

# 44 Work and unemployment

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## 1. Background

In the current globalization process in which nation states are increasingly becoming subordinated to the dominance of the world market, the now independent states of the former Soviet bloc are exposed to countervailing forces: nationalization, regionalization, globaliza-

### Glossary

**Total labor force** comprises people who meet the definition established by the International Labor Organization, (ILO) for the economically active population: all people who supply labor for the production of goods and services during a specified period. It includes both the employed and the unemployed. In general the labor force includes the armed forces and first-time job seekers, but excludes homemakers and other unpaid caregivers and workers in the informal sector.

**Labor force participation rate** refers to the ratio between the labor force and the population above age of compulsory education, usually 15 or 16 years and the current retirement age.

**The economically active population** refers to the labor force meaning individuals who are either employed or unemployed.

**The economically inactive population** includes people who cannot be referred to as either employed or unemployed.

**The employed people** are those who did any work during the reference period or were temporarily absent from work due to such reasons as an illness, care of the sick, leave of absence, strikes etc.

**The employment rate** refers to the ratio of the employed population in relation to the population above age of compulsory education usually 15 or 16 years and the current retirement age.

**Unemployed: 2 types of measurement:**

**1 Registered unemployment** refers to the segment of the labor force registered at the labor offices as unemployed. This administrative approach reflects national rules and conditions and usually generates figures, which are different from those resulting from surveys relying on the so-called ILO concept of unemployment.

**2 International labor organization, ILO, concept of unemployment** is based on 3 criteria and defines as unemployed those people who

- 1) have worked less than one hour in the last week
- 2) are actively searching for work during the latest month using any methods available
- 3) are currently available for work any time in the next 2 weeks.

(Compare for example in table 37 unemployment statistics for Belarus measured according to method 1 above with those of other countries using method 2 above)

**The unemployment rate** refers to the ratio between the unemployed population in relation to the labor force.

**The level of economic activity** is the share of the economically active population in the total population of the respective age group. It is measured in %.

**The level of unemployment** is the share of the total number of the unemployed in the economically active population. It is measured in %.

**Working age population** refers to individuals above the age of compulsory education and below the official retirement age.

tion, and transformation. On the one hand a trend of developing towards a resurrection of real national sovereignty, a striving towards the statehood lost during and after the Second World War, for countries such as Poland, the Baltic States, and erstwhile Czechoslovakia while simultaneously – also as a way of protecting that statehood – on the other hand an endeavor to join larger alliances emerged as in the case with the European Union, whose goal is further regionalization and localization with an implicit loss of autonomy for the nation state. Regaining the power of the state, adjusting to supranational organizations and changing from a planned economy with administrative prices and “soft” budget constraints to a democratic, market economy with “hard” budget constraints have simultaneously been on the agenda during the last decade.

In the planned economy of the Soviet system, productive resources were allowed to be idle, but not the labor force, in contrast to a market economy where the opposite combination usually was at hand. A planned economy normally resulted in the hoarding of labor, overstaffing and therefore hidden underemployment leading to low productivity and efficiency. Unemployment did not exist as everyone was guaranteed work and hence no unemployment statistics were produced. Guaranteeing work, housing at nominal rents with no maintenance, heavily subsidized energy prices, free education, health, and childcare in combination with a contracted wage range increasingly lowered the motivation for work according to Russian researchers. Hence the recent transition for the labor force was becoming a *volte-face*, from a system where the state was in almost total command and control to a vacuum eventually filled in with new institutions, organizations, demands, and criteria.

## 2. Introduction

The Soviet economy was characterized by an increasingly slower growth rate in the 1980s. According to some Russian scholars the very success of the Soviet system in providing all the necessities of life for everybody, though at a low qualitative level, was the embryo of its demise. A number of independent estimates exist on the growth rate of the Soviet economy, its Gross National Product, GNP\* (see Glossary), per capita GNP, productivity and per capita productivity.

