Rates of Exploitation, Income Distribution and Varieties of Capitalism in Transition Economies: What Would Karl Marx Said?

ABSTRACT: The paper analyzes linkages between varieties of capitalism that emerged in former communist countries in the 1990s and the outcome of capitalist transition for labor and capital in terms of income distribution. It is based on the estimates of the Marxian rate of exploitation and other indicators of labor income performance during the period of 1992-2006. The study includes 18 transition economies (TE) of Eastern Europe and the former USSR, for which United Nations National Accounts Statistics Database provided sufficient data for the estimation of the share of labor and capital incomes in the GDP. Similar indicators are estimated for a comparator group of "mature market economies" comprised of the five largest OECD countries - the United States, Japan, Germany, United Kingdom, and France. We find that the distribution of income between labor and capital differed greatly from one group of post-communist countries to another. Based on the estimates of the Marxian rate of exploitation in TE in the period of reforms we argue that workers in the Central East European and Baltic countries were able to shape up a model of capitalism, where their economic interests were reasonably well protected. At the same time, workers in the majority of the former USSR countries were too demobilized to take an active role in the construction of the new capitalist society and suffered the consequences in the form of suppressed wages, unfavorable fiscal redistribution, and sharper income inequality.

Keywords: varieties of capitalism, rate of exploitation, income distribution, inequality.

1. Introduction

Massive literature on capitalist transition in Eastern Europe and the former USSR has so far mostly focused on its different modes – such as shock therapy vs. gradualism – as well as on differences in economic performance among transition countries (Kornai 1995; From Plan to Market 1996; Boone et al. 1998; Blanchard 1998; Fisher and Sahay 2000; Aslund 2002; Transition: The First Ten Years 2002; Svejnar 2002; Hodgson 2006; Popov 2006; Havrylyshyn 2006). Much less attention has been devoted to the discussion of the *models* of capitalism that emerged in these countries and how different capitalist regimes affected the distribution of national income between capital and labor. This paper discusses varieties of capitalism that emerged in former communist countries in the 1990s and the outcome of capitalist transition for labor in terms of income distribution as measured by the Marxian rate of exploitation and other indicators of labor income performance.

Viewed from a Marxian perspective, the polarization of incomes is the normal result of capitalist accumulation (Marx [1848] 1969, Gordon 1980, Bowles et al. 1986, Zafirovski 2005). In Marxian framework of analysis the main outcome of income distribution under capitalism is measured by the rate of exploitation – the ratio between capital and labor incomes (Marx [1867] 1967). Other closely related indicators sometimes used in the literature are profit share and wage share - the shares of capital incomes and labor compensation in the national income or GDP (see for example, Poterba 1997, Diwan 2001, Holscher 2006, Jayadev 2007). All of these measures at an aggregate level indicate how favorable for labor (working class) is a model of capitalism operating in a particular country.[1]

In our paper, drawing on the insights from varieties of capitalism (VOC) literature as well as on findings of studies of TE we consider three main models of capitalism that evolved during Post-Communist transitions: (i) "democratic capitalism" in Central East European and Baltic (CEB) countries (Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic, Slovenia); (ii) "autocratic capitalism" followed by the Central Asian states (Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan, Uzbekistan) and the Republic of Belarus in the Commonwealth of Independent States (CIS) and; (iii) "clan capitalism" dominating in the rest of the CIS (Armenia,

Azerbaijan, Georgia, Moldova, Russia, Ukraine) and most of the South East European (SEE) countries (Albania, Bulgaria, Bosnia and Herzegovina, Croatia, Macedonia, Montenegro, Romania, Serbia). The distinction among models of capitalism in this classification is based on differences in key institutional characteristics of their political and economic systems – including the degree of competitiveness of the political process, the rule of law, separation of powers, freedom of the press, as well as the extent of privatization, level of competitiveness, and openness of the economy and the extent of control of the government by special interests. (See: Hall and Soskice 2001, Amable 2003, Crouch 2005, Holscher 2006, Stefes 2006, Zweynert and Goldschmidt 2006, Lane and Myant 2007).

Based on the analysis of a position of labor under different capitalist regimes the paper puts forward four hypothesis:

Hypothesis 1. Both the primary (before taxes and transfers) and secondary income distribution should be most favorable for labor (the working class) in countries of democratic capitalism and least favorable in countries of clan capitalism.[2] 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.

Hypothesis 2. Compared to the mature market economies profit shares and rates of exploitation in all of TE will be higher and wage shares lower.

Hypothesis 3. In all TE, the distribution of income was less favorable to wages earlier in the transition period as deep transformational recessions and massive unemployment weakened the relative bargaining position of labor vis-à-vis capital owners. As these economies recovered, the increasing demand for labor, the revival of investment and the gradual elimination of structural deficiencies of TE labor markets, such as their geographical immobility, should have acted to increase wage shares.

Hypothesis 4. The integration of TE economies into the European Union (EU) should influence income distribution in these countries towards outcomes characteristic of mature market economies. Thus distribution of income should be less favorable for capital owners in TE of Eastern Europe, and more favorable for capital owners in countries of the former USSR with weaker trade-unions and no influence of the EU "anchor" on wage formation.

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-à-vis* capital in three groups of transition economies in terms of primary income distribution. Section four discusses government policies in TE as they relate to the secondary income distribution and the resulting inequality under the different capitalist regimes. Section five concludes.

