

Models of Labor-Capital Relations in Transition Economies: A Comparative Perspective

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ABSTRACT: The transition to the market was hard on the working class of Eastern Europe and the former USSR. During the 1990s, all of European transition economies (TE) experienced a major recession and suffered from the explosion of poverty and inequality. However, distribution of income between labor and capital differed greatly from one group of post-communist countries to another. The paper discusses and analyzes linkages between models of market capitalism that emerged in former communist countries in the 1990s and the outcome of transition for labor in terms of income distribution. It is based on the estimates of several indicators of labor income performance during the reform period.

Keywords: income distribution, capital income, real wages, government policies

JEL Classification Codes: P16, E11, J30

Introduction

This paper discusses and analyzes linkages between models of capitalism that emerged in former communist countries in the 1990s and the outcome of transition for labor in terms of income distribution. It argues that the costs of market reforms for labor were strongly influenced by public policy choices determined by power relations existing in TE at the time of transition. Following the transition literature, we consider three main models of capitalism that evolved during Post-Communist transitions: (i) “democratic capitalism” in Central East European and Baltic (CEB) countries; (ii) “autocratic capitalism” followed by some of the Central Asian states and the Republic of Belarus in the Commonwealth of Independent States (CIS) and; and (iii) “clan capitalism” dominating in the majority of the CIS and South East European (SEE) countries.²

To measure of the relative position of labor *vis-a-vis* capital we followed the ratio between capital and labor incomes and another closely related indicator more often used in the literature - the share of labor compensation in the GDP (see for example, Poterba 1997, Diwan 2001, Jayadev 2007). Both of these measures reflect the bargaining power of the workers and at an aggregate level indicate how favorable to labor is a model of capitalism operating in a particular country.¹

Based on the analysis of a position of labor under different market capitalist regimes established in TE, we argue that the primary (before taxes and transfers) income distribution should be more favorable for labor in countries of democratic capitalism, where labor had a chance to influence the formation of the new economic regime. The distribution should be least favorable in countries of clan capitalism, where labor did not have such a chance. In autocratic capitalist countries, where ruling bureaucracy dominates both the labor and the capital, the state could directly influence income distribution, for instance for the sake of political stability, making the

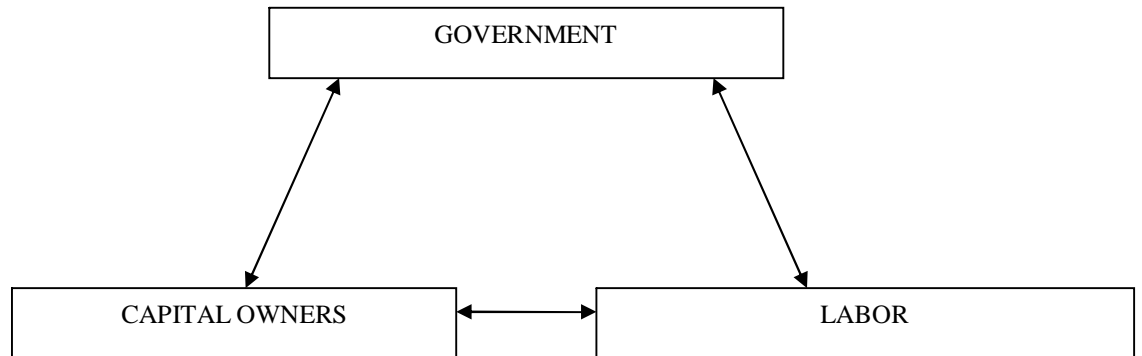
outcome more ambiguous but possibly more favorable for labor than in clan capitalist economies.

The plan of the paper is as follows. Following this introduction, section two discusses models of capitalism that emerged in countries of Eastern Europe and the former USSR in the wake of transition. Section three analyzes economic positions of labor *vis-a-vis* capital in three groups of transition economies in terms of primary income distribution. Section four concludes.