Regardless of their different absolute estimates, based on different methods of definitions and calculations, however, all surveys still demonstrate the same two trends towards a decreasing growth rate of GNP and productivity and hence a decreasing rate per capita from that

### Data and methods

This report is based on special surveys conducted in the Baltic states combined with official statistics from the bureaux of statistics in the Baltic Sea Region countries and from international organizations, such as the European Bank for Reconstruction and Development, EBRD, the World Bank and different UN organizations. In Estonia the author was able to participate in the population survey, “Estonia 98” carried out by the Institute for International and Social Studies, Department of Sociology of Family and Culture. This survey “Estonia 98” included 2321 respondents aged 18-70, in which 1575 participated in the section on “Employment” and 119 in the section on “Unemployment” with open questions. In order to see the transformations within the preceding 5 years, data from the survey “Estonia 93” were included. In Latvia a smaller survey was carried out among unemployed women, and in Lithuania among entrepreneurs of small- and medium size enterprises. Since 1991 states of the former Soviet bloc have changed their statistical systems to make them conform to international standards and definitions. Most of the changes occurred in 1992.

of the “Gosplan” – the Soviet Government Plan – to the Soviet economist Kaluynin to his American colleague Steinberg and the CIA, the US Central Intelligence Agency. The very end of the 1980s showed a negative growth rate.

Being fully integrated into the Soviet economy the Baltic states experienced the same trends. Though the Baltic states had been assigned parts of the most advanced industry of the Soviet Union, and achieved the highest welfare indicators of the Soviet republics such as high literacy, low infant mortality, high frequency of medical doctors although much of this had already been accomplished during Independence in the interwar period – however, the standard of living was, in certain important aspects such as in housing space and food intake, still essentially lower than before the Soviet annexation in 1940.

About a tenth of the Baltic population had been deported to the Gulag, or otherwise perished or tried to survive in abysmal circumstances. The 1960s particularly witnessed a massive immigration of Russian labor, as part of a Russification strategy in Latvia and Estonia, where the best employment and housing was reserved for the Russians. When renewed Independence was gained in 1991 the Baltic states tried to turn towards a new system in all aspects as quickly as possible.

Because the Baltic states, like Poland in the interwar period, had experienced the growth of a civil society that was still in living memory of the older generation, one immediate aim was to regain that society and another goal was to become part of Central Europe again.

The most pressing aim was to make Independence irreversible. Ceasing to be “Homo Sovieticus”, a Soviet being supposedly without any national characteristics, and to become a private citizen in your own right cherishing your roots while modernizing into Europe was the new challenge.

Without understanding these forces at work – sometimes contradictory sometimes creating synergy effects – it is hard to understand views on and by women and men on their changing situations in life, family, and on the labor market.

This chapter will focus on the main structural changes in the labor market, on employment and unemployment. (Some definitions and explanations on labor market will be found in inserts here, others can be found in chapter 52 by Susanne Oxenstierna.)



Figure 158. Former kolkhoz in Zalavas, Lithuania. Photo: Alfred F. Majewicz

### 3. Main structural changes in the labor market

The structural changes in the labor market were particularly rapid in the Soviet Union in the 1960s and 1970s, with a drastic reduction of those employed in agriculture and a swift increase especially of those working in industry. During these two decades Latvia and Estonia experienced a massive influx of Russians when, during this heavy industrialization drive, a number of important industries were located and developed there. With a time-lag of one generation the countries of the former Soviet sphere – compared to those of North-Western

Europe – were exposed to a similar pattern of changes in their labor markets and this was further reinforced by the introduction of a market economy in the 1990s, where a decrease of labor in agriculture was rapid, particularly so in Estonia during the last decade.

Lagging in relation to the West, structural changes in Finland were closer in timing to those in the Soviet system. From a peak in the 1970s the proportion of those active in manufacturing shrank both in Finland and in the Soviet system.

A special feature of the planned economies was the underdevelopment of the service sector in both low and high skilled work compared to the market economies. Hence, with a change from a planned to a market economy, a surge in service sector employment could be expected which also occurred in the 1990s. Services consist of both low and high skilled work, in which, for example, some of the high-skilled work in education and health – totally dominated by female workers – and was and is located in the low salary range, while the new service jobs in banking, finance and information technology, IT – totally dominated by male workers – are located in the high salary range, the former being hired by the state and the latter by the private sector (see table 34).

#### 4. Employment

The growth in the labor force in the Baltic Sea Region countries has been negligible during the last 40 years, with a negative growth rate for the Baltic states, while the Nordic countries have achieved their growth partially through the import of labor since the 1950s.

