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Chinese Economic Reform in a Comparative Perspective: Asia vs. Europe*

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This article views China's economic reform in a comparative perspective. It sets out with the significant phenomenon of China's rise and Russia's fall in the 1990s. The literature is reviewed. Two main approaches are identified: the non-institutional and the institutional, with the latter holding sway. Culture, stage of economic development, international environment, and pre-reform system are the four non-institutional factors; all are found wanting in terms of explaining the performance difference between Asian and European transition economies. The institutional factors are reform philosophy, speed of reform, property rights restructuring, and role of the state—the last two of which constitute an effective analytical framework. It is argued that China's de facto privatization and active developmental state have proven more effective than Russia's de jure privatization and weak democracy in promoting growth and achieving stability. China and Russia are treated as representing two modes of exit from state socialism and two distinct development patterns. The duel between the two harks back to the competition between East Asia's capitalist

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developmental model and the West's neoclassic economics. China's better transition performance proves the effectiveness of the East Asian model.

KEYWORDS: state of the field; economic transition; China; Russia; property rights; marketization; privatization.

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Introduction: An Enduring Duel

Comparative communism was once an important sub-field in comparative politics. The main theoretical foundation in comparative communism was laid by the study of the Soviet Union, the common origins of all the communist regimes throughout the world.[1] Theories once abounded that depicted a common developmental trajectory for the Leninist regimes. However, there had always been a loud dissenting voice against the dominance of the Soviet experience. This challenge resonated from the quarters of Chinese studies, dating back to the early Western missionaries in China. Succinctly stated, China studies were immersed in Chinese exceptionalism that defied the "common conclusions" drawn mainly from the Soviet and East European experiences. Mao Zedong's (毛澤東) turn to ultra-leftism in the late 1950s was a clear deviation from the Soviet experience and seemed to vindicate China's "uniqueness" among the Leninist regimes. In this context the Soviet and Chinese cases were often juxtaposed.[2] Why the two diverged and whether they would reconverge were among the most commonly asked questions when the two countries were compared.

The duel of Soviet and Chinese studies in comparative communism did not abate when reform gradually came into vogue in one after another communist country after the end of the 1970s. The Chinese again took a

[1]One can easily reach this conclusion by reading the content pages of the most important journal in the field, *Studies in Comparative Communism*, later renamed *Communist and Post-Communist Studies*.

[2]One of the earliest significant works in comparing the Soviet and Chinese communism is Thomas P. Bernstein, "Leadership and Mass Mobilization in the Soviet and Chinese Collectivization Campaigns of 1920-30 and 1955-56: A Comparison," *The China Quarterly*, no. 31 (July-September 1976): 1-47.

"unique" path toward reform, different from what their Russian and East European comrades advocated. In the late 1970s, Mao Zedong's ultra-leftism was replaced by Deng Xiaoping's (鄧小平) ultra-pragmatism, while the Soviets were still bogged down in the quagmire of a deficient command economy and ineffective limited reforms. The Soviet "revisionism" paled against China's bold exploration into market reform. Divergence, however, bred convergence. As Mikhail Gorbachev rose to political supremacy and launched "*perestroika*" (restructuring) and "*glasnost*" (openness), both he and Deng were hailed as great reformers of the 1980s, with market socialism becoming the common brand name of Chinese and Soviet reforms. When the tragedy of Tiananmen (天安門) struck in 1989 and the whole communist world was shaken, people predicted the fall of all Leninist regimes throughout Eurasia. The situation in China, at the time, looked even bleaker than in the Soviet Union which was in the seemingly able hands of Gorbachev. The total collapse of the Soviet bloc in Europe and the persistence of the Chinese communist regime took many observers by surprise, yet the general prediction was that China would nevertheless eventually follow suit.[3] The development in the 1990s has shown that China and Russia have again diverged and the chances of reconvergence in the near future look extremely dim.

The duel continues. Russia and China were once considered both ideological and strategic partners in the 1950s. Their rift in the 1960s, however, dramatized the different developmental patterns of the two countries: planned economy vs. great leap forward, oligarchic conservatism vs. revolutionary and charismatic politics. China then plunged into much more radical reform in the late 1970s, keeping the two countries apart. When Gorbachev joined Deng in reform toward market socialism, he temporarily put the two countries in the same camp, but post-Tiananmen developments soon relentlessly tore them apart. Once again people can compare the Russian road and the Chinese way, this time on the strengths and weak-

[3]For the prediction of an imminent fall of the communist regime in mainland China, see Jürgen Domes, "Four Ways Communism Could Die in China," in *The Broken Mirror: China after Tiananmen*, ed. George Hicks (Chicago: St. James Press, 1990), 466-72.

nesses of their respective reform path.

The West was for most of the time on China's side as the Soviet (Russian)-Chinese duel unfolded. Even when the insanity of the Great Proletarian Cultural Revolution reached its climax, the Left in the West wondered what could be learned from this great human experience, while the Right rejoiced at the prospects of driving a wedge between Moscow and Beijing. Deng's market reform in the 1980s provided further reasons for the West to sympathize with the Chinese. This situation changed when the Soviet Union collapsed into more than a dozen succession states, and the Russians and the East Europeans followed the neoclassical prescriptions offered to them by Western pundits. Beijing's insistence on party dictatorship and its gradualist approach to economic reform paled against the zealous drive toward democracy and capitalism in Russia and Eastern Europe. Now the West defends the Russian road against the Chinese way, as the former appears more intelligible and congenial. However, the track records of these two countries show otherwise. It turned out that countries following Western prescriptions fared worse than those that insisted on their own road to reform.

This is the backdrop of the latest stage of the Russian-Chinese contrast, the duel between the exit modes of European and Asian state socialism. It is against this backdrop that this study examines China's reform from a comparative perspective. This article begins with a literature review of the reform in China and Russia. Two approaches are identified: the institutional approach and the non-institutional approach. Reform philosophy, speed of reform, property rights restructuring, and role of the state are identified as the main institutional factors; culture, stage of economic development, international environment, and pre-reform system are the main non-institutional factors. The main finding is that the non-institutional factors are insufficient to account for the stark performance difference between China and Russia, while among the four main institutional factors property rights and role of the state constitute an effective analytical framework. Under this framework, we find China and Russia signify both two modes of exit from state socialism and two distinct development patterns. The contrast between the two harks back to the competition between

East Asia's capitalist developmental model and the West's neoclassic economics. China's better transition performance has proven the effectiveness of the East Asian model.

One caveat is in order here. China's reform is usually compared with Russia's, obviously because of the comparable size and strategic importance of these two countries. There is another comparative context, however, one that concentrates on the reform of European state socialism. In this context, Russia is oftentimes compared with other succession states of the former Soviet Union, and with East European countries.[4] Because the emphasis is on Europe, China is left out. It is interesting to note that the predominant conclusion of the China-Russia comparison is to vindicate the gradualist approach taken by Beijing, while the European comparison often validates the "transition orthodoxy," "big bang," or "shock therapy" approach as advocated by the International Monetary Fund (IMF). The following discussion concentrates on the comparative study of Chinese and Russian reforms. East European countries will be brought into the picture, however, when their experience is directly relevant to the China-Russia comparison.

China's Rise and Russia's Fall

The contrast between China's rise and Russia's fall after the initiation

[4]It is true that there are studies that deal simultaneously with the comparative performance in economic transition of all three—Russia, Eastern Europe, and China. One of the earliest studies on this subject is Ed A. Hewett, "Economic Reform in the USSR, Eastern Europe, and China," *The American Economic Review* 79, no. 2 (May 1989): 16-20. Yu-Shan Wu's *Comparative Economic Transformations: Mainland China, Hungary, the Soviet Union, and Taiwan* (Stanford, Calif.: Stanford University Press, 1994) takes a property rights approach to tackle the issue. In 1996, the World Bank's *World Development Report 1996: From Plan to Market* (New York: Oxford University Press, 1996) is the first comprehensive attempt to compare Chinese, ex-Soviet, and East European experiences and to sort out which strategies have worked and which have not. Yu-Shan Wu's *Yuanli shehui zhuyi: Zhongguo dalu, Sulian han Polan de jingji gaige* (Away from socialism: The economic transformation of mainland China, the Soviet Union, and Poland) (Taipei: Cheng-chung, 1996) is another work in this direction. This being said, the tri-regional comparison is relatively rare in the study of transition economies. Most of the work in the field concentrates on the Russia-China dyad or the post-socialist European comparison.

of economic reform is stunning. From 1979 to 2000, China's gross domestic product (GDP) grew at an average rate of 9.5 percent per annum, surpassing the world average for the same period by 6.5 percent.[5] In contrast, Russia's GDP dropped by 55 percent in 1990-2000. This was a greater contraction of the economy than during World War II (1941-45), which reduced Soviet GDP by 30 percent.[6] China's trade volume was a meager US$20.6 billion in 1978, making the country the 27th largest trading nation in the world. This figure expanded to US$476 billion in 2000 and the PRC rose to 8th place. In contrast, the Soviet Union's trade volume was US$115 billion in 1988, or the 8th largest in the world. In 2000, the trade volume for Russia stood at US$120 billion. Even though this volume was sustained at the 1988 level, rapidly growing world trade during the 1990s downgraded the country's trading status to 22nd place. In 2000, mainland China received foreign direct investment of US$40.8 billion (second largest in the world), compared to Russia's US$4.5 billion. The transition toward market economy proved a blessing for China, which enjoyed unprecedented economic growth and rise in power; it was a disaster for Russia, however, which suffered from unparalleled decline in economic and geopolitical power. The contrast is so dramatic and its implications so profound that one is compelled to ask why China was so successful while its former mentor, Russia, failed so miserably in economic reform.

Between China's super performance and Russia's dismal failure lies Eastern Europe. To be sure, the variation among countries in this region is

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[5]One should be aware of the fact that China's high growth rate is a subject of contention among experts, particularly concerning the growth of the late 1990s, when expansion of the economy was accompanied by deflation. That doubt, however, does not change the basic picture of two decades of high growth since reform began. For the doubter, see Thomas G. Rawski, "How Fast Is China's Economy Really Growing?" *The China Business Review* 29, no. 2 (March/April 2002): 40-43. For the believer, see Nicholas R. Lardy, "Integrating China into the Global Economy" (Speech delivered to the United States-China Chamber of Commerce, July 23, 2002), excerpted in William R. Dodson, "The Imminent Collapse of the Chinese Economy Has Been Greatly Exaggerated," at <www.silkrc.com/China Trade/Lardy.pdf> (accessed on February 12, 2003).

[6]See Huang Jinggui, "Zhong-E jingji gaige de qidian, fangshi, chengben ji xiaoguo bijiao" (A comparison of the starting point, method, cost, and effect of the economic reform in China and Russia), *Waiguo jingji yu guanli* (Foreign Economies & Management) 23, no. 6 (June 2001): 32.

