

# RELATIVE CAPITALIST SYSTEMS AND FAIRNESS IN THE BALTICS: THE CASE OF LITHUANIA

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**Abstract.** *This paper deals with the concept of fairness as it is applied to economic decision making in different cultures. The objective of the research is to determine whether the concept of fairness can be applied universally throughout all cultures by doing a study in Lithuania and comparing it to similar studies done in other countries. Lithuania was chosen because it belongs to the group of the Baltic advanced transition countries with their own unique form of capitalism. We find that Lithuanians are more apt to consider price or wage changes as fair as long as there is an underlying macroeconomic reasoning for the price change. These effects were found to hold true in spite of the framing effects of loss aversion found in previous studies.*

**Key words:** *behavioral economics, fairness, capitalism, Baltics, Lithuania*

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## Introduction

According to standard neoclassical economics, the behaviour of consumers is assumed to be guided in a universal rational way. One of the main goals of economics has been to investigate and discover the basic rules of economic interaction which can be applied to all economic actors. However, not all economists are satisfied with the idea of universality as, for example, the economic outcomes of countries which start from similar conditions vary widely. In reaction to the problems of the neoclassical universalist approach, research in behavioral economics has attempted to understand why and to what extent this theory deviates from reality. However, the behavioralist approach also tries to find some kind of a universal understanding of fairness to explain some of the behaviours unexplainable in the neoclassical model.

This paper will challenge both the neoclassical and the behavioral economics perspectives and criticise the notion that human economic decisions can be catalogued in a universal way. This paper will posit that cultural factors lead to a heterogeneity in economic interactions among actors in different countries with regard to fairness. We will attack the problem by first reviewing the relevant literature beginning with the literature dealing with fairness and culture in economics, and then moving to the subsequent

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varieties of capitalism which these cultural differences have spawned. The purpose is to show that the concept of fairness and the concept of capitalism depend on the historical and cultural context of society. Importantly, the difference in cultures and forms of capitalism result in different perceptions of fairness amongst the general population. Thus, the results of doing experiments in affluent western countries cannot be generalized to the rest of the world. Finally, the authors will present the results of a survey done according to the past surveys, to investigate whether the results of economic decisions and fairness hold universally by examining the case of Lithuania. To the present day, very little research has been published on perceptions of fairness and economics in Eastern Europe since Soviet times.

### **Literature review on fairness**

Neoclassical economic theory has little to say with regards to fairness. The model predicts that workers and consumers are utility maximizers who like being paid and dislike effort. An early challenge to this concept comes from Akerlof (1982) who referred to the example of ‘cash posters’ to examine the case of young women who consistently worked above the minimum requirements of the job (by 15%) without wanting or expecting any promotion or extra pay. From the classic theory, one would expect that since the pay was the same and there was no possibility for advancement, the workers would try to minimize their effort. The apparent inconsistency here stems from the sense of fairness and gift exchange between the employees and the employer. The employees give the gift of extra work to the employer, and in return extra slack is given to the weaker team members of the group by the employer. This created a sense of fairness amongst the employees, which was not accounted for in any of the classical models.

In order to be clear with what is meant by fairness, we can reference the definition put forth by Festinger (1954). Fairness stems from the innate need for humans to compare their situations to those of others. What is determined to be fair treatment depends on the comparability of the treatment faced and by the norms of the people around us. Festinger makes use of the analogy of the child who has just hurt himself / herself and is deciding whether or not to cry. The child looks around at the surrounding adults and uses social cues based on the adults’ reactions to either cry or not cry. Our determination of what is acceptable behavior directly stems from the approval or disapproval of those around us.

Another contribution to the study of fairness in economics stems from behavioral economics. Before this advent, it was widely assumed that fairness was irrelevant to thinking about economics (D. Kahneman, J. L. Knetsch, R. H. Thaler, 1986b). Fairness had been included in many of the other social sciences, and thus, these authors questioned why fairness had not yet been incorporated into economics. According to Kahneman et al. (1986a), the behavior, with regards to achieving a gain, is only fair as long as

it is not simply making a gain at the expense of another. In effect, their theory ('Prospect Theory') posits that people view fairness, regarding gains and losses, relative to some neutral reference point (Kahneman, Tversky, 1979). Thus, they predict that consumers are loss averse in that they feel more strongly about losses vs. non-gains than they do about non-losses vs. gains, even though numerically both situations might be the same.

