

# MONITORING OF RUSSIA'S ECONOMIC OUTLOOK:

## TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

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MAIN TRENDS AND CONCLUSIONS.....	3
1. FINANCIAL PERFORMANCE OF THE BANKING SECTOR IN 2019 S. Zubov.....	5
2. RUSSIAN INDUSTRIAL SECTOR IN JANUARY 2020 S. Tsukhlo.....	8
3. DIGITALIZATION OF THE STATE: TRAPS AND PERSPECTIVES E. Dobrolyubova.....	10
4. UNDERUTILIZATION OF LABOR RESOURCES: GROWTH OF POTENTIAL WORKFORCE V. Lyashok.....	14
5. EMPLOYMENT PROMOTION IN RURAL AREAS: HOW CAN THE STATE PROGRAM BE PROPERLY ADJUSTED? N. Shagaida, A. Potapova.....	17
AUTHORS.....	21

## Monitoring of Russia's Economic Outlook

**Monitoring** has been written by experts of Gaidar Institute for Economic Policy (Gaidar Institute) and Russian Presidential Academy of National Economy and Public Administration (RANEPA).

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## MAIN TRENDS AND CONCLUSIONS

Having assessed the financial results attained by Russia's banking sector in 2019, experts point out a considerable increase in its profitability. Among the main factors behind this rise in profitability, they highlight the considerable drop in credit risk and the introduction of a new procedure for loan loss accounting. As of 1 January 2020, 373 lending institutions were in the green (their profits amounting to almost Rb 2.2 trillion), while only 69 banks were in the red (with their losses amounting to less than Rb 160bn). **On the whole, the percentage of loss-making institutions declined, last year, to 16% (vs 29% in 2018).** It should be noted that the level of capital adequacy was quite acceptable, while the credit adequacy of the small banks was much higher than the norm. **The banking sector as a whole operated in against the backdrop of liquidity surplus.**

**In continuation with the established trend, the source of growth in lending was the retail segment,** which grew throughout the year by 22.4% (vs by 18.5% in 2018), while growth in corporate lending decreased from 10.5% in 2018 to 1.2% in 2019. It is noteworthy that, for the first time in recent years, the effectiveness of retail lending surpassed that of corporate lending. Over the course of last year, growth in the interest income from retail loans amounted to 15.5%, climbing to Rb 2.2 trillion, while growth in the interest income from corporate loans increased by a mere 2.2%, to Rb 2.1 trillion (in 2018, the interest income from corporate loans had even slid into red zone). It can be expected that in the current year the situation in the field of retail lending can become less dynamic than previously due to the RF Central Bank's measures designed to restrict the growth rate in this market segment. As far as **arrears to banks** are concerned, their share in the banks' loan portfolio slightly reduced over the course of last year, from 5.1% to 4.3% as of 1 January 2020.

The business surveys of industrial enterprises carried out by the Gaidar Institute's experts indicate that January 2020 saw a continuation of the steady decline in demand, which in its turn hampered output growth. At the same time, **producers remain moderately optimistic about future growth and the rate of output.** Moreover, the assessment, by respondent enterprises, of their stocks of finished products also visibly improved. Thus, as recently as December 2019, the proportion of enterprises that believed that their stocks of such products were excessively high was very significant, whereas in January 2020, 76% of enterprises characterized them as 'normal' (which represents an all-time high since the survey's inception in 1992). Finally, for the third quarter in a row, **the respondent industrialists noted a skilled labor shortage, which can be attributed to their optimistic demand growth expectations.**

The experts who have analyzed the Federal Project *Digital Public Administration* have come to the conclusion that the system of its targets, indicators and results does not always make it possible to assess the final effects of its implementation from the point of view of citizens, businesses, and the State itself. Although Russia holds relatively high positions in the relevant global rankings (the introduction of digital technologies into public administration, the Global Cybersecurity Index, the UN E-Government Development Index, etc.), the positions in such rankings are prone to radical changes. And it should be noted that some of the changes in Russia's ranking positions are notably negative.

According to the said experts, the Federal Project's indicators so far have not been able to measure the final results of digital transformation (that is, the improvement of the quality of public services or administrative decisions), but instead simply point to the fact that one's interaction with the State (and the interaction between government agencies) has been converted into electronic mode, which does not, in itself, guarantee either time saving or any drop in costs. Therefore, in this case, the main risk associated with the public sector's accelerated digitalization is that it may become an end in itself, instead of becoming a means to achieve a breakthrough in the quality of public administration.

Having analyzed the situation in the labor market, including from the point of view of unemployment, our experts point out that **the rate of unemployment in the Russian Federation has been on the decline for years** (as of the beginning of 2019 it amounted to 4.6%, having dropped by 0.2 p.p. over the course of the previous year). Although differences among Russia's regions are huge in this respect, this index for the country as a whole is lower than in most European states. It should be noted that **the composition of unemployment displays positive dynamics**: the proportion of the unemployed who have been seeking employment for more than 12 months declined from 28.5% in 2018 to 23.8% in 2019, while the average duration of a job search decreased by 0.5 month.

In Russian statistics, the unemployment rate calculated in accordance with the International Labor Organization's methodology represents the main indicator of underutilization of labor resources. However, the application of a single criterion cannot improve our understanding of the situation in the labor market. Therefore, since 2015, in order to increase the accuracy of its estimates of the underutilization of labor resources, the Russian Federal State Statistics Service (Rosstat) has been publishing data on the size of the so-called **potential workforce**, i.e. the number of persons that are ready to work but are not actively seeking employment (these constitute 95% of persons belonging to the afore-said category (including those who, judging from their own experience, believe it to be impossible, in principle, for them to find a job), and 5% of those who are seeking employment but are not ready to embark on it immediately). The size of the potential workforce was estimated, in 2014, at 1.3 million persons; by 2018, it dropped to 1.1 million, and increased to 1.5–1.7 million in 2019. Experts have come to the conclusion that the labor market has been undergoing some rather complex but definite changes. In particular, the decrease in the official unemployment rate in 2019 took place not only due to the decline in the duration of seeking employment among the unemployed, but also due to the 'squeezing out' of the labor market of some of those persons who had been seeking employment for more than 12 months.

