

# The Relationship Between Wages and Profits in a Liberal Economy

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## Abstract:

The author analyses the correlation between wage levels and company profits in the context of liberal economic policy. The study covers various sectors of the economy, using statistical data and econometric models to identify patterns. The authors examine the impact of market liberalization on income distribution, highlighting both positive and negative aspects of these changes. The article concludes that in a liberal economy, there is a complex relationship between wages and profits, which can vary depending on the specifics of the industry and economic conditions. Special attention is given to the analysis of policies aimed at balancing the interests of companies and employees, with the goal of achieving sustainable economic growth and improving population welfare.

**Keywords:** *profit, wages, correlation, globalization, taxation, labour productivity.*

## Introduction

The question of the relationship between wages and profits in a liberal economy occupies an important place in economic literature. A liberal economy, characterized by minimal government intervention in economic processes, provides a unique environment for studying the dynamics of wages and profits. This review will examine key theoretical and empirical studies that analyse this relationship.

**Literature Review.** One of the classical approaches to understanding the relationship between wages and profits is the marginal productivity theory. According to this theory, wages are determined by the marginal productivity of labour, that is, the added value brought by an additional worker. In a liberal economy, wages should correspond to the contribution of workers to the company's profits. Research confirms that in such conditions, market mechanisms tend to balance wages and labour productivity (Blinder, 1990).

On the other hand, the income distribution theory offers a more complex view of the distribution of profits between capital and labour. According to this theory, wages and profits depend not only on productivity but also on institutional factors such as collective bargaining agreements, legislative norms, and workers' bargaining power (Piketty, 2014). In a liberal economy, these factors play a less significant role, which can lead to a stronger influence of market forces on wages. Numerous

empirical studies confirm the existence of a relationship between wages and labour productivity. For example, research by Krueger and Summers (1988) showed that wage differences between industries are explained by differences in productivity. In a liberal economy, companies that successfully increase productivity can afford higher wages, which in turn helps attract and retain skilled workers.

Research also indicates a positive correlation between company profitability and employee wages. For instance, Blanchflower, Oswald, and Sanfey (1996) found that firms demonstrating high profits often set higher wages, which may be associated with the need to motivate employees and prevent turnover. In a liberal economy, companies can utilize flexible forms of compensation, such as bonuses and incentives, to adapt to changes in profitability.

Globalization also significantly influences the relationship between wages and profits. In liberal economies, companies often relocate production to countries with lower labor costs, which can restrain wage growth in higher-income countries. Research by Feenstra and Hanson (1997) has shown that globalization leads to increased income inequality, as skilled workers in developed countries benefit from global value chains, while low-skilled workers face increased competition.

**Analysis and Results.** The issue of producing higher-quality goods corresponding to rising prices and worker incomes, and the change in the ratio between the wage fund and funds allocated for production development, remains extremely relevant and complex. There is always a danger of maximizing the wage fund at the expense of the enterprise's prospective social-innovative progress, i.e., the threat of "eating up" the company's income.

Unfortunately, such a problem did not exist before, when wage and profit norms came from the top and their ratio was strictly fixed. This problem does not exist, at least not as acute in essence, in a truly market economy: any entrepreneur understands well that surviving in the competitive struggle is possible only by producing innovative products or services, which means, by technically improving their production potential and pursuing an active investment policy. The ratio between personnel wages and entrepreneurial income is formed under the influence of market conditions, and the share of accumulation should be quite significant, especially in conditions of economic modernization and fierce competition.

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Hence, in the conditions of economic liberalization, the form of labor compensation should not restrict employee motivation and should correspond to the nature of the work.

In market-developed countries, the system of distributing additional income is more focused on increasing labor productivity: bonus payments are received by every worker, but their level depends on the final results (improvement of quality, cost reduction, etc.). Practically any positive motivation finds support from management, and proactive employees receive moral or material incentives.