One of the most basic questions in microeconomics from consumer theory asks: what determines the purchasing decisions of consumers? Unfortunately, the standard model is unable to explain the strange outcomes like, for example, revenge, where people will choose the outcome that may hurt themselves if it also hurts someone who they deem as being unfair. "(A) People are willing to sacrifice their own material well-being to help those who are being fair; (B) People are willing to sacrifice their own material well-being to punish those who are being unfair" (Rabin, 1993). This idea has perhaps been best illustrated in the 'ultimatum game' whereby one player is given a certain amount of money and asked to decide how much to share with another player. The other player, on receiving the offer, can accept or reject it. If the offer is accepted, both parties keep the money, but if it is rejected, both players get nothing. Experiments have shown that players who receive unfair offers routinely reject the offers, even though they would have been better off from the monetary stance by accepting them.

This basic definition of fairness does not easily translate into a neoclassical model because it lacks the mathematical rigor required. An attempt at remedying this and relating fairness to economics describes fairness as "self-centered inequity aversion" (Fehr, Schmidt, 1999). From the economics perspective, this definition is more easily modeled as a utility function which can be maximized where the utility is based on minimizing inequality in the respective payoffs of agents. This ground breaking addition to the fairness literature was viewed as bridging the neoclassical models and the behavioral models because, when applied to several of the classical game experiments like the ultimatum game and the gift exchange game, the Fehr Schmidt model was in line with the results of the game results, while the earlier "self interest" models were not. While this definition of fairness provides clarity, it is inherently limited by the constraint of viewing fairness concerns as pure inequity aversion. This, for example, would not take into account altruism, as the authors concede. Another problem with this approach is that it assumes that economic actors are purely rational. The authors admit that in the initial stages of a game participants often do not behave according to the model but that they do often learn over time with repeated games.

Fairness may also be thought of as depending on cultural values, but culture has long been problematic in economics. As an explanatory variable, it is often considered to be vague and unreliable. However, some economists have pioneered ways to analyze cultural influences on economic outcomes. According to Sapienza, Zingales and Guiso

(2006), the incorporation of culture in economics was a slow process that only began in the 1990s. The 1990s provided a tumultuous time in the global economy due to the collapse of communism in Eastern Europe. Almost immediately, the transition economies began diverging in terms of economic outcomes with countries which had higher levels of pre-communist cultural and political development performing better than the others. This fact flew in the face of the standard economic models, which would have predicted that these economies all have similar economic outcomes. Obviously, culture had a role to play in the divergence.

Relating fairness and culture, little has been researched with regard to how ideas of fairness could differ between countries and cultures. Bicchieri and Chavez (2010) relate the concept of fairness to culture and develop a theory of social norms to explain how different cultures can differ in their ideas of fairness. They hypothesize that social norms have several specific characteristics: that they exist, that people believe that others will also follow these social norms, and that there will be punishment for transgressions. According to this idea, radically different manifestations of fairness may develop depending on the social norms of the society in question. Taking a survey relating to fairness of, say, Canadian respondents and expecting them to be similar to American or Western European respondents would be a logical conclusion given the assumption that all of these groups share a common cultural heritage and also social norms. However, taking countries with different social norms should produce different responses on what is considered to be fair. This could contradict the prospect theory, which tries to be broad enough so that it applies to all people and cultures.

### **Literature review on the varieties of capitalism in the Baltics**

Although capitalism as a concept has existed for a long time, the comparison of different forms of capitalism has gained significant momentum since the breakdown of communism. Different societies have implemented the ideas of modern capitalism (private property, free markets, wage labor) in various ways. The discussion about the varieties of capitalism is essential as it might explain the different perceptions, approaches, and conclusions individuals draw.

Scholars have tried to cluster and distinguish the various capitalistic systems in the world. One way was to define the prerequisites for 'real' capitalism - as a "combination of private ownership of productive enterprises with competition between them in the pursuit of profit" plus "ownership and ultimate control are vested in capital as distinct from labour" (Chryssides, Kaler, 1993). Basically, other 'non-pure' forms allow a modification of this definition. For example, the German model of the Social Market Economy, which is based on the idea of ordoliberalism, combines the idea of the free market economy with state intervention and regulation in order to establish fair competition – in

other words, the idea of a free market economy within a framework which is set and coordinated by the state. The Scandinavian model, on the other hand, focuses mainly on the redistribution of wealth and the ‘principle of equity’ to support the weakest in society to catch up.

