From Equality to Freedom?
Political Economy of Post-Communism
Today’s Agenda

• Taiwan’s developmental success (cont.)
• A brief look at the other “Tigers”
• Late Developers as a test of Theory
Labor Repression
Results: Weathering the Asian Financial Crisis

![Graph showing economic cycles and real effective exchange rates for US, East Asian, and specific countries including Taiwan.](image-url)
The other “Tigers” have gone through a similar process.
Korea
Singapore

Singapore Real GDP
Year-over-Year Percent Change

Year-over-Year Percent Change: Q2 @ -3.7%
Late Developers as a test of theory

• Development in these countries challenge most of our existing theories about development, and they demonstrate the power of some "parts" of the theories, and diminish the power of other "parts" of the theories
…..as a test of dependency theory

• Troublesome because
  – Dependent on the world economy (terms of trade worked in their favor)
  – Developed with massive amounts of Cold War aid
    • Aid was used wisely
    • Military burden carried by American taxpayers
Why Wallerstein would not like the “tigers”

• Their theories are static and the “Tigers” developed dynamically
• They developed with very little income inequality
• Their colonial legacies helped development
But why Gerschenkron would like them.......  

• They conform most to his theory of state-led development and managed markets  
• (They also conform to Keynes’ embedded liberalism—Gerschenkron didn’t really care about income inequality)  
• They show that timing and technology are everything
These countries developed in a “dependent” relationship

• They showed that foreign investment can contribute to development
What will all of this economic development do to repressive governments?

• Can new information technologies lead to more freedom?
Late developers as a test of liberal theory.....

• Undermines generalizations of liberal theory
• These countries had strong, repressive, developmental states
What about the role of culture? “Asian values?”

- Did Asian “culture” make a difference?
- Does Asian culture undermine the Western laissez-faire approach to economic policy?
- Willingness to sacrifice?
- Commitment to community instead of the individual?
- Authoritarian culture?
What is true is.......
From Equality to Freedom?
Political Economy of Post-Communism
A liberal perspective: Only two systems

- Is Kornai right?

**Socialism**
- One (communist) party
- State dominance
- Bureaucratic resource allocation
- Distorted information
- Absence of freedom, misallocation of resources but full employment

**Capitalism**
- Political power disbursed and friendly to market and private property
- Dominance of private property and markets
- Freedom...resources allocated according to supply and demand
- Buyers market, no shortages, unemployment, fluctuations in business cycle
Socialism: Inevitable distortions

• Bottlenecks arose
• Factories improvised
• Found ways to produce critical inputs themselves or bartered directly for them
• So they were self-sufficient conglomerates
• Did not develop comparative advantage
Bartering is inefficient

• Suppliers of industrial goods often demanded consumer goods for their workers in return
• No direct contracts
Kornai: So Capitalism is better because......

- Capitalism is more efficient because prices and free choice determine industrial inputs and outputs.
And Capitalism spurs Technological innovation

- Innovation brings economic growth
- Because new technologies make industries more competitive in the international economy
- Competitiveness spurs exports
- Which bring in income
- So prosperity depends on knowledge-based production
So the logic behind the “Washington Consensus”: policy should move from promoting equality to promoting freedom

• Reduction of extensive government programs because they.......
  – allocate funds to non-productive activities
  – Prevent Entrepreneurs from finding funding for new knowledge-based production
  – Create wrong incentives
Kornai: Capitalism is better, but problems can arise....like unemployment
But Socialism’s chief goal is equality not growth....

• Social equality
• Both political and economic
• Full employment
• And The Soviet Union pursued that goal....
Health Care for All! Wage Equality!
It worked!
Communism was widespread
But Everyone is equally poor under Socialism

• “We pretend to work, they pretend to pay us”

Comparative GDP and Consumption, USSR and USA, 1990.

