

## CAPITALISM, SOCIALISM AND INCOME DISTRIBUTION

A Review of Anthony B. Atkinson and John Micklewright, *Economic Transformation in Eastern Europe and the Distribution of Income*, Cambridge University Press, Cambridge, 1992, pp. xvi-448. ISBN 0-521-43882-9.

The collapse of communism in Eastern Europe is having major economic, political and social consequences. This book has been made possible by those events and should serve as an important resource for evaluating their effects in at least one dimension, that relating to the distribution of income. It has been made possible partly due to increased access to distributional data for the U.S.S.R. but also because of the more open interaction which now exists between scholars and statisticians in the countries of former Eastern and Western Europe. This in turn has allowed data issues to be discussed and questions of data quality, scope and coverage to be pursued more vigorously. The evidence for this is to be found in the Acknowledgement to this volume, where its authors refer to the assistance provided by no less than 28 named individuals from statistical and related agencies in the four Eastern European countries included in the study—Czechoslovakia, Hungary, Poland and the U.S.S.R.

Such collaboration is commendable and bodes well for future endeavours of this kind. Its fruits are all too easily recognised in this work, not only in the meticulous attention to detail throughout the analysis, but also in the 40 page discussion of data sources and methods and the 140 page Statistical Appendix which presents the raw data used in the study. This information alone would probably be sufficient for the book to serve as the definitive study for years to come, but when it is combined with the analytical and methodological skills exhibited in the 245 pages of text, it ensures that the book will serve as a classic for scholars of income distribution and the performance of the former Eastern European economies alike.

Here we have all that is best in empirical economics and applied statistics: leading-edge methodological techniques applied (sometimes after a good deal of detective work and the mundane hard slog of empirical research) to the best available statistics and described with great authority and clarity. All in all this is an excellent book in every regard and one which should serve to further promote the study of income distribution within the discipline of economics away from the “relegation zone” where it has languished for far too long.

Since the distribution of income is the outcome of a particular nexus of public and private (or state and market) economic and social institutions, income distribution is best studied within the socioeconomic context within which incomes are produced and distributed. To fail to do so is to put at risk the real insights to be gained from, and lessons to be learnt by, the study of the distribution of income and of its components. The last two decades have witnessed a virtual revolution in applied income distribution research (much of it reported in the

pages of this *Review*). This has been made possible by increased availability of data and greater clarity of methodological technique, but it has been motivated also by increased interest in the subject in a world of disappointing economic performance and a switch in emphasis in policy from state to market—from intervention to a more *laissez faire* approach to the determination of prices, wages and household incomes. This latter development is receiving support from governments worldwide and it is thus of as much interest in the context of structural adjustment in Western economies (OECD, 1990) as in the context of economic transformation in the nations of the former Eastern block.

Having said this, Atkinson and Micklewright's main focus is not on how income distribution in Eastern Europe changed during the *process* of economic transformation, but rather on describing the distributional position *before* the reform process began. Their aim in so doing is to "provide a base of evidence against which the economic transition of the 1990s can be assessed" (p. 5). The approach of the book is to present results which are as directly comparable as possible between the five countries studied, the four Eastern European nations already mentioned plus the United Kingdom. The inclusion of this particular set of countries thus permits comparisons to be made of both income distribution *within* Eastern Europe as well as *between* Eastern and (at least one) Western European countries.

In focusing on the comparative method, the book benefits from all of the insights which can flow from the approach, not only in that the results themselves are greatly enriched but also because comparisons inevitably raise questions about the causes of the observed differences which lead, in turn, to the tantalising but exciting path from description to explanation. The benefits of the comparative approach to income distribution will already be familiar to readers of this *Review* who will have been exposed to a number of excellent examples using data from the Luxembourg Income Study (LIS), including the contributions by Buhmann, Rainwater, Schmaus and Smeeding (1988), O'Higgins, Schmaus and Stephenson (1989) and, more recently, Green, Coder and Ryscavage (1992).