1. Varieties 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. Table 1 summarizes some of the main institutional characteristics of the three such models most often distinguished in the transition literature (Boycko et al 1996, Blasi et al. 1997, Hellman 1998**,** Menshikov 1999, Spechler 2002, Goldman 2003, Marangos 2004, Aslund 2005, Beck and Laeven 2006, Acemoglu 2006, Havrylyshyn 2006, Hodgson 2006, Holscher 2006, Stefes 2006, Zweynert and Goldschmidt 2006, Baumol 2007, Lane and Myant 2007).

Table 1. Models of Capitalism and Their Institutional Characteristics in Transition Economies

		Democratic Capitalism	Autocratic Capitalism	Clan Capitalism
POLITICAL SYSTEM	Representative country	Poland	Uzbekistan	Russia
	Separation of powers	Present	Formally present, but effectively absent	Present, but executive power dominates
	Rule of law	Strong	Very weak	Weak
	Party system	Multi-party	Effectively one-party	Multi-party
	Freedom of the press	Present	Absent	Present, but government controls main media outlets
	Government control by special interests	Not significant	Significant	Very significant
	Role of law-enforcement services	Limited	Very important	Very important
	Civil society	Strong	Very weak	Weak
	Index of political freedoms*	8-10	0-2	6-8
ECONOMIC SYSTEM	Extent of privatization	High	Low	High
	Model of privatization	Relatively open, foreigners allowed	Government dominated, foreigners not allowed until later period	Insiders dominated, foreigners not allowed until later period
	Property and contract rights	Strong	Very weak	Weak
	Entry barriers for new businesses	Low	High	High
	Separation of economy from polity	Strong	Very weak	Weak
	Shadow economy (% of GDP, estimate)**	Relatively small (26.8)	Large (41.8)	Large (45.6)

*Polity democracy index for 2000 on the scale of 0-10, as presented in Hodgson 2006: 877
**Average for each group in 1995-2000, author's computation based on Johnson et al 1997: 183; Schneider and Klinglmair 2004: 11.

While different authors suggest somewhat different categorization of individual TE few argue that the early EU accession countries (Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic, Slovenia) can be classified as "democratic capitalist". For the rest of the TE group classification can be more difficult. Due to rapid political and economic changes during the reform period models of capitalism in some of the CIS and SEE countries have undergone serious transformation. As a result some countries with "borderline" institutional characteristics could fit more than one type of capitalism. This for example refers to the recent experience of Bulgaria, Romania, Georgia and Ukraine, which have features of both clan and democratic capitalism, or to Russia, which under the rule of Vladimir Putin demonstrates both autocratic and

clan characteristics. In our study classification of capitalist models refers to the period of 1992-2006, during which insider-dominated clan capitalism in all of these countries was still dominant.

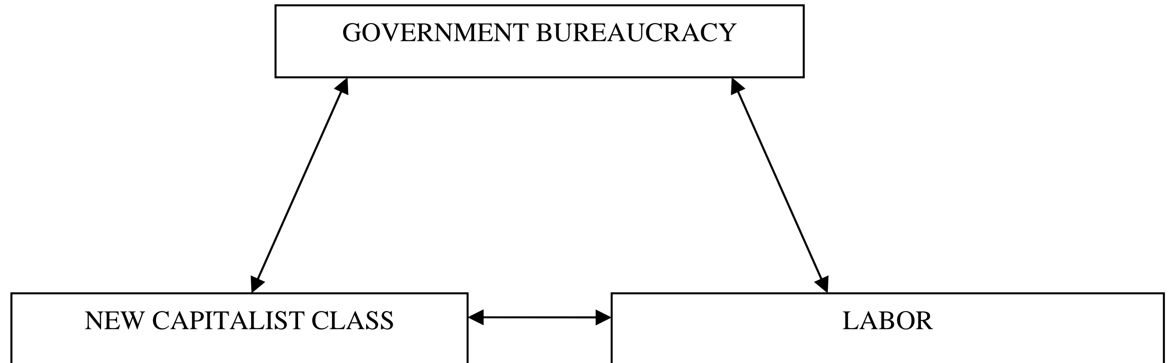
The overarching difference between the models of capitalism in TE consists in the strong role of the civil society and effective separation of economy and polity found in democratic capitalist TE in contrast to very weak civil society and lack of such separation in autocratic and clan capitalist countries. Weakness of the civil society in the latter two capitalist regimes allows their governments controlled by special interests to appropriate full or almost full control over the economy, including redistribution of incomes.

