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Reflections on the Role of Institutions on the Chinese Road to a Market Economy ¹

At the onset of transformation there has been a close to consensus view that the market system has no alternative. While this insight has found its place in the current mainstream on development economics, the so-called Washington consensus or post-Washington consensus (Kolodko, 2000, pp.119-141 and pp. 348-356; and Williamson, J, 2000, Srinivasan, T.N.,2000), very few would venture to repeat in an academic writing the once famous dictum of Vaclav Klaus: the third road leads to the third world. Much of western Europe has remained within the framework of the welfare state, despite its obvious limitations. Also in the transforming economies, the rollback of the state has proven to be much less than the tough normative language adopted by early reformers would have indicated. Actually, it is the structure rather than the size of public spending in these countries that may be a source of social and economic strains by providing less than optimal conditions for sustaining economic growth. And even in the United States the Clinton period has not produced an era of `unbridled capitalism'.² Thus the `do what I say, not what I do` policy advice stemming from the international agencies and much of the academe has lost its original appeal. Last but not at all least, the return of the Right in the US and in most of Europe by the first half of the first decade of the 21st century has not produced a free market backlash either in core Atlantic economies or in the transforming countries. Besides creating macroeconomic disequilibria by a combination of tax cuts and expenditure increases, conservative governments of Berlusconi, Bush and Chirac have retained the salient features of the mixed economy models that shape all modern economies of the globe (more on that in Bornstein, ed, 1994; and Bara and Szabo ,eds, 2000). Last but not at all least we are faced with the `Chinese miracle`, with the GDP of China growing by a staggering rate of ten/!/ per cent in the 1990-2001 period, with merchandise exports reaching 262 bn \$ in 2001. This is equivalent, by and large, to that of Canada, and outpaces imports by nearly 20 bn, making China one of the few trade surplus countries in the world. Moreover, with net private capital inflow, *close to 60 bn\$ in 2001*, it makes the country, with 52 per cent of GDP originating from industry very unlike any model of a developing country (sources for all data: *World Development Report 2003*, World Bank, Washington, 2003, p.234, 238,240). Let us note that the slowdown in 2002-2003 still leaves China with a growth rate of 8 per cent, a surplus country and also one ruled by an unreconstructed Communist party (not reformed in the sense of western European Communist or eastern European post-communist parties). In a typical vein, the German weekly *Wirtschaftswoche*, normally close to the business community, devoted a special edition in no.40 (2003) to China, describing it as the largest economy and largest market by the year 2020, outpacing even the USA.

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² The then active participant, and later Nobel Prize winner Stiglitz (2001) positively attributes the success of the Clinton period to the disregard of rigid academic approaches in the policy-making process, primarily, but not exclusively, by FED Chairman Alan Greenspan.

Thus we find *a series of puzzles to be addressed*, especially in view of the expectations, reflected in part in our previous writings, on the rollback of the state and the strengthening of market and ethical forms of co-ordination. This has not happened, although processes of transnationalization, (more in Csaba, 2004, Chapter Three) might well have called for then. From our perspective this is important both from the academic and the policy perspectives. Although puzzling in a number of ways, most importantly *the Chinese experience needs to be explained*. While not writing a monograph on China in this paper we try to survey Chinese experiences with market socialism. In doing so we try to find out what is and is not similar in Chinese market socialism with other forms that used to exist. The big question to be addressed is if and to what extent, *China can serve as an alternative model of development*, as suggested among others by Nolan (1995), thus offering an alternative to the post-Washington consensus.

The puzzle is the sustained success of the Chinese practice, which seems, for many, to have defied (officially and in reality) all theories in the past 25 years. A quarter of a century is certainly a period long enough to deserve analysis *per se*. Furthermore, it does require clarification why it has been so impressive. This leads to a follow-up research question: it is because of market socialism that China succeeds, as one part of the literature holds, or conversely, despite these arrangements? The controversy is important not only because of China being the seventh largest economy of the globe and accounting for one fifth of humankind. From our perspective it also matters, if there could have been a realistic alternative to what we have observed and what many decry as 'market fundamentalism' (e.g. Poznanski, 1999).

Let us be clear from the very outset: it would be a fallacy to mix up the abstract theoretical models of non-market systems developed in the academe over the past 150 years or so, often exclusively out of intellectual curiosity rather than intending any practical application,³ with the policy experience of a limited number of countries in a limited period of time. All the more so, as Balcerowicz (1995, pp 36 and pp. 47-48) observes, the theoretical debates on alternative models of socialism have nowhere immediately and demonstrably influenced the institutional and policy choices of system designers. This applies *a fortiori* for China, where the study of the Hungarian New Economic Mechanism had been elevated to official policy level by the 1980s. However, the collapse of the Hungarian model must have made it clear that copying had inherent limitations, especially across cultures. On the other hand, as the now classic monograph of Kornai (1992 chapter 24) has eloquently proven, the efficiency losses, the motivational weaknesses, lack of innovation and, finally, the collapse of the Soviet model have been intimately related to China's socialist features, in terms of ideology and orientation. Why socialist reforms try to improve what in Kornai's term is genetically deficient, their limited outcome can not and should not be ascribed to coincidental factors, such as the policies of Gorbachev or the geopolitical constraints put by the Empire on local reformers. This analysis, based on empirical and *ex post* analysis, is supportive of earlier abstract insights of Hayek (1940) on the inherent limitations of any such model that wishes to centralize information and switch of capital markets as a major mechanism of resource allocation.

On the other hand, it is hard to overlook the continued strong presence of the undercurrent of third-way thinking in economic theory. Stiglitz (1994) for one, has always been critical of

³ This applies to the famous model of Malinvaud (1967) showing an arithmetically feasible equilibrium solution in the lack of private property. Similarly, Zalai (2001, pp 41-55) shows the Arrow-Debreu model institutionally neutral; and thus, general equilibrium may be attained in market and non-market systems alike.

market triumphalism. Similarly Giddens (1998) and the ensuing theory and policy of New Labor sustains its skeptical overall assessment of the market as the sole coordinating mechanism. As the German and French social democrats put it, while transnationalization requires a yes to market economy, they never condone market society (cf also Szentes, 1999, pp106-108). The survival of the welfare state in western Europe and of state redistribution in transforming economies, coupled with the Chinese experience do require a rethinking of what we should think about the appropriate mix of bureaucratic and market co-ordination, of institutions and policies, in the sense discussed in our chapter Four on Development.

In the following pages we do not attempt the impossible; that is, to offer a critical survey of most of the non-methodological part of economic theory in a single chapter. Allowing for the inevitable pluralism in all big questions of the discipline we try to achieve a more modest goal. Namely to present a summary of evidence, *at the level of models applied in comparative economic systems*, of what is known about market socialist systems in historical perspective, and then address the Chinese experience at the level of stylized facts. In so doing we rely on analyses by other scholars, and do not aim at writing yet another China monograph, or yet another book on Hungarian economic history. Our discussion remains at a more abstract level, while country-specific and time-specific circumstances tend to be abstracted away in order to underscore the systemic, inherent or structural features that lend themselves to generalizations.

Why Marketize Socialism? Salient Features of the Classical Model

Much has been written, not least because of the decades long `plan and market` debates, on the possible role of market co-ordination in a Soviet economic model. In the following we offer a brief schematic rehash of what economics now has to say about the starting point. In so doing we rely on the classical monograph by Janos Kornai (1992a), Balcerowicz (1995) and our previous monograph (Csaba, 1995) and avoid repeating the arguments, presenting the source material and facts available in these. In a way, this is the axiomatic part for the rest of the analysis, knowing that in scientific progress, especially during revolutions, all axioms and paradigms tend to be re-written. Still, a holistic approach does not allow for the analytical rigor required by any single discipline in the social sciences.⁴

Salient Features of the Soviet Model: Poetry and Reality

In the following we present those features that apply to several countries and several periods, over and above historic coincidences. We also try to keep to that which most researchers of comparative economics and area studies would not concur.

1. The system is based on *mono-archy*. In other words, there is no functional differentiation, characteristic of modern and post-modern societies. Ideological representation is merged with functions of governmental administration. Similarly interest representation is merged with party and economic functions. Bureaucratic forms of co-ordination dominate, though do not fully replace, other forms of co-ordination. The `genetic program` of the system is hierarchical subordination and ideological leadership, that sustain change, though both ideologies and forms of subordination.⁵ The defining feature for the economic structure is

⁴ This of course, as stressed before, calls for a multi-disciplinary approach. In my view cross- or inter-disciplinarity is a misnomer, where none of the disciplines is observed, thus the danger of relapsing to storytelling or voicing empty generalities is great.

⁵ For instance in the Brezhnev period great Russian imperial thinking clearly dominated egalitarianism; e.g., nobody was seriously persecuted, let alone executed (even Solzhenitsyn could leave the USSR). Hanson

the uniform/undifferentiated socialist property belonging to `the people,` i.e, to nobody, but managed by the party-state *nomenklatura*. Oppression and command is an organizing principle; incentives, moral suasion and identification with goals do have their place, though only as additional factors. Therefore it is not easy to privatize, to set up joint ventures, for firms to exit, or harden budget constraints, as the hierarchy dominates.