Table 1
Growth, Inflation, and Unemployment in Transition Economies, 1989-1996

	Change in GDP (%)		Change in Prices (%)		Unemployment
	1989-96	1993-96	1989-96	1995-96	1996
Poland	4	23	16,270	55	13
Czech Republic	–9	12	212	19	3
Hungary	–13	5	479	59	11
Russi	–49	–25	508,010	321	9
China	108	54	118	22	3

Source: Richard Layard, "Why So Much Pain? An Overview," in *Emerging from Communism: Lessons from Russia, China, and Eastern Europe*, ed. Peter Boone, Stanislaw Golumka, and Richard Layard (Cambridge, Mass.: MIT Press, 1998), 2.

great. Poland has been hailed as the best performer, an exemplar of shock therapy yielding rapid recovery and growth. The Balkans are doing much worse, with Albania remaining the poorest country in Europe and surviving on remittances from abroad. Table 1 presents the performances of China, Russia, and the three best East European performers: Poland, Hungary, and the Czech Republic. The table clearly shows that Eastern Europe squarely lies between China and Russia in reform performance. The only area where Russia is on a par with Eastern Europe is in terms of unemployment. That rate, however, tells more about Russia's slow pace in economic restructuring than about its ability to provide jobs.

Even by taking into consideration the best performers in Eastern Europe, China still undeniably surpassed all its former socialist comrades in Europe in terms of reforming its economy. Perceived from a broader perspective, the duel between China and Russia epitomizes the duel between the Asian and European post-socialist approaches to reform.[7] The reform communist systems in Asia (mainland China and Vietnam) have developed into a neo-NIC model that bears striking similarities with its predecessors—the East Asian dragons and tigers;[8] the European socialist

[7]This is the theme of Yu-Shan Wu's *Yuanli shehui zhuyi*.

[8]For an early discussion of the issue of China developing into a huge NIC, see Dwight H. Perkins, *China: Asia's Next Economic Giant?* (Seattle: University of Washington Press, 1986).

systems have emulated their Western neighbors, however, and found this strategy of transition more difficult. In a sense, the duel between China and Russia in particular, and between Asia's reform communism and Europe's emergent capitalism in general, harks back to the duel between East Asia's capitalist developmental model and the West's neoclassic economics.[9] With that broader perspective, we can now delve deeper into the literature dealing with the China-Russia comparison, understanding fully that no less than two paradigms of capitalism are at stake in the debate.

The Non-institutional Approach

Different approaches contend to explain the economic success of reform communism in China, and the conspicuous failure of its European counterparts, particularly Russia. One can divide the enormous literature into two approaches, the institutional and the non-institutional, with the former holding sway. The performance of transition economies is a subject of economic development, a field that has witnessed a shifting focus during the post-WWII period. From the 1940s to the 1960s, the entire emphasis was on the accumulation of physical capital as the key to development (the Harrod-Domar model, etc.). The second phase recognized the importance of human capital which explained the rapid recovery of Europe and Japan compared with developing countries that received large-scale aid. From 1970 on, the policy environment had been thought to determine the productivity of investment. Finally, in the 1990s the consensus was that the central task of economic transition resided in building the institutional infrastructure of a market economy.[10] The centrality of institutions has thus

[9]For the "capitalist developmental model," see Chalmers Johnson, "Political Institutions and Economic Performance: The Government-Business Relationship in Japan, South Korea, and Taiwan," in *Asian Economic Development—Present and Future*, ed. Robert A. Scalapino, Seizaburo Sato, and Jusuf Wanandi (Berkeley: Institute of East Asian Studies, University of California, 1985), 63-89.

[10]For a discussion of the theories on economic development, see John Williamson, "What Should the Bank Think about the Washington Consensus?" Institute for International Economics paper, at <www.iie.com/papers/williamson0799.htm> (accessed on January 7, 2003).

been fully established. Because of the predominance of the institutional approach in studying development in transition economies, we shall begin with a discussion of the non-institutional factors, and then shift back to the main body of the literature that focuses on institutional change.

Among the often-cited non-institutional factors bearing on performance of transition economies one finds *culture*, *stage of economic development*, *international environment*, and *pre-reform system*. We will briefly review these four factors before dealing with the mainstream institutional approach.

Culture

Culture is a ready candidate to explain different economic performance across countries and regions. Max Weber's classic account of the rise of capitalism in terms of the Protestant work ethic ushered in religious and cultural theories of economic activities. The rapid growth of the East Asian region since the 1960s has been widely noticed in academic circles,[11] and was widely attributed to Confucianism prevalent in the region.[12] This led to the debate over "Asian values,"[13] and the ridiculing of those values in the aftermath of the 1997 East Asian financial crisis.[14] If one accepts the proposition that Asian values—including high savings rate, strong work ethic, respect for authority, socialization over individualization, and social harmony—are indeed conducive to economic development, then the phenomenal growth of mainland China since the late 1970s can be seen as a sign both of the communist regime's abandonment of

[11]Examples include Peter L. Berger and Hsin-Huang Michael Hsiao, *In Search of an East Asian Development Model* (New Brunswick, N.J.: Transaction, 1988); and Roy Hofheinz and Kent E. Calder, *The Eastasia Edge* (New York: Basic Books, 1982).

[12]See, for example, Gilbert Rozman, "The East Asian Region in Comparative Perspective," in *The East Asian Region: Confucian Heritage and Its Modern Adaptation*, ed. Gilbert Rosman (Princeton, N.J.: Princeton University Press, 1991), 3-42.

[13]A huge literature has appeared surrounding the concept of "Asian values." For an overall review of the debate, see Richard Robinson, "The Politics of Asian Values," *The Pacific Review* 9, no. 3 (September 1996): 309-27.

[14]Mark R. Thompson, "Whatever Happened to 'Asian Values'?" *Journal of Democracy* 12, no. 4 (October 2001): 154-65.

Maoist ideology and the revival of traditional Chinese culture in the absence of state suppression. The lack of such a growth-prone business culture predestined the more difficult economic transformation of the former Soviet-bloc countries.

Cultural arguments have also sought to explain the lingering impact of communism. Living under a planned economy and socialist property rights for seventy years would assuredly have a stronger impact on people's psychology than living under those circumstances for thirty years. Russia, being the homeland of world communism since the Bolshevik Revolution in 1917, was much more successful in transforming its people's mindset toward accepting rigid state planning in their everyday life than was China with its turbulent and inconsistent exposure to state socialism since 1949. Other things being equal, one then expects to find a weaker tradition of individual farming and private business management in Russia, as compared to within China.[15] The Russian people were also much more accustomed to fixed prices, low rent, cheap transportation, and state-provided medical care.[16] In comparison, China's socialism was originally imported from Russia and lasted for a much shorter period of time. Almost no citizens in Russia had any experience with living under capitalism by the time Mikhail Gorbachev launched his bold market reform of *perestroika* in 1986. By contrast, there were many Chinese with vivid memories of how private businesses worked during the Kuomintang's rule when reform began in the late 1970s. In short, the cultural theory argues that a much stronger pro-individual farming and pro-private business traditional culture, coupled with a much shorter experience with state socialism, go a long way in explaining why China has had a much more successful economic transition than Russia, with its traditional culture being less capitalism-prone and its communist ethos much stronger.

Cultural differences are said to dilute Russia's property rights re-

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[15]See Harry Williams, "Property Reform and Legitimacy," *Journal of Contemporary Asia* 28, no. 2 (1998): 159-74.

[16]James R. Millar, "The De-development of Russia," *Current History* 98, no. 630 (October 1999): 324.

form, which in legal terms has advanced much faster than China's. Lingering behavior patterns from the old days have prevented Russia's radical, but largely legal, property reform in the urban areas from having the dynamic impact that China's piecemeal property reforms have had. There is obviously a disjuncture between legal reform and production reform in Russia. Even after reform, Russian management has focused on relations with outside actors and paid little attention to how work was performed, thanks to the habits developed over the course of seventy years of state socialism.[17]

There is a serious problem with the cultural approach to transition economics: the very nature of culture makes it difficult to explain abrupt change in performance. The glacial pace of cultural change simply does not match the dramatic transformation of the economy and the turbulent fluctuations of performance. Everyone can agree that culture may reinforce or hold back reform to a considerable degree, as an accelerator or decelerator of growth. However, culture cannot be the prime mover of reform. Rapid change in economic life cannot be derived from cultural transition which takes decades to complete. Thus the hyper growth that has occurred in China since reform began cannot be traced to the country's culture, which is relatively static. Shorter exposure to state socialism can neither explain the stronger performance of China vis-à-vis Eastern Europe, nor the wide variation among the East European countries given that they all experienced roughly the same exposure to state socialism.

Stage of Economic Development

Stage of economic development is another often-cited factor to explain the performance of transition economies. The assertion is that the highly industrialized, fully-employed European socialist economies were less prone to growth in their transition to market than the predominantly agricultural economies of China and Vietnam. In essence, among transition economies, backwardness has its advantage. The rationale for this

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[17]See note 15 above.

argument is that the agricultural sector is easier to reform, particularly through decollectivization and reviving family farming, processes involving only minimal trade-offs. Industrial reform, on the other hand, entails painful restructuring that often results in great social costs and almost always encounters strong resistance from managers, workers, and consumers.[18] China was predominantly agricultural when market reform began. In 1978, the rural areas employed three-quarters of China's labor force, industry hired 15 percent, and services took up 11 percent. Per capita GDP was a meager US$230.[19] China then took advantage of its economic backwardness, reaped the immediate benefits of decollectivization, and built up momentum for the entire reform enterprise. In comparison, Russian reform had to start from the state enterprises, which at the time accounted for more than 95 percent of total economic output.[20] Per capita GDP was much higher, at US$3,700. As there is no Pareto-superior solution to reforming socialist industry, the Russian people suffered tremendously from the introduction of market reform, and the momentum for reform dissipated rapidly.

One advantage of having a large agricultural sector and predominant rural employment is the small size of the economic units that reform brings about. Small traditional agriculture, handicraft, and trade enterprises tend to respond to the market much more efficiently than do large industries. Thus Anders Åslund argues that the more there remains of these consumer-oriented sectors, the easier it is to undertake a reform of a socialist economic system, and correspondingly, the greater will be the short-term economic benefits. It is easier for a less developed country to launch a reform and to achieve swift results, since the traditional small-scale economy can

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[18]See Susan Shirk, "The Political Economy of Chinese Industrial Reform," in *Remaking the Economic Institutions of Socialism: China and Eastern Europe*, ed. David Stark and Victor Nee (Stanford, Calif.: Stanford University Press, 1988), 328-62.

[19]Yang Laike (楊來科), "Lun Zhongguo jingji zhuangui de teshuxing—dui Zhongguo jingji gaige de zhidu jingjixue fenxi" (On the peculiarities of Chinese economic transition—An institutional economic analysis of Chinese economic reform), *Caijing kexue* (Finance & Economics), no. 1 (2000): 21.

