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Reforms in Eastern Europe and the Former Soviet Union in Light of the East Asian Experiences

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I

During the past five years, there has been an important international debate over the style of market reforms in the former centrally planned economies of East Asia, Eastern Europe, and the former Soviet Union. The economic performance across regions, summarized in Table 1, could not be more disparate, with rapid economic growth and low inflation in the East Asia transition economies, compared with sharp declines in GDP and high inflation in Eastern Europe and the Former Soviet Union (hereafter combined as EEFSU). This disparity has given rise to a plethora of theories about the underlying differences in the two regions, ranging over cultural, political, and economic factors.

At least three interpretations seem to have won widespread support. The first is that "gradual" economic reforms in East Asia have outperformed "shock therapy" economic reforms in EEFSU. The second is that Asian reformers put economic reforms ahead of political reforms, with superior economic results. In this view, premature democratization is seen to be a serious hindrance to EEFSU's economic performance. The third, raised by some Japanese analysts, is that EEFSU has unwisely rejected industrial policies that proved crucial for Japan's own post-war economic recovery. Such views have been influential not only in academic debate, but among policymakers in the transition economies and the donor community. For this reason, they deserve the most careful scrutiny.

In this brief survey paper, I seek to question these popular conceptions. My basic theme is that the differences in economic performance in the two regions are mainly the result of differences in <u>economic structure</u> and initial conditions rather than of differences in economic policymaking.[1] The more rapid growth of East Asia's transition economies reflects mainly the fact that the East Asian economies began the reform process as highly agricultural and rural economies, with underdeveloped industrial sectors. The EEFSU economies, on the other hand, were heavily industrialized -- indeed overindustrialized -- economies, with most of the population in urban areas. For this reason, East Asia's brand of gradualism, which I describe below, was not applicable in the EEFSU context.

The EEFSU countries adopted "shock therapy" measures as a last resort, because other more gradual strategies attempted first did not fit their specific conditions. Moreover, Russia has unfortunately failed to adopt <u>any</u> consistent reform strategy, and so has suffered particularly poor economic performance. As Boris Yeltsin (1994, p. 147) himself has written recently, concerning Russia's long history of attempted reforms, "Russia's trouble was never a shortage or an abundance of reformers. The trouble was an inability to adhere to a consistent policy." Thus, Russian performance should not be

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[1] This paper draws heavily on Sachs and Woo (1994), as well as on ongoing research with Professor Woo on international comparisons of social welfare spending in Europe, Latin America, and Asia.

understood as a test of any specific kind of policy reform, but rather as a result of policy instability.

Another widespread misconception is that the East Asian reforms are somehow "softer and gentler" than the Eastern European and Russian reforms. EEFSU reforms are often excoriated for the hardships they are imposing on the population. Such appearances are deceptive. Eastern Europe's and Russia's reforms look particularly harsh because governments in these regions must cut back on exaggerated social welfare commitments of the old regime, a step which is very hard for any government. Yet extensive social welfare systems remain in place in these economies. East Asian transition economies, by contrast, do not have such vast social welfare systems, and therefore do not have to make such visible cutbacks in support. In fact, the vast majority of the populations in China, Vietnam, Laos and other Asian transition economies, lack even rudimentary social support, and therefore must scramble for mere survival.

The paper proceeds as follows. Section II highlights some of the key differences in economic structure between EEFSU and East Asian economies. Section III considers various aspects of the debate between gradualism and shock therapy and the sequencing of political and economic reforms. Section IV examines the relevance of Japan's post-World War II recovery for current policy problems in EEFSU and East Asia. Section V offers some conclusions.

II

In this section we make a three-way comparison of economic structure, involving EEFSU, the East Asian reforming economies, and Japan immediately after World War II. We argue that these three economies differ in several fundamental ways that go far to explaining their differences in economic performance, political dynamics, and policy needs. Therefore, this section provides the vital inputs for the analysis of the later sections.

The critical differences in economic structure revolve around: (1) the level of economic development; and (2) the role of the state in the economy. With regard to the level of development, Eastern Europe and the former Soviet Union were much more <u>industrialized</u> and <u>urbanized</u> at the start of their reforms than either the East Asian transition economies at the start of their own reforms, or than Japan in the immediate postwar period. At the start of the reform period (and still today) the vast bulk of the EEFSU labor force worked in industry and services, while in East Asia, the predominant proportion of the labor force was still in agriculture. This has had many ramifications for economic performance and policymaking, generally speaking, it has made the transition to the market much more difficult in EEFSU.

With regard to the role of the state, the EEFSU is burdened by the communist-era commitments of <u>universal social protection</u>, which created a social welfare state far more extensive than anything ever attempted in Asia (either in the communist or non-communist economies). The result is labor immobility, fiscal crisis, and political paralysis in EEFSU, as different social groups and regions fight to preserve their privileges under the old regime. East Asian communist governments (e.g. in China and Vietnam) have done no better than EEFSU governments in cutting back wasteful social expenditure; the difference is that in East Asia there is much less to cut, and therefore much less a fiscal and political burden from unsustainable promises of the state.

The key differences in economic structure are evident in Table 2, which shows an estimated per capita GDP (adjusted for purchasing power parity, PPP); the sectoral structure of the labor force; and the proportion of the population in urban areas. In addition to the three main groups (EEFSU, East Asian transition economies, and Japan circa 1950) the table also reports on middle-income developing countries in East Asia and Latin America. We see that as of the early 1990s, China is still much poorer, agricultural, and rural, than Russia or any of the countries in Eastern Europe. Vietnam and Laos are even poorer, less industrial, and more rural than China. Notice that these differences are true even after fifteen years of market reform and rapid industrial growth in China. Thus, if we were to compare China in 1978, at the start of its reforms, with Russia in 1991, at the start of its attempt at "shock therapy," the differences would be even more striking than in the table. Notice also that Japan in 1950 was a relatively poor and rural society, with nearly one half (48.3 percent) of the labor force in the primary sector. While it is difficult to obtain a reliable comparison of per capita income levels of Japan in 1950 with Russia and Eastern Europe today, the Summers-Heston income data put Japan's 1950 per capita PPP income at 9.8 percent of its 1990 level. Assuming 3.4 percent per capita GDP growth between 1990 and 1991, and taking the estimate of GDP per capita in 1991 (in PPP terms) to be $19,390 (from the 1994 Human Development Report), we arrive at the estimate of $1,900 for 1950 shown in Table 2. This puts Japan per capita income level in 1950 much closer to China's per capita income level than to EEFSU's income levels.