(USA = 100)

GDP       GDP per capita       Consumption per capita
49         43                   31
“the race between the capitalist and socialist systems would ultimately be decided by which could ensure higher productivity.” --Vlad Lenin
But how to change? A Celebrity Economist vs. a Nobel Prize winner

- Sachs Appeal
- Shock Therapy
- Polish success
- Russian Failure

Jeffrey Sachs
Vs. Joe Stiglitz: We’ve met him before...

• Critic of neo-liberalism
• “Closet” follower of Polanyi
• Still a liberal.....
• But advocates gradualism
• Wants a “new social contract”
Changing from one that enshrined Equality to one that enshrines freedom as its basis.....
Real Live Transitions from Socialism to Capitalism: Russia
Economic Nationalists want Growth which leads to wealth which leads to power...

- Soviet Union: The inefficiencies of Autarky
- Soviet Growth rates fall
- Technology gaps widened and multiplied
- Soviet elites: “Yikes! We are no longer a Great Power!”
So......Velvet Revolutions in the Soviet Union and Eastern Europe: Communist elites turn into Capitalist elites overnight

Vlad Putin, then and now: Is Kornai correct?
And China too......

- Wanted to modernize
- “Socialism with Chinese Characteristics”
- Goal: generate sufficient surplus
- Realized socialism wasn’t working.....
- Tried the “Great Leap Forward”
Not if but how: Which path to capitalism?

OR
Russia chooses Shock Therapy....

- “Washington Consensus”
- Same process as the Bolshevik Revolution
- Utopian social engineering?
- Large cluster of simultaneous changes needed
  - Price liberalization + privatization + elimination of subsidies for industry + anti-monopoly policies + enforcement
Results....Unemployment
Privatization benefitted the Rich and Powerful....and the corrupt

- Crony Capitalism
- Emergency of oligarchs
- Asset stripping
- Capital flight
- Bandit Capitalism
- Protest
- Longing for a return to Communism
Figure 2: Russian Growth and Inequality

Brain Drain
Repression
Russia.... A “One Trick Pony” or a new world economic Power?
China choses Gradualism

- The Chinese got “shock therapy” out of their system
- They learned the hard way
- They chose the path of gradualism
- Ideological pragmatism
- Stiglitz believes they had the wisdom to “know what they didn’t know”
Abandoning Protectionism

- China started entering the international economy after 1978
- Foreign trade decisions were decentralized
- Special economic zones were created
- Volume of foreign trade rose
- And foreign investment flowed in......
The China Price

- Low wage “industrial reserve army”
- Joint ventures
- Technology transfer
- Competition
- Remember the “product cycle?”
Influx of Capital: FDI

China’s Reserves Outgrow China’s Trade Surplus & FDI Inflows

How could China save so much more US$ than it earned?

Annual Increase in FDI + Trade Surplus
Annual Increase in Reserves

Source: Reuters, FactWire
China’s growth
Equality and Inequality in China

Figure 1 – Income inequality in China

- Gray bars: urban to rural income ratio
- Black bars: coastal to inland GDP per capita ratio
- Circles: Gini (unadjusted)
Poverty
Economic growth substitutes for political reform?

• Economic reform as a substitute for political reform?
• Institutional reforms limit the power of the one-party state
• Some of the reforms were......
What did we learn from the Transition experience?

• Both Liberals and Economic Nationalists agree that....

• Growth is ultimately more important than equality.
What about the relationship between markets and democracy?

• The Lesson from Russia
  – Simultaneous introduction of markets and democracy backfired
  – Democracy was weak and illiberal
  – The weak state could not regulate the market
  – Market undermined democracy
  – It takes a strong state to introduce the market

• But why did it work in Poland?
The relationship between markets and democracy

• The Lesson from China
  – Gradual introduction of markets without democracy
  – China followed Gerschenkron: strong state led development
China: State-led development

– Moved from focus on equality to focus on growth
– Started with agriculture
– Lifted rural population out of poverty
– Mandatory planning gradually replaced by markets
– developed without inequality