Models of Capitalism in Transition Economies

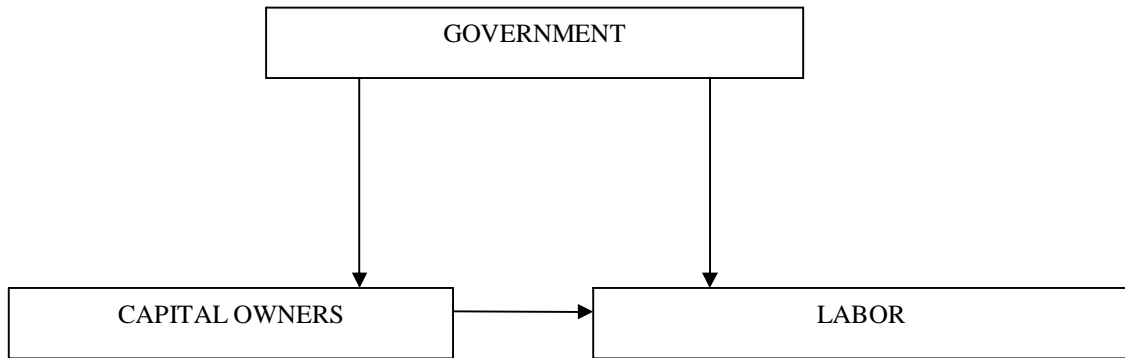
The disintegration of the socialist economic system in Eastern Europe and the former USSR has led to the emergence of several distinct models of capitalism.³ In the more advanced of the East European countries this happened through the incorporation of capital-owners as powerful but not dominating partners on the economic and political arena. From the very start of transition countries of the CEB opted for a model of capitalism combining a fully fledged market economy with democracy. Privatization of state property proceeded in these countries in relatively orderly manner with sales of government assets benefiting not only the new owners (often foreigners) but also the population at large.⁴ Economic integration with Western Europe, including massive inflows of foreign investment and the promise of eventual accession to the EU worked as powerful external factors for this development (Marangos 2004, Bitzenis and Marangos 2007). Not surprisingly, the resulting “democratic capitalism” model in CEB in some ways emulated the corporatist institutional arrangements existing in Western Europe, in particular in Germany (Gabrish and Hollscher 2006, O’Dwyer 2006, McCann and Schwartz 2006).

Figure 1. Democratic Capitalism: Central East European and Baltic Countries



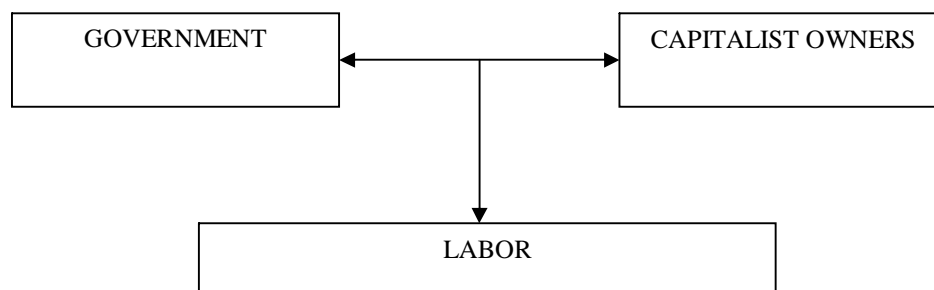
The second model of capitalism, alternatively called “political”, “state-led”, “autocratic”, or “Asian” (as it was pioneered by China in the late 1970s and followed by Vietnam in the 1980s), was adopted in the former Soviet states of Belarus, Kazakhstan, Kyrgyz Republic, Turkmenistan, Tajikistan and Uzbekistan (Spechler 2002, Pomfret 2006). Here the communist bureaucracy never yielded the commanding heights of the economy to either capital-owners or workers. With *both* labor and capital too weak to counter the government, the *nomenclature* maintained a strongly authoritarian political system and from the very start of transition, was able to single-handedly rule on all principal issues of economic policy, including the income distribution (Acemoglu 2006). A significant part of the economy in these countries was not privatized and continued to be operated by the state with the bureaucracy preserving control over the setting of wages and profits. In addition, many of the state enterprises were transformed into public-private corporations.