The ‘principle of coordination’ was also applied by Hall and Soskice (2001) by identifying two distinct types of capitalism. The focus is on five spheres (industrial relations, vocational training and education, corporate governance, inter-firm relations, and employees), which allow to analyze the way how institutional spheres interact in various capitalistic systems (Kuokstis, 2011). The reason why a country chooses a specific system has to do with the historical, legal, and cultural roots of a society. According to Hall and Soskice (2001), the United States is the closest to the first type which is termed Liberal Market Economy (LME). Other countries which are close to this ‘ideal’ type are Australia, Canada, Ireland, New Zealand, and the United Kingdom. Germany, on the other hand, is the most extreme example of the second type – the Coordinated Market Economy (CME). Hoepner (2007) argues that coordination is not only coordination per se, but it also organizes the role of institutions which consider their task not only to improve the efficiency of markets but also to improve social issues. Besides Germany, also Japan, Switzerland, Belgium, Sweden, Norway, Denmark, and Austria are close to the ‘ideal’ CME type (Crouch, 2005).

Both systems (LME and CME) can be distinguished from each other by the five spheres listed above, but they show a similar relationship with respect to economic growth (Hall, Gingerich, 2009). Economic growth was found to be higher when market coordination (LME) or strategic coordination (CME) is extreme, and lower when both types are combined or not well-developed. This is an important finding, considering the ongoing discussion about the question of the best form of capitalism in a globalized world. This hypothesis by Hall and Gingerich supports the idea that other factors, such as culture, might decide which system fits best for any given society.

Hall and Soskice (2001) relate the two previously mentioned systems to the different behavior of economic actors in a market system. The “firm or employer centered account of the origin and function of the welfare state as an institutional device designed to enhance the efficiency of economic transactions” is considered to be an important contribution to the discussion of capitalism and its variations (Streeck, 2010). Whereby employers in countries representing the LME type have the power to set wages which are often based to the idea of supply and demand, employers in countries related to the CME type have significant restrictions. These include strict labour-market regulations, job protection and wage negotiations with the labour unions. Stock markets in LME type economies are considered to be the driving force of the economy, and the maximization of the shareholder value is, therefore, considered a primary task. As an obvious outcome,

investors have very little interest in long-term commitments and are rather interested in short-term profits. This results in relatively little investment in employee skills, as the present hire-and-fire culture results in a high turnover of employees. A lack of training in the job place leads to a relatively low degree of adaptive innovations. On the other hand, shareholders have the opportunity to switch their investment focus to new projects allowing a high degree of radical innovation. Moreover, a CEO, whose overall goal is to increase the shareholder value, has to consider the interests and opinions of its employees as secondary. There has been substantial criticism by Crouch (2005) on the logic and consistency of several of these assumptions (e.g. innovation in 'new industries' such as IT is classified as a radical innovation, whereby a similar innovation in the 'old industry' is classified as an incremental innovation).

Streeck (2010) identifies four models of capitalist variety, based on the kinds of social forces which result in it. The Social Embeddedness Model stresses the social-structural and cultural role in the economy. Moreover, it emphasizes the traditional role of economic order, focused on long-term profitability and on strong network ties. One country which is typical for this model is Japan. In contrast, the Power Resource Model is politically based and focuses on the role of the state in redistributing wealth and collective bargaining. This egalitarian approach is based on social-democratic social policy and is predominant in Scandinavia. On the other hand, the Historical-Institutionalist Model supports the role of institutions to regulate and accommodate the interests of the market and the state (society). This concept is heavily rooted in the historical context of the country and is present in Germany or Austria. Finally, the Rationalist-Functionalist Model is based on the idea of perfect competition in a globalized world. It denies the impact of institutions or culture on the economy and stresses efficiency and a strive for competitive advantage as policies for decision makers.

Other models of distinguishing the types of capitalism are provided by Amable (2003). He identified five types of capitalism by focusing on macroeconomic aspects: the Social-Democratic Model, Mediterranean Model, Continental-European Model, Asian Capitalism, and the Market-Based Model. Crouch (2005) considers Amable's approach "by far as the best and most sophisticated" one. Another methodology is suggested by Knell and Srholec (2006), and is based on three types of institutional arrangement: Social Cohesion, Labour Market Regulations, and Business Regulations. Each of the types was computed by various factors. Social Cohesion measures the bonds that bring people together in society, the degree of social connectedness and economic inequality.

An important application of this research is to find the best form of capitalism for a particular society. The United States runs an economic system which is deeply related to the culture of immigrants who left their home countries and were seeking independence and less state influence. The aim was to build up a strong community culture with the

highest freedom possible for the individual. Little labour market regulations and a general mistrust towards institutions (e.g., labour unions) created a very flexible labour market with a high employee turnover (Kuokstis, 2011). Combined with an emphasis on the invisible hand of the market mechanism, the result is a short-term investment horizon, with little motivation to invest in assets and skills. On the other hand, the German system of the Social Market Economy (SME) is based on Bismarck's influence of defining a framework and collective security system for its citizens. In other words, it successfully combined various requirements.

