemployment, labor legislation, and role of the trade unions.

The paper gathers information on the labor markets of CIS and Eastern European countries that was available by summer 2004, and draws policy recommendations based on comparison between these two groups of countries. The main conclusion is that the transformation of labor markets is not complete in any of the CIS countries; most of the problems that prevailed in the early 1990s remain. These include: centralized wage setting in five CIS countries – Belarus, Moldova, Tajikistan, Turkmenistan, and Uzbekistan; extensive unemployment and underemployment, much of which is hidden; ineffective systems of labor relations and social protection; large mismatches between the labor market skills supplied and the skills demanded by new market economies; inadequate official labor market data.

Fortunately, the strong economic growth experienced by most CIS countries since 1999 has increased the demand for labor and is putting downward pressures on unemployment rates. This offers a window of opportunity for policy makers seeking to further transform labor markets, and to modernize labor relations and social protection systems. The above analysis suggests the policy recommendations to speed up further transformation.

1. Full employment under the Soviet system[1]

Labor market institutions in the Soviet Union differed from those in western countries. Under Soviet economic planning scarce resources were allocated towards priority sectors such as defense and heavy industry; other sectors had to work with what remained. The relative importance of different economic sectors was determined by central planners and not by the market. The official private sector was marginalized, other private activities were criminalized. Enterprise employment decisions had to be based in part on labor market criteria, in order to ensure that labor services supplied by households were consistent with planned priorities. Limited reliance on market forces did not preclude numerous labor market distortions, however. Enterprises hoarded labor in order to meet the unpredictability of planners' demands. This high demand for labor, combined with the criminalization of unemployment, generated high labor force participation rates, including particularly high rates for women. Labor mobility was also very limited due to the *propiska* registration system, housing shortages, as well as the one-enterprise town system. This allowed Soviet planners to direct labor from relatively low productive uses in rural areas to more highly productive uses in urban areas, thereby underpinning the Soviet Union's industrialization and modernization.

Central planners set wages as a multiple of the base wage (the wage assigned to the lowest occupational grade with the least education and seniority). There was not much wage variation between different occupational groups: top managers usually earned only twice as much wages as the average manual worker, while ratio was 20:1 in the United States (Brainerd 1998). However, a significant portion of household incomes took the form of non-wage benefits (such as free or subsidized housing) many of which were provided by enterprises themselves. Hence, the actual wage dispersion in the USSR was probably higher than officially recorded as enterprise managers and other *nomenklatura* members enjoyed greater non-monetary compensation than ordinary workers. Households also benefited from nominally free access to health care, education, and childcare facilities provided by the state. This strong demand for labor combined with extensive social benefits both underpinned women's high labor force participation rates and provided relatively lucrative employment opportunities for low-skilled workers.

2. Labor market inertia during transition

Labor market transformations in the CIS countries have differed from those of the new EU member states, which experienced rapid growth in unemployment, relatively small initial declines (followed by strong growth) in real wages, and relatively generous social safety nets. In CIS countries, despite much larger declines in output and incomes, unemployment rates remained at relatively low levels, even according to the data generated in accordance with the definitions of the International Labor Organization [ILO]). Adjustment instead took the form of much larger, and longer,

[1] This work is done as contribution to the CIS RHDR section 3.7 on "Labor Markets". The paper focuses on discussing peculiarities of the labor market transition in CIS countries, features of unemployment, labor legislation, and role of the trade unions.

declines in real wages. Shrinking labor forces and declining rates of labor force participation were common both to the new EU member states and many CIS countries, due both to sharp declines in labor demand and demographic trends. However, countries of Central Asia are an exception to this demographic pattern where population growth is higher and populations are younger. The labor markets of these countries are also characterized by emigration of younger males, particularly to the Russian Federation.

Table 1. Employment and GDP trends in the CIS countries, unweighted average growth rate

	1990-1994		1995-1998		1999-2002	
	Employment	GDP	Employment	GDP	Employment	GDP
Armenia	-2.2	-16.2	-2.2	5.8	-0.94	7.9
Azerbaijan	-0.5	-17.0	0.5	1.0	0.12	9.7
Belarus	-2.3	-7.8	-1.5	2.7	-0.40	4.6
Georgia	-10.8	-27.5	-0.3	6.6	-0.65	3.8
Kazakhstan	-4.2	-9.6	-1.8	-2.1	2.30	8.8
Kyrgyzstan	-1.5	-14.4	0.9	3.3	2.06	3.6
Moldova	-5.1	-20.5	-0.6	-4.2	0.00	-1.1
Russia	-2.3	-10.3	-2.0	-2.9	0.69	0.8
Tajikistan	-1.1	-20.1	-0.7	-2.7	0.00	0.9
Turkmenistan	3.5	-9.2	2.5	-5.2	0.00	3.8
Ukraine	-2.4	-14.1	-0.7	-6.9	-0.18	-0.1
Uzbekistan	1.3	-4.9	1.9	1.9	0.35	1.0

Source: Economic Survey of Europe 2004; EBRD Transition reports; authors' calculations.