Figure 2. Autocratic Capitalism: Belarus, and Central Asian States of the Former USSR



Russia and most of the CIS and SEE countries throughout the 1990s built and maintained a different model of capitalism, neither European nor Asian. On the surface, it had all the features of a democratic capitalist system. Yet here, the capitalist class, despite its youth and inexperience, was able to capture and control a significant part of the state apparatus and bend the rules of privatization and other market reforms in its own favor (Boycko et al 1996, Hellman 1998, Goldman 2003, Havrilishin 2006, Stefes 2006, Baumol 2007). In the literature this model of capitalism is alternatively labeled, “predatory”, “oligarchic”, “*nomenclatura*”, “clan” etc. (Blasi et al. 1997, Menshikov 1999; Goldman 2003, Aslund 2005, Kosals 2007).⁵

Figure 3. Clan Capitalism: Russia, and Other CIS and SEE in the 1990's



In some TE countries, the clan capitalism proved to be unstable and prone to mutation into other models. Thus in Russia, under President Putin (2000-2008), the state capture was being replaced by “business capture” (Oleinik 2006, Yakovlev 2006, Kalantaridis 2007) making the overall institutional arrangements somewhat closer to that of an autocratic capitalist model. At the same time, in such countries as Ukraine and Georgia in the CIS or Bulgaria and Romania in SEE, under the pressure of public discontent, the system may have started to evolve towards the democratic capitalism model (Aslund and McFaul 2006, Demes and Forbrig 2007).

Factors that brought about the diversity of capitalist models in place of the relatively uniform socialist systems of the pre-reform period are discussed in a number of recent works (Marangos 2004, Boyer 2005, Zweynert and Goldschmidt 2006, Hodgson 2006, Oleinik 2006). Among these factors are differences in geography, religion, ethnic composition, and authoritarian traditions. For example, the origin of democratic capitalism in the CEB countries is often linked to the cultural and religious, Protestant and Catholic, heritage shared with West European neighbors, as well as the homogeneity and compact distribution of their population and relative shortness of the communist experiment. At the same time, the roots of autocratic and clan capitalism in the CIS and

SEE countries are traced to authoritarian tendencies of Orthodox and/or Islamic religions, a traditionally large role of the state in the economy of these countries prior to communist period, a high degree of ethnic diversity and the geographical dispersal of their populations (Gratchev and Izyumov 2003, Zweynert and Goldschmidt 2006, Havrylyshin 2006, Hodgson 2006).

There is no doubt that geographical, historic, and cultural/religious factors have played a major role in predetermining the types of capitalist models that emerged in TE. However, in the more immediate sense, the design and sequence of policies that led to the creation of specific models of capitalism in a particular TE was determined by the distribution of political power on the eve of reforms. One of the key factors in this regard was the ability of the labor to influence government policy choices via political participation, trade-union activity, collective bargaining, strikes, and other forms of class struggle. (Gordon 1980, Bowles et al. 1986, Kotz 2003, Wolfson 2003, Zafirovsky 2004, Philips et al 2005).

In CEB countries, from the very start of reforms the labor was quite vocal and grass-roots organizations, such as the “Solidarity” trade union in Poland and “Charter 77” in Czechoslovakia, were important players in the political arena. As a result, the working population in these countries could count that their interests, including job security, wages, retirement benefits, and welfare programs, would be incorporated into the reform program. In contrast, in most of the CIS and SEE countries practically all power on the eve of reforms was concentrated in the hands of the communist party bureaucrats, managers of large state enterprises and leaders of the law-enforcement bodies (Boyko et al. 1996, Hellman 1998, Layard 1998, Goldman 2003). Taking into account that many of these bureaucrats were busy making themselves into capitalists, few of them were sympathetic to the wishes of labor. At the same time, the labor in these countries was largely disorganized, uninformed and leaderless, and thus had no power to defend their rights and had little

role in determining the reform agenda (Clarke et al. 1993; Boone et al. 1998; Clarke and Borisov 2006; Ashwin 1998, 2004; Brainard 1998).

Based on these differences in the models of capitalism, we expected income distribution outcomes during the transition to be most favorable for labor in countries of democratic capitalism and least favorable in countries of clan capitalism. In autocratic capitalist countries, the extremes of income distribution could be moderated by the strong state bureaucracy interested in social stability. Therefore here we expected labor income indicators to fall somewhere in between these of democratic and clan capitalist systems. At the same time for all of TE we expected the division of income to be less beneficial to labor compared to that found in mature market economies.