The case of the Eastern European countries has to be considered from a historical perspective. The Eastern block collapsed under constant pressure by its people who were opposing socialism and communism. There is, however, little evidence that the former citizens of the Soviet Union were dreaming about a wild-west capitalism, as it was found later in various transformation states. As Klein (2008) states in one of her speeches, "we all know the fairytale about the fall of communism, that the West under Reagan and Thatcher looked so prosperous to the people of the former communist block that they themselves demanded radical free market policies, but this really is a fairytale...It is true that people who have been living under authoritarian communism genuinely wanted democracy, and its also true that people wanted to be able to go out and have blue jeans and buy big macs....".

At the end of the Soviet Union, the Central and Eastern European States were in a political vacuum. Obviously there was a political will for a free market economy, which was distinct to the political system of the planned economy. Most opinion leaders, who were engaged in the reforms of the early days, were naturally in strong opposition to the socialistic idea and blindly considered the extreme opposite as a desired form. The new elite in the transformation countries shared an extreme fascination with the 'US-American model' and were enthralled by the proposals of the radical free-market ideas of Margret Thatcher and Ronald Reagan (Streeck, 2010). This is in line with the analysis of Albert (1993) who concluded in the early '90s that the 'Neo-American model' with its greater dynamism and cultural attraction crowds out the more solidaristic and more efficient capitalism system of France and Germany. Moreover, it should be noted that there is very little tradition and understanding about the various types of capitalistic systems in transition countries. The idea of capitalism was at most a theoretic concept to most of the people of the former Soviet Union as many people had never lived in a time when capitalism existed. What ideas they had about capitalism were based on the Marxist interpretation of capitalistic society. Thus, inequality, crisis, exploitation and such other negative ideas were the concepts that everyone would take for granted as being part of a capitalist system. Therefore, when an employer lowers wages or some members of society become very wealthy in the midst of poverty, it would appear to the masses to be the normal state of affairs and they would, hence, not view the situation as unfair.

Young politicians and a new generation of businessmen promoted the liberal model of the United States. The main problem of adapting this approach was, however, that neither the majority of the population nor the economic environment were ready to implement the free market economic ideas. During the early 90s, most transition countries were in an economic crisis, and the rule of law and the power of institutions had first to develop. The economies in Eastern Europe were highly inefficient and not able to compete with the more advanced economies of the West. Their citizens, however, believed that the transformation process would be short, and that soon they would be able to enjoy the benefits of the free market. Norkus (2012) describes the transformation process of the communist outcome as a kind of social experiment. The outcomes of the process may be diverse, also due to the diversity of the variety of cultural, political, and economic conditions. Moreover, the role the Soviets played during the modernization of the country since WWII might be of importance.

Unlike in the United States where the free market idea is strongly associated with a strong corporate governance, a focus on research and innovation, the Baltic countries lack these essential attributes (Kuokstis, 2011). Arguably, the region with its three nations shows an internal variation of economic policies which, in particular, Baltic authors stress (Norkus, 2007). From the global perspective, the similarities are dominating – also the vast majority of scholars consider them as having similar economic policies (Huebner, 2011). The economic system of the Baltic states could be described as a ‘wannabe liberal market economy’ with a high level of nepotism, corruption, and ownership concentration. The idea of the ‘free-market’ was quickly and without any critical discussion equated as ‘pro-business’. Business owners in Central Eastern Europe can exercise significantly more power over their operations and their labour force than their American counterparts. The absence of powerful labor unions and a strong civil society resulted in a downward adjustment of nominal wages. During the crisis, macroeconomic adjustments were relatively easy, as corporations were able to cut spending and salaries or even liquidate their operations without public outcry. The relatively low level of regulations for investors and the combination of low wages, low corporate taxation but comparatively skilled workforce turned the Baltics into an investor’s heaven (Fifka, 2008). The external openness and domestic unfettered liberalization were the reasons for the (‘pre-Global Financial Crisis’) boom in the Baltic Tigers’ economies (Huebner, 2011). The main reason for the openness was the general belief in the myth that uncontrolled and unlimited capitalism will in the long run reward the ones who play according to its rules. Combined with the fear of being a ‘small country’, the governments of the Baltic States were, as Krugman (1994) would describe it, “thrilled” with the idea of the free market and competition and classified any criticism on the system as “communist” or “socialist”.