At the beginning of the transformation, labor relations in CIS countries were governed by Soviet era regulations that featured the central determination (or indexation) of wages paid in both the state and private sectors, as well as restrictions on the ability of enterprises to fire employees, or the required payout of large severances to workers who are made redundant. Employers therefore preferred to reduce hours and/or wages rather than reduce numbers of employees. Large payroll and social security taxes made it very unprofitable for enterprises to pay higher wages. For instances in 2000, the payroll tax levy on employers in Georgia for a monthly wage of 200 lari was 66% while social security taxes 27%[2]. High payroll taxes also increased the attractiveness of the informal sector for employees. High wage costs and obstacles to firing redundant labor led to large wage arrears in both the state and private sectors. These generally climaxed around the time of the 1998 Russian financial crisis; the subsequent economic recovery and improvements in fiscal discipline significantly reduced wage (and other) arrears in virtually all CIS countries.

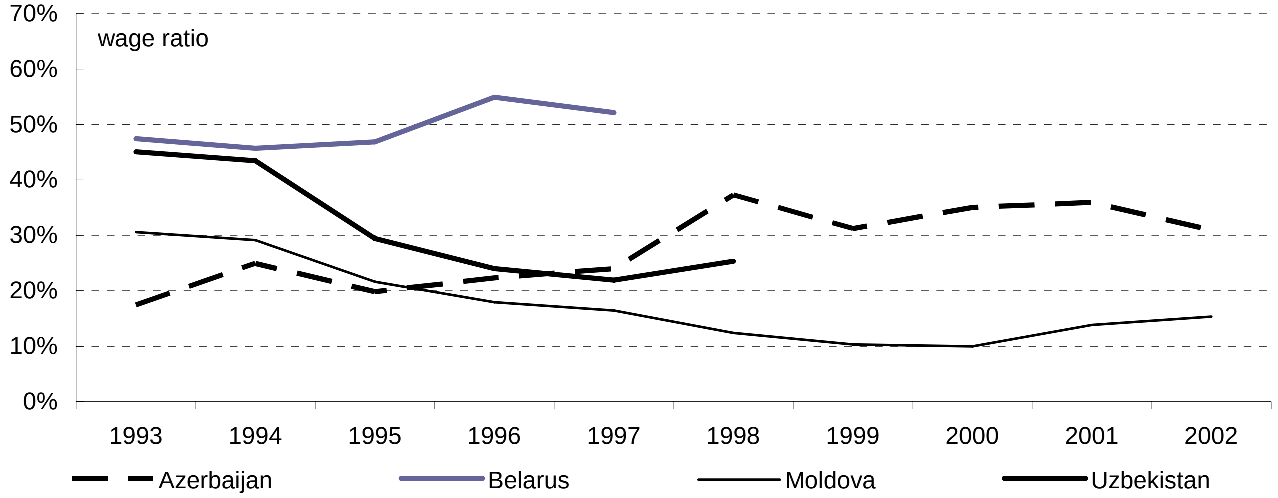
This combination of Soviet-era legacies and transition conditions created major obstacles to much needed enterprise and labor market restructuring, particularly in such sectors as mining, metallurgy, and machine building. The large scale creation of new workplaces and retraining of the labor force were postponed for almost a decade in these sectors. Without vibrant new enterprises to provide employment, redundant labor moved to the low-productivity service sector, as well as subsistence agriculture and other informal sector activities. Together with the labor hoarding practices of enterprises that chose not to release redundant workers, these sectors served as shock absorbers for the losers of transition – particularly in light of the absence of well functioning social policy.

[2] Ruslan Yemtsov, "Labor Markets, Inequality and Poverty in Georgia." World Bank Discussion Paper No. 251.

Labor markets in the CIS countries continue to have relatively low demand for skilled labor, as low wages and unfriendly business climates discourage investment in labor-saving equipment, the operation of which requires more qualified personnel. In addition, the rate of technical and organizational enterprise restructuring is relatively low[3]. Education systems have not responded well to the challenges of re-profiling workers, as fiscal pressures have limited expenditures on education, and educational institutions have not undergone deep reforms. Part-time employment is less common in CIS countries than in the new EU member states, indicating less labor market flexibility and smaller opportunities for women and others with important household responsibilities.

Despite these problems, considerable reallocation of labor has taken place across sectors, with large increases in employment in services and declines in manufacturing. The agricultural sector has become increasingly important in some CIS countries such as Georgia, Armenia, and Kyrgyzstan. Wage dispersion has increased, as market forces are better reflecting premiums for higher skills and productivity. As Figure 1 shows, average wages in agriculture have dropped compared to averages wage in the financial sector. Wage dispersion is smaller in CEE (Central Eastern European) countries (EBRD 2003).

