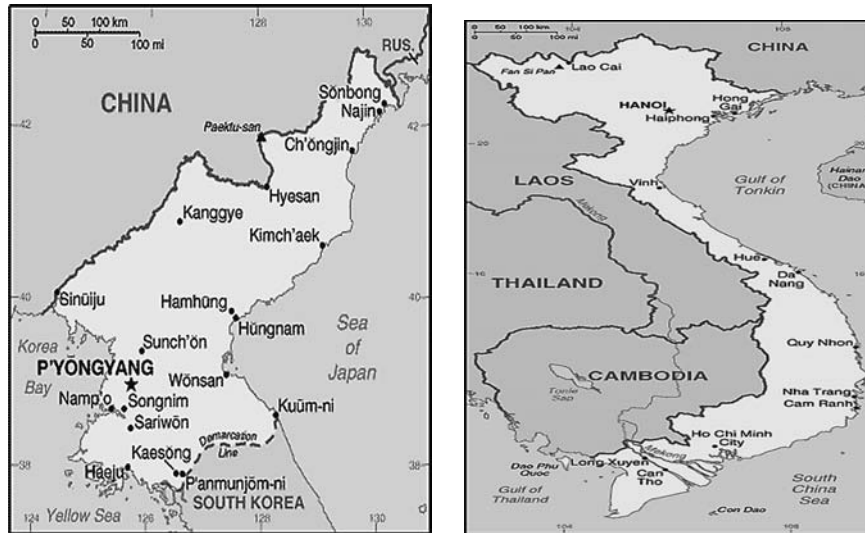


Chapter 1

Introduction: Patterns and Explanations

Asian communist countries demonstrated a different pattern of transition that was characterized by gradual, experimental, phased and partial reform as compared to the former communist countries in Russia and Eastern Europe that were illustrative of a “neoclassical” big bang or radical approach. The debate between shock-therapists and gradualists has dominated professional discussions on transitions from communism throughout the 1990s. On one hand, the proponents of the big bang approach argue for a quick and simultaneous introduction of all reforms. Works by authors in this category include David Lipton and Jeffrey Sachs, Anders Aslund, Andrew Berg and Jeffrey Sachs, Kevin Murphy et al., Jeffrey Sachs, Roman Frydman and Andrzej Rapaczynski, Wing Thye Woo, Jeffrey Sachs and Wing Thye Woo.¹ On the other hand, those who favor a more gradualist approach emphasize the sequencing of multi-stage reforms and the virtues of gradualism. Works by authors in that category include Richard Portes, Ronald McKinnon, Gerard Roland, Mathias Dewatripont and Gerard Roland, John McMillan and Barry Naughton, Peter Murrell, John Litwack and Yingyi Qian, Philippe Aghion and Oliver Jean Blanchard, and Shang-Jin Wei.² The ultimate intellectual difference between the two schools of thought lies in the extent to which each school accepts the validity of neoclassical economics in guiding the economic reforms and each school recognizes the role of political factors in economic policymaking. This difference in faith in neoclassical economics has influenced every debate in economic policy in the 20th century, and the debate between the two schools is unlikely to result in final agreement soon.³

The experience of the early 1990s was that big-bang approaches in Eastern Europe were painful, leading to unexpectedly large and persistent reductions in output growth after the radical departure and transition from state socialism, while gradualist approaches in Asian communist and post-communist states were surprisingly successful, leading to significant accelerations in output growth, except North Korea.⁴ Nonetheless, the North Korean economy has revived in positive growth, particularly since it adopted more open and liberal economic policies since the late 1990s, even though it has been crippled by very unfavorable external conditions and constraints. To provide readers with a visual picture of the five communist and post-communist states in East and Southeast Asia, a map of their relative geographical locations and basic statistics of economic development are presented (see Map 1.1 and Table 1.1).