Labor vs. Capital Incomes

To measure the performance of labor incomes under different post-communist regimes we used two indicators: the ratio of capital to labor incomes, defined here for practical statistical purposes as a ratio of all profit-type incomes to labor compensation and the wage share - the share of labor income in the GDP.

$$\text{CLR} = \Pi / W \tag{1}$$

$$\text{WS} = W / Y_n, \tag{2}$$

where CLR – the capital-labor income ratio; Π is the capital income (sum of profit-type incomes, in current prices); W is the annual labor compensation (also in current prices), WS is the wage share, and Y_n – nominal value of gross domestic product.

The data on the GDP, labor, and capital incomes were compiled from the United Nations National Accounts Statistics Database. This database is jointly published by United Nations, Commission of European Communities, International Monetary Fund, Organization for Economic Cooperation and Development, and the World Bank and is increasingly being used for cross-country studies of income distribution (Diwan 2001, Jayadev 2007).

For labor incomes the United Nations database provides necessary information under the category “compensation of employees”, which includes wages and salaries as well as additional payments to labor, such as retirement and health benefits. However computation of capital income called for some adjustments. To better estimate the capital-labor income ratio, we aimed to use a broad measure of capital income including gross corporate profits before deduction of taxes and interest and a part of proprietors’ income, listed in the United Nations statistics as “mixed profits”. In the current literature, treatment of mixed profits varies from their total inclusion in capital incomes (Diwan 2001) to total exclusion (Moseley 2000). The majority of authors, however, split mixed income between profits and wages on the assumption that some part of it should be treated as labor compensation (Wolff 2001, 2006; Izyumov and Alterman 2005; Jayadev 2007). Following similar calculations made for the US and other economies, we have chosen to allocate mixed income equally between capital incomes and wages. Thus for actual computation of the capital-labor income ratio we used the following formula.

$$\text{CLR} = \Pi / W = [\Pi_c + (\Pi_m)/2] / (W + \Pi_m/2), \quad (3)$$

where Π_c stands for corporate sector profits, and Π_m stands for mixed profits or proprietors income.

Our study covered the period of 1992-2003 and included eighteen TE countries of Eastern Europe and the former USSR, for which United Nations National Accounts Statistics Database provided sufficient information.⁶ Using the same methodology we also computed indicators of the capital-labor income ratio and wage share for a comparator group of “mature market economies” comprised of the five largest OECD countries - the United States, Japan, Germany, United Kingdom, and France.

Table 1 and Figures 1 and 2 present data on levels and trends in the capital-labor income ratio and wage shares for three groups of TE and comparator OECD group during 1992-2003. The results largely confirm our expectations. The average capital-labor income ratio was the lowest for the democratic capitalist group of TE, where it stood at about 74%, and the highest in the clan capitalist group, where it was close to 100%. In autocratic capitalist countries somewhat surprisingly the capital-labor income ratio was close to that of democratic capitalist TE (75%).⁷ As expected, in all of TE the capital-labor income ratio was much higher than in mature market economies (54%).

Table 1. Capital-Labor Income Ratios and Wage Shares in Transition Economies and Comparator Countries: 1992-2003

	Country	Capital-Labor Income Ratios	Wage share
<i>Democratic capitalist</i>	Czech Republic	80,8%	50,7%
	Estonia	68,3%	52,3%
	Hungary	72,3%	50,7%
	Latvia	80,2%	49,1%
	Lithuania	88,2%	46,9%
	Poland	76,3%	48,8%
	Slovakia	76,2%	51,1%
	Slovenia	48,5%	57,5%
	<i>Average</i>	74,1%	50,9%
<i>Autocratic capitalist</i>	Belarus	71,8%	49,5%
	Kazakhstan	83,2%	49,8%
	Kyrgyzstan	68,8%	53,8%
	<i>Average</i>	74,6%	52,0%
<i>Clan capitalist</i>	Armenia	89,1%	48,4%
	Azerbaijan	202,0%	32,9%
	Bulgaria	109,0%	43,3%
	Moldova	73,7%	50,8%
	Romania	95,9%	47,1%
	Russian Federation	65,5%	52,7%
	Ukraine	64,0%	52,2%
	<i>Average</i>	99,1%	46,9%
<i>Mature capitalist (OECD majors)*</i>	<i>Average</i>	53,7%	58,9%