[20]Jingjie Li, "The Characteristics of Chinese and Russian Economic Reform," *Journal of Comparative Economics* 18 (June 1994): 309-13.

be reinvigorated relatively simply.[21]

The stronger performance by the relatively backward transition economies can also be explained by invoking the theory of extensive/intensive growth. The argument is that a developing country, treading the right route, can grow much faster than a developed country merely by mobilizing more resources and increasing input. However, such growth cannot last forever. Sooner or later the factors of production would be fully employed and the source of growth would have to migrate to higher productivity and gains in efficiency that were ultimately derived from advanced technologies; this is the stage of intensive growth. Mere increases in inputs, without an increase in efficiency, must eventually run into diminishing returns, and input-driven growth will inevitably decline.[22] Since having already exhausted their extensive growth potential under central planning and having fully industrialized and urbanized themselves, European socialist economies had to rely on productivity gains that were more difficult to achieve. In contrast, China remained in possession of huge resources to mobilize for extensive growth when reform was ushered in. Even after having fully mobilized their resources for growth, the coastal areas could still depend on the huge inflow of workforce and cheap resources provided by the inland provinces in central and western China. It will take decades before China exhausts its growth potential through increase in input. Natural, therefore, is that transition economies in Europe have grown much slower than the relatively backward China.

The "stage of development" explanation points to the advantage of economic backwardness that China enjoyed in comparison to the European transition economies. However, backwardness certainly does not guarantee high growth. One of the world's gravest problems is the widening gap between the developed and developing countries. Had higher growth been assured for the developing world, the gap between the rich and poor coun-

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[21] Anders Åslund, "Soviet and Chinese Reforms—Why They Must Be Different?" *The World Today* 45, no. 11 (November 1989): 188-91.

[22] Paul Krugman, "The Myth of Asia's Miracle," *Foreign Affairs* 73, no. 6 (November/December 1994): 67.

tries would have already been ameliorated significantly. This approach also fails to address the lack of growth of the backward transition economies in Europe, such as the former Yugoslav republic of Macedonia. Central Asia is a relatively backward region in the former Soviet Union; its five republics after independence certainly have not registered a higher growth rate than their European counterparts. Given the above, the stage of development explanation performs rather weakly when tested against the empirical evidence.

International Environment

The international environment is another non-institutional factor that has often been invoked to explain the performance gap between transition economies in Europe and Asia. In this regard, mainland China is uniquely endowed in having Taiwan, Hong Kong, and the overseas Chinese communities not only providing their ample experiences with world markets but also investing their rich savings in the mainland. The Chinese business networks have proven very useful in sharing market information, financing nascent industries and enterprises, transferring manufacturing technologies, and allocating market opportunities.[23] Russia does not have this advantage, and Eastern Europe as a whole is not in much better shape. Furthermore, as mainland China was reaping the benefits of further integration with the economies of Hong Kong and Taiwan, the former Soviet republics and East European countries were weathering the shock of the breakdown of the Council for Mutual Economic Assistance (CMEA).[24] Because of the planned division of labor and the resulting high dependence among the countries and areas of the former Soviet bloc, the disintegration of the system sent shock waves throughout the entire region and forced the new countries in Eurasia to make painful adjustments. New networks of trade and a new configuration of industry would have to be developed. During

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[23]Minxin Pei, "The Puzzle of East Asian Exceptionalism," in *Economic Reform and Democracy,* ed. Larry Diamond and Marc F. Plattner (Baltimore: The Johns Hopkins University Press, 1995), 117.

[24]Włodzimierz Brus, "Marketization and Democratization: The Sino-Soviet Divergence," *Cambridge Journal of Economics* 17, no. 4 (December 1993): 431.

this process, collapse of output ensued.[25] The former Soviet-bloc countries have had to reorient their production to new markets, while shedding manufacturing lines geared to CMEA demands. In sum, China's economic reform began with an expansion in trading partners and investors, while Russia and other Soviet-bloc countries launched their reform with a dramatic contraction in both counts. The basic international environment facing mainland China was ready accessibility of finance, market opportunities, and manufacturing technologies offered by Hong Kong, Taiwan, and overseas Chinese; Russia confronted a breakdown of the existing network of investment, manufacturing, and trade. Obviously this sea difference goes a long way in explaining the performance gap between Asian and European transition economies.

International factors should not be exaggerated, however, for the performance of European transition economies varies widely, despite the fact that they were all initially knit together under the Soviet command system. Why do some former Soviet-bloc countries perform much better than others? This variation requires explanation that goes beyond the Soviets' breakdown of their traditional network—which, after all, was a factor common to all European transition economies.

Pre-reform System

Many a scholar studying comparative socialist economic transition finds the pre-reform systems in the PRC and European socialist countries to be of quite different varieties. It is generally recognized that the Chinese planned economy was at best a diluted version of the Soviet model. Not only was the system a flawed copy of the Soviet prototype to begin with, the frequent and violent political upheavals launched by Mao in the name of a higher form of socialism totally distorted the inner logic of Soviet-style central planning, and brought about a significantly different system for the Chinese reformers to revise.[26] The Maoist system was less rational, more

[25]Millar, "The De-development of Russia," 323.
[26]Qian Yingyi and Xu Chenggang, "Why China's Economic Reforms Differ: The M-form

diffuse, and extremely unstable compared with its Soviet and East European counterparts. However irrational this system might be, it unintentionally left room for the launching of decentralizing reform at a later stage. The political upheavals in China disrupted central planning and delegated power to local authorities, both of which were conducive to economic reform in the post-Mao era. This "*waida zhengzhao*" (歪打正著, scoring by mistake) turned China's institutional backwardness into a gateway to market reform and non-state sector development.[27]

Specifically, China's "incomplete socialism" is characterized by decentralized economic decision-making power ("cellular economy"),[28] local appropriation of a portion of income and local management control, and exclusion of the rural labor force from socialist welfare.[29] In contrast, the "complete socialism" of the Soviet Union and Eastern Europe featured unitary economic organization, fiscal centralization and central corporate governance, and comprehensive welfare coverage. In China, the Soviet-style command economy was concentrated in large industrial cities while the rural areas and localities were delegated enormous property rights uncharacteristic of the "complete socialism" in the Soviet Union and Eastern Europe. This duality of the Chinese economy on the eve of reform provided both a ready access to market and proliferation of non-state property rights. Thus China was paradoxically endowed to usher in reform through its incomplete form of socialism.

The logic behind the above explanation is the shorter the institutional distance between the pre-reform system and the target system, the easier is the transition.[30] Measuring institutional distance, however, is difficult.

Hierarchy and Entry/Expansion of the Non-State Sector," *Economics of Transition* 2, no. 1 (1993): 135-70.

[27]Yang Xiaokai, "How to Understand the Mainland Chinese Economy" (Lecture delivered at the Mainland China Forum, National Taiwan University, February 25, 1995).

[28]Term as championed in Vivienne Shue, *The Reach of the State: Sketches of the Chinese Body Politic* (Stanford, Calif.: Stanford University Press, 1988).

[29]Minxin Pei, "Microfoundations of State Socialism and Patterns of Economic Transformation," *Communist and Post-Communist Studies* 29, no. 2 (1996): 131-45.

[30]A similar logic is applied in analyzing political stability in newly democratized countries.

One is hard pressed to imagine that Mao's vehemently dogmatic system was closer to capitalism than the Soviet command economy. The fact of the matter is that diffuse property rights and incomplete welfare coverage were but a part of the pre-reform system in China. One can certainly mention other aspects of the same system that were antithetic to capitalism, such as egalitarianism and vehement suppression of material incentives. Those features were built into the Chinese system as much as, or even more so than, those features that are conducive to market reform. How is it that specific aspects of the pre-reform system determined the outcome of economic transition, while other equally prominent aspects failed to act on the reform process? In the case of Eastern Europe, the Czech Republic experienced a relatively more successful transition in the early 1990s than did Hungary.[31] The Czech pre-reform system was one of the most dogmatic in the whole Soviet bloc, however, thanks to the backlash against the Prague Spring of 1968, while Hungary—being the homeland of market socialism—was one of the most open systems in the bloc.[32] Obviously the institutional distance between the pre-reform system and the market system is not a reliable indicator of the smoothness of transition.

The Institutional Approach

As mentioned at the outset, the institutional approach holds sway in explaining the performance of transition economies in the 1990s. Before plunging into the literature, one caveat is in order. The very fact that in-

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It is argued that those countries with an authoritarian past have a better chance of democratic stability than countries with a totalitarian legacy. The institutional distance between the pre-democratized system and democracy is the key variable here. See Juan J. Linz and Alfred Stepan, *Problems of Democratic Transition and Consolidation: Southern Europe, South America, and Post-Communist Europe* (Baltimore: The Johns Hopkins University Press, 1996), chaps. 3 and 4.

[31]See Laszlo Csaba, *The Capitalist Revolution in Eastern Europe: A Contribution to the Economic Theory of Systemic Change* (England: Edward Elgar, 1995), 207.

[32]For the Hungarian economic reform, see Janos Kornai, "The Hungarian Reform Process: Visions, Hopes, and Reality," *Journal of Economic Literature* 24, no. 4 (1986): 1687-1734.

stitutions are the most amenable variable in the transition process predetermined its prominence. One cannot easily manipulate the variables of culture, stage of development, international environment, or pre-reform system. One is then left with only those instruments that are usable. The prominence of the institutional approach is thus not simply a matter of intellectual satisfaction, but also a matter of necessity.[33]

The different routes toward institutional reform in Europe and Asia can be compared in terms of *reform philosophy* (rationalism vs. empiricism), *speed of reform* (shock therapy vs. gradualism), *property rights restructuring* (complete vs. partial marketization, nominal vs. limited privatization, etc.), and *role of the state* (strong and interventionist state vs. weak and laissez-faire state). Those four layers of reform all center around installing new institutions conducive to growth and efficiency. Rather than being mutually exclusive, they often combine to define a single case.[34] Among the four groups of institutional variables, property rights and the role of the state are more important than reform philosophy and speed of reform. This fact will become evident from the following review of these four groups of variables.

Reform Philosophy

The reform philosophy reflects the basic mindset of the reformers. Many of the European reformers, such as former Czech Prime Minister Vaclav Klaus, are ardent disciples of neoclassic economics and aspired to transform the command economies of their countries to idealized nineteenth-century libertarian capitalism. This kind of faith is completely lacking in their Chinese counterparts, who are realists, and at the time were willing to test the most unorthodox treatments in order to salvage an econ-

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[33]A similar consideration prompted scholars to study the process of democratization, and not simply *historical-structural determinants* of democracy, for process variables (such as actors and strategies) were the only amenable ones when scholars were asked for concrete advice on how to initiate democratization. See Adam Przeworski, *Democracy and the Market: Political and Economic Reforms in Eastern Europe and Latin America* (Cambridge: Cambridge University Press, 1991), chap. 2.

