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**HAS THE “CHINESE WAY” BEEN AN
ALTERNATIVE FOR EASTERN EUROPE?**

– Controversies and Paradoxes

Wolfgang Zank & Li Xing

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Has the “Chinese Way” Been an Alternative for Eastern Europe? – Controversies and Paradoxes

Wolfgang Zank & Li Xing

1. Introduction

In Eastern Central Europe and the former Soviet Union the experiences of the transition towards a capitalist system has been disappointing in many respects for many years. In the 1990s, all these countries had to go through a recession, and inequality, poverty, mortality and organised crime have been rising in many parts. Countries such as Russia or Ukraine had to wait until 1998 before GDP started to grow again. China, by contrast, stands among the transition countries as a case of a remarkable success of continuous growth.

These contrasts have led many observers to wonder whether China could have served as a model for Eastern Europe. Or turned critically: Did the Chinese successes show that the policies of the Eastern European reformers were wrong? And did the Chinese transition, by implication, show that the policy recommendations of the IMF, the World Bank and Western advisors to the Eastern European governments were misguided?

These questions have been debated for more than decade. In this paper we want to give an overview of some of the main arguments. We start by providing a framework for the understanding of the “Chinese Way”. This concept embraces, besides economic reform processes, specific historical dimensions, cultural elements and ideological discourses, as well as overseas and geopolitical factors. These elements should be seen in their holistic totality. In a further step, based on a process of studying, interpreting and analysing various pieces of authoritative literature, we present arguments by those who held that China could have served as a model. Thereafter we discuss factors, highlighted by other scholars, which point in the opposite direction. In conclusion it appears to us that China *could not* have served as a model; the conditions were too divergent. But the debate has had the merit of inviting for a *comparative discussion* of China and Eastern Europe.

More generally speaking, it can be fruitful to *compare* regions, countries or cultures, in order to highlight differences and to better understand essential features in the societies in question. But often in social sciences “comparisons” were made in order to extract some “lessons”, which allegedly could be transferred from one region to another¹. In our view, while not rejecting the idea that countries can learn from each other in certain fields, “comparisons” of this kind in general run the risk of being flawed. The conditions for transferring solutions from one country to another are often not in place, or only inadequately.

¹ For instance, the “tiger countries” of East and South East Asia were often used in “comparisons” of this kind.

2. The Chinese Way

Three Reform Periods

The development of the Chinese reform policy can roughly be divided into three periods: 1) agrarian reform, experimental industrial reform and “rationalisation” of the administration; 2) setback between 1989-1991; and 3) further liberalisation from 1992 onwards. The major changes took place in the first and third periods. Before describing the reform steps in more detail, we summarise the main characteristics of these three periods.

In the first phase, the most important economic reforms took place in agriculture, notably the dissolution of the People’s Communes. The resulting rapid increase in agricultural production facilitated the growth of a rural small industry, mainly in the form of the locally owned “Township-Village Enterprises” (TVE). These could develop outside the traditional planning system. The State-Owned Enterprises (SOEs), usually large industrial units, experienced some first tentative reform steps. Other reforms were taken in order to rationalise party and state institutions.²

Following the June 4 incident in 1989 and up to 1992, China experienced a retreat from the reform course. The country suffered internal turmoil and external economic and political pressure. Intellectual and social discontent increased. The leadership faced an unprecedented challenge both at home and abroad.

The policy of renewed liberalisation in the 1990s meant a more dramatic process of moving towards a market economy. It was based on efforts to make the economy more competitive and market oriented, to reduce the level of government intervention in economic activities, and to allow markets to set prices. Material and manpower resources were to be directed through market distribution channels, and the private sector should have more economic freedom. Furthermore, the national economy was to be more closely merged with the world economy.³

The Chinese market reforms started much earlier than the downfall of the Soviet Union. They were conducted on a trial-and-error basis as a step-by-step process. When China began its reforms in the late 1970s, the political leadership did not question the desirability of the traditional economic system. Its original attempt was to improve, within the framework of the existing system, the incentives in the state enterprises and collective farms. By giving them a certain degree of autonomy, a closer link between personal rewards and individual efforts should be established. Later, the government was caught in a “riding tiger” dilemma: Seemingly inevitably it had to proceed on the way of market-oriented reforms – not because market economy was ideologically accepted, but because the economic logics which became established by the first reform steps, pushed into that direction. The entire reform approach can be characterised as a piecemeal, partial, incremental and experimental process in a manner of “crossing the river by touching the stones”. We are going to examine the economic reforms at various levels.

² The key words, in Harry Harding’s formulations, were “restaffing the party and state bureaucracies,” “rationalizing China’s civil service,” “institutionalising the process of policymaking,” and “recasting the roles of China’s three principle political institutions – the army, the party, and the government – and redefining the relationships among them.” The aim of these institutional changes was “to make the Chinese policymaking process more rational, systematic, and pragmatic”. Harding, Harry, *China’s Second Revolution: Reform After Mao*, Washington, DC, The Brookings Institution, 1987, pp. 202-236.

³ Guo, Suijan, “Totalitarianism. An Outdated Paradigm for Post-Mao China?” *Journal of Northeast Asian Studies*, Vol. XIV, No 2, p. 72.

Institutional Reforms at the Micro Levels

In agriculture, after 1978 the collective production of the People's Communes was replaced by a household-based system. This *household responsibility system* improved the incentives of the peasants by dividing the obligatory procurement quotas to individual households. Initially, the new system was based on a "land lease contract"; i.e. land was not *privatized*, but leased for a number of years. However, after the formal abolishment of the People's Communes in 1983, Chinese agriculture became de facto based on private family farming. In agriculture, the seemingly system-imminent and stepwise reforms between 1979 and 1983 had rather large-scale social effects within a comparatively short span of time (see below, section 6).

At about the same time, some experimental initiatives were implemented in the industrial sector. They were aimed at enlarging the autonomy of the enterprises and expanding the role of financial incentives *within* the socialist economic system. The state-owned enterprises could retain a part of their profits, and a performance-related bonus system was introduced. Furthermore, the enterprises received the possibility freely to sell a part of their production at marked prices, supposed they had fulfilled the requirements of the mandatory state plan (selling at administrative prices). Thereby a *dual-price system* developed. The enterprises could also use a part of their foreign-exchange earnings at their own discretion. At around 1985, the financial obligations of the state enterprises were formalised, market influences on their performance became increased and their profit remittances to the state were replaced by a profit tax. A next step was a *contract responsibility system*. Its aim was to clarify the authority and responsibilities of the managers. Employment-on-contract was formalised and widely adopted. In the last stage after 1993, the modern corporate system was introduced and state intervention further reduced.