From a Marxian perspective different models of capitalism that emerged in post-communist economies can be evaluated based on the place and role of the capitalist class, labor (the working class), and the government.[3]

Prior to the massive privatizations of the 1990s, countries of Eastern Europe and the USSR did not have a distinguishable class of capital owners. However, in Marxian terms, all nominally socialist countries could be viewed as exploitation-based societies with the role of exploitators performed by the ruling communist bureaucracy or *nomenclature* through its collective ownership and exploitation of state assets. (Trotsky [1937] 1967, 1941; Djilas 1957; Horvat 1982; Voslensky 1992). In a simplified form, the class structure in a socialist/communist society could be represented as consisting of just two classes: communist bureaucracy at the top and labor (working class) at the bottom.[4]

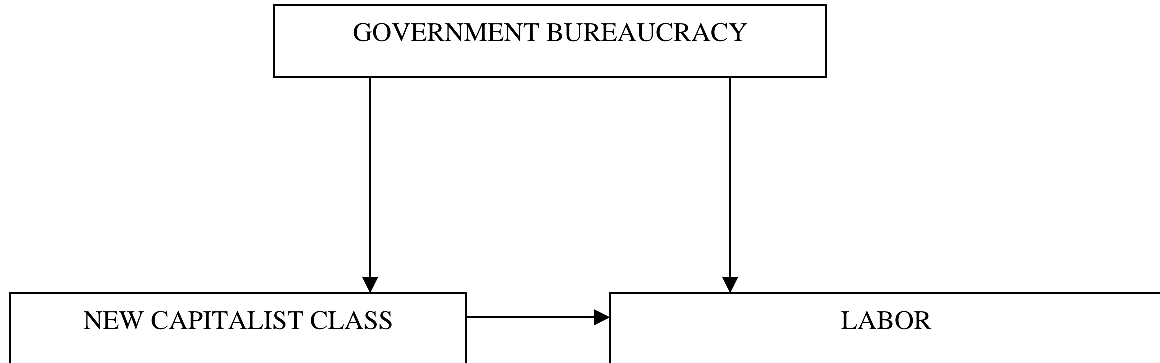
In the course of post-communist transition, the two-class system expanded to make space for the newly emerged class of capitalists. In the more advanced of the East European countries this happened through the incorporation of capitalists as powerful but not dominating partners on the economic and political arena. 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.[5] 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, Holscher 2006, Havrylyshin 2006, 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, particularly in Germany (Gabrish and Holscher 2006, O’Dwyer 2006, McCann and Schwartz 2006).

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



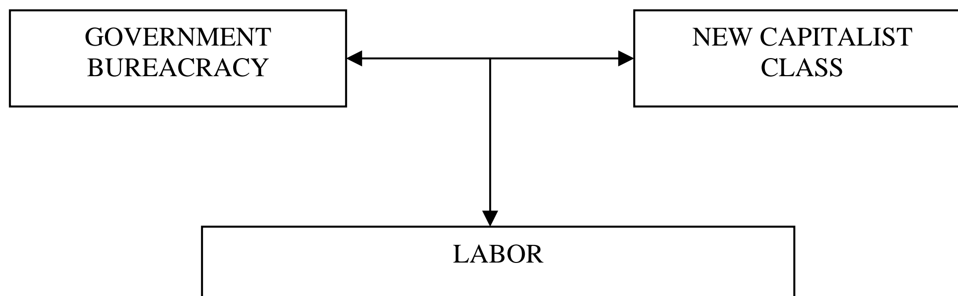
Under the autocratic model of capitalism, alternatively called “political”, “state-led”, or “Asian” (as it was pioneered by China in the late 1970s and followed by Vietnam in the 1980s), the communist bureaucracy never yielded the commanding heights of the economy to either capitalists or workers. With *both* labor and capital too weak to counter the government, the *nomenclatur*e 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 income distribution (Spechler 2002, Acemoglu 2006, Pomfret 2006). A significant part of the economy in these countries was not privatized and continued to be operated by the state with the ruling bureaucracy preserving overall control over the setting of wages and profits.

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). Corruption flourished -- in exchange for "selling out" to capitalists, the bureaucracy enjoyed an unprecedented flow of bribes and many of its members were directly co-opted into the capitalist class. The labor was a big loser in this institutional arrangement. It was largely left out of the process of privatization of state assets and fell under the double exploitation from the new capitalists and corrupt bureaucrats. In 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).[6] We will be using the term "clan capitalism" as it seems to better reflect the group-based system of ownership and control that dominate in these TE.

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



In some TE countries, clan capitalism proved to be unstable and prone to mutation into other models. Thus in Russia, under President Putin (2000-2008), the bureaucrats have been wrestling control of the commanding heights of the economy away from the new capitalists partially subjugating them to the government. The state capture in Russia is 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, such countries as Ukraine and Georgia in the CIS or Bulgaria and Romania in SEE, under the pressure of public discontent, corrupt bureaucratic regimes retreated and 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 and natural resource endowments, 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).

From the Marxian perspective the design and sequence of policies that led to the creation of specific models of capitalism in particular TE could be impacted by political power of labor, specifically by its ability to influence government policy 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**,** Philps et al 2005). In the CEB countries, in the period leading to market reforms labor was quite vocal and grass-roots organizations, such as the "Solidarity" trade union in Poland and "Charta 77" in Czechoslovakia, were important players in the political arena. As a result, the working population in these countries could count that its interests, including job security, wages, retirement benefits, and welfare programs, would be incorporated into the reform program. In contrast to that, 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). At the same time, civil society in these countries was weak. Labor in particular was largely disorganized, uninformed and leaderless, and thus had no power to defend its 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).