Map 1.1 China, North Korea, Vietnam, Laos, and Cambodia**Table 1.1 Statistics of five communist/post-communist countries (2005)**

	China	North Korea	Vietnam	Laos	Cambodia
Population	1.3 billion	22.9 million	83.5 million	6.2 million	13.6 million
Country Size	9.6 million sq km	120,540 sq km	329,560 sq km	236,800 sq km	181,040 sq km
Arable Land	15.4 %	20.76 %	19.97 %	3.8 %	20.96 %
GDP (p.p.p)	\$ 7.262 trillion	\$ 40 billion	\$ 227.2 billion	\$ 11.28 billion	\$ 26.99 billion
GDP Per Capita (p.p.p)	\$ 5,600	\$ 1,700	\$ 2,700	\$ 1,900	\$ 2,000
GDP Real Growth Rate	9.1 %	1 %	7.7 %	6 %	5.4 %
Industrial Growth Rate	17.1 %	N/A	16 %	9.7 %	22 %
Exports (f.o.b)	\$ 583.1 billion	\$ 1.2 billion	\$ 23.72 billion	\$ 365 million	\$ 2.3 billion
Imports (f.o.b)	\$ 552.4 billion	\$ 2.1 billion	\$ 26.31 billion	\$ 579 million	\$ 3.1 billion
Military Spending (% GDP)	4.3 %	31.3 %	2.5 %	0.5 %	3 %

Source: CIA World Factbook; Asian Development Bank; World Bank.

However, both theoretical and empirical work “has not established the superiority of one course of reform over another... There are cases where fast and gradual reformers have succeeded and where they have failed.”⁵ Therefore, the debate remains controversial and inconclusive in the literature. To learn some valuable lessons about the choice of reform strategy from the different patterns of transition, it is useful to put the Asian transition in a broader comparative context in which transition has taken place across the two regions. China is often cited as the leading example of a successful gradualist approach to transition from communism. Some smaller Asian communist countries such as Vietnam, Laos, Cambodia, and North Korea have also adopted the similar gradualist approach. The key features of the Chinese model or the gradualist approach were an initial emphasis on agricultural reform and a gradual opening of the previously closed economy.⁶ Asian communist states have by and large followed a similar strategy of transition, which resulted in a similar pattern of transition, which can be compared to the shock-therapist approach in Russia and Eastern Europe (see Table 1.2).

Table 1.2 Comparisons of gradualist and shock-therapist approaches

	<i>Gradualist Approaches</i> ⁷	<i>Shock-therapist Approaches</i> ⁸
Characteristics	An initial emphasis on agricultural reform and a gradual opening of the previously closed economy; Reforms were partial, incremental, and often experimental; caused no initial downturn and avoided declining incomes and high unemployment; made no use of large scale privatization; gradually reformed prices and trade control; maintained exchange controls; and adopted active state industrial policy while maintaining the party-state control	An all-out approach to replacing the traditional central planning economy with a market economy in a single burst of reforms; a rapid, all-out program including as many reforms as possible in the shortest possible time; caused initial economic downturn, declining incomes, and high unemployment; made use of mass privatization of SOEs through voucher or sale-out programs; rapidly lifting state control over the major factors of production and exchange while maintaining minimal macro-economic control
Outcomes	The result of such gradual or incremental changes is that these Asian countries continue to remain Leninist one-party states, embrace an eventual goal of communism, and move toward market socialism	The result of such rapid or radical changes is that Leninist one-party states and centrally planned command economy collapsed in Russia and East Europe and these countries move toward market capitalism

The central question is why these Asian countries adopted a gradualist approach to their transition that was different from their counterparts in Eastern Europe. Some explanations have been offered to address this question. Most of these explanations focused on exogenous economic and political conditions or different economic structures prior to reform in Asian countries that differed from those prevailing in Russia and Eastern Europe.⁹

- Unlike Eastern Europe that was more industrialized and overly specialized in heavy industry, Asian communist countries were predominantly agrarian societies with a huge surplus rural labor force ready to develop some new economic sector to support the old sector.
- The trade shocks due to the collapse of the Council for Mutual Economic Assistance (CMEA) were so enormous that trade within the former Soviet bloc was totally disrupted and a more radical approach to trade liberalization was imperative in these countries unlike in the early stages of Asian transition.
- The decline in the power of the Communist Party in most of Eastern Europe and the former Soviet Union was coupled with the weakening of centralized political control over the economy while the power of the Communist Party was strengthened as a result of economic growth and improvement of living standards in these Asian countries.

From this perspective, the pattern of transition was predetermined by the initial conditions or macroeconomic and structural differences between Eastern Europe and Asia and therefore no real lessons could be learned from the comparative experience of transition from communism. This explanation is well deduced from the structuralist approaches of transition theory.