Reforms in Resource Allocation

The institutional reforms at the micro-management level made it necessary also to reform the planned distribution system. Raw material supplies became marketised and delinked from the plan system, and also retail commerce became deregulated. This gradual relaxation of the resource allocation system was also due to the rapid growth of non-state enterprises, especially the Township-Village Enterprises. Their position as outsiders to the former economic system gave them greater freedom at obtaining energy and raw materials from competitive markets. Thereby they broke the absolute control of the state enterprises over resources.

Reforms in Macropolicy

The liberalisation of micro-management institutions and resource allocation also made changes within the field of macro policy necessary. Therefore, since the mid-1980s the state began to reform, for instance, the foreign exchange rate policy, the interest-rate policy, or the credit approval policy.

External Factors

The geopolitical constellation created a favourable international environment for the early economic reforms from the end of the 1970s and through the 1980s. During this period the United States were willing to open their markets to China as part of their alliance against the Soviet Union, which in turn enabled China to enter a road of export-oriented growth. According to the statistics of the Chinese customs, the Chinese-US trade increased from \$12.88 million in 1972 to \$2.45 billion (!) in 1979. From 1979, when the two countries established normal diplomatic relations, until 1989 China's exports to the US grew by 22

percent annually (imports by 15 percent). These growth rates were much higher than those of either the world trade or the average growth rate of the Chinese foreign trade as a whole. The Soviet Union and Eastern Europe could never expect to receive a similar treatment by the US-led Western capitalism.

The contributions by overseas Chinese have been another important factor behind the spectacular growth and transformation of the Chinese economy. According to official Chinese figures, foreign investments in China were of the magnitude of \$44 billion between 1979 and 1993. Investments from Hong Kong accounted for about half of this figure. All in all overseas Chinese contributed about 80 percent of all foreign investment. The Chinese “network capitalism” has made important contributions in terms of joint-venture manufacturing, flow of technologies and access to foreign markets.

Cultural, Historical and Ideological Aspects

China’s seemingly well ordered reform process is largely seen as a success. However, the Chinese approach has not been pre-designed. To a high extent, China’s traditional culture and philosophy have influenced it. Since the times of ancient history, the Yin-Yang worldview has had a tremendous influence, not only on the nation state (governance and political culture), but also on the individual way of thinking. A dialectical image of the universe, primarily conceived in terms of the Yin-Yang interaction, is the central feature of the Chinese ideas of change. Seen from the Yin-Yang School, “the universe is conceived of as a well-coordinated system in which everything is related to everything else”, and “this order is conceived of as a process of transformation”.⁴ Therefore, development and social change is not only a matter of “change” but also a question of how to maintain the balance.

Historically, the Chinese Cultural Revolution showed the opposite of this way of thinking. The reformists regarded it as an example of extremism which produced a 10-year disaster. As Dengism claims, the lessons, which have to be drawn from the turbulent pre-reform history, are that development is a gradual process, and that reform must be on a step-by-step and trial-and-error basis which avoids revolutionary radicalism.

The core ideological discourses which underline China’s reform ideology can be summarised as follows:

- China’s industrialisation programme should proceed beyond a socialism-capitalism dichotomy, as it is illustrated by Deng’s “cat theory”. That is to say, China must be open to all theories and practices regardless of their socialist or capitalist nature.
- The result of practice (pragmatism) is the sole criterion of measuring the truth of any theory and thought. In other words, any idea and practice that can bring about a satisfactory result will be considered useful and reliable. By this token, socialism must be flexible in the practical context of the world system. In this sense, pragmatism will lead to truth and power.
- The modernisation process should take China’s own condition into consideration, i.e. “building socialism with Chinese characteristics”. This rejects the idea that Chinese socialism has been theoretically completed and practically established. China’s socialism will continue to be open to all sorts of experiments like “crossing the river by touching the stone.”
- Instead of viewing human beings as the main factor of the forces of production it shares with Western neoliberalism the conviction that science and technology are the prime productive forces. It sees the market as one of the important productive forces, and as being ideologically neutral.

⁴ Chan, Wing-Tsit (translated and compiled), *A Source Book in Chinese Philosophy*, New Jersey, Princeton University Press, 1963, p. 271.

Theoretical Justifications of the Reform Process

The reform discourses are also embedded in a number of theories. The key element of Deng's "cat theory" (white cat, black cat, it is a good cat as long as it can catch mice) is the logic that if capitalism can produce positive result, it is good enough for socialism too. It is an expression of metaphysical and mechanical materialism and based on highly pragmatic and practical assumptions. It has one essential proposition: to reinterpret the relationship between productive forces and relations of production. According to this view, the basic determinant of human history is not politics, nor class struggle, but economics, especially the development of the productive forces. The underlying feature of Dengism is pragmatism based on learning by trial and error, testing here and rejecting there, as measures for liberating and expanding the productive forces.

One of the strongest theoretical arguments of Dengism was a redefinition of the conceptual understanding of "Chinese socialism." The reformist intellectual Su Shaozhi claimed that China "is still in a transition period from presocialist to socialist society, still catching up with the missed lessons of capitalism".⁵ The Dengist elites argued that according to Marx, socialism and communism must develop from mature capitalism. But the Chinese socialism did not emerge from the womb of a highly developed capitalist society but from a semi-colonial and semi-feudal society. And even though China had undergone a profound transformation of her social relations and relations of production after 1949, the decades of socialist economic development still could not free her from the relicts of the old society. Based on historical determinism they argue that "history has decided that many conditions that in a general historic view must be prepared in the capitalist stage must continue to be fully prepared by us in the course of building socialism".⁶ Dengism believed that their economic reforms have to solve the tasks of the lost period of early capitalism.

Furthermore, some reformist intellectuals who favour the development of capitalism base their arguments on the "theory of middle class stability". This theory points out that the advanced Western capitalist societies are much more homogeneous "because of the presence of a large middle class (40% of the total population), which acts as a social stabiliser, and the richest and poorest constitute only a very small proportion of the overall population." Furthermore, "when most people's living conditions are considered to be at a middle level, the social structure is stable".⁷

In order to "create" a middle class, Deng's reform programme called for developing a new economic system which featured various market incentives and special economic zones with considerable latitude for private enterprise. It aimed at breaking the previous low-level equality, letting part of the population become rich first, and then reaching a high-level equality in the future. The economic zones which were set up along southern China's coastal provinces, were blessed with state support and favourite policies.

3. The Pro-arguments: The "Chinese Strategy" could have been a model for Eastern Europe

As we have seen, the path of Chinese transition has been a complex and multidimensional phenomenon. It is therefore not surprising that various authors have drawn different lessons from it. Consequently, they also formulated divergent policy recommendations for

⁵ Su, Shaozhi, *Democratization and Reform*, Nottingham, Spokesman, 1983, p. 175.

⁶ Lu, Zhichao, "Assess socialist society with the theory of development of dialectical materialism", *China Report*, Red Flag, No. 14, 1983, p. 22.

⁷ Li, Peilin, "Changes in the Class and Stratification Structure and Interest Distribution in the New Epoch", *Social Science in China*, third issue, autumn 1997, p. 48.