Our experts have analyzed the **State Program Comprehensive Development of Rural Areas** from the point of view of rural human resource development. From the said State Program, it transpires that the allocation of state subsidies to cover the costs of employers who intend to train specialists needed by the agrarian sector incurred by them in the course of such training is expected to help achieve the target of increasing, by the year 2025, the employment rate of able-bodied rural residents. However, the analysis of the Program carried out by our researchers has brought them to the conclusion that it is capable only of partially improving the existing mechanisms, which raises serious doubts as to the actual possibility of achieving the set targets. Therefore, they recommend the introduction of a number of apparently sound changes regarding contractual relationships in the field of education and training. They have also composed a list of costs to be refunded through state subsidies, and suggested a number of guarantees to be granted to employers. 

# 1. FINANCIAL PERFORMANCE OF THE BANKING SECTOR IN 2019

S. Zubov

Return on assets of the Russian banks at 2019-end has significantly increased despite a slide in bank margin and slowdown of lending growth rates. This fact was due to both credit risk mitigation and putting in operation of a new procedure for loan loss accounting. In 2019 as a whole, bank assets' growth rates have decreased.

At 2019-end, **Russian banking sector numbered 442 lending institutions**. A year earlier their number hit 484. To compare, seven years ago in early 2013, the number of operational lending institutions exceeded one thousand (1094). Thus, the RF CB conducts successive bank resolution.

As of January 1, 2020, 373 lending institutions' profit hit Rb 2,196.4bn and losses of 69 banks amounted to Rb 159.6bn. On the whole, **the share of loss-making institutions in 2019 down to 16% (vs 29% in 2018)**.

**Capital adequacy**<sup>1</sup> stands at the acceptable level: the capital adequacy ratio in the banking sector as a whole stands at 12.4% (the critical capital adequacy ratio stands at 10%). Small lending institutions outside of the Top-200 regarding the amount of total assets are more resilient on this indicator, which comes to 29.7%.

The banking sector continues operating against the backdrop of **liquidity surplus**. The majority of the lending institutions comply with liquidity requirements<sup>2</sup> by wide margins (300-500%)

In 2019, **assets of the lending institutions** went up 2.7% (in 2018, up 10.4%), and **own assets** up 7.6% (in 2018, up 3.8%).

As a year before, retail sales were the source of the **bank lending** growth. **Growth rates of the consumer lending generally correspond to the 2018 index and still considerably outstrip corporate lending**: over the year, growth amounted to 22.4% (vs 18.5% seen in 2018). Corporate lending growth has slowed down to 1.2% against 10.5% seen in 2018.

Therefore, the debt burden index<sup>3</sup> introduced by the Central Bank on October 1, 2019 did not significantly affect the consumer lending and most likely back-

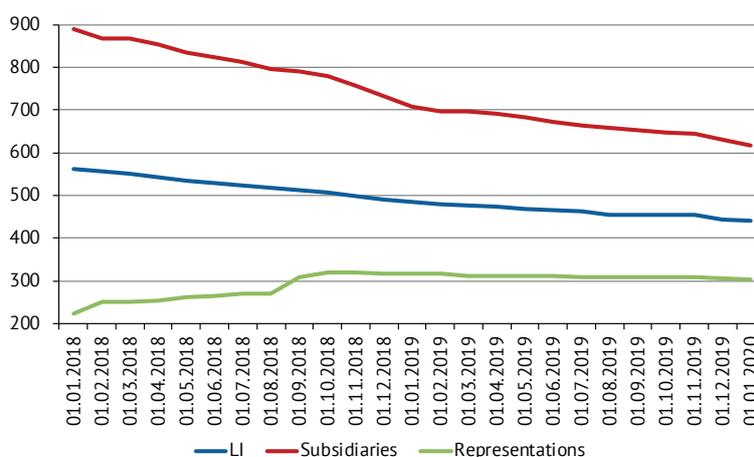


Fig. 1. Number of lending institutions, subsidiaries, and representations

Source: Bank of Russia.

1 Indicator reflecting sustainability of lending institution and fully operate amid potential risks.

2 The RF CB instructs compliance with three liquidity norms: quick liquidity, current, and long-term (according to the Instruction 199-И).

3 Debt burden ratio (DBR) is the burden of all liabilities to income.

fired: due to an increased burden on the capitals of Russian lending institutions, banks decreased lending to other less profitable segments (corporate lending). The majority of broad-based lending institutions were ready for changes and timely introduced the CB recommendations into their methodologies on assessment of solvency of their clients and went on increasing their retail lending portfolios.

**For the first time in recent years, the effectiveness of retail lending surpassed that of corporate lending.** The yield on retail lending in 2019 hit 15.5% and amounted to Rb 2.2 trillion, the yield on corporate lending went up 2.2% (in 2018, down 6.4%), amounting to Rb 2.2 trillion. This was achieved due to growth of the consumer lending and mortgages with interest above those in corporate lending. However, indexes seen in the retail lending in 2020 can decrease due to the CB measures designed to restrict the growth rates in the retail lending segment.

In 2019, **loan arrears** of non-financial institutions went up by 25.1%, however, this was brought about by technical factors, i.e. overdue accounts receivable and past-due debt interests (operations on purchase and assignment of receivables) were included in this index starting from 2019. In 2019, growth of past due debt on retail loans came to 0.5%. Despite absolute past due debt growth, its share in the credit portfolio of banks decreased to 4.3% as of January 1, 2020 (5.1% as of January 1, 2019).