2. *Allocation of resources follows central deliberations, bureaucratic deals/bargains, and ideological postulates, but by no means market or price signals.* This is not a `socialist` or `Russian` feature, as can be observed in the classical east Asian developmental dictatorships as well. Why I find particularly important to underscore this point is that, as known from von Mises (1920, 1976), the existence of capital markets, or their lack, is the defining feature of any market system. If allocation of resources at the macroeconomic level follows bureaucratic rather than market signals, sooner or later the dominance of bureaucratic and political-oppressive forms of co-ordination will prevail. This insight had been amply demonstrated by the re-centralization tendencies of all socialist reforms, as well as the political features of the developmental dictatorships, uncovered during the 1997-99 east Asian crisis. No socialist reform can surpass this point; otherwise they switch `from Marx to market` (Brus and Laski, 1989) became inevitable.
3. *Insulation of domestic processes from those in the global economy is a must.* Let us stress: it is not the volume of foreign trade which really matters, though centrally planned/Soviet type economies tended to trade significantly less than market economies of a similar size and at a similar level of development. This undertrading had, of course, been an additional source of welfare loss, at least in comparative perspective. Still, what really matters for the salient features is that classical socialism is functionally closed. In concrete terms it implies the state monopoly on foreign trade, as well as on currency transactions. It is relatively easy to see that if trade were free, additional currency would just be another commodity, to be purchased and sold at will. Hence `central planning`, i.e bureaucratic hierarchical co-ordination would turn to a farce. If planners chose A, but B is more profitable, people and corporations will arbitrage to circumvent and undermine `scientifically set` policy priorities. In atypical fashion `infant industries` in most, not only in socialist, countries tend to be unprofitable for longer initial periods. Since Soviet type industrialization had been about military might rather than about abstract catching up and improved well-being for the masses, structural priorities actually mattered more than anything else. This resulted in an army being much stronger than the economic might of Russia/Soviet Union, (and also of Yugoslavia or Albania or Vietnam) would have justified.
4. An inevitable by-product of the first three arrangements had been that feature of Soviet model that used to be least understood by outsiders, that is *the passive, subordinate, instrumental role of money*. Money does NOT make the world go round under socialism; it is rather the import license, the plan directive, the bargain with the higher standing authority, or the incorporation of the firm`s priorities in the formal national economic (and supply) plan that really mattered. Thus reported/historic profitability of individual activities and branches did not really matter, either *per se*, or in comparative terms. As a consequence, price liberalization, one of the standard propositions of mainstream economists, was simply missing the point; so did the idea to impute shadow prices.⁶

(2003,p.x) blames this feature for the disintegration of the hierarchic command structures; My own view is that neither sticks nor carrots remained by the time Gorbachev acceded to power in 1985.

⁶ Wilhelm (2003) gives a powerful account of how prime insights and reliable information had been suppressed, even at the CIA, but also at the academe, with reference to the need for academic and methodological rigor.

Therefore, the attempts at re-calculating Soviet GDP at market prices, industriously conducted by mainstream researchers originating from the region, or the big debate of the 70s and 80s over who subsidizes whom in the Soviet trading block Comecon and also within the Soviet economic complex, have often missed the point by taking prices too seriously. There has been a tendency to attribute much more importance to these than they could ever had in reality, which, though psychologically understandable, is still methodologically plainly wrong.⁷ As a consequence much of the ongoing controversy over the size of transition costs, or on the size of actual output decline in the post-Soviet period, covered in Chapter One, is based on shaky footing at best. We certainly are in grave need of quantitative estimates, but what we have is often not more than a guesstimate. If for no other reason, because of major structural changes and their impact on the GDP indicator, long run historical statistics in general and socialist statistics, even recalculated, in particular tend to reflect trends rather than exact magnitudes. This is bad news for the entire profession of economists as well as for historians and quantitatively oriented social scientists as well.

5. As a result, *bureaucratic coordination had been dominant* over all other forms of coordination in all socialist countries in all periods of time, including the reformist periods. This is an important and lasting insight of Janos Kornai's famous book (1980), *Economics of Shortage*, that explained in great detail why concurrent (and still predominant) concepts are incapable of explaining the crux of the matter. For instance, it had been a deep conviction of contemporary economists and policy-makers, that taught plans, over-ambitious catching-up projects, the extreme priority enjoyed by the defense sector and related industries lay at the heart of problems. Also the ideology of overtaking capitalism, the populist promises to let consumption grow in par with investments/needs, and the politically motivated oppression of the rural sectors tended to be invoked. By contrast, Kornai shows that neither the legitimating principle of any socialism, that is central planning, nor policy mistakes, not even 'distorted' prices (whatever this term may mean) may explain the reproduction of shortages: it is systemic. By adopting less extreme policies or more conservative pricing, problems could indeed be alleviated, not, however, solved. The best example for this point is comparing Czechoslovakia to Romania or Poland: the Czecho-Slovak leadership did pay great attention to preserving the coherence of the system and avoiding disequilibria on product markets, or running big external and internal deficits. Therefore, they could preserve power; though the indirect costs of a stagnant economy, in terms of innovation and relative 'competitiveness,' were bigger than elsewhere.

Let us add: bureaucratic coordination alone can not give a full explanation to the question *why such an obviously irrational system, running counter to the basics of any school of economics could survive for so long*. While the prophecy of von Mises on the decay of the socialist system proved fundamentally right, the time horizon he could envisage, a few years rather than decades, has proven wrong.⁸ Besides the crucial role of one-time factors, such as the land and lease agreement during World War Two, or the oil price windfalls of

⁷ I do not doubt the possibility of recalculating pre- and post-Soviet GDP and a trajectory in between. What I do doubt is the methodology in which reported plan prices are taken, by and large, at face value. And there has been a fair degree of politicking in establishing the numbers, wittily exposed by a still unpublished paper of Greskovits (2000) as well as the account of Wilhelm (2003).

⁸ Being a Viennese intellectual of the *fin de siècle* before migrating to Chicago, Ludwig von Mises could not even conceive of the brutality, oppression and cruelty of the regime. Very few people, if any, could have had the Orwellian insights at the time. Even Orwell himself mostly with the benefit of hindsight (after the Spanish civil war). Also, the backwardness of Russian society, not possessing a strong tradition of checks and balances, nor with a strong and organized middle class, had been much better as a training field for Bolshevik ideas and practices, than say France or Spain in the 1930s, or Portugal in the 1970s.

1973 and 1979, the lavish external financing of the 1980s and many other examples, several additional factors need to be mentioned. First, all-encompassing bargaining has though annihilated the *ex ante* coordination claim of the planned economy; however, it did allow for interest articulation and interest representation. Thereby it was softening up the irrationalities and strains stemming from a purely hierarhic system of subordination (a colorful account of this is the bulky volume by Tamas Bauer, 1981). Second, mention should be made of the pivotal role of campaigns, that is politically orchestrated movements, supported by initiatives from below, to attain a few major priorities. Third, the focal role of monetary incentives though denied, especially in the early idealistic period, were widely used (e.g in the form of closed shops open to certain people, such as party bosses or miners). These two, as the large monograph of Soos (1986) has proven, continued to play a major role in the reform Communist periods as well. Lacking these the slowdown of economic performance, readily observable in countries of consolidated Communist rule, such as East Germany, Czechoslovakia or the Soviet Union during the 1980s, had become inevitable and damaging to the continued existence of these regimes.

These and other insights make it clear that the *raison d`etre* of socialism should not be sought in the realm of ideology and self-justification, at least not more than in analyzing the statements of the mentally ill, which also reflect, one way or the other, the real conditions of the patient and the shocks suffered by him. Socialism worked where the power of anti-capitalist postulates, often replaced by (or coupled with) *nationalist and/or imperial ideology*, and the resultant *military needs could dominate* more mundane concerns typical of the `rest of the world`, such as welfare maximization or the search for freedoms. As long as both the anti-capitalist alternative and the military might could be credibly used as legitimating principles, bureaucracy, aided by campaigns, bargains and incentives, could use both the stick and the carrot in managing complex industrial, and in the later phase, post-industrial societies. *When both gradually evaporated, the system collapsed.*

It is most important not to overlook the big *discrepancy between the self-image* propagated by the ideology of socialism and the *realities of the Soviet model*, if for no other reason, because of the lasting influence of the idealized image of the period surviving the system, *inter alia* through the primary sources and the nostalgic views that polish the `good old days`. Implicit in many analyses is the assumption that transition should have delivered all the goodies that the *ancien regime* promised, and many people liked, despite the evidence that these are either non-attainable, or were never produced by the socialist arrangements.

The poetry/self-image part of the system had been based on eight major features: 1. Promotion of equity/equality among members of society at the macro level; 2. The postulate of planned and proportionate development (also called `the basic law of socialism`) postulating, though not delivering, the steady and non-oscillating growth of GDP and well-being; 3. The related claim of *ex ante* regulation of macroeconomic and social processes;⁹ 4. The promise of `surpassing and overtaking the west`, that is catching up, that has nowhere materialized except for China; 5. the evolution of a humane, less brutal/competitive/alienated society than the market system (yet another unfulfilled claim); 6. Social self-management replacing the power of `things over people`, typical of

⁹ This claim has been proven plainly wrong by the cited works of Kornai, (1980) Soos (1986) and Bauer (1981); even if their contemporary counter-claim on the cyclical movement of the socialist economy has proven to be an over-interpretation by the later volume of Mihalyi (1992) and the long empirical study of Schweitzer (/2002).

the market system; 7. A development pattern that is self-contained, thus independent of `harmful` influences of the global economy (that was true in a restricted manner related to being functionally closed); 8. Finally social progress where well-being and human development is superior to those in the west; not exclusively, but also in material terms.