The reasons for weakness of labor in the SEE and in particular in the CIS countries are numerous. Among them is the Soviet tradition of subservience of trade-unions to the government and management; steep fall in trade-union membership; low level of labor solidarity and lack of experience in defense of labor rights via collective bargaining, strikes, etc; harassment of trade unions by management and new private owners; poor representation of labor interests in the political system and in the media. Additional factors undermining willingness of workers to stand up for their rights or quit their jobs altogether include the existence of enterprise-based benefits,

such as subsidized housing, child care and health insurance and wide propagation of various sources of additional income such as employment in shadow economy, subsistence farming, and intra-family transfers. Private safety net provided by these secondary incomes made workers in the CIS less willing to risk their official jobs via strikes and other open protests (Ashwin 2004, Temnitskii 2006, Roberson 2007, Clarke 2007, Leibovich and Shushkova 2007).

The extreme weakness of labor movement in the CIS in the period of reform is reflected by the steep fall in trade union membership and low level of strike activity. For example, in Russia between 1993 and 2005 trade union membership dropped by almost 50% (Clarke 2007, 283). The poor bargaining position of labor vis-à-vis capital in the CIS countries was most explicitly manifested by the delays in payment of wages, which during the 1990s often lasted for several months or even a year. In Russia at the peak of non-payment crisis in 1998 wage arrears reached two thirds of the total wage bill (Mitra and Yemtsov 2006, 11). One recent survey-based study of workers in the Russian industrial heartland of Urals concludes: "It has turned out that blue-collar industrial workers, disunited, socially weak, and dependent on the voluntary action of manufacturers, have been cast onto the periphery of today's social world…. So far they do not represent the social force the capital would have to reckon with." (Leibovich and Shushkova 2007, 34).

Based on differences in the models of capitalism, as described, 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 we expected labor income indicators there to fall somewhere in between those 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.

2. Labor vs. Capital Incomes

To measure the performance of labor incomes under different post-communist regimes we used three indicators traditionally used in Marxian literature: the rate of exploitation, defined here as a ratio of all profit-type incomes to labor compensation and the shares of capital and labor incomes in the GDP.

$$RE = \Pi / W \qquad (1)$$

$$PS = \Pi / Y_n, \qquad (2)$$

$$WS = W / Y_n, \qquad (3)$$

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

The data on the GDP, labor, and capital incomes was compiled from the United Nations National Accounts Statistics Database. This database is jointly published by the 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, Gollin 2002, 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 approximate the Marxian measure of the rate of exploitation, 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 (Menshikov 1999, 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 rate of exploitation we used the following formula.

$$RE = \Pi / W = [\Pi_c + (\Pi_m)/2] / (W + \Pi_m/2), \qquad (4)$$

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

Our study covered the period of 1992-2006 and included seventeen TE countries of Eastern Europe and the former USSR, for which United Nations National Accounts Statistics Database provides sufficient information.[7]

Using the same methodology we also computed indicators of the rate of exploitation 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 2 and Figures 4 and 5 present data on levels and trends in the rate of exploitation and wage and profit shares for three groups of TE and the comparator OECD group during 1992-2006. The results largely confirm our expectations. The average rate of exploitation was the lowest for the democratic capitalist group of TE, where it stood at 73%, and the highest in the clan capitalist group, where it was close to 92%. In autocratic capitalist countries somewhat surprisingly the rate of exploitation was close to that of democratic capitalist TE (74%).[8]

As expected, in all TE the rate of exploitation was much higher than in mature market economies (54%).

Table 2. Profit Shares, Wage Shares and Rates of Exploitation in Transition Economies and Comparator Countries: 1992-2006

	Country	**Profit Share**	**Wage share**	**Rate of exploitation**
Democratic capitalist	Czech Republic	40,3%	50,3%	80,2%
	Estonia	35,7%	51,2%	69,8%
	Hungary	35,9%	50,8%	70,6%
	Latvia	39,9%	48,8%	81,8%
	Lithuania	41,7%	46,4%	89,9%
	Poland	30,0%	48,8%	61,5%
	Slovakia	40,4%	50,3%	80,4%
	Slovenia	30,0%	57,2%	52,5%
	Average	***36,7%***	***50,5%***	***72,8%***
Autocratic capitalist	Belarus	33,3%	49,7%	67,0%
	Kazakhstan	43,6%	48,1%	90,7%
	Kyrgyzstan	36,0%	52,6%	68,4%
	Average	***37,6%***	***50,9%***	**73,9%**
Clan capitalist	Armenia	36,7%	48,2%	76,1%
	Azerbaijan	58,3%	33,2%	175,5%
	Bulgaria	45,4%	42,3%	107,3%
	Moldova	37,4%	50,7%	73,8%
	Romania	45,5%	46,6%	97,7%
	Russian Federation	38,7%	51,1%	75,8%
	Ukraine	37,1%	51,7%	71,8%
	Average	***42,7%***	***46,5%***	**91,9%**
Mature capitalist (OECD majors)*	***Average***	***32,1%***	***58,9%***	***54,5%***

Averages are unweighted

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

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

Figure 4. Rate of Exploitation in Transition Economies and Comparator Countries: 1992-2006