This doctrine had a fundamental effect on the first generation that entered the universities directly after the end of the Soviet Block. Particularly in the social sciences, academia had to fundamentally change its curriculum – teaching capitalism instead of the ideas of a planned economy. Most professors had, therefore, to update their entire teaching material and obviously were emphasizing mainly the ideas of Friedman, Thatcher, and Reagan which were considered in the early 1990s as the holy grail. That led to a biased view in economics, influencing an entire generation of students, young scholars and business people. It set standards for what is ‘moral’ and ‘acceptable’ in single business transactions. Together with the failure of the state in providing adequate basic social services, the term ‘corporate social responsibility’ became popular, combined with the belief that the corporation is a better and more efficient provider of social rights.

Kuokstis (2011) identified for the Baltic economies their own type of capitalism which he coined Flexible Market Economy (FME). The FME type is different from the economic system of the Central European countries (Hungary, Slovakia, Poland, and Czech Republic) which were classified earlier as Dependent Market Economies (DME) (Noelke, Vliegenthart, 2009). DME type countries are dependent on investments from multinational corporations, mainly from Western Europe. The FME countries share this feature, but “diverge on employment and unemployment protection, industrial relations, and skill orientation” (Kuokstis, 2011). Bohle and Greskovits (2007a) conclude that the volunteer Scandinavian Baltic states are, with its extreme focus on neoliberalism, in fact the least ‘Scandinavian’ of all Eastern European States. The Baltics have therefore to be categorized as low in the industry supply structure, but having better institutions than the CIS (Bohle, Greskovits, 2007b). Norkus (2011) refers to the Baltic States Model as a group of countries in Eastern Europe with a greater capacity to absorb technology transfer.

### **The Lithuanian study**

The idea for this study arose from discussions relating to the experience of Lithuania vs Greece during the global financial crisis of 2007–2008. Casual observation appeared to suggest that certain countries like Lithuania were able to adjust to the internal devaluation much more smoothly than other countries like Greece. According to economic theory, during a recession, countries with fixed exchange rates need to undergo the process of price and wage reductions (internal devaluation) in order to return to international competitiveness (Weisbrot, Ray, 2010). Thus, consumers and workers must be willing to accept these price changes and will only do so if they believe that such price changes are fair or acceptable. When workers refuse to accept wage cuts as unfair, strikes and demonstrations will follow, leading to economic paralysis.

This observation led to the formation of the following hypothesis:

*Hypothesis 1:* More Lithuanians judge the same economic action as being fair than people from other cultural groups.

The present study is directly based upon the seminal work of Kahneman, Knetsch, and Thaler (1986a), entitled “Fairness as a Constraint on Profit Seeking: Entitlements in the Market” (KKT). In their work, KKT attempt to criticise the standard neoclassical economic profit maximization assumption by testing the degree to which fairness plays in price and wage changes. A survey was conducted with questions presented to residents from Toronto and Vancouver in Canada as a telephone survey. The authors opine that the result of their survey “probably holds in social and cultural groups other than the Canadian urban samples”. Ultimately, the goal of their study was to show that, despite the fact that fairness was not included in the neoclassical model, there is still a basic, universal idea of what is fair and unfair amongst human populations. The current study was conceived under the assumption that this could not be the case for all cultures.

The original KKT survey was set up using various questions to determine differences by covering the areas of reference transactions, coding of outcomes, occasions for pricing decisions and enforcements. As the authors were eager to concentrate on the question with regard to framing effects on fairness, the portion of the three questions of the ‘coding of outcomes’ sections were used. Only these were chosen because they best relate to the situation of an internal devaluation concerning price and wage changes mentioned above.

In this section, Kahneman, Knetsch, and Thaler confront the participants of the study separately with three different situations. Approximately half of the group receives, for each of the situations, a more ‘social oriented’ framed version and the other half a less ‘social oriented’ framed version. In fact, both formulations have exactly the same outcome – they are just framed in different ways. For the current study, it was decided to use the same questions as the KKT survey in order to measure the difference between the conceptions of fairness in Lithuania and the Canadian sample originally used. Table 1 shows the questions of the KKT sample, which were used for the following study.

Questions 4a and 4b of the KKT sample focus on the framing issue of money illusion. In both cases, the outcome is a decrease of the real income by 7%. Questions 5a and 5b differ by classifying a price increase as a decrease of a discount / bonus and as a nominal price increase. Questions 6a and 6b are similar to questions 5a and 5b by applying the same principle in the context of wage decrease. Hypothesis 1 will be confirmed if the percentage of Lithuanian respondents who find the situations acceptable exceed the surveys from other countries.