[34]Thus one may characterize the Chinese reform case as empiricist, gradualist, limited in property rights restructuring, and retaining a strong state.

omy ravaged by Mao's idiosyncratic experiments. The Chinese reformers did not—and still do not—have faith in either state socialism or laissez-faire capitalism.[35] Their philosophy has been one of trial and error. For the Russian and East European reformers, the guiding principle has been rationalism. For the Chinese, empiricism reigns. This contrast is said to have a profound impact on the performance of transition economies.[36]

Equipped with neoclassic economics, the European reformers tended to design a logically consistent package of policies aimed at restructuring the economy. They were rationalists proclaiming to have discovered the correct route to a market system and private property, and would not want to waste time on experimenting. They set schedules to finish finite tasks that were considered vital in reforming the economic structure.[37] The whole design was based on the assumption that the reformers knew how economic institutions worked and how these arrangements could be properly installed. The international financial agencies and Western advisors had accumulated much experience in the 1980s when dealing with Latin American economic crises; they did not hesitate to prompt the Russian and East European reformers to follow an established pattern of structural reform, such as the "Washington Consensus."[38] The Chinese empiricists, on the other hand, took a "trial-and-error" approach, frankly admitting that they did not know how to reform their Soviet-cum-Maoist system. Much was based on intuition and doing by learning.[39]

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[35]For a discussion of the realism of the Chinese reformers, see Wu, *Comparative Economic Transformations*, chap. 5.

[36]Yang, "Lun Zhongguo jingji zhuangui de teshuxing," 22.

[37]Stanley Fischer and Alan Gelb, "Issues in the Reform of Socialist Economies," in *Reforming Central and Eastern European Economies: Initial Results and Challenges*, ed. Vittorio Corbo, Fabrizio Coricelli, and Jan Bossak (Washington, D.C.: The World Bank, 1991), 67-82.

[38]For a debate on the Washington Consensus, see Moises Naim, "Washington Consensus or Washington Confusion?" *Foreign Policy*, no. 118 (Spring 2000): 86-103.

[39]The experimentalism that guided China's economic reform was evident in the remarks of Deng Xiaoping, who once said: "Reform and opening up require boldness, daring to experiment... Taking no risk, doing everything with 100 percent assurance, never missing a target,who dares say such words?" See Deng Xiaoping, "Zai Wuchang, Shenzhen, Zhuhai, Shanghai dengdi de tanhua yaodian" (Main points in the remarks made in Wuchang, Shen-

Many have argued that since the comprehensive plans designed by the European reformers and their advisors were based on idealism, abstract economic theories, and experiences accumulated in different geographic and institutional settings, policies derived from those plans necessarily failed to produce the expected results.[40] The miserable performance of the European transition economies is thus explained in terms of the fundamental flaws of the reform philosophy. On the other hand, the Chinese experimentalists benefited from their non-ideological, flexible, and piecemeal approach to economic reform. Even though they did not have a comprehensive plan at the outset, they carefully monitored and evaluated each step toward dismantling the command system. Trial points were used to test new reform measures, and only those that proved effective were implemented on a larger scale.[41] In essence, the fundamental difference of European rationalism vs. Chinese empiricism predestined the performance gap between the two groups of post-socialist countries.

The "difference of reform philosophy" argument does carry a certain amount of weight in explaining the performance gap in question. However, philosophical debate on the level of rationalism vs. empiricism does not directly relate to economic activities or economic performance. One has to look into the concrete measures derived from the different reform philosophies to arrive at causal explanations. This brings us to the policy level. Furthermore, rationalism does not entail a specific reform plan, while empiricism may lead to different reform policies. Reform philosophy does not dictate the content, and thus cannot explain the result, of reform. In order to grasp the prime factors of the performance gap, one needs to look to the policy level.

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zhen, Zhuhai, and Shanghai), in *Deng Xiaoping wenxuan* (Sellected works of Deng Xiaoping), vol. 3 (Beijing: Renmin chubanshe, 1993), 372.

[40]See Sun Tongpeng (孫同鵬), "Jianjin gaige yu jingji lifa" (Gradualist reform and economic legislation), *Henansheng zhengfa guanli ganbu xueyuan xuebao* (Journal of Henan Province Political and Legal Management Cadre College), no. 61 (2000): 40.

[41]Zhou Yi (周毅), "Dui Zhongguo jingji gaige lixing moshi de sikao" (Thoughts on the rational thinking model of Chinese economic reform), *Jilinsheng jingji guanli ganbu xueyuan xuebao* (Journal of Jilin Province Economic Management Cadre College) 14, no. 1 (February 2000): 6-7.

Speed of Reform

The biggest debate in the transition of socialist economies literature centers on the speed of reform. "Shock therapy" vs. "gradualism" has been a dominant debate theme and practically every researcher in the field positions him or herself on the issue one way or another.[42] "Shock therapy" refers to reaching for the specified reform goals at maximum speed and disregarding short-term disturbances and dislocations, in the expectation that only stormy measures could uproot the old command system and replace it with a market economy.[43] One can trace shock therapy to two distinct roots: the experience of failed liberalizing reforms in the Soviet Union and Eastern Europe since as early as the mid-1960s,[44] and the experience of successful economic stabilization in Latin America in the 1980s. Both cases point to the need to move the economy away from the old mode and install new institutions as rapidly as possible, lest the reform momentum be dampened and anti-reform forces be built up. "Gradualism," on the other hand, opposes shock therapy from a variety of positions. This approach considers rapid transition unnecessarily painful for society; questions the legitimacy of implementing a transition plan drawn by but a few economists in the government with the help of Western advisors; doubts the desirability of the specified goals of shock therapy; points out the possibility of reaching the same goals with gradualist policies and with much less social costs; resents the intellectual snobbishness of the academic and policy

[42]For the "shock therapy" vs. "gradualism" debate, see Ben Slay, "Rapid versus Gradual Economic Transition," *RFE/RL Research Report* 3, no. 31 (August 12, 1994): 31-42.

[43]Leszek Balcerowicz, the architect of Poland's "shock therapy," explains that "extraordinary politics" after democratic breakthrough provides ample political capital for reformers, but only for a brief period of time. Under those circumstances, a radical economic program launched as quickly as possible after the breakthrough has a much greater chance of success than does a gradual program introduced in a piecemeal fashion. See Leszek Balcerowicz, "Understanding Postcommunist Transitions," in Diamond and Plattner, *Economic Reform and Democracy*, 96-97.

[44]For a discussion of the Soviet economic reforms, see Ed A. Hewett, *Reforming the Soviet Economy: Equality versus Efficiency* (Washington, D.C.: The Brookings Institution, 1988). For a critique of the partial reform measures, see Thomas A. Wolf, "The Lessons of Limited Market-Oriented Reform," *Journal of Economic Perspectives* 5, no. 4 (Fall 1991): 45-58.

communities that produced the rapid transition strategy; abhors the implications of shock therapy on poverty and on political stability in the transition countries; and asserts that transition must be gradual in order for new institutions to take root.[45] In sum, the "gradualist school" is composed of a wide variety of thoughts that are unified under the same rubric only given their common opposition to the treatment of shock therapy. In comparison, shock therapy is a more intellectually coherent school based upon a specific theoretical foundation and past reform experience. Gradualism is more of a residual category, containing arguments that may conflict among themselves.

The validity of shock therapy has been repeatedly demonstrated by those scholars who study the transition cases in the former Soviet Union and in Eastern Europe. Their favorite case is Poland, a country where "shock therapy" originated. They argue that Poland outperformed most of the former Soviet Union and East European transition economies because it adopted shock therapy more consistently.[46] Poland's success was achieved against very unfavorable initial conditions, including massive foreign debt and hyperinflation. In comparison, Hungary's more favorable initial conditions failed to bring about a smooth transition, a failure that was attributed to the gradualist approach taken by Hungary's post-communist democratic regimes. The case of Russia poses some problem for the shock therapists, for despite Yegor Gaidar's radical reform plan and President Boris Yeltsin's open commitment to rapid transition, Russia's economy nevertheless fared miserably. However, this "abnormality" was explained away by claiming that Russia actually did not follow the prescriptions of shock therapy consistently, thus undermining the whole reform enterprise

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[45]For a typical gradualist viewpoint, see Ronald I. McKinnon, "Gradual versus Rapid Liberalization in Socialist Economies: The Problem of Macroeconomic Control," in *Proceedings of the World Bank Annual Conference on Development Economics* (Washington, D.C.: The World Bank, 1993), 63-94; and Grzegorz W. Kolodko, "Transition to a Market Economy and Sustained Growth: Implications for the Post-Washington Consensus," *Communist and Post-Communist Studies* 32 (1999): 233-61.

[46]Poland's shock therapy was initiated under the Balcerowicz Plan. For Balcerowicz's thinking on rapid economic reform, see Leszek Balcerowicz, *Socialism, Capitalism, Transformation* (Budapest: Central European University Press, 1995).

at an early stage.[47]

The gradualist school rebuts the shock therapists' arguments by pointing out the costs of rapid transition, and by proposing an alternative, slower strategy of reform. Their favorite case is China, which supposedly took a gradualist approach, refused to abide by a ready-made and "universally-applicable" reform package, and yet registered the best performance among transition economies.[48] Mainland China's performance towered above not only Russia, but all the East European countries as well, including the better performers in the northern tier that adhered to the prescriptions of shock therapy (most notably Poland and the Czech Republic). The piecemeal, gradualist, trial-and-error approach is said to have contributed significantly to China's relative success.

The "speed of reform" debate is instrumental in calling our attention to the policies of reform, but the focus is not exactly on the right spot.[49] Speed is of course important, but of much greater importance is the direction and content of reform. There is no way to determine the results of reform without first examining these other two variables. Some additional probing would find that oftentimes shock therapists consciously or unconsciously assume an ideal-type capitalist model as the goal of reform. As such, their strategy can be subsumed under marketization-cum-privatization.[50] By focusing attention on the difference in preferred speed rather than content or direction of reform, the shock therapy vs. gradualism debate is misleading.

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[47]For a detailed discussion of the Russian economic reform process, see Yu-Shan Wu, *Eluosi zhuanxing 1992-1999: yige zhengzhi jingjixue de fenxi* (Russia's transition 1992-1999: A politico-economic analysis) (Taipei: Wunan, 2000), chaps. 3 and 4.