The benefits of the comparative method were summarised succinctly by one of the authors of the current study in his Introduction to the first book based on results from the LIS project, where he noted that:

"Comparisons across countries may therefore provide useful indicators as to where domestic policy is in need of scrutiny, but there are limitations to what can be learned from straightforward comparison of two or more countries without any explicit modelling of the policy differences" (Atkinson, 1990, p. xxii).

Unfortunately, Atkinson and Micklewright did not have access to microdata as have researchers involved with LIS, but they have followed the same guiding light—that of striving for data comparability so as to increase the likelihood that the observed similarities (or differences) which emerge are real and not the outcome of the different concepts or definitions used to derive them. It does, however, need to be recognised that the comparability issue may take on an additional, more problematic dimension when making comparisons across economic systems rather than across countries within one particular system. Here too, the authors are all too aware of the pitfalls, arguing that the difficulties of making

East–West distributional comparisons rest not so much on the lack of reliable data for socialist countries, but rather that;

“the major difficulties (are) those of the comparability of data from different countries and of the interpretation of income distribution data in the context of very different economic and social systems” (p. 109).

As ventures like the LIS project—which is currently expanding its coverage to include several Eastern European countries—resolve many (though not all) of the data comparability issues, it is important not to lose sight of the issue of data interpretation. This may be of potential importance within, as well as between, alternative economic systems. Many Western countries, for example, underwent personal income tax reforms in the 1980s which lowered marginal rates whilst maintaining revenue through the introduction of measures designed to broaden the tax base. As a result, many previously un-taxed forms of income (employer-provided fringe benefits; capital gains; etc.) were brought within the tax net. It is likely that these changes will have affected how incomes are recorded in household surveys and thus influenced the interpretation of measures of recorded income distribution. Tax reforms designed to reduce actual post-tax inequality may thus, paradoxically, show up in the data as an increase in recorded pre-tax inequality. How important such matters are for the validity of income distribution comparisons across countries with such enormous differences in attitudes to, and the role of, money income must remain an open but important question.

What then, of the findings which emerge from the study? Do they confirm that the distribution of income is far more equal under socialism, or support Arthur Okun’s presumption that:

“Any realistic version of American socialism that I can envisage would . . . achieve only a small improvement in equality at the expense of a significant worsening of efficiency” (Okun, 1975, p. 61).

The three broad distributional measures analysed by Atkinson and Micklewright, are the distribution of earnings among full-time workers, the distribution of household incomes and the head-count poverty rate. Comparisons are made on all three dimensions across the five countries at the end of the 1980s and developments during the 1980s are also considered. Due to the need to interpolate the shape of the entire income distribution from published statistics, particularly in the higher income ranges, the decile shares and percentile rates ( $P_{90}/P_{10}$ ) are given more emphasis than conventional summary measures of inequality like the Gini coefficient.

In relation to the distribution of earnings among full-time workers—where the data for Eastern Europe appear to be quite similar to those derived from the British New Earnings Survey—the percentile ratio at the end of the 1980s was around 2.5 in Czechoslovakia, 2.6 in Hungary, 2.8 in Poland and 3.3 in the U.S.S.R.: the corresponding figure for Great Britain (in 1986) was 3.2. Overall, the distribution of earnings is very similar in Britain and the U.S.S.R., but aside from that, earnings are less dispersed in Central Europe than in Britain. It is perhaps worth noting that the recent study of earnings inequality among OECD nations undertaken by the OECD indicates that earnings inequality in the U.K.

(actually Great Britain) was in fact at the upper end of their comparisons. The British male percentile ratio in 1990 of 3.2 estimated in the OECD study compares with a ratio at about that time of 2.2 in Australia, 4.0 in Canada, 3.2 in France, 2.3 in Germany, 2.1 in Italy, 2.8 in Japan and 2.1 in Sweden (OECD, 1993, Table 5.2).