Against the backdrop of lending growth, volumes of **attracted funds** demonstrate weak dynamic. Despite the reduction of deposit interest rates, banks managed to build up retail deposits by 7.3%, which is barely below the 2018 index (8.9%). Whereby, growth is partially due to capitalization of interest on deposits. Total increase of deposits as whole leads to a slowdown of net interest profit growth due to a relatively high cost of this type of bank liabilities.

The situation with **corporate deposits** is somehow different. The total volume of deposits and funds on corporate deposits in 2019 went up by 4.6% (in 2018, up 29.3%).

Over the last year, **banking profit** increase by 51.5% (over the previous year it went up by 70.3%) and amounted to Rb 2.0 trillion. A number of technical and onetime factors affect profit dynamic. In particular, among them stands income in the amount of Rb 0.4 trillion obtained from part of adjustments coming from the introduction of a new standard of credit risk assessment.

The RF Central Bank's decisions have contributed to the growth of **Russian banks profitability** even in the context of interest margin reduction, which affects profitability of the banking sector. At the end of 2019, ROA profitability stood at 2.1% and ROE profitability – at 20.3%. At 2018-end, these indicators constituted 1.4 and 12.4%, respectively. Most likely, in the near future bank analysts will include in their practice reserves adjusted profit calculation according to International Accounting Standards. At 2019-end, this indicator demonstrated stable level of bank profitability (13.8 and 13.1%, respectively as of January 1, 2019 and 2020).

Shrinkage of bank margin forces banks to build-up **fee-based income**<sup>1</sup>. In 2019, fee-based income from private corporate loans increased by 72.1% and from retail loans by 227.3%.

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<sup>1</sup> Fee-based income – bank income from clients' operations such as fee for wire transfer, fee for payments, etc.

## 1. Financial Performance of The Banking Sector in 2019

**The RF Central Bank introduces a new approach to the assessment of credit risk** (from 2020 Instruction issued by the Bank of Russia No. 199-И “On Mandatory Ratios and Premiums to Capital Adequacy Ratio with Universal License” is in effect), which will allow to release bank capital and ensure additional resources for lending to the real sector of the economy. The CB new approach envisages calculation of mandatory ratios across contract partners. Instruction No. 199-И sets aside a category of borrows “investment class” with degraded risk ratio of 65% (currently—100%) when identifying them as I and II quality categories to create provisions and admission of listing. This decision should contribute to raise attractiveness of the corporate lending sector for banks.

Taking this into consideration, the Central Bank will continue taking measures aimed at reduction of household debt load, which, in its turn, will lead to **stabilization of financial performance of the banking sector** and insignificant reduction of its profitability. 

## 2. RUSSIAN INDUSTRIAL SECTOR IN JANUARY 2020

S. Tsukhlo

*Downward trend in demand curbs growth of industrial output. At the same time, plans and projections of enterprises still remain optimistic. In the context of personnel shortage businesses put out considerable efforts aimed at keeping their workers and plan to increase employment.*

January 2020 saw a **continuation of demand trend on industrial products** – the balance of sales change adjusted from seasonal and random factors demonstrated a slow downward trend. Over 12 months of 2019, this indicator shed 3.5 points, and in January – another 0.4 points. Sales projections which demonstrated exceptional stability over 11 months of 219 in the range of +3..+4 points, in December declined to +2 points and remained at that level in January 2020. Thus, there were less confidence regarding the future industrial demand.

In January, the industrial sector came to grips with the December upsurge of the surplus of stocks of finished products. Then, the balance of stocks estimate went up hitting 28-month high. Later on, the indicator dropped to the previous value. Furthermore, the absolute majority of producers consider their stocks of finished products as “normal”. In January 2020, such responses were received from 76% of polled enterprises, which is another absolute (all-time high, 1992–2020) maximum.

Further **slowdown of the output growth** became a natural reaction of the industrial sector to a symbolic downward trend in demand and December growth of excessive stocks of finished products. In January, the balance (or in more common terms – growth/decline trend) of actual output declined by another 0.5 point following seasonal and random factors adjustment.

**From July 2019, industrial output plans remain stably optimistic.** This is demonstrated by excess of the balance of plans over the balance of actual output change.

Seasonal and random fluctuations adjustment of estimates of actual and expected price changes revealed a demonstrative **dynamics of growth/decline of the producers' output price** during last 20 months. After May 2018, balance of actual price changes demonstrated a downward trend and in January 2020 hit 1 point. The January absolute decline of the output prices over the last 20 years was observed solely during really crisis for the industrial sector January 2009 (despite high inflation the industrial sector was reducing prices taking into account the fact that the crisis was completely unexpected) and it did not occur in the crisis January 2015 (not all businesses assessed their situation as really crisis-ridden).

Employment policy of the Russian industrial sector for the third quarter in a row has been formed in the context of **personnel shortage**. In such way businesses assess their number of qualified personnel amid their expectations of demand change. To note, these expectation were not so optimistic and demonstrated a downward trend in recent years. From July 2019, the share of responses “insufficient” constantly exceeds responses “more than sufficient” given by the Russian industrial sector. This has not been observed since 2014.

## 2. Russian Industrial Sector in January 2020

In this context the industrial sector tries to keep personnel and has reached certain success: actual dynamic of headcount at the end of 2019 does not look so pessimistic as at the end of 2018, and **January 2020 demonstrated even growth of the number of employed at enterprises**. The second consequence of the personnel shortage is unusually active for the recent years search for new personnel.