[48]Fan Gang (樊綱), for example, characterized China's reform as "gradualist and incremental." Wu Jinglian (吳敬璉), however, questions the gradualist nature of China's reform. See Fan Gang, "Zhongguo jingji tizhi gaige de tezheng yu qushi" (The characteristics and trends of China's economic structural reform), in *Jianjin yu jijin—Zhongguo gaige daolu de xuanze* (The choice of China's route of reform), by Wu Jinglian et al. (Beijing: Jingji kexue chubanshe, 1996), 11; Wu Jinglian, "Zhongguo caiqu le 'jianjin gaige' zhanlue ma?" (Has China adopted the strategy of "gradualist reform"?), ibid., 1.

[49]For a critique of the speed of reform debate, see Vladimir Popov, "Shock Therapy Versus Gradualism: The End of the Debate," *Comparative Economic Studies* 42, no. 1 (Spring 2000): 1-57.

[50]See the following discussion of property rights.

Property Rights Restructuring

Property rights are the center of any economic system. These rights relate people to the means of production. They provide incentives and capacities for economic agents to make use of property. Efficient property rights systems are conducive to productivity gains and economic growth.[51] However, efficiency has never been the sole consideration in the evolution and revolution of property rights. Social justice and political power are at least equally important. Here the distributional impacts of property rights come to the fore. How income is dispersed and society stratified, and how political power is distributed, both owe much to the property rights structure.[52] As a result, social and political factors sometimes prevail over economic efficiency in determining the configuration of the rights structure. The transition of centrally planned economies in Eurasia toward the market system and private ownership is in essence a property rights restructuring, for this shift fundamentally changed the way people relate to the means of production and to each other. This being the case, how property rights are changed certainly has a profound impact on the performance of transition economies.

Based on this understanding, it seems odd that property rights are not at the center of many analyses of the performance of transition economies. The debate on the speed of reform, for example, caught such great attention from the academic and policy communities in part because people were so certain of the property rights system they wanted to install that they took that goal for granted and concentrated on how fast that goal could be achieved. What emerged from the transition process was not a unified system across countries, however, but rather a wide variety of property rights arrangements. That variation explains much of the difference in the

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[51] For a discussion of the concept of property rights and their efficiency implications, see Eirik G. Furubotn and Svetozar Pejovich, eds., *The Economics of Property Rights* (Cambridge, Mass.: Ballinger, 1973); and Johan Torstensson, "Property Rights and Economic Growth: An Empirical Study," *Kyklos* 47, no. 2 (1994): 231-47.

[52] David L. Weimer, "The Political Economy of Property Rights," in *The Political Economy of Property Rights: Institutional Change and Credibility in the Reform of Centrally Planned Economies*, ed. David L. Weimer (Cambridge: Cambridge University Press, 1997), 1.

performance of those transition economies.

Property rights are a bundle of rights concerning the *usus* (use right), the *fructus* (the right to the proceeds of an object), and the *abusus* (the right to dispose of an object) of the means of production.[53] Those property rights do not have to coalesce into an absolute and complete set of rights held by a single person; they can be separately held by multiple rights holders. How the property rights in a society are distributed among rights holders defines the basic structure of the economy. Specifically, property rights can be divided into ownership (right to income) and control (right to use). Depending on the distribution of rights, one can find four basic types of rights structures that correspond to four ideal-type economic systems. *State ownership-cum-state control* is the Soviet-style command economy in which the state both directly controls the use of and extracts full proceeds from the means of production in society. *Private ownership-cum-private control* is laissez-faire capitalism in which the state plays a minimum role. *State capitalism* is a third possibility in which the state does not own the means of production, yet directs the production and exchange activities of private economic actors. Finally, *market socialism* is the amalgamation of state ownership and market coordination, where publicly-owned economic establishments use market signals to coordinate their activities.

The property rights school delineates two major reform routes for Soviet-style economies: from plan to market (marketization) and from public to private ownership (privatization).[54] Both marketization and privatization are structural reforms, and they differ significantly from the intra-systemic fine-tuning of the command economy that had been attempted so many times prior to the launching of the "real" reform.[55] When

[53]Wu, *Comparative Economic Transformations*, 4.

[54]Marketization provides the information, and privatization provides the incentive, for property users to effectively use their means of production. These two reform strategies would lead producers to identify and utilize their comparative advantage, thereby increasing efficiency. Lin Yifu et al. make a convincing argument about the pursuit of comparative advantage by China's managers in the reform era. See Lin Yifu, Cai Fang, and Li Zhou, *Zhongguo de qiji: fazhan zhanlue yu jingji gaige* (China's miracle: Developmental strategy and economic reform) (Hong Kong: The Chinese University Press, 1995).

[55]Examples are the Soviet reforms under Nikita Khrushchev (1957), Aleksei Kosygin

the drawbacks of the command system became clear and the fine-tuning methods were exhausted, communist regimes could have attempted structural reforms.[56] It was without exception that they took the path of marketization first. The reason is clear: privatization violates the cardinal principles of socialism and entails dilution of the political power of the party-state. Marketization, on the other hand, is a less deviant and thus more tolerable strategy of structural reform.[57] The result of marketizing, but not privatizing, the command economy is market socialism—a hybrid system in which publicly-owned economic establishments compete on the market. Even here one witnesses two types of marketization: primary marketization—or indirect bureaucratic control,[58] and complete marketization.[59] It was the inability of the communist regimes to adopt complete marketization that doomed their reform efforts.[60] Prominent failures can be found in the Yugoslav, Hungarian, and Soviet experiences with market socialism.[61] With the breakdown of the communist regimes in Europe, radical reform methods were attempted with the goal of concurrently estab-

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(1965), and Leonid Brezhnev (1973, 1979), and the centralization-decentralization cycles (收放循環, *shoufang xunhuan*) in China under Mao.

56For the defects of the command economy, see Gabriel Temkin, "Information and Motivation: Reflections on the Failure of the Socialist Economic System," *Communist and Post-Communist Studies* 29, no. 1 (1996): 25-41.

57For a detailed discussion of the various layers of values of the party-state, see Janos Kornai, *The Socialist System: The Political Economy of Communism* (Princeton, N.J.: Princeton University Press, 1992), 361-65.

58A good example is the Chinese "state tuning the market, market guiding the enterprises" (國家調控市場,市場引導企業, *guojia tiaokong shichang, shichang yindao qiye*) principle espoused by the reformer Premier Zhao Ziyang (趙紫陽) in the late 1980s.

59Wu, *Yuanli shehui zhuyi*, 39-41.

60According to Janos Kornai, there is an intrinsic connection between type of ownership and method of coordination. Hence state ownership is naturally connected with bureaucratic coordination, and private ownership with market. Market socialism is doomed because it attempts to amalgamate the mutually incompatibles of state ownership and market mechanism. See Kornai, *The Socialist System,* 100-103; and Janos Kornai, *Highways and Byways: Studies on Reform and Post-Communist Transition* (Cambridge, Mass.: MIT Press, 1995), 35-56.

61Market socialism was first attempted in the Soviet Union under Mikhail Gorbachev in the name of "*perestroika.*" For details, see Anders Åslund, *Gorbachev's Struggle for Economic Reform: The Soviet Reform Process, 1985-88* (Ithaca, N.Y.: Cornell University Press, 1990).

lishing private ownership and a self-regulating market. From a property rights perspective, marketization-cum-privatization is the real essence of "shock therapy" under the West-sponsored and IMF-guided reforms in the former Soviet Union and Eastern Europe.[62]

China took a different approach. Still ruled by a communist regime, the country has officially trod the reform route of market socialism, or marketization without privatization.[63] The defects of that strategy were obvious when one takes a look at the performance of the state sector in industry. On the one hand, the managers of state enterprises were granted investment power; on the other, they did not face budget constraints. The result was investment hunger and unprecedented inflation. The government was forced to take austerity measures to cool down the economy, a measure which resulted in unacceptable low growth and social upheaval. Another cycle then ensued, beginning with a renewed wave of marketizing reform.[64] The following monetary expansion then reheated the economy and inflated prices, and the government was forced to manage another hard landing.[65] The first reform decade of the 1980s thus witnessed violent fluctuations of the economy unprecedented in the PRC's history, particularly on the inflation side.[66]

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[62]For a most comprehensive and insightful critique of the "transition orthodoxy" as advocated by the IMF, the World Bank, and the U.S. Treasury Department, see Joseph E. Stiglitz, *Globalization and Its Discontents* (New York: W.W. Norton, 2002). Stiglitz's criticism is particularly influential because he was the chief economist of the World Bank from February 1997 to February 2000, and his critique makes him "a rebel within." For a collection of Stiglitz's critical speeches, see Ha-Joon Chang, ed., *The Rebel Within: Joseph Stiglitz and the World Bank* (London: Anthem Press, 2002).

[63]The most influential advocate of market reform in the mid-1980s was Wu Jinglian of the State Council who had a famous debate with Li Yining (厲以寧) of Beijing University on the relative importance of market vs. ownership reform (所有制改革, *suoyouzhi gaige*). Ownership reform was a euphemism of privatization which has been taboo in word, but not in deed, in mainland China.

[64]For the mechanisms behind the cycles in reform China, see Hu Angang, *Zhongguo jingji bodong baogao* (Report on China's economic fluctuations) (Shenyang: Liaoning renmin chubanshe, 1994).

[65]For a detailed discussion of the reform process in China, see Joseph Fewsmith, *Dilemma of Reform in China* (Armonk, N.Y.: M.E. Sharpe, 1994).

[66]The microeconomic imbalance in repeated boom and bust cycles is the Achilles heel of the Chinese economy. See Barry Naughton, "China's Macroeconomy in Transition," *The China Quarterly*, no. 144 (December 1995): 1083.

If China had stayed with market socialism, and Russia and Eastern Europe had embarked on consistent marketization-cum-privatization reform, the property rights approach would have predicted a dismal future for China's reform, while giving the European post-socialist countries bright prospects. Things did not turn out that way, however, and the performance gap between China and the European post-socialist countries became increasingly obvious. Here one finds the "property rights puzzle": well-defined private property rights do not lead to desirable economic performance.[67]

Three explanations can be offered here. The first is that the property rights approach fails to address the really important questions, and the transition performance gap can be best explained either in terms of institutional factors other than property rights or in terms of non-institutional factors. The second explanation is that the property rights characterizations of China and European post-socialist countries are not correct, that China has not confined its reform efforts to market socialism, and that Russia and other European post-socialist countries have not successfully marketized and privatized their economies. There is yet another explanation that goes deeper into the property rights arguments and focuses on the "functions" of property rights. This last explanation differentiates between "nominal property rights" and "functional property rights," asserting that the performance gap can only be explained in terms of "functional property rights." The first explanation leads us nowhere, as most of the non-property rights approaches to economic transition have been reviewed above and found wanting. The last two explanations offer a more realistic understanding of the transition economies, and address the property rights puzzle adequately.