When changing work results and establishing bonuses, various indicators of labor efficiency or productivity are used: increasing the output per worker, reducing the cost per unit of product, increasing sales volume, quality level, profit, and profitability, reducing the rate of production stocks, attracting new customers, etc.

Analysis of the practice of withholding income tax from employees' income into the state budget has shown that the receipts from employees' income to the state budget are far from commensurate with their actual aggregate amounts, and this gap is increasing (Zaynalov, Zh. R., & Alieva, S. S., 2019). Therefore, profit distribution should occur taking into account the real participation of enterprises in their formation, and a portion of the surplus profit, which is generated independently of the efforts of enterprises, should be allocated as super-normative income to the state budget or classified as distributed profit (if innovative projects are implemented at the enterprise).

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Thus, the dynamics of profit changes using the methodological approaches of modern market theory have allowed for conclusions to be formulated that for the period 2010-2021, the share of profit in the country's GDP is still not high, unlike the share of wages (see: Figure 1). Although there has been a slight increase in the share of labour income in recent years, it is still low compared to developed countries. This fact indicates an uneven distribution of income among the main subjects of the economy, which is typical of developing countries; the low share of profit in GDP is explained by negative factors observed in the country's economy; there is a decrease in savings and accumulations, which has not led to an increase in investments, especially domestic ones, which in recent years have not surpassed the volume of foreign investments in the domestic economy.

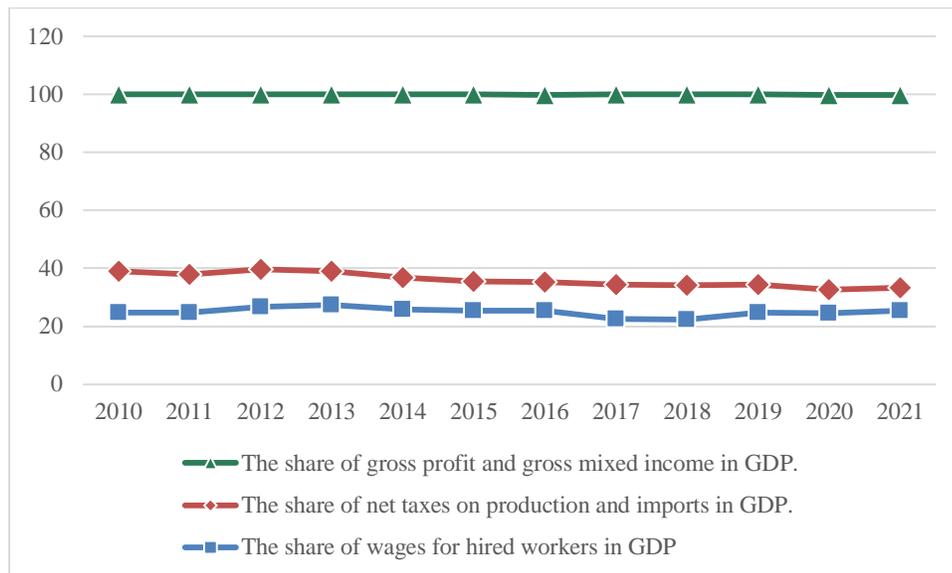


Fig. 1. Share of Profit and Wages to GDP for 2010-2021.<sup>1</sup>

Therefore, in modern economic conditions, the model of innovation-corporate cooperation should take into account the following conditions: in the implementation of the enterprise's innovation development strategy, it is advisable to introduce employee profit-sharing participation in domestic enterprises by incentivizing them, implementing innovative projects by enterprises with the formation of an innovation fund for these purposes, aimed at stimulating innovative projects (Avdeeva, E. A., 2021).

After increasing the volume of profit, paying profit tax (Ahrorov, Z., & Alieva, S., 2022), the remaining part can be reinvested in labor remuneration. Most likely, enterprises should use such a mechanism to maintain their workforce in conditions of development instability caused by crisis and inflationary phenomena.

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<sup>1</sup> [www.stat.uz](http://www.stat.uz)

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