Many studies have stressed that EEFSU was not only industrialized, but in fact overindustrialized. Central planners had planned for a purpose: to create a vast military-industrial complex. The result was that the Soviet Union and the Eastern European communist countries succeeded in producing vast amounts of steel, coal, chemicals, and heavy machinery, to the neglect of consumer goods and services. As just one well-known example, in 1988 the Soviet Union produced 17 times more steel per dollar of GDP than did the United States (with GDP measured in PPP terms).

The second major dimension of difference between EEFSU and the East Asian transition economies lies in the role of the state under the pre-reform regime. Both East Asian communist regimes and the EEFSU regimes created social welfare systems for state-enterprise workers, but the system was <u>vastly more extensive, and expensive, in EEFSU than in East Asia</u>. Essentially, the East Asian social welfare systems covers only the workers in industry and the state bureaucracy, who together constituted a small proportion of the labor force, while the EEFSU social welfare systems were set up to be universal, covering all workers in the economy. State workers in China receive a so-called "iron rice bowl," signify the guarantee of job tenure, adequate income, and other kinds of benefits (lodging, pensions, health care), but such guarantees apply to less than 20 percent of the labor force, and does not reach the rural sector. In the pre-reform

EEFSU, by contrast, a similar "iron rice bowl" was applied to nearly 100 percent of the labor force.

The fiscal costs of these social programs may be seen in Table 3 and Table 4, which show measures of the fiscal burden of social welfare spending for different regions and individual countries. Both tables record social security, education, and health expenditures at all levels of government, measured as a percent of GDP. As we would expect, Table 3 confirms that poorer countries maintain a less extensive social welfare system (measured as a percent of GDP) than do wealthier countries. Nevertheless, we also see that the burden of social expenditures for Eastern Europe was roughly on the level of the OECD economies, even though the average per capita income level was roughly one-fourth ($5,210 compared with $19,000). Both South Asia and East Asia have very small social security systems, 3.4 percent of GDP on average in East Asia, and only 0.7 percent of GDP in South Asia.

In the aftermath of World War II, Japan was far more like East Asia of today than EEFSU with regard to social welfare spending. In Table 5, all social security payments made to individuals, by all levels of government, are added to arrive at a total "transfers" estimate, based on the important work of Emi (1978). Emi lists six subcategories of social security payments, including "livelihood protection, social welfare, social insurance, unemployment measures, measures for health care and sanitation, and pensions," to arrive at the total transfers. We see that as during 1946-50, total transfer payments amounted to just 2.2 percent of GDP, while pensions alone amounted to around one-tenth of one percent of GDP. During 1951-55, the transfer payments had increased to around 3.8 percent of GDP, which pensions still below one percent of GDP. Thus, as is well known, Japan lacked any extensive state social welfare system after World War II. Japanese governments called on the population to rely on personal effort, high savings, and intra-family transfers to address personal financial hardships.

Perhaps as a result of their ideological competition with the much richer Western European countries on the their borders, promised their citizenry levels of social welfare payments and guarantees that were vastly out of line with the per capita income levels in EEFSU. These welfare guarantees not only contributed to the insolvency of the EEFSU governments, many of which are still in default on their international debt obligations, but have also contributed to political paralysis in the EEFSU, <u>by making every needed adjustment in the economy a violation of a preceding guarantee to some class of workers</u>. The ambition of the social guarantees in the Soviet Union was especially remarkable, even by comparison with the social welfare arrangements of the OECD economies.

The burden of social spending not only puts pressure on the budget deficit and makes the government vulnerable to political attack, but it almost surely adds inefficiencies to the labor and capital markets. The very high payroll and income taxes needed to fund the social welfare payments have a number of effects: discouraging labor supply, driving small enterprises into the black economy, provoking unemployment by narrowing the gap between net income at work and in unemployment (especially if workers can both work in the black economy and register as unemployed), and pushing capital abroad to countries with low tax rates. Many analysts believe that the "European disease" of high unemployment results, in large part, from the inefficiencies of excessive social welfare payments. The same is likely to be true of Eastern Europe as well, where unemployment rates are rising to, or above, Western Eurpoean levels.

In an important recent work, The Soviet Social Contract and Why it Failed, author Linda Cook (1993) characterizes in detail the all-embracing ambitions of the Soviet social welfare state during the Brezhnev era. She describes the "social contract" under the authoritarian Brezhnev regime, in which "the Soviet regime consistently [should] deliver to workers economic security and social welfare," and "workers [should] give in exchange political compliance and quiescence." (p. 5). At the core of this system lay job security, which guaranteed not only employment but also protection against downgrading of the job:

> A worker's right to his or her existing job was protected by labor legislation that sharply restricted managers' ability to fire or transfer workers, placed multiple procedural barriers to dismissal even for incompetence or disciplinary violations, and extended strong guarantees to marginal workers (including youth and women with young children). (p. 26)

In addition, the Brezhnev era promised substantial real wage increases, a narrowing of income inequalities across regions and sectors (including, inter alia, a commitment to close the gap between the urban and rural areas), and guarantees of "a long list of basic necessities and social services, including education, child care, medical care, housing, public utilities, public transport, stipends, disability payments, and lunch programs." (p. 21)

The differences in the sectoral allocation of the labor force in EEFSU and East Asia and in the social welfare systems are also reflected in the differences in the social organization of work. In China, only 18 percent of the labor force as of 1978 were employed in state-owned enterprises, and only 8 percent were employed in state-owned enterprises in the industrial sector. Around 70 percent of the population were in communes, which were soon to be dismantled. This meant that by the early 1980s, only around one-fifth of the Chinese population worked in a state bureaucratic unit, while the rest of the population was employed outside of the state bureaucracy, as seen in Table 6. The vast majority of the population worked in activities that had almost no direct financial connection with the state. Peasant farmers did not receive social welfare transfers, state loans, or other kinds of direct state subsidies for production.

In the Soviet Union, by contrast, around 99 percent of the labor force in 1985 worked in state-owned enterprises of various sorts. The entire population, that is, was employed in work units that had a direct financial dependence on the state in one form or another. Even the collective farms (*kolkhoz*), for example, which constituted six percent of the labor force in 1985, were really state-owned bureaucratic units, which depended on the state for loans, subsidies, and allocations of physical inputs. Collective farm workers enjoyed guaranteed employment and income levels, protected by state subsidies. The same pattern of nearly 100 percent employment in state-owned enterprises was the rule throughout the EEFSU economies, with a partial exception for Poland, in which around

15 percent of the labor force was independent, peasant farmers. Even the Polish peasant farmers, however, received substantial state subsidies and depended on the state for inputs and for the sale of outputs.

III

There are several implications of these structural differences between EEFSU and East Asia for the differences in economic performance and reform strategies of the two regions. In one form or another, they all amount to an "advantage of relative backwardness" in East Asia, that has made the reform process somewhat easier to manage in that region.