The reality/empirically observed and in the literature extensively documented features of the Soviet model have been the following ones (without again aiming to be exhaustive):

1. The more advanced a country had been, the more deleterious the consequences of applying this model had been. In relative developmental terms it was eastern Germany – the one-time *Mitteldeutschland* – and the Czech Republic that lost the most compared to their relative position in the interwar period. On the other hand, the development in poor countries like Mongolia or Albania had not produced structures that could have allowed for the continuation of this pattern of growth, once the Soviet Union and Yugoslavia disintegrated. In contemporary parlance it was implicitly acknowledged by the calls for `switching from extensive to intensive patterns of growth,` that meant in economic terms the discontinuation of a factor intensive pattern and a call for endogenous growth based on innovation rather than more inputs.
2. Allocation of resources had proven inevitably mistaken; that is, less efficient than in market economies. This is no surprise given the elimination of capital markets, banking and the signalling function of prices. By the same token the secular trend of lagging behind comes as no surprise. In the calculations of Heitger (1990) in the 1950-1985 period the same unit of GDP required an annual *additional* investment of 5-7 percentage points for the socialist economies. Simply adding up the numbers arithmetically, and not allowing for – otherwise major – differences in quality, choice and availability – this feature reflects a built-in tendency of lagging behind market economies. Even if we discount policy mistakes, most openly criticized in many countries also during the Communist period, such as the introduction of orange trees and cotton to Hungary, or the big computer program of Bulgaria, the long term comparative decline cannot to be avoided.
3. Given that the mono-archic system means switching off all feedback mechanism and their subordination to the party-bureaucracy, there is no room for major corrections of – otherwise inevitable – mistakes, either at the macro- or at the micro levels. Especially major corrections run counter to the nature of any bureaucracy; inevitable minor corrections take place in the form of delays, additional costs and other deviations from planned processes. Neither the incentives nor the pressures for change had been imminent, as best illustrated by the Trabant car. This used to be a miracle of technology, introduced as an innovative replacement for the Volkswagen of the 30s, but based on much poorer resources. The car was renewed only twice in its 35 year life span (compared to 5-6 years in contemporary western models). Still a queue of 8-12 years existed in all socialist countries, including the producer East Germany, even as late as 1989.¹⁰
4. What has been said also implies that welfare always and everywhere has been inferior to what otherwise – all other things being equal – could be attainable at the given level of development, with given technology, and under given resource constraints. This

¹⁰ For obvious reasons shortage produces shortages; it was customary to enroll for a new car before the one already ordered arrived in order to overcome the 12 years queue. Thus it is hard to tell, also *ex post*, how big actual shortage had been; lacking this information it is hard to recalculate meaningful equilibrium prices that could deliver retroactive GDP numbers that could be realistic.

follows already from the lack of capital markets and the lack of signaling and incentive function of prices at the microeconomic level. This insight generalizes what is common knowledge of the military sector, namely that in order to attain the same performance, sizable quantitative superiority had been needed (both in terms of manpower and in terms of ammunitions and technology; in terms of European conventional forces that implied a 3:1 ratio in the 1980s).

5. It is a sociological and business commonplace to observe that any bureaucracy is inherently hostile to innovation. The more we believe in neoclassical and/or endogenous growth theories, the more severe this problem we will consider. Innovations are known to matter at least on three planes: in *organization, technology and product levels*. Without wanting to repeat findings of business management literature, each of these can and does pose major problems for the competitiveness of firms. This is the `micro-foundation` of the macroeconomic insight, that the overall hostility to innovation had been a major source of decay of all existing socialist systems known today (not only in Europe, but also in places like Cuba). The comparative performance of split countries (Korea, Germany, for a time Vietnam, but also Hong-Kong and mainland China) leaves no doubt about the weight of this argument. Also, the downfall of the Soviet Empire had been intimately related to its inability to mobilize resources that would have been needed to keep pace with a technology-inspired military program, such as Star War.¹¹ The inability to adjust, technologically and organizationally, to Star Wars had been a major component of Soviet military decline during the 1980s. By the same token lagging behind was inevitably *cumulative*; contrary to some `revisionist` contemporary views, advantageous features of the system could not compensate for its less advantageous sides. The true size of this problem has been uncovered by the still unfinished process of German re-unification,¹² where despite major injections of official and private capital flows, despite the massive presence of western managerial and administrative skills, despite cultural commonalities, and despite a quick integration into a stable monetary framework, catching up came to a halt by 1997. We do not know of any major endogenous success story in large scale East German industry, banking or services, let alone universities and research centers, over the past fifteen years.

Reform Socialist Alternatives

Reforming the system or introducing market socialism instead of the classical Soviet model is defined as an attempt to avoid reconstruction of the machinery, while allowing for, even at a high cost, changing each and every element of it (in a case by case, not by a comprehensive fashion). Reforms are thus always initiated from above, and aim at *preserving rather than transforming* the logic of the socialist system as defined above. In the following we survey major models, alternatives to the Soviet model, that emerged in the course of crises, and as responses to these. Thus we do not know cases where enlightenment or insight, rather than political and economic exigency would have triggered the introduction of these alternatives. In the following we survey the policy alternatives that emerged in various times and countries.

¹¹ Contemporary analysts spoke of *Totruesten* (waging an arms race to death) in describing the Reagan strategy of undermining Soviet economic power through defense spending.

¹² According to the decisions of the *Bundestag* the major transfers to eastern provinces will continue at least until 2014.

Bukharin's New Economic Policy

In this and other subchapters we do not aim at historical accounts, but attempt to distill institutional and policy models from the episodes. Therefore, while historians are likely to continue discussing, for instance, the role of individual personalities, or the exact conditions that triggered given measures, it is unlikely to be disputed that in 1921, following the uprising of Kronstadt, when the base turned against the Bolsheviks, Lenin changed sides from the hard-liners, led by Trotskiy, to the 'doves', led by Bukharin. Following his switch the Bolshevik leadership made allowances for 'petty burgoise elements,' and the peasantry and abolished War Communism. Let us survey the main features/stylized facts of the first emerging market socialist system!¹³

1. *Agriculture has been de-collectivized, though by no means privatized.* One of the first decrees following the Bolshevik takeover was the famous *Dekret o Zeml'e*, the Decree on Land, that has played a symbolic, even ritual role, defining for common people and the party-folk alike what made Soviet Russia different from the rest of the world. Relying on the long standing tradition of communal land ownership, only partially abolished by the land reforms of the 1860s and 90s, the Decree started with the programmatic sentence: Land belongs to the people.¹⁴ While the collective farms, created forcibly by the Bolsheviks in 1918-20 were abolished, private property had not been restored. Only *usus fructus* had been transferred to the peasants (counting for over 90 per cent of contemporary population). In other words, there was no possibility of trading in land, thus no possibility of concentration of ownership and emergence of scale economies, important in some, though by no means all, sectors of agricultural production. Capital accumulation had been severely restrained, among other means, via state regulation of most prices and the need to pay taxes in kind (*prodnalog*) that left little room for major accumulation of wealth. Meanwhile, the incentives to produce (and thereby to overcome imminent famine) did emerge. The state tended to control machine purchases. And from 1924 on procurement prices served industrial accumulation, not enrichment of successful farmers.
2. *Services tended to be liberalized across the board.* This deregulation had been instrumental in bringing about some reconstruction in a country still in war, in some places as late as 1927, from 1914 on. Mobilization of Hayekian decentralised knowledge did bring results in reconstructing the cities and trade. Services and petty business had been wide spread, from repairing shoes to prostitution, and the word *nepman*, denoting a wheeling-dealing person found a lasting place in Russian vocabulary. The novels of Ilf and Petrov, primarily the *Golden Calf*, as well as many other literary examples, give vivid illustrations of how a bustling society emerged in a spontaneous fashion in a very short period of time. This experience, in my view, invalidated from the very outset the concept of *Homo Sovieticus*, once having played an illustrious role in social sciences. The repetition of the same experience in the 1990s, with the emergence of *noviie ruskiie* (new Russians) supports our claim.
3. *Management of state enterprises had been largely decontrolled.* The specific – non-translatable – technical term *khozraschet*¹⁵ described the crux of innovations. While

¹³ This survey is based on Nove (1992, pp39-158); Carr and Davies (1974); Szamuely (1974); Brus (1972) and Balcerowicz (1995), pp.19-141 .

¹⁴ This might explain why land could not be privatized in the entire Yeltsin period. Even Vladimir Putin needed over two years to gain approval from the State Duma for land privatization in June 2002, eleven full years after the collapse of Soviet Communism.

¹⁵ This is a shorthand for *khoziaistvennii raschet*, literally meaning economic accounting. This, however, has little in common with the concept as understood in market economies, where accounting is the financial side of

firms remained in the hands of the state, their management was allowed to take independent decisions on current issues. What is a “current decision” is of course a fluid category, like ‘small matters’ in a marriage, routinely decided by the wife. In the 1921-24 period *khozraschet* stood basically for a harmonious marriage, with no ‘big issues’ emerging as a rule. Given that planning was merely an ideology and mostly a forecasting exercise, and given that no decision to prioritize the military sector existed, on the contrary, reconstruction and improving living standards in the already conquered parts of Russia was the agenda of Bolsheviks. The arrangement worked. It was a code-word for diminishing, on occasion abolishing, direct party control by uncultivated cadres and a return of intellectuals – engineers and accountants – to overseeing the process of production. Small business also flourished, improving supply-demand relations and overcoming bottlenecks. Profits were taxed, but part of them could be retained, and depreciation was reintroduced. The financial foundations of firms reemerged. The blossoming of private and uncontrolled, centrally non-directed activities had ‘over-shot’ insofar as party loyalists immediately started to question the type of socialism the NEP produced. The ideological backlash was followed by a political one (neatly documented in Nove, 1992, pp. 133-158), since the two logics obviously clashed.