We can concentrate on the two main phenomena of the performance gap between China and Russia: stability vs. instability, and high growth vs. depression. The stabilization of the Chinese economy, particularly in the form of the "soft landing" in the mid-1990s, owes much to the growth of

[67]See Russell Smyth, "Property Rights in China's Economic Reforms," *Communist and Post-Communist Studies* 31, no. 3 (1998): 235-48.

the non-state sector and the crypto-privatization in that area. As property rights theory correctly points out, market socialism results in soft budget constraints, investment hunger, periodical inflation, and up-down cycles.[68] These are common phenomena in China's state industries. With the gradual rise of the non-state sector throughout the 1980s and early 1990s, however, market socialism has no longer been able to sufficiently define China's economy. In the non-state sector, one finds family farming, township and village enterprises (TVEs), private businesses, foreign-invested firms, and many mixed ownership forms. Because they do not enjoy soft budget constraints (i.e., the state would not automatically bail them out if they went under), their investment activities are ruled by realistic calculations of expected profits. Hence there is built-in constraint on investment in the non-state sector. With investment hunger in check, the chances of periodical inflation and government-engineered abrupt contraction have been lessened. In fact, since deputy premier Zhu Rongji (朱鎔基) headed the People's Bank of China (中國人民銀行) in 1993 and successfully orchestrated a soft landing of the economy, the Chinese economy has moved into a period of stability unprecedented in its post-1949 history. Respectable growth of 7 to 8 percent has been coupled with an extremely low inflation rate, and this remarkable record was achieved against the background of both the East Asian financial crisis of 1997-98 and the slump in U.S. market demand of 2000-2001.[69] It is obvious that China has since the mid-1990s maintained the growth momentum of the previous decade, but removed the source of instability. The shrinking of both the state sector and market socialism therein has played a major role in the improvement of the economic record. Here property rights laid the foundation.

Generally speaking, China's economic success is based on a two-tier strategy. One the one hand, the reforms marketized the state sector, thereby

[68]For those cycles, see Lowell Dittmer and Yu-Shan Wu, "The Modernization of Factionalism in Chinese Politics," *World Politics* 47, no. 4 (July 1995): 467-94.

[69]For China's continued strong growth amidst collapse of many of the Asian miracle economies in 1997-98, see Nicholas Lardy, "Growth, Reform, and the Effects of the Asian Crisis in China," *The China Business Review* 26, no. 5 (September/October 1999): 12-15.

preserving the production capacity without ending the inevitable fluctuations of market socialism. On the other hand, the strategy crypto-privatized agriculture (in the form of family contract farming), introduced private businesses (starting with the small *getihu* 個體户), and invited foreign investment. An energetic non-state sector was created. Finally, the resources and savings of the non-state sector were channeled through the state banking system to the state sector in order to alleviate the problems therein and to lessen the pains of phasing out.[70] With the booming of the non-state sector having been coupled, however, with the state playing the role of strategic planning, one finds China shifting from market socialism to East Asian-style state capitalism, the latter of which has proven to be a much more effective institutional vehicle for attaining high growth.[71]

If we shift to Russia and other post-socialist countries in Europe, we find property rights also have played a fundamental role in determining the stability of transition economies. One common feature of all the European post-socialist economies is the appearance of hyperinflation during the early stage of their transition. This persistent rise of prices is much more serious and damaging than the one-time price hike predicted by the reformers who ended state regulation of prices. The fundamental cause of hyperinflation is market socialism. Even though the common strategy in those countries was to embark on marketization and privatization at the same time, the two goals could not be accomplished simultaneously. Prices could be set free overnight, but state enterprises would take years to privatize.[72] The result is that privatization lagged behind marketization, and a

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[70]This is the major argument of Ronald I. McKinnon in his "Gradual versus Rapid Liberalization in Socialist Economies" (cited in note 45 above) The danger of overloading the banking system and the damage of resource misallocation in this scheme are discussed in both Lardy, "Growth, Reform, and the Effects of the Asian Crisis in China," and Naughton, "China's Macroeconomy in Transition."

[71]For a discussion of the optimal institutional mix of East Asian development, see Robert Wade, *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization* (Princeton, N.J.: Princeton University Press, 1990), chaps. 10 and 11; and Yu-Shan Wu, "Away from Socialism: The Asian Way," *The Pacific Review* 9, no. 3 (September 1996): 410-25.

[72]This is recognized even by shock therapists. See Fischer and Gelb, "Issues in the Reform of Socialist Economies," 77.

property rights structure of market socialism was unintentionally created. The state firms were still under the paternalistic protection of the government, but were given the power to determine their production plans and investment policies as well as to set prices for the products; naturally, the general price level rose sharply. This situation was worsened by the monopolistic structure of the market which was dominated by state conglomerates. These mammoth conglomerates set, rather than take, market price. In expectation of a hyper jump in prices, citizens hoarded products, thus exacerbating both shortage and inflation.[73]

This leads us to the second major phenomenon of the performance gap: output collapse in Russia and Eastern Europe vs. hyper growth in China. At the beginning of the 1990s, much hope was cast on the rapid privatization of Russia's economy. Indeed, this reform brought down the state sector's share from 87 percent of GDP in early 1992 to 42 percent in mid-1994 when the first phase of privatization was over. In terms of industry, the private sector grew to 70 percent during that period.[74] This phenomenal growth of the private sector was intended to bring resources away from ineffective state enterprises, and increase output and productivity. In actuality, neither output nor productivity rose. The crux of the matter was that the wrong method of privatization was used. During the first phase of privatization, Yeltsin endorsed a scheme that gave employees premium access to company shares, plus a supplementary form of mass privatization via a voucher system (*narodnaya privatizatsiya*).[75] The result was a predominant "employee privatization" that made employees the majority shareholders in 59 percent of private enterprises in 1995, increasing to 64.7 percent in 1996.[76] Employee privatization was brought about

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[73]For a discussion of the hyperinflation in Russia at the initial stage of reform, see Wu, *Eluosi zhuanxing*, 171-81.

[74]Zhi Xiaohe (智效和), "Eluosi guoyou qiye siyouhua xinjieduan de zhengce tiaozheng" (The policy adjustments at the new stage of the privatization of Russia's enterprises), *Jingji kexue* (Economic Science), no. 1 (1995): 66.

[75]For an assessment of the voucher privatization program, see Lynn D. Nelson and Irina Y. Kuzes, *Radical Reform in Yeltsin's Russia: Political, Economic, and Social Dimensions* (New York: M.E. Sharpe, 1995), chap. 6.

[76]Wu, *Eluosi zhuanxing*, 231.

by the political pressure to appeal to the workers when they endured the unspeakable hardship of Gaidar's "shock therapy."[77] However, it was not a lucrative privatization scheme for the government. As the need for cash rose sharply following the swelling of government budget deficits, Yeltsin shifted to the second phase of privatization designed to maximize government revenue and to create "strategic investors."[78] The result was "conglomerate privatization," in which shares of large state enterprises were transferred to mammoth financial-industrial groups (FIGs) through loans-for-shares plans. This scheme, although providing sorely-needed cash for the Russian government, led to state assets being undervalued and set off widespread corruption.[79]

The speed of Russia's privatization put the country among the top in transition economies, certainly far exceeding the growth rate of the private sector in China.[80] The particular modes of privatization—"employee privatization" and "conglomerate privatization"—did little, however, to achieve the main function of privatizing state enterprises, i.e., hardening the budget constraint. As vast numbers of employees turned into majority shareholders, they could easily vote themselves high wages and bleed the company of profits.[81] Enterprise restructuring and large-scale layoffs also became impossible, even when the company was seriously in the red.[82]

[77]See Lynn D. Nelson and Irina Y. Kuzes, *Property to the People: The Struggle for Radical Economic Reform in Russia* (New York: M.E. Sharpe, 1994), chap. 7.

[78]Daniel J. McCarthy and Sheila M. Puffer, "'Diamond and Rust' on Russia's Road to Privatization," in Sheila M. Puffer and Associates, *Business and Management in Russia* (Cheltenham, UK: Edward Elgar, 1996), 159.

[79]For a detailed description of the "loans-for-shares" scheme and the resulting corruption and scandals, see Alfred R. Kokh, *The Selling of the Soviet Empire: Politics and Economics of Russia's Privatization—Revelations of the Principal Insider*, trans. from *Privatizatsia v Rossii: Ekonomika i politika* (New York: S.P.I. Books, 1998).

[80]For a transnational comparison of the speed of privatization, see Josef C. Brada, "Privatization in Transition—Or Is It?" *Journal of Economic Perspectives* 10, no. 2 (Spring 1996): 77.

[81]Joseph R. Blasi, Maya Kroumova, and Douglas Kruse, *Kremlin Capitalism: Privatizing the Russian Economy* (Ithaca, N.Y.: Cornell University Press, 1997), 58.

[82]Yu-Shan Wu, "Huigu Zhongguo dalu de chanquan gaige" (A review of property rights reform in mainland China), *Hong Kong Journal of Social Sciences*, no. 14 (Summer 1999): 191.

"Employee privatization" kept the unemployment rate low, but only at the expense of resource misallocation as production capacity was locked in inefficient privatized enterprises. Since the state dared not let large privatized firms go under, the government continued protecting these companies, and budget constraints remained soft. The same can be said of the enterprises that went through "conglomerate privatization." Because of the intimate relationship between the Yeltsin government and the FIGs that lent him political support, the state was still willing to bail out failed Russian enterprises that had been transferred from the state's hands to the FIGs. In short, the unique methods of privatization in Russia failed to tighten the budget of the privatized firms, and thus failed to change their corporate behavior.[83] There were, therefore, no productivity gains. This is the problem of "nominal privatization," or transferring legal property rights without achieving the assumed economic function.

The hyper growth in China is another example of the insufficiencies of nominal property rights. Unlike the Russian case in which de jure (or nominal) privatization failed to achieve the assumed functions of property rights reform, the Chinese case demonstrates how de facto privatization can fulfill the functions of property rights restructuring without official pronouncement of privatization. One finds a vivid example in the astronomical growth of China's TVEs. The majority of the TVEs are either collectively-owned enterprises, or have mixed and unclear ownership. They suffer from ill-defined property rights and lack transparency. The traditional property rights school would predict these Chinese TVEs to have a dismal performance, or—when faced with the undeniable success of many of the TVEs—would still foresee ultimate failure for this kind of ownership.[84] However, the contribution of the TVEs to the growth of the Chinese economy is simply too great to be explained away in this manner. The bottom line is that TVEs are collective enterprises, nominally speaking, but function as private enterprises. The crux of the matter is hard budget con-

[83]See note 78 above.