For the survey, students from the ISM University of Management and Economics in Lithuania were provided the questions personally by the authors. These students were a

TABLE 1. Questions 4, 5 and, 6 of the KKT survey

4a	A company is making a small profit. It is located in a community experiencing a recession with substantial unemployment but no inflation. There are many workers anxious to work at the company. The company decides to decrease wages and salaries 7% this year.
4b	A company is making a small profit. It is located in a community experiencing a recession with substantial unemployment and inflation of 12%. There are many workers anxious to work at the company. The company decides to increase salaries by only 5% this year.
5a	A shortage has developed for a popular model of automobile, and customers must now wait two months for delivery. A dealer has been selling these cars at list price. Now the dealer prices this model at \$200 above list price.
5b	A shortage has developed for a popular model of automobile, and customers must now wait two months for delivery. A dealer has been selling these cars at a discount of \$200 below list price. Now the dealer sells this model only at list price.
6a	A small company employs several people. The workers' incomes have been about average for the community. In recent months, business for the company has not increased as it had before. The owners reduce the workers' wages by 10 percent for the next year.
6b	A small company employs several people. The workers have been receiving a 10 percent annual bonus each year and their total incomes have been about average for the community. In recent months, business for the company has not increased as it had before. The owners eliminate the workers' bonus for the year.

Source: (Kahneman et al., 1986a)

combination of undergraduate students of business and economics, and of three different years. The results are split up in two tables, one for the first year and one for the second and third year students. The first year students were at the beginning of their studies and therefore had little knowledge of economics, and are therefore comparable to the general population. The “mixed sample” consists of first year students (end) and second and third year students. The two samples were chosen to double-check if a thorough knowledge of economic concepts (such as inflation) plays a role in answering the questions. Both samples consisted of a mixture of both genders. This study may have some limitations which are present also in similar studies. The sample of survey respondents used in this case consisted of students from a private university which specializes in economics and management. Another issue is that the sample is from a non-representative field study. This methodology faces criticism – it is, however, based on the same methodology which is used in the original KKT and most studies which replicate the model (Gao, 2009; Bian, Keller, 1999; Gorman, Kehr, 1992; Liberman, Idson, Higgins 2005; Tversky, Kahneman, 1986). In the case of the “mixed” sample, prior to learning about economics, the thinking and the behavior of the “homo economicus” may have affected their behavior. However, in a similar study by Gao (2009), a sample of students was also used, but that author found that differences of student versus non-tudent responses were insignificant, except for the questions concerning wage or rent. Both studies were conducted with several different groups over a period of 8 months.

In the case of the mixed sample, the initial groups were given only questions 4 and 5, and the later groups received questions 4, 5, and 6. For the questions 4 and 5, a total of 189 surveys were returned, with 97 returning questionnaire “a” and 92 returning questionnaire “b”. In the case of question 6, a total of 136 responses were collected, with 69 returning questionnaire “a” and 67 returning questionnaire “b”.

In the case of the first year sample, the students were additionally asked to indicate their gender. No other additional demographic factors were compared, because income or age, in the case of bachelor students are irrelevant. A total of 143 surveys were returned, with 69 returning questionnaire “a” and 74 returning questionnaire “b”.

Unlike a few other scholars (e.g., Gao, 2009), the authors do not suggest that the Hofstede methodology should be used to explain the cultural differences concerning economic behavior. Geert Hofstede’s approach was developed to explain the behavior of individuals at the workplace. The two dimensions of the Hofstede model, which were used by scholars to explain cultural differences in economic behavior, are power distance and individualism. Upon a closer look at the questionnaires given to the respondents, it is easily visible that it intends to figure out the ‘perception of the individual about the perfect job’ rather than the question of ‘expected fairness of corporations towards employees’. Also, Huettinger (2008), who conducted the study of the Lithuanian values for Geert Hofstede, notes that the findings have to be carefully interpreted in transition countries. Moreover, individual items which were used to calculate one dimension may have a significant influence on the average score, leading to wrong conclusions.