Businesses are short of headcount amid surplus of the production capacities. Shortage of industrial capacities was registered during 29 years of our surveys solely in 2007–2008. With onset of the crisis of 2008–2009, the shortage immediately disappeared (it was logically replaced by a significant surplus of industrial capacities) and has not popped up yet.

In January 2020, the surveys registered uncommonly sharp for the recent years **changes in estimates of industrial capacities**. The share of responses “more than sufficient” increased by 11 points on the backs of similar reduction of responses “sufficient.” As a result, the balance of estimates of industrial capacities went up to 15-quarter maximum.

This fact, most likely, was the reason for downgrading by the businesses their investment plans. In early 2020, this balance shed 8 points and fell in “minus” which was negative for the start of the calendar year.

The lowest bank interest rate for corporate borrowers in early 2020 demonstrated downward trend. In January, this indicator dropped to 10.6% per annum, which was another record. Between 2009 and 2015 the corporate bank rate declined to 11.8% at best. 

### 3. DIGITALIZATION OF THE STATE: TRAPS AND PERSPECTIVES

E. Dobrolyubova

*In contrast to the 'digitization' and transfer of 'analog' administrative procedures into the electronic interaction format, digital transformation involves substantial changes in public administration processes that affect all stages of the administrative cycle, as well as the functions and powers of public authorities.*

*The purpose of these changes is to fundamentally improve management quality and the performance and efficiency of government agencies, and to achieve a higher level of elaboration of and substantiation for legislative, regulatory and project-based decision-making. An analysis of the Federal Project Digital Public Administration demonstrates that its system of goals, indicators and results does not always make it possible to assess the extent to which the final effects mentioned above can be achieved.*

#### **International Digital Government Ratings**

Formally, Russia still holds a respectable place in the relevant global ratings. Thus, in 2016, by its index of implementation of digital technologies in public administration, this country, according to the World Bank, was in 18<sup>th</sup> place in the world. As seen by the data released by the International Telecommunication Union (ITU), in 2018 Russia ranked 26<sup>th</sup> by its Global Cybersecurity Index. In the same year, this country was ranked 32<sup>nd</sup> according to the UN E-Government Development Index, and 30<sup>th</sup> in the WASEDA-IAC International Digital Government Rankings.

The position in the rankings can change significantly, and such changes are by no means always for the better. For example, back in 2017, Russia was in the top ten by its Global Cybersecurity Index, and in 2012 and 2014 by its UN E-Government Development Index it was ranked even higher (27<sup>th</sup>) than it is now.

This does not mean that the process of digital transformation of public administration in Russia is currently 'in reverse'. Rather, the problem is that we are still not quite keeping pace with the progress of digital transformation in other countries. Russia lags behind the EU countries in terms of the average indicators of electronic interaction in the provision of public services. Thus, in 2018, 64.3% of citizens in the EU countries, when applying for public services to state bodies, did this via the Internet, while in Russia, only 22% of those who requested state and municipal services sent electronic applications forms.

#### **The issues involved in measuring the results and accounting for the risks**

The measures aimed at public administration digitalization are implemented primarily in the framework of the Federal Project *Digital Public Administration*; over the period until 2024, a total of RUB 235.7bn is earmarked for its implementation from the federal budget alone. The supervisory bodies and the experts specializing in this field pay attention primarily to the slow pace of execution of these budget allocations (overall, according to the Accounts Chamber of the Russian Federation, as of December 28, 2019, the cash execution of the National Program *Digital Economy* amounted to 53.6% of the budget targets<sup>1</sup>). However,

1 URL: <http://audit.gov.ru/audit-national/9508>

### 3. Digitalization of The State: Traps and Perspectives

in our opinion, **the main problem is not the rate of budget spending, but the goal-setting itself – i.e., the final results expected to be achieved through digital transformation of the State.**

An analysis of the Federal Project *Digital Public Administration*, performed by the Public Administration Technologies Center of the IAES RANEPa, shows that its system of goals, indicators and results does not always make it possible to assess the final effects of its implementation from the point of view of all the potential beneficiaries of the project activities: citizens, businesses, the government itself, and state and municipal civil servants. This may have to do not only with the more economical spending of resources by individuals and businesses (the degree of resource saving has not yet been estimated as well), but probably also with the new quality of government function performance. In the meantime, **the federal project implementation indicators are not the final results of digital transformation (for example, the public services quality improvement, or the quality of administrative decision-making), but simply the fact of transfer of the interaction with the state (and the interaction between government bodies) into electronic mode**, which in itself does not guarantee saved time or lower costs. No methodologies for calculating these indicators have been approved as yet.<sup>1</sup>

Besides, the Federal Project does not fully take into account the various risks associated with a forced digitalization of the public sector. Among these risks, there is the possibility that the digitalized personal data and corporate commercial information can be used for marketing or criminal purposes, and that there will be an increase in the number of electronic signature frauds in corporate or real estate transactions.

High risks are also associated with the digitalization of government agencies, which may become a bureaucratic end in itself, and not a means of achieving a breakthrough in the quality of public administration. This can lead to the conservation of some of the existing sore problems in the form of duplication of state information systems and platforms geared to the specific needs of certain government departments, thus translating into their poor integration, lack of relevant data for making proper administrative decisions, and only a formal assessment of achievements instead of a deep analysis of the available data.

#### **The effects of and directions for improving the transformation process**

In order to avoid the situation where the digital transformation of public administration may become an end in itself, it is necessary, in our opinion, to introduce a comprehensive system for monitoring and evaluating the performance and efficiency of digital transformation of public administration, capable of identifying and recording the final effects of this large-scale ramified project. **When assessing the final effects from the point of view of the interests of the individual users, the following aspects should be considered:** changes in the availability and quality of public services; the protection of legal rights and interests of citizens; their increased involvement in state and municipal administration; and the reduced time and money spent on the interaction with the state.

