

INTRODUCTION

Experiences in the Transition to a Market Economy

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A historic experiment to provide different economic, political, and social bases to organize society began in 1917 with the establishment of the communist regime in Russia. Participation, sometimes involuntary, in this grand experiment broadened over time, particularly after World War II. Variants of this experiment existed at different times and in different countries, but all participants shared a common core of practices. The common core of socialist economic policy consisted of:

- public ownership as the dominant mode of exercising property rights;
- central planning as the primary mechanism for resource allocation;
- the industrial sector, particularly the heavy industry component, as the most favored economic sector, and the service sector as the most suppressed sector; and
- the collectivization of agriculture in most cases.

The socialist experiment ended abruptly in Eastern Europe in 1989 and in the Soviet Union in 1991 after years of economic stagnation and, finally, economic decline despite repeated attempts at economic reform. The Chinese response to the failure of the experiment in Eastern Europe and the Soviet Union was the official abandonment of the so-called planned commodity economy in favor of what Chinese leaders termed a socialist market economy with Chinese characteristics. By 1994, the traditional socialist economic program was being implemented only in Cuba and North Korea. The experiment of constructing an alternative social order along these lines is now effectively history.

The collapse of this social experiment has confronted the economics profession with the question of how to convert centrally planned economies to market economies. The answer obviously goes beyond getting the prices right to include getting the institutions right, and, arguably, also beyond economic optimality to include political feasibility. Economists have responded with wide-ranging answers that included new schemes for market socialism, improved forms of syndicalism, Western-style capitalism with social safety nets, and Japanese-style capitalism with cooperation among business groups, banks, and government ministries; see, e.g., Roemer (1991), Ben-Ner (1992), Lipton and Sachs (1990), and Hoshi (1992). However, these disparate views on the desired endpoint of economic reform should not be allowed to obscure the overwhelming consensus among them that marketization and corporatization are absolutely essential for economic efficiency.

Other than this single area of agreement, contentions abound over answers to questions such as:

(1) Is privatization really necessary, at least in the beginning of reforms? See, e.g. Rawski (1992). The issue is whether state-owned enterprises (SOEs) can be induced to match their private counterparts in efficiency.

(2) Is the dual-track style of gradual reforms superior to rapid reforms? The dual-track strategy strives to avoid any decline in output by continuing to subsidize the existing state sector while encouraging the nonstate sector to grow; see, e.g., Dewatripont and Roland (1992). The debate is whether such growing out of the plan is an option only for centrally planned economies with small industrial sectors and large underemployed agriculture labor; see, Sachs and Woo (1994).

(3) Should microeconomic liberalization precede macroeconomic stabilization? See Rana and Dowling (1993). While the maintenance of full employment is important, the concern is that the existing high inflation would destroy the responsiveness of agents to relative price changes and hence prevent economic restructuring.

(4) Is there is an optimal sectoral sequencing of liberalization? The positive answers have taken both the specific form that agricultural reform

reforms should precede industrial reforms and the general form that a leading sector should always be established; see Goldman (1991) and Chen et al. (1992), respectively.

(5) Do sustainable economic reforms require that political liberalization be postponed? See, e.g., Griffin and Khan (1993).

(6) Are gradual reforms more politically acceptable than rapid reforms? See, e.g., Roland (1990).

As economic performance is the product of economic structure and luck as well as of economic policies, the answers to the above questions have to be sought through historical and comparative analyses. It was with this purpose in mind that the Pacific Rim Research Program of the Institute of Governmental Affairs at the University of California at Davis and the Asia Foundation organized a conference on Transition of Centrally-Planned Economies in Pacific Asia on May 7–8, 1992, in San Francisco. The organizers selected 16 papers for presentation at the conference and, after peer review, 9 of them were selected for publication in this issue of the *Journal of Comparative Economics*.

The first three articles are comparative in nature. Wing Woo discusses and dismisses the general applicability of three lessons commonly drawn from China's experience with gradual reforms. Jingjie Li argues that the differences between Chinese and Russian reforms reflect their differences in national conditions. Colin Carter and Bin Zhang find that the slowdown of agricultural growth in nine communist countries in the 1980's came primarily from the slower growth of inputs, particularly of fertilizer, rather than from a decline in total factor productivity growth.