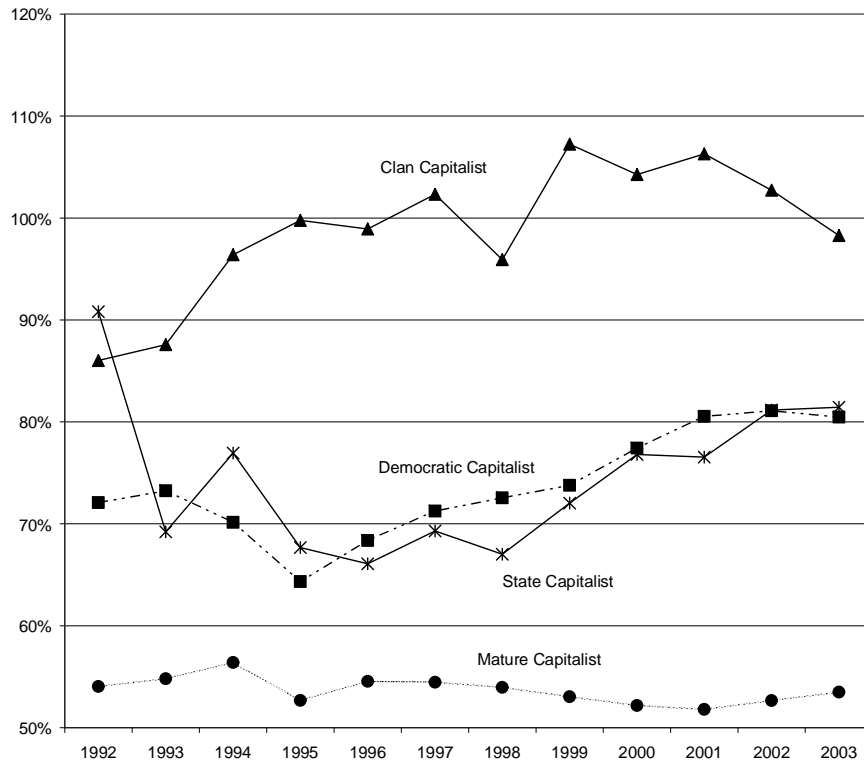
Averages are unweighted

* United States, Japan, Germany, United Kingdom, France.

Source: United Nations National Accounts Statistics Database (see Appendix for details).

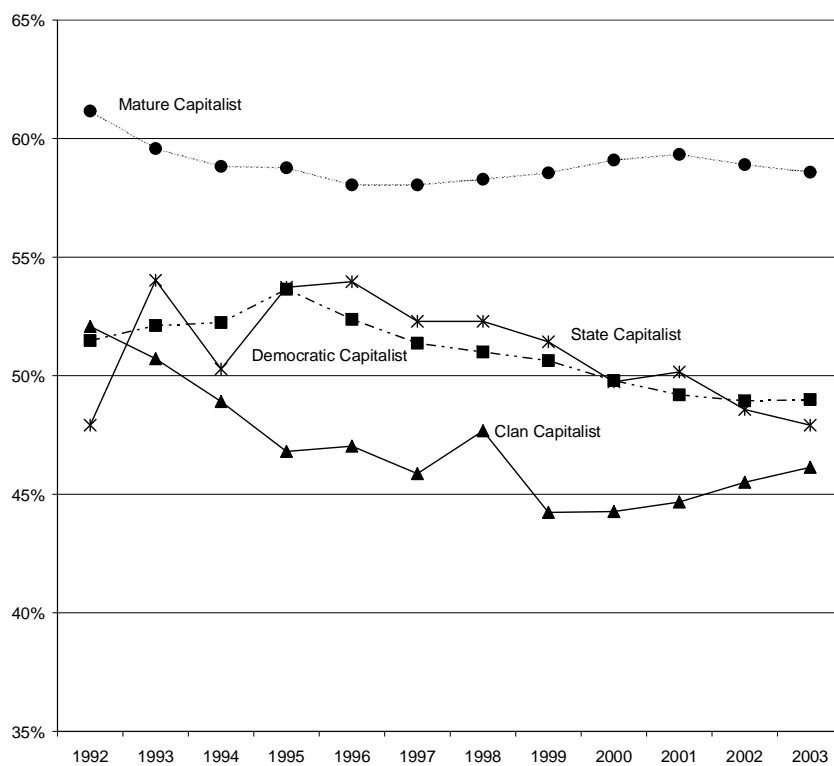
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Figure 4. Capital-Labor Income Ratios in Transition Economies and Comparator Countries: 1992-2003



Sources: Same as for Table 1.