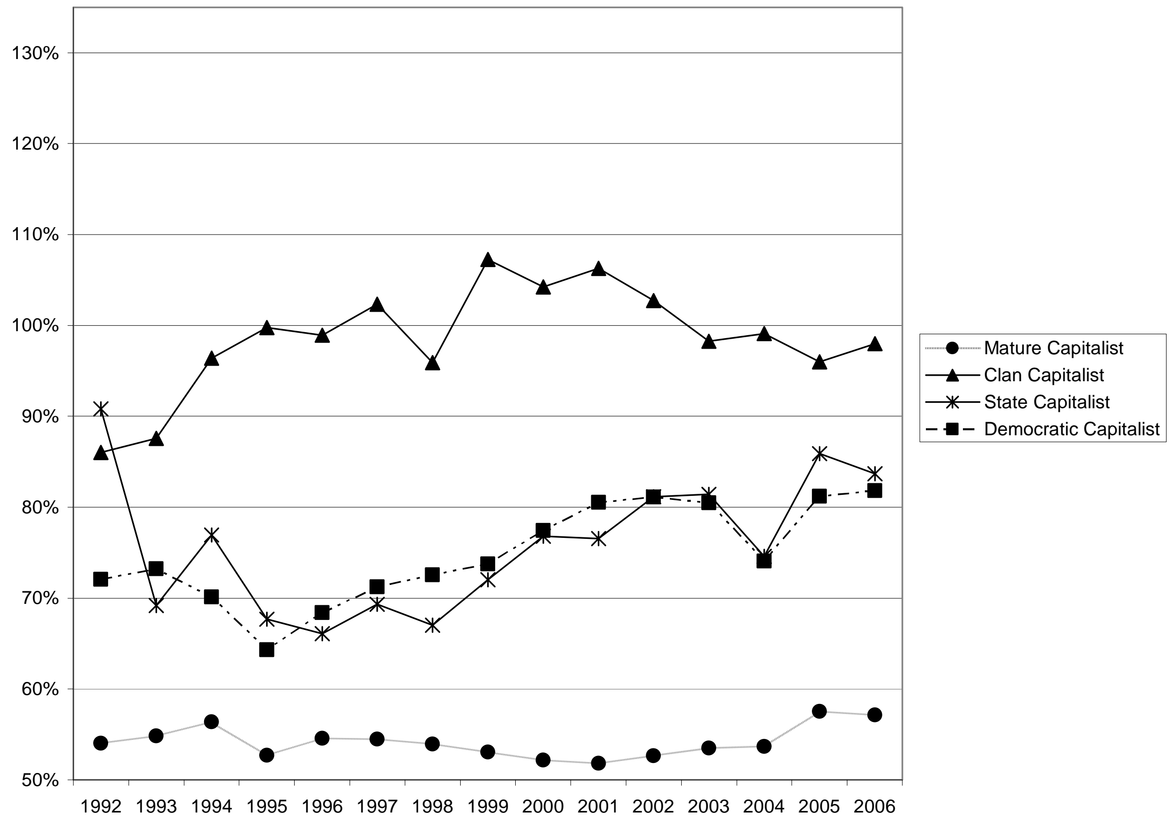
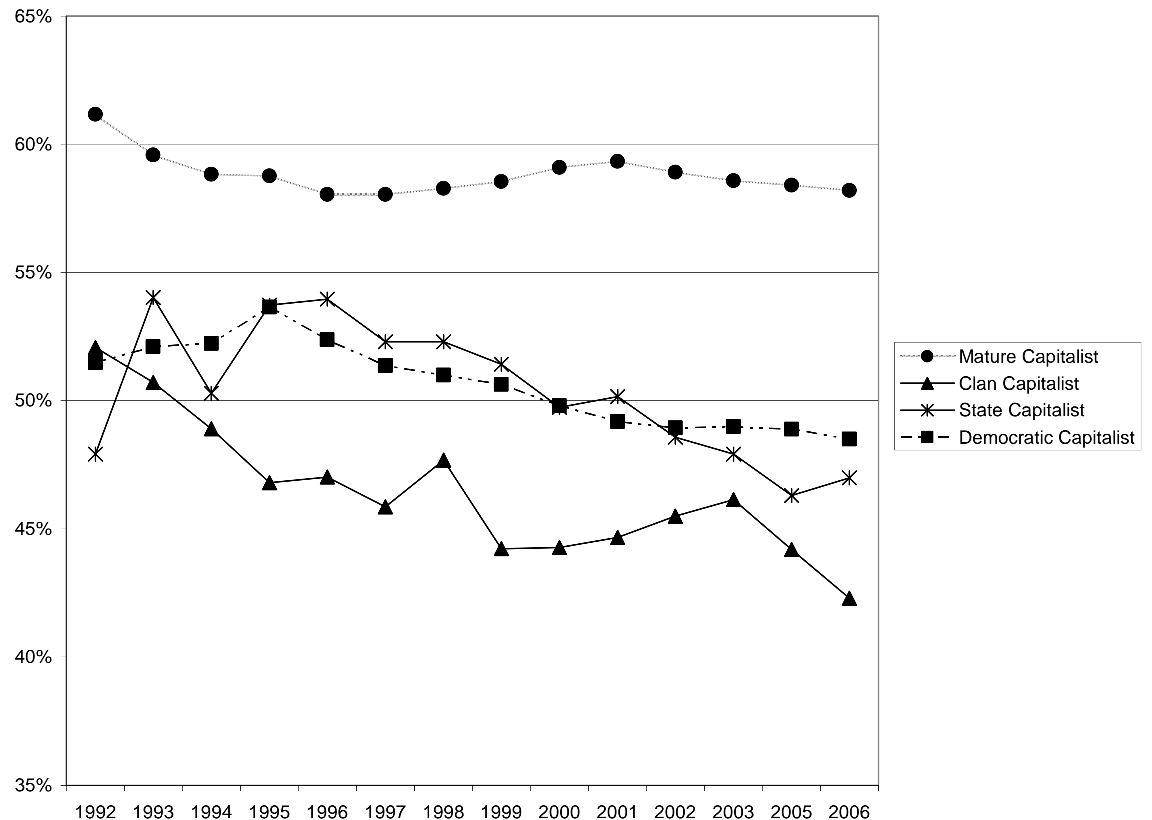