The second group of articles focuses on specific country experiences. Peter Boone argues that legal and political reforms helped Mongolian macroeconomic liberalization by creating a private sector that naturally undermined inappropriate state regulations. David Dollar documents that big-bang reforms in Vietnam produced higher growth immediately. Andrew Berg concludes that the imposition of hard budget constraints on state-owned enterprises, in the context of macroeconomic stabilization, caused structural adjustment despite the lag of institutional reforms.

Since the Chinese reform experience has generated a voluminous outpouring of articles on lessons from China for Eastern Europe, the last three articles focus on China's reform experience. Wing Woo, Wen Hai, Yibiao Jin, and Gang Fan show that, because the official method of calculating industrial growth has two opposite biases, overcounting gross output and overcounting material input, the correction of only the second bias necessarily means overstating total factor productivity growth. Ronald McKinnon attributes the remarkable price stability in China, despite the monetization of rising budget deficits, to the policy of positive real interest rates and the

high investment desire of liquidity-constrained households, which, together, induced households to voluntarily accumulate large amounts of financial assets. Barry Naughton sees *ex post* coherence in the gradual Chinese reforms despite the leadership's not knowing what they were doing at the onset of economic reform, and he hypothesizes "that certain economic forces and institutional conditions shaped a chaotic and inconsistent set of policies into a coherent process."

Developments after the conference in April 1993 now allow us to assess some of the fundamental disagreements expressed then. Events have confirmed the experience that reformers have only a limited honeymoon period to act after coming to power; see Williamson and Haggard (1994). Subsequent dissatisfaction with the reforms is inevitable in overindustrialized economies because the decline in output is unavoidable; see Kirkpatrick (1993). If it were avoidable, the old regimes would not have collapsed. This means that if decisive reforms were not undertaken on a broad front during the honeymoon period, then the duration of output decline would be prolonged unnecessarily.

Poland, the Czech Republic, and the Baltic republics acted boldly, and growth has returned to their economies. Hungary, which stuck to its gradual reform strategy, may see its decline bottoming out only in 1994. The zero-action remedy is obviously the worst solution, as evidenced by the calamitous situation in Ukraine today.

The absence of an output decline in China during its reforms appears to have little to do with gradualism and much more to do with its economic structure. Vietnam, which is an overwhelmingly peasant economy like China, raised its growth rate by 4 percentage points in 1989 when it instituted big-bang-style microeconomic liberalization and macroeconomic stabilization. The lesson is that, for a centrally planned economy that is dominated by an agricultural sector that has widespread underemployment, economic reform is akin to normal economic development. The task is to move labor from low-productivity agriculture to higher-productivity industry. Put in these terms, it is clear that gradual rather than quick transfer of agricultural labor is inhumane and politically unwise. It also explains the puzzle of why China responded to the downfall of the communist regime in Russia by abandoning its much-heralded gradualism and accelerating the pace of economic reform.

One topic that was not discussed at the conference but that has proved to be crucial in economic reforms is the role of foreign aid. The political paralysis in Russia produced microeconomic liberalization without macroeconomic stabilization, and the resulting incoherence brought revanchists to power in the December 1993 election. A *New York Times* editorial put the issue very well:

The election showed that reform cannot proceed without popular support; and Western aid could prove critical to that support by helping to cushion the worst effects of reform.

The West never delivered most of the aid it promised—deciding it was more important to make sure the money wasn't wasted than to back reformers who wanted to take Russia down the road toward democracy and markets. So it held up the money, waiting until reforms were locked into place—and virtually assuring that they would never be tried.

This sad story suggests that for Western aid to sway the political debate in Russia, it must be delivered up front, allowing reformers to set up relief funds for dislocated workers, an inevitable fallout from true reform.

No country this century has undertaken radical market reforms without sizable foreign aid; Russia is not likely to be the first . . . (January 29, 1994).

Even China has been using foreign aid to ease its economic transition. China was the biggest borrower of the World Bank in 1992 and 1993, and is expected to be the biggest borrower again in 1994.

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