These estimates thus serve to undermine any simple dichotomy of the extent of earnings inequality between Eastern and Western European nations. It is simply not the case that the degree of earnings inequality in the former nations was consistently below that in the latter. Further reinforcing this conclusion is the finding by Atkinson and Micklewright that earnings inequality changed considerably over the course of the 1980s (often from year to year) within the five countries studied. Indeed, they indicate that these intertemporal differences are not much smaller than the cross-sectional differences which existed at the end of the decade (p. 87). They go on to suggest that the former “appear to reflect at least in part deliberate acts of government policy” (p. 93) but unfortunately do not expand on the point.

In relation to the distribution of household incomes, the comparative story is broadly similar to that for full-time earnings. The measure used here is the individual (i.e. person-weighted) distribution of household per capita (net) income. Published statistics based on this measure are readily available for the Eastern European countries and these are preferred by the authors to estimates of equivalent household incomes because of the problems inherent in choosing a single equivalence scale which enhances, rather than detracts from the comparisons. Using the percentile ratio ( $P_{90}/P_{10}$ ) as before, inequality is again lowest in Czechoslovakia (2.4), followed by Hungary (2.6), Poland (3.0) and the U.S.S.R. (3.3). The corresponding figure for the U.K. in this case is 3.9, and it is noticeable that the difference between the distributions of earnings and household income is more marked in the U.K. than in the four socialist countries. The reasons behind this finding are not explored by Atkinson and Micklewright. This is a pity because one might have expected the opposite to occur, particularly given the explicitly redistributive role of transfer incomes as means of countering the more heavily market-oriented distribution of earnings in the U.K. The fact that this does not happen presumably reflects the incidence of unearned (not-transfer) incomes, in combination with the distributional profile of part-time work, unemployment and non-participation in the labour force.

Analysis of changes in income distribution over the 1980s reveals a pattern all too familiar amongst many Western nations—the tendency for inequality to rise (Atkinson, 1993; Fritzell, 1993; Gottschalk, 1993). The extent of the rise in income inequality in the U.K. after the late 1990s has already been well documented. Within the four Eastern European countries, there is no common trend in inequality over time. There was a steady increase in inequality throughout the 1980s in the U.S.S.R., a decline in Poland between 1984 and 1988 which is more than outweighed by a sharp rise the following year, and a sharp rise in inequality between 1982 and 1987 in Hungary. There is, however, an exception in the case of Czechoslovakia, where inequality declined slightly between 1980 and 1985, the slight increase thereafter not sufficient to offset the overall downwards trend.

The discussion of Western and Eastern approaches to the measurement of poverty in Chapter 7 is fascinating. All four Eastern European countries have developed a consumption-based poverty standard which is independent of the level of social benefits, not unlike the U.S. poverty line. Using national poverty standards for each country, poverty in the 1980s is found to be around 7.5 percent in Czechoslovakia, between 10 and 15 per cent in Hungary and between 10 and 25 percent in Poland. In the U.S.S.R., the official estimate of the poverty rate in 1989 puts it at around 14 percent, although there is a great deal of variation around this figure in the different republics, ranging from below 2 percent in Estonia to over 51 percent in Tadzhikistan (Table 8.4, p. 241). No evidence on poverty is provided for the U.K., partly for reasons of lack of data, but also because of the absence of a consumption-based poverty standard. In general, this part of the study has much less of a comparative focus than the earlier distributional analysis, its aim being to document the approaches used in each country and to bring together the available results, rather than to provide an exhaustive comparative analysis of these results.