Most importantly, East Asia's heavily peasant economy has permitted the application of a certain kind of gradualism in market reforms, that was simply not available in EEFSU, even if it were desirable. As described in detail in Sachs and Woo (1994), the real meaning of gradualism in East Asia has been the two-track approach, in which the government liberalizes the non-state sector of the economy while still protecting the state sector. The goal is to unleash market forces for new enterprises without creating unemployment and social upheaval in the existing state sector. In this approach, steps such as cuts in subsidies to state enterprises, increased autonomy for the state sector, bankruptcy proceedings, and privatization, should all be introduced very gradually in the reforms.

Shock therapy, by contrast, signifies a package of rapid liberalization and stabilization measures that covers the state enterprises as well as the new non-state enterprises, as well as a program for mass privatization of state industry, usually over the course of a few years. The essential difference in the two policies is not really the speed of reform *per se*, since certain kinds of radical reforms have been undertaken with blinding speed in East Asia (especially the dismantling of the commune sector in China during three years, 1978-81). The essential difference is that in EEFSU, the state enterprises are immediately subjected to market forces and a hard budget constraint, with the expectation (not always realized) of quick privatization. In East Asia, by contrast, the state enterprises are allowed to continue with a soft budget constraint and no clear expectation of eventual privatization.

Let us consider the two-track approach in the Chinese case. Liberalization of the non-state sector has meant three main things:

(1) the dramatic and rapid elimination of the commune-brigade system in agriculture, and its rapid replacement by the "household responsibility system" of individual household plots;

(2) the freedom of local governments to establish township and village enterprises (TVEs) that operate outside of the central plan and on a market-basis for inputs and outputs; and

(3) the opening of the Chinese economy to international trade and finance, especially in the Special Economic Zones (SEZs) in the coastal provinces.

The rural reforms began in 1978-79 and the commune system was completely dismantled by 1981. The international opening of the economy began in the late 1970s, and has proceeded in stages during the past fifteen years.

Chinese state enterprise reforms began in 1984, with a gradual increase in autonomy given to the state enterprises. But in the ensuing years, the enterprise reforms have remained gradual and limited. State enterprises have continued to receive subsidies for more than a decade; bankruptcy laws have barely begun to function; ownership transformation has been delayed; and the state workers continue to enjoy their iron rice bowl. It is estimated that even in the boom conditions of recent years, nearly two-thirds of state enterprises continue to lose money. Around half of the enterprises overtly lose money and are covered by budgetary subsidies; another fraction of enterprises covertly loses money, with the losses hidden in the form of subsidized state-bank loans and rollovers of bad credits.

The two-track approach in China indeed unleashed enormous growth in the non-state sector, including the TVEs and the coastal enterprises, while avoiding, at least until now, the turmoil of closing loss-making state enterprises. Under the two-track approach, most state workers clung tightly to their subsidized jobs in the state sector, while peasant laborers have flowed to TVEs and coastal enterprises. As shown in Table 6, the share of Chinese workers in state enterprises has actually been constant for fifteen years; all of the rise of the share of employment in the non-state industry has come from the decline of the share of agricultural employment. This contradicts the widespread idea that the Chinese state sector is "melting away" under the pressure of the reforms. Could this same approach have worked in EEFSU? <u>The answer is that it was in fact tried during the Gorbachev era, and it failed, for both structural and fiscal reasons.</u> The structural point should be clear from the Chinese case. In EEFSU, there is simply no "third" sector -- structurally equivalent to Chinese peasant agriculture -- to supply the workers for the new non-state enterprises. Since heavily subsidized workers in the state sector will not leave their jobs (either in China or EEFSU), there can be little supply response of the non-state firms unless there is:

(1) a repository of surplus labor outside of the state sector (Chinese agriculture); or

(2) cuts in state sector subsidies (shock therapy).

This lesson was vividly demonstrated in the case of Poland. Two-track reforms in the late 1980s under the reform communist regime allowed some private enterprises to start, but these enterprises were severely hampered by a shortage of workers and material inputs (both of which remained bottled up in the state sector, which continued to operate with soft-budget constraints). The new Polish private sector began to grow dynamically only after radical reforms began in 1990, not during the phase of "gradual" reforms during 1987-89 (see Sachs, 1993, and Johnson and Loveman, 1995, for details).

A simple numerical example, in Table 7, might help at this point. Suppose that there are three sectors: peasant agriculture; state industry; and non-state industry. The respective social products of workers in these three sectors are 50, 100, and 125. Moreover, the state-sector workers each receive a state subsidy worth 50, paid for through inflationary finance (which, I assume, is indirectly paid for by the entire population on an equal per capita basis). The inflation tax borne by each worker may be calculated as the size of the subsidy per state worker multiplied by the share of workers in the state sector. Each worker receives net take-home pay equal to his social product plus state subsidy minus inflation tax.

Suppose that in East Asia, the pre-reform labor force is divided initially as 80 percent peasants and 20 percent state workers, while in EEFSU, the pre-reform labor force is 100 percent state workers. The situation regarding take-home pay for each kind of employment is shown in the two sections of the table. We see that in both East Asia and EEFSU, there is no incentive for a state worker to leave his job and move to a more socially efficient non-state enterprise. On the other hand, the peasant worker in East Asia has the incentive to move to the non-state sector. In East Asia, this would lead to massive flows of workers from the countryside to the new non-state industrial sector. In EEFSU, there would be no movement to the non-state sector.

In the bottom panel, we show the implications of shock therapy, meaning a complete elimination of the state subsidy combined with an end to the inflation (the end of inflation is made possible by the elimination of the subsidy). Now, of course, state workers have the incentive to move to the private sector, and end up with higher net pay despite the loss of the subsidies, since they gain in stabilization what they lose in direct subsidies. Of course, in a more complex setting, there are bound to be losers as well as winners. Some workers in the pre-reform regime receive subsidies that are larger than the burden of the inflation tax plus the gains that they might enjoy by moving to the non-state sector. Workers with high costs of intersectoral mobility are particularly vulnerable. It is not surprising, therefore, that certain groups of workers -- older, less educated, and in small towns -- tend to oppose shock therapy reforms.

The second difficulty with the two-track strategy for EEFSU lies in the public finances. The Chinese two-track approach has been costly, with state-enterprise subsidies typically costing between 5 and 10 percent of GDP per year (see Sachs and Woo, 1994, for details). These subsidies have contributed to chronic inflationary pressures. Inflation has reached nearly 30 percent per year in 1994. In EEFSU, where the state sector was generally 90 percent or more of the labor force, rather than 10-20 percent as in East Asia, the cost of state-sector subsidies has tended to rise far above 10 percent of GDP, and inflationary pressures have been much greater as a result (as was evident in the example in Table 7). Sharp cuts in state-enterprise subsidies were therefore vital to get inflationary pressures under control.