While West Germany experienced a growth in its labor supply through the influx of refugees from East Germany it also imported labor from Southern Europe and Turkey. Because so many East Germans fled their strict, regimented state this planned economy had begun to import labor from another country with even worse conditions, namely Vietnam, thoroughly devastated by war and a rigid, planned economy (see table 34).

Even a Siberian Gulag can be seen relatively as an attractive place for work depending on from where you come. While, as a way of increasing state income, the North Korean state was planning to erect lumber camps – as a Gulag for prisoners – in the remotest corner of Siberia, it realized, however, that this was only possible with a food standard of the Soviet Gulag system. Because of that the government decided instead to let people apply for this work, which meant living in strictly controlled camps behind barbed wire, when not working in guarded labor gangs. There were 200 applicants for every job available.

The growth in the labor force as well as the increase of women in the labor market – though starting from



Figure 154. At work. Photo: Katarzyna Skalska

Table 34. Employment by sector of the economy, 1960 1978, 1993, 1997 in countries of the Baltic Sea region, % of the labor force in agriculture, industry and service

Year Country	Agriculture				Industry				Service			
	1960	1978	1993	1997	1960	1978	1993	1997	1960	1978	1993	1997
Estonia			17	9*			33	34*			50	57*
Latvia*			20	19			28	26			52	55
Lithuania*			22	22			33	27			45	51
Russ.Fed.	42	17	15	14*	29	47	38	32*	29	36	47	54*
Belarus			22				36				42	
Poland	48	33		20	29	39		32	23	28		48b
W.Germany	14	4			48	48			38	48		
Germany			3	3			38	34			58	63
E.Germany	18	10			48	51			34	39		
Finland	36	14	8a	7	31	37	27a	27	33	49	65a	66
Denmark	18	8	5	4	37	37	26	26	45	55	69	70
Sweden	14	5	3	3	45	37	26	26	41	58	71	71

Sources: For the years 1960 and 1978 World Development Report, 1980, The World Bank, August 1980, tab. 19

For the years 1993 and 1997 Statistical Yearbook of Estonia, 1999, p.348

Explanations \* = National sources

Agriculture includes forestry, hunting, and fishing

Industry includes construction, mining, electricity, gas and water supply,

a incl. armed forces

b excl. regular military living in barracks and conscripts

For simplicity West Germany refers to Fed. Rep. of Germany, and East Germany refers to German Dem. Rep

Table 35. Average annual growth of labor force in the Baltic Sea region, in %, selected years

Year Country	1960-70	1970-80	1980-90	1990-98
Estonia			- 0.3	- 0.9
Latvia			- 0.8	- 1.6
Lithuania			0.6	- 0.1
Russ.Fed.	0.7	1.2	0.2	0.1
Belarus			0.4	0.0
Poland	1.8	1.4	0.6	0.8
W.Germany	0.2	0.7		
Germany			0.9	0.5
E.Germany	- 0.2	0.5		
Finland	0.5	1.0	1.0	0.2
Denmark	1.1	0.6	0.9	0.2
Sweden	1.0	0.3	1.2	0.5

Sources: For the years 1960-70 and 1970-1980, World Development Report, 1980, The World Bank, August 1980, tab.19.

For the years 1990-90 and 1990-98 World Development Report, 1999/2000, The World Bank, 2000, tab.2.

Table 36. Females in % of total labor force in Baltic Sea region countries, in 1963-68, 1973-78, 1980, and 1999

Year Country	1963-68	1973-78	1980	1999
Estonia		53*	51	49
Latvia		55*	51	50
Lithuania			50	48
Russ.Fed.		52*	49	49
Belarus			50	49
Poland	44	45	45	46
Germany	40	41	40	42
Finland	42	45	47	48
Denmark	34	40	44	46
Sweden	33	40	44	48

Sources: For 1963-68, 1973-78 World Bank, Social Indicators of Development, (hereafter SID) 1993,  
For 1980 and 1990 World Development Report, 1999/2000, The World Bank, 2000, tab. 3

\* Most recent estimate according to SID-1993 above

Table 37. Unemployment rate in Baltic Sea region countries, selected years, as % of labor force