[84]Jeffery D. Sachs and Wing Thye Woo, "Understanding China's Economic Performance" (Discussion Paper No. 1793, Harvard University, February 1997).

straints. The rural areas in China were never fully covered by the planning and welfare system of the communist regime prior to the launching of reform. The rise of the TVEs was not designed by the state, but was rather the result of local spontaneous initiative. Thus from the very beginning the TVEs were not supported by the state. It is true that local governments in a sense performed the functions of the East Asian developmental state and took pains to develop local TVEs.[85] Local governmental support was no substitute for state guarantees, however, and the TVEs have been operating in a much more stormy and self-help market environment than have state enterprises. The result is tighter budget constraints for the TVEs, and much greater efficiency therein. The property rights school is correct in pointing out that the budget must be constrained before there can be efficiency gains. Their reliance on nominal property rights confuses rights and functions, however, leading to a failure to understand the significance of functional property rights. Both the Russian and Chinese cases demonstrate that what matters is functional—rather than nominal—property rights. Thus the de jure (nominal) privatization of Russia's economy, regardless of how rapid it proceeded, failed to deliver the expected growth and productivity gains, while the de facto (functional) privatization of China's TVEs proved highly effective in stimulating high growth.

The property rights approach offers by far the most promising explanation of the performance gap between Russia and China, or the exit mode from state socialism in Europe and Asia. Russia's fall and China's rise is, to a great extent, determined by the different property rights structures that emerged from economic reform in the two countries. In order to understand the causal linkage between property rights and functions, however, one should be careful to distinguish between de jure (nominal) privatization and de facto (functional) privatization. This last point helps us to solve the "property rights puzzle."

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[85]This is what Jean Oi calls "local state corporatism." See both Jean C. Oi, "Fiscal Reform and the Economic Foundations of Local State Corporatism in China," *World Politics* 45, no. 1 (October 1992): 99-126 and Jean C. Oi, "The Role of the Local State in China's Transitional Economy," *The China Quarterly*, no. 144 (December 1995): 1132-49.

Role of the State

It has been repeatedly pointed out that stability is the premise of growth in transition economies. Successful stabilization plans have always preceded recovery of output and have ultimately led to growth.[86] The core of shock therapy is a harsh stabilization policy coupled with price liberalization. The purpose of this double treatment is to unleash market forces and increase allocative efficiency, while containing the inevitable price hikes. Since privatization takes time, this marketization-cum-stabilization policy has become the hallmark of shock therapy.[87] The foundation of the policy is the centrality of price stability in making economic activities possible. Without stable prices it would be impossible to plan investment and production. Output fall would be inevitable. Inflation would also provide disincentives to labor productivity, and adversely affect the income distribution between those protected and unprotected from price increases.[88] The fact that Russian shock therapy was much less successful than its Polish counterpart was attributed to the much more persistent and thus successful stabilization plan that the Poles adopted at the initial stage of their reform.[89]

Stabilization is a rare commodity in transition economies, purchasable only at a great social cost. The government must freeze wages, limit expenditures, tighten the money supply, and adopt other contractionary policies at a time when the economy is experiencing a most painful transition. It requires both the strongest of political will and state autonomy for such a stabilization plan to be implemented successfully. Here one finds a dilemma. Since most of the post-socialist countries democratized their political system while conducting economic reform, the new democratic

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[86]As argued by Stanley Fischer, Ratna Sahay, and Carlos A. Vegh, "Stabilization and Growth in Transition Economies: The Early Experience," *Journal of Economic Perspectives* 10, no. 2 (Spring 1996): 45-66.

[87]For the rationale of this reform package, see Anders Åslund, "The Case for Radical Reform," in Diamond and Plattner, *Economic Reform and Democracy*, 74-85.

[88]See Kazimierz Z. Poznanski, *Poland's Protracted Transition: Institutional Change and Economic Growth 1970-1994* (Cambridge: Cambridge University Press, 1996), 172.

[89]See note 42 above.

regimes were under tremendous social pressure to contain the transition pains. Successful stabilization, on the other hand, requires ruthlessness in implementing contractionary policies. Here political logic and economic rationality collide. Political institutional factors now come into the picture.

Authoritarianism is a prerequisite for economic development, at least during its early stage.[90] In transition economies, the ability of the government to implement a stabilization plan is crucial to building an economic environment wherein rational economic activities are possible. Stability is important because property rights restructuring, privatization in particular, takes time and measures have to be adopted to prevent production collapse when reform begins and market forces come into play. Obviously a state presiding over economic transition must be powerful enough to achieve economic stability. The question then boils down to whether it is necessary to have an authoritarian regime for successful stabilization. If the answer is yes, then the performance gap between Russia and China, particularly during the early stages of their reform, can be attributed to the authoritarian (or post-totalitarian) nature of the Chinese communist regime and the electoral pressure on Russia's nascent democratic government. The argument, in short, is that China's economy has been more stable because the authoritarian government in Beijing can take harsh measures to suppress prices without fear of losing votes—while Russia has suffered from much higher inflation rates because Moscow's fiscal and financial policies have been held hostage to electoral cycles.

The above contrast is partially correct. One does find that the macroeconomic policies of the Russian government were in sync with the electoral cycles of the country, at least during the Yeltsin era (1992-99). The government would increase spending when general elections were in the offing (the latter half of both 1993 and 1995, and the first half of 1996), or when the pro-welfare opposition won the parliamentary elections (early 1994 and again in the first half of 1996). During the electoral intervals, on the other hand, the government would rein in spending to satisfy the re-

[90]See note 9 above.

quirements of reform and to please international lending agencies.[91] Such election-driven cycles were not seen in China. Politics did play a prominent role in the Chinese reform process, but in a different and less damaging way. In the 1980s, the reform-retrenchment cycles were synchronous with the expansion and contraction of macroeconomic policies, bringing about volatile cycles.[92] This volatility was caused primarily by the defects of the socialist market structure of the then still dominant state sector. The authoritarian nature of the Chinese communist regime at the time made it possible, however, for the government to opt for a hard landing when necessary (most notably in 1996 and 1998). When the non-state sector grew to a sizable proportion and the investment cycles of state enterprises stopped determining the tempo of the national economy in the mid-1990s, the state demonstrated its ability to control prices. The volatility of the 1980s was overcome, and economic growth stabilized. Again, this successful engineering can be attributed to China's economic bureaucrats, with Premier Zhu Rongji as exemplar par excellence. Zhu's accomplishments testify to the high economic rationality of an authoritarian regime committed to development. In both the 1980s and 1990s, the Chinese communist regime had to deal with the factional conflicts at the central level, the thorny relations between the center and the provinces, and bureaucratic infighting among ministries and commissions. However, the CCP regime remained autonomous from society and unchecked by electoral politics. This being the case, the economic bureaucrats had a much freer hand in determining the macroeconomic policies than did their counterparts in Russia. The result was much greater stability and much lower inflation rates in comparison to Russia. Thus, there is some degree of linkage between regime type and economic performance.

If one shifts to an intra-European comparison, however, then the regime type argument loses some of its explanatory power. The Russian-Polish comparison did not yield the conclusion that the more democratic

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[91]See Wu, *Eluosi zhuanxing*, chap. 4.
[92]See note 68 above.

regime had a weaker capacity to deliver stability during economic transition. In Poland, one finds frequent alternations of the ruling party in the 1990s.[93] This compares unfavorably with Russia, where ultimate political power remained in the hands of Yeltsin and his successor Vladimir Putin (disregarding the frequent changes in prime minister). Greater political volatility in Poland did not, therefore, deter the Polish economy from registering greater stability than the Russian economy during the same period. Particularly in view of the fact that both countries pursued shock therapy as their main strategy of reform, their differences in economic stability require an explanation that goes beyond the nature of their political regime.

We have mentioned that Russia's adoption of the wrong privatization method made it possible for the privatized enterprises to continue relying on state subsidies, which prolonged the inflationary effect of market socialism. Polish privatization went ahead at roughly the same speed.[94] It also contained a strong element of employee privatization, although on a much smaller scale than under the Russian scheme. Since the two countries' stability performance diverged widely from the initial stage of reform (i.e., prior to any major privatization drive), property rights cannot offer a sufficient explanation. A casual observer would not fail to note that the major reason for their divergent performance in stability was the much stricter implementation of the stabilization plan in Poland. However, why was it possible for Poland's democratic regime to implement a highly unpopular policy when its Russian counterpart failed to do so?

The crux of the matter is that the Solidarity government enjoyed high popularity when it was first installed in Poland. Hailed as the champion of democracy not only in Poland but also across all of Eastern Europe, Solidarity had accumulated sufficient political capital to make highly unpopular decisions. This is the very reason why shock therapy in the form

[93]For a comparative analysis of Polish political development in the 1990s, see Yu-Shan Wu, "Comparing Third-Wave Democracies: East Central Europe and the ROC," *Issues & Studies* 37, no. 4 (July/August 2001): 1-37.

[94]In 1994, the share of the private sector in the national economy was 55 percent for Poland, and 50 percent for Russia.

of marketization-cum-stabilization succeeded in Poland. Yeltsin was no Wałęsa, and Yeltsin did not have a democratic movement to support him as Solidarity did for Wałęsa. The result was a short-lived stabilization plan that lasted for only six months. What followed was a much diluted policy which failed to alter enterprise behavior.[95] Clearly, political factors other than regime type came into play to determine economic performance in transition economies. In the Russian-Polish comparison we find regime legitimacy playing a critical role. With higher legitimacy, the Polish government was in a much stronger position to implement a stabilization plan. In comparison, the Russian government found it difficult to stick to its original blueprint.

To compare the three cases, we see that China is an authoritarian regime, Russia a weak democracy, and Poland a strong democracy (weak and strong in terms of state capacity). Russia obviously lagged behind in state capacity to implement the stabilization plan, and its record since the start of reform in 1992 clearly demonstrates that weakness. The Polish performance in stabilization was not as strong as China's in the 1990s (see table 1), but one has to take into consideration the fact that China's first decade of reform, the 1980s, was much more turbulent and the inflation rate much higher than in the 1990s, which was Poland's first decade of reform. Also, Poland's stabilization scheme (the Balcerowicz Plan, 1990-93) was much harsher than Zhu's engineered soft landing in 1993-95. The fact that Poland could stick to a more painful stabilization scheme demonstrates the strength of its democratic regime.[96]

However, regime legitimacy is not a stable factor. The Polish success story in the 1990s is unique in that it depends on double miscalculations by the reformers. Poland's shock therapists were not politically naive; they clearly understood the political risks of pushing for a radical economic

[95]Nelson and Kuzes, *Property to the People*, 107-9.