Figure 1. Ratio of average wage in agriculture to average wage in financial services for selected CIS countries, 1993–2002



Source: ILO statistics, authors calculations

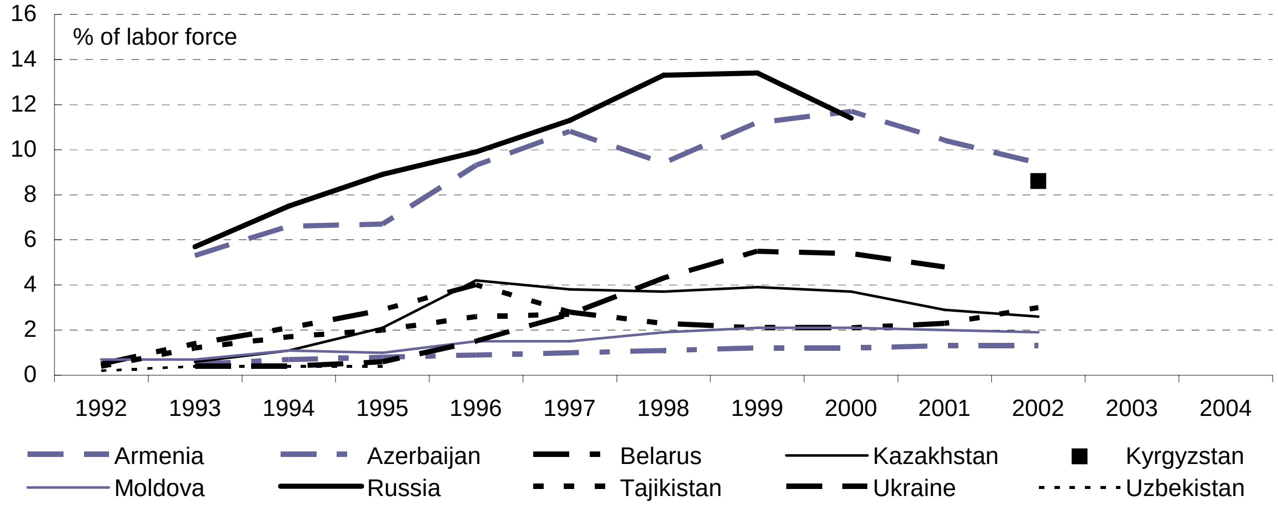
3. Unemployment in CIS countries

One of the most surprising features of transition in the CIS economies is that the large declines in GDP in the 1990s and the strong economic recovery in GDP after the 1998 Russian financial crisis did not result in corresponding changes in employment. Much smaller economic slowdowns in the new EU member states resulted in much larger increase in unemployment than in the CIS countries (see Table 1). During the period of 1990-1994 the unweighted average annual decline in GDP in the CIS countries was around 11%, while the decline in employment was only 1% (com-

[3] Export growth and use of new technologies is much lower in surveyed Russian firms compare to Hungarian and Romanian firms. EBRD Transition Report 2000 pp. 118.

pared to the 3% and 4% declines, respectively, in CEE[4] countries) (see also Nesporova, 2002). During the 1994-1998 and 1998-2004 periods these figures were (-0.2%, -0.3%) and (+4.5%, +0.3%) respectively. Only CIS countries that experienced military conflict, such as Armenia, Georgia, and Moldova, experienced sharp declines in employment.

Figure 2. Official unemployment as % of labor force in CIS countries



Source: World Development Indicators, World Bank.

The CIS countries have since the beginning of transition reported low unemployment rates, particularly when measured by the number of unemployed registered at state unemployment offices (which are generally under 5%). Because the benefits that can be received by those registering as unemployed are quite small, or because the long-term unemployed eventually lose their eligibility for benefits, many people who are without work do not bother to register at unemployment offices. These rates therefore significantly understate unemployment, compared to the internationally used ILO definition (which is based on labor force survey data). As country tables demonstrate, unemployment rates are in the 7 to 16 per cent range when the ILO definition is used. However, these rates do not reflect underemployment and hidden unemployment, consisting of individuals who work less than desired, work for no compensation, or who are on administrative forced leave. In addition, neither definition of unemployment takes into account discouraged workers and others who are no longer looking for a job. In some CIS countries such as Tajikistan the economically inactive constitute about 30% of the working age population (Komilov 2002, pp. 4)

The restrictions at the labor market resulted in the phenomenon unique to the CIS transition: underemployment and unofficial unemployment, the situation when people were officially employed by an enterprise, but were working only couple of hours a week or were on administrative leave without pay. If the numbers of underemployed and unofficially unemployed are taken into consideration, unemployment rates would increase considerably regardless of which definition is used.