It is important to appreciate that market liberalization itself tends to exacerbate fiscal problems, even in the absence of explicit increases in budgetary subsidies to state enterprises. When state enterprises are given more autonomy during market reforms, they inevitably find ways to hide their incomes in the form of higher compensation for workers and management. This may come in greater expenditures for worker housing, or transport, or cafeterias in the factory, or simply higher take home pay. Moreover, with a legalized non-state sector operating alongside the state sector, state-enterprise managers discover ways to launder income through non-state enterprises that they establish as a conduit for skimming the state enterprise incomes. For both legal and illegal reasons, the state sector begins to report smaller profits or overt losses. Tax revenues decline and the budget deficit widens. In this sense, market reforms -- whether two-track or shock therapy -- introduce a race against time to protect the budget against growing losses in the state sector.

Even though China has so far avoided an extreme inflationary explosion, and even though the state sector is much smaller proportionately to GDP than in EEFSU, we should not overlook the risks of much greater inflation in China in future years. As Sachs and Woo (1994) explain, part of China's ability to control inflation has resulted from the rapid buildup of <u>real</u> money balances by the Chinese population. This buildup of real money balances has permitted high levels of seignorage without concomitant inflation. In the past fifteen years, M2/GDP has risen from XX to XX. We can surmise that the M2/GDP ratio will stop rising, particularly as households gain access to other stores of value in addition to savings deposits. In fact, the M2/GDP ratio has been roughly constant during the past two years. As a result of the stabilization of M2/GDP ratio, the inflationary consequences of a given rate of seignorage (as a percent of GDP) could be considerably worse than in the past. If, in turn, the higher inflation started to lead to declines in M2/GDP, and the dependence on seignorage persisted, it is possible that China could enter into a period of explosive inflation.

In most critiques of "shock therapy" reforms, it is forgotten that the communist reformers of the late 1980s <u>fervently tried</u> the two-track approach in EEFSU (see Berliner, 1993, and Sachs and Woo, 1994, for further details). Gorbachev and his disciples in Eastern Europe were anything but advocates of radical market reforms! The Chinese reforms were in fact the major conceptual model guiding the Soviet reforms during the early years of <u>*perestroika*</u>. The problem was that gradualism in the EEFSU context simply did not produce a dynamic flow of workers from the peasantry into industry, a la China, but instead produced an explosive growth of state enterprise wages and fiscal deficits, which combined to sink the economies in monetary instability.

After several years of reform experience, we now have a track record for comparing shock therapy versus gradualism within the EEFSU countries. While a few countries -- the Czech Republic, Estonia, Poland, Slovenia -- successfully implemented radical economic reforms, many others such as Romania and Ukraine, staunchly defended a gradualist course. Russia, unfortunately, followed no consistent policy. Several studies (most recently Balcerowicz and Gelb, 1994) have shown that it is the countries pursuing shock therapy that have best succeeded in restoring economic growth and broad macroeconomic stability, while the gradualists have tended to experience continuing declines in output and accelerating inflation. Both Ukraine and Russia announced at the end of 1994 their intention to proceed with more decisive stabilization measures in 1995.

Many analysts also point to the downturn in industrial production in EEFSU as a prima facie evidence that "shock therapy" has failed in the region, at least compared with the two-track reforms in East Asia. Once again, this simplistic analysis confuses the results of structure versus policy. Rapid price liberalization and subsidy cuts caused a downturn in industrial production in Eastern Europe and the former Soviet Union precisely because those economies had an excess of heavy industrial production relative to services and consumer industries at the start of reforms. Industries such as steel, coal, chemicals, and some machine building, faced a sharp fall in demand once the budget constraints of their customers (especially in the military sector) were hardened. The decline in such overproduction is crucial to enable the growth of new sectors. Importantly, the countries that pursued shock therapy had the <u>smallest cumulative declines in industrial production in EEFSU</u>, precisely because the strong market reforms supported the fastest growth of new sectors of industry.

Another common criticism of shock therapy is that it led to sharp drops in living standards in EEFSU, as contrasted with unambiguous increases in living standards in East Asia. Official data have vastly exaggerated the purported declines in income in EEFSU after the start of market reforms, for several related reasons: private sector economic activity is systematically underreported; the increased availability and quality of consumer goods is not captured in the data; the welfare gains of reduced queuing time are also not measured. In the case of Poland, for example, the widespread assumptions of a sharp drop in living standards after 1989 has been completely refuted by a series of careful analyses. We now know that Poland's reforms in fact ushered in a <u>boom</u> in consumer durables purchases for virtually all social groups, combined with stable or even increasing levels of consumption of non-durables. Real consumption in most broad categories of the population has increased, not decreased sharply as was once assumed.

In China, by contrast, the visible boom in the urban areas has tended to mask continuing hardships in much of the countryside, and among the unregistered "floating population" in the cities (which now totals between 100 million and 200 million persons). Recent press accounts have depicted the harrowing conditions of young women who have come from the countryside to urban areas to work for bare subsistence wages under dangerous factory conditions. Official data show that the urban-rural inequality in China has widened sharply since 1985, so that the gap between urban and rural households is wider than at the start of the reforms in 1978. We simply do not have a solid picture as to the proportion of the Chinese population that might have suffered real income declines in recent years, especially in the underreported countryside.

Finally, the East Asian two-track strategy would be a more convincing model for EEFSU if we could find evidence that China's gradual state enterprise reforms had in fact restored vitality to the state enterprise sector. Unfortunately, in this area of most importance for EEFSU, there is little sign of progress in the Chinese reforms, despite 10 years of effort at state enterprise reforms. We find that after 10 years, the Chinese state enterprises remain heavily loss making, with productivity levels and productivity growth that lag behind the non-state firms, and with evidence of growing corruption, asset stripping, and pressures for privatization. The best evidence is that China will eventually have to follow the Eastern European strategy of privatization in order to eliminate these chronic and unsolved problems. It has had the luxury to avoid this decision mainly because of the small relative size of the state-enterprise sector in total employment.

Let us turn now to some additional aspects of the political economy of reform.

It is often asserted that East Asia's gradualism has allowed a much more stable transition to the market than Eastern Europe's radical reforms. Many observers point to the considerable turmoil and dissatisfaction evident in EEFSU, in apparent contrast to the relatively smooth path of change in the East Asian economies. Moreover, it is asserted that premature democratization in EEFSU has further burdened the economic reforms. This line of analysis prompts several observations.