Year Age limit	1993	1994	1995	1996	1997	1998	1999	2000
Estonia	6.5	7.6	9.7	10.0	9.7*	9.6		
15 – 69						9.9	12.3	13.5
Latvia			18.9	18.3	14.4	14.7		
15 – 69						14.0	13.5	13.0
Lithuania		17.4	17.1	16.4	14.1	13.5		
14+						6.4	8.4	12.5
Russ.Fed.	5.5	7.4	8.8	9.3				
15 – 72	5.9	8.1	9.5	9.7	11.8	13.3		
Belarus**	1.4	2.1	2.7	3.9	2.7			
Poland	14.0	14.4	13.3	12.3	11.2			
15+	16.4	16.0	14.9	13.3	10.3	10.4	12.9	14.0
			14.9	13.2	10.3	10.4	12.9	14.0
Germany	10.4	11.4	12.9	8.8	9.8			
15+								
Finland	17.7	18.2	17.0	16.1	14.5			
15+					10.8			
Denmark		8.0	7.0	6.9	6.1			
15 – 66					4.9			
Sweden**	8.7	8.8	8.7					
15 – 64					6.2			

Sources: Statistical Office of Estonia, "Estonia, Latvia, Lithuania in figures 1999", figures for those countries 1998,  
Statistical Office of Estonia, "Statistical Yearbook of Estonia 1999", Tallinn 1999

For Estonia, Latvia, Lithuania, and Poland line 2 = H'kan Forsberg, "Arbetslöshet hot mot polskt EU-inträde" (Unemployment a threat against Polish EU membership) Dagens Nyheter, (Swedish newspaper Dagens Nyheter) 1 February 2001

For Poland line 3 from Polish Embassy, year 2000= estimate

For Finland, Denmark, Sweden line 2 from Nordic Council of Ministers, "The Nordic Countries in Figures 1998"

For Russian Fed. line 2= "Russijskij statistitscheskij eshegodnik, ofitsialnoye isdanye", (Russian statistical yearbook, official edition,) in Russian, 1999 tab. 6.2

\* refers to national statistics

\*\* refers to registered unemployment

a high level – has been small since the 1960s. In this aspect the Soviet system and the Nordic countries are alike, with only Sweden and Denmark experiencing a substantial increase of women in the total labor force since the 1960s. Hence with a low growth rate of the labor force and women already in the labor market for the last 20-30 years, any expansion and transformation of the economy would entail the retraining of those already in the labor market and/or import of labor and/or a prolongation of working life (see tables 35 and 36).

## 5. Unemployment

Though much was usually done in Western, democratic market economies to counter unemployment particularly when it was politically threatening – retraining and reeducating the unemployed, making it easier to achieve part-time pensions, pre-pensions and shorten the weekly work-time – simultaneously attempts were also made at a prolongation of working life when employment rates were high. These endeavors were in their turn offset by both the Trade Unions, relying on earlier agreements, and by the population that for example in the Nordic countries and West Germany tried as part of its high standard of living and increased quality of life to shorten its work time in various ways.

While the proportion of those employed out of the total population in the rich market economies has been decreasing over time as part of a higher quality of life, the same tendency towards lower labor force participation rates could also be observed in the former planned economies, but for other reasons. One cause was the structural transformation of the whole economy with a shedding of overstaffing and hoarding of labor characteristic of the old system, another the closure of plants when a regime of “hard” budget constraints was introduced replacing the old system of “soft” budget constraints, meaning administrative prices and a constant bailing out by the authorities of enterprises that did not fulfill the norms of the plan. However, while employment in the formal labor market has dropped over time, simultaneously its informal, “gray” and “black”, equivalent has been growing, particularly in former Soviet republics in Central Asia, and in Eastern Europe, except for Poland.

While, for example, Poland’s informal economy has decreased from an estimated 20% of its GDP in 1990 to an estimated 13% in 1995, the reverse trend can be observed in Russia, where the informal sector making up 15% in 1990 made up 42% in 1995, while in oil-rich Azerbaijan in Central Asia the informal sector grew from 22 to 61%.

During the same period the informal sector doubled in Lithuania, from 11 to 22%, while it almost tripled in Latvia from 13 to 35%. Its growing prominence in Latvia was closely related to Latvia becoming a transition country for Russian trade and energy flows.

### Estimating the informal economy

One way of estimating the growth in the informal economy and its associated labor markets is to measure energy usage against reported economic output. If the former is increasing while the latter is decreasing this would imply a growing informal sector. Increased or reduced energy efficiency may to a certain extent be part of the picture. It is acknowledged worldwide that 3 factors contribute particularly to a growth of the informal sector:

- 1) prohibitive tax systems
- 2) costly bureaucratic procedures
- 3) corrupt bureaucratic procedures.