[96]For a discussion of the relationship between regime type and reform strategy in transition economies, see Yu-Shan Wu, "Economic Reform under Different Political Contexts: Poland and the PRC" (Paper presented at the annual meeting of the International Studies Association, Washington, D.C., March 28-April 1, 1994).

reform package, particularly the stabilization scheme. They calculated, however, that when the electoral tests came, the economy would already have gone through the worst part of reform, and positive results would have already been felt by the population, thereby vindicating the reformer's efforts.[97] The shock therapists were wrong, and Solidarity lost the 1993 parliamentary elections and Lech Wałęsa lost the 1995 presidential elections. Yet there was a second miscalculation on the part of the reformers. They thought the post-communist Democratic Left Alliance (SLD) would undo the reform, not realizing that the SLD, led by Aleksander Kwasniewski, had completely changed from an old-style communist party to a West European-style social democratic party. Thus even though Poland experienced frequent changes in government and alternations of political power between the Right and Left parties, the achievements of the original Balcerowicz reform were consolidated and the country experienced the fastest growth among European transition economies. One has to remember, however, that this remarkable achievement was based on the above double miscalculations on the part of the reformers, a situation not readily duplicable in other transition economies. This means regime legitimacy is not a stable factor, and in a democracy like Poland it requires a great deal of good luck for a harsh reform package to be implemented and bring in desirable results. Without such luck, as in the Russian case, democratic institutions and electoral pressure can roadblock radical reform.

Regime type is thus a more stable factor in predicting the capacity of the state. Other things being equal, an authoritarian regime committed to economic stability and growth has a better chance of reaching its goals than does a democratic regime so equally committed.[98] The Chinese reformers have fully utilized this advantage offered by their political system.[99] Here

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[97]For the political calculation of the reformers, see Balcerowicz, "Understanding Postcommunist Transitions," 96-97.

[98]For a exposition of this argument, see Brus, "Marketization and Democratization: The Sino-Soviet Divergence," 423-40. For a rebuttal, see José Maria Maravall, "The Myth of the Authoritarian Advantage," in Diamond and Plattner, *Economic Reform and Democracy*, 13-27.

[99]For a different opinion, see Pei, "The Puzzle of East Asian Exceptionalism," 116-17.

one sees the trade-off between political and economic reforms.

Conclusions

The economic reform on mainland China for the last two decades has been basically an unprecedented success. It is true that Chinese reform entails great social and environmental costs, and has also been conducted under a repressive political regime. Whether the current stability and high growth can be sustained in the coming years is also not certain. Given all such costs and uncertainties, one cannot deny that mainland China has progressed far along the road of economic reform and has made a graceful exit from state socialism. In order to fully understand and learn from the Chinese experience, one needs to adopt a comparative perspective, contrasting China against other transition economies. The purpose is to uncover factors that can best explain differences in transition performance. In order to do so, this paper has compared China with Russia, or the Asian and European modes of exit from state socialism. This comparison is interesting for it focuses on the latest act of the enduring Russia-China duel over the proper mode of economic and political development. Also included in this analytical picture are the transition economies of Eastern Europe—most notably Poland due to its particular reform strategy and impressive transition performance.

The literature survey highlighted two main approaches, the non-institutional and the institutional, with the latter holding sway. Among the often-cited non-institutional factors bearing on the performance of transition economies one finds culture, stage of economic development, international environment, and pre-reform system. The cultural argument calls attention to East Asian Confucianism and Asian values from which mainland China supposedly benefits, and to Russia's longer and deeper exposure to state socialism. The main problem with this approach is that the very nature of culture makes it difficult to explain abrupt changes in performance that is the hallmark of transition economies. Thus the hyper growth of China since reform began cannot be traced to Chinese culture, which is relatively static. Shorter exposure to state socialism also cannot explain the much superior performance of China vis-à-vis Eastern Europe, since all these countries experienced roughly the same exposure to state socialism. The stage of economic development argument asserts that backwardness has its advantage. The highly industrialized European socialist economies were less prone to growth during transition than the predominantly agricultural economies of China and Vietnam. This is because agriculture is easier to reform through decollectivization and reviving family farming, steps which reduce the size of production units. Backwardness also means reserved resources and the potential for extensive growth. The European socialist economies, on the other hand, suffer from large and inflexible units of industrial production, and have a need to rely on intensive growth which is more difficult to achieve. The main defect of the stage of development argument is that backwardness does not guarantee a higher growth rate. Albania, Macedonia, and the Central Asian republics of the former Soviet Union lagged behind their more advanced neighbors in terms of transition growth. Nor was China's growth particularly impressive prior to reform. Obviously the content of reform matters.

The international environment argument points out that mainland China is uniquely endowed in having Taiwan, Hong Kong, and the overseas Chinese communities to provide market experience and investment, while Russia does not have comparable overseas resources. Furthermore, the former Soviet Union republics and East European countries had to sustain the shock of the breakdown of the CMEA. However, this argument fails to account for the variation of performance among European transition economies that share the same disadvantaged international environment. The pre-reform system argument (*waida zhengzhao*) asserts that China was paradoxically endowed to usher in reform through its incomplete form of socialism, thanks to Mao's disruptions of central planning and disregard of rural welfare. The essence of this argument is to measure the institutional distance between the pre-reform system and the market economy as an indicator of the smoothness of transition. However, this approach fails to justify the selection of particular features of the pre-reform system to measure the institutional distance. It also fails to explain why in some European cases a dogmatic pre-reform system proved more conducive to smooth transition than a relatively more open approach.

Since all the non-institutional arguments are wanting in terms of explaining the performance difference in transition economies, our focus shifts back to the institutional approach. These institutional variables include reform philosophy, speed of reform, property rights restructuring, and the role of the state. The reform philosophy argument contends that the fundamental difference of European rationalism vs. Chinese empiricism predestined the performance gap between the two groups of post-socialist countries. It argues the European reformers were ardent disciples of neo-classic economics and aspired to transform the command economies of their countries to idealized nineteenth-century libertarian capitalism. However, policies derived from such idealist concepts necessarily failed to produce the expected results. The Chinese experimentalists, for their part, benefited from their non-ideological, trial-and-error, and flexible approach to economic reform. The problem with this argument is that the philosophical debate on the level of rationalism vs. empiricism does not directly relate to economic activities or economic performance. One has to look into the concrete measures derived from the different reform philosophies to arrive at causal explanations. Furthermore, rationalism does not entail a specific reform plan, while empiricism may lead to different reform policies.

The second institutional argument is concerned primarily with the speed of reform. Here one finds the big debate of "shock therapy" vs. "gradualism." Shock therapists like to use the case of Poland to demonstrate the virtue of pushing for radical reform at maximum speed, while gradualists rebut with the case of China that shows that the best results can be achieved with gradual reform and with manageable social costs. Shock therapy is based on the perceived need to introduce radical reform measures as rapidly as possible, lest the reform momentum be dampened and anti-reform forces be built up. Gradualism doubts the legitimacy of the goals, methods, as well as social and political implications of shock therapy. The gradualists propose an alternative route to reform that they claim to be more cost-effective. The speed of reform debate is misleading in that it fails to focus on the real issue: the direction and content of reform. The shock therapists assume an ideal-type libertarian capitalism as its goal, but fail to justify that goal or at least bring it to the limelight of debate. The gradualists sin on their part in failing to clearly identify their directions and goals (which they either do not have or are not in agreement on among themselves). Obviously it does not make much sense to debate the speed of reform without first reaching consensus on its goal and direction.

This leads us to the core of the literature: property rights restructuring and the role of the state. Generally speaking, the better transition performance by China is based on growth-prone property rights structure and a strong authoritarian state. The dismal performance of Russia is the result of distorted property rights (de jure restructuring notwithstanding) and weak democracy. The better performers in Eastern Europe (those that stand between China and Russia, such as Poland) benefited from both a more successful property rights reform than did Russia and a strong democracy capable of implementing the stabilization plan. The Polish success, however, has in it the element of luck. The combination of property rights and state arguments provides the best analytical vehicle to understand the performance difference in Eurasian transition economies.

Just as the socialist revolution that brought about a command economy was essentially a property rights revolution, the economic reform that leads a command economy back to a market system is also a property rights revolution. Two main strategies of reform are identifiable: marketization (decentralization of control) and privatization (decentralization of ownership). Marketization would lead a Soviet-style command economy to market socialism, while privatization would push toward state capitalism. Marketization-cum-privatization aims at creating a laissez-faire system, which is the goal of shock therapy. The European transition economies have attempted to marketize and privatize their systems, while their Asian counterparts have adopted an official policy of market socialism. The fact that the European transition performance has been much less successful than the Asian performance creates a "property rights puzzle," as the more thorough reform in Europe is supposed to bring about better results.

The puzzle is solved when we delve into the specifics of the property rights systems emerging from reform. In China, de facto privatization in the non-state sector hardened the budget constraint, reined in investment hunger, and stabilized the system, particularly since the mid-1990s. The success of the "soft landing" of 1993-95 engineered by Zhu Rongji owed much to this fundamental change of the Chinese property rights structure. Much of China's phenomenal growth is also attributable to modified property rights. The TVEs that contributed greatly to hyper growth are for the most part collective enterprises in the legal sense, but private establishments in functional terms. The crux of the matter is hardened budget constraints. In Russia, as privatization necessarily lagged behind marketization at the early stage of reform, unintentional market socialism was created and the inflation rate skyrocketed. When state enterprises were later privatized, the wrong methods were used. "Employee privatization" and "conglomerate privatization" did little to harden budget constraints. The result was rampant inflation and a misallocation of resources that led to output depression. The comparison between China and Russia demonstrates the inadequacies of "nominal property rights" and the importance of "functional property rights."

Property rights are basic structures that determine long-term performance. In the short run, stabilization of the economy is a primary task of transition. Only states with strong capacity can implement necessarily painful stabilization plans. This leads us to the nature of the regime. China's enlightened authoritarian regime proved capable of bringing about stability after learning hard lessons in the 1980s and early 1990s. Russia's weak democracy failed to bring stability to the needy economy. Poland's strong democracy showed tremendous resilience in pursuing stabilization plans, but the success of the country's transition derived to a large extent from the "double miscalculations" of the reformers.

The latest chapter of comparative development of China and Russia focuses on the different reform strategies taken by the two countries, the differences in transition performance, and the global implications of China's rise and Russia's fall. This article has examined the literature and delved into both the institutional and non-institutional factors. We have found both economic and political institutions to be important in determining the ultimate outcome. The property rights system and the role of the state interact to provide the institutional background for transition economies. The correct institutional mix leads to better performance. In our comparison, Russia and China represent two modes of exit from state socialism, and two development patterns. Russia's reform is informed by neoclassic economics, China's by East Asia's capitalist developmental model. By shedding more and more defunct state enterprises, and by taking advantage of the power of an authoritarian state, mainland China is consistently shifting from market socialism to state capitalism. Its economic success is more and more attributable to the model that has proven so effective in modernizing the East Asian dragons in the past. That model is a combination of economic and political institutions geared to high growth. In this sense, China is the latest East Asian miracle, the giant NIC. The difference between China and the dragons is the former's sheer size; China's success can both shake and shape the world. China's experience will represent an alternative pattern of economic development, very much like what the Soviet experience meant for the developing world in the 1950s to the 1970s. Through the Chinese case, and through comparison with other transition cases, we can better understand the relationship between institutions and economic performance, particularly for economies in transition.