Engagement in the informal sector by those officially listed as unemployed or economically inactive is widespread in CIS countries. This engagement should in theory be captured by the ILO unemployment data, but large differences in estimates of the size of the informal sector suggest

[4] CEE countries include Czech Republic, Hungary, Poland, Slovenia, Slovakia, Estonia, Lithuania, Latvia.

that this may not be the case (see Table 2). Such unofficial employment is an enterprise reaction to dysfunctional labor market regulations. The unofficially employed have no legal protection: they can be hired or fired at any time, without receiving severance pay or social benefits. At the same time, because the wages of the unofficially employed are not subject to taxation, salaries in the informal sector may be significantly higher than what is officially reported (which is often the minimum wage). Higher salaries do not, however, translate into better job security.

Table 2. Shadow economy and shadow employment in FSU and CEE countries

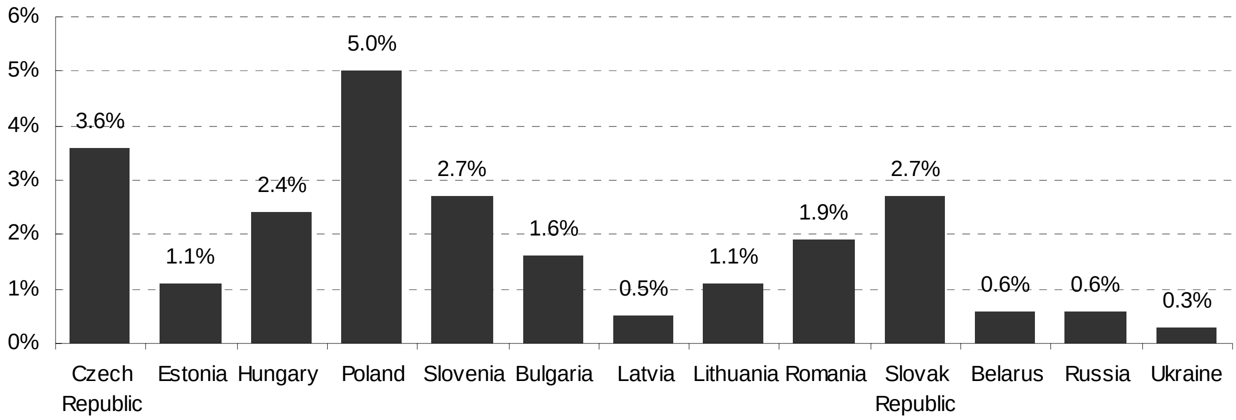
	Electricity method		Dynamic method		Shadow Economy Labor force as % of working age population 1998/99
	Average 1990-1993	Average 1994-1995	Average 1990-1993	Average 2000/01	
CIS					
Armenia	39.4	40.3	40.1	45.3	40.3
Azerbaijan	43.8	59.3	45.1	60.1	50.7
Belarus	34.0	39.1	35.6	47.1	40.9
Georgia	43.6	63.0	45.1	66.1	53.2
Kazakhstan	32.2	34.2	31.9	42.2	33.6
Kyrgyzstan	34.1	37.2	35.2	39.4	29.4
Moldavia	29.1	37.7	29.3	44.1	35.1
Russia	27.0	41.0	27.8	45.1	40.9
Ukraine	38.4	47.3	29.4	51.2	41.2
Uzbekistan	20.3	28.0	22.1	33.4	33.2
Unweighted Average CIS countries	*34.2*	*42.7*	*34.2*	*47.4*	*39.9*
Baltic States					
Estonia	33.9	38.5	34.3	39.1	33.4
Latvia	24.3	34.8	25.7	39.6	29.6
Lithuania	26.0	25.2	26.0	29.4	20.3
Unweighted Average Baltic countries	*28.1*	*32.8*	*28.7*	*36.0*	*27.8*
CEE countries					
Bulgaria	26.3	32.7	27.1	36.4	30.4
Croatia	23.5	28.5	24.6	32.4	27.4
Czech Republic	13.4	14.5	13.1	18.4	12.6
Hungary	20.7	28.4	22.3	24.4	20.9
Macedonia	34.5	40.3	35.6	45.1	35.1
Poland	20.3	13.9	22.3	27.4	20.9
Romania	26.0	28.3	27.3	33.4	24.3
Slovakia	14.2	15.2	15.1	18.3	16.3
Slovenia	22.4	23.9	22.9	26.7	21.6
Unweighted Average: CEE countries	*22.4*	*25.1*	*23.4*	*29.2*	*23.3*

Source: Friedrich Schneider2002, authors' calculations.

Unemployment rates tend to be especially high among young people. Youth unemployment rates are estimated to be twice as high as for the rest of the population in Belarus, Georgia, Armenia, Tajikistan, and Kyrgyzstan. Older, highly educated women who lost their jobs and can find new ones only with extreme difficulty are a particularly vulnerable group, as employers consider them variously as overqualified or as inflexible and incapable of acquiring new skills (ILO 1999). For this and other reasons, unemployment rates for women are generally higher than those reported for men in CIS countries (at least, in those CIS countries that disaggregate their unemployment data by gender). The higher unemployment (and lower labor force participation) rates for women that took hold in most CIS countries, combined with cutbacks in the social services on which women have traditionally relied strongly (e.g., child care, maternity leave), are at the heart of concerns about the gender dimensions of transition.