## Results

The results of the study show that for question 4a, a larger proportion of Lithuanians consider the actions to be fair as compared with the original KKT sample (Table 2). In the case of a salary decrease by 7%, 75% of the respondents consider this action to be fair as compared to the KKT result of 38% ( $\chi^2 = 47.143$ ,  $p = 0.000$ ). In the case of inflation of 12% and a salary increase of 5% (4b), 71% consider this action to be fair as compared to 78% in KKT ( $\chi^2 = 1.913$ ,  $p = 0.166$ ). Although more people in the KKT study found this to be fair, the results are insignificant. In the case of question 5, both versions were found to be fair by the majority of the Lithuanian respondents, and at higher levels than in the KKT study. An increase of the price by \$200 (5a) is considered fair by 66% as compared to 29% in KKT ( $\chi^2 = 46.421$ ,  $p = 0.000$ ). On the other hand, 72% considered the elimination of a bonus of \$200 dollars (5b) as fair as compared to 58% in KKT ( $\chi^2 = 7.632$ ,  $p = 0.005$ ). In the case of question 6, the results are slightly different. Question 6a, which suggests a 10% cut of the salary in the case of stagnation, was considered by only 40% as fair as compared to 39% in KKT ( $\chi^2 = 0.0152$ ,  $p = 0.902$ ). On the other hand, an elimination of the 10% bonus in the case of stagnation was considered as fair by 60% as

compared to 80% in KKT ( $\chi^2 = 13.292$ ,  $p = 0.000$ ). In this regard, the Canadian sample found the situation to be more fair.

The results of the '1<sup>st</sup> year student sample' and of the 'mixed sample' are comparable to question 4. In the case of question 5, there is a slightly higher proportion of the 1<sup>st</sup> year students who consider both scenarios as fair. Scenario 6a was considered by 49% of the first year students as 'fair', whereby only 30% of the mixed sample agreed on that. The factor of the gender had a little impact on the results, as the proportions of men agreeing on specific scenarios as fair (%MF) are comparable to the ones of women (%WF), and the differences were found to be insignificant.

The data on questions 4 and 5 showed different results than the original study by Kahneman, Knetsch, and Thaler (1986a) who propose that "price changes will be more responsive to variations of costs than variations of demand, and more responsive to cost increases than to cost decreases". Fairness in Lithuania seems only mildly related to the question of an increase or decrease in salary – more important was rather the overall situation. It is likely that these results are influenced by the history of the country, which experienced a higher volatility of inflation throughout the last decades. Business actors are therefore allowed to adjust their payment policy according to internal and external indicators. The KKT sample was conducted in Canada where its citizens have enjoyed wage and price stability for a long time.

The proposition "price decreases will often take the form of discounts rather than reductions in the list of posted price" by Kahneman, Knetsch, and Thaler (1986a) was rejected as well. The results of question 5 show that, unlike in the KKT sample, the majority of Lithuanian respondents rejected the idea that a price decrease is different to a loss of a bonus. The results do not necessarily attack the works of many scholars about loss aversion, but it may be assumed that the freedom to set prices by business owners is considered to be more important than the question of loss aversion. Support for this argument was also found by Gorman and Kehr (1992) who conducted the same study among executives.

The results for the two versions of question 6 are slightly different. Similar to the KKT sample, a (slight) majority of Lithuanians consider a cut of bonus as fair due to an unexpected stagnation. Surprisingly, the majority of Lithuanians and the majority of respondents of the KKT sample consider a decrease of 10% of the salary due to a stagnation as unfair. Unlike Kahneman, Knetsch, and Thaler (1986a), the authors of the paper do not agree that question 6 illustrates the same effect as question 5. KKT stated that questions 5 and 6 were similar in that they both showed the difference between losses vs. the loss of a gain. Question 6 was the only one where more Lithuanian respondents found the situation to be unfair. While this may have been true for the Canadian sample, the results of the Lithuanian sample do not support this idea. The results show that the

Table 2. Lithuanian survey results and KKT sample results

	KKT sample				1st year				"Mixed"		LT sample			
	N	Fair	Unfair	N	%MF	%WF	Fair	Unfair	N	Fair	Unfair	N	Fair	Unfair
4a A company is making a small profit. It is located in a community experiencing a recession with substantial unemployment but no inflation. There are many workers anxious to work at the company. The company decides to decrease wages and salaries 7% this year.	125	38%	62%	69	79%	72%	75%	25%	97	74%	26%	166	75%	25%
4b A company is making a small profit. It is located in a community experiencing a recession with substantial unemployment and inflation of 12%. There are many workers anxious to work at the company. The company decides to increase salaries by only 5% this year.	129	78%	22%	74	71%	72%	72%	28%	92	71%	29%	166	71%	29%
5a A shortage has developed for a popular model of automobile, and customers must now wait two months for delivery. A dealer has been selling these cars at list price. Now the dealer prices this model at \$200 above list price.	130	29%	71%	69	76%	69%	72%	28%	97	62%	38%	166	66%	34%
5b A shortage has developed for a popular model of automobile, and customers must now wait two months for delivery. A dealer has been selling these cars at a discount of \$200 below list price. Now the dealer sells this model only at list price.	123	58%	42%	74	75%	74%	74%	26%	92	71%	29%	166	72%	28%
6a A small company employs several people. The workers' incomes have been about average for the community. In recent months, business for the company has not increased as it had before. The owners reduce the workers' wages by 10 percent for the next year.	100	39%	61%	69	47%	52%	49%	51%	69	30%	70%	138	40%	60%
6b A small company employs several people. The workers have been receiving a 10 percent annual bonus each year and their total incomes have been about average for the community. In recent months, business for the company has not increased as it had before. The owners eliminate the workers' bonus for the year.	98	80%	20%	74	65%	57%	61%	49%	67	59%	41%	141	60%	40%