Structuralist approaches place major emphasis on macro-level social conditions or socioeconomic and cultural prerequisites of transition, particularly the long-term influence of the level of economic development, industrialization, urbanization, education, social structures, political culture, the role of civil society, and other social conditions, because they assume that these macro-socioeconomic conditions can explain the causes, paths, and outcomes of transition.¹⁰

Structuralist approaches help us to understand why the old regime is challenged, threatened, or forced to reform, but can not tell us why and how the elites make the change in one way or another, in other words, why different countries take different approaches to transitions. Social and structural conditions may help to explain the dynamics of social change and transition, but they can hardly explain why different political actors make different choices, why their preferences change and policy choices shift from one to another, and why one choice prevails over another within the same social and structural context. Moreover, fundamentally flawed in these approaches is that the path of transition is predetermined by the initial conditions or macro-level economic and structural differences between Eastern Europe and Asia and therefore no lessons could be learned from comparative experiences. This is really deterministic. While initial conditions are important in determining and explaining *why* reforms are adopted,

elite strategic policy choices best explain *how* reforms have been carried out, because it is elite strategic interactions and policy choices that have played a direct role in shaping the pattern of transition while structural factors an indirect one. Initial conditions, elite policy choices, and the pattern of transition should look like a set of antecedent causal relationships between z, x and y (see Figure 1.1).

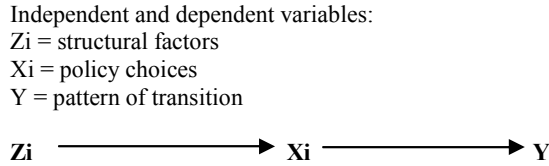


Figure 1.1 Causal relationship between Z, X, and Y

The initial conditions or antecedent causes of transition may differ significantly in different countries. However, these different pre-reform conditions or antecedent causes (such as predominantly agrarian societies, deepening economic recession or trade and financial difficulties) could prompt a common response or policy choice if the communist elite in the different countries shares a common belief in the efficacy of that response or policy choice, for example, the leadership's perception of the necessity for economic growth on one hand and the need for maintenance of communist power and preservation of party-state interests on the other. Just as individuals may take the same medicine to cure different physical problems, these countries may simultaneously choose similar reform policies to cope with different sets of political and economic problems. In this case, the specific antecedent causes (Z_1, Z_2, Z_3, Z_4, Z_5) in different countries prompt the leadership to act on a common set of policy choices, X_i , to produce a similar pattern of transition, Y (see Figure 1.2).

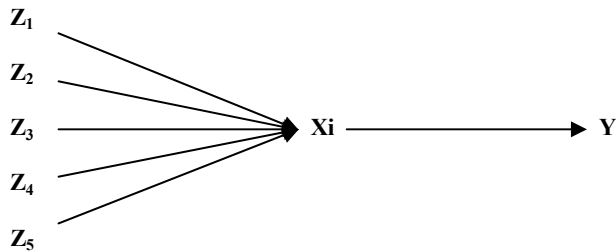


Figure 1.2 Explanation of the pattern of transition

In either case, the choice of similar reform policies, **X**, in coping with their economic and political problems (pre-reform conditions), produces a similar pattern of transition in these countries that is different from that of Eastern Europe. This analytical model of explanation is well deduced from the theoretical approach of strategic choice.

- Strategic choice approaches concentrate on the micro-level critical role of political elites and the interaction of their strategic choices, the splits within the old regime, the compromise or “negotiated agreements” between the “softliners” and “hardliners” on policy choices, and the process of transition.
- Strategic choice approaches emphasize the autonomy of elite strategic choices and political processes rather than the initial conditions and socioeconomic determinants of political and economic change, because elite calculations and preferences, strategic choices, and the interaction between the choices are viewed as decisive in determining paths and outcomes of transition though they do not deny the importance of economic factors.¹¹
- Recent economics literature on the political economy of reform recognizes the critical role of political constraints, such as conflict of political ideologies, political resistance, political support, political acceptability and sustainability, asymmetric information, uncertainty regarding the outcome of reforms and the distribution of gains and losses from reform, in shaping reform strategies and affecting the choice of reform policy. Under these political constraints, it becomes sequentially optimal for the government to begin with partial reforms in some areas or sectors where possible and then extend to other areas or sectors, because gradualist reforms may be easier to get started, avoid excessive cost, especially for the government budget, allow trial and error and mid-course adjustment, reduce political resistance, help reformers gain incremental credibility, and create constituencies for further reforms.¹² The transition process in Asian countries of the last two decades have underscored the importance of the political economy of policy making rather than the initial conditions in understanding the path of transition from communism.