Eastern Europe. Some have argued that transition first and foremost should begin in *agriculture*. Others saw China, in more general terms, as a successful example of an *evolutionary strategy* (as opposed to rapid reform, or “Shock Therapy”). A third group placed the emphasis on the right *sequence of political and economic reforms*; it was better to start reforms in the economic sphere and introduce democracy later on. And finally, China should be seen as a successful case, not of transition to capitalism, but of a successful *transformation of socialism*. Russia, instead of abolishing the old system, should better have transformed it.

We are going to review these lines of argumentation in turn.

“Transition Should Have Started in Agriculture”

Marshall I. Goldmann, of Wellesley College, and associate director of the Russian Research Center at Harvard, belonged to those who have held that Gorbachev was wrong by not starting the Soviet reforms in the in the agricultural sector:⁸

There are enough similarities between Russian and Chinese agriculture to suggest that Soviet authorities might have been able to use agriculture as stimulus to ignite the rest of the economy...

The Yeltsin-Gajdar reformers should have begun by decreeing that peasants could take over the land, and that individuals and groups could establish businesses, both in the services and in manufacturing immediately. This should have been supplemented by authorization to double the size of garden plots, which would have served as backup in case the collective and statefarms chairmen obstructed the move to private farming. Farmers and businessmen should have been allowed to start up and operate without the need for permits or government approval. The goal should have been to act quickly to end the stranglehold of the farm chairmen, mafia, managers of state enterprises, and party apparatchiks.

What Gajdar discovered was that without a sufficient number of individually owned farms, services and industries ... his fiscal and monetary reform efforts were guaranteed not to succeed.

Few authors have been so explicit. However, a “softer” version of this position is to be found in an article by Kang Chen, Gary H. Jefferson and Inderjit Singh,⁹ from Singapore University, Brandeis University and the World Bank, respectively. According to them, six “key lessons” can be drawn from the Chinese experience, the first one (the most important one?) being the “Importance of a Leading Sector” – agriculture – which had a tremendous impact on the whole Chinese economy. The agrarian reforms laid the basis for the development of a blossoming rural industry, mainly in the form of rural Town-Village Enterprises which in the 1980s became the most dynamic sector of the Chinese economy. The agricultural sector generated capital and made labour force available for the other economic sectors.¹⁰ However, at the end of their article Chen, Jefferson and Singh wrote that a similar success in Easter Europe would be “less likely”¹¹ because there the agricultural sector is much smaller, more capital intensive and less flexible. But given the point that they use the word “lesson”, we conclude that in their eyes the Chinese strategy must have some relevance for the other transition countries.¹²

⁸ Marshall I. Goldman, “The Chinese Model: The Solution to Russia’s Economic Ills?” *Current History. A Journal of Contemporary World Affairs*, October 1993, pp. 320-324, quotes from p. 320, 321, and 323.

⁹ Chen, Kang, and Jefferson, Gary H., and Singh, Inderjit, “Lessons from China’s Economic Reform”, *Journal of Comparative Economics*, 16 (1992), pp. 201-225.

¹⁰ Op. cit., p. 205f.

¹¹ Op. cit., p. 222.

¹² As to the transferability of the Chinese strategy, their text ends actually rather vague. Perhaps it would have been more appropriate if they had used the term “most important features” of the Chinese strategy, instead of “lessons”. In our view, the word “lesson” implies something which others can learn for their problems.

China as an Example of Successful Gradualism

In more general terms, many authors have pointed to the fact that China has practised an evolutionary approach, which could have served as a useful guideline for the transition in Eastern Europe. John McMillan and Barry Naughton, both from the University of California, San Diego, have presented an elaborate argumentation of this kind:¹³

While the exact sequence of events cannot and should not be replicated elsewhere, the key features of China's reforms can be adopted in other countries. China's reform success can be seen with hindsight to have resulted from, first, massive entry of non-state firms, second, a dramatic increase in competition, both among state firms and between state firms and non-state firms, and third, improvements in the performance of state-owned firms resulting from state-imposed market-like incentives.

In their view, in particular two factors have – in all planned economies – created favourable conditions for the development of new non-state¹⁴ firms: First, the state-owned firms were mainly larger enterprises, and this has left numerous niches which new small and medium-sized firms successfully could fill. And second, the price system of socialist economies has been highly distorted in order to raise profitability in manufacturing. This meant that new non-state enterprises could make relatively high profits in manufacturing, once they were allowed to do so. In the next step, the state-owned companies were subject to stronger competition, among themselves and as regards the many new non-state firms. This in turn induced the state to become much tougher than before as to state-owned enterprises. Otherwise the state finances (which to a high extent depended on the profits of the state enterprises) would have been undermined. Budget constraints hardened.

In this context, the dual price system played a positive role: When it came to decisions about where to enlarge capacities, then this was done on the basis of the relatively reasonable market prices, at which they could sell their production above plan requirements. At the same time, the production for the plan requirements was as previously sold at (cheap) administrative prices. This in turn allowed for the essential stability of production and social networks.

Also, Macmillan and Naughton stressed the importance of agriculture:¹⁵

In 1978 and 1979 the government increased the prices paid for agricultural outputs, while leaving the structure of the commune system unchanged. Then, from 1980 to 1984, the commune system was gradually replaced by the responsibility system. The results were clear. Agricultural output increased by 67 percent between 1978 and 1985 ... The increase in agricultural productivity in turn spurred the growth of rural industry, by generating a pool of savings and excess labour ... Rural industry expanded rapidly. The entry of these profit-seeking firms provided, as we have argued, the main ingredient in China's transition. Thus the transformation of agriculture was crucial to the overall success of the reforms.

As MacMillan and Naughton continued, any “big-bang liberalisation” causes a rapid fall in the prices of manufactures and consequently a collapse of fiscal revenues. This burden could be avoided in China; there was time to redesign the fiscal system. And under these condition the monetary policy could accommodate to the rising demand for money; something which was much more difficult under big-bang liberalisations. In their view, the core of the matter can be summarised like this:¹⁶

¹³ McMillan, John and Naughton, Barry, “How to Reform a Planned Economy: Lessons from China”, *Oxford Review of Economic Policy*, vol. 8, No. 1, pp. 130-143, esp. p. 131.

¹⁴ In China “non-state” firms are not just private firms. For instance, the Town-Village Enterprises have been the property of the local communities; they have been outside the planned state-sector sector, but they were not private companies.

¹⁵ *Ibid.*, p. 137.

¹⁶ *Ibid.*, p. 141.