Figure 5. Wage Shares in Transition Economies and Comparator Countries: 1992-2006



Matching the TE results for the rate of exploitation, the wage share was the lowest in the clan capitalist countries (47%) but similar in democratic capitalist (51%) and autocratic capitalist (51%) 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 1992-2006 the levels of the rate of exploitation 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-à-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.

3. Income Redistribution and Inequality

Major differences in the primary income distribution, as measured by the rate of exploitation and the wage share of the GDP, can be reversed, moderated, or further increased by regulatory and re-distributive policies of the government. From Marxian (and Veblenian) perspective, the secondary income distribution should depend upon the bargaining power of labor as much or more than the primary income distribution (Marx [1948] 1967, 1969; Veblen [1899], 1994; [1904] 1965). Assuming that the rates of exploitation and wage shares are accurate measures of the relative strength (or weakness) of labor in different TE, one should expect workers in democratic capitalist countries to achieve better treatment and workers in clan capitalist counties to do worse at the

secondary income distribution level. For countries of autocratic capitalism, the secondary distribution outcomes are harder to predict because here ruling bureaucracy can favor larger income transfers to labor for the sake of political stability.

During the transition period, the impact of the state on income distribution and redistribution was transmitted through numerous mechanisms, including labor market regulations, liberalization of prices and monetary policy, as well as fiscal and welfare policies (see Table 3).

Table 3. Public Policies Affecting Income Distribution

		Democratic Capitalism	**Autocratic Capitalism**	**Clan Capitalism**
LABOR MARKET REGULATION	**Unemployment benefits**	Relatively generous	Meager	Meager
	Wage protection	Relatively strong	Weak	Weak
	Trade union legislation	Favorable to workers	Effectively anti-labor	Effectively anti-labor
	Support of small-business	Relatively generous	Weak	Weak
MACROECONOMIC AND WELFARE POLICIES	**Mode of reforms**	Mostly “shock therapy”	Mostly gradual	Mostly “shock therapy”
	Monetary Policy	Moderately inflationary	Highly inflationary	Highly inflationary
	Fiscal policy	Moderate reduction of spending, high effective taxes, major redistribution to the poor	Moderate reduction of spending, high effective taxes, moderate redistribution to the poor	Major reduction of spending, low effective taxes; weak redistribution to the poor
	Welfare policy	Generous pension benefits, targeted subsidies, generous spending on health and education	Moderate pension benefits, poorly targeted subsidies, reduction of spending on health and education	Meager pension benefits, untargeted subsidies, sharp reduction of spending on health and education

From the start of reforms, countries operating under different capitalist regimes conducted very different labor market policies. In countries of the democratic capitalist group, governments maintained relatively high unemployment benefits. In most of the CIS and SEE countries, however, unemployment benefits were meager. For example, in Slovakia during the 1990s, unemployment benefits generally ranged between 40-50% of the average wage, while in Russia they were less than 15% (Boeri and Terrell 2002, Vodopivec et al. 2005). There were similar differences in minimum wage policies. In the CEB countries, the minimum wage was set at 30-40% of the average wage. In the CIS group it was allowed to shrink from close to 30% in 1990 to less than 10% in 1996 and less than 7% in 2002. In Russia, as late as in 2006, the minimum wage was 1,100 rubles a month or just 10% of average wage (Goskomstat 2008: 186).

High minimum wage and relatively generous unemployment benefits helped workers in the democratic capitalist countries to restore their real wages relatively fast. In contrast to that, in the clan capitalist countries of the CIS and SEE, due to the absence of the effective wage floor, real wages continued to decline until mid 1990s losing up to 40-50% of their pre-reform value.[9]

Additional pressure on real wages came from highly expansionary monetary policies. In the first years of reforms, in the wake of price liberalization, inflation in all of the TE was severe. However, in the democratic capitalist countries, the average inflation rate in 1992-2003 period was less than 20%, and the worst annual inflation rate was on the order of 100-200%. In the same period, in countries of autocratic and clan capitalism, the average inflation rate reached 100-124% and in some years many of these countries suffered inflation of 1000% a year or above. In Russia, for example, inflation tax on households resulting from depreciation of their savings estimated to total 12% of GDP (Mitra and Yemtsov 2006, 14). Different outcomes of monetary stabilization efforts were largely predetermined by the balance of political forces. Governments of the democratic capitalist TE, operating under national consensus and controlled by strong civil societies, were able to contain inflation relatively quickly. In contrast to that, in autocratic and clan capitalist countries, the struggle with inflation was undermined by powerful political lobbies. In many of the CIS countries during the first years of reforms enterprise directors secured massive flows of state subsidies and government credits to their firms, which helped to fuel the hyperinflation. By some estimates in Russia in 1992-93, these credits resulted in the net transfer of wealth to enterprises amounting to 15% of GDP (Layard 1998: 8).