However, there are some differences in the composition of the unemployed among CIS countries. Persons with higher education constitute relatively small shares of the unemployed in the countries of Central Asia, where the supply of highly educated people is lower than in other CIS countries. By contrast, workers with higher education are over-represented among registered unemployed in Ukraine. Not only is there an over supply of persons with higher education, but due to the education system's inability to respond properly to new demands for skills, these nominally educated people lack appropriate training for the labor market. Unemployment in CIS countries is also characterized by pronounced sub-national disparities. Urban areas and especially capital cities report much lower unemployment rates than do rural areas, which is a major cause of continuing out-migration (particularly by young men) from the post-Soviet countryside.

Figure 3. Average 1991-1995 Non-Employment benefits[5] as % of GDP



Source: M. Orenstein and E. Willkens, 2001.

4. Labor law and labor market institutions

As with other markets, the effective functioning of labor markets can be undermined by monopolistic power of enterprises or workers, asymmetric information, unfair labor practices, or ill-advised legal or administrative regulations. The need for labor market legislation to protect workers from discrimination by employers, and to ensure that workers receive compensation according to their qualifications, is widely recognized within the CIS (Denisova et al., 1998). The fact that well intended but counter-productive labor market protection can harm both workers and employers is regrettably less well understood. Examples of such counter-productive protection of workers' rights (inherited from the Soviet labor code) in CIS countries at the start of transition included large severance payments for redundant workers, strong roles for labor unions (many of which are the successors of communist era "transition belts") in hiring and firing procedures, high social security and other labor taxes, and extensive reporting requirements ("paper trails") for each worker hired (see Knob, 1998). For many companies, observance of these regulations was not profitable, and workers who would be hired officially if labor market regulation was more liberal were deprived of job opportunities in the official economy. Widespread avoidance of existing labor market regulation

[5] These include unemployment benefits, social assistance, early retirement, disability pensions, and sickness benefits.

and social protection systems, large informal labor markets, and large wage arrears, were the inevitable by-products of these regulations.

Labor codes in all the CIS countries therefore had to be liberalized, in order to meet the requirements of a market economy. This liberalization has been extremely controversial however; and this controversy has slowed the implementation of market-friendly systems of labor relations. At the end of 2003, five CIS countries (Belarus, Moldova, Tajikistan, Turkmenistan, and Uzbekistan) still retained centrally planned wage setting (EBRD 2003). The other countries abandoned centralized wage setting systems, and replaced them with new arrangements that generally favored decentralized plant-level negotiations.[6] These arrangements include individual labor contracts, reductions in the obstacles to hiring and firing procedures, as well as reductions in unemployment protection. Only three countries (Azerbaijan, Russia, and Kyrgyzstan) adopted new labor codes to do this; other countries amended the Soviet labor code.

Minimum wages are still used as a base wage in remuneration system prevailing in the state sectors. Unlike in the new EU member states, minimum wages are generally set at very low levels, lower than officially calculated subsistence minima. As such, they do not serve as a binding constraint on labor markets and the resulting in high wage differentials. In the mid-1990s, the ratio of minimum wage to average wage in Russia and Ukraine was under 1/10 while this ratio was 4/10 on average in CEE states. By this measure wage setting is the most decentralized in Russia, Ukraine, and Kyrgyzstan (Brainerd 2000).

5. Role of trade unions

In the Soviet Union ("the state of workers and peasants"), trade unions were a tool of labor market planning and policy. They were charged with administering enterprises welfare benefits, and (tamely) bargaining with management in matters of benefits, training, and health and safety. Many of these unions did not adjust particularly well to the new circumstances of transition, in which enterprise privatization, price liberalization, unemployment, and wage arrears became key issues.

All the CIS countries' constitutions except for Turkmenistan guarantee the rights of workers to form labor unions.[7] The most important trade unions in CIS countries are generally the successors of the former Soviet labor unions, although independent trade unions have appeared in eight of the 12 CIS countries (based on US Department of State reports, 2004). With the exception of government employees and military personnel, workers in CIS countries generally have a right to strike, and can engage in collective bargaining with enterprises and/or the state. In most countries, unionized workers are protected from discrimination by law. However, extensive anecdotal evidence suggests that state harassment of independent trade union representatives occurs in at least some CIS countries.

[6] By contrast, more centralized systems of tripartite collective bargaining were established in most of the new EU member states.

[7] Even Turkmenistan's labor market legislation does not directly prohibit the existence of trade unions.