In Asian communist countries, the choice of reform policy has been largely constrained by the leadership’ perception of the necessity for economic growth and the need for maintenance of the communist party’s power and preservation of party-state interests, and therefore it has been the interplay between politics and economics or state and market that has led these Asian countries to adopt gradualist approaches to their reforms. Unlike most of formerly communist states in the Soviet bloc who were clear about their objectives of transition to democracy and market economy, the Chinese leaders and other Asian communist states had neither a clear idea nor consensus about where to go. What they knew was that the traditional centrally planned economy was not working well and that some reforms or policy changes were necessary to promote economic growth while maintaining

the domestic political stability and the hard core of the political system. In China, the famous slogan is “groping for stone to cross river.” China has experienced a lengthy process of readjusting reform objectives from “a planned economy with some market adjustment,” to “a combination of plan and market,” and now to “a socialist market economy.”¹³ In Vietnam and other Asian communist states, the intent of reform was to increase production, improve the living standard, and solve the pressing trade and fiscal problems. Reforms have been introduced piecemeal not only out of caution but also a desire to keep the process under control and maintain the balance between reform, growth and stability. Therefore, economically, these Asian communist countries continue to embrace some principles of socialism and espouse an eventual communism, and politically they remain determinedly Leninist party-states.¹⁴

In the real world, reforming an economy does not necessarily mean replacing an old system with a new system as many people believe. It could mean a developmental change within the general framework of the old system without fundamentally transforming the substance or foundation of the old system. In communist states, reform could mean the process of gradual transition toward some sort of improvement of the old system, from state socialism to market socialism, without creating a new economic system or a truly free market economy as it has been defined by economics theory. It seems that Asian communist countries have followed the logic of this developmental pattern and enjoyed the results of their reforms.

New economic sectors and agents are created, but limited within the political and legal framework defined by the communist party and its ideology, norms, policies, and political need, and many of them are also controlled by the party-state apparatus. These new economic sectors and agents might not be under the direct control of the government, but have to compete with predominant state-owned enterprises or party-state controlled agents. After more than two decades of economic reforms, commercial, labor, real estate, and stock markets have emerged and many other elements of a market economy have come into being in today’s Asian communist and post-communist states. The state has sought new incentive systems or market mechanisms within the traditional sector, state-owned and collective owned, in order to allow its agents to respond more effectively to new competitors and adapt existing institutions to the new economic environment which permits more competition and more efficient markets.¹⁵ The state has also allowed and encouraged new private sectors to emerge and develop, and these sectors have become an increasingly dynamic market force that compete with the traditional sector, state- and collective-owned enterprises for resources and markets. These sectors have even become dominant in some industries and agricultural sectors of the countries under study though the situation may vary from country to country.

How to characterize such reformed economies in East and Southeast Asia? They have obviously moved away from the command economy of state socialism, but the key issue is what direction and how far they have moved toward that direction. This study will compare the Asian transitions to examine and evaluate

the nature and process of economic transition from state socialism¹⁶ in the countries under study. This study will attempt to solve the following questions: What are the pre-transition models of state socialism in Asian? What are the causal variables that have contributed to reform efforts across these Asian countries? Why and how is this reform process different from what happened in Eastern European countries? How are reform policies proposed, adopted, and implemented? How is the reform process in these Asian countries similar to or different from one another? What is the goal of the economic reform? What is the nature of the economic reform? To what extent is the party-state playing a role in the economic reform? What are the trends, directions, and limits of the reform in these Asian countries? Has the economic reform transformed state socialism into market capitalism, state capitalism, or market socialism? With the collapse of communism and state socialism in Eastern Europe and the Soviet Union, is it only the capitalist economic model that remains? Is there another way that is neither capitalist nor state socialism? Or is there a third way for economic development? Can market socialism, a market-based form of socialism within the political context of one-party communist rule become a competitive and efficient economy like market capitalism? To provide a common basis for comparisons of these Asian countries and address these questions, the next chapter will define the pre-reform model of state socialism in these countries in order to establish reference points of departure in order to examine the major factors that have contributed to the choice of reform policies in these Asian countries, determine what has changed and what has not, in kind or in degree, and evaluate the nature of the economic reform and the direction of transition in these political economies.

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