The impact of the state on the secondary income distribution was transmitted most directly through fiscal policies. Transition to the market has led to a significant reduction of the fiscal role of government in all of TE. However, both the extent of the "fiscal retreat" and its implementation were very different under each type of capitalist regime. In the democratic capitalist countries government revenues and expenditures fell less drastically: between 1989-1990 and 1999-2002, government spending as a percentage of GDP declined there on average from 51.0% to 38.1%, or by about one quarter. In autocratic capitalist and clan capitalist countries in the same period, it fell by more than a third – from 43.5% to 29.3% and from 46.7% to 29.5% respectively.

No less important, in the democratic capitalist TE the fiscal retreat was accomplished in a relatively orderly manner. Tax collection in these countries did not collapse, tax rates were maintained at a relatively high level, and, thanks to civil society influence, priority in spending was given to social protection. The fiscal retreat was also relatively well organized in authoritarian capitalist countries, where the ex-communist bureaucracy never yielded control of the budget to the new capitalists (Gerry and Mickiewicz 2008). In contrast to that, in most of the clan capitalist countries of the CIS and SEE at the start of transition the budgetary process literally imploded (Havrylyshyn 2006, Gerry and Mickiewicz 2008). Official tax "forgiveness" granted to many enterprises and massive tax evasion made effective tax rates there several times lower than the statutory ones.

The redistributive response of TE governments in the welfare area thus closely corresponded to the types of capitalism established at the initial stage of reforms. In the countries of the democratic capitalism group, governments played an active role in alleviating the costs of transition for labor. In spite of recessionary pressures, the level of social protection there was left largely intact, while the system of welfare was re-oriented towards the needs of the market economy. This was particularly true for such CEB countries as Poland, where the share of GDP spent on welfare transfers have surpassed the pre-transition levels (Milanovic 1998; Transition: The First Ten Years, 2002; Gabrish and Holscher 2006). The level of social protection was also largely maintained in

some of the autocratic capitalism countries, such as Belarus. In countries of clan capitalism with their weak civil societies welfare policies were least sensitive to the needs of working population. Here, the capture of the state by special interests prevented re-distribution of income towards more vulnerable members of the society.[10]

The cumulative effect of primary income distribution, as measured by the increase in the rate exploitation and reduction of wage share, and redistributive impact of differences in government monetary, fiscal, and welfare policies resulted in vastly different levels of income inequality, measured at the household level. In democratic capitalist countries, where redistributive policies were relatively pro-labor, the level of inequality measured by the Gini index, increased in the course of transition (between 1989-90 and 2002) from 0.23 to 0.32 (see Table 4).

Table 4. Income Inequality in Transition Economies

	Gini coefficients of inequality			
	1987-90	1996-98	2002	2002 as a % of 1987-90
Democratic capitalist				
Czech R.	0.19	0.25	0.26	137
Estonia	0.24	0.37	0.38	158
Hungary	0.21	0.25	0.35	167
Latvia	0.24	0.32	0.33	137
Lithuania	0.23	0.34	0.35	152
Poland	0.28	0.33	0.29	104
Slovak R.	0.19	..	0.26	137
Slovenia	0.22	0.3	0.30	136
Average	***0.23***	***0.31***	***0.32***	***139***
Autocratic capitalist				
Belarus	0.23	0.26	0.35	152
Kazakhstan	0.3	0.35	0.41	137
Kyrgyz R.	0.31	0.47	0.44	142
Average	***0.28***	***0.35***	***0.40***	***143***
Clan capitalist				
Armenia	0.27	0.61	0.48	178
Azerbaijan	0.28	..	0.46	164
Bulgaria	0.23	0.41	0.32	139
Moldova	0.27	0.42	0.43	159
Romania	0.23	0.29	0.36	157
Russia	0.26	0.47	0.49	188
Ukraine	0.24	0.47	0.41	171
Average	***0.26***	***0.48***	***0.43***	***165***

Source: Transition: The First Ten Years 2002: 9; Sukiassyuan 2007: 42; World Development Indicators 2009.

While representing a significant increase (about 39%), such level of inequality was still no higher than that observed in the majority of the European OECD countries. In contrast to that in the same period, in clan capitalist countries the Gini index increased by 65% - from 0.26 to 0.43, reaching a level of inequality similar to that found in most unequal of Latin American societies. [11]
In the autocratic capitalist countries, the Gini index rose by 43%, from 0.28 to 0.40. Here the increase in inequality was less severe than in clan capitalist group but more significant than in democratic capitalist TE.

Overall the outcomes of secondary income distribution across types of capitalism, as measured by inequality, generally followed the patterns of primary income distribution reflected in the levels of the rates of exploitation, profit and wage shares.

4. Summary and Conclusions

In the Marxian framework of analysis, the main distributional outcome of capitalist production is reflected by the rate of exploitation – ratio between capital and labor incomes as well as in the level of the wage share - the share of labor compensation in the GDP. To investigate differences in the labor income performance across TE during the transition, we tracked the rate of exploitation profit share and wage share in 18 TE with different models of capitalism for the period of 1992-2006.