Figure 5. Wage Shares in Transition Economies and Comparator Countries: 1992-2003



Sources: Same as for Table 1.

Matching the TE results for the capital-labor income ratio, the wage share was the lowest in the clan capitalist countries (47%) but similar in democratic capitalist (51%) and autocratic capitalist (52%) countries. As expected, in all three groups of TE the shares of labor income were lower than in the mature capitalist countries, where for the same period it averaged 59%.

Over the whole period of 1992-2003 the levels of the capital-labor income ratio in TE countries demonstrated high volatility but have generally trended up since 1994-95 (Figure 5). Matching this increase, the wage shares in all groups of TE have trended down. Thus, both measures of labor income performance point towards a certain weakening in positions of labor *vis-a-vis* capital in the course of transition. Due to data limitations we consider these results as only tentative indicators of underlying trends in capital-labor relations in TE.

Conclusions

The labor did not fare well during the post-communist transition. In all countries of Eastern Europe and the former USSR, it experienced decreasing wage share, and rising income inequality. However costs of the transition for labor were significantly different in countries under different models of capitalism.

In the countries of the CEB, the labor was relatively well prepared for the return of the market. Through trade-union mobilization and political participation, it ensured that its economic interests were included in the reform program from the very start. In contrast to that in most of the CIS and the SEE countries, capitalists “woke up” earlier than workers and took the initiative in subjugating the government to its interests. As a result, the models of capitalism that emerged in different parts of ex-communist block were different: relatively labor-friendly in the CEB group,

but pro-capital in most of the CIS and SEE countries. In some of the TE (e.g., Belarus and Kazakhstan), the ex-communist bureaucracy retained enough power to dominate both capital and labor. In this authoritarian version of capitalism, government bureaucracy could influence income distribution for its own interests, such as to maintain political stability.

To investigate differences in the labor income performance across TE during the transition, we tracked the capital-labor income ratio and wage share in eighteen TE with different models of capitalism for the period of 1992-2003. As expected, we found the capital-labor income ratio to be the lowest (74.1%) and the wage share to be the highest (50.9%) in the democratic capitalist TE. In the clan capitalist countries, the capital-labor income ratio was the highest (99.1%) and the wage share correspondingly the lowest (46.9%). In autocratic capitalist countries both indicators were in between these two groups but closer to the democratic capitalist TE. Due to data limitations we consider our results as only tentative indicators of underlying trends in capital-labor relations in TE.

The inability of the labor in the majority of TE to defend its economic positions *vis-a-vis* capital and/or government bureaucracy is explained in part by the depth of the transformational recession and massive unemployment it caused. As these economies continue to recover, the increasing demand for labor should help improve its relative bargaining position *vis-a-vis* capitalists. The revival of investment and gradual elimination of structural deficiencies of TE labor markets, such as their geographical immobility, should work in the same direction.

In the medium to longer-term perspective, the integration of economies of the CEB and the SEE accession countries into the EU should help workers of these countries to move closer to the distributional outcomes characteristic to mature market economies. However, labor in clan and autocratic countries of the former USSR can hardly reach similar goals unless it makes a concerted effort to develop its institutional strength via trade-union mobilization and political activity. The

alternative scenario for labor in these countries is to continue accepting the status-quo in hope that “benevolent dictators”, in particular in resource-rich countries, will provide better distributional outcomes “from above”.

Notes

1. Invoking the “strength of labor” in explaining distributional outcomes is not limited to Marxist literature and is not specific to TE situations. Commenting recently in *The Wall Street Journal* article (November 2, 2006) on CEO compensation growth in the 1980s and 1990s an MIT economist Frank Levy noted that six times faster growth of the average CEO pay vis-a-vis average worker’s paycheck could not happen in the previous decades (between 1940s and 1970s) as in that period managers were too afraid of labor unrest to pay themselves exorbitant salaries.
2. The CEB countries include Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic, Slovenia. The CIS comprises Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine, Uzbekistan. The SEE countries are Albania, Bulgaria, Bosnia and Herzegovina, Croatia, Macedonia, Montenegro, Romania and Serbia.
3. The diversity of capitalist models in mature market economies is a fairly well researched topic both in mainstream and heterodox literature (e.g. North 1990, Hall and Soskice 2001, Boyer 2005, Crouch 2005, Nee and Swedberg 2005, Baumol et al 2007). However, much less is said on the models of capitalism that emerged in former communist countries of the USSR and Eastern Europe.
4. Literature on models of privatization in TE and its outcomes is quite extensive. For an overview of related issues see, for example, Brada 1996, Boone et al. 1998; Blanchard 1998; Fisher and Sahay 2000; Havrylyshyn and Nsouli 2001, Aslund 2002; Transition: The First Ten Years 2002; Havrylyshyn 2006