4. *In foreign trade* the practice of extending *concessions to foreigners and previous owners* was the name of the game. These, relying on their knowledge and contacts, could re-establish, basically from scratch, foreign trade contacts disorganized by the world and civil wars and the ensuing chaos. Specialized knowledge, capital and contacts were found. This contributed significantly to the overcoming of bottlenecks created by war and War Communism, as well as the international isolation of Soviet Russia and the non-convertibility of the ruble. Concession, similarly to land reform, implied the transfer of *usus fructus* only, and even that for a limited period of time. This arrangement was viable as long as no central planning and industrialization, as defined from 1927-29 existed;¹⁶ thus the option was deemed/and could only be/ a temporary concession (a form Lenin used to describe the entire NEP policy). The state control over foreign trade, as well as over land, and over long-term issues, such as concentration and capital accumulation had been preserved all across the period.
5. *Investments were to be centralized, but central investment accounted only for a fraction of overall investments.* This had been inevitable as long as reconstruction and fighting famine, rather than the later introduced industrialization priorities were put on the agenda. However, similarly to any mixed economy, the borderline between central and decentral, between investment and current expenditure remained fluid and thus politically and bureaucratically contestable. The contest actually started from the very outset, with the left wing opposition declaring the NEP “treason.” Bureaucracy and party bosses also felt immediately their loss of importance and control. A consequence of the NEP was generally seen in party circles (not among the population) as a step back. While the population saw these as a compromise with reality, and an attempt to introduce a modicum of rationality, leaders saw it the other way round. The conflict had been built in, from the very outset, due to the clash of two conflicting logics.
6. The outcome of *the clash of two logics* could hardly be questionable as long as the Bolsheviks managed to consolidate their power, both within the boundaries of what

business administration. The Soviet term implied the ideological turning away from the Marxian concept of a fully non-monetized, only commodity-based economy, that proved unworkable in 1918-20 and was seen to be at the root of economic ills by Bukharin, the chief ideologue of the time. More in (Szamuely, 1974).

¹⁶ How industrialization was defined is the subject of the two volumes by Carr and Davies (1974) and Carr (1976).

remained of the Tsarist Empire and internationally, following the separate deal with Germany at Rapallo in 1922. Once the economy recovered and the opposition crushed, the ideological faithful, supported by the very traditional power logic, i.e., of trying to regain what had been lost in terms of territories and influence in the period after World War One, took over. From the systemic perspective, and with the benefit of hindsight, there can be no doubt that the change had hardly been coincidental, attributable to ideological or personal factors, or the need to overcome backwardness (usually invoked in contemporary and later political science and history works). Once the almighty, uncontested bureaucratic-political center could be established, its need to switch off all possible feedback or forces of protest could easily dominate other considerations. Once the priorities of industrialization and military build-up had been established, the death sentence of the NEP was passed. More importantly, one does not need these priorities to get market reforms rolled back. As evidenced in the economic reforms of Poland in the 1980s and of Czechoslovakia in the 1967-71 period, *once the uncontested power of the Communist party emerges*, and the power of bureaucracy by and large consolidated, *reversion of market reforms is a practicality*, irrespective of an all-out political *demarche* or the lack of it. This insight is supported by the Hungarian experience to be discussed below. Whether intentionally or not, the New Economic Policy has not proven to be that major ideological re-assessment market socialists later attributed to it (Szamuely, 1974; Brus, 1972).¹⁷ Instead, what Kornai (1992b, chapter 15.3) later termed `the genetic program of the system` prevailed.

The Yugoslav Model: Decentralization and Self-Management

The second market socialist model that had been in existence over a long period of time¹⁸ emerged in Yugoslavia. Similarly to the NEP in Russia the arrangement never related in any form to the debates on market socialism, conducted with great fervor in the 1920-1948 period in western academe, having produced some interesting theoretical and methodological insights.¹⁹ In fact, Marhsall Tito as a fully fledged contemporary Communist, acknowledged Soviet practice as the only feasible, only possible, only acceptable model that each country needed to emulate. While this insight followed from the over-centralized and uniform nature of the Cominform/ Comintern, the international movement of Communist parties, actually a side-condition for anybody to survive the great purges of 1937-38, or remain committed to the idea outside Soviet Russia. Therefore, relying on his homegrown guerilla army, delivering the victory against Fascism, and not allowing for the free organization of non-Communist parties and free elections in the postwar period, building socialism in Yugoslavia started already, by and large, in 1945. This included large-scale nationalization, attempts to organize collective farms, persecution of non-Communists, limitation of civil society, brutal oppression of Croat

¹⁷ It is hard to judge the intentions of Nikolai Bukharin with retrospect; what we know of other reform Communists, like Imre Nagy, Lubomir Strougal, or Wladyslaw Gomulka, does not give much ground for hope.

¹⁸ Yugoslav economists at the time and external analysts have been divided over the time limits: some put the Yugoslav model already to 1952; others, more convincingly, to 1965 (when a second, radical phase was introduced); the final stage should be put to 1989/90, with the Markovic Government attempting to impose reforms far beyond any conceivable limits to market socialism. In a contemporary lucid account Szegvari (1991) highlights this point in terms of the convertibility projects and criticized these as being unfeasible and incoherent with contemporary systemic options. This criticism of course applied to all those projects that aimed (implicitly at least) at transforming rather than reforming market socialism.

¹⁹ These include the limits to centralization, the focal role of information, the relevance of mathematical methods for planning and many others.

and Hungarian nationalities for non-compliance (collective responsibility principles) etc. These measures were hardly extraordinary in any way if seen in the context of contemporary Soviet domestic practices, or later east European experience. However, at the time when Stalin, still constrained by Yalta, and hoping to consolidate the government position of Communist parties in the west of the continent, played `people`s democracies` in the region, with multiparty system, private property and avoiding the all-out (not the gradual) elimination of all non-Communist forces. It gets too easily forgotten, that originally, and particularly in 1945-47 *Tito tended to be a left wing extremist*, not a right wing `revisionist,` customarily portrayed in later periods.

This was the period when his conflict with Stalin and Russia started. It was idiosyncratic to emulate domestic Soviet practices when Stalin had a different shop-window, and potentially also a different strategy in the context of his continental strategy of regaining Russian influence lost after 1918-22. The attempts by Tito and the equally influential Bulgarian leader Dimitrov to form a customs union that would have covered Albania, and if Communists won the civil war, also Greece, was to obviously challenge the imperial nature of Soviet power. The split was been inevitable. Since Yugoslavia was seen in the west as yet another Communist country by 1948, the split seemed lethal.

In order to find an answer, the domestically based (not externally imposed) *Tito regime was forced to innovate: a new socialist model, not a copy of the Soviet one but* one that addressed some of the peculiarities of Yugoslavia. This happened via a series of experimental steps and reached full maturity by the reforms of 1965.

Since we do not present a country study, let us just sum up the salient features of this model, disregarding the history and the detail of its emergence. The model, let us recall, had not relied on theories of socialism or self-management, as developed in the west, such as co-operatives, co-decision or kibbutzim. It emerged via trials and errors, based on the local experiences (and outcomes of power fights among) the Yugoslav Communists.²⁰ Let us list the major stylized facts in brief!

1. *The party of the Communists ceased to be organized by a nomenklatura*, i.e. a central list of cadres and competence, but was reorganized on a territorial principle. This was a major must in terms of defense (actually a similar option explained the long resistance of Khmer Rouge in Cambodia against the Vietnamese invasion of 1978). Modern industrial organization theory approves the insight that short hierarchies are more efficient in managing decentralized systems by saving information and mobilizing local knowledge. It also allowed for accounting for the ethnic diversity of the country, where Croatia and Macedonia seceded during the Second World War. As Serbs accounted only for forty per cent of the population, this arrangement was of immense support. Furthermore, and equally radically, the League of Communists ceased to exert immediate petty control over firm management, customary in the Soviet model. Former partisans happened to contain considerable influence. This was, however, a far cry from the feudal dependencies of the Soviet brand. Finally kolkhozes, that were at the root of chronic inefficiency across the entire Soviet period, were abolished. Thereby self-sufficiency in foodstuffs, a major priority all across Europe in the postwar period, could be attained (while Soviets had to import fodder and grain continuously from 1963 onwards). Allowing for small shops and other forms of `petty capitalism` gradually turned Yugoslavia into an envy for the rest of the socialist camp, due to fewer shortages.
2. *Decentralization took two turns: territorial and firm level.* Territorial decentralization implied, that contrary to Soviet or contemporary Czechoslovak practice, member republics have not been relegated to a shadow life. Over time, local ministries of finance,

²⁰ The following account is based on Soos (1986), Mencinger (1991), Tyson/ (980), Gligorov (1998_ Uvalic (1992) Saks (1994); Burkett (1994).

local planning boards, local party organizations, and generally speaking, local leaders gained in importance. The influence of Belgrade tended to lessen to issues of defense and security, although in the latter case ideological intolerance had been bigger and more lasting than in many other Communist countries.²¹ The conflict between Belgrade and Zagreb, Belgrade and Ljubljana, Belgrade and Pristina or Novi Sad enjoyed high publicity all across the Yugoslav period after 1965.

At the firm level two major innovations happened. First, with the abolition of Soviet type central planning the operational independence of managers – referred to as *khozraschet* in the Russian subsection – had been granted without much controversy. Furthermore, self-management of workers was introduced. This was motivated, again, more by military than economic concerns. A firm owned by workers is harder to overturn. From the incentive side, if ‘the firm belongs to you, you build it for yourself,’ then identification with the regime can be more immediate, since this translates into job security, which had a high priority following the unemployment of the inter-war period. Though self-management in the sense known from co-operatives or kibbutzim has been largely formal, the arrangement created a peculiar system. For insiders, identification with the firm and maximization of wages turned into a reality. On the other hand newcomers could easily find themselves without jobs, already from the 60s. Also resource allocation had been severely distorted by the incentives to invest in one’s ‘own’ company rather than in a most profitable use; or in one’s own republic, rather than searching for the nationally or globally most interesting options. This explains why despite high investment rates Yugoslavia showed signs of loss of competitiveness and market shares from the early 1970s on.