As expected, and stated in Hypothesis 1, we found the rate of exploitation to be the lowest and the wage share to be the highest in the democratic capitalist TE. In the clan capitalist countries, the rate of exploitation was the highest (92%) and the wage share correspondingly the lowest (47%). In autocratic capitalist countries both indicators were in between these two groups but closer to the democratic capitalist TE.

Hypothesis 2 was also confirmed: Compared to the mature market economies levels of profit shares and rates of exploitation in all of TE was found to be significantly higher and wage shares lower.

However Hypothesis 3, according to which in all TE the distribution of income was expected to be more favorable to wages later in the transition period when the end of transformational recessions and reduction of unemployment improved relative bargaining position of labor vis-à-vis capital, was not proven. The increasing demand for labor, in the course of economic recovery between mid-1990s and mid 2000s, did increase real wages but productivity increased even more, and as a result profit shares and the rates of exploitation trended up and not down.

Expectation that the integration of TE economies into the European Union should influence income distribution in these countries towards outcomes characteristic of mature market economies (Hypothesis 4) was also not confirmed. During the period of observation the shares of wages and profits as well as rates of exploitation in the EU accession countries of Eastern Europe have not shown signs of convergence towards those of the mature market economies.

The differences in primary income distribution, as reflected by the rates of exploitation, profit and wage shares, were largely reinforced by government redistribution activities conducted via labor, monetary and fiscal policies. However in authoritarian capitalist TE, where both capital and labor were politically weak, the governments kept tighter control of the budget and used fiscal redistribution in favor of labor, making income inequality differences somewhat less severe than in the clan capitalist group, but still larger than in the democratic capitalist TE.

In a longer-term perspective, the integration of East European economies into the EU should help workers of these countries 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.

Notes

1. In the Marxian framework the distribution of incomes in a capitalist country is closely related to the notion of class struggle and the ability of the labor (working class) to defend its rights *vis-à-vis* capital. Invoking the "strength of working class" in explaining distributional outcomes is not limited to Marxist literature and is not specific to TE situations. Commenting on CEO compensation growth in the 1980s and 1990s *The Wall Street Journal* (November 2, 2006) noted that six times faster growth of the average CEO pay vis-à-vis average worker's paycheck could not happen in the previous decades (between 1940s and 1970s) because in those periods managers were too afraid of labor unrest to pay themselves exorbitant salaries.

2. Here and elsewhere in the paper, the term "working class" is used in the broad Marxian sense as being synonymous to "labor" or "working population")

3. In Marxian literature membership in the capitalist or working class is generally determined by the primary source of income so that individuals deriving most of their overall income from profits (including interest, dividend and rental income) qualify as capitalists, while those whose primary income comes from wages and salaries are included in the working class. The issue of borderline categories, such as corporate managers, receiving high salaries and profit distributions and small businesses (proprietorship) using hired labor (e.g. farmers) can theoretically also be decided on the basis of where the majority (50%+) of their overall income is coming from. In practice this is not feasible, so in most studies corporate profits, interest and rents are all considered accruing to capitalist class while proprietors' income is divided between capital and labor in a certain proportion, often half and half (Bottomore 1983, Bowles et al. 1986, Moseley 1988, Zeitlin 1989, Mandel 1992, Wolff 2001, Izyumov and Alterman 2005).

4. Defining bureaucracy as a ruling class of the communist society remains somewhat controversial. There is no generally accepted view regarding categories of communist party members who should be included in its ranks as opposed to those who should be classified as members of the working class. This problem is somewhat similar to that of defining membership of capitalist. One of the most authoritative studies of communist bureaucracy (Voslensky 1992) includes in it all full-time party "apparatchiks" as well as government ministers, regional government officials, managers of state enterprises and senior officers of the military and law enforcement agencies. According to this study, in the former USSR these groups (with families) accounted for 7.5% of the population.

5. 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.

6. 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).

7. 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 a one-time event. In many of them the transition to capitalism proceeded in fits and starts and took a good part of the 1990s. Placing an exact date on the 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.

8. 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.

9. The situation in these countries was further aggravated by lower geographical mobility of labor (Jackman, 1998; McKinsey Report 1999; Guriev 2001, Boeri and Terrell 2002). Due to such obstacles as undeveloped housing markets, high costs of transportation, legal restrictions, etc., millions of workers could not take advantage of job opportunities in other regions and were stuck with poorly paid jobs or no jobs at all at home.

10. The role of the fiscal transfers in compensating income inequality is noted in a number of studies. Thus for Hungary and Czech Republic it is estimated to have reduced Gini from 0.5 to 0.3 in mid 1990s 1994 (Gerry and Mickiewicz 2008, 97).

11. High levels of income inequality in clan capitalist countries are closely linked to major increases in wealth inequality. The extremes in this process were reached in the oil rich clan capitalist counties, such as Russia, where rigged privatization schemes, subsidized government credits, non-competitive license awards, and other corrupt practices created hundreds of instant millionaires and dozens of billionaires. According to the Russian edition of *Forbes* magazine (April 8, 2008) between 2001 and 2008 estimated combined wealth of Russian billionaires grew from $12.4 billion to $522 billion, increasing as a percentage of GDP from 4% to over 30%. By the number of its super-rich (110) Russia surpassed all countries in the world except the US.

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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 rate of exploitation 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).