In order to properly assess the changes in the availability and quality of public services, opinion polls are needed that will reflect the citizens' satisfaction with the accessibility and quality of the priority digital public services. It

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1 URL: <https://www.gks.ru/metod/fed-proekt/FP1105.htm>

is also important to give consideration to the relative share of online state and municipal services in the total number of state and municipal services rendered to their users. Today, in actual practice, the results of public services rendered in an electronic form frequently become available to the applicants only in the course of several weeks: this can hardly be recognized as a great achievement in the process of public administration digitalization. In order to access citizen involvement in the process of administrative decision-making, the indicators applied in foreign countries may be used (e.g., OECD OURdata Index (Openness, Usefulness and Re-usability of government data), as well as the data, stored in the government databases, on the number and percentage of citizens involved in the elaboration, monitoring, and performance assessment of government policies, the implementation of government programs and projects, and government measures.

A separate component of monitoring and evaluation should be **the indicators that reflect the level of protection of citizens from the risks discussed above**, which are associated with digital transformation. These include, for example, the percentage of citizens who assess the level of protection of their privacy and personal data as sufficient, and the proportion of citizens who have experienced unauthorized use of their personal data, calculated on the basis of opinion polls; the results of Rosstat's sample studies that reveal the proportion of citizens who do not use the Internet for security reasons; and cybercrime statistics<sup>1</sup>.

**The key effects of digital transformation of public administration for businesses should be as follows:** 1) the emergence of new opportunities for business development, including the use of public platforms and open data; 2) better quality of public services for businesses; 3) higher predictability and transparency of government policies, government regulation, the creation of more convenient and popular formats for interacting with the authorities and promoting the interests of entrepreneurs; 4) institutional and procedural simplification of the protection of legitimate rights and interests of organizations – both an improvement of the pre-trial appeal procedures and the protection of their interests in court; 5) lower risks of property damage and commercial information misuse (including by comparison with the 'analog' interaction practices), and an appropriate level of protection of the rights and legitimate interests of legal entities and individual entrepreneurs in the context of digital transformation.

The digital transformation of public administration, as noted above, should conduce to a measurable increase in the performance of government agencies through improving the quality of administrative decision-making and the speed of interagency cooperation. **A better administrative performance is also achieved thanks to certain specific effects of digital transformation**, such as the reduced administrative costs of the execution of public functions and the provision of public services, higher competitiveness and transparency of government purchases. **The government officials themselves can also become important beneficiaries of digitalization:** digital transformation results in a lower share of routine operations performed by them, in an increased transparency and better quality of their personnel management systems, and in a higher remuneration

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<sup>1</sup> For the detailed proposals concerning the system of indicators applied to assess the effects of digital transformation of public administration for all its beneficiaries, see the monograph by E.I. Dobrolyubova and V.N. Yuzhakova, *Monitoring and Evaluation of the Performance and Efficiency Public Administration Digitalization: Methodological Approaches*, which will be released by Delo Publishing House (RANEPa) in 2020.

### 3. Digitalization of The State: Traps and Perspectives

in the civil service system, thus making it possible for them to focus on their project activities, and creating proper conditions for the employees to acquire new skills and abilities.

It is also important to implement the **performance-based management tools**, which have proved useful in the course of preparing, implementing and evaluating the new digital initiatives in the public sector. Among these successful foreign practices, which could be incorporated in the Federal Project, there are the feasibility studies conducted during the development, approval and implementation of digital initiatives by government agencies (with mandatory assessment of their costs and benefits), as well as the measurement and evaluation of transaction costs (in order to assess the cost of public services (the performance of other public functions)) and the impact of digitalization on this particular parameter. 

## 4. UNDERUTILIZATION OF LABOR RESOURCES: GROWTH OF POTENTIAL WORKFORCE

V. Lyashok

*In the course of four recent years the unemployment level in the Russian Federation is on the decline. However, application of alternative criteria for the estimation of underutilized labor resources demonstrate somewhat different dynamics. In 2019, we observed growth of potential workforce number including those who believe it to be impossible for them to find a job.*

Over the course of several recent years Russia sees a decline in the rate of unemployment. By 2019, it amounted to 4.6% shedding 0.2 pp over a year. Meanwhile, there is a significant regional divide (from 1.5% in Moscow to 26.3% in Ingushetia reported in Q4), however on the average across Russia **the rate of unemployment is lower than in the majority of European countries**. Upward trend has been observed in the composition of jobless: the proportion of the unemployed who have been actively seeking employment for more than 12 months declined from 28.5% in 2018 to 23.8% in 2019, while the average duration of a job search decreased by 0.5 month.

The unemployment rate calculated according to the International Labor Organization's methodology represents the main indicator of underutilization of labor resources. Its dynamics allows to determine the state of the labor market and the economy as a whole, moreover, its monthly update makes it one of the most effective indicators in economic statistics. The application of international methodology allows to make comparison with the majority of countries. However, the application of a single criterion cannot improve our understanding of the situation in the labor market because in the number of cases the borderline between employed and unemployed is rather vague. As a result, there appear certain differences between Rosstat data and public surveys' findings which use other tools for estimation of the number of jobless or different respondents sample<sup>1</sup>.

Not every individual seeking employment is considered to be unemployed according to the ILO methodology. An individual is considered unemployed who has no job but is seeking employment over the last four weeks and who is available for work immediately. Change in criteria can significantly tell on the number of this category. **Since 2015, in order to increase the accuracy of its estimates of the underutilization of labor resources, Rosstat has been releasing data on the size of the so-called potential workforce**, which consists of the following two categories:

- a subset ready to work but are not engaged in an active job search. This category hits 95% of the overall potential workforce;
- a subset who are seeking employment but are not available for work immediately. This category is small – around 5% of the total potential workforce.