5. World Bank experts diplomatically call the state-dominated capitalist systems – “non-competitive political regimes” and clan capitalist systems – “concentrated political regimes” (Transition: The First Ten Years 2002: 98).
6. Choosing 1992 as a starting point was a compromise. In most CEB and SEE countries radical market reforms started in 1989, while in the former countries of the USSR they started in 1992. However, in none of the TE was the dismantlement of the communist economy was a one-time event. In many of them transition to capitalism proceeded in fits and starts and took a good part of the 1990s. Placing an exact date on a transition of any formerly communist country to capitalism is probably impossible. One option for selecting a symbolic “threshold” is to choose a year, when the share of private sector in the GDP of a formerly communist country surpassed 50% (Izyumov and Alterman 2005). According to this criterion, most of European TE converted to capitalism around 1994-95.
7. It should be noted that due to data limitations the results for authoritarian capitalist group are based on a sample of only three countries and thus are less reliable than those for democratic and clan capitalist groups.

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Appendix

The scope of this study included eighteen transition countries in the period between 1992 and 2003. For this period the United Nations National Accounts Statistics Database (<http://unstats.un.org/unsd/snaama/introduction.asp>) provides data for seventeen of the twenty eight transition economies of Eastern Europe and the former USSR. National accounts data for Slovenia was taken from its national statistical agency website. There was not enough data available to include Tajikistan, Georgia, Albania, Turkmenistan, Bosnia and Herzegovina, Croatia, FYR Macedonia, Serbia and Montenegro, and Uzbekistan. In addition, we computed indicators the capital-labor income ratio and wage share and for a group of "mature" market economies comprised of the five largest OECD countries - the US, Germany, United Kingdom, France, and Italy.

The needed data components were not available for most countries as part of the Primary Distribution of Income Account. Thus, we relied on the Generation of Income Account and the data came from Table 4.1 and Table 2.3 from the National Accounts. Table 4.1 "Total Economy (S.1) at current prices," contained line items that relate the GDP production to the GNI. Table 2.3 "Output, gross value added, and fixed assets by industries at current prices" includes line items for compensation of employees, mixed income, and gross operating surplus.

Not all line items were available for all countries. In some instances the values for mixed income were not available, but the value for gross operating surplus included mixed income. This confounded the data in that mixed income needed to be split between gross operating surplus and compensation of employees. In many transition economies, mixed income as a percentage of GDP is high; not accounting for this would skew the resulting ratios. To compensate for this deficiency we extrapolated values for mixed income and adjusted surplus values. If mixed income was provided for some years, the average was used to populate mixed income cells for the other missing years. If no mixed income values for a country were available, the average percentage for that country's model of capitalism category was used.

Definitions of variables as provided in the United Nations National Accounts Statistics Database are as follows.

Gross Operating Surplus: The operating surplus measures the surplus or deficit accruing from production before taking account of any interest, rent or similar charges payable on financial or tangible non-produced assets borrowed or rented by the enterprise, or any interest, rent or similar receipts receivable on financial or tangible non-produced assets owned by the enterprise; (note: for unincorporated enterprises owned by households, this component is called "mixed income").

Compensation of Employees: Compensation of employees is the total remuneration, in cash or in kind, payable by an enterprise to an employee in return for work done by the latter during the accounting period: total remuneration - in cash or in kind - paid by an enterprise to an employee in return for work done during the accounting period (System of National Accounts).

Mixed Income: Mixed income is the surplus or deficit accruing from production by unincorporated enterprises owned by households (System of National Accounts).

Gross Domestic Product: Income Based: Income-based gross domestic product is compensation of employees, plus taxes less subsidies on production and imports, plus gross mixed income, plus gross operating surplus (System of National Accounts).