Trade unions under the Soviet system enjoyed important *de jure* roles in enterprise hiring and firing processes. Although these strong *de jure* roles have remained in force in most CIS countries, the practical role of independent and other trade unions generally differs significantly from what is defined by law, and in most CIS countries is marginal. The development of the union movement has also been hampered by rivalry between the old unions and new independent ones. In contrast to new EU member states, the successors to the Soviet-era trade unions have generally remained dominant in the CIS countries, in many cases working hand in hand with the governments just like in the old times. This trend is particularly pronounced in Central Asia and the Caucasus.

6. Labor migration

Differences in labor market conditions, income levels, and demographic trends are generating significant labor migrations in CIS countries, both within and outside of the CIS region. Countries with relatively high unemployment rates, relatively low wages and incomes, or rapid labor force growth (i.e., the countries of Central Asia, the Caucasus, and Moldova) are experiencing out-migration, while the Russian Federation and (to a smaller extent) Kazakhstan and Ukraine benefit from in-migration. Poor economic conditions and unfavorable employment prospects are the most frequently cited reason for working abroad, according to survey respondents from out-migration countries. Migrants to Russia, Ukraine, and Kazakhstan benefit from these countries' large informal labor markets, relatively high wages, intra-CIS visa-free travel,[8] and growing labor shortages (due in part to demographic factors). Migrants tend to take jobs in such sectors as construction, metallurgy, sale of fruits and vegetables, agriculture, and catering.

While migration helps balance labor markets in the receiving countries, it can also contribute to the displacement of domestic workers, the expansion of shadow economy, and the criminalization of business. Since migrants can be among the most productive and mobile constituents of their home countries' labor forces, out-migration may be a brain drain for the poorest CIS economies. It may also magnify gender imbalances in the countries of origin, as young men tend to be over-represented in migration flows. HIV and other sexually transmitted diseases are known to be spread by migrants as well. Because most of the labor migration within and outside of the CIS is unofficial, it is too often associated with human trafficking and other human rights violations. While young women are particularly likely to suffer from the criminalization of migration flows, children and others are also victims of trafficking.

On the other hand, countries of origin benefit from labor incomes and remittances sent home by migrants. According to one estimate, remittances in Armenia constituted some 10% of household incomes in 1999, amounting to $122 million (Yeghiazaryan 2003). In addition to supporting

8 While the CIS was originally conceived of as a visa-free zone for the citizens of CIS countries, some formal and informal exceptions to this principle have emerged. The Russian Federation's 2001 introduction of visa requirements for citizens of Georgia is one such example. The government of Uzbekistan's decision to mine portions of its borders with neighboring Tajikistan and Kyrgyzstan in 1999, following armed incursions of the Afghanistan-based Islamic Movement of Uzbekistan through Tajikistan and Kyrgyzstan, is another example of barriers to the free movements of labor within the CIS.

consumption and living standards directly, remittances and other incomes earned in migration can provide working capital and sometimes investment capital for country of origin companies. Also, half of Armenia's foreign direct investment in 1999 is estimated to have come from diaspora members (Yeghiazaryan 2003). In this sense, migration in CIS countries (and their associated diasporas) may be able to play the role performed by expatriates from the new EU member states during these countries' transitions, as facilitators of trade and providers of capital, expertise, and in-kind development know how. The further deregulation of domestic labor and housing markets and the maintenance of visa-free intra-CIS travel, combined with enforcement of legislation called for under the Palermo Treaty to protect vulnerable individuals and groups against egregious exploitation and the expansion of formal inter-state labor exchanges, could ameliorate the worst of the intra-CIS trafficking problems.

7. Major differences with Central and Eastern Europe – comparative advantages or disadvantages for CIS countries?

Comparisons of labor market trends in the CIS and new EU member states can be particularly valuable for the European CIS countries. Policy makers, citizens, and workers from these countries can visit their neighbors and compare conditions there with those at home. This proximity has also resulted in the large informal migration flows to these countries that have been observed during the last decade.

Table 3. Real wage trends in CIS countries and new EU member states since 1989

	1989	1991	1993	1995	1997	1999	2001	2002	2003
CEE countries									
Bulgaria	100	64	78	60	39	51	51	51	
Czech Republic	100	69	79	93	103	108	115	120	
Estonia			102	120	132	150	169	183	
Hungary	100	97	98	92	93	99	111		
Latvia		68	49	55	58	63	68	72	
Lithuania	100	78	33	40	48	57	56	57	
Poland			100	104	117	127	131	134	
Romania		85	64	74	64	62	71	72	
Slovakia	100	67	71	76	87	86	82	90	
Slovenia	100	57	62	67	73	76	80	82	
CIS countries									
Armenia	100	51	6	5	7	9	11	14	15
Azerbaijan	100	80	44	14	26	37	50	60	71
Georgia	100	73	15	12	24	31	40	45	0
Kazakhstan		83	34	23	25	30	36	43	45
Kyrgyzstan	100	82	28	21	24	24	26	30	33
Moldova	100	96	41	25	28	26	32	39	47
Russia	100	76	33	36	54	34	52	57	63
Tajikistan	100	88	17	5	4	6	7	9	12
Ukraine	100	108	47	44	41	38	46	56	63
Uzbekistan	100	91	100	133	165	240			