<sup>1</sup> VTSIOM estimated the rate of unemployment twice as high as an official one URL: <https://www.rbc.ru/economics/18/12/2017/5a36ca439a79475cee64de28>. Sberbank revealed unemployment growth among the middle class URL: <https://www.rbc.ru/economics/13/02/2020/5e43f9cf9a7947c50823cae5>.

## 4. Underutilization of labor resources: growth of potential workforce

It is envisaged that these categories number surveyed who are ready to work but in current socio-economic conditions refuse to look for a job. On the one hand, this can be due to family reasons, health problems or other individual reasons. On the other hand, such behavior in the labor market is caused by the fact that the individual judging from his/her personal experience believes it to be impossible to find a job. As a result, there forms a **category of the so-called discouraged workers**, judging by its dynamics one can indirectly estimate the barriers to entry in the labor market.

Finally, Rosstat on the basis of sample surveys of workforce separates another category – a subset ready to work but not engaged in an active job search and not available for work immediately. By contrast with potential workforce, respondents from this category are not ready to work in the near future. That is why this category only marginally can be considered part of underutilized labor resources although from common point of view its representatives can be considered unemployed.

Fig. 1 demonstrates quarterly dynamics of the official number of unemployed, potential workforce and ready to work but not working individuals for 2014–2019<sup>1</sup>.

Fig. 1 demonstrates that **the number of potential workforce** gradually declined from 1.3 mn individuals in 2014 to 1.1 mn individuals in 2018, however in 2019 this indicator increased to 1.5–1.7 mn individuals. Let's point out that Rosstat did not change the methodology last year or a set of questions which attached respondents to this category<sup>2</sup>. Consequently despite

reduction of the unemployment rate the total number of jobless and potential workforce increased by 0.1 mn individuals. The number of ready to work but not engaged in job search and not available for work immediately remained relatively constant, although in 2018–2019 a slight growth emerged. Total number of all three categories – unemployed; potential workforce; ready to work but not engaged in job search and not available for work immediately – can be considered **as upper bound of underutilization of labor resources** in the country. On the whole, a subset is twice as high as the number of unemployed. In 2019, this indicator demonstrated growth.

Alternative indicators of unemployment are not limited by those which have been used by Rosstat. **International statistics uses several additional indicators.** The most detailed list of monthly released categories is given in the US statistics where six categories of unemployed are shown:

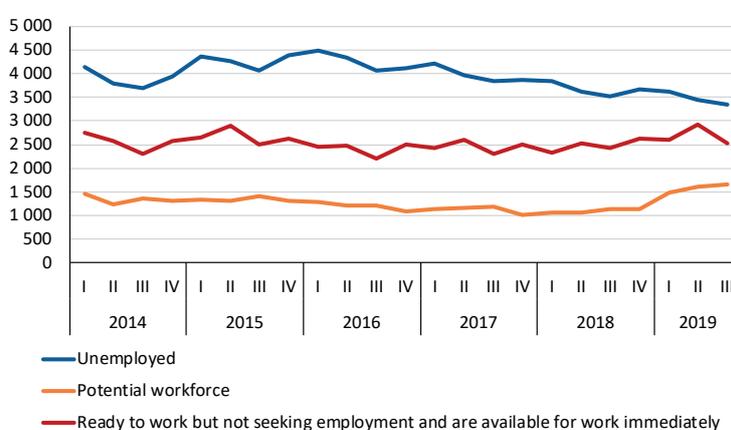


Fig. 1. Indicators of underutilized labor resources in Russia, thousand individuals.

Source: Rosstat.

1 Although the official statistics on last two categories is available only starting from 2015, but openly accessible micro data on workforce surveys allow to estimate these indicators for earlier period.

2 In any case, we have found Rosstat material allowing to explain such growth due to changes in methodology.

- U-1 – the official unemployed according to the ILO methodology, seeking employment during 15 or more weeks, i.e. who are in stagnant unemployment;
- U-2 – the official unemployed with work experience;
- U-3 – the official unemployed according to the ILO methodology;
- U-4 – the official unemployed and discouraged workers;
- U-5 – the official unemployed and jobless ready for employment but are not actively seeking employment;
- U-6 – those in U-5, and part-time worker, but are ready for full-time employment.

All categories except the first one are built on the Matreshka principle where each next one is wider than the previous.

Fig. 2 provides alternative measures of the unemployment rate, measured on the basis of the Rosstat survey of the labor force according to methodology close to the one used in the USA<sup>1</sup>. Indicators of U-2 and U-6 can be measured solely on micro data available exclusively for 2018.

Over much of the period under research, the dynamics of the majority of indicators ran parallel. After growth seen in 2015, in 2016–2018 a slide emerged across all indicators of unemployment. However, starting from late 2018 growth of U-5 and U-6 set in, in other words the number of discouraged workers and potential workforce amid ongoing slide of the number of official unemployed went up. The number of stagnant unemployment continued falling. As a result at Q3 2019, **the number of potential workforce was equal to half of the number of official unemployed** according to the ILO methodology, which is significantly higher than in the US where this ratio comes to around 25% and somewhat lower the average level seen in the EU where it constituted around 60% in recent years.