Hence it is hard to calculate if these trends – one towards lower labor force participation rates, the other the growth of the informal labor market – offset each other. For example, a survey of the unemployed in Estonia revealed that a tenth of those jobless enjoyed a higher standard of consumption than those in full-time work.

As unemployment did not formally exist in the former Soviet system, unemployment statistics were only starting in the early 1990s.

A low rate of registered unemployment can indicate a number of factors:

- a) a low level of unemployment,
- b) a low level of unemployment benefits,
- c) strict and/or complicated rules for defining unemployment
- d) strict and/or complicated rules for receiving unemployment benefits,
- e) the existence of an informal economy and hence an informal labor market,
- f) a slow structural transformation from a planned economy to a market economy
- g) a decline in GDP so large and abrupt that an equivalent fall in employment would not be politically possible, hence employment, but not real wages, are kept up, indicating a sharp decline in labor productivity, the standard of living of the employees and hence an increase of the working poor.



Figure 155. Transformation of the economy endangers some traditional professions. Modern heating systems do not need as much service as the traditional, coal-based systems. Polish chimney-sweeps, in 2001. Photo: Katarzyna Skalska

Of the Baltic Sea Region countries, Belarus and Sweden display the lowest rates of registered unemployment (see tab. 37).

While Sweden has relatively generous unemployment benefits, particularly for low income earners, and a high level of voluntarily unionized labor, the opposite would be more true of Belarus, implying that a higher percentage of the unemployed would also be more motivated to register as unemployed in Sweden than in Belarus. The low rate of unemployment may in the case of Belarus also indicate a low level of transformation of the economy as well as a decline in GDP and real wages, but not of employment for political reasons (see fig. 156).

In the transition index from the European Bank for Reconstruction and Development, EBRD, Belarus and Turkmenistan in 1998 scored lowest on 8 different dimensions deemed important for a transition to a market economy such as enterprise restructuring, banking, trade and legal reform, price liberalization, and privatization. In regard to privatization Belarus was placed lowest of the 26 countries of the former Soviet sphere. Furthermore, in the report on macro economic reforms by the EU Commission in 1999, Belarus lagged even more behind, while Hungary was most advanced followed by Poland and then Estonia.

Hence for Sweden factor a) above, while for Belarus factor f) and g) above, would have most relevance in explaining a low level of unemployment.

Hence in countries with a delayed restructuring process open, formal unemployment will usually remain low and Belarus is a good example of this.



In the Russian Federation factors b), e) and g) above, would have the highest explanatory value. While evaluating Swedish cooperation projects in North-Western Russia in 1998, the author encountered individuals living about 100 kilometers away from the bureau where registration for unemployment had to be made twice monthly, where unemployment benefits would not even pay the two bus trips to the unemployment registrars.

In 1998 Russia's GDP had contracted by 45% compared to its 1989 level, hence a hollowing out of real wages followed, with wage arrears and falling labor productivity being considered more manageable than massive unemployment.

Therefore, according to surveys, only one out of six families have managed to improve their lives during the last ten years in Russia, meaning that 62% of the families surveyed had been exposed to a lower family income, another 15% had managed to achieve higher incomes and a quarter remained on the same level. Hence open, formal unemployment could be kept down by a massive lowering of real wages and hence also of the standard of living for the majority of the Russian population.

Exposed to what experts from the World Bank and the International Monetary Fund, IMF, would call the curse of being endowed with abundant natural resources and hence a lesser urgency for thorough reforms, Russia's structural transformation had begun promisingly in 1992 with a rapid privatization in 1994-95, and stabilization in 1995, but was then stalled at mid-point. A sizeable part of the old "nomenklatura" – the Soviet elites of party hierarchy, managers, and bureaucrats – managed to benefit from Russia's voucher privatization schemes. By not being able to gain enough from further reform by exposing its economy to the world market, to the "hard" budget constraints which in the long run would be beneficial for the general Russian public, for generating growth and employment and, increasing competitiveness and efficiency, it managed to slow down the continued restructuring of the economy after the 1996 elections. Therefore a regime of "soft" budget constraints already existing as a left-over from the Soviet system managed to seep into all cells of the economy from enterprises not paying their employees and/or suppliers, debtors not their creditor banks to the state often being behind in paying pensions and wages.