The countries of EEFSU are vastly freer in political debate than are the East Asian countries. For this reason alone, there is no easy way to calibrate the differing degrees of dissatisfaction and social instability. During a brief period of political liberalization in 1988-89, China experienced mass unrest, which was repressed by army in June 1989. Moreover, there has been extensive unrest in the Chinese countryside, especially in 1993 and 1994, but political suppression and the absence of uncensored media make it hard to calibrate.

It is clear that politicians in both EEFSU and East Asia have found it extremely difficult to reduce employment in over-manned state-owned enterprises. In China, there has been almost no retrenchment of labor in state enterprises during the past decade, despite many attempts at "enterprise reform." Recently, attempts to introduce new bankruptcy proceedings in loss-making state firms were met with civil unrest and strikes, prompting local Chinese officials to reverse the bankruptcy orders. The big difference between the regions, therefore, is not in the ability to undertake restructuring, but in the fact that EEFSU simply needs much more restructuring than East Asia, because EEFSU starts from a much higher level of industrialization, and a much greater degree of structural imbalance in the economy. We should also keep in mind that uncertainty related to structural adjustments can generate a majority political opposition to reform even when a majority of the population stands to benefit *ex ante* from the reforms (see Fernandez and Rodrik, 1991, for an important theoretical analysis of this point).

Moreover, as I have stressed earlier, governments in EEFSU are held accountable by their citizens for universal social welfare, whereas in China, the social welfare system has never extended beyond the urban areas. The EEFSU thus carries the burden of decades of ideological commitments to universal social guarantees that never existed in East Asia. In addition, most of the rural East Asian population still has a natural (if rudimentary) safety net in the form of the household plot of land. Poor families can rely on their own agricultural output to achieve the bare minimum of subsistence. In EEFSU, by contrast, most of the population is urban and therefore lacks any guaranteed source of subsistence other than from the state itself. Recent research (Rose, 1994) has shown however an astoundingly high proportion of Russian and Ukrainian urban households that depend, at least in small part, on their own garden plots for part of their food supply.

An enormous amount of political activity in Eastern Europe is now devoted to protecting the previous social welfare commitments. The return of left-wing parties to political power throughout Eastern Europe should be understood mainly as a result of the popular view among voters that these post-communist parties will better protect the "entitlements" that had been promised by the old regime. The most powerful block of left-wing voters seems to be the pensioners, who represent a surprisingly large proportion of the electorate and who lobby aggressively for increases in real pension payments. In Poland and Hungary, pensioners living off of the state now account for around one-third of all adults, and in Slovenia the proportion is closer to forty percent of the adult population! The result of these political pressures is clear: social spending has actually increased sharply in most countries of Eastern Europe in recent years, even as subsidies to state industry have been cut, as shown in Table 8.

Nonetheless, the argument that democratization in EEFSU was "premature" is surely too facile if not wholly incorrect, even if we restrict our attention purely to economic matters.[2] The authoritarian regimes of Eastern Europe were even less able than the new democratically elected governments to hold the line on budgetary spending and social demands. It was, after all, the authoritarian regimes rather than the new democracies in EEFSU which first plunged the economies into financial destabilization. Many countries throughout EEFSU and in the rest of the world have been able to manage simultaneous economic stabilization and political democratization. The added legitimacy of democracy has often played a key role in helping governments to reduce state corruption and to implement needed economic reforms, a point that was vividly demonstrated in Poland in the first years of the 1990s, and likewise in Argentina and Bolivia during their reforms in the past decade. In comparing EEFSU and East Asia along the political dimension, we should also make the obvious point that while much of EEFSU has made the transition to democracy, further instability and unpredictability still lies ahead in China and other authoritarian regimes, which still lack a stable and legitimate system of political succession.

It is also important to remember that democracy was "ripe" in Eastern Europe and Russia, in view of the levels of economic and social development in those countries. Countries around the world with the per capita income levels and urbanization comparable to those in EEFSU (income levels above $6,000 per capita on a PPP basis, and with urbanization of more than 60% of the population) are almost always democracies. As shown in Table 9, <u>every country in the world with a per capita income level of $6,000 or more in 1992 (in PPP terms) is currently a democracy, with the exception of a few oil-rich Middle Eastern countries and Singapore</u>.[3] In Asia, when

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[2] I find it morally repugnant to view democracy purely in instrumental terms, as a condition working for or against short-run economic reforms. Democracy promotes many other values -- human rights, personal initiative, the limitations of state-sponsored violence, the promotion of civil society, a law-bound state -- that are of fundamental importance independent of economic reforms.

[3] The oil countries, of course, are rich not because of a complex degree of social organization, but because of their oil production. They therefore constitute an exception that proves the rule. As for Singapore, it is of course a small island economy of fewer than 3 million people, and it has been moving towards full democratic rule in recent years.

countries such as Korea and Taiwan reached comparable levels of development, they too experienced tremendous internal pressures which led to democratization.

Perhaps the Achilles heel of economic reform in Russia and China will lie not in the tactics of stabilization and privatization, or even in politics, but rather in the incapacity of the state to implement the rule of law. At China's relatively low level of economic development, with two-thirds of the labor force still in the peasant sector, the rule of law has not yet been a major constraint on economic growth. But for the more complex economies of the EEFSU today, and for China in the future at a higher level of economic development, the rule of law will be absolutely vital if markets are to replace administrative fiat as the foundation of the division of labor in the economy, and if the state itself is going to be able to function in a stable manner.

In some of the countries of Eastern Europe, the transition to commercial law has been relatively smooth. Czechoslovakia, Poland, and Hungary have interwar traditions of commercial law that they can draw upon.[4] Even before World War I, Czechoslovakia, Hungary and part of Poland were part of the Austro-Hungarian empire, which had a legal system based on Roman Law common to continental Europe. And even earlier, Poland demonstrated its rule-of-law tradition in promulgating Europe's first written constitution, in 1791.

Russia, by contrast, has no interwar tradition to draw upon, and pre-revolution Russian was also deeply deficient in its legal framework. The patrimonial tradition in Russia put all of Russian property nominally under the ownership and control of the Tsar. There was no legal or moral concept of private property rights. In practice, feudal boyars were sovereign in their own estates, so that the serfs of Russia had no protection of civil or property rights and had not recourse to the state itself. Some legal reforms had taken place during the reign of Alexander II, but these were checked by his autocratic and reactionary son, Alexander III. During the entire tsarist period, for example, Russia never adopted a modern company law, despite nearly three-quarters century of debate over the need for a modern company code. (See Owen, 1991, for a brilliant history of the debate over the tsarist company law). The absence of the rule of law in Russia today is painfully evident in all aspects of its current struggles over reform. Privatization is being hampered by the absence of securities law. Financial scams are rampant. Tax evasion is widespread and rising. Even straightforward contracts are nearly impossible to enforce, since the judicial and police system do not function to protect private property rights. There is an increased reliance on "private" mafias for hire as agents of contract enforcement, a phenomenon strongly reminiscent of the private enforcement system that gave birth to the Sicilian mafia in Southern Italy (see Gambetta, 1993, for an analytical and historical account of the Sicilian mafia, and Leitzel, et. al., 1994, for an application to Russia). With the sharp rise in criminality and private "mafia" enforcement of economic relations, the state itself is at risk, if only because of its declining capacity to provide

[4] For example, at the start of Poland's market reforms in 1989, the 1934 Commercial Code was brought back into operation.

basic security to its citizens, and to collect tax revenues to cover these basic services.