Lacking clear objectives and having weak administrative capabilities, China began its reforms by permitting entry of non-state firms and state firms to sell outside the plan. Markets then spread ... China's jumble of ad-hoc-reforms can be seen, with hindsight, to have added to a coherent package.¹⁷

In 1996 Alice H. Amsden (MIT), Dongyi Liu (New School for Social Research, New York) and Xiaoming Zhang (Bankers Trust, Hong Kong) published a paper¹⁸ which, while placing the emphasis slightly different, has been essentially complementary to Macmillan and Naughton. Apart from the gradual character of the Chinese reform in general and price liberalisation in particular, they highlighted the fact that China's state-owned firms were not privatised but restructured. In a first step the agrarian reform had boosted the production of foodstuff and nondurable consumption goods, and only then did the government cautiously experiment with price liberalisation and a dual-track pricing system. Dual pricing had its drawbacks (efficiency problems, corruption opportunities¹⁹), but it made it possible to keep inflation at low levels. "This compares with the raging inflation in Russia and Eastern Europe that was triggered by sudden and abrupt price decontrol..."²⁰ Because inflation remained rather low, the Chinese incomes preserved their real value. Aggregate demand did not collapse; state-owned enterprises did not go bankrupt in large numbers, as in Eastern Europe. This in turn provided the Chinese market reform with a much more "hospitable environment". State-owned enterprises received investment and became more productive, gradually their budget constraints could be hardened. This positive circle was reinforced by e.g. special economic zones, in which foreign investors found exceptionally favourable conditions. "This contrasts with East European traditional policy toward foreign investment, where apart from newly freed markets, no systematic incentives were offered to foreign firms..."²¹ All in all, China had "violated a canon of market theory" and "has grown very rapidly on the basis of heterodoxy while Eastern Europe's economies have stagnated (or collapsed, in the case of Russia) on the basis of orthodoxy."²²

Pradumna P. Rana (Asian Development Bank) emphasised the point that Vietnam and Laos essentially followed a similar strategy as China, so we can speak of an "Asian approach". He sees "several valuable lessons which could be useful for transition economies worldwide."²³ Firstly, given certain conditions (mainly greater reliance on agriculture and light industry), reforms on the micro level are highly beneficial at the start of the process, whereas "fiscal and monetary policies are less important than standard policy prescriptions would make them appear." Secondly, the experiences of the Asian approach "suggests that gradualism can work." And finally, "the dominance of agriculture and light industry is a definite advantage for reform." According to Rana, particularly Mongolia, which "has adopted an Eastern European approach to liberalization", and

¹⁷ At this point, the text exhibits perhaps a smaller inconsistency: According to the last quote (and others), the starting point of the reforms was allowing the creation of non-state firms, and permitting state firms to sell outside the plan. But according to the longer quote above, the raising of agricultural prices and the replacement of the communes by the household responsibility system created the necessary basis for further growth – and should therefore perhaps be deemed to be the essential starting point of the reform process.

¹⁸ Amsden, Alice H, Liu, Dongyi, and Zhang, Xiaoming, "China's Macroeconomy, Environment, and Alternative Transition Model", *World Development*, vol. 24, No. 2, pp. 273-286, 1996.

¹⁹ Under a system of double prices, officials can e.g. obtain resources at cheap administrative prices and redirect them, against bribes, to private uses. Even without corruption, dual prices create efficiency problems because cheap administrative prices create incentives for over-using these resources.

²⁰ Op. cit., p. 277.

²¹ Op. cit., p. 278.

²² Op. cit., p. 276.

²³ Rana, Pradumna B., "Reform Strategies in Transitional Economies: Lessons from Asia", *World Development*, vol. 23, No. 7, 1995, pp. 1157-1169, esp. p. 1167.

Myanmar, a reform-laggard, “can learn a good deal”²⁴ from China, Laos and Vietnam. Rana is, however, much more cautious as regards Eastern Europe. His emphasis upon the importance of agriculture and light industry as initial conditions brings him actually quite close to authors such as Anders Åslund or Jeffrey Sachs (see below). We might perhaps conclude that the Asian approach could have worked in Romania; still in 2000 about 43 percent of the population was employed in agriculture there.²⁵

More recently Gérard Roland (Brussels), in a 400-page volume on the economics of transition, placed the Chinese experiences in the context of a critical comparison of an “evolutionary-institutionalist perspective” with the so-called “Washington Consensus”, which ruled the IMF and the World Bank. According to Roland, scholars working in the evolutionary-institutionalist tradition emphasise the importance of uncertainty and the possibility of undesired and unintended outcomes. Instead of using “windows of opportunity”, as e.g. Jeffrey Sachs recommended for Poland and Russia, the “emphasis is rather on ensuring continuous and growing support for reforms among the populations. This implies ... a stronger emphasis on a gradual approach to reforms, relying on the flexibility of experimentation, with an adequate sequencing of reforms, to possibly reverse reforms that do not work and try other ones.”²⁶ This approach also underlines “the need to use the existing institutions to prevent economic disruption and social unrest while developing new institutions.”²⁷

By contrast the “Washington Consensus” has been characterised, again in Roland’s words, by an attitude of “breaking as rapidly and thoroughly as possible the existing communist state structures. The logic is one of “cavalry attack” or Bolshevik-style campaign to break any possible resistance and sabotage of reforms by the conservative communists of the former *nomenklatura*.”²⁸

More specifically, Roland concludes. “On the effects of partial reform, I would claim that the Chinese experience vindicates the evolutionary-institutionalist perspective that sequencing of reforms does not necessarily stall reform progress but can be used to create momentum for further reform.”²⁹ As MacMillan and Naughton before, also Roland attaches particular importance to the dual-price system. According to him, dual prices open the possibility for liberalising the prices in a way that no one is worse off than before. This is important with a view to the political support of the reform process. Furthermore, such a system can prevent an output decrease which the Soviet Union and the Eastern Central European countries experienced in the 1990s:

It is in a way surprising to observe not only that the dual-track approach had not been proposed by academic economists in the context of transition but also that it took several years before economists started to understand the advantages of the dual-track system ... One may argue that the dual-track approach could not have been implemented in the former Soviet Union and Russia because of the government collapse that followed the implosion of communism after the failed putsch of 1991. However, ... the dual track system itself can be seen as an instrument to prevent government collapse in a credible way.³⁰

²⁴ Op. cit., p. 1165.

²⁵ Roederer-Rynning, Christilla, *Intet nyt under solen? Landbruget i østudvidelsen*, Dansk Udenrigspolitisk Institut (DUPI), København, 2002, p. 26.

²⁶ Gérard Roland, *Transition and Economics. Politics, Markets, and Firms*, The MIT Press, Cambridge/Mass and London, 2000, p. 329.

²⁷ Op. cit., p. 333.

²⁸ Ibid.

²⁹ Op. cit., p. 337.

³⁰ Ibid., p. 340f. He adds, however, “careful research is needed to understand whether or not conditions existed to implement the dual-track system itself, and mostly to enforce it credibly.”