A system of "soft" budget constraints is generally considered a most favorable breeding ground for corruption, while a legacy of secrecy and dictatorship make it worse. Independent estimates show that corruption generally is higher in former and present communist countries compared to non-communist countries with similar cultural backgrounds, raising corruption levels by 2 units on a 0 to 10 scale (see figures in chapter 26 and table 10)

### **"Hard" and "soft" budget constraints**

"Soft" budget constraints refer to the common tendency towards over-investment in a centrally planned economy because of "soft" budget constraints by the bureaucratic-redistributive center in the public sector, which produces excessive demands for investment goods. This demand will in turn lead to a systematic occurrence of shortages, thereby forcing firms to substitute for products and raw materials which in turn will lead to decreased quality and an inability to compete in a high-technology oriented world market. This cause of crisis under state socialism, can only be solved by allowing the emergence of firms and/or an economy with "hard" budget constraints.

"Hard" budget constraints means that prices should not be administrative, but give information about the real cost of products and services. This means phasing out directed credits and budgetary support to enterprises, which in turn initially leads to higher unemployment.

This theory was developed by Hungarian economists, particularly Janos Kornai, mainly during the 1970s, in order to explain the difficulties of planned economies in competing with market economies. (See prof. Janos Kornai, *The Economics of Shortage* 1980)

As was already shown 20 years ago, rent seeking by vested interests was more profitable than productive activities in developing countries. This also turned out to be the same for some transition economies. Much higher profits could be made by acquiring privileges than setting up new industries. Side-payments and corruption were natural side effects of such a new rent-seeking system.

Hence the further a country has managed to transform its economy towards an open system, with transparency, with managers and politicians being held accountable and re-appointable, the less corruption this society experiences. Hence a close inverted correlation between the level of transformation and corruption can be observed, the more transformation the less corruption and vice versa. (compare fig. 156, figures in chapter 26 and table 10).

Surveys – such as the one carried out by the EBRD in combination with the World Business Environment Survey covering 10 000 firms in 90 countries – show that the costs of corruption fall disproportionately on the poorer segments of society and on smaller enterprises and also hinders growth and employment as smaller enterprises in particular generate employment.

The positive correlation between lack of corruption, growth and democracy has been established by, among others, the Nobel Prize Winner in Economics, professor of Economics at Harvard University, Amartya Sen.

The wish to join the European Union, EU, has worked as a great incentive for implementing structural reforms in applicant countries, while lacking this motive force reform has resulted in lagging or stalling and has hardly begun.

Though the structural transformation so far has been relatively successful for the Baltic states and Poland, unemployment has remained on a high level and is threatening to increase even further.

Turning to the Nordic countries, Finland's unusually high unemployment rates for the 1990s can be explained by two factors: its relatively high proportion of foreign trade in relation to GDP and the dependence of this trade on the Soviet market, particularly for exports. With the implosion of the Soviet Union, roughly half of Finland's export trade market vanished and a reorientation of foreign trade began with ensuing high unemployment (see table 37).

Being used to unemployment rates hovering around 4% from the 1950s onwards combined with a slow growth of the labor force and a fast growing economy, Sweden since the 1950s had become a labor importing country. However, through a self-induced crisis it experienced high unemployment in the early 1990s. Sweden then decreased some of its unemployment, initially cosmetically, by converting some of the unemployed into different categories, such as adult students, participants in retraining courses, pre-pensioners. After the mid-1990s the growing economy led to decreased unemployment and a boom and bust in the modern IT sector.