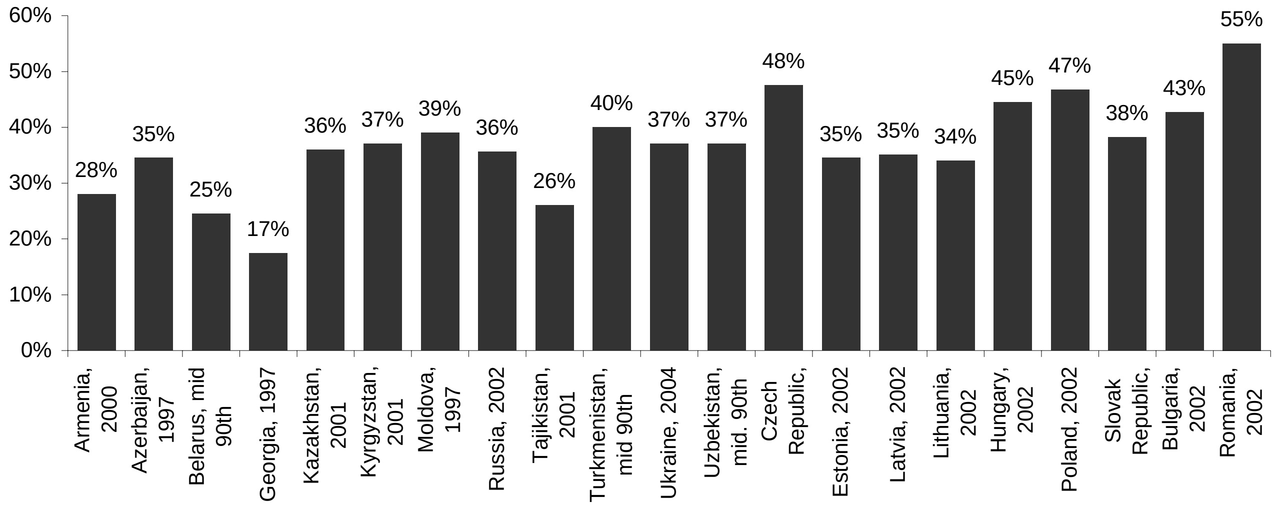
Source: Economic Survey of Europe, 2004, national sources, authors' calculations.

One key difference concerns the way labor markets adjusted to economic downturn and the transition process. Contrary to the CIS countries, unemployment rates in new member states rose dramatically at the beginning of transition, and even now remain higher than in most of CIS countries. For example, unemployment rates in Poland and Slovakia in 2004 were around 18-19%.

These rates are comparable only to that of Georgia, which has been a post-conflict zone for the past decade. Real wage trends also reflect these different adjustment patterns: real wages in the new EU member states countries did not declined as dramatically in the early 1990s as they did in CIS countries. In most of the new member states, average real wages did not drop below 50% of their 1989 levels, and are now at or above 1989 levels (see Table 3).[9] By contrast, real wages in the CIS countries underwent much more dramatic declines in the 1990s, and remain below pre-transition level in all countries.

This difference reflects a greater willingness on the part of policy makers in the new EU member states to introduce hard budget constraints for enterprises and force labor market restructuring. The rapid growth in new private companies in the new member states, and the greater emphasis on efficiency for state-owned (and parastatal) companies, led to higher unemployment rates, but also made possible the rapid increases in labor productivity that underpinned the economic expansions and the strong income growth for workers and managers able to take advantage of the new market conditions. The new member states' geographic proximity to incumbent EU countries, as well as the relative unimportance (compared to the CIS economies) of company towns, afforded workers mobility and opportunities not present in most CIS countries. While unemployment rates in many new EU member states are above both EU averages and the rates posted in the CIS countries, others – including Hungary, the Czech Republic, and Estonia – report unemployment rates that are well below these levels.[10]

Figure 4. Social security tax rates as % of gross wages



Source: European commission "Social protection in the 13 candidate countries", World Bank.[11]

Differences in labor market and social policy models are also apparent between the CIS and new EU member states. The requirements of EU accession, and the relatively large shares of GDP that are redistributed through the public sector, naturally pushed the new member states toward

[9] Pre-transition real wage levels are problematic baselines for comparison, due to the shortages pressures and generally poorer quality of the goods that could be purchased with these wages under central planning.

[10] Unemployment rates in the Western Balkans, by contrast, are well above the rate posted even in Slovakia and Poland.