Sandwiched between the chapters on income inequality and poverty is an important analysis of the distributional impact of some of the factors which have often in the past been thought to detract considerably from East–West inequality comparisons based on money incomes. After all, money income is supposed to play a far more dominant role in market economies than in command economies, where resource allocations do not always respond to purchasing decisions backed by monetary demands. The first issue addressed is the distributional impact of noncash social benefits, specifically in the areas of health and education. There are substantial conceptual and measurement issues involved here, but the authors conclude that the available evidence suggests “similarities in the general impact of social benefits, but there are noticeable differences when we examine individual spending categories” (p. 159). Having for the last few years been involved in a comparative study of the distributional impact of noncash education, health and housing benefits based on the LIS microdata—the results of which have recently been published in this *Review* (Smeeding *et al.*, 1993)—I am able to report much the same findings for Western countries.

In relation to the impact of price subsidies, indirect taxes, shortages and privileges for the elite, the authors are less sanguine, although they point out that these do not only exist in socialist countries. Again, it is emphasised that to treat all Eastern European countries as a single block is misleading, because of the real differences which exist between them. Since they are unable to reach any conclusions in this section, and in light of the enormous conceptual and practical difficulties involved, the authors support the call for the devotion of “more statistical and analytical resources to the resolution of these difficulties, or the evaluation of their consequences” (p. 177), a conclusion with which it is difficult to take issue.

However sophisticated the analytical techniques employed, it has to be remembered that research on income distribution is ultimately only as good as the data on which it is based. Here, the conventional wisdom has been that distributional data for socialist countries have been either non-existent, of poor

quality, not published, or some combination of all three. Blades (1991), for example, has recently observed in relation to the situation in Central and Eastern Europe that:

“... because they had no independent status, many statistical offices were required to be highly selective in publishing their data. Statistics that cast an unfavourable light on economic and social developments were not published or were presented in ways that made it difficult to draw the appropriate conclusions”. (Blades, 1991, p. 13).

In their penetrating and informative analysis of data quality, Atkinson and Micklewright argue that the actual practice and quality achievements of the West (in their case, the U.K.) represents an appropriate benchmark against which to evaluate performance in Eastern Europe. In relation to earnings, they conclude that the earnings surveys for Eastern Europe exhibit more similarities with, than differences from, their British counterpart. The authors then show how perceptions in the West about the quality of data on household incomes in Eastern Europe have been clouded by the acknowledged deficiencies of data for the U.S.S.R. but that the budget studies data for the other three countries “compare favourably with the information available for Britain” (p. 74). Britain itself is perhaps of somewhat questionable relevance as an appropriate benchmark given that, unlike most other Western countries, the availability of data on income distribution declined over the 1980s. Overall, however, the discussion of data issues indicates that the view that statistics have been of poor quality and/or were selectively suppressed in Eastern countries, but are of uniform high quality and openly available in the West is little more than a myth.

The book is brought to an end all too abruptly. On page 245 the reader is still enmeshed in the issues surrounding the usefulness of income as a measure of the living standards of mountain shepherds in Uzbekistan (because of their access to high-grade meat, a valuable employment-related fringe benefit) and about twenty lines later the book—or at least its main text—is all over. This sudden ending partly reflects the authors’ unwillingness to engage in any overall interpretative analysis of their findings. There are many reasons for why this was probably a wise decision, but some such assessment, however cautious and guarded, would have been welcomed, particularly given the undoubted wisdom and authority of the authors.

However, that is a minor quibble. The book has so many strengths as a piece of scholarship that any criticism quickly pales into insignificance alongside the book’s many valuable contributions. It is an example of applied economics at its best and illustrates how useful and informative, provocative and powerful, such attempts to “establish the facts” can be. The book dispels many of the myths which have surrounded previous research in this area which have in part developed from Western researchers doing their best to analyse and interpret what was widely-recognised to be deficient and inadequate data. Atkinson and Micklewright have uncovered a wealth of new data which will forever change perceptions about East–West comparisons of income distribution. In the process, they have revealed that many of the data problems traditionally associated with Eastern Europe are also to be found in Western nations (at least in the U.K.). They have also

succeeded in establishing distributional benchmarks for the pre-reform period, against which subsequent performance can be judged. We are all in their debt for the enormous effort and expertise that has gone into producing this excellent book.

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