On a more general level, the experiences – he repeatedly refers to China, but not only to China – “tend to show ... that the evolutionary-institutionalist perspective is more complete and adequate than the Washington consensus ...”³¹ Roland is, however, not very explicit as to the political conclusions because “there is always a considerable distance between theory and complex reality.”³² But given the point that he sees the evolutionary-institutionalist perspective as the more adequate one, we conclude that also Roland sees the recommendations of rapid reform as flawed, and that the Chinese experiences have played an important role in forming this judgement.

Some authors, who perhaps can be seen as a subgroup of the gradualist approach, have concluded that economic and political reforms should be sequenced. As summarised by Michael Burawoy (University of California, Berkeley), “in this institutionalist view the lesson of China is that economic reforms must precede political reforms. Shirk (1993) concludes that Russia’s mistake was to embark on political reforms that brought down the entire order before economic reforms could be implemented. Opening up the party-state is more dangerous than liberalizing the command economy.”³³

China: Not Abolishing but Transforming Socialism

Burawoy himself sees China not on transition to market economy, but as a case of successful *transformation of socialism*. By contrast, Russia tried to introduce capitalism, with disastrous results. The key point, in Burawoy’s view, lies in the political sphere.

Reformers in Russia and China were equally enamored of markets but their attitudes toward the state were diametrically opposed. For the Russian “reformers” the party state was so morally and politically repugnant and its incumbents so corrupt and venal that the destruction of the state apparatus was worth any price. The Chinese “reformers”, on the other hand, were prepared to go any length to preserve the party-state but realized that if it were to be sustained the system of rules and incentives that connected the central state to the region and thence to localities had to be drastically changed to allow the reconstruction of state-society ties at the local level ... [The] Chinese party state has promoted accumulation, while the Russian democratic state has created a developmental disaster.³⁴

In Burawoy’s view, the Chinese party has been such a powerful force that the state could give considerable autonomy to the regions and local units. These, however, were residual claimants to financial resources. They became subject to hard budget constraints and thus had strong incentives to promote industry. By contrast, the Russian state reasserted the central redistribution of assets and thereby reproduced soft budget constraints. The secret of the expansion of the Chinese rural industry lies in “local state corporatism” where the enterprises are not privately, but locally owned and governed by a “contract responsibility scheme”; the local state can monitor enterprise managers and apply sanctions. Even nominally private enterprises are dependent on local governments and public enterprises. But in Russia, property has been privatised which implied that the state lost control. This, in connection with short time horizons, led to the outflow of resources from production to circulation: “In Russia markets combined with privatization led to disinvestment whereas in China markets combined with public ownership stimulate accumulation. Behind the mutual stimulus of production and exchange lies the Chinese party-state. Behind the wanton destruction of Russian industry lies liberal democracy.”³⁵

³¹ Ibid., p. 343.

³² Ibid.

³³ Michael Burawoy, “The State and Economic Involution: Russia Through a China Lens”, *World Development*, Vol. 24, No. 6, pp. 1105-1177, esp. p. 1107. The title referred to is Susan L. Shirk, *The Political Logic of Economic Reform*, Berkeley, 1993.

³⁴ Burawoy, p. 1105.

³⁵ Ibid., p. 1108.

In Burawoy's view, Russian disintegration began in 1989 with the national strike of the miners. "Failure to repress this strike marked the beginning of the end of the Soviet state."³⁶ With the withering away of the state the industrial conglomerates gained more power. When prices were liberalised in 1992, the weak state did not have the capacity to impose bankruptcy, and the conglomerates could extract subsidies and loans from the Central Bank. Privatisation concentrated control in the hands of managers who continued short-term strategies. The soft budget constraints were only monetarised, but not hardened. When the government eventually moved ahead with stabilisation, many enterprises turned back to barter. The absence of effective institutions stimulated also the appearance of agencies for private protection and contract enforcement. "The mafia ... provides a service without which many economic transactions might not take place."³⁷

All in all, Burawoy sees *four development trajectories*. Each is characterised by a specific combination of property relations and budget constraints: *Socialism* in its old form was characterised by public property and soft budget constraints, as opposed to *capitalism* with private property and hard budget constraints. *Russia* experienced an economic "involution" because of her combination of private property and soft budget constraints, whereas *China* managed to combine hard budget constraints with public ownership. "The Russian state has no communist party to fall back on its project of national integration and therefore it has sought to use economic concessions and soft budget constraints to contain centrifugal pressures."³⁸ Russia and China represent "emergent and enduring types". Russia's reformers attempted to leap from socialism to capitalism and "plunged the economy in the abyss of involution. Rejecting this manichean view China has manufactured a more effective transformation of socialism, creating a fourth alternative, which for all its problems offers some optimism for the future."³⁹ We interpret these passages in the way that the Russian politicians better should have tried, similar to the Chinese strategy, to maintain the party state and *transform* socialism, not to abandon it.

4. Opposing Views: Why China *could not* have served as a model: On agriculture and the state

Among the experts at the International Monetary Fund and the World Bank, or among Western advisors who in the beginning of 1990s worked for Eastern European governments, there has been consensus that China could *not* serve as a model. Anders Åslund, in the 1980s Swedish diplomat in Moscow and from 1991 to 1994 advisor to the Russian ministry of finance, published already in 1989 an article under the title: "Soviet and Chinese Reforms – why they must be different."⁴⁰ According to him, reforming agriculture was hardly the best point to start market-oriented reforms in the Soviet Union. One reason was technical: "The [*Soviet*] economic system is characterized by gigantomania and monopolisation. Under such circumstances, it is hard to recreate property rights and a balanced market. For instance, a normal Soviet cow-shed harbours 400 cows, and such a unit can barely be run by one single family."⁴¹ More important perhaps, at the end of the 1970s, almost three quarters of the Chinese labour force were working in agriculture; reforming this sector was bound to have a much bigger impact in China than in the Soviet Union.

³⁶ Ibid., p. 1109.

³⁷ Ibid., p. 1111.

³⁸ Ibid., p. 1115.

³⁹ Ibid.

⁴⁰ Anders Åslund, "Soviet and Chinese reforms – why they must be different", *The World Today*, volume 45, January-December 1989, pp. 188-191.

⁴¹ Op. cit., p. 189.