[11] http://lnweb18.worldbank.org/eca/eca.nsf/0/84bcf033ac636f0885256a940073f4e7?OpenDocument.

adopting the European labor market model. In contrast to the CIS countries (although not necessarily the other EU members), the new member states chose to maintain relatively high levels of worker and social protection. They allocate 2-5 percent of their GDP to unemployment insurance, social assistance, and sickness benefits, compared to less than 1 percent of (generally much smaller) GDP for most CIS countries (see Figure 4). This is despite the fact that average replacement ratios (social benefits received relative to social security payments) are higher in the CIS countries than in the new member states (M. Orenstein and E. Wilkens, 2001). At the same time, labor market realities in the new EU member states are in many respects closer to those in the CIS countries than incumbent EU countries. Workers in Central Europe and the Baltic states are more likely to work in the informal sector, and are less likely to be covered by nominal social protection schemes, than are workers in Western Europe.

It is easy to unfavorably contrast labor market performance in the CIS countries with their neighbors across the EU border. On the other hand, the extensive de facto labor market deregulation that has taken hold in many CIS economies is generating the labor market flexibility needed to support their economic recoveries. While the CIS economies' investment and business climates seem difficult by any standards (see section 3.4), few companies report practical difficulties with militant trade unions, or in hiring and firing workers. The CIS economies' large informal labor markets may deprive workers of "rights" guaranteed by law, but they also offer opportunities for those who are willing to work for wages and in conditions that the market will bear. In this respect, the CIS economies may not compare so unfavorably with at least some of the new member states, where more centralized wage setting and stronger union presences limit labor market flexibility and may be a disincentive for investors.

8. Key conclusions and policy recommendations

The transformation of labor markets is not complete in any of the CIS countries; most of the problems that prevailed in the early 1990s remain. These include:

- Continued centralized wage setting in five CIS countries – Belarus, Moldova, Tajikistan, Turkmenistan, and Uzbekistan. The reintroduction of such controls is periodically discussed by policy makers in the other CIS countries.
- Extensive unemployment and underemployment, much of which is hidden.
- Ineffective systems of labor relations and social protection, which generate extensive informal sector employment and the concomitant problems of abuse of social benefit systems, workers' rights, and illegal labor migration.
- Large mismatches between the labor market skills supplied by outdated education systems on the one hand, and the skills demanded by new market economies on the other. This is especially the case in the towns and regions whose economies are dominated by a single (or small number of) enterprise(s).

- Inadequate official labor market data. Although the quality of these data has improved since the beginning of the transition, in most CIS countries they do not provide adequate pictures of labor market trends.

Fortunately, the strong economic growth experienced by most CIS countries since 1999 has increased the demand for labor and is putting downward pressures on unemployment rates. This offers a window of opportunity for policy makers seeking to further transform labor markets, and to modernize labor relations and social protection systems. The above analysis suggests the following policy recommendations:

First, labor market reform in any CIS country requires improvements in the quality and quantity of labor statistics, based on the international standards. Government institutions should build the capacity needed to collect such statistics on a regular basis. These data should be available to the public and to independent researchers, in order to improve the quality of labor market monitoring and analysis.

Second, steps need to be taken to increase the effectiveness of the institutional mechanisms for supporting redundant workers, with time-bound unemployment benefits tapering to social assistance. In most new EU member states, unemployment benefits are only provided for six months after the loss of employment; thereafter other forms of social protection come into the picture. More broadly, policy makers need to find better solutions to the trade-offs between preventing the unemployed from falling in to poverty on the one hand, while strengthening the incentives for the unemployed (particularly the long-term unemployed) to adopt proactive labor market strategies and avoid poverty traps on the other. The expanded use of partnerships with the private sector, and greater reliance on employment-related civil society organizations, could help reduce the costs of these trade-offs.

Third, rates of payroll and other taxes on wages should be reduced, in order to reduce the incentives for informal sector employment while simultaneously increasing net pay for workers. Reductions in payroll tax rates might appear to be inconsistent with the recommendation to increase unemployment and other social benefits. However, the Russian and Ukrainian experience with reducing personal income and payroll tax rates demonstrates that, when done correctly, cuts in tax rates can be more than offset by growth in the tax base.

Fourth, new labor codes should be introduced in those CIS countries that have not already done so. These new codes should align *de jure* worker and social protection systems with what employers and states in CIS countries can afford, in order to reduce the size of the informal sector and thereby increase the extent of effective social and worker protection. Simpler, more market friendly labor codes will make labor relations more internally consistent, and therefore easier to enforce.

Fifth, governments should invest more in human capital by increasing spending on education and health, in order to prevent the further erosion of the skilled labor force. Education systems should be reformed, in order to better align curricula and skills with the demands of the new market economies.

Last but not least, measures to facilitate the movement of workers across countries and within countries should be introduced. The further deregulation of domestic labor and housing markets and the maintenance of visa-free intra-CIS travel, combined with enforcement of legislation called for under the Palermo Treaty to protect vulnerable individuals and groups against egregious exploitation and the expansion of formal inter-state labor exchanges, could ameliorate the worst of the intra-CIS trafficking problems.

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