Thus, complicated changes have been taking place in the labor market. In the context of reduction of the most active category of unemployed, the number of not so active categories of potential workforce and on the whole ready for work have been growing. The decline of the official rate of unemployment reported in 2019 occurred not only due both to reduction of the period for job search and by “pushing out” from the labor market part of citizens who seek employment for over 12 months. As a result, certain alternative indicators indicate growth of the rate of unemployment in the last year. ▀

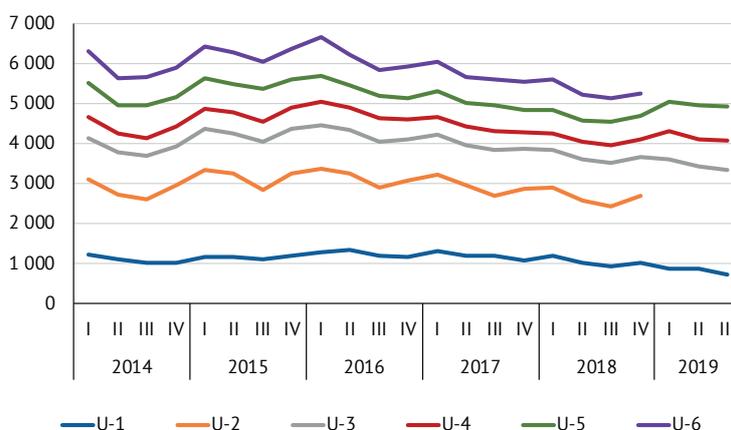


Fig. 2. Alternative measures of the number of unemployed, thousand persons

Source: U.S. Bureau of Labor Statistics. Alternative Measures of Labor Underutilization for States. URL: <https://www.bls.gov/lau/stalt.htm>

1 For measuring U-1 as a borderline determining stagnant unemployment, 12 months were taken according to the Rosstat methodology.

## 5. EMPLOYMENT PROMOTION IN RURAL AREAS: HOW CAN THE STATE PROGRAM BE PROPERLY ADJUSTED?

N. Shagaida, A. Potapova

*The State is implementing the policy of labor market (human resource) development in rural areas in the framework of the State Program for Comprehensive Development of Rural Areas (hereinafter – State Program)<sup>1</sup>. It is expected that the allocation of state subsidies designed to cover the costs of employers incurred by them in the course of training their personnel to acquire the professions needed by the agrarian sector will conduce to the achievement of the State Program's target – an increase, by the year 2025, of the employment rate of able-bodied rural residents. However, an analysis of the State Program's provisions has raised doubts concerning the actual possibility of achieving the set targets. In fact, the draft of the State Program's latest version is capable only of partially improving the existing mechanisms.*

The State Program envisions **measures designed to refund the costs of agricultural producers incurred by them under the so-called apprenticeship contracts<sup>2</sup>**.

The subsidizing mechanism has given rise to a number of questions. Some proposals have already been incorporated into the draft of the RF Government Decree 'On the Introduction of Alterations into the State Program of the Russian Federation *Comprehensive Development of Rural Areas*', which is currently being discussed<sup>3</sup> (hereinafter – draft of the State Program's latest version).

*Firstly, who may conclude apprenticeship contracts?* The State Program defines the list of recipients of subsidies to cover the costs of their apprenticeship contracts<sup>4</sup>: individual entrepreneurs (IE), peasant (farm) holdings (PFH), and agricultural organizations (producers of agricultural goods). The same recipients are now listed in the draft of the State Program's latest version. This runs contrary to Article 198 of the RF Labor Code, whereby only a legal entity is allowed to enter in an apprenticeship contract. The fact that neither an IE nor a PFH, both lacking the status of a legal entity, are actually allowed to conclude such a contract will be revealed to them only during an audit of their activity conducted with the purpose of identifying instances of unlawful spending of government funds, as the auditor may be guided by the provisions of other existing laws, and not only by the State Program.

*Secondly, which specific costs incurred by an employer will be refunded by way of a subsidy?* The State Program specifies that these will be the costs incurred under apprenticeship contracts. In the draft of the State Program's latest version, targeted training contracts are also added to this category. While the terms of a targeted training contract are described with sufficient detail in the Provision 'On Targeted Training under Secondary Vocational Training and Higher

1 Approved by Decree of the RF Government No 696 dated 31 May 2019.

2 The second set of measures – those designed to refund the actual costs associated with remuneration and housing of students who are citizens of the Russian Federation – is not discussed here, because it requires special consideration.

3 URL: <https://regulation.gov.ru/projects#npa=99477>

4 An apprenticeship contract for vocational education or retraining with or without leaving work (Article 198 of the RF Labor Code).

Professional Education Curricula<sup>1</sup>, no such description exists for apprenticeship contracts. Thus, according to Article 204 of the RF Labor Code, during the period of their apprenticeship<sup>2</sup> the students are to be paid a stipend, the size of which must be stipulated in an apprenticeship contract depending on the qualification to be received by them, and it cannot be less than the size of the minimum wage. Besides, an apprenticeship contract may also envisage some other obligations of the employer pertaining to training<sup>3</sup>, which may or may not include also the payment of tuition fees, travel costs, the cost of lodging in another area, etc. The information gleaned from interviews with government officials<sup>4</sup> and announcements posted by agricultural higher educational establishments (HEEs)<sup>5</sup> suggests that the State Program subsidizes those forms of training the costs of which the employers are not obliged to cover on a mandatory basis under their apprenticeship contracts. Meanwhile, apprenticeship contracts – in accordance with the RF Labor Code – may envisage employer obligations with regard to a wide range of expenditure items which, however, may exclude tuition costs, because a student may be enrolled under a free-of-charge government-funded program, with the hope of receiving some extra money from the employer in addition to the regular stipend. So, the employer may experience some problems both with receiving a subsidy and with providing a proof, during a later audit, that it has been received lawfully.