3. Yugoslavia was a more open economy and society than the other Communist countries. Nevertheless, *functional closedness remained*. Foreign trade was dominated by socialist firms. Trade was transacted in a variety of ways, thus shortages were milder. However exchange rate policies remained subordinated to central deliberation and the financial system suppressed. Investment priorities never followed market signals – this is why each republic had its own oil refinery by the mid-1980s. On the other hand, external relations had been helpful in overcoming some of the typical weaknesses of the Yugoslav system. Unemployment, which exceeded contemporary west European levels, could be alleviated by exporting these people as guest workers to the welfare states of Europe, where they could even earn money for starting up their own business when returning home. The large scale movement of people thus helped remedy the otherwise prohibitive costs of an insider dominated arrangement.²² Regular devaluation helped to inflate away excessive wages and stimulate exports, including revenues from tourism (an important source since the 1960s).

4. It follows from the above that, contrary to the classical Soviet model, where price stability was given,²³ *in the Yugoslav model inflation was built-in phenomenon*. The leadership soon understood the advantages of moderately inflationary policies as devices that alleviate strains. Contemporary adversaries tended to overplay the relevance of this

²¹ Glirgorov (1998 pp. 350-351) blames Yugoslavs for having taken their home made self-management ideology too seriously for too long, also in the 1980s, thus incapacitating themselves for preparations to a capitalist order.

²² Madzar/2000, p.358-362/ ascribes to the survival of this feature most of the inefficiencies of all Serbian reforms of the 1990s.

²³ As prices were mere accounting units, keeping them stable helped the technology of planning immensely. It had also been elevated to the level of political accomplishments, especially in periods when this stability could be contrasted with inflation in the west. The shortage component was either denied, or as later, its relevance played down/similarly to issues of choice, quality and innovation/

feature until the 1980s, when other socialist countries started to emulate it. As inflation helps sustain existing structures, and this was precisely the aim, the option was coherent with the model. Meanwhile it is hard to overlook that the soft, inconvertible currency equals the non-relevant, passive money, discussed in the case of classical Soviet model.

5. As could be expected, *the two logics defining the system were in lasting conflict*. The bureaucratic logic, supported by power interests of Belgrade, called for regular reversals, most intensively in 1971, in 1984 and in 1990. In each of these cases the primacy of politics, so openly formulated by Lenin, could be observed. In the period under Tito, the army and secret police – the backbone of the regime – were efficient, and centralization could be reestablished. In 1990, by contrast, when differences turned into major inter-ethnic economic, political and cultural differences, these culminated in the disintegration of both Yugoslavia and the economic system. We have already addressed the diversity among the successor states that also reflects their economic systems, with Slovenia being an EU member and net contributor, and Kosovo being still a quasi-state where subsistence and mafia activities help avoiding famine. It seems that the external conditioning of both Yugoslavia and the self-management system played a usually underestimated role in sustaining the market socialist arrangement over decades.

The Hungarian Alternative²⁴ - the New Economic Mechanism

To put a long story short, initial conditions for socialism in Hungary were the *opposite to everything listed in the case of Yugoslavia*. Hungary experienced partly free multiparty elections in 1945, with the Smallholders` Party, integrating all major non-socialist forces, attaining 57 per cent of the vote. This was a clear message on the limitations, speed and forms of introducing a regime loyal to the Soviet Union. Hungarian Communists never got more than 22 per cent of the vote (in 1948, when all major competitors have already been marginalized with the help of Soviet troops). This prompted the Rakosi leadership to adopt an overzealous pro-Soviet stance, trying to imitate even those features of Stalin`s rule that were obviously at odds with Hungarian realities. These included building up a strong defense industry, aiming at self-sufficiency, or introducing ideological and lifestyle uniformity. Introducing the crude Soviet methods in an already urbanized and industrialized country was counterproductive, also from the regime`s perspective. This is why immediately following the change in Soviet leadership in 1953 a large-scale experimentation with reforms started. The loss of political control, partly triggered by the open contest between the two major factions of the Communist Party, and partly by the ever growing popular dissatisfaction with the regime, culminated in the revolution of 1956. This was crushed by Soviet troops; however, the insight that overdoing Soviet practices might harm the colonial power itself gained acceptance. Khrushchev, inclined to some changes, supported the idea of cautious experimentation, while Janos Kadar, himself a victim of oppressions of the Rakosi group between 1951-55, earnestly believed in the merits of the original reform Communist platform of Imre Nagy (the Communist Prime Minister turned to the leader of the uprising). Thus the ideas and the initiatives have gradually been put in practice, later radicalized when confronted with new challenges.²⁵ In

²⁴ This formulation is borrowed from Tamas Bauer (1983) rightly avoiding the ideology-loaded question if the Hungarian experience could and should qualify as a model, while stressing its basic dissimilarity to Soviet model.

²⁵ Libraries have been produced on this process. The best monographic account is still Berend (1990), drawing on a large number of unpublished sources and archive materials. For a more critical assessment and literature survey, covering the bulk of English language sources and current evaluation of projects of Kornai (1986), Szamuely and Csaba (1998) and Csaba (2002).

the following we follow the previous practice and list stylized facts only (the reader interested in bits and pieces should consult the references given above under 22). It is important to recall, that most Hungarian actors were ignorant of the debates on market socialism, definitely in the 1957 period, when the Commission of Economic Experts, headed by the non-Marxian Professor Istvan Varga elaborated the original model. Later, especially in the 70s and 80s, the point of reference tended to be the mainstream policy literature rather than specifically socialist authors.

1. Reacting to the supply crisis of the 50s *the kolkhoz system was given up*. This implied the abolition of compulsory deliveries (kept both in the NEP and in China, to be discussed below). Khozraschet was introduced, but in 1959-62 agriculture had to be collectivized, in line with the decision of Moscow wanting to avoid an open clash with China, and in line with all satellite countries except Poland. However, Hungarian collective farms, from the mid-60s on, never resembled their Soviet counterparts. The scope of obligatory targets was limited. More importantly former rich farmers/kulaks were integrated, often in leading positions to the co-ops. Their auxiliary – non-farming – activities flourished and had become a hotbed for petty capitalism, capitalizing on tax benefits supporting the farm sector. By the late 80s a typical co-op earned over 80 per cent of its profits from such activities. This helped the structural change from first to tertiary sector. It also explained why there had been no food shortages in Hungary, a circumstance openly envied by other Communist countries. It contributed to the first priority of the Kadar regime, to sustain peace domestically.
2. *The New Economic Mechanism proper was introduced in 1968* and implied the *abolition of command planning*. Not only the numerous obligatory plan targets were abolished (this freed the output side of firms), but also the more controversial input side was freed, by giving up the centralized supply system. The latter measure was introduced in Russia only by the outgoing government of Yegor Gaidar in September, clearly indicating how important this arrangement is for centralized control. Once freed – or delivered to the mercy of circumstances, as contemporary managers felt – corporate bosses ceased to be party appointed political supervisors: they turned into businessmen by default. They and nobody else were held responsible for supply bottlenecks, shortages, quality problems and the rest; all vividly exposed by a press, whose freedom was largely constrained to criticizing such economic mal-practices. In systemic terms these moves equalled a decentralization without property reform (a controversial move per se). What is beyond doubt is that it changed the system fundamentally by modifying the rules of the game; when external constraints triggered a return to command practices, these immediately translated into enhanced bargaining and efficiency losses, reminding the leadership of the limitations of its power (Antal, 1983).
3. The debt crisis of 1981-82, largely brought about by spillover effects from declaring martial law in Poland, also triggered another wave of liberalization. This time the *irregular economy* was freed up, with all the ensuing consequences. On the one hand, people were openly told to rely on themselves, rather than expecting anything from `Daddy State`. Entrepreneurships of various sorts flourished, long working hours and/or taking up second and third jobs have become the norm. In the social sphere much of what other countries would experience in the transition period had already started. These resulted in a sizable supply response, since prices were partially freed up. Money started to matter. On the other hand, these `socialist enterpreneurships` carried a series of socialist features. For one, relying on public assets to create private profit became the norm. Similarly, the typical behavior of eschewing rather than abiding by rules developed, which is also not an asset for a market economy based on the rule of law. Transparency of the

system, especially in economic matters, further diminished. Enterprising abilities that are oriented at finding loopholes and cheating are hardly the ideal training ground for civilized market behavior.

4. Analysts developed a second, more radical market socialist reform by 1983. However, the leadership rejected most of its substance and chose to rely on external funding. Still, a part of reforms were introduced in the 1984-87 period. Most importantly, *enterprise councils* were elected, thus managers became legitimate and even *quasi-owners of assets* (with pluses and minuses of the Yugoslav syndrome). In the following years firms were corporatized. A (soft) bankruptcy law stipulating exit was in force from August 1986. The two tier banking system emerged in 1987. All this laid the foundations for a real market economy, by creating some of its legal and institutional infrastructure, and by supporting social learning.
5. Finally, in order to avoid open crisis, from 1989 the government introduced a three year program of *liberalization and external opening*. This abolished restrictions of various sorts, abolished the state monopoly on foreign trade and currency transactions, abolished price and wage controls in most of the economy. The stock exchange was recreated. Spontaneous privatization started, FDI surged. In short, the switch from a socialist to a customary market economy was smooth, initiated by the outgoing and completed by the incoming government, between 1989-92.²⁶

In a way, the lesson has again been the same: as long as the central bureaucratic power of the Communist party, this time supported by and integrated in the Soviet imperial system remained intact, the socialist features of reforms constrained their market character. With the decline of economic performance market features strengthened. Left on their own, later even supported by the enlightened part of the ruling class, preparing its place in the new regime, evolution of market forces took a turn and abolished the socialist features of the market economy. The Hungarian experience, similarly to the other two cases, have proven, as a mirror image, the consistency of the Soviet model and the vulnerability of the mixed market socialist model. The latter *required special circumstances to be sustained*, which is not the case with the market order.