Source: (Kahneman et al., 1986a), by the authors.

supply & demand based behavior has to be considered different than in the case of labour. Customers enjoy more flexibility and have aswitching power, unlike employees of companies (Wen-Qiang, Keller, 1999). A cut of the salary due to a zero increase in business (with direct effects for both sides) is obviously a different case than the decision of a businessman to increase his price level in a free market economy. It appears that Lithuanians were more concerned with the macroeconomic factors when making their judgments about fairness. If there was a recession, they were much more willing to take a pay cut, but if there was only stagnation, they were less willing to take a pay cut.

This is not the first study to investigate the concept of fairness along the same lines as the KKT study. A similar study using KKT-inspired questions was done using samples from China, Switzerland, and Canada (Gao, 2009), which found cross-cultural differences with regard to eastern (China) and western (Canada and Switzerland) countries with respect to fairness judgements, although the differences found between east and west were smaller than the difference found in the present study between Canada and Lithuania. Another study examines fairness judgments between North Americans (Canada and USA) vs. Chinese with similar results (Wen-Qiang, Keller, 1999).

## **Conclusions**

This study presents the judgments of fairness by a student sample in Lithuania. The hypothesis can be partially accepted with regard to questions 4 and 5 as the results from the Lithuanian survey show that the respondents were more apt to view the economic decisions posed as being fair (4b had a higher level of Canadians reporting fair, although it was statistically insignificant). Question 6b had higher levels of Canadians reporting as fair vs Lithuanians. This result can be related to the Gao (2009) study where he has found that students differ from the general population regarding fairness concerning wage or rent. The results have shown that there is little difference among first year students and other students. Also, the role of the gender seems to be insignificant. One limitation is that the study was only performed on young students. This might, however, be an advantage in the case of Lithuania, as young people are less influenced by the values of the Soviet Union. The sample might therefore reflect the direction of how the behavior and perception of the general population will change in future (Mockaitis, 2002).

These results have implications which can be applied both to the field of economics and for the policy makers of Lithuania and other similar countries. With regards to economics, perhaps it would make more sense for economists to stop focusing on universal principles as they are too broad and cannot be expected to hold for all humans. Instead, more emphasis should be put on cultural and behavioral differences of economic actors across countries. This would prevent the problem of economists suggesting the same remedy for countries like Greece and Lithuania where the economic actors have

responded very differently to similar economic policies. Regarding policy makers in Lithuania, this study would suggest that, in fact, the policy of austerity and internal devaluation would be viewed as fair by the populace, and hence it would be a viable option.

This study has looked at the concept of fairness as a universal concept. While the behavioral economists and prospect theory hold that losses will always be viewed more negatively than losses of gains, the results of this study only weakly support this idea. Fairness, as mentioned initially, can be thought of as how individuals compare their situation to that of others. Differences in cultural norms influence the perceptions of fairness and, therefore, influence the economic decision making. As nice and convenient it would be to have a universal theory which could be applied to all countries and societies, in reality, such a theory is naive at best. The simplifying assumption that fairness does not matter or that all people react to fairness in a similar way should no longer be made as it is incorrect.

The results indicate that the respondents have a rather liberal understanding when it comes to the question of freedom in wage and price setting. In other words, all actors in the economy are subject to supply and demand conditions and should adapt to them. There is an exception in the case of a salary decrease as a result of unexpected slowdown of business; this issue was, however, already discussed before.

The characteristics of the “Baltic” form of capitalism – the FME type – were confirmed by the study in Lithuania. The majority of respondents agree with an adjustment of the wage level in cases when the economic conditions require it. There seem to be very little understanding of the role of employees as stakeholders having equivalent rights and power as employers have. The results of the KKT study also confirm the literature research by the authors that in more coordinated market economies a nominal wage decrease would be considered to be unfair. Moreover, there seem to be little understanding of the social role of corporations in society. The often used example of the social appropriateness of an increase in the price as snow shovels due to a demand boost caused by a snow storm seems to play a little role in Lithuania (Kahneman et al., 1986b).

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