Only 20 per cent of the [*Soviet*] labor force was occupied in agriculture in 1985, and a mere 8 per cent in trade and catering. For someone seeking quick improvements in the performance of the whole economy, it might have been far-fetched to look towards these branches of the economy, particularly if the key issue was to speed up economic growth and technical development in order to match the American armament efforts.⁴²

Furthermore, Gorbachev, under the impression of the Chinese reforms, had actually tried his best to promote family farming. Again in Åslund's words: "He turned to this theme at the 27th Party Congress in February 1986, in August 1987, in May and October 1988, and finally in connection with the Central Committee Plenum in March 1989, when a couple of decrees were issued on leasehold. His scant success is obviously due to resistance at all levels."⁴³ As to this last point, Åslund gave an illustration:

In the spring of 1986, Gorbachev issued a decree on agricultural reform. As a foreign diplomat, I went to Gosagroprom to find out what it meant. However, my questions were met with derisive laughter from senior agricultural officials. They openly declared that nothing would change, and they could not have cared less about decrees passed by Gorbachev.⁴⁴

This leads to a general political difference between China and Russia: In the Soviet Union, after the end of Stalinist mass terror, state power has become increasingly diluted. In the 1980s, the industrial societies of Eastern Europe, as opposed to the predominantly agrarian Chinese one, have become comparatively complex. It was impossible to steer everything from the top, power had to be delegated to sub-units of an increasingly complex bureaucratic machine. To quote Åslund again: "Consequently, when Gorbachev became General Secretary of the CPSU, he turned out to have surprisingly little power. Instead, a multitude of bureaucrats were all dictators within their own spheres of competence. Decisions from above were distorted to the bureaucrats' advantage, which rarely corresponded with a benefit to society."⁴⁵ By contrast, in China the state regulated much less, but its actual power was much greater.

From our point of view, this point has substantial consequences for Burawoy's position. It was not the hatred of Russian reformers after 1990 that destroyed the state. It has been slowly decaying for decades, and the main reason was structural (bureaucratic hypertrophy).

We might also add that currently (2003), after five years of rather high Russian growth rates, it does not seem plausible to see Russia on a stable but miserable path of "involution".

5. The "Chinese Strategy" has been Tried – Before 1990

The "Chinese Way" of gradual reform *was actually tried* in the Soviet Union and in several Eastern Central European countries. Already in 1993 Włodzimierz Brus, a leading Polish economist who in 1968 was forced to emigrate, pointed out that in the 1980s Soviet and Chinese reforms had many things in common. In both countries the reform was initiated from above, and the respective leaders

intended not to dismantle but to prop-up socialism, not to weaken but ultimately to maintain and to strengthen the Communist party's power monopoly ... Gradualism should also be regarded as a

⁴² Ibid.

⁴³ Op. cit., p. 190.

⁴⁴ Anders Åslund, *How Russia Became a Market Economy*, Washington D.C., The Brookings Institution, 1995, p. 91.

⁴⁵ Ibid., p. 15.

common feature of both the Chinese reform-process and “perestroika”, though it must be clear that neither the final (aimed-at) shape of the reformed system nor the proposed path of reaching it was spelled out in advance ... [The] initial ideas did not go beyond an instrumental attitude to the market as a servant to the plan ... No ex ante design was at hand not only at the beginning of the process (i.e. in 1978/9 or 1986/7 in the USSR) but also later in the course of the step-by-step radicalization of the market-oriented measures.⁴⁶

But under the conditions of the Soviet Union, Gorbachev’s gradual reforms did not work. In Åslunds summary:⁴⁷

The Central Committee (CC) plenary meeting of the CPSU in June 1987 heralded an attempt at more substantial economic reform. In its immediate aftermath, the Law on State Enterprises was promulgated, coming in force in January 1988 ... The Law on State Enterprises was a halfway attempt at economic reform, leaving the economy with neither plan nor market. Officially, compulsory plain targets were abolished; in reality they remained in watered-down form. Similarly, enterprises were offered more freedom in setting prices and wages. They were given substantial rights but little responsibility. Rather than paving the way for a market economy, the Law on State Enterprises encouraged manipulation of the old rules. The main consequence of its enactment was that wages started rising excessively. Enterprise managers raised prices whenever they were allowed to by the state, while costs and demand were neglected. As a result, relative prices became increasingly distorted, the prices of heavily taxed industrial goods rose, while those of subsidized food stayed low. The aggravated economic crisis prompted fears of hyperinflation from the fall of 1990.

Already back in 1963 the GDR had introduced a reformed planning system, with decentralisation of the command structure and more power to the managers of the state-owned enterprises. It was largely revoked in 1970 because the party leadership sensed that the new mechanism implied a loss of control. In 1968, however, Hungary entered on a reform path which gradually became “wider”. By the end of the 1980s, this country was the most “liberal” one within the Soviet orbit. Also the Polish leadership experimented with gradual reform in the 1980s. The Polish experiences were particularly disappointing. Jeffrey Sachs, who in 1989, worked in Poland as advisor for the government, summarised: “What the Polish regime tried ran parallel to what Gorbachev attempted on the domestic side under *perestroika* – and it led to an almost identical economic debacle. Both Poland and the former Soviet Union ended the Communist reform period with a hyperinflation, intense shortages in the state-run distribution system, a burgeoning black market, and sharply falling industrial production. The similarity of outcomes in both cases points to deep flaws of the communist reform strategy.”⁴⁸

Hungary did not experience the same degree of macroeconomic instability, but also the Hungarian reforms failed to produce economic dynamism. This meant in turn increasing problems as to the serving of the external debt. It would, however, be wrong to blame *reform as such* for the economic debacle: Unreformed systems encountered the same problems.⁴⁹ So, not reforming did not help either.

⁴⁶ Brus, Włodzimierz, “Marketization and Democratization: The Sino-Soviet Divergence”, *Östekonomiska Institutet – Stockholm Institute of East European Economics, Working Paper*, No. 63, 1993, p. 5.

⁴⁷ Åslund, 1995, p. 29f.

⁴⁸ Jeffrey Sachs, *Poland’s Jump to the Market Economy*, The MIT Press, Cambridge/Mass. and London, first paperback edition, 1993, p. 28.

⁴⁹ Just to mention one example, in October 1989 the GDR leadership had to confront the fact that the foreign debt has risen from 2 billion D-Mark (West) in 1970 to 49 billion in 1989; the foreign currency income covered only 35 percent of the expenses. In order to prevent a further increase of the debt, living standards had to be reduced by 25-30 percent. Wolfgang Zank, “The Power of Legends and the Long-Term Effects of Short-Term Mistakes – The Convulsions of Monetary and Economic Transformation in East Germany 1990-1997”, Tadeusz Kowalski, *Financial Reform in Emerging Market Economies. Quantitative and Institutional Issues*, Poznań, 1997, pp. 261-284, esp. p. 263.