China's historical tradition regarding the rule of law is not more helpful. The Confucian tradition long put property relations at the mercy of local aristocrat-bureaucrats, who could ruthlessly "squeeze" the local merchants and peasants for increased tax payments and bribes. There was no recourse to the law for protection of property rights. As Fairbank (1992, 180-81) summarizes a generation of research:

> In short, capitalism failed to prosper in China because the merchant was never able to become established outside the control of the landlord gentry and their representatives in the bureaucracy. In feudal Europe the merchant class developed in the towns. Since the landed ruling class were settled in their manors upon the land, the European towns could grow up outside the feudal system instead of being integrated in it. Medieval burghers gained their independence by having a separate habitat in these new towns, and new political authority to protect them, in the persons of the kings of nation-states. In China, these conditions were lacking. The early abolition of feudalism and the dependence of the emperor and his officials upon the local gentry left no political power outside the established order to which the merchant could turn for special protection . . . Between them, the gentry and officials saw to it that the merchants remained under control and contributed to their coffers instead of setting up a separate economy.

In China, the absence of a system of commercial law has not yet severely hampered the reforms mainly because of China's early stage of economic development. This is evident, for example, in the role of foreign investors in China's economy. Foreign investors have shown themselves willing to invest tens of billions of dollars into China, despite the absence of a clear legal system of property rights.[5] But this has been possible because the foreign investors operate on the "edge" of the economy, both literally and figuratively. These enterprises operate in coastal and border regions; import the components they need for assembly; use low-cost labor for the assembly operations; and then export the finished product for the world market. There is relatively little integration with domestic Chinese firms, either for the purchase of inputs or the sale of outputs. In other words, these firms have been able to function without much legal protection since they have few contractual relations with Chinese enterprises.

The absence of rule of law has recently started to adversely affect China's international economic relations. Towards the end of 1994, the Chinese government became embroiled in several contractual disputes with foreign companies. Some Chinese

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[5] Note that much of the apparent foreign investment, however, is actually laundered Chinese state-enterprise funds, which have been illegally taken out of China to Hong Kong, and then recycled as private funds back into China. Hong Kong analysts put the laundered funds as equal to half of more of the recorded foreign investment from Hong Kong to China. The Hong Kong investment, in turn, is more than half of the total FDI now entering China according to the official statistics.

enterprises defaulted on debts to foreign investment banks. The Chinese Government defaulted on a long-term lease with the large McDonald's outlet in Beijing, which it has forced to move from its premises in order to make room for a new real estate development. The Chinese Government became more deeply enmeshed in controversy with the United States Government over China's failure to protect intellectual property rights. Within China, moreover, growing lawlessness and corruption are also threatening political stability. As one acute analyst (Willy Wo-Lap Lam, 1995, p. 411) has written: "The attractiveness of the 'socialist market-economy' may be ephemeral. Within a few year, it enabled senior officials and their offspring to make a fast buck. At least superficially, it also allowed the CCP to maintain its monopoly on power. Yet in the longer run, this contraption might prove detrimental to the interests of all."

III

In this section, we briefly examine the lessons for EEFSU that might be gleaned from Japan's economic recovery in the immediate postwar era. Many commentators, such as Prof. J. Teranishi (1994), have pointed favorably to Japan's industrial policies during 1946-48 as the types of policy measures needed in EEFSU. Unfortunately, the conditions in Japan during that period were so fundamentally different from those of EEFSU or East Asia today that such analogies are highly misleading.

In the immediate aftermath of World War II, Japan suffered from an extreme collapse of industrial production, with overall industrial production on the order of 20 percent of the 1939 level. There were several factors leading to the sharp decline in industrial production between 1939 and 1945, including:

(1) extensive war damage to basic industries;

(2) severe bottlenecks in scarce inputs, because of a complete control on Japanese trade by the U.S. Military Occupation authorities;

(3) a crisis in domestic production caused by the sudden shortage of coal miners, as forced laborers from Korea and China left the coal mines at the end of World War II to return home; and

(4) a shortage of capacity caused by the wartime conversion of some civilian industries to military use.

In these circumstances, the Japanese government was able to target a small number of basic industries in 1946-48 (mainly steel and coal) to overcome the production bottlenecks, in a policy known as the Priority Production System (Keisha Seisan Hoshiki, PPS). As summarized by Yoshikawa and Okazaki (in Teranishi and Kosai, 1993, p. 97):

> The primary purpose of the policy was to input as much steel as possible in to the coal mines and then, in return, send coal back to the steel industry to make a kind of virtuous cycle between two industries. Because the Japanese economy faced at that time a serious shortage of raw materials,

> this policy was essentially an attempt to <u>substitute domestic production of coal for interrupted imports</u>, and made sense, at least in theory. How successful the policy actually was still remains a controversy today. (Emphasis mine)

Fukao, et. al. (1993, p. 112) concur that the PPS was "a desperate move by the Japanese government in response to SCAP-imposed constraints on the import of industrial materials." [note: SCAP is the Supreme Commander of the Allied Powers, i.e. the U.S. military occupation authority]. By 1947, U.S. restrictions on Japanese imports were relaxed, as the U.S. changed course and began to promote Japanese economic recovery as part of the emerging cold-war strategy. Industrial production increased sharply, and the main mechanisms of the PPS were dismantled by 1949.

This description of the PPS shows how different is the current challenge faced by EEFSU. These countries do not face "supply bottlenecks" as in postwar Japan, but rather deep misallocations and waste of industrial resources. Unlike Japan in 1946, EEFSU faces no international constraints on its imports; no sudden shortfall of industrial employment; and no war damage. Moreover, EEFSU's aim is not to increase steel and coal production, simply because the basic capacity is present. The traditional heavy industries in EEFSU -- coal, steel, chemicals -- are in a crisis of <u>overcapacity</u>, not supply bottlenecks. The need is to cut back the heavy industrial output, to make room for light industry (e.g. food processing), consumer goods, and services.