The Chinese Model

China watchers tend to be split into two camps. In one we find traditional area specialists, with a focus on language and culture, obviously stressing the peculiarity of the field of their study, and not allowing for any serious comparisons, not even for analytical purposes. In the other camp we find international policy makers and global analysts, who base their judgements on a few selected indicators and especially on officially reported figures —a practice by definition quite dangerous in any Communist ruled country. The commonality of both camps is the tendency to *oversee those features of Chinese market socialism that may be comparable to other similar models*. Therefore, we first offer the stylized facts as a preliminary to our more extended discussion of China as a developmental alternative. It is hard to overlook that many institutional innovations that emerged in China bear great resemblance in substantive features with those observed in other market socialist models. The fact that Chinese policymakers have often been ignorant of these, which applies to many Chinese researchers and China watchers as well, is not a paradox. As we have seen, this has always been the case with socialist reformers. Nevertheless, a comparison may be useful, for analytical purposes as well.

²⁶ This point, of course, has always been controversial. I tried to offer a detailed documentation in a contemporary article (Csaba,1992), confronting my point with concurring views.

1. First and foremost Chinese reforms also *followed the pragmatic path of others*: when confronted with a deep crisis threatening the base of Communist rule, the rigid ideological stance changes and flexibility is shown. But it does have its limits. In China, the four modernizations of Deng, declared in 1979, his famous dictum `it does not matter if the cat is black or white, what matter if it catches the mouse` is the one side. The slaughter on the Tienanmen Square in June 1989, setting clear limits to democratization is the other side of the same coin.

Since the `Cultural Revolution` *disintegrated not only party and state structures*, but also supply chains, and famine proved real, not just a threat, for the most populous country of the globe, the challenge was indeed comparable to that faced by the Bolsheviks in 1920. Therefore it is hardly surprising that the ideas developed for addressing the same issues also bore great resemblance: the *de facto de-collectivization of agriculture*, without, however, fully fledged deregulation or *without the creation of private property rights for land* and allowing for the ensuing trade in land and fixed assets. Also quite in line with the long forgotten NEP, petty capitalism was tolerated in the cities, as a kind of bridging solution, helping overcome shortages, especially for daily necessities in both commodities and services. It is unsurprising to see that the rulers profit from petty capitalism, from the overcoming of shortages and the improvement of living conditions. Contrary to ideological fears, *the leading role of the party only strengthened* from these changes, similarly to all other observed cases.

Unlike Russia, China had not adopted a vigorous industrialization policy that follows centrally set priorities and primarily focused on the defense sector. Also Chinese leaders never aimed at diminishing dependence on the outside world, as various anti-capitalist schools of import substitution would have advised them. At the same time the leadership adopted a *conservative, mercantilist stance*, not allowing for the so-called `modernization deficits`, approved by most theories of industrialization catch-up. Rather they opted for the mercantilist view, seeing trade and finance surpluses as a guarantee against potential external crises.

2. Second, it is important to see *decentralized resource allocation* as a major difference of the Chinese model from its Soviet counterpart. In Soviet Russia the major aim was to recreate the central state. In China, in line with several millenia of tradition, a strong omnipresent central state has not been seen as a precondition of the power structures to survive. On the contrary, decentralization has been seen as a way of sharing burdens and responsibility. The Chinese state, according to the World development Report 2003 (op.cit.p.234) collects spends only 12 per cent of GDP, a number comparable to European states of the Middle Ages rather than the Soviet Union. Therefore, central taxes need not be high. Municipal budgets and taxes are, of course higher; but being a developing country China does not operate an extended welfare state thus does not need to levy all the public dues that such a model requires. Allocation is thus not in the hand of the central bureaucracy, but in the hands of local bureaucracies. Likewise, as Herman-Pilath (1994) explains, the role of the Chinese cultural community transgressing all state borders has been pivotal. From this it follows that the `genetic program of the system` is modified, problems arising from big centralized projects do not show up. By contrast, problems of lack of central coordination do emerge, as the deepening urbanization crisis, regular blackouts, or seasonal floods indicate.

3. China is often mistaken for an open and *export led* economy. This surely is *not the case in the sense postulated by the theory of open economy and outward orientation* (Balassa, 1993). Though China does export a lot (as we have seen, on par with Canada in dollar

terms),, the equal treatment of exporting and import substituting industries, or more importantly, the influence of price signals on investment decisions is not given at all. As long as development theory does not equate outward orientation with export promotion, the regular surplus in the Chinese trade balance cannot qualify as a sign of the latter. Rather we see the insulating and filtering role of centralized trade regime and centralized currency management, that lead to the inconvertibility of the yuan. In a nutshell, while China opened itself up in microeconomic terms, it remained a closed economy in macroeconomic terms. The big question is, of course, to what extent joining the WTO in 2002 is likely to change the overall landscape. Conditions of China`s joining prescribe a gradual liberalization and proscribe the continuation of command economy, i.e., bureaucratic practices, that used to ensure the surpluses in the Chinese current account.²⁷ It remains to be seen to what extent the WTO has the implementing and surveillance capacity to assist and monitor liberalization; in the case of Hungary, similar hopes were frustrated from 1973 until the Communist system crumbled in 1989. Should it work the other way round, liberalization would be lethal to the socialist nature of the Chinese market economy.

4. Since 1984 a *stock exchange has been operating* in Shanghai. In theory, it should have sounded the death knell of socialism; however, it has not been. The reason is simple: the market economy/order is a complex set of institutions, none of which functions in isolation. The stock exchange, as we could learn more recently from the Enron and World Com scandals, requires sound and solid accounting, controlling and auditing practices, otherwise it is turned into a pyramid scheme. Whereas in the USA the scandals were due to mal-practices that were to be remedied by modifications of regulations following the propositions of the Sarabanes Commission, in China `creative accounting` is the name of the game. It is hardly by chance that residents are not allowed to trade in Hong Kong, and non-residents are not allowed to trade in yuan- denominated shares. Lacking bankruptcy regulation, soft banking, and continued Party involvement in business affairs ensure the continuation of soft budget constraints for enterprises. As a result, financial results do not decide death or survival. Moreover these can be manipulated. Therefore the stock exchange can not serve as a major instrument of capital allocation; *it does not even allow for evaluating asset prices*. Thus the stock exchange is more a form of financial gambling than a macroeconomic control device.
5. As an important innovation to comparative economic systems we could learn from China that *bureaucratic co-ordination* does not necessarily equal centralized command and control: *it may well be decentralized*. On its own, this insight emerged already in the late socialist period in Hungary, Russia, Poland and Yugoslavia. However, contemporary analysts tended to ascribe it to the failure and disintegration of the system. By contrast, in China in the quarter of a century following 1979 this has contributed to the preservation of the system by decentralizing problems. On the other hand, empirical analyses (OECD, 2000) have called attention to the problems resulting from this option: the under-provision of public goods, lack of control over management, macroeconomic disequilibria that cannot be covered forever, bankrupt firms whose lack of performance is covered by soft credits, that is bound to show up sooner or later in the books of banks, etc. The `roaming population`, i.e people no longer residing in the villages, but not yet registered in cities, is just the tip of an iceberg, where problems, previously swept under the carpet, surface.
6. Our summary of the salient features of the Chinese system does allow for qualifying it as yet another model of market socialism. On the one hand, the common features of this

²⁷ During the September 2003 visit of US Treasury Secretary Snow to China, as reported by all major business newspapers, local authorities vigorously resisted calls by Mr.Snow to let the yuan float in order to equilibrate the Chinese current account.

arrangement, such as retaining party control and a closed economy, can be seen. On the other hand, *Chinese characteristics, such as the long tradition of decentral control, or the predominantly rural society, allowed for the evolution of solutions different than in eastern Europe.* Furthermore, the sustained economic growth does lend some legitimacy to a non-elected regime, and provides room for manoeuvre in political and economic terms alike. It remains to be seen *if China will prove to be an exception* to the general insight on the non-sustainability of market socialist systems, that is, if a transition to a market can be avoided for long periods.

Is China a Developmental Alternative?

The Chinese experience is very rarely addressed in comparative terms, that is measured against options that prevailed in circumstances that allow for comparisons in space and time. While 25 years of sustained growth is indeed impressive, one should not forget that, for similar periods, following 1921, 1929 or even 1945 *the Soviet economy did register high growth rates.* Official Soviet growth in the post-1929 period is comparable to the numbers reported by China. However, past growth should not be taken as evidence for further growth in the future. All the less so, since growth rates, especially for the long run, cannot be chosen at will, following abstract `optimality` criteria. These result from a complex interaction of factors, leading to slower trend rate of growth in more developed societies (Erds, 1989; Barro, 1997). Still, the forecasts portraying China as Asia`s next giant, the third biggest economy of the globe by 2020 and the like, often are based on mechanistic extrapolation of past growth and an uncritical use of official Chinese statistics (Wu, 2003). Allowing for this approach – widespread though methodologically poorly established – would come close to defying the fundamental insights gained in the past three decades of policy reform (for a concise summary cf. Buiter et al, 1996). China may thus seem a development alternative to the post-Washington consensus, a suggestion frequently evoked in the policy debates on CIS countries (e.g Nolan, 1995), but also in the wider community of development economists. In the following we shall try to address this puzzle, without however venturing a country study. The latter would certainly overstretch the confines of a monograph on emerging Europe, while not addressing the issue would leave the overall argument unduly narrow, torn out of the global context.