*Thirdly*, it is not clear **with whom an employer may conclude an apprenticeship contract in order to receive a subsidy**. Under the RF Labor Code, an employer is granted the right to sign such a contract with an individual who is looking for a job or with an employee of the said employer organization. The State Program stipulates that a subsidy may be received only by a producer of agricultural goods who enters into an apprenticeship contract with an employee of an organization. According to Article 187 of the RF Labor Code, when an employee is sent by an employer for skill enhancement with an interruption in work, he shall retain the job (the position) and the average wage at the primary place of work. Thus, the employer under a labor contract concluded with an employee of an organization must pay him or her the average wage, and to pay a stipend under an apprenticeship contract, and besides, to cover some other costs associated with professional training. Can such a contract be concluded by the graduate of a rural secondary school? Yes – under the RF Labor Code, with the obligation to come back to the potential employer. No – under the existing version of the State Program. The individual must first be hired (as required by the State Program), the size of his or her wage established (as required by the general provisions of the RF Labor Code, stipulated in Article 187), and an apprenticeship contract concluded, whereby the refund of travel costs and tuition fees, as well as the size of stipend, be established. The draft of the State Program's latest version now envisages the possibility of a subsidized targeted training contract, which can be concluded with a citizen of the Russian

1 Approved by Decree of the RF Government No 302 dated 21 March 2019.

2 An apprenticeship period is the term necessary for training in a given profession, specialty, and skill (Article 200 of the RF Labor Code).

3 Article 199 of the RF Labor Code.

4 Agricultural enterprises will be compensated for 30% of their student practicum program costs // Ministry of Agriculture and Food of the Republic of Tatarstan <http://agro.tatarstan.ru/rus/index.htm/news/1501792.htm>

5 Up to 30% of tuition costs are covered by subsidy in the framework of the State Program Comprehensive Development of Rural Areas, approved by Decree of the RF Government No 696 dated 31 May 2019 // Orenburg State Agrarian University <https://orensau.ru/ru/abiturientu/9424-vozmeshhenie-do-30-stoimosti-obucheniya-2019>

## 5. Employment Promotion In Rural Areas

Federation. Thus, some solution to the existing problem has been provided: an apprenticeship contract can be concluded with an employee, and a targeted training contract – with an individual who is not an employee. However, the conflict with the RF Labor Code has not been eliminated, because the latter allows that an apprenticeship contract may be concluded either with a current employee or with a future employee.

*Fourthly*, the current version of the State Program **establishes special conditions for some HEES** that educate future employees for agricultural organizations: the subsidizing may apply to the tuition costs of HEES subordinated to the RF Ministry of Agriculture. The draft of the State Program's latest version introduces significant improvements to the State Program's mechanism: it now applies to a wider range of federal state educational establishments (for higher education, secondary vocational training and retraining) – both to those subordinated to the RF Ministry of Agriculture (subsidizing up to 90%) and to those subordinated to other federal bodies of executive authority (subsidizing up to 30%). However, the discrimination based on the applied rate of subsidizing has not been eliminated: it overlooks those educational establishments that are subordinated to the other tiers of state authority. As early as 2011, the Russian Federation transferred its agrarian colleges to RF subjects. The former rural technical schools need their own modernization and retraining program. They are situated in rural districts and could train rural children in modern professions. However, the subsidizing mechanism applies to neither the former nor the latter. So, the widened range of organizations in the draft of the State Program's latest version, whose tuition costs are to be subsidized, is a very useful but insufficient initiative.

*Fifthly*, **what obligations concerning a mandatory term of work for a given agricultural producer after receiving a professional training will be assigned to the individuals who choose to take advantage of an apprenticeship contract?** The State Program does not offer a solution to that problem. How long should be the mandatory employment term, what wage size should be guaranteed? Should there be any differences in the length of that term and the wage size if one employer has received a 90% refund, and another one – a 30% refund of their actual costs, while both of them have concluded contracts with, say, future veterinarians?

*Sixthly*, neither the current State Program nor the draft of the State Program's latest version **envisages any guarantees that employers will be subsidized throughout the entire training period**. What are the guarantees that all the employers who conclude contracts in 2020 are going to receive subsidies even in 2021 or 2022?

For those young people who have not yet firmly decided that they are going to stay in their rural area, to get a job in a rural area with a low average wage that they would not be able to quit for several years will be worthwhile only if their family is totally destitute, or they themselves have gained a low Unified State Exam score. The existing alternatives in the form of a student loan or the ability to get a part-time job in a city during the period of study make it possible for them to get a professional education without being tied to a rural employer.

So, while offering incentives for employers, the State Program creates no incentives to a broad range of rural residents who could become potential employees. Some of them do want to get an education but, for lack of sufficient resources, they are prepared to make do with a low pay during the next few years after their period of study is over. However, there is no guarantee that

they will stay and work in a rural area thereafter. Others are the children of farmers who have their own small and medium-sized businesses, and so they can inherit from their parents and stay in their rural area. Their number is small, but this is a reliable resource – the State may help them get an education (their parents acting as their employer), and they will stay there. But they will provide no solution to the problem of agro-holdings, which suffer from shortage of qualified staff, because they will be employed by their own family businesses.

**Considering what has been discussed here, it would be feasible to proceed as follows:**

- to bring the apprenticeship contract (envisaged in the State Program) in conformity with the RF Labor Code. Or, on the contrary, to separate the RF Labor Code and the State Program, by changing the definition of a contract between an employer and potential student, and to adopt the Provision 'On a Contract for Agrarian Professional Training and Retraining', with a detailed description of all the nuances;
- to specify the list of expenditure items to be subsidized by the State;
- to specify the mechanism for interaction between the employer and student during and after the study period, including with regard to the mandatory employment term and wage size, and the compensation mechanism to be applied in case of a breach of the contract by the student;
- to link the possibility of subsidizing the training costs to certain specific professions needed in rural areas, instead of a specified range of educational establishments;
- to guarantee to the employers, which have concluded training and re-training contracts, that they will be subsidized throughout the period of training their potential employees;
- to develop a subsidizing (or money compensation) mechanism that could be used by all the employers that have concluded such contracts (a switchover from a percentage-based compensation principle to equal compensation based on a training level and the State Program's budget for a given year). ▀

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