It was against the background of evident failure of imminent reform that a number of Eastern European economists came to the conclusion that piecemeal reform was not sufficient. A comprehensive reform package was needed. Just to mention one example, in 1986 János Kornai, of Budapest and of Harvard University, published an influential paper in which he analysed the shortcomings of the Hungarian reform process. In the end he sketched a programme of Hungarian “radical reformers”. Their proposal contained political demands (appropriate representation of all social groups) and, among others, all the ingredients of Rapid Reform, including comprehensive price liberalisation, liberalisation of imports, currency convertibility and macroeconomic stability.⁵⁰ “The changes listed above and perhaps a few more important measures must be introduced in a consistent manner, as a “package”. Any one of these changes, implemented separately without the appropriate conditions created by the other necessary changes can be risky and harmful.”⁵¹

Leszek Balcerowicz in Warsaw, Vaclav Klaus in Prague, or Grigory Yavlinsky and Yegor Gaidar in Russia reached similar conclusions. So did experts at the IMF and the World Bank who followed the development in Eastern Europe closely. In these institutions in the meantime another consensus had emerged, based mostly on Latin American experiences and the combat against the Israeli hyperinflation in the middle of the 1980s, namely that hyperinflation should not be reduced gradually. Instead, it should be brought down rather rapidly under a threshold of about 50 percent, by stabilising the money supply. The recommendations of swift macroeconomic stabilisation (as first priority) in combination with price liberalisation, opening of foreign trade and currency convertibility formed the paradigm of rapid reform.⁵² Journalists soon labelled it Shock Therapy. Some governments in transition countries, for instance Poland in 1990, followed it rather closely. Russia after 1992 practised a kind of hybrid, with comprehensive price liberalisation (and fast privatisation), but blatant failure as to macroeconomic stabilisation during the first years. Other countries hardly reformed at all in the first half of the 1990s. A particularly sad example was Ukraine which until 1998, as a counterexample to “Shock Therapy”, experienced an economic “involution” which was much worse than the Russian one.

It is a mystification when Roland and others juxtapose the “Washington Consensus” against an “evolutionary-institutionalist approach”, where the representatives of the latter are cautious people with a sense for traditions and institutions whereas the advocates of Rapid Reform were shortsighted “cavalry officers”. Those who recommended rapid reform have often emphasised the necessity of a long-term strategy for institutions building.⁵³ But in their view, long-term institution building was no excuse for delaying some important reforms which could and should be implemented rather quickly.

⁵⁰ János Kornai, “The Hungarian Reform Process: Visions, Hopes, and Reality”, *Journal of Economic Literature*, Vol. XXIV (December 1986), pp. 1687-1737, esp. p. 1732f.

⁵¹ Ibid.

⁵² A comprehensive overview from 1991 can e.g. be found in Stanley Fischer and Alan Gelb, “The Process of Socialist Economic Transformation”, *Journal of Economic Perspectives*, Volume 5, Number 4 – Fall 1991, pp. 91-105.

⁵³ See e.g. Stanley Fischer and Alan Gelb: “A secure legal environment has to be created to protect property rights and regulate commercial relations. Accounting and audit systems are needed to organize and monitor information. Complementing the system reforms are needed investments in human capital, in areas such as accounting, credit and market analysis, and bank inspection. Management skills have to be upgraded and modernized, especially in finance and marketing.

In some areas, such as financial markets, reform may require a greater state role than before. Such inevitably lengthy reform processes constrain the inefficiency and speed of reform; for example, in the United States it takes a minimum of five years to train an examiner capable – perhaps – of dealing with the smallest and simplest bank.” Op. cit., p. 100.

In our context it is important to underline that it was only after the failure of the gradual, Chinese-inspired reforms that the paradigm of rapid reform emerged. This point, as far as we can see, has been invariably overlooked by those who have recommended a Chinese Way for Eastern Europe. And it should perhaps also be underlined: None of those who recommended Shock Therapy for Eastern Europe did ever do so *for China*.

Roland wondered why a double-track price liberalisation “had not been proposed by academic economists in the context of transition”, a riddle only further research could solve.⁵⁴ But this is a misunderstanding. Already in 1994 Jeffrey Sachs and Wang Thye Woo pointed out (at a conference where Roland was present⁵⁵) as to the Soviet Union:

The two-track pricing mechanism applied, in effect, after 1987: state enterprises delivered goods under state orders at official prices while they were given increased freedom to establish “contract” prices for deliveries outside of state orders. The trading system was also partially liberalized, extending trading rights to industrial enterprises, and introducing retention quotas for foreign exchange. Joint ventures and foreign direct investment were also legalized. Private farming was legalized by decree in 1987, but notably, unlike China, very few farmers nevertheless took advantage of the opportunity...

Also Poland and in particular Hungary have experimented with double-track pricing. Already in 1968 Hungary introduced a system with three categories – fixed, regulated (or flexible within centrally determined limits), and more or less free prices. This system was to some extent emulated by Poland in 1982.⁵⁶ But nowhere in Eastern and Central Europe did it produce beneficial results.

Nowhere has dual pricing been in itself sufficient to contain inflation, as e.g. Amsden, Liu and Zhiang seem to indicate. Poland was gliding into hyperinflation 1988/89 under a dual-price system; the central bank made the money stock ballooning by giving cheap credits to the state and enterprises. Something similar happened under Gorbachov. And in Russia after 1992 it was not price liberalisation which produced hyperinflation. Liberalisation as such produces only a one-time price rise. Also in this case it was the credit policy of the Russian central bank and the huge state deficit which plunged Russia into the abyss of hyperinflation. In these years the architects of Russian monetary policy acted – of course – in plain disregard of all pieces of advice from the IMF, World Bank or other Western advisors.

6. The “Chinese Way” has been Successful - in China

If gradual reform did not work in Eastern Europe, how then could it be successful in China? Because the conditions were different. In 1978, 71 per cent of the Chinese population was engaged in agriculture and only 15 per cent in industry. The Chinese peasants were living near subsistence level, their consumption were only at about one third of that in the cities.⁵⁷ By contrast, Soviet agricultural workers had real income levels which were only about 15 per cent lower than that of urban workers. The wide income spread in China reflected three things: Firstly, in China (as in many other developing countries) there existed a vast pool of surplus agricultural labour, i.e. labour which could not substantially contribute to agricultural production. Prior to 1978, the Chinese surplus labour was held in place by restrictions on migration and on starting non-agricultural enterprises. But in none

⁵⁴ Roland, p. 340f.

⁵⁵ Jeffrey Sachs and Wing Thye Woo, “Reform in China and Russia”, *Economic Policy*, April 1994, pp. 101-145, esp. p. 120. As to Roland’s presence, see his comments on p. 139.

⁵⁶ Thomas A. Wolf, “The Lessons of Limited Market-Oriented Reforms”, *Journal of Economic Perspectives*, Volume 5, Number 4, Fall 1991, p. 52.

⁵⁷ Sachs and Wing Thye Woo, p. 106.

of the Eastern European countries was there surplus labour of this magnitude. The large rural urban income spread in China was also caused by the heavy implicit taxation of the rural sector, whereas Soviet agriculture was subsidised.