Our thesis goes as follows; if accounting for the actual/comparable/ level of development, economic structures and the catch-up potentials inherent therein; and furthermore, if not allowing for statistical manipulation well known from other socialist periods and countries, then there remains nothing truly puzzling about China (cf. also Chow and Lin, 2002). Taking into account the special circumstances that make China different from Russia, the remarkable Chinese growth, that has allowed, among others things, for two peaceful transitions in the top leadership since the death of Deng, *can be explained with the standard theories of development.* Let us list the major factors only, remaining at the level of stylized facts (rather than a country study).

1. For the Soviet Union and also for Russia the central role of state bureaucracy has been formative ever since the period of Peter the Great. Likewise ideological inspiration and legitimation has been vital for the sustaining power structures. By contrast in China ideological legitimation has normally not been comparable, and Mao`s `great proletarian cultural revolution` in 1966-69 crushed the almighty party and state apparatus. In the following period it could never regain its earlier standing, never regain control in the provinces, in the south and in the coastal areas. Ideology itself

tended to be discarded, owing to the destruction and famines brought about by Mao's revolutionary zeal. *This is lastingly modified, though not suspended, the 'genetic program of the system'*, as mono-archic organization could not be re-instituted. Furthermore, the egalitarian Communist ideology has gradually been replaced by a combination of nationalism and greed/materialism, where ends justify means. This had been helpful insofar as the borderlines of what is or is not compatible with socialism could be *continuously re-interpreted* in the course of time. Not aspiring for military power well beyond the economic potential of the country, China could save the priority calling for large-scale and continuous redistribution of resources in favor of the defense sector, and the resultant impoverishment of the rural areas. Certainly, these changes do not turn Chinese villages rich. But where the issue of famine tended to resurface all across the pre-1979 period, the change has been important. On the other hand field work (Chen, Ch. H, 2002, pp. 359-360) has shown only a very partial emergence of what could be called a market for land, and this contributes to the continued low productivity of the sector.

2. Ever since Max Weber, the *'commercial spirit'* has been seen to be at the heart of capitalism as a macro-system. The commercial spirit having been abolished is seen as a major impediment to change in rural Russia, or even in east Germany. By contrast, China conducted lenient policies vis-à-vis small business up until 1958.²⁸ *Only two decades later* the reforms of Deng abolished collective farms, and allowed for petty capitalism along the NEP lines. This policy may well have failed in Russia, *but in China the commercial spirit was alive and well*. I recall a long discussion with a leading Chinese professional in Vienna in 1985, where he insisted on my explaining how the stock market is compatible with socialism. When I turned to technicalities, he stopped me saying: 'Enough, my son, this is what I remember from my youth'. It is easy to generalize, that in trade, services and agriculture, requiring much less sophisticated technical knowledge, survival of the commercial spirit could have been even more vigorous.²⁹ *Therefore, bottom-up evolution of trade and other market forms of exchanges, later more sophisticated transactions, can be relied upon* – a factor obviously hardly replicable in countries of central Asia, for example. It is an interesting – and mostly unsettled – issue in the empirical literature on China if and to what degree market reforms of large -scale industry and farming, and to what extent emergent *de novo* firms account for the vitality of the Chinese economy. Beyond doubt, the latter do play an important role; and from the point of view of long run dynamics of changes, a vital role.
3. *Regions have been largely autonomous*. This is in line with millennia-old Chinese traditions,³⁰ but is at odds with the way we conceptualize a socialist economy while generalizing the Soviet experience. In a way, the idea of competing systems, developed originally by Hayek, has become a reality. Already in the 1970s the radical reforms in Sichuan Province had gone much farther in allowing for market co-ordination and cutting back party tutelage than the national economic system in China allows nowadays. Abolishing ideological taboos was no major sacrifice as long as the *People's Army*, managed from Beijing, *poses a credible threat* to anybody attempting a violent overthrow of the rulers. Meanwhile, as long as no central ideological approval was needed, in backward western provinces stone-age Communist practices

²⁸ The fourth star in the Chinese flag is 'national bourgeoisie,' reflecting the fact that small business were not nationalized in the decade after the Communist victory in 1949.

²⁹ Let us not forget that the business community in most of southeast Asia is ethnically Chinese, cultivating intensive relations with mainland brothers and sisters. Ninety per cent of FDI in China is from overseas Chinese.

³⁰ More on that in the bulky summary of Gernet (2001).

could be continued. Similarly in the northeast, where most military and related industry is located, more centralized and less tolerant forms of management survive until today. Lacking the ideological and imperial component, that requires checking the substance of `the only right way` and its ideological substantiation, allows for the continued *co-existence of various management forms within a single diverse country*. As it is cultural community rather than military power that keeps the nation together, this is a viable, though non-replicable option.

4. Mention should be made of the *special economic zones*, created in the late 70s in coastal areas. In these an off-shore regime is operating, thus `laws of socialism,` in their direct and indirect meaning, have been largely suspended. The blossoming of Shenzhen, itself a tiny village in the mid-70s, is a nice example of trying to emulate Singapore rather than Hong Kong in development terms. While political freedoms continue to be curtailed, economic freedoms are basically observed and public dues remain low. The relevance of these zones is shown by the fact that some calculations attribute no less than 70 per cent of Chinese value creation to them. These also represent the shop-window of China, also for the domestic population. Unsurprisingly there is no free entry for ordinary citizens to these zones. Here the tradeoff between economic and political controls did work.
5. A further feature of Chinese development, highlighted by informed analysts (Sun, L.-X., 1997) is the pivotal role played by *a long continuum of non-state activities that often are by no means private*. This fact is often overlooked in large global comparisons of privatization, also in the ones quoted in Chapter One, where non-state property – de-statization – is automatically counted as part of the private sector. The role of township-village enterprises, managed by locally appointed managers, or the agricultural ventures dealing in part, on fixed prices and set routes, but in part on free prices and free trade channels are cases in point. However, as Xia (2004) explains, even in joint stock form of TVE stocks are non-tradable, thus they may be seen as *a promise, rather than an embodiment of private property rights*. A large part of China watchers attribute the success of China to them. It is hard to measure their performance, and it is equally hard to settle, even in abstract theory, where state property ends and private property begins. More importantly, save for intensive field studies, it is hard to define to what extent these work according to the logic of the market. The two forms mentioned above are, for instance, severely constrained in their ability to accumulate and invest. Consequently they were hard to describe as asset value maximizing ventures in microeconomic terms. But they are obviously not the model bureaucratic units either, caring about public purpose, ideology, or only their own convenience.
6. Mention has already been made of *foreign direct investments* that runs in the range of 40-45 bn \$ a year,³¹ which is ten to twenty times that of Russia, and one of the largest also among developing countries. Since Chinese per capita GDP at the official exchange rate was only 1131\$ in 2001 according to the World Bank, *such a major inflow could substantially influence, even define the pattern of investment allocation*. This is good news if we compare it to the practices of the Soviet model. It is bad news if we consider that non-central allocation implies the involvement of local party bosses, rather than the capital market. Thus some of the most trivial gigantic prestige

³¹ Authors of the World Investment Report 2002 voiced their view that Chinese FDI figures are inflated, basically by including many domestic flows via `round tripping` through Hong Kong. In their estimate inward FDI reached the 40 bn \$ threshold only by 2002 (as reported in: F. Williams: Foreign investment flows set to pick up. *The Financial Times*, 5 Sept 2003). Even so, the magnitude of FDI does remain a macro-economically sizable portion, thus the line of argumentation remains.

projects may be aborted, but other, less gigantic, but equally poorly founded ones may be realized. No economic control over these is exerted, the rule of law and transparency are non-existent. The earlier discussed accounting problems here multiply. Since local banks are at the end of the day in the hands of the local party bosses, the practice of soft credit and rolling over any debt in a major priority investment is a 'given.' These practices have been at the root of collapse of market socialism in Yugoslavia, Poland and Hungary in the 1980s, and this feature should not be so benevolently overlooked as has become customary among China watchers. Generalizing the experience of frontrunners of transition Keren and Ofer (2003, pp254-256) highlight the interconnection of legal infrastructure and foreign bank entry, that may be the final solution. On the one hand, if legal arrangements are inadequate, FDI in the banking sector remains limited. On the other hand, central European experience has shown a strong positive correlation between foreign bank entry and performance of the financial sector. Foreign entry has also helped to upgrade the originally backward financial legislation and improve prudential supervision. This component seems to be entirely missing in China at the time of writing. While the dynamic consequences of this circumstance are clear and call for downward revisions of Chinese growth potential, in the short and medium run this does not necessarily show up in the numbers of economic activity. Therefore it is congruous with our assessment to underscore that hand *the success of Chinese exports is attributable to a large degree to the special zones and FDI flowing therein.*