There are certainly many relevant lessons from the Japanese postwar recovery, but they have little to do with industrial planning, and much more to do with the establishment of a competitive, privately owned economy. **First**, and perhaps most relevant, the Japanese economy was <u>demilitarized</u> after World War II. Japan became a civilian-oriented economy, with economic growth was fueled by consumer goods rather than heavy industry, and with security needs provided mainly by the U.S. security umbrella. **Second**, <u>land reform</u> after the war improved the distribution of income and wealth, and established a wide base of property holders. These factors were favorable for agricultural productivity and even more importantly for political stability. **Third**, competition was enhanced through the dissolution of the large industrial conglomerates *(Zaibatsu)*. Later on, of course, new industrial groups *(Keiretsu)* emerged, but these new groups were less tightly integrated than the *Zaibatsu* had been. **Fourth**, Japanese labor markets were made highly competitive. Hiring and firing was left to the discretion of individual enterprises; unions were relatively weak; and labor legislation was also permissive. **Fifth**, the postwar Japanese boom was fueled by privately owned industrial enterprises rather than state-owned enterprises. **Sixth**, after 1949, the Japanese economy operated with a low budget deficit, low inflation, and a unified, stable nominal exchange rate. Fiscal stability was supported by low levels of social expenditures as a percent of GDP.

These key features of the postwar Japanese economy are virtually missing from Russia, which remains militarized, oligopolistic, hamstrung by extensive social welfare guarantees (if now much underfinanced), and with continued state ownership of most land and farms. Russian budget deficits remain on the order of 10-15 percent of GDP, fueling inflation rates of more than 10 percent per month for most of the period 1992-94. When Russian analysts wax rhapsodic about Japanese postwar planning, they usually believe that the role of state could be carried out in lieu of these more fundamental changes.

Suppose that the EEFSU countries are finally able to carry out the fundamental reforms of ownership, macroeconomic policy, and competition policy. Would they then be advised to pursue MITI-style planning as an additional element of their strategy? Of course, this question can not be simply answered. There is a huge disagreement about the real character of Japanese industrial policy; it has changed markedly over the years; and there is enormous professional disagreement about its effectiveness. The most recent research on the East Asian economies has landed in a split decision over whether industrial planning helped or hindered the overall development effort, with Rodrik (1995) suggesting important positive effects, while Young (1994) and Beason and Weinstein (1994) have argued against such effects.

But whatever the conceptual judgement on industrial policy, there is one practical factor that militates strongly against any extensive industrial policy at this stage. Throughout the region, the bureaucracies have been inherited from the communist era, and are generally deficient in the knowledge of basic market economics, much less conditions in the world economy. More over, these bureaucracies tend to be highly corrupt (a legacy of the communist past), and penetrated by key interest groups from agriculture and the military-industrial complex, that are much more interested in extracting rents or preserving old structures than they are in overhauling the economy. In short, they lack the technical knowledge, experience, training, and political insulation that was vital for effective planning in Japan and South Korea. Under any circumstances, it should be a high priority to create a new, professional civil service in the economics ministries, but that effort will take a decade at the very least.

There is one more factor in Japan's postwar experience that has been widely forgotten today. Japanese recovery, like Western European recovery, benefitted enormously from U.S. financial assistance at the end of the 1940s and the early 1950s. Japan received $980 million in U.S. aid during 1946-48, and $1.2 billion during 1949-52. Of the total $2.2 billion, $1.7 billion was in the form of grants rather than loans. During the 1946-48 period, the aid amounted to roughly 4.2 percent of GDP, and during the 1949-52 period, to roughly 2.3 percent of Japanese GDP.[6]

This aid was vital in giving the postwar governments sufficient resources to maintain domestic political stability while meeting urgent economic needs (see the discussion in Eichengreen and Uzan, 1992, for an analysis of the stabilizing effects of the Marshall Plan). It also gave the opportunity for policy conditionality in Japan, in the

[6] The following dollar figures for Japanese GDP for 1946-52 are used in the calculation in the text (all in $ billion): 6.25, 7.66, 9.26, 9.38, 10.96, 15.12, 16.99. There are taken from Fukao, et. al. (1993), Table 5.6, p. 119. The aid data are taken from U.S. Overseas Loans and Grants, July 1, 1945 - September 30, 1993, U.S. Agency for International Development.

form of the Dodge Plan, which finally succeeded in stabilizing the Japanese economy. Despite the fact that the needed aid to Russia would constitute a minuscule fraction of Western GDP, the West consistently failed to support the Russian Government in the early stages of reform.[7] Thus, all of Russia's intrinsic difficulties -- fiscal crisis, weakness of law, structural imbalances -- were given time to destabilize the economy, without being held in check by outside resources that could have come from donor governments. (See Sachs, 1994, for further details on the failures and inadequacies of the Western aid program for Russia since 1991).

IV

Both EEFSU and East Asian economies in transition reveal complex patterns of adjustment, that can not be reduced to simple debates over "shock therapy" in EEFSU versus East Asian gradualism. These economies start from very different levels of development with very different roles of the state. What has worked in East Asia does not automatically work in Eastern Europe or Russia, and vice versa. More to the point, the attempt of Soviet reformers in the 1980s to institute Chinese-style reforms failed badly.

In EEFSU, the countries that succeeded in implementing rapid and comprehensive reforms have done the best. The gradual reformers have done poorly. Fears of large declines in living standards as a result of "shock therapy" in Poland and elsewhere in Eastern Europe have not been borne out. Several countries seem to be securely on the path of democratization and reintegration in Western Europe. Russia has proven to be a case unto itself, as yet unable to sustain any coherent economic policy or to implement necessary measures for financial stabilization. Partly as a result of this incoherence, and partly as the result of the lack of a tradition of rule of law, Russian society and the Russian state are victims of massive corruption and criminality, and the resort to mafia-style violence to enforce private agreements.

In East Asia, early reform successes have been somewhat easier, because of the lower level of development, the reduced expectations concerning the role of the state, and the existence of an ample supply of low-cost labor outside of the state sector, which has fueled the growth of China's dynamic non-state economy. Yet in China as well, there are serious clouds over the medium term. As in Russia, the rule of law is weak or non-existent. The political system is increasingly illegitimate and therefore subject to unpredictable developments. And even the limited state sector is imposing heavy fiscal costs that could still ignite an explosive inflation in the future. Therefore, China and other countries in East Asia will have to turn to the more orthodox aspects of reforms that

[7] I have estimated the necessary budgetary support for Russia at around $15 billion per year from the West. As the OECD GDP is on the order of $20 trillion, the Russian aid would amount to 0.075 percent of GDP, that is, less than one-tenth of one percent. Moreover, some of this aid could have come in the form of loans rather than grants.

they have so far avoided in their "two-track" approach: privatization, state-enterprise restructuring and bankruptcy, the promotion of commercial law.