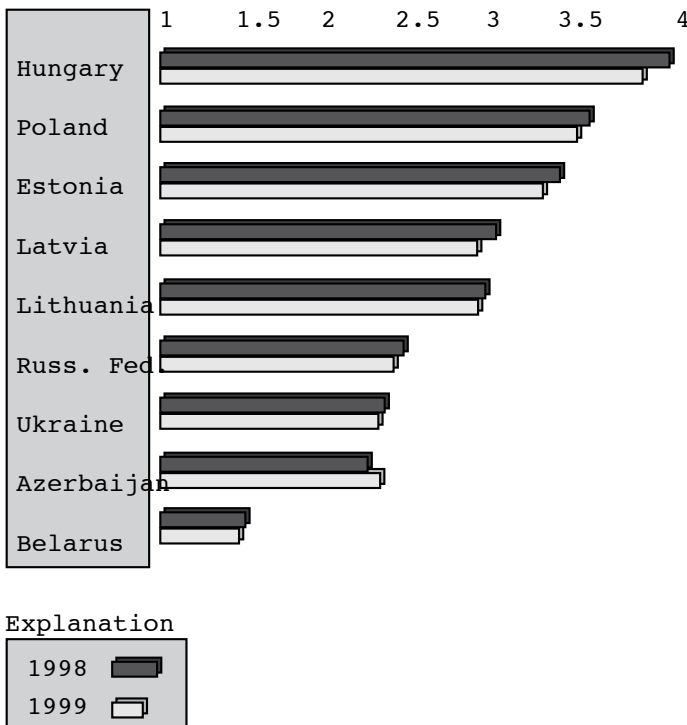
Being endowed with the most generous unemployment benefits of any country, in the end swallowing up more of the budget than social security, Denmark began tightening up its unemployment system in the 1990s and with every tightening of the rules unemployment lessened. Researchers discussed whether the decrease of unemployment was more caused by stricter regulations or by an upsurge in the economy, but the correlation in time between the tightening of rules and reduction in unemployment was indisputable, as was the economic upsurge.

## 6. Conclusions

In the Soviet system structural changes on the labor market were essentially the same as those in Western Europe but with a time lag of 20-30 years. Hence, the decrease of those working in agriculture began at a much later date, while the service sector, subdued in the planned economies, only experienced an accelerating expansion when the transition to market economies began. Industrial employment peaked in North-Western Europe in the 1960s, only to reach its top 20 years later in the Soviet system. Though being part of the Nordic area and a market economy, Finland with half of its trade with the Soviet Union, showed a development in time closer to that society. After the demise of the Soviet Union the exports of mineral and energy resources in the Russian Federation initially softened the shocks of transition while simultaneously contributing to delays in reforms and restructuring. Halfway through the reforms the new *nomenklatura* managed to halt further reforms.

Just as the robber barons of the era of wild capitalism during the industrialization period in the United States in the late 19th century were the predators over time turned conservators a somewhat similar development might be perceived for Russia. To protect recently acquired wealth, a system with the rule of law rather than lawlessness would be preferred. For example

Figure 156. Indicators of reform in transition economies, on a scale from 0-4, with 4 being the highest, 1998 and 1999.



Sources: Data for 1998 from European Bank for Reconstruction and Development, EBRD, "Transition Report 1998: Financial Sector in Transition", London, 1998

Data for 1999 from Dagens Nyheter, (Sweden's largest newspaper broadsheet) Marknadsekonomska reformer i Öst, (Market economy reforms in the East) 16 September, 1999, data from the EU Commission

the American robber barons became increasingly interested in following laws which aided them in protecting their new riches. Likewise, to make higher profits on ill-gotten capital, a stronger economy is needed that is more beneficial than barter trade. Hence rule of law, protection of property rights, price stabilization, privatization and economic expansion were, over time, in their interests.

Meanwhile as the economy contracted particularly for Russia and Belarus massive lay-offs and unemployment were not a political option. Hence roughly speaking the same number of people was producing half the amount of the production as in 1989, meaning real wages sank, labor productivity sank as did the standard of living of the employees.

Simultaneously the “gray” and “black” economy and labor market grew. Those in formal employment sank in number over time. Whether these trends outbalance each other or not is hard to calculate.

But open large unemployment was avoided, paid by a drastic lowering of the standard of living for two thirds of the population.

Though on the surface similar developments were visible in North-Western Europe such as a contraction of those in the labor force, the underlying causes were different, with a higher quality of life being the the main cause in the West.

The wish to join the EU has also acted as a prime motivation for applicant countries, while lacking this reform has been so much slower.

Corruption particularly hurts the poorer segments of society and the small entrepreneurs, the latter being those that create new employment particularly well. The further from Western Europe, the more years under communism and the less of secondary education the higher the level of corruption, that is the lesson of large surveys being carried out.

Hence democracy, transparency, the rule of law, making decision makers accountable and removable are essential and critical ingredients in building a successful market economy and in creating growth and employment.