7. *Fiscal federalism* has been a major feature of Chinese development since the mid-80s. This implies limited central interference in many affairs. This is good news if seen from the point of view of decentralization and independence, both of firms and of regions. On the other hand, as seen in Yugoslavia, Hungary and Yeltsin's Russia, decentralization without responsibility may create trouble for more than one reasons. The responsible conduct of professional fiscal and monetary policy does require central supervision, central implementation powers, and yes, control over lower level organs. Otherwise money creation becomes decentralised and non-controllable, and so does tax collection. The latter may become a problem for the central state as seen in Russia. Moreover, *the inflation and lack of transparency that is covered up in an arbitrary financial system, sooner or later, may explode*, creating a crisis known from the post-World War One period and from the Soviet and Yugoslav disintegration experience of the 1990s. The fact, reported in Xia (2004) that the role of the stock exchange has been diminishing both in absorbing private savings and in financing corporations, due to lack of transparency, lack of enforceable regulation and the resultant series of scandals, is hard not to see as a writing on the wall.
8. In a system dominated by hybrid forms and non-transparency in basically all aspects of the economic system, *contract enforcement is anything but trivial*. Lack of formalization does not allow litigation and court decisions to play a formative role in conflict management. The special Chinese arrangement filling this gap is called *guanxi*, which is the Asian equivalent of private enforcement mechanisms, known in the 19th century US and Italy as mafia. In a recent analysis of this institution Schramm and Taube (2003) highlight the club good character of the arrangement: it works while the number of participants is small. In the Chinese case it means that the *guanxi* have developed into a network of networks, and anybody wishing to be sure of contract enforcement must be a member, otherwise not even high spot prices or bribes may do the job. The above quoted analysis also highlights the inherent reasons why this arrangement is unlikely to be transformed into a formal legal system, despite China's WTO membership. The tradition of avoiding law that is perceived as a tool of state

repression strengthens this likelihood. Thus informalism, a feature known to be a component of laggards, is unlikely to change soon.³²

9. Sustainability of market socialist systems has been questionable from the very outset. We have seen that not only theoretical considerations but empirical evidence has shown their inherent instability; that is, their tendency to regress either into centralized control or to free markets. In the Chinese case the *regionalism defining the overall state structure allows for a long period of uncertainty*, since local power is not directly conditioned by the shape of central state structures, as was the case in Yugoslavia and the Soviet Union. Financial repression did brake out into crisis in east Asia during 1997-99, and has left many casualties. Roaming people in the range of ten per cent of the overall population rarely bode well for public security. And living in a country with one of the worst Gini coefficients also does not pacify many. The urbanization crisis has been a source for discontent in all developing nations.
10. We can only speculate for how long and in what form the centralized Communist power structures, lacking transparency and rule of law, will be compatible with the market forces. *If China does follow its obligations taken up in WTO, if it does make its currency convertible, and does make its capital market (and by implication its accounting practices) transparent, it is unlikely to retain the socialist features of its market economy for long.* The big question is if this change can be peaceful and orderly, or if it will happen via more *revolutionary* ways. One should not forget that China is located in the region where the developmental state emerged and survived for decades. Where it has not, levels way above the current per capita Chinese have been attained. Nor are any of the newly industrialized countries any longer a predominantly rural society, as China remains. Therefore, the long run perspective is likely to differ from the short and medium term view: market socialism is viable in the medium run, even though a comparison to free market Hong Kong speaks for itself (in terms of development alternatives).
11. The question of *the developmental sub-state* needs to be addressed, that is, can the theories generalizing the experience of newly industrializing countries be adopted by Chinese provinces, the major non-market actors of development in the most populous country of the globe. We tend to be sceptical, since the core state does put limits on what is feasible within its limits. The Tienanmen massacre in 1989, or the crushing of the pro-democracy movement in 2002 has already indicated this. Meanwhile the *role of networks and other informal institutions* of the Chinese ethnic community (Hermann-Pillath, 1993) over and above the state looks like a very modern phenomenon, much in line with what we discussed in the chapter on Transnationalization. By the same token these forms may both lend support to the continued existence of an unchanged status quo (while changing structures at the micro-level), and act as lubricants of change *undermine the centralized control structures* both in the economy and society. It is objectively impossible to predict what way the interactions will produce an outcome.
12. Finally, we should address some of the *academic debates on the nature of the Chinese model*. These tend to revolve around the role of competition and hardening of budget constraints. Tian (2002) underscores that the lack of a competitive environment may and does produce situations where public firms outperform their private competitors. His conclusion is that creating competition is a precondition to successful privatization. By contrast Li, Zhang and Li (2000) conclude that the competition on commodity markets, already strongly present, supports managerial, performance-oriented selection and creates a counterweight to bureaucracy. Similarly, the emerging

³² For more on the role of legal system in shaping the nature of the market cf (Kulcsar, 1997).

competition among regions will impose severe constraints on attempts to constrain everything – basically the market – to a single region. Arguing in the same line Cull and Yu (2000) report of the growing role of credit finance and the resultant hardening budget constraints. In the same line Yu (2000) reports on the growing role of meritocracy in setting manager pay basically triggered by the evolution of product markets and competition therein. These changes, however, as the OECD (2000) notes, *fall short of addressing problems of corporate governance, fiscal reforms and overall transparency*. Therefore, what we face is an atypical Janus faced market socialist process, where the internal dynamics of reform moves toward free markets, even though these are a long way off.

13. We have quoted North (2003) highlighting the crucial importance of formal institutions against informal solutions in turning the market, a millennia-old institution, into a modern capitalist institution and the engine of growth. In his theory, it is impersonal contacts' formalization that allow for the locomotive role of accumulation and exchange (a view shared by the late Peter Bauer and others). If this is the case, the continued informalism that has been a defining feature of Chinese institutional system is a paradox. The real paradox, according to this view, is much less that China can grow under Communist rule, but a different one. In our interpretation, *if the market remains a pre-modern institution*, due to its culturally determined mode of functioning, than the spread of market co-ordination should not be equalled with overall modernization. Field work by Whiting (2001) in three provinces seem to indicate that this is indeed the case: informal command structures, often related to the Communist Party matter more than free market considerations of various sort, though the latter, of course, are growing in importance.
14. It might be interesting to test *if lack of formal judicial institutions will constrain growth and property reform in China, and if yes, how*. A recent agnostic paper by Feld and Voigt (2003, esp. pp. 516-518) has indicated that, similarly to central banks, real rather than formal independence of courts matters. Formal independence has been shown to have no effect on growth in a panel of 71 countries. In contrast, real judicial independence has shown favorable results in 57 of these. But his finding is also contingent upon the influence of other economic and institutional factors. This may prompt decision-makers to delay legal reform, which may well backfire by sustaining the unclear status of private property rights and of formalization of impersonal relations. This is precisely the line taken by official reform economists (Gang, F, 2003) that consider the continuation of the process, short of political reforms, and relying on improvisation as the only way open to them. But these are long run constraints; the `unlimited supply of labor` a la Singer and Lewis, still allows for China to grow in a factor intensive manner for a decade at least. The quality of this growth, however, and the move towards real market, may be a different matter. Ahrens (2001, chapter 7), for one, highlights the limits to ad-hoc solutions, especially with the economy and society growing not only in quantity, but turning itself into more complex structures that need finer forms of regulation.

Marketization without modernization might therefore be a shorthand form for the Chinese paradox. As long as we accept that in countries like Bolivia, Moldova, or even Sri Lanka a market economy may and does function without `necessarily` producing social, cultural and other `by-products` of modernity in the sense of Max Weber, this is not so much perplexing. For it is not the mere existence of certain institutions, rather *their quality which is decisive for the long term economic and social outcomes* (Srinivasan, 2004). By

the same token the Chinese paradox is in need of major redefinition against the majority view in the literature.

Concluding Remarks

The jury is still out over the merits and de-merits of Chinese reforms. What we tried to present in this paper is a broad generalization in comparative economic systems, non-country-specific view of analytical economics. Adopting a comparative approach we addressed the Chinese model in terms of market socialism. We have proven the fundamental similarity of this model to other forms of market socialism. We also have highlighted the special circumstances that allow for China to grow with an eclectic system that seems to defy all theories. *But it does not, and existing theories allow for explaining what we observe in empirical terms.*

Success of China in the past three decades seems to have been conditioned by *a series of factors that are not replicable in other countries*. Most importantly the millennia long decentral tradition, the survival of the commercial spirit and the major role of the cross-border cultural community of ethnic Chinese. Meanwhile it is worth calling attention to statistical analyses (Wu, 2003) that call into question much of the official numbers; these also show that *very high factor inputs and non-replicable structural factors* explain the high growth rates (cf the evidence provided in Chow and Liu, 2002). Exactly this had been the case in the Soviet Union in the 1930s, 40s and 50s. Economic theory is quite clear about the limitations of a growth pattern based on high factor inputs only (Easterly and Levine, 2001). Others (Lo, 2001) explain that if accounted properly, the superiority of private property in terms of efficiency can already be proven for China. This seems to be in line with our standard knowledge and thus discount culturalist claims of Chinese exceptionality (as of Russian exceptionality).

Finally, it is time to answer the original question. *There does NOT seem to exist something called the Chinese puzzle* (a finding in the negative) Thus, and in view of the specifics, including level of development and complexity of social structure, the parallel drawn between China and central or eastern Europe seems basically misplaced. Unless falling back to a pre-industrial structure, or developing something comparable to the Chinese cultural community, *no country in transition, and definitely no CIS country can look to the east for a developmental alternative*. By contrast, Chinese reformers can still capitalize a lot from studying mature and overripe socialist reforms in central Europe, as well as the failures of transition. Notwithstanding our theoretical skepticism it is beyond doubt that the way China will settle its problems will be an issue to be watched for decades to come, and not only for the two traditional groups of China watchers, but for academic economists with a comparative orientation as well.

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