Table 1. Economies in transition: annual growth (%per annum)

	Avg. 1986-89	1990	1991	1992	1993	1994
China	8.7	4.1	7.7	12.8	13.4	11.5
Russia	2.4	-2.0	-9.0	-19.0	-12.0*	
Bulgaria	5.2	-11.6	-22.7	-7.9	-4.2	-1.2
Czech.Rep.	1.6	-3.0	-15.5	-5.0	-0.3	2.3
Hungary	1.4	-4.0	-10.5	-4.6	-2.0	2.5
Poland	2.7	-11.4	-7.7	1.5	4.0	4.4
Romania	-0.9	- 7.1	-15.4	-10.2	1.0	-0.3

Source: 1986-92, Sachs and Woo (1994); 1993-94, United Nations, The World Economy t the Start of 1995, December 1994.

* CIS

Table 2. Indicators of Economic Development

			Employment		
	% Rural	$GDP (PPP), 1991	Ag	Industry	Services
East Asian transition economies					
China	72	2946	73	14	13
Vietnam	80	1250	67	12	21
Laos	80	1760	76	7	17
Eastern Europe and the Former Soviet Union					
Poland	37	4500	27	37	36
Hungary	34	6080	15	31	54
Bulgaria	31	4813	17	38	45
Russia	26	6930	20	46	34
East Asian NICs					
Thailand	72	5270	67	11	22
Malaysia	55	7400	26	28	46
Indonesia	70	2730	56	14	30
Latin American NICs					
Argentina	13	5120	13	34	53
Brazil	23	5240	25	25	47
Mexico	26	7170	23	29	48
Chile	15	7060	19	26	55
Japan (1950)	**62**	**1900**	**48**	**22**	**30**

Source: Human Development Report, 1994, for all data except Japan (1950). Rural population from Paul Bairoch, Cities and Economic Development, University of Chicago, 1988, Table 19.1, p. 302.

Table 3. Social Security Expenditures

	GDP per Capita	Social	Educ.	Health	Total
Developing Countries					
South Asia	1260	0.7	3.4	1.4	5.5
East Asia	3210	3.4	2.8	2.2	8.4
Latin America	5360	3.4	4.2	2.4	10.0
Eastern Europe	5210	14.9	4.8	5.2	24.9
OECD	19000	16.3	4.9	5.9	27.1

Source: World Development Handbook

Table 4. Social Expenditures, 1985-90

	Social Sec.	Educ.	Health	Total
East Asian transition economies				
China	3.4	2.3	2.1	7.8
Vietnam			1.1	
Laos	1.1	1.0		
Eastern Europe and the Former Soviet Union				
Poland	11.5	4.9	5.1	21.5
Hungary	18.2	6.7	6.0	30.9
Bulgaria	15.4	5.4	5.4	26.2
Russia				
East Asian NICs				
Thailand		3.8	1.1	
Malaysia	0.5	6.9	1.3	8.7
Indonesia			0.7	
Latin American NICs				
Argentina			4.2	
Brazil	4.6	4.6	2.8	12.0
Mexico	1.5	4.1	1.6	7.2
Chile	9.9	3.7	3.4	17.0

Source: Human Development Report, 1994

Table 5. Japan Social Expenditures, 1947-1955 (billion Yen)

	Pensions	Transfers	GDP	Pensions (%GDP)	Transfers (%GDP)
1946-50	10[a]	259	11771	0.1[a]	2.2
1951-55	237	1314	34349	0.7	3.8

[a]1947-50

Social expenditure is the sum of Series 2 and 5, Table 2, pp. 71, K. Emi (1978). GNP is Series 1, Table 3, p. 74, K. Emi (1978)

Note: Transfers are the sum of social expenditures of the central and local governments, including pensions.

Source: Emi (1963 and 1978)

Table 6. Distribution of Employment by type of Organization(in percent)

	China			**Russia**	
	1978	***1984***	***1991***	***1985***	***1991***
State enterprise	18.6	17.9	18.3	93.1	86.1
Collective Agriculture	72.0	67.0	63.9	6.0	5.3
Urban collective	5.1	6.7	6.2	na	na
Industrial TVEs	4.3	7.6	10.0	na	na
Private and other	0.0	0.8	1.6	0.9	8.6

Notes: For China, all agricultural activities and non-industrial TVEs are put in the "collective agriculture" category. Source is China Statistical Yearbook 1992.

For Russia, state enterprises included leased state enterprises as well as traditional (pre-1985) consumer cooperatives (mainly in retail distribution). Post-1985 cooperatives are counted in "private and other." For Russia, collective agriculture is *kolkhoz* employment. As discribed in the text, the organization of the kolkhoz sector is virtually indistinguishable from the state-farm sector *(solkhoz)*.

Source: Sachs and Woo, 1994, Table 4, p. 108.

Table 7. An Illustration of the Two-Track Approach and Shock Therapy

	Labor Force	Social Product (1)	State Subsidy (2)	Inflation Tax (3)	Take-Home Pay (1 + 2 - 3)
East Asia:					
Peasant	80	50	0	10	40
State Industry	20	100	50	10	140
Private Industry	0	125	0	10	115
EEFSU:					
Peasant	0	50	0	50	0
State Industry	100	100	50	50	100
Private Industry	0	125	0	50	75
Shock Therapy:					
Peasant	0	50	0	0	50
State Industry	0	100	0	0	100
Private Industry	100	125	0	0	125

Table 8. Social Expenditures, Eastern Europe. % of GDP

	Social Expenditures		***Subsidies***	
	Pre-reform (1989)	Post-reform (1993)	Pre-reform (1989)	Post-reform (1993)
Poland	10.0	21.0	12.9	3.3
Hungary	15.8	22.5	10.7	3.1
Bulgaria	10.4	12.9	15.5	3.9
Czech Republic	13.2	14.6	16.6	na
Russia	14.8	13.1	8.5	12.0

Source: European Bank for Reconstruction and Development, Transition Report, 1994, Table 6.6, p. 87 except for Poland, which is based on national data.

Table 9. Democracy and Per Capita Income. Countries with GDP Per Capita Above $6,000 (PPP)

	Democracy
Barbados	x
Cyprus	x
Korea	x
Uruguay	x
Trinidad and Tobago	x
Chile	x
Singapore	
Venezuela	x
Kuwait	
Mexico	x
Malaysia	x
Bahrain	
Mauritius	x
UAE	
Saudi Arabia	
Oman	
Czech Republic	x
Hungary	x
Malta	x
Portugal	x
Estonia	x
Latvia	x
Russia	x
Belarus	x
Israel	x

[OECD: 23 countries]

x democratic

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