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A RESPONSE OF THE ECONOMY TO CHANGES IN EMPLOYMENT STRUCTURE

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POLICY BRIEF

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Now Russian Federation is going through an economic crisis based on internal inefficiencies of structural institutes, persisting influence of the last world crisis and an abrupt decline of relationship with Western partners. According to announced plans of the Russian government, the economy will start its new growth, (i) developing such hi-tech sectors, in which it has a comparative advantage, (ii) inducing substitution of the import, and (iii) developing new trade flows. In May 2016, Prof. Kudrin and Prof. Glazyev prepared their competing programs of economic development. Since the programs are not published, in this policy brief we rely on secondary sources including interviews of the authors and comments of other economists. Accepting the above items (among some others) the two programs seem to propose different origins of growth. The Glazyev program seems to be in favor of the ruble emission to induce growth and of a strong control of the exchange rate to secure financial stability. On the contrary, Prof. Kudrin intends to establish transparency in business affairs and reform the justice system to (i) improve conditions for entrepreneurship and (ii) defend better private property.

Our research indicates additional problems in development hi-tech sectors, based on basic principles of economics, appeared as delayed consequences of the current reconstruction of the economy. Assuming that those barriers has to be taken into account by decision makers, we highlight measures that weaken or overcome them.

Let us imagine for a moment that countries are in an economic isolation. Then the endowment of natural resources and different productivities of labor underlie the discrepancy in inter-country welfare. Losses (initiated by different reasons that are not discussed here) of great many trade partners and a limited availability of world financial resources reveal problems of the Russian economy linked to productivities. It includes a productivity of labor as such, a limited efficiency of institutes, a certain level of corruption, and other factors. The economy moves to a new equilibrium that is characterized by lower costs of domestic relative to foreign firms because of ruble devaluation, a higher level of unemployment (including a hidden unemployment), and a decrease of consumers' income. As a consequence, an unprecedented decrease of demand is registered. The Ministry of Economic Development reports the 8% fall of demand for January-September 2015, which is greater than in 1991 and 2009. A fall in some hi-tech sectors (f.e., in new car markets) exceeds 20%.

Our paper finds a secondary effect of the occurred shock, which might be undertaken by policy makers. A drop of the income makes consumers to redistribute their spending between available

products decreasing the demand for hi-tech products. This redistribution triggers mechanisms of successive changes. We posit that being short in differentiated products, consumers less value their diversity. Following varying demand, the size of hi-tech sectors decreases and they become closer to traditional sectors. Then the number of firms declines. Each firm receives a larger market share and enlarges its production. It hires more workers but the marginal benefit from employees decreases. As a result, the wages in hi-tech sectors go down. The integral influence of a fall in demand for hi-tech goods and consolidation of firms onto the number of employees is negative: workers lose their jobs in hi-tech sectors incurred an adverse demand shock. Thus, hi-tech sectors lose their potential of development and advantages of career opportunities.

A fall in wages reduces the attraction of hi-tech jobs; less agents apply for them, and the unemployment rate decreases even despite some former employees are dismissed. We argue that the outflow of workers from hi-tech makes pressure on traditional sectors and may cause a hidden unemployment among state employees and a fall of wages. Therefore an integral conclusion regarding unemployment is unclear. Nevertheless, we stress that a decrease of social inequality goes in parallel to a fall of the income faced by a majority of population.

Based on our theoretical modeling, we claim that basic consequences of the uncovered secondary effect is a decrease of competition in hi-tech sectors, which are declared to be the clusters of growth, and a fall in wages. The first consequence is potentially dangerous in Russia with a current low level of competition that leaves more room for corruption schemes. The fall in wages is likely to cause a further shift of demand from hi-tech to traditional goods and make negative effects self-enforcing.

Just described negative effects are generated by a redistribution of spending forced exogenously. Nevertheless, tastes of consumers remain, in general, unchanged. We describe in the project that tastes for hi-tech products can be an origin of the development and growth. However an explicit interdiction of trade by a variety of products, in addition to the reduction of competition, blocks a positive influence of tastes in Russia because the mechanism of tastes is out of work without an extensive trade of desired goods. The devaluation of the ruble decreases domestic industrial costs with respect to foreign costs and gives domestic industries a comparative advantage. This gives an economic mechanism that limits import but keeps it alive. Leaving aside positive and negative consequences of the devaluation, this policy brief accepts it as such. Aiming to restore old trade agreements, at the same time regulators should weaken other trade barriers. Then tastes for hi-tech products through a tighter intra-sector competition would favor a development of technologies in the way that is reverse to the above description. We do not avoid here well known claims that market mechanisms work properly under efficient institutes and transparent

rules specially because of on-going efforts of different level of administrations to strengthen its control over business. All these recommendations are in line with the program of Prof. Kudrin rather than with the program of Prof. Glazyev.