Some reforms in China have been, to quote again Sachs and Wing Thye Woo, “breathhtakingly rapid. The rural reforms ending the commune system that covered hundreds of millions of peasants farmers essentially took place in the three years 1979-1981 ... By 1981 there was a massive, almost spontaneous, dismantling of collective property in agriculture. In 1983, the People’s Communes were formally eliminated, and the individual household was established as the basis of agricultural production.”⁵⁸ And: “When the communes were dismantled, nearly three-fourths of the Chinese workers found themselves outside the socialised economy and subject to hard budget constraints with little social protection.”⁵⁹ The Chinese social security system covers basically only the urban population, the rural population is practically left out. As Stanley Fischer, by then chief economist of the World Bank, added in the discussion of this paper: “[The] Chinese agricultural reforms were truly shock therapy.”⁶⁰

Under these conditions the reforms “spurred enormous flows of workers out of subsistence agriculture into new sectors of the economy, including township and village enterprises (TVEs) and new labour-intensive manufacturing exporters set up in coastal regions. The latter used offshore Chinese capital, technology and management.”⁶¹ But still in 1993, the Chinese Ministry of Agriculture calculated that there were some 130 million surplus farm labourers in the countryside, out of an agricultural labour force of 342 million; the “floating population”, workers in urban areas without residence permits, was estimated at a magnitude of 50 million.⁶² Fortunately, the huge Chinese overseas community has been willing and capable of investing large sums in China, as soon as they were allowed to, and their investments were essential at creating the new jobs for the migrants. None of the Eastern European countries could count on an overseas community of such a strength as China. Nor could they, in contrast to China, expect a benevolent US trade policy before 1989 (see above, section 2).

Under the Chinese conditions, the early reforms could also vitalise the agrarian sector much more than analogue measures could have done in Eastern Europe. In contrast to the gigantomanian Soviet agrarian enterprises, Chinese agriculture was mostly using traditional small-scale methods, with a high input of manual labour. China’s relative backwardness created, somewhat ironically, an advantage as regards the transition to a market economy. As Anders Åslund put it:

Essentially, communist economic reforms have only succeeded in solving economic problems in small-scale production and services, and the means has been the reconstruction of private ownership or some kind of quasi-property rights, such as leaseholds, small cooperatives or various contracts. Small enterprises are typical of traditional agriculture, handicrafts and trade...

In China, the solution was too obvious. Some 80 percent [71, according to Sachs/Wing Thye Woo, see above] of the labour force was occupied in agriculture, where manual work prevailed. The Chinese government could seize on a spontaneous trend to parcel out land to families on lease and dissolve the people’s communes. With privatised family agriculture, it was natural to continue with the development of private handicrafts, small-scale industry and trade. A comprehensive private market economy with millions of producers and buyers could swiftly be established, limiting the distortions of the market that are otherwise typical of an economy in transition between two systems.⁶³

⁵⁸ Ibid., p. 115.

⁵⁹ Ibid., p. 104.

⁶⁰ Op.cit., p. 134.

⁶¹ Op. cit., p. 104.

⁶² Op. cit., p. 103n5 and 109.

⁶³ Åslund, 1989, p. 189.

After the Chinese “Shock Therapy” the household units in agriculture, the township and village enterprises, the numerous small private enterprises in handicraft and trade, and the joint ventures and private firms in industry were working under hard budget constraints. These covered about three-quarters of the population. But China has been less successful in imposing hard budget constraints in the big state-owned enterprises (SOEs) which have been dominating industry. The degree of profitability and the softness of their budget constraint have been the subject of some debate among the experts. But Burawoy’s statement that China has managed to combine public ownership with hard budget constraints is certainly overoptimistic. Sachs and Wing Thye Woo pointed already in 1994 at the “continued failures of SOE reform in the past 10 years. The continued losses of SOEs despite rapid economic growth in 1992-93 is the clearest sign that SOE problems are chronic, not cyclical ... According to widespread reports, official and unofficial, corruption is rampant, in significant part because of the lack of clarity in ownership rights. ‘Spontaneous privatization’, in which managers redefine part of state property as their own, has reached alarming proportions...”⁶⁴

After the millennium shift many problems of the SOEs seem to be far from solved. As the *Economist* reported in September 2000: “In 1985, one in ten SOEs admitted losses; by 1998 it was one in two. Many of the nominally profitable SOEs, moreover, were really only breaking even. In Liaoning, the SOE heartland, virtually all were making losses ... One foreign banker in Beijing estimates that dirty book-keeping accounts for almost half of the SOEs’ recent profit figures.”⁶⁵ Furthermore, given the point that about 80 percent of the bank loans were given to SOEs, the non-profitability of the SOEs implies a grave potential banking crisis. The four big banks are technically insolvent. The governor of China’s central bank, Mr. Dai Xianlong, was quoted in May 2001 that three of them failed to meet international levels of capital adequacy even under the present, lax accounting rules. The director of one of them, the Bank of China, admitted that 30 percent of its loans were non-performing.⁶⁶

So, contrary to Burawoy’s view, state-ownership, at least as regards many SOEs, has not been an asset. Furthermore, in the 1990s China has taken substantial transition steps which have brought her very close to the model of an open capitalist development. Just to mention one, by January 1994 the currency was devaluated and the exchange rate unified.⁶⁷ In Eastern Europe, this was an essential ingredient in the set of the “Washington Consensus” recommendations. And by January 1, 2002, China became a member of the World Trade Organisation (WTO) – a step which brought her even closer to the open capitalist model. The present authors cannot see that China represents a type of a transformed socialist economy, as Burawoy depicts her. Actually, the picture of millions of rural people living at subsistence levels without social protection, being driven by their harsh conditions from their homes to the coastal and urban areas, in order to find a modest living under very long working hours, all this reminds us more of how Karl Marx depicted the genesis of capitalism in England.⁶⁸ Today Chinese inequality has risen to levels where the authorities have reasons to concern for social stability. According to the official news

⁶⁴ Sachs and Wing Thye Woo, p. 130.

⁶⁵ “China’s State-Owned Enterprises. The longer march”, *The Economist*, September 30th 2000, pp. 93-97, esp. p. 94.

⁶⁶ “An outbreak of honesty”, *The Economist*, May 19th 2001, pp. 75-76, esp. p. 75.

⁶⁷ Naughton, Barry, “The Dangers of Economic Complacency”, *Current History*, September 1996, pp. 260-265, esp. p. 261.

⁶⁸ See e.g. Karl Marx, “Das Kapital. Kritik der Politischen ökonomie, Erster Band”, *Marx Engels Werke (MEW)*, Band 23, (Ost-) Berlin 1970, p. 761.

agency Xinhua, the Gini-coefficient is at 0.458, and independent experts put it as high as 0.6.⁶⁹ The high inequality is also a kind of parallel to early English capitalism.

All in all, the scrutiny of the arguments have not substantiated that Eastern Europe could have followed a “Chinese Model”, the conditions were too different. In those cases where it actually had been tried, it did not work. On the other hand, Rapid Reform would certainly not have been a good piece of advice for China. But no one ever recommended that.

I

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⁶⁹ “Income distribution in China. To each according to his abilities”, *Economist*, June 2nd 2001, p. 63f, esp. p. 63.

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