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PRESS RELEASE

Wage and employment effects of a wage norm: The Polish transition experience

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In imperfectly competitive markets, wages and prices can be set according to the market power of participants. The efficiency cost and the redistribution effects are not always those desired by the government or by society. In transition economies, the inheritance from central planning made market power a key issue; competition could not be taken for granted. Moreover, the redefinition of property rights and the liberalisation of wages and prices could affect the objectives and the bargaining power of employers, employees and consumers drastically. A specific problem with wage liberalisation in state firms could be the decapitalisation of the firm by the workers. In transition economies inheriting no unemployment, layoffs were bound to increase due to reallocation needs across firms in transition, but the market power of firms on the goods market and of unions on the labour market could make unemployment needlessly high.

In this context, and out of fear of excessive wage increases, most transition economies have introduced some form of wage norm, usually at the firm level, and enforced it through taxes on the wage bill side or from the average wage exceeding the norm. Poland made heavy use of an excess wage tax in 1990 and 1991. There, back in 1990, the norm and the tax were based on the wage bill of each firm, in an environment starting with no official unemployment. In 1991, Poland switched to the average wage of each firm as the reference. Between 1992 and 1994, it slowly dismantled the system, while many observers estimate that firms and unions adjusted quite quickly to the new market system. In Eastern Germany, after reunification, wages were raised in an attempt to accelerate convergence between East and West. There, Akerlof, Rose, Yellen and Hessenius (1991) suggested a wage subsidy to help firms cope with this wage shock until productivity had recovered.

The paper extends the literature on wage-setting and excess-wage taxation in a transition economy by looking more specifically at the labour-demand effects of a tax-enforced wage norm at the level of the firm, as implemented in Poland in 1990 and 1991. We show that taxing wages over and above a norm affects the demand for labour perceived by the union by rotating it around the norm. We prove that, under the assumption of a monoploy union, this tax yields an increase in equilibrium employment, and this result can be extended to a wide range of cases in the right-to-manage setting. In the efficient bargaining model, the mechanism leads to an employment increase only if the tax may be turned into a subsidy.

We test the effect of the norm on the wages on a unique dataset drawn from Polish firms in 1990 and 1991. The data support the role of the wage norm on the position of the perceived demand for labour and the role of the tax rate on its slope. The empirical analysis confirms that the excess-wage tax has indeed been favourable to employment in Poland in the early transition years 1990-1991 and that it may have protected firms from excessive decapitalisation by shielding the employer surplus from excessive wage claims.